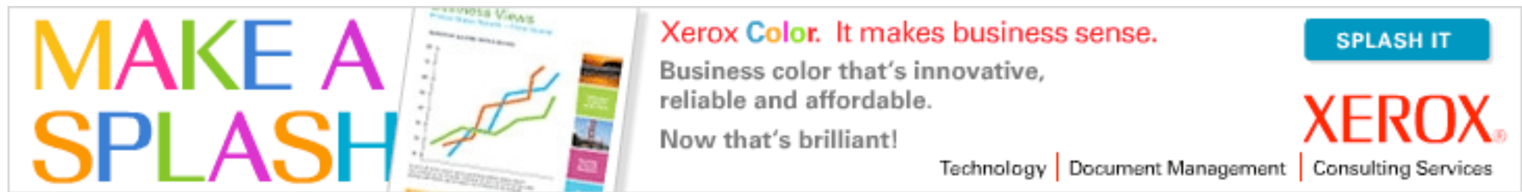

INNOVATION March 15, 2007, 10:58AM EST

Deloitte Study: Emerging Market Innovation

The management consultancy surveyed 446 top executives to profile business practices of U.S. companies in developing countries

by Reena Jana

"Everyone knows emerging markets are a big deal—they've got growing populations and growing wealth. And everyone is talking about 'innovation' as a way to tap into these markets," says Gary Coleman, global managing director of the Manufacturing Industry Group of management consulting firm Deloitte, referring to two of today's business buzzwords and how they affect each other.

"But the fact is less than 50% of top-tier executives of [developed-world] companies doing business in emerging markets say they're successful at meeting their operational and revenue goals," says Coleman. That's even after designing and marketing innovative products tailored for consumers in key developing markets such as China, India, Latin America, and Russia.

Coleman is sitting in a light-filled, glass-walled conference room at Deloitte's New York headquarters discussing the results of a new survey, *Innovation in Emerging Markets*. He previewed the study's findings at the World Economic Forum's annual meeting in Davos, Switzerland, in late January. Deloitte publishes the entire report on Mar. 14.

THREE TIMELY ISSUES

The 23-page study, which yielded some surprising results, features data culled from an online survey completed by 446 C-suite executives from manufacturing companies in 31 countries. Although Deloitte won't disclose the list of corporations represented, 36% of the executives work for companies with annual revenues of $1 billion or more, 34% work for companies with annual revenues between $100 million and $1 billion, and 30% for companies with revenues under $100 million.

The questions focused on three issues of particular relevance to managers at global companies with operations in emerging markets today: 1) attracting and retaining talent, 2) managing risks, and 3) operational structures.

One of the most intriguing findings: the lack of rigorous and ongoing risk management strategies used by global companies with operations in emerging markets. "To me, it's newsworthy that even in the large companies we surveyed, only a small percentage conducted a 'very rigorous' risk review before entering an emerging market and followed up with regular assessments after that," Coleman says.

RISKY BUSINESS

This is a surprise because it seems somehow counterintuitive. Nations in the developing world lack intellectual-property laws and are vulnerable to rampant product counterfeiting—dangerous conditions for developing proprietary technologies or inventive product design. Emerging nations also are known for unstable political environments and shaky, underdeveloped infrastructure systems (limited power lines and highway systems, e.g.) that can be knocked out by natural disasters such as monsoons.

But the report states that only 56% of all executives polled conduct a "very rigorous" risk assessment before opening a satellite office, a research-and-development lab, or another business operation in a developing nation. Only 45% of those stated that their companies continued to perform "very rigorous" risk assessments regularly, after establishing a presence in an emerging market.

Legal and regulatory risks were top of mind for companies who did complete any form of risk assessment, with 77% polled listing these as risks they analyzed, followed by typical business issues of supply chain (76%) and business continuity (72%). All of these risks are concerns for corporations around the world. Intellectual-property risk was another important concern for most of the executives surveyed (64%).

ASSESS FOR CONFIDENCE

"IP really is the most obvious risk when focusing on innovation, especially in emerging markets" says Coleman. Why? A lack of intellectual-property laws means that it's easier for other companies to copy new products. But perhaps surprisingly, risks related to the unstable political and natural environments of the developing world were not as much of a concern. Fifty-seven percent of the executives surveyed assessed security risks, but only 51% considered geopolitical risks, 30% assessed terrorism, and 30% analyzed the impact of natural disasters.

Among the companies that did perform regular risk assessments, 86% reported that they are "very confident" in their abilities to manage such issues. What this data indicates is that ongoing risk assessment yields more satisfying risk management when doing business in an emerging market, where a variety of factors may be present.

In addition, the Mar. 14 report reveals that greenfield investment, or the formation of a wholly-owned new subsidiary, is currently the most popular strategy among the global companies surveyed when establishing a presence in emerging markets. IP can be more easily monitored within a new wholly-owned subsidiary, as opposed to when it has been outsourced to a local company, which was previously the norm.

REGULATING AFTER DEREGULATION

Sixty-five percent of executives at companies that deployed this strategy had rated their ability to meet their operational goals as "extremely or very successful." Although the report doesn't provide a detailed case study, it concludes that a key factor in deciding when to deploy a greenfield strategy is whether a company is relying on proprietary technology or process—true innovations—as the main element of a value proposition in an emerging nation. Why? Because intellectual-property protection is crucial.

But Coleman says greenfield investments are also so popular today simply because they are possible, thanks to a loosening of governmental policies regarding foreign companies doing business in nations such as India within the past five years or so. In many emerging nations, government policies used to state that foreign entities couldn't fully own new companies or subsidiaries. Now, foreign-ownership policies have generally been deregulated in many developing nations, opening the door for greenfield investments. "If you went back five years ago, greenfields weren't an option because of [national] regulations," Coleman points out, offering context for the report's data.

The report also advises that companies redesign their human resources policies. These are areas where cost-effective innovation, or improved internal practices, are possible—and can affect a company's bottom line. One-fourth of the polled

executives stated that attracting qualified workers is "very difficult" in China, India, Latin America, and Eastern Europe, and one-third stated that retaining them was "very difficult," mainly because there are so many growing opportunities in these nations.

TALENT RETENTION

One brief case study in the report discusses how AstenJohnson, a $260 million Charleston (S.C.) manufacturer of specialty fabrics and drainage equipment, spreads out bonuses throughout the year in its Chinese facility vs. one lump sum at the end of the year—to keep employees from leaving.

"Retaining talent is a great way to leverage resources," says Coleman. "It's an opportunity to lower costs, because the cost of losing people after only a year or two can be expensive" in terms of lost hours spent searching for talent, as well as abandoned projects, says Coleman. Plus, attracting and retaining talent familiar with local cultures can offer a competitive advantage in developing markets, he adds.

"After annual performance reviews, we write letters of recognition to the parents of Deloitte's Mumbai employees, even if [the employees] are 40 years old," Coleman says, illustrating that Deloitte practices what it preaches. "We learned that parental praise is important in India, even for adults." So the company used that cultural observation to tweak its human resources policies.

EXPANDING FOCUS

The Deloitte study is the second annual report on innovation in developing nations including China, India, Russia, and countries in Latin America. The previous report, released the same time last year, focused on how countries are developing fresh new products to appeal to consumers in these regions.

When asked whether some of the innovation strategies discussed in the new report can be applied to companies in developed nations too, Coleman says they can. For instance, companies could certainly try out the bonus-spreading technique practiced by AstenJohnson. And U.S., European, and Japanese companies should begin observing emerging-world companies' practices directly—rather than simply looking at how developed-world companies with offices in developing nations are innovating and gaining name recognition internationally.

On this note, Coleman hints that Deloitte is beginning to research management strategies of home-grown companies in China, India, Latin America, and Russia—the Tatas and Lenovos of the world—and that this research will most likely be worked into Deloitte's 2008 report. "We'll soon be looking at how companies like China's Haier, which now has the No. 1 market position for compact refrigerators in the U.S., built their brands globally," Coleman says. "In terms of innovation in emerging markets, that's the story of tomorrow."

Jana is a writer with BusinessWeek.com in New York.

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