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The China *and* India Strategy

by Anil K. Gupta and Haiyan Wang

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tion potential flaws such as overreliance on rating agencies.

To accomplish this, auditors must possess not only extensive knowledge of the business — how the front office makes money — but also clear comprehension of the risk management discipline. In topnotch organizations, audit and finance teams blend strong process and IT know-how with an in-depth understanding of the business and risk. For example, audit teams investigate and validate mark-to-market positions, ensuring the integrity of information as it passes from one system to the next.

Audit findings then need to be acted upon. Audit items cannot be allowed to remain open quarter after quarter, with no consequences for the executive who fails to act on them. A more disciplined approach is required, with senior executives taking the leading role.

The ultimate goal is a culture that combines healthy risk taking with effective risk management. It takes a total, unmistakable, continual, and widely communicated commitment from the CEO to make this shift. Companies and banks that accomplish this will be much better equipped to weather the next set of economic storms.

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Far too many companies still spend considerable time and energy debating whether to focus on China or India as their next big market. These are both vast nations with huge population densities — China has 135 people per square kilometer (about 350 people per square mile) and India has two and a half times that, whereas the U.S. has only 31 people per square kilometer (about 80 per square mile). At first glance, China and India seem overwhelmingly large as well as distinct enough to merit separate strategies.

But that approach is shortsighted. As the two fastest-growing economies in the world, China and India together represent an immediate opening for unparalleled market penetration. The opportunity to tackle them simultaneously cannot be ignored without the real possibility that latecomers will be, well, too late. Other companies will have already staked their claims and raised the barriers to entry. Moreover, economic integration between China and India is proceeding apace. Few people outside these two nations are aware that China is India's number one trading partner and India is among China's top 10 trade relationships. Even if the growth rate in China–India trade slows down to 25 percent annually from its current rate of about 50 percent, bilateral trade will reach almost US$75 billion in 2010 and $225 billion in 2015 — equal to China–U.S. trade just three years ago. And investment between India and China is likely to grow even faster than trade. As these economies become more intertwined, it will be more difficult for outsiders to find an easy path in.

In short, for most Fortune 1000 companies, the right question to consider now is how best to pursue China and India together. The strategic benefits of having a nearly equal presence in both countries, instead of a single focus on one or the other, can be broken down into four categories.

1. Scale. A combined market strategy for China and India is particularly important when a company's cost structure depends on significant economies of scale and when profit margins are razor thin. This is increasingly the case for makers of inexpensive products targeted at the middle- and low-income segments of emerging markets. Take the EC280, a new $335 compact desktop computer with a low-end Intel processor, introduced by Dell Inc. in March 2007 for first-time buyers in emerging markets. Because this machine would be sold in stores rather than online, Dell would have to share profits with retailers and accept extremely slim margins. In fact, the only way that Dell could make real money on the EC280 was by selling the computer not only throughout the vast Chinese market but also in India and other developing nations.

The rivalry between Cisco Systems Inc. and China's Huawei Technologies Company offers yet another illustration of the potential downside a company faces if it fails to stretch its core skills across a cohesive China–India market strategy. Huawei is one of Cisco's most aggressive global challengers; indeed, in 2003, Cisco sued Huawei for stealing its source code and using it in competitive routers and switches. The case was dropped nearly 20 months later, after Huawei agreed to discontinue the products. Between 2003 and 2007, Huawei's annual revenue grew from about 20 percent of Cisco's to nearly half. Huawei's increasing competitive advantage rests heavily on cost leadership, which derives primarily from the fact that the bulk of its R&D and manufacturing operations are based in China. With its lower-cost product portfolio, Huawei is attractive to customers in emerging markets. In fact, in 2007, the Chinese company generated 72 percent of its revenues from outside China, largely in developing countries.

Huawei is on the record as saying that its goal is to become India's number one supplier of telecom infrastructure equipment. The implications for Cisco are clear. It must develop a counterstrategy that rests on at least three legs: innovating faster than Huawei, drastically reducing its cost structure to match or beat Huawei's low prices, and then riding these gains to attack Huawei in both of its key markets — China and India.

2. Complementary strengths. China is much stronger than India in terms of physical infrastructure and manufacturing efficiency — its manufacturing sector is five times as large as that of India — whereas India bests China in software development, IT-enabled services, and many types of analytical and knowledge-intensive tasks such as legal research, finance and accounting, and advertising.

IBM Corporation provides a near-perfect example of how to leverage the complementary capabilities of manufacturing in China and IT services in India. IBM has built its largest procurement center outside the United States in Shenzhen, China, and two years ago IBM's chief procurement officer relocated there. Sourcing from Asian (primarily China-based) suppliers accounts for about 30 percent of the company's $40 billion annual purchasing budget; IBM hopes that these moves will make this very busy supply chain more efficient, especially for products destined for Asian markets. But whereas it relies on China for hardware procurement, the company has made India its global center for the delivery of IT services. At the end of 2007, IBM employed more than 70,000 IT professionals in India, about 20 percent of its global workforce and a group four times the size of its staff in China.

The complementary strengths of China and India extend beyond manufacturing and information technology services. China's chemical industry (particularly specialty chemicals) is significantly more advanced than India's. In addition, certain types of pharmaceutical raw materials are available more abundantly and at lower cost in China than in India. Thus, many India-based pharmaceutical companies turn to China as a primary supplier of pharmaceutical ingredients. In turn, India is emerging as an important source of specialized talent in finance, accounting, and global marketing for many Chinese companies as well as the Chinese units of major multinational corporations. In mid-2007, Chinese computer maker Lenovo Group Ltd. centralized its worldwide advertising activities in Bangalore, to a hub that is responsible for all ads placed outside China.

3. Knowledge transfer. The fact that China's economy is 12 to 15 years ahead of India's provides many companies with an opportunity to leverage lessons from China. This helps them fine-tune their strategies for the Indian market at a relatively fast pace. Take

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the case of the PC industry. Dealing with the Chinese and Indian PC markets involves many common factors, such as extremely rapid growth, large proportions of first-time buyers, the need to reach customers not just in the most populous markets but also in smaller ones, the importance of selling through the retail channel, low buying power, few credit cards, and the need for local-language software.

Lenovo has attempted to take advantage of these similarities in the two markets by first putting on paper the essence of the Chinese business model and then "distilling it down to five salient points that we could implement in any country," according to William J. Amelio, Lenovo's president and chief executive. India was picked first for this knowledge transfer, and the company's success with this market entry strategy there has driven Lenovo's wider global sales strategy.

4. Risk reduction. Establishing a presence in both India and China can reduce companies' exposure to political risk. Given the rapid transformations in their economies, the Chinese and Indian governments are still trying to determine whether and how to differentiate between domestic and foreign enterprises and what types of policies to adopt for each category of firm. For example, China's new enterprise income tax law eliminates the tax advantages that foreign enterprises historically enjoyed over domestic ones, and a new antimonopoly law may put fresh restrictions on acquisitions within China by foreign firms. Meanwhile in India, the government is often ruled by a coalition of widely disparate partners, populated by incumbents who almost always lose in the next election. With so much uncertainty surrounding future policymaking in both countries, a multinational enterprise with dual operations in China and India stands to do the best job of hedging against political vulnerability.

Economic instability is another concern. From early 2007 to early 2008, manufacturing costs in southern China, where many multinationals have set up shop, have increased by as much as 40 percent. A rapid increase in the cost of raw materials and energy as well as new labor laws and environmental regulations are the chief reasons. India's labor costs have thus far been relatively stable, so a company can offset China's higher wages with its Indian presence.

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Finally, intellectual property risk can be mitigated by disaggregating and distributing core research and development and core-component production across China and India as well as other countries. Consider the case of a European manufacturer that sells machinery to construction contractors. Burned by seeing its former Chinese partner produce copycat versions of its products, the company has divvied up the production of subsystems between India and China. Such an approach still permits the company to benefit from low manufacturing costs in each country but minimizes the extent to which the company's design blueprints and manufacturing processes are exposed to local partners or job-hopping local employees.

By 2025, it is highly probable that China–India economic ties (composed of trade, investments, and technology linkages) may be among the five most important bilateral relationships in the world. The rising dragons and tigers from China and India will be one set of beneficiaries. And multinationals that take advantage now of openings in China and India simultaneously are likely to find themselves equally rewarded.

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