

Globalization: causes, pitfalls and enablers

by Michael de Kare-Silver

The forces of globalization and consolidation are significant trends across almost all industries. More than ever before, firms are acquiring, merging and endeavoring to enter new markets. One major reason is that, in business, size can matter. Properly employed, it allows the organization to dominate a market and exploit the synergies of scale and competence. A further reason is the unrelenting pursuit of lower manufacturing costs in a world economy where trade barriers are falling. Exploiting world-wide manufacturing opportunities becomes easier with global scale, so these factors reinforce each other in encouraging organizations to expand globally.

The rise of the global organization presents us with a conundrum, however: the need to grow bigger while not becoming an inflexible and remote monolith. Figure 1 highlights typical areas of conflict, and in this article we analyze how this tension can be managed by:

- Exploring the rise of globalization and its causes
- Examining the pitfalls and rewards of globalization
- And finally, assessing how certain key enablers, and their supporting technologies, can allow us to make a virtue of size, securing the rewards of globalization while steering clear of its pitfalls.



Figure 1: Goals vs. roadblocks: the tensions inherent in globalization

Globalization and its causes

A number of trends bear witness to the rise of globalization.

The rise of the mega firm

M&A activity has risen at a dramatic annual rate of 42% over the past 20 years. Completed value in 1999 was \$2.3 trillion, which represents 24,000 deals.¹ A key development is the creation of the mega firm, such as BP Amoco, Daimler Chrysler and Citicorp Travelers. The market-share concentration picture varies across sectors but, overall, most industries are consolidating, with BNP/Paribas in financial services, Daimler Chrysler in automotive, and retail's Wal-Mart/Asda merger being notable examples.

The growth of the trans-national firm

World-wide exports have increased faster than the Gross World Product over the last ten years. In 1998, global exports reached \$5.4 trillion and accounted for 14% of world GDP, compared to \$3 trillion in 1987 (10% of world GDP).

¹ *Global Investment Report 2000*, United Nations.

Even more striking is the development of international production by trans-national corporations. World-wide sales of these trans-national corporations' foreign affiliates is now nearly three times as high as global exports and stood at \$14 trillion in 1999, compared to \$3 trillion in 1980. The gross product associated with international production is about 10% of global GDP, compared to only 5% in 1982. The number of trans-national parent firms in the 15 most developed home countries increased from some 7,000 at the end of the 1960s to around 40,000 at the end of the 1990s.

Consistent with general investment trends over the past decade, much of the growth in international production has been via cross-border M&As rather than greenfield investment: the value of completed cross-border M&A rose from less than \$100 billion in 1987 to \$720 billion in 1999, representing over 6,000 deals.²

M&As are today the dominant form of foreign direct investment (FDI) in developed countries, while FDI into developing countries is still dominated by greenfield investment. However, cross-border M&A activity is clearly on the rise there too.

So what lies behind globalization's rise?

The liberalization of world trade and capital movements

One of the main drivers of globalization has been major changes in the policy and regulatory environments. Global trade and investment have been liberalized (World Trade Organization, General Agreement on Trade and Tariffs); regional agreements have further eliminated trade barriers (free movement of goods in the European Economic Area, European Union, NAFTA, ASEAN). At national levels, major deregulation and privatization initiatives have increased the competitive marketplace and have opened up former monopoly markets to new local or foreign players. These changes have been particularly apparent in telecommunication, energy, airlines and financial services.

The liberalization of trade barriers, coupled with advances in supply chain management, has also made it easier for organizations to shift parts of their supply chain overseas to exploit lower labor or factory costs. As organizations have been developing more global markets for their products, the economics of a more global approach to manufacturing have also steadily improved.

Major changes in financial markets have also played a role in the general trend towards globalization and concentration. Firms now have easier access to capital to fund their expansion initiatives and big players now raise money beyond their home-country stock exchange. More recently, high stock-market valuations have allowed firms to acquire more (and at higher prices) by paying with their own stock rather than in cash.

A new world economy: the impact of the Internet

The emergence of the Worldwide Web is another factor driving globalization and its full impact has not yet been realized. By itself it removes all physical and time-based barriers: reach is global and 24/7, and anyone anywhere can be contacted at any time. This is forcing companies to re-appraise their global market presence and can easily become an accelerator of corporate developments. For some organizations, such developments may remain virtual but for others it will lead to alliances and joint ventures as companies try to serve customers in the regions.

Big is beautiful

Scale-based notions of corporate strategy are deeply rooted in executive boardrooms and organizations strive to be the biggest player in the industry. Their goal is to secure the greatest share of market, establish a low cost position by exploiting economies of scale, and eventually integrate vertically to capture incremental value.

² *Global Investment Report 2000*, United Nations.

In fact, these ideas of the value of scale are more than intuitive: the advantages of size were measured in the 1970s by the PIMS principle (Profit Impact of Market Strategies).³ The relation between the level of market share and return on investment was shown to add several points of return on investment (see Figure 2). Although this analysis was carried out 30 years ago, and should be taken with a pinch of salt today, it still has some resonance.

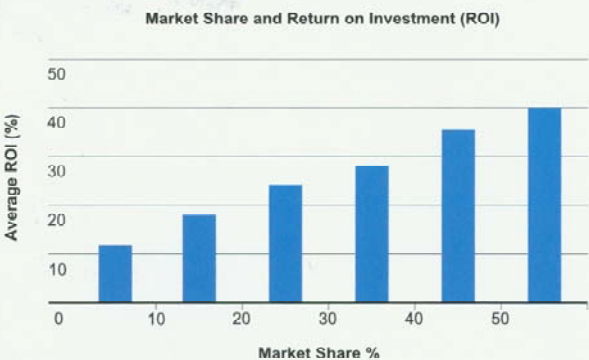


Figure 2: Profit Impact of Market Strategy (PIMS)

Mixed blessings: the pitfalls and rewards of globalization

Pitfalls: how globalization can go wrong

Large incumbents are not invincible and there are many examples of industries where the dominant players have lost significant ground to new entrants. In computing, Compaq (itself a brilliant newcomer 20 years ago) suffered from the challenge of the low-cost, flexible and customer-centric business model of Dell computers. British Airways, with its global network, has been challenged by low-cost airlines Easyjet and Ryanair – carriers that focus on cost rather than service. Smaller niche players like Easyjet take advantage of competitive factors such as the following:

- Lack of customer focus in big companies. As an example, French company Etam consolidated its design and purchasing capabilities in France instead of having separate functions for France and the UK.

However, customer tastes between the two countries varied, and Etam started to lose significant ground to its main competitors, leading to major restructuring

- The falling cost of technology. In the past, only large firms could afford leading-edge computer and telecommunication technology. However, with the falling cost of computer power and telecommunications, smaller firms have access to the same technology as the major players. Even worse, large firms have to replace their legacy IT systems on a much bigger scale, incurring higher costs and exhibiting less flexibility compared to their smaller counterparts.

Economies of scale are not a competitive advantage per se. The big companies that survive and prosper have many other strengths beyond their sheer magnitude. GE, for example, has also placed strong emphasis on culture, process and quality in recent years, and has not been afraid to go through significant downsizing, with 120,000 jobs cut under Jack Welch's tenure.⁴ Economies of scale have given way to economies of scope, finding the right size to best exploit synergy, market flexibility and speed-to-market.

Getting it right: globalization's rewards

Size can bring some significant advantages. In fact, 60% of the large firms that were in the top 50 industrial firms by revenue in 1990 are still in the top 50 today, such as GE, General Motors, Shell, Siemens and IBM.⁵

The 'rule of three' is a proposition that only three global majors will come to dominate many industries. As these industries mature – and economies of scale in development, production, administration and branding are fully realized – industries have been observed to consolidate to three volume players, plus several niche players. This is already apparent in automotive, drinks, and athletic footwear sectors, and arriving in pharma, banking and telecoms.

³ *The PIMS Principles*, R. Buzzell & B. Gale, The Free Press, 1987.

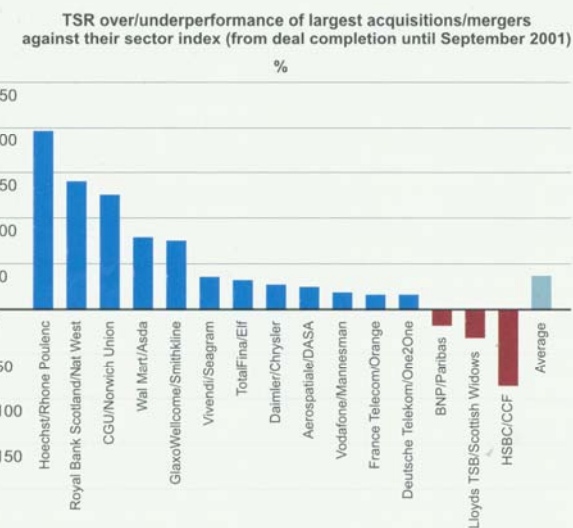
⁴ *The end of shareholder value*, Allan Kennedy, 2000.

⁵ PA analysis of Fortune 500 (2000) and The Times 1000 (1989–1990).

It is possible to view this trend across many maturing industries, at different stages of consolidation.

Profits correlate with market shares for most volume players (>10% global market share) but negatively correlate with market shares for niche players (<5% share).⁶ Firms can profit by being big or by being small and specialized, but those that get caught in the middle (5–10% share) are likely to have sub-optimal profits.

Although there are many analyses that show mergers and acquisitions can destroy shareholder value, the stock-market performance of some of the largest M&As in recent years shows that investors do recognize the benefits of size (see Figure 3).



Source: Hydra, PA Consulting Group analysis.

Figure 3: The market appears to see the benefits of the latest large mergers

Size as a virtue: key enablers of globalization

Scale alone does not bring increased value creation – a company must have a competitive advantage that it can increase or leverage more widely as a result of expansion. Successful global companies combine the advantages of global capability (economies of scale, market power) with the exploitation of local knowledge and focus. This is why ABB, the world's largest power engineering group, has gone a long way in 'deconstructing' its global business.

The company does not see itself as a 'global business', but a collection of local businesses with intense global co-ordination. ABB reduced its headquarters workforce from 4,000 to 200 to avoid the trap of too much concentration and lack of local focus.

Global organizations have a nervous system – the underlying structure that supports decision-making and forms its unique identity, from systems to culture. Important systems elements include common IT platforms and shared open Net platforms. The purpose of having a global technology infrastructure is to enable the sharing of information and resources, to execute key business processes, and to interact with customers and suppliers on a trans-national basis if necessary. Sharing of information creates integration across units or functions, therefore leveraging scale and synergies.

At a local level, the global business has to decide on the degree of autonomy and flexibility of the technology platform relative to the common global infrastructure. PA has identified a number of factors that influence this decision:⁷

- The degree of commonality of customers and customer channels
- The degree of commonality of products and company philosophy
- The extent to which the business portfolio is stable
- The intimacy of IT to business strategy
- The criticality of IT service delivery
- Geographic and cultural obstacles
- Economic considerations.

For the global firm, the variety of businesses, products, customers and the instability of the business portfolio make the design of the technology platform more likely to be decentralized. This is true to the extent that the financial benefits of a single unified system are outweighed by the need to be able to understand and respond to customer needs in a flexible and agile way, geographically or by business line.

Some firms can operate on a single centralized technology platform because their business model rests on the standardization of the offer. This is the case for McDonald's, offering the same products with little variation from country to country in terms of content and style of delivery. However, the more complex global firms, offering hundreds of products or services to dozens of different customer groups, have much to gain in exploiting the flexibility that technology offers. The real prize for them lies in combining global infrastructure bringing synergies where necessary (knowledge management, information sharing, customer databases) with a local agile system that is adapted to respond efficiently to customer needs (CRM capabilities). Figure 4 highlights some of the areas that can be exploited, and they are considered in more detail below.

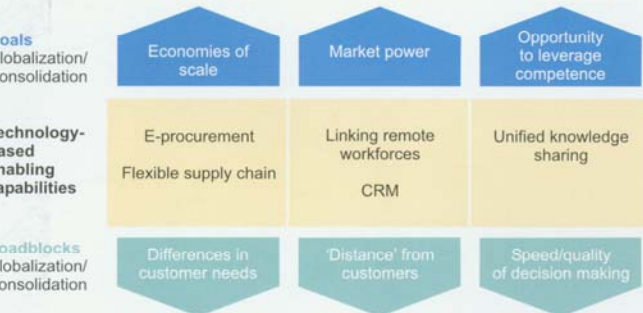


Figure 4: Key enablers of globalization and consolidation

E-procurement

Many global companies have, until recently, been unable to leverage their purchasing power. There are two principal reasons for this. First, transaction costs fail to fall with size. It has been calculated that the US government used to spend \$100 to order a screwdriver. Recent developments in purchasing automation, based on Internet technology, have enabled this transaction cost to be reduced dramatically, and scalability to be enhanced, providing further economies of scale.

The second issue is that of management of procurement. Many global organizations have been formed from mergers and acquisitions. Merging companies often have incompatible systems, and this has often led to global organizations failing to have a unified view of their procurement spend. When BP merged with Amoco, PA helped BP to develop this integrated view across the entire organization. Completed in only a few weeks, this enabled BP to save over £200 million per year through improved negotiation with suppliers.

Flexible supply chain

The ability to ensure that the right product is in the right place at a reasonable price is key to maximizing sales opportunities. Failure to do this can be costly. When British retailer Marks and Spencer entered the Spanish market in the early 1990s, it transplanted the British model to its new stores. This meant British stock in British sizes – taking little account of the difference in Spanish tastes, weather, or body shape. When the Spanish managers asked for a different stock profile, the supply chain policies and operations were unable to adapt, leading to lost sales. Marks and Spencer has since decided to pull out of Europe.

Unified knowledge sharing

The value of knowledge has long been appreciated tacitly, but because of the costs of sharing knowledge, and the difficulty of measuring benefits, it has historically been an area that has received insufficient attention.

With the development of intranet-based systems, and the management processes to support and incentivize their use, the value of knowledge is finally being realized, at least amongst leading organizations. These companies have realized their key differentiator is the skills and experience of their employees. For example, BP has asked its managers to become 'T' shaped. Far from being a contortional morning exercise, this refers to depth of knowledge and responsibility (the vertical part of the 'T') and sharing that knowledge and expertise with colleagues who may benefit (the horizontal 'T' bar).

Persuading managers to act in this way has led to measurable operating performance improvements: 10% performance improvement on a business unit through collaborative problem solving; 20% working capital reduction through collaborative opportunity identification; \$24 million per year at one refinery from enabling benchmarking and process knowledge sharing between plants.⁸

Additionally, there are softer benefits from this approach – better understanding across the organization of divisional and functional environments, issues and priorities. This can help avoid problems before they arise. Also, there can be faster integration of acquisitions, as networks develop faster and a common identity evolves.

The key to success in knowledge sharing is in the behaviors of the technology. Technology is only an enabler, assisting opportunity spotting or identification of experts. Delivering the benefits requires incentivizing people to spend time on collaborative projects (15–20% at BP), and ensuring that collaborative projects are focused on addressing the business issues of the managers involved with practical action – avoiding airy discussions of vague principles.

Linking remote workforces

Consider the example of a Spanish fashion retailer that has expanded internationally on a rapid basis. The key issues facing Zara were how to keep in touch with its workforce and customers and how to ensure that its key success factors of quick response to local customer needs can continue to be met despite the complexity of distance, varying customer needs and additional logistics.

Zara used the Internet to resolve these issues. It has a single unified intranet for sharing information and especially local customer knowledge. It has linked its design team into a 24/7 remote access virtual group which allows Hong Kong

suppliers to communicate with Spanish factories continuously and in real time. It has established communication parameters around 'quick response'. It has committed to using the new shared information platform to turn around new product ideas faster. Store managers can get new products into their stores in just two weeks!

Customer relationship management

In order to mitigate against perceived 'distance' from their customers, global organizations need to take steps to develop the closest possible relationship with their customer base.

The need for customer relationship management (CRM) has grown with the scale of organizations. All of us can quote personal examples of poor customer service where we have tried to deal with an organization across several channels (such as phone and Internet), but where the organization has failed to carry out its promises, because the staff who are dealing with us lacked the appropriate information and empowerment.

CRM systems, particularly those providing an integrated view of customer interactions across all divisions and channels, can help organizations solve this problem, and further enable them to spot cross-selling and up-selling opportunities.

Summary: exploiting globalization

Although the benefits of size are compelling, the process of globalization introduces its own tensions on companies' business models that have vexed and undermined some high-profile players. Organizations can exploit a number of critical enablers, all supported by new technology platforms to help make globalization work, through e-procurement, a flexible value chain, knowledge sharing, fostering a unified workforce and remaining close to customers.

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