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Textile troubles: size matters; so does organization

With more than half share in total exports, there is little doubt that Pakistan must stop relying solely on textile exports. The sector already has a small share in global trade, and gradually falling. Ergo, it's about time for this 72-year old country to learn the idiom usually taught in grade five: do not put all your eggs in one basket. But since textile is the biggest employer in Pakistan at the moment and the main driver of growth (exports & GDP), it cannot be completely ignored. Reforming it, therefore, needs a two-pronged strategy.

Size matters: First, the government must pronto consult financial, corporate and tax experts and figure out a way how it can incentivise growth in the size of Pakistan's textile companies, whether in terms of organic growth or through mergers and acquisitions. At a recent moot held by the Pakistan Business Council (PBC), Musadaq Zulqarnain, CEO Interloop Ltd, rightly said that "we are minions", a realisation that former deputy chairman Planning Commission Nadeem Ul-Haque has been trying to bring home for a long time.

Musadaq flagged that the largest exporter in Pakistan sells under $400 million, echoing what BR Research has been highlighting for quite some time. A look at Pakistan's listed companies shows that the biggest listed textile composite, Nishat Mills Limited, had a share of only 2.5 percent ($354 million) in the country's total textile exports ($13.4 billion) in FY18.

The state of fragmentation in Pakistan textile industry can be gauged by the fact that Australia has 30 factories to process 1.3 million bales of its cotton production. In contrast, Pakistan has 2500 factories for 12 million bales. This means that Pakistani factories are processing about 4800 bales on average per factory whereas the Australian ones are 43000 bales. Whatever happened to the idea of economies of scale? (Caveat: This data is as per last available statistics cited by Mian Mansha a few years ago in his interview with BR Research. However, channel checks with the industry reveal that the ratio is nearly about the same today.)

Some people cringe at the very idea of big business. And understandably so! But the hard realities of global trade cannot be discounted. As Musadaq argued at the PBC moot, global demand is moving fast towards fashion. In order to deal with that, businesses need quick turnaround time, which is why companies in Pakistan's competitors such as Bangladesh, Vietnam, are moving towards backward integration.

This is simply business 101: vertical integration to efficiently process the various stages of product development is necessary to become cost effective, whereas industry consolidation to have at least some big players is needed to ensure that Pakistan is able to exhibit in foreign countries, invest in research, testing and product development – elements of business that SMEs cannot afford. Going forward, the model should be to have few big players at the top for which smaller companies can produce according to the quality standards given to them – ala the successful examples of Japan, China and Germany.

Organisation matters too: The second area of reform relates to industry organisation for collective goals. Why is it so that the country's biggest non-farm employer and the biggest forex revenue spinner does not have one single voice for advocacy? Why do the likes of Gul Ahmed Textile and Interloop Limited need the PBC to channel their concerns effectively?

Well for one, size does matter. An industry that is divided in small, fragmented, mom-and-pop shops will not have economies of scale: neither for production, nor for advocacy. Second, the idea of organisation for collective interest is lost on Pakistani businesses at large – they have a monopoly for not thinking big, and their associations and chambers lack sense of organisation for the collective good. The textile sector is clearly not exempt from this poverty of thought. (See BR Research, Empty Chamber? 18 Jan 2016)

One proposed solution lies in changing the structure of industry representation, as is visible in the four illustrations. Each of those illustrations demand a close look: they show how a large number of government bodies and private associations with overlapping mandates represent textile industry; and how could Pakistan learn from the likes of India and Sri Lanka to fix the problem.

These proposals were made nearly a decade ago by McKinsey & Company, of course under a funding by the Asian Development Bank. And like so many other proposals, this too has been catching dust since then. Whether or not Pakistan's various textile associations agree with the structure proposed by ADB- McKinsey study is another question. Rest assured, the current structure of industry representation is clearly not working out, save for perhaps getting some SROs.