

Textiles & Apparel Cluster in South Africa

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Introduction

South Africa's current economic, political and social realities are rooted in its long history of racial segregation and apartheid. While developing the most advanced economy in Africa, the country experienced a two-speed development process that created gross inequality along racial lines. Since the transition to democracy in 1994, the country has had to grapple with establishing political stability, unity and reconciliation; improving its economic performance; and ensuring equal participation in the country's progress. One avenue to improved economic performance in South Africa has been the growth of a number of clusters in the country, including mining, automotives, chemical products, and textiles among others.

This paper seeks to apply the frameworks developed by Professor Michael E. Porter in an analysis of the South African textiles and apparel cluster. Section I provides an introduction to South Africa, a discussion its economic performance, and an analysis of its competitiveness at the national level with country-specific recommendations. Section II provides an overview of the global textiles industry, a detailed account of the South African textiles and apparel cluster, and an analysis of the cluster's competitiveness. Section III concludes and provides cluster-specific recommendations.

I. Country Analysis

About South Africa

Geography

Located at the southern tip of the African continent, South Africa borders Namibia, Botswana, Zimbabwe and Mozambique. South Africa has more than 1500 miles of coastline along the Atlantic and Indian Oceans. In 1652, Dutch settlers established an outpost of the Dutch East India Company at the Cape of Good Hope—an important stopover along the trade routes to the East. With the construction of the Suez Canal in 1869, however, traffic between Europe and Asia no longer needed to navigate around southern Africa. The ports in South Africa, including Cape Town and Durban, are the main

entry points for incoming shipments to the Southern Africa region, but are very far from major markets in Europe and North America. Natural resources include gold, coal, iron ore, phosphates, diamonds, and copper. The discovery of diamonds in 1867 and gold in 1886 stimulated rapid economic growth in the 19th century, although the economy has since become more diverse. Johannesburg is the economic center of the country, and Cape Town is a key regional economic hub in the Western Cape.

Society

Roughly twice the size of Texas, South Africa has a population of 49 million people and a median age of 24.4 years, which is kept low by the high prevalence of HIV/AIDS (18% adult prevalence rate). Approximately 60 percent of the population lives in urban areas, led by Johannesburg (3.9 million), Durban (3.5 million), and Cape Town (3.5 million) (UN Department of Economic and Social Affairs, 2007). As an indication of the general standard of living, South Africa ranks 125th among all countries in the Human Development Index, which is low relative to its position at 79th in terms of GDP per capita (UNDP, 2008; IMF, 2009). South African society is comprised of four general racial categories: African (80 percent); white (9 percent); “coloured” (9 percent) and Indian (2 percent). The African category encompasses several different ethnic groups, including Zulu, Xhosa, and Sotho. South Africa has a long history of racial segregation, which was institutionalized as the official state policy of apartheid from 1948 to 1994. The majority non-white population was politically disenfranchised and economically marginalized throughout much of South African history. More recently, migrants from other African countries, including Zimbabwe, Somalia, and Congo, have relocated to South Africa. A wave of xenophobic violence targeted these recent migrants across the country in 2008.

Politics

In 1994, South Africa underwent a transition to a democratic constitutional republic in which all residents were permitted to vote regardless of their race. Until then, only whites could vote in elections. In the first free elections, Nelson Mandela was elected president in 1994. Thabo Mbeki succeeded Mandela in 1999, but was ousted in internal party disputes in 2008. Although Mbeki’s

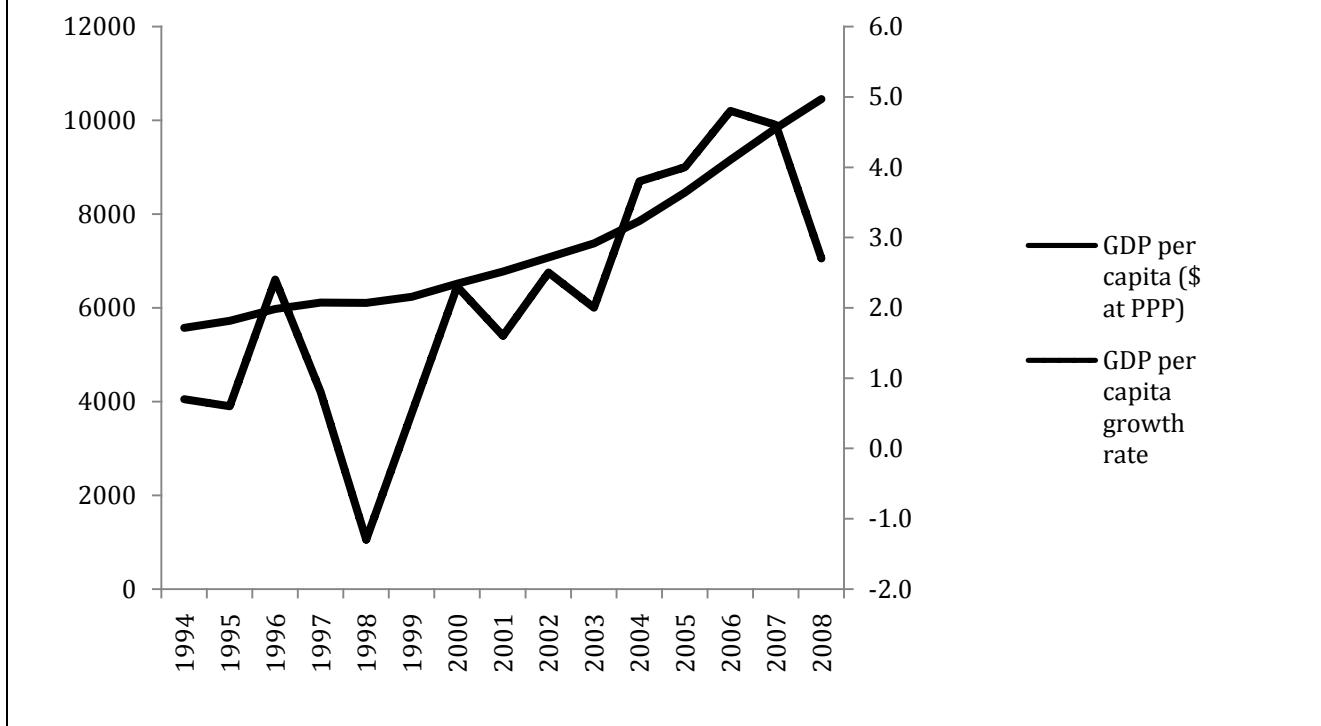
removal was ostensibly attributed to failures of political leadership, there was growing disillusionment that his liberal macroeconomic policy orientation had not significantly improved opportunities for previously disadvantaged groups. Despite these sentiments, the African National Congress (ANC) maintained its political dominance in 2009, with the election of Jacob Zuma. The leading opposition party, Democratic Alliance, improved its showing in 2009 and is strongest in the Western Cape. Disappointment among poor Africans about the slow pace of change in their position since 1994 and the benefits accrued by an emerging black middle class has fueled speculation that the ANC may eventually split (Lelyveld, 2009). In the foreseeable future, however, the private sector can expect political consistency with the widespread popularity of the ANC, which is not threatened by formidable rivals. The ruling ANC is in a long-running alliance with the Congress of South African Trade Unions (COSATU) and the South African Communist Party (SACP). Despite these alliances with leftists, the ANC has pursued liberal macroeconomic policy since 1994. In relations with its neighbors, South Africa is positioned as a regional leader, as evidenced by its involvement in brokering a settlement to recent political turmoil in Zimbabwe. Domestically, the government will continue to confront the ongoing HIV/AIDS pandemic and persistent economic inequality.

National Economic Performance

GDP and Growth

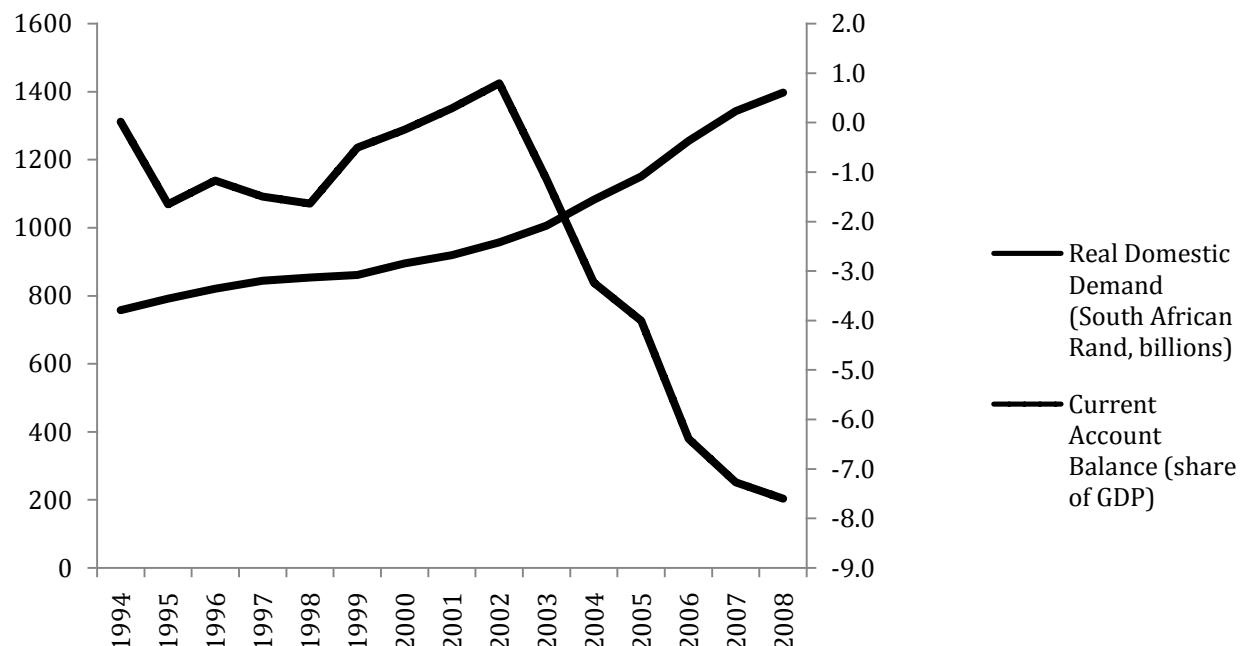
South Africa has among the highest GDP per capita in Africa (\$10,450 in 2008 at PPP), and the largest economy in the southern Africa region with a total real GDP of \$455.2 billion (PPP at 2005 prices). Its overall real GDP in 2008 accounted for 65.6 percent of the combined GDP of all economies in the southern Africa region (EIU, 2009). Since the transition to democracy in 1994, it has experienced general macroeconomic stability and moderate, sustained growth. Between 1994 and 2004, real GDP grew at a compound annual growth rate of 3.1 percent. Economic growth has since accelerated to 4.6 percent from 2004 to 2008 (see Figure 1).

Figure 1: GDP per capita in South Africa (source: EIU)



A decomposition of South Africa's growth indicates that improvements in labor force productivity contributed heavily to pre-2004 growth. Between 1995 and 2003, the average annual growth rate in labor productivity was 5.5 percent; from 2004 to 2008, this rate dropped to 2.2 percent. The post-2004 acceleration in growth has coincided with an expanding labor force. The South African labor force actually declined by approximately 600,000 workers (-3.7 percent) from 2000 to 2004; it then increased by 1.7 million (+10.7 percent) by 2008 (EIU, 2009). The post-2004 acceleration in growth "has been driven mainly by domestic demand and has been financed through a rising current account deficit" (Hausmann, 2008, p. 2). The deficit increased from near balance in 1994 to 7.6 percent of GDP by 2008, suggesting that growth in domestic demand has outpaced GDP (EIU, 2009).

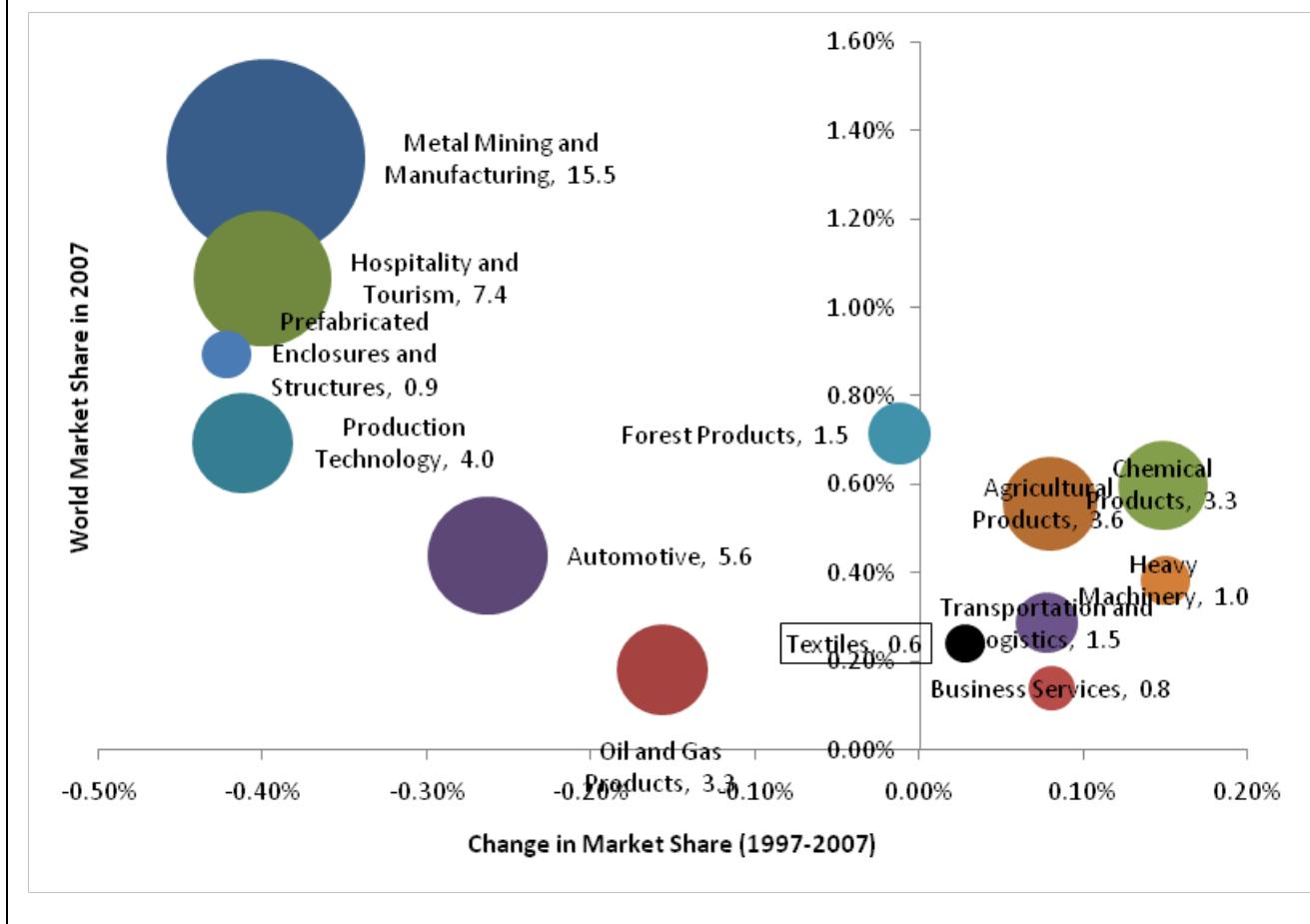
Figure 2: Domestic Demand and Current Account Balance, 1994-2008 (source: EIU)



Economic Profile

The service sector contributes to GDP with a share of 67 percent, followed by industry (30 percent), and agriculture (2.5 percent). South Africa has maintained its position as the world's leading producer of platinum, gold, and chromium, but key economic sectors have suffered recent declines. By the end of 2008, retail sales had decreased by 4.4 percent and manufacturing had dropped by 4 percent over the previous year. Within manufacturing, steel, iron, and motor vehicles have been particularly hard hit (EIU, 2009). As a contributing factor to its increasing current account deficit, South Africa is losing global market share in some of its leading clusters. The largest clusters in terms of value are metal mining and manufacturing (with a total export value of \$15.5 billion), followed by jewelry and precious metals, hospitality and tourism, and automotive, which have all been declining in world market share. The clusters with the greatest increases in world market share have been coal and financial services (see Figure 3).

Figure 3: South Africa Export Portfolio



The problems of high unemployment and entrenched inequality have persisted since the democratic transition in 1994. Recorded unemployment has actually increased since then, as workers have entered the formal labor force at a faster rate than jobs have been created. Unemployment is concentrated among low-skilled workers and is linked to historical racial inequality. In 2005, the overall unemployment rate was 27 percent; while 32 percent of African workers were unemployed, the rate for white workers was 5 percent. This racial gap in recorded unemployment has widened since 1994 (Banerjee, Galiani, Levinsohn, & Woolard, 2006). The concentration of low-skilled workers among the unemployed poses a particularly difficult challenge for South Africa. The industries that traditionally employ workers with low skill levels have been in steady decline. From 1994 to 2004, employment has decreased in mining by 29 percent, in manufacturing by 12 percent, and agriculture by 12 percent (Hausmann, 2008). The sectors that have been growing, including finance and business

services, have created employment opportunities for those with higher levels of skill. The overall poverty rate was 57 percent in 2001 (Human Sciences Research Council, 2004). South Africa is one of the most unequal countries in the world, with a Gini coefficient that is ranked lower than only a handful of countries, including Namibia, Bolivia, Haiti and Paraguay (CIA, 2009). The economy exhibits what has been termed the ‘two-economy phenomenon’—a divide between a formal economy with high productivity that matches industrialized economies, and an informal economy with low productivity in which low-skill, low-income workers are concentrated.

Constraints to continued and shared growth

The government has pursued the Accelerated and Shared Growth Initiative for South Africa (ASGISA) since 2005—a macroeconomic policy framework that aims to raise the annual growth rate to 6 percent and reduce poverty and unemployment by half by 2014. The challenges facing South Africa are marked by an underlying tension between the objectives of efficiency, which requires improved competitiveness, and equality through the creation of opportunities for the previously disadvantaged black population.

The robust domestic demand that has been driving recent growth has been met by imports. Since South Africa cannot rely on domestic demand to remain high, it would face an extremely difficult challenge in maintaining growth and unemployment in the absence of increased exports. To the extent that domestic demand does remain high, it will continue to be met by imports and a persistent current account deficit. The current condition of its transportation and energy infrastructure limits its ability to expand exports. There has been little investment in improving transportation, and the energy supply has been unreliable as the public electricity utility, Eskom, has resorted to rolling blackouts and ‘load shedding’ in 2007 and 2008. Several other factors constraining South Africa’s growth potential will be discussed in the country competitiveness analysis in the next section, including trade policy and labor market rigidities. In terms of addressing the structural unemployment problem, underinvestment in the tradable sector has led to low long-term growth in exports and serious declines in employment. Further, a central element of the government’s strategy to address inequality,

the Black Economic Empowerment (BEE) policy, has focused on extending opportunities to black South Africans at the managerial and ownership levels. While BEE may play a role in creating a relatively small subset of wealthy black South Africans, it has not meaningfully addressed the chronic unemployment at the low end of the labor market.

Analysis of National Competitiveness

South Africa was ranked near the middle (#36) of a set of 74 countries in the Global Competitiveness Index in 2008. In its assessment of the overall business environment across countries, the World Bank noted particular strengths for South Africa in various measures of governance, including government effectiveness (75%), regulatory quality (70%), and control of corruption (67%). At the same time, it noted that the high level of crime and violence is a liability for business (World Bank, 2009). In its assessment of national competitiveness, the World Economic Forum noted that South Africa benefits from sophisticated financial markets, but lags in primary education, national savings, quality of infrastructure, and the incidence of serious disease, including tuberculosis and HIV/AIDS (WEF, 2009). The diamond framework presents a deeper analysis of the competitiveness issues facing South Africa.

Factor Conditions

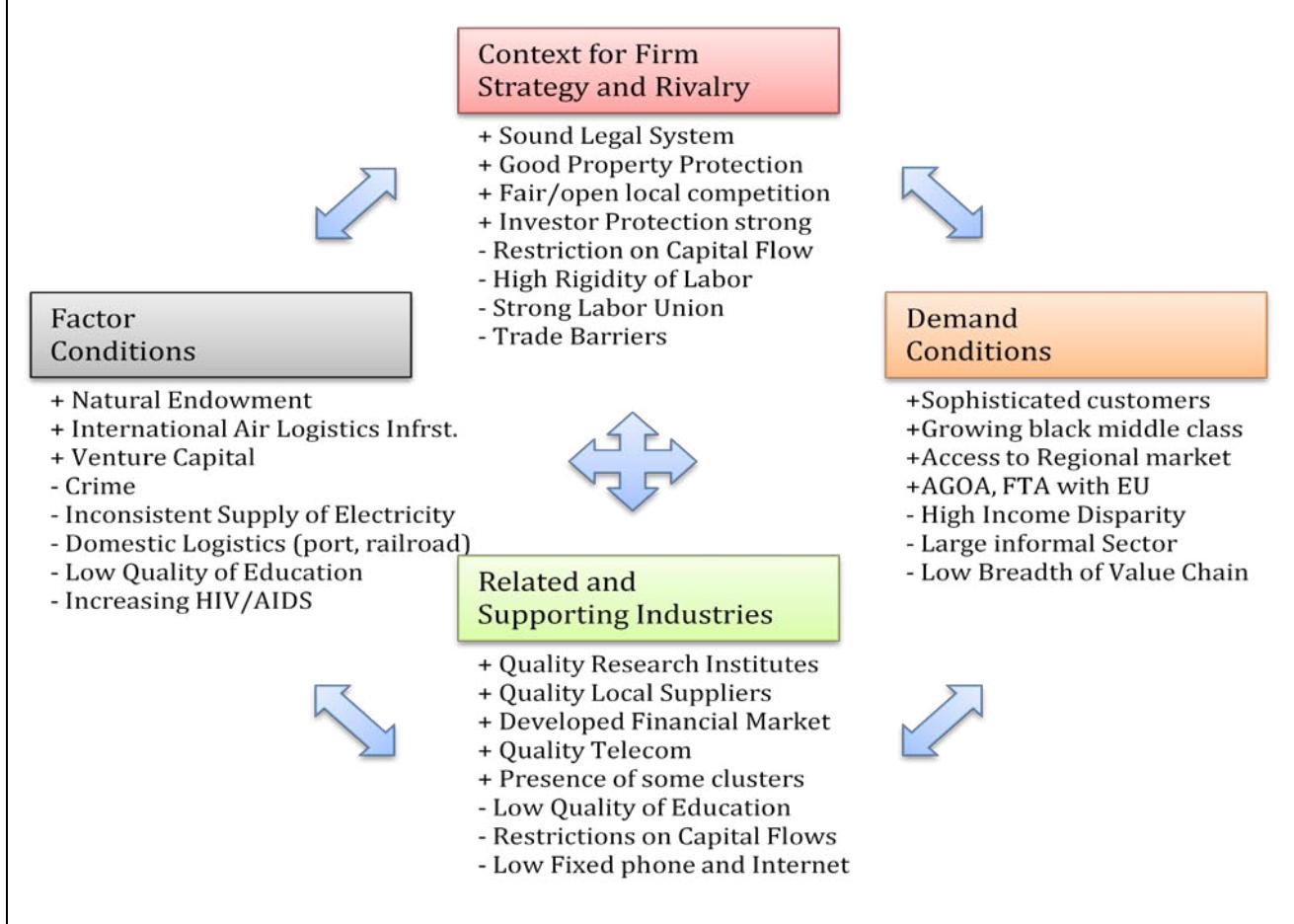
Three important factors negatively impact South Africa's competitiveness and constrain business: an inadequately educated workforce, crime and theft, and inadequate infrastructure (WEF, 2009). Low skills and high crime in particular are a greater problem in South Africa than in other middle-income, expanding economies. South Africa ranked last among 74 countries in assessment of the cost that crime imposes on doing business.

Reflecting a shortage of high-skilled workers, the net university enrollment is only 15 percent; for comparison, the tertiary enrollment rate is 17 percent in Brazil and 28 percent in Malaysia. This translates into higher costs of high-skilled workers and constrains the economy's capacity for innovation. The historical exclusion of the black majority from higher education has played an important role in the lower level of high-skilled workers. A rigid labor market with high costs of hiring

and firing and the outmigration of high-skilled whites pose challenges, and the employment mandates under the Black Economic Empowerment (BEE) policy makes it difficult for firms to hire high-skilled foreigners. To address this challenge, government, business, and labor organizations launched the Joint Initiative for Priority Skills Acquisition (JIPSA) with the aim of overcoming the lack of skilled labor in key sectors (including textiles), which they commonly identify as a serious bottleneck to the country's development. Since JIPSA was only recently launched in 2006, it is too early to assess its impact. The high prevalence of HIV/AIDS among working age adults poses another serious challenge to the availability and stability of labor across the economy.

The country's infrastructure presents a mixed picture. Johannesburg is a major regional hub for air travel, and the market is served by a national air carrier (South African Airways) and several

Figure 4: South Africa Country Diamond



smaller domestic carriers. With a well developed highway system and improving quality of roads, South Africa ranks number 23 in road infrastructure (WEF, 2009). The quality and consistency of electricity supply, however, has been deteriorating in recent years due to the lack of sufficient investment by ESKOM, the public electricity utility. Power outages and rolling blackouts have had a negative impact on productive capacity in recent years. To address these issues, the government plans to spend approximately \$49.5 billion to improve infrastructure over the next five years through investments in railway lines, harbors, ports, and roads, as part of the ASGISA initiative. A new international airport will open in Durban in 2010, along with expanded facilities for cargo, trade and support services for export. With primary emphasis on increasing export capacity, the project is billed as the Dube TradePort with the objective of serving as "Africa's global trade gateway." The plans identify the textiles and apparel cluster as one of the five key export sectors to benefit from the project (Ministry of Finance and Economic Development, KwaZulu-Natal, 2005).

The efficiency of financial markets is one of South Africa's greatest strengths, among factor conditions. The World Economic Forum gives South Africa high scores for ease of accessing loans, availability of venture capital and the sophistication of the financial sector (WEF, 2009). In a survey of businesses, only 1 percent cited access to finance capital as a constraint (World Bank, 2009).

Context for Firm Strategy and Rivalry

The labor market is characterized by a low level of flexibility in the labor market. According to an assessment by the World Bank, South Africa's score on an index of labor rigidity (42/100) was significantly higher than the average for OECD countries (31.4). There are considerable constraints on hiring and firing employees, wage determination is rigid, and employer-worker relations are considered to be weak (World Bank, 2009). Labor unions have a strong presence in South Africa, and the national labor federation, COSATU, has close relations with the ruling ANC.

South Africa does have a number of strengths in facilitating competition in domestic markets. In an assessment of competitiveness across countries, South Africa ranked high on efficacy of

corporate boards (14); efficacy of legal framework (16); protection of minority shareholders' interest (11); effectiveness of anti-monopoly policy (10) and intellectual property protection (19). There are still concerns regarding favoritism in government decisions, trade barriers and the intensity of local competition (WEF, 2009). To facilitate competition in private markets, the government established the national Competition Commission to tackle the impediments to competition in 1998. Of particular concern for the textiles and apparel cluster, the inconsistent enforcement of customs regulations enables dumping that may threaten domestic producers.

Country Related and Supporting Industries

The availability of research and training services and the quality of collaboration between universities and industry research contribute to the South Africa's capacity for innovation, which the WEF ranks at 28 across countries. However, its potential is constrained by the low level of tertiary enrollment, particularly in mathematics and sciences. South Africa has 109 internet users per 1000 people, which is higher than China (85), but significantly lower than other middle-income countries like Brazil (195) and Malaysia (172). South Africa also trails Brazil and Malaysia in landlines per capita. It performs better in cellular phone infrastructure with 724 lines per 1000 people, significantly higher than Brazil (462) and just behind Malaysia (771) (UNDP Human Development Database). The government plans to increase investments in information and communication technologies (ICT) through the growth of the broadband network and the reduction of telephony costs. The quality of domestic ICT suppliers is generally high, but they have limited capacity to meet market demand. More broadly, supporting industries are generally hampered by the low level of cluster development in South Africa. Although the historical roots of economic development were based on early mining clusters near Johannesburg and Kimberley, the economy has since diversified but has not seen the emergence of a range of well-developed, integrated clusters at the sub-national level.

Demand Conditions

The domestic market benefits from an increasing black middle class but also faces the limitations of a extremely high inequality and the persistence of a dual economy with the black majority relying on

work and even consumption in the informal sector. Considering its strong economic position, South Africa should stand to gain in the regional market in the context of ongoing regional integration through SADC¹, SACU² and COMESA³. Unfortunately, this opportunity is limited by the slow pace of the integration, the low level of implementation of the common integration measures, and by the low purchasing power of the neighborhood. In the global market, South Africa has favorable demand conditions for improving its exports to the US market through the Africa Growth and Opportunity Act (AGOA) and the Free Trade Area for the European market through the Trade, Cooperation and Development Agreement (TCDA). South Africa faces difficulties in establishing itself in these markets, however, because of its geographical location creates a long shipping time to large markets and it is unable to compete on cost with lower-wage economies.

Strategic Issues

South Africa faces a set of key challenges regarding its competitiveness:

- **Macroeconomic stability:** Its real exchange rate has been volatile in the past decade and its current account deficit continues to increase as a share of GDP.
- **Regional opportunities:** The neighboring countries are poorer and have much smaller economies. Ongoing turmoil in Zimbabwe presents some regional instability, and South Africa is very far from important potential markets.
- **The economic impact of legacy of apartheid:** Deeply rooted in political, economic and social inequality, South Africa is confronting the impact of apartheid on: the structure of the economy (informal/formal; “one country, two economies”), the labor market (lack of skilled workers, rigidity of employment and strong unions, productivity), social indicators (poor public health and transmissible diseases; low level of education), market size (large inequalities) and the business environment (crime and violence associated in part with high levels of inequality).
- **Infrastructure:** South Africa has some important weaknesses in electricity supply, ICT, ports, and logistical infrastructure.

¹ The Southern African Development Community (SADC) comprises Angola, Botswana, the Democratic Republic of Congo (DRC), Lesotho, Malawi, Madagascar, Mauritius, Mozambique, Namibia, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe.

² Botswana, Lesotho, Namibia, Swaziland (the BLNS countries) and South Africa have organized themselves into South African Customs Union (SACU) with a common tariff regime without any internal barriers and with customs revenues shared according to an agreed formula.

³ Common Market for Eastern and Southern Africa promotes regional economic integration through trade and investment in nineteen countries.

Efforts to improve economic competitiveness must also consider the perceived tensions between improving efficiency and increasing equality. The ASGISA has set out to facilitate shared growth by addressing six key constraints: (i) inadequate infrastructure and logistics; (ii) skills shortages; (iii) barriers to entry and competition in several key economic sectors; (iv) the regulatory environment; (v) capacity limitations within the government; and (vi) the volatility of the exchange rate. These constraints are all identified as key factors in our competitiveness analysis.

Recommendations: Country-level

Recommended steps for government and the private sector are outlined in Figure 5. To ensure macroeconomic stability, the South African Reserve Bank and the National Treasury should move beyond its current focus on inflation targeting and more effectively manage the exchange rate. Fiscal policy should promote increased savings and reduce the current account deficit. To develop a more inclusive economy, steps should be taken to increase access to higher education among black South Africans to incorporate SMEs, particularly in the informal sector, into the mainstream economy. The development of infrastructure can both contribute to national competitiveness directly and lead to job creation and economic stimulus. A more open immigration policy

As ASGISA is oriented around macroeconomic and broad sector-based strategy, South Africa should simultaneously incorporate a cluster-oriented development strategy. South Africa's recent policy initiatives have not adequately dealt with two key issues: HIV/AIDS and crime. In the short run, the government should increase the confidence in law enforcement by fighting corruption and developing more coordination among police units. In the longer term, a commitment to reducing entrenched inequality may relieve some of the structural underpinnings of high crime rates. In the labor market, the Black Economic Empowerment (BEE) should put more emphasis on skills development through education and incentives for the first job and developing stronger links between schools and industries (Hausmann, 2008).

Figure 5: Country-level recommendations for South Africa

Issue	Recommendation	Government	Other Actors
Macro-stability	Manage the inflation, the exchange rate and the current account deficit	SA Reserve Bank and National Treasury to better balance the inflation targeting policy with a monetary policy aiming at managing the exchange rate; Fiscal policy to reduce demand and increase savings and investment rates for the implementation of ASGI	Private firms in the finance sector
Improve regional opportunities	Improve implementation of regional integration	Lead neighboring countries to emphasize benefits of integration for competitiveness	Regional neighbors
Inequality, Growth, and Apartheid Legacy	Balance tensions between efficiency and equality	Focus on skills empowerment and less on ownership in BEE; Separate Dept of Trade and Industry policy role from implementing programs; Support more efficiently SMEs and links with larger firms	Partnership with Private sector
Scarcity of high-skilled workers and high labor costs	Expand access to higher education to black South Africans	Increase investment in education, mainly to increase the tertiary enrolment; Implement the JIPSA program with focus on cluster development; Incentives to facilitate the first contract of young people mainly black	Firms, universities, unions
	Increase supply of high-skilled workers	Ease the immigration rules restricting employment of high-skilled foreigners	
	Reduce the cost on business of HIV/AIDS, Tuberculosis	Improve the access to health and expand access to HIV/AIDS treatment	Public health sector, firms
Crime and violence costs	Increase effectiveness of law enforcement	Increase trust in the police by fighting corruption and restoring state legitimacy; Develop more coordination among the various units fighting violence and crime	Partnership between private security companies and public police
Infrastructure	Improve low quality of some logistics areas	Improve the consistency of electricity supply by efficiently implementing the ESKOM 5-year plan; Improve the quality of infrastructure mainly ports and internet by implementing the Transnet program and liberalizing the ICT sector	Private sector ownership in ICT sector

II. Cluster Analysis

Global Textiles and Apparel Industry

Since the termination of the Multi-Fiber Agreement (MFA) quota system, the global textile and apparel industry has been in a state of flux. Under the MFA, global trade in textiles and apparel was restricted using a complex quota system. As a new era in global textiles emerged, numerous developing countries faced greater competition in terms of prices (McNamara, 2008).

In 2004, global exports of textiles and clothing were valued at \$453 billion, representing 5.1 percent of total world merchandise trade (McNamara, 2008). Developing countries are responsible for producing over half of the world's textile exports and nearly 75 percent of its clothing exports (UNCTAD, 2005). While textiles tend to be capital-intensive businesses and apparel businesses are labor-intensive, trade in the two is similar. Including intra-EU trade, the European Union is the biggest exporter of textiles, followed by China. According to WTO trade statistics, India, Turkey, Pakistan, Indonesia, Thailand and Mexico are all among the top fifteen textile exporters. In all, Asia accounted for 45.1 percent of world textiles exports in 2004. The EU, the US and China are the largest importers of textiles. For apparel, the EU and China, again, are the largest exporters of clothing. Countries such as Turkey, Mexico, India, Indonesia, Bangladesh, Thailand, Vietnam, Tunisia and Pakistan are ranked in the top 15 clothing exporters, but lag far behind China. In all, Asia accounted for 46.8% of world clothing exports in 2004. The EU, the US, and Japan are the largest importers. (McNamara, 2008).

A number of countries, including Cambodia, El Salvador, Bangladesh, Sri Lanka, Mauritius and Lesotho, depend heavily on the clothing industry for their exports. In fact, more than 40 percent of total merchandise exports in these countries was from the clothing industry.

Quotas, Tariffs and the End of the Multi-Fiber Arrangement

At the beginning of 2005, restrictions on trade in textiles and apparel imposed by the Multi-Fiber Agreement (MFA) expired. Today, trade in these areas is governed by normal WTO rules. Under the MFA, the amount of exports from a number of low-cost countries into the US and Europe was limited

to enable the domestic producers in these countries to compete. While designed to protect US and EU producers, the MFA had limited success. The restrictions stimulated an “unintended growth in apparel manufacturing in a number of low-cost quota-free countries in Africa and Asia” (McNamara, 2008). Concurrently the quota system kept prices artificially higher for European and American consumers. As a consequence, trading patterns were distorted, which predicted clear winners and losers once the quotas were to be lifted. After protracted trade negotiations, China agreed to new lower-level voluntary quotas that would restrict Chinese export growth into the US and EU until the end of 2008 and 2007 respectively, thus allowing for other “vulnerable” developing country producers time to adjust to a completely quota free environment.

For many low-income producers, a complex system of tariffs and preferential trade agreements remains firmly in place. Among them is the African Growth and Opportunity Act (AGOA), which offers duty- and quota-free entry into the US until 2015 for certain textile and apparel products from designated sub-Saharan African countries. As tariffs on textiles and clothing are usually higher than on other manufactured goods, preferential market access offers many developing countries a platform from which to devise a strategy for their textiles and apparels industry.

Jobs and Poverty Reduction

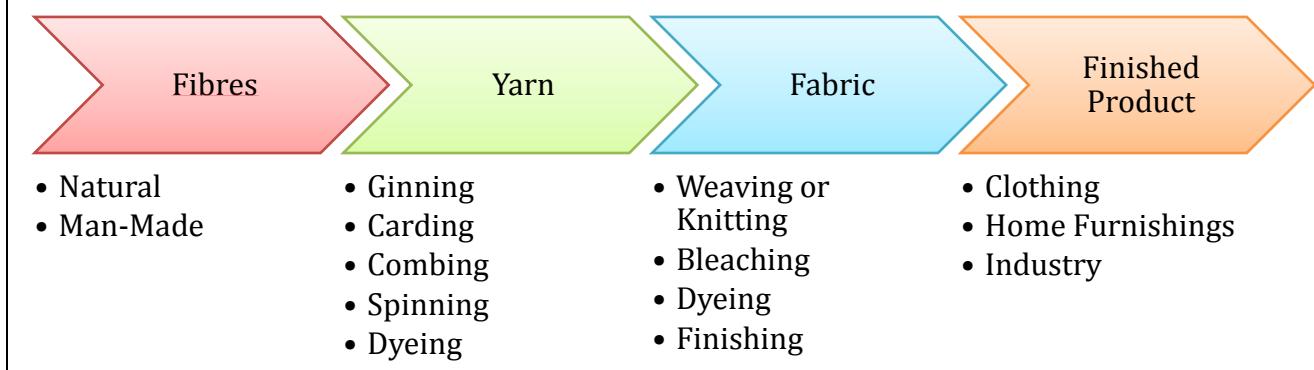
No less than 40 million workers are estimated to be employed directly in the global textile and apparel manufacturing industry, of whom half are in China. The textiles and apparels sectors account for a very high proportion of total manufacturing jobs in a number of countries where poverty-alleviation is a central issue. In South Africa, textiles and apparels account for 13.4 percent of manufacturing employment (Barnes, 2005). The World Bank and IMF have estimated that barriers to textile and clothing trade have cost 35 jobs in developing countries for every job saved in rich nations (de Jonquieres, 2004). The removal and reduction of quotas since 2005 presents an opportunity for job creation in some poorer countries. However, there are likely to be job losses in low-income countries whose textiles and apparel industries emerged as an unintended consequence of the quota system.

Trends in the Value Chain

The value chain in the textile and apparel industry consists of a number of discrete activities, ranging from sourcing of raw materials, through yarn spinning, fabric weaving, dyeing and finishing, apparel sewing, trimming, to labeling, packaging and delivery (See Figure 6). Elements in the value chain tend to be geographically dispersed and involve different parties (McNamara, 2008). In the last ten years, four key trends have been shaping the industry:

- **Geographical shifts.** The shift of apparel manufacturing from developed to low-cost countries has been pronounced over the past decade, with China leading the way in winning market share.
- **Transnational Corporations (TNCs).** The emergence of large international retailers has come to dominate the global textiles and apparel industry, influencing the geographical locations of parts of the value chain and putting further downward pressure on prices because of their immense bargaining power.
- **“Lean retailing”.** Retailers increasingly prefer not to undertake supply chain activities and therefore transfer these onto its suppliers. This necessitates the supplier to offer a “full package” service, which can include taking responsibility for sourcing fabric and trim upstream and taking on logistics, transportation, and delivery downstream.
- **Speed-to-market.** With the emergence of apparel retailers such as Zara and H&M, new standards for fast turnover in styles and fashion trends have emerged, necessitating ever shorter product life-spans. This puts considerable demands on the apparel manufacturers to respond to a series of small, irregular orders.

Figure 6: Textile/Apparel Value Chain



Textile and Apparel Cluster in South Africa

Development of the Cluster

In the early 1920s, the South African clothing sector was almost nonexistent. Clothing was either imported or tailored (Sawkut, 2008). The industry began with the manufacturing of blankets by

limited number of small companies in Johannesburg and Cape Town in 1920s and 1930s. During World War II, the industries provided blankets, rugs and sheeting; employed 3,500 workers; and supplied 90 percent of domestic need (The RATES Center, 2005). After World War II, the cluster expanded into furnishings, industrial textiles and clothing. In the 1960s, the cluster further expanded into synthetic fibers and the sector almost doubled in size (Morris, Barnes, & Esselaar, 2005). Because apartheid limited the use of African labor in urban areas, the clothing industry moved to areas with concentrations of Indian and Colored labor: Durban, Cape Town, and areas bordering "Bantustans." Cape Town soon became the center of the South African clothing industry, partly driven by the large retail chains based there. In the Western Cape, from 1935 to 1980 the number of firms increased from 30 to 332, and the number of employees increased from 3,500 to 53,421 (Sawcut, 2008).

Through the 1980s, however, competition in the industry was constrained by protectionist policies. The government maintained tariffs and quotas to protect the domestic market, which grew by 150 percent in demand during this period. Economies of scale were never achieved because companies competed only in the domestic market. From 1983, the government took several efforts to reform the trade regime, and there was an increase in manufactured imports in the late 1980s. The General Export Incentive Scheme (GEIS) in 1990 supported export through a tax-free subsidy, but had a limited impact in the more labor-intensive segments of the industry.

South Africa implemented trade liberalization in the 1990s, and joined GATT in 1994. (Mabugu, 2004) Levies on imported machinery, however, limited upgrading. Liberalization and the restructuring of the industry resulted in large decreases in employment, while productivity has increased through cost-minimization and downsizing rather than production growth. A total of 30,000 clothing and textile jobs were lost between 1996 and 1999, as the firms competed on cost-minimization and downsizing (Morris, Barnes, & Esselaar, 2005).

In 2000s, as global competition intensified, jobs continued to be eliminated and firms went out of business. The clusters in Gauteng (Johannesburg) and KwaZulu-Natal (Durban) were harder hit than Western Cape cluster, which now has both the largest number of firms and the highest employment

level in the clothing sector. The country signed on the Free Trade Agreement with the European Union, and potentially can benefit from the African Growth and Opportunities Act by the US, but their potential benefits are yet to be fully materialized.

Current Cluster Condition: Losing in price competition

In the past decade, domestic demand for clothing and textile has been constantly increasing, but the domestic industry has not captured the growing demand. Imports of textiles have grown rapidly to an all-time high, while exports have stagnated. Imports of yarns, for example, have increased from 77,000 tons in 2001 to 99,000 tons in 2006. Imports of made up textiles and clothing increased by an even greater degree; from 4,900 tons in 2001 to 28,700 tons in 2006 and from 139 million items in 2001 to 567 million items in 2006 respectively (Textile Federation of South Africa, 2009).

Countries with cheaper labor force, including China, have captured large share of sales volume in the global market, which has pushed down the international prices. As the labor cost in South Africa is much higher than competitors, South African textile cluster is losing in the price competition to cheaper exporters. Because of this tough competition in the domestic market, employment in the cluster has been declining since the 1990s. The employment in clothing industry was 121,108 in 1990, but it decreased to 59,580 in 2001 (Sawku, 2008). Employment in the textile industry has also declined in recent years, decreasing from 70,500 in 2003 to approximately 50,500 in 2006 (Textile Federation of South Africa, 2009).

Western Cape: trying to survive by cluster initiative

Western Cape Province is now the central region for the clothing and textile cluster in South Africa, creating 35 percent of South Africa's total added value from textiles, clothing, and leather goods (Morris, Barnes, & Esselaar, 2005). The provincial government of Western Cape is trying to support the textile and clothing industry through a cluster initiative, and companies are seeking for ways to compete in domestic and international market other than price competition. Compared to clusters in Gauteng and Kwazulu-Natal, Firms in Western Cape survived not by cost minimization but by differentiating and upgrading the value chain (Gwynne-Evans, 2009). Traditionally, clothing industry

in Western Cape used higher value-added fabrics (e.g. wool). While firms in Kwazulu-Natal, many of which are foreign owned by Chinese, Taiwanese, Indonesian and Singaporean investors, have lower cost structures and tend to target lower end market, firms in Western Cape are mostly South African-owned, have higher cost structures and have more production for the higher end of market (Barnes, 2005).

As Cape Town is one of the wealthiest cities in the country, the proximity to the sophisticated market and retail head offices in Cape Town also motivate firms to produce high end products for such markets. Its coastal location also provides advantage in logistics (Gwynne-Evans, 2009).

The government of Western Cape has been active in promoting the cluster initiative since its first cluster initiative in IT in 1998, and it now has eighteen cluster initiatives in different sectors (Gwynne-Evans, 2008). The Cape Clothing and Textile Cluster (CCTC) Initiative began in 2004, by coordinating national government, firms, IFCs, the design industry, and universities (Cape Clothing and Textile Cluster, 2009). The initiative has 42 member firms: 15 full clothing manufacturers, 12 CMTs (Cut, Make and Trim manufacturers), 10 textile firms and 5 retailers, including Multi-National Companies (MNCs) like Nike SA and Woolworth (Cape Clothing and Textile Cluster, 2009). The main objectives of the cluster initiative are: (i) to foster joint action between clothing firms to achieve economies of scale not possible individually, and (ii) to facilitate knowledge enhancement through the exchange of firm-level expertise (Barnes, 2005). The initiative has structured its activities around several areas: value chain alignment, human resource development, and upgrading manufacturing (Cape Clothing and Textile Cluster, 2009). Through cooperation with retailers, manufacturers can improve the speed and quality of production. Through the cluster initiative, manufacturers are also encouraged to move up the value chain by working closely with fashion and design industry and developing strategies to export high-end products to European markets (Gwynne-Evans, 2009). The government of KwaZulu-Natal followed the example of Western Cape and launched the KZN Textile and Clothing Cluster in August 2005.

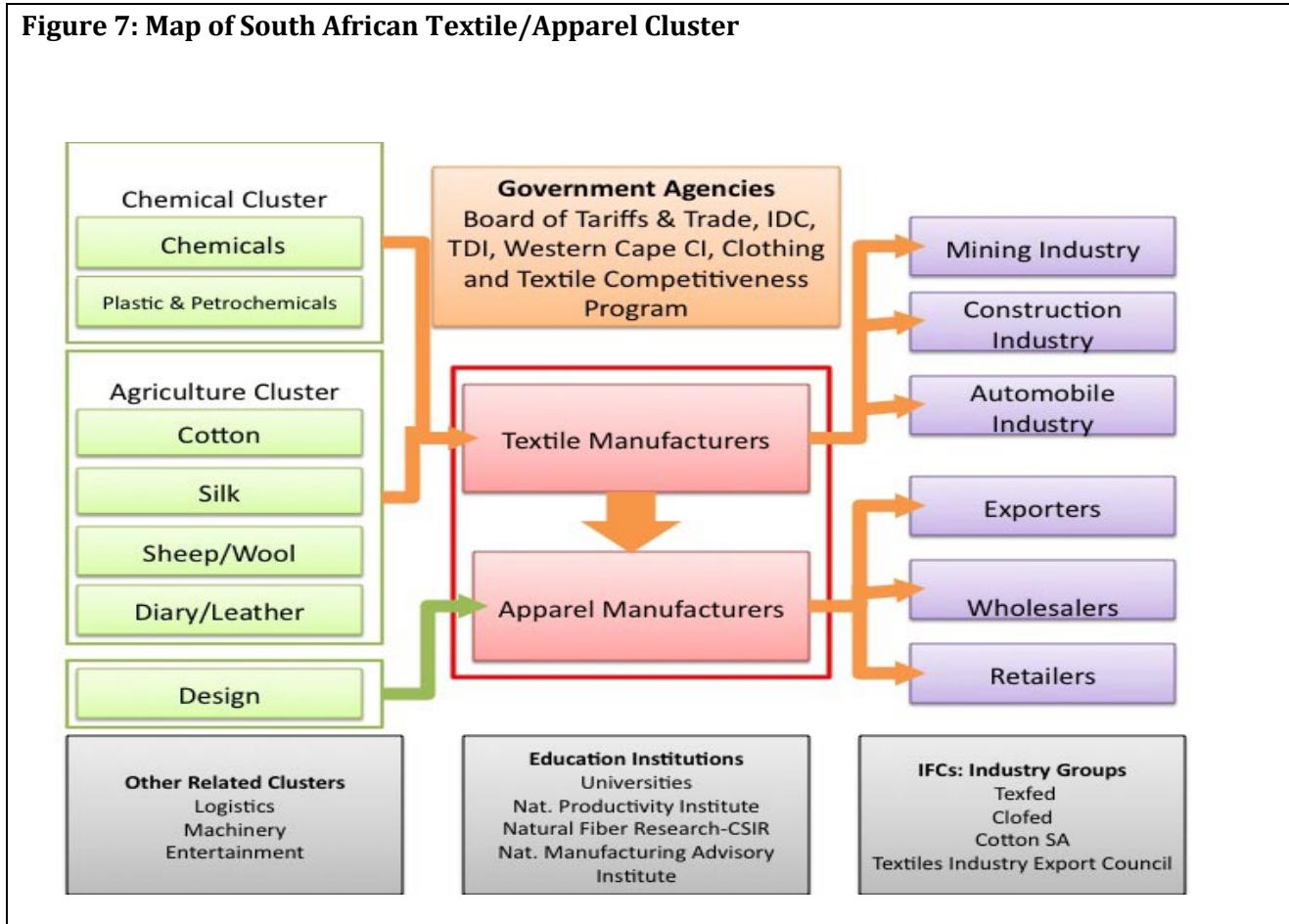
Firm Strategies in the Cluster

Companies that are still doing business in the cluster have survived the tough competition in the domestic market. Their strategies to survive can be classified into the following three types:

- **Price competition:** These low-end firms compete mainly in cost-minimization. They compete with cheap imported products in the domestic market by vertically integrating with modern container berth and mobilizing modern equipment. They face steep challenges, however, given the relatively higher cost of labor in South Africa. *Example: SBH Cotton.*
- **Exporting high-end product.** These firms sell high-end products to retail outlets in international markets in Europe. An example is *Monatic*, which has been successful in selling a large volume of fashionable men's suits, but the proximity from the large international market limits their ability to keep up with up-to-date fashions.
- **Diversify to value-added products:** These companies diversified their products and dominate niche segments of the market. They consolidate with related industries, including chemical and medical industries, in South Africa to create value-added unique products; some companies have been successful in the global competition. An example is *Gelvenor Textiles*, which specializes in technical textiles and has 50 percent global market share in parachute fabrics.

Cluster Map

Figure 7: Map of South African Textile/Apparel Cluster

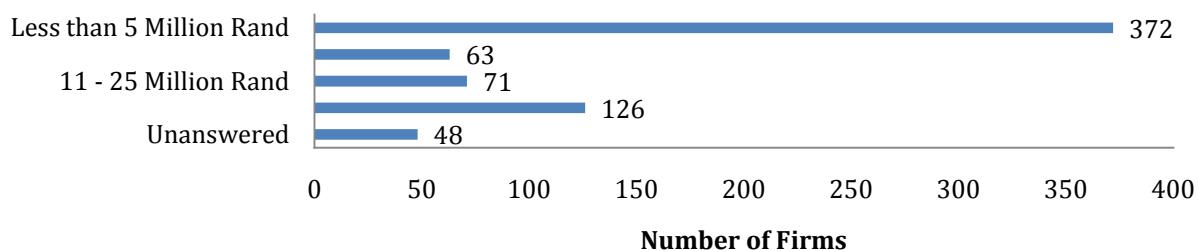


Textile and Clothing Industries

Textile and clothing industries are interdependent, as the fabric is the single most significant input into the clothing sector, accounting for approximately half of the cost to produce a garment. About 48% of output from textile industry in South Africa goes to the domestic clothing industry. Without an efficient and supportive textiles industry, clothing industry expansion is constrained. On the other hand, clothing industry's growth in export would have a positive impact on the textile industry by creating the higher demand (Barnes, 2005). The clothing industry requires a significant amount of low-skilled labor; as much as 83 percent of employees in the Western Cape clothing industry was semi- and unskilled in 2004 (Sawkut, 2008). In the production of poly-cotton fabric for garments, for example, labor costs comprise 14 percent of the ex-factory price. The costs of other inputs are: fiber/raw material (18 percent); spinning process (18 percent, of which 6 percent is labor cost); yarn (36 percent); weaving process (20 percent, of which 5 percent is labor cost), and finishing process (44 percent, of which 4 percent is labor cost) (The RATES Center, 2005).

Firms in the textile and clothing cluster vary from well-established large firms to SMEs and home industries. The number of firms in the cluster has declined since 1990s, suggesting a possible move toward economies of scale (Sawkut, 2008), but the majority of companies in the cluster are still small firms and the broader consolidation has not yet occurred.

Figure 8: Number of Firms by Revenues (source: Department of Labor of South Africa)



Input and Output Industries to the Cluster

South African producers use three types of raw material production for the textile industry: animal, vegetable, and synthetic. As an indication of the strength of domestic production of animal fiber, South

Africa has approximately 21 million sheep with a wool production of about 52.8 million kilograms, of which only 11 million kilograms are locally consumed. Wool products in South Africa are used for high quality and environmentally sound apparel. South Africa is the world leader in the production of mohair, a high-end fabric, accounting for more than 60 percent of the global production. Cotton production in South Africa, however, is not large enough to cover domestic consumption; thus cotton is imported from neighboring Zimbabwe, Zambia and Mozambique. About half of the output from the textile industry goes into domestic clothing production. Other main buyers for the textile industry are motor vehicle, mining and construction firms. (The RATES Center, 2005).

Institutions for Collaboration

The cluster has many potential institutions for collaboration (IFCs), including associations of employers, labor unions, and government initiatives. In their current form, however, they are fragmented and lack coordination. Labor unions in South Africa played important role in fighting against apartheid and have maintained strong political power. Cooperation between labor and employer is very low in South Africa in general (ranked 65th in GCI). Thus far, industry associations have primarily involved in lobbying for domestic market protection, instead of developing the competitiveness of the cluster. Some organizations that can play an important role as IFCs include: Clothing Manufacturers Association, CMT Employers association, Bargaining Council for the Clothing Industry, Clothing Trade Council of South Africa, Industrial Development Corporation, Garment Manufacturers Association, Clothing Industry Export Council, and the South Africa Clothing and Textiles Workers Union (SACTWU). Some of these groups have undertaken activities to mobilize stakeholders in the cluster. For example, SACTWU has organized the Cape Town Fashion Festival with the theme “Wear South African” since 2003 under the auspices of the “Proudly South African” campaign by the National Economic Development and Labour Council (NEDLAC) and other companies. In general, however, the cluster-focused activities of the IFCs are underdeveloped.

Cluster Competitiveness Diamond Analysis

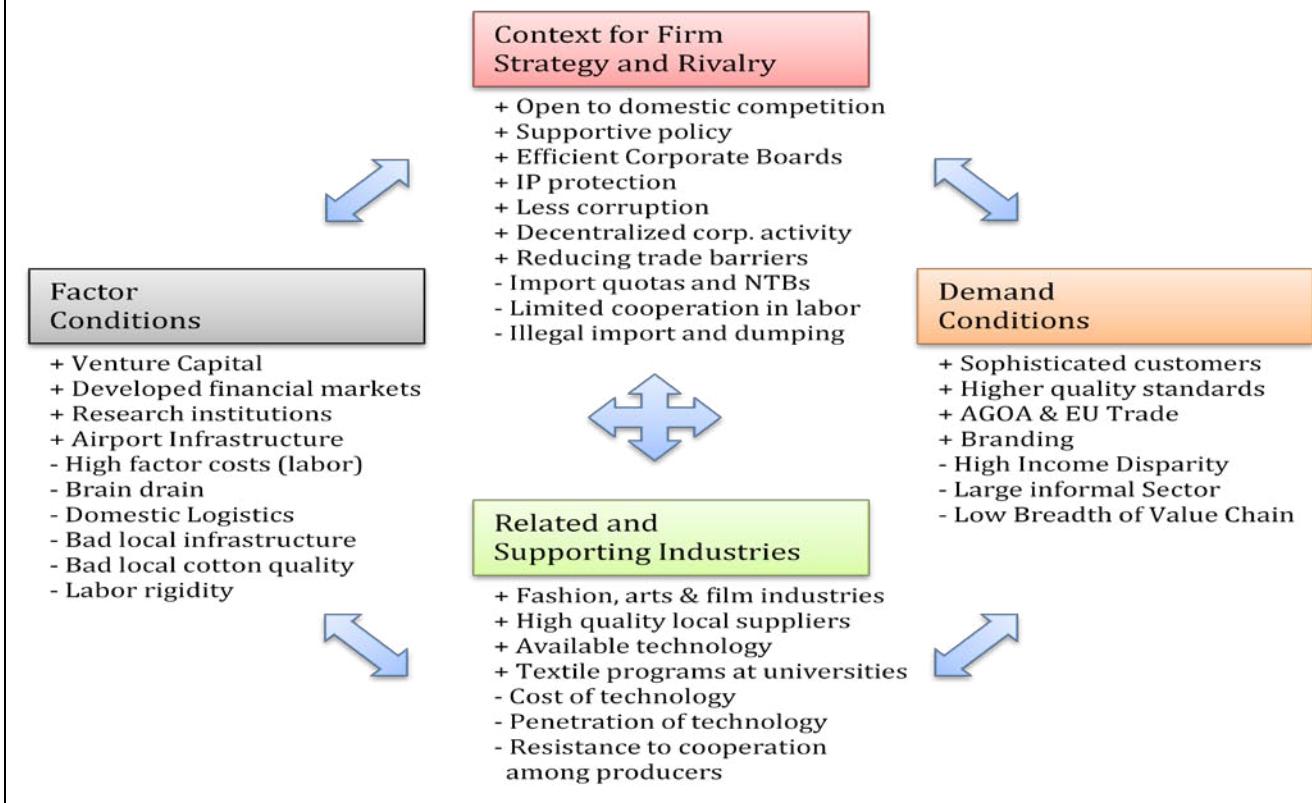
The South African textile and apparel cluster shares some of the key challenges and advantages identified in the country competitiveness analysis. An efficient financial market is helpful in nurturing new enterprises in the cluster. A growing black African middle-class is a driving force for the cluster to shift to the high-end sophisticated market. However, high-income inequality limits the size of an emerging sophisticated market. The high cost of labor, influenced by strong labor unions, rigidity of employment and the restriction by the Black Economic Empowerment policy, is a significant obstacle for the cluster development. The lack of high-skilled labor is also a concern. With a strengthened cluster, South Africa could take advantage of potential opportunities to benefit from the FTA with EU and the AGOA of US. The cluster competitiveness diamond analysis illustrates how the textile and clothing cluster can potentially upgrade by fully utilizing the opportunities in related and supporting industry and demand condition. The cluster should cooperate with high quality local suppliers, foster design-related industries to produce value-added products, and take advantages of domestic sophisticated customers and the international free trade agreements with the US and the EU.

Factor Conditions

High Factor Cost

High factor costs (especially labor cost) constraint the ability of the cluster to compete with foreign companies in on price. The hourly labor cost is US\$1.35 in South Africa (in 2002), which is more than three times higher than Sri Lanka (\$0.48) and India (\$0.38), and twice as high as China (\$0.68-0.88) (Sawku, 2008). The labor cost disadvantage is crucial, particularly because the cluster is very labor-intensive. The high labor cost is due in part to the rigidity of employment. Strong labor unions and BEE limit the option of companies in hiring and firing. Regulations regarding overtime and shift pay, sick leave and pension contributions pose an additional burden for firms (Barnes, 2005). The strong Rand since 2003 also made the cluster less competitive by raising the factor costs in South Africa even higher while lowering the prices of imported goods.

Figure 9: South Africa Textile/Apparel Cluster Diamond



Raw Materials

Limited access to raw materials is another important challenge to accessing the high-end market.

Domestically produced fabrics are limited in terms of their volume and variety. Cotton produced in South Africa is relatively low, and the cluster cannot rely on domestic cotton for high-quality products (Sawkut, 2008). Recent studies point to other weaknesses in the cluster: long lead times, poor delivery reliability and deteriorating quality performance (The RATES Center, 2005). The limitation of raw materials is particularly important when firms try to meet the rules of origin requirements for exports under preferential trade agreements. These rules of origin tie the domestic textiles industry to the clothing production process, and any weakness in the textiles sector has a marked impact on the success of clothing exports (The RATES Center, 2005).

Distance from the International Market

The long distance from EU and US limits the ability of South African firms in updating the design in high-end fashion market. As firms compete in lead time in the high-end fashion market, the distance

from these markets and the transportation time required by it will be a huge disadvantage for South African companies. Low quality of infrastructure in domestic logistics is an additional challenge. This problem is more severe for the companies outside the Western Cape. Due to the proximity to the large port, companies in the Western Cape are relatively less affected by the poor domestic infrastructure.

Context for Firm Strategy and Rivalry

While the competition among domestic companies is competitive and well regulated, South Africa has a problem in dealing with imported products. Because the customs control can be very ineffective, many Chinese products are imported without any duties or customs (Gwynne-Evans, 2008). Illegal dumping of foreign products is also a threat to local producers. With the aim of reducing the impact of Chinese imported products, the government introduced the China Restraint Arrangement in 2007. This scheme introduced a quota for Chinese export to South Africa, but the effect was questionable because of the loose customs control (Textile Federation of South Africa, 2009). Since that arrangement expired at the end of 2008, the government is now considering the implementation of a "Rescue Plan" to provide subsidies to local textile and clothing industries and help them compete in the domestic and international market (ReDress Consultancy, 2009).

Related and Supporting Industries

The lack of trust and cooperation between clothing producers and textile producers hinders the ability of firms to compete effectively (Sawkut, 2008). Different segments in the cluster are fighting against each other to protect their own profits rather than collaborating with each other to promote the competitiveness of the cluster. An emerging opportunity is the potential collaboration with growing design-related industries. The textile and clothing cluster will benefit from the growing fashion, arts and film industries, if they can cooperate with each other to create high end products and promote South African products in domestic and international markets. Design and fashion industry is growing but still weak, and it needs improvement in the technical schools in design and fashion. Cape Town Fashion Week is a good trial to market the design industry and clothing industry of South Africa to the international market (Sawkut, 2008). Collaboration between retailers and manufacturers is another

important opportunity. They can jointly participate in the design of garments for local markets so that they can directly capture what customers' preferences in design, patterns, and quality (Sawkut, 2008).

Demand Conditions

The South African domestic market has a growing middle-class black population that is increasingly sophisticated in its consumption decisions. This is a segment in the domestic market that the textile cluster can compete in quality and uniqueness of the products. However, as the income disparity in the country limits the size of the sophisticated market, the country needs to address the problem of inequality to create a significant and sustainably large segment of the market that will support higher-end products. International markets in the US and the European Union are another opportunity for the cluster. AGOA and the FTA with the EU provide the companies with valuable access to these markets. If companies in the cluster increasingly develop unique products, they can improve their ability to penetrate these markets. (Sawkut, 2008).

III. Cluster-Specific Recommendations

Considering the high labor cost in South Africa, it is very difficult to compete with Asian exporters on price. Though the government has begun to promote cluster initiatives, the coordination between industries, employers and workers, and public and private sector has not been sufficiently effective. Successful companies in the cluster are those who found their competent niche market and provide value-added products to the global market. The textile and clothing cluster in South Africa should improve its competitiveness by transforming the cluster to focus on value-added, high-end niche segments.

In order to achieve that goal, the cluster can still improve its efficiency and reduce production costs. The cluster initiatives and improved IFCs should help different industry associations, research institutions, and government to coordinate more effectively. The capacity of IFCs should be improved to create "cluster-based" policy options. By doing so, the cluster should identify the niche segments in which South African firms can compete in the global market. Finally, as this strategy would potentially

lead the cluster to specialize and reduce the total number of employees, the government can expand the social security net to avoid social problems triggered by this structural transformation in an industry that currently employs a large number of low-skilled workers.

Figure 10: Cluster recommendations

	Firms	IFCs	Government
<i>High Factor Costs</i>	Invest workers' training Improve production facility	Provide opportunities for dialogue between employers and unions Provide training facilities to improve workers' productivity	Reduce the tariff on raw materials Revise BEE to loosen the rigidity of employment Stabilize exchange rate Improve customs control for illegal imports and dumping Improve efficiency of customs clearance
<i>Lack of Coordination</i>	Improve employer-labor relations Vertical integration Close collaboration between textile and clothing industries	Enhance coordination across industries	Support cluster initiatives Provide support to companies for upgrading, vertical integration
<i>Targeting Niche Segments</i>	Find the niche segment in which each firm can compete Invest in R&D in niche segments Focus on sophisticated customers in domestic market	Support joint R&D in specialized segments Research activities with academic institutions Organize fashion shows, trade promotion event	Marketing South African brand Support education on design and fashion Invest in tertiary education to create high-skill labors
<i>Improving safety net for transitioned workers</i>			Provide retraining for workers to shift to other industries

Reducing Factor Costs

The cluster should pursue several measures to reduce costs without compromising the quality of the product. Firms should improve their productivity by investing in worker training and production facilities, particularly in the high value-added segments of the cluster. IFCs should function not primarily as representatives of either employers or workers, but instead as facilitators of collaboration between the key players in the cluster. IFCs can also invest in training and skills development through joint arrangements with industry players, as another strategy for improving labor productivity.

Government should pursue several policy reforms to help the cluster reduce costs and improve productivity. As the quality and availability of raw materials limit the production capacity, the high tariff on imported raw materials should be removed. A reform of the Black Economic Empowerment (BEE) policy can loosen the restrictions on ownership and employment and effectively reduce the rigidity of the labor market. Government can also facilitate the development of the cluster by more effectively managing a stable exchange rate and improving the capacity of the customs process to control illegal imports and dumping. In the long term, the government should also work on improving the capacity of customs clearance, so that the disadvantages of the long distance from international market can be minimized.

Promoting Coordination among Stakeholders

The lack of coordination is a problem in many aspects of the cluster—between employers and workers, firms, industries, public and private. Stakeholders in the cluster should promote the coordination through joint initiatives. Firms should improve their relations with workers, so that they can collaborate more effectively to transform the cluster. As the cluster is fragmented to so many small firms at different levels of the value chain, vertical integration can be an effective strategy to promote coordination. In fact, clothing manufacturers have already started to work with retailers to capture the market trends quickly. IFCs should also play a leading role in promoting collaboration between firms in the textile and apparel segments of the cluster. The government should facilitate the cluster initiatives by providing financial support and responding to requests for policy support from the cluster. It should also establish a financial support facility to companies for upgrading and vertical integration.

Targeting Niche Segments

The cluster should move up the value chain by targeting niche segments. South African firms cannot compete with other countries on price, and increasing share in high-end segments in international market is also difficult because of the disadvantage in longer lead times. Firms should actively identify

niche segments in which they may have important competitive advantages in the global market and invest in R&D to develop their capacity to compete in those particular segments. Firms can also target the more sophisticated market of middle-class consumers in South Africa, other middle-income countries, or to a lesser extent neighboring countries in southern Africa. IFCs should support joint R&D in specialized niche segments. They can promote academic research on fabric and textile technology, production skills and fashion design to improve the added value of the products of the cluster. Organizing fashion shows (such as Cape Town Fashion Week) and trade and investment promotion events is another effort that IFCs should make to promote niche production in the global market. The government should assist the cluster in marketing the “South Africa” brand in the global market. In long term, it also should support education in technology, design and fashion to create high skilled labor in these segments.

Improving Safety Net for Transitioned Workers

While these recommendations will improve the overall competitiveness of the cluster, it will be difficult for South Africa to maintain the level of employment in textiles and apparel. As the textile and apparel cluster has is a major source of employment for low-skilled workers, declining employment may upset the tensions between efficiency and equality underlying much of South Africa’s economic policy. With this in mind, the government should identify ways to support low-skilled workers in the cluster who may need to transition to work in other industries. In short term, the government can guarantee sufficient unemployment insurance and training for these workers. In the longer term, the government should improve their education system and skills development to adjust their workforce to the new competitiveness environment.

Required Disclosure

None of the team members is originally from South Africa. Fode Ndiaye lived in Johannesburg from November 2004 until June 2008 working for the UNCDF but covering LDCs in the region and did not have any operations in South Africa (which is not an LDC). Anmol Chaddha lived in Johannesburg for one semester, while studying abroad in 2001. No special or nonpublic access to information was utilized. No team members travelled to South Africa during the project period.

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