UK TRADE & INVESTMENT

ACCESSING INTERNATIONAL MARKETS

GREAT EXPECTATIONS: DOING BUSINESS IN EMERGING MARKETS

Economist Intelligence Unit

The Economist

About the report

Great Expectations: Doing business in emerging markets is a UK Trade & Investment (UKTI) report, written in cooperation with the Economist Intelligence Unit. The Economist Intelligence Unit bears sole responsibility for the content of this report.

The report explores the changing outlook for businesses already operating in emerging markets – or planning to expand into these markets – both in terms of which markets are presenting the best opportunities and the primary rationale for operating in these countries. It is the third in a series of annual reports from UKTI on emerging markets, after *Survive and prosper: emerging markets in the global recession (2009)* and *Tomorrow's Markets (2008).* All reports can be downloaded from: **www.ukti.gov.uk/highgrowthmarkets**

The report is based on a wide-ranging global survey of 523 companies, representing all major industries, conducted by the Economist Intelligence Unit during July and August 2010. All respondents hail from companies that either already operate in one or more emerging market or plan to do so within the next two years. In all, 31 per cent of respondents are from companies with headquarters based in Western and Eastern Europe, 28 per cent in North America, 25 per cent in Asia-Pacific, 9 per cent in the Middle East and Africa, and 7 per cent in Latin America. More than half (56 per cent) of respondents are at a C-suite level within their organisations, 27 per cent are at a director or vice-president level, with the balance in management positions. Respondents represented companies of all sizes: 25 per cent hailed from firms with 50 employees or less, while 32 per cent worked in firms with at least 10,000 employees. Nearly half (46 per cent) of firms polled had annual revenues US$500 million or less, while 20 per cent had annual revenues of US$10 billion or more.

Please note that not all answers add up to 100 per cent, because of rounding or because respondents were able to provide multiple answers to some questions. Also, in the charts displayed within this report, we sometimes exclude respondents selecting "Don't know" or "Not applicable".

Our thanks are due to all respondents and interviews for their time and insights.

EXECUTIVE SUMMARY

Brazil, Russia, India and China, the so-called BRICs, have for some time been big, fast-growing countries that represent the primary targets for those companies seeking new sources of growth. Indeed, economists are largely united in their belief that global economic gravity is shifting from developed economies to today's emerging markets. But the rise of the G20, which includes several non-BRIC economies, as the premier forum for discussing global economic issues, serves as a reminder that the shift of power to emerging markets is a bigger story than just the rise of the BRICs.

This report identifies some of the key markets that companies are looking to target in their pursuit of growth globally. It also outlines the ongoing shift from using these countries as a source of low-cost production to instead accounting for the bulk of new consumer demand. Finally, it reviews the approaches that companies are taking to realise their ambitions within these markets.

Some of the key findings of this report are highlighted below.

- **Emerging markets are now viewed as sources of new consumer demand, ahead of simply being low-cost production hubs.** About three-quarters (76 per cent, up from 67 per cent in our 2009 survey) of respondents see emerging markets as a source of new business growth, compared with just 23 per cent looking for a low-cost manufacturing base. They are looking for new consumers and though relatively few of these are rich, they are numerous. McKinsey, a consulting firm, estimates that by 2020 some 900 million people in Asia will enter the middle class, which it defines as US$5,000 per capita in purchasing power parity (PPP) terms – enough to have significant disposable income, although mostly well below Western levels.

- **‘Frugal innovation’, aimed at creating cheaper and simpler products for poorer consumers, is also generating new sales in rich markets.** Only one-quarter of companies intend to rely on their existing products and services in emerging markets, with most intending to customise their offerings (and prices) specifically for these new markets. Many firms, such as Fiat and Nokia, develop products aimed at particular emerging markets or regions, usually with an aim of making them cheaper and simpler. In turn, many of these products are later modified and exported into wealthier markets, at a premium on emerging market rates. Both Renault and Tata have developed vehicles for emerging markets which are now being adapted for sale in developed markets.

- **Vietnam is a top destination for investment as companies seek new sources of growth beyond the BRICs.** Companies are now prioritising a range of second-tier countries alongside their well-established operations in the BRIC countries. In all, 71 per cent of respondents agreed that emerging markets beyond the BRIC countries collectively offer an opportunity too big to ignore. Asked to name their top three countries for investment over the next two years, Vietnam (selected by 19 per cent) was second only to China (20 per cent), edging out India in third place (18 per cent). This is the third consecutive year that Vietnam has been selected by executives as their number one investment target outside of the BRIC countries. Brazil was chosen by 14 per cent of respondents, putting it approximately in line with Indonesia (15 per cent) and South Africa (13 per cent). Russia, hard hit by the global recession, was chosen by just 8 per cent of respondents, making it less popular than Mexico (11 per cent), and roughly on a par with Turkey (9 per cent) and Nigeria (8 per cent).

- **For many, emerging markets are increasingly familiar places.** Nearly half of the companies surveyed for this report have been operating in one or more emerging markets for at least a decade and two-thirds have been there for six years or more. Accordingly, institutional knowledge of these countries is far higher than it was at the turn of the century – and far more executives believe that the potential rewards far outstrip the risks within both the BRIC countries and other emerging markets. As such, confidence is high: 52 per cent expect growth prospects for their once-risky emerging markets business to be “significantly better” over the next two years (sharply up from just 27 per cent in 2009); just 17 per cent say the same about richer countries.

- **Local companies in emerging markets are sought after for partnerships and alliances.** Despite a greater ease with the risks of new places, the need to tap into local knowledge and contacts quickly remains strong. As such, the majority of executives partner with local companies when entering a new market, specially for smaller businesses. Large companies are about twice as likely to buy their way into a new market as their smaller rivals, although this approach is still subsidiary to partnering. Just 15 per cent of survey respondents say they intend to make a greenfield investment in their most important target country, compared with about 40 per cent planning either a joint venture or partnership.

PART I: THE RISE (AND RISE) OF EMERGING MARKETS

At the start of this decade, Goldman Sachs, an investment bank, coined the acronym 'BRICs' to describe the big, fast-growing emerging markets of Brazil, Russia, India and China that would be the top picks for global investment capital. More recently, it came up with a list of the 'Next 11' (or N11) markets it thought would be the most important after the BRICs. Events have overtaken some of its picks, with places like Pakistan and Bangladesh battling with issues ranging from political events to natural disasters. Nevertheless, this survey of over 500 companies active in emerging markets confirms that many businesses are now looking well beyond the BRICs for growth. More generally, businesses acknowledge that they now rely on emerging market growth to compensate for stagnation in the developed world. In addition, some consensus is emerging over the most important markets of the future, with countries such as Vietnam and Indonesia high on investors' agendas.

This message is increasingly verified elsewhere. In a 2008 report *(The World in 2050)*, PricewaterhouseCoopers (PwC) argues that "the relative size of the major economies is set to change markedly over the period to 2050, with the emerging markets becoming much more significant". It expects China to overtake the US as the world's biggest economy in 2025, and to be nearly one-third bigger by 2050. By then, India will be close to being 90 per cent of the size of America; Brazil will be bigger than Japan; and Russia, Mexico and Indonesia will be bigger than Germany, the UK and France. It reckons its E7 grouping of fast-growing emerging markets – the BRICs plus Mexico, Indonesia and Turkey – will grow by an annual average of 6.4 per cent in US dollar terms to 2050, compared with just 2 per cent for the G7 countries of Canada, France, Germany, Italy, Japan, the UK and the US. "Investors with long time horizons should look beyond the BRICs," it concludes.

For company executives, this is a profound shift, meaning that they can only remain global players if they have a presence in the big markets of the future. Moreover, although economists might disagree over some of the countries with the most potential, few dispute PwC's general point. In fact, Goldman Sachs says that the recent global crisis has made emerging markets far more important to global growth, and industry. In a report late last year *(The Long-Term Outlook for the BRICs and N11 Post Crisis)*, it acknowledged that its long-term projections of the BRICs and N11 overtaking today's G7 by 2050 is more, rather than less, likely to materialise. The bank's N11 list identifies Bangladesh, Egypt, Indonesia, Iran, Mexico, Nigeria, Pakistan, the Philippines, South Korea, Turkey and Vietnam as key countries to explore. It looked at a range of factors to produce this list, from economic and political stability to educational levels. But essentially, these are all home to large populations (above 50 million), with the potential to grow rapidly into significant markets.

Too big to ignore?

GDP forecasts by country, US$ billion (2010 and 2030)

Country	2010	2030	Percentage increase*
India	4,108.00	28,415.20	592
China	10,019.88	58,998.31	489
Egypt	500.09	2,928.01	486
Indonesia	1,027.51	5,633.86	448
Vietnam	276.19	1,506.94	446
South Africa	526.72	2,206.76	319
Turkey	934.05	3,817.29	309
Brazil	2,194.55	8,884.21	305
Colombia	418.73	1,584.70	278
Russia	2,234.34	7,956.98	256
Canada	1,345.89	4,317.60	221
US	14,889.07	44,641.57	200
UK	2,151.89	6,133.45	185
France	2,139.00	5,969.19	179
Germany	2,881.39	7,662.10	166
Japan	4,293.87	10,192.05	137
Italy	1,825.55	4,311.55	136
BRICs	18,556.78	104,254.66	462
CIVETS	3,683.29	17,677.56	380
G7	29,526.67	83,227.51	182

* to the nearest percentage point.

Source: Economist Intelligence Unit.

Markets like these are already driving global growth: emerging markets contributed 80 per cent of global GDP growth, as opposed to 20 per cent from the G7, over the past two years. As a result, Goldman Sachs has accelerated its previous forecasts of emerging economies' growth relative to the developed world. "It is now possible that China will become as big as the US by 2027, and the BRICs as big as the G7 by 2032," it says.

The predictions fit the Economist Intelligence Unit's own calculations. It too expects emerging markets to rival, or even overtake, today's developed countries soon: by 2030, it expects the BRICs' economies to be 25 per cent bigger than the G7's, up from just 63 per cent of their size today. In its own forecasts, the Economist Intelligence Unit identifies a different list of target countries: the CIVETS[1], encompassing Colombia, Indonesia, Vietnam, Egypt, Turkey and South Africa (see box on page 6 - 7). They are forecast to account for up to 20 per cent of the G7 total, making them a significant global market in their own right.

For corporate executives, pinpointing individual countries is not as critical as the overriding conclusion: today's emerging markets are becoming tomorrow's main markets and they must be present there. Several countries, such as Indonesia, Vietnam, Egypt and Turkey, crop up on the lists of both the Economist Intelligence Unit and Goldman Sachs. Others, such as Malaysia, the United Arab Emirates and Saudi Arabia are in the sights of executives polled for this report (see Part II of this report). But companies often concentrate on individual countries or regions where they have a well-established presence, or which are particularly suited to their product, rather than on economists' lists of target markets. With the possible exception of war-threatened places like Iran, many companies would still agree with the importance of all the N11 and CIVETS countries; even if they are receiving little foreign investment at the moment they could well grow into significant markets in future. Pakistan might be out of favour with investors at the moment, for example, but it remains a priority for companies like Coca-Cola simply because it is so big, and under-developed enough to have growth potential. It is not wrong to single it out for its long-term growth potential; it is simply a little early to be certain.

[1] The term CIVETS was first used in November 2009, for *The World in 2010*, an Economist Group publication. See http://www.economist.com/blogs/theworldin2010/2009/11/acronyms_4

WHERE TO NEXT? BRICS, CIVETS AND THE RISE OF EMERGING MARKETS

An Economist Intelligence Unit forecast

Global economic gravity is shifting from developed economies to today's emerging markets. The emerging world is going to be where the action is over the next decade, accounting for the bulk of incremental consumer demand. This shift is being led by the BRICs. But although the BRICs is a convenient acronym, it fails to capture the breadth of what is happening in emerging markets. The rise of the G20 (which contains several non-BRIC and G7 economies) as the premier forum for discussing global economic issues serves as a reminder that the shift in power towards emerging markets is a wider story than the rise of the BRICs. There is also an investor interest in looking for new markets, partly in order to diversify risk and partly because many of the BRIC economies' assets are increasingly costly.

As a second-tier of large emerging markets, beyond the BRICs, most likely to deliver sustained high growth over the long term, the Economist Intelligence Unit has identified six countries it believes stand out: the CIVETS (Colombia, Indonesia, Vietnam, Egypt, Turkey and South Africa).

Like the BRICs, this group is geographically dispersed and contains obvious variations – but there are also important similarities. They all have sizeable, young populations. They are all diversified economies not excessively reliant on commodities. And they have reasonably sophisticated financial systems (at least in the case of the non-Asians in the group).

In general, the CIVETS' economic fundamentals look robust and the countries largely proved fairly resilient during the recent global economic crisis. Finally, the political baseline also looks supportive: there are risks, but all of these countries have a good chance of remaining stable. (Colombia's long-running guerrilla conflict has held the country back, but security has improved in recent years.) Overall, the Economist Intelligence Unit expects the CIVETS to post very healthy average annual GDP growth of 4.7 per cent over the next decade – below the 5.6 per cent average projected for the BRICs, but well above the G7's likely rate of just 1.8 per cent.

CIVETS: A promising outlook

	Population (million)	GDP per head (US$, PPP)	Consumer price inflation (per cent, average)	Public debt (per cent of GDP)	Average annual real per cent GDP growth, 2010-2020
Colombia	46.9	8,920	2.6	47.3	3.6
Indonesia	243.0	4,230	5.1	27.0	5.6
Vietnam	87.8	3,150	9.3	52.0	5.9
Egypt	84.7	5,910	11.8	80.3	5.6
Turkey	73.3	12,740	8.7	48.7	3.9
South Africa	49.1	10,730	5.8	33.3	3.3

Forecasts for 2010 unless otherwise indicated.

Source: Economist Intelligence Unit, Country Data.

As income levels rise sharply, the six countries will be of interest to investors looking to sell into their sizeable internal markets, but they also offer various other opportunities for investment. Turkey looks especially attractive as a market: it is already fairly prosperous and boasts an agglomeration of closely situated large urban areas that offer huge retail opportunities. It could also become a manufacturing base for exporting into the EU, particularly if the EU accession process eventually un-jams or at least results in closer trade integration.

Colombia and South Africa are also already quite wealthy, boast sophisticated banking sectors that will help unlock consumer spending, and have a range of natural resources that should benefit from booming demand in the emerging world over the coming decade. South Africa dominates the African corporate line-up with several major multinationals, and regional economic integration, such the Southern African Development Community's planned free-trade area, will boost potential market size. Colombia benefits from a relatively developed regulatory system for business and stronger institutions than in many other Latin American countries. Egypt has a broad industrial base, including textiles, cement, petrochemicals and light goods, in addition to natural gas and oil.

Vietnam and Indonesia are poorer, but Vietnam has been on the radar of manufacturers looking to move beyond China for some time. With its large, well-educated workforce, the country has good prospects for moving up the value chain. Indonesia, meanwhile, has a huge natural resource base. Its traditional manufacturing industries, such as clothing and footwear, have been suffering from declining competitiveness, but investment that has started to flow in under the current pro-market government could help to reverse this trend. Both countries also stand to benefit from their proximity to China and India.

The CIVETS are not going to reshape the global economic order in the same way as the BRICs. Only two countries, Indonesia and Turkey, are in the top 20 globally at present, and that will not have changed by 2020. Their combined GDP by 2020, even at PPP, will remain only 16 per cent of that of the G7. And the CIVETS story comes with an important caveat. A decade from now these countries will remain very much emerging markets, significantly less prosperous than the developed world, with GDP per head in 2020 ranging from 37 per cent of the US level for Turkey to just 12 per cent for Vietnam. But they will account for a significant proportion of global growth in that period, and their emergence will help to strengthen their respective regions and add weight to the shift of gravity in the global economy.

The doubters

Saul Estrin, an economics professor at the London School of Economics (LSE), does not doubt the general maths being used to justify these claims, but he does sound a note of caution. “Companies are forgetting that emerging markets are not just high growth but also high risk,” he says. “We used to talk about developing countries, but now we talk of ‘emerging markets’. That does rather assume that they are bound to emerge [to become developed markets in their own right].”

As he highlights, long-term forecasts to 2050 contain so many uncertainties that they should not be relied upon – and “forecasts can miss shocks”. There are plenty of reasons to doubt whether China can maintain its very rapid growth, for example, and the forecasts might also risk pessimism over developed countries’ growth prospects – he points to the technology-driven growth in America in the 1990s and the UK’s “Thatcher-effect” growth a bit earlier as examples of forecasters missing an upside. “Groupings like the N11 are a bit artificial,” he adds, referring to the wide disparities between a relatively developed country like South Korea (which the IMF considers too rich to be an emerging market) and a poor one like Bangladesh. “I don’t believe any company is basing its strategy on these groupings.”

New consumer markets

Ian Gomes, Chairman of KPMG’s high growth markets practice, would not necessarily disagree with this view. However, he does point out that companies are already starting to consider the major non-BRIC emerging markets for global product development. “They will develop a product for, say, Africa. If it sells well, then they will adapt it for sale in another big market such as Brazil or China – and if it does well there, too, they will introduce it to developed markets as a discount or lower range model, but still selling for more than it would in its original market.”

Companies are already starting to consider the major non-BRIC emerging markets for global product development

Tata, for example, developed its Nano as an ultra cheap car for the Indian market. It plans to export it to other emerging markets in Asia and eventually Europe, in a form of reverse marketing. Renault has already started selling its Dacia cars, which it bought in Romania, in Western Europe. Mobile phones developed for emerging markets by companies like Nokia are now being sold in developed countries, where they still command a higher price than in their 'home' emerging market. This process, dubbed "frugal innovation" by some, but also known as "reverse innovation" or "constraint-based innovation", by no means implies a downgrade. Nokia's cut-price emerging markets handsets, for example, include a range of features to cater for local needs, from flashlights (for power cuts) to multiple phone books (for several users) and rubberised keys (for dust and heavy use). No longer are emerging markets seen as a dumping place for obsolete Western models, it seems.

Indeed, the expansion of high-income segments in emerging markets will boost the luxury goods market. In China, for example, the estimated number of high net worth individuals rose some 31 per cent from 2008 to 2009, to 477,000 people, according to the *2010 World Wealth Report*, from Merrill Lynch and Capgemini. By contrast, the UK had 448,000. But the really significant changes will take place below this level. The incomes of emerging-world middle classes will mostly be lower than in the developed world. McKinsey estimates that by 2020 some 900 million people in Asia will enter the middle class, which it defines as US$5,000 per capita in PPP terms – enough to have significant disposable income, but still mostly well below Western levels. This will mean a strong focus on providing cheaper versions of Western-style products. The brands that are best able to adapt to this shift will prosper.

EMERGING MARKETS: NOT JUST FOR BIG BUSINESS

In the discussion about emerging markets, it is easy to assume that this is solely the domain of large companies with offices scattered around the globe, the true "multinationals". But this assumption would be wrong. Aided by the internet and low-cost telecommunications, small and midsize businesses (SMEs) are often playing the role of multinationals too.

Over the next two years, about one in three SMEs (those with less than 100 employees) polled for this report plan to expand into one new emerging market. When looking at expansion into multiple markets, larger companies (those with at least 1,000 employees) inevitably take the lead: about twice as many (39 per cent versus 21 per cent) will enter at least three new markets.

On the other hand, smaller businesses polled here are far more likely to take bets on expanding into developed markets, despite the tough times (51 per cent will enter at least one new developed market, compared to 34 per cent of large firms).

So scale helps firms grapple with multiple new targets for expansion, but it also gives bigger firms more options (and financial muscle) in how they enter those markets. Although both big and small firms agree that the insights of local companies are very helpful, 21 per cent of the larger companies polled would acquire a local company to enter a new emerging market, compared to only 8 per cent of SMEs, who usually opt for partnerships or joint ventures with local companies. Even more noticeably, larger companies see new emerging markets as springboards for regional expansion, whereas small businesses still focus largely on the services-related outsourcing potential of these markets.

PART II: THE CORPORATE RESPONSE

For companies, of course, the implications are far-reaching: in a few decades' time, the biggest economies will be in today's emerging markets, and not in the developed world alone. Therefore, if they want to remain global players they must be present in these giant new markets. This survey finds that many companies now have a mature emerging markets presence. That means they are less scared of the risks and are looking for new markets beyond the BRICs, as they recognise the massive sales potential of even mid-sized emerging markets.

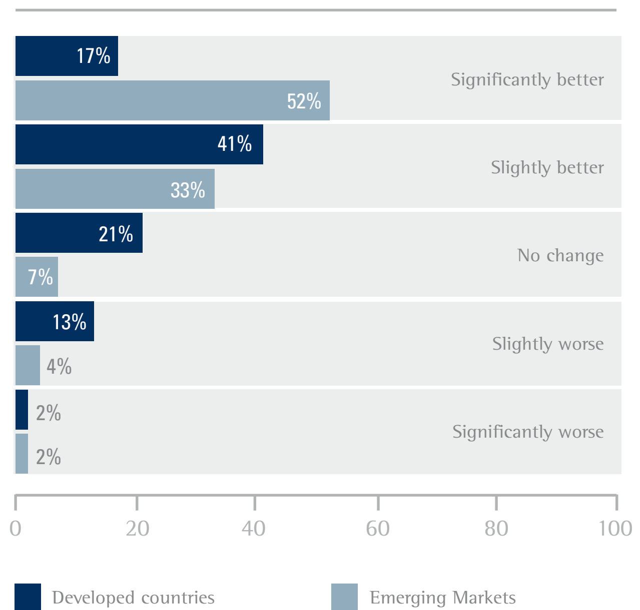
Some two-thirds of respondents have been operating in emerging markets for six years or more, with nearly half (49 per cent) active for more than a decade. Only 15 per cent are entering for the first time. Companies have been increasing emerging market sales for a while, and now they seem increasingly confident in their growth prospects. This survey finds cautious optimism that developed markets will start to recover from the recent recession, with over three-quarters of respondents expecting improvements over the next two years after a brutal downturn. However, 41 per cent expect developed markets to be just 'slightly better', with only 17 per cent expecting them to improve 'significantly'. "Companies will be hugely challenged to find top-line growth in developed markets," says Mr Gomes of KPMG.

Emerging market optimism

There is far more confidence in emerging markets. Over 90 per cent of survey respondents expect their emerging market business to grow or at least remain steady over the next two years. More importantly, perhaps, over half (52 per cent) expect growth to be significant – three times the proportion feeling bullish about developed markets. Accordingly, far more companies plan to enter new emerging markets in the coming two years: 78 per cent plan to enter at least one new emerging market, compared with 43 per cent who plan to do the same in developed markets.

Mixed expectations

Q *In general, how do you view your business's growth prospects over the next two years within the developed and the key emerging market that your firm is most heavily invested in, compared with the past two years?*



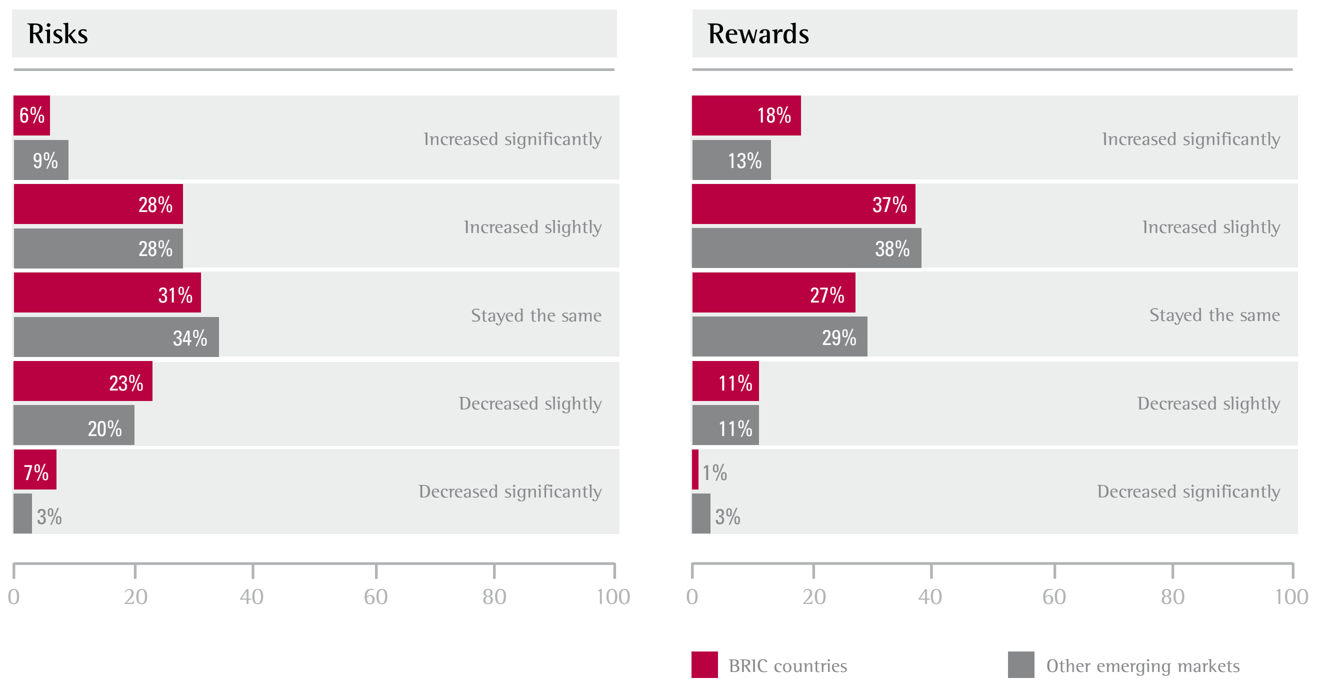
Source: Economist Intelligence Unit survey, July-August 2010

Companies' greater experience of operating in emerging markets makes them less wary of the risks

Equally, companies' greater experience of operating in emerging markets makes them less wary of the risks – although they are slightly more wary of non-BRIC markets. And some firms, such as Fiat, remain tightly focussed on the BRIC markets for now (see case study on page 12).

Risk and reward

Q *How do you think that overall levels of risk relative to rewards in emerging markets have changed over the past two years? (per cent respondents)*



	Risks: BRIC countries	Risks: Other emerging markets	Rewards: BRIC countries	Rewards: Other emerging markets
Increased significantly	6%	9%	18%	13%
Increased slightly	28%	28%	37%	38%
Stayed the same	31%	34%	27%	29%
Decreased slightly	23%	20%	11%	11%
Decreased significantly	7%	3%	1%	3%

Source: Economist Intelligence Unit survey, July-August 2010

At a corporate level, this is perhaps unsurprising. The bulk of Coca-Cola's sales growth comes from a relative handful of markets, for example, and it has done the sums to identify new markets well beyond the BRICs, or indeed the N11 (see case study on page 19). Clearly, it is not hard to increase sales levels in countries where Coca-Cola and others sell virtually nothing. What is new, however, is that the once unstable emerging economies are now seen as key to driving sales growth, suggesting that they are now considered as promising markets rather than just as cheap bases for production or service provision.

In itself, this is a sign of the growing maturity of multinationals' emerging market presence: from cars to bicycles, much manufacturing was transferred to low-cost hubs in Eastern Europe and Asia a decade ago. The fact that the shift has already happened does not mean that outsourcing production has ended. Instead, it is now well established, and these emerging market production bases have made multinationals familiar enough with these new countries to judge the risks acceptable – and open their eyes to their consumer potential.

NOT YET BEYOND THE BRICS

CASE STUDY: FIAT

Sergio Marchionne, the CEO of Fiat Group Automobiles, has set an ambitious target for his company's survival. Longer term, only a few big car makers will survive, he says. And therefore Fiat must be producing 5.5 million to 6 million cars a year by 2015. At the moment, the figure is more like 2 million so this looks ambitious, some would say impossible. In fact, Fiat reckons it can get at least close through a combination of tie-ups with other manufacturers and growing sales in emerging markets. "The world is changing," says Paolo Gagliardo, head of Fiat Group Automobiles' International Operations. "We need to be a global player and intend to be a player in all the important markets in the world. At the moment, we remain [over-]focussed on Western Europe and South America [which still account for around two-thirds of sales]."

A big part of the strategy revolves around Fiat's soft takeover of Chrysler, an American car maker in which it bought a 20 per cent stake a year ago. Fiat-Chrysler in combination makes 3.9 million cars a year, and, crucially, buys Fiat back into the North American market. But by its own estimates it still needs to hike sales by another 2 million a year. And it is looking squarely towards the BRICs for much of that growth. "It's a question of size," says Mr Gagliardo flatly, when asked how he identifies markets for expansion.

Fiat has long been the biggest car maker in Brazil, and one of the biggest in other South American markets like Argentina. But it has almost no presence in the other BRICs. It has now launched a series of joint ventures in Russia, India and China, which it hopes will provide up to 1 million of the extra sales it needs. "We need to focus on the individual markets," says Mr Gagliardo. Fiat is following the same strategy in all three of these key target markets, teaming up with a local car maker to produce new designs aimed specifically at that country. The new cars will be badged as Fiats and aimed squarely at the biggest car sectors in those countries. Pricing "will be in the middle of segment [in that country]," says Mr Gagliardo: Fiat needs these cars to be profitable, so it is not simply buying market share through discounting.

All told, this is a very focussed approach to the individual big emerging markets, with Mr Gagliardo admitting that Fiat's woeful lack of a global presence is down to an "unfocussed" approach in the past. Chinese and Indian models will be exported to other Asian countries, of course, and Russian models will provide a good entry to the countries of the Commonwealth of Independent States (CIS). But wider emerging markets must wait until Fiat has cracked the BRICs.

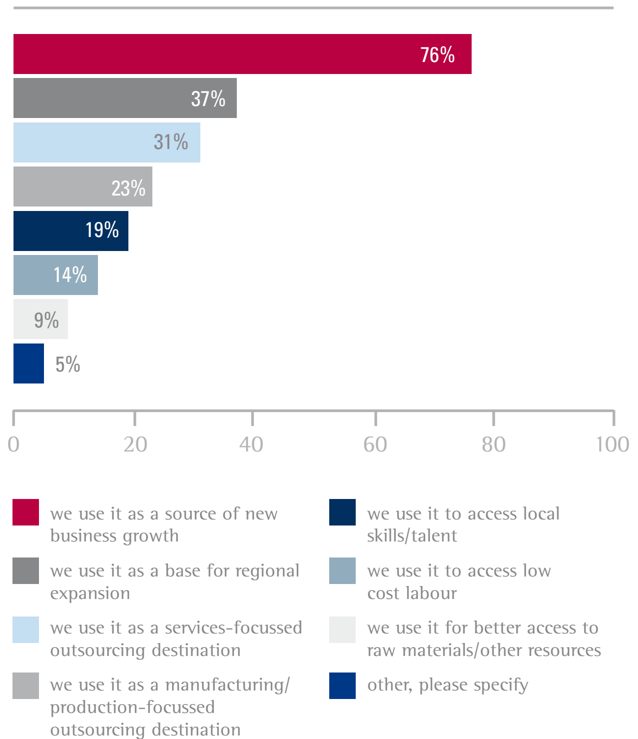
A new world of consumers

This is an important point to bear in mind when considering this survey, which shows very clearly that companies are now looking at emerging markets as a way of increasing sales, rather than at setting up new low-cost production bases. Some three-quarters see them as a source of new business growth, compared with just 14 per cent looking for access to low-cost labour. This holds true for any new emerging markets that companies are seeking to enter within the next two years. By far the primary reason for expanding into this market (selected by 57 per cent of respondents) is to target new consumers. By contrast, seeking to reduce labour or operating costs is relatively low on the list (17 per cent).

Companies are now looking at emerging markets as a way of increasing sales, rather than at setting up new low-cost production bases

Growth focus

Q *Which of the following activities does your company conduct in emerging markets today? (per cent respondents)*



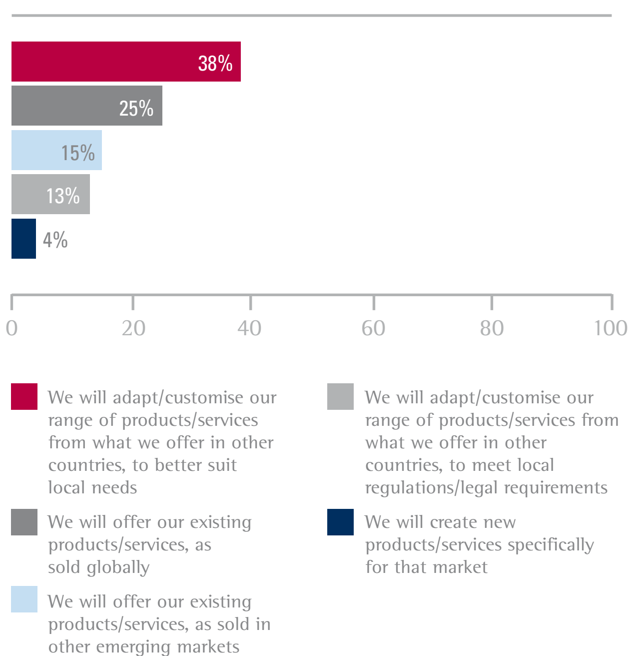
Source: Economist Intelligence Unit survey, July-August 2010

This is significant, but companies are still shifting production to cheaper countries. Fiat would agree with the general response, for example, which fits with its international sales drive. But it long ago switched production of many of its models to countries such as Poland and Brazil. That, of course, is true of other car makers from Volkswagen to Renault, and of companies in industries from electronics to defence. Equally, much of Vietnam's boom in foreign investment is down to companies like Intel setting up new plants there in preference to increasingly expensive China. The chip maker spent US$1 billion on a Vietnamese factory in 2007.

However, outsourcing production is no longer just for the creation of cheap exports, it also aims at unlocking the local market – something evident in Fiat's plans to build new models in dedicated BRIC factories. This survey finds widespread acceptance that products must be tailored to individual countries, which often requires local production (of course, products made for, say, China or India can then be exported). Only one quarter of respondents intended to rely on their existing products in emerging markets, with most intending to customise their offerings for new markets or, in a few cases, design completely new ones.

Targeting local needs

Q *If you're planning on targeting new or emerging "middle class" consumers in emerging markets, which of the following best describes the scope of the products/services you will offer? (per cent respondents)*



Source: Economist Intelligence Unit survey, July-August 2010

Only one quarter of respondents intended to rely on their existing products in emerging markets, with most intending to customise their offerings for new markets or, in a few cases, design completely new ones

Routes to market

It is a similar story over pricing, with most companies accepting the need to offer different prices to different countries. UK-based GlaxoSmithKline (GSK), like other drug companies, faces a battering as its blockbuster drugs come off patent and suffer competition from cheap generic products. But, unlike other drug makers such as Pfizer, it has not decided to enter the generic drug business itself. Rather, it is looking to increase sales to emerging markets to escape stagnation in developed countries. Changes to pricing will be part of its strategy, offering drugs to emerging markets at more than an 80 per cent discount compared to developed markets.

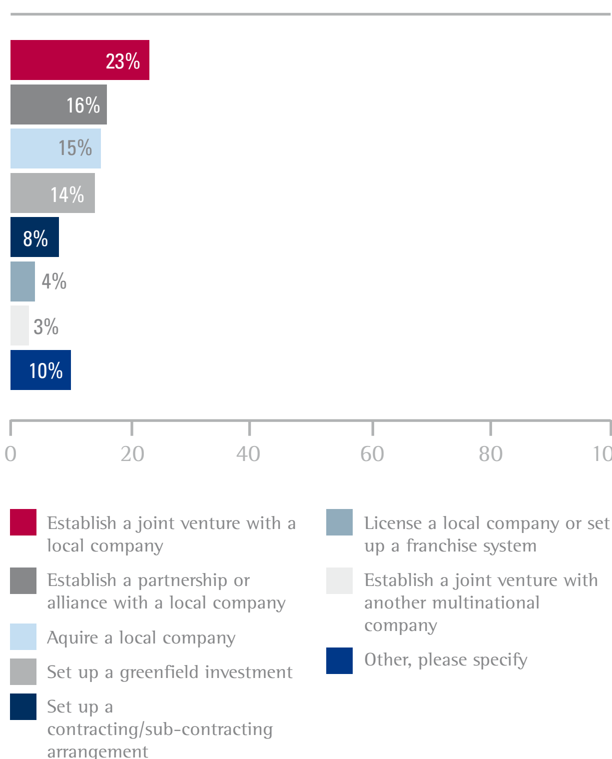
"It's a price versus volumes equation," says David Redfern, GSK's Chief Strategy Officer, who points out that drug companies have long offered cheap drugs for things like HIV/AIDS treatment for humanitarian reasons. It can work – sales of Cervarix, a cervical cancer vaccine, surged sixfold after a 60 per cent price-cut in the Philippines. The product mix is changing too, with a heavy emphasis on products such as vaccines that are in high demand in emerging markets – and much harder for the generics makers to copy in developed countries. As well as concentrating on emerging market-friendly products, GSK is emphasising consumer sales of over-the-counter medicines. It has been doing so in India for decades, for example, and wants to build on its retail presence there, with Indians being big buyers of its cheap off-patent medicines.

In terms of geographical location, GSK is launching a series of collaborations and acquisitions worldwide to increase its global spread. Another clear survey finding was that partnership with local players that understand the country and have local contacts is by far the preferred method of entry (although entry methods do differ by company size, see box on page 9). 15 per cent of firms plan to merge or buy a local firm, while 40 per cent intend to enter into a partnership or joint venture (just 14 per cent will go for a greenfield investment). For many, there is little real alternative.

For example, following the opening of China's financial services sector to competition in December 2006, foreign banks have been theoretically able to enter the market and compete directly with local banks. In reality, however, the majority have opted to partner with Chinese banks, in recognition of the daunting challenges in directly competing within this sector. Similarly, banks wanting to tap into South Africa's well developed financial services sector have done so almost entirely by acquisition: first with Barclays' acquisition of Absa Bank, then China Bank's purchase of a 20 per cent stake in Standard Bank, and the current bid by HSBC to acquire a majority position in Nedbank.

Entry strategies

Q *Which of the following best describes how your company will be likely to enter your next new emerging market? (per cent respondents)*



Source: Economist Intelligence Unit survey, July-August 2010

Partnership with local players that understand the country and have local contacts is by far the preferred method of entry

What GSK is not talking about, however, is a concentration on the remaining BRICs or other big emerging markets. Rather, it is deepening an existing emerging markets presence. This is not an unusual attitude. Another British company, the Prudential, an insurance firm, seems to have little interest in Russia or Brazil, even though it relies on emerging markets for growth. Rather, it is concentrating on Asia, where it already has a deep presence (see case study below).

"Many of the highest return opportunities are in Asia," confirms Tidjane Thiam, its CEO. "We find the emerging markets of South-East Asia – such as Indonesia, Vietnam, Singapore and Malaysia, together with Hong Kong – particularly attractive. These remain the priority destination for our marginal capital investment. Even within Asia, we remain committed to focussing our capital on the areas with the highest returns."

FROM WEST TO EAST

CASE STUDY: PRUDENTIAL

'The man from the Pru' is something of a cliché to British people, summoning images of earnest men peddling insurance. But the venerable UK insurer hit the headlines in June when its own shareholders shot down a proposed takeover of American insurer AIG's Asian operations. At a stroke the deal would have transformed Prudential from a British institution to a global giant with a focus on Asia. The deal might be dead, but the Pru's strategy has not changed. "South-East Asia remains our main area of focus," says Tidjane Thiam, the group's embattled CEO, firmly.

In fact, Prudential regards its UK operations as mature, and to some extent that goes for its US presence, too, despite a recent surge in American business as it picks up the scraps left by the collapsed AIG at home. Therefore growth is being driven squarely by Asia, where it has a well-established presence in 13 countries and is a market leader in seven. Last year, 44 per cent of new business premiums came from Asia, so it is unsurprising that it will focus its new investment on the continent. "Asia is the most attractive region in the world for Prudential," confirms Mr Thiam. "The region's changing demography, wealth and savings ratios offer a unique opportunity for profitable growth, which, in turn, is underpinned by the bedrock of our established businesses in the UK and US."

This is hardly surprising talk from a Western multinational, but the significant thing about the collapsed AIA (AIG's Asian subsidiary) deal is that it might have turned Prudential from a British company into an Asian one. Had the deal gone through, it would have been funded largely through a new share issue which could have transferred much of the Pru's ownership to new, Asian, investors, such as sovereign wealth funds. Had that happened, the Prudential would have become a very different company, and there was even press speculation that it could spin off its UK operations.

The deal's collapse does not mean that the Prudential is giving up on its Asian plans. It aims to grow in the markets where it is already well established, using the army of over 400,000 agents it has developed in the region. The emphasis is very much on looking at each country individually, forming alliances with local banks and insurers as well as building up its own sales force, however. This certainly includes China, the only BRIC country where the Pru operates in any depth. The aim is for a deep, regional, presence, not for a presence in every big, and fast growing, market on earth.

All this means Asia, with or without AIA. It also means a very focussed approach to individual countries in the region, with talk of a wider global presence conspicuous by its absence.

New horizons?

Companies are taking a focussed approach to their target countries, with Fiat also saying that it will concentrate on its joint ventures in Russia, India and China before looking for new opportunities in other fast-growing markets like Vietnam or Ukraine. But equally, attention is switching to fresh countries as companies look to broaden their now well-established emerging market presence.

The most popular destination for investment among survey respondents remains China, selected by 20 per cent of survey takers. But there are some surprises: 19 per cent chose Vietnam, making it the second most popular choice overall, ahead of India (18 per cent) in third place. In fact, leaving aside China and India, the remaining two BRICs are now just one of a clutch of countries being prioritised by investors. Brazil is a priority destination for 14 per cent of respondents, for example, roughly on a par with both Indonesia (15 per cent) and South Africa (13 per cent). Russia, which suffered badly in the global recession, is favoured by just 8 per cent of respondents, making it less popular than Mexico (11 per cent), and roughly on a par with Turkey (9 per cent) and Nigeria (8 per cent). Overall, a substantial majority (71 per cent) of respondents agreed that emerging markets beyond the BRICs collectively offered an opportunity too big to ignore. And although the BRIC countries remain likely to grow rapidly for some time to come, nearly one in four executives polled said that growth rates in those countries were starting to level off for their organisations.

Leaving aside China and India, the remaining two BRICs are now just one of a clutch of countries being prioritised by investors

Where to next?

Q *Aside from the BRIC countries, which emerging markets that will be your company's main targets for new and/or increased investment over the next two years?*

Country	Change on 2009	2010	2009	2008
Vietnam	none	1	1	1
Indonesia	+4	2	6	5
Mexico	none	3	3	2
Argentina	+8	4	12	8
Saudi Arabia	+6	4	10	10
South Africa	-2	6	4	8
Nigeria	-5	7	2	12
Malaysia	-3	8	5	12
United Arab Emirates	+6	8	2	3
Turkey	none	8	8	9

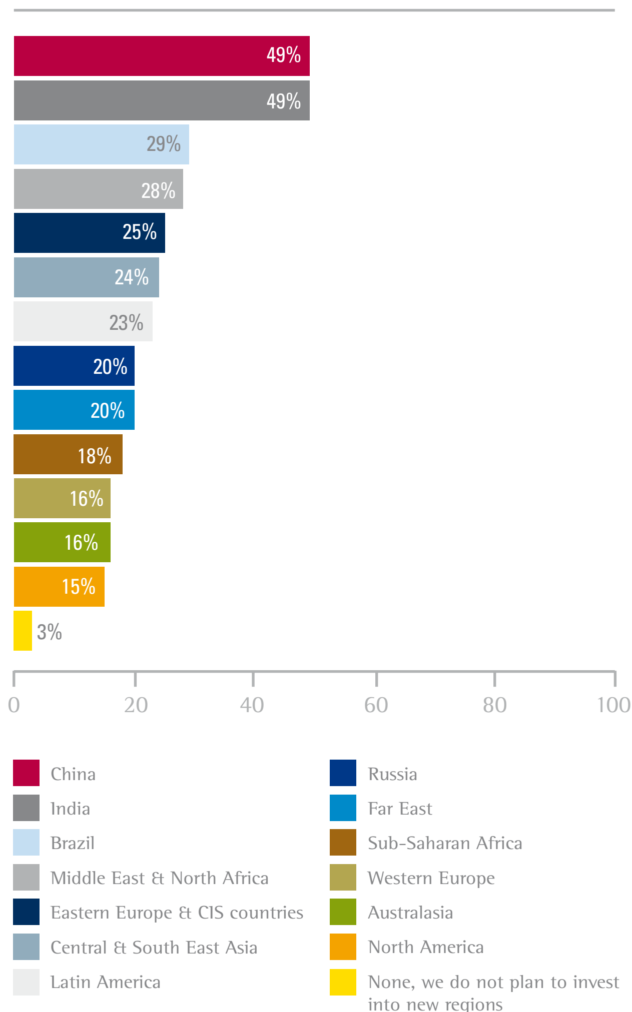
Sources: Economist Intelligence Unit survey, July-August 2010; *Survive and prosper: emerging markets in the global recession (2009); Tomorrow's Markets (2008)*

Nevertheless, it is also worth pointing out how rapidly listings such as the N11 and the CIVETS can change. Of the N11 countries, Iran and Pakistan are almost non-existent prospects for survey respondents. Political events and natural disasters cannot always be foreseen, and the lists from both Goldman Sachs and the Economist Intelligence Unit come with the important caveat that their progress depends on sustained reform. Coca-Cola, for example, lists Iran along with countries like Sudan as places that are simply too unstable. Such uncertainty might help to explain companies' clear preference for teaming up with a local company when entering a new market, rather than setting up a greenfield investment (favoured by just 14 per cent of respondents).

Another important point is that rankings like the CIVETS can ignore the potential of a region like the Gulf States for multinationals, simply because countries like Saudi Arabia are too small. When asked to prioritise regions for investment, China, India and Brazil top the list, but the next individual region is the Middle East and North Africa. Companies ranging from Coca-Cola to GSK are waking up to Africa's potential, but the Middle East is a good example of a region with prime growth potential. Both Mr Gomes of KPMG and Professor Estrin of the LSE mention them as good prospective investment targets.

Q New prospects

Which of the following countries or regions are priorities for your company's future investment over the next two years? (per cent respondents)



Source: Economist Intelligence Unit survey, July-August 2010

More intriguing still is the good showing by Eastern Europe and the CIS, a region that is selected by executives ahead of Russia, Western Europe and the Far East. In some ways, this is counter-intuitive: Ukraine, for example, has failed to attract much foreign investment, while Poland's growth prospects look sluggish. As in Russia, a prolonged recession has taken the shine off the region and foreign investors seem to be shunning the place. France's Carrefour, for example, sold its Russian shops after just a few months last year. "What you're looking for is a country that's growing and whose people are experiencing rising affluence," says Mr Gomes. "An added bonus would be a big regional market where consumers show the same behaviour." Despite recent wobbles – and a shrinking population – Eastern Europe still meets these criteria, as do countries such as Turkey and the Middle East. It is also worth remembering that Russia is already a major market for products such as cars. Fiat, which has a history in the country and the region, is making by far its biggest individual investment in Russia. This will also give it a useful hub for regional expansion. This survey hints at a much greater interest in the wider region than the recent dearth of foreign investment might suggest.

It is, after all, a long time until 2050. Companies know they must enter countries like Russia, or indeed Vietnam. When they do so, and where they prioritise for investment, simply depends on how much they can sell and (lest they forget) how safely.

CALLING ALL MARKETS

CASE STUDY: COCA-COLA

These days, Coca-Cola is only half the size of its great rival, Pepsi. But that disguises the fact that Pepsi grew when it was forced to diversify away from cola. "Coke won the cola war," says Dominique Bach, a former head of Pepsi in Eastern Europe who is now on the supervisory board of Emmi International, a Swiss dairy group. "That's why Pepsi went into snacks."

Mr Bach says that Pepsi tends to win blind taste comparisons with Coke, so it was not product quality that determined the result. Rather, it was the strength of Coke's marketing and the depth of its presence in individual countries that gave it a global presence. And today, it is looking for growth by hiking sales in hitherto ignored countries. That is the message from Paul Fourie, Coke's Group Strategy and Business Planning Director for Eurasia and Africa. Economists' lists of the emerging markets that should be targeted for growth tend to be based on a country's size, with any fast-growing, low-income country with a population above 50 million likely to be mentioned. Mr Fourie, in contrast, used a formula based on population and consumer spending power growth to identify the countries that his company should target for investment. It is a rare example of a multinational using an economic formula to determine target markets, and the results are in some ways startling.

Out of the 90 or so countries that Mr Fourie covers, around 30 were identified as priority markets. These include the obvious such as India, a vast country that already accounts for one-third of the growth in Eurasia and Africa. In general, Coke "can't afford to ignore the BRICs," confirms Mr Fourie, adding that "China is simply too big for us not to be present and investing for leadership." But the company is looking way beyond the BRICs for new growth markets. Mr Fourie gives the example of Ethiopia, "one of the poorest countries on earth but with a population of 80 million." Sales have surged fivefold in the past decade "to the extent that it now qualifies as a large market for Coke, and one with potential to grow another five-fold, over the next ten years." The secret lies in working hard on local distribution and basics such as allowing the product to be sold chilled – not so easy in a country with erratic electricity supplies. In fact, there are just a few countries that Coke will not touch, such as Sudan, Afghanistan and Iran.

For a handful of truly global companies such as Coke, the debate over emerging markets has already gone well beyond the BRICs, and even second-tier countries. As for Pepsi, it is not trying to rival Coke's global spread, but it is looking for a very deep presence in the big emerging markets. Two years ago it paid US$1.4 billion for a big Russian fruit juice maker, Lebedyansky, in one of the biggest soft drinks deals in recent years. To sell significant amounts in Russia, and the wider Eastern Europe region, it needs a local name and indeed local products. Mr Bach wonders how resilient the Lebedyansky brand will prove when it faces competition from more Western brands. But in different ways both Coke and Pepsi are spending very heavily on prising open new emerging markets.

CONCLUSION

In last year's report, one of the uncertainties being pondered was the degree to which growth within China and India had "decoupled" from growth in the West. One year on, while Europe and the US debate whether they have done enough to avoid a "double dip" recession, it is the world's emerging markets that are being increasingly relied upon for new sources of growth.

If long-term economic growth forecasts are even slightly reliable, then the BRIC countries are likely to collectively grow more than twice as fast – and 25 per cent larger in total – than the G7 countries over the coming two decades. Alongside this, a much smaller, but also much faster growing set of second-tier emerging markets are also increasingly attractive prospects for executives planning their next moves. Indeed, this is just one of the shifts underway within emerging markets; another is that of so-called "South to South" investment, driven by emerging market multinationals, which about six in ten executives polled for this report agree is changing the competitive landscape in these markets today. In turn, the rise in power of these emerging markets is being closely watched: 60 per cent of respondents to this survey felt that protectionism is likely to rise in developed markets, as an attempt to protect growth there.

Regardless of all this, the BRIC countries will remain a key focus for investment: to use just one industry as an example, no carmaker can afford to be absent from China and India when they will soon rival America's market for size (already, more cars are sold in China than America). This example plays out for many other industries, too. Beyond the BRICs, different companies and industries will look at different countries for expansion – taking on new risks, in pursuit of new opportunities. But as highlighted in this report, many firms pay no heed to economists' varied segmentations of ideal groupings of target markets, and instead simply focus on the individual countries that match their particular needs. Whatever the selection strategy, though, success in these markets usually takes both local partners and locally-relevant products and pricing strategies. With luck, the latter in turn will drive new growth back into richer, but more stagnant markets.

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