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What's next in apparel sourcing?

Chief procurement officers at the world's largest apparel companies are facing higher costs, tackling knotty compliance issues, and exploring new sourcing markets.

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A lot has been written lately about rising labor costs in China, where much of the world's clothing is made. In Bangladesh, home to thousands of garment factories, a series of tragic industrial accidents has made consumers and the media pay closer attention to where, by whom, and under what conditions clothing is manufactured. How have these developments affected the purchasing function at apparel companies? What has—and hasn't—changed in apparel sourcing? From where will apparel companies source their products in the future?

To find answers to these and other questions, in late 2013 we surveyed 29 chief procurement officers (CPOs) at leading apparel companies, responsible for a combined €28 billion in purchasing volume. This was our second such survey; we conducted the first in 2011. To deepen our findings, we also conducted lengthy interviews with several CPOs and hosted a roundtable for sourcing executives in March 2014. (For more on the roundtable, see sidebar, "What the sourcing industry needs now: New capabilities, more cooperation.")

Our research shows that most apparel players expect long-term increases in labor and energy costs and are looking to move a portion of their manufacturing out of China and into some surprising new sourcing markets. We also found that Bangladesh remains at the top of the list of apparel-sourcing markets expected to grow in importance in the next few years. More apparel companies are taking a proactive approach to ensuring that suppliers, in Bangladesh and elsewhere, comply with regulations on worker safety and environmental protection.

Costs rising steadily

Three out of four survey respondents expect sourcing costs to rise in the near term. The average expected cost increase is 1.7 percent, with the largest fashion retail chains expecting a 3.5 percent increase. And unlike past cost increases, this time the trend is expected to last—even with cyclical dips in raw-material prices—due in large part to structural factors, including the steady upward trajectory of labor costs in China and rising energy costs worldwide. Almost three-fourths of sourcing executives report that they want to reduce their exposure to China (Exhibit 1).

With consumers unlikely to tolerate higher apparel prices, companies are forced to find other solutions to relieve margin pressure. On this front, two trends are emerging: some companies are seeking to reduce costs further by sourcing from largely untapped low-cost countries in Southeast Asia and sub-Saharan Africa, while others are looking for ways to boost the productivity of their current suppliers. Apparel buyers are working closely with suppliers, for example, to implement lean techniques in factories.

Compliance increasing in importance

In engaging more deeply with suppliers, apparel companies are aiming to improve not only productivity but also compliance—particularly with rules on building and fire safety. More than 150 clothing companies from 20 countries have signed the Accord on Fire and Building Safety in Bangladesh, which was initiated in Europe. Pursuant to this agreement, more than 1,700 suppliers will be inspected in the coming

Exhibit 1

Chief purchasing officers plan to move some of their sourcing out of China over the next 5 years.

Expected change in sourcing share (value) from China in next 5 years,
% of respondents, n = 29

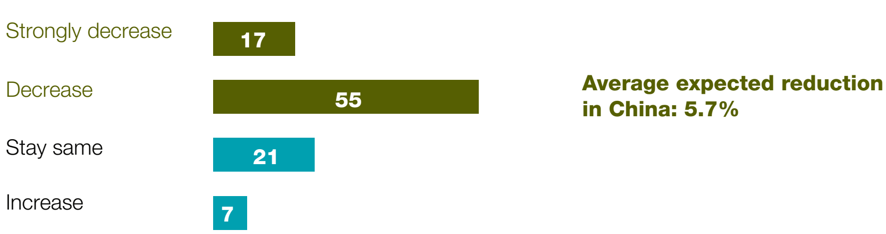
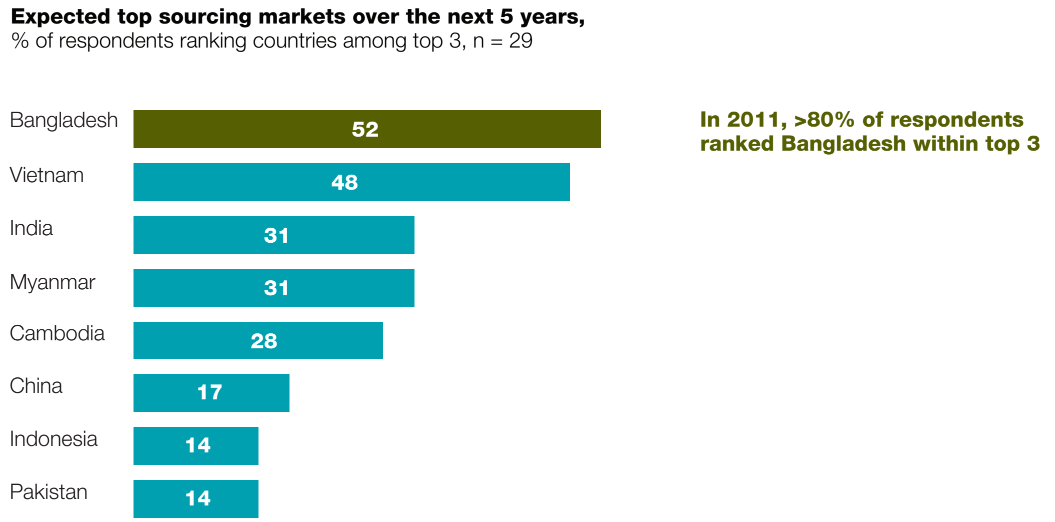


Exhibit 2

Bangladesh remains at the top of the list of sourcing markets expected to grow in importance in the next 5 years.



months. In addition, a group of North American companies formed the Alliance for Bangladesh Worker Safety. These two initiatives have brought apparel companies together to develop industry standards and ensure transparency and compliance.

In evaluating new sourcing markets and new suppliers, compliance is now a top criterion for CPOs, along with cost and capacity. With these pre-requisites in mind, half of the survey respondents—down significantly from more than 80 percent in the 2011 survey—ranked Bangladesh among the three markets expected to grow in importance over the next five years. Also on the list are Vietnam, India, Myanmar, and Cambodia (Exhibit 2).

A new entrant to this list is Myanmar, a country located in the heart of Asia that has just begun reintegrating with the global community.[1] It remains to be seen how Myanmar will develop. Several other industries are also interested in investing in the country, and Myanmar may decide to focus on industries other than apparel manufacturing.

Looking to new sourcing markets

Myanmar is only one of the low-cost countries piquing the interest of apparel buyers. Others include countries in sub-Saharan Africa and regions in close proximity to Western Europe and the United States.

[1] For an in-depth perspective on Myanmar, see *Myanmar's moment: Unique opportunities, major challenges*, McKinsey Global Institute, June 2013, on mckinsey.com.

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One-fourth of the CPOs we surveyed expect sub-Saharan Africa to become a much more important sourcing market in the next five years. Swedish retailer H&M is already testing the waters by placing a small order with a supplier in Ethiopia. However, we expect that it will take some time for countries in the region to make the investments necessary to fulfill large-volume orders.

Seventy percent of the sourcing executives we surveyed said they would like to move more of their manufacturing closer to Europe, making the Mediterranean and Eastern Europe appealing options. Similarly, US-based companies, in a quest for closer-to-home suppliers, are increasingly looking to US and Latin American manufacturers. In particular, CPOs are interested in “proximity sourcing” (either nearshoring or onshoring) when it comes to high-quality products and fast-fashion items. Midmarket apparel players find proximity sourcing especially attractive, but some discount retailers are joining in as well, as Wal-Mart’s “Made in America” campaign demonstrates.

The optimal mix of sourcing markets differs for every apparel company. In our view, each company must first define its procurement requirements and then compare them with the

What the sourcing industry needs now: New capabilities, more cooperation

In light of the growing need to balance compliance considerations with cost and other factors, and given the rising demands of a globalized multichannel market, apparel sourcing has become more complex. Today, success in sourcing requires new ways of doing business: specifically, new skills among sourcing professionals and greater cooperation among industry players. These were the dominant topics of discussion at McKinsey's inaugural Apparel Sourcing Roundtable, held in Hong Kong in March 2014. Twenty-six sourcing executives from some of the world's largest apparel retailers and manufacturers gathered to share ideas and learn from one another. The participants are responsible for a combined €50 billion in apparel-purchasing volume.

Participants agreed that one imperative for future success is instilling a new skill set among sourcing managers and promoting what one executive called a "new breed of merchandisers"—buyers who possess not only product knowledge but also business acumen, design and engineering capabilities, and a consumer-centric omnichannel perspective. Executives cited two main hurdles to building such a cadre of sourcing professionals: the perception that the sourcing profession is unappealing and "not sexy," and low availability of multidimensional, multiskilled talent.

They also discussed ways to make the sourcing profession more attractive, including empowering sourcing staff, providing meaningful professional-development opportunities, and even "rebranding" the profession—for instance, by introducing job titles that better reflect the sophisticated requirements of sourcing roles. As for increasing the talent pool, executives suggested cooperation with universities, global development programs, cross-pollination of staff among functional departments and regions, and an enhanced role for the HR function in talent management.

Additionally, increased coordination among industry players will be critical to overcoming these challenges. It remains to be seen whether the Accord on Fire and Building Safety in Bangladesh and the Alliance for Bangladesh Worker Safety are effective models, but participants agreed that involvement and commitment from the Bangladeshi government and local factory owners are essential to the sustained impact of the initiatives.

strengths and weaknesses of various countries, weighing the trade-offs among five main criteria: cost, quality, capacity, speed, and risk. For example, Bangladesh has very low labor costs and can handle high-volume orders, but—in addition to the high-profile problems of building and fire safety—the quality of the products it manufactures is variable, suppliers there are often set up inefficiently, access to raw materials can be difficult, it has poor infrastructure and energy supply, and the political risks are significant. Turkey, on the other hand, does not offer the lowest labor costs, but it boasts different advantages: apparel factories that have high capacity and can produce high-quality goods, the ability to make speedy deliveries to European markets via rail or road, regional manufacturing clusters that make up an efficient and integrated textile industry, and comparatively low political risk.

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Undeniably, apparel sourcing is becoming more challenging. CPOs, once focused primarily on cost, must now take into consideration several other important factors. Corporate social responsibility is more than a buzzword: leading apparel companies are working to improve standards throughout the value chain and adhere to sustainability strategies consistently. We firmly believe these are steps in the right direction.

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