



Trade war – An opportunity for India to make it big in fashion

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In 2018, US apparel imports were USD 86 bn (FOB value), growing at a staggering 9.8% CAGR since 2010. The US apparel market is the largest single apparel market in the world, rivaled only by the combined EU market. A breakdown of US apparel imports shows that top 8 countries have a combined market share of 74.2%, headed by China. Vietnam and Bangladesh have already been drawing the attention of many apparel brands looking for alternatives to China, as have other more non-traditional Ready-To-Wear apparel countries such as India.

The growing trade war between the world's two largest economies, the US and China, is creating ripples across all sectors, including

apparel and textile. Since early 2018, the US has imposed multiple tranches of trade tariffs on lists of goods imported from China with the most recent tranche spreading to cover textile and apparel goods.

According to a recent study using GTAP data (Global Trade Analysis project, Purdue university), between USD 3.0-8.8 bn worth of apparel exports has the potential to be sourced from 3 key countries – Bangladesh, Vietnam and India.

This view on country locations is supported by apparel executives indicating that Bangladesh, Vietnam and India will be the top 3 sourcing destinations for the coming 5 years.

Sourcing Country	Apparel exports to the US (US bn), 2018	Share in US import market
China	28.828	33.2%
Vietnam	12.600	14.5%
Bangladesh	5.429	6.3%
Indonesia	4.676	5.4%
India	4.025	4.6%
Mexico	3.520	4.1%
Honduras	2.730	3.1%
Cambodia	2.524	2.9%
Rest of World (ROW)	22.395	25.8%

Source: UScom trade

Stage	Punitive Tariff rate	Effective	Current state	Products covered (US bn)	Impact on textile and apparel
Tranche 1	25%	Jul-18	Active	34	No textile and apparel products covered
Tranche 2	25%	Aug-18	Active	16	No textile and apparel products covered
Tranche 3	10%	Sep-18	Active	200	Around US 3.7 bn textile products covered
Tranche 4	Up to 25%	-	Proposed	300	Around US 36.0 bn textile, apparel and home textile products covered

Source: <https://www.just-style.com/analysis/us-china-tariff-war-the-textile-and-apparel-hit-list>

Exhibit 1: Top 3 sourcing destinations among CPOs

“What will be the top 3 country hot spots over the next 5 years”?

Percent of respondents who ranked the respective countries within top 3, n=29



Source: McKinsey & Co.

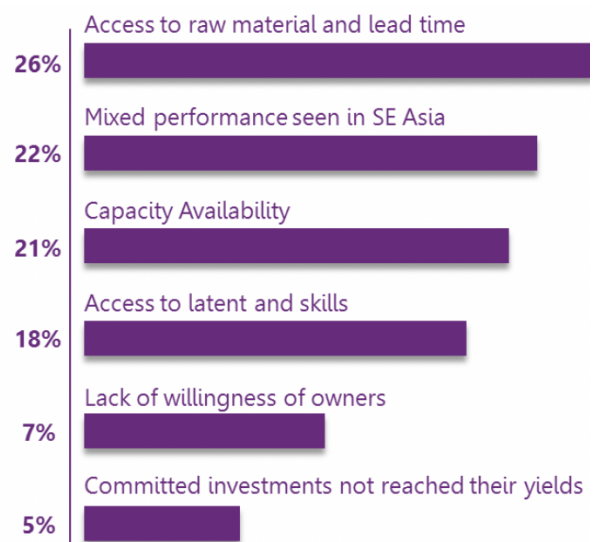
Moving out of China requires a plan

The apparel sourcing paradigm is known for ever-shifting to low wage countries; making products until a cheaper option becomes available, then moving sourcing to this new location. In the 1990's Sri Lanka, Taiwan and Korea were hot spots, with the 2000's moving further to China, Bangladesh and starting in South East

Asia. The 2010's have seen a growth across the Asian subcontinent, South East Asia and the start of manufacturing in Africa. For the current shift, it is important to understand what apparel manufacturers are looking for before moving production out of China.

A recent survey conducted by Weave amongst leading apparel brands and sourcing offices based in Hong Kong indicates that access to raw materials and lead times are the biggest concerns for moving volume out of China.

Exhibit 2: Key challenges faced by apparel manufacturers while moving production out of China







Source: Weave Analysis



Looking towards opportunity in India

Analysis of the apparel value chain indicates that India has abundant availability of raw materials, robust textile processing capacity (yarn to fabric) and comparable labor costs.

Exhibit 3: Comparison of apparel value chain

Value chain Category		Units				
Raw Material Availability	Cotton	'000 (170kg) bales	125	4	29500	27000
	Man-Made Fiber (MMF)	'000 tons	206	470	5213	39337
Yarn	Ring Spindles	Millions	6	6	50	120
	Rotors	'000	230	103	814	2400
Weaving	Shuttle Less Looms	'000	17	3	135	620
	Shuttle Looms	'000	14	17	2370	650
Apparel units	Labor cost	USD/Month	90	182	120	730
	Efficiency	%	39	40	48	57

India has a significant edge over other sourcing countries, especially Bangladesh and Vietnam, in terms of raw material availability. India is the largest producer of cotton and second largest producer of Man Made Fibers. Indian apparel producers source raw material domestically, leading to significant opportunities to reduce lead time, which is a competitive advantage for China. Outside of China, India has the largest yarn spinning and textile weaving capacity among apparel exporting nations.

India loses ground on labor cost competitiveness to low cost countries, despite a high labor efficiency, due to the way in which low price FOB is the key factor in winning large volume, low value-add export orders. With the escalation of US-China trade war, nations importing raw materials (yarn, filament and fabric) from China have high risk of exposure to future rounds of US taxes as the 'yarn forward rule of origin' would be applicable under current tax definitions. If this occurs, Vietnam and Bangladesh manufacturers have potential to experience increases in raw material costs, which could offset their advantage in supplying low cost labor. In addition, after withdrawal of US from TPP

in 2017, countries like Vietnam have lost their advantage of having 0% import tax to the US market. This can further reduce their attractiveness as all sourcing countries are at level playing field in terms of import duties.

India requires internal reflection if it wants to grow

In spite of the fact that India has advantages in cotton and labor supplies, its share of the global clothing export market was a meagre 4% in 2016, compared with China's 36.4%, Bangladesh's 6.4% and Vietnam's 5.5%. India's inability to attract more apparel export orders can be attributed to 3 key reasons - poor infrastructure, high lending rates and archaic tax laws.

1 - Poor infrastructure

Apparel producing units in India face acute power issues (in terms of availability and price) and high logistics costs (both inland and sea). Use of secondary power sources such as diesel generators, makes the business unviable and unsustainable on the local environment.

As a result, most apparel makers adopt outsourcing and overtime to ensure on-time delivery. This practice has been seen to lead

Indicators	Bangladesh	Vietnam	India	China
Power cost (USD/KWH)	0.09-0.12	0.08-0.01	0.1-0.12	0.15-0.16
Logistics (USD/Container)	1,281	610	1,332	823
Lending Rate	12-14%	6-7%	11-12%	5-6%

Source: Wazir Advisors

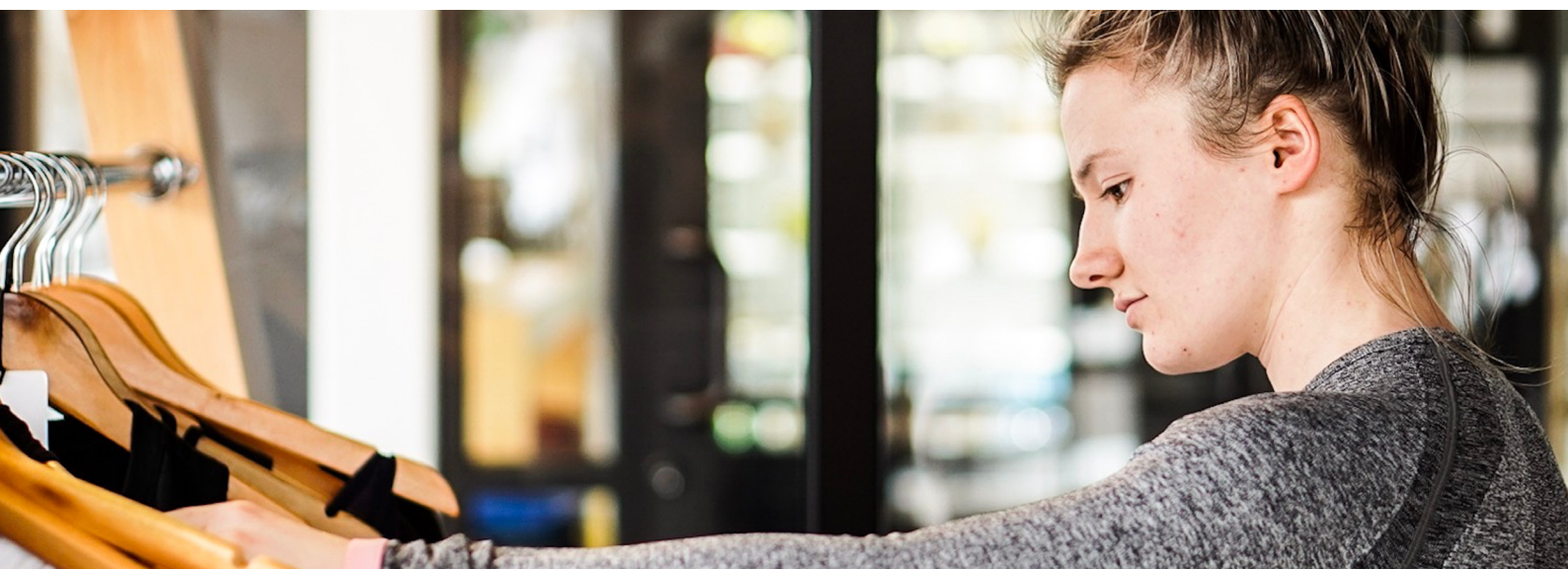
to quality issues and impacts the ability for facilities to scale up.

2 - High lending rates

Lack of cheaper institutional credit has restricted Indian factories to grow and expand. As a result, many Indian factories remain small to mid-sized, resulting in a highly fragmented sector. To compensate for high credit, Indian government supports small and medium size producers by offering a slew of benefits ranging from tax rebates, to partial exemptions of labor laws on layoffs, overtime etc. This has kept production concentrated at small factories that lack the economies of scale and the ability of fulfill large orders which is sought after by large brands.

3 - Tax laws

Natural fibers such as cotton and wool constitute only 30% of global fabric consumption. The key battle in apparel is played now in Man-Made Fibers (MMF). India's share of global MMF production is only 7% while China is the dominant player with 66% share. MMF imports to India are taxed at 15%-25%, increasing the input costs and limiting Indian manufacturers from producing a wide range of synthetic garments. In addition, domestic MMF suppliers (who are predominately large chemical companies) sell MMF's at high prices due to limited competition and lack of regulation.



India can address these challenges

To overcome the challenges which is hindering apparel exports, India is required to take concrete steps in the areas of policy design, fund availability and labor reforms. The current Indian government has taken a pro-growth stance, and has initiated several reforms to support the sector –

- Promoting FDI – 100% FDI is now allowed under the 'automatic route' in the textile sector; During FY10-15, FDI to Indian textile and apparel sector grew at CAGR of 14.21%. In recent years, large apparel manufacturing units have received significant shares of FDI, driving overall increases in capacity of the apparel manufacturing sector

- Fiber neutrality - The Indian government has assigned 18% GST (Goods and Service Tax) on imports of Man-Made Fibers (MMF), a simplified tax rate compared to multi-tax scenarios on various MMF categories. India is also exploring a fiber neutral tax regime to improve the competitiveness of Indian apparel units in synthetic garment category

- Make in India – India is encouraging investment under the 'Make in India' initiative. Under this initiative various elements of fiscal, tax, and investment support is provided to businesses starting manufacturing in India across the textile value chain. As part of this initiative, India has launched a US 24 bn fund - TUFs (Technology Upgradation Fund Scheme) to



- Capacity building – To address capacity and technology drawbacks, the Indian government has launched the 'Scheme for Integrated Textile Parks' to attract large players for private investment. As of 2019, 74 textile parks have been approved with 18 currently operational and 32 under implementation. In addition, Government has recently allocated US 900 mn towards labor reforms. Under this proposal, the government will bear the entire 12% employer's contribution towards EPF. Therefore, small scale apparel units will now have more incentive to hire more workers.

assist textile and apparel players towards modernization

- Sustainability – The Indian labor department ministry of textile has been actively working towards improving the lives of workers in factories. The Draft Labor Code on Social Security and Welfare has been proposed by the Ministry of Labor and Employment to simplify, rationalize and consolidate the 15 existing social security legislations into a single 'Code', which will be easier in terms of understanding, implementation and enforcement.

These changes are required to ensure that India has fundamentals in place to secure the drive. The success of these initiatives driven by the government will start to be reflected in the 2019 financial year exports for India after a period of stagnation and sourcing shifts.

The road to growth

India has advantages in terms of raw material and competitive labor costs compared to other potential sourcing countries. India has not been able to showcase its inherent strength due to infrastructure issues and policy paralysis, resulting in muted export growth over the past 10 years. With China embroiled in a trade war with the US, many sourcing nations have an increased risk of tariff on their final product as they import most of their raw material from China. In such a situation, buyers are now exploring sourcing countries which have easy access to raw material and have a competitive labor cost. India fits this requirement, provided it can address the existing bottlenecks.

Recent policies and tax benefits offered by India are steps in the right direction. India has a unique chance to be a leading player in the future of the apparel industry, but it requires successful implementation and execution of the new policies at all levels, to reach the smaller regions of their apparel ecosystem. With the right support, Indian apparel manufacturers can break the status quo and pursue high ambitions.



Weave Services Limited is a supply chain consulting firm that specializes in demand and production planning based in Hong Kong working with global manufacturers, retailers, brands and sourcing organizations. Our advisory services drive lasting transformation through process re-engineering and change management, guide retailers into the new frontier of big data through our replenishment and analytics outsourcing services, while our certified APICS trainers build supply chain capabilities with your teams.

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