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Not sewn up

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A decade ago, Peachtree Fabrics of Atlanta sourced virtually all of its textiles in the U.S. Today, Peachtree, which designs and distributes fabrics for makers of cars, furniture, boats and other products, imports 60 percent of its material. The largest portion of those imports comes from China, and that portion is growing.

China's share of Peachtree's business could grow further after Jan. 1. That's when World Trade Organization-sanctioned import quotas on textiles and apparel under the multilateral Agreement on Textiles and Clothing will be lifted. Companies will be able to shop the world for the best price and delivery. The textile-and-apparel industry has been abuzz with talk that with its low production costs, China will soon overwhelm its competitors.

The existing quota system guarantees numerous countries specific shares of textile markets in the U.S. and Europe, and has turned such out-of-the-way places as Vietnam, Cambodia, Mauritius and Myanmar into key links in the global textile-and-apparel supply chain. Can these burgeoning markets survive when buyers will be able to purchase as much as they want from China, Asia's Mecca of low-cost, high-volume, high-quality manufacturing?

Many well-informed observers are not sure what to expect. "The overwhelming emotion is total uncertainty. It's virtually impossible to predict anything," said Emma Ormond, international trade consultant at PriceWaterhouseCoopers.

This much, though, is certain. For importers such as Peachtree, the change will mean lower costs, if only because it will remove the costs and administrative burden of managing a nightmarishly complicated system of quotas. Much production now is based not on efficiency but on quota availability. Quotas have become a commodity that importers sometimes must buy at a markup in quota "auctions."

"These auctions raise the prices for importers of Chinese textiles," said Tom Hall, vice president of finance at Peachtree Fabrics. "The end of quotas will decrease our costs."

For many multinationals that buy from several countries, the end of quotas will lower costs in another way: It will enable them to consolidate their supply sources and tighten their supply chains. "We used to source in 50 countries because of the quotas," said Gary Ross, vice president of worldwide operations at Liz Claiborne. "Quotas meant we had to spend 45 percent of our time on figuring out the rules and regulations and limits of the quotas. Now without quotas, we'll be able to cut the sourcing down to 10 to 15 countries and save a lot of time." He expects his company to save 8 percent on import costs.

Ron Schulman, vice president of strategic sourcing at Limited Brands, also cited the benefit of tighter supply chains. "Prices will drop, but the biggest impact will be an improvement in speed to market," he said. "Speed to market is the Holy Grail of the retail industry. Quotas elongated our supply chain. Speed will be the pump that drives the business. Speed is important, so the focus will be on key suppliers, not on countries. We danced with people we didn't want to dance with because of quotas. Quotas forced us to use suppliers in such countries as Saipan and Mauritius. Now we can pick our own dance partners."

Although the end of quotas will mean simpler, leaner supply chains - and more reliance on China - this doesn't mean textile firms will be placing all their eggs in the Chinese basket. Kurt Cavano, chairman and chief executive of TradeCard Inc., predicted that newly developed textile-manufacturing plants in such countries as Vietnam and Cambodia will continue to receive their share of orders from U.S.-based buyers. Most of the companies that use TradeCard's automated trade services are in the textile-and-apparel sector. "Our guys are pretty excited about business in Vietnam," Cavano said, describing a recent trip by his staff to textile suppliers there.

Harry Lee, managing director of TAL Ltd. (Textile Alliance Ltd.) of Hong Kong, and vice chairman of the Hong Kong Textile Council, also said China will not have a monopoly on production. "I will use China and other countries as production centers, and I will seek the places that are optimal production centers, be it in China or North Carolina," Lee said. "We will keep our plant in Thailand, where we have 10,000 employees; it's very efficient and profitable. We will also stay in Malaysia, Indonesia and Thailand and North Carolina. We will also stay in Taiwan, even though the labor costs are 10 times those in China, because the plant is profitable and because we have very efficient 10-day shipping to the U.S. through the Port of Kaohsiung."

In the short run, India could benefit more from the end of quotas than China does, said Christopher Prey, general manager of North America for P&O Nedlloyd Logistics.

Because of the textile quotas, a sizable volume of Indian cotton has been shipped to India's neighbors - the Maldive Islands, Sri Lanka, Bangladesh and Myanmar - for processing. In the absence of quotas, the entire manufacturing process would have usually remained in India. "With the end of quotas, it is now natural to make those textiles in India," Prey said. He expects the positive impact for India to come in 2005. Although China will eventually benefit, he said many companies "are not making plans for 2005" to relocate textile plants to China.

Higher up the fashion scale, leading sources of niche products will continue to thrive, despite low-cost Asian competition from China and elsewhere. Peachtree, for example, will continue to buy silk from India and specialized high-end textiles from Italy. "Italian textiles have a certain look that has a niche market in upscale furniture manufacturers," Hall said. TradeCard's Cavano agrees. "The relentless rush to low-cost locations will continue, but people are beginning to realize that you don't just calculate the hourly wage," he said. "You also consider the quality of the work. If you are producing knits, it's OK to think only about low cost, but if you are in high-quality garments, you have to think about other factors," including being close enough to your customers to respond quickly to changes in demand.

Why aren't most companies making plans to relocate most of their textile sourcing to China?

One reason may be widespread fears of political repercussions if they seem to be abandoning other suppliers closer to home, Prey said. Although much apparel manufacturing already has shifted overseas, the U.S. still has a considerable amount of textile manufacturing that is centered in the Carolinas and Georgia.

Another factor may be the perception that Chinese wages are starting to rise, eroding the appeal of some Chinese locations. If Chinese allows its currency, the yuan, to float upward against the dollar, that could make China a less attractive location for some manufacturers.

There are also rising fears that China's infrastructure is strained to its limits. South China's ports are expanding rapidly, but port congestion persists and inland transportation continues to struggle to meet demand. The ports of Los Angeles and Long Beach, which together handle 40 percent of U.S. containerized imports from Asia, have been plagued by severe delays this year.

According to Cavano, some recent visitors are afraid that China's power grid is not prepared to handle abrupt increases in textile manufacturing. Cavano said, "China has a shortage of electric power. In some rural areas, there is not enough power to run the plant every day. We have not heard about that problem in Vietnam."

The Chinese government also seems to be setting limits on industrial expansion, in an effort to avoid overheating the economy and putting too much strain on the infrastructure. Lee said, "We have one plant in China, and we applied for the license to build a second plant, but Beijing denied us the license because it wants to keep control over the economy and cool it down."

What kind of supply chain will leading textile-and-apparel importers have in the future? Although China will play a key role, David Birnbaum, chief executive of Third Horizon Inc., predicts that diversified sourcing will be a key to success. He described a "virtual vertical factory that involves a combination of sourcing locations. Nowadays, if you were set out to manufacture men's shirts, for example, you would send a sample to an Asian factory and it would take three months to start production." But in the new world of quota-less global trade, he said, "sourcing will include a combination of locations that will cut the two-to-three month lead time to one day. Your designer will go to Barcelona. A Spanish mill has the design and the fabric, which you will send to a plant in El Salvador for production ... The time from design to delivery will be one month."

To survive, textile-and-apparel importers will need to be highly responsive, flexible - and global. China alone won't provide all the answers.