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Introduction

THE WORLD IS FOCUSED on emerging markets.[1] The liberalization, growth, and globalization of these still-nascent economies have made them tremendous sources of interest, opportunity, and anxiety over the past twenty years. For households, emerging markets are a source of cheap consumer goods. For frustrated computer users, they are often the location of outsourced technical support. For executives of multinationals, emerging markets are growth drivers amid stagnation and financial crisis in developed economies—and the home turfs of powerful new corporate competitors.

In the first six months of 2009, the FTSE International Emerging Markets Index was up 41.1 percent, whereas the FTSE All World Developed Markets Index was up 7.2 percent. China, India, and Brazil have reported robust and significant growth during this period as the developed world struggled to recover from financial crisis.[2] For companies drowning in the crisis, these markets have offered life preservers of capital and growth. For upstart entrepreneurs and well-established companies alike, emerging markets are becoming testing grounds and incubators for innovation. For entrepreneurs, business leaders, and citizens in emerging markets, this newfound global standing is a great source of pride.

For some workers in the developed world, however, these markets are a source of job security angst. This anxiety has only increased in the wake

of the financial crisis and recession in developed markets. For others—such as Wall Street investment bankers displaced by the U.S. financial crisis—emerging markets can be havens of new job opportunities. For new university graduates and young professionals in emerging markets, this growth has created tremendous opportunities and recalibrated career aspirations.

For politicians and pundits in the developed world, emerging economies are both derided as the destinations of offshored jobs and pitched as prospective customers for vaunted innovative products and green technologies of the future. For national treasuries in the developed world, the savings held in emerging markets have helped finance government deficits. For politicians from all over the world, emerging markets figure prominently in global trade and multilateral agendas. For environmental and labor rights activists, the rapid industrialization and undeveloped safeguards in these economies are cause for serious concern.

In a small but telling sign of a growing perception that emerging markets were both important and distinctive, the *Economist* in 1994 began including a page of emerging market economic and financial indicators at the back of each weekly issue. The rationale for the feature, the editors noted, rested on a simple premise: "Rich industrial countries dominate the world economy rather less than they used to."[3] In 2007, the *Economist* discontinued the feature, lumping the world's major economies together in a single table of indicators.[4] Whether the change was made for substantive reasons or simply to save space, the place of emerging markets in the global economy changed dramatically in that thirteen-year period.

Consider a few items that appeared in that 1994 issue of the *Economist* in which the emerging market indicators debuted. The magazine's summary of the week's news included a capsule noting the enactment of the North American Free Trade Agreement (NAFTA), linking emerging market Mexico more closely with its more developed northern neighbors—the United States and Canada.[5] One article forecast that India would be "a power in its own neighbourhood but its frail economy and its physical isolation between the Himalayas and the sea will almost certainly keep it out

of the global competition" to be among the world's preeminent powers.[6] A two-page advertisement touted companies from Taiwan, noting, "Many of the computers crunching numbers and making their reputations on Wall Street are made in Taiwan. That's right, Taiwan."[7]

Since then, agreements similar to NAFTA have dismantled trade barriers in many emerging markets. India's economy has boomed, in part by leveraging global communications technology that renders moot many of the challenges of its "physical isolation." The promotional advertisement rebutting the incredulity that Taiwan could produce sophisticated computers is now almost laughable: four of every five personal computers now produced by contracted manufacturers are made by Taiwan-based firms.[8]

What Is an Emerging Market?

As economic globalization has brought down trade and investment barriers and has connected far-flung countries in integrated global supply chains—and emerging markets seem to be converging with the world's "rich industrial countries"—distinguishing these economies from developed markets may seem to matter less than before. We disagree. One fundamental premise of this book is that businesses still need to distinguish emerging markets—collectively from developed markets and individually from each other.

But what, really, is an emerging market? The term *emerging markets* was coined by economists at the International Finance Corporation (IFC) in 1981, when the group was promoting the first mutual fund investments in developing countries.[9] Since then, references to emerging markets have become ubiquitous in the media, foreign policy and trade debates, investment fund prospectuses, and multinationals' annual reports, but definitions of the term vary widely (see table I-1).

The term is often reduced to the unhelpful tautology that emerging markets are "emerging" because they have not "emerged." To understand emerging markets, we need to consider carefully the ways in which they are emerging and the extent to which they are genuine markets.

TABLE I-1

Frequently used criteria for defining emerging markets

Category	Criteria
Poverty	Low- or middle-income country Low average living standards Not industrialized
Capital markets	Low market capitalization relative to GDP Low stock market turnover and few listed stocks Low sovereign debt ratings
Growth potential	Economic liberalization Open to foreign investment Recent economic growth

Source: Standard & Poor's; International Finance Corporation; Trade Association for the Emerging Markets; J. Mark Mobius, *Mobius on Emerging Markets* (London: Pitman Publishing, 1996), 6–23.

If you ask a conference room full of business executives how they would distinguish emerging markets from developed economies, variants of three stories will likely arise. Emerging markets such as Brazil, China, India, and Russia, some will certainly say, are emerging by virtue of their recent fast economic growth. The opening of these large economies to global capital, technology, and talent over the past two decades has fundamentally changed their economic and business environments. As a result, the GDP growth rates of these countries have dramatically outpaced those of more developed economies, lifting millions out of poverty and creating new middle classes—and vast new markets for consumer products and services. Large, low-cost, and increasingly educated labor pools, meanwhile, give these markets tremendous competitive advantage in production, and information technology is enabling companies to exploit labor in these markets in unique ways.[10]

Other executives will focus on emerging markets as emerging competitors. On the macro level, a landmark Goldman Sachs report published in 2003 forecast that the economies of Brazil, China, India, and Russia could grow to be collectively larger than the G-6 economies

(United States, Japan, United Kingdom, Germany, France, and Italy) in U.S. dollar terms before the middle of the twenty-first century.[11] Commentator Fareed Zakaria sees this "rise of the rest" as a transformative, tectonic shift in the distribution of global power.[12] Companies based in these economies, meanwhile, are already challenging multinationals based in the developed world—and not only in their home emerging markets. China-based Lenovo's purchase of IBM's personal computer business in 2004 and the acquisition of Jaguar and Land Rover by India's Tata Motors in 2008 are only two examples of the increasing global mergers and acquisitions activity by emerging market-based firms. Some observers see the financial crisis of 2008–2009 as an inflection point, accelerating the emergence of these markets as dominant players in the global economy.

A deeper discussion might elicit a list of the persistent headaches of doing business in emerging markets. These markets, the executives might say, are prone to financial crises. Intellectual property rights are insecure. Navigating government bureaucracies can be thorny. Product quality is unreliable. Local talent is insufficient to staff operations. Reliably assessing customer credit is difficult. Overcoming impediments to distribution can be frustrating. Sorting through investment opportunities or performing due diligence on potential partners is often a guessing game. Others might throw up their hands and say that corruption is so endemic in emerging markets that the risks simply outweigh the potential rewards.

Based on many of these signs of emergence, some might say, emerging markets are not distinctly different from other markets; rather, they are simply starting from a lower base and rapidly catching up. Indicators such as the growing numbers of emerging market-based companies listed on the New York Stock Exchange or the growing ranks of billionaires from emerging markets listed annually by *Forbes* illustrate this trend.[13] Behind those indicators, however, is a more complicated story of why firms based in these economies have sought out overseas listings and how those moguls have amassed fortunes in developing countries that are, by many standards, still quite poor.

All these criteria—the indicators of opportunity and the causes for complaint—are important features of many emerging markets, but they do not delineate the underlying characteristics that predispose an economy to be emerging, nor are they particularly helpful for businesses that seek to address the consequences of emerging market conditions. We see these features of emerging markets as symptoms of underlying market structures that share common, important, and persistent differences from those in developed economies.

A fundamental premise of our work is that emerging markets reflect those transactional arenas where buyers and sellers are not easily or efficiently able to come together.[14] Ideally, every economy would provide a range of institutions to facilitate the functioning of markets, but developing countries fall short in a number of ways.[15] These *institutional voids* make a market "emerging" and are a prime source of the higher transaction costs and operating challenges in these markets. By relying on outcome criteria to assess markets, managers often overlook the ways in which emerging markets operate differently than do developed economies. Ranking the world's economies by per capita gross domestic product would suggest that the United Arab Emirates, for example, is among the world's most developed economies, but it is an emerging market nonetheless because of its market structure.

Intuitively, managers know that operating a business in an emerging market is different from doing so in a developed economy. It is tempting to chalk up these differences simply to country context. Indeed, market structures are the products of idiosyncratic historical, political, legal, economic, and cultural forces within any country. All emerging markets feature institutional voids, however, although the particular combination and severity of these voids varies from market to market.

An Actionable Framework

The chapters in this book identify ways in which the uniqueness of emerging markets is shaping the business opportunities and challenges in these economies. We offer a simple actionable framework to help

managers map the institutional context of any emerging market. By developing a granular understanding of the underlying market structure of emerging economies—and not only cataloging symptoms to be incorporated in an overall risk assessment—companies can tailor their strategies and execution in emerging markets to avoid mistakes and outcompete rivals. Familiarity with the framework and toolkits in this book can help organizations address key questions:

- In this particular market, which market institutions are working, and which institutions are missing?
- Which parts of our business model can be adversely affected by these institutional voids?
- How can we build competitive advantage based on our ability to navigate institutional voids?
- How can we profit from the structural reality of emerging markets by identifying opportunities to fill voids, serving as market intermediaries?

In part I of this book, we unpack our structural definition of emerging markets by examining the institutional anatomy of these economies. In part II, we apply this framework to the challenges facing various actors as they manage in these contexts: companies filling voids as intermediaries; multinationals based in developed markets; and domestic companies based in emerging markets, which we call *emerging giants*.

Companies of various stripes face similar strategic choices as they respond to institutional voids in emerging markets.

Replicate or adapt? Institutional voids invariably challenge the execution of business models in emerging markets. Businesses need to determine the extent to which business models can be replicated in emerging markets or adapted to fill institutional voids. Multinationals need to weigh the extent to which they can transfer business models cultivated in developed markets to emerging economies rife with institutional voids or determine how they should adapt. Local companies with global aspirations

can learn from the business models of developed market-based multinationals but also can exploit their local knowledge by developing models based on their intimate understanding of institutional voids in their home markets.

Compete alone or collaborate? Developed market-based multinationals and emerging market-based companies each bring inherent advantages to bear in emerging markets, but each might also gain from collaboration with other parties. Multinationals bring brands, capital, talent, and other resources to emerging markets, and yet their track records in these economies have been mixed. Local knowledge is a particularly valuable asset for firms to exploit in navigating institutional voids, and multinationals need to decide whether some form of collaboration with a local player makes sense for their business. Sharing is a two-way street in such collaborations, however, and multinationals need to weigh the benefits of local knowledge against the risk of empowering a partner that could turn into a well-trained and well-informed competitor. Local companies can exploit their inherent advantage in navigating institutional voids as a source of competitive advantage vis-à-vis incoming multinationals, but these firms can gain capabilities and credibility through global partnerships.

Accept or attempt to change market context? Businesses operating in emerging markets can take the institutional contexts of these markets as a given or can work actively to change them by filling institutional voids. Multinationals based in developed markets can either sidestep voids as best they can or strive to fill them in service of their businesses. Given regulatory constraints and other sensitivities, however, it can be difficult for multinationals to fill some voids in emerging markets. Local companies are in some ways better equipped than multinationals to operate amid institutional voids, but they also can exploit their local knowledge to fill voids and create a barrier to entry and expansion by foreign competitors. As we discuss in chapter 3, changing market context can be an entrepreneurial opportunity in its own right for intermediary-based businesses that fill institutional voids.

Enter, wait, or exit? Based on an assessment of institutional voids, companies need to decide whether to enter and operate in an emerging market, to wait and emphasize opportunities elsewhere, or to exit if they are already in the market. Multinationals can bring their global capabilities to bear in an emerging market or say, "Not now" if the challenges posed by institutional voids are too daunting. Exercising the option to wait is relatively easy for multinationals, because they can choose where to compete and have the resources to move to different markets. Although not entering is not an option for local companies based in emerging markets, these firms do have an exit option. Local companies with capabilities unrewarded in their home market contexts can say, "Not here" and exit their markets early in their corporate histories. Exercising this option is difficult for emerging market-based firms, because often they lack the resources needed to go global soon after their founding. Emerging market-based companies operating in different industries might emphasize opportunities elsewhere by waiting to enter a particular industry where institutional voids are more serious obstacles.

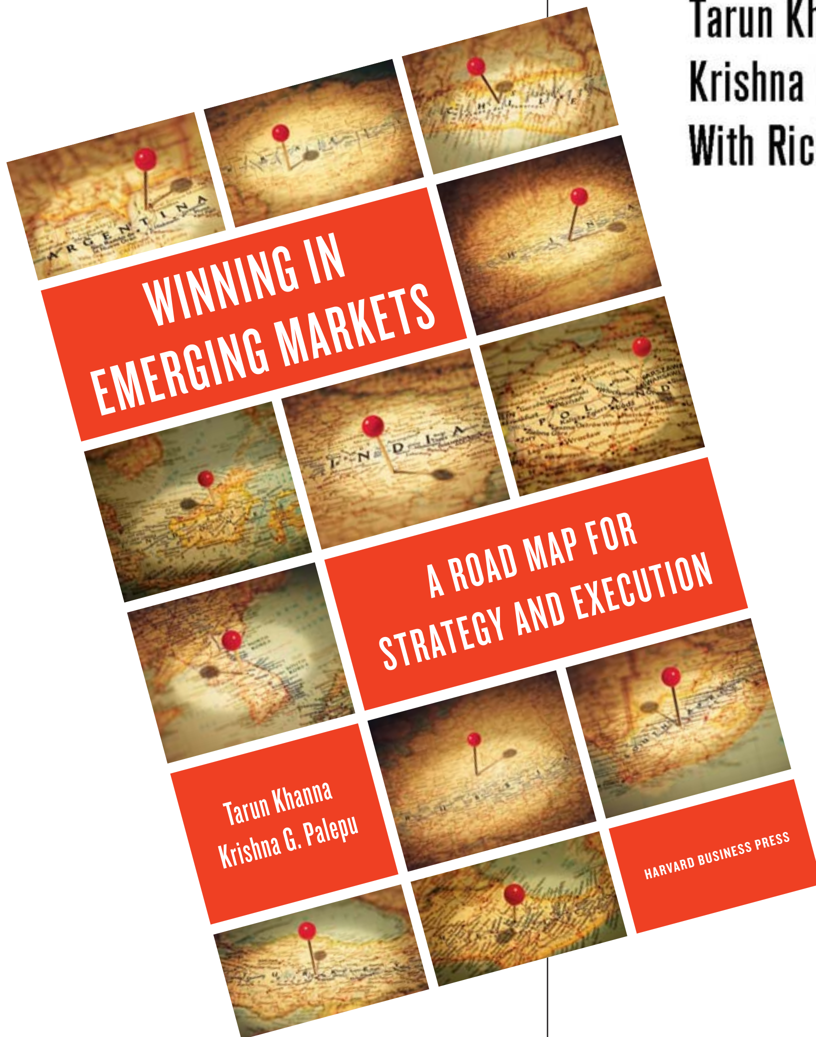
Overview of This Book

Part I (chapters 1 and 2) describes the importance of market intermediaries to businesses in all markets and offers a toolkit for companies operating in emerging markets to spot and respond to institutional voids (see figure I-1). Part II begins, in chapter 3, by looking at how companies can see voids as entrepreneurial opportunities and examines the challenges of building intermediary-based businesses in emerging markets. Chapters 4 and 5 then discuss how developed market-based multinationals and emerging giants from a wide range of industries, operating in a wide range of contexts, have wrestled with the strategic choices above to compete in emerging markets. Chapter 6 looks at how the institutional contexts of emerging markets shape the globalization journeys of emerging giants. We conclude the book in chapter 7 by summarizing an agenda for companies to use in developing and deploying strategies that fit emerging markets.

FIGURE I-1

Book structure and organization

Introduction	
Part I: Conceptual Introduction	Chapter 1: The Nature of Institutional Voids in Emerging Markets
	Chapter 2: Spotting and Responding to Institutional Voids
Part II: Applications	Chapter 3: Exploiting Institutional Voids as Business Opportunities
	Chapter 4: Multinationals in Emerging Markets
	Chapter 5: Emerging Giants: Competing at Home
	Chapter 6: Emerging Giants: Going Global
Chapter 7: The Emerging Arena	



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