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THE JOURNAL REPORT: BUSINESS INSIGHT
Global Business
How to Get China and India Right
Western companies need to become smarter -- and they need to do it quickly

By ANIL K. GUPTA AND HAIYAN WANG

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The breakneck economic growth in China and India presents tremendous opportunity for Western multinationals -- as well as major challenges.

For all the big investments Western companies are making in the two nations, the vast majority of businesses don't have much of a clue regarding how to succeed in China and India, or how to leverage the strengths of these two countries for global advantage.

MOVING INTO CHINA & INDIA


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PODCAST:² Anil Gupta, of the Robert H. Smith School of Business at the University of Maryland, talks to WSJ's Carol Hymowitz about how companies are building new business models from the ground up as they move into China, India and other developing countries.

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Some of the most common mistakes companies make include looking at the markets solely through the lens of offshoring and cost reduction, building marketing strategies centered around just the rich cities and the top 5% to 10% of the population, naively choosing local partners, and treating these two countries as peripheral rather than core to the company's global operations.

Given the size and sizzling growth of these economies, a suboptimal strategy for China and India is no longer a matter of merely leaving some money on the table. Many of today's Western giants that don't

have solid China and India strategies will face severe threats to their very existence in as little as 10 years' time. If they're not making the most of China and India, rest assured that somebody else is -- either a Western competitor or a homegrown firm.

What follows are the central ideas for how companies can get their China and India strategies right.

CHINA AND INDIA TOGETHER

There are three reasons why multinational companies should pursue an integrated China and India strategy rather than waste time debating whether to pursue China *or* India.

First, for many industries, China and India both present some of the highest growth rates in the world and are emerging as megamarkets. Take cellphones. The number of users in China exceeds 450 million, and the estimated figure for India is 150 million -- a number that is growing by six million new subscribers a month.

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[What is the best approach](#)⁶ to doing business in China and India? And how much of a company's resources should be devoted to expansion there? [Join Anil K. Gupta and Haiyan Wang in an online forum](#)⁷.

Second, China and India present different but complementary strengths that companies can use. China is much stronger than India in mass manufacturing and logistics; in contrast, India is much stronger than China in software and information-technology services.



EMERGING MEGAMARKETS

The Problem: Many companies claim to have successful strategies in China and India -- but few really know how to leverage

the complementary strengths of these countries' economies.

The Risk: Companies that don't take a vigorous approach to China and India will face threats to their very existence in coming years.

The Solution: There are a number of strategies companies should follow to make the most of China and India, including the pursuit of an integrated strategy for these two markets; learning to finely segment these complex markets; and making sure the countries are central, rather than peripheral, to their global agenda.

Consider **International Business Machines Corp.**'s approach. Outside the U.S., IBM relies on China as the primary procurement source for its hardware business and has decided to relocate its global procurement headquarters to Shenzhen. Complementing these moves, IBM has made its Indian operations one of its most important global hubs for the delivery of IT services to clients world-wide. Nearly one-sixth of IBM's global work force is now based in India.

The third benefit of an integrated China and India strategy is intellectual-property protection. Companies can significantly reduce risks of intellectual property leaking out by distributing R&D and production activities 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 a former Chinese partner producing copycat versions of its equipment, the company is now

planning to spread the production of key subsystems across India and China. That way, the new designs can't be easily copied by competitors -- or allies -- in individual locations.

PURSUE A TWO-TRACK STRATEGY

In each country, a company must think along two strategic tracks: how to make the most of the company's capabilities from other markets for success *within* China and India, and how to use the strengths of China and India for *global* advantage.

Of course, it won't always be apparent which track may yield faster results. Thus, it is often better to keep both in mind and let unfolding events dictate which path should get higher priority at any particular time.

WALL STREET JOURNAL VIDEO

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WSJ's Carol Hymowitz interviews⁹ Dr.

Anil K. Gupta, a professor at the Robert H. Smith School of Business at The

University of Maryland, about how foreign companies can develop markets for their products in China and India.

In its early forays in China, **Microsoft Corp.** wasted years in futile efforts to generate meaningful revenue from local sales of its operating systems and applications software. In recent years, however, the company has done an about-face and started to place much greater emphasis on using Chinese universities for leading-edge technology development for its global operations.

The company, for example, has set up research labs at some of China's top universities, created Microsoft Fellowships for China's best computer-science Ph.D. students, and expanded the scope of its research center in Beijing, recently lauded by MIT's Technology Review as one of the hottest computer labs in the world.

This shift in strategy has also made it easier for Microsoft to get the government's cooperation in enforcing intellectual-property laws in the software sector. In the long run, then, the two tracks often serve as steppingstones for each other.

FORGE A BEACHHEAD

Each of the two markets is too big and too complex for broad attack. Such an approach runs a high risk of costly

failure. A much smarter approach is to identify and occupy a beachhead that offers the best potential for early success and can serve as a launching pad for deeper market penetration.

Look at **McCormick & Co.**'s entry into China. In the early stages, McCormick, a food-products company based in Sparks, Md., targeted Western fast-food chains -- such as McDonald's -- that were already its industrial customers in the U.S. and Europe. This meant that McCormick had a ready-made market with low risks. Using this customer segment as a beachhead gave McCormick an operational base from which to broaden its marketing efforts to include local industrial customers as well as retail chains.

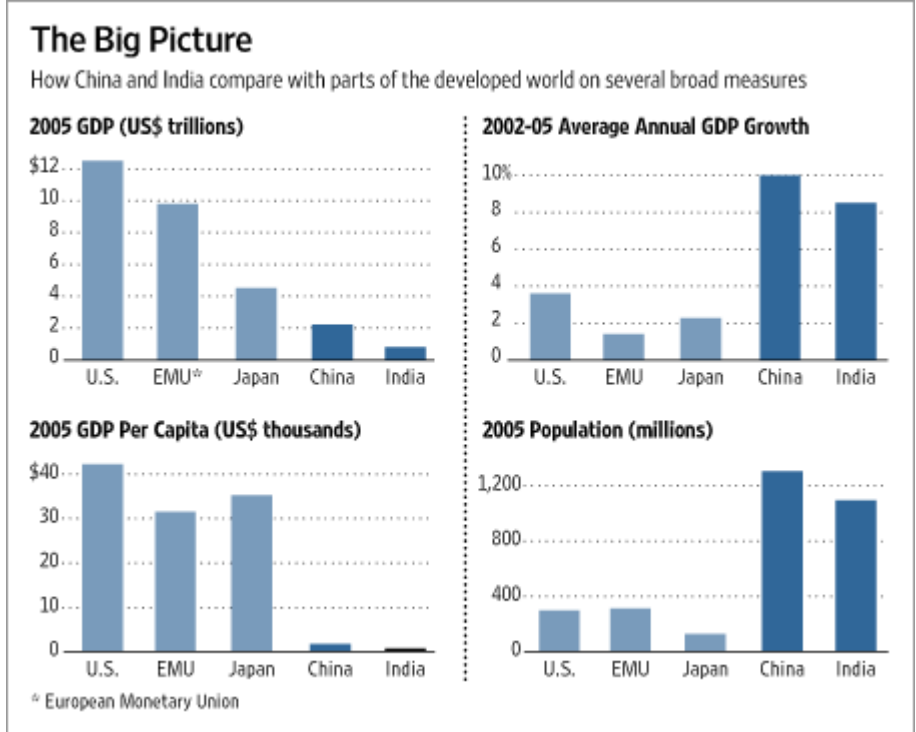
Metro Group, a German retailer, entered India as a wholesaler by setting up cash-and-carry distribution centers targeted at business customers such as hotels, restaurants, caterers and small retailers. While Indian regulations don't permit foreign multibrand retailers to operate within the country, there are no such restrictions on business-to-business wholesaling. Although Metro has yet to state its ambitions in the retailing sector in India, by setting up business-to-business distribution centers, the company has positioned itself well to start retail operations through local partners or, if the regulations change, its own stores.

FROM THE GROUND UP

China and India are the only two poor countries among the world's 10 largest economies. Per capita incomes in China and India are a tiny fraction of those in the other large economies -- 1/20th of the U.S. in the case of China and 1/40th in the case of India. In essence, China and India constitute megamarkets with microcustomers.

Thus, unlike a U.S. firm entering Japan or vice versa, companies can't simply adapt their business models to China or India. In most cases, such an approach will do little more than scratch the surface of the vast market opportunity in each country. While employing their global capabilities, companies will have to invent their business models for China and India from the ground up.

Almost always, this reinvention will require designing products and services that can be manufactured and delivered at ultralow prices while still yielding satisfactory profit margins. **Toyota Motor Corp.**'s recently launched efforts to develop an ultra-low-cost car for China, India and other emerging markets reflects such an approach.



THE JOURNAL REPORT



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With fewer outside CEOs as directors¹¹ on corporate boards, here's how companies are filling the gap. Plus, eight warning signs¹² that an acquisition may not pay off.

• See the complete [Business Insight](#)¹³ report.

Dell Inc. also provides an excellent example of thinking from the ground up. The company recently unveiled the EC280, an inexpensive personal computer (base price starting at about \$335) specifically designed for China, India, Brazil and other emerging markets.

FOCUS ON MARKET DEVELOPMENT

FOR FURTHER READING

These related articles from MIT Sloan Management Review can be accessed online

• **The Seven Disciplines for Venturing in China**
By Ajit Kambil, Victor Wei-Teh Long and Clarence Kwan (Winter 2006 issue)

China's institutional private-equity and venture-capital markets have similarities to those of the U.S. Europe, but there are important differences.
<http://sloanreview.mit.edu/smr/issue/2006/winter/17/>¹⁴

• **Strategies for Competing in a Changed China**
By Peter Williamson and Ming Zeng (Summer 2004)

Experienced multinationals have long been aware of the challenges, but few predicted the emergence of tough competition from local Chinese players.
<http://sloanreview.mit.edu/smr/issue/2004/summer/13/>¹⁵

• **Offshoring Without Guilt**
By N. Venkat Venkatraman (Spring 2004)

Why moving business processes overseas to India, China and elsewhere is a critical component of next-generation business design.
<http://sloanreview.mit.edu/smr/issue/2004/spring/03/>¹⁶

• **Corporate Spheres of Influence**
By Richard A. D'Aveni (Summer 2004)

The sphere-of-influence model focuses attention on the company's overall strategy, including how it wants to structure the division of product and geographic markets in an industry.
<http://sloanreview.mit.edu/smr/issue/2004/summer/07/>¹⁷

Given the combination of low per capita incomes and rapid growth rates, Chinese and Indian markets for most products and services are at a very early stage of development. Thus, companies must focus also on market development and creating demand for their products -- as opposed to focusing solely on grabbing bigger chunks of the existing market.

Consider the case of **Adidas** AG, the German sports-products company. Among many other efforts in China, Adidas is trying to build up the market for soccer shoes -- and make its image synonymous with soccer there -- with a number of initiatives. For instance, the company is developing soccer camps and sponsoring Chinese players.

SEGMENT, SEGMENT, SEGMENT

China and India have the world's two largest populations, two of the world's largest geographical areas, greater linguistic and sociocultural diversity than any other country -- and among the highest levels of income disparity in the world.

Given this scale and variety, one should abandon any notion of "an average Chinese customer" or "an average Indian customer." In each country, even the middle of the income pyramid consists of more than 300 million people encompassing significant diversity in incomes, geographic climates, cultural habits, and even language

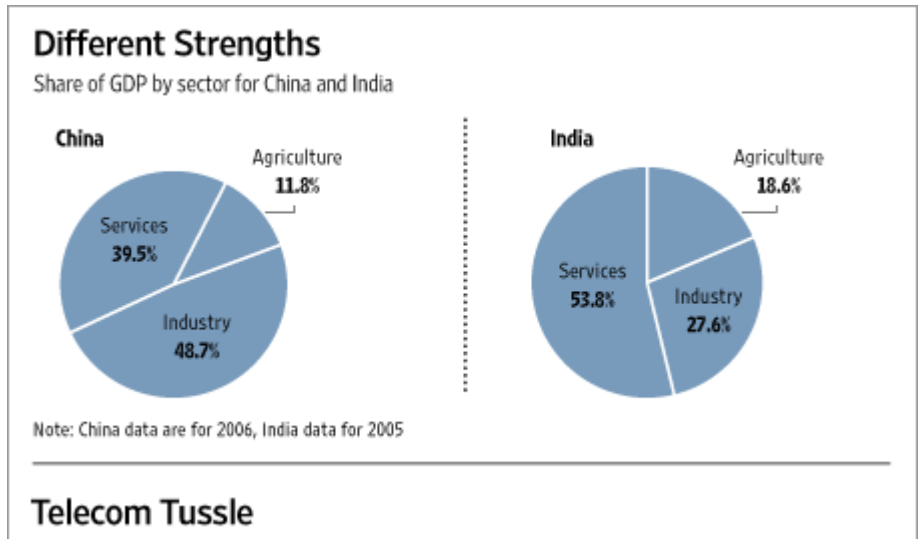
and religious beliefs. Because of this diversity, market success in China and India is rarely possible without finely segmenting the local market in each country, developing a strategy tailored to the needs of the targeted segments, and exploiting a strong position in one segment to enter and occupy one or more adjacent segments.

Haier Group, China's leading appliance maker, has proven to be particularly adept at fine market segmentation. For example, Haier's portfolio of washing machines for the Chinese market includes a washing machine for rural peasants that can clean not only clothes but also sweet potatoes and peanuts. Haier also sells a tiny washing machine designed to clean a single change of clothes, which has proven to be a hit with the busy urban customers in Shanghai.

DON'T OBSESS OVER INTELLECTUAL PROPERTY

In our judgment, arguing that intellectual-property issues constrain you from having aggressive China and India strategies is a cop-out. It is almost certainly true that more than 80% of the software and music consumed in China and India is pirated. But people forget that estimated piracy rates in the U.S., the bastion of intellectual-property protection, run upward of 30%.

It is also important to note that



governments in both China and India are becoming increasingly serious about enforcement of laws on intellectual property. In each country, what's driving this trend is the ambition to beef up the country's science and technology base, coupled with the realization that weak intellectual-property protection inhibits technology development.

Instead of obsessing about these issues, companies should aim for a rapid rate of innovation that makes life difficult for imitators and pirates in developed and developing countries alike. Rapid innovation may not reduce piracy, but it will help ensure that pirates' products are viewed as consistently inferior, and thus less desirable.

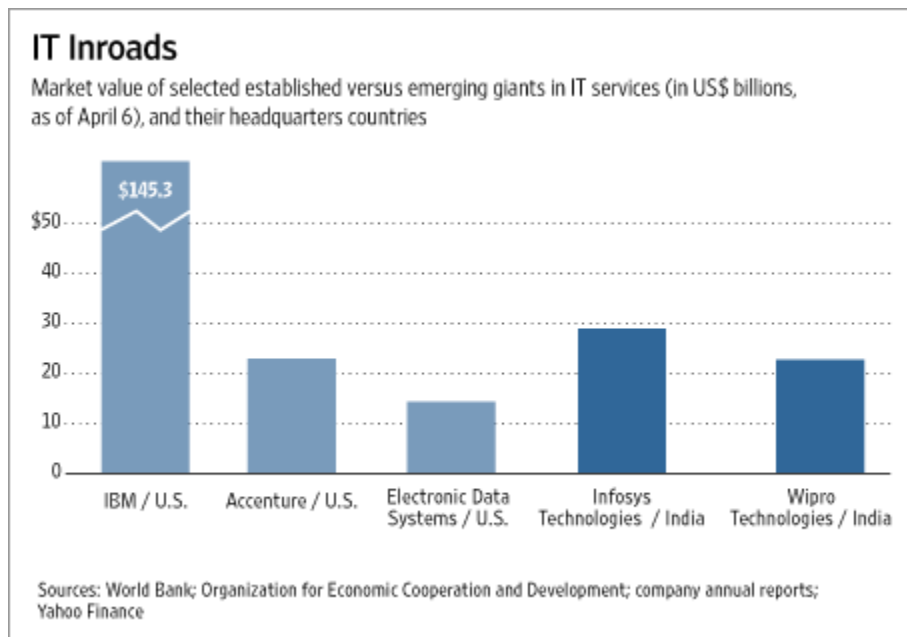
Companies can also reduce piracy by making their products or services more affordable. This is what Microsoft is now attempting with the introduction of Windows XP Starter Edition, a no-frills and low-priced version of its operating system for India, Brazil and many other emerging markets.

Also, as discussed earlier, companies can reduce the risks of intellectual-property leakage by dispersing R&D and production across China, India and other locations.

MINIMIZE PARTNER RISK

Every company relies on a network of partners in the countries where it does business. In China and India, however, companies often find they must rely on partners even for their core operations because of regulatory requirements or the need to bridge gaps in local knowledge, capabilities and relationships.

Far too many companies act naively when deciding whether to partner, whom to partner with and how to manage the relationship. Companies should look for partners that bring the highest set of complementary capabilities but the lowest level of business overlap -- thereby reducing the potential for conflict. They should also minimize dependence on any single partner by assigning a narrow scope to each alliance. Finally, they should attempt to keep control over complementary activities such as R&D, component production and distribution channels.



Honda Motor Co.'s efforts in India are examples of smart partnering. The company has used different partnering strategies for different product lines and activities. For instance, it has a motorcycle joint venture with Hero Group, India's largest bicycle manufacturer, and it entered the car business through a joint venture with Siel, a chemicals and vegetable-oil products company. Honda's stake in the auto venture has climbed from 90% initially to 99% today.

In contrast, there's **General Motors Corp.** The company claims success in China, but we believe that it has made itself overly dependent on Shanghai

Automotive, or SAIC. The web of alliances that support Shanghai GM -- the joint venture between GM and SAIC -- is controlled by SAIC rather than GM. Also, as one of China's largest and oldest car companies, SAIC has explicitly declared that it aims to become one of the world's 10 largest auto companies within the next five to 10 years. Tellingly, about a year ago, SAIC hired Philip Murtaugh, former chairman of GM China, to run its SAIC Motor subsidiary. Could it be that SAIC is taking GM for a ride?

Asked about the alliance, a GM spokeswoman says that SAIC and GM "operate as partners, not just to the letter of the contract, but to the spirit of the contract. To say either partner controls the alliances is a gross misrepresentation.... Both parties bring a great deal to the partnership, and frankly, there is not a great feeling that either side is keeping score."

As for SAIC's plans, the GM spokeswoman says, "Yes, they are ambitious. So are we. Hopefully, we can help each other realize our individual and combined ambition." She adds that both sides are taking advantage of the partnership, and "it's strong and getting stronger."

SAIC officials have said they remain deeply committed to their joint ventures. They play down the potential for competition between SAIC's own models and those made by Shanghai GM.

OFFER A FUTURE

No matter how large the opportunities and how brilliant a company's strategy, success in China and India is impossible without winning the war for local talent.

One of the byproducts of explosive growth in each market is that top-quality scientists, engineers and managers are scarce, and job-hopping is far too common. Salaries are rising more than 10% a year, and even for blue-chip companies, turnover rates can run in the 15% to 20% range.

Winning the war for local talent requires a fundamental shift in mind-set about the future role for Chinese and Indian stars. They need to see that their local operations are central rather than peripheral to the parent company's global agenda, and that they have a career track in the company's global operations. In addition, they must see that the flow of knowledge, capabilities and people runs both ways, not just from the U.S., Europe, or Japan to China and India, but also the other way round.

Given the changing economic topography of the world, we take it as a given that the large corporation of tomorrow will be much more China- and India-centric than at present. The only open question is whether this will be your company or your competitor's.

--Dr. Gupta is the Ralph J. Tyser Professor of Global Strategy and Entrepreneurship at the Smith School of Business, the University of Maryland at College Park, and the co-author of "The Quest for Global Dominance" and "Smart Globalization." Ms. Wang is managing partner of the China India Institute, a Bethesda, Md., research and consulting organization. They can be reached at reports@wsj.com¹⁸.



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