INDIAN INDUSTRY IN POST-LIBERALISATION ERA

- Some Critical Issues

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"Free Enterprise was born with man and shall survive as long as man survives".

-A. D. Shroff
1899-1965
Founder-President
Forum of Free Enterprise

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- *Some Critical Issues*

By

S. S. Bhandare*

Key Macro Perspectives:

It is just over a decade since the launching of economic reforms in July 1991. Among other things, the main objective of reforms was to place India on a high growth path. In particular, industrial liberalization unleashed hopes of healthy and competitive industrial expansion. But contrary to general expectations of business and industry, the post-reforms industrial performance has not been robust, at least in quantitative terms. Indeed, during the pre-reforms period spanning over a decade (1981-1992), industry scored an average growth rate of 6.3% per annum. In the post-reforms period of over nine years (1992-2001), the average growth rate has just been marginally higher at 6.5%. In short, the general perception is that reforms have not provided any impetus to the growth momentum of Indian industry.

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Indeed, what has been worrisome is the phenomenon of increased volatility of the industrial sector. Witness the fact that co-efficient of variation of industrial growth in the post reforms period has increased to 47.18 from 38.75 in the pre-reforms period. No doubt, cyclical upturns and downturns in agro-based industries like cotton textiles, sugar, vanaspati, tea, rubber plantations etc. are common phenomena. Also, a few other industries like shipping and metals are subject to violent fluctuations depending upon global trends. But in the post-reforms period, it is evident that even some of the sunrise industries like chemicals, engineering and automobiles are experiencing substantive fluctuations in their growth performance.

Simultaneously, many structural changes are impacting the relative contribution of different sub-segments in the overall industrial performance. Thus, the capital goods sector is on a rapid retreat, while in the case of basic and consumer non-durable industries, there is a moderate setback. In contrast, the intermediate goods segment has surged remarkably well in the post-reforms period, and the consumer durables industry in particular has sustained its high double-digit growth, which is truly the hallmark of the post-reforms period.

On the other side, the qualitative dimensions of industrial performance are undoubtedly showing distinctive gains, most of which are primarily attributable to:

- First, the liberalised and intensely competitive market environment;
- Second, the consumer enjoying wider choices of products and services and the satisfaction of his

growing expectations now inevitably assuming a critical strategic response of industry;

- Third, unleashing of the discipline of market-determined prices, except where the system of administered pricing is still prevalent (*e.g.* petroleum products);
- Fourth, imperatives of productivity drivers in the manufacturing operations and in the overall corporate culture;
- Last, the pressures of globalising prices of almost all industrial products and consequential compulsions of globalising profit margins.

Hitherto, Indian industry was blessed with favourable terms of trade for a prolonged period. Barring a few exceptional years, the rate of price rise in manufacturing goods has generally been higher than the general level of inflation. The prevalence of a seller's market in the wake of endemic shortages of quality industrial products made this eminently feasible. In recent years, such 'inflationary support' is found wanting, as there has been only a modest price rise in manufactured products vis-à-vis other goods and services. Indeed, various cost pressures generated on industry through escalating prices of fuel, energy, transportation, etc. are perforce required to be absorbed by most manufacturers. The impact of this is clearly visible in the downward profitability trends of the manufacturing corporate sector. Of course, there are units in each and every industry, which are doing remarkably well, thereby shoring up the over-all corporate results. The disaggregated performance evaluation, however, brings out the winners and the losers in the new battle of the competitive market place.

Critical Issues for Debate:

Against this backdrop, we need to raise some critical issues for discussions in this article. Most of the issues that are sought to be raised are by way of propositions or untested hypotheses. One cannot claim the benefit of rigorous academic or empirical validation of many such observations and perceptions at this stage. Nevertheless, they reflect the on-going changes on the industrial scene of the country, and the shape of things to come.

Industrialisation to By-pass India !

First, to begin with, let us evaluate the changing growth profile of the Indian economy on a trend basis during the pre-reforms and the post-reforms period. [Please see Appendix I]. It is evident that the services sector has emerged as the dominant growth driver of the economy. If the annual GDP growth has moved up from 5.4% in the pre-reforms period to 6.4% in the post-reforms period, it is almost entirely due to the services sector growth surging from 6.4% to 8.2% during these two separate phases. In contrast, the industrial sector has remained stuck at around 6.5% annual growth, albeit it did show a transient promise of double-digit growth in the mid-nineties.

As a consequence of moderate and highly fluctuating industrial performance, quite a few experts have been ardently propounding that vigorous industrialisation or industrial revolution would be by-passing India. The question is whether this is a legitimate or valid contention.

Or is it that many of us are strongly being influenced by the sudden dynamism of the services sector? Or is there a hype and hoopla of the so-called 'new economy' paradigm dominated by the emergence of the information technology?

Admittedly, while scanning the present industrial structure, one tends to *prima facie* believe that India does not offer industrial leadership in any major segment of the manufacturing sector despite building up a broad-based industrial structure under the domain of both public and private sector ownership over the last five decades. No doubt, India has achieved a long-term average compound rate of industrial growth of about 6.5% in the post-independence period. But this itself is not enough. To assume the status of industrial leadership, India has to be seen as a significant player in the global export markets commanding, if not the top position of any specific industry, then at least being amongst the first four or five major producers in some specific key industrial products in the global economy. Unfortunately, this is not so. Indeed, India has lost its status from being the tenth largest industrial power in terms of aggregate value added of manufacturing output till about the early seventies to being 17th or 18th at present in the global league table. Many other countries, which embarked on the industrialisation process much later than India, have scored a march over it thanks to their emphasis on (i) economies of scale, (ii) infusion of foreign capital and technology, and (iii) outward orientation and thrust on export markets.

Having said this, we need to evaluate the other side. As India climbs the ladder of its current per capita GNP of $

450 ($ 2149 on PPP basis) to the level of, say, China, with its per capita GNP of about $780 ($ 3,291 PPP), then one can envision the prospect of comparable (not necessarily identical) levels of industrial consumption over a period of, say, next decade or so. However, on the basis of our present standards of industrial consumption this sounds a highly optimistic and impracticable proposition. While we are about 35% lower in terms of the purchasing power parity (PPP) per capita income, our consumption of major industrial products, be it steel, cement, electricity, petrochemicals, or even consumer goods like textiles, is seen to be one-third or one-fourth of the Chinese standards. [Please see Appendix II]. Thus, China is said to be consuming 110 mn. tonnes of steel in contrast to India's just about 30 mn. tonnes; nearly 400 mn. tonnes of cement *versus* India's 105 mn. tonnes; and power generation of 1250 bn. kwh *versus* India's 400 bn. kwh; and so on. Such massive divergence in the levels of industrial production and/or consumption suggests that India has a long way to go in meeting its likely future potential requirements of most manufactured products.

Second, as a consequence, the related question is whether India needs to have its own long-term industrial programme to meet the likely huge potential demand of industrial products or whether she can rely on global supplies of most such products. Once again, many experts argue that given the shortage of capital and its high opportunity cost, India can as well re-position itself as a powerful services sector economy. It is further being pointed out that our consumption needs of many industrial products (*e.g.* steel, aluminum, fertilisers, a host of capital goods, etc.) can be imported at competitive prices since globally there exists excess capacity in these products. This position is unlikely to change at least in the medium-term period of next three to five years.

Does this mean that India must necessarily depend on imports as and when there is a surge in demand for such basic and capital goods industries in response to the projected increase in the levels of its per capita income? There is obviously no conclusive answer to this proposition. Indeed, given the broad-based industrial structure created so assiduously over the last four or five decades, enterprises belonging to both public and private sectors are bound to contest the infirmities in the logic of this argument. Indeed, many of them having gone through the difficult tasks of restructuring of their businesses in the last few years are now wanting to forge ahead as global players subject, of course, to the facilitative role of the government and financial institutions, especially through the route of second generation reforms. The issue is: Will this happen? And if so, when?

Restructuring and Competitiveness of Industry:

Third, this takes us to the related critical issue, namely, how far do various structural changes in industry reflect the competitive re-positioning of Indian industry? As mentioned in the beginning, in terms of the growth profile, only two segments of Indian industry seem to have come out as winners in the post-reforms period. Thus, intermediate goods and consumer durables with their impressive growth rates stand out in comparison with basic and capital goods industries. [Appendix III]. At the same time, it must be recognised that even in the basic and capital goods segments, there are units which have made promising progress in consolidation and restructuring of their businesses, just as there are still many laggards in the intermediate and consumer durables segment. But the moot question is whether in all such product categories, can India be said to have competitive advantage or core competency from the long-term developmental perspective? This aspect assumes vital significance in the context of the withdrawal of quantitative restrictions (QRs) and projected further reduction in customs tariffs.

It is evident that for a whole range of industrial products, even our present customs tariffs are seen to be very high, and are slated to be brought down to the level of East Asian countries in the next 3 to 5 years. In his last budget, the Finance Minister has already proclaimed that "I will like to move progressively within three years to reduce the number of rates to the minimum with a peak rate of 20%". Indeed, the Advisory Group under the chairmanship of Dr. Parthasarathi Shome has suggested that the peak rate needs be reduced to as low as 15% by 2004-05.

This concern to align India's customs tariff with global standards is no doubt understandable. But Indian industry also expects the government to take a holistic view on this issue based on the likely implications of constellation of various factors, namely, (i) the recent removal of virtually all quantitative restrictions (QRs); (ii) an imminent entry of China into the WTO; (iii) the relative divergence in the levels of devaluation in recent months of the Indian rupee vis-à-vis currencies of major competing countries in the global trade; and (iv) the extent of prevailing disparity between the burden of domestic indirect taxes as applicable to Indian industry and similar taxes applicable to foreign producers in their respective economies. There is also an issue about the handicap suffered by Indian industry and exporters of manufactured products from disproportionately high transaction costs borne by them vis-a-vis their competitors from many other countries.

In substance, there is a persistent view that the level playing field is uneven and is posing enormous challenges to Indian industry. Even granting some degree of exaggeration in this argument, it is very difficult to ignore the case for more vigorous pursuit of internal liberalisation, especially pertaining to the reduction and rationalisation of domestic indirect tax structure, both at the level of Centre and of the States. It is legitimately argued that unless affordability of domestically manufactured goods improves, in which the burden of domestic indirect tax structure is of critical relevance, Indian industry cannot effectively exploit the economies of scale and scope. Indeed, further rationalisation of domestic indirect taxes becomes a condition precedent for progressing with the substantive reduction of customs tariff as well as for endowing Indian industry with the scales of global competitiveness.

Impediments to Restructuring:

Fourth, the post-reforms experience suggests that Indian industry is not averse to the process of restructuring. In recent years, there have been significant efforts towards industrial consolidation and restructuring, including some tough decisions on downsizing, divestments and the pursuit of global norms of productivity, costs and pricing. The classic examples are cement, petrochemicals, steel and pharmaceutical industries. This restructuring process obviously needs enormous stimulus, and it must spread across many other sub-sectors of Indian industry. The crucial question is: what are the impediments to the acceleration of industrial restructuring process in the country? Will the proposed changes in the budget in terms of imparting flexibility in labour markets and reforming of the bankruptcy laws including the repeal of SICA (Sick Industrial Companies Act) and the dissolution of BIFR (Board for Industrial and Financial Reconstruction) facilitate the restructuring of Indian industry? How soon will the proposed reforms become operative and effective given the limitations of coalition governance?

Surely, the gains of technology upgradation and competitive cost structure are not easy to come by. At the same time, the lack of economies of scale due to the historical baggage of fragmentation of capacities in various industry segments, the high cumulative incidence of domestic indirect tax structure (excises, sales taxes, octroi, etc.), and the invisible burden of transaction costs due to infirmities of infra-structure and administration are imposing severe restraints on productivity gains. There is yet another crucial issue concerning the ratio of wage cost to total manufacturing expenses. Apparently, in the post-reform period, there has already been a welcome reduction in the wage cost ratio across various segments of industry. Therefore, quite apart from the flexibility of labour management as a crucial element of input cost, Indian industry will inevitably need to concentrate on improving productivity in several other areas of industrial management. This will predominantly involve emphasis on more efficient working capital management and optimal 'sweating' (turnover) of fixed assets.

In this context, even at the cost of repetition of the point, there has to be an adequate appreciation of the substantive restructuring efforts of the Indian corporate sector manifesting in the adoption of focussed business strategies through shedding of non-core activities and progressing with mergers and acquisitions, wherever feasible. No doubt, the restructuring process involving (a) strategic focus on core competency, (b) rationalisation of product portfolio, (c) efficient resource mobilisation, (d) mergers, acquisitions and divestments, (e) overseas diversification and expansion, etc. needs further impetus and vigorous pursuit. The new ball game in the global context is to exploit the economies of scale and scope not only through the mergers and acquisitions route, but also through induction of new technology and development of export markets. How far is Indian industry gearing itself to such challenges? This issue will continue to dominate the industrial scenario of India for quite some years.

Challenges of Globalisation:

Fifth, is Indian industry gearing itself to challenges of globalisation and if so, to what extent? This issue is of great importance in the post-WTO scenario. Undoubtedly, global markets offer opportunities for all, but opportunities do not guarantee the desired results. For High Performing

Asian Economies as well as for China, the benefit of globalisation is clearly reflected in the rising ratio of their trade (imports plus exports) to GDP which is currently hovering around 40 to 45%. But in case of India, even granting the fact that our trade to GDP ratio has increased in the post-reforms period from about 13% of GDP in the early nineties to about 20% of GDP at present, we have a long way to catch up with the levels achieved by the Asian Tigers.

It is evident that India has a definite competitive advantage in products like gems and jewelry, readymade garments, cotton yarns, fabrics, leather and leather products etc. which are typically labour-intensive and low value end products. There are also some of the sophisticated manufactured products like engineering goods and drugs and pharmaceuticals wherein some contribution to exports is visible. But if we take the top ten of India's exports wherein our share of global exports varies in the range of 2 to 13%, these product categories together have only 12 to 15% of the total share of the global markets. In other words, in most significant areas of global manufactured product exports, India does not have any meaningful share of global markets.

The issue, therefore, is that the post-reforms period has yet to endow India with areas of comparative advantage to establish its leadership in the global markets. In contrast, India seems to be emerging as a major exporter of IT products and services. In the last few years, exports growth of the IT sector has been surging at 40 to 50%, and our total exports are projected to be $ 50 bn. by 2008 from the present about $ 6.5 bn. But even in the IT sector it is the software segment where India is doing extremely well, while the hardware sector remains in its nascent stage.

In substance, what has been achieved so far is impressive, but is not very inspiring. India has lost its status as the tenth largest industrial power in the world in the course of the last two decades or more. It has also to make its visibility in the export markets of manufacturing products. Witness the fact that India's overall share in global exports is at present hovering around a modest 0.7 percent. Further, in areas where we are seen to be visible players (*e.g.* cotton textiles, garments, leather goods, gems and jewelry, light engineering products, etc.), the markets of all such products together occupy a small proportion of the total global exports. In a vast majority of other product categories accounting for 85-90% of global exports, and which are essentially high value and/or technology intensive manufactured goods, India's presence is evidently negligible. All this goes to suggest that in the coming years Indian industry will have to either shape up or shape out.

Social Implications – Rationalisation of Manpower:

Sixth, and relevant to the above issue, is the question about the implications of accelerated industrial restructuring and globalisation on the existing and future employment potential of Indian industry. This aspect is surely upper-most in the minds of many – be they trade unionists, social thinkers or policy-makers. It also has intense emotional overtones. As such, there is no substantive official evidence so far about the adverse impact of reforms on industrial employment. However, the anecdotal evidence is so overwhelming that there is hardly any need to prove the gravity of the situation arising out of widespread closures of units and/or downsizing of jobs whether in big, medium or small industrial enterprises. Undoubtedly, this situation is unlikely to change for quite some years given the imperatives of modernisation and globalisation, and the fact that a large part of Indian industry carries with it the legacy of excess employment.

Surely, there remains an urgency of strengthening the mechanism of social safety net. The concept of National Renewal Fund (NRF), which was sought to be so vigorously pursued in the early part of reforms, somehow seems to have fallen by the wayside. The crux of the problem is about allocation of adequate financial resources for the NRF and using them not only for retrenchment compensation (by way of voluntary retirement benefits), but more importantly for re-training and re-deployment of the growing army of even the relatively younger labour force likely to be rendered jobless with the massive onslaught of competition and globalisation. How does one provide the financial as well as organisational wherewithal for the effective management of NRF? Perhaps aggressive privatisation (or disinvestment) programmes may generate fiscal resources. But unfortunately the political will, consensus and commitment for this purpose is found wanting even after a decade of reforms.

The Message of Stock Markets – the Value Migration:

Seventh, in the context of declining role of the Planning Commission and the corresponding rising influence of capital markets in the allocation of resources, what is the message for Indian industry from the perceived migration of the value chain? Surely, stock markets are becoming the driving force in the new market-driven industrial structure that is coming into existence. In the past, the allocation of resources to industry was predominantly determined by forces of industrial licensing, import controls, pricing and distribution regulations. In the implementation of this regime, the perspective planning programmes in the sequence of five-year plans of the Planning Commission essentially offered the driving principles. But this is no longer valid now.

Consequently, stock markets have come to assume enormous importance in evaluating corporate enterprises including even those under predominant public ownership, on the basis of their perceived manifestations of value creators or value destroyers. Accordingly, industries which are seen to be typically operating in the commodities sector (in contrast to branded sector), high capital-intensive areas (in contrast to low capital intensive activities), engaged in unfocussed diversified businesses (in contrast to specialising in core competency areas), and so on, are generally being punished in recent years. As a consequence, there is an uncertainty about whether many of our basic and capital goods industries will be looked upon favourably, if they seek the support of capital markets for funding their new programmes of expansion and diversification. This also raises an important issue that in the event capital markets (which also include the new orientation of banking and financial institutions) do not support the future resource needs for the creation of new industrial capacities, who would then come forward to support the process of further industrialisation ?

The Jigsaw of New Economy

Last but not least important, incidental to the above issue is that in the last couple of years, there has been considerable debate about the relevance of the "new economy" to bring about the transformation of the old economy. What precisely is going to be the convergence of the two different dimensions of the so-called 'old' and 'new' economy syndrome ?

This question becomes relevant in view of the growing perception that the old economy is all "bad old guys and bad old days", while the new economy is ushering new hopes of prosperity. The reflection of this thought process is evident in the growing market capitalisation of IT technology stocks in the total market capitalisation in stock markets. Of course, the recent rapid slide in the IT sector stocks has brought about substantive correction in the extreme distortion created earlier. Even in the global stock markets, especially at NASDAQ there has been a precipitous fall in the new technology stocks. This also is a phenomenon worth pondering over; increasing globalisation also means transmission of investment sentiments across the stock markets in the world, and Indian markets cannot be immune from this trend. But this raises the question: Has the old economy failed us or is it our wrong policies that have failed most sectors of the old economy ? The basic issue is how to utilise the new economy dynamics to modernise and galvanize the old economy rather than getting lost in the irrelevant debate of our past failures.

Without going into the specific composition of the new economy, suffice it to say, the new economy symbolizes exponential growth of computer power, telecom capability and internet development. The main drivers of the new economy come through the fact that there are low entry barriers; there is low capital intensity; there is high profit potential (but at the same time, unduly high risks); and there is reduced communication and transaction costs. Moreover, it transgresses the national boundaries and even local ideas hold out promise of a global market reach. Of course, we have a long way to go in unleashing India's full IT potential and in order to achieve our aspirations, there has to be tremendous support from various growth enablers. The impact of the new economy is obviously expected to be felt through the route of productivity, which will manifest in better ways of using various resources from manpower to machines, and from capital to organisational skills. How 'brick and mortar' industries deploy IT technology to secure competitive advantages in their core businesses can perhaps be learnt from the experiences of many MNCs abroad.

Conclusions:

It has been the best times and the worst of times for the Indian industry in the post reforms period. The overall growth profile has not been inspiring. But, in the qualitative terms, the achievements have been very encouraging. After the initial phase of consolidation and exuberance, the new ground realities of intense competition and globalisation are coming to surface. The restructuring process is on, but its progress is yet to gather momentum. While there is an urgency of tough second generation reforms to be made effective by the government, there is an equally important need for the attitudinal shift among both public and private sector enterprises across large, medium and small sectors to respond positively and proactively to the imperatives of the market driven economic system. Undoubtedly, the next few years are going to be very crucial in determining not only the fortunes of Indian industry, but also about India's status as an industrial power in the global league.

Appendix I

Sectoral Real Growth Rates in GDP (at factor cost)

	Item	19980-81 to 1991-92	1992-93 to 2000-01
I.	**Agriculture and allied**	3.9	3.3
II.	**Industry**	6.3	6.5
	Of which :		
	Manufacturing	6.1	7.4
III.	**Services**	6.4	8.2
	Of which :		
	Trade, hotels, transport and Communications	5.5	8.3
	Financial, real estate & Business services	9.4	8.8
	Community, social and Personal services	5.6	7.4
IV.	**Total GDP**	5.4	6.4

Appendix II

India-China Comparison

- Per Capita Consumption Of Selected Items

	Unit	India	China	World
Steel	(Kgs.)	23	105	116
Cement	(Kgs.)	95	420	390
Electricity (Kwh.)	(Kwh.)	64.3	120	110
Fertilisers	(Kwh.)	12.0	28.3	23.3
Plastic	(Kwh.)	2.4	4.8	17
Cloth	Metres	28.2	47	195
Per Capita GNP	(PPP$)	450	780	29,232
Per Capita GNP	($)	2,149	3,291	6,490

Appendix III
Growth Trends In Industrial Production

	Weight (%)	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01
Mining & quarrying	10.47	9.8	9.7	-1.9	7.0	-0.8	1.0	3.4
Manufacturing	79.36	9.1	14.1	7.3	6.6	4.4	7.2	5.2
Electricity	10.17	8.5	8.1	4.0	6.6	6.4	7.3	4.0
General	100.00	9.1	13.1	6.1	6.6	4.1	6.6	5.0
Use Base Classification								
Basic Goods	35.51	9.5	10.8	3.0	6.8	1.7	5.5	3.8
Capital Goods	9.69	9.2	5.4	11.4	5.8	12.6	7.0	1.4
Intermediate Goods	26.44	5.3	19.3	8.1	8.0	6.1	8.8	4.6
Consumer Goods	28.36	12.1	12.8	6.2	5.5	2.2	5.7	7.9
Consumer Durables	5.12	16.2	25.8	4.6	7.8	5.6	14.2	14.0
Consumer Non-Durables	23.25	11.2	9.8	6.6	4.9	1.1	3.2	5.9

"People must come to accept private entriprise not as a necessary evil, but as an affirmative good".

- Eugene Black

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