TOMORROW'S CHALLENGES

DIVERSIFICATION KEY TO GLOBAL EXPANSION

PROACTIVE STRATEGIES FOR EMERGING MARKET COMPANIES

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Emerging market economies, and especially the BRICs (Brazil, Russia, India and China), continue to experience impressive growth. Yet despite the progress they have made, the economic growth they have enjoyed risks grinding to a halt unless they can effectively deal with a gaping problem: a lack of effective global leaders. Experience has shown that as the BRIC companies expand internationally, many of the factors that contributed to early successes in the home markets are likely to prove irrelevant or even a hindrance when the company tries to go global.

Most companies in emerging markets start their globalization journey by taking advantage of economies of scale. This makes sense given their effort to compete on low cost. It is not particularly difficult to achieve because they are able to take advantage of a work force that usually speaks a common language, responds to the same cultural references and is willing to work long hours at wages substantially lower than those in competing countries. It also doesn't help that companies from the developed countries have abandoned many of the lower end markets in favor of high value add segments. Other factors can also play a role in the success of the high volume, low cost strategies of many BRIC-based companies. In China, for instance, personal connections are a powerful determinant of success when building business in Asia. This is not surprising given the cultural importance of extended families, which in Asia are often the prime source of support in getting any business started.

Sooner or later, most BRIC-based companies face saturation in their home markets and rising labor costs. They naturally aspire to move out of commodity-based strategies and into branded, higher value-added products and services. However, the leadership team that excelled on exporting high volume manufactured goods finds it difficult to overcome old ways of doing business. And those that do find that they are severely lacking in the skills required to succeed through new, more complicated strategies. How can they best adjust to their evolving ambitions and the realities of the global marketplace they have discovered?

The best approach, we believe, is to embed foreign expertise in the company's management structure early on by carefully selecting and hiring executives who are knowledgeable about the markets in which the company wants to operate. And they should start now, *before* the contributions of their current strategy begin to wane.

The overarching question is: what happens when a company that is highly successful in its home market begins to hire employees who don't speak the same language and who have very different cultural references? What holds the company together and how does senior management guarantee employee loyalty and dependability? The answer, we believe, is to expand the company's culture so that both homegrown and foreign-hired executives have the same commitment to core values and management principles.

Our research has shown that when a company does 50% of its business internationally, its performance can be optimized when it hires roughly a quarter of its executives from the countries in which it plans to operate. The average among many leading American companies is a ratio of 17% foreign executives in a company that does roughly 40% of its business internationally. In Europe the average is slightly higher. IBM, which has grown into a truly international company, does about 60% of its business internationally and hires roughly 40% of its executives from outside the United States. Companies from the BRIC countries would be wise to follow the lead of these companies.

Unfortunately, most BRIC countries still haven't managed to meet those standards. In China and India, the senior management of the top companies still tends to be completely Chinese or completely Indian. These countries would do well to beware of the example set by Japan. In the 1990s Japanese companies seemed unbeatable, but from 1995 to 2010, the Japanese share of revenues earned by the world's leading Fortune 500 companies dropped from 35.2% in 1995 to a mere 11.2% in 2010. While Japan's economy slipped into the doldrums, the share of Fortune 500 revenues held by American companies remained relatively stable, and even increased slightly from 28.4% in 1995 to 30% in 2010. In the same period, European companies advanced from 31% to 36%, while the BRIC countries rose from less than 1% to 10.4%.

During that critical 15-year period, Japan faced rising labor costs and the steadily increasing value of the Yen, which made Japanese products more expensive. But in addition, many analysts feel that it also suffered from the failure of Japanese management to understand the characteristics of the global marketplace, mostly because of a lack of diversity at home. By the time most Japanese executives were sent overseas, they had already been so indoctrinated in the intricacies of Japan's large domestic market that they failed to grasp the characteristics of the foreign markets to which they were assigned to work. Language also proved to be a formidable barrier.

A rash of similar problems can be found in BRIC-based countries today. When a major Chinese petroleum company recently bought a western oil exploration company in Europe, the western executives, whose expertise it had hoped to acquire, found that they not only had difficulty understanding orders translated from Chinese, but they failed to understand the subtle cultural signals emanating from the head office. Much of the acquired company's foreign top talent soon left in frustration. We see this pattern all too often.

One solution to the problem is to send promising young executives abroad at an early point in their career when they can still absorb foreign culture. The major international business schools such as IMD leverage this strategy, by putting diverse groups of executive peers together in a learning environment where they can exchange best practices.

An even more direct approach is to hire a certain percentage of the company's executives from key target markets and then to integrate them into the corporate culture. An essential ingredient in making this strategy work is to base the expatriate executive in the home office long enough for them to get hands-on experience with how the company operates and to absorb the company's core culture. It is also critical for the expatriate executive to establish a basis of trust with senior management. The end result is an executive equipped to translate the company's strategy into terms that the global market understands and can relate to.

Allen Morrison is Professor of Global Management and the holder of the Kristian Gerhard Jebsen Chair for Responsible Leadership at IMD. He will be teaching on the Orchestrating Winning Performance program, which is for individuals and teams who seek the latest management thinking and practical, innovative solutions for their business.

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