

# THE JOURNAL REPORT

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## A WHOLE NEW WORLD



*Competition from China and India is changing the way businesses operate everywhere. Here's what companies are—and aren't—doing to survive.*

By NEIL KING JR.

**C**HINA'S GIANT CLOTHING factories lie 8,000 miles west of Raymundo Hache's cluttered office in the Dominican Republic, but their shadows hang right over his head. Every day, as chief of sales for one the region's largest apparel makers, Mr. Hache

scrambles to keep at least a tiny step ahead of the relentless competition from China. All the talk at Interamericana Products International is about getting pants to the U.S. market faster and more efficiently for big-name companies like Liz Claiborne and Tommy Hilfiger. "If we're not fast enough, China will trample us," Mr. Hache says.

In Plano, Texas, Electronic Data Systems Corp. is also feeling hot breath at its back—from a slew of upstart competitors in India who have turned the tech-services world upside down. EDS, the world's second-largest computer-services company, is scurrying to cut costs—in large part by going to India itself. By next year, EDS plans to have 5,000

employees at half a dozen centers in India, up from 600 workers three years ago.

China and India—two of the world's hottest economic powerhouses—are rattling businesses around the globe, in very different ways. The boom in China's world-wide exports—up 125% in four years—has left few sectors unscathed, be they garlic growers in California, jeans makers in Mexico or plastic

PHOTO ILLUSTRATION BY RAY BARTKUS

Please Turn to Page R3, Column 1

# A Whole New World

Continued From Page R1

mold manufacturers in South Korea. India's punch has been far softer, but the impact has still altered how hundreds of service companies from Texas to Ireland compete for billions of dollars in contracts.

The causes and consequences of each nation's surge are somewhat different. China's exports have boomed largely thanks to foreign investment: Lured by low labor costs, big manufacturers have surged into China to expand their production base and push down prices globally. Now manufacturers of all sizes, making everything from windshield wipers to washing machines to clothing, are scrambling either to reduce costs at home or to source more of what they make in cheaper locales. Some of the braver small fry are even setting up factories in China despite huge cultural and logistical challenges.

India, too, is prompting a massive rush east by many U.S. and European service providers. But, unlike the manufacturers that headed into China, service companies didn't go to India until cheaper and increasingly sophisticated Indian enterprises invaded their territory. Bangalore-based consulting and information-services firm InfoSys Technologies Ltd., for example, nearly tripled its overall revenue from 2000 to 2002, in large part thanks to surging sales in North America.

U.S. service companies say they have little alternative other than to confront Indian competitors on their home turf: For many of these companies, the price of manpower is king. Consulting and tech-services company Accenture Ltd. plans to have as many as 10,000 people in India by the end of this year, or about one-eighth of its entire work force.

## Rising in the East

For all the dust it has raised in the IT world, though, India is still far from having the sheer, globe-rattling heft of China.

China last year shipped goods to the rest of the world worth about \$438 billion, and services totalling \$44 billion. In less than five years, China has become the world's dominant supplier of whole categories of products, ranging from computer keyboards to bicycles, bras and neckties.

China's boom came as foreign manufacturers—led at first by Taiwan, South Korea and Japan in the 1980s—raced to slash costs by tossing up factories there. The first big U.S. investors began to move into China around 1985, but the real investment surge from the U.S. didn't come until the late 1990s, when dozens of big multinationals moved in to open factories.

Edward Gresser, a trade specialist at the Progressive Policy Institute in Washington, estimates that foreign companies opened as many as 60,000 new factories in China from 2000 through 2003. China last year took in \$53.5 billion in foreign direct investment, compared with \$40 billion in the U.S.

By some estimates, as much as 55% of the goods the U.S. imports from China now come from foreign-owned companies with operations there. These include telephone makers such as Nokia Corp. and Motorola Inc., computer companies such as International Business Machines Corp. and nearly all the big clothing and footwear brands.

Car makers also have a huge presence. Volkswagen AG has the biggest footprint in China, doing around 14% of its world-wide production there. Close behind is General Motors Corp., which plans to double its manufacturing capacity in China over the next three years at a cost of \$3 billion. Ford Motor Co. has been a laggard in the market but says it will triple its car production in China this year, to 65,000 vehicles. German auto maker BMW AG plans to build a new factory later this year to put out 30,000 cars a year.

Foreign factories have helped push China briskly up the technological ladder. In a recent report, Mr. Gresser pointed out that U.S. imports of dolls from China have fallen 1% since 1999, while imports of Chinese-made television sets jumped 470% and electric toothbrushes by over 7,000%.

"We are holding our own because we've aggressively pursued new business," says Nels Leutwiler, Parkview's president. "But there's less and less work, with more and more people competing for it. Our margins are disappearing."

Parkview is now looking to move into the sort of lower-volume, more expensive part-making work that isn't as exposed to Chinese competition—work that is also much harder to find. Mr. Leutwiler may also turn over some of the company's more costly tooling work to companies in China.

## Meeting the Challenge

Companies in other hard-hit sectors also are responding creatively to the pressure. The Dominican Republic's Interamericana, a major producer of trousers, is emphasizing speed to market and short production runs, hoping to capitalize on the island's proximity to U.S. retailers.

Dozens of other big apparel makers across Central America are struggling to make similar changes, fearing China could suck up huge market share once the global system of clothing quotas phases out at the end of this year. Those quotas for decades have regulated access to the consumer-rich markets of the U.S. and Europe by imposing a ceiling on how many trousers or shirts a given country can supply.

Interamericana has shifted some of its production to neighboring Haiti, where wages are far cheaper. In the U.S., some small manufacturers are being forced to do something even bolder: look to set up shop in China to augment what they do at home.

P.J. Thompson had his wake-up call in 2002, when the metal-parts company he runs lost its most profitable contract to China. Transmatic Manufacturing Co., based in Holland, Mich., makes hundreds of different high-precision parts for cars, power tools, locks and other gadgets.

In 2001, Transmatic won a job from Motorola Inc. to build a complex swivel system for a popular cellular phone. Motorola sourced the part in China at the same time, but "this was a very complex part," Mr. Thompson says. "We figured it would be years before the Chinese were able to build the part to the same specifications." In reality, it took all of six months. What Mr. Thompson figured would be a five-year job for his company was gone in 12 months.

The reason Motorola shifted to the Chinese supplier, he says, had less to do with price and everything to do with location. "They assembled the phones in China and wanted to use local components, too."

Mr. Thompson is getting the same message from many of his other top customers, including Delphi Corp., the auto-parts giant. "My customers are multinational, and they want me to be multinational, too."

Mr. Thompson says he now spends nearly a quarter of his time—which has included making several lengthy trips overseas—figuring out how to get into China. His plan is to set up a small factory there, worth up to \$4 million, by the end of the year, most likely in the Suzhou area west of Shanghai. He doesn't plan to cut jobs in the U.S. as a result.

This is no small leap for a company the size of Transmatic, with 300 employees and about \$60 million a year in revenue. "This is going to be me risking my own money," Mr. Thompson says.

The logic of being close to your customers isn't new to Transmatic, which has a plant in North Carolina to supply car makers in the region, and another in Arizona to supply various factories across the border in Mexico. But there are other reasons for having a presence in China. Factories there are sucking up so much steel and other raw materials that Mr. Thompson has seen the price of his own supplies soar by as much as 60% this year. "It's been a crisis of pricing and availability like we've never seen before," he says.

Making things worse, many of Transmatic's traditional U.S. suppliers of high-end presses and other equipment have turned all their attention to the Chinese market, further boosting prices and lessening competition at home. "They've basically left the North American market for dead," Mr. Thompson says.

## A Place at the Table

Another company that has headed east to survive is Howard Miller Co., the world's largest maker of floor clocks and a major seller of higher-end furniture, with annual revenue of around \$200 million and 875 employees.

Few industries in the U.S. have been harder hit by Chinese competition recently than furniture, which sought and won new tariffs on Chinese imports this year. Buzz Miller, president of Howard Miller, has watched as many of his peers have moved overseas or morphed from manufacturing into trading companies. He has picked what he calls a "blended strategy," mixing domestic manufacturing with two joint ventures in China, which together employ about 2,800 workers. The company, which also includes Hekman Furniture, brings in other carved pieces from the Philippines and Indonesia.

"The Chinese can do all sorts of things, like hand carving and special finishes, that we don't do anymore, or that are too costly to do at home," says Mr. Miller. By having as much as half of its parts made overseas, the company has remained competitive and kept its domestic work force steady for the past five years. Mr. Miller says the recent tariff increases haven't hit his Chinese operations.

The competitive pressures are by no means limited to North America. South Korea's Solinc Co., a maker of plastic injection molds and parts, started getting underbid by companies in China last year. The company did some detective work, even bidding out various jobs to China to get a more precise feel for prices there. "We then broke down every aspect of our own pricing to find what parts of the chain were costing too much," says Steven Koons, a marketing manager at Solinc.

The company has now embarked on what Mr. Koons calls "creative outsourcing." Solinc has opened a training center in Vietnam and flown in high-end design computers. Thirty specialists at the center in Hanoi will soon handle much of the company's three-dimensional design work, at prices much lower than in South Korea.

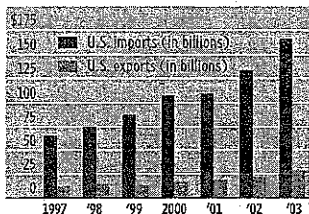
Solinc's main factory outside Seoul is still making all the molds, but some of the simpler and more labor-intensive manufacturing work has gone to a company in the Philippines. The company has also put more effort into marketing and service. It has opened sales offices in

## Trade Trends

An overview of U.S. economic ties with China and India

### The China-U.S. Exchange

The U.S. is China's second-largest trading partner, after only Japan. How the two sides of that relationship have grown:



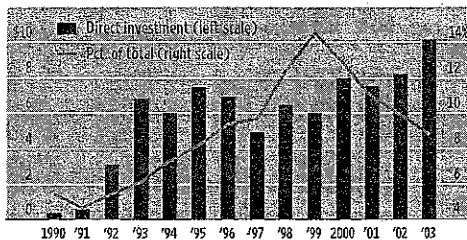
### Hot Products

Leading U.S. imports from and exports to China in billions, 2003, and percentage change from 2002

IMPORTS	VALUE	PCT. CHANGE	EXPORTS	VALUE	PCT. CHANGE
Power-generation equipment	\$31.04	47.3%	Electrical machinery & equipment	\$4.78	21.1%
Electrical machinery & equipment	30.04	18.2	Power-generation equipment	4.64	12.9
Toys & games	17.40	12.3	Oil seeds & oleaginous fruits	2.88	213.5
Furniture	13.67	21.8	Aircraft/spacecraft	2.45	-28.5
Footwear & parts	11.14	3.5	Medical equipment	1.59	26.6

### Capital Ideas

U.S. direct investment in China (in billions) and as a percentage of total foreign direct investment in China

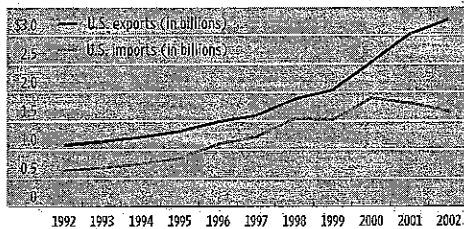


Note: Figures are based on amounts contracted in each year.

Sources: U.S. International Trade Commission; U.S. Commerce Department; U.S.-China Business Council; China Ministry of Commerce

### India-U.S. Trade

U.S. services exports to India tripled from 1992 to 2002, outpacing the growth of U.S. services imports from India during that time



the U.S. and Germany to get closer to customers. For similar reasons, it is now scouting for a site in Eastern Europe to build a factory to make and rebuild specialty molds for European customers.

"I think it's fair to say that China has made us stronger," says Mr. Koons. Still, he doesn't buy the idea that China will remain seriously competitive on price for years. "As they are getting more capable, they are also getting more expensive," he says.

### Pump IT Up

Shrinking margins are also squeezing the biggest players in the information-technology services business, which involves everything from writing software and monitoring computer systems to handling complex personnel and accounting matters. The emergence of India as a true competitive challenge in this field was almost as abrupt as the jolt that China gave the manufacturing world.

Through the 1990s, many of India's big IT companies were still working on the fringe, often as contracted software writers for U.S. companies. By the late 1990s, though, the companies moved rapidly into more complex and profitable areas, ranging from accounting and payroll to customer service. Their revenue soared, and their profit margins were huge, often 30% or more.

Cost has been a major advantage for the Indian upstarts, but even their U.S. rivals concede they came on strong with marketing, too. Indian companies two years ago, for instance, began touting aggressively their high scores on the SEI CMM certification scale, a well-known measurement of software effectiveness within the IT industry.

"There's no doubt they were good at selling themselves," says Travis Jacobson, a spokesman at EDS.

The same could be said for India itself,

which until recently was largely protectionist on the trade front, and generally inhospitable to large foreign investors. That began to change in the late 1990s as India opened up and began to pursue a more aggressive export strategy.

The U.S. in the first six months of this year took in goods and services from India worth \$7.4 billion, compared with \$9 billion for all of 1999. Globally, India's service exports have jumped 77% since 1999, to a total of \$24 billion last year. It exported \$64 billion in goods in 2003; its top sellers in the U.S. were precious stones and metals, and woven garments.

Companies such as EDS have had to move more rapidly to slash costs by sourcing work in cheaper locales. EDS has launched its own offshore marketing campaign, called Best Shore, and plans to double its work force in low-wage countries around the world by the end of next year, to 20,000 total employees. At least a quarter of those will be in India. The company in turn plans to cut as many as 20,000 jobs from its higher-paid work force by the end of 2006, according to EDS chief executive Michael Jordan.

Michael Childress, an EDS vice president involved in the company's overseas ventures, says EDS is not planning to wage "a labor arbitrage" in a rush to India. But the company is keen, he says, to balance its "deep industry expertise with more low-cost capabilities."

### A Back-Office Migration

Rafiq Dossani of Stanford University and Martin Kenney of the University of California at Davis predict that India will have more than 500,000 people working in back-office, or "business process," jobs by 2006, up fivefold in less than four years. "The number of activities that are amenable to offshoring are incalculable," they said in a recent report.

Services being sourced out of India

are expanding quickly into a range of back-office work, from accounting and bookkeeping to preparing tax returns and processing insurance claims. Many tech companies, including Intel Corp. and Microsoft Corp., are now opening significant research-and-development operations in India, while some venture-capital firms are making funding for projects contingent on start-up companies' cutting costs by outsourcing significant work to India.

Consulting company Forrester Research Inc. predicts that as many as 800,000 white-collar jobs will leave the U.S. by the end of next year, and 3.4 million by 2015. IDC, an IT market-research group, says it expects EDS, IBM Global Services, Accenture and Computer Services Corp., of El Segundo, Calif., to add around 50,000 positions abroad over the next three years, mostly in India.

Then the real battle lines will be drawn. The main Indian players, such as Infosys and Wipro Ltd., still have tiny revenue compared with their U.S. and European rivals. IBM Global Services, for instance, has global revenue of around \$42 billion, more than all its Indian competitors combined.

Many analysts contend that India's own service companies could be in for a rough ride as their Western rivals set up in their own backyard and whittle away at their cost edge. There are other factors at play. Wages are rising there amid intense hiring sprees in cities like Mumbai and Bangalore. The rupee is rising, also eroding profits.

Ronil Hira, an expert on the IT industry at the Rochester Institute of Technology in New York, asserts that the real fight in India is not really between U.S. and Indian companies but between U.S. and Indian workers. "In the end, U.S. companies may triumph, but using workers in India and elsewhere to do much of the work," he says.