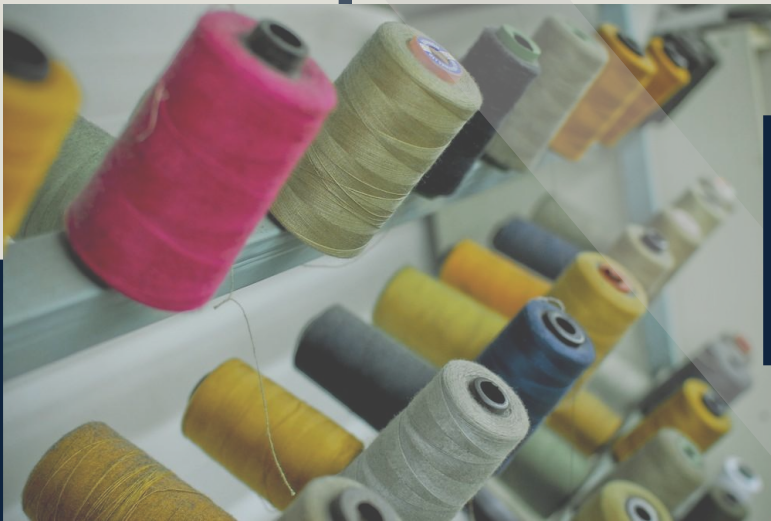


Ready Made Garment in Bangladesh: a hopes of new market opportunities remain, but challenges still appear in productivity, compliances and new price hikes in Gas and Electricity



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**Emerging Research Division
Emerging Credit Rating Ltd**

About Emerging Research

Emerging Credit Rating Limited (hereinafter referred to as ECRL) began its journey in the year 2009 with the motive to deliver credible superior & quality credit rating opinion in various industry segments around Bangladesh. ECRL obtained credit rating license from Bangladesh Securities and Exchange Commission (BSEC) in June 2010 as per Credit Rating Companies Rules 1996 and also received Bangladesh Bank Recognition as an External Credit Rating Institution (ECAI) in October 2010.

Emerging Credit Rating Limited's team is oriented towards the continuous improvement of processes, striving for an important role in the leadership of the business world. Every individual in ECRL is committed to provide top most ingenious Credit Rating Services and Comprehensive Research Services in Bangladesh. ECRL's ratings services and solutions reflects independency, professional, transparency and impartial opinions, which assist businesses enhance the quality of their decisions and help issuers access a broader investor base and even smaller known companies approach the money and capital markets. The Credit Rating process is an informed, well-researched and intended opinion of rating agencies on the creditworthiness of issuers or issues in terms of their/ its ability and willingness of discharging its financial obligations in timely manner. Issuers, lenders, fixed-income investors use these risk assessments for the purpose of lending to or investment in a corporation (such as a financial institution, an insurance company, a non-banking corporation or a corporate entity) as well as evaluating the risk of default of an organization's financial obligations in terms of loan or debt.

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Arifur Rahaman
Chief Rating Officer & Research Coordinator
arahman@emergingrating.com

Biplob Kumar Nandi
Economist
bipnon.du@gmail.com

Al Mamun
Senior Research Associate
mamun_nt987@yahoo.com

Subrata Howlader
Research Associate
subrata.acca@gmail.com

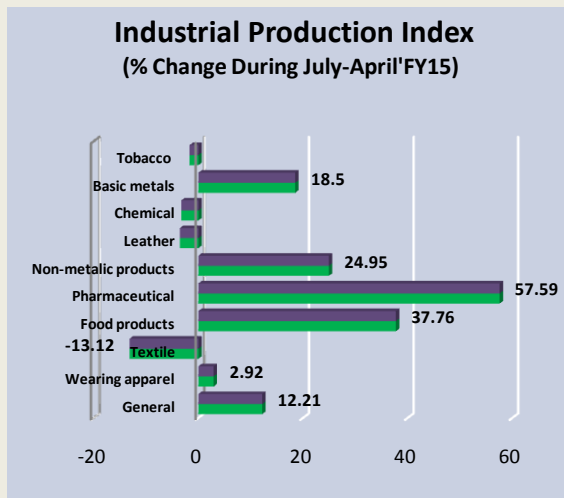
Mohammad Riad Uddin
Junior Research Associate
riad497@gmail.com

Hafsa Binth Yeahyea
Junior Research Associate
123hafsabinth@gmail.com



With lower export earnings in readymade garments during the fiscal year 2014-15, production of readymade garments appears not to be quite impressive in Bangladesh.

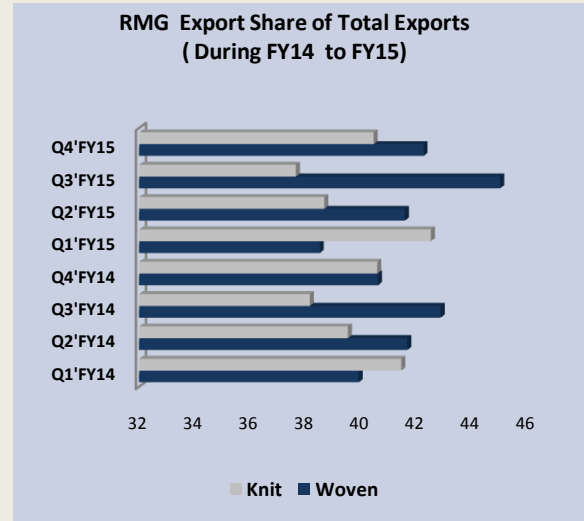
- At the end of July-April 2015, the general index of industrial production, medium and large scale manufacturing, stands higher at 232.5, recording an increase of 12.2 percent over the same period of preceding fiscal year.
- Although general production increases by 12.2 percent, overall production index of textiles is negative while wearing apparel records to only 2.9 percent growth.



- Textile and wearing apparel reveal that less production of RMG in Bangladesh due to persistent decreases in buyer's order from European countries as well as Euro currency has been devalued more against US dollar.

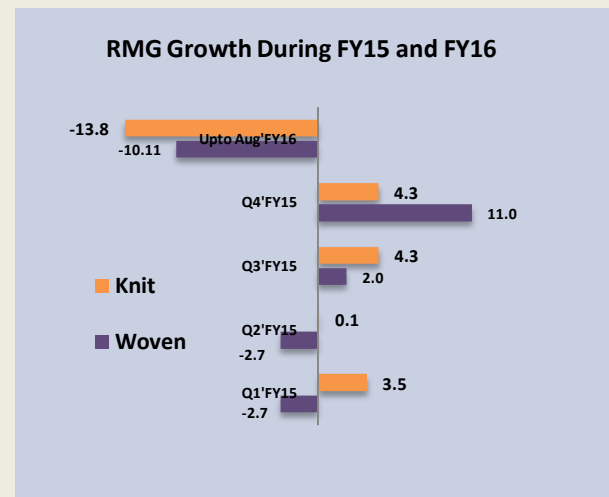
During fiscal year FY15, Bangladesh loses RMG export share by amount of 1.2 percent comparing to fiscal year FY14, trend remains to continue in the beginning of FY16.

- At the end of July 2016, Bangladesh has lost export share of RMG, especially from knit



garments, which records to 1.2 percentage point decline.

- Bangladesh's readymade garments export has increased by 58 percent in terms of volume during August 2016, while in the same period both Knit and Woven garment has registered fairly negative growth in the figure below.

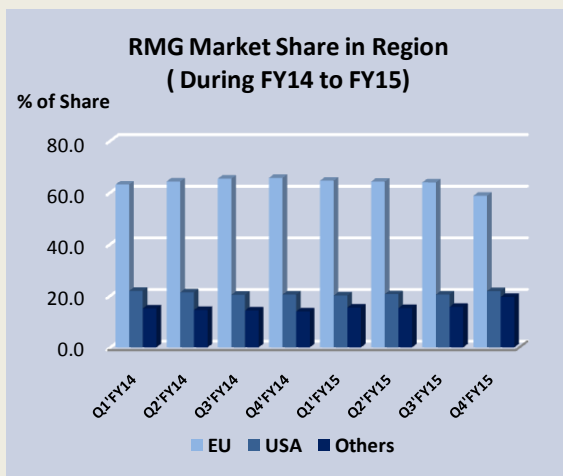


- The value of exports has declined in August 2016 because downward movement of international price and devaluation of Euro, thus, lower prices offer from buyers. Moreover, increase in production cost due

to compliance and wage increase, has negative shocks on market competitiveness.

In terms of market share of RMG, Bangladesh has the achieved second position in EU market, but market share of RMG in EU market declines at the beginning of FY16.

- With the negative growth of RMG exports during August 2016, Bangladesh RGM industry has received a loss of market share by amount of 6.9 percentage points in EU market, while market share of Bangladesh RMG exports gradually follows upward trend in others emerging market – China, India, Brazil, Turkey, UAE.

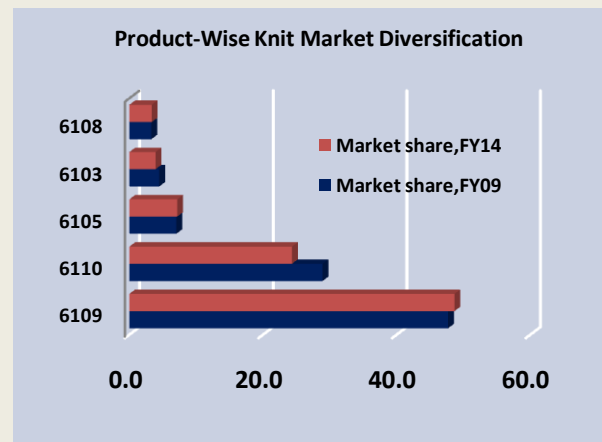


- During FY09, four emerging economies- Brazil, India, China and Japan accounts 1.09 percent RMG export share, while it reaches to 4.9 percent in FY15 due to product diversification, attractive price and intra-industry trade.
- Major reasons behind the declining market share of Bangladesh’s RMG industry are sharp Euro devaluation against US dollar and cost of production. Bangladesh RMG

industry incur higher cost for per unit RMG production that explains recent wage hike, price hikes in gas and electricity and some compliance issues raised due to factory crash, safety issues of employees.

Although overall Bangladesh RMG products were heavily concentrated on main two or three items, RMG products start to more diversify in recent, which help to reduce risks and higher profitability for all firms in RMG industry.

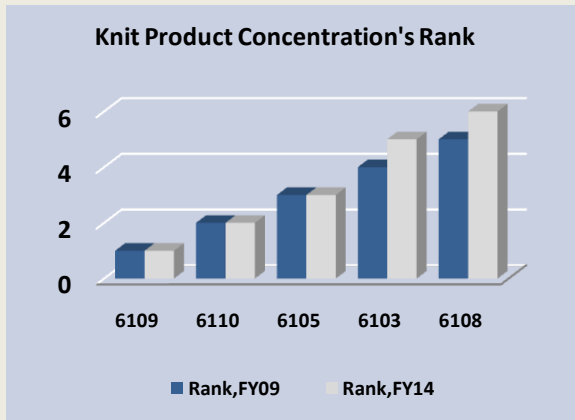
- Bangladesh RMG Knit products are highly concentrated on product 6109 and product 6110, which captures almost 77 percent in FY09 while it accounts to 73 percent in FY16. Thus, this is a good indication of production diversification in Knit garments industry in Bangladesh, but it seems to be slower pace in case of Woven garments.



- Knit product concentration ranks of top three products remain constant during FY09 to FY16. These include top three knit products- 6109, 6110 and 6105. But, the share of these top three Knit products start to decline, which reduce the dependency of top three major products, so, earning opportunities of every firm of Bangladesh

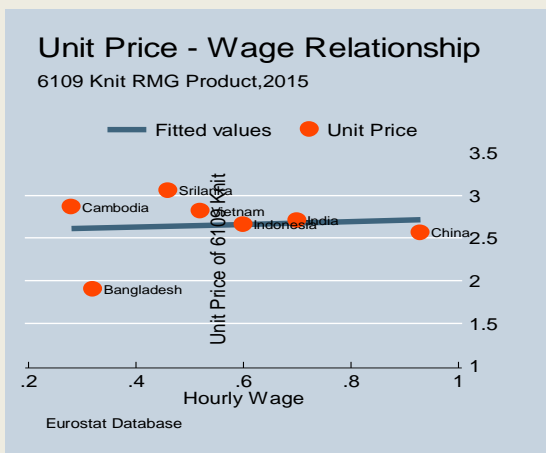


RMG industry will expand in future with minimal uncertainty for higher investments in RMG sectors for local firms.



With Wage increases, bound higher investments for RMG industry owners of Bangladesh in improving compliance issues, and persistent devaluation of euro currency against US dollar, Bangladesh has lost market share in EU market, but Bangladesh has still the highest relative comparative advantage(RCA).

- This relative comparative advantage for Bangladesh in RMG sector attributes to mainly for two reasons – lower wages and lower price for RMG products in international market.

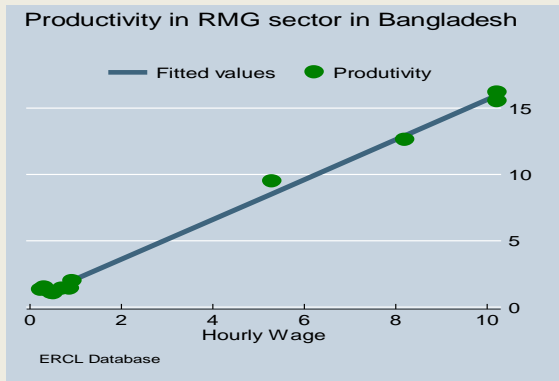


- Scatter plot states that country with the lower minimum hourly wage in RMG industry, are capable to selling their products at the lower unit price. In this context, Bangladesh's position is at nadir indicating Bangladesh offers same type of product with the lowest price among comparators in the world in EU market due to wage cost advantage in globally after implementing minimum wage laws.
- But, recent wage increase and decline price trend of all commodities reduce the profit margin for firms level of RMG industry in FY15. While product diversification in RMG industry and new market expansion in developing countries may reduce risks for firms' level.

Although Bangladesh has a successful story in the case of expansion of new export markets in developing countries, challenges remain in terms of supply chain, compliance, infrastructure and productivity issues.

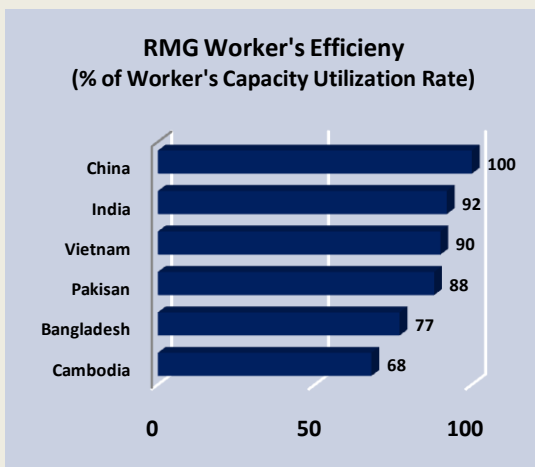
- The productivity of RMG increases over time in RMG sector in Bangladesh. Moreover, challenges in productivity of RMG sector still remains due to lack of investments, lower backward linkages and lack of infrastructures and skilled labor.
- Productivity in Bangladesh increases over time because of improvement in reduction in lead time, higher value addition leading improvement in backward linkages through





higher investment in capacity development and quality improvement.

- Scatter plots suggest that Productivity is directly proportional to wage increases – the higher level of minimum wage increases causes to higher increases in productivity in RMG industry at different country level. All points at left corner in scatter plots indicate lower middle-income country, i.e. Bangladesh, Cambodia, India, Vietnam etc. Thus, wage increase in RMG industry explains a precondition for higher productivity.



- Worker's efficiency is a fundamental to meet up buyer's demand in time, management skill among product lines in the production

process. Based on the Emerging Survey in 2015, 88 percent of the owners think that productivity and efficiency largely depend on the outcome of the sewing and cutting line, skill of operators of sewing to operate machines and in some extent less noisy environment. In Bangladesh, worker's efficiency lower attribute to lack of proper training of sewing operators, lower wages and compliance issues that disturb worker's attention.

Based on McKinsey Survey 2011, Bangladesh has a huge potential for becoming top sourcing country in the world, but success story will depend on supply chain efficiency including buyers and supplier relationship.

Due to increases in costs of production of RMG in China, many buyers from Europe and the USA continued to show interest in sourcing RMG products because of cost advantage and long-term reputation of suppliers in Bangladesh in terms of supply all products on delivery date and maintaining high quality and fashionable products with lower costs.

To become top sourcing country in the world, Bangladesh has to improve productivity and supply chain efficiency. Moreover, supply chain efficiency depends on industry's capacity to reduce the lead time, improve the facilities in ports and roads network system, mitigation of buyer's compliance issues as much as their requirements on the basis of order contacts and increase value addition.

Although Bangladesh has achieved some improvement of value addition in the case of



knit garments, it accounts 77 percent value addition for overall RMG product in FY2015, ECRL Estimate.

Value addition is still low in RMG product in Bangladesh due to the lack of raw materials collection from domestic sources and cost increases during collection of raw materials from China and India which was relatively high. Thus, scarcity of backward linkage industries attributes lower value addition in RMG sector; along with lack infrastructures facilitate more to expand lead time on an average 30 to 75 days for small scale RMG firms (ECRL Survey Data).

Table1: Hindrances for Bangladesh as Sourcing Country

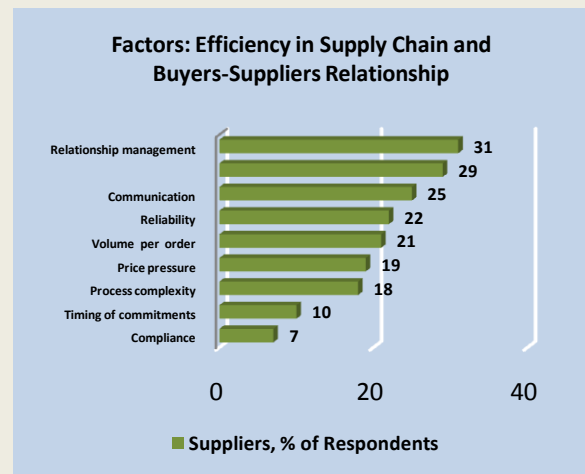
Problem Issues	Detail in each Criteria	Rank of Hindrance	Firm's Opinion
Infrastructure	Utilities, road network, and port facilities are seen as major limiting factors	1	87%
compliance	Situation has improved over the last few years, however, significant continued efforts required	3	54%
Performance	Labor costs are expected to increase, in addition, skill and capacity gap needs to closed	4	55%
Workforce supply	Dependency on imports is considered a major source of risk regarding lead times	2	62%
Raw Materials	Risks of political instability threaten sourcing activities	5	40%

Source: ECRL Survey Data

Supply chain efficiency determines the productivity and long-term relationship among buyers and suppliers. Based on the survey, 87 percent of the firm's owner provided on the highest importance of infrastructure development 62 percent emphasized on the supply side capacity -produce more raw materials in the domestic market; improve workers' efficiency – to mitigate hindrances for becoming top sourcing country within 5 years. However, few of the firms agreed that political

instability and wage increases for workers creates some obstacles to supply products at low-cost price along with manageable lead time , they personally believe that it is not a long-lasting episodes.

Moreover, the effectiveness of maintaining delivery order for buyers with standard quality attributes more expected product order in future leads to efficiency in the production process and supply chain. But, recent political instability, workers' unrest are responsible for losing contracts from international buyers, thus, small RMG firms have faced some problems to maintain order date, shipment, and production.

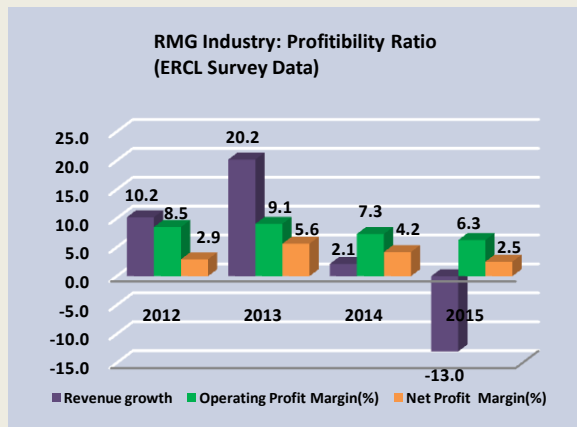


Based on ECRL Survey data, 31 percent of suppliers believe that supply chain efficiency is highly dependable on the good relationship between suppliers and buyers. Suppliers and buyers relationship indicates the capacity of individual firms to supply quality products on the basis of order contacts on time. Based on the survey, 31 percent of suppliers emphasized on the improvement in relationship management, they also highlighted on improvement in communication at regular basis



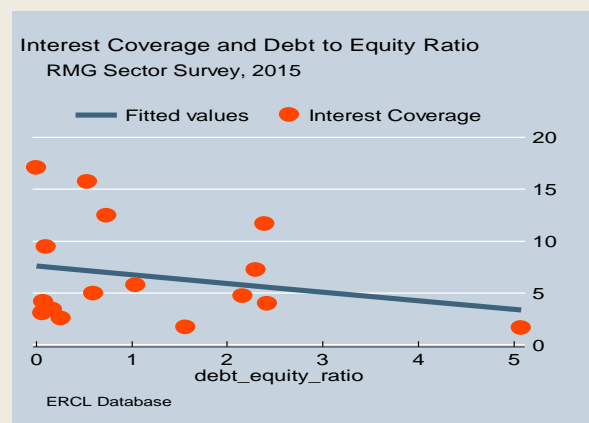
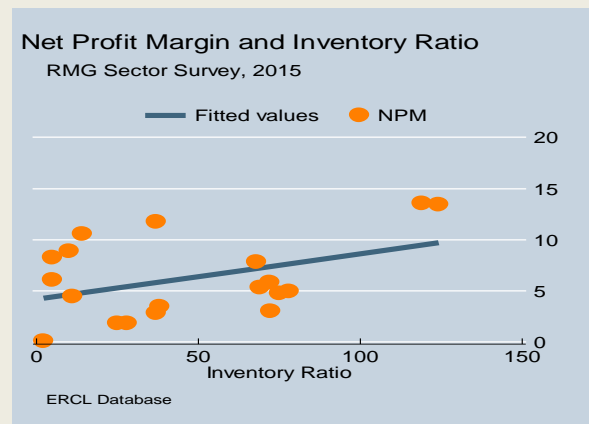
with international buyers and increasing reliability.

With continued to lowering exports earnings, lack of infrastructures, and also recent Bangladesh government’s decision to hike the prices of gas and electricity may reduce the firms’ profitability that may give birth to credit default risks and financial soundness volatility in RMG industry in future.

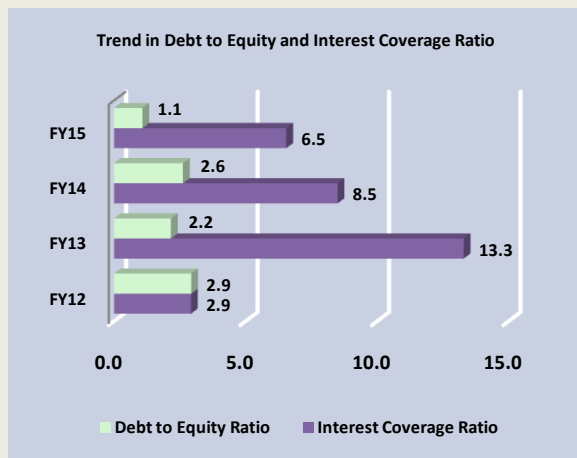


Financial stability largely depends on the profitability condition of a firm – i.e. revenue growth, net profit margin, receivable turnover ratio, inventory turnover ratio, etc. During the last four years, it is explicit that there is a positive relationship between revenue growth and net profit margin. Since export is the only sources of revenue earning of all RMG firms in this sample, so, with negative growth of all industry average, implementation of minimum wage laws in RMG workers along with price hikes of gas and electricity, net profit margin drastically falls at the end of FY15. It will deteriorate more in the first quarter of the current fiscal year due to continued exports fall in both knit and woven garments.

Moreover, average inventory turnover ratio decreased to 46.4 at the end of FY15 from 49.3 in FY14. High inventory turnover ratio provides a good signal of strong sales and better liquidity for a firm, but average inventory turnover ratio started to fall during the middle of FY14, leads to exports earning for almost all of the RMG firms was lower due to EU debt crisis and price falls in the international market. In addition, the average receivable turnover ratio of industry decreased to 41.3 percent in FY15, while it was 47.6 percent on an industry average in FY15. Since Euro currency depreciates against US dollar, buyers who trade under fixed exchange rate contracts, have to pay more on the payment time, may hinders smoothing credit collecting process, and sometimes, buyers are incapable of retain good relationship among suppliers.



Interest coverage ratio indicates the signal of firm's solvency, profitability and ability to the debt burden, which leads to the higher return on assets and equity. This above scatters plot in relating to interest coverage ratio and debt to equity ratio implies a strong significant positive correlation, indicating the higher return on equity and assets depends on the degree of a company's ability to meet its interest obligations from existing debt burden. If the debt burden is high along with lower interest coverage ratio, then, there exist potential default risks to repay the loan with their available earnings.



From the above graph, it is clear that debt to equity ratio decreased to 1.1 percent in FY15 while it was 2.6 percent in FY14, implying that overall debt for all firms in the RMG industry on an average decline in FY15. In terms of interest coverage ratio followed the similar trend, on an average it decreased by the amount of 2.0 percentage points during last year, thus most of the medium scale firms faces a serious problems to expand their business, if this becomes to be more deteriorate due to further decline of RMG export and recent price hikes in

gas and electricity, some of the small firms face a credit constraints, and potential default risks.

Thus, for sustained RMG export growth, Bangladesh government should take more importance to expand new market among Asia, Africa, and South America, and also focus on the product diversification. Although Bangladesh has achieved some gains from expanding new markets in India, Brazil, China and South Africa, share among these are is still not quite impressive. Meanwhile, RMG industry should more focus on the high-end products for export in EU and US market to earn more revenue. Most of the Bangladesh RMG products are highly inelastic, thus, with the lower price it may be difficult to earn more revenue target when the international market price starts to decline. Thus, this the high time to take advantage of the international market, to become a top sourcing country in the world, by shifting policy for high productivity, standard compliance, product diversification, improvement relationship among buyers and long-term conducive infrastructure for an industrial revolution.