4

CHAPTER 4

Globalized Trade

4 Globalized Trade

The international economic recession has led to an international rise in protectionist feeling and a fear of globalization. Some experts predict that this rejection will increase significantly in emerging countries.

When the World Trade Organization's Doha Round of talks was launched to deregulate the global market, soon after September 11, 2001, goodwill was the order of the day. However, its progress is being hindered by national security concerns, unease over possible food shortages and the desire to protect domestic employment and the environment.

The Director-General of the World Trade Organization (WTO), Pascal Lamy, sees international trade as an essential factor in overcoming the crisis: "Doha does not have the answers to the financial crisis, but it would be an important step forward in reinforcing international confidence at a time of uncertainty. Stability in trade relations has always been one of the WTO's main contributions to the world economy."[43]

The ministers of trade who attended the World Economic Forum at Davos in 2009 promised to rescue the Doha Round in order to revive the world economy, and to refrain from creating new trade barriers. They also pledged "to refrain from raising new trade barriers [...], imposing new restrictions on exportation or applying measures incompatible with the World Trade Organization (WTO) to stimulate their exports." As a result, Obama's decision to reconsider the Buy American clause that would prohibit the use of foreign steel in major infrastructure projects was widely praised.

Behind these attempts to promote free trade lies the conviction that it will increase the welfare of millions of people, particularly the inhabitants of developing countries. Taking advantage of the benefits of free trade is one of the great challenges in the new multipolar order.

The experience of countries like Korea, China, India and Chile suggests that trade liberalization leads to an increase in annual economic growth rates of several percentage points for some years. If that is true, doing away with subsidies and trade barriers would result in resources being used more efficiently, thereby creating more scope for the reduction of inequality and poverty, social tension, environmental damage, malnutrition and disease. However, the recession has made it clear that the outlook is not completely positive. The countries most open to international trade are also the most vulnerable. This argument could foster anti-globalization and anti–free market feeling, which could have a harmful effect. It could mean not only the failure of Doha, but also an increase in barriers to trade and immigration.

[43] http://www.aol.es.

Did you know?

According to the WTO, the highest tariffs applied to agricultural imports in developed countries are 350% for tobacco, 277% for chocolate, 171% for oilseed and 134% for poultry, which harms exports by developing countries.[45]

Meanwhile, the trend toward signing bilateral and regional trade agreements may also be a threat to the international trade regime, which has been built up with a great deal of effort over the last 60 years[44] (see Figure 20). Fear of losing the privileges stipulated in these agreements may be a barrier to the liberalization of international trade.

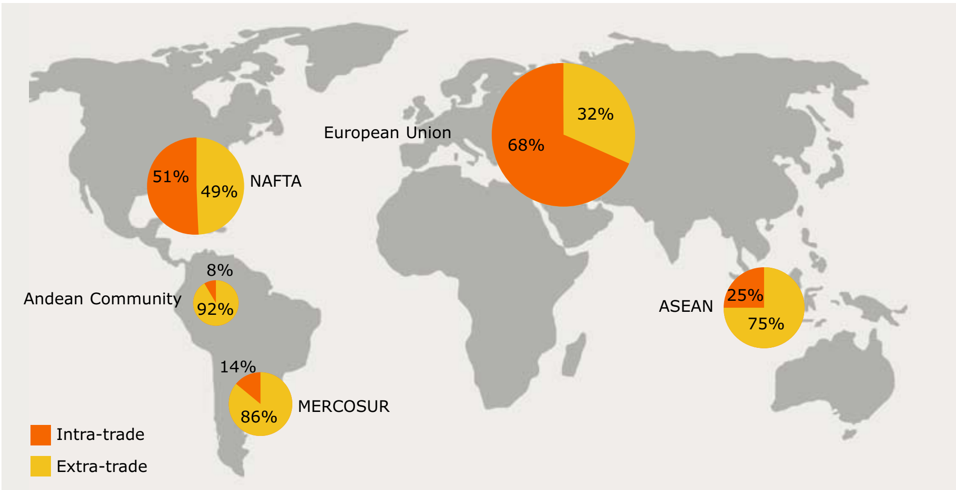


Figure 20. Distribution of intraregional exports, 2007.
Source: World Trade Developments, World Trade Organization 2008.

The New Consumers

Regardless of the trade agreements reached at the international level, the sudden drop in demand will lead to an irreparable decline in the volume of international trade[46] in the coming months. Consumption is falling, not only in the developed countries, which are undergoing a recession, but also in the emerging countries.

When the financial crisis began in the rich countries, the large multinationals thought that developing economies, where demand was still increasing at a brisk pace, would be an easy route to continued growth. It seemed that the flourishing middle class in those countries would absorb excess production from the developed countries at a faster rate than has in fact occurred. Despite this, the transfer of consumer power from the developed countries to the emerging countries is nevertheless taking place. In fact, the crisis seems to have increased the need to seek consumers in these countries (see Figure 21).

[44] *Dialogue on Globalization,* Joseph E. Stiglitz y Stephany Griffith-Jones.

[45] http://www.fao.org/docrep/007/y5419s/y5419s04.htm.

[46] *Global economic prospects 2009: commodities at a crossroad,* The World Bank.

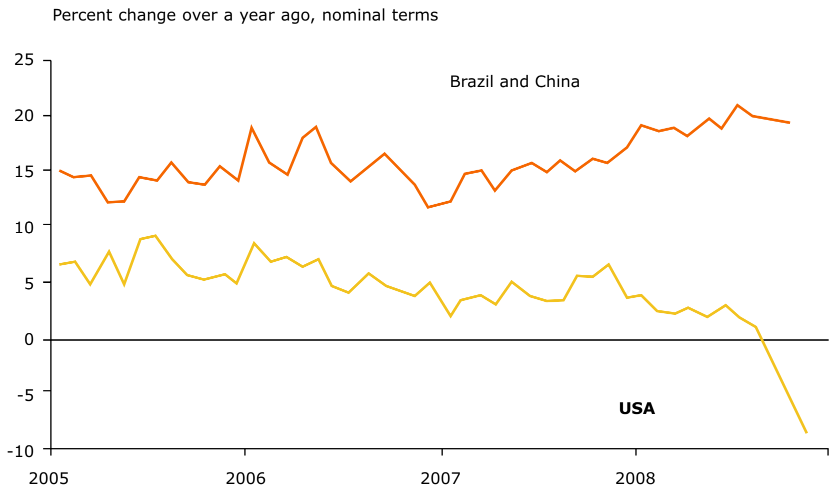


Figure 21. Percentage changes in retail sales.
Source: *Emerging Markets Outlook for the business environment,* Deloitte.

Most emerging countries—including the largest, China and India—anticipate continued growth in the next two years, although at considerably lower levels than in the period 2000-2007. A symptom of the vitality in these economies are their retail consumption figures, which remained relatively high in 2008. Furthermore, the drivers of growth in Asia, such as the increase in productivity, the adoption of new technologies and cultural and institutional changes, were not halted by the 1997 financial crisis. This seems to suggest that the new consumers will be able to boost international trade in the coming years.

The hopes placed on emerging countries as the regenerators of international consumption lie in their rapid population growth as well as their solid economic performance. This is an opportunity for the developed countries, where population trends point toward imminent decline and aging. Estimates suggest that by 2030, the population aged over 65 years old will have increased by a billion people, with the fastest growth taking place in the developed countries, with an increase of 140% by that year.[47]

The new consumers in emerging countries would be part of a growing middle class, consisting of hundreds of millions of people with an annual income of between 6,000 and 30,000 dollars per capita. According to the calculations by the Indian economist Surjit Bhalla, the Asian middle class is now larger than the Western middle class for the first time since 1700 (see Figure 22).

[47] *Global Demographics 2008: Shaping Real Estate's Future Reports Aging, Urbanization and Migration Set to Dramatically Affect Real Estate,* Urban Land Institute (2008).

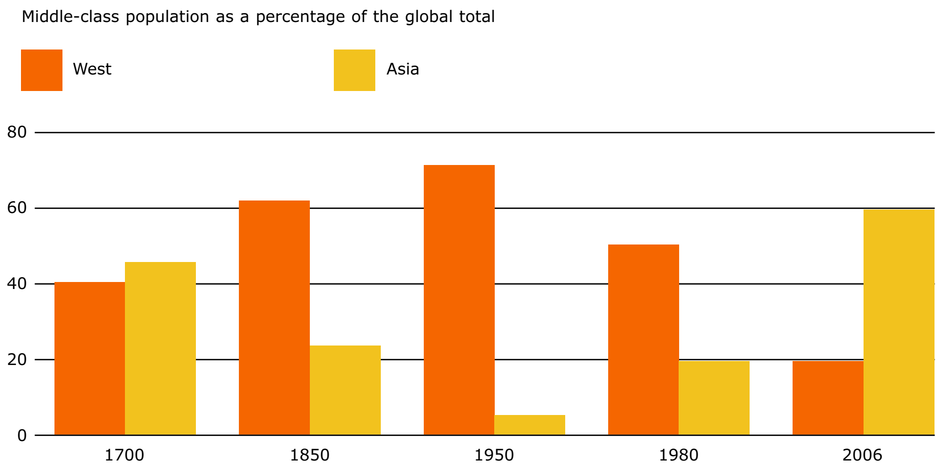


Figure 22. The middle-class population in Asia as a percentage of the global total.
Source: *The Middle Class Kingdoms of India and China,* Surjit Bhalla.

These people will change their dietary habits, make improvements to their homes and increase their spending on education, technology and financial services. This will lead to new business opportunities and to new global challenges arising from greater pressure on resources at the same time. Mark Foster, Accenture's Group Chief Executive of Management Consulting and Integrated Markets, estimates that in 2025, China will have the world's highest number of consumers (see Figure 23).

Did you know?

The Chinese middle class increased from 15% to 62% of the population between 1990 and 2005.

	2005	2025	CAGR
China	3.088	14.527	8,0%
United States	7.335	12.512	2,7%
India	1.924	4.264	4,1%
Russia	749	2.489	6,2%
Japan	1.780	2.291	1,3%
United Kingdom	1.058	1.707	2,4%
Germany	1.180	1.512	1,2%
Brazil	757	1.465	3,4%
France	917	1.374	2,0%
Italy	836	1.168	1,7%
Mexico	648	1.139	2,9%
Canada	539	1.045	3,4%
Spain	560	945	2,7%
South Korea	413	914	4,1%
Australia	339	592	2,8%

Figure 23. The 15 largest consumer markets in 2025.
Source: Mark Foster, Accenture.

Some go even further, and see the four billion people living on less than two euros a day as potential consumers. The idea of providing commercial services to these people at the "base of the pyramid" has been endorsed by authors including C.K. Prahalad, professor at the Ross School of Business at the University of Michigan, who is recognized as one of the world's top ten management experts. According to his line of argument, these people on low incomes may be the driving force behind the next chapter in international trade and prosperity, and a source of innovations that would benefit both rich and poor countries. Microloans in India are an example of this type of business. However, critics of this theory say that this market is very small, and is not a real business opportunity.

Nonetheless, new consumers with medium and low incomes in emerging countries are not the only segment that is attractive to business. The World Luxury Association predicts that consumption of luxury goods in China will account for 32% of the international total in 2015.[48]

[48] «Noticias de la Red de Oficinas Económicas y Comerciales de España en el Exterior: 25/06/08», *China Economic News.*

Did you know?

The International Monetary Fund and the World Bank have classified 42 states as Heavily Indebted Poor Countries (HIPC). Thirty-seven of these receive over half of their goods export income from basic primary products.[49]

Contraction in the Volume of International Trade

Coupled with the problem of fallen international demand is the strong restriction on credit internationally, which also has a bearing on the contraction of international trade. This will have a serious effect on private investment, which is the most cyclical component of GDP, and is most closely related to international trade. At the same time, this marked decline in credit is reducing financing for exports. Commercial banks are restricting credit to businesses, which are finding it increasingly difficult to insure export operations. Finally, the crisis is leading to sharp and unpredictable swings in exchange rates, which can also be an obstacle to trade.

Several factors which have compensated for the effect of the decline in demand from the United States in international trade have converged in recent years. However, this situation may not arise again in the near future. Some exporting countries have focused on markets in developing countries with higher growth rates. For example, despite the United States' share of India's exports falling from 17.1% in 2004 to 15.3% in 2007, China's share of India's imports increased from 5.5% to 8.4%.

Likewise, the rise in prices of basic commodities compensated for the slowdown in exports from several countries (many of them in Latin America) due the lack of growth in American demand.[50] The robust growth in intraregional trade in East Asia—which was to a large extent generated by China's integration into international markets—also contributed to the improvement in the overall trade balance. China's imports and exports have increased by over 20% in recent years.

Unfortunately, the decline in international demand for goods and services as a result of the recession means that there are few centers of growth left for redirecting exports, and the prices of basic products are falling. As a consequence, the developing countries will experience a sharp, albeit probably temporary, fall in their income from exports.[51] The countries that will be most affected are those that have opened up to international trade to the greatest extent, such as Singapore, where exports account for 86% of GDP, and Taiwan (60%).

The Transfer of Power to Asia in International Trade

American consumption levels had begun to decline even before the beginning of the world recession. According to some experts, the country's future as the driving force behind international trade is in doubt. The baby boomer generation's massive consumption during the 1980s and 1990s will decline as this group retires, with the consequent decline in income, which will be depleted even further by the decline in housing prices and the fall of the Stock Exchange.

Businesses will increasingly have to look toward the Asian market. The recession has accelerated a process that had already started, albeit at a leisurely pace.

[49] *Global economic prospects 2009: commodities at a crossroad,* The World Bank.

[50] http://www.fao.org/docrep/007/y5419s/y5419s04.htm.

[51] *Global economic prospects 2009: commodities at a crossroad,* The World Bank.

Did you know?

Thirty years ago, the United States produced 80% of what it consumed, and today it produces 65%.[52]

Despite the slowdown in the growth rate in emerging countries, it is unlikely that it will cease altogether. If they do not succumb to the temptation of establishing protectionist measures leading to a regression in their market dynamics, the transfer of power will continue in the direction in which it is already moving.

4.1. Business Strategies and Globalized Trade

In the new globalized trade landscape, the speed of adaptation required by businesses is constantly increasing. The strategies that have recently made it possible for businesses all over the world to survive and prosper by adapting to the changes, and which will continue to enable them to do so, are listed below in the form of rules. These are based on the hypothesis that strategies for businesses in developed countries should not be the same as strategies for businesses in emerging countries, as their starting points are very different. Spanish companies, whose internationalization process has been outstanding in recent years, will be looked at in particular detail.

Globalized Trade Strategies for Companies from Developed Countries

The opportunity for companies arising from the increasing demand from emerging countries has been discussed above. In order to take advantage of this opportunity, it is necessary for companies to understand these new consumers' needs and preferences. They must adapt their business models and strategies in order to design value proposals in local terms, which meet the demands of these new consumers. By doing so, they will be in a good position to absorb a demand which forecasts suggest will be crucial.

Jagmohan Raju, Marketing Professor at the Wharton School, suggests that the distribution of the middle class all over the world will continue to change, as developing countries remain competitive within the world economy. "Due to economic pressures, more and more companies in developed nations are seeking educated workforces in emerging markets to outsource manufacturing and service jobs. […] More economic pressures in the West mean more jobs in emerging markets and a bigger middle class that has higher buying power."

As a consequence, the multinationals that have so far to a large extent thought of developing countries in terms of a source of cheap labor will once again benefit, as many workers that they pay to manufacture products will be increasingly in a position to purchase them. "Countries like India consist of young consumers who are ambitious and save quite a bit, but are also willing to spend on small luxuries like Western brands of consumer packaged goods."[53]

Those at the base of the pyramid in these economies could also be a business opportunity for companies that are able to adapt their products and sales strategies to this group's conditions. Finally, the outlook for sales of luxury goods is also favorable, although it has worsened due to the current economic situation.

[52] Manufacturers Alliance/MAPI.

[53] http://wharton.universia.net/index.cfm?fa=viewArticle&id=1549

Despite the strength of emerging market economies, businesses that decide to focus on them should take into account the inherent volatility of these regions, and the risks involved in investing there.

There are various models that companies can use in their internationalization process. The Future Trends Forum experts consider that over the next three years, companies in developed countries will mostly follow a "global sellers" model, which involves manufacturing and supply domestically, while seeking new consumer markets for sales abroad (see Figure 24). They also believe that these companies will be global sourcers that, in a very similar way, are businesses mainly interested in selling in their domestic market, but must obtain supplies internationally due to the their country's limited resources. To a lesser extent, and at the bottom of the list, the Future Trends Forum experts believe that companies in the developed countries will tend to be smaller, and in many regions will be multiregional niche players, in sectors based on technology or innovative processes.

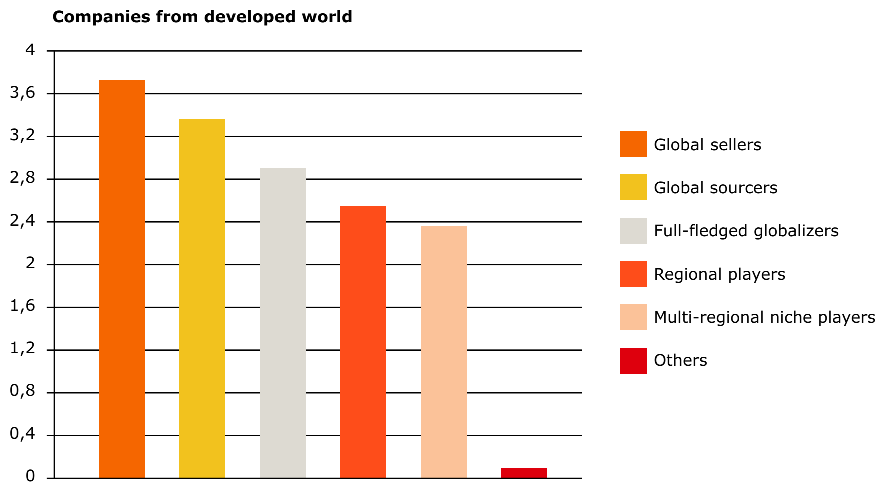


Figure 24. What will be the most common internationalization models for businesses in developed countries in the next three years?
Source: Drawn from the conclusons within the Future Trends Forum.

Rule 1: Business is Good for Development and Development is Good for Business[54]

C.K. Prahalad believes that one of the alternatives open to multinationals for survival in the modern environment is "to discover how to convert the [world's] poor into consumers and introduce them to the global market." This expert feels that the large companies have so far overlooked a market which accounts for around 70% of the world's population, encouraged by the mistaken idea that a

[54] Ian Johnson, World Bank Vice President for Environmentally and Socially Sustainable Development.

lack of resources is synonymous with low profitability. In his opinion, the key to overcoming this challenge lies in "learning from emerging markets and developing a balanced business model of products that are affordable and have acceptable quality."

Prahalad summarizes his "oblivion curve" theory by saying that, "We are all used to thinking in one way. For example, we believe that poor people are not a market because they don't have money to spend. But if we devise a new business model, such as [selling] tickets that are pre-paid [by customers] through cellular phone service, we can convert those sorts of people into effective consumers. This new model has opened the cellular phone model to three billion people. We have to be aware of the limitations involved in looking at opportunities and threats through our [usual] 'management lenses.' What concerns me is that we recognize these tendencies and we change them. That is the 'line of oblivion': it's about learning to forget the old ways of doing things."

One of the most successful ideas for high-yield companies has been to create business models involving local entrepreneurs, backed by microfinancing programs that facilitate access for these low-income customers. The Nokia-Siemens project in Africa is an example of successful deployment of this tactic. The telecommunications giants carried out the "Village Connection" program in countries like Uganda and Rwanda, and involved various agents, starting with local business leaders, whose task was to find customers. Then they sought an operator to provide the services and finally, a microfinancier to manage the supply. The program succeeded in reducing fees, and having a cellular phone these days costs three dollars a month.

Above all, it has been companies in the telecommunications and financial sectors that have used this tactic. However, Unilever's penetration in India, another clear example of a successful strategy, is very similar. The Anglo-German consumer goods company uses local microenterprises to reach rural communities. In India, it used Hindustan Unilever as its local subsidiary. It is repeating this model in Bangladesh, Sri Lanka and Vietnam, and considering it for the Latin American and African markets. 50% of Hindustan Unilever's income now comes from the rural market, thanks to "Project Shakti," which consisted of providing microloans to achieve direct distribution of their products in homes.

Products and services must also undergo a profound transformation to meet the needs at the base of the pyramid. With this objective in mind, Hindustan Lever (Unilever) sells a shampoo that works better with cold water in the Indian market.

When designing products and services for this group, their needs must be given careful consideration. Many businesses are allocating resources to this task, in order to serve this segment and obtain privileged positions. Nokia organized multidisciplinary teams with non-governmental organizations and universities in Kenya, South Africa and Uganda in order to improve its understanding of Africans' needs in mobile communications. Other multinational tech firms, such as Google and Microsoft, are working on designing products directly for the Indian rural market. Google is developing a new search product that uses voice, as well as the unusual feature of being able to understand the various Indian accents, so that people without a computer can also have access to their services.

In rural areas in India, there are thousands of soy farmers who do not sell their crops without first visiting a communal center with Internet access. There, they can see the price of the product, not only on the local market but also on the international markets, and can decide whether to sell that day, or to wait for prices to rise. They can also see information about the weather or look at studies on fertilizers or pesticides. The project is called e-Choupal and the company behind it, ITC, saw an excellent business opportunity as well as the chance to provide service to a group that has traditionally been excluded from any technological means. This situation is also a win-win scenario. The farmers benefit from selling their crops at better prices, and ITC gains access to thousands of farmers to whom it can sell its products, and becomes an intermediary between these people and the international markets.

Also in India, the life-insurance company Max New York has developed an adapted insurance policy to attract customers on low incomes, with a payment of 20 dollars when it is arranged and a minimum premium of just 20 cents. It is also possible to make payments in any store in the country.

Other projects with win-win strategies for businesses and low-income consumers include those launched by GrupoNueva, who learned to distribute products more directly to low income markets, and created a competition for producing other business ideas focused on these markets in mind; Suez, which found new partners for distributing water in Brazilian communities; Procter & Gamble, which is committed to developing consumer products that meet the needs of the poor; Vodafone, which developed a new franchising method for telephone services in isolated communities; and SC Johnson, which obtains ingredients for its products by buying them from poor farmers in Kenya. In the future, other large oil and mineral companies such as Shell, BP and Rio Tinto may create business opportunities in low-income countries and communities.[55]

Rule 2: New Consumers are Concerned about the Price

Although millions of individuals are currently joining their countries' middle classes, they have yet to reach the same income levels as their counterparts in mature economies. In order to win over consumers in these markets, businesses need to create new products that take price sensitivity into account. In the specific case of China, consumers appear to have no brand loyalty and their main motivation is often the price, rather than any perception of quality or the prestige that may be associated with the product.[56]

The aim of multinationals in emerging countries has traditionally been to sell premium brands because they have larger profit margins. However, they have

[55] http://www.wbcsd.org/web/publications/sl-fieldguide-spanish.pdf.

[56] «Los desafíos de vender en Asia», *Knowledge@Wharton* (9/01/2009).

realized that the main business lies with a broader market, which they must focus on by means of a pricing strategy that competes with local brands. This strategy also usually requires personalized products, and even new ones, in order to meet the specific needs of the market concerned.

One example here is Coca-Cola, which has designed a successful strategy for adapting prices to the needs of new consumers. To do so, it prices its product slightly lower in urban areas than in Western markets. The price is even lower in rural areas, but consumers have to drink it immediately and return the bottle to the supplier, as part of a strategy that saves on costs and cuts prices. The bottles are also smaller than in the West.

Despite this significant price sensitivity, there are more expensive products (i.e., the premium products mentioned above), for which new consumers would be willing to pay more, which resembles Western patterns of consumption. The baby-food segment is an example. Mike Booker, a partner at Bain & Co. in Singapore, says: "Nobody wants to be seen as not spending money on their child, so infant formula is very premium. When you raise the price, sales go up. This will likely remain a premium product, so there's no reason for [companies] to water down their lines with less expensive offerings."[57]

Likewise, Ellen Hu, Global Marketing Director of Estée Lauder skin care products in Asia, says that Chinese women are prepared to pay for high-quality products like those marketed by her company. However, they are not loyal to a brand and change if the competition offers them a good discount. "In terms of cosmetics, the Asian market is extremely sensitive to promotions […]. One question that is always on the consumer's mind is: what type of promotion is it offering me? We had to work hard to find a way to respond and preserve our brand's tradition at the same time." Unfortunately for the multinationals, the premium segment in these countries is still small.

Rule 3: Create Alliances between Sectors

Businesses' strategies have always ultimately aimed to maximize their share value, i.e., to meet the demands of their investors. To do so, it is essential to manage and meet the demands of two of the cornerstones of all businesses: customers and employees. These three groups (investors, customers and employees) have historically been the base on which business strategies have been established. In capitalist market economies, these strategies are an appropriate response to the market situation. However, in many markets in emerging countries, governments and other social agents have a great deal of influence, which means they must also be taken into account when establishing strategic plans. Obtaining these groups' loyalty is crucial when entering these markets, and in subsequent positioning vis-à-vis competitors.

Governments and Non-Governmental Organizations (NGOs) are becoming increasingly interested in working with businesses for mutual profit. By involving

[57] http://wharton.universia.net/index.cfm?fa=viewArticle&ID=1461.

development organizations that share similar objectives, companies can benefit from their basic experience and additional resources. An intersectoral vision can also lead to innovative alliances that involve companies in various sectors, tackling a range of needs holistically.[58]

At present, multinationals are failing to meet this tactical objective. Although they invest vast amounts of resources in CRM (Customer Relationship Management) applications to exploit all the opportunities provided by consumers, investments in seeking alliances in target countries are at an all-time low.

The case of Carrefour clearly shows how obtaining approval from the government or social communities is by no means unimportant, and definitely not a tactic that can be repeated in the same way in every emerging country. The French retail group had a highly successful entry into the Chinese market, but was unable to repeat that success in the Indian market. This may have been due to a lack of planning, as it was feeling the pressure of Wall Street's short-term expectations of rapid growth for emerging countries. Or it may simply have been the complexity of the target. Carrefour had everything in its favor: there were vast amounts of consumers, it could cut prices by up to 10% thanks to its optimized supply chain, and it had a job-creation proposal that would have been quite attractive to any government. However, it did not take into account the pressure from a pro-labor group that succeeded in making the Indian government backtrack on its decision. Finally, it granted 100% of the wholesale market in India to the German company Metro, Carrefour's direct competitor, and in so doing severely restricted Carrefour's right to sell in supermarkets.

Another case of a failed entry into the Indian market due to a lack of commitment from various communities or governments involved both Coca-Cola and PepsiCo. The Indian Government informed the two soft-drink companies that they would have to reveal their secret recipes in order to do business on government premises in several Indian states. They obviously declined, and were thus prevented from entering this market. The Indian government's demand was the result of studies undertaken by a local NGO, which declared that the products of both companies contained levels of pesticides up to 24 times higher than those considered safe for consumption.

Some companies, such as Procter & Gamble (P&G), have learned the importance of these strategies from experience. In 1999, P&G decided to focus on the needs of consumers in some emerging countries. The company firmly believed it would be able to make money and benefit the communities where it was operating. It initially focused on products that met dietary deficiencies, while offering consumers a product that was appealing and affordable.

It created a product called NutriDelight, an inexpensive powdered drink that contained all the essential micronutrients, and also tasted good. It was introduced in the Philippines using launch strategies and tactics similar to those of many other P&G products in developed countries. The results were disheartening, but provi-

[58] *Oportunidades de negocios para reducir la pobreza,* World Business Council for Sustainable Development.

ded an important lesson. The product had been designed for a problem in the developing world, but based on a developed country's mentality. This product included all the latest technology, instead of being designed for a low price. P&G also realized that its infrastructure in the country was insufficient to offer this product in the lower market segment, or in the poorest communities.

P&G changed the name of NutriDelight to NutriStar, and launched it in Venezuela. It changed its approach to "Let's do it all ourselves" and began to seek new partners among businesses and in other sectors, with firmly established local roots. It built up a network of alliances with NGOs, multilateral agencies and local pediatric associations in order to make people aware of the need for the product. It also included local business leaders and entrepreneurs as allies to form a chain of coordination from the producers to the distributors. P&G gave the license for the product's formula to local businesses, thereby spreading the risk and reducing the capital investment. Local businesses benefited from the technology transfer, and P&G from the early positioning of the brand in markets with a potential for future growth.

These cases highlight the importance of establishing strategic alliances in local markets. This is even more necessary as a consequence of the economic recession. The increase in protectionism will lead to further difficulties for businesses, which will have to make even greater efforts to convince governments and other social agents of the contribution made by their business to the economies of the target countries.

In emerging regions such as Latin America, some governments are placing increasing obstacles in the way of European multinational companies. Countries such as Argentina, Bolivia and Venezuela are trying to re-establish their presence in business areas in which foreign companies such as Repsol YPF, Grupo Marsans, Endesa and Telefónica competed.

Rule 4: Consider the Diversity of Tastes

Before embarking on the adventure of serving new consumers in emerging countries, the particular features of local tastes must be studied, and the range of products and services adapted to them. According to Bain & Co.,[59] local businesses have advantages in terms of consumer loyalty, lower costs and more favorable government regulation. Multinationals attempting to enter emerging markets must overcome these obstacles in order to obtain a competitive advantage. Substantial changes must often be made to the products offered. For example, Procter & Gamble realized that in order to obtain a share of the Chinese market, it had to adapt more to local tastes. It launched new flavors of toothpaste onto the market, such as fruit, tea and herbs. This helped the company to obtain 25% of the market in 2007, when its presence was practically nonexistent ten years beforehand.

[59] «Winning in Emerging Markets», *Bain & Co. Newsletter* (17/06/08).

Many manufacturers are starting to adapt their products to local tastes. The telecommunications companies in the Indonesian market analyzed consumption patterns in mobile services and discovered that their income from the middle- and lower-income classes came almost exclusively from text-messaging services (SMS). These companies are focusing their efforts on designing new services for sending data and wireless broadband devices.

A yogurt manufacturer launched a version of its product which combined the flavors of cucumber and kiwi, because the product obtained good results among some Chinese consumers. Meanwhile, McDonald's always adapts its product range to suit local tastes. For example, in India it does not sell its international flagship hamburger, the Big Mac, replacing it with vegetarian products that it does not sell in other countries.

It is important to remember that Asian markets in general—and China in particular—are much more diverse than many companies assume. Professor Fred Young, team leader of the Asian division of Swain Tours, a tour operator specializing in exotic destinations and tailor-made itineraries, says: "There's no such thing as one China. In Shanghai, people prefer having a separate MP3 player and phone. In other cities, people want one device. In Shanghai, people want carousel loaders for their CD players. Down south, one-CD trays are fine because they're cheaper. And tastes can be completely different when you drill down to the small cities."[60]

Rule 5: Dress up in Local Culture

It is necessary to go a step beyond simply adapting the range of products and services, and obtain an image as a local business. The transformation must be far reaching and sometimes affects the corporate image, processes, the supply chain, the organizational model, etc.

According to Diana Farrell, Director of the McKinsey Global Institute[61], distribution is an important consideration for companies hoping to reach the emerging middle classes. The infrastructures in many countries are underdeveloped and businesses often forget the importance of the distribution system. Placing a product on the market with the right distribution in these cases can be a major challenge (although it can also be a great business opportunity). Many companies start in the big cities, where behavior, perception and attitudes are more similar to those in developed markets. However, conditions in small towns are very different, despite their rapid development, because more value is placed on the face-to-face relationship with the vendor. For this reason, it is easier for companies to reach this type of consumer through small shops.

The British supermarket chain Tesco made its sales format more flexible in order to adapt to the idiosyncrasies of the local business in the Asian countries where it was expanding. In these countries, consumers prefer to buy small amounts of fresh food on an almost daily basis, instead of buying supplies for longer periods

60 *Knowledge@Wharton* (9/01/2009).

61 «Las dos caras de la nueva clase media global», *Knowledge@Wharton* (23/07/2008).

in larger stores. In their eagerness to adapt to local tastes, the supermarket even started selling live tortoises and toads, which are common items in food stores in China. Meanwhile, McDonald's adopts the style and architectural image of some countries where it wants to increase its presence. In the end, what companies seek is to build their brand, and it is only possible to establish a long-lasting relationship with the consumer in the target country by presenting a long-term project, with a network of recognized and trusted distributors. Investment must be focused on the long term, and be persistent. Having a subsidiary working exclusively on the market means that more specialized strategies can be defined. Another strategy is to purchase a local player, which can facilitate entry into an emerging market in the following ways: successfully adding local brands to the business line, reinforcing product distribution, reducing operating costs and hiring scarce local talent. In 2007, Coca-Cola bought the Russian company Aquavision in order to increase its production and presence in that country.

Another factor related to local culture that may influence the sales of multinationals in emerging countries involves the political measures taken in their countries of origin. Given the world population's access to international information and news, in many cases there is an immediate rejection of multinationals' products when their countries of origin make a decision that is unpopular in the target country. The most obvious example was when the United States invaded Iraq in 2003. Many consumers rejected all companies they identified as American, such as McDonald's and Coca-Cola, which were deemed the main American brands to boycott. There was even a parallel product launched in Muslim countries to compete with Coca-Cola, called "Mecca-Cola." In view of multinational companies' inability in most cases to influence the political measures introduced in their countries of origin, and the difficulties in softening their impact in the countries where they operate, trying to disguise themselves culturally as local businesses is an alternative.

Rule 6: Know your Competitors

While competition between companies offering the same products or services is certainly nothing new in business, it is a key factor to consider when contemplating entry in emerging countries, given the differences between them and developed countries. The relative poverty of these countries is offset by their lower competitive intensity and better prospects for growth.

The characteristics of the "enemies" must be studied before entering a country. Some companies, for example, have a department focused exclusively on assessing the specific features of each emerging market and designing entry strategies adapted to the situation. Furthermore, once positioned in the target market, it is also necessary to analyze the entry of new competitors in the same way.

However, what are the competitors in these developing countries like? Obviously, multinationals expanding their services in other countries also want to take up a position in rapidly growing markets. An article by Bain & Co. warns that some of the leading organizations in mass consumption, such as Coca-Cola, Unilever and Danone, already get 9%-15% of their total income from the world's three main emerging markets— China, India and Indonesia—but these competitors are already well known.

There are also local competitors who start with the advantage of greater knowledge of consumers' needs and tastes. Hence it is worthwhile to study the way they operate, their processes and strategies, which although probably improvable, are currently efficient.

In many emerging countries, such as India, it is increasingly common to find business conglomerates—such as Tata and Reliance—which are giants in their country's economy. The distinguishing competitive factor of these large companies operating in various sectors is their diversification of businesses and risks. Furthermore, they achieve synergies between one another, optimizing resources, knowledge and talent. They are sometimes powerful enough to drive competitors out of the market with temporary price wars, while being supported by their other businesses. These conglomerates are normally owned by extremely wealthy families that decide to diversify, thereby obtaining a competitive advantage over other companies.

One of the latest Indian conglomerates to emerge is Bharti, the company established by Sunil Mittal, which operates in agriculture, financial services, insurance, telecommunications and retail sales. Its target income is up to 10 billion dollars in 2010.

Globalized Trade Strategies for Companies in Emerging Countries

The globalization process has entered a phase in which business opportunities are not exclusively taken by multinationals from developed countries in emerging economies. The trend is shifting toward these investment flows taking place in both directions, and to an increasing extent, even between some emerging economies and others. Mark Spelman, Global Head of Strategy at Accenture, highlights the interdependence between these flows. He feels that much can be learned from the strategies of multinationals in developed countries, but also from those in emerging economies. What formulas have led to the growth rates seen by the emerging economies and their multinationals? What strategies will sustain the rise of multinationals from emerging countries?

In the opinion of the Future Trends Forum experts, the search for new markets will be the main factor behind the internationalization of companies from emerging countries (see Figure 25).

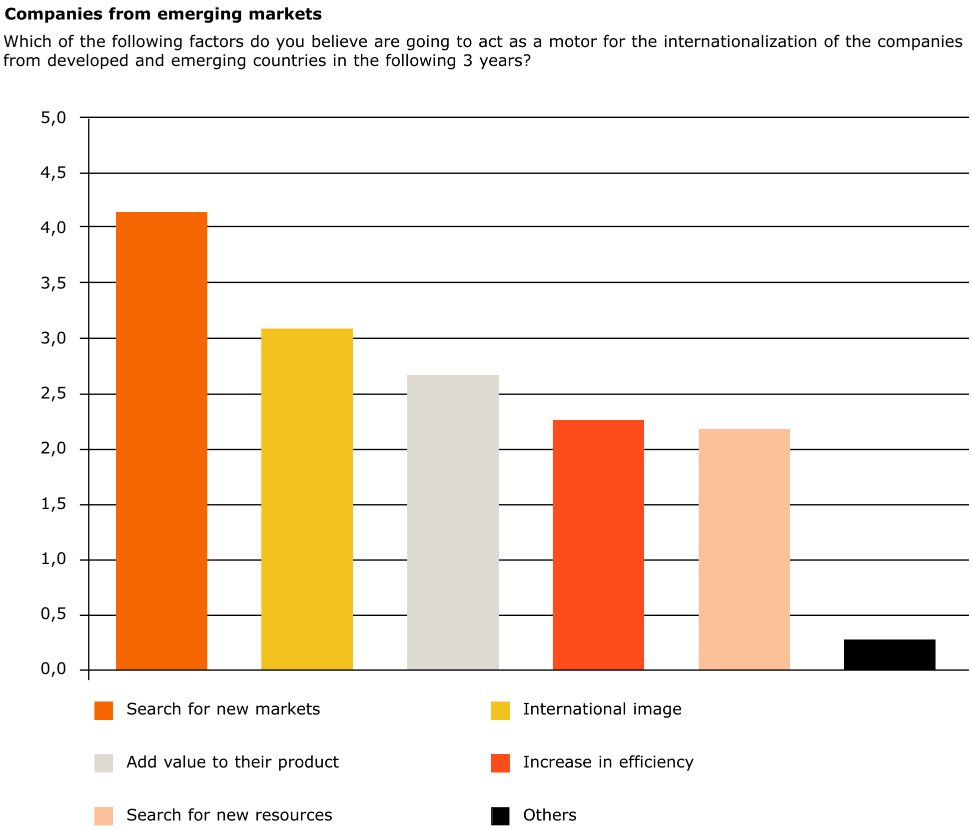


Figure 25. Factors encouraging the internationalization of companies from emerging countries.

Various types of barriers will arise in this internationalization process toward developed economies (see Figure 26). Indeed, the main barrier cited by the Future Trends Forum experts will be the high level of competitiveness in the global market. To overcome this barrier, these companies can use their experience in their local market for their international expansion and adopt strategies involving mergers, takeovers and joint ventures with businesses in developed countries. For example, Hyundai Card, the result of a joint venture between Hyundai Motor (South Korea) and General Electric (the United States) is planning to expand to the United States, China and India.[62] The trend toward more ambitious mergers and takeovers is increasingly applicable to multinationals in emerging economies.

[62] «To save, South Koreans use credit cards», *International Herald Tribune* (13/12/2007).

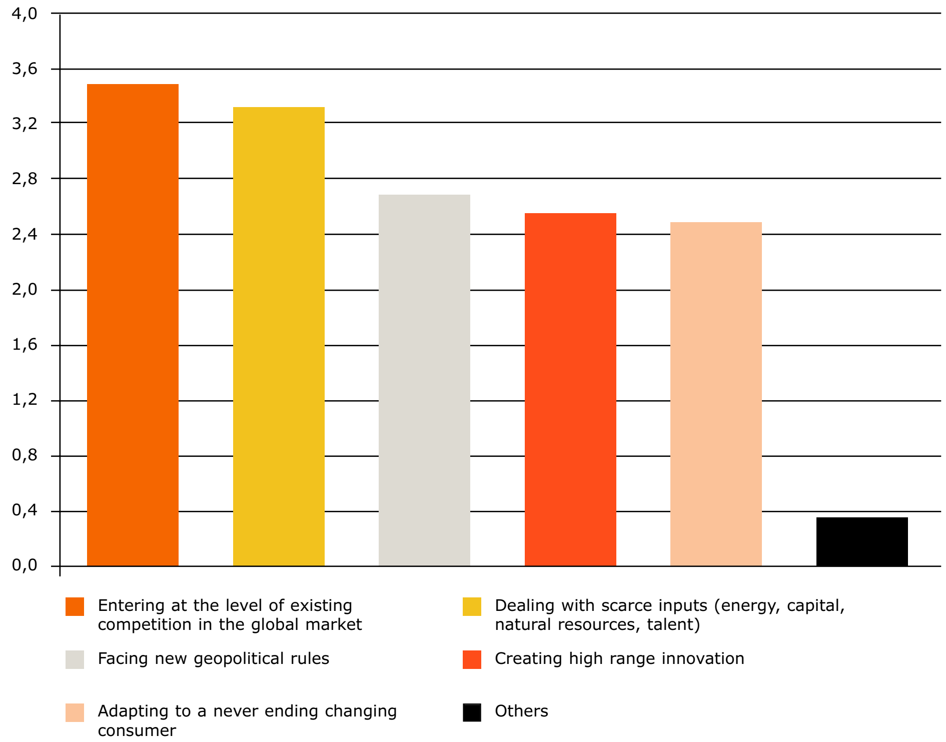


Figure 26. The main barriers on the path toward global competition for multinational companies from emerging markets.
Source: Drawn from the conclusons within the Future Trends Forum.

As for the most common internationalization models to be adopted by businesses in emerging countries, the Future Trends Forum experts point to "regional players" and "global sellers." The former seek out new consumers in nearby emerging countries for reasons of cultural affinity and proximity. The latter seek consumers elsewhere, despite producing goods using local resources in the source markets (see Figure 27).

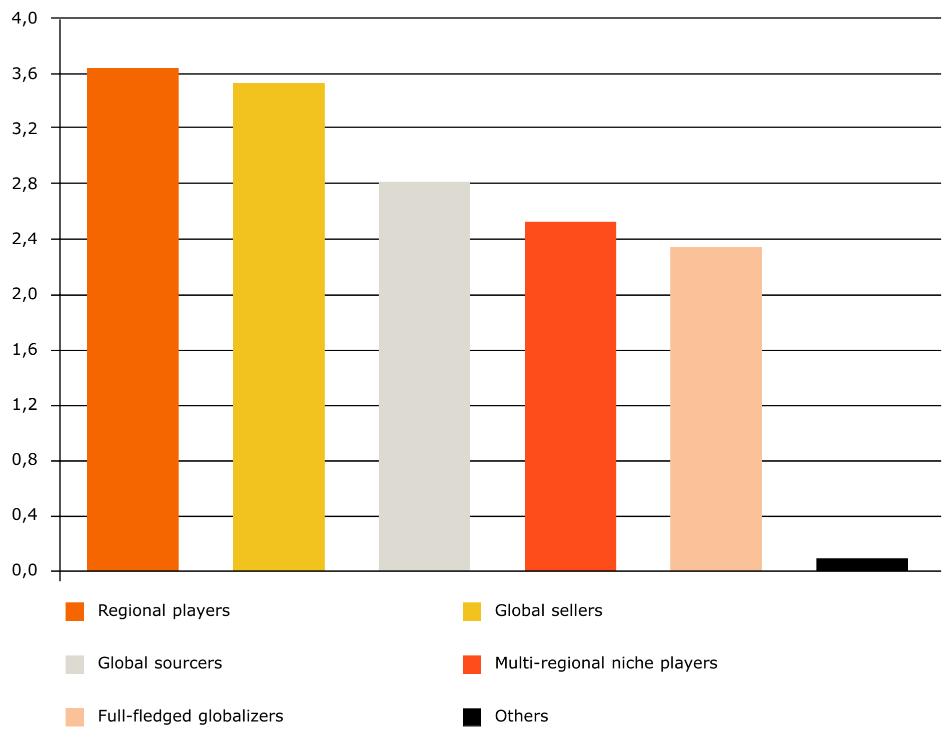


Figure 27. The most common internationalization models adopted by companies from emerging countries.

Rule 1: Withstand the Crisis in Western Consumption with Local Demand

One noticeable phenomenon occurring in emerging countries is the "return home" of major export companies that originated there. The sharp drop in demand from developed countries has led them to foster the neglected local demand in their own markets. These companies' competitive advantage, and the key to their success, lies in knowing how to use their employees' knowledge of the tastes and needs of consumers in their own country. There are several cases of traditional Chinese exporters adopting this strategy. These include the advertising campaign by Lenovo, the Chinese personal computer manufacturer. The company, looking to refocus on its domestic market, was aided by its staff's extensive knowledge of that market, which is only now being explored by the company.[63]

Chinese mobile handset users have also been offered a wider range of advanced services, such as video calls and wireless broadband connection. In January 2009, the Chinese government granted 3G licenses to three national operators: China Mobile, China Unicom and China Telecom.[64] Competition in the market is thus being encouraged, as well as the opportunity for users to compare the technology in each range of products.

[63] «Chinese exporters look to sell in the home market», *Business Week* (12/02/2009).

[64] *«China business: 3G era opens», Economist Intelligence Unit* (14/01/2009).

Accenture uses the concept of "incubating local demand" to refer to the way in which businesses can create purchasing power so that consumers with fewer economic opportunities can become part of their clientele. There are three strategies for "incubating demand"[65]:

- **Developing infrastructure.** Some companies in emerging countries have invested in the infrastructure necessary to promote new markets in the areas of telecommunications, transport and financial formulas. Prospéritas, a microfinancing institution that won first prize in the IE Business School 2008 entrepreneurial project, offers microloans to Colombia's low-income population.[66] Cell Bazaar, the company founded by Kamal Quadir, one of the Future Trends Forum experts, uses wireless technology to create a virtual market that provides a means of communication between farmers and traders in Bangladesh and potential buyers. The vendors advertise their products by price and location in a market with transparent information. Both Prospéritas and Cell Bazaar are creating a group of potential consumers.

- **Innovating.** Access to the right technology also plays an important role in winning over "hidden" demand. Many businesses have included new technology in their products and services. In Bolivia, a new debit card has given many people access to the banking system for the first time, by means of over 50,000 cash machines. The machines talk to users instead of communicating through written text, which is very useful considering that 25% of the customers are illiterate. By selecting the color on the screen, users can even choose the language in which they want to be served: Aymara, Spanish or Quechua.[67] The project was developed by Prodem, a local organization with expertise in microfinancing, and has proved beneficial to both sides. The company earns money with the seven dollars it charges each customer annually for maintenance, and the users have banking services that they previously had no access to, along with the advantage of having their money available 24 hours a day, seven days a week.

- **Adapting products.** Businesses in emerging economies are often forced to adapt their products to comply with the needs or preferences of new consumer segments. A case in point is Arvind, one of the world's largest manufacturers of denim garments, which was unable to corner the Indian low-income segment because its prices were too high. The company ultimately decided to market a kit for making denim garments for only six dollars. It was distributed to local tailors in rural areas, thereby reaching a largely inaccessible consumer group.

Rule 2: The Recession Makes Low-Cost Products Fashionable

As a result of the economic crisis, consumers have started to tighten their belts and although they have not stopped buying, they want to do so more cheaply. The difference is in the price, and whoever offers the most competitive products will increase their market share. Low-cost flights, low-cost computers, low-cost

[65] *The Rise of the Emerging-Market Multinational,* Accenture (2008).

[66] «Prospéritas, espíritu emprendedor con vocación social», *Knowledge@Wharton* (11/03/2009).

[67] http://www.iadb.org/NEWS/detail.cfm?language=Spanish&id=1904.

Did you know?

Despite the effect of the recession on consumption and the figure for automobile sales in the United States being 16% lower than a year ago, in global terms it reached a record high of 59 million in 2008. This was largely due to the emerging economies.

cars... more and more sectors are joining the trend toward cheap prices. The pioneers in the new sectors that have jumped on the bandwagon are merely continuing on a path that others have trodden successfully. Low-cost companies in sectors such as fashion, household goods, and food are taking advantage of the decline in consumption to increase their turnover. Companies from emerging countries have an initial advantage, which is their lower production costs in their countries of origin.

Starting with low-cost cars , the Indian company Tata Motors launched its European version of the Nano low-cost car in March 2009. It costs around 100,000 rupees (approximately 1,930 dollars) in India. The European version has been adapted with improved specifications, and the price is around 5,000 euros.[68] There is even a model with lower cylinder capacity to appeal to consumers who want to cut down on their fuel costs. This shows that companies must include aggressive cost cutting in their business models if they are to compete on price in a market in recession. Companies from emerging economies will find this strategy much easier to apply, thanks to their lower production costs. Tata's Nano was supposed to compete with the motorcycle market in India, but has succeeded in adapting to the needs of consumers in developed countries. These needs, specifically in the automobile sector, take the form of cheaper and more ecological means of transport. There are Chinese models already competing with the Japanese hybrids because they have managed to cut costs while also reducing their environmental impact.

In the technology field, Lenovo aims to overcome the economic crisis by focusing on regions with emerging economies. The company's new strategy is to sell low-cost computers in rural areas in China.[69] Meanwhile, the Brazilian factory Tectoy in Manaus and the largest wireless chipset manufacturer, the US firm Qualcomm, have launched the Zeebo console onto the market. The novel feature of this new video game console is that it is designed for sale in developing countries, specifically Brazil, India, China and Russia, where promoters see a market niche of 800 million young people wanting to play with something cheaper than the devices currently available.[70]

Rule 3: Aspire to "Global Localization"

Companies must strike a balance between business strategy at a global level and adapting to local tastes and expectations. McDonald's was a pioneer in offering fast food at an affordable price and also serves wine in France and beer in Spain. Korea's Samsung is a company from an emerging country that has followed the same example: it launched washing machines onto the market in India that had a memory-recovery function to compensate for power outages, as well as a special wash cycle for saris (the traditional dresses worn by Indian women).

Another example is Brilliance China Auto, which has set up factories for car production in Russia, Egypt, Vietnam and North Korea. In the first six months of 2007, its international sales increased by 85% compared to the same period in

[68] «Tata hopes the time has come for a Western Nano», *Times Online* (2/03/2009).

[69] http://www.vnunet.es/es/vnunet/news/2009/03/06/lenovo_enfoca_su_mercado_de_portatiles_low_cost_a_los_campesinos_chinos

[70] http://www.elpais.com/articulo/ocio/Zeebo/consola/low/cost/paises/desfavorecidos/elpeputeccib/20090326elpciboci_3/Tes

the previous year.[71] The Chinese carmaker has succeeded in reproducing a model that competes with other companies from emerging economies in terms of price, but is also appealing to the lower segment of the market in developed countries.

As a result of the crisis, a trend is starting to become apparent in which companies from emerging economies avoid depending on income generated by the United States. It is therefore no surprise that the two largest telephone operators in Russia, having saturated their own market with an increase from 1 to 170 million users, are implementing sales strategies in India and Vietnam.[72] Meanwhile, Mexican "maquiladora" assembly plants[73] are seeking to increase their sales in countries like Chile, Peru and Brazil.[74]

Rule 4: Acknowledge Differences in Emerging Consumption Habits

One conclusion reached by the Future Trends Forum experts was that consumers in emerging countries are undergoing a phase of consumption prior to that of developed countries. Whereas "mass" consumption products meet the needs of the inhabitants in emerging countries, consumers in developed countries are not satisfied with the standard products that appeal to the vast majority. They are increasingly demanding more varieties, leading to what is known as "mass customizing" or product personalization. As the development of the emerging countries continues, they will follow the same path. Acknowledging this process will be crucial to the success of companies from emerging countries.

In fact, the markets in countries such as China are so large that these differences in consumption habits can be found within their borders. While in some parts of the country, businesses merely meet basic demand, in other areas—mainly in the cities of the East—they satisfy a far more sophisticated emerging demand. Companies such as Youngor, one of China's largest firms, designing, manufacturing and selling menswear, use their "mass customizing" process to reach the high end of the market. The company offers tailor-made suits in the Chinese market for 320-378 dollars.

Other examples of China's slow progress toward "customizing" can be seen in the automobile sector, where it is possible to order an "à la carte" car, something unthinkable in markets like the United States. In 2002, Haier also offered the opportunity to customize refrigerators. Although this was not very successful among individual consumers, it worked well among local businesses, who saw it as a means to distinguish themselves from the competition.

C.K. Prahalad feels that part of a strategy's success depends on whether it "includes the user community in the process of creating new products and services, as in the video-game industry. This is the first time that the human race has been connected together, thanks to the advance of new technologies ranging from the BlackBerry to cellular phones to television. This connectivity makes it easier for customers to be closely connected to the company and to work together." For Prahalad, "it is the customer who now decides what can be done and

[71] «Brilliance to set up factory in Russia», *China Daily* (2/11/2007)

[72] «Russia Telcos look to Asia for growth», *BusinessWeek* (22/04/2008).

[73] Businesses that import materials without paying tariffs, with a product that will not be sold in the country. Most of these factories are in Mexican cities located on the United States border. The capital for the "maquiladora" factories tends to be entirely foreign; the proprietors are generally American companies, although there are also some important emerging-economy companies.

[74] «Mexico's manufacturers seek new markets», *Financial Times* (12/02/2008).

what cannot be done." It is the customer who "defines where the value of the product is; not the company that does so, as in the past."[75]

As well as creating systems for customers to participate in product development, and updating products and services in response to the market's rapidly changing tastes and needs, "corporate strategy has to go beyond fulfilling the expectations" that customers reveal through this interactivity.

Rule 5: The Importance of the Brand

Emerging markets do not have a history of brand marketing and management as developed markets do. However, the rapid growth of their economies—with the subsequent availability of money to spend and the increased sophistication of their consumers—represents a great opportunity from the commercial standpoint.

The challenge for emerging markets is to adapt their marketing strategies to changes taking place in society and therefore among the consumers. The Indian "1298" service (the number for calling an ambulance) received unexpected attention when images of their bright yellow vehicles were broadcast internationally after the terrorist attacks in Mumbai. Without realizing it, the service was capitalizing on its television appearance.[76]

Who wins among consumers in emerging markets when a local brand comes face to face with an international rival? Forty-seven percent of South Africans believe that the quality of locally produced brands matches that of international brands.[77] Furthermore, almost 60% of consumers in emerging markets would be more likely to buy a local brand than an equally priced international brand (see Figure 28).

[75] http://www.wharton.universia.net/index.cfm?fa=viewArticle&ID=1361.

[76] «The Value Of Brand In Emerging Markets», *The Inspired Economist* (15/01/2009).

[77] Study by Synovate, a market research company belonging to the communications group AEGIS.

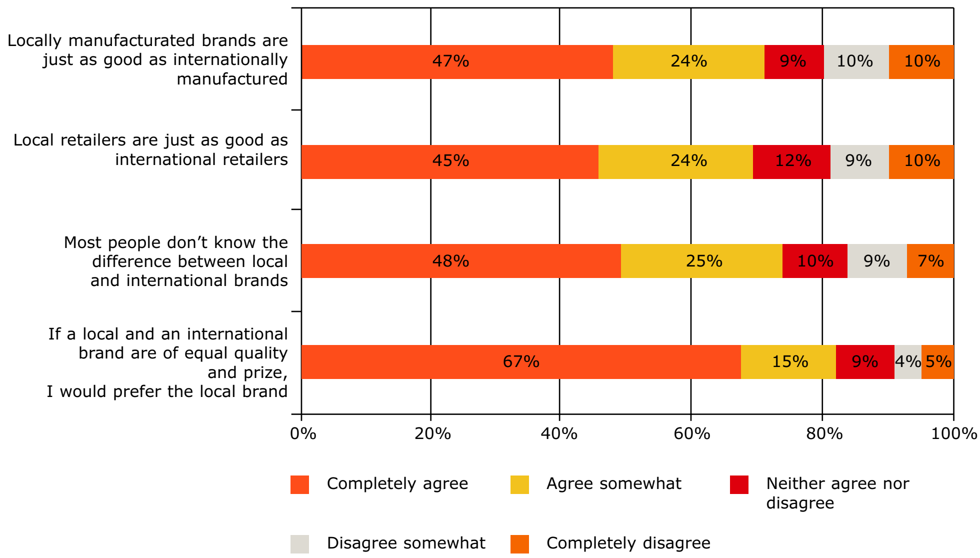


Figure 28. Brand perception by consumers in emerging countries.
Source: Synovate Hotspots Report (South Africa).

Meanwhile, on their way toward internationalization, Asian economies aim to silently but swiftly shed their image of manufacturers of cheap products of dubious quality, and start competing with their own high value-added brands.

In recent years, markets worldwide have started to receive products from emerging countries that are not commodities competing exclusively on price, and which aim to compete on equal terms with the established international brands. In all cases, the main objective of the Chinese brands is to repeat the success of their Japanese counterparts 30 years ago, when they began their international expansion with an image associated with quality and technological breakthroughs.

The TCL television and air-conditioning brand began manufacturing in a plant in Argentina a few years ago. Its sales director says that, "with televisions and electronic products, there was a very big change 15 years ago in the market, when all the major manufacturers moved to China, meaning that today quality is associated with the brand and not the origin of the product."[78]

One of the strategies used by companies from emerging markets is to purchase Western brands in order to penetrate the market. This occurred with the Taiwanese multinational Acer, and China's Lenovo. However, there are companies that have decided to enter the Western market on their own account, without a partnership with another business. Asus, another multinational Taiwanese elec-

[78] http://www.lanacion.com.ar/nota.asp?nota_id=1086956.

tronics manufacturer, decided to change its image to become an up-market international brand within its sector.[79]

Another example is the Chinese car brand Chery, which is taking its first steps in Argentina, in partnership with the entrepreneur Franco Macri, at almost the same time as entering the United States. The cars sold domestically are assembled in a plant in Uruguay, although a second factory is scheduled to open in 2010 in Argentina, with an investment of 500 million dollars. Chery's objective is to follow in the footsteps of Lenovo, which quickly positioned itself among consumers in Argentina and the rest of the world by taking over IBM's PC division in December 2004.

The tobacco sector is another in which Chinese brands are taking their first steps. To enter the Chinese market, Philip Morris reached an agreement with the country's tobacco monopoly, which includes production of Marlboro in China and the expansion of Chinese brands in various markets throughout the world. In Argentina, the Harmony brand was chosen, being aimed at the upper segment of the market.

In the near future, additions to this list could include other Chinese brands that are starting ventures abroad, such as the sportswear line Li Ning Sports (which has already become the shirt sponsor of the national basketball team), Tsingtao beer, and Haier refrigerators and washing machines.

Rule 6: "Green" is Fashionable

A study by the National Geographic Society and the company GlobeScan presents a new method for measuring and comparing the individual behavior of consumers in terms of their relationship with the environment. The study,[80] entitled *Greendex 2008*, highlights significant differences between consumers in developed countries and those in developing countries, in terms of environmentally sustainable behavior in the areas of housing, transport, food and consumption of goods. One revealing part of the analysis is its focus on the individual behavior of each consumer, factoring in both consumption habits that are determined by active decisions (such as repairing something instead of replacing it, washing clothing in cold water, etc.) and those that arise due to circumstances (such as the availability of "green" products or public transportation). The results show that Brazilian and Indian consumers score highest on sustainability. They are followed by consumers in China, Mexico, Hungary and Russia. Among the European countries, Spain ranked slightly above Great Britain and Germany. The countries with the worst scores are the United States, Canada and France. The main conclusion of the study is therefore that the behavior of people living in developing countries is more sustainable. The fact that consumers in developing countries usually live in smaller homes, use public transportation, and own fewer electronic devices could be attributable to their lack of alternatives due to income levels. However, another study by Accenture[81] shows that 50% of citizens in emerging countries would be willing to switch products if it meant reducing

[79] «ASUS aims for the "gorgeous" market», *The Guardian* (16/10/2008).

[80] Servicio de Información y Noticias Científicas (May 2008).

[81] http://www.ecologiaverde.com/los-ciudadanos-de-los-paises-emergentes-son-los-mas-concienciados/.

the negative impact on the environment. However, only 24% of those living in developed countries shared that willingness.

This analysis, together with other studies, gives a very good idea of which countries have the most sustainable consumption from the environmental point of view, because the fact is: green is fashionable. Concern about the devastating effect of human beings' habits on Earth is nothing new, as "green" practices have been part of business strategy for decades. However, in reality companies are increasingly incorporating respect for the environment into their marketing and advertising. Two years ago, a company in Malaysia built a natural gas pipeline that crosses South Vietnam in order to carry cleaner alternatives and meet the growing demand for energy, which is forecast to increase by 15% in 2010. The countries of Southeast Asia have also discovered the profits available in the biofuel sector, as well as its advantages in terms of environmental protection, cost cutting and job creation. Indeed, in Indonesia the sector employs 1.5 million people.[82] Meanwhile, China has become one of the economies with the world's highest growth rates, which are accompanied by a pollution problem. After the United States, it is the country with the highest level of carbon dioxide emissions. That is why in 2006 it adopted the GreenWatch program, on the advice of the World Bank's Development Research Group, to publish information on the Internet about factories' emissions in order to encourage their reduction.[83]

4.2. The Situation of the Spanish Economy in the Globalized Trade Landscape

Spain is facing the challenge of competing in an increasingly global, multipolar trade landscape. Businesses must deal with the current decline in domestic demand due to the recession, as well as the reduction in talent in the medium term due to the aging of the population. Faced with this twofold problem, the internationalization of companies and the conquest of new consumers in emerging countries should be a prime concern.

Internationalization has not been a priority among Spanish companies in recent years. The robust performance of domestic consumption has been sufficient for them to obtain good results. In fact, growth in the Spanish economy has mainly been based on the continuous increase in domestic demand (40% growth between 2002 and 2006). Private consumption and construction (housing and public works) were the driving forces behind domestic spending, based on favorable financial conditions and job creation.

The high level of household and corporate debt to finance this demand led to further vulnerability in this growth model. At the same time, the strength of domestic demand was counteracted by the gradual decline in net foreign demand. This development can be explained by both the slower growth in exports of Spanish products and services, and the increasing penetration by imports. The foreign trade deficit thus highlights the low levels of competitiveness in the Spanish economy.

[82] http://ifcblog.ifc.org/emergingmarketsifc/green_investments/.

[83] *Polluters in China Face Public Scrutiny,* The World Bank (17/05/2006).

A Growth Model Based on Domestic Consumption

The recession has cleared up all the doubts concerning the medium-term sustainability of this growth model. The sharp rise in unemployment, the marked decline in domestic demand and the credit drought have brought the Spanish production model to its knees. The Spanish economy therefore faces a dual challenge. First, immediate measures must be implemented to stimulate the economy in the short term. Second, structural reforms must be undertaken to change the production model in the medium term and improve its competitiveness and productivity.

The drastic decline in domestic demand arose from the fall in consumer and business confidence to record lows, according to data published by the European Commission (see Figure 29). If this situation is to be counteracted, the outstanding issue of increasing exports and improving Spain's position in the field of international trade must be addressed. To do so, improvements must be made in the Spanish economy's productivity and competitiveness by reforming the cornerstones of its production model. If these areas are not improved, the risk of the Spanish economy sliding down the international ranking, while more competitive emerging countries move up, is becoming increasingly apparent. The opportunity to serve the new consumers in these markets must also be seized. As mentioned above, in the new multipolar landscape, consumers must also be sought beyond Spain's frontiers. The recession heightens the dependence of localized markets on emerging economies. Exports to these areas must therefore be promoted. The euro area currently accounts for approximately 45%[84] of Spanish goods and services exports, while markets with high growth rates play a minor role.

[84] International Monetary Fund, 2008.

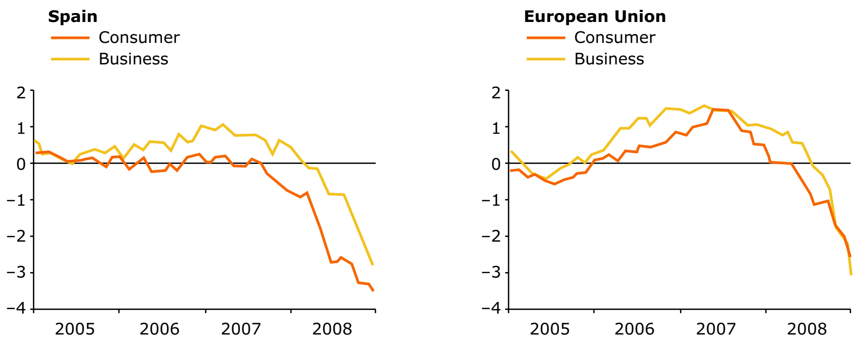


Figure 29. Indicators of consumer and business confidence
(standard indicators—difference between indicator and its average, divided by standard deviation).
Source: European Commission.

Did you know?

Spain is the world's 17th largest exporter and 11th largest importer of goods, while as exporter it ranks 5th worldwide and 8th as an importer of services.

The Major Challenges of the Spanish Economy in a Globalized Trade Landscape

The specific influence of industry in the Spanish economy is lower than the average for countries in the euro area, and the majority of products consumed domestically are therefore produced abroad. This combination of high imports and low exports leads to a deficit in the trade balance that has been a normal feature of the Spanish economy for some decades, and hindered its growth. The increase in the foreign trade deficit and the divergence between the development of the domestic market and the production levels of Spanish companies highlight the difficulties faced by Spanish industry in terms of successfully meeting the new challenges raised by globalization.

José Luis Leal, an ideologist, politician, Spanish entrepreneur and Future Trends Forum expert, describes the scale of the problem in the following terms: "our trade balance's current account situation is unsustainable in the long term. The fact that the cost of financing the foreign debt exceeds the tourism revenues gives some idea of the magnitude of the problem that we must solve. Unless we strongly promote our exports of goods and services, it will be impossible to maintain growth rates higher than those of the euro area and, consequently, the convergence of our living conditions and those of more advanced countries will cease, or even fall back."[85]

In order to increase its volume of exports, Spain should invest in improving its "country brand," given its adverse position compared to neighboring countries. A strong country brand not only attracts tourists and investors, but can also increase the sale of products. Products with a country brand can have a significant influence on preexisting perceptions and increase awareness, create an image and influence opinions on product quality. In the final analysis, the stronger a country's brand, the more advantages its products will have in terms of preferences, price and loyalty.[86]

The survey carried out by ICEX to assess Spain's image abroad[87] identifies Spanish products' strong points as being the price-quality relationship of its products and services, and design/style (see Figure 30).

[85] http://www.elpais.com/articulo/economia/olvido/sector/exterior/elpepieco/20090318elpepieco_6/Tes/.

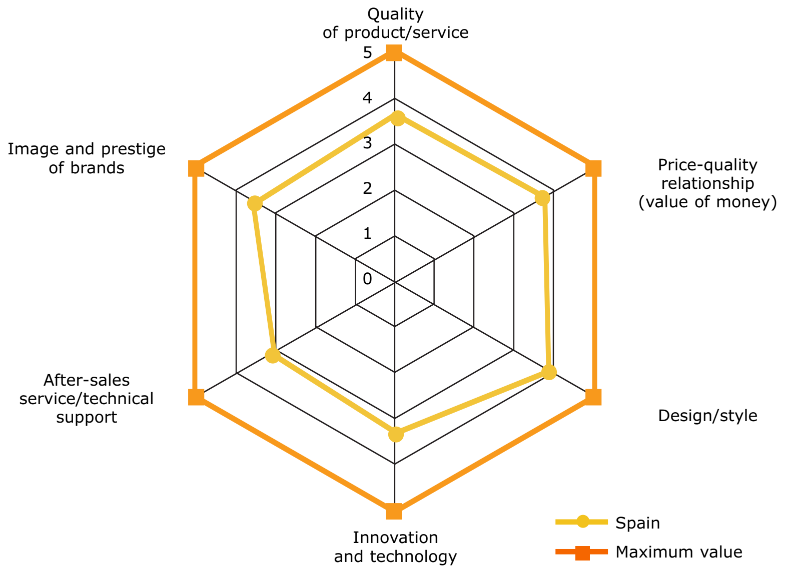
[86] http://www.countrybrandindex.com/resources/pdf/CBI08_Spanish.pdf

[87] *La Imagen de España, sus Marcas y Empresas en el Mundo*, ICEX, March 2008.

Did you know?

There are "filters" that can distort a country's image abroad. Examples of filters that affect Spain's image abroad are:

- The British filter creates an image of Spain as a country of flamenco and bullfights.
- Americans are influenced by their confusion over what is Spanish and what is Mexican.[88]



(1) Very negative; (2) Negative; (3) Nor positive, nor negative; (4) Positive, and (5) Very positive.

Figure 30. Assessment of Spain's brand image in other countries.
Source: *The Image of Spain, Its Brands and Businesses in the World,* ICEX, 2008.

The same study shows that the business sectors most closely associated with competitiveness in Spain are tourism, food and drink, and fashion and accessories. The main competitors in these sectors are France in tourism, and Italy in the other two sectors. Spain will need to design an image that gives it a different and unique positioning in the market compared to these strong competitors. The Future Trends Forum experts believe that Spain should invest more resources in promoting its image abroad, mainly in Asia. They also believe that more publicity should be given to the achievements of Spanish companies that have successfully become international players.

Meanwhile, the aging of the Spanish population will change the nature of domestic consumption in the medium and long term. If present trends continue, the decline in the birth rate will lead to a reduction in domestic demand. Immigration will help to relieve the situation, but it will not compensate for its effects completely (see *New consumers: Aging Population and Immigration* by the Bankinter Foundation of Innovation). These are further grounds for improving the trade deficit by increasing exports.

Spanish companies are facing major challenges in this new context characterized by the globalization of trade, a topic we will discuss in the following section, which looks at the trade strategies of Spanish companies. The telecommunications, transportation, retail and financial services sectors, all of which are crucial in the new multipolar landscape, appear to be the best prepared to meet the in-

[88] *La imagen de España en Asia-Pacífico,* Real Instituto Elcano.

Did you know?

The National Statistics Institute calculates that Spain will stop growing by an average of 720,000 people a year to only half that figure after 2010.

ternational challenge. The emerging countries in Latin America are the ideal place to begin international operations, due to the natural advantage of a common language and culture. Meanwhile, the Asian countries are a matter pending in the internationalization process of Spanish companies, and an opportunity that must not be missed.

As regards the tourism sector, which has historically been one of the cornerstones of the Spanish economy, the Future Trends Forum experts feel that efforts should be made to attract more tourists from Asia in the medium term, mainly from countries like China and India, which have enormous potential in terms of numbers.

In short, the economy must be restructured in order to improve its productivity and competitiveness if Spain is to take advantage of the new cycle of economic growth when the world economy is back on its feet. Reforms in education, research, the labor market, the energy market and competition are some of the tasks that must be carried out in Spain if this is to happen, and if high added value products and services are to be designed that win over new consumers in the globalized trade landscape.

4.3. Spanish Companies' Strategies for Globalized Trade

Few countries have made as much progress as Spain has made in the last 30 years. However, a vast difference remains between the perception of the country and its businesses abroad and the real socioeconomic and business conditions. In this context, it is necessary to define the strategies that provide sustainable growth. A distinctive positioning in international trade will undoubtedly contribute to this objective. Some of the formulas that can help Spanish companies to deal successfully with the globalization of trade and thereby improve the Spanish trade deficit are listed below.

Rule 1: Sell "Made in Spain"

Spain, and Spanish companies by extension, must work together to improve the image of "Made in Spain" products, as stated in the previous point.

In order to take advantage of Obama's economic stimulus plan, the Spanish government has recently begun to implement strategies to sell "Made in Spain" in the United States.[89] This program by the Spanish Foreign Trade Institute (ICEX) has been given a budget of 44 million euros. The plan's outlines were presented by a hundred Spanish companies, with the minister of Industry, Miguel Sebastián, and the Prince and Princess of Asturias in New York. As the minister put it, "we have the world's largest company in construction and use of wind power; the second largest in wind turbines, and six of every ten companies specializing in motorway concessions are Spanish."

[89] «España pretende vender el "made in Spain" en Estados Unidos», *El Economista* (17/03/2009).

Did you know?

Spain is a world leader in holiday tourism.

In order to sell *typical Spanish* products and service in the United States and the rest of the world, foreign consumers' perception of what Spain has to offer and the sectors that could make a more significant contribution at the global level must be taken into consideration. The Future Trends Forum experts discussed the most attractive investments in Spain in the future, and came to the conclusion that these were renewable energy and tourism. Spain is in a very good position in renewable energies, nanotechnology, high technology, tourism, infrastructures, urban building construction, and operating concessions for freeways, airports, hospitals and tunnels. Companies that work in these sectors must therefore take full advantage and reinforce the good "Made in Spain" brand image even further, to counteract the lack of awareness of the Spanish brand. "Although the connotations of 'Made in Spain' are not negative—because they are not associated with poor quality—the country's products do not have a very high profile," according to a study carried out by the researchers Javier Noya, Beatriz Rodríguez and Antonio María Ruiz Jiménez, of the Elcano Royal Institute, which takes an in-depth look at Spain's overall image in American public opinion.[90] "The new icons in the public eye in the United States, such as actors, athletes and chefs, are also not sufficiently associated with Spain."

Seat, Zara, Freixenet, Osborne, Rioja and Serrano and Iberian ham, in that order, are the brands that most Germans mention when they are asked to name a Spanish brand, product or service. Mango, Telefónica, Camper, Santander, Chupa Chups, Tío Pepe and Codorníu are also mentioned by up to one in every ten Germans, according to a study on Spanish brands' strategies in Germany by the consultancy Ingo Rütten.[91] In terms of geographical areas, Spain has yet to raise its profile in emerging countries, which have so far accounted for a minority of its exports.

"Made in Spain" products are not clearly identified in some countries, and neither is Spanish culture. The British writer Michael Eaude said in his book *Barcelona:* "No one has been able to explain to me why so many English tourists come back to Manchester from the Reus [Catalonia] airport wearing Mexican hats." Attempts to differentiate Spanish culture and products date back a long time. Many will remember the famous tourism promotion campaign with the slogan "Spain is different," which highlighted the Spain's diversity of landscapes and exotic nature. This difference should be passed on to the business sphere, to distinguish Spanish products and services in the new, multipolar context.

Rule 2: Become Visible on the International Landscape

The internationalization of Spanish companies was a process that began in the early 1990s. In 1990, direct Spanish investment abroad accounted for barely 3% of GDP, while in 2002 it was 34.3%, exceeding the average figure for the other industrialized countries.[92]

One of the most well-known Spanish success stories abroad is the Santander Group, which has risen from being a local bank which was sixth in Spain and

[90] «"Made in/Made by Spain": La forja de la marca España en EEUU», *Knowledge@Wharton* (25/03/2009).

[91] «El "typical spanish" todavía pesa en Alemania», *Expansión* (11-04-2008).

[92] «"Spain" también "is different" cuando valora las inversiones en el extranjero», *Knowledge@Wharton* (08/02/2006).

number 152 in the world, to the global group that it is today—number two in Europe, seventh in the world and the leader in Latin America.[93] This all took place thanks to a strategy "based on the search for new levers for growth and on diversification when the domestic market was mature, striking a balance between mature and emerging markets, and prior knowledge of the markets where investments are going to be made and where sufficient critical mass is available."

According to the *2007 Spanish Business Internationalization Yearbook,* by the Wharton School Circle of Entrepreneurs, one of the major challenges for Spanish companies was visibility in the international media. According to its indicators, this has improved thanks to businesses like Endesa, Telefónica, BBVA, Santander and Repsol. It is important for Spanish companies to have a good reputation in international financial circles because they need financing, and this is to a large extent obtained from institutional investors, bond placement, etc. An example is Santander's involvement in the largest bank takeover in history with the acquisition of the Dutch ABN-AMRO bank.

The inevitable question is: if the recession is a global problem, how does the current situation affect companies' internationalization? The recession may be a double-edged sword, because as well as its negative consequences, it may also create a number of opportunities. Investing in the United States currently makes sense in view of the low asset prices and the euro's strength compared to the dollar. It is wise to take up a position in a market which will in all likelihood recover and undergo future growth.

One of these impending opportunities is in China (and in emerging economies in general), where aggressive policies to maintain their growth rate by means of fiscal stimuli are being implemented. Infrastructures will play a key role in these policies, and Spanish companies in the sector should position themselves there. As far as the future is concerned, the internationalization of Spanish companies toward emerging countries will be crucial.

Rule 3: Follow the Formulas for Success

What is the top-ranked international company in terms of growth in the food distribution sector? The answer is relatively easy: Wal-Mart. And what is the second-place company? This answer is a little more surprising: Mercadona, which is also the leader in the Spanish supermarket segment. Mercadona starts with a universal assumption: "in order to be satisfied, you first have to satisfy others."[94] Its business model therefore focuses on total customer satisfaction and increasing value to them by means of a policy of low prices, instead of temporary offers and discounts. It uses meetings with local residents, courses on its own brand's product lines, open days, blind testing and efforts to increase the nutritional quality of its range to build up trust among its customers, which keeps them loyal. Its slogan is "Supermarkets you can trust" for a reason. They also say that "overall revenues have grown nearly twelve-fold over the last 10 years, and at an average annual rate of 22%," thanks to the policies mentioned above and the de-

[93] *La empresa española en el mundo multipolar. Retos y oportunidades ante el nuevo escenario,* Accenture (2008).

[94] «Para Mercadona, líder del segmento de supermercados en España, el modelo GCT ha sido una inversión excelente», *Knowledge@Wharton* (30/04/2008).

sign of their stores, which aims to minimize the customer's shopping time. In other words, the opposite strategy to large outlets.

This does not mean that a business model can be imitated perfectly. The Silicon Valley formula has been reproduced many times (Silicon Alley in New York, Silicon Glen in Scotland and Silicon Roundabout in London, for example) but they were not as successful as anticipated.[95] However, there are some models for business initiatives that have been repeatedly proven to work. *The Economist* describes some of these in its article "The Magic Formula." First, there is the anchor-firm model, which is when a large company creates other small ones, giving them the money necessary to start them on their way. A second model, currently very popular, is driven by crisis. This takes advantage of a consequence of the recession and makes it into an opportunity. An example is companies that hire people with specific talent and skills who have lost their jobs. The example given in the article is the hundreds of highly trained scientists that were recruited by local start-ups in San Diego in the 1990s, after the end of the Cold War. The third model is that of the local hero who sees an opportunity, starts up a business and makes it into a goldmine. An example of this is Zara, which began in 1975 with one shop in A Coruña in Spain, and has become a leader in international textiles as a result of its international expansion.

Rule 4: Change the Rules of the Game

The Inditex group is the Spanish success story par excellence. Its Zara, Pull and Bear, Massimo Dutti, Bershka, Stradivarius, Oysho, Zara Home and Uterqüe retail chains have more than 4,200 outlets in 73 countries. The group's flagship, Zara, has shown that it is able to adapt quickly to customers' tastes all over the world. By keeping its means of production in-house (Zara produces 60% in its own factories and the fabrics come from Spain, the Far East, India and Morocco) and operating with virtually no stock, it can take almost immediate advantage of the changing opportunities in the market. Zara dyes its collections with new colors, sends out new designs within two weeks, and even scraps a product line completely if it fails to sell. In short, it has revolutionized the way in which textile companies operate by challenging the concept of fixed fashion seasons.

The Inditex group was in the news once again in February 2009 with the announcement of an agreement with the Tata group to open shops in India from 2010 onwards.[96] This joint venture strategy shows that one of the formulas for penetrating the market in a new country is to form a partnership with a company with experience and knowledge there.

To return to the recession, who would have said that uncertainty in the markets would have boosted the business of the large auditing companies? Until 2007, the lucrative business was giving advice on corporate operations. At that time, it was the numerous movements taking place on the Spanish business scene (with the successive takeover bids with Endesa playing a leading role) that enabled these companies to increase their turnover, which was boosted by the increase

[95] «Magic formula», *The Economist* print edition (12/03/2009).

[96] www.inditex.com.

in the demand for financial advice[97]. The rules of the game have changed since 2008, and the trend is now for large companies in the sector to seek assistance with feasibility plans, detailed analysis of their clients' credit risk and debt restructuring, and advice on downsizing plans and redundancies. Flexibility to adapt to the constantly changing situation is a sine qua non for survival, especially in times of crisis.

Rule 5: Join the "Low-Cost" Fashion

Spain is one of the low-cost paradises. Brands and companies including McDonald's, IKEA, Primark and Ryanair have succeeded in this market, which has seen the emergence of local brands based on the model of mid- or low-price positioning, such as Dia and Zara. The central role of leisure and consumerism in Spanish culture, as well as income limitations, make the country a great testing ground for these models.[98]

This price awareness is typical of American culture, with its slogan "Why buy one article of clothing when I can buy three for the same price," which has reached Spain with the force of a hurricane. The recession has made things difficult for conventional businesses, as consumers will think much more about where they spend their money. This phenomenon is turning low cost into an increasingly common trend and a magnificent opportunity for businesses able to increase their productivity. What is most surprising is that these businesses' incomes are increasing in the middle of the recession. For example, in 2008 McDonald's Spain (in the middle of a recession) saw its income increase by 7%, to 755 million euros.

Primark shops, the new fashion distribution phenomenon, were invaded by hordes of shoppers in Spain. Why? Because there is not a single product in their shops that costs more than 35 euros. However, let there be no misunderstanding. These are not liquidation sales or cheap, low-quality goods. Primark fashion does not appeal to the middle class for price reasons alone. Its designs are all the rage. It is the new "low-cost chic."

In view of these results, it is not surprising that many large companies, especially those starting to feel the pinch of the recession, are adopting the low-cost model. Inditex, a pioneer in low-cost chic in Spain, has understood that cutting its prices in Zara or Pull and Bear is no longer enough. In the last two or three years, it has intensified the opening schedule of the outlets of its subsidiary Lefties, a type of factory outlet with which it plans to halt the unstoppable Primark invasion. Lefties, which sells pants for as little as 9 euros, increased from 38 stores in 2006 to 63 in October 2008. In fact, some Zara stores have been closed in order to become Lefties. Not even El Corte Inglés has escaped the carnage. Along with its house brand, it has the recently launched Aliada. In the air transport sector, Iberia has high hopes for the new Vueling-Clickair brand.[99]

In this area, new business models and a change in travelers' attitudes make quality low-cost hotels possible. These combine affordable prices and facilities

[97] «Los servicios anticrisis impulsan el negocio de las grandes auditoras», *Expansión.com* (12/03/2009).

[98] http://www.gaceta.es/negocios/11-03-2009+low_cost_arrasa_espana,noticia_1img,68,68,50034

[99] http://www.gaceta.es/negocios/11-03-2009+low_cost_arrasa_espana,noticia_1img,68,68,50034

that are very similar to those found in classic four- and five-star hotels. An example is Room Mate, a Spanish hotel chain founded in June 2001. Room Mate hotels, which have over 700 available bedrooms, are more like real hosts, and their customers, rather than guests, are roommates. The concept is that they are “homes” that open their doors to travelers who have arrived in the city in search of comfort, quality and the warm welcome that all hosts offer their guests. The most important thing when attracting consumers is the price-quality relationship.

There are currently a wide variety of companies in Spain promoting themselves as low-cost. There are real-estate agencies such as Modainmobiliaria.com, carwash services like Living, construction companies like Inverborche, consultants like Rhino Consulting and legal services like Legálitas—all sectors have been caught the fever. There are even low-cost jets (which fly at 1 dollar per kilometer). Not even restaurants have escaped this phenomenon. Sergi Arola has decided to follow in the footsteps of Ferran Adrià (with Nhube, in partnership with NH) and is developing several luxury fast food chains. One of these is D’E Sergi A.

Despite it all, several marketing professors say that low-cost has acquired such prestige that many undertakings of this type owe more to marketing than to the possibility of providing a genuine service at a low price. Joaquín Garralda, of the IE Business School, emphasizes that “low-cost has become a magnificent label for attracting consumers.” In fact, some companies that declare themselves to be low-cost apply similar prices to the others. Francesc Valls of ESADE says: “One of the characteristics of these businesses, especially those applying dynamic pricing, is that they advertise the lower price, despite subsequently selling part of their range at prices similar to conventional companies.”[100]

[100] http://www.gaceta.es/negocios/11-03-2009+low_cost_arrasa_espana,noticia_1img,68,68,50034