Emerging Market Entry—Keys to Success

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Introduction

The two-speed recovery has been confirmed as an enduring reality for businesses around the world. For many industries, it has become clear that the vast majority of growth in the near to medium term will occur within emerging markets, and that the companies that compete in them need to be there in order to participate in that growth.

Population trends and the GDP growth rates of emerging markets speak for themselves. Emerging market countries are expected to add 1.4 billion people to their middle classes in the next decade[1] and account for more than 60 percent of global GDP growth between 2010 and 2016.[2]

Beyond the growth imperative, businesses have other compelling reasons to participate in emerging markets. For industries where scale is an important cost driver, such as automotive, pharmaceuticals or electronic equipment, the volume potential of emerging markets is vital to recovering fixed costs and achieving competitive scale efficiencies. In industries serving global customers, such as financial services or logistics, an emerging market presence is essential to providing full service to those customers, wherever they are. For companies in highly branded industries, such as fast-moving consumer goods, luxury goods or fast food, the growing strength of global media and the convergence of consumer needs create compelling reasons to establish these brands as early as possible in the minds of the newly emerging middle classes in developing economies.

Furthermore, emerging market multinational companies (MNCs) are innovating rapidly, introducing competitive new business models and product development approaches that allow them to bring products to markets at a much lower price point than in developing markets. The development of the Tata Nano auto is a good example—it would be nearly impossible to conceive of a Western manufacturer bringing a car to market at the $2,000 price point targeted for the Nano. As MNCs expand both to other emerging markets and to developed markets, they create a powerful competitive threat for established players. There is much that other Western companies can learn from these players, which creates yet another powerful incentive to be present in the emerging markets.

As a result, few companies with global aspirations can afford to ignore emerging markets, and for those companies not yet present, emerging market entry has become a high priority. But simply relying on past approaches used to expand into other developed markets is not sufficient; companies need to define an emerging market entry strategy and operating model that links directly to their long-term corporate strategy and is tailored to handle the different success drivers and unique characteristics of each market. While the specifics will vary both by industry and country, what follows are several key general considerations for successful emerging market entry.

I. Where will you play?

An emerging market entry plan should create clarity as to the role emerging markets will play in your broader corporate strategy. The ultimate aim is to create long-term value.

There are a variety of ways you can achieve this goal:

- Build regional or global scale
- Tap into local talent pools
- Secure the supply of scarce resources
- Build a beachhead for future growth
- Serve global customers present in the regional market
- Acquire skills or develop insight into competitor capabilities

While it is entirely possible to pursue a strategy that achieves different goals in different markets, some degree of specific focus is advisable. History demonstrates that the simultaneous pursuit of too many different strategic objectives typically results in no single target being achieved particularly well. Beyond the BRIC markets (i.e., Brazil, Russia, India and China) lie dozens of emerging market countries that could potentially play a role in your future strategy. But since few companies have the resources needed to sustain the cost and complexity of maintaining a presence in all markets, they must prioritize their entry plans. While specific criteria should reflect the goals an organization is pursuing, experience shows they all fall broadly into two categories:

Market attractiveness

What is the future profit potential of this market? Indicators might include total market size, GDP growth, population growth trends, income distribution, quality of infrastructure, and connections with other regional markets. Leaders should also note the potential political, regulatory and intellectual property issues and risks, as well as the current state of competition.

Potential to create advantage

What are your prospects for earning superior profits in the emerging markets sphere? Your considerations could center on a variety of factors, including your company's ability to share infra-structure or leverage skills and assets in nearby markets; language skills and cultural fit; exclusive relationships with

local suppliers, partners or customers; the ability to overcome entry barriers more easily than the competition; and the opportunity to gain critical skills or neutralize a competitive threat.

This exercise should yield a short list of priority targets, together with high-level goals for each. Articulating the company's strategic objectives for each market will be an important element of this exercise, since it allows you to set clear targets, measure progress, and obtain valuable feedback on the feasibility of the initial strategy. And while it is highly unlikely that every market entry will proceed exactly as expected, each attempt does offer the potential for valuable learning that can increase the prospects for future success.

II. How will you enter?

Entry barriers can vary greatly from market to market and region to region in larger national markets. Typical issues you may need to overcome might include a lack of infrastructure, which can create challenges in areas like product distribution and supply chain management.

To combat this challenge, global brewer SABMiller has even gone so far as to pave the roads that link its distributors to its plants, making sure that it has the infrastructure required to operate in new markets.[3] Another issue involves specific regulations in countries that restrict ownership of local assets or that place other constraints on local operations by foreign companies. In the years prior to 2002 when China entered the World Trade Association, for example, the Chinese government would prevent multinational automakers from retailing their products directly, which forced new foreign entrants to partner with local players.

In addition, corruption can often become a major impediment to entry into an emerging market country, particularly for global companies governed by strict anti-corruption laws in their home countries. Other challenges include the need to build a local brand presence, hire local talent, displace established competitors, and respond to unique local customer requirements. Indian motorcycle buyers, for example, expect bikes under 800 cubic centimetres in size to be fitted with "saree guards" to protect women who sit side saddle on the rear seat from catching their sarees on moving parts. Other risks to be considered include political stability, exchange rate volatility, and local inflation rates.

A critical question when considering an entry strategy concerns the feasibility of going it alone, or partnering with or acquiring a local player. Each route has both advantages and risks:

Go it alone

Striking out on your own can provide a high degree of control over brand presentation, quality, local business practices, and intellectual property. It also means that your company alone captures all of the upside from market success. However, it will also likely take longer to establish a local market position, and your company's probable lack of local market knowledge could lead to expensive mistakes.

Finding a partner

Partnering with a local player has the potential to create a "win-win" situation, enabling the market entrant to capitalize on the partner's current presence and local market knowledge to establish operations, build market share and rapidly overcome local obstacles. Such an alliance could also provide a less capital-hungry way to enter the market, since the potential exists for sharing a partner's already established retail and/or wholesale footprint.

However, a foreign company might have to contend with a local partner whose strategic interests could at some point diverge from its own, along with longer times to make decisions, which also reflects potentially different priorities. Furthermore, the loss of control increases the risk of brand damage even as the partner is sharing in any profits, thus reducing returns and lowering the potential value that the foreign company could realize in the event of a market exit. One good example of a successful partnership is Honda's India joint venture, Hero Honda, that has enabled Honda to establish a dominant market share in the Indian motorcycle and scooter market through partnering with local company Hero.

Acquire

On the one hand, buying an established player in an emerging market provides a foreign company with a ready-made local position that it can fully integrate into its global operations over time. The opportunity often arises to add value to such an acquisition by making use of the parent company's global skills, assets, and access to capital. And having a local asset can help to "ease the way" in the event that a market exit is required.

On the other hand, arriving at a reliable valuation is difficult, considering that prices in many markets are on the rise, and dealing with family-owned business structures can be complex and time consuming. Potential entrants must be very clear about what they are buying into and lock in value through retention payments or other means such as distribution and supply contracts.

The choice of which route to take should reflect a company's goals and priorities, the size of the market opportunity, the state of local market development, and the specific nature of any entry barriers. In order to help determine the best entry strategy, each company should ask itself the following questions:

1. How well do we understand this market? Do we "know what we don't know"?

2. Do we have the skills and patience to pursue a "go-it-alone" strategy? What are the implications if we fail?

3. Are there local companies with whom we could partner? Do we understand their goals, priorities and decision-making process? What is our track record in similar partnerships elsewhere and what have we learned from them?

4. What can we learn from the experiences of other foreign companies entering this market?

5. What risks do we run of losing control of our brand, product and service quality, or intellectual property in this market, and how can we minimize these risks?

6. Are there attractive acquisition targets available? What is our track record in mergers and acquisitions and what have we learned from these experiences?

III. How will you build a profitable position?

Once the leadership of your company has chosen a market and agreed on an entry strategy, the focus should then be put on how to create a defensible position that has the potential to satisfy your long-term objectives.

This strategy needs to address three critical questions:

- Who are our competitors and how will we win in the market?
- Which customers will we go after, how do they buy, and why will they choose us over others?
- How should we configure our local operations to deliver the capabilities we need as efficiently as possible?

Competitors

To understand the competitive land-scape, you need to identify all of the current competitors (both foreign and domestic) as well as others likely to enter in the coming years. You are probably not the only one planning to enter a specific market, so it is essential to look ahead and evaluate how the environment may evolve. Your company's leadership also needs to consider the industry economics and the goals, assumptions and aspirations of competitors and how competitive rivalries will likely play out in this market. Industries with high fixed costs and low levels of product differentiation are the most prone to price competition as companies fight to build sufficient scale rapidly, but even players in highly differentiated categories will regularly see price wars as competitors seek to establish their presence and build share of mind and wallet with their target customers in a rapidly growing market.

Despite these challenges, companies have several ways to create defensible long-term positions:

- Develop a cost advantage by building sufficient scale and/or efficiency. Creating the ability to price competitively can enable players in emerging markets to ride out periods of intense price competition.
- Tailor a differentiated product or service portfolio so that it meets the needs of the emerging market country. By delivering superior value for a distinct group of customers, companies can price at a premium and/or build high levels of loyalty within that group.
- Reengineer an existing product to bring it to market at a substantially lower price. For example, one manufacturer of industrial equipment has partnered with a local Indian company to create a lower spec "good enough" version of its leading product at approximately 10 percent of its original cost.
- Develop a defensible niche, based on unique assets or capabilities or exclusive access to customers. Doing so can shield a company from direct competition, allowing it to earn higher margins.

- Seek access to low-cost capital, which can allow a company to invest ahead of the competition, providing the opportunity to build scale and market share.

Customers

Understanding the needs of local customers is vital to success in entering emerging market countries. For example, the average customer of the market segment that has been targeted could have less disposable income than their counterpart in developed markets and will therefore look for products or services that minimize cash outlays. Furthermore, the sophisticated product features demanded by developed market shoppers will likely be less attractive to first-time emerging market customers for whom a very basic product is probably a significant improvement over what they currently have. Colgate-Palmolive Company, upon realizing that Indian villagers had been using their fingers and less water to clean their teeth with charcoal, brick dust and similarly abrasive substances, replaced its ubiquitous toothpaste with a more basic "toothpowder" that was more immediately recognizable to these customers.[4]

But even when marketers target more sophisticated customer segments in the country, it is vitally important that they understand the unique characteristics of those customers. Examples abound of market entry failures caused by incorrect assumptions as to what local customers would buy. One multinational clothing retailer's entry into the Shanghai market failed to achieve the results it had expected based on launches elsewhere. The reason? It was offering a mix of styles and sizes that were based on its Hong Kong operations, where a substantial proportion of its customers were expatriates. In targeting a predominantly Chinese customer base, the retailer discovered that a very different mix was needed.

Understanding customer buying behavior in B2B markets is also critical. The tendering process in emerging markets can be very complex, with hidden pitfalls for the unwary. For example, competitors will often try to influence the terms of the tender, introducing criteria that make it difficult for other players to bid successfully. Anticipating these competitor tactics, building relationships with customer buyers, and understanding and influencing their buying criteria are all critical for success.

Customer segmentation is an important tool for establishing a defensible long-term position in emerging markets because it reveals distinct groups of customers for whom companies can tailor products or services. But the lack of reliable customer data in emerging markets will likely be a problem. As a result, marketers need to make their segmentation schemes as simple as possible by using available demographic data such as age, domicile and household income that can serve as proxies for predicting customer needs. Original market research can also provide insights regarding how to stimulate demand among target customers. For example, Standard Chartered, a banking group with operations in several sub-Saharan countries, launched a number of financial literacy programs for its customers, based on a finding that better-educated consumers buy more banking services and products.[3]

Operational strategy

When a company's leadership is configuring an emerging market local value chain, it needs to answer many of the following questions:

- Which activities should we perform in the target country and which will be done elsewhere?
- What will our supply chain and manufacturing operations look like?
- How will we distribute products?
- How will we collect and process payments?
- How will we make customers aware of our offerings and encourage them to try them out?
- What will our pricing strategy be?
- What are the key risks in the local market and how will we manage them?
- What is our leadership and talent strategy for this market?

Because the characteristics of emerging markets can differ dramatically from each other and from those in developed markets, managers need to tailor operations to reflect the local culture, customer needs, infrastructure, partner and supplier capabilities, regulations and any distinctive attributes. Getting it right usually requires management team members to possess strong local knowledge, which can be gained by hiring local nationals, partnering with other companies present in the market, or by using third-party advisors to navigate the market's unique features.

Given these differences, operations in emerging markets will most likely differ substantially from those in developed markets. A company's leadership should take this into consideration as part of the overall evaluation process, since it may find that local operational adjustments could thwart its plans to leverage global systems or shared services. Depending on the market position you choose, it could make sense to pursue a very different operational strategy in order to maximize success in the market. For example, if your customers are cash poor but exist in large numbers, a strategy that delivers the minimum acceptable outcome at the lowest possible cost can yield attractive profits if enough of these customers can be persuaded to sign up. You may need to strip down products and services and configure operations, supply and distribution networks in a very different way in order to reach a price point that makes the service affordable.

Leadership and talent strategies for emerging markets can also present major challenges. Critical skills may be in scarce supply within a country, resulting in strong competition for local management talent with the experience and qualifications to operate in a multinational environment. As a consequence, it may ultimately be necessary to train local staff from scratch in some emerging market countries. Over the longer term, talent development programs that rotate local management into other regions in order to broaden their business perspective can be helpful. For example:

- While SABMiller uses expatriates in its African markets, the company develops local replacements through training programs, helping them to build a network of skills across the continent.[3]
- Foschini does all buying and sourcing from its South African head office, with local stores being responsible for sales and operations. It also undertakes regular training at its head office.[3]
- Coca-Cola has built its success in emerging markets in part by building strong relationships with individual franchisees, including providing managerial and technical assistance from its head office and employing local market brand ambassadors to build brand equity.[3]

IV. How will emerging market activities fit into your global business model?

Because emerging markets typically require different approaches, processes and governance policies compared to more developed markets, organizations usually cannot simply replicate a standard operating model within an emerging market or across multiple ones. Each new market therefore has the potential to add significant amounts of complexity to a company's global operating model.

Participating in emerging markets can bring additional risk to the corporation and thus often requires unique governance elements and stronger risk management policies. Contractual risk, reputational risk, banking and currency risk, a lack of transparency, different levels of intellectual property protection, local sustainability concerns, the need to oversee new local management or to work with local partners—all will necessitate closer oversight and more careful control of local decision making. However, in a rapidly evolving competitive situation, you will need to provide oversight in a way that doesn't constrain your organization's ability to respond nimbly to changing market circumstances. A common solution to this challenge is to nominate a trusted manager from the global organization to relocate to the market and provide day-to-day supervision of the local business while concurrently developing local talent to assume longer-term management responsibility. But executing this strategy successfully may be more challenging than it sounds. In many organizations, managers view foreign postings, particularly into joint ventures, as diminishing their promotion prospects, often leaving them with no role to play in their home market once their assignment finishes. You should give careful thought then to management development and succession planning in order to overcome these challenges.

Leaders should also prepare for the increased susceptibility of emerging markets to macro shocks from inflation, commodity prices and, in certain cases, the kind of political instability demonstrated by the turbulent events in North Africa this year. The combination of high growth and higher exposure to fluctuating commodity prices in emerging markets has heightened inflationary risks and resulted in recent

large-scale withdrawals from emerging market funds as investors seek the relative stability of advanced economies. Companies can address these issues by establishing proper risk management processes, currency hedges, scenario development and contingency plans. The need to customize local processes can create challenges for organizations that have invested in developing highly efficient, global back-office functions or shared services. The choice of what to standardize and what to customize requires careful thought, since too much customization will add significant amounts of complexity, while not enough can impair the success of the local operation.

Companies operating in multiple emerging markets may find opportunities to create tailored processes that apply to all emerging markets within a region or across the globe, which typically results in better economics due to increased scale. They may also find opportunities to share other resources and assets across emerging markets that can reduce costs, allow faster give and take of learning and best practices, and ultimately support future expansion.

Companies can benefit from having a presence in emerging market countries by, for example, relocating activities in them to take advantage of abundant local skills or lower labor costs. And this opportunity can resonate far beyond back-office activities: One pharmaceutical company has moved its clinical data management activities to India, taking advantage of the abundance of local medical graduates. An established emerging market presence can also serve as a vital source of other talent that may be scarce, more expensive or less effective in other regions where the company operates. For example, some Western financial services players are augmenting their analyst ranks with teams of researchers in low-cost Asian countries. The goal? Taking advantage of time differences to offer 24/7 services and provide market insider perspectives.

Emerging markets can also play an important role in innovation. The unique needs of emerging market consumers may offer specific insights into how to deliver products and services more efficiently, which could apply across all of the countries where a company operates. African mobile companies are currently leading the world in areas such as mobile banking and mobile health monitoring and treatment precisely because of the absence of developed market-style infrastructure that is irrelevant to the region.

Opportunities also exist to move R&D activities to local markets in order to take advantage of educational systems that are providing growing numbers of technical graduates, or to develop products uniquely tailored to emerging market environments. For example, China continues to graduate several times the number of science and engineering students as the United States, and more than 225 of Fortune 500 companies have established R&D and product design centers in India, which is also an engineering educational powerhouse.[5]

Looking forward, the experience that is gained from managing in an emerging market can be a powerful development tool for high-potential management talent. Many multinational companies have adapted their leadership development programs to ensure that their future leaders spend some time in emerging markets in order to understand where future growth for the company will come from.

Conclusion

Expansion, innovation and competition will continue to accelerate in emerging markets, luring more companies into entering the developing world. Firms with global ambitions who want to realize the promise of emerging markets should craft a strategy designed to execute in response to the critical success factors unique for each target market, provide for flexibility amid market transitions, and position them for long-term success.

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