

Lesotho

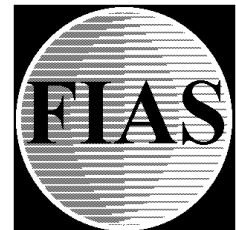
The Competitiveness of Regional and Vertical Integration of Lesotho's Garment Industry

DISCUSSION DRAFT

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FIAS

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List of Acronyms

ACP	African, Caribbean and Pacific
AGOA	African Growth and Opportunity Act
CAFTA	Central American Free Trade Agreement
CMT	Cut, make and trim
CSIR	Center for Scientific and Industrial Research
DCCS	Duty Credit Certificate Scheme
DTI	Department of Trade and Industry (South Africa)
EU	European Union
G/M2	Grams per square meter of fabrics
kg	Kilogram (2.204 lb)
lb	Pound
LC	Letter of Credit
LDC	Least Developed Country
LNDC	Lesotho National Development Corporation
LRA	Lesotho Revenue Authorities
Ne	English count, used to describe which method is used to for weight
Ne 24	The number describes the weight of the yarn. For example, Ne 6 is course and Ne 30 is fine
OE	Open-end spinning – see Textiles terminology
RS	Ring spinning – see Textile terminology
RSA	Republic of South Africa
SABS	South African Bureau of Standards
SACU	South African Customs Union
SADC	Southern African Development Community
US (US)	United States of America
WTO	World Trade Organization

Key Textile Terminology*

Blending	The efficient mixing of various lots of fiber which may differ in physical properties, market value or color
Carding	Process of disentangling, cleaning and intermixing fiber to produce a sliver or a web (the latter a stage in between combing and/or spinning)
Combing	Process after carding in which the fibers are parallelized, cleaned and a predetermined proportion of short fibers are removed
Cotton Lint	The cleaned cotton fiber after ginning, delivered in bales (200-250kg) to spinners
Ginning	The process of separating cotton fibers (lint) from the seed by mechanical means
Knitting	Technique for forming fabric by intermeshing loops of yarn
Regional Integrated companies	Companies that source from the Sub Saharan African region.
Spinning	The process of drafting and inserting twist used in the formation of yarn from sliver or roving
Spinning (Open-End)	Spinning process in which individual fibers are assembled at the end of rotating yarn and twisted in to become part of the yarn
Spinning (Ring Spun)	Spinning system in which twist is applied to the yarn by using a traveler which rotates around the spindle at a slower rate than the spindle rotates
Textile Pipeline	Incorporates all industry activities, from fibers to end-products such as garments
Vertical Integrated Companies	A company that consists of both a textile and a garment factory.
Weaving	Construction of fabric on a loom by interlacing the warp (running length) and weft (running diagonally across the warp) thread

* See Annex 1 for further detail.

EXECUTIVE SUMMARY

Overview

The Lesotho textile and garment sector faces two major challenges: (1) increased competition after the phase-out of the Multi-Fibre Arrangement (MFA) in 2005, and (2) the scheduled 2007 expiration of the third-country fabric provision in the African Growth and Opportunity Act (AGOA). The provision currently allows Lesotho to import cheap fabric from Asia to process and sell duty-free to the United States (US). If lobbying efforts in the US do not result in an extension of the third-country fabric provision, Lesotho manufacturers will have to start sourcing from AGOA compliant countries in on the African continent¹, in order to retain duty-free access to the US market after 2007.

This study outlines the opportunities that can be gained from regional and vertical integration² and provides recommendations to the industry and the Lesotho Government on how to remove obstacles to the integration.

Timing is key. The US and EU have recently imposed trade restrictions on China in order to protect their industries from the most aggressive Chinese competition. This safety mechanism provides a window of opportunity for Lesotho to integrate regionally. However, as the imposed restrictions on Chinese export will not last forever; there is a need for immediate action.

It is necessary to map the regional supplier base against the demand for African-produced cotton, yarn and fabric in order to determine whether or not supply is sufficient to meet demand after the third-country fabric provision expires. Based on a limited mapping, this report finds that the regional cotton knit-fabric sector has the capacity to meet the demand. The question is whether or not the exact types and qualities will be available. On the other hand, the report also finds that the synthetic knit industry (a growing market) and the denim industry do not currently have the capacity to meet the demand. Investments in these areas may prove to be profitable, granted that the third-country fabric provision is not extended.

Benefits of Regional and Vertical Integration

This report finds that regional integration with cotton-knit fabric resources in other countries can reduce the current cost of Lesotho's garment industries by approximately 10% and reduce lead times by between 14 and 21 days. Vertical integration can reduce these costs by between 20 and 25%. The lead-time advantage of vertical integration, based on similar orders, is approximately 25 days.

With the constant pressure from retailers to increase speed-to-market, the reduced lead time gained from regional and vertical integration provides a tremendous opportunity and will

¹ Or the United States of America.

² A *regional integrated company* is defined as a company that source from the Sub Sahara African region rather than from e.g. Asia. A *vertical integrated company* is defined as a company that owns both a textile and a garment factory. A vertically integrated company does not have to buy fabric from a third-party. The only fully vertically integrated manufacturer in Lesotho is Formosa Textiles/Nien Hsing. The company spins yarn, dyes the yarn, weaves the denim fabric and produces jeans.

improve the competitiveness of the industry. However, to compete with Chinese garments, producers in Lesotho must provide services such as dyeing and finishing and strengthen access to knitted fabric, preferable in Lesotho.

Attracting Investors

In order to attract investments in a dyeing factory, The Ministries of Natural Resources and Finance have to ensure i) that there is the necessary factory space ii) that there is sufficient water and that the available water has the right quality iii) that a waste water and a solid waste facility can be established.

In order to attract investors in the textile and garment industry and improve regional integration, general infrastructure constraints must be addressed. These include i) problems with energy surges and dips ii) inefficient local freight transport iii) excessive bureaucracy iv) necessity for a new Duty Credit Certificate Scheme (DCCS).

Recommended next steps for the Lesotho Government

- A priority for the Ministries of Natural Resources and Finance should be to address the bottlenecks to attracting investment in a dyeing facility.
- A priority for LNDC should be to exploit the tax advantages provided to industry, targeting knitting manufacturers in South Africa (RSA) that do not enjoy these benefits.
- In a push for vertical and regional integration, the LNDC should establish an Integration Task Team by recruiting one or two persons with experience from the textile and garment industry and with knowledge of trade-related issues. Relevant Ministries (including Finance, Trade and Natural Resources) should also make staff available to support the Integration Task Team. The task team should collaborate closely with ComMark.
 - The task team's objective will be to actively engage in identifying suitable vertically-integrated companies. It should initiate its work by mapping out the 30 to 40 main textile companies and mills in the region.
 - A starting point for the task team is to fully engage the three companies that have already expressed an interest not only in supplying fabric, but in investing.
 - The information gathered, inclusive of core fabric samples, should be made available to the garment industry, fabric buyers in the East and US apparel buyers. Further, the task team should use the findings to target suitable fabric mills for relocation and/or investment in Lesotho.
- The Ministry of Trade and Industry, the LNDC and industry should organize a business-to-business event that would enable international fabric buyers currently sourcing directly from headquarters in Asia to tour the knitting mills in the region. Arrangements could also be made for regional fabric suppliers to meet the fabric buyers in Asia.

Recommended next steps for the industry

- Industry should actively engage and encourage the two companies that are already supplying the Lesotho garment industry to meet with other manufacturers.
- Lesotho garment manufacturers should request current and planned fabric specifications from international fabric buyers that currently source directly from headquarters in Asia. Without these specifications, local knitters are unable to fully exploit their proximity to client/lead-time advantage.
- Industry should request that parent companies (that engage in textile activities) and fabric buyers/sourcing houses assist in identifying suitable candidates for investment.
- Denim manufacturers in Lesotho should upgrade the skill levels of staff to reap the benefits of vertical integration.
- Management of the Lesotho manufacturers should start engaging with their respective parent companies to ensure that more decision-making power is transferred to Lesotho operations.

1 INTRODUCTION AND OBJECTIVE OF THE STUDY

The formal garment manufacturing industry in Lesotho started in the early 1980s when South African garment manufacturers entered Lesotho in order to avoid sanctions imposed by the US and Europe. The Lesotho National Development Corporation (LNDC) also offered incentives to companies who set up in Lesotho. The incentives included favorable rent rates on pre-constructed shells, a relatively cheap and educated labor force and a 5-year tax holiday.

During the 1980s, the key advantage that Lesotho enjoyed over South Africa (RSA) involved trade benefits. These benefits included preferential duty regimes into the US and, under the Lomé convention, duty-free access to the EU.

However, in the late 1980s, the Lomé convention required “cumulation” (fabric sourcing and garment manufacturing) within the African, Caribbean and Pacific states (ACP). Lesotho applied for and received the right to manufacture garments from fabrics sourced outside the confines of the ACP countries. The derogation was initially for four years but it was later extended through 1995.

This favorable environment of manufacturing opportunity and market access attracted new investments to Lesotho. This time the investments came from South East Asian garment manufacturers. Several factories closed when the derogation expired in 1995, but many successfully shifted their target market from the EU to the US. At that time, their garments were subject to an average import duty of 17% as well as a quota allocation.

Lesotho was declared eligible for the Apparel Provision under AGOA in April 2001. This provision enabled manufacturers to source their fabrics from anywhere in the world and export garments to the US market duty and quota free.

The initial AGOA status attracted considerable new investments not only in the garment sector but also in textiles. Textile investments by Nien Hsing and CGM were in part to protect their garment manufacturing operations by providing them with regional/local fabric sourcing options after the expiration of the third-country fabric provision in 2004. The investments were also in preparation for the increasing demand of regionally-produced fabrics after the expiration of the third-country fabric provision.

By April 2004, no decision had been reached regarding an extension to the third-country fabric provision. Buyers were thus not certain that their orders would enter the US duty free after September 2004, and orders started to dwindle. Some buyers simply stopped sourcing from Sub-Saharan Africa (SSA).

When the extension was finally announced in June 2004 to be effective in October, many buyers had already ordered elsewhere. A number of garment manufacturers in Lesotho (and elsewhere in the region) consequently closed.

The third-country fabric provision uncertainty was exasperated by the WTO January 2005 ruling that eliminated quotas and thus made China even more competitive. By early 2005, more factories closed and employment in the Lesotho textile and garment industry had declined from just above 50,000 to just under 40,000 people.

The impact of quota removals has been significant for China. China's garment exports to the US and the EU have risen significantly. In the first quarter of 2005, Chinese exports to the US of items such as cotton T-shirts increased by 331% and cotton trousers increased by 1,500%. Imports into the EU also rose significantly.

By late 2005, the continual increase in exports to the US from China led to the imposition of safeguards on Chinese garment exports to the US. These safeguard measures limit Chinese exports of 22 garment categories to an increase of between 10% and 17% per annum through 2008. Similar safeguard measures on Chinese garment exports were adopted by the EU.

When quotas were still in place before 2005, Chinese garment manufacturers utilized 25% of their yearly-allocated quota volumes in the first 3 months. The imposition of safeguards, effectively the same as quotas, has seen utilization of the quota volumes drop below 10% for the first 3 months of 2006.

These safeguards are clearly beneficial for Lesotho garment manufacturers. There also appears to be a renewed optimism since Lesotho's budget announcements that company tax is zero-rated for those exporting to the US and the EU. The nominal tax rate of 10% for other manufacturers appears to have attracted South African garment manufacturers to set up production facilities in Lesotho.

This renewed optimism is manifested by the Win Garment Consortium's new garment factory that is expected to employ 3,000 people by July 2006. It is hoped that knitting and dyeing plants may follow. According to the ComMark Apparel Project, Lesotho's textile and garment industry could again be employing 50,000 people before the end of 2006.

However, under AGOA, the Lesotho knit garment-manufacturing industry will by 2007 need access to regionally or locally-produced woven denim and knit fabrics. Knit fabrics and denim are available regionally and denim is also produced in Lesotho.

Regional sourcing raises three key questions, namely:

- 1) Are the yarns and fabrics available in the quantities, ranges and qualities needed?
- 2) Is local fabric competitively priced with fabrics currently sourced from the East?
- 3) Will vertical integration (spinning, knitting and dyeing) make the Lesotho garment industry more competitive?

This report aims to answer these questions and provide policy guidance on both forward and backward integration. It will also discuss which impediments must be removed in order to facilitate manufacturer sourcing, production and distribution.

1.1 Research Methodology

The information in this report has been gathered from various sources, including interviews with regional suppliers, buyers and government officials.

Companies selected to be interviewed were drawn from MPC's database of approximately 4,500 companies in the textile pipeline (fiber to end-product) in SSA.

The following selection criteria were used:

- A combination of companies that were:
 - vertically integrated (spin, knit/weave, dye and make garments),
 - semi-integrated (knit, dye and make garments), and
 - stand-alone (only spin, knit, dye or make garments).
- Large fabric producers.
- Companies that export to the US, EU or supply major South African retail chain stores. Preference was given to companies that have exported yarn and fabrics within SSA and/or have visited Lesotho garment manufacturers.

Outside of Lesotho, companies were interviewed in Mauritius, South Africa and Tanzania. The main reason for selecting companies in these countries was that all have supplied yarn and/or fabric regionally and have visited companies in Lesotho. Time did not permit the incorporation of companies in Kenya, Namibia, Swaziland and Zambia.

In total, 23 companies were interviewed. Of these, 14 were personally interviewed and 9 were interviewed telephonically. Due to the sensitive nature of the information, only the types and number of companies is provided.

The **personal** interviews were conducted with:

- Six stand-alone garment manufacturers (five were knit garment manufacturers and one was a jeans manufacturer), all exporting to the US and other countries.
- One integrated and one semi-integrated denim/jeans company, both exporting to the US, EU and within the region.
- Two semi-integrated fabric knitting, dyeing and garment manufacturing companies that export to the US, EU and within the region.
- Two fully integrated companies, one that was knit fabric orientated and one that was both woven and knit fabric-orientated. One exports to the US, EU and the African continent, and the other is geared to regional sales.
- Two associations/authorities that represented exporters.

Phone interviews were conducted with:

- Five cotton and synthetic fiber, yarn and/or fabric importers. Two of these were also fiber importers and exporters within and outside of Africa.

- One stand-alone cotton yarn-spinning mill, exporting to companies in Africa and the EU.
- One international sourcing house that exports garments to the US, EU and RSA but sourced from China and SSA. It also sources fabrics regionally and internationally and undertakes quality control for overseas buyers. It is active in Lesotho.
- One cotton producers association
- One garment exporters association

2 MAPPING THE REGIONAL SUPPLY BASE

Limited fabric availability, especially for synthetic fabrics, is one of the main challenges of regional integration. Many producers do not sell to third parties, but merely produce for their own operations. Garment manufacturers also have relatively little information on potential suppliers in the region. This is particularly the case for Lesotho garment manufacturers as their fabric buyers are based in Asia (the East).

The following chapter addresses the challenge of limited fabric availability and provides an overview of yarn, knit fabric and denim sourcing options available to garment manufacturers in Lesotho. The overview is not complete because more interviews in the region are necessary to create a complete picture.

2.1 Yarn Sourcing

The fabric knitting industry uses two types of yarns, namely spun and filament yarns. Spun yarns are produced from staple fibers (cotton and synthetic, or blends thereof) of a defined length (in millimeters). Filament yarns are synthetic (polyester or nylon, for example) and continuous (never-ending and measured in kilometers).

There are two further spun yarn distinctions: open end (OE) and ring spun (RS). OE yarns are generally of a courser count (6 to 24) and RS yarns are generally speaking of a finer count (24 and higher).

The yarn count (N_e) depicts the weight of the yarn.

2.1.1 Cotton and Polycotton Spun Yarns

The main countries from which cotton and polycotton yarns for *third*-party sale can be sourced are:

Botswana – has one mill with limited capacity. It only produces OE cotton yarns, predominantly used for denim and toweling weavers (heavier-weight fabrics).

Lesotho – has one cotton-spinning mill (RS) with substantial capacity. Its yarns are suitable for fabric knitting. They also produce organic cotton blend yarns. Although OE yarns are also produced, they are predominantly for denim weaving activities.

Mauritius – has one cotton-spinning mill (RS). It is currently being expanded and has substantial capacity. Its yarns are also suitable for fabric knitting. The two other cotton spinning mills are forward integrated.

South Africa – has five spinning mills. Four of them are reputable. Of the four, one spins only OE yarns (cotton and polycotton). One spins OE and RS cotton yarns only. The other two also produce polycotton yarns. All are in a position to supply knitters and weavers. Of the four companies, two have substantial capacity, one is of medium size and one is small. Two of the companies also produce organic cotton yarns. A third is about to commence spinning with organic cotton. Other spinning mills are forward integrated.

Swaziland – has one spinning mill that supplies yarn for sale, but is heavily sewing thread - orientated. It also produces polycotton yarns, but in relatively small volumes. There is another spinning mill, but it mainly produces for its own use.

Uganda – Although originally a knitting and garment manufacturing plant, a new spinning mill is being set up to supply third-party yarns and will specialize in organic cotton yarns. Capacity at this stage is not yet known. Other mills are forward integrated.

Zambia – has one RS and OE cotton yarn spinner with substantial capacity. There was another OE cotton yarn spinner but it closed down in late-2005. There are others mills, but they only produce for their own weaving or knitting operations.

All spinners in the countries mentioned above are AGOA-compliant and have supplied yarns regionally. Most of the companies have also exported yarns to the EU and quality is not a problem.

In terms of volume, the aforementioned spinning mills have a combined capacity of between 65 and 70 thousand tons of cotton and polycotton yarns per annum. Lesotho's knit garment manufacturers utilize approximately 20 thousand tons of knit fabrics, of which an estimated 50% is cotton and polycotton. Based on the spinning industries' low utilization rates in 2005, they would be in a position to meet these volumes. Should demand for yarns in the region return to the status quo of 2001/2002 (strong dollar and weaker regional currencies), this would no longer be the case.

There are very few companies in the region spinning polycotton yarns for third-party sale. Splitting out the volumes of polycotton yarns would readily identify the capacities of the mills in question. The proportion of polycotton yarn available for third-party sales is relatively small and insufficient for the increased demand.

Other African countries – There are other cotton and polycotton spinning mills in the region. However, they are generally geared to supply their own knitting or weaving operations. They can be found in the DR Congo, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Namibia, South Africa, Swaziland (as indicated earlier), Tanzania, Uganda and Zambia.

The same applies to West Africa, with the one exception of Mali. The company in Mali was set up specifically to supply cotton yarn to a knitting mill (shareholder) in Mauritius. The investment was made because the investor believed that the third-country provision would expire in 2004. The company was forced to close down due to cotton contamination.³

Although Nigeria had a very large textile industry, today there are less than 10 stand-alone spinning mills. Only 2.4% of its RS yarn capacity is less than 10 years old. For OE yarns under 30% of capacity is less than 10 years old. This compares to 40% and 90% respectively

³ Farmers in West Africa tend to use polypropylene (PP) bags when picking cotton from their farms. PP has a tendency to break up in to tiny fragments and cannot be detected by looking at the cotton. It is also undetectable during the ginning, spinning, weaving/knitting processes. Only when the fabric is dyed (colored) do the PP contaminants become clear to the eye. The PP fragments do not get colored by the dye and thus leave tiny white patches in the fabric. The industry has tried to resolve this issue by providing farmers with cotton bags. However, their fertilizer, etc. comes in PP bags and is thus "free," whereas the cotton bag is sold.

for South Africa. Only one spinning mill exports yarns to the EU. As is the case in Mali, the Nigerian industry suffers from cotton contamination.

Zimbabwe does have spinning plants that supply third parties in the region. However, Zimbabwe is not AGOA-eligible. Angola and Mozambique have no operational cotton textile mills.

As indicated earlier, the region currently has the capacity to supply cotton and polycotton yarns and their quality will also pass the test. The key remaining issues of importance to a possible knitting plant in Lesotho are range of yarn counts and price.

Most fabric knitters use cotton and polycotton yarn counts of Ne 20, 24 and 30. This yarn can be supplied by the regional spinning industry. An estimated 20% of the knitting industry would be using finer counts (Ne 40s, Ne 60s, etc.), but capacity for these yarns in the region is very limited.

The finer the yarn count, the longer it takes to spin compared to course counts.⁴ A more in-depth analysis would thus have to be done to find yarn counts available and capacities.

Price competitiveness will be discussed in a later chapter.

Conclusion

In summary, a knitting mill in Lesotho would be able to source cotton yarns from within Lesotho as well as cotton and polycotton yarns from the region. Due to the SADC trade agreement, there are no duties for yarn suppliers from this region supplying a Lesotho knitting mill. However, yarn coming from China, India, West Africa, and Uganda attract a 15% duty.

The ideal countries from which a knitting mill in Lesotho could source cotton and polycotton yarns without any duties are thus Lesotho, Mauritius, South Africa and Zambia.

2.1.2 Synthetic Spun Yarns

The synthetic yarn spinning industry is small compared to cotton and polycotton. There are only 5 mills in South Africa where synthetic yarns such as polyester, viscose and polyviscose could potentially be sourced. Only one of those mills is specifically geared to supplying third parties.

Although the other four companies do sell these yarns to third parties, it is not part of their core activities.

There are also other synthetic yarn spinners, namely of acrylic yarns. However, the knit fabrics used in Lesotho are not acrylic yarn-based. Even in the region, acrylic knit-based fabrics have only a small market. Fiber substitution (cotton and polyester) is the main reason.

In all, the capacity to produce 100% synthetic yarns is small. Although cotton and polycotton yarn spinners could switch to spinning synthetic yarns, cotton and polycotton yarn availability would be reduced.

⁴ Example: An OE spinning mill with a capacity of 5 tons/day spinning Ne 6 yarns (used for denim weaving) would only be able to spin 2 tons/day of Ne 12 yarns (used for example by weavers of towels).

Synthetic rich cotton yarns⁵ fall under the section dealing with cotton and polycotton yarns.

Conclusion and Recommendation

The limited production capacity of synthetic yarn in SSA is concerning. Since the quotas were removed (by the WTO in January 2005), there has been a marked shift to synthetic and synthetic rich fabrics used by the knit garment industry.⁶

This shift to synthetic and synthetic-rich fabrics is, apart from fashion demands, mainly due to the US duty structures. The duty on garments made from synthetic or synthetic-rich fabrics is at its highest of 33%. For garments made from cotton, the highest duty is 18%. To compete more favorably with China and India it would make sense for SSA to produce garments that attract, for competitors, the highest duty.

The African Cotton and Textile Industry Federation (ACTIF), an organization that lobbies for changes to AGOA rulings, should look into lobbying for a two-stage transformation for synthetic yarns due to limited regional availability of these yarns. Any other ruling that would allow industry access to third-country synthetic yarns would also benefit the industry.⁷

2.1.3 Continuous Filament (CF) Yarns

There is only one producer of polyester and nylon CF yarns for the apparel knitting and weaving industry in Southern Africa. However, it has switched most of its apparel yarn capacity, in particular polyester, to industrial yarns.

In order to produce AGOA-compliant fabrics, regional apparel fabric knitting and weaving mills will thus have to import these yarns from the US. But this is not without problems.

In taking the same yarn,⁸ the FOB price is 45% higher from the US than it is from the East. Costs are compounded because transportation costs for this yarn in a 40-foot container from the US are 50% higher than from the East.

Again, with the high costs of sourcing from the US, and in the absence of sufficient local availability, there is a need to lobby for two-stage processing for synthetics, e.g., knitting or weaving and garment making, or third-country access. The African Cotton and Textile Industries Federation (ACTIF) is lobbying for changes to AGOA. The direction this will take is not clear as yet but may involve a percentage value-add rather than the third country fabric provision.

There are other synthetic filament yarn producers, but they produce polypropylene (PP) CF yarns. These are not yet used for fabrics that the Lesotho knit garment industry sources and will remain an unlikely knit fabric component.

⁵ Synthetic-rich yarns are those where the synthetic content exceeds that of cotton, e.g., polycotton-65/35 yarns, where the polyester content is 65% and cotton content is 35%.

⁶ This was particularly evident from the factories visited in Lesotho and Mauritius.

⁷ The Lesotho Textile Export Association (LTEA) is a member of ACTIF.

⁸ The yarn in question is CF polyester, 167 dtex, 48 filaments, used to produce a single jersey knit fabric weighing between 145 and 180 g/m².

2.2 Knit Fabric Sourcing

Although knit fabrics can be sourced from a number of countries in the region, the capacity available for third parties is less than that for cotton and polycotton yarns. Similarly, the volumes of synthetic knit fabric are also less than those in cotton. Again, following is a brief outline of possible knit fabric sources for knit garment manufacturers in Lesotho.

Botswana – There were five fabric-knitting mills in Botswana, but two were closed some time ago. Of the remaining three, two own dye houses and produce for their own garment factories. The third company, although it also produces garments, does not have a dye house. Its fabrics are sold to companies in RSA and it re-imports dyed fabric. The capacity of the company that sells knit fabric to RSA is relatively small.

Kenya – Although there are a few knitting mills in Kenya, most have their own garment manufacturing facilities. They are relatively small in terms of capacity and operate fairly old equipment.

Mauritius – Has a large number of fabric-knitting mills, one in excess of 10,000 tons per annum.⁹ However, many are also garment manufacturers and thus use the bulk of fabric production themselves.

Of total installed capacity, an estimated 5,000 tons per annum could potentially be made available for third parties. Volume would all depend on what prices they could get for their fabrics in the region compared to their domestic market. However, many companies are not operating at capacity and would thus be open for new business. In Mauritius, 85% of knit fabrics are cotton-based.

South Africa – Also has a large number of fabric knitting mills. However, they generally have less capacity than the knitting mills in Mauritius. In South Africa, unlike in Mauritius, most of the fabric-knitting mills do not own their own garment manufacturing operations. There is thus more third-party fabric available in South Africa than from Mauritius.

It is estimated that approximately 25,000 to 30,000 tons of third-party fabric could be available annually. Cotton and polycotton fabrics are the dominant types, the majority of which is for the local market. However, as cheap Chinese garment imports have seen capacity utilization rates drop considerably, it is estimated that the South African fabric knitters could supply 10,000 tons per annum. The question is again, at what price? (The price they can obtain from local garment manufacturers compared to that which the Lesotho garment manufacturers pay.)

Note that total installed knitting capacity is close to 45,000 tons, inclusive of those companies that also have their own garment factories.

Uganda – There is only one apparel fabric-knitting mill in Uganda with limited capacity. It is incidentally the same company that is installing a new spinning plant.

⁹ This company also spins cotton yarn. The investment was made when the third-country provision was set to expire in 2004.

Other countries – Namibia, Swaziland and Tanzania have fabric-knitting plants. However, all are integrated operations that also make garments. Potentially 10% of capacity may be available for third parties (approximately 1,500 tons per annum).

There remain only a few operational fabric-knitting mills in West Africa. Quality is generally poor and it is all for local consumption.¹⁰

Conclusion

The third-party knit fabric capacity available to supply Lesotho knit garment manufacturers is thus not sufficient. However, a much more detailed study should be conducted to identify the exact capacities available for third parties. This study should include capacity by fabric type, fabric weight and quality.

2.3 Denim fabrics

The only denim mills in the region are based in Lesotho, Mauritius and South Africa. However, the region has lost considerable capacity since 2004. The companies that closed down were Arvind in Mauritius, and Novel Textiles and Lien Fu in South Africa. These closures reduced regional capacity by 2.5 to 3.0 million linear meters (lm) per month¹¹.

Although Novel closed its Mauritius factory as well, it was bought by an Italian company, renamed Denim des L'Isles and is operational.

The denim factories that remain have a combined capacity of approximately 5 to 5.5 million lm/month. If all denim fabric had to be sourced from the region after 2007, the supply/demand equation would be tight. For example, Lesotho has the capacity to use approximately 2.7 million lm/month and Kenya has the capacity to use 1.1 million lm/month. There would thus only be approximately 1.5 million lm/month available for jeans manufacturers in Mauritius, Madagascar, South Africa and Swaziland (the main jeans manufacturing countries).

Indications are, however, that if denim fabric has to be sourced regionally from 2007, further investments will follow. If this is not the case, it is unlikely that any further investments in denim will take place in the region.

Conclusion

Apart from the need for additional investments, a key question is the availability of specific fabric qualities and ranges (stretch denim or mop yarn denim for example), should the third-country provision not be extended. This issue will need further research.

¹⁰ It has not been possible to confirm whether or not a new integrated knitting and garment factory has been set up in Senegal.

¹¹ A linear refers to a meter-long piece of fabric where the width can be 1 to 1.5 meters for apparel purposes. In the case of denim it is 1.5 meters wide.

3 THE COMPETITIVENESS OF VERTICAL INTEGRATION AND REGIONAL SOURCING

When comparing sourcing from the SSA region with sourcing from China or India, there are a number of other issues that need to be taken into account, apart from availability/capacity criteria (Chapter 2).

They are:

1. Production Costs
2. Lead Times
3. Transport Costs and Logistics
4. Quality of Raw Materials

3.1 Production Costs

Buyers perceive the benefits of vertical integration of a textile industry from raw materials to end products as a more competitive manufacturing process than if each of the individual parts (spinning, weaving/knitting, dyeing and garment making) is done by separate companies.

Vertical integration reduces time and costs expended to produce the finished article/garment. Other softer benefits include control over production and the ability to sample fabrics and garments more quickly. Further, it is easier to claim liability from one company if something goes wrong with quality (e.g., fabric faults or shade variations).

For the aforementioned reasons, buyers prefer to deal with vertically-integrated operations. However, buyers are fully aware that a vertically integrated garment manufacturer has the ability to squeeze-out costs. They will therefore also demand better prices.

The only fully vertically integrated manufacturer in Lesotho is Formosa Textiles/Nien Hsing. The company spins yarn, dyes the yarn, weaves the denim fabric and produces jeans.

Although CGM is also vertically integrated, the spinning, yarn dyeing and weaving is done in South Africa, while the jeans are produced in Lesotho.

Some of the Lesotho garment manufacturers are also in some way vertically integrated because their parent companies also produce fabrics in the East. However, the majority of knit garment companies are stand-alone manufacturers with no links to fabric manufacturers.

Some of the companies interviewed had a marginally different view of vertical integration and opted for the clustering approach instead (stand-alone operations with ease of access to raw material suppliers). They argued that a garment manufacturer that is integrated has to produce garments using the fabric that the knitter/weaver produces. In a clustered approach, the garment manufacturer has access to a greater variety of fabrics and the fabric mill is then

also able to sell fabrics to other, potentially better paying garment manufacturers. They also believe that they are then more efficient as there is only one process to concentrate on.

To determine conversion costs from one stage to the next is difficult because there are many variables and they impact companies differently. A common denominator is used when possible.

Since the Lesotho textile industry has spinning facilities, the following section starts by analyzing spinning costs in terms of raw materials.

3.1.1 Spinning Costs

In the spinning industry the main cost components are raw materials (fibers such as cotton) and the actual cost of converting the cotton into yarn for use by weavers and knitters.

Cotton Lint/Fiber Costs

To spin yarns to be used by knitters or weavers, a spinning mill's largest single cost component is fiber (cotton lint or synthetic staple fiber such as polyester – see Appendix 1).¹² As cotton is a natural fiber, properties of the fiber (length, for example) will vary. Spinners blend different grades of cotton to try and achieve an optimum consistency, price and performance mix.

The type of yarn being spun generally determines the type of fiber used. The finer the yarn count, the better the fiber properties will have to be. However, better quality commands a higher price. Conversely, the coarser the yarn count being spun, the less stringent the fiber quality must be.

In the Southern Africa region, cotton fiber qualities tend to be strict middling to middling (see Appendix 1 for more details) and these types account for up to 80% of the cotton lint (fiber) volumes produced.

Based on the dominance of yarn counts (Ne 20, 24 and 30s)¹³ produced in the region, the quality of regionally-produced cotton is high and results in an over-engineered yarn for the end-use purpose of knitting and weaving. Naturally this also results in a higher price.

The second largest cost lies in the conversion of the fiber to yarn. This cost will again vary by the type of yarn produced (count) and the type of spinning process used (RS or OE).

Currency and Weight Conversions

Cotton lint prices are quoted internationally in US dollars per pound (lb) as a delivered price to port. If regionally sourced, the cotton lint tends to be delivered by truck (road) to the factory and the price will include delivery. Where trucks cannot be used, e.g., from northern Mozambique, the price quoted will be to port. Transport from there to the spinning factory would then have to be added. Most spinners thus prefer to use regionally sourced cotton.

¹² The textile industry is littered with technical terms. Attempts have been made to simplify the text and more technical aspects are provided in the Appendices.

¹³ Yarn counts (Ne) denote the weight of a yarn over a given length. The lower the Ne count, the coarser the yarn is and thus the heavier it is. The higher the Ne count, the finer and thus lighter the yarn is.

The cotton lint prices are calculated in the following steps:

1. The prices for cotton:

Better quality cotton lint (strict middling to middling): US\$0.58 - 0.60/lb

Lower grade qualities: US\$ 0.45 - 0.55/lb

(Note that large spinners (20.000+ tons/annum) are able to buy direct from gins (the cotton lint manufacturers) and do not have to go through cotton merchants or traders. This can reduce the price of cotton lint by as much as \$0.10/lb.)

2. For cost calculation purposes in this report, price averages have been used as benchmarks:
Better quality cotton price: \$0.59/lb (for spinning the higher quality fine count yarns)
Lower-grade cotton: \$0.50/lb
3. The Rand/\$ exchange rate used is R6.20/\$1.00. To convert lbs to kgs, the conversion factor is 2.204.
4. In the spinning industry, much like in any other industry, waste is incurred when adding value to raw materials. When spinning different yarns, waste factors range from as little as 4.5% to 22%. The cotton fiber waste (processing loss) has to be added back to the price of the raw material because it has been paid for.

As cotton lint is sourced in US dollars, spinners in Africa need to take out forward cover (in case of exchange rate movements). Some spinners that export yarns may only take out forward cover on part of their US dollar exposure.

Most companies will pay for their raw materials by Letter of Credit (LC). If taken over 90 days, the costs will be R0.08 on the spot-exchange rate prevailing at that time.

Rather than set out all of these costs individually, they have been incorporated into an equivalent exchange rate. The R6.20/\$1.00 thus becomes R6.40/\$1.00. This has been used as the exchange rate for converting the cotton lint prices.

5. The benchmark cotton lint price of \$0.59/lb and \$0.50/lb thus becomes R8.32/kg and R7.05/kg respectively.

Should a company want to spin 100% polyester, the raw material (polyester staple fiber) would cost R9.80/kg, whether it is imported or locally sourced (parity pricing). The only real difference to cotton is that spinning polyester incurs less waste (2.5%). The reason for the lower wastage rate can be found in Appendix 1.

Conversion Costs

Conversion costs are the costs incurred in transforming the fiber to yarn and include labor, overhead and utilities (electricity, water) through to packaging, but exclude profits and transport costs to customers. The conversion cost is thus a “bare-to-the-bone” ex-factory price. It also excludes the costs of cotton fiber stocks because they vary too widely to use as a common denominator.

Conversion costs will vary from company to company. It depends on the age and technical capabilities of the equipment that a spinning mill has installed e.g., spin box type and speed, number of spindles and even cleaning lines in place.

The costs of spinning key yarn types used by denim weavers and fabric knitters are as follows:

Table 1: Cotton Spinning – R/kg¹⁴						
Yarn Type	Count	Lint Mix¹⁵	Waste %	Input Cost	Conversion Cost	Yarn Cost
RS combed	Ne 24	8.32	22.0	10.15	5.50-6.00	15.65-16.15
RS carded	Ne 24	8.27	9.0	9.00	4.50-5.00	13.50-14.00
OE	Ne 24	7.75	8.0	8.35	4.00	12.35
OE	Ne 6-7	7.05	4.5	7.35	3.00	10.35

The aforementioned lint mix costs assume that the spinner has access to the right cotton grades. As discussed in Appendix 1, this is unfortunately not always the case in the region.

The Ne 24 yarn types are used predominantly by fabric knitters. The Ne 6 would normally be used by a denim fabric weaver.

The bare-to-the bones ex-factory price has been used because this is what a vertically integrated textile-to-garment mill would charge in order to obtain maximum margins at the finished product/garment side of the business.

As indicated earlier, some mills, either due to top-heavy management structures or other unnecessary costs, indicated that they cannot operate at a conversion cost of below R6.00 per kg of yarn produced for any of the Ne 24 count yarn types. In such a case, the OE Ne 24 would then cost ex-factory, no margin, R14.35/kg.

This cost incidentally is also the Ne 24 yarn cost in China (R14.25 to R14.50 per kilogram). This price was given to an inquiry by a vertically integrated company from the region while recently in China. As will become apparent when looking at yarns imported from China, export subsidies exist.

Actual local versus imported yarn sales prices are set out in the next section, as these are the input costs (raw materials) for a knitting or weaving mill that is not vertically integrated.

¹⁴ These are at cost, with no “fat”.

¹⁵ The exact prices paid for cotton lint and the resulting cotton mix price by the various mills is held in confidence. The exchange rate of R6.40/\$1.00 takes into account forward cover and LC costs on a real rate of exchange of R6.20/\$1.00.

Cost of Yarn Delivered to Customers

The following table displays the yarn prices that a non-vertically integrated knitting mill or denim weaving plant will pay as raw material costs. The prices obtained are from the spinning industry and knitting industry for imported and locally-produced yarns.

Table 2: Local vs. Imported Delivered Yarn Prices (R/kg)					
		South Africa		Lesotho	
Type	Count	Local¹⁶	Imported¹⁷	Local¹⁸	Imported¹⁹
Cotton OE	Ne 6-7	11.50-12.50	12.00-13.00	11.70-12.70	12.15-13.15
Cotton OE	Ne 24	13.50-14.50	14.00	13.70-14.70	14.15-15.15
Cotton RS carded	Ne 24	16.00-17.00	17.00	16.20-17.20	16.65-17.65
Cotton RS combed	N 24	18.50-20.00	19.50	18.70-20.20	19.15-20.65

The delivered yarn prices now include profit margins and transport costs and are therefore considerably higher than what a knitter or weaver is likely to pay if they are vertically integrated.

Before putting the cost savings of vertical integration into perspective, a brief look at the yarn prices paid by fabric knitters in Mauritius is in order.

To try to compare prices with what the knitters pay in Mauritius is difficult as the majority of cotton yarns used are often finer counts than is the case in South Africa and, secondly, they use mainly RS combed and some carded yarns. There are no real signs of OE yarns being used by knitters in Mauritius.

For guidance, RS combed and carded yarns from India land in Mauritius for \$2.55 and 2.35/kg respectively, and clearing and forwarding charges need to be added. In using the same R/\$ rate as done for the South African companies (including forward cover and LC costs) and adding back the clearing and forwarding costs, the yarn costs the Mauritian knitter/weaver R16.90 and R15.55/kg respectively.

Mauritian stand-alone knitters and weavers thus have an approximate R0.50 to R1.50 per kilogram cost advantage over their South African fabric knitting and weaving counterparts.

The main reasons are the shorter shipping route (and thus lower shipping costs) from India to Mauritius and that most Mauritian yarn customers are larger than their South African counterparts. They have more bargaining power.

¹⁶ These are ex-local spinning mills, delivered to knitter/weaver. Delivery costs will range from R0.20 to R0.80/kg. R0.50/kg has been used as an average.

¹⁷ Prices are landed, duty-paid (15%) with clearing and forwarding to customers and return of container.

¹⁸ Prices include container return.

¹⁹ Prices include container return.

However, Mauritian knitters are prepared to pay up to 9-10% more for AGOA-compliant yarns. That is, they would pay for yarns from the region rather than from India or China. This brings their yarn costs back in line with those prevalent in South Africa for exports to the US under AGOA.

Prices in Tanzania are in line with those from Mauritius.

The cost savings of vertical integration of weavers and knitters is put in perspective below.

Vertical Integration – Yarn Cost Savings

Compared to a stand-alone fabric knitter or denim fabric weaver, a vertically integrated operation (spinning and weaving or spinning and knitting) would be at a considerable advantage in terms of its major raw material component (yarns).

Table 3: Yarn Cost Savings of Vertical Integration (R/kg)				
Yarn Type	Count (Ne)	Vertically Integrated Yarn Cost (RSA)	Stand-Alone Knitter/Weaver Yarn Cost (RSA)	Cost Savings of Vertical Integration²⁰
OE	6 – 7	10.35	11.50 – 12.50	1.15 – 2.15
OE	24	12.35	13.50 – 14.50	1.15 – 2.15
RS carded	24	13.50 – 14.00	16.00 – 17.00	2.50 – 3.00
RS combed	24	15.65 – 16.15	18.50 – 20.00	2.85 – 3.85

Vertically integrated fabric knitters could potentially save themselves from approximately R1.00 to nearly R4.00/kg for ordinary, run-of-the-mill yarns to the higher quality yarn types. Imported yarns are used for illustration purposes as these tend to be marginally higher priced for the course count yarns (Ne 6-7) to being on par with the finer count yarns (Ne 24s). (See Table 2.)

As mentioned earlier, the yarn conversion costs used in the example for vertical integration exclude any profits. The major potential savings lie in the profit margins on yarn. Vertically integrated companies create the margins higher up the value chain. The transport costs (R0.50/kg average within the region, versus R0.70/kg to Lesotho) are a factor for the OE yarn counts. For the RS yarn counts this is not so much a factor because OE yarn prices are lower than those of RS yarns.

There are availability problems dealing with regional sourcing of synthetic yarns, as mentioned in Chapter 2, as well as other yarn types. For example, yarn types such as pima cotton and very fine count yarns (finer than Ne 40s or Ne60s) are not spun in the region.

²⁰ RSA is used as a benchmark. The savings for a vertically integrated spinning and knitting plant in Lesotho would be on average R0.20/kg less, principally because of marginally higher transport costs.

The only recourse that a fabric knitter or weaver then has in order to remain AGOA-compliant is to source these yarns from the US. However, the pima cotton yarn costs \$6.35/kg in the US with a shipping cost of \$0.30/kg. The same yarn costs \$4.85/kg in Korea with a shipping cost of only \$0.20/kg. Having to use US cotton yarns (like the synthetic yarns discussed earlier) precludes the region from being competitive in the US garment market even with the duty advantage.

Yarn Price Pressures

The general consensus is that there has been little movement in yarn prices between 2004 and 2006, with the exception of general market volatility (with a range of 10 to 12% between high and low).

However, most of the yarn price “damage” was done during early to mid-2004 when China and India prepared for WTO quota removals in January 2005.

However, duties for yarns supplied by companies to South African Customs Union (SACU) clients had already been reduced to zero. Yarn prices in these countries were thus already lower in January 2004.

3.1.2 Fabric Knitting Costs

Few vertically integrated textile companies see their fabric knitting divisions as a money-making operation. It is seen more as an essential service since little value is added.

In taking a straight-forward, stand-alone fabric commission knitter equivalent yarn (yarn provided by the client, as would be the case for a vertical mill) its conversion cost is R2.50/kg. Under extraordinary circumstances this may be reduced to R2.00/kg.

For a knitter that buys yarns for his own account, e.g., not provided by the client, knitting conversion costs would lie between R2.50 and R3.00/kg in South Africa (cost of yarn stock etc. comes into play).

For vertically integrated companies running lean operations (not as profit centers, but as a “service” element), fabric knitting conversion costs can vary from R1.50 in South Africa to R1.75-1.85/kg in Mauritius. Excluding depreciation, knit fabric conversion costs can be as low as R1.00/kg.

In taking like for like, namely a single jersey knit fabric (used for T-shirts) of 145-180 g/m², the conversion cost of a knitter in China would be RMB Yuan 1.00/kg (R0.80/kg).

In all cases, an approximate 3% knitting loss would have to be added.

Table 4 shows the costs for a vertically integrated operation (spin and knit) versus a stand-alone knitter buying yarns for its own account and merely commission knitting.

Table 4: Fabric Knitting (Greige)²¹ Cost Savings of Vertical Integration (R/kg) (Single Jersey Fabric, 145-180 g/m2)				
Activities	Vertically Integrated	Commission Knitter	Knitter for Own Account	Cost Savings of Vertical Integration
OE Yarn (Ne 24) cost ²²	12.35	14.00	14.00	1.65
Knit conversion cost	1.50	2.25	2.75	0.75 – 1.25
Greige knit fabrics ²³	13.85	16.25	16.75	2.40 – 2.90
Conversion loss 3%	0.40	0.50	0.50	0.10
Greige fabric price (ex-factory)	14.25	16.75	17.25	2.50 – 3.00

Vertical Integration Advantage

The R1.65/kg advantage that the integrated knitter has in sourcing the yarn from its spinning division is now approximately R2.75/kg for the greige fabrics produced.

Using the same parameters for a stand-alone knitter in China, the knitter would source the same yarn and pay R14.50/kg delivered. Its knitting costs are R0.80/kg and it also incurs a 3% conversion loss. Its greige fabric equivalent would thus cost ex-factory R15.75/kg. Its price is thus 7.0 to 7.5% lower than its stand-alone South African counterparts.

However, when looking at the cost advantage of vertical integration, the South African vertically integrated operation would be 9.5% cheaper than a knitter in China.

There are not that many vertically integrated knitters in China, primarily because knitters have an abundance of choice when it comes to yarn availability.

Whilst there are competitive advantages in the region for greige knit fabrics, the cost benefit is reduced when dyeing and finishing are taken into account.

3.1.3 Dyeing and Finishing Costs

Rather than going through the whole range of colors for dyeing of knit fabrics, two ends of the price spectrum were taken: bleached (white) and dark colors (black, navy).

For dyeing operations in South Africa the cheapest bleaching costs for finished fabrics were R4.00/kg, while the cost for dark colors was R10.00/kg. This cost still excludes processing losses of 8 to 10%.

²¹ Greige refers to a fabric in its natural state, not yet colored/dyed or printed.

²² For the non-integrated companies, the price averages between R13.50 and R14.50/kg.

²³ Averages have also been used for knitting conversion costs.

In Mauritius, the bleaching costs were lower, at R3.00 to R3.50/kg of fabric. Dark colors cost more, though, at R12.00 to R12.50/kg, still excluding processing losses.

In China, bleaching costs were R3.00/kg and for dark colors the cost was R7.00/kg. These costs are significantly cheaper than in the region primarily because of the lower cost of labor and because they use dyestuffs and chemicals made in China. The African continent imports all dyes and chemicals, from Europe, because of historical reasons (quality perceptions).

Another issue raised centered around environmental legislation. There has been little need for Chinese dye houses to adhere to strict environmental legislation such as effluent treatment/purification, recycling and solid waste dumping.

As some garment manufacturers in Lesotho use up to 15 colors for any particular order, a price was calculated that included a mix of 60% dark colors, 30% light colors and 10% white.

The table below displays the advantages of vertical integration versus those knitting companies using commission dye houses (companies that dye fabrics for many fabric knitters).

Fabric Type	Vertically Integrated	Commission Dye House	Cost Savings of Vertical Integration
Single jersey, greige, 145-180 g/m ² ²⁴	14.25	17.00	2.75
Dyeing/finishing cost ²⁵	8.50	11.50	3.00
Dyed fabric cost	22.75	28.50	5.75
Processing loss ²⁶	1.80	2.80	1.00
Ex-factory price	24.55	31.30	6.75
Transport (Greige fabric in, dyed fabric out) ²⁷	X	0.90	0.90
Fabric back to client	24.55	32.20	7.65

Vertical Integration Advantage

The vertically integrated company that spins, knits, dyes and finishes has a major advantage over stand-alone companies that only spin, knit or dye.

For the example used throughout, an OE spun cotton yarn, Ne 24 count, single jersey knit fabric weighing 145-180g/m², an integrated mill has a 23 to 24% cost advantage (lower cost).

²⁴ The average price between that of a commission knitter and a knitter for own account has been used.

²⁵ Mix of 60% black, 30% light colors and 10% white.

²⁶ For a dedicated, integrated mill with core products this will be around 8%. For a commission dyer this will be closer to 10% as there are more recipe changes to be made and many more different fabric types will be dyed.

²⁷ A similar average to that of yarns has been used. As a 40-foot container will hold less fabric by weight (bulkier than yarn), the cost per kilogram is higher.

The following section discusses the knit fabric prices paid by the Lesotho garment manufacturers. These prices can then be compared to the above prices to determine whether an integrated mill in Lesotho can compete.

Knit Fabric Prices in Lesotho

Obtaining exact prices that the Lesotho knit garment manufacturers pay for their fabrics is difficult to say the least. The buyers for some companies pay for not only the shipping cost to port (Durban and/or Port Elizabeth) but also the transport cost to Maseru, inclusive of the cost of return of the empty container.

In other instances, Lesotho garment manufacturers pay for the local transport leg or just the return of the container. Furthermore, some companies use the same container that the fabrics are delivered in for their exports of garments, thus reducing the cost of transport. Others cannot do so as different ports and different shipping lines are used for fabrics coming in and garments going out.

The main problem is inconsistency; sometimes the buyer pays for container returns, sometimes not or only half the amount.

The prices in the table below are delivered prices to Maseru. In order to make container return costs consistent, half of the cost of the container paid for by the company in Lesotho has been taken as an average. This cost is approximately R0.45/kg of fabric equivalent.

Table 6: Knit Fabric Prices – Delivered to Maseru					
Fabric Type	G/m²²⁸	Price/kg (Rand/kg)	Container Return R/kg	Actual Price Paid R/kg²⁹	Comment
Single jersey cotton & cotton/lycra (97/3 & 93/7)	140 – 180	HK\$30.85 –35.25 (R39.30 – 44.00)	0.45	39.75 – 44.45	Light to dark colors, from China
Fleece 55/45 cotton/polyester	275 (175?)	\$5.20 (R32.25)	0.45	32.70	Light to dark colors, from China
Rib	Not available	\$4.70 (R29.15)	0.45	29.60	Light to dark colors, from China
Cationic Pes/spandex (80/20)	155	\$12.00 (R74.40)	0.45	74.85	Mainly dark colors, from Taiwan
Single jersey cotton	155	\$5.00 (R31.00)	0.45	31.45	

²⁸ Prices were often quoted in pounds or grams/yard. In all instances widths have been taken into account when converting to g/m².

²⁹ An estimate based on buyer paying/not paying for the container return.

Single jersey polyester	155	\$8.00 (R49.60)	0.45	50.05	
Polyester polar fleece	Not available	\$6.00 – 7.00 (R37.20 – 43.40)	0.45	37.65 – 43.85	Light color, from China

Vertical Integration Advantage

The vertically integrated knit fabric manufacturer in South Africa can compete with the imported single jersey fabric of 155g/m² at a final cost of R31.45/kg in Maseru.

The vertically integrated mill's fabric price, now including profits and delivery is R28.45/kg, nearly 10% (9.5%) cheaper than the current imported fabric price.

However, there is one caveat. It was not possible to establish fabric specifications. The single jersey fabric in question may not have been produced from OE yarns, but rather from RS carded cotton yarns. This situation is complicated further because there is no knowledge of yarn counts used. These could therefore also be different.

In taking the same costing processes as done for the OE Ne 24 count yarn and substituting it for a RS carded Ne 24 count yarn, the delivered price to Lesotho garment manufacturers is still 6.5% lower.

Although the permutations of the specifications can be argued many ways, for knit cotton fabrics such as those used for T-shirt-type garments, a vertically integrated knit fabric mill has the opportunity to compete with those in China.

Should the duty be taken into account and offset against the Duty Credit Certificate Scheme, then the vertically integrated fabric knitting mill would be in an even more advantageous position (23% to 24% cheaper).

3.1.4 Denim Fabrics

The prices of yarn for denim weaving (OE Ne 6-7) are shown in the table with other yarn types.

The same principles for vertical integration of knit fabrics apply to denim weaving. The entire costing exercise is thus not repeated.

3.1.5 Fabric Price Pressures

Inputs were mixed from the Lesotho garment industry. A number of companies indicated that there had been little movement in fabric prices over the 2004/06 period, primarily because parent companies had contracts in place with mills in the East (China). For some, this is a 5-year supply program. Others indicated that they had seen an approximate 10% drop in prices over this period.

However, for those sourcing from Taiwan rather than China, prices for 2005/06 have increased between 5 and 7%. Note should be taken that buyers had looked at similar fabrics from China (up to 20% cheaper) but had been rejected on quality grounds. Price is thus certainly not the sole purchase criteria, even with a 20% price differential.

For 2007, a number of garment manufacturers felt that there would be price increases simply because they have been held relatively stable since 2004. Others mentioned that prices were higher since they had recently moved more into synthetics (away from cotton). They had also been given indications by their buyers that there were upward price pressures.

However, based on discussions with one of the international sourcing houses, it appears that there has recently been some “distress” selling from the East with prices half those of the norm (companies liquidating stocks and/or in need of cash/liquidity). This does not auger well for the immediate future although it may mean that “excess” capacity in China may be removed. 2006 is thus expected to be turbulent for fabric prices, but by 2007, some sanity may return (all is not that well in China).

3.2 Lead Time³⁰

Lead time is the time it takes for a company to produce the yarn, weave or knit the fabric, make the garment and have it delivered. Lead time is also commonly referred to as “time to market”.

The general perception is that lead times from South African and Mauritian companies are too long compared to sourcing from the East. However, this is a misunderstanding by people that are comparing shipping time from the East with manufacturing *and* transport time from South Africa or Mauritius.

In reality, a fabric factory in Lesotho will have a delivery advantage of 25 days compared to sourcing from the East (20 to 21 days for shipping from China to Port Elizabeth, and 4 to 5 days for clearing and forwarding).

Due to the capital-intensive nature of the textile industry, it does not take a weaving or knit fabric manufacturer in the East less time to produce fabrics, from order, than it does for a similar company in South Africa, Mauritius or even in Lesotho. This situation differs in the garment industry because of the labor intensiveness of the manufacturing process.

However, the misperception is caused because the buyers in the East have a number of fabric mills that they have been working with for a long time. Thus they have the equivalent of “standing orders”. The fabric mills are therefore already prepared to produce the fabrics in question or have done so already in greige³¹. If this were the same case for a fabric mill in the region, it would similarly be in a position to supply more quickly. The question of how long it will take to develop the same relationship as the buyer has with the fabric mills in the East is discussed under Chapter 3.4 that discusses the quality of raw materials.

Textile companies with equipment less than 10 to 12 years old tend to operate similar equipment. In South Africa, for example, approximately 90% of installed weaving equipment is less than 10 to 12 years old.

Therefore, if a fabric mill in the East and one in South Africa were given a totally new order (yarns they are not using and a fabric construction they are not making), the time to produce the fabric would be approximately the same.

³⁰ The time it takes for a company to produce the yarn, weave or knit the fabric and have it delivered.

³¹ This is a fabric that has not yet been dyed or printed.

Recommendation

Lesotho garment manufacturers must talk with their buyers in the East to dispel the perception that fabric mills in the East can produce a new order quicker than a similar mill in South Africa. Buyers must be shown how to compare like with like.

Lead-Time Pressures

Lead times (sampling, fabric production, garment manufacturing and shipping) used to be 6 months, in particular for “commodity” garments such as jeans and T-shirts.

For “fashion” garments, lead times have in some cases been reduced to a matter of weeks. Shorter lead times require a relationship of trust between yarn, fabric suppliers and garment manufacturers, as “greige” stockholding is paramount.

SSA geographic location, in relation to the US and EU markets, mitigates against the production of fashion garments.

Airfreight may be an alternative. However, with few exceptions, airfreight costs per garment equivalent (\$1.00+) from Africa are too high. *The lowering of the high costs of garment shipping should be explored with airlines.*

While the SSA geographic location does not lend itself to producing fashion garments for the US and EU markets, garment manufacturers are not reduced to producing commodity garments only. They can, by way of utilizing different fabrics or embellishments (embroidery/artwork), move up the value chain.

For commodity garments, lead times have been reduced to approximately 3 months over the last few years. This was evident as early as 2004 when quota-restricted manufacturers in the East started gearing up for the removal of quotas in 2005.

Vertical Integration Advantage

This relentless drive by retailers worldwide to reduce lead times makes vertical integration (and clustering) so important. *Vertical integration is key to reducing lead times.*

In order to remain competitive, purely on a lead-time basis, a garment manufacturer must today be able to:

- sample in one to two weeks,
- have fabrics delivered in 4 weeks,
- manufacture the garments in 2 to 4 weeks and
- deliver in 4 to 5 weeks.

If Lesotho garment manufacturers were vertically integrated or had fabric suppliers on their doorstep, the aforementioned lead times could be met.

The proviso is that the fabric supplier is approved by the buyer/sourcing house in the East or US. This quality-related issue will be dealt with separately.

Lead times could potentially be further reduced if the fabric supplier was “geared up” to supply the buyers as is the case for the garment manufacturer in Lesotho sourcing from the

East. Vertical integration (or clustering as preferred by some of the Mauritian manufacturers) is the route to take.

Some of the garment manufacturers in the region, other than Lesotho, have seen their traditional EU market share being eroded by Turkish garment manufacturers (proximity to market). To counter this, they are developing strategies to make fabric available in 10 days, garment-making in 10 days, and looking to airfreight to beat the Turkish companies on lead time.

Vertical integration has the advantage of reducing lead time. In taking the lead from the aforementioned companies, Lesotho could then potentially also compete with garment manufacturers in Bahrain, Jordan, Egypt, Oman and CAFTA countries, all of whom now also enjoy free-trade agreements with the US.

Relationships and trust between buyers in the East and suppliers in the region will need to be developed. This process takes time and is discussed in the chapter dealing with quality.

In terms of lead-time costs, this is only quantifiable as “lost orders”. If a garment manufacturer cannot meet the sampling to garment delivery requirements, the order will simply be placed with a company that can.

Today’s apparel retail environment is uncompromising where delivery schedules are concerned. Apparel retailers impose penalties for delivery delays. This can be 1% of the garment price per day of late delivery. If garments have to be cleared from the client, this can cost as much as \$2.50 per garment. The relationship between client and vendors will, however, influence penalties imposed.

Mishaps – Vertical integration solutions

From time to time fabric content and trim³² requirements imported for a particular order do not match up. They would run short of buttons or sewing thread, for example. To be able to still produce the garments in time, the missing trim volumes have to often be couriered or collected by the manufacturer. This will add an additional week of production delays.

Were trims to be sourced within the region, on the same basis as they are from the East, and similar mishaps occur, delays in production would be considerably less. Courier costs would also be lower.

3.3 Transport Costs and Logistics

In Africa, transport costs and logistics have always been costly and often fraught with delays (truck breakdowns, poor road conditions, customs/paperwork etc.).

Shipping costs have risen 30% over the last two years and are thus now also costly. China’s increasing need for imported raw materials and export of manufactured products is often cited as the reason for increased prices.

³² Trim is commonly used to refer to sewing thread, buttons, labels, zips, elastic, etc. needed to make up a garment.

Increases in fuel costs and availability of containers and ships also plays a role. Recent acquisitions have seen shipping lines such as Maersk/Safmarine control approximately 80% of the market. This lack of competition has also influenced shipping costs.

Recommendation

However, grouping exporters together, a cluster of garment manufacturers in the region were able to reduce shipping costs by 25%. Like airfreight, this is also an area that should be explored.

Freight Costs and Time

Freight costs from China, India and within the region are set out below.

Table 7: Freight Costs and Transport Time			
By Sea (Shipping)			
Container Size	From/To	Cost (US\$)	Time (Days)
40-foot	China / RSA ³³	3,000	20 – 21
40-foot	India / Mauritius ³⁴	2,200	14
20-foot	Mauritius / RSA ³⁵	700	4
40-foot	Tanzania / RSA ³⁶	1,900	7 – 8
By Road			
40-foot	RSA / Lesotho	2,500 ³⁷	2 – 5
40-foot	RSA / Lesotho	3,065 ³⁸	2 – 5
40-foot	RSA / Lesotho	1,950 ³⁹	
40-foot	Arusha / Dar es Salaam	1,500 ⁴⁰	2 – 3

The high cost of local/regional road transport is clearly evident. Road transport costs from Arusha to Dar es Salaam and Port Elizabeth to Maseru are almost as much as shipping costs.

A more accurate cost can be derived from taking content into account.

By way of illustration, a 40-foot container can hold 20 tons of yarn. For the garment manufacturers in Lesotho and the knit fabric they use, this is between 10 and 12 tons per container. The shipping cost per ton will thus be less for yarn than it is for knit fabrics.

³³ Durban or Port Elizabeth.

³⁴ Port Louis.

³⁵ Port Elizabeth.

³⁶ Dar es Salaam/Durban.

³⁷ Back-to-back cost. Container of fabrics from Port Elizabeth to Maseru, with the same container used to export garments.

³⁸ Container of fabric transported from Port Elizabeth to Maseru, but container going back empty.

³⁹ Container of fabrics transported from Durban to Maseru. This includes the return of the empty container.

⁴⁰ Transport costs within Tanzania.

To be able to make comparisons, the freight/transport costs have been defined by product (container content).

Table 8: Transport Costs^{*1} by Mode, Product and Time					
Mode	From/To	Days	Product	Volume	Cost/Product
Road-Truck	RSA denim mill/Maseru	1-2	Denim fabric	28,000 lm	R0.16/lm
Road-40' Container	Dbn Port/Maseru	1-2	Denim fabric	32,000 lm	R0.19/lm
Road-40' Container	PE Port/Maseru	2-3	Denim fabric	32,000 lm	R0.33/lm
Rail-40' Container	PE Port/Maseru	5-10	Denim fabric	32,000 lm	R0.24/lm
Ship-40' Container	China/Dbn or PE	20-25	Denim fabric	32,000 lm	\$0.133/lm
Ship/Road 40' Cont.	China/PE PE/Maseru	20-25 (+2-3)	Denim fabric	32,000 lm	\$0.172/lm
Ship/Road 40' Cont.	China/PE PE/Maseru	20-25 (+2-3)	Knit fabric	11.000 kg	\$0.50/kg
Ship/Road 40' Cont.	China/PE PE/Maseru	20-25 (+2-3)	Yarn	20.000 kg	\$0.275/kg

To arrive at the actual cost for denim fabric, knit fabric and/or yarn actually paid, the return cost of the empty container would in many cases need to be added.

A denim fabric FOB price (India) of \$1.75/yard lands at the jeans manufacturer's gate in Maseru at \$2.185/yard, duty paid. Once the empty container-return costs are added, the actual cost is \$ 2.235/yard (extremely close to the price of denim fabric delivered from RSA or Lesotho of \$2.25/yard equivalent).

The additional \$ 0.015/yard savings by importing would not make sense if all of the problems (tracking, potential quality problems, shrinkage) are taken in to account as well as the fact that a 40'-container takes 32,000 yards rather than the volumes they need.

The key issue is not the cost of the imported fabric versus locally produced denim, but rather buyer/customer approval. This is discussed in detail in Chapter 3.4.

^{*1} The above costs exclude the return of the container (R6,000/container if full: back-to-back, fabric in/garment out or R9,500 if empty). This would add for denim \$0.048/lm if returned empty; thus total shipping from China to Maseru would be R0.22/lm denim fabric (fabric in, returned empty). For knit fabric, total shipping costs \$0.64/kg, yarn \$0.35/kg.

However, some companies are making use of back-to-back transport (fabric in/garment out) in the same container, saving the company R3,500 per container (approximately R0.25 per garment/jean).

As mentioned, one of the problems in calculating the transport cost is that in many cases, the parent company (buyer/merchandiser) has paid all or part of the local additional transport leg. Some of the companies in Maseru thus pay only part of the empty container return Maseru/Port Elizabeth costs; others pay the full costs (both ways), others nothing.

Logistics

Whereas rail transport was used from Durban and from Port Elizabeth until 2002/03 (and still is from time to time), a key issue has become “time to market”. The garment manufacturers can no longer wait up to 10 days for containers to arrive at the Maseru depot and then collect the container from the depot and truck it to their factory. The latter, if it rains heavily (like the first quarter of 2006), could become inaccessible and result in further delays and costs.

Rail is cheaper than road transport, but because of the time rail takes to deliver goods, road transport is the preferred mode.

There have been a number of previous studies⁴¹ done on the rail transport issue to/from Maseru and this report will thus not dwell on all the problems associated with rail/Mascom.

Most of the companies would prefer to use Durban port. Some still do, especially for garment exports. However, the bulk of all imports go via Port Elizabeth for the simple reason of congestion at Durban port.

Port congestion can and does from time to time delay off-loading containers. Once off-loaded, congestion in the container terminal can mean that a transporter may not be able to access the container for a number of days.

Another logistical issue is that, from time to time, too many containers are entering and leaving Maseru, causing congestion within Maseru itself (traffic jams). The premises are also too small for a few of the manufacturers to store/load/off-load more than one container at a time. *Vertical and/or regional integration would allow the garment manufacturers to have their fabric deliveries staggered.*

At certain times of the year there is an overload of containers going to Durban for exports. This has resulted in delays in finding the transporters/trucks to transport the containers. Due to this occurrence one particular company missed sailing 6 times in 2005. Two of the consignments had to be air freighted. *Many costs can be avoided by having access to fabrics regionally or in Lesotho.*

Although airfreight is an option, costs out of RSA to the US/EU were not established. It could add 25% of the cost of the garment if Mauritius is anything to go by (at least \$2.50-3.00/kg or close to \$1.00 per garment – for a 500kg-assignment).

There are other problems with transport logistics, such as the pressure to use local transporters. This will be dealt with under Public Sector Support for Regional Integration.

⁴¹ “Lesotho Garment Industry Sub-Sector Study,” Andrew Salm (Team Leader) in January 2002 and “Value Chain Analysis of Selected Strategic Sectors in Lesotho,” Global Development Solutions in June 2004.

3.4 Quality of Raw Materials

In sourcing fabrics and trims regionally, there are a number of criteria to take into account.

Fabric Approval

The Lesotho garment industry is not averse to sourcing from companies in the region. It all depends on whether buyers in the East or US will approve the fabrics. This approval takes into account consistency of quality, delivery lead time and price.

For the majority of Lesotho garment manufacturers the factory owner (and therefore the decision maker) as well as buyer and sourcing house, is located in the East. Therefore, any regional fabric supplier has to send samples to the East for approval. The time within which the sample is provided is critical.

It is encouraging that some of the buyers in the East are beginning to ask the Lesotho garment manufacturers for information on the fabric mills in the region. The problem is that many Lesotho companies do not know who the fabric knitters are and many of the regional mills are known to be slow on the sampling issue.

The lack of market intelligence is an important component of regional integration and is dealt with under a separate heading.

Fabric Ranges and Varieties

It is very concerning that the region does not produce all of the variety and ranges of fabrics that the Lesotho garment factories need. This problem applies to synthetic fabrics, in particular, due to lack of available yarns. It will, however, also be the case for some denim fabrics.

Similarly an inquiry from a branded retailer for garments made from air-jet spun polar fleece fabrics had to be rejected as there are as yet no air-jet spinners in the region.

Fabric Sampling/Testing

If buyers in the East approve a particular fabric supplier, it will be a problem that the garment manufacturers in Lesotho do not have a fabric technologist on site.

This challenge could be overcome by having an independent fabric inspection service in Lesotho approved by buyers in the East or US clients.

Fabric Specifications

Another concern is that the current fabric suppliers shipping fabrics to Lesotho do not include fabric specifications. This means that if they run short in Lesotho and would like to source it locally to shorten the lead times, it would take longer regionally than re-ordering from the East.

Without fabric specifications (yarn types used and fabric constructions), a fabric sample has to be sent to the local mill. There the fabric has to be analyzed to identify the yarn types used and how the fabric is woven or knitted. This takes time. The local fabric mill will have to see

who can supply them the yarns before coming back with a price quote. Additionally, samples for approval and delivery time need to be taken into account. It is thus more convenient for the Lesotho garment company to phone the buyer in the East and ask for more fabric to be sent.

Recommendation

The aforementioned problems could relatively easily be resolved. Buyers in the East could simply provide the fabric specifications with all the materials they send. It would be even more efficient if the buyers met with some regional fabric mills and, once the trust was built up, nominated them as alternative supplier with a copy of fabric specifications every time a new consignment of fabrics went to Lesotho. Over time, the local mills could then become the approved supplier for some of the fabrics buyers need to source.

Textile Mill Apprenticeship

Some garment manufacturers have indicated that their buyers in the East have concerns with mills that are new and have not yet been running for two to three years, regardless whether the mill is in Africa or the East. Companies in Mauritius expressed similar sentiments. They refer to it as “apprenticeship”.

This apprenticeship period is worrying as there are a number of relatively new fabric mills that could potentially supply Lesotho garment manufacturers but may, because of this apprenticeship period, be left out of the running for some time.

Any new fabric mill established in Lesotho or somewhere else in the region could also fall into the apprentice category. A new mill may not be able to reach its full potential by October 2007 (one-and-a-half year’s time) when the third-country fabric provision is set to expire.

Price

Price issues and transport-related costs are discussed in Chapters 3.1 and 3.3.

Order Size and Time to Market

Illustrations were given that, for some manufacturers, orders used to be 5,000 dozen pieces of one style, but are now 2,000 to 3,000 dozen pieces, and spread over 6 styles.

The lead times associated with these orders could trigger regional sourcing, as fabrics must be delivered quicker to the factory, made up in a shorter time period and shipped out.

The problem is that the 25 shipping days from the East remain the same and shipping time to the US remains the same. Garment manufacturers thus have to produce the garments in a shorter space of time.

Recommendation

If the buyers in the East were to take the time to meet some of the regional fabric mills and develop relationships with them, they could shorten fabric deliveries by at least 2 to 3 weeks (Tanzania to South Africa).

Market Intelligence

The lack of knowledge of who produces what and where in the textile pipeline in SSA and Lesotho (fiber, yarns, fabrics and garments) is disconcerting. The importance of market intelligence (sourcing and outsourcing) should not be underestimated because regional integration will not take place without it.

Recommendation

It is important that an in-depth analysis is made of all those regional denim and fabric knitting mills capable of supplying fabric and trims in reasonable quantities and over a reasonable lead time and with an acceptable quality standard. This will be discussed in more detail in Chapter 5.

Buyers Bypassing SSA

A number of companies in the region are concerned that fewer apparel retail buyers visit their countries in Africa. There are a number of reasons that this is happening.

The first is that when AGOA commenced, many US buyers did not know all of the vendors in the region and thus visited the countries more frequently to create contacts.

Secondly, a considerable number of international sourcing houses had previously assisted US apparel buyers in identifying additional vendors to be visited. However, the weakening of the dollar (strengthening of local currencies) saw the industry become less competitive and a number of vendors and sourcing houses closed.

The late announcement of the third-country provision extension in 2004 and quota removals did not improve the situation.

Finally, as most of the Lesotho garment manufacturers' decision-makers are based in the East, few companies in Lesotho itself are able to independently sample, negotiate prices and buy fabrics. To negotiate, apparel buyers therefore need to deal with the East.

Trims

“Trims” is a common term in the garment sector that encompasses buttons, sewing thread, zips, labels, press studs (for jeans), labels and patches.

When trims are in short supply, a number of Lesotho manufacturers have looked to source from South Africa. The following factors were encountered:

Buttons – all companies in Lesotho are using different buttons. Therefore, a local manufacturer would first have to make the mould for the buttons. By the time the mould was made a colleague (in Lesotho manufacturers often ask those traveling to the East to bring back “items” and everybody knows who is traveling when), the manufacturer would have been in China and returned with the buttons in question.

Sewing Threads – A sewing thread manufacturer was asked to produce a specific type that the company had run out of. After analyzing the situation indicated that they did not produce the thread locally and would have to import it themselves (defeating the objective). This scenario also highlights the reason that specifications have to be provided for alternative regional sources to respond quickly.

Other issues concerned price.

Companies in South Africa and regionally have little idea of the size of the garment industry in Lesotho. Those that did find out were, to say the least, “flabbergasted”. *Lesotho garment industry should thus be able to extract more favorable price terms because of its size.*

4 PRIVATE SECTOR SUPPORT FOR REGIONAL INTEGRATION

Regional integration should no longer be seen as an option for Lesotho's manufacturers, but as an imperative to survive. Before the expiration of the third-country fabric provision in 2007, the manufacturers must be in a position to source fabrics regionally.

Several issues must be addressed by the private and the public sector to prepare for the integration. The government's role is discussed in Chapter 5, while key steps to taken by the private sector are outline below.

4.1 Sourcing

Vertical Integration

As discussed previously, vertical integration will make the Lesotho garment industry more competitive in terms of costs and time to market.

Lesotho garment manufacturers, through their owners, buyers and sourcing houses in the East, should be targeting fabric knitting mills and dye houses in order to evaluate the possibility of these companies relocating to or investing in Lesotho. The companies should preferably be those with whom buyers and sourcing houses are dealing.

The market for knit fabric exists. Its size, approximately 20,000 tons per annum, is significant and should be of interest to any fabric knitter or dye house. After the expiration of the third-country fabric provision, demand will be bigger than supply – also a major enticement for any investor.

Based on announcements already made to some target audiences, the Win Garment Consortium is evaluating this option. Knit garment manufacturers in Lesotho (and their owners, buyers and sourcing houses) should be encouraged to discuss with the consortium their fabric requirements and commitment (quality, delivery and price being equal) to sourcing from this consortium before they invest.

Regional Integration

The LNDC and ComMark Apparel Project have encouraged a considerable number of regional knitters and dye houses to visit Lesotho garment manufacturers. Some came with a view to supplying, while others came to evaluate investing in Lesotho. Again, Lesotho garment manufacturers should be encouraging these companies and also making the effort to visit the companies and countries concerned in order to understand what they are capable of producing.

The Lesotho garment manufacturers that visit regional fabric suppliers should inform their overseas owners, buyers and sourcing houses of the existence of these fabric knitting mills and dye houses, and provide information on capacities and fabric types produced. Similarly, the Lesotho garment manufacturers should encourage their buyers to visit the region and evaluate the sourcing options and fabric qualities first-hand.

Conversely, arrangements should be made to get the regional supply base (those that warrant it in terms of quality and capacities) to meet with buyers and sourcing houses in the East. This will probably require public sector backing.

Two of the companies that have already visited Lesotho to explore investment opportunities expressed several concerns regarding water availability, effluent treatment and disposal of solid waste to the LNDC. These concerns should urgently be addressed and communicated with prospective investors to keep their interest from waning.

Lesotho garment manufacturers should also request that their buyers' (or fabric suppliers') fabric specifications be available prior to shipping. These specifications then need to be given to pre-selected regional suppliers. This would enable them to supply when fabric/trim mishaps occur. This is currently not possible and regional suppliers are thus severely disadvantaged from a lead-time point of view. The time it takes to analyze which yarns and fabric construction have been used, and then to source and produce, is too long compared to reordering from the East.

4.2 Production

Electricity

Some of the key issues such as utilities (electricity and water) will be addressed in detail in Chapter 5 because they fall under the domain of public sector support.

However, note that power surges/dips are too frequent, particularly in the textile sector (but also the garment sector). This must not be confused with power outages. Surges and dips in electricity cause enormous costs and at times damage equipment.

For garment manufacturers, power outages mean lost productivity. If no indication can be provided regarding when electricity will be restored, workers are sent home. With companies under pressure to meet shipping deadlines this can also become a costly affair in terms of penalties by the customer or even order cancellations.

The Lesotho Textile and Exporters Association (LTEA) is encouraged to take this issue up with the Lesotho Electricity Commission. If they do not receive adequate answers on how the issue will be addressed, the matter should be taken to the relevant Minister under whose authority the Lesotho Electricity Commission falls.

Productivity

The equipment installed in the textile sector in Lesotho is very modern and of the best types available. The highly capital intensive nature of the textile sector makes it difficult to make major productivity gains. An additional study would be required to assess Lesotho mills' levels of productivity.

Based on various reports dealing with the clothing sector and value chain in Lesotho, as well as information gained from garment manufacturers in other countries, it is in the interest of the garment industry that productivity is improved.⁴²

⁴² See Appendix 2 for more information on productivity.

Quality and Ranges

The industry and buyers express concern over the quality and variety of the denim fabric produced. Their concern is that Nien Hsing and CGM are not producing all of the fabric to meet jeans manufacturing requirements. They are thus not taking maximum advantage of their vertical integration capabilities, also impacting costs and time to market.

The problem appears to be that neither company has been able to obtain fabric approval/nomination for the full fabric ranges they produce. There are possibly three areas of concern: fabric quality, fabric range/design/variety and garment washing.

The mills in question should have a frank discussion with their clients and potential clients to address their concerns. If washing is the issue, the mills could possibly request key staff to train at a jeans washing plant that is fully accredited with a number of the major brands. If the issue is fabric ranges/design, etc., it may be necessary to employ a fashion fabric designer or set up a design studio.

Fabric quality problems are caused by a variety of factors. They may lie, for example in the yarns or faults in the fabrics. *Trained supervisory staff should be able to manage such quality issues.*

4.3 Distribution

The main problems surrounding distribution are addressed in Chapter 5 on public sector support.

One of the issues, however, is container congestion in Lesotho itself. Another issue is the inability of some companies to off-load more than one container on their premises at a time due to space limitations. Vertical and/or regional integration would allow a company to have deliveries staggered rather than having many containers arrive at the same time when the ship has docked.

With the volume of container traffic flowing into and out of Lesotho, there may be a need to have a clearing and forwarding office in Lesotho. Clearing and forwarding companies should be contacted by either the garment manufacturers or the LTEA, and they should be requested to evaluate the possibilities to potentially reduce costs and/or speed up container assignments.

4.4 Other Issues

Duty Credit Certificate Scheme (DCCS)

This is essentially a government-to-government issue within SACU and will be further discussed in Chapter 5. However, Lesotho garment manufacturers, through the LTEA and their regular meetings with the Minister of Trade and Industry, should lobby Lesotho Government officials to put pressure on the South African Government to have the new WTO-friendly version in place before it expires.

The importance of on-time intervention cannot be stressed enough considering that the April 2005-March 2006 extension was only ratified in April 2006 and will expire in March 2007.

The LTEA should also be working together with the South African garment export association, Clo-Trade, to address the issue.⁴³

Banking Services

According to garment manufacturers, the prime rate in Lesotho is between 1.0 and 1.25% higher than in South Africa. Bank charges are also 1% higher on average and deposit/withdrawals are also more expensive.

Banks in Lesotho are perceived by clients to be far less efficient than their South African counterparts. Loans are almost impossible to negotiate with Lesotho banks and have to be arranged in South Africa. There should be no intrinsic reason for a higher prime rate or higher bank charges.

The LTEA, speaking on behalf of the textile and garment exporters, together with Chambers of Commerce (and possibly the Ministry of Finance) should take this issue up at the highest levels with the bank's parent company in South Africa.

⁴³ Clo-Trade is a driving force in lobbying the South African DTI to finalize the new, WTO-friendly, DCCS.

5 PUBLIC SECTOR SUPPORT FOR REGIONAL INTEGRATION

The Government of Lesotho has made great strides in making the manufacturing environment more attractive to existing and potential investors. However, there are a number of areas where the Government still needs to take action in order to improve the business environment.

5.1 Sourcing

Vertical Integration and New Investments/Expansions

The major impediments for support of vertical integration and new investments in Lesotho are related to infrastructure. The main areas of concern are:

Factory Space – lack of adequately sized (>5,000m²) factory shells and factory zoned/serviced land.

Utilities – lack of water availability (large quantities), water treatment/purification and effluent treatment facilities, as well as solid waste disposal sites. Electricity is another challenge; there is a need for uninterrupted power supply.

Factory Space

Factory space suitable for a large knitter and dye house is not readily available. The factories that are currently empty range in size from 1,000 to 1,500m². If a vertically-integrated knitting and dye house operation is to use these factories, handling costs between the factory sites will increase.

If the number of inquiries for investing in garment manufacturing operations in Lesotho come to fruition, Lesotho will run out of manufacturing factory space. This situation is especially concerning at a time that the tax environment favors additional investments.

The LNDC should undertake an inventory of all factories (full and standing empty) by size and location, both those administered by the LNDC and those administered by the private sector. The latter appears to be charging considerably more than the LNDC for its factory shells.

The land area earmarked for factory development appears to be very suitable for an export-oriented manufacturing zone. This land will need to be developed sooner rather than later.

Utilities

Water – Water is available for the existing industries in Lesotho. However, if a commercial dye house is set up, as already proposed by the Win Garments Consortium, availability of water will be a problem.

A 600-ton/month dye house would use approximately 75,000 cubic meters of water per month. Mid-2005 costs were approximately R5.18 per cubic meter in South Africa. Lesotho would need to be able to match or under-cut this price.

The problem is not just availability, but also consistency of water, and amongst other, the pH balance. If water is not consistent, dye recipes cannot be replicated from batch to batch and would thus be rejected by customers; this would again have cost and lead-time implications.

Knit fabric dye houses use considerable volumes of dyes and ancillary chemicals. There will thus be a need to be able to treat the water outflow, requiring water purification/effluent treatment and preferably recycling facilities. The capital expenditure required for this cannot be expected to be born by the investor.

The cost of effluent treatment including chemicals and discharge costs should be less than the cost of water coming in.⁴⁴ If funded publicly (perhaps with support from international agencies) and run independently from Lesotho water authorities, other uses could certainly be found for the effluent treatment plant should the textile/dyeing/washing industry disappear.

Many dye houses have energy recovery processes installed. These include hot waste water that is pumped through a heat exchanger to warm up incoming fresh water, reducing the energy requirements to heat the water to the right temperature again. Whether this “service” could be provided by an independent effluent treatment plant is not known. It would reduce the energy costs of a dye house.

In terms of public sector support, a study to determine water quality and availability is necessary. An assessment should be made of the uninterruptible power supply (electricity) to examine where suitable qualities and quantities are available. Studies should also be conducted to determine the best waste water recycling options, ranging from the most environmentally friendly to those that merely clean water of all toxins.

The study should also identify and estimate the potential cost savings of water recycling. Further, it should analyze possible alternative uses for the water treatment plant should the textile dyeing and finishing not be sustainable. These studies should be carried out as a matter of urgency.

Solid Waste – A dye house capable of processing some 600 tons of knit fabric per month would require the removal of around 55 tons solid waste per month. The costs for this service would be approximately R360/ton.⁴⁵ A suitable site for this would have to be found. If a suitable site is available, Lesotho entrepreneurs would be able to service clients’ solid waste disposal needs.

⁴⁴ Based on experience from South Africa.

⁴⁵ Based on experience from South Africa.

Electricity – Electricity is not as big of an issue for garment manufacturing as it is for textile mills and/or washing/dyeing operations. For the textile and washing plants, however, electricity supply is too erratic in terms of power surges and dips. Formosa Textiles indicated that over the 2004/05 period they experienced 100 “trips” due to power surges and dips. According to management, the down-time associated with each trip was at a cost of R30,000 per “trip” or R3 million for that period. This cost is unacceptable for any textile mill and there should be mechanisms in place that hold the Lesotho Electricity Commission accountable for “trips” with possible provisos for each party.

Power surges and dips will also have serious implications for a potential new dye house. If black-outs last for more than a couple of minutes, the fabric in the dyeing machines has to be removed, stripped of colorants and then re-dyed. Apart from the costs, a key issue is that lead times increase. Delivery delays are then the order of the day.

Electricity supply inconsistencies (surges/dips) must be removed by upgrading infrastructure or supplying contracts that would compensate large users for losses incurred. The best option would be an electricity supply upgrade.

In terms of attracting knitting and dyeing facilities, the price for electricity should be in line with that in South Africa, which is approximately R0.13/kwh.⁴⁶ A knitting and dyeing company⁴⁷ would require approximately 1.1 to 1.2 million kwh/month and a maximum demand of between 2000 and 2250 KVA.

Regional Integration

Market Intelligence – It is recommended that an in-depth analysis is carried out of all regional denim and fabric knitting mills capable of supplying fabric and trims in reasonable quantities, over a reasonable lead time, and with an acceptable quality standard. This analysis would not only benefit the industry in Lesotho, but all producers in the region that are facing the same challenges as Lesotho in terms of the AGOA requirement of regional integration.

Although there are over one hundred fabric-knitting mills in the region, a shortcut would be to select mills with a minimum capacity of around 100 tons/month, a short delivery lead time, and a record of supplying export-oriented garment manufacturers.

This research should cover a number of other issues such as when the company was established, fabric types/ranges and capacities with, for example, samples of their core fabric types. The findings could then be presented to buyers in the East as well as US retailers.

Both the garment manufacturers in Lesotho and the rest of the region have little knowledge of where the fabric mills are located or what they produce. ComMark and the LNDC narrowed the knowledge gap by inviting around 15 fabric knitting mills to Lesotho. The next step for ComMark and the LNDC would be to encourage the Lesotho garment manufacturers, and their buyers, to visit the regional knitting mills.

Further, it is important to take company representatives with fabric samples from pre-selected regional fabric mills⁴⁸ to the East to meet owners, buyers and sourcing houses. Since this

⁴⁶ Mid-2005 prices.

⁴⁷ With 600 tons/month throughput.

⁴⁸ Those from the aforementioned study.

investment is of regional interest, the Government of Lesotho should not undertake the investment alone, but seek support from Departments of Trade of the countries involved.

Without improved market intelligence in the region, regional integration will not take place. This is best illustrated from the last Centre for the Development of Enterprise business-to-business (CDE B2B) event where some garment manufacturers made contact for the first time with textile mills from Madagascar and Mauritius; both parties had been equally unaware of the other's existence.

Although B2B (buyer/seller) meetings have been arranged by some international bodies, it has often been an open conference where anyone could attend. In order to have the most impact, it is important to pre-select companies that could potentially best benefit each other.

Regional Integration Policies – Seamless integration of across-border movement of products within the SADC is difficult. Nevertheless, considerable strides have been made within SACU, in particular with the Customs & Excise Procedural Act for goods carried by road across the Transkalahari between RSA, Botswana and Namibia. Paperwork has been minimized by the use of forms SAD 500, 501, 502 and 503: Customs Declaration Form, Continuation Sheet, Transit Control and Bill of Entry Query Notification/Voucher of Correction, respectively.

Notwithstanding the aforementioned, a major problem is that a sourcing house is unable to combine orders from Lesotho and Swaziland in one container.

In discussion with owners and managing directors of textile mills, garment manufacturers and export associations, based on AGOA, there are no individual country government policies, let alone regional that actively promotes the sourcing of inputs for goods to be exported to the US. In a way, the third-country fabric provision extension took care of the need to do so.

Those policies that are in place, such as the SADC Trade Protocol (preferential access to RSA markets), were set in place before AGOA came in to being.

A number of the people spoken to were also portfolio members of ACTIF (African Cotton Textile Industry Association), a body set up and supported by RATES (USAID) and acting as Secretariat to promote regional integration and sourcing, investment, etc. However, the third-country fabric provision appears to have taken over the agenda and, as one person succinctly indicated, there was a lot of talk but no action or implementable measures regarding integration for sourcing purposes.

Manufacturers indicated that it is up to industry to pursue regional integration opportunities and that governments' tasks are to ensure that the infrastructure (road/rail/ports) is in place and that customs procedures are not too burdensome or slow down product movement across borders.

Many companies mentioned that the only way to have any form of regional integration is if individual manufacturer attitudes change, manufacturers engage with companies in other countries, and actually do deals and make it work.

A number of companies tried this approach when AGOA was implemented. At the time, however, the attitude of competition rather than cooperation or partnering was prevalent. This is now changing, as illustrated below.

An approach that appears to be working (2006 will be make or break) is the one adopted by the CDE (Centre for Development of Enterprise), based in Brussels (EU). In 2002, 2004 and 2005, it brought together regional textile and garment manufacturing entities. In 2005, the approach was transformed into a business-to-business event in which manufacturers were pre-selected and matched according to the needs of the companies in attendance. Sourcing, outsourcing and even joint ventures for export to the EU were being forged. (Some outcomes are as yet confidential but certainly successful.)

The B2B event is not cost-free. Each company invited pays its own airfare and accommodation. The motivation is to do business.

The CDE's aim is for companies in the regional textile industry, from raw material to end product, to take ownership of this event.

It is as yet not clear whether or not the CDE will continue to fund the venue, research and administration that go into making the B2B event work after 2006.

If the CDE does not fund the next event, the World Bank could possibly work to fast-track regional integration and possible industry clustering in Southern/Eastern Africa.

Fabric Inspection/Testing

There are no fabric technologists employed by the garment industry in Lesotho primarily because all fabrics are imported from the East and there is thus no need to do so.

Should regional integration take place, an option would be to have regional fabric samples tested, on a regular basis, by any vertically-integrated mill that has invested. However, this measure is fraught with problems, least of which is vested interests. It would be worthwhile to explore with overseas buyers, sourcing houses and clients the possibility of investing in a fabric-testing facility run by an approved group that is already in the business.

To use the services of the SABS and/or CSIR in South Africa defeats the objective. Quite apart from the time this will take, one main problem is that each sample will have to have Port of Entry documentation and will be liable for VAT.

An independent fabric testing facility approved by the majority of brands and buyers/sourcing houses would facilitate regional integration considerably.

Investment Promotion – This appears to be a haphazard LNDC exercise (shotgun approach). Investment promotion must be highly focused on a target market and potential clients therein. The LNDC must target specific companies in order to facilitate investments by vertically or semi-integrated fabric mills.

By way of example, the companies that have expressed interest in supplying Lesotho garment manufacturers and those investing in Lesotho must be followed up with and provided with all information necessary to make these decisions. There are current inquiries outstanding.

Other investment promotion issues will be discussed under another heading than regional integration.

Customs/Documentation – As mentioned earlier in the report, sampling and time to market are becoming more critical. On many occasions lead time has been increased as samples get stuck in the middle of Customs processes.

The main Customs complaint is with South African Customs officials. It appears that they are rotated from time to time. Although not established why, it could be to prevent corruption. However, the new in-take invariably brings about problems such as the issue of insisting on a Bill of Entry for goods that are in transit (insisting that VAT be paid and then reclaimed). This process has caused considerable delays (3-4 days) on a number of occasions.

Secondly, there were complaints of tariff interpretations (this was in the case of fabric imports) differing from one customs official to another, and resulting in the paperwork having to be sent back and forth between supplier and customer (delays of a week).

In terms of inspections, there have been occasions where the Manifest/Bill of Lading was not as exact as it should have been. For example, blankets were used to cover the products, but as blankets were not on the paperwork there was a 7-day delay.

On another occasion, two weeks before being in Lesotho, there was a strike by Lesotho Customs officials regarding overtime pay. The dispute was finally settled on the basis that the Customs officials would be paid R40.00/hour during the week for overtime and R140.00/hour on weekends. However, garment manufacturers would have to sign that the Customs officials were indeed working on overtime.

This settlement appears to be open to exploitation, e.g., go-slow to abstract maximum overtime pay and the ability to take more time than usual for inspection and documentation handling. There should be a more efficient and less expensive way of handling this.

Lesotho Revenue Authorities (LRA) – A number of manufacturers indicated they were discontent with the attitude of the LRA. Some felt tantamount to being terrorized (abuse of authority), be it from tax inspections to use of local transport. There is the belief that because LRA staff/inspectors are working on a commission basis they are more intimidating than they need be. The need for compliance manifests itself in the fact that manufacturers need tax clearance certificates for just about all transactions (trading, manufacturing, forex, etc.). Companies are easily bullied because they are worried about losing “Tax Clearance Certificate” status.

Another issue is that some companies that also export feel aggrieved that they do not have the same tax status as fully-fledged exporters despite their investment being large in comparison to others. Such tax issues could have implications for investments in vertically-integrated knitting and dyeing operations.

5.2 Production

Amongst a number of issues, the lack of product diversification and lack of market diversification feature prominently in Lesotho's textile and garment industry.

It is an area where the LNDC could be very instrumental in rectifying by way of targeted investment promotion.

Lack of product diversification – Lesotho is essentially known for T-, polo and golf shirts as well as jeans. It lacks any visible sign of knitwear and hosiery (pullovers and sock) production. Similarly, for example, there is no production of underwear/lingerie and limited woven shirt, jacket or constructed/formal trouser production.

Although the industry itself must address the issue of product diversification, the LNDC can facilitate the process by way of targeting regional (in particular, South African) and overseas manufacturers of these garments. There exists a manufacturing environment and additional favorable financial (tax) incentives.

The LNDC, with the possible assistance from such institutions as the World Bank, must undertake an evaluation of companies in South Africa and overseas that are suitable candidates as manufacturers of the aforementioned products. These companies must then be visited specifically for relocation/investment purposes. There are companies in South Africa that would relocate but are unaware of that which Lesotho can offer them.

A strong presence of knitwear and hosiery manufacturers, for example, could well lead to an investment in acrylic (and blends such as wool) yarn spinning as it is the main yarn used by these manufacturers. In terms of knitwear, both Botswana and Swaziland have export-oriented knitwear manufacturers. Why Lesotho does not have these industry sectors should be evaluated.

A weaving mill has made inquiries to possibly relocate part of its mill in order to supply the South African market. If this were to be actively pursued, it could potentially help attract manufacturers of formal garments such as jackets and trousers.

However, infrastructural restraints (factory space, etc.) need to be addressed first. There is no point in funding an investment drive if the manufacturers cannot be accommodated or strain existing utility capacities (electricity and water).

Lack of market diversification – Although also a function of private enterprise, the LNDC and Lesotho Government can greatly assist manufacturers in this regard.

Lesotho garment manufacturers know very little about EU trade regulations, cumulation issues and duty structures where they have an advantage over other countries due to the trade agreement with ACP countries. Even existing exporters to the EU from the region are unclear of all the rules, especially when it comes to cumulation issues.

It could be helpful to invite EU trade legislators, buyers and manufacturers from Mauritius (major exporters to the EU) to explain what can and cannot be done. At this point, an evaluation can be made whether it is worthwhile to pursue the EU market or whether changes in rulings can be suggested in order to facilitate exports from the region into the EU.

This increased understanding of trade regulations could provide additional impetus to existing integrated denim mills such as Formosa Textiles/Nien Hsing and Crucial Trade/CGM. Any new fabric knitting mills and dye houses would also benefit.

Order size changes – As discussed earlier, orders for some garment manufacturers are being reduced. For one company the reduction was considerable (from 5,000 dozen per style to 2,000 to 3,000 dozen over 6 styles). Order size changes will necessitate regional integration because the fabric volumes for these smaller orders may not be viable to import, quite apart from taking too long to deliver.

As this order size change is already occurring, market intelligence on regional suppliers becomes more urgent. The LNDC and Ministry of Trade must urgently discuss this issue with the World Bank and look into funding options. These issues should also be discussed with buyers, sourcing houses and brands in terms of the kind of information they would need for evaluation purposes.

Waste – For the purpose of this report ‘waste’ is defined as: Spinning/fabric conversion waste and rejects from the textile and garment industry. Although claims were made that waste (fabric off-cuts) were burned in boilers, this is questionable as it could considerably harm the efficiencies of boilers (steam generation). In touring some factory sites, waste fabric (off-cuts/rejects) rates were deemed to be high among a number of factories (off-cuts 5% and rejects up to 10%, although some claim <5%). One jeans factory gave a 10% rate for fabric off-cuts. Rates should not be more than 4 to 5%.

In terms of knit fabric volumes used (approximately 20,000 tons in 2005), waste/off-cuts from the fabric should be around 100 tons/month if a 5% ratio is used – the equivalent of at least nine 40-foot container loads per month. It has not been possible to identify this kind of volume. However, assuming that these waste volumes exist, an entrepreneur should look at the opportunity for a rag-tearing plant to reduce/tear the waste fabric back to fiber that could be used by some spinners (certainly in RSA).

Rag tearing would add value to the fabric waste stream and employment – not just in the rag-tearing operation, but in particular by way of collection, transport and sorting. Some of the waste fabric would then have a “value” that could go back to the garment manufacturer.

As this reconstituted fiber (cotton) does not attract duty into RSA from SADC countries, it should not fall foul of existing legislation. It is suggested that the relevant authorities (Ministry of Trade/Finance) discuss this with their South African counterparts to be clear of the rules regarding 470.03 fabric imports (duty-free imports for manufacturing of items to be exported). These measures must be taken urgently because one company is already evaluating the cost of setting up such a textile waste-recycling venture in Lesotho.

A textile and garment waste recycling project would add value to the existing industry value chain and also increase regional trade by way of “fiber” exports into the region. A ready market exists, as some spinners in South Africa currently have to import waste for recycling purposes.

Duty Credit Certificate Scheme – A year late, the DCCS has finally been extended and is a major life-line to the Lesotho (and SACU) exporting industry. However, the terms were that in its first year of extension, the DCCS could be sold to any interested party in the industry. In the second year of DCCS extension, it is only allowed to be sold to other manufacturers.

As the first year of DCCS extension has effectively already passed (due to “delays” in implementing it/signing-off by the Department of Trade and Industry in South Africa), it can now only be sold to other manufacturers. The price/value of the DCCS certificate may thus be reduced because the retailers were major users of it. However, there should still be a ready market for the DCCS because in RSA, many garment manufacturers down-sized with the balance of what used to be produced for retailers now being imported by the garment manufacturers themselves, often for the very same retailers.

In Chapter 4, it was indicated what the private sector should do regarding further extensions of the DCCS or the envisaged more WTO-compliant alternative.

Within the framework of public sector support and regional integration, it is very important that the Government of Lesotho relentlessly pursue and pressure the South African Minister of Trade and Industry to ensure that a new version of the DCCS is in place well before the current DCCS expires. It should ideally be in place before the end of 2006 because garment manufacturers, taking cognizance of the 3-month lead-times, need to know whether cost-wise they can utilize DCCS.

Without DCCS, many Lesotho garment manufacturers will not be able to survive in the export market. The same holds true for manufacturers in South Africa and other SACU countries.

5.3 Distribution

Lesotho Revenue Authorities – The LRA unduly influences garment manufacturers to make use of local transporters. This is counter-productive and should be stopped.

According to the industry, Lesotho transporters are not as efficient as South African transporters and the trucks breakdown regularly. When this happens, the garment manufacturers have to personally intervene and find another transporter willing to off-load and reload the container before continuing to port. Depending on the location of the breakdown, the necessary equipment for handling the container is not always available.

The breakdowns lead to time-to-market delays. It is not in the interest of the Government to prevent the use of operating out of countries other than Lesotho and such rules should be eliminated.

Once the Lesotho transporters become more efficient, market forces will dictate who the garment manufacturers use to transport their goods to port for export.

The Government of Lesotho should encourage the use of local transporters to add value to their economy. However, there is a need to evaluate the preparedness (state of trucks, maintenance, availability, etc.) of the Lesotho transport industry and provide assistance to enable to it compete at the same level as the transport companies predominantly from South Africa.

Customs/Documentation – Garment manufacturers need to regularly send samples of garments from their production lines to buyers/clients (within 5 to 7 days). This is somewhat problematic in Lesotho.

Currently, the manufacturer has to get document approval stamped by the Ministry of Trade, taken to the Bank, then on to Customs and then back to the bank for final clearance for the sample to go out. To avoid this tedious process, some have tried to take the samples to Ladybrand to be sent by DHL overseas. The problem is that at this point the sample needs a Bill of Entry and VAT needs to be paid.

The authorities have to solve the problem of bureaucracy in Customs in order to prepare for regional integration. The government is strongly recommended to simplify the procedures and registration forms in order to make the system more efficient. The Ministry of Industry must not only speed up the process, but also reduce the bureaucracy in the system. It is strongly recommended that the export procedures are streamlined and simplified.

Time to market – As discussed at length, speed to market is key to remain competitive post-Multi-Fibre Agreement. Regional integration (sourcing) and vertical integration will go a long way in alleviating these pressures and resulting in the ability to meet the deadlines. It would be a worthwhile exercise to make an estimate of the cost of airfreight from Johannesburg International to the relevant markets.

The LTEA and the Minister of Transport should determine the potential volumes/container loads that could be shipped, from Lesotho, by air to the US. They should then engage SAA and other airlines to negotiate the best possible prices.

Should it be cost-effective, in terms of time-to-market value, this information can then also be used to re-negotiate the cost of shipping by sea. The fact that shipping lines may lose revenue from existing Lesotho exports may just be sufficient for them to entertain more competitive shipping costs.

6 CONCLUSION AND RECOMMENDATIONS

The Government of Lesotho and the garment industry face unprecedented challenges. The main challenges are the expiration of the AGOA third-country fabric provision in 2007 and the impact of the MFA quota removals that took place in 2005.

This report shows that it is possible to meet these key challenges through regional and vertical integration and an improved business climate. However, the Government of Lesotho and the industry must take immediate action in order to avoid factory closures and major job losses.

The study has explored the yarn, knit and denim fabrics available to garment manufacturers in Lesotho. One of the main findings is that the demand by Lesotho's knit garment-manufacturing industry for *cotton and polycotton knit fabrics* of approximately 10,000 tons can be met, even after the expiration of the third-country fabric provision. However, it is not clear whether or not the exact types and qualities of fabric are available.

On the other hand, the installed *synthetic knit fabric-manufacturing capacity* in the region (for sales, not internal consumption) will not be sufficient to meet Lesotho's demand of the other 10,000 tons per annum (total knit fabric demand is approximately 20,000 tons per annum). The same is true for *denim*. Investments in these industries may prove to be profitable provided that the third-country fabric provision is not extended.

Lobbying efforts are currently taking place in Washington, DC to either extend the third-country fabric provision in AGOA, or include a value-added criterion. The LNDC should follow the efforts closely and disseminate the information to potential investors, the Ministry of Trade and the textile and garment industry in Lesotho.

Amongst garment manufacturers, there is a distinct unawareness of fabric suppliers and the types of fabrics they produce in the region. This lack of market intelligence risks undermining any attempt to prepare for the expiration of the third-country fabric provision.

It would be preferable not only for Lesotho but for the region as a whole to conduct an in-depth study of suitable fabric suppliers, detailing, amongst other, company capacities by fabric type and quality. The task team, as described below under "Recommended next steps for the government," should be responsible for carrying out such research.

A key task of this report was to explore the competitiveness of regional and vertical integration. The conclusion is that *regional integration* of knit fabric resources in other countries can reduce the Lesotho garment industry's current costs by approximately 10% and its lead times by between 14 and 21 days.

Vertical integration has the ability to reduce these costs by between 20 to 25%. The lead-time advantage, based on similar orders, is approximately 25 days.

With the constant pressure from retailers to increase speed-to-market, the reduced lead-time resulting from regional and vertical integration is a tremendous opportunity and will improve the competitiveness of the industry. However, to compete on an international market, Lesotho's producers will have to provide services, such as dyeing and finishing, and have easy access to knitted fabric e.g., through knitting mills, preferably in Lesotho.

In order to attract major investors in dyeing, Lesotho has to fulfill four major requirements:

- 1. Availability of space.** Lesotho does not currently have the factory space available to accommodate new factories. Land and sites are being developed, but whether or not they will be available in time is unknown.
- 2. Water.** It is not clear whether or not Lesotho has sufficient water to sustain a dyeing house and whether or not the quality of the water meets the necessary standards.
- 3. Waste water facility.** A waste water facility that can clean the large quantities of liquid effluent from a dye house is necessary to avoid major environmental damages.
- 4. Solid waste disposal facility.** There are no current facilities or land sites earmarked for the disposal of the solid waste that will emanate from a dye house.

Regarding availability of space, the LNDC should undertake a detailed inventory of all LNDC factories, warehouses and other suitable buildings and, based on investor inquiries, increase the number of factories to be built. The industry is encouraged to let the LNDC know what its immediate and long-term factory space requirements are.

The Ministry of Natural Resources, possibly in conjunction with or funded by international agencies, should undertake a feasibility study of the latter three requirements. The industry (vertically-integrated textile investors) should provide the aforementioned authorities with factory space requirements, the quality and quantity of water required to meet its standards and the cost parameters that would make local production competitive.

The World Bank's Private Sector Development Department is carrying out an assessment of market demand, cost, and environmental impact of establishing a central dyeing facility supported by textile mill(s). A feasibility study should build on these findings.

In order to attract investors in the textile and garment industry and improve regional integration, general infrastructure constraints must be addressed. These include:

- 1. Problems with energy surges and dips.** Electricity supply in Lesotho is too erratic for textile manufacturing and would also pose a problem for a potential dye house.

The Ministry of Natural Resources must upgrade electricity supply by eliminating power surges and spikes when supplying electricity to the textile industry.

At the same time, the industry and the Lesotho Electricity Supply Commission should consider drawing up performance contracts that hold the electricity supplier financially accountable for power surges and dips. The installation of Power Factor Correction equipment has not yet helped the industry as the surges and dips have been too severe. The industry, in return, should be held accountable if it has caused the power problems.

- 2. Inefficient local freight transport.** While the rail transport in Lesotho is nearly 75% less expensive than road transport, garment manufacturers prefer to use trucks because of speed-to-market. Trucks can deliver a container from Port Elizabeth to Maseru in one day, while rail transport takes between 9-30 days.⁴⁹

If the rail system was upgraded, the private sector could save substantially on transportation costs. In order to explore the best ways to improve the local transport system, the Ministry of Transport should undertake an evaluation of the state of the local transport industry, exploring various solutions for upgrade. The EU has previously funded a study on improving the effectiveness of the rail system and the evaluation should build on findings from this report.

Garment manufacturers prefer to use South African truck companies because they have experienced problems with the breakdown of Lesotho trucks. The Lesotho Revenue Authorities' pressure on certain companies to use local road transportation is therefore counterproductive and should be stopped. Apart from the benefit the garment industry would have from free choice of transport companies, the direct competition from South African truck companies would also serve as a strong incentive for local transport companies to either upgrade/modernize or improve maintenance of the trucks.

- 3. Excessive bureaucracy.** Garment manufacturers need to regularly send samples of garments from their production lines to buyers within 5 to 7 days. This is somewhat problematic in Lesotho.

Currently, the manufacturer has to get document approval (stamped) by the Ministry of Trade, then clearance from the bank, then on to Customs and then back to the bank for final clearance before the sample can go out. To avoid this lengthy procedure, some companies have tried to take the samples to Ladybrand and send them overseas by DHL. The problem, however, is that at this point the sample needs a Bill of Entry and VAT must be paid.

The Ministry of Industry must not only speed up the process, but also reduce the bureaucracy in the system. It is strongly recommended that export procedures are streamlined and simplified. The World Bank's Private Sector Department is assisting the government in simplifying business registration and licensing. It is recommended that export procedures are analyzed under this framework.

- 4. Necessity for new Duty Credit Certificate Scheme.** A critically important part of garment export manufacturing activities is the DCCS. Without this export incentive, many garment manufacturers in Lesotho and SACU will cease to export

The Government of Lesotho must work with its South African counterparts at the highest level for the new, WTO-friendly DCCS and ensure that it is issued before the end of 2006. Since South Africa's Minister of Trade and Industry previously had the DCCS ratified at Cabinet level, all of Lesotho's Ministers could lobby their South African counterparts.

⁴⁹ See Global Development Solutions "Value Chain Analysis of Selected Strategic Sectors in Lesotho," June 2004.

The LTEA should at the same time work closely with Clo-Trade in South Africa and add weight to the need for the new DCCS to be finalized and published before year-end.

Recommended next steps for the Government

- A priority for the Ministries of Natural Resources and Finance should be to address the bottlenecks to attracting investment in a dyeing facility.
- A priority for LNDC should be to exploit the tax advantages provided to industry, targeting knitting manufacturers in South Africa that do not enjoy these benefits.
- In a push for vertical and regional integration, the LNDC should establish an Integration Task Team by recruiting one or two persons with experience from the textile and garment industry and with knowledge of trade-related issues. Relevant Ministries (including Finance, Trade and Natural Resources) should support the Integration Task Team when necessary. The task team should collaborate closely with ComMark.

The task team's objective will be to actively engage in identifying suitable vertically-integrated companies. It should initiate its work by mapping out the 30 to 40 main textile companies and mills in the region. The team should specifically focus on:

- Suitable vertically integrated companies. These selected companies should be approved or nominated suppliers to major US apparel retailers and brands. Once identified, the task team's objective shifts to attract the companies to Lesotho.

A starting point would be to identify Lesotho garment manufacturers whose parent companies also own textile mills in the East. (Brands and other US apparel retailers can also be asked who they believe are potential candidates.)

- Suitable fabric-knitting mills in the region that have been in operation for 5 years or more, supply garment manufacturers that export to the US or major retail chains in South Africa and are of a size that the Lesotho garment manufacturers can deal with.

The information, set out earlier, should be recorded in a "sourcing reference manual" that should be updated every time a new textile investment is made in the region, or conversely, a company is liquidated. This recordkeeping will equip the task team to more actively target companies that could fill the gaps.

The information gathered, inclusive of core fabric samples, should be made available to the garment industry, fabric buyers in the East and US apparel buyers. Further, the task team should use the findings to target suitable fabric mills for relocation and/or investment in Lesotho.

A starting point for the task team (armed with relevant factual and actionable information⁵⁰) is to fully engage the three companies that have already expressed an interest not only in supplying fabric, but in investing.

- Many buyers are sourcing directly from the factory headquarters in Asia without involving local factories. This reduces the visibility of the Lesotho garment industry. The LNDC, together with the industry, should organize a business-to-business event that would enable the fabric buyers in the East to tour (with pre-selected fabric suppliers obtained from the task team's report) knitting mills in the region. Conversely, arrangements could be made for the regional fabric suppliers to meet the fabric buyers in the East. Since other countries' governments and the industry would benefit from the initiative, they should be encouraged to contribute resources.

Recommended next steps for the industry

- The industry should actively engage and encourage the two companies that are already supplying the Lesotho garment industry to meet with other manufacturers.
- Obtaining fabric specifications is a key issue that must be addressed with the buyers of fabric from the East. The Lesotho garment manufacturers should assist by requesting the current fabric specifications and those planned for the next season's ranges. Without the specifications, the local knitters will not be able to fully exploit their proximity to client/lead-time advantage.
- The existing industry should request that their parent companies (that engage in textile activities) and fabric buyers/sourcing houses help identify suitable candidates for investment.
- The low levels of utilization of locally-produced denim fabrics by the jeans manufacturers in Lesotho are disconcerting. The low level of utilization undermines the fundamental principle of the competitiveness of vertical integration. The reasons for the low level of utilization are not fully clear, but appear to range from fabric quality, to variety/fashion and garment washing. Appropriate supervision of all stages of production is key:
 - *Fabric quality.* Relevant companies must look into upgrading the skill levels of the people involved (mainly supervisory and quality control staff from the raw material stage to finished fabric).
 - *Variety/fashion.* People able to translate the needs of the garment and fabric buyers into new fabrics should be hired. Their skills take years to develop and the companies concerned may need to "buy in" these skills. The denim mills obviously need to also work more closely with the fashion industry/buyers.
 - *Garment washing.* It is recommended that relevant employees are sent to a company that specializes in garment washing and finishing. In the meantime, it may be more cost effective to request a key person from one of the

⁵⁰ Land, building, factory rental, water, energy, etc. cost issues. Where they are not yet available, the potential investor must be made aware that these are being addressed. Once available, this information should not be emailed; face-to-face discussions must take place.

independent garment washing and finishing companies to spend time in the washing plants in Lesotho and transfer the necessary skills.

- Management of the Lesotho textile (and garment manufacturers) must start engaging with their respective parent company to ensure that more decision-making power is transferred to Lesotho operations. Increased decision-making power could greatly enhance regional integration opportunities and would increase factory visits by sourcing houses and US apparel buyers.

Appendix 1

Fiber Qualities, Prices and Waste

Cotton Lint

Cotton grown in the SADC region tends to be of a higher quality than required for the yarn counts spun in the region (predominantly Ne 30, 24, 20). Coarse count denim yarns are around Ne 6 to 7. The gins tend to blend the seed cotton that they receive from the farmer in order to produce cotton lint with a staple length of 1 1/8 to 1 3/32 inches and micronaire of 3.3 to 3.5, more commonly known as “strict middling to middling”.

Elsewhere in the world these cotton types are used to produce finer count yarns (Ne 30 and higher) than in Southern Africa. These cotton types account for up to 80% of lint produced in the region. The balance is generally 1 1/16- and 1 1/32-inch staple lengths (used for OE course count spinning – denim yarn end use) and lint with too short of a fiber to be much use for a spinner. However, these shorter staple fiber varieties tend to be produced in areas where transport costs eliminate up to half of the price advantage of sourcing lower-grade qualities.

More often than not, there is insufficient 1 1/16- and 1 1/32-lint available in the region for the course count denim yarn spinners, resulting in an over-priced raw material (and over-engineered yarn) compared to competitors elsewhere in the world with access to the lower quality/shorter fiber cotton grades.

Spinners of denim yarn in RSA are at a further disadvantage in that although cotton lint imports from SADC countries attract no duties, they do if imported from elsewhere (R1.60/kg). However, from time to time, import permits that waive the duty (currently the case for one spinner obtaining his lower-grade cotton from India) are provided. The cotton lint duty applies only to RSA and not the other SACU countries. Lesotho thus has an advantage over RSA-based spinning mills where the transport costs do negate the lower-grade cotton prices.

Cotton lint prices will vary based on grade, size of the order, whether cash or letters of credit, etc. As a guideline, the strict middling to middling grade cost around \$0.58 – 0.60/lb (\$1.28 – 1.32/kg). In comparison, the lower grade needed by OE course count yarn spinners cost \$0.50 – 0.55/lb (\$1.10 – 1.21/kg). This difference is significant if a denim mill in Lesotho or RSA cannot access the lower grade cotton required (due to lack of availability).

Naturally, the size (20,000 to 25,000+ tons/year) of the spinner buying cotton lint also plays a big role. It is often cost-effective to buy in bulk if the price is right because the mill can go direct to the gin rather than having to go through cotton traders/merchants. A savings of \$0.10+/lb or R1.35-1.45/kg can be realized. However, the cost can be considerable if price movements are read incorrectly.

Another factor to take in to account when looking at the competitiveness of say China, is that last year the country instituted a minimum landed price of \$0.60/lb to protect their farmers. Based on visits to mills in China in the past and recent discussions with cotton traders, cotton prices are on average 15% to 17% higher than world related prices (in 2001 this was 20-25%). Thus against China, regional-based mills should have similar raw material input costs for cotton lint. A key difference, however, is that coarse-count spinning mills in China do have access to the cotton grades they want. China's protectionist stance regarding its cotton farmers against imports will vary and will be adjusted when the new crop comes on the market.

Regional mills do have a marginal disadvantage with RS (ring spinning) in that SADC cotton is generally better suited for spinning finer counts than the norm (Ne 30, 24, 20) in the region. However, when compared to China, the same principles set out earlier apply.

Although cotton lint sourced/available in the region tends to be of a quality too high for the average yarn counts spun, the OE and RS yarns produced by mills in the region have the ability to compete against yarn imports from China and India when cognizance is taken of shipping, yarn duties and clearing/forwarding costs.

Cotton Waste

As cotton is a natural fiber, there tend to be considerable variances in quality. These variances could be due to different varieties being planted, weather conditions and farming practices.

When farmers take their cotton crop to the ginners to process the cotton (cleaning the cotton from seeds, leaves, dirt, etc.), they try and produce cotton as close to strict middling to middling quality as possible as this provides the ginner with the best possible price.

The spinner receives his cotton in compressed bales of 200 to 250kgs. These bales are then opened (bale opening) and fed into blenders (blow room) to mix the different types of cotton they have bought into a more homogeneous product.

The resultant cotton is then fed through a carding machine that disentangles, cleans and intermixes the cotton fiber to produce a sliver or a web. (This is the first fiber waste loss in the process.) There are various other processes that take place depending the type of yarn to be spun. Another process is combing. In this process, more of the shorter fibers are removed, leaving the spinner with the longer staple cotton fiber lengths used for producing higher-quality yarns with different characteristics to those yarns that have only gone through the carding process.

Whereas waste from the carding process can be up to 10%, waste from the combing process is more than double this.

Without going to the technicalities, some of this carded or combed waste cotton fiber can be used again for different yarns.

Polyester Staple Fiber

This fiber for the spinning industry is produced from granules that are fed into an extruder (high temperature melting) and forced through a disk with tiny holes. The resulting tow (bunch of the threads) are cooled. The tow, consisting of multiple strands, is then cut to predetermined lengths of 33 or 38mm long. At this point they are referred to as staple fibers.

There is only one producer of polyester staple fiber in the region. This producer also exports within Africa and overseas.

Locally-produced polyester staple fiber for spinning on cotton and allied spinning equipment is priced equal to landed imported polyester staple fibers. The polyester staple fiber price is R9.80/kg.

However, as polyester staple fiber is man-made, the staple fibers are (unlike cotton) all of a pre-determined length. There is thus less waste when spinning synthetic/man-made fibers.

Appendix 2

Garment Industry Observations

Productivity

In the Value Chain Analysis of Selected Strategic Sectors in Lesotho by GDS in June 2004, Labor Productivity for Lesotho was given as 16-20 T-shirts per person per day (pp/pd). Subsequent ComMark co-sponsored training and productivity programs saw some garment manufacturers lift this by approximately 25% to 20-25 T-shirts per person per day.

Most of the garment manufacturers in Lesotho were using lay-flat fabrics for T-shirt production. For those companies using tubular knit fabrics, mills visited were capable of 30pp/pd in Tanzania, but 50-55pp/pd in one of the RSA-based manufacturers. This production range makes a vast difference in costing.

Based on labor costs of R680/month, 21.67 days per month producing 54 T-shirts per person per day would give a direct labor cost per of R0.58 per garment. Based on existing productivity in Lesotho of 20-25 T-shirts/day (after the productivity improvements of R1.25 are taken into account), direct labor costs are R1.60/garment. As labor makes up on average 20% (15 to 25%) of the cost of garments in Lesotho, competitiveness can certainly be improved.

However, in taking labor as percentage of cut, make and trim costs, in some factories this is as high as 75%.

Of concern is also the fact that when discussing style changes, one manufacturer indicated that this took 3 days to bed down with a resultant 50% loss in productivity over those 3 days.

In a video made by a company that has T-shirt manufacturing operations in SACU and regularly visits China, the Chinese operation was making 90 T-shirts pp/pd.

Productivity in the garment industry in Africa must thus be vastly improved. A number of Lesotho garment manufacturers alluded to this anomaly, but appear to have done little about it.

Garment Washing (Jeans)

Washing, brushing, spraying, etc. can add between 20 to 33% to the price of the garment. As costs, these will vary from around \$0.35 to \$1.00 for stone washing to special washes and finishes.

Although no comparative data was collated for Lesotho, it may be of interest that one jeans manufacturer in SADC was producing 11.5 jeans per person per day based on machinist, store room, cutting room, sampling/inspection and packaging, etc. Once washing staff were added the number became 10 jeans per worker per day.

It appears that jeans washing in Lesotho is still not up to the quality standards required for some vendors. A possible solution could be that instead of each company having its own washing plants, “special washes” could be done by an independent washing facility run/managed by an internationally nominated washing/finishing company. The washing facility could potentially then become a training ground as well.