FEATURE

Strategies for emerging economy markets

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Emerging economies

have opened their gates, and multinational enterprises (MNEs) are flooding in. Some seek new opportunities for low cost production and re-configuration of global value chains. Most investors, however, seek fast growing markets that offer new growth opportunities, for example:

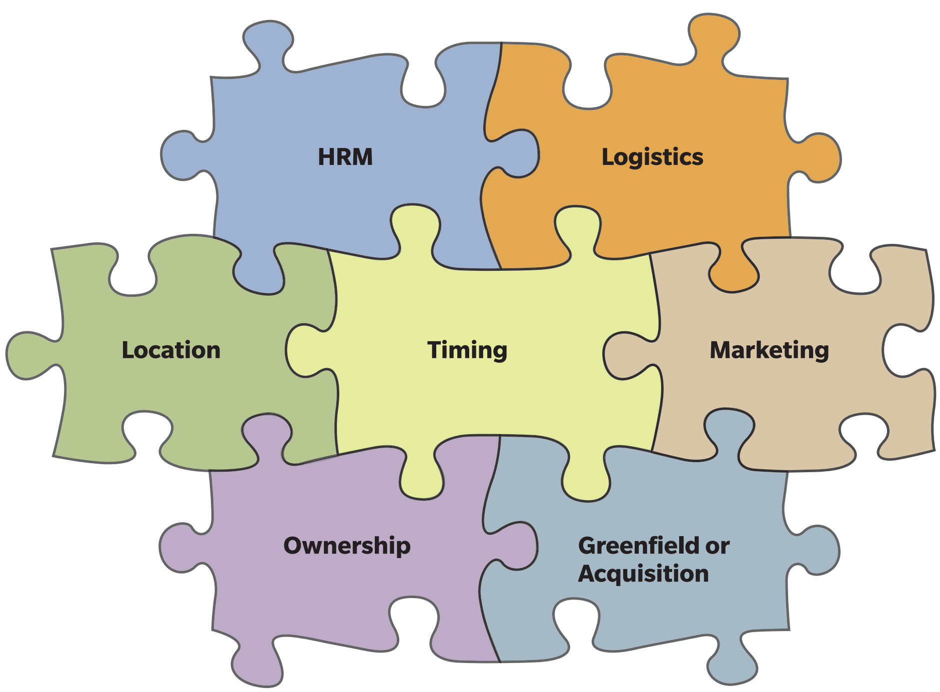
- The emerging middle classes are seeking quality and luxury goods that support lifestyles resembling those of mature market economies.
- Huge numbers of people at the 'Bottom of the Pyramid' are becoming potential customers, especially for business concepts that meet their needs, resources and aspirations.
- Local businesses, some of which themselves enter the global stage, seek specialist investment goods and components, industries that are the traditional strength of Northern European businesses.

To take advantage of these opportunities, MNEs need strategies to enter and grow their businesses. The strategy needs to create value for local customers as well as profits for the MNE. Thus, investors aim for market positions that are viable in the long term, preferably as a leader in their market. The initial entry thus needs to provide not only a foothold, but a perspective to develop a leading position.

The entry strategy has to match the needs and resources of the MNE with the opportunities and constraints in the local environment. Entry strategies thus require adaptation to the local resource endowment, market demand and the institutional environment, i.e. the local 'rules of the game'. The degree of such adaptations varies across industries and host countries.

The design of an entry strategy is a creative process of integrating many interdependent elements (Figure 1). Various scenarios may be explored to decide over a wide range of

Figure 1: **The Building Blocks of an Entry Strategy**



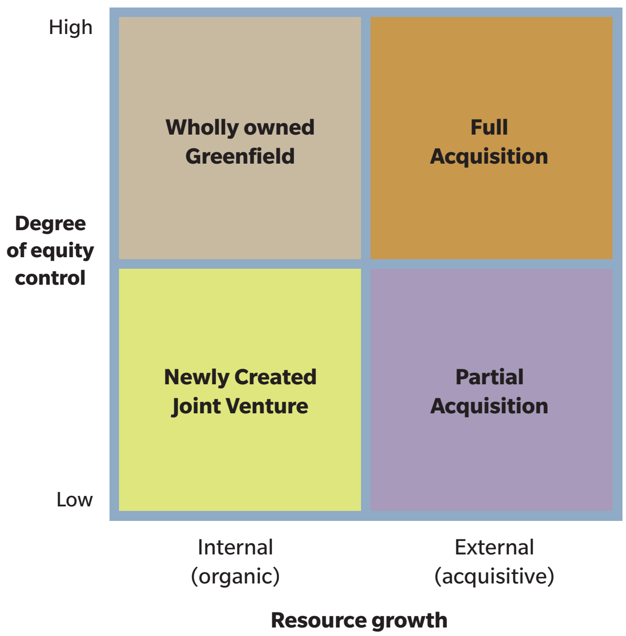
issues. This essay introduces and discusses key questions and issues that strategists have to consider when designing an entry strategy for an emerging economy.

Should we go alone …?

The first question that often comes to mind when discussing foreign entry is the choice of entry mode, especially the 'JV issue'. Yet, entry modes vary in fact across multiple dimensions; crucial is not only the ownership stake, but how the entrant develops its resources locally: organically or by acquisition (Figure 2).

Businesses usually like to be in control of their operations. Control facilitates the effective management of knowledge, avoids dependencies on external partners, and allows reacting flexibly to new market opportunities. If an entrant has (or has access to) all the resources required for a new operation, and if no legal requirements mandate local ownership, then foreign investors would normally prefer to establish a wholly owned subsidiary to attain full control over the operation.

Figure 2: **Dimensions of entry Modes**



… or should we share with a local partner?

Despite the attractions of full control, many foreign investors choose a joint venture (JV) as an entry mode in emerging economies. A JV creates a new entity with two or more partner firms contributing resources and sharing the control.

Theoretical models suggest that a JV would be chosen if three conditions are met: (a) the new business unit depends on resource contributions from two or more firms, (b) the transfer of these resources or the expected benefits for the investors are subject to high transaction costs, and (c) it is not feasible for the entire parent firms to be integrated into one firm, for instance because they are big relative to the envisaged project, or one of them is a state-owned enterprise.

In market-seeking JVs in emerging economies, local partners typically contribute local business networks and knowledge of the local business environment, especially consumer behaviour and the role of governments. These types of resources are important where local conditions lack transparency, where markets do not function well, and where relationships are an essential foundation for business.

At the same time, MNEs contribute their own technologies, business processes and brands. Such transfers are often essential to achieve competitiveness, while asymmetric information inhibits the efficiency of markets for their transfers, such that investors prefer to keep them internal and under control. Moreover, knowledge to be transferred is often tacit and thus requires 'learning by doing' and thus an intra-organizational mode of transfer.

The ownership preferences depend on the institutional environment governing the market, notably the feasibility and cost of enforcing contracts. Where these institutions are weak, investors would abstain from arm-length contracts; at the same time local partners may be helpful to interact with other local businesses. Thus, JVs provide an avenue to operate in unfamiliar contexts, especially where the investor lacks experience and understanding of local culture and business practices.

Should we acquire a local firm …?

The other dimension of entry is essentially a make-or-buy decision, namely the choice between a greenfield operation and an acquisition of (a stake in) an existing company. This decision is primarily driven by the investor's need for local resources: An acquisition provides local organizationally embedded resources, such as human capital and networks with local authorities. Acquisitions thus are preferred by those who need complementary local resources, or who wish to establish a strong market position on the basis of the acquired firm's market share, brands and distribution network.

Acquirers often prefer a full acquisition and thus full control over the operation. This is particularly important when they want to implement radical restructuring to upgrade and integrate the acquired organization with the acquirer's own operation. Yet, in some circumstances partial acquisitions may be appropriate, at least as a temporary arrangement. For instance, only partial equity stakes may be available for acquisition in the context of a privatization. Or, the business may be acquired from a local business group that may continue to contribute in a variety of ways.

... or should we create a new entity as a Greenfield project?
A greenfield operation in contrast allows investors to create a new operation from scratch according to their own designs, and thus to replicate organizational procedures and practices used elsewhere. The greenfield option thus is preferred in particular by investors whose competitive advantages are grounded in the firm's organizational structure and culture, and who thus would not want to dilute them by adapting to an existing local organization.

Should we locate in the country's economic hub...?
Location concerns both the choice of country to invest in, and the selection of a specific site. Market-seeking investors are primarily concerned with the access to distribution channels and potential customers in the target market. They would invest in a central location for sales, marketing and logistics, while the distribution network may cover the entire country. In some industries, also, the actual production needs to be located close to the customer or the point of consumption, notably in service industries such as tourism, and for manufactured goods that face high transportation costs. Thus, market-seeking investors locate in large and growing markets, and where traffic infrastructure allows convenient access to customers.

... in peripheral areas offering specific resources...?
For investment projects aiming for export markets, the primary concerns are costs of production. Hence, the key parameters for such location decisions are the costs and quality of the local resources. This includes the specific inputs required for the operations, including natural assets like cost of the local workforce and natural resources, and 'created assets' like intermediate goods, human capital and infrastructure. Such created assets are of increasing importance in emerging economies, and they are often provided by other businesses. Therefore, foreign entrants often invest where a strong community of related local and foreign-owned businesses already exists.

... or where local governments offer attractive subsidies?
In addition, location decisions are often moderated by investors' concern about regulation of the industry, political risk and law enforcement. Investors may negotiate with the pertinent national and local authorities about specific conditions and benefits. Investment incentives such as the provision of local infrastructure or subsidies and financial incentives may tip the balance for a particular site, especially if competition for FDI is strong. Yet, such incentives are usually only worthwhile pursuing if the fundamentals – resource endowments and institutional infrastructure – are solid.

Should we seek first mover advantages...?
Market-seeking foreign investors normally aim to be number one or two in their industry or market segment, especially if the industry tends to oligopolistic market structures. Investors may pursue market leadership by entering ahead of major competitors in pursuit of first mover advantages.

First movers may build reputation and consumer loyalty, and establish relationships with key suppliers and customers. They may even be able to lock business partners into a relationship, and thus raise barriers to entry for potential competitors. Moreover, they may build goodwill with local authorities, slide down learning curves, and acquire unique local resources, such as distribution channels, local brands and raw material sources.

In some industries, first movers have to commit heavy up front investment to establish a leadership position from which to face later entrants, as for branded consumer goods, or because of the capital intensity of the industry, as for oil exploration. Other first movers may pursue a 'platform strategy' that establishes a foothold to observe the local industry and to react flexibly to business opportunities if and when they emerge.

... or should we wait?
Followers, on the other hand, may benefit from a less uncertain business environment, and from observing the first mover, its customers and the local authorities. In particular, 'fast seconds' may learn from the experiences and mistakes of the first mover, yet create a challenge before the market structure has stabilized.

Empirical evidence suggests that first movers can maintain their leadership position if they continuously commit resources and focus on learning about the local environment. Yet, ample case evidence points to first movers who did not succeed in creating sustained market leadership, especially when challenged by resourceful and determined competitors entering the market.

Should we position in the premium market ...?
In emerging economies, markets tend to be highly segmented, both regionally and in terms of income groups. In consequence, differences of margins between global brands and local mainstream brands tend to be large. The premium segment is the prerogative of the middle and upper classes,

who often aspire to 'Western' style living standards and are less price sensitive. Moreover, premium brands are often important status symbols for this group of consumers.

Foreign investors may be able to reach these consumers with global products, brands, and marketing strategies. Advantages of such a strategy include economies of scale in product development, production and marketing. Global standardization is most likely to be appropriate for MNEs with core competences supporting premium brands and products, in industries that are technology intensive and face little variation in consumer preferences, and in urban locations with a cosmopolitan outlook (Figure 3).

… or the mass market…?

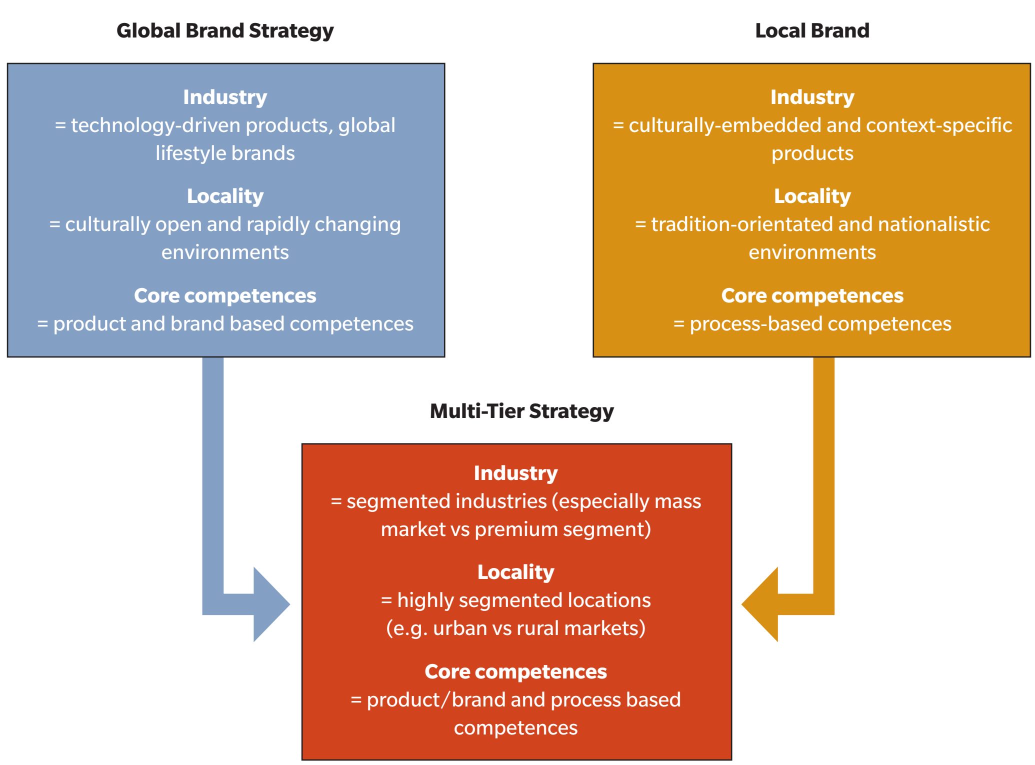
Mass markets in emerging economies are potentially vast, yet margins are typically small. Consumers have tight budgets and thus react highly price sensitively, while local business may offer price-competitive products. Goods and services for such "Bottom of the Pyramid" markets would have to accommodate local needs and purchasing power for instance with simpler yet more robust product designs. Marketing strategies may be very people intensive – thus taking advantage of low labour costs – and use traders in the informal sector to reach customers.

Foreign entrants may create or acquire local brands that provide a local image, and are distinct from global brands. Such localization is important when targeting markets where volume driven strategies with small per-unit margins may be most appropriate, and for culturally sensitive products such as foods. To succeed in such markets, firms need operational capabilities to profitably run low cost/low margin production and distribution operations.

… or both?

Some MNEs target both premium and mass markets using a multi-tier strategy. This allows combining an international product positioned in the premium segment and a local brand aimed at the mass market. Such a strategy allows synergies, for instance in the use of distribution channels, yet it requires MNEs to have both strong international brands and deep understanding of how to operate under emerging economy conditions.

Figure 3: **Branding Strategies for Emerging Economies**



Source: Meyer and Tran (2006)

How should we manage our expatriates, ...?
A foreign entry depends on qualified and motivated people to implement the strategy. Thus, along with the establishment of a new subsidiary, expatriate managers have to be selected and prepared for their assignment. Expatriates play a pivotal role in this process; without suitable managers in charge of local operations, even the best planned strategy is likely to flounder.

... and our local staff?
Local staff need to be recruited and trained. For newcomers it can be hard to identify the most suitable individuals, especially for managerial positions. Often local middle and top management are headhunted from other foreign investment firms. Technical skills may often be readily available, yet potential leaders are scarce, and thus in a strong position to negotiate salaries.

Human resources management has to create mechanisms for two-way knowledge sharing within the organization: to transmit key technologies and organizational practices to the new operation, and to inform decision makers at headquarters about the local business. Training for local staff has to convey tacit knowledge and may thus include learning by doing in other operations of the MNE. Related challenges include leadership of a workforce in a culturally different context, and adaptation of systems for recruitment, performance assessment and remuneration of local staff.

How should we ship our products around the world?
An important aspect of a foreign entry strategy that is little analyzed in the literature but of great importance for management practice is logistics. Lower labor costs are only valuable if the products can be transported to the customer in good time at acceptable costs. Modern transportation infrastructure and IT systems are designed to allow MNEs to optimize the integration of their internal operations as well as supplier relations. Specialist intermediaries offer services that may include not only warehousing, shipping and door to door delivery, but processing of customer orders and identification of appropriate suppliers.

A foreign entry often triggers changes in these systems, especially if it involves the relocation of production. When designing a foreign entry, MNEs thus have to establish processes to coordinate over great distances, to interact with distant customers and suppliers, and to move products around the world.

Round Up
Thinking strategically about entry in emerging economies requires developing a vision of the development of the market, and the firm's position within it. The initial entry strategy establishes the foundations for a subsidiary that creates value for both local customers and for the global company.

The design of this strategy concerns many interdependent decisions. Take, for example, the choice of entry mode. If timing and speed of entry are crucial for an investor – as they are for those pursuing first-mover advantages – an acquisition or a JV may offer quick access to local marketing assets. On the other hand, acquisitions pose greater challenges in terms of integrating marketing, logistics and human resource management with the entrant's existing structures and practices. Thus, foreign entry strategies have to integrate the complex interdependencies of multiple dimensions.

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