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BY JOHN JULLENS

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**T**he shadow of gloom cast over the global economy shows no sign of abating. More than 70 percent of CEOs believe growth will remain static at best over the next 12 months, according to PwC's most recent CEO survey. In January 2016, the IMF shaved another 0.2 of a percentage point off its global growth forecast for both this year and 2017, now projected at 3.4 percent and 3.6 percent, respectively. Even the typically supremely confident attendees of the annual World Economic Forum were subdued; Davos still offered plenty of snow this year, but otherwise precious little to write home about.

The immediate cause is, of course, the precipitous fall in global equity and commodity markets. They are off to their worst annual start ever, due primarily to the collapse in oil prices, concerns about Beijing's ability to successfully rebalance the Chinese economy, and weaker-than-expected economic data from the United States. But PwC's survey also points to longer-term concerns, such as overregulation, geopolitical uncertainty, and exchange rate volatility.

Investors are especially pessimistic about emerging markets, as the once-mighty BRICs — Brazil, Russia, India, and China — seem to have hit the economic development wall. Brazil and Russia are already in deep crisis, India is struggling to implement much-needed structural reforms, and China's economic slowdown is

rippling across the world's commodity and financial markets. Worse, emerging markets' challenges may be long-lasting. Many of these markets remain far too dependent on commodities, such as oil, which are unlikely to recover any time soon.

In addition, the coming fourth industrial revolution may impact emerging markets even more than developed economies. For example, the World Bank estimates that whereas automation may threaten about 57 percent of jobs in Organisation for Economic Co-operation and Development (OECD) countries, this figure rises to 69 percent for jobs in India, 77 percent in China, and a whopping 85 percent in Ethiopia. It's no wonder a recent study from the Center for Strategic and International Studies questions whether the BRICs still matter at all. And even Goldman Sachs, whose former chief economist Jim O'Neill, coined the popular acronym in 2001, closed its BRIC fund last November.

Fortunately, concerns about another global financial crisis seem overblown. The exuberance so memorably depicted by Michael Lewis in *The Big Short* may have been replaced by a pessimism that would make many a cold-blooded practitioner of the dismal science envious, but that doesn't make investor sentiment any more rational. For example, although there is no question that all is not well in China, an outright collapse remains highly unlikely. And despite heated campaign

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rhetoric to the contrary, the U.S. economic news isn't all bad — unemployment is down, and wages are on the rise. Moreover, although the negative impact of lower oil prices on exporting nations, such as Russia and Venezuela, may outweigh the corresponding benefits for net importers, the financial markets' reactions appear far worse than justified by the underlying fundamentals. The real issue is investor uncertainty and an excess supply of financial capital that encourages asset inflation, risk taking, and volatility.

Similarly, although recent headlines may have been unrelentingly negative, the major demand drivers remain quite strong in many emerging markets — and are likely to stay that way for some time to come. This is especially true in Asia, where populations are still growing, disposable incomes are still rising, and urbanization will likely continue unabated. For example, PwC has forecast that roughly two-thirds of future automotive industry growth until 2021 will come from the “developing Asia-Pacific,” region including 40 percent from China alone. Similarly, growth prospects remain strong in development-related sectors, such as engineering services, environmental technology, and infrastructure development, as well as in food processing, healthcare, and retail.

What has changed, however, is that the period of unambiguous growth is clearly over. In its place needs to come a much more sober assessment and far deeper understanding of the remaining opportunities and challenges in each emerging market. And that will require a new mind-set and different organizational capabilities for all stakeholders.

Many emerging market governments failed to take advantage of the recent boon years to implement the

structural changes required to wean their economies off primary commodities, upgrade their industrial base, and support the development of world-class domestic firms. This is partly due to poor governance, which remains a major impediment to growth in many emerging markets, including Argentina, Brazil, Russia, and South Africa. Now these countries need to implement new economic policies, improve their institutions, and become much better at developing home-grown competitive firms when it has become that much harder to do so.

Similarly, the challenge for those domestic firms themselves is not that emerging markets are suddenly passé, but that the easy phase is mostly over. Firms will have to accelerate their transition from being merely “good enough” to becoming truly world-class. They'll have to develop new capabilities and move into higher value-added activities, as well as start expanding into international markets, not just to gain market access or acquire technology, but also to gain exposure to the highest of performance levels.

Meanwhile, multinationals from developed markets already have world-class capabilities. But to continue to thrive in emerging markets, they'll need to up their game considerably; success will no longer be a function primarily of access and distribution. Instead, they'll have to develop a much more granular understanding of each market's growth opportunities and challenges, create truly local products, rethink their regional operations footprints, strengthen their local capabilities and organizations, and transition from a top-line focus on revenue growth and market share to a bottom-line focus on improving productivity and efficiency levels. For many, this represents a formidable challenge.

Finally, investors urgently need to return to investing in specific companies, instead of broadly defined sectors or even entire countries. It is important to remember that, in developed markets, relatively little of the considerable variance in firm performance can be attributed to the industry in which a firm operates — the remainder being a function of the firm's strategic choices as well as the resources and capabilities it brings to its competitive environment. As growth slows, we should increasingly see the same pattern for firms in emerging markets. Many attractive investment opportunities will undoubtedly remain, but primarily in firms that are well-managed and can appropriate the returns from a set of differentiated capabilities and other advantaged resources instead of merely relying on industry growth in general.

In other words, it's *schluss mit lustig* ("the party's over!") and back to basics for all. +

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