

Coronavirus: Economic impact and the road ahead





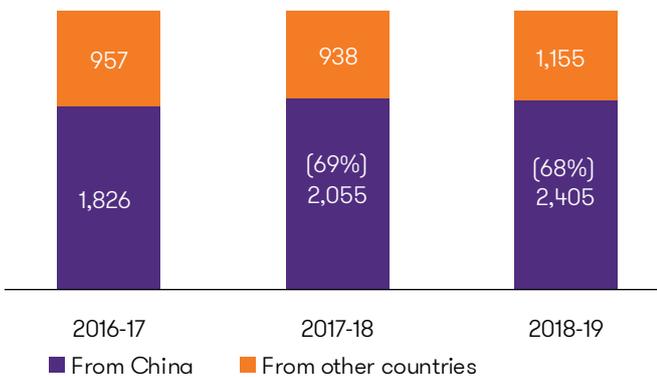
As coronavirus (COVID-19) outbreak is slowly gripping the world trade, many Indian sectors are staring at a shortage in supply of raw materials. Technology, poultry, automobile, and chemicals are some of the sectors that are already hit by the outbreak. But the pharmaceutical industry is said to be the worst affected.

As the factories in China are closed, India is working to maintain supplies of active pharmaceutical ingredients (APIs), a key raw material for medicines. India supplies low-cost generic drugs, both within and outside the country. The pharmaceutical firms procure almost 70% of the APIs from China, the world's leading producer and exporter by volume. Indian companies and the government are now concerned over the vulnerability of the supply chain.



Impact on healthcare industry

Bulk drugs imports - China dependencies



* All figures are in USD million
Sources: Directorate General of Commercial Intelligence and Statistics

At 12%, organic chemicals are the third most imported products from China. Within organic chemicals, imports for the pharmaceutical industry are the largest. Heterocyclic nitrogen compounds and antibiotics are the largest organic chemical imports by China from India, accounting for almost 30% of such imports.

Apart from wide applications in pharmaceutical research and drug discovery, heterocyclic nitrogen compounds are used in antibiotics, anti-cancer, anti-migraine, anti-ulcer, anti-inflammatory, anti-viral, and anti-depressant drugs. Nearly 70% of India's total imports of heterocyclic compounds are from China. Of these, 80-90% of the entire requirement of

some compounds, such as those with unfused rings, are also sourced from China.

India's reliance on China for pharmaceutical imports reflects a particular character of the industry. The companies have achieved great proficiency in the downstream value chain. This essentially pertains to preparation of formulations, packaging and marketing. Indian pharma firms have been especially successful in manufacturing generic drugs. The proficiency has enabled them to quickly pick up branded drugs once their patents expire and produce their generic versions. These versions are sold at much cheaper rates than the branded drugs in both domestic and international markets. However, the success of this process depends heavily on the availability of bulk drugs as these have critical drugs that can be used as APIs in formulations.

India's pharmaceutical industry has not always been so dependent on the Chinese imports. In 1991, Chinese ingredients made up only 0.3% of the India's bulk drug (API) imports. But as the drugmakers moved into formulations, they started procuring APIs from China, where the cost of production is lower.

India's dependence on China for APIs is increasingly seen as a matter of health security. In 2018, the government had set up a taskforce to revive the API sector. Over the past fortnight, several high-level meetings between the Centre and key representatives of the pharmaceutical industry have taken place to step up the API manufacturing capacity within India. One such meeting, was organised by NITI Aayog, a government think tank, raised suggestions such as speeding up approvals for building factories, including necessary clearances from the environment ministry, giving concessions on electricity, and the promotion of pharmaceutical manufacturing hubs.



API manufacturing in India: The fine print



- Assessment of the company's supply chain dependency on Chinese bulk products
- Determination of critical inventory components and related buffer stock strategy
- Interruption simulations
- Capacity scale-up while balancing challenges in maintaining utilisation
- Production turnaround and infrastructure for scaling up of quality functions



- Optimisation of product planning considering risks on account of failure to supply
- Developing alternative sources of supply
- Pre-booking sea and air freight facilities
- Investment in backward integration to establish self-sufficiency in production on some supplies
- Managing working capital requirement to get the supplies first in hand



- Relook at force majeure clause in supply contracts
- Identify idle capacities to supplement production
- Disaster recovery planning in case of prolonged disruptions
- Identify specific origin of supply from China (Wuhan, Hubei, Guangdong, etc.)
- Determine inventory requirement for next six months



Drug for COVID-19: Opportunity for Indian firms

At present, there are over 50 major pharma companies worldwide that have joined the race to develop a drug for the COVID-19. While the drug is still at least a year or 18 months away from the actual launch, the Indian Institute of Chemical Technology (IICT) researchers said that once the drug is launched, they would be able to reverse engineer the technology and transfer it to Indian pharmaceutical companies for mass manufacturing.

Such innovation will also go a long way in reducing the costs of the COVID 19 drug, in case the pharmaceutical companies decide to sell their drug for a premium. In case the companies refuse to sell or share the drug technology in India, Parliament has the right to invoke 'compulsory licensing' clause, which will allow high-end laboratories like IICT to reverse engineer the drug and transfer the generic version to Indian drug manufacturers.



Impact on other sectors

Most of India's machineries and components are imported from China. Various electrical and non-electrical machineries, and industrial appliances comprise half of Indian imports from China. These are followed by imports of organic chemicals and fertilisers. The repercussions of the outbreak can be seen in the **technology sector**. Many prominent mobile phone manufacturers have said that the outbreak has taken a toll on their supply chains.

The outbreak has also hit **poultry sales** in India because of rumours on social media platforms that the virus can be transmitted through chicken. In the past few weeks, there has been a significant decline in the poultry sales and prices have almost been halved.

The **agro-chemical industry** also depends on the raw materials from China, known as technicals. The imported technicals or active ingredients (AIs) are then added to certain chemicals, which are used on crops as pesticides.

The spread of virus across continents has brought the **travel**

and tourism sector to a standstill. All existing visas issued to foreigners have been suspended till April 15. Visa-free travel for OCI card holders has been kept in abeyance till April 15. All incoming travellers, including Indian citizens who may have visited China, Italy, Iran, South Korea, France, Spain and Germany on and after February 15, will be quarantined for 14 days. Travel through land borders in India will now be restricted to immigration checkposts, followed by medical screenings for COVID-19.

The **automotive component sector** is already witnessing sluggishness in the demand for over a year. The sector is on the cusp of adopting BS-VI regulations, effective 1 April 2020, leading to higher cost of components and finished vehicles. Inventories are sufficient to manage in the short term, but the lack of single critical components can hurt the original equipment manufacturers (OEMs). Local auto-component manufacturers cannot immediately capitalise on the void created by Chinese products, as OEMs take time to recalibrate their supply chains.



Looking ahead: What this means for the Indian economy

According to the United Nations Conference on Trade and Development (UNCTAD), the pandemic, as termed by the World Health Organization (WHO), is expected to cost the global economy around USD 2 trillion in 2020. It is also likely to depress the global growth to below 2.5%.

Shanghai and Beijing are home to Indian information technology (IT) and business process outsourcing (BPO) companies. Their key concerns include artificial intelligence (AI), the internet of things (IoT), and the big data. Many companies are already encouraging their employees to work from home. Also, there have been restrictions on travel. The big picture is that many of them have been unable to complete their ongoing projects.

The reverse case is that of Chinese firms in India as many of their teams work in collaboration with their Chinese counterparts. It has been found that some of these companies have had to face delays while launching new products, as many offices have fully or partially shut down in China. Meanwhile, the start-ups that are in talks with Chinese investors are likely to get a lukewarm response.

The stock market's crash has brought down the net worth of most companies, across sectors by 5-10%. The Indian stock markets have entered the bear territory by plunging more than 20% from their recent highs. This fall can largely be attributed to the outbreak.

China has the world's biggest manufacturing hub and connects with global supply chains. Many raw materials are sourced from China and this will adversely affect the manufacturing process of consumer electronics goods. About 67% of India's electronic components are imported from China. Though India has progressed from assembling to manufacturing of low-end electronic components, the import dependency remains high, especially in the case of critical components.

White-label goods such as televisions, smartphones and refrigerators are sold online. Products and tech accessories that have been customarily shipped to India will instead reach us via air freight. With this, the prices of product have escalated. The consumers are already feeling the heat, as anticipated promotional offers and discounts on many such products will inevitably be reined in. It may not be practically viable to replace China with Vietnam because the latter also relies on China for many of its electronic components.

Hence, a long-term perspective is to promote the domestic manufacturing industry in sync with the Make in India initiative.

In an attempt to boost the domestic production of mobile phones, the Indian government has announced a scheme, which is a production-linked incentive (PLI), to the tune of INR 42,000 crore. This will be for mobile companies that manufacture in India. These home-grown brands will be given a benefit of 4-6% on incremental sales on goods manufactured locally for five years. The scheme, which is slated to begin on 1 August 2020, is expected to generate two lakh jobs. The ambition is to establish India as an electronics and hardware manufacturing hub.

As the supply of solar panels is also disrupted, big solar projects are heading towards dark days: India imports 70% of solar modules from China. Supply disruption of solar panels (80% capacity globally is controlled by China) for projects commissioned in India for the next six months could lead to delay in project completion and possible invocation of force majeure clauses to avoid penalties by solar developers.

Additionally, the tourism, the hospitality and the aviation sectors are witnessing significant impact on their businesses due to travel restrictions imposed by the government.

When we look at the shipping and logistics scenario, over 90% of the global trade is transported overseas. China is the key consumption centre for bulk drugs and containers. It accounts for 70-75% of iron ore trade, 20-25% of coal trade and 25-30% for crude oil globally. The outbreak is expected to keep the demand and freight rates low in the short term. There has been a drop in the cross-border e-commerce supply chains from China. An extended outbreak of the coronavirus could spell a big trouble for India.

The Reserve Bank of India has flagged COVID-19 as a new risk for stuttering economic growth. The growth rate is estimated to slip to an 11-year low of 5% in the financial year ending in March. However, to calm the sentiments, it recently decided to sell dollars worth USD 2 billion to banks to infuse liquidity in the domestic forex market. The rupee bore the brunt as well. It breached the 74.5-mark against a dollar as the global investors flock towards the world's most liquid currency (USD) amid ongoing panic. The rupee, however, recovered later. But according to the finance ministry, India could also benefit as the outbreak is leading to lower oil prices and softer global interest rates.

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