CEOs today are focusing on fast-growing emerging markets as major engines of growth. But success in unfamiliar markets requires more deliberate alignment of risk monitoring with strategic planning and operational execution. How prepared is your organisation to grow away from home?
Introduction

As emerging-market growth continues to outstrip that of advanced economies mired in fiscal and debt crises, it is not surprising that an increasing number of companies are refocusing their growth strategies on those fast-growing markets. With youthful populations, rising per capita incomes and often healthy public finances, emerging markets have moved centre stage for both intercorporate as well as intergovernmental competition for investment. While many CEOs naturally gravitate toward the prospect of opportunity, their optimism about emerging-market potential needs to be moderated by healthy realism and sound strategic planning and execution.

Despite sustained higher growth rates in emerging markets, many CEOs are still cautious about venturing forth. As a result, first-mover advantages in some of these markets are being enjoyed by multinationals from other emerging-market countries, most notably China, Brazil and India. Trade among emerging-market countries accounts for 45% of total global trade today, and a third of foreign direct investment into emerging-market countries now originates from emerging-market-domiciled firms. But ultimately, for any company, entering or growing in these markets demands a clear understanding of the hurdles to establishing or expanding a presence in an unfamiliar market, working with partners in an uncertain environment, sustaining constructive government relations and monitoring a more complex supply chain network. The particulars of each market require more rigorous attention to change to determine approaches to both opportunity and risk.

There is no recipe; no two emerging markets are the same. While one may be attractive to a South American agrifood company, for example, it may hold little promise for a European retailer. Country growth rates alone don’t tell the whole story. Achieving growth in unfamiliar markets demands a more deliberate alignment of risk monitoring with both strategic planning and operational execution than ever before. This report discusses how companies can weigh the array of risks that go along with tempting opportunities in unfamiliar markets, along three stages: 1. entering a market 2. maintaining a presence 3. deciding to exit a market

It also considers the particular need to build a resilient global supply chain. Each section offers a concise toolkit of questions to which CEOs need answers to assess growth prospects realistically and shape strategies accordingly. As uncertainty continues about the state of major advanced economies, the appeal of high-growth markets rises. But, however strong its current growth rate, no country is immune from the ills of the global economy. A rigorous approach to assessing and monitoring both opportunities and risks is essential to success in unfamiliar markets.
“Any industrial company — if it’s going to be a global leader — has to have a large presence in emerging markets,” said Edward D. Breen, Chairman and CEO of Tyco International, based in Switzerland, summing up the mood of respondents to the PwC 14th Annual Global CEO Survey. “Fifteen percent of our revenue right now is coming from emerging markets and we’re looking to double that in the not-too-distant future. It’s an opportunity that you have to take very seriously.”

Section 1
A two-speed economy sets the stage

In a recent Pulse survey of the international CEO panel that contributes to PwC’s Annual Global CEO Survey, 42% of the 201 CEOs surveyed said they were “very confident” about their companies’ growth prospects in the coming year, with the number rising to 54% replying “very confident” about growth prospects over the next three years. (See Figures 2 and 3.) These results may appear surprising given the number of warning lights still flashing on CEOs’ economic dashboards. However, this confidence seems based on a substantial strategic rethink undertaken in the aftermath of the initial economic crisis. In the 14th global CEO survey (conducted in the final quarter of 2010), over a third of CEOs reported that they had already changed their strategy “in fundamental ways” over the past two years, and another half reported that they’ve “somewhat changed” their strategies. Despite the recent high level of economic turmoil and ongoing uncertainty, CEOs may now feel more prepared for future shocks as a result of those strategic changes. Many firms focused on costs and margins, and even as markets have reacted to poor macroeconomic data and the menace of sovereign debt contagion, companies in various sectors have returned healthy earnings and profits.

But there may be a more fundamental change in the basis for CEO confidence levels: as traditional economic leaders struggle to sustain a recovery, emerging-market growth has hardly faltered, and their contribution to global GDP and growth continues to rise. The BRIC economies accounted for just 17% of global GDP in 2010 but are expected to account for 40% of world GDP growth over 2011 and 2012.

Figure 2: CEOs are confident about growth over the next 12 months

Q: How confident do you feel in prospects for the revenue growth of your company over the next 12 months?

<table>
<thead>
<tr>
<th>Category</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Very confident</td>
<td>42%</td>
</tr>
<tr>
<td>Somewhat confident</td>
<td>38%</td>
</tr>
<tr>
<td>Not very confident</td>
<td>15%</td>
</tr>
<tr>
<td>Not confident at all</td>
<td>4%</td>
</tr>
<tr>
<td>Don’t know/uncertain</td>
<td>1%</td>
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Base: All respondents (201)
Source: PwC Pulse Survey of the International CEO Panel of PwC’s Annual Global CEO Survey, 26 July 2011
While global economic growth returned to 5.1% in 2010, this headline figure reflects two speeds of economic activity. Developed markets, which represent about 50% of the world economy, are expected to grow slowly, at an average of 2.2% in 2011, little more than half the rate anticipated for the world economy overall. Among developed economies, the United States is expected to grow 2.6%, Japan is expected to contract to −5% and the Eurozone is expected to grow by just 2.0%. Meanwhile, emerging markets are expected to grow at a relatively zesty 6.6%. The most rapid growth in that group is expected among the largest countries: China at 9.5% and India at 8.0%. Even these forecasts are uncertain given the pace of change across different markets this year, but they reinforce the divide between economies that appear to have growth potential and those that appear to be stalling.

Even with so many markets on the fast track of the global economy, the levels of CEO confidence reported in this latest survey result seem high. CEO confidence levels were also high in the 2007 survey. CEOs have to be bold in their growth and communication strategies: pessimism is not what investors or the markets want to hear. CEOs have also traditionally shown less concern about slowly emerging or long-term threats than risk or issue experts have. Hence why, when seeking growth in new markets, CEOs need to strengthen their understanding of the threats those markets face and to focus on resilience against a broader range of risks.

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“We believe it is very important to adopt stricter risk control standards and maintain a monitoring system that is prudent on a macro scale and can give early warnings regarding potential problems,” said Li Lihui, President of the Bank of China. “Of course the implementation of such a policy needs to be adjusted for countries at different stages of development.”

Section 2
Global growth strategies: factoring in greater operational complexity and risk

There are many indicators that the path to renewed growth will not be smooth: an ongoing European debt crisis, upheaval in the Middle East, earthquakes along the Pacific Ring of Fire, market volatility worldwide, budget deficits, rising competition (and prices) for natural resources and the consequences of climate change, to name a few. So, the more countries in which companies expand their operations around the world, the more those companies are vulnerable to events occurring in every part of the globe.

While CEOs have become more optimistic, 71% of them also said they were “somewhat” or “extremely” concerned about economic uncertainty. The fact that these growth expectations are built upon a soft economic foundation suggests the potential fragility of their optimism.

This risky reality isn’t lost on CEOs; they’re putting risk high on their agendas as strategies change. Sixty-seven percent said they will formally incorporate risk scenarios into their strategic planning.

And 72% said they will devote more senior management time to addressing risk. Risk is commanding attention at the highest levels: 58% of CEOs said they will dedicate more board time to risk. (See Figure 5.)

Figure 5: Strategies are responding to changes in demand

Q: To what degree has your company’s strategy changed over the past two years? Which factor had the biggest impact on your need to change your strategy?

- Economic growth forecasts or uncertainty: 51%
- Customer demand: 33%
- Industry dynamics: 16%
- Competitive threats: 12%
- Regulation: 9%
- Attitude toward risk: 8%
- Shareholder expectations: 1%
- Capital structure/deleveraging: 1%

Base: All respondents (1,201).
Source: PwC 14th Annual Global CEO Survey
At the same time, CEOs are improving their companies’ operational risk management. More than three-quarters of CEOs said they intend to change their company’s approach to risk management over the next 12 months — 23% described that change as “major.” While those percentages seem high, they represent declines from a year earlier, when 41% of CEOs expected “major changes” to their risk management practices.

This could reflect that many CEOs feel they successfully made changes in operational risk management and are now confident they can turn their attention elsewhere. They have a growing understanding of the appropriate division of responsibilities with respect to risk; senior management’s job is to gain a comprehensive understanding of existing risks, decide how much risk their company will take and what risks are beyond bounds, map strategy accordingly and ensure that the rest of the organisation is managing operational risks. “We are more sensitive to the risk/reward trade-offs, because the volatility in the market created during the recession had a big impact on many foreign economies — whether it’s sovereign risk in Europe, capital markets in the US or economic policies in China,” said John V. Faraci, Chairman and CEO of US-based International Paper. “We pay much more attention now to making sure we understand and pressure-test the upside/downside of various decisions.”

What risks are of increasing importance? While many emerging markets are growing briskly, they are also among the most volatile. Their financial markets may be subject to sharp reversals, their political systems may be unstable, their legal systems may be unfamiliar and regulations may be unpredictable. Corruption (or at least the perception of it) may be common, and infrastructure may be poorly developed in some regions. There are untapped opportunities precisely because of the many risks that make the rewards uncertain.

In addition, there are a number of growing global risks that pose immediate threats in emerging markets. Among these are economic disparities that can lead to civil strife; food, water and energy shortages; climate change bringing increasingly extreme and destructive weather, along with uncertain government policy reactions; illegal activities that undermine legitimate business and governments; and macroeconomic imbalances that could lead to growing capital flows to emerging markets and potential asset bubbles.

The risks are daunting, but the fundamental approach to planning is unchanged. Companies need first to decide on their risk appetite and then on which markets afford the best opportunities given that appetite, and finally on the limits for their tolerance for risk. That tolerance will dictate what markets to avoid or when it is time to pull back from those the company has ventured into. While it may be impossible to identify every possible low-probability, high-impact event (aka black swan events), crisis plans need to be in place and well tested to prepare for or respond to these rare but devastating possibilities. Beyond that, leaders will want operational risks monitored, reported and managed at all levels of the organisation and throughout its supply chain. There must be a continuous flow of up-to-the-minute information, from a variety of sources and perspectives and analysed to determine what is relevant and how it impacts their organisations. Organisations may be deluged with information, but unless they have the ability to interpret that information, it can be useless or worse misleading. For example, many countries are improving infrastructure or adopting judicial and financial reforms. Those are important changes to ease doing business in these countries. But if the greatest risk to a company is reputational risk due to poor treatment of workers by a supplier, no amount of improved infrastructure is going to make doing business in that country less risky.

Risk monitoring for different stages of market participation

The greater reliance on unfamiliar and potentially volatile markets makes strategic planning and execution more difficult. Below we focus on the risks companies will want to consider when approaching different stages of participation in unfamiliar markets and how they can embed risk monitoring into strategic and operational processes along the way.

Market entry

The success of companies that have set up operations and done well in a country whose GDP growth is approaching double digits can prove enticing to latecomers. But any given market, no matter the attractions, may be a poor fit for companies from a particular sector, from a certain home country or with a particular strategy. A key danger is that advocates of entering a given market will fail to weigh factors aside from the enviable overall growth numbers. While overall growth may be extraordinary, the same is not likely to be true for every sector. Competition may be evolving differently than managers have experienced before; customers could behave differently. Even if your sector is growing strongly, the government may be curtailing local companies in that sector and protecting them from outside competition. And every sector has its own vulnerabilities. The energy and natural resources sectors, for example, are more at risk if there are questions about the sanctity of contracts or expropriation in the prospective new market.

In general, any company entering a new market must gather a great deal of both qualitative data — including growth rates, GDP, demographic statistics, savings rates, employment rates and market sizes for particular products — and qualitative information that will have a major impact on the success of a business in that country. The qualitative data should include information about a country’s regulatory environment, labour conditions, infrastructure, transparency, corruption, distribution channels, competition, pricing, human rights records, monetary and fiscal policy and a host of other factors.

Then, companies considering the new market must be able to synthesise the data, weigh the various factors and decide whether the opportunity is attractive on balance. All of this is complicated by the fact that data about emerging markets is often less reliable and more difficult to obtain than in developed markets.

Potential risks are numerous. When making a decision about whether to enter a new market, a company needs to ask where the country is headed, not just where it is. Geopolitical risk is a major consideration. Rising expectations contribute to rivalries between countries competing to attract waves of new investment. A related consideration is the relationship between a company’s home country and the potential new market. Clearly, venturing into a market whose government is hostile to a company’s home country is risky. The list could go on.
Get local
Insight into local culture is especially important for companies entering an unfamiliar market. Culture can be a critical determinant of the business model a company chooses for a given locale, including customer focus, product or brand localisation and distribution. It can also be a deciding factor in the investment vehicle used, the selection of partners and the composition of management.

Companies cannot assume that they can simply transplant their home business models to a new market. A US insurance company that hoped to take advantage of rapidly growing car ownership in Russia did not find out until it had made a major investment there that its product would not appeal to the Russian consumer. Another US-based company found out too late that Russia did not find out until it had made a major investment in Russia, suffering major losses.

The composition of management.

Companies must differentiate between the cultures and norms of the many diverse parts and populations of the countries, particularly in the largest markets. And because there can be such marked differences from region to region, it is crucial that companies aim their business models at specific market segments. Even internal growth rates can vary dramatically between different regions of any given country. Every area is likely to be distinct, as cultural factors are one of the biggest challenges to any global growth strategy. Just because a company has become acquainted with the culture of one section of the country and established a successful business there does not mean it is well prepared to do business in other parts of the country. For example, China’s latest five-year economic plan prioritises inland growth, which has lagged behind the recent boom in coastal cities. Similarly, if a company has established a business that appeals to one portion of the population, it may well be missing out on other opportunities with other segments.

Change happens
In making the decision to enter a new market, companies also cannot assume that the attractive business environment that they have heard about for the past several years will continue. Markets evolve, and the appeal of emerging markets is speeding up evolution. The fact that many emerging markets are growing rapidly and attracting new market entrants from all over the world means that there is much more competition for the low-cost labour and natural resources that traditionally have made these markets attractive. As a result, access to talent and resources can no longer be taken for granted. China, for example, is now intent on shifting from being a source of low-cost manufacturing to attracting more high-value businesses. It’s raising taxes on foreign-owned businesses and offering incentives for high-value business activities, like developing clean energy technologies.

Brazil, which had been providing incentives for international energy companies to help develop its gas and oil resources, is giving Petrobras, the state-owned company, a stake in any consortia formed to explore the lucrative “pre-salt” offshore oilfields. 2

On the other hand, while international energy companies are not finding Brazil as hospitable a market as it had been, infrastructure companies are likely to be more welcome. Brazil is currently making preparations to host the summer Olympics in 2016 and the World Cup in 2014, both of which require major infrastructure improvements. At the same time, Brazil is developing its transportation links with the country’s interior and it’s seeking foreign investment and participation for all these projects.

Check alternatives
An insufficiently thought-out decision may also cause companies to overlook alternative markets with equally good growth prospects. A lower-profile market may afford better opportunities than a more popular one because it is less competitive and less costly to operate in it. In general, emerging-market strategies should consider business needs across markets. Setting up regional headquarters in talent hubs may make more sense than setting up full-fledged headquarters in every country.

Have you considered?
Ensuring strategic alignment
- How do I view risk in emerging markets, in particular from a portfolio perspective?
- Market prioritisation
  - Is the market I am looking at large and growing in my sector?
  - Is the host government trying to protect the domestic industry in my sector?
  - Does my strategy mitigate the risk of contracts’ not being honoured in the new markets?
  - Is there a danger of expropriation in the new market?
  - Are there special local risks for my sector?
  - Are there alternative, less popular markets with equally good growth prospects?
  - What weight should I give the various risks in deciding whether to enter the market?
- How stable is the government? What is the relationship between my home country and the country of the new market I am considering?
- How business friendly is the regulatory environment? Are domestic market players protected by regulations or enforcement norms?

Developing entry strategy
- How will the cultural norms in the target country guide my distribution, supply chain or customer interactions? How will this impact my costs?
- What risks and opportunities do the country’s labour conditions, infrastructure, level of transparency, corruption, distribution channels or other factors present?
- Does my strategy mitigate the risk of IP loss? Are partners’ objectives aligned to protect IP? Is it possible to keep the IP critical operations in home markets?
- What are the country’s demographics, and how is that likely to change its labour force and consumer purchasing patterns?
- Are there interim steps I can take before fully entering the market? Are there steps I can take to prepare the market so it is more hospitable when I decide to enter?

Plan implementation
- Does my strategy mitigate the risk that I am receiving poor-quality and unreliable information about this market?

Choosing the right moment to enter is also crucial. The US insurer that retreated from Russia would have had an entirely different experience had it entered the market several years later. By then, other companies had familiarised consumers with the concept of deductibles and the market became profitable. Or the company could have developed a network of existing brokers through which to sell its products rather than entering the market with full-scale operations. The brokers could then have laid the groundwork for a more established presence several years later.

2 “Oil: Dominance of Petrobras may slow development,” Financial Times, 14 November 2010.
Market presence
A company that has had a presence in an emerging market for some time has a greater imperative, amid volatile global growth, to resist complacency; the need to collect data, monitor the business environment and weigh evolving risks versus the benefits of maintaining or expanding that presence continues. It must keep tabs on shifts in political sentiment and power brokers, regulation, budget conditions and other factors. A company that gets off to a good start in a new market may be blindsided if it assumes the situation is static. It should reassess its business model on a periodic basis; entry models may not be optimal after a year or two of competition. Companies will want not only early warnings if the business climate turns against them but also cues to help them decide whether it’s time to expand operations. Succeeding long term requires operating as a responsible corporate citizen, balancing economic rewards with social and environmental investment.

To remain successful, companies need to be aware of the expectations communities have of them. Companies will want to know whether the environment for foreign investment will shift, which can happen anywhere. An Australian minerals and energy company, for example, found its bid to acquire a fertiliser company in a country where foreign investment has long been welcomed thwarted over the government’s concerns about jobs and public-sector revenues.

Government tax policies are subject to change, particularly for foreign companies. For example, when oil and gas prices fell in 2008, some companies extracting other natural resources in one country faced substantial new fees and taxes imposed to offset the decline in fees and taxes the government received from oil and gas operations. Sudden changes in tax regimes are risks not just in emerging markets. Recently, the UK government, for example, imposed a windfall profits tax on oil companies.

And companies need to be ready for surges in business. In fast-growing markets, a company that cannot keep up with skyrocketing demand can be as much at risk as one for which demand collapses. If demand goes unmet, customers may look for substitutes.

The understanding that corporate headquarters has of conditions in a new market — a view often heavily influenced by the headlines of global news organisations — can be very different from what local managers see. For example, the Western headquarters of an insurance company, concerned that there was too much political unrest to insure a specific risk in a Middle Eastern country, refused to approve offering a product that local managers said would be highly profitable. The local managers argued that the group the proposed insurance would cover posed no risk and that other companies had successfully offered the insurance. But headquarters stood firm, and the business opportunity was lost. While management at headquarters can receive an inaccurate impression of conditions in a country, local managers’ information can have a vested interest in maintaining and building their businesses, so they may be inclined to give overly rosy reports of local business conditions.
Understand where you are globally — and where you want to be

Just as no two growth markets are alike, companies, and indeed industries, also vary greatly according to their emerging market strategies. The reality for most executives considering new markets is that they will have to manage a new, external risk set, while at the same time dealing with internal, operational and business risks that companies have to manage as they expand. Developing new partnerships, project finance, hiring, and legal and regulatory compliance issues are all essential and complex aspects to entering markets or building market presence. Over time, a company may move from a focus on exporting, to expanding their regional presence and level of adaptation, to the point where overseas operations are themselves a source of products and innovation. The Globalisation Maturity Model (GMM) (see Figure 7), describes some of the dimensions most affected as companies move through these different phases. It offers a simple but comprehensive framework for decision-makers to identify some of the key challenges at each stage. Key to this framework is the understanding that a company’s globalisation trajectory may not be linear, not all businesses will, or should, move from the export to the originate phase. A company’s absolute position, how global it is, is less important than its position relative to its major competitors or industry leaders. Indeed, in some industries the “export” phase may be sufficient as long as the company can ensure it maintains its competitive advantage.

![Figure 6: Three distinct phases of globalisation](image)

![Figure 7: Globalisation maturity model](image)

Source: PRTM Front Line Survey of 30 Global Businesses, December 2009
Building risk resilience — no room for complacency

Top level goals and strategies for global expansion are often clearly defined but the operational and risk management plans needed to realise those strategies are often less well shaped when companies embark on that expansion. Companies seeking growth in new markets will inevitably have to face greater operational complexity and increased systemic risks. In many cases, the full extent of operational issues and systemic risks only emerge “on the job”. While some risks cannot be prevented, companies can build in safeguards and greater resilience through systematic and on-going risk identification and analysis, in particular, as we have already discussed, around non-quantifiable risks, such as political risk or exposure to reputational damage. In Figure 7, we have highlighted some of the risks discussed in this document in light of characteristics of phases 2 and 3. As elsewhere in this report, a key point to remember is that risk identification is never a one-off exercise, no matter where a company is in its expansion, or how long it has been operating in a market, one of the biggest risks to growth is complacency about risk monitoring and management.

Have you considered?

- Is information flowing from local managers to the boardroom and vice versa?
- What are the factors making this market grow, and what are the factors slowing it down?
- Am I being sufficiently patient with the difficulties of doing business in an unfamiliar market and about realising returns?
- Am I doing enough to further economic and social development to ensure that our company is seen as a good corporate citizen?
- How can I prevent local managers from becoming the competition?
- How am I mitigating the risk of surges or dips in demand?
- If the government is planning tax breaks or other forms of social and economic investment. Sometimes, a company that leaves a country will not be allowed to return, as happened to one European bank that exited a key emerging market. In other instances, host countries erect barriers to entry — for example, by making it difficult or impossible to withdraw capital or profits.

Just like companies weighing whether to enter a market and those staying on top of conditions while they are in a country, companies considering an exit need to consider trends.

Market exit

Choosing the right time to exit (or scale back from) a market can be as difficult and risky as choosing the right time to enter. Companies whose businesses in new markets have not met their profit expectations have several options. Besides exiting entirely, or remaining in hopes of an improvement, they could consider pulling out temporarily until conditions get better. But in doing so, they should consider whether there will still be partners for them to work with when they expect to return. They should also consider whether it will be more expensive to reenter the market and whether there are likely to be other heightened barriers to entry in the future. Reputations and brands can be damaged by a pullout, and governments might respond to broken promises of maintaining employment and other forms of social and economic investment. Sometimes, it can be a cost of investable resources.

Have you considered?

- Am I taking optimal advantage of the diversification benefits of being in multiple emerging markets?
- How can I take advantage of long-term trends in taxation, labour market conditions and other factors?
- Are there potential roadblocks to exiting? Will I be able to repatriate capital and profits?
- If I exit now and attempt to return in the future, will there be barriers to reentry? Will my company be allowed to reenter the market?
- If I exit now, will I damage my company’s reputation or violate our commitment to social responsibility?
Supply chains

The effects of Japan’s earthquake (and the resulting tsunami and nuclear crisis) on the global automotive industry, among others, makes clear how sensitive modern supply chains are to crises. And the oil spill in the Gulf of Mexico is a stark reminder that even though business partners share responsibility for a calamity, the lead company suffers most of the reputational damage.

Indeed, global supply chains and corporate partnerships are more complex today than they have ever been. Companies have to keep track of many more business partners, participants in their supply chains, suppliers to their suppliers — and the local conditions that affect all of those businesses. At the same time, governments are increasingly demanding that companies, including their supply chains and business partners, be socially responsible and that their products meet quality standards. In order to protect their reputations and to comply with regulations throughout their supply chains, companies need to have access to and continually analyse information — for example, about distribution and customer satisfaction and feedback — from the downstream supply chain.

The physical risks present in any supply chain are also exaggerated as supply chains become longer and more extensive. Transit times can become prolonged for many reasons, including a dependence on one mode of transport. A shutdown of the Panama Canal could seriously disrupt a business dependent on shipping through the canal. Similarly, companies dependent on air transport in Europe were stymied by the Icelandic volcanic cloud. Customs delays, delays in storage and terrorism can further disrupt supply chains. Extended supply chains may have a higher likelihood of disruption but also may be more adaptable, whereas simple ones are vulnerable to excessive concentration.

Companies with extended supply chains need to have access to and continually analyse information about any changes that occur in the countries from which they source. For example, a company must keep informed of energy price increases and resource shortages and the impact they have on suppliers’ abilities to remain in business. It’s also important to know suppliers’ relationships with their governments. For example, for anyone doing business with US automakers and financial institutions, it would have been crucial to know that the United States stood ready to prevent those sectors from failing in the economic crisis. Companies further need to keep informed of factors affecting the supply of and demand for raw materials and parts, including competitor activity. Risks also arise from the difficulty in many emerging markets of getting information — for example, about distribution and customer satisfaction and feedback — from the downstream supply chain.

Global supply chains and corporate partnerships are more complex today than they have ever been.
Section 3
Balancing opportunities and risks

There are many reasons for companies to be optimistic as the recession relaxes its grip on the world economy. But unresolved challenges that contributed to the recession continue to pose risks, and new global risks are mounting.

Filled with confidence, business leaders could neglect to consider the peculiarities of particular sectors, with particular business models, within particular cultures. They might overlook differences between their home markets and new markets and attempt to replicate successful business models in unfamiliar territories. And they might assume — because many businesses found a welcoming business environment a year ago — that that same environment will persist indefinitely. On top of these are the high-impact, low-probability risks — like natural disasters, oil spills and civil unrest — that seem to be occurring with ever-greater frequency and that have the ability to destroy a business.

To navigate clear of these risks, companies will be wise to focus on a range of steps related to planning, people and culture and partners.

Planning

• Define your company’s risk appetites and tolerance and use them to guide international strategy.

• Anticipate high-impact risks that could bring your company down, and create crisis management plans based on likely consequences rather than possible causes.

• Understand how quickly those risks can affect your company, your suppliers or your customers.

• Ensure boards are sufficiently informed about potential high-impact risks so they can challenge their CEOs’ appreciation of and preparedness for those risks.

• Embed key risks into your business plans. All too often, there is poor linkage between risk identification and business planning in emerging countries.

• Analyse information continuously, from a variety of sources representing different perspectives. Draw on experts from a variety of disciplines and from around the globe.

• Consider the best pace for entering a new market. That could mean monitoring a market until it reaches certain milestones; jumping in on the ground floor before competitors enter; initially developing a small foothold, such as through a liaison or sales offices or representatives; or moving aggressively into an already competitive market.

• Test a market by setting up operations in a similar, neighbouring country. That way, a company can gradually gain familiarity with the country and slowly build its presence. Participating in joint ventures and mergers, meanwhile, enables a company to establish a substantial presence in a new market and quickly gain knowledge of doing business there from locals.

“Clearly, we are not in normal times and some observers believe — especially in the aftermath of the unprecedented highly contentious debate over raising the national debt ceiling in order to prevent sovereign default in the US, the world’s largest economy — that there’s a possibility that the global economy will slip into a double-dip recession,” said Sajjan Jindal, Vice Chairman and Managing Director, JSW Steel Limited. “Governments are doing what they can to prevent that from happening, but one cannot know for sure how the global economy might avert another slide.”
There are many reasons for companies to be optimistic as the recession relaxes its grip on the world economy.

People and culture

- Create a risk management culture such that when things go wrong, employees respond appropriately and top management is quickly informed. Compensation systems must reward desired behaviours. To the extent possible, spread that same culture throughout supply chains.

- Put top talent in charge of key new ventures. If it doesn’t feel like the investment is worthwhile, it probably means the plans are too ambitious.

- Hire people with cultural sensitivities and those familiar with local cultures. Some of the most successful companies doing business in emerging markets are committed to hiring only local executives and managers. Hiring local accountants, lawyers and other professionals can also help.

Partners

- Establish solid partnerships with suppliers that can provide invaluable insight into their home countries, as well as transparency into their operations. Strong relationships can be formed by giving suppliers significant volumes of business, assisting them with the development of new capabilities and meeting regularly with their executives. Strong, loyal relationships can help ensure that the supply chain meets sudden demand spikes. At the same time, companies should consider diversifying their sourcing to reduce dependence.

- Collaborate with governments to gain a window into the direction of taxation, regulations and other key trends that will affect new entrants’ businesses like yours and help you sort out conflicting and opaque laws. To lay the groundwork for such collaborations, it is vital for managers to network with a range of government officials. The more extended your connections, the better prepared you will be to weather changes in political parties or individual officials. It should go without saying, however, that the highest international standards on anticorruption must be upheld at all times.

- Get involved in community development efforts to create goodwill and earn a license to operate through corporate social responsibility.

As knowledgeable and strategic as a company may be about entering an unfamiliar market, though, diversification should be the foundation of its risk management may be. No matter how appealing a market and no matter how astutely you oversee your presence there, the most dependable strategy is not to rely on investments in any one market but to pursue opportunities in many diverse markets at once.

Have you considered?

Despite all the best intentions and the most rigorous planning processes, three strong forces continuously threaten to disrupt and distract companies competing in unfamiliar markets.

1. The very optimism and confidence that spur companies to venture into new markets and pursue bold growth opportunities can also cause them to ignore the high-impact, low-probability risks that can destroy their companies. It can be difficult to forge ahead into new territory if you focus too much on all the things that could go wrong. This is all the more reason to ensure that nonexecutive directors be well-informed about and fully appreciate the high-impact risks companies face and that they continuously challenge their CEOs’ decisions regarding risk appetite, tolerance and preparedness to deal with the consequences of high-impact risks.

2. A related tendency is that senior management does not do enough about risk because of the unpredictability of the most devastating risks they face. Disastrous events, on the orders of a major spill, the earthquake in Japan and Hurricane Katrina have been so rare that when risk managers calculate the probability of such events, it is negligible. Yet all those events happened in just the past decade. Managers don’t know how to think through the costs versus the benefits of mitigating such unusual but high-impact risks, so they ignore them. The dangers from this inclination to ignore what is so difficult to anticipate can be overcome by planning for consequences rather than causes, since many consequences will be the same regardless of cause.

3. Another force is the breakdown in the sharing of information between parts of the organisation that need it — a phenomenon we call the information chasm. Such information breakdowns are key reasons that companies do not do enough to address risk. As indication of the existence of such a chasm, 93% of CEOs in our survey two years ago said getting information about risk was crucial, but only 23% of them said they were getting the information they needed.

That chasm concerns the sharing and flow of risk information throughout the enterprise. Too often, information about risk is confined to the boardroom, siloed in business units or lost in Byzantine information systems. Effective risk management requires that organisations make sure risk information is shared throughout the enterprise.

These impediments to addressing risk — psychological barriers, the information chasm and high-impact risks — all play critical roles in the emerging and other unfamiliar markets for which CEOs have such high hopes. Companies that want to be the winners in these ever-more-competitive markets will need to have a deep understanding of both the practical risks of doing business in them and how psychological and organisational biases can amplify these risks.
Sample Table of Risks

General risks
- Economic disparity
- Food, water and energy shortages
- Climate change
- Illegal activities
- Macroeconomic imbalances
- Volatile markets
- Unstable political systems
- Unfamiliar legal systems
- Unpredictable regulations
- Corruption
- Undeveloped infrastructure

Market entry
- Differing sector and country growth rates
- Evolving market
- Government protection for national players
- Contract protection
- Expropriation
- Geopolitical risk
- Rising expectations
- Relationship between home and host countries
- Cultural differences
- Variations in culture, growth rates and other factors between regions
- Changing economic environment
- Rising wages
- Shifting government incentives
- Mismatched risk tolerance
- Intellectual property protection
- Labor conditions
- Infrastructure
- Corruption
- Government instability

Market presence
- Complacency
- Shifts in political power
- Shifts in power brokers
- Changes in regulations
- Changes in budget conditions
- Changes in tax policies
- Surges in demand
- Information gap between headquarters and local markets
- Lack of up-to-date data
- Growing competition
- Inadequate data
- Cultural differences between regions
- Government instability
- Changing economic environment
- Impatience

Market exit
- Barriers to reentry
- Reputational risk
- Prohibitions against capital, profit repatriation
- Exiting too early or too late
- Corporate responsibility and ethics

Supply chain
- Ethics
- Working conditions
- Human rights
- Community development issues
- Carbon footprint
- Security
- Intellectual property rights
- Product quality
- Changing market conditions
- Rising labor costs
- Rising raw materials costs
- Transit times
- Customs delays
- Terrorism
- Rising energy prices
- Resource shortages
- Weak suppliers
- Inadequate downstream data
- Overdependence on limited suppliers
- Cyberattacks
- Overdependence on one mode or route of transportation
- Fraud
- Corruption

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Acknowledgements

We thank the PwC experts listed above who took the time to share their viewpoints with our editorial team. Special thanks to Christopher Michaelson for instigating and shepherding this report. The editorial team for this publication included Christopher Michaelson, Linda Corman, Sheana Tambourgi, Cristina Ampil, Larry Yu, Emily Church, Lock Nelson, Lisa Cockette, Suzanne Snowden and Shannon Schreibman.

In addition, Sage Newman from the Eurasia Group served as an advisor to the analysis herein. Shannon Schreibman led project management and marketing efforts; Jacqui Rivett, Gary Fairman and Odgis + Company were responsible for design and production; and Adiba Khan and Tracy Fulham coordinated online promotion.