The Real Impact of Globalization

"GLOBALIZATION" IS BY NO MEANS A NEW buzzword – it is one of the defining issues of our time. And at Ernst & Young, we are watching as global capital shifts from west to east and north to south. We know that, for the first time, dramatic growth is taking place outside the U.S. and that we want and need to be part of that growth. We are also keeping an eye on demographic trends, which show that by 2020, the Middle East, India, and Africa will be a full generation younger than those who live in Europe and Japan. What will that mean for consumer spending, immigration, and education policy, for starters?

Globalization has real impact, creating both opportunity and risk. It is not just the developed world looking at the growth and potential of the emerging markets; it is also the emerging markets taking a hard look at us. And, of course, this complexity has been compounded by the radical shifts that have taken place since the financial crisis – shifts in economic power, in regulation, and in mindset. Based as we are in 140 countries around the world, Ernst & Young is well-placed to see the effects of globalization on our clients. We've also been in many of the emerging markets for years, growing with them on their impressive journeys.

For this reason, we decided to assemble the best thinking Ernst & Young has to offer to our clients who are doing business in or considering entering the emerging markets. We realize that no one of us has all the answers to tackling the global environment, but maybe – just maybe – we can collectively come up with the right insights. A few highlights from the event follow, but you can see all the proceedings of the Ernst & Young Global Growth Forum at ey.com/ggf. We hope to keep this dynamic conversation going and welcome your feedback at twitter.com/EY_Growth.

Jim Turley,
Chairman and CEO, Ernst & Young

HIGHLIGHTS FROM THE ERNST & YOUNG GLOBAL GROWTH FORUM

THE ERNST & YOUNG GLOBAL GROWTH Forum held its inaugural gathering in Washington, D.C. from June 7-8, 2011. The event featured high-level discussions on what the business world should consider as emerging markets rise to prominence on the global stage. Here are just some of the particularly informative and insightful comments our guests heard from the following speakers and panelists.

Dr. Henry Kissinger, interviewed by Bloomberg Emmy-award journalist Charlie Rose, said that as China's political institutions continue to evolve, new political structures will develop – perhaps more transparent, although not necessarily more democratic. Soon, Kissinger observed, we could see a China that is more nationalistic, more assertive, and more ideological. Alternatively, China may simply continue along its current path. In either case, he said, "China will inevitably have to adjust its political institutions to its economic achievements."

Asked what advice he would give to China's leaders, he answered with advice to both China and the United States, where, he noted, there are nationalistic elements struggling to assert themselves. The U.S. and China should make regular cooperation a habit, he said, to avoid a confrontation that would be disruptive or worse to the global economy.

One emerging market in particular – the entire African continent – was the subject of a well-attended panel discussion. "We are indeed quite optimistic and positive about sub-Saharan Africa," said panelist **Antoinette Monsio Sayeh**, Director of the African Department of the International Monetary Fund. "Growth has been tremendous in the past decade." The IMF expects GDP growth of 5.5 percent for Africa this year and about 6 percent in 2012, she said. Still, she noted, Africa has challenges such as an inadequate educational system, continuing social instability, and a business climate that is not yet optimal for investment. While intra-regional trade is fairly strong, "there are more than 30 regional groupings that are not optimum trade arrangements," Sayeh said. "There is a lot of work to be done to make these regional organizations work better."

A.G. Lafley, former Chairman, CEO, and President of Procter & Gamble, advised companies attending the Ernst & Young Global Growth Forum to first ask themselves if the emerging markets are necessary to their business. The answer for P&G, of course, was yes. "That's where the population and consumer markets will rise. And since P&G is in consumer goods, of course we had to be there."

Lafley learned that one product does not fit all markets. The need may be the same – detergents, for example, that make for clean clothes – but the managers had to localize the way they communicated about it. China went fast and India slower in terms of P&G's business growth. Human resources in these markets posed a particular challenge: it took much more time to recruit, train, and manage a foreign work force than expected.

Other insights offered by Lafley from the P&G experience include:

- Start slow. Run a small pilot in the new market and see where the successes and failures are.
- Keep a constant touch point with upper management and the board and make sure you are devoting enough resources to the new market. You won't get there if you under-resource with either capital or human talent.
- Develop partnerships with the locals and the government.
- Bear in mind that most innovations fail. Most M&As fail. The truth: expect to fail before you succeed in any emerging market.

What a World!

The outlook for emerging market economies at a glance

Emerging markets could account for two-thirds of the world economy a decade from now. Is your business ready to compete in this new multipolar world? Here is a quick review.

AFRICA – KEY POINTS

- Average GDP growth in sub-Saharan Africa will be a relatively strong 5.5 percent in 2011 and 2012.
- Foreign direct investment in the region is expected to top $40 billion in 2011.
- An emerging middle class represents a potentially large consumer market.

Questions for global business leaders

- How did or will your business pick your entry point and grow your operations across such a varied region?
- Despite its promise, the region still experiences political and social instability. Is your business prepared to cope with this challenge?

BRAZIL – KEY POINTS

- Brazil is ready to play a leading role on the global stage, despite currency and inflationary pressures.
- Foreign direct investment in Brazil has nearly doubled in the past four years.
- The implementation of International Financial Reporting Standards is a big move toward improved corporate governance, but tax complexity remains a challenge.

Questions for global business leaders

- A growing skills gap is leading to a shortage of professional and technical workers in Brazil. How is your company dealing with this issue?
- From your position in Brazil, how do you view Mercosur and the rest of Latin America?
- Is there a likelihood of Brazil slipping back into an inflationary cycle and crisis? Is your company equipped with a contingency plan if this happens?

CHINA – KEY POINTS

- China is on its way to becoming the largest economy in the world.
- At current rates, trade could be three times the size of the U.S. in 10 years.
- Productivity and costs will continue to rise as China grows more urban and employment in state enterprises declines.

Questions for global business leaders

- Is your company prepared to take advantage of the opportunities that a more urban China will create?
- Alignment with government plans and authorities is vital to success in China. Have you developed strategies to connect with central authorities and also those at the provincial and local levels?
- Do you have a strategy to compete for and retain the talent your business will need to succeed in China?

EAST ASIA – KEY POINTS

- East Asia is likely to remain the powerhouse of the global economy for some time.
- The World Bank forecasts growth in the region to be 5 percent to 6 percent in 2011 and 2012.
- An aging population will pose demographic challenges.

Questions for global business leaders

- What does your company see as the opportunities in East Asian markets other than China? In particular, have you developed strategies for such promising markets as Vietnam and Indonesia?
- How do you plan to manage a multicultural workforce (salaries, educational levels, professional skills, benefit expectations, cultural differences)?
- Entrepreneurship and innovation are key drivers of growth in mature markets. Is your company prepared to partner with governments to drive this activity?

EASTERN EUROPE – KEY POINTS

- Despite strains to their banking systems due to the global economic crisis, no Eastern European country has come close to sovereign default.
- Eastern European countries have had much higher growth rates than their Western European counterparts and they are set to grow even faster in the years ahead.
- Big plus: this region is now the home of upper-middle-income countries.

Questions for global business leaders

- Are you considering the growth potential for the mid-tier emerging markets in Eastern Europe, i.e. Romania, Bulgaria, and the Baltics?
- How do you leverage the state sector and the government to help your business succeed in Eastern Europe?
- What impact will your Russia and Turkey priorities have as you develop or grow your business strategy in Eastern Europe?

INDIA – KEY POINTS

- Capital flows have been coming steadily to India, attracted by high growth and high returns.
- The outlook for the economy remains very positive with growth in the 8 percent range.
- Heavy bureaucracy and weak governance are stumbling blocks to investment and entrepreneurship.

Questions for global business leaders

- Market-oriented policies coexist with rigid bureaucratic controls in India. Is your company prepared to operate successfully in this landscape?
- Does your company have a strategy to grow its business across the diverse regions and states of India?
- Commercial disputes can be difficult and time-consuming to resolve in India. How does your company expect to plan for and establish effective dispute resolution mechanisms?

MIDDLE EAST – KEY POINTS

- The recent uprisings provide a great opportunity to lay the foundation for a socially inclusive growth agenda.
- Average real GDP growth (excluding Libya) is projected to reach 4.9 percent in 2011, up from 3.5 percent in 2010.
- The region has a dynamic and young population, vast natural resources, and access to key markets.

Questions for global business leaders

- What is the outlook for your industry? If you are not in the oil business, what do you see as the most promising markets?
- Political instability dominates the region. What measures has your company taken to cope with this challenge?
- Women tend to be underutilized resources in the Middle East labor market. What is your company doing to tap their potential?

RUSSIA – KEY POINTS

- Despite setbacks during the recession, the Russian economy – the sixth largest in the world – remains generally strong.
- About 80 million middle-income and lower-middle-income consumers make for a promising market.
- Heavy reliance on energy exports, bureaucracy, and rigid state controls on foreign investment pose challenges.

Questions for global business leaders

- How do you measure risk and opportunity in a market dominated by the energy sector?
- Russia can be a challenging environment in terms of complex regulatory frameworks and relationships with the government. Do you have effective strategies in place to deal with these issues?
- How do you expect Russia's macroeconomic scenario to play out in the next few years? What signals are you watching for and are you prepared to adapt your business accordingly?

TURKEY – KEY POINT

- Capital inflows are strong, with foreign direct investment totalling about $85 billion in 2010.
- GDP is poised to grow about 5 percent a year over the next few years.
- Possible admittance into the European Union could make Turkey a game-changer.

Questions for global business leaders

- Turkey is a booming market, but a complex one. Does your company expect to achieve sustainable growth in this environment?
- Does your business have a strategy to expand from Turkey into the Middle East and other emerging markets?
- The state still plays a key role in Turkey. Do you have effective mechanisms in place to manage bureaucratic requirements?

Tracking Global Trends

How six key developments are shaping the business world

By John Murphy, Ernst & Young Global Managing Partner, Markets

CHANGE HAPPENS QUICKLY IN TODAY'S business world and business leaders must respond effectively. But some things don't change much. Structural features of the business landscape are shaped by global trends, and these trends create the realities that executives and board members must understand in order to position their organizations for future market leadership.

This year, Ernst & Young looked at six global trends that have redefined business success. How leaders plan for and respond to those trends in the coming decade will determine which companies become the market leaders of tomorrow.

Spotlight on emerging markets

In this article, we've chosen to spotlight the rising power of emerging markets – once viewed mainly as a low-cost manufacturing base but now seen as promising markets in their own right. In particular, we see the following trends ahead:

Leading markets will continue to drive global growth. Already a force to be reckoned with, emerging markets will soon become equal competitors with mature economies, commanding more economic and political power. They are expected to generate about 70 percent of global growth over the next few years, 40 percent of it from China and India. The International Monetary Fund forecasts that emerging markets' total GDP could overtake that of the developed economies within three years. By 2020, the BRIC countries – Brazil, China, India, and Russia – are expected to account for nearly half of all GDP growth worldwide.

Leading companies in emerging markets will become a disruptive force in the global economy. Working to serve customers of limited means, these companies will produce innovative designs that reduce manufacturing costs and disrupt entire industries. This trend is already underway in India, where the $2,900 Nano – made by Tata Motors – is priced at less than half the cost of any other car on the market worldwide. In addition, multinational companies in emerging markets are well positioned to benefit from growth in domestic consumption, likely to become the most significant development in China and many other developing markets in the years ahead.

While emerging markets offer great promise, they are not homogeneous entities. Each emerging market has unique needs that developed-market companies must understand and prepare to meet. For example, China relies heavily on manufacturing, India on technology services, Russia on energy, and Brazil on agriculture.

Rising population and prosperity drive new consumer growth and urbanization. Between now and 2050, the world's population is expected to grow by 2.3 billion people, and by 2030, the combined purchasing power of the global middle classes is estimated to more than double to $56 trillion. Most of the world's new middle class will live in the emerging world and almost all will live in cities, often in smaller cities not yet built. This surge of urbanization will stimulate business opportunities that request multinationals to develop strategies for particular cities or for city clusters and to extend their selling efforts beyond the first-tier locations that have absorbed their attention thus far. In addition, mass urbanization will put huge strains on infrastructure – physical infrastructure such as water supply, sanitation and power systems, and soft infrastructure, such as recruitment agencies and intermediaries to deal with customer credit checks. Building or upgrading this infrastructure to cope with the growing urban middle class will likely require public/private partnerships, new approaches to equity funding, and the development of capital markets.

Emerging markets will become the new battleground. The BRICs are having a major impact on their regional trading partners and more distant, resource-rich countries, an increasing number of which are being pulled into their economic orbit. In 2009, emerging-to-emerging (E2E) trade reached $2.9 trillion. This massive flow of investment among emerging markets is well on its way to creating a second tier of emerging market leaders. As pressure for resources increases, we expect a battle for first-mover advantage among emerging heroes, global players, and emerging market governments in regions such as the Middle East and Africa. In Nigeria, for example, the Chinese government is helping to establish two special economic zones. China will invest $500 million in the zones, which will focus on manufacturing machines and mineral extraction. China is also involved in similar programs in Ethiopia and Egypt.

Global influence grows. Inevitably, the BRICs' growing economic strength is leading to greater power to influence world economic policy. In October 2010, for example, emerging economies gained a greater voice under a landmark agreement that gave 6 percent of voting shares in the IMF to dynamic emerging countries such as China. Under the agreement, China will become the IMF's third largest member. Of course, it would be a mistake to see economic growth in the emerging markets as a winner-takes-all contest with developed countries on the losing side. Billions of new middle-class consumers in the emerging markets represent new markets for developed-world exports and companies based in developed countries. Emerging market corporations are another big new market: business-to-business sales to China and India, for example, are a key factor in Germany's strong export economy.

In sum, emerging markets present a massive opportunity, but companies will need strategic clarity if they are to capitalize on it. Many will have to rethink their business models considering, for example, the relatively low spending power of many consumers in the developing world. They will also have to prepare for fierce competition from local enterprises, which often enjoy advantages such as strong distribution capabilities, superior government relations, or lower-cost business models. Getting these and other elements right will be vital to companies' long-term success.

Other global trends

In addition to the rising power of emerging markets, Ernst & Young believes five other key trends will shape tomorrow's business landscape:

- *Cleantech becomes a competitive advantage.* Governments and private organizations plan to shrink their carbon footprints to address the problems of climate change and dwindling global energy supplies. This move toward cleaner technology represents a second industrial revolution that will have effects as great as the first.

- *Global banking seeks recovery through transformation.* The global financial system remains uncertain and poses opportunities and risks for financial institutions, alternative asset managers, and other enterprises that need funding to grow.

- *Governments enhance ties with the private sector.* Readjustment will continue between the developed and emerging economies, the public and private sectors, and global institutions and nations as these entities define their roles in the post-crisis world.

- *Rapid technological innovation creates a smart, mobile world.* Smarter technology offers the promise of remote access to health care and education, while blurring boundaries between industries. The power of the individual will grow and new competitors will emerge, disrupting industries and creating new business models.

- *Demographic shifts transform the global workforce.* Rapid demographic change, especially an aging global population, will force employers around the world to recruit from a shrinking workforce.

Winners and losers

As these trends change how businesses grow and compete, winners and losers inevitably will emerge. The winners – easy to spot – will be organizations that constantly monitor broad trends in the external environment, embrace technology, and look for talent everywhere, especially among previously neglected segments of the workforce such as women, minorities, and older workers.

As businesses and governments look to the future, they would do well to remember that executing on their current strategy may no longer be good enough. Instead, they will have to think more deeply about the opportunities and risks presented by evolving global trends. With a different mindset, they can reimagine what is possible, discovering what they can do that is new and how best to do it. Those that succeed may find themselves not just navigating tomorrow's global trends, but actually shaping them.

For the complete Ernst & Young white paper on this subject, Tracking global trends: How six key developments are shaping the business world, *please go to www.ey.com/globaltrends*

Questions for the board to consider

- *Emerging markets*: Do you have the right talent, cultural understanding, age profile, experience, and skills to create credibility and relationships with critical stakeholders – such as regulators, company officials, and key business leaders – in the emerging markets most important to your organization?

- *Cleantech*: Is your cleantech strategy optimized for both operational efficiency and revenue growth, and does it maximize opportunities in both mature and emerging markets?

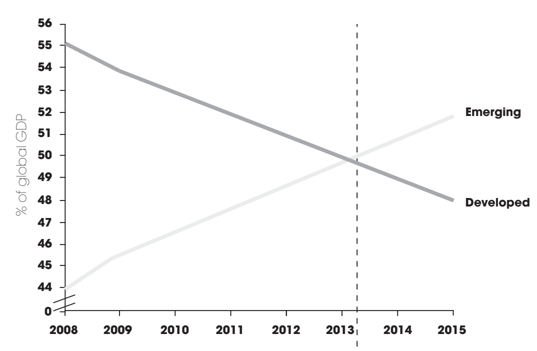
- *Global banking*: Have you evaluated the impact of regulation on your capital requirements and determined how to manage them while getting the best possible returns?

- *Government*: Significant government investments are needed in pensions, social security systems, infrastructure, and education. In many cases, these investments will require greater funding from the private sector. Has your organization identified opportunities in this space?

- *Technology and innovation:* Are you satisfied with your ability to leverage newer technologies, such as social media and cloud-based services, analytics, security and privacy, and virtualization solutions?

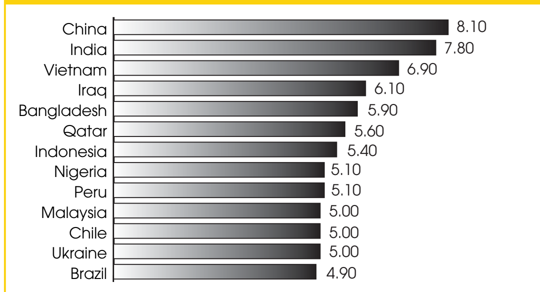
- *Demographic shifts*: When you make location and investment decisions, do you consider shifts in demographic factors, such as the percentage of working-age population, education level, and skills base?

Emerging and Developed markets share of Global GDP (PPP)



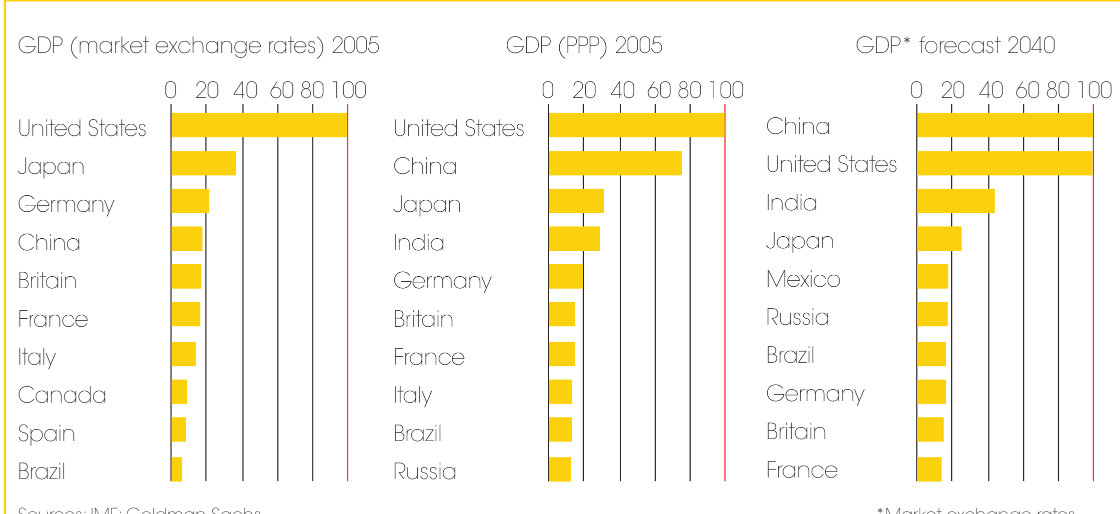
According to the IMF, by 2014 emerging markets will have overtaken developed economies in terms of share of global GDP PPP

2010 - 2020 CAGR for Fastest Growing Countries (10)



China and India lead the way with the strongest growth rates

World's Ten Biggest Economies, 2005 and 2040



Sources: IMF; Goldman Sachs

*Market exchange rates