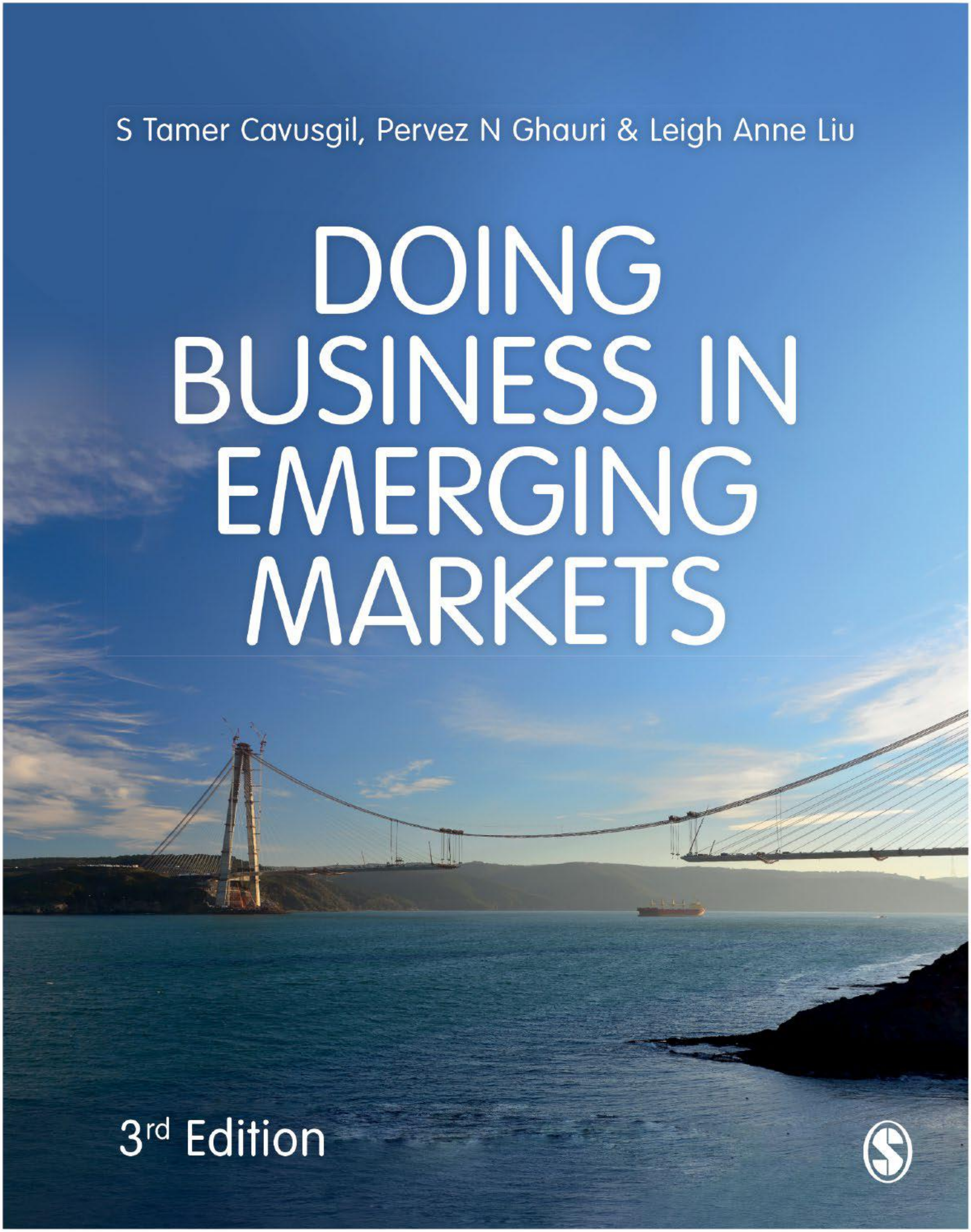
S Tamer Cavusgil, Pervez N Ghauri & Leigh Anne Liu

DOING BUSINESS IN EMERGING MARKETS



3rd Edition

DOING BUSINESS IN EMERGING MARKETS

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Contents

Praise for *Doing Business in Emerging Markets*, 3rd Edition

'This third edition of *Doing Business in Emerging Markets* by Cavusgil, Ghauri, and Liu provides fresh perspectives on these dynamic, rapidly transforming economies. The authors offer multi-disciplinary perspectives on the fundamentals of their rise, and prospects for their future in view of the global pandemic. Numerous original cases, authored by colleagues in various emerging markets, make the book especially suitable for higher education. Readers will find numerous examples of fresh perspectives and helpful teaching notes that enrich this book.'

Peter J. Buckley, OBE, FBA, FAcSS is Professor of International Business, University of Leeds and director of the Centre for International Business, University of Leeds, UK

'Emerging markets continue to be a major agenda of business, even after three decades of their prominence. Cavusgil, Ghauri, and Liu's newest edition of their book provides a solid review of their evolution, attractions for business, practical advice on working with emerging market business partners, and more. The addition of a large number of original case studies, covering different emerging markets and diverse sectors, is a welcome feature. The book is highly recommended for both scholars and practitioners of emerging markets.'

Jagdish N. Sheth, Charles H. Kellstadt Professor of Business, Emory University, USA

'With its rich range of global contexts and perspectives, *Doing Business in Emerging Markets* offers readers a potent set of case studies that will spur not only new ways of thinking about our world, but also new ways of acting within it. The book's presentation of different cultures' approaches to strategy, execution, and even the shape and meaning of enterprise, serves not so much as a snapshot of today's world, but a preview of the forms, norms, and ideals that will shape our world and lives in the coming decades. A work of global breadth and intellectual depth, this intriguing new book provides academics and practitioners invaluable insight into the powerful new set of players emerging in our shifting global landscape.'

Ming-Jer Chen, Leslie E. Grayson Professor of Business Administration, The Darden School, University of Virginia, USA

'Having led global operations of a major multinational company, I know that doing business in highly dynamic emerging markets can be challenging. This book provides an essential understanding of the economic and commercial environment in these diverse markets, and lays out specific strategies for partnering with and working in emerging markets. Highly readable and concise treatment of the topics make the book a requisite reading for practitioners and scholars of emerging markets.'

President, Coca-Cola International, and Executive Vice President, The Coca-Cola Company, (ret.)

'Insightful, data driven. A go-to guide for business development in the emerging markets.'

Xianqin Lisa Wallace, former Senior Vice President, Malaysia Airlines

'The new edition of *Doing Business in Emerging Markets*, by Professors Cavusgil, Ghauri, and Liu, fills a major gap in the international business literature. As widely known and respected experts on emerging markets, the authors provide an authoritative and comprehensive book with contemporary perspectives on the topic. The book's many excellent features include its analytical frameworks, tools, and best practice insights which, along with the addition of 13 original cases, make it especially suitable for classroom use. The authors' practical treatment of market potential assessment in emerging markets, makes the book equally relevant and valuable for managers as well.'

Saeed Samiee, Collins Professor of Marketing and International Business, The University of Tulsa, USA

'Nothing remains the same in Emerging Markets. A contemporary, multidisciplinary treatment of the new realities in these rapidly transforming economies was long overdue. Fortunately, the author team of Cavusgil, Ghauri and Liu delivered an authoritative book on emerging markets, addressing their past evolution, current challenges and future prospects in view of the global health pandemic. The book is enriched by 13 original cases about doing business in emerging markets, making it an ideal text to use in the business curriculum.'

Ying Zhu, Professor of International Business and Director, Australia Centre for Asian Business, University of South Australia, Adelaide, Australia

About the Authors

S. Tamer Cavusgil currently serves as Fuller E. Callaway Professorial Chair and Executive Director, Center for International Business Education and Research (CIBER), J. Mack Robinson College of Business, Georgia State University, Atlanta, USA. A trustee of Sabanci University in Istanbul, Turkey, Tamer is also a visiting professor at Leeds University Business School, UK, and The University of South Australia Business School.

Professor Cavusgil has been mentoring students, executives, and educators in international business for the past four decades. A native of Turkey, his professional work with the International Trade Center (WTO) has taken him to numerous emerging markets for training and exporter development projects. Recognizing the importance of emerging markets for Western firms, he developed the *Emerging Market Potential Index* while serving as the CIBER director at Michigan State University (https://globaledge.msu.edu/mpi).

Tamer has authored more than several dozen books and some 200 refereed journal articles. His work is among the most cited contributions in international business. Google Scholar lists him among the top scholars in the world in emerging markets, international business, international marketing, and export marketing. Various reviews have listed him as one of the most influential and prolific authors in international management. Google Scholar indicates over 47,000 citations as of late 2020 (h-index of 90).

Tamer holds an honorary doctorate, *Doctor Honoris Causa*, from The University of Hasselt, Belgium (May 2014), and an honorary doctorate from the University of Southern Denmark (October 2017). In April 2018, Tamer was honoured with the title Honorary Professor by Atilim University in Ankara, Turkey.

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Pervez N. Ghauri completed his PhD at Uppsala University (Sweden) where he also taught for several years. Over the years he has worked at Manchester

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Pervez has published more than 30 books on international business and international marketing topics, and more than 100 articles in top level journals such as *Journal of International Business Studies*, *Journal of World Business*, *Journal of Organizational Behavior*, and *International Marketing Review*. His books include *Internationalization of the Firm*, *International Business Strategy*, *International Business Negotiations*, *Project Marketing*, and *Research Methods in Business Studies*. He consults and offers training programmes to a number of organizations such as BP, Airbus Industries and Ericsson.

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Leigh Anne has been a visiting professor at the University of South Australia, the University of Toulouse in France, and Peking University and Nanjing University in China. She has consulted for Fortune 500 companies and the non-profit sector on conflict management and multicultural competency projects. Leigh Anne has taught courses and workshops for undergraduate, MBA, MIB, EMBA, PhD, DBA, and high school students on the topics of international negotiation, multicultural competency, global management, and cross-cultural research.

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Dr Mourad Dakhli is Professor of International Business at Georgia State University and holds a PhD from the Moore School of Business at the University of South Carolina. His research focuses on the value-generating processes of human and social capital across different cultural and institutional settings with implications on innovation and entrepreneurship. He is active in business case research and in the scholarship of teaching & learning. Dr Dakhli held leadership and faculty positions in Africa, Middle East, Europe and Asia, and has extensive experience in managing capacity development projects around the world. Dr Dakhli has earned certifications in Six Sigma Black Belt, Business Analytics, Master Teacher, and Master Online Teacher.

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Cuneyt Evirgen is Director of Executive Development Unit at Sabanci University (SU) and practice faculty member in the Sabanci Business School. Dr Evirgen holds BSc degrees both in Electrical Engineering and Mathematics and MBA degree from Bosphorous University, Turkey and PhD degree in marketing (with minor in international business) from Michigan State University, USA. He runs custom and open enrolment programs in exec ed as well as professional non-thesis graduate programs at SU. His expertise and teaching focus on Marketing Strategy and Retailing. In regards to experience in retail, Dr Evirgen, was a Board Member at Teknosa Inc. (www.teknosa.com) during 2005–2012 and Vice President during 2012–2018. He has also been an independent Board Member at Cilek Mobilya Inc. (www.cilek.com) and at Carrefoursa Inc. (www.carrefoursa.com) during 2012–2018. Dr Evirgen is also the academic consultant of the Retailing Sectoral Assembly of the Union of Chambers & Commodity Exchanges of Turkey since 2007. In 2010, he has received the Outstanding Alumni Achievement Award given by MSU Eli Broad College of Business.

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Preface from the Authors

Emerging markets – rapidly transforming and dynamic economies – have been the focus of numerous firms in search of market and growth opportunities over the past four decades. The term 'emerging' actually describes a phase in the evolution of economies characterized by rapid economic transformation, market liberalization, and impressive gains in competitiveness. This phase, often accompanied by significant social and political change and urbanization, is subject to acceleration, deceleration, and even interruption. Its duration also varies for different economies. For this reason, although emerging markets share many similarities, each experiences a unique journey.

We wrote this book as the world experienced one of the most devastating disruptions in the history of mankind, the global pandemic of 2020. The ensuing global recession caused much hardship and ushered in a new global economic order, yet the phenomenon of rapid economic transformation and the story of emerging markets remain very relevant. Despite having to endure economic shocks, emerging markets continue to be highly dynamic and full of market potential.

With an amazing alleviation of poverty and steady rise of middle-class households, income levels are escalating, and emerging market consumers are striving to raise their living standards to the same level as those in advanced economies. Most are keen to buy Western products and adopt contemporary lifestyles. Such advanced economy firms as VW, BMW, and Citibank, as well as many luxury brands, are already generating the bulk of their revenues from emerging markets. Clearly, the share of the global consumption accounted for by emerging markets is on the rise and expected to grow steadily. As the share of global consumption accounted for by emerging markets continues to increase, so will global competition for resources and capital. To help alleviate this intensifying contest, we expect more emphasis on the rapid deployment of new technologies, the sustainable use of resources, and collaborative business models.

This book provides a primer on the evolution of emerging markets, their firms, and consumers. Individual chapters provide the essential knowledge, and the accompanying cases illustrate the rich experiences of firms doing business in these economies. The cases, covering a wide range of emerging markets, serve to showcase specific industries and topical contexts.

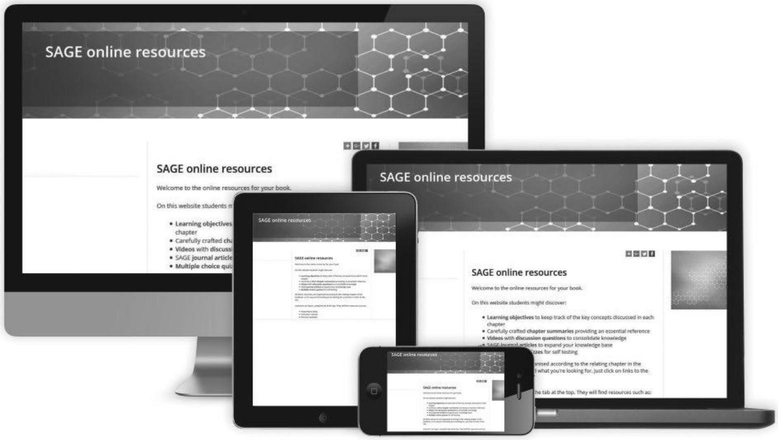
We trust that the book will be of interest to students, scholars, practitioners, and policymakers eager to grasp a comprehensive understanding of the contemporary trends in emerging markets. Readers should find the writing clear, concise, and accessible.

We wish to acknowledge the highly valued assistance of several individuals in the preparation of the book. Dr Maria Luiza Pinho provided skilful research assistance and exhibited design creativity with almost all of the exhibits featured in the chapters. We received exceptional editorial guidance from Mr Sebastian van der Vegt of Untold Communications. His contribution to the development of the chapters was invaluable. Having lived and worked in emerging markets for much of his career, his practical insights and experience helped shape the flow and content of the book. Additionally, Mr Frank Armstrong was very helpful in reading and editing the manuscript. Finally, we are thankful to the team at SAGE Publishing who provided excellent editorial guidance in the preparation of this book.

We trust that you will enjoy the story of the fascinating economies we call emerging markets!

S. Tamer Cavusgil
Pervez N. Ghauri
Leigh Anne Liu

Online Resources



Doing Business in Emerging Markets, 3rd edition is accompanied by online resources for instructors to help support teaching. These resources are available at: https://study.sagepub.com/cavusgil3e

For Instructors

- Easily **integrate the chapters** into your weekly chapters with the **PowerPoint slides** created by the author team.
- **Support wider reading and research** for students with the help of the useful links provided, including **key publications and web resources**.
- **Encourage further discussion** of the case studies within the text with the **teaching notes** provided by the case author teams.

PART ONE

FOUNDATION CONCEPTS

1

Emerging Markets – Setting the Stage

The Cuckoo Clock

In the 1949 film *The Third Man*, the character of Harry Lime, memorably played by Orson Welles, opines: 'In Italy for thirty years under the Borgias, they had warfare, terror, murder, bloodshed. They produced Michelangelo, da Vinci, and the Renaissance. In Switzerland, they had brotherly love, five hundred years of democracy and peace, and what did they produce? The cuckoo clock.'

The point he's making is that times of peace and security are not necessarily conducive to great innovation, whereas adversity can often accelerate its development, as well as opening up a range of commercial opportunities, as established players struggle in altered conditions. Thus, the near constant warfare occurring in Italy after 1400 coincided with great merchant families, like the House of Medici in Florence, developing banking systems that spurred great works of art and science. Although it should also be recognized that Switzerland's challenging Alpine topography and climate have moulded a resilient national character, reflected in that country's enduring economic success, the cuckoo clock is a pretty impressive piece of engineering too, and paved the way for the country to become a hub for world-leading luxury watch-making.

A better comparison between countries responding to challenges, might be the Netherlands and Venezuela. Much of the Netherlands is below sea level, and it operates without a strategic competitive advantage except in its proximity and connections to the main European markets through North Sea ports and its location at the mouth of the River Rhine. Venezuela, on the other hand, with a tropical climate, holds the world's largest oil reserves,[1] and is accustomed to receiving vast revenues in exchange for a commodity requiring little labour or innovation to bring it to the market. Today the Netherlands, occupying a land mass the size of the US state of Maryland, is the number two exporter of food, as measured by value, in the world, second only to the United States, which has 270 times its landmass,[2] whereas Venezuela has been a net importer of food since the 1930s[3] and now struggles to feed itself, having succumbed to what is effectively a dictatorship, leading to a mass exodus from the country.

There are of course numerous historic, geographic, and environmental factors explaining why one country outperforms another, but confronting difficulties, whether political or climatic, is often a formative experience for any nation. Likewise, on a personal level you may find challenging times bring out the best in you. This explains why 'tough love' is considered a hallmark of good parenting, and why, similarly, sportspeople say, 'no pain no gain'. It's also the case that in business, necessity is the mother of invention, and firms that respond rapidly to shifting circumstances in an interdependent global economy will survive to thrive when the good times eventually return.

This book aims to untangle the rewards and challenges and chart opportunities for doing business in emerging markets and growth economies. These markets have often been associated with higher uncertainty, turbulence and volatility, yet they also present tremendous opportunities. Moreover, as the recent Covid-19 crisis has shown, this uncertain global operating environment is not confined to emerging markets.

The McKinsey Global Institute revealed that emerging market economies accounted for almost two-thirds of the world's GDP growth and more than half of new consumption between 2003 and 2018, albeit economic performance among individual countries varied substantially. The authors anticipated that these economies, overall, would represent 62% of total consumption growth between 2015 and 2030, the equivalent of $15.5 trillion. These calculations are being reconsidered in the wake of the pandemic, but it demonstrates the vast wealth that has already been accrued in these markets.[4]

More than ever, businesses that are adept at operating in a VUCA (Volatile, Uncertain, Complex, and Ambiguous) environment, and can adjust rapidly to an altered trading environment, are likely to prosper. Global business is shaped by technological drivers, interconnectivity, and disruptions that contribute to risk and uncertainty. Just as in Italy under the Borgias, and in a country such as the Netherlands, however, great feats can be achieved when people are put to the test.

As a businessperson, you exist in an interdependent global economy. You cannot ignore what is happening in what may seem like far-away locations. Competition is now global for many firms, disruptions in distant supply chains can have a major impact, as can sudden geopolitical and regulatory shifts. Moreover, you don't want to miss out on an opportunity to expand your business globally and take advantage of rapidly changing consumer habits, trends, and preferences.

As mentioned, emerging markets now make up a rapidly rising percentage of global GDP, and any firm with genuine global ambitions must assess the opportunities they offer. At the same time, serious businesspeople will benefit greatly from a thorough assessment of both the risks and the opportunities in emerging markets prior to doing business there. This includes analysis of, among other factors, rapidly changing technological and demographic trends, new or existing industry 'hubs', geopolitical relations, access to services, goods and labour, as well as the unique cultural backgrounds of each trading environment.

This book will provide comprehensive and objective coverage of doing business in emerging markets, adopting a treatment that is analytical rather than descriptive. We also adhere to an interdisciplinary approach, drawing on the varied lenses of economics, history, politics, anthropology, and others. The rise of emerging markets is significant not simply because of increased cross-border trade and investment, but because of its impact on the societal, political, and cultural trends of a converging global system.

The contents of this book should be helpful to executives, students, and educators of international business, as well as regulators and general readers, eager to gain an edge in their understanding of emerging markets. Clearly, the rise of these rapidly transforming markets around the world over the past three decades is one of the megatrends of this century. Their story of creating wealth, forming middle classes, triggering new lifestyles, and shifting global trade and investment patterns is highly compelling. It is our hope that you will find it instructive.

The Global Pandemic of 2020 – Just Another Disruption?

As of the time of writing of this book, the world is in the middle of a global health emergency caused by the Covid-19 virus. How long it will last, and what impact – both financial and social – it will have on our society and on the pace of globalization remains to be seen. What is clear is that, even if the effects of the crisis pass quickly, the era of dealing with multiple crises and unforeseen events is likely to stay with us for some time. In this context, it is useful to begin the book with a look back at the events of the last few months, and examine the lessons learned for the next time something similar happens.

To recap: in late 2019, a novel coronavirus disease (Covid-19), caused by severe acute respiratory syndrome Coronavirus 2 (SARS-CoV-2) was identified in China. It is early days in terms of predicting the long-term social and humanitarian consequences of this pandemic, but scientists are already busy developing a possible vaccine and cure. The scaly, anteater-like animals called pangolins may have been the missing link in the zoonotic transmission between bats and humans hosts,[5] beginning with the unfortunate, and thus far anonymous, Patient Zero.

It is suspected that the outbreak originated in the so-called 'wet markets' around Wuhan in China, where many different wild animals are sold alive as delicacies to eat, and for their supposed medicinal benefits. The rapidity of the contagion now comes as a shock in a world connected by air travel as never before, although it now appears that an early projection of an infection fatality rate of 0.9% was significantly wide of the mark.[6] On 11 March 2020, the WHO declared a global pandemic. A shocked official said: 'We have never before seen a pandemic sparked by a coronavirus. And we have never before seen a pandemic that can be controlled at the same time.'[7]

Having brought severe dislocation and thousands of deaths in China, the pestilent wave first struck neighbouring countries, such as South Korea, before reaching Europe, the United States and the rest of the world. The vast majority of casualties are over the age of 70, with most suffering from underlying morbidities, especially obesity and heart disease.[8] The real danger of contagion is within older and infirm people. The rapidity of the spread has brought unprecedented measures to protect these risk categories and prevent intensive care units and hospitals from being overwhelmed. This has led to the curbing of basic liberties in advanced economies, emerging markets and even developing countries.

Ubiquitous global air travel facilitated the spread of the contagion, requiring government interventions. Moreover, citizens of many advanced economies, especially the United States and Europe, are often unwilling to accept government interference in their lives. The adoption of any kind of 'lockdown', whereby citizens are confined to their homes, save for going out to purchase necessities, or compulsory quarantine, where a person presents a risk of further contagion, poses enforcement difficulties over the long term in democratic societies.

US President Donald Trump, after initially dismissing the disease as nothing worse than a bout of 'flu, announced that the US would ban travel from the EU and other countries to the United States. Congress quickly passed a $2 trillion stimulus package to counter the devastating economic consequences of a steep stock market crash. The economic stimulus, signed into law on 27 March 2020, was the largest ever of its kind, and came even as half the nation was in a 'shelter at home' lockdown.

In the developing world, the full effects of the crisis remain unclear. According to *The Economist*, as of late March 2020 foreign investors had pulled $83 billion from emerging markets since the crisis began, the largest outflow ever recorded.[9] While market flight was easy for investors, even

Foreign Direct Investment (FDI) looks set to suffer, with some estimates expecting as much as a 40% decline in 2020 over 2019 (www.gfmag.com/topics/blogs/emerging-markets-bear-brunt-covid-19-blow). In addition to economic hardships, underdeveloped medical facilities and general lack of preparedness were expected to bring serious difficulties for populous emerging markets. Yet, despite the lack in preparedness, emerging markets often have a youthful population – the median age in Africa is under 20 for example – and a resilient population accustomed to dealing with crises of various kinds.

Among the emerging markets, responses to the crisis have varied. For example. In Brazil, President Jair Bolsonaro's initial response to rising Covid-19 cases was loose and miscalculated. As the number of cases increased, the economic indexes worsened. With some reluctance, the government and Congress launched an emergency package comprising $30 billion to help the most vulnerable, to support companies in keeping jobs and to fight the disease. Despite the government intervention, a damaging economic impact from the cessation of much commercial activity and people fearfully staying inside is inevitable. At the same time, denials of the pandemic worried Argentina and neighbouring countries. They feared Brazil would become the epicentre for the pandemic's spread in the South American region, carrying other countries with it.[10]

The initial stages of the pandemic also sparked fears that emergency measures taken by governments all around the world would become normalized, with profound implications for the survival of basic liberties, including entrepreneurship. Writing in *The Financial Times*, Yuval Noah Harari argued:

> Humankind is now facing a global crisis. Perhaps the biggest crisis of our generation. The decisions people and governments take in the next few weeks will probably shape the world for years to come. They will shape not just our healthcare systems but also our economy, politics and culture. We must act quickly and decisively. We should also take into account the long-term consequences of our actions. When choosing between alternatives, we should ask ourselves not only how to overcome the immediate threat, but also what kind of world we will inhabit once the storm passes. Yes, the storm will pass, humankind will survive, most of us will still be alive – but we will inhabit a different world.[11]

As with most crises, there will be losers and winners, both at the country and industry level. While China was initially hit hard by the pandemic, the country's ability to quell the outbreak was impressive, further cementing its status as a 'mature' emerging market. Other emerging markets with younger populations and at different stages of development experienced the crisis differently.

The ability of emerging markets to cope with the crisis, through authoritarian measures or voluntary means, seems likely to determine their capacity to attract long-term investments and capitalize on trading opportunities.

On an industry level, certain sectors, such as the airline industry, were hit immediately, but were also first in line for government bailouts, as a national airline is considered a long-term strategic asset. Other industries, like the cruise ship industry, with an annual revenue of $46 billion prior to the crisis,[12] seem unlikely to be supported, and could be seriously damaged. Business calls in the US for a government rescue package were initially met with resistance as most of the companies are headquartered in tax havens such as Panama, meaning they contribute little tax revenue to nation states.

Finally, one of the long-term effects of Covid-19 is likely to be on the international financial system that emerged after World War II out of Bretton Woods. Unprecedented government stimulus packages are bringing about staggering levels of sovereign debt that could lead to inflation and the devaluation of reserve currencies. Ironically, we seem to be seeing a convergence between the levels of debt associated with emerging and advanced economies.

Lessons Learned

As is the case with any crisis, the context in which the 2020 global pandemic occurred significantly influences the long-term implications for companies. At the time of the crisis, the US and China were already involved in an advanced trade war, with the US seeking to lower its dependence on China's vast manufacturing base. Emerging markets were, on balance, performing relatively well, with the burgeoning middle classes driving economic growth.

The disruption caused by the Covid-19 virus will have profound implications for the economies of both emerging and developed markets. Here are some of the main takeaways.

1. The interdependency of national economies has multiplied the magnitude of disruptions

The global pandemic of 2020 emphasized the extent to which we operate in a globalized context of interdependence, where new opportunities follow periodic crises. The very factors which have allowed the global economy to prosper over the course of the previous half century (including liberalization of markets, and increased trade and mobility), have also allowed the virus to spread around the globe at an alarming pace. Moreover, global supply chains have been disrupted, and an economic downturn has been felt in nations not immediately affected by the pandemic. Overnight, the tourism and hospitality industries were among those most seriously hit, but they were by no means alone. For instance, farms in Europe complained of a lack of seasonal workers, who were unwilling to travel to areas hard hit by the virus.

The question of whether the crisis will ultimately spur increased or decreased international collaboration remains up for debate. The crisis has underlined the interdependencies of nations, reminding us that 'we're all in this together', and this sentiment may influence future collaboration on issues like trade and the environment which will, in turn, influence the international business climate for years to come.

2. Risk mitigation and management processes become the most critical leadership function in the organization

Companies doing business in emerging markets have long known that flexibility, speed and adaptability are the keys to success. In a crisis, the time available to react to disruption shrinks dramatically. Big multinationals, like those listed on the Fortune 500, are used to slower decision-making processes and risk averse structures. These structures have been tested during the Covid-19 outbreak. The chances are that some business practices employed by these firms in emerging markets – where they are more accustomed to dealing with crisis management – will now become the norm in their developed market operations as well. This should lead to greater speed, agility, and flexibility among multinationals going forward. As a minimum, the task of risk management – anticipating and mitigating potential adverse events – will be the most critical task of senior management and the directors, whether of for- or not-for-profit organizations.

3. How firms and governments respond to disruptions has larger societal impact

In the aftermath of the Covid-19 outbreak, commentators have pointed to the outsized influence that decisions made during a crisis – by governments and by businesses – will have on society in the years to come. Numerous decisions taken in the heat of battle, so to speak, will impact on the future distribution of wealth, safety nets for unemployed and medical emergencies, supply chain and production decisions, tax rates, carbon emission targets, and inflationary pressures, among other issues.

For example, many firms that lost an ability to source directly from China shifted operations elsewhere during the crisis, with indigenous producers among the beneficiaries. After the crisis, few firms will want to revert to old ways of doing things. Similarly, Governments will find it hard to reverse both popular emergency benefits and tools to monitor their populations to give them greater control. As a result, data privacy is likely to take a back seat, as we consent to more centralized control.

4. The way the world uses technology is changing

In recent years, many firms have learned to use information technology to ever greater effect. Storage in the cloud is commonplace, the Internet of Things (IOT) has become a household name, and new technologies like blockchain and videoconferencing are becoming routine. The 2020 global pandemic has accelerated the pace of adoption of change. With many workers obliged to stay at home due to the constraints, videoconferencing has become the norm, as enterprises develop new approaches that do not require face-to-face contact. As we have observed all over the world, educational platforms quickly turned to online tools and media for students from kindergarten to college.

Internet Protocol (IP) traffic increased by 70% in Italy, and 40% in Poland and Spain. Simultaneously the consumption of voice data increased 25% in the US and Spain. This posed a challenge for telecommunications networks to optimize traffic and avoid bandwidth stress.

Once this health emergency passes, it seems likely that many of these habits will endure, and the businesses that adapt the fastest are likely to find themselves best placed to take advantage. What the outbreak underlines is that change is a constant in a period of rapid technological transformation, with new environmental and political challenges reshaping societies in myriad ways.

Rationale for this Book

As the Covid-19 case study shows, the world we inhabit today is strikingly different to that of 20 years ago. Growth and change are exponential, driven by rapid advancements in technology. As we speak, entire industries are undergoing profound transformations in the wake of advances in artificial intelligence, machine learning robotics, the Internet of Things, genomics, blockchain, 5G networks, 3D printing, to name but a few. These will also help transform emerging markets in the decades to come. Just as many Africans' first phone has been a mobile and not a landline, emerging markets can often bypass other developmental stages and introduce new technologies directly, unencumbered by legacy technologies. In many ways, the emerging markets, leap-froggers in nature, will be among the first to embrace innovations and new lifestyles.

Today a rising middle class of millennials, with Generation Z following in their wake, are shaking up aspects of life their parents took for granted, all around the world. Success in a turbulent commercial arena depends on your versatility and a capacity to recognize sound business decisions when, and where, these arise.

Over the course of the forthcoming decades, we expect that much of the world's economic expansion will occur in emerging markets, more accurately defined as 'growth economies'. Although a degree of volatility appears to have returned in recent times, along with geopolitical tensions, market reforms are now deeply embedded in many of these societies. Once thought of as backward and 'low tech', these countries have witnessed rapid transformations at all levels of society. Through new technologies and production techniques, powerhouses such as China, Brazil, and India have emerged as prime locations for production. Also, within these countries purchasing power has risen dramatically, bringing into play large and discerning internal consumer markets.

Parallel to this growth, these countries are also rivals to one another. While much of the developed world in the Western Hemisphere has seen rates of economic growth flatline, due to high production costs and labour inflexibility, growth economies continue to expand rapidly, with young and increasingly well-educated populations the driving force. Thus, in the 21st century, the focus of international business has shifted towards analysing emerging markets, and the opportunities these present.

Just as new technologies are bursting into life at a pace that is often mind-boggling, as a business you cannot afford to dismiss developments happening in a distant part of the world. New technologies and the new business trends these bring – just like the 2020 global pandemic – will arrive whether you like it or not. Like the proverbial ostrich that buries its head in the sand in the face of danger, by ignoring what you are uncomfortable with you are exposing yourself to greater difficulties in the long-term. Ignore the global nature of trade and investment at your peril.

The magnitude of emerging markets and the vibrant populations these countries contain make them a permanent feature in the global business landscape. The challenge is to recognize in advance where commercial opportunities lie and how to take advantage in a way that doesn't conflict with the long-term direction, and indeed interests, of society. This requires a broad knowledge of the kind of challenges you will meet, including the cultural differences, which endure in spite of our global shrinkage. In a knowledge economy such as we have entered, it pays to know the distinct opportunities and challenges that emerging markets present, and the relationships that you must manage if you wish to compete in any given country, or utilize the unique skills and capabilities of the workforces there.

Who Will Benefit from this Book?

Way back in the 17th century Francis Bacon wrote that 'knowledge is power'. Thus, this book is designed to empower you and your business with the knowledge to understand and manage the complexity of an interdependent global marketplace, where emerging markets now play an increasingly central role. Another leading thinker, Benjamin Franklin, said that time is money, and we suggest that reading this book will be time well spent.

With this third edition of *Doing Business in Emerging Markets*, our aim is to present an analytical treatment of emerging markets (EMs) highlighting the key challenges of firms and managers in doing business there. We hope that this edition will provide an enlightened perspective on the EM phenomenon – its meaning, evolution, and significance.

As authors, we have also strived to present a concise treatment of the topics involved. As a major update, we have included over a dozen cases illustrating real-world practices and managerial decisions. These cases – all original and written by authoritative experts – cover circumstances from a wide variety of emerging markets.

Anyone, from thoughtful executives, students and educators of international business to regulators and general readers, is likely to appreciate the lessons that can be drawn from this book.

Organization of the Book

This third edition of *Doing Business in Emerging Markets* is divided into three parts. Part One addresses foundational concepts. Chapters 2 and 3 elaborate on the nature of emerging markets and trace the remarkable journey these countries have travelled in transforming their economies.

Part Two focuses on the potential of emerging markets and presents practical approaches to assessing their attractiveness for globalizing businesses.

Part Three is comprised of three chapters. Chapter 6 enlightens the reader on the practical challenges arising from operating within emerging markets. These include risk management, partnering strategies with local firms, and government relations. Chapter 7 provides a comprehensive discussion of negotiation strategies and conflict management in the emerging markets context. Finally, Chapter 8 presents an overview of the key take-aways from the book, and considers the future challenges of operating in emerging markets, including greater demand for social accountability and sustainability.

Notes

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2

What is an Emerging Market?

Kongdan Oh remembers life growing up in South Korea in the 1950s, when per capita annual income was about US$100. A civil war divided the country into North and South, ruining the economy of both, as millions of families were separated or relocated. His family, which came from the North before the war, settled in the South at the tip of the peninsula in Busan, to escape possible retribution from the authorities in the North. He recalls:

> Food was sometimes scarce in the 1950s. In the springtime, after the autumn harvest had been eaten and before new crops could be gathered, poor people in the pre-urbanized time would scour the hills for edible herbs and plants – just as they do in North Korea today. Schoolrooms lacked desks and chairs and had little heat in the winter.

As the 1950s progressed, South Korea's economy slowly recovered. Foreign aid alleviated poverty and provided a catalyst for economic growth. By the early 1960s, President Park Chung-Hee had launched an economic and social development plan, called the New Village Movement, and the economy began to see an upturn in fortunes, although the lives of ordinary people barely improved until the 1970s. By the time of Park's death in 1979, income had risen to over $1,700 per annum. Life was still difficult, but it was definitely getting better. The Korean economic miracle achieved under Park Chung-Hee's leadership is a story of dazzling national transformation from poverty to wealth, built on the foundation of external aid, a strong work ethic, and pragmatic economic policies. In contrast, totalitarian North Korea, despite similar cultural traits, at least so far, has conspicuously failed to lift its people out of poverty.

Any society wishing to advance economically requires a crucial cultural ingredient, without which all plans are worthless, namely a strong work ethic. This may be a bottom-up process, as in the United States, or it can even occur through top-down imposition, as was the case in the Soviet Union, which became a superpower after World War II, but faded as the combination of propaganda and repression proved insufficient to galvanize the economy in the long term. Either way, any country aspiring to economic growth requires dedicated workers.

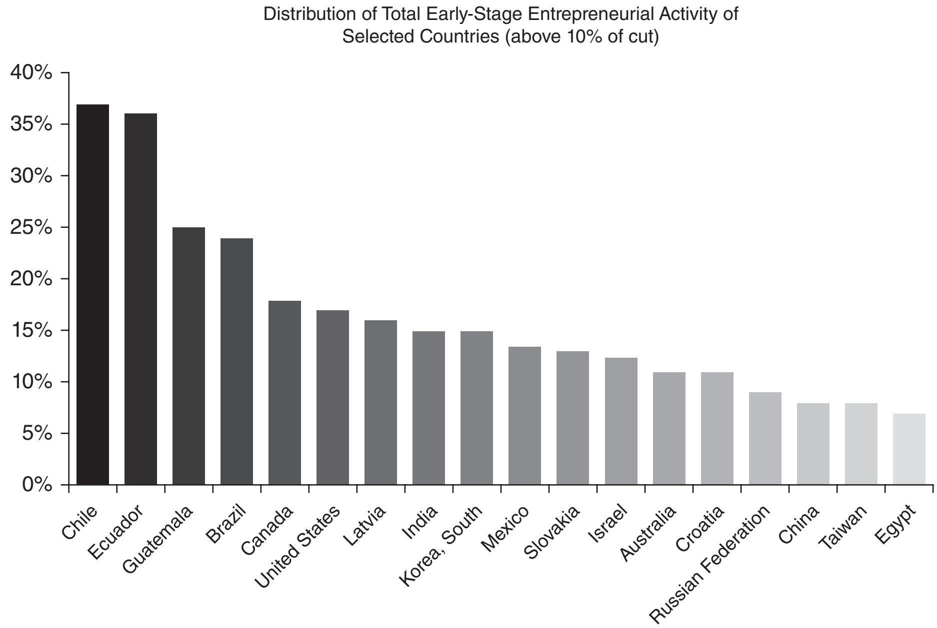
Importantly, however, for that success to endure, workers must also demonstrate ingenuity, adaptability, and flexibility. These qualities are only likely to be present when the reward of being able to purchase consumer goods and services is available; in other words, a capitalistic system which rewards a recognizable 'middle class' with disposable incomes. Therefore, it seems that any emerging market economy firstly requires a culture of hard work for an upturn to occur, and, then, enough incentives for workers to do that little bit extra to make a business entity profitable, and ultimately capable of competing in an integrated global market.

Another crucial catalyst for economic growth in any economy is entrepreneurial spirit. Working independently, Max Weber (in the 1890s) and Joseph Schumpeter (in the 1910s) both argued that certain economic and non-economic institutions are necessary for vigorous and healthy capitalism.[1] Later they elaborated on this, indicating that capitalist institutions are a necessary but not a sufficient condition for this outcome. The missing element, they argued, is the 'spirit of capitalism' according to Weber, or the 'civilization of capitalism' in Schumpeter's words. By this, they were referring to the role of entrepreneurs, whom Swedberg[2] defines as 'individuals who are driven to be creative in economic affairs by their own motivation – not by pressure from the outside and from institutions'. These are individuals who are willing to take business risks in the hope of profit.

Weber and Schumpeter predicted that healthy capitalism could be jeopardized, or even cease altogether, without sufficient entrepreneurial activity. More recently, a host of researchers have reinforced the contention that entrepreneurs create new businesses and these, in turn, foster employment, competition, productivity, and overall prosperity.[3]

Indeed, as emerging markets began to liberalize and transform their respective economies, they witnessed a substantial increase in entrepreneurial activity. Economic dynamism fostered new business start-up activity. As the emerging markets (EMs) began to build a robust middle class, consumers began to demand a host of new products and services, facilitating entrepreneurial start-ups. Exhibit 2.1 illustrates that, in general, early-stage entrepreneurial activity in emerging markets surpasses comparable levels in advanced economies. Chile and Ecuador stand out as outperformers in new business start-ups.

Exhibit 2.1 Entrepreneurial Activity in Select Emerging Markets, 2019



Source: Calculated by the authors based on *Global Entrepreneurship Monitor* survey data (2019).

Bearing in mind the factors we have just discussed, in this chapter we delve into the constituents of emerging markets, distinguishing these from advanced economies, frontier markets and developing economies. By the end you should be able to recognize how, in the wake of seismic events such as the end of World War II (1945) and the Cold War (c. 1990), certain countries have risen from the ashes of war and poverty to assume a position at the top table, while others have stumbled.

McKinsey estimates that, over the next two decades, most of the world's growth is expected to occur in today's emerging markets, noting that 'By 2025, more than half of the world's population will have joined the consuming class, driving annual consumption in emerging markets to $30 trillion, from $12 trillion. Emerging markets could account for more than 70% of global economic growth during this period'.[4]

McKinsey's research further shows that the largest companies headquartered in advanced economies currently derive only 17% of their revenues from emerging markets, even though these markets already represent 36% of global GDP. Moreover, despite advantages in scale, technology, and access to capital, multinationals often lose out to more nimble local competitors.

Time will tell whether the global pandemic of 2020 will alter these calculations, and shake up the global economy to the detriment of some, and the benefit of others, or if we have entered a new economic epoch in which more localized commerce predominates. In any case, emerging markets seem likely to rebound more rapidly than advanced economies given the natural advantages they enjoy, including a young and increasingly well-educated labour force and ample natural resources. This will create huge opportunities for those who are willing to negotiate the undeniable risks.

Characterizing Advanced, Emerging, Frontier, and Developing Economies

It is helpful to distinguish emerging markets from other groupings of countries – advanced, developing, and frontier economies. Profiles of each country grouping category are illustrated in Exhibit 2.2. Each category – developing, advanced, frontier, and emerging markets – possesses distinct opportunities for businesses, alongside common, inherent risks. By recognizing and analysing a country in terms of its stage of economic development, any manager will gain valuable insights into the relative purchasing power of its citizens; the level of sophistication of its business sector; and the nature and scope of its commercial infrastructure, among other factors.

The world map represented in Exhibit 2.3 identifies the country groups which we examine in this chapter – advanced economies, developing economies and frontier economies, as well as emerging markets.

Exhibit 2.2 Profiling Country Groups

Advanced Economies: These are post-industrial, sophisticated economies featuring relatively high average incomes, competitive industries, and well-maintained commercial infrastructures. Among them are the world's wealthiest nation states, including Australia, Canada, Germany, Japan, New Zealand, the United States, and most European countries.

(Continued)

Emerging Markets: Also referred to as emerging market economies, these are former developing economies that have industrialized, modernized, and achieved rapid economic growth since the 1980s. The main distinguishing features of emerging markets are a legacy of rapid improvements in living standards and a growing middle class with rising economic and societal aspirations. As a result, EMs are attractive destinations for international trade and investment.

There are approximately two dozen countries that fall into this category, found mainly in Asia, Latin America, and Central and Eastern Europe. The largest economies among them are Brazil, Russia, India, and China (for whom the acronym BRIC was invented). In addition to the BRICs, leading EMs include: Chile, the Czech Republic, Poland, Indonesia, Mexico, Malaysia, Philippines, Thailand, Turkey, South Africa, and Vietnam. Another group of countries, while initially referred to as EMs, have now achieved substantial sophistication in key sectors and are now best categorized as advanced economies. These are: South Korea, Israel, Taiwan, Singapore, and Hong Kong. Each has developed world-class companies that now compete globally.

Frontier Markets: A frontier market is a country that has advanced further economically than developing economies, but is still in a transitional phase prior to being defined as an emerging market economy, and thus carries greater inherent risk. Frontier markets may also be referred to as 'pre-emerging markets'. Examples include: Central Asian countries such as Kazakhstan; several Middle Eastern countries – Bahrain, Kuwait, Tunisia, Oman; and Egypt, Morocco and Nigeria in Africa.

Developing Economies: These are low-income countries where limited industrialization has occurred and poverty tends to be endemic. This is the largest category of countries in terms of population in the world, and includes Bangladesh, Nicaragua, and Zaire.

Exhibit 2.4 overviews distinguishing features of the country groups. In this table, we have called attention to those 'mature' emerging markets that have transformed their economies into fairly competitive ones, with world-class companies. For all practical purposes, these countries have 'graduated' and moved into advanced economy status, even though most sources still refer to them as 'emerging'. We consider the following mature emerging markets: Hong Kong, Israel, South Korea, Singapore, and Taiwan.

We also created a category, 'Other', for countries that do not quite fit any of the standard categorizations. An example is Saudi Arabia. Even though this is a high per capita income country, it does not have a market economy and features an autocratic regime. This group of countries also includes many small island economies, or otherwise idiosyncratic states.

It can be noted that developing economies contribute least to the world's GDP, and citizens subsist on meagre incomes. Their disposable income,

Exhibit 2.3 Map of the World Depicting Advanced Economies, Emerging Markets, Frontier Economies, and Others

Sources: Prepared by the authors based on data from the World Bank, www.worldbank.org; the International Monetary Fund, www.imf.org; the International Organization of Motor Vehicle Manufacturer www.oica.net; and Worldmeters www.worldometers.info

which is the proportion of personal income spent on items other than food, clothing, and housing, is very limited. Regrettably, poverty still prevails among a high percentage of the world's population. Poverty is also geographically concentrated; Sub-Saharan Africa was home to 27 of the world's 28 poorest countries in 2015. The total number of extremely poor people in this region amounted to some 413 million people in 2015.[5] The unfortunate combination of low incomes and generally high birth rates leads to significant levels of poverty in these countries.

Exhibit 2.4 Key Differences Among the Country Groups

Dimension	Advanced Economies	Mature Emerging Markets	Emerging Markets	Frontier Markets	Developing Economies	Other
Representative Countries	Canada, France, Japan, United Kingdom, United States	Chile, Israel, Hong Kong, South Korea, Macao, Poland, Singapore, Taiwan	Brazil, China, India, Indonesia, Turkey	Bulgaria, Romania, Nigeria, Ukraine, Morocco, Croatia,	Angola, Bolivia, Nigeria, Bangladesh	San Marino, Burundi, Saudi Arabia
Approximate Number of Countries	27	8	18	37	30	69
Population (% of world)	13%	1.4%	55%	12.5%	9.6%	8%
Approximate Average Per-Capita Income (U.S. dollars; PPP basis)	$46,274	$17,206	$8,386	$10,149	$1,618	$8,991
Approximate Share of World GDP (PPP basis)	43.1%	2.2%	42%	6%	2%	5%
Population (millions)	996.29	103	4.176	994.57	727.24	623
Telephone Lines per 1,000 People (mobile)	3,230	17,501	2,016	4,397	1,703	5,524
Secure Internet Servers per 1,000,000 People	1,364,379	234,392	133,878	333,857	3,333	193,689
Percentage of Individuals using the Internet	85%	41%	54%	62%	18%	37.57%
Motor Vehicles per 1,000 People	511	214	213	227	27	91

Source: Prepared by the authors based on data from the World Bank, www.worldbank.org; the International Monetary Fund, www.imf.org; the International Organization of Motor Vehicle Manufacturers www.oica.net; and Worldmeters www.worldometers.info.

Exhibit 2.4 also expresses the countries' technological development. In this respect, the developing economies are in their infancy, whereas the emerging markets are rapidly catching up on advanced economies. Technology can be defined as the knowledge and application of tools, techniques, systems, and methods of organization in the service of industry, science, or the arts. Technology underpins economic development, and includes not simply hardware – whether computers, telephones, or industrial machinery – but also educational systems, workers' skill base, and banking infrastructure.

Information and communications technologies (ICTs) have had a tremendous impact on the progression of advanced economies and emerging markets, aiding knowledge acquisition, as well as raising workers' productivity. The lack of access to such technologies in most developing economies often explains why they lag behind the rest in terms of education and economic output. Let us now discuss the four country categories in greater detail.

Advanced Economies

Most advanced economies, such as the US or the UK, have developed from primarily manufacturing bases, into increasingly sophisticated, and largely service-based economies. Containing a mere 17% of the global population, they have long been the dominant business players internationally. Today, they account for about 40% of the world's GDP, over half of world trade in material goods, and about two-thirds of trade in services. Of the Advanced Economies, G20 countries account for some 77% of the world merchandise traded in 2019.

All advanced economies have democratic structures and avoid one-party rule. In general, their economic systems are based on capitalism, although many maintain welfare states and guarantee a basic standard of living for all residents. Collectively, these countries have huge purchasing power, with few curbs on international trade and investment, especially within trading blocs such as the European Union. They are home to the world's largest multinational enterprises (MNEs). Advanced economies include the United States, Canada, and Japan, as well as many European Union states, and the United Kingdom.

Developing Economies

Developing Economies were previously referred to as underdeveloped or Third World countries. These terms were, however, imprecise, and even potentially offensive as, despite weak underlying economic indicators, developing economies tend to be rich in historical and cultural terms.

Most developing economies are held back by high infant mortality rates, widespread malnutrition, short life expectancies, prevalent illiteracy, and dysfunctional education systems. Thus, for example, 50% of children do not complete a primary education in many African countries. Since there is a strong correlation between education and economic development, this contributes to persistent poverty. Also, a lack of adequate healthcare facilities is a major stumbling block. It is worth bearing in mind that the vast majority of the 38 million people living with HIV are located in low- and middle-income countries, and an estimated 68% live in sub-Saharan Africa. The same is true for other endemic illnesses such as malaria. Naturally, this disease burden significantly hinders these countries' developmental prospects. Many adults are unable to work, or even care for their children, and require significant, ongoing medical treatment, which is often non-existent. This results in productivity stagnating in many sectors, and a vicious circle of grinding poverty.

Another feature of developing economies is that most of these states are severely indebted to external creditors. Indeed, many African, Latin- and South-American and South Asian countries have accumulated debts that approach or even exceed their annual gross domestic product, meaning it would require the combined national earnings of a whole year to pay off their sovereign debts. Moreover, a variety of institutional barriers that inhibit entrepreneurship, trade, and investment tend to hold back many African countries. This, along with excessive bureaucracy and red tape, often deters firms from investing in these countries, preventing them from participating in the global economy.

Frontier Markets

Some ambitious global players have discovered that their opportunities for further growth and expansion are declining in established emerging markets such as Brazil, Russia, China, or India, which are becoming more costly bases for operations, and where new restrictions on trade and enterprise are emerging. This means multinationals are paying greater attention to low-income, high-risk countries, both as potential new markets for their goods and services, and also as platforms from which to export elsewhere.

Frontier economies are 'up and coming' economies in the developing world. They exhibit the promise of upgrading to an EM but are constrained by several handicaps, including political instability, debt, weak institutions, and inadequate commercial infrastructure. Examples include: Central Asian countries such as Kazakhstan, Middle Eastern countries such as Bahrain, Kuwait, Tunisia, Oman, and Egypt, and Morocco and Nigeria in Africa. Some Frontier Markets are home to untapped reserves in minerals, gas and oil, and other natural resources.

Frontier economies are generally characterized by faltering prosperity and corrupt regimes. In fact, these countries score typically among the most corrupt in Transparency International's Corruption Perceptions Index. Thus, countries such as Bulgaria, Turkmenistan, Nigeria, and Venezuela suffer from high perceptions of public sector corruption and arbitrary enforcement of rules and regulations. Frontier economies score lower than 3 on the Polity IV[6] in terms of 'executive constraints'. This measure is used widely by economists to assess the extent of institutionalized constraints on the decision-making power of country leaders.

Defining Emerging Markets

Terms such as 'emerging economy, 'emerging markets' and 'rapidly industrializing nations' are often used interchangeably, which can lead to confusion. The term 'emerging market' was first used by Antoine van Agtmael,[7] an economist at the World Bank, at the end of 1980s, to refer to fast-growing economies with rapid industrialization.

Emerging economies are perhaps better conceived as 'growth markets' or 'growth economies', since their most conspicuous characteristic is sustained economic growth. The term 'emerging market' is indeed something of a misnomer, since most of the original ones are now fully-fledged competitive economies, and in a post-emergent phase. Taiwan, South Korea, Israel, Singapore, Hong Kong are such examples. Each has a sophisticated economy and is home to world-class companies such as Grupo Bimbo, InBev, Infosys, Embraer, Huawei and Yildiz Holding (owner of the Godiva Chocolates).

Other original emerging market economies, such as Nigeria, Egypt, Pakistan, and Venezuela have, on the other hand, descended from that status. The most noticeable features of emerging markets include high rates of economic growth, economic modernization and liberalization, and a growing middle class, along with globally competitive home country firms.

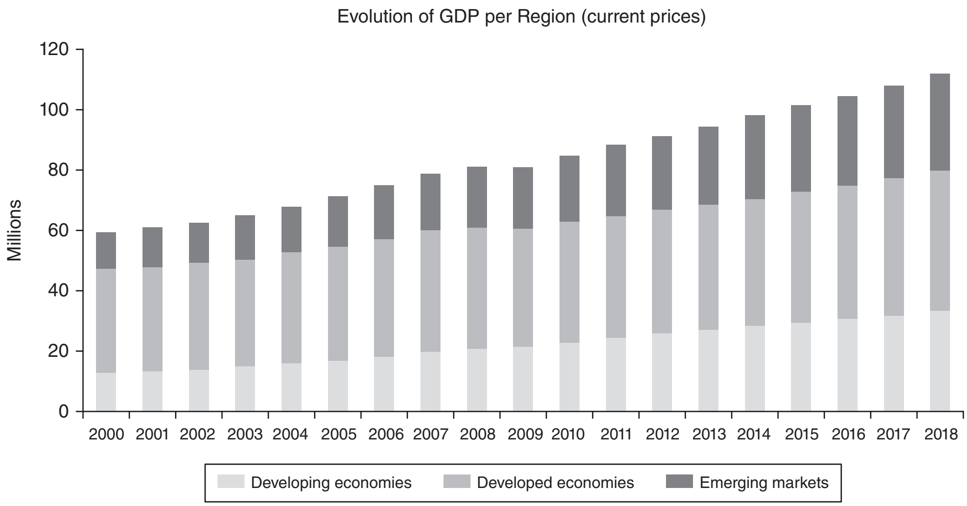
Emerging markets that best fit the definition are those undergoing economic transformations through rapid growth and industrialization. During this transformation, they have: (a) begun an economic reform process aimed at alleviating impediments to growth, for example by improving poor infrastructure and reducing overpopulation; (b) maintained steady growth in gross national product (GNP) per capita; (c) displayed a rising proportion of middle-class households; and (d) increased integration in the global economy. Once these trends are evident, they may truly be called EMs.

To differentiate between less developed and emerging markets, consideration is given to economic growth figures as well as advances in living standards. Commitment to sustained growth, continuous efforts to catch up with the industrialized nations and an increased presence in world trade distinguishes emerging markets from developing economies.

According to the McKinsey Global Institute, over the past fifteen years emerging markets have accounted for almost two-thirds of the world's GDP growth and more than half of new consumption.[8] Exhibit 2.5 displays the evolution of GDP in advanced, emerging, and developing economies. Note the steady rise of GDP for the latter two groups of countries over the past two decades.

Yet economic performance varies substantially from country to country. Taking an in-depth look at the high-growth economies and the companies that propel them, McKinsey examined the long-term track record of 71 developing economies to identify the outstanding performers. They found two key factors: (a) a pro-growth policy agenda of productivity, income, and demand that has driven exceptional economic growth; and (b) highly competitive large companies.

Exhibit 2.5 GDP Trends for Advanced, Emerging, and Developing Economies



Source: UNCTAD – GDP Evolution in US dollars at constant prices (2015) in millions.

Note: Please note that the UNCTAD's definition of the country classifications are different to the ones we advocated and used in this book.

Various organizations compile lists of emerging markets for specific purposes. These lists vary in terms of which countries are included as each is selected according to different growth indicators and annual projections. The lists also vary between institutions, as they all use different indicators and alternative growth projections. Exhibit 2.6 displays some examples of emerging market lists generated by different institutions.

The Financial Times Stock Exchange (FTSE)[9] Equity Country Classification March 2020 Interim Update index breaks down stock market indices according to their development level; consequently, the advanced emerging countries are Brazil, the Czech Republic, Greece, Hungary, Mexico, Malaysia,

Exhibit 2.6 Countries Classified as Emerging Markets by Various Sources

Country	FTSE	MSCI	S&P
China	x	x	x
India	x	x	x
Korea, South		x	
Czech Republic	x	x	x
Poland		x	x
Indonesia	x	x	x
Malaysia	x	x	x
Mexico	x	x	x
Philippines	x	x	x
Hungary	x	x	x
Turkey	x	x	x
Chile	x	x	x
Thailand	x	x	x
Russia	x	x	x
Brazil	x	x	x
Peru	x	x	x
Argentina		x	
South Africa	x	x	x
Taiwan	x	x	x

South Africa, Taiwan, Thailand, and Turkey. The secondary emerging countries are Chile, China, Colombia, Egypt, India, Kuwait, Pakistan, Peru, Philippines, Qatar, Russia, Saudi Arabia, and UAE.

The Morgan Stanley Capital International (MSCI)[10] Emerging Markets Index consists of 26 developing economies, namely: Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Pakistan, Peru, Philippines, Poland, Qatar, Russia, Saudi Arabia, South Africa, Taiwan, Thailand, Turkey, and the United Arab Emirates. This classification is based on the size of the companies, and market accessibility. It considers information such as market capitalization, openness to foreign ownership, efficiency of operational frameworks, and the stability of the institutional frameworks.

Goldman Sachs considers BRICs and other emerging markets, referring to the 'Next Eleven' as those economies which will grow rapidly in the 21st century.[11] Their list consists of Bangladesh, Egypt, Indonesia, Iran, Mexico, Nigeria, Pakistan, the Philippines, South Korea, Turkey, and Vietnam. This list is based on macroeconomic and political stability and openness to trade, as well as education levels.

Cavusgil[12] developed the *Emerging Market Potential Index* (MPI) based on indicators such as market size, growth rate, consumption capacity, commercial infrastructure, and country risk. The MPI is especially indicative of the EM's attractiveness as an export market. These measurements are updated regularly and reported on the global EDGE knowledge portal.[13]

A Brief History of an Emerging Market

South Korea's 'Rags to Riches' Story

As we have seen, by the mid-1950s much of South Korea lay in ruins. By the end of the 1960s, however, under the authoritarian leadership of President Park Chung-Hee the country was making significant progress. The willingness of ordinary people to make sacrifices and show a strong work ethic paved the way for an upsurge in the country's fortunes. One of the prominent business leaders, Lee Byung-Chul, founder of Samsung, convinced him to offer favourable tax breaks to select companies. This led those companies to invest in new businesses, and entrepreneurship began to develop within constraints.

Samsung, formally a sugar and flour producer, expanded rapidly, and diversified its business significantly. Owing to its state connections, it was able to acquire cheap confiscated properties. This facilitated rapid expansion into unrelated sectors such as real estate, banking, insurance, retail, and electronics. Tax breaks, cheap bank loans, reduced export-interest rates, allocation of foreign aid materials, and government contracts all allowed Samsung's corporate power to expand significantly.

During the 1970s and 1980s, the government prioritized investment in heavy and chemical industries, involving restrictive licensing arrangements. This meant only select companies, such as Samsung, were permitted to operate in these 'key' sectors. This led to the creation of Samsung Petrochemical, Samsung Semiconductor, and Samsung Heavy Industry, among others.

During a 30-year spell from the 1960s to 1990s, through targeted government investment and entrepreneurship, South Korea was among the fastest growing economies in the world, with conglomerates like Samsung, LG and Hyundai spearheading export-led growth. This has lifted many millions out of poverty, and ultimately engendered middle and affluent classes. Moreover, The Economist Intelligence Unit[14] rated South Korea as the 23rd most democratic country in 2019.

South Korea is not alone, between 1990 and 2013, the number of people living in extreme poverty in the 71 emerging market economies fell from 1.84 billion to 766 million.[15]

In contrast, North Korea, which to this day is under a Communist dictatorship, is mostly closed to the outside world, with a devastating famine occurring as recently as the 1990s, and a combination of propaganda and repression used to uphold the regime.

Elsewhere, since the fall of Communism after 1990 in Central and Eastern Europe, we have seen formerly tightly controlled economies appear as emerging markets, with a culture of entrepreneurship and recognizable middle and affluent classes. In other places, such as Vietnam, we have seen a movement towards more liberalized socialist economies, which have brought seismic change to the international economy.

Less pronounced are the similar movements towards more liberal economic policies in other emerging markets. Traditionally, the emerging market environment has been characterized by protected domestic firms, high tariffs, weak institutions, conglomerates and business groups, and a turbulent climate delaying the entry of MNEs into these countries.[16] In the 1950s, many developing countries maintaining protectionist policies and low levels of export income were faced with the burden of subsidizing their economies through increased borrowing. Inefficient state-owned enterprises, as well as the constricted private sectors in these economies, accelerated an economic downturn, contributing to increased debts that became harder to pay. Many emerging market countries faced a severe economic crisis in the 1990s and had to implement policies ensuring more robust financial systems.[17] Such policies lay behind a rapid recovery from the financial crisis of 2008, with many emerging market countries coming out of that crisis with relatively fewer ill-effects than their counterparts in developed nations.[18] It remains to be seen whether this pattern will be repeated after the economic depression caused by the global pandemic of 2020.

Towards the end of the 20th century, many emerging markets embarked on structural reforms in order to create stability and growth.[19] Thanks to such reforms, many EMs stabilized their economies and started growing rapidly. As EMs adopted relatively liberal approaches to world trade, they continued to integrate further with the global economy.

Economic reforms of EMs have been facilitated by external and internal influences. The regulations of trade institutions such as the WTO or credit-providing agencies such as the IMF have significantly contributed to these reforms. Such international institutions recommend and enforce a liberalization of trade, support regulations which contribute to a stable economic environment, and endeavour to ensure that the market system is fair and efficient. Thus, such recommendations lead to the privatization of state-owned enterprises; the deregulation of industries; an opening up of borders to ensure competition; the enforcement of laws for the protection of intellectual property; and the implementation of sound fiscal and monetary policies.[20]

Governments play a significant role in the economic development of emerging markets. Opting to open borders and increase focus on international trade, as well as allocating budgets for the advancement of the economy, have fuelled the growth of EMs. Research from the Heritage Foundation[21] shows that there is a strong positive correlation between economic freedom and prosperity. According to the same study, the best way to improve a country's openness is through policy reforms limiting the role of government. Countries with the most significant improvement in the index (more than 4 points) reached an average economic growth of over 3% from 2018 to 2019.

Faced with high budget deficits, governments were also incentivized to privatize state-owned enterprises. Many of these state-owned enterprises were a burden on the state budget. These enterprises – often very large – generally suffered from weak management, while also preventing fair competition in their respective sectors.[22] With adequate planning and effective budgeting, some EM governments were also able to direct their budgets to develop the infrastructure necessary for economic growth.

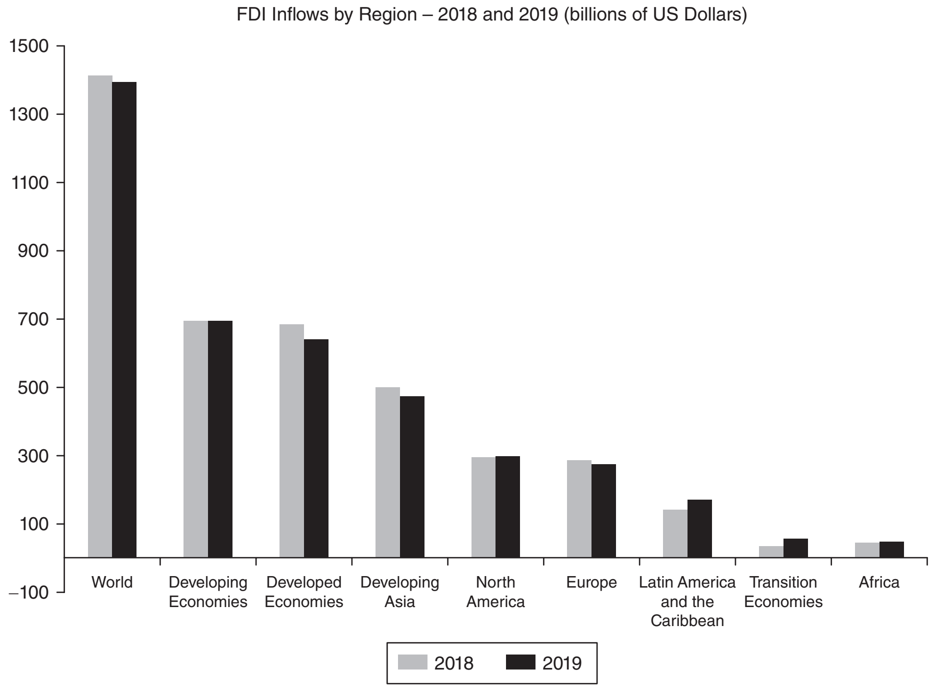
The active participation of governments in economic activities can often be explained by ambitious developmental goals and historical factors.[23] A government may be involved indirectly through centralized economic planning or directly through ownership of economic enterprises. The active economic role played by governments in emerging economies is evident in the private sector's ability to accumulate the capital required for certain investments, in national and economic security issues, and in subsidizing a particular sector. The share of state-owned economic enterprises (SOEs) in most emerging economies is quite substantial, although the privatization of government-controlled enterprises over time has reduced their importance in countries' national economies.

Most EM governments have tended to minimize state interference in the economy and allow for market-based solutions. A strong performance during the global financial crisis enabled India to become one of the 10 largest economies in 2010.[24] China's economic stimulus package in response to that crisis amounted to approximately US$590 billion and emphasized infrastructure projects, while compelling financial institutions to increase the availability of credit. This enabled the country to avoid the worst effects of the crisis.[25] Hence, especially in response to a crisis, preconceived notions about the superiority of market-led responses and dogmas regarding non-intervention in economies by governments are subject to greater challenge.

The economic growth rates of emerging markets are higher than those of advanced economies. However, high economic growth often leads to significant fluctuations as well as high inflation rates. Some multinationals historically avoided emerging markets due to the volatility associated with such markets. On the other hand, policy reforms in these markets leading to improved fiscal and monetary policies, as well as stronger financial markets, have reduced volatility significantly. Indeed, as shown in Exhibit 2.7, transformational economies continue to attract a substantial flow of foreign direct investment. Another factor which has decreased volatility is liberalization. As markets are integrated into the world economy, external earnings diminish external debt. Moreover, output is not significantly affected by rapid changes in policy or in consumer demand within the domestic market, as companies are able to function in an open economy. Greater liberalization also gives rise to the development of financial institutions.[26]

Recent policy changes in emerging markets indicate growing concerns around environmental and social protection, which has resulted in limitations in some industries and a larger involvement by states in some cases.[27] To an extent, this is a product of their success in producing recognizable middle classes that are more educated about the world in general, including climate change, and more health conscious, with clean air and water becoming growing concerns. Currently, even though reliable investment conditions are emphasized, governments are also focusing on regulations which honour specific international agreements, ensuring environmental safety as well as appropriate corporate conduct.

Exhibit 2.7 Foreign Direct Investment Inflows by Regions[i]



Source: Prepared with data from UNCTAD – Foreign Direct Investment: Inward Flows, annual, https://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx

Note: [i] United Nations Conference on Trade and Development – UNCTAD (2020), 'Global FDI Flows Flat in 2019, Moderate Increase Expected in 2020', 20 January, 2020,. https://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=2274

Why Should You Study Emerging Markets?

There is no question that the global pandemic of 2020 will adversely impact cross-border trade and development. Together with rising nationalist sentiments in many countries and the erection of trade barriers, these disruptions have dampened growth prospects in emerging markets in the near to medium term. However, in the long term these trends are unlikely to be interrupted.

As we will elaborate in later chapters, the trends that make emerging markets attractive for international firms are enduring. These countries continue their journey towards higher standards of living, playing catch up with advanced economies and acting as an engine of economic growth for the world economy. McKinsey forecasts that by 2025 overall global consumption will reach $62 trillion, twice its 2013 level, and fully half of this is predicted to come from these economies. In 2010, the global 'consuming class' – people with disposable incomes of more than $10 a day – comprised 2.4 billion people, just over a third of the world's population. By 2025 that figure is predicted to have risen to more than half the world's population. Taking population growth into account, that means there will be an extra 1.8 billion consumers, the vast majority living in emerging markets.

For international managers looking to sustain growth, cut costs and launch new products and industries, emerging markets represent a tremendous opportunity. Despite literacy and education levels rising, skilled labour in these countries is still relatively inexpensive. Over forthcoming decades, hundreds of millions of new middle-class consumers in these emerging markets will have the disposable income to purchase Western goods and services. International firms can even enhance their offerings in these new markets. The old notion of emerging markets as inherently risky for foreign businesses no longer holds true, at least relative to advanced economies, which experience their own difficulties. Conditions are continuing to stabilize in emerging markets, and our ability to predict and manage risk has improved.

For manufacturers, the story is even more compelling. By some estimates, emerging markets will provide the market for 65% of the world's manufactured goods by 2025.[28] This consumption includes basic commodities, as well as of capital-intensive goods such as cars, building materials, and machinery, which is driving the transition. By 2013, emerging markets already accounted for 59% of global demand for building materials, 57% for iron and steel, and 47% for machinery.

Many factors contribute to an increased focus on emerging markets in international business. Some of the key factors are as follows:

1 The size and sophistication of these economies justify marketing campaigns. Over 56% of the world's population reside in emerging markets and these consumers cannot be ignored. Including the frontier economies, this figure would be 69%. In fact, many innovative marketing campaigns and go-to-market strategies have come from within emerging markets in recent years.
2 Many emerging economies are investing in infrastructure development, especially in transportation, power and communication. This has helped bring down the costs of selling in emerging markets.

3 Though some emerging markets have highly differentiated structures, demand forecasting has become easier, with professional consulting and advertising organizations well established in most locations.
4 Many of these economies have developed or accessed technologies that allow them to compete globally. Also, an increasing number of managers are now training using modern management tools, making production and planning far more straightforward than heretofore. Unencumbered by legacy technologies, emerging markets often have the luxury of immediately implementing the latest available technologies at a lower cost than international competitors.
5 With many governments in emerging economies facilitating foreign direct investment, reaching business agreements is now a less cumbersome process. Though intercultural differences remain, many managers recognize the value of creating global 'win–win' relationships and alliances. Even though recent years have witnessed global trade wars – between the US and China in particular – regional trade pacts are flourishing, including in Africa, Asia Pacific and Latin America.
6 The information superhighway of the Internet now provides abundant information on emerging markets, facilitating more efficient business strategy formulation. As indicated, their ability to convert directly to the latest technological advances often works to their advantage.
7 Emerging markets are also now home to significant multinational companies that compete globally. As a result, innovations are occurring in these locations rather than arriving from more advanced economies.
8 The populations of emerging economies are often more resilient in confronting periodic crises, and workers may also often show more of a 'can-do' attitude when confronting new work practices or changes in conditions by comparison with their counterparts in advanced economies. This is a fact of life that many firms from advanced economies can learn from and apply when attempting to develop better coping mechanisms in the face of market uncertainties and gaps in the rule of law.

Multiple Facets of EMs

While we may associate emerging markets status simply with rapid economic growth, parallel developments also generally occur in these societies, including political reforms, more varied forms of cultural expression, changing lifestyles, education, and greater urbanization. Economic development paves the way for other megatrends: movement to urban areas; political