Partner or protectionist? India's view of Europe

The rise of Asian economies such as India and China is a real opportunity for Europe to expand the reach of its markets and strengthen its economy. But it must first abandon its inward-looking, protectionist national policies. Narayana Murthy, Infosys.

Illustration: Nick Lowndes

Europe is a strong, vibrant player in the global market. It is the largest trading partner in the world economy and possesses significant economic strengths, including a well-educated work force, an efficient public infrastructure and strong financial systems. Five European nations rank in the top ten of the World Economic Forum's Growth Competitiveness Index: Finland; Sweden; Denmark; Norway; and Iceland. European companies are world leaders in several industries. Half of the Fortune Global 100 are European firms: Volkswagen, DaimlerChrysler and BMW in automotive; Shell and BP in oil; and Deutsche Bank, HSBC and BNP Paribas in banking, to name just a few. These companies are among the best in the world in quality, innovation and growth.

Europe is valuable as an economic and strategic partner for the Indian economy. The European region is India's largest source of foreign direct investment (FDI). Over the past two decades, EU-India trade has registered an impressive growth, from $5.6bn in 1980 to $42.2bn in 2004. Today, the EU is India's largest trading partner, accounting for over 20 per cent of India's trade. Of this, approximately 50 per cent comes from the UK and Germany. The EU also forms an important market for India in key sectors like textiles, chemicals and, increasingly, software and services.

However, India today accounts for just 1.7 per cent of EU trade, whereas China's share of EU imports is over eight per cent. Access to the EU market for Indian companies has, to some extent, been constrained by domestic, restrictive labour policies, which limit the ability to scale up in sectors such as textiles and manufacturing, and regulations that encourage sub-scale plants and manufacturing inefficiencies. In fact, the manufacturing productivity of Chinese companies is 30–180 per cent higher than their Indian counterparts, depending on the sector.

Indian companies also face challenges in penetrating the European market because of multiple languages, business practices and regulatory environments across European countries. The economies of Ireland and UK are business-friendly, with a flexible regulatory environment, low entry and exit costs for businesses, and a vibrant labour market. The economies of France and Germany are more closed to foreign businesses in terms of visa conditions, labour markets, tariff and non-tariff barriers to trade and regulatory conditions. According to the World Bank, for example, tax payments as a percentage of gross profits average 48 per cent in France and 50.3 per cent in Germany, compared to 21.5 per cent in the US and 30 per cent in Asia's emerging economies. Infosys picked the UK as its launch pad for business in Europe because of the low friction to foreign companies entering the UK market.

Much of Europe also lags behind the US in technology and in adopting new business practices. While the contribution of ICT investment to per capita output growth increased by 50 per cent in Europe over the past decade, for example, the corresponding figure for the US was 200 per cent. Europe is the second largest regional market for worldwide IT services, and it is estimated that European businesses can save 50–60 per cent of service costs through offshoring. But European companies have been slow to accept offshoring. Today, just 16 per cent of offshoring demand comes from the EU-15, compared to 53 per cent from the US and 16 per cent from the UK.

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The challenges for Europe

A failure to adopt flexible political and economic policy frameworks will, in the long run, hurt Europe. Let us remember that the average GDP growth rate in Asia has outpaced European economies by five percentage points annually over the past decade. In Western Europe, FDI fell by almost 50 per cent in 2004. While Europe and the US had similar per-capita incomes in the seventies, today Europe's average per-capita GDP is roughly 70 per cent of the US. Europe's labour productivity growth, since 1990, has been half that of the US.

Output growth rate in Europe has averaged two per cent, a decline of one per cent since 1990. Europe's highly-regulated labour market is to blame. Germany, Italy and France are ranked at 131st, 138th and 142nd respectively in employment flexibility among 155 countries surveyed in a World Bank study. Companies in these regions are competing against the emerging economies of Eastern Europe and Asia, where labour costs are as much as 80 per cent lower.

To enable investment and drive business growth, Europe must focus on building an open, dynamic and innovative economy. Over the past five years, the EU has successfully absorbed 15 member states – but economic integration across Europe has been hampered by cultural differences, country-specific business practices, asymmetries in legal systems, and heterogeneous regulatory frameworks. It has also been deterred by protectionist national policies, which were designed in the sixties to develop "national champions" in local industry.

Europe's governments must recognise that companies that face strong competition at home are more likely to become successful on a global scale. An inward-looking, protectionist economic policy leads to economic isolation, diminished growth, and falling revenues. European governments should study economically successful markets such as Ireland and accelerate structural reforms to streamline market regulation and policy across the EU market.

European nations must also drive reform by bringing greater flexibility to labour markets and reducing entry restrictions for skilled workers from abroad. This is particularly important as contemporary Europe faces critical demographic challenges. Its population is rapidly ageing and the fertility rate in Western Europe is below the population replacement rate of 2.1. The Population Reference Bureau estimates that, by 2050, Europe's population will drop by ten per cent. Europe is faced with a shrinking labour pool and rising welfare costs. Today, for every retired person in Western Europe, there are four people of working age. In 40 years, this ratio is estimated to fall to 1:2.

New knowledge produced through research – and used through innovation – is essential to boost Europe's economic competitiveness. Today, R&D spending in Europe is less than 1.9 per cent of the region's GDP. While the establishment of the European Research Council (ERC) to fund research is an excellent step, European economies must provide incentives for greater private sector participation in R&D. Businesses currently contribute only 45 per cent of the R&D spending in Europe, compared with 75 per cent in the US.

In keeping with its centuries-old liberal policies, Europe must demonstrate its commitment to global trade and market access for developing countries. A few examples of such commitment are rolling back the continued quota on China's textile imports and the new proposed tariffs on Asian imports such as footwear, and removing trade-distorting agriculture subsidies. If Europe and the US pulled down their trade barriers and subsidies in agriculture, the World Bank estimates that developing countries would have a trade gain over $30bn a year by 2008.

I believe that the rise of Asian economies such as India and China is not a threat but a real opportunity for Europe to expand the reach of its markets and build on its economic strengths. For this to happen, European nations must create a momentum towards reform, economic restructuring and growth.

Today's increasingly integrated markets represent opportunities for some, threats for others and change for everyone. Nations and firms that anticipate and adapt to these changes will emerge at the forefront of the new global economy. As the legitimate, historical leader of this world, Europe cannot afford to be left behind and cede the leadership.

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When expanding beyond their domestic shores, Indian firms have typically focused on the Anglo Saxon markets of the UK and the US. Business in continental Europe has been stifled by rigid labour laws and strict visa conditions. Alan Rosling, Tata Sons.

Last year I invited a European minister for inward investment to lunch at the Taj Mahal Hotel in Bombay. Over dessert we discussed a recent episode in which a state-owned company in her country had terminated a contract – in our view without justification – leaving us with hundreds of our staff stranded in Europe and a significant loss. Her initial reaction was: "You must have broken our laws or regulations." When I explained that this was not the case, she fell back on a second explanation: "You must appreciate the sentiment of our people against outsourcing."

For Indian companies, doing business in much of continental Europe tends to be more complex than in the US or the UK although statistics suggest that Indian ingenuity is slowly overcoming the hurdles. Collectively, the EU countries are India's largest trade partners. Indian exports to the EU in 2005–06 amounted to $23bn – 22 per cent of India's total exports and a compound growth rate of 23 per cent over the previous five years. The largest single markets were the US ($17.2bn) and China ($6.7bn). Within the EU, exports were heavily skewed to just a few countries, namely the UK and Germany.

Tata seems to have been proportionately less successful in penetrating the Continent than other Indian businesses. Of our total international business of $6.7bn in 2005–06, $2bn was in the US and $1bn in the UK. Sales in the rest of Europe amounted to only $550m although the compound growth rate over the previous three years was higher than that in the UK.

The key reasons for this US and UK orientation is that our sales are heavily dominated by software services, which are much tougher for Indian companies to sell in Europe. We have done a series of acquisitions in the US (Tyco Global Network, Eight O'Clock Coffee) and the UK (Tetley Tea, Brunner Mond, INCAT), but have yet to make a significant acquisition on the Continent.

I believe that the reasons why Indian companies tend to concentrate on Anglo Saxon markets has less to do with language or historical links, and more to do with contrasting business cultures and regulations.

Let us take a simple example. To secure a visitor's visa for the UK takes my Indian colleagues about three working days. It takes more than seven days for most major continental countries, and, in some cases, it can take up to three weeks. It is even more time consuming to secure a work permit. It typically takes up to 15 days for Tata Consulting Services to second one of its Indian employees to its UK business, to France a month, to Germany six weeks, and to Spain up to six months.

Having finally arrived in the country, we now want to do business. Selling items such as gems, leather goods and generic pharmaceuticals is relatively straightforward. But persuading a major European bank or manufacturing company to offshore its IT needs to India is much tougher. European businesses have traditionally wanted to keep their IT in-house or at least keep their suppliers close to home, although there are signs that this is beginning to change in countries like Germany, the Netherlands and Spain.

Finally, it is easier for Indian investors to acquire a company in the US and the UK compared to the Continent. The market for company control is still much freer in the Anglo Saxon countries than in Europe, and the political acceptance of foreign direct investment from Asia is higher (witness Arcelor/Mittal). More importantly, the ability to restructure post-acquisition and, in particular, to shed labour, is tellingly greater in the US and UK.

It is natural, therefore, that the first wave of internationalisation of corporate India has focused on markets close to home in Asia, and on the relatively open Anglo Saxon markets, particularly the US and the UK. The same was also true for the earlier internationalisation of Japanese companies.

Indian business, however, is now turning its attention increasingly to the markets of continental Europe. These markets are becoming more accepting of goods, services and even investment from India. A major Dutch bank transferred all of its back-office functions to Tata Consulting Services last year, following a proven model pioneered in the US and the UK. However, it will take longer to penetrate these markets. We will have to employ more locals with language skills, networks and an understanding of the local business culture.

Sheer economics must, in the medium term, win over the sort of protectionist prejudice expressed by my friend, the minister for inward investment.

But what about the longer term? Unless Europe reforms faster, liberalises quicker, and frees its product and labour markets, it seems to be a safe bet that all of Europe will lose out economically to China, South Africa, Brazil and Russia to the detriment of ordinary consumers, employees and investors in Europe.

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If Europe relaxes its restrictions on labour movement and signs a free trade agreement, India could be the magic bullet that will solve the economy's shrinking labour pool and welfare state problems. Kumar Mangalam Birla, Aditya Birla Group.

Europe is not merely a political entity or a business and investment partner. I believe, in a larger sense, the "idea" of Europe transcends nations. And that can be best expressed in the words of Jean Monnet, the man who championed an integrated Europe: "Continue, continue, there is no future for the people of Europe other than in union… Make men work together, show them that beyond their differences and geographical boundaries there lies a common interest."

It is striking that Jawaharlal Nehru, India's first prime minister, echoed the same line of thought: "I have long believed that the only way peace can be achieved is through world government."

It is said that all generalisations about India are false. This is because of its huge diversity and contrasts. Europe, too, is almost as diverse as India in terms of its people, languages, ethnicity and geography. And yet it is a vibrant voluntary union of 25 different countries, functioning as a common economic area with minimal barriers to movement of goods, services, capital and labour. For us Indians who also live in a federal setup, the EU experiment is a source of wonder and admiration. Europe's Stability Pact (see pages 72–4) and its independent Central Bank are both external constraints that member nations have chosen to accept. Despite this self-imposed fiscal and monetary pan-European framework, each country is free to pursue an individual development strategy. Each country also preserves a distinctive cultural heritage as well as competitiveness. It is indeed a remarkable coexistence of nation states.

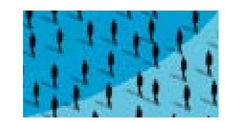
This is one of modern Europe's great strengths. On this count, I think India has a lot to learn from Europe, as our federal union has yet to emerge as a genuine common economic area. We still face many internal constraints as different states pursue different policies and sometimes inhibit movement of goods and services across borders. Regional growth in India is uneven, reflecting the differences in the investment climate. Europe, too, has different growth rates; Eastern Europe is growing much more rapidly than the Western part. But, unlike India, the standard of living across the Continent is fairly consistent, whether you are in Ireland or in Greece.

The surest way of raising the standard of living of a billion Indians is through rapid economic growth. India's recent eight per cent growth has been sustained by its demography, its prowess in IT and its emergence as a low-cost manufacturing hub. Exports, too, have been growing at more than 20 per cent for past few years. This success in trade has made India an increasingly outward-looking economy. Europe is already India's number-one trading partner.

As India engages the world, certain global developments are worth mentioning. The biggest trend is the shift of global manufacturing GDP to the East, away from the US and Europe. In the past three decades, the share of developed nations in global manufacturing value added (MVA) has declined from 85 to 75 per cent, while for developing nations it has gone up from 15 to 25 per cent. Incremental GDP and incomes are rising much faster in Asia. But the base demand from Europe and America is still very large and cannot be ignored. As established manufacturers in those continents face competition from low-cost producers in India and China, some facilities will have to shut down, providing additional opportunities for Indian producers.

As an India-based multinational conglomerate spanning both manufacturing and services, we look at Europe as an important and growing market. We are confident of wresting market share from our competitors. We have recently acquired BPO company TransWorks, based in the US and the UK, as we find near-shoring to be a better value proposition than pure outsourcing to India.

A major global trend that intertwines the destinies of Europe and India is demographics. Most European nations are ageing. This is leading to an increase in the social security tax burden on working age populations, and also a shortage of personnel in health and medical services. Meanwhile, it is projected that India in 2050 will have the largest number of young people under the age of 25 in the world (over 550 million) and the largest number of people in the productive age group of 20–60 years (800 million). This implies that labour shortages in the European economies will continue to drive the flow of labour-intensive services from places like India. Telecommunication technology is also increasingly transforming hitherto untradeable services into tradeable services.



"Most European nations are ageing. Meanwhile, India in 2050 will have the largest number of people under the age of 25 in the world"

What's true in labour is also reflected in capital. Large pools of capital in countries with ageing populations will need to be invested in high growth regions with a large need for capital, such as India. Investment ties are therefore bound to grow. When capital flows into India as foreign direct investment, it brings with it other intangibles such as technology, innovation and superior management practices. Europeans are world leaders in providing environmentally cleaner technologies, for example, which are acutely needed in Asia.

While Europe looms large in India's trade links, the converse is not true. Indian producers still need to gain a market and mind share of Europe. The European outsourcing opportunity remains largely untapped, mainly because of an excessive focus on the US and language barriers.

As the outsourcing juggernaut continues to roll, it will represent an ever-growing opportunity for India. Services delivery can flourish if the movement of labour is facilitated. A few years ago, Germany tried to induce Indian software professionals to the country by offering a range of benefits and perks. If the restrictions on labour movement are relaxed, as the World Trade Organisation has been advocating, this could provide the much-needed immigrant labour input into Europe.

Indian businesses have visibly improved their ties with European companies in the areas of trade as well as investment over recent years. A free trade agreement is on the anvil. There is immense scope – based on the demographic factors and forces of competitiveness – to strengthen and deepen these ties even further in the coming years.

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Western Europe has long been an important source of finance into India. Investment is now starting to flow in the opposite direction, as Indian firms acquire manufacturing and service-sector assets in Europe. Saumitra Chaudhuri, ICRA.

There are more dimensions to life than mundane economics, however loathe some economists may be to acknowledge it. For India, Europe matters not only for good reasons of economics but also in terms of strategic interest and for reasons of culture. I will focus on the reasons mundane, in the full knowledge that there are others better equipped to deal with the subtler dimensions.

Western Europe has always been an important trading partner and a source of overseas financing for India's trade deficits. In times past, the latter took the form of development assistance; as we shed the burden of underdevelopment, the financing source has switched from aid to private investment – both direct and portfolio. Indian companies are also investing in manufacturing and service-sector assets in Europe, making investment, like trade, the two-way street that it perhaps always ought to be.

Viewed from the European end, the Indian market is yet small – just 1.5 per cent of imports into Europe and 1.9 per cent of its exports. However, from the Indian perspective, Europe looms larger. In fiscal 2005/06 (April to March) Western Europe bought 22 per cent of India's exports and supplied 20 per cent of India's imports, leaving a trade balance in favour of Europe of €3.6bn. By geographic region, Western Europe was the single largest block in India's trade. North America absorbed 18 per cent of Indian exports and supplied six per cent of India's imports. With East Asia, both exports and imports were 16 per cent of India's global totals; with South East Asia it was ten and seven per cent for exports and imports respectively.

Western Europe is particularly important for certain important categories of products. Cotton textiles and apparel are a major component in India's export portfolio. Western Europe bought 39 per cent in 2005/06, more than the 32 per cent shipped to North America. In leather goods, garments and footwear, the European market accounted for as much as 70 per cent, while North America took 17 per cent; in handmade woollen carpets the proportions were 42 and 46 per cent respectively. These are all consumer goods; they also happen to be labour intensive and draw from a large pool of indigenous skill and talent. For this kind of product, it is Europe and North America that are, and will continue to be, by far India's biggest markets. On the import side, Western Europe was the biggest supplier of capital goods, supplying 44 per cent of India's imports during 2005/06, with the ratio being as high as 50 per cent for general machinery. The proportion of such items imported from North America was smaller at 12 per cent.

Even if present volumes viewed from Europe may be small, the initial conditions for future expansion are extremely favourable. The prospective needs of India's growth will boost the demand for capital goods. To this we can add the widely known purchases of civil and military defence equipment and airplanes, which often do not show up in the trade statistics.

Not surprisingly, Western Europe has been an important source of foreign direct investment (FDI) into India. The data is badly mangled on account of the tax treaties that we have with Mauritius. It seems, however, that FDI originating in Western Europe provided nearly 50 per cent of FDI inflows during 1999–2001. This may have declined to about 30 per cent in recent years.

Of late, FDI has also begun to move in the opposite direction, with Indian companies buying manufacturing, software and research outfits in Europe. In fact, over the past three years, outbound FDI on average amounted to 35 per cent of the inbound FDI. Indian manufacturing enterprises have made a number of acquisitions in Eastern Europe seeking to benefit from cost advantages and ease of access to Western European markets. However, there have also been several acquisitions in Western Europe, based on the assumption that the economics and management styles of the enterprise would offset the labour cost disadvantages. The post-1991 period of reform in India has provided challenges that have induced a process of accelerated learning in Indian corporates. Their globally enlarged business plans visualise integration at the production stage with prospective markets and this will see greater level of Indian investment in Europe and North America.

One of the biggest contemporary developments for India is the reworking of our relationship with the rest of the world on the question of nuclear energy. The energy needs of our future growth, under any scenario, are so large that there will be enormous scope for co-operation on nuclear electricity, on clean coal technologies, on liquefied natural gas networks and on renewable energy resources. The degree of cross-border investment, technology interchange and trade is likely to be greatly enhanced over the next decade. European business is also likely to register significant growth in the financial sector. Several European banks and insurance companies already operate in India and eventually the existing restrictions on their expansion in India will be relaxed.

Finally, Britain's long history of colonial association has metamorphosed into a special post-colonial one. The ties of many elements of shared language, education and culture is not unique. But for Indian businesspersons – many of which were educated in Britain – it is easier to conduct business there. Mittal, the steel company, is registered in the Netherlands but operates out of London. Vedanta, another metals group has also chosen to operate from the UK. As business and other interests engage India with Europe more closely, the importance of the UK will certainly remain, but it will cease to be as overwhelming. Back-office locations in India will engage more youngsters conversant in the languages of the Continent. The economies of both India and Europe will certainly benefit, as will their strategic interests; perhaps eventually the greatest beneficiary will be culture.

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The relationship between India and the EU reached new heights in 2004 with the signing of a Strategic Partnership Agreement. India should now focus on the opportunities brought by the EU's eastward expansion. GK Chadha, Jawaharlal Nehru University.

India's relationship with the EU dates back to the early sixties, when it became one of the first countries to establish diplomatic ties with the European Economic Community (EEC). Progress in economic relations has been rapid, reaching new heights in November 2004 when the two sides signed a "Strategic Partnership Agreement", putting India at par with the EU's special partners: the US; Canada; Japan; China; and Russia.

The strategic partnership involves concrete steps in four key areas: cooperating on conflict prevention and the fight against terrorism; boosting trade and investment through better market access and continued economic reform; cooperating on sustainable development, protecting the environment, reducing climate change and combating poverty; and fostering parliamentary, academic and cultural exchanges. From what used to be a purely economic and trade-driven relationship, India and the EU have clearly expanded the scope of their partnership to cover wider issues of global concern.

A likely first step in this strategic partnership might well be a Comprehensive Economic Cooperation Agreement (CECA) on trade in goods and services, investment and taxation. This would spell out a whole range of opportunities for both sides, especially now the prospects of reaching a deal at the multilateral level stand severely jeopardised after the collapse of the Doha trade talks. While India would gain greater access to its largest trading partner, the EU could improve its trade ties with one of the strongest emerging economies.

Despite India's "Look East" policy – an economic and strategic orientation to South East Asia – the EU remains its largest export destination. From the EU's perspective, however, India accounts for just 1.5 per cent of its imports – even less than Malaysia and South Africa.

The same picture is seen in the area of investment. Several EU members, including Germany, France, the Netherlands and the UK are among the top sources from which India attracts foreign direct investment (FDI). In 2004-05, these four countries accounted for almost a fifth of total FDI inflows into India. India, however, remains one of its least preferred destinations. India's share in the total outflows of FDI from the EU is stuck between 0.2 and 0.5 per cent.

Although a CECA between the EU and India would create more opportunities, Indian businesses should be aware of the problems that await them. Protectionist sentiments have been rife in the EU, and this is particularly evident in the areas of textiles and agriculture. In both these sectors, a host of non-tariff barriers have often thwarted the market-access ambitions of many an enterprise. This is especially true of agriculture, where sanitary and phytosanitary standards have been imposed by the EU, not as much for ensuring food safety standards as for meeting its own protectionist ends.

India must also realise that its geo-political and economic interests would be best served if it focused on the opportunities brought by the EU's eastward expansion. Europe's newly acceded members have been growing significantly faster than the old member states and yet India has only a token presence in most of these countries. It therefore needs to engage more intensely with them. However, this must not be at the cost of the ties that have persisted between India and many of the earlier members of the EU. While the UK market is likely to remain dominant because of the historical and linguistic links, the other EU members will have to soften their approach towards India, most notably in the vexatious visa issue.

The most promising area for EU-India cooperation is science and technology. In the 59 years since independence, the Indian educational system has produced one of the largest pools of technical manpower in the world. Formal collaboration in this field started in 2001 with the EU-India Science and Technology Cooperation Agreement, laying out the possibilities for cooperation and joint research in areas such as genomics, biotechnology and nanotechnology. Success in this area will ultimately depend on how well the results of these joint projects can be disseminated for the greater good.

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In order to capitalise on the opportunities outside their home market, Indian companies must now invest their resources in hiring the right talent and training employees to become part of the global workforce. Ashok Som, ESSEC Business School.

I believe that Europe is India's most valuable market and will continue to be so in the future. This is not wishful thinking. Statistics from the Government of India show that Western Europe accounted for 32 per cent of the country's imports in 2005–06, a significantly greater share than East Asia (21 per cent), South East Asia (ten per cent), North America (8.6 per cent), and China and Hong Kong (12 per cent).

A similar trend can be seen in India's share of exports. Western Europe accounted for 22 per cent in 2005–6, East Asia for 15 per cent, South East Asia for 11 per cent, North America for 18 per cent, and China and Hong Kong for 11 per cent.

Trade collaboration between India and Europe is likely to continue. For historical reasons, India has been closer to the UK and to the Commonwealth Nations. India's relationship in education and business will therefore grow at a faster pace in these nations compared to others.

The liberalisation of the Indian economy started in 1991 and has created a dynamic business environment. This is being spurred by the Indian IT industry and sectors such as pharmaceuticals, bio-technology, auto components, forging, minerals and Bollywood.

For the past three years, India's GDP has grown over eight per cent and the middle class has quadrupled to about 300 million people. This has catapulted India to becoming the ninth largest economy and the largest English-speaking nation in the world, in which 35 per cent of the 1.2 billion population are below the age of 15. India also boasts the second largest pool of scientists engineers in the world.

We will see the creation of even more Indian-born multinational companies like Bharat Forge, SBI, Ranbaxy, Dr Reddy's Lab, Infosys and Wipro, and business houses like the Mahindra Group, Tata Sons and Aditya Birla Group. Many Indian companies are already in Europe, some with their European headquarters in the UK. Others are planning to follow suit.

To encourage this trend, Indian firms must now invest their resources in hiring and retaining the right talent, and nurturing them to be leaders. Although India has a large, English-speaking knowledge workforce, the interesting question will be whether organisations have the capability to instill among their employees a sense of being part of not just India's business community, but part of the global workforce. Three factors will determine that; mobility of capital; mobility of talent; and mobility of knowledge.

Innovative human resource management (IHRM) strategies will enable Indian firms to survive the hyper-competitive environment and grow profitably. Take Mahindra & Mahindra, for example. The tractor division was suffering from manufacturing inefficiencies, low productivity, a stretched production cycle and poor output – a result of its under-productive and excess-unionised labour force. The work atmosphere was polluted with corrupt and injurious practices. The company introduced a Business Process Reengineering (BPR), focusing on a total overhaul of the style in which the company was organised. It adopted a flat structure and began outsourcing non-core activities. It also encouraged team work to build trust and placed emphasis on training programmes. This enabled the company to maintain steady profits, reduce working capital levels and rationalise the manufacturing processes.

Implementing modern HRM strategies is a tough task for senior management; changing the mindset and motivating workers to agree to the change process is an uphill struggle. But once achieved, it is not easy to duplicate.

"There is an increased sense of doing business legally and ethically. Indian companies are starting to think big"

There is an increasing sense of clarity, confidence and commitment within Indian companies that was not very obvious earlier. They have started putting proper training processes in place, borrowing best practices from the West. There is also an increased sense of doing business legally and ethically. Indian companies are starting to think big. With acquisitions and successful integration across the globe, they are experimenting and taking risks – and they are learning from the experience. This, I believe, is the first step in developing entrepreneurial skills and world-class businesses.

An Indian manager recently told me: "I have been working for one of the top-three strategy consulting companies in the UK for just over five years. Towards the end of my stay, the British Government proposed to give me a UK passport. I was deliberating whether or not to surrender my Indian passport. I understood that the UK was committed to retaining me and I realised that I had just graduated to be part of the global workforce." The opportunities for Indian businesses outside their domestic market are clearly growing. I believe that Europe will be India's most valuable market for years to come. But now is the time to act.

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While private firms, such as Düsseldorf-based Metro Cash and Carry, could strengthen the supply chains between India and Europe, protectionist policies on both sides are thwarting attempts at value creation. Tarun Khanna, Harvard Business School.

Does Europe matter to India? Yes, it does. But it could matter more. Much more.

The EU accounts for a fifth of each of India's imports and exports. Bilateral trade at about €33bn is more or less balanced and growing sharply. Further, the EU has been among the largest sources of foreign direct investment (FDI) into India in the decade since economic reforms began in earnest.

That said, the EU should matter more to India than it does today. FDI into India, while significant, amounts to just one per cent of EU outflows and is less than a tenth of that going into China. And India is not even among the ten largest trading partners for the EU.

For decades, Europe – especially Britain – has profitably run businesses in India. Unilever's subsidiary, Hindustan Lever Ltd, has been one of India's most respected private sector companies for decades. Today, investment comes from outside Britain as well. Düsseldorf-based Metro Cash and Carry offers a recent example. The business-to-business wholesaler is one of the best in the industry. The company operates wholesale stores for small businesses, retailers and hoteliers. To serve these customers, the company has had to link several of Europe and Asia's urban areas with their semi-urban hinterlands. This has required heavy investments in state-of-the-art physical supply chain infrastructure. Metro has either undertaken this directly, or its presence has induced others to do so. A wide range of high quality items and produce has become available at affordable prices as a result. Storage costs have been cut, wastage eradicated, and incremental profits realised throughout the value chain. Vietnam and Russia are recent success stories at Metro, and China is rapidly becoming so.

Metro also has the potential to facilitate commerce in the reverse direction, from India to Europe. There is potential to export fresh agricultural produce to Europe, for example. Metro's global supply chain could link Indian producers and farmers with European retailers.

Despite this potential in both directions, Metro faces obstacles. Its Bangalore-based stores are hamstrung by the local government's unwillingness or inability to dismantle archaic, and widely discredited, legislation that precludes them from selling agricultural produce in stores. Metro's arrival is in the interest of society, certainly for its business customers who would pass on the benefits to ultimate consumers, and for suppliers for whom Metro would be an easy-to-deal-with outlet. But inefficient wholesalers would not value the additional competition that Metro brings, and might be expected to resist the entry. Protectionism or bureaucratic inertia has valued the interests of the few over those of many.

On the other hand, any future plans to export from India to Europe are overshadowed by European governments' efforts to protect their domestic agricultural markets from competition. In both directions, thus, the domestic politics of protectionism trumps the private sector's attempts to harness economic opportunities and generate wealth through EU-India.

Consider a different sector: healthcare. There has been wide coverage in the British media of Britons travelling to India to seek cheap medical care either because they are priced out of the UK health market or because they have to wait in interminable queues to receive care. In India, full-service medical care companies like Apollo Hospitals in Chennai or speciality hospitals like Narayana Hrudayalaya heart hospital in Bangalore are filling the gap by catering to "medical tourists". With a large pool of highly trained doctors and low treatment prices, healthcare aims to replicate the Indian software sector's success.

The market is working and the incremental competition is starting to drive up the levels of care in many parts of the UK health sector. However, regulatory backlash and sheer unfamiliarity with the quality of care offered in India remains an issue. The uncertainty is legitimate but it can be resolved through joint investments.

Europe clearly matters, as both a source of investment in India and a market for India's own entrepreneurs. But it could be much more important, to the benefit of both Europe and India.

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Indian companies are keen to apply what they have learned at home and in the US to Europe. The benefit will ultimately be two-way. Even strong European brands such as Nokia have emerged fitter from engaging with India. Khozem Merchant, *Financial Times.*

In May 2006, while Indian drinks tycoon Vijay Mallya was smarting in Paris from the Gaullist pique that destroyed his bid for French champagne house Taittinger, GE's CEO Jeffrey Immelt was in Bombay chiding the rise of "economic nationalism". The look on the faces of business leaders listening to Immelt seemed to say: "Well, that's Europe's loss."

The rise of globally ambitious Indian companies may indeed be good news for European companies, from champion brands looking for new markets to manufacturers resting on their laurels.

So appealing is the prospect of doing in Europe what Indian companies have achieved at home and in the US – reducing costs, lifting margins and achieving global competitiveness – that "there's a line of bidders from pharmaceuticals to construction targeting Europe," says Ranjit Pandit, chairman of McKinsey in India.

Europe's historical "social contract" between bosses and unions has largely resisted the first wave of Indian global capabilities, as demonstrated by offshore outsourcing. Europe should now emphatically grab the India opportunity.

The benefit can be mutual. Take the case of Crompton Greaves, an Indian manufacturer of transformers, which last year acquired Pauwels – a Belgian company with five manufacturing plants spread across three continents – for €32.1m. "We got access to European markets, and that allows us to go global," says Gautam Thapar, whose family controls the Crompton Greaves group. "We can apply Indian process-led management expertise to poorly run companies."

The impact was immediate. The imposition of process-based management systems helped turn Pauwels' €3m loss into a €17m gross profit within a year.

Crompton followed this success with the acquisition of two Hungarian companies. "It was clear the three companies we have acquired in Europe lacked capital to grow, management focus and the ability to compete globally. That's a good cue for a globally competitive Indian company," says Thapar.

In a way, that makes Crompton Greaves' trio of European companies in the past 16 months a template for others from India. First, Europe's pool of mid-sized engineering and manufacturing companies are an attractive test-bed for Indian companies looking to globalise via mergers and acquisions. The choice of assets is affordable and wide. In contrast, the hollowing out of manufacturing in the US has left few mid-sized assets on the table. "If you want to be global you must manufacture near your customer," says Surinder Kapur, founder of Sona Koyo Steering Systems in Delhi, which paid €5m for a 20 per cent stake in a components manufacturer in France in 2004.

The prospect of acquiring superior technology to build on quality standards and efficiencies is a second factor, typified by Bharat Forge, India's largest manufacturer of axles and crank-shafts. It has acquired six companies over the past five years, mostly in Europe, relocating some of the manufacturing back to India, where it can leverage its higher productivity and lower costs, while keeping the rest overseas. Amit Kalyani, who controls and manages Bharat Forge, claims that Europe's better technology has helped the company to "leap-frog" and "widen out" its product profile. One immediate consequence is that the Indian company can quickly ramp up partnerships with blue-chip customers, such as Volkswagen.

A third factor is that globally competitive Indian players can apply what they have learned in the US and at home to Europe. This is evident at multiple levels. In management, for example, Europe is a new home for Indian talent, previously confined to companies with historical ties to India and Asia, such as Citibank or Unilever. That experience has given today's wave of managers "exposure in multiple markets," says Anjanli Bansal, country head of Spencer Stuart, a global search firm in Bombay. "Their experience of India's unique environment enables them to transfer effectively to the global environment."

Managerial, cost and capital arbitrage add up to the new Indian competitiveness. The result is companies that are "competitive in a world sense," argues Pandit. Indian companies can provide telecoms services at one cent a minute when elsewhere it is seven cents.

That said, only the most determined Indian industrialists are venturing into a Euro-market, which all describe as a hostage to the continent's "social contract". This makes restructuring tougher.

"We need to be in Germany to be closer to vehicle manufacturers. It is costlier [higher wages] and labour laws can be inflexible – but we have adapted," says Kalyani. Kapur, meanwhile, notes that labour costs at the auto-components company he bought into in France were equal to a third of sales, compared to eight per cent at the Indian acquirer. "And ours was still too high by half," he adds.

"India as a market is showing European giants how to innovate on products and how to distribute them in a disintegrated consumer market"

The wage rigidity of core Europe, notably in France and Germany, may drive Indian companies to smaller Benelux states or East Europe, where eagerness to sell and a quicker turnaround in decision-making have made assets easier to snap up. Here, too, unfamiliar hurdles are emerging for Indian players. Take Mahindra & Mahindra (M&M), India's largest tractor maker. Its bid to acquire Romania's Tractorul is stuck because large debt write-offs for the state-owned tractor maker, which may amount to an unfair competitive advantage, have made Brussels nervous as it negotiates Bucharest's accession to the EU.

Nor are the cultural or language hurdles regarded as insuperable. As for xenophobia, Mallya's bid for Taittinger and Lakshmi Mittal's takeover of Arcelor involved national champions and inevitably raised the heat. But bankers say many more mid-sized deals are getting through without a whimper. Additionally, since most Indian companies see the move into Europe as strategic and long-term, they tend to retain local management, making acquisitions and integration less painful.

Ultimately, the benefit is two-way. Even strong European companies such as Nokia, the mobile handset manufacturer, have emerged fitter from engaging with India. Nokia has devised low-cost phones for a cellular market that is not only the fastest growing in the world but arguably the most price-conscious. In other words, India as a market is showing European giants how to innovate on products and how to distribute them in a fearsomely disintegrated consumer market.

Yet Europe's more enduring contribution may be on "softer" issues. Rana Talwar, a former boss of Citibank in India and ex-CEO of Standard Chartered Bank in London, says European companies' focus on upholding stakeholder interests, in contrast to a narrower shareholder focus, is something that "India acquirers can learn from". As the Mittal-Arcelor merger demonstrated, the Indian-born acquirer gave ground on these and other governance points. Such sticks are a critical external disciple – and a signal for Indian family controlled companies that are eyeing Europe assets. Both, it seems, need each other.

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