

# Globalization 3.0

## Competing for growth



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# Introduction

Between 2011 and 2025, emerging economy GDP is expected to grow by about 4.7% every year, more than double the 2.3% pace of the developed world, according to the latest World Bank forecast.

If growth continues in line with these expectations, nearly half the world's GDP will be produced in rapid-growth markets by 2015. "The fast rise of emerging economies has driven a shift whereby the centers of economic growth are distributed across developed and developing economies – it's a truly multipolar world," said Justin Yifu Lin, the World Bank's Chief Economist and Senior Vice President for development economics. The primary cause, in his view, is "emerging market multinationals are becoming a force in reshaping global industry."

This report, *Globalization 3.0*, looks at a key force behind this revolutionary shift: a dynamic group of leading companies now dominant in rapid-growth markets. We compared the performance of 150 enterprises from rapid-growth markets to 80 leading US and European companies.

Our analysis found that whatever short-term volatility may be ahead for businesses across the world, the longer-range trend is toward a broader geographical distribution of market leading enterprises. For established companies that grew in an age of more limited competition, this new era is likely to prove an exciting and dangerous time – it's now a much more complex game with threats and opportunities in all directions.

For investors, our findings suggest that balanced portfolios can no longer be neatly divided between well-established, financially sound companies at home and potentially more volatile ones abroad. World-class companies are now found everywhere, and in the rapid-growth markets, prudent fiscal policies are now the rule rather than the exception. For business leaders everywhere, the old certainties are gone too – where the serious competitive threats will come from, where the richest markets are located, and which locations will have the greatest cost advantages. As a result, we all must learn to compete in a world turned upside down.

## Highlights

- ▶ Nearly one-third of the world's 1,000 largest public companies by market capitalization are now based in rapid-growth markets. Of these, BRIC companies (Brazil, Russia, India, China) represent 70% of the value.
- ▶ Over the last five years, the average annual sales growth rate of the 150 companies from rapid-growth markets in our sample is almost three times higher than our developed market sample (17% versus 5%).
- ▶ Despite a slight downward dip in their growth rates last year, our rapid-growth market sample came through the recent global financial crisis in a much better shape than our developed market sample.
- ▶ The average operating margin of the companies from rapid-growth markets reached 24%, compared with 18% for the companies from developed markets. There is a similar gap with net margins. Rapid-growth market companies reached 19%, compared with 13% for the companies from developed markets.
- ▶ The overall stock performance of the 150 rapid-growth market sample tracked in this study has increased by 132% over the last five years compared with 6% for companies from the developed market sample.
- ▶ Research from Ernst & Young<sup>1</sup> shows that as the world economy grows, high performing companies have focused on executing four drivers of competitive success: customer reach; operational agility; cost competitiveness and stakeholder confidence.

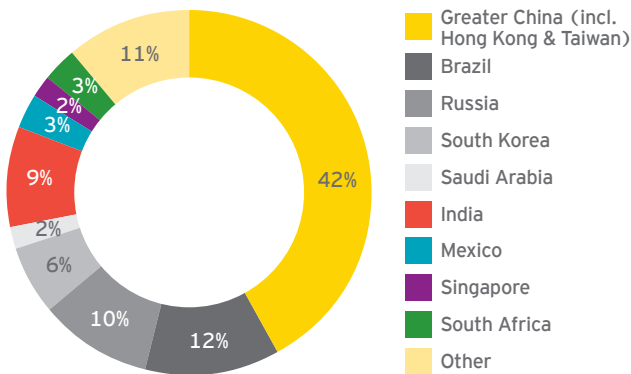
1 Ernst & Young: Competing for growth: How business is growing beyond boundaries, April 2011.

# A truly global marketplace

## The rise in economic power of rapid-growth markets has caused a fundamental shift in the global competitive landscape.

In 2000, only 10% of the world's top 1,000 public companies by market capitalization were from rapid-growth markets. Now it's 31%. By value, rapid-growth markets represent 27% of the top 1,000 cumulated market capitalizations, up from 5% only 10 years ago. Within the rapid-growth markets, 73% come from the BRICs: 42% from China; 12% from Brazil; 10% from Russia; and 9% from India. In fact, rapid-growth market corporate strength may be even greater than it appears on corporate indices, given that relatively few developing market companies are publicly traded. Family-owned firms still represent 75% of the largest business groups in Brazil, for example, according to the *Latin American Business Focus*.

**Global top 1,000 market capitalizations – share of the rapid-growth market sample. Breakdown by economy (in value)**



Acquisitions continue to play a critical role in a company's growth strategy. Alongside the typical mature market to rapid-growth market deals such as PepsiCo's US\$2.5b purchase of a controlling interest in the Russian juice and dairy giant Wimm-Bill-Dann in December 2010, we are seeing deals between companies from rapid-growth markets and from rapid-growth markets to mature markets. In 2010 global M&A totalled US\$2.4 trillion and roughly one-third of this value was from rapid-growth markets, according to Thomson Reuters.

Rapid-growth market players are holding their own as competitive bidders. In March, General Mills bought a controlling stake of French dairy company Yoplait for US\$1.15b, winning the bid over China's Bright Foods. In 2010 Geely, a fast-growing Chinese automotive company bought Swedish carmaker Volvo, from Ford Motor Company for US\$2.5b. Geely was reportedly looking for car-making know-how, access to export markets and a high-quality brand to sell in China.

But it's not really a story of youth triumphing over age. Instead, some global deals today are bringing together leading practices, such as melding the entrepreneurialism and operational excellence of Tata Motors with the engineering and branding of Jaguar/Land Rover – which now has an Indian shareholder, a German manager and an English brand.

More and more leading companies today are trying to pull in talent and expertise from all corners of the globe. Consider Skype, founded by a Dane and a Swede in Estonia and based on peer-to-peer architecture. It was designed by an Estonian team, first bought by eBay (itself founded by a French-born Iranian working in California) and recently resold to Microsoft, based in the US.

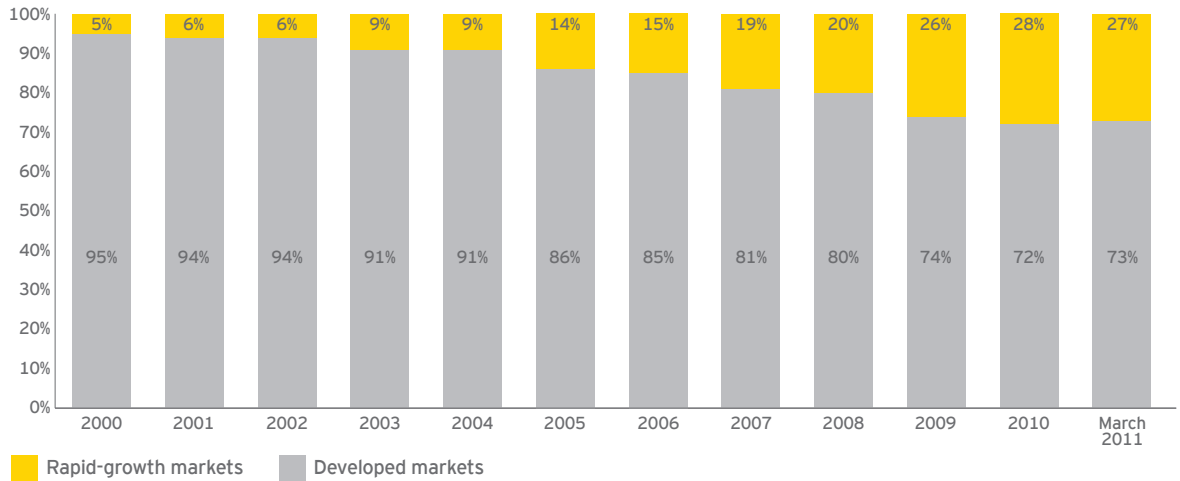
Growth cannot be accomplished without volatility, however. Clearly for some rapid-growth markets, investors are pricing in concerns over the complexities of doing business in these markets. For example, the concerns over inflation and price bubbles and their implications in China. The ongoing developed-market debt crisis could also have unpredictable consequences. But the longer view is tending toward a world where the best ideas reach the global market faster, and the most significant technologies roll out almost simultaneously across all markets. Nearly five billion cell phones are now in use – almost universal penetration since the broad market rollouts began 20 years ago, according to Wireless Intelligence.

Despite macroeconomic concerns, the deeper fear of missing out on spectacular growth stories continues to spur investment almost everywhere.

**“World-class companies are now found everywhere and business leaders need to adjust to this new reality.”**

– Alexis Karklins-Marchay, EMEIA Capital Transformation Leader

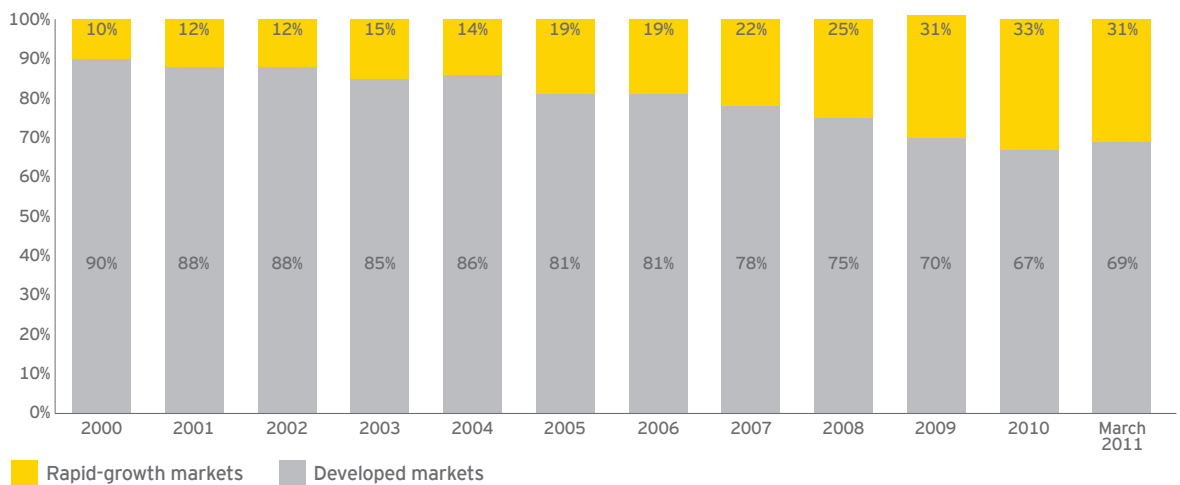
**Global top 1,000 market capitalizations – by value**



Source: Ernst & Young analysis, based on Bloomberg data

**31% of the top 1,000 public companies in the world are from rapid-growth markets**

**Global top 1,000 market capitalizations – number of companies**



Source: Ernst & Young analysis, based on Bloomberg data

# Three dimensions of performance

For this study, we reviewed the performance of 150 leading rapid-growth market companies. This included approximately 20 from each of Brazil, Russia, India and China, plus a further 10 from each of South Korea, Mexico, Poland, South Africa, the Middle East, Turkey, Indonesia and Malaysia.

These results have been compared against a sample of 80 listed large cap peer companies in the developed markets. Fifty were drawn from the Dow Jones Europe Stoxx 50 index and 30 from the US Dow Jones Industrial Average.

Performance has been broken down into three key dimensions:

- ▶ growth in sales
- ▶ margins
- ▶ stock performance.

All three are key indicators of success, which are of course related, but each indicator tells its own story.

## Sales growth

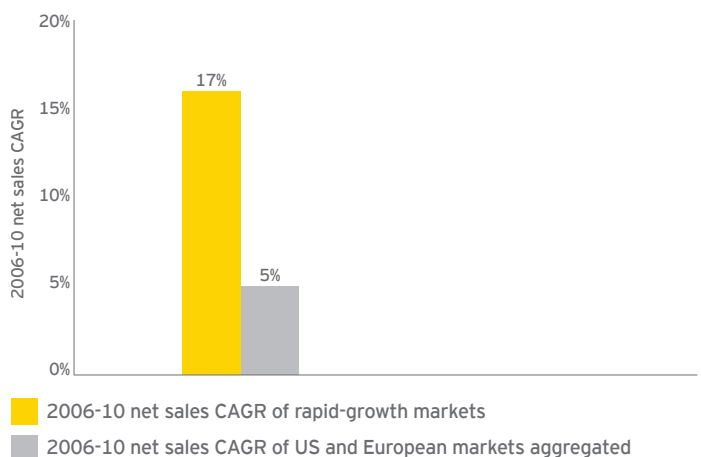
For the rapid-growth market companies in our sample, the growth in sales has been much stronger over the last five years (2006-10) than the developed market sample. Over this period, the average annual sales growth rate of the rapid-growth market companies is 17%. This is almost three times higher than the developed market companies' average annual sales growth of 5%.

Some of these gains are due to the exceptional growth of their domestic economies. Others have benefitted from rising raw materials prices, particularly mining and oil and gas companies.

Developed market companies suffered more from the financial crisis than those from rapid-growth markets. Except for a knock against exports, the economic downturn was experienced as a distant concern in the rapid-growth markets. With lower public debt, different levels of regulatory control and less access to leverage, very few rapid-growth market companies experienced the extent of difficulties that befell so many players from the developed markets.

Overall, the best performers in sales growth have been companies from India, where sales have climbed by a compounded annual average of 27%; Brazil, where sales have climbed by 22%; Russia, where they have grown by 17%; Indonesia and Malaysia, where sales are up 16%; and China, where they have grown by 17%.

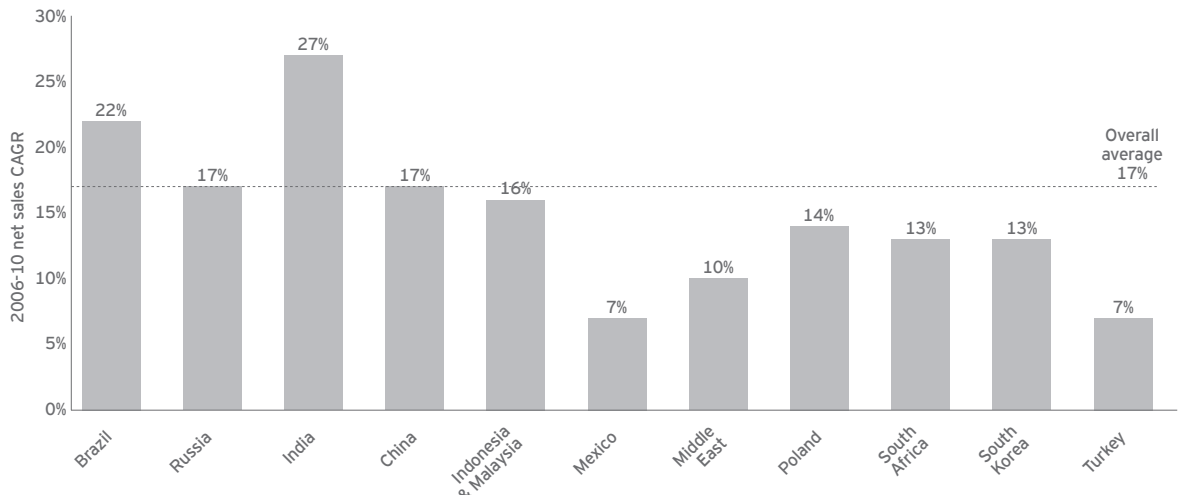
### 2006-10 average net sales CAGR – rapid-growth markets vs. US and European markets



Source: Ernst & Young analysis based on OneSource database



### 2006-10 net sales CAGR – rapid-growth markets



Source: Ernst & Young analysis based on OneSource database

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**17% the average annual sales growth rate of the rapid-growth market sample**

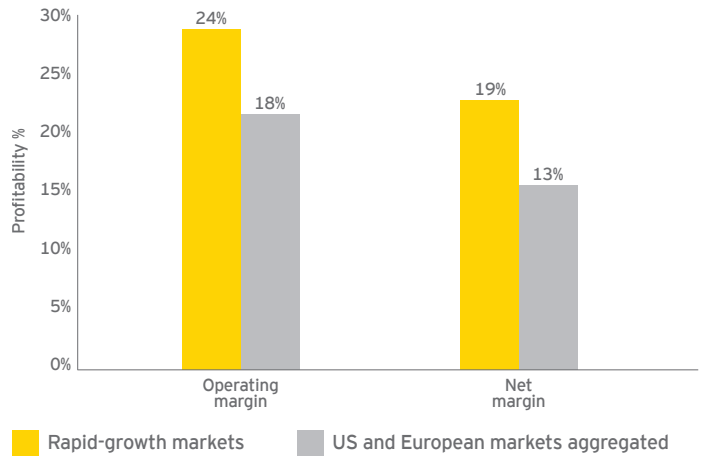
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## Margins

Performance is not only based on strong top-line growth; margins are another indicator. Average operating margin of the rapid-growth market sample reached 24%, compared with 18% for the companies from developed markets. There is a similar gap for net margins. Rapid-growth market companies reached 19%, compared with 13% for the companies from developed markets. The average operating margin of the Russian companies in our sample were particularly high at 27%. As usual in Russia, prosperity and petroleum go hand in hand. This year, as mining, oil and gas prices rose, so did the margins.

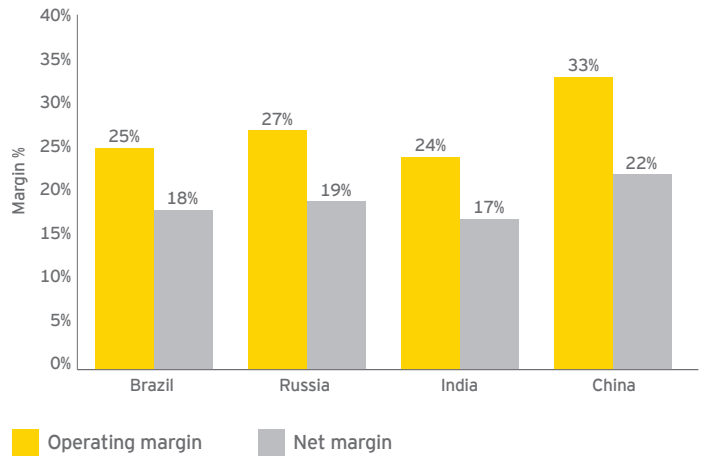
Lower labor costs and a lighter regulatory hand are still the biggest contributors to margin performance in the rapid-growth economies. However, margins are also increasingly being driven by the fact that many of these companies are now world-class operations that command real intellectual property. Tata Steel, for instance, is one of the most efficient steel producers in the world. Taiwanese company HTC is a leader in touch screens. Embraer, a Brazilian aerospace company, is one of the top three global aircraft manufacturers. Increasing numbers of high performers aren't so much rapid-growth market companies, as companies that happen to be based in rapid-growth markets.

### Profitability – rapid-growth markets vs. US and European markets



Source: OneSource data as of 31 December 2010

### Operating and net margin – BRIC (Brazil, Russia, India, China)



Source: OneSource data as of 31 December 2010

**24% average operating margin of the rapid-growth market sample**

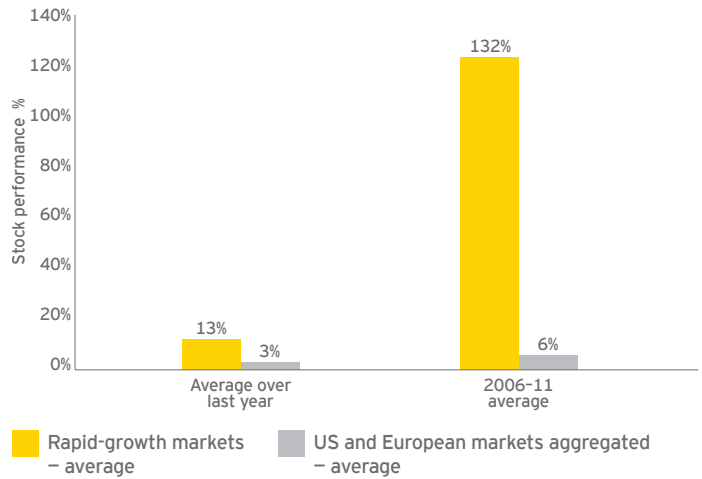
Overall stock price of rapid-growth market companies has increased by 132% over the last five years, compared to just 6% for companies from developed markets.

## Stock price

The overall stock performance of the companies from rapid-growth markets in our sample have risen on average by 132% over the last five years compared with 6% for the comparable developed market sample. However, the rate of increase now seems to be slowing which is not unexpected after many years of exceptional growth. Our rapid-growth market sample saw 13% growth last year on average compared with 3% for companies from developed countries (11%+ for the US and -1% for Europe).

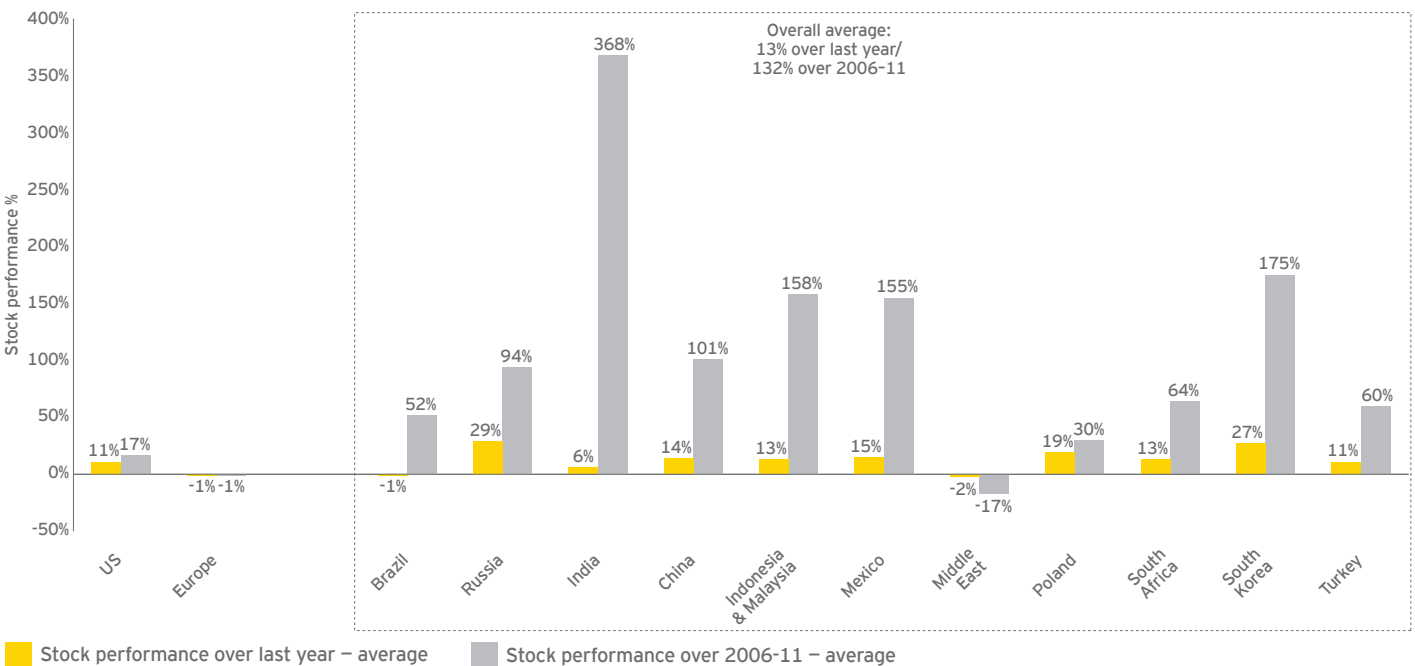
Of course, these are just averages. Some rapid-growth market players had spectacular runs over the past five years, including MMTC and Jindal Steel and Power, both of India; and LG Chem Ltd. of South Korea. The majority doubled. The only poor performers of our entire list were in the Middle East, pulled down by concerns over the recent revolutions in Tunisia and Egypt, war in Libya and protests in Yemen, Bahrain and Syria.

### Stock performance (average) – rapid-growth markets vs. US and European markets



Source: Factset, Bloomberg

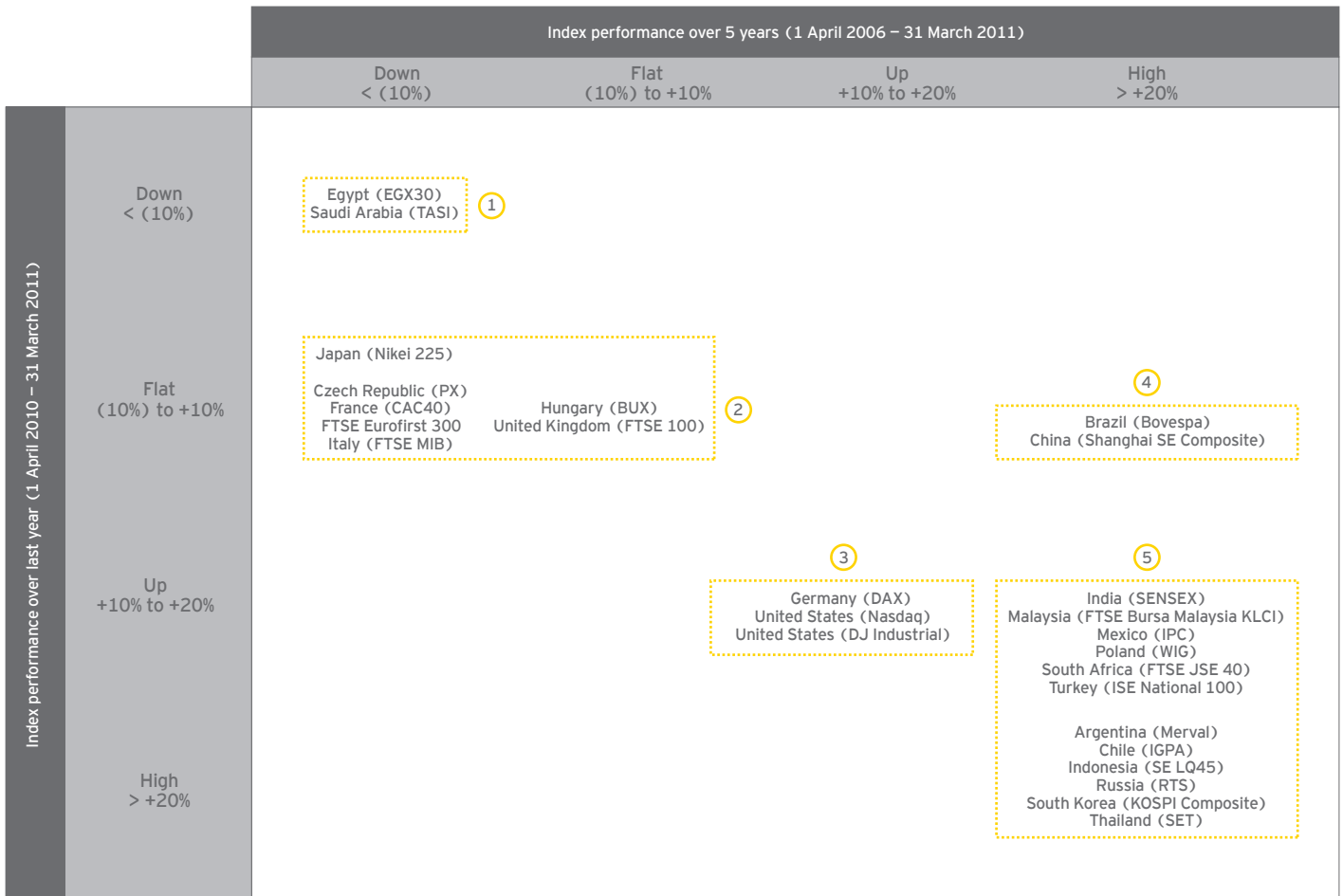
### Stock performance (average) – rapid-growth markets vs. US and European markets



Source: Ernst & Young analysis as of 31 March 2011 based on Factset and Bloomberg data

# Rapid-growth markets trounce mature market stock indices

A look at the performance of 26 of the world's top indices shows what is now a familiar story – the continuing rise of many of the leading rapid-growth markets.



Source: Ernst & Young analysis based on Factset



### 1 Egypt (EGX30) and Saudi Arabia (TASI)

Investors hate uncertainty, but despite the toppling of the governments in Tunisia and Egypt in these demographically young countries, enough remains uncertain. At the end of Q1, Egypt ended more than 10% down from where it stood five years ago. Saudi Arabia also ended over 10% down, which, given the price of oil, clearly shows how seriously investors are taking the risk of political uncertainty in the region.

### 2 Japan (Nikkei 225), Czech Republic (PX), France (CAC40), Italy (FTSE MIB), FTSE Eurofirst 300, Hungary (BUX), United Kingdom (FTSE 100)

The performance of this group reflects concerns about economic prospects, as well as the ongoing cleanup around the financial crash (UK).

### 3 United States (Nasdaq), United States (DJ Industrial) and Germany (DAX)

Overall, Germany has been the healthiest market in Europe over the past five years. Both indices reflect similar prospects in terms of GDP and corporate performances.

### 4 China (Shanghai SE Composite) and Brazil (Bovespa)

Every country is unique, but China and Brazil have similar profiles in terms of their scale and vast possibilities as a consumer market. Both countries have had strong growth in the last five years but some fears about potential speculative bubbles and inflation have appeared recently, which explains why stock indices have not performed as well in recent months.

### 5 India (SENSEX), Mexico (IPC), Turkey (ISE National 100), South Africa (FTSE JSE 40), Malaysia (FTSE Bursa Malaysia KLCI), Poland (WIG), Russia (RTS), South Korea (KOSPI Composite), Indonesia (SE LQ45), Thailand (SET), Chile (IGPA) and Argentina (Merval)

This group is the largest band of rapid-growth market indices. The diversity of this group is an indication of how widespread growth is across rapid-growth markets, and the level of investor faith in the rapid-growth market story.

# Competing for growth

With the rise in global power of rapid-growth markets, competition for growth continues to increase. What does it take to succeed? After surveying 1,400 companies around the world and looking closely at the top quartile (high performers) in terms of revenue and EBITDA growth, Ernst & Young identified four drivers of competitive success:

## Customer reach

High performers choose their markets carefully, and pick their targets within those markets well. They are also expanding their product range, taking cues from their employees and current customers. Most work hard to find the right technical and operational talent needed to set up new operations, and aren't afraid to go outside the organization and traditional recruiting channels to find the right executives.

## Operational agility

Flexible but cautious, high performers achieve sales quickly, using agents for rapid entry, but seek managerial control of longer-term operations. They tend to move quickly from idea to market, using a structured "from thought to finish" process with a launch built into the plan from the start. They take their time recruiting the right senior operations executives, but hire everyone else quickly, trusting that their fast-track staff development programs will fill the gaps.

## Cost-competitiveness

High performers tend to move production as close as possible to the target market, and move their pricing closer to target market levels as well. Often, these companies also seek to lock in their cost bases as much as possible. They structure their cost base to capture value but increase their marketing spend to capture margin. Innovation tends to be kept close to the target as well – and these days, that increasingly means rapid-growth markets. Finally, they're learning to cope with high turnover of people, and becoming increasingly experienced in deciding when hiring the right person matters and when it is only part of the equation.



Source: Ernst & Young: Competing for Growth – How business is growing beyond boundaries

## Stakeholder confidence

High performers are upfront with their stakeholders about the expense and effort required to enter a new market, and they are prepared to go into some detail about their entry strategy. They frequently provide more detail to external stakeholders regarding the opportunity and risk, and are quick to identify and reward innovative talent. Finally, most emerged from the financial crisis in better shape than their developed market cousins.



For more information about Competing for Growth please visit [www.ey.com/competing-for-growth](http://www.ey.com/competing-for-growth)

# Conclusion

Stock prices go up and down in response to changing sentiments, but they tend eventually to reflect the stock value of the company. Clearly, the growth in sales and profit in our sample of 150 leading rapid-growth market companies suggests that, far from being a bubble, their growth is based on genuine financial gains, a fact confirmed by the daily experience of hundreds of millions of people who now have better jobs and lives than they once led.

This is not to say that risks are banished. In the short run, economic growth tends to fuel demands for social and political change as well, and can lead sometimes to political instability. However, although there may be setbacks, we believe the longer-term trend is likely to be for large rapid-growth market companies to continue to grow stronger and more numerous.

For Western companies, this creates a complex new challenge. Where once the competition tended to be just down the street, led by people with a similar education and outlook, competitors can now emerge from almost anywhere. Finding enduring competitive advantages will not be easy. The good news, however, is that economic growth is not a zero-sum game. By definition, the size of the opportunity will almost certainly continue to grow.

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**Competitors now can,  
and do emerge from  
anywhere in the world.**

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# About this report

The approach used in *Globalization 3.0* essentially relies on three types of analysis:

- ▶ Several standard financial metrics (growth of sales over five years, operating margin, net margin)
- ▶ Stock price (stock performance over one and five years)
- ▶ Analysis of stock market indices based on Factset data

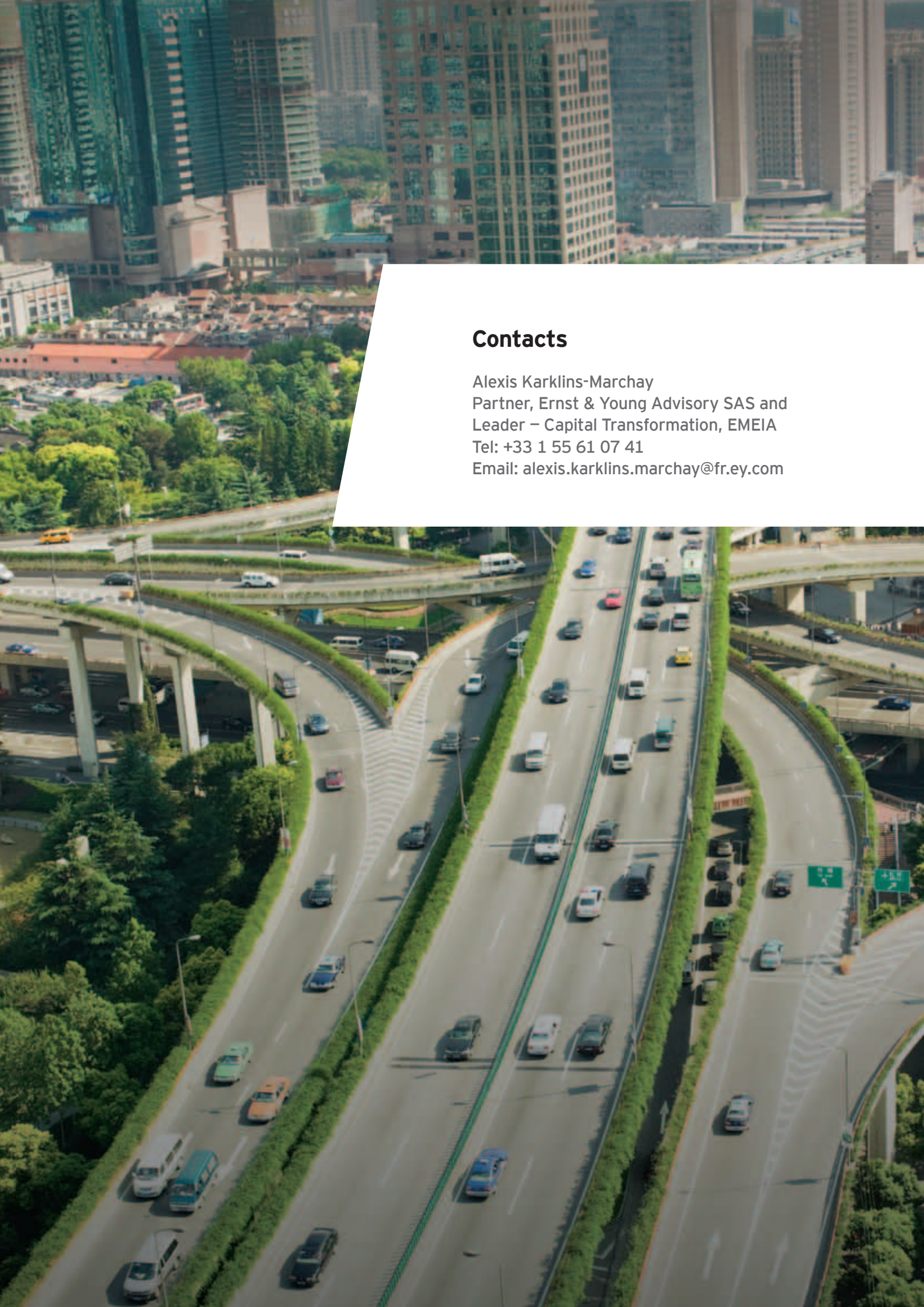
The aim of this report is not to conduct a detailed analysis of the selected companies. The report presents high level factual data based on publicly available information, with the aim of a better awareness and understanding of the performance of developed and rapid-growth market companies. The findings on select financial and operational performance are not meant to represent in any way a judgment of the individual companies analyzed.

For the record and unless stated otherwise:

- ▶ The research of the top 1,000 market capitalizations as of 31 March 2011 is based on market capitalizations expressed in euro and available in Bloomberg;
- ▶ The sales, operating margin (computed as net revenue less operating expenses) and net margin figures are publicly reported actual figures for 2010 and were taken from the OneSource database;
- ▶ For banks, only the net margin is included in our analysis;
- ▶ Apart from the groups listed for only a short period of time, the stock performances over one year and over five years are computed from 31 March 2010 to 31 March 2011 and from 31 March 2006 to 31 March 2011 respectively, based on the price per share expressed in local currency and available in Factset and Bloomberg

It must also be noted that the estimated averages only provide a general trend and need to be analyzed with caution. Indeed, from one company to another, whether they are originally from a rapid-growth country or a developed country, the situation may vary significantly in terms of business and financial results.

The information provided in this report is only relevant as at 31 December 2010 for operating data and 31 March 2011 for market data, unless stated otherwise or apart from any subsequent information included in this report. Any modification of the analyzed groups' financial performances or any evolution of the financial markets that occurred since those dates could lead to partially or completely different conclusions.



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