

Indonesia's BACK IN FASHION

STABILITY – both political and economic – is putting Indonesia at the top of the apparel sourcing “hot list” even as lower labor costs, higher-growth rates and a more abundant supply of youthful labor in Vietnam and Bangladesh make those countries appear to be more viable alternatives to China.

“Indonesia is growing fast like China and India, but maybe at a less rapid pace,” said Frank Smits, managing director of Hollit International, a Jakarta-based Dutch-Italian sourcing company which works with brands such as Hugo Boss, Tommy Hilfiger and Replay. “The country has a very solid foundation, with a modest growth rate, making it quite a consistent place for manufacturing.”

Stable and Able

Hedging against stability (political, social and economic) is becoming a more important strategy than simply scouring the globe for the cheapest labor costs.

“Compared with elsewhere in the world, the political situation in Indonesia right now is much more stable,” said the managing director of the Indonesian and Malaysian sourcing office for a major U.S. mass market retailer, who requested not to be named. “Inflation is about 5-6%, wage increases are controlled by the government and workers rarely go out on strike.”

Indonesia was hit by a political crisis in late 1998, right on the heels of the devastating

1997 financial crash. But since then, massive political cleanups, decentralization and gradual democratization and institutional reforms (*Reformasi*) has helped stabilize the nation’s socioeconomic atmosphere.

“The government has since instituted a lot of labor friendly legislation which has given protection to workers including new policies for overtime, holidays and wage protection,” said Mr. Smits.

In the decade since many big international buyers left Indonesia for China, labor costs for migrant workers in China have risen to about \$160-170 per month. In Guangdong, wages could be as high as \$197, compared to wages in Indonesia which remain at a slightly lower \$140 to 150 per month.

But labor costs are only one reason manufacturers are returning. While productivity can be up to 30% lower than in China, Indonesia’s workforce is more stable. China is now discouraging migrant workers, urging them to take jobs in their home cities and provinces. Unlike rapidly-growing China, the level of ‘ambition’ and competitiveness in Indonesia’s workers is generally not as high resulting in lower worker turnover rates than in China.

“Indonesian workers can work 10 to 20 years on the job and develop very specialized skills. In China, workers are probably on the job for 3 to 5 years and then they move out of the textiles industry to more sophisticated in-

dustries like electronics in search of better pay and prospects,” said Mr. Smits.

“It is true that labor costs are lower in places like Cambodia and Laos, but the skill-sets might not be [very sophisticated],” said Eka Hartano of P.T Sutera-Indah, a vertically integrated garment and textile manufacturer specializing in circular knits. “Indonesia was involved in garment and textiles production way before China or any other Southeast Asian country...the technical know-how of Indonesian manufacturers is hard to match.”

To Ms. Hartano, the biggest misconception of Indonesia is that it is more expensive and thus, less competitive. But like in most things, you get what you pay for. Cost is only one aspect of measuring competitiveness. Reliability, quality and short-lead times are also essential. Indonesia’s more sophisticated systems allow it to take in order volumes of all sizes and be flexible enough to adjust production accordingly.

“In new markets like Laos or Cambodia you can reap bigger profit margins because labor costs are lower but there’s a downside to big margins - you tend to overlook timeliness and reliability of delivery and a price is paid for delays,” said Ms. Hartano. “Margins in Indonesia are thinner but production systems are more advanced. Many factories are implementing successful just-in-time (JIT) strategies, Kaizen practices and Six Sigma management.”

Superior Supply-Chain

Indonesia has traditionally benefited from a robust upstream textile supply-chain. As one of the oldest industries in the country, it keeps about 1.8 million people directly employed and 3.7 million, indirectly employed. In 2005, Indonesia became the 11th largest textile exporter in the world. As an oil producing nation it is also one of the world’s biggest manufacturers of synthetic fibers which furthers its appeal for many apparel companies specializing in sportswear, active wear or functional textiles.

According to the International Trade Centre (ITC), the country’s cotton production accounts for less than 2% of its demand. Indonesia is now the fourth largest cotton importer in the world behind Turkey, Bangladesh and China, importing 2.1 million bales of cotton in 2009-10. The elimination of the 10% VAT imposed on cotton in January 2007 positioned the nation as a net exporter of cotton yarn and fabric.

According to Ms. Hartano, the problem in Indonesia is that there is too much expensive high-quality yarns and not enough lower-end yarns. “For brands with average prices above \$10.50-\$25.00, Indonesia will be good to be a source. Those with average price points around \$6 will actually find it more expensive here,” she said.

On The Downside...

Lack of investment in the textile industry means that most of the textile machinery is

old and inefficient in power usage. According to the ITC, about a third of total spinning machinery in Indonesia is more than 20 years old. While larger companies have invested in automation and new technology, the country as a whole has a lot of catching up to do in order to be competitive. Since it’s difficult to raise prices, the solution is to boost productivity.

Infrastructure is another problem. “Transportation is congested and expensive due to poor infrastructure. It is a major disadvantage,” said the manager of a large US sourcing office, who asked not to be named.

“Local companies have poor design development capabilities and vendors are less proactive,” she said.

Sizing Up the Competition

Indonesia’s biggest problem will be competition with China, a situation which was potentially worsened by the signing of a free trade treaty between the two countries at the beginning of 2010. With unrestricted access to Indonesia’s markets, Indonesian textile businesses have been finding it increasingly hard to compete with the Chinese. Two grim scenarios may spring from this.

Cheaper Chinese materials (mostly smuggled) into Indonesia will reduce incentives for further private investment into the domestic textile industry. Secondly, already considered by the government as a ‘sunset’ industry, textile businesses such as mills, spinners and

weavers will find it harder to get financing from banks without being charged higher rates. The vicious cycle could go on until garment producers finally decide to move out and ultimately cause the industry to collapse.

The Indonesian government, on which the fate of the industry heavily rests, will have to do more to attract long-term investment in the industry to keep it afloat. To do this, foreign companies must be incentivized to make longer-term commitments. There has been evidence however that the tide may be shifting.

“We’ve been seeing a lot more sourcing come in the last 6 to 12 months. Many companies are rapidly approaching Indonesia seriously, which they were not always doing with a clear strategic direction in place before. Previously everything was pretty much done according to a price comparison with China,” said Mr. Smits. As more companies see the advantages in doing business in Indonesia, the trend is expected to continue.

“The biggest challenge for buyers now is to tweak their sourcing model from an individual order placement model, which was a very emotionally and price driven model, to becoming a strategic cooperation model.” Mr. Smits believes that it will be crucial that companies start to strategize better and think “more long term” rather than doing everything “order based”. Partnership models would be the best way to enter. This way companies would get the best capacity allocations and fairest pricing.

| | AVERAGE MONTHLY WAGES | OPPORTUNITIES | STRENGTHS | WEAKNESSES/THREATS |
|-------------------|-----------------------|---|---|---|
| China | \$170 per month | Low-end to high-end garments of all types: men’s shirts, womenswear, knits, wovens, denim | <ul style="list-style-type: none"> • Skilled labor • Organized/clustered • High productivity • Vertical supply chain • Natural resources | <ul style="list-style-type: none"> • Labor shortage/unstable workforce • Increasing costs • Inflationary pressures • Issues with quality |
| Indonesia | \$150 per month | Mid to high-end garments, high quality knits, sportswear, activewear, denim | <ul style="list-style-type: none"> • Skilled labor • Stable workforce • Politically stable • Stable inflation • Natural resources | <ul style="list-style-type: none"> • Poor design development skills • Lack of long term investment • Lower productivity than China • Needs investment in machinery and technology • Social compliance is a problem |
| Vietnam | \$85 per month | Mid-market apparel, footwear, polo shirts, men’s shirts, jackets | <ul style="list-style-type: none"> • Skilled labor • Cheap • Young population • High growth • Proximity to China | <ul style="list-style-type: none"> • Workers lack experience • Raw material shortage • Lack of mills • Poor infrastructure • Inflationary pressures |
| Bangladesh | \$58 per month | Basics, fast-fashion, t-shirts, | <ul style="list-style-type: none"> • Cheap • Labor surplus • Abundant natural resources | <ul style="list-style-type: none"> • Unskilled/uneducated labor • Unorganized/underdeveloped • Sociopolitical instability • Poor infrastructure |