

'This is our moment in the Sun ... and I am waiting for a revolution in education'

Or so says Tarun Khanna, the Jorge Paulo Lemann Professor at the Harvard Business School, where he has studied and worked with multinational and indigenous companies and investors in emerging markets worldwide. He has most recently co-authored *Winning in Emerging Markets — A Road Map for Strategy and Execution*. In this interview, he speaks to Vivek Kaul and Promit Mukherjee. *Excerpts:*

One of the major things you talk about in your book is the institutional void in emerging markets. Can you elucidate?

The definition for us has got more to do with the rudimentary nature of mechanisms of bringing buyers and sellers together. In that sense, when you want to sell me something, and you and I cannot find each other, or can't trust each other for a variety of reasons because the contracting regime isn't robust or you worry about the courts and adjudication, then that market will not emerge. It will be non-existent.

Can you get into some detail?

It has more to do with structure of opportunities available at a given point of time and the mechanisms available to deal with those opportunities. For example, any time you have a big technological change you are likely to have a lot of institutional voids. Take the dotcom bubble — suddenly there were a variety of different ways of transacting that hadn't

China entered the consciousness of the developed world much sooner than did India, arguably ten to fifteen years before. So you have a number of western companies that initiated operations in China before they did in India. There was a sense in which those efforts that have been successful led to the institutionalisation of ways of doing things, within the companies. And that made it even more easy for those companies to do business in China and ignore other places like India.

been available before. But the mechanisms to bring transacting partners together virtually had not been formalised yet, so that was very much an emerging market. Of course, political change would be another reason why things dramatically change, like when Korea decided to transition to an equity-based market. It is one thing to say that we want to have a robust equity market, for whatever set of reasons, but it's quite another thing to develop the mechanisms to identify potential listers or to tell people who want to buy certain stocks what stocks are good and what stocks are bad. So the market takes a while to develop as these institutions emerge over time.

Can you give us an example?

A good example is a company called Aspiring Minds, with which I have been working very closely of late. It's the ultimate institutional void in India. The idea being that, we have 300-400 million people, depending on how you count, who are locked out of urban India or out of the mainstream economy. But, nonetheless, there is a lot of talent there. There is a big void between companies that demand tal-

ent, which are often complaining about attrition and scarcity and so on, and all these people who would like to get a job and are often qualified to get one, but there is no mechanism to break down the institutional barriers between them.

And Aspiring Minds is trying to fill that gap?

Yes. There are two entrepreneurs — one from Massachusetts Institute of Technology and one from the Indian Institute of Technology, who have created this assessment mechanism which is state-of-the-art and world-class. The idea is to very cost-effectively, almost seamlessly, test almost hundreds of thousands, perhaps millions of people, in different locations around the country and make those available to corporations. So when you go around to our biggest corporations and say where are you sourcing talent from? Even the most ambitious of them will say from fifty, sixty or hundred colleges. You can tell them why not twenty thousand colleges? Here is a cost-effective way to do it.

A theme running through your book is that when multinationals enter emerging markets, they have to at times develop their own infrastructure as they go along. Can you give us some examples of this?

Most large global multinationals would have encountered this at virtually all times when expanding into particular countries. One is a company that is trying to create a foothold in India — Metro Cash & Carry — which happens to be a German wholesaler. What they do, among other things, is offer rural-to-urban connectivity of produce and goods and services of different sorts. So they make large amounts of material available to urban consumers often sourcing it in different places. Take the simple example of sea food or fish of some sort. For sea food to be made available to large numbers of people in good condition and in a hygienic way there has to be a cold chain and that cold chain often does not exist. In many countries there are established entrepreneurs who deal with cold chain services. And they provide the cold chain. Metro has had to create the cold chain. It is not that cold chain providers don't exist in India but it is just that sector isn't vibrant enough to meet the needs of specialised users that particular service

Any other example?

McDonald's is a company which has had to do it over and over again. The particular instance that is quite striking for McDonald's is in Russia where they literally discovered that a lot of support mechanisms they needed to run their business in the West were missing. What was worse that many of their conventional suppliers refused to come to Russia in those days, which is a couple of decades ago, because they did not find the opportunity attractive enough. So McDonalds had to set up a horticultural institute, a transportation system, an educational institute, a cleaning service, and a quality adjudicating service. All the things that it took for granted for in the West, in order to cater to its business which is ultimately selling clean fast food.



And over time, as institutional infrastructures emerged in Russia, they have been able to spin off these businesses and are left with a narrow footprint business that does much less than it had to do in the past.

One of the mistakes that companies seem to make while getting into emerging markets is to enter with the exact same business model that worked back home. Can you give us an example?

Wal-Mart is very successful in Mexico these days. But it went through a very lengthy learning process.

And a part of that process was getting the merchandise entirely wrong and learning about that over time. Even

some of the most celebrated success stories — look at GE in India — they went through a long period prior to becoming successful, trying to sell goods and services that are arguably built more for the developed west than India. At some point they more or less abandoned the effort and decided that they were going to use India more as a talent and a source of back-office operations. Eventually that led to Genpact being formed and spun off from GE and then they returned to the idea they are going to sell things that are more suited to the Indian environment. So in that brief description of a long chronology, what you see implicit are several mistakes, reinventions and experiments. And I think that is very natural for almost every company that I know to go through a series of experiments to identify what is it about the business model that is likely to work.

How should a company decide what is the right business model when

entering a new country?

It is a series of iterations. One reason that we wrote the book is because we feel it is possible to iterate more efficiently as opposed to iterate *ad nauseam* and inefficiently. And so our claim, our thesis, our hope is that people will start with a map such as the maps in the book and say let's use this as a starting point to layout some of the issues in the country and to use that as a template through which you can design experiments to determine what parts of your existing business model can be replicated and which can't. Hopefully that would make the iteration process a bit more efficient.

You talked about Metro Cash & Carry. They have had hiccups...

If you look at the original Bangalore store, I believe it is built to specs that are very close to the stores in Germany. And what I think Metro's new CEO will tell you is that it is not necessary to have store built to German specs in a very different socio-economic milieu, in a very different setting, where people interact with customers differently, very different climatic settings, a very different need for temperature control and humidity. So a lot of things vary. And so a part of it is getting the physical form of the dispensing mechanism right. Part of it is recognising that there are multiple ways to be a wholesaler in different situations because you are ultimately a wholesaler. And they still remain a wholesaler and they remain true to the admonition that they don't do any retail around the world and they don't do any retail in India. And they remain true to the idea that there brand Metro Cash & Carry should be presented in a particular way and there are three or four other things that are not allowed to change. But other than that there is a lot of experimenting

Companies that I find really interesting in India are companies like SKS, or start-ups like Aspiring Minds or companies like Bharti Airtel that has taken communication to the masses. Or even my good friend, the heart surgeon in Bangalore, Devi Shetty (of Narayana Hrudayalaya fame) who has taken cardiac surgery to the masses. I think the common denominator among these is finding economically viable, sustainable ways to take things that we normally associate, whether it is cars, financial products, heart surgery or fancy phones, to anybody and make them readily really available across the spectrum and affect change and enable livelihood.

is going on in the Metro business model in India, as well as the Metro business model in China and in Turkey, in Prague and all sorts of other places.

One of the interesting examples in your book is about the success of GM in China. What explains that and their rather slow expansion in India?

A variety of things. China entered the consciousness of the developed world much sooner than did India, arguably ten to fifteen years before that. So you have a number of western companies that initiated operations in China before they did in India. There was a sense in which those efforts that have been successful led to the institutionalisation of ways of doing things, within the companies. And that made it even more easy for those companies to do business in China and ignore other places like India. Motorola would be another good example. Motorola, for a variety of historical reasons, went to China first and did very well, so there was seamless connectivity between the China headquarters and the headquarters of Motorola at Schaumburg in Illinois, United States. Motorola never really came to India in the beginning and therefore any operation that was going on in India had to be done through Singapore, or through some other place and it then went to Schaumburg.

And that made it difficult?

Yes. You can imagine the local Indian country manager trying to get resources. In the case of the Chinese, it was just (the matter of) a phone call. There are companies that have gone the other way. Unilever is very strong in India but historically hasn't been strong in China and am sure there are others. Often reasons are not particularly scientific and they are just idiosyncratic. In China's case, just the idea that they opened up much earlier than India has played a big role in many companies, getting there and settling and then cementing on that strength over time.

From your book one can gather that Microsoft made a few big mistakes when it entered the Chinese market. What were those and how did it correct?

I think in the early years they made a lot of mistakes. And I think it is a prototypical case study of a series of very classic mistakes. One is the presumption that the mechanism through which they had managed to get packaged software standardised in the West could be replicated in China. And the presumption that the Chinese will see that what we did with the standardisation of the software industry was so good for the industry and that the Chinese want a software industry and therefore they will let us do it. What they did not realise at that time, though it was reasonably clear — that there was an indigenous software industry that would not want to see its own bread and butter being taken away from it and so understandably would resist and more than that, the local industry understood the power structure much better.

I think at some point, particularly under Craig Mundie, who is the No. 2 or 3 guy in Microsoft — and he is jokingly referred to as the secretary of state within Mi-

crosoft — with reference to the term that is used for the American foreign minister....

So what was the lesson learnt?

They realised that you almost needed a secretary of state to deal with many countries, that you need to be plugged in not just into the technical aspects of the industry structure but you need to understand the political and social environment as well. Somebody with Mundie's stature is fulfilling that role. Microsoft did not set itself up as a partner in progress in those days. It set itself as "we are the software vendors of choice, you should use us as it is good for us, it's good for you."

Is Google making the same mistakes now in China?

No, Google has a different set of challenges but it's not making those mistakes. For instance, Google had been pretty aggressive in tapping into high-end technical Chinese talent, which Microsoft was not doing in the early days, though now they have corrected that mistake. The Beijing R&D centre of Microsoft is state-of-the-art and is fantastic. I think it is the best in the world among Microsoft's centres anywhere, at least in some technical areas. And Google is doing the right thing by tapping into high-end technical talent even in China, of course it's got a different set of issues—the privacy issues, the emails, the security issues - something that Microsoft didn't have. Whether Google will be able to surmount those challenges, I don't know.

You are on the board of SKS Microfinance. How do you see that company doing in the days to come?

The thing that really makes me happy about SKS Microfinance is the women whose children are going to the school because they have good few extra rupees and we know from decades of social science, not just in India but also across the world that once children go to school, the families in the next generation would be better.

How do you actually rate entrepreneurship in India vis-a-vis the Western world and the emerging markets?

Right now it's hard to find a place that is more exciting than India. You know, this is our moment in the Sun.

Which are the companies in India that you really find exciting?

Companies that I find really interesting in India are companies like SKS, or start-ups like Aspiring Minds or companies like Bharti Airtel that has taken communication to the masses. Or even my good friend, the heart surgeon in Bangalore, Devi Shetty (of Narayana Hrudayalaya fame) who has taken cardiac surgery to the masses. I think the common denominator among these is finding economically viable, sustainable ways to take things that we normally associate, whether it is cars, financial products, heart surgery or fancy phones, to anybody and make them readily really available across the spectrum and affect change and enable livelihood. What I am waiting for is a revolution in education.

Shrinking 'quant' funds struggle to revive boom

The combined assets of quantitative funds specialising in US stocks have plunged 61% since 2007, to \$467 billion

Julie Creswell

They were revered as the brightest minds in finance, the "quants" who could outwit Wall Street with their Ph.D's and super-fast computers.

But after blundering through the financial panic, losing big in 2008 and lagging badly in 2009, these so-called quantitative investment managers no longer look like geniuses, and some investors have fallen out of love with them.

The combined assets of quantitative funds specialising in United States stocks have plunged to \$467 billion, from \$1.2 trillion in 2007, a 61% decline, according to eVestment Alliance, a research firm.

That drop reflects both bad investments and withdrawals by clients.

The assets of a broader universe of quant hedge funds have dwindled by about \$50 billion. One in four quant hedge funds has closed since 2007, according to Lipper Tass.

"If you go back to early 2008, when Bear Stearns blew up, that's when a lot of quant managers got blown out of the water," said Neil Rue, a managing director with Pension Consulting Alliance in Portland, Ore. "For many, that was the beginning of the end," he added.

Wall Street's rocket scientists have been written off before. When the hedge fund Long Term Capital Management nearly collapsed in 1998, for instance, some predicted that quants would never regain their former glory.

But this latest setback is nonetheless a stinging comedown for the wizards of high finance. For a generation, managing a quant fund — and making millions or even billions for yourself — seemed to be the running dream in every math and physics department. String theory experts, computer scientists and nuclear physicists came down from their ivory

towers to pursue their fortunes on Wall Street.

Along the way, they turned investment management on its head, even as their critics asserted they deepened market collapses like the panic of 2008.

Granted, Wall Street is not about to pull the plug on its computers. To the contrary. A technological arms race is under way to design financial software that can outwit and out-trade the most sophisticated computer systems on the planet.

But the decline of quant fund assets nonetheless runs against what has been a powerful trend in finance. For a change, flesh-and-blood money managers are doing better than the machines. Much of the money that is flowing out of quant funds is flowing into funds managed by human beings, rather than computers.

Terry Dennison, the United States director of investment consulting at Mercer, which advises pension funds and endowments, said the quants had disappointed many big investors. Despite their high-octane computer models — in fact, because of them — many quant funds failed to protect their investors from loss or when the markets came unglued two years ago.

And many managers who jumped into this field during good times plugged similar investment criteria into their models. In other words, the computers were making the same bets, and all won or lost in tandem.

"They were all fishing in the same pond," Dennison said.

Quant funds are still struggling to explain what went wrong. Some blame personnel changes. Others complain that anxious clients withdrew so much money so quickly that the funds were forced to sell investments at a loss.

Still others say their models simply failed to predict how the markets would



react to near-catastrophic, once-in-a-lifetime financial events like the credit crisis and the collapse of Lehman Brothers.

"It's funny, but when quants do well, they all call themselves brilliant, but when things don't go well, they whine and call it an anomalous market," said Theodore Aronson, a quant fund manager in Philadelphia whose firm's assets have dropped to \$19 billion, from \$31 billion in the spring of 2007.

But Aronson, who has been using quantitative theories to invest since he was at Drexel Burnham Lambert in the 1970s, said investors would eventually return.

"In the good years, the money rolled in, so I can't really complain now about the cash flow going out," Aronson said. "If somebody can give me proof that this is a horrible way to invest, then I'm going to get out of it and retire."

Still, some of the biggest names in the business are shrinking after years of breakneck growth. During the last 18 months, assets have fallen at quant funds managed by Intech Investment Management, a unit of the mutual fund company Janus; by the giant money management company Blackrock; and by Goldman Sachs Asset Management.

Even quant legends like Jim Simons, the former code cracker who founded Re-

naissance Technologies, have seen better days.

Simons was celebrated as the King of the Quants after his in-house fund, Medallion, posted an average return of nearly 39% a year, after fees, from 2000 to 2007. It was an astonishing run rivaling some of the greatest feats in investing history.

But since then, investors have pulled money out of two Renaissance funds that Simons had opened during the quant boom. After losing 16% in 2008 and 5% in 2009, assets in the larger of the two funds have dropped to about \$4 billion from \$26 billion in 2007.

In an effort to woo back investors, some quants are tweaking their computer models. Others are reworking them altogether.

"I think it's dangerous right now because a lot of quants are working on what I call regime-change models," or strategies that can shift suddenly with the underlying currents in the market, said Margaret Stumpp, the chief investment officer at Quantitative Management Associates in Newark. The firm has \$66 billion in assets under management, and its oldest large-cap fund has had only two down years — 2001 and 2009 — since opening in 1997.

"It's tantamount to throwing out the baby with the bathwater if you engage in wholesale changes to your approach," Stumpp said.

But many quants, particularly late arrivals, are hunting for something, anything, that will give them a new edge. Those who fail again may not survive this shakeout.

"What we're seeing is that not all quants are created equal," said Maggie Ralbovsky, a managing director with Wilshire Associates, which gives investment advice to pension funds and endowments. NYT

Retailers step up discounts to 'right price' products

Continued from Page 9

"Each retailer wants more market share than the other, and to grab the market share, they discount more," Shrikhande said.

Retailers are trying their best to woo customers to walk in to the stores and buy.

"Retailers are seeing lot more competition and also, propensity to spend for consumer is increasing and that is why retailers are trying to get deeper share in consumer wallets," Rajagopalan said.

And customers wait for the time when brands offer the highest discounts. Agarwal said. "Consumers are getting smarter and are willing to delay their purchases to discount periods," he said.

Dutta said that retail in India was still over-priced as western counterparts pay

half for the same products. "The fundamental issue of right-pricing has to be addressed and till that happens discounts will be present in the market. We have an issue with pricing, and modern retail here becomes just more apparent. Unfortunately, over the last few years because of ongoing discounts there is an expectation that has creped into consumers' minds," Dutta said.

Retailers order goods or inventory basis the sales targets they have and the current scenario in retail is that of surplus inventory that retailers are sitting on. Last year, British skin care company, The Body Shop slashed its prices in India by 10-30% in order to become a 'right-priced' brand for Indians. There are other apparel brands that are perennially on sale.

Branch-banking going barebone

Continued from Page 9

Availability of alternate channels like automated teller machines, internet banking, phone banking and point-of-sales terminals has led to a decrease in the number of people visiting bank branches.

"The footfalls in bank branches in the cities have come down on account of more and more people using alternate channels for banking transactions. One can see the number of people required in front office is reducing, while back office is increasing," says a top official from Indian Banks' Association (IBA).

This is especially the case with old public sector banks, which once had branches sprawling over large spaces. Compared with them, new public sector

banks such as IDBI Bank and new generation private sector banks have started out with much smaller space.

"Banks like SBI had spare capacity, so probably they are deploying that. It is not the case with us," says Paul Abraham, chief operating officer, IndusInd Bank.

But then, a smaller bank branch with higher investments in technology can be viable only if customers have access to alternative channels, and such channels are not going to be very popular in Tier-II and Tier-III cities, says B A Prabhakar, executive director, Bank of India.

The IBA official, too, points out: "Investment in technology will be fruitful only if larger volume businesses are undertaken with reduced or same area."