chapter 9

Understanding Emerging Markets

Learning Objectives
In this chapter, you will learn about:

1. The distinction between advanced economies, developing economies, and emerging markets
2. What makes emerging markets attractive for international business
3. Estimating the true potential of emerging markets
4. Risks and challenges of doing business in emerging markets
5. Strategies for doing business in emerging markets
6. Catering to economic development needs of emerging markets and developing economies

The New Global Challengers: Newly Internationalizing MNEs from Emerging Markets

Emerging markets are countries such as Brazil, China, India, Mexico, and Turkey that, in contrast to advanced economies, are experiencing rapid economic growth, industrialization, and modernization. Most emerging markets are characterized by a young population and a growing middle-class. While emerging markets represent attractive markets and low-cost manufacturing bases, they also tend to have inadequate commercial infrastructure, evolving legal systems, and a high-risk business environment. Despite their drawbacks, emerging markets have begun to produce new global challengers, top firms that are fast becoming key contenders in world markets. These firms pose competitive challenges to companies from the advanced economies, such as in Europe, Japan, and North America.

In a recent study, The Boston Consulting Group identified the top 100 firms from emerging markets that have successfully ventured into global markets. While many of these firms are from China and India, others hail from various other countries. For example, the Mexican firm Cemex is one of the world’s largest cement producers. In Russia, Lukoil has big ambitions in the global energy sector. In Turkey, diversified conglomerate Koc Holding owns Arcelik, the giant home appliance producer.
The Brazilian food processors, Sadia and Perdigao, exemplify the international entrepreneurship of the new global challengers. These firms operate farms and market chilled and frozen foods, cereals, and ready-to-eat meals. Each firm is a $2 billion enterprise and exports about half of its annual production. Abundant production resources for pork, poultry, and grains in Brazil and ideal growing conditions for animal feed provide advantages for these firms. Both Sadia and Perdigao also take pride in their world-class global distribution and supply-chain management systems.

The new global challengers, including Sadia and Perdigao, apply business strategies, such as using home-country natural resources, low-cost sources of labor, engineering and managerial talent that sometimes exceed those of their counterparts in highly industrialized countries. Many of the firms are growing internationally by taking their established brands to global markets. For example, China’s Hisense sells millions of its branded television sets and air conditioners in over 40 countries. It is the best-selling brand of flat-panel TV in France. Hisense also makes stylish consumer electronics at low prices.
Another strategy of new global challengers is to turn engineering into global innovation. Brazil’s Embraer has tapped the large labor market of experienced but low-cost engineers in that country to build innovative small jets. Embraer has zipped past Canada’s Bombardier to become the world’s largest producer of regional jet aircraft. Some emerging market firms have assumed global leadership in specific product categories, such as Hong Kong’s Johnson Electric, the world leader in small electric motors for automotive and consumer applications.

Other new global challengers have leveraged local bases of ample natural resources. Russia’s Rusal is extracting the country’s rich reserves of bauxite to produce aluminum for international markets. The majority of the world’s natural resources are located in developing economies, and a growing number of new global challengers use those resources to their advantage. China’s CNOOC, for example, has been buying into oil and gas reserves in Asia and Africa.

Rolling out new business models to multiple markets is another strategy employed by new global challengers. Some gain access to key markets by acquiring important local businesses. Others build relationships with major retailers, such as Home Depot and Wal-Mart. Still others target high-volume sales to large industrial buyers. For instance, China’s BYD targets Motorola, Nokia, and Sony Erickson to sell its cell phone batteries.

The success of new global challengers suggests that the character of international trade and investment is shifting. Today, there are many more emerging market firms active on the world stage. They possess distinct advantages and are becoming key competitors to MNEs from advanced economies, which have traditionally dominated international business. The firms identified in the Boston Consulting Group study are just the tip of the iceberg; thousands of firms from emerging markets have big global dreams and are progressing accordingly. Managers from the advanced economies who don’t take these new rivals seriously risk getting blindsided.


In this chapter we discuss emerging market economies and contrast them to the other two major groups of countries: advanced economies and developing economies. Our focus is on the emerging markets since they represent the most important settings for growth-minded companies today. Each country group poses distinctive opportunities and risks for companies engaged in international business. By exploring a country’s stage of economic development, a manager can gain insights into at least three important country characteristics: the purchasing capacity of its citizens, the sophistication of the business sector, and the adequacy of commercial infrastructure, in such areas as communications, transportation, and energy generation.

**Advanced economies**
Post-industrial countries characterized by high per-capita income, highly competitive industries, and well-developed commercial infrastructure.

**Developing economies**
Low-income countries characterized by limited industrialization and stagnant economies.

**The Distinction between Advanced Economies, Developing Economies, and Emerging Markets**

Exhibit 9.1 highlights the advanced economies, developing economies, and the emerging markets. Advanced economies are post-industrial countries characterized by high per-capita income, highly competitive industries, and well-developed commercial infrastructure. The advanced economies are the world’s richest countries and include Australia, Canada, Japan, New Zealand, the United States, and most European countries. Developing economies are low-income countries characterized by limited industrialization and stagnant economies. Of the developing
emerging markets, refer to a subset of former developing economies that have achieved substantial industrialization, modernization, and rapid economic growth since the 1980s. The economies are differentiated by degree of economic development and per-capita income. Currently, some 27 countries are considered emerging markets. These economies are found mainly in Asia, Latin America, and Eastern Europe. The largest emerging markets are China, India, Brazil, and Russia.

Exhibit 9.2 on pages 258–259 provides an overview of the key differences among the three groups of countries.

Advanced Economies

Having reached a fairly mature state of industrial development, advanced economies largely transformed from manufacturing economies into service-based economies. Home to only about 14 percent of the world’s population, the advanced economies have long dominated international business. They account for about half of world GDP, over half of world trade in products, and three-quarters of world trade in services.

Advanced economies have democratic, multiparty systems of government. Their economic systems are usually based on capitalism, with relatively little government intervention in business. They have tremendous purchasing power, with few restrictions on international trade and investment. They host the world’s largest MNEs. A leading example is Ireland, which has one of the world’s best performing economies, a booming job market, and per-capita income higher than many of its European neighbors. Ireland succeeded through a program of strict fiscal and monetary policies. The government cut federal spending, taxes, and borrowing. Such policies gave rise to lower interest rates, more available capital, and attracted much FDI from foreign manufacturers in high-tech industries, such as Gateway and Polaroid. Over time Ireland has built up a strong educational system, producing a steady supply of skilled workers, scientists, engineers, and managers.3

Developing Economies

Developing country consumers have low discretionary incomes; the proportion of personal income spent on purchases other than food, clothing, and housing is very limited. Approximately 17 percent of people in developing economies live on less than $1 per day. Around 40 percent live on less than $2 per day.4 To compound matters, birth rates in developing economies tend to be high. The combination of low income and high birth rates tends to perpetuate the poverty characteristic of developing economies. Developing economies are sometimes called underdeveloped countries or third-world countries. However, these terms are imprecise because, despite poor economic conditions, the countries tend to be highly developed in historical and cultural terms.

Developing economies are also hindered by high infant mortality, malnutrition, short life expectancy, illiteracy, and poor education systems. For example, the proportion of children who finish primary school in most African countries is less than 50 percent.5 Because education is strongly correlated with economic development, poverty tends to persist. Lack of adequate health care is a big concern. Some 95 percent of the world’s AIDS victims are found in developing economies, an additional hardship that hampers their development. Ailing adults cannot work or care for their children and require much medical care. As a result, productivity is stagnant, which means living standards deteriorate. Orphaned children are unlikely to get an education, and the vicious cycle of poverty persists.
Exhibit 9.1
Advanced Economies, Developing Economies, and Emerging Markets
Governments in developing economies are often severely indebted. In fact, some countries in Africa, Latin America, and South Asia have debt levels that approach or exceed their annual gross domestic product. This means it would cost a year’s worth of national productive output just to pay off the national debt. Much of Africa’s poverty is the result of government policies that discourage entrepreneurship, trade, and investment. For example, starting a new business in sub-Saharan countries in Africa involves an average of 11 different approvals and takes 62 days to complete. In the advanced economies, by contrast, starting a new business takes an average of six approvals and 17 days to complete. Bureaucracy and red tape in developing economies often hinder the ability of firms from these countries to participate in the global economy.

International trade and investment help to stimulate economic growth, create jobs, raise incomes, and lower prices for the products and services demanded by consumers and companies. When countries are cut off from the global economy, the result is increased poverty and unemployment – conditions that can give rise to revolution, terrorism, and war. By contrast, nations that participate actively in the global economy enjoy economic stability and better living standards. As Exhibit 9.3 illustrates, there are substantial differences in critical trade conditions across the three country groups.

### Exhibit 9.2  Key Differences among the Three Major Country Groups

<table>
<thead>
<tr>
<th>Dimension</th>
<th>Advanced economies</th>
<th>Developing economies</th>
<th>Emerging markets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Representative countries</td>
<td>Canada, France, Japan, United Kingdom, United States</td>
<td>Angola, Bolivia, Nigeria, Bangladesh</td>
<td>Brazil, China, India, Indonesia, Turkey</td>
</tr>
<tr>
<td>Approximate number of countries</td>
<td>30</td>
<td>150</td>
<td>27</td>
</tr>
<tr>
<td>Population (Percentage of world)</td>
<td>14</td>
<td>24</td>
<td>62</td>
</tr>
<tr>
<td>Approximate average per capita income (U.S. dollars; PPP basis)</td>
<td>33,750</td>
<td>6,450</td>
<td>13,250</td>
</tr>
<tr>
<td>Approximate share of world GDP (PPP basis)</td>
<td>48</td>
<td>9</td>
<td>43</td>
</tr>
<tr>
<td>Population (millions)</td>
<td>892</td>
<td>1,877</td>
<td>3,775</td>
</tr>
<tr>
<td>Telephone lines per 1,000 people (fixed and mobile)</td>
<td>1,369</td>
<td>355</td>
<td>724</td>
</tr>
<tr>
<td>Personal computers per 1,000 people</td>
<td>517</td>
<td>39</td>
<td>191</td>
</tr>
<tr>
<td>Internet users per 1,000 people</td>
<td>533</td>
<td>103</td>
<td>240</td>
</tr>
</tbody>
</table>

Emerging Market Economies

Emerging markets are found in East and South Asia, Eastern Europe, South Africa, Latin America, and the Middle East. Perhaps the most distinguishing characteristic is that these countries are enjoying rapidly improving living standards and a growing middle class with rising economic aspirations. As a result, their importance in the world economy is increasing as attractive destinations for exports, FDI, and sourcing.
Because of dynamic changes in these economies, the list of countries regarded as emerging markets is also evolving. For example, it can be argued that Hong Kong, Israel, Saudi Arabia, Singapore, South Korea, and Taiwan have developed beyond the emerging market stage. Several emerging markets will join the group of wealthy nations in the not-too-distant future. In 2004, emerging markets, including the Czech Republic, Hungary, and Poland, received a boost when they became members of the European Union. By joining the EU, these countries had to adopt stable monetary and trade policies. They leverage their low-cost labor to attract investment from Western Europe, thereby boosting their economies.

Similarly, some countries currently classified as developing economies have the potential to become emerging markets in the near future. These include the European countries of Estonia, Latvia, Lithuania, Slovakia; the Latin American countries of Costa Rica, Panama, and Uruguay; as well as Kazakhstan, Nigeria, Vietnam, and the United Arab Emirates. Finally, economic prosperity often varies within emerging markets. In these countries, there are usually two sets of economies—those in urban areas and those in rural areas: urban areas tend to have more developed economic infrastructure and consumers with greater discretionary income than rural areas.

Those emerging markets in Eastern Europe such as the Czech Republic, Hungary, and Poland have also been engaged in rapid privatization of former state enterprises since 1989 after these countries transformed from centrally planned economies into liberalized markets. Therefore, these emerging markets are also referred to as transition economies. China and Russia are also considered transition economies. Privatization of state enterprises and promoting new, privately-owned businesses were important first steps in attracting foreign direct investment. Privatization refers to transfer of state-owned industries to private concerns. Most transition economies have been engaged in large-scale privatization of state-owned enterprises.

The transition economies hold much potential. Long burdened by excessive regulation and entrenched government bureaucracy, they are gradually introducing legal frameworks to protect business and consumer interests and ensure intellectual property rights. Yet, the changes that have been occurring in transition economies are often painful. For instance, within a few years of the collapse of the Soviet Union, the Russian economy shrank by nearly half the size it had been at the beginning of its transformation in 1989. Russia endured high inflation with annual price increases reaching 100 percent or more, hindering foreign investment and economic development. Shaking off the Soviet legacy required the country to restructure not just institutions and firms, but also adopt new values about private ownership, profits, intellectual property, and other fundamental aspects of a free-market economy. Initially, western companies

<table>
<thead>
<tr>
<th>Trade condition</th>
<th>Advanced economies</th>
<th>Developing economies</th>
<th>Emerging markets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industry</td>
<td>Highly developed</td>
<td>Poor</td>
<td>Rapidly improving</td>
</tr>
<tr>
<td>Competition</td>
<td>Substantial</td>
<td>Limited</td>
<td>Moderate but increasing</td>
</tr>
<tr>
<td>Trade barriers</td>
<td>Minimal</td>
<td>Moderate to high</td>
<td>Rapidly liberalizing</td>
</tr>
<tr>
<td>Trade volume</td>
<td>High</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>Inward FDI</td>
<td>High</td>
<td>Low</td>
<td>Moderate to high</td>
</tr>
</tbody>
</table>

**Exhibit 9.3**
Trade Conditions within Major Country Groups

Chapter 9  Understanding Emerging Markets

As transition economies liberalized their markets, many foreign companies initiated trade and investment relationships with them. Privatization provided many opportunities for foreign firms to enter these markets by purchasing former state enterprises. In Eastern Europe, Western companies are leveraging inexpensive labor and other advantages in the region to manufacture products bound for export markets. Hungary, Poland, the Czech Republic, and other former East Bloc countries have made great strides in political and economic restructuring. These countries are well on their way to more advanced stages of economic development.

Exhibit 9.4 contrasts the national characteristics of emerging markets with the other two country groups. Exhibit 9.5 shows that emerging markets account for over 40 percent of world GDP. Similarly, they represent over 30 percent of exports and receive over 20 percent of FDI.

In the mid-2000s, the emerging markets collectively enjoyed an average annual GDP growth rate of nearly 7 percent, a remarkable feat. As Exhibit 9.6 shows, their economies have been growing much faster than those of the advanced economies.

Emerging markets possess numerous advantages that have fostered their rise. The presence of low-cost labor, knowledge workers, government support, low-cost capital, and powerful, highly networked conglomerates have helped make these countries formidable challengers in the global marketplace. New global challengers are top firms from rapidly developing emerging markets that are fast becoming key contenders in world markets. One example is Orascom Telecom, an Egyptian mobile telecommunications provider that has leveraged managerial skills, superior technology, and rapid growth to become one of the leading telecoms in Africa and the Middle East. Starting in 1997, management strung together a telecom empire that stretches from North Africa to Iraq to Pakistan and

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>Advanced economies</th>
<th>Developing economies</th>
<th>Emerging markets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Median age of citizens</td>
<td>38 years</td>
<td>24 years</td>
<td>32 years</td>
</tr>
<tr>
<td>Major sector focus</td>
<td>Services, branded products</td>
<td>Agriculture, commodities</td>
<td>Manufacturing, some services</td>
</tr>
<tr>
<td>Education level</td>
<td>High</td>
<td>Low</td>
<td>Medium</td>
</tr>
<tr>
<td>Economic and political freedom</td>
<td>Free or mostly free</td>
<td>Mostly repressed</td>
<td>Moderately free or mostly not free</td>
</tr>
<tr>
<td>Economic / political system</td>
<td>Capitalist</td>
<td>Authoritarian, socialist, or communist</td>
<td>Rapidly transitioning to capitalism</td>
</tr>
<tr>
<td>Regulatory environment</td>
<td>Minimal regulations</td>
<td>Highly regulated, burdensome</td>
<td>Achieved much economic liberalization</td>
</tr>
<tr>
<td>Country risk</td>
<td>Low</td>
<td>Moderate to high</td>
<td>Variable</td>
</tr>
<tr>
<td>Intellectual property protection</td>
<td>Strong</td>
<td>Weak</td>
<td>Moderate and improving</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>Well-developed</td>
<td>Inadequate</td>
<td>Moderate but improving</td>
</tr>
</tbody>
</table>

New global challengers Top firms from rapidly developing emerging markets that are fast becoming key contenders in world markets.
The Distinction between Advanced Economies, Developing Economies, and Emerging Markets

Exhibit 9.5  Why They Matter: Emerging Markets as a Percent of World Total

Note: Taiwan is not included because of insufficient data.


Bangladesh. Orascom now has roughly 50 million subscribers and more than $3 billion in annual revenues. Operating expenses in Egypt are perhaps a tenth of what they are in Europe, because engineers and sales people work for less. Orascom’s advantage is growth, which provides a continuous stream of capital to fund expansion plans. Management has excelled at local branding and tailoring telephone products and services to local pocketbooks.8

Exhibit 9.6  GDP Growth Rates in Advanced Economies and Emerging Markets

China is the largest emerging market, and its role in international business is expanding rapidly. With a population of 1.3 billion people (one-fifth of the world total), the Chinese economy continues to grow at an impressive rate of nearly 10 percent per year. The country has already produced numerous new global challengers, such as Shanghai Automotive (China’s top automaker), Sinopec (a large oil company), and Shanghai Baosteel (a steel manufacturer). The Global Trend feature highlights China’s growing role in international business.

A huge population and rapidly growing economy make China a huge importer of consumer products, technology, and commodities. Long a communist regime, China began pursuing market reforms in the late 1970s. It achieved explosive economic growth, quadrupling its GDP during the succeeding 30 years. China’s growth was especially fast in the 1990s—while exports amounted to just $78 billion in 1993, they surged to $794 billion by 2006. Although income per person is still modest at around $6,800, China in 2007 stood as the second-largest economy in the world (after the United States).

China’s economic reforms have progressed in fits and starts, with the national government periodically loosening and tightening central controls. China has struggled to sustain job growth for tens of millions of workers laid off from state-owned enterprises, migrants, and new entrants to the workforce. Roughly one hundred million rural workers drift between villages and the huge cities, many subsisting through part-time, low-paying jobs. Poor infrastructure in communications and transportation remains a major challenge, especially in the countryside.

After joining the WTO in 2001, China’s role as a global manufacturing site expanded, triggering massive exports to Europe, the United States, and elsewhere worldwide. Investment has poured into China from MNEs who perceive a bright future for the country both as a manufacturing platform and huge consumer market. China buys roughly 20 percent of the world’s aluminum, copper, washing machines, soybeans, poultry, and ice cream. It consumes roughly one-third of the world’s coal, cotton, fish, rice, and cigarettes. The country buys one-quarter of the world’s steel and one-half its pork. It is home to 20 percent of the world’s cell phone users. Rapid industrialization means that the country needs to import aircraft, machinery, production equipment, telecommunications technology, and various raw materials.

These trends are both a boon and a bane to international business. While it is a booming new market, China also puts considerable strain on world resources, leading to higher commodity prices. It also means environmental degradation. Eight of the 10 most polluted cities in the world are now in China. The country now releases 13 percent of global carbon dioxide emissions, second only to the United States (23 percent). There are also serious problems of water pollution, deforestation, desertification, and soil problems. Nevertheless, all this suggests opportunities for western firms marketing technologies and equipment for the protection of the environment.

To profit from China’s low-cost labor and growing affluence, thousands of foreign companies set up sales offices and manufacturing facilities there. For most of these firms, however, success has come slowly, or not at all. The biggest problem is that China is still relatively poor. Out of a total population of 1.3 billion, the realistic target consumer segment is much smaller, perhaps 250 million middle-class residents of urban areas, largely along the more developed eastern coastal regions. Other challenges include regional differences in language, autonomous local governments, and inadequate infrastructure. Yet, many companies have succeeded in China, including Coca-Cola, General Motors, McDonald’s, Motorola, Airbus, and Volkswagen. Wal-Mart saved immense sums by sourcing over $30 billion of merchandise from China in 2007. Success in China requires a deep understanding of the market and long-term commitment. The country holds huge long-term potential for firms that take the time and invest the resources to succeed there.

Emerging markets are attractive to internationalizing firms as target markets, manufacturing bases, and sourcing destinations.

**Emerging Markets as Target Markets**

Emerging markets have become important for marketing a wide variety of products and services. The growing middle class in these countries implies substantial demand for a variety of consumer products such as electronics and automobiles and services such as health care. For example, roughly a quarter of Mexico’s 105 million people enjoy affluence equivalent to many in the United States. Businesses in these countries also demand technology and equipment. Exports to emerging markets account for one-third of total merchandise exports from the United States. The largest emerging markets have doubled their share of world imports in the last few years.

Emerging markets are excellent targets for manufactured products and technology. For example, the textile machinery industry in India is huge, oil and gas exploration plays a vital role in Russia, and agriculture is a major sector in China. Emerging markets are also home to various niche markets. For example, Lockheed Aircraft, whose Hercules turboprop is a popular airliner in poorer countries, has developed transport planes that carry bulk commodities at relatively low costs. Novartis and Pfizer are pharmaceutical firms that reap big profits from selling vaccines and medicines that can be stored without refrigeration when shipped to distant markets. Airbus Industries is a leading commercial aircraft manufacturer based in Europe. It has developed a double-decker plane for both passengers and cargo, targeted to increasing traffic between advanced and emerging markets. For various products and services, demand is growing fastest in emerging markets. For example, for power tool companies like Black & Decker and Robert Bosch, the fastest-growing markets are in Asia, Latin America, Africa, and the Middle East.10

Finally, governments and state enterprises in emerging markets are major targets for sale of infrastructure-related products and services such as machinery, power transmission equipment, transportation equipment, high-technology products, and other products that countries in the middle stage of development typically need.

**Emerging Markets as Manufacturing Bases**

Emerging markets have long served as platforms for manufacturing by MNEs. Firms from Japan, Europe, the United States, and other advanced economies have invested vast sums to develop manufacturing facilities in emerging markets. The reason is that these markets are home to low-wage, high-quality labor for manufacturing and assembly operations. In addition, some emerging markets have large reserves of raw materials and natural resources. As examples, Mexico and China are important production platforms for manufacturing cars and consumer electronics. South Africa is a key source for industrial diamonds. Brazil long has been a center for mining bauxite, the main ingredient in aluminum. Thailand has become an important manufacturing location for Japanese MNEs such as Sony, Sharp, and Mitsubishi. Motorola, Intel, and Philips manufacture semiconductors in Malaysia and Taiwan.
Emerging markets also enjoy considerable success in certain industries; for example, South Korea in electronics, semiconductors, and automobiles; Taiwan and Malaysia in personal computers; and South Africa in mining. Individual firms, including those highlighted in the opening vignette, have also become world class companies. Did you know, for example, that the world’s number three and four top-selling beer brands are produced by new global challengers based in Brazil (Skol, made by InBev) and Mexico (Corona, made by Grupo Modelo)? Together, these firms make more than 50 million barrels of beer annually. South Korea’s Samsung is already the world’s leading producer of semiconductors and flat screen TVs. It has displaced better-known MNEs in these industries in Japan and the United States, such as Sony and Motorola.

**Emerging Markets as Sourcing Destinations**

In recent years, companies sought ways of transferring or delegating non-core tasks or operations from in-house groups to specialized contractors. This business trend is known as *outsourcing*—the procurement of selected value-adding activities, including production of intermediate goods or finished products, from independent suppliers. Outsourcing helps foreign firms become more efficient, concentrate on their core competences, and obtain competitive advantages. When sourcing involves foreign suppliers or production bases, then the phenomenon is known as *global sourcing* or *offshoring.* Thus, *global sourcing* refers to the procurement of products and services from foreign locations. Procurement can be from either independent suppliers or company-owned subsidiaries. We dedicate Chapter 16 to global sourcing topics.

Emerging markets have served as excellent platforms for sourcing. For example, numerous MNEs have established call centers in Eastern Europe, India, and the Philippines. Firms in the IT industry such as Dell and IBM reap substantial benefits from the ability to outsource certain technological functions to knowledge workers in India. Intel and Microsoft have much of their programming activities performed in Bangalore, India. Investments from abroad benefit emerging markets as they lead to new jobs and production capacity, transfer of technology and know-how, and linkages to the global marketplace.

**Estimating the True Potential of Emerging Markets**

Estimating the true potential of market demand in emerging markets poses various challenges. Unique country conditions such as limited availability of data sources or reliability of information make it challenging for western firms to gather market insights. Carrying out market research may be more costly than in advanced economies. Often firms may have to improvise. To overcome these challenges, in the early stages of market research, managers emphasize three practical approaches to develop more reliable estimates of market potential. These relate to the use of per-capita income, size of middle-class, and market potential indicators.
**Per-capita Income as an Indicator of Market Potential**

When managers evaluate the market potential of individual markets, they often start by examining aggregate country data, such as gross national income (GNI) or per-capita GDP, expressed in terms of a reference currency, such as the U.S. dollar. The second column in Exhibit 9.7 provides per-capita GDP for a sample of emerging markets and the United States, for comparison purposes. For example, in 2007 China’s per-capita GDP converted at market exchange rates was $2,310, while that of the United States was $45,490.

However, per-capita GDP converted at market exchange rates paints an inaccurate picture of market potential because it overlooks the substantial price differences that exist between advanced economies and emerging markets. Prices are usually lower for a wide variety of products and services in emerging markets. As an example, a U.S. dollar exchanged and spent in China will buy much more than a dollar spent in the United States.

So what should managers do to accurately estimate market potential? The answer lies in using per-capita GDP figures adjusted for price differences. Economists estimate real buying power by calculating GDP statistics based on purchasing power parity (PPP). As you learned in Chapter 8, the PPP concept suggests that, in the long run, exchange rates should move toward levels that would equalize the prices of an identical basket of goods and services in any two countries. Since prices vary greatly among countries, economists adjust ordinary GDP figures for differences in purchasing power. Adjusted per-capita GDP more accurately represents the amount of products that consumers can buy in a given country, using their own currency and consistent with their own standard of living.

Now examine per-capita GDP, adjusted for purchasing power parity, for the same sample of countries in the third column in Exhibit 9.7. Note that a more accurate estimate of China’s per-capita GDP is $8,486—more than three times higher the per-capita GDP at market exchange rates. Compare the two figures for other countries as well. These estimates are a more realistic indicator of purchasing power of consumers in emerging and developing economies. This helps explain why firms increasingly target emerging markets despite the seemingly low income levels indicated in conventional income statistics.

### Exhibit 9.7

<table>
<thead>
<tr>
<th>Country</th>
<th>Per-capita GDP, Converted using market exchange rates (U.S.$)</th>
<th>Per-capita GDP, Converted using PPP exchange rates (U.S.$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>$6,278</td>
<td>$17,062</td>
</tr>
<tr>
<td>Brazil</td>
<td>6,220</td>
<td>9,531</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>4,704</td>
<td>10,677</td>
</tr>
<tr>
<td>China</td>
<td>2,310</td>
<td>8,486</td>
</tr>
<tr>
<td>Hungary</td>
<td>12,433</td>
<td>20,701</td>
</tr>
<tr>
<td>South Korea</td>
<td>19,485</td>
<td>25,403</td>
</tr>
<tr>
<td>Mexico</td>
<td>8,530</td>
<td>11,761</td>
</tr>
<tr>
<td>Russia</td>
<td>8,209</td>
<td>13,210</td>
</tr>
<tr>
<td>Turkey</td>
<td>5,882</td>
<td>9,629</td>
</tr>
<tr>
<td>United States</td>
<td>45,490</td>
<td>45,176</td>
</tr>
</tbody>
</table>

Source: International Monetary Fund, World Economic Outlook Database, April 2007, at www.imf.org
Another way to illustrate the PPP concept is to examine the Big Mac Index available at globalEDGE™ and developed by the Economist (www.economist.com). The Big Mac Index first gathers information on the price of hamburgers at McDonald’s restaurants worldwide. It then compares the prices based on actual exchange rates to those based on the PPP price of Big Macs to see whether a nation’s currency is under- or over-valued. The Index reveals that the currencies of most European countries (mainly the euro) are overvalued, while those for most developing economies or emerging markets are undervalued. If you are hungry for a Big Mac, go to China where you can get it for as little as 1.31 in U.S. dollars. You should avoid Norway, where the Big Mac will cost you 7.05 in U.S. dollars.

Even when adjusted for purchasing power parity, managers should exercise caution in relying on per-capita income as an indicator of market potential in an emerging or developing economy. There are four reasons for this caution.

First, managers must adjust the numbers for the existence of an informal economy—economic transactions that are not officially recorded and therefore left out of government calculations of a nation’s GDP. Yet, in developing economies, the informal economy is often as large as the formal economy. These countries typically lack sophisticated taxation systems for detecting and reporting commercial transactions. Individuals and businesses often underreport income to minimize tax obligations. In addition, barter exchanges do not involve monetary transactions and, therefore, are not captured by national estimates of GDP either. Second, the great majority of the population is on the low end of the income scale in emerging markets (and developing economies). As you would remember from your statistics training, ‘mean’ or ‘average’ does not accurately represent a non-normal distribution; often, the median or the modal income would reveal a better understanding. Third, household income is several times larger than per-capita income because of multiple wage earners in these countries. Multiple-income households naturally have much greater spending power than individuals. This fact is overlooked by statistics that emphasize per-capita GDP. Fourth, governments in these countries may underreport national income so they can qualify for low-interest loans and grants from international aid agencies and development banks.

In addition to per-capita GDP, managers should examine other market potential indicators including GDP growth rate, income distribution, commercial infrastructure, the rate of urbanization, consumer expenditures for discretionary items, and unemployment rate. Managers will also find the size and growth rate of the middle class to be revealing. Let’s explore this next.

### Middle Class as an Indicator of Market Potential

In every country, the middle class represents the proportion of people in between the wealthy and the poor. The middle class has economic independence and includes people who work in businesses, education, government, and hourly jobs. They consume many discretionary items, including electronics, furniture, automobiles, recreation, and education. Middle-class households make up the largest proportion of households in advanced economies. In emerging markets, the size and growth rate of the middle class serve as signals of a dynamic market economy.

Exhibit 9.8 provides data for a sample of emerging markets with relatively sizeable middle-class populations. For marketers of products and services, these countries are prime prospects. India and Indonesia rank at the very top, given their large populations. Note, however, the trade-off between various indicators. While India and Indonesia feature large middle-class populations in absolute terms, per-capita GDP in these countries is rather modest, especially when compared to South Korea, China, Russia, and Mexico. Note, however, that the percentage of income held by their middle classes is relatively high at 49 and 48 percent,
respectively. Contrast this to Brazil where the middle class citizens control only about 35 percent of national income. Demographic trends indicate that, in the coming two decades, the proportion of middle-class households in emerging markets will become much bigger, acquiring enormous spending power. As incomes increase, spending patterns will evolve, fueling growth across various product and service categories.

Use of a Comprehensive Index to Measure Market Potential

While a large and growing middle class points to a promising emerging market, with growing opportunities for internationalizing firms, managers should consider other indicators as well. Exhibit 9.9 presents one such comprehensive approach, the Emerging Market Potential Index (EMPI). The EMPI compares emerging market countries using factors that, together, provide managers of western firms with a realistic measure of export market potential.

What makes a good market? For emerging markets, the following dimensions serve as comprehensive indicators of market potential (For a detailed discussion of the EMPI methodology, see Cavusgil, 1997):

- **Market Size**: the country’s population, especially those living in urban areas.
- **Market Growth Rate**: the country’s real GDP growth rate.
- **Market Intensity**: private consumption and gross national income per capita represent discretionary expenditures of citizens.
- **Market Consumption Capacity**: the percentage share of income held by the country’s middle class.
- **Commercial Infrastructure**: characteristics such as number of mobile phone subscribers, density of telephone lines, number of PCs, density of paved roads, and population per retail outlet.
- **Economic Freedom**: the degree to which government intervenes in business activities.
- **Market Receptivity**: the particular emerging market’s inclination to trade with the exporter’s country as estimated by the volume of imports.
- **Country Risk**: the degree of political risk.
Managers can use the EMPI in several ways. First, they can use the rankings as an objective basis for prioritizing emerging markets in the course of planning international expansion. For example, using the data of Exhibit 9.9, a manager would conclude that China, Hong Kong, and Singapore represent highly attractive export markets. China has steadily risen in the Index in recent years, as well as the central European economies of the Czech Republic, Hungary, and Poland.

Second, online EMPI rankings are interactive, so users can rank markets on the basis on any of the eight dimensions making up the overall Index (see the EMPI at globalEDGE™). Third, managers can modify the assigned weights to fit the unique characteristics of their own industry. For example, in evaluating market size, food industry firms may attach more weight to market size, while firms in the telecommunications equipment industry may attach more weight to infrastructure and country risk. Fourth, managers may add additional indicators that are not currently included in the EMPI as a way of refining the tool for greater precision, or they may add additional countries beyond the emerging markets already represented in the Index.

**Exhibit 9.9** Emerging Market Potential Index, 2007

Note: Data for top 11 emerging markets are provided. For the full table, visit http://globaledge.msu.edu/resourceDesk/mpi.asp

SOURCE: globalEDGE™ at globaledge.msu.edu

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Emerging markets exhibit certain risks that affect their viability for international business. Let’s review the most common, and most detrimental, of these risks.

**Exhibit 9.9** Emerging Market Potential Index, 2007

Note: Data for top 11 emerging markets are provided. For the full table, visit http://globaledge.msu.edu/resourceDesk/mpi.asp

SOURCE: globalEDGE™ at globaledge.msu.edu
Political Instability

The absence of reliable or consistent governance from recognized government authorities adds to business costs, increases risks, and reduces managers’ ability to forecast business conditions. Political instability is associated with corruption and weak legal frameworks that discourage inward investment and the development of a reliable business environment. In Russia, for example, evolving political conditions threaten the business activities of foreign firms. Bureaucratic practices favor well-connected, home-grown firms. Western oil companies have been denied access to Russia’s energy resources. In the 2006 Ease of Doing Business rankings of the World Bank, Russia ranked 163rd in dealing with licenses; 159th in getting credit; and 143rd in international trade procedures (www.doingbusiness.org). These conditions have harmed foreign investor confidence.15

Weak Intellectual Property Protection

Even if they exist, laws that safeguard intellectual property rights may not be enforced, or the judicial process may be painfully slow. In Argentina, for example, enforcement of copyrights on recorded music, videos, books, and computer software is inconsistent. Authorities attempt to stop shipments of pirated merchandise, but have inadequate resources and slow court procedures that hamper enforcement. Laws against Internet piracy are weak and ineffective.16 Counterfeiting—unauthorized copying and production of a product—is common in China, Indonesia, and Russia, especially with software, DVDs, and CDs. In India, weak patent laws discourage investment by foreign firms.

Bureaucracy, Red Tape, and Lack of Transparency

Burdensome administrative rules, as well as excessive requirements for licenses, approvals, and paperwork, all substantially delay business activities. As an example, one of the biggest insurance firms, American International Group (AIG), formed a joint venture with the giant Indian conglomerate Tata, to enter India’s underserved $8 billion insurance market. Even with a strong local partner, it still took six years before the Indian government granted AIG permission to sell property and life insurance to Indians. For another example, the South Korean government enacted import barriers to protect the LG Group and other Korean firms from foreign competitors. Also, the Indonesian government granted an agricultural monopoly to its home-grown PT Bogasari, allowing it to become one of the world’s biggest producers of instant noodles.

Excessive bureaucracy is usually associated with lack of transparency, suggesting that legal and political systems may not be open and accountable to the public. Bribery, kickbacks, and extortion, especially in the public sector, cause difficulty for managers. Where anti-corruption laws are weak, managers may be tempted to offer bribes to ensure the success of business deals. In Transparency International’s ranking of the most corrupt countries, emerging markets such as Argentina, Indonesia, and Venezuela are among the countries that experience substantial corruption.17

Partner Availability and Qualifications

Foreign firms need to seek alliances with local companies in countries characterized by inadequate legal and political frameworks. Through local partners, foreign firms can access local market knowledge, establish supplier and distributor networks, and develop key government contacts. Qualified partners
that can provide these advantages are not readily available in emerging markets. Especially smaller emerging market countries will have few well qualified business partners that foreign firms can retain as distributors or suppliers.

**Dominance of Family Conglomerates**

Many emerging market economies are dominated by family-owned rather than publicly-owned businesses. A family conglomerate (FC) is a large, privately-owned company that is highly diversified. Their businesses range from manufacturing to banking to construction. FCs control the majority of economic activity and employment in emerging markets like South Korea, where they are called chaebols, India where they are called business houses, Latin America where they are called grupos, and Turkey where they are called holding companies. A typical FC may hold the largest market share in each of several industries in its home country. In South Korea, the top 30 FCs account for nearly half the assets and industry revenues in the Korean economy. Samsung, perhaps the most famous Korean FC, has annual revenues of $140 billion. In Turkey, the Koc Group accounts for about 20 percent of trading on the Istanbul Stock Exchange, and Sabanci provides over five percent of Turkey's national tax revenue. FCs enjoy various competitive advantages in their home countries, such as government protection and support, extensive networks in various industries, superior market knowledge, and access to capital. For example, Hyundai Group was an early mover in South Korea's auto industry and now holds the largest share of the country's car market. When foreign automakers tried to enter the market, they found Hyundai's advantages overwhelming.

The origin and growth of FCs are partly attributable to their special relationships with the government, which often protects FCs by providing subsidies, loans, tax incentives, and market entry barriers to competitors. In some emerging markets, the government may even launch the FC, as in the case of Siam Cement Group in Thailand. One of the largest FCs in Indonesia, the Bimantara Citra Group, got its start by selling its foreign oil allocations to the state-owned oil monopoly. The Group has long enjoyed a close relationship with the Indonesian government and secured numerous lucrative contracts. When the Hyundai Group in South Korea experienced a financial crisis, the Korean government and Hyundai's major creditors provided over $300 million in assistance, including credit extension and short-term loans. FCs provide huge tax revenues and facilitate national economic development, which explains why governments are so eager to support them.

The fact that FCs dominate the commercial landscape in many emerging markets suggests they will be either formidable competitors or capable partners (possibly with much bargaining power). We return to this issue in the next section.

**Strategies for Doing Business in Emerging Markets**

Different market conditions abroad compel companies to devise unique approaches. For example, Toyota markets simple, low-cost car models in various low-income countries. In India, Toyota has built a large factory and aims to boost its share of the India car market to 10 percent by 2010. The “ultra-low-cost” vehicles carry a price tag of roughly $7,000. Meanwhile, General Motors is building low-cost cars targeted to emerging markets such as China, India, and Russia. Renault, Volkswagen, and other big carmakers are following suit. In this section, we discuss three strategies that firms employ to succeed in emerging markets.
Partnering with Family Conglomerates

As we discussed, family conglomerates are key players in their respective economies and have much capital to invest in new ventures. For example, most major FCs in Korea, as well as Koc and Sabanci in Turkey, Vitro in Mexico, and Astra in Indonesia, own their own financing operations in the form of insurance companies, banks, and securities brokers. Many FCs possess extensive distribution channels throughout their home countries. They have a deep understanding of local markets and customers.

For foreign firms that want to do business in emerging markets, FCs can make valuable venture partners. By collaborating with an FC, the foreign firm can:
1. reduce the risks, time, and capital requirements of entering target markets;
2. develop helpful relationships with governments and other key local players;
3. target market opportunities more rapidly and effectively;
4. overcome infrastructure-related hurdles; and
5. leverage FC’s resources and local contacts.

There are many examples of successful FC partnering. Ford partnered with Kia to introduce the Sable line of cars in South Korea. Ford benefited from Kia’s strong distribution and after-service network. Digital Equipment Corporation (DEC) designated Tatung, a Taiwanese FC, as the main distributor of its workstations and client-server products in Taiwan. DEC benefited from Tatung’s local experience and distribution network. In Turkey, Sabanci entered a joint venture with Danone, the French yogurt producer and owner of the Evian brand of bottled water. Danone brought ample technical knowledge in packaging and bottling, and a reputation for healthy and environmentally friendly products, but it lacked information on the local market. As the Turkish market leader, Sabanci knows the market, retailers, and distributors. The collaboration helped make Danone the bottled water market leader in the first year.

Marketing to Governments in Emerging Markets

In emerging markets, as well as in developing economies, government agencies and state-owned enterprises are an important customer group for three reasons: First, governments buy enormous quantities of products (such as computers, furniture, office supplies, and motor vehicles) and services (such as architectural, legal, and consulting services). Second, state enterprises in areas such as railways, airlines, banking, oil, chemicals, and steel buy goods and services from foreign companies. Third, the public sector influences the procurement activities of various private or semi-private corporations. For example, in India the government is directly involved in planning housing projects. Construction firms lobby the government to gain access to promising deals to build apartments and houses for local dwellers.

Emerging market governments regularly announce tenders—formal offers made by a buyer to purchase certain products or services. Tender is also known as a request for proposals (RFPs). Government agencies seek bids from suppliers to procure bulk commodities, equipment, and technology or to build power plants, highways, dams, and public housing. Vendors submit bids to the government to work on these projects.

Governments in emerging markets as well as developing countries often formulate economic development plans and annual programs to build or improve national infrastructure. To
find vendors, the government follows specific buying procedures that lead to large, lucrative sales to international vendors. Securing major government contracts usually requires substantial competencies and resources. Firms competing for such projects assemble a team of managers and technical experts, especially when pursuing large deals. Governments prefer dealing with vendors that offer complete sales and service packages. The most successful vendors also offer financing for major sales, in the form of low-interest loans or grants. Governments are attracted by deals that create local jobs, employ local resources, reduce import dependence, and provide other country-level advantages.

Bechtel, Siemens, General Electric, Hitachi, and other major vendors regularly participate in bidding for global tenders from emerging market governments. Some of the largest construction projects include the Panama Canal expansion and the channel tunnel between France and the United Kingdom. Another mega project, the Three Gorges Dam on the Yangtze River in China, is expected to cost about $25 billion when completed. It will be the largest hydroelectric dam in the world. Six groups of global contractors have been involved in this project, including ABB, Kvaerner, Voith, Siemens, and General Electric. The dam is expected to be fully operational in 2009, following 16 years of construction.

Skillfully Challenge Emerging Market Competitors

As the opening vignette shows, the new global challengers possess various strengths that make them formidable competitors in the global marketplace. Advantages such as low-cost labor, skilled workforce, government support, and family conglomerates are fostering the rise of firms that are capturing market share from incumbent international players. For example, the global farm equipment industry long has been dominated by venerable names such as John Deere and Komatsu. Recently, however, India’s Mahindra & Mahindra has been grabbing market share with brands such as the Mahindra 5500, a powerful, high-quality tractor that sells for far less than competing models. One dealership in the state of Mississippi—a market long dominated by John Deere—sold more than 300 Mahindras in just four months.²²

Advanced economy firms can counter in various ways. Initially, managers must conduct research to develop an understanding of the new challengers. It is critical for managers to analyze the advantages of the emergent firms and how they can transform the incumbent’s industry. The next step is to acquire new capabilities that improve the firm’s competitive advantages. For example, many incumbents are boosting their R&D to invent new, superior products. Others are partnering with competitors in order to pool resources against emerging market rivals. Incumbent firms can also match new global challengers at their own game by leveraging low-cost labor and skilled workers in locations such as China, India, Mexico, and Eastern Europe. Many advanced economy firms partner with family conglomerates and others in emerging markets on critical value-chain activities such as R&D, manufacturing, and technical support.
Catering to Economic Development Needs of Emerging Markets and Developing Economies

In recent years, internationalizing firms have become increasingly more involved in activities that help to facilitate economic development in emerging markets and developing economies. The most important of these trends are: (1) fostering economic development with profitable modernization projects, and (2) facilitating entrepreneurship through small-scale loans. Such efforts are a form of corporate social responsibility because they help developing economies grow. In most cases they make good business sense, too.

Fostering Economic Development with Profitable Projects

International firms increasingly recognize that serving buyer needs in poor countries can be profitable. Historically, few firms targeted such countries because managers assumed there were few profitable opportunities. In reality, if firms market appropriate products and employ suitable strategies, doing business in emerging markets and developing economies can be profitable. Companies formulate innovative solutions to succeed in markets with limited spending power. For example, Unilever and P&G sell Sunsilk and Pantene shampoo in India for less than $0.02 per mini-sachet. Narayana Hrudayalaya is an Indian insurance provider that sells health insurance for less than $0.20 per person per month in India. It has signed up millions of customers. Amul, one of India’s largest processed-food firms, sells a wide range of food products to millions of poor people. Such firms had to devise new business models—manufacturing, packaging, distribution, and market reach—to be profitable, but they have succeeded in profitably serving countless customers.

Consider the case of Africa, where estimates indicate there are fewer telephone lines than in New York City. Between 1998 and 2004, however, the number of mobile-phone users in Africa grew to 81 million—the fastest growth worldwide. The phones were supplied by such firms as Ericsson, the Swedish telecom. Ericsson helped modernize the telecom infrastructure in rural parts of Tanzania. The firm installed phone lines and cellular systems that facilitate not only the communication needs of households and businesses, but also those of non-governmental organizations and other aid agencies. The emergence of a significant cell phone market in Africa led to the development of related industries and the launch of local firms that produce accessories, such as devices for recharging cell phone batteries.

Ericsson’s experience suggests that market-based solutions not only contribute to social and economic transformation, but can be profitable as well. This company has skillfully turned modernization projects into profitable operations in emerging markets. Ericsson also modernized much of Russia’s antiquated phone systems; installed Hungary’s digital telephone system, in partnership with local government; and was instrumental in expanding Vietnam’s telecommunications network, in sales financed by the World Bank. Collaborating with government agencies and state-owned enterprises provides...
firms with competitive advantages when entering emerging markets. In India, Ericsson manufactures optical fiber cables in partnership with the Birla Group, one of India’s largest family conglomerates. Ericsson entered joint ventures in Russia to navigate a tough market characterized by poor business infrastructure and significant risk.

Advanced economy firms that invest in developing economies and emerging markets support the development of infrastructure in transportation, communications, and energy systems. Firms create jobs and contribute to regional and sector development. Investment generates local tax revenues, which can be spent to improve living standards among the poor. Transferring technology and know-how promotes local innovation and enterprise. Many firms develop community-oriented social programs that foster economic and social development. For example, Novartis and Microsoft used portions of their profits to create programs in developing economies that improve living standards, reduce poverty, encourage dialog on development policy, and drive research on development concerns such as healthcare and infrastructure.

**Microfinance to Facilitate Entrepreneurship**

Microfinance refers to providing small-scale financial services, such as “microcredit” and “microloans,” which assist entrepreneurs to start businesses in poor countries. By providing small loans, frequently less than $100, small-scale entrepreneurs accumulate sufficient capital to launch businesses that help pull them out of poverty. This concept led economics professor Muhammad Yunus to found the Grameen Bank in Bangladesh in 1974. Since then, millions of Grameen borrowers in Bangladesh have risen out of acute poverty. Aspiring entrepreneurs use the small loans to buy everything from cows that produce milk to sell in markets, to mobile phones that villagers can rent to make calls. The majority of microloan recipients are women.

Today, the World Bank estimates there are more than 7,000 microfinance institutions, serving some 16 million poor people in developing economies. The Grameen Bank now has over 2,100 branches. The Bank has spun off 17 microfinance organizations in China alone. Thanks to the success of microfinance, Yunus was awarded the 2006 Nobel Peace Prize. Grameen Bank has inspired similar efforts in dozens of poor countries worldwide, often sponsored by philanthropic organizations such as the Bill and Melinda Gates Foundation and the Omidyar Network.

Ordinary banks do not loan money to startup entrepreneurs because such individuals lack collateral, steady employment, and a verifiable credit history. Microfinance gets around traditional practice, enabling impoverished people to develop small businesses that allow them to build wealth and exit poverty. Proponents point to how a small amount of money can have a dynamic, ripple effect on many lives in a village. They argue that microfinance might be the most effective way to tackle global poverty, bringing better lives to millions of people.

Over time, microfinance has gained credibility in the mainstream banking industry as a source of future growth. Various organizations now offer other forms of small-scale financial services, including insurance and mortgage lending in poor countries worldwide. In Mexico, Cemex’s *Patrimonio Hoy* program has widened access to cement and other building materials by organizing low-income customers into groups of three families that monitor each other’s progress in constructing their own homes and collectively paying off debts at regular intervals. *Patrimonio Hoy* and other Cemex programs have made home ownership a reality for tens of thousands of low-income Mexican families.
Arcelik: International Aspirations of an Emerging Market Firm

Arcelik is a Turkish appliance manufacturer with 16,000 employees and sales of around $4 billion per year. The company is controlled by the Koc Group, Turkey’s largest and most prestigious family conglomerate. Arcelik has over 100 home appliances in its product line. Since its founding in 1955, Arcelik has sold more than 75 million appliances, including air conditioners, dishwashers, washing machines, cooking appliances, and refrigerators. Arcelik produces more than half of Turkey’s consumer durables, under brand names such as Beko, Altus, and Arcelik. As trade barriers declined in the 1980s and 1990s, several competitors from Europe entered the Turkish market, threatening Arcelik’s market share. Arcelik management began to view its home market as too small and launched a plan for aggressive international expansion.

Turkey is an emerging market and has applied for membership in the European Union. Over 50 percent of Turkey’s 71 million residents are under age 25. There are roughly 15 million households with an average family size of four. The younger population drives higher marriage rates, approximately 500,000 annually, which drives demand for household goods. Urbanization is increasing—people are moving to the cities to improve their living standards. Relatively low saturation levels of domestic brands promise strong annual growth in the market, significantly higher than in advanced economies. Turkey’s average per-capita income is relatively low; $9,600 in 2007. Purchasing power outside urban areas like Istanbul, Ankara, Izmir, Bursa, and a handful of other cities is still very low.

The Global Household Appliance Industry

Consumers tend to view home appliances as commodities, and often value low prices over brands and features. Some home appliances, such as dishwashers and cooking equipment, carry smaller profit margins. The average life span of a major appliance is 10 to 15 years. To lower manufacturing costs, firms attempt to standardize the materials, parts, and components used to make appliances, and devise similar manufacturing processes. Manufacturing plants are becoming more automated, and the use of low-cost labor is advantageous only in the short run.

To be able to charge premium prices and increase profit margins, some appliance makers differentiate their products by incorporating innovative, value-added technology and distinctive features. However, innovation is costly. Offering appliances with the latest high-tech features requires frequent changes in production methods and regular re-training of factory workers. Passing higher prices on to customers is difficult due to substantial competition and the low spending power of buyers in emerging markets.

In the advanced economies, the household appliance industry is mature and most markets are saturated. There are many global competitors, such as BSH, Electrolux, General Electric, Haier, Merloni, National, and Whirlpool. Intense competition has triggered widespread industry consolidation. Mergers and acquisitions have created several large firms that have forced out smaller independent players. For example, where once some 400 appliance producers operated in Europe, today only five companies control over 70 percent of the market.

Although major appliance manufacturers began to globalize in the 1990’s, most continued to market products specifically suited to individual markets. Because of differences in cultural, legal, technical, and economic variables, manufacturers cannot market the same products across all of Europe, North America, South America, and Asia. For example, in India, consumers prefer washing machines that offer superior cleaning power at a low price. Consumers in China and Latin America have low spending power, but still want to buy popular models with ample features. In Europe, Arcelik must contend with strict environmental rules that regulate the amount of electricity and water that washers can use. Some markets prefer front-loading models, while others emphasize top-loading models.

Increasingly, appliance firms emphasize smart business strategies. Because “hard” factors such as tooling, equipment, factory layout, materials procurement, and design do not provide a long-term competitive edge, appliance makers emphasize dynamic “soft” factors, such as innovative use of information technology, in order to achieve competitive advantages.

Market research reveals that the distribution of sales in the global household appliance industry is approximately: 34 percent for Asia/Pacific, 24 percent for Western Europe, 23 percent for North America, and 19 percent for other regions. The table on the next page indicates total sales of household appliances in millions of units. As you can see, sales prospects are especially favorable in the Asia/Pacific region, where ongoing industrialization, high population, and rising incomes promise appliance firms attractive opportunities. Latin America also offers strong growth potential due to ongoing industrialization and urbanization. Above-average gains are also expected in most of Eastern Europe and the Africa/Mideast region.
Arcelik's Aspiration:
To Become a Global Player

In Europe, Whirlpool is the market leader in home laundry appliances. Electrolux is the leader in refrigerators and vacuum cleaners, and BSH is the leader in dishwashers. Outside Turkey, Arcelik’s biggest markets are in Europe. Arcelik first established the Beko brand of appliances and TV sets in Britain in the 1990s. The firm gradually expanded into France, Germany, and Spain. In the early 2000s, Arcelik purchased well-known local European brands Blomberg (a subsidiary of Brandt) and Grundig in Germany, Elektra Bregenz and Tirolia in Austria, as well as Leisure and Flavel (appliances and TV sets) in Britain. In Romania, Arcelik acquired Arctic (washing machines, ranges, and TV sets), and immediately invested to modernize the company’s operations and double its productive capacity. In 2005, the firm built a refrigerator and washing machine manufacturing plant in Russia and established sales subsidiaries in the Czech Republic, Hungary, and Italy.

Arcelik is advantaged through its knowledge of how to produce products for lower-income countries. Manufacturing plants in Turkey and Eastern Europe allow Arcelik to produce appliances less expensively than some competitors. Arcelik aims to become a leading player worldwide. One challenge is that Arcelik's brands are largely unknown outside Europe. Brand image acts as a barrier to entry and could reduce the likelihood of short-run success. Arcelik's competitors rely on both local and regional brands. Regional brands are distinguished by decades of tradition and a high degree of consumer awareness. Both local and regional brands are tailored to meet customer needs in their respective countries or regions.

To better manage sales and service, the firm established distribution centers throughout Europe, Arcelik has an unparalleled distribution network of roughly 1,700 Arcelik dealers and Beko dealers, as well as approximately 1,700 non-exclusive agents. The network is valuable because geographic reach is critical in maintaining market leadership, and few firms can afford to build such as extensive dealership network. Arcelik also boasts a strong after-sales service network with 530 authorized service shops.

Arcelik has embraced information technology (IT) to help reduce costs and facilitate its international ambitions. Cisco aided Arcelik’s e-transformation by supplying the underlying networking technology that supports the firm’s key business applications. Arcelik has created a virtual networked organization online, where information and knowledge flow not only internally but also externally to business partners such as sales outlets and service centers. All of the firm’s suppliers are connected over an extranet, with access to key ordering and product information. This innovative use of information technology saves the firm millions of dollars annually.

The Future

Arcelik aims to sustain continuous growth in the global marketplace and become a leading, global household appliances company. To achieve this goal, management needs to improve operational efficiency to levels that match or exceed major competitors, and increase investment in high-growth markets. Arcelik sees its best prospects in emerging, fast-growing markets in Eastern Europe, Asia, and Latin America. The firm’s success will depend on lowering operating costs in manufacturing, leveraging low-cost manufacturing platforms and information technology, and producing products that appeal to foreign markets.

AACSB: Reflective Thinking, Ethical Reasoning

Case Questions

1. Arcelik has been very active in Western Europe. Do you expect Arcelik’s prospects to be better in emerging market and developing economies than in advanced economies? In what ways are emerging market and developing economies attractive to Arcelik? In general terms, how can the firm reap benefits from such markets in order to maximize company performance?

2. Arcelik management is keen on entering some emerging market or developing economies. What types of risks and challenges does Arcelik likely face in doing business in emerging markets? What should management do to identify the most promising markets? How should the firm adapt its products?
3. Originating from an emerging market, Arcelik may be better poised to cater to the economic development needs of emerging market and developing economies. In what ways can Arcelik skillfully fulfill its corporate social responsibility in such countries? Suggest specific approaches that may include: developing simpler, less expensive appliances; arranging for multiple installment purchases; encouraging the development of local suppliers; and designing products that conserve water and energy.

This case was prepared by Professor Zumrut Ecevit Sati of Celal Bayar University, Turkey, and Goksel Yalcinkaya of Michigan State University, under the direction of Professor S. Tamer Cavusgil.


CHAPTER ESSENTIALS

Key Terms

- advanced economies, p. 256
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- emerging markets, p. 257
- family conglomerate, p. 272
- global sourcing, p. 266
- new global challengers, p. 262
- outsourcing, p. 266
- privatization, p. 261
- tenders, p. 273
- transition economies, p. 261

Summary

In this chapter, you learned about:

1. The distinction between advanced economies, developing economies, and emerging markets

Advanced economies are post-industrial countries characterized by high per-capita income, highly competitive industries, and well-developed commercial infrastructure. They consist primarily of post-industrial societies of Western Europe, Japan, the United States, Canada, Australia, and New Zealand. The developing economies represent low-income countries that have not yet industrialized. Due to low buying power and limited appeal to foreign firms, their participation in international business is limited. The emerging markets are former developing economies well on their way to becoming advanced economies. Located mainly in Asia, Eastern Europe and Latin America, emerging markets are transforming themselves into market-driven economies by liberalizing trade and investment policies, privatizing industries, and forming economic blocs. Brazil, Russia, India, and China are examples of large emerging markets.

Transition economies are a subset of emerging markets that have transitioned from centrally planned economies into liberalized markets. Privatization refers to the transfer of state-owned industries to private concerns. New global challengers are top firms from rapidly developing emerging markets that are fast becoming key contenders in world markets.

2. What makes emerging markets attractive for international business

First, emerging markets represent promising export markets for products and services. Second, they are ideal bases for locating manufacturing activities. Low labor costs have made emerging markets major suppliers of a variety of manufactured products to the rest of the world. Finally, emerging markets are popular destinations for global sourcing—procurement of products and services from foreign locations. Procurement can be from either independent suppliers or company-owned subsidiaries. Sourcing from
foreign suppliers has been a steadily increasing activity among firms due to the popularity of outsourcing—procurement of select value-adding activities, including production of intermediate goods or finished products, from independent suppliers.

3. Estimating the true potential of emerging markets
Special considerations must be taken into account to estimate the true demand in emerging markets. Managers can follow one of three approaches to more realistically assess emerging market potential. They can: rely upon per-capita income, considered the size and growth rate of the middle class, and build a more comprehensive set of indicators such as the Emerging Market Potential Index.

4. Risks and challenges of doing business in emerging markets
Emerging markets pose various risks. Political instability, inadequate legal and institutional frameworks, lack of transparency, and inadequate intellectual property protection are among the factors that add to the cost of doing business. Another complication arises from the prevalence in the emerging markets of family conglomerates—large, diversified, family-owned businesses. These firms dominate the respective economies and represent either formidable rivals or attractive choices for partnerships.

5. Strategies for doing business in emerging markets
Firms aspiring to do business in emerging markets need to adapt strategies and tactics to suit unique conditions. These countries are ripe for global sourcing and as export and direct investment destinations. Some firms succeed in these markets by partnering with family conglomerates. Governments are often major buyers in emerging markets. Selling to government agencies involves responding to a tender, a formal request for suppliers to bid on projects. Firms from advanced economies follow various approaches to skillfully challenge emerging market competitors.

6. Catering to economic development needs of emerging markets and developing economies
Leading firms display good corporate social responsibility by engaging in activities that facilitate economic development in emerging market and developing economies. Firms can serve low income countries with inexpensive, specifically-designed products and services, and community involvement. Microfinance, emergence of financial institutions that serve emerging-market entrepreneurs with small-scale loans, has already made a big difference in terms of promoting entrepreneurial initiatives by start up companies.

Test Your Comprehension AACSB: Reflective Thinking, Ethical Reasoning

1. What are advanced economies, developing economies, and emerging markets? What are the major distinctions among these three country groups?

2. Explain the major reasons why firms would want to do business in emerging markets. What makes these markets attractive?

3. How can managers examine the true market potential of emerging markets?

4. Describe the various risks and challenges that managers encounter in emerging markets.

5. What is a family conglomerate (FC)? How are FCs different from publicly owned companies? What role do FCs play in emerging markets?

6. Describe the process for selling to foreign governments and state enterprises.

7. Doing business in emerging markets involves strategies that are often distinct from those of other international venues. What types of business approaches can firms use when doing business in emerging markets?

8. How can firms show corporate social responsibility in emerging markets and developing economies?
Apply Your Understanding  

**AACSB: Communication, Reflective Thinking**

1. Auto Ornaments Ltd., is a firm that makes accessories for cars, such as seat covers and window tinting. The firm has never conducted any international business. The general manager, Steve Diesel, would like to expand into foreign markets. He heard that roughly three quarters of the world’s people live in developing economies and emerging markets. He figures there must be a big market in those countries for Auto Ornaments products. What should Steve know about the characteristics of developing economies and emerging markets that make them attractive targets, and unattractive targets, for Auto Ornaments. Make a recommendation to Steve on the advantages and disadvantages of entering these markets. Be sure to justify your answer.

2. Suppose you work at Microsoft in their Xbox video game console division. Microsoft has long targeted Xbox to the advanced economies, especially in North America and Europe. Management would like to sell more Xbox 360’s to emerging markets. What are the main characteristics of emerging markets that might make them potentially good markets for Xbox? Identify the major risks and challenges that Microsoft might encounter in selling the Xbox 360 to emerging markets.

3. CBKing has been trying to export its products to various emerging markets and has enjoyed little success so far. You know a lot about emerging markets and have been anxious to share your views with CBKing’s president, Mr. Roger Wilko. What strategies would you recommend Roger pursue in doing business with emerging markets? You conclude there should be some demand in the military and the government agencies. Explain how your firm should go about selling to emerging market customers.
**AACSB: Analytical Skills, Reflective Thinking**

Refer to Chapter 1, page 27, for instructions on how to access and use globalEDGE™.

1. The World Bank sponsors the Doing Business database (www.doingbusiness.org/), which provides measures of business regulations and their enforcement in 175 countries. Firms can use these measures to analyze specific regulations that enhance or constrain investment, productivity, and growth. Visit the site and choose two emerging markets. Then answer the following questions: (a) How well does each country rank in terms of ease of starting a business, employing workers, and trading across borders? (b) How long does it take to start a business? (c) How much time does it take to pay taxes? (d) Review other statistics and identify which country is most friendly for doing business.

2. Using globalEDGE™, find the “country commercial guide” for two emerging markets of your choice. Compare the two countries on the following dimensions: “leading sectors for exports and investment” and “marketing products and services.” (a) Which of the two countries is more promising for marketing laptop computers? (b) Which of the two countries is promising for sales of portable electrical power generators? (c) Which of the two countries is promising for sales of telecommunications equipment?

3. The three groups of countries we studied in this chapter can also be contrasted in terms of degree of economic freedom. Economic freedom refers to the extent to which economic activities in a nation can take place freely and without government restrictions. The Heritage Foundation provides an Index of Economic Freedom (http://www.heritage.org) that considers such factors as trade policies, extent of government intervention, monetary and fiscal policies, inward foreign direct investment, property rights, and infrastructure for banking and finance. Countries are classified into various categories including ‘free,’ ‘mostly free,’ ‘mostly unfree’ and ‘repressed.’ How are emerging market and developing economies classified? What seems to be the overall relationship between market liberalization and economic development?
Emerging markets are rapidly industrializing and dynamic economies. When companies decide to do business in emerging markets, the first important step is to identify the most attractive countries to enter. This involves comparing almost 30 countries across various criteria.

Managerial Challenge
Each emerging market has its own distinctive characteristics. Managers must determine which markets to enter and learn about the characteristics of those markets. Such knowledge helps managers to avoid wasting organizational resources, and to maximize the firm’s profits and competitive advantages.

Background
Emerging market countries have transformed their economies into dynamic and progressive markets. Among other things, we witness in these countries: robust private sector activity and entrepreneurship, liberalization of trade and investment, rapidly improving living standards, and a growing middle class with rising economic aspirations. Dynamic changes in these societies also make it difficult for the manager to assess their current market potential.

Managerial Skills You Will Gain
In this C/K/R Management Skill Builder©, as a prospective manager, you will:

1. Learn how to increase prospects for enhancing company performance by targeting an important group of foreign markets—emerging markets.

2. Learn about critical factors to consider when targeting emerging markets.

3. Access key information sources related to emerging markets.

4. Analyze disparate data to arrive at recommendations.

Your Task
Assume that you are a product manager of a firm that makes and markets cordless telephones. Your task is to analyze factors in leading emerging markets and choose the best one to target with exports of your product. You may also investigate information sources on the evolving status of emerging markets.

Go to the C/K/R Knowledge Portal©
www.prenhall.com/cavusgil
Proceed to the C/K/R Knowledge Portal© to obtain the expanded background information, your task and methodology, suggested resources for this exercise, and the presentation template.