Study of Hong Kong’s Industry Level Competitiveness

The Garments Sector
Introduction

For the greater part of the past half century, the textiles and garment industries have provided the engine room of the Hong Kong economy. At their peak, they accounted for almost 450,000 jobs, spread across approximately 16,500 factories. But the past two decades have literally decimated these industries, if basic data are to be accepted at face value. In 2005, Hong Kong’s Census and Statistics Department reported fewer than 3,000 establishments involved in the textile and garment industries, employing fewer than 46,000 people (see Chart 1, Chart 2).
Chart 1

<table>
<thead>
<tr>
<th>Year</th>
<th>Garment Sector</th>
<th>Textiles Sector</th>
<th>Garment &amp; Textile</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Establishments</td>
<td>Workers</td>
<td>Establishments</td>
</tr>
<tr>
<td>1980</td>
<td>10,474</td>
<td>306,785</td>
<td>5,966</td>
</tr>
<tr>
<td>1985</td>
<td>9,704</td>
<td>276,342</td>
<td>4,799</td>
</tr>
<tr>
<td>1990</td>
<td>8,938</td>
<td>220,901</td>
<td>5,556</td>
</tr>
<tr>
<td>1995</td>
<td>3,117</td>
<td>80,545</td>
<td>2,925</td>
</tr>
<tr>
<td>2000</td>
<td>1,620</td>
<td>27,658</td>
<td>1,784</td>
</tr>
<tr>
<td>2004</td>
<td>1,330</td>
<td>24,143</td>
<td>1,580</td>
</tr>
</tbody>
</table>

Chart 2

Source: Census & Statistics Department, HKSAR
The improbable rise of these industries in a compact city location like Hong Kong, and the subsequent decline, provide a fascinating insight into the emergence over the past five decades of globally-organised business. They also tell clearly the story of China’s disengagement, and subsequent re-engagement with the global economy, and of Hong Kong’s indispensable role in facilitating this re-engagement. Perhaps most important of all, they provide insights into the remarkable flexibility and versatility of the Hong Kong economy and Hong Kong-based businesses over the past half century, which leaves Hong Kong’s garment manufacturers still today a leading global force in the sector, in spite of the dramatic shrinkage in their Hong Kong-based workforces. Strikingly, those 46,000 workers today accounted in 2004 for sales valued at HK$50 billion – more than 10% higher than the HK$45 billion in sales generated by more than 440,000 workers in 1980.

**From Rags to riches in half a century: a brief history of Hong Kong’s garment industry**

Hong Kong’s emergence as a global force in the textile and garment sectors is both accidental and extraordinary, from its earliest days determined by events on the Chinese Mainland. The victory of Mao Zedong and the Communist Party in 1949 after decades of civil war resulted in the hermetic closure of China from almost all outside contact, and in particular economic contact. As Chinese industrialists sought safe haven, many flooded into Hong Kong and found themselves staying in spite of any particular expectation at the time. Shanghai’s textile and garment barons arrived in large numbers with hastily dismantled industrial equipment, and they lost no time in putting their manufacturing roots down in tiny Hong Kong. Almost overnight, Hong Kong inherited a textile and garment industry which within a few years grew to become a global force in the export of textiles and apparel of all kinds.
As world textile exports tripled between the late 1970s and the late 1990s, with garment exports almost quadrupling ¹, Hong Kong emerged as the world’s third most important exporter in the sector, behind only the European Union and China (much of whose exports were also attributable to Hong Kong companies).

This growth was in spite of – and perhaps even because of – unstinting efforts on the part of European and U.S. garment manufacturers to slow the penetration of Hong Kong exporters into their domestic markets. As these protectionist interests lobbied the Governments of Europe and the US to keep Hong Kong exporters at bay, so their efforts played a vital role both in consolidating, and then in accelerating the global dispersal of garment manufacturing under Hong Kong ownership.

How so? First, the establishment of the Multi Fibre Arrangement in 1974, and the global quota system for garment trade created by it, had the effect of cementing Hong Kong’s leadership. The process of assigning quota based on global trade as it existed at the time enabled established exporters like Hong Kong to capture and retain a dominant position in global trade that may not have been so easily defended in free market circumstances. With such a large part of the garment trade subject to severely limiting quotas, manufacturers were also persuaded to compete by seeking higher value-added in each garment, and to innovate with materials like ramie and silk, and novel mixtures of them, that fell outside the remit of the quota system.

Second, successive efforts to block imports by changing the industrial processes that determined the country of origin of particular garments forced on the industry a flexibility and versatility that might otherwise never have emerged. The highlighting of particular stages of the manufacturing process to confer country of origin prompted garment manufacturers to disaggregate

¹ *“Textile Restrictions and Hong Kong’s Textiles and Clothing Industry”, Richard Wong, Ka Fu Wong, Asia Case Research Centre, The University of Hong Kong, 2004*
these stages, and in due course to separate them geographically to meet the ever-shifting country of origin requirements. It is arguable that this pressure, which over three decades has led garment manufacturers to disperse their manufacturing operations cross dozens of different countries, provided the original template upon which was based the practice of dispersed manufacturing in many industrial other industrial sectors.

A third factor enabling such growth and geographical dispersal was the decision by Deng Xiaoping in the late 1970s to begin opening China to international markets. This occurred at a time when Hong Kong manufacturers were becoming increasingly anxious about shortages of space and manpower within Hong Kong, and rising costs linked with these shortages. Within a matter of months of Deng Xiaoping’s now-famous decision to open China’s borders to foreign investment, Hong Kong garment manufacturers had begun to transplant manufacturing operations into the neighbouring Chinese municipalities of Shenzhen and Dongguan. Escaping the physical constraints of Hong Kong, they at last found ready access to cheap land, and almost infinite supplies of cheap and pliant labour.

A fourth powerful factor forcing this extraordinary geographic dispersal was the Cold War restriction imposed on China’s engagement with global markets. In particular, the highly-politicised brinkmanship that surrounded the US Government’s annual renewal of China’s conditional most favoured nation trading status (MFN) forced Hong Kong manufacturers that might otherwise have concentrated a large majority of their production capacity on the Chinese Mainland to disperse manufacturing operations elsewhere. As part of a globally-structured “hedging” strategy, Hong Kong manufacturers built factories wherever low costs and quota advantages dictated. As a result, by the mid 1980s Hong Kong garment manufacturers were operating in countries as diverse as Bangladesh, Thailand, Indonesia, Malaysia, Mauritius, Honduras, Mexico and the Czech Republic.
As a result of these extraordinary factors, simple measurement of Hong Kong’s garment sector within Hong Kong’s own geographical boundaries has become steadily less meaningful over the past two decades. Nominal contraction within Hong Kong provides no indication of the health or ill-health of the sector.

The picture in the mid-1990s

It was because of these subtle forces that I and fellow authors of “The Hong Kong Advantage” concluded in 1997\(^2\) that Hong Kong’s garment sector was in fact in robust good health, in spite of clear evidence then of the contraction within Hong Kong of the number of garment-manufacturing establishments, and of the number of staff employed by them. At this time, it had become conventional wisdom that Hong Kong’s garment industry was in terminal decline – and this provided excuse for many manufacturers to seek special favours or sympathetic and concessionary policies from the Hong Kong Government.

By the mid 1990s, the industry within Hong Kong had fallen to 5,600 factories employing around 140,000 staff. Garments still accounted for approximately 40\% of Hong Kong’s domestic exports. Most of Hong Kong’s leading garment manufacturers had by this time become globally-dispersed multinationals employing literally millions of workers worldwide – many of them located in the fast-growing Pearl River Delta hinterland to Hong Kong. While jobs had dwindled in Hong Kong, the importance of Hong Kong at the heart of these global operations was critical. Hong Kong was the headquarter hub, and a “one-stop-shop” sourcing centre for garment buyers worldwide. It provided the locus for order processing, design, product development, prototype making and quality control. While Hong Kong manufacturers still tended to veer away from investing in building brand presence in the main US and

\(^2\) Enright, Scott and Dodwell, “The Hong Kong Advantage”, Oxford University Press 1997
European markets (because of a sense of unacceptable cost and disproportionate risk), they had moved significantly up-market in terms of the quality of garments produced, had built direct control of the supply chain back towards the raw materials and forward towards the ultimate retail markets. They was also innovating in the use of new technologies to manufacture garments for shorter production runs and with shorter lead-times to market.

As our 1997 study concluded: “The further development of brands, a focus on niche markets, greater incorporation of new technologies, further penetration into Asian markets, and better use of relationships and communication technology” were seen as offering the best opportunities going forward: “Hong Kong’s advantages as a headquarter hub, a strategic centre, and as a packager of services for importers are likely to make Hong Kong the unchallenged “one stop shopping centre” for garments from the region.”

Revisiting the sector today, almost a decade later, many of the strengths and strategies described in this earlier study remain evident. However, the mood of confidence about future leadership appears to have slipped. Extraordinary changes that have occurred since 1997 are in the process perhaps of redefining the global garment industry for the first time in half a century. It may take another two to three years for the exact implications to become clear, but already leaders in the garment industry in Hong Kong see a more modest future in store. The era during which global dispersal of operations was a natural strategic response to the MFA and China’s Cold War ostracism. In its stead, a new era appears to have begun characterized by consolidation, no longer distorted by artificial quotas, and dominated by China.

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3 *Enright, Scott, Dodwell 1997, p 136*
Extraordinary Recent Developments

The major developments occurring over the past decade were clearly signaled, but even now their exact consequences cannot clearly be anticipated in terms of Hong Kong’s position in the global garment industry. China’s entry into the World Trade Organisation (WTO) was under negotiation from the late 1980s, took effect in 2001, and began to began to bite in terms of practical liberalization in 2005. This brought to an end a half century of exclusion from a global trading system that has grown out of all recognition over that time. Membership of the WTO brought many discriminations against trade with China to an end. It also signaled China’s commitment to reform and restructure its market to make it more transparent and more accessible. For Hong Kong companies – foremost among them the textile and garment manufacturers – this provided tremendous opportunities and unprecedented challenges. The logic behind a strategy of manufacturing dispersal across the globe which had predominated for 50 years finally appeared to make no sense. Coinciding with the agreed end on January 1 2005 of the global system of garment quotas, the opportunity arose to consolidate operations on the Chinese Mainland where competitive advantage had for so long suggested that manufacturing should be based. The process of adaptation to this new global trading environment is yet to finish, but within two to three years – when safeguard arrangements expire against the inevitable export surge from China that occurred at the beginning of 2005 – the character of this new era should become clear.

China’s entry into the WTO

While Hong Kong textile and garment manufacturers have been in the process of rationalizing their operations between Hong Kong and the Mainland for more than two decades, this process accelerated through the 1990s as China’s commitment to liberalization deepened, and certainty
emerged over its eventual re-entry into the WTO. For Hong Kong companies, endorsement of the Closer Economic Partnership Arrangement (Cepa) provided a practical head-start in accessing and setting up operations on the Mainland, not just for export manufacturing, but for selling goods into the domestic Chinese market. For Hong Kong’s garment manufacturers, this provided huge opportunities, but new and daunting challenges.

China’s domestic textile and garment sector has been strong for many decades, but has been a limited threat to Hong Kong’s flexible and market-savvy manufacturers. Mainland manufacturers until recently relied heavily on Government-controlled import-export corporations to sell products into the international market. They had little in-house knowledge of how to access international markets, or of retail consumer tastes in the key US and European markets. This lack of down-stream experience gave Hong Kong manufacturers a substantial competitive advantage in international markets and explains Hong Kong’s significant role as a garment trading hub even to this day.

But as China approached WTO entry, and as the Government in Beijing began to dismantle and privatize its state-owned enterprises, so this competitive edge came under challenge. Increasing numbers of Mainland companies, now unimpeded by conditional MFN status or limited access to quotas, have taken an active interest in selling their garments overseas. Companies are building better knowledge of downstream consumer markets, and are beginning to add sophisticated design and just-in-time capabilities to their traditional strengths of low cost and massive volume.

Impetus to the trend is being given by the rapid development of China’s own retail consumer market. Domestic consumption of fibre has grown from 6 kilos per capita in 2000 to 14 kilos in 2005, according to the China National Textile and Apparel Council’s 2005/06 China Textile Industry Development
Report\(^4\). While this takes China well above the world average consumption of textiles, it remains far behind the US at 29 kilos, and Japan (which equals the rich world average) at 25 kilos (see Chart 3). Strong growth can be expected in the domestic market as living standards rise, and as more of China’s population moves from the countryside to live in large cities. Between 1990 and today China’s urban population has risen from 302 million to 562 million (rising from 25% of the population to 43%), and it is expected to rise to more than 1 billion by 2030\(^5\) (see Chart 4). Such demographic trends are sure to lift the importance of China’s domestic consumer market for garments both in relative and absolute terms. China’s liberalization commitments under the WTO mean many of these opportunities will be fought over by Hong Kong and other international garment manufacturers, as well as China’s own large domestic firms.

\(^4\) provided courtesy of Esquel Group
\(^5\) China National Bureau of Statistics
Chart 3: 2004 World Fibre Consumption per Capita


Chart 4: China’s Population Distribution

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<tr>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Rural</td>
<td>841</td>
<td>808</td>
<td>745</td>
<td>560</td>
<td>(185)</td>
</tr>
<tr>
<td>% of Total</td>
<td>74%</td>
<td>64%</td>
<td>57%</td>
<td>35%</td>
<td></td>
</tr>
<tr>
<td>Urban</td>
<td>302</td>
<td>459</td>
<td>562</td>
<td>1040</td>
<td>478</td>
</tr>
<tr>
<td>% of Total</td>
<td>26%</td>
<td>36%</td>
<td>43%</td>
<td>65%</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>1143</td>
<td>1267</td>
<td>1307</td>
<td>1600</td>
<td>293</td>
</tr>
</tbody>
</table>

Source: China National Bureau of Statistics
The end of Quotas and the Multi Fibre Arrangement (MFA)

The end of the global garment quota system, agreed on completion of the Uruguay Round of global trade negotiations in 2004, and taking effect on January 1 2005, was one of the most keenly watched upheavals seen by the global trading system in the past half century. The certainty that China would be a massive beneficiary of liberalization, which had for three decades been so constrained by quota limitations, created near-panic among protectionist lobbies, in particular in the US. Papers prepared by the American Textile Manufacturers’ Institute (ATMI) through 2003 and 2004 forecast 630,000 job losses concentrated in the textile states of North Carolina, South Carolina and California, with the expected closure of 1,300 factories. They predicted that China’s share of garment exports to the US would rise from 13% in 2002 to 71% in 2006 in the absence of safeguard measures blocking such a surge. Such anxieties were effectively endorsed by a major report prepared by the US’s International Trade Commission in 1998 (but only declassified in 2004).

Perhaps inevitably, data tracking China’s garment exports, and European and US imports to and through January 1 2005, show huge volatility. In reality, it appears to have begun long before January 1 2005 as many retailers sought to jump the gun in anticipation of supply dislocation. It led to a tremendous spike in exports in the first six months of 2005 (See Chart 6 & 7), which in turn created the emergency circumstances needed for Europe and the US to impose safeguard quota restrictions to staunch the surge. Since then, global garment trade has steadied, with China’s share significantly higher, and few of the dire predictions forecast by US protectionist lobbies being vindicated.

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Chart 5

* 2005 exports of some categories only represent partial year data due to embargo

Source: Esquel Holdings Limited
**Chart 6**

![Chart 6](image)

**Source: Esquel Holdings Limited**

**Chart 7**

<table>
<thead>
<tr>
<th>Major Categories</th>
<th>Quota Description</th>
<th>China Quota in 2004 (doz)</th>
<th>China Quota in 2006 (doz)</th>
<th>% Increase 2006 vs 2004</th>
<th>2005 US Total Imports (doz)</th>
<th>China Quota vs US Total Imports</th>
</tr>
</thead>
<tbody>
<tr>
<td>US338/9</td>
<td>Knit Shirts</td>
<td>2,523,532</td>
<td>20,822,111</td>
<td>725%</td>
<td>372,187,606</td>
<td>6%</td>
</tr>
<tr>
<td>US340/640</td>
<td>Men's Woven Shirts</td>
<td>2,345,946</td>
<td>6,743,644</td>
<td>187%</td>
<td>47,714,767</td>
<td>14%</td>
</tr>
<tr>
<td>US347/348</td>
<td>Cotton Trousers</td>
<td>2,421,922</td>
<td>19,666,049</td>
<td>712%</td>
<td>167,861,739</td>
<td>12%</td>
</tr>
<tr>
<td>US352/652</td>
<td>Underwear</td>
<td>5,276,745</td>
<td>18,948,937</td>
<td>259%</td>
<td>276,462,763</td>
<td>7%</td>
</tr>
</tbody>
</table>

**Source: Esquel Holdings Limited**
While in principle the imposition of safeguards quotas was regrettable, the outcome appears in practice to have provided a stable foundation for resumption of quota-free trade when the safeguards expire between 2008 and 2009. In many of the more sensitive export categories (like men’s woven shirts, cotton trousers and underwear), the safeguard quota limits have been sufficiently generously set both to allow a reasonable increase in Chinese exports, and to leave quota allowances unfilled. (See Chart 8 & 9).

**Chart 8**

| 2006 China quota filled rate on US restricted category till September 13th |
|-----------------|-----------------|----------------|
| Category        | Quota description | Filled rate (%) |
| US338/339       | Knit Shirts      | 37             |
| US340/640       | Men's Woven Shirts | 36             |
| US347/348       | Cotton Trousers  | 48             |
| US352/652       | Underwear        | 29             |

*Source: Esquel Holdings Limited*

**Chart 9**

| 2006 China quota filled rate on EU restricted category till September 15th |
|-----------------|-----------------|----------------|
| Category        | Quota description | Filled rate (%) |
| EU2             | Woven cotton fabrics | 44             |
| EU4             | Knit Shirts      | 38             |
| EU5             | Pullovers        | 49             |
| EU7             | Blouses          | 51             |

*Source: Esquel Holdings Limited*
The end of protectionism?

The end of the MFA’s global quota system, and the successful implementation of safeguard measures for the next two years to ease the transition, will of course not mean the end of protectionist activity by lobbies in Europe and the US. Apart from the possibility that safeguard arrangements may be extended, many exporters from Hong Kong and China expect increasing resort to anti-dumping measures as the weapon of choice for protectionist lobbies going forward. This danger is even greater, according to numerous Hong Kong garment exporters, in view of ferocious competition within China between garment manufacturers as a result of massive investment in recent years, and generous distribution of production and export licences by Beijing. This “hyper-competition”, which has been complained of in other areas of China’s consumer economy, has taken prices for garments to such low levels that even Hong Kong manufacturers are perplexed, claiming that such retail prices are lower than their own production costs within the Mainland. Clearly, if Hong Kong manufacturers find it hard to believe how Mainland competitors can offer garments at such low prices, then the view in Spain or North Carolina must be as strident as ever that garments are being dumped.

The Future

So what does all of this extraordinary change mean for Hong Kong garment manufacturers, and for Hong Kong as a global leader in the sector? In-depth interviews with a cross section of Hong Kong manufacturers suggests we are entering a new and less certain era in which China and its interaction with global markets is in the process of altering the structure of the garment industry in very fundamental ways. Hong Kong companies report a reversal of the decades-long trend of manufacturing dispersal driven by “hedging strategies” in response to quotas and Cold War protectionism. Not only they, but also Taiwanese and other international garment exporters have over the
past few years begun to invest increasingly in capacity on the Mainland. Most say they retain limited manufacturing capacity in countries like Thailand, Malaysia – and even Hong Kong – as part of a hedging response while safeguard measures remain in place.

As these companies have invested, so Mainland companies have been building their capacity, and building the capability to sell their products into international markets rather than simply into the domestic China market. Indeed, with garment prices inside China persistently low, many are actively pursuing opportunities in international markets as a means of bolstering profit margins, according to some Hong Kong competitors.

But just as production capacity is building to unprecedented levels (one Hong Kong expert talked of 100 million spindles now in operation on the Mainland, compared with 40 million less than a decade ago) so this has resulted in labour shortages and rising wages in many of the factories based in the Pearl River Delta and the Yangze River Delta. This has led to talk among manufacturers of low-cost textile and garment manufacture now shifting to countries like India, Bangladesh and Pakistan, where market liberalisation has led to improving reliability and efficiency. Thus, after decades during which manufacturers in the developed world have complained about the unbeatable low prices possible in China, it now appears that China is starting to become expensive for the most basic kinds of garments. Evidence of this shift has been noted recently as officials in Guangzhou have talked of the need to push low value adding industries out of the Pearl River Delta region. It was reinforced when Fountain Set, the world’s largest circular knitted fabric manufacturer and a driving force in innovation in vertically integrated spinning, knitting, dyeing, printing and finishing, was apparently refused permission to expand its facilities in the PRD.
So, as the dispersed manufacturing model of past decades is being superceded by the end of the trade-distorting global quota system, so it is being replaced by a market-driven model which involves a consolidation of manufacturing and a convergence of manufacturing capacity on Mainland China, running parallel with a fresh dispersal back to new low cost locations – with even Mainland manufacturers joining this flow.

**A lean-margin sector**

The changes described above have been gloomily greeted by Hong Kong exporters, who talk universally of the garment sector likely to offer lean pickings for decades to come, even for the most innovative of manufacturers. A combination of abundant supply driven by decades of over-investment on the Chinese Mainland, fierce pricing power in the hands of the world’s leading retail groups which today concentrate a large proportion of the world’s garment-buying power, and rising land and labour costs in the traditionally cheap production locations of the Pearl River Delta, suggest that profit margins are likely to remain under severe pressure for years to come.

**China**

While talk by the US’s ATMI of China taking the world by storm in the global garments trade may be alarmist and overblown, there is no question that China’s industry is set to consolidate its position as a world leader, and will be the competitor against which all manufacturers based in other locations must benchmark their market strategy. For this reason, all interviews with Hong Kong textile and garment manufacturers focused on the scale and nature of the competitive challenge from Mainland companies, and of the competitive responses needed whether in international markets or within the domestic Mainland market.
The competitive advantage among Mainland companies identified above all others was the colossal scale of production. Along with this, manufacturers reported rapid improvements in reliability and quality. While many of the Mainland competitors are reported to have very strong upstream linkages to the production and supply of good quality raw materials – whether cotton, ramie or silk – they are reported still to lack any confident or sophisticated knowledge of the down-stream supply chain, and of the forces behind fast-changing fashion tastes that drive patterns of production. They are proving hardest to compete with inside the Mainland domestic market, and in supplying the largest retail buyers in the rich world markets – like WalMart, Gap, the Limited, and so on. Fast response for short production runs for second-tier retailers is seen by Hong Kong executives as a key area of retained competitive advantage, and many have responded by strengthening down-stream linkages to retail customers, acquiring western brands directly in order to capture better knowledge of final markets, and focusing on higher-value-added niche supply to second-tier retail groups in Europe and the US.

**China as an export platform**

New challenges appear to be emerging for Hong Kong manufacturers who use the Mainland as their primary export platform. All interviewees talked of rising wages, difficulties in recruiting sufficient workers, higher staff turnover, and a consequent fall in overall skill levels in the key export production regions of the Pearl River Delta and the Yangze River Delta. As a result of these pressures, companies like Milos Knitwear and Leighton Garments have recently opened large new factories in Jiangxi province.

This pressure to move operations deeper into China’s interior is being driven by non-market forces too. Guangdong officials have, with the apparent support of Beijing, expressed increasing concern over the environmental damage being inflicted by “low-tech” industries like textiles and garments,
and of the crowding out by such factories of investments in cleaner, higher-
technology activity. They have identified over 2,000 Hong Kong companies
which they would like to see move out of the PRD. Providing substance to
these convictions, officials are understood recently to have rejected an
expansion application by Fountain Set, a world-leading Hong Kong textile
group with significant existing operations in the PRD.

Pressure to move operations deeper into the Chinese Mainland is predicted to
erode many Hong Kong competitive advantages. At present, Hong Kong
companies have been able to maintain tight quality control of Mainland
operations when these operations are based within a three-hour driving circle
of Hong Kong. This three hour limit essentially reflects the ability of an
executive to visit a factory and return within a single working day. While
improvements in China’s domestic road infrastructure have stretched the
three hour frontier deeper into the PRD, this cannot embrace Guangdong’s
remoter interior municipalities, nor inland provinces like Jiangxi, Guangxi or
Hunan.

Moving deeper into China’s interior not only dilutes executive control; it also
brings executives into more direct competition with strong local
manufacturers, and forces them to deal with administrations less aligned with
their export-oriented activities.

**Emerging Mainland giants**

Moving deeper into China’s interior is also bringing Hong Kong
manufacturers face to face with China’s domestic giants – companies
employing 40,000 workers and more. One Hong Kong exporter noted one
Mainland company alone employing 37,000 staff, and exporting more than 25
million pairs of boxer shorts per year – more than the entire EU quota for
boxer shorts. It is estimated that garment companies on the Mainland employ
in excess of 7.9 million workers – almost 15% of China’s total industrial employment – with 30,000 factories in Guangdong alone accounting for more than one third of national garment production. Just how reliable such numbers are remains unclear, however. Two leading Hong Kong garment manufacturers reported that a recent “audit” by the Guangdong provincial government of leading Mainland exporters revealed that 10 of the top 15 exporters could not be traced. They expressed concern over the potential for illicit activity by such “ghost” exporters, which were generating significant pressure on international competitors because of their low costs and large available volumes.

On the back of their strong domestic market share, and colossal production power, a number of the largest Mainland garment companies have been seeking international listings in the Hong Kong stock market as a platform for raising hard currency, and building a stronger direct presence in export markets. Of the 173 Mainland companies now listed on Hong Kong’s two stock markets as Red Chips or H Shares, at least 10 are textile and garment companies. As they build this direct international profile, so it is believed to be inevitable that they will drive strong competition with existing Hong Kong exporters.

**China’s domestic market**

Until recently, most Hong Kong garment manufacturers were shut out from competing in China’s domestic market. Despite the large numbers of factories based on the Mainland, and the millions of workers employed, these companies were established explicitly for export, and were specifically barred from selling their output into the domestic market. After China’s entry into the WTO, and because of liberalization linked with Cepa, Hong Kong manufacturers have recently had improved access to the domestic market (though a number of manufacturers reported that operation within the
domestic market remained problematic). Even without formal restrictions on operation within China, most Hong Kong manufacturers were cautious about their ability to win significant market share in this undoubtedly-fast-growing market in the years ahead (See Chart 10) They reported that domestic companies had a tremendous grip on the local market, with significant numbers of manufacturers having developed strong domestic brands which commanded strong retail loyalties.

Chart 10

Source: 2005/6 China Apparel Industry Development Report
In addition, they reported that Chinese consumers seeking brand “distinctiveness” were rarely attracted to Hong Kong brands. Rather, they were more attracted to clearly global brands, in particular those associated with the US or Europe. Brands and retail chains like Toppy, Goldlion, Esprit or Giordano, which have begun to build a meaningful Mainland presence, may thus be exceptions to a broader rule by which Hong Kong manufacturers prefer to remain OEM manufacturers rather than incur the risk and expense of building their own brand presence. One other option reported by some local garment manufacturers has been to acquire “second-tier” western brands which have a strong western feel. Since within the Mainland, shoppers are at present often unaware whether a western-sounding brand truly confers quality or exclusivity, such brands are being positioned successfully on the Mainland without demanding of Hong Kong manufacturers the huge investment that would be needed in acquiring truly “top-tier” international brands. One example of this, quoted by several interviewees, was Jeans West, an Australian brand now proving successful within the Mainland market. Fang Brothers Knitting’s acquisition of the flagging “Pringle” brand from the UK can be seen as a second clear example of this tactic to compete profitably against China’s behemoths within the Mainland Chinese market.

Hong Kong

For Hong Kong as a world-leading location for the textile and garment business, the present period of extraordinary change augurs a new role that is likely to be more modest, but not unimportant. Although all interviewees remain cautious while the hedging strategies linked with current export safeguard measures remain in place, most believed that Hong Kong’s textile- and garment-related workforce would stabilize at present levels, about 40,000 people. The limited OPA production activity still in place would steadily be wound down, but job losses here would be replaced by new jobs linked with
headquarter operation, sales and marketing, merchandising, quality control, and increased design activity, they said.

Numerous interviewees believed that Hong Kong’s role as a headquarter hub for the garment industry would, if anything, strengthen as more Mainland companies joined Hong Kong companies on the HK stock market to use Hong Kong as their primary fund-raising base, as a base for organizing international business activity, and as a locus for building closer links with, and better knowledge of key importing markets.

As such, they believed that Hong Kong had the potential to remain Asia’s leading fashion hub, built around the already-strong trade fair platform provided by the Hong Kong Trade Development Council, and a steady strengthening of design skills in Hong Kong. Linked with this, all believed Hong Kong retains critical strength as a global sourcing hub. As one leading academic analyst noted: “There is in Hong Kong a deep tradition of international buying and selling, and a lot of expertise in terms of the way we conduct business, coordinate cross-cultural management, and link businesses in different countries. These are skills that really are very difficult to displace. If Hong Kong is not exist, someone would need to replace it, but no replacement readily comes to mind.”

Linked with this deep-rooted strength, numerous interviewees noted a further recent trend which suggests Hong Kong will retain a vital role as a buyer hub: they complained of the proliferation of what one called “Young Turks” – one or two person operations which have emerged in large quantities exploiting links with perhaps just a single Mainland manufacturer to sell their garments to carefully targeted retailers in the US or Europe. Many of these “Young Turks” have spent some time as merchandisers for local garment manufacturers and are using the knowledge they developed of the international markets to assist Mainland companies to enter export markets,
exploiting these companies’ historic lack of knowledge of markets, of the
global logistics supply chain and of consumer tastes outside the Mainland.

Such anecdotal references appear to be endorsed strongly by an explosion of
training activity at Hong Kong’s Clothing Industry Training Authority (Cita).
Executive Director Professor Yeung Kwok-wing reported that students taking
up short and part time courses had exploded from “a few hundred” in 2003 to
more than 2,000 this year, boosting the Authority’s income from HK$4m to
HK$8.5m over the same period.

It thus appears that while manufacturers are in the process of downsizing, a
considerable and unmeasured community of garment trading intermediaries
is emerging to capitalize on Hong Kong’s strength as a sourcing and trading
hub. Since capital investment for such activity is negligible, the hurdles to
market entry are low. In addition, such activity depends more on energy and
entrepreneurship rather than high academic qualification, which suggests that
such activity may be playing a valuable role in absorbing workers in Hong
Kong who cannot easily make the transition to high tech, financial services or
the high-value-adding professions.

Company survival strategies

In the context of this fiercely pressured competitive environment, Hong Kong
manufacturers appear clear-headed about the need to develop carefully
crafted survival strategies if they are to continue to trade successfully in this
chronically low-margin sector. A number of contrasted strategies appear to
have been developed, though some common threads are apparent:

• Taking full control of the supply chain, integrating activity from
multiple manufacturers at all stages of the supply chain: this has been
most popularly developed by the Li & Fung Group, which manages to
meet the fast-changing needs of major global clients by building intimate relationships with literally dozens of producers distributed around Asia, and efficiently integrating their output to deliver finished products to destination retailers.

- Moving closer to the retail consumer: this has been critical, and has been achieved perhaps by acquisition of retail brands, perhaps by developing relationships with buyers that ensure clearer access to, and control of, the down-stream end of the supply chain. The process of developing retail stores began some time ago, with retail chains like Giordano, Esprit and Toppy being successfully developed on the Mainland. Companies like Esquel have achieved the same objective by building a vertically integrated supply chain from cotton farming, spinning, weaving and knitting through garment manufacturing to sales and merchandising, retailing, and even the production of accessories. Companies like TAL, which employs 24,000 people worldwide producing 50 million garments ranging from tops and pants to outerwear and tailored suits, has invested massively in computer driven vendor-managed inventory systems which underpin intimate knowledge of buyer needs and continuous stock replenishment, effectively locking retail clients into exclusive long-term relationships with TAL.

- Focusing carefully on niches: smaller manufacturers have opted out of supplying to the global giants like WalMart, instead concentrating on shorter production runs and short just-in-time lead times to meet the needs of second-tier retailers in Europe and the US. Along with this trend, companies are investing significantly in stronger design capabilities in response to expectations on the part of increasing numbers of buyers that they no longer simply respond to detailed buyer requests, but table clear and detailed design ideas of their own. Professor Yeung at Cita noted: “Companies that historically employed
no designers at all are having to train and employ large numbers – some I know have jumped from none to 50 in just a few years.”

- Consolidation of the dispersed manufacturing structure: this process has only recently begun, but a number of interviewees talked of closures or planned closures of operations in countries like Thailand, Malaysia, Mauritius and Honduras, which had historically been developed as hedging operations, and quota-circumventing initiatives. Some also talked of the need to consider consolidation with other smaller manufacturers, in order to achieve sufficient critical mass to compete effectively with giant Mainland-based companies.

- Concentration of more operations on Mainland manufacturing plants, with more emphasis on selling into the domestic China market, and with Hong Kong-based executives spending more time living in the Mainland rather than commuting on a weekly basis, as they tend to do today. This response suggested that in the long term, design, sample making and quality control activity could shift away from the Hong Kong headquarters, leaving only the most senior executives based in Hong Kong, along with sales and marketing personnel.

Interestingly, not a single interviewee considered Cepa to provide a framework that would assist in consolidating future competitiveness. Nor did any interview endorse the proposal, circulated widely by politicians and in the media, that the Hong Kong Government should facilitate the import of cheap labour into Hong Kong from the Mainland to enable manufacturers to sustain production activity within Hong Kong. All saw such an initiative as ineffective in tackling core competitive challenges, and at best a temporary palliative that would delay restructuring that is regarded as inevitable.
Conclusion: insights on Hong Kong’s competitive strengths and weaknesses

Hong Kong’s once-world-dominating textile and garment industry has been in steep decline in terms of labour employed in Hong Kong for more than two decades. But quirks associated with the global quota regime that has since 1974 determined the structure of world trade in garments preserved many key roles in Hong Kong, and protected the value added generated within the Hong Kong economy. The end of the global quota system at the beginning of 2005 has taken the industry into a two- to three-year period of extraordinary transition, at the end of which Hong Kong’s competitive strengths are expected to be trimmed to those of headquarter operation, and international sales and marketing activity linked with Hong Kong remaining a key global buyer hub for the garment industry, and an emerging fashion hub underpinned by globally competitive design activity.

While these Hong Kong companies are trimming their operations within Hong Kong, many remain keenly competitive as global enterprises, capitalizing on their considerable manufacturing strength on the Chinese Mainland. As such, there appears to be confidence that the sector will remain an important economic driver in Hong Kong for many years to come, with significant competitive strengths underpinning this.

These competitive strengths are above all else underpinned by Hong Kong’s value as a headquarter hub, with its easy access to capital markets, international legal and accounting services, fluent global communications, and considerable strengths as a buyer hub. This competitive strength appears to have been recognized by many leading Mainland textile and garment manufacturers, who have in recent years begun to list in Hong Kong, and establish their own international headquarter operations in Hong Kong.
In parallel with this abiding strength, Hong Kong’s deep reservoir of personnel who are skilled in international trading, knowledgeable about the workings of an increasingly complex logistics supply chain, and familiar with consumer tastes in ultimate consumer markets appears to give Hong Kong a formidable long term competitive advantage as a garment trading facilitation hub. These are expected to play a significant and growing role with second-tier Mainland garment manufacturers, indispensably linking them with retailers in Europe and the US.

As Cita’s Professor Yeung concluded: “If Hong Kong did not exist, someone would need to recreate it, and it is not readily clear where the replacement is. Keeping Hong Kong’s leading position will unquestionably require great clarity as to our relevance. It will require a lot of innovation and creativity, but at the end of the day it could well remain Hong Kong’s one true globally competitive industry.”