MALAWI: TECHNICAL ASSISTANCE TO THE GARMENT AND TEXTILE MANUFACTURERS ASSOCIATION OF MALAWI (GTMA)

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Final Report

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Individual Reports **- Confidential to each company**

ACRONYMS

ARTS	Agricultural Research and Technical Services
ACP-EU	Africa-Caribbean-Pacific-European Union
ADMARC	Agricultural Development and Marketing Corporation
AGOA	African Growth and Opportunity Act
CCI	Cotton Council International
CMP	Cut, Make & Pack
DWS	David Whitehead and Sons (Malawi) Ltd.
EPZ	Export Processing Zone
EU	European Union
GTMA	Garment and Textile Manufacturers Association of Malawi
LDC	Least Developed Country
LDP	Landed and Duty Paid
MCCCI	Malawi Confederation of Chambers of Commerce and Industry
MCI	Ministry of Commerce and Industry
MFN	Most Favored Nation
MIPA	Malawi Investment and Promotion Agency
M of AG	Ministry of Agriculture
MMTZ-SACU	Malawi-Mozambique-Tanzania-Zambia--Southern Africa Commercial Union
NAFTA	North American Free Trade Agreement
NTR	Normal Trading Relations
NASFAM	National Small Farmers Association
SADC	Southern Africa Development Conference
sme	Square Meter Equivalent
SSA	Sub-Saharan Africa

PREFACE

This technical assistance project for the Garment and Textile Manufacturers Association of Malawi (GTMA) was carried out by a two member team consisting of Brian Goshawk, textile marketing specialist and John Moody, textile and clothing technical and marketing specialist, under contract with Chemonics International Inc. To carry out the project, the team spent three and a half weeks in Malawi, visiting both Blantyre and Lilongwe, during which time they made visits to the factories of every member of the GTMA, toured all their facilities and held in-depth discussions with the senior management of each company. Apart from the industry representatives, they interviewed employees of USAID, various Malawi Government officials, bankers, freight forwarders and cotton traders.

The team participated in two meetings of the task force, set up to establish future policy for the clothing, textile and cotton production business areas in the country. An oral briefing and discussion was held at the conclusion of the visit with all members of the GTMA, together with representatives from the Ministry of Commerce and Industry. A draft report was distributed to all GTMA members at that time, and a copy given to USAID and the Ministry of Commerce and Industry, soliciting their comments.

The team wishes to thank Mr. K.K. Desai, Chairman of the GTMA and Mr. Raman Mohanlal, Treasurer of the GTMA for the time they devoted to us, for their informed advice and information and for allowing the use of their office facilities so willingly. Additionally, we thank Venge Nkosi of USAID in Lilongwe for assistance in planning our schedule, and all those other individuals who devoted so much time to us, to assist us in preparing what we hope will be an informative and useful report.

Given the need for us to gather information and make recommendations in a relatively short time, and given that there is little published information about the clothing industry in Malawi, we have, of necessity, relied upon our discussions with private sector individuals and with Government officials, as well as our own field observations. For these reasons, some factual errors are possible. To the extent that any such factual errors do exist, they are the responsibility of the team members and in no way reflect on the detailed advice and information given to us by all those, whom we interviewed.

EXECUTIVE SUMMARY

This draft report, for consideration by members of the GTMA and USAID, examines the status of the export-orientated apparel manufacturing industry in Malawi as of September 2001, and suggests how member firms can best take advantage of the opportunities for export growth offered under the terms of the AGOA.

In addition to this main report, at the request of the GTMA, we have prepared a separate and confidential short form report for each individual company in the Association, which will only be distributed to the individual company concerned.

The draft report affirms that by taking advantage of the incentives offered by AGOA, the apparel industry in Malawi has an opportunity to contribute positively to the National economy. This will help by both providing additional job opportunities and by earning foreign exchange which helps to offset in some small way the country's adverse balance of payments situation. If the existing member companies make a success of their business and show positive growth after entering the US market, then it is more than likely that others will see the opportunities available and we may then see a growth in the number of apparel companies in Malawi.

The industry today is relatively small, consisting of only 8 garment companies, and one textile company. One of the garment companies also engages in knitting and fabric dyeing and printing. The eight garment companies today employ some 7,500 people and are currently producing at a rate of 1.8 million garments per month. If they were all to utilize 100% of their existing sewing equipment and manage within their existing factory confines, then total monthly capacity could be increased to 2.75 million garments per month and they would need to employ some 11,000 workers in total. Beyond this figure, the factories could further increase production by working more than one shift, or in the longer term, they would need to build additional capacity.

Four of the companies have foreign ownership, and four have local owners. Two of the companies are financially strong enough to sell to US buyers on FOB terms, whereas all the rest are working on a Cut, Make & Pack (CMP) basis, with the buyers supplying all the raw materials. To maximize foreign exchange earnings and profits, all companies should work towards doing as much business as possible on FOB terms.

The most important factor for an industry which is acknowledged to be extremely labor intensive, and which makes Malawi a viable exporter of apparel to the United States market, is the plentiful supply of very inexpensive labor. Together with the duty free and quota free access to the market which AGOA has provided, it is a powerful combination which more than compensates for the following negative aspects of working in Malawi. The country is landlocked, which adds to the cost of importing raw materials, and lengthens the production lead times. The cost of money is extremely high, making it unprofitable to compete with many countries when the effect of the high interest rate is taken into the costings. The workers, whilst being paid at very low levels, are also not too productive, and have a limited amount of formal education, with consequential difficulties in following instructions. Finally, unless the spinning and weaving mills of David Whitehead are rehabilitated, it will not be possible in Phase 2 of the AGOA, for exporters in Malawi to source the fabric in country. In

Phase 1of AGOA, manufacturers in Malawi are allowed to source the fabric from any country in the sub-Saharan region, so the business can still continue without a David Whitehead presence, but this lengthens the lead times and costs more due to the financing costs and to the extra freight charges, for importing the raw materials.

We referred earlier in this summary to the relatively small size of the apparel sector in Malawi, and for this very reason, the attitude of Government towards the industry is not likely to be as supportive as it is for say large agricultural activities. We advocate that the garment industry is likely to be better represented if it were possible to establish a Cotton Council to represent all sectors from cotton growing through to garment manufacture. There are many points of common interest amongst these various sectors, and a new Council speaking with one voice for all the sectors is more likely to gain attention and perhaps get Government support and interest in their concerns.

The needs of the various companies do vary, since the foreign owned companies have a pool of resources not so easily available to the local companies. The latter particularly require assistance with marketing to US customers, and many also will need help to identify fabric suppliers as they move to FOB terms, as well as requiring access to cheaper financing.

As the industry grows, it will require a larger number of skilled production and quality supervisors. This will be a common problem for all companies, big and small and it would be very much more cost effective if more local Malawi people can be trained for these additional positions, rather than employing more expatriate staff. Such training might well be organized by either the GTMA or by a Cotton Council should it come into being, and specialist trainers can be brought into the country as required to run specific courses.

We are attaching to this summary a list of all the actions, which we recommend might be taken, to bring the Malawi apparel industry up to a level, where it can compare favorably with most of the other garment exporting countries in the world. This list is not in any particular order of priority, and not all the recommendations apply to all companies

RECOMMENDATIONS

Recommendation	**ACTION**
1 Develop relationships with potential US customers by visits to buying offices, agents' offices and attending trade fairs etc.	All companies
2 Send mission from exporting companies to Far East to coincide with Interstoff, Asia to develop sourcing opportunities and meet buyers	GTMA
3 Investigate sources of yarn and fabric supply in other SSA countries to prepare for second phase of AGOA	All companies
4 Meet Reserve Bank officials to promote the idea of a two tier interest rate system permitting preferential rates to finance imports by EPZ companies	GTMA and Export Promotions
5 Organize training for middle management and supervisory levels e.g. pattern making, cutting, quality control and line balancing	GTMA
6 Establish industry -wide “Cotton Council”	MIPA,GTMA other Ministries
7 Negotiate on industry -wide basis with transport companies for bulk rates for inward and outward shipments to Durban	GTMA
8 Prepare individual company business plans, setting objectives and targets for marketing, quality and productivity issues	All Companies
9 Seek out ways to revitalize David Whitehead on sound basis as a support to the apparel industry	MIPA, GTMA with ADMARC
10 Establish cotton seed program to improve quality and yield	Min of Agriculture MIPA, ADMARC Great Lakes

1 MISSION

To provide technical assistance to the GTMA to allow them to take advantage of the opening-up of the United States apparel market under the terms of the African Growth and Opportunity Act (AGOA).

2 THE ASSOCIATION

GTMA is an association of garment and textile manufacturing firms, which was established in 1996 to provide a forum for addressing a variety of issues, opportunities and problems facing producers in the sector. It is committed to the expansion and development of the sector as a leading contributor to the growth of jobs, incomes and foreign earnings in the country. Its membership includes producers, both publicly and privately owned (see Annex A). The Ministry of Commerce and Industry (MCI), the Malawi Investment Promotion Agency (MIPA), and the National Working Group on Trade Policy are all ex-officio members and are invited to all GTMA's meetings and functions. The Association is also a member of the Malawi Confederation of Chambers of Commerce and Industry (MCCCI).

There are now only eight apparel manufacturers in the GTMA, four of them locally owned and four owned by Taiwanese or South African companies. One other member, David Whitehead and Sons (Malawi) Ltd. (DWS), is a textile manufacturer, and is wholly owned by various elements of the Malawi Government.

3 OBJECTIVES

A number of objectives are set out in the task order, and we have addressed these in various parts of this report.

- Article IV.A

Most of the fabrics needed to adequately service the requirements of the targeted buyers in the USA are simple sheeting and twill woven constructions and single jersey and pique knits. During the first four years of the AGOA, the most competitive sources of supply for these fabrics can be utilized i.e. the Far East (see Para 11.5). From year 5 onwards, it will be imperative to source such fabrics from the SSA countries. Should David Whitehead not be able to assist with reliable, well-priced fabrics, then yarns and fabrics must be sourced in Zambia, Tanzania, Zimbabwe etc. and perhaps from Mauritius or South Africa.

At the time of placing orders, the buyers normally supply the detailed design specifications for both the fabrics and the garments. These are so varied and change so much depending on the specific style and type of garment, that it is not practical to attempt to define them in this report.

The issue of quality is discussed in Para.11.2 and a proposed marketing system is set out in Paras 11.4,12 and 14.

- Article IV.B.1

We have performed an evaluation of each of the firms in Malawi, interested to participate under AGOA, and have prepared a separate report on each company.

- Article IV.B.2

Technical and Market development strategies are discussed in Paras 11.4 and 14.

- Article IV.B.3

As outlined in Para 11.5, we advocate that the garment companies in Malawi should visit the Far East to survey the sourcing opportunities for fabrics, garment accessories and machinery. It would be very feasible to organize a mission of interested parties, accompanied by an experienced advisor.

- Article IV.B.4

Para 14.1 addresses some of the technical inadequacies, as do the individual company evaluations. The financial inadequacies are discussed in Para 11.6.

- Article IV.B.5

Para 11.4 sets out some guidelines for establishing contacts with agencies in the destination markets, and again this would be most comprehensively and effectively followed up through a conducted mission to the Far East.

4 BACKGROUND

In October 2000, Malawi was among the more than 24 countries designated as eligible to benefit under AGOA. The purpose of the act is to promote trade and investment between the United States and sub-Saharan countries. Malawi appears to have a comparative advantage for the export of clothing to the USA and recognizing this opportunity, USAID/Malawi is assisting the GTMA to develop a strategy to take the maximum advantage of this.

Malawi has a fairly short history of garment manufacturing for export and this has been largely with the South African market. Much of the exports were developed as a result of a bilateral agreement signed in 1994, which gave Malawian exporters virtually unlimited access to the South African market. With the subsequent establishment of the Southern Africa Development Community (SADC), apparel manufacturers believed that this access would continue without any interruption or change, and that in fact access would be expanded in open competition with other regional countries. With a relatively skilled labor force and low wage levels, combined with high unemployment and few alternative opportunities for jobs, it was anticipated that Malawi would have a distinct competitive advantage in this area.

What happened instead was that an influential group of Trade Union officials and protected domestic producers put the South African Government under strong pressure to restrict imports from Malawi. This resulted in a great deal of harassment of Malawian exporters with the end result that South Africa was removed as a credible market for would-be investors in Malawi. In addition several Malawian producers were forced to close down, putting several thousand employees out of work.

Following this downturn in the South African market, there has been little new investment in Malawi's textile market, and even in those cases where a company has managed to survive, production facilities in many factories have suffered from inadequate financial support and equipment has not been updated or well maintained. The exceptions to this were the 2 or 3 larger international groups, whose parent companies provide them with markets for their production, as well as access to supplies of raw materials at most competitive prices, supply of new equipment when required and adequate financing. Two of these companies have already been exporting to the USA, with the importers paying normal import duties at MFN (Most Favored Nation) rates. This terminology has been changed and MFN has now been renamed as Normal Trading Relations (NTR).

Given help in establishing international supply, technology and marketing links, it is anticipated that the other Malawian garment companies will have the means to respond to the AGOA opportunities.

Although the problems with South Africa have now been largely resolved, the experience underlines the vulnerability of a country or a company, when relying mainly on only one export market. AGOA comes at a most opportune time, allowing Malawian exporters to spread their sales geographically, and introducing a new vital market.

This report tests the assumption that the firms in Malawi's textile and garment manufacturing sector have the potential to respond to the AGOA market opportunities.

5 THE AFRICAN GROWTH AND OPPORTUNITIES ACT (AGOA)

The purpose of this Act, promulgated by the Commerce Department of the United States Government, is to promote trade and investment between the United States and the sub-Saharan African countries (SSA), and it is targeted mainly at the apparel manufacturing sector in those countries. The Act permits exports of clothing, manufactured in qualified SSA countries, to be imported into the USA free of any quota limitations, and free of all the normal NTR import duties. The effective time scale of the Act is from October 1st 2000 until September 30th 2008.

Currently some 24 SSA countries are eligible for qualification as beneficiaries of the Act. Most of these are classified as "least developed", which is defined as being a country with a per capita income of less than US$1,500 per annum. Six of the countries are classified as "not least developed, namely South Africa, Mauritius, Seychelles, Gabon, Namibia and Botswana. Malawi is included in the list of "least developed countries" (LDC).

There is a demanding and fairly complex qualifying process, which must be completed between the US Authorities and each beneficiary country, before they can start to avail themselves of the quota and duty free benefits. As at September 2001, only seven of the eligible countries have qualified and Malawi did so only on 17th August 2001.

With some exceptions, duty- free access is capped during the first year of the agreement at 1.5% of total US apparel imports during the most recent 12 months for which import data is available, growing in regular annual increments to 3.5% after eight years. It is significant that the percentage cap each year is based upon actual imports during the preceding year. In other words, the percentage cap will grow as the volume of total US imports grows. Typically this has averaged about 10 % per annum in recent years. It is also important to note that the cap is based upon the volume of imports and not the value. The volume is expressed in square meter equivalents (sme). This is of importance, since apparel imports from the region in 1999/2000 accounted for 0.9% of US apparel imports by volume, but 1.15% by value. Thus the volume-based cap allows more room for the growth of duty -free imports.

In 1999, the total volume of US apparel imports was 14,245 billion sme, of which 128.2 million sme was imported from the SSA countries. It is projected that at 1.5% in year one of the Act, the volume eligible for duty free access will be approx. 211.5 million sme, and in year two with a cap of 1.768% the volume will rise to at least 251.9 million sme, a growth of 96% over 1999. In value terms, total US imports of apparel in 2000 amounted to US$64.2 billion, and with a 1.5 % share, this would theoretically give the region a cap for duty -free access of $964 million in year one.

5.1 Main Provisions of the Act

- If apparel is made wholly from US manufactured yarn or fabric and the garment sewn with US thread, apparel produced in the qualified countries can be imported quota and duty-free with no cap.

- If apparel is made from regional fabric or regional yarn, it can be imported quota and duty-free into the USA up to a cap of 1.5% in the first year, rising to 3.5% in the eighth year.

- It should be noted that "regional " means the least developed countries, and the 6 not least developed countries must use either US materials or materials manufactured in their own country.

- For the first four years of the Act, i.e. up to September 30th. 2004, the least developed countries can use materials imported from any least developed country in the World, not solely from the region, and this apparel qualifies for the duty and quota-free benefits. The six not least developed countries do not have this benefit.

- During the last 4 years of the Act, the least developed countries who have qualified, must only use yarn or fabric produced in the region. Again the six not least developed must continue to use materials from the US or manufactured in their own country.

See Annexes B and C for further details about AGOA.

6 NORMAL QUOTA AND DUTY STRUCTURES FOR APPAREL IMPORTS INTO THE USA

To put into context the advantages, which Malawi and the other qualified countries in the region will enjoy as a result of AGOA, it is pertinent to review some of the quota arrangements and duty rates, which are imposed by the US Customs on other exporting countries.

6.1 Quota arrangements

Most of the major apparel exporting nations in the world have, over the years been forced to negotiate quota limits with the USA, restricting the quantity of textiles and clothing which they can export to the USA in any one given year. The total quota is divided into many sub sections, with separate limits for yarns, fabrics and clothing. These are often sub-divided into fiber groupings such as man-made or natural fibers, and then once more the quotas are split up into different garment categories, i.e. mens shirts, ladies dresses, children's tops etc.

Since the imposition of quota limits is a restricting mechanism, in many of the more competitive exporting countries, the suppliers have more production capacity and can obtain more orders than there is quota available. This creates a demand for the available quota within that specific country and as a result the quota is traded amongst the exporters for a transfer fee. In China, for example, the Government firstly allocates the quota to the exporters for a fee. Exporters will often sell on their quota, at a profit, to a company who has orders, but insufficient quota to fill them.

These quota costs must be passed on in some form to the buyer. The cost of quota varies due to many factors, such as the timing, with quota being cheaper at the beginning of a year when there is plenty of quota available. Also some garment categories are not in so much demand, so such quota is often available at no cost. Other so-called “hot” categories are always in demand, and fetch higher prices. These categories are those where demand is consistently high from the market, such as men's and ladies jeans and twill pants, men's knit and woven shirts and T-shirts. To give some examples, in China, the cost of the quota for cotton jeans and pants (Cat 347/8) is consistently around US$ 1.50 to 2.50 per pair and for knitted polo and T-shirts (Cat 338/9) ranges from $ 1 to 2 per shirt.

The cost impact for a buyer is that for a plain T-shirt for example, the ex-factory FOB price is around $2.00 and with quota costs added, this rises to $3 or 4 per shirt.

6.2 Import Duties

With few exceptions, such as Mexico and Canada (who trade with the USA under the terms of their NAFTA agreement) all apparel imported into the USA attracts import duties. The rates of duty vary, depending on the fiber composition and on the category of garments. For apparel made of cotton or mainly of cotton, the duty ranges from around 14 to 22 % of the FOB cost. For clothing made chiefly from man-made fibers, the duties range up to some 35%.

The USA has two levels of import duties for clothing. For most exporting countries, the duties are leveled at rates set by the Normal Trading Relations protocols. Most countries in the world qualify for the NTR duty rates, with a few exceptions, such as North Korea, Cuba and Vietnam. Imports of apparel from these particular countries can attract import duties of up to 100% of the FOB value.

An increasing number of countries, however, and in particular the least developed countries, are being given duty-free status for their apparel exports, putting them in the same favorable position as Malawi. These include Mexico, (now the largest supplier of garments to the USA), most Caribbean countries, Jordan, Israel and of course the SSA countries.

7 THE CURRENT SIZE OF THE MALAWIAN APPAREL EXPORT INDUSTRY

As at September 2001, there are eight apparel-manufacturing members of the GTMA, all of them with EPZ status (Export Processing Zone). Apart from these eight companies, there are no other apparel manufacturers of any size in the country, the remainder being very small tailoring establishments employing from 2 to 10 workers and concerned only with the relatively small domestic market.

We visited each of the eight member factories, inspected all their facilities and held discussions with their senior management. Based on the information we have been given and on our own calculations, we give below the approximate present size of the industry and what their potential size could be, if they were to fully utilize all existing equipment and not have to take on more factory space or machinery.

Description	Present Status	At Full Capacity
No. of Employees	7,500	11,000
Monthly Capacity (pieces)	1.8 Million	2.75 Million

8 THE APPAREL MARKET IN THE USA

The market for clothing in the USA is vast. With just 5% of the world's population, Americans consume 22% of the world's textiles and clothing. The USA still has a very large and important domestic apparel industry, but in recent years imported clothing has grown to be larger than what is produced domestically. In the year 2000, total imports of apparel were U.S$ 64.2 billion.

The market is quite clearly segmented by selling price considerations, snob-value labeling and quality levels.

Top End Buyers	Major designer brands i.e. Pierre Cardin, Polo, Ralph Lauren, Valentino etc.
Middle Market	Well-known brands i.e. Levi, Gap, Lee, Wrangler, Van Heusen and some house brands like J.C. Penney
Mass Market	Discounters i.e. Wallmart, K-Mart, Target as well as some mail order and the budget-priced importer /wholesalers

Each of the above market segments has its own quality demands, and the higher up in the quality/brand name chain one goes, the more demanding the requirements for the supplier. It is likely that buyers in the top end and middle market sections of the business will be content at this time to continue dealing with their existing suppliers of garments. They can generally afford to pay a little more for their garments than is paid by the discounters, and for this, they expect a very high standard of service and quality.

We recommend that exporters from Malawi should concentrate on developing clients in the mass-market sector. The prices are very sharp, but can be easily achieved from Malawi at current labor costs and using raw materials from China, India etc. The quantities per style or color from such buyers can be very big.

In general, the quality requirements are not quite as demanding as from the buyers in the upper levels of the market, although it is still very important to at least achieve the standards agreed in the contract, and it is vital that an exporter keeps to the agreed delivery schedule.

9 OTHER MARKETS

Today Malawi has only two existing and viable export markets, South Africa and the USA. In both cases there are no import duties imposed on the garments being sold, which gives Malawian exporters a very considerable trading advantage. With an annual cap of 8.5 million garments to South Africa (700,000 per month) it is evident that the current level of exports from Malawi to South Africa, is running at a much higher level than can be sustained on an ongoing basis. At the present shipping rate, there is a real danger that the quota for South Africa could fill before the end of the quota year. Therefore it is imperative that the US market be developed very quickly if the industry is to maintain the current level of production, let alone get production up to the total existing capacity.

Per capita spending power of the average man in the street in Malawi indicates that there will not be any substantial domestic market for clothing for some years to come. The lack of disposable income will continue to direct a great deal of apparel purchasing by Malawians to the second hand clothing outlets, who offer very cheap clothing in large quantities widely available throughout the country.

The second largest market in the world is the European Union (EU), which has 7% of the world's population, and which consumes 18% of the world's production of textiles and clothing.

The EU countries do permit clothing to be imported from some third world countries free of any import duties, provided that the raw materials have also been produced in the exporting country. As a result, there are substantial imports from Turkey, Bangladesh and Cambodia as well as from some of the North African countries and other beneficiary nations of the ACP-EU Partnership Agreement renewed last year at Cotonou.

For Malawi to be able to benefit from this, yarn and/or fabric would need to be produced in Malawi. The only existing facility is the textile manufacturing plant of David Whitehead, which is virtually at a standstill. Rehabilitation of this factory would permit Malawi to offer products to the EU on an equal footing with the other existing protected suppliers. This would not be an easy marketing exercise, since Malawi would be trying to wrest away business from existing suppliers, who are established and have a reliable track record.

10 CRITERIA FOR ENTERING THE US MARKET

For garment manufacturers to succeed in gaining a foothold in the US market, the following criteria must be met. These actually pertain in equal measure to all other developed world markets. We will examine the state of preparedness of the apparel makers in Malawi against these criteria in the following chapter**.**

- **Competitive pricing:** Malawi must be at least on a par with other AGOA countries.
- **Productivity:** although labor is cheap, the competitive edge can soon be frittered away by over-employment in an attempt to achieve production numbers
- **Quality:** care must be taken to match customers agreed quality levels, since shipping defective quality will normally result in expensive claims and loss of a customer.
- **On-time delivery:** Customers depend on this to ensure they keep their stores well stocked all the time. Late delivery means loss of sales for the customer, who will often not place repeat orders with an unreliable supplier
- **Ethical trading practices:** all over the Western world, human rights movements are forcing retailers to ensure that the products they sell are produced in countries where human rights are respected, and that workers can enjoy safe and clean working conditions
- **Adequate financial capability:** this is taken into consideration by many buyers especially when placing large orders. They normally check a suppliers financial status, since they wish to be certain, that lack of funding will not result in non delivery of the ordered merchandise.
- **Market knowledge**: an understanding of the mechanics of a buyers market is essential to building a close working relationship or partnership with the buyers.

11 CURRENT STATE OF THE APPAREL INDUSTRY

11.1 Prices and productivity

The cost of labor in Malawi is as low or lower than in most other third world countries, where apparel is being made for export. Our survey revealed that average take-home wages in the GTMA members factories amounted to about MK 2,400 per month, which included lunch and travel allowances etc. Equivalent to about US$40/month, this is more or less on a par with Cambodia, and compares favorably with Vietnam and Bangladesh at about $50/month and with Northern and Eastern China at about $60/month and Southern China around $100 /month. Wages in some other regional countries are much higher, viz. Mauritius, South Africa and Botswana as they are in most North African countries as well as in Turkey and Portugal.

On the other hand, productivity in Malawi remains low, with a low level of output per machine day. Added to this, is the expensive habit in the factories to over employ, working on the false assumption that since labor costs are so low, it does not matter if a factory has an excessive number of workers. Whilst fully appreciating the urgent need in the country to find jobs for as many people as possible, this over employment can in fact be counterproductive.

There is always a temptation for the workers to waste time in chatting etc, and the cost of making a garment is higher than it should be, thus eroding the country's competitive edge. More time spent in training the operatives would result in increased productivity from each individual worker. Our observations showed, that on average in the seven working factories we visited, the ratio of actual machinists to non-machinists was about 1:1 and sometimes higher. In an efficient factory in Asia, we would expect one ancillary worker to every two machine-operators. This would encompass all the cutting, pressing, packing and quality checking operatives.

11.2 Quality Issues

The standard operating method for buyers of clothing in the USA is to submit a sample for pricing and counter sampling. Once price and delivery etc has been agreed, the buyer demands an approval sample, which he will examine, amend as necessary, and he will normally "seal" the approved sample as a standard for the order.

This sets the standard for production and makers should not deviate from this unless authorized to do so by the buyer. Normally, during the production cycle, the buyer, or his agent, will visit the factory to ensure that the quality is in line with the sealed sample, and will request changes if necessary.

Our observations are, that all the factories we visited are already making a product, which would be acceptable from a quality point of view in the sector of the market we have identified, i.e. the discounters etc.

We observed that in some factories, new sewing machine operatives are often seated side by side with an established operator, and the intention is that he should learn the process by example. This is not to be recommended as a procedure. This approach saves management time in training, but the results are usually not satisfactory, and the trainee generally picks up all the bad habits of the old operative. It is far more effective, and raises the standard of a factory's production, if some formal training can be given to all new operatives, even if they do come from another manufacturer and have some previous sewing experience.

Training of operatives can normally be carried out by the factory production supervisors and where possible by a dedicated supervisor, who runs regular training sessions covering all new operatives. Quality levels and more importantly productivity can be raised in a marked fashion, if a factory can organize training of the factory supervisors in both the quality assurance areas and in production. The GTMA might well be the forum for organizing training courses for the Industry. A similar role might be assumed, by a Cotton Council, should this idea come to fruition. We discuss this issue of establishing an organization to be called the "Cotton Council" in a subsequent paragraph of this report. There are a number of companies in Europe and in the USA, who specialize in organizing training courses in offshore companies, particularly where any degree of technical know-how is required. The regular teaching approach of such companies would be to carry out this training on production equipment in a factory environment, rather than in a classroom.

11.3 Timely Delivery

It is essential that manufacturers have a good understanding of the demands of the market. For example, when new seasonal merchandise should be delivered into store, and the problems facing a buyer if merchandise arrives late into a market, and subsequently has to be reduced in price to close it out before the end of a season. By cooperating closely with buyers and getting merchandise out of the factory on or before the deadline, an exporter is often able to gain the confidence of his buyers, thus encouraging repeat business.

Another facet of the apparel retailing business today is the ever growing desire by buyers to reduce lead times from the time of ordering up to the time merchandise arrives in store. There is now a widespread pattern for all retailers and wholesalers to do all in their power to reduce their inventory levels, which improves their cash flow and makes mistakes in ordering merchandise less likely. It would be helpful to buyers, if the exporter in Malawi could demonstrate that he understands these market requirements and does all he can to reduce the lead times.

In this respect, the landlocked nature of the country is not a helpful factor. Again, if David Whitehead was operating normally, lead times could be reduced substantially. But assuming that fabric is coming from the Far East, it will generally take some 25 days to arrive in Durban and then to get the fabric from Durban to the factory requires a further 10 to 12 days. The exporter should do all he can to produce the order within 30 days of fabric arrival in his factory. Transportation to Durban will again take 10 to 12 days, and then the vessel takes about 20 to 25 days to reach the West Coast Ports. This does not allow any leeway for delays at the border and it is not uncommon for Customs authorities to delay clearance for several days.

Thus, the total lead-time from shipment of fabric from the Far East to arrival of finished garments in the USA, is about 105 days, or 3.5 months. For comparison, the same order given to a factory in China can reach a port in the USA within 60 days, and for countries like Sri Lanka or Bangladesh which like Malawi also have to import all their fabric, their lead times are about 90 days. The inducement to make a buyer live with a longer delivery period from Malawi would be to offer him a quality level equal to suppliers in other countries and at a cheaper landed and duty paid price (LDP).

11.4 Knowledge of the US Apparel Market

With the exception of the two or three companies in GTMA, whose parents in Taiwan or South Africa do all the selling for them, the remaining members have not had a great deal of experience in dealing with the US apparel market. As a result, our advice is for all members to make a special effort to acquaint themselves with the way this market works and to develop a circle of potential customers as soon as possible.

To learn about the market, read everything available about it. Study buyers' web sites on the Internet, read all the trade magazines, and in particular talk to visiting buyers from the US or their agents and really question them. The average international buyer likes to feel that his suppliers understand how his business in the US works, because then, when problems of any sort arise, an understanding of how this will impact on the buyers business often assists the supplier to see a way to resolve the problem.

The supplier in Malawi, who does not have many existing connections with US buyers will have to show some initiative and go out to find clients. Some few buyers will come to

Malawi, and of course this is an easy and inexpensive way of making contacts. A few of the major US companies have their own buying offices or have agents based in the African continent, such as the A.M.C. office in Johannesburg, and there are several others within relatively easy reach in Egypt and the UAE.

To contact a wider range of buyers, a visit to Hong Kong can be very productive, since every major US company has a buying office or agent there, and a visit to Hong Kong can also be combined with a survey of suppliers of fabric and accessories.

The opportunity offered recently to the GTMA by the Cotton Council International (CCI) representative, Marsha Powell, also presents exporters in Malawi with a way to meet a good cross section of US buyers. Ms Powell advised that CCI will be hosting a seminar in Miami in April 2002, to which they are inviting some 100 importing companies as well as manufacturers from many of the countries benefiting from the AGOA.

Twice a year in Las Vegas in February/March and then again in August/September, there is a very large and important trade show, known as Magic. The purpose of this show is to present new lines of men's clothing to the nation's retailers, and almost without exception all US manufacturers and wholesalers of men's clothing participate. Magic is also visited by almost all the men's retail store groups in the country, including all the discount chains. It would be a very useful exercise for any Malawian apparel manufacturer to attend a Magic show, in order to meet possible buyers and to see how the industry works.

11.5 Competitive Sourcing of Raw Materials

It is self evident that to sell competitively to US importers, it is vital that a manufacturer should know how and where to purchase quality yarns, fabrics and accessories at the most competitive prices. At present the four foreign owned companies in GTMA rely on their parent companies to provide this service for them. The others are currently also mainly working on a CMP basis, and their customers supply the fabric etc on a consignment basis.

In the next three years, exporters in Malawi are permitted to use fabric and other raw materials from any LDC in the world, and experience shows that the most competitive sources of fabric supply are from the Far East, particularly from China, India, Pakistan and Indonesia, as well as from Korea and Taiwan for selected products.

We suggest that, if exporters in Malawi need introductions to this source of supply, it would be feasible to organize a GTMA trade mission to Hong Kong and to some of the other countries, perhaps coinciding with Interstoff in Hong Kong. This should be led by an expert, familiar with the many sources of supply and with knowledge of the main buying offices in the region.

In the final four years of the AGOA, raw materials must originate either in Malawi or in the region. Obviously, if David Whitehead can be revitalized and can offer competitive pricing, it would be very advantageous for Malawian apparel exporters to buy either yarn or fabric from them. This would result in very quick lead times, and by being able to pay in Malawi Kwacha, the exporters would be relieved of the need to open Letters of Credit to the Far East at exorbitant interest rates.

If it transpires that David Whitehead will not be a viable supply source, then exporters in Malawi must carefully investigate supply sources from the regional countries, and there are spinners and weavers in many of these countries, i.e. Zambia for yarn, Zimbabwe and Tanzania for fabrics.

AGOA rules allow duty free imports from Malawi, without any caps if exporters can use yarns or fabrics made in the USA. Cost considerations probably rule out the use of US fabrics, but it may well work for a Malawian knitter to import US origin yarn, knit and dye this in Malawi and sew garments in Malawi.

11.6 Financial Issues

There are two factors, particular to the present economic conditions in Malawi, which impact very unfavorably on the competitive advantage of apparel exporting companies in Malawi.

- The extraordinarily high interest rates charged by banks in Malawi, and
- The cost of freight in and out of the country.

As at September 2001, regular interest rates charged by the domestic banks on loans or other borrowings by exporters were of the order of 48% per annum. If a manufacturer wishes to establish a letter of credit to an overseas fabric supplier, even when he has in hand a letter of credit from the buyer in US Dollars, and where he wishes to use the incoming LC as collateral for a back-to-back LC, then, as soon as the fabric supplier draws down on the LC, the interest clock starts running and he faces an interest charge of some 4.0% per month for probably 3 to 4 months, before he can ship out the buyers order and be paid.

The cost of this interest when incorporated into the price of a garment, almost outweighs any advantage the buyer of the Malawi exporter gets under AGOA with the duty free status.

We understand that the Commercial Banks set their interest rates, dependent upon the dictates of the Malawi Reserve Bank, and they are unable on their own to set any preferential interest rates to encourage exporters. In many export-orientated countries, the Central Bank and the commercial banks set two-tier interest rates, giving a lower and more competitive international standard rate of interest to companies, who must borrow to finance their work - in -progress. Since AGOA brings fresh new opportunities to Malawi to increase exports and employ many more workers, this is perhaps an opportune time for the GTMA together with other organizations like the Export Promotion Council, to make new overtures to the Reserve Bank.

The larger foreign-owned companies do not need to finance their raw material imports, which are generally supplied to them by their parent companies. They currently work on a CMP basis and will probably continue to do so as the parent company generates profit elsewhere.

The smaller independent apparel companies in Malawi are in general not large enough or sufficiently well financed to be able to import raw materials without funding from the banks. Because of the very high interest rates, their only viable working method today is also to work on a CMP basis, and try to find buyers who will entrust their fabric to them. CMP work is the least attractive garment manufacturing option, since one is essentially just selling skilled labor. If these exporters were in a position to offer FOB terms to the US buyers, they would be able to work with many more US companies and they would be able to increase their profit margins.

The cost of sending containers to and from Durban, firstly to import fabrics and then to send out completed garments is also very high, and we have already commented on the negative effect which the long transit times create, as they lengthen the production lead times. The following are the official costs of moving both 20 and 40foot containers from Malawi to and from Durban by the 3 existing routes. These rates are negotiable and big users are getting lower costs, albeit still quite high.

Route	20 Foot Container	40 Foot Container
Blantyre-Johannesburg-Durban	US$1,156	US$2,281
Blantyre-Beira-Durban	US$1,030	US$1,961
Blantyre-Nacala-Durban	US$ 1,458	US$2,823

Most of the GTMA member companies expressed a preference for the first route, by road to Johannesburg and then by rail to Durban. From experience, they have found this to be the most reliable of the three routes, and transit time is normally about 10 days, with a quicker transfer to the ocean-going vessels than via the other two routings.

The cost factor arising from this need to first move cargo to a port in another country is also significant, and again eats into the competitive margin created for AGOA countries, by the waiving of import duties. To take one hypothetical example, it is known that approx. 18,000 pairs of men's cotton trousers can be packed in a full 40foot container. Thus the extra freight cost just to get the container to the port of Durban is US$0.125 per pair of pants, and to this must be added 3 or 4 cents to cover the cost of getting the fabric from Durban to the factory.

Malawi is landlocked, and it is therefore inevitable that there will always be an additional cost incurred for getting goods to and from the port. It is to be hoped that as the business grows, the companies carrying this freight will be able to reduce their prices, due to economy of scale.

11.7 The Decline of Malawi Cotton

In recent years, the Malawi cotton crop has been declining, and in this year, 2001, will amount only to some 5,000 to 6,000tonnes of lint, down from a high of some 15,000 to 20,000tonnes. The main reason for the poor crop this year was a combination of bad weather conditions, and the declining potential of the seed in terms of yield /ha and lint quality. This problem is compounded by insufficient use of pesticides and fertilizers.

This is of major concern of course to the tens of thousands of farmers and their families, who grow cotton, as well as to the ginneries, who can now only work at a fraction of their capacity.

It is also of importance in the context of developing a strong textile and clothing industry in Malawi. A supply of good quality Malawi cotton, and a capable rehabilitated David

Whitehead factory, would allow garment factories in the country to buy local yarns and fabrics, ensuring that all the most stringent of origin rules are complied with. This would be an important factor to the survival of the Malawi apparel exporting companies in the fifth to eighth years of AGOA. It would also satisfy EU regulations and give local exporters the opportunity of competing in another large export market.

12 ETHICAL TRADING STANDARDS

Over the past 20 years, attention in the USA and in most other developed countries has become more focused on conformity with a set of ethical trading standards, not for the clothing industry alone, but for many other industries as well.

Manufacturers have become increasingly aware that they have a duty to ensure that working conditions in their factories are such that all employees can work in a safe and clean environment. Manufacturers must accept that employees will expect to be treated in a decent and civilized way. They expect that they will be paid a fair wage, within the normal boundaries of salary scales in their respective countries, and they expect that they will not be exploited by being forced to work unduly long hours or work under substandard conditions.

Almost all major apparel companies in the USA, and in most EU countries have moved in this direction, and we attach as Annex D some conditions promulgated by Marks and Spencer of UK. They issue this document to all their suppliers throughout the world. This document is quite representative of the criteria used by all the major players, and we believe it will serve as a good guide to clothing manufacturers in Malawi.

In the individual company reports that we prepared after visiting each factory, we have drawn attention to any deficiencies we observed. In summary, we found that only 2 factories would in our view be approved immediately by the auditors of any major buyer. In three cases, there were a few relatively important deficiencies, but it would be possible to put them right with little effort. The other three factories need to make some significant changes to be sure of being accepted as approved suppliers.

13 COTTON TEXTILE INDUSTRY STRUCTURE

We have observed that there is no one body, which represents the industry as a whole, and indeed even some sectors of the industry have no mechanism to express the needs of their sector with one voice. We support the concept of creating a “Cotton Council” in Malawi, with the aim of bringing together representatives from all sectors of the industry including farmers, ginners, cotton traders, textile manufacturers and apparel makers. Concerned government departments should also be represented, such as the Ministry of Commerce and Industry and the Ministry of Agriculture and MIPA. Where a sector already has an association, such as GTMA and NASFAM, then that existing body should be the representative for the sector in the Cotton Council.

The aim of this body would be to ensure that in every sector of the industry, the concerns of all sectors are understood and that the members all work together to help resolve each others problems and concerns. This council would talk on behalf of the entire industry to Government and to other outside agencies.

Subject to adequate funding, there are many areas where the Council could play a key role i.e. industry training for managers and supervisors, compiling accurate industry statistics and working with Government, whenever there are issues with other countries which affect the cotton industry in Malawi.

An operating budget would need to be prepared, and methods of funding the organization agreed. Funding could be by way of membership fees or perhaps by some system of imposing a levy on some of the operations.

To bring together such a diverse collection of business and Government interests will probably need the services of a skilled, but independent negotiator, who would assist in setting up this vital new body.

14 STRATEGIC ISSUES

We have prepared separate confidential reports for each member company of GTMA, in which we have addressed any specific technical, management and marketing requirements. The following general observations are worth mentioning.

14.1 Technical Strategy

Garment sewing operations are relatively uncomplicated, as is the machinery, and therefore a factory producing clothing for the targeted clientele at the present time in Malawi does not require much in the way of sophisticated equipment. We do recommend, that each operative be instructed to thoroughly clean his machine, say once a week, so that there is minimum risk of oil or cotton fly contaminating the fabrics. Periodic and planned overhaul of each machine should be carried out by the company mechanics, and a good time to do this is on Saturdays, when the factories are normally closed.

Finally, as a company develops its business with the USA and after it has reached a stage, where it is working continually for a circle of clients at full or nearly full capacity, thought should be given in all cases to planning a program of machine replacement. As a group of machines are replaced, the model should be upgraded, incorporating devices like thread cutters, so that the factory can simultaneously reduce staffing numbers and become more cost efficient.

14.2 Management Strategy

Typically, the smaller companies in Malawi are owner-managed, with a small management team. In most cases, the supervisors are expatriates from Sri Lanka, Taiwan and Bangladesh, where they have received training in their fields and where they acquired experience. It is desirable to gradually train local people to achieve these supervisory skills. This is obviously more cost efficient and permits a company to gradually expand its capacity and quality without incurring the expense associated with hiring more and more expatriates.

We further suggest management sets up monitoring systems and improvement targets for themselves in some key measurable areas, such as the number of defective products made and the enhancement of productivity levels.

14.3 Marketing Strategy

Paragraphs 11.4 and 11.6 discuss some possible ways to enter the US apparel market, and comment on the general need to start by working as a sub contractor on CMP terms of sale.

Initially the targeted buyers for the US market will most likely be companies based in Taiwan, Hong Kong or Korea, who already have a solid business with established US importers and who have gone offshore already with their manufacturing to other more cost effective countries. Other possible suppliers to the US market may also be found in Mauritius or South Africa, tempted to produce in Malawi as well as in Madagascar, since for another 3 years at least, Malawi exporters are permitted to use inexpensive raw materials from any LDC. By contrast the Mauritians and South Africans, manufacturing in their own countries, must use materials made in their own countries.

In this initial phase, exporters in Malawi should gradually learn all they can about the US market, and develop a circle of buyers, so that as soon as financial circumstances permit, they can begin accepting FOB business at enhanced margins.

Within the limits of the quota available to each company, they should continue to supply the South African market, and use all of their allocated quota. All remaining production capacity should be for the US market. Production planning is critical, so as to ensure the factory works at full capacity on a continuing basis, greatly aiding overhead recovery.

If a company gets to a situation, where they do have full order books all the time for a protracted period, it normally follows that productivity will rise and quality levels will also improve as the workers become more skilled. At that point, it may be worthwhile for an exporter to start looking for more up-market buyers, who can normally pay slightly higher prices, so that profit margins can be enhanced. It is also very helpful to be able to get orders from a company with a well known brand name, since it is always a good selling point to be able to demonstrate to new buyers, that a factory is successfully working with a well known brand, and achieving the necessary quality levels required by that brand.

15 DAVID WHITEHEAD AND SONS - A CRITICAL ROLE

Elsewhere in this report, we have shown how this company, if revitalized and properly managed and financed could play an important role in helping in the growth of a currently small but dynamic apparel industry in Malawi. It would be key that the products be to internationally acceptable quality standards with prices as close to Far Eastern levels as possible, whilst permitting a small premium to adjust for the freight and financing charges, which are incurred when importing from the Far East.

DWS is directly, or indirectly, wholly owned by the Malawi Government. It is well known that it is carrying a huge debt to a variety of creditors, it employs some 1,800 people at this time, which is far in excess of the number required to run the factory at recent capacity, and what is being produced is of very poor quality. In addition, at the present time, the company is operating without a Chief Executive fully experienced in the industry. There has been no investment in new equipment for many years, and there is not even sufficient money to buy spare parts for the existing equipment.

From a peak output of over 30 million meters per annum in the early 80's, the annualized production capacity today is around 1.5 million meters. To reactivate the operations, present management forecasts that they require urgent new funds of US$ 2.5 million, which will provide working capital for about 1 year, plus sufficient money to import all the required spare parts and some new cards in the spinning department. Given this additional funding, management believes it can start to produce first quality yarns and fabrics again, and that within about 1 year, they can take production back up to some 1.5 million meters/month.

Government is anxious to privatize the company, but all efforts to date have been unsuccessful. We submit that it is fairly unlikely that a suitable investor will be found for the following reasons:

- Even given that in a privatization situation, it could be so arranged that the debt burden be fully forgiven and that the new owner would have some latitude in handling the problem of the excessively high workforce, an investor would have to inject a very large capital sum to bring the machinery up to a reasonable working level, and provide enough working capital to run the factory until the time when it can be made to break even.

- There is already an over capacity in the world in the spinning and weaving industries, so much so that China for example has carried out a forced reduction of over 3 million spindles in the country just a few years ago.

- The future for the apparel industry in Malawi is somewhat uncertain in that the makers will be relying on exports to two markets only. In both cases there are at present some time limitations on the arrangements, which make the business viable. In the case of AGOA, there is no certainty that the benefits will extend beyond September 2008, and in the case of South Africa, the present trade deal is due to expire at the end of 2005.

- An additional factor is that at the end of 2004, it has been agreed that all existing quota controls, imposed on textile and garment imports by the USA, Canada and the EU, will be dismantled. This will certainly have a large impact on prices, and for example, prices of ready made clothing from China can be expected to fall as the quota premiums disappear, and we can expect to see completely different and lower prices being offered to the developed importing markets. The uncertainty about how the market will realign, will also be a deterrent to any investor looking at putting money into a relatively small and inexperienced exporting country like Malawi.

- The domestic market in Malawi is not very attractive to any erstwhile investor in a textile manufacturing plant. There is some business demand for printed fabrics for javas etc, and the current Whitehead management estimate that this could account for up to 500.000 meters /month. This area is however affected by the continual flow into the country of smuggled fabrics, imported from the Far East at very low prices which even copy original Whitehead designs. There is virtually no demand for fabrics to be made into clothing for sale in the domestic market. This market is very small, and the majority of Malawians do not have sufficient disposable income to buy new clothing, so they resort to purchasing imported second hand clothing available in huge amounts all over the country.

The benefits of having this factory rehabilitated and running again at good capacity and producing good quality fabrics at reasonable prices are clear as far as both the apparel industry and the country is concerned. For exporting garment manufacturers, good fabric would be available on local delivery terms, and lead times could be reduced substantially. For Malawi, a well functioning David Whitehead would be a large employer of labor, it would be able to supply some of the needs of the garment exporters, thus providing export substitution advantages, and it should be possible to develop some export sales of grey fabric to both South Africa and EU, which would generate foreign exchange earnings for the country.

Accepting that Government would like to find a way of ending a situation, where they are continually pumping in more money, just to keep the present staff employed, and in view of our conviction that it will be at best improbable and in the worst case impossible to locate an acceptable investor to buy out the business, we would like to recommend one other course of action, which might find acceptance, and which has certainly been mooted before. We suggest that Government/ADMARC should consider awarding a management contract to a very carefully selected company, who could bring to the company a very high degree of expertise in textile manufacturing and marketing.

It is certain that there would be conditions set on both sides. The new managers would obviously not wish to be liable for turning the company around if they have to operate with the burden of paying interest charges on the debt. They would also probably require a reasonably free hand to reduce ineffective labor, possibly by allowing early retirement terms to some of the workforce, and to reduce the financial and social impact, phasing this over 2 to 3 years. Targets would also need to be set, after the new managers have assessed the situation thoroughly, with Government continuing to provide budgeted working capital, up to such time as both parties agree that the factory can at least stand on its own feet.

Locating a suitable and willing party, to undertake a management contract of this sort, would entail an international search, and the authors of this report feel that they may be able to identify suitable candidates, who do have the necessary experience and management ability.