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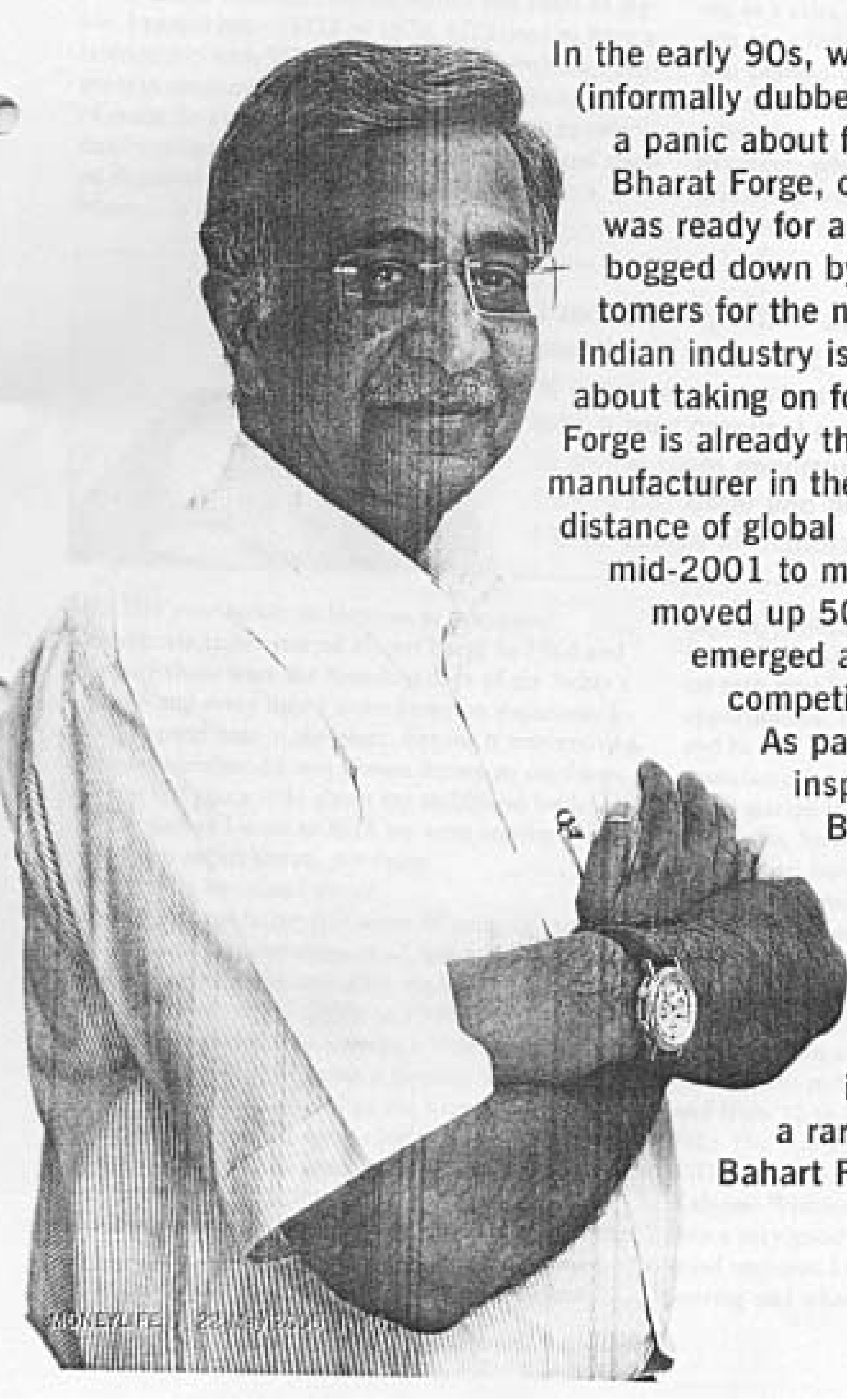
"India's competitive strength has never been cheap labour, it is brain power which we recognised in the late 80s. The rest of the industry is begnining to see this today"



In the early 90s, when the Indian businessmen (informally dubbed the Bombay Club) were in a panic about facing foreign competition, Bharat Forge, controlled by Baba Kalyani, was ready for a global foray. But it was still bogged down by ties to the domestic customers for the next decade. Today, when the Indian industry is just getting comfortable about taking on foreign competition, Bharat Forge is already the most profitable forging manufacturer in the world and within spitting distance of global leadership. In five years from mid-2001 to mid-2006, the stock has moved up 50 times as Bharat Forge has emerged as the showpiece of globally-competitive Indian manufacturing. As part of MoneyLIFE series on inspirational CEOs, Chairman Baba Kalyani reveals to Debashis Basu and Sucheta Dalal what were the key turning points in this leader's life in building a world-beating, metal-bashing company. Excerpts from a rare, expansive conversation in Bahart Forge headquarters in Pune.

ML: We know the basics, like you went to MIT (Massachusetts Institute of Technology), but can you tell us what dictated your choices?

Kalyani: Let me start a little before MIT. I did my engineering at BITS (Birla Institute of Technology) Pilani. In those days people who wanted to pursue an engineering career either looked at IIT (Indian Institute of Technology) or at the next level, which are places like BITS. Those were the most formative five years of my life. I passed out of BITS in 1970. BITS used to have a relationship with MIT under the faculty exchange program in mechanical engineering, which was my branch of study. So I came in close contact with one or two faculty members of MIT who taught at BITS and started developing the idea of wanting to go and do a Masters in Engineering.

I spoke to my father about this within three to four months of my joining. SL Kirloskar was the chairman of our company, so my father spoke to him. Kirloskar was a very practical man who believed in people and in giving them opportunities. He told my father, "put him in the water and he will learn how to swim". So I took charge of manufacturing within three months

ML: Was your family in business at that time?

Kalyani: My father started Bharat Forge in 1964 and therefore those were the founding days of my father's business and every time I came home on vacations, I used to spend time in the plant. For me it was exciting. From my childhood I was always drawn to machines. I will just tell you a little about my childhood background. Before I went to BITS we were staying at a small town called Karad, not Pune.

ML: Did you have land there?

Kalyani: Yes, my father had some 40 acres of land, no big deal, nothing very substantial, but it was pretty good. My grandfather was a big trader of turmeric in his times, that is in the 1930s or 1940s and he had a very high reputation. We were in a little town but well-known as a family. My entire schooling was at the military school in Belgaum, called the King George School started by the British. I spent nine years there, then five years in Pilani and two years in the US, so I was away from home for a long time. My transition from the rural environment of Karad to Pune did not really take place because before I even came and lived in Pune I was in Pilani and then in the US. Whenever I came here, I saw big things happening like building of factories, large equipment etc. That was the kind of excitement I grew with when I was doing my engineering. During my summers in the US, I worked with our collaborators from Cleveland called Sifco Industries, a private forge facility using conventional technology, nothing very fancy. I didn't learn a whole lot in terms of technology, but when I came back here I started working as a sales engineer. When it is your family business, you are a little more passionate about what to do. I was charged-up about wanting to make things happen. I started as a sales engineer but quickly I realised that sales were never a problem. We were simply not able to execute whatever business we were getting. So manufacturing was a problem. I spoke to my father about this within three to four months of my joining. In those days SL Kirloskar was the chairman of our company, so my father spoke to him. Kirloskar was a very practical man who believed in people and in giving them opportunities. He told my father, "put him in the water and he will learn how to swim". So I took charge of manufacturing within three months. This is when I really started learning the nuts and bolts of how to run a business, how to lead people, how to deal with people, how to create an organisation, how to create a business process. Almost all these things I had to learn by myself and on the job because of the need of the job. Fortunately, we started getting great results. The business doubled at the end of the first year itself and doubled again the end of the second year. This of course was on a very small base - it went from Rs 3 crore a year to Rs 6 crore and from 6 to Rs 12 crore and from 12 to Rs 20 crore. Those were exciting times.

ML: Did you apply a lot of the stuff you learnt at MIT those days?

Kalyani: Without being falsely modest I would say I was a very good engineer, I think I am still a pretty good engineer. I have a very good notion about engineering and what works and what doesn't. I was able to apply that. In engineering you need the basic knowledge of physics and metallurgy - that you learn in an engineering school - but you also need very strong common sense to apply it in real life situations. We were able to do just that and change things dramatically. I also went through other issues. I was 23 years old, had just come out of college when I joined and being the son of the boss, I had my own problems with the older guys who started resigning. It was normal because in those days the organisations were very hierarchical, everything was structured and the flow of command was always with age and experience. This was in 1972.

ML: Was this only because you were young or you were trying to change the hierarchy?

Kalyani: Both. I was impatient. I was impatient because I could see very quickly that you could make things differently. There was no business process in place here, so I was putting in business processes. When I did that, people's authority level was getting diluted. Everything was run by authority rather than by a process, so these issues came up. Then the general manager of the factory resigned, then the next guy resigned. But it didn't really matter because those guys were not doing anything significant. Those were the early days of the company and were extremely exciting for me. I kept on doing that job for 22 years. My father was the Managing Director and he used to run the other part of business like finance, the external environment and all that. I used to run manufacturing and sales.

ML: At that time Telco was your biggest customer?

Kalyani: Yes. We had only four customers in those days - Telco, Mahindra & Mahindra, Ashok Leyland and Kirloskar Oil Engines. Kirloskar Oil Engines were making diesel engines, so we were supplying crankshafts and connecting rods. Telco was in Jamshedpur. The Pune plant was just coming up. Ashok Leyland was making 6000-7000 trucks a year, not the 70,000 trucks that they make today. Mahindras used to make jeeps not tractors. So we had four customers and I had just started our relationship with Bajaj Auto. I still remember the day I went to meet Rahul, it was back in 1972-73.

ML: Mr. Kirloskar (popularly known as SL) was the common factor for Bajaj and Bharat Forge?

Kalyani: Yes, as I said, he was our Chairman and it was he who encouraged my father to set up a forging plant because he needed forgings for his engines and he was not getting them. The Kirloskar family and our family know each other for five generations. The Kirloskars come from Kirloskarwadi and we come from Karad, which are 18 miles apart. Each time SL's father Laxmanrao Kirloskar used to travel from Kirloskarwadi to Pune, he stopped at our house to meet my grandfather. That is how SL was our chairman for 16 years right from the start of the company.

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ML: So you developed Bajaj Auto as a customer?

Kalyani: Yes. At that time Rahul used to run Bajaj Auto in a very different manner from the way he runs it today. (Laughs). Everything was growing. From a loss situation we were making profits, profits were doubling. It was a very exciting experience.

ML: You were making losses earlier?

Kalyani: Yes, the year I joined, 1972, we made a loss. But we never made a loss ever after that. In the 1970s we were expanding as our customers increased their products. So we had put in place technology, we created a lot of knowledge within the company, brought in new people with experience etc. We were able to develop the company at a much faster rate than our competitors. The forging business has always been very competitive because the entry barrier to this business has been very low. Today it is a different story. But in those days anybody could set up a forge plant with some Rs 10-15 lakhs capital. There are 60 forging plants set up by ex-Bharat Forge people.

ML: So you had to struggle with product duplication?

Kalyani: We had to struggle with a situation of high employee turnover because our competitors were always after our people. We had to struggle with our senior guys wanting to set up competing shops and we had to struggle right from beginning with our overheads. In those days everybody, including our customers, would say that Bharat Forge has very high overheads. It was a fact. In 1972 we had 1900 people for a turnover of 3.5 crores (laughs).

I realised around 1986 that if we want to be a major supplier in the world market and export to the US, Japan or Europe in a big way we cannot do this with existing technology. I was the one struggling in the plant for 15 hours a day. It is not that I had a problem with the workforce. We always had good workers and good unions but somehow the mindset for top class manufacturing environment was not there

ML: So were you over-staffed or you actually needed that level of staffing those days?

Kalyani: It was actually highly over-staffed! In fact, it was staffed to the capacity that was created but we were never operating at that capacity. We were operating at 10-15% of that capacity. But we solved all those issues quickly. In about 6-7 years the company was trim, fit and competitive. In the later part of 1970s and early part of 1980s we started diversifying and getting into many other customer base. We got into defence, which used to be a big business in those days. We started making shells, armaments and other things. We then started getting into value-added products. From the start, my philosophy was to start developing machine components. It is the main ingredient of our success. In early 1980s we decided to start exporting products. In those days there used to be a lot of trade with Russia. We got some business opportunities selling crankshafts and track links to the USSR. We started some business in Eastern Europe. British Leyland had a plant in Poland and they were producing the same engine that was being produced here, so there was an opportunity to export crankshafts. That is how we started our export business. We were quite aggressive and built up a fairly big export business in Russia - Rs 10-15 crores was considered quite big in the forging business those days. We tried very hard to see how we could export to the Western world. That was the time when the Japanese were coming to India in the LCV (Light Commercial Vehicle) business. Mazda, Toyota, Mitsubishi and Nissan came here. Eicher had a deal with Mitsubishi, which included an export component as part of the government policy of foreign exchange equalisation. The Eicher management and Mitsubishi were very serious about it and so we got a break in supplying front axle beams for trucks to Mitsubishi Motors in Japan. We used to get 10-15 Japanese coming here to meet our people and teach us in the typical Japanese way of going into details. Right to the last nail they put into the packing box, they would sketch it out and tell us how it has to be done...we learnt a lot.

ML: Did you push exports because fiscal incentives were very attractive?

Kalyani: Yes, exports were profitable. There was almost a 20% incentive between cash compensatory support, advance licensing and duty drawbacks. But in our case I don't think we did it so much because of the fiscal angle. We did it because we wanted to break out into the global market. We wanted to export because it was challenging. It was a milestone, something that made everybody proud within the company that we are exporting products to Japan in those days. The Japanese also helped us to get technology. We had a limited, three to four years tie-up with a company in Japan called Toyo Tanko which gave us technology on front axles which we exported. We were doing all this at our existing facilities and although we were struggling, we supplied 15,000 to 20,000 front axles a year to Japan for five to six years. But I also realised around 1985-86 that if we want to be a major supplier in the world market and export to the US, Japan or Europe in a big way we could not do this with existing technology. I was the one struggling in the plant for 15 hours a day. It is not that I had a problem with the workforce or the workers. We always had good workers and good unions but somehow the mindset for top class manufacturing environment was not there. That is when we decided to modernise our plants - the idea was born out of the experience of exporting front axles to Mitsubishi. We had to decide whether to take this up in a linear manner or a hop-step-and-jump. I pushed really hard saying let's create a new structure with state-of-the-art facilities, a new technology platform, new culture and mindset. We agreed internally to have a separate building but at the same location. That's how our modernisation started.

ML: Normally, it is hard to do new things in the same location, off the same financial statements...Didn't you need to create a separate company for this?

Kalyani: We decided to bring in a high level of technology and bring totally new people and not take anybody from our existing operations. I had come to a conclusion that we needed different skills to run high technology processes, which would involve multiple interventions on technology. I believe you need a different work system and different HR processes. You need a highly educated workforce, you cannot use a regular Indian worker in that environment.

We took a bold decision to set up a modern human resources infrastructure to drive technology and completely change the business model from a low technology, low capital, very labour intensive set up to a high capital, highly skilled and less labour intensive workforce. We said we will create a different organisation and we will have a college education as a minimum requirement for anybody working there. So we took a couple of hundred of these young people who were at least B.Sc. or Diploma engineers in 1987-88 and embarked on a modernisation drive. We set up one big 16,000 ton press. We set up our CAD/CAM and CAE infrastructure, our robotics centre, a new Die & Tool making capability and in one step we bridged a technology gap of 20-25 years in this company. The facilities came on stream in 1990 and in one year we were up and running. It required a lot of hard work, but it was amazing how things were just coming up and happening.

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ML: But the economy was not doing too well?

Kalyani: The economy was not doing too well, but we did not suffer too much because we started getting a lot of interest from the US by then. In the kind of products that we made - front axles, steering knuckles, crank shafts - a lot of US manufacturers were shutting down their plants and were looking for suppliers. That's how we really got business from Rockwell to supply front axles and now we have more than 50% of the US truck market today, supplying products from here.

ML: Why did you not opt for a new plant and start with a clean slate?

Kalyani: We asked ourselves this question many times. I think what drove us was two things: one, I was personally involved in running the plant - not the company - so I was pretty confident that we would have no issue with the existing plant. That was not just a gut feel but a pretty involved process. We explained to the union what we were doing, had a big meeting with 1500 people, explained that we are going to bring in robotics, CAD etc. and this requires engineers. We offered an opportunity to anybody who wanted to learn.

The second reason was that my management team and I had to still manage the existing plant while creating a new plant. We couldn't divert our attention and put it somewhere else and move from here to there - it was a practical limitation. Third, we had infrastructure, elec-

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tricity, water, land and compressed air here, which brought the capital cost down by almost 20-30%. On hindsight, it was the right decision to work in the same location, it turned out extremely well. We were lucky that our timing was right, our technology selection was right, our processes were right, what was happening in the US market gave us opportunities - so it all came together very nicely.

ML: So around the time the Bombay Club was getting ready to protest against foreign competition, you were at the take-off stage.

Kalyani: Yes. Actually, I was not even worried. Even in those days my philosophy was very different about this. I have never been afraid of competition. Never. I have always believed that if we did things right we can go and compete with anybody in the world... okay it is not that you will succeed 100% of the time, but for a large percentage of the time you will succeed.

ML: Many of the vocal guys in the Bombay Club and CII were your customers.

Kalyani: Yes, but its one of the reasons why a large portion of these guys have missed the bus in the global markets. Today the Indian automobile industry should have been where the Korean or the Chinese are, but we are way behind, because we chose to put this protective guard around ourselves.

ML: The first phase of modernisation was the early 1990s?

Kalyani: Yes, this was the early 1990s - things went well for us. The domestic market was also beginning to do well after liberalisation and things became a lot easier. Capital cost came down, interest rates dropped and availability of capital increased. 1995-96, were peak years for the Indian automobile industry. We had expanded capacity and things were going well, but by 1997 things had soured. That was a turning point for our company.

ML: But didn't exports contribute a lot to turnover?

Kalyani: Very little - just 20%. Here we were stuck with a huge capacity because we had expanded capacity. I remember in 1995 Ratan Tata had called for a meeting in Lucknow. He had invited 200 Telco suppliers - Suresh Krishna, Venu Srinivasan... all the big guys in the automotive component business were there. Ratan Tata told us that all of you need to double your capacity because Telco is going to double its capacity. This was 1995. By early 1997 the bottom fell out of this business... and it took eight years for the domestic annual output to go above 600,000 vehicles. We were hurt so badly that we came down to something like three days working a week. We had to resort to all kinds of cost saving measures - you can't believe what we were doing. The worst thing was that when this happened, the Indian automotive guys started auctioning their business - they forgot about our long term relationships. Maybe they were doing it for their survival because they were having as much pain as everybody else. So price erosion started happening and with no volumes we were completely sandwiched especially with the high investments we were making. That was another inflexion point for the company and we decided that we wanted to create an export strategy.

ML: But you were already exporting in a big way. Couldn't you have increased your export effort?

Kalyani: We didn't have a strategy. We were only exporting, but we could not have increased our exports without a well-defined strategy. So we started defining our strategy. Since we were in the truck business we focused on supplying to North America as well as Europe and Asia, to get into the passenger car side of the business in all the three continents. We also put in place an export organisation and started moving aggressively after this and we succeeded in just one year.

ML: Was it because of the quality of your products?
Kalyani: Quality and cost. India was extremely competitive. The only problem was that nobody considered India a place you can buy manufacturing products from. We had a poor reputation. It was the bad baggage we had to carry. But fortunately, because we were supplying to the US that became a point of reference for us with our other customers. That helped us gain entry into the European market and Asian market. Once you attain critical mass things become a lot easier - so in the period from 1997 to 2001 we quickly overcame the shock of the downturn in the Indian

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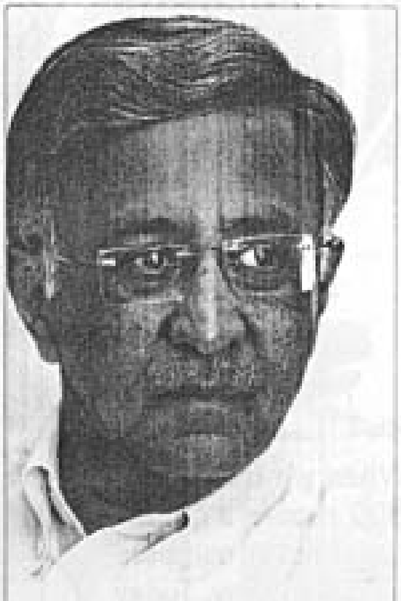
market and started growing on exports. When our exports started accelerating, it also changed our performance, profitability and the culture within our company. We suddenly started looking outwards and developed the business processes and capabilities required to deal with international customers.
ML: Did you again have to change your HR policies to enable this export thrust?
Kalyani: No. Actually the HR initiatives that we took in the late 1980s actually became our assets in the late 1990s. I think it takes 10 years to change the HR system in a company. By then there were enough of skilled people in our company, they had become fairly capable and were delivering. The processes were reasonably well set. We had in place a continuous improvement coming from the bottom and a technology-driven process from the top. These were all merging extremely well.
This helped us to move to the next level: creating an export strategy to get significant market shares in products that we sell on a global basis. I don't think there is any Indian company that has that kind of market share in any product worldwide.
Then, in 2001, one of Dana's forging companies in UK was for sale. It was a company called Kirkstall, a small thing with 15 million pounds in sales, located in Leeds just opposite the Leeds cricket stadium. They were making the same kind of components as us and were supplying to Europe. It was a great opportunity to acquire a few more customers. So we made an offer to buy out their book of business. It was a unique transaction. For three million pounds we bought their book of business but not the equipment or facilities. They sold that off to some real estate developer and liquidated their liabilities towards the employees. It gave us ten million pounds of business for seven years, which we were quickly able to transfer to Pune. It was our first step towards becoming a global company.
Then we asked ourselves, why are we restricting ourselves only to exports? Why are we not becoming a global company ourselves rather than just exporting products? This was the third inflexion point in our history. We then carefully crafted a strategy - we were good at chassis components so we focused on those. CDP of Germany was the best-known and most respected company in the chassis component business. There were some rumours that it was in trouble so we started discussions in 2001. Meanwhile, the company went into bankruptcy so we immediately got into the process of bidding for it. Many of our competitors also bid for the company but the bankers, creditors and unions liked our business model and our bid succeeded. In 2003, when we bought the company it had a 100 million sales and just about 5 million Euro of Operating Profit. Today we are doing 150 million Euros. It also gave us experience of managing a large outfit in Germany and tremendous visibility in the European market. That visibility fetched us business from BMW, Audi, Volvo, Volkswagen and all the big guys. Customer acquisition was a major benefit and technology was another benefit because we got into passenger cars.
By 2001 we knew what we wanted to do in terms of being global. We wanted to be in passenger cars, chassis business, trucks, crankshafts and front axles. We also knew which companies to target and we targeted

them. Somewhere it was quick, somewhere it took a little time, but at the end of the day we were able to get every company we targeted. We targeted Aluminiumtechnik and we got it. Then we targeted the second largest front axle and crankshaft producer in Europe. We needed a foothold in the Scandanavian business in trucks. That is when we went after Imatra Kilsta, along with which came the plant in Scotland called Scottish Stampings. Then we went to the US and got Federal Forge which is again very similar to CDP - a smaller version of CDP supplying to the passenger car sector in the U.S. so this gave us a good platform to expand our business in the US again at a very small cost - we paid just 9 million dollars for this through the bankruptcy process.

ML: How do you improve the competitiveness of these businesses?

Kalyani: First of all, the leverage we get is in terms of the customers we acquire. Most of these customers want to buy a lot of other low cost stuff from India. Second, our experience is that, Indian managers are probably better than most people that I have seen anywhere in the world. Maybe the Germans are better in technology and engineering but if you look at just managing things, day-to-day management especially middle level, Indian managers are probably among the best. That is the first thing. Secondly our guys here can understand numbers, figures and finance in one tenth the time a German, an American or a Swede will understand it. We put together a combination of this, like we did in Germany, where we used the technology and engineering capability of the Germans and brought in our management practices, philosophies and strategies and we turned it profitable in one year. The same thing is happening in Sweden and in United States... in some places we changed CEOs to bring better leadership.



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ML: How is this actually implemented? Do you send people from here?

Kalyani: We have formed a team here of 3 to 4 guys from finance and costing, 2 to 3 guys from operation and 2 to 3 guys from marketing. Every six weeks they are in a new facility. They have a route chart, they make a report, they make an action list and those guys just simply implement this strategy.

ML: Isn't this black cat team of yours a target for other companies?

Kalyani: Well, I have not lost even one guy. I think, at that level people don't go for money. It is the challenge to do things, the power and opportunity. These were simple guys here and are today running plants in Europe and US and China. Their excitement is fantastic.

ML: What is your China strategy?

Kalyani: Let me just complete the global strategy. Initially, we wanted to get into the global market and make Bharat Forge a global company, but by 2005 we felt why not we go in for global leadership. When I look at numbers, Thyssen group's profit margin is 0.6%. Bharat Forge is at 20%. These are big differences.

When I look at technology levels, they are almost similar - may be the Germans have a slight edge but no big deal, we supply to the same customers around the world. We supply to 35 OEMs (Original Equipment Manufacturers) around the world, so we said why not go in for global leadership? And that started our China strategy. If Bharat Forge wants to be a global leader in this business we cannot do it without being in China. China has an automotive market of 5 million vehicles today, probably will be 8 to 9 million vehicles by 2012 and by 2015 the Indian market will be one-fourth of China's. Secondly, everybody in the automotive world is in China, so if you are not in China you tend to get ignored by the rest of the world in this business. We had two options - start a greenfield project or take over an existing company. We didn't think we had the capability of putting up a greenfield project, invest $100 million and start the whole process from scratch. By taking over a business we can apply the same techniques and models that worked elsewhere in the world for us. We decided that if we want to be in China, why not be No. 1 and go and get the biggest forging company there. So we acquired the forging plant of FAW. FAW is the largest automotive company in China and makes over a million vehicles. It had a captive forging facility.

ML: You went and made an offer? Or how did it work?

Kalyani: Oh! We went after it. It took one and a half years, but we just went after it. We hired an investment banker and we asked them to list the four best forging companies in China. Then our guys visited all four companies - the best one was Dongfang but they didn't want to sell. FAW was the second best and the biggest but they had no clue how to run a forging business - managing technologies and technical processes. The Chinese government had decided that whatever they cannot run, they would privatise. FAW plant was part of that decision, so we went after it. We met the Chairman of the Board, the CEO and everyone that mattered.

When we hired labour of 500 rupees a month we could never compete with Germany. Today with 25,000 we can compete with anybody

ML: And none of your competitors were interested?

Kalyani: Surprisingly, nobody else really went after them. They were, in fact, trying to get other people interested. If you look at the last two to three years, most automotive component ventures in China aren't doing too well. Everybody is losing money, there is a little bit of negativity right now and our timing and strategy was right. But the fact is that China is the fastest growing automotive market in the world. They are making 5 million vehicles - five times India's size and eight times India's total automotive business value wise. That is because 700,000 of our million are entry level vehicles. From Bharat Forge's perspective, getting into China sent extremely strong signals to our key customers. Daimler, Volvo, MAN, GM and Volkswagen ... are all in China. They all wanted a good forging supplier and we are their supplier around the world, so there is connectivity. We now have such a huge list of requests for quotations that I am telling them that I cannot work miracles and make things happen overnight.

ML: You said recently that you expect to be No.1 by 2008. How will you go about it? More acquisitions?

Kalyani: My understanding of No. 1 is this. Thyssen is the No. 1 in the forging business worldwide and their sales are roughly about a billion dollars. Our target is to overtake them by 2008. I don't think we will need more acquisitions, but my gut feeling is that we will be able to cross the magic billion dollar number by 2007. A lot of that growth is going to come out of Thyssen, because they are going to lose market share. Their steel business is doing very well but their automotive business has gone down. They work on a 0.6% gross margin on sales, their gross profit is $ 46 million. My profit is already more than that.

One of the issues that I didn't touch was technology. In the last five years we have taken some very significant steps in creating a technology platform at Pune. We want to be leaders not only in terms of size but also technology. We want to be at least five to ten years ahead of the next guy in the world in technology. We have developed a lot of new technology and processes, invested over Rs. 600-700 crores in this facility and the technology is so advanced today that even Thyssen does not have it. For the first time, they have begun following us on technology rather than we following them as we have been doing for the last so many years.

ML: Is this product improvement?

Kalyani: No, this is brand new technology and a level of automation you will not see in India - all developed by us over here. In the automotive industry you define capability by things like fatigue strength etc. Our products are 27-30% better than similar products. And that is winning us more business today than anything else.

ML: Do you have a collaboration for technology development?

Kalyani: No. All this is done by us and this is India's competitive strength - the brain power and we recognised this in the late 1980s while the rest of the industry is beginning to see this today. India's competitive strength has never been cheap labour, never. When we hired labour of 500 rupees a month we could never compete with Germany. Today with Rs 25,000 a month we can compete with anybody in the world.