Make in India: An Alternative Production Base with a Huge Local Market

India is on the rise, not only as a new choice of relocating labour-intensive industries from China, but also as a retail market of good potential.

In recent years, the sustained rise in production costs on the Chinese mainland has eroded the profit margins of many Hong Kong companies with labour-intensive factories located on the Chinese mainland, prompting them to seek alternative production bases elsewhere. While Southeast Asian countries offer many choices, HKTDC Research embarked on a field trip to India recently to assess its suitability as an alternative production base. In a nutshell, India offers many advantages as an alternative production base, along with the added advantage of having a domestic market of great potential.

This article provides a broad outline of India's manufacturing landscape, beginning with an overview of labour cost, supply and quality, along with logistics performance and land costs, followed by an examination of some government initiatives and reforms. India is a Union of States with division of power between the Federal (Central) and State governments, working together or individually to enhance the FDI environment for overseas companies. This article closes by touching on the retail market as an added consideration of factory relocation to India. The evolution of the Indian retail market and recent market trends, along with the diversity of the States and their alternative production locations, will be examined in later articles.

India's Manufacturing Sector for Exports

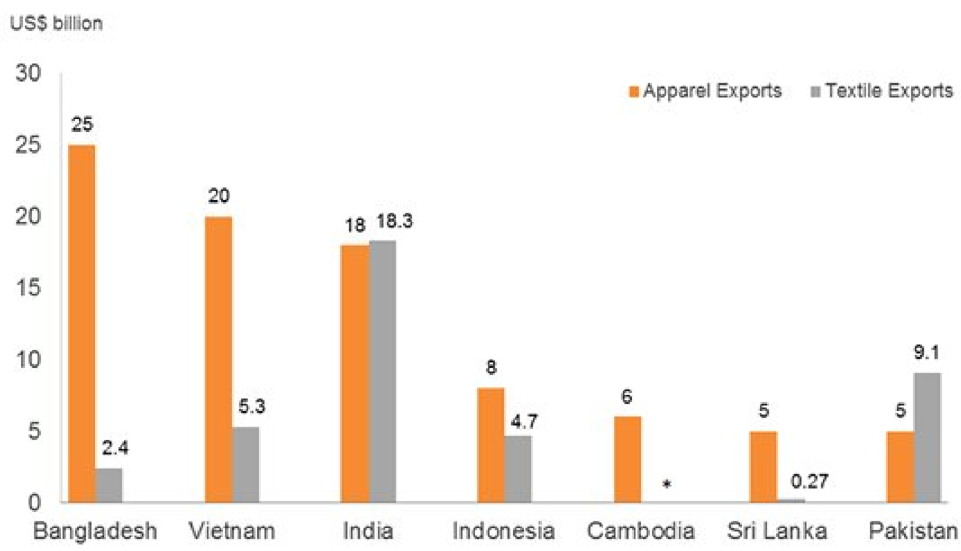
India has the third largest GDP in Asia, after China and Japan, with both heavy and light manufacturing activities spread across the country. Heavy industries, including automobile and machinery, are typically found in organised factories. This contrasts with light manufacturing, which comprises a good deal of home-based, cottage industry activity and work subcontracted from factories, as in the case of garment manufacturing.

As the world's second most populous country after China, India has a huge market appetite for manufactured consumables. However, decades of following Soviet-style economic policies skewing to state ownership, heavy industries and import substitution, prior to big bang reforms in 1991, deprived India of building a strong and efficient base for light consumable productions. This was in stark contrast with China's emergence to be the world's factory, following the footsteps of Japan and the four Asian 'tigers' in deploying export-oriented policies.

According to the World Bank, India's manufacturing sector has grown only steadily in recent years, with the GDP share of the manufacturing sector rising from 15% in 2000 to 17% in 2015. According to WTO figures, India's exports totalled US$322 billion in 2014, only 1.7% of the world's total exports. This was dwarfed by China's exports of US$2.4 trillion, which accounted for 12.7% of total world exports. In 2014 India's exports comprised many traditional light manufactures, like jewellery and garments, though high-tech manufactures, including engineering goods, were also increasing.

While China is the undisputed world leader in exporting textiles and garment products, many have overlooked India's position as the world's second biggest exporter of textile and garment products in 2014, selling a total of US$36 billion, during the year, far behind China's US$399 billion. For textile exports alone, India was second after China in 2014, with a share of 5.8% of the global market, compared to China's enormous 35.6% share. It is not surprising that the bulk of garment manufacturing in India is for the domestic market, supported by the country's huge capacity in textiles production. In the figure below, India stands out to be a substantial exporter in both garments and textiles. In 2014, India imported textiles worth only US$3.8 billion, lagging much behind Vietnam's US$12 billion, Bangladesh's US$6.8 billion, and just ahead of Cambodia's US$3 billion.

Major Apparel and Textile Exporters in Asia (excluding China) in 2014



Source: WTO
* Not Available

The field trip to India included factory visits, with garment manufacturers interviewed invariably noting that the majority of Indian garment producers were focused on the domestic market, as their product quality was generally lower than the standards required by overseas importers. Nonetheless, many big Indian exporters have successfully lined up with international buyers, including department stores, retail chains and brands. In the four years to 2014, India's garment exports increased at an average annual rate of 12%, surpassing China's 9%, in line with Bangladesh's 13% and eclipsed by Vietnam's 17%. With advantages of raw materials and prospects of vertical integration, India is a strong garment exporting country and a location worth considering for factory relocation in relation to labour-intensive manufacturing, such as garment-making.

An export-oriented garment factory

Male workers much more than females

Indian Products Subject to Relatively Low Tariffs in Key Overseas Markets

Another key consideration for factory relocation is the import tariffs levied on manufactured products originating from the country in question, and whether it has entered into any preferential trade deals that lower the import tariffs. India has been an active player in Asia, securing free trade agreements (FTAs) inside and outside the region, including engaging in an FTA talk with the EU. Taking yarn-related products as an example, import tariff rates for India range from 0% to 5%. Further, US import tariff rates for Indian yarn-related products range between 0% and 2.7%. Below is a table showing the weighted average import tariff rates of the EU and US on non-agricultural products originated from different Asian countries.

Import Tariff Rates of the EU and US (%)

	India	China	Vietnam	Sri Lanka	Bangladesh
US	2.7	2.9	8.6	12.1	15.4
EU	4.5	3.3	3.5	8.3	11.7

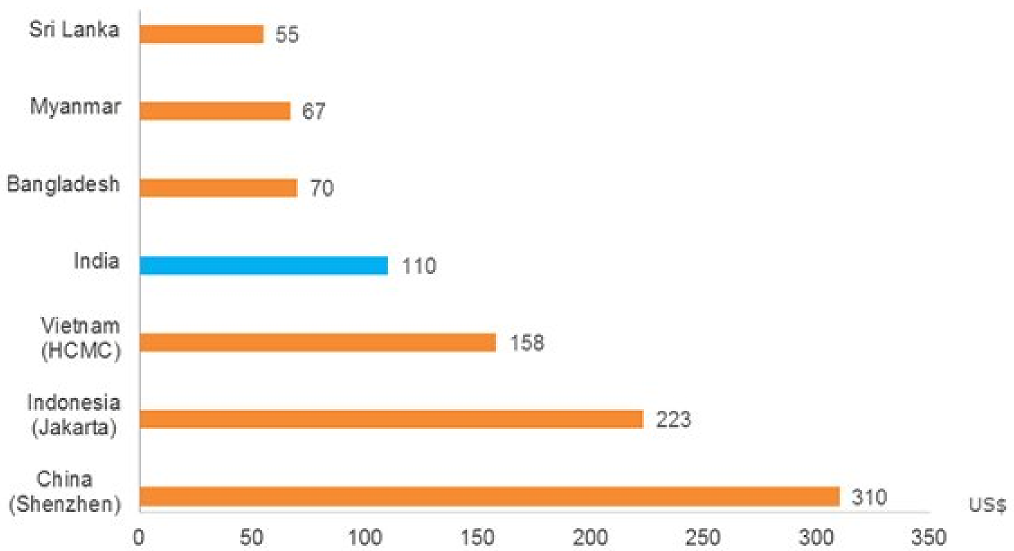
Source: WTO

Good Supply of Young, Low-cost Workers Conducive for Manufacturing in India

Export-oriented manufacturers considering factory relocation would have to pay special attention to “total landed cost”, which covers cost elements along the whole supply chain, as well as the time to delivery. Labour is one of the prime considerations, especially for Hong Kong manufacturers engaged in labour-intensive industries. While India’s population size of 1.25 billion is comparable to that of China, the Indian median age of 27 is way below China’s 37, ensuring a good supply of young workers for many years to come. As an aside, China recently announced abandonment of its one-child policy in response to the country’s ageing population, though the effect would not be appreciable over the short-to-medium term.

India’s labour cost is significantly lower than that of China. In terms of the minimum wage, unskilled workers in India’s Haryana (which is close to Delhi) and Gujarat (west coast of India) are given a monthly basic pay of about US$110 (based on respective daily wages of INR276 and INR292 (US$4.1-4.4) for 25 working days, excluding any allowance). Though these Indian wages are not particularly low compared with some countries in Southeast Asia, such as Myanmar (US$67) and Vietnam (US$107-156), they compare well with China's minimum monthly wage in Guangdong, given the line-up of US$310 (RMB2,030) in Shenzhen, US$288 (RMB1,895) in Guangzhou and US$229 (RMB1,510) in Dongguan. Further, it is noteworthy that there is not a steep climb of, or a sharp difference between, the minimum wages for unskilled, semi-skilled and skilled workers in India. An abundant supply of low-cost labour in India fulfils the basic condition for conducting labour-intensive manufacturing activities for the sake of factory relocation from Southern China.

Comparision of Monthly Minimum Wage in Selected Asian Countries



Source: Wage Indicator Foundation

India's Labour Productivity Improves as that of China Continues to Decline

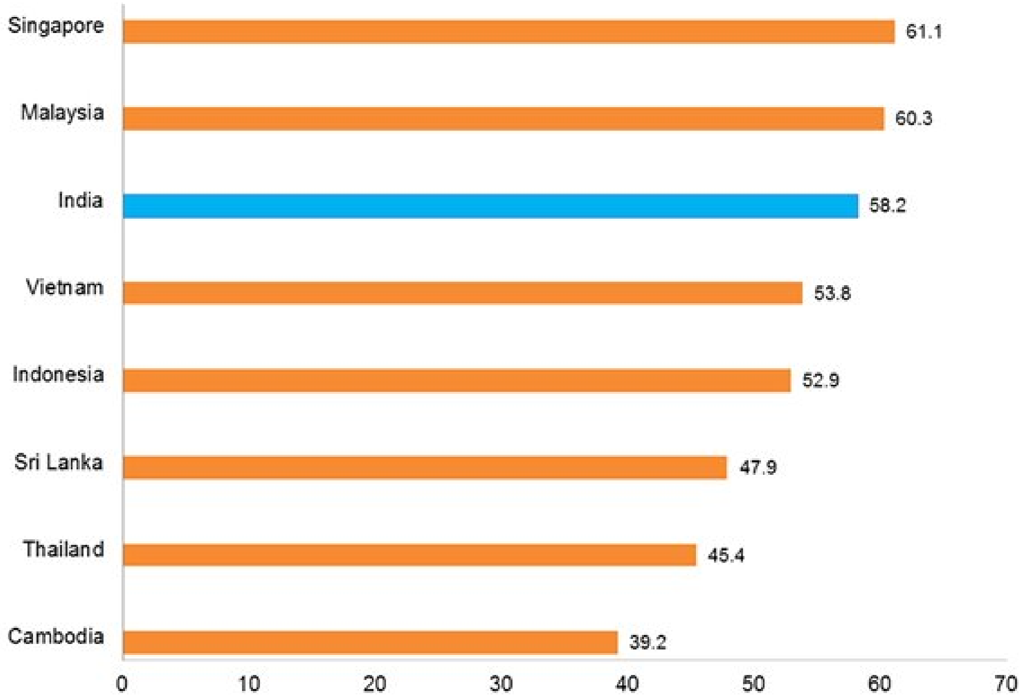
In contemplating factory relocation, labour productivity features as a key consideration. Labour productivity measures output per employed worker, which takes into account the value of the product made or service rendered. As such, developed countries making high value-added items would inevitably become more productive, as in the case of the US, Japan or Singapore.

It would be difficult to measure output per hour worked at factory level, in particular for developing countries. Therefore, output is typically measured as GDP adjusted for inflation at country level, with labour productivity then measured by GDP per worker employed. In order to measure a country's productivity trend over time and undertake cross-country comparison, labour productivity growth is used. According to the *Conference Board*, China continues to show one of the highest labour productivity growth rates in the world.

In 2014, however, India's labour productivity growth showed a significant improvement to 3.8% from 2.8%, while China's labour productivity growth continued on a longer-term slowing path to 7% compared with 7.3% in 2013, and an average of 9.5% from 2007-2012. The *Conference Board* noted that India needs to commit to structural reforms to realise its full productivity potential, improving labour market flexibility and further opening up the economy to FDI, which are being pursued by the Modi government, as discussed in the section below.

In comparison with other low-cost alternative production bases in Southeast Asia, like Myanmar and Vietnam, India has an added advantage in terms of language. A British colony for a long time, India declared English to be one of the official languages shortly after its independence in 1947, and is now widely spoken across India. Most Indian workers have no difficulty of communicating in English. According to the 2015 EF English Proficiency Index, India ranked third in Asia after Singapore and Malaysia, and was the only country in South Asia commanding "High English Proficiency".

High English Proficiency in India



Source: EF English Proficiency Index 2015

India's Logistics Performance Fares Well among Asia's Production Bases

With a coastline of 7,517 km, India has 12 major ports, about 200 intermediate ports and some 170 dry ports spread all over the country. Jawaharlal Nehru Port, located east of Mumbai, is the largest container port in India, handling 4.47 million TEU in the fiscal year ending March 2015, second in South Asia after the Port of Colombo in Sri Lanka.

Like Sri Lanka, which sits on the Indian Ocean trade route as a major transhipment hub in South Asia, India also benefits from its geographical location in its trade with Europe compared with China and many Southeast Asian countries, such as Vietnam. The table below canvasses the shipping days for shipping goods from various Asian locations to major European ports.

Average Shipping Days from Asian Ports to European Ports

	Mumbai, India	Chennai, India	Colombo, Sri Lanka	Chittagong, Bangladesh	Shanghai, China
Hamburg, Germany	27	24	18	25	31
Rotterdam, Holland	27	23	17	25	29
Antwerp, Belgium	23	35	20	35	30

Source: Maersk Line

Aside from its geographical advantage in trading with Europe, and an abundant supply of young and low-cost workers, India is also the top logistics performer in South Asia, also faring well compared with other alternative production bases in the region. According to World Bank's Logistics Performance Index 2014, India scored the highest among South Asian countries. It led Sri Lanka and was only marginally behind Vietnam, the latter of which is a hot spot in attracting FDI from Japan and South Korea in recent years. Nonetheless, the *World Bank* also found that India's export cost was high relative to the other manufacturing hubs in Asia, also shown in the table below.

Logistics Performance and Cost to Export in Selected Asian Countries

	India	Bangladesh	Sri Lanka	Vietnam	China
Logistics Performance Index 2014 *	**3.08**	2.56	2.7	3.15	3.53
Cost to Export in 2014 (US$ per container)	**1,332**	1,281	560	610	823

Source: World Bank
* Overall index, 1=low and 5=high

The field trip in India covered many special economic zones (SEZs), industrial estates and ports. India has a highway system that is being upgraded by the Federal and State governments. Highways are multi-lane and well paved, with not much congestion on most parts, until coming closer to the cities and industrial estates. Within the industrial parks, roads are wide enough for large or container trucks to move in and out, and the conditions are generally good.

In comparison, the traffic conditions in the cities would vary considerably with the precise locations within the city, with some places becoming congested and sometimes very disorganised. For example, visits to some wholesale markets in Delhi found that roads were overcrowded by pedestrians, motor tricycles, cars and vans. The last-mile delivery of finished goods to these locations would be a constant challenge due to the poor road conditions.

Congested traffic in Delhi's urban areas

Roads outside Jawaharlal Nehru Port

Industrial Parks are an Easier Route to Factory Relocation in India

Indian laws and regulations are widely lamented for being complex, and many of them are arcane, with updates and amendments badly needed. They include laws concerning land acquisition, especially acquisition from private owners like farmers. Land acquisition can be very a complicated issue due to certain existing restrictions applying to foreigners, whether or not they are residents or non-residents in India, not to mention the complicated application procedures and long approval process. For example, a foreign national resident in India who is a citizen of China or Sri Lanka would require, among other things, prior approval of the Reserve Bank of India (RBI) in relation to the purchase of immovable assets like land and properties.

In comparison, relocating factories to industrial parks scattered in various Indian States will prove less cumbersome. First of all, land acquisition and utilities connection are mostly dealt with by the State or local governments. It should be noted that India has become a lot more FDI-friendly for overseas factory relocation in recent years. In the event of factory relocation to India, Hong Kong manufacturers, the majority of whom are small-and-medium enterprises (SMEs), are advised to establish their factories in industrial parks, where centralised land allotments and well-connected utility systems are provided, i.e. availability of plug-and-play options. The allotment price of land varies with the location of the industrial parks and other factors, including the FDI size. More details on industrial parks of Indian States will be taken up in subsequent articles.

Make in India Initiative to Hasten India's Manufacturing Transformation

With half of its employment in the agricultural sector, India relies heavily on the import of light manufactured consumables. In order to reduce the reliance on import and create more jobs in higher value-added sectors, the Modi government launched the "Make in India Initiative" (MIII) in September 2014. This is one among many important policy initiatives that the Modi government has introduced after taking the office in May 2014.

The MIII aims at transforming India into a global manufacturing hub by encouraging foreign manufacturers to set up their production bases in India on the one hand, and domestic manufacturers to increase their production scale on the other. Under the MIII, the government of India has implemented a number of business-friendly policies to encourage FDI. For instance, more sectors in India are open for FDI, with simplified government approval process. Specific investment incentives are provided for selected industries, for example the Modified-Special Incentive Package Scheme (M-SIPS) for the electronics sector[1]. Tax incentives are also given to exporters[2].

The Modi government, along with State governments, has been active in promoting the MIII and India as a preferred location for factory relocation, with early harvests reported. For example, Japanese trading company, Toyota Tsusho, has acquired about 200,000 sqm of land in the Mandal Industrial Park in Ahmedabad, Gujarat. After meeting Prime Minister Modi in June 2015, China's Dalian Wanda Group unveiled its interest in building several industrial townships and shopping malls in India, investing as much as US$10 billion over the next decade. This was followed by Foxconn's move in August 2015, signing an MOU with Maharashtra to invest US$5 billion over five years in a new manufacturing facility in the State, with the EMS company indicating that it intends to set up 10-12 plants and employ a million workers in India by 2020.

Other government policies aimed at creating a more favourable business environment include the introduction of a unified Goods and Service Tax (GST) expected in April 2016, replacing the existing multiple tax structures of Central and State taxes. Also, attempts have been made to merge and reform a host of labour regulations to streamline the hire-and-fire processes, as well as reducing the costs for business owners.

India's Business Environment Seen as Making Rapid Improvement

Implementing any nationwide reform is never an easy task for a country the size and population of India. It involves negotiations between different stakeholders, such as Central and State governments, business owners, developers and land owners, such as farmers, along with possibly protracted parliamentary and legislative processes. While acknowledging the huge difference that the Modi government is making in comparison with the previous regime, Indian business leaders in various sectors interviewed during our field trip noted of the difficulty of implementing all those policy initiatives within a short period of time, including in particular labour market reforms.

Nonetheless, India has been making progress regarding its business environment based on external ratings. The World Bank's 2016 Ease of Doing Business Survey (EODB) ranked India 130 out of 189, a sizeable leap from 142 in the 2015 EODB survey, with biggest improvements in starting business and getting electricity. Nonetheless, India still needs to further improve its business environment in order to catch up with other Southeast Asian competitors in overseas factory relocation, such as Vietnam (90) and Indonesia (109).

Ease of Doing Business 2016

Country	Rank (out of 189)
China	84
Vietnam	90
Sri Lanka	107
Indonesia	109
India	130
Myanmar	167
Bangladesh	174

Source: World Bank

India is not just an Alternative Production Base but also a Potential Market

With the world's second largest population, India has a huge consumer base with increasing discretionary spending amid robust economic growth. India's retail market, currently estimated at about US$600 billion, is projected to grow at an average annual growth rate of 12% to reach US$1,000 billion by 2020.

The Indian retail market is currently dominated by unorganised trade[3], accounting some 90% of the whole retail market. Yet, the retail landscape is fast evolving, with organised retail expected to keep expanding alongside the surge of Indian middle-class consumers, who are more willing and able to spend for better quality goods and services, and tend to develop stronger brand loyalty. This should be welcome to Hong Kong companies who have plans to explore the Indian retail market, while also considering the option of relocating factories to the country.

In recent years, more and more multinational manufacturers have relocated their production bases in India, not only taking the advantage of a low-cost production base, but also for the strong domestic market. One of the recent examples is *Abbott*, a US-based health care manufacturer, which established its production lines in India and employed 14,000 workers. In 2014, it generated total sales of US$1.09 billion in India by providing customised products for its Indian consumers.

Unorganised trade in India

Modern shopping malls with international brands are popular in India

India Deserves Close Examination for its Production and Market Potential

The preceding sections provide a quick sketch of the basic factors underpinning the suitability of India as an alternative production base for Hong Kong manufacturers. Nevertheless, more in-depth examination is naturally warranted given the country’s diversity along with its improving, yet challenging business environment. Interviews with Indian manufacturers almost unanimously pointed out the added benefit of India being a relatively low-cost production base as well as a billion-strong consumer market for overseas companies, a duality that may not find an easy parallel in any single country in Asia.

However, one should not overlook the challenges of tapping into India’s retail market, in light of the ethnic and consumer group diversity, even though it may well present a promising market for many years to come. For instance, consumers in major Indian cities are more willing to try new products, while consumers in the rural areas tend to be more conservative. All these consumer and retail features will be examined in forthcoming articles, along with relocation choices in India.

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[1] Under the Modified-Special Incentive Package Scheme (M-SIPS), subsidies on capital expenditure and reimbursement of central tax will be provided for companies considering expanding or investing in the Electronic System Design and Manufacturing (ESDM) sector.

[2] Tax incentives include the duty credit scrip, which is a pass that allows the holder to import raw materials without paying a certain amount of import duties.

[3] Unorganised trade: trading activities are mostly run by individuals or hawkers, and some of them may not have proper registration with the government.

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