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Tejpavan Gandhok

## The Indian Market Entry Strategy: “build a local business with skin in the game”

Australian businesses are not lacking advice to get into Asia’s rapidly emerging economies, but they tend to head for the United States, Britain and New Zealand -- partly as a result of cultural blinkers and the poor track record of previous international business forays. But these expensive failures resulted from lack of unique “exportable” capabilities that could help withstand the significantly greater competition in new markets versus the protected smaller home market in Australia. Australian companies must take better advantage of emerging markets, especially as the USA and Europe may well experience long periods of stagnation.

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Consider a “string of pearls” approach i.e. an appropriate mix of smaller, phased investments, rather than a big-bang acquisition.

We must unbundle “Asia” into developed versus emerging countries, then further unbundle within these countries into distinct sub-segments. So let’s look at one very big emerging market, India.

First a vertical cut. Only about 10 per cent of Indians speak English, about 125 million out of the 1.2 billion population. But almost half the population, 550 million people, speak or are familiar with Hindi. There are over a dozen other language / regional pools as big as the larger European national populations, each with distinctive culture, cuisine, dress and other features.

Now some horizontal cuts. There’s nothing average about a billion plus people — nor is that an addressable market for any one organization. The demographic is no longer a pyramid — it is already diamond shaped, having changed significantly over the past two decades. The top, the middle (and its various sub-segments) and bottom end of the consuming classes each represent sizeable market opportunities, by my estimate greater than \$10 billion per annum each for many categories.

Indian consumer behaviour is not so mysterious. The hierarchy of needs developed by the psychologist Abraham Maslow works for Indians too. Economies developing ahead of India in Southeast Asia show how they might advance. Already there has been spectacular “leapfrogging” in some sectors, notably mobile telephony. There is also a considerable literature about the successes of firms and brands in India. Localized consumer brands — such as Hindustan Lever (Unilever), Nestle India, ITC (BAT), and Bata — show foreign transplants can take hold.

A first step is to focus on a market segment, evaluate its under-met needs, and look at your competitive advantages. If the opportunity is too obvious, the market will be quickly crowded out. Arguably it’s already “game over” in sectors such as telecommunications, automotive and hypermart / supermarket retailing with a large number of deep pocketed, very big players already slugging it out.

Look closely at sub-segments of markets. Within infrastructure, telecommunications is already a crowded, highly competitive field. But water management, airports and ports, urban public transport are still under-served. Even before investment restrictions are formally lifted, big foreign chains like Walmart and Carrefours are already positioned in the supermarket segment, while suitable luxury retailing space is limited, but lifestyle and cafe retailing is wide open.

The next step is to decide whether or not to join up with a partner. Even if investment rules require a partner, the foreign investor should study the strategic rationale of what a partner can bring to the venture. Could they be replaced by hiring experienced local employees, or outsourcing? Do foreign brands have an advantage in consumer minds, or not?

Even in a highly compatible partnership, the chances of an eventual break-up are very high, so plan for it with a well thought through pre-nuptial agreement. Who will be better positioned to continue running the business? Who should cash out, and under what exit formula?

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Now let’s look at three cases of great relevance to Australia.

**If the opportunity is too obvious, the market will be quickly crowded out.**

Rio Tinto is not just content with its immense near-term opportunity of shipping resources to India. In parallel it is also building a local resources business by exploring and developing local mines, through a network of six offices across India and 1200 employees. As a senior India based Rio official puts it: “India very interestingly combines the geology / mineral potential of Australia and the potential market demand of a China. A world class resources company like Rio has a lot to offer the Indian mining industry and the economy — by bringing world class safety, environment, infrastructure, project management and efficient mining practices.”

An early success is its Bunder Diamond Project, a diamond discovery with an inferred potential of over 27 million carats and India's first new diamond mine in over a century (since the days of the legendary Golconda mines which supposedly unearthed the Koh-i-noor or “Mountain of Light” and many other legendary diamonds). It provides a great vertical integration / import replacement story, since India is already one of the largest centres for diamond cutting and one of the largest markets for diamond jewellery.

Rio took the strategic decision to build its overall India business on its own rather than entering into a partnership with a local private or public-sector player — although it reserves the choice to do so on a case-by-case basis for commercial exploitation of the particular resources it discovers and opens up. It means a lot of effort spent on dealing with the regulatory bureaucracy, and in developing the infrastructure and skilled workforce for its projects.

A different business model and scale suggests itself in the field of premium ice cream brands. Several leading super-premium ice cream brands have entered the Indian market, but achieved only small sales volumes, in most cases under \$5 million a year.

Their strategy has been export (air flown) premium product to the Indian market, with an exclusive master franchise arrangement with a local player to establish franchised ice cream parlours and institutional sales to hotels and premium retailers. The imported product attracts high duties of 100 per cent or more. It is therefore typically priced at a 100 per cent plus mark-up above local alternatives. The poor cold-chain infrastructure creates huge logistics and product quality consistency hassles.

A better strategy would be to manufacture the ice cream locally, considering that the key ingredients of ice cream (milk, air and sugar) are readily available locally, and ice-cream manufacturing is not very capital intensive. Perhaps import should be limited to the key packaging components and some specialised flavouring ingredients (eg imported dark chocolate, summer berries, kiwi-fruit concentrate, macadamias etc). The product could then be priced at a 30-50 per cent premium over the local alternatives. This strategy has a much better chance of achieving a greater than \$50 million a year business, as have brands like Dominos, Yum Brands, and McDonalds. The window of opportunity is still open with no dominant player in super-premium ice cream.

In services, a glaring opportunity lies in vocational education and training. India has anywhere between 5 million and 10 million young people entering the working age cohort each year, who desperately need job ready skills. The existing education and training sector in India is hopelessly ill equipped for this task. This creates a tremendous need and opportunity for the private sector to step in, as it has done in transforming the Indian health care sector.

Although 100% foreign investment in India's higher education sector is technically permitted, it remains practically limited due to restrictions on issuance of foreign degrees and “not for profit” clauses. New legislation to remove such hurdles is pending.

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However, the business model this case study advocates — of a collaboration with a local partner — can very readily overcome any such regulatory restrictions with clever deal structuring and foreign accreditation of a locally provided qualification — just as Microsoft or Novell certified IT certificates are recognized globally. Furthermore the Indian government established National Skills Development Corporation that acts as a catalyst to promote public-private partnerships in this sector could help facilitate such an initiative.

The challenge is a lack of credible local providers. Everonn and Educomp, for example, were briefly capital market darlings but recently have had severe reputation-damaging corruption scandals. Their examples at least show the potential for profitable growth. Australia's Technical and Further Education or TAFE sector is world-class and has significant strengths. But TAFE leaders are currently more captivated by the tactical opportunity of how to re-attract Indian students to come to their home market.

A more strategic opportunity exists for the Australian state governments to encourage two or three of their leading TAFE colleges to act as a consortium (a more credible force) that offers its intellectual property (courses, accreditation, train-the-trainer, branding credibility and so on) to a partnership with a strong, well-regarded Indian business group. The Australian TAFE consortium would provide the IP for a reasonable equity stake and royalty/licensing fees. Even at conservative estimates of a 10 per cent market share it should be possible to build up a \$1 billion per annum revenue in such a business, based on 0.5 million students, paying fees of around A\$2000 a head. In five to six years, the enterprise could be worth over \$2 billion.

The above three examples illustrate the pursuit of entrepreneurial business models, suggesting the feasibility of \$100 million to \$1 billion-plus business opportunities if Australian businesses move beyond the approach of shipping out a standard home market product or attempting a licensing or technology transfer. This is demanding: the investor needs to get more involved up and down the value chain than at home; the costs are higher; and the gestation period longer. But the rewards are commensurate: in excess of 25 per cent return on investment and potentially wealth creation valued in the billions of dollars.

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