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China Continues to Take the Lead among Emerging Economies

The global economic crisis that began in 2008 has affected most every country. Even China, which had achieved remarkable economic growth, has been greatly affected. The coastal areas that are highly dependent on exports have been suffering from serious difficulties in maintaining employment. China's real GDP (gross domestic product) growth rate in the first quarter of 2009 was 6.1 percent, which is a further drop from the rate of 6.8 percent in the forth quarter of 2008. In particular, Shanghai, which has the largest economic performance in China, has recorded a sharp downturn with the real GDP growth rate in the first quarter of 2009 being only 3.1 percent; this rate in the adjacent Zhejiang Province during the same period was 3.4 percent.

Because other major municipalities in the coastal areas were able to remain at a level of 6 – 7 percent, such as 6.1 percent in Beijing, 5.8 percent in Guangdong Province and 7.0 percent in Shandong Province, in terms of the real GDP growth rate in the first quarter of 2009, stagnation is pronounced in the areas along the Yangtze River such as Shanghai and Zhejiang Province, which had been the most advanced in achieving economic success in the past.

Turning to the inland municipalities, which have been less affected by the worldwide recession as compared to the coastal areas, all have attained high growth. Specifically, the real GDP growth rate in the first quarter of 2009 in Chongqing was 9.0 percent; this rate was 10.8 percent in Sichuan Province, 15.9 percent in Guizhou Province and 12.9 percent in Jiangxi Province.

The number of new cars sold in March 2009 in China hit a record high at 1.11 million cars. This strong demand was driven by increases in the number of small cars sold in the inland areas. The current Chinese economy can best be expressed by "west high and east low" (meaning high demand in the inland areas and low demand in the costal areas).

Looking at China's economic indicators in March 2009, exports fell 17 percent as compared to those in March of the preceding year, but showed improvement (up 10 points) from a dive in February. Industrial output rose 8.3 percent year on year, which was a rise of 5 points from the figures for January and February. Real estate sales in major cities in March also shifted to an increase. These indices suggest that the overall Chinese economy has been near to bottoming out although some large cities are still struggling with the impact of the global economic crisis.

In contrast, a situation similar to an economic bubble has been occurring in the inland areas and in some industries due to increased spending for large public projects and the relaxation of monetary policy. While China's two-year stimulus package worth ¥54 trillion (1 yuan = ¥13.60) announced by the central government is well known, the effect brought about by the relaxation of monetary policy is much greater. The net increase in lending by financial institutions was ¥22 trillion in January 2009, ¥15 trillion in February and ¥26 trillion in March. As such, huge amounts of money were supplied to the market. At the end of March, the money supply was up 25.5 percent year on year, scoring a record high growth rate. Recent moves such as the rise in China's stock market and the recovery of the real estate market in large cities are assumed to be largely attributable to these expanded money supplies.

China's aggressive measures to lift the economy out of recession will continue for some time until the government can unquestionably perceive that economic indicators have started to take a favorable turn. Actually, Premier Wen Jiabao said that China is ready to launch new stimulus measures at any time if needed. The government has already made huge investments in traditional priority fields including transportation infrastructure, environmental protection and energy conservation.

In addition, increased government spending is seen in extensive fields such as direct investments, subsidies or financial support by the government for enterprises if they are certified as ones pursuing high-tech businesses. While there would be concern over the generation of bad loans as a result of loose monetary policy, this situation can be described as a get-rich-quick opportunity that occurs once in 100 years for Chinese entrepreneurs rather than as an economic crisis that occurs once in 100 years. While it would be difficult for foreign capital companies to directly benefit from such government spending, it would be possible for them to indirectly benefit through relationships with Chinese companies and/or Chinese consumers.

India and Vietnam Rank High Next to China as Promising Countries

According to the Survey on Overseas Business Operations by Japanese Manufacturing Companies conducted by the Japan Bank for International Cooperation in July – August 2008, China ranked first as the most promising country/region for overseas business operations in the medium term (next three years), followed by India and Vietnam. This order remained the same since 2006, suggesting the high interest that Japanese companies have in these three countries. Among Asian countries, next to China, India was less affected by the current global economic crisis.

Next to India, Vietnam was less affected. While the above-mentioned survey was conducted before the occurrence of the worldwide economic recession, the order of China, India and Vietnam in terms of promising markets is coincidentally in proportion to the degree of suffering caused by the economic crisis.

India faces a chronic current account deficit because of a lack of major export industries. Such deficit has been offset by securities investments and direct investments in India from overseas and, in such a way, the country has accumulated foreign currency reserves. The following favorable cycle has contributed to the achievement of high growth driven by domestic demand in the past several years: by being attracted by its large population of more than 1.1 billion and an economic growth rate close to 10 percent, foreign capital companies have successively brought capital and technology to India; based on such capital and technology, workers' income has increased, which has led to increased consumer spending; and in view of such growing demand, foreign capital companies have made further investments in India.

In the face of the current global economic crisis, securities investments from overseas have decreased considerably, as might be naturally expected. However, consumption in the segment of low-income earners and in rural areas continues to remain robust. Accordingly, the economic growth rate in fiscal 2009 is projected at a level of 5 percent, which is the highest in Asia next to China.

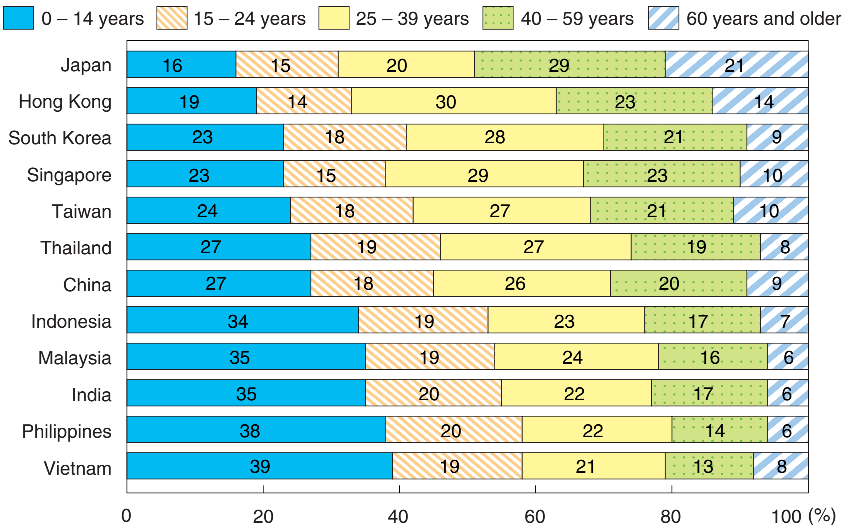
It is projected that some 500 million people will migrate from rural to urban areas in India by 2030 due to the urbanization of the rural areas and through urban sprawl. New households will emerge through such accelerated urbanization, creating huge demand for durable consumer goods.

Japanese companies are also highly interested in Vietnam as they are in India. Vietnam has continued to maintain an annual economic growth rate at a level of 7 percent since 2002. Since 2005, the country even recorded a level of 8 percent for three consecutive years. In 2008, because the rate in the fourth quarter dropped sharply to 5.5 percent (year on year), the annual growth rate for the whole of 2008 fell to 6.2 percent. The rate dropped further in the first quarter of 2009 to 3.1 percent, which leads to projections that the rate for the whole year in 2009 would decline to a level of 4 percent. Nevertheless, in 2010, the Vietnamese economy is expected to recover to a level of 6 percent, which is the highest level in Asia next to China and India.

One of the characteristics recently seen in the Vietnamese economy is the remarkable growth of its retail and service industries. The nominal growth rate of sales in the retail and service industries in 2008 was 31 percent year on year. Such high growth suggests that while foreign companies have so far positioned Vietnam as a production base, they are now paying greater attention to Vietnam as a market.

When we examine the market of consumer goods, we should pay more attention to the size of the middle-income stratum rather than to population and/or average per-capita GDP. While the population of Vietnam was about 86 million in 2008, it is projected that the population will exceed 100 million by around 2015.

Figure 1. Population of Major Asian Countries: Age Structure



Source: GeoHive (http://www.xist.org/)

Table 1. GDP (Gross Domestic Product) Projections for 15 Major Emerging Economies

(Unit: $ Billion)

	1995	2000	2005	2013
China	727.9	1,198.5	2,235.8	7,562.2
Russia	313.5	259.7	764.3	3,725.5
Brazil	769.7	644.3	881.8	2,020.9
India	354.0	461.9	783.1	1,977.6
Mexico	314.1	628.9	847.0	1,539.1
Turkey	223.7	265.2	482.8	968.2
Saudi Arabia	142.5	188.7	315.8	848.6
Indonesia	223.4	165.5	285.9	787.6
Iran	90.8	96.4	188.0	704.5
Argentina	258.0	284.2	181.5	502.6
South Africa	151.1	133.0	242.2	449.5
UAE (United Arab Emirates)	40.7	70.2	135.2	434.9
Nigeria	36.9	46.1	112.2	418.4
Thailand	168.0	122.7	176.4	396.8
Malaysia	90.2	93.8	138.0	322.1

Source: World Economic Outlook Database (October 2008, International Monetary Fund)

Another appeal of Vietnam is the large number of young people (see Figure 1) who are highly motivated to learn, with a literacy rate of 94 percent. The recent consumption boom seen in the urban areas is indicative that new-generation people becoming acquainted with the latest knowledge have been forming working households in urban areas, and that the number of these middle-class households has been increasing steadily.

Searching for Promising Markets among Emerging Economies

These days, we frequently hear the phrase "post-BRICs (searching for promising emerging economies subsequent to BRICs (Brazil, Russia, India and China))." The thinking behind this search is that because the US and Europe are the epicenters of the current global economic crisis, the recovery of demand in these advanced countries would inevitably be slow, and that in the early years of the 2010s, emerging economies would primarily drive economic growth. Japanese companies already have a profound understanding of BRICs through their research on these four countries. Accordingly, the focus of their interest has shifted to which are the most promising emerging markets subsequent to BRICs.

While it is difficult to define "emerging economies," Table 1 lists the projected GDPs (based on data published by the International Monetary Fund (IMF)) of countries other than advanced countries that have been achieving high growth recently and are attracting increased attention.

Looking at the projected GDP for 2013, China ranks first with an overwhelming difference and, as logically anticipated, BRICs occupied the top four positions. Following these four countries are Mexico, Turkey, Saudi Arabia, Indonesia and Iran. As such, countries having large populations or countries rich in natural resources in Central and South America, the Middle East and Asia are ranked high.

Among these emerging economies, countries that have large populations and robust domestic demand, and whose dependence on exports is relatively low are relatively immune to the current worldwide recession. In contrast, because the prices of natural resources have fallen substantially, countries that depend on exports of natural resources have seriously been affected by the current economic slowdown.

Among the countries listed in Table 1, a representative example is Russia. Russia has plunged into a substantial economic downturn with many negative factors coming to the fore all at once, such as a sharp decrease in revenue from exports of oil and gas, forcible withdrawal of funds borrowed by the private sector from Europe where procurement cost was low, capital flight overseas in anticipation of ruble depreciation, delays in wage payments and layoffs due to deteriorated company performance.

Other countries listed in Table 1 that are dependent on exports of natural resources face a similar situation although the extent of severity varies. Nonetheless, these countries should not be underestimated. When the economy of a resource-rich country falls, it falls in the twinkling of an eye. However, when it recovers, it recovers quickly. When clear signs emerge in the next several years indicating that the global economy has begun to recover, the prices of natural resources will undoubtedly increase.

Such increases will lead to the revitalization of the markets of resource-rich countries with Russia being the first. It should be judged that now is the time for these countries to build up their strength in anticipation of economic recovery.

While each individual country is generally seen as one market, one region can also be seen as one market. Figure 2 shows GDP projections by country groups (aggregated data). Looking at the GDP projections for 2013, China, a single country, accounts for an overwhelming amount.

Following China, however, the amount of the projected GDP is almost identical in Russia, Central and South America, and the Middle East and North Africa. While situations may vary by industry and product, the countries/country groups that warrant the highest attention would be China and Russia, followed by South Asia centered on India, the Middle East and North Africa centered on Turkey and Central and South America centered on Brazil.

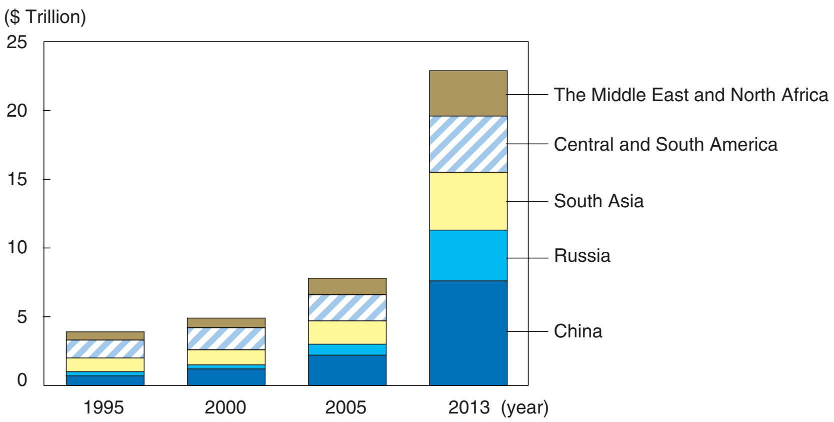
Developing Products that Bring about Success in Emerging Economies

No matter where companies operate businesses—BRICs or post-BRICs—in order to be a winner in these markets, companies must provide products that meet the needs of the consumers that live there. Consumers in these countries are generally sensitive to price.

There is an oft-repeated phrase about products: “one who can afford to buy it does not want to buy it; one who wants to buy it cannot afford to buy it.” Wealthy people (ones who can afford to buy products) pay much greater attention to value such as brand and design than to price and functionality, and completely ignore (do not want to buy) products designed for developing countries with a focus placed on price and functionality.

Conversely, people who want to buy foreign-made products equipped with advanced functions (middle-class

Figure 2. GDP Projections for Emerging Economies by Region



Notes: The Middle East and North Africa: Turkey, Saudi Arabia, Egypt and UAE
Central and South America: Brazil, Mexico and Argentina
South Asia: India, Indonesia, the Philippines, Vietnam, Thailand, Malaysia, Bangladesh and Pakistan
Source: World Economic Outlook Database (October 2008, IMF)

people in the target country = ones who want to buy) cannot afford it because the price is too high. In short, this phenomenon suggests that adequate product planning is lacking.

If the target customers are wealthy people, products at the level of those designed for advanced countries should be offered, rather than reducing the price to some extent and eliminating some functions. If the mass market (middle-class people) is targeted, products should be offered by thoroughly reviewing the design policy and drastically reducing costs.

It is difficult to unconditionally classify any particular emerging economy into a single segment. Among BRICs, for example, the product lineup that is similar to that offered for advanced countries can be offered in Russia where the per capita income has traditionally been high. While the size of India's market is large, the core households of the middle class principally consist of those with annual household income of around 200,000 rupees, which means that success cannot be achieved in this market unless prices are substantially reduced.

China has a skewed distribution of wealth—from extremely wealthy people to extremely poor people. As such, there are high-price range markets to low-price range markets. These differing conditions of each country naturally require marketing surveys and product introduction plans appropriate for each country.

If a company were to expand business in emerging economies in such a way as to offset slowdowns in the markets of advanced countries, the primary requirement would be to develop products that can lead to success in the markets of these new economies. Figure 3 shows the sales of Nokia's mobile phones in recent years, which indicates rapid increases since around 2004 in sales in emerging economies such as China, Asia, the Middle East and Africa, and South America. In order to attain success in the mass markets of these countries, it is essential to include mobile phones priced at $100 or below in the product lineup.

Of course, Nokia maintains a high market share in Europe with its high-priced products at the level of several hundred dollars. At the same time, Nokia is realizing a greater market share and increasing its sales by expanding its low-priced product lineup designed for emerging economies.

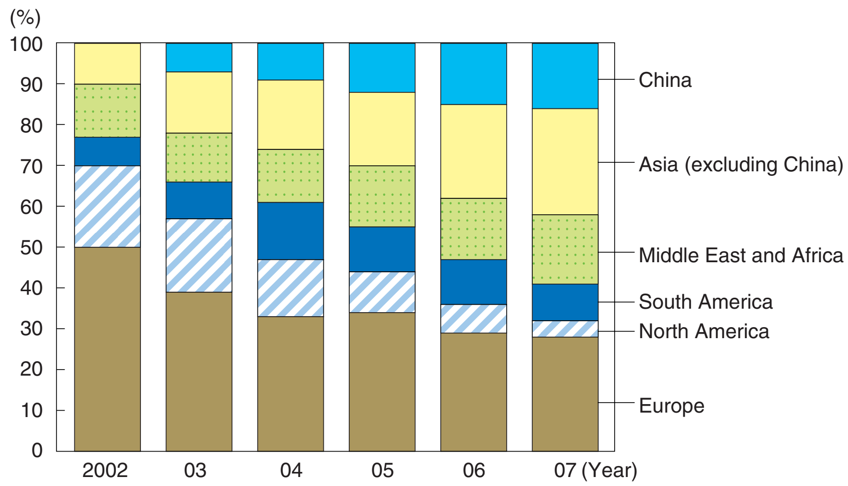
Nokia conducts only marketing and product planning; it outsources production to OEM (original equipment manufacturing) suppliers known as EMS (electronics manufacturing service) providers as represented by Taiwan-based Hon Hai Precision Industry Co. Ltd. (sales in 2008 were ¥5,500 billion). These EMS providers accept production contracts from many manufacturers of assembled products such as Nokia, thereby achieving overwhelming cost competitiveness through large-scale production.

If Nokia were to have engaged in the production of all its products, it would have been unable to offer product groups ranging from those targeting advanced countries to those aimed at emerging economies. In the field of electronic equipment such as mobile phones and PCs, it is possible to create product lineups by means of an international division of labor because the EMS industry has already been fully developed.

What about products other than electronic equipment for which EMS/OEM partners are available? Fundamental measures to reduce cost must naturally be adopted. These include developing designs in such a way as to reduce the number and cost of components in cooperation with component manufacturers to develop products aimed at emerging economies. It also means creating units and/or modules by combining multiple components to facilitate common use.

It should be noted, however, that if the product is an automobile, the price must be within the $10,000 range in order to offer products that are attractive enough for buyers in emerging economies. Can development of such a product be based on conventional design and development methods and production systems? If not, a

Figure 3. Percentages of Nokia Sales by Region



Source: Compiled based on Nokia's annual reports and other related materials.

change is necessary in the basic ideas behind the development of products.

While opinions are divided on their efforts, we should consider the objective behind the moves of local Chinese manufacturers in which they are attempting to commercialize electric cars in their own way that require a limited number of components, which facilitates the development of modules.

Someday, electric cars will become popular, promoting the reduction of component costs and the development of modules. By then, a company specializing in OEM of low-priced electric cars, which is similar to Ho Hai Precision Industry in the field of electronic equipment, might appear in emerging economies. Although the required specifications between automobiles and electronic equipment are different in terms of safety and durability, there is a reasonable possibility that electric cars will meet the needs of the mass markets of emerging economies.

Global Management Reform Aimed at Emerging Markets

Most every country has been working towards implementing measures to support financial systems and deploy economic stimulus packages. Nevertheless, the decline of aggregate demand has not yet come to a halt, principally in advanced countries. The business performance of Japanese companies that are highly dependent on overseas markets is projected to further deteriorate in fiscal 2009 as compared to the poor results recorded in the preceding fiscal year.

Until we can see clearer signs of recovery in the world market, it would be difficult for companies to embark on risky investments for which they cannot see an unmistakable return on investment. Accordingly, fiscal 2009 would be a year in which companies should retain and build up their strength in preparation for a resumption of improvement in the global economy.

The president of a machinery manufacturer said that "while activities in the sales and production departments are slow, staff members of the design and development departments are all busy." In view of the market trends after overcoming the economic crisis, these staff members are making every effort to develop new products.

This fiscal year would provide good opportunities for companies' R&D and design departments to settle down to thoroughly develop their strategies. For example, now is a good time for manufacturers to consider and select the fields to which they will give priority in order to establish a competitive edge and to consider and develop core technologies to differentiate themselves from others.

With the current trend of weak consumption, now is the time to strengthen the basic sales structure such as by reviewing sales channels, rebuilding sales agency networks to develop more dominant networks, reconsidering user services and analyzing supply chain management. Sales agencies would be busy spending their time to sell goods when consumer spending is active.

However, nothing can be sold these days without corporate efforts to hear customer opinions, enhance after-sales service and systematically increase customer satisfaction. Jointly with sales agencies, manufacturers should make the best use of the current economic slowdown since it provides good opportunities for discussing the most appropriate sales methods and providing education and training programs to members of the sales staff, thereby improving a company's marketing capabilities.

The same thing can be said to back-office departments. While back-office departments are fully occupied with handling an ever-increasing number of processes to respond to increasingly complex business operations when business is going well, business slowdowns would allow them to spend time to study business reform in a more relaxed manner. It would be a good idea to visualize the number of business processes in the back-office departments and consider the use of BPO (business process outsourcing) to drastically reduce cost.

What is first necessary during the recession is to review the fundamental factors underlying business operations and to firmly establish the basis of corporate strategies that consist of competitive products, strong sales capabilities and highly productive back-office operations that support core business operations.

Among others, an important factor in successfully evolving business operations in emerging economies is cost competitiveness. To this end, a drastic review is necessary for the design, development and production systems of products tailored to emerging economies.

Targeting emerging economies that are new global markets, companies would have a number of themes on which they should scrupulously consider strengthening their bases during this period of global economic slowdown. These include R&D structure, supply chain and business management information systems, human resource development, sales and service structure and appropriate head-office functions necessary for global management in the future.

How skillfully a company uses this one-year period to prepare for the recovery of the global economy is all up to the decisions of a company's top management executives who are positioned to supervise overall business operations.

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