Which business models can deliver growth in emerging countries?

By
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In the next few years, emerging countries are going to present a significant challenge to Western groups. The lion's share of growth in most capital goods and consumer goods industries will come from these regions.

Only those groups that have a significant proportion of their activities in emerging countries will be able to grow rapidly and create value (see table 1).

The issue at stake is no longer whether a company should be active in those countries, it is how to develop competitive and sustainable business models there.

Emerging countries – challenges and opportunities

Emerging countries are set to deliver sustainable structural growth for the next 15 years at least. Their economic growth will result in the main markets growing in volume *and* in value.

In the car industry, the market penetration rate is following an S-shaped growth curve. In China, the car market is expected to grow twice as fast as per capita GDP. This is driven by the 'dream of car ownership,' and the large proportion of inhabitants that have a driving licence but do not own a car (see table 2). In Brazil, only 20% of inhabitants that have a driving licence own a car, as compared to 70% in Poland and 120% in the USA.

The issue at stake for business models is that of capturing this market's 'natural' growth, and even accelerating its expansion. For market followers, it is simply a matter of riding the 'up' escalator. The market leaders will take the lift. This is the strategy pursued by KFC in China. This brand has invested heavily in China over the last 10 years, and now has more than 3,000 restaurants there. It has 20 years of growth ahead of it in China before it reaches its penetration level in the USA (see table 3).

In addition to volume, it is essential to develop an approach that increases the per-unit value of the market. Volumes are substantial for many products and services, but the value of the market is still low. Once again, there is a strong correlation between economic growth and the per-unit value of the products. With mobile telephones, for example, the challenge is to increase revenue per subscriber (see table 4). The penetration rate of mobile telephones in China and India was extremely rapid, but revenue per subscriber is still extremely low. The most competitive models are those that manage to increase the value of the products within a given price position. It is simply a matter of taking the "growth" lift.

Nowadays, emerging countries offer growth potential that must be segmented into market levels. There is an emerging middle class that is looking for basic products and services, an upper class looking to purchase mid-market products and a wealthy class for whom only the best will do.

For example, there are now 10 times more billionaires in China than in France. There are more than 700,000 millionaires. Forty million of the country's inhabitants enjoy the same standard of living as Greece, and 80 million enjoy the same standard of living as Poland (see table 5). In dealing with emerging countries it is essential to differentiate between approaches and business models. Companies must define a strategy that specifically targets the population and customers that are to be reached first.

Operating in these countries therefore necessitates business models that must:

- Address the issue of growing volumes (and accelerating this growth, if possible);
- Address the issue of growing the value of each segment;
- Target the various customer types using business models suitable for the various types of population and levels of wealth;
- And, in all cases, make it possible to achieve a competitive position.

Specific business models for emerging countries

With a few exceptions, business models that have generally worked in developed countries cannot be transferred lock, stock and barrel to emerging countries. At best, they can be adapted or redesigned.

For luxury business models, the developed countries' models can generally be applied without significant changes: customers have an international profile, and buy a unique product and experience associated with status rather than a cultural dimension. Pricing, cost and margin structures are similar. This is the case for Ferrari and Porsche, for which China became their largest market in 2010. Their approaches in emerging countries are the same as those developed in Europe and the USA.

For up-market products, some adjustment is generally required, but business models are based on Western fundamentals. These changes may involve the product range (reflecting powerful cultural specifics), production (with the development of labour-intensive manufacturing approaches) and marketing (if developed countries' traditional sales models do not apply).

For mid-market products, the approach in emerging markets must be redesigned from the bottom up, starting with customers' requirements and redesigning the product range and its distribution to reflect these requirements. This is the principal challenge for a Western group, as this segment may offer rapidly growing volumes with a significant increase in value. It is from this segment that such groups derive medium-term growth in emerging countries.

Mid-market products have the same attributes: products or services that offer a good compromise in terms of quality and price. The levers of competitiveness are often the same: product innovation, competitive production, the use of bulk distribution channels, advertising, etc. However, these attributes and levers must be implemented in a very different fashion:

- *In terms of the product range*, the application of the above must be adapted to reflect specific requirements and price points. It must establish the mid-market and form consumers' habits. The risk with this approach is often that of producing too high a quality as compared to the entry-level players, thereby creating too large a price differential. It is more a question of encouraging consumers to "go up-market" by giving them hopes for a new experience. It is essential to have development departments in emerging countries that understand consumers' needs and can convert them to a competitive product range that differentiates between segments;
- *In production*, the challenge is to scale up production to the maximum using two often conflicting levers of competitiveness. First, the possibilities offered by emerging countries (manpower in particular). Industrialisation is key. Second, bolstering manufacturing competitiveness by capitalising on the experience gained over the years in developed countries. If the first lever is too dominant, the company will miss out on the chance of differentiating itself from the competition. If the second is favoured, there is a risk of being uncompetitive in terms of manufacturing.
- *For marketing*, the challenge is to accelerate the development of modern distribution channels that promote the products and brands at competitive cost. Hypermarkets in China or Russia offer mass-market consumer brands the chance to grow rapidly. In some cases, opening own-brand stores helps to boost growth in these countries. Adidas generates more than 70% of its sales in emerging countries through its own-brand stores, as compared to less than 30% in developed countries. Vodaphone has grown

rapidly in India by setting up mobile telephone sales kiosks, even in remote areas. This approach involves lobbying governments, and targeting consumers with advertising to ensure and accelerate growth in the value of the products.

For entry-level products, the challenge is to get as many customers as possible on board the “growth” lift. It is a question of winning the battle for the consumer’s shopping basket.

Some products grow faster than others in emerging countries because they manage to convince consumers that they are more useful and necessary than others. If the vast bulk of consumers fail to become habitual users of a product, it is difficult to grow rapidly over the long term, both in volume and, above all, in value. In India, more than 600 million consumers now have a mobile telephone, largely because handset manufacturers (especially Nokia) and operators (especially Bharti) took steps to encourage Indians to buy a mobile rather than perhaps more pressing purchases.

Unilever has pursued this strategy in India for many years. It developed specific products retailing at 5 rupees (the 5 rupee piece being the most common coin in circulation in India) by revising the products’ technical features and packaging. It also set up a door-to-door sales network, the Shakti, thereby bolstering their sales force in rural areas.

Conclusion?

Defining a growth strategy in emerging countries necessarily involves identifying and implementing a number of business models that differentiate between market levels and profitably capture the growth of each segment, and take a clear lead in the market.

At entry level it is a question of achieving volume, and for each superior level it involves delivering value to consumers through positioning. Only this two-pronged strategy can deliver long-term growth.

The challenge is to define these various models precisely, to analyse the economic levers and to put in place the structures to deploy them. Only a clear, well-defined strategy can deliver profitable, sustainable growth in emerging countries. Financial and organisational resources can be effective only in such circumstances, and not the reverse.

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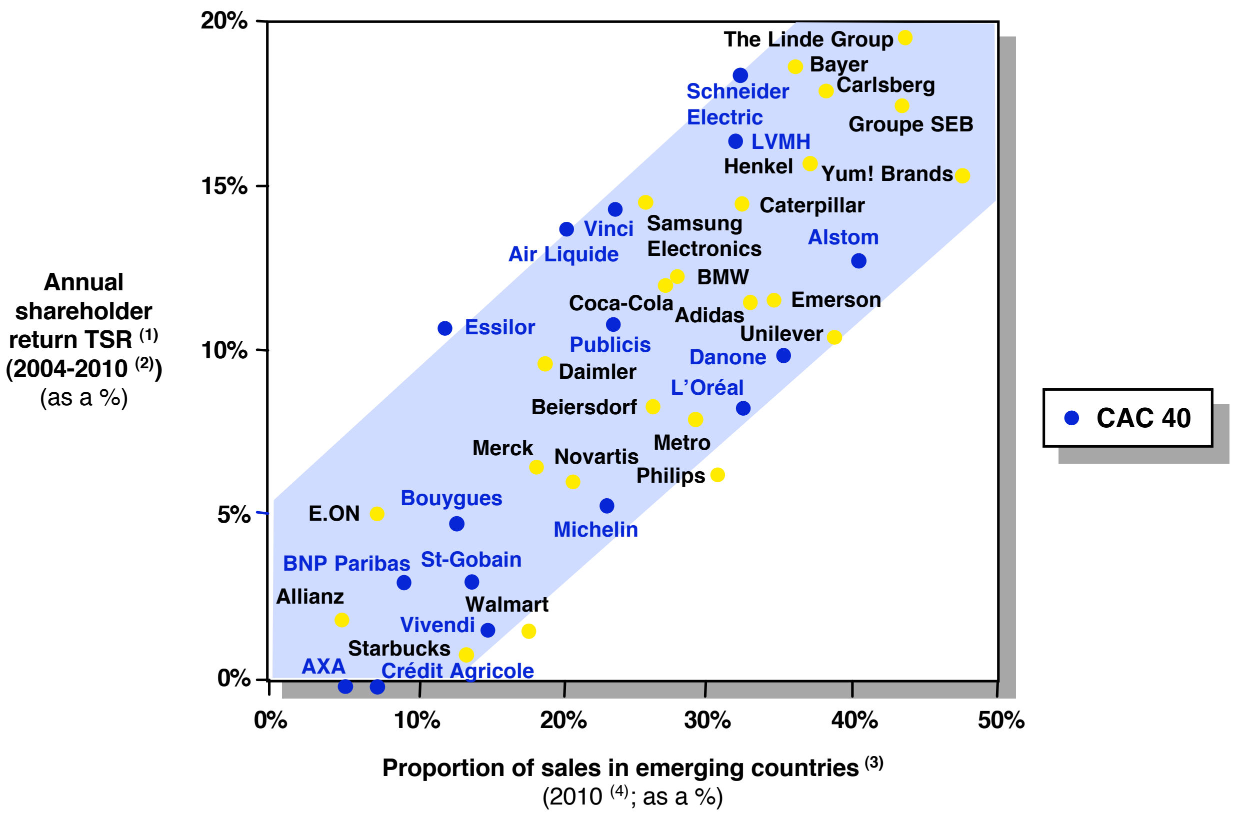
Estin & Co is an international strategy consultancy based in Paris, London, Geneva and Shanghai. The firm assists the boards of major European, North American and Asian groups in their growth strategies, and private equity funds in analysing and improving the value of their investments.

- Table 1 -

Only groups that derive a significant proportion of their sales from emerging countries can create meaningful added value

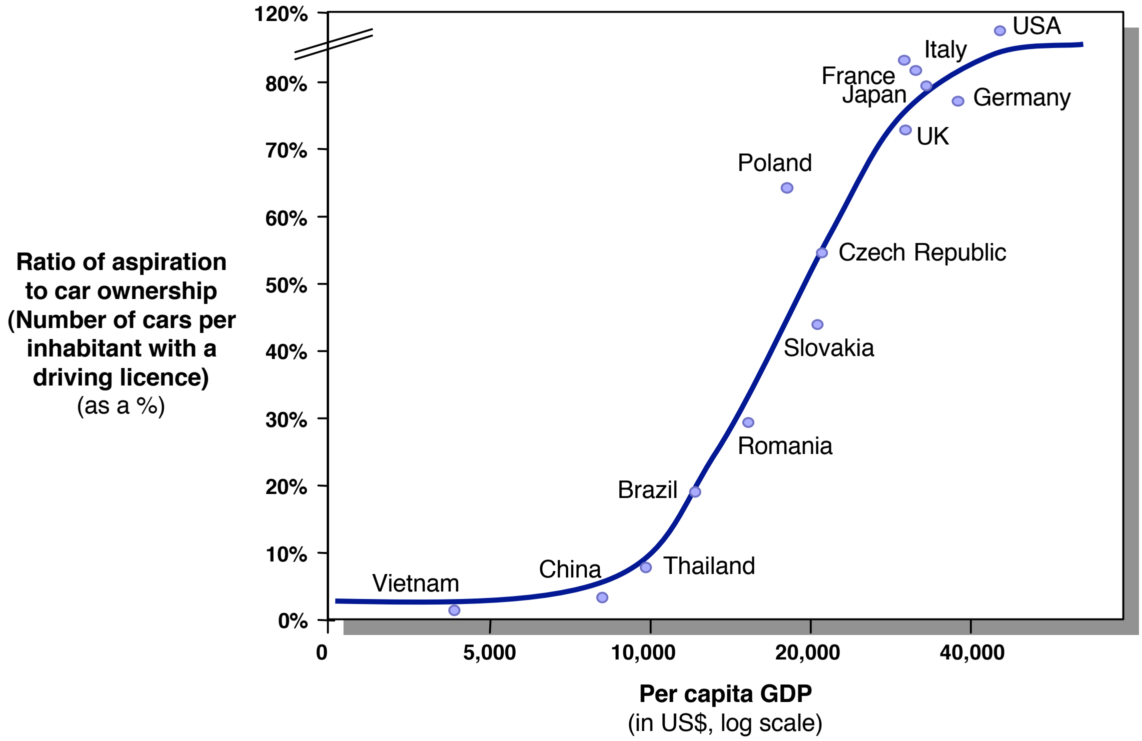


(1) TSR: Total Shareholder Return: shareholder's annual return on investment (stock market gains, dividends, free share distributions etc.); (2) 31 Decembre 2004 - 31 Decembre 2010; (3) Emerging markets: emerging Asia, Eastern Europe, South America, Middle East and Africa; (4) Depends on the company and on availability of 2009 or 2010 data, mainly 2010 data (with a variation between 2009 and 2010 for infrastructure companies such as Alstom and The Linde Group as a result of large contracts won between 2009 and 2010)
Source: Bloomberg, annual reports, Estin & Co analysis

- Table 2 -

Growth in car sales is linked to economic growth (and the realisation of the dream of car ownership)

Example: car ownership

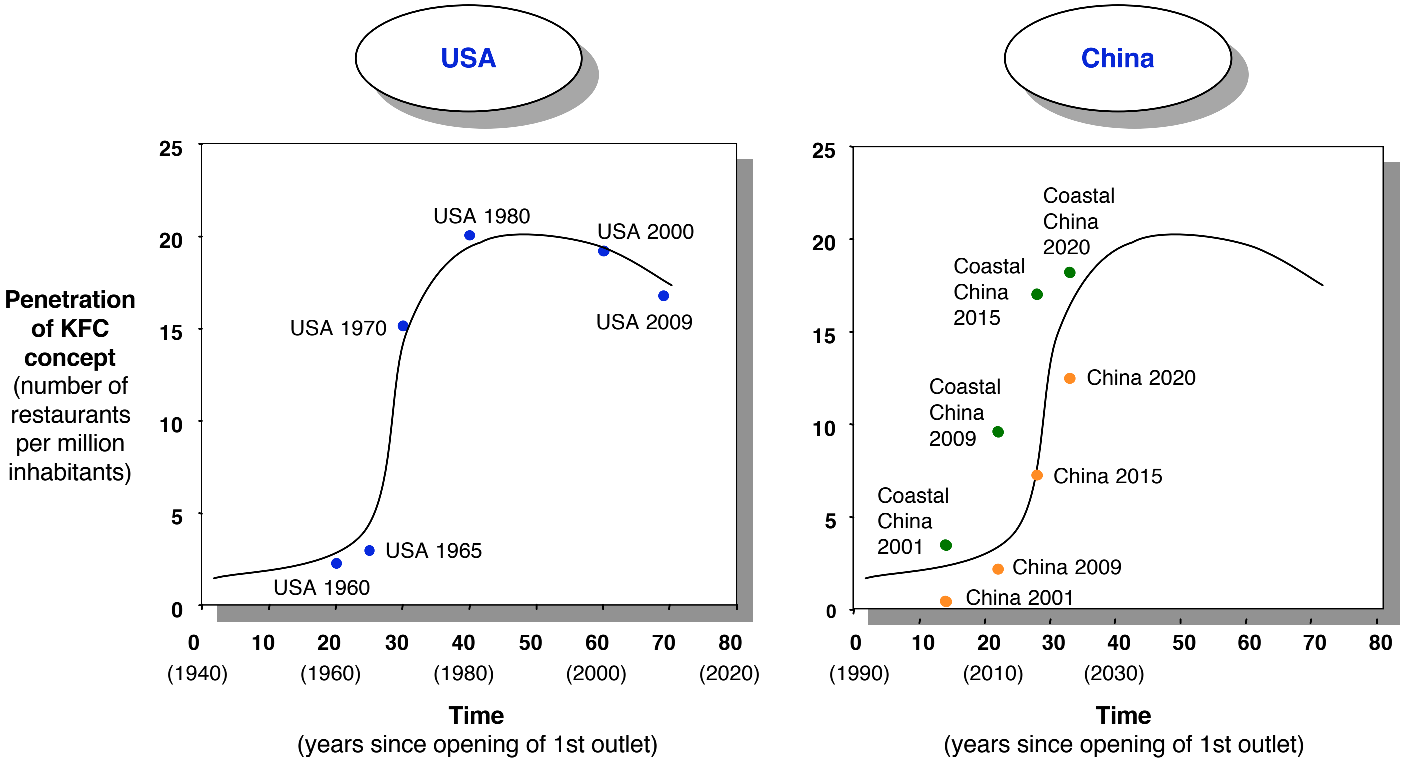


Source: Worldbank, CCFA, Estin & Co analysis and estimates

- Table 3 -

KFC (Kentucky Fried Chicken) has 20 years of growth ahead of it before it reaches its level of market penetration in the USA

Example: comparison of penetration rates in USA and China



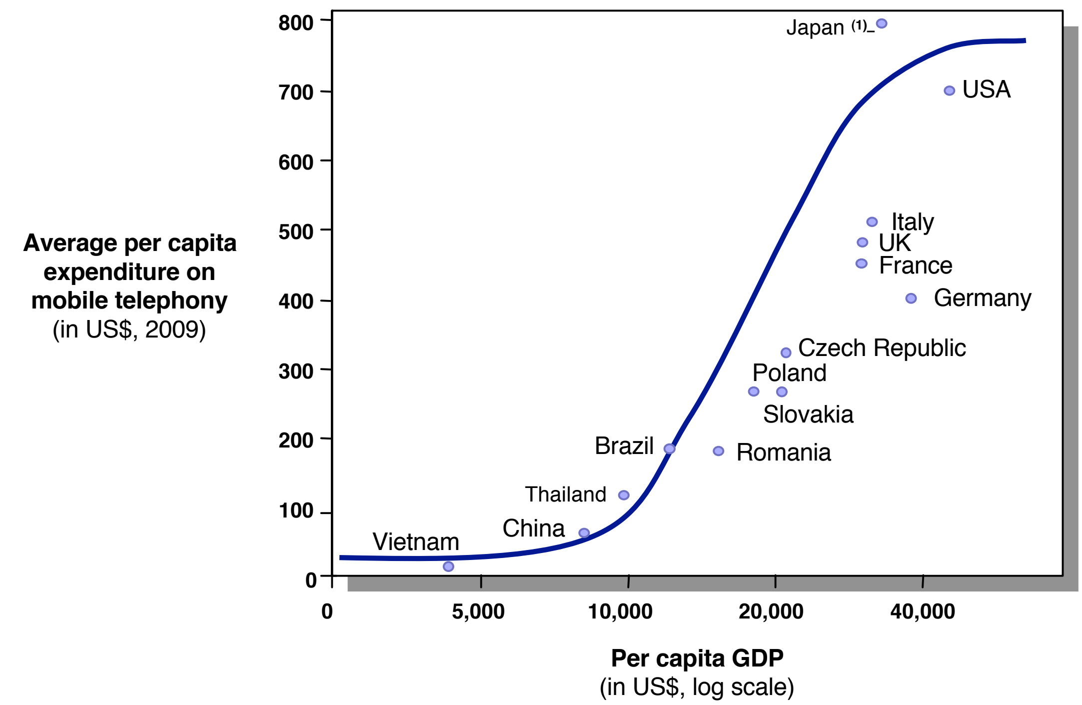
KFC's investments in 2009:

- **China:** **60%**
- **Brazil:** **15%**
- **Europe:** **10%**
- **USA:** **15%**

Source: Annual report, Estin & Co analysis and estimates

- Table 4 -

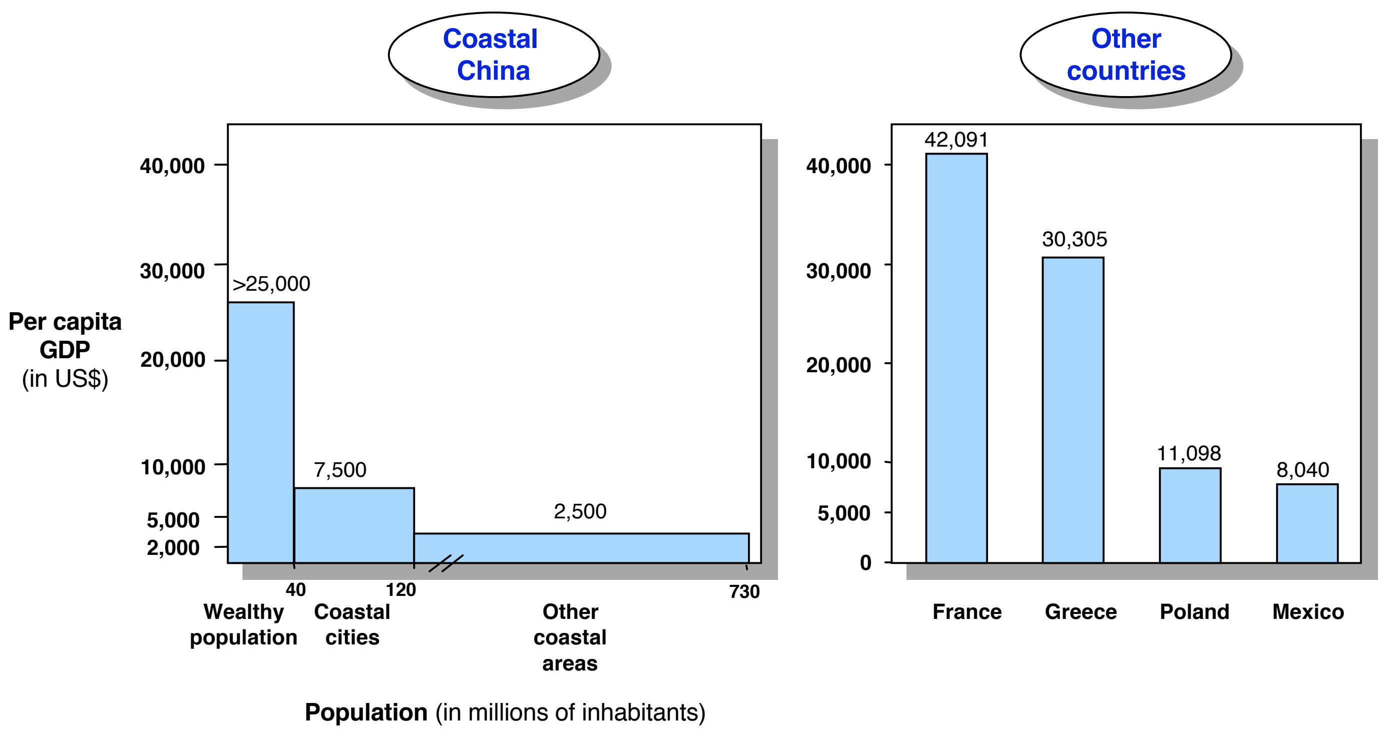
Growth in the value of markets depends on economic growth
Example: Mobile telephony



(1) $1,200 par habitant
Source: Euromonitor, Estin & Co interviews and analysis

- Table 5 -

In China, a wealthy population with a standard of living approaching that of Western Europe is developing along the coastal region
Per capita GDP by region (2009)



Source: Estin & Co analysis