



Will India Match China's Manufacturing Might?

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When C. Northcote Parkinson -- economist, historian and humorist -- wrote "East and West" in 1963, the book's basic theme was that one day, India and China would combine to take on the West. At the time, the Sino-Indian war had just ended, and the book didn't make many waves. Over the past few years, however, things have changed; everyone has been talking about the powerful combination of India's expertise in software and services and China's capabilities in manufacturing. Today, there's a new twist. China has been upping its strength in the former and India has a newfound confidence in its might in the latter.

This is not confined to the IT arena. "India will emerge as a strong manufacturing base," predicts [Janat Shah](#), a professor of production and operations management at the Indian Institute of Management, Bangalore (IIMB) and founder-chairperson of its Center for Supply Chain Management. [Jagdish Sheth](#), marketing professor at Emory University's Goizueta Business School in Atlanta, adds that India will become "a second sourcing destination" for the world economy.

The numbers have already started signaling this development. In March, a new United Nations Industrial Development Organization report put India as one of the top 10 manufacturers in 2010. "India tops developing countries (China excluded) in production of textiles, chemical products, basic metals, general machinery and equipment, and electrical machinery," the report noted. In motor vehicle production, the country has overtaken Brazil and is behind only Mexico among developing countries. India's manufacturing value added has grown by over 10%, compared to 3.4% for the industrialized countries. The share of China, India and Brazil in world manufacturing output is now 32%, up from 20% a decade ago.

Examples of this manufacturing story are everywhere. In March, General Motors India announced that the company wants to become an outsourced vendor of car engines made at the newly-opened Maharashtra plant. The firm also wants to ship the parts to GM's joint ventures in China. GM India's strategy is to find customers for the excess capacity at its US\$220 million engine manufacturing plant at Talegaon near Pune. The plant can make 300,000 engines a year, but GM India doesn't need them all immediately. Last year, the company sold 110,000 Chevrolet cars in India, and expects to hit 300,000 only in 2013. "If I need to sell 300,000 engines [annually] domestically, then I need to start filling the gap," GM India president and managing director Karl Slym told business daily *Business Standard*.

Pharmaceutical company AstraZeneca sources active pharma ingredients (APIs) from India for use in its global operations, according to James Chelliah, CFO for branded generics operations at AstraZeneca India. "Over the years [sourcing from India] has been increasing year on year by around 100%," he says. "Of course, it's on a small base.... China is big for us from a market perspective. Our China business will be almost US\$1 billion this year. But from a sourcing perspective, India is ahead of China."

Through a partnership between Suzuki and Nissan, Indian subsidiary Maruti Suzuki manufactures the Pixo model compact car for sale in Europe, according to Mayank Pareek, Maruti Suzuki India's managing executive officer for marketing & sales. The Indian auto major is likely to start making vehicles for Volkswagen soon; in 2009, the German carmaker bought a 19.9% stake in Suzuki for US\$4.5 billion. "The scope of the tie-up is under discussion between Suzuki and Volkswagen," adds Pareek.

At Pfizer India, Thomas Lobo, director of global external supply, says there has been a significant increase in sourcing activity from India with an average annual growth of 35 to 50%. "We source drug formulations, APIs and drug intermediates. India is a leading country in drug product-formulation outsourcing, although we are starting to see competition from other markets, including China."

The First Awakening

The potential of Indian manufacturing was first highlighted in a 2005 Confederation of Indian Industry (CII)-McKinsey report titled, "Made in India." According to the report, "In the past, India did not tap into its manufacturing exports potential to the fullest. Going forward, however, Made in India could become the next big manufacturing exports story." Chelliah of Astra Zeneca agrees with that prediction. "India would be much better off in anything that has value-add and needs precision, because of its technical capabilities and qualified manpower," he notes.

The McKinsey report predicted that the global trend to manufacture and source products in low-cost countries is likely to gain strength over the next decade, "particularly in the skill-intensive industries where India has a significant competitive advantage. If India were to take advantage of this trend, manufacturing exports could increase from US\$40 billion in 2002 to approximately US\$300 billion by 2015, leading to a share of approximately 3.5% in world manufacturing trade."

But the report warned that in order to be successful, Indian companies needed to "adopt a global mindset to build scale and achieve cost excellence; acquire market access rapidly, including using inorganic routes such as acquisitions where required; strengthen design and innovation skills; build a global or regional operating footprint, and master the ability to manage a world-class talent pool and organization."

Indian companies are now preparing to go the extra mile. A Capgemini-IDG research report titled, "Manufacturing in 2020," found that Indian companies "claim they will lead the pack in customer collaboration in 2020, a position they already say they hold. All the responding Indian companies say they already collaborate with customers at the R&D level. This could reflect the historical lack of manufacturing in India, and a strong national desire to 'catch up.'"

India's rise in the manufacturing arena has to come at somebody's cost -- namely, China's, experts say. China has built its economic fortunes over the past three decades with large-scale, low-cost outsourced manufacturing for global markets. But economists have long predicted that China will cede its outsourced manufacturing base to other developing countries as its working-age population declines in the coming decades. The country has periodically battled threats to its status as a low-cost manufacturing hub -- a designation that has been helped by massive investments in infrastructure, education and training, and state incentives.

The China Factor

Are China's problems a passing phase? "This is not a flash in the pan," says [Marshall Meyer](#), a Wharton professor of management and sociology. "Efficient and younger-age factory workers have been in short supply." In addition, factory wages have risen around 50% in the country's southern provinces like Guangdong that lead the export juggernaut.

According to Meyer, the Chinese central bank's efforts to contain inflation by limiting liquidity aren't working as intended. "Inevitably there is leakage," he says, adding that money supply has risen 52% in the past two years. "This creates a very powerful inflationary force. One way or another, goods coming out of China will cost more ... [and business] will go where costs are lower." China's "weak spots" are in low-margin manufacturing such as garments, toys, pharmaceuticals and foods, some of which could head to Vietnam, Indonesia and Sri Lanka, he notes.

Lower costs alone will not tilt the scales, however. Many Western companies head to India for outsourcing manufactured parts and sub-assemblies because China lacks the required expertise. "We have been seeing increased activity in sourcing from India, primarily in components requiring some degree of complexity," says Ketan Chandarana, a partner at Synergy, a Bangalore-based consulting firm. Synergy advises mostly multinational firms in outsourced manufacturing. His clients prefer India also in cases that call for "sensitivity" to intellectual property rights and manufacturing in low-to-medium volumes with high degrees of variation in products.

Among Synergy's clients is a Canadian maker of high voltage electrical equipment that two years ago needed a wide variety of components but in volumes ranging from a few hundred pieces to tens of thousands. "They tried to source from China, but were not able to get the quality levels and attention to detail," Chandarana notes. The company now sources brass components from Gujarat and Karnataka.

India has traditionally had an edge in high-end manufacturing with lower volumes relative to China and design-intensiveness, according to Shah of IIMB. "India's problems are in low-end manufacturing, where wage costs play a role. Higher-end manufacturing is not that sensitive to wage costs." India will enhance its overall manufacturing competitiveness in the next five years, according to a June 2010 Deloitte study that gives China a current score of 10 in that area and 8.15 to India. Five years from now, however, the study projects India advancing to a score of 9, with China staying at 10. In addition to India and China, Korea, the U.S. and Brazil were ranked as Deloitte's top five countries in manufacturing competitiveness.

Investing in India

Global companies attracted to India's markets also realize they need to invest in local manufacturing for maximum advantage, according to [Prabhudev Konana](#), a professor of business at the McCombs School of Business in the University of Texas at Austin. "You cannot tap a growing market by being outside. You want to be inside, closer to the market." All the major global automobile manufacturers, including General Motors, Ford, Nissan and Hyundai have invested in manufacturing in India with an eye on exports to third-country markets, he adds. It also helps that the Indian market "is very similar to a lot of Asian countries and Africa.... Roads are not wide and not designed for big vehicles."

Chinese companies are not sitting quiet as their outsourcing clients get restive. "Chinese companies and the state, [which are] often hard to separate from each other, are aware of the pressures on their competitiveness, most immediately from rising wages," says [Tarun Khanna](#), a Harvard University professor and author of the 2007 book, "Billions of Entrepreneurs," which tracks entrepreneurship trends in China and India. China has responded with two "structural" solutions, Khanna adds. "The first is to encourage a 'Go West' policy to tap into the still incredibly-large labor pools available in the western part of the country, a process now underway for some time. The second is to compel foreign investors to disseminate technology to domestic companies, so that the local entities can begin to compete on non-price dimensions and move up the proverbial value chain."

Those new controls should be "serious food for thought" for multinationals entering China these days, according to Khanna. He also noted an increasing fear that foreign investors "will not be allowed to achieve critical scale in China." If MNCs get too big for comfort in China, the government could extend preferential treatment to local companies "to contain over-reliance on outside investors," Khanna says, a new approach that contrasts with China's pampering of foreign investors with tax and other incentives since seeking them out in 1980. China started phasing out incentives five years ago.

India's reluctance in earlier years to welcome foreign investments brought unintended benefits in grooming local manufacturing, according to a 2003 paper titled, "Can India Overtake China," written by Khanna and Sloan School of Business professor Yasheng Huang. They wrote that as the Chinese economy took off in the past two decades, "Few local firms have followed, leaving the country's private sector with no world-class companies to rival the big multinationals." By contrast, India "took a dim view of Indians who had gone abroad, and of foreign investment generally, and instead provided a more nurturing environment for domestic entrepreneurs. In the process, India has managed to spawn a number of companies that now compete internationally with the best that Europe and the U.S. have to offer."

A Second Sourcing Destination

Emory's Sheth offers four reasons for India becoming a second sourcing destination. For one, India's large market for everything from cars to cell phones will attract investments in capacities that will be used also to supply West Asia and Africa. Secondly, as China grows, it will "selectively divest low-end manufacturing to other parts of the world to protect its own resources." Third, by using modern manufacturing techniques to tap into its vast agricultural and industrial resources, India can lower costs and improve its competitiveness. His fourth reason: "India is becoming a strategic alliance partner with America," the world's largest market. He sees India and China sharing a common destiny along with America as partners.

Some of initiatives currently underway, including a plan to implement a uniform goods and sales tax and a direct tax code, could help boost India's manufacturing competitiveness, Shah of IIMB notes. Dedicated freight corridors along eastern and western India totaling 2,762-kilometer (1,716 miles) would increase freight movement capacity, although they are set to open no earlier than 2017. India's latest budget also allocates Rs. 500 crore (US\$110 million) for the government's National Skills Development Fund, which has a target of providing job training to 500

million people by 2022. The University of Texas' Konana would like to see that implemented with missionary zeal. "For China, it is an obsession; they are training large numbers of people with passion. One CEO told me they are teaching English in stadiums in China."

China's latest challenges do not translate into automatic wins for India, warns Khanna. "Can India benefit from this re-calibration? In a sense, yes, but probably no more than before." The primary deterrent to investment in India "will be internal to India," he notes, listing "good infrastructure" and "low-hassle processes" as the chief inducements. Investors are also wont to make politically correct noises about the need for democratic institutions and transparent processes, but they sometimes ring hollow, says Konana. "Most U.S. companies love China because it provides stability. That is where I see the hypocrisy. India is a democracy but they don't like the uncertainty [that goes with the territory]."