FACING UP TO GLOBAL COMPETITION IN LABOUR INTENSIVE MANUFACTURING – A CASE STUDY

V.K. Talithaya

In one of his interviews on CNBC, the noted management guru C.K. Prahalad said that when Indian industrialists expressed the fear of Chinese competition they were already paving the way for losing the game! If you are afraid of putting your first step forward in the war of competition, how are you going to win that war? Premier Industries* is a company which dared to compete with China, because it believed that competition is much more than producing with cheap labour or aggressive export of products. Premier Industries had been established in late 2004 for the manufacture of FMCG products for export, mainly to the United States. The promoters who included a US citizen having a decade's experience in trading in the FMCG sector, two non-resident Indians and a scion of one of India's business families, believed that they could create competitive advantage where none seemed to exist. The company was established as an export-oriented unit (EOU).

Premier Industries began with the marketing strength of its US promoters who had been supplying the products to almost all the major retailers in the US such as WalMart, Dollar General, Dollar Tree, Michaels etc. Therefore, when the company started, the focus was on creating a dependable manufacturing facility which could cater to the US promoter's requirement. The company did not think it had to worry about marketing. It entered into an MOU with the US promoter to supply the product in the US market only through them at negotiated prices. The US promoter in turn took upon itself the onerous responsibility of buying a minimum volume of products from Premier every year, fairly equally spread over different quarters. However, the products the company manufactures and sells are not branded. Any manufacturer can enter this market, and there is no entry barrier

* Not the real name

such as brand, technology, intellectual property etc. The only strength Premier can strive to acquire is reputation as quality manufacturer and a dependable supplier. Though in the first few years of its operation Premier depended totally on its US promoter to market the products, eventually its reputation as a large, diversified, dependable quality manufacturer of FMCG products in its class spread by word of mouth. As a result a number of retailing companies approached Premier to supply them directly. Today, Premier supplies about 40 per cent of its output directly without the hand-holding by the US promoter.

The manufacturing facility was set up in South India near one of the ports. Initially the capacity was to produce about 750 Metric tons of products a month. Eventually the capacity was raised stage by stage to reach the present capacity of about 2500 Metric tons a month. Today, Premier is one of the largest manufacturers of its type of products in the world. The company has the capability to manufacture all varieties within its class.

The company has a well equipped laboratory and design departments, with very talented and capable staff. The laboratory's function includes making samples and prototypes of products based on the request of customers. These departments also make new designs for suggestions to customers. All samples and production batches are subjected to various tests as per the standards stipulated by the customers.

An important aspect of Premier's manufacturing model is the mix of technology and labour-intensive process. The company made a deliberate choice of going in for highly labour intensive manufacturing with higher technology in limited areas to ensure quality. The reason was that a completely automated process would still involve employing a large labour force for the packing area. Secondly, a fully automated process is so expensive that the final price of the products will be higher than what can be manufactured manually.

Company Performance

The company's performance has been progressively improving. The last four years' performance in terms of volumes and value are as follows:

Year	Volume	Value
2005-06	5000 MT	Rs.50 Crs
2006-07	15000 MT	Rs. 70 Crs
2007-08	18000 MT	Rs.110 Crs
2008-09	15000 MT	Rs.120 Crs

The margins vary from product to product. On an average, it hovers around five per cent of the value mentioned above. However, in the first two years of operation the company did not make any profits, as a huge cost was involved in learning the processes.

As can be seen above, while the value has been consistently increasing, the volume dropped in 2008-09. In spite of this drop in volume, value rose because of two factors: (1) the cost of raw materials rose phenomenally, raising the cost of manufacture. Customers were persuaded to raise the prices to compensate for part of the rise in cost. (2) The learning over the period of the past three years helped the company manufacture high quality products which attracted high-end customers. This enabled the company to realize better price. (3) There has been huge improvement in productivity. Reliable systems were put in place which ensured reduction in cycle time. Improvements in operations also ensured reduction in wastages. The drop in volume also needs to be seen in the background of the global financial crisis and resulting drop in consumer buying in the US.

It needs to be noted that some of the products Premier manufactures are subject to seasonal variation. October to February are months of high sales, which means that production will be higher in the months of July to November, providing for a month's time for shipment from India and another month for moving the products from warehouses to the outlets in the buying countries. Therefore, the volumes or financial performance do not remain uniform over the months. As a result, while capacity utilization is more or less full in the busy season, in the lean months due to capacity overhang the cost of production will be a little higher.

Employee profile and productivity

While discussing Premier, a former chairman of one of India's high-tech companies told me that high-tech did not mean laser beams, chips and ICs. Hundreds of people systematically organizing themselves to do *consistently high-quality* products in a labour-intensive process also are high-tech, he said. Indeed, Premier adopted this model of manufacturing. More than a thousand employees were manufacturing millions of pieces of products ensuring consistency of quality. This means that the company invested considerable resources in training and developing its employees in the required skills, manufacturing processes, quality standards, customer expectations and efficient operations. But what kind of employees does Premier employ?

The manufacturing workers are mostly under-matriculates. Most of them come from very poor families. About 50% are women, who work to supplement their families' meager earnings. The supervisors and staff are mostly graduates. The laboratory staff are primarily graduates in chemistry. It is only at the managers' levels that the company has well-qualified employees, such as chemical engineers, chartered accountants, MBAs etc.

On the face of it, this is a motley group of employees belonging to different levels of society and different also in terms of education and family values. What is it that binds them all into an effective team, particularly to perform in an industry where personal involvement is so important? What motivates them to show commitment in contributing to manufacture highly sophisticated products? How do they connect with the customer? In the sensitive retailing business what counts is quality, consistency, delivery schedules, the systems in the organization, proper documentation of the processes and finally conforming to social standards laid down by the customers.

The manpower increased with rise in output. From about 500 employees in the first year of operation it rose to 1500. This is in line with the increase in volumes. With establishment of systems and improvements in productivity, however, further rise in manpower was restricted even as volumes increased. The company has a target of improving productivity by another 10 per cent in the current year.

In the present manufacturing model, every employee has to be conscious of quality. The products the company manufactures are delicate. They require careful handling while manufacturing, packing and stacking. Therefore, an important concern for the management is how to sustain the commitment and self-discipline of the employees in the long term.

Employee turnover was very high in the early years. For women, marriage is one of the important reasons for leaving. Men leave for higher daily wages in construction sites. They prefer higher wages today than deferred payment of PF, gratuity etc.

Supply Chain

An important area of challenge for the company is managing the supply chain. The major raw materials are imported. The variety and number of materials needed for manufacturing as inputs are an inventory manager's nightmare. Each batch of purchase by the customers is unique in design. Except the items which sell throughout the year (the non-seasonal items) which are proportionately small, all other items which include their packaging, labels etc. are designed for the occasion. Rarely the design repeats. Accordingly the bought out items change. This creates a huge challenge of managing the supply chain.

The major issues in managing the supply chain are:

1. Managing the complexity of bought out materials. This means identifying new vendors, as existing vendors may not be producing the new items, co-coordinating with the vendor to ensure conformity with design requirements, quality standards etc.

2. Ensuring the quality of materials from a number of suppliers. Many of these suppliers are not conversant with world-class quality concepts. Secondly, even when a vendor is able to produce quality materials,

consistency is a serious challenge. Many local vendors do not appreciate the need for consistency in quality from one batch to the next of the same item.

3. Managing lead-time. In export market the shipping date is of paramount importance. Unless the bought out items reach on time the entire manufacturing schedule will go off the rail affecting the shipping date. Slipping on shipping date will invite penalties. Poor infrastructure, delays in transport, bureaucratic hold-ups of materials etc. are perennial problems with vendors. These potential problems need to be factored into supply chain calculations.

All these involve creating a different equation with the vendors. There needs to be continuous communication between the vendors and Premier not only with regard to the supply schedule and quality, but also on efforts to continuously improve quality and delivery schedules. Building the dependability of vendors is an important task.

Vendor development is another area of importance. New products, new designs and new packaging means using materials which have not been used so far. Locating these materials, adapting them and finally manufacturing to world class standards is important. This involves a lot of co-coordinating with the vendors.

Quality creates competitive advantage

When Premier began operations, China was a major competitor. Chinese products were flooding markets in the US and Europe. Even in India most shop shelves were filled with the products from China. What was China's competitive advantage? (1) Labour was cheap. But the difference between India and China was insignificant. (2) Raw material availability and price. Chinese companies enjoyed two advantages. (a) Transport cost of some of the raw materials was less for them. (b) Chinese companies might be getting subsidies, giving them an edge over foreign companies. (3) Packaging is comparatively cheaper in China. (4) China's infrastructure is comparatively better, particularly in areas where manufacturing is concentrated, giving manufacturers an advantage with regard to the supply chain. However, these advantages are marginal and Premier concluded that the Chinese threat could be faced by improved quality, creative and innovative designs and higher productivity.

What could be the competitive advantage of India? Here Premier went by the adage that countries do not have competitive advantage, firms have. The challenge was to create the competitive advantage of Premier. The key was productivity and quality. If all the competitive advantage showered on Chinese companies through subsidized raw materials etc. could be out-balanced by higher productivity and quality, Premier could establish itself in the global market. Therefore, all efforts were focused on productivity and quality.

An important aspect that the customer for the kind of products that Premier manufactures looks for is the dependability of the company. Does the company have the technical capability to create the products he needs? Do they have the knowledge and ability to create the formulations, matching the ingredients, ensuring the product qualities and providing the aesthetic appearance of the product? Premier developed people in these areas and continuously upgraded their knowledge. The ability of the laboratory staff to reassure the customers that this company has the capability to deliver both quality and volumes is what drew customers to it.

Premier's products are a difficult class of products. Getting consistency is as important as merely manufacturing quality. A process of collective learning is what ensures consistency of quality. In the long term, Premier's ability to ensure a major presence in the global market will depend on its ability to provide higher quality, newer designs and consistency of quality.

The marketing challenge

Premier supplies its products to the large retailers with thousands of outlets. As mentioned earlier, the products are not branded. Here is the marketing challenge. When the company has to reach the consumer only through the retailers, and when the retailers do not want the manufacturer's name or brand to be promoted as far as the ultimate consumer is concerned, Premier has to, per-force, adopt the strategy of marketing itself as an organization rather than its products. What does the retailer look for in Premier as a supplier? We have mentioned some of them in the previous section with regard to quality. There are other issues:

1. The retailer looks for capability of the organization to manufacture world-class products.

2. He looks for the ability of the organization to maintain the highest standards of quality on a consistent basis.

3. He looks for the versatility of the organization to manufacture a wide range of products in its class, so that he can limit his transaction costs by limiting the number of his vendors.

4. He looks for assured supply. That means the organization will not be disrupted by poor employee relations, litigations, non-compliance with statutory requirements etc. Besides assured supply also means strategically managed vendors of bought out items.

To meet these challenges Premier adopted the unique marketing strategy of focusing on marketing itself as an organization with which the retailers can do business to their advantage. As a result what Premier has been doing these last five years is marketing its own capabilities, competencies, knowledge-base, skill-reservoir and its exacting manufacturing systems. Marketing these organizational strengths means that the organization should, indeed, have these strengths. Premier had spent considerable resources in building enormous capabilities in design, quality assurance, consistent manufacturing, product development, anticipating customer needs etc. And that is why Premier could market itself as a competent manufacturer and supplier of world-class products.

But that goes as far as the retailer takes into account the organization. It is an acceptable and successful strategy for the global market. Premier has set its sights on the domestic market as well. India does not presently have a huge market for its range of products. However the market is growing. Secondly, Premier can position its products for the high end to start with and eventually move down to lower levels. All this means that Premier has to build a brand. Brand creation, maintenance and growing are a costly proposition for Premier at its present level of operation. Secondly, the important question is: Should Premier divert its focus from the huge international market to build the domestic brand which is not even as big as 1% of its sales in the international market? At the same time, looking far into the future, if Premier does not create a presence in the domestic market, eventually it will have no space there. Therefore, Premier has worked out a unique strategy of enlarging its market-share in the international market. That will help the organization marshalling the resources needed to create, maintain and build the domestic brand. Meanwhile, by creating a brand and ensuring its presence in some of the choicest high-end outlets, Premier makes sure that it has a presence in the domestic market.

The challenges ahead

In the last few years of its operation Premier has established itself as a manufacturer of quality products. Its range of products in its class is wide. In volumes it has few peers. Yet, the challenges ahead of Premier are many:

1. How can Premier sustain the competitive edge it presently has over China and other low wage countries of Asia and other parts of the world? In the absence of brand recognition, and the products being almost a commodity, how will Premier retain and grow its dominant position?

2. With its turnover at about US $ 30 million, Premier's present market share is about 1.5 per cent of the US market of $ 2 Billion. The market is widely spread, with the major players forming about 50 per cent of the total market. How can Premier enlarge its market share in this fragmented market?

3. Today Premier is depending only on the US market for selling its entire production. In the long term its interests will be better served by

diversifying into other markets also. However, these markets are more fragmented. Secondly, the customer preferences in different markets are different. How should Premier gear itself to become not only a major player in the US market, but also globally? This also means that Premier needs to build its own marketing set-up.

4. Having realized that virtually Premier's products have the characteristics of commodities, Premier has willy-nilly taken a decision to play the volumes game – sell huge volumes with low, highly competitive margins. But in the long term volumes can rise only by enlarging the work-force. Managing a much larger work-force, maintaining the high level of motivation and productivity, and keeping the commitment of the work-force to high quality standards are some of the intangible challenges of the future.

5. As Premier grows with the enlarging workforce, the labour cost will increase. Since on the one hand, wages are linked to the Consumer Price Index, and on the other hand as years pass the expectation of annual increments will lead to a rise in individual wages, the unit cost of the products will grow. How long can Premier (a) continue with the labour intensive strategy and (b) continue to improve productivity?

6. Eventually Premier may have to automate its manufacturing processes. It may have to introduce labour-saving machinery and equipment. In that scenario how will Premier retain its competitive advantage? There are some products which will always need highly labour-intensive processes. Should Premier focus on those products, or should it innovate on an appropriate mix of products?

These are the issues which Premier is now grappling with.

* * *