

Growing Beyond

Fast forward

Strategies for success in tomorrow's
hot new markets



Introduction

The global economy is at a turning point. Fast-growth economies in Asia, the Middle East, Africa, Latin America and Eastern Europe now form almost half of global GDP and, in 2010, they contributed 70% to overall global growth. These trends are accelerating. By 2050, fast-growth economies are projected to account for 65% of the global economy. In contrast, most developed markets are still struggling to recover after the global recession.

Today's global executives increasingly need the skills to manage across these very different environments. To explore this challenge, Ernst & Young hosted its first Global Growth Forum in Washington, DC, on 6-8 June 2011. Senior global businesspeople joined speakers including Henry Kissinger, former U.S. Secretary of State, James Wolfensohn, former President of The World Bank, and Min Zhu, Deputy Managing Director of the International Monetary Fund, in a discussion of what this new reality looks like and how companies can succeed in it.

This report continues and expands that discussion through a series of additional interviews. It forms part of Growing Beyond, an ongoing Ernst & Young program that explores how companies can grow faster by expanding into new markets, finding new ways to innovate and implementing new approaches to talent management.

Three key themes are starting to emerge:

1. **A reversal of fortune.** Developed and fast-growth markets will continue to diverge, but both will face challenges in the years ahead. Leaders must learn to operate across both environments.
2. **New markets, new competitors.** Entrepreneurs and companies from fast-growth markets are competing globally. Leaders must understand the challenges these new competitors present.
3. **A global mindset.** To succeed in this complex business environment, leaders will need to adopt a set of characteristics and traits that enable them to move fluidly across different cultures.

Through discussing these themes and understanding the implications for their companies, global executives, no matter where they are based, can greatly improve their chances of success in the coming years.

Sincerely,

James S. Turley
Chairman and CEO
Ernst & Young

Playing to win

In business, as in life, reversals of fortune are common. Yet few organizations or individuals could have predicted the turnarounds in developing markets in the past few years – or the fallout for countries that have dominated the global playing field for decades. Recent political and economic upheavals only underscore the fact that to win in this new landscape, organizations in both emerging and developed markets must deal with environments where change is unpredictable and happens at dizzying speed.

The business models needed to shape and sustain success in this new landscape are evolving in fundamental ways. Today's globalization is a far cry from that of the last half-century, in which a multinational company usually took a linear approach to global expansion, going from export sales to international sales affiliates to overseas manufacturing facilities. Today, "multinational" really means "multidimensional." This means focusing simultaneously on far-ranging markets and customers, a diverse workforce, efficient and adaptable supply chains and relationships with governments and communities at all levels. It also means addressing complexity and ambiguity to remain flexible in times of adversity.

This multidimensional company must operate in a context of different models of government and regulation, new rules of collaboration and new competitors. What came out of the Ernst & Young Global Growth Forum and subsequent discussions are ideas as to how both entrepreneurial and mature companies might respond to these opportunities and pressures. Although they face different challenges, fast-growth and developed-market companies have much in common. To succeed in this complex environment, they must seek out new perspectives as a way of stimulating innovative thinking. They must learn how to operate across different business and economic environments and understand how to balance autonomy with control. And they must do all this swiftly and decisively. As policy makers and the new companies of tomorrow grapple with these formidable challenges, we hope to find new and thought-provoking ways to stimulate further dialogue, recommendations and action.

Acknowledgements

We are pleased to share some of the great insights from our Global Growth Forum and valuable perspectives from leading thinkers.



Albert Ng
Ernst & Young's Managing Partner
for Greater China



Bing Xiang
Dean of the Cheung Kong
Graduate School of Business



Dr. C. Fred Bergsten
Head of the Peterson Institute for
International Economics



Fons Trompenaars
Co-founder of Trompenaars
Hampden-Turner



Francisco Sánchez
Under Secretary of Commerce
for International Trade at the US
Department of Commerce



Mansour Javidan
Director of the Najafi Global
Mindset@ Institute at the
Thunderbird School of
Global Management

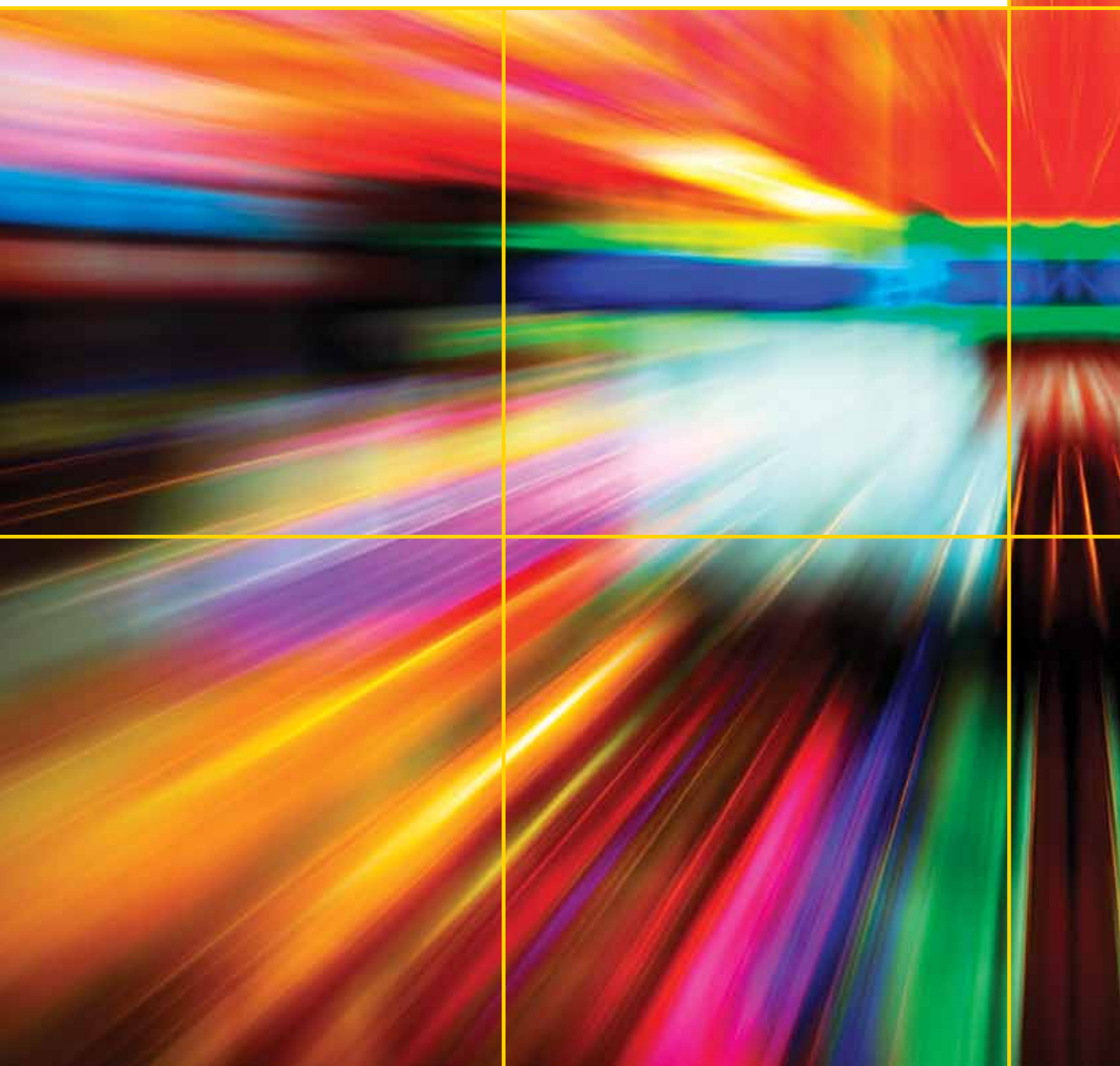


Min Zhu
Deputy Managing Director
of the International Monetary Fund



Navi Radjou
A fellow at the Judge Business
School at the University
of Cambridge

A reversal of fortune





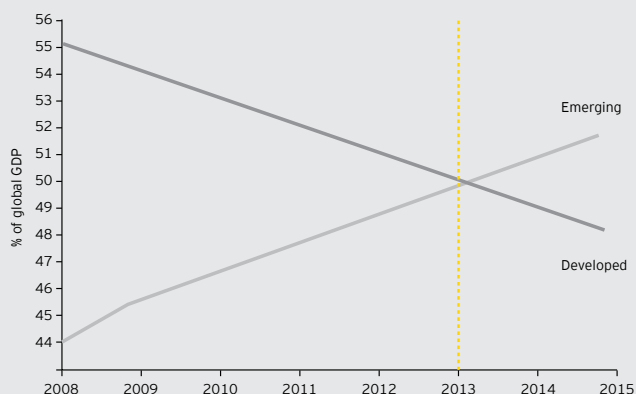
When the inaugural Ernst & Young Global Growth Forum took place in June 2011, speakers were unanimous about the seismic structural changes taking place in the global economy. The era of dominance by the developed OECD countries is drawing to a close. The fast-growth markets of Asia, Africa and Latin America are becoming the engines of the global economy.

Implications for business

- ▶ Ensure that enough long-term funding is available to weather any potential weakening of credit conditions.
- ▶ Play an active role in creating demand even in the face of a potential downturn in the developed economies.
- ▶ Dial back expectations of quick rewards from a huge emerging middle class, but invest now to capture future market share.
- ▶ Expect slowdowns in growth along the way. Be prepared to ride out volatility and be willing to invest for the long term.
- ▶ Update risk assessments of fast-growth markets, focusing on the intensely competitive landscape.

Emerging and developed markets' share of global GDP

According to the IMF, by 2014 emerging markets will have overtaken developed economies in terms of share of global GDP.



Source: World Economic Outlook Database, International Monetary Fund, October 2010.

“It’s good news that investors are increasing allocation to emerging markets, but there is always volatility associated with that”

– Min Zhu

Since June, a series of major events has further skewed the balance. The European sovereign debt crisis now threatens to engulf Italy and Spain. Efforts to address fiscal sustainability in the US have been mired in political gridlock and resulted in the first-ever downgrade of US debt by a major rating agency. This could lead to a loss of confidence in US Treasuries as a safe haven and ultimately to higher borrowing costs across the economy.

“What we are seeing is a series of significant doubts about the economic future of the rich industrial countries, compared with the continued rapid growth and successful economic performance of many of the emerging markets,” said Dr. C. Fred Bergsten, Head of the Peterson Institute for International Economics.

Landmarks in the shifting landscape include:

A darkening outlook for developed markets. Failure to tackle structural problems in developed markets could accelerate the long-term relative decline in their dominance. Even before the debt downgrade, speakers at the Ernst & Young Global Growth Forum expressed strong concerns about the size of US debt and the failure of policy makers to grasp the nettle. Although an outright default may have been avoided, US legislators have merely postponed the tough decisions about how to tackle the country’s debt. As a speaker at the Forum warned, if the US and other developed markets don’t adapt to the new scenario, they will not be the developed markets much longer – becoming, instead, the “submerging” markets.

A reluctance to make tough political choices also lies at the heart of the problems facing the Eurozone. Measures such as the second Greek bailout, which was agreed upon in June, may have averted catastrophe in the short term, but are unlikely to eliminate the risk of default and restructuring altogether. An even bigger concern is the spread of the contagion to the much larger economies of Spain and Italy. “The European countries will continue to kick the can down the road in terms of dealing with their sovereign debt problems, but at some point it’s clear that there will have to be a rescheduling or a partial default of debt,” says Dr. Bergsten.

The overturning of long-held perceptions of risk. The loss of the AAA rating for the US is symptomatic of a broader transition of risk perceptions between developed and fast-growth markets. A decade ago, default by a major developed country was unthinkable, so yields were correspondingly low. And when investing in fast-growth markets, investors demanded a much higher risk premium to protect themselves against what they considered to be a much higher likelihood of default.

But in the wake of the financial crisis, these risk/reward ratios have been turned upside down. Traditional concerns that emerging markets were prone to blow-ups have to a large extent receded. The major risks of investing in fast-growth markets are now competitive, rather than political or economic. A speaker at the Ernst & Young Global Growth Forum pointed out that historically, a foreign investor would have expected high rates of return from markets like China because the main concerns would have been the effect of political decisions, boom-and-bust cycles and liquidity; today, however, the threat is replacement by local investors.

“What we are seeing is a series of significant doubts about the economic future of the rich industrial countries, compared with the continued rapid growth and successful economic performance of many of the emerging markets”

– Dr. C. Fred Bergsten

A major reallocation of global financial assets from West to East. Increasingly, financial assets are likely to move from West to East. As Min Zhu, Deputy Managing Director of the International Monetary Fund, noted at the Forum, only 19% of financial assets are invested in emerging markets, despite these economies making up almost half of global GDP. “Financial assets follow the growth, and this means we will see increasing capital flows into emerging markets,” he said. These inflows can help fund investment and infrastructure, but they can also stoke inflation and unwanted currency appreciation. “It’s good news that investors are increasing allocation to emerging markets, but there is always volatility associated with that,” says Mr. Zhu.

Policy makers in affected countries will increasingly draw a distinction between long-term and speculative capital, with regulators being keen on differentiating between capital that is truly committed to the sustainable development of the country and capital that is invested for short-term speculative returns.

Fast-growth markets’ shift to consumption-driven growth. A key challenge for policy makers in fast-growth markets will be to decrease their reliance on government-led infrastructure spending and increase domestic consumption. As this shift occurs, the opportunities for multinationals increase. As we will be discussing in our forthcoming report *Growing beyond borders – New patterns in international trade*, companies need to gain footholds in fast-growth markets at an early stage to establish a significant market presence and gain market share. But with many fast-growth markets just beginning to make the shift, companies should not expect significant returns quickly. Investments in these markets will require patience and a long-term approach.

Since the global financial crisis, China has made massive investments in infrastructure, largely funded through a US\$500b fiscal stimulus program. As this stimulus is withdrawn, and as the need for infrastructure investments falls, policy makers must seek a new model for growth. In terms of stimulus spending, “investment-driven growth is not sustainable,” says Mr. Zhu.

The changing role of government. The need for a consumption-based model opens a broader debate about the role government should play in managing this transition. Speakers at the Ernst & Young Global Growth Forum expressed uncertainty over whether this model would lead to the kind of world-class companies needed to drive a consumption-based economy. “If the goal of emerging markets is simply to grow and have a stable economy with enough employment, perhaps there will always be a fair amount of government control,” says Francisco Sánchez, Under Secretary of Commerce for International Trade at the US Department of Commerce. “But if they want to grow world-class companies, I think that having that kind of control through state-owned enterprises is in conflict with that objective.”

State-owned enterprises in China continue to be a major employer, and policy-makers must also strike a careful balance between increasing consumption and maintaining economic stability. “The Government would like people to spend more but to recognize that increased consumption can lead to a rise in inflation,” says Albert Ng, Ernst & Young’s Managing Partner for Greater China. “Making the transition to a consumption-based society while maintaining an acceptable rate of inflation will be a key challenge for policy makers in China.”

“If the goal of emerging markets is simply to grow and have a stable economy with enough employment, perhaps there will always be a fair amount of government control”

– Francisco Sánchez

New markets, new competitors





Until recently, Western multinationals that invested in fast-growth markets were accustomed to a surplus of opportunity but a shortage of local competition. This benign competitive landscape is now a thing of the past. As speakers at the inaugural Ernst & Young Global Growth Forum explained, companies in fast-growth countries have grown in confidence and are moving up the value chain. They are investing in innovation, consolidating market share in their domestic markets and, increasingly, expanding overseas – to both other fast-growth and developed markets.



Implications for business

- ▶ Learn from new fast-growth-market competitors and apply the lessons to traditional companies.
- ▶ Anticipate the possibility of becoming an acquisition target for fast-growth-market companies.
- ▶ Expect to see fast-growth-market companies taking minority stakes in developed-world multinationals.
- ▶ Look for deal synergies that might result from different demographic profiles and cultures.
- ▶ Shed the “old” way of doing things and increase flexibility and speed of response to opportunities in global markets.

“Leading economies in Asia have not just they are rapidly closing the innovation gap. innovation output is now market-leading”

– Albert Ng

Fast-growth-market companies are:

Using their huge domestic markets as a springboard for global expansion. The major fast-growth economies are becoming the engines of global consumption. For example, China is already the world’s largest market for cars, mobile phones, luxury goods and televisions. As more people enter the middle class in the fast-growth economies and feel comfortable about spending, these markets will continue to expand, and it is possible for domestic companies to become global giants without venturing overseas. Still, a growing number are doing so, even as they enjoy strong balance sheets and consolidate their domestic position. Their stable platform will help them weather the ups and downs of globalization and potentially give them an advantage over developed-world multinationals heading in the opposite direction.

Born global. Not all fast-growth market companies see the need to consolidate their domestic position before heading overseas. A new breed of younger entrepreneurs is moving beyond the traditional business models of low cost and economies of scale to build competitive advantage around innovation, technology and the leveraging of global resources.

Fast-growth-market companies are building strong export brands and developing the resources and capabilities to compete against established players in developed markets. As these companies grow in confidence, they are casting off their role as contract manufacturers and using their innovation capabilities to build market-leading companies and globally recognized brands.

“The new generation of fast-growth-market entrepreneurs is global at the outset,” says Bing Xiang, Dean of the Cheung Kong Graduate School of Business in China.

Likely to make cross-border acquisitions. The desire to build an innovation-based society will encourage a growing number of companies from fast-growth markets to acquire assets in developed markets. For instance, China may seek to support increased rates of foreign acquisitions as it considers alternative means of investment for its foreign currency holdings, given recent concerns about US Treasuries. “Many Chinese companies are looking at acquisitions of small, innovative companies as a way to move up the innovation value chain,” says Mr. Ng.

Professor Xiang cites deals between Chinese and Japanese small and mid-sized enterprises as one potential growth area. “Japanese companies are very strong in processes and efficiency, so when you combine that with the Chinese strengths of quick innovation, flexibility and experience in fast-growth markets, this could create some powerful synergies,” he says. “The two countries also have very different demographic profiles, which mean that deals between them could be a good strategic fit.”

Set to benefit from equity participation. Regardless of whether they are global or domestic, fast-growth-market companies will need to leverage global resources in order to succeed. A company that derives most of its revenues from China still needs to scour the world for the best materials, talent and technologies. If it doesn’t, it will lose out to competitors that are better able to integrate resources from other markets.

closed the production gap with the West; In many critical industries, Asia's

Companies from fast-growth markets have successfully pulled off global mergers and acquisitions, but equity participation may be a better alternative. "The chances of failure in outright acquisition are very high," says Professor Xiang. "Many Chinese companies lack the experience of managing a truly global company. Equity participation enables them to leverage global resources without the headache of full integration, and is therefore likely to have a much better chance of success."

Able to adapt and respond quickly to external changes.

Leading Western multinationals have spent decades building their operations and business processes around an assumption that developed economies will remain their most important markets. Their management teams consist of individuals whose experience is limited to these core markets, and their infrastructure and innovation processes are set up to meet the needs and price point of their developed-world customers.

This model has served these companies well, but it is unlikely to enable them to compete effectively with more agile and flexible fast-growth-market businesses. "Companies in China and India have none of the organizational baggage of the Western firms," says Navi Radjou, a fellow at the Judge Business School at the University of Cambridge. "They can move quickly to take advantage of new opportunities and have the flexibility to adapt to changing circumstances. The challenge for Western companies when they enter these fast-growth markets will be to unlearn the old paradigm and sever their ties with the accepted way of doing things."

"The new generation of fast-growth-market entrepreneurs is global at the outset"

– Bing Xiang

A global mindset





When companies decide to expand overseas, they can allocate the capital, recruit the teams and install the infrastructure within a matter of months. But mindsets move more slowly. Just because a company has built up global operations, it does not automatically follow that it has a global outlook.

Implications for business

- ▶ Appreciate and reconcile cultural differences.
- ▶ Know when to tolerate contradictions and when to reject them.
- ▶ Consult with diverse management teams to understand the implications of headquarters-based decisions on other markets.
- ▶ Make sure that there is a link between company values and employee behavior; management incentives can be a useful tool to strengthen this link.
- ▶ Increase the diversity of management teams so that they better reflect the breadth of the company's geographical footprint.
- ▶ Allow executives to express their diversity rather than conform with a homogenous corporate culture.

“Values are the environment or context within which you can globalize while still giving managers the freedom to make decisions locally”

– Fons Trompenaars

Making the transition from a local to a global mindset is a highly complex challenge. Business leaders must understand and influence stakeholders from a wide variety of cultures and take their perspectives into account while maintaining strong values and consistent leadership. A global mindset requires leaders to:

Tolerate ambiguity and integrate multiple perspectives.

Companies that operate in multiple international markets constantly encounter contradictions. Marketing strategies that work in one country may be inappropriate in another. Variation in growth rates requires companies to operate at multiple speeds. Speaking at the Ernst & Young Global Growth Forum, Mansour Javidan, Director of the Najafi Global Mindset® Institute at the Thunderbird School of Global Management, outlined the challenge for senior executives. “Corporations today exist in a world of huge complexity and ambiguity, which means that managers must be able to face divergent views and be able to reconcile them,” he says.

Cultural differences may require different styles of leadership and engagement across national teams. “Your job as a global leader is a balancing act,” says Mr. Javidan. “On a minute-by-minute basis, you are balancing opposing forces, contradictory views and different ways of doing things.”

At the same time, adopting a new set of behaviors and practices for every market will lead to fragmentation. What’s more, this constant re-invention means that companies will fail to capture cross-border synergies or draw on their global capabilities and experience. “Business leaders not only need to accept differences but also know how to integrate those different perspectives,” says Mr. Radjou.

Adopt an interdependent approach to decision-making.

Decisions taken in one part of the world can have unintended consequences in another. A CEO may decide, for example, to ramp up investment in R&D to develop new premium products at the company’s global headquarters. This may be good for business in the core developed markets, but may mean that the company’s Indian subsidiaries end up with a product range they will be unable to sell to customers who expect high-quality but lower-cost products.

Having a global mindset means understanding the interdependencies among regions and how decisions taken in one region will affect another. “As a leader, you need to know instinctively what repercussions your business decisions will have in markets around the world,” says Mr. Radjou. “This requires you to adopt a systematic approach to decision-making that takes into account multiple perspectives and incorporates a period of reflection and consultation with diverse management teams into the decision-making process.”

Look to underlying values to bridge cultural differences.

Global companies must find a dynamic integration between local autonomy and centralized control. Autonomy gives regional managers the freedom to take advantage of market-specific opportunities and adapt the business to suit local needs and customs. But control enables an efficient allocation of resources and facilitates the sharing of global capabilities and resources. “The basic dilemma of any organization is what do you share and where you are different,” says Fons Trompenaars, co-founder of Trompenaars Hampden-Turner, a consulting firm.

Values provide a framework through which companies can find this reconciliation between global and local. “Values are the environment or context within which you can globalize while still giving managers the freedom to make decisions locally,” says Mr. Trompenaars. “Having a set of values holds the company together no matter what culture you are operating in.”

To be effective, values must combine simplicity with the flexibility to allow local behaviors to fit within them. Mr. Radjou gives the example of a value that requires employees to give back to society. In India, this may mean helping to alleviate poverty, while in the UK it may refer to working with universities. “It’s important to not just have a global set of values but also to ensure that local managers have the freedom to implement those values in a way that is appropriate for the local market.”

Companies should also be comfortable with changing their values as the company evolves. “In a global mindset, you might realize that certain values that helped you in the past may burden you in the future,” continues Mr. Radjou. “If your values are not in sync with the changing world, that can send you down the wrong path.”

“Corporations today exist in a world of huge complexity and ambiguity, which means that managers must be able to face divergent views and be able to reconcile them”

– Mansour Javidan

Four imperatives for global leadership

A recent Ernst & Young report titled *The new global mindset: driving innovation through diverse perspectives* revealed four imperatives for successful leadership in a global business environment.

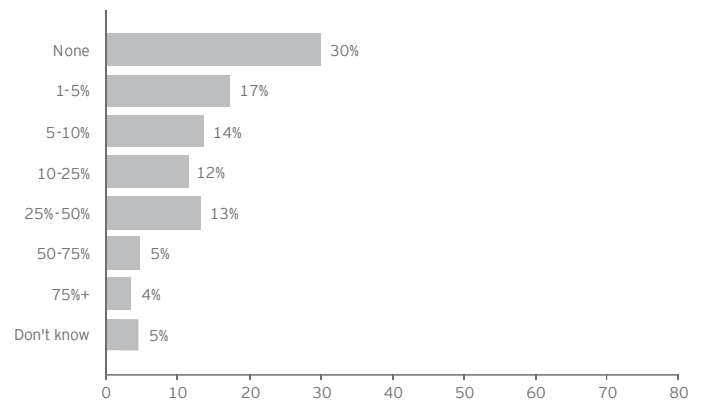
1. Stir the pot: leverage conflict (sparked by differing viewpoints) to generate new ideas
2. Anticipate the Next Big Thing – or better yet, drive the Next Big Thing! Use diverse perspectives to develop new products and services
3. Nurture a spectrum of talent: find talent in unexpected places and forge creative collaborations
4. Get the mindset: focus on transformational leadership

Value the expression of diversity. Most companies understand that diversity is good for business. But as we explored in our report *Winning in a polycentric world*, business leaders struggle to convert this belief into action. Three out of 10 respondents surveyed for the report say that they have no representatives on their management team from outside their home market, and less than 10% have management

boards where more than half of the executives come from outside the home market (see chart). Yet a substantial body of research has shown that diverse perspectives lead to innovation and more effective collaboration.

Even if companies do build diverse management teams, the pressure to conform with a homogenous corporate culture can erode the benefits by encouraging individuals to conceal, rather than celebrate, their differences. “In many companies, you’ll find that people in a team might look different when they’re sitting around a table, but they are speaking more or less the same language,” says Mr. Radjou. “For me, the ultimate expression of diversity is when everybody in the company is allowed to be themselves.”

What proportion of your global management board originates from countries outside of your home market?

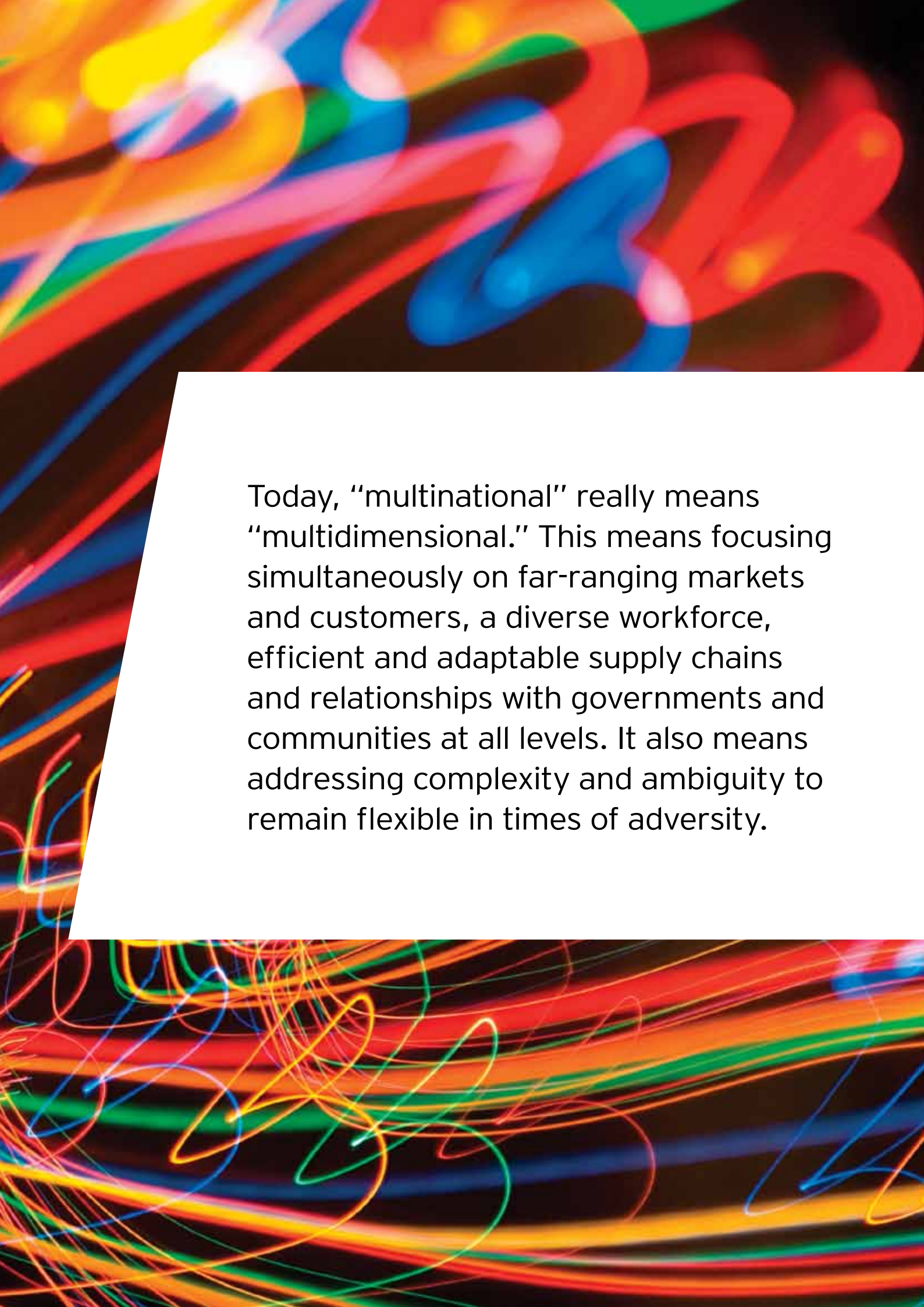


Source: Globalization survey 2010

“In many companies, you’ll find that people in a team might look different when they’re sitting around a table, but they are speaking more or less the same language”

– Navi Radjou





Today, “multinational” really means “multidimensional.” This means focusing simultaneously on far-ranging markets and customers, a diverse workforce, efficient and adaptable supply chains and relationships with governments and communities at all levels. It also means addressing complexity and ambiguity to remain flexible in times of adversity.

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Growing Beyond

Global growth is the business issue of today. In *Growing Beyond*, we're exploring how companies can grow faster – by expanding into new markets, finding new ways to innovate and taking new approaches to talent. It's an ongoing program to help you grow beyond your expectations. Join the discussion at www.ey.com/growingbeyond