



Why Businesses in India are Building Local Supply Chain Capacity

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- *Some businesses in India have set-up local supply chain operations with the aim of de-risking from China, lowering manufacturing costs, and escaping high import duties levied by the government.*
- *By gradually expanding its local sourcing capacity and distribution networks enabled by provision of key incentives and regulatory relaxations to foreign investors, India can enter the global supply chain and become an alternative to China.*
- *While China's supply chain is well integrated with the global market needs, it is possible that firms might move from depending on a single economy and look for supply chain and sourcing from across the world or closer to their target markets.*

Given the world's dependence on China for raw material and components, it is not surprising that COVID-19 lockdowns in the country have gravely affected the global supply chain.

The [disruptions in China](#) impacted several industries in India, especially in the [automobile](#), [pharmaceutical](#), electronic, and [manufacturing](#) sectors, as well as [micro, small, and medium enterprises](#) (MSMEs).

While factories and manufacturing units in China have now resumed operations, delays in delivery of products and components is expected as the outbreak has spread across the world. Some businesses in India, however, have managed to pre-empt exposure to the risk by having an existing [local supply chain](#) in place.

In the last year or so, some India-based businesses have begun setting up local sourcing and distribution networks in order to de-risk from China, and to drive manufacturing costs down. Also, with the Indian government increasing import duties on certain components, it became a cost-effective solution for several firms to set up a less broken chain here in India itself.



It is important to note that, at this time, businesses across all sectors in India (like much of the world) are facing manufacturing and supply chain disruptions, irrespective of their dependency on China. India is currently on a nationwide lockdown until April 14, has been showing [rising number of COVID-19 cases daily](#), and with workers either [being laid off temporarily](#) or [moving back to their hometowns](#).

And, while local units in India were operational until late March, those firms dependent on supply from China have been suffering since late January.

Diversifying sourcing networks away from China

Even before the pandemic, some companies in India had already started setting up a local ecosystem for supply chain procurement of components and products.

One of the main reasons why – is because the Indian government started to levy high customs duty on the import of certain finished products and components. Industry experts believe that the purpose of this move has been to boost domestic manufacturing and push its [‘Make in India’](#) initiative that encourages companies to manufacture their products in India.

Let us take the example of the smartphone industry.

During [India’s budget for FY 2020-21](#), the finance minister increased duties on mobile-related imports to boost domestic manufacturing. From October 2020, the duty on the display panel and touch assembly – which are currently imported from China – will be 10 percent. Earlier, there were no import duties on these components. The government also proposed increasing the import duty on printed circuit board assembly to 20 percent from 10 percent and on chargers to 20 percent. Therefore, it will be more beneficial for smartphone companies catering to the Indian market to produce these parts here in order to save costs.

For instance, the Indian mobile company Lava began to localize some parts from 2015 itself due to rising import costs. Initially it started with the local manufacturing of chargers, batteries, and headphones; now, five years later, almost 35 percent of the company’s feature phones by value are localized.



Late last year, Chinese smartphone maker Vivo set up a manufacturing facility in Greater Noida – an industrial town in the north Indian state Uttar Pradesh – with hopes to use this unit to exports products in the future.

Not only local firms, but foreign companies with a base in India are also looking to start local production. For example, South Korean multinational company Samsung announced earlier this year that it is setting up India's first smartphone display manufacturing unit in Noida. The company is investing around INR 35 billion (US\$460.13 million), and can also use the facility to manufacture displays for other electronic devices at some point. While Samsung has been manufacturing mobile phones in India since 2007, it is the first time the company is setting up units to create mobile parts.

[Media reports](#) also state that the company may be looking to start local production of smartphone batteries in the future.

Another reason why businesses in India are keen on setting up a local supply chain is due to the rising labor costs in China. According to industry experts, the entry level salaries for workers in India start between INR 12,000 (US\$157) and INR 15,000 (US\$196), while in China the salaries are about three times higher.

India as an investment destination in Asia

By gradually expanding the capacity of its local sourcing and distribution networks enabled by provision of key incentives and regulatory relaxations to foreign investors, India can enter the global supply chain and become an alternative to China.

Last month, the Indian government announced its allocation of about [US\\$6 billion to boost domestic manufacturing](#), and to attract investment and incentivize electronics and components manufacturing and exports in the country.

Meanwhile, in a [report published in February 2020 by UBS](#), a financial services company based in Switzerland, analysts remarked on initial signs that India was becoming a preferred destination for companies looking to shift from China, and to diversify their supply chain.



The UBS report added, “given India’s competitive advantage in terms of land and labor availability, exports has always been a big hope historically but it is now seeing a turn as global manufacturers long settled in China are looking to diversify their manufacturing base. India has scale advantage and key success factors locally are also improving.”

However, this report was published two months prior to the COVID-19 outbreak spreading out of China. Since then, it has been labeled a pandemic, and affected manufacturing globally, including in India, Germany, and South Korea. With Chinese factories slowly resuming operations, it is possible that multinational firms may not shift their supply chain wholesale anytime in the near future; however, current risks do underscore the importance of moving away from dependency on a single economy like China.

India’s supply chain after COVID-19

Due to the economic fallout caused by COVID-19, multinational companies will have look for alternative destinations to manufacture their products in order to cut costs. This requirement can be met by India as these companies can [manufacture in India’s special economic zones \(SEZs\) and free trade zones](#). However, the government will have to introduce incentives and regulatory relaxations for foreign investors to attract investment, especially for manufacturing.

It is important that India steps up its domestic manufacturing and diversifies their vendors and supply chain – as relying on China or any other single country will not be advisable.

Through well-established local supply chains, MSMEs and firms operating in India are likely to survive a crisis in the future. Due to COVID-19, companies in India, particularly MSMEs, are struggling to survive as they are dependent on imports from China and have limited financial resources and huge fixed costs.

With the COVID-19 challenges faced by every single country in the world, India is one of the few that has proven its domestic manufacturing and capacity capability. For instance, India like many countries fighting the outbreak has faced lack of equipment, especially ventilators. Here the industry and the government came



together to find a solution in span of a few days. Now, auto companies are retooling their facilities to manufacture ventilators.

However, India's protectionist tendency is one of the reasons why the country has not been able to integrate in the global supply and production chain. This is evident from the government's budget announcement where customs were increased for a range of products and components. According to a [media report published last month](#), these "protectionist barriers mark a clear embrace of import substitution. This hurts India's objective of expanding exports through greater integration with cross-border production chains, which involve goods and services crossing borders several times while assembling a product."

Further, India may also have to sort its trade preferences, logistic costs, transportation infrastructure, and work on non-tariff barriers and restrictions along with creating a robust foreign trade policy to become a leader in the global supply chain in the post COVID-19-world.

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