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KC5 – Corporate Strategy and Contemporary Issues

Section 2: Case Study

Pilot Paper Pre-seen

Apex Apparels

History of Apex Apparels

Apex is a family owned retail store from the colonial era in a prominent location in Colombo where imported textiles and garments were sold. In 1962 with the support from a government subsidy Apex opened up a small scale textile mill which produced yarn, fabric and textiles from imported cotton from India. Due to the government protection given for local textiles manufacturers by controlling of imported products, Apex's textile manufacturing business was able to grow by securing demand for the products in the domestic market. Within a few short years Apex was able to increase production by opening up another larger textile mill. However the range of products from this business was limited and the margin was low since the lower end of the market was targeted.

In the 1970's Apex's founder's three sons; Tharuka, Hiruka and Pushpika left for the United Kingdom (UK) for their higher studies. Tharuka followed a degree in textile engineering and Hiruka the artistic person in the family followed a textile design degree. Unlike his two brothers whose interests were shaped by the family business related to textiles, Pushpika, the youngest of the family was interested in monetary and financial aspects of businesses and followed a degree in accounting and finance.

In 1980 after the completion of their higher studies in the UK they came back to Sri Lanka and joined with their father in managing the family business. The three sons were also similar to their father with exceptional entrepreneurial spirit. They were enthusiastic about venturing into the apparel (garment) business during that time after the initiation of the open economy. This business conducive economic environment prevailing at that time supported export led businesses such as apparel manufacturing where the government allowed duty free import of raw materials, granted subsidies and charged lower taxes. The three brothers saw a huge opportunity from venturing into the apparel exporting business. The ability of exporting enabled to commanding a higher price and thus earn a higher margin unlike the existing sale of textiles to the domestic market.

Another favourable condition for apparel exporting businesses was the Multi-Fibre Agreement (MFA) functioning at that time which provided Sri Lankan apparel exporters the opportunity to enter into foreign markets with ease by providing secure markets free from foreign competition. The MFA was a mechanism that governed the international trade in textiles and apparels by means of imposing restricting quotas on the amount developing countries could export to developed countries.

The three brothers were able to convince their father and this led to opening up of a medium scale garment factory in 1985 giving rise to the birth of Apex Apparels Pvt Limited (AAPL). The factory was located in the Katunayake Export Processing Zone which was a dedicated area for export oriented production with suitable infrastructure facilities and incentives, which were created in line with the government's policy of export promotion.

The financing for the purchase and setting up of the apparel factory was done by family funds as well as by the sale of the oldest textile mill. The other textile mill was disposed in 1998 as a result of the government removing the import duty on textiles which made it possible to import cheaper textiles. In spite of Hiruka's best efforts to keep the mill operational, it was found not viable due to the high cost of replacement machinery needed to increase efficiency, high electricity costs and the non-availability of raw material in the country to produce textiles.

Growth of AAPL

In the following years AAPL experienced rapid growth by methods of both organic growth and acquisitions. The end of the MFA in 2005 resulted in the closure of many small scale apparel exporters who crumbled under the pressure from diminishing margins and competition from emerging countries from the free market environment. In this period AAPL acquired several small scaled factories which were struggling at highly favourable prices.

The successful growth of AAPL can be partially attributed to several joint ventures and trading alliances with clothing retailers in the USA and EU. The government provided a conducive investment environment for foreign entities to establish operations in Sri Lanka by providing necessary facilities and incentives. These joint ventures and alliances were also beneficial to AAPL in terms of technology and knowledge transfer. The joint venture partners generally provide the majority of the investment amount needed to start up the manufacturing plants. Under a typical joint venture agreement terms, AAPL has the responsibility for the manufacturing and supply chain operations and the joint venture partner takes the responsibility for the designing and marketing aspects. They maintain and staff their design offices which are located in major cities in their home countries.

Over the years it has been a high priority of Alex (founder) and his sons in maintaining a strong relationship with these joint venture and alliance partners which has resulted in AAPL successfully maintaining all of the joint venture partnerships. However last month AAPL had to disband one of its oldest joint venture's which was with a UK department store chain due to the department store going into administration.

Today AAPL has positioned itself as an emerging apparel manufacturer in the country with attractive annual growth rates and a huge potential. The three brothers' aim is to steer the company to become an apparel giant in Sri Lanka and to make the company a key player in the apparel industry in the South Asian region.

Current Structure and Divisions of AAPL

The organizational structure type of AAPL is mainly a divisional structure based on types of products. Each division excluding the 'Global' division is a self-contained unit consisting of several functions which aims to produce a range of similar products. This

divisional structure fosters flexibility and speed which had helped AAPL to increase the speed to market by quick response to customer needs and fast delivery.

There are 4 divisions and the types of products which fall under each of them are:

- Official - This includes formalwear for men and women such as shirts, trousers, dresses, skirts etc.
- Outdoor - This includes sportswear and swimwear.
- Global - This division includes all of the factories controlled and managed under the joint ventures and they produce a range of products as required by the joint venture partners.

The company has several subsidiaries under its belt whereas each joint venture is taken as a separate subsidiary falling under AAPL. AAPL also owns and operates another subsidiary company which manufactures packing material, cartons, tags, labels and other such items related to its production.

Including the factories controlled under the joint venture partnerships, AAPL Presently has a total number of 26 factories. The 2 biggest of them employs around 2000 workers, 10 medium sized factories employ on average of close to 500 workers and the remaining small sized factories employ less than 100 workers each.

The refurbished family retail store in Colombo now serves as AAPL's head office. It consists of a state-of-the-art design studio which undertakes the designing for own branded products. It also houses the centralized marketing and information technology departments.

Management and Shareholding

Alex held the both the positions of Chairman and the Managing Director of AAPL until his passing in 2001. The eldest son Tharuka is the current Chairman and Managing Director, Hiruka is the Design and Marketing Director, Pushpika the Finance Director and Nalin is the Operations Director.

Before joining the Board of AAPL, Nalin worked as the Head of Procurement of East Asian Region for a leading retailer based in the USA which was also a major customer of AAPL. Nalin was born in Sri Lanka however he resided in the USA. Nalin had maintained a good relationship with AAPL, especially with Tharuka who served as the prior Operations Director. In 2004 Nalin retired from his position and came back to Sri Lanka where he was requested by Tharuka to join the Board of AAPL.

To this day the company remains a private limited entity and during the period that Alex was the Chairman and Managing Director it was never his intention to get listed. However recently Pushpika has been repeatedly suggesting to the board that getting listed in the

Colombo Stock Exchange is a possible option and this would facilitate a new era for AAPL by enabling a further huge opportunity to expand and grow.

AAPL has an authorized share capital of 1000 million ordinary shares. 500 million of it has been issued. Tharuka owns 250 million shares, Hiruka owns 150 million shares and Pushpika owns 100 million shares.

Customer Base

Presently AAPL only manufactures clothing for the export market and it also caters to a small number of well-known high street clothing retailers. The majority of its clothing produced is in the medium price ranges and recently AAPL has been focusing on producing for the high price ranges as well.

Except for the Outdoor division the other divisions manufactures clothing for customers under their own labels. The Outdoor division manufactures AAPL's own branded sporting clothing range under the brand name of "Dynamic" and a swimming wear clothing range under the brand name of "Splash". These two brands falls under the medium price range.

80% of AAPL's total sales value comes from customers based in the USA and 20% in the European Union. Most of the customers in the USA were those that AAPL entered into contracts during the period the MFA was in place. When the MFA ended AAPL was able to secure these contracts due to its high quality and timely delivery which were two key competency factors favoured by these customers. However competitors of AAPL follow different strategies which enables them offer wide range of products to wide range of customers.

Human Resources

AAPL always placed a high concern on its human resources. This helped to improve quality as well as win customers and retain them.

International buyers are stringent when it comes to labour rights and a key selling point of AAPL has been the high standard of labour maintained. The company provides free meals at all of its factories and also provides free transportation for the factory workers, to and from the factories. AAPL also adheres to several internationally recognized initiatives regarding ethical and fair treatment of labour.

AAPL has a young work force and nearly 80% of its factory workers are women.

Over the last few years AAPL has experienced a labour shortage and a high labour turnover and its factories have been running under capacity. As a counter measure AAPL has been increasing its remuneration packages offered to factory workers which are presently much higher than the industry average. AAPL has also been undertaking increased advertising in newspapers, radio and even in outdoor advertising methods to attract workers.

However it was evident to the board of AAPL from the results of an industry wide survey that more than the remuneration the negative perception of the people for working in factories was the root cause for the labour shortage. People preferred white collar office jobs rather than factory work even if the salaries were small. All of AAPL's factories are based in the Colombo and Gampaha districts and this social stigma has been prominent in these areas compared to rural areas which had led to a worsened labour shortage situation.

Proposed Overseas Expansion

At the recent board meeting, Nalin came up with a proposal for opening up a manufacturing plant in Bangladesh. Pushpika pointed out that several Sri Lankan apparel giants as well as Chinese apparel manufacturers have already initiated operations in Bangladesh and they were benefiting from the cheaper operating base there and thus enhancing their competitiveness. Nalin further stated that there were also tax incentives available in Bangladesh such as tax exemptions up to several years and the release from import duty for input material.

Nalin suggested that another reason for the overseas venture was mitigating the labour shortages that AAPL is currently experiencing. He argued that repeatedly increasing the remuneration package can ultimately harm the company's margins and it is not sustainable. Nalin also stated that a joint venture with a Bangladeshi apparel manufacturer is one avenue that can be considered in setting up operations there. There have been accidents reported in some Bangladesh factories last year. And the ethical manufacturing practices have been questioned by the buyers from the developing countries.

Nalin also feels that Vietnam and China are two other countries that they could consider to expand their business. Further at the same meeting Nalin tabled two paper articles, where the first one carried an interview with general secretary of joint apparel forum (Annex 1) and the second one carried views of leading apparel exporters in Bangladesh on how they should improve the apparel sector in Bangladesh.

Finally at this meeting Board of Directors of the company were contemplating whether the Sri Lankan garment industry has long term prospects.

Risk associated with the investments

Apparel sector has higher risks compared to the average risk faced by other sectors in the Sri Lankan market due to high dependence on foreign revenues and their volatilities. Therefore the industry practice is to consider the systematic business risk as 1.2 for risk assessments for local operations.

Supply Chain Enhancements

After Nalin joined the Board of AAPL, there has been a significant level of enhancements to AAPL's supply chain. Few years ago with the direction of Nalin an electronic data interface (EDI) was installed. The EDI enabled to securely and efficiently communicate with its joint venture partners, customers and suppliers. It also helped to improve communication between the head office and the factories.

The enhancements initiated by Nalin includes not just the tangible investments related to the supply chain but also the change in the mind-set of the other Board members regarding elevating AAPL from just a exporting manufacturer to a total service provider who carries out the functions of research of trends, product design and engineering, development, supplying of raw materials and manufacturing. This resulted in investments being carried out for the design studio located in AAPL's head office which now contains advanced computer aided designing (CAD) facilities.

Nalin with his many contacts with textile mills in China was also able to secure competitively priced contracts for procurement of textiles to AAPL.

Through his market research Nalin has identified that "Speed to market" is a critical success factor. Some of the competitors currently operating in the country have reduced their lead time by 75% through alignment of supply chain which includes fabric , plastic , bands , lace and other accessories required for garment making. It has helped the brands like Victoria Secret to reduce their stock holding and mark down due to off season impacts.

Nalin also said that distribution of finished products is a very important process in the apparel industry. Because delays in transit can result stock outs in retailers and it will not be healthy for the long term business relationships with them. Currently, AAPL is shipping each order to the customers individually. This incurs significant shipping costs and makes tracking of the shipments difficult. Sometimes container space will not be fully utilized in a situation where buyers order doesn't exactly match with the container capacity. As a solution for these problems, I propose a centralized distribution system. In this system finished orders will be consolidated and shipped to a warehouse in US or EU. Upon the arrival of the bulk shipment it will be spilt into individual orders and shipped to each buyer using a domestic delivery company.

Accounting for revenues and costs

Revenues are accounted for at the point of shipping which occurs at the same time as the legal ownership transfers. The price agrees are mainly FOB (Free On Board) and sometimes work based on CIF (Cost Insurance Freight) as well. In the case of CIF, the company uses a third party freight and insurance companies to provide services and then charge the cost to the CIF price with a margin. Most buyers pay AAPL in 30 days' time and discounting of export bills is a common arrangement with the banks. There are

discounting system arranged by the buyers at lower rates, based on the financial strength of the buyers.

From the FOB, the raw material cost for fabric and accessories, would be deducted to get the Cut and Making (CM Charge). CM Charge is the net revenue for AAPL. At the price discussions AAPL agree a CM charge for each minute that they put in to a garment, and this is the standard practice of the industry. It is the industry practice to prepare financials in USD since majority of revenues will be in USD

Extracts from AAPL's statement of profit or loss and statement of financial position

Statement of profit or loss for the year ended 31 December 2015 and 2014

		USD million	USD Million
Revenue	notes	939.75	757.65
Cost of sales		(675.63)	(548.52)
Gross profit		264.12	209.13
Administrative/Distribution and Finance cost		(146.73)	(131.40)
Profit before tax		117.39	77.73
Tax	1	(18.78)	(9.33)
Profit after tax		98.61	68.40

Statement of the financial position as at 31 December 2015 and 2014

	notes	USD million	USD million
Assets			
Non-current assets	2	251.43	138.54
Current assets			
Inventories		56.75	41.55
Trade and other receivables		125.42	88.40
Cash and cash equivalents		1.00	4.5
Total current assets		183.17	134.45
Total assets		434.60	272.99
Equity and liabilities			
Equity			
Share Capital		50.00	35.00
Retained earnings		148.60	49.99
Total Equity		198.60	84.99

Non-current liabilities

Long term borrowings	3	128.00	103.00
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Current liabilities

Trade and other payables		96.00	74.25
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Tax payable		12.00	10.75
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Total liabilities		<u>108.00</u>	<u>85.00</u>
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Total equity and liabilities		<u>434.60</u>	<u>272.99</u>
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Notes:

1. The corporate income tax rate is 12%.
2. The non-current assets have not been re-valued
3. The long term loan has been taken in USD and the interest rate is 5% per annum

Annexure 1

Sri Lanka apparel industry beyond 2015

Daily FT

Today, Sri Lanka stands strong as one of the premier fashion and apparel outsourcing hubs in the world, possessing a wealth of long established culture which represents ethical entrepreneurship and sustainability. At present, the country is on a seamless and relentless process of setting up a unique platform to accomplish its ascendancy through superior quality, incomparable turnaround time and adoption of state-of-the-art technology.

Amidst the harsh competition from numerous global contenders within the sphere of apparel manufacturing, Sri Lanka has taken a bold initiative to mark its signature in the global apparel arena by building the competitive edge over 'Value' as oppose to 'Volume

This significant transition indicates the country's readiness and also its maturity in terms of the developed and sophisticated infrastructure, to optimize efficacy of the supply chain, which is a demand of great importance towards aligning with future market trends.

Compelled ethical standards to ensure sustainability, instant connectivity through technological advancements, dynamic transportation and logistics systems, unique creativity backed by state-of-the-art technology and the labour skill-set with a passion for consistent delivery of excellence along with a stabilized economic and commerce background has rendered the vibrant nation of diverse potentials, a momentous boost towards supremacy.

"The continuous success is heavily based on the sincere global relationships built by all the players in the industry over the years and it further strengthens," said M.P.T. Cooray, Secretary General of the Joint Apparel Association Forum (JAAF).

The industry has positioned itself as the apparel hub of the entire South Asian Region. Stating on the strategic location Cooray further added that, "Sri Lanka has the highest per capita of apparel exports in Asia and by harnessing the regional strengths, the country could effortlessly thrive in positioning the South Asian region as a strong competitor, second to China.

“Sri Lanka has strategically nurtured its supply chain to reach its target of \$ 8.5 billion in the year 2020. The industry has proven its capacity by recording a significant growth of \$ 4.3 billion in 2013 and indicates a further progression with its current achievement of \$ 2.3 billion by June 2014.”

With the proven excellence during the yester-years, Sri Lanka has brought the change into the Sri Lankan Apparel with the introduction of innovative technology; wearable electronics, eco-friendly fabric treatment etc. to further strengthen the areas of design management, inventory management and product life cycle management.

By taking ‘Designing’ to its pinnacle, the country has introduced intangible assets through her very own home grown brands of international repute such as Amante, Arugambay, Avirate and Adithi which already gained recognition and acceptance in regional markets.

The journey from Sri Lanka’s humble beginnings is replaced today with modern technologies and sophisticated machinery, speedy delivery and the presence in digital and e-commerce platforms. Sri Lanka is moving aggressively towards digitalisation through e-commerce, e-business and virtual business, which enables a direct link to the European markets which operates in the age of digital presence.

Amidst this gamut of revolutions, the industry is driven towards the fully integrated digital value chain, which creates a distinction on Sri Lanka Apparel; ‘Sri Lanka is Future’.

Sri Lanka is the undoubted manufacturing facility to many world renowned brands like Victoria’s Secret, Gap, Nike, Tommy Hilfiger, etc. The unique state-of-the-art technology blended with the distinctive quality, accuracy and speedy delivery has upholstered the gaps of the global supply chain. Use of modern machinery to master the tiny edges with high end finishing techniques has leveraged this beautiful resplendent island to stand among the rest. Local factories and other infrastructure facilities can be classified as best in class. They conform to the highest standards in building construction ensuring safety and security of people and machinery.

Remarkable achievement

“Sri Lanka Apparel is experiencing a significant shift of its markets due to its continuous sustainable growth over the years. The total share of exports to United States from Sri Lanka alone has increased by 6.7% compared to yesteryear. This is a remarkable achievement,” emphasised Cooray.

Sri Lanka which is quite aptly described as The Pearl of the Indian Ocean, possess multifaceted natural resources, is in a good standing with Eco fashion. This significant part of the growing design philanthropy has embraced the Sri Lankan apparel industry with an indefinite support of environmentalism and social responsibility. This comes quite naturally as Sri Lanka enjoys abundance of natural resources and all we need to do is its application.

The nation defines its sustainability upon Triple Bottom Line approach. The three dimensional approach, People-Planet-Profit, created the preferential access to the global market place to reach its mastery.

Acquiring a world class certification on its primary sources of the supply chain is another jewel in the crown of Sri Lanka apparel. LEED (Platinum) certification by US Green Building Council was awarded to many of its manufacturing plants ensuring the best green design categories: sustainable sites, water efficiency, energy and atmosphere, materials and resources and indoor environmental quality. This process has further enhanced the character of the industry by lowering carbon foot print, environmental pollution and many others.

Sri Lanka has always been recognised for its magnificent accomplishments many times at majestic forums for its excellence in quality manufacturing, green manufacturing, quick delivery of service etc.

Several of Sri Lanka's leading apparel manufacturing companies has received international accolades over the years for their dedication and commitment towards earth friendly initiatives alongside their core business responsibilities. These companies are recipients of awards for Leadership in Energy & Environmental Design best known as LEEDS, for the green building concepts.

The country has a 'pool' of a labour skill-set and other second to none expertise in design, efficient logistics services for speedy delivery, reliability and assurance, which are the most critical factors in today's manufacturing environment.

The remarkable after sales services provided by Sri Lankan apparel arena should be discussed with a key note.

Unceasing growth over the years enables Sri Lanka apparel to sharpen its saw by mastering its speedy delivery, reliability, assurance, unique design, skilled labour and flexibility in legislations through cultural peace in mind. Further, the rapid development in infrastructure has fortified the industry to reach its super brand status. This innovatory change proves that Sri Lanka- the premier fashion and apparel outsourcing hub – is elevating 'Fashionably to its Mastery'.



"Target US\$50 Billion: We Need Your Support to Reach It"



**Marcia Bernicat, US
Ambassador to Bangladesh**

Setting a goal of doubling apparel exports in less than six years is ambitious. But I don't know how you get big results without setting big goals. I appreciate BGMEA for setting this goal. We are committed to helping you to reach the target.

Bangladesh's apparel sector is a major industry leader, and it is growing to be the top producer. It

is not because of cheap labour. Buyers have told me there are countries that have lower wages than Bangladesh. What these industries [in other countries] don't have is skilled workforce that delivers quality products on time. That's what puts this industry on top.

The sector has an opportunity to transform itself by adopting the international standards that are increasingly required of this industry and other industries everywhere. There is no going back on this issue. All manufacturing units in every country had to adopt the same international standards to qualify for the trade preference, like the standards Bangladeshi manufacturers were asked to comply. When we will see that all the factories have done their remediation works, risks no longer exist, workers are not fired for trying to organise union, we will have a discussion about duty free and quota free facilities.



**Siddiqur Rahman,
President, BGMEA**

To reach US\$ 50 billion in 2021, we have to maintain 11 percent growth every year. To ensure that growth we need to address some issues on priority basis. Skill development, productivity enhancement, access to finance to bear the cost of remediation of factory, infrastructure, and uninterrupted gas supply to factories, are some key

areas to focus on. We recommend formation of a taskforce to mitigate the gas crisis which has now become the biggest concern for the industry. Both government and private sector representatives would be members of this taskforce. The RMG industry uses only 5 percent of the total gas supply of the country. The government should actively think about supplying more gas to this booming industry. There should be a serious study on this issue to substantiate our demand.

In the last one year, the price of crude oil has dropped by 50 percent in the international market. Still in our country it has remained the same. We should look into this seriously.

Rana Plaza is not the whole picture of our garment industry. There are many factories in the country that maintain global standards. So far twenty-six garment factories have been LEED certified by the United States Green Building Council (USGBC). And there are hundred more in the pipeline. There are five Platinum rated green garment factories in the country.



**Pierre Mayaudon, Head
of the European
Union mission in
Bangladesh**

To reach the \$50 billion target, Bangladesh would have to fight and win three battles: the battle of technology, international engagement and team spirit.

The battle of technology starts with remediation and a fund of \$200 million has been put on the table for the companies that need the money to implement the remediation plans.

But things are not moving very fast. So we need to put a mechanism in place so factories that need the fund can take the advantage from the donors. Skilled workers, energy efficient machines and modern machineries are also needed.

Bangladesh also needs to invite a lot of foreign direct investment. It will give more chance to local industries to forge partnership with foreign investors. Please, be more foreign investors-friendly.

Media has a very important role in this comprehensive approach. Media can help you to find which areas you need to improve on.



Mohammed Nasir,
*Vice President
(Finance), BGMEA*

McKinsey report talks about 5Ps: skilled and efficient people, safe place, uninterrupted power supply, smooth operation of port and stable politics. If we can maintain these 5Ps we would be able to achieve our target quite easily. We also need support from all the stakeholders.



Professor Sadeka Halim,
Dhaka University

We need to formulate a strong public policy for the RMG sector.

If we talk only about the economic side we cannot achieve the expected growth. We also have to look at the social side of the RMG

industry.

BGMEA needs to have a strong research team who will find out various bottlenecks of RMG sector. At the same time, it will counter the propagandas that tarnish the image of the industry.



Dr. Ahsan Mansur,
Executive Director, PRI

We need to invest more than what we have already invested in the last four decades to double our RMG export. Now we need capital

intensive investment. Our average implemental capital output ratio is 4.5. So we need to invest about US \$ 100- 150 billion in this sector. I want to ask BGMEA whether we can arrange this investment without FDI. I do not think it is possible for our local investors only.

Our Dhaka-Chittagong four lane has already become overcrowded. We need to think about making it six or eight lanes highway.



A. Matin Chowdhury,
Former President, BTMA

We need a robust supply chain. In our supply chain the main products are yarn and fabric. We require 990 thousand metric ton of extra yarn

in order to meet our targeted growth demand based on the same quality of yarn now we are supplying. That means we need fifty thousand more spindles in spinning mills and 800 MW of power. It appears to be really difficult to achieve within five years. We need to secure our raw materials from outside. Chinese industries are opening their factories in the USA because America provides the best cotton and the best power and land facilities. We may need to think about investing in a third country where we can get the raw materials more easily. Our current policy does not allow us to invest outside. If we invest in the USA to establish spinning mills we can secure our raw materials supply. The USA also offers duty free facility if you use their raw materials. This is what they are providing to all the Latin American countries. We should seriously think about this option.

We need huge improvement in production capacity and skills. We need to focus on quality, not just quantity. We need to fully utilize our existing training institutions to impart training to our workers. We also need to create new training facilities to meet our increased demand of skilled manpower.

We need to improve our bargaining skills. BGMEA should team up with universities to introduce courses on negotiation skills which is critical for ensuring fair price of products.



Mohandas Seneviratne,
Program Manager, PaCT, IFC

Through the PaCT programme we are establishing common effluent treatment plant. It will save your cost and increase your capacity. The RMG industry should invest more in checking pollution

and wastage. This is not a cost. It is an investment.