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Emerging Markets: Business Opportunities and Risks

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A critical question increasingly on the minds of boards and C-suites today is: What are the risk-opportunity tradeoffs of investing in high-growth emerging markets?

Emerging markets - a term that typically refers to all developing countries—are not a monolith. They are a very heterogeneous group. But the fact is that, as a whole, the average rate of growth in emerging markets for the past decade and a half has been twice that of advanced countries. This trend is unlikely to abate anytime soon. This is why there is increasing interest in emerging markets by advanced economy-based companies: growth in their mature markets is unlikely to have sustained rapid rates for the foreseeable future.

Importantly, the growth differential between emerging and advanced country markets reflect a secular transformation in the structure of the global economy. It is not a cyclical phenomenon occasioned by the recently passed financial crisis or current policy "surprises". This is a fundamental insight that too few boards of directors and corporate executives appreciate.

Unravelling Misperceptions. There are, however, significant misperceptions about the challenges and rewards of doing business in emerging markets. In many cases, the risks are either highly understated or grossly overstated. The same is true with opportunities. Exploiting these misperceptions yields gains from arbitrage.

Let me pose two opposite extremes to illustrate my point. Take China, for example. Many executives believe their companies can-indeed must-do business there, whether on the supply or sales side or both. From my experience, having worked for two and a half decades in China, the investment environment there is far more nuanced and complex than most executives appreciate. Understanding who is the beneficial owner, the 'fuzziness' of property rights, and the timing and nature of regulatory changes is extraordinarily difficult. It's a classic case of a place where the on-the-ground investment risks generally are fundamentally understated.

At the other end of the spectrum, consider Africa. Most board members and corporate managers whom I talk to in developed countries lack accurate information about market conditions on the African continent (or at worse do not want to know). They don't understand that about one-half of the population in sub- Saharan Africa lives in countries where GDP growth, adjusted for inflation, has averaged more than 5 percent per year over the last two decades, or they don't know that there is a burgeoning African customer class that is far more discriminating in judging price-quality tradeoffs in even small-sized purchasing decisions. (And I'm not referring to South Africa alone, by any means). Indeed, a large number believe there simply aren't any realistic investment opportunities in Africa.

At the same time, people see African markets as fraught with excessive risk. There are, of course, appreciable risks of investing in Africa—just as there are substantial risks of investing in Asia, Latin America, the Middle East, the former Soviet Union, and so on. But the perceived risks in Africa are grossly overstated.

New Rivals Threaten 'First Mover' Advantages That Used To Go To Others. It's not just advanced country boards and executives who are pondering investment in emerging markets. Powerhouse multinationals out of China, Brazil, India, and South Africa - among others - are themselves investing across their own and other emerging market geographies. That poses a new competitive challenge to existing and new advanced country firms coming into these markets. At the same time, as we all know, emerging market- based firms are becoming bona fide contenders for market share in developed country companies' own home markets. In short, US, EU and Japanese businesses increasingly are competing not only with their longtime rivals from other developed countries but also with world-class emerging market firms. Grabbing 'first mover' advantages no matter where firms are locating—whether at home or abroad—now requires much greater strategic thinking and agility in decision-making by boards and C-suites than ever.

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The State Still Plays A Changed But Still Prominent Role. There's all too common a belief in the boardrooms and C-suites that governments—especially in emerging markets—have palpably retreated from the marketplace. Not so. States may have changed their 'stripes' but they're still present. This is particularly the case with intra-emerging market trader and investment. Let me give one recent example.

Most of the major footwear firms are headquartered in the advanced countries but produce a majority of their output in emerging markets, such as China, Ethiopia, the Philippines, Thailand, and Vietnam, among others. Today a sizable portion of well-known athletic footwear is produced in China and a considerable amount of it is exported to Brazil. The result is that Brazilian athletic footwear factories feel they cannot effectively compete against the Chinese. So much so that Brazil believes these products are being dumped at artificially low price into the Brazilian market. Consequently, Brazil's government placed a duty on imported Chinese athletic footwear. This ensuing trade war among the governments of two large emerging markets has sideswiped the world's major branded athletic footwear companies, cutting their sales revenues and leaving these companies with little recourse for remedies in the short run.

Ways Forward. In light of these factors how should advanced-country boards and C-suite executives take advantage of the higher growth of emerging markets?

First, there are innovative approaches being used for laser-like reputational due diligence, employing different types of lenses and techniques than conventionally carried out by name-brand due diligence providers and law firms, and especially by using independent, anonymous but verifiable sources.

Second, establishing business-to-business (B2B) alliances can be very powerful avenues to risk-share, and if done between companies in complementary sectors, the relationship can be replicated elsewhere in other countries/region.

Third, business-to-government (B2G) agreements or public-private partnerships (PPPs) are another avenue and can be crafted to expand both the top and the bottom lines.

Fourth be a model of absolute business ethics with modern corruption compliance practices. I'm surprised when companies don't realize that if they simply tell their partners that bribes are just not "on", that their partners more times than not back-off.

This list, of course, is not exhaustive. But it illustrates the type of tactics that, if adopted, can significantly enhance a business' chance to enjoy the benefits of emerging markets' growth while minimizing exposure to risks. The biggest risk of emerging markets could be just ignoring them.