It's not will you succeed? but can you afford to fail?

The re-visioning of the Silk Road in the 21st Century

With India and China's economic ties no longer defined only by trade, the countries' convergence is opening up new opportunities and challenges for businesses on either side seeking to cross the Sino-Indian border.

By Girija Pande

The China-India relationship is set to become one of the most significant economic ties of the coming decades. Bilateral trade between the two countries has jumped from US$3 billion in 2000 to US$69 billion in 2012. In the same year, China became India's second-largest trading partner, after the United Arab Emirates. In turn, India was China's twelfth-largest and fastest-growing trading partner. Yet, direct investment remained minimal. However, for adventurous corporates seeking to do business in either country, the question for their strategists, advisors and investors becomes not, "Will you succeed?" but "Can you afford to fail?"

In many cases, pioneering companies from India entering into China and vice versa, are operating outside their comfort zones and are being forced to innovate and adapt their processes and strategies to succeed. The lessons learned, many of which have been identified in The Silk Road Rediscovered, a book I co-wrote together with Professor Anil K Gupta and Haiyan Wang,[1] can help pave the way for others and encourage multi-national enterprises (MNEs) in the U.S., Europe, Japan and other countries to brave the waters in these economies which, to date, have been negotiated with trepidation.

> China is changing substantively, and the evolving structure of the Chinese economy along with its growing consumer movement will result in the country becoming much stronger in the services sector.

I believe that the biggest stumbling block in the relationship between the two countries developing further is the current mind-set—particularly on the part of Indian executives.

The economies will converge

I do believe that Indian companies can succeed in China, and conversely—and they must. While India still lags in infrastructure, the country does, of late, boast of strong leadership. If Indian firms decide to enter China, they would no longer be inhibited by the infrastructure weaknesses of India. Similarly, the Chinese would love to build their business in India. Their leaders recognise that the Indian economy is growing rapidly, and have publicly accepted that the trade ties in China's favour need to be more balanced. We therefore forecast that Chinese investments in India will hit US$30 billion in 10 years' time.

But while it is commonly said that there is complementarity between the two economies—with China being the manufacturing capital of the world and India acting as the back office of the world—we argue in the book that this is not the way it will continue in the future. China is changing substantively, and the evolving structure of the Chinese economy along with its growing consumer movement will result in the country becoming much stronger in the services sector. Moreover the fast increasing cost structures and slowdown in the size of the labour force will require China to vacate certain areas in manufacturing. As for India, I expect that once its infrastructure investment takes root, the well-educated and low-cost labour force, along with the growing scale of market, will result in a strengthening of its manufacturing sector—more so for exports.

Hence, over a ten year time frame, both countries will go into manufacturing and services—and that represents convergence, not complementarity.

Although the challenges and strategies are similar, and most of our argument is symmetrical and applies to companies in both countries, I will focus here largely on one side: that is about Indian companies entering China.

Challenges and strategies for Indian companies to operate in China

I believe that the biggest stumbling block in the relationship between the two countries developing further is the current mind-set—particularly on the part of Indian executives. Let me elaborate. If you look at China, it has historically had varying degrees of border issues with its neighbours—Korea, Japan, Taiwan, Vietnam, Mongolia, Russia, Hong Kong and India. (And that's not a surprise—so does India—big countries do have this challenge). But these East Asian countries, other than in South Asia—including India, have managed to deftly separate political issues from business issues, and remain large trading partners with China. While I do not expect the Indians to forget the boundary and other disputes with China, I argue that this should not come in the way of sound economic cooperation. The age-old geopolitical tensions between China and India are not likely to be resolved in a hurry, but the economic relationship between the two countries needs to take centre stage. Over the next decade, cross-border investments between China and in India are likely to grow even faster, both organically and indirectly through third-country acquisitions.

The other major issue with the Indian mind-set is the lack of confidence in the corporate headquarters of Indian companies, which do not believe that they can really build a large and sustainable business in China, given factors such as its size, diversity and language barriers. Hence the first step an Indian company would need to take would be to ensure that they 'Think Global', not just 'In-China-For-China' when entering China. Potential investors need to look carefully at how the move will fit into their global strategy. Besides looking at the competitive advantages they can gain by leveraging their distinctive competencies (whether it is technology, organisational capabilities, corporate reputation or global relationships) in the new market, business leaders need to consider the ways in which a move into China will bring added benefits to the company outside the host country.

Companies can reduce the risk of failure by first targeting a very clear and narrow beachhead market segment.

Almost every multinational company in the world is in China—though not as yet in India.

Chinese economy (2013)

US$9.3 trillion

Indian economy (2013)

US$1.6 trillion

CHINA: VAST AND DIVERSE, AND CHANGING RAPIDLY

I always advise Indian companies not to say that they are building a business in China, but that they are building a business in a specific province such as Guangdong or Shanghai because China is not only an extremely large country in terms of geography, population and economy, it is also very diverse. You have to look at it regionally. For instance, the per capita income on average in say Shanghai or Beijing is seven to eight times that of those residing in the poorer western parts. This wide income disparity means that the customer profile will also vary widely, and adds complexity to an already unknown environment. The company thus has to be very flexible and adapt its products and services not just for 'China', but also for its different provinces and cities.

At about US$9.3 trillion, not only is the size of the Chinese economy substantially larger than the Indian economy at around US$1.6 trillion (2013), it is also growing more rapidly. And this gap only continues to increase. The rate of change is much more rapid in China than that to which Indian firms are accustomed. This means that consumer behaviour and industry structure are changing constantly, and represents an unstable situation where the economy is growing at a rate that the world has never seen, and where businesses must adapt to this rapid change in an incredibly vast country.

Companies can reduce the risk of failure by first targeting a very clear and narrow beachhead market segment. For instance, when the Mahindra group ventured into China, it did not go into a broad automotive sector, but instead focused on small farm machinery recognising that China, like India, had small land holdings. The product mix was thus adapted to the social and business climate of small farms.

Another way of reducing the uncertainty is to learn as much as possible about China before entering the market, by say, attending relevant seminars, and learning from others and their mistakes. It can also be extremely helpful to ensure that the team that goes in–particularly the leaders–is well experienced in China. At Tata Consultancy Services (TCS), for instance, only expatriates with China or Taiwan experience were sent in as senior managers. Similarly, Mahindra hired someone from Unilever, who had worked several years in China, to set up and lead their business.

BRUTAL COMPETITION

Almost every multinational company in the world is in China–though not as yet in India. China has a rather pragmatic view that these companies will, at the very minimum, contribute to building the infrastructure and creating jobs, but the Indians tend to get more nationalistic and bogged down by the concerns of having a foreign company on their land. As a result, competition in China is generally far more intense than what the Indian companies would have faced. And it is not only the multinationals, but also the booming Chinese private sector with its host of small and medium enterprises (SMEs) with which foreign firms must contend. And finally, there are the state-owned enterprises (SOEs), many of which do not look at margins, but go for volume. Typically, SOEs are not listed, and have a much longer horizon for returns on investment than the Indian companies, which look at capital very differently with quarter-to-quarter targets. Hence, the company needs to have a very clear strategy: looking at China with a global lens and recognising the global capabilities that it brings and which will differentiate it from these competitors.

Provinces too, are often competing fiercely with one another to bring in investment–and this can prove to be a great boon to firms ahead of deciding where to establish operations.

SAFEGUARDING INTELLECTUAL PROPERTY WHILE INNOVATING

Historically there have been concerns about the protection of intellectual property (IP) in China. While laws do exist, enforcement has not been consistent and in line with best practices. But we argue that this will soon lessen as a key concern. Since China became a member of the World Trade Organization in 2001, and particularly over the past four to five years, Chinese companies and the Chinese government have realised that the days of low-cost mass production are over. They can no longer compete on those grounds given the changing cost structure and the strengthening currency. They have understood the significance of competing through the creation of new ideas and therefore recognise the need to respect IP. Today, Chinese companies such as Huawei are some of the biggest filers of patents. And to safeguard those patents, they are now suing one another; the end result being that some of the most heated discussions in the IP arena are now between the Chinese themselves.

But cross-border investments are not just about growth. Companies moving into China get a chance to share knowledge and to adapt and innovate–creating unexpected products and opportunities along the way–and at least some of these innovations are likely to be globally relevant. This type of benefit is illustrated well by the case of NIIT in China (refer to Box 1).

TALENT MANAGEMENT: ACQUISITION, ENGAGEMENT AND DEVELOPMENT

A major worry of doing business in China is the high levels of attrition. Turnover rates among professional staff can be as high as 20 to 40 percent a year. There are two key reasons for this. First, the kind of growth rate that China is witnessing has resulted in huge opportunities across industries and services. And second, the average Chinese worker has changed over the past couple of decades: China's one child policy has created princelings, who are far more individualistic and demanding than previous generations. Hence, retaining these individuals and managing their careers becomes a real challenge. In TCS, if employees did not get a promotion every 18 months, they typically started looking elsewhere for other options.

It is therefore important for managers to make sure that employees are well-compensated and in line with the market. Deferred compensation, such as stock options and employee loans, are some other ways that could work to effectively retain employees.

BOX 1: INDIA'S NIIT IN CHINA

Global IT learning and out-sourcing company NIIT's unique "Inside" business model was incubated in China after the company's journey into the country took a surprising path. NIIT entered China in 1997, when information technology was still a nascent industry. After some difficulty getting a license, the Shanghai Education Bureau agreed to a 10-year contract teaching at just one centre in Shanghai under tightly controlled conditions. The interest from potential participants was immediate and unexpected, with newspaper advertisements prompting more than 2,000 applications for the company's first two- to three-year courses.

For NIIT's leadership team in China, this was a period of massive learning on all fronts, not least on how to protect their intellectual property. They hired 14 professors to translate the textbooks, breaking each into 14 parts and giving a different part to each professor. Innocuous but deliberate mistakes were made in course materials so that copies could be easily identified, and the marketplace was policed closely to keep track of pirated logos, text material or even fake NIIT centres that showed up. Adaptions were also made in teaching techniques and for remunerating staff.

After a successful first year, NIIT was given permission to expand. However, difficulty obtaining licences from other city governments forced them to rethink their usual models. Instead of going it alone, the company began signing up universities and colleges as franchisees, which meant that as well as having the necessary licences, the universities had existing infrastructure, so no new investments were necessary. It didn't take long before the universities came up with the idea of embedding the NIIT curriculum in their bachelor's degree programmes—a win-win situation—which eventually became the NIIT Inside model, an idea they have since taken back to India.

NIIT has thrived in China, and as of 2013, it was training over 30,000 IT professionals a year at more than 140 centres, and had signed a memorandum of understanding with the Hainan Government for a multi-year large-scale talent development project.

Above all, rapid learning and familiarisation is critical as is recognition that internally, India is far more diverse than China on a host of dimensions—income levels, language, religion, climate, and political leanings—and like China, India too is changing rapidly.

BRAND RECOGNITION

For an Indian company wishing to enter or expand in China, brand recognition will be a challenge. Hence the choice is either to acquire a well-known third-party brand, like Tata Motors did when they acquired Jaguar Land Rover, or build it. A key difference is that when a brand is built in India, it is essentially being done for the firm's customers and its employees; but in China, the brand has to be built for the government as well. Because in China, the government is omnipresent—and if it believes that the firm has a strong reputation and is socially responsible—then brand-building becomes far easier.

UNDERSTANDING GOVERNMENT RELATIONSHIPS

It follows that any firm operating in China must understand the importance of the government at every level. While the state (particularly at the province level) heavily promotes investment, the fact is policies do tend to change. The mayors typically enjoy considerable autonomy in decision-making—but this does not mean that approval at their level implies unanimous agreement across other states and government functionaries. Hence the company has to keep abreast of developments and understand these nuances while navigating the political landscape.

DECIDING WHETHER TO PARTNER OR NOT

My view is that while a firm may still manage 'China for the world and China for the region' on its own, 'China for China' is another issue altogether. There is almost no hope of making any headway into the Chinese domestic market without a partner. Of course this depends very much on the firm's existing capabilities and relationships in the target market. The Mahindra Group's entry into China via joint ventures is a case in point (refer to Box 2).

The Silk Road ahead

While this article has focused largely on the challenges, opportunities and strategies that Indian companies can adopt to succeed in China, it is interesting to note that there are similar lessons emerging from the journeys of Chinese companies into India—which we have outlined in our book.

BOX 2: MAHINDRA & MAHINDRA GROUP

Mahindra Tractors, a unit of India's Mahindra & Mahindra Group, took time to explore China's marketplace before making a move. As a result, it is now the fifth largest tractor manufacturer in China, while selling 240,000 tractors annually in more than 40 countries, with manufacturing operations in India, China, the U.S. and Australia.

Mahindra's first foray into China was to explore the potential for exporting tractors from India. They soon realised their Indian-made tractors were far too expensive, and the design was not compatible with Chinese farmers' requirements. The only way they could compete would be to design and manufacture the vehicles locally. Instead of rushing in full tilt, they started small, forming a US$10 million, 80:20 joint venture with the financially troubled, state-owned enterprise, Jiangling Tractor Company (JTC). It didn't take long before Mahindra identified areas of concern. The company's manufacturing locations were far away from markets, there was a capacity constraint, and a majority of the dealers were ineffective. But all was not lost. For Mahindra, the JTC commitment had been a learning move, through which they were able to get people into China to study the market and figure out possible entry and follow-on strategies.

After four years, Mahindra felt ready to make a bigger move, and signed their second Chinese joint venture, this time with Jiangsu Yueda Yancheng Group, one of China's top 100 business groups with revenues of about US$7 billion. In November 2009, another US$40 million was added to the venture to create an R&D centre and a new engine manufacturing plant.

Like China, India too often suffers from not just unpredictable government policies, but also the fact that it is a low-income country open to players from every other country. Thus companies often face brutal competition and thin margins. Moreover, the Chinese find the chaos in India rather difficult to manage, as the new generation of Chinese in particular has not experienced such a lack of infrastructure. Yet if they are to have any hope of emerging as successful players over the next five to 10 years, they must make investments now, and see India as part of the company's global strategy.

They too must be very cautious and selective when entering into a joint venture, for joint ventures can be disastrous and costly, as the example of Haier shows (refer to Box 3).

Finally, Chinese companies must not forget that the media and the government in India are important stakeholders—and they have to build their trust with them. Above all, rapid learning and familiarisation is critical, as well as recognition that internally, India is equally or even more diverse than China on a host of dimensions—income levels, language, religion, climate, and political leanings—and like China, India too is changing rapidly.

Chinese companies must not forget that the media and the government in India are important stakeholders—and they have to build their trust with them.

BOX 3: HAIER

Chinese home appliance multinational, Haier's first push into the Indian market began in 1999 when it set up a joint venture with Hotline, a Kolkata-based company. Hotline Haier Alliances Ltd. ran into trouble from the very beginning as the partners differed profoundly in strategy. The move set Haier's China plans back at least two years. By 2003, the company's management decided to go it alone, setting up Haier India as a wholly owned subsidiary, importing white goods from China and later Thailand. Later agreements saw it sourcing from Indian companies Whirlpool and Voltas, hoping to build up sales before starting its own manufacturing. The company focused on premium brands but in mid-2006 changed course to focus on rural India and the bottom-of-the-pyramid market. A year later they acquired their first company-owned manufacturing facility in India.

Girija Pande
is Executive Chairman, Apex Avalon Consulting, Singapore, and was previously Chairman, Asia-Pacific, for Tata Consultancy Services

The material in this article is derived from the author's recently published book: "The Silk Road Rediscovered - How Indian and Chinese Companies Are Becoming Stronger by Winning in Each Other's Markets"; co-authored with Anil K. Gupta and Haiyan Wang.

Reference

[i] Anil K. Gupta, Girija Pande and Haiyan Wang, 2014, "The Silk Road Rediscovered - How Indian and Chinese Companies Are Becoming Stronger by Winning in Each Other's Markets", John Wiley and Sons.