Structural stitch

India’s textiles exports: Can the current measures make a difference?

July 2021

Summary

India's share in global exports of cotton yarn shrunk 600 basis points to 23% in CY2020 from 29% in CY2015, while in readymade garments (RMG), its share has stagnated at 3-4% over the past decade. Lack of free trade agreements (FTAs) and significant improvement in peer competitiveness have caused this.

Textiles is important to India's $313 billion merchandise exports as it accounts for ~11% of the pie. The sector is also a significant employment generator.

Given its economic importance, the sector has seen a slew of measures from the government of late, including the textile parks announced in Union Budget 2021-22 and inclusion of the sector for allocations under the Production-linked Incentive (PLI) scheme. While these are steps in the right direction, CRISIL Research's analysis indicates more is needed to address the issues and spur a revival.

In cotton yarn, India has lost market share over the past decade to Vietnam and China because of high cost and lack of FTAs amid intensifying competition.

In RMG, India has done well to maintain its share even as global trade in the segment contracted. But competitors such as Vietnam and Bangladesh have done much better – they capitalised on China's falling share in the past five fiscals, while India could not.

Further, Indian textiles players were pushed to the brink in 2020 as the Government of India reduced export incentives in line with guidelines of the World Trade Organization.

CRISIL Research does not expect any significant improvement in incentives with the launch of the Remission of Duties and Taxes on Export Products (RoDTEP) scheme, which aims to reduce tax burden of exporting entities. However, to revive the textile value chain, the government has announced additional structural reforms whose impact needs to be evaluated.

The recently announced PLI scheme for man-made fibres (MMF) and technical textiles is expected to improve the potential of MMF-based RMG exports where India's share has been weak. Along with the integrated textile parks scheme, the PLI scheme may help the sector enhance its export share over the medium to long term, if implemented well. However, continuous support in terms of trade negotiations, more investments to improve infrastructure at larger scale may be needed.

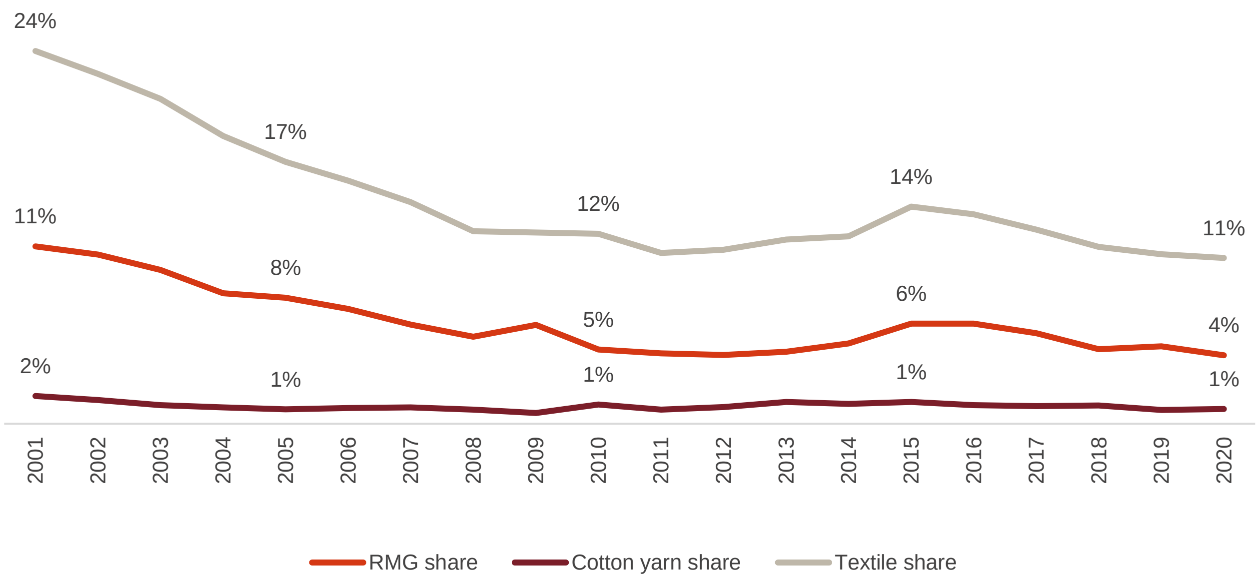
India is in a favourable position with China facing political backlash globally, but capitalising on this opportunity would need continuous and concerted effort.

Textile exports important for India, but dwindling

The share of the textile sector in total Indian merchandise exports declined from ~24% in CY2001 to ~11% in CY2020. Cotton yarn contribution in Indian export basket declined during the same period from ~2% to ~1% and RMG export share declined from ~11% to ~4%.

Exports are estimated to have accounted for ~28% in cotton yarn and ~25% in RMG sector last fiscal. With 45 million direct employees and 60 million employees in allied industries, textile is the second largest employment-generating sector in India.

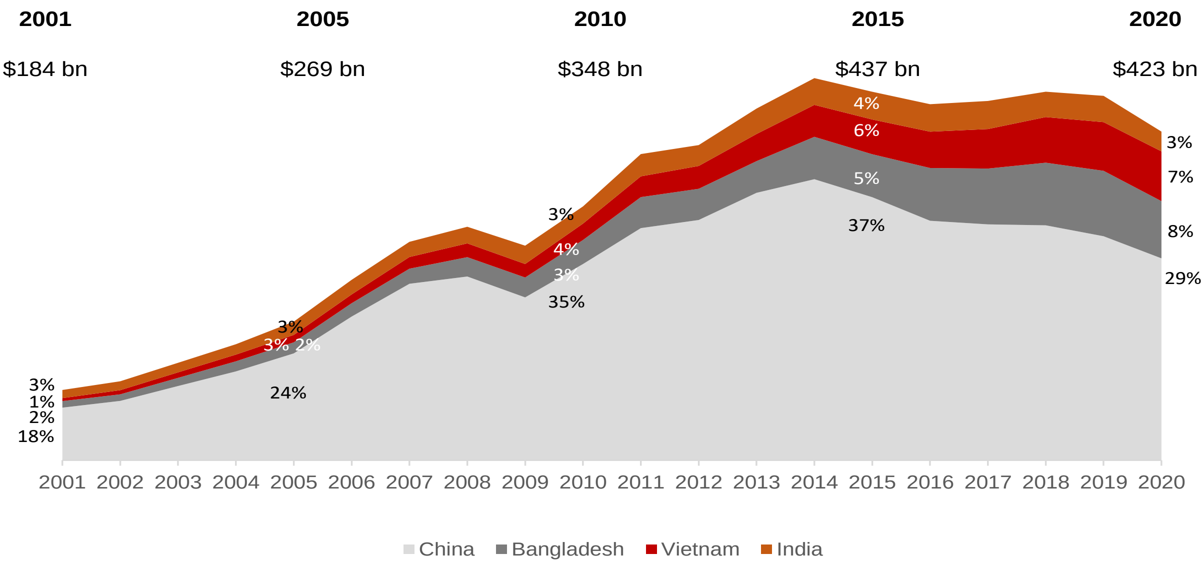
Share of RMG and cotton yarn in India's export basket declined significantly in the last two decades



Source: ITC Trade Map, CRISIL Research

Note: Trade data for calendar years; textile includes fibre, yarn, fabric, apparels and home textile products based on silk, cotton, man-made filaments and wool, among others

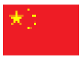
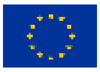
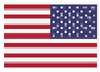
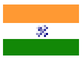
Vietnam, Bangladesh corner Chinese RMG spoils



Source: ITC Trade Map, CRISIL Research
Note: Trade data for calendar years

Despite the EU and the US being the largest RMG export destinations for India with ~32% and ~27% share in fiscal 2020, respectively, India was unable to increase its presence there. While Bangladesh was able to improve its share in EU exports due to low cost of labour after abolition of quota system for developing nations, Vietnam increased its share in US exports as it acquired most favoured nation (MFN) status in 2001.

Vietnam and Bangladesh have increased their shares in the EU and US RMG imports

	Share in import basket				Exporter	Share in import basket				
	2005	2010	2015	2020		2005	2010	2015	2020	
	21%	31%	25%	13%		24%	40%	36%	27%	
EU 	1%	2%	3%	3%		4%	8%	12%	19%	US 
	4%	7%	11%	6%		3%	5%	6%	7%	
	4%	5%	4%	2%		4%	4%	4%	4%	

Source: ITC Trade Map, CRISIL Research

Recently, however, the US imposed a ban on cotton and cotton-based products originating from Xinjiang region in China, which contributes more than 80% in Chinas' cotton production. Since it is the largest cotton-producing area globally, with ~20% contribution, the ban will affect the entire textile value chain.

Consequently, several RMG brands started looking for alternatives globally and this led to a spike in Indian-originated RMG exports in or since March 2021. This trend is expected to underpin India's exports trajectory providing it a much-needed opportunity to re-establish relations with global brands.

Over January-May 2021, cotton yarn/ fabric and made-ups exports from India have grown at ~69% and RMG exports have grown by 39%. Even raw cotton exports have gone up by 55% on-year basis during October 2020 – May 2021 to 5.8 million bales of 170 kg as US and Brazil struggle with lower cotton production.

Vietnam and Bangladesh enjoy lower duties, India needs to seep in

Trade agreements and low import duties in key export destinations

Exporters	EU	US	Canada	China
India	10%	16%	18%	5%
Bangladesh	0%	16%	0%	0%
Vietnam	0%	16%	0%	0%

Source: ITC Trade Map, CRISIL Research

With changing global dynamics, India, too, can take advantage of the global need to reduce dependency on China and increase presence in global trade like Vietnam and Bangladesh, which are delivering right products at competitive prices. However, for this, India will have to revamp its product portfolio, restructure incentive schemes and reduce cost.

Trade agreements with leading destinations provide easy access. Both Vietnam and Bangladesh succeeded in signing preferential trade agreements, which helped them with competitive pricing.

India is in negotiations with the UK – which accounts for ~10% of India's RMG exports – for a new FTA. If the agreement is inked, Indian exporters (who pay 8-12% import duty at present), may gain a preferential and competitive status where India is offering higher-priced products compared with Bangladesh and Vietnam, which signed FTAs with the UK recently.

Rival countries also offer better incentives to their players compared with India; lower RoDTEP may make India vulnerable

Both Vietnam and Bangladesh are offering better incentives to RMG manufacturers in the form of cash incentives, zero import duties on raw material/ material, tax relief, or incentives on investment.

Indian manufacturers are also being incentivised under several schemes, such as MEIS (4%), duty drawback (2%) and interest subvention scheme for SME (2%), to make them competitive in global market. However, the allocation towards incentives has been declining post fiscal 2020 with the withdrawal of MEIS, which can affect exporters' price competitiveness negatively.

In India, the MEIS scheme is being replaced with RoDTEP this fiscal. However, the declining export incentive allocation for the fiscal will further affect exporters. With better incentives and investment opportunities in competitor countries, the gap between Indian exporters and their counterparts is set to increase.

Declining incentives to hurt Indian exporters

	FY20	FY21	FY22
Export incentive scheme	MEIS/RoSCTL	MEIS	RoDTEP*
Total allocation (Rs crore)	~39,000	~15,500	~17,000
For textiles (Rs crore)	6,700	2,100^	2,920^
Change over FY20		~(69)%	~(56)%
Export incentives	6%	<4%	<3%

Source: CRISIL Research

Amid shrinking export incentives, PLI scheme could boost India's presence in MMF-based RMG

India lags in MMF-based RMG global trade. Though MMF-based RMG constitutes 65-70% of global trade, for India, it accounts for 35-40%. India's share in global MMF-based RMG trade stands at a mere 2% despite it being second-largest MMF producers, whereas China, Bangladesh and Vietnam accounted for ~38%, ~9% and ~6%, respectively, in calendar 2019.

The primary reason behind India lagging in MMF-based garment exports is the cost competitiveness and trade agreements between rival countries and export destinations such as the US and the EU.

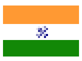
In the US, despite similar import duties, Bangladesh and Vietnam are offering products at ~34% and ~19% lower price as compared to India, whereas in the UK, Bangladesh, the largest MMF garments importer in the EU, is offering at 33% discounted price. This has led to rapid growth in the share of Bangladesh in US- and EU-bound trade and helped Vietnam to gain share in US.

India's share in global MMF based garments also remained range bound due to limited processing capability of manufacturing of MMF-based fabrics with high percentage of spandex.

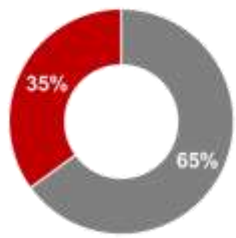
Minuscule share of India in global MMF-based RMG trade

Global

% share in MMF-based RMG exports

	2015	2019
	47	38
	7	9
	2	6
	3	2

India



MMF-based RMG | Cotton-based RMG

Source: ITC Trade Map, CRISIL Research

To improve India's share in the global RMG trade, exporters need to increase their presence in the MMF garments business. With this in view, the government included MMF and technical textiles under the PLI scheme with a total incentive of Rs 10,683 crore.

PLI scheme: snapshot

Total revenue potential @9% incentive Rs 1,50,000 crore

Investments under PLI Rs 25,000-30,000 crore

Capacity added ~2.5-3 mn tonnes

Total incentive- Rs 10,700 crore

IRR generated @9% incentives- 17-18%

PLI scheme project categories

- **Brownfield projects with:**
  - Rs 100-400 crore turnover will receive 9% incentive for the first year
  - More than Rs 400 crore turnover will receive 7% incentive
- **Greenfield projects with:**
  - Minimum Rs 500 crore investment will receive ~11% incentive for the first year
  - The incentive rate will decline by 1% each year in all categories

PLI scheme calculation

To set up a 100 ktpa capacity MMF plant, ~Rs 530 crore investment is required, which works out to a 12% capex to sales ratio, and provides a total capex requirement of Rs 25,000-30,000 crore during the scheme tenure. That translates into 2.5-3 million tonne capacity addition. Assuming 9% incentive with 1% decline for the next five years, the IRR could be 17-18%.

PLI scheme benefits to be passed on

Some established producers earn stable return on capital employed (ROCE) of 12-14%. Under the PLI scheme at 9% incentive, the IRR is estimated at 17-18%. So if a company setting up capacities passes on additional benefit to end-users, their prices may become more competitive in the global market. This may reduce their IRRs, but would lead to higher share in export sales.

Criteria for being eligible for incentive payouts

- For brownfield expansion projects with Rs 100-500 crore turnover, the turnover should increase by 50% each year
- For brownfield projects with turnover of Rs 500 crore and more, the turnover should increase by 50% in the first year and then by 25% each year
- For greenfield projects, Rs 1,500 crore turnover in the first year and then 25% increase each year

Source: Ministry of Textiles, CRISIL Research

- The PLI scheme is expected to improve India's presence in MMF-based RMG exports. India's MMF production capacity, is projected to reach 10.5 MTPA in fiscal 2025 post investment of Rs 25,000-30,000 crore under the PLI scheme
- With demand improving to an estimated 6.1 MTPA from 5 MTPA last fiscal, the exportable surplus is estimated to increase to 2.5-3.0 MTPA (29% of capacity) from 1.4 MTPA (18% of capacity) under the scheme by fiscal 2027
- Limited processing capability for fabrics with high percentage of spandex, which are in demand for sportswear and leisure wear across globe, is restricting export growth. Both Bangladesh and Vietnam command a higher share in these fabrics due to better processing capabilities, resulting in higher export share in global markets
- IRR from the scheme is estimated to be around 17-18% against stable ROCE of 12-14% for leading industry players. We believe India will be able to improve its competitiveness to some extent if MMF players pass on the full benefit, though it will continue to be an expensive choice as exporter compared with Bangladesh

In addition to PLI scheme, which offers incentives, players may need to build scale and integration to further reduce costs and become more competitive in export markets. The recently launched Mega Investment Textiles Parks (MITRA) scheme by the Government in Union Budget 2021-22 can play a key role.

MITRA to boost structural competitiveness, but continuous support needed

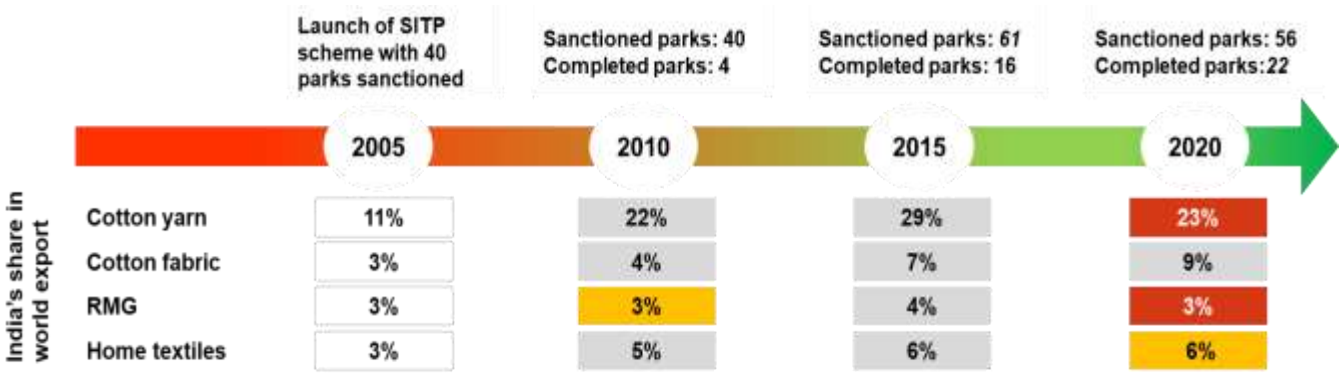
Under MITRA, the government has proposed to establish seven mega textile parks over 1,000 acres of land in the next three years.

So far, most parks developed under the Scheme for Integrated Textile Parks (SITP) have been of very small area – average 50 acres – compared with larger textile parks in Bangladesh, Vietnam and China, with average area of 100 acres or more. Smaller area of the parks, lack of adequate incentives, and implementation delays were the key reasons for limited success of this scheme.

Parks under the SITP scheme were unable to drive export growth due to several other reasons, too. The land allotted for the parks was outside the city limits in most of the instances, and large distance from inland container depots was a hurdle in delivering products from park to port. Added to this, there was poor or no marketing, which resulted in low interest and hence lower investments in these.

Alongside addressing these issues, provisions to ensure timely execution, better amenities such as plug-and-play infra, water treatment, enabling emerging ESG-linked parameters, and dedicated power distribution will support the success of the scheme and will boost economies of scale and export competitiveness.

Slow pace restricted the success of SITP scheme in the past



Source: Ministry of Textiles, Ministry of Commerce and Industry, CRISIL Research

Timely implementation of PLI and MITRA schemes can help India bridge the gap with rivals in key export markets to the extent of 10-15%. While PLI scheme will incentivise players to set up capacities in MMF, mega textile parks will aid in setting up of large-scale integrated capacities by providing world-class infrastructure and fiscal incentives. If implemented well, this has the potential to help India increase its share in MMG based RMG exports and regain lost share in key export markets.

Along with these, FTAs with key trading nations of EU, USA and continuous investments via textile parks may be a pre-requisite to improve India's competitiveness structurally.

Annexure A

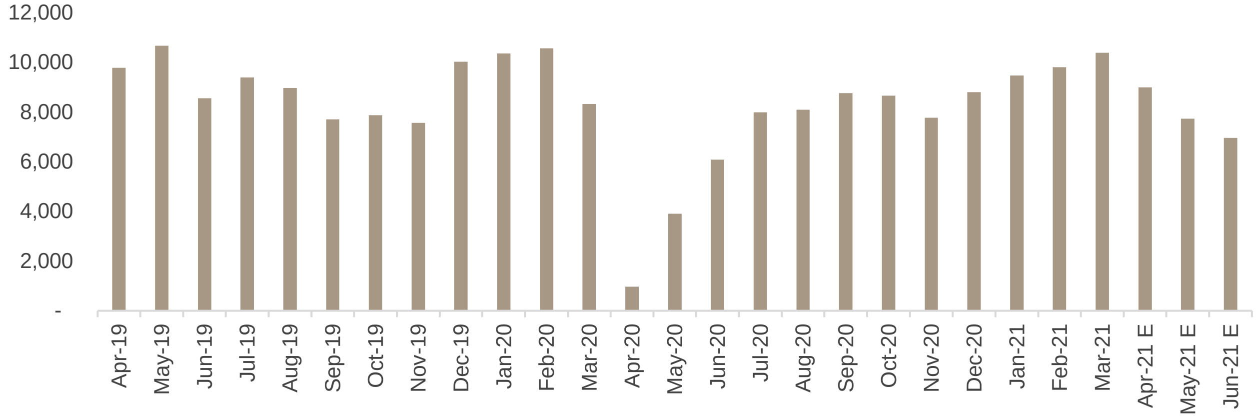
Incentive structures in competitor countries

Incentives	Bangladesh	Vietnam	India
Cash incentives	5%; 10% subsidy on power bill for SMEs	0%; refund on VAT to local industries	0%; subsidy on different cost components across different states
Import duty	0% import duty on raw cotton 1% import duty on machinery & spares for export-oriented industries 3% for non-export-oriented industries 3% import duty on dyes and chemicals for all textiles	0% on capital machinery and equipment	10% import duty (basic customs duty) on raw cotton 5-12% import duty (basic customs duty) on textile machinery
Duty drawback	Available	-	2%
Export incentives	On export free-on-board value: 5-20% on selected products		MEIS: 2-4% (until fiscal 2021), RoDTEP: % not yet decided
Other incentives	Fiscal/non-fiscal incentives: Remittance of royalty and residence permits, tax holidays, depreciation allowances	Incentives for textile equipment and machinery manufacturing; incentives to the companies with 500 to 5,000 employees on a regular basis	Interest subvention scheme: up to 2% relief on interest component for MSMEs

Source: CRISIL Research

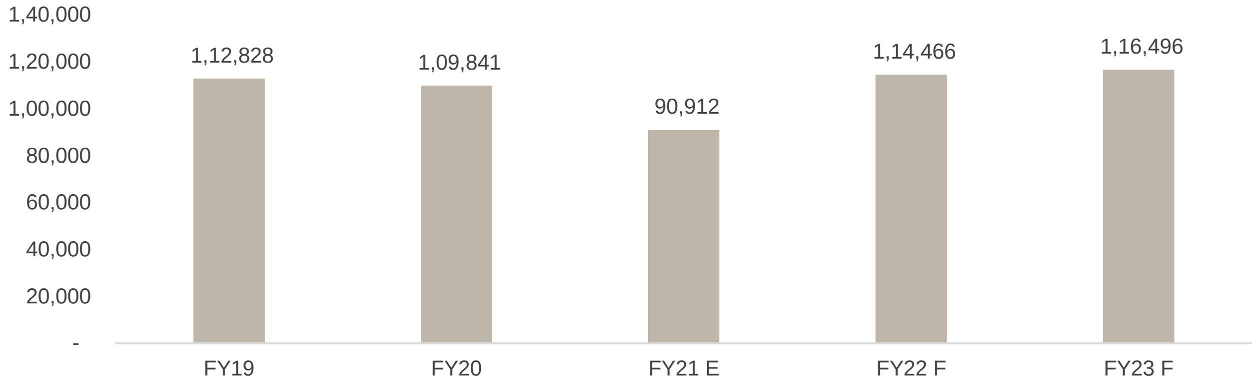
Annexure B

Lockdowns amid second wave of Covid-19 likely hit RMG exports in first quarter this fiscal (Rs crore)



Source: Ministry of Commerce and Industry, CRISIL Research

RMG exports estimated to overtake fiscal 2019 level this fiscal (Rs crore)



Source: Ministry of Commerce and Industry, CRISIL Research

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