Indian Journal of Economics & Business, Special Issue China & India (2006) : 1-...

THE INDIAN ELEPHANT AND THE CHINESE DRAGON: DIFFERING DEVELOPMENT STRATEGIES OF INDIA AND CHINA AND EFFECTS ON BUSINESS ENVIRONMENTS

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This paper deals with economic and institutional development policies and trajectories followed by India and China, including an emphasis on education, political philosophy, economic philosophies and sustained investments in future growth. These differing strategies have resulted in vastly different business environments, each with their strengths and weaknesses in the new global economy. The authors conclude that despite capital shortages, Indian companies have consistently outperformed Chinese companies, although the Chinese are catching up in certain sectors. The paper also explores the role of Foreign Direct Investment (FDI) in shaping competitive environments and local companies' strengths. Consequently, the paper has policy and developmental implications for India and China.

Comparisons between the iconic Asian giants, India and China are inevitable and appear to have spawned an industry (see the recent special issues comparing India and China in the Economist, BusinessWeek, and McKinsey Quarterly). India's growth rate of 6% seems solid, but melts beside one of close to 10% for China. Indeed, China appears to have done better than India on virtually every measure of economic growth and poverty reduction. Several Indians, including Prime Minister Manmohan Singh, have spoken about adopting "the Chinese model". Yet, India's different political, cultural and social environments, as well as achievements, should call for a closer examination of the Chinese model. The two countries, share a 2,170-mile border, and the distinction of each being home to more than one billion people, many of them poor. However, myriad differences exist in their policy orientations that have affected the companies they have spawned and their impacts on the global economy. Several factors indicate that the two countries are committed to divergent paths of development and that the race has not yet been completed.

First, we explore the economic, political and institutional development policies and trajectories that the two countries have undertaken. Next, we underscore the different business environments that have resulted. We focus on the characteristics of the local companies that the countries' business environments have spawned, with their unique, though sometimes complementary strengths and weaknesses. Finally, we explore the implications of our analysis for policymakers and global investors.

THE TRODDEN PATHS

India embarked on its economic reforms more than a decade after China. Consequently, it has had less time to see policy effects. However, enormous differences exist between the economic, political and institutional strategies that the Indian and Chinese governments have undertaken. These strategic paths have led to vastly differing business environments.

First, the Chinese government nurtures and directs economic activity more than the Indian government does. It invests heavily in physical infrastructure and often decides (based on government connections) which companies receive government resources and listings on local stock markets. Second, the two countries have adopted divergent policies towards trade and foreign direct investment (FDI): China has embraced it, India remains cautious. Third, the countries have adopted differing forms of government: China remains a communist, single-party country, India the largest democracy in the world. Fourth, both countries' policies have placed differing emphases on hard infrastructure (such as ports, roads and electricity) and soft infrastructure (such as laws, institutions and financial markets). While China has consistently invested in the hard infrastructure, its investments in the soft have been often prompted by external, especially multinational corporations' and foreign governments' requests. India on the other hand has failed to invest sufficiently in hard infrastructure, but its competitive market policies have allowed soft infrastructure to flourish. This section now explores each of these strategic paths in turn.

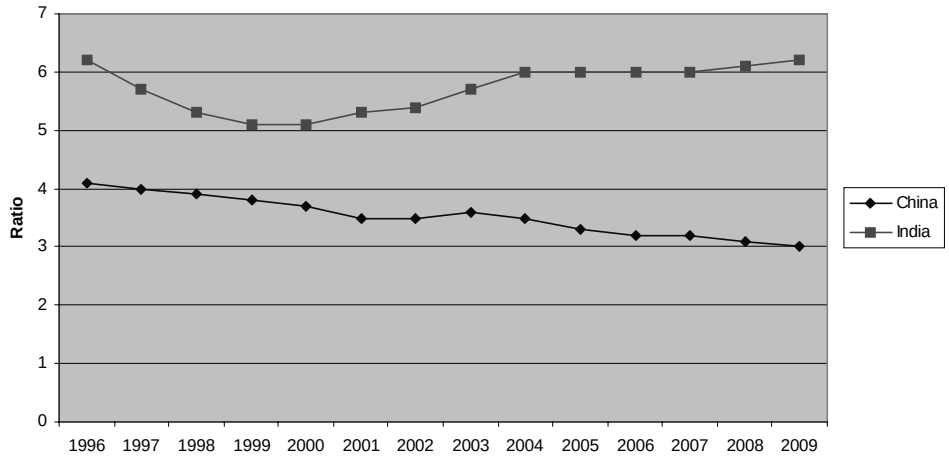
GOVERNMENT DOMINANCE

As we argued in *The Chinese Tao of Business* (p. 170), the government dominates every aspect of business in China. Successful Chinese managers constantly, almost unthinkingly, incorporate the central or provincial governments' goals and desires into their planning. The best Chinese entrepreneurs wield governmental plans and goals to their own benefits, to grease their strategic moves as well as to consolidate their control of special market information. As Pan Shi Yi, CEO of Redstone and Beijing's largest developer told us, "If you recognize the government's needs on one project, it will help them remember you on another" (Haley, Haley and Tan, 2004).

Figure 1 hghlights the continued dominance of the government in the Chinese economy. Despite the much-trumpeted Chinese economic reforms, including the opening of the economy to private entrepreneurs, the ratio of private consumption to government consumption in China has declined from 1996 to the present. This trend indicates that government consumption as a contributor to Chinese GDP is growing at a rate even faster than private consumption and will probably continue to grow in the future. Conversely, in India, though government consumption increased significantly in the late 1990s, the trend reversed itself in 2000. Private consumption as a contributor to Indian GDP grew significantly faster than government consumption. These data show that since 2000, the Indian government has consistently become less interventionist.

The Chinese government's intervention in the economy—including the decisions to welcome FDI—has brought material improvement in the standard of living that India hasn't enjoyed. Yet, government intervention and control also have a seamier side including the stifling of entrepreneurial activities and innovation as the next sections argue.

Figure 1
Ratio of Private to Government Consumption



Source: Economist Intelligence Unit time series database, 2004 estimated, 2005-2009 projected.

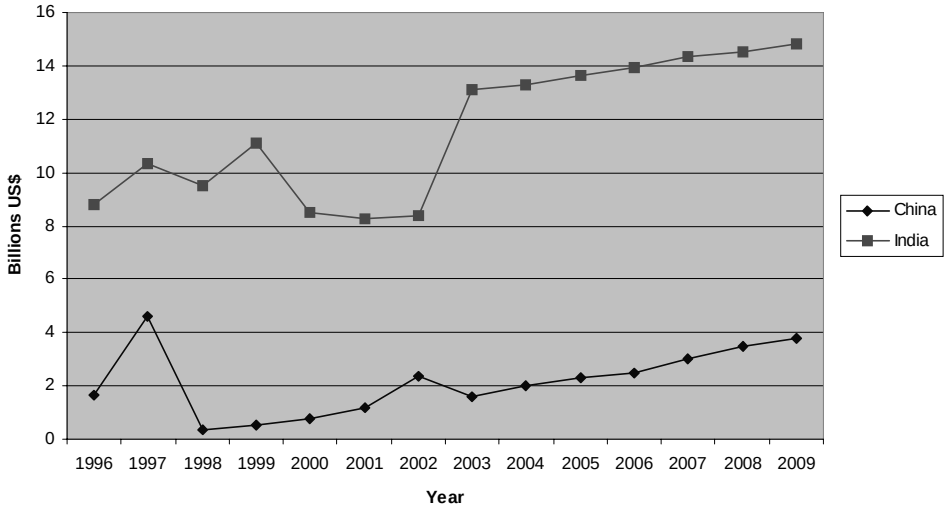
FDI, PORTFOLIO INVESTMENT AND TRADE

No other country attracts as much FDI as China does. In 2004, approximately $60 billion poured into China, about ten times the amount that flowed into India. Between 1979 and 2004, China absorbed a total of about $560 billion in FDI. According to a survey of big firms by A.T. Kearney, a management consultancy, India serves as the next most popular destination for foreign investment in manufacturing after China (see Haley, 2004). However, in the past four years, India has received almost $200 billion less in FDI than China has and is far less integrated into the global supply chain.

FDI figures understate India's abilities to draw investment. Besides FDI, India attracts several billion dollars a year in portfolio investment ($9 billion in 2004). The country also attracts billions of dollars in deposits from non-resident Indians ($33.3 billion in 2004). Figure 2 shows the advantage India has in Workers' Remittances alone. In 2004, this advantage amounted to $11.27 billion and economists estimate that it will continue through the decade. FDI figures also exaggerate China's supremacy — especially if you allow for Chinese domestic investors' "round-tripping", using foreign vehicles to take advantage of tax breaks (Xiao, 2004). On the downside, India's minority portfolio investors do not bring foreign technology, management systems, or competition that helps raise domestic firms' efficiencies as do multinational companies for China. Indian banks (much healthier than their Chinese counterparts and capable of intermediating between savers and investors) still keep about 40% of their assets in government bonds.

Trade data provide another indicator of China's supremacy in world markets. In 1990, China's share of world exports approximated 1.9% and of imports 1.6%. By 2003, its share of exports had increased to 5.8% and of imports to 5.3%. In 2004, two-way trade grew by 36% and China overtook Japan to become the world's third-largest trader

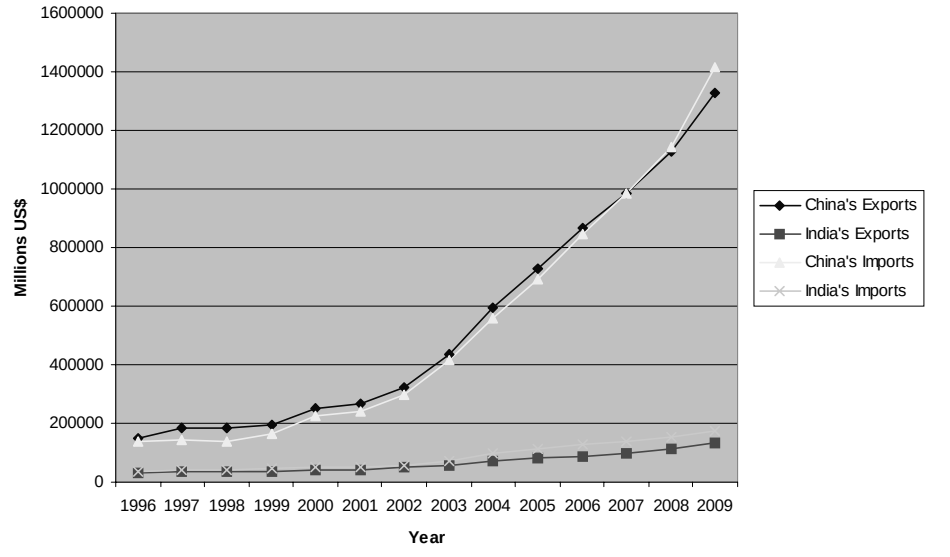
Figure 2
Workers Remittances



Source: Economist Intelligence Unit time series database, 2004 estimated 2005-2009 projected.

behind the USA and Germany. In the 1990s, China's trade-to-GDP ratio grew by over 70%, more than that of any other country; India's trade-to-GDP ratio increased 23%. China exports about six times more goods and services than India and its exports are growing faster. Figure 3 captures some of the disparity between China's and India's total exports and imports.

Figure 3
Chinese & Indian Import/Export Data



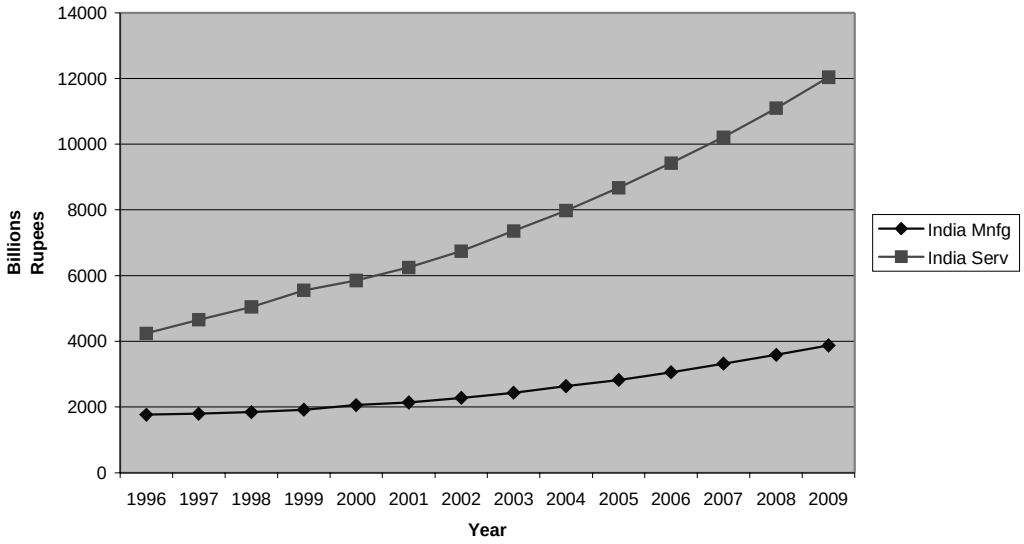
Source: Economist Intelligence Unit time series database, 2004 estimated, 2005-2009 projected.

China's economy appears more open than India's: in 2005, China's average tariff on manufactured products will approximate 9%, compared with 30% for India. The Economist Intelligence Unit (EIU) projects that by 2008, China will incur trade deficits that will increase substantially in 2009. Exports lead much of China's economic growth, and growth may be detrimentally affected in this scenario.

Indian trade has also been growing fast, notching up a 16% rise in 2004. Even so, its total two-way trade in 2004 reached only around $168 billion, less than 1% of the global total. For the third year running, China's trade increase exceeded India's total foreign trade reinforcing perceptions of the two countries' vastly different weights in the global trading system. China's continued trading prowess has also changed mutual perceptions. Indian exporters, who feared that Chinese competition might destroy them, now worry that a hard landing for China might destroy a big growth market for Indian goods.

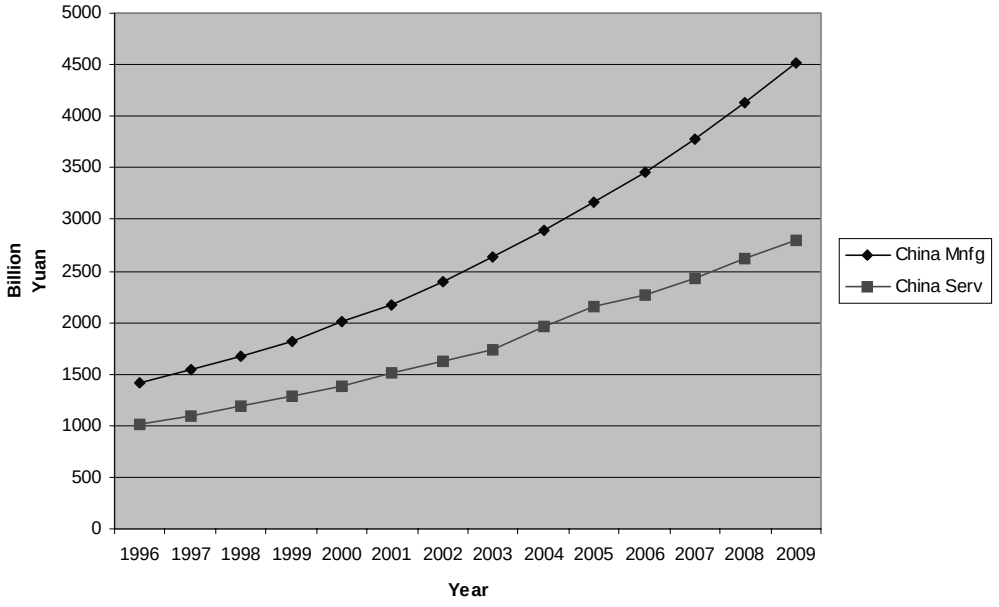
As with FDI, analysts may have discounted some aspects of India's trade prowess vis-à-vis China. We argue for re-evaluating the two countries' weights in the global trading system based on the two economies' strengths. Policy makers and US politicians have long justified the USA's long-term, consistent trade deficits in part as a symptom of its post-industrial service economy. Analysts have difficulty measuring exports of services and consistently underreport them. Consequently, any comparison of India's economic and trade performance vis-à-vis China's would underestimate India's comparative performance. As Figures 4, 5 and 6 show, services dominate India's economy, while manufacturing dominates China's. Figure 4 emphasizes that the contribution of services to Indian GDP is growing substantially faster than the contribution of manufacturing; Figure 5 shows that the reverse is occurring in China.

Figure 4
India: Contributions of Real Manufacturing and Real Services to GDP



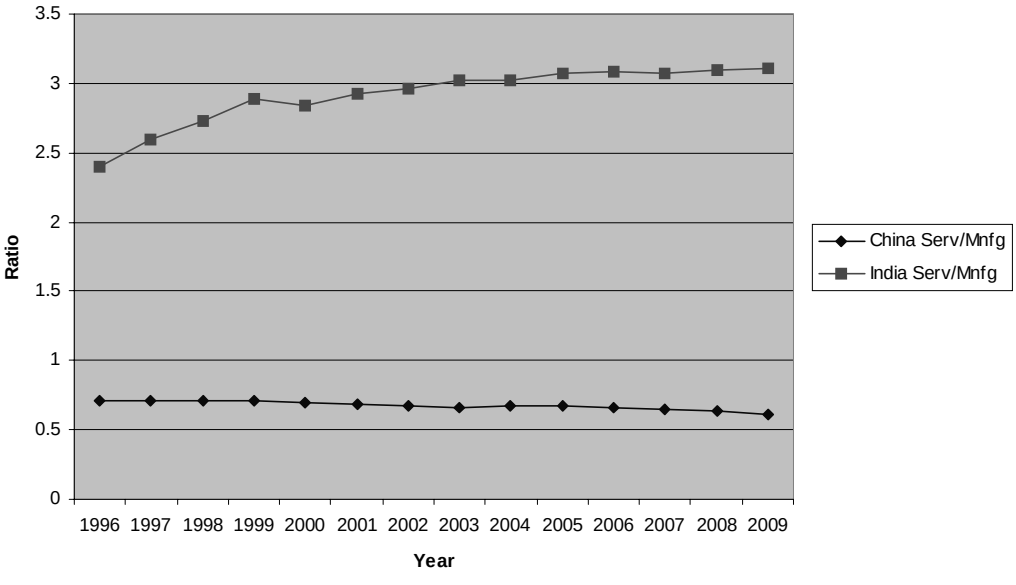
Source: Economist Intelligence Unit time series database, 2004 estimated, 2005-2009 projected.

Figure 5
China: Contribution of Real Manufacturing & Real Services to GDP



Source: Economist Intelligence Unit time series database, 2004 estimated, 2005-2009 projected.

Figure 6
Ratio of Real Service to Real Manufacturing Contribution to GDP



Source: Economist Intelligence Unit time series database, 2004 estimated, 2005-2009 projected.

Figure 6 compares ratios of contribution to GDP by services and manufacturing. We developed the ratios by dividing the contribution to GDP of services by the contribution to GDP of manufacturing. India's economy is more dominated by services than China's and is becoming increasingly so. From 1996 to 2004, India's ratio of services to manufacturing has moved from about 2.4 to 1 to about 3 to 1, and may go to about 3.1 times manufacturing by 2009. China's equivalent ratio started at 0.71 to 1 in 1996, dropped slightly to an estimated 0.68 to 1 in 2004, and may drop further to 0.62 to 1 by 2009.

The presence of so many self-reliant multinational companies, which also serve as the engine for China's exports (see Haley, Haley and Tan 2004), has partly relieved the Chinese government of pressure to develop or to reform the institutions that support free enterprise and economic growth. The remainder of this section explores some of the ramifications of China's political and institutional policies.

COMMUNISM v DEMOCRACY

China seems more politically tolerant than a generation ago. Yet, unlike India, people in China do not have the power to effect political change: China still remains a one-party dictatorship kept in power by military might. The government regularly and unabashedly incarcerates people who exercise their rights to freedom of expression, association or belief. Torture and ill treatment remain widespread (see Haley, 2003 for a discussion of political risk in China). All of this has bred a diffidence that the Chinese governments from the Imperial days to the present Communist regime have deliberately cultivated. In The Chinese Tao of Business, we argued that two Chinese quotations capture how Chinese governments have fanned such diffidence. The first (p. 7) from Confucius' The Analects states, "Do not enter a state that pursues dangerous courses, nor stay in one where the people have rebelled." The second (p. 69) from Lao Tzu's Tao Te Ching states, "The fish must not be allowed to leave the deep; The instruments of power in a state must not be revealed to anyone." Confucius and Lao Tzu both would not countenance the citizenry challenging the state's rulers under any circumstance. If the 'instruments of power in a state' are never revealed, the citizenry cannot influence state policy except through rebellion; to Confucius, rebellion in a state represented absolute evil and one should not 'stay in a state where the people have rebelled'.

Conversely, India has been a democracy since its independence in 1947. India enjoys one of the freest media in the world and people can and do exercise their rights to freedom of expression, association and belief (see Sen, 2000, 2005). Pratap Bhanu Mehta, of Jawaharlal Nehru University in Delhi, in a book called *The Burden of Democracy*, quotes Clement Attlee, a former British prime minister: "Democracy means government by discussion, but it is only effective if you can stop people talking." India often seems a state where people never stop talking (Mehta, 2003).

Prime Minister Manmohan Singh's Congress party rules in coalition with a number of smaller parties. The Congress party also relies on the Communist party's outside support. The Communists routinely oppose most reforms, sometimes through the courts, notably to India's labor laws, one of the biggest deterrents to FDI. Many Indians point to the universal veto as an excuse for India's slow pace of reforms, its stop-go cycles and its constant back-pedaling. For example, in 2003, when the Supreme Court banned the

proposed sale of government shares in two oil companies, Arun Shourie, an Indian journalist, economist and former privatization minister, expressed the common exasperation of many Indians: "This is the difference between India and China. In India everybody has a veto" (quoted in *The Economist*, 2005).

China is not a monolith; decision-making in China can also be painfully slow and rife with internal opposition not often visible to outsiders. For example, Wu Jichuan, China's telecommunications minister routinely opposed foreign investments in China's telecommunications sector in opposition to the then prime minister, Zhu Rongji (see Haley, 2003). Outsiders rarely saw these divergent views or infighting among China's power elite. But, overall, India's reforms have been slower than China's. As Jia Qingguo, a professor of international studies at Beijing University, argued: "Democracy in essence is a conservative arrangement. If all interests are represented, how can you make rapid and fundamental reforms?" (quoted in *The Economist*, 2005).

In return, India's democracy grants relative political stability. Except for the brief interlude of "emergency" that Prime Minister Indira Gandhi declared in 1975, Indian democracy has prevailed. Turnout at elections is higher than in many developed countries and the poor vote in large numbers. India's stability has encompassed communal violence and several insurgencies in Punjab, Kashmir and the northeast, and a long-running Maoist rebellion that has affected a quarter of India's 593 districts. The war in Kashmir, fanned by Pakistan, has taken about 60,000 lives and seen Indian forces engage in persistent human-rights abuses. Yet none of these developments have posed systemic threats to India's democratic structure.

China in contrast appears politically risky (Haley, 2003). Questions continuously arise as to how the party that presided over catastrophic blunders and crimes, in particular the famine of 1958-61 and the mishandling of the SARS epidemic of 2002-03 (Haley, Haley and Tan, 2004), has continued in office. Indeed, the 15 years since the Beijing massacre of 1989 have offered the longest period of relative political calm since "liberation" in 1949; these years probably represent the longest period of quiescence that China has enjoyed since the Opium Wars of 1840.

India has more than a billion people, 29 states enjoying considerable autonomy, 33 main languages and 1,650 dialects, and six main religions, one of which—Islam—is followed by 13% of the population. A slow-moving but flexible democracy forms the chosen way of holding all this together. Like India, China is big and diverse as a continent. China, however, has more ethnic homogeneity than India, with more than 90% of its people belonging to the Han group. China has also spent far more of its history as a united nation. But, many political risk analysts warn, because China has no institutional framework for managing dissent, and because its ossified political structures may have difficulty absorbing the country's economic transformation, it risks a huge explosion: *The Coming Collapse of China*, as one book's title indicates (Chang, 2001).

History indicates that democracies demonstrate greater stability and endurance as well as long-term sustainable development and growth. China, though an extraordinarily important exception, remains an exception. India, whose performance is disappointing only by Chinese standards, proves as much. Democracy has taken root in many countries in Asia and Latin America and economic progress has continued apace in those places

as a result. Governments can mobilize democratic backing for economic reform. This democratic backing imparts more security to the prospect of continued political and economic stability.

HARD v SOFT INFRASTRUCTURE

China enjoys another big advantage over India in hard or physical infrastructure such as ports, roads, power lines, and telephone lines. It has 19,000 miles of expressway, ten times as much as India, and six times as many mobile and fixed-line telephones per 1,000 people. India's power supply also appears less reliable than China's. In India, 61% of manufacturing firms own generators, compared with 27% in China, where the cost of power is 39% lower than in India.

For both domestic and foreign investors, India's poor infrastructure remains a huge barrier. Although, the Indian government recognizes this problem, combined state- and central-government deficits of about 10% of GDP for the past seven years have left little room to build for growth. Table 1 presents a comparison of the infrastructure ratings for China and India developed by the EIU for its most recent forecast of the countries' economies. India has trailed China in four of the ten categories, led in three, and tied in three over the period of 1999-2003. Three of the four leading categories in China are crucial for the production and physical movement of manufactured products to export markets: these categories include the extent and quality of road network, production of electricity per head, and quality of ports infrastructure. The EIU projects that India's performance in infrastructure relative to China will improve in the 2004-08 period so that China will maintain its leads in only two areas, telephone density and production of electricity per head.

Despite lagging in hard infrastructure, India leads China in the soft infrastructure of laws, institutions and financial markets. For example, India has achieved excellence in higher education, especially technical and managerial education. At the high end of the market, China cannot equal India's supply of technical wizards with fluent English. Table 1 also indicates one of India's traditional strengths isits investment in technological excellence as represented by R & D expenditure as a percent of GDP. India has historically led in R&D expenditures, but Table 1 also shows China's determination to develop its technical capabilities through forthcoming investments in R & D.

Table 2, also drawn from the EIU rankings, enhances further the comparisons of the soft infrastructure variables. On almost every aspect of policy towards private enterprise, India ranks more highly than China. The only exceptions include policies towards foreign investment, foreign trade and exchange controls, and the labor market, where China has moved from a virtual tie with India to a clear advantage in the 2004-08 period. With respect to all aspects of the political environment, India appears to have a clear lead, even with respect to political effectiveness. With the exception of the labor market, the same appears true of policies towards domestic private enterprise. India ranks more highly in policies towards private enterprise and competition, financing, and taxation.

As indicated earlier, many factors hinder India's ratings in the labor market. Firing workers remains hard in India, and deters companies from hiring them in the first

Table 1
China-Indicator Scores for Infrastructure in the Business Rankings Model

		1999-2003		*2004-08*	
		China	*Regional average[a]*	*China*	*Regional average[a]*
1.	Telephone density*	2	2.8	3	3.4
2.	Reliability of telecoms network**	1	3.0	2	3.6
3.	Extent and quality of road network**	2	2.7	3	2.9
4.	Production of electricity per head*	2	2.5	2	2.8
5.	The infrastructure for retail and wholesale distribution**	1	2.9	2	3.3
6.	Extent and quality of the rail network**	2	2.8	2	2.8
7.	Quality of ports infrastructure	3	3.5	3	3.6
8.	Stock of personal computers*	1	2.8	2	3.3
9.	R&D expenditure as % of GDP*	2	3.0	3	3.1
10.	Rents of office space*	1	2.7	1	2.7

India - Indicator scores for infrastructure in the business rankings model

		1999-2003		*2004-08*	
		India	*Regional average[a]*	*India*	*Regional average[a]*
1.	Telephone density*	1	2.8	2	3.4
2.	Reliability of telecoms network**	2	3.0	3	3.6
3.	Extent and quality of road network**	1	2.7	3	2.9
4.	Production of electricity per head*	1	2.5	1	2.8
5.	The infrastructure for retail and wholesale distribution**	2	2.9	2	3.3
6.	Extent and quality of the rail network**	2	2.8	2	2.8
7.	Quality of ports infrastructure	2	3.5	3	3.6
8.	Stock of personal computers*	1	2.8	2	3.3
9.	R&D expenditure as % of GDP*	3	3.0	3	3.1
10.	Rents of office space*	1	2.7	1	2.7

Note: A single asterisk (*) denotes scores based on quantitative indicators. Indicators with a double asterisk (**) are partly based on data. All other indicators are qualitative in nature. Ratings range from 1 (very bad for business) to 5 (very good for business.

(a) Out of 16 countries: Australia, China, Hong Kong, India, Indonesia, Japan, Malaysia, New Zealand, Pakistan, Philippines, Singapore, South Korea, Sri Lanka, Taiwan, Thailand and Vietnam.

Source: Infrastructure segment of the Economist Intelligence Unit 2004 (a,b)

place. Many companies feel unable to reap economies of scale, because once they employ more than 100 people they become subject to India's restrictive labor laws. This has a big impact on productivity. In China (at first only in the four Special Economic Zones set up in 1980, but nationwide later that decade) companies can lay off staff and can link pay to performance.

Despite these obstacles, India has better-developed institutions than China. India has an established rule of law and protection of intellectual property and brand equity. India lags badly in primary and secondary education (its adult illiteracy rate is 39%, compared with 9% in China), but has a much more developed infrastructure of high quality universities. In the financial sector, India's saving rate of 24% impedes growth:

Table 2
China -Business environment rankings

	Value of index[a]		*Global rank*[b]		*Regional rank*[c]	
	1999-2003	*2004-08*	*1999-2003*	*2004-08*	*1999-2003*	*2004-08*
Overall position	5.29	6.23	42	38	11	11
Political environment	4.3	4.5	49	46	14	14
Political stability	5.0	5.0	44	46	13	14
Political effectiveness	3.6	4.0	50	46	13	12
Macroeconomic environment	9.3	9.0	5	3	3	3
Market opportunities	8.4	8.4	2	1	2	1
Policy towards private enterprise & competition	3.3	4.9	55	48	16	15
Policy towards foreign investment	6.1	7.2	41	33	10	9
Foreign trade & exchange controls	4.9	7.8	50	36	13	11
Taxes	5.1	5.2	34	52	12	14
Financing	3.6	5.5	52	44	15	13
The labor market	5.3	6.0	52	42	16	13
Infrastructure	2.6	3.9	57	51	14	10

India - Business Environment Rankings

	Value of index[a]		*Global rank*[b]		*Regional rank*[c]	
	1999-2003	*2004-08*	*1999-2003*	*2004-08*	*1999-2003*	*2004-08*
Overall position	5.16	6.15	46	40	13	12
Political environment	5.1	5.3	38	40	10	11
Political stability	5.5	5.5	39	40	11	11
Political effectiveness	4.8	5.1	35	35	10	11
Macroeconomic environment	8.1	7.8	26	35	10	10
Market opportunities	6.9	7.4	13	12	5	5
Policy towards private enterprise & competition	4.4	5.8	44	39	12	10
Policy towards foreign investment	4.9	6.6	51	43	15	12
Foreign trade & exchange controls	4.4	7.2	55	44	15	14
Taxes	5.7	6.5	27	26	11	10
Financing	4.4	5.9	46	41	12	11
The labor market	5.4	5.4	49	51	14	16
Infrastructure	2.4	3.7	58	56	15	13

(a) Out of 10.
(b) Out of 60 countries.
(c) Out of 16 countries: Australia, China, Hong Kong, India, Indonesia, Japan, Malaysia, New Zealand, Pakistan, Philippines, Singapore, South Korea, Sri Lanka, Taiwan, Thailand and Vietnam.

Source: Policy and Business Outlook segment of the Economist Intelligence Unit, 2004 (a,b)

only half of China's savings rate, it appears too low to finance the required investments in industry and infrastructure.

However India's banking industry appears better-managed and significantly stronger than China's. Though its consolidated fiscal deficit appears restrained at 2.5% of GDP, China has an opaque budget and vast disguised deficits in the form of the mountains of non-performing loans, as much as 40-50% of the total, that have accumulated in the banking system (see Haley, Haley ad Tan, 2004). For years, the banks eased the pain of

restructuring loss-making state-owned industries by continuing to throw money at them. The banks also financed a large part of that impressive infrastructure that the bankrupt local governments built.

The lack of adequate, soft infrastructure increases the costs of acquiring relevant strategic information for business decisions in China. As discussed in prior research (Haley, Tan and Haley 1998; Haley, Haley and Tan, 2004), Chinese business environments appear as black holes of information and are characterized by a lack of valid statististical information. This lack of high-quality information greatly hinders the abilties of companies to strategize effectively. Haley, Haley and Tan (2004) elaborated on the invalidity of Chinese statistics and how Chinese businesspeople wield the unreliable economic and market data to their advantage. For example, the Chinese and Overseas Chinese networks withhold access to market information from non-network members; simultaneously, these networks provide their members with the necessary information and data to make valid business decisions and to develop appropriate and successful business strategies.

The next section highlights how the different strategic paths trodden by India and China have affected their business environments and indigenous companies.

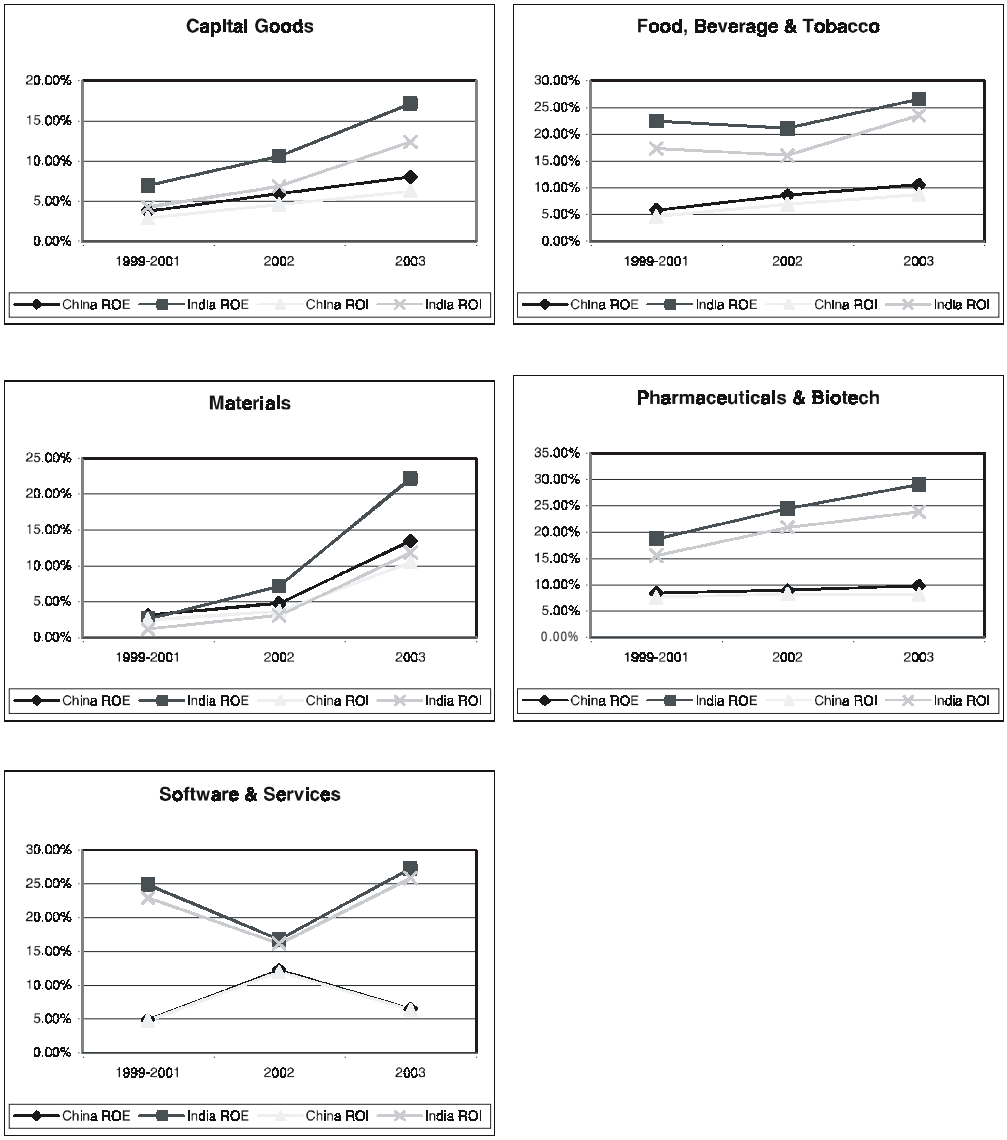
THE COMPANIES THAT SUCCEED

A joke on business environments highlights China's trouble as capital that costs zero; India's as zero capital. Indeed, companies in both countries face the same challenge: failures of financial intermediation. Neither country has found efficient ways to translate their globally high rates of private savings into productive investments. China has relied on FDI. India has underinvested and has a big fiscal deficit, financed by the banking system. Comparing return on equity (ROE) and return on investment (ROI) data for various industries in China and India provides some evidence that in India, entrepreneurship and inspiration may circumvent some barriers posed by lack of capital. Figure 7 indicates that Indian companies' ROEs and ROIs clearly trump those of Chinese companies in several industries. As expected, Indian companies perform far better in industries such as software and pharmaceuticals/biotech, and unexpectedly also in capital goods and materials. Figure 8 shows that although Chinese companies perform better in consumer durables and telecommunications, Indian companies still compete effectively.

Figures 7 and 8 show that China beats India as a production base in industries that rely on hard infrastructure (roads, ports, power) . But in soft infrastructure industries (in which intangible assets matter), India trounces China. One sees India's soft infrastructure advantage in software, biotechnology, or creative industries such as advertising. Indeed, Indian exports to China consist mainly of high-value-added mechanized and electronic components whose production depends more on know-how than on infrastructure (see Huang and Khanna, 2003).

Moreover, many successful indigenous multinational companies in China (such as those in commodities and telecommunication services) exist because the government injects massive amounts of capital into them. The government can do this because it intervenes in domestic capital markets. India has no such government intervention.

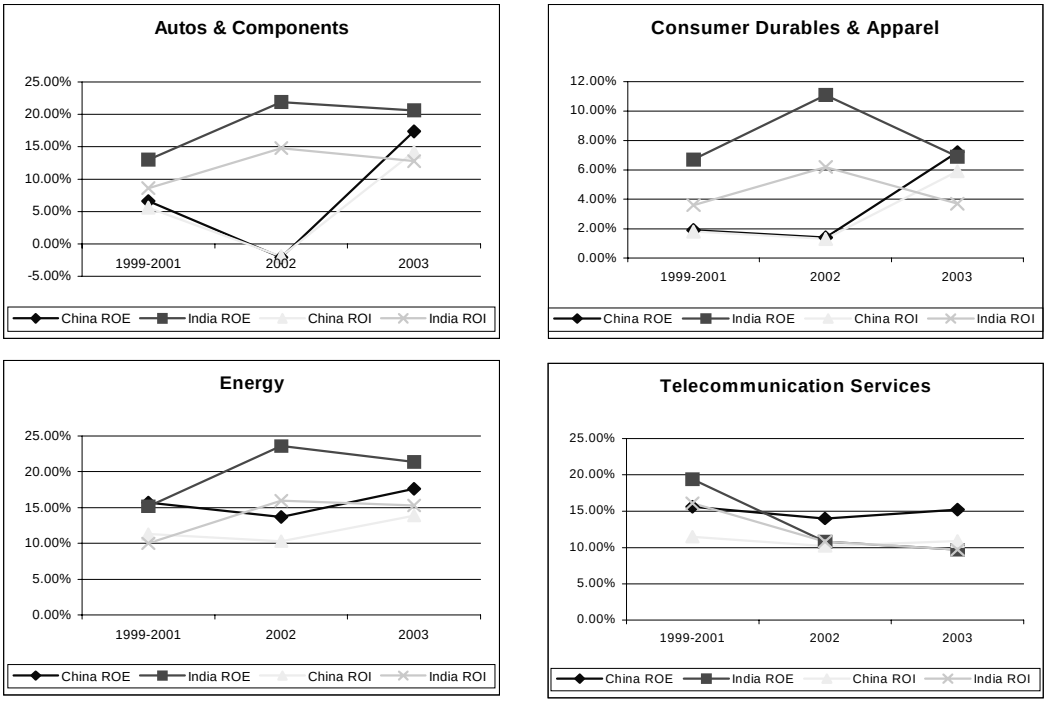
Figure 7
Where India Trounces China



Source: Compustat.

Therefore, successful companies tend to cluster in industries where capital constraints become less important or where India possesses a clear competitive advantage — such as software. Technology-based multinational companies in India (such as Wipro, Biocon and Infosys), unlike China's large, successful companies, have no government links. Unlike the large, government-linked Chinese companies, private Chinese companies operate in business environments characterised by inefficient capital markets, a banking

Figure 8
Where China Catches Up with India



Source: Compustat.

system notorious for bad loans, and the general lack of patronage from local officials who largely decide which companies receive funding or investments (through listing on China's stock markets). Consequently, private Chinese companies have greater difficulty doing business in China than multinational companies do (with their global access to capital and technologies) .

Figure 8 shows that Chinese textile and garment firms have dominated their Indian competitors. Analysts expect China to strengthen its position further with the end of export-quota restrictions mandated by the World Trade Organization. China's market share for textiles in Europe has risen from 24% to 45% from 2001-2004 in the sectors where quotas were lifted. In contrast, according to a report by Khandwala Research India, global market share for Indian textiles has stagnated. Constrained by more stringent labour laws and poor industry integration, India's share has moved from 2.9% in 1995 to just 3.7% in 2002.

Figure 7 shows how Indian companies turn the tables on Chinese companies in software and services. Indeed, China may lag as much as 12 years behind India in information technology (*The Economist*, 2005). Though China excels at manufacturing relatively low-cost hardware designed elsewhere, in the software sector, mediocre English language skills, poor quality control and a dearth of managerial talent hurt Chinese companies. One of China's top hardware firms, Huawei, has posted hundreds of engineers

to India's technology centre of Bangalore to scour for applicable and transplantable lessons.

Despite its global influence, the software and information-technology (IT) sectors comprise very small portions of India's ballooning service sector. India's entire IT industry employs only about 1 million people. According to estimates by NASSCOM, its lobby, income in 2004 from exports of software and services, and from outsourced services such as call-centres, reached nearly $17 billion, equivalent to a quarter of India's merchandise exports. But the industry makes up only 4% of India's GDP and a small portion of its service sector. Correspondingly, manufacturing has seen no growth in India. The Indian government's numbers show that in 2002 just 6.2 million people were employed in manufacturing, fewer than the 6.3 million in 1991. In China, about 160 million people work in "secondary industries", i.e., manufacturing. Figure 6 highlighted the stark contrast between India and China in services. However, research by the IMF's Jim Gordon and Poonam Gupta has shown that, although services constitute a larger share of its economy than normal for a country at its stage of development, India does not constitute an oddity (Gordon and Gupta, 2004). Rather, China has a peculiarly stunted services sector.

China has yet to produce a recognized, world-class company, although it is now the world's third-largest spender on research and development. However, many Indian companies, meet that qualification–Infosys, Wipro, Tata Group's Tata-Unisys and Consultancy Services, Dr. Reddy's Laboratories and Ranbaxy Laboratories in the pharmaceutical industry, and Bajaj Autos in the motorcycle and scooter industry provide just a few of the examples of well-known, world class companies.

The excellence of Indian companies underscores that despite its capital shortages, India also appears much more efficient than China at using capital. Having invested an average of 22-23% of GDP for a decade, India has seen average real economic growth of about 6% annually. China has invested twice as much, but its average growth rate has been only about 50% higher than India's. Indeed, incremental capital output ratios show that China has devoured a staggering amount of investment to fuel its growth.[1]

The next section discusses some implications of Chinese and Indian strategies on the global economy and their indigenous companies' performances.

IMPLICATIONS

Indian companies perform better than Chinese companies because they face greater market pressures (see Engardio, 2005; Mehring, 2005). Chinese companies conversely have to co-operate more with governmental initiatives and strategic imperatives. Indian companies also raise a larger share of their capital in equity markets. Private investors place an emphasis on ROEs. In China, a notoriously high savings rate and large amounts of FDI are suppressing the costs of financing. This glut of capital is fuelling excess capacity. Chinese manufacturing is also concentrated in low-end production that reduces profitability. Since most Chinese banks are state owned, there is little emphasis on maximizing returns.

Our analysis shows that India should provide a fertile economy for FDI. Yet, foreign multinational corporations in many industries have failed to see that they can obtain better ROIs and ROEs in India than in China.

However, China has moved faster than India to improve its hard infrastructure. India still invests only about one-quarter of GDP. In China, with a GDP about two-and-a-half times as big, the ratio is more than 40% (*The Economist*, 2005). The investment gap becomes apparent in the differing qualities of the roads, sea-and airports, and electricity supply in India and China. India grapples with two main obstacles to new investment: regulations that deter business; and a fiscal deficit, of around 10% of GDP, that leaves little scope for public spending.

Unless India moves faster in building its infrastructure, energy production and distribution perhaps by opening up these sectors to foreign multinational companies and investors as China did, the country could repress the development of its economy and its companies. Conversely, unless China moves faster to open up its political climate and institutions, as well as to reduce in real terms the governmental domination of its economy, it is unlikely that its massive investments in research and development will result in world-class companies.

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