WHY IS TEXTILES IN INDIA A LOW MARGIN/PROFIT BUSINESS?

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Textile Industry is said to be a low margin/profit business – apart from niche segments, most players complain of this trend. I have been part of this business for last 15 years and have participated in various parts of the chain – fibre/yarn/fabric/garments. This has given me to see all the segments from close proximity and also interact with leading players of various segments.

I would agree with this observation of low margins and the struggle that most players have had to make to survive and grow . Textile industry as the common man knows, is basically divided broadly into Textiles (fibre to fabric stage) and Clothing (the end garments used by the consumer). Both segments have different characteristics and features and hence the reasons for failure/success would naturally be different. The first part i.e. Textiles is essentially an industrial product and goes as an input into the second part i.e. Clothing which is a consumer product.

Commonsense would say Indian Textile Industry should be thriving as:

- Clothing as we all know is one of the necessities of human beings and is something whose demand can never die. Recession or any other situation – clothing is always needed and is indispensable. India with its billion plus people, provides a huge market for the industry.
- Secondly it is has been a trend for centuries that this industry moves from the developed high cost centres to the developing/low cost centres. India fits perfectly into this criteria and the dismantling of MFA in 2005 provided it a perfect platform to boom.
- Thirdly the Government of India has been very kind to the industry in terms of interest/capital subsidies through TUF and other State textile Policies, concessional infrastructure through SITP scheme and various export incentives to develop global markets.
- Fourthly India has a huge production of raw cotton, which makes the essential raw material available at reasonable prices in abundance, providing it a competitive advantage.

However the truth is very different, which is obvious by some of these indicators:

- The growth of fabrics and yarn over the last few years has been just about 5% per annum i.e. below our GDP growth rate
- One of the largest restructured industries in India has been textiles – the Government itself made concessions twice in last 4 years to enable smooth restructuring of loans
- The industry is least preferred by both Banks and Stock Markets – it enjoys very low valuations in stock markets (P/E of 3 to 5) and hardly any analyst covers the industry.
- Most textile companies are heavily leveraged and have very low profit margins

- The new generation is shying away from the industry
- All major corporate/business groups have moved out of this industry like Reliance and Tatas.

There are many reasons attributed to the poor performance of the textile industry for almost the last two decades. Some of them are:

- Inconsistent government policies (however to be noted that probably no industry is more subsidized than this)
- Too many players / competition due to low entry barriers and cheap funding available from Banks due to interest/capital subsidy by Government – an advantage actually becoming an indirect burden
- The developed countries, where most of the market is there, squeezing the poor &developing nations. Till 2008 the dollar prices of textile products fell for almost a decade – USA & Europe saw deflation in textile products.
- Low labour cost and other factor costs of our competitors like China, Bangladesh, Pakistan and Vietnam.
- Concessional tariffs for LDCs like Pakistan, Bangladesh, Vietnam etc – however to be noted that the largest player i.e. China has none.
- Removal of MFA in 2005, which lead to dismantling of quota regime and created opportunities for volume growth of the efficient producers – hence margins enjoyed by existing players due to holding of quotas was gone.
- High energy costs vis a vis competition, which nullified other advantages.

However while giving these excuses, one doesn't realize that most of them hold true in the global context and for the exports market. Poor performance by export oriented companies can be understood, but why is the domestic market based companies not doing well – their volumes and sales may be growing but profits are low or absent and balance sheets are under severe stress.

Yes, where the industry has almost 30-35% of export contribution, its fortunes would be linked to the same for sure. But is this the main and only reason ?

As I sat and wondered about it, some of the facts which came up for consideration were that still 75-80% of the fabric and apparel industry is fragmented, unorganized and in the small scale (spinning industry is the only segment which is organized and modernized). These are typically family owned companies operated by the owners' themselves. Hence

- Factors of production like rent, capital and salary are not accounted for – these important resources are not priced in for costing purposes.
- Taxes and duties of various types are not paid by this segment of the industry
- It's not clear whether the profits earned by the unorganized sector are "real profit of enterprise" or just return on resources employed.

As a result the organized sector or new companies that enter this field find it difficult to compete and make profits. They have to compete with the large unorganized sector, which has no real sense of costing/pricing. The organized sector prices in all its cost of production in form of interest, rent and salaries. In India typically costs are linked with cash flows and when you own resources like capital, land and enterprise/labour – it's taken for granted. Hence it's very important for new or existing entrants in the organized segment to take this into account and treat this as an important competitive challenge while drawing up their business plan.

The domestic industry, except for some competition from Bangladesh and Sri Lanka over the last 2 years, has been immune to external competition due the prohibitive import duty rates. However with FTAs getting signed it's a matter of time when we shall be fully open to all types of competition. It's hence important that we understand the complexities of the business/industry and gear up for the same before its too late. We can't keep functioning the way we have been doing .

The industry needs to discipline itself to earn a reasonable margin on its products. Mindless pursuance of topline at the expense of bottomline isn't sustainable in the long run. The absence of large groups and new generation in the one of the largest industry of the world is clear indicator and alarm for all of us. Demand and supply are the ultimate determinants of price and margin, hence expansion without understanding the competitive forces would lead the industry into further bad shape.

How long will the industry walk on the crutches of government subsidy, tax exemptions and protected tariffs – we need to become more efficient and sharpen our competitive position with sustainable advantages/strengths to make the industry a healthy and prosperous one.

Conclusion:

To many it may be seen as a diagnosis with no treatment prescribed. However, if read between the lines, the solution is very obvious and apparent. In simple words, we need to ensure that the supply side consists of efficient and competitive players. The inefficient players need to be weaned out and discouraged from entering. Supply should be commensurate to the demand we can meet competitively and inefficient supply should be strongly discouraged.

Appeal to all textile players:

Please cost in all your factors of production like rent of owned property, interest of own capital and salary of family members and see whether after it, there is real profit in the profit & loss account. Please ask yourself are we really making profits? if not, please have a relook at your business and restructure the same to make it really profitable.
