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Emerging Markets in 2010

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Emerging Markets Outlook in 2010

In this edition of the Spire E-Journal, Spire's Group Managing Director, Leon Perera, shares his views on trends that will impact the business and marketing landscape in 2010 and beyond – with a focus on the Asia-Pacific as well as other global Emerging Market regions.

Spire E-Journal (SEJ): *Looking back at the same time last year, it seems like the world has gone to the precipice of total disaster and then returned safely. The economic recovery is well underway in most emerging markets. This has provoked a furious debate about whether the developing world has decoupled from the G3 (USA, European Union and Japan). What's your take on this?*

Leon Perera (LP): There is no doubt that 2009 marked a historic turning point in the decoupling debate. The contrast has never been more stark – between the G3 countries which are all still mired in close-to-record unemployment, albeit recovering now, and the emerging markets, of which the brightest stars (China, India, Indonesia) are growing at a more or less robust clip. I think we need to see this in the right context, but at the same time not underplay its significance.

The crisis is not a sign that the emerging world will overtake the G3 any time soon. Developed countries still account for something like two thirds of global GDP in market exchange rate terms. And due to its deeply-rooted advantages in generating R&D, innovation and entrepreneurship, the USA in particular is likely to recover its old glory. We won't see a situation in our lifetimes where what happens in the G3 becomes irrelevant to emerging markets – or anything close to that. There is still way too much dependence on the G3 for exports, capital, FDI, tourism, aid, technology and innovation.

Having said all that, I think people will look back on 2009 as the year that marked the tipping point in terms of how people look at economic growth in the world. Since 2001, emerging markets have already been generating more than half of global GDP growth. But in 2009, for the first time, emerging markets continued to grow or at least contracted much more slowly, while all three developed zones (North America, Europe,

Japan) were in simultaneous, deep recession. This is historically unprecedented. The contrast with the global economic crises of 2001 and the early 1990s could not be more stark. And of course the great symbolic moment for this was the announcement by the G8 countries that henceforth the G20 (which includes more developing than developed economies) would become the world's pre-eminent economic policy review platform.

SEJ: So are you saying that the rise of emerging economies is not much more than a recognition of something that been gradually building up for a long time? Will this change in perception affect the rules of the game for global companies?

LP: Paradoxically, in the short-term, the big Multi-National Companies (MNCs) will derive the most corporate success from emerging market growth. The reason is that you have to be globally competitive to exploit growth across the emerging markets as a whole, which are tough markets to compete in and dispersed across the globe. The MNCs are best positioned to do so, with established global brands, world-class processes and a fairly developed footprint in emerging markets already. Growth in demand outside of this MNC universe will be claimed by locally-oriented or regionally-oriented firms, but these will tend to be fragmented and compete on price. There will always be exceptions here and there, but the general rule should hold in the short-term.

The pool of MNCs, incidentally, includes many firms which are not in the current Global Fortune 500 due to being held as part of a large conglomerate, being government-linked or being privately-held (ie not listed on a stock exchange). This pool is dominated by firms based in the G3 economies, but there are many based in emerging market regions – not only traditional hubs of entrepreneurship like Korea and Taiwan but also, increasingly, China, India, Brazil, Russia, Turkey, Mexico, Indonesia, South Africa and so on. Think of Lenovo, Tata and Embraer.

Among the MNCs, there will be a profound change in marketing stance. There will be a wealth of new initiatives in product development, marketing and sales conceived for and oriented primarily towards emerging markets. The old model of global campaigns being designed

for the G3 and being adapted for emerging markets almost as an afterthought is becoming obsolete.

But the interesting thing is that many of these initiatives will be driven from the head offices of MNCs rather than from their local or regional offices. Emerging market sales will be seen as so important to the future of MNCs that it will need to be spearheaded from the global HQ. This movement is already underway. In some cases it is fairly well advanced. The global CEO of HSBC Bank announced that he was relocating from London to Hong Kong a few months ago, in recognition of the centre of gravity of global growth.

SEJ: But this is not the first time emerging markets have been hyped. In the 1960s and 1970s Brazil was touted as the next economic superpower, only to become mired in inflation and low growth. In the 1980s and 1990s everyone raved about the “Asian Tigers” who were hit by the Asian financial crisis of 1997. Is the current situation a temporary one that is being exaggerated as a major, permanent change?

LP: It is certainly being exaggerated by those who have a vested interest in selling the emerging market story, and we should be wary of that. But that doesn't detract from the fundamental reality that emerging markets will be powering growth for a long time to come.

The danger of hype goes beyond inaccuracy, though. There is always an over-reaction to new trends once they become apparent. This was the case with E-commerce, for example. But the dot com bubble did not invalidate the internet's transformative power on business and markets.

For the emerging market story, there will be bubbles developing, as short-term money rushes into the stock, financial and property markets in these countries. One can see signs of such bubbles at a nascent stage even now. These bubbles will eventually be burst, but this won't deflect the general trajectory.

SEJ: Is the sun now setting on the West and Japan?

LP: That's an interesting question. The analysis I've outlined above is primarily looking at the short and medium-term. I would say that it applies to the long-term as in the next 10 years or so. But whether this is a historic turning point beyond which the G3 countries can never recover their global lead is much more difficult to judge. If we take a 20 or 30 year horizon, we cannot rule out a strong rebound on the part of the G3, which have incredibly strong fundamentals as well as tremendous reserves (or potential reserves) in terms of technology, intellectual and social capital and military prowess.

SEJ: Spire's E-Journal has devoted a lot of analysis to government fiscal stimulus programs in 2008 and 2009, which were implemented to counter the economic crisis. With economies moving into recovery, will most of these programs be wound down or are we entering an era of more or less permanent Big Government?

LP: I think we are entering an era of big government relative to the era of the 1980s to the early 2000s. Economic policy in the past thirty years, as inaugurated by Reagan and Thatcher in 1980, has stressed fiscal restraint and small government, even if this wasn't always implemented in practice. The pendulum has now swung in the other direction. Government intervention in the economy will have to be more substantial for years, maybe decades to come. The reason for this is not mainly the fall-out from the economic crisis, which is short-term, but rather massive structural challenges facing the global economy and indeed humanity - the aging population and the urgent need to curb climate change. All these will require the government to become more involved in intervening in the economy.

SEJ: Does this mean that governments will be nationalizing private companies?

LP: Rather than the government intervening through government-owned business entities, which history has shown is hard to execute successfully, this intervention will take place through regulation of mechanisms. There will not be a rash of new state-owned entities being created, let alone nationalizations.

But in order to create and run new social programs, for example to retrain seniors to be able to fill vacancies in the modern economy, the bureaucracy will need to expand. So the role of the government as a customer will continue to be significant. We will need to get used to thinking of the government as the biggest B2B customer around, particularly as purchases become increasingly consolidated across government agencies.

SEJ: There is much talk of the government's fiscal stimulus programs piling on problems for the longer-term. Will excessive government borrowing herald a repeat of the 1970s, with low growth, high interest rates and high inflation?

LP: The first point to note is that this fiscal crisis of indebtedness is primarily limited to the G3 economies. It is especially acute in Japan and the USA.

What is inescapable is that these governments will eventually have to pursue a course of either raising taxes, depreciating their currencies or cutting back on fiscal spending drastically. At the end of the day, they will end up pursuing some combination of all three. I expect that raising taxes on the private sector indirectly, for example through carbon emission taxes, will be a major thrust in the 2010s.

There is one avenue for lessening this problem which is usually neglected – selling off state assets to the private sector. I expect we will see an uptick on this front in years to come, particularly in countries which still have large State-owned Enterprises and also high levels of government debt, like India for example. This will stimulate growth in the mergers and acquisitions industry.

SEJ: How will all these economic trends affect demand in consumer and B2B markets in the emerging world?

LP: One of the factors behind the food price crisis of 2008 was the fact that huge numbers of people in China and India had begun eating meat

on a regular basis. Here's another interesting fact: global luxury brands are expanding fastest in emerging economies like China, including vendors of products like yachts and private aircraft. This illustrates two aspects of the situation we are looking at in 2010 when we talk of demand in emerging economies.

Firstly, emerging markets are placing a huge amount of demand onto the global economy for what we can call "basic" products and services such as, to take a random assortment, meat, deodorant, computers, cement and so on.

Secondly, emerging markets are big places population wise, and pockets of demand exist within them that are effectively, at least in some respects, First World regions – the middle-class in First-Tier cities for example, or even the affluent elite in rural areas.

I will not say too much about the first trend, as its imperatives are well known. Emerging economies have placed a huge strain on global commodity markets where supply is limited in the short-term. This has driven the price increases we have seen and will see in categories like oil, natural gas, metals, palm oil and so on. For "basic" manufactured products where supply is not as constrained in the short-term, like computers and mobile phones for example, or processed foods like wine, emerging markets are even more attractive, as they are a huge volume play. Nevertheless we should not forget that what happens in the commodities space will affect the "basic manufactured goods" space in some form and at some point.

The second trend is more interesting and I would like to spend more time discussing that. This trend is what Spire has termed in the past "bi-polarity" in emerging economies - simultaneous growth of high-end and low-end goods and services.

I foresee that the premium space will see a great deal of movement in emerging economies in 2010. This will occur around three very

fundamental types of demand impulses - “positional goods”, leisure solutions and self-improvement solutions.

- **“Positional goods”:** As rising average incomes combine with rising income inequality, there will be a great deal of demand for what economists call “positional goods”. These are goods that derive their value from their scarcity. This is already evident in categories such as luxury fashion-wear and high-end cars. It will extend to more or less all product categories and to a far greater extent than what we now see. To take one example: consumer banking, where we already have several gradations of “priority”, will see more fine differentiations in products over the next few years, catering to an ever more narrowly defined elite, while also servicing other segments who will be incentivized to upgrade into that elite. In 2010 marketers will strive to create ever more products differentiated by relative scarcity, in effect creating more categories of “positional goods”. The key competitive success factor will be the ability to embody exclusivity. Think of the evolution of Platinum, Titanium and Infinity credit cards.
- **Leisure:** As average incomes hit critical tipping points, local consumers will demand more of the leisure options at home that they have experienced during travel abroad. Think of the explosive growth of high-end shopping malls in China and Indonesia, resembling and even surpassing what is on offer in Hong Kong and Singapore. This will stimulate markets such as outbound tourism, performance events, hospitality, digital music and movies, theme parks, recreational facilities and much else. It is sometimes said that fun is serious business. We will see more clubs, theme parks, concerts...as well as busloads of tourists invading the rest of the world, particularly Europe. Of course, consumption of leisure services can also embody the “positionality” I discussed above.
- **Self-improvement:** Concerns about individual education and health are coming to characterize emerging economies, which mostly lack well developed systems of public healthcare and education. These concerns are felt by those who cannot afford private clinics and hospitals, or full-time private schools for their children. This will drive massive demand from the middle-class for private training in skills aimed at enhancing individual career progression, child

development and self-esteem. At the same time, private providers of solutions promising to improve individual health and “wellness” will continue to see growing demand as health consciousness and literacy become widespread. This is good news for suppliers of English language training, distance learning degrees and child tuition and enrichment classes, as well as fitness centers, “wellness centers” and health-food supplement manufacturers.

SEJ: We are entering a new era where success in emerging economies will determine the survival of most global corporations. What do marketers have to do to effectively execute on these big-picture themes?

LP: Probably the most important consideration will be to think global but execute local. In the emerging market context, this means that, while big campaigns are still needed to exploit economies of scale and ensure brand coherence over large geographic spreads, the execution of campaigns will have to be done with respect to local nuances – not only at the country level but down to region, state and city. In the emerging world, while customer segments can be defined to be broad, the media landscape as well as the channel landscape still varies greatly by sub-region. This is in stark contrast to the developed world, where channels and media outlets are highly concentrated. Emerging economies are dominated by unorganized channels and fragmented local media, complicated even further by the enormous growth of online social media and e-communities in recent years. So execution has to be sufficiently localized, which is often not the case right now.

The second major consideration would be to make the right segmentation distinctions when looking at emerging market customers. They should not, for example, be generalized as price-conscious. Distinct segments can be discerned, and these can and should be grouped across countries when designing products. As we discussed above, at least some of these segments would be far more oriented towards conspicuous consumption than value.

There is another point to be made here, a more subtle one. Purchasing behavior is still in flux in emerging countries, given the rapid pace of economic and demographic change in these societies. The same

demographic group may indicate impulses towards positional goods in certain categories at certain moments, while behaving like price-sensitive shoppers in other contexts. This fact, which can be incredibly frustrating to deal with, points to the critical importance of grounding marketing strategy in good intelligence.
