Emerging Markets

Different challenges for different markets
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The global economic landscape is undergoing fundamental changes. Emerging markets are more than just a rising force: they’re now the main game in economic growth. E7 is expected to overtake G7 by 2040. By 2050, E7 will be 50% larger than G7 economies. Companies around the world and across industrial sectors are seeking out opportunities in these markets and what they represent in terms of new consumers. But it is fundamental to recognize and accept that these emerging markets are fundamentally different from one another and different from developed countries, especially as they mature. The maturity path that many of the emerging economies are following is different from the one that developed countries once followed and hence the demands at the macro and micro economic level are quite different. The end result being different from the one developed countries reached.

Groupings such as BRICS (Brazil, Russia, India, China and South Africa) hold little meaning when it comes to planning to win in these markets. A detailed understanding of the differences is essential to define growth aspirations in these markets and rethinking service offerings and go-to-market strategies in order to meet the needs of existing and new clients.

These countries typically have:

- High growth rates and potential to become developed economies in the mid/long term;
- A unique risk profile;
- Lower per-capita income, with differences in consumption behaviour when compared to developed economies;
- Either untapped talent pools or are undergoing specialized labour shortages (e.g. Brazil);
- Transparency, market regulation and operational efficiency under development;
- Unique economic and political environments which are still stabilizing.

Success lies in placing emphasis on a complex set of global vs. local trade-offs whilst attempting to capture and market cross country best practices (within emerging markets and between developed and emerging markets), clearly understanding potential areas of cooperation, and strengthening economic/business links within an emerging markets context.

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Since the macroeconomic parameters and features of development vary within BRICS and other emerging economies, the challenges they face to make their growth process sustainable also vary. Furthermore, governments in these regions have a strong development agenda and having their support/approval is key to drive growth (i.e. obtaining regulatory approvals, fiscal benefits, etc.). For example, in Brazil, and not limited to, macroeconomic stabilization is a key precondition for successful reforms and sustainable growth. The challenges that the Brazilian economy face are: (i) that its tradeable goods sector is small when compared to other EMs like China; (ii) saving and investment rates have to increase as in other BRICS economies like China and India; (iii) improvements are required in public sector management; and (iv) it also needs to enhance the depth of the financial sector as well as improve long-term financing structures for the private sector. In the case of Russia, the key challenges are accelerating the implementation of structural reforms, particularly in inefficient and undercapitalized natural monopolies, and strengthening the investment climate. For India, the major challenges are (i) making the growth process more inclusive, (ii) improving physical infrastructure, (iii) developing the agriculture sector, and (iv) enhancing delivery of essential public services, such as education and health, to large parts of the population. Similarly for China, policy changes are needed to address both domestic and external challenges. The policy challenge for China is to sustain rapid and stable economic growth, driven by both exports and domestic demand in a more balanced way. To facilitate restructuring of the economy, financial sector reforms are needed to improve the intermediation of China’s large private savings. The government also needs to raise social spending in the areas of education, healthcare, and pensions, which will serve to reduce precautionary saving and boost consumption over time. There is also a need to improve the investment structure, advance reforms in the healthcare, pension, and education systems, and provide more support to rural areas and less-developed regions. Countries in E7 present some differences and challenges at various levels (non-exhaustive):
As we can see, each of these countries, even though growing, individually presents differences across the board, from institutions all the way to the firm level. These factors continue to influence business organizations and managerial behaviours in their respective markets.
Finding new sources for growth is the key reason developed economy companies are vigorously investing in emerging markets. By entering emerging markets, traditional multinationals are playing both offense and defence. They know they must be on the ground in emerging economies, investing for the long term, physically close enough to learn the ways of markets that differ from those they’re used to. However, emerging economies are beginning to produce their own powerful multinationals—Haier in China and Tata in India, Vale and JBS in Brazil, are examples which are posing unprecedented competitive challenge.

Any move into emerging markets will require innovations in products, technology, and services, as well as major changes in operating procedures. No longer can a company simply export a product to a distribution network in an emerging market and expect it to succeed. Multinationals’ business models are based on practices established in the markets of the developed world, where the game is won slowly by finding cost savings and making product improvements that capture single percentage points of market share over time.

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<table>
<thead>
<tr>
<th>Institutional factors</th>
<th>Upsides</th>
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| **Country institutions** | • The legal system  
| | • The government (regulations, public sector governance)  
| | • The society (religion, culture, ideology, custom, social norm) | • Potential for political instability  
| | | • Politically less stable governments and internals tensions can create difficulty operating environment for companies  
| | | • Currency fluctuations  
| | | • Government involvement | • Typically have low levels of debt  
| | | • Healthy banking systems  
| | | • Prudent fiscal policies |

| Markets | • Product (technology, innovation, etc.)  
| | • Labor (quality and availability)  
| | • Management  
| | • Raw materials  
| | • Financial capital | • Stock and bond markets are less mature in their functions. Rules of conduct and liquidity (volatility)  
| | | • Lack of sound fiscal and monetary policies can undercut growth | • Availability of natural resources  
| | | • Growing household income  
| | | • Young working age population  
| | | • Export strenghts |

| Firms | • Firm boundary (vertical integration, diversification)  
| | • Ownership and control structures  
| | • Governance structures (accounting, board of directors, executive compensation, etc.) | • Regulatory environment  
| | | • Rules and regulations tend to be under development  
| | | • Market regulation, corporate governance, transparency and accounting standards may not be reliable  
| | | • Higher costs to invest | • Geographic expansion (cross-country)  
| | | • Professionalization |

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Different types of markets dictate different growth strategies and process challenges:

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<tr>
<th>Types of Market</th>
<th>Growth</th>
<th>Value proposition</th>
<th>Channel management</th>
<th>Integrating supply and demand</th>
</tr>
</thead>
<tbody>
<tr>
<td>Emerging</td>
<td>Generate volume growth</td>
<td>Medium</td>
<td>High</td>
<td>Medium</td>
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<tr>
<td>Established</td>
<td>Achieve value growth through</td>
<td>High</td>
<td>High</td>
<td>High</td>
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<tr>
<td>Developing</td>
<td>Ensure availability establish</td>
<td>Medium</td>
<td>Low</td>
<td>Medium</td>
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As a result, companies will face challenges in developing their EM strategies around some key implementation issues such as:

- How to orchestrate the organization;
- How to allocate resources;
- How to manage resources;
- How to improve performance;
- How to manage risk.

The world’s customers, even the poorest, have become too sophisticated. In fact, companies may have to rethink repetitive business models to compete effectively. All of this is easier said than done, of course, because consumers in emerging markets are extremely diverse. In some ways, they resemble those in developed nations: they are aware of and have a fondness for brands and want access to a variety of products at different prices, including products they aspire to but can’t currently afford. Yet their tastes are often localized, and while they are middle-class in regional terms, they are still not wealthy enough to replace products regularly, because their percentage of truly discretionary income is lower: in China and India, for example, about 40 percent of average household income is spent on food and transportation, compared with 25 percent in the United States. Even multinational companies that despite having strong global brands face challenging competition in emerging markets from local players have had to adapt to a new reality.

For example:

- PepsiCo (Frito-Lay) in India had to create a new platform called Kurkure with a local feel, for younger consumers and as a consequence shaped the snack market;
- Wal-Mart entered Brazil with aggressive growth plans which went awry because they tried to replicate the basic store format prevalent in the US in Brazil and they failed to understand the needs of the local markets. Now, after the initial problems, Wal-Mart planned and implemented new strategies that included acquisitions, new store formats, bringing in experienced store personnel, etc;
- Chinese beverage maker Hangzhou Wahaha, for example, has built a $5.2 billion business against global competitors such as Coca-Cola and PepsiCo by targeting rural areas, filling product gaps that meet local needs, keeping costs low and appealing to patriotism.
Addressing these differences may well determine success or failure. Companies doing well in one region often falter in another.

When a business with a value-generating or managerial capability invests abroad, its shareholders and the host country’s citizens both stand to benefit. But no matter how good the apparent fit between what foreign companies offer and what host countries need, success is far from assured. Understanding specific market challenges, pertinent to each emerging market, is key. Companies have to ensure that they have clearly understood the market structure, its dynamics and peculiarities. Issues such as changing regulatory and tax environment, taxation of executive compensation, the proper scope of financial regulation, elections and other political events, economic crises, and changing societal attitudes can disrupt the best-laid plans in emerging economies. Companies best able to anticipate and manage the related risks and opportunities will have the strongest competitive edge as they seek to compete in emerging economies.

PwC Brazil has put together a multi-disciplinary team prepared to support you with these issues either while you are considering investing in Brazil or with existing investments.
For further information, please contact:

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