

Rethinking emerging markets

Beyond global
products and low cost
manufacturing in the
BRICs

Summer 2011



Introduction

Growth is now returning to the top of most boardroom agendas. Whereas historically developed economies offered lower growth but greater stability, developed economies now have greater risk than in the past (e.g. Italy, Japan, Greece), while the outlook for emerging economies is much brighter. Emerging markets are now more than ever expected to drive growth – in our recent CEO survey*, 92% of Western European CEOs expect growth in Asian operations, while only 48% expect growth in their European operations.

However, this is not more of the same. Key trends in emerging markets mean it's no longer merely a BRIC (Brazil, Russia, India, China) story of basic consumer products and low cost manufacturing. These trends mean it's time for companies to rethink their emerging market strategies. For companies yet to enter, the time may now be ripe. New areas of demand are emerging, and first entrants may have de-risked entry. For those already in emerging markets, questions are 1) how to move out of heavily competed high-end markets to sustain growth; and 2) how to create a defensible position.

Market entry has a high chance of failure, because it involves a large number of choices that all require difficult trade-offs. However, we believe there are a number of ways to de-risk market entry. For example, the private equity model offers lessons like focusing on financial systems. We believe most critical is creating an environment for success: following a structured process and putting the right capabilities in place.

We would be delighted to talk to you more about the topic. Please contact us if you are interested.

* PwC's 14th Annual Global CEO Survey: Growth reimagined



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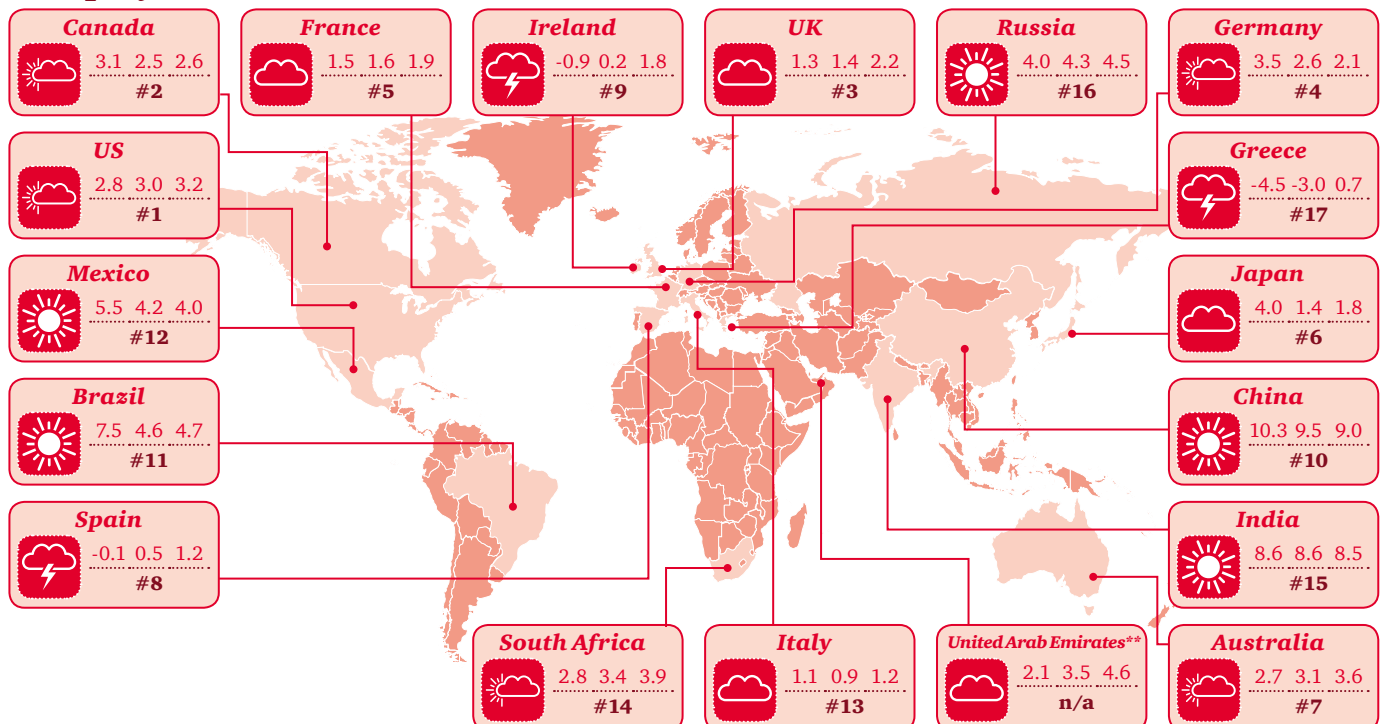


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Coming out of the recession, Europe faces a tough time, while emerging markets are expected to expand rapidly

PwC projected economic climate – March 2011



Key

Outlook	2010*	2011†	2012†
	GDP growth		
	Med-term risk ranking*		

* PwC ranking of relative medium-term risk premium
** Based on March 2011 Economist Intelligence Unit projections
Source: PwC Economics, IMF

This is not just more of the same. It's no longer merely a story of basic products and low cost manufacturing in BRIC

- 1 Urbanisation**
 - India, China, ASEAN and Nigeria will add 1.3bn urban residents between 2009 and 2050
 - The cities of the world will require tremendous investment in infrastructure to support this growth
- 2 Emerging middle class**
 - Shanghai and Mumbai alone will generate 25m more middle class households by 2025, but the new middle class will not be constrained to the world's megacities
 - This will create substantial opportunities in consumer goods, whilst straining the agricultural capacity of the world
- 3 Changing labour markets**
 - China may no longer be the world's factory. Many emerging markets now have lower labour rates than China, and countries like Thailand and India could become more competitive relative to China
 - Innovation is now the key area of competition in BRIC
- 4 Emerging competitors**
 - Between 2005 and 2009, over 2,000 companies in emerging markets began investing abroad. Some are becoming industry leaders (e.g. Embraer from Brazil)
 - These companies will become stronger, and could be joined by as many new multi-nationals
- 5 Currency movements**
 - Currencies in Brazil, Vietnam and Indonesia are all expected to depreciate relative to the RMB, making these countries more competitive as a low cost manufacturing destination

It's time for companies to rethink emerging market strategies

If you haven't entered, now may be the time

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|--------------------------------------|---|
| <i>Capturing growth</i> | <ul style="list-style-type: none">• Demand is shifting to new sectors like Infrastructure• Demand is becoming sizeable in less developed countries like Indonesia• Changes in the cost base are creating opportunities for competitive advantage (e.g. Vietnam and India) |
| <i>De-risking entry</i> | <ul style="list-style-type: none">• Second-mover advantage: First movers are likely to have educated customers, built up an ecosystem, reducing market and execution risk• Regulatory changes may have reduced entry barriers. Now it may be possible to go-it-alone |
| <i>Defending home markets</i> | <ul style="list-style-type: none">• Establishing a presence in emerging markets is a tactic to put global rivalry in check |

If you have, it's time to shore your position

- | | |
|--|---|
| <i>Sustaining growth</i> | <ul style="list-style-type: none">• Serving new customers: Is a mass market strategy in place? Are you addressing demand in 2nd tier cities and less developed markets (e.g. the 550m people in India earning \$1-3/day)• Offering new products and services: Are customised products required for the local market? |
| <i>Creating a defensible position</i> | <ul style="list-style-type: none">• Maintaining competitive advantage: Macro trends may open new low cost competition• Building entry barriers: Current barriers (e.g. regulatory) may be diminishing |

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Our four big emerging markets are China, India, the Middle East, and Brazil. But if you look out, say, five years, there is no doubt that others – for instance, South Africa and Indonesia – will be significant growth markets for us.

*Ed Breen,
Chairman and CEO, Tyco*

The key point about Asia is that there is no real need for capital to come into that market. Rather, the emphasis is on what sorts of technology enhancements are needed there.

How can Asian labour work smarter and more efficiently?

How can Asian operations deliver added value to a global marketplace that is already well served?

Being in Asia for its own sake is entirely pointless – and a great way to destroy value.

*Nicholas Moore
CEO, Macquarie Group
Limited, Australia*

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Market entry has a high chance of failure because it involves a large number of difficult choices

	Key Decisions	Choices	Some Considerations		
Business model	1 Customer focus	High end	Mass	<ul style="list-style-type: none"> Willingness to pay Cost of customer education Minimum efficient scale 	
	2 Product offering	Global quality levels	Cheap and cheerful	<ul style="list-style-type: none"> Cost to deliver Potential for defensible advantage 	
	3 Supply chain footprint	Export	License	Local production	Local R&D
Execution	4 Investment vehicle	JV	Acquisition	Go-it-Alone	<ul style="list-style-type: none"> Regulatory requirements Management bandwidth Execution vs. partner risk (IP, control)
	5 Partner type	State-owned/affiliated	Small private sector	Private conglomerate	<ul style="list-style-type: none"> Need to navigate regulations vs. commercial behaviour Balance of power in partnership
	6 Location	Cost-advantage	People friendly		<ul style="list-style-type: none"> Proximity to raw materials and customers Liveability
	7 Management	Foreign	Local		<ul style="list-style-type: none"> Global career development Adaptability Retention

We believe it's possible to de-risk market entry

Key learnings from market entry

Align people: Get involved early to begin learning and developing relationships. Ensure senior management stay involved and focused on the long-term rational

Utilise light touch models: Models like exports and licensing can be used to test the market

Don't change the core: Understand what's critical to the success of your core business model and first replicate that in emerging markets. Limit localisation decisions to non-critical parts of the business model (but do make sure the business is tailored to the local market)

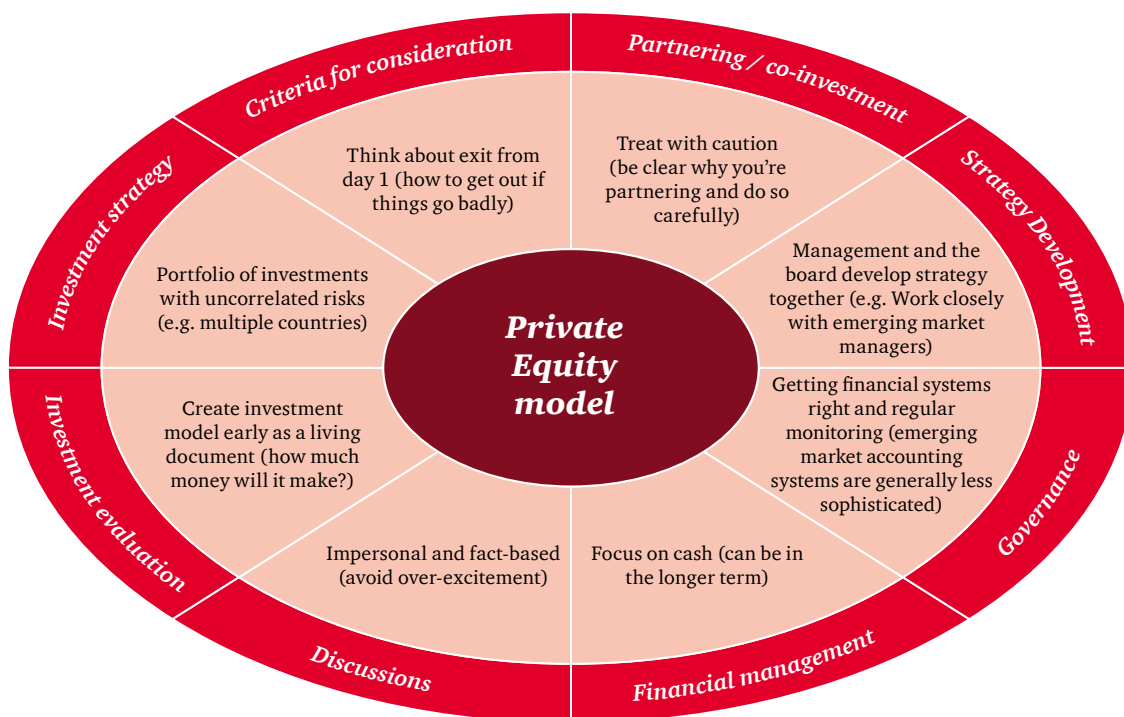
Phase investment: Understand the timing of demand growth, the economics of your cost to serve, and the key step changes in capacity. Plan around these step changes and plan for flexibility

Don't be afraid to walk alone: Many clients assume they have to partner in emerging markets. This is not necessarily the case. Partners can bring a great deal of risk. Be clear about what you get from, and provide to, a partner

Develop local deals capabilities: Deals in emerging markets are different and harder than they are in home markets. If you're going to pursue an acquisition, invest in emerging markets deal execution capabilities

Learn from Private Equity: There are a number of lessons from Private Equity that can be used to de-risk market entry

In particular, the private equity model offers lessons applicable to market entry



A structured approach to market entry with the right capabilities increases the chances of success

	Ensure strategic alignment	Market prioritisation	Develop entry strategy	Plan implementation
Activities	<ul style="list-style-type: none"> Tie to strategic ambition for company Identify burning platform for market entry Understand company perspective on emerging market risk Understand investment appetite 	<ul style="list-style-type: none"> Develop criteria Evaluate markets at high-level and screen to short-list Deep-dives on priority markets 	<ul style="list-style-type: none"> Define business model: target customers, value proposition, operating activities, etc. Develop options for entry: partner vs. go-it-alone, legal options, potential partner/ locations Evaluate options for entry: e.g. Detailed business cases 	<ul style="list-style-type: none"> Establish priorities People: identify roles and key individuals Develop project plans and stakeholder plans
Deliverables	<ul style="list-style-type: none"> Strategic rationale for entry 	<ul style="list-style-type: none"> High-level market overviews Market short-list Issues and opportunities for short-listed markets 	<ul style="list-style-type: none"> Strategic straw man/ blue print description of ideal business Option short-list Business case for market entry 	<ul style="list-style-type: none"> Implementation plan

Capability required

Strategy				
Finance				
Operations				
Tax & Legal				
Deals & Corporate Finance				

We have helped a broad range of companies to grow in emerging markets

China

- US steel producer
- Several big-3 automotive assemblers
- US glassware supplier
- Global cosmetics supplier
- Global industrial distributor
- Health product provider
- Global pneumatic valve manufacturer
- Mobile office rental provider

India

- UK automotive components & specialty metals supplier
- US specialty retailer
- Several European consumer goods companies (condensed milk, FMCG, infant nutrition)
- Pan-Asian retailer
- Global medical disposables supplier

Russia

- Global excavator supplier (also covered Ukraine and Kazakhstan)
- UK truck and spare part supplier
- Japanese construction equipment company

Brazil

- Japanese consumer electronics supplier
- German manufacturer of electrical transmission and distribution equipment
- Global chemicals company
- Chinese automotive assembler

Southeast Asia

- Nutritional products division of a leading global pharmaceutical company
- Japanese edible oil producer
- Global convenience store operator
- Global life sciences company

Eastern Europe

- Health clinic operator
- In patient healthcare provider
- Global consumer products company

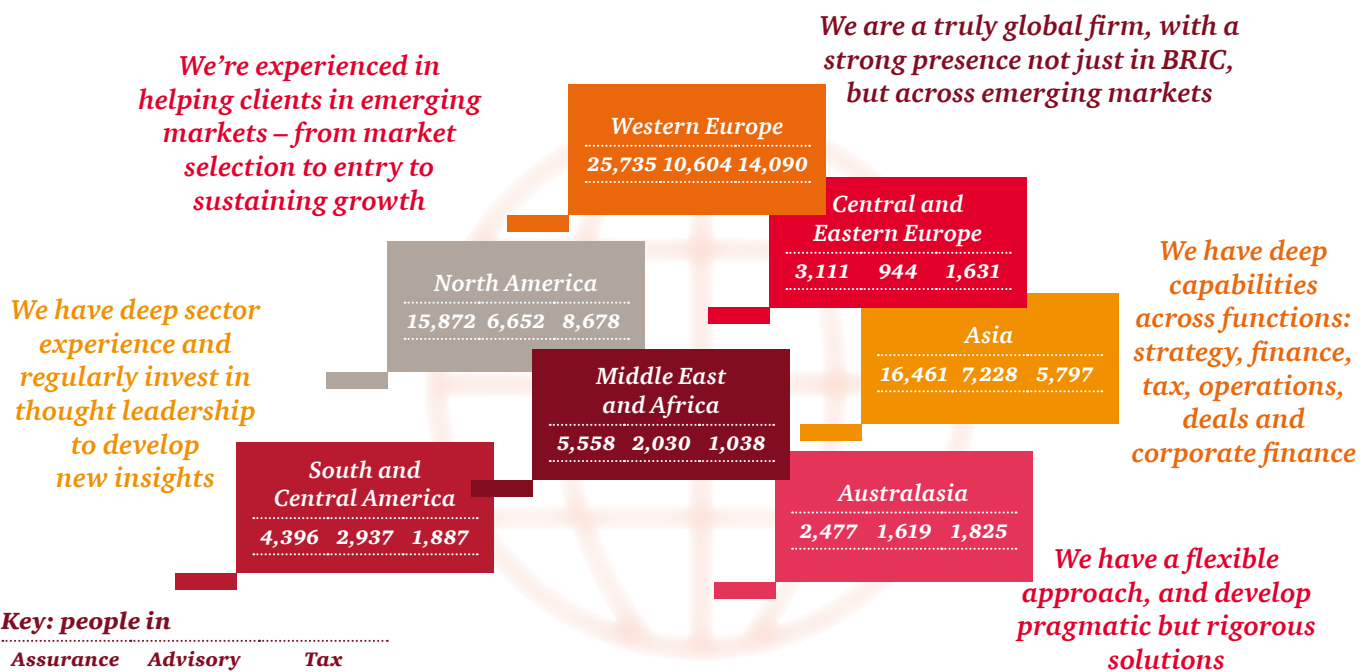
Middle East

- 2 global consumer electronics companies
- US business jet operator and a home appliance company

Africa

- Global brewer
- Global formal wear brand
- Leading African commercial bank
- 2 Middle Eastern investment houses

We are a global network. Our success lies in how we work with clients to deliver this capability



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