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Compte rendu

New business models: India - China

Sous la présidence de JEAN-JOSEPH BOILLOT
Conseiller, Club du CEPII ; co-fondateur, EIEBG

INTERVENANTS

SOUMITRA DUTTA
Roland Berger Chaired Professor of Business and Technology & Academic Director, eLab, INSEAD

CHRISTIAN PAQUET
Vice president, Huawei France

GILBERT NAUD
Directeur financier, HCL Europe

ALAIN RICHEMOND
Consultant, ancien Vice-Président Economie, Arcelor Mittal

Compte rendu rédigé par
Jules Hugot, Junior Economiste, CEPII

Introduction by Jean-Joseph BOILLOT

China and India are undoubtedly rising economic powers in terms of GDP, growth, FDI, trade and many other aspects. Beyond these macroeconomic trends, the world is discovering that China and India can also rely on microeconomic strengths. In 1995, there were four Chinese firms in the top 500 companies ranking by Fortune. Among them, three were from Hong Kong. In 2010, there were 35 Chinese firms in the top 500 among which three are from Hong Kong and six from Taiwan. In India, no firm was in the ranking in 1995. There are now about ten Indian firms in the top 500. Meanwhile, the companies from developing and emerging countries have risen from 24 to 90 between 1995 and 2010. Some studies claim that these firms will account for half the 500 biggest firms within 20 years.

Chinese and Indian firms are also active in terms of FDI. In 2010, the outward flow of FDI from India reached 20 billion dollars. In the case of China, it is more difficult given that most Chinese companies invest abroad through Hong Kong or Singapore. But we know that outward FDI represents between 60 and 80 billion dollars.

The global rise of so-called "Chindian" corporations has opened a new field of research about the existence of specific business models. How could we name them? First, they are structured by the need to innovate, which makes them innovation-constrained models. Then these innovations are particularly disruptive since they affect all sides of the firm production function: products of course, but also processes and management.

Soumitra DUTTA

The world is changing, and certainly more rapidly in India and China.

"Very recently, I went to the fifteenth annual reunion of my class at the Indian Institute of Technology (IIT), the Indian "MIT". I graduated in 1995. In my class, everyone moved overseas to the USA and other western countries. I asked the head of IIT: How many students who graduated this year? from the computer science program have left India? And he replied: two of them. The large majority was hired by Indian companies and foreign based companies operating in India. Some started their own company: when I met them, they gave me their business cards underlying their CEO status. So we have a whole generation of leaders in India who have succeeded in the field of technology."

"When I was growing in India there were two ways to make it if you had talent: becoming a cricket star or a Bollywood star. Now, in this knowledge-based economy, becoming an entrepreneur has become a way to make it".

History of the Indian IT sector

The most successful sector is undoubtedly "software and technologies". What have been the factors of success of the software sector? Until 1997, the technological sector was dominated by Western companies. When Indira Gandhi, the Prime Minister, imposed a state of emergency in 1975, many industries were nationalized. One of them was linked to technology. IBM had to either transfer its technology or leave the country, which it did. Small Indian companies started their business because major US companies had left the market: they came to fill the gap. However, they had tremendous problems in the 1980's.

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In 1991-1992, India was close to bankruptcy. Part of the IMF package forced India to transfer its gold to London as collateral. The government freed up the sectors that could bring foreign currencies, which was a requirement to balance the current account. One of these sectors was Information and Technology (IT). There was no regulation because it was a new sector. In parallel, US companies started to open subsidiaries in India in the early 1990's. The second company that came to India was Motorola, who settled in Bangalore in 1992. Motorola let its Indian subsidiary free to experiment new management techniques because its top management understood that the US legacy was too heavy and could not be transferred to India. Within three years, the Indian subsidiary of Motorola achieved the highest level of quality. Looking back at the experience of Japanese firms, many Indian managers realized that quality could be a good card to play, following Japanese firms in the 1950's that managed to reach the US market.

The Indian business model also relies on proximity with the customer. The programmer sits next to the customer while programming his software. US businesses appreciated this new way of doing business. India was a good partner for them with no language barrier, low cost destination, and time lag. In other words, you send a task in the afternoon and it is potentially done by the next morning.

Then, there was the internet boom. India got lucky because IT were already its field of specialization. Some start-ups succeeded and became big companies. Today, India counts some of the best companies in the sector. It does not mean that all companies are at the highest level. It is often argued that the innovation in the sector has been process oriented rather than product oriented

History of the Chinese technological boom

In China, the boom of high speed train technology started in 2004. Why? Because at this time, there was a big push towards building power plants to fuel the factories. The ministry of transports had not ordered enough trains to carry coal to these plants. So there was a shortage of power in China. They had to stop production in order to avoid power disruption. Investing in railways became a national objective. And because it is China, they decided to build the biggest and fastest train system. In six years, China has become leader in the sector and now Chinese companies have been chosen to build the London-Scotland high speed line and another one in Chicago. In other words, it all came originally from domestic needs but the government orchestrated the growth of the sector. China has eventually become a world leader. Some Western companies were forced to sell their technology is they wanted an access to the Chinese market. Their idea was to remain two steps ahead: selling n-1 technology while designing n+1 technology. But Chinese firms also went further in this technology and developed a high speed technology on conventional tracks. In this specific field, China holds the world record in terms of speed.

India and China: two distinct models

China and India have a history of innovation. They benefit from many human talents, a relatively stable economic environment. Finally, both countries benefit from a huge domestic market. However, there are fundamentally two models at play.

The Indian growth had been led by the software industry and private sector entrepreneurs. There was very little change in terms of infrastructures: the streets are the same, but if you walk into companies' headquarters, you will see brand new buildings and high level management. Some of these progresses rely on the Indian strong track record in business training.

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In China, all fast-growing sectors (solar energy, airport building, high speed trains, etc…) were monitored and stimulated by the government. It is a more centralized approach.

When I meet an entrepreneur I always ask: "which country do you want to beat?" Chinese entrepreneurs answer "the USA": the whole country shares this target. In India, they say they want to beat China. Maybe China is the best thing that happened to India. From Western companies' point of view, China and India are gigantic fast-growing markets. They are also the places where Western firms can produce high quality products at low costs.

Christian PAQUET

(4 slides in annex)

Introduction to Huawei

Huawei-technologies was founded in China. We build telecom equipment, mainly for operators. In 2001, the revenue of Huawei was $2.3 billion, now it is $28 billion and we became number two in the sector in the world. Two thirds of our sales take place out of China. Huawei is special given that it is entirely owned by its employees. In France, we would call it a "coopérative". Finally, we employ 110.000 persons and our headquarter is in Shenzhen, one of the first Special Economic Zones (SEZ). It became a SEZ in 1988 and was designed for US companies to open subsidiaries, but a few Chinese start-ups also managed to grow: Huawei was one of them.

Enthusiasm and energy

Huawei completely recognizes the enthusiasm that is expressed by Chinese youth. Given that the average age of its employees is 29 years old only. Huawei benefits from this dynamism The average age of Huawei competitors' employees is between 40 and 45 years old.

Learn from the best

A lot of Western companies outsource their Research and Development (R&D) activities in China. The first business of Huawei consisted in buying products in Hong Kong and selling them in China. The founder is 65 years old. He never went to the West before 1992. The first thing he did when it became possible is travelling to find out how things work overseas, especially in the US. He recognized that Huawei was producing low quality products and understood that Huawei had a lot to learn from abroad. This learning process can be decomposed in three steps: (i) How to develop products? How to manage human resources? How to grow fast? The only way to learn was to get support from foreign companies. In 1995, a contract with IBM consulting helped to re-define the product development process. Then, contracts were signed with Accenture, Mercer HR and other consulting firms. Given the low software capacity in China, Huawei has located its 3,000 employee's development center in Bangalore (India). The general philosophy of the company is to learn from the best. Our research center in Bangalore has been awarded the CMM5 certification just after a few years of existence. Huawei has also set up R&D activities in the US, mainly related to Internet Protocol (IP) simply because the US is the place to be when it comes to IP. If you add Chinese dedication and hard working employees, you get a successful firm.

Global world approach

Usually, companies start following big footprints in their domestic market. This was impossible because in the early 1990's, Western companies were much stronger in China. Chinese companies were compelled to

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sell abroad, which, in turn, constrained them to focus on quality. In 1996, Huawei sent people out of China (in Hong Kong) for the first time. Then, in 2000, Huawei opened subsidiaries in Europe, the US and Latin America. It was not easy because the management team did not speak English at all: they had not learned English at school. So they went out with their translators to understand how to do business.

Customers first

Usually, Western firms refer to China and India as low cost destinations. We prefer: “high quality products at reasonable costs”. We make products with a different approach: we provide something different from our competitors. We meet our customers and ask them what they need. We ask them: “What do you need that we can develop”. We also tell them that we can develop a product at a faster pace and with a higher quality than competitors. Our “customer first” policy reflects our core value but we also focus on openness and initiative. We hire young engineers because we believe they can develop these values in our company.

Gilbert NAUD

Introduction to HCL

HCL was born in India in the late 1970’s. It was founded by two entrepreneurs. The story is reminiscent of that of Microsoft or Apple: the founders had a technical background and like Steve Jobs they invented the first Indian micro computer in their garage. Then came the episode when Western companies left India. At this time, HCL became an IT hardware manufacturer. HCL is still the most famous Indian brand in IT. The second part of the business, software, was launched in the early 1990’s. HCL is now a company with 5.5 billion dollars revenue and almost 80,000 employees, mostly located in India. But we are also active in 30 countries.

Empowering employees

Vineet Nayar, HCL president, had a disrupting thinking: “how can we transform an almost dead company into a thriving business?” The answer was not so much about products, markets or processes, or putting customers first. HCL thought about the value-producing chain and found out that human resources were the focus point because it adds the greatest value when it comes to the interaction between customers and employees. Our customers think of this relationship when they choose us over our competitors. So we decided to empower our employees. Usually, managers have the knowledge and they can decide for employees. In fact, sometimes the person who does the job knows better what is efficient. So we put the hierarchical chain upside down and now, the employees who in direct relation with customers can state their ideas through a very organized process. As a result, HCL is one of the fastest-growing companies in the world. This is an evidence that innovation in management can also bring value.

Adapting management to Europe

We have been in Europe for ten years now and we employ 5,000 people. In France, we started our activity two years ago and we now work with 25 companies of the CAC40. We offer our European customers a value chain that is quite different than the one offered by the other companies. Yes we are cheaper, yes we outsource, but we also develop employment in Europe. For instance, we have 2,000 employees in Ireland who produce services for the European market. We also employ people in Poland, Austria and France: we are not only an “offshore” company. In other words, we give our customers the advantages of outsourcing (best practices, innovation, low cost) but we also maintain a close relationship with them.

Alain RICHEMOND

(5 slides in annex)

The main axis to describe Chinese firms is a challenge: how to transform manufacturing export-dedicated firms to finished goods producing to firms in order to serve the domestic market. The cost of labor in China is rising. Some estimate that wages will increase by 70% in the next three years (however, given that the average wages in China are 9% of those in the USA, even an increase by 70% would let Chinese wages much below US wages). One solution is to compensate the rise in labor cost with productivity gains. One possibility is to outsource production in other Asian countries. Another solution is to bet on quality. I asked Nicolas Hayek who invented Swatch (the Swiss watch brand) what country he wanted to beat. He said Japan because on the market of watches, Japan managed to produce high quality goods at reasonable costs. To achieve this type of goal, one needs to take advantage of the best production processes whether locally or abroad. For instance, Haier, a leading Chinese fridge company, built a plant in Florida which now exports to the Chinese market. Americans know how to build these huge fridges: what better choice than to locate where the knowledge is?

Two Chinese companies producing tractors want to invest in France for the same reasons. The two companies came to St-Dizier (Champagne-Ardennes) to buy a plant that produces transmissions for McCormick, an Italian subsidiary of Argo. Ten years ago, 2,000 people used to work in this plant. Today, the plant employs 200 employees.

When the plant closed, the two Chinese companies were competing to buy it. Yto acquired and refurbished the plant and it now produces transmissions that will be mainly exported to China. This is a question of comparative advantages: one has to choose the most competitive production facility, even if one needs to re-export the output. In this case, the Chinese firm came to France for two good reasons: benefit from an access to the local market and to learn the technology.

This process reminds me of Japanese car factories, except that it is much faster: it took 20 years for Japanese car factories to reach success at the global level, 10 years to the Korean carmakers, and Chinese firms do the same in a few years.

The cultural gap

Jean-Joseph Boillot - What about your experience working for Arcelor Mittal? How did you perceive this Mittal business model compared to Arcelor?

Alain Richemond: There is the cultural gap dimension. The two groups (i.e. Indian and French) did not speak the same language. I remember meetings where people were talking about completely different things. France has a long industrial history with a social dimension. The Indian industry does not have such a history: managers are completely off the social environment. The social dialogue is therefore weak and employee’s level of confidence and adhesion is feeble.

Debate

Jean-Joseph Boillot: Would you say that the Lakshmi Mittal corporate culture does reflect the so-called Indian way of doing business? Same question for Huawei in China: do you think Huawei policy of “customer first” reflects a broader Chinese model? In short, is there a specific-country corporate culture or a broader set of cultures within each country?

Soumitra Dutta: It is natural that culture influences companies. It is difficult to reduce this gap that can be found at two levels: among employees on the one hand, and between employees and customers on the other hand. To succeed, a foreign culture-based firm has to adapt its management to the country in which it chooses to locate. Given the number of Chinese and Indian firms that will open subsidiaries in Europe in the next few years, we have a major challenge ahead. One axis that separates firms for which adaptation is easy from firms for which adaptation is less easy is ownership. For example, Mittal is a family-owned company, while Tata has become a more open company with professional top managers. It should be easier for the latter to set up activities abroad.

Thanh Nguyen: *What is your thinking on the perspectives for the future? Do you see more growth in mature markets that are big or in new countries that are growing almost from scratch?*

Soumitra Dutta: The fastest growth is clearly coming from emerging markets.

Philippe Humbert: *The ownership of the companies you presented are relatively stable, whether family ownership (Lakshmi Mittal), cooperative (HCL) or government ownership. It is very different from pension fund style ownership, which is based on the goal of a 15% yearly return to investment. When you have such a target, you do not manage a company the same way as when you are more based on a long term perspective. How far is this ownership issue important?*

Soumitra Dutta: These days, you see a revival of family ownership or longer term strategies, more of private investments not going to the capital markets. People are realizing there is a need for longer term strategies. And it is a fact: more stable companies tend to obtain better results. If you have leadership changing every 18 months it is not easy to define a strategy and stick to it.

Gilbert Nau: The shareholder law is bringing some rigor in the way finances are handled within the company. It is sometimes necessary to have financial reports, especially if we link this issue to corruption. The ownership of Indian companies clearly favors long term strategies. For instance, 40% of the capital of HCL is listed on the stock market in Bombay. The remaining 60% is held by managers (40%) and founders (20%): so it is easier for them to think of the future.

Christian Paquet: Huawei has decided just a few years after it was founded that the ownership would be spread across the employees and that no one would hold more than 2%. Even the founder only holds around 1.5%. The idea is close to “employees first”. The only way to motivate employees is to make them part of the success. So every year, the employees are very happy to see the return from their work. In terms of management: 100% of the top management is now Chinese. One of our key challenges is to hire non-Chinese top managers. It is not easy, especially given the language barrier.

Qi Zheng, Consultant for IRD/AFD, specialist of the Chinese-African relationship: *Chinese telecom companies have found great success in recent years in Africa. How do you perceive these public-private partnerships, especially in a risky environment such as in Africa?*

Christian Paquet: Chinese banks want to be more global. They grant credits not to Huawei, but to the customers so they can get money to buy equipment from these companies. French and Japanese have done

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the same. However, the share of these credit lines that has actually been used by customers is probably less than 50%. Africa has changed a lot: most of the telecom companies are now held by major operators like Orange, Vivendi or Vodaphone. These companies can fund their own projects in Africa. Finally, finance has helped a little bit but it is not the main factor.

Suyan Zhou: *What about corruption, which is an underwater subject in developing and emerging countries?*

Soumitra Dutta: Corruption is an endemic issue in India, at all levels. The good news is that there is a legal system to take care of some corruption issues. New laws have been put in place recently.

Conclusion by Jean-Joseph BOILLOT

China and India share a common model, which is innovation-constrained leading to low cost-high quality products and processes, but also high commitment of all the managers and employees.

But there is a very large diversity, even within Chinese or Indian companies, of paths taken to reach these objectives. We can see nevertheless three common points. First, pragmatism is making these companies very effective and flexible. Second, these companies benefit from the energy of their employees, which is related to their youth. Besides, people are especially motivated because most of them know what bad living conditions mean and they want to reach better standards of living. Finally and I think this is the main challenge: globalization. There is no Indian or Chinese company today that is not focusing on globalization. And they are building a very specific model here, which is "scaling out". Western countries have based their industry and services models on Fordism: mass production, mass consumption, but standardized products. Now, companies from China and India are using the so-called offshore paradigm to get the best of R&D wherever it is and the best of the unit labor cost wherever it is, and to scale-out production whenever they need to reach economies of scale and even more, economies of scope.

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