ONE An Overview of Emerging Markets

Introduction

Economic and political developments are rapidly transforming our world and prompting us to consider more global perspectives. Social and cultural changes are helping us renegotiate our identities as well as our values, shaping our vision of the future. Communication and information technologies continue to shrink geographical distances and put more of the world's knowledge at our fingertips. Undoubtedly, the challenges ahead of us will be formidable, but the opportunities in a globalizing world are simply too great to ignore. Our potential to succeed in this exciting environment will depend on our ability to recognize and act on these opportunities.

Over the next two decades, most of the world's growth is expected to occur in today's emerging markets (EM). Many countries which were associated with high levels of volatility and risk have now liberalized and reformed. Once thought of as backward and 'low tech', these countries are now rapidly transforming their economies. By adopting new technologies and production techniques, countries such as China, Brazil and India have become important locations for production. As purchasing power continues to increase with development in these countries they are becoming important consumer markets as well. Parallel to the rapid growth, they are also increasingly becoming competitors. While developed countries are faced with limited growth options and high costs of production, emerging markets are growing rapidly and at a faster pace. Thus, in the 21st century, the focus of international business has shifted towards analysing emerging markets, and identifying opportunities within these markets. Table 1.1 summarizes the changes in the emerging market environment in the past decade.

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Table 1.1 Trends in emerging markets

Developing countries (prior to 2000)	Emerging markets (2000 and beyond)
High risk for foreign business	Risks are increasingly manageable
Economically and technologically backward	Technologically competitive
Consumers had poor purchasing power	Increasing purchasing power among consumers
Few opportunities for business	Offer many opportunities, as large untapped markets and low-cost, high-quality sources
Unpredictable growth patterns	Higher income growth than developed nations

For Western managers struggling to sustain growth, cut costs and launch new products and industries, emerging markets can be an ideal answer. With literacy and education levels rising, skilled labour in these countries is relatively inexpensive. Over the next several years, millions of new consumers in these emerging markets will desire and be able to afford Western goods. Western firms can even enhance their capabilities in new markets. The old notion that developing countries are inherently risky for foreign businesses is no longer true. Conditions are continuing to stabilize, and our ability to predict and manage these risks has improved. Many factors have led to an increased focus on emerging markets in international business. The key factors are as follows:

1. Market potential is no longer too small for marketing efforts. Maximum population growth and infrastructure development rates are predicted for emerging economies. The size of the market is huge as over 80% of the world population resides in emerging markets and cannot be ignored.
2. Many emerging economies are investing in infrastructure development, especially in transportation, power and communication. This has helped bring down the costs of selling in emerging markets.
3. Though some emerging markets have highly differentiated structures, the demand forecast has become easier, with professional consulting and advertising organizations established in most of these markets.
4. Many emerging economies have developed or accessed technologies that have made them competitive on a global basis. More and more managers in emerging economies are training themselves with modern management tools and skills, and this has made production planning much simpler.

5 With governments in emerging economies providing full support for foreign investment, reaching business agreements is no longer a cumbersome process. Though intercultural differences remain in some countries, more and more managers have realized the value of creating global 'win–win' relationships and alliances. Many Western managers have started learning foreign languages and have a better understanding of foreign cultures. Also, many local managers have been educated in the West and have gained vast experience in dealing with Western firms and cultures.
6 The information revolution has made more and more information available about emerging economies, and business strategy formulation has become a lot easier.

What are Emerging Markets?

Terms such as 'developing markets', 'emerging markets' and 'rapidly industrializing nations' are often used interchangeably, which often leads to confusion in understanding what emerging markets are. The term 'emerging market' was first used by Antoine van Agtmael, an economist in the World Bank, at the end of 1980s, to refer to rapidly growing economies with rapid industrialization (Van Agtmael, 2007). The lists of emerging markets change rapidly as the markets included are often selected according to growth indicators and projections on an annual basis. The lists also vary between institutions, as they all use a varied range of indicators and different growth projections when creating their emerging market lists. Table 1.2 displays some examples of emerging market lists generated by different institutions.

Box 1.1 Who are Emerging Markets?

The FTSE index breaks down stock market indices according to their development level; accordingly, the advanced emerging countries are Brazil, the Czech Republic, Hungary, Mexico, Malaysia, Poland, South Africa, Turkey and Taiwan. The secondary emerging countries are Chile, China, Columbia, Egypt, India, Indonesia, Malaysia, Morocco, Pakistan, Peru, the Philippines, Russia, Thailand and the UAE (FTSE, 2012).

MSCI, a global provider of investment decision support tools, classifies the emerging markets of Brazil, Chile, Colombia, Mexico and Peru as part of the

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Americas; the Czech Republic, Egypt, Hungary, Morocco, Poland, Russia, South Africa and Turkey as within the Europe, Middle East and Africa region; and China, India, Indonesia, Korea, Malaysia, Taiwan and Thailand within the Asia region. This classification is based on the size of the companies, and market accessibility. With this framework, information such as market capitalization, openness to foreign ownership, efficiency of operational framework and the stability of the institutional framework is considered (MSCI, 2012).

Grant Thornton has created an index called the 'Emerging Markets Opportunity Index', using indicators such as GDP, size, population, international trade and future growth projections (Grant Thornton, 2010), while Goldman Sachs considers BRICs and other emerging markets, referring to the 'Next Eleven' as those economies which will grow rapidly in the 21st century, and their list consists of Bangladesh, Egypt, Indonesia, Iran, Mexico, Nigeria, Pakistan, the Philippines, South Korea, Turkey and Vietnam. This list is based on macroeconomic and political stability and openness to trade, as well as education levels (Wilson and Stupnytska, 2007).

Table 1.2 Who are emerging markets?

	FTSE	MSCI	S&P	Goldman Sachs	Grant Thornton
Algeria					x
Argentina					x
Bangladesh				x	x
Brazil	x	x	x	x	x
Chile	x	x	x		x
China	x	x	x	x	x
Colombia	x	x			x
Czech Republic	x	x	x		
Egypt	x	x	x	x	x
Hungary	x	x	x		x
India	x	x	x	x	x
Indonesia	x	x	x	x	x
Iran				x	x
Korea		x		x	
Malaysia	x	x	x		x
Mexico	x	x	x	x	x
Morocco	x	x	x		
Nigeria				x	x
Pakistan	x			x	x
Peru	x	x	x		x
Philippines	x	x	x	x	x
Poland	x	x	x		x
Romania					x

	FTSE	MSCI	S&P	Goldman Sachs	Grant Thornton
Russia	x	x	x	x	x
South Africa	x	x	x		x
Taiwan	x	x	x		
Thailand	x	x	x		x
Turkey	x	x	x	x	x
UAE	x				
Ukraine					x
Vietnam				x	x
Venezuela					x

Emerging markets are countries which are in a transition phase from developing to developed markets due to rapid growth and industrialization. Hence, markets which have (a) started an economic reform process aimed at alleviating problems, for example of poverty, poor infrastructure and overpopulation, (b) achieved a steady growth in gross national product (GNP) per capita, and (c) increased integration in the global economy, may truly be called EMs.

To differentiate between less developed and emerging markets, growth figures as well as increased levels of improvement in living standards may be considered. Commitment to sustained growth, continuous efforts to catch up with the industrialized nations and an increased presence in world trade distinguish between EMs and developing markets.

In discussions on EMs, the term 'BRIC' is often used. BRIC, as identified by Jim O'Neill of Goldman Sachs in a paper published in 2001 (O'Neill, 2001), stands for Brazil, Russia, India and China. These economies are the fastest growing and may potentially overtake the world's largest economies (Goldman Sachs, 2003). BRIC economies currently constitute 25% of the world's land mass and 42% of the population (Wilson et al., 2011b). The contribution of BRICs and other EMs to the global economy has been increasing rapidly. They are continually investing in education and technology, increasing foreign investments, and focusing on integrating themselves in the global economy as major players. For the purposes of this book, we have identified 11 countries in addition to the BRICs which have been growing steadily, industrializing rapidly, and becoming significant markets, investors, traders and producers within the global economy. These countries, which are shown in Table 1.3, will be referred to as 'New Frontier Economies' throughout this book (the selection criteria for this are summarized in

Table 1.3 BRICs and New Frontier Economies

	GDP ($ billion), 2009	GDP per capita, PPP ($) 2009	GDP growth (%) 2005-2009	Average GDP per capita growth (%) 2005-2009	Population (million), 2009	Investment inflow ($ billion), 2009	Urbanization
WORLD	58,259	10,686	8%		6775	1164	50%
Developed Countries							
Developed Countries	41,608	36,408	5%		1117	804	76%
Share Held by Developed Countries	71%				16%	69%	
USA	14,119	45,989	5%	2%	307	135	82%
Japan	5,069	32,418	3%	2%	128	12	67%
Germany	3,330	36,338	5%	4%	82	39	74%
France	2,649	33,674	7%	3%	63	60	78%
UK	2,175	35,155	1%	2%	62	73	90%
BRICs							
Brazil	1,594	10,367	25%	5%	194	26	86%
Russia	1,232	18,932	21%	13%	142	37	73%
India	1,377	3,296	18%	9%	1155	35	30%
China	4,985	6,828	27%	14%	1331	78	44%
Share Held by BRICs	16%				42%	15%	
New Frontier Economies							
Chile	164	14,311	14%	4%	17	13	88%
Egypt	188	5,673	25%	7%	83	7	43%
Indonesia	540	4,199	21%	7%	230	5	53%
Malaysia	193	14,012	12%	5%	27	1	71%
Mexico	875	14,258	4%	3%	107	14	78%
Pakistan	162	2,609	13%	5%	170	2	37%
Peru	130	8,629	17%	8%	29	5	72%
Phillipines	161	3,542	17%	5%	92	2	66%
South Africa	285	10,278	7%	5%	49	5	72%
Thailand	264	7,995	13%	4%	68	5	34%
Turkey	615	13,668	12%	6%	75	8	69%

Note 1). In the table, average growth rates of these economies within the period 2005–2009 highlight their increased contribution to world growth and further emphasize the potential of these countries in the future. The table also presents important indicators for selected advanced economies to enable comparison. In the table, PPP stands for purchasing power parity.

The Emerging Market Outlook

Recent developments in the global business environment have been unprecedented. Barriers to trade and investment have been reduced over the past decades and this trend is expected to continue as national economies further integrate. Markets have been increasingly liberalizing, especially following the collapse of the Soviet Union's economy, and India's and China's free market reforms. Developments in IT, which can mainly be identified as developments in communications and computing, have undeniably changed the business structure around the globe. Increased globalization of our economies has allowed technology and capital to become very mobile. As the cost of moving a segment of production elsewhere in the world has decreased substantially, production chains have been reconfigured globally. In EMs, market liberalization, together with increased political stability, economic and legal reforms, has led to a more productive business environment and increased foreign investment inflow. In a more productive business landscape, these markets are growing rapidly. Figure 1.1 shows the relationship and trade linkages between developed and emerging economies.

As the economies of the industrialized countries mature, the growth rates of these economies are becoming stagnant. The global financial crisis of 2008 has also affected the economies of industrialized markets adversely. On the other hand, rapid growth can be observed in the economies of EMs. As they grow, economic power and influence is bound to shift towards these countries (Bernanke, 2010). The size of the Indian economy is expected to be larger than those of Japan and the UK within the next two decades, while the size of the economies of Brazil, Mexico and Indonesia is expected to surpass most European countries and Japan by 2050 (Magnus, 2010). Table 1.4 shows the top 20 countries ranked according to their GDP, starting from 1990. BRICs and New Frontier Economies are highlighted in this table.

EMs have been contributing to world GDP more than advanced economies, and their contribution is expected to increase. In fact, IMF estimates reveal that EMs will account for 48% of the world gross domestic production (GDP), which is estimated as US$90,452 billion by

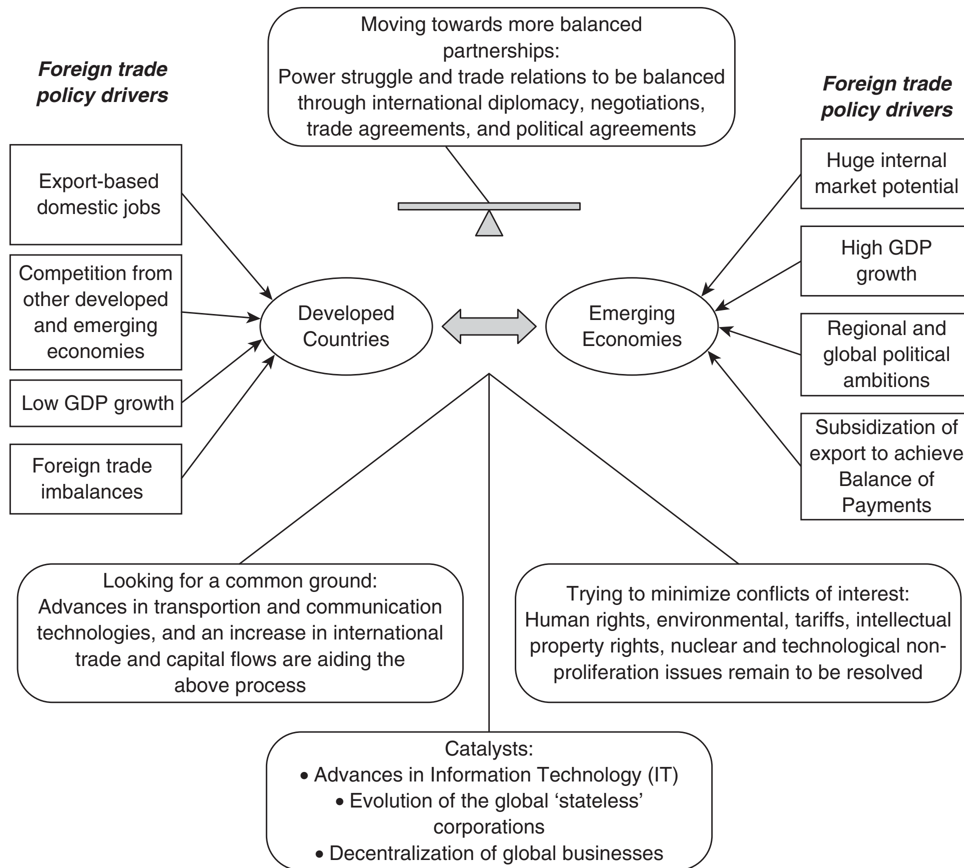


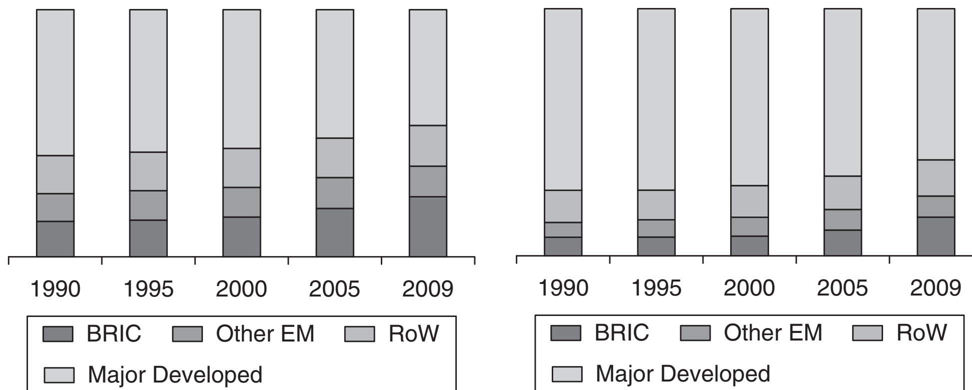
Figure 1.1 Relations between developed and emerging markets

2016, while they accounted for 21% of GDP in 2000, which was around US$32,227 billion at the time (IMF, 2011b). The World Bank estimates a global GDP growth of 2.5% in 2012 and 3.1% in 2013. Within these predictions, growth from EMs and developing countries is expected to be at higher rates, estimated as 5.4% in 2012 and 6.6% in 2011, while the growth rate estimations for developed countries in the same periods are 2.8% and 2.4% respectively (World Bank, 2011c). In terms of GDP, BRICs accounted for more than 50% of the global growth between 2003 and 2007, which shows a significant increase from 2003–2007 where the same figure was approximately 27% (Wilson et al., 2011a). As such, it is clear that EM contribution accounts for more and more of the growth in world production. This difference is more pronounced when GDP figures are considered in terms of PPP. In Figure 1.2, the contribution of EMs and forecasts depicting their performance in the near term can be seen. The weight of EMs in the global economy has increased at higher rates than developed countries, and their contribution is also expected to increase rapidly in the near future, as is also shown in the figure as well.

Table 1.4 The top 20 countries ranked by GDP (US$)

1990	1995	2000	2001	2005	2006	2007	2008	2009	2010
USA	USA	USA	USA	USA	USA	USA	USA	USA	USA
Japan	Japan	Japan	Japan	Japan	Japan	Japan	Japan	Japan	China
Germany	Germany	Germany	Germany	Germany	Germany	China	China	China	Japan
France	France	UK	UK	UK	China	Germany	Germany	Germany	Germany
Italy	UK	France	France	China	UK	UK	France	France	France
UK	Italy	China	China	France	France	France	UK	UK	UK
Canada	Brazil	Italy	Italy	Italy	Italy	Italy	Italy	Italy	Brazil
Spain	China	Canada	Canada	Canada	Canada	Spain	Russia	Brazil	Italy
Russia	Spain	Brazil	Mexico	Spain	Spain	Canada	Brazil	Spain	India
Brazil	Canada	Mexico	Spain	Brazil	Brazil	Brazil	Spain	India	Canada
China	Korea	Spain	Brazil	Mexico	Russia	Russia	Canada	Canada	Russia
India	Netherlands	Korea	Korea	Korea	Mexico	India	India	Russia	Spain
Australia	Russia	India	India	India	Korea	Korea	Mexico	Australia	Mexico
Netherlands	Australia	Australia	Netherlands	Russia	India	Mexico	Australia	Mexico	Korea
Korea	India	Netherlands	Australia	Australia	Australia	Australia	Korea	Korea	Australia
Mexico	Switzerland	Argentina	Russia	Netherlands	Netherlands	Netherlands	Netherlands	Netherlands	Netherlands
Sweden	Mexico	Turkey	Argentina	Turkey	Turkey	Turkey	Turkey	Turkey	Turkey
Switzerland	Belgium	Russia	Switzerland	Belgium	Belgium	Sweden	Poland	Indonesia	Indonesia
Belgium	Argentina	Switzerland	Belgium	Switzerland	Sweden	Belgium	Indonesia	Switzerland	Switzerland
Austria	Sweden	Sweden	Sweden	Sweden	Switzerland	Switzerland	Belgium	Belgium	Poland
Turkey	Austria	Belgium	Turkey	S. Arabia	Indonesia	Indonesia	Switzerland	Poland	Belgium
Argentina	Indonesia	Austria	Poland	Poland	S. Arabia	Poland	Sweden	Sweden	Sweden
Finland	Denmark	S. Arabia	Austria	Austria	Poland	Norway	S. Arabia	Austria	S. Arabia
Denmark	Turkey	Poland	S. Arabia	Norway	Norway	S. Arabia	Norway	Norway	Norway
Norway	Thailand	Hong Kong	Norway	Indonesia	Austria	Austria	Austria	S. Arabia	Venezuela

Source: World DataBank, 2011.



Source: IMF, 2011a.

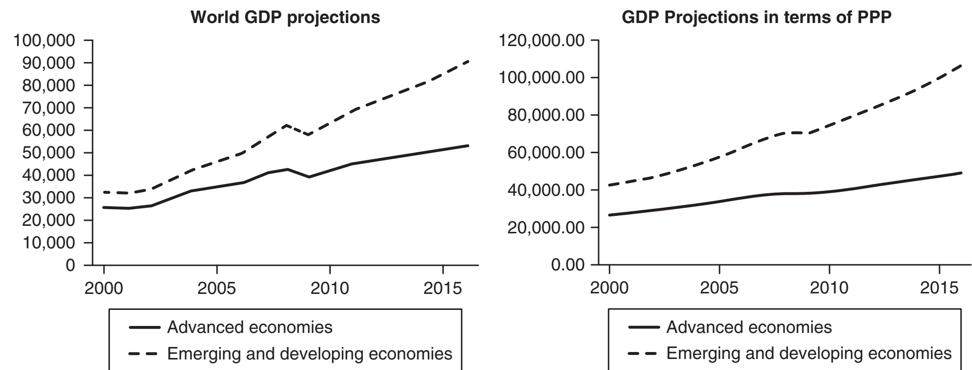


Figure 1.2 Emerging market growth
Source: IMF, 2011a.

As of 2008, China has surpassed the USA in terms of manufacturing output; meanwhile, other EMs such as India, Brazil, Turkey, Mexico, Indonesia and Thailand contribute to world output significantly, as can be seen in Table 1.5.

Trade and Foreign Investment in EMs

Lower trade barriers and global economic integration have led to a dramatic increase in world trade levels since the second half of the 20th century. In parallel to the increased importance of trade in most countries' economies, governments started focusing on easing trade restrictions globally. The General Agreements on Tariffs and Trade (GATT) was signed in 1947 by 23 countries, of which Brazil and India represented EMs. GATT was

Table 1.5 World output (top 20 countries), 2008 (US$ billion)

Largest industrial output		Largest manufacturing output		Largest services output	
USA	3073	China	1850	USA	10562
China	2104	USA	1831	Japan	3036
Japan	1282	Japan	1011	Germany	2517
Germany	1101	Germany	855	France	2215
UK	634	Italy	424	UK	2022
Russia	625	UK	360	China	1734
Italy	622	France	341	Italy	1635
France	584	Russia	293	Spain	1096
Spain	463	Brazil	281	Brazil	1029
Brazil	440	S. Korea	257	Russia	970
Mexico	404	Spain	242	Australia	694
S. Korea	345	Canada	210	Mexico	643
India	334	Mexico	203	Netherlands	635
S. Arabia	329	India	202	India	622
Australia	295	Indonesia	140	S. Korea	560
Indonesia	246	Turkey	132	Turkey	468
Netherlands	222	Netherlands	127	Belgium	383
Norway	209	Australia	110	Poland	341
Turkey	203	Thailand	106	Sweden	338
Poland	163	Switzerland	101	Switzerland	302

Source: *The Economist*, 2011b.

a significant move towards settling trade issues such as tariffs, non-tariff barriers, trade balancing requirements and local content requirements globally, however it did not have any binding power over the member states. Thus, GATT was replaced by the World Trade Organization (WTO), which has the power to settle disputes between members.

The WTO, especially by establishing the Doha Development Agenda, aims to concentrate on the needs of developing countries (Busse, 2009). The issues which developed countries want to focus on in these proceedings can be outlined as trade facilitation, transparency within governments, competition policies, and investment governance. The purpose of the Doha round initially was to enable a fair-trade environment for developing economies. The negotiations agenda was later expanded to include the protection of intellectual property (Gifford and Montemayor, 2008).

Following the initial conference, the Cancun conference – which was designed to agree upon the purpose of the Doha round – failed, as the differences in opinion of members from developed countries and developing countries became more pronounced. At the time of writing, the issues within the Doha round have still not been resolved. The main issues preventing the resolution are: agriculture, compulsory licensing

and patent protection, differential treatment for developing countries, and the implementation of the agreements reached in WTO negotiations (Schwab, 2011).

Yet due to the lower tariffs advocated by organizations such as the WTO, many EM countries are also able to fuel growth via increased export levels. In addition to the WTO, over the past few decades, various trade agreements – such as the North American Free Trade Agreement (NAFTA), the Association of South East Asian Nations (ASEAN) and the Latin American free trade regime (MERCOSUR) – have led to trade gains (Ghauri and Cateora, 2010). Recent changes in policy indicate that the trend towards liberalization is likely to continue in the near future, as in 2009, 71 out of 102 policy changes on foreign investments were globally focused on the promotion of foreign investment (WIR, 2010).

At the end of the 20th century, many EMs were faced with financial crises mainly due to reasons such as high deficits, excessive borrowing and an overdependence on foreign capital, which led them to restructure their institutions. Another effect of these crises on some EMs, such as Thailand, Malaysia and Indonesia, was the shift in their development strategy towards export-led growth in order to generate trade surpluses (Magnus, 2010). Asian countries such as China and India, motivated by the economic success of neighbours such as Japan and Korea, started opening up their economies in order to fuel growth. China's entry into the WTO in 2001 has particularly affected the global trade balance. EMs, especially in Asia, focused on export-led growth in a similar way to the Asian Tigers in the 1960s, shifting from import substitution to export promotion. This strategy was successful due to increased efficiencies stemming from globalization and the high consumption levels in developed countries leading to a continuous demand for imports (Magnus, 2010).

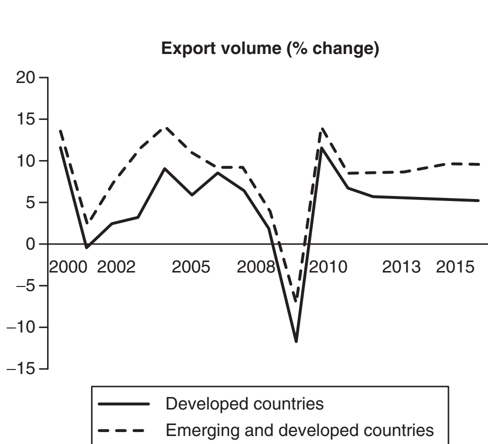
Another factor which facilitated the increased involvement of EMs in international trade was the reorganization of production (Buckley and Ghauri, 2004). As companies locate each of their activities in the most suitable location, manufacturing trade grows. For instance, in 2009 over half of the world merchandise trade, excluding oil products, involved intermediate goods (WTO, 2011b). The movement of manufacturing processes to EMs has also led to increased production and increased exports from these markets. As of 2009 China has become the largest exporter of merchandise, while the USA preserved its status as the leading merchandise importer followed by China (Economist, 2011b).

World trends towards increased trade, a shifting of production, and increased EM policy focusing on export revenues have all instigated a rapid growth in exports in EMs. In 1997, exports were US$4,257 billion for advanced economies versus US$1,279 billion in emerging and developing economies. Such a gap has since decreased substantially – as of 2008, the figures were US$9,811 billion and US$6,215 billion respectively (IMF

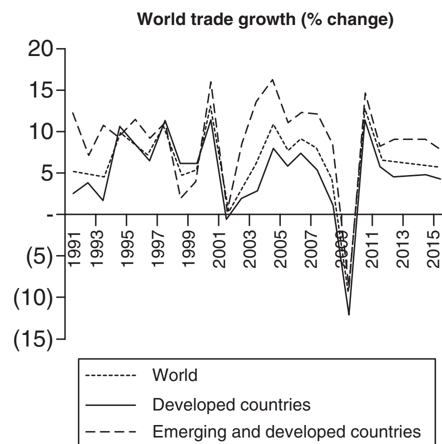
Statistics Database, 2011). Developing countries including EMs accounted for 45% of the world exports in 2010 (WTO, 2011b). Export volumes of EMs, as well as their involvement in world trade, have been increasing more rapidly than those of developed countries, as can be seen in Figure 1.3.

Growth prospects in EMs, fuelled by increased liberalization, have led to increased investment inflows to EMs (WIR, 2010). In 2008, foreign direct investment (FDI) levels to developed markets decreased by over 30%. On the other hand, foreign investment to EMs increased by 11%. In 2009, the decline in foreign investment to developed countries was much deeper than the decline to EMs, due to the disproportionate effects of the global crisis. In fact, EMs and developing economies attracted more foreign direct investment than developed economies for the first time in 2009 (Sauvant et al., 2011).

Multinational enterprises (MNEs) are increasingly investing in developing and emerging markets in order to generate cost efficiencies. Investment in these economies is also increasing due to the shift in consumption and the emergence of such economies as potential markets (UNCTAD, 2011). Following the global financial crisis, multinationals further increased investments in developing and emerging markets as the growth prospects in their own markets narrowed. Hence, in 2010, 49% of the investment by developed country MNEs was in developing and emerging markets, which showed a radical increase from 32% in 2007 (WIR, 2011). EM attractiveness for foreign direct investment is significantly affected by economic conditions, the regulatory framework, and the promotion of foreign investment. Of these factors, economic growth of the market is regarded as the most important driver for foreign direct investment (Sauvant et al., 2011).



Source: IMF, 2011a.



Source: EIU, 2011.

Figure 1.3 Trade growth

In terms of the type of foreign direct investments, non-equity forms of investment are growing rapidly around the globe. In 2009, cross-border, non-equity mode transactions were estimated to be US$2 trillion. Within this total, US$1.1–1.3 trillion is due to contract manufacturing and services outsourcing, US$330–350 billion to franchising, US$340–360 billion to licensing, and US$100 billion to management contracts. Non-equity modes of production employ approximately 18 billion workers, of which 14–16 billion are in developing countries and EMs. Over 50% of global trade in toys, clothing and footwear, and electrical goods is due to contract manufacturing (WIR, 2011). In 2010, global foreign direct investment inflows increased by 5% to reach US$1.24 trillion, from US$1.185 trillion in 2009. FDI to developing countries also increased by 16% (World Bank, 2011c). The recovery was due to a gradual increase in cross-border merger and acquisition activity as the investments in greenfield ventures decreased in 2010. Modest increases in foreign investments are largely due to the cautious approach of MNEs in the aftermath of the global crisis in 2008 (WIR, 2011).

Common Features of Emerging Markets

In defining EMs, large populations, rapid growth in GDP, and an increased contribution to world trade can be identified. Such markets are also characterized by progressive economic reforms and expectations of accelerated economic expansion. Even though EMs are very different from each other in terms of culture, political and economic characteristics, market structures, and demographic structures, some general trends can be identified in order to understand the rise of such markets, as well as the opportunities and challenges presented by them.

Demographic characteristics

Over half of the world's population lives in emerging economies. Figures for 2009 indicated that 42% of the world population resided in BRICs and 14% in new frontier economies, as can be seen in Table 1.3. The structure of the population in EMs is younger than that of developed economies (with the exception of Russia). This shows that EMs all have sizeable working-age populations and upcoming young populations who will soon enter the workforce. Meanwhile, economic growth within these markets leads to an increase in this education of this upcoming labour force, thereby providing a source of human talent.

Another key demographic trend in EMs is the growing rates of urbanization. Urbanization is another result of economic growth and the focus on industrialization. As the weight of agriculture is reduced within EM economies job opportunities are provided with economic growth, urbanization rates have been increasing rapidly. For instance, in 1990 the urbanization rate was 75% for Brazil, 27% for China, 26% India and 31% Indonesia. By 2010, these rates had increased to 87%, 45%, 30% and 54% respectively (World DataBank, 2011). Growth in urbanization indicates the movement of populations from low-income agricultural work to rural-based activities such as higher income industrial jobs. The changing population framework also leads to an increase in the demand for infrastructure, housing, and services in cities (WEO, 2010). As can be seen in Table 1.6, working-age population in EMs is already large. The growth of the urban population results in continuous growth of the workforce in industrial production.

Table 1.6 Population breakdown

	Population growth (annual %)	Population aged 0–14 (% of total)	Population aged 15–64 (% of total)	Population aged 65 and above (% of total)	Urbanization (%)	Growth of urban population (%)
USA	0.86	20	67	13	82	2
UK	0.7	17	66	16	90	1
Brazil	0.91	26	67	7	86	2
Russia	-0.07	15	72	13	73	1
India	1.34	31	64	5	29	2
China	0.51	20	72	8	43	3
Mexico	1.01	28	65	6	77	2
Peru	1.13	30	64	6	71	1
Chile	0.98	23	68	9	88	1
Indonesia	1.15	27	67	6	52	3
Malaysia	1.66	30	66	5	70	3
Thailand	0.56	22	71	8	33	1
Philippines	1.79	34	62	4	65	3
Pakistan	2.14	37	59	4	36	3
Egypt	1.79	32	63	5	43	2
South Africa	1.07	31	65	4	61	
Turkey	1.21	27	67	6	69	2

Source: *The CIA World Factbook*, 2011. Available at: www.cia.gov/factbook/

The old-age dependency ratio shows the ratio of the population not in the labour force to the population in the labour force. The general trend estimated to increase in the long run is due to lower birth rates and higher life expectancy in most of the world. Figure 1.4 shows a comparison of the old-age dependency ratio projections of BRICs with those of Europe and North America. In looking at this figure, the dependency ratios of North America and Europe are consistently higher than the BRIC countries, with the exception of China after 2040. The higher old-age dependency ratios indicate an increased burden on the economy by increased government spending on social security, increased company spending on pensions, and the additional burden on the labour force of supporting higher pensions. Projections indicate that the share of working-age population is not bound to decline in most emerging markets until the 2030s (Magnus, 2008).

The relatively lower old-age dependency ratios of the BRICs then indicate the potential for these markets to be major consumers as well as the potential for continued economic growth. The Chinese trend line is significantly different and shows radical increases in the long run, due to the one-child policy endorsed by the government and the rapid decline in population growth.

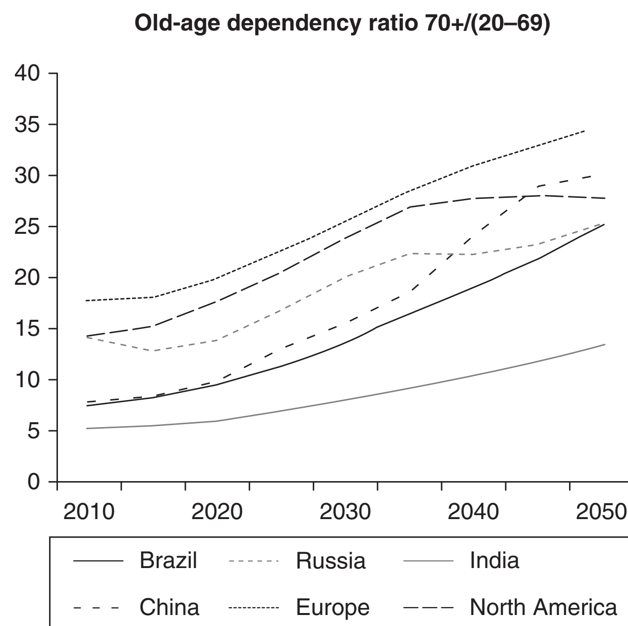


Figure 1.4 Dependency ratio in BRICs

Source: United Nations, Department of Economic and Social Affairs, population Division, 2011. World Population Prospects: 2010 revision, CD-ROM edition.

Favourable demographic conditions and increased welfare lead to increased education levels in many EMs. Higher education levels in the working population contribute to productivity (O'Neill, 2011). Figure 1.5 shows changes in spending on education and changes in literacy levels in BRICs over 30 years. As can be seen in the figure, expenditure on education has increased and this is especially so in China and Brazil. Moreover, literacy rates across the BRICs are rapidly growing and are now close to 100% in Brazil, Russia and China.

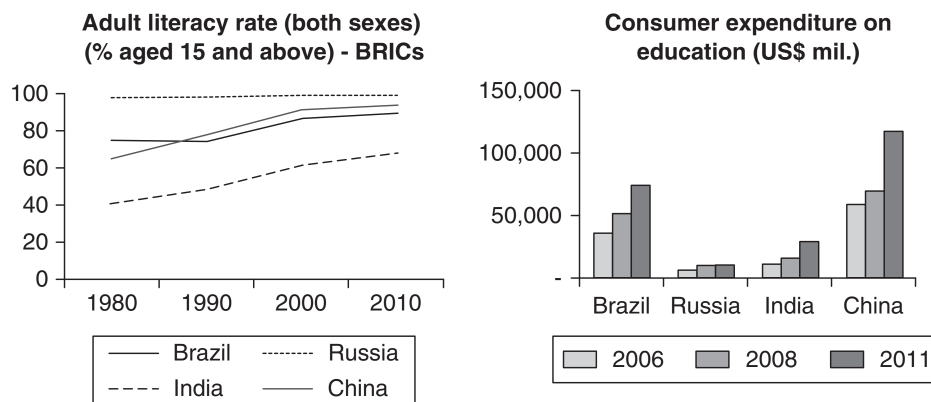


Figure 1.5 Education in emerging markets

Source: Euromonitor, 2012. Data retrieved 22 February 2012 from www.portal.euromonitor.com/(Euromonitor, 2012).

Looking back at Table 1.3, significant differences in GDP per capita between the EMs and industrialized nations can be observed. Even though per capita income shows a rising trend, the level of income in EMs is still significantly lower than that of developed economies. On the other hand, average per capita growth in major industrialized nations between 2005 and 2009 is between 2 and 4%, while this range is between 3 and 14% in EMs (World DataBank, 2011). An unequal distribution of wealth is observed in EMs, meaning a smaller percentage of the population holds the majority of the wealth and economic resources, leading to a large gap between rich and poor.

Political and economic characteristics

Over the past few decades, the fall of socialist economies in markets such as that of Russia and the movement towards more liberalized socialist economies such as exists in China have been cited as major changes in the world. Less pronounced are the similar movements towards more liberal

economic policies in other EMs. Traditionally, the EM environment was characterized by protected domestic firms, high tariffs, weak institutions, conglomerates and business groups, and a turbulent climate delaying the entry of the MNE into these countries (Casanova, 2009). In the 1950s, many developing countries – maintaining protectionist policies and low levels of export income – were faced with the burden of subsidizing their economies by increased borrowing. Inefficient state-owned enterprises, as well as the constricted private sectors in these economies, further fuelled their economic downturn and contributed to increased debts which became harder to pay. Many of the EM countries faced a severe economic crisis in the 1990s and had to implement new policies ensuring better conditions and financial systems (Glick et al., 2001). Such policies also assisted in their rapid recovery from the financial crisis of 2008 and many EM countries have come out of the crisis with relatively fewer issues than their counterparts in developed nations (IMF, 2011b).

Towards the end of the 20th century, EMs started to go through structural reforms in an attempt to create stability and growth (Cuervo-Cazurra and Dau, 2008). Due to such reforms, many EMs stabilized their economies and started growing rapidly. As EMs adopt relatively open approaches to world trade, they integrate further with the global economy.

Economic reforms of EMs have been facilitated by external and internal influences. The regulations of trade institutions such as the WTO or credit-providing agencies such as the IMF have significantly contributed to the reforms. Such international institutions recommend and enforce a liberalization of trade, support regulations which contribute to a stable economic environment, and try to ensure that the market system is fair and efficient. Thus, such recommendations lead to the privatization of state-owned enterprises, the deregulation of industries, an opening up of borders to ensure fair competition, the enforcement of laws for the protection of intellectual property, and the implementation of sound fiscal and monetary policies (Aulakh and Kotabe, 2008).

The government's role in the economic development of these countries is substantial. The decision to open up borders and increase the focus on international trade, as well as allocating budgets to the advancement of the economy, has enabled the growth of EMs. In order to sustain this growth, many governments are still trying to ensure that democratic institutions are put in place to shield businesses from economic shocks (Rodrik, 2006), supporting policies towards market-based economies and creating opportunities which can contribute to economic growth. Faced with high budget deficits, governments were also incentivized to privatize state-owned enterprises. State-owned enterprises were mostly a burden on the state budget, and such enterprises – often very large – generally suffered from weak management while also preventing fair competition in their respective industries (Cuervo-Cazurra,

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2006). With adequate planning and effective budgeting, successful governments from many EMs were also able to direct their budgets to develop the infrastructure necessary for economic growth.

The active participation of governments in economic activities can often be explained by ambitious developmental goals and historical factors (Magnus, 2010). A government may be involved indirectly through centralized economic planning, or involved directly in the economy through ownership of economic enterprises. The active economic role played by governments in emerging economies is evident in the private sector's ability to accumulate capital required for certain investments, in national and economic security issues, and in subsidizing a sector. The share of state-owned economic enterprises (SOEs) in most emerging economies is quite substantial, although the privatization of government-controlled enterprises is under way in many of them.

Most developed countries often question state control of the economy and advocate market-based economies. However, the effective response of the Chinese authorities in the face of the global financial crisis has challenged this notion and increased the sympathy for government involvement in finance and economic development (Magnus, 2010). A strong performance during the global financial crisis also enabled India to become one of the 10 largest economies in 2010 (Wilson et al., 2011a). China's economic stimulus package – amounting approximately to US$590 billion, emphasizing infrastructure projects and instigating financial institutions to increase loans – enabled the country to avert the effects of the global financial crisis (Magnus, 2010). Hence, especially following the global financial crisis, preheld notions about the superiority of market-based systems and strict beliefs about non-interventionist government policies are being challenged.

The economic growth rates of EMs are higher than those of developed markets. However, growth figures often lead to significant fluctuations as well as high inflation rates. Many multinationals historically avoided EMs due to the volatility associated with such markets. On the other hand, policy reforms in these markets leading to improved fiscal and monetary policies, as well as stronger financial markets, have reduced volatility significantly. Another factor which has decreased volatility is liberalization. As the markets are integrated into the world economy, external earnings decrease external debt. Moreover, output is not significantly affected by rapid changes in policy or in consumer demand within the domestic market, as companies are able to function in an open economy. Efforts at liberalization also give rise to the development of financial institutions (Enderwick, 2007).

Recent policy changes in EMs indicate a growing concern about environmental and social protection, which has resulted in limitations in some industries and a larger involvement by the state in some cases (WIR, 2010). Currently, even though sound investment conditions are emphasized in

policies at higher levels, governments are also focusing on regulations which favour specific agreements, ensuring environmental safety as well as appropriate corporate conduct.

Market characteristics

Compared with developed economies, EM business systems are considered as being more relationship-based. First, family businesses are much more common and structures based on multiple firms operating together due to family ties are also frequent. Even when no family connection is present, the business structures are based on long-term relations, which can create entry barriers for multinationals in some cases. Relations with the government also gain precedence in many cases within EMs, as the government's involvement in market operation is greater than that of developed country governments (Khanna and Yafeh, 2007).

Wholesale distribution in many EMs is controlled by manufacturers or importers, thus creating formidable barriers to entry. New entrants soon discover that although their products may be a better buy, there is no way of distributing these through existing channels. Wholesalers tend to control the retail outlets in terms of their product portfolios and financing agreements. These wholesalers can dictate the product mix to retailers in the absence of fair-trade regulations and anti-trust laws. These market imperfections then result in highly controlled markets in which the buyer must purchase whatever is offered. The power of natural monopolies remains unchallenged in many cases because of their traditional ties to the government and each other.

Governments are trying to ensure that adequate infrastructure investments are made in order to support economic activity and also to accommodate growth in major cities. Hence, investments in infrastructure arise as an opportunity for multinationals and also signal the increasing future attractiveness of doing business in such markets (Airoldi et al., 2010). Infrastructure investment in cities with populations over 500,000 in EMs is predicted to be between US$30 trillion and US$40 trillion over the next 20 years (Jin et al., 2010).

MNEs also face problems regarding the availability of information in EMs (Hexter and Woetzel, 2007). Such issues are caused by institutional inefficiencies. Thus, MNEs need to consider and plan for challenges stemming from difficulties in reaching target customers, evaluating the creditworthiness of customers, collaborating with supply chain partners, hiring qualified personnel, raising funding, and finding reliable partners before entering into an EM (Khanna and Palepu, 2010).

Emerging Markets and Multinationals' Global Strategy

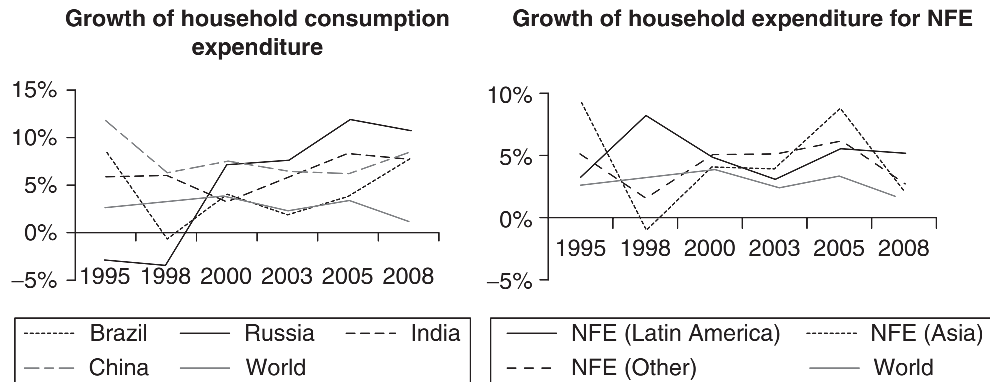
Emerging economies as growing markets

EMs have been contributing increasingly to global growth, fuelled by increasing levels of domestic demand. As these countries grow, rising income levels lead to the emergence of a new middle class which will affect the world economy and global demand significantly in the long run (Wilson et al., 2010). Parallel to the economic conditions, the consumption patterns of EM countries are changing with the rise of a new middle class. For instance, demand from the BRICs is expected to rise exponentially – Goldman Sachs estimates that India's GDP per capita will quadruple and the consumption of cars will increase fivefold, while the consumption of oil will increase threefold by 2020 (Wilson and Stupnytska, 2007).

Global players' firms are now fighting each other for resources, talent and capital in order to capture the needs of newly emerging customers. This will depend on their ability to innovate and distinguish the company, create new competitive resources, and defend such capabilities (Nunes and Purdy, 2008). One may imagine the effects of doing business in China for firms such as Coca-Cola, Caterpillar, Carrefour and Ericsson, which have successfully established themselves in this market. China attracts a high level of foreign capital, and investment in factories and manufacturing facilities, which leads to the creation of millions of jobs within the economy. In return, as exports increased fivefold within a decade, currency reserves have also reached record levels, indicating that China can further augment its economic growth by investing in its infrastructure. This rapid growth has led to increased incomes for Chinese consumers and the country has now become the world's largest market for many products such as cars and electronics.

Increased consumption is a major driver of growth in EMs. Long-term forecasts all suggest that BRICs, as well as other large emerging economies, will contribute more to growth, especially via the expanding numbers of the middle classes. The USA doubled its per capita income in 47 years starting in 1839, and the UK doubled its per capita income in 58 years starting in 1780. In contrast, Chinese income doubled in the nine years between 1978 and 1987. After 1987, the per capita income in China doubled again in the following nine years and the same pattern is continuing. India's rate has been somewhat lower, as per capita income doubled first over a 25-year period and then doubled again in the next 15-year period (Enderwick, 2007). Even during the global financial crisis, household spending in EMs increased by 8% in 2009 (IMF, 2011b).

In contrast, in advanced economies, consumer confidence and income declined. As can be observed in Figure 1.6, household expenditure in BRICs, as well as the NFEs, has been growing at higher rates than the world average. The growth of consumption is parallel to the growth of income, and the increased income also leads to a shift in consumption patterns and a greater focus on items such as clothing, which are not basic needs. Figure 1.6 also shows the increased expenditure on clothing and footwear in EMs. Considering that US and UK expenditure on clothing and footwear increased only by 17% and 28% between 2002 and 2010, the significance of the growth in EM spending can be highlighted. The only country which showed decreased expenditure on clothing and footwear in this period was Mexico, and the major reason for the decline can be attributed to the greater effects of the global financial crisis on this country.



Source: World DataBank, 2011.

Source: Euromonitor International, 2011 (Euromonitor, 2012).

Figure 1.6 Consumption in emerging markets

Multinationals are increasingly focusing on EMs for growth. For instance, in the future, 70% of the income of large pharmaceutical companies is expected to come from EMs (BCG, 2011). Other examples can clearly be observed in Table 1.7. World leaders have already started building their markets in EMs.

Table 1.7 Exposure to emerging markets

Company	Percentage of operating income from EMs
Anglo American	91
Holcim	83
Toyota Motor	68
Barrick Gold	52
Coca-Cola	45
Anheuser-Busch InBev	44
Bayer	41
Unilever	36
British American Tobacco	27
Honda Motor	26
GlaxoSmithKline	25

Source: WIR, 2011.

Emerging markets as manufacturing bases

Increased competition among multinationals resulted in splitting value chain activities internationally at increasing rates during the 20th century. Increased levels of globalization enable today's companies to slice their operations and locate them in the least costly or most advantageous locations (Buckley and Ghauri, 2004). Partially due to lower costs and to more specialized capabilities, multinationals have been locating parts of their operations in EMs. As such, they are able to focus on their core competences, reduce costs, and benefit from the best suppliers of each activity, creating increased levels of efficiency. In this respect, EMs provide opportunities – both as suppliers and customers – to multinationals.

Developments in communication and transportation, along with availability of information, have greatly reduced the costs of procurement from other locations. In outsourcing, a firm can choose to work with independent suppliers or procure from its own subsidiaries. A firm decision to source from its own subsidiary, or from a joint venture that the firm is part of, is referred to as captive sourcing. Offshoring is a type of outsourcing where the vendor is not located in the same country as the company (Gottschalk and Solli-Sæther, 2006).

In choosing a location, the availability of infrastructure and skilled workers, as well as government incentives, play a large role (Farrell, 2007). In order to attract investment, many governments are offering incentives such as tax breaks, cheap land, easy access to energy sources, and duty-free imports (UNCTAD, 2000). Attracting investors who can invest in manufacturing facilities creates jobs in the EM economy and augments the growth of the supplier industries. Moreover, the ability to attract large investors also leads to further investments by suppliers.

The decision to move production facilities to EMs is often accompanied by concerns related to product quality. However, continued presence of multinationals in EMs has enabled them to increase efficiency and raise quality by implementing new technologies and training programmes in the manufacturing facilities. In fact, these manufacturing bases will often surpass the average productivity levels of the manufacturing bases in advanced countries and meet the quality targets of multinationals. Movement of production to EMs has resulted in increased specialization. For instance, Mexico and China are important platforms for manufacturing cars and electronics, Brazil for mining bauxite, Malaysia for semiconductors, and India and Pakistan for textiles (Cavusgil et al., 2008). EMs are also increasingly shifting their production to higher quality services and goods (Magnus, 2010).

Many developed countries experience issues related to diminishing workforces and an aging population, contrary to most EMs. Thus, the growing population within EMs provides not only a prosperous outlet for multinationals but also a potential area for tapping into a new workforce. Table 1.8 shows the drivers for relocating manufacturing to EMs.

Most of the EMs have thus become centres of outsourcing for Western companies. At present, about 40% of the world's software development

Table 1.8 The Global Manufacturing Competitiveness Index

Government forces	Market forces
• Regulations related to trade, finance and taxation • Efficiency of infrastructure • Government's policy on investments • Legal and regulatory systems	• Talent • Cost of labour and materials • Energy costs and relevant policies • Characteristics of the supplier network • Characteristics of the local business landscape

According to the Deloitte study on Global Manufacturing Competitiveness in 2010, conducted by interviewing 400 executives worldwide, the availability of talented labour and the cost of materials and energy were identified as the most important drivers augmenting the competitiveness of a country in manufacturing.

Source: Deloitte Touche Tohmatsu, 2010.

is being done in India. Most multinational companies (MNCs), from Intel to Microsoft, are moving their R&D activities to India. Between 2002 and 2005, 25.6% of all globally offshore R&D projects were based in India and 17.2% in China, while only 6.3% and 4.4% respectively were in the USA and UK (Huggins and Izushi, 2009). Most of the branded clothing companies are now producing in India and Pakistan. Companies such as Motorola, Intel and Philips are producing their semiconductors in Malaysia and Taiwan.

Emerging markets as competitors

Domestic firms in EMs provide intensive competition for multinationals trying to enter these markets. Most of the time, multinationals from developed markets concentrate on high-end markets due to higher competition at lower ends of the market. Local competitors possess a deep knowledge of consumers, and are able to operate at lower costs, and have built strong relations with authorities and have built other players within the value chain. Often, EM firms will have higher production efficiency than MNEs from developed markets, due to their ability to optimize production processes in EM conditions (Ramamurti, 2008). Meanwhile, multinationals from advanced economies are faced with markets dissimilar to their home economies in terms of business processes as well as customer profiles.

Some EM multinationals are catching up with their counterparts from developed economies and becoming global competitors. Such a phenomenon is further fuelled by these companies' efforts to invest in new processes as well as technologies. For instance, China and India have entered another economic arena, investing in innovation and R&D (Sachs, 2008). In parallel, many Chinese enterprises – faced with intensive domestic competition – are no longer relying on cost advantages, rather they are enhancing their technological bases to overcome competitive disadvantages in the domestic market (Yiu et al., 2007). There were approximately 560 companies with sales over US$10 billion headquartered in EMs in 2008, while this number was as low as 20 in 1990 (Magnus, 2010).

Factors Affecting International Business

The concepts of international business and international marketing are universally applicable, but the environments within which firms operate

will vary. The environment includes market structure, political and legal forces, economic forces, the level of technology, the structure of distribution channels, and cultural and social characteristics. According to Ghauri and Cateora (2010), international marketing involves managing both controllable and uncontrollable elements, as illustrated in Figure 1.7.

In Figure 1.7, the outer circles show various uncontrollable elements of international markets. Uncontrollable elements are present both in domestic and international business. However, the scope and depth of these elements in international business make international transactions more complicated and comprise the internal decisions and marketing mix of the firm. The elements are very dynamic, involving dramatic social, economic, political and cultural changes with increasing uncertainty. This uncertainty can be reduced significantly by carefully studying the operating environments of each country the firm is planning to enter. Competition, economic restraints, government rules and regulations, infrastructure, and cultural factors are some of the uncontrollables that firms have to manage in foreign markets.

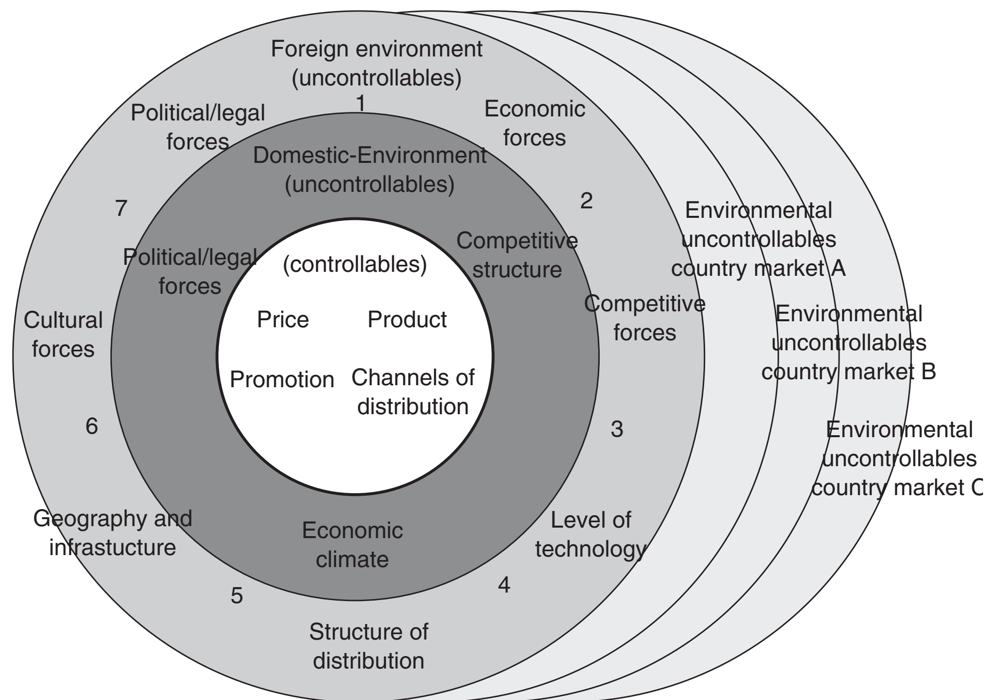


Figure 1.7 The international marketing task

Source: Ghauri and Cateora, 2010, p. 11.

Firms need to adjust and mould the controllable elements to the uncontrollable elements of a particular market. As illustrated by Figure 1.7, these uncontrollable elements differ drastically from market to market, and firms will face a new set of uncontrollables when they enter a new market. Some aspects of the international environment can be directly dealt with using basically identical marketing strategies, and experience in some regions can be helpful in addressing problems in another. Not only do firms need to manage and adapt to these uncontrollables in foreign markets, they also have to handle and adapt to the domestic uncontrollables, the second circle in Figure 1.7. A political decision at home (the domestic market) or an economic recession or boom at home may directly influence a company's international operation. In the same way, if economic conditions at home deteriorate, it may lead to restrictions on purchasing/imports from abroad in order to strengthen the domestic economy, but perhaps will then influence the competitive position of some of the domestic companies.

The economic, political and sociocultural character of the target market can affect the choice of entry mode and strategy. For example, many products can be deemed as luxury items in a market with low levels of economic activity or skewed economic activity, in which most people will live modestly or at a survival level. In many countries, there are dual environmental conditions. These dual economic structures – the coexistence of modern and traditional sectors in the economy – will create additional challenges for foreign firms. China, India and Pakistan are good examples of this idealism, in which people living in cities (some 25–30% of the total population) will demand modern Western-style products, while those in the traditional sector, living in rural areas, will demand more indigenous and simpler products. There are different market segments; each can prove profitable for a foreign company but may require different marketing programmes (Ghauri and Cateora, 2010). Moreover, external or bilateral economic relations will influence the complexity of the environmental impact of a company's entry strategy into a particular market.

The first part of this book analyses uncontrollable elements in an emerging market setting. In the second chapter, political/legal and cultural forces are discussed. The third chapter focuses on the economic environment in emerging markets, discussing technology, infrastructure, distribution, and income levels.

Chapter Questions

1 How do you define emerging markets? What are some of the common characteristics?

2 What are some of the reasons for increased importance of emerging markets in the global economy?
3 What do the current growth and characteristics of emerging markets show in terms of their future potential?
4 What is the role of emerging markets in a multinational's global strategy?

Note

1 In formulating a list of EMs for the purpose of this book, we have first considered the gross domestic product (GDP) figures, both in real terms and adjusted for purchasing power parity (PPP). PPP estimates take into account local living standards and local spending, therefore some economists consider PPP-adjusted measures as a more realistic measure of the comparison between countries. PPP correlates to the pricing in a given country. Especially in EMs, where consumer prices are low, the PPP is a better determinant of lifestyle. For instance, a Big Mac which costs US$3.73 in the USA costs US$2 in China, or US$2.20 in Thailand. In the future, sustained growth in EMs may lead to higher incomes, which will contribute to higher prices, and therefore converging differences in PPP between EMs and developed countries. However, currently price levels are different between EMs and developed countries, hence looking at figures in terms of PPP may give a better indication of the living standards and market growth in these economies (Magnus, 2010).

In categorizing countries as EMs, our first criterion leading to an exhaustive list of countries was based on GDP, PPP levels. From this list, we eliminated developed countries, members of the European Union, and economies intensively based on oil resources.

In narrowing down the list further, we considered market size factors such as five-year average growth in GDP in terms of PPP, and average growth in GDP per capita over a five-year period between 2005 and 2009. The first reason for focusing on averages in our calculations is to avoid biases due to abnormalities in a single year, and identify those countries with the growth potential. Considering that the figures for 2009 present an anomaly due to the effects of the global crisis, looking at the progression of markets over a five-year period is more accurate. In estimating size we also took urbanization levels into account, as urbanization can be an indicator of market potential in terms of consumption and production possibilities. The second reason for using average growth values over a period is due to our focus on the growth attribute of EMs. EMs currently offer many opportunities and their contribution to the global economy in the future is expected to increase continually. To be able to identify markets with continuous growth, we chose a longer-term approach. Another major criterion we used in narrowing down the list of EMs was the trade potential of a country, the growth in exports and imports, and the level of foreign investment attracted. In considering foreign direct investment inflows, we looked at the aggregate figures as well as foreign investment levels with respect to the size of the economy.