



TEXTILE REVIEW

SPINNING BY ITS TAIL

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The article illustrates the volatility in the spinning sector, the recent crisis in the textile industry and the reason leading to the crisis, authored by Mr. Sathyanarayanan, Partner, Audit & Assurance, BDO.

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SPINNING

– BY ITS TAIL

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Spinning Industry- an analysis of the recent crisis

The Textile Industry, especially the spinning sector, witnessed an unprecedented volatility in the past 9 months. Though Volatility is not an uncommon scenario in textile industry, the one that the industry is presently going through is very unusual and has proved the predictions and calculations of the experts of the industry wrong in many ways. To put it in a casual style, the Industry went for a toss and has raised a very critical question as to why the experts of this age old industry couldn't assess the volatility in the first place and as a follow up why they are still struggling to predict how long this would continue to haunt them.

Sequence of events leading to the present crisis

The textile industry, especially the spinning sector has been adversely affected due to certain government policies announced during the last 12 months. Following are the sequence of events:

1. Cotton is an important raw material for the Textile Industry. Cotton which was all along classified as an essential commodity was removed from the essential commodity list in 2008. This resulted in large international cotton traders moving into the cotton trade in India. With the perceived shortage of cotton crop world wide, international traders started accumulating stocks of cotton in India, pushing up prices to unprecedented levels. The incentive given to cotton exports with retrospective effect and a discount of 5% for bulk buyers fuelled speculation, making way for large international trading houses with access to cheap funds to speculate and corner all the good cotton on arrival and keeping the market artificially high. Cotton already enjoyed a very high support price. The increased prices did not benefit the farmer as he had already sold his produce to the traders at lower prices. Strangely, our competitors in countries like Bangladesh China were able to procure cotton at a cheaper price than what was available here. The industry feared that the world would run out of cotton and there was panic. This caused unprecedented increase in cotton prices. To give you an idea, prices of the main variety of cotton which is used for spinning 40s count, shot up to Rs. 62000 per candy from earlier levels of Rs. 28000 per candy over a period of 6 to 8 months.
2. Surprisingly 55 lac bales of cotton were allowed for export in mid 2010, much before the actual assessment of the crop size. These quantities were lapped up in 10 days time by the international traders. Industry's plea to allow 4 lac bales every month for exports was ignored. This really was the game changer with disastrous consequences to follow.
3. Yarn prices also shot up steeply from early 2010. With India having a significant share in the world cotton yarn trade, prices started going up in the international market and India's export went up further. Spinning mills did reasonably well during 2010, inspite of the high cotton prices. However the working capital requirement went up steeply due to high cost of cotton and high yarn prices.

4. The garment industry, mainly the knitting industry started complaining of the high yarn prices and lobbied for price control on yarn. In actual fact, the garment industry especially the knitting industry is an inefficient sector and the productivity levels were one of the lowest and even countries like Bangladesh had high productivity levels as compared to Indian garment industry. Instead of modernising and improving their productivity, the garment sector clamoured for export control and price control. In response to this, the Central Government set up Cotton yarn Advisory Board. This resulted in informal price control and in November 2010 the government imposed an arbitrary quantitative ceiling of 720 million kgs. on cotton yarn exports for the financial year 2010-11. This was done without ascertaining accurate production and consumption figures of yarn. Since a major portion of exports had already been affected, cotton yarn exports came to a virtual standstill from December 2010. This resulted in a over supply situation in the domestic market and there was a steady fall in yarn prices within the country.
5. In the international market, India was perceived as an unreliable supplier due to the government policies on exports. Also the DEPB and duty drawback benefits were also withdrawn on cotton yarn exports. However the draw backs have now been restored back with retrospective effect from 1st April 2011.
6. Normally cotton season starts in October/November of every year, with the arrivals peaking in January. It is a normal practice to accumulate cotton stocks, since after April cotton availability will come down drastically. In view of this most of the spinners had accumulated cotton stocks at high prices to meet their requirement for 2011-12.
7. With low yarn prices and high cotton prices, many mills started incurring losses from February/March 2011. Hence demand for cotton also came down. With a better cotton outlook world wide, international cotton prices started coming down from March 2011 and there was a steep fall in Indian cotton prices from March 2011. Normally cotton prices don't come down in March, coinciding with the end of cotton season with new sowing expected from June. Cotton prices have now come down to Rs. 35000 per candy from a peak of Rs. 62000 per candy in mid-May 2011.
8. With the reduction in cotton prices, yarn prices also started crashing. From March 2011 to June 2011, yarn prices have crashed by more than 40%. With the high inventory cost of cotton and mounting yarn stock, most of the mills will incur cash losses for the first 2 quarters of 2011-12.

From the above sequence of events, you will notice that faulty government policies are the main reasons for the plight of the industry today.

Burden on the Industry

Unlike many other industries, which have embraced market determined policies and prices, there are certain peculiar features in the textile industry, which imposes a burden on the industry.

1. Cotton being an agricultural commodity, farmers lobby leads to frequent interference from the government in determining exports and support prices, thus affecting the main input costs. While the government is sensitive

- to the needs of the farmer, are not sensitive to the problems of the industry.
2. The recent formation of Cotton yarn advisory board is one more step leading to control of yarn prices. There is a constant fear of exports ceiling being imposed on yarn exports, which could change the dynamics of the industry.
3. Predominantly the garment sector is in the small sector, leading to fragmented capacities and inefficiency. Whenever there is an increase in yarn prices, there is a clamour for reduction. Market determined prices only will lead to a healthy growth in the industry. While the Indian spinning sector is world class with modern and efficient machinery and high degree of automation, garment sector is outdated and far behind in modernisation and technology. The priority of the government should be to modernise the garment sector and bring productivity levels in par with the best in the world.
4. As a result of the inefficient garment sector, countries like Bangladesh, Vietnam and Indonesia have overtaken India in garment exports to U.S.A.
5. Hank yarn obligation, which was introduced in March 1963, continues in the statute book, even though this has outlived its purpose. This is an artificial control, mainly because yarn comes under the essential commodities act.

Representations to the Central Government

Following representations have been made to the Central Government by both CITI, based in New Delhi and SIMA, based in Coimbatore.

1. Government to put in place a methodology for data collection to ensure near accurate figures both with regard to cotton crop or outlook on yarn production in the country.
2. Cotton Corporation of India (CCI), the government body entrusted with the task of procurement of cotton for the benefit of farmers, should sell only to Mills and not to traders.
3. Abolish hank yarn obligation, which has outlived its purpose.
4. All controls on yarn-both price controls and quantitative- should be removed.
5. Industry is not against cotton exports- but should be allowed only after ascertaining the crop size and only after December every year.

Long Term Outlook

Long term outlook for the industry continues to be good. Cotton crop in USA is expected to be much high in the coming cotton season, which should bring cotton prices to the near normal levels. Because of the crisis, domestic cotton consumption by the industry will be lower during the current year. This should further ease cotton prices. With labour costs and other inputs costs going up in China, Indian products are likely to become more competitive in the international markets. With further reforms in opening up of the economy, it is bound to benefit the industry.

However, one should keep in mind that in a spinning industry- especially cotton spinning- raw material constitutes about 55% to 60% of the sale value. Cotton being an agricultural commodity, there will be volatility in prices, which results in wide swings in the profitability of the industry. ■