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Trade Performance of India and China in Micro, Small and Medium Enterprises Sector- A Case Study

[1]Shantanu Shukla, [2]Sanjana Kini Agarwal, [3]Shashi Bala, [4]Vaishali Saxena, [5]Aftab Alam, [6]Mamta Shukla

Department of Management, Axis Institute of Higher Education, Kanpur, Uttar Pradesh, India

Abstract

In Chinese, the term for Crisis (Wei Ji) is represented by two characters: Danger and Opportunity. This duality perfectly captures China's emergence as a formidable economic force. As Stephen Roach, Chief Global Economist at Morgan Stanley, puts it, "Over the next 10 years, China's rise will present both a significant challenge and a major opportunity for other Asian countries." This paper explores the strategic goals of Chinese MSMEs and their potential to become dominant players on the global stage. It includes a SWOT analysis of Indian MSMEs to evaluate their readiness for the anticipated challenges posed by this major emerging economy. The paper also examines the current economic situation in India, the role of MSMEs, and compares the performance and Foreign Direct Investment flows between China and India across various sectors. It further analyzes the strategic actions of Chinese MSMEs to warn Indian MSMEs of potential impacts and offers recommendations for how they can effectively address these forthcoming challenges.

Key words: China, FDI, Globalization, GDP, India, MNC, MSME, Strategy.

1. Introduction:

Globalization is gradually permeating every corner of the world. Large corporations are entering new markets and capitalizing on every commercial opportunity. This era is marked by the rise of previously overlooked nations as emerging centers of potential and dynamism. These countries are increasingly recognizing their role in the global economy and adapting to the changes brought by globalization. This phenomenon is not confined to capitalist countries; even deeply communist nations like China are experiencing its impact in unique and innovative ways.

As globalization advances, countries are drawn into the international marketplace through the influence of multinational corporations (TNCs) seeking better margins, quicker returns, economies of scale, and enhanced productivity. This trend has primarily benefited economically advanced nations such as the U.S., U.K., Japan, and South Korea. Conversely, China has adopted a different strategy by focusing on penetrating India's Micro, Small, and Medium Enterprises (MSMEs). Instead of directly challenging large corporations, China has outpaced Indian MSMEs by offering more affordable and appealing products, including electronic accessories, idols, bangles, and locks.

While some view this strategy as "dumping," which carries a negative connotation, it is recognized as a clever business tactic with significant implications. This approach has made Indian markets highly attractive to China, raising concerns about the potential adverse impacts of this invasion. Although the negative effects have been minoring so far, they may worsen over time.

Savvy consumers benefit from these affordable offerings, appreciating the value relative to the price. However, small and medium-sized workers are facing significant challenges as their livelihoods are threatened. The effects are already being felt, with many daily wage earners either abandoning family businesses in search of new employment or facing unemployment. If these issues persist, there is a real risk of severe economic and social consequences.

At a macro level, this invasion is severely affecting India's small and medium enterprises, much like termites undermining a structure. While large Indian companies are struggling against the influx of multinational corporations (MNCs), leading to their decline or disappearance, China's gradual but persistent presence is poised to challenge Indian MSMEs, potentially weakening the Indian economy. Thus, there is an urgent need to address this issue proactively to protect Indian industries from further damage. As the saying goes, **"A stitch in time saves nine."**

2. MSMEs in India -The Current Scenario:

The Indian economy is projected to grow at an annual rate of 8% over the next five years, as outlined in the Government of India's 12th Five-Year Plan. However, the growth rates for 2014-15 and 2015-16 fell short of expectations, recording 7.2% and 7.6% respectively. The plan highlights that achieving and maintaining this level of growth, along with higher employment rates, requires boosting the industrial and service sectors, particularly through the expansion of Micro, Small, and Medium Enterprises (MSMEs). MSMEs have the potential to generate significant wage employment, second only to agriculture. They are recognized as crucial for economic growth, job creation, and the empowerment of marginalized communities.

To address this, the National Common Minimum Program of the current government includes several initiatives: increasing technological, investment, and marketing support for household and artisanal manufacturing; removing bureaucratic obstacles for Small Scale Industries (SSI); and prioritizing infrastructure upgrades in major industrial clusters.

The MSME sector is essential to India's economic development, contributing nearly 40% of the gross industrial value added. It also provides the largest employment opportunities after agriculture. Despite certain limitations, MSMEs have significantly advanced technological development and export growth. They are present across diverse sectors including food processing, textiles and garments, agricultural inputs, leather goods, chemicals and pharmaceuticals, bio-engineering, engineering, electrical and electronics, electro-medical equipment, sports goods, plastics, and computer software.

2.2 Comparison Between India and China on Overall Performance in Different Sectors:

China stands out as one of the most remarkable and significant development stories in modern history. Never before have so many people experienced such rapid improvement in their living standards, largely through their own efforts and innovations. Much of this progress can be attributed to China's open economy policy, especially its focus on exports, which totaled $178 billion USD as of October 2016.

Export growth has been a key driver of China's swift economic expansion. Although global demand weakened over the past two years, China's share of global exports increased from 12.3% in 2014 to 13.8% in 2015. China's major exports include mechanical and electrical products (41% of total exports), high-tech products (20%), labor-intensive goods such as clothing, textiles, footwear, furniture, plastic products, and ceramics (16%), as well as motors, generators, and integrated circuits (5% each). The United States remains China's largest export partner, accounting for 18% of total exports, followed by Hong Kong (15%), the European Union (16%, with Germany, the UK, and the Netherlands each contributing 3%), ASEAN countries (12%, with Vietnam at 3%), Japan (6%), South Korea (4%), and India (3%).

In contrast, India's merchandise exports to China were slightly higher at $14 billion in 2010-11 but were only a third of the imports from China. By 2014-15, India's exports to China had decreased to $11.9 billion, while imports surged from $43.5 billion to $60.4 billion, creating a trade deficit of approximately $48 billion USD. This trade deficit grew to $44.7 billion during April-January 2015-16, with India's exports to China falling to $7.56 billion and imports rising to $52.26 billion.

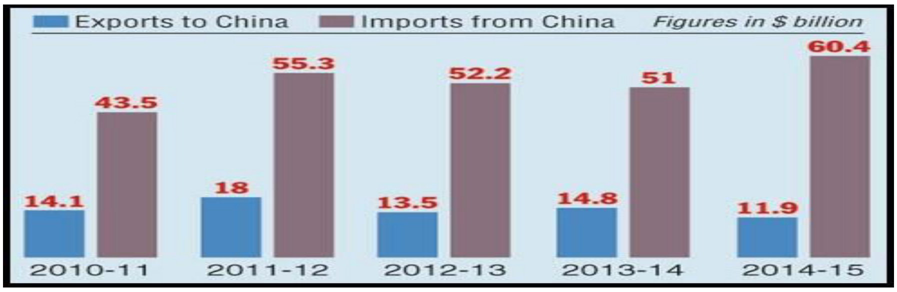

Fig-I: http://allindiaroundup.com/news/india-bans-import-mobile-phones-milk-from-china/

According to a survey by the global professional services firm Ernst & Young, China remains the most attractive destination for foreign direct investment (FDI). Conducted between February and March 2007, the survey of 809 managers from European, American, and Asian firms revealed that nearly half—48 percent—considered China one of their top three preferred business locations, an increase from 41 percent in 2006.

On the other hand, India's appeal to investors is also growing rapidly. In 2004, only 11 percent of investors listed India among their top three preferences, but this figure jumped to 26 percent in 2007 (China Daily, July 5, 2007). Despite this increase, India's FDI potential was initially limited by a public sector bias in industrial policy and restrictive foreign investment regulations.

However, with changes in government and the introduction of business-friendly initiatives like the Make in India campaign, FDI in India has surged significantly. The number of jobs created from FDI rose from 116,000 in 2013 to 225,000 in 2015, the highest globally.

In 2015, India surpassed China to become the top destination for foreign direct investment, attracting $63 billion in FDI projects. According to FDI Intelligence, a division of The Financial Times Ltd., India was the leading country for capital investment that year, surpassing both the U.S. and China. Minister of State for Finance Jayant Sinha confirmed this milestone, noting that India had overtaken the U.S. and China in FDI for the first time.

2.3 Reasons Why Indian MSME are Lagging Behind.

Difference in outlook of Government policies for development: India and China, the two leading powers in Asia, are also among the fastest-growing economies globally. China, once a poor and insular country, has risen to become the fourth-largest economy in the world with a GDP of $1.65 trillion. Its growth rate averaged 7.3% annually from 2014 to 2015, and it is projected to grow at 6.7% per year from 2016 to 2020. Meanwhile, India, which began its economic liberalization efforts in the early 1990s, started later than China, which has been on this path since 1978.

India's average annual economic growth was 7.3% in 2003 and 7.5% in 2004-05. During this period, its per capita income more than doubled from 1978 to 2005-06. In contrast, China's per capita income increased approximately fourfold over the same timeframe.

The significant disparity in GDP growth between China and India can be attributed to their differing engines of growth. China's economic expansion is primarily driven by its extensive and diverse manufacturing sector, whereas India's growth is largely fueled by its burgeoning services sector, particularly in IT. One major reason for India's less impressive economic performance is that its reforms and liberalization efforts have largely bypassed the agricultural sector, which accounts for 20% of GDP and supports roughly 70% of the population. This sector remains highly dependent on unpredictable monsoon patterns, leading to growth rates of less than 1% over the past decade, while the population continues to grow at around 1.9% annually.

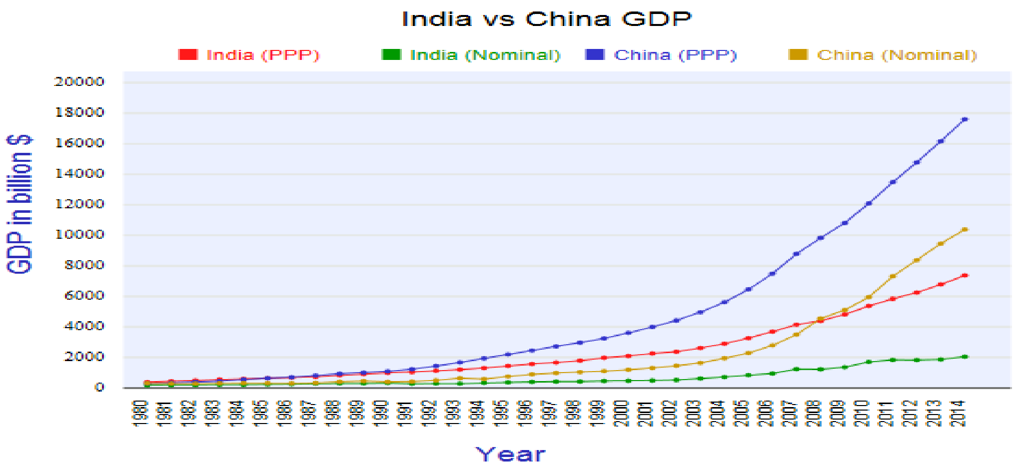

Fig-II: Per-capita GDP in India and China 2014($US)

Source: http://statisticstimes.com/economy/china-vs-india-gdp.php

Despite rapid population growth, China has achieved remarkable improvements in living standards. Between 1981 and 2001, the proportion of people living below the poverty line (BPL) dropped dramatically from 53% to just 8%. This means that, by 2001, around 400 million fewer people were living in extreme poverty compared to two decades earlier. What accounts for China's extraordinary success in poverty reduction, and what can India learn from this experience?

China's success is largely attributed to its labor-intensive manufacturing sector, which generated substantial employment and contributed to poverty alleviation. Additionally, reforms in the agricultural sector played a crucial role in economic growth and poverty reduction. These reforms spurred the development of the "Township and Village Enterprises" (TVEs), a new economic sector that emerged from the rural areas. The share of TVEs in industrial output soared from 9% in 1978 to 58% in 1997, and employment in these enterprises grew from 28 million to 135 million during the same period.

This highlights the interconnectedness between agricultural and industrial growth. In contrast, India's incomplete reforms in the industrial and manufacturing sectors have left the economy with many uncompetitive firms. Moreover, the limited growth in the industrial sector has restricted the movement of low-skilled labor out of agriculture, hampering overall economic progress.

The Facts Advocating the Outrun of Indian MSMEs by China (Business Economics,15/10/06, Pg.28-29)**:**

• Chinese consumer durables generate trade exceeding 8 to 10 million rupees daily, according to market insiders.

• Chinese products have established an extensive retail network throughout India, including in remote villages, often without significant media promotion or advertising.

• Local artisans who traditionally craft idols are facing severe challenges due to the influx of innovative, decorative, and affordably priced Chinese idols. This competition makes it difficult for artisans to match the lower prices of Chinese products, leading to hardship. For example, in Maharashtra and West Bengal, local artisans are struggling as Chinese-made idols of Lord Ganesa, Goddess Durga, and Kali have largely replaced traditional Indian idols, pushing some artisans to the brink of starvation.

• The once-renowned Aligarh Locks Industry has lost its prominence due to the arrival of Chinese locks, which offer innovative features at lower prices, leaving local artisans struggling to survive.

• Firozabad, long known for its glassware production, has been adversely affected by the influx of Chinese glass products, leaving local manufacturers uncertain about their future.

• Shivakashi, the center of India's firecracker industry, is also facing decline as superior, more colorful, and affordable Chinese firecrackers dominate the market.

• India's toy industry is losing ground to Chinese products. Electronic toys, soft toys, decorative toys, plastic toys, and other items from China have effectively edged out Indian-made toys from the market.

…. the list continues as other items like attractive chandeliers, watches, battery cells and even decorative items all made in china have flooded the Indian market.

More Focused on PSUs: Historically, the public sector held a monopoly or dominant position in most industrial policies, severely restricting opportunities for the private and small sectors to develop. Government policies on foreign direct investment (FDI) were highly selective, prioritizing only high-tech industries, which left the scope for private investment—both domestic and foreign—in the MSME sector very limited. As a result, the sector has remained reliant on outdated technology, inadequate infrastructure, high production costs, frequent labor turnover, and insufficient emphasis on quality.

Late starter: China enthusiastically embraced globalization and trade, welcoming foreign direct investment with open arms and gradually dominating global markets for low-tech, labor-intensive goods (MSMEs). In contrast, India began its liberalization process in 1991, continuing with reforms initiated under Rajiv Gandhi and accelerating after 1991. While these reforms led to a doubling of growth rates from the previous "Hindu rate" of growth, India still lagged behind China.

As a result, despite starting with similar per capita incomes 25 years ago, Chinese incomes are now twice those of India. This disparity is due not only to faster GDP growth in China but also to a lower population growth rate, thanks in part to the one-child policy—an area where India’s approach has been less successful.

Infrastructure: The world’s first commercial maglev (magnetic levitation) train operates between Pudong International Airport and downtown Shanghai, covering the 30-kilometer distance in just seven minutes. This contrasts sharply with the 75 minutes to a few hours it takes to travel the same distance between Mumbai's international airport and Nariman Point. China’s impressive advancements are evident not only in higher incomes and reduced poverty but also in areas such as literacy, labor efficiency in the public sector, and infrastructure investments.

International observers are often astonished by the rapid implementation of infrastructure projects in China. As noted by the Financial Times on January 21, 2004, "if thousands of villagers have to be relocated for roads or power stations, so be it: investment in infrastructure is a cornerstone of China's success."

While the Deng Xiaoping era dramatically shifted away from Mao’s economic policies, the Chinese have retained one of Mao’s strategic principles: respect your adversary strategically while dismissing him tactically.

Cost of production increased due to delay: Comparing China's Three Gorges Dam with India's Sardar Sarovar Project highlights a stark contrast in project execution. While the Three Gorges Dam in China was completed with relative speed and efficiency, the Sardar Sarovar Project in Gujarat has been mired in agitation, endless court battles, and environmental concerns, typical of a democratic, rule-of-law society. These factors have not only delayed the project's implementation by possibly a decade but have also significantly increased costs. The direct cost escalation represents only a fraction of the overall economic impact. This issue is not isolated; numerous other projects, large and small, such as Tata's Nano project in Singur, have faced similar delays or abandonment due to these complications.

In China, it typically takes about a month to initiate a venture, whereas in India, it can take up to three months, with completion dates frequently falling well behind initial projections. The economic loss due to such delays in starting projects is substantial and impacts overall productivity.

3. Strategy Adopted by China to Penetrate the Grass-root Level of India’s MSME Sector:

Although Chinese goods dominate global markets today, Indian industries have been particularly hard-hit. Chinese products have infiltrated the Indian market relatively recently but have already posed a significant challenge to local manufacturers. By 2004, trade between India and China had exceeded $13.6 billion, with imports valued at $5.93 billion. Indian importers view India as a prime market for Chinese products, which offer low prices and lower quality, making them accessible even to less affluent consumers.

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Chinese manufacturers often deploy marketing teams to India to identify high-demand products with strong future potential. These samples are then brought back to China, where they undergo significant value additions and innovative enhancements before being reintroduced at prices much lower than their Indian counterparts.

Once produced, these goods are shipped to India through legal channels, adhering to customs regulations. The process typically involves a Chinese agent, who earns a 3% commission, and an Indian agent, whose commission varies based on the size of the consignment.

The lower costs of Chinese products can be attributed to three main factors: first, economies of scale, as Chinese manufacturers benefit from serving a vast customer base; second, a compromise on quality, which, despite being acknowledged, is accepted by Indian buyers; and third, the consolidation of production processes under one roof in China, facilitated by favorable labor laws, compared to India's fragmented production sectors.

In some cases, manufacturers resort to illegal practices. Goods often transit by sea, increasing expenses, but under-invoicing (up to 30%) helps reduce selling prices and further lower costs.


Chinese good in every festivals and occasions flooded Indian market.


Chinese good in every festivals and occasions flooded Indian market.
India still thousand years back in Technology & Innovation!!!

4. Alarm for Other Sectors:

Despite already establishing a significant presence in India, China remains a formidable competitor, targeting new sectors for expansion. The emerging industries where China is making inroads include glassware, chandeliers, battery cells, digital diaries, dental equipment, toothpaste, crystal trophies, sanitary products, hardware, cosmetics, and pet accessories. Over 100 Chinese pharmaceutical companies are planning major expansions in India through joint ventures, strategic alliances, research collaborations, and wholly-owned subsidiaries.

Additionally, China is setting its sights on the steel industry, with Sino-Steel proposing a $4 billion investment to build a 5 million-ton Greenfield steel plant in India. This could become one of the largest Chinese foreign direct investments in the country.

Chery Automobiles, China's largest car manufacturer, is collaborating with Delhi-based International Cars and Motors Ltd (ICML), known for its Sonalika tractors, to launch a small car in India by 2008. This move poses a significant threat to local small parts manufacturers.

5. What India Can Do to Nullify the Attack.

Given the alarming impact of China's economic strategies on Indian MSMEs, it's crucial to address these challenges swiftly. The following recommendations are proposed as potential solutions to help Indian MSMEs evolve and regain their competitive edge:

1. Innovation: In today's market, innovation often outweighs quality and price. Indian MSMEs should focus on incorporating innovative features into their products while maintaining quality and affordability. While Chinese products may sometimes compromise on quality, Indian manufacturers can attract customer loyalty by striking a balance among innovation, quality, and price.

2. Government Facilitation: Indian MSMEs are often disorganized, under-managed, and underprivileged, limiting their potential. The government should play a central role in offering subsidies, financial support, management education, technical assistance, and marketing help. Current programs are often inadequate or plagued by bureaucratic inefficiencies and corruption.

3. Anti-Dumping Measures: China's practices of flooding the Indian market with low-cost goods can be seen as a form of dumping. This has significantly impacted Indian businesses, with Chinese products capturing a large share of the market. The government should address this by enforcing anti-dumping laws to protect local industries from further harm. India has previously taken steps such as banning imports of certain substandard products from China. For instance, milk and milk products, as well as some mobile phones, have been banned due to quality and security concerns. Despite WTO regulations limiting the scope of complete bans, such measures are crucial for safeguarding Indian industries.

4. Reducing Transaction Costs: The government should focus on reducing transaction costs through improved trade facilitation and infrastructure. This includes increasing the frequency of direct shipping routes and expanding air cargo facilities with dedicated terminals and ports.

5. Promoting Indian Brands in China: Building awareness of Indian products in China through increased exhibitions and trade shows can help establish a stronger Indian brand presence. Events like the CII Made in India Shows have been successful models and should be replicated in multiple Chinese cities to boost visibility.

6. Enhancing Banking Links: Strengthening banking relationships and working on bilateral agreements for letters of credit (L/C) between EXIM Bank of India and Chinese financial institutions can facilitate smoother transactions and support Indian exporters.

7. Exporting Higher Value-Added Products: India should focus on exporting higher value-added products to China, rather than the raw materials and intermediates currently being exported. Despite India’s competitiveness in global markets, its exports to China are limited. Targeting higher-value products can improve trade balance and capitalize on India’s strengths in various sectors.

Implementing these measures can help Indian MSMEs navigate the competitive pressures from China and strengthen their position in the global market.

6. Conclusion:

Despite its large population, China remains a dominant economic force in Asia, outpacing India due to several key factors:

- China initiated its liberalization process in 1978, significantly earlier than India's 1991 start.
- The Chinese government has maintained consistent policies, whereas India's approach has been more volatile and inconsistent.
- China’s rapid adoption of new technologies and strong government support have driven industries to produce innovative and cost-effective goods.

However, this does not mean India cannot compete. Positive trends in India’s GDP, infrastructure, and literacy rates suggest potential for growth. As India seeks to expand its global business presence, China has become a major investment destination for Indian companies. Notable investments include Tata Consultancy Services (TCS) securing a $100 million deal over five years with the Bank of China for technology solutions, and Binani Cement planning a $100 million investment in its newly acquired Chinese cement company, Shandong Rogan Group, which has a capacity of 0.4 million tons per year. Additionally, in May 2007, ten Indian companies across various sectors, including consumer durables, electronics, telecom, and industrial development, signed memorandums of understanding worth $5 billion to establish manufacturing units in China.

According to Manu Bhaskaran, a partner at the Centennial Group, maintaining growth momentum requires improvements in regulatory frameworks, infrastructure, and fundamentals like education and technology application. Recent international acquisitions exemplify these advancements. The focus should be on extending economic consolidation to other sectors as well.

The Indian government has redefined its role as a promoter and facilitator of business development, enacting policies and reforms to create a supportive environment. The MSME Development Act of 2006 and subsequent promotional measures, along with a budgetary emphasis on the sector, highlight its importance. Many banks now have dedicated MSME divisions to address the financial needs of small enterprises. Promoting MSMEs is crucial for inclusive growth, poverty reduction, and achieving development goals. Supporting micro enterprises so they can grow into small and medium-sized businesses is essential for reducing poverty and fostering economic development.

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