Boston University

OpenBU **http://open.bu.edu**

BU Open Access Articles BU Open Access Articles

2014-07-04

Doing business in emerging markets: roadmap for success

Marcus Goncalves. 2014. "Doing Business in Emerging Markets: Roadmap for Success." "Invited presentation at the Conference/Workshop at the Danish Institute of Studies, Copenhagen on July 4, 2014."
https://hdl.handle.net/2144/40345
Downloaded from DSpace Repository, DSpace Institution's institutional repository

Conference paper presented at Danish Institute of Studies, in Copenhagen, Denmark – July 2014

Danish Institute of Studies
Copenhagen, Denmark
July 04, 2014

Keynote Speaker

Doing Business in Emerging Markets: Roadmap for Success

Marcus Goncalves
Associate Professor
Chair International Business Program
Nichols College

Overview

Entering an emerging market is not easy. In my experience in teaching this topic, consulting for several multinational corporations around the world, and being a practitioner myself, I find that emerging markets are tough to enter. Government interference, backward infrastructure, and a lack of skilled workers require a lot of patience, perseverance, and specialized assistance. Opportunities in the emerging markets come with their own set of challenges. For instance, often lack of education of the workforce translates into thwarted growth being curbed by a lack of a skilled workforce. Other challenges that arise are legal frameworks with regard to trade policies, which may be absent or underdeveloped, or tendencies for political paternalism or blatant interferences, which we see in India and Latin America. This paper provides basic business strategies for entering emerging markets.

Compare the above to the advanced economies, which, despite the fact that growth has been flat to negative since 2008, continues to supersede emerging markets. When looking at the EU, the 27-member countries allow for labor mobility and a free flow of goods without tariff or nontariff restrictions. Furthermore, the workers in many EU countries are highly educated and have conferred great reputations for their economies. "German engineering" is well known around the world for its high level of quality, the same cannot be said for Indian or Russian engineering.

India has been making progress in opening its economy, but its political response to a much-needed foreign investment is troubling. Large foreign retailers such as IKEA are willing to employ thousands of Indians, but politicians continue to fret about mom-and-pop stores and other small businesses that may be displaced. In 2012, politicians forbade IKEA from selling half its product line in India. In 2012, the deputy chief minister for Punjab went as far as to declare that there was no need for foreign-owned discount retail chains because there are already a multitude of stores selling cheap goods.

Foreign investors become confused and frustrated with these types of patriarchal decisions such as these. Although many nations have transitioned from autocratic rule to democracies with free markets, some continue to dabble in market interference. Take Argentina as an example, where President Cristina Fernández de Kirchner, to prevent a run on the peso by Argentines, has put strict currency controls in place. It is not wonder that in an annual World Bank study titled Doing Business (2013), New Zealand, Singapore, and Hong Kong ranked first, second, and third place respectively in protecting investors, while Argentina ranks 98.

Emerging markets such as India and China have huge and growing populations and thus demand rapid growth rate if they are to make any headway in social development. If India's economic growth falls below six percent the nation would be in crisis, whereas in most advanced economies, such as the United States, if the economy grew at that rate it would risk overheating.

India can barely keep up with educating its rising populations. It needs as many as 1,000 new universities and 35,000 new colleges if it is to achieve its stated goal of raising post-secondary enrollment from 12 percent today to 30 percent by 2020. Meanwhile, Mexico is turning out more engineers and engineering technicians a

year than Germany, and it must scramble to ensure they all get jobs. To fail would be to spawn social unrest. Another key factor when considering entering emerging markets is the distance between emerging markets, which can hamper trade. One study found that a 10 percent increase in distance between north-to-north traders reduces trade by 10 percent; the same distance between south-to-south traders reduces trade by 17 percent.

An improved policy would make an important difference in resolving such problems but emerging market have yet to demonstrate serious desires for true bilateral cooperation. Although the ASEAN nations have a trade agreement, it has yet to yield much economic improvement, as the bloc has yet to turn their loose organization into a trading block, even though economic integration has been touted as a central pillar.

Public administration in emerging markets has much to be desired. The 2013 Doing Business study by the World Bank ranks Brazil, Russia, India, China, and South Africa (BRICS) as 116th, 92nd, 134th, 96th, and 41th respectively out of 189 countries.

Infrastructure remains a significant problem in most emerging markets. China continues to invest heavily in roads, railways, and ports, but elsewhere the progress is weak. India has called for $1 trillion in infrastructure modernization but it lacks the funds to do so independently and its politicians remain suspicious of external sources of capital. The situation is no different in Latin America, in fact, it is arguably worse, as 80 percent of Latin Americans live in cities, compared to fewer than half of Asians. The need for modern urban infrastructure is urgent. Brazil, for instance, wants to improve its infrastructure, which is a bottleneck for the outflow of many of its export products, but it is moving glacially. It has been so slow that Sao Paulo's underground rapid transit system covers only one-tenth of the distance of the one in Seoul, South Korea.

Does all this mean that foreign investors should avoid trading with or investing in emerging markets? On the contrary, however, any organized program of opening up to emerging markets must include specialized expertise, on-the-ground knowledge, local partnerships, and, most of all, patience.

Why Multinationals Fail in Emerging Markets

Pacek and Thorniley (2007) identified an exhaustive range of factors contributing to the failure of companies from advanced economies into emerging markets. These factors may be divided into external and internal factors and almost all are related to strategic and leadership issues:

- Leaders fail to consider emerging markets as an integral part of strategy and acknowledge that such markets need to be approached with a distinct set of criteria for judging progress and success.
- Top leaders fail to commit sufficient resources to get businesses established and growing in emerging markets, or acknowledge that it is never a short-term affair.
- Companies fail to appoint a head manager for emerging markets and often assign this responsibility to an international manager who is responsible for markets in both developed and emerging countries. The problem with this is that operational approaches are distinct in each of these markets.
- Companies fail to understand that business is driven by heads of regions and business units rather than by heads of functional areas. While the former has a focus and appreciation for the emerging markets, the latter tend also to be interested in developed markets.
- Companies do not acknowledge that emerging markets operate under distinct business models and structures, and often merely transfer practices tested in developed markets without considering adaptation.
- The board members of many companies have limited diversity in terms of culture and ethnic background and do not develop sufficient appreciation for the peculiarities of emerging markets.
- Multinationals underestimate the potential and often early competition from smaller international and domestic companies, thus never accepting that they may be destined as a follower in emerging markets.
- Economic and political crisis also exist in emerging markets and have a significant impact on business performance. Top managers need to understand this, be prepared to adapt and introduce new tactics rather than changing strategy, which despite having short-term success, tend to be the wrong approach in the long term.
- Companies get alarmed by short-term slippages and cut costs to attain favorable temporary results, yet this is likely to have a structural impact on strategy implementation and long-term

results.
- Companies set unrealistic targets to achieve, which leave managers with limited maneuvering space and short-lived careers.

The failure factors are numerous and diverse but as Pacek and Thorniley noted it all boils down to a lack of adequate market entry preparation. Preparation requires companies to continuously research the external environment and know how to use internal resources to take advantage of opportunities. Hence, a preliminary audit that focuses on external and internal factors is essential. The external factors may be examined by posing questions concerning the market, the political and economic environment, as well as the business environment.

Having done a preliminary external and internal audit, managers need to prepare a business proposal describing what to do, how to do it, by when, and resources required. Business must then ask themselves whether there are similar or better opportunities available in other emerging markets. How then, can we compare the potential of different emerging markets?

Ranking Emerging Markets

According to the GlobalEdge team at the International Business Center (IBC) at The Eli Broad Graduate School of Management, Michigan State University, there are three main reasons why emerging markets are attractive. They are target markets, manufacturing bases, and sourcing destinations.

As target markets they present a growing middle class with substantial demand for consumer products and services. They are also excellent targets for electronics, automobiles, and healthcare services. The textile (machinery) industry in India is huge, oil and gas exploration plays a vital role in Russia, agriculture is a major sector in China, and airplanes are almost everywhere.

As manufacturing bases they present advantages such as low-wages, high quality labor for manufacturing and assembly operations. South Africa is a key source for industrial diamonds; Thailand has become an important manufacturing location for Japanese MNEs such as Sony, Sharp, and Mitsubishi; Malaysia and Taiwan are home to manufacturing of semiconductors by MNEs such Motorola, Intel, and Philips; and in Mexico and China we find platforms for consumer electronics and auto assembly.

As sourcing destinations, the emerging markets also are using their advantages to attract MNEs. MNEs have established call centers in Eastern Europe, India, and the Philippines; Dell and IBM outsource certain technological functions to knowledge workers in India; and Brazil is a leading raw material supplier namely in oil and agriculture.

The Emerging Market Potential Index (EMPI) was based on Cavusgil[7] indexing approach and developed by the GlobalEdge team to assess the market potential of Emerging Markets. EMPI is based on eight dimensions: market size, market growth rate, market intensity, market consumption capacity, commercial infrastructure, economic freedom, market receptivity, and country risk. Each dimension is measured using various indicators and are weighed in determining the overall index. The result is a score on a scale from 1 to 100.

From Indicators to Institutions

It is common wisdom that size and growth potential are the two best criteria to select an emerging market. Not so for Khanna and Palepu (2010) who argue that lack of institutions, such as distribution systems, credit cards systems, or data research firms, is the primary factor to consider when entering into an emerging market. For them, the fact that emerging markets have poor institutions, thus, inefficient business operations, present the best business opportunities for companies operating in such dynamic markets. However, the way businesses enter into emerging markets is different, and are contingent upon variations presented by the institutions and the abilities of the firms.

Khanna and Palepu point out that the use of composite indexes to assess the potential of emerging markets, as executives often do, has limited use because these indicators do not capture the soft infrastructures and institutions. These composite indexes are useful in ranking market potential of countries when and only these countries have similar institutional environments. When soft infrastructures differ we must then look at the institutional context in each market. In fact, when comparing the composite indexes of the BRIC countries we find that they are similar in terms of competitiveness, governance, and corruption. Yet the key success

factors for companies in the BRIC differ significantly from country to country. Take for example the retail chain industry.

In China and Russia retail chain operators, both multinationals and local companies, converge in urban and semi-urban areas. In contrast, in Brazil very few multinational retail chains are located in urban centers, and in India we find even fewer international retail chains due to government restrictions that until 2005, did not allow foreign direct investment in this industry. Thus, when looking at the economic indicators of the BRIC countries we find that increased consumption provides opportunities for retail operators.

Best Opportunities Fill in Institutional Voids

From an institutional view the market is a transactional place embedded in information and property rights, and emerging markets are a place where one or both of these features are underdeveloped. Most definitions of emerging markets are descriptive based on poverty and growth indicators. In contrast a structural definition as proposed by Khanna and Palepu points to issues that are problematic therefore allowing an immediate identification of solutions. Moreover, a structural definition allows us not only to understand commonalities among emerging markets but also to understand what differentiates each of these markets. Finally, a structural approach provides a more precise understanding of the market dynamics that genuinely differentiates emerging markets from advanced economies.

To illustrate, let us contrast the equity capital markets of South Korea and Chile. According to the IFC definition, Korea is not an emerging market because it is an OECD member, however, when we look at its equity capital market we notice that until recently it was not functioning well, in other words it has an institutional void. Chile on the other hand is considered an emerging market in Latin America but has an efficient capital market, thus no institutional void appears in this sector. However, Chile has institutional voids in other markets such as the products market.

Strategy formulation in emerging markets must begin with a map of institutional voids. What works in the headquarters of a multinational company does not per se work in new locations with different institutional environments. The most common mistake companies do when entering emerging markets is to overestimate the importance of past experience. This common error reflects a recency bias, or when a person assumes that recent successful experiences may be transferred to other places. A manager incorrectly assumes that the way people are motivated in one country would be the same in the new country (context). It may be assumed that everyone likes to be appreciated, but the way of expressing appreciation depends on the institutional environment. Khanna and Palepu point out that the human element is the cornerstone of operating in new contexts. Ultimately, human beings, who provide a mix of history, culture, and interactions, create institutions.

In short, based on Khanna and Palepu's institutional approach to emerging markets it is necessary to answer several questions. Which institutions are working and missing? Which parts of our business model (in the home country) would be affected by these voids? How can we build competitive advantage based on our ability to navigate institutional voids? How can we profit from the structural reality of emerging markets by identifying opportunities to fill voids, serving as market intermediaries?

Strategies for Emerging Markets

The work of Khanna and Palepu indicates that there are four generic strategic choices for companies operating in emerging markets:

- Replicate or adapt?
- Compete alone or collaborate?
- Accept or attempt to change market context?
- Enter, wait, or exit?

Emerging markets attract two competing types of firms, the developed market-based multinationals and the emerging market-based companies. Both bring different advantages to fill institutional voids. Multinational enterprises (MNEs) bring brands, capital talent, and resources, whereas local companies contribute with local contacts and context knowledge. Because they have different strengths and resources, foreign and domestic firms will compete differently and must develop strategies accordingly.

An example of how companies fill institutional voids is provided by Anand P. Arkalgud (2011). Road infrastructure in India is still underdeveloped in terms of quality and connectivity. Traditionally, Tata Motors

has been the dominant player in the auto industry but when it started to receive competition from Volvo in the truck segment and by Japanese auto makers in the car segment Tata responded. It created a mini-truck that not only provided more capacity and safety than the two and three-wheeled pollutant vehicles used to access market areas but also an environmentally sound vehicle, one that could easily maneuver U-turns in such narrow streets.

Another case in India involved Coca Cola, who discovered that their beverages were being sold "warm." Coca Cola realized that it needed a solution to sell its product "chilled." The reason for the warm bottles was that electricity supplies in these remote locations were unstable especially in summer periods. Thus the company developed a solar-powered cooler and partnered with a local refrigeration company.

Tarun Khanna and Krishna Palepu propose the following five contexts as a framework in assessing the institutional environment of any country. The five contexts include the markets needed to acquire input (product, labor, and capital) and markets needed to sell output. This is referred to as the products and services market. In addition to these three dimensions the framework includes a broader sociopolitical context defined by political and social systems and degrees of openness. When applying the framework managers need to ask a set of questions in each dimension.

Conclusion

Entry mode is determined by product, market and organizational factors. In regard to products, companies need to know whether the nature and range of the product, along with available marketing strategies will require any adaptation. If so, they should consider a partner in that emerging market. Usually a higher level of control and resource commitment in the foreign market is required for new or wider product offerings as well as higher levels of adaptation. When taking into account market factors managers need to consider physical distance and experience, as well as identify appropriate marketing strategies and distribution channels, and priorities in revenues, costs, and profits.

Organizationally, major concerns are communication with foreign operations and control of overseas activities. One particular concern in foreign markets is the control of assets. Firms will prefer to internalize activities where there is a higher chance of opportunism by the partners in the emerging market.

Thank you for your time and consideration. I'm open for questions.

References

Arkalgud, A.P. 2011. "Filling "institutional voids" in emerging markets," Forbes. http://www.forbes.com/sites/infosys/2011/09/20/filling-institutional-voidsin- emerging-markets/

Cavusgil, S. Tamer, Tunga Kiyak, and Sengun Yeniyurt. 2004. "Complementary Approaches to Preliminary Foreign Market Opportunity Assessment: Country Clustering and Country Ranking," Industrial Marketing Management, October 2004, Vol. 33(7), pp. 607–617.

Cavusgil, S. Tamer. 1997. "Measuring the Potential of Emerging Markets: An Indexing Approach," Business Horizons, January-February 1997, Vol. 40(1), pp. 87–91.

Khanna, T., and K.G. Palepu. 2010. Winning In Emerging Markets: A Roadmap for Strategy and Execution. Boston, MA: Harvard Business School Publishing. Koelbl, Susanne. 2011. "It Will Not Stop: Syrian Uprising Continues Despite Crackdown," Der Spiegel. http://www.spiegel.de/international/world/it-willnot- stop-syrian-uprising-continues-despite-crackdown-a-753517.html, (last accessed on 11/10/2013).

Mitchell, Jared. 2013. "Why Emerging Markets are tough to enter," HSBC Global Connections. https://globalconnections.hsbc.com/canada/en/articles/ why-emerging-markets-are-tough-enter, (last accessed on 12/16/2013).

Mutum, D.P., S.K. Roy, and E. Kipnis (Eds). 2014. Marketing Cases from Emerging Markets. New York, NY: Springer.

Pacek, N. and D. Thorniley. 2007. Emerging Markets: Lessons for Business and the Outlook for Different Markets (2nd edition). London: The Economist and Profile Books.

World Bank Staff Writers. 2013. "Tourism in the Arab World can mean more than Sun, Sand and Beaches," The World Bank, http://www.worldbank.org/ en/news/feature/2013/02/11/tourism-in-the-arab-world-can-mean-morethan- sun-sand-and-beaches, (last accessed on 01/03/2014).

View publication stats