

China & India: New realities in the 21st century

A shift in economic center of gravity taking place

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If you're in the management ranks of a multinational company doing business in China and/or India, you may think your company's strategy is paying off. But according to Anil K. Gupta, if your understanding of these markets does not reach far below the surface, you're missing opportunities and leaving an opening for local competitors to swoop in and push you aside.

In his address to the International Executive Roundtable presented by the Institute for International Business, University of Colorado Denver, Gupta offered a new way of thinking about China and India as the economic center of gravity shifts from the developed to these emerging economies.

"To be present in a country does not imply that you have either insight or a good understanding about the market other than your strategy for the moment is producing results even if those results fall short of what they could be," said Gupta,

Generally, foreign companies are under-invested in Asia, failing to commit an adequate number of employees, assets and R&D resources, said Gupta. But are Asian markets worth the time and investment necessary to maximize returns? As an answer, Gupta drew a picture of what India and China will look like in 2020, a little more than 10 years from now.

- India and China are likely to be among the four largest economies in the world.

- India-China trade linkages are likely to be among the world's top 10 bilateral trade relationships.

- In many industries, half of the top 10 global giants are likely to have their origins

in India or China.

"The winning global enterprise of 2020 is likely to be simultaneously a European-American-Chinese-Indian-Japanese company," said Gupta, "and companies that represent a single country will become increasingly meaningless."

Current reality

"No country can escape the wrath of the current economic crisis, the worst in 80 years," said Gupta. Although the GDPs of China and India have fallen, they have not toppled as low as other economies. "In the last quarter of 2008, China's GDP growth closed at 6.8 percent and India's at 5.3," a far cry from the years before the downturn. The numbers are not expected to improve this year. "IMF projections for 2009 show China's GDP growth at 6.7, India's at 5.1, and negative figures for almost every other country.

"While 2009 projections are significantly lower than what China and India racked up in previous years, these are numbers developed economies would kill for even in the best of times," said Gupta. He predicts that "three years from now the economic crisis will have accelerated the rise of China as an economic and political power and will have kept India's rise as an economic power on track."

Which is why, said Gupta, "we are today, in 2009, at a strategic inflection point, a turning point." Gupta quoted figures to support this contention:

- In 1950, the GDP of the United States was more than 20 times the GDP of China or India.

- Today the GDP of the US is about 3.5 times that of China and about 10 or 11 times that of India.

- By 2025, China's GDP will have caught up with that of the US and India's will have caught up with Japan's.

What happens in the years after 2025?

"It is not unrealistic to predict that by 2050 China and India's GDP together could be as large as the combined GDPs of the US, Europe and Japan," said Gupta. This prediction is based on "assumptions that between 2025 and 2050, the US GDP grows at 2.5 percent a year and China's GDP grows at 5 percent, and that no further adjustment in exchange rates is necessary."

FOUR STORIES

The economies of China and India are characterized by "four stories – four realities – playing out at the same time. There is no other economy in the world – not Russia or Brazil or Vietnam – that captures all four stories in this way," said Gupta, who laid out the issues from economic and business

Today's Reality				
<i>Annual GDP growth rates (%)</i>				
Country*	2000-2007	2008E	2009P**	2010P**
US	2.7	1.1	-1.6	1.6
Japan	1.7	-0.3	-2.6	0.6
Germany	1.1	1.3	-2.5	0.1
France	1.7	0.8	-1.9	0.7
UK	2.6	0.7	-2.8	0.2
Italy	0.8	-0.6	-2.1	-0.1
China	10.2	9.0	6.7	8.0
India	7.8	7.3	5.1	6.5
Russia	6.6	6.2	-0.7	1.3
Brazil	3.3	5.2	1.8	3.5

*The world's top 12 economies also include Spain and Canada
 **IMF World Economic Outlook, updated January 28, 2009
 As illustrated in Anil K. Gupta's book "Getting China and India Right"

strategy points of view and urged US executives to rethink the tactics they employ to stay on top of these rapidly-growing markets.

1. Mega markets/mega growth/micro customers

The first story is about population and markets. “In the last five years, China and India have accounted for 10 percent of the world’s GDP, 25 percent of the growth in world’s GDP and 40 percent of the world’s population. Looking ahead to 2025, chances are high that these two countries with billion+ populations will account for 25-40 percent of world demand for almost every product and service. “There are things like clothing, food products, autos, mobile phones and pharmaceuticals that are driven by population numbers.

“Clearly, China and India have high growth potential. However, the markets are fragmented and brand loyalties are weak. They are simultaneously rich and poor: while these two economies are very large in terms of GDP, they also have very low per capita incomes. Despite a growing middle class in both China and India, much of the population lives in poverty.

“Unless you have high technical and/or brand advantage, you’ll find it hard to compete by exporting from the US,” said Gupta. “To capture these markets, you need local production, localized product design, and local marketing.”

2. Global cost reduction platforms

Offshoring is the second story or reality and it directly impacts a company’s bottom line as the following figures show.

In China, even in the Tier 1 manufacturing locations, labor is \$2.50 an hour; in India it’s \$1.50 an hour; in the US it’s \$20+ an hour. The average annual salary for software engineers in India is \$15,000 with benefits; in China it’s about \$20,000; in the US about \$90,000-100,000.

“So what is the billion dollar question?” Gupta asks. How much can a company save through offshoring? A case in point is Accenture.

“In 2001, Accenture had less than 500 people in India; today they have somewhere between 35,000-40,000 or 20-25 percent of their worldwide workforce. Over 80 percent of their people are working on global projects with a client outside India although the work is being delivered from India. That’s a savings of around \$40,000 per person or \$1 billion when you multiply the savings by the number of employees.

And that’s a conservative figure.

“If Accenture hadn’t engaged in this strategy, it would be either a much less profitable company or a much slower growing company.”

3. Innovation platforms

“The third story that’s playing out is innovation,” said Gupta, which has a direct correlation to education. “In both China and India, the output of bachelor degrees in engineering, computer science and information technology (IT) is growing while the numbers in the US are steady.”

Patents can be used as a measure of innovation, Gupta said. The period 2000-2006 saw a significant increase in the number of filings originating from China, India Australia and the Republic of Korea. The average annual growth rate in patent filings for these countries was far above that of all reported countries in Europe and North America. Japan, the United Kingdom and Sweden experienced modest growth in patent filings (less than 1 percent a year).

“In 2020 the patents granted by the US Patent and Trademark Office to inventions originating from China will likely exceed those granted to inventions originating from Germany, France, UK and Italy combined.”

Gupta cited GE’s presence in India and Microsoft’s presence in China to show that innovation, while still in the early stages, is the next big story in these countries.

China’s advantage

“Indicators of innovation drivers give China an advantage over India. The differences between the countries, while large, are not as large as we may assume them to be. It’s a case of the world’s largest democracy versus the world’s largest autocracy. Autocracy has an advantage as long as you have smart autocrats, which China has had for the past 30 years,” said Gupta.

“There’s a saying in China that ‘the mountains are high and the emperor is far away.’ In many cases the central government will create a policy but the governor who has to implement it will look the other way. Or the governor will create a policy and the city mayor will look the other way. In-

creasingly at the central level in the Chinese government, the different ministries will publicly disagree with each other. So getting clearance from one arm of the government doesn’t necessarily mean that you’re not going to run afoul of another arm of the government.”

4. New global competitors: Dragons and Tigers

“The fourth story is about how success in China and India allows national companies to springboard beyond their borders and challenge long-established multinationals for global dominance,” said Gupta.

The key to this success has been in the transformation of the workforce from worker bees to highly sought after professionals. After decades of trailing developed economies, “China and India now boast educated talent in some of the world’s leading edge industries in addition to home-grown innovation in technology, products, processes and even business models.

“The story of dragons and tigers is not confined to particular industries because no big economy can be a niche economy. Big economies claim all industries and all industries eventually become big and give rise to global champions. India has thus far spawned more global champions but China is beginning to make strides in this area,” said Gupta.

“What multinationals are not aware of is that their market share is shrinking and they are being pushed into a corner.”

Company perspectives

Special guests **Ian B. Bird**, senior vice president, WGH Holding Corp., Golden, and **Scott M. Shafer**, executive vice president of sales and business development, HOV Services, Denver, were invited to talk about how they approach the China and India markets.

Ian B. Bird. “We knew that China and India were growth opportunities for the

Platforms for Innovation					
Output of bachelor degrees in engineering, computer science and information technology					
	2001	2002	2003	2004	2005
US	114,000	121,000	134,000	137,000	134,000
China*	220,000	252,000	352,000	442,000	517,000
India	82,000	109,000	129,000	139,000	170,000

**China figures include “short cycle” degrees completed in 2-3 years.
Source: Pratt School of Engineering, Duke University
As illustrated in Anil K. Gupta’s book “Getting China and India Right”*

development of our business,” said Bird, whose company is in the process of making an acquisition in China that will “expand our footprint there and also give us a footprint in India for the first time.”

WGH Holding Corp. is the parent of The Wheelabrator Group, a leading provider of metallic surface preparation equipment. About ten years ago, Wheelabrator made inroads in China through two joint ventures, selling old but still viable technology to its Chinese partners. “In a sense, we created competitors but at the lower end of the market,” said Bird.

Bird described China’s market as a pyramid. “At the top end of the pyramid are high end users in the aerospace and medical industries. We’re exporting to these customers out of Europe, which is very costly to do, but customers are willing to pay the price to get the quality they want.

“What we’re working on now is how to get into that middle part of the pyramid where the customers are not the upper tier of suppliers to international companies, but suppliers to the national market.”

Wheelabrator’s newest acquisition will provide it with a manufacturing base in China, thus reducing or eliminating the need to export out of Europe. To protect its intellectual property in China, “Wheelabrator acts as a systems integrator. Different manufacturers produce different parts of the technology and no one company is privy to the total blueprint,” said Bird.

Scott M. Shafer. HOV Services, with more than 12,500 employees and opera-

tions in the US, India, Canada, China and Mexico, is a leading global business process outsourcing and knowledge process outsourcing provider.

Outsourcing has undergone many changes in recent years, said Shafer. “Call center business in India is waning. There’s not a lot of interest in the US for more off-shore Indian call centers due to issues with accents. However, on the IT side, the interest is very strong.” But most companies no longer make their outsourcing decisions based solely on cost. “Five years ago labor arbitrage was a key strategy,” said Shafer. “I think the labor arbitrage piece is still important, but companies today are primarily concerned with value.

“They want to know how we can streamline their operation and make it better. Right now that message is resonating in the marketplace.

“I think for a company’s long-term survival you have to set your markers in a global sense and not just domestically. In addition to India, we also set our markers in Europe and in China. HOV’s revenues are 15 percent from Europe, and in 2009 we can count on 15 percent from China. It’s just another way to grow the company and take advantage of those markets.”

Strategies for success

Asked whether he thought it important for students to learn the Chinese language in order to be better prepared for the world of business, Gupta said, “More important than building fluency in the Chinese language – which is a very hard language to

learn – is to build a deep knowledge of China: its history, politics, economy and culture. Beyond this, what will give students a competitive advantage is proficiency in math and science.”

Gupta offered suggestions to help companies rethink their China and India strategies.

- Be market centric, market centric, market centric.
- Leverage global capabilities and be open to building a business model from the ground up.
- Be open to local creation of products, prices, distribution channels, advertising execution.
- Go after (or enable your customers to go after) not just the top tier but also the mass market.
- Aim for a dominant position within each market.
- Keep local competitors tied down locally.
- Master the art and science of frugal innovation.
- Cultivate and assign global hub (and/or center of excellence) roles to Chinese and Indian operations.
- Seek a mix of long-term expats and local nationals.
- View local managers as part of your global resources.
- Think China *and* India, not China *or* India.
- Learn to look at the world through Chinese and Indian eyes.
- And beware of mental traps such as assuming that if you’ve been to Shanghai you know China,” said Gupta.

What’s wrong with this assumption?

“Shanghai has about 17 million people, a tiny percentage of China’s 1.3 billion citizens. The top 25 cities in China combined are less than 10 percent of the population. City No. 25 is far smaller and poorer than Shanghai and in no way comparable. So Shanghai doesn’t offer any clues about what to expect as you try to penetrate markets outside its borders. There are so many dissimilarities city to city that even if you understand cities 1-25 you still don’t really understand China.

“In the past, multinational companies have had to figure out how to operate in rich-and-rich countries (high GDP, high per capita income) and how to operate in poor-and-poor countries (low GDP, low per capita income),” said Gupta. “But they haven’t figured out how to operate in rich and poor countries.

“This requires learning about globalization from the inside out.” ♦

Dragons and Tigers on the Global Stage

<u>Industry</u>	<u>Incumbents</u>	<u>Chinese & Indian challengers*</u>
Steel	ArcelorMittal, Nippon Steel	Tata Steel, <i>Baosteel</i>
PCs	Dell, HP	<i>Lenovo</i> , <i>Acer</i>
IT Services	IBM, Accenture	Tata Consulting, Infosys, Wipro
Mobile Telecom	Vodafone, T-Mobile	Bharti Airtel, <i>China Mobile</i>
Internet Services	Google, Yahoo, eBay	<i>Alibaba</i>
Automotive	GM, Toyota, Ford	Tata Motor, Mahindra, <i>SAIC</i> , <i>Chery</i>
Pharmaceuticals	Novartis, Pfizer	Ranbaxy, Dr. Reddy’s
Wind Turbines	Vestas, Siemens	Suzlon, <i>Goldwind</i>
Home Appliances	Whirlpool, GE	<i>Haier</i>
Telecom Equip.	Cisco, Nokia-Siemens	<i>Huawei</i>
Construc. Machinery	Caterpillar	Larsen & Toubro
Commercial Aircraft	Boeing, Airbus	<i>China Commercial Aircraft Corp.</i>
Power Tools	Black & Decker, Bosch	<i>TTI</i>

*Italics denote Chinese company
As illustrated in Anil K. Gupta’s book “Getting China and India Right”