India Manufacturing Barometer, July 2013

India Manufacturing Barometer

Taking the pulse

While being cautiously optimistic, the sector is using this period of comparatively sluggish activity to realign the business models and prepare for the future

www.pwc.in

Foreword

The Indian manufacturing sector is facing challenging times. It has become imperative for India to breathe life and growth into its manufacturing sector. The vision to have the sector contribute to 25% of GDP is critical to achieve as it is needed to increase our GDP growth and provide jobs- both integral to the inclusive growth we would like to see.

The government has to make every effort to improve the investment environment enabling manufacturing and infrastructure projects to be implemented in the shortest possible time. We need the competitiveness of our industry to be at the core of policy so that we can supply the domestic market and export to the world.

The survey conducted by FICCI and PwC, 'Manufacturing Barometer' has brought out key challenges facing the sector in the current macro-economic scenario and also the expectations of manufacturers for the next ten to twelve months.

I hope this report will help in addressing and prioritising the issues concerning manufacturing in the short term as well as long term. I compliment PwC India and the team at FICCI for collaborating for the Indian version of Manufacturing Barometer Report.

Naina Lal Kidwai
President, FICCI

Preface

It gives me immense pleasure to initiate our manufacturing sector journey with FICCI with our first edition of the India Manufacturing Barometer, a report to survey the confidence and growth outlook of CXOs across the manufacturing sector.

The country's status as a developing economy, accompanied by an increasing need to generate employment opportunities for its youth, has highlighted its potential as a manufacturing hub. Government recognition of the criticality of the manufacturing sector has led to the announcement of the National Manufacturing Policy (NMP), setting out a bold vision for the sector achieving a growth rate of 12 to 14% over the medium term.

In FY13, India's manufacturing sector grew slower than the rest of the economy, with GDP growth itself having slowed. With this background, we have attempted to profile and analyse the views of organisations in the sector, on economic and market conditions, industry opportunities and challenges, business performance and prospects.

The India Manufacturing Barometer finds that CXOs are largely concerned with increasing cost pressures especially interest rates, declining domestic demand, foreign exchange volatility and political uncertainty. However, contrasted with the many prophets of gloom, majority of the CXOs are cautiously optimistic about future growth prospects both for their segment as well as for their company. Majority of the companies surveyed had strategies in place to negotiate the various threats to growth. These strategies are not merely focused on cost reductions and efficiencies and reigning in capex but are aimed at building competitive advantage beyond costs. The most common themes were new product or service introductions, research and development, facilities expansion and, most importantly, understanding the changing customer preferences and demands and fostering longer term profitable relationships with customers.

My sincere thanks to the participating CXOs across various segments of the manufacturing sector for their valuable time and for sharing their thoughts and strategies with us.

I hope you find this survey report insightful and useful and welcome any suggestions you may have.

Bimal M. Tanna

Bimal Tanna
Leader, Industrial Products
PwC India

Economic climate

The performance of manufacturing, in most developed and emerging nations, is a bellwether of the health of their respective economies. Due to interwoven linkages between the sector and the rest of the economy, we started this survey by gauging the environment that the domestic and global economies are providing to Indian manufacturing.

Global economy yet to bounce back

Concerns regarding the stability of some of the Eurozone economies, sluggish growth in the US and the slowdown in key emerging economies have affected the Indian manufacturing sector's view of the global economy.

Given this background, a majority of companies participating in our survey saw the world economy as being in a decline. Looking forward over the next 12 months, the outlook does not seem to improve much, with more companies describing it as uncertain or mildly pessimistic.

GDP growth rate: The global economy could see a mild recovery

	2013*	2014*
World	3.1%	3.8%
Advanced economies	1.2%	2.1%
Emerging and developing economies	5%	5.4%
China	7.7%	7.8%
India	5.6%	6.3%

Source: World Economic Outlook, the IMF, PwC analysis
**Calendar year forecast*

Mostly uncertain or pessimistic about world economic growth

Today

- Significant growth **0%**
- Moderate growth **14%**
- No noticeable change **24%**
- Moderate decline **50%**
- Significant decline **12%**

Next 12 months

- Very optimistic **0%**
- Somewhat optimistic **26%**
- Uncertain **35%**
- Somewhat pessimistic **35%**
- Very pessimistic **4%**

Source: India Manufacturing Barometer Survey, July 2013

India expected to turn the corner

The release of the annual GDP figures for 2012-13 threw few surprises, with GDP growth at its lowest in a decade at 5% y-o-y[1]. With this growth following figures of around 9% in FY10 and FY11[2], it is probably not surprising that views on the economy tended towards ‘no growth’ or ‘moderate decline’.

The outlook for the economy is, however, relatively brighter for the next 12 months. In FY14, 70% of companies surveyed expect the economy to exceed the 5% growth rate of last year, with a median growth estimate, among companies interviewed at 5.5% for FY14.

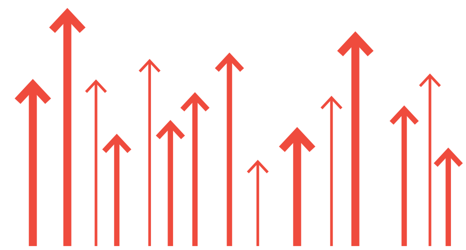
This estimate matches reasonably well with the Asian Development Bank [3] and IMF estimates for GDP growth in CY13, which range between 5.6 and 6.0%, though it is lower than the government’s own estimates of 6.4% in FY14. On the whole, however, uncertainty seems to be the theme for the majority of companies, with some believing that impending elections may delay government decisions and limit growth in the current fiscal year.

More optimistic about the future GDP growth rate of India

Growth expectation in FY14

Above 5% **70%**

Less than 5% **30%**



Today

Significant growth **2%**

Moderate growth **22%**

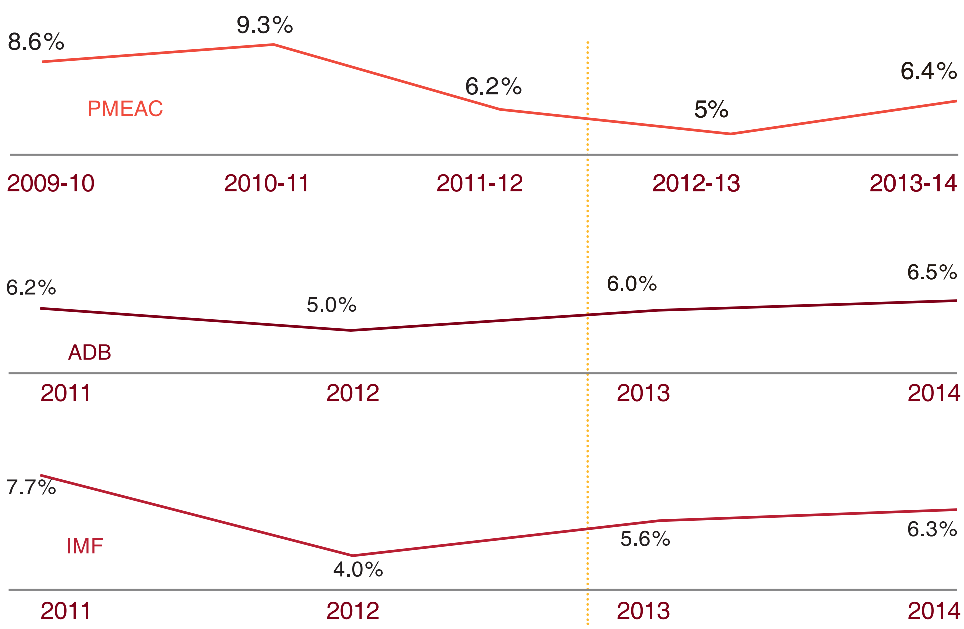
No noticeable change **38%**

Moderate decline **30%**

Significant decline **8%**

Source: India Manufacturing Barometer Survey, July 2013

GDP growth rate: Indian economy might have bottomed out



Source: Economic Advisory Council to the Prime Minister, Asian Development Bank (ADB) and the IMF.

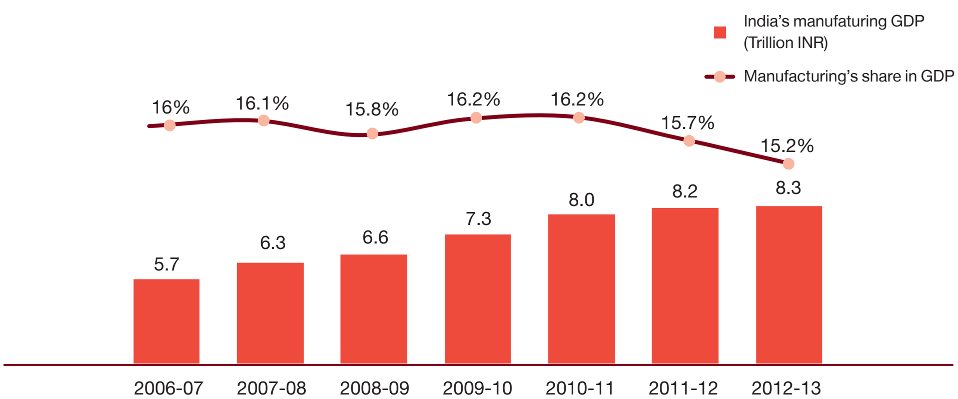
1 The Central Statistics Office (CSO), Ministry of Statistics and Programme Implementation

2 The Planning Commission of India

3 Asian Development Outlook 2013, Asian Development Bank

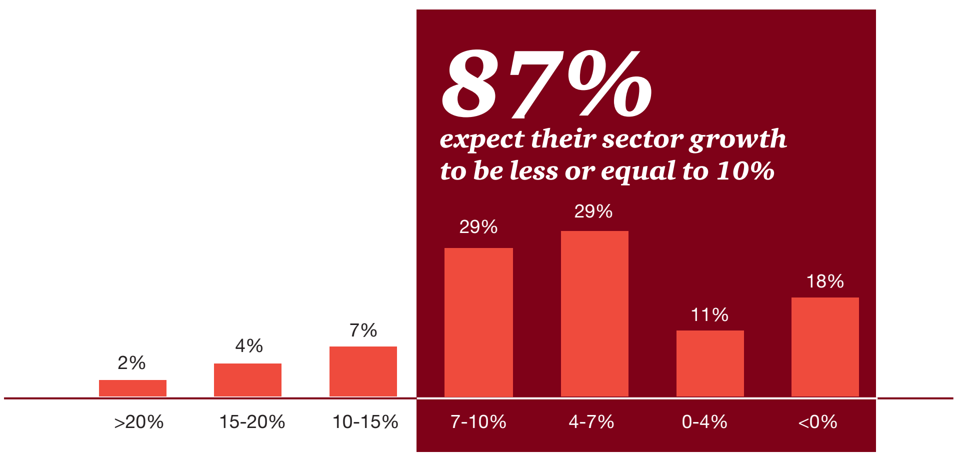
Sector dashboard

Manufacturing's share in the economy has been declining



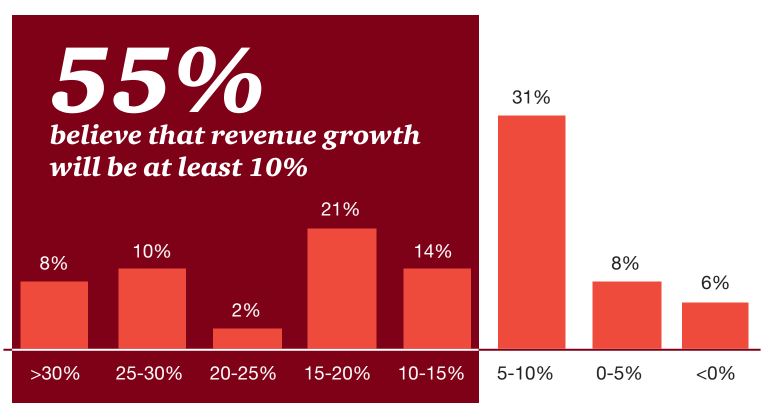
Source: The Planning Commission of India, PwC analysis

What is the estimate of your sector's likely revenue growth rate in FY14?



Source: India Manufacturing Barometer Survey, July 2013

What is the estimated revenue growth rate for your business in FY14?



Source: India Manufacturing Barometer Survey, July 2013

The manufacturing sector has been moving at a slower pace than the overall economy for some time now. As a result, the sector's contribution to GDP has declined marginally from 16.1 to 15.2% in the five years till March 2013. Growth rate in manufacturing reduced from 9.7% in 2010-11 to 2.7% in 2011-12 and 1% in 2012-13. In FY13, only 3.3% of the country's growth was generated by manufacturing as opposed to 83% contributed by services.[4] The sector is not at its strongest at the moment, but are the manufacturing companies in lockstep with rest of the economy?

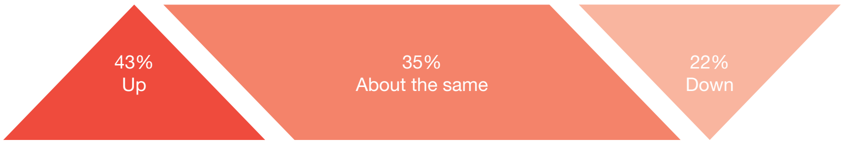
Companies are positive

Estimates for industry revenue growth do not appear to be very optimistic, with the mean estimate being 4%, and nearly one in five companies expecting their segment to show negative growth over the next 12 months.

On the other hand, companies expect their own revenues to grow at a faster pace in FY14, with a mean estimate of over 15%. In fact, one in five companies expected revenue growth to exceed 20% in FY14.

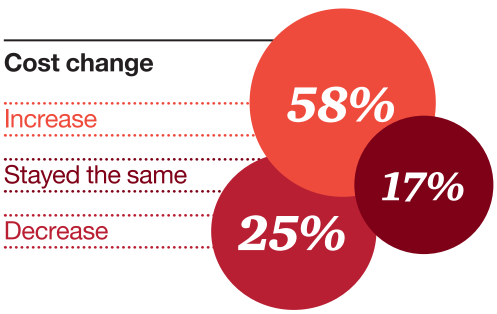
4 *The Central Statistics Office, Ministry of Statistics and Programme Implementation*

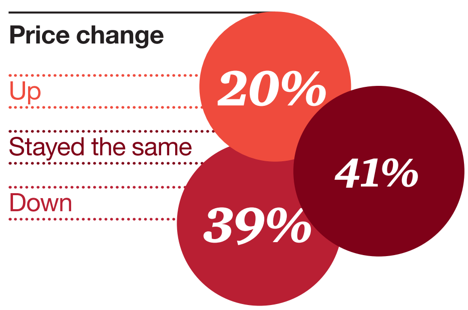
Finished inventories as a percentage of sales in the past six months

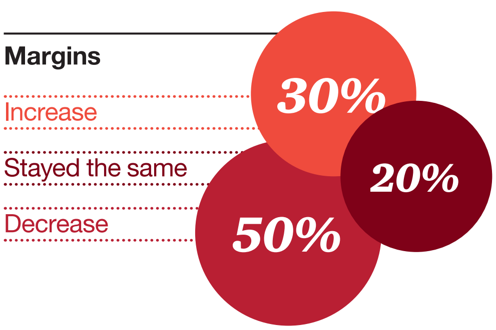


Source: India Manufacturing Barometer Survey, July 2013

What happened to costs, prices and margins in the past six months?

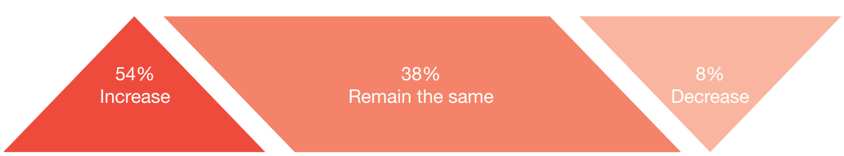






Source: India Manufacturing Barometer Survey, July 2013

Expectations of margins over the next 12 months are optimistic



Source: India Manufacturing Barometer Survey, July 2013

Margin pressures have not dented their optimism

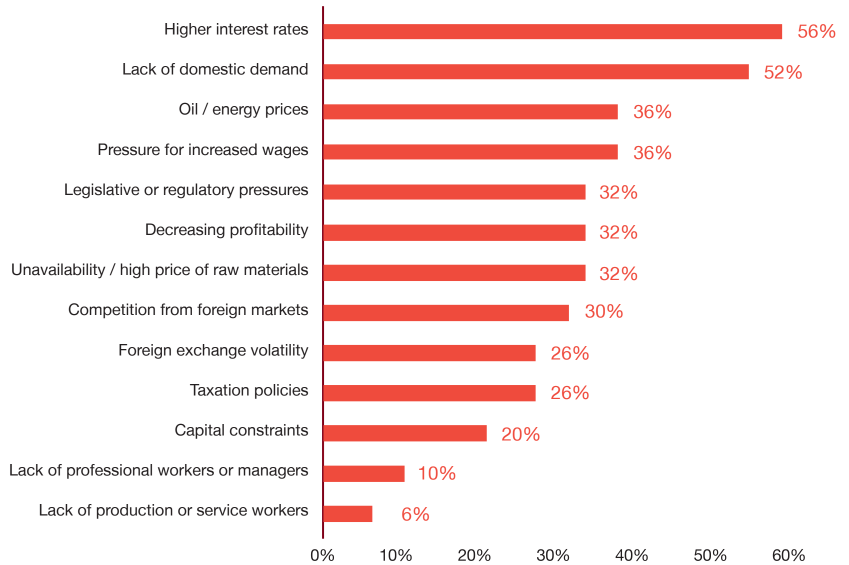
The global economy has been volatile, adversely impacting business and consumer sentiments. Slow market demand generally results in inventory accumulation and sales slowdown, reflecting the trend depicted by manufacturing companies. Finished inventories as a percentage of sales have gone up for 43% of the respondents in the past six months.

Faced with uncertainty regarding demand in the market, it is also likely that the bargaining capacity of the manufacturers has reduced. For half of the companies surveyed, gross margins declined over the past six months. Typically, this was due to a combination of constrained pricing power and cost pressures. For 58% of the companies, costs increased over the past six months, yet only 20% were able to increase prices.

Significantly, most organisations believe the market has 'bottomed out', and the next few months will be better. Over half of the respondents believe that margins will improve over the next six months, while another 38% expect them to remain steady.

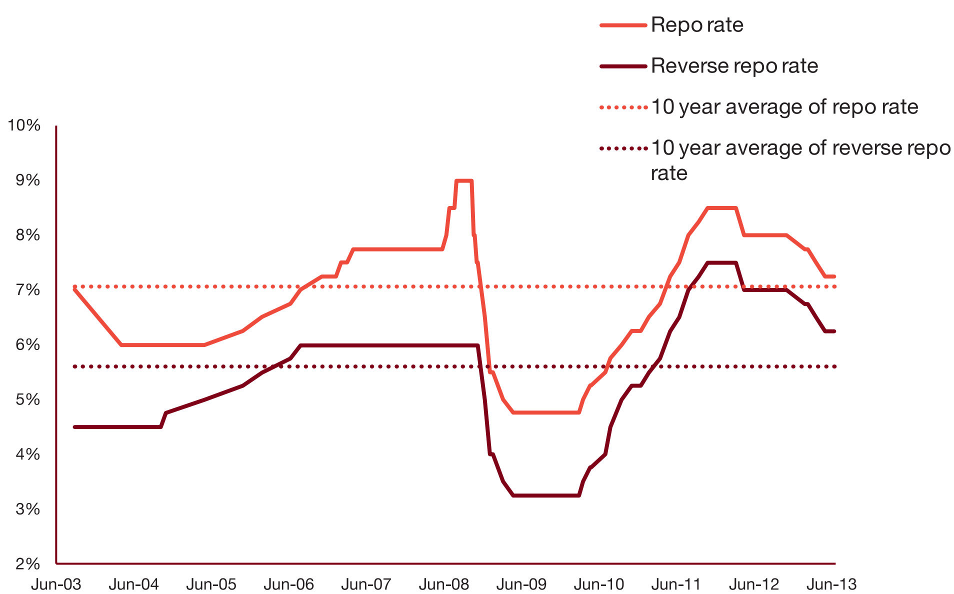
Speed breakers

Barriers to business growth over the next 12 months



Source: India Manufacturing Barometer Survey, July 2013

Interest rates are trending above the 10-year averages



Source: The Reserve Bank of India

Major barriers to growth over the next 12 months are expected to mirror those that have constrained business activity over the last few quarters.

Higher interest rates

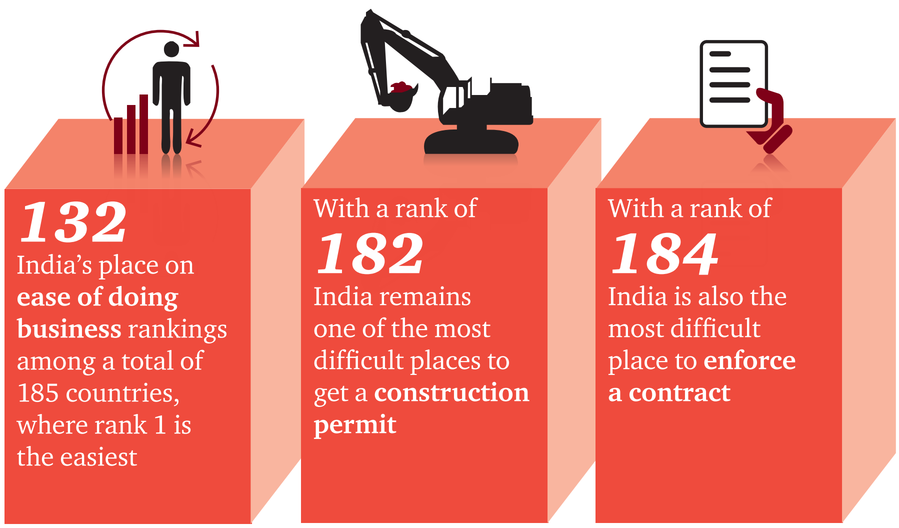
Not surprisingly, 56% of respondents felt that higher interest rates would be the key factor limiting growth over the next 12 months. High interest rates not only impact consumer borrowing, but also increase the cost of capital for corporations, thus impacting new investments. This has a cascading effect on demand and economic growth. The RBI started easing the rates from the second half of last year. However, rates are still trending above the 10-year averages, and with pressure on the exchange rate may not see a downward momemt in near term.[5]

Lack of domestic demand

Lack of demand in the domestic economy is identified as a key concern by 52% of the respondents. With private final consumption having grown at 4% and gross fixed capital formation grown at 1.7%, demand for industrial products has been sluggish. Companies surveyed anticipate that this will continue to be a limiting factor for growth in FY14 as well.

5 *The Reserve Bank of India*

Tedious regulations, legislations and taxation



Source: The World Bank Group

Other concerns

Pressure on wages was a concern for more than one in three companies. This may not surprising as companies believe that in an environment of high inflation, wage increases are imperative. In addition, taxation policies and legislative or regulatory pressures are perceived as a barrier to growth by several companies. Restrictive labour laws and a complex tax and duty regime have been exacerbated by delays in approval and implementation of government and infrastructure projects. Delays in government spending and procurement have a cascading impact on industrial demand. The World Bank Group in a recent study drew attention to this[6].

Thirty-two per cent of companies are concerned about unavailability of raw materials and 36% are about high energy prices. In the last financial year, fuel and power inflation have seen a gradual moderation, but are yet trending at an elevated level, range-bound between 8 to 12%[7].

6 Doing Business 2013, Smarter Regulations for Small and Medium-Size Enterprises, The World Bank Group (The World Bank and the International Finance Corporation)

7 Office of Economic Advisor, Ministry of Commerce and Industry, Government of India

Emerging trends

Manufacturers are cautious about new investments but cost control has not stopped job creation

50%
are refraining from planning any major new investments

79% in India
plan to add or at the most keep their full-time equivalent employees same

Source: India Manufacturing Barometer Survey, July 2013

Manufacturers remain optimistic about expansion in the next 12 months

34%
Expect more than 20% of revenues from international sales

57%
Expand to new markets abroad

43%
Start at least one new strategic alliance

2 in 5
Plan to set up a new manufacturing, production or distribution facility abroad

Source: India Manufacturing Barometer Survey, July 2013

The importance of manufacturing in the overall well being of the economy is more than evident and the government has paved a mission for the sector. Notwithstanding the plans of the government, companies are already taking measures to try and drive growth in their individual businesses.

Restraining expenditure, not value

Customer growth targets for companies are also strongly guided by tightly defined investment parameters. Manufacturing companies are careful about adding capacity but are not in a mood to cut manpower.

Expenditure: Tread carefully

Faced with rising costs and weak demand, investments could have taken a back seat. Half the companies surveyed are not planning major new investments and 10% are uncertain about it.

No job cuts yet

However, in India, while companies have stalled their plans of capacity additions and investments, they have also been careful not to cut value in the process. For instance, 44% of the respondents were planning to retain their existing staffing levels, while a further 35% expected to increase headcount over the next 12 months.

Looking forward to expand

Companies are ready to explore their options beyond national borders and capture an increasing share of the global pie.

Markets without borders

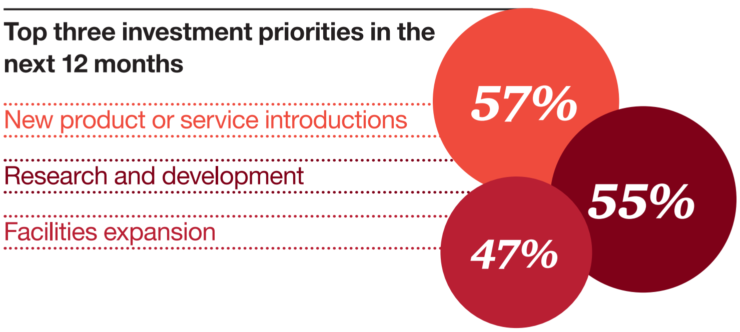
The trend is evident in the responses. Only 4% of the total interviewed companies want a reduction of activity in selected markets abroad in the next 12 months. For the balance, resolution to increase their global footprint seems more aggressive for the future, compared to the last six months. Over the next 12 months, a third of companies surveyed expect international sales to comprise over 20% of their revenues, with the median expectation being 14%.

Size specific optimism

When we segregated the companies surveyed on the revenues of their respective divisions or SBUs, we found that the intensity with which they expanded across the border, in the past six months, varied with size. The participating companies with revenues of 5 billion INR or above in FY12 were more inclined to expand than those with revenues below that level.

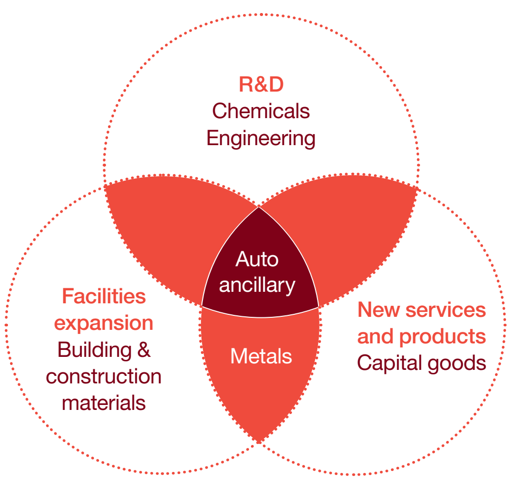
However, the limited, but carefully selected investments are aimed at climbing the value ladder

Top three investment priorities in the next 12 months



Source: India Manufacturing Barometer Survey, July 2013

Sector-wise investment priorities



Source: India Manufacturing Barometer Survey, July 2013

Target business activities

While 57% are expecting to expand to new markets abroad, 43% believe that they will start at least one new strategic alliance or joint venture in the next 12 months. Nearly, two among five companies also plan to set up a new manufacturing, production or distribution facility abroad.

Building competitive advantage beyond cost

Competitive advantages need to be sustainable for Indian manufacturing to maintain its attractiveness, since they face competition not only from other domestic players, but also players in other countries.

Strategically allocating limited resources

Manufacturers may have started working towards these goals already. We say this since despite the objective of cost-effectiveness and capped expenditures, they are strategically planning to allocate their limited expenses in the next 12 months. They have chosen to spend on new product or service introductions, research and development and facilities expansion. R&D aimed at improving product portfolio and mix to increase margins. The focus area of their investment shows that they are resolute about climbing up the value ladder to sustain their advantage and not solely rely on providing low costs.

Sector-specific investments

A closer look at the data reveals that sectors such as auto ancillary were actively pursuing all three areas of expenditure. Metal companies were mostly looking forward to expanding facilities and introducing new products and services. A majority in the building and construction materials sector want to spend only on facilities expansion, capitals goods segment on new products and services and chemicals and engineering companies on R&D.

Key comparisons: India and the US

Mean expected industry growth	4.0%	3.5%
Mean expected own revenue growth	15.7%	4.6%
Planning to hire	35%	42%
Planning major investments	40%	40%

Key future business activities

Expansion to new markets abroad

57%

18%

Acquisition of a business

33%

18%

New manufacturing, production or distribution facilities abroad

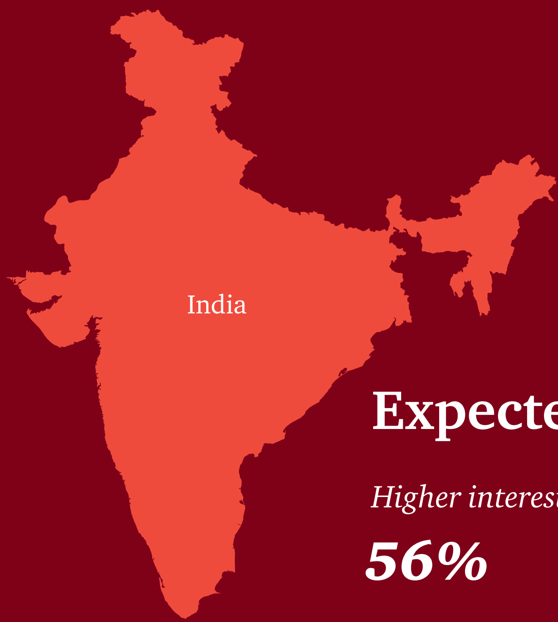
37%

12%

Spin-off or sale of certain operations

6%

10%



Expected barriers to growth (India)

Higher interest rates

56%

Lack of domestic demand

52%

Pressure for increased wages

36%

Expected barriers to growth (US)

Legislative or regulatory pressures

53%

Lack of domestic demand

47%

Taxation policies

32%

Source: India Manufacturing Barometer Survey, July 2013 and PwC US Manufacturing Barometer: Business outlook report, July 2013

Special focus: Customer expectations

In a difficult economic climate, as sales become sluggish, companies begin to focus, apart from their own operations, on driving additional value from their suppliers. With most manufacturers, being themselves suppliers to other businesses, we obtained a range of viewpoints from them, on whether and how customer expectations were changing and how they were reacting to them.

Understanding customer needs

Companies are not only aware, but are also preparing to tackle changing demands and preferences of customers by fostering long-term relationships. While customers are becoming more demanding, particularly with respect to price and payment terms, manufacturers appear to be evolving their business models in order to maintain their operating margins.

Cost efficiency

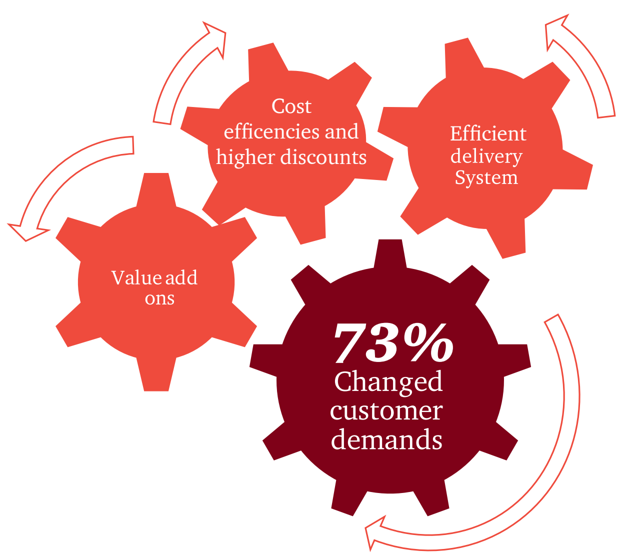
Indian manufacturers are seeing a change in customer dynamics in the present market. Of the companies surveyed, 73% believe that customer requirements and expectations have changed due to the global economic environment as well as the domestic slowdown in growth. We found that Indian customers have strong preferences for higher discounts, among other things.

Our interviews also revealed that some players wanted to respond to these shifts to build and maintain long-term relationships with customers, both new and existing. So, how are they doing it? Cost efficiency appears to be the primary strategy to respond to changing customer needs. 76% of surveyed companies stated that they are resorting to cost efficiencies to meet customer requirements. There is ample room to reduce average costs in Indian manufacturing, but such cost savings can come from the elimination of cost inefficiencies.[9] Cost efficiency can ensure cost competitiveness, which enables companies to gain a larger share of the market.

Not just products, but also solutions

As customers crave for value additions and efficient delivery systems, companies are striving to keep them interested with service additions. Around 42% are adding services to their products in order to respond to frequently shifting and disparate customer preferences. This finding is witness to the trend that manufacturing companies are progressing much beyond factory operations, driven by competition. Some companies now want to link their manufacturing operations with nonmanufacturing functions such as customer service, logistics, business solutions, procurement and planning. The trend could help manufacturing companies integrate seamlessly with multiple business partners.

Providing customers value along with low cost



Cost efficiencies are important with ***76%*** resorting to these to meet changing customer demands

42% are **adding services to products** to engage with the customer

Source: India Manufacturing Barometer Survey, July 2013

9 Are Indian firms too small? A nonparametric analysis of cost efficiency and industry structure of Indian manufacturing, University of Connecticut, March 2008

In summary

In an environment of sluggish economic growth, and deceleration of the manufacturing sector, it is not surprising that the mood exhibited by companies appears cautious. Companies appear to have battened down their hatches and are preparing for a period of uncertainty. New investments seem to have been put on hold, with half of the companies surveyed indicating that they had no plans for major investments in FY14.

Encouragingly, however, it appears that the sector is using this period of comparatively sluggish activity to realign the business models and prepare for the future. Much of the focus of new investments is on new product introduction and on R&D initiatives aimed at improving product portfolio and mix to increase margins. In the light of a challenging economic environment, companies are also re-evaluating customer propositions and relationships. while adding value to the core product and focusing on longer-term and profitable relationships with customers.

Despite uncertainty related to economic conditions, and continued constraints to growth, companies seem to believe that the market may have 'bottomed out', with GDP growth in FY14 expected to be higher than in the previous year. Further, the company surveyed appear confident about its own prospects for growth, with more than 50% largely expecting their own revenues to grow at higher than 10% over the next year and profit margins to improve.

Key indicators for the business outlook

Business outlook among manufacturers for the next 12 months

Mean expected industry growth	4%
Mean expected own revenue growth	15.7%
Margins expected to increase	54%
Planning to hire	35%
Planning major investments	40%
Expenditures planned in:	
New product or service introductions	57%
Research and development	55%
Facilities expansion	47%
Expected barriers to growth:	
Higher interest rates	56%
Lack of domestic demand	52%
Pressure for increased wages	36%
Oil and energy prices	36%
Legislative or regulatory pressures	32%
Key future business activities:	
Expansion to new markets abroad	57%
Start at least one new strategic alliance or JV	43%
Acquisition of a business	33%

Source: India Manufacturing Barometer Survey, July 2013

Survey demographics and research methodology

Demographics

Interview period	15 April to 15 June 2013
Average number of employees	3,644
Average business unit revenue	20.5 billion INR
Industry sectors	• Auto ancillary • Building and construction materials • Capital goods • Chemicals • Engineering • Metals

Methodology

The India Manufacturing Barometer is based on a survey conducted by PwC and Avalon Global Research. Our survey covered senior executives from a sample of manufacturing companies in India; interviewees typically held designations such as CEO, CFO, COO or Head of Strategy.

About FICCI

Established in 1927, FICCI is the largest and oldest apex business organisation in India. Its history is closely interwoven with India's struggle for independence, its industrialization, and its emergence as one of the most rapidly growing global economies. FICCI has contributed to this historical process by encouraging debate, articulating the private sector's views and influencing policy.

A non-government, not-for-profit organisation, FICCI is the voice of India's business and industry.

FICCI draws its membership from the corporate sector, both private and public, including SMEs and MNCs; FICCI enjoys an indirect membership of over 2,50,000 companies from various regional chambers of commerce.

FICCI Contacts

Mr Chetan Bijesure
Director & Head Manufacturing
chetan.bijesure@ficci.com

Mr Samir Mathur
Senior Assistant Director
samir.mathur@ficci.com

Ms Nisha Goel
Senior Assistant Director
nisha.goel@ficci.com

Ms Shailja Garg
Assistant Director
shailja.garg@ficci.com

About PwC

PwC* helps organisations and individuals create the value they're looking for. We're a network of firms in 158 countries with more than 180,000 people who are committed to delivering quality in assurance, tax and advisory services.

PwC India refers to the network of PwC firms in India, having offices in: Ahmedabad, Bangalore, Chennai, Delhi NCR, Hyderabad, Kolkata, Mumbai and Pune. For more information about PwC India's service offerings, please visit www.pwc.in.

*PwC refers to PwC India and may sometimes refer to the PwC network. Each member firm is a separate legal entity. Please see www.pwc.com/structure for further details.

You can connect with us on:

facebook.com/PwCIndia

twitter.com/PwC_IN

linkedin.com/company/pwc-india

youtube.com/pwc

PwC Contacts

Bimal Tanna
Leader, Industrial Products
bimal.tanna@in.pwc.com

Dushyant Singh
Associate Director, Strategy
dushyant.singh@in.pwc.com

Acknowledgements

Amiya Satpathy
Avalon Global Research
Manan Tolat
Mohan Verma
Neelesh Shrikhande
Neeta Phaterphekar
Ravind Mithe
S V Sukumar
Tapobrata Das Roy

pwc.in

This publication does not constitute professional advice. The information in this publication has been obtained or derived from sources believed by PricewaterhouseCoopers Private Limited (PwCPL) to be reliable but PwCPL does not represent that this information is accurate or complete. Any opinions or estimates contained in this publication represent the judgment of PwCPL at this time and are subject to change without notice. Readers of this publication are advised to seek their own professional advice before taking any course of action or decision, for which they are entirely responsible, based on the contents of this publication. PwCPL neither accepts or assumes any responsibility or liability to any reader of this publication in respect of the information contained within it or for any decisions readers may take or decide not to or fail to take.

© 2013 PricewaterhouseCoopers Private Limited. All rights reserved. In this document, "PwC" refers to PricewaterhouseCoopers Private Limited (a limited liability company in India), which is a member firm of PricewaterhouseCoopers International Limited (PwCIL), each member firm of which is a separate legal entity.

NJ 36 - July 2013 ManufacturingBarometer.indd
Designed by: PwC Brand and Communications, India