

# ISAS Insights

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## **Problems on the China Front: Can India be the Next Manufacturing Hub?**

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### **Introduction**

China's manufacturing reputation is in trouble. Recently, Mattel, the American toy company, is reported to have recalled more than 400,000 toy cars and 18 million toys worldwide. The China-made and -supplied toys had used lead-based paint and contained small magnets that could prove to be health hazardous and would have serious medical consequences. This was followed by the world famous British toy seller, Hamleys, taking off from its shelves two jewellery products imported from China containing potentially fatal levels of lead.

The problem of flawed toy dolls and toy cars may not have caused much damage to China's exports but they have certainly raised serious concerns not just among American corporates and consumers but in many parts of the world. Consumer confidence has suffered a severe jolt by these incidents. If we look at the crux of the matter, the issue is really about the outsourcing strategy of overdependence on China (single country strategy) and the difficulties or ineffectiveness of monitoring quality from a distance.

Whilst one Asian giant picks up the pieces of its manufacturing fall-out, attention is perhaps turned to another rising Asian giant – India. Can India fill in the shoes of its East Asian counterpart? Can it emerge as an alternative manufacturing hub?

India, for a start, is not a big player in the toy industry. However, to immediately dismiss this as a non-event from the Indian viewpoint would be a mistake. When one considers the possible alternatives of outsourcing countries for a variety of products like garments, toys, consumer durables and auto-components, India's name is, quite naturally, thrown up.

In March 2007, India's manufacture exports were valued at US\$80 billion and constituted more than 65 percent of total commodity exports. This is in the same ball park as Brazil (US\$62 billion), Thailand (\$84 billion) and Malaysia (\$89 billion, excluding re-exports) in 2005. India's manufactures export growth is remarkable – the figures stood at US\$13 billion in 1990-91 and US\$35 billion in 2000-01.

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The structure of Indian exports has also undergone significant changes when compared to a decade ago. Two key product groups that have gained prominence are engineering and electronics (US\$29 billion in 2007) and chemical goods (US\$17 billion in 2007). Here chemicals include drugs and pharmaceuticals. India's chemical products registered an annual growth of 17 percent in the last three years, consistent with the high growth of world trade in chemicals (WTO Annual Report, 2005). Automobile exports crossed the US\$2 billion in 2005-06. The automobile industry produced 1.7 million four wheelers and over eight million two and three wheelers. The auto-components industry has done even better, recording a growth rate 28 percent between 1998 and 2006. It had a turnover of US\$10 billion and exports of US\$1.8 billion last year. The Automotive Component Manufacturers' Association of India expects the auto component sector to grow at a compound annual growth rate of 31 percent between 2005 and 2014 to reach US\$40 billion.

It is also interesting to note that leading international companies have established manufacturing units in India. Similarly, domestic companies have scaled up to meet global requirements.

Tata Motors, following the success of Tata Indica, is bringing out 600cc, four door sedans that will cost a mere US\$2,500 at current exchange rates (Economist, 27 August 2007). Tata estimate that its engineering costs would be half of what they would be in Europe or the United States. Tata Indica V2, India's first indigenously-designed and manufactured passenger car, has been a phenomenal success. Hyundai India has become the global manufacturing hub of Hyundai's small car and plans to convert its India production base as the global hub for mid-sized cars. Toyota Kirloskar is outsourcing components from its Bangalore plant. Similarly, Ford has a plant in Chennai which exports completely knocked down kits and auto components. Maruti Suzuki supplies to the European markets from India. Electrical equipment leaders ABB, Siemens and Cummins have a large capacity in India. Bajaj Auto, which is also one of the largest two-wheeler manufacturers in the country, exports nearly eight percent of the total sale of its two-wheelers. Hero Honda is considered to be the world's largest manufacturer of two-wheelers.

In cotton textiles and clothing, India has the capability to be the full-package supplier with many companies completing backward and forward integration in recent years. In hardware manufacturing, Moser Baer is the world's largest producer of compact discs and other optical media storage products. LG India (mobile and other consumer durables) is expected to become the export hub for LG worldwide, catering to the West Asian and African markets. Nokia has already invested more than US\$1 billion in India. Nokia Siemens Network facility has announced a US\$100 million investment in a telecommunication equipment manufacturing. Nokia India Director, in expressing his confidence in India, said, "The Indian manufacturing facility is key to our global manufacturing system and we will make additional investment if the need arises" (Business India, 12 August 2007). The Nokia Chennai plant is reported to produce 230,000 handsets in a day. Nokia exports 50 percent of its Chennai plant output which adds up to 60 million handsets since it was set up 18 months back (The Economic Time, 24 August 2007).

### **Favourable Factors**

There is little doubt that India has been moving progressively to becoming a competing manufacturing hub to China and other developing countries. There are several reasons for India's manufacturing competitiveness:-

- a. **Cheap raw materials:** India is the lowest cost producer of steel, cement and aluminum. It exported 3.5 million tonnes of finished (carbon) steel in 2005-06.
- b. **Manufacturing quality and skills:** India's manufacturing quality and engineering skills have improved significantly over the year. Ten Indian companies have won the Deming prize for total quality management. Another 18 plants in 10 Indian companies have been recognised by the Japanese Institute of Plant management for excelling in total productive management in 2004. Tata Motors has set up two in-house engineering research centres, including India's only certified crash-test facility. The company has implemented several environmentally-sensitive technologies in manufacturing processes. A number of Indian pharmaceutical companies have received international regulatory approvals for their plants from agencies such as the United States Food and Drug Administration (USFDA), Medicines and Healthcare Products Regulatory Agency (United Kingdom) and Therapeutic Goods Administration (Australia). India has the largest number of USFDA-approved plants for generic manufacture. In hardware manufacturing, India has the potential to move up the value chain by offering design capabilities and not merely low cost facilities (for example, WeP peripherals in UPS market and D-Link in network products).
- c. **Software and service support:** India's software skills and information technology (IT) industry provide great complementary advantage in supporting the country's manufacturing growth. Engineering manufacturing services have been the fastest growing segments in the world electronics industry. Several leading players have moved to India or acquired Indian firms. Examples include Solectron, Flextronics, Jabil Circuit and Celetron. Motorola chip design had software developed in Bangalore.
- d. **Competitive labour cost:** The benefit of labour arbitrage continues to provide the basic comparative cost advantage. In the automobile sector in India, available data indicates annual wages cost to be less than US\$4,000 compared above US\$30,000-\$40,000 in the United States (the wage cost for comparable skilled worker in China is not known but it is indicated to be higher by industry managers in India).
- e. **Large domestic market advantage:** India's gross domestic product grew by nine percent in the last two (fiscal) years. India grew at six percent in the 1990s, compared to five percent in the 1980s. This large, rapidly growing market will be the key to India's manufacturing base. India's mobile market is the world fastest growing market with over 6 million new subscriber additions every month. Companies in India can leverage on this domestic market growth to attain export competitiveness through scaling up capacities. Domestic scale restrictive policies such as the reservation for small-scale industries have been largely removed and are no longer an entry barrier in many labour-intensive industries like garments, toys and sports goods.
- f. **Global supply capability:** Many India firms are building up the global supply capability model by accessing the China market for components, acquiring stake in foreign companies to facilitate marketing, servicing, and establishing local assembly and/or manufacturing units abroad (for example, TVS Motors and Bajaj in Indonesia). This is a completely new mindset of globalising Indian companies.

## **Possible Bottlenecks**

Whilst the Indian manufacturing sector holds great promise, it is perhaps a bit premature to carry the Indian manufacturing flag too high up. There are several critical areas in the manufacturing chain that could derail India's effort to becoming a manufacturing centre, let alone competing and taking over from China in this regard.

The key obstacle for India is its poor infrastructure, especially in ports and shipping facilities and power. These are important entities and India need to invest significantly in infrastructure. Equally important but perhaps less challenging is the need for India to build the reputation of the "made in India" brand label.

The dominating industry rule, whether it is toy cars or real car components, is supply chain management which ensures timely and quality supply. The supplier needs to meet the quality standards set by the buyer. India enjoys the reputation of high quality and delivery in the IT and IT-enabled industries (Business Process Outsourcing). However, it needs to set up a large number of product quality testing laboratories to meet environmental and sanitary standards required to sell in the global market. One possibility is to rapidly upgrade university laboratories by encouraging industry-government-university collaborations.

## **Conclusion**

The concerns with China-manufactured products have provided the opportunity for India as well as other developing countries to try and claim some portion of the manufacturing pie from China.

India has made significant progress in the manufacturing sector and has many factors in its favour. However, it faces several serious challenges which hamper the growth of its manufacturing sector. Nonetheless, despite these handicaps, India has been able to achieve remarkable growth in the manufacturing sector in recent years.

India has the potential and capacity to become the next manufacturing hub. If the recent incidents relating to China-made products continue to haunt consumers worldwide, and if India is able to further build its reputation in the manufacturing sector in the coming years, the world will soon be asking for Indian-manufactured products and not Chinese.

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