strategy+business

**ISSUE 73** WINTER 2013

BEST BUSINESS BOOKS 2013

# Globalization: Here Come the New Competitors

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**REPRINT** 00223

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# GLOBALIZATION

Nirmalya Kumar and Jan-Benedict E.M. Steenkamp, **Brand Breakout: How Emerging Market Brands Will Go Global** (Palgrave Macmillan, 2013)

Seung Ho Park, Nan Zhou, and Gerardo R. Ungson, **Rough Diamonds: The Four Traits of Successful Breakout Firms in BRIC Countries** (Jossey-Bass, 2013)

Christopher M. Schroeder, **Startup Rising: The Entrepreneurial Revolution Remaking the Middle East** (Palgrave Macmillan, 2013)



## Here Come the New Competitors

by John Jullens

**AS NOBEL PRIZE–WINNING** economist A. Michael Spence pointed out in his book *The Next Convergence: The Future of Economic Growth in a Multispeed World* (Farrar, Straus and Giroux)—selected by *strategy+business* as one of the best business books of 2011—we are living in the middle of a century-long journey during which the rest of the world will catch up with the developed economies of the West. By the time that journey is over, around 2050 or so, perhaps 75 percent of the world's population will live in developed economies, as opposed to a mere 15 percent today.

Spence explains this convergence primarily from the elevated but limited perspective of nations: macroeconomic policy, institutions, technology, culture, geography, and political systems. Country-level policies are undoubtedly important, but ultimately it is the individual firms within nations that will become the actual engines of economic convergence. In the words of Paul Krugman, another Nobel laureate, nations don't compete; companies do.

This year's best business books on globalization examine the rise of the emerging market companies that will drive the process of economic convergence and will also compete head-to-head against established multinational corporations (MNCs) from the United States, Europe, and other developed economies.

**Brand Breakouts Ahead**

The first wave of multinationals from emerging markets have already arrived on the global scene. In fact, several companies, including China's Sinopec, India's Reliance, and Brazil's Vale, have earned spots on the Fortune Global 500. But these pioneers are typically large state-owned enterprises in foundational industries, such as financial services and telecommunications. In their new book, *Brand Breakout: How Emerging Market Brands Will Go Global,* Nirmalya Kumar and Jan-Benedict E.M. Steenkamp, professors at London Business School and the University of North Carolina's Kenan-Flagler Business School, respectively, explain why that's the case. According to the authors, the pioneers are thriving so far because of their preferential access to capital, resources, and large, fast-growing domestic markets, not because they possess strong brands, technology, or other firm-specific advantages. For example, no Chinese or Indian names appear on Interbrand's 2012 list of the top 100 global brands, and few Western consumers can spontaneously identify a Chinese or Indian brand.

This may be good news for established consumer-facing companies from developed nations, but Kumar and Steenkamp believe the current situation is unlikely to last for long. No emerging market has evolved into a developed one without spawning at least a few global brands along the way. The ability of emerging market companies to build powerful brands and migrate upmarket and overseas is crucial for the upgrading of the economy as a whole. Kumar and Steenkamp refer to this process as *brand breakout* and describe eight pathways that emerging market companies can pursue to launch their global products and services.

Some routes are strategic and involve repositioning the entire firm, whereas others are much more tactical. For example, the highly strategic "Asian Tortoise Route" requires establishing a beachhead niche in a developed market by selling a decent product at a very low price, and then, in an upward spiral of interlocking steps, increasing product quality and price until the brand achieves a dominant market presence across the entire price/quality range. This approach was, of course, pioneered by a group of now global Japanese firms, including Sony and Toyota, and later adopted by a host of South Korean and Chinese firms, including Hyundai, Samsung, and, more recently, Haier. The "Business to Consumer Route" is similarly strategic. On this path, the emerging market firm first enters the industry as a business-to-business contract manufacturer for global retailers (such as H&M or Walmart) or consumer brands (such as Apple or Nike). Then, it enters an adjacent product category or a higher value-added business with its own consumer products. Witness how China's Galanz went from being an OEM to being a branded player in microwave ovens.

On the other hand, the "Diaspora Route" is far more tactical, and simply requires following first-generation emigrants into developed markets, as many of these potential customers retain at least some of their traditional brand preferences and consumption patterns. This provides a foothold from which the brand can subsequently be launched into more and more consumer segments. Notable examples include India's Reliance BIG cinemas and Malaysia's Maybank Islamic banks. A variation is the "Reverse Diaspora" path, through which a brand such as Hong Kong's Mandarin Oriental Hotels or Mexico's Corona beer successfully expands globally by tapping the awareness generated by tourists and other visitors to its home market. Another tactical path is the "Positive Campaign Route," which some emerging market firms have used to overcome potentially negative consumer perceptions by obscuring the country-of-origin association, among other tactics.

Unfortunately, not all of the eight routes are equally compelling, and the last, the "National Champion Route," seems largely disconnected from the rest and comes across as a bit of an afterthought. It is also unfortunate that many of the case studies are from China and the automotive industry, as neither author is an industry expert or native to China, so their explanations occasionally sound a bit naive. Nevertheless, Kumar and Steenkamp provide plenty of useful, real-world examples, and the book is well grounded in academic research, yet admirably free of scholarly jargon.

**Beware Rough Diamonds**

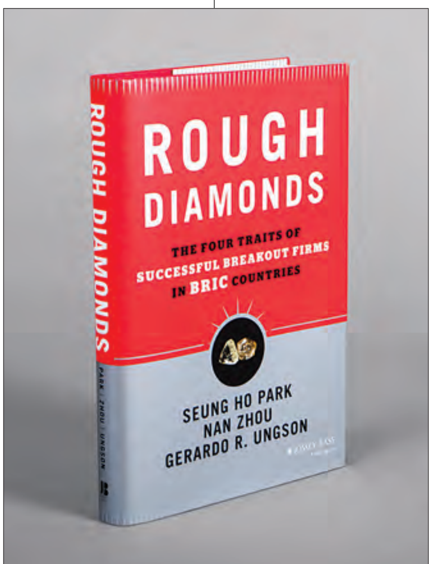
The large companies described by Kumar and Steenkamp are probably already on the radar of established MNCs; however, a second wave of lesser-known emerging market firms are just beyond the horizon and rapidly approaching. These new competitors are smaller, privately held companies from the BRIC nations (Brazil, Russia, India, and China), and some of them are already posting long-term growth rates far higher than those of most of their counterparts in both emerging and developed economies.

Under the auspices of the SKOLKOVO Institute for Emerging Market Studies, Seung Ho Park and Nan

Zhou, professors at the Moscow School of Management SKOLKOVO, and Gerardo R. Ungson, a professor at the College of Business at San Francisco State University, spent three years identifying and studying these companies using a five-step process that included several screens of data analysis (financial metrics and frontier analysis to evaluate each company's resource allocation efficiency), secondary data analysis, and field interviews. They ended up with a list of 70 "stars of the future"—22 in India and 16 each in China, Russia, and Brazil—that are the focus of their book, *Rough Diamonds: The Four Traits of Successful Breakout Firms in BRIC Countries.*

In it, the authors report that this select set of companies grew at an average rate of 43 percent per annum from 2000 to 2009. Moreover, they write, "in terms of profit margins and return on assets over an extended period of time, these rough diamonds match and often exceed the top five hundred private firms in their respective countries, not to mention the top twenty-five manufacturing firms in their countries and comparable firms worldwide."

How did the rough diamonds achieve this feat? The authors trace their success to a progressive sequence of four strategies that they label "the Four Cs of High Performance."



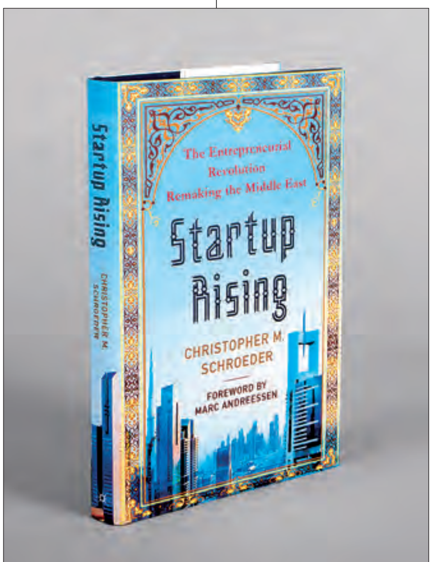

First, the rough diamonds *capitalize* on being latecomers to their industries, which are often global and already mature, with well-established technologies and scale advantages—all formidable barriers to entry. The rough diamonds can deal with this because they are unusually adept at spotting the opportunities that arise in established markets during economic transitions, such as market liberalization, privatization, and shifts in consumer demand. For example, Russia's OMK (United Metallurgical Company), which was cobbled together at low cost through the acquisition and consolidation of several run-down, state-owned metallurgical companies, found success by focusing on two nascent markets: railroad wheels and large-diameter piping.

Second, rough diamonds *create* inclusive market niches and segments. In emerging markets, demand is not only nascent, but often extremely fragmented as well. The enormous diversity in customs, cultures, and languages can be bewildering, especially in continent-sized markets, such as China and India. Rough diamonds leverage their superior knowledge of local markets and customers to anticipate demand, secure first-mover advantages, differentiate their products and services, and consolidate their positions ahead of their foreign competitors. For example, Esmaltec, a Brazilian appliance manufacturer, changed production from one-door to two-door refrigerators, added frost-free technology, and lowered the energy consumption on every one of its products, all without a large increase in price, while its Western competitors were waiting for high-end demand to grow.

Third, rough diamonds *craft* operational excellence. The authors found that these companies all spend a good deal of time and effort developing efficient and flexible operations. Since distribution and logistics systems tend to be extremely fragmented in emerging markets, rough diamonds invest heavily in both backward and forward integration, often building out complete supply chains of their own. In Brazil, for example, Magnesita developed an integrated supply chain from scratch, establishing a network that stretched from mining to the manufacturing of its nonclay refractory products to distribution and logistics. Rough diamonds also pay much attention to ensuring quality along the entire value chain, because trust in a company's integrity can be even more important in emerging markets than elsewhere, due to weak institutions and a lack of enforcement power. And they are innovative, building up their R&D capabilities by making investments in education, hiring top researchers, and creating focused learning centers.

Finally, rough diamonds *cultivate* profitable growth. The conventional wisdom holds that success in emerging markets is a function more of rapid revenue and market share growth than of early profitability. However, such a top-line growth fetish often leads to overextension in emerging markets, because the requisites of growth—such as manufacturing facilities, managerial talent, and physical infrastructure—are limited by underdeveloped market institutions. In examining more than 105,000 BRIC companies over consecutive five-year periods, the authors reported that more than 70 percent of the firms that adopted a profit-oriented strategy in Phase I retained their higher profitability in Phase II, whereas fewer than 10 percent successfully made the switch from a sales-first strategy to profits later. Thus, it is not surprising that virtually all rough diamonds adopt a more balanced approach to growth that doesn't overtax their internal resources or incur unnecessary risks. These companies recognize that growth is important, but pursue it in a phased approach of gradual and incremental expansion, while remaining intently focused on sustaining high levels of profitability. Accordingly, the authors also find that rough diamonds do not engage in M&A nearly as much as do many state-owned enterprises, especially those in China. Undoubtedly this is partially due to their incrementalist management philosophy, but perhaps it also reflects their relatively small size and few resources.

The book's focus on a hitherto little known set of private companies, instead of Huawei, Lenovo, Tata, and the other usual suspects, makes it a valuable addition to the growing body of literature on emerging market multinationals. In addition, the authors' data on the long-term benefits of adopting a profit-first versus a top-line growth orientation is truly insightful, and their extensive experience and insight into the peculiarities of doing business in emerging markets shine through on every page. For these reasons, *Rough Diamonds* is my choice for the best business book on globalization in 2013.




**A Tidal Wave of Entrepreneurialism**

The emergence of rough diamonds, and indeed of any national economy, depends on an environment that encourages and supports entrepreneurial activity. China's economic growth spurt didn't start until the early 1980s, when Deng Xiaoping unleashed a wave of entrepreneurship via township and village enterprises, which were effectively private firms at the local level. Similarly, India's economy took off only after it finally abandoned the stifling bureaucracy of the License Raj in the early 1990s (although India continues to have a large number of rules and regulations that, for example, make it difficult to start a new business).

We are seeing hotbeds of entrepreneurial activity in emerging economies throughout the world. It is highly likely that this is where many of the great global competitors of the future are being incubated right now. One of these hotbeds is the Middle East. It's easy to forget that, like China and India, the Middle East was once one of the most technologically advanced and economically powerful regions in the world, with a leadership position in science, math, and philosophy, and a long tradition of entrepreneurship. Today, even as the region is experiencing wrenching political upheavals, Christopher M. Schroeder, a venture capitalist and former e-commerce CEO, points to another revolution—a less-heralded entrepreneurial one—that is unfolding with far fewer headlines.

In *Startup Rising: The Entrepreneurial Revolution Remaking the Middle East,* Schroeder reminds us that the collective GDP of the Arab world is larger than Russia's and India's and nearly twice that of China on a per capita basis. The Middle East also has more than 350 million people whose disposable income has grown by 50 percent over the last three years and whose Internet appetite has been expanding at a speed that rivals that of any other region in the world. And more than 40 percent of those online denizens say that they would like to start their own businesses.

Schroeder categorizes the startups that are being launched in the Middle East into three buckets: improvisers, problem solvers, and global players.

Improvisers are businesses that adopt proven models from other markets and "Arabize" them in both language and cultural sensibility. For example, Altibbi.com is reminiscent of WebMD, but adds the anonymity of message boards to protect female users. Egypt's Nezal Entertainment created a Facebook game based on its founders' experiences in Tahrir Square, using those 18 days of protest as a backdrop.

Problem solvers are businesses that take on local and regional challenges that were once relegated to governments to solve. In Egypt, RecycloBekia has developed a successful business around the recycling of computer components, which the company plans to introduce throughout the Middle East.

But it's the global players that should be of most interest to established MNCs trying to understand the fast-changing competitive lineup. In the healthcare arena, for example, Lebanon's Cardio Diagnostics has designed a lightweight device with heart-monitoring sensors that regularly send signals to a dedicated monitoring center. In contrast to the cumbersome, wired devices that are usually used for one or two days in the United States, Cardio Diagnostics' devices are used for six weeks or more, and they offer improved monitoring via intelligent algorithms.

Schroeder thinks that we will see Middle East startups offering similarly innovative solutions that could be scaled throughout the region and beyond in at least three other areas: mobile communications, on the basis of the nearly 100 percent mobile penetration and rapid adoption of smartphones in the region; solar-powered electricity, which, for example, could be used to cost-effectively tap into the world's largest untapped body of fresh water, which lies beneath the Egyptian–Libyan desert; and social networking, through these entrepreneurs' intimate knowledge of their local markets and the consumer-facing platforms that would work best in the region.

Unlike the authors of the other best business books on globalization, Schroeder makes little attempt to provide a diagnostic framework to explain what he sees on the ground. Instead, he provides a highly engaging account of his encounters with one Middle East entrepreneur after another, and, in doing so, is convincing in his argument that we should not overlook the entrepreneurial spirit of the Middle East, and other emerging economies, as we try to anticipate where the competitive thrusts of tomorrow may originate.

The effect of these new competitors—from large enterprises pursuing global brand breakouts to the rough diamonds to the startups—on established MNCs from developed markets will no doubt be profound. The incumbents will have to not only develop new markets for their products and services in emerging economies, but also simultaneously defend their global leadership positions against increasingly formidable competitors. Further, they'll have to do so in a vastly more complex political and business environment, as, contrary to the conventional wisdom, economic convergence will not necessarily lead to cultural or political convergence, any more than the "death of distance" means that the world has suddenly become flat.

Most MNCs have only just begun to develop the organizational capabilities they'll need to meet this challenge. For example, merely a handful have shifted significant innovation resources to one or more emerging markets to acquire the frugal engineering capabilities required for developing the low-cost products demanded by local customers. Fewer still have mastered managing their emerging market distribution channels, partnering with local players, and successfully navigating the often treacherous political waters of emerging markets. Most importantly, few MNCs have developed truly global mind-sets, mainly because the leadership ranks of most of them continue to be dominated by executives from their home countries, with all the predictable global blind spots and misunderstandings this entails. But as this year's best business books on globalization vividly illustrate, they will soon be dealing with a flood of new competitors—ready or not. ✚

> We are seeing hotbeds of entrepreneurial activity in emerging economies, where the great global competitors of the future are being incubated.

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is published by Booz & Company Inc.
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