Eternal Hope to Reality

Sustained Global Competitiveness for the

Indian Textile and Apparel Industry

Report Prepared and Presented by

Third Eyesight

www.thirdeyesight.in

FICCI

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About Third Eyesight

Third Eyesight is a **consulting and management solutions** firm focussed on **retail and consumer products**. Third Eyesight's professionals have deep and extensive experience in the lifestyle merchandise sectors (such as textiles, apparel, accessories, home, footwear and other products).

Clients that have benefited from Third Eyesight's experience and expertise include Indian and international **retailers**, **brands** and **manufacturers**, **private equity & venture investors**, **suppliers to the retail sector**, as well as **government agencies** and **industry bodies**. Third Eyesight has worked with companies that are market leaders (with **annual sales of over US$ 80 billion**) as well as early-stage and start-up businesses.

Strategy and operational support provided by Third Eyesight for retail and consumer products sectors includes: opportunity scanning, evaluating new business areas, market and industry research, business strategy and business plan development, development of sales and distribution networks, including support with acquiring key client relationships, business due diligence, partner evaluation, strategic alliances, mergers & acquisitions, sourcing and supply chain strategy, merchandising support, operational audits & assessment, training and skill-development, and a variety of other operational support.

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About FICCI

Set up in 1927, FICCI is the largest and oldest apex business organization of Indian business. Its history is very closely interwoven with the freedom movement. FICCI inspired economic nationalism as a political tool to fight against discriminatory economic policies. FICCI's commitment is now directed at changing the economic landscape of India, through reforms that expand the space for private sector and public private partnerships. FICCI is the rallying point for free enterprises in India. It has empowered Indian businesses, in the changing times, to shore up their competitiveness and enhance their global reach.

With a nationwide membership of over 1,500 corporates and over 500 chambers of commerce and business associations, FICCI espouses the shared vision of Indian businesses and speaks directly and indirectly for over 2,50,000 business units. It has an expanding direct membership of enterprises drawn from large, medium, small and tiny segments of manufacturing, distributive trade and services. FICCI maintains the lead as the proactive business solution provider through research, interactions at the highest political level and global networking.

In the knowledge-driven globalised economy, FICCI stands for quality, competitiveness, transparency, accountability and business-government-civil society partnership to spread ethics-based business practices and to enhance the quality of life of the common people.

Myth–Busting as an Introduction: Let's Not Rebottle Old Wine

There are many myths that are prevalent among the observers of the Indian textile and apparel industry. Here are a few illustrative ones that point to the need to seriously review of the way the Indian industry competes globally:

- **Myth # 1 – To grow, India needs to do what China has done:**
  Comparisons between the two countries are bound to happen, and surely there are some areas for India to learn from China. However, the fact is that India does not have many of the advantages that China had in the past (including a huge business portal in the shape of Hong Kong), nor can it so quickly build the advantages that China has developed over the last 15 years in terms of production capacity, infrastructure etc. India's political and administrative structure, financial systems, and internal dynamics are completely different. Some obvious internal gaps need to be filled in India's case, but sustainable competitiveness cannot be built through a copy-China strategy.

- **Myth # 2 - India is competitive because Indian labour is cheap:**
  India has low salaries and wages. But studies show that most Indian clothing factories are less productive, possibly even only half as productive as factories in India's major competitors on the global stage. Add to that inefficient factory management, expensive power, higher financial costs, and costs of bureaucracy and corruption. The true cost of business can be far higher for Indian businesses – and with the market determining the price boundaries for exporters, it's no surprise that many of them are losing money.

- **Myth # 3 - Indian handiwork is irreplaceable:**

  When embroidery was automated, suppliers of embroidered goods from Delhi and its surrounding areas certainly felt the heat but they maintained a competitive edge due to embellished (sequinned / beaded) products that are a staple in the “value-added segment” and that flood the market whenever the “India-look” is in. However, in recent times, machinery manufacturers have developed equipment that can provide the same look. The only difference is that the beads and sequins are stuck on with adhesive rather than being stitched on. The buyer is not likely to care about the production method – after all, the quality and look produced on these machines is more consistent, and the garment is less expensive because the machines have a very high throughput.

- **Myth # 4 - Compared to China and other Asian giants, the fragmented supply base of Indian manufacturers is more flexible and can competitively fulfil small orders:**

  For long, the small-scale reservation created a situation where the size of the factory was determined by an investment ceiling rather than by business economics. This base of small factories, by default, fitted into a specific competitive niche, where buyers wanting to place small orders (say, less than 2,000-3,000 pieces in a style) would mostly come to India, as most other factories around the world worked with higher “minimum-order quantities”. However, with retailers switching to the new mantras of quick-response, efficient supply chains and reduced inventory exposure, manufacturers in other countries are now working on much smaller orders.

- **Myth # 5 - India needs to focus on its core strengths – for example, India has a sustainable advantage in cotton that will maintain its competitive edge:**

  One of India's great strengths is one of its greatest weaknesses. Due to its suitability to India's climate, cotton has naturally achieved a very high share of the Indian production base. However, the global market is skewed in favour of man-made fibres. Cotton accounts for just about a third of global apparel consumption (including blended fabrics where cotton is used along with other fibres). For India to remain a globally-significant player, Indian production and exports must be aligned to consumption patterns – that means a strong thrust in products made out of synthetic fibres, as well as natural fibres such as wool. Similarly, Indian manufacturers need to look at the product range that their customers wish to buy, and identify new areas into which they can enter.

Perspective: India

The textile and apparel industry is of particular importance to India. The sector directly and indirectly results in the largest employment next to agriculture and retailing activity in the country. Its presence is not confined to the urban centres of industry and commerce – the textile sector is the most deep-rooted industry in rural India as well, and has been historically so.

India is one of the world's oldest major textile suppliers and once was, in fact, the largest by far, with a recorded history of global trading in textiles dating back several thousand years. We treat globalisation as a new phenomenon – the fact is that many thousands of years ago, the Egyptian civilization was trading with the Indus Valley civilization, the Chinese and the Romans had discovered each other way before US department store buyers landed in Hong Kong and Korea.

The textile sector in India started industrialising in the late-1800s and early-1900s, heralding a new era for growth. However, shortly after independence in 1947, the industry was constrained by licensing that limited mill capacity growth and other restrictions that forced companies to remain small-scale.

Later in 1962, just as India's exports had begun to grow, quota-restrictions closed the gates to free trade, nipping India's exports in the bud. For years, quotas determined where buyers could place orders, and trade was accordingly channelled and fragmented. Preferential trade arrangements placed further constraints, as both the US and the EU provided duty-free and quota-free access to some countries.

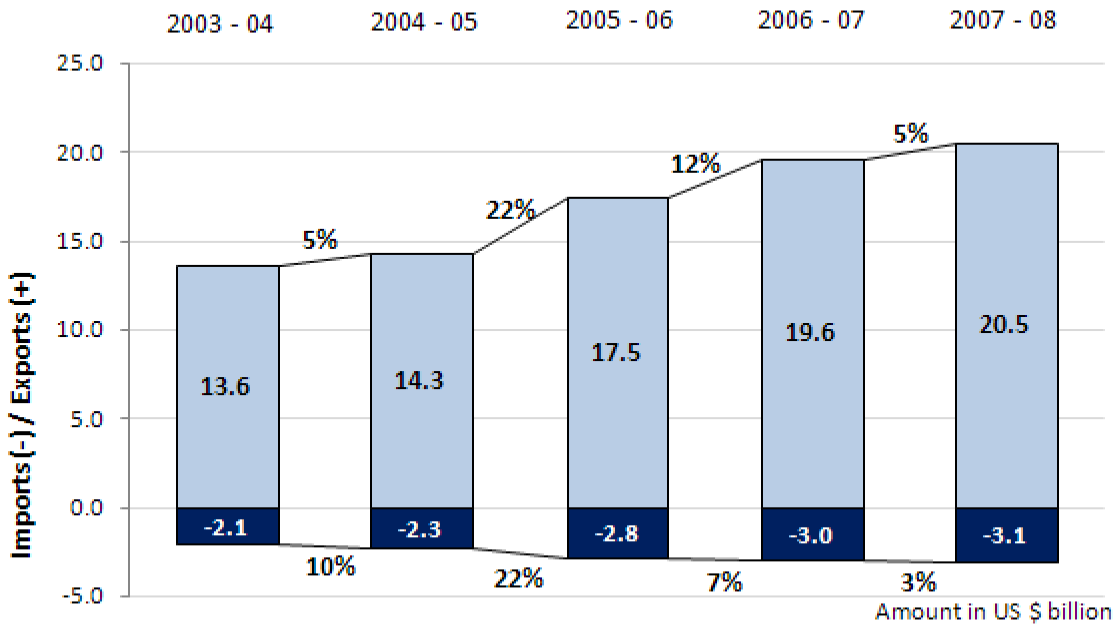
The net result is that India currently has just over 3 per cent of the global exports in textiles and clothing. However, despite its low share, India remains among the Top-10 exporters of textiles and clothing in the world.

After the removal of quotas in 2005, India was expected to grow its share of the global marketplace. However, views varied widely on whether India really had the mettle to stand-up to China – the largest exporter. Some observers and even people from within the industry expected India's share to decline in global trade.

India has actually grown its exports of textiles and apparel from US$ 13.6 billion in 2003-04 to US$ 20.5 billion in 2007-08, an annualised growth of a little over 14 per cent. During a similar period, China has grown its exports from US$ 95 billion to US$ 161 billion, with an annualised growth rate of almost 20 per cent.

Given the current market share positions, it is unrealistic to expect India to catch up with China any time soon. However, the trend clearly is towards a re-integration of India's industry with the global trade.

India's Global Textile and Clothing Trade



Source: Government of India Trade Statistics, Third Eyesight Analysis

We also feel that past perceptions, and prejudices ignore the potential India offers as a sustainable and strategic supply base. Among the Top-5 low-labour-cost clothing suppliers

(China, Turkey, Mexico, India, Bangladesh), only China and India do not have preferential access to their major markets and yet compete very effectively on the basis of their inherent strengths.

The fact that India is one of the few countries in the world that offers:

- A vertical industry structure, from fibre to clothing
- A large and replenishable low-cost pool of labour
- A multi-product capability
- Product development skills
- A large domestic market that can sustain the industry in the face of global competition

The last is an important and under-weighted factor in the Indian industry's competitive strategy. Worldwide, countries that have strong sectors for textile, apparel and other lifestyle products, have very strong domestic markets and strong 'brand delivery' mechanisms. The focus, in these countries, is not just on production but the entire ecosystem for the industry. We believe that India should be no different.

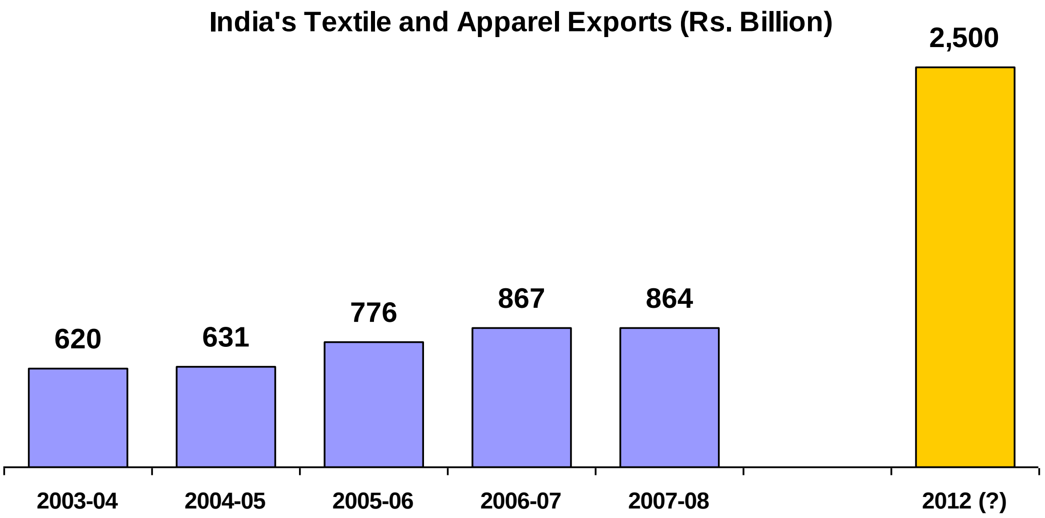
So far, exporters and domestic-market focussed companies have had very little common ground to work on. As compared to the customers based in the western markets, the domestic market needed very small quantities per style, processes and systems were weak, with high responsiveness required from the supplier – for exporters it was an "unviable" market to step into. On the other hand, for domestic buyers, exporters were far too rigid in their processes, payment terms, minimum quantity requirements etc. That has started to change with the emergence and significant growth of modern retailing in India (the so-called "organised retailing").

Although many people believe that modern retailing is a recent development in India, the fact is that the textiles and apparel sector has been at the forefront of its development since the 1950s-1960s, when the first chains started coming up. In about 30-years significant single-branded dealer-networks (now widely morphed into exclusive branded outlet chains and franchise networks) were built by textile and then apparel companies.

However, since the mid-1990s, there has been significant and visible development in the domestic market for textiles, apparel and other lifestyle products. Large retail chains have begun appearing, and new platforms have emerged for apparel and textile companies to grow their business domestically. The large Indian retailers' requirements have more in common with western retailers and brands (the customers for India's exporters) than ever before. This provides an opportunity for the two sectors to work more closely together.

Thus, with its long history, and these two growth engines – the export industry and the domestic market – we believe the Indian textile and apparel sector can retain its significant role in the country's economy, and create a differentiated position among global trade that is sustainable into the future. However, as the global economic growth slows, the domestic economy follows and inflationary pressures push up the cost of doing business, fresh thinking is also needed to keep the sector in growth mode.

The other urgent driver is the vision of what India's export numbers could potentially be by 2012: Rs. 2,200-2,500 billion. The number currently stands at a little over Rs. 864 billion, and to achieve the vision, exports must grow at around 25-35 per cent a year for the next 4 years, depending on how weak or stable the current year is.


India's Textile and Apparel Exports (Rs. Billion)
620
631
776
867
864
2,500
2003-04
2004-05
2005-06
2006-07
2007-08
2012 (?)

Incremental thinking will not help to achieve the vision

Let's not debate whether this vision is achievable or not. The purpose of a vision being articulated is to drive the actions that will help in achieving it.

What is very clear is that this vision is not "incremental" in nature, and incremental thinking will not help in realising it.

Even if we assume a robust incremental growth rate of 15 per cent per annum, India's exports will only be able reach Rs. 1,500 billion by 2012.

If this vision is to become reality, if India's textile and apparel industry is to change from being (as described by the head of an international company) "the eternal hope" to a true global leader, the industry and the institutions supporting it, including the government need to put in place a radically different course of actions.

This report is not being presented as a definitive strategy document for the Indian textile and apparel industry, or for the Government to mould its policies. However, it does attempt to present a view on historical and recent developments, the constraints that the industry cannot wish away and must, therefore, embrace, and also to highlight the factors that can create a sustainable competitive advantage for India as a leading global resource of textiles and apparel products.

A Health Check on the Indian Industry

While the All-India Index of Industrial Production registered an increase of 8.1 per cent during April-March 2007-08, as against the corresponding period of the previous year, the growth of textiles sector was slow.

Although Jute & other vegetable fibre textiles (excluding cotton) registered significant growth (33.1 per cent), the other textile sub-groups showed small growth rates. Wool, Silk & Man-made fibre textiles registered a growth of 4.2 per cent followed by Cotton Textiles (4.1 per cent) and Textile Products [including wearing apparels] (3.3 per cent) as against the corresponding period of previous year.

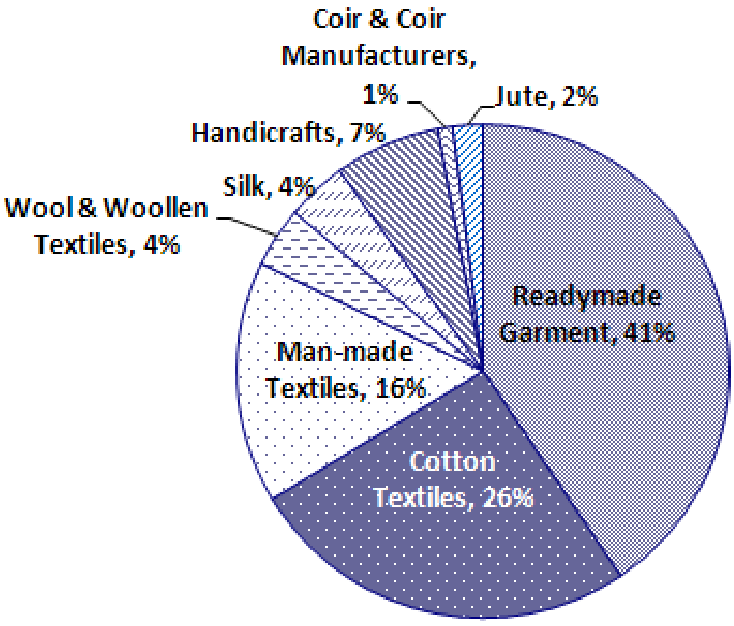
According to Ministry of Textiles, during fiscal 2007-08, spun yarn production increased by 4 per cent and cloth production increased by 3.9 per cent. The handloom sector recorded the highest growth (6.0 per cent) followed by the power loom sector (4.5 per cent).

The Indian textile industry is export-weighted, with almost 55 per cent of the total production being exported. The US market is the largest destination for Indian textile and apparel exports. The recessionary trend in the US and relentless ascent of the rupee led to a decline in the total trade with India in 2007, resulting in smaller orders, lower prices and deep uncertainty for apparel exporters.

Indian exporters are now trying to increase their share in EU market and diversify to other markets other than US. However, the market scenario in most major global markets is looking grim in the short term.

Though the dollar's appreciation this year should have brought a breather to exporters, the benefits of a weaker rupee has been offset by the surge in costs and the global economic slowdown. India' textile & clothing companies' margins are under severe pressure due to rising cost of raw material, fuel, real estate and more expensive credit.

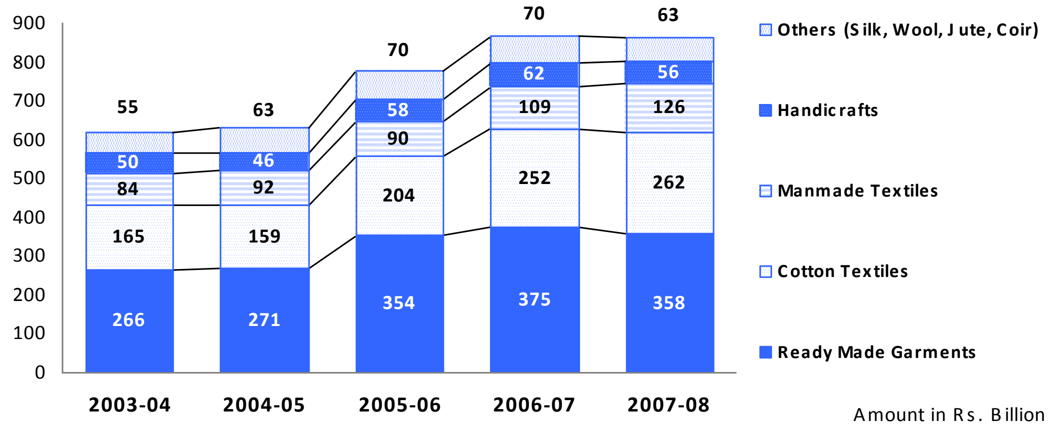
In addition, many of India's competitors have recently enhanced their export incentives in the context of declining demand in the US and EU markets. For instance, China has increased VAT refund rates from 9 per cent to 13 per cent for synthetic textiles and from 11 per cent to 13 per cent in case of others. Pakistan has introduced Research & Development assistance of 6 per cent for garments.



India's Textile & Clothing Exports (2007 – 08)

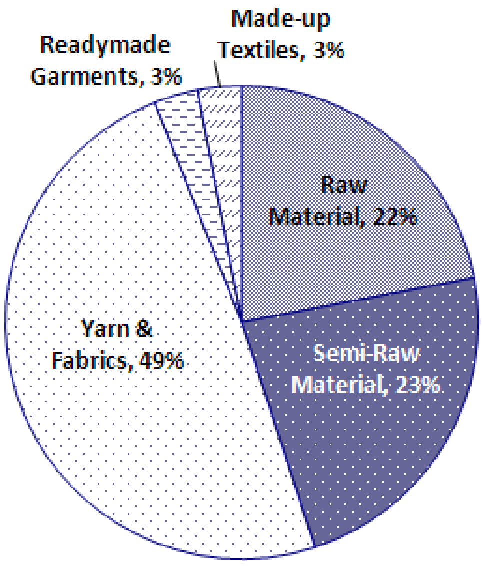
Source: Ministry of Textiles, Third Eyesight Analysis

Clearly, India's exports are still too weighted in favour of raw materials and intermediate products, rather than finished products, and this is a major concern if one looks at the long-term competitiveness and value-capturing capability of the industry.



Source: Ministry of Textiles, Third Eyesight Analysis

Imports have also begun to grow in India, although the numbers are still small. Import of fabrics and other products for conversion into clothing has been allowed duty-free for several years, and now imports are also growing for domestic consumption.



India's Textile Imports – Break-up (2007 – 08)

Source: Ministry of Textiles, Third Eyesight Analysis

Imports up to April-February 2007-08, indicate an overall increase in both, rupee terms and in US$ terms, to 3.78 per cent and 16.71 per cent respectively. Imports of Readymade Garments (RMG), Made-ups and Raw Materials increased by 36.80 per cent; 28.93 per cent and 11.75 per cent respectively, in rupee terms, over the corresponding period of the previous year.

Government Policies & Support

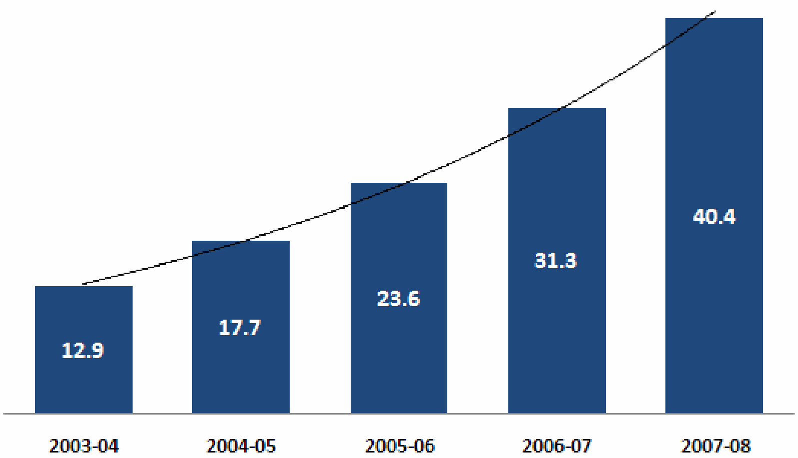
India's government has only a small direct ownership in the textile and apparel industry. Its role in growing the industry must therefore focus on creating an enabling environment through:

- Physical Infrastructure (and associated processes) to enable smoother movement of goods
- Soft infrastructure for skill development within the country and to attract skills from outside the country
- Fiscal Policies encouraging investment into the critical segments in the sector

Buyers and suppliers express equal concern towards the significant gap in infrastructure to deliver on the vision outlined for textile exports from the country. Software and services exports were a non-existent global business for India only a few years ago. Once they had grown to a certain size, even this area required investment in communications infrastructure. Similarly, the textile and apparel trade needs significantly higher capacity roads and ports for the goods to be transported within, and out of, the country.

India's IT Exports

Source: NASSCOM



The current plans project a doubling of annual port capacity by 2012 to 1.5 billion tonnes (compared to China's existing capacity of 3.4 billion tonnes per annum, which is being grown further).

The question may be asked whether even that planned capacity growth will be adequate to meet needs over the next 20-25 years.

Meanwhile, with current capacity utilisations of over 90% at major ports, peak shipping seasons for Indian exports are chaotic at best and seriously debilitating at their worst.

On the other side, the Indian Government, in recent years, has initiated a number of policy changes aimed at boosting investments in the textile and clothing sector.

Government Support

- Scheme for Integrated Textile Parks (SITP)
- Technology Up gradation Fund Scheme (TUFS)
- Special Economic Zones (SEZ)
- Cluster Development

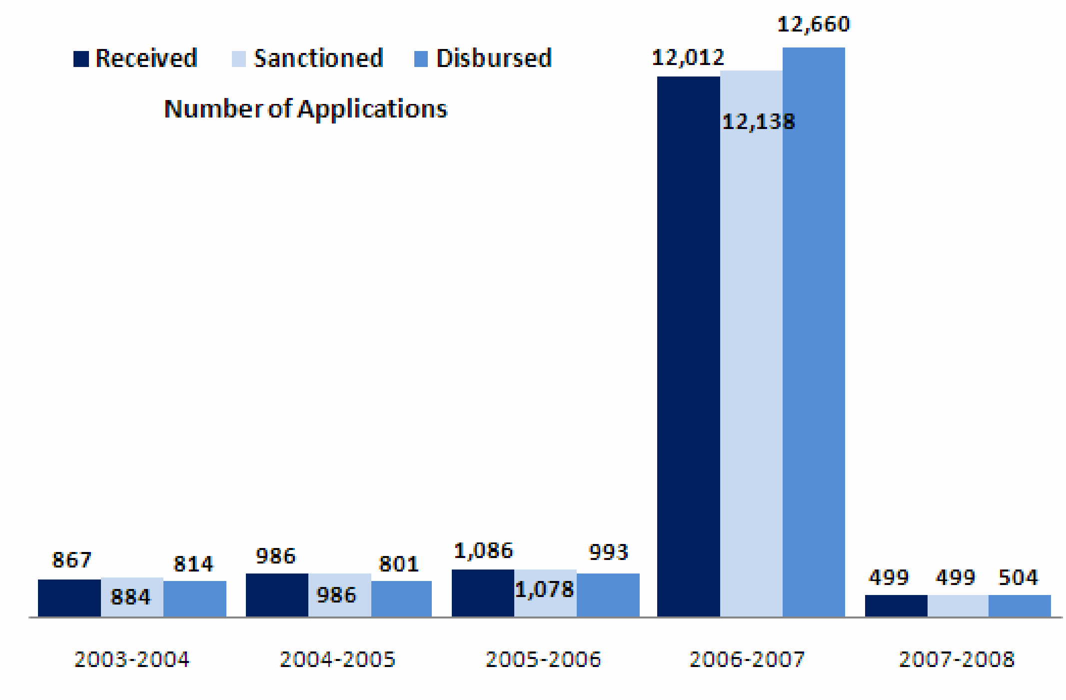
The two principal schemes of the Ministry of Textiles – the scheme for Integrated Textile Parks (SITP) and the Technology Upgradation Fund Scheme (TUFS) are being continued in the Eleventh Plan period.

Under the Scheme for Integrated Textile Parks (SITP), 30 integrated textile parks have been approved and 20 units in four parks have commenced production.

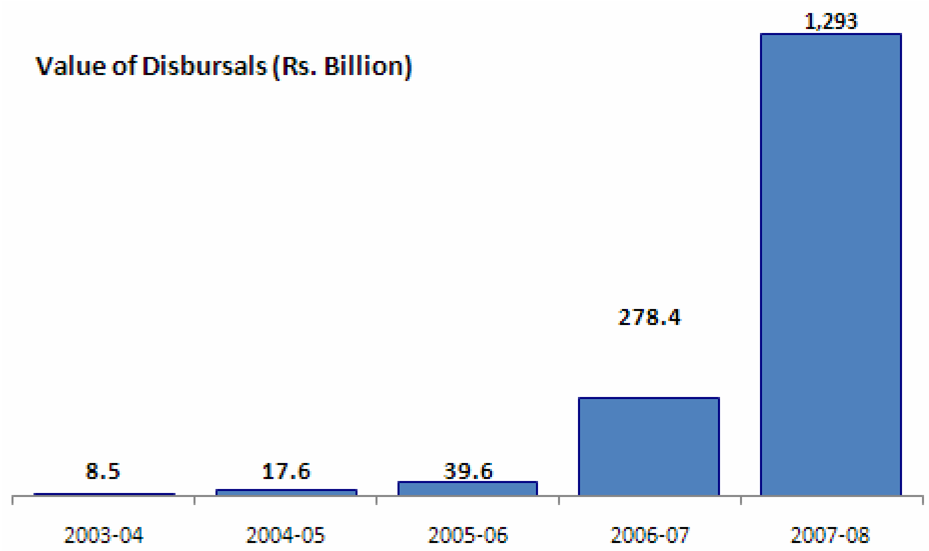
For the textile industry to sustain and improve its competitiveness, the Technology Upgradation Fund Scheme (TUFS) was launched by the Government that would reimburse 5 per cent on the interest that is actually charged by identified financial institutions on the sanctioned projects. TUFS focuses on additional capacity building, better adoption of technology and provides for a higher level of assistance to segments that have a larger potential for growth, like apparel manufacturing, technical textiles, and processing. The funds provided for TUFS have been increased in 2008-09 over the previous year. The scheme is expected to infuse capital investment into the textiles sector, and help it capitalize on the vibrant and expanding global and domestic markets, through technology upgradation, cost effectiveness, quality production, efficiency and global competitiveness.

However, the industry has been slow to take up these benefits. Until the period 2005-06, and again during the last year, the confidence among the industry to invest in textile and apparel manufacturing has been low as evidenced by the number of TUFS applications received by the Ministry. Funds have been invested in alternative areas, rather than being tied up into plant and machinery for which the government is providing an interest subsidy.

Progress of TUFS



Source: Ministry of Textiles, Third Eyesight Analysis



Source: Ministry of Textiles, Third Eyesight Analysis

The government has also converted "export processing zones" into special economic zones (SEZs), allowing companies operating within the zones to be exempted from customs and excise duties, central sales tax and income tax. Specific state governments are also providing exemption from taxes, cess, duties, and other fees, to promote investment in manufacturing capacity.

Several 'apparel parks' are being set up around the country, which aim to provide self-sufficient infrastructure and the entire supply chain, from yarn to finished products. However, the execution at various levels has been slower than desirable.

100 per cent FDI is allowed in the textile and apparel manufacturing sector under the automatic route. However, the level of inward investment in this sector has been very small, and there is a need to examine the causes for this trickle of FDI – according to the Department of Industry Policy & Promotion the share of FDI in the textile sector during 2007-08 was 0.76 per cent (Rs. 7.5 billion) of the total FDI inflows.

Until a broader picture of India as a good manufacturing destination for the textile and apparel industry is developed, foreign investment will remain negligible, even as other countries such as Vietnam, Cambodia and Bangladesh thrive on the back of foreign investors setting up large manufacturing bases in those countries.

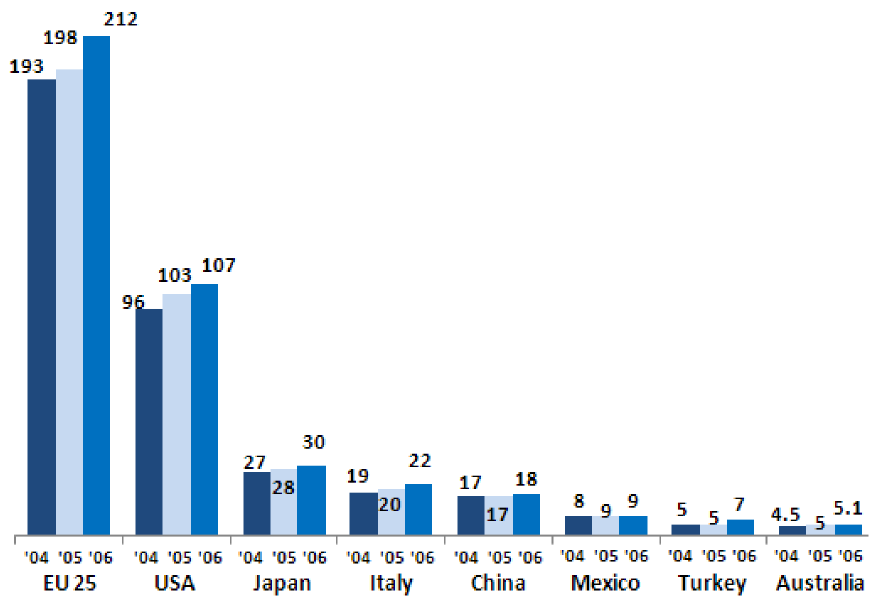
What can India offer as a manufacturing destination that these countries cannot, or what is its differential advantage? A well-thought out strategy is needed at the central and state government level to not just convey this image to global investors in textile and apparel manufacturing, but also to translate that image into speedy execution of proposals.

The Global Textile & Apparel Marketplace

Global trade statistics are notoriously difficult to work with due to mismatched time-series data, currency differences, missing links etc. However, on the issue of the leading markets and the leading suppliers, there is absolutely no doubt as to which those are.

Among marketplaces for global trade in apparel and textiles, the EU-25 together hold the top-slot, with over US$ 200 billion worth of imports, followed by the USA (which is the single largest importer country, with imports of over US$ 100 billion a year).

However, the EU-25 are also a large supply base, including to their intra-EU requirements – over 71 per cent of the European Union countries' imports are sourced from other countries within the Union.



Textile & Clothing Imports (US $ billion)

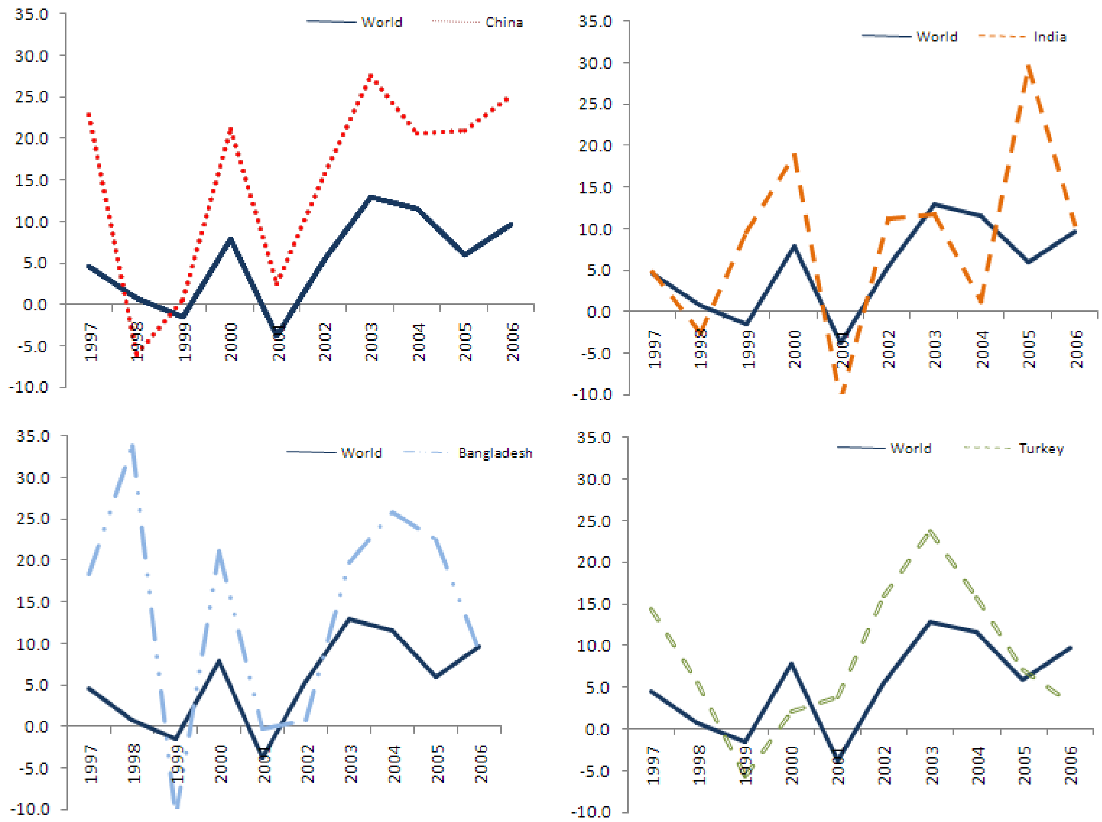
Source: WTO, Third Eyesight Analysis

On the supply side of the equation, China is head and shoulders above all other countries. In addition Chinese companies also have a contribution in the exports out of other countries in the region. India together with its neighbouring countries only still provides for about 6 per cent of the world's imports of textiles and clothing.

Textile & Clothing Exports, 2006 (US$ million)

Regions	Clothing Exports	Market Share	Textile Exports	Market Share	Total	Market Share
China, Hong Kong, Macau	125,389	40 per cent	62,835	28 per cent	188,224	35 per cent
EU-25 (incl. trade within the EU)	83,415	27 per cent	71,208	31 per cent	154,623	29 per cent
Other Far East	24,123	8 per cent	35,875	16 per cent	59,998	11 per cent
India and South Asia	17,145	5 per cent	16,953	7 per cent	34,098	6 per cent
Turkey and East Europe	20,616	7 per cent	10,222	4 per cent	30,838	6 per cent
NAFTA	12,998	4 per cent	17,226	8 per cent	30,224	6 per cent
Central and South America	10,319	3 per cent	1,225	1 per cent	11,544	2 per cent
Africa	7,632	2 per cent	694	0 per cent	8,326	2 per cent
Other Major Asian Exporters	1,875	1 per cent	1,268	1 per cent	3,143	1 per cent
Miscellaneous (various continents)	9,746	3 per cent	10,502	5 per cent	20,248	4 per cent
Total	**313,258**		**228,008**		**541,266**	

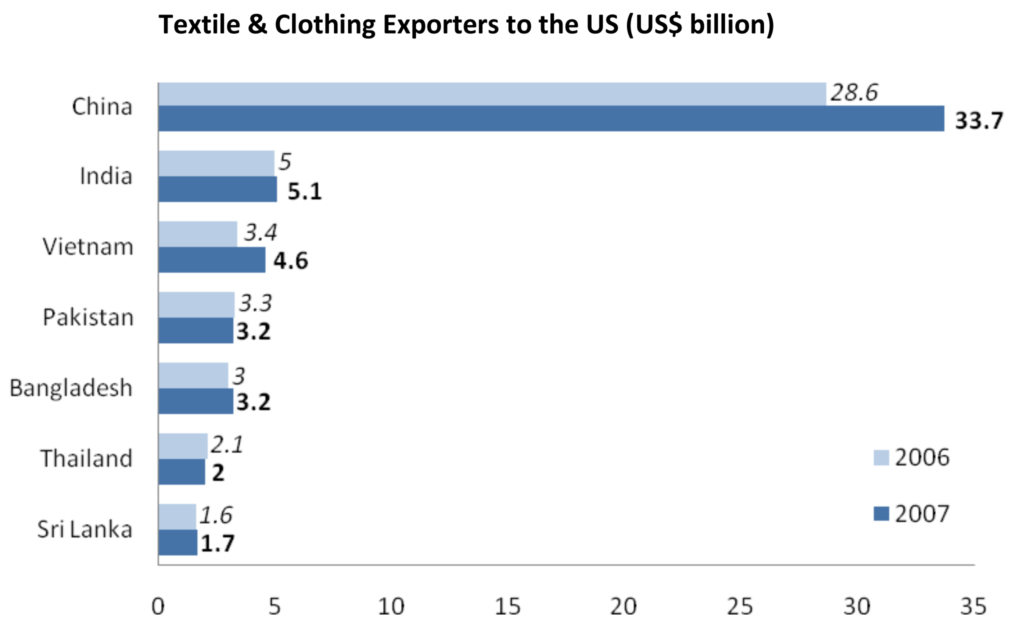
Source: WTO, Third Eyesight Analysis



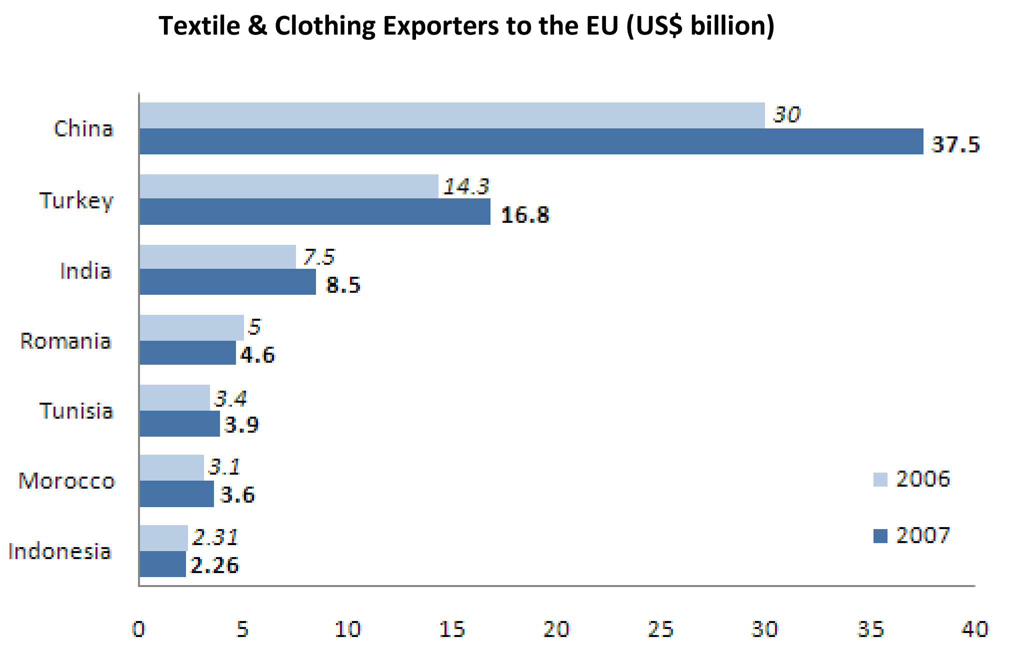
Annual Growth Rates for Textile & Clothing Export Exports

Source: WTO, Third Eyesight Analysis

While looking at the growth trends of the past few years, one thing becomes absolutely clear: past trends are no indication of any sort for the future growth of a country's textile and apparel exports. Firstly, past trade patterns were hugely influenced by quota availability as well as preferential access. While preferential access is still a factor, its importance is only partial, and quotas are no longer a major barrier for most countries. Secondly, extraneous factors, such as suitability of product to a certain fashion trend, are of less importance to countries with a wide product portfolio which is sustainable over the changes in the fashion cycle. Lastly, the highest growth correlation with global trends exists in countries that have invested in fundamental strengths for a long-term advantage (e.g. China, Turkey).



Source: OTEXA, Third Eyesight Analysis



Source: Various data sources, Third Eyesight Analysis

The possibility of breaking-away from past trends provides a situation of hope for the Indian industry.

Global retailers who account for the bulk of imports into their countries, earlier sourced from all over the world because of quota restrictions. Now they are reducing the number of supply countries, as well as the number of suppliers, with key considerations being product differentiation, costs and manufacturing lead times.

India has some of the ingredients in place to be a significant No. 2 in global trade in the short term, but that position is by no means certain. Much investment is still required to deepen the competitive foundations of the industry.

In some of these aspects India can learn from China, in others it must pick lessons from Turkey and Italy, and other countries.

Where Next? China, China, China

The Next China is…China!

There is been a lot of speculation in recent months that China is becoming uncompetitive in terms of manufacturing costs, labour availability, power and several other factors. It was premised that the Chinese government wishes to encourage the growth of high-technology industries rather than “low-value” manufacturing such as textiles and apparel. Tax rebates on textiles were reduced from 13 per cent to 11 per cent last year, hence increasing the exporting costs.

A large chunk of China's garment and apparel makers are located along the Southern Pearl River Delta or East coast of the country and benefit from close proximity to ports and good infrastructure. In an endeavour to reduce inequality among provinces the government is encouraging them to relocate in North and West of China. In the inland area, though the labour cost would drop by 30 per cent but would result in increased transportation time and cost. New labour regulations have already increased the wage component for Chinese manufacturers.

Increased environmental concerns and effort to comply by the various environmental regulations is also resulting in increased operational costs and requires trained labour for managing the sophisticated and environment friendly processes.

According to Globecot, by January 2008, the demand for electricity had outstripped supply by 70 gigawatts in China; and currently, the shortage is at the equivalent of the United Kingdom's total generating capacity. In 2004, the power shortage was estimated to be 40 gigawatts. Unlike 2004, this time the problem is not power capacity but the increasing prices of coal and lack of coordinated market.

In China, many of the power plants are privately owned; because of the rising fuel prices, the cost of electricity production is going up whereas the electricity price is not increased as they are decided by government. The government’s reluctance to increase the price has caused the power plants to shut down and many are running in losses. According to China Daily, this year 19 power generation units with a total capacity of 3,790 mw that stopped operation.

Observers have, thus, rushed to announce the demise of China as a textile and apparel supply base. With costs significantly rising in China, and the risks of a concentrated sourcing basket, which other countries could companies look to? In the first four months of 2008, Vietnam has taken into the China'a market share to become the second larget apparel exporter to the US. Exports from China dropped by 6.8 per cent. The fall in China's share has coincided with deterioration in the competitiveness of Chinese manufacturers as Chinese exports have become more expensive.

However, this window of time is too short to conclude that Chinese exports are in any major trouble, or that Vietnam is the next China.

According to Dr. William Fung (Li & Fung), "within the next 3 years, the follow-up country to China is…China".

After all, which other country's industry has poured billions of dollars in up-to-date manufacturing capacity and supply chain infrastructure?

The Chinese industry and government are not standing still, in the face of the current challenges. To counter the current cost increases, China has increased tax rebates in August on several categories of Apparel and Textile to help Chinese manufacturers. Government is further studying credit policy, fiscal policy and support available for small and medium enterprises.

Another major problem as recognized by China's 11th five year National Development Plan for Textile and Apparel Industry is lack of self innovation and designing capabilities to develop self owned brands and marketing networks. The country already has various institutes to design and innovation need of the industry, and there are several other new initiatives that are being undertaken by these bodies as well as new ones being set up, to provide product innovation inputs to the Chinese industry.

For buyers in the developed markets, economic uncertain times such as these are a good context for shaking up current practices and processes. Certainly, other countries such as India and its neighbours, as well as Indonesia, Vietnam etc. can be developed significantly more than they have in the past.

We believe that what buyers did in China 15-20 years ago, is probably what is needed in South Asia and other supply bases now. At that time, China had neither the production capacity nor the supply chain and other infrastructure that it has now. But intrepid buyers opened the Chinese frontier and created the demand pipeline which pulled the supply base up.

Would retailers have a similar focus on the other supply bases today, to balance their exposure in China? The answer is, probably yes, but only if several other elements were put in place.

During China's "mega-growth" years, the cost differential was too high and no other low-cost country was as accessible as Hong Kong and Taiwanese entrepreneurs made China. Today, with China already being a major source, and several low-cost options being available simultaneously, cost differential is only a factor of competitive hygiene, and not the definitive edge.

During our work with major international retailers in the area of global sourcing strategy in the last few years this question has come up several times whenever there has been a hurdle or barrier to cross with China (quotas, SARS etc.). Among the countries that come up strongly in the analysis, India is certainly among the top of the list in terms of potential.

According to Li & Fung's Dr. William Fung, India shows higher product differentiation and development skills that make it a logical place for buyers to invest time and energy.

In a recent survey conducted by Booz Allen Hamilton and the American Chamber of Commerce in Shanghai, nearly one in five companies said they plan to move at least part of their China operations to other countries. Vietnam topped the list of alternative countries among 63 per cent of these corporations; India was first among 37 per cent. Almost 90 per cent of these companies said lower labour costs originally drew them to China, but now they're finding other countries offer cheaper labour and tax benefits.

So India has some advantages to its favour, including a perception and mind-share that is better today than it was possibly 10-15 years ago. But is that enough to get to US$ 55 billion in the next 4-5 years? Can India be the next China in the short term? Should it even attempt to be the next China?

The answer to all those questions is "No".

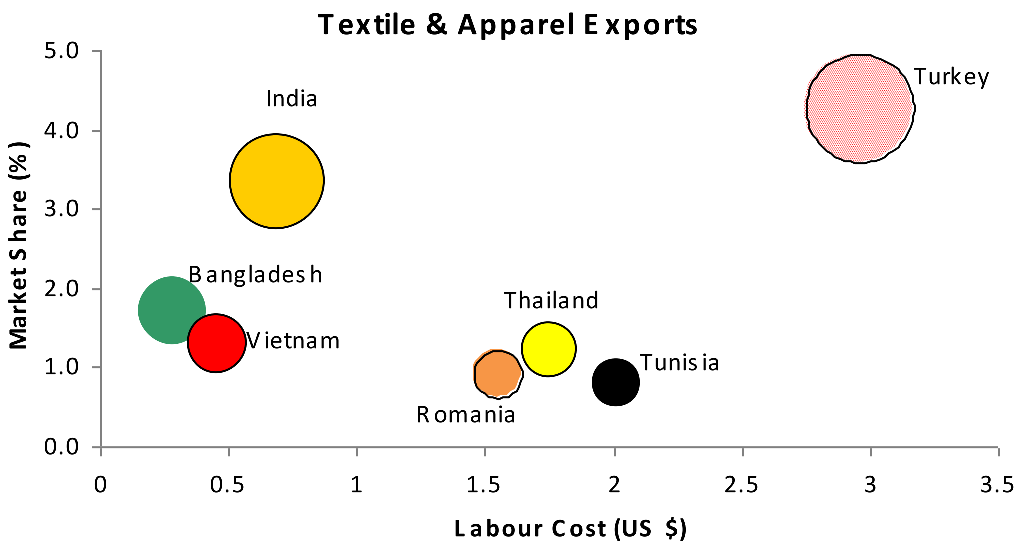
Costs ≠ Value, Low price ≠ Market Share

Costs & Prices are Not Moving in Step

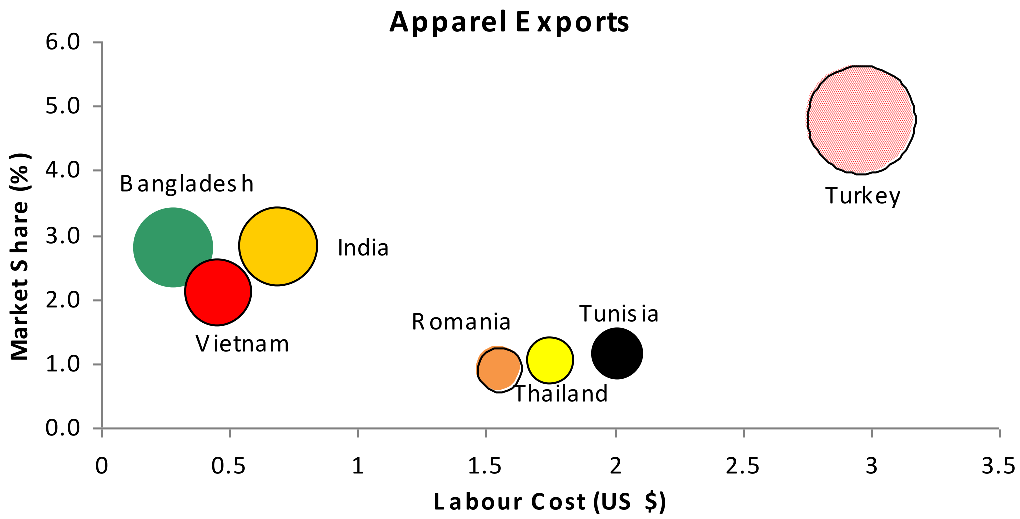
Once upon a time prices used to go up when costs went up. But that has not been the case over the last two decades. Even as costs have climbed, retail prices and FOBs have remained steady or even declined. Clearly, the question is whether this is a sustainable situation - though consumers and retailers have been winners so far, how long can factories and labour be squeezed without impacting the very survival of the business?

The interesting contrast is luxury goods, where production costs have come down due to outsourcing and manufacturing in low labour cost countries. (So even in that area, prices and costs don't show a correlation!)

The popular perception is that the cheapest source wins the business, low-cost suppliers are interchangeable, and buyers can easily flit from one to the other, as the comparative costs rise or fall. Nothing could be farther from the truth. While China is far ahead of the pack, there are several other countries that are much more expensive than India even on a landed-basis, but have significant market shares (see graphs).

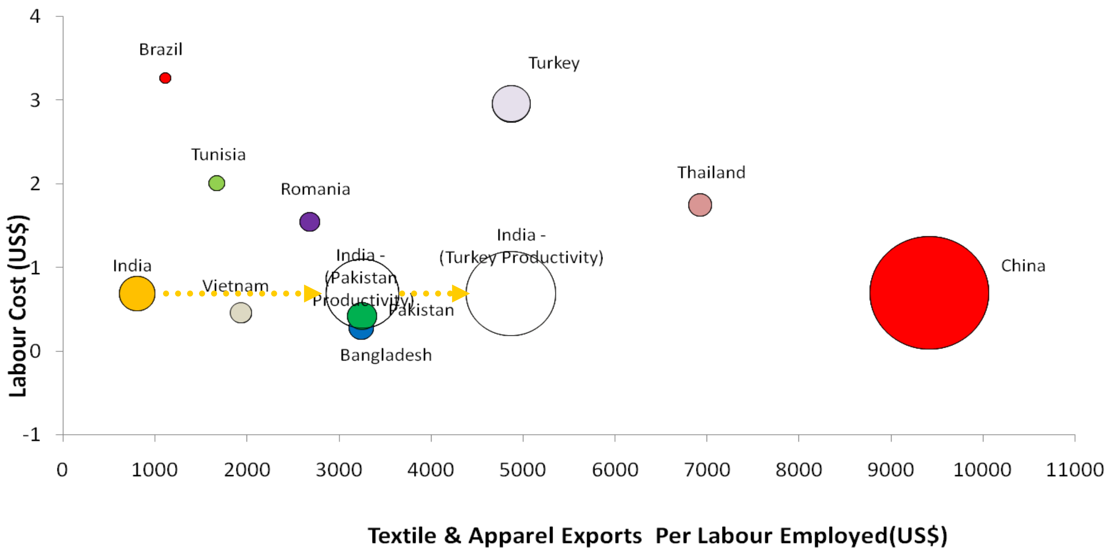


Source: Third Eyesight Analysis, various data sources



Source: Third Eyesight Analysis, various data sources

India's orientation towards exports of intermediate products, raw materials and other low-value items is also evident in these comparisons. In fact, if we compare the value of exports per head of employment in the sector, it strongly suggests that Indian industry must turn its focus from a "cost-plus" mentality, to a "value-delivered" method of working.



Source: Third Eyesight Analysis, various data sources, incl. WTO trade statistics and labour comparison by Werner International

(On a hypothetical note, if India's industry had captured an amount of value per employee similar to Pakistan or Turkey, its exports would be much closer to the size of China's exports. However, an interesting question to raise is: can that hypothesis be converted to reality?)

Fashion is change and speed…

Are we prepared?

Respond to the Pace of Fashion, or Set It

The textile industry in India has various different facets including cottage skill, industrial scale and aesthetic development capability. However, as organisations grow in scale and work with large customers based in remote markets, the processes become more industrialised and largely slower.

Though global benchmarks of 2-week turnaround and even 2-day turnaround exist, by and large the industry works over a lead time of months rather than weeks. In this India's industry is not unique – it is part of a pattern that is driven by the buyers, who need to compensate for distant low-cost buying by allowing more time for planning and execution.

However, the very nature of the fashion business is "change" and it is humanly impossible for even the best buyer to predict with 100 per cent accuracy as to what will sell 6-12 months in the future.

Especially in these uncertain market conditions, it is better for buyers to take product decisions closer to the sell-date, rather than try and forecast accurately over longer periods. The only way to reduce the risk is to respond to market needs, rather than to try and predict what the market will need in the future. Even if that means sourcing from a country with more expensive labour, additional margin from reduction in markdowns and also from responding to short opportunity windows can adequately compensate for the extra costs. Hence, "speed to market" is a term that has become more and more common in the textile and apparel sourcing community over the last decade. Speed to market is not just about producing quickly and shipping fast, it is about responding to change in the market.

One result of speed-to-market and quick response working has been the growth of "proximity sourcing" from relatively lower cost supply bases that are near the markets. For the USA this has meant NAFTA and Caribbean sourcing, while for Europe it has led to North Africa, Eastern Europe and Turkey. Since travel and shipment times are short, and the time zone differences are also small, these supply bases could respond to buyers' needs more quickly.

However, over the last few years the gap between cheaper Asian sources and these proximity suppliers has widened due to various reasons. Since the available labour force in these countries is limited, it is getting channelled into higher-value industries, reducing the availability for the textile and apparel industry. Therefore, after the removal of quotas, the renewed move to Asian sourcing was expected.

But, lately, companies' business models have fallen victims to their own success.

Too much has been outsourced too far. Where earlier, buyer and supplier were next to each other or close-by (as in the case of proximity sourcing), today there is a physical and cultural distances between them, that sometimes seems impossible to bridge. Where earlier, a buyer and designer could pop around the corner to the pattern room to check the fit, and discuss the quality with the factory; today they sit at opposite ends of the earth, and work in a phase difference of day and night. As manufacturing has moved away from the retailers' and brands' neighbourhood, the skills related to working with product development and manufacturing have also declined. The cost related to bringing these skills back into the developed markets is prohibitively high. However, recreating or transferring the skill that have been lost is an opportunity for countries such as India to hook into the product development process early.

It is critical to understand that the brand or retail buyer's list of needs starts with the need to design and develop a successful product for the forthcoming season – the starting point is a blank sheet. As the trends get researched, and the product development continues, the needs become more and more precise, and finally end up being a well-defined style-brief with a request-for-quote.

A supplier who responds to a buyer's complete product brief at this stage is competing on the basis of having production capacity available and having the lowest price (all other things being equal). Such suppliers can more easily be replaced.

On the other hand, the competitive advantage offered by being able to influence the development of a product is immense. And given that sourcing lead times are shorter in unpredictable times, a supply base that has been involved with the development is most likely to get the final order as well, as the buyer is unlikely to lose time in shopping around for marginally lower costs.

Design, merchandising and product development skills are under-valued

India's Domestic Market – An Underestimated Source of Strengths

India has a significant sized and vibrant domestic market for textiles and apparel products.

India has the youngest population in the world, with 54 per cent of population below 25 years of age, 80 per cent below 45 years, and a large population between the ages of 20-34 in the urban regions.

What is critical to note is that during the years that the population that is currently in the 20-34 years age group has grown up, the overall consumption environment in India has undergone vast changes. This is partly due to concrete changes in the market structure and availability of products, but is also greatly influenced by the changes in the electronic media.

Starting with the introduction of colour television (1982), to the explosion in the number of television channels in the 1990s, this population has been exposed to media and consumption habits that are much more in step with the rest of the world.

The power of the youth is evident not just in its large numbers, but also its inclination to consume and in its ability to influence larger household decisions.

Fashion constitutes a chunk of the organised retail market in India and, in many ways, has been at the forefront of the development of modern retail since the 1960s. Therefore, most appropriately, it is also fashion brands and retailers that have led the penetration of the smaller cities and towns.

Other than Indian brands and retailers, international retailers are also present in the country through their own presence (Adidas-Reebok, Nike, Levi Strauss), through franchisees (Marks & Spencer, Debenhams and Next) and also through strategic licensing agreements (Tommy Hilfiger).

Men's apparel is the largest segment in the apparel organised market. However, the children's and women's wear segments are also growing rapidly as many domestic and international retailers are entering the market. The clothing segment is positioned for further organised retail penetration due to the high level of branding effort by apparel retailers across formats such as department stores, hypermarkets, and exclusive branded outlets.

Changing lifestyle aspirations of Indians have also led to the sizeable increase in the home improvement segment in India. Home furnishings are mostly retailed through the unorganized sector and serviced mainly by exporter manufacturers and importers catering to the various segment of the industry. However, in recent years, retailers like Landmark Group, Future Group, the Raheja group and Fabindia have launched focussed home fashion chains. Branded suppliers such as Welspun, Bombay Dyeing and Creative have also developed a branded retail presence. Some of these players have brought international brands to the Indian market through a licensing arrangement while some of them are exploring joint ventures with international players.

There is a tremendous diversity of formats available today in the Indian retail market, each with its own unique product and service needs, and each reflecting some element of how retailers operate elsewhere in the world.

Table 3(d) Modern Retail Present in a Variety of Formats: 2008

Format	Some Domestic Retailers / Brands	Foreign Retailers / Brands
Department Stores	Shopper's Stop, Westside, Pantaloon Lifestyle, Globus, Ebony, Reliance Trends	Debenhams
Exclusive Brand Outlets, Speciality Stores	Zodiac, Raymond, Allen Solly, Fabindia, Spaces, Wills, Woodland, Bombay Dyeing, Planet Fashion (Madura Garments), Anokhi, ColorPlus, Killer, Blackberrys, Biba, Atmosphere, Grace	Tommy Hilfiger, Esprit, Lacoste, Levis, FCUK, Guess, Nike, Reebok, Benetton, Wrangler, Adidas, Aldo, Marks & Spencer, Next, Pepe
Discount Stores	Brand Factory	-

What each of these companies has found is that, for all the growth of the consumer market, India is still a very tough environment to operate within. The consumer's expectation of value in terms of product design, variety and service are very high, and the retail price available for that offering is very competitive.

This means that the product development pipeline, comprising of designers, merchandisers, buyers, raw material sourcing people, textile manufacturers and apparel manufacturers, have to really sharpen their skills of reading the market and developing new products that can differentiate their brands or retail stores.

This is a skill-set that is very valuable anywhere in the world. It is unfortunate that the Indian suppliers to the world, the exporters, are not really tapping into this skill-base.

At the same time, the process-driven working that the exporters have adopted with their international buyers, is a tremendous asset for domestic retailers, but is again under-utilised.

The maximum value in the global textile and apparel industry is retained by companies that are facing the consumer (brands and retailers). These are usually based in economies where the supply base and the market are truly integrated – from manufacturing to consumer-facing brands and retailers – these include countries such as the USA, the countries of Western Europe, Japan and a few others.

The next chunk of value is retained by strategic suppliers (companies and countries) that are perceived to be valuable and have a "trade brand", in a manner of speaking. (India's IT sector can be said to have achieved this status, and thus draws in premium rates over many other suppliers around the world.)

Currently India's textile and apparel supply base, by and large, falls into neither of these categories as far as global markets are concerned.

This is ironic, since until the 1960s India not only had "trade-credibility" but "consumer-credibility" as well.

The growth back into that position will be slow, but fortunately the foundation for this already exists in the widespread sensibility with respect to customer needs, design and product development.

4-D Framework

→ **D**efine

→ **D**esign

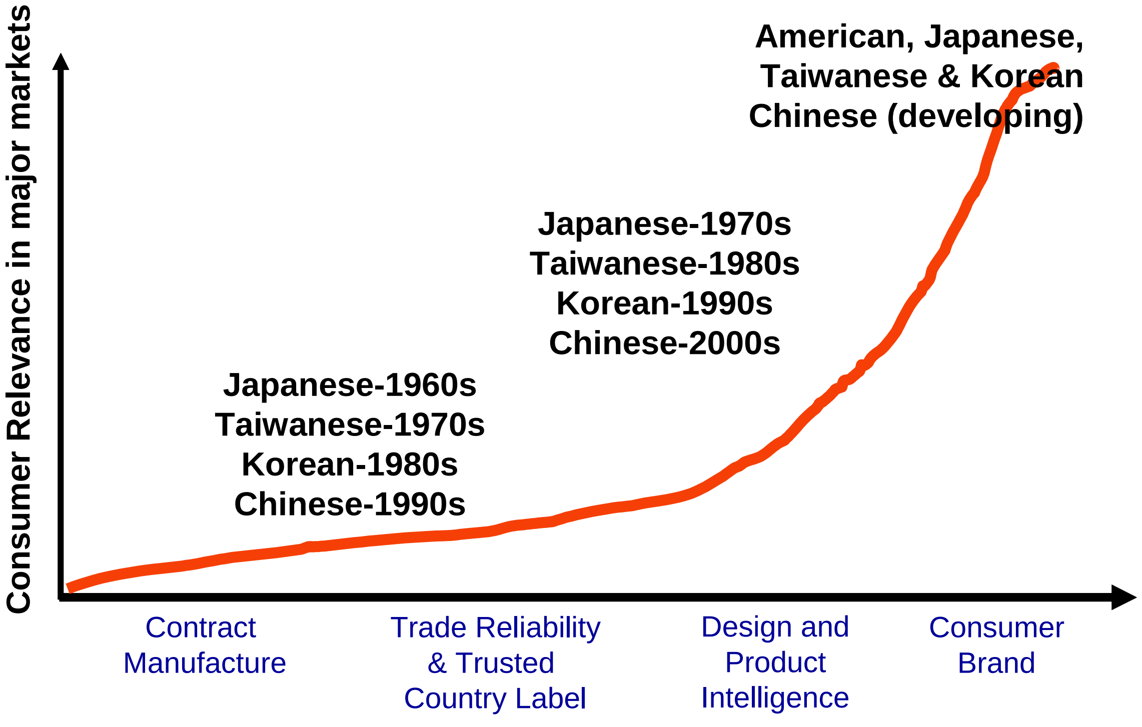
→ **D**evelop

→ **D**eliver

Positioning India – The Way forward

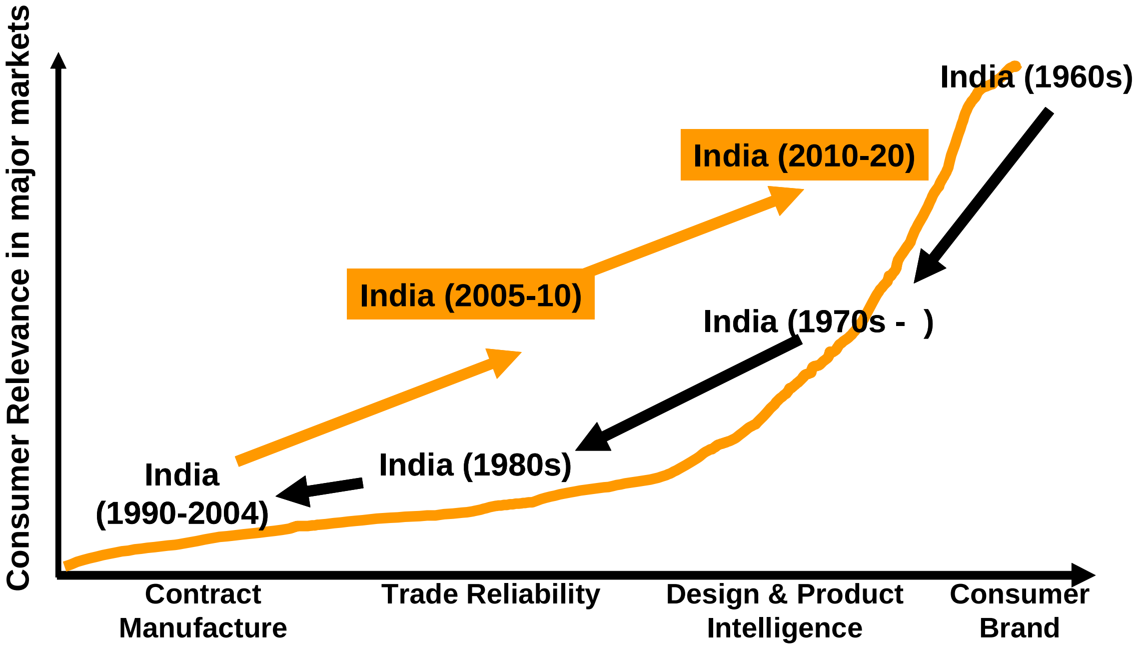
As discussed in the previous chapter, economic value increases as a company moves closer towards servicing consumers, with consumer brands and retailers holding the maximum value. India once had a consumer-cache.

The developed economies have evolved along this path over the last 3-4 decades, through the various stages of being pure contract manufacturers, to trusted supply partners, to active participants in design development, and then on to consumer brands.



Source: Devangshu Dutta, 2004

The irony, as mentioned earlier, is that India had a consumer-cache until the 1960s, and it steadily slipped thereafter due to a variety of reasons, including the emergence of other alternatives.



Source: Devangshu Dutta, 2004

The possibility exists today of taking the Indian industry up the slope again, because the basic ingredients already exist:

- A large and diverse base of products (including fibre, intermediate products and finished products)
- A diverse base of techniques
- A pool of talent with strong design, product development and merchandising sensibility
- A vibrant and growing domestic market

Even if many companies choose to stay B-2-B suppliers rather than launching their own consumer-oriented brands, they can only sustain their business if they are seen as valuable suppliers – in that sense, there needs to be significant investment in developing the "trade-oriented brand".

Why is this so important for India?

Because the logistical constraints that confine India's merchandise trade will not disappear quickly, and the only way to dramatically increase the value captured would be to produce market relevant finished products that cannot be quickly or cheaply re-sourced by a buyer from elsewhere. If this is not focussed upon, the vision of US$ 55 billion by 2012 or thereabouts will remain a dream.

However, to make effective use of this foundation will require significant investment in the soft-infrastructure, the knowledge and skill base, in addition to the physical logistical infrastructure and manufacturing capacity. An entire eco-system needs to be nurtured and grown that not only develops skills of product development within the country, but also attracts designers and product development people from the major markets to come in and create products from the ground-up.

In the recent past, Indian businesses (especially in the apparel sector) have largely been averse to investing in anything that cannot be reflected in the assets column, or which may have a tendency to disappear (such as trained employees who join another company or start up their own business).

Some of these companies invest in modern plants; the factories are grown out of a plan driven by technical details to provide a range of generic products, rather than being market-driven. Thus, "product development" is dismissed as a single head of expense in business plans. Market research and consulting may not even appear on the expense or investment sheets. And spare capacities to enable quick response and selective fast-tracking of orders – a must in the developing competitive environment – are seldom considered.

We believe that some of the insecurity is getting swept aside by the greater insecurity – the threat of going out of business. A few companies are taking an alternative approach – hiring expatriate managers on 1-3 year contracts, giving themselves enough time to absorb better practices and systems. But these are few and far between.

We believe the industry-wide development, of projecting India as a valuable supplier, and sustaining its value needs an integrated approach and a different mind-set. We propose a 4-dimensional framework:

- Define
- Design
- Develop
- Deliver

Define

What does the market need? What new products, new materials, and new trends could the market look at? Anyone who has a hand in defining the product trends or is early in identifying the forthcoming strong trends clearly has an upper hand. This needs significant investment in collecting market knowledge, and in developing the capability to make sense out of it. This is not a stand-along "research" role, nor is it only confined to textiles and apparel. The approach will need to be applied in a cross-disciplinary manner, drawing linkages with other creative sectors also.

Countries such as Australia and the UK, which actively encourage their companies to look at overseas markets, extend government support to research into those markets, if the returns to the economy can be clearly demonstrated. Even if the Indian government does not extend research subsidies, any active support to creating infrastructure that provides a stream of information to the Indian industry will surely go a long way.

Design

Design needs to be understood in the broader context, rather than the narrow definition of "aesthetics". Textiles and apparel are functional as well as aesthetic products. True design, therefore, needs the inclusion of fundamental materials research, knowledge of usage (including draping, body measurements, pattern making), dovetailing that into the market trends and the aesthetic sensibility. The objective is not about "being in style" or "being in fashion", but of being chosen by the customer because the experience of buying and wearing the garment has been thought through completely to reflect in the final product, its price and presentation.

If we move away from the narrow definition of design as the industry broadly understands it today, then we will realise that most of the industry's employees are involved in some aspect of design. Therefore, there needs to be a move towards democratisation of design skills.

At the same time, there need to be centres of design excellence, possibly in the form of the existing design institutes that need to upgrade the quality of providing a broad-based and comprehensive design education.

This will also require the active involvement of designers, technologists and product developers from around the world, especially the major markets. India current industry eco-system already attracts many of these – in fact, one can argue that India still remains in the business because of this well-established product development system and capability. But it is now time to consolidate and enable it further, consciously, rather than just accepting it as a matter of fact.

Develop

Once the product need has been defined and the product has been designed, there is no reason why it cannot or should not be produced within India.

India already has a varied manufacturing capability, but it is clearly unbalanced and weighted in favour of raw material and intermediate products such as yarns and grey fabrics.

There needs to be significant investment in fabric processing and finished product manufacture, to capture the immense opportunity lost when these raw materials are shipped out to other countries to be made up into finished products.

Deliver

The final link in this chain is getting the product to the final consumer. This needs work at three levels.

One is just sheer logistics capacity that has been referred to earlier in the report. There is capacity growth in the pipeline, but much more can and needs to be done to effectively meet the needs over the next three decades or more. Second is the framework of processes and regulations that slow Indian ports down (compared to 10-12 hours in other Asian ports), Indian ports can take over 3 days to turn a ship around. Clearly, speeding up processes will also temporarily enhance the port capacity, even with the existing infrastructure. Lastly, we would like to mention that delivery of the product actually starts with the design process. If the design process is visible to all the participants in the chain, and information flows are clear, a number of decision-making and process delays can be reduced dramatically. This requires a shift from thinking in silos (for instance, a yarn supplier, a fabric supplier and garment supplier, all believing that they are selling a “finished” product) to a collaborative method of working.

All of these are seemingly simple, disparate steps.

However, put together and carried out consistently over a period of time, they can move the Indian industry into a different orbit.

Let's imagine an old valve radio – the tuning knob had two parts – a large outer piece to select the major frequency, and a smaller inner part for fine-tuning closer to the frequency. Many of the industry's moves are short-term oriented and many government policies are helping to fine-tune the frequency set by the industry.

We would ask the industry to "Change the Frequency", and select the path of higher value growth.

Time to change the frequency