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The Changing Face of Asia: What Companies Need to Know Before Expanding into Emerging Asian Economies

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Once regarded as a beacon of opportunity for consumer organizations, China is now losing many of the competitive advantages it offered as costs rise and foreign direct investment wanes. As a result, many multinational corporations (MNCs) have their sights set on neighboring countries. We recently spoke with key executives at some of today's leading global brands to better understand how consumer organizations are structuring their teams and operations as they expand into emerging Asian economies. We found that while a few key markets have absorbed a significant amount of the business fallout from China, there is not a single region that provides a one-size-fits-all solution to uniformly address the needs of every corporation. It is crucial for organizations expanding into more cost-effective markets to identify the unique set of challenges and advantages associated with each region to find the opportunity that most closely complements their strategic goals.

Initial Draw to China

In their common pursuit of globalization, many MNCs flocked to China to tap into its growing consumer middle class, low manufacturing and labor costs, and efficient production cycle. Consumer organizations in particular found that they could leverage China's massive population, currently standing around 1.3 billion, to build a low-cost labor force that would manufacture or assemble more products at a lower cost than in their native countries.[1]

The demographics in China have changed dramatically in response to the growing presence of MNCs and increased foreign direct investment. Many Chinese citizens have relocated from the countryside to coastal urban areas in an effort to get a piece of the booming market and advance their careers. As a result, a powerful middle class has grown to a size that outnumbers the entire United States population. The percentage of middle class citizens in urban households in China has risen from 4 percent to over two-thirds of the urban population in just 12 years. The middle class population is expected to reach 630 million by 2022, equaling 45 percent of China's population.[2] With these figures in mind, it comes as no surprise that consumer-oriented companies were eager to plant their feet on Chinese soil to learn more about the buying habits of middle-class Chinese citizens and market directly to the massive base of new buyers.

China Begins Losing its Competitive Advantage

Rising Labor Costs

Once seen as the land of opportunity, China is now saturated with MNCs and large local corporations. Despite the sheer size of the Chinese population, the pool of local working-aged citizens with the skills and expertise to lead organizations in this key market is far smaller than the region demands. For this reason, many MNCs in China have recruited expatriate leaders to spearhead their business efforts. These leaders, however, require salaries that are competitive with the standards set in their home countries, as well as funding for relocation, private schools for their children, housing, and transportation. Of the few executives who are qualified to oversee operations in China, many are hesitant to move into the polluted urban areas that are plagued by "metals in the soil, pollutants in the water, and soot in the air."[3] The environmental concerns

of best-in-class executives prompt organizations to offer aggressive packages to woo expatriate and local leaders. This costly talent solution creates a high cost structure that serves as the baseline for executive compensation in China. As a result, many organizations are questioning the sustainability of their talent programs and profitability in what is becoming an incredibly draining market.

The human capital challenges in China extend far beyond the C-suite level. Factory workers' wages have increased dramatically as well, impacting cost structures and therefore companies' ability to remain competitive with low-cost alternatives manufactured in neighboring markets. In 2012, the wages of private sector employees rose by 14 percent, up from the 12.3 percentage increase in 2011.[4] The Chinese government welcomes and encourages this wage increase in hopes that it will add more individuals to the population of middle class consumers, and consequently drive local consumption and overall economic growth.[5] With the Chinese government working against the very thing that originally attracted so many MNCs to China, many organizations are struggling to maintain productivity amid substantial wage increases.

According to the 2013 "China Business Climate Survey Report" by the American Chamber of Commerce in China, 47 percent of the 325 executives surveyed reported rising labor costs as

1 "China," *The World Bank*, http://data.worldbank.org/country/china.
2 Barton, Dominic, "Half a Billion: China's Middle-Class Consumers," *The Diplomat: Pacific Money*, May 30, 2013, http://thediplomat.com/pacific-money/2013/05/30/half-a-billion-chinas-middle-class-consumers/.
3 Chang, Gordon, "Move Over, Michigan, China is the World's Next Rust Belt," *Forbes*, December 9, 2012, http://www.forbes.com/sites/gordon-chang/2012/12/09/move-over-michigan-china-is-the-worlds-next-rustbelt/.
4 Orlik, Tom, "Rising Wages Pose Dilemma for China," *The Wall Street Journal*, May 17, 2013, http://online.wsj.com/article/SB10001424127887324767004578488233119290670.html.
5 Orlik, Tom, "Rising Wages Pose Dilemma for China," *The Wall Street Journal*, May 17, 2013, http://online.wsj.com/article/SB10001424127887324767004578488233119290670.html.

the greatest business risk to their organizations. Moreover, a combined 61 percent of respondents reported that the shortage of qualified employees and managers was their greatest risk.[6] With these figures in mind, it comes as no surprise that companies are looking to tap into the less-costly talent markets of surrounding economies for relief.

Rising Real Estate and Tax Expenses

The cost of labor is not the only factor that has increased since China's economic boom; real estate and land have also appreciated in value, pricing out many businesses in the area. For example, a multibillion dollar skin and beauty care company set up its Asia-Pacific headquarters in Shanghai, but the city is proving to be too expensive—tax equalization acting as the main cost, with additional impact from housing and schooling expenses.

Inefficient Enforcement of Intellectual Property Rights

Some organizations are also wary of China's lack of enforcement around intellectual property rights (IPR). For consumer companies, specifically, theft of product designs and the influx of counterfeit goods pose a number of issues, not the least of which are damage to brand integrity and decreases in revenue.[7] From auto parts to handbags, and electronics to shoes, approximately 79 percent of all counterfeit goods imported into the United States hail from China.[8] Businesses' growing concerns around China's intellectual property protection programs are prompting them to explore operations in alternative locations with stronger

intellectual property enforcement. As of April 2013, 58 percent of executives in China rated China's enforcement of intellectual property rights as ineffective, with 48 percent stating that IPR infringements in China have caused material damages to either their China or global operations.[9]

China's Economic Slowdown

The lending practices and banking decisions in China are also a source of apprehension for some consumer-driven companies. From 2008 to 2011, China initiated a $2.5 trillion stimulus aimed at building infrastructure and condominiums.[10] These developments, however, were built in "ghost cities" that don't have any inhabitants. Many of the condos were purchased by Chinese citizens as investments, but few are actually occupied. Due to small returns on bank deposits, high inflation, and stringent government controls, there are few alternative investment opportunities outside of real estate for Chinese citizens.[11] With approximately 12 percent of its GDP generated from real estate and many of its citizens' life savings invested into these empty condo complexes and "ghost cities," China's lending activities and subsequent large-scale real estate projects have caused many MNCs to question whether the loans used to finance these multibillion dollar projects—mostly undertaken by state-owned enterprises—will ever get repaid.

Some fear that this lending craze may lead to the creation and subsequent burst of a debt-induced economic bubble and eventual decline of the Chinese economy. In the study conducted by the American Chamber of Commerce in China, 47 percent of respondents listed the economic slowdown in China as one of the greatest risks impacting their organizations.[12] Moreover, the President, Asia, at a multibillion dollar business services organization feels that China's growth story cannot continue, and that there must be an alternative or correction to its current trajectory. In his opinion, "Banks are over-lent and bad loans are high; lending seems to be very inefficient."

6 "China Business Climate Survey Report 2013," *The American Chamber of Commerce in the People's Republic of China*, April 2013, http://web.resource.amchamchina.org/cmsfile/2013/03/29/0640e5a7e0c8f86ff4a380150357bbef.pdf.

7 Woollacott, Emma, "US Should Get Touch on Chinese IP Theft, Committee Warns," *Forbes*, May 23, 2013, http://www.forbes.com/sites/emmawoollacott/2013/05/23/us-should-get-tough-on-chinese-ip-theft-committee-warns/.

8 "Intellectual Property Theft: Get Real," *National Crime Prevention Council*, accessed August 9, 2013, http://www.ncpc.org/topics/intellectual-property-theft/fake-consumer-goods-1.

9 "China Business Climate Survey Report 2013," *The American Chamber of Commerce in the People's Republic of China*, April 2013, http://web.resource.amchamchina.org/cmsfile/2013/03/29/0640e5a7e0c8f86ff4a380150357bbef.pdf.

10 Menza, Justin, "Why China's Economy May be Heading for a Crash," *CNBC: Asia Pacific News*, June 29, 2013, http://www.cnbc.com/id/100849458.

11 "China's Real Estate Boom: Miracle or Mirage," *Day on Bay*, January 13, 2012, http://www.dayonbay.org/chinas-real-estate-boom-miracle-or-mirage-2/

12 "China Business Climate Survey Report 2013," *The American Chamber of Commerce in the People's Republic of China*, April 2013, http://web.resource.amchamchina.org/cmsfile/2013/03/29/0640e5a7e0c8f86ff4a380150357bbef.pdf.

Should this decline occur, commodity prices will surely drop as Chinese citizens bear the full weight of the economic downturn and have less disposable income for non-essential consumer goods. Many organizations are consequently moving out of China, or at the very least, diversifying their presence in Asia, to limit exposure to a potential economic downturn.

Popular Targets for Expansion in Asia

As the rose-colored glasses begin to clear, many MNCs are looking at China's offering with a more critical eye. No longer clouded by the excitement around a budding new class of consumers or low labor costs, companies are looking for alternatives to the Chinese market that will give them a competitive advantage. Countries in Southeast Asia (SEA), including Thailand, Vietnam, Myanmar, and Indonesia, are proving to be attractive destinations for organizations looking to redirect investments and operations out from China. Foreign direct investment in these countries is growing quickly, accounting for 7.6 percent of global foreign direct investment, compared to China's 8.1 percent.[13]

For the multibillion dollar skin and beauty care products company, the second most important region for their strategic direction outside of China is SEA. The company hosts its talent center in Bangkok, Thailand, to manage its presence in the SEA cluster, which is regarded as a region with immediate opportunity. A multibillion dollar pest control and hygiene company, on the other hand, views India, Indonesia, Malaysia, and Vietnam as strategically important markets. Each of these neighboring regions, however, has challenges and barriers to entry that organizations must consider before acting based solely on the cost of doing business.

Qualifying the Alternatives

The Undeveloped Infrastructure

Few of the countries previously mentioned can match the strength of China's infrastructure. The lack of developed ports, railways, and roads in these emerging economies complicates the efficiency of a company's supply chain, and can ultimately lead to increased distribution timelines and logistics costs. Moreover, unstable building foundations, undeveloped infrastructure, and the overall absence of structural support for inevitable weather-related disasters places companies at the mercy of Mother Nature. MNCs looking to diversify into regions where infrastructure is lacking should carefully assess the costs associated with potential delays or catastrophic events.

Unstable Political Landscape

The political environment is also an important factor that deserves heavy consideration. For example, dissension between the People's Alliance for Democracy (PAD) and the United Front for Democracy Against Dictatorship (UDD) in Thailand has sparked riots, violence, and bloodshed since 2006. At one point, the PAD rioted and stormed Bankok's Suvarnabhumi international airport terminal, forcing the closure of the entire airport.[14] Such political unrest not only wreaks havoc on the country's financial stability, but also puts companies' teams and production at risk.

Talent Shortage in Emerging Markets

Perhaps the most important consideration for MNCs looking to enter a new market in Asia is the talent pool. Few of the emerging economies in SEA have skilled labor forces that can perform the duties required by investing organizations. MNCs must be willing to design and implement training and safety programs for local workers to ensure their products live up to consumer expectations.

To circumvent the labor shortages in some of these emerging economies, many companies have created joint ventures with local organizations to procure skilled teams. A multibillion dollar beverage company based in Singapore, for example, established a joint venture with a market leader in Myanmar that proved successful for a number of years, and also won 100 percent of a brewery based in Vietnam through a joint venture.

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13 Zhang, Yajun, Orlik, Tom, and Obe, Mitsuru, "China Begins to Lose Edge as World's Factory Floor," *The Wall Street Journal*, January 16, 2013, http://online.wsj.com/article/SB10001424127887323783704578245241751969774.html.

14 Balakrishnan, Angela, "Thai Protesters Storm Bangkok Airport as Fighting Escalates," *The Guardian*, November 25, 2008, http://www.theguardian.com/world/2008/nov/25/thailand

Although in many cases joint ventures and mergers and acquisitions can be lucrative for expanding organizations, it is important for companies to exit swiftly when investments turn south. The brewery, for example, refused to support the corrupt activities of local politicians and generals and subsequently reduced interest in their joint venture in Myanmar. According to their Director of Human Resources, "We know when to get into markets, but even more importantly, we also know when to get out. We have had a number of unsuccessful partnerships that we have learned from, especially in Cambodia and China, and early exit is the best solution."

Local Demographics

Companies should also carefully analyze a potential market's working age population to better understand what the talent landscape will look like in years to come. For example, many organizations are moving to or ramping up production in Vietnam to remain competitive. However, the Vietnamese population is aging, despite its median age of 27.4 years, and will likely experience a dramatic downshift in the pool of working age citizens.[15] According to a study by McKinsey & Company, "Vietnam's labor force is likely to grow by about 0.6 percent a year over the next decade, a decline of more than three-quarters from the annual growth of 2.8 percent from 2000 to 2010." While this growth will still positively impact GDP, the gains will prove noticeably less than what was observed from 2000 to 2010.[16] It is important for MNCs to fully understand how demographics will impact future operations and costs as they develop and expand strategic programs in emerging economies.

Talent tends to lag investment in all regions; just as China is experiencing a talent war for senior leaders, so too, will SEA and surrounding economies. For this reason, companies must be prepared to compensate senior leaders with Chinese salary standards in mind. Since the pool of experienced local senior executives is incredibly shallow, MNCs will likely need to bring in expatriate talent to lead in the short term until the supply of local leaders rises to meet demand through strategic development and training programs. For example, the Managing Director in Vietnam for a multibillion dollar pest control and hygiene company is from New Zealand, but most employees in the next level down are Vietnamese. The company believes that their business has become more knowledge based and that training for technicians is critical to long-term growth. Although the cost of labor draws companies into these emerging markets, we recommend that organizations create detailed human capital budgets with realistic salaries and retention bonuses for senior leaders in mind.

Leadership Requirements in Southeast Asia

For any executive in charge of a particular region, it is incredibly difficult to balance the needs of the local team with the goals of the organization. This struggle is exacerbated in SEA economies because the channels of communication with headquarter-based executives are obstructed by inconvenient time zones and cultural variances. To be successful, executives must have the flexibility to adjust schedules and interact with leaders across countries, a clear understanding of the company's mission and strategies, and the ability to effectively communicate those goals to the local team.

Senior leaders must also understand the local cultural and business norms of the country in which they operate to better communicate with local team members and gain insight into what local citizens value and deem important. This awareness will allow executives to gear products toward the specific buying habits of local consumers.

A company's success in an emerging market is often driven by joint ventures and partnerships. Country leaders must have the ability to manage relationships with professionals, general managers, and local partners or owners of the companies with which they interact. Executives will also benefit from having a working knowledge of the local language when interfacing with local employees, businesses, and government agencies.

Considering that some of the alternative markets to China are plagued by political corruption and unrest, it would be smart for organizations to hire executives with experience navigating the regulatory complexities of emerging economies.

[15] Bland, Ben, "Vietnam Offers Companies China Alternative," *Financial Times*, March 14, 2012, http://www.ft.com/intl/cms/s/0/46d052b8-6446-11e1-b30e-00144feabdc0.html#axzz2bQEwAJpW

[16] Breu, Marco, Richard Dobbs, and Jaana Remes, "Taking Vietnam's Economy to the Next Level," *McKinsey & Company*, February 2012, http://www.mckinsey.com/insights/economic_studies/taking_vietnams_economy_to_the_next_level

Such experiences will be helpful in understanding how various mandates impact revenue, product life cycles, and overall growth.

From managing the local workforce to communicating with headquarters-based executives, and understanding local consumer preferences to navigating in a complex regulatory environment, the executive in charge of an emerging market wears many hats. For this reason, finding an executive with the right blend of experiences and competencies—who is also willing to relocate to an underdeveloped region—is incredibly difficult. Given the shallow pool of local leaders and expensive cost of expatriate talent, we encourage organizations to design diverse teams of leaders to address the many complexities of doing business in an emerging market.

Designing Talent Development Strategies

Companies should adopt a forward-looking talent strategy to build bench strength as the markets in which they operate become more developed. To create a talent pipeline that will ensure quality local leadership for years to come, it is essential for organizations to design sustainable talent development programs that leverage seasoned senior leaders' expertise and knowledge, as well as local leaders' market and cultural insight.

Many companies are asking senior executives to mentor promising local professionals to learn the local language, customs, and business practices, and explain western business practices, organizational goals and strategies, and general principles for success to those high-potential leaders. This will create a marriage of ideas that will ultimately lead to better productivity and employee engagement throughout the entire global organization.

Many companies also view their entry into new markets as valuable teaching opportunities for their most senior leaders. As an example, a global multibillion dollar food and beverage company uses top positions in emerging markets as development steps for their top managers. Similarly, a multibillion dollar skin and beauty care products company created a talent swap program in Asia where high-caliber employees rotate through leadership roles in various countries as part of their development paths. The ability to create and develop teams of skilled leaders will prove to be a game-changing element in organizations' efforts for expansion.

Determining the Next Move

The decision to redirect investments out of China and into more cost-effective, yet less stable Asian markets is not one that should be taken lightly. For some MNCs in the consumer industry, the growing middle class in China is too large of a strategic opportunity to completely abandon for low-cost alternative markets. As such, some organizations are choosing to continue building their presence in China, while also expanding into surrounding areas. Forty-seven percent or survey participants reported that China remained a top-three investment priority for their organizations, demonstrating that companies still have a vested interest in the market. Similarly, China accounts for 80 percent of the business focus for the multibillion dollar skin and beauty care company, despite their recent losses.

Some argue that the demand for talent, land, quality, and overall cost of doing business in emerging Asian economies will inevitably skyrocket as MNCs seeking low-cost alternatives saturate the secondary markets. Comparable to China's current talent situation, these regions, originally exploited for their low-cost offering, will eventually see such significant price and wage increases in response to heightened demand that they will no longer provide enough cost savings to warrant doing business in such remote locations. If companies' decisions to move into emerging markets are based solely on cost-effectiveness, they will undoubtedly end up hopping from region to region in an effort to stay ahead of rising costs associated with economic development.

It is important to note that many of these emerging Asian economies, including some regions in inland China, have significant potential apart from their cost advantage. As foreign direct investment continues to increase and more companies enter alternative markets, the employment opportunities and salaries for the regional population will also rise. As such, many of these citizens will find themselves with more disposable income to purchase items outside the realm of bare necessities for the first time. Consumer organizations consequently have a unique opportunity to market their products to an incredibly large population of potential buyers with blank slates and educate those consumers on their brand heritage. By expanding into underdeveloped Asian economies, companies can familiarize themselves with local consumer behavior and create unique strategies for success.[17]

The key to gaining a new consumer base, however, is early market entry. If organizations are too late to the game, what could have been a new group of brand loyalists will likely already be attached to a competing company's products. The multibillion dollar beverage company based in Singapore received an early movers' advantage in Vietnam, a market they entered almost 20 years ago, which led to successful profit margins and customer loyalty. Before deciding which markets to enter, consumer-driven MNCs should have a lens on competing organizations' intentions in order to determine if they can reasonably saturate the uninfluenced market ahead of their rivals.

Looking Ahead

With experts on one side of the table promoting China's long-term growth potential, and on the other its impending economic decline, it is difficult for organizations to make sound decisions on business strategies in Asia. For this reason, there is no universal solution for expansion that will generate success for consumer organizations in Asia. A footwear manufacturer may find incredible success in Vietnam, whereas a beverage company might stand to gain significant profits by adding operations in a second-tier city in inland China. MNCs must conduct due diligence and weigh the costs and benefits of relocating or expanding before acting based on what has been effective for other organizations.

A company's opportunity for growth in emerging economies in Asia depends in large part on their ability to hire an effective leader and tap into and train local talent. Failure to create an efficient talent solution will lead to increased costs, weakened productivity, and ultimately, early exit out of those markets.

Based on our combined experience placing senior leaders at MNCs around the globe and conversations with leading brands at the forefront of expansion in Asia, we created the chart below to help guide consumer organizations in their efforts to develop human capital strategies in emerging Asian markets.

Leadership Requirements

- Flexibility to adjust schedules and interact with leaders across countries
- Ability to communicate the company's goals and strategies up, down, and across the organization
- Clear understanding of local business and cultural norms and consumer preferences
- Firm grasp on the regulatory and socio-political environment of the local market

Human Capital Budgets

- Anticipate wage increases as economies become more developed and saturated with foreign direct investment activity
- Include retention bonuses and schooling and relocation costs in the compensation budget for senior leaders so as to not exceed talent budgets
- Factor in the cost of initial lost production or efficiency from long talent acquisition cycles or unskilled laborers in need of training

Talent Development Programs

- Understand and commit to the time and resources it will take to build and manage talent development programs
- Build bench strength and strong talent pipelines by investing in promising local leaders
- Pair experienced expatriates with local talent to expose expatriates to the market's cultural norms and local leaders to global dynamics

Consumer organizations must critically evaluate the resources and programs necessary to develop skilled teams to lead their regional operations through challenging development periods.

Conclusion

China remains the focal point for many organizations' Asia strategies; however, more and more companies are looking to alternative emerging markets in Asia for a broad range of strategic and operational reasons. It is important for companies considering diversifying throughout Asia to weigh the pros and cons of each developing region and understand that there is no one-size-fits-all solution for success in Asia.

[17] Daily, Jing, "For Luxury Brands Targeting China, Expansion to Lower-Tier Cities Beckons," *The Business of Fashion*, June 5, 2013, http://www.businessoffashion.com/2013/06/for-luxury-brands-targeting-china-expansion-to-lower-tier-cities-beckons.html

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