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From Crisis to Opportunity

How Global Challenger Companies Are Seeking Industry Leadership in the Postcrisis World

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The current financial crisis has had a massive impact on economies, industries, and companies around the world. This impact extends to companies in the emerging markets, including those comprising the 2009 BCG 100 New Global Challengers.[1] In the period leading up to the economic crisis, these 100 companies were among the most formidable new competitors on the global stage. Leveraging the many strengths they derive from their origins in rapidly developing economies (RDEs), these players were capturing significant global market share and creating superior shareholder value. But has the global financial crisis arrested their ascent or accelerated it? How have the effects differed for challengers operating in various industries and regions, including RDEs such as China and India, which have positive economic growth and significant stimulus packages, and developed countries with stagnant economies? And how should executives of incumbent multinationals expect these challengers to be positioned in the aftermath of the crisis? In these pages we explore these important questions and suggest some implications both for challenger companies and for multinational incumbents.

Our bottom-line conclusion: the challengers are still in the fight, aggressively reshaping their businesses for the new global environment and continuing to strive for global leadership. Though the consequences of the financial crisis are as diverse as the challengers themselves, many of these companies are poised to emerge from the crisis with an unprecedented degree of influence on their global industries.

Have some challengers been hard hit by the crisis? Certainly. Those that incurred heavy debt to pursue mergers and acquisitions (M&A) before the crisis, as well as those that serve highly cyclical industries, have been particularly affected and will face a more daunting recovery than others. Many are cutting costs, restructuring debt, selling off assets, and even divesting businesses to improve cash flow. Others are repositioning their efforts toward higher-growth markets.

Meanwhile, those challengers with adequate funding are using the financial crisis as an opportunity to gain stronger market positions and enhance their competitive advantage. Some are continuing to make global acquisitions, capture growth in home markets, invest in product innovation, or undertake multiple moves of this kind in combination. Chinese companies, able to tap into state capital and boosted by massive domestic stimulus spending within a large home market, appear particularly well positioned to make such moves.

For incumbent multinational companies, the lesson is clear: do not underestimate the challengers' postcrisis performance. Their role in the dynamics of many global industries has never been more important.

Impacts of the Financial Crisis

The financial crisis has affected both challengers and incumbents in various ways, both negative and positive. On the negative side, companies have seen falling global demand, rising capital costs, and declining equity valuations. On the positive side, governments have pursued stimulus programs, while increasingly cost-conscious consumers and companies have been drawn to some challengers' affordable offerings. And some effects have cut both ways: cheaper commodities have been a positive development for purchasers and a negative one for sellers. Currency fluctuations have also affected companies both positively and negatively.

1. The 2009 BCG 100 New Global Challengers are a carefully selected group of companies based in rapidly developing economies that are going global fast. For information about these companies, see *The 2009 BCG 100 New Global Challengers: How Companies from Rapidly Developing Economies Are Contending for Global Leadership,* BCG report, January 2009, available at www.bcg.com/publications.

Falling global demand has hurt companies of all kinds. Imports into the world's advanced economies in 2009 will slump 14.4 percent from 2008 levels, according to Goldman Sachs's *Global Economics Analyst,* July/August 2009, while consumer expenditures will fall 0.9 percent and domestic fixed-asset investment 14.1 percent. Already, reductions in demand in Europe and North America have triggered sharp declines in exports from major RDEs. China's 2009 exports are forecast to drop 13 percent from 2008 levels, while Brazil's are forecast to drop 12.7 percent.

Rising capital costs, similarly, have constrained both challengers and incumbents. As the financial crisis spread from the United States and Europe to other regions, companies around the globe found capital scarce and costly. At one time, even investment-grade borrowers had to pay interest rates as high as some 6 percent for 60-day loans. Companies with BBB ratings were paying rates of some 8 percent, compared with 4 to 5 percent in 2006 and 2007. In response, many governments have taken steps to inject liquidity into their economies. Nonetheless, several months into the crisis, financial risk premiums and the cost of capital remain significantly higher than they were before the turmoil.

Moreover, companies have found it difficult to use equity as currency because of the steep decline in stock prices and the consequent difficulty of issuing new stock or conducting initial public offerings. As the economic crisis developed, all stock indexes dropped significantly—some to their lowest levels in years—before the mid-2009 rebound. In some capital markets, such as China's, initial public offerings were suspended by regulators. Low valuations and the lack of opportunity in public offerings have made it difficult for companies—particularly those with large amounts of debt—to raise new equity to support continued expansion or to improve liquidity and lower debt ratios.

On the positive side, governments worldwide are pursuing various policies to restore their economies to full health. In addition to trying to improve liquidity, they are attempting to stimulate buying, boost consumer confidence, and assist industries in crisis. Such stimulus programs in the challengers' home countries are generally beneficial, helping them not only to survive the crisis but also very likely to emerge larger and stronger after it ends.

Meanwhile, consumers have become more cost-sensitive and have traded down to lower-priced goods—a trend that has benefited some challengers as well as some incumbents. Moreover, the massive business disruptions incumbents have faced as a result of the financial crisis have opened up opportunities for some challengers to expand. For instance, as companies in high-cost markets have looked to reduce expenses, they have sought lower-cost suppliers in RDEs. We expect RDE-based companies to gain market share in global export markets during 2009.

The large drops in commodity prices have affected some companies positively and others negatively. The cost of oil, for example, fell precipitously, from more than $140 per barrel in July 2008 to less than $40 per barrel in December 2008, before recovering to approximately $70 per barrel in mid-2009. Other commodities—including steel, aluminum, and copper—experienced similar plunges. The falling prices created serious pressures on challengers that sell such commodities, while creating a price break for challengers that buy them.

Currency fluctuations, similarly, have had both positive and negative impacts on companies. After the outbreak of the financial crisis, many countries saw dramatic changes in exchange rates. For example, in March 2009 the Mexican peso lost nearly 40 percent of its value against the dollar. It subsequently rebounded by 15 percent in mid-2009. Since the crisis began, the currencies of most RDEs have weakened relative to the U.S. dollar, though the degree of change varies widely. The Chinese yuan's value relative to the U.S. dollar remained virtually unchanged from July 1, 2008, through June 30, 2009, whereas the Russian ruble lost approximately one-third of its value against the dollar and the Indian rupee depreciated about 10 percent relative to the dollar in the same period. Such changes affect the relative competitiveness of different RDEs and the attractiveness of different export markets.

Despite these effects, many challengers have continued to push for global leadership, making bold strategic plays and taking advantage of the economic crisis, while carefully managing risks and shareholder returns.

The Challengers' Recent Performance

The list of RDE-based companies chosen for inclusion in the 2009 BCG 100 New Global Challengers was unveiled in January 2009, when the financial crisis was already in full sway, wreaking havoc around the world. (See Exhibit 1.)

Exhibit 1. The 2009 BCG 100 Global Challengers Represent 14 Countries

Argentina
- Tenaris

Brazil
- Camargo Corrêa Group
- Coteminas
- Embraer
- Gerdau
- JBS-Friboi
- Marcopolo
- Natura
- Odebrecht Group[1]
- Perdigão
- Petrobras
- Sadia
- Vale
- Votorantim Group
- WEG

Chile
- CSAV
- Falabella

China
- Aluminum Corporation of China (Chalco)
- Baosteel Group[2]
- BYD Group
- Chery Automobile[3]
- China Communications Construction Company (CCCC)[1]
- China International Marine Containers Group (CIMC)[2]
- China Minmetals
- China Mobile
- China National Chemical Corporation (ChemChina)[2]
- China National Offshore Oil Corporation (CNOOC)
- China National Petroleum Corporation (CNPC)[1]
- China Petroleum & Chemical Corporation (Sinopec)
- China Shipbuilding Industry Corporation (CSIC)[3]
- China Shipping Group
- COFCO
- Cosco Group
- Dalian Machine Tool Group (DMTG)[3]
- FAW Group[2]
- Galanz Group[3]
- Gree Electric Appliances[2]
- Haier
- Hisense Group
- Huawei Technologies[3]
- Johnson Electric
- Lenovo Group
- Li & Fung Group
- Midea Group[2]
- Shanghai Automotive Industry Corporation (SAIC)[2]
- Sinochem
- Sinomach (China National Machinery Industry Corporation)[2]
- Sinosteel[3]
- Suntech Power
- Techtronic Industries (TTI)
- VTech Holdings
- Wanxiang Group[2]
- ZTE

Hungary
- Gedeon Richter

India
- Bajaj Auto
- Bharat Forge
- Crompton Greaves
- Dr. Reddy's Laboratories
- Hindalco Industries
- Infosys Technologies
- Larsen & Toubro
- Mahindra & Mahindra
- Reliance Industries
- Suzlon Energy
- Tata Chemicals
- Tata Communications
- Tata Consultancy Services (TCS)
- Tata Motors
- Tata Steel
- Tata Tea
- United Spirits
- Vedanta Resources
- Videocon Industries
- Wipro

Indonesia
- Indofood Sukses Makmur
- Wilmar International[4]

Kuwait
- Agility

Malaysia
- MISC Berhad
- Petronas

Mexico
- América Móvil
- Cemex
- Femsa
- Gruma
- Grupo Bimbo
- Mexichem
- Nemak

Russia
- Basic Element[1, 3]
- Evraz Group
- Gazprom
- Lukoil
- Severstal
- Sistema

Thailand
- Charoen Pokphand Group
- Thai Union Frozen Products

Turkey
- Koç Holding
- Sabanci Holding

United Arab Emirates
- Dubai World
- Emaar Properties
- Emirates Airline[3]
- Etisalat

Source: BCG analysis.
[1]Replaces subsidiary company from 2008 list.
[2]Traded on the Shanghai or Shenzhen stock exchanges only.
[3]Privately held.
[4]Headquartered in Singapore.

Nonetheless, in the succeeding months, many challengers have continued to expand their operations on the global stage. Noteworthy examples include the following:

- Two Brazilian food giants, Perdigão and Sadia, have completed a deal to merge their worldwide operations, creating a combined entity, Brasil Foods (BRF), with much larger global scale.

- Hungary-based pharmaceutical group Gedeon Richter announced that its sales in the first half of 2009 had grown 17 percent when compared with the prior year, and that U.S. sales were up 59 percent. The company also announced that it had increased its research-and-development spending 44 percent in the same period, compared with the prior-year period.

- In May 2009, India-based Tata Motors launched a new premium truck range, which some have dubbed the "world truck." The truck was developed jointly by Tata Motors and its two subsidiaries: Tata Daewoo Commercial Vehicle Company, based in South Korea, and Tata Motors European Technical Centre, in the United Kingdom. The truck will be launched sequentially in markets around the world.

- Turkish conglomerate Sabanci Holding announced plans to expand both organically and through acquisitions, in retail as well as in other businesses in its portfolio.

- Sistema Shyam TeleServices, the telecommunications joint venture between Sistema of Russia and the Shyam Group of India, announced plans to invest $70 million in building a mobile communications network in India.

- In late July, the United Arab Emirates telecommunications company Etisalat bid for a telecommunications license in Libya as part of its globalization plan.

- Brazilian mining company Vale acquired coal assets from Cementos Argos in Colombia, and announced plans to acquire iron ore and potash assets in Argentina, Brazil, and Canada from Rio Tinto. Vale also increased its stake in ThyssenKrupp CSA, a joint venture with German steelmaker ThyssenKrupp that owns and operates steel plants in Brazil to produce slabs for the export market.

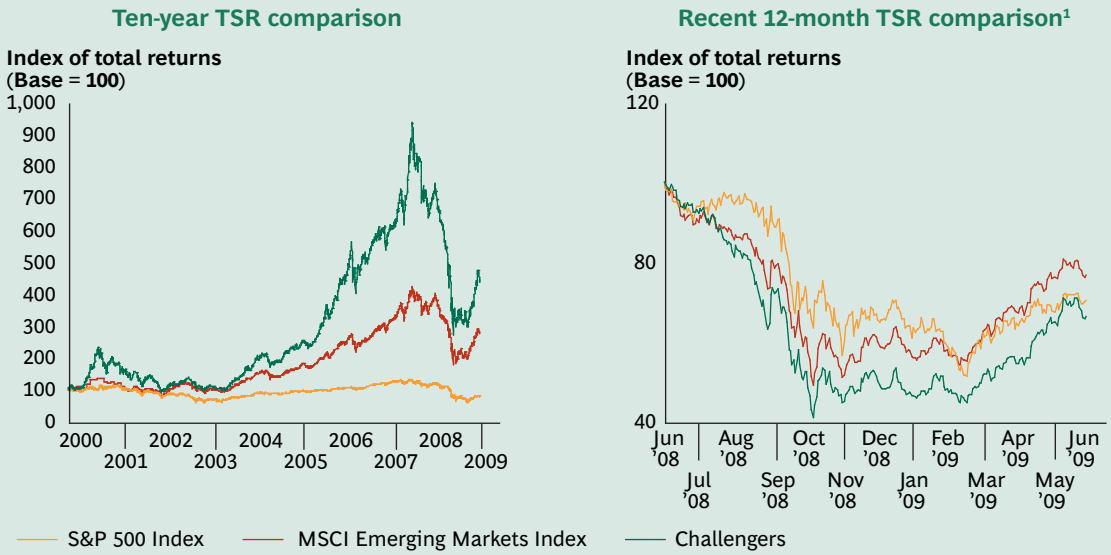
- Thai food conglomerate Charoen Pokphand Foods' flagship subsidiary, Charoen Pokphand Group, opened a feed mill plant in Russia; it also announced plans to invest further in its Taiwan affiliate, Charoen Pokphand Enterprise (Taiwan) Co., the leading agroindustrial and food conglomerate in that market.

- Agility, the Kuwait-based logistics provider, acquired Trafinsa S.A. de C.V. to expand its presence in Mexico, and Oy O. Nyström & Co. AB in Finland to further strengthen its platform in the Nordic region.

In addition to making major new global commitments such as those listed above, the challengers have continued to closely manage their total shareholder return (TSR) performance. The Boston Consulting Group recently analyzed the TSR of 79 publicly traded challengers and compared it with the TSR of both the Standard & Poor's 500 Index (S&P 500) and the MSCI Emerging Markets Index. (See Exhibit 2.) Historically, the challengers have outperformed both of these indexes. However, as shown by our analysis of TSR over the 12 months from June 2008 through June 2009, as the crisis unfolded, the challengers experienced a deeper initial drop in TSR than either index. This drop primarily reflected significant declines in the stock prices of a few large companies in the energy sector, as well as sharp moves in the stock prices of some highly leveraged challengers. Since March 2009, however, both the MSCI Emerging Markets Index and the TSR of the challengers have rebounded faster than the S&P 500, as the relative growth prospects of RDE economies became clear.

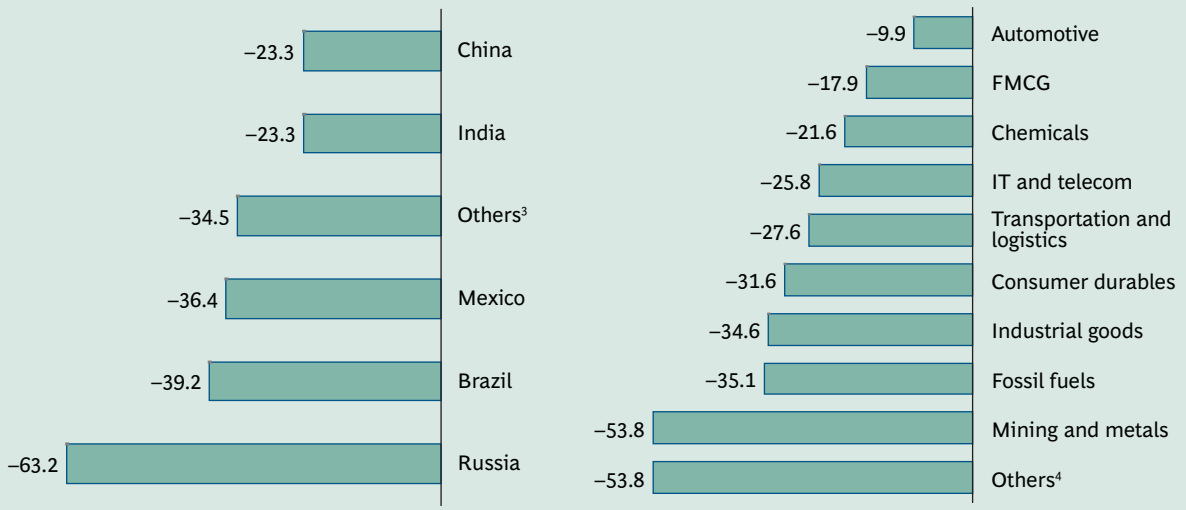
Against this background, we have analyzed the challengers' TSR performance along several dimensions: by country, by industry, and relative to their local economies and industries. Clearly, challengers based in different countries have achieved very diverse performance. For instance, despite having negative TSR, challengers based in China and India have had relatively modest declines in shareholder value. (See Exhibit 3.) These challengers certainly benefited from their stronger domestic markets and from their governments' stimulus programs. In contrast, publicly traded Russian challengers, which are mostly in the

Exhibit 2. Despite Historically Superior TSR Performance, the Challengers' Recent TSR Was Highly Volatile



Sources: Thomson Reuters Datastream; BCG analysis.
Note: The TSR index represents 79 challengers or their subsidiaries listed on the following stock exchanges: Bombay/Mumbai Stock Exchange, Borsa Italiana (main stock exchange of Italy), Budapest Stock Exchange, Bursa Malaysia (also known as Kuala Lumpur Stock Exchange), Dubai Financial Market, Hong Kong Stock Exchange, Indonesia Stock Exchange, Istanbul Stock Exchange, London Stock Exchange, Mexico Stock Exchange, Russian Trading System Stock Exchange, São Paulo Stock Exchange, Singapore Exchange, The Stock Exchange of Thailand, and Toronto Stock Exchange.
[1]Recent 12-month span: June 19, 2008, through June 19, 2009.

Exhibit 3. The Challengers' Recent TSR Performance Has Varied Widely by Country and Industry



Sources: Thomson Reuters Datastream; BCG analysis.
Note: All TSRs were calculated in local currency; numbers are as of June 2009; the total number of companies included is 79 because of data availability. FMCG = fast-moving consumer goods.
[1]TSR consists of capital gains and free-cash-flow yields from June 19, 2008, through June 19, 2009.
[2]Industry definitions are based on *The 2009 BCG 100 New Global Challengers: How Companies from Rapidly Developing Economies Are Contending for Global Leadership,* BCG report, January 2009.
[3]Other countries are Argentina, Chile, Hungary, Indonesia, Kuwait, Malaysia, Thailand, Turkey, and United Arab Emirates.
[4]Other industries are health care and real estate.

fossil-fuels and the mining and metals sectors, as a group have suffered more severe declines in their stock prices than other groups, driven by the drop in commodity prices over the period.

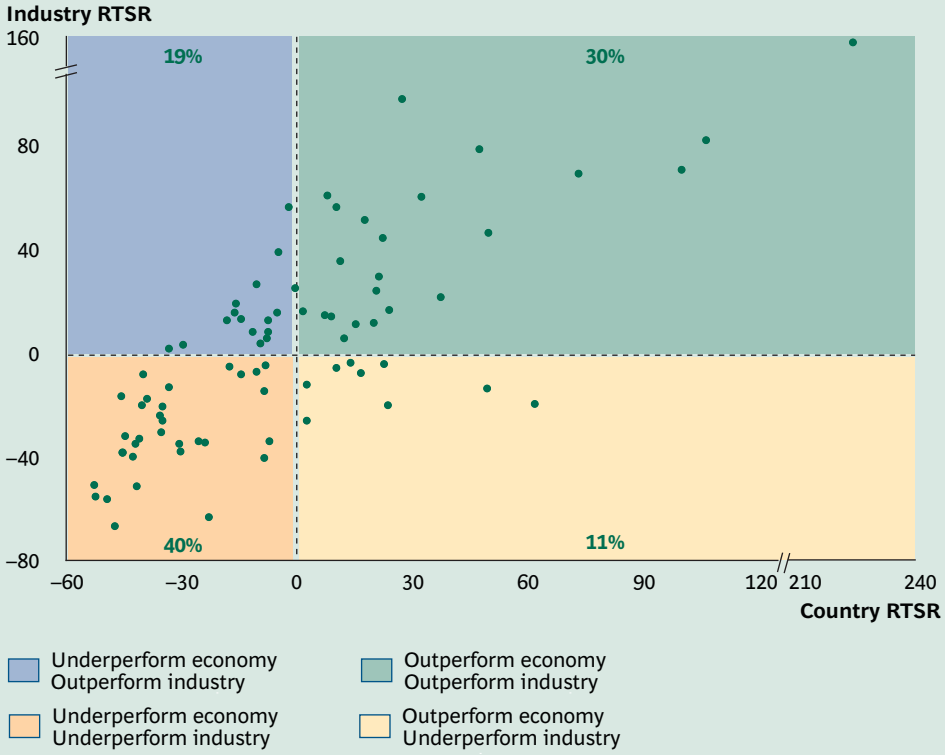
Similarly, the challengers' performance has varied widely by industry. Challengers in the automotive and the fast-moving consumer-goods (FMCG) industries have had a more modest TSR decline than challengers overall. Automotive challengers in China and India, in particular, are performing quite well, thanks to low cost structures and government stimulus programs. FMCG challengers—especially those that focus on essential products, such as food and beverages—face less cyclicality in demand. The consumer durables and industrial goods industries were hit especially hard, as consumers became more cautious in their spending on expensive and discretionary items and as demand from manufacturing and business sectors slowed. Not surprisingly, challengers in the fossil-fuels and the mining and metals sectors are lagging, and the latter group has been particularly susceptible to reductions in commodity prices and fluctuations in demand during the slowdown.

We also analyzed challengers' relative total shareholder return (RTSR) performance, as measured against their local economies and their industries, by benchmarking each challenger's TSR against the MSCI Emerging Markets Index and industry indexes. (See Exhibit 4.) The 24 outperformers in the upper right quadrant span eight countries (Brazil, China, India, Indonesia, Malaysia, Mexico, Thailand, and Turkey) and represent eight industries (automotive, chemicals, consumer durables, FMCG, fossil fuels, industrial goods, information technology and telecommunications, and transportation and logistics).

Among the outperformers, automotive players have fared particularly well, with very high RTSR through mid-2009. However, the FMCG and the IT and telecommunications industries also have quite a few challengers with strong RTSR.

The impressive performance of these 24 challengers rests on four contributing factors: their home countries' economic growth; their industries' well-being (as measured by the MSCI Emerging Markets Index);

Exhibit 4. Twenty-Four Challengers Have Outperformed Both Their Local Economies and Their Industries



Sources: Thomson Reuters Datastream; MSCI Emerging Markets Index; BCG analysis.
Note: Analysis based on the individual TSRs of 79 publicly traded challengers from June 19, 2008, through June 19, 2009.

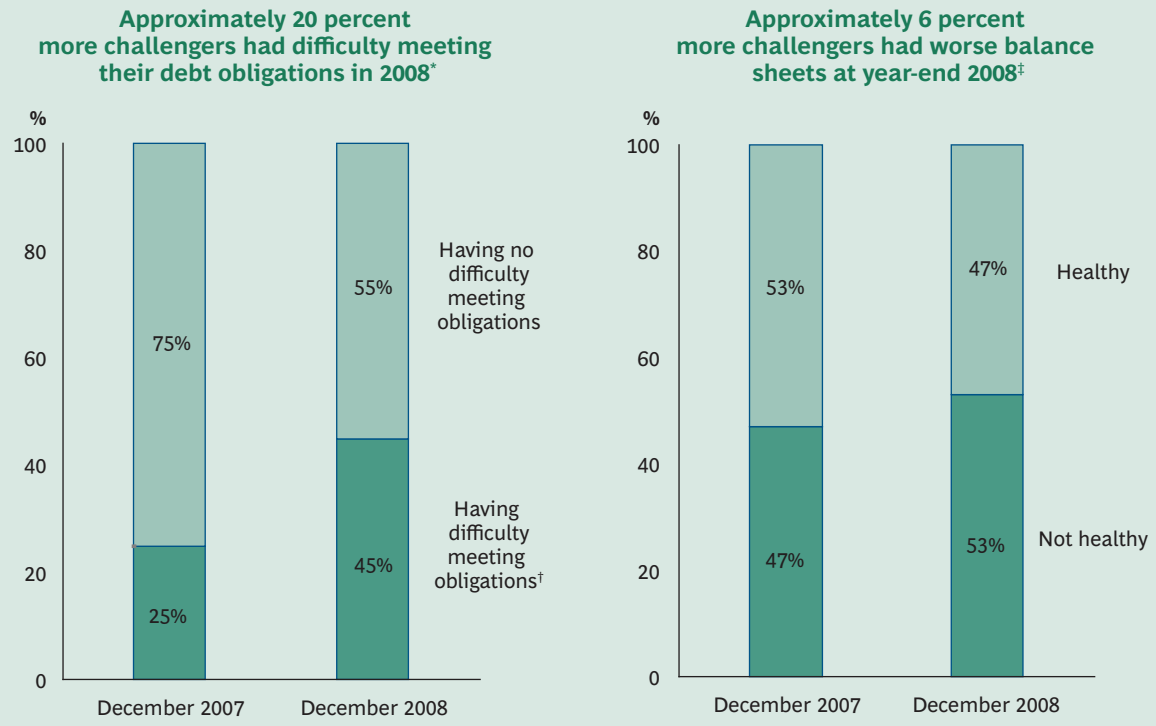
their own financial health; and their strategic responses to the crisis. Of the first two factors, the industry's well-being appears to have the stronger impact on RTSR performance. In other words, the health of a challenger's global industry has a bigger impact on its stock performance than the state of its domestic economy. This is to be expected, as a challenger's growth and profit opportunities are influenced heavily by demand and competition within its own industry.

In terms of financial health, a number of challengers have highly leveraged balance sheets. In some cases, this is because they acquired large amounts of debt before the financial crisis to fund M&A activities. Subsequently, during the downturn, they have had a hard time maintaining healthy liquidity and meeting debt payments. Some are struggling and face a more daunting road to recovery than others. At the end of 2008, some 20 percent more challengers were having difficulty meeting their debt obligations than at year-end 2007, as indicated by a decline in their solvency ratios, and some 6 percent more challengers had seen their debt-to-equity ratios climb above market medians. (See Exhibit 5.)

We also assessed the varying circumstances of the challengers by considering two dimensions: internally, the condition of their balance sheets, and externally, the level of opportunity in the markets they serve. As indicators of their financial strength, we considered their debt-to-equity ratios relative to their industry averages. As indicators of their market opportunity, we considered their respective home countries' GDP growth and the condition of their respective industries.

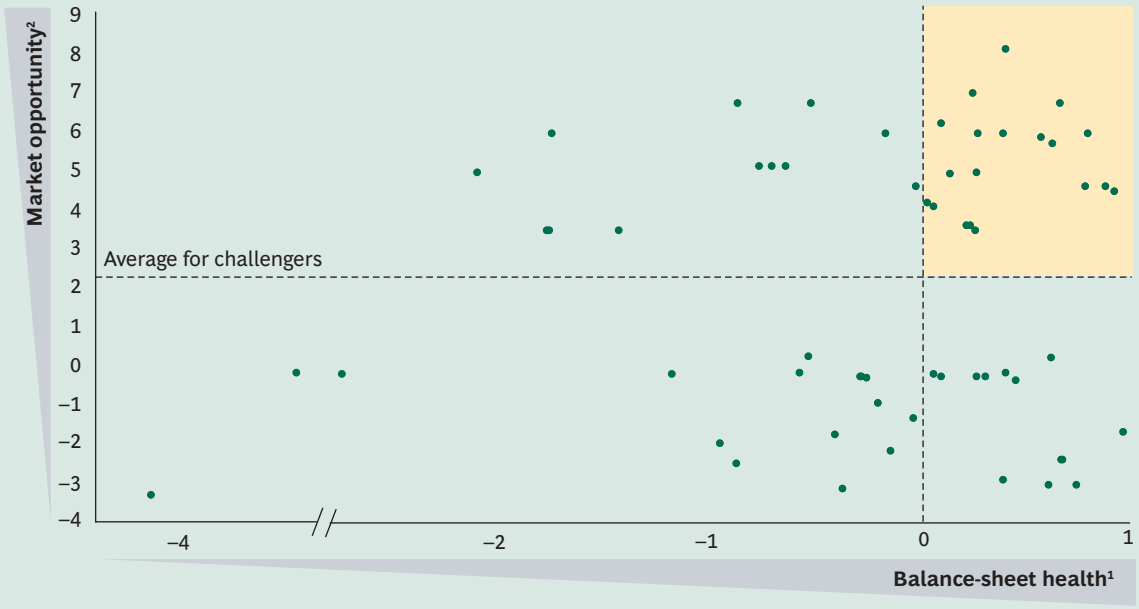
We analyzed 60 challengers for which information on these measures was available. The diversity of their circumstances is apparent. (See Exhibit 6.) On the positive side, 19 challengers are well positioned to take advantage of promising opportunities in their home markets and industries. These companies are likely not only to survive the economic crisis but to emerge even stronger than before.

Exhibit 5. Challengers' Financial Health Deteriorated from December 2007 to December 2008



Sources: Thomson Reuters First Call; Hoover's; BCG analysis.
Note: Analysis of debt exposure was based on 62 companies and 75 companies, respectively, because of data availability.
*Based on estimated debt-to-EBITDA ratios as of December 31, 2007, and December 31, 2008.
†Challengers with solvency ratios lower than 20 percent are regarded as having difficulty meeting their debt obligations.
‡Challengers with debt-to-equity ratios lower than 69 percent—the median debt-to-equity ratio of companies listed on U.S. stock exchanges (NYSE and NASDAQ)—are regarded as not healthy.

Exhibit 6. Balance-Sheet Health and Market Opportunity Affect TSR Performance



Sources: Thomson Reuters Datastream; Infinancials; Thomson Reuters First Call; BCG analysis.
Note: This matrix includes only the 60 challenger companies for which data are available.
[1]Balance-sheet health is a measurement of each company's debt-to-equity ratio compared with the average debt-to-equity ratio in its industry (from Thomson Reuters). The less debt a company has, the higher the score it receives.
[2]Market opportunity reflects challengers' home countries' GDP growth and their respective industries' conditions based on the MSCI Emerging Markets Index; the higher scores reflect better market opportunity.

The Challengers' Strategic Responses

Besides the health of their domestic markets, industries, and balance sheets, other factors affecting challengers' performance include the strategic and tactical choices they make and the flexibility and robustness of their business models.

Their first order of business is to ensure an adequate cash flow and a healthy balance sheet. Toward that end, challengers are reducing costs and restructuring their assets. For example, Severstal, a leading steel company in Russia, is focusing on restructuring its business and making it leaner.

At the same time, some challengers are taking the financial crisis as an opportunity to expand by executing one or more of the following strategic initiatives: acquiring resources, capabilities, and assets; globalizing through partnerships; capturing more growth in RDEs, particularly home markets; investing in innovation in new product segments; taking advantage of the trading-down phenomenon; and leveraging government stimulus programs.

Acquiring Resources, Capabilities, and Assets. Some challengers are recruiting valuable human resources as ways to integrate their value chains and strengthen global competitive positions. Galanz Group, a leading home-appliance manufacturer based in Guangdong, China, is an example. It is the world's largest maker of microwave ovens and has a strong balance sheet. Demand has held up despite the financial crisis because more people have been cooking at home during the economic downturn, driving sales of microwave ovens. In addition, Galanz has effectively capitalized on the Chinese government's stimulus program by setting its prices and product specifications to meet demand in rural areas, where a significant part of the stimulus program is focused. Moreover, the company's costs have dropped, thanks to falling prices for aluminum and steel.

Galanz is looking for technical experts and other professionals who have been released from large international companies. To accelerate the company's R&D programs, Galanz hopes to acquire entire R&D teams rather than individuals, so that a team leader can carry out an R&D strategy with an established group that is accustomed to working together. Besides research talent, Galanz is also looking for experienced managers with local knowledge and the capabilities to manage the company's overseas operations.

Some challengers are pursuing acquisition strategies in order to strengthen their market positions. For example, Grupo Bimbo, the Mexico-based giant in the baked-goods industry, has adopted this approach. In 2008, Bimbo bought the remaining U.S. fresh-bread and baked-goods operations of Weston Food, Inc. (WFI), the U.S. bakery business of Canada's George Weston Limited, for $2.5 billion. Bimbo had already bought another portion of WFI's U.S. operations in 2002. The more recent transaction allows Bimbo to unite WFI's brand across the continent and expand its presence by leveraging the combined distribution networks. The united operations will help Bimbo create stronger partnerships with national retailers. Bimbo also hopes to benefit from WFI's recent investments in modernized manufacturing capabilities.

To finance this acquisition, Bimbo was able to raise $1.7 billion in debt from financial markets, which increased its debt-to-EBITDA ratio to 3.3. (EBITDA is earnings before interest, taxes, depreciation, and amortization.) Despite Mexico's current economic downturn, Bimbo's leadership is confident that the company will be able to manage its increased debt. "It is large, but we can handle it," CFO Guillermo Quiroz said in an interview with *LatinFinance* on March 20, 2009. Quiroz based his confidence on the observation that people eat at home more during downturns, which will drive demand for Bimbo's product and generate steady revenue, allowing Bimbo to pay back the debt quickly. In fact, Bimbo's sales increased 46 percent in the first quarter of 2009, largely as a result of the WFI acquisition.

Other companies are using acquisitions to secure valuable assets. For example, on June 11, 2009, China Minmetals bought certain assets from Australia's OZ Minerals (the world's second-largest zinc miner) for $1.4 billion. OZ Minerals had been hard hit by tumbling commodities prices and needed to pay a bank debt of $880 million by June 30, 2009. The deal helped to solve OZ Minerals' financial difficulties while giving China Minmetals access to some of OZ Minerals' mining assets in Australia (except for the flagship Prominent Hill mine and other assets near Woomera, Australia's sensitive military area).

Zhou Zhongshu, president of China Minmetals, told *China Economic Times* on March 24, 2009, that the financial crisis was a very good opportunity for the company to expand overseas. Before the crisis, political issues made this kind of international acquisition difficult, even when a company had enough money to make such a deal. Today, circumstances have changed, and win-win opportunities are possible. China Minmetals can leverage the resources and managerial experience of OZ Minerals, whereas OZ Minerals can benefit from China Minmetals' strong cash position and good market situation.

Challengers contemplating acquiring assets should think carefully about their overall strategic direction and exercise particular care in selecting target companies. A target's financial health, as well as the risk associated with the acquisition, the future strategy of the company after it has acquired the target, and the potential for realizing synergies with the asset are crucial factors to be considered during a thorough due-diligence process.

Globalizing Through Partnerships. The goal here is to leverage a partner's business models, product portfolios, and distribution networks. Dr. Reddy's Laboratories, the Indian drug developer, offers a good example of this strategy. Dr. Reddy's formed a partnership with U.K.-based GlaxoSmithKline (GSK), the world's second-largest pharmaceutical company, to produce and market more than 100 products in emerging markets outside of India. Dr. Reddy's will make the products and GSK will license and market them in a number of countries in Africa, Asia-Pacific, Latin America, and the Middle East. In certain markets, GSK and Dr. Reddy's will comarket the products. This partnership will allow Dr. Reddy's to gain access to markets where it has little or no presence, at relatively low cost, by leveraging GSK's marketing and distribution channels. GSK, meanwhile, will gain access to more than 100 low-cost products by leveraging the regulatory dossiers and low-cost-manufacturing capabilities of Dr. Reddy's. Such partnerships with incumbents can provide a good avenue for challengers to gain affordable access to capabilities and markets.

Capturing More Growth in RDEs, Particularly Home Markets. For some challengers, the best prospects for near-term growth are in their own backyards. For example, Indian IT companies Infosys Technologies and Wipro are both capturing growth in their domestic markets. The economic crisis has hit their major developed-economy markets particularly hard, and high unemployment in those regions has led to protectionist sentiments that pose a potential risk: a reduction in the number of projects outsourced to India.

Meanwhile, the Indian IT market is continuing to expand, spurred by India's general economic growth and by increased investment in IT. Within the private sector, investment is particularly strong in the telecommunications, finance, and manufacturing sectors. Notably, there are many small-to-midsize companies that cannot afford their own full-fledged IT departments, and so constitute an opportunity for IT companies to offer modular solutions.

The Indian government, for its part, is pursuing e-government initiatives. The model for e-government is a one-stop portal, such as www.firstgov.gov, where citizens have access to a variety of information and services. The Indian government has plans to build the necessary infrastructure and systems to provide various online e-government services.

As examples of recent activity in the IT sector, Wipro has signed a nine-year IT outsourcing contract with telecom operator Unitech Wireless and a six-and-a-half-year contract with Employees' State Insurance Corporation. And Infosys recently signed a contract with India's Income Tax Department to set up a pilot central processing center to collect, digitize, and process income tax returns filed by businesses and citizens in the Karnataka and Goa region from 2009 through 2010. The company also has several customers in the private sector.

In order to meet customer needs in the Indian market, Wipro and Infosys are using transaction-based pricing, which bases contract prices on a set of parameters (such as, for banking clients, the number of transactions during the contract period) rather than charging a set price for building a system. This type of risk sharing can be attractive to customers while allowing vendors to benefit further when their customers' businesses do well.

But seeking customers at home does not necessarily mean doing the work there. Wipro is offshoring some jobs for customers in India and the Middle East to subcontractors in Egypt, which offers a low-cost workforce with relevant skills. In addition, Egypt provides attractive subsidies for training new recruits.

Infosys, meanwhile, plans to set up partnerships with providers of business-process-outsourcing services that have operations in India's rural areas and small towns. Its strategy is to cater primarily to the domestic market, meeting local demand for native language skills at low cost. Infosys expects this domestic business to generate significant gross margins.

Challengers should explore opportunities to expand in their home markets as well as into other RDEs as a way to capture growth opportunities during the general slowdown in the global economy.

Investing in Innovation in New Product Segments. Although some companies are choosing to cut costs and conserve cash during the financial crisis, BYD Group, one of the world's leading battery makers, is determined to grow—and toward that end has chosen to enter the electric car business. In 2008, BYD introduced the world's first mass-produced plug-in hybrid electric car, the F3DM. Since 2003, the company has invested more than $300 million in electric car innovation. BYD's new electric car immediately attracted widespread attention, as it represented an important milestone for the automotive industry.

With its advanced technology in battery manufacture, BYD aims to expand strongly into the automotive market. Though BYD faces competition (both General Motors and Toyota will be launching electric cars in the United States), as well as the slowdown of the U.S. market, BYD is determined to go ahead with this bold strategy. The timing of this move could work in BYD's favor. With key automotive players in developed markets significantly affected by the financial crisis, there could be more room for BYD to expand.

Taking Advantage of the Trading-Down Phenomenon. ZTE, a China-based manufacturer and supplier of telecommunications equipment, has been performing well despite the financial crisis, as shown in its

RTSR performance. At the same time, the company sees the financial crisis as a good opportunity for expansion. ZTE is the sixth-largest mobile-phone manufacturer in the world—and aims to become the third-largest (after Nokia and Samsung) in the terminal business by 2014. Examples of terminal products include mobile handsets, data cards, and walkie-talkies. The company's low cost structure and advanced technology are competitive advantages that have helped it expand into developed countries as well as RDEs. ZTE's low costs have proved particularly advantageous during the crisis, as budget-conscious consumers have been switching to lower-cost products. Meanwhile, ZTE is aiming to leverage its advanced technology by selling more higher-end phones in developed markets, such as Europe, Japan, and the United States. The U.S. carrier MetroPCS Communications has announced plans to buy 4G phones manufactured by ZTE, beginning in late 2010 or early 2011.

Leveraging Government Stimulus Programs. The automotive industry has been especially affected by the economic crisis because cars are both costly and durable—qualities that motivate owners to postpone replacing them with new ones. So a number of governments have introduced stimulus measures to spur sales in their respective automotive industries. The Chinese government, for example, is helping to boost demand by reducing the sales tax on cars with engines of 1.6 liters or less and by providing subsidies for rural residents who replace old cars.

In early 2009, Chinese automotive companies were expecting a downturn in the industry and slowed production accordingly. But the demand created by the government stimulus program was so unexpectedly strong that these companies actually ran out of stock. In May 2009, the China Association of Automobile Manufacturers raised its forecast of 2009 auto sales growth from 5 percent to 8 percent to reflect the strong surge in demand.

Chery Automobile, another China-based automotive challenger, had originally expected weak demand and set a conservative target of 200,000 vehicles for its 2009 sales. But because of the strong demand that in fact developed, the company achieved two-thirds of its target sales in the first four months of the year. It has said that if this growth continues, it would consider raising its sales target by 50 percent, from 200,000 to 300,000 vehicles.

The Chinese government's stimulus measures are designed to encourage people to buy smaller and more fuel-efficient cars. Chery's dedication to R&D in this area is one of the reasons that the company can capture the stimulated demand so effectively. Chery's QQ series of small, inexpensive, locally designed cars is one of the most popular types of cars in China's small-car market. And Chery is not alone in benefiting from the strong growth of demand in this market. Shanghai Automotive Industry Corporation, another Chinese automotive challenger, achieved 29.3 percent growth, on an annual basis, during the first six months of 2009.

Like China, India too has taken measures to stimulate demand in the automotive industry, although the size of India's stimulus package is smaller than China's. According to the Society of Indian Automobile Manufacturers, government incentives were an important factor in spurring increased auto sales in the first quarter of 2009. With continued support from the government's stimulus package, the sales of Indian automotive challengers are picking up. These challengers have also launched new product platforms to combat the slowdown. Mahindra & Mahindra, for example, believes that its new products, including the XYLO, new Muscular Scorpio, and Bolero, may help the company increase both sales volume and market share. During the 2008–2009 fiscal year, Mahindra & Mahindra's sales volume grew 3.3 percent and its market share swelled from 51.3 percent to 57.2 percent. The market's confidence in Mahindra & Mahindra is reflected in the company's good RTSR performance.

By capitalizing effectively on their home-country government stimulus programs, challengers can generate a significant amount of revenue relative to incumbents, which have only limited access to these programs. To capture the opportunity, challengers should act fast and tailor their strategies, marketing, and products to meet the stimulated demand.

In the above examples, each strategy described represents only a portion of the company's full strategic portfolio. In order to obtain a full picture of a challenger's performance, it is important to take into account not only the various strategies it employs but also competitive factors such as the market

opportunity it faces and the health of its balance sheet. (For a case in point, see the sidebar "The Huawei Example: Adopting Multiple Strategies to Effect a Transformation.")

Implications for Global Challengers

The global financial crisis has had traumatic effects on the challengers, as it has on many other companies. However, despite their relative youth, the challengers have had experience with economic turmoil in their home regions, such as the Asian financial crisis of the late 1990s. Moreover, challengers know that the competitive advantages of their RDE origins—low costs, abundant talent, and fast-growing markets—will be even more valuable in the postcrisis world. In that world, as challengers are likely to conclude from

The Huawei Example: Adopting Multiple Strategies to Effect a Transformation

Huawei Technologies, based in Shenzhen, China, is one of the world's leading providers of telecommunications and systems equipment. It has business in radio access networks, Internet protocols, broadband networks, core networks, software, services, and terminals. Huawei's competitive advantages—strong financials and advanced technology—are keys to the company's strategies for expanding into developed markets.

Network equipment is a large investment for telecommunications system operators, which typically need financing to purchase it. However, the financial crisis has made it difficult for some operators to access capital. Huawei, with its strong financials—and its Chinese background—can secure contracts by helping foreign operators get financing. Huawei can introduce operators to strong Chinese commercial banks, which have not been much affected by the crisis and are interested in overseas businesses.

In addition to helping operators with financial arrangements, Huawei occasionally employs mechanisms that allow carriers and system equipment providers to share revenues. Such mechanisms, like the transaction-based pricing in the Indian IT industry, base the price of a telecom solution on the revenue to be generated by the network, rather than specifying a fixed price up front. The carrier benefits by avoiding the need to make a large cash payment for the equipment before putting it into use; Huawei benefits when and if the network generates a lot of revenue. Only providers that are financially sound enough to postpone payment for equipment until after a system is built, put into use, and generating revenue can employ such mechanisms. Strategic options of this kind, which Huawei has at its disposal thanks to its healthy balance sheet and the stability of the Chinese financial market, put the company at a marked advantage compared with its foreign competitors during the present financial crisis.

Thanks to its financial strength, Huawei is also positioned to capitalize on M&A opportunities. It is seeking acquisition opportunities in developed markets, including foreign companies that are in financial difficulties, in order to obtain distribution channels in tier-one markets, as well as management talent. Because of Huawei's rapid expansion, it has considerable need for experienced executives who can transform it into a truly global company—and manage it.

In addition to obtaining capabilities through acquisitions, Huawei has continued to invest heavily in R&D projects despite the financial crisis. As a result, Huawei is among the top three holders of patents for promising new wireless technology known as long-term evolution, or LTE. Huawei is also rapidly developing new products based on other new technologies, such as small mobile base stations known as femtocells.

Huawei derives its revenues from both hardware and services. Currently, hardware represents a larger percentage of Huawei's revenues than services do, whereas at Huawei's international competitors this ratio is reversed. Earning a higher percentage of revenues from services is advantageous because service businesses yield larger margins than hardware businesses and grow more readily, as customers gradually demand more and higher-quality services.

The economic crisis has accelerated Huawei's transition from a low-cost hardware provider to a service-oriented company because during the crisis customers have been more sensitive to price while also expecting more service at the same cost. This expectation has created pressure for Huawei to transform its business model. Huawei aims to acquire professionals through its M&A activities to help it redesign its services in order to provide them to customers at prices and terms that are in line with those of their international peers.

the financial crisis, being big and strong on a global scale will matter more than ever. So the best challengers will accelerate their quest for that kind of size and scale.

The confluence of these two developments—the unprecedented importance of having home-market origins in RDEs and the accelerating ambition to seek global leadership—will prove formidable.

At the same time, challengers that are aggressively buying assets and acquiring competitors should be wary of taking on hidden risk or becoming overextended. It is critically important, especially during times of crisis, to exercise proper due diligence and study both the quality of the target company's assets and the health of its balance sheet. And companies should be very sure of their ability to repay any debt they incur in making aggressive expansions.

Challengers that acquire competitors, particularly from other regions, need to be prepared to expend considerable effort to integrate them. Often there are strong cultural differences that must be handled carefully. In particular, a challenger will need to properly manage any additional capacity it acquires in order to realize the economies of scale, cost reductions, and synergies that will play a key role in the repayment of its debt. Past experience demonstrates that when an acquired business is not properly integrated, the acquisition distracts management's focus and even lowers the company's efficiency. Moreover, such acquisitions often fail to realize the expected synergies and could be disastrous for challengers with lower-than-targeted cash flows, ultimately threatening their survival.

Finally, in order to become real multinational corporations and global leaders of their respective industries, challengers need to develop globally diverse management teams. It is critical that the team leading the organization has top-notch management capabilities and represents the full range of markets in which the company operates.

Implications for Incumbents

Tempting though it might be when facing financial difficulties, incumbents cannot afford to retreat to their home countries. RDE markets, though highly challenging, provide enormous growth potential and are key battlegrounds on which to confront global challengers. Ceding such markets will only enable the challengers to gain strength.

Incumbents should closely monitor the activities of the challengers in their industries, as the latter are taking the financial crisis as an opportunity to change the competitive landscape and contend for global industry leadership. Some incumbents may see the present crisis as challengers do: as an opportunity to partner with or even acquire companies in RDEs, especially China and India, in order to secure access to growth in those markets.

Another promising path for incumbents is to partner with challengers in acquisitions and divestments. Rather than competing with challengers for acquisition opportunities, incumbents can consider creating partnerships with them to bid for assets. This strategy would reduce the competition incumbents face and allow them to leverage challengers' strengths, such as deep knowledge of emerging markets.

Similarly, incumbents that want to divest some of their assets will likely find that prospective buyers include RDE-based players, some of which may be challengers. Incumbents should be prepared to thoroughly understand the challengers, as well as other RDE-based players, in order to make successful divestments. Deep familiarity with a potential buyer's situation and aspirations will prove invaluable in negotiating an attractive price and navigating through any politics to successfully complete a sale. For many incumbents, these are a whole new set of challenges.

The Imminent Challenge of the Postcrisis Era

As the world economy begins to stabilize, it is clear that RDEs are poised to play an increasingly prominent role in global growth, trade, and investment. Billions of workers in these economies are acquiring

ever-higher levels of education, skill, and experience, while the economies themselves are accumulating capital and building their productive capacity. Meanwhile, billions of consumers are wielding more and more spending power, which in turn is driving the growth of industries across RDE markets. And the companies resident in RDEs, most notably the global challengers, are gaining in overall capabilities, size, and influence on global markets.

In some industries, the financial crisis marks a turning point in the role played by global challengers. More challengers than ever before are now positioned to capture global industry leadership. Their ascent toward leadership will soon become the dominant dynamic within their respective industries. Incumbent companies must take urgent action to anticipate this dynamic and respond to it. It will be their most pressing imperative in the postcrisis world.

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