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From Brazil's multinationals, important lessons about geographic expansion

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Executive summary

Growing numbers of companies based in emerging markets are moving beyond their borders to claim a share of global trade in everything from apparel to city buses. But this trend shouldn't be mistaken for a continuation of the "made in China" era, when developing countries served mostly as sources of cheap labor and low-cost goods. Nowadays, emerging market companies are more likely to be big, ambitious brands of their own. Companies from Brazil, China, India, and Mexico compete with Western rivals in every conceivable way, going after the same customers, the same revenues, and the same sources of capital.

Global expansion has emerged as a strategic imperative for emerging market companies with stunning speed, and the evidence is in Global 500 lists, where the ranks of these companies have swelled. But emerging market companies are still in a relatively early stage of globalizing, and like anyone doing something for the first time, they need some advice to find their footing.

To get a clearer sense of the challenges faced by emerging market companies as they globalize, Strategy& studied seven companies in Brazil — a country that has emerged as one of the great economic success stories of the last decade. In deconstructing the journeys of Brazil's rising multinational companies, we arrived at a framework for companies that are new to globalization. The framework breaks down the major areas that multinationals must think about, including their strategic intent and operating models, and offers a comprehensive view that will be useful not just to Brazilian companies but to emerging market companies everywhere.

Beyond "made in China"

Up until a few years ago, whenever anyone talked about companies expanding internationally, they usually meant Western companies expanding into fast-growing emerging markets. Western companies, after all, had the necessary resources, brands, and infrastructure to start operating far from home. Western companies also had the motivation since, for many of them, emerging markets represented a chance at growth they could no longer get in the mature markets where they had operations.

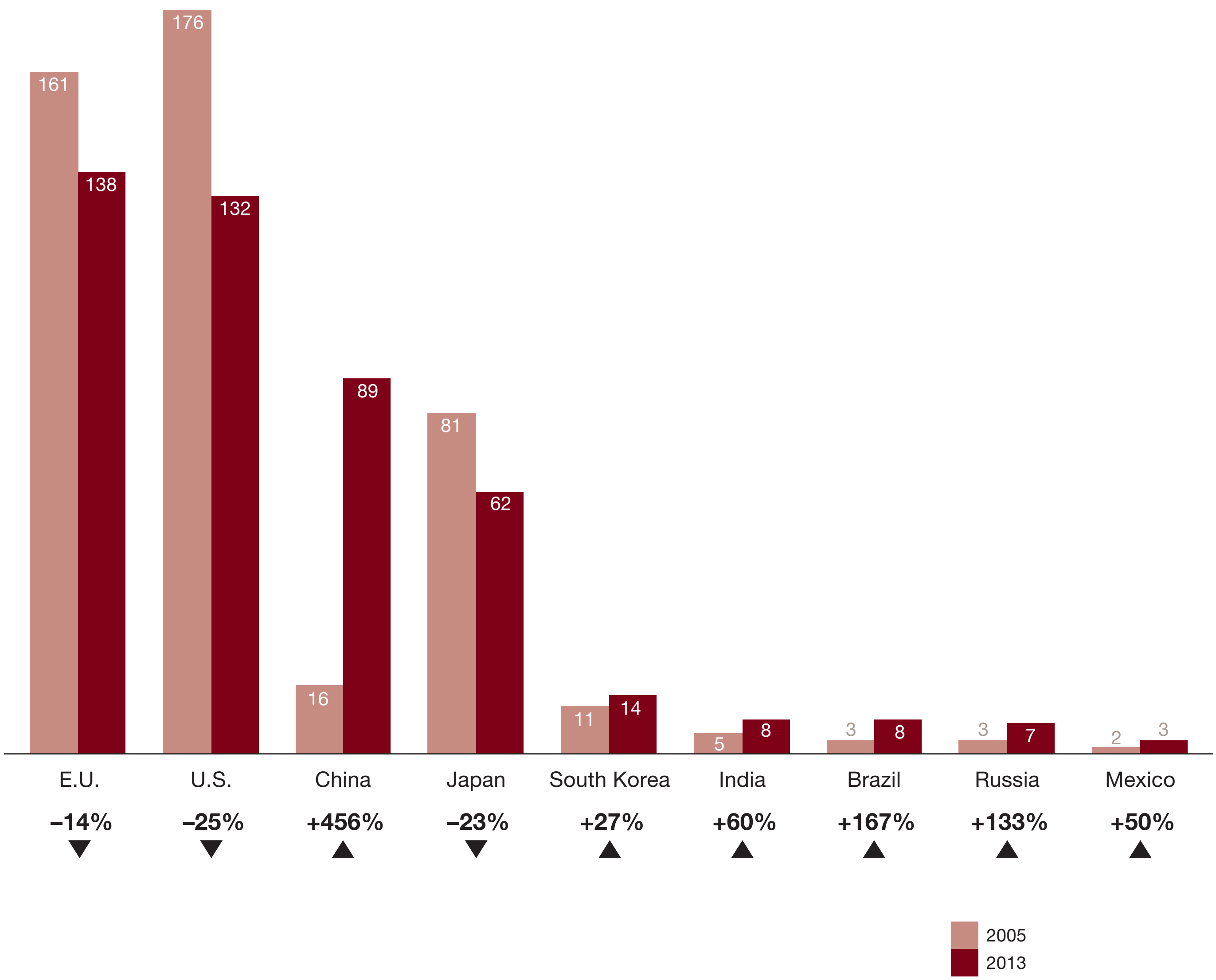
Many Asian and Latin American companies are flexing their muscles abroad.

Nowadays, when you hear talk about international expansion, it's almost as likely to involve an emerging market company. Having benefited from growth at home, many Asian and Latin American companies are flexing their muscles abroad. On the lists of the world's biggest companies, those from developing markets are starting to displace some of their U.S., European, and Japanese counterparts (*see Exhibit 1, next page*).

Brazil is among several developing market countries whose multinationals (MNCs) are rising in stature. The country's large and young workforce, great natural-resource base, and relative economic stability have transformed it into a force in export markets and in foreign investment. With all these things coming together, the time has come to study how some prominent Brazilian MNCs are tackling the globalization challenge. These companies' experiences are relevant not just to other Brazilian companies, but to emerging market MNCs everywhere.

Exhibit 1
A shift in influence toward emerging market companies

Companies in Fortune Global 500
(Number of companies, 2005 and 2013)



Source: Fortune Global 500

Companies in our study

- **Alpargatas**
  Apparel and footwear
  Revenue: US$1.59 billion
  International represents 30 percent

- **Banco do Brasil**
  Banking
  Revenue: $64.2 billion
  International represents 11 percent

- **Braskem**
  Chemicals
  Revenue: $18.9 billion
  International represents 16 percent

- **Construtora Camargo Correa**
  Engineering and construction
  Revenue: $2.7 billion
  Presence in nine countries across two continents

- **Embraer**
  Aeronautics and aerospace
  Revenue: $6.1 billion
  Presence in six countries across three continents

- **InterCement**
  Cement and construction materials
  Revenue: $3.48 billion
  International represents 56 percent

- **Marcopolo**
  Bus manufacturing
  Revenue: $1.64 billion
  International represents 31 percent

Revenue figures are for calendar year 2013.

For a new era of globalization, six key lessons

Emerging market MNCs are entering a far more competitive global marketplace than their predecessors encountered in the late 20th century. When PepsiCo started selling soda in Russia in the 1970s, or Carrefour opened a hypermarket in Argentina in the 1980s, or the Japanese electronics manufacturer Sharp started selling household appliances in poorer parts of Asia (Malaysia, Indonesia) in the 1990s, the competition wasn't as intense. Consumers in those countries couldn't find elsewhere what those companies had to offer — not at the same level of quality, anyway — and that made it possible to succeed without much expertise in local tastes.

On the organizational side, companies that globalized in that earlier era — we'll call it Globalization 1.0 — didn't have to go out of their way to customize for local tastes, employ local executives, or take account of local cultures. Some companies did these things anyway, out of a sense of what would work best in the long run. The dearth of competitors meant the foreign units of big MNCs could make substantial sales and contribute to top-line growth at their companies even if they added only limited local elements to their operations.

Today, an MNC is likely to face much stiffer competition and a more demanding consumer environment.

Today, an MNC venturing into virtually any country for the first time is likely to face much stiffer competition and a more demanding consumer environment. That means less time to get it right. Our study of Brazilian MNCs reveals six key lessons.

1. **Work from your capabilities on out.** Before they expand internationally, companies should take stock of their unique capabilities and determine whether those capabilities will retain their power in foreign markets. One example of a company that has done this analysis is Marcopolo, the Brazilian bus manufacturer. Marcopolo's differentiated capabilities include the ability to translate different customers' requirements into finished products, and an in-depth understanding of the economics of vehicle subsystems and parts. The first has allowed Marcopolo to increase the portion of business it does in foreign markets, including Colombia, India, Mexico, and South Africa; the second has allowed the company to establish a reputation for itself as a value player in its markets.

2. **Don't assume one management model fits all.** What works domestically may not work in a foreign country. MNCs must find the right balance between exporting management practices that have proven successful at home and adopting new practices better suited to countries they're entering. At the Brazilian apparel and footwear company Alpargatas, managers in Argentina, the U.S., and Europe (which collectively account for almost a third of Alpargatas' revenue) have considerable autonomy in product positioning, market development, and customer dealings. (Brand positioning continues to be handled out of the company's headquarters.) To increase the odds that its overseas operations will be successful, Alpargatas is increasingly relying on native-born managers who know the markets well.[1]

3. **Understand that foreign-country operations need autonomy.** Whenever a company establishes operations in a remote country, it creates a hub-and-spoke question: How much autonomy or decision-making authority to give to the foreign operation? This is a tricky question to answer, but some companies have figured it out. For instance, Banco do Brasil showed a lot of resourcefulness when it entered the Argentine retail banking market through an acquisition in 2010. Recognizing that there was a lot they didn't know and too much to do, executives at Banco do Brasil's headquarters created an interface between their central functions and their new asset in Argentina. In doing so, they managed to maintain control without becoming meddlesome, a balancing act that helped the Argentine subsidiary operate without disruption.

What works domestically may not work in a foreign country.

4. **Be open to situating operational and functional activities where they make the most sense.** Centralized corporate functions are sometimes a real strength, and can often serve far-flung operations quite well. The point is not to proceed as though every function *must* be centralized at headquarters. Locate these activities where they make the most sense. Embraer, the airplane manufacturer, is a good example. To be sure, most of Embraer's R&D is in Brazil. But the company manufactures private jet aircraft in China and the U.S. (where most of the customers are located) and has also opened two plants in Portugal. The Portuguese plants — one focused on metallic materials and the other on composite materials — are helping Embraer tap into Europe's technology expertise.

5. **Find and develop local talent in the countries you enter.** The practice of assigning homegrown executives to run new foreign divisions is common to MNCs all over the world. But if the senior management team does not also include some local people, it's missing a crucial element. The cement and construction materials

maker InterCement seems to understand this; it has relied on local talent in Argentina and Portugal and promoted executives from these operations to key positions.

6. **Get involved in the local culture.** When it was in the midst of expanding internationally, Mittal Steel (a company with roots in India that is now called ArcelorMittal) was looking for a way to turn around a struggling plant it was buying in Romania. On the advice of a local politician, Mittal built a Roman Orthodox church near the entrance to the plant, signaling to workers at the plant, where morale was low, that their efforts were valued and that they wouldn't be abandoned. The gesture helped Mittal not only in Romania but in other markets Mittal entered afterward, by allowing Mittal to cultivate a reputation as a citizen of the world. There are many ways to demonstrate sensitivity to local cultures. MNCs should find ways that suit the markets they're entering.

A framework to help emerging market MNCs globalize

Our study of Brazilian MNCs — and our belief that a big undertaking like geographic expansion becomes more manageable when it is broken into pieces — has led us to develop a framework for global expansion, with five dimensions (*see Exhibit 2, next page*). We'll devote most of the rest of this report to explaining these dimensions, using the Brazilian MNCs we studied as examples.

1. Strategic intent and differentiated capabilities. Strategic intent is about being able to offer something that fulfills customer needs. Differentiated capabilities are the three to six things an MNC does uniquely well — better than any competitor could do them — that allow it to serve those customer needs.

When companies embark on an international expansion effort, you would think they would have clarity on this first dimension. Surprisingly, they often don't — they are just opportunistically going where the money is. The capabilities side of the equation, if anything, is even more likely to be overlooked. Emerging market companies' advantage is often rooted in their connections in a market that has suddenly gotten hot. This makes them latecomers to the business of capabilities development and can keep them from succeeding in markets where they lack what might be called a home-field advantage.[2]

Brazil's MNCs have had some capability challenges of this sort, but there are also examples of companies that have paid close attention to this dimension and have the results to show for it. One such example is the chemicals company Braskem. As part of the sprawling Odebrecht Group, Braskem uses a system called TEO (short for Tecnologia Empresarial Odebrecht), which emphasizes entrepreneurship and accountability. TEO is essentially a capability based in culture — a flexible approach to business management — that has helped many Odebrecht businesses in their international expansion efforts.

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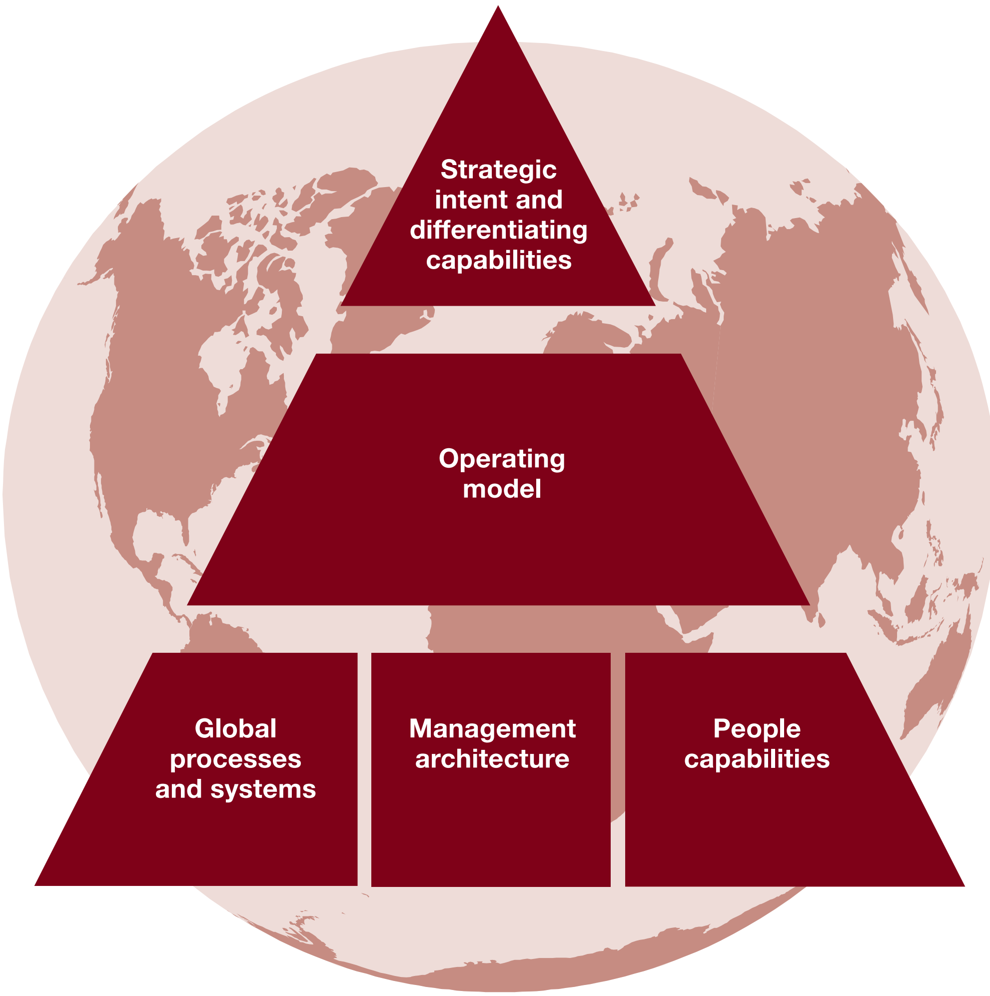
Exhibit 2
Global enterprise model framework



Source: Strategy& analysis

A set of five simple questions can go a long way in determining your company's international readiness

Success in international markets depends on many factors, including demand for the product you're planning to sell, the kind of competitors you're facing, and the regulatory environment. You'll probably be in a better position to succeed — whether your immediate objective is to enter one new country or a whole new continent — if you can answer "yes" to all five of the following questions.

- Are the capabilities that made us successful at home applicable in the new market(s) we're trying to conquer?
- Do we have a clear sense of how the demand for what we're selling will be different here than in the markets we're already in?
- Have we given local managers the autonomy they need to help us compete abroad?
- Are we performing critical functions and activities in the best possible locations?
- Do we have executives or board members who — by virtue of their international experience — can help us overcome any obstacles we'll hit?

2. Operating model. If the first dimension of successful internationalization is mostly a question of identity — what an MNC has that it can bring to a new market — this second dimension is about choices. The choices have to do with the degree to which the MNC plans on handing down a set of practices devised at home, versus being open to practices in the new country it's entering; with the control mechanisms it will put in place to manage its international assets; and with the organizational structure it will use for its international business.

Usually, the organizational structure isn't static — it evolves as the international business grows. InterCement, whose major international expansion moves have all happened via acquisition in the last 10 years, is currently using a centralized structure, with its international operations all reporting to a single executive (overseeing all individual country operations). It would not be surprising to see the company move to a more distributed structure, with geographic business units, as the volume and complexity of its international business (currently in Africa, Portugal, and South America) increases.

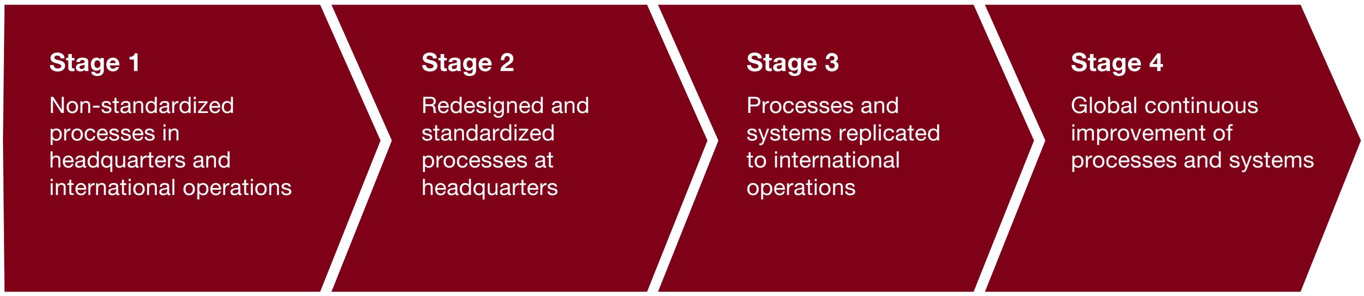
The organizational structure evolves as the international business grows.

3. Global processes and systems. By their nature, processes and systems are mechanisms of mature companies operating in competitive markets. In fact, there is a continuum of maturity that companies demonstrate in their approach to this dimension, starting with almost no standardization when they first expand internationally, all the way to standards that are continually being fine-tuned and perfected (*see Exhibit 3, next page*).

In addition to how long they have been around, another factor that usually influences how attentive companies are to this third dimension is the industry they're in. Of the Brazilian companies in our study, only the chemicals manufacturer Braskem and the aircraft manufacturer Embraer use global processes. The surprise would be if they did not: It is hard to imagine a chemicals company, or a manufacturer of aircraft, being able to globalize today if it did not have well-developed safety standards and procedures.

Capitalizing on its scale, Banco do Brasil uses a dual platform for its international division — with centralized processes to support foreign operations that have grown organically, and decentralized processes for newer international acquisitions. To ensure adequate control over foreign subsidiaries, the bank has strengthened its oversight in areas like planning, asset allocation, and risk management. The bank's international division (Banco do Brasil has 26 international subsidiaries) is responsible for coordinating the interfaces between international operations and HQ functional areas.

Exhibit 3
Processes companies have as they become more global



Source: Strategy& analysis

In industries where the need for process isn't glaringly obvious, Brazilian MNCs tend to be process-light. This is largely a function of culture; Brazilian organizations tend to put relationships and trust before systems and rules. At a big American or European company, an executive stepping into an important overseas assignment would think nothing of being handed a book of rules and procedures. A Brazilian executive would respond very differently, and less positively, to the notion that everything might be planned down to a T. As it happens, the greater faith in experience and trust over process is true not just of Brazil, but also of other emerging markets — China, Russia, and India in particular.

4. Management architecture. Senior leaders need expertise in the areas that are most important to their companies' futures. Companies that see international expansion as a major opportunity should have top executives or board members who have business experience in, or who are natives of, the target markets. U.S. MNCs clearly recognize the need for international diversity at the top levels; companies including Alcoa, Altria, McDonald's, and PepsiCo have, or have had, foreign-born CEOs. (Nissan, the Japanese automobile and financial-services company, has a Brazilian-born CEO, Carlos Ghosn.)

Brazilian organizations tend to put relationships and trust before systems and rules.

Boards of directors seem to be trickier in terms of international representation. Even on the boards of Western companies that do substantial amounts of business internationally, it is unusual to find foreigners, especially foreigners who didn't grow up speaking the company's home language. Besides language barriers, culture and trust may be part of the problem here.

In any event, emerging market companies have even further to go than developed market companies in terms of achieving international diversity in their top ranks. For instance, at the moment, there isn't a single foreigner on the boards of any of the Brazilian companies in our study. Even a modicum of international business experience (which should be more easily acquired) is a rare attribute on Brazilian boards. To be sure, the perception of better opportunities elsewhere for people with broad international experience may contribute to Brazilian MNCs' challenges in this area, as might language barriers (Portuguese is typically learned in only a few parts of the world). Adding international experience at the executive and board levels is something that MNCs in Brazil, and other emerging markets, should probably set as a future goal.

5. Human capital management. One of the advantages of going global, in addition to the opportunity for revenue growth, is getting access to new sources of talent. Depending on where the expansion is being done, the type of talent may be different. Western Europeans have a reputation for strong organizational skills. Americans know how to do deals. China and India have a vast supply of highly trained engineers. And there can be a special benefit to entering a country that was previously not well developed economically, and whose people are getting their first taste of economic advancement. People in such countries are often industrious and eager to learn.

To capitalize on the talent they encounter overseas, MNCs have to cultivate an openness to practices, approaches, and cultures they didn't invent. This can be especially challenging in M&A situations, where the talent is often incidental to the asset or market position the acquirer wanted. The default approach in these situations is often to dispatch homegrown executives to run the operation.

The balance that needs to be struck is between air-dropping a set of people and practices from headquarters and identifying foreigners who can step in and handle important roles. Construtora Camargo Correa has done the latter, recognizing that foreign-born executives may have an easier time working with the authorities and environmental officials who are critical to the company's success in foreign markets. Likewise, its corporate sibling, InterCement, is starting to rotate some of its executives through foreign operations in a bid to facilitate two-way learning.

Having a strategy to make the most of your international talent isn't only important at a management level; it's also important at a workforce level, and for reasons of talent mobility. To increase their flexibility and competitiveness, Brazilian companies need to take a more structured approach to organizing talent, and they need to start making overseas assignments a condition of advancement. These are things that most of them haven't yet done.

Brazilian companies need to start making overseas assignments a condition of advancement.

Conclusion: The new multinationals' advantage

This is a moment of opportunity for emerging market MNCs. Their domestic growth has built a foundation from which to expand internationally. Most emerging market MNCs remain behind their Western rivals in the maturity of their international operating models and in the sheer extent of their international experience. But if the countries they're going into are developing markets, emerging market MNCs have a hidden advantage. They know all about the inadequate infrastructures, lower-income customers, regulatory change, and exchange-rate fluctuations common to developing markets. They've dealt with these issues at home.

A lot of international expansion comes in the form of opportunistic "landgrabs," often through inorganic M&A moves. A deal is done, and then the acquirer has to get down to the distinctly less glamorous business of figuring out how to execute in the new country it has entered. The most successful multinationals are those that take a long-term view of internationalization, and work hard to get their capabilities, international business models, organizational structures, and systems and processes just right. In the end, it's not a transaction but a journey, one we expect more and more emerging market MNCs to undertake. With the locus of power shifting, these companies' time has come.

Endnotes

[1] Paolo Pigorini, Ashok Divakarian, David Suarez, and Ariel Fleichman, " "Managing the Global Enterprise in Today's Multipolar World," Strategy&, November 2011. http://www.strategyand.pwc.com/media/uploads/Strategyand-Managing-Global-Enterprise.pdf

[2] John Jullens, "How Emerging Giants Can Take On the World," *Harvard Business Review*, December 2013.

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