

# Business Trends 2013

**Adapt. Evolve. Transform.**

  
**Deloitte  
University  
Press**





# Preface

**W**ELCOME to Deloitte's inaugural report on some of the most important emerging business trends that influence executives' approach to top-line strategy. These aren't the only trends in business today, but we've focused on these eight for a variety of reasons. First, these trends have the potential to have a significant impact on business strategy within the next two years, beginning right now. Second, each of these issues has continued to bubble up in our conversations with clients and other business leaders over the past year. Our research bears out those impressions and informs the forward-looking view of this report.

Our theme for these trends is *Adapt. Evolve. Transform.* because each has the potential to upend long-held assumptions, energize strategic planning efforts, and even fundamentally shift the business environment for individual companies or industries. If you're looking for ideas to challenge your thinking today and spur some big new ideas, look no further.

This year, we have grouped our trends into two categories. "Get Closer" trends are those that offer the potential to help organizations become more interconnected with customers, partners, and other stakeholders such as governments. "Reach Further" trends can help you find new opportunities, products, markets, and leaders. Of course, there's plenty of overlap between the trends in these categories, and each of them deserves your attention.

Each trend is structured similarly, to help you get the most value from reading them. In a few words, each entry answers critical questions: What is this trend about? What drivers are contributing to this trend? What lessons have leaders already learned about this trend? What advice can be offered for someone who wants to turn this trend to his or her advantage?

Thanks for your interest in this year's report. As always, we welcome your feedback and questions—and we wish you the best as you turn to face new strategic challenges and opportunities this year.



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## Reach Further

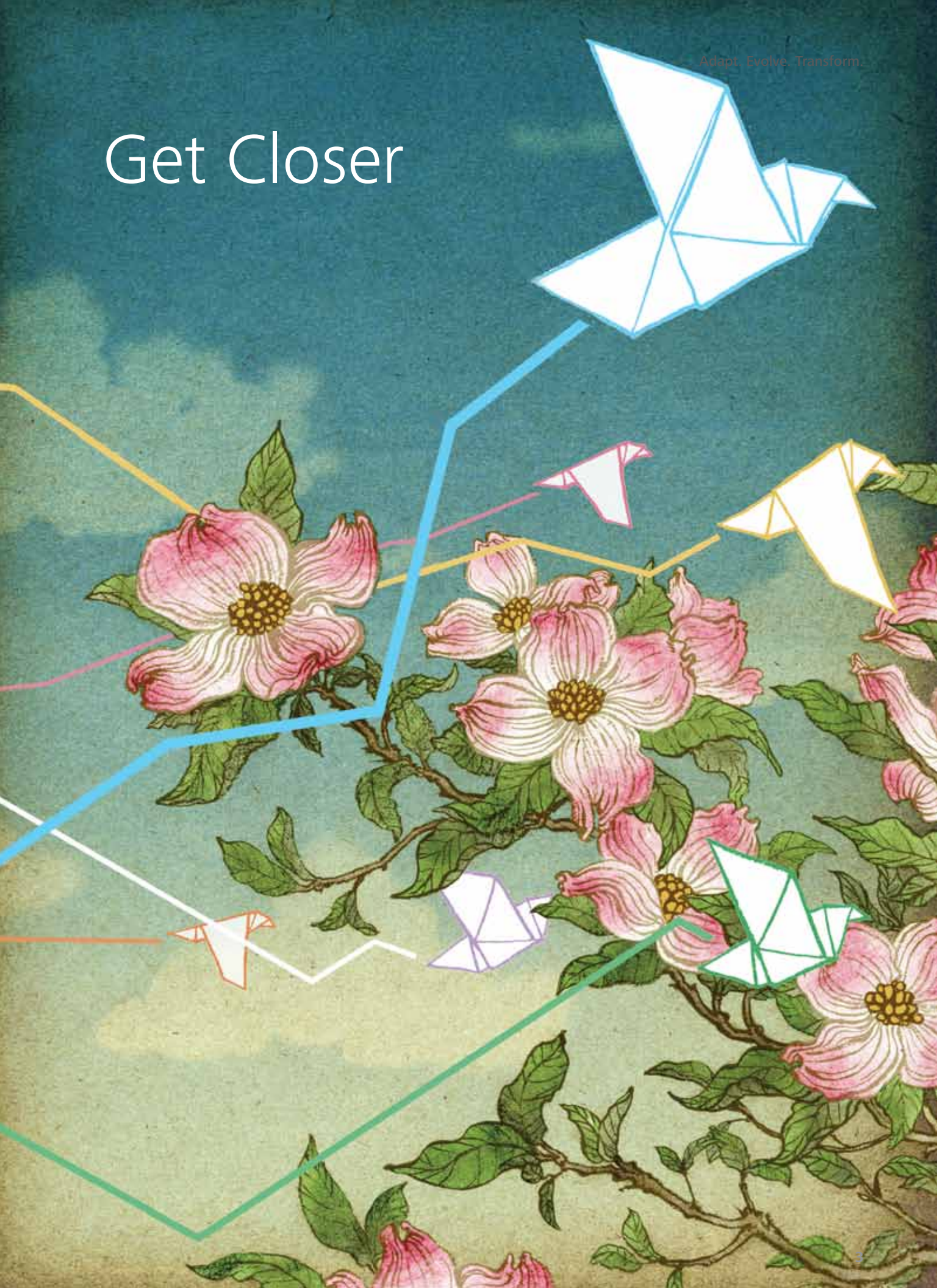
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# Get Closer





# The Rewired Customer

## Ready. Set. Change. Repeat.

By Jonathan Copulsky and Christine Cutten

**Neuroplasticity describes the capacity of the human brain to “rewire” itself in response to injury and dramatically changed circumstances. This phenomenon provides a powerful metaphor for understanding how consumers continuously and fluidly adapt their behaviors in the face of new technologies, challenging economic realities, and shifting cultural norms.**

**“Things that one day seemed impossible seem inevitable in retrospect.”<sup>1</sup>**

**—Condoleezza Rice**

## Overview

What a difference 30, 20, or even 10 years makes when it comes to consumer behavior.

Go back 30 years to 1983. 24x7 shopping means mail-order catalogs and telemarketing. Commercial access to the Internet will take another 12 years, and AOL’s online service, based on a proprietary dial-up network, has yet to launch. Self-service means you go to a supermarket and fill your cart before going to a cashier who rings you up and bags your groceries. You may belong to newly launched loyalty programs from an airline or a hotel, and carry a retailer-specific credit card in your wallet. Call centers are starting to implement interactive voice response capabilities, but you shudder when you encounter them because they seem so unnatural.

Move forward 10 years to 1993. You have more and different shopping alternatives. Cable channels, such as Home Shopping Network, and “big box” stores are the rage. AOL’s signature greeting, “You’ve got mail,” will be featured in a movie starring Tom Hanks. Amazon will soon ship its first product, and consumers will have widespread access to the Internet.

One more leap forward, this time to 2003. Although the iPhone and iPad have yet to appear, Apple has opened its first retail stores, which will soon generate the highest sales per square foot of any retailer in the country. Self-service and 24x7 gain new meaning with a broad array of Internet-based shopping alternatives and proliferating self-service options, ranging from automated ticketing

machines in airports to self-checkout in supermarkets. Mobile phone use is high, with the shift from 2G to 3G and smartphones. While Mark Zuckerberg is still a Harvard student, the launch of MySpace signifies the arrival of social networks.

Now back to today. Your 2013 shopping choices include real-time price checking, daily deals, self-designed rewards programs, mobile phone-based payment systems, ubiquitous rating sites, and more than a billion people and companies you can “friend” via social media.

What happened? Clearly, there has been an astonishing stream of innovations in retail, as well as in health care, financial services, and other consumer-oriented sectors. But are changes in consumer shopping behavior simply the inevitable response to innovation? Or are there other factors that help explain the seismic shifts in consumer behavior that have taken place?

## What’s driving this trend?

Through extensive research, Michael Merzenich and other neuroscientists have observed that the human brain is incredibly *plastic*, even in adulthood, constantly adapting to shifts in our circumstances and experiences.<sup>2</sup> Although the research originally described how brains adapt to trauma, scientists now believe that it has broader applications.

“We have learned that neuroplasticity is not only possible but that it is constantly in action,”<sup>3</sup> writes Mark Hallett, head of the Medical Neurology Branch of the National Institutes of Health. “That is the way we adapt to changing conditions, the way we

learn new facts, and the way we develop skills.”<sup>4</sup> “Plasticity,” says Alvaro Pascual-Leone, a Harvard Medical School researcher, is “the normal ongoing state of the nervous system throughout the life span. Our brains are constantly changing in response to our experiences and our behavior, reworking their circuitry with each sensory input, motor act, association, reward signal, action plan, or [shift of] awareness.”<sup>5</sup>

If smartphones, tablets, and social media were not part of the discussion 10 years ago, how can we plan for what’s on the horizon in the next two or three years, let alone the next decade? Are there factors other than technology that contribute to these radical shifts in behavior that we need to understand, as well? There are indeed.

## Do it yourself

Over the past 30 years, American consumers have become consummate devotees of *do it yourself* (DIY) across wide-ranging elements of the shopping and consumption experience. The Internet and smartphones have been critical enablers of the DIY consumer. From 1990 to 2010, the percentage of the US population using the Internet grew from 1 percent to 68 percent,<sup>6</sup> while the percentage of smartphone owners grew from 11 percent in 2007 (when the iPhone was introduced) to almost 50 percent today.<sup>7</sup> By 2016, smartphones used as a part of a shopping experience could influence between 17 percent to 21 percent of retail sales, representing between \$627 billion and \$752 billion.<sup>8</sup>

Initially, DIY in the retail environment meant allowing consumers to perform

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## WHERE IT’S HAPPENING

Expanding consumer use of price-checking capabilities is a good example of DIY in action. Amazon’s PriceCheck mobile app allows customers to scan the barcode of a product in a store and immediately see Amazon’s price for the product—and purchase it. This app has made competitive pricing awareness a necessity for retailers, as it has made instant comparison shopping easier than ever.<sup>9</sup>

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relatively simple tasks without having to involve sales associates. These tasks ranged from printing airline tickets to checking product availability to finding store locations. Over time, the complexity of DIY tasks has increased to include such activities as checking product price and availability across a number of retailers and geographies, allowing the DIY consumer to perform tasks far more efficiently than might be done by an associate.

One consequence of this shift toward DIY is that consumers who now contact associates are often:

- The “Have-Nots” who have no Internet and/or smartphone access
- The “Exasperated” who give up on self-service options
- The “Perplexed” who have incredibly complex challenges that don’t lend themselves to DIY

As a result, expectations for associates are increasingly high: they now help the least competent, the most frustrated, and the most demanding consumers. Deloitte’s 2012 Annual Holiday Survey found that 56 percent of respondents are more likely to complete an in-store purchase from a retailer that offers knowledgeable store associates.<sup>10</sup> This suggests

that, even in a DIY world, selecting, training, and retaining highly skilled associates is increasingly important.

### Anywhere-anytime

Consumers are sometimes referred to as multi-channel or omni-channel customers, but it may be more appropriate to think of them as *anywhere-anytime* consumers.

Today’s consumers can make purchases via laptops, tablets, or smartphones at any time of day from almost any location, thanks to increasingly ubiquitous Wi-Fi and expanding 4G networks that are now available to 75 percent of the US population.<sup>12</sup> Sixty-eight percent of smartphone owners responding to Deloitte’s 2012 Annual Holiday Survey said that they will use their phones to assist with holiday shopping. More than 90 percent of consumers who responded to Deloitte’s 2012 Hospitality and Leisure loyalty survey book their own travel via airline or travel sites.<sup>13</sup>

Technology has even allowed online retailers in certain categories to best the immediacy offered by brick and mortar stores. The collapse of bookstores, with their ample selections of CDs, is an example of what happens when the need to go to a physical location to take physical possession of a product disappears.<sup>14</sup>

To some shoppers, however, physical location is still important. It provides immediacy for many aspects of the shopping experience—the opportunity to browse, examine, compare, select, purchase, and take physical possession of the purchase. For other shoppers, a lower online price may be sufficient incentive to forego the gratification of taking home a purchase from a store, thus relegating stores to the *de facto* showrooms for online sites.<sup>15</sup> And with major retailers now offering same-day home delivery for online purchases in select markets, they’re discovering that a few hours’ delay is proving to be sufficiently “immediate” for eager buyers.

The challenge for retailers is to make the shopping experience relevant to the way consumers want to shop. Whether it is exclusive

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## WHERE IT’S HAPPENING

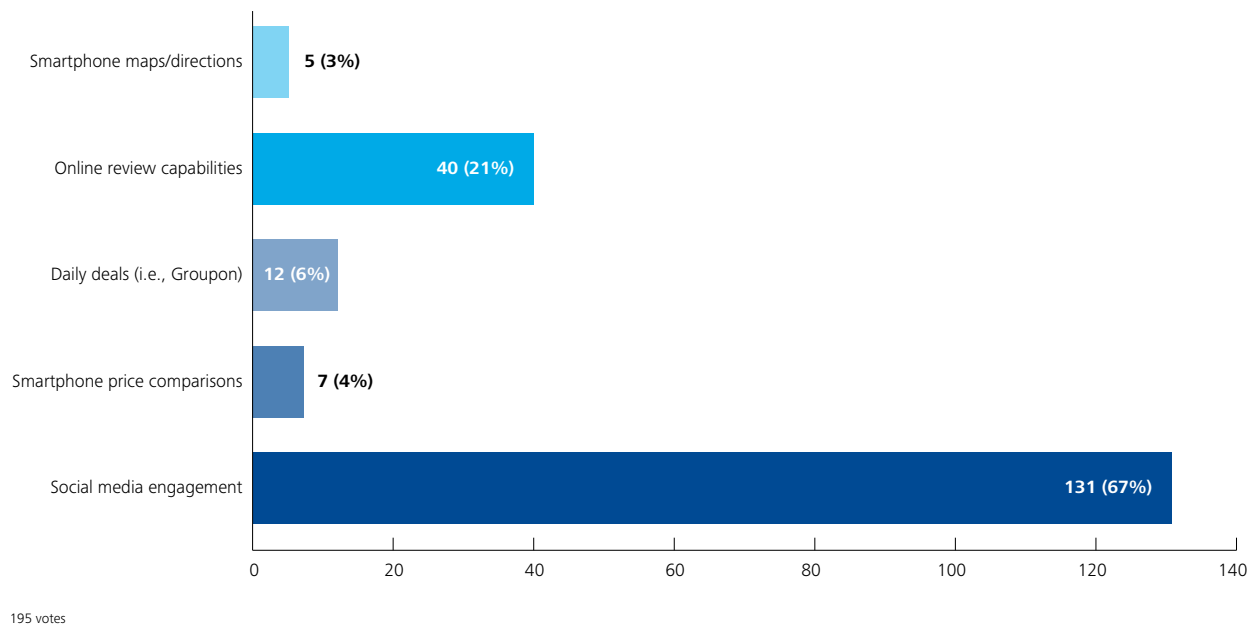
Savvy retailers are bringing *anywhere-anytime* concepts to their stores. British retailer Marks & Spencer (M&S) has equipped store associates with iPads to help customers find and order items online. They also offer Quick Response (QR) codes and free Wi-Fi to enable customers to access product information, including reviews, recipes, and alternative product options. These moves bring the full line of M&S products into smaller stores and demonstrate a role reversal for the usual customer interaction with a store’s website and retail location. Rather than simply using its website to help guide in-store shopping, M&S facilitates in-store research to enable an online purchase.<sup>11</sup>

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**Figure 1. Priorities for driving consumer engagement (LinkedIn poll results)**

To improve consumer engagement, what is your organization's top priority?



products, an enhanced in-store experience, or site-to-store delivery capabilities, engaging *Anywhere-Anytime* consumers requires supporting the cross-channel experiences that consumers have come to expect.

### The wisdom of my tribe

We consumers have long asked for the advice of our tribes—family, friends, and colleagues—when it comes to making purchases. We also rely on third-parties that specialize in evaluating and rating products and services. What's different today is that we now operate with a much more expansive definition of who is a member of our tribe.<sup>16</sup>

It's hard to pinpoint exactly when this shift began. In 1979, for example, Tim and Nina Zagat surveyed their friends regarding their dining experiences and published their first guide.<sup>17</sup> Since then, ratings sites ranging from Angie's List to Trip Advisor to Yelp have proliferated. Amazon adopted "collaborative filtering" technology to make recommendations,<sup>18</sup> which are now a common feature on many shopping sites.

In our 2012 surveys of consumers, 28 percent said they would "significantly increase"

or "increase" reliance on online reviews prior to purchases this year compared to 2011.<sup>19</sup> Many shoppers routinely interrupt their in-store browsing to check ratings on their smartphones. The 2011 Deloitte Shift Index found that younger consumers "generally rely less on brand names as an indicator of product reliability, turning instead to the Internet for product and service information, user reviews and feedback, as well as substitutes. Older consumers have historically relied on 'tried and true' brand names and consumer product assessment agencies in the absence of other forms of reliable published information."<sup>20</sup>

Social media has been a significant enabler of this expanding definition of tribe. The average number of daily visitors on social networking sites increased from 46 million per month in 2007 to 90 million per month in 2011, while the percentage of time spent using social media increased from 7.4 percent in 2007 to 14.4 percent in 2010.<sup>21</sup> Furthermore, executives have made it their top priority when it comes to customer engagement (figure 1).<sup>22</sup>

Our tribes and the wisdom they offer are likely here to stay. The challenge for retailers is to incorporate tribes into marketing

## WHERE IT'S HAPPENING

Gamification—the use of game mechanics and game design in non-game contexts—provides an example of how the “wisdom of my tribe” can play out. Samsung worked with Badgeville’s suite of Behavior Lifecycle Management solutions to develop Samsung Nation, a “social loyalty program” aimed at fans who are already engaged with Samsung’s corporate website. Samsung Nation lets users earn badges for engaging in tribal activities, including writing reviews, watching videos, and participating in forums. Two of Samsung’s gamification goals are to increase engagement and the number of product reviews. Early reports suggest strong results on both counts.<sup>23</sup>

and outreach efforts, without compromising their authenticity.

### Lessons learned: What works and what doesn't

Companies can capitalize on this consumer rewiring trend in two ways. They can proactively deliver new experiences that help shape rewired behaviors—or they can react to new customer behaviors by providing experiences that take advantage of the latest developments. Innovators will likely do both.

For those who want to proactively shape customer behaviors, an innovative culture supported by “test and learn” capabilities is important to delivering new experiences. This requires an agile approach to marketing planning rather than a traditional planned marketing calendar. It also requires deep analytics capabilities to measure which experiences are valued by customers. In addition, since social media tracking shows that experiences that combine brands tend to generate higher positive sentiment, enhanced partnerships among brands will be important.<sup>24</sup>

To reactively address the rewired customer, an advanced sensing capability is important for detecting and understanding evolving customer behaviors. By using new engagement mechanisms, such as gamification and the use of a “second screen” (e.g., smartphone), while consuming entertainment from another device,<sup>25</sup> companies can gain new insights

about how customers are rewiring. These insights are the foundation for developing new ways to interact with these customers.

Whether a company chooses to shape rewiring behaviors by experimenting with innovative concepts or react to changing trends by sensing how consumers are rewiring, new and deeper capabilities will likely be needed, including:

- Active, rather than static, marketing planning
- Delivery of smooth customer experiences across all customer touch points
- Enhanced partnerships to deliver across the experiences
- Flexible engagement processes
- Sensing and insights analytics

### Looking ahead

What developments should companies be monitoring when it comes to anticipating the next generation of consumer rewiring?

- **National same-day shipping** may allow companies to address the desire of DIY and *anywhere-anytime* consumers for immediate fulfillment.<sup>26</sup> Amazon.com has offered same-day delivery since 2009 and now provides it in 10 cities. eBay recently launched

a trial of eBay Now, which hires couriers to deliver goods directly to customers' doorsteps within an hour of an online order. Other companies, including Google, are racing to offer same-day delivery of online orders. Startups such as Shutl, Instacart, and Postmates are also tackling same-day delivery.<sup>27</sup> Instantaneous fulfillment via 3D printers may soon trump same-day shipping by allowing customers to fabricate a wide range of products from the comfort of their own home.<sup>28</sup>

- **Social shopping** will likely increasingly tap into the “wisdom of my tribe” phenomenon. Pose, Feyt, and Lifestyle Mirror are examples of existing social shopping networks that allow fashionistas to collaborate with like-minded individuals.<sup>29</sup> Facebook's newly announced “Gift Store” will allow the social network to make automated, yet highly personalized gift recommendations for a user's “friends.”<sup>30</sup>
- **Augmented reality** may drive additional customer rewiring. The MIT Media Lab has

developed a system that overlays interactive product information onto product counters in retail stores. Google has created eyeglasses that pipe the functionality of the smartphone (and more) directly into the user's visual field.<sup>31</sup> As augmented reality technology matures, customers can expect visually immersive, interactive, and real-time engagement with companies, their products, and their services.

Despite the challenges of predicting how and when consumers will rewire their behaviors, companies should focus in three areas. First, strong sensing capabilities are important when it comes to detecting and interpreting the impact of new technologies, changing demographics, and shifting economics. Second, memorable and compelling customer experiences often trump whiz-bang technologies that may look dated by the time they are fully implemented. And third, given the unpredictable speed of customer rewiring, agility and nimbleness will likely be important competitive differentiators.



# My take



*John Hagel III, co-chairman of the Deloitte Center for Edge Innovation, Deloitte Consulting LLP*

New digital technology infrastructures are redefining relationships across customers and vendors. As soon as we think we have it figured out, new technology capability can change the game yet again.

Let's take just a couple of examples. Consumers are seeking more and more value from the products and services they buy and use. This is putting pressure on vendors who in the past aspired to establish a one to one relationship with each customer, building walls to prevent anyone else from coming in between them. However, with the expansion of and reliance on our "tribe" facilitated through mechanisms such as online rating sites, customers want to connect with each other and with specialized third parties to get more value both in the initial purchase and subsequent use of products and services. This will likely give rise to collaboration marketing where vendors increasingly become orchestrators, creating platforms to help connect customers with a broader array of participants that can help them to realize more value. Johnson & Johnson's BabyCenter is an early example. It's a rich online platform that brings together mothers who have just had babies as well as a broad array of third party specialists who can help them navigate through the challenges of rearing their babies. Instead of one to one, J&J is connecting many to many.<sup>32</sup>

These same trends are likely to drive a transformation of large swathes of physical retailing. As physical retailing faces increasing competition from Internet-based vendors that allow consumers to make purchases *anytime-anywhere*, we are likely to see retailers increasingly repositioning themselves as gathering spots to help connect customers with each other and relevant specialists. Some early examples include independent bookstores convening reading circles around shared interests like children's books or science fiction, as well as providing a platform for authors to speak with their audiences. Some photography stores bring together gatherings of amateur photographers to share and compare techniques, helping them to get more value from their cameras. We're still at a very early stage of this development, but one can speculate that, over time, storefronts may become important platforms for collaboration marketing, bringing people together to get more value from the products and services they buy.

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# The Scale Paradox

## Analytics disrupts the size factor

By John Lucker, Jerry O'Dwyer, and Ryan Renner

**Disruptive technologies continue to change how companies innovate and compete. Combined with the power of analytics, they allow small companies to achieve insights once afforded only to large enterprises. At the same time, large enterprises can use these disruptive forces to shorten the time-to-insight and innovate in ways that used to be the sole domain of much smaller and more agile startups. This is the *scale paradox*.**

### Overview

Less than a decade ago, large enterprises held significant scale advantages over small businesses in the same industry. The enterprise advantage was one of might. The bigger the company, the more vast and diverse its resources. The most effective financial, customer, and business intelligence solutions were cost-prohibitive for small businesses.

Today, the growth of open-source platforms, cloud computing, social media, and analytics technologies has eroded much of the large-enterprise scale advantage. Even with their investments in third-party data, statisticians and data scientists, and decision-support technology, big companies are facing big challenges from small and mid-sized businesses. With open-source and cloud options that can cost more than 80 percent less than traditional systems,<sup>1</sup> advanced analytics solutions are now attainable without extraordinary IT investments, giving smaller companies new and

deeper insights into everything from customer preferences to potential new products and markets.

### What's driving this trend?

In addition to smaller organizations gaining access to new data and technologies, an even bigger shift is occurring in the analytics operating environment. A remarkable democratization of talent and data is unfolding; as demonstrated by the data scientist being called the sexiest job of the 21st century,<sup>2</sup> the battle for talent is on.

Smaller companies have been forced to innovate in order to compete on the talent front, using strategies such as crowdsourcing of analytics to engage the talent they need. Competitive predictive modeling platforms like Kaggle, with more than 60,000 data scientists worldwide,<sup>3</sup> help both small and large companies outsource the science of data analysis. Access to top data scientists is now readily

available in a bidding-style format designed to flex with demand.

Finally, the notion of data ownership and master data management itself is being challenged by innovative companies that are building repositories of information (by trading data assets) and making them available on the open market. For example, global data provider Factual owns products-and-places data that it aggregates and shares across a community of users. One leading social network uses Factual's Global Places suite of data and application programming interface (API) when users "check in" to one of 64 million places in

50 countries. Factual in return aggregates even more data,<sup>4</sup> making it a one-stop shop for master data for not only the social network, but for other customers as well.

In short, the convergence of all of these analytics tools are enabling a new level of insight at a more affordable price point, arming even the smallest startups with predictive powers that could disrupt almost any industry. Combined with the forces of mobile, social, and cloud, analytics capabilities can be scaled up and down without the costly infrastructure requirements of the past.

## SCALE PARADOX DRIVERS

Driver	Impact
<b>Talent shortfall</b>	<ul style="list-style-type: none"> <li>Forcing new thinking about how to leverage current talent—and how to acquire more.</li> <li>Driving new talent models of collaboration and crowdsourced problem-solving.</li> </ul>
<b>Democratization of data</b>	<ul style="list-style-type: none"> <li>Businesses will likely have growing access to internal data sources, and may need to link that data with external structured and unstructured sources to gain more relevant business insight.</li> <li>The conversation should move away from "big data" to "smart data"—focusing resources on identifying the right data and information needed to solve the problem at hand.</li> </ul>
<b>Ecosystem collaboration</b>	<ul style="list-style-type: none"> <li>Historical divisions in the value chain are being blurred by the advent of more and more third-party data—and the need for all stakeholders to get closer to the consumer.</li> <li>Many organizations are increasingly willing to share their information assets in order to get a holistic value-chain picture.</li> </ul>
<b>Strategic imperative</b>	<ul style="list-style-type: none"> <li>Widespread recognition of analytics as a strategic imperative at the top of many organizations creates new opportunities to act upon data in new ways.</li> <li>Organizations are beginning to become more open to challenging ideas that were once off-limits for analytics.</li> </ul>
<b>Analytics tools</b>	<ul style="list-style-type: none"> <li>Analytical tools are becoming less expensive and more easily available to companies of all sizes.</li> <li>In addition, analytics tools are more user-friendly and intuitive, allowing individuals within the business to perform a level of analysis and insight that was previously reserved for a select few.</li> </ul>
<b>Disruptive technologies</b>	<ul style="list-style-type: none"> <li>Mobility, cloud, and social are disruptive forces that have built the expectation of "insight on demand"—getting actionable information into the hands of decision makers who need it, when they need it, no matter where they happen to be.</li> </ul>



## Lessons learned: What works and what doesn't

### Small business, big insights

Today's small and mid-size businesses are using analytics to achieve a competitive advantage by more deeply understanding customers—something many customers long for and feel doesn't occur with larger organizations. The democratization of data and the advent of more-intuitive technologies give a clearer picture of customer wants and needs, even to those executives not steeped in statistics.

Take the example of a global retail startup that had grown by leaps and bounds during its first few years in business. The company successfully scaled up, using data from a variety of sources, including social media, to better understand and connect with its customers. The company used analytics to understand “who” the consumer was and then proactively communicated with them through social media and non-traditional marketing campaigns. It built brand loyalty and engaged with the consumer to displace much larger rivals.

While large organizations can also access these new tools, small companies are often

better able to adapt and embrace the creative recommendations that result. Large organizations may attempt to create barriers to entry—for example, Amazon's recommendation engine—but they often find well-funded, nimble startups close behind with an alternative solution. Such is the case with the new publisher-co-funded book discoverability platform, Bookish.<sup>5</sup>

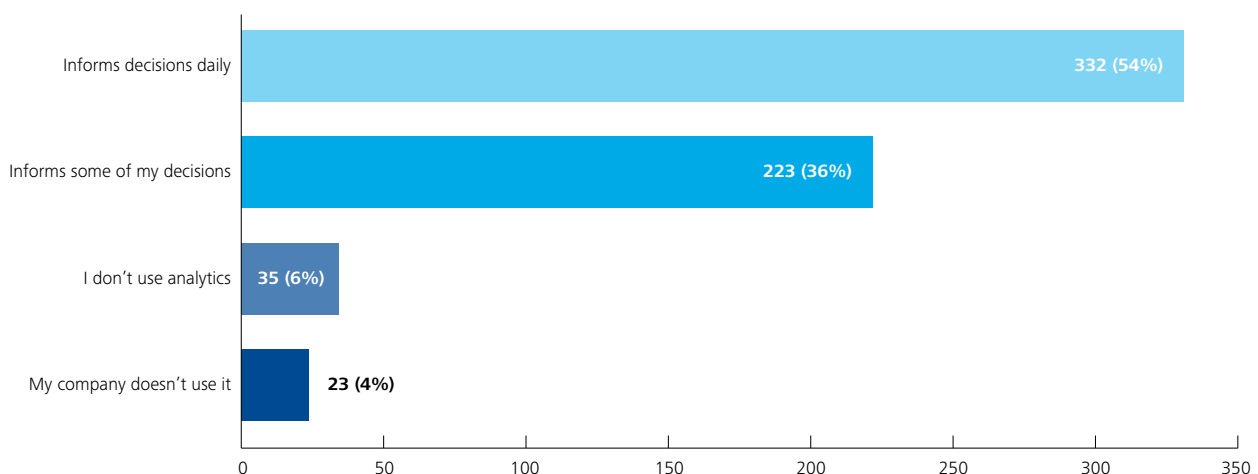
### Big business, agile enterprise

Historically, large organizations have found it difficult to execute in a timely manner, hampered by siloed information, layers of bureaucracy, and a fiscal rigor that can make agility difficult. Due to their sheer size, large companies sometimes lack the flexibility and focus necessary to use analytics effectively. With strategies that often look years ahead, large organizations can struggle to adapt outside their regular planning periods.

If the scale paradox allows small organizations to “punch above their weight,” it also provides the opportunity for large companies to become more nimble—what we call the *agile enterprise*. Analytics, in particular, can enable new levels of flexibility and agility that were once the domain of small businesses and

**Figure 1. Use of analytics in decision making (LinkedIn poll results)<sup>7</sup>**

How much does analytics inform your decision making on crucial matters?



613 votes

startups. Executives surveyed at larger organizations understand the role that these new capabilities can play in daily decision making.<sup>6</sup> To capitalize on this shift, large companies should create a culture of action driven by insight.

Analytics enables greater visibility into execution as well as the ability to monitor how changes in strategy are affecting business performance in near-real time. While execution of strategy may have been center-led historically, large enterprises that take advantage of the scale paradox can learn to experiment with trial and error and other methods that enable them to be more fluid and adaptable to the pace of change.<sup>8</sup>

Such was the case for one large-scale global retailer that used analytics to push past its size barrier. Adept at collecting, managing, and deriving insights from data, the company was facing challenges around execution. Because of its size and culture, moving from insight to action was a slow process. To meet this challenge, the company developed an “insights group,” staffed by analytics specialists with business acumen, and charged it with improving decision making and financial performance across the business. In just two days, the group was able to provide decision makers in supply chain and sales with a visual representation of inventory positions that were used to resolve important product supply challenges for both organizations.

## SCALE PARADOX DRIVERS

Challenge	Recommendations for large-scale enterprises	Recommendations for small and mid-size businesses
<b>Talent shortfall</b>	Consider alternative models (e.g., crowdsourcing), alternative delivery methods, and changes to traditional HR models to attract and retain analytics talent.	Compete in scarce talent market to build competency. Attract talent with flexible working environment, challenging roles, equity options, and growth opportunities.
<b>Democratization of data</b>	Mine data effectively and focus analytical expertise on the specific data that matters to solve a business issue; avoid “data deluge”; in essence, large organizations should begin to turn “big data” into “smart data.”	Become data stewards, capturing and structuring data more effectively for analysis and decision making.
<b>Ecosystem collaboration</b>	Break down internal organization silos and share information in a fluid and collaborative process, with all functions seeking creative solutions and working toward more effective decision making. Value flexibility, mobility, and adaptability and incent individuals to solve problems outside of their functional silos.	Work with other businesses to collaborate; scale up and scale down the value chain to gain consumer insight.
<b>Strategic imperative</b>	Create flexible governance for analytics that focuses talent on the top business issues—not just on functional issues.	Embed analytics into decision process and “close the loop” by using analytics to measure the effectiveness of actions.
<b>Analytics tools</b>	Challenge a focus on ERP-supported tools. A combination of tools in conjunction with ERP is needed to provide insight.	Be flexible. Use open-source and cloud-based software to keep investment costs down.
<b>Disruptive technologies</b>	Use disruptive technologies to rapidly pilot and implement analytic insight, challenging the typical long lead times for traditional deployments. Look to cloud and mobile solutions to effectively scale and distribute insight.	Pursue the consumerization of IT and cloud services to seize markets and buyers. <sup>9</sup>

# My take



*Tom Davenport, Independent Senior Advisor to Deloitte Analytics,  
Deloitte Touche Tohmatsu Limited*

I agree with the authors on several points. First, it's true that in the past, large organizations have had the advantage in building and exploiting analytical capabilities. Large banks, retailers, airlines, hotel chains, and insurers have been the primary users of analytics in their strategies. As a result, they've prospered and become even larger. The authors are correct that many of the factors favoring large organizations have diminished in recent years.

The authors also have the right focus on human capital—quantitative analysts and data scientists—as an important element to effectively using analytics. Software and hardware have become cheap, commoditized, and, in the case of open source, free. But human analytical talent remains difficult to source and retain, particularly if the organization seeks analysts who understand not only analytics, but also business issues and how to communicate effectively with decision makers.

In addition, there are two human capital factors that are critical to whether small-to-medium enterprises (SMEs) can prosper with analytics. One works in favor of SMEs, the other against them.

The factor in SMEs' favor is the fact that—at least in my research—many data scientists are not interested in working for large, bureaucratic organizations. When I researched them in 2012 (for the "Sexiest Job of the 21st Century" article cited by the authors), data scientists wanted timely impact, close relationships with specific decision makers, and the freedom to experiment and fail—all characteristics that are often more difficult to find in large firms.

The human factor working against SMEs in analytical competition is that many small business owners don't have the orientation to analytics that I've seen in large company executives. Outside of online businesses, managers of startups don't often think of analytics as a way to compete. Their greatest analytical limitation is their own imaginations. Perhaps this limitation will also be eased over time.

## Looking ahead

The scale paradox is pushing small and larger enterprises out of their comfort zones. From talent to tools, organizations are discovering they can—and should—create new approaches to move forward.

Large enterprises should have a good understanding of their analytical maturity before investing in talent. In addition, they should be more agile in using analytics to help set their strategy and measure its effectiveness. And most important, they should empower decision makers to adjust the execution of their strategy based on analytic measurement of its effectiveness on a much more frequent basis.

Culturally, the shift toward embracing analytics in decision making will likely accelerate. More and more companies may realize that analytics doesn't always "answer the question," but instead can be used to reduce the risk of unknowns, allowing leaders to focus on issues that truly require their attention.

Disruptive forces are eroding the historical scale advantage once held by large enterprises.

Effectively using analytics can help address this disruption for organizations large and small.

For many large companies, becoming an agile enterprise requires a focus on execution, linking analytics to specific business issues. In many large organizations, the largest barrier to change is the cultural shift needed to empower decision makers throughout the organization to execute effectively—and then provide the analytics needed to measure results and adjust in a timely manner. Smaller organizations should retain their ability to execute with speed and precision, while taking care of their data and finding creative ways to scale up to compete with larger, resource-rich competitors.

Either way, the scale paradox in analytics represents an opportunity to achieve deeper insight and timely action, reduce risks associated with strategic and tactical decisions, and measure the impact of execution. Whether you are a large company or a small one, you can use the scale paradox to create more value for your organization and shareholders.

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# Reengineering Business Intelligence

## Amplify social signals

By Doug Palmer, Vikram Mahidhar, Tom Galizia and Vijay Sharma

**Senior executives are developing next-generation business intelligence capabilities by rebuilding the engines that deliver insight. Along the way, they're making the transition from decision making that is aligned with traditional budget cycles to near-real-time decision making. These engines blend social media with other external and internal data sets, along with refined analytics, to help anticipate strategic risks and opportunities.**

### Overview

Marketing executives already recognize the power of social data to yield insights into customer behavior and expectations.<sup>1</sup> Over the course of just a few years, social data became invaluable to them as customers readily revealed information about themselves and their interests, friends, and purchasing decisions.

But when it comes to strategic decision making, social data is just one piece of the puzzle. At the same time, it has become bigger than marketing for some. Businesses are beginning to see its value in areas such as risk management, product development, reputation management, and supply chain operations. Still, *nearly half (44 percent) of senior executives consider social data alone inadequate to attain the strategic insights they need to guide their organization* (figure 1).<sup>2</sup>

Senior executives increasingly recognize the need to account for a regularly changing

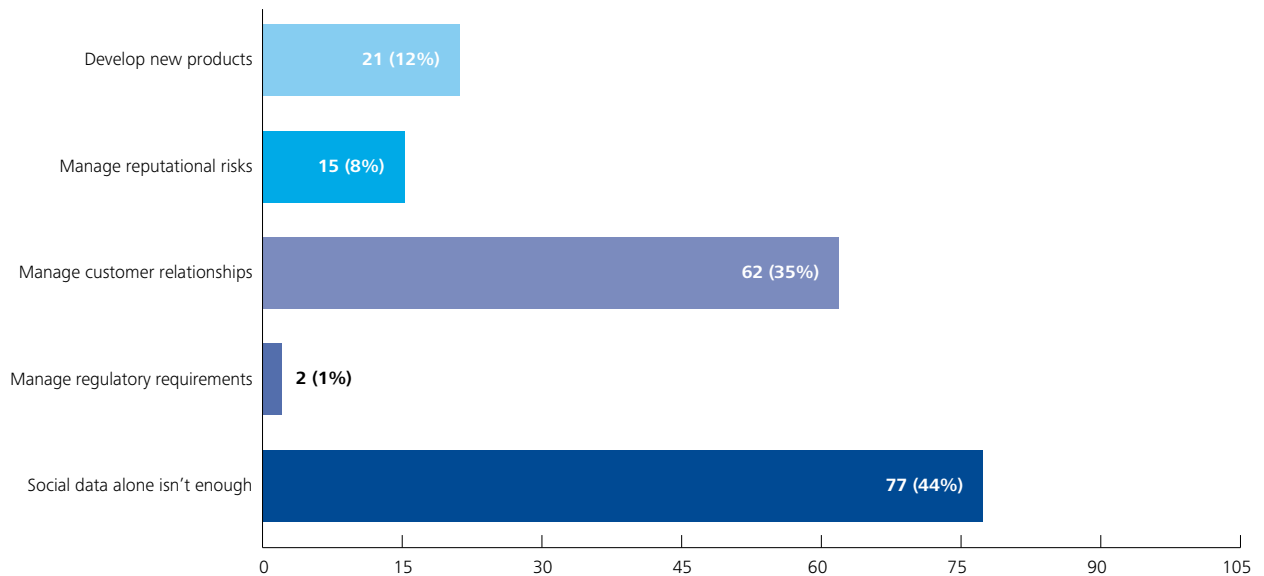
context in their decision making. By *combining* social data with other data sets both inside the enterprise (such as financial, enterprise resource planning, and business intelligence systems) and outside (such as traditional media, insights from industry analysts, and human intelligence), they're able to lend new context to their insights. Plus, using this approach they are able to regularly assess their strategic decisions so critical issues don't have to wait until the next budget cycle or ad-hoc market research study.

To reach these bold goals, businesses are rebuilding their "insight engines." They are expanding data sets, deploying advanced analytics tools, and using different types of human expertise to answer increasingly complex questions. As a result, business leaders should be equipped to make swift decisions as situations unfold.

This isn't a "bolt-on" analysis capability. Companies are embedding signal detection and analysis across their organizations.

**Figure 1. Uses of social data (LinkedIn poll results)<sup>3</sup>**

Does your organization use social data insights for any of the following?



177 votes

For example, Burberry, a luxury retailer, has accelerated the identification of emerging trends around its products throughout its operation. The company achieves this by combining enterprise information (e.g., SAP data) with social data (e.g., customer social data feeds and employee communications via Salesforce® Chatter®) to make timely adjustments throughout its supply chain, including changing product design.<sup>4</sup> Such initiatives, however, are relatively nascent, as early adopters learn what is required to deliver these new capabilities effectively.

### What's driving this trend?

In 2008, Barack Obama's first presidential campaign team made pioneering use of social networks to raise awareness, generate funds, and encourage voter turnout. They doubled down on this approach in 2012. The day after Obama won the 2012 election, *Time* magazine trumpeted the role of big data and data analytics in Obama's historic win. The team was able to reduce many unknowns about voters and their behaviors by combining knowledge about people from the party database, the campaign's interactions with people, and people's reactions to campaigns (including their opponent's campaign) through social media and other media sources. Mash-up analyses of these data sets allowed them to monitor the changing context,

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## SOCIAL DATA—PART OF A BIG(GER) DATA TREND GROWING INTENSELY

In a recent survey, 93 percent of C-level executives indicated that their organizations are losing revenue opportunities by not fully taking advantage of the data they collect. Nearly all of the respondents say their organizations need to improve information optimization soon. Nearly half feel that the ability to translate information into actionable insight is the most important area on which to focus.<sup>5</sup>

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consistently identify specific targets for special campaign efforts, and make strategic investments in certain states over others, beyond the so-called “swing states.”<sup>6</sup>

Many companies that are rebuilding their insight engines have a similar goal. They too want to remove the unknowns from strategic decision making. In the corporate world, strategic decision making has often relied on a combination of experience, intuition, and, more recently, business intelligence derived from analysis of enterprise and market data. Previously, business leaders were often unable to detect the early signals of change when executing their strategy.

For example, competitor moves, new investment patterns, and changing stakeholder behaviors that had the potential to increase organizational risk may have taken months to identify. By that time, the business context may have already shifted.

Analyzing both social and traditional media can deliver strong signals about emerging developments in the market. But unless those signals are identified and integrated into the decision making process, their strategic value can be limited.

### Lessons learned: What works and what doesn't

Until recently, the idea of harnessing both external and internal data sets to provide executives with early signals was more fantasy

than reality. But that's changing. There are already several hundred companies involved in developing solutions in this space—driven by available, mature, and sustainable technologies.<sup>8</sup> The capabilities being developed can be as diverse as the data they analyze.

Want to know what this approach looks like in action? Here are four recent examples of innovators that have shaken up their approach to insight delivery, and are already beginning to reap the benefits.

- **UBS: Reputation risk management.**

Brand reputation management is a big issue for boards and the C-suite, which are beginning to establish capabilities for integrating and analyzing news media and social media with their internal compliance systems, giving them the ability to regularly monitor and assess emerging risks. UBS, a global financial services firm, analyzes thousands of external sources in combination with its internal compliance database to detect controversial information and compliance issues at the organizations with which it does business. UBS uses this information to vet clients, determining that its reputational risk profile falls in line with the bank's risk exposure.<sup>9</sup>

- **GE: Operations.** GE developed a tool called Grid IQ Insight that mines social data, including geotag data and attachments such as photos, for mentions of electrical outages. The tool is designed to help electrical utilities identify and validate service

On what makes a data scientist successful:  
“Think of him or her as a hybrid of data hacker, analyst, communicator, and trusted adviser. The combination is extremely powerful—and rare.”

— Tom Davenport (author, professor, and senior advisor to Deloitte Analytics) and D. J. Patil (data scientist in residence, Greylock Partners)<sup>7</sup>

outages in a timely manner, determine the resources needed to address them, and accelerate the repair process.<sup>10</sup>

- Walmart: New product development and demand prediction.** Walmart Labs acquired Kosmix, a \$300 million unstructured data analytics company, to build its Social Genome Platform. It uses a wide variety of data, including social media updates, blogs, transactions, images, media check-ins, and location, to help business users more effectively predict product demand and launch products.<sup>11</sup> For instance, Walmart's private-label brand introduced new spicy chips in California and the Southwest based on consumer preference insights from Walmart Labs, which combined social chatter analysis and sales of branded spicy chips carried by Walmart stores to identify a new geography-specific opportunity.<sup>12</sup>
- DoD: Strategic investments.** The US Department of Defense (DoD) and Central Intelligence Agency (CIA) use temporal analytics (trend analysis over a period of time) and other analytics technologies to pick up "predictive signals" amid the clutter of the World Wide Web and social media data. The DoD is using these capabilities to guide future science and technology investment decisions. Similarly, the CIA uses this approach to track protests around the world to predict threats against the interests of the United States.<sup>13</sup>

For companies that have been experimenting with social data analytics or semantic analytics tools, there are some lessons learned from efforts that have failed to deliver the desired degree of insight:

*Analysis without defined goals:* Exploring—sometimes in real time—data sets that you never had access to before may offer new insights. However, starting without strategic questions, clear metrics, and hypotheses

around insights generally leads to poor utility of those insights.

*Frameworks without context:* Using off-the-shelf social data analytics tools that track key words, volume, and sentiment allows you to listen in to external conversations. However, these tools do not include your business context and almost inevitably lead to an incomplete analysis.

*Right problem, wrong resources:* Deploying analytics or market research resources who have experience with mining large volumes of qualitative data, pattern discovery, or anomaly detection capability is only half the solution. Neglecting to connect these resources with people who have a deep understanding of your business and strategic decision making process can position them to fail. They may struggle, for example, to raise insights to the right levels in the organization.

## Looking ahead

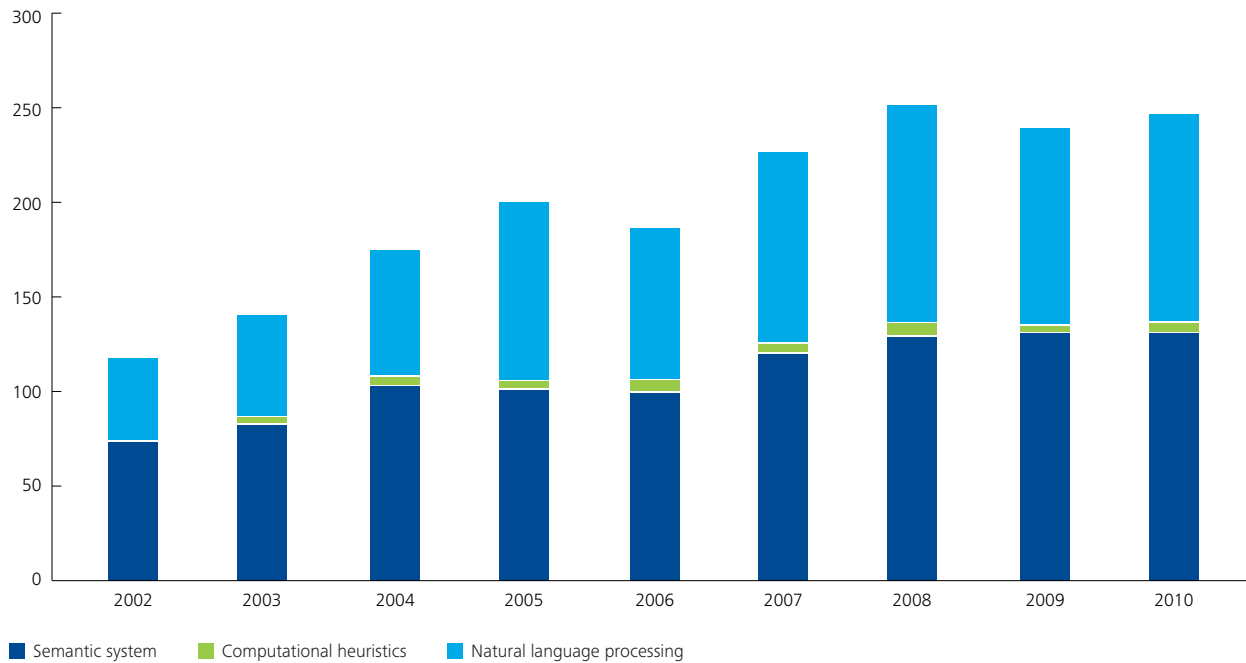
In many companies, merely capturing and managing enormous volumes of data, much less analyzing them for insights, can seem like a virtually insurmountable task. But technology can help—along with a recognition of the role that humans and organizations have to play in the process. Here are some likely short- and long-term implications of this trend on business.

### Technology will likely continue to evolve at an accelerated pace

Already, academic and corporate scientists are continuing to advance the state of the art of data science in areas such as natural language processing, computational heuristics, and semantic systems. And they're being spurred along by a more intense public recognition of, and interest in, such technology. Big events like elections only serve to keep such technologies in the public eye. Meanwhile, practical applications of these technologies continue to mount. It all adds up to a self-perpetuating system



**Figure 2. Growth in number of published patent applications driving the science behind insight engines<sup>14</sup>**



that could drive analytics capabilities to new heights in coming years.

### Talent and organizational strength

Developing these capabilities often requires the skills of three specific leaders: data scientists, change agents, and executive champions. Data-gathering and analytics technologies receive plenty of attention, but capitalizing on the opportunities they introduce ultimately requires people who can examine, understand, and interpret the data, then present it in a way that the organization can use it effectively.

Large businesses today typically employ strategic analysts to examine competitive and market intelligence, conduct financial analysis, and create forecasts. Often, these professionals are focused on transactional analysis or solving huge problems that take years to address.

As they begin to triangulate social and traditional forms of data, businesses should expand and accelerate their analytical and pattern-detection capabilities. This demand is elevating the role of the data scientist, “a hybrid of data hacker, analyst, communicator, and trusted adviser.”<sup>15</sup> Data scientists plunge into

the volumes of data to identify patterns, extract insights, and then apply and present their findings in the context of business problems. These professionals often have strong mathematical skills and investigative capabilities, are adept at pattern recognition, and are able to understand and articulate business problems.

Change agent roles are also important. They can be filled by people who understand the business, have analytical capabilities themselves, and are able to create targeted messaging to help improve acceptance and adoption of the data findings across the enterprise generally and within discrete areas specifically.

Finally, executive champions can play an essential role in driving the development of and budgeting for insights capabilities. In a recent survey, strategic corporate leaders—CEOs, presidents, and managing directors—were almost twice as likely as CIOs and CFOs to say that social business (and by inference the data underlying it) is important to their organizations.<sup>16</sup> Providing top executives with the solution to a thorny problem can help build momentum for insight initiatives.

## Data tailoring

Bite-sized tweet, meet the 1,000-page enterprise report. As executives begin to factor in social data and other enterprise data sets for fact-driven decision making, some will be more comfortable with a graph of tweets or other summary messages, while others will demand more detailed analysis. The new insight engine should have the ability to do both, allowing users to peel the layers of the onion.

## Contextualization

Companies should have the ability, on demand, to mash up social data with enterprise data from ERP systems and other sources for timely contextualization, much like Burberry has done. Framing the resulting insights within broader issues and trends that are relevant to recipients of the information can facilitate understanding and decision making.

## Workflow integration

Over time, more users across the value chain will likely need to be able to consume the new insights as part of their normal workflow or risk being left behind. The process

of disseminating insights should factor in the ability of the organization to absorb and respond to them.

## Speed

The devices and visuals used to access timely contextualized insights will likely become increasingly important. Passive output such as retrospective status reports will likely give way to consistently refreshed and collaborative data vehicles such as mobile applications and alerts.

Some companies are already surging ahead in the race to harness the potential of insight engines fueled by social data and big data. But no clear winners have emerged, and the technologies and processes continue to evolve in a timely manner. An important factor for the achievement of a company's goals will likely be its ability to transition from decision making based on traditional survey and budget cycles to near-real-time strategic decisions, without sowing organizational anarchy. Rebuilding insight engines, deploying human expertise in new ways, and effectively integrating resulting insights into the existing workflow can help make this happen.

# My take



*Don Springer, VP Product Management/Strategy, Oracle Cloud Social Platform*

Until 2012, I was CEO of Collective Intellect (CI), the social media analytics company acquired by Oracle. We helped businesses track, understand, and use social data to evaluate consumer opinion, measure buzz, identify customer sentiment, and manage corporate reputations. Now, as part of Oracle, we're augmenting large enterprise data with social data to deliver insights on everything from emerging company risks and new product demand to customer purchases. And we're doing it in part by blending unstructured data from social media with structured enterprise data to create real-time signal detection capabilities. The result is a whole new set of insights for the C-suite, business unit leadership, and even frontline workers.

Along the way, interesting use cases are emerging. In the financial services sector, we're creating next-generation global wealth management solutions that combine research about a company with consumer demand signals from social media on that company and its products. This allows research analysts, almost in real time, to make more informed interpretations, which in turn can drive smarter decisions. We're also helping some large retailers that are looking to intercept customers who are already in the store, but are using their mobile devices for comparison shopping and price checking. We want to influence the decisions of those customers while they're in the store making up their minds. Ten minutes after they leave the store could be too late.

C-level executives should understand that they have a window of 12–18 months to complete the shift to real-time signal detection. After that, they will likely be well behind their toughest competitors. To do it, they should attack this challenge at the enterprise level, shift business intelligence and insights, and begin making strategic decisions in alignment with their changing context.

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# Partnerships for the Future

## Redefine public/private cooperation

By Lauren Rosenbaum, Edward Van Buren, and John Mennel

**While public-private partnerships (PPPs) have occurred in the United States for at least 200 years,<sup>1</sup> they have primarily involved large infrastructure projects with formal contractual agreements, considered too costly or risky for one side to take on alone. But the increasingly complex nature of our national challenges, along with recent shifts in economic and social forces, are creating incentives for government and business to collaborate more frequently and in new ways that go well beyond traditional infrastructure investments, expanding the definition of partnerships in the future.**

### Overview

Traditionally, government and business had few incentives to actively collaborate. For the most part, government regulated business, and business lobbied government on areas of economic interest. When partnerships did occur, they were usually undertaken to invest in large infrastructure projects through formal contractual agreements, as represented in the National Council for Public Private Partnerships' definition of PPPs:

**Public-private partnership:** A contractual agreement between a public agency (federal, state, or local) and a private sector entity. Through this agreement, the skills and assets of each sector (public and private) are shared in delivering a service or facility for the use of the general public.

Today's challenges for the United States—including an unprecedented recession and

fiscal crisis, global warming, terrorism, the Afghanistan conflict, and crises in health-care and education—are changing the equation. There is a sense that these problems are increasingly complex, requiring new responses. Faced with mounting pressure to resolve these complex challenges, government is introducing regulations to prevent future crises, and seeking innovation to execute its mission more effectively with fewer resources. In spite of these actions, there is an increasing recognition from government that it cannot solve these challenges alone.

Meanwhile, in the business world, there is also an increasing recognition that these challenges, as well as the government's response, represent both a threat and opportunity. The impact of government behavior on business was evident in a recent Deloitte LinkedIn poll of more than 500 senior executives, which found that 82 percent of respondents believe

government's influence on their business has either greatly or somewhat increased in recent years.<sup>2</sup> This seems to indicate that business leaders acknowledge that something fundamental is changing in their relationship with government. The question is, *what will come next?* Lobbying spending rose dramatically in response to new regulations in recent years,<sup>3</sup> but government and business are also starting to take more creative approaches to collaborating. Both sides seem to realize that business problems are now government problems—and vice versa—and both are proactively intensifying new approaches to partnership at the highest levels.

## What's driving this trend?

The complexity of the current challenges and changes occurring at the political and macro-economic level have fundamentally changed the federal government's traditional behaviors, creating new incentives for partnership. Here are a few examples of these changes.

### Complexity of national challenges

The challenges facing the US government are becoming increasingly complex. For

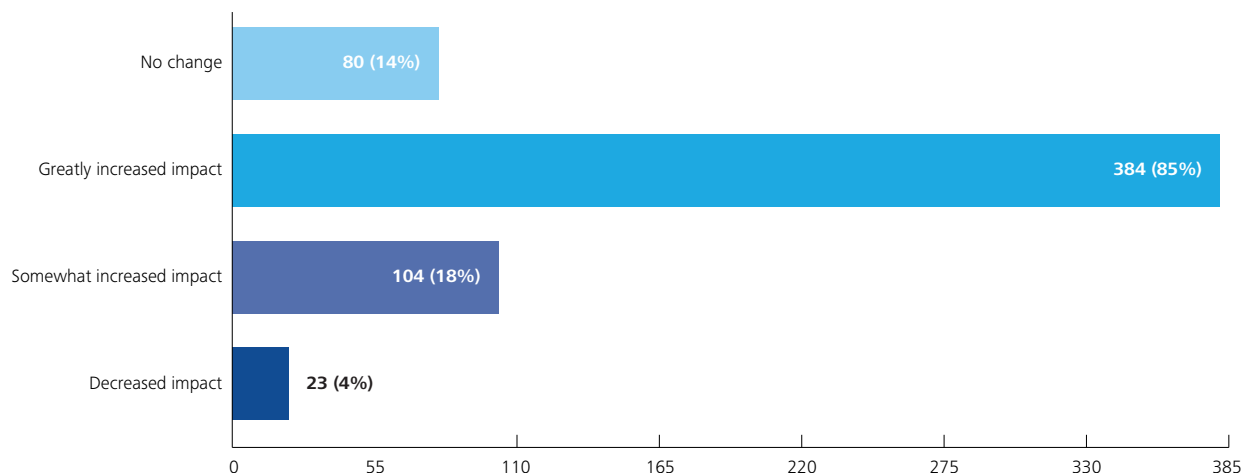
instance, education used to be about building a system that would deliver basic skills to children through high school. Now it can be about creating highly specialized training that is delivered well into adult years, evolving as the needs of business change over time. Protecting the environment used to be about developing local and national regulations and subsidizing improved technology to mitigate industrial pollution. Now, protecting the environment often involves dramatically reducing the burning of fossil fuels not just in one industry in one city, but across multiple uses and in countries all over the world. As a result of these types of fundamental shifts, government is increasingly looking to business for resources and new approaches to these challenges. The business world has an incentive to help solve them both out of a sense of social responsibility, and because they affect economic growth and the bottom line.

### Cost reduction

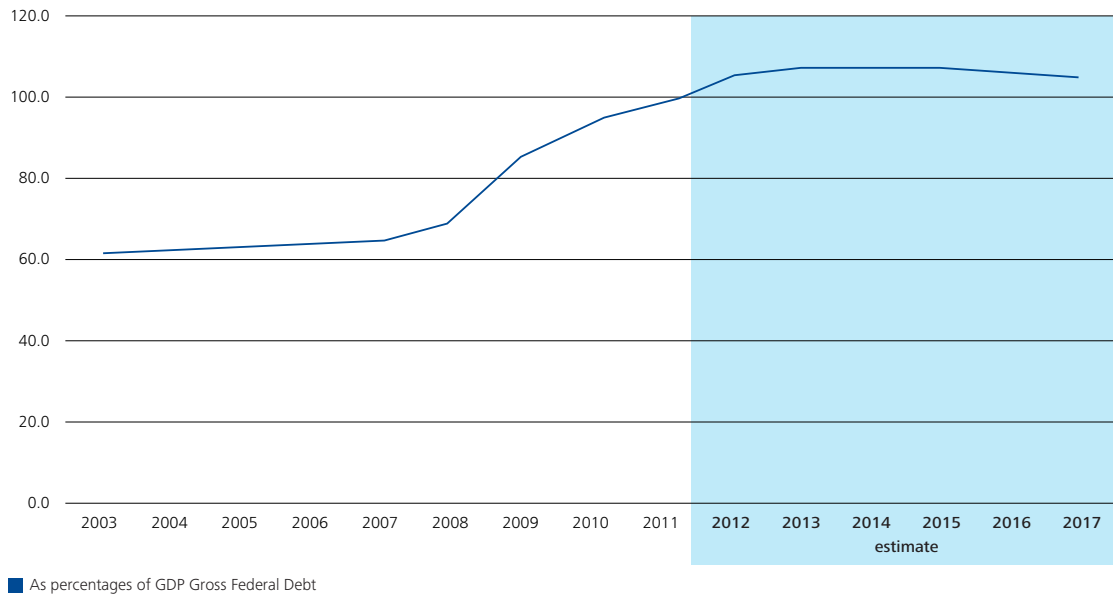
Not only must government solve more complex problems, but they must do so with fewer resources. In the last five years, gross federal debt rose sharply as a percentage of GDP (figure 2).<sup>5</sup> The federal government is

**Figure 1: Perceived government impact on businesses (LinkedIn survey results)<sup>4</sup>**

How has the government's impact on your business changed in recent years?



591 votes

**Figure 2: Gross federal debt as a percentage of GDP<sup>7</sup>**

under tremendous pressure to reduce costs. Federal discretionary spending has already declined—by 3.4 percent between 2010 and 2011 and by 2.07 percent between 2011 and 2012.<sup>6</sup> With government looking to reduce costs, there will likely be an incentive to cooperate with business on joint investments or to open up opportunities for business to provide services traditionally performed by government, creating a new opportunity for private sector growth.

**Figure 3: Number of rules reviewed by the Office of Information and Regulatory Affairs<sup>9</sup>**

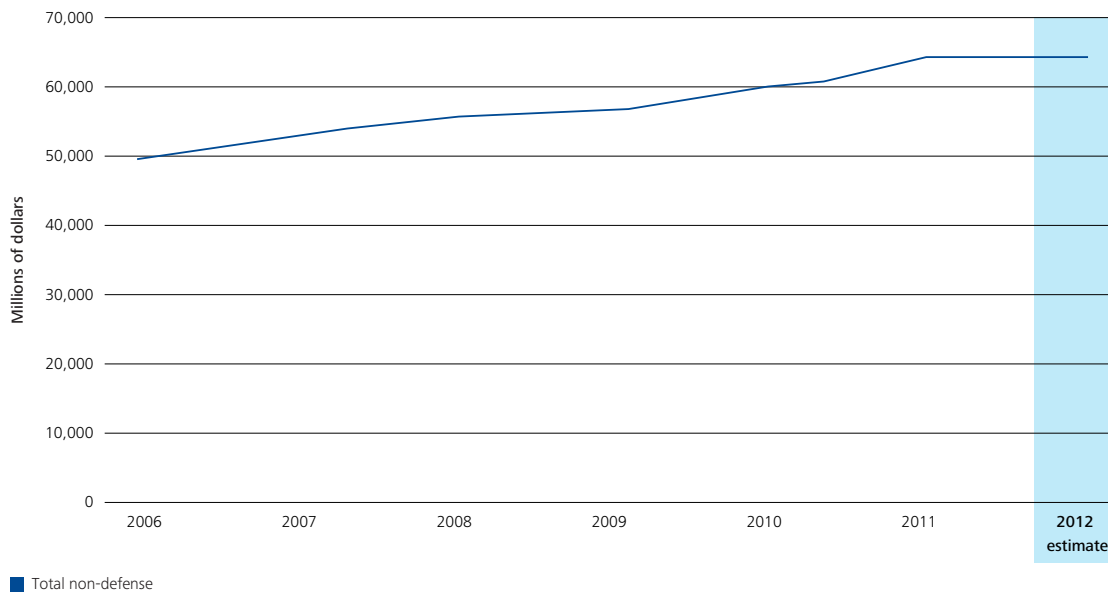
Agency	Jan 2006-Jan 2007	Jan 2011-Jan 2012
ALL	600	741
DOD	14	53
DOE	11	15
HHS	87	127
TREAS	8	22
EPA	87	97

## Re-regulation

The government's response to the recent financial crisis was largely aimed at offsetting the chances of another such disaster, most notably with regard to the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act. To date, the Commodity Futures Trading Commission has issued 40 final rules related to Dodd-Frank legislation alone.<sup>8</sup> Meanwhile, government has become more active in regulating other areas, particularly healthcare, energy, and defense, reversing the de-regulatory trend. Evidence of this trend can be seen in the Obama administration's requirement for doubling fuel efficiency standards by 2025. While government clearly sees re-regulation as part of the solution to prevent future crises, it should also avoid taking unilateral regulations that unduly harm business and damage economic growth. Both sides have an interest in partnering to develop smarter regulations.

## Innovation

The federal government is increasingly turning to innovation as a means to improve services and engage more effectively with consumers. In recent years, more than 28

**Figure 4: Total non-defense R&D outlay<sup>12</sup>**

federal innovation offices and programs have been created, and many agencies have developed programs specifically focused on promoting innovation within the government.<sup>10</sup> According to data from the Office of Management and Budget (OMB), the government has backed that commitment with consistent increases in R&D spending for non-defense, energy, and health sectors over the past four years.<sup>11</sup> Innovation is also seen as a way for government to “do more with less” by adopting new technologies or dramatically changing its existing operating models. Government is increasingly looking to partner with and learn from business on how to innovate more effectively, and may represent a new market for business innovations.

### Lessons learned: What works and what doesn't

The current environment calls for broader thinking about all that public-private partnership can really achieve beyond traditional PPP investment structures. It is important to realize that PPPs are not one-size-fits-all. There is a range of PPP models that can work in different contexts. Important to selecting the

right model is to carefully evaluate the need. Selecting the wrong model can unnecessarily increase the chances of failure. Here are a few models that have already been shown to work.

1. **Compete**—When business or multiple agencies within the government can approach the same problems with new solutions, competition can improve programs and spread innovative ideas while cutting costs. This may involve opening programs and services historically owned by one government agency or jurisdiction to competition, and may even require divesting programs entirely when it is clear that the private sector can more effectively and efficiently deliver services. Some entrepreneurial thinkers within government and industry are already fostering healthy competition between sectors. The “Mayor’s Challenge,” led by Bloomberg Philanthropies, encourages local leaders to compete with each other to solve national challenges and receive funding for the boldest ideas.<sup>13</sup> Combining managed competition and gain sharing, the city of Tulsa fostered competition between city workers and private sector contractors by inviting



them to bid on projects for Tulsa City Hall. Tulsa's public maintenance staff won the contract and identified more than \$100,000 in incremental cost savings, beyond reductions outlined in their initial bid. Engaging city workers in city solutions through a competitive bid process for projects enabled Tulsa to effectively leverage employees' insights and capture cost savings.

2. **Engage**—When solving problems that impact multiple, dispersed actors, business and government can form relationships and solicit new ideas even before legislative and regulatory processes take shape. Business and government's collaboration to address foodborne illness regulation is a case in point. One in six Americans suffers from foodborne illnesses annually.<sup>14</sup> Plus, food recalls can cost companies millions of dollars and take a significant toll on brand value. In order to foster foodborne illness prevention and food safety, the FDA is coordinating with other government agencies, the food industry, and non-US governments in the design and implementation of the Food Safety Modernization Act. Through this collaborative reform effort, the FDA aspires to create a cohesive, practical, and efficient food safety system.<sup>15</sup>
3. **Incubate**—When new ideas require significant risk-taking but have transformational potential, government and business can work together to test and incubate ideas that cut across various agencies and/or commercial industries. One example of the power of public-private partnerships to test and incubate promising ideas was NASA's 2010 OpenStack project,<sup>16</sup> launched with the goal of significantly expanding cloud computing services. NASA launched the project in collaboration with Rackspace, a cloud computing company. Rackspace contributed its cloud files and servers service to the OpenStack project, while

NASA provided its Nebula architecture and experience in building large-scale cloud platforms. Both NASA and Rackspace shared a similar vision for embracing open source and both reduced project risks by contributing their own assets. Through their collaboration, OpenStack has grown to become a global software community of developers aiming to create and offer cloud-computing services to virtually any organization on standard hardware.<sup>17</sup>

4. **Share**—When the relationships between regulators and those they regulate aren't at stake, government and business should actively encourage data sharing, communication and external rotation among their employees to glean knowledge, keep track of trends, and grow tangible skills. While some businesses may believe that they have little to learn from government, this perspective is slowly changing, particularly given government's enhanced regulatory role. For example, after Hurricane Katrina, private sector companies were often cited as having advanced planning systems that allowed them to respond in ways that outpaced government support in some areas. As the Federal Emergency Management Agency (FEMA) began to realize the changing, more important role of the private sector in disaster response and recovery, it pursued an initiative to include the private sector in federal response and recovery efforts. FEMA initiated a partnership to invite private sector executives drawn from a wide range of sectors to participate in three-month rotations at FEMA headquarters focused on issues of national security and preparedness. Through this initiative, FEMA and the private sector are collaborating to develop joint solutions that enhance the quality of disaster relief efforts and improve information sharing and collection.<sup>18</sup>

5. **Cooperate**—When government and business—and even government, business, and the social sector—can collaborate in ways that align their core competencies and strengths, there can be significant benefits for all involved. In the area of social and economic impact, a new model called Strategic Social Partnerships is emerging to characterize business, government, and social sector collaboration on issues of sustainability, human rights, and cross-sector knowledge sharing. In order to address the adverse implications of toxic cookstove smoke in the developing world, the Department of State launched The Global Alliance for Clean Cookstoves. This alliance is an innovative public-private partnership led by the United Nations Foundation that aims to save lives, improve livelihoods, empower women, and combat climate change by creating a thriving global market for clean and efficient household cooking solutions. The alliance’s mission is for 100 million homes to use clean and efficient stoves and fuels by 2020.<sup>19</sup> This effort has become one of the Department of State’s flagship initiatives under the Secretary’s Global Partnership Initiative.<sup>20</sup> Through the Global Alliance for Clean Cookstoves, the government seeks to work with public, private, and non-profit partners to address problems of global scale.<sup>21</sup>

## Looking ahead

So what will the future look like? The socioeconomic forces driving change today are expected to evolve into the future, requiring practical mechanisms to harness the opportunities presented by PPPs. The broad PPP strategies above, while just starting to occur today, will likely become a standard component of government and business strategy over the next decade as the two sides work to address their complex challenges. Effective

organizations understand the potential that partnership strategies offer not only to solve national challenges, but also to create opportunities for economic growth and business success. But to make partnerships work, they should match the partnership model to the appropriate context. Partnership opportunities can be identified and initiated in either the public or private sector, and to achieve their goals both organizations should:

- Develop a “partnership culture”: Create the type of environment that encourages and rewards employees to constantly be on the lookout for new opportunities to engage and collaborate across sectors.
- Include the identification of new government challenges and the corresponding PPP opportunities on the CXO agenda. Measure activity to encourage managers to think about the potential in addition to other private sector business development initiatives.
- Assign a senior leader to oversee PPP efforts: Appoint a leader who has a long-term vision of the project and can take the steps needed to break down barriers and win the confidence of the staff.
- Define a clear point of contact and mechanism for tracking PPP efforts: Often, PPP efforts are hampered by confusion over what is being done in other parts of the organization, which can result in turf battles or a lack of consistent messaging.
- Address legal or other organizational aspects of partnerships: Partners should be clear about what each party can or cannot do legally and about what each party brings to the table.
- Reach out to potential PPP partners early in the process. Use the outreach as an opportunity to jointly diagnose the problem,

create the rationale for the PPP, gain consensus on the vision, identify potential barriers, and structure the activities which the PPP will undertake.

- Select the appropriate model: The wrong approach can waste resources and, at worst, destroy value. The focus should be on understanding the context and the specific problem that needs to be solved.

By finding ways to balance their respective strengths and experiences, government and business can form effective partnerships to help resolve critical challenges, generate economic growth, and realize cost savings for the government. Some have estimated potential savings benefits of 20 to 50 percent.<sup>22</sup> But PPPs are complex arrangements, and the

difficulties of making them work should not be underestimated. Achievement of goals will likely depend on each side recognizing where it adds the most value and gains the greatest benefits: for example, when government engages business interests where it can now provide only limited financial resources; when business leaders proactively leverage government resources and guiding actions to better support the competitive needs of the United States; or when both public and private sectors partner with NGOs and the academic community to explore new realms and markets with innovative approaches. The door to new partnering opportunities is beginning to open even wider. Who will be the first to take full advantage of these opportunities?

# My take



*Bill Eggers, Global Director, Public Sector Industry, Deloitte Research, Deloitte Services LP*

We are experiencing a dramatic change in how societal challenges are tackled—a shift away from a government-dominated model to one in which governments are just one problem-solver among many. Over the last decade, a number of new players have entered the arena and operate within what we call a “solution economy.” Through dynamic partnerships, these innovators are closing the widening gap between what governments provide and what citizens want. This new approach intends stronger results, lower costs, and the high hope we have for public innovation in an era of fiscal constraints and unmet needs.

Paul MacMillan and I explore this collaborative economy in our forthcoming book, *Solution Revolution: How Business, Government, and Social Enterprises Are Teaming Up to Solve Society’s Toughest Problems*. We argue that public sector problems transcend the domain of traditional government and require a broad, collaborative approach.

As discussed in *Partnerships for the Future*, the rigid silos of traditional industry, government, and other public institutions often run directly against the ethos of how problems are being effectively addressed today. Partnerships among private, nonprofit, and public enterprises are critical to developing effective, multidimensional solutions.

Consider waste management, a problem that affects citizens in the developed and developing world alike. Eight thousand miles away in India, Parag Gupta, a social entrepreneur we profile in our book, chose to test a collaborative business model to clean up the 40 million tons of garbage his country produces each year. Gupta established Waste Ventures, working with international donor institutions and social impact investors to engage a segment of the Indian population known as “trash pickers.” For Gupta, it was quickly apparent that acting in isolation or through a government-only paradigm would be a path to failure. Instead, he worked with the “trash pickers,” local NGOs, and government officials to build an ecosystem to clean up some of India’s worst garbage-plagued urban areas.

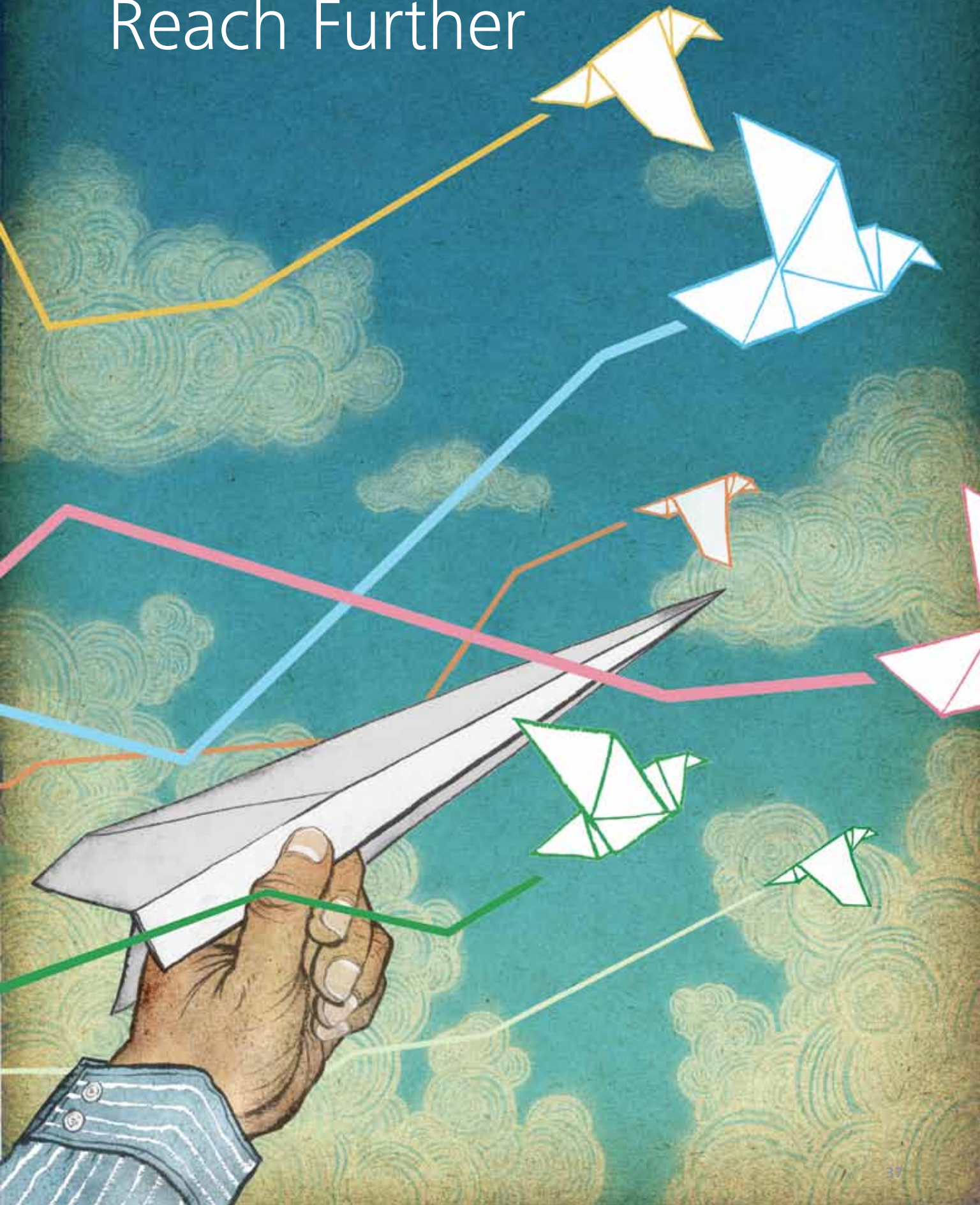
Going forward, governments should look to business and social entrepreneurs as important partners in solving the world’s greatest problems. The solution economy thrives in this environment where a cadre of actors—from governments to business, from social investors to ambitious entrepreneurs—work in partnership to create positive change.

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# Reach Further





# The Responsible Enterprise

## Where citizenship and commerce meet

By Chris Park and Dinah A. Koehler

**More and more companies today are undertaking environmental and social efforts to complement traditional business activities, using these efforts as catalysts to improve everything they do—from innovation and customer relationships to brand building and beyond. The results? Higher profits. Lower costs and risks. Increased shareholder value. Competitive advantage. And, though it may not be the primary motive, a measurable positive impact on society and the planet.**

**Embedding environmental, social, and governance (ESG) factors into your strategy and business practices isn't just good corporate citizenship. It's smart business.**

### Overview

Historically, many companies treated ESG issues as important—but tangential to the core business. Sometimes their motivation was a desire to be recognized as good corporate citizens. In other cases, ESG issues were viewed as compliance requirements, or perhaps good public relations. But more often than not, these issues were managed as secondary activities with an indirect connection to the core business and bottom line.

All of that is changing. The market today is undergoing a significant shift, with companies increasingly expected to address ESG issues head on. At the same time, many are recognizing both the tangible and intangible value of integrating these issues into core business activities. Commitment of human and

financial capital to this area continues to grow, especially among companies that see clear impacts on their value chain.

In a recent Deloitte survey (“ESG survey”) of 250 business executives about these issues, three drivers of ESG imperatives were identified: a need to bolster the corporate reputation and brand, increased regulatory scrutiny, and higher expectations from consumers and the broader community.<sup>1</sup> Most of the surveyed executives expect ESG issues to have a growing impact on their strategies, products and services, and operations over the next two years. Not surprisingly, large companies (with more than \$10 billion in revenue) foresee the greatest impact. These companies tend to operate across industries and geographies where the social and environmental issues are most acutely visible.



Another Deloitte survey found that two-thirds of global CFOs expect their role in ESG-related strategies to increase over the next two years.<sup>2</sup> This suggests that the ESG imperative is becoming a C-Suite issue and is expected to have a material impact on the bottom line.

## What's driving this trend?

Five factors account for the accelerating growth of corporate interest in ESG issues—none of which shows any sign of letup. A new era of the responsible enterprise appears to be here to stay.

- Loss of trust.** According to the 2012 Edelman Trust Barometer, public trust in business continues to decline, dropping to 45 percent in the United States, compared to 51 percent in 2010.<sup>3</sup> Trust in government is even lower.<sup>4</sup> These findings indicate a growing perception that large institutions are not serving the public interest well.
- Stakeholder pressures.** Pressure from consumers and investors is an important motivator for businesses to take action on ESG issues. Globally, this pressure is increasing, especially as the ranks of the middle class expand in emerging markets such as China and India.<sup>5</sup> A wealthier and more educated middle class tends to have higher expectations for corporate ESG performance, as illustrated by growing protests against new factories in China.<sup>6</sup> In addition, today's investors are increasingly concerned about short-term ESG risks and tend to reward companies that disclose more ESG information.<sup>7</sup> The number of S&P 500 companies that issued sustainability reports jumped from 19 percent in 2010 to 53 percent in 2011—and is expected to continue rising.<sup>8</sup>
- Natural resources pressures.** Growing global demand and supply constraints are generally pushing up prices for energy, agricultural products, and raw materials—an upward trajectory punctuated by periods of extreme volatility.<sup>9</sup> For example, precious metal prices have increased fourfold since 2005.<sup>10</sup> Also, the recent US drought, which affected nearly two-thirds of the contiguous states, was the worst in 60 years and drove up cereal prices by 17 percent.<sup>11</sup> Such resource trends are increasingly top of mind for business leaders and managers. More than 70 percent of Deloitte's ESG survey respondents said their organizations were making a significant commitment to improved resource efficiency.
- Supply chain pressures.** Executives surveyed by Deloitte see a multitude of supply chain risks that directly affect their businesses, including climate adaptation, regulatory pressures, and the unethical practices of certain business partners. Companies rely on global supplier networks that are largely beyond their immediate control, but those same companies are being held publicly accountable for the actions of those suppliers. Also, the strong emphasis that many companies have placed on supply chain efficiency often reduces the margin for error and makes supply chains more vulnerable to all forms of risk, including ESG risks. In recent years, companies have been hit by a number of major disruptions, including floods in Thailand, the tsunami in Japan, and labor unrest in China and South Africa. Disruptions such as these help explain why ESG survey respondents expect to commit more resources to mitigating environmental and social risks over the next two years. The increasing frequency and financial impact of these types of supply chain risks are not going unnoticed.<sup>12</sup>
- Social and mobile enablement.** A Deloitte risk management survey of 192 US executives found that social media ranks among the top five most important sources of risk.<sup>13</sup> With social and mobile technologies becoming globally pervasive, questionable

business practices have no place to hide. Problems that in the past might have remained behind closed doors can now be exposed to the world in a few minutes without a lot of advanced technology—and then scrutinized in detail, long after traditional media sources would have lost interest.<sup>14</sup>

## Lessons learned: What works and what doesn't

Many companies today are transforming their cultures to more strongly reflect ESG values and align them with their core mission and strategies.<sup>15</sup> They are actively measuring and mitigating ESG-related risks and improving transparency, using advanced analytics to improve reporting, perceptions, and management of environmental and social risks. These companies are also aligning their business models with their environmental and social goals, and their performance management systems with desired outcomes. Among the senior leaders we surveyed who work at companies that recognize the importance of environmental and social issues, 63 percent said they support changing compensation plans to reflect their ESG commitments.

Looking ahead, survey participants expect to commit more human and financial resources to ESG, not only to mitigate risk and improve transparency but also to change the organizational culture. According to the executives surveyed, this commitment will require three crucial actions that are closely linked to the core business:

- 1) Clear articulation of the company's ESG goals and values to all stakeholders
- 2) Improved alignment of the ESG strategy with the overall company mission
- 3) A demonstrated business case for investment in ESG initiatives

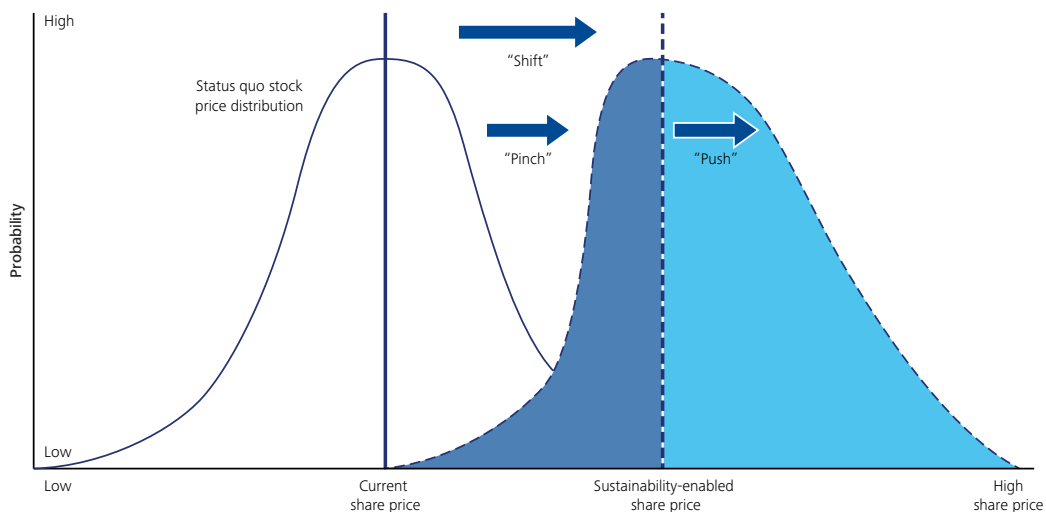
These actions can boost a company's competitiveness by making it more attractive to investment capital and top talent in a global marketplace that is increasingly conscious of ESG issues and risks.

## Looking ahead

Aligning ESG issues and corporate citizenship with commerce can help companies create shareholder value in three measurable ways: pinch, push, and shift.

**Pinch.** Downside risks should be reduced or "pinched", especially in a global marketplace

Figure 1. Responsible enterprise value creation<sup>16</sup>



## WHERE IT'S HAPPENING

*"You can't build value for your shareholders if you don't link it to value for your people."*

– Howard Shultz, Starbucks CEO

After a long and spectacular history of growth, Starbucks was beginning to show signs of weakness. Financial markets and analysts had started to write off the company, leading to a loss of more than \$25 billion in market capitalization. In response to the crisis, the board reinstated company founder and former CEO Howard Shultz to orchestrate a turnaround.

Starbucks had a strong track record of corporate citizenship. In fact, it was the first US company to offer all employees health benefits and stock options. However, it had gradually drifted away from its core values. In a bold and symbolic move, and despite board reservations, Shultz organized a major conference that brought together all 11,000 of the company's managers to New Orleans in the wake of Hurricane Katrina. The conference kicked off with more than 50,000 hours of community service in the city's 9th Ward, reminding store managers how citizenship and ESG are core values for Starbucks, and a yardstick for measuring personal and corporate achievement.

Although the New Orleans conference and other ESG-related activities were just part of the company's turnaround, Shultz believes they were a catalyst that helped people think differently and inspired them to find new and innovative ways to serve customers and improve the business. And the results speak for themselves, with the company's share price increasing by more than 500 percent from 2009 to 2012.<sup>24</sup>

that is increasingly volatile, resource-constrained, and socially engaged. One way to do this is by integrating ESG and financial reporting, which can increase transparency, improve understanding of ESG risks, and help drive targeted mitigation strategies. Improved transparency can also help build trust with customers, investors, and employees, creating a halo effect that makes it easier for a company to earn forgiveness when things go wrong, while getting more credit for things it is doing right.<sup>17</sup>

**Push.** Companies can also leverage social and environmental issues to create new product and service innovations that drive revenue and reduce operating costs. Deloitte's research on innovation shows that leaders on ESG issues are over 400 percent more likely to be considered innovation leaders.<sup>18</sup> For example, Nike's Considered Design initiative has enabled the company to recycle 82 million plastic bottles into high-performance sportswear, reduce waste by 19 percent in its footwear business, increase the use of environmentally preferred materials by 20 percent, and achieve a 95 percent reduction in volatile

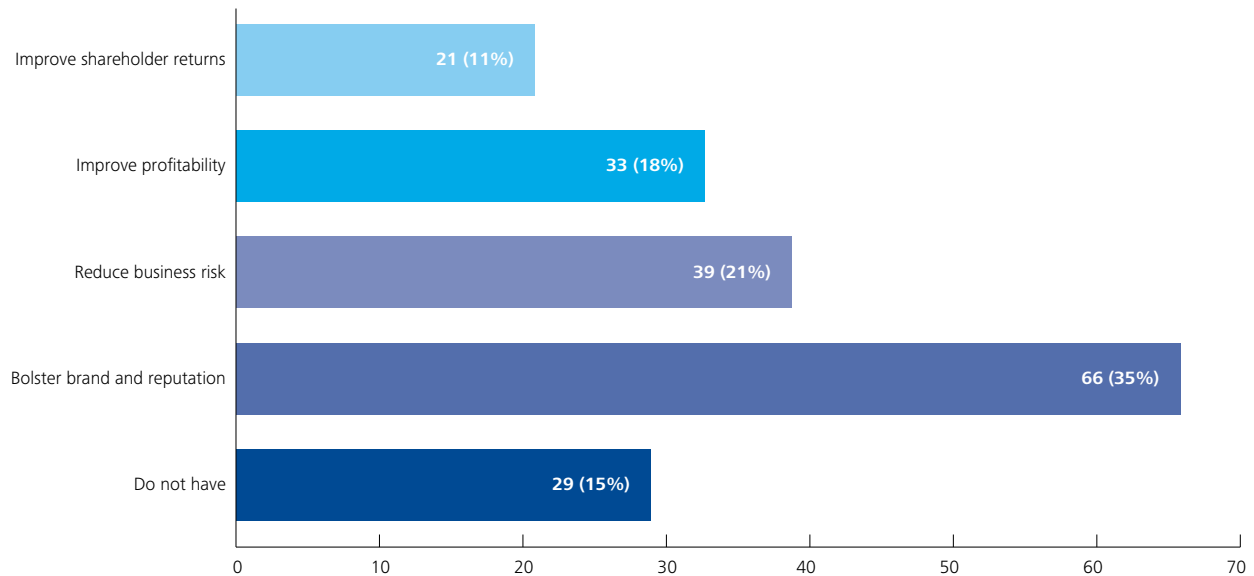
organic compounds.<sup>19</sup> In addition, our ESG survey shows that 32 percent of senior executives expect more than 5 percent of future annual revenue growth to come from products and services that reduce environmental and social impacts, while another 32 percent expect 1 to 5 percent of future annual revenue growth to come from those same kinds of sources.<sup>20</sup>

**Shift.** Weaving ESG factors into the fabric of a company can improve shareholder value over time by permanently shifting the expected share price to a higher level, creating a valuation premium.<sup>21</sup> Part of this shift comes from pinch and push, which strengthen a company's brand, reduce risk, and fuel innovation. Another part comes from improved operating efficiency and reduced waste, which can significantly reduce costs and increase profitability. In addition, a strategic approach to ESG issues can boost a company's value by helping to attract financial and human capital. Responsible enterprises attract more funding and enjoy a lower cost of equity capital than their less responsible counterparts.<sup>22</sup> They also have an easier time attracting



**Figure 2. Goals of ESG strategy (LinkedIn poll results)**

My competitors have an environmental, social, and governance strategy to:



188 votes

talent—especially younger workers, who tend to be particularly conscious of social and environmental issues.<sup>23</sup> These effects can help create a lasting competitive advantage.

The increasing focus on ESG issues is a long-term trend, driven by rising public awareness and concerns about adaptation to a changing business environment, income disparity, and quality of life around the world.<sup>25</sup> Companies that are further along the journey toward effective integration of ESG issues into risk management approaches, business

operations, and strategy will likely be in a stronger position to compete in the future. In particular, they will likely have the benefit of being able to take a strategic and measured approach when responding to stakeholder pressures and environmental crises. On the other hand, companies that continue to treat ESG issues merely as compliance could be missing an opportunity to be rewarded for the good work they do, making it harder to attract the customers, talent, and capital that are crucial to value creation.

# My take



*Al Iannuzzi, PhD, Senior Director, Worldwide Environment, Health & Safety, Johnson & Johnson*

Demand for sustainability has increased significantly in recent years. At Johnson & Johnson, we've been striving to improve our environmentally sustainable product design since the late 1990s—before many people even knew what sustainability was. Back then, we did it simply because it was the right thing to do. Now, we're seeing growing interest in sustainability from virtually every market sector. Retailers are asking for more products that emphasize sustainability. Consumers are increasingly looking for products and services with environmental and social appeal. And business customers are making sustainability an integral part of their procurement processes—creating sustainability scorecards and adding sustainability criteria to requests for proposals.

In the markets we serve, differentiation is important. Beyond the significant environmental and cost savings that sustainable solutions can offer, one of the biggest benefits for us is the ability to engage further with our customers in driving more innovation, performance, and distinct value in our products and services. This helps customers achieve their sustainability objectives and provides opportunities to drive leadership and change in the marketplace.

Our Sterilmed business is a good example of how sustainability is shaping the medical device market. Although single-use devices remain predominant in the practice of medicine, Sterilmed's reprocessing technology (remanufacturing of single-use devices) offers a compelling new business model with significant benefits for the environment—and for our customer's bottom line.

Moving forward, we have set aggressive corporate-wide goals to reduce our environmental impact, and have established our proprietary Earthwards® ([www.earthwards.com](http://www.earthwards.com)) process to develop and market greener products. Every Earthwards® recognized product must achieve a greater than 10 percent improvement in at least three of the seven goal areas:

- Materials used
- Packaging reduction
- Energy reduction
- Waste reduction
- Water reduction
- Positive social impact or benefit
- Product innovation

Through Earthwards®, we are delivering tangible sustainability benefits across the entire product lifecycle.

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# Manufacturing beyond China

## New options. New opportunities. New risks.

By Darin Buelow, Doug Gish, and Josh Timberlake

**China has long been the default choice for offshore manufacturing. For the past two decades, many businesses have made the move without even seriously considering other countries. But that's starting to change. Rising production costs and increasing competition for talent along with other factors such as intellectual property risk and dwindling government incentives are reducing China's appeal for export-oriented manufacturers and prompting many companies to explore other production locations within Asia and beyond.**

### Overview

Though China's manufacturing base continues to grow, the rate has tapered in recent years. Perhaps equally important, the country's vast production base is changing. Increasingly, new manufacturing capacity is being deployed to satisfy demand from Chinese consumers,<sup>1</sup> rather than to serve the export market.

Although China remains the dominant player in offshore manufacturing, several trends are causing companies that are highly cost-sensitive to consider alternative locations (figure 1). For example, China used to be the obvious choice—or even the only choice—for offshore production. However, businesses looking for low-cost export platforms in Asia are increasingly considering countries such

as Indonesia, Vietnam, and Thailand. Others that are focused on reducing transportation costs and supply chain risk are shifting to nearshore locations closer to their customers, or even repatriating production to low-cost regions back home. A growing number of US companies are reconsidering—and in many cases moving production to—Mexico,<sup>2</sup> which was once a favored spot for many US-based manufacturers. Many are also migrating to the southeastern United States.<sup>3</sup> In fact, a recent Deloitte poll of more than 900 predominantly US-based executives and managers found that 39 percent believe their company is likely to deploy its next manufacturing operation in the United States, compared with only 16 percent who cited China as the likely destination.<sup>4</sup>

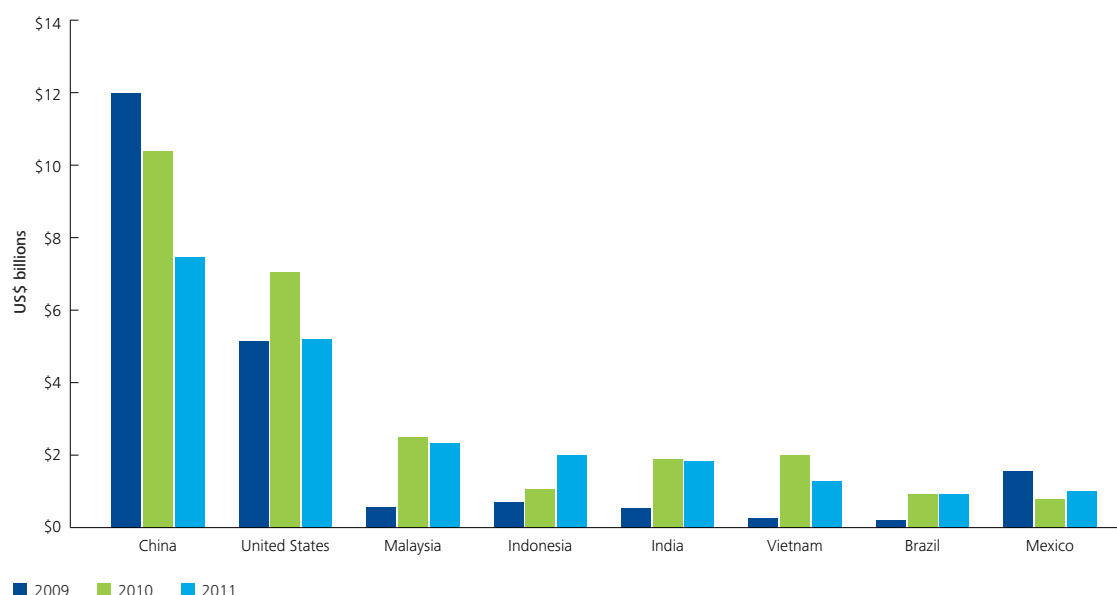


## What's driving this trend?

Several specific drivers, both internal and external to China, are causing manufacturers to increasingly seek alternative production locations:

- Labor costs and competition for talent are rising.** Cheap, plentiful labor used to be China's biggest advantage—but that benefit is shrinking. Deloitte's recent poll found that rising labor costs and increased competition for labor are two of the biggest challenges for companies operating in China (figure 2). Foreign companies and fast-growing local businesses are all vying for qualified employees—especially workers with skills such as fluency in English—making it harder for businesses to attract and retain top talent. Wage inflation in Shanghai and other prime business locations, particularly along the eastern seaboard, has remained in the double digits for roughly a decade, with no apparent relief in sight.<sup>6</sup>
- Other costs are rising too.** Depending on the industry, China may no longer be the cheapest place for foreign companies to do business. Real estate costs have risen at near-manic rates following the institution of government-mandated minimum land prices.<sup>7</sup> Electricity rates are also rising,<sup>8</sup> although the same is true in many other countries. And corporate income tax rates for most foreign companies have increased from 15 percent to 25 percent, while tax-related incentives are disappearing or becoming increasingly difficult to obtain.<sup>9</sup>
- Intellectual property protection remains a risk.** Foreign companies operating in China have long been worried about protecting their intellectual property; yet, despite the considerable attention this issue receives, it seems little progress has been made. Deloitte's recent poll found that protection of intellectual property lingers as the top challenge for companies operating in China (figure 2).
- China's competitors are steadily improving.** Other countries in Asia have long offered appealing labor rates, and have also attracted inbound manufacturing investment (though to a much lesser degree than China). However, they often lacked the

**Figure 1: Foreign direct investment trends in traditional “cost cutter” industries, 2009–2011 (US\$ billions)<sup>5</sup>**



skilled workers and business infrastructure to support complex or large-scale manufacturing investment. That's also changing. Nations such as India, Indonesia, Vietnam, Thailand, and others are becoming increasingly competitive. China still has an edge in advanced manufacturing with its ability to scale up massive production operations. For example, Foxconn grew its Chengdu manufacturing campus from scratch in 2010 to a reported 164,000 employees by December 2012,<sup>10</sup> a growth rate that most likely could be achieved only in China. Yet many of China's competitors have reached the point of viability, and will only get more competitive as they build critical mass and begin to attract more business. In addition, less developed regions, perhaps even Africa, may emerge in the not-too-distant future.

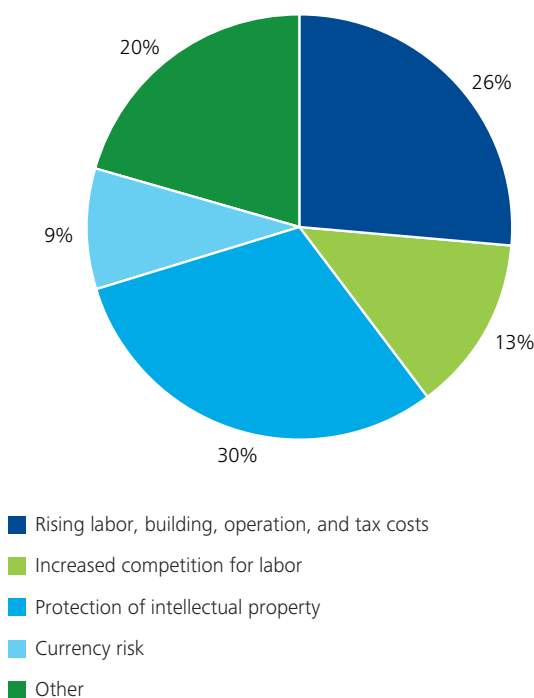
- **Many companies are shortening their supply lines.** Manufacturing products in China and then shipping them halfway around the world can be expensive, time-consuming,

and risky. With a jittery economy causing demand fluctuations, being able to shorten supply chains and quicken response times while reducing exposure to volatile fuel prices is vital. That is why a growing number of companies are shifting production to nearshore or domestic locations, reducing supply chain costs and risk and making the business easier to manage.<sup>11</sup> Leaders no longer have to subject themselves to all-day flights and midnight conference calls or settle for running their far-flung operations by remote control.

- **China's domestic consumption continues to rise.** Despite the current and pending future challenges as a low-cost export platform, China will likely continue to attract manufacturing investment in droves to serve domestic consumers. Separately, manufacturers revealed that while 37 percent expect to shift production from China to other countries by 2014, nearly as many (32 percent) expect to expand in China to sell products locally (figure 3). Meanwhile, only 10 percent cited plans to grow their use of China as a low-cost platform. These findings suggest that while China's role in manufacturing will likely remain significant, its future course may veer away from "factory to the world" toward "factory to China."

**Figure 2: Operational challenges in China<sup>12</sup>**

Which is the biggest challenge for your company's operations in China?



## Lessons learned: What works and what doesn't

When it comes to choosing a location for offshore production, there are a number of practical and demonstrated practices that can help you make an informed decision.

- **Evaluate your game plan.** Start by getting clarity about your organization's strategic goals and objectives. Do you intend to reduce costs? Serve a new market? Expedite response times? Diversify risk? Because costs likely rise more quickly in

less established countries, some organizations find themselves consistently playing catch-up as they seek to move from low- to lower-cost locations. Bringing broader organizational goals into the decision may support the long-term sustainability of your manufacturing investment.

- **Assemble a cross-functional team.** An effective assessment of potential manufacturing locations requires the involvement of a broad range of functions such as HR, supply chain, legal, and tax. Getting those functions engaged *before* choosing a location can help avoid unpleasant surprises down the road.
- **Look beyond labor costs.** The location with the lowest labor costs may not actually be the preferred one—or even the most

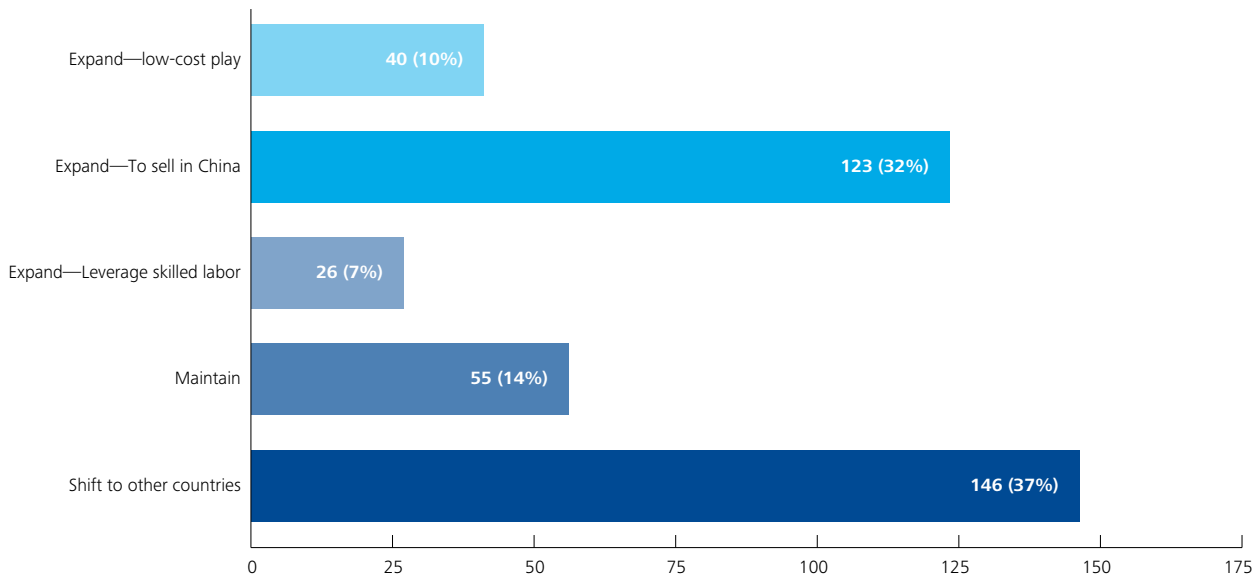
cost-effective place to do business. To make the right choice, consider a wide range of factors, including everything from the cost of transportation and electricity to supply chain risk, workforce skills, and tax incentives. Identify and prioritize all the needs of your business, and then see how each location stacks up against your specific requirements. As companies apply more “total cost” decision models, past and future decisions to source in China will likely be called into question.

- **Consider the entire supply chain.** Many modern factories are really just assembly operations, with much of the actual manufacturing done by upstream suppliers. When deciding where to locate, proximity to suppliers should be an important factor. Proximity to customers (and to corporate

Country	Potential advantages	Potential disadvantages
China	<ul style="list-style-type: none"> <li>• Large consumer market with growing spending power</li> <li>• Demonstrated ground for offshoring manufacturing</li> <li>• Easier and faster to achieve large scale</li> </ul>	<ul style="list-style-type: none"> <li>• Rising costs for labor and other inputs</li> <li>• Challenges in attracting and retaining skilled talent</li> <li>• Continued IP protection risks</li> </ul>
India	<ul style="list-style-type: none"> <li>• Low labor costs</li> <li>• Large potential consumer market</li> </ul>	<ul style="list-style-type: none"> <li>• Significant bureaucracy can constrain start-up and ongoing operations</li> <li>• Underdeveloped infrastructure to support manufacturing</li> </ul>
Indonesia	<ul style="list-style-type: none"> <li>• Relatively low operating costs (particularly labor and electricity)</li> <li>• Large labor pool</li> </ul>	<ul style="list-style-type: none"> <li>• Greater risks related to natural disasters, economic instability, and safety/security</li> <li>• Loose regulatory environment</li> </ul>
Malaysia	<ul style="list-style-type: none"> <li>• Comparatively stable political and economic environment</li> <li>• Significant potential for incentives (in select industries)</li> </ul>	<ul style="list-style-type: none"> <li>• Higher costs (particularly labor) compared to many other Asia-Pacific locations</li> <li>• Relatively small domestic labor pool</li> </ul>
Thailand	<ul style="list-style-type: none"> <li>• Strong transportation and utility infrastructure</li> <li>• Favorable environment for attracting ex-pats</li> </ul>	<ul style="list-style-type: none"> <li>• Recent political instability and natural disasters (flooding)</li> <li>• Poorly rated intellectual property protection</li> </ul>
Vietnam	<ul style="list-style-type: none"> <li>• Low production costs (particularly for labor and electricity)</li> <li>• Growing momentum in attracting manufacturing investment</li> </ul>	<ul style="list-style-type: none"> <li>• Cost escalation (especially for labor, electricity, and gas)</li> <li>• Limited natural gas infrastructure throughout the country</li> </ul>

**Figure 3: Future of manufacturing in China (LinkedIn poll results)<sup>14</sup>**

How is your Chinese manufacturing footprint expected to change by 2014?



390 votes

headquarters) should also be taken into account. All else being equal, closer is usually preferred.

- Assess the current footprint.** Manufacturers seeking a beachhead in Asia may steer toward China, especially if domestic market potential is an important consideration. Meanwhile, those that already have a deep China presence may see risk diversification as a driver, and be more apt to move existing production from China—or divert the next manufacturing investment—to another country.
- Understand the alternatives.** For companies deploying cost-sensitive, export-oriented manufacturing in the Asia-Pacific region, a handful of countries most commonly emerge as alternatives to China. Each has its own set of advantages and disadvantages.<sup>13</sup>

## Looking ahead

Two years from now, fewer businesses may automatically assume China is their leading option for low-cost, export-focused manufacturing. As production costs rise and other challenges intensify, many companies will likely feel increasingly fatigued by and overinvested in China as a low-cost export platform. If the emerging countries in the region continue along their current growth trajectory in the required labor, infrastructure, and supply base capabilities to support more complex foreign manufacturers, they may catapult themselves into consideration for all types of production expansion or relocation decisions involving the Asia-Pacific region.

China will also likely face growing competition from other parts of the world. A movement toward supply chain regionalization is already causing manufacturers based in North America and Europe to reevaluate far-flung supply lines, and in some cases, shift production closer to home. At the other end of the spectrum—for operations where cost trumps

## WHERE IT'S HAPPENING

The recent case of a US-based heavy equipment manufacturer embodies the dilemma faced by many Western manufacturers regarding China. This company continues to experience growing global demand for its product, driven by urbanization and infrastructure needs in emerging markets, particularly China. This increasing demand is particularly strong throughout the commodity-rich Asia-Pacific region, currently supplied by manufacturing plants in China and several North American facilities. However, the company faces many of the challenges typical with operating in China, including increasing pressures on cost, talent attraction and retention, and IP protection. These concerns, along with an overall desire to diversify production, led the company to investigate alternatives to China for its third production facility in the region.

While familiar with China from its two current operations, the company had limited knowledge or experience in other Asia-Pacific countries. After defining and prioritizing the specific decision drivers for the new plant location (for example, electric power reliability, quality, and costs were particularly important), the company filtered the region down to the short list of countries that could realistically deliver on their objectives—and then went into the field to investigate the top candidate industrial zones.

In-depth analysis of the cost and non-cost considerations in each location led to many interesting insights:

- Several countries demonstrated the capability to support an operation of the proposed scale (\$60 million in capital investment and 250–300 employees).
- Viable candidate countries offered savings ranging from 7 to 22 percent in “geographically variable” costs, such as labor, utilities, real estate, and freight, compared to China.
- Aside from potential cost savings, some countries also appeared to offer more favorable operating conditions, including talent, infrastructure, and risk environment, based on the company’s particular preferences and requirements for the new operation.

Despite the opportunities, there are risks associated with expanding elsewhere in Asia. China’s challenges, while significant, are well known and understood by the company. There is also concern that expansion outside of China will stretch the company’s Asia-Pacific management team too thin. The company is currently evaluating these dynamics and also examining the potential to serve Asia by increasing production capacity in North America as it narrows in on a final deployment decision for the new factory.

all factors—Africa lurks as the potential next frontier for low-cost manufacturing, assuming it can address the political, social, and infrastructure barriers that currently deter many foreign investors. Even China was once untested territory. Organizations that took the first step into China were well positioned to take full advantage of what has turned out to be an unprecedented growth wave. Many companies are now looking beyond China for the next wave.

China will likely remain a dominant player in global manufacturing for the foreseeable

future, and will likely continue to be the leading production option for many companies, especially those serving markets in China and other parts of Asia. However, it is no longer the only option. Manufacturers are already starting to look further afield, and may increasingly consider alternative locations both within and outside the Asia-Pacific region. When choosing a location, more companies may take a holistic, long-term view that examines operating costs, business conditions, and risks, and then make decisions based on their own specific business requirements.



# My take



*Deborah L. Wince-Smith, President and CEO, Council on Competitiveness*

China will likely remain a manufacturing powerhouse. Supply networks, talent pool, infrastructure, and other factors, including government policies and investments, are too entrenched in the fabric of global manufacturing for China to be displaced in the near future. China's position atop our 2013 Global Manufacturing Competitiveness Index rankings<sup>15</sup> indicates that CEOs around the world believe China's manufacturing strength seems secure for the next five years.

The changing global manufacturing dynamic also favors expanding manufacturing in the United States, as we point out in our Council on Competitiveness' national manufacturing strategy publication *Make: An American Manufacturing Movement*. US-based production addresses many of the challenges in China, ranging from shorter cycle times and supply chain challenges to energy and transportation costs, IP protection, and market access.

The United States is expected to remain a leading manufacturing competitor—poised to lead the technological transformation in manufacturing. Today, US manufacturing remains at the technological forefront—and companies are investing here to seek access to cutting-edge US automation and robotic technology.

Several forces are shaping China's manufacturing outlook. Internal factors such as rising production costs and competition for skilled labor continue to pose challenges for many manufacturers. Externally, several emerging countries in Asia, including Vietnam, Indonesia, and Malaysia, already rank among the 20 most competitive manufacturing countries, and their competitive positions are only slated to improve. Likely improvements in manufacturing competitiveness drivers—such as talent-driven innovation, physical infrastructure, and supplier network—will make Southeast Asia the strongest ascending region over the next five years. Individually, these countries pose a small threat to China. Collectively, however, they are positioned to erode China's role as the default choice for cost-driven, export-oriented production.

Global manufacturers are taking notice—and are increasingly thinking about alternatives for manufacturing beyond China, including the United States.

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# Emerging Market Talent Strategies

## Creating an effective global talent model

By Tom Morrison, Jonathan Pearce, Suzanne Kounkel, Matt Szuhaj, and Ina Gantcheva

In the past, global business and talent strategies typically ran in one direction: from north to south, from developed markets to emerging markets. But the BRIC economies (Brazil, Russia, India, and China) have since matured as global growth engines, and countries in the new tier of emerging markets, including Indonesia, Malaysia, the Philippines, South Africa, Thailand, Turkey, and Vietnam, are establishing themselves as growing economies and growing sources of talent. As a result, the “north-to-south” model is becoming outdated. Companies looking for fresh new approaches to their most pressing talent challenges should consider “south-to-south” or “south-to-north” strategies, particularly as they extend their global reach further into Asia and Africa. Eventually, the lessons learned in BRIC countries and other emerging markets could drive talent strategies around the world.

### Overview

Until recently, global companies tended to have limited business strategies in emerging markets, centering on labor arbitrage, driving mature products, and locating mature business processes in the BRIC countries. As a result, many had limited expectations of workers in emerging markets. Meanwhile, employees in these regions were satisfied with the global opportunities available at the time. With wide-ranging access to low-cost talent for manufacturing and support functions, employers could reduce their focus on talent strategies, focusing instead on improving other functions that supported their business strategy. While many companies realized that long-term development and retention of employees in these

markets was to their advantage, many viewed that as a secondary concern when compared with cost containment and greater supply chain efficiency.

Today, the environment has changed. The BRIC countries and newer emerging markets are becoming the new centers of gravity for the global economy, and competition for talent is becoming fiercer almost by the day. Access to talented workers is considered by some as the top indicator of a country’s competitiveness. Enhancing and growing an effective talent base remains important to many traditional manufacturing leaders such as the United States, Germany, and Japan—and is rising in importance among emerging market challengers such as Vietnam and Indonesia.<sup>1</sup>

As emerging market consumers demand products and solutions tailored to their values and priorities, global companies are beginning to recognize the need to build a local workforce that can respond to more sophisticated local buyers. Meanwhile, knowledge workers in these markets are increasingly sophisticated and recognize the value of experience gained from working in global organizations as they seek personal and professional development.

Global companies recognize the changes afoot and sense the need to modify their existing global talent frameworks to allow for local customization. But when it comes to the degree of response warranted, answers are hard to come by. How much talent do they need? What type? How timely can the response be to new opportunities?

In the face of such uncertainty, many are deploying strategies designed to increase flexibility. With a more flexible global structure in place, companies are able to open the flow of ideas between markets and deliver localized approaches, including:

- New career paths for talent that offer real advancement opportunities, both locally and globally
- Rewards strategies that consider differing market values and retention strategies

- A strong leadership development program
- A greater openness and respect for ideas and innovations that originate in emerging markets

## What's driving this trend?

While the global talent market is incredibly complex and changing all the time, a few consistent themes appear to be at work.

### The lion's share of global growth is taking place in emerging markets

Emerging market economies are growing by leaps and bounds, while mature markets are often flat or declining. Income levels in emerging markets increased 96 percent from 2000 to 2010, and are expected to increase 45 percent from 2010 to 2016, driving a wave of consumerism.<sup>2</sup> As a result, over the next five years, GDP growth in emerging markets is expected to outpace that of mature markets by more than 50 percent.<sup>3</sup> Local customers seem to prefer to buy from local companies. Customers in emerging markets increasingly want to do business with companies that contribute to the local economy, provide local jobs, and take care of local workers.

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## EXECUTIVES SAY EXPANDING TO EMERGING MARKETS IS A TOP STRATEGIC PRIORITY<sup>4</sup>

- The expansion to emerging markets is of upmost priority for surveyed consumer products executives (29 percent of them indicated it is among their top three priorities), closely followed by automotive and tourism, hospitality, and leisure (25 percent each).
  - The expansion is the highest priority for surveyed Asia Pacific executives: 45 percent of them indicated that it is among their top three strategic priorities.
-

## Competition for talent is heating up

Employers in emerging markets face both established and new competition for talent. The demand for skills in marketing, finance, and HR is approaching the level of interest in traditional stalwarts such as R&D and operations (figure 1). In some cases, this is due to the growth of emerging market-based companies like Shoprite and Jollibee that are making a stronger push both locally and globally.<sup>5</sup> In other cases, forward-thinking global companies are already developing country-specific talent strategies and HR programs that make them more attractive to the local workforce.

These new demands in emerging markets are being met with some anxiety from executives who realize the importance of

responding, but don't feel they have the tools or capabilities in place to do so effectively. Forty-four percent of executives from surveyed global companies consider global talent to be an important executive-level issue. But only 30 percent believe they have sufficient capabilities for managing global talent, and only 28 percent are actively investing to improve those capabilities.<sup>6</sup>

As a result, more global organizations are shifting the center of their attention and efforts in the talent arena. Johnson & Johnson recently expanded its talent management capabilities into BRIC countries in order to gain more immediate access to the people and perspectives that may help shape the company's future business strategies.<sup>7</sup>

**Figure 1. Expected talent shortages by functional area<sup>8</sup>**

Functional area	APAC	Americas	EMEA
China	68%	45%	33%
Operations	64%	56%	34%
Procurement and supply chain	64%	36%	19%
Risk and regulatory	63%	41%	38%
Strategy and planning	62%	46%	38%
Customer service	62%	38%	22%
Sales	60%	44%	28%
IT	59%	50%	33%
Executive leadership	58%	56%	47%
HR and talent	56%	44%	32%
Marketing	56%	43%	24%
Finance	56%	38%	24%
<b>Average across 12 functional areas</b>	<b>61%</b>	<b>45%</b>	<b>31%</b>



## Many workers in emerging markets are becoming more discerning

In many developing countries, the growth of local employers, as well as the presence of more global companies, results in more choices for prospective employees. Plus, many talented people in emerging markets are recognizing their own value and are adopting a free-agent mentality, jumping from company to company in pursuit of what's most important to them—improved career development opportunities,

stronger financial incentives, improved working conditions, or all of the above (figure 2).

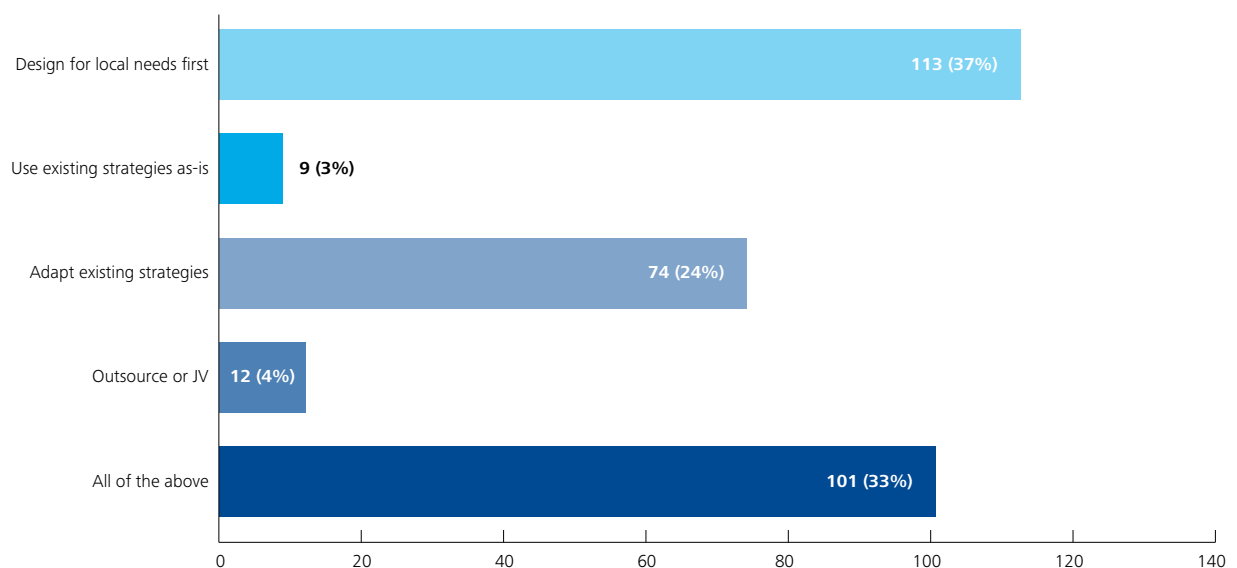
Companies are beginning to recognize the importance of directly addressing the specific requirements and preferences of local talent. In fact, when asked how best to establish talent management strategies for new geographies, 37 percent of respondents chose “design for local needs first,” making it the top response (figure 3).<sup>10</sup> But many companies have yet to turn this breakthrough insight into meaningful action.

**Figure 2. Regional insights: Top retention drivers<sup>9</sup>**

Americas	52%	• Additional bonuses or financial incentives
	49%	• Additional compensation
	43%	• Promotion/job advancement
APAC	36%	• Promotion/job advancement
	36%	• Additional bonuses or financial incentives
	35%	• Additional compensation
EMEA	44%	• Promotion/job advancement
	41%	• Additional bonuses or financial incentives
	35%	• Additional compensation

**Figure 3. Talent management in new geographies (LinkedIn poll results)<sup>11</sup>**

How do you establish talent management strategies for new geographies?



309 votes

## Lessons learned: What works and what doesn't

Global companies should carefully consider both corporate and geographic expectations when developing their talent strategies. Attempting to force-fit global HR and business standards into emerging markets without acknowledging local values and culture can make it difficult to attract and retain top local talent. At the same time, companies that develop geography-specific strategies should keep in mind the reason why many workers look to them in the first place. Respect for the global talent brand, access to global colleagues, improved resources, global mobility opportunities—these aren't just the reasons that employees are attracted to an organization. They're also the reasons they stay.

Perhaps most important, global organizations should recognize that employee priorities are dynamic, especially in the maturing workforces in emerging economies. The timely evolution of BRIC talent markets provides lessons that should inform the design and investment of talent strategies elsewhere.

While there are few hard and fast rules, here are some important considerations to inform talent strategies focused on emerging markets (figure 4).

**New career paths.** Talented employees need room to grow—both locally and as part of the global enterprise. Effectively managing top talent in emerging markets often requires organizational structures and career paths that are aligned to cultural values while still part of a global framework. In India, progression through job titles and rank is an important part of the culture—one that runs directly counter to the established market trend toward flatter organizations. Meanwhile, employee perspectives in BRIC countries on the importance of international assignments tend to vary considerably. Understanding how these cultural perspectives may shape career paths in

newer emerging markets can have a big impact on outcomes.

**Country-specific compensation and benefits.** Different cultures, environments, and regulatory regimes drive different needs and employee priorities. While it may seem obvious that workers in countries with universal health care do not value employer-provided medical benefits, it may require deeper analysis to understand if those same workers are attracted to employer-provided transportation or on-site daycare. Global employers in growth economies should keep pace with rapidly changing employee priorities. For example, while pay continues to be one of the most important tools for retention in China, other factors such as benefits that support work-life balance are increasingly important.<sup>12</sup> Even something as seemingly minor as the timing of paycheck disbursement can be a significant differentiator. Paying employees through direct-deposit debit-card accounts has become more common in emerging markets such as Mexico.<sup>13</sup>

**Improved leadership development.** Companies in emerging markets may not have the leadership pipeline needed to drive growth. As a result, many may choose to make investments in personal growth and long-term leadership development, not just technical training. Adopting a model in which senior company executives are deployed to emerging markets may still be an effective solution for some organizations, but others are developing talent locally. For example, IBM has established a software center of excellence in India with more than 100 locations.<sup>14</sup> In 2011, GE set up its Global Growth & Operations (GGO) business unit in Hong Kong in order to develop business models that are cross-business in nature and globally scalable. The leadership for the GGO operation, which supports 13 different markets, is also based in Hong Kong.<sup>15</sup> As more companies expand into new emerging markets, the ability to develop local leaders will likely become a differentiator.

**Figure 4. Evolution of talent strategies**

	North to south	South to north	South to south
<b>Career paths</b>	<ul style="list-style-type: none"> <li>Traditional career paths either streamlined or redefined for in-country roles</li> </ul>	<ul style="list-style-type: none"> <li>Career path progression considers global experience and offers mobility options</li> </ul>	<ul style="list-style-type: none"> <li>Career paths adjusted to local market and cultural expectations for progress in line with business strategies</li> </ul>
<b>Total rewards</b>	<ul style="list-style-type: none"> <li>Rewards programs mirrored in emerging markets with adjustments to local economic conditions</li> </ul>	<ul style="list-style-type: none"> <li>Rewards program choices</li> </ul>	<ul style="list-style-type: none"> <li>Rewards program strategy and delivery takes into account global strategies and local needs</li> </ul>
<b>Leadership and development</b>	<ul style="list-style-type: none"> <li>Headquarter executives rotated to emerging market</li> </ul>	<ul style="list-style-type: none"> <li>Bilateral assignments and appointments; top committees' composition reflects diverse viewpoints</li> </ul>	<ul style="list-style-type: none"> <li>Development opportunities incorporate virtually all emerging markets</li> </ul>
<b>Innovation</b>	<ul style="list-style-type: none"> <li>Innovative ideas rolled out to emerging markets</li> </ul>	<ul style="list-style-type: none"> <li>Local emerging market practices are considered for global rollout</li> </ul>	<ul style="list-style-type: none"> <li>Free flow of ideas and practices across markets</li> </ul>

**Respect for new ideas and innovations.**

In the past, many companies missed opportunities to augment R&D capabilities in established markets with those from emerging markets. This was not only discouraging emerging markets workers; it also left many valuable ideas and insights untapped. Some are addressing this opportunity by investing in emerging markets design centers or by moving entire operations to emerging markets from traditional strongholds. For example, Bayer MaterialScience relocated the global headquarters for its polycarbonates business to Shanghai in order to gain improved access to customers and innovative ideas.<sup>16</sup> Of course, that's just one way to drive "reverse innovation." At a more fundamental level, the main requirement is for business leaders and staff in established markets to be receptive to new ideas and innovations from their counterparts in emerging markets. Such a perspective will likely only grow in importance as emerging markets gain stature in the global business landscape.

**Looking ahead**

Companies attempting to impose existing talent strategies and HR programs that don't match the context of the local workforce may find themselves at an increasing disadvantage, both in the local talent market and broader business marketplace. Conversely, global companies that adapt too much to a local talent market risk diluting their global talent brand, inadvertently losing their original advantage.

Competition for talent will likely continue to increase as emerging market companies attempt to grow global market share for their products and services. While this is true for local BRIC companies, they are not the only ones that will be affected. As we mention in *Building on the BRICs*, companies in the new tier of emerging markets are expanding aggressively into adjacent emerging markets, creating additional competition for business and talent. The pressure created by the cumulative competition, new demands of the emerging markets,

and companies' limited ability to respond will likely raise the level of intensity.

Using regionally oriented talent segmentation models that account for the growth potential of different markets, as well as traditional role and talent dimensions, organizations will likely be able to focus their portfolio of talent investments and programs on growth markets like the BRIC countries. From there, they can be poised to expand into the new tier of emerging market countries and others, depending on their core business strategy. For every high-potential market, global companies should have a detailed plan that forecasts changing talent requirements to support growth in these maturing geographies. Such a plan should also identify the talent acquisition, talent development, and talent mobility investments required to support growth. Global talent programs should be designed with insight into growth market dynamics as companies consider, for example, how to create a mobility

program that can work in both India and Latin America.

The ground is shifting on global talent and on global business in general. BRIC has become not only a prime source of economic growth but also the center of many companies' talent strategies. For example, India's demographic dividend (the average age in India is 28, in China it is 37.6, and in Japan, closer to 44.4) will be a driver of the world's employable talent pool.<sup>17</sup> Hence, figuring this out now will be critical for companies in the United States and throughout the world. Finding ways to share lessons from BRIC and apply them to the needs of emerging talent markets may require a shift in how concepts and innovation are shared across geographies. In order to meet these changing needs, talent strategies for emerging markets require a global framework that applies these concepts, with flexibility to meet the needs of local markets.

## My take



*Parag Saigaonkar, Regional Managing Director, US India Consulting, Deloitte Consulting India Private Limited*

When Deloitte Consulting LLP established an offshore subsidiary in India (US India Consulting), we did what most multinationals do: We viewed the new organization as separate and subordinate relative to our existing operations, and adopted talent management strategies and programs that were serving us well in more established economies—almost as if we were setting up an “American embassy” environment in India. This standard model was a reasonable starting point; however, we have since made significant improvements to reflect the various needs and attributes of the local market. The resulting hybrid—which continues to evolve as the market matures—helps us harness the full capabilities of local resources while boosting our brand appeal in an increasingly competitive talent marketplace.

In the United States and other Western nations, there tends to be a strong delineation between work and family. But in many emerging economies, a person's career is more than just personal—it's a family affair. Case in point: At a recent group meeting, one of our employees stood up and told the crowd that his job hadn't just changed his life, it changed the entire future of his family, and that his father was now being invited to participate in social events and other prestigious activities that were previously out of reach. To improve our engagement with families, we write letters to the parents of top performers to acknowledge their accomplishments and create a sense of shared pride. In practical terms, this informal recognition may be even more important than money.

In India, job titles and frequent promotions are important symbols of status and achievement. This presented a significant challenge, since our US organization has a flat structure with only six distinct job levels for professionals. We initially solved the problem by creating more than a dozen job levels tailored to India. However, as our India subsidiary evolved and became more important, we decided the top priority was to fully integrate it with our US operations so that employees in India could have the same career and advancement opportunities as anyone else in our firm. US India Consulting needed to be a vertical slice of the corporate pyramid, not just the bottom level. This was a major decision that affected every aspect of talent management.

The first challenge was to realign job levels in India with those in the United States. People were willing to accept this change because it increased their status within our global firm, and made it easier to advance and pursue career opportunities in other countries. To ease the transition, we made a conscious effort to address practical obstacles—for example, by continuing to use the fancier job titles in acceptance letters to help new employees qualify for mortgages.

Another important step was to enhance our learning and development programs beyond technical training. We created a leadership academy to help employees develop leadership skills and a strategic mindset, preparing them for a larger role in our global organization. We also established a communication "gym" where employees could develop advanced business communication skills by practicing presentations, getting videotaped to enable first-hand feedback and coaching, and listening to business audiotapes in English.

Blending leading practices from established and emerging markets produced a hybrid model that improves our ability to attract, develop, and retain top local talent. Looking ahead, we will continue to refine and enhance our talent management strategies and programs as the market evolves. Many of today's emerging market workers have much higher expectations than did their predecessors. In fact, one of the most important current trends is that local workers no longer view a ticket to America as the only path to achievement of goals; instead, they recognize the vast growth opportunities that exist "south to south"—either at home or in other emerging economies. Also, innovative practices that are still taking root in developed countries—such as greater inclusion of women in the workforce—should eventually be incorporated into every market.

Given current economic and demographic trends, it likely won't be long before emerging markets provide the majority of global talent. As this shift occurs, competition for talent will likely intensify. Our continued effectiveness hinges on adapting to the needs of local workers in a timely manner without sacrificing the advantages that attracted them to our global business in the first place.



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# Building on the BRICs

## Redraw the global map of opportunity and competition

By Kishore Rao, Ira Kalish, and Simon McLain

**BRIC countries have been effective stepping-stones for multinationals from developed nations. But as growth cools in the BRICs, where should multinationals turn? Seven new emerging markets are enticing alternatives, providing fresh opportunities—and competition—for businesses in Western countries.**

### Overview

The economies of Brazil, Russia, India, and China (the BRICs) have commanded significant attention in recent years as they transcended emerging market status and became global players. Now, as their growth pace decelerates, focus is shifting to a new tier of emerging markets, including Indonesia, Malaysia, the Philippines, South Africa, Thailand, Turkey, and Vietnam. The gross domestic product (GDP) growth in these new emerging markets has caught up with and even surpassed that of some of the BRIC nations, creating large numbers of middle-class consumers and spawning competitive local businesses.

Looking ahead, these new emerging markets could become significant B2B and B2C growth opportunities for multinationals from developed countries. But they are also producing tough competitors, both at home and abroad.

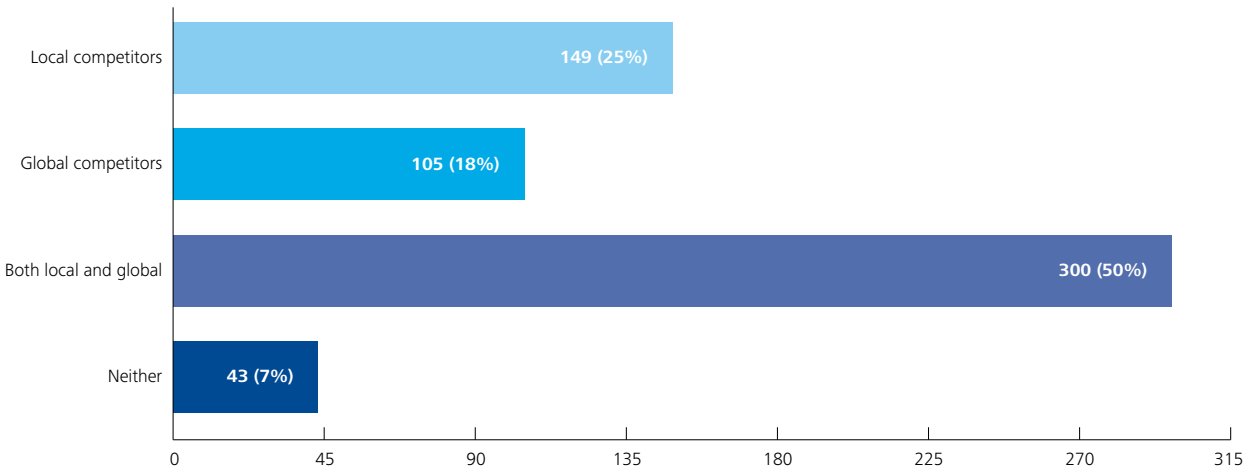
### What's driving this trend?

Five common traits of companies headquartered in the new emerging markets underscore the nature of this trend:

1. **Bursting onto the global stage.** Businesses anchored in these countries are effectively penetrating their own local markets and expanding aggressively into other emerging and established markets globally.<sup>1</sup> Three companies profiled in this report (headquartered in Turkey, South Africa, and the Philippines) have created a strong presence in multiple regions, including Europe and North America. Current direct investment outflows from the new tier of emerging markets increased to \$39 billion in 2012.<sup>2</sup> South Africa, which has met with BRIC representatives at their annual summit since 2011,<sup>3</sup> is the third-largest investor in least-developed countries, trailing only China

Figure 1: Competition in new markets (LinkedIn poll results)<sup>7</sup>

When your firm enters a new market, which competitors concern you most?



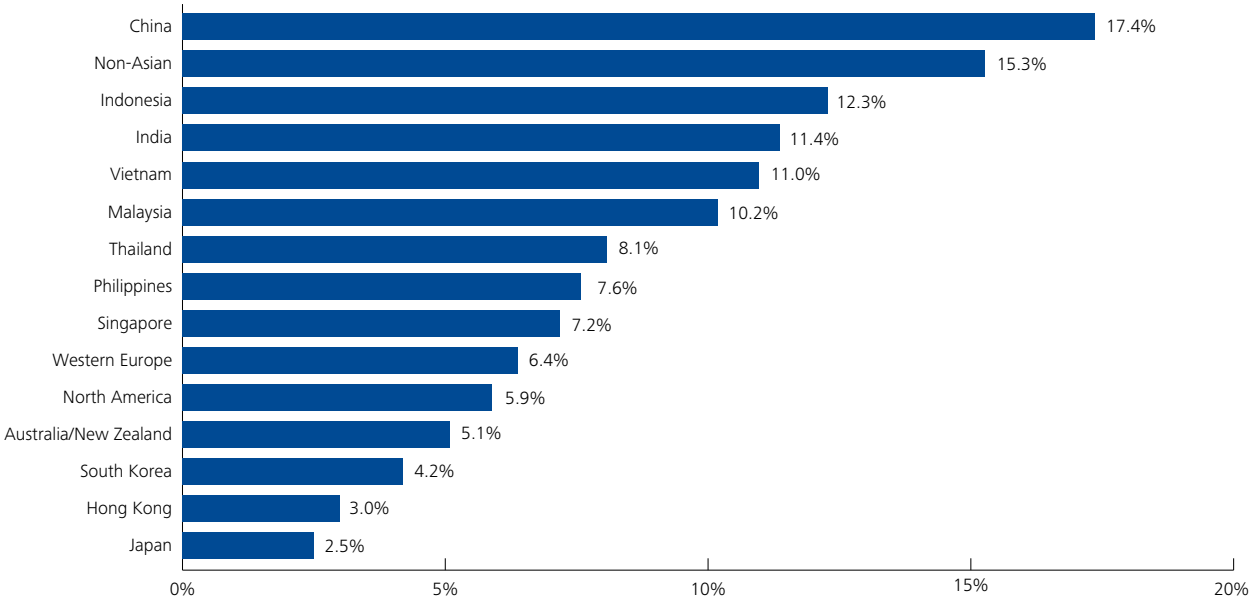
597 votes

and India.<sup>4</sup> Further, 36 percent of executives based in Southeast Asian<sup>5</sup> markets are making new market expansion a top priority.<sup>6</sup> Multinationals entering these markets will likely face stiff competition from local firms, companies from other new emerging markets, and multinationals from other Western countries.

2. **Hybrid business models.** Companies in new emerging markets are leveraging innovative products and business models perfected in their home markets, even as they pursue expansion in other emerging markets. This is an important objective according to executives based in Southeast Asia, who cited expansion into both Asian

Figure 2: Global expansion is high on the agenda of new emerging market companies<sup>8</sup>

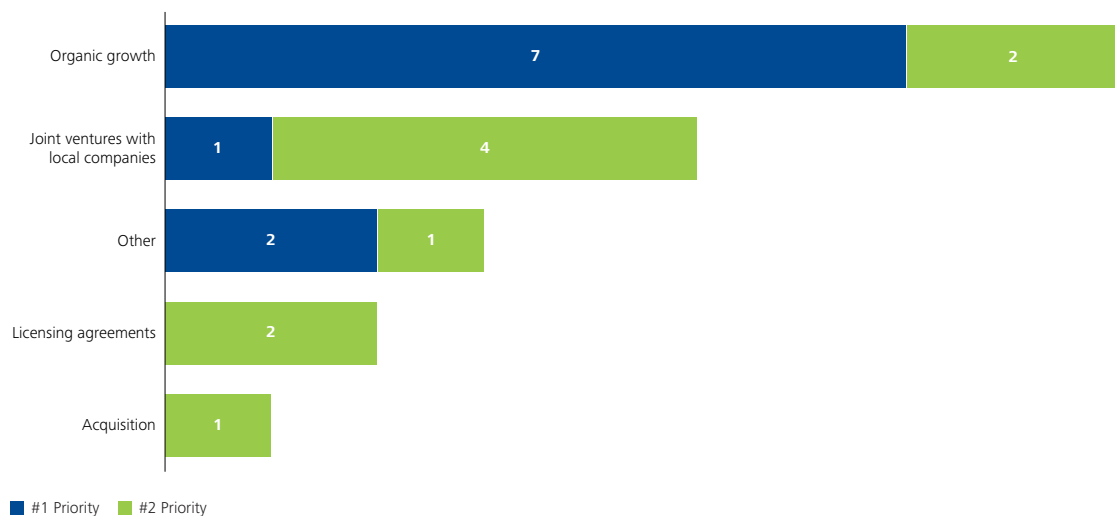
Results from the survey suggests that expanding into emerging markets is high on the agenda



Sample size: 234

**Figure 3: Many South African companies favor organic growth, but will likely use other strategies<sup>10</sup>**

Number of times ranked as a top two strategic priority by South African executives



Sample size: 11

and non-Asian emerging markets as among their highest priorities (see figure 2). We have seen this tendency in companies from other new emerging markets as well. They are likely to be strong contenders given their home-market advantage and the cultural and socio-economic similarities of the markets.

3. **Aggressive growth strategies.** Many companies from new emerging markets employ a potent combination of organic and inorganic growth strategies. Organic growth typically is the preferred method of expansion, yet inorganic growth is also a major factor in their plans. For example, companies based in South Africa are highly focused on organic growth in the next three years to increase revenue in emerging markets, but they'll also use joint ventures as needed (see figure 3).<sup>9</sup>
4. **Proximity to home markets.** This is an important consideration in the expansion plans of new emerging market companies. For example, two of the three companies featured in this report focused their expansion plans on countries within the

same region—Eastern Europe and Africa, respectively. This inclination is further evidence that Western multinationals are likely to face formidable competition in new emerging markets.

5. **Focused innovation.** Low-cost disruption is giving way to market-focused innovation and R&D as the basis of competition for local companies. Rather than merely offering “good enough” products at cheaper prices, these companies are focused on product and business model innovation to compete effectively. We’re not talking Silicon Valley-style innovation, but rather incremental shifts aimed at solving unmet needs, building brand strength, and improving customer service. For example, our featured company in Turkey employed innovations in barley production and corporate sustainability to gain a competitive advantage. The Philippine company we profile invests heavily in food products and tailored promotional programs developed specifically for the new markets it enters. Western multinationals may need to adjust their strategies to compete effectively against these approaches.



## Lessons learned: What works and what doesn't

Three main factors are helping companies in new emerging markets flourish—alongside their burgeoning economies.

First, although China and India are expected to lead all emerging markets in terms of real GDP growth in the near term, countries in Southeast Asia, Eastern Europe, and Africa are seeing strong economic growth rates, equal to or greater than that of BRIC countries.<sup>11</sup> They may even outperform Brazil and Russia by 2016 (see figure 4).<sup>12</sup> Such impressive GDP growth rates are the product of improved infrastructure and an expanding middle class. Local companies too are benefiting from strong organic growth at home and in similar nearby foreign markets. Of course, each country is growing at a different rate and, therefore, represents a different level of opportunity. But the opportunities appear to be strong overall.

Second, companies in new emerging markets often profit from local product and business model innovations. For example, many companies focus on just a few specialty

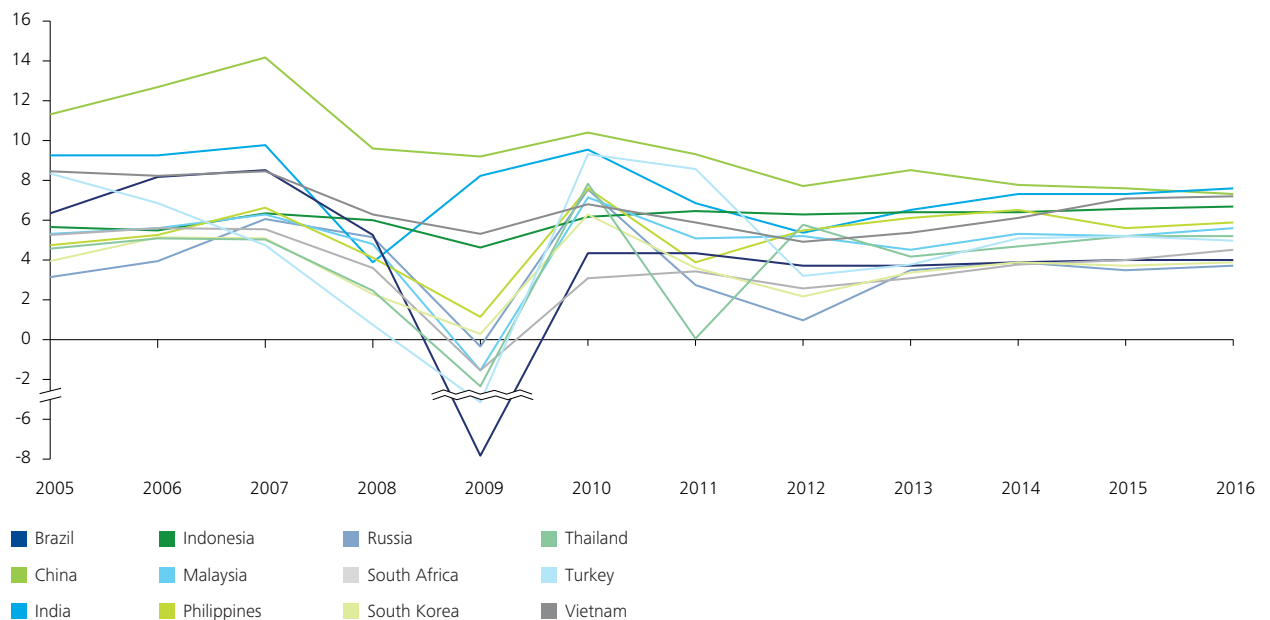
product lines when they enter a new market, requiring fewer and lower-scale facilities. Such structural choices can create sustainable competitive advantage. Often, emerging market competitors are also willing to sacrifice profit margin on individual products to gain market share, whereas multinationals from other countries may not.

Finally, participation in new emerging markets can require multinationals to undergo a steeper, more experimental learning curve than is typical in more developed countries. That learning curve is likely to be different in different markets, and may be steeper in some than others. Local companies, on the other hand, can often translate lessons learned from one emerging market to another more efficiently. This, when added to agile corporate governance structures, proximity to other emerging markets, advantageous cultural and ethnic factors, and a focus on long-term growth (rather than a capital market-driven short-term focus), can enable these companies to redeploy assets and capabilities easily and effectively.

These three drivers are self-reinforcing and multiplicative in nature. For example, strong

**Figure 4: Economic growth in new emerging markets is a compelling driver<sup>13</sup>**

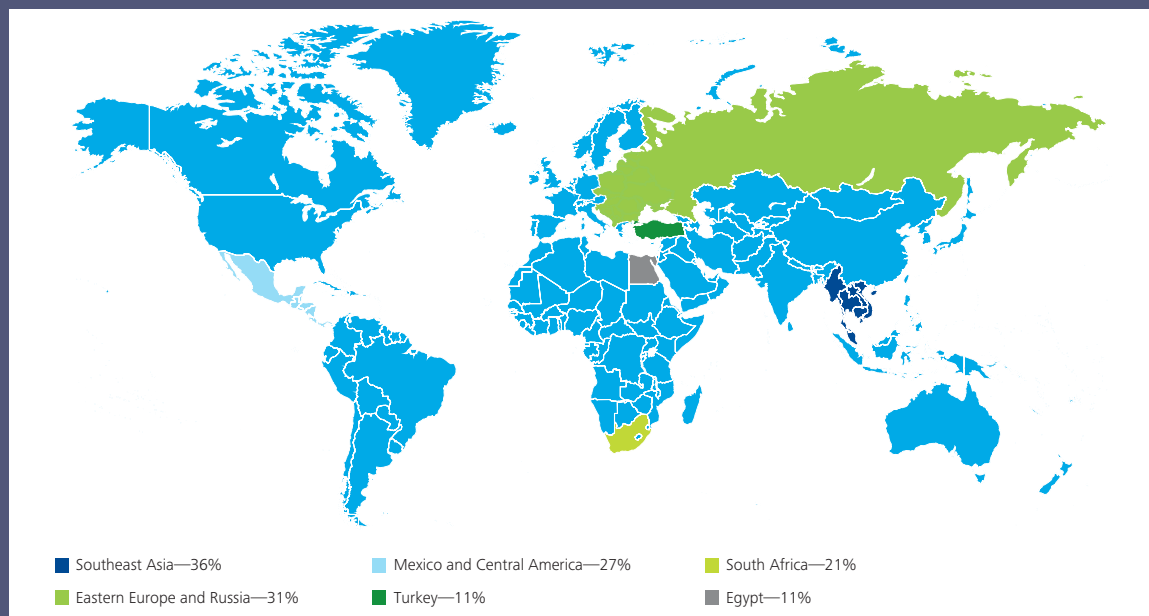
BRIC economies are no longer the only compelling growth story



## TELEGRAPHING THEIR MOVES

Many companies in developed nations that have no emerging market revenues are prioritizing new emerging markets for expansion ahead of the BRICs (see figure 5).

**Figure 5. Geographies prioritized for expansion by companies in developed nations with no emerging market revenues<sup>14</sup>**



growth often spurs strong investment in innovation, and that, in turn, can lead to timely deployment of assets, which reinforces and restarts the cycle.

### Looking ahead

The Building on the BRICs trend has four broad implications for Western multinationals.

#### **Business as usual will likely not prevail.**

Western multinationals expanding abroad into new emerging markets today may understand the importance of local relationships and use of low-cost operating models. But they also should understand hybrid business models, including:

- Developing market-specific product lines
- Reviewing ROI metrics frequently with a willingness to redeploy assets in a

timely manner to more profitable uses when necessary

- Dealing with structural impediments, such as limited telecom capabilities, slow or irregular supply chain partners, and undependable power supplies, by bringing more activities in-house
- Leveraging local market advantages, such as resources, labor, and willingness to adopt new technologies in a timely manner
- Adopting tactics used by emerging contenders, such as expanding in a timely manner into new markets, developing market-specific innovative products and services, and focusing on long-term growth

**Competitive threats from emerging market challengers will likely increase.** Emerging market companies are winning in their home

regions, and are now looking to expand into developed markets in Western Europe, North America, and Japan. For example, while smaller companies such as JFC are making inroads through gradual footprint expansion, BEKO—a Turkish appliance and consumer electronics manufacturer—has established a credible presence in a number of developed markets. This trend is likely to accelerate.

**Competitors will likely exploit structural advantages.** New emerging market companies possess many structural advantages, including streamlined operations and large, low-cost labor pools. They are also investing in R&D to drive higher product quality. Such companies are likely to challenge multinationals in developed markets through disruptive innovation strategies.

**Conventional business models could become obsolete.** New emerging market companies may deploy self-improvised, non-traditional business models that they have tested in emerging markets to overcome market constraints in developed countries.

New emerging markets benefit from strong GDP growth and locally headquartered businesses that are both aggressive and innovative. For Western multinationals looking to build momentum, even as developed markets continue to sputter, these new markets could represent the next major frontier. But it won't be easy. The leaders of the new emerging market companies could challenge Western multinationals, both in emerging markets and even in mature Western markets.

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## WHERE IT'S HAPPENING

A number of locally headquartered companies display many of the specific traits underlying our “Building on the BRICs” trend. The activities, strategies, and achievements of three companies, in particular, are prominent examples.

### Anadolu Efes

As a large beverage company in Turkey and one of the top 12 beer brewers in the world, Anadolu Efes exhibits all five traits of new emerging market companies:

*Bursting onto the global stage.* The company operates 16 breweries in 6 countries, runs soft drink operations in 10 countries, and exports the Efes brand to 74 countries.<sup>15</sup>

*Hybrid business models.* Anadolu Efes leverages product and business models perfected in Turkey to hedge risk before entering new markets. It frequently acts as a holding company by purchasing stakes in breweries and plants. It also creates subsidiary companies to oversee international beer operations and sales, and develops local product portfolios to build brand loyalty in new markets.

*Aggressive growth strategies.* To achieve strong growth in local markets, Anadolu Efes uses joint ventures and acquisitions for expansion, targeting breweries that lead sales in their respective countries. Seeking partners with complementary brand portfolios, logistics, and sales forces, it has partnered with SABMiller, Heineken, and ABIn Bev to break into nearby markets, and expanded its portfolio to include beer varieties and cocktail mixers.

*Proximity to home markets.* Although growing, Anadolu Efes has set its sights on markets close to home, such as Eastern Europe, the near Middle East, and North Africa, and has acquired breweries exclusively in neighboring countries. The company favors joint ventures with multinational companies that want to expand into Turkey and the region.

*Focused innovation.* Anadolu Efes has invested in improvements to seed quality and crop yield in barley farming, and has launched corporate social responsibility and sustainability initiatives, such as reducing fuel, water, and electricity consumption in barley farming.

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## Shoprite

Shoprite is a leading food retailer company in Africa. It exhibits four of the five traits of new emerging market companies.

*Bursting onto the global stage.* Founded in 1979 in South Africa, Shoprite today owns and runs more than 1,300 corporate stores and 400 outlets in 17 countries across Central and Southern Africa, employing roughly 100,000 people.<sup>16</sup>

*Hybrid business models.* One important aspect of Shoprite's business model is how it leverages experience in South Africa to enter other emerging markets, establishing retail locations in countries that generally have poor infrastructure and lack supply chains. In this way, it effectively competes against multinational retailers as they try to enter its markets. One of the biggest challenges Shoprite faces is locating shopping malls and complexes with adequate infrastructure. As a result, the company set up an entire division for finding real estate that supports operations in countries experiencing frequent power outages.

*Aggressive growth strategies.* Shoprite's primary growth has been organic, but it has also aggressively acquired companies in markets close to South Africa, which produce complementary products to its own. It also recently sought to acquire furniture, hardware, and other non-food retail brands.

*Proximity to home markets.* Outside of South Africa, Shoprite's largest footholds are in Namibia and Zambia, and the company is gaining ground in other Central and Southern African countries. It plans to investigate expansion to Western Africa in coming years.

## Jollibee Food Corporation

Jollibee Food Corporation (JFC) is a restaurant company headquartered in the Philippines. It exhibits all five traits of new emerging market companies.

*Bursting onto the global stage.* In addition to its own Jollibee brand fast food restaurants, JFC owns the Red Ribbon pizza chain, a Chinese restaurant chain called Chowking, and a number of other restaurant brands. Currently, JFC owns and operates approximately 2,500 stores globally, and is expanding its presence in Southeast Asia, China, and the Middle East.<sup>17</sup>

*Hybrid business models.* The JFC brand is largely differentiated by its focus on quality and strategy of increasing transaction volume rather than competing on price—a strategy it developed in the Philippines and exports to its other markets. It also tailors menus to local palates and uses effective advertising and promotions developed in its core market.

*Aggressive growth strategies.* JFC's aggressive international expansion has been achieved through a potent combination of organic growth, acquisitions, and joint ventures. It has opened approximately 25 stores in the United States in regions with large Filipino populations; acquired the Burger King franchise in the Philippines, along with a number of Chinese restaurant brands; and entered into a joint venture with Vietnamese restaurant chain SuperFoods to expand its reach in Vietnam.

*Proximity to home markets.* Until its expansion into the United States, JFC's expansion plan was, and to a great extent still is, focused primarily on Southeast Asia, East Asia, and Middle Eastern markets.

*Focused innovation.* JFC capitalized on its R&D and product innovation, introducing new products targeted at specific local markets, such as Saudi Arabia. Its Greenwich Pizza brand invested significantly in market research and consumer testing to develop a wildly popular new pizza crust. JFC's Hong Zhuang Yuan brand leveraged a new prototype restaurant, new products, and refinements to its service model to achieve 12 percent sales growth in 2011. The company's Mang Inasal brand achieved nearly 40 percent growth in 2011 due to new product, marketing, and promotional innovations.<sup>18</sup>

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# My take



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To achieve differentiating growth in the future, established multinationals will likely need access to a broader set of emerging economies—BRIC countries alone are no longer sufficient. The new emerging markets identified in this trend represent exactly that broader set of opportunities.

As they enter these new emerging markets, multinationals in many industries will likely face increasing competitive intensity from local and regional rivals. Winning will likely require the ability to translate customer and market insight into appropriate products and business models. Customer insight, as simple as it may sound, is remarkably hard for global players to achieve in new emerging markets. Another significant challenge is gaining access to those markets. What channels will be most timely, most efficient, and most profitable?

At the same time, there is a sense among local companies in new emerging markets—Thailand and Indonesia are good examples—that the gold rush is now. Many believe they have the opportunity to set the foundation and grow, with strong returns to capital for those that make a move sooner. There also may be a sense of nationalism that comes into play. Many corporate leaders I've met in some of these nations feel they are on a mission for their nations and are very connected to their role in society as stakeholders in their country's success.

Reinforcing these dynamics are trade and economic development policies in the new emerging markets. Changes to free-trade regulation are reshaping the competitive landscape and giving favor to companies headquartered in new emerging markets. Consider the 2015 objective of the Association of Southeast Asian Nations (ASEAN) to have a single production market to counterbalance those in China and India. Such policy changes can give competitors in those new emerging markets a degree of freedom that Western multinationals should understand really well if they are to compete effectively there.

Important questions for Western multinationals may include: Which markets are most favorable? How do you compete and win against companies that may be younger and less mature, yet potentially have a structural cost advantage or understand the local markets more fully? That's where the real battle will likely be in the future.



## Endnotes

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