Market Diversification of the Lesotho Garment Industry

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DISCUSSION DRAFT

FIAS

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Executive Summary

Lesotho is small country far from most major apparel markets and traditional sources for fabrics and trims in Asia. Nevertheless, it has been riding a wave of apparel investment driven by generous tariff and quota benefits provided under the U.S. African Growth and Opportunity Act (AGOA). Through its third-party fabric provision, AGOA also enables Lesotho to readily adapt to long-established Asian supply chains for fabrics and trims. The recent elimination of U.S. and EU quotas on textile and apparel products has put the relationship between the U.S. market and producers located in Lesotho under stress. The expiration of AGOA's third-party fabric provision in October 2007 will further test that relationship. Lesotho will then lose its advantage of adaptability to supply chains for Asian-sourced fabrics and trims. Ninety percent of Lesotho's exports are destined for the U.S. market, so the industry could face a rapid downturn. To reduce risks, Lesotho's producers need to diversify their markets and customer base in a rapidly changing global market.

Market access provisions will be crucial to any market diversification strategy. As a least developed country, Lesotho is accorded generous preferential access to major world markets. The markets of Australia and Canada, however, are distant and small while Japan's market is already dominated by large low-cost producers, such as those in China and South East Asia. In the EU market, Lesotho's producers can compete with low-cost producers from Asia or regional producers, such as Turkey and Tunisia, if they use local fabrics in making up garments, reduce tariff costs, and reduce shipping and lead times. Meanwhile, the South African market offers unique opportunities for Lesotho's producers, should the government and industry decide to take them up.

Lesotho will be seeking to diversify its markets and customer bases as the global textile and apparel industries go through seismic changes. For example, to cut logistics costs and outsource services to manufacturers, retailers, buyers and their agents are reducing the number of countries and companies from which they source apparel. Lesotho's producers primarily engage in simple cut, make, and trim (CMT) operations while agents in Asia carry out preproduction operations, such as fabric sourcing, financing, sample making, pattern making, and marker making. Lesotho's producers thus have little opportunity or means to work with a large number of buyers or handle direct orders from retailers. In addition, the scant number of local textile manufactures and finishing capabilities limits local fabric production and product offerings. Diversifying markets for the long term will require apparel producers to meet demands for more services, flexibility, rapid turnaround, and product diversity (offerings) as well as cost. Firms committed to the future are far more likely to develop new relationships with markets and buyers.

To assist the goal of market diversification, Lesotho's government-sponsored export promotion and training will need to take these realities into account. Export promotion for the EU market should aim to attract vertically integrated producers that can meet EU rules of origin, and training and\or strategic partnerships with regional service firms should aim to build capability in preproduction services. Bringing buyers in for a standard factory tour will reap few orders if factories cannot execute samples or provide preproduction services. The South African market offers opportunities, but buyers and retailers there need to become familiar with Lesotho as an apparel source, preferably through direct transactions rather than simple factory tours. The following recommendations for the government, development agencies, and producers reflect these new market realities.

Recommendations for Government and Development Agencies

- **Develop a regional fabric sourcing model with complementary rules of origin for the U.S., EU, and South African markets.** Rules of origin governing preferences accorded fabrics and trims used on garments produced in Lesotho are divergent. U.S. and South African rules permit the use of regional (SACU) fabrics and yarns; EU rules do not permit the use of South African materials—the largest regional supplier. A strategy must be developed to bring current and future EU rules of origin into a regional sourcing model, including South Africa and other AGOA eligible sub-Saharan African countries.
- **Build consensus for diversification among foreign owners and managers.** Most of Lesotho's apparel firms are owned by Taiwanese investors who are not in Lesotho, but who require factory managers to take strategic direction from them. Market diversification, however, will require factory managers to make high-level decisions. Foreign owners, local managers, and their agents should be surveyed as a first step in gaining their support for diversification and ensuring that the government's strategy is consistent with most industry leaders.
- **Support diversification into the South African market.** The South African apparel market is relatively large, affluent, and close to Lesotho, yet few firms in Lesotho make significant sales there. South African retailers are not familiar with Lesotho's capabilities and products. This market should not be taken for granted, especially given the approaching changes in AGOA's rules for fabric sourcing. A first step would be to introduce South African buyers to Lesotho's producers and products by hosting a trade fair that features products for immediate sale. At the same time, the Lesotho Revenue Authority (LRA) will have to ensure that tax regulations and procedures promote intra-SACU transactions.

Recommendations for Lesotho's Producers

- **Conduct an internal strategic analysis.** Producers should inventory their capabilities, strengths, and weaknesses and take stock of opportunities and threats in the industry. A realistic assessment will help them decide which customers to pursue and which service areas to develop.
- **Pursue strategic partnerships.** In the medium term, many firms could benefit from strategic partnerships that involve local and regional fabric sourcing; fabric testing, sample making and preproduction services; and financing fabric and work in progress (especially for locally owned establishments).
- **Diversify product mix.** Buyers and agents need to justify apparel sourcing costs associated with Lesotho's remote location by spreading costs over a number of orders. Multiple orders are more likely if producers offer a broad range of products; otherwise, only a very low price will sustain sales. New product opportunities, innovation, and services also attract buyers and agents. Denim washing facilities would complement the denim production in Lesotho, for example.
- **Augment preproduction capabilities.** Lesotho's apparel industry consists largely of CMT firms that can do little to adapt their supply chain to market needs. In the long term, Lesotho's apparel firms need to develop preproduction capabilities in fabric sourcing and sample and marker making to remain attractive to old and new buyers alike. In the medium term, they could partner with South African firms that have these capabilities. Using service firms, however, is no substitute for long-term development of in-house capacity; even service firms appreciate working with producers who offer some preproduction services.
- **Upgrade management and supervisory skills**. All firms should refine and upgrade managerial skills not only to reduce costs and ensure reliable delivery, but also to (1) make production lines flexible enough to handle short runs of various products without raising costs or causing delays; (2) improve planning, pricing, and delivery estimates for competitive bidding and to identify customer and market segments that match current and projected capabilities, including their full-package costs; and (3) maintain labor standards, since well managed firms reduce pressures on line supervisors and management to meet unrealistic deadlines and cost estimates. Production line flexibility is critical to industry restructuring based on a regional fabric sourcing model. Regional and local textile producers may not be able to produce the quantities required by large U.S. buyers and may have to switch to customers or product styles with smaller order sizes.
- **Seek new customers and markets today.** Producers should not wait for AGOA's third-country fabric provisions to expire before seeking new customers. They should (1) work with agents and owners to identify new customers and markets; (2) identify agents or importers who buy in target markets that match their current and planned capabilities; and (3) attend trade fairs in target markets to build new relationships and learn about buyers' needs and the directions of markets and customers.

To penetrate new markets and acquire new customers, Lesotho's producers will have to meet the changing demands and requirements of today's globalizing textile and apparel industries.

1. Introduction

Global Textile and Apparel Industry

The global value chains for textiles and apparel are going through a period of unprecedented change because of major events in the world trading system. The Multifiber Agreement\ATC quotas expired on January 1, 2005; China has joined the WTO; special safeguards are in place against a flood of Chinese products; regional and preferential trading systems are on the rise; and buyers, rather than suppliers, are increasingly driving production chains. That these events are occurring simultaneously creates unusually high risks as trade agreements and market demands cause orders and sourcing patterns to shift rapidly.

To meet the risks inherent in the newly globalized textile and apparel industries, governments and the private sector will have to form new partnerships. Governments need to keep abreast of changing trade agreements, negotiate new ones, and ensure that old ones are used to maximum advantage. They also have to do all they possibly can to ensure that country-specific factors, such as infrastructure, laws, regulations, transportation systems, and border crossings are supportive of an industry struggling to meet escalating demands for lower prices, faster delivery, and more services.

The industry itself also needs to adapt. Businesses need to invest in human resources, offer more services (e.g., sample making, industrial design, quick response), and boost productivity and flexibility on production lines. Suppliers can reduce their risks by diversifying their customer, market, and supplier base. Such diversification, in turn, depends on conditions of market access and trade agreements. In fact, diversification is critically dependant on trade agreements, general competitiveness, and supplier capabilities.

Lesotho's Textile and Apparel Industry

The textile and apparel industries in Lesotho account for 20 percent of GDP and nearly 50 percent of the formally employed workforce. Nearly all of Lesotho's apparel products are exported, with 90 percent or more going to the U.S. market in 2004 (Table 1-1). This dominance of the U.S. market is no accident of nature, geography, or industrial advantage. Numerous studies (Hilligas 2005; Salm *et al* 2002) have documented the importance of past quota benefits and, in 2001, of tariff and derogation benefits provided under the African Growth and Opportunity Act (AGOA).[1]

Table 1-1
Major Market Imports from Lesotho, 2004

Importer	(US$ 000)	Percent
United States	481,786,959	90
South Africa (est.)	40,000,000	7
Canada	10,770,108	2
EU (15)	1,109,059	< 1
Japan	299,041	< 1
Australia	11,528	< 1
Total	533,976,695	100

SOURCE: *UN COMTRADE database.*

Note: Lesotho and South Africa do not report trade data within SACU, so the values for South Africa are estimates based on data from 2002.

In allowing Lesotho's producers to use fabrics from anywhere in the world, the AGOA derogation enables them to source the most cost-competitive fabrics and tap production and supply networks in Asia. Industry actors are keenly aware that the current sourcing paradigm favors fabrics and trims from textile factories in China, Taiwan, and sometimes Korea. This process is known as "nomination" of fabrics and materials. Buyers or their agents gain economies of scale and quality control when fabric sourcing is concentrated in fewer factories. Thus, the AGOA derogation provides Lesotho, and other least developed sub-Saharan African (SSA) producers, an advantage that no other supplier to the U.S. market can claim: ready adaptability to Asian sourcing networks for fabrics and materials, and tariff benefits ranging from 15.5 percent for cotton trousers to 32.0 percent for manmade fiber knit shirts and blouses.[2]

The AGOA provision that permits Lesotho's producers to source fabrics from anywhere (single transformation rule of origin) will expire on October 1, 2007.[3] When it does, Lesotho's

[1] Salm *et al* document that quotas, though present, were allocated to firms cost- free, allowing owners to capture quota rents.

[2] Some free trade partners of the United States are permitted limited tariff preference levels for fabric from outside the FTA region, know as tariff preference levels (TPLs). In addition, FTA provisions allow for the use of fabrics in short supply in the region.

[3] The single rule of transformation was to expire on October 1, 2004. In early 2004, trade ministers from SSA countries convened in Washington D.C. to advocate an extension. They agreed, at least in principal, that there would be no further extensions of the provision, in its current form, after 2007 [(Author's observations from discussions held among African ministers at the AGOA Form in Washington DC, (public and closed session at the US State Department)]. In July 2004, the U.S. Congress passed legislation extending the provision to October 1, 2007.

producers will be challenged in maintaining relationships and markets. To meet the standard AGOA rule of origin, Lesotho's producers will have to source fabrics from within the SSA region. Lesotho has only one denim plant that can produce 24 million linear meters of fabric per year. U.S. imports of trousers from Lesotho, made of principally cotton fibers, were estimated to use 41.7 million linear meters of fabric in 2005 alone. Total fabric demand for U.S. imports from Lesotho was close to 100 million linear meters of knit and woven fabrics.[4] Though fabrics may be sourced from other SSA countries, the development of regional supply chains is not yet proven. And even if regional fabrics can be mustered to meet AGOA needs, relationships between suppliers and buyers will change radically. It is not likely that market relationships based on fabric sourcing in Asia and cutting and making up garments in Lesotho will endure. New customers and markets will need to supplement or replace old relationships, and new skills and supply chains will have to be established.

Can Lesotho's apparel producers adjust to changing global markets by finding new opportunities? What are the conditions of entry into new markets? Can Lesotho's apparel products compete with products sourced from other major suppliers in non-U.S. markets? Seeking new markets and new customers is inherently risky. The sheer number of possible markets, market segments, distribution channels, and customers is daunting. To be fruitful, the search must be focused. Producers must first conduct an internal audit of their strengths and weaknesses, keeping in mind that the risks of diversification increase as they move further from their traditional production capabilities and markets. The probable changes to the possible, and the possible changes to what can only be long-term goals. Once producers understand their own capabilities and limits they can focus on probable, not merely possible, market leads. This will likely differ for every company, depending on its individual strengths and weaknesses.

Methodology

This report explores the most promising markets for export diversification of apparel products from Lesotho, then focuses on the largest market, the EU. The South African market, because of its proximity and size, also warrants consideration. In focusing on the goal of diversification, the report analyzes the elements required to assess new markets and customers. Some countries or companies will choose not to face these challenges; they will most certainly exit the market at an earlier period than those that decide to meet the challenges with an intelligent and coordinated strategy.

Market access rules for other markets, such as Canada, Japan, and Australia are reviewed, but were not the subject of field work. These markets may present opportunities to Lesotho's apparel producers—after all, the diversity of apparel buyers and suppliers has shown that just

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[4] Office of Textiles and Apparel (OTEXA).

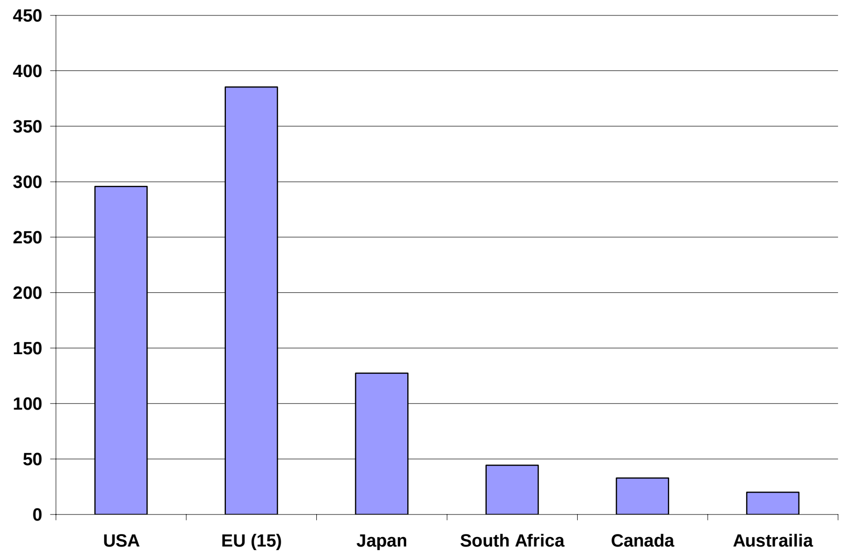
about anything is possible. But because of their size or location—as in Canada or Australia—or the dominance of regional suppliers, as in Japan, these markets are not deemed ***probable markets*** for most of Lesotho's producers (table 1-1). In Japan and Australia, for example, large integrated producers such as China already claim at least 75 percent of the import market, presenting a highly competitive landscape in the products and market segments of most interest to Lesotho's producers.

Information for this report was gathered from various sources, including interviews with

- Lesotho National Development Corporation (LNDC)
- Lesotho Revenue Authority (LRA)
- ComMark
- Baffoe & Associates (Administrator of DCCS Programs)
- Ministry of Trade and Industry, Cooperatives and Marketing
- Nien Hsing (denim and garment producer)
- Export Unlimited (garment producer)
- Humin Jeanswear
- Ever Unison
- Lesotho Precious Garments
- EU Trade Mission to Lesotho
- EdCon (South African retailer)
- PEP (South African retailer)
- Foschini (South African retailer)
- African Sourcing (garment sourcing agents)
- AMC (garment sourcing agents)
- Maersk Africa (shipping and logistics)

The authors of this report have more than 20 years of experience in the textile and apparel industries and in trade law, manufacturing supply chains, sourcing, and industry logistics.

Figure 1-1
Population in Major Markets of Interest to Lesotho, Millions, 2004


450
400
350
300
250
200
150
100
50
0
USA
EU (15)
Japan
South Africa
Canada
Austrailia

2. Market Access Requirements

Apparel products are subject to some of the highest tariffs on nonagricultural goods entering developed economies. Tariffs often exceed 10 percent and can peak at 40 percent or more. Preferential access, therefore, can make the difference between being competitive in the market and being uncompetitive. As a least developed country (LDC), Lesotho enjoys preferential access to developed country markets such as the United States, EU, Canada, Japan, and Australia. Under the World Trade Organization's enabling clause, these countries may reduce or eliminate tariffs on imports from developing countries as part of the general system of preferences (GSP) or as part of free trade agreements, or both. While the WTO provides a basis for preferential market access, countries are not uniform in how they implement preferences. Understanding how tariffs and duties affect market access requires a country-by-country, and even product-by-product, analysis.

Lesotho is party to or eligible for benefits under a wide array of special clauses or agreements, such as the GSP, the EU Cotonou Agreement for African and Caribbean and Pacific Island countries (ACP), the EU Everything but Arms provisions,[5] and the South African Customs Union (SACU). In the EU, Lesotho can claim tariff reductions or tariff elimination under more than one arrangement or agreement (Table 2-1). The proliferation and evolution of trade agreements presents threats as well as opportunities to a small remote country such as Lesotho. For example, if SACU signs a free trade agreement (FTA) with the United States it would cease to be a party to the AGOA arrangement.[6] This means that provisions for the use of AGOA eligible yarns and fabric by SACU countries, such as Lesotho, would probably have to be redefined in the FTA with the US. Meanwhile, the EU is negotiating economic partnership agreements (EPA) with ACP countries in anticipation of the expiration of the ACP agreement in 2008.

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[5] EBA is a subset of the EU GSP program.

[6] That the United States might redefine the terms of use of materials might seem odd, but U.S. trade agreements rarely support the use of materials and processes across free trade agreements and preferential arrangements, such as AGOA. Likewise, the EU restricts ACP countries' use of South African yarns and fabrics.

Table 2-1
Preferential Agreements and Arrangements Affecting Lesotho's Apparel Exporters

	Summary	Rule of Origin	Cumulation	Tariff Range
UNITED STATES				
AGOA	Any imported fabric or yarn; SSA regionally formed fabric and yarns after Sept. 2007	CMT through Sept. 2007; regional yarn forward thereafter	Full-cumulation in SSA region	14.0 – 32.0
EUROPEAN UNION				
GSP\Standard	Fabric must come from Lesotho	Fabric forward	None, except SARCC and ASEAN	~12.0
GSP\EBA	Fabric must come from Lesotho	Fabric forward	None, except SARCC and ASEAN	~12.0
ACP-Cotonou	Fabric must be formed, cut and made-up in ACP region (expires Jan. 2008)	Fabric forward	Full cumulation in ACP region	~12.0
SOUTH AFRICA				
SACU	All materials imported from outside SACU must have duty paid—DCCS can not be claimed	N\A duty paid on imported inputs	SACU	~40.0
JAPAN				
GSP	Single transformation, subject to a GSP cap	CMT	None	~5.0 – ~11.2
CANADA				
GSP	Fabric and yarns must be formed by any LDC or GSP beneficiary; fabric must be cut and sewn in Lesotho	Fabrics and yarns must be sourced from other GPT or LDCPT countries;	Full-with other GPT and LDC countries	16.0 – 18.0
AUSTRALIA				
GSP	Lesotho fabrics, or LDC fabric, with 50 percent value added to imported fabrics	LDC fabric forward w\value added requirement	LDC fabrics permitted with value added criteria	25.0 – 28.0

Notes: Summaries are general, refer to text for more specific requirements and always check with a customs attorney in the target country before committing to any individual shipment.

The EU and US use similar terminology for rules of origin, but their meaning is decisively different. The US uses fabric forward to mean "from non-originating yarns" where the EU would interpret fabric forward as" from non-originating fabrics". The US terminology is used in this table. So, fabric forward means from non-originating yarns—that is, the fabric must be formed in the beneficiary country. ~ designates approximate values, some small variations exist, but the numbers emphasizes the majority of products rather than extremes.

To be sure, the development of Lesotho's textile and apparel industries would respond positively to the establishment of long-term rules and certainty. The United States has secured access for AGOA countries, under standard rules of origin, through 2015 and the EU has secured market access under its EBA program for LDCs for as long as they remain classified as such.

The fact that a producer is in Lesotho, however, is not sufficient to ensure preferential access for its products. Access depends on rules of origin, which stipulate which processes and materials confer preferential treatment for a product (Table 2-1). Without such rules, products would simply be shipped from one country through another to avoid tariffs. Knowing the rules for each program is the key to understanding the value of market access.[7] This section describes the elements—rules of origin, labor and social governance regulations, health and safety regulations, and other requirements—of each program in major markets.

Rules of Origin

UNITED STATES

AGOA Standard Rule of Origin

Under AGOA's standard rule of origin, apparel assembled in sub-Saharan Africa from fabric wholly formed in an eligible sub-Saharan Africa country from U.S. or SSA yarns is eligible for duty- and quota-free entry into the U.S. market. Garments may contain up to 7 percent of their weight in yarns of foreign origin (i.e., not wholly of U.S. or SSA origin).[8] The fibers (cotton, wool, staple, or tow) and chemical polymers (i.e., manmade fibers) used in these garments may come from anywhere. Because they involve minimal cutting and sewing, knit-to-shape and circular knit or seamless knit garments are subject to a more stringent rule. Fibers and filaments used in these garments may come only from sub-Saharan Africa or the United States. The standard rule does allow for tolerance for findings or trimmings (buttons, zips, elastic bands, snaps, or decorative lace) of foreign origin, up to a maximum of 25 percent of the cost of the components in the finished garment. It also provides tolerance for specific piece good inner linings of foreign origin (producers using these types of materials should consult U.S. customs attorney to ensure their eligibility.

AGOA Special Rule for Least Developed Countries

AGOA provides an exception to its standard rule of origin for LDCs, such as Lesotho, through the end of September 2007. The special rule permits LDCs to use fabric and yarns from non-U.S. and non-SSA eligible sources. The use of these materials is subject to a quota limit that has never been reached. When this special rule expires Lesotho's producers will have to meet the standard rule of origin.

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[7] The UN Committee on Trade and Development (UNCTAD) has handbooks outlining the GSP programs of major developed countries (http://www.unctad.org/Templates/ Page.asp?intItemID=1421&lang=1.) Some handbooks are fairly new (Japan and EU) ,while others are out of date for textile products (Canada added textiles to its GSP list in 2003 but the handbook was published in 2000).

[8] AGOA limitations on preferential access are usually defined according to the combined amounts of U.S. materials and threads used in making the garments. So far, SSA producers have never reached any of these caps. If and when they do, more complicated and restrictive rules of origin apply.

Proposed US-SACU FTA

The United States and SACU started negotiating a free trade agreement at the end of 2002. Progress has been slow as many issues, including South African investment laws, pose obstacles to the conclusion of the agreement.[9] It is unlikely that an agreement will be concluded soon; however, producers and government officials should keep abreast of these negotiations. A US-SACU FTA would have many implications for Lesotho's apparel industry. On the one hand, it could make negotiating new tariff rate quotas (TRQs) on specific items of apparel possible, essentially extending the third-party fabric derogation. On the other hand, U.S. rules of cumulating would likely sever supply chain ties now possible with other AGOA countries, since the United States rarely allows cumulating between trade agreements and arrangements.[10]

EUROPEAN UNION

The EU's tariff structure and Lesotho's preferred access to the EU apparel market do not impart advantages or differentials on the basis of fibers and fabrics, and the EU's most favored nation (MFN) tariffs on apparel cluster around 12 percent.[11] EU rules vary with the access program: the ACP/Cotonou Agreement, the GSP, and the EBA for LDCs. The EU has proposed that EPAs replace the ACP agreement, which expires in 2008. While all the programs' descriptions of tariff preferences appear similar, crucial differences in rules of origin give rise to different preferences.

EU rules of origin require that two significant processes be performed in the country or region claiming origin in order for a shipment to obtain official certification of origin and relief from tariffs. The concept of significant process is highly technical and legalistic. However, in many cases, significant processing results in a product being reclassified from one four-digit tariff heading to a completely different four-digit tariff heading.[12] In industry terms, this means garment construction, including cutting and sewing, must be coupled with one other significant process, usually "forming of fabrics and\or yarns." Dying and finishing fabric and\or a garment is usually not sufficient to confer origin. One exceptional circumstance for dying and finishing (explained below) pertains to printed fabric—but this special case is not likely to benefit a broad industry strategy. All garments for which duty-free treatment is sought must be shipped directly to the EU without entering the customs territory of another country, though allowance is made for goods shipped to foreign ports but not entering the customs areas of another country and stored solely for onward freight.

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[9] http://www.ustr.gov/Trade_Agreements/Bilateral/Southern_Africa_FTA/Section_Index.html

[10] The US-CAFTA has a very limited provision for cumulating between Central American countries and Mexico (NAFTA member). It is not expected that this provision will be materially significant.

[11] Important exceptions to the general 12 percent EU tariff on apparel include the following: knit wool jerseys and pull-overs (8.5 percent), gloves and mittens, (8.5 percent), elastomeric knit swimwear (8 percent), nonknit babies' garments (10 percent), women's support garments (6.5 percent), handkerchiefs (10 percent), gloves, scarves and veils and the like (8 percent), and ties (6.0 percent).

[12] The EU provides a separate list, called the one list, for products that do not follow this general rule.

ACP/Cotonou Agreement

The ACP/Cotonou Agreement eliminates import duties on apparel meeting its rule of origin. Garments, including those of cotton, wool, and manmade fibers, may be constructed of nonregional yarn, but fabrics must be formed (knit or woven) and made-up into a garment in one or more of the ACP countries. For example, under this liberal "full-cumulation" clause, Mauritian textile producers import yarn from Asia, knit or weave the yarn into fabrics, and ship the fabrics to Lesotho, where they are made-up into garments and certified for duty-free access to the EU.[13] As with the AGOA rule of origin, the yarn used in knit-to-shape garments—such as circular knits, panels and seamless garments—must also be spun in an ACP country, in addition to the fabric construction and minimal making-up that occurs in this case.

Exceptions to the general rule cover products containing significant embroidery and impregnated fabrics. Lesotho's producers could leverage EU rules of origin for apparel constructed of printed fabrics. Nonregional fabrics may be used in made-up garments if the fabrics are printed in an ACP country and the printing adds at least 52 percent to the value of the fabric—a significant barrier for basic garments.[14] A 15 percent tolerance for nonregional content like that for findings, trimmings, or nonoriginating fibers and yarns, is provided.

GSP and EBA Provisions

The standard GSP provides for a 20 percent reduction in tariffs for apparel imported from many developing countries, including Lesotho. The standard rules require that beneficiary countries form fabrics and make up garments, though the yarn in the fabric can be from anywhere. This means that Lesotho's producers have to form fabrics and make-up garments in Lesotho. Under the EBA provision, certain LDCs, including Lesotho, are eligible for complete tariff elimination. In either case, Lesotho's producers often find it impossible to meet the EU rule of origin because the country has so few fabric producers. (Denim fabrics are produced in Lesotho by Nien Hsing Textiles, a Taiwanese producer.) As Lesotho expands its base of domestically produced fabrics, its market access to the EU will correspondingly improve. But simply having fabrics is not sufficient to make sales. Major brand and retail buyers often specify the plants from which fabric is to be supplied. If the buyer or retailer does not prequalify a particular plant, many potential customers remain beyond reach.[15]

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[13] An exception to this rule is made for embroidered apparel for which a value-added threshold must be met. The ACP Agreement provides for full cumulation with other ACP members, but the region's largest manufacturer of textiles, South Africa, is not an ACP member. Consequently, its textiles cannot cumulate to meet the origin requirement. Separately, the Cotonou Agreement does provide for cumulation with South Africa, but the ACP and South Africa have never implemented that provision.

[14] Application of the printing provision in the EU rules of origin has been controversial as the definition of "printing" is interpreted by individual EU customs authorities differently. Exporters seeking to use this provision to claim preferential access to the EU should, therefore, consult local EU customs officials or brokers with knowledge of the application of these rules which may change from time to time. Mercerizing combined with bleaching, dying, and printing is often required to meet this rule.

[15] The largest buyer from Lesotho's producers, The Gap, has not yet certified this denim mill for its products.

Meanwhile, EU apparel imports from big integrated suppliers, such as China and India, have graduated from the standard GSP list to face the full EU tariff. While this might appear to be an advantage for Lesotho, many other Asian developing countries are eligible for EU preferences. Furthermore, countries such as Indonesia, Cambodia, Vietnam, Bangladesh, and Pakistan all benefit from a regional cumulation rule that allows producers to source fabric and yarns from each other and from large textile producers such as India, as long as the fabric originates in the region and certain value added criteria are met. These countries also stand to gain from their ability to adapt to the dominant fabric and trim sourcing paradigm, which favors the use of Asian fabrics and yarns.

In part, the EBA was created to be a safety net for LDCs covered under Cotonou, which expires in 2008. Its provisions, however, are much more restrictive for SSA countries than for LDC counterparts in South and South East Asia. Those LDCs may use fabrics from neighboring countries as long as 51 percent value is added in the making up processes and the fabrics come from designated partners or regions. For example, Cambodia may use fabrics originating in the Association of South East Asian Nations (ASEAN) and still qualify for complete elimination of EU tariffs—a distinct advantage that Lesotho does not enjoy. Similar conditions apply to countries such as Bangladesh for the use of Indian fabrics. Moreover, a derogation for Cambodia, Laos, and Nepal broadens their potential supply base and eliminates the value-added requirement. Though labeled "temporary," this derogation has been in place for many years and is currently subject to EU revisions of rules of origin or December 31, 2006, unless extended.[16] The derogation caps the quantity of apparel from countries claiming this preference, but the cap has never been reached. SSA officials should petition the EU for rules of cumulation comparable to those of counterparts in South and South East Asia.

In addition, while the Cotonou Agreement provides a 15 percent tolerance for non-originating findings, trimmings, and components, the EU GSP provides only 10 percent tolerance. There is no cumulation with other SSA producers. Therefore, garments must be constructed of fabrics formed, to include dying and finishing, in Lesotho or the EU.

CANADA

In 2003, Canada expanded its GSP product coverage to include textile and apparel products. Previously, only FTA partners, such as the United States, Mexico, some Central American countries, and Israel claimed duty relief on textile and apparel products. As in the United States, Canada's apparel tariffs clustered around 16–18 percent.[17] But Canada's tariff peaks

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[16] See commission regulation 2187/2004. The EU provides an extensive list of products covered by this provision.

[17] A list of Canadian tariffs for apparel products and preferential rates can be found at http://www.cbsa-asfc.gc.ca/general/publications/tariff2006/01-99/table-e.html

are less than 20 percent—in the United States, they reach 32 percent for garments of manmade fibers.

Canada's GSP program offers benefits under a general preferential tariff (GPT) and an LDC preferential tariff (LDCPT).[18] The GPT applies to only 42 apparel products, many of them specialized, such as impregnated garments for industrial use and garments made of silk or special fibers or for religious purposes. Such garments are not likely to be sourced from Lesotho. A duty reduction of 30 to 40 percent is often claimed for these products. The LDCPT system covers 226 apparel products (HS chapters 61 and 62), including shirts and trousers of knit and woven fabrics, products of interest to Lesotho.

As an LDCPT country, Lesotho can claim complete relief from duties for apparel qualifying under the rules of origin. Under Canada's GSP system for textile and apparel products, the fabric and\or yarn used in most products of interest to Lesotho's apparel manufactures must come from one or more GPT or LDCPT countries. Apparel originating in the customs territories of developing countries claiming relief from Canada's tariffs must be cut and sewn in that country.

Lesotho can claim complete tariff relief if fabrics are from Canada or other GPT countries. If the fabric is formed outside Lesotho, it must meet one of the following requirements for fabric and yarn origin to qualify for preferential tariffs[19]:

1. Fabrics should come from an LDCPT or Canada and be constructed of yarns originating in an LDCPT, a GPT country, or Canada (further processing outside an LDCPT or Canada is restricted).
2. Lesotho can source fabrics from a GPT country, but yarns must originate from an LDCPT, GPT-qualifying country, or Canada. The value of any materials coming from outside the LDCPT claiming the benefit, including packaging, cannot exceed 75 percent of the ex-factory price of the goods in Lesotho.

The two rules are similar in requiring that fabrics and yarns come from GPT or LDCPT countries. Fibers may come from anywhere. If fabric is formed in a GPT country, the cost of fabrics and trims may not exceed 75 percent of the ex-factory price. This value added criterion is difficult to meet for simple tubular fabrics apparel, such as stockings or socks, where value added by making up is very low. This value added requirement should not be a large barrier to Lesotho's producers for many standard garments.

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[18] The most up to date list of countries covered under the two systems can be found at http://www.cbsa-asfc.gc.ca/general/publications/tariff2006/01-99/2006LOC-e.pdf .

[19] An explanation and examples of Canada's GSP rules can be found at http://www.cbsa-asfc.gc.ca/E/pub/cm/d11-4-4/d11-4-4-e.html

AUSTRALIA

Australia has some of the highest average apparel tariffs for a developed country, with most tariffs clustered around 25 to 28 percent.[20] Before 2003, it deducted five percentage points from MFN tariff rates for all developing countries. Nearly all developing countries are no longer eligible for this treatment, leaving LDCs as the sole beneficiaries.

In July 2003, Australia announced a program to relieve LDCs of duties on apparel meeting its rules of origin. The rules require single transformation, which includes cutting and sewing of the garment in the LDC. The value added in the LDC must be 50 percent or more of the garment's ex-factory price. This criterion limits the types of products that Lesotho can claim benefits for under the program because adding 50 percent value to fabric is difficult in a low-wage country. In Lesotho, which produces basic garments, fabric costs frequently exceed value added. Garments that might meet this criterion include those made of very low-cost fabrics, such as polyester and poly-cotton blends and garments requiring a great deal of work, such as brassieres or support garments.[21] Garments made of fabrics formed in Lesotho would also qualify.

As with the EU's EBA preferential regime, many countries in Asia, close to the dominant source of textile fabrics, can also claim these benefits with shorter lead times.

SOUTHERN AFRICA CUSTOMS UNION

As a member of SACU, Lesotho enjoys tariff-free access for goods entering a member state. Imported inputs can be used if the prevailing common external tariff rate is paid on the good and not otherwise rebated or credited to the Duty Credit Certificate Scheme (DCCS) of the South African Revenue Service. So far, most of Lesotho's apparel producers do not take advantage of the liberal SACU rules of origin, preferring to focus on traditional markets in North America.

Labor, Environment, and Regulatory Requirements

Market access depends not only on tariffs and duties, but also on meeting

- Labeling requirements (care, fiber content, origin, and sizing conventions);
- Health, safety and environmental standards (e.g., restrictions on the use of dyes, metals or carcinogens); and
- Labor and social compliance standards.

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[20] Tariff rates for Australia can be found at http://www.apectariff.org/tdb.cgi/ff3133323230/apeccgi.cgi?AU
[21] The details for calculating value added can be found at http://www.customs.gov.au/webdata/resources/files/Volume_8B___Origin1.pdf

Some standards are set by national bodies, such as the EU or individual states. If a product does not meet a government's minimum standards, the importer may be subject to fines or criminal penalties. Importers of stock garments frequently contract for purchases on the condition that the producer meet minimum standards. If a producer does not meet them, the importer may cancel the order or not pay for it. Other standards set by buyers and retailers often exceed national standards and can extend to the packaging. Failure to meet retailer and buyer standards can result in steep discounts, order cancellation, and loss of future sales. Standards vary by country.

Most producers seeking to sell to multiple markets find it easier to meet the most demanding specifications of potential customers, rather than the minimum standards for each market. For example, restrictions on the use of formaldehyde are the highest in Japan and Germany, but nonexistent in the United States. A producer seeking to sell to all three markets often will comply with the highest of the three standards.

LABELING

Labeling requirements vary significantly by country. The United States requires the most extensive labeling on garment care, fiber content, and origin, as well as an importer or producer number (R\N). In EU and Asian markets, care labels must include internationally recognized symbols for care (see www.textileaffairs.com/c-common.htm).

Size is also noted on labels. Sizing standards vary considerably from one market to another and sizing should correspond to national convention. For example, denim jeans are sold internationally based on their measurements in inches (waist and inseam). In European markets, trouser size is based on a ratio of the two measurements. For example, in Germany a man's denim jean of waist size 32 and an inseam of 34 would be a size 46; in England, the same garment will correspond to another measure. The importer or buyer usually specifies the label position. Variances for fiber content specifications also vary from country to country

STANDARDS

Textile standards vary by country. Buyers and importers usually specify and enforce technical standards for garment performance. Performance standards usually include specifications for dimension stability, colorfastness, strength, pilling, and abrasion. Producers should ensure that not only their materials, but also work in progress and finished garments meet buyers' specifications by testing through the manufacturing process. As the market for textile products continues to globalize, standards will likely be harmonized. At present, groups of industry representatives set minimum standards for garment and fabric performance.

HEALTH AND SAFETY

Governments usually specifies health and safety standards. Failure to comply with them can result in fines and criminal prosecution. Many countries have instituted restrictions on flammability (Table 2-2) and on the use of caustic chemicals. In addition, as consumers have grown more concerned about the environment and safety, governments have restricted the use of known carcinogenic chemicals and materials (Table 2-3). The EU, in particular Germany, has been at the forefront in creating related specifications, which can be expected to continue to expand. Producers who can meet these standards will have a critical advantage over producers who cannot.

Table 2-2
Flammability Standards

Test\Standard	USA	Canada	EU	Australia	Japan
General wearing apparel	16 CFR 1610	Time of flame spread between 3.5 and 4.0 seconds	None	None	None
Nightwear	None	None	Nightwear safety compliance rules	None	None
Children's and babies	CFR 1615/1616	Children's regs	None	AS/NZS 1249	None

Source: Source-it: Global material sourcing for the clothing industry, International Trade Centre, UNCTAD/WTO.

Table 2-3
Restrictions on the use of Hazardous Chemicals

Chemical	USA	Canada	EU	Australia	Japan
Azo dyes	None	None	Banned in Germany and Netherlands	None	None
Formaldehyde	None	None	Restrictions for various classes of garments	None	Banned in infants and < 75 ppm in all other
Lead	Limited	Limited	Limited	Limited	None
Cadmium	Limited	Limited	Limited	Limited	None
PCP	None	None	Limited	Limited	None
Nickel	None	None	Limited	None	None

Source: Source-it: Global material sourcing for the clothing industry, International Trade Centre, UNCTAD/WTO.

Voluntarily imposed standards are also growing in importance. Consumer groups continue to demand garments made of natural dyes and finishes and that use organic materials. The Austrian Textile Research Institute has gained recognition for its Oeko standards labels, which signify that garments are made from materials that meet a high standard for chemical and material safety.[22] Recently, the Fairtrade group announced a program to promote garments made of its certified organic cottons, wools and dyes[23] and big retailers in the EU, such as Marks and Spencer, are promoting these products.

LABOR AND SOCIAL GOVERNANCE

Retailers and importers are keenly aware of how labor abuses and corruption can damage their reputations. Highly publicized labor abuses in developing countries have resulted in most buyers requiring suppliers to follow strict codes of conduct, enforced by independent auditors who ensure that minimum labor standards are met. Buyers from major markets require that suppliers adopt the retailer's codes of conduct. These usually ban the use of child labor, require payment of a minimum wage, and require obedience to all local regulations and laws.

Producers unable to comply with buyers' codes of conduct are at a major disadvantage. In fact, complying with the codes is now a basic requirement for market entry. How exceeding buyers' standards might benefit a producer is not clear. In general, a well managed, efficient, high-quality service firm also consistently meets and exceeds labor and governance standards. Poorly managed firms tend to meet only minimum standards, since they have not mastered the nexus of productivity, safety, and labor relations. A producer with high labor standards might not prosper automatically, but does show commitment and sophistication—a valuable sign to buyers seeking to source from only a few, select companies in the post-quota world.

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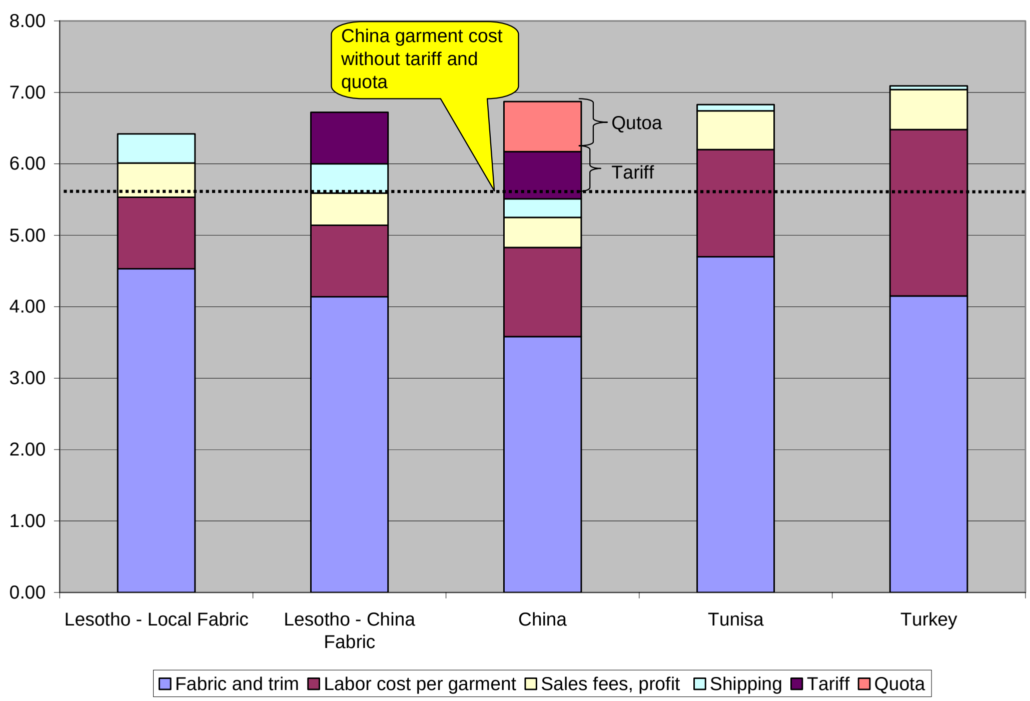
[22] http://www.oeko-tex.com

[23] http://www.fairtrade.org.uk/products_cotton_buy.htm

3. Competitive Analysis

When sourcing apparel, buyers (i.e., retailers, importers, wholesalers, agents) seek to balance country- and company-specific criteria. Country-specific criteria include all ex-factory issues related to apparel production, such as wage rates, infrastructure, local and regional fabric and trim availability, shipping and utility costs, shipping lead times, local regulations, red tape, and tariff and quota costs (Figure 3-1). Company-specific criteria include service capabilities, such as design and sample making, turnaround time, compliance with codes of conduct, and management.

Figure 3-1
Cost of Five -Pocket Denim Jeans, Lesotho, China, Tunisia, Turkey (US$ per garment)



Source: Nathan Associates and Werner International.

Country-Specific Criteria

Table 3-1 compares benchmark values for Lesotho and China, Tunisia, and Turkey for the manufacture of a medium weight, five-pocket denim jean destined for the EU market. China, by far the largest supplier, offers the greatest competition for Lesotho in the market segment for basic garments. Turkey and Tunisia, two regional suppliers, offer quick turnaround over cost advantages. Since EU tariffs and quotas are significant for this product (12 percent), fabric source is important in determining preferences and final landed cost. If they use local fabrics, products from Lesotho, Tunisia, and Turkey qualify for complete tariff elimination. Trims may be from anywhere unless they surpass a specific value.

Table 3-1
Benchmark Costs of Garment Making-up and Shipping 2005–2006 (US$ per Garment)

Garment making up country	Lesotho			China	Tunisia		Turkey	
Fabric source	Lesotho	RSA	China	China	Tunisia	EU	Turkey	EU
FABRIC, MATERIALS, AND LABOR								
Fabric cost per linear yard incl. shipping	2.40	2.20	2.14	1.85	--	2.40	2.10	2.40
Fabric cost per garment including waste	3.60	3.30	3.21	2.78	--	3.60	3.15	3.60
Trim cost per garment (thread, rivets, pocketing)	0.93	0.93	0.93	0.80	--	1.10	1.00	1.10
Fabric and trim	4.53	4.23	4.14	3.58		4.70	4.15	4.70
Labor cost per garment	1.00	1.00	1.00	1.25	--	1.50	2.33	2.33
Cut\ Make\Finish Cost	**5.53**	**5.23**	**5.14**	**4.83**	**--**	**6.20**	**6.48**	**7.03**
Sales fees, profit (exclusive of agent's fees)	0.48	0.45	0.45	0.42	--	0.54	0.56	0.61
Factory gate price per garment	**6.01**	**5.68**	**5.58**	**5.24**	**--**	**6.74**	**7.05**	**7.64**
SHIPPING COST								
Local shipping to port per garment	0.14	0.14	0.14	0.05		0.02	--	--
International Shipping per garment	0.27	0.27	0.27	0.21	--	0.07	0.05	0.05
C.I.F cost to foreign port	6.41	6.09	5.99	5.51	--	6.83	7.09	7.69
TARIFF AND QUOTA COST								
China quota (Average 1/2006 - 3/2006)	--	--	--	0.70	--	--	--	--
Tariff (12% where applicable)	--	0.73	0.72	0.66	--	--	--	--
Landed duty paid cost (2006)	6.41	6.82	6.71	6.87	--	6.83	7.09	7.69

Source: Werner International and Nathan Associates.

The factory gate price per garment is lowest in China, and up to 20 percent higher in Tunisia and Turkey. In Lesotho, the factory gate price is 6.4 percent higher than in China when fabric is sourced from China, but 8.3 percent to 14.7 percent higher when fabric and trims are locally and regionally sourced. Shipping costs include inland shipping to port and from the port to

Northern Europe. Producers from Turkey and Tunisia enjoy the lowest freight cost while producers in Lesotho bear the highest because the country is landlocked and far from Europe. Total shipping costs from Lesotho average 6.8 percent of the C.IF cost as compared to 4.7 percent of the C.I.F cost from China.

Safeguards
The United States and EU eliminated textile and apparel quotas on January 1, 2005, but have since applied safeguards that permit them to limit imports of textile and apparel products from China through the end of 2008. The United States and EU may then decide to apply a general safeguard, included in China's accession agreement, for another seven years; however, applying the general safeguard requires that imports from China be shown to injure domestic industries and be the main cause of injury.

Figure 3-1 shows the impact of tariff and quota costs on EU imports of denim jeans. When producers in Tunisia and Turkey use their own fabric or fabric from the EU, they do not incur tariff costs and their CIF price equals the landed duty paid price. Producers from China must pay tariffs or purchase quota, which raises their prices to that of Tunisia's and Turkey's producers and above that of Lesotho's producers using fabric from China. If Lesotho's producers use local fabrics, they do not incur tariff costs and enjoy a 6.7 percent delivered cost advantage over the same product from China. This cost advantage depends on (1) using local fabrics, and (2) the continuing imposition of quota costs on Chinese products in the form of safeguards. Safeguards are only assured through 2008. At that time, products from China will be able to undercut prices for products from Lesotho, unless Lesotho's local fabric suppliers reduce their costs to meet the price of Asian and Chinese suppliers.

In today's highly competitive markets, retailers source garments on the basis not only of costs, but also lead times, which helps them reduce inventories and increase the number of styles they offer. Table 3-2 presents typical lead times from the time a fabric order is booked with a textile producer to the time it is delivered for cutting in the apparel factory.

Table 3-2
Delivery Times in Weeks for Garment Making Up Countries, by Fabric Source

	Lesotho			China	Tunisia		Turkey	
Production Stage	**Lesotho**	**RSA**	**China**	**China**	**Tunisia**	**EU**	**Turkey**	**EU**
Fabric production	4.0	4.0	8.0	4.0	--	4.0	3.0	4.0
Making up	2.0	2.0	2.0	2.0	--	2.0	2.0	2.0
Garment shipment	2.5	2.5	2.5	4.0	--	1.5	1.0	1.0
Total	8.5	8.5	12.5	10.0	--	7.5	6.0	7.0

SOURCE: *Werner International.*

A textile mill usually takes about 4 weeks to turn around a denim order. In Lesotho, delivery time for items using fabric from China is about 8 weeks because shipping from China to

Lesotho adds 4 weeks. Lesotho's apparel producers could improve their lead times if they used local fabrics.

Shipping times from Lesotho to Northern Europe edge out similar shipments from China thanks to regular departures from South Africa to Europe from the ports of Durban, Port Elizabeth, and Cape Town. Garments shipped from China require about 1.5 additional weeks to arrive in a Northern European port. This is partly because shipments from China to Europe are often shipped via Singapore, where they may be consolidated for forwarding to final destinations in Europe.

In using direct shipping, Lesotho enjoys a slight advantage over China, but producers in Turkey and Tunisia take, on average, only 1 to 1.5 weeks to deliver garments. So when Lesotho's producers use denim from China, they are 2.5 weeks behind China and more than double the 6-week delivery time from Turkey—not a good situation in a market that values rapid turnaround. If Lesotho's producers used locally or regionally source fabric, they could cut their total lead time—from fabric order to garment delivery—by 4 weeks. This would give them a 1.5-week advantage over China, and put them only 1.5 weeks behind the turnaround times for Turkey and Tunisia.

Buyers, of course, balance the advantages of lower cost garments with the longer lead times. When Lesotho's producers use fabric from China, they are only slightly more competitive, edging out the Chinese product by 1.9 percent—but they require 2.5 weeks more lead time. On average, one day of shipping in the apparel industry is equivalent to a 0.8 percent tariff on the garment (Hummels 2001). Thus, the additional shipping time from Lesotho is equivalent to an 11.2 percent tariff, more than the price advantage of 1.9 percent. And when safeguards are removed this small price advantage will disappear.

When Lesotho's producers us South African fabrics their lead times are 1.5 weeks less than Chinese producers' lead times—but their garment costs are within 2 percentage points of producers' costs in Turkey and Tunisia, who have better lead times.

When Lesotho uses locally produced fabric it can be both cheaper than China and the lowest cost producers in Turkey and Tunisia, and still maintain a competitive position on delivery time. Again, this advantage depends on the EU imposing safeguard restrictions on China, requiring Chinese producers to purchase quota rights ($0.70/garment). To compete with Chinese garments absent safeguards, Lesotho's producers will have to match unique abilities, such as dying and finishing, to their products in order to set them apart.

Lesotho's apparel producers may avail themselves of a program that could provide a critical advantage when exporting: the Duty Credit Certificate Scheme (DCCS) of the South African Revenue Service(SARS). Under DCCS, exporters may apply a 25 percent rebate certificate for exports against duties for imported apparel, fabrics, and yarns in SACU. Producers must spend 3 percent of their sales on worker training. The program may not be combined with other duty suspension schemes. Because the rebate is calculated on the basis of the value of the final good, not the materials, the DCCS offers an effective subsidy (the prevailing rate of duty on fabrics is 20 percent). Certificates may be sold and traded. In Lesotho, the usefulness of the DCCS has been questionable because most producers their have had difficulty selling certificates to South African retailers, who often view the DCCS operation in Lesotho as risky and corrupt. When retailers purchase certificates they demand steep discounts. Few producers could count the DCCS as a distinct advantage when exporting, due to the unreliable nature of the system.

Company- level Criteria

Buyers in most markets rely on several types of sourcing to meet their needs for product variety, delivery, and cost. A large buyer is likely to (1) source some apparel directly from well known, reliable manufactures, (2) commission agents to manage some fashion-forward merchandise, and (3) purchase product lines from wholesalers and importers. Buyers expect certain skills in each market channel. In sourcing directly from manufacturers, buyers seek the most capable, those with their own fabric testing, quality control, and financing capabilities and who sometimes offer design and sample services. This type of high-service firm is often referred to as an FOB or full-package producer.

Agents specializing in global sourcing offer services for a commission (5-15 percent). These agents source and finance fabric, execute samples, arrange logistics, and ensure that the buyer's quality control and compliance requirements are met. The agent may be in the buying country, the producing country, or a central location or sourcing hub, such as Hong Kong, Singapore, or Kuala Lumpur. For producers unfamiliar with the requirements of a new market, or that lack significant service capabilities, working with agents is often the best way to learn a market's needs and requirements before risking an order with a new customer.

Most of Lesotho's producers are reportedly cut-make-trim (CMT) operations.[24] These firms are primarily of Taiwanese or East Asian origin and on average employ more than 1,000 workers (Table 3-3). The competitive advantage of CMT firms of this size is based on producing standard runs of basic garments, or core runs, where repetition and low wages compensate for low productivity and skill. Firms that pay higher wages compensate for higher costs by managing production lines more efficiently and offering flexibility, by reconfiguring production lines fast, and offering lean and quick response.

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[24] This study relies on reports and surveys of Lesotho's producers including Salem *et al* (2002) and Hillagas 2005.

Table 3-3
Lesotho Apparel Firms, 2005

Company	Investor	Product	Employees	Market
Alleycat Lesoto	RSA	Jeans	650	USA
BA Tex	RSA	Kids wear	272	RSA
Baneng Lesotho	Singapore	T-shirts	600	USA
C River	Taiwan	T-shirts	805	USA
C&Y Garments	Taiwan	Jeans	1,950	USA
CeeBee	Lesotho	Jeans	-	RSA
CGM	Taiwan	Jeans	1,888	USA
Chainex	Taiwan	T-shirts	70	USA
E-River	Taiwan	T-shirts	416	USA
Ever Unison Garments	Taiwan	T-shirts, pants	1,400	USA
Export Unlimited	Taiwan	T-shirts	307	USA, RSA
Five-Eight	China	T-shirts/sweaters	220	USA
Global Garments	Taiwan	Jeans	1,790	USA
Hippo Knitting	Taiwan	T-shirts	1,300	USA
Hong Kong Knitters	Taiwan	T-shirts	1,049	USA
Humin Jeanswear	RSA	Jeans	249	USA, RSA
J&S Fashions	Taiwan	T-shirts, skirts	580	USA
JW International	RSA	Work wear	240	USA, RSA
King-Ang	Taiwan	T-shirts	900	USA
Lesotho Fcy Garments	Taiwan	T-shirts	2,500	USA
Lesotho HAPS*	Taiwan	T-shirts	1,400	RSA
Lesotho Hinebo	Taiwan	T-shirts	1,014	USA
Maluti Textiles	Taiwan	Jeans	500	USA
Maseru, E Textile	Taiwan	T-shirts	430	USA, RSA
N River	Taiwan	T-shirts	562	USA
Nien Hsing	Taiwan	Jeans	2,295	USA
P&T Garments	Taiwan	T-shirts	2,695	USA
Precious Garments	Taiwan	T-shirts	3,878	USA
Presitex Clothing	Taiwan	Jeans	2,700	USA
Raytex Garment	China	T-shirts	520	USA
Santi Kon	Taiwan	T-shirts	700	USA
Shining Century	Taiwan	T-shirts	1,100	USA
Sun Textiles	Taiwan	T-shirts, pants	1,014	USA
Super Knitting	Taiwan	T-shirts	806	USA
Sweatsun	Mauritius	Garments	370	USA
Tai Yuan	Taiwan	T-shirts	945	USA
TW Garments*	Malaysia	T-shirts	249	NA
TZICC	Taiwan	T-shirts	1,975	USA
United Clothing	Taiwan	Jeans	1,811	USA
Vogue Landmark*	Taiwan	T-shirts	1,142	USA
Wonder Garment	Taiwan	T-shirts	330	USA
Total	--	--	43,622	
Average Firm Size	--	--	1,090.55	
Median Firm Size	--	--	853	

SOURCE: LNDC as reported by Hillagas (2005).

Industry experts agree that the role of the CMT producer is weakening as agents, retailers, and buyers prefer to "outsource" more and more of the service overhead or indirect costs, such as sample making, fabric sourcing, and financing to capable firms, close to materials and trims, with lower cost structures. How fast and to what degree this trend will take hold is debatable.

Engaged primarily in the CMT part of production, Lesotho's producers receive orders and raw material from the Far East, where their holding companies take orders from East Asian agents or buyers that represent major U.S. retailers. All materials and trims, and sometimes markers for cutting, are shipped in containers to factories in Lesotho. Lacking significant preproduction processes—such as fabric sourcing, financing, pattern making, sample making, grading or marker making—these companies depend on agents or owners. Going it alone is not an option for firms that take their technical and strategic direction from owners and agents thousands of miles away.

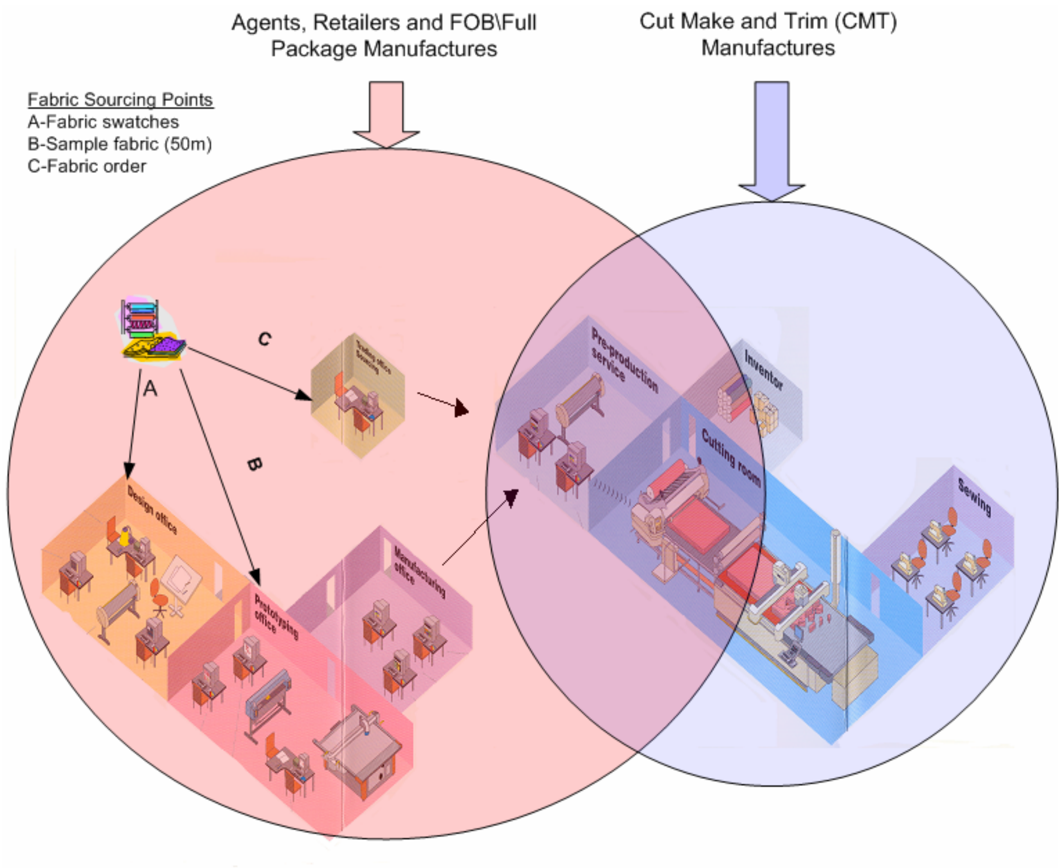
Changing this relationship and building preproduction skills in Lesotho entails significant effort and risk. Fabrics are thousands of miles away, while markets are equally distant from the production base. Moving into a full-package process will require extensive travel and investment in staff and equipment. It should be no surprise that when major buyers request samples in Lesotho, they are referred to the "head office" in Asia. This is the best these firms can do in their situation. Otherwise, they risk disappointing a buyer who places a sample order that the producer cannot complete.

Figure 3-2 illustrates the production model common in Lesotho's firms. Sample making, grading, marker making, and fabric and trim sourcing are handled outside Lesotho (red), with the exception of a few firms. Preproduction results in a "spec" sheet detailing fabric type and mill source, garment sizes (grading), and trims. The CMT manufacturer (blue) follows these specifications exactly as conceived. Those with facilities for marker making can make last minute changes based on final adjustments to the buyer's order before fabric is laid out and cut. After cutting, order modifications are either extremely costly (blue and red) or not possible.

Fabric sourcing requires skill and experience. For example, in Figure 3-2, major fabric sourcing processes are noted at points A, B and C. At point A, a buyer, importer, or wholesaler might ship sample swatches to a producer, who then locates textile suppliers and gets sample fabric swatches (dips or strikeoffs) from them in very small quantities. The buyer approves the swatches and then orders several prototypes, or garment samples, in several sizes and colorways (B).

It is difficult, though not impossible, for an apparel producer to order swatches if they are not reasonably close to the textile supplier to facilitate the transaction. Moreover, step B requires the textile producer to provide an odd quantity of fabric (50m) in multiple colorways or finishes, with no guarantee of an order (C). Few textile firms will turn out expensive sample runs that require setting up sample warps and using specialized dying and finishing machines for anyone but reliable producers or buyers. If they do, time lags are likely to be long and results less than desirable.

Figure 3-2
Apparel Production Process



SOURCE: *Nathan Associates Inc. and Werner International.*

At this point, the quality of the 50m of sample fabric (B) is far more important to the apparel manufacturer and the buyer than the large quantity order placed later. Mistakes in color, finish, or quality at this point are fatal and cannot be compensated for by cutting. The retailer, importer, or wholesaler will examine the sample garments with the most careful of quality checks, knowing they have made no commitment to order. Proximity to the textile supplier can be critical where multiple swatches and sample runs must be done to adjust quality and specification. Preproduction and interaction between buyers and fabric suppliers often take up to one year before an order is placed. Proximity to the buyer and\or the fabric supplier is an advantage. Lesotho's distance from the center of garment buying and fabric and trim suppliers is a distinct disadvantage (except for core garments ordered every year with no or little change, the South African market, or when using locally produced fabrics).

Having local fabrics is still far from having the ability to meet buyers' requirements for product diversity. Diversity can be based on fabric type, weight, fiber combination, and finish.

It seems unlikely that a small country, such as Lesotho, could compete with the capabilities and product ranges available in Asia. Without a diverse product range, buyers will have fewer product opportunities, and correspondingly fewer opportunities to spread fixed purchasing costs for travel, local agents, quality control, etc. across product ranges. Lesotho's producers would do well to expand their dying and finishing capabilities. For example, washing and finishing facilities for denim, or embroidery and printing for knits would broaden ranges and possibilities for current products. Focusing on core fabrics is not likely to attract anyone except agents who can match these products with products from other countries, and they will only do so if the cost is compelling.

Agents are the obvious solution to these problems. Lesotho's producers should solidify their relationships with agents and work with them on a strategy to diversify their markets and products. They should take care in finding new agents in new markets because existing agents may view such relationships as a threat, especially when an agent is active in the same market.

Once producers master fabric sourcing, they will likely have to venture into the riskier business of fabric and trim financing. Financing of fabrics is often a major obstacle to the CMT producer, who rarely has the cash flow to support this kind of activity from its own operating budget. The risks are high; one failure can push a company into bankruptcy. Letters of credit (LCs) issued by U.S. buyers reduce some risks and guarantee payment if goods are delivered as specified. LCs are not common among EU buyers, who instead rely on long-term relationships between buyers and sellers to ensure payment. Foreign-owned factories, such as those from Taiwan, are reportedly less accommodating to the EU buyer's demands on the point of financing, preferring to work with large U.S. buyers who provide payment guarantees.

In summary, the service capabilities of Lesotho's producers will determine their opportunities to diversify their markets and customers. Firms with limited services will have to pursue new customers through agents and manufactures that can assist them with preproduction processes. Some opportunities may be available to sell overstocks directly to wholesalers, but this strategy is not sustainable. In the short term, producers should seek new partners (joint ventures) and agents that can compensate for their service shortcomings. A wide array of firms providing preproduction services and financing are located in South Africa. For the medium to long term, Lesotho's producers should augment their capabilities to include some preproduction processes and thereby broaden their range of potential markets. They also need to offer a variety of apparel products. Increasing the products, fashions, and finishes they offer will pique buyers' interest and make a more compelling case for sourcing from Lesotho than price alone.

4. Market Opportunities for Apparel

Having established the terms of market access, such as relief from EU or South African tariffs, producers need to match their capabilities with the requirements of the target market. These requirements include retailer's preferences for buying directly or through agents, minimum order size, and expected services, financing, and lead times. In this section, we review the market requirements and channels into two of the most accessible and promising markets for Lesotho's producers—the EU and South Africa.[25]

EU Apparel Market

The EU market is as diverse as it is large. With 385 million consumers in the traditional markets of the EU-15, it is nearly one-third larger than the U.S. market. But its size is deceptive, since each country has distinct sales and retail channels, intensifying the task of identifying customers and limiting the size of orders and reorders. The most promising EU markets for Lesotho's producers include Germany and the United Kingdom (UK). These are not only the two largest markets for apparel in the traditional EU-15 market, but also the most value conscious, including large retailers requiring large orders of standardized (core) products (Figure 4-1). The UK market is the world's most concentrated retail market and is highly value conscious. The German market, somewhat less concentrated, is also value conscious, with consumers putting less emphasis on fashion goods and more on price. Domestic retail laws in southern Europe encourage and support a highly fragmented sourcing model, not well suited to Lesotho's producers, who tend to specialize in longer runs of basic (core) fabrics and garments.

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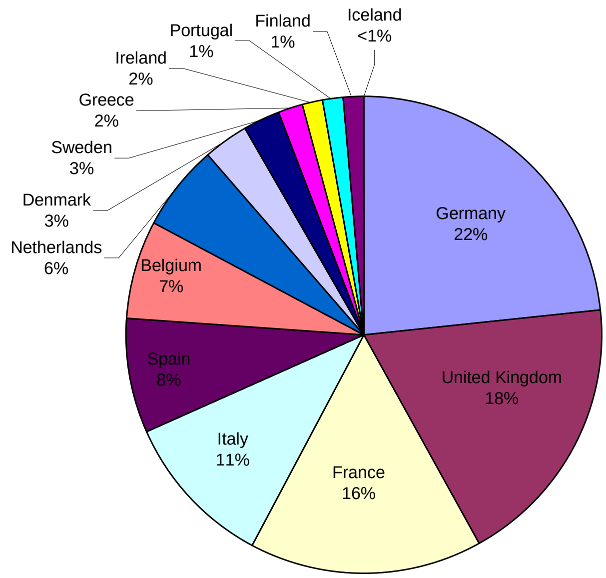
[25] Sales to Australia or Japan are possible, but those markets are remote and dominated by Chinese exporters. Canada's relatively small market is dominated by regional and Asian producers who offer full-package capabilities.

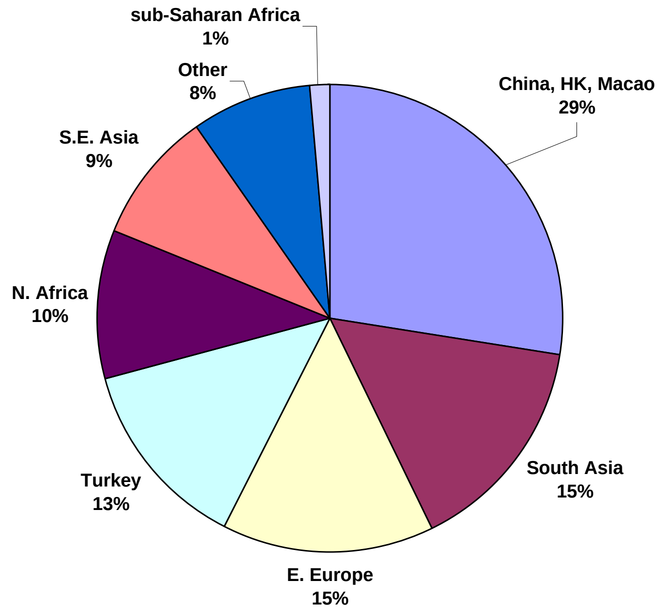
Figure 4-1
EU Imports of Apparel by Country, 2004



In 2004, apparel sourcing by EU-15 was relatively concentrated, with 53 percent of imports coming from China, South and South East Asia, and 38 percent from regional suppliers such as Eastern Europe, Turkey and North Africa (Figure 4-2). Less than 1 percent came from sub-Saharan African countries. The most successful SSA exporters are Mauritius (US$682 million), Madagascar (US$201 million), and South Africa (US$74 million). Mauritius and Madagascar have long supplied the French market, and South African firms export mainly to the UK. All three of these countries have local textile producers in the knit and woven garment segments and are capable of meeting EU rules of origin, which require the fabric be formed in the beneficiary country. Countries such as Botswana, Zimbabwe, Kenya, and Lesotho have had far less success supplying the EU market.

Many South African suppliers to the UK market are full-package manufactures, such as Seardel, and have long-established direct links with UK retailers and South African textile suppliers. Seardel is also a part owner of Frame, the largest South African textile manufacturer. Additionally, Marks and Spencer has several high quality plants in South Africa with highly capable management and full-package capabilities. Other South African suppliers to the UK market have provided specialized garments for technical use (e.g., bullet proof vests, surgical garments, nonwovens) and basic fashion garments, such as wool suits and lingerie—unique product areas.

Figure 4-2
Apparel Sources for EU-15 Importers, 2004



Since elimination of worldwide textile and apparel quotas was announced as part of the WTO Uruguay Round, retailers have devised strategies to take advantage of their new flexibility. They are sharply reducing the number of companies from whom they source apparel while balancing geographical and supply chain risks. Retailers are increasingly looking for suppliers with service capabilities such as financing, lean production techniques, and even sample and design departments. This means Lesotho's producers and export promotion representatives will be approaching an increasingly demanding market. The best way for Lesotho's producers to meet this challenge is to focus on market segments and sales channels for which their current capabilities are most suited.

As Table 4-1 shows, all retail channels are hybrids that employ two or more buying methods. In general, only large department stores and specialty apparel producers buy directly from a factory, although discounters are increasingly doing this to manage costs and create unique products. All channels use importers and wholesalers (except specialty apparel producers, who rarely use wholesalers). Buying clubs, which are very popular in Germany, are hybrid importers-wholesalers. Finally, agents usually work with department stores, especially for sourcing own brands and unique lines, and with specialty apparel producers (e.g., GAP, Benetton, Zara). The lines are blurring and hybrid models are common. Table 4-2 presents prominent examples of retailers in each buying channel.

Table 4-1
Retail Channels and Buying Characteristics

Buying Characteristic	Department Stores	Discounters	Specialty Apparel	Independents	Home Shopping
Direct buying	√		√		
Importers	√	√	√	√	√
Wholesalers	√	√		√	√
Buying clubs				√	
Agents	√		√		

Table 4-2
Major European Apparel Retailers

Location	Department Stores	Discounters	Specialty Apparel\Multiples	Home Shopping
UK	M&S, John Lewis, Debenhams, Hose of Fraser, Selfridges, Littlewoods	Peacocks and Matalan	Benetton, Mango, H&M, Zara, ARCADIA Group, Burberry's, Barbour and Pringle	Great Universal Stores (GUS), Littlewoods (home shopping), N Brown
Germany	Kardstadt\Quelle; Kaufhof\Metro; Woolworth	NKD, Tenglemann, Lidl & Schwartz, Ensting's and Takko	Benetton, Mango, H&M, Zara, West and Ansson's, Voegele	Otto Versand, Kardstadt\Quelle\ Neckermann
Other Europe	Les Galeries Lafayette, Pinaulty-Printemps-Redoute		Benetton, Mango, H&M, Zara, Carroll, Kookai,	La Redoute and 3 Suisses.

The relationship between EU retailers and suppliers is different from the relationship between U.S. retailers and suppliers. EU retailers favor long-term partnerships and will sacrifice some aspect of price and quality to this end. Most important, EU retailers and buyers tend to finance on the basis of open lines of credit, as opposed to U.S. buyers who rely heavily on letters of credit (LCs).[26] Agents and producers who are used to receiving LCs often disregard buyers not issuing them because they view the risks of entering into these types of relationships as too high.

Several U.S. retailers have penetrated the EU market—Levi Straus, Nike, and the GAP in the branded segments, and Wal-Mart, through its acquisition of Asda supermarket chain in England and Germany. Here, is another method for Lesotho's apparel producers to diversify, by working through buyers already familiar with Lesotho's producers can adapt their purchases and shipments to include the EU market.

For Lesotho's garment producers, going it alone will be a difficult, be it for service, fabric sourcing, proximity to the market, market knowledge, or financing. If they use local or

[26] East Asian suppliers have noted that U.S. buyers seem to be reducing the number of LCs they issue, pushing financial risks onto the manufacturer.

regional fabrics, services also be local or regional. If they continue using Asian fabrics and supply chains, they likely continue working through established East Asian buying agents. Two of the Asia's largest agents are already in Lesotho and in the U.S. and EU markets, lowering many of the barriers to market entry. Linmark and Li & Fung—both based in Hong Kong—can coordinate all preproduction, financing, and buying relationships. It would be crucial that the LNDC and local factory managers engage these agents in the local and regional fabric sourcing process, perhaps making a hybrid model. Fabrics and finishes will have to be adjusted to meet new customer and market demands for diversity and quality.

In summary, most EU apparel imports from developing countries are from integrated producers, such as China and Turkey, or CMT operation in Morocco, Tunisia, Eastern Europe, and the EuroMed area. These countries offer low cost, fast delivery, preferential access, and local fabrics and services. To compete, Lesotho will have to match some or even all of these advantages. Today, they can do this only by using locally produced denim. In the medium term, Lesotho's apparel firms would do well to upgrade their preproduction skills and offer full-package\F.O.B. services. In the near term, firms without this experience will have to match themselves with agents and manufactures employing CMT services, including Li & Fung and Linmark. Target markets should include the largest, value conscious, and concentrated markets of the UK and Germany—fragmented southern European markets require more services, smaller orders, and faster turnaround.

South Africa

South Africa's market for apparel is fourth in size, ahead of Canada and Australia. Approximately half the market is estimated to consist of affluent consumers who regularly purchase new garments. Lesotho's proximity to that market and its membership in SACU hold promise for apparel exporters.

The South African market can be divided into several consumer groups:

- Upper income fashion\brand conscious;
- Lower income highly value conscious;
- Lowest income purchasing second quality cloths and overruns

South African retailers directly source from local full-package manufactures and through wholesalers and importers that are often unrelated, but have strong relationships with buyers. In this way, they meet requirements for cost and fashion. South African fashion trends are driven largely by trends in the United States and Europe. Major retailers send buyers and designers to these markets to "canvas" for design ideas and sample garments, which are then modified for the needs of South Africans. This marketing system is supported by the fact that South African fashion seasons are opposite those in the major markets, providing lead time not only for retailers to develop their collections, but also for importers to take stock of overruns and surplus garments from Asian factories attuned to fashion seasons in the United

States and EU. The ownership of the South African retail market is highly concentrated; four or five firms account for most sales. But each of these retail holding companies often accounts for more than one retail chain. For example, Edcon, a holding company, directs sales for both Edgars and Jet stores, which serve the middle and upper market and low to middle markets respectively. Other major retailers include Woolworth's, Mr. Price, and Pepkor (Pep, Ackermans, Best & Less) stores.

In interviews, major South African retailers indicated that they did not have a well-developed image of Lesotho, and that they had not looked there for manufacturing since the late 1990s. Many felt that the Taiwanese investors were simply not interested in working with them. They also mentioned that they prefer to buy locally and that the South African government was keen on retailers buying from black empowered enterprises (BEE) in South Africa, and that Lesotho did not qualify under the BEE programs, which are limited to firms in South Africa, not SACU. On the other hand, several retailers mentioned that they likely purchase from Lesotho-based factories through intermediaries and wholesalers from stocks; they just do not source directly. Many South African retailers shared the belief that there is trade with Lesotho producers that simply may not show up in usual statistics (e.g., SACU does not report imports from Lesotho).

In general, South African retailers would welcome new suppliers in Lesotho. However, most of their direct purchases are for fashion and fashion-forward merchandise—most firms in Lesotho have no design, sample making, or financing capabilities. Indeed, one firm in Lesotho exporting to South Africa noted that a firm in South Africa handles all of its preproduction, design, and sample making. Since Lesotho's firms do not usually compete on services, they would have to compete on price, including logistics costs. Retailers indicated that current logistic costs for sourcing from Lesotho could nullify lower production costs. Finally, the willingness of firms to produce smaller runs would be advantageous, although South African retailers are also increasing order volumes while narrowing selection.

SACU officials have received a commitment from Chinese exporters to voluntarily limit their exports; however, no targets have been set and the duration of the limit is uncertain. This could still present an opportunity for Lesotho's apparel producers to re-introduce themselves to the South African market. In approaching that market, they will have to overcome tax and financing challenges. Lesotho's apparel producers export 90 percent or more of their production, so they have well-honed financial systems for minimizing the impact of import tariffs and taxes on cash flow. To export to South Africa, they will have to evaluate their accounting systems and be ready to absorb tariff costs—shipments to South Africa will require paying tariffs on fabric. This problem should not be underestimated; many firms carry large stocks of distressed garments that they would sell on local markets except for the fact that they would be required to pay the tariff on the imported fabrics. These firms consider tariff payment, before the sale of the garments, a formidable challenge.

Apparel firms in Lesotho that are owned or operated by naturalized foreigners, or regional or local owners, will be the most likely to diversify for the South African market and be committed to retooling operations to serve that market. In this regard, the LNDC should devise incentives to attract South African investors.

In summary, South Africa's market holds opportunities to Lesotho's producers. Restrictions on imports from China would only improve those opportunities. Producers will have to either sell from stock or take orders from South African retailers. Firms that want to sell nonstock items will likely have to partner with South African companies that can provide preproduction skills and financing.

5. Export Promotion and Diversification

Lesotho's export promotion programs are implemented through the LNDC, a division of the Ministry of Industry, Trade, Cooperatives, and Marketing (MITCM). The LNDC's garment export promotion aims to attract new producers rather than diversify exporters' markets or products. Though this model has worked well for Lesotho, it relies on relationships with Taiwanese investors familiar with U.S. buyers and markets. The result is an industry with similar demographics, capabilities, customers, and markets.

The LNDC is pursuing a trade mission with Lesotho's embassy in Germany to introduce parties from the textile and apparel industries in Germany to Lesotho. Specifics of this program are not clear, but it may be best if the LNDC focuses on attracting vendors with fabric production capabilities. Ideal producers would include those interested and capable of investing in vertically integrated production, for either knit or woven products. Managers of large retail groups are not likely to produce significant investment or interest because they usually have buyers and agents manage sourcing decisions. Wholesalers, agents, and buying manufactures from Germany seeking CMT operations might also be considered, but it will be important to identify factories with management capable and empowered to make contracts with new clients.

The LNDC has also been trying to attract investment for denim washing or finishing capabilities so Lesotho's industry can respond to the demands of U.S. buyers, such as the GAP. Such investment would also further market diversification because all buyers value product diversity. Only one industrial estate (Thetsane) has sufficient water treatment facilities for wet processing. The LNDC is also exploring contracting with South African facilities for wet processing. These opportunities have been impeded by the lack of clear directives on the use of these facilities and the ability of producers to use current export rebate programs and meet the rules of origin of various trade agreements. This type of outward processing trade (OPT) often requires legislation and changes in custom rules.

COMMARK Trust, a project funded by DFID, provides assistance for export promotion. The trust has collaborated with the LNDC on the wet processing facility, provides contacts with buyers in South Africa, and co-financed some buyer visits to Lesotho. The trust has also been

- ***Working to attract vertically integrated knit producers***. Factory shells may exist for garment producers but not textile producers. Local restrictions on foreign land ownership and lack of sufficient water treatment capabilities are hindering development of shells for textile producers.
- ***Seeking to stimulate demand for regional fabric, primarily from South Africa.*** The goal here is to introduce buyers and producers to South African formed fabrics to stimulate demand for regional fabrics and making–up in Lesotho. The first step is to persuade some large U.S. buyers in Lesotho, such as GAP, to buy local fabrics. Since AGOA's rule of origin permits the use of South African fabrics, this is a viable strategy, even after the special derogation for using Asian fabrics expires in 2007. But using South African fabrics for EU imports would result in application of the full EU tariff of 12 percent—only local fabric production qualifies. South African retailers are familiar with their local textile producers and are not likely to be enticed by this marketing effort.
- ***Proposing to create a matrix of textile fabrics available in the region, along with their technical specifications, to persuade buyers to use regional fabrics.*** The likely success of this effort must take into account apparel buyers' notorious demands for fabric quality. Buyers insist on having sample fabrics that they can touch and feel—since they are keenly aware of the variations in quality that can occur even with "spec" fabrics. To gain confidence in new sources they will require a visit to textile facilities. They must be confident that all manufacturing procedures, including cotton and yarn sourcing, are consistent enough to reproduce the same fabrics with same feel, shrinkage, and dye qualities.
- T***argeting high tariff categories under the AGOA program.*** U.S. tariffs on apparel range from 16 to 32.5 percent, with maximum tariffs charged on manmade fiber apparel (Minor 2004). These efforts would be most useful after the U.S. derogation to the rule of origin expires in September 2007, compelling producers to source fabrics regionally from Lesotho or other AGOA-eligible countries, such as South Africa.

All of these programs focus on existing market structures rather than new markets. Strengthening existing exports to the U.S. market is given higher priority than penetrating new markets, such as the EU and South Africa. Indeed, it is much easier to diversify products and sourcing structures in a given market than to seek new customers and build long-term relationships—and approaching new markets, such as the EU, without substantial local fabric production to meet the rule of origin is a serious constraint.

In conjunction with South African manufactures and buyers, Lesotho should aggressively seek new ways into the South African market. Simply attracting South African retailers to Lesotho is unlikely to result in significant sales. Instead, attracting South African buyers, importers, and wholesalers engaged in day-to-day buying and thereby demonstrating that the relationship can work will be more effective. To this end, it may be advantageous to promote a trade fair in Lesotho, featuring products from local stocks for immediate purchase. This type of trade would have to be supported by the Government of Lesotho and South Africa's SARS to ensure a simple, legal system for clearing suspended duties on imported fabrics. This approach may be limited by the stocks of ready-made garments in Lesotho's factories, but it would let South African buyers experience directly the opportunities available in Lesotho.

By focusing on productivity improvements, training is also supporting the current production model and Lesotho's strength as a low-cost producer. Future training should also emphasize preproduction training in (1) marker making and grading, (2) manual and automated cutting, (3) pattern and sample production, and (4) fabric and trim sourcing. These skills may take a few years to develop, so Lesotho's firms should seek to collaborate with South African firms capable in these areas to accelerate entrance into "fuller" package capabilities and diversify their customer and market base. To the extent possible, these skills should be developed in local personnel, rather than expatriate managers and supervisors.

6. Conclusions and Recommendations

A small landlocked country, Lesotho is far from most major markets and the major sources of garment fabrics and trims in Asia. Nevertheless, generous preferential access to the U.S. market has attracted many foreign (Taiwanese) producers to Lesotho. For many years, these producers have enjoyed not only liberal quota and tariff benefits, but also rules of trade that enabled ready adaptation to Asian supply chains for sourcing fabrics and trims. For its part, Lesotho has provided a willing and capable work force at competitive wages. The combination of preferential access and supply chain flexibility has overcome the long distance from Lesotho to the United States and shielded producers from demands for preproduction skills in sample and marker making, financing, and fabric and trim sourcing.

Lesotho is a party to preferential trade arrangements with the EU, Canada, Australia, and Japan, but its distance from these major markets is a serious obstacle. Regional producers and other LDCs can offer faster turnaround times, diverse service capabilities and products, and lower transport costs—as well as tariff-free access. Lesotho is also challenged in meeting the rules of trade for these markets, which require that fabrics and yarns be produced locally or that high value added requirements be met. Lesotho's producers have not been able to reap the full benefits of these arrangements and are not likely to unless the rules change. They have exported limited quantities to Canada, but Canada's market is modest in size, and Asian countries, such as Cambodia, claim similar preferential tariff benefits and have lower logistics and production costs. Japan offers liberal market access, but 75 percent of its import market is claimed by Chinese producers who can respond effectively to very short lead times. Export promotion programs will find it difficult to find a basis for promoting exports from Lesotho when less developed producers in Asia enjoy a greater base of textile production as well as preferential access.

The South African market offers a unique opportunity for Lesotho's apparel producers to diversify. As a member of SACU, Lesotho can claim duty-free access to South Africa's market so long as producers pay duties on imported fabrics or use locally or regionally sourced fabrics. As South Africa's producers have been hurt by rising wages and restrictive labor regulations that prohibit piece rate payments and raise the costs of retrenchments, its retailers have been forced to seek new apparel sources. The decline in South Africa's making-up industry is leading to a voluntary agreement between SACU and China to limit imports from China's garment factories. The agreement should improve opportunities for Lesotho's producers, but its final form and duration have not yet been agreed. To penetrate South Africa's market, Lesotho's producers will have to master new skills in fabric sourcing, financing, and sample, marker, and pattern making. In the short-term, it may be easier to sell from stock and create strategic partnerships (e.g., joint ventures) with South African manufactures that have preproduction skills.

The EU market offers opportunities if locally produced fabrics meet the needs of EU buyers and agents. In the long-term—and certainly by the end of 2008 when EU restrictions on imports from China expire—Lesotho will have to ensure that fabrics are both available and competitively priced. Only the use of locally produced fabrics could eliminate tariffs *and* reduce lead times to the EU market. Given the significant obstacles Lesotho faces in developing local textiles that meet rules of origin and market requirements, the government should petition the EU for derogation to their GSP program to permit producers to use regional fabrics and trims, with the advantage of preferential market access.[27] Creating a regional model for fabric sourcing could create the important production synergy needed, since regional fabric production would then be eligible for preferential treatment in the United States (AGOA), EU (GSP\EBA), and South Africa.

Sustainable long-term market access for Lesotho will likely require going beyond rules of origin and greater sources of local and regional fabrics. Producers will have to augment services to include financing, fabric sourcing, and preproduction services. Buyers and retailers are shifting these activities to production facilities overseas. They are therefore increasingly demanding that producers have more than cut, make, and trim capabilities. Preproduction services increase market opportunities, improve turnaround time, and provide supply chain flexibility. Such structural changes will require the full support of factory owners and managers. Most of Lesotho's factory owners are in Asia and their commitment to such support is not clear. In addition, producers are having difficulty retaining workers skilled in pattern and sample making—demand is rising for a skill in short supply and worker turnover is frequent. Skill supply and demand must be balanced if more than a handful of companies are to acquire preproduction capabilities.

Recommendations for market and product diversification, summarized in Table 6-1 and detailed below, call for discrete activities that will have complementary effects. For example, improving finishing capabilities *and* building preproduction skills, such as sample making, will give rise to more opportunities than doing either alone.

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[27] The EU is reportedly resistant to allowing the use of South African fabrics by regional producers, since the EU has an FTA with South Africa. South Africa has not yet eliminated its duties on EU textile and apparel imports. Reportedly, once the South Africa eliminates tariffs on EU textiles, the EU will permit cumulating of South African fabrics with regional producers.

Recommendations for Government and Development Agencies

Develop Regional Fabric Sourcing Model with Complementary Rules of Origin for U.S., EU, and South African Markets

The three most significant markets for Lesotho—the United States, South Africa, and the EU—have different market access rules. The United States allows fabrics to be sourced from anywhere; the EU requires that apparel seeking preferences be produced in Lesotho of imported yarns; and South Africa allows the use of Lesotho and SACU fabrics. When the derogation to the AGOA rule of origin expires, Lesotho will be required to use regional (AGOA) fabrics and yarns. At that time, Lesotho could have tariff-free access to the U.S. and South African markets if its producers use regional fabrics and yarns. Lesotho should petition the EU to permit it to use regional fabrics; this would leverage possibilities in place under existing trade agreements and provide synergy for greater regional fabric demand, use, and investments. The regional fabric sourcing model should emphasize full regional cumulation, allowing processes to take place in either Lesotho or other SACU countries (e.g., fabrics could be knit in South Africa, embroidered and made up in Lesotho without loss of originating status). In brief, this is a proposal for an integrated regional industry. Only in this way can the region hope to offer the full range of products, fabrics, trims, and services that will keep attracting customers to Lesotho. Achieving a regional sourcing model will require

- Petitioning the EU for derogation to the EBA rule of origin to permit the use of regional fabrics (subject to a cap if needed);
- Petitioning South Africa to implement the Cotonou cumulation rule for Lesotho; and
- Identifying the product ranges and capacities of regional fabric producers.

Monitor Developments in Trade Agreements

Preferential trade agreements present threats as well as opportunities. They present opportunities in the form of liberal market access; they present threats when they proliferate and provide other countries more liberal access to the same markets. For example, South and South East Asian countries enjoy special rules of origin (cumulation) under the EU EBA program. Lesotho's officials need to keep abreast of these developments and continue to represent the country's interests before the EU so that its preferential access is not further undermined. This will require assigning a government office to work with the EU mission in Lesotho.

Build Consensus on Industry and Market Restructuring

Most of Lesotho's firms depend on agents and owners who are not in Lesotho. Though many factories are capably managed, managers must check with owners and agents before making decisions outside normal operating procedures. At this time, the interest of agents and owner in market diversification programs is unclear. Foreign owners and agents should be surveyed to learn their intentions for future sourcing, interest in industry restructuring, market diversification, and obstacles. Roundtables should be convened (including foreign factory management) to disseminate information on strategy, opportunities, and new programs for industry restructuring and market access.

Diversify Sales to the South African Market

Many South African buyers have not seriously considered Lesotho as an apparel source since the late 1990s. They source from Lesotho, but usually through agents and wholesalers. The first step in building new market relationships will be persuading South African buyers and agents to take a fresh look at Lesotho. Marketing should go beyond providing buying managers tours of facilities in Lesotho—it should aim to attract dealmakers and facilitate transactions. A Lesotho based trade fair, offering goods from stock for sale, may be the fastest way to start this process. Arranging a trade fair will require facilitating the payment of suspended duties on imported fabrics and addressing finance issues (e.g., who will pay the duty and how). The Government of Lesotho should also engage SARS to ensure the transactions are viewed as legitimate under customs regulations and will not be subject to fraud investigations—dampening the interest of South African transactions.

Promote South African Investment in Lesotho

When U.S. and EU textile and apparel quotas were eliminated several apparel producers rapidly left from Lesotho, demonstrating the footloose nature of external investors. Serious consideration should be given to attracting local or regional South African investors with an eye on penetrating South African or EU markets. Attracting these investors should be considered in light of South African programs to entice investment by black entrepreneurs (BEE) in South Africa. Matching the investment incentives of these programs will need to be considered, and having South African officials recognize them would go a long way toward integrating South Africa's and Lesotho's manufacturing bases. Some basic regulation will have to be reviewed in light of the position of Lesotho in SACU and the special needs of regional investors. For example, special procedures and documentation will be required to allow manufacturing machinery and equipment to be brought into Lesotho from South Africa with the option to return it, duty-free.

Develop Programs and Regulations to Help Firms Enter the South African Market

Nearly all of Lesotho's producers focus on export markets. Developing sales to the South African market will require new accounting and finance rules. Most duty suspension programs are based on accounting for fabric imports and garment exports that balance. When a firm starts producing garments with local fabrics, or it ships substantial amounts within its own customs territories (SACU), accounting systems become more complex. The complexity of these systems can be so costly as to cause firms to develop separate facilities and accounting programs to serve both markets. Simplifying regulations and training producers to manage regulations will be important. The Lesotho Revenue Authority (LRA) and international donor agencies can ensure that these programs are attuned to market diversification strategies. The ComMark Trust has already documented these needs, which include procedures and documentation to

- Bring regional (SACU and SADC) fabrics, trims, and packaging material into Lesotho;
- Export garments into South Africa and SACU;
- Send garments into South Africa and SACU for further processing (e.g. sometimes garments are sent to South Africa for dyeing);
- Control factory bond stores for firms that will supply non-SACU and SACU markets; and
- Simplify cross-border transportation of samples.

Recommendations for Lesotho's Producers

Conduct Internal Strategic Analysis

Producers should inventory their capabilities, strengths, and weaknesses and take stock of opportunities and threats in the industry. A realistic assessment will help them decide which customers to pursue and which service areas to develop.

Pursue Strategic Partnerships

In the medium term, all firms could benefit from strategic partnerships that involve local and regional fabric sourcing; fabric testing, sample making and preproduction services; and financing fabric and work in progress (especially for locally owned establishments).

Diversify Product Mix

Buyers and agents need to justify apparel sourcing costs associated with Lesotho's remote location by spreading costs over a number of orders. Multiple orders are more likely if producers offer a broad range of products; otherwise, only a very low price will sustain sales. New product opportunities, innovation, and cost savings also attract buyers and agents. Denim washing facilities would complement the denim production in Lesotho.

Augment Preproduction Capabilities

Demand should drive the development of preproduction capabilities. Unlike training in productivity, preproduction training has no application in a factory not engaged in preproduction activities. However much a factory wants to upgrade preproduction skills, setting up a training center and offering classes is not likely to result in significant uptake. Instead, subsidized programs should be offered on a consulting basis, at least initially. Agents and foreign owners will have to be engaged, since the move into preproduction processes will require factory cooperation and, in some instances, investment in new equipment and computers. Preproduction processes can be segmented into four groups of complementary but separate skills:

- Marker making, grading and cutting;
- Sample and pattern making;
- Design; and
- Fabric sourcing and financing

Training can be delivered as needed and can augment existing productivity programs. No single model for skill development exists, but workforce development in the textile and apparel industries is most effective in the factories themselves, rather than training institutes.

Upgrade Management and Supervisory Skills

All firms should refine and upgrade managerial skills not only to reduce costs and ensure reliable delivery, but also to (1) make production lines flexible enough to handle short runs of various products without a raising costs or causing delays; (2) improve planning, pricing, and delivery estimates for competitive bidding and to identify customer and market segments that match current and projected capabilities, including their full-package costs; and (3) maintain labor standards, since well managed firms reduce pressures on line supervisors and management to meet unrealistic deadlines and cost estimates. Production line flexibility is critical to industry restructuring based on a regional fabric sourcing model. Regional and local textile producers may not be able to produce the quantities required by large U.S. buyers and may have to switch to customers or product styles with smaller order sizes.

Seek New Customers and Markets Today

Producers should not wait for AGOA's third-country fabric provisions to expire before seeking new customers. They should (1) work with agents and owners to identify new customers and markets; (2) identify agents or importers who buy in target markets that match their current and planned capabilities; and (3) attend trade fairs in target markets to build new relationships and learn about buyers' needs and the directions of markets and customers.

Table 6-1
Summary of Recommendations and Implementing Parties

Recommendation	Lead Party	Participants or facilitors
Develop a regional fabric sourcing model with complementary rules of origin for the US, EU, and South African markets.	LNDC	ComMark Trust; South African Textile Associations and DTI; Development Agencies (DA); Manufacturing Representatives
• Petition EU for derogation to the EBA rule of origin to permit the use of regional fabrics (subject to a cap if needed)	Government of Lesotho	Development Agencies
• Petition South Africa to implement the Cotonou cumulation rule for Lesotho	Government of Lesotho	LNDC, Government of Lesotho, ComMark Trust

Recommendation	Lead Party	Participants or facilitors
• Identify regional fabric producers, their product ranges and capacitates	ComMark Trust	South African Textile Producers; South African Department of Trade and Industry (DTI)
Monitor developments in trade agreements worldwide	LNDC	
Marshal garment industry ownership and management to attain consensus on industry and market restructuring	LNDC	ComMark Trust, Informal Taiwanese Chamber of Commerce; manufactures
• Survey foreign owners and agents on their future sourcing intentions, interest in industry restructuring, market diversification, and obstacles	AID Agencies	LNDC; Informal Taiwanese Chamber of Commerce; Lesotho Textile Exporters' Association (LTEA)
• Convene roundtables disseminating information on strategy, opportunities and new programs for industry restructuring and market access	LNDC	Manufactures; LTEA
South African market diversification	LNDC	COMMARK Trust, LTEA
• Introduce South African buyers to Lesotho based companies through a Lesotho based trade fair.	LTEA	South African buyers and service suppliers; ComMark
• Prepare simplified tax payment procedures for stock selling by Lesotho producers to South African buyers\importers	LRA	South African Revenue Service (SARS)
• Promote factory shells to South African apparel producers	LNDC	--
• Develop new regulations to assist Lesotho's firms to employ efficient accounting systems and finance supporting the dual production for export and SACU markets	LRA	LNDC; COMMARK; AID Agencies; manufactures\LTEA
• Petition South African government to recognize South African producers in Lesotho as BEE enterprises	Government of Lesotho	Government of South Africa
Diversify product mix	LNDC\LTEA	
• Regional fabric sourcing	COMMARK	South African Textile Producer's Association
• Improved finishing capabilities (wet processing)	LNDC	LTEA, ComMark Trust
• Expanding printing and embroidery industry segment	LNDC	LTEA, ComMark Trust
Augment preproduction capabilities to adapt to new markets and new fabric and yarn supply chains	LTEA	COMMARK; AID Agencies
• Determine training model based on the size and demand of the Lesotho industry	LTEA	ComMark Trust
• Promote joint ventures and production sharing arrangements with South African service providers and manufactures	LTEA	South African service providers; ComMark
Diversify Customer and Market Base	LTEA	
• Work with exsisting network of buyers and owners	Manufactures	LTEA
• Identify agents and buyers in new markets (EU)	LNDC	ComMark
• Attend trade fairs in new markets	Manufactures	LNDC\ComMark Trust

These recommendations take into the account that diversifying markets and meeting the trends of today's global textile and apparel industries are largely the same endeavor. Developing countries must now couple their strategies for negotiated market access with a strategy to meet market-driven requirements for services, product, and market development.

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Appendix. EU Apparel Trade Fairs and Associations

Trade Fairs

European Service Pass (Serving the needs of retailers and their suppliers list trade fairs workd wide, including Europe) http://www.Europeanservicespass.com/home/fairs

Pure Womenswear (Dedicated to Women's Wear in the UK) http://purewomenswear.co.uk

Internet Sites and Useful Organizations

AEDT (European Association of National Organizations of Textile Retailers) http://www.aedt.org

International Apparel Federation (IAF) http://iafnet.org

European Apparel Associations

Country	Name	Leadership	Address	Contact
Austria	Fachverband der Bekleidungsindustrie Osterreichs	Chairman: Mr. Wolfgang Sima Director General: Mr. Franz J Pitnik	Wiedner Hauptstrasse 63 A - 1045 Wien – Autriche Austria	T : +43 1 712 1296 F: +43 1 713 9204 www.fashion-industry.at office@fashion-industry.at
Belgium	CREAMODA Belgian Fashion	Chairman: Mr. Bernard Siau Director General: Mr. Eric Magnus	Leliegaarde 22 B - 1731 Zellik – Belgique Belgium	T: +32 2 238 1011 F: +32 2 230 4700 www.belgianfashion.be info@belgianfashion.be
Czech Republic	Association of Textile, Clothing and Leather Industry		Asociace Textilniho Odevniho Kozedelneho prumyslu – ATOK Tèsnov 5 CZ 110 01 Praha 1 Czech Republic	T: 00/420/224/805.341 F: 00/420/224/805.339 www.atok.cz atok@atok.cz

Country	Name	Leadership	Address	Contact
Denmark	Federation of Danish Textile and Clothing	Chairman: Mr. N. O Vestergaard-Poulsen Director General: Mr. Jens Bollerup-Jensen	Birk Centerpark 38 P.O. Box 507 DK-7400 Herning Denmark	T: + 45 97 11 72 00 F: + 45 97 11 72 15 www.textile.dk info@textile.dk
Estonia	Estonian Clothing and Textile Association – ECTA		Tartu mtn 63 – EE - 10115 Tallinn Estonia	T: 00/372/6/115.567 F: 00/372/6/115.568 www.textile.dk info@textile.dk
Finland	Federation of Finnish Textile and Clothing Industries	Chairman: Mr. Jussi Karinen Director General: Mr. Matti Jarventie	Etal?nta 10 FI-00130 Helsinki Finland	T: + 358 9 686 121 F: + 358 9 653 305 www.finatex.fi posti@finatex.fi
France	Union Francaise des Industries de l'Habillement (UFIH)	Chairman: Mr. Claud Tetard Director General: Philippe-Jean Lecas	8, rue Montesquieu 75001 Paris France	T: +33 (0) 1 44 55 66 60 F: +33 (0) 1 44 55 66 61 www.lamodefrancaise.org secretariatufih@lamodefrancaise.com
Germany	Gesamtverband der Deutschen Textil und Modeindustrie	Director General: Mr. Wolf-Ruediger	Frankfurterstrasse 10-14 Postfch 5340 D - 65728 Eschborn Germany	T: + 49 6196 966 233 F: 00 49 6196 42170 www.textile-mode.de eraak@textil-mode.de
	German Fashion - Modeverband Deutschland	Director General: Mr. Rasch Thomas	An Lyskirchen 14 D - 50676 K? Germany	T: + 49 221 77 44 131 www.germanfashion.net rasch@germanfashion.net
Greece	Hellenic Clothing Industry Association	President: Mr. Nicos Giannetos Executive Director: Mr. Meletis Karabinis	51 Ermou Str 10563 Athens Greece	T: +30 210 322 39 79 F:: +30 210 323 91 59 www.greekfashion.gr info@skeek.gr
	Sepee - Hellenic Clothing Industry Association		18a Ermou Str GR 54624 Thessaloniki Greece	T: +30 2310 257 075 F:: +30 2310 257 076 www.greekfashion.gr info@greekfashion.gr
Hungary	Association of Hungarian Light Industry, AHLI		Magyar Könnyuipari Szövetség Jozsef krt. 29 H - 1085 Budapest Hungary	T: + 36 1 266 06 94 F: + 36 1 266 16 25 mksz2@axelero.hu
Ireland	Irish Clothing Manufacturers' Federation	Executive Director: Mrs. Susan Doyle	Confederation House 84/86 Lower Baggot St IE Dublin 2 Ireland	T: + 353 1 660 10 11 T: + 353 1 660 17 17 www.ibec.ie/icata susan.doyle@ibec.ie
Italy	Federazione Imprese Tessili e Moda Italiane - SMI-ATI	President: Dr. Paolo Zegna Director General: Mr. Piero Costo Director International Affairs: Mr. Gianni Brovia	Viale Sarca 223 I - 20126 Milano – Itale Italy	T: + 39 (0)2 641 191 F: + 39 (0)2 661 0 3667 www.smi-ati.it gbrovia@sistemamodaitalia.com
Latvia	Latvian Textile and Clothing Association – LATVIA		Elizabetes iela 2-420 Latvia 1010 Riga	T: 00/371/9488.338 00/371/750.0267 F: 00/371/732.6169 00/371/703.9745 stragu@latnet.lv
Lithuania	Lithuanian Apparel and Textile Industry Association – LATIA		Saltoniskiu 29/3 Lithuania - 2677 Vilnius	T: 00/370/5/2790.131 F: 00/370/5/2721.127 Website:www.latia.lt latia@latia.lt

Country	Name	Leadership	Address	Contact
Netherlands	Modint	President: Mr. Harry van Dalfsen Director General: Mr. Han J.A. Bekke	World Fashion Centre Kon Wilhelminaplein 13 2.08.02 P.O. Box 69265 NL 1060 CH Amsterdam The Netherlands	T: + 31 20 512 14 16 F: + 31 20 617 06 34 modint@modint.nl directory.modint.nl modint@modint.nl
Norway	TBL Teko	Chairman: Mr. Aksel Linchhausen Managing Director: Mr. Oyvind Haugerud	Oscars gate 20 P.O. Box 7072- Majorstua 0306 Oslo Norway	T: + 47 22 59 0000 F: + 47 22 59 0006 www.tbl.no oh@tbl.no
Poland	Polish Federation of Apparel and Textiles		Ul. Kielecka 7, Poland - 81-303 Gdynia Poland	T: + 00/48/58/620.9501 F: + 00/48/58/621.6923 http://www.textiles.pl piot.gdynia@textiles.pl
Portugal	ANIVEC - National Association of Clothing Manufacturers	Chairman: Dr. F Aurelio Silva General Manager: Dr. Jorge Lemos G da Costa	Av. da Boavista 3525-7 Apartado 1398 4107 Porte Cedex Portugal	T: + 351 2 610 00 50 F: + 351 2 610 00 44 ANIVEC anivec@mail.telepac.pt
Slovakia	Textile and Clothing Association of the Slovak Republic/Asociacia textilneho a odevneho priemyslu SR – ATOP		Stefanikova 19 SR - 911 60 Trencin Slovak Republic	T: 00/421/32/7437.811 F: 00/421/32/7431.440 www.atop.sk atop@atop.sk
Slovenia	Gospodarska Zbornica Slovenije Chamber of Commerce and Industry of Slovenia Textiles, Clothing and Leather Processing Association		Dimiceva 13 SI - 1504 Ljubljana Slovenia	T? 00/386/1/5898.286 F: 00/386/1/5898.100-5898.200 www.gzs.si jadranka.marasovic@gzs.si
Spain	Gremio Industrias Confeccion Barcelona	President: Mr. Pere Prat Vice President: Mrs. Jose' Louis Marin Vice President: Mr. Julian Lazaro Secretary General: Mrs. Rosario de Vicente	Gran Via de les Corts Catolenes, 670 4-08010 Barcelona Spain	T: + 34 93 317 6200 F: + 34 93 317 6208 www.gic-bcn.com info@gic-bcn.com
Sweden	TEKOindustrierna (Swedish Textile and Clothing Industries Association)	Managing Director Trade Matters: Mr. Sven Cele	Box 5510 SE-114 85 STOCKHOLM Sweden	T: +46 8 762 66 62 F: +46 8 762 68 87 www.teko.se teko@teko.se, sven.cele@teko.se
Switzerland	Swiss Textile Federation	Chairman: Dr. Thomas Schweizer Director General: Mr. Tibor S. Pataky	Beethoven Str 20, P.O. Box 2900 CH 8022 Zurich Switzerland	T: +41 71 274 9090 F: +41 71 274 9100 www.swisstextiles.ch tibor.pataky@tvs.ch
	Swiss Fashion	Chaiman: Mr. Urs Hagmann Director General: Mr. Rolf Langenegger	Beethoven Str. 20, P.O. Box 2900 CH 8022 Zurich Switzerland	T: +41 1 289 7940 F: +41 1 289 7981 www.swissfashion.ch contact@swissfashion.com
United Kingdom	British Apparel and Textile Confederation	Chairman: Mr. James McAdam Director General: Mr. John Wilson	5 Portland Place London W1B 1PW UK	T: + 44 171 636 77 88 F: + 44 171 636 75 15 www.batc.co.uk bcia@dial.pipex.com