

CRISIL YOUNG THOUGHT LEADER



How can the new government make India a global manufacturing hub?

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Executive Summary:

The future lies in manufacturing. Domestic manufacturing is the central tenet for achieving faster, more inclusive and sustainable growth. Manufacturing has large stakes involved, not just because the sector employs 30% of the non-agricultural workforce in India, but also because of its contribution to the overall economy. Only a sharp increase in the Indian manufacturing sector workforce will increase overall income levels of the country which in turn will ensure inclusive and sustainable growth. If India is to regain and sustain overall GDP growth of 9% per annum, it is essential that manufacturing sector should grow at more than 12%.

The Government of India has taken a number of steps to further encourage investment and improve business climate. 'Make in India' mission is one such long term initiative which will help to realize the dream of transforming India into a 'manufacturing hub'.

This report starts with identifying issues related to manufacturing sector and how the government's efforts can remove hurdles to augment the same. According to the analysis of the secondary data available and author's personal views, this report establishes that the Governments efforts at various levels can lead to resurgence of India as a manufacturing behemoth.

[Executive Summary: 199 words]

[Report: 2420 words]

1.0 Introduction:

An ancient nation like India has undergone many evolutionary cycles. A well admired supremacy of ancient India in the field of Science and technology requires no mention. But with the advent of modern era, many western societies surpassed India in term of advancement in Science and technology. But India is slowly re-emerging to acquire its leadership position. On 24th September 2014, India entered a new era of leadership with its Mars Mission successfully entering the orbit with a cost which was one tenth of the cost of Mars project by NASA. This reaffirmed India's capability to deliver on cost, quality and time. This triad is building block for the success of a country.

India's manufacturing sector has far lagged behind and it is the opportune time to focus on this sector. What India has to focus on is to integrate manufacturing operations with IT based services to offer solutions which boost the most critical sectors of the economy. Shining manufacturing sector is an export driver which is evident from the fact that 40% of China's GDP comes through manufacturing.

75% of India's working population is educated only to middle school or below. This staggering figure of approximately 600 million¹ people is not even equipped to benefit from the opportunities in the flourishing service sector. It is only the labor intensive manufacturing sector that has the potential to generate employment in adequate numbers to absorb the larger labor pool. Indian manufacturing sector currently contributes close to 15% of GDP which is almost half when compared to "factory of the world" China, whereas service sector contributes almost 60% to GDP. This huge mismatch in terms of contribution to GDP makes it imperative for India to focus on manufacturing and bring it close to 25% over next decade.

Contribution to GDP (%)	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Agriculture, forestry & fishing	15.77%	14.64%	14.59%	14.37%	13.95%	13.94%
Industry						
Mining & quarrying	2.36%	2.3%	2.25%	2.11%	1.98%	1.86%
Manufacturing	15.78%	16.17%	16.17%	16.28%	15.76%	14.94%

¹India's Manufacturing Sector: Policy Framework(Anderson Business Consulting, IIM L, IITM)

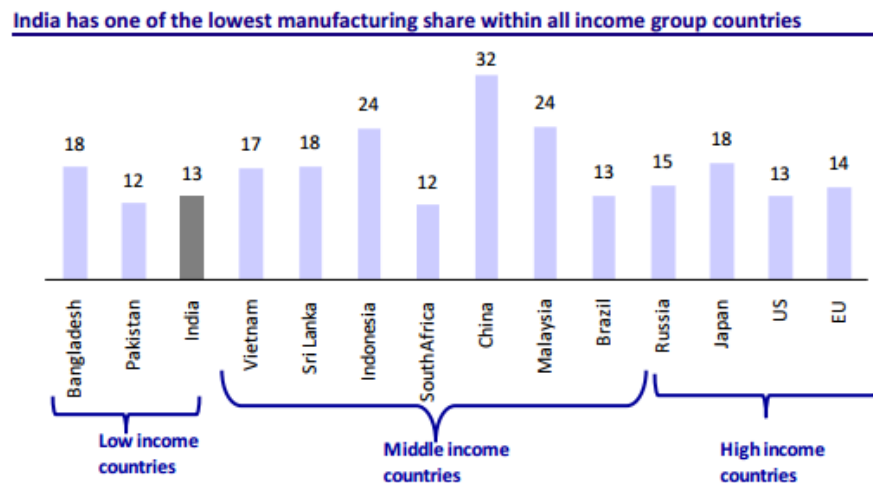
Electricity, gas & water supply	2.0%	1.95%	1.89%	1.92%	1.88%	1.9%
Construction	7.99%	7.85%	7.62%	7.91%	7.66%	7.43%
Services	56.11%	57.09%	57.48%	57.42%	58.79%	59.93%

Source: Ministry of Statistics & Programme Implementation

The manufacturing sector in India faces acute challenges. From problems with power, ports, railroads and roads to shortage of human capital, manufacturing in India has long lagged behind targeted goals. But the Indian government's commitment to raise its investment in infrastructure from 7% to 9% represents a US\$ 500 billion opportunity for growth within India's manufacturing sector. Among all the stakeholders Government by far is the largest stakeholder in Indian Manufacturing sector and wields a great amount of control over manufacturing sector through its policies and regulations.

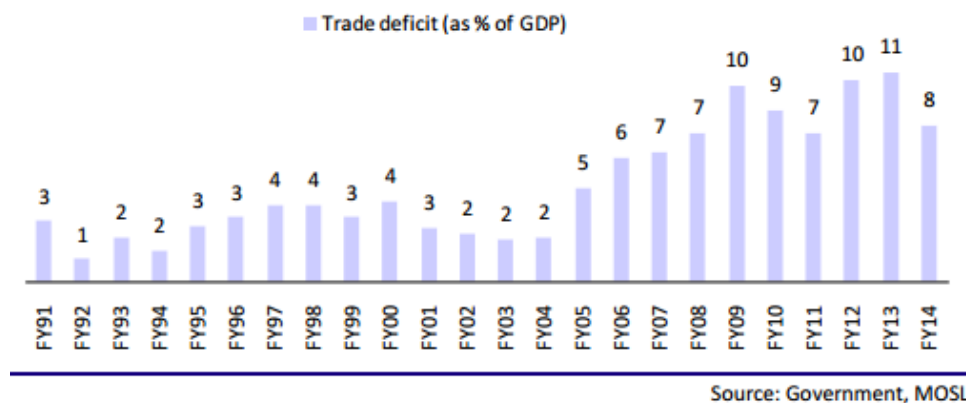
2.0 What stymies India's Manufacturing Vision?

Presence of a huge domestic market, low cost labor availability and home to a variety of resources, but these factors have still not catapulted India to the zenith of its manufacturing dream. India's share of manufacturing out of total GDP is relatively low even if it is compared with any income group either below or above its income level.



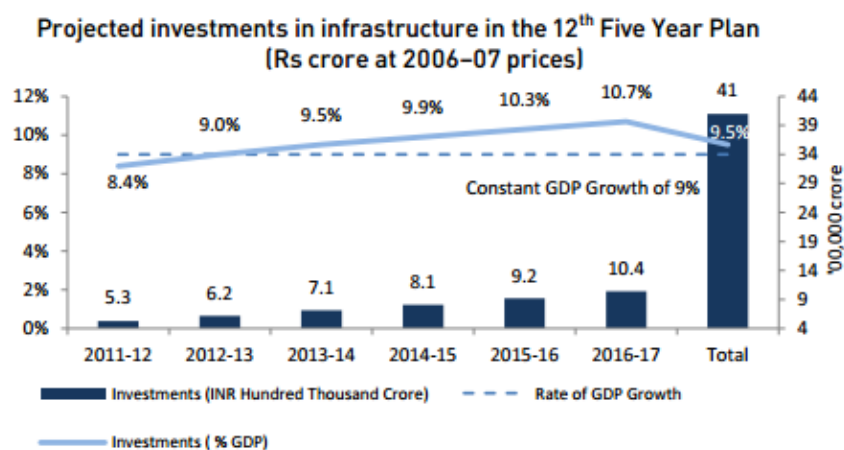
Source: World Bank, MOSL

Meanwhile the gap in manufacturing has resulted in widening of trade gap that is not fully offset by services surplus.



Source: World Bank, MOSL

Nation's infrastructure challenges are a major drag on economic growth. India's urban population of around 375 million² is projected to reach 500 million by 2017. By 2030, the country is expected to have 68 cities with over 1 million residents³. This rate of urbanization necessitates availability of urban transport, clean water, power generation and affordable housing. Recognizing this, Govt. has called for \$1 trillion in infrastructure spending in the five years through 2017.



Source: Planning Commission

Private investment constituted about one third of infrastructure investment in the Eleventh Plan and this is projected at 50 percent for the Twelfth Plan period. In these times of tight fiscal environment, private sector will need to play a greater role in infrastructure development

² Milken Institute Report on "Urbanizing India

³ India's urban awakening: Building inclusive cities, sustaining economic growth", McKinsey Global Institute, September 2010

3.0 Fulfilling the ‘Make In India’ vision

The Government of India, knowing the importance of the sector to the country’s industrial development, has taken a number of steps to further encourage investment and improve the economy.”Make in India”⁴ mission is one such long term initiative which will help to realize the dream of transforming India into a ‘manufacturing hub’. The prime minister’s call for ‘zero defect and zero effect’ manufacturing resonates well with our industry as we grow and produce for the world with concern for the environment. The Government in the last few months has taken a lot of steps in this direction. Major ones being:

Improving Business Environment

- Ease of Doing Business
- De-licensing & Deregulation

Enabling Manufacturing

- Industrial Corridors
- Industrial Clusters
- Smart Cities
- Nurturing Innovation
- Skill Development

Opening up Foreign Direct Investment in key sectors

- Opening of critical sectors like Defense, construction and Railways for FDI

A slew of important measures have been taken in the short term:

Ease of doing business

- Fastracking of projects: Defence projects worth Rs 80,000 Crore
- Process of applying for Industrial License & Industrial Entrepreneur Memorandum made online on 24X7 basis through eBiz portal
- Validity of Industrial license extended to three years.
- Major components of Defence products’ list excluded from industrial licensing.
- Dual use items having military as well as civilian applications deregulated.
- Process of obtaining environmental clearances made online.
- For all non-risk, non-hazardous businesses a system of self-certification to be introduced.

⁴ www.makeinindia.com

Delhi-Mumbai Industrial Corridor:

work on 5 smart cities in progress: Dholera, Shendra-Bidkin, Greater Noida, Ujjain and Gurgaon

Chennai-Bengaluru Industrial Corridor:

Master Planning for 3 new Industrial Nodes [Ponneri (TN), Krishnapatnam (AP), Tumkur (Karnataka)] in progress

Chennai-Vizag Industrial Corridor:

Feasibility Study commissioned by ADB.

Amritsar-Kolkata Industrial Corridor:

DMICDC selected as Nodal Agency for doing Feasibility Study,

A new 'National Industrial Corridor Development Authority' being created to coordinate, integrate, monitor and supervise development of all Industrial Corridors.

Infrastructure initiatives

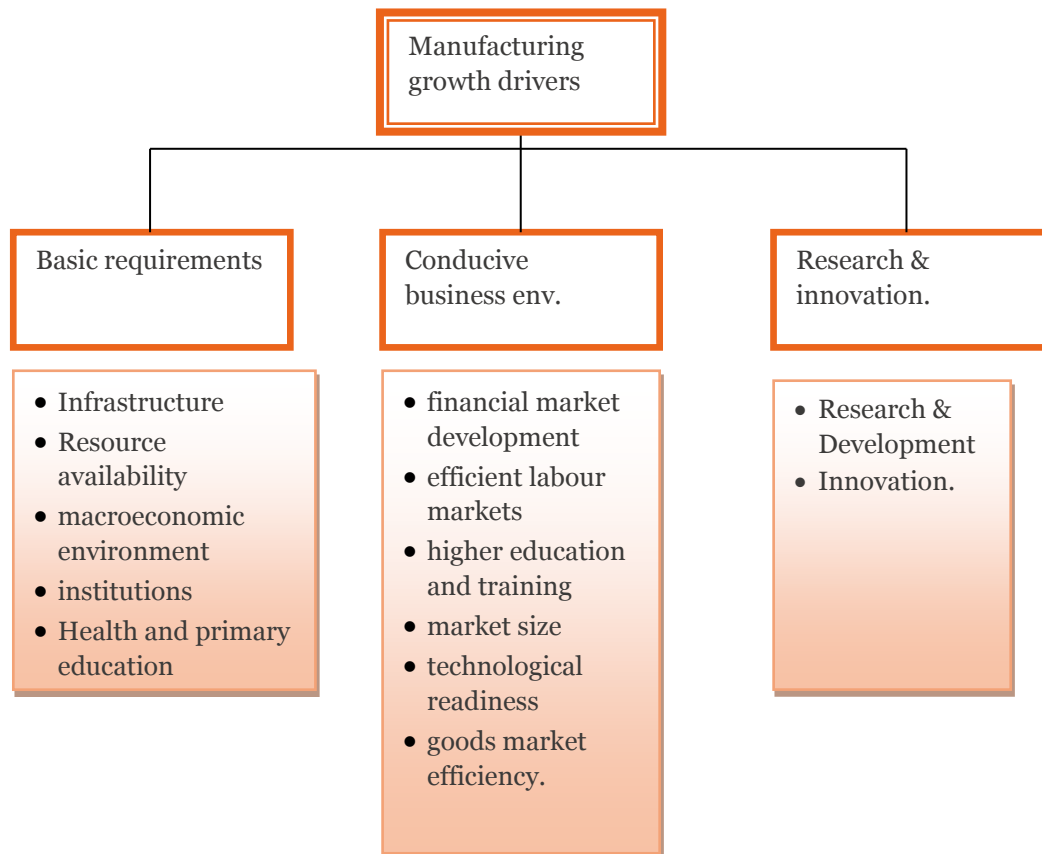
Source: Confederation of Indian Industry

With the easing of investment caps and controls, India's high-value industrial sectors – defence, construction and railways – are now open to global participation.

- Policy in Defence sector liberalised and FDI cap raised from 26% to 49%.
- 100% FDI allowed in Defence sector for modern and state of the art technology on case to case basis.
- 100% FDI under automatic route permitted in construction, operation and maintenance in specified Rail Infrastructure projects such as:

5.0 Is It Enough: Steps for the future:

India needs to address supply and demand side. On the supply side we need resources, skill development, infrastructure and on the demand side we need innovative practices, technology deployment, low cost innovations, productivity improvement and integrated manufacturing. The common factor on both the sides is better economic policy and efficient implementation. This includes basic requirements, productive business environment and Research & innovation.



Ease of doing business: According to World Bank, India ranks 142 out of 189 countries in terms of the ease of doing business⁵. India performs especially poorly in categories that involve interface with the government (paying taxes, construction permits, etc.). With government's vision of "minimum government, maximum governance", India can climb up the ladder fairly quickly. In its recent rankings, even the World Bank admits that the next quarter rankings of India will be better on account of a slew of measures taken by the new government.

Investments: Huge investments are required for Infrastructure development. But Domestic savings have come down from a peak of 37 per cent to 30 per cent of GDP and gross FDI inflows into India have averaged less than 2 per cent of GDP. Government has to open up sectors such as defence and insurance as India's gross investment rate will have to go up from 31 per cent of GDP in 2013-14 to 38-40 per cent of GDP

⁵ Ease of doing business ranks economies from 1 to 189, with first place being the best. A high ranking (a low numerical rank) means that the regulatory environment is conducive to business operation.

Labour law reform: With the launch of ‘make in India’ Government has recently announced measures to end ‘Inspector Raj’ with a system that is expected to sharply curb the element of discretion with labour inspectors and a single window compliance process for companies on labour-related issues. - These are the firm steps towards the goal of simplification of trade.

Goods and Services tax (GST): implementation of this indirect tax reform by 2016 will improve competitiveness of India’s manufacturing and help India grow faster.

Power: In order to grow at 8 % annually India will require a total installed capacity of 450 GW from present capacity of 250 GW. In order to boost electricity production government must form a National power commission (NPC) which would facilitate in accelerating Capacity addition, securing fuel supplies and improving efficiency for production, transmission and distribution of electricity. Various important issues like coal block allocation, gas pricing strategy should be addressed as soon as possible.

Logistics: Government should come up with National integrated logistic policy (NLIP) which can comprehensively address the logistic issues emerging out of road, rail, waterways and air transport comprehensively covering Rail dedicated freight corridors, Coastal freight corridors, multi modal logistic parks, better warehousing and logistic skill development

Health & education: India lags far behind in the area of Health education and ranks 135 on HDI⁶. Various government initiatives like National Health mission (NHM), Integrated Child Development Services (ICDS), Midday Meal Scheme etc. are trying to achieve Millennium Development Goals by UNDP. But efficient execution of these schemes remains a challenge for the government. According to Indian Census 2011 enrollment figures in educational institutes are very encouraging. But quality of education and high dropout rates remains a matter of concern. To address these issues government should make comprehensive and efficient frameworks for better delivery of health services and education. Like Right to education, Right to Health should also be made a fundamental right.

3Es: Efficiency, Effectiveness and Excellence are imperative. Productive business environment encompasses financial market development, efficient labour markets, training, market size, technological readiness and goods market efficiency. A reasonably well-developed corporate bond market is very much required in any economy to supplement banking credit and the equity market.

⁶ Human Development Reports (HDI) released by the United Nations Development Programme (UNDP).

Up scaling Small scale industry: SSIs have for long received government's attention but effort to build global scales is not apparent. China's Town & Village Enterprises have succeeded on the back of significant support in terms of fiscal incentives. In India we have geographical specializations which can be developed into large scale industries. It is imperative for small scale industries in India to cover new global markets. These are the industries that are capable of touching the bottom of the pyramid with their reach and product portfolio.

Knowledge management: According to times higher educational (THE) rankings no Indian university was in top 100. A survey found that almost 50% of respondents said they would like to work in outside of manufacturing sectors⁷. Government should direct educational institutes to come up with courses specifically designed to cater to requirement of manufacturing sector. Courses like PGPEX-VLM jointly run by IIM Calcutta, IIT Kanpur and IIT Madras are dedicated to develop leaders in manufacturing sector. National Skill Development programs should run programs in collaboration with industry to not only make people employable but employed in industry.

ICT: India is home to world's third largest internet users. But ironically India ranks 121st on ICT Development index⁸. Various new technologies like Internet of Things (IOT), Big data etc thrives on ICT. Moreover providing ICT skills to workforce is another great challenge. ICT technology will be a toothless weapon if manpower is not skilled enough to use it. Therefore government should come up with plans to increase penetration levels and skill development in ICT.

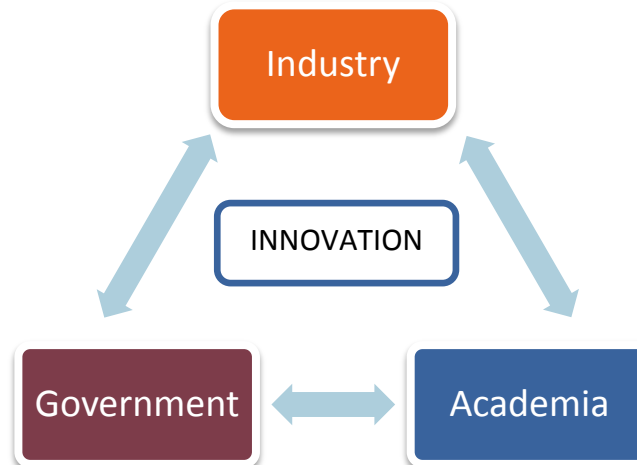
Supporting Public Sector Units: Government should focus on augmenting the strengths of the strong public sector units for efficient execution and create large entities based on the models of Temasek in Singapore and Khazanah Nasional in Malaysia, whereby both of these countries hold SOEs with significant international presence. The increased presence of leading Russian SOEs like Gazprom and Sberbank abroad is accompanied by an expressed political aim of facilitating international expansion. In China the government has pursued a 'going out' policy encouraging Chinese companies to invest and acquire market share abroad.

Research & innovation: Research and innovation are twined with each other. In Indian context, these are the 'Rambaan' weapons for building competitive advantage. Today no longer

⁷ **High university enrolment, low graduate employment** - Analysing the paradox in Afghanistan, Bangladesh, India, Nepal, Pakistan and Sri Lanka

⁸ The **ICT Development Index (IDI)** is an index published by the United Nations International Telecommunication Union.

innovation is not a point of difference (POD) in the market rather it has become point of parity (POP). In India also various government initiatives like National Innovation foundation, National innovation Council have tried to promote innovation in the country. Government should increase spend on research from present level of 1 % of GDP to at least 2% of GDP⁹. Moreover a Government academia & industry nexus must be developed to foster innovation in country



Given the need for a strong Intellectual Property (IP) regime also mandated by WTO, following steps need to be taken from a long-term point of view

- Improving IP enforcement mechanisms
- Accelerate the process of Patent Examination and according patents
- Encouraging joint IP filings by industry / academia / research institutes. This will strengthen joint working amongst Industry, Academia and R&D institutes
- Encouraging MSME sectors for filing IPs.

Conclusion:

India has the capability to push its manufacturing contribution to GDP to 25% by 2025. Government has to act as the central pivot of aligning industries, private companies, public sectors and all stakeholders in realizing this vision. Government has to put policies in place be it sector reforms, labour reforms or the elimination of business barriers. 11. The Government of India has taken a number of steps to further encourage investment and improve business climate. ‘Make in India’ mission is one such long term initiative which will help to realize the dream of transforming India into a ‘manufacturing hub’. Hon’ble Prime Minister’s call for ‘zero defect and zero effect’ manufacturing resonates well with our industry as we grow and produce for the world. India’s expanding economy offers equal investment opportunities to domestic entrepreneurs and international players. It is our responsibility to leverage emerging

⁹ Source: 12th FYP, Planning commission

opportunities and work towards shaping this ‘manufacturing vision’. Indian Manufacturing is slowly but surely sweeping back in the national economic space.

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