Global supply chain reconfiguration: the India opportunity

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(5 min read)

Global supply chains are undergoing a radical reconfiguration, against the backdrop of the COVID-19 pandemic, rising economic nationalism across the world, and significant geopolitical shifts.

The pandemic has highlighted the risks a single-source supply chain carries, as companies across the world have faced disruptions to the flow of materials from China, the initial epicentre of the pandemic. Geopolitical and trade tensions between the U.S. and China have also simmered in recent months, turbocharging the push to diversify supply chains[1].

As multinational companies seek to relocate their global supply chains, emerging economies— including Thailand, Vietnam, Malaysia, Indonesia, Philippines and India—are increasingly seen as attractive sourcing destinations.

Scale, skills and space: India's strengths as a supply chain alternative

As a stable economy with a host of enabling factors for attracting investments, India emerges as a natural choice in filling the supply chain vacuum left by the exodus from China.

The strength of India's case lies in its diverse business landscape, skilled workforce, and domestic market of 1.3 billion people with growing disposable incomes. Labour costs are also relatively low-- monthly minimum wages in India are INR5340 (or USD73)[2], versus USD320 in China[3], USD132 in Vietnam[4], and USD127 in Indonesia[5]. India has the fifth largest gross domestic product (GDP) by World Bank estimates and is ranked ninth in the list of global FDI recipients in 2019[6]. A young populace, a wide base of English speakers, robust macroeconomic indicators, massive consumption levels, and a politically stable government dedicated to fast-tracking reforms, are among the other factors that can be considered in India's favour.

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[1] Trump administration pushing to rip global supply chains from China: officials, Reuters News, May 4, 2020

[2] Minimum wage hike may be deferred this year, The Economic Times, May 25, 2020

[3] International Labour Organisation data, accessed on 30 September 2020

[4] Minimum wage set to increase by 5.5% in 2020: National Wage Council, Vietnam News, July 12, 2019

[5] International Labour Organisation data, accessed on 30 September 2020

[6] World Investment Report 2020, United Nations Conference on Trade and Development, accessed on September 17, 2020

Further, India has been liberalising its foreign direct investment (FDI) policy in recent years; and now has a 100 per cent FDI allowance in greenfield projects and 74 per cent in brownfield projects under the automatic route[7].

Among India's states, Tamil Nadu, Gujarat, Andhra Pradesh and Odisha offer advantages, with dedicated regions spreading over 250 sq. km. for manufacturing facilities and logistics support, as well as various export-, state-, and area-based incentives to promote investments in specific regions.

The key challenges

While India offers global investors a large and attractive market, a sizeable demographic advantage and a vibrant private sector, there are a few obstacles that need to be addressed if the country is to realise its immense potential as a global manufacturing hub. Two of the most well cited impediments are poor infrastructure and stifling bureaucracy.

There's broad agreement that infrastructure development is key to lifting India out of its worst economic crisis since independence. Infrastructure spending has, therefore, received a great deal of attention from the government, which last December created the National Infrastructure Pipeline (NIP) that envisages about USD1.6 trillion (INR111 lakh crore) of infrastructure spending over the next five years, with the sweeping objectives of improving productivity, ease of living, economic growth and employment.

Complex government regulations and red tape can also be critical challenges and there can be a lot of variance in central and state government jurisdictions. Manufacturing operations, for instance, apply under state jurisdictions. India is making progress towards addressing some of these challenges, with central and state governments increasingly aligned and dedicated towards the twin-targets of improving the ease of doing business and transforming India into a global manufacturing hub.

Businesses that are looking to reconstitute their global production networks will require substantial due diligence in evaluating the suitability of specific geographies for their respective set ups. The availability of raw material, land and labour, are among the factors that they will need to carefully assess.

Sectoral advantages

Given India's inherent strengths and weaknesses, specific industries in India are relatively better positioned than others to emerge as attractive and viable alternative locations in the global supply chain rebalancing efforts. India could offer significant advantages in the following sectors to businesses that are seeking to diversify supply chains.

Lifesciences and Pharmaceuticals: potential to emerge as the world's pharmacy

The Indian pharmaceutical industry is the world's third largest in terms of volume and thirteen largest in terms of value. The impact transcends the value chain, with Indian pharmaceutical companies leading in APIs as well as formulations. India's API industry is ranked the third largest in the world, and the country contributes approximately 57 per cent of APIs to the WHO's pre-qualified list[8].

[7] Invest India website accessed 29 September 2020

[8] Indian API Industry – Reaching the full potential, KPMG in India and CII report, 7 July 2020

It also caters to 62 per cent of the global vaccine supply and is the largest supplier of generic drugs to the global manufacturing industry. Supported by a growing pharma industry, India has a large, growing trained and skilled workforce to support large-scale pharmaceutical manufacturing projects. It also has the ability to manufacture high-quality medicines at competitive prices, with approximately 33 per cent lower manufacturing cost than that of the U.S. and half of that in Europe[9].

Chemicals: a catalyst of manufacturing growth

India's chemical industry is expected to clock a compound annual growth rate (CAGR) of 7 to 8 per cent[10] to reach USD160 billion by 2025 and account for 3-3.5 per cent of the global chemical industry according to KPMG in India's analysis. India has showcased continuous growth and outperformed the global industry in the past decade, driven by strong domestic demand, export competitiveness and an enabling ecosystem. India is seen as a reliable source for chemicals, with increased exports to the EU and the US on the back of rising competitiveness of domestic production, investments in R&D and protection from cheap imports. India has also witnessed manufacturing growth driven by usage in construction, automotive, F&B and consumer products.

Automobile: stepping on the gas

Auto-components segment in India is estimated at USD48 bn and is expected to motor along at a CAGR of 27 per cent[11] in years to come. The Automotive Mission Plan 2016-26 targets 3X growth for automotive industry and establishes India as a manufacturing base and an export hub. The plan also seeks to outline the trajectory of advancement of the auto-ancillary ecosystem in India. Central and state governments have introduced multiple policies and financial incentives to drive the growth in the auto-components segment. India is well positioned to be an alternative source of supply to the global auto-components industry with 100 per cent FDI, cost advantages and incentives.

Telecom: an attractive hub for handset and component manufacturers

India is poised to become one of the world's largest connected economies owing to a huge strategic ecosystem of digital consumers, the internet and smartphones. India is home to the second largest digital citizenry in the world, after China, with a reported 673 million internet users[12], and is also the second largest global market for smartphones[13]. Given these intrinsic advantages, India is emerging as a destination of choice for smartphone manufacturers across the globe. The government has rolled out various policies and incentives to drive the manufacturing of electronic components and launched production-linked incentive schemes to drive investments in the sector.

The way forward

While India has many of the ingredients to emerge as the preferred market for global investments and manufacturing, it is critical that the government maintains both the pace as well as scalability of reforms, while strengthening infrastructure growth.

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[9] Invest India website accessed on 30 September 2020
[10] KPMG in India analysis based on primary and secondary research
[11] Invest India website accessed on 30 September 2020
[12] TRAI data accessed in August 2020
[13] Live Mint, 7 February 2020

Regulatory and investment reforms will need to integrate progressive policy changes in land, incentives and infrastructure, with foreign investment norms and tax regimes. India also needs a more aggressive approach in reaching out to global companies to expand their business footprint in the country.

As China is expected to remain one of the most popular destinations for FDI, even with the ongoing geo-political rebalancing, the most realistic strategy for supply chain realignment is a 'China Plus One'[14] approach. This also allows for a non-linear consideration of global trade and a de-risking of supply chains.

There would, therefore, likely be a shift in focus from efficiency and lowest cost drivers, to a value framework that assigns greater weight to risk exposure, supply alternatives, tax considerations, and channel complexity.
In the quest for safer harbour in supply chain configurations and selection of manufacturing locations, three factors will ultimately play a pivotal role: 1) long-term geopolitical stability; 2) supportive policies, taxation and regulations; or 3) availability of land and logistics infrastructure.

[14] Supply chains: Specialisation, stronger leaders and self-sufficiency, HSBC Global Research, 27 April 2020