Retail & Consumer

Building to win

How multinationals are structuring to compete in emerging markets

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Foreword

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With the current volatile condition of the global economy and any real recovery in developed markets appearing to be some time away, the importance of emerging markets to global retail and consumer-products companies is clearer than ever. Countries like China and India promise brighter returns to counter lagging results in more developed economies. Market-facing strategy is not the only key to success for retail and consumer-products companies operating in emerging markets, however. Internal organisation structures must provide flexibility on the ground, support long-term corporate direction, ensure timely, effective decision-making and attract and grow the right talent. Striking the right balance between local, regional and corporate is critical.

How does the emerging market fit within the existing organisational structure? How are multinational organisations creating the kinds of structural platforms necessary to compete and win in emerging markets — where geography, cultural differences, business practices and regulatory frameworks often collide?

Over the past decade multinationals have simplified and standardised processes globally to improve operational efficiencies, and they are continuing to do so. This report, produced in cooperation with the Economist Intelligence Unit, examines how successful companies are organising to create economies of scale; where power resides — and why; what impact cultural values can have on the organisation and why talent and leadership are such challenging areas to manage.

To all our interviewees, thank you for your time and insights.

We hope this report helps you build an approach to support long-term success.

Sincerely,

Carrie Yu

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Executive summary

01 Executive summary

The global retail and consumer sectors face, at best, an uncertain outlook in 2009. Most of the developed world is in recession and despite some glimmers of hope — mainly in the form of slowing rates of decline in key indicators — real economic recovery is likely some distance away. Now, emerging markets, on which many companies in the retail and consumer sectors — and indeed, many other sectors — have been pinning their hopes for growth, are also being dragged down into the mire. The depth and length of the emerging-market troubles are of great concern to senior executives in the retail and consumer-products sectors. They have made large-scale investments in these countries in recent years based on expectations of significant growth. Operations in emerging markets will be under intense pressure to deliver on these growth targets despite the sombre outlook. With the economies of many developed markets still in freefall, the financial returns from emerging markets are needed to shore up global profits as well as to justify the investments made over the past decade.

The coming year will see the retail and consumer-products sectors buffeted by the following trends:

1 The cooling down of emerging markets

Emerging markets have traditionally been expected to pick up the slack during slowdowns in mature economies (in 2009, the US economy and Euro area are both expected to contract by 2%, the UK by 2.6%). However, the outlook for the retail and consumer-products sectors is far from certain given the global nature of the current malaise. Latin American and transition economies are vulnerable to the downturns of trading partners in North America and Western Europe respectively. Growth prospects remain more favourable in Asia, buoyed by the strong showing of China and India in recent years, but both face slower retail growth. The table shows how GDP growth levels are slowing in emerging markets. In the case of several countries such as Brazil, China and Russia, among others, growth is not expected to return to 2008 levels within the next five years.

Table 1: Slowing GDP growth levels

	2008	2009	2010	2011	2012	2013
Country	**GDP (% real change pa)**					
Brazil	5.3	1.6	3.2	4.1	4.0	4.0
China	9.0	6.0	7.3	8.4	8.5	8.7
India	5.3	5.0	6.6	7.8	8.1	7.9
Indonesia	6.1	1.9	2.2	5.2	5.9	6.1
Mexico	1.5	-1.8	1.4	3.5	3.8	3.5
Poland	4.8	1.5	2.4	3.3	3.7	3.8
Russia	6.0	1.0	4.0	4.6	4.6	4.7
Ukraine	2.1	-6.0	2.0	3.8	5.0	4.8
Vietnam	6.2	3.0	4.0	4.3	5.1	6.5
US	1.2	-2.0	0.6	1.5	1.9	2.1
EU	0.9	-2.0	0.1	1.5	2.0	2.2
World	6.1	2.5	4.6	5.9	6.2	6.2

Actuals
Estimates
Forecasts

Source: Economist Intelligence Unit

2
A worldwide slump in consumer confidence

Declining trade between developed and emerging markets is already resulting in a slowdown in manufacturing, factory closures and rising unemployment in Latin America, Central and Eastern Europe, and Asia. For countries that export high numbers of workers, such as Mexico, India and the Philippines, the contraction of remittance flows is also starting to hurt.

This will lead to depressed consumer sentiment and a decline in the value of purchases in many markets. Essentials such as food, beverages, tobacco and household goods are unlikely to see sales fall in volume terms, although they will certainly experience a decline in value terms as consumers trade down to cheaper or discounted brands. Spending on apparel and consumer electronics, as well as leisure services such as restaurants and hotels, is more vulnerable since consumers see it as less attractive in times of financial hardship.

Many governments have announced radical financial stimulus packages in a bid to maintain consumer spending. Barack Obama has pushed through a massive fiscal stimulus (just under US$800bn) to start his term in office as US president. Developed and emerging markets are also increasing government spending to stimulate demand, although the impact of these packages will take time to be felt.

3
Intense focus on cost efficiency and pricing

Retail and consumer-products companies will discount heavily to maintain market share. For essential goods such as food, consumers will switch to cheaper substitutes, which will benefit discount retailers at the expense of mid-market retailers, who are expected to alter pricing to protect market share.

Luxury-goods companies are heavily exposed as wealthier consumers economise and a lack of credit affects more aspirational purchases. While the luxury sector has traditionally been more resilient in downturns than the mid-market, job losses in highly-paid areas such as banking will inevitably filter through to lower sales. French luxury-goods group LVMH and UK-based apparel brand Burberry, for example, have continued to see growth, buoyed by Asian markets and sustained demand for their high-profile brands. Both, however, have raised concerns about the impact that a sustained downturn will have on sales in the coming years. French cosmetics firm L'Oréal also expects difficult trading conditions during 2009. Luxury retailers will now face the challenge of reducing prices without damaging profit margins or brand perception.

Companies will also be looking at their own internal structure and using the opportunity to drive out costs and eliminate redundancies. This includes reviewing internal processes to find efficiencies and putting common functions into shared services organised on a regional or global level.

4 Moves among retailers to organise to penetrate emerging markets better

Most retail companies that are operating in emerging markets have not been there for very long. Ample market opportunity in their home countries and the high levels of regulation abroad have traditionally acted as deterrents to foreign investment. In the past 15 years, however, retail companies have become aggressive in their quest to internationalise and capture market share in some of the fast-growing countries in Latin America, Eastern Europe and Asia.

The most international of retail companies now have a secure presence in emerging markets and are evaluating how they are internally structured and whether they can transform themselves to penetrate these countries better. The companies that do have enough critical mass in emerging markets are moving towards regional structures, in which they are putting a management layer between global headquarters and in-country operations.

The regional structure has a number of benefits. For global headquarters, it speeds up information transfer from the markets and enables better strategic direction and control. Regional offices also take a proactive stance on talent and leadership development. For local operations, the benefits include increased access to global best practices, faster roll-out of technology and more compelling career paths.

5 Moves among consumer-products companies to seek economies of scale

Many consumer-products companies are far ahead of retailers, since they have been operating in emerging markets for a much longer period of time. Where they have in the past had a decentralised structure, consumer-products companies are in a period of transformation. They are streamlining and centralising parts of their organisation to reduce costs and eliminating duplication of back-office functions by establishing shared service centres that support multiple markets or regions.

The net effect is that consumer-products companies are centralising in some areas and remaining decentralised in others. Decision-making for consumer-related activities such as marketing, store promotions, pricing strategy and product localisation is still carried out at a country level. However, functions such as HR, finance, IT, facilities management, supply-chain management and procurement are carried out by regional headquarters or organised into global service centres.

The transformation of consumer-products companies in emerging markets has been spurred by the entry of foreign retailers. This has had a radical effect on how consumer-products companies think about their supply chain and distribution networks. Forging strong relationships with retail companies is a top priority as this is becoming a hugely important channel for increasing penetration into emerging markets.

6 Emphasis on creating consistent global corporate cultures that are sensitive to the national cultures of emerging markets

As well as expanding their physical operations into emerging markets, retail and consumer-products companies are also seeking to apply more of the cultural glue that binds their organisations together. Companies cite a globally consistent corporate culture, based on universal values of respect and customer service, as a key factor for maintaining their corporate identity as they expand into emerging markets. Firms make a concerted effort not to impose a management culture that strongly leans towards any one national identity. Culture must be based on values that resonate regardless of the nationality of employees.

Values must filter into all corporate decisions and ways of doing business in emerging markets. For example, companies find that choosing joint-venture partners that share cultural and ethical values is a key determinant of a successful and sustainable relationship. This is particularly important because corporate conduct in emerging markets is vital to maintaining companies' reputations at home. Compliance has been a key function through which companies have succeeded in ensuring that their values, ethics and sustainability policies are clearly defined.

7 Continued high demand for management talent in emerging markets

Retail and consumer-products companies have created strong employment brands in emerging markets and are highly sought after by job seekers. However, a talent gap opens up at the mid-career and executive level as there are fewer seasoned individuals in emerging markets. There is a perception, mostly false, that staff in emerging markets will jump company for a small pay increase. What seems to be more the case is that companies have not correctly identified or focused on the most important factors that drive engagement and retention on an individual level. Companies should aim to create a total rewards package that includes everything from base pay to training and career-advancement opportunities.

It is vital that organisational knowledge be quickly and successfully transferred into emerging markets and, for this purpose, companies often assign expatriates from global headquarters and use talent-management policies that facilitate mobility. Establishing regional headquarters can speed up knowledge transfer as well as provide companies with a more strategic vantage point over talent within a region.

02
Introduction

02 Introduction

With the global economic recession, emerging markets hold out the promise of continued growth (albeit at a lower rate), without which many retail and consumer-products companies face the prospect of retrenchment. Companies are looking to emerging markets — particularly the BRIC countries of Brazil, Russia, India and China, in addition to other large emerging economies such as Indonesia, Mexico, Turkey and Vietnam — to shore up their positions globally. Multinationals such as Unilever are focusing on the prospect of up to one billion people joining the ranks of potential consumers for their products over the next decade and counting on a rising middle class in emerging markets to drive growth.

In the current environment, retail and consumer-products companies will need to penetrate deeper and increase market share at the same time as they rein in spending plans. This will require leveraging an organisational structure that allows firms to be agile within individual markets while streamlining, simplifying and centralising other parts of their operations.

A new landscape emerges

Retail companies are at an entirely different stage of development in emerging markets compared with many consumer-products companies. The global expansion of retailers such as Wal-Mart, Tesco, Carrefour and Metro, among others, has taken place within the past 15 years. Tesco, for example, first started operating in Thailand in 1998, established a joint venture in South Korea in 1999, and then went into Turkey in 2003, and China in 2004. High levels of regulation abroad and seemingly unsaturated markets at home have meant that expanding overseas has only recently risen to the top of most retailers' agendas. In contrast, many consumer-products firms such as Procter & Gamble, Johnson & Johnson and Nestlé are well over 100 years old (P&G's heritage dates back to 1837) and have been operating in emerging markets for more than 50 years. The latter opened its first factory in Latin America in 1939 and accelerated its expansion into emerging markets after the second world war.

As a result of their different stages of development, retail and consumer-products companies have different strategic objectives for their organisational structures. Retail companies are organising themselves into structures that will allow them to grow more quickly in emerging markets. They are establishing regional head offices that manage a group of emerging-market operations by providing strategic direction and planning support, developing talent for the region and evaluating new opportunities for property acquisitions or new market entry.

"I always look at it as globally efficient and locally relevant."

– Paul Polman, formerly executive vice-president for the Americas, Nestlé (now CEO at Unilever)

For consumer-products companies, their objectives are to re-organise; they already have strong brand presence and local partnerships but are looking to leverage economies of scale by streamlining and centralising non-core activities, empowering in-country marketing operations and enhancing their distribution networks and supply chains. "I always look at it as globally efficient and locally relevant; you can't be too global because there is no global customer," says Paul Polman, formerly Nestlé's executive vice-president for the Americas (now CEO at Unilever). "You can't be too local either anymore, because if you're not efficient the competition will do it for you."

The focus on supply chain and distribution is in large part driven by the entry of retailers into markets where consumer products are already established. The entry of international retail companies into emerging markets has dramatically changed the landscape for consumer-products companies. Where developed markets have seen a shift in the balance of power from consumer-products manufacturers to retailers over the past three decades, this trend is now occurring in emerging markets too. And the emergence of global retailers is forcing consumer-products companies to examine their cost bases and their structures. Paul Graham, CEO Asia Pacific of DHL Exel Supply Chain, notes: "Prior to the entrance of the global retailers, supply-chain efficiency and to a lesser degree supply-chain costs have been of less importance with a view that a lot of costs were borne by the local distributor."

Consumer-products companies march to regional centres

...for many companies the shift from European or North American production to developing and emerging markets is irreversible...

Many international consumer-products companies have been prioritising investment in developing and emerging markets in recent years. Their twin objectives have been to position themselves to exploit the growth potential of the new consumer base, especially in Asia, and to leverage supply side cost efficiencies for the benefit of their worldwide businesses. While the downturn will likely curtail overall investment spending in the near term, there is no reason to believe that this will reduce the priority on investment in, particularly, Asia. Indeed, the recession may well accelerate the trend on capacity retrenchment in Europe which has been evident in recent years — companies will not want to risk exiting the downturn with uncompetitive cost structures, as this is the time to get that work done if it's needed.

There are some cases of companies repatriating production from developing and emerging sources to make better use of surplus capacity becoming available in home markets. This can be a particular advantage if the focus is now on cash delivery through shortening supply pipelines. But, for many companies, the shift from European or North American production to developing and emerging markets is irreversible, and the challenge is to make the new footprint work more effectively.

For supply chain leadership in consumer packaged goods, there has been a growing trend towards establishing regional centres in developing and emerging markets, and there is evidence that this continues despite the recent turbulence. These centres are charged with managing the capacity footprint, ensuring good economies of scale in supply chain overheads and managing the inbound supply network. For many, it has been essential to separate these regional supply chain functions from the authority of local country leadership where regional and local interests often clash. Singapore and Hong Kong, with their outstanding logistical connections, remain the centres of choice despite increasing costs. Companies increasingly incorporate global functions into these centres, especially purchasing, since the centre of gravity for inbound supplies for many has shifted sharply eastwards in recent years.

Ian Midgley, advisor, PricewaterhouseCoopers UK and former chief supply chain officer, Unilever

Few bright spots

At the time of writing, there were some signs that the economic crisis was at least bottoming out. But a real economic recovery — at least in developed markets — is unlikely to come until after 2013. While emerging markets look relatively better off — they are expected to recover sooner — overall, the short-term outlook for retail and consumer-products companies is a difficult operating environment globally.

In mature markets the threat of high-profile bankruptcies could have a profound impact on the sector. US retailers such as Circuit City, Steve & Barry's, Linens 'n Things, Shoe Pavilion and Mervyns have already filed for bankruptcy. In the UK, furniture and high-street retailers MFI and Woolworths have gone into administration.

"We also chase all the opportunities that this distressed market may offer."

– Evgeny Kornilov, CFO, X5 Retail Group

Global retailers with deep pockets could see operations expanding and diversifying through opportunistic acquisitions. Overall, however, there is likely to be less interest in mergers and acquisitions. The ***PricewaterhouseCoopers 12th Annual Global CEO Survey*** shows that only 16% of CEOs at consumer-products companies and 6% of CEOs in retail will focus on mergers and acquisitions in 2009. "We believe that we do all the right things in the current financial crisis environment — we prudently manage our cash flows and have taken a decision to scale down capex [capital expenditure], focus on highest returns and shortest paybacks, and reduce short-term debt exposure," states Evgeny Kornilov, the chief financial officer of X5 Retail Group, a Russian retailer, in the company's 2008 third-quarter report. "We also chase all the opportunities that this distressed market may offer. It is quite clear by now that the strongest and the smartest will successfully live through the crisis and come out as winners, and it is our intention to continue to lead the way."

The global economic downturn is already having a sharp impact on property markets, but falling prices will be a mixed blessing. On the one hand, they will lower the cost of entering markets around the world, and companies will be able to acquire new locations at a lower price. On the other hand, a sluggish property industry is reflective of a slowdown in demand.


03
Global
restructuring

03 Global restructuring

As companies evolve, expand and mature in emerging economies they are increasingly aware that their market-facing strategy is only one of the factors required to win market share. Their organisational structure, ability to roll out new processes quickly and enter new markets in a cost-effective way are equally, if not more, important. To this end companies are changing their internal alignment and transferring power to regional headquarters.

Market-facing strategy is only one of the factors required to win market share.

Key findings:

- There is no right organisational structure for companies to adopt. Successful companies continuously evolve their structure depending on their strategy and stage of development in international markets.
- This research shows a clear trend towards companies organising themselves around regional clusters with a regional head office. For retail companies, this means decentralising and allowing more flexibility in the markets. Consumer-products companies are coming from the opposite direction and centralising to benefit from economies of scale.
- A strong regional office can help foster a consistent corporate culture, leverage economies of scale and speed up knowledge transfer between global headquarters and country-level operations.
- Cultural considerations must be taken into account when selecting the location for a regional office, in addition to factors such as transport links and talent availability.
- Challenges to regionalisation include unclear divisions of responsibilities between internal stakeholders and a lack of change management in the shift of power from local offices to regional headquarters.

One step at a time

...the most international of consumer-products companies have been operating in emerging markets for a lot longer than the most international of retail companies.

As discussed in the introduction, the most international of consumer-products companies have been operating in emerging markets for a lot longer than the most international of retail companies. For consumer-goods producers, overseas expansion typically begins with exporting abroad and entrusting marketing and distribution to local agents. Retailers have been slower to expand abroad since exporting their business models via franchising requires a robust legal environment.

As sales overseas increase, companies set up in-country manufacturing and sales operations, frequently with joint-venture partners. Regulatory change is another factor in the decision to invest directly. By introducing Western-branded products and retail formats into emerging markets, multinationals have frequently been able to skip the pioneering stage of the industry life cycle[1] and concentrate spending on marketing and distribution rather than research and development (R&D).

Table 2: A product-process lifecycle model

Extending the life cycle?	
Industry development	**Characterised by:**
Pioneering phase	Low demand, low margins, high start-up costs
Growth phase	Rising demand, expanding margins, little competition
Mature growth phase	Above average growth, increasing competition, margin pressure
Mature phase	Average growth, declining margins
Decline phase	Declining growth

In order to further penetrate emerging markets, however, increased investment in product innovation is often required. Paul Graham, CEO Asia Pacific of DHL Exel Supply Chain, notes: “The challenge that global FMCG (fast-moving consumer goods) companies will face is to develop local feel and flavour while driving lowest cost to serve and to convince the consumer that there is still a point of difference”.

1 Abernathy and Utterback 1978 theory, which presents a product-process lifecycle model. As industries mature, competition shifts from product to process innovation (more specialised or efficient manufacturing to exploit economies of scale). In emerging markets, industries are at an earlier stage of lifecycle; therefore, firms compete on the basis of product differentiation.

Retailers face the same hurdles. Organisationally, to introduce product innovations, companies need to be decentralised to some degree. The need to streamline business processes at the same time pulls them towards centralisation. Likewise, successful retailers often use local sourcing for a high percentage of the products that they stock, which limits opportunities to reap global economies of scale in procurement.

The global economic crisis is increasing the urgency for realising economies of scale and steering management focus away from new product development. Indeed, only 17% of CEOs at consumer-products companies say they will be focusing on product development in 2009, according to the ***PricewaterhouseCoopers 12th Annual Global CEO Survey***.

Towards regionalisation

There is no such thing as the “right” organisational structure. As shown in Table 3, there are many examples of multinational companies that operate successfully under a variety of organisational structures — from highly centralised to regionally managed to entirely decentralised. Each of these structures has advantages and potential disadvantages. However, in the course of this research, one trend has become evident: international retail and consumer-products companies, whether they are decentralised or centralised, are shifting their balance of power in emerging markets towards regional structures (or dedicated emerging-market units).

Table 3: Organisational structures: What's the right fit?

Organisational structure	Key features	Advantages	Potential disadvantages	Company case example
Centralised	Reporting lines for most functions and product groups in emerging markets lead into corporate headquarters Back office functions are centralised and often operated as shared services	Product and brand consistency Corporate headquarters has control and insight into local operations Back office cost efficiency	Can lack product localisation abilities Lack of local autonomy and agility Slower decision-making	**McDonald's** The company has a highly centralised global strategy that enables it to have a high degree of brand and product consistency
Regionalised	In-market independence on operational issues Individual markets report into regions Regions report into headquarters	Achieves a balance of centralised and decentralised Faster local decision-making than a centralised structure More central oversight and control than a decentralised structure Ability to spot organisational synergies and streamline accordingly	Regional headquarters risk becoming an additional layer of bureaucracy There must be a degree of scale in the markets before a company can afford regional overheads	**Wal-Mart** Having previously been a highly centralised company, Wal-Mart has adopted regional structures in Asia, the Americas and Europe
Decentralised	All functions and product groups report locally Top local management reports to global headquarters	Fast local decision-making Agile local structure and strong product localisation ability	Duplication of corporate functions It is difficult to roll out technology systems globally High in-market cost base	**Pernod Ricard** The company has a history of decentralisation since 1975 and is run like a federation. The holding group sets some strategy but decisions are made in the markets

Companies that have operated under decentralised structures have identified opportunities to consolidate activities in order to reduce duplication and reap global economies of scale, transferring processes and decision-making to regional centres of excellence. They do not seek to centralise entirely as this would take control too far away from the markets. The transformation programme of Anglo-Dutch food, home and personal care giant Unilever, for example, aims to reduce 100 in-country units to 20-25 multi-country organisations (MCOs) in addition to closing 51 factories. As of September 2008 the company had established 29 MCOs and closed 14 factories.[2]

Companies that have relied on developed markets for the bulk of their sales are finding that international growth requires a shift towards more decentralised operations. Brian Walker, vice-president APAC for Wal-Mart, notes that “Wal-Mart’s structure has been centralised in some ways, and decentralised in others — we have always strived to think global and act local, keeping the needs of local customers in mind.” Individual markets have always had the authority to make their own decisions within a governance framework but have all reported to the corporate headquarters in Bentonville, Arkansas. “Now we are decentralising further by pushing more governance authority to our regional offices.”

Likewise, Kraft, an American processed-food maker, aims to establish a more flexible, decentralised business model around four growth engines (South-east Asia, Brazil, China and Russia). Kraft, America’s largest — and the world’s second largest — food company, has lagged behind the world’s largest, Nestlé, in expanding internationally. Kraft makes 56.8% of its total revenue from the North American market and 26.6% within the EU. The proportion of its revenues that comes from other international markets is only 16.6%[3]. Both Unilever and Nestlé are far less dependent on their home region, Europe, for their share of total revenues.

2 Presentation by Unilever’s CFO, Jim Lawrence at CAGNY Conference. February 17th 2009
3 Kraft Annual Report, 2008

...Western multinationals are selecting locations for regional headquarters offices that have one foot in the West and one in the East.

Bridging the gap

By moving towards regional structures, companies are tacitly admitting that it is extremely difficult to drive rapid growth in emerging markets with a centrally-run organisation. The challenge, then, is to bridge the divide between headquarters and country markets and particularly between the developed and developing worlds. To do so, some Western multinationals are selecting locations for regional headquarters offices that have one foot in the West and one in the East. According to Guenter Thumser, president of Central and Eastern Europe and head of divisional laundry and home care at German consumer-products company Henkel, "you cannot steer expansion into emerging markets from one headquarters; it is beneficial to have a regional headquarters which is closer to the markets". Henkel's regional headquarters for Central and Eastern Europe is located in Vienna, Austria.

Mr Thumser explains that, "even the big markets which were opened from [headquarters in] Düsseldorf were later transferred to Vienna as it was acknowledged that Vienna has far greater experience in developing strategies that were close to the market. There is deeper insight with hundreds of market-research projects being carried out". He cautions that, "expansion was not overnight, it took over a decade of making smaller steps".

Henkel's Global Excellence initiative involves multiple projects aimed at ensuring that the company has the structures and processes in place to maximise operational efficiency. It is, for example, rationalising its production and supply chain in addition to expanding the use of shared services centres. Projects include the expansion of a shared services centre in Slovakia and the transfer of centralised R&D operations to the company's three business sectors: laundry and home care; adhesive technologies; and cosmetics and toiletries.

Similarly, there were a number of stages involved in Procter & Gamble's restructuring around three global business units — beauty care, household care and health and well-being — last year. In 1999 back-office functions were consolidated into one global business services unit, based in Costa Rica, the Philippines and the UK. A degree of linguistic homogeneity is noteworthy. Spanish and English language skills are widespread in Costa Rica and the Philippines.

Likewise, Austria's official language is German. Mr Thumser says that "Vienna's focus is much more operational and we are directly involved in the countries". He continues: "One reason the regional headquarters is so successful is that it has one foot in the West and one in the East. We are able to quickly roll out sales systems, strategies and tools at the speed of Western Europe into Eastern Europe and benefit from synergies. The regional headquarters has a bridging effect and is able to import knowledge quickly." Procter & Gamble's consolidation and standardisation of shared services has been credited with speeding up Gillette's integration following its acquisition in 2005.

Where to locate the regional headquarters, particularly in some parts of the world, is far from a straightforward decision. Paul Etchells, Coca-Cola's deputy group president for the Pacific, notes that "unlike Latin America, which has greater cultural homogeneity, Asia is not a natural grouping". Adding to the complexity of choosing regional offices to serve Europe, Asia, Africa and the Middle East is the large number of time zones and languages in each of these regions. In contrast, companies typically run their Latin America operations from the US or out of Mexico City, Buenos Aires or Sao Paulo, often depending on the order of entry into the region's various markets.

Important considerations include transport links, executive leadership availability and political stability. Mr Thumser of Henkel notes that Central and Eastern Europe is "a diverse region dominated by big countries such as Russia, Poland and Ukraine, but it also has many small countries, such as the Baltic countries. It is respectful to the cultures of the region to be located in a smaller, neutral country — for example, Austria rather than Moscow".

In 2008 Wal-Mart established a new regional office in Hong Kong, responsible for overseeing the company's operations in China, India and Japan, in addition to developing new business opportunities. The move follows in the footsteps of the company's Miami regional office, which was established three years ago to oversee the company's operations in Latin America and Canada. Mr Walker says that the regional office "has a strategic, not operational, role. All operational decisions are taken in the markets. The office's role is to push out strategic thinking and governance in existing markets, while looking for new business opportunities across the region".

"regionalisation started happening because we realised you can't do it from the US. The markets are too large and too complex."

– Brian Walker, vice-president APAC, Wal-Mart

Mr Walker notes that, "regionalisation started happening because we realised you can't do it from the US. The markets are too large and too complex". But in managing complexity, Mr Walker cautions that "this structure can only work if we can ensure it is not an extra layer of bureaucracy. It has to be focused on the big picture and opening new markets". To manage emerging markets through a regional framework requires companies to have clear structures and responsibilities. According to Mr Walker, "to respond to the regionalisation, the central headquarters has realised the need to let individual markets have freedom within a framework. This enables us to better focus on customer needs at the market level".

Hong Kong was chosen for its transport links, its strategic location with one foot in the East, one in the West, and also because of the wider availability of an international base of talent compared with mainland China. “We chose Hong Kong because you can get global, diverse talent which is essential because Asia is a diverse region,” says Mr Walker. The high degree of diversity within Asia has persuaded some companies not to staff their regional Asia offices solely with Asian nationals. “There is so much diversity in the region that being from one Asian country doesn’t necessarily mean that you can work well in another,” says one executive. “It is better to have the best skills regardless of nationality.”

Brazil has become a major hub for shared services for the multinational retailers and consumer-products firms operating in Latin America. “As well as having plentiful skills availability, the country is economically stable and is being chosen as a location for back-office functions and supply-chain and distribution-network management,” says Ricardo Neves, a partner at PricewaterhouseCoopers Brazil. “Considering the countries’ relative sizes, language and cultural proximity in Latin America, regionalisation and shared-services programmes have been more easily implemented in the region than in Europe or Asia where there are large differences in culture, language and size of the countries.”

Growing pains

…there are often areas of blurred accountability or decision-making when moving from decentralised structures to global category-led businesses.

As with any business-process change, when companies change their structures there are often areas of blurred accountability or decision-making. This is typically more of a challenge for consumer-products companies when moving from decentralised structures to global category-led businesses.

When there are brand managers and marketing managers at global as well as local level, this can result in stalemates on decision-making. For example, a beverage company (which declined to be identified for this report) described gaps in governance that required a management initiative to resolve. There were several instances where either a global brand head or global marketing head could veto an advertising campaign, but neither could overrule the other. A small team went about documenting major decision-making rules in the business, then sought senior management approval for all of the rules. Having the decision-making rules documented enabled the company to determine where power should lie in the organisation.

Complex matrix structures... are slowly being phased out.

Complex matrix structures, for which consumer-products companies are well-known, are slowly being phased out. Executives interviewed for this report acknowledge that matrix reporting lines still exist in a few places, but issues such as decision-making ambiguity have been resolved. “Some kind of matrix is inevitable when you reach a certain size,” says the Russia general manager of a luxury goods company. “To know if it will work, just look up the chain to see how far a dispute needs to go before it’s resolved. Too far and it’s a disaster.”

The trend is clear. To gain the benefits of centralisation (think global) and decentralisation (act local), companies are moving towards regional-management structures. They are also simplifying their governance and decision-making to enable more agility in the markets. However, within the markets themselves there is a lot of variation as to the operating models being employed. It is noteworthy that many companies are breaking away from their tried and tested home-market structures (usually wholly owning their operations) and trying new models such as franchising or joint-venture partnerships in order to succeed in emerging markets.

04
In-country operating models

04

In-country operating models

Companies often use joint ventures or franchises rather than wholly-owned subsidiaries in emerging markets. The main reasons for this include regulation, level of market knowledge and desired exposure to risk versus control.

Key findings:

- Decisions about which business model to use in emerging markets are based on the regulatory environment, the level of investment a company wants to make and how much local knowledge the firm possesses.
- Joint ventures can provide companies with opportunities to quickly gain local expertise. The size of the large emerging markets can necessitate different models even within a single country.
- Joint-venture partnerships may help firms avoid large start-up investments, but their usefulness has a shelf-life. Partnerships should be structured with an exit strategy in mind.
- Companies should scrutinise all of their partners to ensure that governance, ethics, supply chain and control mechanisms do not pose hidden risks.

Table 4: Finding the right operating model

The table below shows some of the reasons that companies choose different operating models in different markets.

Operating model	Key features	Advantages	Potential disadvantages	Company case example
Wholly owned	Operating in emerging markets in entirely the same way as in developed markets, without co-ownership structures	Enables a company to have full control over its operations in the market and to be the sole recipient of any profits	Has a high level of risk attached — particularly when companies are entering new markets for which they have no precedent in the region May be prohibited by regulation in some industries such as retail	**Yum! Brands — China** Where Yum! operates through franchises in most markets, it operates wholly-owned stores in China
Joint venture	Operating under joint-ownership structures, either indefinitely or for a set period of time	Joint-venture partners can provide valuable local knowledge Companies can leverage the product portfolio of the local partner and their distribution networks Reduces some of the risk of entering new markets	Joint venture agreements can be difficult to exit The governance, supply chain and controls of a joint-venture partner may contain hidden risks Having a local partner may weaken or change corporate culture	**Tesco — India** Tesco operates under joint-venture structure in India due to the regulatory constraints on retailers
Franchise	Allowing a local partner to sell a company's products and use its brand name despite having a completely separate ownership structure The franchisee gives a percentage of profits to the franchiser	Franchising minimises financial risk while enabling a company to capture market share Franchise agreements can avoid management spending lots of time on lesser important markets	Brand and quality controls must be in place to manage reputational risk A company only receives a share of the profits, therefore this practice is not suited to high-value, high-growth markets Requires the market to have a legal framework that is robust enough to support the contractual rules of the franchise agreement	**Carrefour — Middle East** The firm operates through franchising in the Middle East in order to capture market share without diverting management attention away from markets that are more strategically important

Regulated retail

Government policy restricts the organisational structures that can be deployed by global companies entering different markets. Since retail companies operate in highly visible, labour-intensive industries, they are greatly affected by the political context within which they operate. India's government has, for example, liberalised foreign direct investment (FDI) policies for most sectors of the economy. Retailing, however, remains a conspicuous exception. Objections to the entry of foreign retailers on the part of the country's 12 million-plus small retailers make a major relaxation of FDI policy difficult for the government.

India's FDI policy does permit 100% foreign ownership in wholesale trading operations (such as cash and carry) and 51% ownership in single-brand retailing. German-headquartered retail company Metro opted to expand in Asia by opening cash and carry outlets and thus has a model that works perfectly for India. A company spokesperson says that Metro's business in India grew by 54.4% in fiscal 2007 "despite licence restrictions and the absence of modern infrastructure and supply chains".

Wal-Mart and Tesco, though normally engaged in front-end retailing, have had to follow Metro's lead in India and establish wholesale cash and carry businesses. Wal-Mart and Tesco are working through joint ventures with Bharti Enterprises and Trent — the Tata Group's retailing arm — respectively. At the same time, they have entered into exclusive franchise agreements to supply retail technology to their partners. Though the two companies would doubtless prefer to be permitted to enter the market directly, their current operations will provide them with valuable experience in the Indian retail industry, which will stand them in good stead when they are eventually allowed to invest.

Joint ventures can minimise risk

Turkey and Poland have been serving as starting points for companies looking to expand deeper into Eastern Europe, the Middle East and North Africa.

Most companies have taken a step-by-step approach to international expansion, allowing themselves time to learn from each market experience and to leverage positioning in relatively hospitable markets to enter more daunting ones nearby. Taiwan, for example, has long served as a popular base for companies to gain experience prior to setting up operations in mainland China, with Taiwanese joint ventures and franchises serving as important sources of future employees for mainland operations.

More recently, markets such as Turkey and Poland have been serving as starting points for companies looking to expand deeper into Eastern Europe, the Middle East and North Africa. Duncan Tatton-Brown, former group finance director at UK home-improvement chain Kingfisher, says the company "wouldn't have felt as confident in Russia if it had not experienced success in Poland". In turn, the company has applied lessons from its experiences in Russia to its entry into Turkey's market.

One of the keys to successful international expansion is a step-by-step approach that can "minimise the risks associated with big step changes".

– Duncan Tatton-Brown, former group finance director, Kingfisher

Indeed, Mr Tatton-Brown says that one of the keys to successful international expansion is a step-by-step approach that can "minimise the risks associated with big step changes", such as setting up company-owned warehousing or distribution facilities. Joint-venture partners also can be useful in this regard since they frequently already own assets on the ground.

A key point to bear in mind with regard to joint ventures, however, is that they are likely to eventually outlive their usefulness, and they must be structured accordingly. At some point, companies may be able to reduce costs or increase profits by either changing joint-venture partner or by taking over the entire operation themselves.

Joint-venture partners are clearly of value in markets that companies would struggle to develop on their own.

Benefiting from established local brands

Joint-venture partners are clearly of value in markets that companies would struggle to develop on their own. A. Mahendran, managing director of Godrej Sara Lee and "mentor" director of Godrej Hershey, joint ventures between India's Godrej group and the US companies Sara Lee and Hershey, says that there is a belief within both Sara Lee and Hershey "that the Indian partners know better than them, as far as the Indian market is concerned". Both ventures are managed by the Indian partner despite the fact that they are majority owned by the respective foreign partners, who are only involved at the board level.

Each venture involved the American partner acquiring a stake in existing Godrej businesses and then introducing their brands through that business. The result is that each joint venture markets a base of products that are already successful in the Indian market, reducing the risk of introducing new products and leveraging the distribution network.

Godrej Sara Lee was established in 1995 and has introduced Sara Lee products such as Ambi Pur air freshener, KIWI shoe polish and Brylcreem hair cream to the market. The joint venture's sales, however, continue to be dominated by the local brands which Godrej sold prior to the partnership. The joint venture is the leader in India's huge market for mosquito repellents (and claims to be the world's largest manufacturer of mosquito-repellent mats). Likewise, Godrej Hershey is a market leader in hard-boiled candy and soya milk and not, as yet, focused on Hershey's trademark chocolate.

As well as local brands, the Godrej group provides extensive distribution networks, vitally important given India's underdeveloped retailing sector and vast rural hinterland. Godrej Hershey has 2,000 distributors that reach more than 1m retail outlets. In other words, the Godrej joint venture gives Hershey access to 2,000 additional partners.

As the legal environment across emerging markets has matured, companies such as doughnut maker Krispy Kreme have been able to expand internationally by franchising.

Business environment is another factor that plays a large role in decisions relating to how in-country operations are structured. For example, Yum! Brands operates through franchising in the US but through wholly-owned restaurants in China. As an early entrant, KFC's first outlets in China were established at a time when the legal environment was not sufficiently developed for franchising to be a viable model. Retaining control has facilitated the company's efforts to develop a mass market positioning, adapting the menu to local tastes, for example. As the legal environment across emerging markets has matured, companies such as doughnut maker Krispy Kreme have been able to expand internationally by franchising.

Developing a competitive market positioning requires a longer-term perspective. Marks & Spencer's stores in India were operated by a franchisee that positioned the store as a premium retailer. The British retailer has now entered a joint-venture agreement to develop larger format stores and increase local sourcing, allowing it to price more competitively.[4]

4 Marks & Spencer press release, April 18th 2008

05 Corporate culture

05 Corporate culture

As multinational retailers and consumer-products companies expand globally, particularly into markets where there is little cultural affinity with the headquarters country, questions arise as to whether a company's culture will be a help or hindrance in its efforts to penetrate markets. Companies have found that it is better to focus on corporate values rather than behaviours, taking a gentle approach that is respectful of national sensitivities.

Key findings:

- Finding joint-venture partners that share cultural and ethical values is a key determinant of a successful and sustainable relationship.
- Core values matter more than workplace behaviours — the latter are closely linked to national cultures and norms and may not translate as well in emerging markets.
- Corporate conduct in emerging markets is vital to maintaining companies' reputations at home. Compliance has been a key function through which companies have succeeded in ensuring that their values, ethics and sustainability policies are clearly defined.
- Companies are pushing the "green" agenda in isolation from each other. More industry collaboration would give these efforts greater impact.

Successful companies also export the cultural glue which binds the organisation together.

A cultural evolution

One factor behind the increasing adoption of regional structures is the recognition that exporting a company's culture requires more than exporting formats or setting up factories abroad. Successful companies also export the cultural glue which binds the organisation together.

The key to building a strong and cohesive corporate culture in emerging markets is to focus on the company's core values, rather than workplace behaviours, since behaviours are more closely linked to national cultures and often do not translate well across borders. It must also be accepted that certain aspects of corporate culture may not resonate in particular emerging markets.

Mr Walker, vice-president APAC for Wal-Mart, emphasises the importance of values. He observes: “There’s an interesting relationship between corporate and country culture. It’s got to do with values and driving the ones that are critical to success.” Wal-Mart’s values are respect for the individual, customer service and striving for excellence. Mr Walker states that, “these values are universal and resonate with all of our employees but are carried out differently depending on where you are, focusing on local customer needs”. For example, there may be significant differences in how employees demonstrate excellent customer service in Brazil versus China. The interpretation of excellence must be in keeping with the national culture.

As overseas operations grow in size, there can be a tendency for headquarters to try to force management culture and behaviours in an attempt to align corporate culture across markets. This is not always helpful. There should be some understanding that the culture of a large and mature organisation is not necessarily sufficiently entrepreneurial to succeed in emerging markets. Consequently, the culture must evolve to embrace a diversity of behaviours without promoting inconsistent values.

As overseas operations grow in size, there can be a tendency for headquarters to try to force management culture and behaviours in an attempt to align corporate culture across markets.

As subsidiaries develop different products for different markets, there is an increased risk that the brand values of products developed for overseas markets conflict with the company’s core values. Unilever’s stated purpose and principles include an aim to “make a positive impact in many ways: through our brands, our commercial operations and relationships, through voluntary contributions, and through the various other ways in which we engage with society”. Yet the company has faced criticism that advertising for its successful skin lightening products is patronising and discriminatory.

...there is an increased risk that the brand values of products developed for overseas markets conflict with the company’s core values.

The Western standard of practice for dealing with different ethical standards across borders has been to articulate a global set of core values. However, these values reflect Western norms. “As the global economic balance of power shifts towards markets other than those in North America and Europe, we might expect to see new tensions around ethical norms and priorities as emerging markets exert more cultural and political influence,” argues Christopher Michaelson, a director at PricewaterhouseCoopers US. “There is a need to reconsider ethical norms in the context of emerging cultural and political priorities in our changing world.”

When cultures collide…

Differences in ethical norms across cultures in business have led to confusion and misunderstanding for as long as business has been done cross-culturally. Leading thinkers point to “overlapping consensus” among core human values as a reason to believe that differences are not as fundamental as they may seem. However, cultural and economic priorities can still get in the way of easy answers. Take the following examples:

The giving and receiving of gifts in business is one way that good intentions can be tainted by the appearance of corruption. Whereas in some Asian cultures giving gifts normally accompanies the execution of a business transaction as a signal of good faith, gift giving is increasingly frowned upon in North America and Europe. Even if the gift is given in good faith and not as a condition of doing business, the appearance of (as well as the incipient potential for) corruption is reason enough for many Western companies to prohibit the practice. This, however, can offend business partners.

Recently, what the United Nations refers to as “differential responsibility” for climate change mitigation between developed and developing markets has caused cross-cultural tensions. Long-industrialised nations that have historically emitted the greater proportion of greenhouse gases into the atmosphere have also enjoyed the economic benefits of decades of relatively unfettered industrial activity. Emerging markets, meanwhile, are seeing their chance at economic growth potentially impeded by limitations on industrial activity imposed by global environmental agreements. Solving the tension of differential responsibility must be a priority in order to resolve the conflict fairly and equitably.

Finally, child labour is a particular hot button among human rights advocates and companies alike. However, the definitions of “child” and the expectations of a child in different cultures are influenced by cultural traditions, as well as economic need. Companies that have sought to impose a minimum age on foreign contract manufacturers have found that a universal standard may not be acceptable to the diverse stakeholders whose interests are involved.

Christopher Michaelson, director,
PricewaterhouseCoopers US

As these examples show, different cultures have different perspectives depending on their vantage point. There is no right or wrong answer, but there are several layers of subtle but important differences of opinion. The challenge for people engaged in international business is to understand the other person’s view by standing in their shoes — and to be able to manage both the relationship with the foreign team as well as the “norms” expected at home. As the world becomes smaller, this challenge gets ever larger.

Mark Hudson, UK retail and consumer leader,
PricewaterhouseCoopers UK

Operating under different rules due to differing legal systems in different markets can be more costly than adapting one set of rules…as a standard for every market.

Doing good

Well-defined corporate social responsibility (CSR) programmes can help ensure that the company's values are consistent across markets. An additional benefit of CSR is to promote a standard set of rules. Operating under different rules due to differing legal systems in different markets can be more costly than adapting one set of rules — above the minimum in any country — as a standard for every market. Doing so can considerably reduce bureaucracy in subsidiary offices lacking the manpower that administrative functions have at their disposal at head office.

Richard Welford, chairman of CSR Asia — a promoter of more sustainable business practices in Asia — says that "it is often the case that headquarters have great policies and procedures, but that internal communication is really miserable. A company may have great poverty-alleviation strategies, but the people on the ground where poverty is an issue don't know about them". He notes that it often takes a crisis for CSR to be taken seriously, and where companies have been successful in pushing CSR down through the organisation, it has often been through compliance. For example, Nike and Adidas responded to criticism about the existence of sweatshops in their supply chains by introducing strict standards and processes to ensure that ethics policies are adhered to. Articulating a code of practice for suppliers can raise awareness of ethical standards throughout the organisation.

Articulating a code of practice for suppliers can raise awareness of ethical standards throughout the organisation.

This trend of driving sustainability through both culture and compliance is gaining momentum. And it's not only internal compliance. Retail companies are taking the lead in pushing sustainable practices down through their entire supply chain. Wal-Mart, for example, is in the process of setting out a sustainability scorecard that will be used to assess its own internal buyers as well as the firm's suppliers. Consumer-products companies and their suppliers will be forced to meet ever more stringent environmental and ethical standards. Wal-Mart will use a carrot-and-stick approach to respond to any failure to meet the targets. It will advise suppliers on how they can improve their environmental records, but persistent poor performance will result in contract termination. In July 2008, Wal-Mart held an event for representatives of its supplier companies and other sustainability experts to help the company design the index.

Companies are working hard to improve their environmental records, as well as align themselves to key social issues. However, rather than tackling all the environmental and societal challenges in the world, they are now focusing on "signature" issues that are core to their strategy and culture. Coca-Cola has, for example, identified water as a signature issue.

Increasing concern about reduced water supplies is a threat to Coca-Cola's ongoing business, since making Coca-Cola is a water-intensive process. CSR Asia's Mr Welford says that the company has successfully reduced the amount of water that it takes to make Coca-Cola in China, but the company has also faced serious protests over its use of water in India. Identifying signature issues then informs the type of organisational response that a company must employ. In Coca-Cola's case, this means working with bottling companies to improve water use. The focus on water also feeds through to other CSR initiatives such as providing drinking water to the victims and rescuers of the 2008 Sichuan earthquake in China, working with the World Wildlife Fund to conserve freshwater resources and taking part in an international sanitation for schools development programme.[5]

Supply-chain collaboration

On one hand, companies appear to promote their environmental credentials while, on the other, they are slow to make progress when it comes to working with their competitors across the industry to increase levels of efficiency. Mr Graham, CEO Asia Pacific of DHL Exel Supply Chain, observes: "Many Asian markets still see both local and global FMCG companies running separate facilities but more importantly separate transport networks. A retailer may receive as many as eight or nine deliveries a day from no more than two or three suppliers." Mr Graham blames this on a "real reluctance" to collaborate. For consumer-products companies, this reluctance is because their distribution networks were at one time (and still are in some markets) a key competitive differentiator. However, the multinational retailers and logistics companies are changing the distribution landscape in emerging markets. It is also likely that continued oil price volatility as well as the global economic downturn will put pressure on companies to seek further efficiencies in their supply chains and distribution networks.

On one hand, companies appear to promote their environmental credentials while, on the other, they are slow to make progress when it comes to working with their competitors across the industry to increase levels of efficiency.

5 Coca-Cola China, 2007 Annual Sustainability Report, http://www.coca-cola.com.cn/responsibility.htm

Information availability over the Internet, and particularly the commentary provided by bloggers, make it difficult for companies to paper over inconsistencies in corporate values.

The world is watching

Information availability over the Internet, and particularly the commentary provided by bloggers, makes it difficult for companies to paper over inconsistencies in corporate values and failures to address pressing social concerns. How companies behave in emerging markets will be scrutinised at home and accepting lower standards of service in emerging markets than in the West can result in overwhelming media criticism.

This new global scrutiny can present some interesting dilemmas. For example, while food companies are under pressure to promote healthier eating in developed markets, sales teams on the ground in emerging markets may find less healthy foods easier to sell. Successful companies will find ways to embed the company's corporate values throughout the organisation — from top down and bottom up. Achieving this goal requires increased investment in training and a clear strategy.

06
Emerging talent

06 Emerging talent

For retail and consumer-products companies, their ability to expand in emerging markets is largely dependent on their ability to develop and retain the best talent in the region: individuals who can bridge global and local cultures, transfer knowledge around the organisation and fit with the company's culture. Unfortunately, talent retention and leadership issues are among the most challenging areas for retail and consumer-products companies to manage in emerging markets.

Key findings:

- Retail and consumer-products companies are highly sought after as employers in emerging markets. Talent attraction is not a problem — retention is.
- Money talks, but not as much as development opportunities and career advancement.
- Companies must anticipate the human-capital needs and challenges that will present themselves in emerging markets. Too often, HR strategies have not kept pace with market expansion.
- The management team for regional headquarters must have seniority and credibility with country-level general managers who have previously reported to headquarters.
- Hiring local nationals is important at market level but not at the regional level, because regions such as Central and Eastern Europe and Asia are so diverse.

Retention

A lack of talent has always been blamed as a major bottleneck to emerging-market expansion. But retail and consumer-products companies have actually been very successful at building strong employment brands that attract individuals early on in their careers. As a result, Western multinationals with household brand names and good reputations are highly desired places to work. A talent crunch does in fact appear at the management and leadership level and stems from high attrition among mid-career managers and a shortage of executive talent. "I keep hearing that there's no talent, but I don't buy it," says one executive. "Engagement and retention are what matter," notes Paul Etchells, Coca-Cola deputy group president for the Pacific. "We attract people at an early stage in their careers, but turnover is often high and retention can be an issue," he says. The problem is not confined to Asia. Executives in Latin America and those in Central and Eastern Europe agree. "When I meet other general managers, this is what they are talking about," notes the general manager of a luxury goods company in Russia.

"The key for me is to build local capability and leave a generation of leaders and managers who have the capacity to drive the business in the future."

– Maarten van Beek, HR director for Latin America, Unilever Foodsolutions

Emerging markets are known for rampant poaching and wage inflation, which have given rise to a perception that employees can be retained with ever-larger salaries. It is true that money does talk — particularly in emerging markets, where employees often come from a background of hardship. Fast-growing economies have also experienced rising inflationary pressures, although such pressures are easing as the global economy slows. Maarten van Beek, HR director for Latin America with Unilever Foodsolutions, says that "in some countries you can talk about great pension plans, but employees know what inflation can do to these and they prefer to have the cash now."

Leading companies have shifted their focus towards development opportunities and career advancement in order to retain their best staff — including international rotations for those with leadership ability. Says Mr van Beek: "The key for me is to build local capability and leave a generation of leaders and managers who have the capacity to drive the business in the future. That means giving local people the right functional and leadership skills. Moving managers to other countries in Latin America is a very good first step, but also sending people to North America or Europe to have a look at developed markets is also important."

There can be a mismatch in perceptions between what employers think motivates their staff and what the employees themselves consider to be the most compelling aspects of their jobs.

There can be a mismatch in perceptions between what employers think motivates their staff, and what the employees themselves consider to be the most compelling aspect of their jobs. While base pay remains an important motivator in emerging markets, Mark Gilbraith, a partner at PricewaterhouseCoopers China, says that companies should look at levels of employee engagement and consider adopting broader rewards policies. “What drives this engagement varies by employee group as well as from individual to individual. More work should be completed to understand the underlying drivers of engagement so that line managers and leadership and can work on a few critical differentiators that would increase retention, productivity and the general attractiveness of the workplace. These differentiators can be built into a total rewards package that includes everything from base pay to career opportunity, development and advancement.”

One important signal of how far emerging-markets employees can progress internally is the representation of foreign nationals at the leadership level. Companies are making it a priority to develop talent locally to staff their in-country operations. However, there is still a large representation of expatriates in emerging markets and at the regional level. This is partly because it is difficult to find people who can open up a new market, then it takes time to hire or develop local people to run the business.

HR catches up

Part of the retention problem stems from the fact that companies have expanded faster than their HR functions. “HR doesn’t keep up. It catches up once the problems are there,” says the general manager of a luxury goods firm in Russia. High staff turnover can result in the HR department spending a lot of time recruiting and inducting employees rather than creating more strategic retention strategies.

For Wal-Mart, the need to focus on HR issues was another driver behind the move towards regional structures. Mr Walker points out that the HR function used to be managed from the US, but the new regional structure strengthens the firm’s people-development capability. “Where bench building was done within individual markets, we can now use our growth strategy of global leverage for people development. This means talent that is developed in one market can take best practices from that market and implement them when they go to work in another one of our markets. This allows us to grow talent in the region with a truly global and local point-of-view,” he says.

Speed of knowledge transfer is a critical enabler of success in emerging markets.

Transferring knowledge, quickly

Speed of knowledge transfer is a critical enabler of success in emerging markets. Most companies rely on people to spread knowledge, rather than technologies or processes. This is why organisational structures and talent mobility receive so much attention. Staff rotations between markets and headquarters are not only valuable development and retention tools, but they spread organisational knowledge and enable emerging leaders to be fully immersed in corporate culture.

Companies are taking a regional (if not global) view of talent management so that they can spot opportunities for moving people to different countries and spreading best practices. "Because we manage people at the regional and global level, we can offer better careers and development opportunities," says Mr van Beek, HR director for Latin America with Unilever Foodsolutions. "We know where the talent is, what the challenges are, and it is easier to move people across borders. It is easier to use best practices from one country and translate them to another country. If you have a local-country structure, you are not able to do that."

A management training ground

A lack of management talent is a headache for retail and consumer-products companies in many markets. Unilever's subsidiary in India, Hindustan Unilever Limited (HUL), however, has proven to be a fertile source of skilled managers for the company's operations globally. The Hewitt ***Top Companies for Leaders 2007 Survey***, for example, ranked Hindustan Unilever fourth out of 548 companies in 41 countries — trailing General Electric, Procter & Gamble and Nokia.

According to D. Sundaram, Hindustan Unilever's vice chairman, over 100 managers from HUL are working in Unilever's subsidiaries outside of India. These include the chairmen of subsidiaries in Japan, Poland and Russia. Mr Sundaram says that the fact that many of HUL's managers are able to gain international exposure "helps us enormously", adding to the depth of experience within HUL when managers return to India.

Managers employed by HUL at the entry level are carefully groomed for higher positions through well-designed HR policies. The company has been one of the first to recognise the quality of the graduates coming from the top Indian institutions (such as the Indian Institutes of Management). According to Mr Sundaram, "brands and people are our greatest assets, and these are not reflected on the balance sheet."

It is more important to staff the regional headquarters with executive talent of the right level of seniority and with a global, rather than local, outlook.

Staffing regional headquarters

To really “act local” in the market, companies must employ managers who understand local culture and preferably are a native of that country. Does the same rule apply for regional offices? No, say the executives interviewed for this report. It is more important to staff the regional headquarters with executive talent of the right level of seniority and with a global, rather than local, outlook.

Making sure that the right level of seniority is in place is vital, since reporting lines from the individual markets will change and the regional leadership must have the appropriate level of credibility in the markets. Where companies have previously been decentralised, or there are strong local general managers in the markets, regionalisation must be accompanied by a comprehensive change-management programme. Resistance in some places is inevitable. One global beverage company was forced to replace general managers in a number of markets following the firm’s move towards regionalisation as these individuals would not comply with the new structure.

Where companies have previously been decentralised, or there are strong local general managers in the markets, regionalisation must be accompanied by a comprehensive change-management programme.

As companies follow the trend towards regionalisation, one of the most significant effects on staff is that it involves a transition of power — up or down the organisation. The credibility, leadership and experience of the individuals tasked with running the regional headquarters are more important than their nationality. Additionally, as mentioned earlier in this report, regions such as Eastern Europe and Asia do not share the cultural or linguistic similarities that are present in Latin America. An executive from China is not necessarily better able to run operations in India or Indonesia than an executive from the UK.

For retail and consumer-products companies, it is clear that the main challenge they are facing is to develop the right leadership capabilities globally, regionally and in the emerging markets themselves. If they are not focused on developing leaders and spreading organisational knowledge, companies will not be able to drive organisational transformation and keep corporate culture and values aligned.

Global governance?

Diversity throughout the ranks of retail and consumer-products company employees has increased markedly in recent years. Yet, diversity at the board level has often taken longer to realise. An Economist Intelligence Unit analysis of 40 leading retail and consumer-products companies for this report found that only 15 have executives from emerging markets on their boards of directors, only marginally greater than the total in 2003 (please see full table in Appendix 1).

"It is very difficult to get someone in Asia… to commit to attending ten or so board meetings in the US per year."

– Robert Grandy, managing director for financial services and board consulting, Korn/Ferry International in Asia Pacific

"We do have discussions about it, when we're recruiting board positions for North American companies, and they want to have someone from an emerging market — particularly in Asia — but once the search process starts, other criteria take precedence," says Robert Grandy, managing director for financial services and board consulting with Korn/Ferry International in Asia-Pacific. "It is very difficult to get someone in Asia — who may be in a full-time position — to commit to attending ten or so board meetings in the US per year," he says, "and another challenge is that there are fewer Asians that have had a senior operating role with a large multinational." While companies are keen to find board members from emerging markets, it is deemed more important to find members that have an operating role at a multinational firm or previous board-member expertise.

Since it is difficult to recruit emerging-markets nationals externally for board-member positions at multinational companies, succession planning, globally, will become ever more important. This also illustrates the importance of managing talent at a regional rather than purely local level.

07 Conclusion

The greater transformations under way are those that involve people and culture.

As developed markets enter what appears likely to be a prolonged economic downturn, the importance of emerging markets for multinationals will only increase. Many are already reorganising themselves to take their emerging-market penetration to the next level. There is no one solution for every company although many have found more integrated regional operations to be a platform for success. Regionalisation has enabled them to get a better understanding of markets, not only to drive strategy, but also to exert control. For those just beginning the transformation, depending on whether they are coming from a centralised or decentralised stance, the first stage of regionalisation may involve consolidating physical assets — many companies that have rushed to carve out leading positions in new markets will have over-invested. Regionalisation enables them to leverage economies of scale in product-related functions such as R&D, procurement, manufacturing, distribution, as well as the back office — IT, finance and HR.

Cost reduction is a big driver for regionalisation — not just operating cost reduction, but lowering the cost to expand. The current environment will be very challenging for multinationals with lean balance sheets, yet they need to keep expanding and strengthening their positions in emerging markets. Having a corporate structure that can enable fast expansion into a new market at a low cost will be a critical differentiator of success, particularly for retail companies.

As discussed in this report, however, the physical transformation is only part of the picture. The greater transformations under way are those that involve people and culture. It is only natural that people resist changes in power, authority and decision-making. For some companies taking fiscal control out of the hands of in-country management, this will be particularly painful. However, for the most part, regionalisation is seen as a positive step. It offers new career paths for leaders in emerging markets, it speeds up on-the-ground decision-making, it provides a platform to move deeper into each region, and it promotes the dissemination of organisational knowledge.

Key to the success of the regional structure is the management team. Not only must regional management teams have a high degree of seniority and credibility to allow them to manage across markets, but they must also have credibility with the executive committee, especially if they are to prevent headquarters from developing overly exuberant expectations for growth. With emerging markets such as China expected to be among the few growing economies in the near term, the risk of such exuberance is high indeed.

Appendix 1

Composition of boards of directors in retail and consumer-products companies, compiled from desk research and annual reports.

Company	Number of emerging market nationals*		Number of women	
	2003	2008	2003	2008
Altria Group, Inc.	1	0	2	1
Anheuser-Busch InBev	0	3	0	0
Best Buy Co., Inc.	1	3	1	1
British American Tobacco p.l.c.	3	2	1	3
Cadbury p.l.c.	0	0	1	1
Campbell Soup Company	0	0	2	3
Carrefour Group	0	0	0	1
Colgate-Palmolive Company	0	1	3	2
Diageo p.l.c.	0	0	1	2
GAP Inc.	1	0	4	2
General Mills, Inc.	0	1	4	5
H&M Group	0	0	2	7
Heineken N.V.	0	0	0	1
H. J. Heinz Company	0	0	4	2
Imperial Tobacco Group p.l.c.	0	0	0	2
Inditex Group	0	0	2	1
Johnson & Johnson	0	0	1	3
Kellogg Company	1	1	2	2
Kimberly-Clark Corporation	0	0	0	2
Kraft Foods Inc.	2	1	3	5
L'Oréal Group	0	0	2	3
LVMH	1	0	1	1
McDonald's Corporation	0	0	2	3
Metro Group	0	0	3	3
Nestlé SA	0	1	0	2
Nike, Inc.	0	0	1	2
PepsiCo	0	1	3	3
Pernod Ricard SA	n/a	0	3	4
Philip Morris International Inc.	n/a**	1	n/a**	0
PPR SA	0	0	1	1
Procter & Gamble Company	0	2	3	3
Richemont SA	0	2	0	1
SABMiller p.l.c.	1	6	1	2
Starbucks Coffee Company	0	1	1	2
Tesco p.l.c.	0	0	0	2
The Coca-Cola Company	0	0	1	3
The Home Depot, Inc.	1	0	1	2
Unilever	1	2	0	2
Wal-Mart Stores, Inc.	0	0	1	3
Yum! Brands, Inc.	0	0	3	2

* *Defined as born in an emerging-market country*
** *The company was spun off from Altria in 2008*

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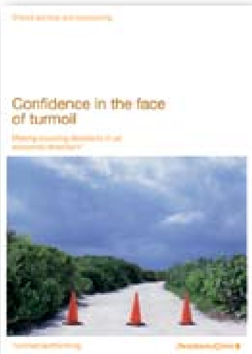

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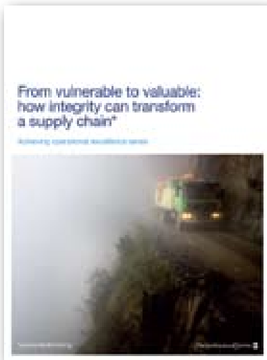

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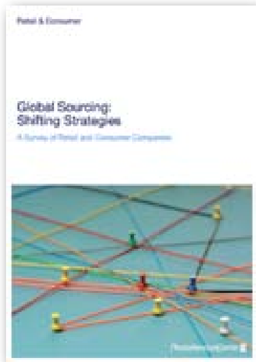

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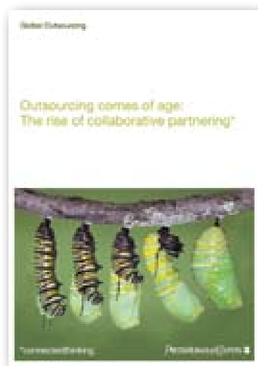

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