Emerging markets can still drive global growth

Never mind the recent turbulence—emerging-market fundamentals remain sound.

Kevin Sneader

OCTOBER 2018

Financial markets are again having jitters about economic turbulence in some emerging markets, notably Argentina—and fretting about contagion. Such fears are understandable, given painful precedents, but they risk confusing short-term volatility with a long-term trajectory of powerful growth.

New McKinsey Global Institute research explores how nearly one in four emerging economies has achieved rapid and consistent growth over long periods. These "outperformers" have found the recipe for relative stability, collectively accounting for 29 percent of global trade in goods, 24 percent of global trade in services. They drove half of all consumption growth from emerging economies over the past two decades. They—and other emerging economies that emulate them—can continue to serve as the engine of global growth in the years ahead, and their highly competitive top companies will continue to give western incumbents a run for their money.

We examined the long-term record of gross domestic product per capita growth in 71 emerging economies and found that seven— China, Hong Kong, Indonesia, Malaysia, Singapore, South Korea, and Thailand—had achieved annual average growth of at least 3.5 percent over half a century to 2016. In 11 others, GDP per capita grew by at least 5 percent for 20 years from 1996 to 2016. Many of these economies have already showed resilience by recovering quickly from the 1997 Asian crisis. They also withstood the 2008 crash reasonably well.

Two key factors underpin this success. They have pro-growth agendas that include steps to increase capital accumulation, often through mandatory retirement saving, and efforts to improve government effectiveness. Some of these countries have also sought to create more competitive dynamics in their home markets.

Large public companies with annual revenue of $500 million or more also play a standout role. Outperforming economies have twice as many of these groups, when adjusted for the size of the economies. They not only helped boost GDP but also served as catalysts for change.

These companies are as tough as their western rivals—and in some ways, tougher. It is much harder for them to stay at the top: more than half that reached the top quintile for economic profit generation between 2001 and 2005 had been knocked off their perch ten years later. By contrast, 62 percent of incumbents in high-income economies remained at the top.

Our research shows the best emerging-market companies innovate rather than copy. They derive 56 percent of revenue from new products and services, more than their peers in high-income economies. They invest almost twice as much, as measured by a ratio of capital spending to depreciation, and on average, they make important investment decisions six to eight weeks faster. They can also earn better returns. Between 2014 and 2016, the top quartile of companies in outperforming emerging economies generated average total return to shareholders of 23 percent, compared with 15 percent for top-quartile companies in high-income countries.

To be sure, debt levels are still cause for concern. China's total corporate debt relative to GDP is among

Our research shows the best emerging-market companies innovate rather than copy.

the highest in the world, and corporate debt has grown strongly in Vietnam, Chile, Turkey, and Peru. Rising global interest rates would put some of these corporate borrowers at higher risk. Our analysis shows that total emerging economy debt levels, including households, corporates, and governments, remain lower than those in developed economies.

While it would be rash to assume that any emerging economy could be immune to global volatility, those with strong macroeconomic fundamentals and a stable of competitive companies remain the world's likeliest source of long-term growth. ■

This article first appeared in the *Financial Times*.

Kevin Sneader is the global managing partner of McKinsey & Company and is based in McKinsey's Hong Kong office.

Designed by Global Editorial Services.