Making the Case for Emerging Markets

By Lord Waverley **20Aug, 2020**

The world awaits what emerges from post-Covid traumas. States will be required to consider how to balance budgets, how to derive income from which aspects of the economy to pay for essential services. There will be those who will dig in their heels and advocate an insular approach, others who will wish to kickstart economies by driving advantage of what remains of globalisation. This centre ground will become sought-after, as supply chain sources will be challenged by the option to secure non-historic marketplaces or to entrench nationally. Both are plausible.

Covid-19 has been a Litmus test for the strength of many frontier and emerging markets, with economic struggles highlighting structural frailty. Many developed-status nations tentatively believe they are approaching a recovery stage, while others urge caution over a second spike. Economies such as China and Europe are beginning the process of starting economic recovery. However, many of the emerging markets will suffer, disproportionately affected by their negative import and export marketplaces due to commodity-based economies.

A lack of international investments, caused by a lack of economic surplus, will lead to a system of increased borrowing against national debt, which will in turn affect emerging markets due to large contract-based employment systems and a lack of international stimulus. This does not bode well, and will haunt all nations in whichever economic category they find themselves, with the potential effect of the redrawing also of geo-strategic and geo-political relationships.

The impact on import and export markets cannot be understated, highlighting a greater issue within the current international system. A large proportion of those nations do not currently raise enough foreign currency through trade and exports or raise sufficient funds internally through taxation to pay off their debts. Debts that have usually been incurred by Tier-1 nations "supporting" massive infrastructure projects but outsourcing the construction to foreign organisations.

This will be exacerbated due to many not having the banking systems to issue enough bonds in their local currency in order to pay off borrowing. While there are exceptions to this for nations such as South Korea and the BRIC countries that have deep international ties with Tier-1 nations, states such as Peru or Kenya will be challenged by not having the strength of currency to support internal economic development. This will lead to borrowing against their own currencies which will lead to a cycle of circulating debt.

A complicating factor for those markets might also be increased resentment towards globalisation. Already international organisations are facing coercion from governments to exit foreign manufacturing markets to support their own struggling economies, resulting in the international system becoming more introspective.

The growing trade hostilities between China and the United States, and the impact this is having on foreign relations, is evidence of this. Both are fuelling hostilities and threatening sanctions while emerging market economies are suffering. Bluster from the West will not keep the world order as it was with more of an alignment to the East.

Many of the larger consulting and money firms are already reacting to how the impacts of tensions are dramatically reducing share values on Wall Street. The potential for a breakdown of relations will have an adverse impact on trading value, threatening the economies of many

emerging, markets such as Pakistan and central African nations, that rely heavily on American and Chinese infrastructure investment.

While the potential for the economic growth of emerging markets has been foremost in our minds over the past decade, the idea that nations such as Turkey, Azerbaijan and others can engage with Tier-1 nations on an mutually beneficial and equal footing is at risk of fading. Historically it has been assumed that, with the growth of manufacturing capabilities of Tier-2 nations, their economies will naturally strengthen and grow in-line with an increasingly global consumer base.

This analysis has been conducted in the past based upon GDP purchasing parity due to financial crashes that increased isolationist tendencies of developed economies. It was anticipated that China, India and Brazil would be responsible for over 50 percent of the world's economic growth, whereas the Eurozone was predicted to contribute less than one percent. Emphasis was being made on proposed significant advances that they would be making — but those advances have been eroded over the past two years, which have in turn damaged this modelling.

While manufacturing is often outsourced from Tier-1 nations that benefit emerging markets, any potential stagnation in the international economy will disproportionately affect Tier-2 nations, and severely limit their ability to develop sustainably, leading to boom-or-bust economic policies. Sustainable investment in these nations is crucial, not only for generating rewards for conglomerates, but with the added benefit for a more integrated global economy.

With the right support, emerging markets should be able to adapt more quickly to the pandemic as they can benefit from the experience and scientific resources of Tier-1 nations. Access to this knowledge can help arm developing organisations with the best business practise to assist full recovery. While such co-operation is preferable, with the concentration of expertise centred within western Europe and the US, addressing this imbalance is crucial.

While this is beneficial for Tier-1 economies, many organisations have now learned that to function in an increasingly volatile international market, diversity of supply — and not concentrating the sourcing or manufacturing of a product from within a single geographical location — is preferable. Companies have learned to "atomise" their supply chains and so drive-down manufacturing costs and increase efficiency resulting from multi-tier supply change re-configurations.

Diversification of global supply will however carry the risks of increased logistics costs. An increasingly volatile international system and the problems of concentration outweigh the logistical challenges of atomisation. A take-away from 2020 is that diversification in supply chain management and the implementation of a more global approach to business will not only assist recovery, but have the effect of better protecting future business interests. Modern advances in technology will significantly reduce the frictional distance between nations, thus providing the platform to bridge the gap between developed and developing nations.

This new-found sustainably will also allow for local development through increased regional wages and the development of a stronger local consumer-based economy. Supporting Tier-2 consumers through investment will also be beneficial for the consumer in Tier-1 nations as increased competitiveness in the global system encourages innovation and drives down prices for commodities and services. Emerging markets will grow at a rapid rate. Ethiopia, for example, recently shared the view that the country has colossal potential for export — but

requires investment to increase the value-added possibilities. This is good for all parties concerned.

Investment in the technology sector is particularly viable as developing nations will be able to capitalise on the benefits of current trends without being associated with heavy research and development costs. With increased support from businesses working internationally, governments will become more connected, and develop their capacity for closer co-operation centred around development and trade. That can only be a good thing.

Support for emerging and frontier markets with their low production costs, flexible working practices and the opportunity to establish in a rapidly growing consumer market that is currently undersaturated have the potential to reap rewards. Any organisations that are internationally minded, but adhere to the saturated established markets, will miss out on the next generation-defining investment opportunities. Exceptional times require innovative change, which requires unorthodox solutions to challenges.

What is lacking is the pragmatic co-operation of governments and multipliers to provide access to the requisite information. The potential for reward is high. The effective bridging of the gap between knowledge and action will have the power to unlock the potential. I wish decision makers well as they grapple with the challenge ahead.