EXECUTIVE BRIEFING

Global Emerging Markets

Developing a manufacturing and distribution footprint in an emerging market

by Harsh Koppula

finding *new answers* in business.

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Developing a manufacturing and distribution footprint in an emerging market

Big risk, big reward

For many companies, emerging markets can resemble wide-open fields of opportunity – billions of consumers ready to buy and entire industries ready to spring into development. Yet, establishing or expanding manufacturing operations is increasingly challenging today. Demand is inherently volatile. Competition is fiercer, including global leaders as well as a growing roster of domestic players with a home turf advantage. And supplier networks are not quite as mature, and constantly shifting.

In the midst of rapid change and with many unknown market factors, a company must craft a sound business strategy. How many factories and in what locations? Where are the best suppliers, labor and talent located? Where will customers be? What is the cost of distribution and logistics? What government incentives are available?

With such limited vision, many companies are tempted to start small. They want to avoid overinvesting, building in the wrong locations or misjudging market needs. Too much caution, though, carries its own risk that a more aggressive competitor will capture a larger share of the opportunity.

This is the challenge of developing manufacturing operations in an emerging market. And companies don't have a lot of time to react. So how can they compress the decision cycle while establishing a right investment plan? This Executive Insight paper provides a look at key best practices companies are following today and should be a guide for any company that wants to thrive in an emerging market.

Preparing the foundation

One of the toughest challenges is where to establish operations in an emerging market and how large to build. An ideal goal is to minimize capital outlay while enabling rapid expansion. Getting that formula right depends on assessing four key criteria: demand profile, supplier profile, product profile and competitor profile. These factors are the foundation of any footprint expansion plan, but manufacturers must consider additional criteria on the context of an emerging market.

Demand Profile

Manufacturers first need to identify demand and customer characteristics for current and future volumes and locations. Yet in emerging markets, demand must be considered in the light of government policy, which can escalate an opportunity or bring it to a halt. And it must be mapped geographically, especially as tier two and three cities and market regions mature.

Supplier profile

Developing a reliable, cost-effective supplier network can be a critical strategic advantage. As companies consider where to locate their manufacturing facilities, they need to consider proximity to suppliers. Manufacturing facilities also need to be located within reasonable reach of customers to manage distribution costs effectively. And government incentives impact suppliers as well. They are prone to shift their focus and geographic strategy as industry policies change.

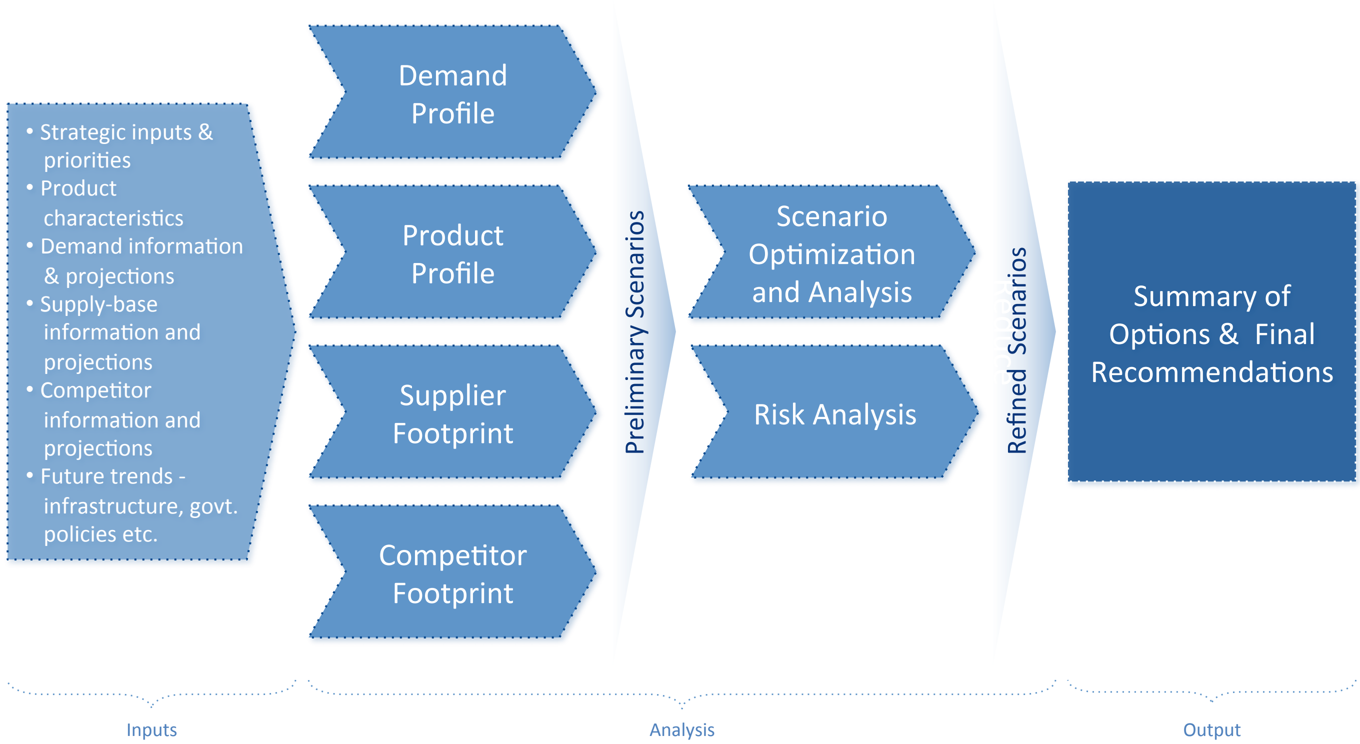
Product profile

Setting up a manufacturing base is just one challenge. Companies also need to develop the right product profile, including features, pricing and marketing. This entails understanding local market characteristics, from prospective customers to competitors and aftermarket opportunities. And given high sensitivity to price, companies must consider supplier and distribution costs as a critical part of their product profile.

Competitor profile

In emerging markets, the competitive landscape is continually changing with new market entrants and shifting regulations. A solid assessment must start with product and market share analyses. It must then extend to competitors' existing locations and planned investments as a way to gauge access to local talent, government incentives. Another measure of competitive strength or weakness is a company's supply base. Understanding competitors' respective supplier and distribution networks is a key indicator of speed and cost to market.

Figure 1. Companies should establish a framework that considers the key factors impacting manufacturing location decisions and then applies scenario and risk-based analysis in order to arrive at fact-based recommendations



Scenario planning and evaluation

When companies plan against these core criteria, they need to produce and analyze highly complex, multiple variable scenarios. After a company runs scenario analyses to determine where it should establish operations, the next step is evaluating each cost component of the value chain against the various locations being considered. These include factors such as taxes and incentives, land costs, labor characteristics, workforce availability, transportation, and utility access and rates.

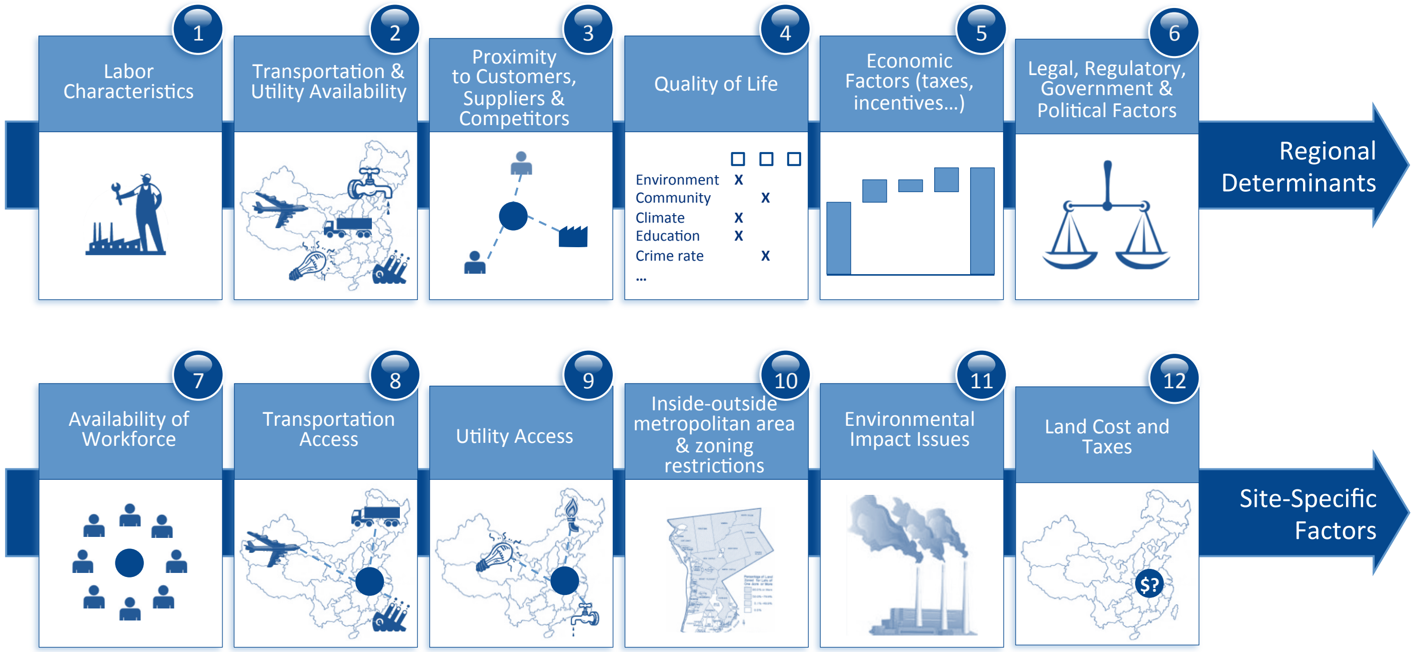
Then go beyond that by examining site-specific conditions. On a per site basis, a geographical risk analysis should include factors like the legal and regulatory climate and trends, availability of transportation and utilities, and zoning restrictions. Research may determine, for instance, that the reason government incentives are so good in a specific site is that the region desperately need jobs – but the local labor force is largely unskilled and unfit to your your business needs.

Stakeholder evaluation

You've determined the factors you need to consider and what criteria can change. You create a range of investment scenarios and conduct a cost and benefit comparison. Then some of the hardest work begins. Before going into a market and investing huge amounts of money, resources and talent, you need to present the best scenarios to key stakeholders. Companies need to put the right information in front of management, financial, operational, engineering, marketing and other key stakeholders so they can participate in the decision. While this is difficult enough to achieve in domestic business, it can be even more so in emerging markets.

The more visual and evidence-based your scenario planning, the easier it is to drive comprehension and consensus. Lay information out for key stakeholders to analyze so they may develop informed, strategic opinions. Participants from every department – finance, business, marketing, operations – should then gather together and debate questions like "How much risk do we want to take?" and "What are the consequences of that risk scenario?" This collaboration forms the basis for a strong organizational entity moving forward. With everyone on the same page and everyone voicing an opinion, the project becomes a truly shared endeavor, cultivating a sense of investment and ownership throughout the company.

Figure 2. A total cost and risk modeling approach takes into account location selection characteristics that are driven at both a regional and site-specific level



Global risk analysis

Investments in emerging markets are costly and can represent a significant share of a company's larger global capital resources. Companies today are evaluating their opportunities and risks on an increasingly global basis. Risk needs to be balanced across all emerging, global and domestic markets. If the endeavor is not properly undertaken and ultimately unsuccessful, it can put a strain on a company's worldwide profitability.

Constant refinement

With all that hard work behind them, companies must the come to terms with the hyper pace of change. It's not unlikely that by the time a company has hashed out a comprehensive business case and is ready to pour the concrete, it needs to pause and reassess if the business case is still viable.

Throughout the process of building a manufacturing footprint, you must continuously monitor the market to ensure your assumptions and strategies are aligned with the current reality. Don't stop running scenario analyses – in fact, enhance them by adding new factors, adjusting hypothetical risk investments and modifying variables to reflect the changing business landscape. And most importantly, adapt and aggressively refine your strategic plan to keep pace with market changes.

These rapid shifts and corrections are vital to your success. If, for instance, your supply chain breaks down, it may cause you to take too long to build a factory. You lose substantial market share and fall behind schedule on your strategic rollout. That delay can leave you prone to a competitor, who might capitalize on demand more quickly than you, which will affect your pricing strategy. But if you have properly run your scenario analyses, you can make the necessary adjustments to avoid such calamities, mitigating your risk and increasing your chances for ultimate success.

Conclusion

Companies have been operating globally for decades, so many emerging market risks are familiar. But new issues and challenges materialize and evolve rapidly. For every obviously foreseeable market shift, there are hundreds of challenges that are nearly impossible to detect in advance.

Still, today's businesses have several advantages. Emerging markets have rapidly developing economies, with rising middle class populations, increasingly sophisticated suppliers, improving talent and greater options overall for business expansion. There's greater access to local talent and expertise on the ground. And data and analysis tools are significantly more sophisticated than they were even a few years ago.

Success requires a significantly greater effort – more detailing planning, deeper understanding of local and global market conditions, the right financial strategy and resources. With access to the right tools and counsel, though, companies can achieve significantly greater returns.

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