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New masters of management

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Pervasive innovation adds up to a new management paradigm



BUSINESS innovation in the emerging world has got to the point where all those individual advances add up to more than the sum of their parts. Just as Japan's quality circles and just-in-time delivery were part of a new system called "lean production", so the emerging world's reverse innovation and frugal production are part of a new approach to management.

This new management paradigm pushes two familiar ideas beyond their previous limits: that the customer is king, and that economies of scale can produce radical reductions in unit costs. Companies are starting with the needs of some of the world's poorest people and redesigning not just products but entire production processes to meet those needs. This can involve changing the definition of a customer to take in all sorts of people who were previously excluded from the market economy. It means cutting costs to the bone and eliminating all but the most essential features of a product or service. And it often stretches the idea of economies of scale beyond what the emerging Japanese giants of the 1970s could aspire to. Most companies in developing countries have access to large domestic markets and all of them have opportunities for mergers and acquisitions that did not exist a few decades ago.

But they are also extending economies of scale into new areas, potentially gaining bigger markets without the disadvantages of a centralised bureaucracy. They are also pushing the logic of economies of scale into sophisticated services that have traditionally been dominated by professionals who have little interest in efficiency gains.

The evolution of this new paradigm is strikingly reminiscent of the emergence of earlier management paradigms, particularly the rise of mass production in America in the 1900s and lean production in Japan in the 1960s. Emerging-market companies are harnessing technologies such as mobile phones and the mobile internet in much the same way as American companies harnessed the railroads and the telegraph. They are discovering

new customers, much as American companies discovered their Everyman. They are turning disadvantages (such as poverty and dreadful distribution systems) into strengths, much as the Japanese invented just-in-time production to compensate for their lack of storage space. This new management system, like all successful ones that went before it, is self-reinforcing. New technology allows companies to bring their services to more customers and to apply economies of scale to new areas. Globalisation allows them to cut costs by serving ever more customers.

There are good reasons to be suspicious of new management paradigms of any sort. Even the best ones can end in tears. Toyota, the company that was at the heart of the Japanese management revolution and thrived on it for years, is currently fighting off complaints about quality, the very thing that was supposed to define that revolution. And there are several objections to a new emerging-market paradigm in particular.

First, there is nothing new in any of this. Companies have always tried to put their customers first and cut costs. And many of the “de-engineered” products being made for the emerging markets seem to be just modern versions of the Model T Ford (offered in any colour so long as it was black).

The second objection is that this supposed emerging-market paradigm is just a set of disparate responses to different circumstances. There is arguably no such thing as a single emerging market, let alone an emerging-market paradigm. China enjoys a comparative advantage in manufacturing, India in services and Brazil and Russia in energy and commodities.

	China	Brazil	India
Ease of doing business	89	129	133
Starting a business	151	126	169
Dealing with construction permits	180	113	175
Employing workers	140	138	104

Source: World Bank

Third, it is argued, all this talk of new paradigms simply signals another manifestation of irrational exuberance: the overselling of emerging markets. In reality, emerging countries are plagued by huge problems. The 2010 “Doing Business” report published by the World Bank ranked India 133rd out of 183 for ease of doing business (see chart 5). China has a heavy-handed government and an inflated property market. Emerging countries in general continue to rely on cheap labour rather than innovation to drive their growth. The only way that companies can prosper in these markets is to cut costs relentlessly and accept profit margins close to zero.

The genius of the sandwich

The first objection contains an element of truth: none of this is new. But Donald Sull at the London Business School points out that many great business innovations are of the Earl of Sandwich variety: bread and meat had both been around long before the earl put meat between two slices of bread so that he could eat while gambling. The Japanese lean-production school borrowed from American management gurus such as W. Edwards Deming and Joseph Juran, but put their ideas together in new ways. Likewise, extending Henry Ford’s manufacturing revolution to heart and eye surgery is truly innovative.

The second objection also has some truth to it. Smoothly managed China is very different from chaotic India. Brazilians have a much higher standard of living than Indians. Plenty of emerging-market companies are flourishing without either reverse innovation or frugal production. But emerging markets nevertheless have something in common. They face similar challenges (such as large numbers of poor people) and similar opportunities (such as rapid economic growth). And emerging-market companies interact all the time, learning from each other and poaching each other’s customers.

A number of these companies have set up joint ventures. Mahindra & Mahindra is working with a Chinese company, Huawei has opened a research centre in Bangalore and Lenovo is now applying the model that served it so well in China to India. It has also moved its global advertising headquarters to Bangalore. Brazil's Embraer has found keen customers in Saudi Arabia, Panama and Poland and set up a joint venture in China. GE sells its electrocardiograms as successfully in China as in India.

As for the argument that emerging markets are being oversold, there is surely a lot to justify the enthusiasm. This starts at the macro level: emerging-market companies are learning how to compete on productivity, not just low cost. Last year productivity in China grew by 8.2%, compared with a rise of 1.0% in America and a decline of 2.8% in Britain. A few years ago Airbus and Boeing were willing to outsource only basic work to Indian firms, but now they entrust some of their most complicated tasks to them. Airbus hired Infosys to design part of the wing of its double-decker A380 and Boeing asked HCL Technologies to produce two vital bits of machinery, one that averts airborne collisions and another that allows planes to land in zero visibility.

In some areas emerging-market firms are leapfrogging Western ones. Mobile-phone companies are pioneering mobile money in Kenya and elsewhere. Computer-games makers are introducing several innovations in the emerging world, such as the use of mobile phones for video-gaming and the creation of a market in "virtual" goods such as swords and toys.

High-level and low-level innovation are often combined to excellent effect in emerging markets. GE's ultra-cheap electrocardiogram, for instance, is driven by a state-of-the-art algorithm. VNL, an Indian company based in Haryana, has redesigned mobile-phone base stations so that they can run on a solar-powered battery, not only helping poor people who are not connected to the electricity grid but also creating a new green technology.

The emerging markets' new management paradigm also has an army of proselytising gurus and consultants, led by an Indian elite, who are busy refining it, advising companies on how to exploit it and selling it to companies anywhere in the world that want it. Many teach in some of the West's best business schools. C.K. Prahalad has been one of the most influential gurus for many years: over the past couple of decades his interests have shifted from the West to emerging markets, not just because he feels the call of his native India but also because he thinks that this is where the cutting edge of innovation is.

Mr Prahalad has been joined by a number of rising superstars such as Vijay Govindarajan, Tarun Khanna, Ranjay Gulati, Nirmalya Kumar and Anil Gupta. They keep in close contact with their mother country. Many of them sit on corporate boards. Most have a special interest in the emerging world in general. Mr Prahalad's book, "The Fortune at the Bottom of the Pyramid", has been hugely influential over the past decade. Mr Govindarajan's article on reverse innovation in the *Harvard Business Review* made him famous. Cambridge's Judge Business School maintains a website about Indian innovations.

Emerging-market countries are investing heavily in business schools. The most recent *Financial Times* three-year-average ranking of business schools includes three from emerging markets among the world's top 20: Hong Kong University of Science and Technology Business School (14), the Indian School of Business (16) and the China Europe International Business School (14). They are also developing high-quality consultancy services, with the Indians once again taking the lead. Tata Consultancy Services, which operates in 42 countries and had revenues of \$6 billion in the 2009 tax year, is a vigorous advocate of frugal innovation. The emerging-market paradigm may have been a response to local deficiencies, but some of the world's best business brains are now turning it into a coherent management system that is just as applicable in rich as in poor countries.