The Emerging Markets Century Revisited

Antoine van Agtmael

The era of emerging markets companies being nothing more than unsophisticated makers of low-cost, low-tech products is rapidly coming to a close. It would be naïve to dismiss them for deriving their competitive advantage "unfairly" from "cheap labour." The "global" financial crisis turned out to be only "half-global" because most emerging markets went into the crisis with resilient banking systems and prudent macro-policies. The economic fall-out caused global havoc but emerging markets were "first-in-first-out" and are expected to come out of the crisis with greater respect and one-third of the world's GNP. The greatest corporate victims of the Great Recession were developed-market icons. Most of the 25 world-class emerging multinationals are escaping the crisis and are getting ready for a post-crisis world in which the American consumer is no longer king.

Antoine van Agtmael is Chairman & CIO of Emerging Markets Management, LLC, a pioneering and leading investment firm focusing on emerging markets with over $10 billion under management. E-mail: AVA@emiemm.com. This article is adapted from the author's "The Emerging Markets Century: How a New Breed of World-class Companies is Overtaking the World" (Free Press, 2007) and provides an update of his earlier findings.

Emerging Markets Passed a Major Stress Test

The "emerging markets century" was not yet a decade old when it was put to an abrupt and severe test – even though this time the crisis was imported and not of their own making. Until the fall of 2008, economic growth in many emerging markets had been rapid and virtually uninterrupted. Led by the four BRICs (Brazil, Russia, India and China), they made their presence felt on the global economic scene. Now it suddenly seemed that the sky was falling in. Perhaps the sinking feeling that everyone experienced – from policy makers and investors to the general public – led to a sense of vulnerability that begged for company. If banks in the United States and Europe were facing problems, the financial systems in emerging markets had to be even worse off.

Briefly, market volatility went through the roof as did credit default swaps for several countries that investors considered at risk. A global panic quickly ended hopes for

"decoupling", in any case a suspect notion in a globalized world. Fears of a deep global recession caused a steep drop in exports and production. Not surprisingly, many emerging economies felt this fear first and most severely because they manufacture much of what the rest of the world consumes. However, they also proved more resilient and less crisis-prone than many expected. In earlier crises they had clearly learned lessons that now seemed ignored in the United States and much of Europe. As a result, by the middle of 2009 (well before the developed world) many emerging markets showed signs of having turned the corner.

The Rise of Emerging Markets

In the aftermath of the dissolution of the Soviet empire in 1989, central planning definitively lost out as an economic "model". Bureaucratic socialism in India fulfilled neither its promise of dynamism nor that of equality. The market economy became the default option for all but a handful of emerging markets. Then, stung by the Latin American crisis of 1994 and the Asian crisis of 1998, policy makers and corporate leaders in emerging markets recognized that too much debt was a recipe for future trouble, whether it was at a national level (in Latin America) or corporate level (in Asia). Instead of borrowing to finance deficits (as they had before), they built their foreign exchange reserves to over $5 trillion by turning their current accounts and budgets into surpluses. In the meantime, they also learned that keeping competition out ultimately did not protect industry beyond infancy but thwarted innovation and led to mediocrity. China and India joined the World Trade Organization. In this school of hard knocks, leading companies survived devaluations, recessions, debt restructuring and the lifting of import barriers, often managing to turn these crises into platforms for global success.

Bureaucratic socialism in India fulfilled neither its promise of dynamism nor that of equality.

The "rise of the rest" (as Fareed Zakaria has called it) did not happen unnoticed. China flooded world markets with low-cost consumer goods while building a world-class infrastructure. India and Pakistan became nuclear powers. Russia again threw its weight around thanks to its dominance of the European gas market, and Brazil (where Fiat made virtually all of its profits) became the home of flex-fuel cars, bio-fuels and deep-sea, pre-salt oil discoveries. Even traditional multi-nationals began to realize that most of their growth – in everything from beer and mobile phones to cars and planes – came from hitherto ignored countries that were on the move from the periphery to centre stage of the global economy. Trade and climate change negotiators from emerging markets began to talk back and propose their own ideas. The prices of oil, cement, iron ore and steel were suddenly no longer captive to just the cyclical ups and downs in the West

but also the growing demand in newly industrializing economies. And instead of being thought of as a vast sea of poverty, emerging markets are now catching the world's attention with a new phenomenon: the rise of the emerging consumer in a brand-new middle class, stretching from Seoul, Shanghai and Bangalore to Sao Paulo and Santiago.

The Emerging Markets Century

According to Goldman Sachs calculations, the combined gross national product (GNP) of 15 leading emerging markets will overtake that of the leading developed economies (G7) in about 25 years. As a group, the share of today's emerging markets in the global economy will be over 50%, about double their share of just over 25% in 2008. Just as they were before the Industrial Revolution, China and India will soon re-emerge as the dominant economies of the Emerging Markets Century. By 2040, China will replace the United States as the world's anchor economy. The world may not be flat (as Tom Friedman has persuasively argued), it is actually *tilting* away from the developed to the emerging economies. Rather than slowing down this trend, the recent global financial and economic crisis has only *accelerated* this powerful seismic land slide which will shift the centre of gravity of the global economy and, with it, not just opportunities but also *risks*.

The recent global financial and economic crisis has only *accelerated* this powerful seismic land slide which will shift the centre of gravity of the global economy and, with it, not just opportunities but also *risks*.

The crisis provided an early taste of what is to come as emerging markets showed their clout. Their participation in the world's U-turn on monetary policy was crucial. China's fiscal stimulus package of close to $600 billion was the first to be announced, the fastest to be disbursed and the highest as a percentage of GNP in the world. Together with its boost in lending, it pulled Asia out of its slump and boosted market confidence worldwide. Many governments and corporations in emerging markets drew admiration for largely avoiding financial collapses, reacting quickly, and demonstrating resilience thanks to earlier de-leveraging, healthy balance sheets and consumers who could bounce back because they were not burdened by debt. Meanwhile, in the developed world unquestioned credit risks became questionable, some corporate icons fell hard, the need for de-leveraging of the consumer became painfully obvious, and confidence in financial institutions was shaken.

As emerging markets begin to grow again while much of the developed world is still mired in recession and headed for slower growth than before, emerging markets are likely to come out of the current crisis with a share of about one-third of global GNP. No wonder that the G-7 meetings became regarded as an anachronism and the first G-20 meeting gathered in Washington DC soon after the crisis.

Rise of the Emerging Multinational

With the rising power of China, India, and other emerging markets, companies from all over Asia, Latin America, Eastern Europe, and Africa have evolved from small, little-known producers of commodities or low-tech goods into globally-oriented makers of demanding, high-quality products. They have succeeded against the odds and become battle-hardened survivors of tough crises and Darwinian competition. This new breed of companies will play a critical role in producing this shift. After all, companies from emerging markets are already playing a major part in everyone's lives. They make much of what we use, eat, drink, and wear, in addition to providing us with energy and raw materials. Many of these are more profitable than their peers in the United States, Europe, and Japan. They are no longer bit players, but leading actors, even budding international superstars, on this new global stage.

Many emerging multinationals would surprise those who still regard "Third World" companies as raw material producers or imitative makers of cheap electronics.

Many emerging multinationals would surprise those who still regard "Third World" companies as raw material producers or imitative makers of cheap electronics. A host of new products are, based on the quality of their design, sophistication of function and durability, equal, if not superior, to competing products made in the United States, Japan, and Europe. Traditional multinationals are losing their dominance in global presence, in technology and design, and above all, in brand recognition and marketing prowess as emerging multinationals catch up.

- Korean Samsung's powerful global brand is now better recognized than Sony's, its R&D budget is larger than Intel's and its 2008 revenues and profits were higher than those of Dell, HP, Intel, Motorola, Philips or Panasonic's Matsushita.
- The regional jets we fly are made by Embraer in Brazil.
- Computers are now not just made but largely *designed* in Taiwan and China. We get most of our advice about how to fix those computers from India.
- Major corporations worldwide - from banks to telecoms – have become dependent on Indian IT service companies for the design and maintenance of sophisticated software systems.
- Russia's Gazprom's gas reserves are larger than those of all the oil majors *combined*. Europe would freeze in the winter without its gas supplies, as was pointedly demonstrated when it briefly turned off the tap.
- A Brazilian CEO became head of Inbev-Ambev, the world's largest beer company in a merger in which

"old" European beer companies were amazed at the efficiency of their Brazilian partners.

- Indian hospitals attract hundreds of thousands of patients from all over the globe who flock here each year for treatments ranging from heart operations to cosmetic surgery, all obtainable at a fraction of the price in the United States. In Thailand's Bumrungrad hospital, patient information is entirely paperless in sharp contrast to even the most advanced hospitals elsewhere in the developed world.

Emerging multinationals frequently serve dual roles of competitor *and* business partner with established First World multinationals.

Emerging multinationals frequently serve dual roles of competitor *and* business partner with established First World multinationals. New proprietary drugs are being developed in Indian labs no longer content to compliantly turn out high volumes of low-cost generics for resale in mature economies. New inventions in consumer electronics and wireless technology are moving from Asia to the United States and Europe, as opposed to the other way around.

Instead of being the targets of mergers and acquisitions, they are increasingly the acquirers. Over the past few years, Tata companies from India took over European steel giant Corus and well known brands such as Tetley tea, Jaguar and Rover. China's Lenovo acquired IBM's ThinkPad. In two major resource-oriented deals, Brazil's Vale took over Canada's nickel giant Inco and India's Hindalco bought the US-Canadian aluminum roller Novelis. The recent financial and economic crisis has not stopped the buying spree of emerging multinationals. Emerging markets still have a cash pile of more than $5 billion (including $2.1 billion in China alone). Direct investment in "hard" assets has become more attractive as assets have become cheaper in the recession and as the safety of U.S. treasury bills is no longer viewed as unquestionable, while they offer barely any return and are subject to currency depreciation.

The Invisible Champions

It is time to start getting used to the idea that the household names of tomorrow - many of the next Microsofts, General Electrics, and McDonalds - will increasingly come from emerging markets as their home markets grow, their global footprint widens and they catch up in technology. These emerging multinationals have grown from small, second-rate producers of cheap goods to large-scale, well managed, state-of-the-art corporations that are leaders in their industries and top-ranked in their market niches.

Each year, more and more world-size companies emerge into the mainstream. Of the 500 corporations on the *Fortune 500 Global list,* 77 are already emerging-markets-based including 29 from China, 15 from Korea, 7 from India, 6 from

Taiwan, and 5 from Brazil, Russia and Mexico. Within the next ten years, I expect that about half of the companies on this list will come from emerging economies.

In *"The Emerging Markets Century"*, I analyzed how a much more selective list of 25 companies from emerging markets rose to world-class status based on five criteria:

1. Being widely recognized as leaders in their industry on a *global*, not just national or regional, basis.
2. Having a truly *global* presence in exports and, often, production.
3. Having a top-three market share in enough countries to be a global player.
4. Being globally competitive not just in price but in quality, technology, design, and management.
5. Can be benchmarked against the biggest and best corporations in the world.

Based on these tough criteria, I narrowed down a long list of candidates using financial analysis together with interviews with managements, founders, industry experts and broker analysts.

The list of 25 World-Class Emerging Multinationals

Samsung Electronics	Korea	The premier emerging market brand
Hyundai Motor	Korea	Competitive car brand
Hyundai Heavy	Korea	Largest shipbuilder in world
Posco	Korea	Efficient, high quality steel manufacturer
TSMC	Taiwan	First independent semiconductor foundry
Hon Hai	Taiwan	#1 electronic contract manufacturer
HTC	Taiwan	Leading smart phone/PDA designer and maker
Lenovo	China	#3 global computer maker, bought IBM ThinkPad
Infosys	India	Successful IT services provider
Ranbaxy	India	A leading generics drug maker and researcher
Embraer	Brazil	Leading small jet maker
Tenaris	Argentina	World leader in pipes for oil industry
Sasol	South Africa	Leader in synthetic fuels
MISC	Malaysia	Leading LNG shipper
Vale	Brazil	#1 iron ore producer with global exports
Aracruz	Brazil	#1 market pulp producer, innovative and low-cost
Petrobras	Brazil	Oil and gas company strong in deep sea drilling
Reliance	India	Global-scale petrochemical producer
Cemex	Mexico	#3 global cement producer, #1 in the United States
Yue Yuen	China/Taiwan	Athletic and casual shoes for leading brands
Haier	China	Leading brand in China, #3 globally in refrigerators
Modelo	Mexico	Maker of Corona beer, a leading global brand
Concha y Toro	Chile	A leading wine brand
Televisa	Mexico	Hispanic soap operas attract a global audience
America Movil	Mexico	Latin American Telecoms with global aspirations

"Global-size" does not always mean not truly world-class. China (with two "world-class" companies), India (3) and Russia (none) score less well when it comes to having companies with global reach as well as global competitiveness. One major reason is, no doubt, that they had a much later start than Korea and Taiwan in going after exports although they have been catching up fast.

Another reason for India being under-represented is that some industries boast more than one company that can be classified as "world-class but I have included only one in each industry. I include Infosys but not Tata Consulting and Wipro in IT services even though they are comparable in size and sophistication. I chose Korea's Posco as the leading steel company but Tata Steel has become global with its acquisition of Corus. Mittal is not an Indian company but its founder is.

More than half (14) of the 25 world-class companies operate in capital intensive or technology-oriented industries requiring high rates of spending on research and development to remain competitive.

What is remarkable is that more than half (14) of the 25 world-class companies operate in capital intensive or technology-oriented industries requiring high rates of spending on research and development to remain competitive. Some even leap-frogged previous industry leaders. Most are located in emerging Asia.

Five others are commodity producers but just two are truly resource-based: iron ore for CVRD and pulp from eucalyptus trees for Aracruz. The other three are increasingly sophisticated producers of cement, petrochemicals, and energy but these resources are abundant and each has had to develop its own special edge – both technological and logistical – in order to remain globally competitive.

The remaining six emerging multinationals are consumer firms and service companies, producing a wide range of products from shoes to refrigerators, beer, and wine, and providing telecom and media services.

Conclusions we may draw from this list are:

- Only a handful of emerging multinationals rely on natural resources or cheap labour as a major competitive edge.
- Although many (but not all) firms were at one time government-subsidized, promoted, or protected, they could not have become world-class if they had failed to wean themselves of this clumsy shield or had not tested themselves in the demanding arena of export markets.
- The competitive edge of these companies typically includes "man-made" factors (driven by management) rather than merely "natural" factors.
- World-class companies can be found not just in emerging Asia (14) but also in Latin America (10) and in South Africa (1). Early industrial starters like Korea (4) and Taiwan (4) have a

heavy representation, mostly in technology, while Brazil (4) and Mexico (4) have more resource and consumer companies on the list.

- While some of the leading Russian and Chinese energy and telephone companies are global in *size*, they are not yet *world-class* in market share, efficiency, or technology.

Emerging multinationals aspire to be truly global, to operate globally, think globally, manage globally, and grow globally.

Emerging multinationals are no longer content to be viewed as leading Korean, Mexican, Taiwanese or Chinese companies. They aspire to be truly global, to operate globally, think globally, manage globally, and grow globally. This goal is rapidly becoming a reality for many. Many emerging multinationals are already owned by shareholders from all over the world: Samsung is owned 52 percent by international shareholders, Cemex 71 percent, Hon Hai 57 percent, Infosys 54 percent and the emerging multinationals as a group about 50 percent.

Companies like Samsung, LG, and Hyundai began by making products efficiently and cheaply but now have recognized brand names, a high-quality image, world class technology and appealing designs. China's Haier and others are following in their footsteps. In fact, they are already better known than GE, Sony or Toyota by hundreds of millions of consumers in China, India, and other emerging nations.

One reason that emerging multinationals have remained below the radar of so many executives, as well as the general public, is that companies such as Yue Yuen and Hon Hai remain deliberately hidden in the shadows cast by better-known brands such as Nike or Apple's iPhone even though they are the actual producers of products for those companies. These firms' prevailing invisibility—a conscious stealth strategy in some cases—does not mean that they are powerless, less profitable, or that they will be content to take the low-profile road forever. It won't be long before the biggest companies you have never heard of become household names.

The True Success Factors

In interviews with founders, managers, competitors and industry analysts, I found that the following factors best explained the success of emerging multinationals.

Factor	Count
An early commitment to export markets	21
A relentless focus on superior execution and quality	20
Emphasis on technology and design	15
Inventing a new industry model	13
Spotting a niche overlooked by established players	12
Using cheap brainpower as a competitive edge	12
Acquisition strategy	11
Fast-to-market	9
Branding	7
Organizational model/logistics	6
Natural resources	4
Cheap labour	4

Source: Interviews and research by author

The primary success drivers are different from general perception. "Man-made" factors turn out to be more important than natural resources or the advantage of low-cost labour in determining whether a firm wins or loses over the long haul. It turns out that unconventional thinking, an ability to adapt to life-threatening crises, a global mind-set, and disciplined ambition are crucial ingredients in the success of virtually all companies that succeed in attaining world-class status.

Unconventional thinking, an ability to adapt to life-threatening crises, a global mind-set, and disciplined ambition are crucial ingredients in the success of virtually all companies that succeed in attaining world-class status.

Successful, world-class companies from emerging markets have often made up their own rule book or adapted global best practices to their own. I call these adaptations "emerging market twists":

1. Unbundle integrated industries, taking advantage of the "legacy thinking" of established competitors (TSMC, Aracruz)
2. Vertically integrate related areas of competitive expertise (Hon Hai)
3. Move like a chameleon up the value chain (Samsung Electronics)
4. Turn the outsourcing model upside down (Embraer)
5. Follow a an "emerging markets" strategy (Ranbaxy, Televisa) taking advantage of being on the same wave length as a competitive edge
6. Get around the zip code problem by going global (Vale, Cemex)
7. Use a veil of anonymity by aspiring to be the largest company no one has ever heard of (Yue Yuen, Hon Hai)
8. Following Sun Tzu, focus on a niche ignored by market leaders (Embraer)
9. Take advantage of cheap brainpower rather than cheap labor

Impact of the Crisis

Most emerging multinationals had the advantage of being crisis-trained and used to volatile market cycles. As a result, they reacted quickly and easily weathered the storm thanks to healthy balance sheets with low debt and plenty of cash even though they suffered (like companies everywhere) from drops in sales, margins, and capacity utilization. Occasionally, they even benefited from the inevitable consolidation in industries during a recession. For example, Hyundai Motor was able to expand its market share in the U.S. car market as American car companies faced major restructuring. Even though oil prices dropped from their peak, Petrobras

Most emerging multinationals had the advantage of being crisis-trained and used to volatile market cycles.

benefited from new oil discoveries thanks to its unique deep-water drilling expertise. And Taiwan's HTC, a leading smart phone maker and designer (which makes the Gooogle Android), was focused on a growing niche in the declining handset market. And the maker of the iPhone, Taiwan's Hon Hai, benefited from Apple's success with its revolutionary product.

Only two of the 25 have faced serious financial difficulties as a result of the recent crisis. It had been clear for some years that Cemex's acquisition strategy was highly aggressive and financed with too much debt. It now faces refinancing $15 billion in short term maturities at a time when construction activities in two of its major markets (the United States and Spain) have plummeted. Brazil's Aracruz became the victim of a $2 billion derivatives exposure and had to sell out to its competitor VCP.

Indian companies on my list such as Infosys, Reliance Industries, and Ranbaxy as well as others in the world-class category such as Wipro and the Tata Group companies have generally survived the crisis well even though the aggressive European acquisition strategy of Tata Steel and Tata Motor has burdened these companies with debt.