# Manufactured Exports: A Small but Powerful Tailwind

Manufactured exports are one of India's growth tailwinds till India's services sector re-orients itself to transforming global markets and brings forth its inherent buoyancy

India's tryst with manufacturing as a desired driver of growth continues. Manufacturing's ability to create jobs is significantly higher than services, first on account of a higher ripple effect and to a lesser, but no less important, degree, of an easier matching of skill sets of those coming into labour pools compared to the more 'white collar' jobs available in the services sectors. In the more immediate term, manufacturing in specific and industry at large (31 per cent of the economy) will need to make a bigger dent next year if we are to move beyond the 7 per cent GDP growth paradigm.

By the end of 2017-18 less than a month on, industry as a sector will have grown in the 5.5-6 per cent range for 2 years running, with manufacturing (just under 2/3rd the total) in the 7 per cent+ range. At first glance, this appears lower than the 10 per cent+ heydays, but a closer look reveals tailwinds that should, in the coming year, give a higher fillip to overall growth.

One of these is India's manufactured exports, where gently accelerating growth is palpable, even if still anecdotal in sector after sector. Some of India's more established medium to large enterprises are expanding capacities (many of IMA's Forum members hail from here), and so are much smaller firms that are going up the 'quality' curve in response to global customer expectations. This is first on account of an expanding global

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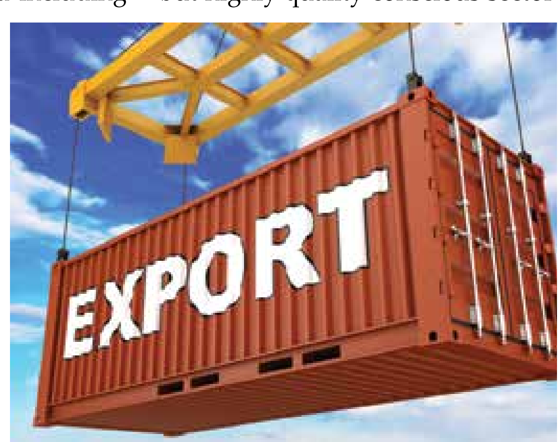
economy. Sectors like specialty chemicals on one hand and glass on the other for example, are all seeing rising demand, most of all in Europe as it returns to growth, but also in other parts of the world including Latin America (Brazil too seems to be righting itself) and of course, the US.

The second fillip is the fact of a changing China. As it vacates sectors that it considers no longer strategic or those where polluting industries closer to business regions like Shanghai are being shut down, opportunities are opening up for every competing economy. The fact of China's ability to counterfeit (especially high end) goods and its weaker IP regime is another related fillip. Net: net, Indian businesses particularly in sectors like specialty chemicals are gaining. Clearly, India may lose this piece of the global pie in sectors like textiles where both value and cost arbitrage are higher in countries like Vietnam and Bangladesh. High technology sectors that require skilled engineering or chemistry are, however, a sweet spot that Indian firms are capitalising on. Global MNC need to diversify away from China is a continued positive context.

The other source of growth is on account of rising competitiveness across sectors in India. Piramal Glass for example, competes with European suppliers of high-end glass bottles to the world's perfumeries industry that is led by France. Slowly, this high margin, but highly quality conscious sector



is expanding its supplier base for products new and old, many times at the cost of European suppliers with whom leading luxury brands like Louis Vuitton, Coty and Puig go back generations. China is not an option – counterfeit Dior perfumes would probably make their way into the world market sooner than later. The Piramal Group company made the conscious effort away from pharma to this sector over the last twenty years and is now in a position to drive supply in a phase of rising luxury demand. And rising it once again is.

The specialty chemicals sector is also likely to be a key sector of quantum growth in the coming 12-18 months. Every player in the segment speaks of expanding capacity as global majors like Bayer and Lanxess ramp up in India or requisition supply from Indian players. Firms like UPL and SRF, who play both directly in export markets and indirectly through foreign majors, are also expanding capacity on rising orders. New capacities – not significant enough to count yet in the bigger riptide – are being built also by smaller firms with turnover under Rs 100 crore as they respond to global opportunity with greater process, better marketing and new technology. The ripple effect on capital equipment is clear – players in that related key sector speak of a boom not seen in the last twenty years. Too early perhaps to quantify, but categorical.

Is there a flip side? Yes. As players ramp up, fears of expanded capacity in a still-volatile world concern boards and operational teams. Contract manufacturing is therefore rising as a way to diversify risk.

At the other end of the risk spectrum is the continued volatility in key inputs like energy. Oil prices have risen steadily – all the way up to USD 70/barrel before falling to USD 65, but still way above predictions of USD 50 factored into near and medium term business plans. Currency volatility is also a spoiler.

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Even as orders in manufacturing are sticky and tend to be resistant to change (the long confirmation process itself has something to do with it), margins are impacted by currency fluctuations. Most Indian firms had taken depreciation (3-4 per cent pa) for granted. By those calculations, the INR should have crossed 70 for a business plan (and related contracts) made 2 years ago. As things stand, it has appreciated to 64. You can take forward bookings, as most have, but it does not make business easier or anything beyond the most immediate term at all certain. With most contracts in USD or Euro, the global (largely Western) customer is only concerned with competitive pricing. Sectors with traditionally higher margins (playing in luxury or very specialised sectors) can take this hit easier than those with slimmer margins and the need to still prove viable sustainability. Increasingly then, as India's exposure to world markets increases, the capability to run rigorous risk assessments by Indian firms that enable optimal capacity creation on one hand and robust contractual planning on pricing at another will be the need of the hour. Gaining the confidence – and capability - to win long-term contracts from customers is also critical to success.

India's labour environment also poses a challenge. Most Chief Executives will admit that managerial workforces are the easier fish to tackle given the relative ease with which a slow growth environment can be explained. The challenge is for contract workers, where rising minimum wages – a clear necessity in principle to create greater parity across workforces – are forcing a rethink on business plans and profitability. The other is in the engagement with unionised workforces. Whilst that may lend predictability (most agreements remain in the 3 year range, if not 5), the fact is that a 13-14 per cent agreed increase takes wages cost on a consistently upward trajectory. The response by firms is a focus on productivity. In manufacturing, that translates to machine learning, digitalisation, automation and robotics. Firms are reducing workforce strength – anecdotes place reduction in the last two years, despite rising orders, in the 10-15 per cent range already – and expanding capacities in robotics (if not for current plants then certainly so for planned expansions). India's start-up eco system is throwing up innovation that the most alert are beginning to hone in on, and engaging either through joint ventures, or funding, or acquisition. This may well be an early red flag for linear employment generation, but a welcome sign of rising competitive capability.

Manufactured exports then are one of India's growth tailwinds. Till India's services sector re-orients itself to transforming global markets and brings forth its inherent buoyancy once again, these may well hold the fort. ■

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