ENTERING THE INDIAN MARKET: KEY ISSUES

Presentation by A. Sheshabalaya, Ascendex, at the ERA Conference: Growth Through Partnership
Sheraton Brussels Airport Hotel, October 12-13, 1998

A carefully structured entry strategy is a prerequisite for companies who wish to succeed on the Indian market.

The first step is to understand India, its market and to define business objectives.

MARKET OBJECTIVES

SHORT-TERM ISSUES (<1 year)

Assessing costs and benefits

In the short term, the overriding goal would be to make a serious professional assessment of Indian opportunities, costs and benefits - of real opportunities, real costs and real benefits.

One good way to begin, which our clients have found useful, is an assessment of what the competition is up to in this fast changing market. Our newsletters and alerts, for example, provide quick updates on developments in several Indian business sectors.

Opportunity cost of inactivity

Also included in this phase should be the opportunity cost of inactivity.

For example, companies who were comfortably ensconced last year in southeast Asia are still wondering who zapped whom, how and why. Whether it is computers or cars, televisions or soda ash, the region's sales this year will be a little over half that of India, which still chugs along close to its usual pace.

Elephant or tiger

Yes, it is true, the Indian elephant lives longer, and it seems, more happily, than do Asian tigers.

Visitors to our Web site would know what Schlumberger CEO D.E Baird noted last year, that India moves slowly but it moves surely.

Realism in the land of rope tricks: Colgate, Misys and Shisheido

On the other hand, it is also important to avoid playing Alice in Wonderland.

It is of course true that Colgate sells more toothpaste in India than anywhere else in Asia, that one of UK software company Misys' largest banking orders ever came from India, and that India's truck production - in a good year like 1996 - was more than France, Italy, the Netherlands, Spain and the UK combined.

It is also true that Director's Special whisky from India's Shaw Wallace is - since 1993 - the world's fastest-growing alcoholic drinks brand.

But - whoever told cosmetics company Shisheido that there were 200 million middle class Indians was surely not speaking Japanese.

For Coke, Nike and Mercedes: A peculiar market

What is important, indeed crucial, is to know that India is one of the world's most peculiar markets.

Coca Cola found this out when it acquired two Indian soft drink brands. It tried hard, in its usual way, to bury them. But unlike old soldiers, India's Thums Up cola and Limca refused to fade away. Coke now sells these brands not only in India but also exports them to Southeast Asia and Hong Kong.

This too is the story of Nike and Reebok, who could not displace local market leader Bata. Nike has in fact been forced to team up with the Indian company in this huge market - which sees sales of 150 million pairs a year.

In some ways, this is also the story of Mercedes-Benz which set up a plant in India. Wealthy Indians preferred to pay penalty import duties for the latest Mercedes models from Germany - rather than the slightly older models Mercedes was manufacturing in India.

Good approach: The Australian way

But, as my earlier examples - Colgate and Misys - show, good marketing strategies do pay off.

And sometimes very quickly.

In spite of huge loyalty to Indian brands, Foster's of Australia had 10% of India's No.1 beer market - Bombay - within just one month of launch.

There are numerous such examples I could give.

MEDIUM-TERM ISSUES (1-5 YEARS)

Performance, expansion and fallback

In this phase, financial targets are important. So also are controls to closely monitor and assess performance.

Another point is to devise and begin action on the link between market entry and market expansion.

A third point is to engender second line or fallback options, in case things go wrong with the preferred approach to market entry.

India as a re-export base

Several companies have also chosen to use the Indian market as both a base for local sales as well as re-export.

The key issue here is India's relatively large industrial base, which makes it easier than in many smaller countries to source or contract out production of inputs locally, and achieve satisfactory economies of scale.

Some companies adopt a two-pronged approach in the medium-term. For them, exports out of India provide economic logic in what is still a relatively small market, but which is expected to grow massively in the longer term.

While updating its Indian produced models, Mercedes has also been exporting them to Asia and the Middle East - and last week was discussing selling them in Russia too. Several other car companies plan to follow this pattern. Hyundai, in fact, is now planning to export its new Atos from India back to its home country, South Korea.

Several other companies also follow this pattern, especially in the field of engineering. GE and ATL, for example, export medical electronics equipment from their Indian units, Alfa Laval exports food processing machinery

LONG-TERM ISSUES (>5 YEARS)

If we overlook the Keynesian verdict that everyone is dead in the long term, what does India offer in the plus 5-year timeframe ?

What exactly is this middle class ?

In a report we authored for Find/SVP in New York two years ago, we divided India's - now infamous - 200 million middle class - into three separate rungs: premium, middle-market and mass market.

Premium market consumers in India are an interesting lot. They wear Cartier watches and Christian Dior suits, use Chanel perfumes and go on holidays to Zug, Switzerland. There are 4-5 million of them in India.

The middle market, according to our estimates, is 50-60 million strong. They have purchasing power equivalent to that of an average European or American, and are a major target for most companies.

The mass market numbers 150-200 million. They are not middle class in the sense this term is understood here. But they will increasingly become so in the next 5-10 years.

The real key is middle class behaviour

What is important is that many of these consumers already buy products by brand, watch television and have savings accounts.

More gold buying than the US, Europe and Japan combined

They are also the reason for India's voracious appetite for gold. Indians like these buy four times more gold than another major market, China, and indeed more than the US, Europe and Japan, combined.

A long-term market

India is therefore a long term market.

Today's scooter buyer in the mass market will be tomorrow's middle market car buyer. Today's mass market branded shampoo buyer will buy his scooter and color TV tomorrow.

And then, we must not forget, there are the remaining 600 million who are currently outside the market system.

They will begin to provide day after tomorrow's demand for branded shampoo, scooters, color TVs, cars and much more.

They will resurrect Keynes. In other words, the Indian market will not die in the (foreseeable) long term.

For serious companies, this is the uniquely long-term opportunity, and devising a successful way to move up (or down) this quantitative ladder is the key challenge.

Bring to buy, these huddled masses

International companies like Unilever understand this only too well. Without rural India's hundreds of millions, Lever's Lifebuoy would not be the world's No.1 soap brand.

Indian companies too appreciate this fact. Home electronics market leader BPL (which has a joint venture with Sanyo) has recently raised 220 million rupees to fund expansion explicitly into rural markets with a rugged, fault-tolerant, low-cost hi-fi system.

ENTRY MODES

The second step is to define entry modes into India. We will consider only those ways where there is a physical transfer of products or technology to the country.

In other words, private placements and bought-out deals, which are rapidly growing as a means to obtain funding in the country - are not included.

Entry rules and procedures are again an area where conditions are changing continuously, often - but not always - positively. Once again, Ascendex's information services are a good way to stay in touch.

One major recent positive move is the government's intention to widen the automatic approval route for foreign investments. The target is 95-99% approvals via this mechanism, up from about 40% at present.

In general, there are several ways to enter the Indian market.

DIRECT EXPORT

Agent, Distributors and Resellers

Trade fairs, government-organized buyer-seller meets, delegations. These are preferred ways to find commission agents and distributors.

Background checks are however always advisable. Another factor to carefully account for - in distributor agreements - is the possibility of severance, and the penalties to be incurred.

Japan's Aiwa hi-fi company is in fact facing exactly this problem after signing a distributorship deal with an Indian company, Baron International, which had previously represented Akai.

Direct to buyer

In some sectors (especially high technology niche markets), this is the obvious way. Once again, a fairly convenient means for newcomers is to commission a quick study of prospects and locally based competitors.

As a Cussons executive told the 'Financial Times', very frequently, there is an Indian manufacturer of something else, nearly as good.

ALLIANCES WITH INDIAN COMPANIES: SOME ISSUES

Awash with candidates

There are literally thousands of Indian companies looking for international alliances. India's 25 stock exchanges list about 8,000 companies.

What Indian companies seek

For an Indian company, acquisition of foreign technology, especially if it is an internationally-known brand (or what we in India call a reputed company) brings in knowhow, prestige, funding, and, if it works, steadily growing profits plus the possibility of overseas sales.

Rise to world class quality standards

One good example is the heavily foreign-partnered auto components industry. Of 350 manufacturers, 170 now have ISO 9000 certification. 22 are in fact QS 9000 certified. Sundaram Clayton has won one of the world's most prestigious awards, Japan's Deming Prize.

New products

Indian companies also look over time for additional products in their portfolios, and successful alliances see good responses from foreign partners.

Sanyo has moved from supplying BPL with audio technology - to providing knowhow for nickel cadmium batteries.

Germany's Empe Werke has transferred technology to Birla Corp. for jute-based car door panels, and is now enhancing the relationship to engine mounts. Belgium's Etex is providing its Indian partner with the latest fire-resistant building materials technology.

What foreign companies seek

Conversely, for a foreign company, a good local partner offers access to distribution channels, business and cultural knowhow in what can often be a bewildering market.

Modifying legal form of alliance

Not infrequently, the way to enhanced collaboration is underpinned by upgrading the legal form of an alliance. Nicholas Piramal, for instance, which marketed Boots OTC pharma products under licence, will now bring them into a new joint venture, 51% held by Boots.

From medical electronics to chemicals: Tapping third markets

Alliances can also involve a re-export dimension. The Far East and Southeast Asia are the favorite targets for re-export strategies by international companies - for example General Electric (with Wipro) for medical equipment, Bacardi-Martini (with Gemini) for rum, whisky and cognacs, Ciba (with Atul and Mafatlal) for polyurethanes and VAT dyes, Owens-Corning (with Mahindra) for glass fibre composites.

Harnessing gains in Africa: From mines to medicines

However, one region where this form of collaboration remains absent is Africa, where Indian companies have since some years made rapid inroads: beer and hospital software in South Africa, mines in Zambia, bicyles in Zimbabwe, insurance, chemicals, buses and jeeps in Kenya and Nigeria, pharmaceuticals in Uganda, plastics processing in Namibia, and railways and telephone systems in several places - these are just a sample of Indian success stories on that continent. India plans to double its trade with Africa to $8 billion in 4-5 years.

A move to higher levels of collaboration between Indian and international companies on the African market could be of great benefits to both.

Growing transparency facilitates partner choice

For foreign companies, one encouraging factor in partner choice is the move in India to greater transparency, especially by the bigger companies. After recommending quarterly reports, the Indian Securities and Exchange Board, for example, is now working out rules to tighten disclosure norms (including publication of adverse ratings from credit agencies).

A note of caution

Nonetheless, it remains very important to conduct independent background checks of prospective partners. After several months of negotiation, a Belgian pharma company pulled out when it discovered that its prospective Indian partner, had been negotiating for more than a year with the Belgian's British and US competitors, and to cap it, was also under investigation by the Income Tax Department.

The Belgian company did not need a Hercule Poirot to figure all this out. The story was being widely covered in the Indian business media.

Other key points are to provide suitable technology as well as an arbitration clause, enforceable either in India - where the laws have been streamlined in 1996 - or at a mutually agreed place overseas.

Some typical problem cases

There have indeed been some much publicized problems where foreign companies have tried to palm off outdated technologies in India, and everyone has come to grief.

Italy's Breton, for example, supplied India's Polar group with marble agglomeration technology. Polar later found the Italian technology was not suitable for Indian raw materials, which, it said, got scratched and abraded. Several hundreds of consumers filed complaints against the Indian company, which promptly filed its own $15 million damage claim against the Italians in a Geneva arbitration court. The contract price, including technical know-how fee, was just $2 million.

The much-reported Maruti-Suzuki conflict which began last year also revolves around such issues, that is, tying continuing royalty payments from India to inflows of Japanese automotive technology.

Currently, the most celebrated dispute of this kind is a scooter joint venture between Italy's Piaggio and LML, now in front of Indian courts as well as the ICC.

CONTRACT MANUFACTURE

The norm in some sectors

Contract manufacture is more or less the norm in sectors such as consumer electronic components, jewellery and computer hardware.

Advantages for the foreign company arise from the hands-free nature of the operation - as well as their relative simplicity.

Harris Corporation, for instance, explicitly chose contracting arrangements because it found them easier to manage than joint ventures.

The most popular contract manufacturing is in 100% export processing zones, such as one by Golden Systems of California, which is one of the largest OEMs in switch mode power supplies.

Pitfalls to avoid: The ABB example

On the other hand, there can be risks, especially if contract manufacture is part of world production schedules, lean production schedules. ABB, for example, had huge problems four years ago as a result of delays in supply of Indian-built circuit breakers to Sweden. "They had another concept of meeting deadlines," its CEO Goran Lindahl complained to the 'Wall Street Journal'.

Using regulatory loopholes

Some companies also exploit loopholes in Indian regulations. For instance, in pharmaceuticals, contract manufacture by the small scale sector allows bypassing price controls. Nearly all major drugs companies, Indian and international, use this route via what are called loan license units, of which there are no fewer than 25,000 in the country.

CONTRACT DISTRIBUTION

Bypassing entry barriers

For mass and even middle-market products, contract distribution avoids the need to set up one's own network, which is not easy. Mass market companies in India need 500 to 5,000 sales staff and outlets ranging from some 10,000 to 5 million. Even for the Indian middle market, a satisfactory reach requires at least 1,000 to 5,000 outlets.

These figures do not apply only to consumer goods. In finance, for example, mutual fund giant UTI has more than 50 offices of its own and about 100,000 sales agents for its various schemes.

Gillette leverages a niche

Contract distribution is also chosen due to the stratified nature of the Indian market. Gillette, for example, chose contract distribution to target the premium, urban consumers most likely to buy its electric epilators and its newly launched ThermScan thermometer - even though it had a huge network of its own for razor blades.

LICENSING AND TECHNOLOGY ALLIANCES

Intellectual property

The key issue in this field is intellectual property protection. There are some high profile stories of problems here. However, India is beginning to make serious moves to enhance intellectual property protection.

India has finally signed the Paris Convention on patents and was last month elected to chair the World Intellectual Property Organisation.

Of pharmaceutical patents and software piracy

In one of the most high profile fields in this context, namely pharmaceuticals, influential Indian companies who have made inroads overseas (e.g Ranbaxy Labs and Dr. Reddy's) are now among the most vociferous champions of Indian accession to the international product patents regime.

The message here is simple. Indians are pragmatic people (both William James and John Stuart Mills are popular in the country). India does reverse direction, though sometimes quite noisily, when it is in its greater interest to do so.

The software industry is a good example of this. Piracy rates in India, according to the Business Software Alliance, are over 25 percentage points lower than China or Indonesia.

From fridges to tractors: Multiple alliances rule

Many Indian companies have multiple technology alliances. In other words, there is room for everybody.

A good example is refrigeration company Blue Star. It has a tech collaboration with York International to upgrade technology for its product range - as well as to add a new range of air-cooled and water-cooled chillers. Another alliance is with Bohn of the US for cold room refrigerating units. It also has a third alliance with Kolpak for package refrigeration. Blue Star's agreement with York is also sourced at exports to West Asia and the Far East, towards which it may eventually upgrade the alliance into a joint venture.

Another example is tractor manufacturer Escorts, which has a joint venture with Carraro of Italy to make tractor transmissions, a tech transfer agreement with Yanmar of Japan for farm implements, and a two-way technical alliance with AVL of Austria for engine development. It has also recently signed an MoU with Long Tractor for a US joint venture in North Carolina, based on SKD and CKD assembly.

Foreign companies mirror trend

Foreign companies also adopt several routes. Tatra, for example, has a long-running joint venture with Bharat Earth Movers for army trucks but recently set up another joint venture with Venus Udyog for the civilian trucks sector.

What to avoid

Sometimes it might be wise to wait. Continental of Germany was entering into a tech collaboration arrangement with one Indian company, which was being acquired by another. Meanwhile, Continental was finalizing its own radial tyres joint venture with the latter.

At that time, the director of this Indian company was quoted as saying, "the proposed agreement would be for the manufacture of all kinds of tyres and in due course it will be decided what the range would be".

For these kinds of partners, it is of course wisest to wait and see.

What about Indian technology ?

Another new - but growing - possibility is to reverse the usual course of events, in other words, to access Indian technology and invest in its marketing and sales overseas.

The software industry is, of course, the most visible in this respect, as Hughes, Motorola, Siemens and Honeywell know. Even smaller international IT companies have struck this chord. SMART Modular Technologies, for instance, designs its products in India and manufactures them in Scotland.

Other sectors too are flush with opportunities. In the last few months alone, some examples of exciting new developments from Indian labs which we are aware of include:

- a coconut coir-based building materials technology already transferred to Southeast Asia
- a pumpless lubrication kit for two stroke motor vehicles
- a vapor recapture system for the textiles industry
- a crop antifungal called Kalisena
- an anti-cerebral malaria drug called arteether
- and a wireless in local loop telecoms system, which is already being investigated for purchase in Brazil, Tunisia, Taiwan and South Africa.

Americans tap Indian knowhow

Software aside, the Americans, of course, are no strangers to this.

EOSAT supplies global markets with Indian remote sensing satellite imagery (which have the world's highest commercial resolution).

Very recently, American Diversified Group acquired marketing rights in South America, Asia and Africa for an Indian-developed vaccine.

JOINT VENTURES

Prerequisites for success

Joint ventures generally require several conditions to succeed. Some of the main ones are:

- mutual understanding
- a converging strategic vision - not just a common competitor on a big market
- objective agreement on where each partner adds value to the other's efforts, and how this develops over time.

Procter & Gamble's JV unravels

None of these qualities is of course readily available.

This was already highlighted in 1996 when a joint venture between Procter & Gamble and India's Godrej Soaps - billed during its formation as a 'marriage made in heaven' - unravelled as rapidly as such marriages sometimes do.

Next year's winner was the failed car joint venture between France's Peugeot and India's Premier.

Majority or minority

In terms of structuring joint ventures, foreign partners generally prefer to adopt majority control or to keep a way open to migrate upwards to majority.

Some however choose minority shares from the outset. BMW, for example, found the $50 million minimum investment required for a car sector majority controlled joint venture too much, given the limited potential for its vehicle in India. It therefore opted for a minority stake.

Mitsubishi, on its part, feels that minority stakes underpin the importance of tech transfer to the Indian partner, in this case, Hindustan Motors.

Small and medium-sized companies

One final point. For several industrial categories, it is also fruitful for foreign companies to target small and medium sized companies - or SMEs, since they constitute the bedrock of India's industrial infrastructure - which indeed, is one of the most important differences between India and China.

Today, FICCI, the Indian industry and trade federation, is pressing for venture capital support explictly targeted at SMEs. SIDBI (the Small Industries Development Bank of India) plans to finance 50% of equity and terms loans by SMEs that enter into joint ventures with foreign collaborators.

100% SUBSIDIARY

100% subsidiaries are sometimes the obvious way, especially for international companies which dominate their market sectors - or have very strong brands.

In other cases, the option can be forced.

Italy's Graziano, for instance, started out by wanting 89%, but could find no suitable Indian partner willing to take the magic figure of 11%. It therefore applied for a 100% subsidiary.

Multiple presence: Allen Bradley Exxon

Some companies also have 100% subsidiaries for one purpose and other alliances to supplement their Indian business objectives.

For international pharmaceutical companies, this kind of mix is emerging, with a 100% subsidiary used to register new drugs and monitor patents, and joint ventures or marketing alliances to sell their products.

This is also the case in other sectors, for example engineering. Allen-Bradley has a tech transfer agreement with Lakshmi Electrical to manufacture switchgears. Its 100% Indian subsidiary provides technical support and has set up the marketing, sales and channel network. Lakshmi does not pay royalty to the US company for the tech transfer, but serves as a contract manufacturing source point for exports.

Once again, this is also the case with Exxon which has a 100% subsidiary in India, while its Mauritius subsidiary provides lubricants technology to Hindustan Petroleum.

Holding company for one-time approval

One of the most attractive investment routes is expected to be a 100% subsidiary set up as a holding company.

The Indian government is considering allowing foreign-owned holding companies - with an in-principle one-time approval from the Foreign Investment Promotion Board (FIPB) - to make any number of downstream investments through the automatic route, that is without further FIPB approvals.

100% EXPORT UNITS

Appeal wanes

100% export-oriented units (EOUs) and export processing zone (EPZ) schemes were set up in the early years of reforms. They have since lost a good part of their appeal, most importantly due to a decline in peak tariffs from over 300% in 1991 to 40% at present.

Secondly, while EOUs and EPZs are allowed to procure capital goods free of duty, in real life these duties are only deferred and become payable at depreciated rates.

On the other hand, a strong remaining incentive for EOUs/EPZs is a 5-year tax holiday.

At present, there are about 900 EOU units and 50 EPZ units, mainly in software, electronics, textiles and garments, gems and jewellery, engineering items, and chemicals.

One relatively new EoU sector is pharmaceuticals, or rather bulk drugs. Byk Gulden of the Netherlands is in fact setting up an Indian JV as a 100% EOU for pantoprazole, an anti-ulcerant.

EXPANSION MODES

The Indian government willingness to make things easier for upgrading a foreign company's presence has been met with a rapid response.

Many companies, among them Motorola, Adidas, Delphi Automotive and Tupperware, have increased capital in their Indian operations - to fund expansion as well as write off start-up losses.

Foreign companies increase joint venture stakes

In recent months, several foreign partners in Indian joint ventures have also increased majority stakes. The process has been seen across the board. One of the main reasons has been the easier access to capital by international companies, in the face of India's own slowdown and high interest rates.

Germany's FAG Precision Bearings, for example, is now hiking its stake in its Indian joint venture from 40% to above 51% - just one year after this move was resisted successfully by Indian shareholders.

Some other recent examples of international companies increasing or planning to increase control of their Indian joint ventures:

- Cement machinery manufacturer Fuller International, from 80% to 100%.
- Automobile companies Mercedes and Ford, to 74% and 92%, Honda from 60% to 90%, Daewoo to 92%.
- ABN Amro from 40% to 75% in its securities joint venture Hoare Govett
- Engineering giant ABB to 74% in its joint venture with Birla company Universal Cables.
- Alcoholic beverages company International Distillers and Vintners, from 60% to 100%.
- 3M Corporation, from 51% to 76%.
- Seminis of Mexico from 50 to 90% - in Indian biotech company Nath Sluis.
- Swiss textile machinery manufacturer Benninger, from 50% to 100%.
- Medical electronics company Picker, from 50 to 100%.
- Thomson Multimedia is currently persuading the Obul Reddy group to offload its 49% stake in their JV and enable the French company to hold 100%.

Indian buy out of foreign partner

Finally, there are also some surprises. Indian scooter manufacturer Kinetic Engineering is buying out Honda Motor's 51% majority stake in their 13-year-old joint venture.

It will be the first-ever buyout of a foreign ally's stake by a Indian minority partner.

There is however a happy ending.

Honda will continue to supply Kinetic with technology.