



**ISTANBUL
CHAMBER OF INDUSTRY**

Istanbul Chamber of Industry Professional Committees'
Sector Strategies for Development Project
Towards EU Membership Process

GARMENT MANUFACTURING INDUSTRY

December 2012

Executive Summary

Garment manufacturing industry has long been the leading sector within the outward-oriented growth and industrialization preference of Turkey since 1980. Within this period, it became the largest manufacturing sector of Turkey as of investment, production, employment and export indicators. The value added generated in this sector has been used for the sector's own development, and the capital accumulation has served as an important domestic resource for the other economical activities of Turkey. Garment manufacturing industry built its investment and production capacity mainly based on foreign markets and export, and the generated net foreign exchange earnings have contributed significantly to the foreign exchange need of Turkey for many years.

Garment industry has also contributed significantly to the socio-economic development with its labor-intensive structure and employment-friendly nature. The sector continues to be the one that generates the highest number of jobs within whole manufacturing industry, and even within all economical fields. When considered together with the textile industry, it becomes almost impossible to substitute the generated employment possibilities.

In garment manufacturing industry, approximately 75 percent of the employees are female. Thus the sector provides a huge contribution also in the socio-economic sense. The sector that can turn even the most unqualified person out to be a qualified person in a short period with on-the-job trainings provided, fulfills the functions such as reducing unemployment and poverty with the opportunities it creates. None of the other industry branches has such a wide socio-economic and cultural function.

Another important asset of garment manufacturing industry is the experience and the know-how established with knowledge built-up over the years in this sector. The sector has all the rings of a very wide integration from cotton and synthetic fiber production to fashion retail brands. This knowledge and integrated structure are available in four countries at most, including Turkey. As a matter of fact, Turkish garment industry is the world's fifth and Europe's third largest exporter/supplier and also it is a sector that can reflect these advantageous qualities to global competitive power.

Garment industry continues to be the sector that generates the highest local value added and net foreign exchange earnings. By using local inputs such as yarn, fabric, dye, print, finish, sub-industry and accessory starting from cotton and synthetic fiber production, the sector generates a high local value added. With this quality, the sector continues to generate net foreign exchange earnings at a level of almost ten billion US dollars every year. Nowadays that Turkey's need for local value added and foreign exchange earnings are at the highest level, garment manufacturing industry provides the highest contribution to both.

With all these properties, garment manufacturing industry goes through a transformation process that the foreign competition began to be increasingly felt. The sector is aware of this transformation and its needs for a long time and tries to fulfill its responsibilities in order to enhance its competitive power.

Besides this increasing competitive power, one of the most important issues that creates a kind of uncertainty for the sector within this transformation process is the economic administration's perception and assessment of the sector. The assessments made about the sector such as the claims that it will have no competitive power left in time and it is a sector that will get smaller or that will not grow creates a kind of uncertainty for the sector

representatives. Thus this uncertainty negatively affects the investment and production decisions.

However in Italy, France and Spain that are among the developed countries of European Union, the significance of garment manufacturing industry still continues. With this high value added and branded industrial manufacturing in these countries, the sector remains to be competitive. While this is the state, such negative assessments made regarding Turkish garment manufacturing industry that turned towards high value added and branded manufacturing in the transformation process it is going through with its wide knowledge and experience are in fact not true. For the sector to go through this transformation process while increasing its competitive power will be possible by the economic administration to primarily change its negative perception of the sector.

Another obstacle in order to make a healthier assessment of the sector within the economic picture and a successful completion of the transformation process is the shadow economy in the sector. While one leg of this shadow economy in the sector is the unregistered employment resulting from the high public burdens on labor costs, the other leg is the unrecorded economic activities in Osmanbey-Laleli-Merter market. Due to the terms of trade implemented by the export markets, the reflection of the foreign sales at an annual level of 6-7 billions US dollars on official export, production and employment records are limited. Under these conditions, the manufacturer-exporter companies operating in this region don't benefit from any incentive mechanism. This shadow economy issue generally results from the developments outside the sector and requires to be solved through sector-public cooperation.

Unless the conditions the sector is facing change, it is not possible to reduce such acts as one-sided. In order to reduce and eliminate the unrecorded economic activities in the garment manufacturing industry, the suggestions of the sector must be considered and the government should solve this issue step by step in an industry and sector friendly manner. With the growth of recorded activities, the values that the sector generates will reflect the indicators more truly and the real size of the sector which is much larger than it seems will be revealed.

With the belief that garment manufacturing industry will continue to increasingly contribute to the economic and social life of Turkey with its knowledge and experience, the following strategy and policy suggestions are made and demanded to be realized.

DEFINITION AND SCOPE OF THE GARMENT MANUFACTURING INDUSTRY

Garment manufacturing industry is a sector that manufactures semi-durable consumer goods to fulfill the basic clothing needs of individuals. Garment manufacturing industry produces all kinds of cloths and accessories.

Garment consumption is not just for fulfilling the needs of individuals, but also for satisfying their tastes and preferences and offering them the style and status they are looking for.

Garment manufacturing industry is composed of clothing that includes outerwear, underwear, work and leather clothes, knitted and fur clothes.

DEVELOPMENT OF THE INDUSTRY AND THE MAIN INDICATORS

The development of the garment manufacturing industry is assessed under the titles of number of initiatives, value added, investment, employment, productivity, foreign trade, domestic market and net foreign exchange generating activities.

The contribution of the garment manufacturing industry that is the most important driver of the economy and manufacturing industry since 1980s began to remain limited at the beginning of 2000s.

The up-to-date bulk data used for the indicators such as the number of initiatives in the garment manufacturing industry, the production value, the value added and the investment amount belong to the year 2009. The share of garment manufacturing industry within general manufacturing industry fell in all of these four indicators in the period 2003-2009. Its share dropped from 16.3 to 15.9 percent within the number of initiatives, from 10 to 6.8 percent within the production value, from 10.4 to 6.7 percent within the value added and from 8.1 to 3.5 percent within the investment.

Thus the production in the garment manufacturing industry is decreasing and the capacity usage rates also drop as years pass. In the period 2005-2011, the industry's production dropped almost 9 percent. In 2006, the capacity usage rate which was 82.5 percent dropped to 76.4 percent in 2011.

Since garment manufacturing industry is a labor-intensive sector, it is an important employment area within the overall economy. The garment manufacturing industry's employment rate has dropped 15 percent in the period 2005 - 2011.

The productivity measured as the production value per employee in the garment manufacturing industry increased 8.6 percent from 2005 to 2011. However, the labor productivity increased 17.9 percent industry wide and the increase in this sector stayed below the general average.

The garment manufacturing facility uses its production capacity mostly for export activities, and its investment and production processes has been shaped by foreign markets and export opportunities as of 1980s.

The sector's export which was 11.8 billion dollars in 2005 increased to 13.9 billion dollars in 2011, but its share in the overall export of Turkey dropped from 16.1 to 10.3 percent. The two sub-groups with highest export figures are outerwear and underwear segments. The amount of import which was 738 million dollars in 2005 increased to 3.1 billion dollars in 2011.

In the garment manufacturing industry, the unit values of the export products increase. The unit price increased 43.2 percent in the period 2003-2011. On the other hand, the export volume decreases on amount basis. The industry turns towards exporting lesser amounts with higher unit prices.

It preserves its share and significance among European Union export markets. While the share of Germany decreases, the shares of France, Italy and Spain increases. The share of export to USA decreased significantly. The share of export to close and neighbor countries, particularly to Russia increases.

Garment manufacturing industry is exhibiting an export oriented growth and development for many years now. Moreover, there are significant developments in the domestic markets as of the mid 2000s. The ready-to-wear expenditure, which was 32.2 billion TL in 2005, increased to 47.2 billion TL in 2011.

The net export and net foreign exchange earnings of garment manufacturing industry stayed above the level of 10 billion dollars since 2005 and continued its property to be the sub manufacturing industry sector with highest earnings.

GLOBAL GARMENT INDUSTRY AND POSITION OF TURKEY

The quotas to be removed and discounts to be made in the tariffs with the liberty in world trade in 2005 initiated a brand new period for the global garment industry. The industry production rapidly shifted towards countries with low production costs and the expansion in garment trade accelerated. Especially the countries with cheap workforce such as China rapidly increased their production and level of exports by benefiting from the freedoms of the new period.

While global garment export was 281.4 billion dollars in 2005, it increased to 398 billion dollars in 2011 data. The share of garment export within global goods trade is down back to 2.24 percent from 2.69 percent. While outerwear has the highest percentage with 41.9 within garment export, underwear follows that with 26.1 percent.

While global garment consumption expenditure was 1.24 trillion dollars in 2005, it increased to 1.46 trillion dollars in 2011. USA is the largest consumption market with 305.6 billion dollars. China became the second largest market in 2011 with 114.6 billion dollars and USA is the largest importer market with 84.7 billion dollars. Germany follows that with 38.3 billion dollars, Japan with 32 billion dollars and UK with 25.5 billion dollars. And recently Russia and South Korea entered into the top 15 importers. When EU-27 countries are considered as a whole, they continue to be the largest market with 97.5 billion dollars.

In the global scale, the region that the garment manufacturing industry focused in the last decade is Asian and East Asian countries. In these countries that have cheap workforce as in China, the production capacities of the garment manufacturing industry expand rapidly and significantly. Due to the increasing workforce costs and the unutilized capacity issue of the recent years, the increase in the production capacity of China for garment manufacturing industry is stabilized. On the other hand, producer countries such as Bangladesh, India, Vietnam, Pakistan, Cambodia, Sri Lanka and Indonesia stand out.

In global garment export, China is the largest exporter with 148.3 billion dollars volume and 37.3 percent share in 2011. Hong Kong is ranked second despite of its decreasing export volume. Italy and Germany took the third and fourth places with their brand exports. Bangladesh rose up to the fifth place with 16.2 billion dollars in export.

Turkey is an important manufacturer, supplier and exporter country with its strong production capacity and competitive advantage in export as of 1980s. Turkey continues to hold this strong position and faces an increasing global competition with the participation of new and strong rivals as of mid 2000s.

Even though Turkey continues to be among the leading manufacturer and exporter countries in the global garment manufacturing industry, its share in the global garment export has decreased since 2005 and dropped from 4.2 to 3.5 percent.

MAIN COMPETITIVE ELEMENTS AND DEVELOPMENTS IN THE GARMENT MANUFACTURING INDUSTRY

For manufacturing industry, the availability of sufficient, affordable raw material/cotton, raw leather and precious raw fur etc. in the country are primarily important. Similarly, access to the same semi-products with the rivals in terms of both quality and price is also very important in the competition. In the last years, Turkish ready-to-wear sector became import dependent in cotton and leather. Even though there are important input suppliers in the country, the protection measures defined for imported inputs negatively affect the competitive power.

Production costs are among the determinant factors in the competition. Especially energy, finance and environment costs are the determinant factors along with labor costs. In Turkish ready-to-wear sector, the production costs and particularly labor costs are high compared to the rivals.

According to the 2010 data, while Turkey's labor cost is 100 units, the figure is 9 units in Bangladesh, 16 in Vietnam, 15 in Pakistan, 21 in India, 44 in Coastal China, 69 in Tunis and 81 in Morocco. This difference in labor costs creates a significant competitive pressure. Even though labor productivity and production quality are respectively high in Turkey, this advantage is not enough to eliminate labor cost differences.

In product development and quality chain; high value added production, design, collection and fashion capacity are important competitive elements besides brand creation. Recently, Turkish ready-to-wear sector turned towards production with high value added, reinforced its design collection and fashion capacity, and created new Turkish brands.

In marketing and sales chain, the main competitive elements are active overseas marketing, the sales with Turkish brands both in the country and overseas, and the introduction of Turkish ready-to-wear fashion and brands with "Made in Turkey" image that represents the quality of Turkish garment manufacturing. The active marketing functions of supplier manufacturers are still limited and sale with Turkish brands is yet in development process.

Among financial indicators; industry profitability, stability and predictability of Turkish Lira, tax regulations and tax rates are the main competitive elements. Industry profitability decreases significantly in the recent years and the fluctuation in Turkish Lira negatively affects predictability.

For productivity, the availability and employment of qualified and trained work force is the main determinant factor. In Turkey, labor productivity and human resources quality are high in metropolitans. However the sector struggles in finding new generation qualified human resources and attracting talented, trained manpower.

The main determining competitive factors for market and sector conditions are legal regulations, practices, bureaucracy and government supports. Especially regarding export activities and incentives, the sector faces an intense, complex and heavy bureaucracy bringing additional financial obligations.

SWOT ANALYSIS AND ASSESSMENT OF TURKISH GARMENT MANUFACTURING INDUSTRY

The results of the SWOT analysis conducted for Turkish garment manufacturing industry are summarized below:

Strengths of the Industry: continuing cotton production, sectors that provide input to the industry and effective cooperation with these, diversity of production capacity, capacity to produce each product group in sufficient amount and quality, ability of fast, flexible, frequent and small batch of production, knowledge and experience in production, production with higher value added, fast loading and supply, domestic and overseas logistics opportunities, closeness to EU, Russia, Middle East, Africa and Central Asia markets, high risk appetite in market entry with the promotion ability, experienced and trained workforce, employment of trained manpower in all stages, related units and education capacities of higher education institutions.

Weaknesses of the Industry: foreign source dependency in cotton and leather raw materials, high indirect taxes applied on various raw materials used by the industry besides the taxes in precious fur raw skin import, high production costs, increased input costs due to protection measures defined for imported fabrics, lack of support for design activities of the companies (except Turquality and brand support program), bureaucratic and slow implementation of Turquality and brand support program, insufficient active marketing and promotion despite of the available capacity, low and decreasing industry profitability, inability of the vocational training to fulfill increasing and diversifying human resources need of the industry, poor cooperation between industry and university, inability of the companies to benefit from government grants due to lack of knowledge and implementation problems, and lack of corporation that would benefit from these grants due to extreme bureaucracy.

Threats of the Industry: unrecorded economic activities due to high tax rates and high production costs, unfair competition between the recorded and unrecorded activities, obligation for the production facilities in Turkey to be restructured because of the new city plan, regions to have different incentive programs and different production costs, weakening of the will to stay in the market, limited number of new entries to the industry, the supports for new investments to be limited with only the cities in the Regions 5 and 6, and these cities to lack trained workforce and required infrastructure, limited brand creation tendency, weakening of the EU market, political uncertainties in the region and surrounding countries defined as the alternative and potential markets, special sales made to the region and surrounding countries not to be considered as export and thus not benefit from export supports, some European countries to create an unfair trade environment by employing cheap workforce from overseas, attraction of the sector to decrease in respect to employment due to negative perception of the public about the future of the industry, lack of up-to-date official inventory, lack of individual strategy and policy document, insufficient industrialization.

Opportunities of the Industry: fulfillment of the job, work, production, quality standards defined as "code of conduct" that the foreign buyers are looking for in the supply phase, ability to produce GMO free cotton and organic cotton based on experience, capacity to use organic fashion potential, rapidly growing domestic market, rise of quality, brand and modern retail perception in the domestic market, increasing popularity of Turkey and Turkish products in the surrounding region countries, market opportunities offered by Russia, Middle East, Africa and Central Asia countries, opportunity to expand with Turkish brands in existing developed markets, acquisition of European brands, cooperation and partnership with European producers, Turkey to become the region's shopping center and the increasing demand of the surrounding countries, Turkey to be the regional fashion center, being the

determiner in fashion events and regional fashion trends, European buyers to turn towards high quality products of Turkey with specific price margins due to the increasing production costs in China and increasing small, frequent and fast batch demands.

SECTOR STRATEGIES AND POLICIES

Based on the findings and assessments regarding Turkish garment manufacturing industry, and the outputs obtained from the international comparisons, strategy and policy suggestions have been made in 13 titles to improve the competitive power of the sector.

1. Supporting domestic raw material resources and minimizing import dependency

- a. Supporting domestic production of cotton, raw leather, fur and precious fur skin since they are the three main raw materials of the garment industry;
- b. Removing the special consumption taxes imposed on the precious fur skin production and encouraging the production.

2. Removing safeguard measures in the import of fabric as the main input and supporting fabric production

- a. Removing the safeguard measures applied to fabric and thread import;
- b. Supporting domestic thread and fabric production, and decreasing production costs for this purpose.

3. Improving production costs and decreasing the production costs of the existing enterprises

- a. Supporting existing production facilities at their own locations and decreasing production costs;
- b. Moving the production facilities at major cities to exclusive organized industrial zones that will be established around cities and decreasing production costs at these zones;
- c. Declaring the regions that the leather production facilities are located as exclusive (refined) industrial zones and decreasing production costs at these zones;
- d. Supporting environmental investments and expenditures in the leather industry.

4. Improving investment incentives

- a. Expanding regional scope of the incentives for garment manufacturing industry;
- b. Making improvements in the new investment incentives;
- c. Supporting investments in existing clusters and forming new clusters.

5. Providing suitable options and conditions besides preserving clusters during the spatial restructuring of the industry in Istanbul

- a. Defining exceptions and flexibilities for industry branches without waste and pollution such as garment manufacturing industry;
- b. Establishing garment exclusive organized industrial zones in west and east axes of Istanbul;
- c. Preserving the old supply chains and clusters and ensuring that spatial restructuring supports all cluster elements;
- d. Providing suitable financing opportunities to organizations that will enter into spatial restructuring scope such as corporate tax exception for the first 3 years.

6. Strengthening and supporting design product development and brand creation capacities of the companies

Redefining the incentives provided with the Communiqué on Design Support (2008/2) in a way that will support the design activities of

1. Companies that operate in Turkey and sell their products with their own registered brands at overseas,
2. Companies that operate as contract manufacturers of local-foreign brands in Turkey,
3. Companies that sell their products under their own brand in Turkey,

and taking these companies to the scope of the incentive program.

7. Increasing export with supplier quality and brands, and defining supports for this purpose

- a. Defining support programs for companies carrying out branded sale, wholesale and retail sale operations at overseas;
- b. Establishing a data bank for sectoral foreign market information and supporting the respective actions;
- c. Implementing the Eximbank branded export financing program;
- d. Giving the right to be exempted from all kinds of taxes, duties, charges and safeguard measures in specific amount of input import based on export performance;
- e. Exempting the grants taken from the government from the corporate tax sum.

8. Strengthening regional fashion and shopping center quality

- a. Establishing corporate infrastructure and organizations;
- b. Organizing regional fashion week events, ensuring regional participation to these events;
- c. Establishing informative and commercial fashion portals, supporting these and promoting them overseas;
- d. Cooperating with the companies in world's fashion centers, organizing joint events;
- e. Introducing Turkish garment brands to region countries more and offering wider overseas introduction supports;
- f. Extending shopping festivals to the entire year by supporting them with entertainment-recreation, sports, culture etc. events, and removing the idea of them just being "opportunities for discount".

9. Raising qualified new generation workforce for the sector and encouraging employment in the sector

- a. Planning the new generation workforce required in medium term in line with the transformation process the sector is going through;
- b. Renewing vocational high schools, vocational schools of higher education, universities, undergraduate and graduate education programs, shifting towards practice based training, offering trainings that will fulfill new generation workforce needs;
- c. Increasing the education supports of Istanbul Fashion Academy and similar institutions;

- d. Providing social insurances premium support in the same year employment of graduates in order to encourage employment of vocational school graduates in the sector;
- e. Improving the on-the-job training programs of the companies, supporting the expenditures regarding the training offered by accredited institutions;
- f. Defining flexible and half time work opportunities, enabling the employment of local and foreign workforce at flexible conditions.

10. Improving economic administration and the public perception

- a. Attracting attention to the leadership qualities of the sector in the economy and introducing the sector to the public;
- b. Sharing regularly the phases of the transformation, transition to the value added production, brandization, development in the modern retail markets in the sector and the extra value added created out these phases with the economic administration and the public.

11. Preparing and applying long term individual sector strategy document

- a. Taking and updating all kinds of capacity inventories of the sector;
- b. Aligning and consolidating various existing industry, export and similar titled sector strategy documents in public and private sectors;
- c. Removing the uncertainties in the sector by preparing and implementing a long term strategy and action plan with the participation of all the stakeholders in the public and private sector, ensuring harmonization with the economic administration and improving the image in the eye of the public.

12. Giving a 'status' to the production-trade and overseas sale activities in the region of Osmanbey-Merter-Laleli by regulating, improving and supporting these activities

- a. Ensuring step by step integration to the existing sector and economy by defining a special status for the activities in Osmanbey-Merter-Laleli region which has a significant overseas sale capacity in the ready-to-wear and clothing sector; Declaring or establishing export oriented free trade regions/areas with defined physical boundaries.

13. Improving government supports and practices

- a. Ensuring that all the payments within the scope of government grants and particularly Turquality and Brand Support Program are made rapidly in line with the expenditures;
- b. Making improvements in Inward Processing Regime practices and changes in Customs Regulations;
- c. Taking precautions to protect the consumer health in import and domestic market;
- d. Decreasing the Resource Utilization Support Fund rate in forward imports;
- e. Removing Resource Utilization Support Fund payment in the imports of goods not produced in Turkey or in the imports for export activities;
- f. Including the export carried out with special invoice to the official export figures.