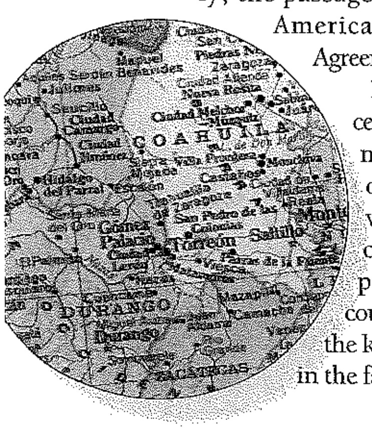
U.S. Companies Eye NAFTA's Prize

Mexico's sudden rise to the head of the pack in North American apparel exports has kept the merry-go-round of NAFTA-inspired sourcing moving at a dizzying rate. Those companies hanging on for the ride are keeping a focus on continued vertical integration of the country's apparel sector and the growth of full package production.

Establishing the full package market in Mexico has become the quest of the U.S. fiber, textile, apparel and retail sectors alike. But those seeking to grab the golden ring on the merry-go-round of North American sourcing must hold their balance against the dizzying changes that have transpired in this decade — from the 1994 devaluation of the peso to, more importantly, the passage of the North American Free Trade Agreement (NAFTA).



Mexico's success in the apparel market is based on several noteworthy developments that are positioning the country to become the key driver within the fast-paced environment of the North American apparel commodity chain:

1) Geographic proximity and preferential access to the U.S. market have resulted in the emergence of Mexico as the leading exporter of apparel to the United States.

2) Mexico's meteoric rise reflects the expansion of its maquiladora (apparel assembly) industry, which was accelerated by the peso's devaluation. Moreover, as a result of NAFTA, the Mexican apparel industry is in the process of making a transition beyond export assembly to become a full package supplier of finished garments to the U.S. market.

3) Mexico is figuring more prominently in the strategies of many U.S. companies that want to increase their security and enhance profits by coordinating the activities associated with full package supply in North America.

Mexico's Export Profile

Long an important 807 supplier to the United States, Mexico's apparel exports have skyrocketed in the past decade. The country exported $700 million worth of apparel to the United States in 1990. Just seven years later, the value of 1997 exports surpassed $5.3 billion. Most of this tremendous growth has occurred since 1994, during the first years of NAFTA. In addition, Mexico's *non*-807/9802 apparel exports to the United States have doubled in percentage terms since 1994 (from 9 percent to 18 percent of the total), and increased more than fivefold in value from $170 million to $960 million between 1994 and 1997 (see **Table 1**). This surge in non-807 exports can be taken as one indicator of a qualitative shift in the Mexican apparel sector beyond mere assembly to package programs that involve more value added through cutting and textile production.

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Mexico's main export products include cotton trousers (mostly jeans) and man-made fiber (MMF) trousers, cotton and MMF knit shirts, MMF bras and cotton underwear. As the largest exporter to the U.S. market in four of these leading six product categories, Mexico has unseated both Asian and Caribbean countries in its climb to the top of the export rankings, surpassing Hong Kong as the No. 1 exporter of cotton trousers, Taiwan for MMF knit shirts, Honduras for cotton knit shirts, and the Dominican Republic as the No. 1 exporter of MMF bras (see **Table 2**).

Apparel exports from the Caribbean countries also have increased dramatically over the past decade, particularly in products such as underwear and cotton trousers. However, the boost that Mexico has received from the devaluation of the peso and NAFTA has propelled the country far ahead of any of the individual Caribbean Basin Initiative (CBI) exporters to the United States. And Mexico's apparel industry is not only expanding, but also changing in character.

A look at production networks and linkages within the worldwide textile and apparel complex helps put Mexico's current exporting position into a broader perspective. **Figure 1** illustrates the different sectors of the apparel commodity chain and the relative strength of these sectors in the United States, the Caribbean, Mexico and East Asia — the latter historically being the strongest source of apparel exports to the U.S. market.

The well developed apparel industries in East Asian countries, such as Korea, Taiwan and Hong Kong, have a large number of high quality fiber and textile producers, as well as many apparel companies that serve as full package suppliers to the U.S. market. The United States also is characterized by strong sectors throughout the chain. In contrast, Caribbean countries, which have been linked to the United States solely as 807 suppliers, lack strong fiber and textile sectors. Mexico's apparel industry is between the Caribbean and the United States in terms of its level of development.

Making the Transition

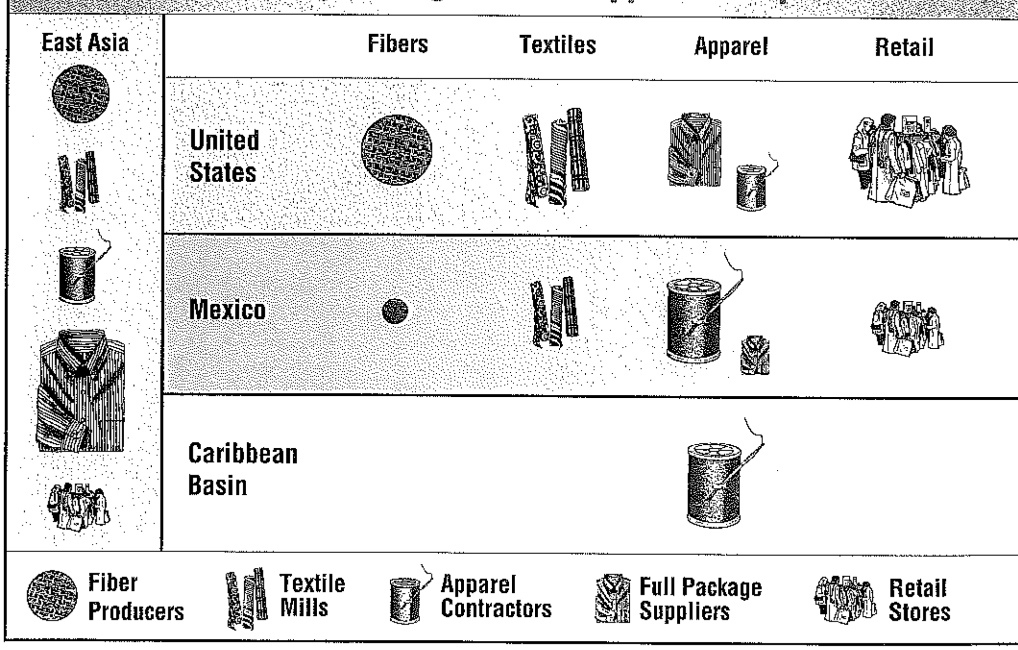
The strong ties that exist between retailers and branded marketers in the United States and full package producers in East Asia now are beginning to emerge between the United States and Mexico. However, Mexico's transition to full package will not occur overnight. The strength of 807 production in Mexico, as well as in the Caribbean, means that companies have extensive experience in assembling garments, but little familiarity with the wide range of other tasks involved in the production of apparel, such as purchasing textiles and trim, cutting fabrics, designing and marketing.

How is NAFTA changing this scenario? In addition to eliminating the tariffs and quotas that serve as disincentives for integrated production in Mexico, the agreement is opening the Mexican economy and exposing the country's apparel manufacturers to the pressures of global competition, including the stringent quality requirements necessary for supplying the U.S. market. Moreover, the sections of the Mexican apparel commodity chain that historically have been weak — fiber, textile and retail — are being strengthened through joint ventures and other arrangements with U.S. firms that facilitate upstream and downstream linkages (see **Table 3**).

For example, fiber companies are looking for ways to shape apparel demand and consequently maximize the sale of their fibers. One such company, DuPont, has played a key role in establishing the Nustart apparel training and production complex in the Mexican state of Morelos. Also known as "Textile City," Nustart was inaugurated in July 1997 as a joint venture between DuPont S.A. de C.V., Grupo Alfa (one of Mexico's leading fiber manufacturers), and the U.S. textile companies Burlington Industries Inc. and Guilford Mills Inc. The idea is to attract mid-sized U.S. apparel companies that have an interest in producing in Mexico, but have not yet established 807 production. The organization also will offer assistance with other business functions, such as customs documentation and worker training.

Initially "Textile City" was thought of as a complex of clustered companies

Figure 1: Key Linkages in the Apparel Complex



This commodity chain helps illuminate the types of linkages that U.S. companies are developing with each other and with their Mexican and Caribbean Basin Initiative (CBI) counterparts as they attempt to maximize the benefits of Mexico's transition to full package production. The size of the different symbols representing fibers, textiles, apparel and retail suggests which parts of the commodity chain are strongest in each of these areas.

that would create synergies for the different manufacturers located in the $15 million industrial park. As of September 1997, however, only two swimwear firms had committed to manufacturing in Nustart. Although the project's designers hope that Nustart's development will pick up speed as more apparel companies begin producing there, the industrial park remains a rather sparsely populated textile city.

Fiber producers in Mexico may encounter significant logistical problems in trying to control the rest of the chain. Consider DuPont's failed Initiatives Inc. project, which was launched in September 1994 as a subsidiary offering private label sportswear. The venture was designed to establish DuPont's presence as a manufacturer of finished apparel, but it collapsed only 16 months after it was announced, and cost DuPont $10 million. Subsequently, DuPont has refocused its Mexican efforts on helping U.S. retailers find North American partners to replace products imported from Asia, and to increase the use of its fibers in these apparel orders.

Table 1: U.S. Apparel Imports: Total and 9802/807 Trade

Mexico and the Caribbean Basin Initiative Countries

Year	Total Apparel Imports ($ Millions)	807/9802 Trade ($ Millions)	807/9802 Trade as a Share of Total Imports (Percent)	U.S. Content of 807/9802 Imports (Percent)
World				
1990	25,518	2,412	9	64
1991	26,250	3,141	12	63
1992	31,235	4,124	13	62
1993	33,904	5,034	15	62
1994	36,878	6,030	16	62
1995	39,660	7,981	20	62
1996	41,684	9,039	22	63
1997	49,380	11,655	24	63
Mexico				
1990	709	614	87	71
1991	908	796	88	70
1992	1,181	1,035	88	69
1993	1,415	1,255	89	69
1994	1,889	1,716	91	70
1995	2,876	2,549	89	70
1996	3,850	3,218	84	70
1997	5,325	4,380	82	68
CBI Countries				
1990	1,985	1,475	74	68
1991	2,533	1,958	77	67
1992	3,292	2,550	77	67
1993	4,015	3,169	79	66
1994	4,538	3,634	80	64
1995	5,481	4,510	82	64
1996	6,076	5,015[a]	83	66
1997	7,620	6,385[a]	84	66

Source: Compiled by U.S. International Trade Commission (USITC) staff from official statistics of the U.S. Department of Commerce; U.S. imports for consumption, customs value.
Note: [a]Estimates by USITC staff based on Major Shippers Reports.

Textiles: The Catalyst for Full Package Supply in Mexico

Although many U.S. textile companies initially opposed NAFTA, several recently have embarked on ambitious new projects in Mexico. This is an important development because the textile sector is considered the "wild card" in terms of Mexico's overall ability to strengthen its role in the apparel chain. The reason: Mexico's textile sector is relatively weak, with the exception of a few noteworthy denim producers. Only about one-third of Mexico's textile firms are considered capable of producing at the quality and volume levels required for the U.S. market. From the U.S. perspective, there remain differences of opinion regarding the future viability of textile production in Mexico. Some U.S. textile companies are establishing joint ventures in Mexico to ensure a manufacturing presence near the country's expanding apparel sector, while others believe that Mexico's proximity to the United States will allow service to the country via direct imports.

Illustrating the value of Mexican partnerships, Burlington Industries started construction in October 1997 on the first of three new plants it plans to open in Mexico. The new facilities, one of which is a 50/50 joint venture with Parkdale Mills Inc., will be located in Morelos, where Burlington has a history of production through its Mexican subsidiary, Textiles Morelos.

Cone Mills Corp. also has launched a joint venture in Mexico — this one with the country's largest textile producer, Compañía Industrial de Parras. The Cone-Parras project involved the construction of a $110 million denim manufacturing plant in the northern Mexican state of Coahuila, capable of producing 24 million linear meters of denim per year. The two companies are sharing access to the denim being produced in the new mill, much of which ends up in jeans for Levi Strauss & Co., Wrangler and JCPenney's Arizona private label program. Cone's interest in Parras, a company that produces both textiles and garments, was

Table 2: Mexico's Top Apparel Exports to the U.S. Market and Main Competitors

in $ Millions

Mexico					Mexico's Main Competitors		
Product	1990 Value	1993 Value	1996 Value	1996 Rank	Country	1996 Value	1996 Rank
1. Cotton trousers	194	459	1,259	1	Hong Kong	636	2
2. Cotton knit shirts	16	81	456	1	Honduras	342	2
3. MMF knit shirts	9	65	384	1	Taiwan	339	2
4. MMF trousers	55	64	257	2	Taiwan	260	1
5. MMF bras	49	97	167	1	Dominican Rep.	135	2
6. Cotton underwear	6	38	120	4	Honduras	213	1

MMF: man-made fiber
Source: USITC Annual Statistical Report on U.S. Imports of Textiles and Apparel, various years.

motivated in part by its desire to tap into the Mexican firm's apparel capacity, although Cone since has reconsidered its interest in the apparel business.

In contrast, Burlington Industries is forging ahead with its full package plans. Burlington Sportswear, a new division with apparel capabilities, was launched two years ago. Initially, it produced men's sports shirts from cotton knit fabrics that were manufactured in the company's U.S. mills, cut in the United States and then assembled by contractors in Honduras and the Dominican Republic.

Burlington Sportswear's full package action now has moved to Mexico, where it is producing men's shirts and slacks from woven cotton fabrics, some of which are coming from Burlington's Mexican weaving facility. The sewing is contracted out to several apparel manufacturers around Mexico City. In addition, the other three divisions of the company that make apparel — Global Denim, Klopman and Menswear — are at different stages in developing full package services for their customers, whose demand for apparel packages reportedly is outstripping Burlington's current capacity for garment production.

Galey & Lord Inc. also has begun making apparel, and like Burlington, Mexico figures prominently in the company's full package plans. In June 1996, Galey & Lord, which is strong in woven sportswear fabrics, purchased Dimmit Industries from Farah Inc. for $22.5 million. The six factories in Piedras Negras, Mexico, that make up Dimmit Industries have become the cornerstone of a newly formed subsidiary, G&L Service Co., North America, which allows the company to offer finished apparel to its customers.

U.S. Apparel Firms: Manufacturers or Marketers?

There are several related trends currently affecting the U.S. apparel industry's move toward more full package work in Mexico. The first is de-verticalization — the decision to move out of manufacturing and focus on higher value activities in the commodity chain, such as global brands and product design. Sara Lee's recent sale of nine U.S. yarn and textile plants to National Textiles L.L.C. is perhaps the best known example of the de-verticalization trend (see "Industry Watch," page 10).

Branded marketers, such as The Gap and Liz Claiborne Inc., which traditionally have been big Asian sourcers, also are moving some of their orders to Mexico. The trend supports the claim that Mexico is gaining ground on Asia with the establishment of sourcing networks capable of handling package programs for fashion-oriented U.S. apparel firms.

Additionally, the rise of private label lines among varied retailers ranging from Wal-Mart to JCPenney to Canada's Hudson Bay department stores is likely to have a significant impact on the growth of full package production in Mexico. Lacking factories, retailers must rely on sourcing networks with manufacturers. With the advent of NAFTA, these retailers are seeing some new opportunities to stimulate the development of their own full package suppliers in Mexico, particularly in key product categories, such as jeans, where the market share of private label products has grown from 9 percent in 1990 to 19 percent in 1997.

The Jeans Story

There are two important developments in the Mexican jeans sector. First, U.S. manufacturers began relocating their denim cutting operations to Mexico in earnest during the second half of 1997, anticipating the elimination of remaining tariffs on Jan. 1, 1999. Second, as a result of joint ventures like the Cone-Parras partnership, there is substantial growth in the volume of high quality denim being produced in Mexico, making it possible for jeans makers to use Mexican denim. Much of the growth in jeans production in Mexico is being managed by U.S. contract manufacturers, such as Aalfs Manufacturing Inc., Kentucky Apparel and Sierra Pacific Apparel, which receive orders from branded manufacturers and retailers sourcing their private label lines in Mexico.

The jeans story in Mexico is a highly localized one, with production concentrated in a few areas. Chief among these regions is Torreón, Mexico's most significant center for denim and jeans production. JCPenney, for one, sources its St. Johns Bay and Arizona private label jeans from a large Mexican apparel supplier in this area, while other major contractors in the region produce for Levi Strauss & Co., The Gap and Sears.

One factor limiting the availability of full package jeans producers in Mexico, however, is that the most reputable Mexican suppliers already have solid relationships with U.S. manufacturers for the production of leading national brands. They tend to be unwilling to jeopardize these ties by filling private label orders for other U.S. buyers.

The expansion of the jeans sector in Mexico includes not only increased assembly, but also performance of more stages of the production process within the country. In addition to cutting, finishing operations are being performed more often in Mexico than in the past. Two months ago, for example, Burlington announced a joint venture with International Garment Processors (IGP), an El Paso, TX-based company that offers finishing and laundering services for jeans. The two companies are combining efforts to build a new processing facility in the state of Chihuahua, Mexico. This finishing plant is designed to strengthen Burlington's supply chain for full package denim apparel in Mexico, which includes the company's new Torreón denim production facility.

Women's Wear in Mexico: The "Old" and the "New"

The jeans story suggests that in the "old" 807 sector, the expansion of production and the transition to full package supply in Mexico will be managed by U.S. companies with their own plants or with well established networks of local contractors. This also is true for bras and underwear, two other leading export categories for Mexico that have been characterized by 807 production. Sara Lee (the maker of leading intimate apparel brands including Hanes, L'eggs, Bali and Playtex) and Fruit of the Loom

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Table 3: Strategies of Key Firms in Mexico's Apparel Commodity Chain

Segment	Firm	Strategies	Mexican Connections
Fiber	DuPont	• Recapture fiber markets lost to Asian imports	• Bring U.S. retailers to Mexico to source apparel
Fiber	Grupo Alfa (Akra)	• Establish downstream linkages with apparel manufacturers	• Participant in Nustart ("Textile City") in Morelos • Develop a sourcing arm in Mexico
Textile	Burlington Industries	• Develop full package apparel services (in both denim and non-denim divisions) • Expand textile production in Mexico	• Develop a supply network of Mexican contractors • Established full package apparel division, Burlington Sportswear • Joint venture (50/50) with Parkdale Mills in Morelos • Build finishing plant for jeans in Chihauhua with IGP (50/50 joint venture)
Textile	Cone Mills Corp.	• Establish textile production in Mexico • Develop apparel capabilities	• Joint venture with Mexican apparel company owned by Parras • Built and operates new mill as Cone-Parras joint venture
Textile	Galey & Lord	• Develop full package apparel services	• Purchased six Farah plants in Mexico (1996) • Purchased Swift Denim from Dominion Textiles (1998)
Textile	Guilford Mills	• Establish integrated apparel complex in Mexico	• Prime mover in Nustart ("Textile City") in Morelos
Apparel	Sara Lee	• De-verticalize	• Likely to sell Mexican subsidiaries and increase sourcing from contractors
Apparel	Levi Strauss & Co.	• Streamline U.S. production	• Exclusive reliance in Mexico on independent contractors (no company-owned and operated subsidiaries)
Apparel	Avante	• Promote its own brands and vertically integrated full package service for foreign retailers and marketers	• Produces for U.S. retailers' private labels • North American licensee for Skiny brand (Europe)
Apparel	Aalfs	• Expand its production as non-branded contract manufacturer for U.S. retailers and branded manufacturers	• Makes JCPenney's private label Arizona jeans in Mexico
Retail	JCPenney	• Expand private label sourcing networks	• Opened sourcing office in Mexico to supply North American stores
Retail	Wal-Mart	• Expand into Mexican market	• Acquired Cifra and now is Mexico's largest retailer • Expand supply networks in Mexico
Finance / Trade	Bancomext	• Promote mutual awareness of Mexican suppliers and foreign buyers • Improve the quality of Mexico's small- and medium-sized apparel exporters	• Organize yearly trade fairs to bring foreign retailers to Mexico • Sponsor vendor certification program for Mexican exporters

What Does 'Full Package' Mean Anyway?

There are many varieties of apparel sourcing arrangements in Mexico, and several are commonly called "full package." Different companies source in different ways from Mexico, so it is useful to have a simple checklist:

- **Branded apparel manufacturers** go to Mexico for 807-type assembly, which means they provide cut cloth to, and import finished garments from, contractors in Mexico.
- **Textile firms** generally use the term full package to refer to any apparel production for which the cutting occurs in Mexico. This especially applies to standardized products like jeans. Companies such as Burlington, which have developed more elaborate apparel production services for non-denim garments, also produce "floor-ready products" that include services such as tagging and bar coding.
- **Retailers**, lacking manufacturing expertise, tend to have the most comprehensive definition of full package. In Asia, where full package supply has been developed to the fullest extent, retailers frequently place FOB (freight on board) orders. This means the vendor provides all the materials, produces the garments and is responsible for all costs and terms up to the point the order is shipped. Full packages offered to retailers often include pattern and sample making, packing and certain transport and financial services.
- **Branded marketers** like Liz Claiborne Inc. or The Limited — with short fashion seasons and moderate- to high-priced, coordinated outfits — often will supply the piece goods or specify textile companies from which the contractors must purchase piece goods. Retailers and branded marketers typically are responsible for both product development (design) and quality control.
- **Non-branded apparel manufacturers**, frequently with substantial manufacturing capacity in the United States and Mexico, also provide full packages for branded manufacturers, marketers and retailers. In contrast to the 807 contractors in Mexico and the Caribbean, which only assemble garments, these contract manufacturers are capable of supplying all the steps in garment production from design through distribution of finished apparel. They are especially important in the booming U.S. private label retail market.

In summary, the variety of full package options reflects the range of processes that can be bundled together in production arrangements. Fully integrated apparel firms are a dying breed, and today they mainly make simple, standardized products. In an era of ever-increasing specialization, package programs will encompass more and more stages of the apparel production process. ❑

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use company owned-and-operated plants in Mexico, as well as contractors, and most of their Mexican production will remain 807 programs.

The manufacture of women's underwear and bras in Mexico resembles the jeans model of 807 assembly more than the production of other types of women's wear, such as casual wear and sportswear coordinates. Mexico has not been a strong exporter of fashion-oriented apparel, largely because of the country's relatively weak textile sector. Adding to the problem is the fact that textiles from Europe and Asia do not meet NAFTA's rules of origin requirements. Therefore, lacking preferential access to the U.S. market for garments made from non-North American textiles, the success of Mexican companies such as Julio and Evan has been limited to packages of basic women's apparel, such as suits and slacks made from fabric blends that are available in Mexico.

Vertical manufacturers in Mexico may have an edge in this "new" women's wear sector. Mexican companies that produce their own textiles appear to be the most successful in getting full package orders from U.S. retailers and marketers, since U.S. companies assume that greater control over fabrics makes vertical firms a better bet for on-time delivery. One example is Avante, a vertically integrated apparel manufacturer located in Toluca, close to Mexico City, which produces ready-to-wear apparel for several major U.S. retailers. The company also is making its own line of intimate wear called Tops and Bottoms, and it is the sole North American licensee for the upscale European underwear brand Skiny.

In contrast, many non-vertical women's wear apparel companies in Mexico, which neither manufacture their own textiles nor are involved in 807 production networks, are meeting roadblocks in trying to develop supply relationships in the U.S. market. One group of Mexican women's wear companies even established an organization called Grupo Moda Mexico in 1997, but its efforts to get a foothold in the U.S. market have met with little success.

Developing Support Services

The difficulties faced by Mexican companies trying to connect with U.S. retailers and manufacturers underscore the importance of an infrastructure of support agencies that are trying to facilitate and strengthen Mexico's export efforts.

One of these is Mexico's foreign trade bank, the Banco Nacional de Comercio Exterior (Bancomext), which plays an important role in creating alliances between U.S. and Mexican firms. Bancomext is promoting Mexico in several important ways:

- Establishing a vendor certification program that carries out plant-level evaluations of Mexican suppliers, especially small- and medium-sized firms. This process provides smaller firms with the technical advice necessary to become successful exporters to the U.S. market.
- Providing modest financial assistance in terms of working capital to creditworthy Mexican exporters.
- Encouraging Mexican manufacturers to export to South American countries with smaller markets and a similarity to Mexico in terms of fashion. This is a good "first step" for firms eventually looking to export to the United States.
- Sponsoring annual trade fairs designed to familiarize U.S. retailers with the offerings of Mexican apparel manufacturers.

A second coordinating agent working within Mexico's apparel commodity chain is the sourcing company. This type of firm, which in a more elaborate form has been critical in establishing full package relationships between U.S. retailers and East Asian apparel manufacturers, began to gain momentum in Mexico with the passage of NAFTA.

Owners of sourcing companies typically are industry insiders who play a role in helping Mexican contractors get up to speed in terms of producing for the U.S. market. They assist with the development of skills ranging from design and pricing to meeting the specifications of companies placing package orders. Some merchandising organizations even are helping Mexican manufacturers establish Quick Response programs, target certain market niches and develop networks of fabric and trim suppliers.

Despite these gains, full package programs in Mexico frequently are hindered by financial constraints. For example, Mexico has no "letter of credit" system, as Asia does, for providing exporters with working capital. As an alternative, Mexico seems to be moving in the direction of using factors in the U.S. banking community to provide loans at competitive market interest rates.

Facing the Future

While the devaluation of the peso has lowered wages and spurred the expansion of the Mexican maquiladora sector, the effects of NAFTA on the Mexican and U.S. apparel industries — which include integration in the apparel commodity chain and the evolution of coordinating agents — will prove even more significant. Based on current trends, it is apparent that the ride has just begun for firms on both sides of the border.

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