IS THERE A FUTURE FOR INDIA'S MANUFACTURING SECTOR?

EXECUTIVE SUMMARY

There are only two priorities for India – creation of 10-15 million jobs per year, growth of 10-15% per year. We cannot achieve these solely on the basis of service industry. We need growth both in inputs and in efficiency. The three things that we need to do are: be a solution provider and connect our manufacturing operations to non-manufacturing functions, such as design and distribution, thereby offering greater value to our customer; promote the small-scale industries to build global scales; and create new markets by focusing on the bottom of the economic pyramid.

INTRODUCTION

The best way to predict the future is to create it.

- Peter F. Drucker

A decade ago, India and China had roughly the same gross domestic product per capita. But at $440, India’s current GDP per capita is only about half that of China, and India’s GDP is growing at a rate of only 6 percent a year, compared with China’s 10 percent.

India has one of the largest domestic markets in the world and it has a large labour force available at relatively low cost. It also has well educated workers, particularly in areas of engineering and science. If these were the only determinants, India should be hugely successful at attracting investment. But India does not receive the amount of FDI its market size would predict. In 1999, FDI inflows were a mere 0.5 per cent of GDP. This is considerably lower than China (4.1per cent), Brazil (4.1 per cent) or Thailand (2.9 per cent). China received almost $40.3 billion as FDI in 1999, while India had to make do with $2.1 billion.

But where does Indian manufacturing come into the picture? **Why are we concerned about the future of Indian manufacturing?**

Because **manufacturing is the export driver throughout East and Southeast Asia**. China, with more than 40% of the GDP coming from manufacturing, has emerged as a preferred destination for manufacturing labour intensive products. On the other hand, India, which sees only 26% of the GDP coming from the manufacturing sector, has failed to capitalize on this huge opportunity. Indian manufacturers are facing increasing competition from the Chinese and other East Asian players. The increasing contribution of the services industry to the GDP further aggravates the skepticism about the future of the Indian manufacturing.

WHAT DOES INDIA NEED?

As C. K. Prahalad puts it "**there are only two priorities for India – creation of 10-15 million jobs per year, growth of 10-15% per year**." But the million-dollar question is how do we accomplish this? There are two distinct groups of people who propound opposing viewpoints about this. One group I call the **reductionists** and the other **emotionals**.

The reductionist approach is what we refer to as the traditional approach in the production and operations parlance. It accepts the constraints as given and tries to optimize. The emotionals also suffer from the same syndrome, though in a different sense. They are in favour of manufacturing just because they want to utilize our cheap labour pool. But they do not have any answer as to how to utilize this vast labour pool.

The Reductionists

The reductionists favour the American model. They say that there is a surfeit of manufacturing capacity in the world, so **we should concentrate on what we do best**. We already have a competency in services and we should focus on building it further. We are recognized as a low cost-high quality service provider in the software industry and we should expand our expertise to a host of other fields – banking and finance, insurance, etc. As far as manufacturing is concerned, they advocate that we should maximize our gain by shifting our production base to China, thereby exploiting their economies of scale to our advantage. In essence, the reductionists propose that we should take a short cut and leapfrog from an agriculture based economy to one that is dominated by the service industry, without experiencing a true industrial revolution. After all, this is how we benefited in the IT industry. We did not have to waste our resources dealing with the legacy systems and the Y2K problem. Instead, these were the very factors that were responsible for the sudden boom in the IT sector.

The Emotionals

The emotionals, on the other hand, are apprehensive of India transforming itself to a 'knowledge economy' without having to transition through a manufacturing-led growth phase. They feel that India cannot move beyond the current levels of growth rate only on the back of the services sector. India needs strong manufacturing to sustain the high levels of growth rate needed over the next one and a half decades. In addition, they also feel that **we might lose our self-reliance in manufacturing** and become dependent on other countries for fulfilling even our basic needs. They also fear the **loss of learning curve effects**, which even the Americans haven't surrendered to their contract manufacturers yet.

Also, with nearly 75% of India's working age population of over 600 million educated below middle school level, it may not be possible to generate the required levels of employment. This is because services in general, and knowledge based service sectors more so, require a much higher level of education than either agriculture or repetitive labour intensive manufacturing.

Is there a way out of this Indian chakravyuh? Is there any other path we can take? Sure there is and I call this the **holistic** approach.

THE HOLISTIC APPROACH

The key to survival is to learn to add more value today, and every day.

-Andrew S. Grove

The emotionals are correct when they say that we cannot create 10-15 million jobs based only on the service industry. The reductionists are also correct when they say that we should focus on what we are best at. But can't we have the cake and eat it too?

Economic expansion or growth should come as result of two sources of growth. One source being increases in **inputs**: growth in employment, in the education level of workers, and in the stock of physical capital (machines, buildings, roads, etc). The other source of growth should be the increases in the output per unit of input or **efficiency**. Such increases may result from better management or better economic policy, but in the long run are primarily due to increases in knowledge. In Paul Krugman's terminology, we need both **perspiration** and **inspiration** to sustain growth. And this is how we can do that.

Provide Solution, rather than just products or services

On one hand, we have talented graduates, postgraduates and PhDs who are second to none in the world, and on the other, we have a huge labour pool of more than 400 million people that is educated below middle school level. Why should we look at these two pools as the two extremes? Can't these two join hands and work in tandem?

India need not reinvent the wheel and do exactly what the Chinese and other Asian tigers are already doing. Instead, India has to present itself as a **solution provider** to the world. It has to offer greater value to the world. India need not be at the bottom of the value chain by being a mass manufacturer; rather India should and can move up the value chain and capture a greater part of the value chain.

In other words, I am arguing that **modern manufacturing is more knowledge intensive than many knowledge intensive businesses**. Manufacturing is no longer confined to a factory. It has gone much beyond that. Today, it also includes distribution and supply chain management. And that's higher up in the value chain. Today, we are witnessing a **convergence of traditional manufacturing and supply chain management.**

As supply chains become more of a competitive weapon, it is more critical—and possible—for companies to **connect their manufacturing operations to non-manufacturing functions, such as design, procurement, planning, forecasting, logistics and customer service.** Supply chain management has now reached a point where manufacturing companies can interact more seamlessly and routinely with myriad business partners.

One Indian industry that is already doing this is the Indian pharmaceutical industry. The Indian bulk drug manufacturers, in the past, were under a serious threat from the Chinese. It had become very difficult for the Indian players to continue solely with their price paradigm. Hence, they focused on improving their quality and changing their product profile. They also moved up the value chain.

And now the Indians are back in business in bulk chemicals and pharmaceuticals. Indian companies are focusing on marketing and R&D, thereby capturing greater value for themselves and simultaneously offering greater value to their customers. They are licensing out molecules and even marketing their own generics outside India. They now offer a much richer basket to the world than just cheap bulk drugs.

A similar example exists in the consumer durables industry. Samtel, which manufactures picture tubes for majority of the television brands in India, has joined hands with IIT Kanpur for development of indigenous plasma technology. If some Indians can do it, I do not see any reason why the others cannot.

Build Global Scales

Small-scale industry in India has received significant preferential treatment – both in terms of specific sectors being reserved exclusively for small-scale industry and in terms of preferential excise and other fiscal concessions. Since the preferential treatment is contingent on these units remaining small, there is no incentive for these units to expand.

This is one area where we have to learn a great deal from the Chinese experience. The Chinese experience with Town and Village Enterprises (TVEs) is in sharp contrast to our own experience with the small-scale industry. The Chinese Government has provided significant support in terms of fiscal incentives for an initial time period (and not based on size) and additional technical support (training, technology development etc.) without instituting market distortions.

We also need to do the same and **promote the small-scale industries to build global scales**. It is not necessary that a single player builds up the scale. Like in China, we can have a geographical area that concentrates on just one industry. We already have numerous examples of these – the glassware industry of Firozabad, brassware of Moradabad or the chikan industry of Lucknow. What is required is financial and technological support to further promote these industries. In the case of the chikan industry, the work being done by MIT Media Lab and IIT Kanpur would go a long way in the development of the industry. But we need many more similar sincere efforts.

Building global scales does not require the presence of a large domestic market. With WTO in place, there does not remain much of a difference between domestic and foreign markets. If one can succeed in the domestic market, one can repeat the success in the global markets as well.

Create New Markets

Sixty five percent of the world's population, which means more than 4 billion people, earns less than $2000 per year. But not many companies are catering to the needs of this section of the society. We need to capture the buying power of this market. Individual incomes of these people may be low, but the aggregate buying power of this market, due to its sheer size, is huge. So the **question is**

how do we conceive of a market built around the bottom of the economic pyramid. **Why can't India be the export platform for the poor of the world?**

If we look at the economic pyramid of India, we find that MNCs and most of the organized sector in the country play at the top. Some companies like HLL and Godrej play in the middle also. But no body touches the bottom. That is where the bulk of India is. There is a lot of money to be made here. **The lower middle class and the poor, especially the urban poor, are a potential market and can act as a source of fundamental innovations**. The Indian FMCG industry has already realized this and is taking steps in this direction. It is trying to expand the markets, for example shampoo and tea, by introducing smaller pack sizes and sachets. Parle has been successful in capturing this buying power with its **Parle-G** brand, the world's largest selling brand of glucose biscuits.

The large base of the economic pyramid is waiting for someone to come and capture its buying power. Is anyone willing to increase its sources of revenue?

CONCLUSIONS

These three areas – **providing solutions, building scales and creating new markets** – need our immediate attention. If we start working on these, other things would automatically fall in place. We do not have to run after FDI. If we show the world that we offer greater value, no one can stop FDI from pouring in. Aren't we witnessing this in the IT-enabled services sector? MNCs are not setting up shop just because we offer cheap labour, but because we offer much more – we offer greater value for their money.

This would also help plug the outflow of talent, as the Indian companies would then be able to offer a challenging career path. Unless the Indian manufacturers are ready to create their own future, how can they offer a future to their employees? Thus, we would be able to take full advantage of our low cost high quality talent.

At the same time, government cannot remain a mute spectator to all this. The government needs to put in place the policies to promote business – the labour laws, business exit policies, transport and power sector reforms, elimination of barriers to setting up new businesses. **The government has to support the industry while it creates its own future.**

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