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Observations

Adapting for emerging markets

The village roads can be impassable, home cooking is still a way of life, and local products often have generations of loyal customers. But emerging markets in Eastern Europe and Asia are delivering some of the strongest growth for global makers of fast-moving consumer goods – everything from snacks to toothpaste – despite concerns that lower prices would mean lower profits.

Emerging market leaders like Coca-Cola, Unilever, Danone, and Pepsi now earn five to 15 per cent of their total revenues from the three largest emerging markets in Asia – China, India and Indonesia. And the trend is likely to continue: the GDP of emerging markets equalled that of advanced nations for the first time in 2006, with much of the growth coming from Brazil, Russia, India, China, Eastern Europe and Turkey.

With growth slowing in the mature markets of North America and Western Europe, some FMCG companies have figured out how to tap into the purchasing power of a growing middle-class with rising income, credit cards and access to personal loans. What separates the winners from the losers?

Flexible thinking, to begin with. The successful firms reconfigure global products to compete with popular local brands, both in price and taste. They adapt Western marketing and management practices to local customs. And, where infrastructure is poor, they develop work-arounds to distribute their products – such as Unilever's use of motorcycles to reach remote villages in Indonesia.

The rewards can be substantial. In some categories, growth in emerging markets is three times that of developed markets. Each market requires different adaptations, but there are some common practices.

Multinationals used to target premium segments with higher profit margins in developing nations. But now leading firms have started selling brands aimed at the mainstream – a strategy that allows them to drive down the costs of their premium products and achieve economies of scale in manufacturing, distribution, and brand building. Cosmetics giant L'Oréal took this approach in Eastern Europe, introducing a diverse line of facial and body-care brands targeted at the mass market, as well as its affordable "luxury" skin care brands. In the first half of this year alone, L'Oréal saw its Eastern European year-to-year sales jump 30 per cent.

Home-grown competitors have several built-in advantages, including consumer loyalty and lower costs. But by taking the time to learn and master local market complexities, multinationals can gain a competitive edge. Often, it requires fundamental changes to the product offering, such as switching to smaller pack sizes, using unconventional distribution channels, or developing products in local flavours. In Russia, P&G surmounted the distribution obstacles of breaking into that vast market by investing $40m in a van and car fleet that often delivered products directly to stalls in open-air marketplaces.

Coca-Cola accelerated its growth in the Russian soft drinks market by acquiring the second-largest Russian fruit juice maker, Multon, positioning itself to exploit the popularity of fruit juice drinks. Russia is the largest producer and consumer of fruit juice in Eastern Europe, where sales shot up 64 per cent between 1998 and 2003.

In between the traditional high- and low-end market segments is the large and flourishing market for what we call "good-enough" products, with higher quality than low-end goods, but affordable prices that still generate profits. Feeding this market requires that companies aggressively manage costs. Among the techniques: taking advantage of used plants, local suppliers, and outsourcing. It also means reducing fixed costs and localising management. For multinationals catering to the premium end of the market, a strategic acquisition can help slash costs enough to compete.

Unilever's India subsidiary,

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Hindustan Lever, used aggressive cost management – making changes in production, packaging, distribution and marketing – to help create a low-cost alternative laundry detergent line to compete with a popular new domestic brand. By hitting the pricing sweet spot, Hindustan Lever has gained a 36 per cent market share in the laundry detergent segment.

Too often, multinationals count on expatriates to guide their entry into emerging markets, an approach that can backfire. Expatriates can drive up costs and frequently fail to deliver the deep market understanding offered by local managers. A strong local team can offer the kind of market insights that provide a competitive edge in product design, promotion, and distribution. Market leaders foster loyalty by empowering local teams and providing them with global opportunities. It's a talent pool they can tap when entering other emerging markets. Consider P&G, the most successful consumer products company in China: 98 per cent of its employees are Chinese.

A strategic acquisition can accelerate a multinational's entry into an emerging market by adding popular local brands to its product line-up, broadening its reach with a stronger distribution network, providing a local talent pool, and lowering operating costs.

The leaders maximise their investments by building dedicated emerging markets capabilities. British American Tobacco – one of the most successful consumer goods companies in emerging markets – has long had a stable of international management talent that it deploys across Asia, Africa and Latin America. It recognises the difference between emerging and developed markets, and has developed distinct approaches.

With consumer markets in Asia and Eastern Europe growing at double-digit rates, multinationals are moving fast to build their brands, and the expertise to manage them. Succeeding here is essential to defend – and increase – their stakes in the global market. Ultimately, how they fare in emerging markets is a key indicator of how they'll perform everywhere else.

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