



Winning in Emerging Markets: A Road Map for Strategy and Execution

By Tarun Khanna, Krishna G. Palepu

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The best way to select emerging markets to exploit is to evaluate their size or growth potential, right? Not according to Krishna Palepu and Tarun Khanna. In *Winning in Emerging Markets*, these leading scholars on the subject present a decidedly different framework for making this crucial choice.

The authors argue that the primary exploitable characteristic of emerging markets is the lack of institutions (credit-card systems, intellectual-property adjudication, data research firms) that facilitate efficient business operations. While such "institutional voids" present challenges, they also provide major opportunities-for multinationals and local contenders.

Palepu and Khanna provide a playbook for assessing emerging markets' potential and for crafting strategies for succeeding in those markets. They explain how to:

- Spot institutional voids in developing economies, including in product, labor, and capital markets, as well as social and political systems
- Identify opportunities to fill those voids; for example, by building or improving market institutions yourself
- Exploit those opportunities through a rigorous five-phase process, including studying the market over time and acquiring new capabilities

Packed with vivid examples and practical toolkits, *Winning in Emerging Markets* is a crucial resource for any company seeking to define and execute business strategy in developing economies.

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- Sales Rank: #259711 in eBooks
- Published on: 2010-04-28
- Released on: 2010-04-28
- Format: Kindle eBook
- Dimensions: 1.28 pounds



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Editorial Review

Review

From the authors:

"The crux of this book is to advance a structural framework for thinking about the nature and extent of differences between emerging markets and mature markets on the one hand, and among emerging markets on the other."

Praise for Winning in Emerging Markets:

"The authors provide a road map for assessing the potential of emerging markets and for crafting strategies to succeed in them." - Strategic Finance

"The scope of this book's research is broad and deep, the authors' thinking is deliberate and well tested, and the result is a compelling must-read for any leader who is seeking sustainable growth in dynamic emerging markets." —Muhtar Kent, Chairman and CEO, The Coca-Cola Company

"Learning to compete in emerging markets is one of the greatest challenges facing global businesses today. In this book, Tarun Khanna and Krishna Palepu show leaders how to navigate the different operating conditions in these markets and how to take advantage of the tremendous growth opportunities they offer in the twenty-first century." —Dominic Barton, Worldwide Managing Director, McKinsey & Company

"Emerging markets have piqued the interest of many business scholars. Much has been written about them, but this book is unique in that it proposes an actionable framework for assessing the challenges and opportunities associated with the institutional voids in such markets." —N. R. Narayana Murthy, founder and Chairman, Infosys

About the Author

Krishna Palepu is the Ross Graham Walker Professor of Business Administration and Senior Associate Dean for International Development at the Harvard Business School. Tarun Khanna is the Jorge Paulo Lemann Professor at Harvard Business School and the author of *Billions of Entrepreneurs: How China and India Are Reshaping Their Future and Yours*.

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Chapter 1

Introduction

The world is focused on emerging markets. The liberalization, growth, and globalization of these still-nascent economies have made them tremendous sources of interest, opportunity, and anxiety over the past 20 years. For households, emerging markets are the source of countless cheap consumer goods. For frustrated computer users, they are often the location of outsourced technical support. For executives of multinationals,

emerging markets are growth drivers amid stagnation and financial crisis in developed economies—and the home turfs of powerful new corporate competitors. In the first six months of 2009, the FTSE emerging markets index was up 41.1% while the FTSE All World developed markets index was up 7.2%, as the developed world struggled to recover from financial crisis. For companies drowning in the financial crisis, institutions in these markets have offered life preservers of capital. For upstart entrepreneurs and well-established companies alike, emerging markets are testing grounds and incubators for new innovation. For entrepreneurs, business leaders, and citizens in emerging markets, this newfound global standing is a great source of pride.

For some workers in the developed world, these markets are a source of job security angst. This anxiety has only increased in the wake of the financial crisis and recession in developed markets. For others—such as Wall Street investment bankers displaced by the U.S. financial crisis—they can be havens of new job opportunities. For new university graduates and young professionals in emerging markets, this growth has created tremendous opportunities and recalibrated career aspirations.

For politicians and pundits in the developed world, emerging economies are both derided as the destinations of offshored jobs and pitched as prospective customers for vaunted innovative products and green technologies of the future. For national treasuries in the developed world, emerging market savings have helped finance government deficits. For politicians from all over the world, emerging markets are featuring prominently on global trade and multilateral agendas. For environmental and labor rights activists, the rapid industrialization and undeveloped safeguards in these economies are cause for serious concern.

In a small but telling sign of a growing perception that emerging markets were both important and distinctive, *The Economist* began including a page of emerging market economic and financial indicators at the back of each weekly issue in 1994. The rationale for the feature, the editors noted, rested on a simple premise: “Rich industrial countries dominate the world economy rather less than they used to.” In 2007, *The Economist* discontinued the feature, lumping the world’s major economies together in a single table of indicators. Whether the change was made for substantive reasons or simply to save space, the place of emerging markets in the global economy changed dramatically in that 13-year period.

Consider a few items that appeared in that 1994 issue of *The Economist* in which the emerging market indicators debuted. The magazine’s summary of the week’s news included a capsule noting the enactment of the North American Free Trade Agreement (NAFTA), linking emerging market Mexico more closely with its more developed northern neighbors, the United States and Canada. One article forecasted that “India will be a power in its own neighbourhood but its frail economy and its physical isolation between the Himalayas and the sea will almost certainly keep it out of the global competition” to be among the world’s preeminent powers. A two-page advertisement touted companies from Taiwan, noting that, “Many of the computers crunching numbers and making their reputations on Wall Street are made in Taiwan. That’s right, Taiwan.” Since then, agreements similar to NAFTA have dismantled trade barriers in many emerging markets. India’s economy has boomed, in part by leveraging global communications technology that renders moot many of the challenges of its “physical isolation.” The promotional advertisement rebutting the incredulity that Taiwan could produce sophisticated computers is almost laughable today: four out of every five personal computers now produced by contracted manufacturers are made by Taiwan-based firms.

What is an emerging market?

As economic globalization has brought down trade and investment barriers and connected far-flung countries in integrated global supply chains—and emerging markets seem to be converging with the world’s “rich industrial countries”—distinguishing these economies from developed markets may seem to matter less than before. We disagree. One fundamental premise of this book is that businesses still need to distinguish emerging markets—collectively from developed markets and individually from each other.

But, what, really, is an emerging market? The term “emerging markets” was coined by economists at the International Finance Corporation (IFC) in 1981, when the group was promoting the first mutual fund investing in developing countries. Since then, references to emerging markets have become ubiquitous in the media, foreign policy and trade debates, investment fund prospectuses, and multinationals’ annual reports,

but definitions of the term vary widely (see Figure 1-1).

The term is often reduced to the unhelpful tautology that emerging markets are “emerging” because they have not “emerged.” To understand emerging markets, we need to consider carefully the ways in which they are “emerging” and the extent to which they are genuine “markets.”

Ask a conference room full of business executives how they would distinguish emerging markets from developed economies, and variants of three different stories will likely arise. Emerging markets such as Brazil, China, India, and Russia, some will certainly say, are emerging by virtue of their fast recent economic growth. The opening of these large economies to global capital, technology, and talent over the past two decades has fundamentally changed their economic and business environments. As a result, the GDP growth rates of these countries have dramatically outpaced those of more developed economies, lifting millions out of poverty and creating new middle classes—and vast new markets for consumer products and services.

Large, low-cost, and increasingly educated labor pools, meanwhile, give these markets tremendous competitive advantage in production, and information technology is enabling companies to exploit labor in these markets in unique ways.

Some executives will focus on emerging markets as emerging competitors. On the macro level, a landmark Goldman Sachs report published in 2003 forecasted that the economies of Brazil, China, India, and Russia could grow to be collectively larger than the G6 economies (United States, Japan, United Kingdom, Germany, France, and Italy) in U.S. dollar terms before the middle of the 21st century. Commentator Fareed Zakaria sees this “rise of the rest” as a transformative, tectonic shift in the distribution of global power. Companies based in these economies, meanwhile, are already challenging multinationals based in the developed world—and not only in their home emerging markets. China-based Lenovo’s purchase of IBM’s personal computer business in 2004 and the acquisition of Jaguar and Land Rover by India’s Tata Motors in 2008 are just two examples of the increasing global mergers and acquisitions activity by emerging market-based firms. Some see the financial crisis of 2008-09 as possibly an inflection point, accelerating the emergence of these markets as dominant players in the global economy.

A deeper discussion might elicit a list of the persistent headaches of doing business in emerging markets. These markets, the executives might say, are prone to financial crises. Intellectual property rights are insecure. Navigating government bureaucracies can be thorny. Product quality is unreliable. Local talent to staff operations is inadequate. Reliably assessing customer credit is difficult. Overcoming impediments to distribution can be frustrating. Sorting through investment opportunities or performing due diligence on potential partners is often a guessing game. Others might throw up their hands and say corruption is so endemic in emerging markets that the risks simply outweigh the potential rewards.

Based on many of these signs of emergence, some might say, emerging markets are not distinctly different from other markets; they are simply starting from a lower base and rapidly catching up. Indicators such as the growing numbers of emerging market-based companies listed on the New York Stock Exchange or the growing ranks of billionaires from emerging markets listed annually by Forbes illustrate this catch-up. Behind those indicators, however, is a more complicated story of why firms based in these economies have sought out overseas listings and how those moguls amassed such fortunes in developing countries which are, by many standards, still quite poor.

All of these criteria—the indicators of opportunity and the causes for complaint—are important features of many emerging markets, but they do not delineate the underlying characteristics that predispose an economy to be emerging, nor are they particularly helpful for businesses to address the consequences of emerging market conditions. We see these features of emerging markets as symptoms of underlying market structures that share common, important, and persistent differences from developed economies.

A fundamental premise of our work is that emerging markets reflect those transactional arenas where buyers and sellers are not easily or efficiently able to come together. Ideally, every economy would provide a range of institutions to facilitate the functioning of markets, but developing countries fall short in a number of ways. These...

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