

Central America strategic sourcing review - a focus on Guatemala, El Salvador and Honduras

2016 edition

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July 2016

Published by
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Web: www.just-style.com/market-research/

Registered in England no: 4307068

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About the author

Rupa has over 15 years' experience across various aspects of the textiles and clothing value chain. Her interest in apparel trade and economics led her to intern at the World Trade Organization (WTO) in 2002, where she participated and assisted in the trade negotiations for the second major review of the Multifibre Agreement.

In 2003, she was involved in setting up the first-ever benchmarking software tool for clothing manufacturers, as a project consultant to the United Nations agency, The International Trade Centre (ITC). She went on to serve as the ITC's advisor for textiles and clothing. In addition to facilitating public private partnerships, she also advised, designed and implemented integrated textiles and clothing sector programmes across South, Central and South East Asia, Africa, Latin America and Eastern Europe.

She is currently the managing director of Clothing Connect B.V. (www.clothing-connect.com), a specialised consulting company offering services in research, value chain analysis, market connectivity and export competitiveness programmes with development agencies worldwide.

Led by her strong belief in the empowerment of women entrepreneurs and professionals, she founded the non-profit organisation – 'SPINNA Circle' www.spinna.org with a focus on getting more women in the textiles and clothing value chain to move up the ladder. As a result, she is a signatory to several international projects.

She is a graduate of economics from St. Xavier's College, Mumbai, holds a post-graduation in textile design and development from the National Institute of Fashion Technology New Delhi, a Masters in textile management from the University of Leeds, UK, a certificate in fashion buying and merchandising from the London College of Fashion and has a certificate in international law from The London School of Economics (LSE).

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METHODOLOGY AND OBJECTIVES OF THIS REPORT

Methodology and objectives of this report

This report is aimed as a tool for both buyers and suppliers to assess and compare the advantages and challenges of sourcing and manufacturing apparel in the Central American countries of El Salvador, Guatemala and Honduras. Central America has long been a sourcing destination for the Americas, with its exporters being well-trained and seasoned business people with sound knowledge of the garment business. However, with current movements and changes in global sourcing trends, trade agreements and consumer markets, how will Central America add up as a sourcing destination? Will Central America remain competitive with finalisation of the TPP (Trans Pacific Partnership) Agreement, especially with the inclusion of Vietnam? Will the EU become a new market for Central American countries since the signing of the Association Agreement? Is it viable for Central American companies to service retailers and buyers in emerging retail markets? Will the CAFTA-DR¹ (Dominican Republic-Central America FTA) still continue to increase exports from Central America into the US?

just-style believes there are dynamic developments across the apparel sectors of these selected countries, which could offer interesting sourcing opportunities for both conventional buyers as well as potential first time buyers from other regions such as the EU and parts of Middle East and Asia.

Approximately 66% of the apparel manufacturing industry in **El Salvador** now offers full package services and the industry makes up approximately 46%² of the country's total exports. Since 2005 there has been impressive investment in the synthetic sector, especially in the Zona Francas (free trade zones); there are 17 free trade zones and service parks according to 2015 data from PROESA (the export and investment promotion agency of El Salvador). Several large brands have set up ODM / OEM manufacturing facilities in the country. With a focus on 'speed to market' and 'services', more than 20% of the factories are vertically integrated.

Compliance and sustainable production seems to be the most discussed topic after labour laws and tax incentives in Guatemala. Its new generation of entrepreneurs in the textiles and apparel industry are taking on their parents' or grandparents' factories and mills, and introducing concepts such as recycling, product design and community development as core business principles. Several factories have their own 'codes of conduct'. These suppliers are starting to actively explore new export destinations beyond the conventional US market. With competitive pricing and better productivity rates, Guatemala's apparel industry is set to see a new phase in its 'maquila'³ history.

¹ <http://web.ita.doc.gov/tacgi/fta.nsf/FTA/CAFTA-DR?opendocument&country=CAFTA-DR>

² Datos del Sector T&C Cierre 2015 Camtex El Salvador

³ The maquila industry has its roots in simple 'assembly' and 're-export' of garments to the US. Cut pieces of garments were sent to get sewn into finished products for re-export to the US. This form of manufacturing required very low levels of skill sets

PART 1: THE VALUE CHAIN APPROACH TO SOURCING CRITERIA

Part 1: The value chain approach to sourcing criteria

Will Central American countries remain garment sourcing destinations?

Central America has always been an interesting destination for investors in the garment sector. In the mid-1990s, several Asian investors set up factories to benefit from the quota regime and gain more access to the US market. Soon after the quotas were phased out in 2005, several factories shut down and many investors left the region to head back to Asia. Post-2006, Central America benefitted again from preferential access into the US market through the CAFTA agreement, which was modelled on the NAFTA agreement (North American Free Trade Agreement). While there were many rules and regulations and monitoring mechanisms to benefit from the duty free access, the 'maquila' industry in the majority of the Central American countries adapted and built further systems based on the requirements of the CAFTA agreement. In 2009, CAFTA was extended to include Dominican Republic. Proximity to the US market, lower labour costs, competitive tax laws, the growth of free trade zones and several investment incentives in the region, all helped the maquila to become one of the key export revenue generators across the Central American region.

In August 2012, the EU signed the 'Association Agreement' with Central America offering preferential access into the EU28 market to Costa Rica, Nicaragua, Honduras, El Salvador, Guatemala and Panama. The agreement has been applied or been in effect since 1st August 2013 with Honduras, Nicaragua and Panama, as of 1st October 2013 with Costa Rica and El Salvador and finally from 1st December 2013 with Guatemala. While the rules of origin for duty free market access differ from the CAFTA-DR, it is a huge opportunity for Central American garment and textile manufacturers to expand their exports and diversify their portfolio.

Ten years on since signing the CAFTA agreement, Central America is once again faced with a potential new threat in the form of the TPP agreement, which is made up of 12 countries including the US and Vietnam⁵. This agreement, once completely adopted, will mean competing directly with Vietnam for access into the US market. Since 2007, when Vietnam joined the WTO, its garment exports have increased substantially into the US and EU markets. In February 2016, the final text of the agreement between EU and Vietnam was published. The EVFTA (EU-Vietnam Free Trade Agreement), will potentially provide duty free access for many of Vietnam's products into the EU28 market based on the schedule of elimination of tariffs⁶.

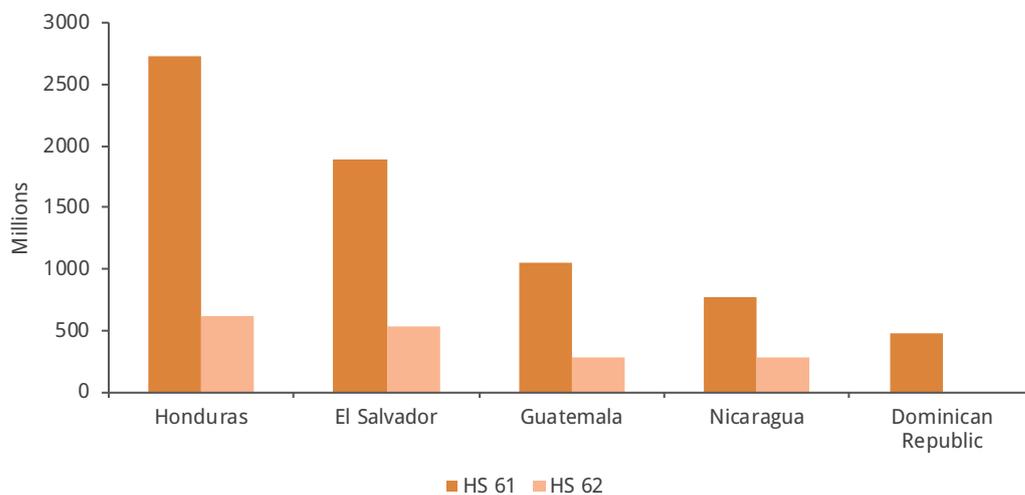
⁵ <https://ustr.gov/tpp/>

⁶ <http://ec.europa.eu/trade/policy/countries-and-regions/countries/vietnam/>

The key manufacturers and exporters of textiles and garments in Central America are principally El Salvador, Guatemala, and Honduras with some growth being seen out of Nicaragua and Dominican Republic. Figure 1 provides an overview of exports (in value) of knit and woven garments (chapters HS61 and HS62 respectively) from the key Central America garment countries to the world for 2015.

The region is dominated by exports in knits as compared to non-knits. Key product categories exported include women’s knit or crocheted tops and blouses, men’s knit or crocheted shirts, various types of hosiery and T-shirts. Some emerging categories include seamless tights and shapewear, swimwear, socks and yoga wear.

Figure 1: Central America’s top garment exports in knits (HS 61) and non-knits (HS 62), 2015 (US\$ value)



Why have we focused on El Salvador, Guatemala and Honduras?

These countries are the main exporters of garments from Central America (see Figure 2 showing total value of exports in knits (HS 61) of the key Central American countries to the world from 2005 through 2015). More than 90% of garment exports from the three go to the US market. While some experts in the region are of the opinion that the TPP will not have an impact on trade with Central America, others are convinced that a significant quantity of business from the region will shift to Vietnam. This report compares the three key Central American countries against each other and against Vietnam on specific competitiveness criteria to see what the possible sourcing strategies could look like in five years.

Part 3: Comparing El Salvador, Guatemala, Honduras and... Vietnam

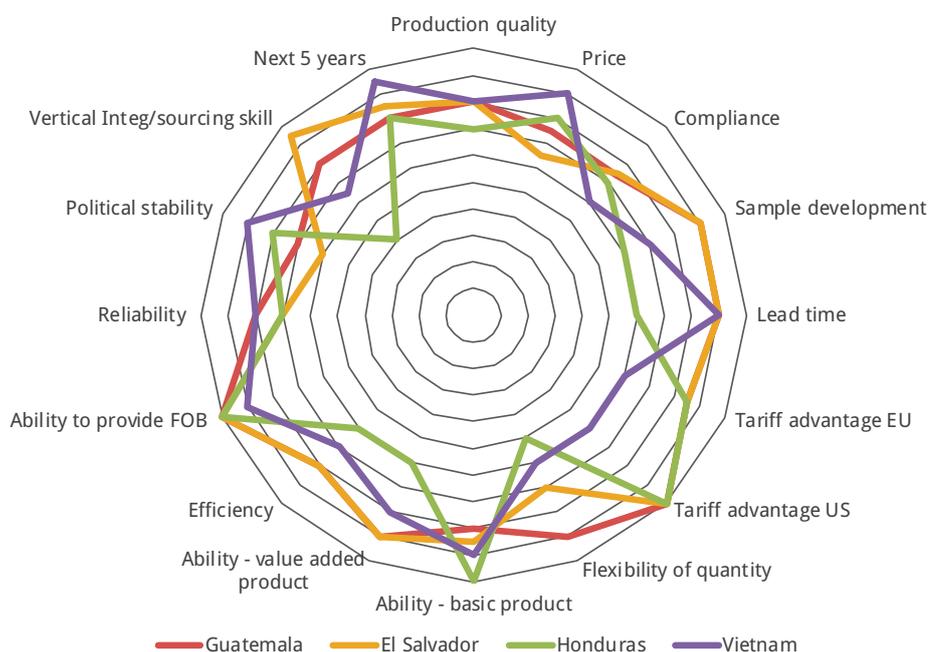
From a buyer’s perspective: as sourcing destinations

The majority of brands and retailers work on their strategies for sourcing based on information from trade journals, by speaking with embassies, sector associations in the relevant country, by sending out scoping missions to assess the scenario in the country and of course from word of mouth and information from other colleagues in the industry.

In an ideal world a brand, retailer or independent designer is looking for a sourcing destination that has no logistics or labour problems, has competitive prices and has factories which are highly competitive from a product development and design perspective, which can provide high levels of efficiency, compliance and safety. With this in mind, the three Central American countries were compared at the macro level as sourcing destinations, to identify which could come closest to an ideal scenario. In addition, the three Central American countries are compared against Vietnam. With the recently negotiated TPP in February 2016, Vietnam could potentially become a direct competitor to Central American countries for access to the US market. With similar product categories and preferential market access for most textile and clothing products (although the TPP is not yet in force and sensitive textiles and clothing tariff lines could be eliminated over time), Vietnam is currently being considered with a lot of interest by many international brands and retailers as a strategic sourcing destination.

The snapshot below provides a visual comparison of the four countries using the 15-point sourcing criteria. We then compare the four countries across each of the 15 points.

Figure 18: Comparing El Salvador, Guatemala, Honduras and Vietnam on the 15-point sourcing criteria



Source: just-style