Growth Markets Centre – Building effective operating models for growth markets

Bridging growth markets' voids

www.pwc.com/gmc


振奋

Executive summary

The intrigue, complexity and challenge of the growth markets can be characterised by their people and local environment. Consumer segments in these countries are evolving and expanding at a rapid rate, thanks to an increase in disposable income which fuels aspirations of enhanced lifestyles.

However, this affluence is still so nascent that the desire for value-based products continues to be a key purchasing characteristic, making growth markets' consumers very complex customers. Adding to the intrigue and complexity is the fact that these consumers live in business environments that are still maturing, whilst infrastructure, systems and processes are developed, skills acquired and political and regulatory stability established.

These characteristics mean that ambitious companies seeking success in growth markets need business operations that can address an ever-evolving set of consumer targets, with a constantly maturing business environment foundation. Companies must be prepared to step away from their slick and efficient processes and the systems that made them so successful in developed markets and establish a flexible business plan that can keep pace with the evolving consumer base. They will also need to deliver this through an operating model that is effective in a less mature business environment than they are accustomed to.

As we shall see, some companies have been successful in the growth markets by adapting only certain parts of their well-established developed markets' operating model, but we have seen more sustained profitability coming from companies which have embraced the need to develop a differentiated holistic operating model for the target growth market. These successful companies have not only identified which capabilities they need to localise, but developed bespoke, innovative processes to overcome the lack of infrastructure, data and systems that are critical to success back home. They have also recognised the need to adapt and innovate their propositions to meet locally evolving demand and to hire, train and, most importantly, retain local talent to manage these differentiated operations. These adaptations have been made most successfully when the company has looked both at the fiscal implications of operating in a growth market and how it can navigate the local regulations and trading blocks to its advantage. This is all whilst not forgetting a host of operational and environmental risks which are common across many growth markets.

In this paper we will look at several examples of companies which have looked to adapt new business models when expanding in the growth markets; some with great success, others less so. Regardless of the outcome, the common theme is an acknowledgement by these companies that it's not possible to secure long-term success without stepping away from their comfort zone and their pride in what made them successful in developed markets.

Part 1: Expanding in the growth markets

Why change a winning formula?

Many corporates find achieving success in the growth markets quite challenging, and discover that it takes much longer than they had planned to be sustainably profitable. This is often a surprise to companies which are very successful in their developed markets and which pride themselves on their efficient and lean processes, sophisticated systems and effective organisational structures. In many cases, pride in existing developed market operating models is a key contributory factor to lack of success or slow progress in growth markets, as the business environments in these new markets are quite different from those which these established operating models have been created in.

Companies which are truly successful in growth markets appreciate that they do not have a right to win just because they have a set of products and services which have been very profitable back home. Instead they have acknowledged that the consumers they are targeting belong, in most cases, to a relatively new segment of society, which simultaneously aspires to a higher standard of living and all the conveniences that go with it and yet is cautious about spending newfound wealth. Value for money is as important as ever.

Adding to this complexity in targeting consumers is the fact that many of these consumer segments are constantly evolving and growing, with consumers moving from one segment to another as their personal disposable income increases. Consumer groups are much more fluid than the more established and stable segments in developed markets.

Furthermore, these segments differ widely across growth markets. For example, a middle-class German consumer in Berlin may have many similar characteristics to a middle-class UK consumer in Birmingham, with the same spending power, aspiration and basic tastes, yet the same does not necessarily hold true between a Nigerian in Lagos and a Kenyan in Nairobi, or between an Indian in Mumbai and an Indonesian in Jakarta.

Having identified these new target segments, successful companies have also appreciated that these groups have very different needs and aspirations from those they have previously targeted back home; hence they have adapted their product and services portfolios and, in many cases, have also innovated to meet these new needs.

In addition to this, these companies understand that they are in a very competitive environment, competing for consumers' attention and loyalty not just with other foreign players like themselves, but also with local domestic companies who are able to compete across the complete range of goods or even a small part of the portfolio.

Although these companies appreciate the value of adapting their strategies for the growth markets, this is not enough to guarantee success. These plans must be executed in the most appropriate way for a growth market, adapting operations and processes to the local environment – very different from the way in which most companies have succeeded in developed markets.

In the developed markets companies can rely, for the most part, on a relatively stable and predictable business environment with stable and predictable political and judicial processes, good infrastructure and an easy way of doing business. These factors, among others, have provided a stable business environment foundation for companies to develop the key capabilities and processes that make their businesses profitable, i.e. defined long-term business plans; structured and lean business processes and mature organisational models with strong governance and reporting.

Unfortunately the growth markets have not yet reached this level of stability. Not only are their environments different, but they are still evolving and maturing at a fast rate, which means that companies not only have to adapt their operations to a less mature environment, but to do so in a way that is flexible enough to enable them to react and adapt to the ever-evolving environment around them. If they fail to do so and rely on employing tried and tested models and practices in these less stable environments, their businesses will suffer.

Institutional voids

So what makes these growth market business environments so different that companies need to abandon, or at least adapt, their slick and celebrated business models to succeed? These differences can be termed as 'institutional voids' (see Fig 1 page 4 & 5). 'Upstream voids' may include certain fundamentals such as a lack of infrastructure: good roads and regular and sufficient power are obviously key here. Others may include insufficient local supplies or quality materials and an absence of reliable supply chains and qualified suppliers, if the requisite materials do actually exist.

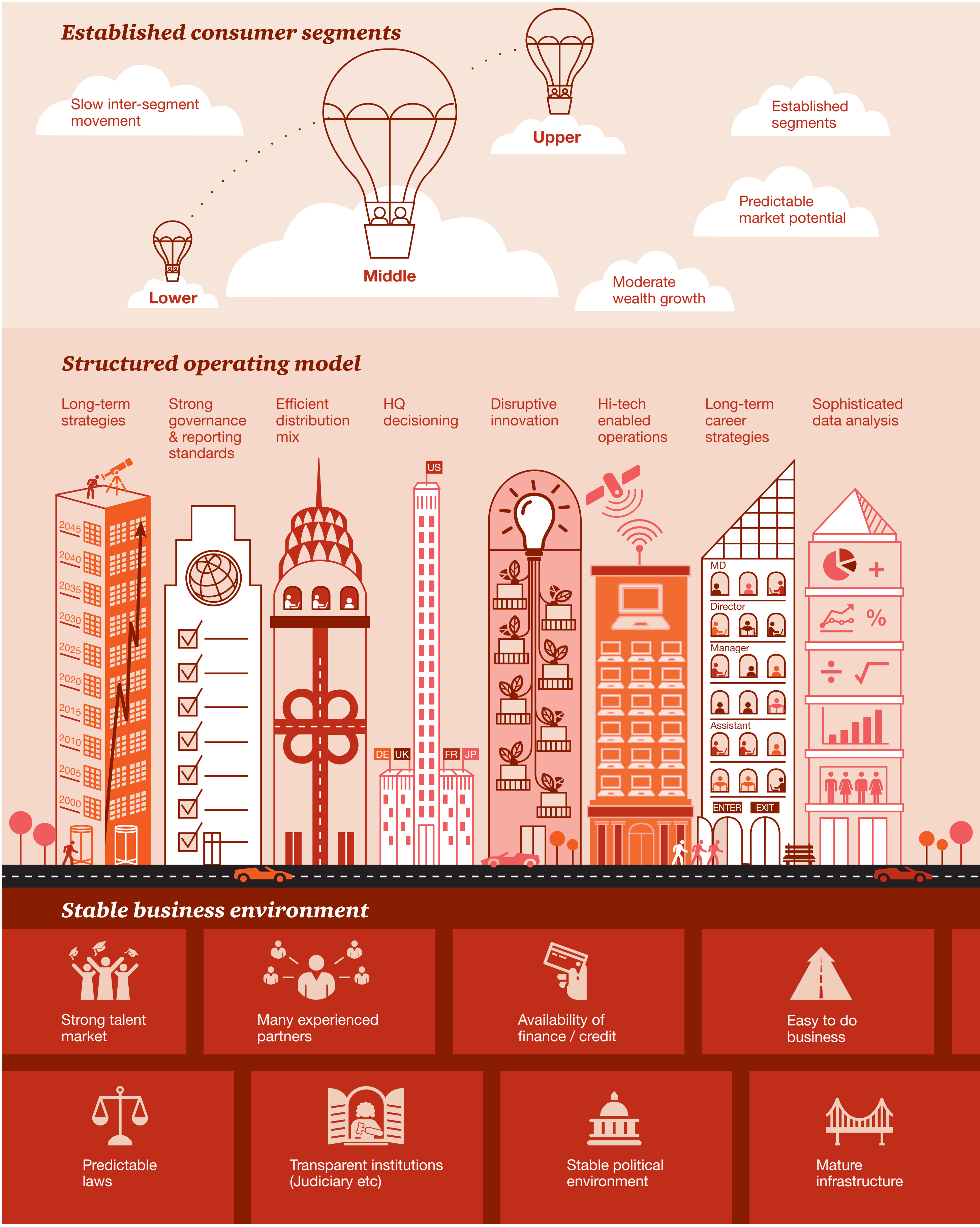
At the other end of the value chain, there exist 'downstream voids', where there is often a lack of coordinated distribution channels, congested with multiple distribution players which lack the sufficient scale, process, knowledge and motivation to support a foreign company in distinguishing itself from the competition and establishing profitable market share.

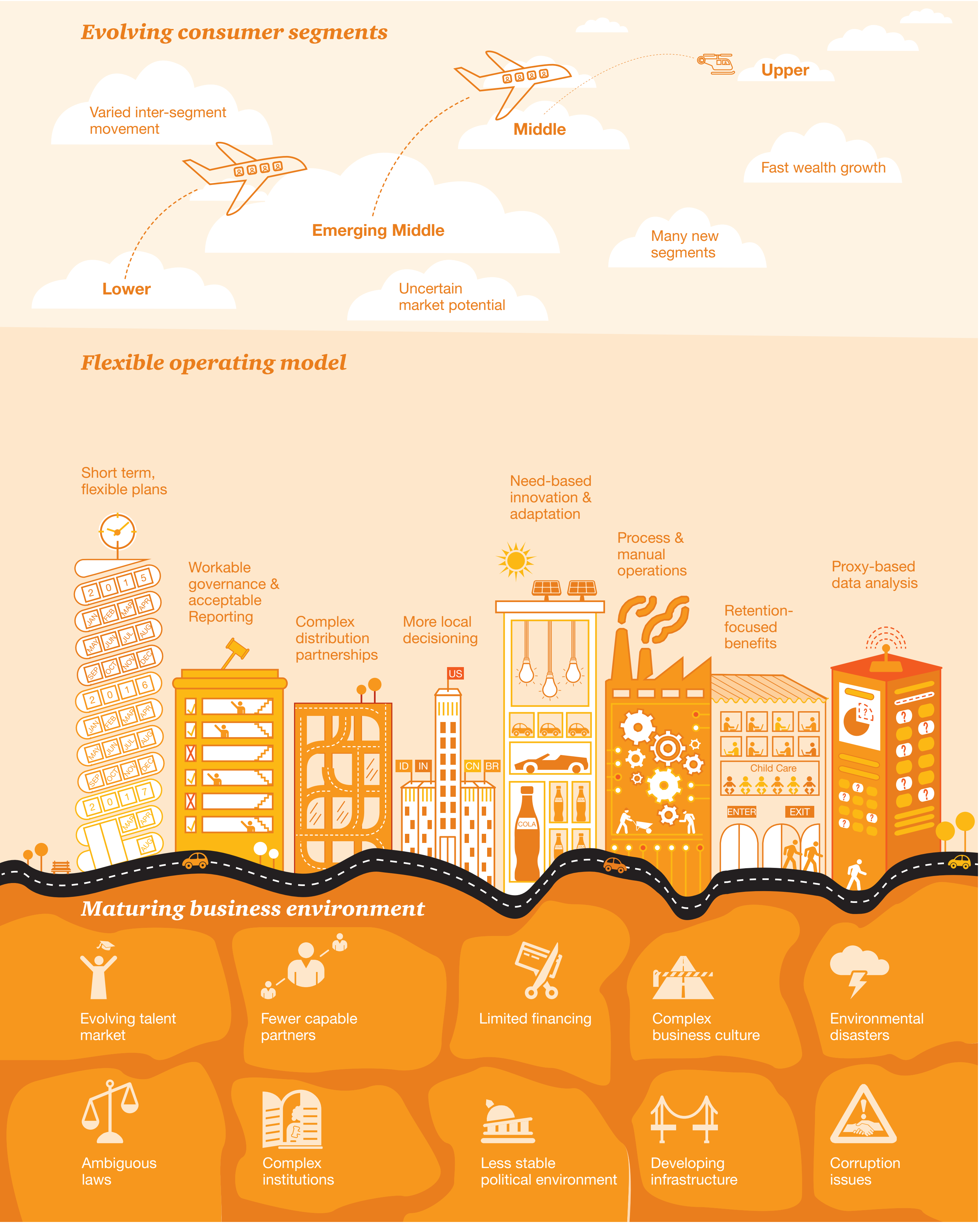
Encapsulating both of these types of voids are 'environmental voids', which are often the hardest to navigate as they are not within the power of influence or control of a foreign company. The unpredictable political situations that are often a key characteristic of these markets impact the pace of change and evolution of both the 'upstream' and 'downstream' voids and also the general nature and ease of doing business. Corruption is a notorious risk of doing business in many growth markets. Companies need to work out how to 'navigate the grey', so that they are able to establish a workable and legal business, until governments are able to stamp out corrupt practices, starting with their own representatives, as we have begun to see recently in China. The lack of skilled labour also inhibits the execution of developed world business plans and processes, and whilst this is something that companies can influence, it is an issue they need to address today, despite the fact that they will only be able to reap the real benefits in years to come. These 'environmental voids' can, at best, merely be managed by companies, but quickly acknowledging their existence and then developing an operating model that works with and around them will help a company succeed in the longer term.

Collectively, these institutional and environmental voids create a business environment that is very different and much more unpredictable than that which companies have taken for granted in their home developed markets. The companies which have acknowledged this have developed flexible business plans and processes that can adapt to the evolving and maturing environment. They have appreciated the need to be comfortable with a lack of visibility of data on which to base their decisions and have managed to establish workable governance processes and reporting methods.

This is not at all easy to achieve and manage, especially for companies which are organised in global business units, rather than by geography. And even for those organisations which are structured by territory, convincing HQ that a different business model and set of processes need to be developed for a new market is a difficult task. Those which are not able to make a convincing argument for a different approach are left to work with tools that are not suitable to deal with the growth markets' voids and pace of change.

Fig 1: Bridging institutional voids – Developed vs. growth markets




Evolving consumer segments
Varied inter-segment movement
Upper
Middle
Fast wealth growth
Emerging Middle
Many new segments
Lower
Uncertain market potential
Flexible operating model
Short term, flexible plans
Need-based innovation & adaptation
Process & manual operations
Workable governance & acceptable Reporting
Proxy-based data analysis
Retention-focused benefits
Complex distribution partnerships
More local decisioning
US
ID
IN
CN
BR
COLA
Child Care
ENTER
EXIT
Maturing business environment
Evolving talent market
Fewer capable partners
Limited financing
Complex business culture
Environmental disasters
Ambiguous laws
Complex institutions
Less stable political environment
Developing infrastructure
Corruption issues

Brazil – Walmart

Walmart was very optimistic when it entered the Brazilian market through a partnership with Lojas Americanas, the country's leading department store chain. The company's growth was saturating in the US, and growth markets such as Brazil, with their consumers' increasing levels of disposable income, were attractive for discount retailing. The company invested US$120m in its first year and planned to exploit its tremendous buying power with giant suppliers, including Procter & Gamble, Nestlé and Coca-Cola, and also draw upon some of the competencies that had brought it success in the US, such as efficient store management, effective use of technology with suppliers and merchandising skills. Walmart opened five stores in the state of São Paulo, with two Walmart supercenters and three Sam's Club stores (membership only retail warehouses), using very low pricing to attract thousands of enthusiastic consumers, who were ready to empty its shelves. It certainly looked like the strong beginning Walmart was looking for – yet at the end of the first year the company registered a loss of US$16.5m.

So what went wrong?

Walmart was not prepared for the level of success it achieved in such a short period, and before long crowded stores were witnessing long checkout queues and stock outs for the most popular items, with no provision to replenish stock to meet demand. Furthermore, many items of the merchandising mix did not appeal to Brazilian consumers and were left untouched on the shelves, which then led to Walmart being accused of 'dumping' for selling products below production costs. This low pricing issue was further compounded as store managers were evaluated by sales volumes and hence motivated to decrease prices and sell below costs.

Walmart's challenges were due to certain local cultural differences and a number of institutional voids. For a start, most Brazilians preferred to shop in small or medium-sized neighbourhood stores rather than at large discount supercenters, and even when they did visit, only frequented these large stores once a month compared to weekly in the US. Furthermore, Walmart's large US superstores assigned only 25% of floor space to food, whereas food represented 60% of supermarket sales in Brazil. Added to the store size and merchandising mix issues was Walmart's extreme low pricing, in contrast to the more dynamic 'high-low' strategy and mark-ups that Brazilians were used to. They were also not used to having to register for membership, especially when greater savings and extra benefits were not obvious. Walmart could have chosen to promote its products and pricing via radio to raise awareness of the benefits, but chose not to use that marketing channel.

Institutional voids compounded these cultural challenges. For example, Brazilian suppliers' technology was not sufficiently mature to cope with heavy traffic jams and support Walmart's 'just in time' model; and coordinating the local distributors proved more complex and time-consuming than anticipated.

What did Walmart do?

To get its business on track and consolidate its position in the Brazilian market Walmart chose to focus on areas where it could differentiate itself in the market. This included superior customer service, a broad and targeted merchandise mix to compete with smaller local competitors and modifications to its supplier relationships. It also replaced certain US executives with locals and learnt to develop local advertising to launch campaigns to position private labels such as 'Sentir Bem'. These modifications in strategy and operations enabled Walmart to continue its expansion across Brazil, both organically and via acquisitions such as Bompreço (118 stores) in the north-east and Sonae (140 stores) in the south.

Did it work?

These changes have helped Walmart become Brazil's third largest supermarket chain, with sales of US$7.5bn (2013), over 75,500 employees, 21 distribution centres and 544 stores, serving on average 1 million consumers daily. Nevertheless, the company's retail strategy – Low Prices Every Day – still has not reached predicted levels and Walmart is still working to attain cost efficiency and positive results.

Walmart's experience neatly illustrates the difficulty of converting the rising wealth of growth market consumers into profitable business.

Sources:

1. www.walmart.com.br
2. Taking Wal-Mart Global: Lessons From Retailing's Giant. strategy + business is published by certain member firms of the PwC network
3. Walmart Annual Report 2014
4. Wal-Mart Brasil Ltda In Retailing (Brazil). Euromonitor International, 05/2014
5. Retailing In Brazil. Euromonitor International, 05/2014
6. PwC analysis

Part 2: Bridging the voids

Building a flexible growth markets operating model

Acknowledging that a different business model is needed to be profitable in the growth markets is a key step, but knowing which parts of an existing successful business model to adapt, and making those changes, is often challenging (see Fig 2 below). As we shall see, these modifications are not just limited to designing an appropriate new product or service and positioning it through the right set of channels, but can also include major process overhauls, as well as revisions to financial structuring and the way the organisation evaluates risk and measures progress.

The navigation of these issues is made even more complex by the fact that it is not possible simply to look at growth market companies to learn from their success in home markets, as they have not always been completely successful themselves.

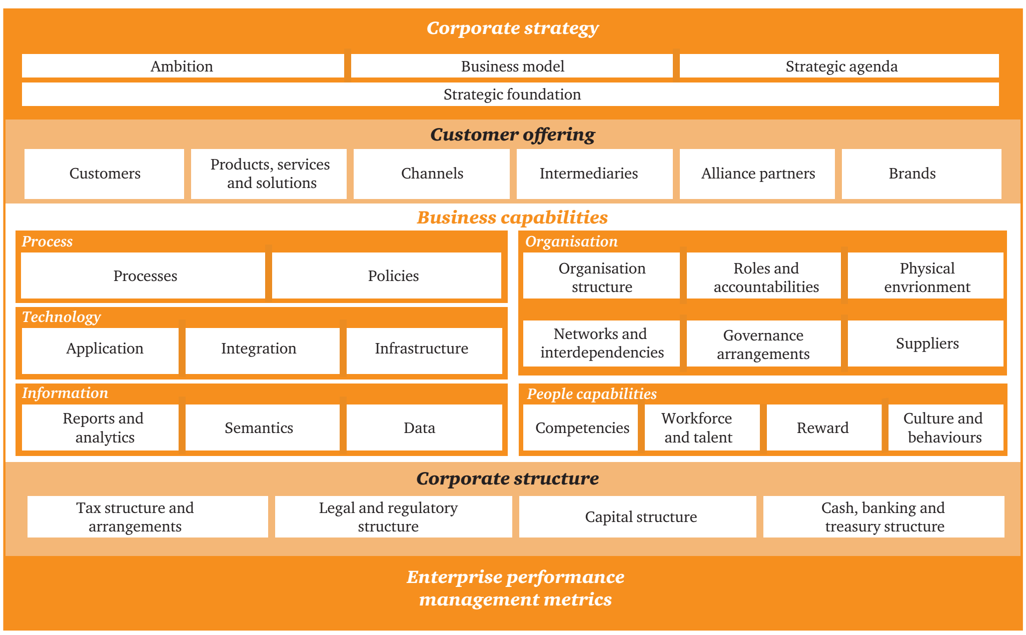
Fig 2: Growth markets impacts on a global operating model

Corporate strategy may come from HQ, but will need to be interpreted locally for the growth market to be executed successfully.

Channels to serve consumers will differ in growth markets due to size, disparity of the markets and maturity infrastructure

Technology and data availability may not be as established in a growth market leading to the need for new 'work around' **processes** to be created, which are more manual and labour intensive

Tax and legal considerations will vary by growth market and trading blocs, forcing companies to review how they financially structure their growth markets operations and how to develop workable governance



Customer offering will be tailored to meet growth markets consumer needs.

Local partners and intermediaries play a significant role in distribution and filling system and process gaps.

People with necessary skills are likely to be in short supply and heavily sought after by competitors, leading to the need for new hiring training and retention strategies

Performance metrics will differ in growth markets due to the lack of reliable data and therefore new measures will have to be agreed with HQ

India – Tata Nano[7]

7In 2009, Tata Motors' introduction of the Nano was based on an assumption that a car priced at 100,000 rupees (US$1,500) would provide an affordable path to improved transport for less affluent Indians. However, the Nano originally performed poorly, due to a combination of safety issues and poor marketing. Tata made the key mistake of positioning the Nano as a 'cheap' car, neglecting the fact that even though its target consumers could only afford a car priced at US$1,500, they also had high aspirations and wanted to feel proud about their new car, not to feel that it was cheap nor, more importantly, to have others know it was cheap. Subsequently several international car manufacturers made plans to introduce similar low cost local models, but positioned to appeal to the aspirations of the target consumer bases as being slightly more expensive and by emphasising the foreign brand and the value features.

Sources:

7. PwC publication – Profitable growth strategies for the Global Emerging Middle – Learning from the Next 4 Billion markets – Jan 2012

Striking the balance

Global and local operating capabilities

In identifying and addressing the needs and wants of a growth market, an organisation must first understand all the capabilities needed to create a new business model which adequately caters to the needs of the new market whilst leveraging its global expertise and brand value.

As part of this process it will need to identify which core capabilities need to be managed globally to leverage established expertise and avoid unnecessary duplication and those which need to be based in the local market, either to fulfil the law or to address market needs. It must then establish how these can be locally sourced (see Fig 3, page 11).

Core capabilities might include global strategy, governance, reporting and IT systems, while local capabilities may be more relevant for market innovation, local operations and routes to market, which may be established through modifications to existing processes or may be created afresh or sourced through local partnerships.

Understanding this split will allow the organisation to manage its resources and concentrate skills appropriately, as well as remaining flexible to quickly address changes and needs in the local markets, without having to wait for global HQ to assess the impact of a local change to its one global operating model.

Often those capabilities which have been identified as needing to exist locally are hard to source in the format needed or in a way which is similar to or meets the standards of what was established in a developed market. Therefore where local capabilities are scarce, an organisation must consider how these can be developed with the available local expertise and assets or a work-around established.

Hybrid model

The balance of this 'hybrid model' can range from one where the local growth market has a small impact on decision making and is more of a caretaker of common service to another where the local business is coordinating and driving synergies, but still does not have any real P&L control. Beyond this is a situation in which the local entity has a key role in the decision making, raising the territory's profile at the global board level and controlling the local P&L.

The type of model a company decides to adopt very much depends on the characteristics of the growth market. The answers to a few key questions will enable a firm to decide what degree of customisation it needs to make to its existing global operating model to adequately address the local growth market:

Consumer needs/ Behaviours
Are the local needs of consumers significantly more diverse and different from developed markets?

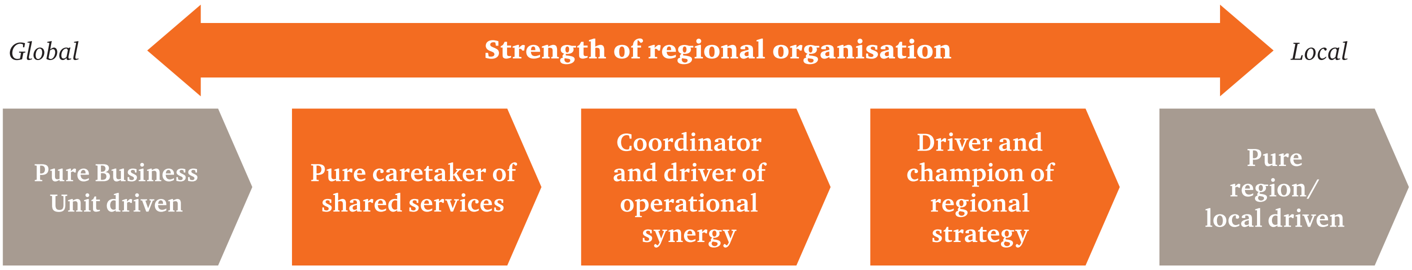
Market dynamics
Are the market stages and competitive environment similar to the HQ market?

Technology
Can you leverage standard global technology/IP or do you need to tailor locally?

Brands
Will the market accept the global brand or require more local positioning?

Product
Does the market require a certain customisation or innovation to the company's existing product portfolio?

Fig 3: Global versus regional capability responsibility



A common issue in both the automotive and aerospace and defence sectors is that the regulations of a particular growth market stipulate that a certain percentage of the final component is locally sourced, but the quality of materials from local suppliers falls below the high standards that these sectors demand. In these situations the foreign organisations have been known to work with local suppliers to help them improve the quality of their products so as to meet global safety standards. Therefore the lack of capability or quality of local suppliers forces organisations to venture further down the value chain from their core business to ensure that their needs are locally met.

Companies in the frozen foods or pharmaceuticals business, for example, have found it necessary to take more active involvement with cold chain providers in developing markets to ensure that standards are maintained throughout the chain. This can mean assisting in design or upgrade of service providers' facilities, audit of transport and transfer processes and, in some cases, direct investment to plug a gap in the chain.

China – General Motors[8]

Over the last two decades the automotive sector has seen significant changes, particularly in terms of where producers are setting up their manufacturing hubs and also to tap into the consumer markets which are growing the fastest. In both of these situations, China has been at the forefront in automotive executives' minds.

Since 2001, General Motors has adopted a more regionally focused operating structure in China to cater to local consumer needs by developing regional production facilities, which enables it to serve consumers more quickly and maintain a lean inventory with efficient local logistics. In addition to this it has also adapted its sales and marketing approaches to be more locally appealing and competitive to better address local consumer preferences. Nevertheless, certain functions such as global sourcing were still centralised at headquarters to maintain economies of scale.

The ownership and responsibility of GM's operations in China are divided across three entities: GM Headquarters, GM China and its joint venture Shanghai GM (SGM, with SAIC).

GM Headquarters still retains control for many key capabilities, such as technology innovation, quality standards, market research and segmentation as well as product design and global brand management.

The China regional entity, GM China, has the responsibility to develop product and portfolio plans for the region and provide facility and quality management support to its joint venture partner SGM. From a consumer perspective, it also customises and executes the global brand strategy to be locally relevant and appealing.

However it is GM's local joint venture, SGM, which has the responsibility for the day-to-day manufacturing operations and the autonomy to manage the pricing and promotion strategies and local dealer relationships.

In addition to developing an effective regional operating model, GM has also managed to navigate the challenges of IP and technology protection to enable it to be the leading foreign original equipment manufacturer (OEM) in R&D and production across China. GM has grown at a 10-year CAGR of 50%, selling more than 2.35 million units in 2010, surpassing US sales and capturing 13% of the Chinese market. China is now a sourcing hub for GM, with 50% of all production being sold abroad.

Sources:

8. PwC's Strategy& analysis

Stick or twist

The need for innovation

Innovation is always an important consideration when looking to enter or expand further in a growth market, yet it is also an area of considerable uncertainty and risk. The uncertainty associated with innovation in growth markets can be viewed in at least two ways.

For example, is innovation required for success in growth markets, or is it more important for an organisation to stick to what it knows best and hope that its proven road to success pays off once more in its newer markets? Every example of a company which claims success in a new market because of a 'market-tailored innovation' to its product offering can be countered with an example of a company which attributes its success in a new market to sticking to elements of its established product or service portfolio which have worked elsewhere.

Adding to this uncertainty is the relative dearth of robust external data and infrastructure to measure and communicate innovation success in growth markets. Mature markets often enjoy the support of independent market and consumer sentiment surveys and often also operate in the presence of pervasive, reasonably well-structured and consolidated networks of social and consumer media. These support systems offer companies a way to objectively (or at least mostly objectively) evaluate and publicise their innovation success, or assess the lack of it. Companies attempting to offer innovative products and services in growth markets often cannot count on this same external support to measure and share the successes they have earned. Instead, companies in growth markets are confronted with the prospect of their innovation success being disproportionately influenced by a particularly flashy article in the media, or an initially obscure provocative social media post that manages to become widely shared.

Innovation choices

So, how can companies make progress in view of these uncertainties? From our perspective there are two important innovation-related decisions a company should make first in approaching growth markets.

First, what business outcomes does it expect to achieve as a result of participating in a growth market – for example, is it about reaching a market share target? Is it about achieving higher brand awareness among a certain demographic? Growing revenue and/or profits?

Second, what level and types of incremental investment is the company willing to make in order to develop and support the innovation that may be required for success? Is the company willing to accept that specific investment may be needed to develop and maintain market-specific brands? How about investment to find, vet and maintain relationships with new vendors needed only to supply components and ingredients for products developed specifically for a growth market? Or possibly disrupting manufacturing and logistics flows that are well-tuned for high-volume sales in mature markets in order to make and deliver innovative products destined for a growth market?

It is not necessarily straightforward to establish goals for growth market participation and determine a comfort level for the investment needed to support growth market innovation.

However, these are elements a company can control and measure, rather than narrowing the definition of its success to external viewpoints – often without full context – of whether its original assumption as to whether it should stick with what works when entering a foreign market was correct or whether it should try something new.

Innovation mix

From a practical point of view, there are broadly three types of product and service changes that will ultimately define the mix of 'innovation' that a company offers in a growth market. Each of them can have an impact on the business outcomes that a company achieves in the market, and each of them carries different implications for specific investments that it must make in order to make the innovation an operational reality.

First, there is innovation that impacts the product or service itself – in other words, the form, fit and/or function (and in a consumable sense, the taste) of a product. In formulating a product offering for a growth market, a company may discover that some changes to existing product attributes are needed to appeal to local customer preferences. Many companies make cosmetic changes to products to appeal to specific demographics in growth markets, while others make modifications to functional attributes to enhance performance or durability in usage conditions that may be very different from those in existing markets. For example, a global US car manufacturer learnt that it needed to adapt the fuel its vehicles ran on across many parts of Africa, after learning that 95% of the cars sold in the segment it was targeting ran on diesel.

Second, there is innovation that impacts the packaging and positioning of the product or service. These innovations are often driven by differences in storage, handling and display and usage in a growth market compared to markets in which a company is used to operating. These differences are relevant both to the supply chain before reaching a customer and in terms of the customer's premises itself. Smaller package sizes tuned for retail venues with fewer and smaller facings and packages with higher corner and edge damage tolerances tuned for unpredictable journeys to customers are two examples of packaging-related changes companies can make in order to support success in growth markets.

Innovations rooted in how a product is packaged often require a significant level of coordination and investment in the supply chain. Unilever and Coca-Cola[9] have invested considerable energy and funding in adapting the packaging of their respective products in order to remain affordable and immediately consumable by those segments of growth markets who cannot afford to bulk buy or do not have the storage or cooling capacity in their homes.

Placement is also key in these new markets and often non-traditional methods need to be embraced to blend in with local customs and preferences. For example, many convenience stores in Vietnam and other South East Asian countries display snacks and hot food in the open so as to catch the eye (and nose) of potential customers.

Finally, there is innovation that has an impact on how a product or service is supported, both before and after sale to customers. These are changes a company makes to accommodate a higher level of unfamiliarity customers may have in a growth market concerning the adoption, use and enjoyment of the product or service being offered.

Support staff who are capable of communicating in a growth market's local language and using informational assets (e.g., user manuals, FAQs) are among the more obvious examples of specific investments companies may make in support of their business in growth markets. Companies like Sodexo have gone so far as to offer entire lines of service that are devoted to the unusual and unpredictable needs of customers in growth markets.

Sources:
9. PwC Analysis

From PwC's global experience, we believe that some degree of innovation – i.e. some amount of change to the product or service – will be required in order to be successful in growth markets. The search for solutions is more complicated than answering the question of '*should we try something new or not*?'; moreover, the determinants of whether a chosen path has been successful can be murky in growth markets.

Our suggested first step to innovation success in growth markets is to be clear up front about what benefits you expect from participation in growth markets, and to what degree you are willing to invest to change your products, your package, and your support model.

Flexible operations
Adapting processes for the market

Many organisations begin their growth markets journey by importing products and engaging local distributors. This is viewed as a low risk approach, enabling an organisation to test the waters of a new market with minimum capital invested and with manageable risk. However, this strategy often results in a loss of control over market development, brand and product management.

Therefore, if the initial years of operating in a growth market have proved to be worthwhile and there are good signs of longer-term profits, organisations often choose to enhance their exposure to the new market in order to scale up their operations. When an organisation chooses to do this and establish its own operations in a growth market, whether distribution only or full production and supply chain management, it must develop processes which are appropriate to the local market and within the boundaries of the local laws and regulations.

To add complexity to this, local business rules for foreign companies may mandate that they operate certain aspects of their operations, or an overall percentage, with local third parties, state-owned enterprises or directly with local or national governments, which do not have such sophisticated capabilities or access to the key infrastructure that is available to the foreign company in its home market.

For example, in Cambodia, companies and foreigners are not allowed to own land and so must enter into joint ventures with locals to access land for facilities. These JV partners may have different investment priorities and appetite for change.

Support capabilities such as service and spare parts provision may be equally constrained, and so the organisation must consider how to compensate effectively for these limitations. This may require higher levels of parts and inventory than in home markets, establishment of alternate sources of supply, higher allowances for air freight or courier services, and different arrangements with service providers to ensure continuity of service.

The need to work with numerous stakeholders naturally leads to an increase in the amount of handovers required throughout a supply chain compared to developed markets. Quality management and governance can therefore become more complex, with simpler controls or higher levels of supervision required to maintain global standards and avoid product or reputational risk.

The establishment of operations in growth markets therefore requires a broader range of considerations and a greater focus on planning and flexibility than is likely to be required in developed markets. It is also clear that due to the wide range of factors influencing successful operations, a model adopted successfully in one growth market will not necessarily translate with the same degree of success to another.

China – Global automotive company[10]

A global automotive components manufacturer had been established for many years in China. In an effort to reduce costs and follow an expected migration of automotive manufacturing to Vietnam, the company established a plant in the country following its China model. Despite substantial experience in emerging markets manufacturing, the plant suffered ongoing quality issues and was eventually closed. Issues cited included difficulty in filling skilled technical positions, and a lack of awareness of quality expectations in the industry. While the China operations had been established in concert with experienced local partners and a structured industry environment, limited industry knowledge was available in Vietnam at the time. The company needed to bridge the voids that existed in Vietnam and not rely completely on its Chinese model.

Sources:
10. PwC analysis

A winning team

Building and retaining the best organisation

Achieving the most effective and well-balanced organisational structure is one of the most delicate tasks when developing a growth markets business model. It is understandable that organisations venturing into emerging complex markets have a heightened sense of protection towards their new project and are conscious that it faces many new risks which they want to oversee as closely as possible. This fear of relinquishing control is accentuated by the scale of operations, particularly in markets such as China, India, Brazil and Indonesia, as well as the different and often bespoke local operating requirements needed to address these markets.

These challenges influence an organisation's approach to how it structures and resources its growth market activities, and often organisations are tempted to over-rely upon expensive expat expertise rather than develop a suitable local workforce. The lack of access to skilled staff may cause a consolidation of roles, particularly at a senior level, while the complexity of governance can require additional oversight and new roles. The need to deal with third parties such as distributors, regional officials and other intermediaries can introduce new roles which may not exist or may have different responsibilities in the home territory. Whether these roles are filled by expats or the few local managers who have sufficient experience, the situation causes considerable stress due to being overburdened.

Successful organisations in the growth markets have therefore been open to designing local organisational structures which differ dramatically from their global or developed market norms.

A global beverage company, for example, dramatically increased its market penetration in China by investing heavily in a large local direct sales force, while sales teams were being streamlined and channels differentiated elsewhere in the world.

Splitting roles into different jobs in order to create job descriptions that meet the available talent, as well as developing a clear hierarchy which is familiar to local employees, has helped organisations to acquire the talent they need and manage staff effectively.

Retaining rare talent

As mentioned in Part 1, many potential employees within the emerging middle segment of the growth markets have high aspirations, not only in relation to commodities and lifestyle, but also in their desire to work for a foreign company. However, lesser-skilled talent is usually more readily available than skilled talent, which causes a variety of challenges for companies looking to staff their organisations in new growth markets. This imbalance creates a war for skilled talent and higher than usual turnover rates between companies, as skilled local employees look to cash in their rare talents to the foreign organisation which will pay higher or promote them quicker. This issue, if unchecked, can destabilise whole sectors over a period of a few years, as many young local managers reach senior roles without the benefit of years of practising their skills and learning from failures and successes.

To address this ever-present issue of high attrition rates, organisations are looking beyond their hiring processes and packages, which are designed to attract talent, to develop retention strategies which differ greatly from those used back in developed markets. Organisations are having to look beyond just the employee and what his or her professional ambitions and goals may be and understand the person's non-professional commitments too.

For example, a typical employee in a growth market such as India, Indonesia or Brazil has more immediate family responsibilities than a similar employee will typically have in the US, UK or Europe. A growth markets employee is less likely to be inspired and retained with the promise that in three to five years' time they will be promoted to the next level and have a 20–30% increase in salary. Their aspirations and family needs are much more immediate, which means that understanding the employee's motivations for work and how best to address these will help reduce attrition.

Non-financial retention strategies

This can take the form of offering wider employee benefits which apply to close family, such as medical insurance, flexible working hours to allow employees to attend to elderly parents and company events which family members can attend. If an employee feels a company is helping to look after their family as well as their career, they are less likely to look around.

Whilst these initiatives are good, they are ineffective without those which are more professionally focused, so organisations need also to consider how they can provide training and career development opportunities which will inspire and retain their best talent. Certain initiatives have been seen to be particularly effective in some growth markets. For example, developing specific training to enhance the skills of junior managers will inspire them, and prepare a succession line for senior management. Offering secondments for senior management to other geographic locations in the organisation has also been successful, as it showcases that the company values the individual and has a plan for future growth for them.

Therefore investment in time and effort is needed by organisations to retain talent in ways that may be different from the norm. Furthermore, they also need to be prepared to place a greater focus on collaboration with third parties or the contracting of functions to leverage the skills available from providers outside the organisation such as service networks or third party logistics providers.

These differences in organisational structure can have significant implications for measurement and control, meaning that existing performance management structures may not be appropriate in the new market. Where measures can be retained, it may still be necessary to revise the targets associated with them to reflect the local environment.

Malaysia – Tenaga Nasional Berhad[11]

Tenaga Nasional Berhad (TNB)[12], Malaysia's national power utility which employs about 33,500 employees, is well known for its high employee engagement that is founded upon providing mainly non-monetary benefits such systematic training and development opportunities and competitive family-wide benefits. As a result, the company's attrition rate is relatively low averaging between 3% – 4% over the last two years.

As TNB views talent management as a critical investment, their employee engagement programmme focuses on providing opportunities for growth through wider exposure across the company with job movement and in developing different skills and competencies. They also nurture their talent pipeline by identifying high potential employees and ensuring that they receive accelerated learning and leadership development opportunities. Furthermore, in addition to a dedicated Integrated Learning Solution centre (ILSAS) and Leadership Development Centre, TNB also provides numerous training platforms such as classroom training, e-platform learning, mentoring, coaching and paid membership in professional organisations.

To ensure a more fair development of talent, these development opportunity programmes are not exclusive to only executive and managerial levels, but also to non-executives, who make up of 60% of TNB's workforce. These non-executives also benefit from 'Upward Mobility' schemes as part of their professional, personal and socio-economic development.

In addition to its training, education and development programmes, TNB has one of the most comprehensive healthcare benefits programme in Malaysia. The healthcare benefits cover employees' spouses and children up to the age of 18 years or up to 24 years if they are still studying. TNB also supports employees with young families by providing child-care centres. Currently, it has 13 kindergartens and nine nurseries throughout the nation. The company also provides tuition for children of employees at a minimal rate under a programme called Kelas Bimbingan Tenaga.

TNB continues to care for the families of employees even after the employees have passed away through one-off contributions of RM2,000 ($525) to widows and offers support to orphans by giving them monthly financial assistance of RM100 ($25) each (children aged 7-12 years) and RM150 ($38) each (children aged 13-17 years). Additionally, other benefits that TNB provides are extra EPF[13] contributions, housing loans and subsidies for all employees.

Sources:

11. PwC analysis
12. Government-linked utilities and power station.
13. EPF – Employees' Provident fund – compulsory savings and retirement plan for private sector workers in Malaysia.

Back to basics
Overcoming technical and system gaps

Companies in developed markets are heavily reliant on IT systems and technical infrastructure to drive data and transaction flows and to provide accurate reporting and information for decision-making. Advanced data models and analytics have enhanced supply chain and inventory planning as well as the targeting of consumers with certain propositions to increase sales and retentions.

However, it can be difficult to reach the same levels of analysis and insight when operating in growth markets, as the effectiveness of these key data gathering and IT support systems can be constrained by a range of factors, including:

1. ***Lack of availability*** of physical infrastructure to provide data access and speed of processing
2. ***Inability to extend*** the systems due to regulatory, language or technical limitations
3. ***Lack of access to necessary IT*** talent or external technical support to maintain the systems in the local market
4. ***Lack of access to basic transaction data***, particularly in the 'last mile', and confidence in the integrity of the data that is available.

Basic information on aspects such as order acknowledgement, in-transit status and even proof of delivery can be difficult to obtain in these circumstances, making it difficult to provide reliable management information. This can have a direct impact on business performance and profitability as, for example, cycle times are extended due to lack of shipping data, causing inefficiencies in customs processing and shipping delays.

Working capital requirements may also be affected as extra inventories and safety stocks are required to offset lack of visibility in the supply chain. Capital requirements and targets may therefore be quite different from those expected in developed markets.

In these situations, companies must decide what systems and information are business-critical, and what actions to take when these critical capabilities are not available. Options may include outsourcing, partnering with other businesses or de-scoping their requirements and agreeing more basic reporting and analysis with headquarters to simplify systems needs and reduce reliance on them. This must, of course, be considered with respect to impacts on business governance and control.

A general result of these constraints is a greater reliance on process and people to drive data and analysis in the absence of suitable infrastructure. This in turn places greater emphasis on training of staff and consistency in approach to drive better accuracy.

Point of sale information, in particular, may rely on alternative approaches and data sources, and on manual work-arounds to provide a level of data suitable for business decision-making. Local dealers can be a valuable source of information, but may require incentives to keep logs of customer visits and sales.

India – Leading automotive company[14]

A leading automobile multinational wanted to expand its distribution network to tier 3 and 4 areas of India, but being the first mover in the market, there was a lack of any organised data on the potential demand for passenger cars in the towns. To overcome this gap the OEM decided to collect primary data itself, using such proxies as the number of two-wheeler and tractor sales in an area, as well as analysing the number of banks, hospitals and schools in similar towns. To corroborate and strengthen its assumptions, the company also established relationships with local agencies such as cooperative banks and agri-societies. This enterprising 'work-around' enabled the company to gather enough data to be able to plan its market expansion into the tier 3 and 4 towns with a degree of confidence previously unobtainable.

The use of mobile technology is also beneficial to both companies and customers in growth markets, as mobile infrastructure requires lower investment and can proliferate faster in markets with less developed 'fixed-line' structures. In early 2015, for example, mobile phones accounted for 72% of web page traffic in India, 73% in Myanmar and 76% in Nigeria, compared with a global average of 33% [15]. This allows opportunity for greater communication between manufacturers and consumers in growth markets as well as providing valuable information for both parties.

India – Bharti Airtel

Bharti Airtel collaborated with fertiliser manufacturer Indian Farmers Fertiliser Cooperative (IFFCO), selling co-branded subscriber identity module cards through retail outlets and providing free voice updates to farmers about market prices, farming techniques, weather forecasts and fertiliser availability. This was linked with micro-financing services which allowed users of mobile phones to pay instalments on their devices over a period of 25 months. The use of simplified technology for the rural market and making mobile communications available improves information flows up and down the supply chain.

Sources:

14. PwC Analysis
15. We Are Social/StatCounter Q1 2015

Presence to Profitability Developing profitable distribution partnerships[16]

One of the questions that companies most commonly grapple with throughout their growth markets journey is how to reach their customers effectively and efficiently. Few multinationals have been able to develop distribution networks that give them the same level of confidence and, more importantly, profits, as they enjoy in their home markets due to some significant challenges they face in these emerging markets. The challenges are often related to the lack of basic infrastructure and then compounded by the sheer size of some markets and the need for local knowledge and strong local relationships.

These challenges historically have led many multinationals to minimise investment risk by entering new emerging markets through arms-length agreements with one or more local third-party distributors to meet their primary goal of achieving market presence: '*How can I get my product/service out there as quickly as possible*?'

However, although this approach was quite successful in the early years of growth markets expansion, as growth markets continue to evolve, multinationals are being forced to fundamentally rethink their go-to-market (GTM) strategies to meet future demand and remain competitive in the major emerging markets.

In order to meet these new challenges and evolve from mere 'presence' to 'profitability', many multinationals are having to get more involved and invest more time and money in their distribution partners to develop more advanced GTM capabilities, which provide granular information about the new consumer segments and achieve far greater levels of transparency and control over how their own products and services are actually reaching them.

In addition, multinationals need to ensure that these new partnership agreements leave them with enough freedom to vary the distribution mix and reduce their reliance on 'indirect' approaches only, as opposed to more heterogeneous GTM solutions that achieve a better balance of power with their distributors.

Achieving greater insight, control and profitability requires a higher degree of effort to identify the right set of select partners and develop an operating model that is effective and will enable the company to expand and grow profitably with the opportunities and challenges of the market.

These aspects are considered in greater detail in an earlier PwC Growth Markets Centre publication, '*Presence to Profitability*'.

Sources:

16. PwC's publication 'Presence to Profitability'

Latin America – Major snacks company [17]

A major manufacturer of sweets, chocolates and biscuits in Latin America needed to revise its channel strategy in order to improve its competitiveness and make it more efficient in serving the market. It was facing challenges of low profitability and reach through its existing channel partners and conflict between wholesalers and distributors.

To address these challenges, the company decided to revise its distribution strategy by providing certain capabilities to its third party distributors to enhance their targeting and reach, as well as serving some distributors' clients direct through its own salesforce.

This new channel strategy included client segmentation and a redefinition of the sales model and service levels per segment, as well as customer prioritisation by segment, product and geography. Additionally, a cost of service model was built to monitor the profitability of the proposed solution.

The company's actions not only enhanced the capability and effectiveness of their distribution partners, but also provided them with greater control and visibility at points of sale and across the indirect distribution channels.

Sources:
17. PwC analysis

Workable governance

Getting a practical and legal balance

Maintaining appropriate levels of governance in a growth market can present particular difficulties for organisations seeking to maintain global standards and protect internationally renowned brands. The ability to implement workable governance can be affected by the capabilities and skills available in the local market, access to the information necessary to identify and quantify risks, and availability of appropriate controls to manage the risks. Skills and infrastructure which are readily available in home markets may not exist or may be rudimentary in a growth market.

Organisations typically prefer to adopt a global governance framework, which often causes headaches for regional leaders who are trying to work within the high standards set by headquarters in a developed market whilst trying to operate and generate profits in a complex growth market. In such markets doing business is not so straightforward: key roles are often occupied by local partners or outsourced parties, and the data demanded from HQ is not available.

In these scenarios, organisations need to review their global governance frameworks and take care to define workable solutions which are practical for the local ways of business. A key starting point is identifying the core ethics and elements of the company's governance model which uphold the way it does business, and also those parts which are fundamental to abiding by the laws and regulations of both the growth market and the home market. Relatively recent pieces of legislation in developed markets, such as the US Foreign Corrupt Practices Act and the UK Bribery Act, have increased the levels of liability foreign companies operating in the growth markets need to meet and hence now form part of the core elements of governance that companies must adhere to.

Having established where the governance bar lies for a particular growth market, local regional leaders then need to work to establish processes and business methods to meet these standards. Companies may need to review definitions of activities to reflect local conditions, or spend additional time documenting differences in approach and the justifications for these changes. They may also require a higher degree of local supervision or more regular audit and headquarters oversight to ensure compliance.

China – US multinational [18]

In December 2014, the Securities and Exchange Commission (SEC) charged a US multinational corporation (MNC) with Foreign Corrupt Practices Act (FCPA) violations for providing non-business-related travel and improper payments to various Chinese government officials to win business. Poor internal controls allowed employees in its China offices to enter into sham 'collaboration agreements' to direct money to foreign officials and send them on sightseeing trips around the world. These officials were often responsible for authorising the purchase of the company's products, and the leisure trips funded by the company typically followed business-related travel for these officials. The company agreed to pay US$2.4 million to settle the SEC's charges.

Sources:
18. http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370543708934

Measuring success

How to report, what to report?

As for governance structures, organisations must consider the appropriate level and frequency of reporting in a growth market. Working to a global framework may be impractical where quality and availability of data are unreliable, partners may be unwilling to share information and local regulations may place restrictions on what can be shared.

Companies need to consider the appropriate metrics to be applied to a growth market business, and the level and scale of reporting necessary to manage the business. This may be a streamlined version of the organisation's home reporting, or may require focus on different elements to serve local needs as well as expectations from headquarters.

Information which cannot be used to drive action due to the local environment will have limited value, while comparisons with other businesses under the same organisation may not be relevant. Third parties may also require incentives or encouragement to provide necessary data.

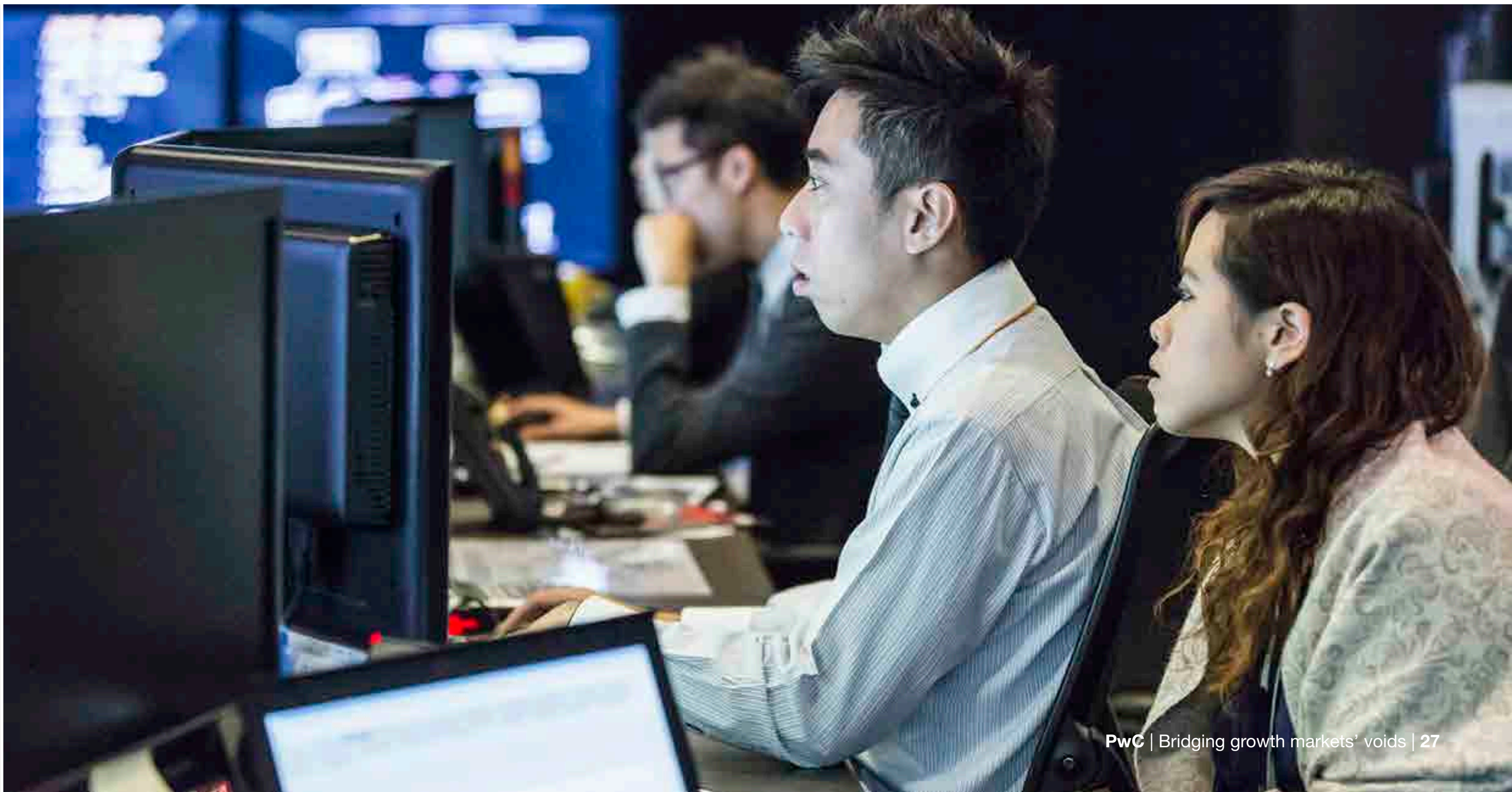
These factors provide a structure for a local operating model which can vary significantly from the organisation's standard model, but with due consideration a balance can be established between headquarters' requirements and policies and the flexibility required for day-to-day management of the local business.

Part 3: Managing the money

Financially supporting growth markets' operations

Just as companies should not expect to succeed in a new growth market by lifting and shifting existing developed market strategies and operating models, nor should they expect to replicate the supporting developed market fiscal models into these growth markets.

For many multinationals, the developed markets have long offered the opportunity to align the fiscal model with the operating model in order to achieve a tax-efficient outcome. Many US and UK multinationals, for example, run highly centralised European operating models from locations such as Switzerland, the Netherlands or the UK. Properly structured and managed, these have the effect of attracting a significant portion of the overall system profit from operations across the region to these centralised, co-located management hubs, where they are taxed at competitive and favourable rates. Whilst these centralised fiscal models are coming under intense international scrutiny and regulatory challenge, through the G20-sponsored OECD Base Erosion and Profit Shifting ('BEPS') initiative, they are expected to remain tax effective and attractive to multinationals for whom a centralised operating model makes good operational sense.



Acknowledging the fiscal risks

The critical point to note for MNCs expanding into growth markets is that the operational logic inherent in these centralised models is often a product of the developed market environment. Where those characteristics, as previously discussed in Part 1, are not (yet) present in developing markets, the adoption of the same centralised fiscal model may present significant risk to the business and operations in these new markets.

It may be that the centralised model assumes a level of co-located management, across both the developed market HQ and the growth market, which actually is not the case. This misalignment is a major tax risk and sits squarely within the crosshairs of the BEPS initiative.

Alternatively, it may be that the business has been forced into a co-located, centralised management model, mitigating the tax risks but then presenting major risks to the operationalisation of a market strategy which often requires a more decentralised approach. Neither of these outcomes is attractive or sustainable.

To understand this point it is helpful to keep in mind the key points mentioned earlier in Part 1 of the main differences between developed and developing markets.

As a generalised statement, developed markets tend to be characterised by a reasonably homogeneous consumer base, allowing innovation to be commercialised through an integrated, internally owned (or managed) supply chain which serves multiple markets from multiple (often highly scaled) manufacturing and supply hubs. Distribution networks are established and well understood. This is underpinned with standardised business processes supported by integrated management information systems supplied with plentiful rich market data.

Tax and regulatory barriers or costs to cross-border trade (e.g. customs tariffs) and cashflows (e.g. exchange control) are low and the overall tax and regulatory environment is relatively stable and predictable. All of this enables a concentration of management, strategy and planning at the centre, with execution roles in-market, leading to centralised profit taking and cashflows taxed at a low rate.

Developing markets, on the other hand, depending on their state of maturity, lack many of these characteristics and can in some cases present the polar opposite. The consumer base is often highly heterogeneous, both socio-economically and culturally. Innovation and marketing therefore often need to be more locally focused. Supply chains are highly fragmented. In a market entry phase goods tend to be imported and distributed by untested third parties and/or JVs with local partners. particularly for the 'last mile', which lack scale and rarely operate across borders.

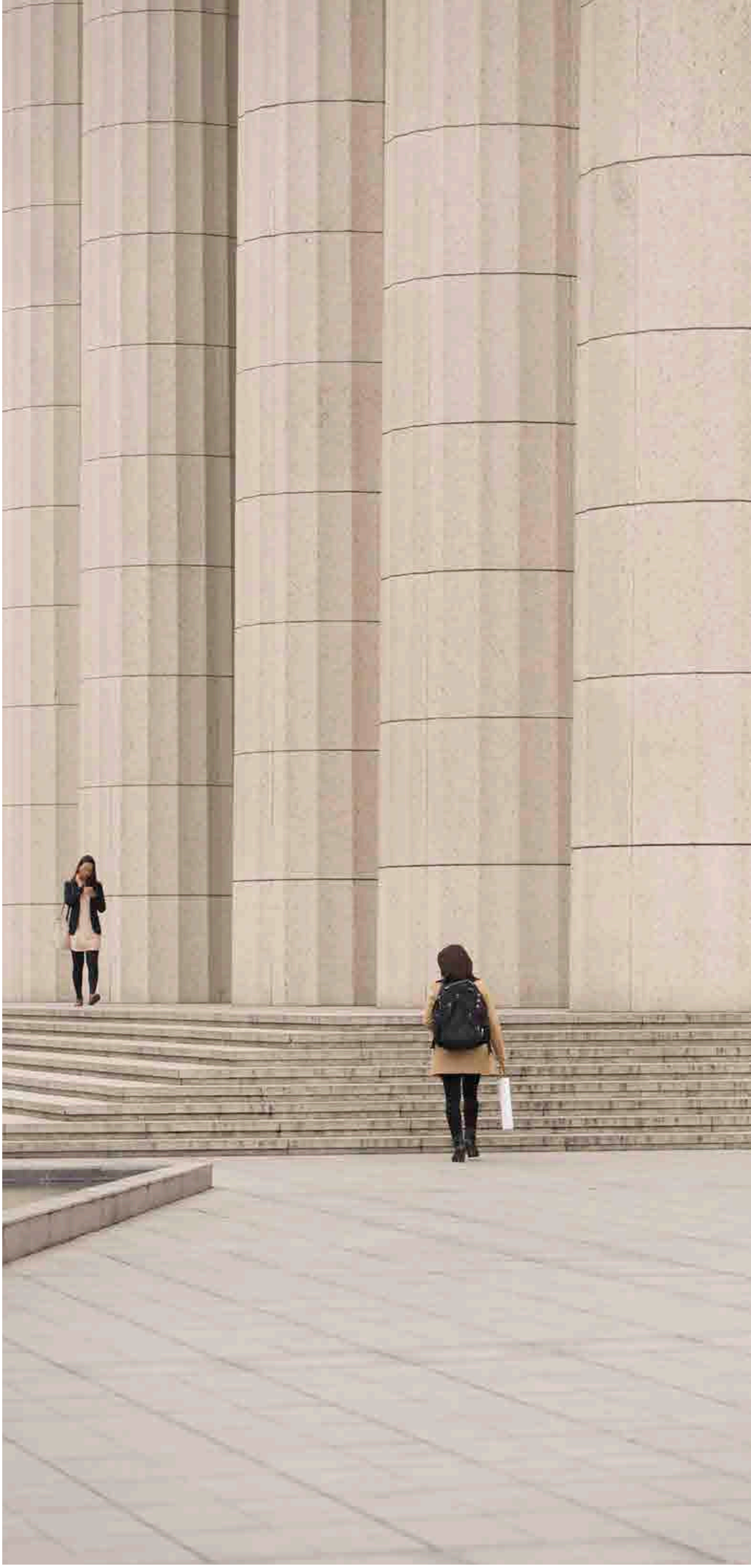
Data is uncertain. IT infrastructure is patchy and group processes are often disregarded in the interests of getting things done. In addition to the difficulties this presents for general management reporting, it can also create problems in identifying where substance and value are added within the operating model to satisfy local and global tax and regulatory authorities.

Tax and regulatory challenges

There are often significant tax and regulatory challenges to cross-border trade. Customs tariffs can be higher than corporate income tax rates and customs clearance times are slow and expensive. For example, importing a container into Kenya requires nine documents, takes an average of 26 days and costs on average USD$2,350, as compared with three documents, four days and USD$440 in Singapore.[19]

Exchange control regulations proliferate (for example in Brazil, India, China and most of Africa, including South Africa) and restrict the free flow of cash across borders. Tax and regulatory regimes are unpredictable.

In the absence of the enabling features seen in the developed markets, growth markets therefore tend, at the outset, towards the adoption of localised operating models as a matter of business necessity. That prevents the lift and shift application of a centralised fiscal model and the tax benefits that follow. However, nothing is forever. As growth markets mature, the operational logic for a degree of centralisation grows, but while this creates the opportunity to adopt operating models with centralised features and tax efficiencies, these models will typically differ from the traditional developed markets models.



Sources:
19. http://data.worldbank.org/indicator/IC.IMP.COST.CD

Keeping up with a maturing market

Many of the tax problems experienced by MNCs in developing markets as they mature can be thought of as 'referred pain', as an initially localised operating model fails to keep pace with development.

Imported finished goods often attract high duties. Data constraints and a highly localised view of demand, combined with long import lead times, lead to stock outs and over-supply in different countries across a region. The solution – expedited re-exports (sometimes repeatedly) of product across customs borders – solves the operational problem but can easily eliminate the profit in the stock, through multiple layers of duty and freight costs.

The need for strong governance, as the market opportunity grows, gives rise to increased global or regional management attention, from teams usually located outside the developing market in an established (high cost) group management location. The tax function then struggles to get the resultant management fees pushed down to the markets, giving rise to exchange control and transfer pricing challenges and, if the fees can be paid, irrecoverable withholding taxes.

The net effect is a 'fiscal drag' on profitable growth. The sustainable solution to this is to look at the whole business model, both operational and fiscal.

A fiscally effective operating model

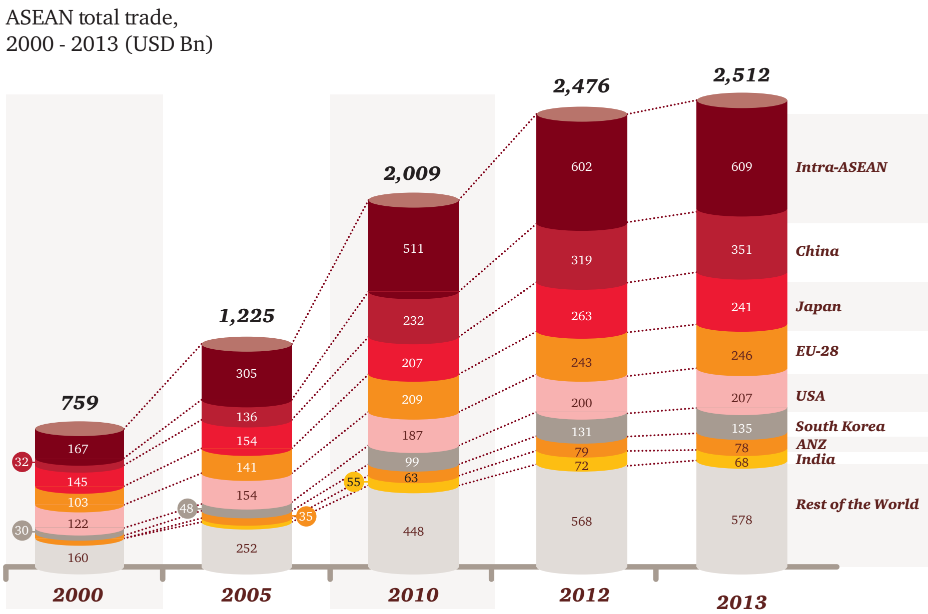
Onshoring of manufacturing will significantly reduce duty costs. This is often combined with the establishment of a regional distribution centre. The key here is to select a location which allows optimal navigation of the trade blocs.

Across Africa for example, there are around eight major trade blocs, with differing degrees of liberalisation. Territories such as Kenya and Tanzania, which straddle two blocs (Southern African Development Community – SADC and East African Community – EAC) can present an attractive proposition, particularly when combined with corporate tax export manufacturing incentives. Whilst free trade within Africa is admittedly still a long way off, the direction of travel is positive, with increased trade liberalisation in West Africa through the Economic Community of West African States (ECOWAS) community (including hot markets such as Nigeria and Ghana) and plans for the integration of the Southern and Eastern African trade blocs to create, ultimately, a free trade zone from The Cape to Cairo.

Intra-African trade grew 92% from 2010 to 2014, as compared with a 63% growth in bilateral trade with Africa. All of this points to increased possibilities for regional supply hubs within Africa, with perhaps three or four hubs serving three or four discrete regions (Maghreb, West, East, South) as defined by trade blocs, language and cultural affinity.

Similarly, the proportion of intra-regional trade in Asia has expanded rapidly and is expected to continue (see Fig 4). China and Japan are now the top export destinations for ASEAN countries overall and they are also the leading suppliers of imported goods to ASEAN countries, with China being significantly ahead for products supplied to the CMLV countries (Cambodia, Myanmar, Lao PDR, Vietnam). However, even the smaller ASEAN economies are trading heavily in the region, as seen by Myanmar exporting 15% of its goods to India [21].

Fig 4: total trade is growing rapidly with Intra-ASEAN trade being dominant[20]



Sources:
20. ASEAN Community in Figures 2014, PwC's Strategy& analysis

21. www.ficci.com/international/75143/Project_docs/Myanmar.pdf

East Africa – Unilever[22]

Unilever has long had a manufacturing presence in Kenya. However, in 2014 it announced its intention to triple capacity from 80m to 250m tonnes a year and to create additional warehousing capacity, an investment of €150m. The facility will give Unilever the capability to serve not only Kenya and its adjacent East African Community markets (Uganda, Burundi, Rwanda and Tanzania), but, over time, developing markets further afield such as fast-growing Ethiopia, Mozambique and Zambia. This complements similar levels of investment in South Africa and Nigeria and is consistent with the vision for Africa set out by CEO Paul Polman, focusing investment and talent in these three regional hubs as a means to build scale and 'Lift Africa', which Unilever has identified as its next market.

Sources:
22. PwC Analysis

It must be remembered, though, that even within a trade bloc, needs, priorities and stages of development will vary. As ASEAN countries move along the path to an ASEAN Economic Community (AEC) targeted for 2020, the focus of the individual member economies still differs significantly, from improving basic necessities such as education, agriculture productivity and infrastructure (Indonesia, Vietnam, Thailand etc.) to international policies and regional expansion (Singapore, Malaysia).

These countries are inherently different in terms of language, religious beliefs, ethnicities, culture and political viewpoint. Operating in the maturing markets with varying business practices is a constant challenge for multinationals and professional services firms (see Fig 5 below).

Centralising management functions

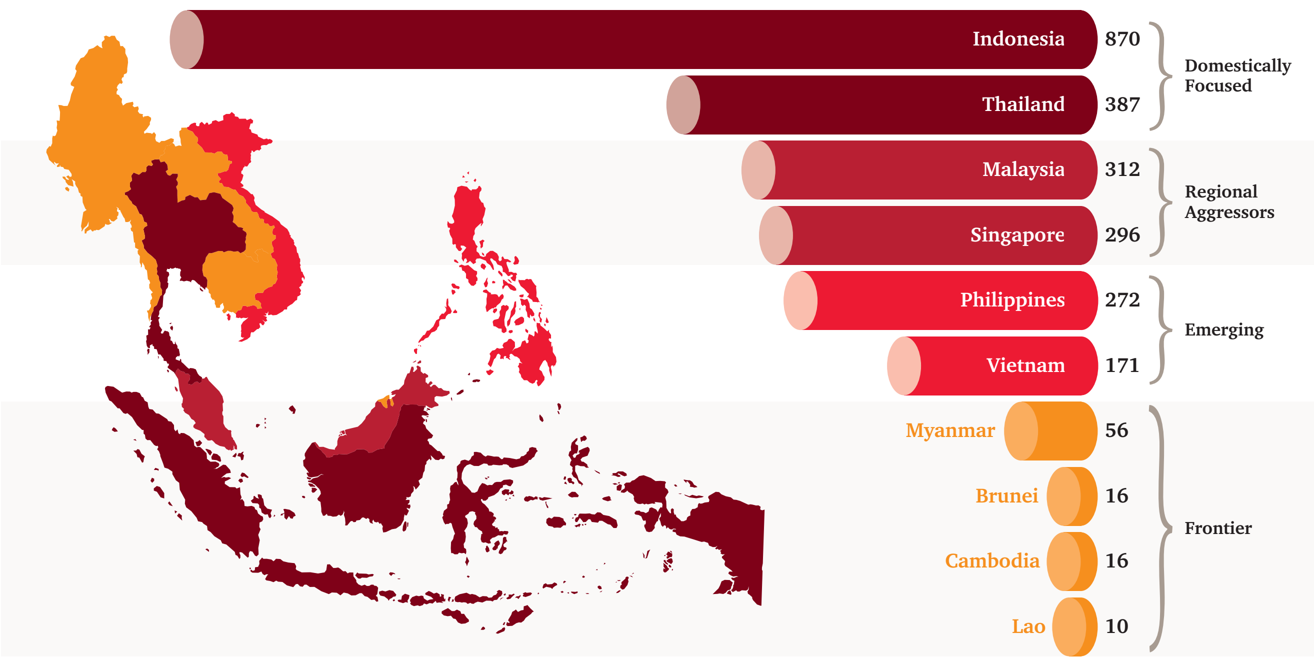
As the regional supply chain and manufacturing model possibilities develop, so does the opportunity to centralise management functions, either within onshore regional centres, making use of attractive tax incentives or regimes (e.g., Nigeria, Ghana, Kenya or within Asia, Malaysia, Thailand, Hong Kong and Singapore) or offshore, within a wider management hub.

Nevertheless, important differences will remain as compared with the developed markets model. The efficiencies to be gained by moving supply chain management above market may not necessarily be found in marketing, where heterogeneity may persist for some years to come. Furthermore, transfer pricing outcomes may differ, with a relatively larger share of profits left in market to take account of increased levels of local marketing functionality, complex and fragmented last mile distribution, and the impact of legacy arrangements with powerful third-party local distribution partners.

Finally, inter-company transactions may not be standardised, as bespoke solutions are typically required country-by-country to accommodate local, non-harmonised, tax and exchange control requirements.

In summary then, planning for an optimal fiscal and operating model outcome in developing markets is complex and cannot be taken for granted. A straight lift and shift of a developed markets model is unlikely to prove successful. However, over time, as the markets mature, trade liberalises and the operational imperatives to centralise emerge, elements of a developed markets fiscal model can be adapted to fit the developing market profile.

Fig 5: GDP of ASEAN Countries, 2014 in current prices (USD Bn)



Sources:
23. International Monetary Fund, World Economic Outlook Database, April 2014; PwC's Strategy& Analysis

Part 4: New risks

Navigating the risks of a differentiated operating model

Developing and operating a differentiated operating model for a growth market brings a number of different risks, which are new to those organisations expanding into these new markets.

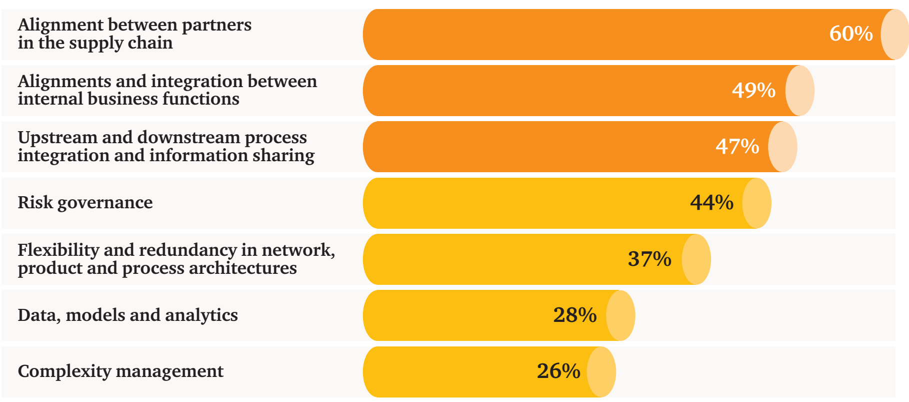
Many organisations have mitigated and managed the risks of how they do business in their home markets by consolidating operations, employing efficient reporting processes and having good access to data. However, as we have said, this is not always possible in a growth market.

Hence the need for new operating models brings with it new operational risks, such as within supply chains, and also risks which are more political, environmental and specific to the way of doing business in that market.

Supply chain risk

The development of global supply chains, especially those which focus on resourcing from and serving the growth markets, exposes organisations to more high-risk scenarios such as price fluctuations, market changes and the impact of natural disasters. A recent Global Supply Chain and Risk Management Survey conducted jointly by PwC and the MIT Forum for Supply Chain Innovation identified some of the most important capabilities to address these risks as including alignment between partners and their business functions across the supply chain, sharing and analysis of data and the ability to adapt network, process and product architectures.

Fig 6: Key capabilities to address supply chain risk



Sources:

24. Global Supply Chain and Risk Management Survey by PwC and the MIT Forum

As this paper has outlined, the ability to manage any or all of these factors is severely curtailed in a growth market. The lack of infrastructure, fragmented networks and reliance on multiple third parties limit the ability of the organisation to control risk factors and require a different and often greatly simplified approach.

These simplified approaches will rely on a few key elements:

Fig 7: Managing the risks of a decentralised operating model

Managing the risks of a decentralised operating model

Local business readiness and continuity plan

- Based on local capabilities and conditions
- Ensure that controllable risks are easily identifiable
- Mitigating actions can be implemented without significant direction or additional training

Inclusion Skilling of suppliers and business partners

- Plan and train to broaden available skills and capabilities
- Ensure training is built on and refreshed

Local eEmpowerment of management

- To make decisions locally without lengthy analysis

Flexible, decentralised supply chain structure

- Potentially simplified product lines or geographic coverage for some markets
- Budget for increased day-to-day supply chain costs.

Supply chain risk management approaches for growth markets may therefore require strong central control focused on advance planning and preparation to account for numerous scenarios, but also incorporate a wide amount of flexibility for local input and action when an incident occurs.

Fig 8: Structured disaster response plan – Illustrative

Step 1	Ensure the safety of company staff
Step 2	Protect company information
Step 3	Ensure the business can continue to receive revenue
Step 4	Ensure availability of information to meet regulatory requirements
Step 5	Protect company assets
Step 6	Ensure ability to make payments as required
Step 7	Inform stakeholders

Environmental risks

Whilst human risk can be somewhat planned for, natural disasters are much harder to predict and mitigate for. Recent incidents such as the 2011 earthquake and subsequent tsunami demonstrate that even developed countries are not immune to natural disasters. In growth markets with poor infrastructure and limited funds for investment, such disasters can have greater impacts and take longer to recover from.

While typhoons can cause businesses to shut down several times a year in Taiwan and Hong Kong, these interruptions are typically short and operations restart readily once the typhoon passes. However, in the Philippines, the same natural events can cause significant damage and extended interruption to daily life. Similarly, floods in Thailand in recent years have caused severe disruption to the regional and global technology and automotive industries.

A business operating in a growth market requires greater focus on business continuity planning, ranging from stockpiling inventory, scenario planning alternative distribution routes and establishing procedures protection and the safe evacuation of staff.

Organisations may look to mitigate these environmental risks with specialist support in developing and implementing continuity plans, but the execution will certainly require a high degree of local authority to take decisions and act in the event of an incident. Ongoing training is key to ensure that all staff are aware of procedures and understand their roles. The company may also need to invest in its own facilities such as shelters and medical facilities to compensate for the lack of local infrastructure.

While natural disasters may not be predictable, appropriate planning and training can mitigate the risks. In growth markets, it may be necessary for the company to take greater responsibility for mitigation and action due to the limitations of the local environment.

South East Asia – Japanese automotive multinationals

The floods in Thailand in October 2011 provide a graphic illustration of the effects of limited infrastructure and constrained supply chains in emerging markets. The relative experience of three major Japanese automotive manufacturers highlights the importance of risk planning in these markets.

Thailand – and in particular Bangkok – has been a preferred location for automotive and electronics manufacturing in the past 20 years because of its low cost but well-trained workforce, available land facilities and good shipping access. Major industrial parks have developed around Bangkok which have attracted a wide range of companies, including some Japanese businesses seeking to diversify production to mitigate against home-based natural disaster risks such as the Tohoku earthquake and tsunami which struck in March 2011. Bangkok, however, is located on former floodplains and the associated risks had not been adequately considered when establishing the network of industrial parks. In the view of insurers Lloyd's: *'…the country's flood hazard had not been modelled and was poorly understood and appreciated.'* [25]

The relative experience of three major Japanese automotive manufacturers highlights the importance of risk planning in these markets. Toyota, Honda and Nissan have estimated lost production of 240,000, 150,000 and 33,000 vehicles respectively due to the floods in Thailand. Of the three, only Honda's plant at Ayutthaya was flooded but all three were affected by lack of parts from suppliers based in the affected parks. Final payouts from the three major Japanese casualty insurers for the Thai floods are believed to have exceeded those for the March 2011 Tohoku earthquake.

While Honda's production was directly affected by its plant closure, the significant difference in losses by Toyota and Nissan has been attributed to Nissan's stronger focus on supply chain risk management. Nissan had established a structured approach to risk planning which included early identification of risk factors, a continuous readiness plan and business continuity plan for its operations, empowering of local management to make decisions, partly through dismantling its Keiretsu system of interlocking business relationships and ownership structures, diversifying sources of supply and improving visibility and co-ordination between internal and external business functions. In the aftermath of the Tohoku earthquake, Nissan's Japanese production decreased only 3.8% in the following six months compared with an industry-wide decrease of 24.8%. Following the Thai floods Nissan was also able to manage the disaster better than its contemporaries.

Following the floods, Toyota announced a move from global control to a regionally independent production system, and conducted a risk review on 500 suppliers, which led to a request for risk mitigation plans for 300 supplier production facilities. Honda began construction of a new Thai production plant at a higher elevation in June 2013.

At government level, the Japan International Co-operation Agency (JICA) prepared a Flood Management Plan of the Chao Phraya River for the Thai government, and is assisting with upgrades to infrastructure including major transport routes and water gates.[26]

Sources:

25. http://lloyds.com/news-and-insight/news-and-features/environment/environment-2012/learning-from-the-thai-floods

26. M Haraguchi and U Lall, Flood risks and impacts: A case study of Thailand's floods in 2011 and research questions for International Journal of Disaster Risk Reduction (2014), http://dx.doi.org/10.1016/j.ijdrr.2014.09.005i

Corruption

It is an unfortunate perception and, in some cases, a reality that growth markets tend to have relatively high levels of both administrative and petty corruption, and multinational companies are facing unprecedented compliance challenges. This burden of compliance has been heightened following the introduction of the UK Bribery Act and US Foreign Corrupt Practices Act, which effectively ended ignorance as a defence. Companies now have to abide by their domestic corruption standard as well as those in the growth markets they are operating in, which tend to be far more lenient and flexible.

The flurry of recent cases involving allegations of bribery and corruption highlights the increased scrutiny by regulators, not just in the US or Europe, but increasingly in Central and Southeast Asia.

Russia, Brazil, China and Poland – US multinational

In December 2012, the US Securities and Exchange Commission ('SEC') charged a US MNC for improper payments made by its subsidiaries to foreign government officials to win business in Russia, Brazil, China and Poland. The SEC alleged that the company used offshore 'marketing agreements' to make payments to third parties chosen by government customers or distributors with little or no knowledge of the third parties beyond their address and bank account information. The SEC further alleged that even though the company was made aware of possible Foreign Corrupt Practices Act ('FCPA') violations, it did not restrict the use of such marketing agreements for more than five years. The company eventually agreed to pay U$29m to settle the charges.[27]

Sources:
27. http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171487116

China – UK multinational

In July 2013, four executives from a UK MNC were jailed on suspicion of orchestrating US$489m in bribes to doctors and medical officials in China. The allegations involved payments made to around 700 travel agencies and consultants who were said to free up bribe money by grossly inflating billings in connection with staff attendance at pharmaceutical conferences. Subsequently, Chinese state television broadcast a confession by an executive admitting to paying off doctors to increase sales.[28] The company subsequently lost 61 per cent of its sales in China.

Russia, Vietnam and Thailand – US multinational

In November 2014, the SEC charged a US MNC for violating the FCPA when its subsidiaries made improper payments to foreign officials in Russia, Vietnam and Thailand in order to win business. The allegations involved excessive payments disguised as commissions to foreign agents with phony addresses and offshore bank accounts. The company's country managers were allowed to communicate through at least ten different personal email addresses with aliases and used code words such as 'bad debts' when referring to those commissions. The company agreed to pay US$55m to settle the charges.[29]

Sources:

28. http://www.fcpablog.com/blog/2013/7/22/gsk-apologizes-for-breaking-china-law.html
29. http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370543347364

As seen, companies cannot afford to ignore the consequences of non-compliance, which can include not only fines and penalties but also reputational loss, leading to an adverse impact on sales and market share.

Both the SEC and the UK's Serious Fraud Office have highlighted the importance of a rigorous compliance programme to mitigate bribery and corruption risk. In a 2012 case the US Department of Justice (DoJ) declined to prosecute a global financial services firm, even though an employee was convicted and jailed for bribery. Contributory factors noted by the DoJ in its decision to decline prosecution included the fact that the company had implemented an anti-bribery and corruption programme which provided reasonable assurance that employees were not bribing government officials.[30]

Governance in this environment requires a combination of skills and behaviour development to ensure that rules are understood and are interpreted correctly. Processes such as procurement or supplier management may be at particular risk of breakdown.

In such cases, a common approach is to move activities of a strategic or complex nature to a location with better access to experienced specialist staff, and to minimise the risk of human error, potential violations of policies and corruption by centralising decision making. These centres may provide services to operations in multiple countries, or act as a 'control tower' for key functions in a region.

Political and regulatory risk

Whilst the impacts of the risks associated with the environment, supply chains and corruption can be expensive and time consuming, the effects of mismanaging the political and regulatory landscape can lead to the closure of an organisation's operations in a growth market.

Laws and regulations in certain growth markets may be worded unclearly or hard to interpret, particularly from a foreign company's perspective, having been designed from a domestic perspective or to favour local business. This characteristic is sometimes accompanied by complex or biased arbitration procedures, which can tie foreign companies up in process and 'red tape' for months, if not years, if they fall foul of the law or do not know how to effectively navigate the regulatory and legal environment.

Like many other aspects of growth markets, the political and regulatory environment of these markets is often open to rapid or unpredictable change. Changes in government or in political priorities can lead to substantial regulatory change, often without consultation. For example, a recent ban on alcohol sales in minimarts and kiosks by the Indonesian government has caused uncertainty in the investment plans of the main local producer to expand capacity in the market.

Local content and manufacturing rules in industries such as automotive and pharmaceuticals can also affect the efficiency and viability of businesses within countries, as smaller production runs or reduced product ranges may be necessary. In certain growth markets such as Laos and Vietnam, state-owned enterprises and even the governments themselves take stakes in businesses and influence business strategy and operations, making it more difficult for new players to enter the market.

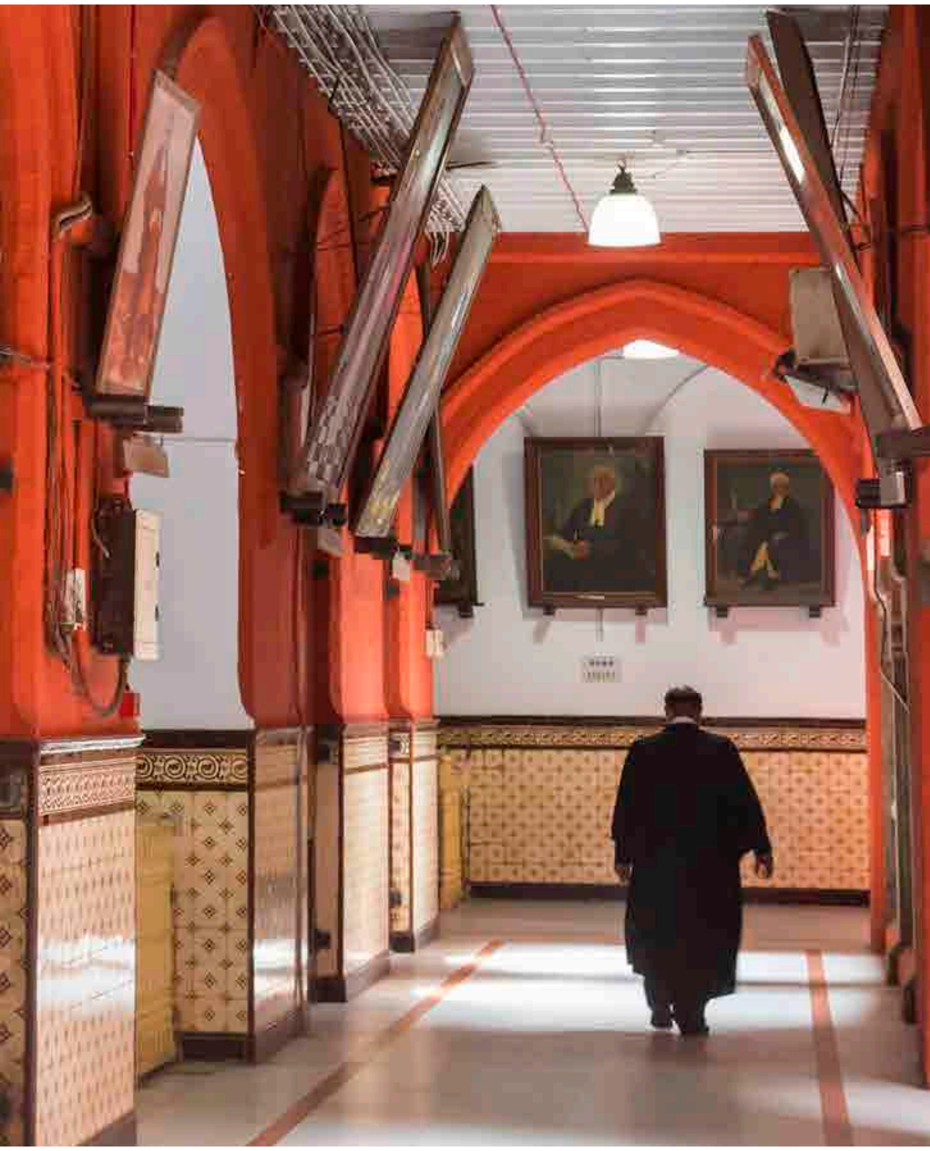
Therefore, organisations need to liaise constantly with regional and federal bodies to make sure that they are not wrong-footed by a subtle amendment that may impact their growth plans, operations and future sales.

Changes in indirect tax or local content rules are frequent hurdles that organisations need to navigate, as well as keeping track of how regional and federal laws interact with one another, especially for a company which is operating and transporting goods across multiple states. Even when rules and international treaties are seemingly clear, their interpretation may not be as expected, especially if they constrain a particular growth market.

Sources:
30. http://www.justice.gov/opa/pr/2012/April/12-crm-534.html

All these risks take careful navigation, and even then it is important to be mindful that when a company is up against a government body, it is rare for it to come away victorious and resume business as usual.

Working with local partners and professional bodies to understand the intricate nuances of the regulatory environment and taking the time to develop strong relationships with the legislative bodies, so as to at least be aware of potentially troublesome changes in advance, is an effective way to avert challenging situations. This approach is often strengthened when organisations lobby as a group or as an industry, such as a Chamber of Commerce, and of course support from the organisation's headquarters is crucial. Not only will this help to add weight to an organisation's local position, it will, most importantly, ensure that senior leadership in the developed market headquarters are fully aware of the circumstances that you are operating within and will set their own expectations of progress accordingly.



India – Vodafone[31]

A well known example of the regulatory challenges faced by multinationals operating in growth markets comes from the Vodafone tax case in India, which began in 2007. The mobile phone giant used a common tax planning strategy involving the sale of shares in an offshore (i.e. non-Indian) holding company to sell its Indian business to another operator. Notwithstanding that there was no change in the immediate ownership of the underlying Indian business, the Indian tax authorities sought to tax Vodafone on the sizeable gain realised from the sale, issuing a tax assessment in the region of US$2.5bn, plus a similar amount in penalties.

The Indian Supreme Court ultimately ruled in favour of Vodafone in 2012, stating that India did not have any right to tax a transaction between companies incorporated outside India; however, the Indian government firmly disagreed with this view and retrospectively amended certain tax laws in order to raise another tax assessment against Vodafone. This case has become one of India's largest ever tax disputes and, more than eight years later, Vodafone remains embroiled in costly litigation in the Indian courts – probably for several years to come.

The impact of the case is far-reaching, fuelling the perception of India as a challenging place to do business. However, changes to the tax law as a result of this case have provided greater clarity for new entrants, but it is likely that more disputes will arise over the new few years, as international players with existing investments in India seek to avoid large tax bills that they did not anticipate when they first entered the market.

Sources:
31. PwC Analysis

Conclusion

As we have seen, the characteristics of most growth markets require companies to adapt both their go-to-market strategy and their operating model to address the ever-evolving consumer needs and segments within the limits of the country's institutional voids and culture.

Some companies have managed to make their growth markets journey profitable by merely tweaking their existing operating model a fraction. However, most companies which are looking for longer term growth in these markets, and which are embracing them as part of their overall corporate plan, need to make more far-reaching and bold changes to their operating models that step away from the structured and efficient capabilities which have made them so successful in the developed markets and of which they are rightly so proud.

These alternative business models embrace holistic and complementary change, which can meet the tastes, styles and preferences of the consumer segments in a growth market, whilst also overcoming some of the institutional voids which would impede developed market approaches. They are holistic in the way that they address several aspects of how a company operates in a growth market, from the different propositions it adapts or innovates for the new market consumers and the new distributors it partners with to the 'work-around processes' employed to meet the infrastructure, data and system gaps.

All these capabilities are entwined, and so the more holistic the change the more successful the operating model. However, for these operational adaptations to be truly successful, they need also to be supported from a financial and governance perspective to ensure that they benefit from and adhere to both the local and home regulations and working practices. All too often, the benefits or new processes are negated due to a lack of understanding of how to structure a business fiscally in a new growth market.

Until then, companies must be prepared to move away from the tactics which brought them success in developed markets and have the courage to develop new models which can overcome institutional voids while meeting the ever-growing demands of consumers in the growth markets.

PwC’s Growth Markets methodology

About the Growth Markets Centre (GMC)

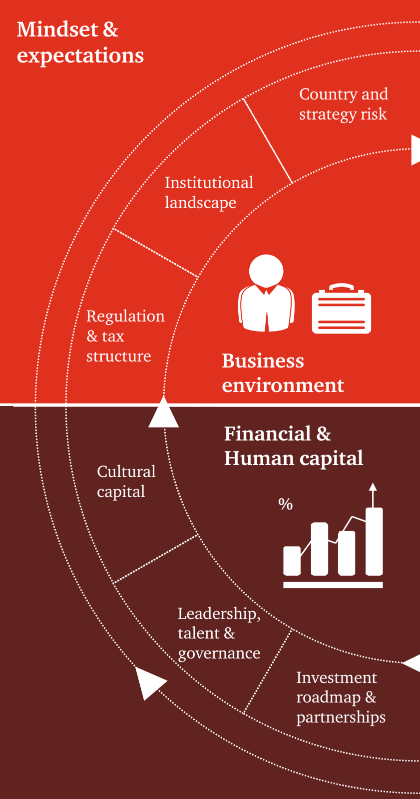
PwC’s Growth Markets Centre brings together the best of PwC and Strategy& growt
complex new markets profitably.

Our growth markets methodology supports companies in addressing their market e

Growth Markets methodology

Business environment:

Acknowledging the complexities associated with a territory’s laws and regulations, including its political and economic stability



Financial and human capital:

Addressing the ‘softer’ challenges of acquiring talent, developing partnerships, securing financial suppoort and appreciating cultural differences

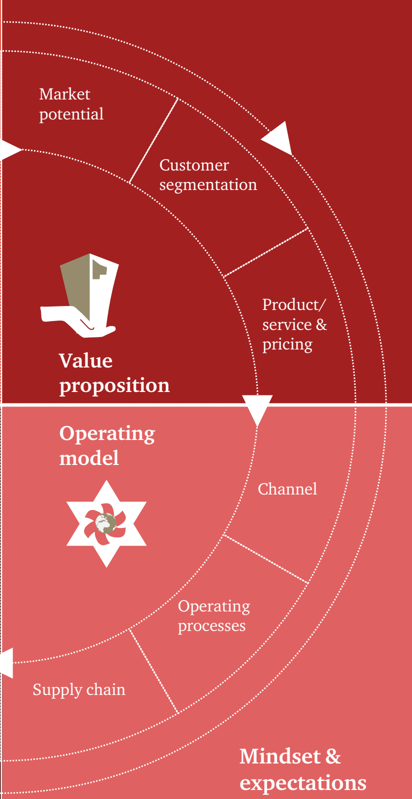
Mindset and expectations:

*Linking all of these is the change in mind-s
succeed in a growth market*

PwC has recognised the need for companies to review their operating models from a holistic perspective when looking to expand in the growth markets and has developed PwC's Growth Markets Framework, which embraces this concept and acknowledges that changes to one part of a company's operating model will have an effect on several other capabilities.

h markets expertisefrom across the globe to help companies navigate these

ntry and expansion needs.



Value proposition:

Assessing the attractiveness of new markets or regions, identifying the right customers and evaluating which products and services to take to market and at what price

Operating model:

Establishing the necessary balance of global and local expertise to be able to source, manufacture, and distribute effectively in a market

et needed to understand what it takes to

For further information

David Wijeratne
Growth Markets Centre Leader,
PwC Singapore
david.wijeratne@sg.pwc.com

John Jullens
Principal, PwC US Strategy&
john.jullens@strategyand.us.pwc.com

David McKeering
Partner, PwC Singapore
david.mckeering@sg.pwc.com

Andrew Fairfoull
Partner, PwC South Africa
fairfoull.andrew@za.pwc.com

Paul Cornelius
Partner, PwC Singapore
paul.cornelius@sg.pwc.com

Andrew Parker
Partner, PwC Australia
andrew.parker@au.pwc.com

Sarah Butler
Partner, PwC China Strategy&
sarah.butler@strategyand.pwc.com

Toshio Banno
Partner, PwC Japan
toshio.banno@jp.pwc.com

Felix Sutter
Partner, PwC Switzerland
felix.sutter@ch.pwc.com

Sachin Mehta
Partner, PwC Brazil
sachin.mehta@br.pwc.com

Shashank Tripathi
Partner, PwC India Strategy&
shashank.tripathi@in.pwc.com

Matt Alabaster
Partner, PwC UK
matthew.alabaster@uk.pwc.com

Acknowledgements

South East Asia

Roger McNicholas
PwC Singapore
(retired Aug 2015)

Kheng Tek Chan
PwC Singapore

Ramon A. Chelva
PwC Malaysia

Kartina Abdul Latif
PwC Malaysia

Scott Constance
PwC Malaysia

Benjamin Azada
PwC Philippines

Mary Jade Roxas
PwC Philippines

Jo Ann P. Ocampo
PwC Philippines

Vilaiporn Taweelappontong
PwC Thailand

Don Gadsden
PwC Thailand

Stephen Gaskill
PwC Vietnam

Hien Nguyen Luong
PwC Vietnam

Marina Tusin
PwC Indonesia

Pieter van de Mheen
PwC Indonesia

China

SiuFung Chan
PwC China

Benjamin Ee
PwC China

Africa and Francophone Africa

Ahmed Chohan
PwC South Africa

Hentus Honiball
PwC South Africa

Peter Hoijtink
PwC South Africa

Peter Links
PwC South Africa

Jonathan Le Henry
PwC Morocco

India

Suman Jagdev
PwC India

Middle East

Anil Khurana
PwC Middle East

Philip Shepherd
PwC Middle East

Per-Ola Karlsson
PwC Middle East Strategy&

Latin America

Rafael Barreto
PwC Brazil

Calena Carrera
PwC Brazil

Leandro Spadini
PwC Brazil

Raul Lozano
PwC Mexico

Alfredo Reynoso
PwC Mexico

Central and Eastern Europe

Onur Vuruskaner
PwC Turkey

Murat Dikmen
PwC Turkey Strategy&

Paul Stewart
PwC Czech Republic

Peter Winkler
PwC Czech Republic

Oganes Sarkisov
PwC Russia

PwC insights

Japan Rebooted – ASEAN, the next frontier – Tapping Southeast Asia's surging growth

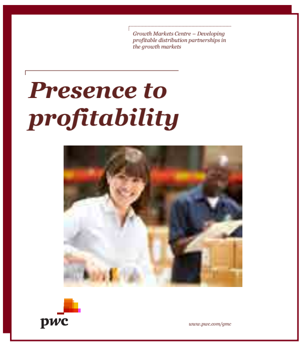
April, 2015

The World in 2050: Will the shift in global economic power continue?

February, 2015

Closing the Gap between knowing and doing – Asian Business Leaders Guide to Digital Change

February, 2015

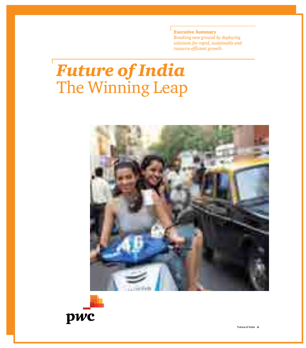


Presence to Profitability – PwC's Growth Markets Centre report, 'Presence to profitability', articulates steps to identify and grow profitably with the right partner in growth markets

December, 2014

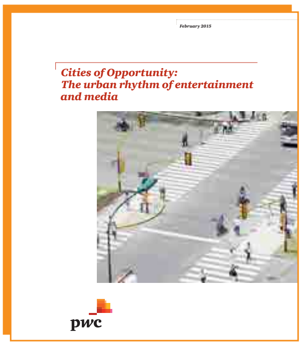
Trends, challenges and future outlook: Capital projects in East Africa, Southern Africa and West Africa

November, 2014



Future of India – The Winning Leap

November, 2014

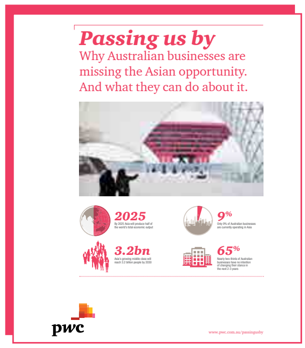


Cities of Opportunity – The urban development of entertainment and media

February, 2015

18th Annual Global CEO Survey – A marketplace without boundaries? Responding to disruption

January, 2015



Passing Us By – Why Australian businesses are missing the Asian opportunity. And what they can do about it

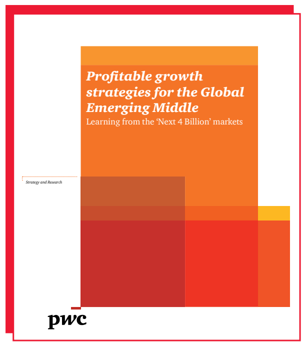
December, 2014

PwC and the MIT Forum for Supply Chain Innovation

August, 2013

Closing the talent shortage gap in the emerging world

December, 2012



Profitable growth strategies for the Global Emerging Middle – Learning from the 'Next 4 Billion' markets

January, 2012

150917-122704-AL-OS