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Emerging Markets - A Challenge Ahead

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ABSTRACT

Economic and political developments are rapidly transforming the world and prompting the society to consider more global perspectives. Over the next two decades, most of the world's growth is expected to occur in today's emerging markets (EM). An emerging market is a country that has some characteristics of a developed market but is not a developed market. This includes countries that may be developed markets in the future or were in the past. It may be a nation with social or business activity in the process of rapid growth and industrialization. Primarily, this paper brings out the characteristic features of Emerging Markets. Presently, the largest emerging and developing economies are the BRICS countries. The contribution of BRICS and other EMs to the global economy has been increasing rapidly. Emerging markets also act as manufacturing bases. Due to increased competition among the MNCs, they are concentrating their part of operations in EMs for cost benefits. By adopting new technologies in production, distribution and marketing channels, countries such as China, Brazil and India have become important locations for production. Secondly, the challenges ahead for the emerging economies in different dimensions are explained in this paper. EM provides great opportunities for entrepreneurs to build the future. The pros and cons of doing business and investing in emerging market is also included in this paper.

Key words - emerging market, BRIC countries, opportunities, challenges

INTRODUCTION

The most promising markets for doing business in future, for the world's mostcompetitive companies are the so-called emerging markets (EMs). Emerging markets are fast growing developing countries that are creating not only a rapidly expanding segment of middle class and rich consumers but also have a sizeable segment of poor consumers. They have become the engines of economic growth rapidly gaining share of the world economy. Most of the world's growth is expected to occur in today's emerging markets. In 2016, emerging markets have accounted for 35% of the global GDP. China, India and Indonesia, the three most populous emerging markets had average annual growth rates of 6.9, 7.1 and 5.0 respectively in the year of 2017. Once thought of as backward and low-tech, these countries are now rapidly transforming their economies. Market potential is no longer too small for marketing efforts. Maximum population growth and infrastructure development rates are predicted for emerging economies. The size of the market is huge as over 80%of the world population resides in emerging markets which cannot be ignored. Many emerging economies have developed or accessed technologies that have made them competitive on a global basis. They are investing in infrastructure development, especially in transportation, power and communication. This has helped bring down the costs of selling in these economies.

NEED OF THE STUDY

To understand the functioning and flourishing of emerging markets.

OBJECTIVES OF THE STUDY

- To study about the emerging markets.
- To understand the challenges faced by emerging markets.
- To know the opportunities and risks of doing business in emerging markets.

RESEARCH METHODOLOGY

Data is collected from secondary sources which are mostly from various websites and web sources pertaining to the information on emerging markets.

WHAT ARE EMERGING MARKETS?

An **emerging market** is a country that has some characteristics of a developed market, but does not meet standards to be a developed market. It is a nation's economy that is progressing toward becoming advanced, as shown by some liquidity in local debt and equity markets and the existence of some form of market exchange and regulatory body. Emerging markets are not as advanced as developed countries but maintain economies and infrastructures that are more advanced than frontier market countries.

Terms such as 'developing markets', 'emerging markets' and 'rapidly industrializing nations' are often used interchangeably, which often leads to confusion in understanding what emerging markets are.The lists of emerging markets change rapidly as the markets included are often selected according to growth indicators and projections on an annual basis.

The BRICS countries namely Brazil, Russia, India, China and South Africa (joined the BRIC nations on 24th December, 2010) come under the category of emerging markets. Other emerging markets are the Czech Republic, Hungary, Mexico, Malaysia, Poland, Turkey and Taiwan. The secondary emerging countries are Chile, Columbia, Egypt, Indonesia, Malaysia, Morocco, Pakistan, Peru, the Philippines, Thailand and the UAE.

CHARACTERISTICS OF EMERGING MARKETS

- Lower level of economic development (less-developed country), which could beexpressed in GDP per capita.
- Transitional economy (and society): Government does an attempt to create a framework of a market economy (and democratic society) through an adequate economic (and political) reform.
- High rate of growth, which could be expressed through GDP growth rate (it should be at least 5% per year), that is caused by a governmental attempt to create market economy.
- A huge room for future growth, which could be expressed through difference between obtained level of economic development (also purchasing power parity could be used as a criteria) and an average GDP of developed countries. A driving force of every EM is aquality of economic (and political) reforms which is at the same time a highly risk area.
- Physical characteristics, in terms of an inadequate commercial infrastructure as well as inadequacy of all other aspects of physical infrastructure (communication, transport, power generation).
- Sociopolitical characteristics which include, political instability, inadequate legalframework, weak social discipline, and reduced technological levels.
- Economic characteristics in terms of limited personal income, centrally controlledcurrencies with an influential role of government in economic life, expressed, besideother, in managing the process of transition to market economy.

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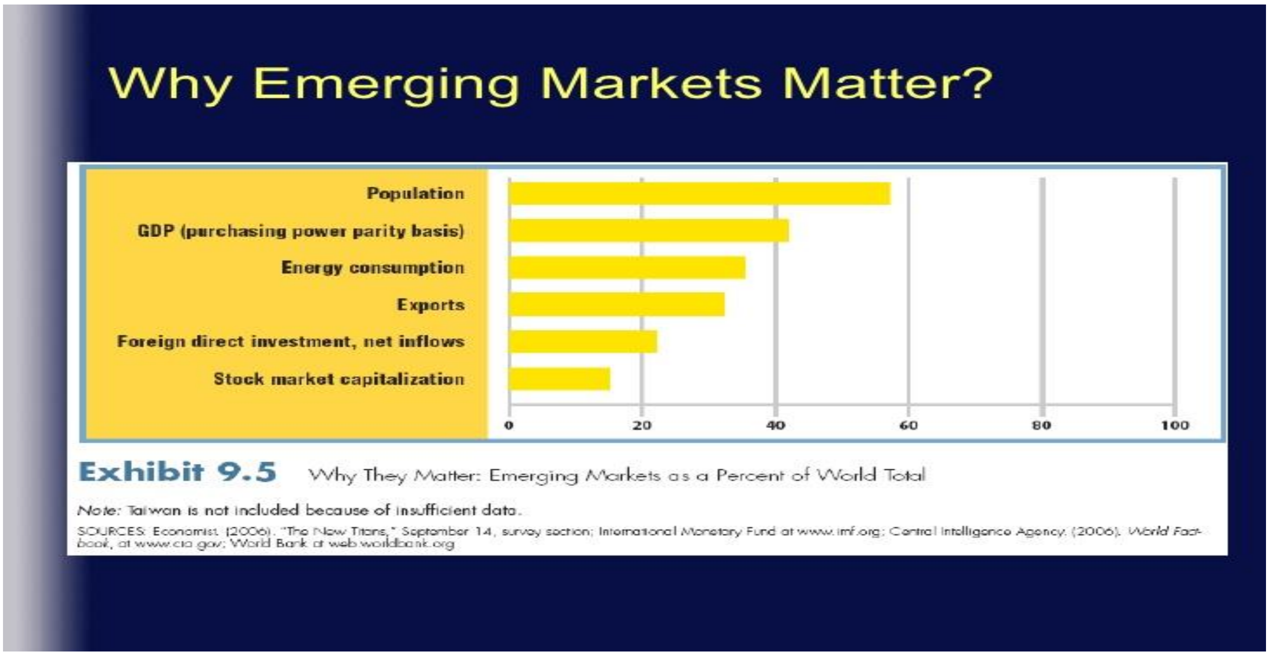
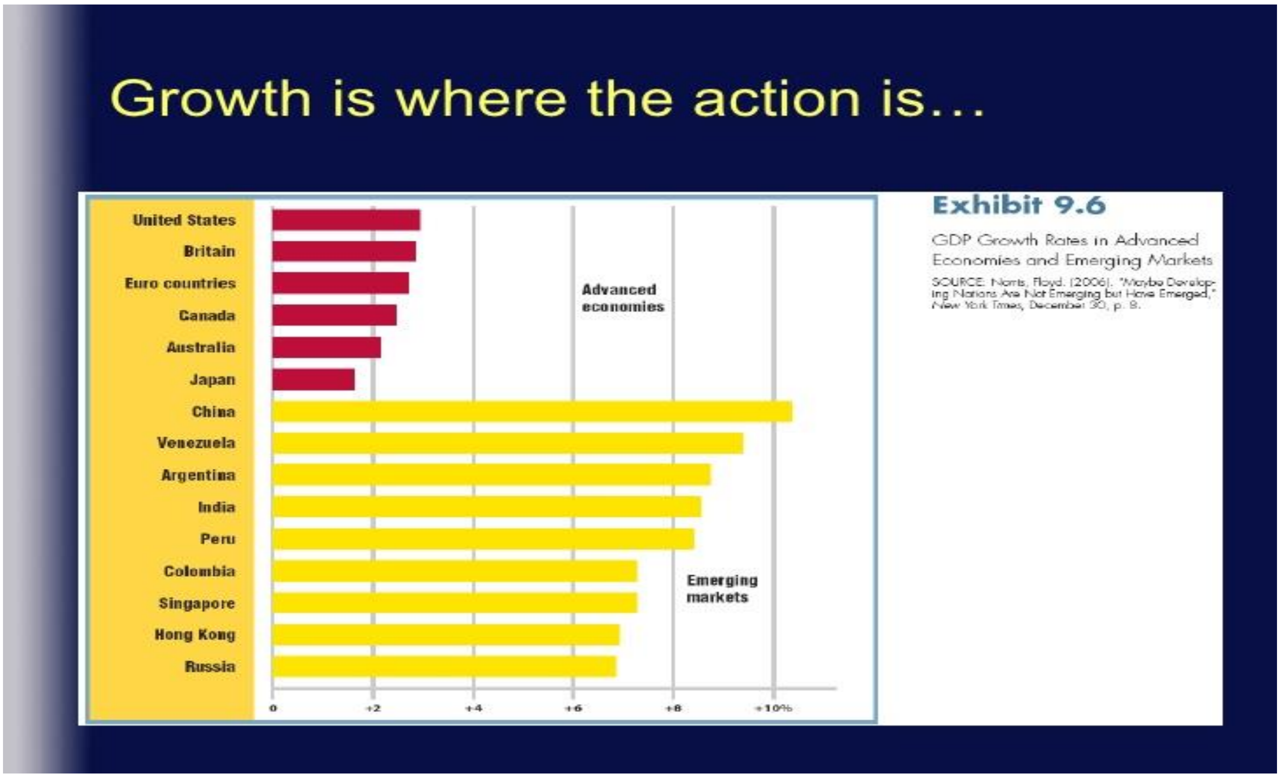
EMERGING MARKETS VS DEVELOPED MARKETS

Dimensions	Developed markets	Emerging markets
1. Level of economic development	High	Low/Medium
2. State of economy	Developed/Stable	Transitional/Unstable
3. Market conditions	Stable	Unstable
4. Government involvement	Not so high	Relatively high
5. Rate of growth	Low	High
6. Room for growth	Narrow	Huge
7. Per capita income	High	Low
8. Investment risk	More	Less
9. Infrastructure	More	Less
10. Demographics	Smaller share	Larger share

EMERGING MARKETS- WHY DO THEY MATTER?





- Emerging markets account for around 40% of world GDP.
- They represent over 30% of exports and receive around 20% of FDI.
- Some of the multinationals in emerging markets:
  - India: Ranbaxy, Infosys, Wipro etc.
  - Brazil: Embraer, Sadia & Perdiago, Natura etc.
  - China: Haier, Lenovo, Pearl River Piano etc.
- <u>Emerging markets as manufacturing bases:</u>
  - Home to low-wage, high quality labor for manufacturing and assembling operations.
  - Large reserves of raw materials and natural resources.
  - Examples:
- South Africa is a key source for industrial diamonds.
- Thailand has become an important manufacturing location for Japanese MNEs such as
- Sony, Sharp and Mitsubhishi.
- Malaysia and Taiwan- Motorola, Intel and Philips manufacture semiconductors there.
- Mexico and China- platforms for consumer electronics and auto assembly.
- <u>Stability of employment:</u>Many emerging markets are boosting their efforts to grow employmentin their respective countries. For instance, in India, the Governmentrecently launched a program called 'Skill India' to create skill set readyworkforce. The initiative will provide training to over 500 million youthby 2020, to make them employable directly.
- <u>Growth in money:</u>Emerging markets will definitely provide you more growthopportunities than any developed economy.The chances of creating wealth of self arebright in emerging markets.
- <u>Power to control:</u>As emergingeconomies tighten their regulatory and judicial systems, the 'power tocontrol' will be more uniform across developed and emergingeconomies.

- Opportunity to innovate:Emerging economies offer a lot of potential for indigenous and cheapinnovation. Many incubators have found success in emerging markets as the cost of innovating and failure is less as compared to matured markets.

CHALLENGES FACED BY EMERGING MARKETS

- Fluctuating oil prices:

The fall of global oil prices has put growing pressure on energy-exporting countries that count on the commodity as their primary source of income. Economies in Nigeria, Indonesia, Saudi Arabia, and Qatar are all influenced by the changing prices. Nigerian finances are dependent on crude oil for 70 percent of revenue, and therefore any drop in prices has a significant impact of the country's primary source of income. However, these countries are diversifying their economies away from dependence on the oil and gas sector. In Qatar, for example, the drop in oil prices is expected to have little impact on the country's finances.

- Infrastructure development:

Growing cities within the emerging markets must invest in themselves, to develop their infrastructure, and position themselves as competitors to the bigger markets. In Indonesia, the government is eager to invest billions of dollar in infrastructure projects across the country.Industrial infrastructure is inefficient, lack of intellectual property right protection, high tariffs, expensive bureaucracy, ambiguous rules and regulations, monopolistic practices, control of distribution systems, unreliable and low quality suppliers and overall industrial manipulation.

- Lack of recognition:

Smaller cities within the emerging markets are often unheard of which is a big challenge in attracting FDI and human talent, and therefore in supporting business development. Bigger cities, particularly in the western world, are in the news, attracting investment, whilst the smaller cities are growing rapidly but stay out of the spotlight. The biggest challenge here for these countries is drawing attention to themselves to really show off their potential to investors.

- Political instability:

The challenge of political instability is traditionally associated with developing or emerging countries for MNEs coming from developed nations where MNEs from developing countries consider economic risk such as exchange rate risk as a greater challenge.

- Market segmentation:

Appropriate market segmentation, relating to the low spending power of the major part of the market and developing effective marketing strategies to apply in different sections of the transforming society are other major issues facing MNEs in emerging markets.

- Corporate social responsibility:

CSR is growing challenge for the MNEs operating in emerging countries. MNEs are expected to balance their role in economic development with social responsibilities toward the country in which they operate.

- These markets may often suffer from insufficient labor and raw materials, high inflation or deflation, unregulated markets and unsound monetary policies. All of these factors can present challenges to investors.
- Other challenges are corruption, inadequately educated workforce, poor public health, inflation, tax regulations etc.

OPPORTUNITIES AND RISKS OF DOING BUSINESS IN EMERGING MARKETS

Opportunities

- Access to new capital is what drives many businesses to take on the risks of doing business in emerging markets. Small businesses may have opportunities to grow in emerging markets not available to them in domestic markets.
- Apart from cost-saving factors, emerging markets have become important growth hubs, fueled by a rising middle class, increasing purchasing power, steady economic growth, and improved infrastructure.
- For startups and small businesses, the incentive to enter emerging markets is huge. Instead of struggling to be seen in a saturated and highly competitive local market, it might have the opportunity to become a pioneer and leader in an economy that is just getting off the ground. For example, 18.48 million people own smartphone in South Africa and 18 million people in Nigeria. This creates a fertile environment for tech startups to bring new mobile products and services to those consumers, much like Vodafone did with its hugely successful M-Pesa in Kenya.
- Partnering with local firms and contracting talent from these regions is also an opportunity to tap the market.
- Investors and entrepreneurs can respond to niches in institutional infrastructure in the private sector, such as the need for information analyzers and advisors, aggregators and distributors, transaction facilitators, and more.
- Professor Michael Porter's strategies for competition on a global scale is very much useful. Businesses can take advantage of local clusters of knowledge.
- Emerging economies have a rapid growth. Investment in the emerging economies helps corporate profits which means stocks go up. This can lead to further investment giving rise to opportunities.
- Emerging economies can provide golden opportunities. We can take the example of China, the move from an economy that was mostly based on agriculture to the one based on manufacturing.
- According to the Confederation of Indian Industry, intellectual skills, exceptional quality and low cost sourcing of services and products provide competitive advantage opportunities for the companies that operate in the Indian market.
- Companies take advantage of this growing size of the middle and higher classes, which means increasing income and paying capacity and finally an increase in consumerism and brand consciousness.

Risks

- Corruption, political instability, economic crises, logistics issues, or bureaucracy are some of the risks in emerging countries that can disrupt the business plans.
- Foreign exchange rate risk- Foreign investments in stocks and bonds will typically produce returns in the local currency of the investment. As a result, investors will have to convert this local currency back into their domestic currency. Therefore, currency fluctuations can impact the total return of investment.
- A disadvantage of trying to do business in emerging economies is the challenge in overcoming cultural risks. Cultural perspectives, rituals and product usage vary around the world and when new economies emerge, they may have different expectations than ones in which a business is established.
- Although most countries claim to enforce strict laws against insider trading, non haveproved tobe rigorous.Insider trading and various forms of market manipulation introduce market inefficiencies, whereby equity prices will significantly deviate from their intrinsic value.
- Emerging markets are generally less liquid than those found in the developed world. This market imperfection results in higher broker fees and an increased level of price uncertainty.
- A poorly developed banking system will prevent firms from having the proper access to financing that is required to grow their businesses. Attained capital will usually be issued at a high required rate of return, increasing the company's weighted average cost of capital (WACC).
- A poor system of checks and balances and weaker accounting audit procedures increase the chance of corporate bankruptcy. Within emerging markets, firms can more freely cook the book to give an extended picture of profitability. Once the corporation is exposed, it experiences a sudden drop in value.
- Political risk refers to uncertainty regarding adverse political decisions.Emerging markets may have unstable, even volatile, governments. Political unrest can cause serious consequences to the economy and

investors. Some additional factors that contribute to political risk are: possibility of war, tax increase, loss of subsidy, change of market policy, inability to control inflation and laws regarding resource extraction.

Entering into an emerging market can be challenging. It takes perseverance, patience, and vigilance when it comes to understanding, managing, and proactively mitigating any of the associated risks. However, the long-term opportunities for the business can be significant and well worth it in terms of reaching new customers, gaining new business partners, and attracting employees that will help in growing and scaling the business.Tapping into this reservoir of bright, young talent can yield high returns for your business, and there is infinite value in bringing in diverse cultures, backgrounds, and perspectives to your business.Investing in emerging markets can produce substantial returns to one's portfolio. However, investors must be aware that all high returns must be judged within the risk and reward framework.

COMPETITION FACED BY EMERGING MARKETS

Emerging markets are becoming more competitive. Product market competition is more intense in leading developing countries like Brazil, India, Korea, Malaysia and Mexico than in developed countries. A research revealed that the short- and long-term persistence of profitability of firms are lower than those observed for advanced countries, indicating that competition is more intense. Emerging markets are conventionally regarded as lacking in competition, with many structural factors inhibiting competition, including government-created barriers to entry and exit. But the essential point is that just as there are structural factors against competition in emerging countries, there are many similar pro-competition factors. In particular, there are the sunk costs of entry, which are far lower in emerging markets than in advanced countries. Another pro-competition factor is the faster rate of growth of emerging countries relative to advanced countries, which leads to bigger markets, more new entry and greater competition.

The new wealth (increase in per capita income), coupled with the increasing use of smartphones, has sparked greater competition for customers who have money to spend and manage, and new consumption habits.

BRICS COUNTRIES AS EMERGING MARKETS

There are many emerging markets around the world, but the largest are known as the BRICS. Many investors believe that these markets are relatively stable and may eventually replace the G7 as the world's next super powers. This makes them essential for any international investor's portfolio.

Brazil

Brazil has been a significant growth driver in Latin America as the largest economy in the South America. Brazil has experienced nothing short of an economic miracle over the past decade. In fact, the country is now the second largest producer of iron-ore in the world and produces more ethanol than Asia and Europe combined. There are several factors in Brazil's favor. The rising economic links with China, demonstrated by the increase of trade. Another important factor in the sustainable growth of Brazil is the projection of the rate of investment.

Russia

Russia is commonly thought of as a Siberian desert, but it's one of the hottest investment destinations in the world. As a leading exporter of oil and natural gas to Europe, the country has benefited from the secular growth in commodities and continues to expand.Russia's transformation from communism to a Wild West-like embrace of capitalism has had a staggering impact on its economy. The global boom in commodities has also helped Russia's stock market become one of the world's top performers until the downturn in 2015.

India

China is often cited as Asia's most promising economy, but India is a country that shouldn't be ignored. With its promising "demographic dividend" and significant farm output (second in the world), investors should definitely consider adding it to their portfolios. While India's economic growth rate recently surpassed China's

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as a key emerging market. Investors in India have also seen some upside over the past several years. India's large English-speaking population and technology-savvy outsourcing firms like Infosys Technologies have helped make this country of 1 billion an emerging market economy to watch.Also, textile industry in India is huge.

China

With a population of 1.3 billion, China is the world's most populous nation and itseconomy isn't far behind. China's economy has been slowing down over the past couple of years, but it remains a major global growth driver. China is expected to surpass the United States in size over the coming years, which makes it extremely important for any international portfolio. But given the country's government and controversies, it's important for investors to recognize some key risks. Investors can participate in China through mutual funds, ETFs, and Chinese companies with listings on NASDAQ and the New York Stock Exchange. China has low cost sourcing. For example, Wal-Mart sourced over $30 billion merchandise from China. Ithas achieved rapid industrialization in the fields of aircraft, machinery, telecommunications.

South Africa

South Africa is a part of the BASIC group comprising emerging countries opposed to Western pressure to undertake legal emission obligations.

CONCLUSION

Emerging markets are rapidly growing and are becoming one of the part of developing countries and are the need of the hour. These markets are definitely going to give a tough competition to the already existing markets in the avenues of profitability, factors relating to development index, technological advancements, growth rate, purchasing power parity (PPP), creation of more employment opportunities, innovation in product variation, introduction of new entrepreneurial skills etc. In future, these emerging markets will overtake the advanced economies and will become world’s leader in economy. Emerging economies are large force in the world economy but still face many challenges to achieve sustainable growth. Investing in emerging markets reaps profits to the investors if they invest keeping in mind the conditions of the emerging economy.Therefore, cooperation among these is a key factor to retain their growth factor so that they can set up to top rank in the existence of big economies.

SUGGESTIONS

- The emerging markets should invest more in infrastructure in order to further capture the global market.
- Whenever investment is to be made in an emerging market, the political stability should be taken under consideration as the political decisions such as change in rules may affect the business.
- The small cities growing rapidly should attract the investors by means of strategies in order to gain share in the market.
- Corporate Social Responsibility (CSR) should be there in terms of ethical values to be followed in conducting a business. A business with an effective CSR and good ethical norms attracts the confidence of the investors.
- Business strategies should be customized as per the conditions existing in that particular nation.
- The companies must leverage the local resources to the maximum possible extent.

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