TUCK SCHOOL OF BUSINESS AT DARTMOUTH
GLASSMEYER/MCNAMEE CENTER FOR DIGITAL STRATEGIES

Conducting Business in Emerging Markets

A Thought Leadership Roundtable on Digital Strategies

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An executive roundtable series of the
Center for Digital Strategies at the Tuck School of Business

The Thought Leadership Roundtable on Digital Strategies recently convened for a discussion on doing business in emerging markets. This roundtable, graciously hosted by Česká spořitelna in Prague, focused on effective strategies for developing and leveraging a presence in emerging markets, successful solutions for the inherent organizational issues encountered, and potential efficiencies to be gained from shared services centers of all stripes. While the discussion was on emerging markets as a whole, there was particular focus on Central & Eastern Europe given the location. The sessions included academics and business leaders from A.T. Kearney, Cargill, Česká spořitelna, Cisco Systems, DHL, Egon Zehnder, Erste Bank Group, General Motors, Hasbro, Henkel, IBM, University of Michigan, and the Tuck School of Business at Dartmouth.

Key Insights Discussed in this Article:

The Thought Leadership Roundtable on Digital Strategies (www.tuck.dartmouth.edu/roundtable) publication series is edited by Hans Brechbühl, Executive Director of the Center for Digital Strategies.

Introduction

As global businesses look to emerging markets for growth, sourcing, and outsourcing, best-of-breed strategy and execution in these markets have become crucial to global success.

How should executives think about emerging markets, and in particular key issues like market assessment and entry strategy, operating best practices and leveraging shared services operations? What are the most important cultural, organizational and human capital issues to focus on? And what are the unique considerations in Central and Eastern Europe, as distinct from the BRIC countries (Brazil, Russia, India, and China) and other emerging markets?

Approaches to Entering Emerging Markets

What are the key drivers and approaches for entering emerging markets and how should companies assess and prioritize these opportunities?

The stepping-stone approach

Strategically entering markets using a stepping-stone approach was a common theme of the day. Several participants outlined approaches that leveraged JVs, acquisitions, or market adjacencies to build up a presence in a region. Henkel's Georg Novak walked the group through the strategy his company used in Eastern Europe to reduce market entry risk, beginning with a joint venture in Hungary and culminating in the company's present twenty-plant footprint.

"We started thinking about Eastern Europe in 1984 and tried to start exporting consumer detergents and cosmetics," explained Novak. Rather than build greenfield operations, he said, Henkel developed a staged approach, leveraging joint venture partners.

"We always found some detergent producer with a high market share, production capabilities, and a known brand, and then invested in them, improved the recipes, and slowly substituted premium brands," he added. "We develop the market with a partner and later take over up to 100 percent … you have to start with local brands because washing habits are different from country to country."

Skoda's Martin Taege described how Skoda parent Volkswagen started early in Eastern Europe with a stepping-stone approach—first integrating Skoda into the group and then entering new markets in Eastern Europe and Asia by building greenfield local car plants. "It was quite successful, but it needs a lot of time," said Taege. He added that importing cars into these emerging markets would have been difficult due to luxury import taxes and local-content requirements, plus the need to build local dealerships and after sales support.

Leveraging adjacencies

Erste Bank Group's Herbert Juranek explained his company's market adjacency strategy for Eastern Europe, a string of aggressive acquisitions to quickly build market share at the expense of global competitors who'd been in the markets much longer.
"We started in 1999 with the Czech Republic because we had a branch there and knew the market," Juranek recalls. "We did our acquisition of Česká spořitelna with 16,000 employees to our 7,000, and people said 'you're crazy, you cannot handle that.'" What made the strategy work, he added, was that Erste Bank correctly anticipated the growth of these markets and paid attractive prices for assets which quickly appreciated. "The perspective of the market has changed," he said.

Following consumer demand

Piggybacking on key customers as they expand in emerging markets is another effective approach—starting slowly and then expanding. Bram Klaeijsen of Cargill's agricultural products group said his company was initially pulled into Eastern Europe in the early 1990s by its customers, who needed local ingredients as they started selling consumer product such as candy bars. "We ended up buying an enterprise in Russia, for less than a million dollars," Klaeijsen recalled. "We learned how to do business there … we did it slowly, step by step until we felt comfortable."

When Russia had its financial crisis in 1998, Cargill decided to stay, he added, which paid off doubly: not only did it keep them in an important market, building relationships and knowledge, but the currency devaluation resulted in greater demand for locally-produced food products. Cargill expanded its first acquisition, "and when we felt more confident, we also built plants to produce fats, malt, oils and pigments," Klaeijsen said. Cargill then expanded into the rest of the region based on a market analysis focused on factors like population and agricultural base, resulting in the prioritization of Poland, Romania, and Turkey.

University of Michigan's Andy Lawlor warned that accurate market information is often lacking in emerging markets, a challenge especially true in the 1990s in Central Europe. "You couldn't get representative data," Lawlor explained. "You could get early starter kits from GFK, which was polling the trade partners, who might have been padding the numbers." The data is now getting better, he noted, although as you move east into Romania and Bulgaria, it's still "amazingly unreliable."

Hasbro's Henk Suelmann said the existence of a strong consumer market is his company's top criteria in entering emerging markets, leading to extensive analysis of purchasing power and product performance by market. Other participants added that such factors as the availability of managerial capacity, and even the sophistication of the media infrastructure for companies dependent on advertising/marketing are important to assess.

IBM's Tony Fricko ran through the factors his company looks at, including potential market sizes, the ability to source technical talent, quality of infrastructure, and the ability to protect and monetize investments. Culture is also a factor, he added, noting that Central and Eastern

Europe engineers are more likely culturally to be able to improvise work without prescriptive instructions, which is an advantage. "In India you get back what you've written down word for word, there's no hint of interpretation," he said. "Whereas in Eastern Europe, you'll probably get back something better than you expected."

GM's Mark Hillman explained that the capital-intensive auto business tends to set a high bar for emerging market investments. "You get into this risk conversation and all this complexity—deep supply chains, complex processes—to lay out a footprint, it's a very serious decision." And though Eastern European wages might be attractively low, he added, "guess what, you can't sell anything there … the average production worker at 2-3 hundred Euros a month is not going to be able to buy a vehicle."

Part of a Global Strategy

Participants talked about emerging market initiatives as part of a broader global strategy of building both market strength and capabilities in key regions ahead of competitors.

Emerging markets as a separate business …

Cisco's Yvon Le Roux suggested that companies should separate their emerging market efforts from mature market operations so these ventures can be more entrepreneurial, moving out from under the bigger operation's shadow.

"We had a traditional EMEA (Europe, Middle East and Africa) approach, but after analyzing the market, we noticed that all the focus kept constantly going towards the west—U.K., France, Germany, Spain, Italy, and Greece," he explained. "We did what we call 'divide and grow'—split it in two, 'you run Western Europe and you run emerging.' And you see the growth. There is no other way out—you have to fully invest."

… even prioritizing market development over metrics

University of Michigan's Lawlor agreed that splitting off an emerging market operation often frees it from expectations that might thwart its ability to succeed in the new environment. He cited the example of Whirlpool, which established a separate Central Europe operation in the early/mid-1990s and held its leaders accountable for absolute profit rather than traditional gross margin metrics.

"They found young entrepreneurs," recalls Lawlor, "a guy in Hungary who was selling Whirlpool refrigerators out of a pickup truck, made him president of Whirlpool Hungary." The entrepreneurial effort resulted in strong absolute profits and a 30 percent market share, recalls Lawlor, because local management wasn't hamstrung by gross margins. "Hungary might only have an operating profit of 18 percent, Poland might have 23 percent … they could never have lived in the 33 percent profit zone Western Europe would have wanted."

Small markets can be strategic

DHL's Alexander Pilař responded that although countries like the Czech Republic or Slovakia "might always be rounding errors" as sales markets in terms of global profit, they should be viewed as part of the bigger global picture and for their potential as hosts for back office or BPO operations. "By expanding in an emerging market, you get the presence, confidence, and knowledge of how that market operates, and [that] can create an opportunity that's much bigger," Pilař said.
Pilař said because DHL delivers packages in almost every country it doesn't spend much time analyzing markets before entering them. "Being everywhere has given us a lot of data, it opens up a lot of opportunities." he noted. "We flew into Czechoslovakia about ten days after the communist government resigned," he recalled. "We can go into countries confident because we already have someone there that can run the business—we can test new initiatives based on their experience and gut feel."

He also suggested that companies take a broad regional view of emerging market opportunities, for example when hiring. "If I'm going to Bratislava and Slovakia is only 4 million people, I'll never be able to hire people. You'll find people applying from Hungary, Ukraine, Poland, etc. We have only 5 percent ex-pats in our Czech operation, and 60 percent Czechs … 35 percent are foreigners who happened to live in Prague, or were willing to move here."

Competitive considerations

Cisco's Brad Boston said his company has taken a more focused yet global view of emerging markets lately thanks to a "wake-up call" from Huawei, an aggressive Chinese competitor. "Their strategy was to attack the small emerging market countries where we had very little presence, and they were growing tremendously," Boston recalled. "We found out that doing business in all those emerging countries was more similar to each other then it was to the other larger economies we had previously associated them with. Going to market in Russia, for example, was much more similar to Brazil than it was to Europe."

Henkel's Peter Hinzmann echoed the strategic importance of a global approach. "The Huawei example is striking, their people nearly all have university degrees," he said. "These young companies are all hungry and ambitious: they run like hell … you suddenly realize that a big developing power is changing global businesses." In Henkel's case, Hinzmann explained, this realization led to the decision to transfer a large R&D team to Shanghai, because of the highly skilled chemical researchers available there. "Look around and figure out where the availability of resources is increasing," he advised, "in order to figure out what you can do better."

GM's Hillman explained that for similar reasons, his company has recently transformed its purchasing from a regional to a 'global hub' model, where even an emerging market can be a hub if the expertise is there. "All global purchasing of aluminum for example is going to be in China, because it is the best place—the best processes, the volume, and the domain knowledge is there," he explained. "We're acquiring material around that knowledge base and their job is to figure out how we support the company across the board."

Central and Eastern Europe as an Emerging Market Benchmark

Participants used Central and Eastern Europe (C&EE) as a point of reference to discuss how to approach rapidly evolving emerging markets, noting that proactively managing government relations and understanding changing consumer dynamics can be key success factors.

Regarding government relations, University of Michigan's Lawlor recalled that many of the C&EE countries, like emerging markets elsewhere, had regimes which for years protected their home markets by 'capping' foreign firms at a certain penetration level. "There was a minister whose job it was to keep AT&T at 10 percent market share," he said, adding that many government officials were primarily interested in lining their own pockets, a behavior they'd learned during the long Soviet occupation.

But A.T. Kearney's Bill Dewey said he thinks those days are fading, and that those government officials "have taken their money and run," he said, replaced by "exceptionally well-educated people with good values."

Proactive government outreach

Cisco's Le Roux said that rather than working back-room politics, his company's focus is educating governments as to how technology can improve their global competitiveness and how they can tap into World Bank and European development funds.

"We do a lot of independent research, with the World Economic Forum and other institutions, to find out where the governments are on IT usage and competitiveness," he explained. "They all want to see that chart, 'how do we get further up'. We spend a lot of time educating government leaders on how IT can be an enabler for them, to help transform their country." Le Roux also mentioned that Cisco runs 'networking academies' in emerging markets as part of its corporate social responsibility effort. "It's a tremendous talking point for us," he said.

Egon Zehnder's Erik Slingerland linked the major political and demographic changes in Central and Eastern Europe to significant changes in both workforce and consumer attitudes. The lifting of communist rule, plus higher birthrates in the East and Southeast, have created "motivation for market growth and upward mobility," he explained. "There's a willingness to go forward and build because you're still gaining, you're still picking up on the things that you have missed before. For this new generation, that makes a huge difference," he said.

Evolving market expectations

Tuck's Eric Johnson pointed to a "change in consumer expectations" as a common turning point for emerging markets in C&EE and globally. He said he'd studied a Czech start-up office supply company called Papirius, which grew from zero to 50 million in revenue in five years, based on providing fast overnight delivery to small- and medium-sized businesses, before being recently acquired by Office Depot.

"It was fascinating how that resonated with the local market, there was nothing previously providing that kind of level of service," he said. "They built up a nice little business around exploiting the changing expectations of the customers."

Hasbro's Henk Suelmann and Doug Schwinn added that both brand awareness and the retail environment varied among these emerging markets. "There's high brand awareness in certain young age groups here, but we'd like to see more specialist chains in the toy business coming here to set up," said Suelmann. "The C&EE market is hypermarket dominated." Whereas in Asia, Schwinn noted, "brand awareness is weak, and we have to take a different approach to the market because of that."

Other regional differences

How do the C&EE emerging markets compare to BRIC (Brazil, Russia, India and China)? Skoda's Martin Taege said that while Central Europe's common culture makes it easy to do business across countries, "the further east you go, the more complex it is," with business risks more akin to doing business in India or China. He added that he worried that some C&EE countries, like Slovakia, are becoming too heavily dependent on a single industry, such as automotive.

Taege also said Central Europe's labor force dynamics may be different than Eastern Europe or BRIC, with countries like the Czech Republic already experiencing talent shortages based on 10-15 years of success in attracting foreign direct investment. "Today you have a lot of bright IT graduates in Prague," he said, "but forget about cheap. It's not anymore, because companies like DHL and the German stock exchange have opened centers here."

Cisco's Brad Boston noted that in both China and Russia, brand protection from counterfeiting is a big issue. "Having to go out and police our brand in those markets is a very big effort for us." He added that these countries also often make doing business difficult by requiring a certain amount of profits be reinvested back into the country.

Process Standardization vs. Local Flexibility

Once the decision has been made to enter an emerging market, companies should tread carefully in imposing global processes, policies, and metrics agreed participants. And they should be creative about empowering local market entrepreneurs and then learning from their successes.

"You have to look at the processes and decide which ones will need to be different and which don't," said GM's Hillman. "On the go-to-market side we tend to have a lot more diversity, and then on all the back-office stuff we try for standardization."

But Hasbro's Doug Schwinn cautioned it may not be so easy in an emerging market to draw the line between the two. "What is sales side and what is back office? You may have to say your distribution is definitely sales side in a specific market because you can't use the standardized process," Schwinn explained. "You've got to cut it into smaller increments."

Enabling unique and creative approaches

University of Michigan's Lawlor shared a couple of stories to echo Schwinn's point, that emerging markets often present unique circumstances where pre-existing processes aren't always relevant. He cited P&G's experience entering Romania in 1994, realizing it had to invent a new distribution system for soap and other SKUs in order to serve the small kiosks that dotted the countryside in the absence of hypermarkets.

"If they'd followed the westernized procedures," Lawlor recalls, "the distributors would have had to buy a pallet. But what were they going to do with twenty cases of soap?" The solution was to use minivans to loop through the little towns and enable distributors to buy smaller quantities, even down to the half case.

"They dominated the early market share because of that," explained Lawlor. "You can't go in with a pure western point of view … you have to be creative." He noted that Whirlpool tried a similar program in 1995 in Hungary, setting aside standard operating procedure (and gross margin and data gathering requirements) in order to allow a third tier of entrepreneurs in smaller cities to resell the company's products to build brand awareness and market share. That successful experiment, he added, created a new best practice which has been replicated in several other emerging markets.

GM's Hillman said because his company emphasizes running emerging markets with local management, it often makes sense to wait on imposing global best practices, especially when entering the market with a partner. "They have a mindset on how they look in the factory and how they build and so on," he said. "So we let it run that way for now, but it can change over time. You can't bring in knowledge and processes right away; it's just not likely to succeed."

Balancing flexibility and accountability

IBM's Fricko agreed that in some cases it may make sense to defer to a local partner's processes, but noted that "sometimes what they call entrepreneurial is actually sort of a cowboy style that's half legal and half illegal … and that doesn't work with IBM business ethics."

Cargill's Rita Heise cautioned that rigor is required regardless of which processes are initially appropriate. "You might not need the sophistication, but you still need the discipline," she said. Cargill's approach, she added, is to "go in first with the understanding that you don't know how work gets done in that market, and that you need to know before you can really establish good practices."

"We tend to talk about being part of a global company but a local business, and we think that has been a big key to our success," she added. Other participants spoke of the importance of integrating acquisitions fully and immediately.

Henkel's Peter Hinzmann said he recommends simplifying and adapting standardized processes to emerging countries, to provide flexibility to local management and avoid overloading their capacity. But at the same time, he added: “let’s be honest—sometimes it’s very healthy to have internal auditors look in on certain procedures in these countries.”

Erste Bank’s Herbert Juranek proposed that the right approach to process standardization depends on the size of the subsidiary and of the company overall, noting that some of Erste Bank’s C&EE acquisitions were larger than the parent bank. “The bigger the group gets, the stricter you have to be, the less room there is for compromises,” he said. “The investors are asking ‘where will you find synergies’,” he noted, even though such standardization may raise the cost of doing business for an individual unit.

“On one hand, the most important thing is that the country gets a high ROE and that the growth path is in the right direction,” he added. “On the other, if you want to have strong local management, you want to have certain things in place on the local level. We try to change things gradually, and the most important step is finding a common language: what is important for you? What brings the whole group forward? Where you are willing to make compromises?”

People, Trust, and Cultural Issues

Understanding the cultural drivers of current behavior is one of the keys to operating effectively in emerging markets, proposed IBM’s Tony Fricko. In some formerly communist countries, he noted, while engineers never developed mistrust of outsiders, sales and business people who’d had to navigate the communist system developed instincts and methods for protecting their turf. “So when you say ‘how about reporting’ or ‘how are things in Poland’,” he explained, “what they hear is ‘so here is Big Brother watching me.’”

But A.T. Kearney’s Bill Dewey argued that this is changing: “these companies are increasingly staffed with people who are educated in accordance with western norms and standards, beneficiaries of company sponsored training programs, as they in some cases they’ve experienced expatriat*e* assignments off-shore, they bring all of that back with them.”

Bridging cultural differences

Cross-pollinating people across emerging markets, rather than from headquarters, may be the best way to ensure shared culture and practices, offered Egon Zehnder’s Erik Slingerland, citing Erste Bank as a successful example. “It’s the only way to glue it together if you don’t put all of these strict systems,” he said. “You have good risk management and the rest is basically individual, and you go slowly. It only works if the people stick.”

University of Michigan’s Lawlor pointed out that the less developed the market, for example Serbia and Bosnia in Eastern Europe, the more likely there will be resistance to such cross-pollination, from locals who just want to be left alone. “In the smaller emerging economies, you’ll get triple billings, consignments … all the normal problems you had in Central Europe in the mid-90s as a result of a cowboy mentality,” he explained. “They’re just thinking about sales quotas.”

DHL's Alex Pilař recalled that it was difficult to address cultural issues quickly at DHL's new shared services facility in Prague (part of a consolidation of the company's European IT operations) because of the extremely fast ramp from zero to 600 employees in under a year. "It was a quite intensive build-up phase," he recalled, "and then we started to build a normal culture." Although only 60 percent of the employees were Czech, some common cultural attributes began to manifest themselves in interactions with other DHL units—specifically a lack of assertiveness on conference calls.

"These were really intelligent guys, fluent in English, who knew how things should be done but couldn't make a point," explained Pilař. "It took 15-17 months for them to have the confidence to be more assertive on the calls to Asia or the U.S.," he said. "This is a hard one to change—you need to deal with it over time. We'd worked it into the design by having ten ex-pats for the first year who knew how to run it. And then we phased them out."

Trust takes time

Skoda's Martin Taege said that time and cross-pollination of people were also crucial elements in bridging cultures during Volkswagen's investment in and then acquisition of his company in the 1990s. "You can't do it via e-mail, you have to live there, to make your own experiences and intensively communicate," he said. "To get a common understanding … is a process which needs years."

He recalled that when Volkswagen people first started showing up en masse along with new processes and procedures there was a lot of tension. This dissipated over time once people saw the results. "What I heard in the 1990s was 'the Germans are idiots,'" he said. "But lately what they tell me is 'We're producing cars. We are producing the best cars in the world.' It's gone from 'they' to 'we'—congratulations!"

Henkel's Georg Novak said it's typically taken two years after fully acquiring a JV for his company to achieve some harmonization and mutual understanding with the local operation, primarily through exchange of people who can convey 'The Henkel Spirit'. "Normally ex-pats come in from the marketing area of course, while finance and manufacturing stay local," he said. "Our management team is then bilateral, and the time is then right to introduce our systems and best practices."

A.T. Kearney's Dewey questioned the view of several participants that it's crucial to have a national-running local operations. "In the multinational sector in particular, we're moving away from that," he said. "I think we'll see people moving around all over the place as time goes on." He noted that in the banking world, from a risk management standpoint, "you find that when a local guy embedded in the business community is running it, the bank may have asset quality problems because he can't withstand pressure from his local contacts."

And at the end of the day, he said, it's results that matter, citing the example of SAB Miller, which brought its top brewmaster from Hungary to fix some problems at its Czech breweries, over the strenuous objections of the Czechs. "But it worked out, because it turns out that the guy knew what he was talking about," he recalled.

Labor and Local Community Issues

Proactively shaping the dialog with labor is a key opportunity for global companies entering emerging markets, where unions are often nonexistent or immature, proposed Egon Zehnder's Slingerland. "If you invest, you have a chance of helping create a reasonable union that's a good negotiating partner as opposed to what we typically find in Western Europe, where it is very political."

The labor relations opportunity

Indeed, most participants seemed to view the labor situation in C&EE as more flexible than in the west. "I think there's still a sense of urgency in Central Europe that we have to catch up," said Česká spořitelna's Petr Hlavaček. "We have negotiations but we always push through harsh measures when we need them. I think in terms of flexible work practices, emerging countries can be a lesson for other countries."

Erste Bank's Juranek added that because the EU now allows establishment of common workers' councils across member nations, the potential exists to begin harmonizing labor negotiations, and with them worker expectations. "There's a night-and-day difference," agreed Erste Bank's Juranek. "Just the benefits that people have in Austria compared to the benefits they have here, and the willingness to give them up. The whole situation becomes interesting because suddenly people have to find the common workers council for the whole group."

Cargill's Bram Klaeijsen, although agreeing that the Central Europe labor situation has enabled some negotiating leverage to get better work-hours terms in Western Europe, said that the opportunity is limited because of the strong western unions. But he did say that in countries like Russia, the potential labor efficiencies are dramatic, if approached properly. He recalled that his company's first acquisition there in 1994, which had 1400 people processing 100 tons of grain per day, was ultimately reduced to 600 people over time.

"We could have fired a lot of them immediately, but decided not to, because we were the only paying employer in the area," he explained. "To build a good face, we did it slowly. We did immediately let go about 200 people who repeatedly showed up for work indisposed, but then got the workers' leaders together and got them to agree on work ethics, that for certain lack of behavior, like stealing, we could fire people. We made a plan with them to reduce people slowly. We also added about 200 higher quality people."

Cultivating community ties

Getting deeply involved in local communities, noted Cargill's Rita Heise, is another valuable investment that can shape perceptions in emerging or even developed markets. Cargill tries to get very involved in the local community, she said, helping with schools or hospitals and "trying to build the relationship and the partnership with the locals, to be perceived as a company that's very local."

A.T. Kearney's Dewey commented that while community involvement may work well in some countries, it might backfire in China, where "there's absolutely zero interest on the part of the Chinese in that kind of thing. They'll tell you they know perfectly well what is good for their communities. So, there are differences in how that issue should be approached."

Tuck's Eric Johnson recalled an innovative approach he'd seen to labor challenges in Brazil by Volkswagen, noting that many companies' emerging market innovations have potential for broader application back into more developed markets.

"Emerging markets can be fertile ground for experimentation," he said, explaining that Volkswagen had faced strong labor unions in São Paolo, and reacted by creating a completely new type of modularized truck plant that used much less labor. "They broke the truck into seven key modules, subbed it out to seven key suppliers across three unions and there were only 200 Volkswagen employees in the whole plant," explained Johnson. "The suppliers were actually bringing their part to that truck … it was all incentive driven, with different metrics." Subsequently, he noted, GM adopted the same model for a plant in Brazil, and "the U.S. the auto industry is watching it closely."

Shared Services and IT in Emerging Markets

Supporting emerging markets from regional shared service hubs, or locating shared services in emerging markets, requires carefully analyzing overall risk, infrastructure quality, cultural compatibility, and labor cost and quality as key criteria for selecting these hubs.

The regional hub approach

Hasbro's Doug Schwinn said his company decided to support emerging market expansion from shared services hubs in North America (for South America), Hong Kong (Asia) and Frankfurt (Europe). "We're positioning where we have core best practices for back-office processes, and then we put sales and marketing guys out in the field," he explained.

And although Hasbro's IT services are run from the U.S., the company leverages individuals with key IT skills all over the globe. "No matter where they live, we then leverage them to ensure we get that best practices," Schwinn said. "Our best guy in warehouse management happens to live in Valencia, Spain. He just got off an Australia project and his next one is Chile."

IBM's Fricko noted that IBM has outsourced business process and IT operations in the Philippines, Bangalore, and Bratislava, among other locations. "It's not just a means of having cheaper labor," he said. "It's also tapping into new markets, new ideas, and innovation. Tel Aviv is building something that's getting tested in Bangalore."

Cargill's Heise said her company started with support staff embedded on-site in Eastern Europe, but has moved to regional hubs for HR, finance, and IT. "You can get economies-of-scale and leverage people over multiple sites," she explained. "In all of Eastern Europe we have about 80 IT folks … if they're the lone IT person in the plant or site, where do they go? What do they do? How do they grow and develop?"

Peter Hinzmann said Henkel is also consolidating administrative shared services operations regionally, despite having to deal with the politics of doing so in a family-owned company. But regarding IT services, he argued for giving third-party vendors maximum latitude as to location. "Talk quality and price with them, but leave a lot of space for them to optimize," he said. "This is something which can't be mixed with your emerging market entry strategy."

DHL's Alex Pilař disagreed, noting that his company's decision to locate one of three global IT facilities in Prague was a strategic one. "As the chairman buys more local companies we keep consolidating into these locations," he noted. "The advantage we're seeing in Prague is that companies are very strongly positioned in Asia and India and are trying to establish themselves in Central Europe because of its attractive labor pool."

Labor costs and tradeoffs

Pilař cautioned that while the Prague offered a 30 percent labor discount from DHL's previous operations in London and Basel, yielding $20M per year in cost savings, cost wasn't the only criteria, because the company could have saved 20 percent more by locating in Brno or Ostrava. "It gives you very little additional benefit but your risk goes up," he said. "The discussion we had was about managing risk."

Cisco's Boston said cost and talent availability were two of the reasons Cisco built a 1200-employee IT and R&D campus in Bangalore, India, but noted that finding good managers with business skills and "instituting the Cisco culture and mentality" had been challenging. So the company is now relocating a senior vice president to Bangalore to address those issues, he said.

Boston added that turnover was running 5-8 percent annually vs. 20-25 percent for Indian IT vendors, because of Cisco's large local presence and strong multinational brand. "We've also done a good job of starting to give them a whole mission as opposed to just being parts of project teams that are run out of San Jose. "The more you give them that ownership and accountability, the more they feel part of the bigger company." And despite intellectually property concerns, he added, Cisco has also opened an R&D center in Shanghai. "It's a big market for us and we can't compete unless we go there and localize our technology."

Infrastructure quality issues

Several participants warned that inadequate infrastructure continues to be a key obstacle to leveraging shared services operations in emerging markets. Cisco's Boston noted that the cost of delivering browser-based services is dramatically higher in some emerging markets, and that local telecom companies are often protected from competition by regulations and can take months to install needed circuits.

"We have significant problems getting circuits in mainland China," said Hasbro's Schwinn, "although Hong Kong's gotten much better in the last few years." Henkel's Georg Novak added that many CIS countries have so-called ‘area protection,’ which means each building for example in Moscow or Kiev is only served by a single telecom provider. “If this isn’t your provider of choice, you’ll have a hard time convincing them to do a contract with another one,” he explained.

But DHL’s Alex Pilař said the telecom situation is changing quickly in many regions. “The Middle East is still expensive and you need to have a sponsor,” he said. “Sub-Saharan Africa is very expensive, and South Africa doesn’t have good cables or capacity. Japan and Hong Kong are much less expensive than they were 2-3 years ago. And Latin America is a mix.”

Many C&EE countries, Pilař noted, invested in a new generation of infrastructure in the 1990s. “Compared to some Western European countries which is just finishing writing off 1980s technology,” he said, “Poland, Slovakia, Czech Republic and Hungary had to replace the whole thing pretty much from scratch in the 1990s—so most of their infrastructure is very, very new.”

Looking Forward

At the conclusion of the roundtable, the group summarized the key issues and insights.

IBM’s Tony Fricko argued that Central European countries have developed sufficiently that they’re not really emerging markets anymore. “They’ve matured,” Fricko said, “a better term might be ‘fast developing markets’.”

“The Czech Republic has become sophisticated as corporations have better leveraged its capabilities,” agreed Phil Barta. Business is “moving from a focus around consumption in Central and Eastern Europe to viewing it a source of efficiency and a source of innovation.”

Several participants pointed out that emerging markets and regions aren’t homogeneous, and that it’s difficult to make generalizations about them. “Some emerging markets aren’t third world, but may still have power and infrastructure issues,” noted Cargill’s Heise. “So from a market standpoint they may be not emerging, but there are underdeveloped capabilities … how do you live with that juxtaposition?”

Being good at understanding similarities and differences, she proposed, is a key success factor in entering emerging markets. “Eastern Europe is very good adjacent market to Western Europe and so we tend to rely on our Western Europe resources and insights to guide us there,” she said. “How do you understand the Eastern Europe uniqueness yet still piggy-back off of the Western European success?”

Egon Zehnder’s Erik Slingerland expressed surprise that the issue of government corruption didn’t really come up, given how much press it gets, to which Cargill’s Klaeijsen responded that “it’s happening all the time, everywhere, but it can be managed.” Klaeijsen added that “if you have good high level people in place, you don’t have to give in, you don’t have to give bribes … it’s a matter of being consistent and educating people on a continuous basis.”

GM's Mark Hillman said he was struck by the concept of "putting a wall" between emerging market and developed market efforts in order to enhance focus and minimize distraction. "It's really a simple idea," he said, "so that the urgency and pressure of all the issues that come with the mature side don't just swamp the emerging market side."

Timing and opportunistic strategies were identified as critical success factors in approaching emerging markets. "In certain countries and cultures, if you don't enter early and get the ties that you need," said Tuck's Hans Brechbuhl, "you're just not going to be able to." Specific circumstances may often trump the stage of development of an emerging market, he added. "If you have a capability or capacity or natural cultural affinity, that could perhaps move your entry timing or change your analysis."

University of Michigan's Lawlor highlighted the importance of vision in emerging market strategy, as exemplified by Erste Bank's contrarian roll-up of C&EE banks over the past several years. "I'm impressed that in 1999 Erste Bank's chairman laid out that type of growth strategy, really had it nailed at the top although people scoffed at it," he said. "Seven years later he's really put the footprint out there … he had the strategy in place, and was able to pick the countries one at a time."

The stepping-stone approach was viewed by the group as a market entry strategy warranted further research and discussion, given the potential for learning for and from high profile markets like China. "It's an interesting case that would be worth looking at," said A.T. Kearney's Bill Dewey, noting that many companies had taken varied approaches, trying to enter through Macao, Hong Kong and Taiwan, without fully understanding the relevant cultural and political dynamics.

Tuck's Eric Johnson said he was struck by the opportunities to cross-pollinate lessons learned in emerging markets, even back into more developed markets. "It's a very fruitful area to gather more intelligence," he said.

And several participants said they were impressed by the depth of the C&EE talent pool and how some companies like DHL had been able to exploit it so effectively. "The question is always 'is it possible to ramp up resources,'" said Erste Bank's Juranek, "so for me it was very impressive that you were able to ramp up 450 people in six months." "This reinforced in my mind that there are some very talented engineers in Eastern Europe," agreed Cisco's Brad Boston, "that this is a good labor market to go build some capacity."

But University of Michigan's Lawlor noted that companies will have to be smart in managing emerging market local talent to avoid brain drain, in particular by paying above-market wages to locals who get advanced training abroad to induce them to return home.

And Egon Zehnder's Erik Slingerland summed up the day by applauding the diversity of the emerging market approaches discussed. "What I liked a lot was to see that there's no single best way to go about it," he said. "There are different models, and each of them can be quite successful."

Participants in Thought Leadership Roundtable on Digital Strategies September 26, 2006

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Petr Hlaváček	CIO Česká spořitelna, a.s.
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