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How to Integrate "Chindia" into a Cohesive Global Strategy

Prof. Nitin Pangarkar of the NUS Business School and authority on China and India, looks at the implications of the emergence of "Chindia", dispels common misconceptions about these fast growing economies, explores opportunities, and outlines 5 rules of thumb for effectively integrating "Chindia" into a global strategy.

Over the last 15 years, observers, analysts, and managers have been fascinated by the rapid growth of emerging markets, especially China and India. Large populations are a clear advantage enjoyed by these countries – together China and India account for more than a third of the world's population, and when this population has a growing income level, the market potential will be substantial. Many believe that the growth potential of these markets offers a unique opportunity for all firms, multinational or local. It is not surprising then that managers of multinational companies are enthusiastic and interested. Andy Grove, the co-founder of Intel, said that "China is the most vigorous market for US (and) its most vigorous competitor." Likewise, a senior manager of Nissan said that "not being in India would be a huge strategic mistake. It's an investment for the future."

Historical Growth and Future Predictions

To get a better sense of the sustained growth enjoyed by these two countries, one should look at past growth rates: between 1979 and 2004, China grew at an annualized growth rate of 9%, and India at 6%. Still, estimating the current market size for specific sector industries is challenging, especially since the data may not always be available or reliable and factors such as Purchasing Power Parity need to be accounted for. Aggregate level indicators, however, are generally more easily available and reliable. These estimates support the argument about the importance of China and India, which account for 49%

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of world iron ore consumption, 55% of world cement consumption, and 59% of world vegetable production.

While forecasting future market size can be more hazardous than estimating current market size since such exercises may require making forward-looking assumptions, we can identify some of the estimates. According to one estimate,

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by 2020, China's GDP will be $12 trillion and India's about $3.4 trillion; together they could constitute 60% of the US GDP. If current growth trends continue, by 2050, China's GDP would exceed the US GDP significantly while India's would match the US. Low current penetration levels – in terms of ownership of durable goods – is another factor working in favor of these markets. In 2003, only 0.9% and 1.6% of the population in China and India had cars, versus 55% for Japan, 25.7% for Taiwan, 22.7% for Malaysia, and 9.1% for Thailand. There is strong prior evidence about the increase in percentage of car ownership with increasing incomes, suggesting that both China and India's markets have plenty of room to grow.

Operating in Chindia: A Plethora of Misconceptions

Despite the attention received by these markets in the popular press, many misconceptions remain. For instance, many analysts and managers tend to view China as a cheap source for low value added manufacturing and India

as a cheap location for low value added high tech services (e.g. software and business process outsourcing) while believing that the market size for these markets is rather limited for high tech goods and services. Another misconception is that China and India offer large markets for counterfeit goods and limited opportunities for genuine goods, which often come at high prices. Finally, some question whether these markets are profitable to serve and wonder about the risks rewards equation for serving these markets is appropriate – in other words whether these markets are characterized by higher levels of risk than what expected returns would suggest. On the other hand, there are also optimists who believe that capturing even a 1% share of these markets is not unreasonable and would significantly impact their overall performance.

We submit that China and India's low average income levels belie the fact that they have plenty of consumers that can buy a wide variety of goods and services, whether

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low or high tech. By 2006, China had more than 350 million mobile phones subscribers, a number India is expected to reach by late 2008. As producers, these countries will play an even bigger role in high tech industries. India's exports of software and technology-enabled services are expected to increase from US$22 billion in 2006 to US$140 billion in 2012. In 2005, high technology exports constituted 28% of China's total exports and amounted to US$220 billion. In life sciences, which are the epitome of high tech sectors, China and India are expected to widen their lead over the US in terms of the sheer number of young researchers. Even after allowing for the possibility of quality differences, the difference is large enough to shift the center of gravity of these research-based industries towards Chindia.

It is also important to dispel the misconception about the difficulty of operation in these countries and the risks/rewards equation. According to one estimate, 68% of the US companies in China are profitable, and for 70% of the companies, the margins in China are greater than their global margins. In India, the proportion of profitable companies is as high as 90%, and the Indian operations exhibit better than average profitability for 60% of the MNCs.

Finally, while it is true that counterfeits pose a challenge, Chindia offers plenty of opportunities for selling genuine, high-quality (and premium-priced) goods. China, for instance, is the second largest market for Louis Vuitton, the purveyor of high quality fashion accessories. In terms of risks/rewards equation, the challenging nature of these

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markets implies that once strong competitive footholds are established, they are likely to be sustainable simply because later entrants would often face similar difficulties and barriers as the pioneers. In fact, there are several examples of firms that struggle in their home markets to compete with the leaders in their industries but have managed to capture the pole positions in Chindia – these include Buick and KFC in China and Suzuki in India.

Integrating Chindia into Your Strategy

While the Chindia market represents a tremendous opportunity, it clearly is not without challenges. In fact, firms that rush in and expect to easily capture a 1% market share often receive a rude shock. Upon its initial entry into India, even Kellogg's, a company with a wealth of experience of operating in global markets, struggled badly. Corn Flakes, its main product, were considered too expensive and bland for the local tastes and preference.

So how can multinational firms integrate Chindia in their

global strategy? Below, we suggest a few rules of thumb which improve the chances of success in the Chindian markets:

1. **Be early:** In emerging markets, early movers may be able to build brands cheaply, create impregnable positions in the distribution channel, and shape consumer expectations, all of which makes it difficult for later entrants to match their success. As Jorgen Clausen, CEO of Danfoss, which has enjoyed significant success in China, said, "We want to have the same high market share as in Europe. We need to do it now when the competition is small and young".

   Singapore-based Asia Pacific Breweries, which makes Tiger beer, is an excellent example of moving early. In the Hainan province of China, where it was the first multinational brewer, it commands 80% of the market and its international brands, such as Anchor, enjoy leadership positions. Conversely, the company has not been as successful in the Shanghai market, where it was not the early mover and jockeying for market share is intense. KFC in China is another example of early market entry. KFC not only leads McDonald's in the China market but has been growing at a faster rate (200 stores per year versus 100 stores per year for McDonald's).

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2. **Have a long and broad view:** Given the evolving nature of these markets, MNCs looking for quick returns are likely to be disappointed. Those who patiently build their operations towards ultimate success, however, are likely to be handsomely rewarded. It is also important that companies look beyond a pure local market orientation and look at these markets for diverse purposes such as sourcing products, services, and talent.

   Motorola in China serves as an excellent example of the importance of broad view. It entered the country in 1987 by opening a representative office and followed up with the establishment of Motorola (China) Electronics Ltd. in Tianjin five years later. Its product range included mobile phones, two-way radios, wireless communications equipment, semiconductor products, and automobile electronics for the Chinese and other global markets. In June 2002, it announced a "2+3+3" strategy: "2"centers to make China into a global production base and a global R&D base for Motorola; "3" growth areas (e.g. digital trunking communication systems, semiconductors and broadband); and "3" 2006 US$10-billion targets (e.g. an annual output of US$10 billion in China, an accumulative investment of US$10 billion in China, and accumulative local sourcing in China to reach US$10 billion by 2006.

3. **Be adaptable:** Adaptability is a key success factor in emerging markets. In Sir Isaiah Berlin's terminology, being a fox is likely to be more rewarding than being a hedgehog. Lack of adaptability has led to many failures, with Nestle's bottled water business and Ericsson's handsets business being prime examples. Nestle's bottled water business in China failed because it adopted a centralized facilities model that resulted in high costs and long delivery times. While Ericsson enjoyed a peak market share of 37% in China, it refused to deal with cases involving defective products. The resulting bad publicity led to rapid erosion of its market share. McDonald's, whose beef-based core product offends religious sensitivities in India, is an excellent example in this regard. Over more than 10 years, it has assiduously built up a local supply chain, adapted its menu significantly (75% of its Indian menu is unique to India), worked hard at satisfying the vegetarian segment (some of its advertisement promise a "Veg surprise'"), and reduced its prices to improve affordability with meals selling at the equivalent of US 50 cents. While the profitability of its Indian operations is not known, it has laid a solid foundation for future growth.

4. **Don't underestimate local companies:** Multinational firms often enjoy strong competitive advantages over local companies in the form of scale economies, technology, and brand advantages. Some firms, however, run the risk of underestimating local competition. Recently, many Chindian firms such as Haier, Huawei, Ranbaxy, and Tata Steel have emerged as important competitors on the global stage. A recent survey found that a smaller proportion of Chinese firms operate very old manufacturing plants (i.e. greater than 10 years), and a greater proportion consider innovation as being very important than US firms (54% versus 26%). These statistics suggest that Chindian firms are likely to be vigorous competitors.

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5. **Be an insider:** Multinational firms can significantly enhance their chances of success by becoming an insider, a term coined by the noted management

consultant and writer Kenichi Ohmae. Becoming an insider might include a broad range of strategies including developing a local supply chain, getting involved in the local communities, making extra efforts to hire local managers, and presenting a local face in promotional and other strategies. Danfoss has worked extremely hard at becoming an insider in China by establishing a R&D facility (2005), sending Chinese employees to Denmark for training and thus preparing them for taking over expatriates' roles. Hyundai has also become an insider in India. It was early in developing the local supply chain, which has reduced its costs and helped it charge lower prices. As a result, India has become a global centre for the export of the tall hatchback called Santro, with exports to 68 countries (including faraway countries such as Mexico). Hyundai also employs local movie celebrities as its spokespersons, which has further enhanced its popularity. Motorola has served as an excellent corporate citizen by supporting education, environmental protection, and China's bid for the 2008 Olympics.

6. **Partnerships:** Partnerships offer interested multinational firms several advantages over going it alone. They can ease the task of obtaining regulatory permissions, fill competence gaps (especially in terms of local knowledge), and give a local face to the multinational entity. In the highly regulated telecoms sector, IBM has found a way to operate in the booming Indian market without going through the trouble of obtaining a license. The company provides technical expertise and services to Bharati Airtel, India's leading mobile operator, in exchange for a fee tied to Bharati's revenues.

Is Chindia Homogeneous?

Despite their similarities, there are differences between the Chinese and Indian markets. China is further ahead in terms of infrastructure, which helped it become a "factory to the world." India's weak infrastructure, on the other hand, has meant that it is more competitive in high tech services. Furthermore, China has a mixed model in terms of its political economy, while India is a vibrant and contentious democracy where a new round of elections might entail a completely different set of policies. Despite these differences, the markets are sufficiently similar for the above arguments to be applicable to multinationals seeking to build positions in both countries. Additionally, in time, these differences will become less salient.

Concluding Remarks

While multinationals face significant challenges in competing in Chindia, successful establishment of positions in these markets is likely to enhance performance significantly. With its large population and market potential, Chindia offers significant opportunities and reward for the patient and

open-minded investors. Indeed, as Peter Engardio asserts, "Few companies any longer can afford not to engage in China or India. As consumers, suppliers, competitors, innovators, investors and sources of skilled labor, they are reshaping the world." To succeed in Chindia, however, firms must identify misconceptions about the markets. They must enter the market early, operate for the long term, adapt, respect local companies, be an insider, and form partnerships.

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