Momentum Now: Emerging Markets

Innovations East –> West: Which Way Is Up?

By Mohsen Moazami and Eileen Lavergne, Cisco IBSG Emerging Markets

Introduction

Two to three decades ago, U.S. corporate behemoths such as Walmart, GE, Coca-Cola, and Nike established their presence in developing countries with factories in Indonesia, China, Latin America, Asia, and elsewhere. Their objective was to take advantage of inexpensive labor to provide products at costs that aligned with the growing middle class in Western markets.

Today, approximately 21,500 multinational companies are based in the emerging world.[1] They are innovating at a pace that is disrupting their Western counterparts—from cheaper products such as $3,000 cars, $300 computers, and $30 mobile phones that provide nationwide service for just 2 cents a minute, to wind turbines and high-speed bullet trains.

More important, these companies are reinventing product/distribution systems and experimenting with new business models to address the growing middle class *in emerging markets*.

New Frontiers for Future Growth

Emerging economies encompass a significantly growing portion of the world's GDP. In fact, by 2020, the BRIC countries (Brazil, Russia, India, and China) are expected to account for a third of the global economy (in terms of purchasing-power parity), contributing about 49 percent of global GDP growth, according to Goldman Sachs.[2]

Multinationals expect about 70 percent of the world's growth over the next few years to come from emerging markets, with 40 percent emanating from just two countries: China and India.[3] According to *Bloomberg Businessweek*'s 2010 ranking of the "50 Most Innovative Companies," 15 are Asian and, for the first time, 11 are from emerging economies.[4]

Western companies are also expanding operations in emerging markets. General Electric's healthcare division spent more than $50 million to build a vast R&D center in Bangalore, India. Cisco is spending more than $1 billion on a second global headquarters—Cisco East—in Bangalore. Microsoft's R&D center in Beijing is the company's largest outside its American headquarters in Redmond, Washington. IT specialists and consultancies have increased the number of people they employ in developing countries. For example, a quarter of Accenture's workforce is in India.[5]

Furthermore, approximately 80 percent of the world's population that falls outside the high-income per-capita bracket (as classified by the World Bank) is concentrated in emerging economies and is rapidly gaining middle-income status. They represent significant new customer and market segments for multinational companies operating in today's connected global economy.

Challenges

The emerging world is no longer simply a source of inexpensive labor, but also a fountain of disruptive innovation that is being homegrown in the East for local markets and then exported to the West. To be successful, companies must find ways to innovate and sell in emerging markets. Doing so not only requires localization of products and services, but also development of entirely new business models that support a distributed way of doing business. CIOs looking at this evolving trend come from two perspectives:

1. **Western world:** If a company sets up operations in, say, Brazil and makes products that work for the growing middle class there, how can CIOs help the company keep operations costs (CapEx and OpEx) down to enhance business margins? By taking this approach, will the company cannibalize its "cash cow?" In other words, will it eat into the profits of the products that have served the company for years?
2. **Emerging markets:** Growing global multinationals from emerging economies have an advantage because they know their local markets. So the challenge becomes one of how to expand the company's global footprint by providing products/services that are applicable to consumers in the West.

Regardless of perspective, one of the most essential questions many CIOs must address is, "How do I optimize global operations, rendering them agile while ensuring that they support and enable the front end of the business to be localized and close to the customer?" One answer is through *polycentric innovation.* A concept that is gaining ground, polycentric innovation is based on "multiple centers"—the belief that innovation will occur not only where the company is headquartered, but also in different places around the world based on how the company defines its operational culture and go-to-market strategy.

General Electric is an example of a company that has had a polycentric culture for some time through innovation in both the East and West (see "Reverse innovation" in the "New Business Models" section of this paper). Polycentric innovation is starting to happen for other companies as well. Tata Motors, for example, is tweaking its Nano car—an automobile designed for Indian consumers—for Western markets.[6] Tata innovated first for its local market and then enabled its operations and systems to expand into foreign markets.

A polycentric view is essential for both Eastern and Western companies wanting to expand their global footprints and capture future market share. It will cultivate and lead to disruptive innovation that "thinks" beyond products and services by experimenting and testing new business models. It will build on and support the culture of collaboration across the global corporation and broaden the partner ecosystem across the entire value chain, including consumers.

New Business Models

Disruptive innovation in emerging markets has more to do with new business models than with sophisticated product design. The following examples demonstrate this point:

Reverse innovation: GE Healthcare historically sold sophisticated medical imaging devices in emerging economies such as India. Only 10 percent of Indian hospitals, however, could afford a $10,000 ECG machine. Rather than just cut costs, GE took a radical approach to innovation by considering that most Indians live in rural areas and do not have access to local hospitals. Therefore, the ECG machine needed to be mobile, affordable, and easy to use. GE built a device, called the "MAC i," that fits into a shoulder bag and includes a built-in, replaceable printer, professional-level analysis software, and a battery that performs 500 ECGs on one charge and costs only $500. The MAC i created a new market in developing countries and was exported to the West for use in ambulances.

Innovative distribution model: Tata Motors' Nano sells for just $2,500. In addition to focusing on the costs of every system of the car, Tata also took into account the costs of distribution and sales. To keep costs low, Tata created a modular design and an innovative distribution model that enables Tata to manufacture modules centrally and, in some cases, ship the cars as kits to local entrepreneurs, who assemble and sell them.

Service innovation through partnerships and mobile technology: Kingfisher Airlines of India partnered with PayMate, an Indian wireless transactions company, to provide an SMS-based service that allows customers to search, book, and pay for tickets using their mobile phones. The service enables a new business model that encourages partnerships and allows the airline to be proactive with its customers.

Innovative Solutions Enabled by IT

Identifying valuable players—employees, external partners, customers, and even consumers—along the value chain and connecting them through an IT architecture that enables them to share ideas and information is key to developing innovative business models that help companies understand their market. In this way, companies have the opportunity to be in closer proximity to new customers and partners, whereby market and business intelligence are gathered faster from the source and innovation takes place because of intraorganizational and intercompany collaboration. Following are examples of innovative solutions enabled by IT in emerging markets:

- The Turkish textile industry provides an example of an innovative business model anchored by a new ecosystem of partners brought together via a Web 2.0 collaborative platform. The textile and clothing sector in Turkey is predominantly comprised of small and medium-sized businesses (SMBs). In an effort to promote SMB development, Turkey worked with the Cisco Internet Business Solutions Group (IBSG) to adopt a virtual clustering/collaboration strategy that combines the efforts, resources, and expertise of SMBs in this sector to increase productivity and improve competitiveness. Turkey implemented Cisco Unified Communications tools integrated with web-conferencing technology to facilitate meetings with geographically dispersed partners, allowing them to easily share documents with other stakeholders in a secure environment. In addition to increased productivity, greater visibility and transparency are achieved through the collaborative industry directory database, which serves as a marketing window to the textile industry inside and outside Turkey.

- M-PESA's cell phone-based cash transfer system has changed the way Kenyans handle their finances. The system, which was introduced by mobile service provider Safaricom, lets users deposit, transfer, and withdraw funds via text messages.[7] Other companies have since followed suit. In 2009, Nokia announced its plans to enter this market with its "Nokia Money" service, and will roll out the service on a county-by-country basis. Nokia's move shows how a large, successful multinational is benefiting from innovation born in an emerging market and then taking this innovation global.
- Cisco uses its own virtual meeting system to operate globally and get closer to its customers in emerging economies. Cisco operates from two headquarters: one in San Jose, California, and the other in Bangalore. Each location has its own center for innovation and development, and each is tightly connected to the other so that both can operate as a single corporation. Much of this is accomplished through the use of Cisco TelePresence™, Cisco Unified Communications, and other collaboration tools that allow company executives and ecosystem partners in different parts of the world to work as if they were in the same room.

Borderless networks, communications and collaboration technologies, and Web 2.0 solutions are just some ways in which CIOs can help their companies construct an efficient global operation that favors and enables polycentric innovation.

Next Steps

To ensure long-term, sustainable success in emerging markets, a growing number of company leaders are taking a polycentric view toward innovation. One way of addressing this new reality is to adopt (as Cisco has) a distributed management style and implement focused globalization efforts enabled by communications and collaboration technology.

This approach requires a change in mindset about defining new business models, which may sound challenging to business executives accustomed to innovating and building their businesses in one country (typically in the West) and exporting the model elsewhere. Overcoming this challenge by investing, learning, and adapting to innovative business models being developed in these high-potential markets can yield much greater profits and tremendous growth opportunities. Companies that are successful in emerging markets stand to gain new consumer segments that can potentially wield $12.5 trillion in purchasing power.[8]

Endnotes

1. "The World Turned Upside Down: A Special Report on Innovation in Emerging Markets," *The Economist,* April 17, 2010.
2. *BRICs Monthly,* Issue No. 10/03, Goldman Sachs Global Economics, Commodities and Strategy Research, May 20, 2010, http://www2.goldmansachs.com/ideas/brics/brics-decade-doc.pdf
3. Ibid.
4. "The 50 Most Innovative Companies," *Bloomberg BusinessWeek,* April 15, 2010, http://www.businessweek.com/magazine/content/10_17/b4175034779697.htm
5. "The World Turned Upside Down: A Special Report on Innovation in Emerging Markets," *The Economist,* April 17, 2010.
6. http://www.insideline.com/tata/nano/tatas-nano-coming-to-europe.html
7. http://web.mit.edu/newsoffice/2010/mobile-money-0223.html
8. "The Next 4 Billion: Market Size and Business Strategy at the Base of the Pyramid," World Resources Institute, 2007.

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More Information

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