

# MANUFACTURING IN INDIA: A RESURGENCE

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India's manufacturing sector has emerged as a vital pillar of the country's economic growth and development. With a focus on encouraging domestic production and increasing exports, India is striving to harness its potential across the four factors of production:



LAND



LABOUR

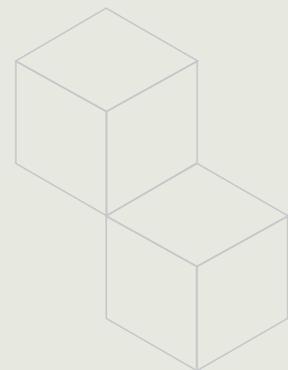


CAPITAL

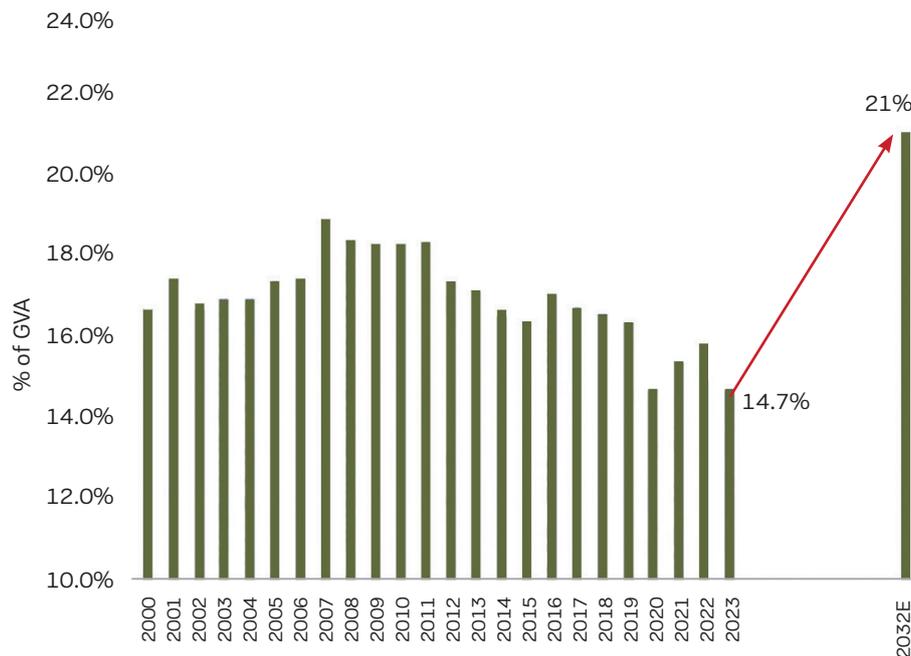


ENTREPRENEURSHIP

India targets to increase its share of manufacturing from 15-16% of GVA (Gross Value Added) to 20% and further to 25%. However, several challenges must be addressed to further bolster the manufacturing landscape. We delve into India's manufacturing outlook, examining its efforts to foster domestic manufacturing, expand exports, and overcome the hurdles it faces.



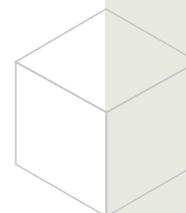
## India targets to increase share of manufacturing in GVA

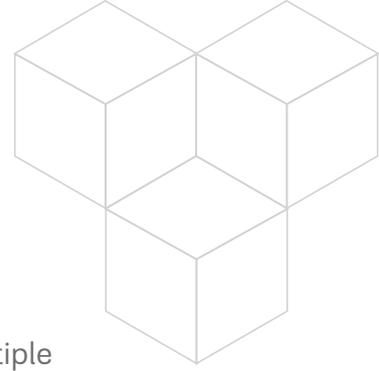


Source: Morgan Stanley

## What will lead to a resurgence in manufacturing?

We believe India’s growth can be fired by a double engine i.e., led by services and manufacturing. India is already a significant player in global services. However, it is now focussing on growing its share of manufacturing. India targets to grow its domestic manufacturing through reforms while providing incentives to grow exports. As global supply chains realign post-pandemic and Russia-Ukraine conflict, India stands to benefit given its strong manufacturing base. India is advantaged to have a strong domestic demand base, which makes it a viable destination for foreign companies to set up manufacturing plants, which can also be reoriented to meet global demand.





## Some initiatives of the government that help increase domestic manufacturing:

The government has undertaken initiatives to drive manufacturing across multiple sectors which will have a long-term impact on developing manufacturing and engineering capabilities in India.

a) **Reforms in the Defence sector:** 75% of the defence budget has been earmarked for domestic companies leading to procurement of Rs. 1.1 trillion. This should lead to higher localisation and the development of the supply chain as the government has also notified 400+ items that cannot be imported beyond FY26-27.

b) **Railway capex:** In the past 12 months Ministry of Railways (MoR) has placed orders for 1200 x 9000 HP Electric Locomotives and 300 Vande Bharat Trainsets totalling Rs. 1.1 trillion to the private sector. Further orders for locomotives, trains and signalling systems are expected over the next 1-2 years with an opportunity of >Rs. 1 trillion. This should lead to increased localisation of propulsion and signalling technologies.

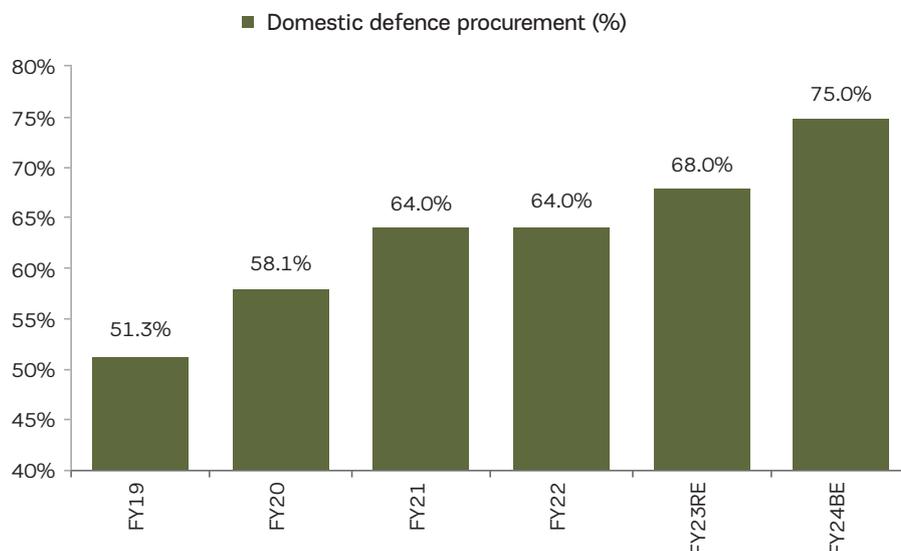
c) **Renewables:** India targets 500GW of renewable capacity by 2030 from the current 172GW (as of March 2023), this would imply ~46GW of annual capacity addition over the next seven years. Currently, Solar Power Projects mainly rely on the import of solar modules but going forward capacities to meet local demand are expected to be set up in India.

d) **Government mandates:** Government mandates such as EBP-20, restriction on imports of drones (certain categories), large irrigation and water distribution schemes and push to localise the power equipment value chain are also leading to increased demand for capital goods.



In the past 12 months Ministry of Railways (MoR) has placed orders for for **1200 x 9000HP Electric Locomotives and 300 Vande Bharat Trainsets** totalling Rs. 1.1 trillion to the private sector

### Allocation of the defence budget towards domestic companies has increased



Source: The Press Information Bureau (PIB)

## Railway contracts awarded to private sector in the past 12 months:

Projects	Value (Rs. billion)
90000 Wagons	232
9000 HP Electric Locos	255
80000 Wheel Sets	122
200 Vande Bharat Trainsets	768
100 Distributed Power Vande Bharat Trainsets	300
<b>Total</b>	<b>1,677</b>

Source: ABSLAMC Research



## PLI shows early promise

In the past four years, the government has announced production linked incentive (PLI) schemes for fifteen sectors with a total outlay of USD 33 billion. These schemes will enable domestic capacity creation and localisation for many technologies to make India self-dependent. These incentives will spur capacity

expansions that will not only be oriented to meet local demand but also drive exports. The scheme has shown initial success in Electronics manufacturing, and it should help develop capabilities for many other segments such as medical devices, drones, solar power equipment and white goods.

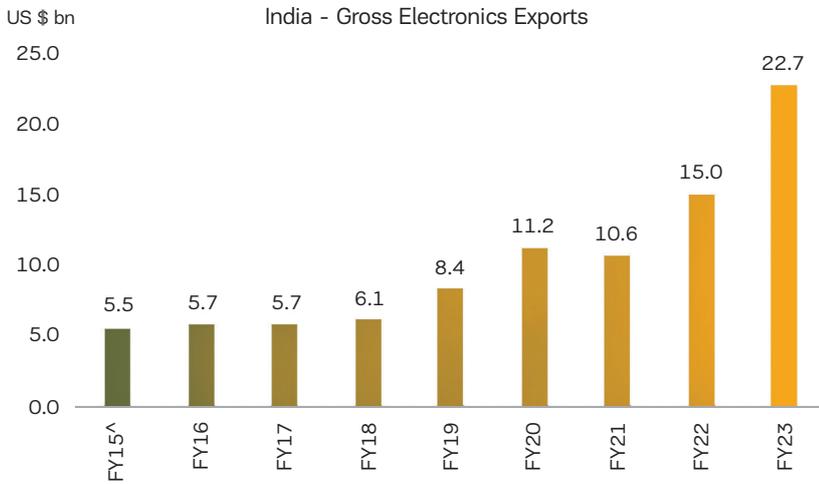
### 15 sectors have announced USD 33 billion PLIs to encourage domestic manufacturing capacities

Sectors	Incentive (\$ bn)
1. Advanced Chemistry Cell (ACC) Battery	2.3
2. Automobiles and Auto Components	3.2
3. High Efficiency Solar PV Modules	3.0
4. Large scale Electronics & Components	4.8
5. IT Hardware	0.9
6. Telecom & Networking Products	1.5
7. White Goods (ACs and LED)	0.8
8. Drug Intermediaries & API	0.9
9. Medical devices	0.4
10. Speciality Steel	0.8
11. Pharmaceuticals drugs	1.9
12. Textile	1.3
13. Food Products	1.4
14. Semiconductors	9.5
15. Drones	0.0
<b>Total</b>	<b>32.7</b>

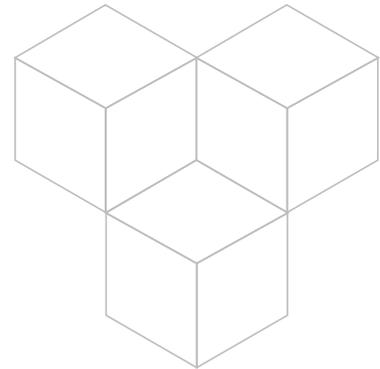
Source: Goldman Sachs



**Impact of PLI has been most visible on exports of Electronics**



Source: CEIC, Axis Capital <sup>^</sup> May 2014-March 2015

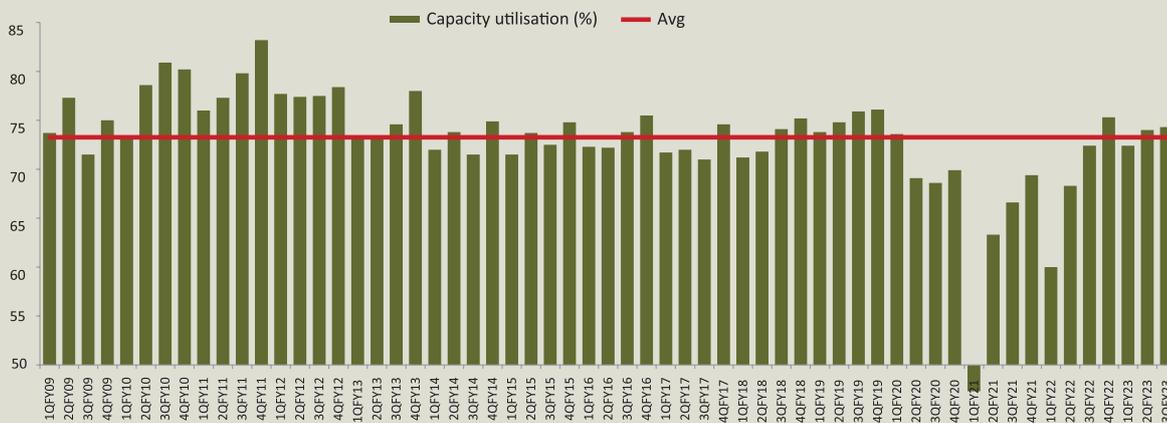


**Revival in private sector capex**

We believe efforts of the government to spur capex and localisation will also lead to an increase in private sector investments. Private sector capex had remained range bound between 2011-2022 and has seen a revival in 2022-23. We expect sectors such as Renewables, Steel, Cement, Chemicals and Real

Estate to be in focus. Progressively investments in new energy and chemical segments such as Green Hydrogen and Ammonia likely to pick up. We believe this will lead to increased manufacturing activity and capacity building in the private sector beyond sectors that are investing to meet PLI guidelines.

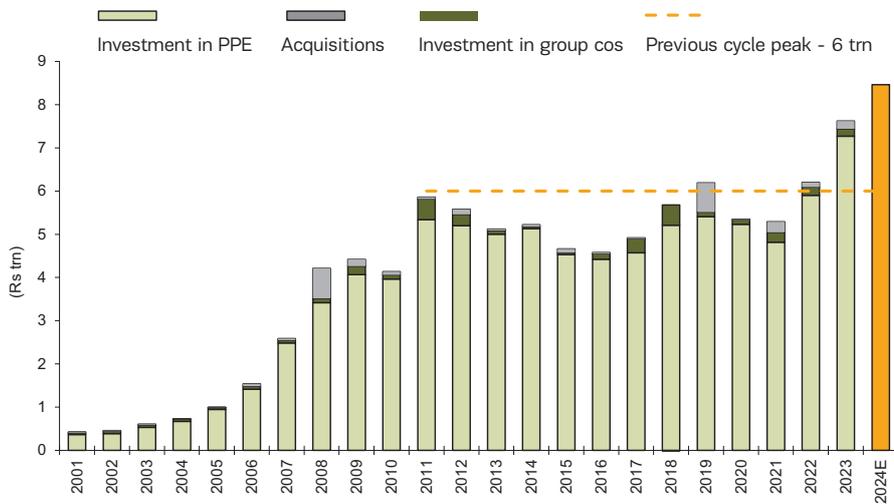
**Industry wide capacity utilisation levels are moving above long term averages and should trigger new investments**



Source: RBI, ABSLAMC Research



### Capex by listed corporates has seen a meaningful increase in FY23



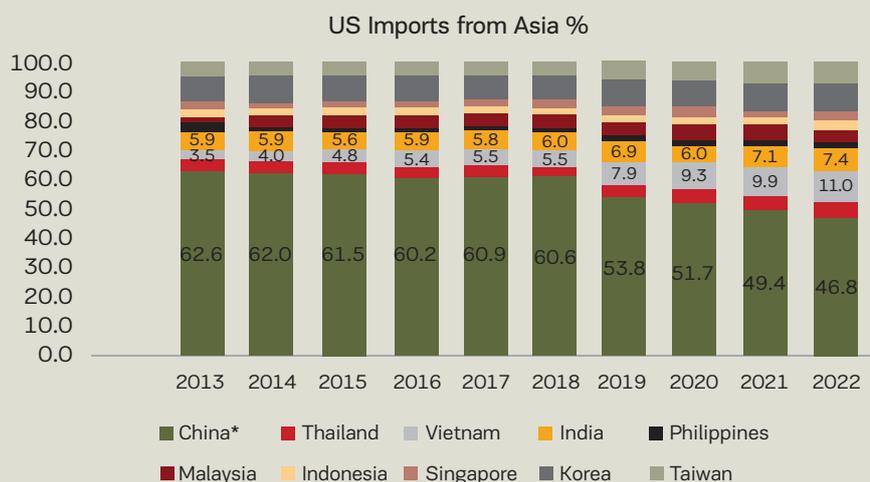
Source: ICICI Securities, Capitalline

### India's share in global exports has turned around...



Source: Axis Capital, CEIC

### ...as India further integrated into global supply chains



Source: JP Morgan, WITS

## India has a role to play in reorientation of global supply chains

In the past decade India has gained from global companies reimagining their sourcing strategies. As we have seen with specialty chemicals and electronics. India does have an advantage over other Southeast Asian countries with its large workforce and competitive wage rates. We believe India will have an important role to play in global supply chains, albeit slightly disadvantaged on source materials (read semiconductor chipsets and materials for Li-ion batteries) but given the strong potent domestic market, it will lead to localisation of many of these capabilities over the next few years.



## Brass tacks: Reforming factors of production

In the past few years, the government has tried to reform all four key factors of production.

**Land:** India boasts ample availability of land, enabling the establishment of industrial clusters, special economic zones, and manufacturing hubs. However, effective land management practices and sustainable land use policies are imperative to balance industrial expansion with environmental concerns.

**Labour:** India's vast labour force is an asset, providing a skilled and semi-skilled workforce across various sectors. Its working age population (15-64 age bracket) of 940 million is twice that of the sum of all major Asian peers. However, bridging the skill gap, improving labour productivity, and enhancing the quality of vocational training programs remain crucial to fully utilise this potential. Labour reforms have been on the anvil though their implementation has been delayed.

**Capital:** Reduction in corporate tax rates, GST implementation, resolution of bad loans, and export incentives (RoDTEP) are some of the examples that highlight the reforms in India to improve the availability of capital.

**Entrepreneurship:** Production Linked Incentive schemes, Programmes such as Start-up India, increasing availability of capital to MSMEs and widespread proliferation of digital infrastructure have led to increased business opportunities for local businesses.

### Government has undertaken multiple reforms to improve ease of doing business



#### Production Linked Incentive Scheme

To augment indigenous manufacturing capabilities to increase GVC participation.



#### Labour Reforms

Codification and rationalisation of labour laws to facilitate implementation flexibility.



#### Direct Benefit Transfer

To facilitate transparency & accurate targeting of beneficiaries, benefit/subsidy is directly transferred to citizens below poverty.



#### Tax Reforms

1. GST implemented to simplify indirect taxes.
2. Corporate tax reduced to bring at par with Asian nations.
3. Abolition of retrospective tax.



#### Insolvency & Bankruptcy Code

To resolve insolvency cases in a time bound manner for maximisation of the value of assets.



#### Digitisation

UPI recorded 5.6 billion transactions worth INR 10.4 billion in May 22. Digitisation will likely unleash productivity gains for the entire economy.

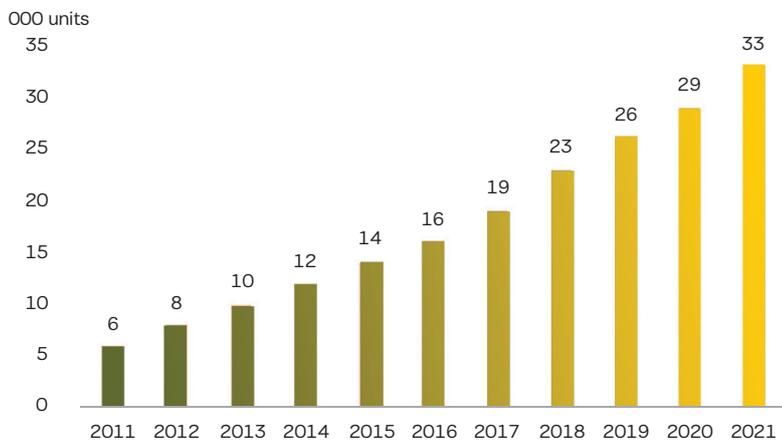
Source: Morgan Stanley



## Global trends in Manufacturing – An Indian perspective

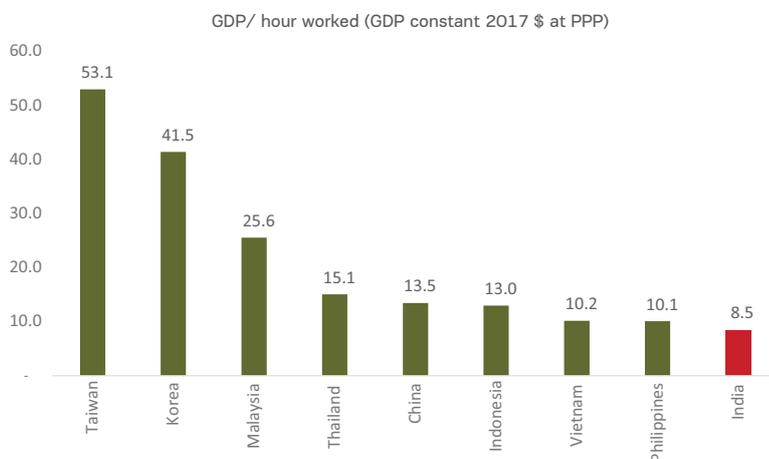
Globally, there are multiple mega trends that are likely to drive the manufacturing sector. Industrial Internet of Things (IIOT), 5G & Edge computing, Robotics and Digital Twins are some of the mega trends that are likely to shape manufacturing for the next few decades. We believe Indian businesses are adapting to these trends in order to remain competitive in the global landscape.

### Penetration of industrial robots in India is increasing



Source: World Robotics 2022

### India's low labour productivity is a challenge that needs to be solved for



Source: International Labour Organization (ILO)

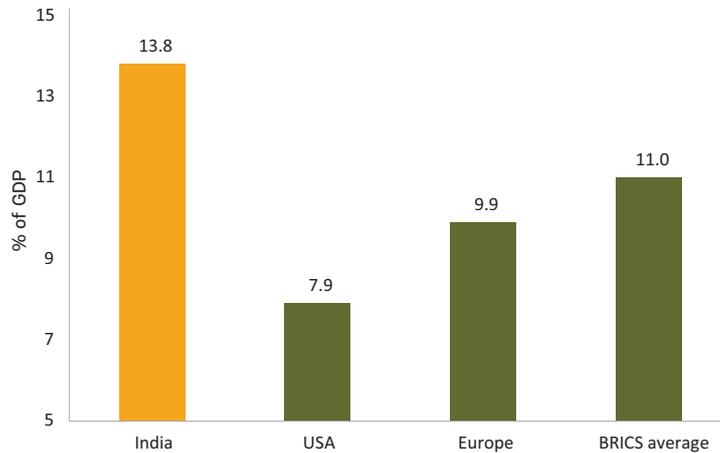
## Key challenges

We believe that despite India taking steps in the right direction there are some fundamental challenges that still exist.

- Ease of doing business is still low compared to some of the South East Asian countries
- Labour productivity in India is lower than in other developing nations
- High logistics cost at ~14% of GDP
- Lastly, it is pertinent that India is able to develop source materials as its absence puts it in a structurally disadvantageous position to its more advanced peers.



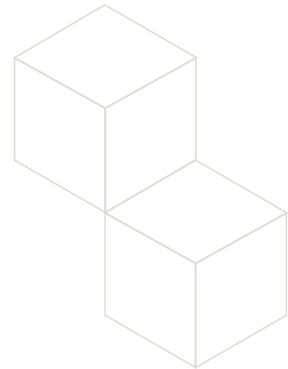
**India's logistics cost ~14% of GDP is significantly higher than averages**



Source: Niti Aayog, Axis Capital

## Outlook

We believe India is amidst a major growth cycle in manufacturing for the next decade. India should gain most from structural advantages of a large workforce, competitive wages, high literacy, robust domestic demand, and strong engineering skillsets. India has already demonstrated its ability to manufacture for the world in sectors such as Automobiles, Specialty Chemicals, Electronics and Building materials. We believe new areas of growth would be engineering goods and new energy products. However, achieving scale benefits to be globally competitive will be the key challenge. We are most positive on engineering companies that not only have a dominant presence domestically but also have credible export share. In addition, we like the defence sector as we believe there will be democratisation of opportunities as more companies become part of the manufacturing ecosystem.



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