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Case study: Hong Kong clothes company considers its options

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When costs started rising in China recently, TAL Apparel, the Hong Kong-based textile manufacturer, began looking to further diversify its operations.

The company, which says it makes one in every seven dress shirts sold in the US for department stores and brands such as JC Penney and LL Bean, already employs about 24,000 people in China, south-east Asia and Mexico, so the obvious choice was to look west, towards the Indian sub-continent.

“Where from a cost point of view should we be? Looking at low-cost countries, that would be India, Bangladesh or Cambodia,” says Delman Lee, a director at TAL, who went on a fact-finding mission to decide which market would be most suitable. What Mr Lee encountered provides an insight into the challenges facing foreign direct investors when trying to decide whether and how to invest in India.

The textiles sector is seen by many as a new growth area for Indian industry. Once crippled by debt, unions and inefficiency, it has made a strong comeback in recent years.

Helped by the abolition of US and European quotas, India textiles and apparel exports rose 19 per cent to $16bn last year.

Exports to the US were up 27 per cent and to Europe 18 per cent. Investment in the sector, which also services a $30bn domestic market and employs about 35m people, rose 71 per cent to $4.1bn last year, according to Technopak, a consultancy.

The sector has also witnessed a sharp rise in interest from foreign companies, with Brandix Lanka, one of Sri Lanka’s biggest clothing makers, announcing a plan to set up India’s largest garment unit in Andhra Pradesh and big buyers setting up sourcing offices in the country, such as Marks and Spencer.

In TAL’s case, the company typically builds a new factory every couple of years to meet its expanding order book, and is due to launch its second Chinese factory in southern Guangdong province, by the end of this year.

The company began looking towards India as the potential location for its next factory after its new Guangdong facility when overheads in China started rising, particularly labour costs.

“With [China’s] minimum wage going up, it meant our costs were rising,” Mr Lee says.

He began comparing Bangladesh, Cambodia and India from the point of view of labour costs and availability, electricity supply, ports and road infrastructure, the quality of middle management and, of course, relative levels of corruption.

It was not TAL’s first contact with India. The company already offers third party logistics in the country, in which TAL assists JC Penney’s suppliers to package goods to a point they are ready to be placed on shop shelves and then ship them direct to stores in the US. But it has yet to manufacture in the country.

Concerns over labour unions and corruption in Cambodia and Bangladesh led the company to rule out both these countries as potential manufacturing bases. Businessmen in India complain about the same issues – particularly the country’s archaic labour laws. Technopak says rigid laws on hiring and firing workers in India made it difficult for the industry to adjust to different business cycles compared with China, where it is possible to lay off workers during the non-peak season.

But TAL found that corruption and industrial action were less severe in the textile industry in India compared with some of the country’s neighbours.

More challenging was the curious logistics of textile manufacturing in India. The cotton is grown in the north of the country, milled in New Delhi and then sent south to Bangalore for further processing and shipping. For a high-technology producer such as TAL, Indian grown cotton may not suitable.

Because it is hand-picked, it becomes contaminated with traces of human hair, dirt and other impurities, forcing apparel producers to import their top quality cotton from the US or other countries.

The country’s mills, however, are more advanced, with good senior managements, most of whom are keen to partner with a foreign manufacturer of TAL’s experience.

Mr Lee also estimates that manufacturing costs in India compared with China are up to 30 per cent lower. India’s minimum wage is about Rs2,500 a month, or about 60 per cent of China's $85 a month. Perhaps India's biggest drawback is its notorious infrastructure problems.

Technopak calculates the total shipping time from India to the US takes eight to 10 weeks, compared with two to three weeks from China to the US. Time at customs alone in India can take nearly two weeks. The consultancy also cites Merrill Lynch findings that India's shipping costs are nearly twice the world average.

Indian textile mills are also not yet providing services such as "advance shipment notice", under which they notify the garment manufacturer of the width of a given batch of fabric and its shrinkage so that the apparel maker can calibrate its machinery accordingly. This can save a company such as TAL one week – a crucial amount of time in an industry in which shorter lead times can make or break a business.

The other issue facing any foreign manufacturer such as TAL that is looking to enter India is the cultural challenge of managing domestic workers.

In China, the company encourages workers to be more productive through various incentive schemes. This means that usually two thirds of workers earn more than the minimum wage.

In India, however, where the workers are about half as productive as their Chinese counterparts and a large number are on the minimum wage, the company will have to experiment with such schemes to see if they are culturally acceptable.

"It's a doubt in our minds but not insurmountable. Being a global company, we should be able to go into any country and set up operations," says Mr Lee. He says TAL is still exploring its options in India, including whether to participate in one of the country's plethora of new special economic zones.

But in the meantime, it is taking small orders of Indian fabrics to test their suitability with a view to possibly setting up a factory in the next two years or so.