HOW LARGE BUSINESSES CONVERT VOLATILITY IN EMERGING MARKETS INTO OPPORTUNITY

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The article describes with what challenges international companies face with when they do business in emerging markets. The author reveals 7 strategies which can be used by global corporations to effectively combat evolving challenges and maximize value from doing business in developing countries. The article touches important aspects of operations including portfolio analysis, pricing strategies, foreign exchange risk management and organizational changes. The key objective that the author pursued was to demonstrate that regardless of severance of the financial crisis there are always ways to minimize losses and mitigate risks. Throughout the text, the author provides personal perspective based on his own professional experience and knowledge. Below strategies can be applied during high inflation, exchange rates volatility and during decline in purchasing power of consumers. The article will be interesting for those who deal with corporate finance, strategies, financial analysis, emerging markets and crisis management. Everybody who study financial management can find interesting approaches in the article based on first hands experience.

Keywords: emerging markets, strategy, international business, consumer goods, financial crisis

In fact, the rapid pace of change and unpredictability in volatile markets make it harder for any company to plan and commit on top line as well as bottom line figures. However, in case with international companies, once volume and profit forecasts are submitted to headquarters, it has to be delivered upon HQ's expectations, otherwise the creditability of local management might be seriously doubted. As a result, the question "What shall we do today in order to deliver tomorrow even if a storm arises?" is on top of the agenda among business leaders in emerging markets. The article describes 7 strategies that, when implemented properly, may help consumer product goods companies to be better prepared for uncertainties and capture growing opportunities in the world's most dynamic economies.

Strengthen portfolio via down-market brands

In the parts of the world where buying power of consumers is constantly decreasing due to growing inflation, companies need to have a balanced portfolio in order to win in a down trading ecosystem. In my experience, I witnessed how quickly consumers are able to switch from premium brands to low-tier ones leaving smaller chances for superior products to succeed. Therefore, to convert a threat into opportunity, launch of a down-market brand can be a solution. Firstly, having a down-market brand in the portfolio, the company protects its market share by capturing its existing customers who have started to move down due to personal budget constraints. Secondly, it allows to target a different customer type that was out of radar before, thus generating extra sales. Selling more volume leads to higher market share; high market share means bigger scale, cost advantages, greater market power and larger cash flow.

Indeed, to have a down-market brand in the portfolio is necessary but that alone isn't sufficient. Stephen Wunker in his article *"5 Ways to Reach Down-Market Consumers Without Harming Your Brand"* mentioned that marketers and financial managers should work together to develop the right marketing mix for a newly introduced offer [2]. The brand should be properly distinguished from core product line in terms of pricing, promotion, distribution and merchandising. In fact, placing differently priced offerings next to each other on the same shelf creates confusion among shoppers and pushes them to choose the brand which stays in the middle. One way to avoid this is by selling premium and low-tier brands in separate trade channels or at least merchandise them differently.

Optimize portfolio to eliminate gaps and embrace opportunities

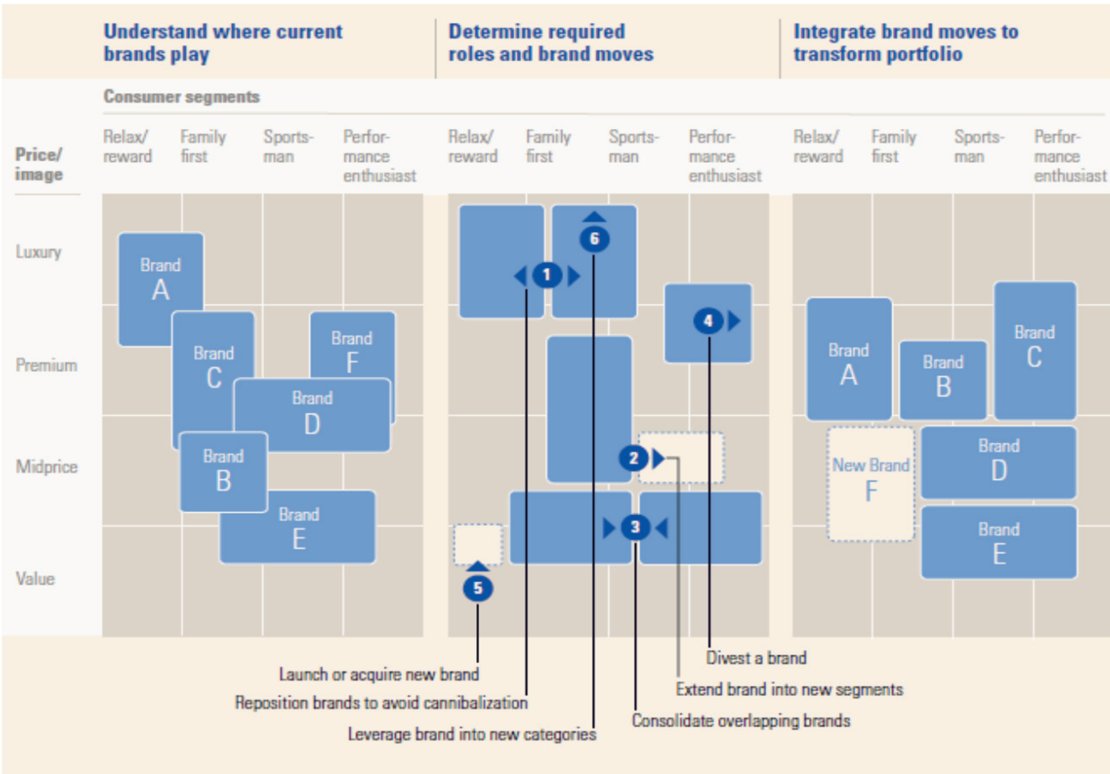
While down-market brands improves company's sales and market share during times when people are stretched in budget, when consumer confidence increases premium and super premium offers will be keys to high profitability margins. Therefore, when building a portfolio strategy, it is important to keep in mind that any crisis is temporarily and eventually consumers' affordability will improve, creating demand for aspirational brands. Then the question arises: "How to build the balanced portfolio that embraces opportunity?" A good start is to analyze existing brand board in order to detect gaps and missing prospects. "Does the current product line satisfies needs of target consumer segments?" "Does it provide offer for growing segment?" "Does the assortment look overlapping?" "Does the portfolio clearly communicate value of each brand to customers?" – all these questions would apparently evolve when the company decides to increase the portfolio's value by making strategic decisions on the restructuring, acquisition, divesture or launch of brands.

Exhibit 1 shows how companies, based on McKinsey's analysis in the article *"Making Brand Portfolios Work",* can restructure their brand portfolios in different ways, which are often interconnected – if one brand is repositioned, another can be extended into a new category [3]. The ultimate goal is to enhance the portfolio by positioning brands distinctively, eliminating inefficiencies (e.g. overlapping) and monetizing potential growing opportunity.

Setting the portfolio strategy is never easy – it requires resources, is costly and risky. However, in dynamic markets, where economic environment and consumers' needs changes rapidly, companies have to put brand-portfolio management in perspective in order to be a step ahead of the competition.

Drive pricing momentum wisely

Based on my experience I know that during economic crisis consumption patterns significantly change. Particularly, people start to consume less, switch to store brands and become very responsive to discounts, special offers and promotions. As a result, decline in demand make large companies decrease volume forecast what negatively affect their revenue. In this case, the power of pricing comes into play, compensating decline in sales and delivering top line numbers. However, development and execution of effective pricing programs, that will generate positive returns, requires a deep understanding of buying behavior of consumers, particularly in emerging markets. For instance, in developing countries people tend to shop frequently at open-air market stands or small neighborhood grocery stores while their peers from developed markets enjoy superior customer service at modern trade [1].



Potential restructuring of portfolio [3]

If executives decide to drive pricing aggressively, than a sharp increase in prices would shock consumers making them switch from global brands to store brands or local ones, sacrificing quality for saving a family budget. Therefore, the question arises: "How to drive pricing during recession with minimum hurt for consumers?" The answer is – via bridging plans.

Bridging plans are sets of activities developed to transit consumers smoothly from one price point to another. Those activities may contain one to many actions depending on company's capabilities and market environment. One of the simplest in terms of execution is gradual pricing. For example, a company has lost 20% of sales due to 20% decline in volume and wants to restore the sales via pricing. In order to do so, with all things being equal, it has to increase prices by 25% (1/0.8-1) which is a significant jump and may lead to further reduction of volume. Alternatively, immediate price up of 25% can be divided into 3 or 4 steps – 10% increase at first followed by 5%, 5% and 3% increase respectively. In fact, gradual pricing builds effective communication with consumers, because it allows to monitor how demand reacts on new price points, learn from real-life experience and make timely corrections if needed; while in case with immediate pricing the cost to revoke the decision can be very high. In addition to gradual pricing, investment into temporary promotions is a good solution to retain loyal customers. For instance, "Buy four get one for free" or "Special discount on bulk sizes" – all these allow households to build long-term stock at discount staying loyal to a brand.

Hedge foreign exchange risk to minimize pressure on profitability

Since 2008 many global companies are facing the fact that it is a particularly tricky time to do business in emerging markets due to currencies' exchange rates volatility. In fact, a series of events – credit crisis, falling oil prices, geopolitical tensions and reduction of foreign investments into developing economies – all these led to significant devaluation of local currencies putting a pressure on international companies' profits. For instance, Russian ruble in Sept 2008 was trading at ~25.5 per dollar; ten years later, in Sept. 2018, it was trading at 67 rubles per dollar meaning that in order to report the same revenue in dollars in Sept. 2018 as in 2008 it requires to collect 2.6times more rubles than a decade ago [4]. Therefore, proactive FX hedging is vitally necessary to avoid sizable transactional and translational losses in income statement.

First of all, reduction of expenses in foreign currency helps to decrease transactional losses. For example, an international company does business in Russia consequently it collects revenue in rubbles but its' expenses aren't necessarily all in local currency – suppliers of materials, advertising agencies, key business partners and etc. – some of them might ask to pay them for service performed in hard currency (e.g US dollar). In this case, having contract obligations with partners in USD, the company exposes itself to inescapable losses when the ruble decreases in value. Therefore, to avoid transactional losses, a global producer should exploit its negotiation skills to minimize expenses in hard currency. Those negotiations can be tough so the management has to be ready for pushbacks. I remember it took us a while to assess the bargaining power of suppliers before we could make a progress in negotiations and respectively hedge FX risk.

Another tool to manage currency risk is to use FX forward contracts that allow to purchase or sell currency at predetermined exchange rate and at a certain date in the future. The major advantage of this option is predictability, which means a company will be able to build a precise forecast thus protect itself from ups or downs in exchange market. However, "forwards" are financial instruments that have to be monitored and managed very careful; therefore it requires specific expertise and skills. Moreover, if a spot exchange rate changes unfavorably versus forward rate the company will incur losses and in this case the hedging via forward contracts would hurt not help. Nevertheless, existing instability on FX market make it critical for companies to proactively build capabilities that are strong enough to stand the test of volatility.

Take contingency planning seriously and keep it up-to-date

What if your biggest customer goes bankrupt and stops paying you tomorrow? What if your distributor stops operations today because of XYZ reasons? What if…? – these are questions to think about because there are millions of negative events that might happen at any time, especially the high risk of failures during the recession. Therefore, business leaders have to be proactively prepared for unknowns and, when undesirable situation occurs, protect the business from catastrophic consequences. To do so, companies should develop Business Contingency Plan (BCP); a course of actions that the organization would take if an unexpected negative event happens. Ideally, BCP should contain a list of all potential threats that can undermine the organization's reputation, financial health or ability to stay in business, providing specific instructions on how to combat those threats when a crisis hits.

For global companies BCP is high priority and management pay a lot of attention to keep it relevant and updated all the time. Specifically, it is vitally important to have a solid BCP if you operate in unstable markets where political, economic and social environment changes very fast and consequences of those changes may hurt day-to-day business activities. For example, I know a case when a distributor, which was the biggest customer, suddenly stopped its operations meaning that the producer urgently had to find solutions on how to revive sales. In this case, the senior executives referred to BCP and followed the guidelines that recommended switching from outsourced to in-house distribution until a new partner (distributor) could be found. Hence, using corporate cars and available human resources the company could build its own product delivery capabilities thus could manage the temporarily crisis.

Unfortunately, based on my observations small and medium firms underestimate the importance of contingency planning – they either keep it for the sake of having it in folders or don't have it at all. My personal position is that BCP serves the role of a life jacket for business – it can stay in the emergency cabinet forever or when an accident happens can save the enterprise. You may never use it but is necessary to have and keep up-to-date.

Prepare a list of choices before you have to make them

Sometimes, due to the recession, the pressure on profitability can be very strong and management has to make tough choices in order to achieve financial goals of the company. If cost-cutting programs are inevitable it is better to proactively analyze the budgets and decide which expenditures bring insignificant value to the business.

In my career, I had a chance to lead cost optimization projects where I precisely analyzed investments into marketing programs, estimated effectiveness of those and provided recommendations to management regarding which activities contribute to business's objectives and which ones don't. I only focused on brand and trade expenditures because these were the biggest expenses in overall marketing budget. The analysis showed that the company spends money on two types of activities: 1. Ad-hoc projects that require onetime investment; 2. Ongoing promotions that require constant cash outflow within the year. If the first were cascaded from HQ as "must have", effectiveness of ongoing promotions could be easily challenged. As a result, I found out that some incentives pushed volume very well, others highly contributed to profitability margins, a few did both – increased profit and units sold – but several of them delivered neither profitability nor volume. Having this analysis, the team could decide whether it is better to stop doing ineffective marketing campaigns and re-invest funds into more promising opportunities; or release these budgets to increase net earnings. In any case, we achieved a flexibility that we could leverage for resource allocation purposes to improve business metrics.

Drive ownership culture in the organization from the top to bottom

When every single employee wakes up every morning and asks himself "How can I improve the business performance of the company I'm working for?" then any crisis shouldn't be an issue at all. When a person treats company's assets as his own and makes decisions in the best interest of business, he demonstrates high ownership and entrepreneurial mindset that eventually brings tangible benefits for the organization in the long run. Therefore, the goal is to build a sustainable ecosystem where, regardless of seniority, every employee constantly looks for ideas to eliminate inefficiencies in the value chain, save money for the company, and, eventually, strengthen the business. The only way that top managers can integrate the ownership culture into company's DNA is by leading by example. It is wrong to ask your team not to do things that you're doing or vice versa. For instance, I worked in the culture where top managers, for business trips, flew with economy class and stayed at friend's houses instead of hotels. They didn't have to do it, but they were willing to save budgets in order to reinvest them for returns. As a result, every person in the organization was led by example, and eventually, cost savings initiatives have become part of a daily routine. Only by cascading the culture from top to bottom are the senior managers able to motivate their teams to do the right things for business; but, first, they have to become role models.

Conclusion

Large companies constantly face uncertainties in developing countries and there is no a single recipe on how to overcome headwinds. Challenges vary significantly and always arise at the wrong time. To enable the business to compete in increasingly fast-paced markets large businesses should take an incremental approach to the development of their crisis management capabilities.

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