Introduction: the global challenge

The global market place is the World Cup. It definitely is not one big level playing field. Many top teams vie for supremacy, with the best talent scattered around the world. Teams from many countries bring different traditions and diverse playing styles. Every football team brings a different mix of athletic skills and their competitive strategies vary widely. No competitor can count on home-field advantages. Success requires sufficient endurance and versatility to overcome many teams. Winning requires beating multiple challengers from across the globe.

Gaining the World Cup requires world-class competitive advantage – and global competitive advantage is what your company must have to make it in the global market place. This book provides a new method for strategic analysis that accounts for variations in business environments across countries. It explores novel competitive strategies that can help your company to win worldwide. The discussion further considers global investment strategies and the design of the international business organization. The analysis offers managers a comprehensive framework for gaining global competitive advantage.

Global competition

Globalization changes everything! Before globalization, a firm's competitive advantage was likely to be little more than a critical edge – just a subtle distinction between rival firms. In the global market place, companies can have spectacular differences. Firms with a global competitive advantage will overwhelm rivals who are not prepared.

Before globalization, your main competitor likely was located in the same country, the same city, even on the same street! Your company and its competitors fought for the same customers. Your firm and its rivals drew from the same labor force, with similar wage and benefit costs and comparable skills. Managers in your firm and its rivals shared the same outlook and cultural background, often coming from the same business schools, ethnic groups, and perhaps even the same family. Your firm and its rivals often had the same costs of capital, resources, energy, equipment, parts, and technology. Your company and its competitors faced the same legal, regulatory, and public policy constraints.

In this cozy environment, competitive advantage was at best the result of luck, talent, and clever management maneuver. Some firms expected to deter rivals just by outspending them on capital investment. Strategy recommendations were tailored to this environment, urging companies to gain the upper hand through pricing techniques, marketing gimmicks, bundles of product features, or frequent model changes.

Companies could afford complacency. They could go to market with similar products, relying on customer inertia or traditional sales channels. Firms could depend on brand image and marketing messages to drive home a competitive wedge. They could even prosper while offering uninspired designs and planned obsolescence, relying on rebates and end-of-season sales to move merchandise. Companies could dictate styles and trends to their customers and hope for the best. They could tolerate inflated labor costs and workplace inefficiencies, secure in the knowledge that their competitors faced the same problems. Survival was possible even with poor performance, uneven service, bureaucratic organizations, and sluggish responses to market forces.

With rapidly increasing globalization, such safe strategies are no longer sustainable. Managers cannot hope to stay within their comfort zone. The global market place requires managers to go beyond their familiar surroundings. Their companies face intense competitive challenges from around the world.

Managers must think globally to succeed. They need a global strategy framework because of the complexities of the international market place. Those frameworks developed for the analysis of purely domestic business strategy necessarily fall short in the international business context. Suppliers, customers, partners, and competitors likely are located abroad. Competitors have vastly different costs, products, technologies, and strategies. It is only by understanding – and, indeed, harnessing – the forces of globalization, that managers can develop global competitive advantage.

With globalization, competitive advantages become earth-shattering chasms. A competitor's costs may be a tiny fraction of your company's costs because their products are made in low-cost countries. Robert "Steve" Miller, chief executive officer (CEO) of the world's largest auto-parts maker, Delphi, noted that: "Globalization is a fact of life these days."[1] Delphi declared bankruptcy in its US operations where its labor costs were $65 per hour while comparable labor costs in China were only $3 per hour. Miller further observed that:

> Behind all this financial drama are the lives and livelihoods of thousands of our loyal and dedicated workers. These are honest, hard-working human beings who played by the rules and cannot be blamed for pursuing the American dream by taking a job at General Motors Corp. or Delphi. They expected us to live up to our promises, but have been caught by fast-changing global economics.

Looking ahead, your company is more likely to face a competitor with extremely innovative products and world-class brands. US auto makers GM and Ford struggled with considerable effort but experienced declining market share competing against global brands such as Toyota, Honda, BMW, Audi, and MercedesBenz. Brock Yates, the editor at large of *Car and Driver* magazine, worried about the chances for GM's survival, its only hope being in "revamped, reformed, and re-energized design studios and engineering spaces."[2] With Toyota headed for the top slot in world markets, both GM and Ford considered an Alliance with Renault–Nissan.

The classic generic competitive strategies of cost leadership and product differentiation, while useful, offer limited guidance with globalization. New strategies must address the vast differences in costs, capabilities, and products that exist in world markets. Companies need to understand how global competitors devise dazzling business deals that cross international borders. Firms require strategies that create advantage from new international combinations of buyers and sellers.

Before globalization, you often knew your competitors intimately; their strategy and tactics were all too predictable. As globalization unfolds, your competitor is not only coming from half-way around the world, its very identity may be previously unknown to your company. Global competitors may follow innovative and original strategies. Your greatest competitor may turn out to be an aggressive entrepreneurial firm from an emerging market rather than a familiar stodgy conglomerate from a developed economy. The element of surprise heightens the new entrant's competitive advantages.

Before globalization, your target markets were familiar, as well. With increasing globalization, keeping up with competitors means that you must expand your reach to distant countries. Getting close to your customers requires adapting to many distinct national environments. This requires managers and employees that are familiar with local languages, customs, cultures, and business practices.

The global market place is not only a matter of competitive challenges. It also represents an expansion of opportunities. Global firms choose target countries to select from 6.5 billion potential consumers in over 190 countries. Countries with large populations such as China and India offer diverse internal markets. Emerging markets are just that – opportunities to serve new consumers. Emerging markets offer faster growth rates for consumption than in developed economies, as consumers there have not had the best choices of goods and services.

The global market place offers firms vast new labor forces. Many emerging markets suffer from unemployment and underemployment, and there are significant opportunities to increase productivity in such markets through infusions of capital, technology, and training. As the impact of globalization expands, there are opportunities to increase productivity in developed countries, as well. Global competition will require companies in the developed world to streamline organizations and change wasteful work patterns. Companies in developed economies must increase innovation and productive efficiency to stay in the game.

Achieving global competitive advantage cannot be done in a domestic fortress. Lobbying governments to erect barriers to trade has limited value: better or cheaper goods find their way into even the most closed markets. Trade barriers merely postpone the inevitable and provide a false sense of security. Companies cannot resist the forces of globalization for very long: success goes to those companies that actively address the global challenge and seize global opportunities.

Global competitors use the international market place to transcend the limits of their home market – on both the demand side and supply side of the business. Companies seek incremental revenue from targeting customers abroad. Companies also must go global to lower their costs, improve their products, and find innovative suppliers and partners. Innovative business strategies are those that embrace globalization.

What is globalization?

Christopher Columbus was right. The world is round, not flat. In fact, the world is very bumpy! The countries of the world differ greatly, with some at the highest peaks of industrialization and technology, others on the hillsides of economic development, and emerging markets roaring out of the economic valleys. It is this great diversity that provides opportunities for trade.

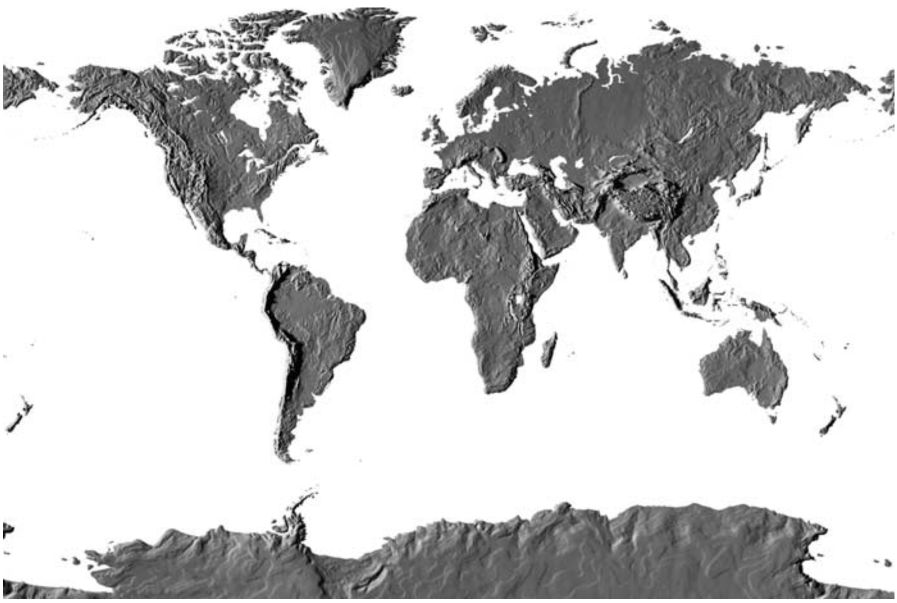

Fig. I.1 The world is bumpy! Managers need to read the contours
Source: Digital Wisdom, Inc.

Just like the physical topography shown on a globe, the map of the economic world is *contoured*, see Figure I.1. In each area of the world, there are many different levels of economic development. The uneven distribution of income, technology, human capital, and infrastructure creates a contoured world, and the manager must understand how to adjust strategy to the ups and downs of the world's contours.

Why is the world so bumpy? The Internet was supposed to eliminate all frictions. Video teleconferencing and software fostered collaboration across borders. Mobile computing and advances in telecommunications made it possible for people to be constantly in touch. Improvements in express shipping led the shift to just-in-time (JIT) production. Jet-age advances in transportation allowed people to meet customers and suppliers anywhere and anytime.

Shrinking distances should have begun to erode economic differences between countries. In a frictionless world, the playing field was level, and this would stimulate enough competition to even things out around the world. Yet there was an apparent puzzle – many of the "peaks" and "valleys" remained.

What could explain the persistent economic differences between countries? What made country borders into barriers? The answer to the puzzle is the costs of trade, costs that decline only at a measured pace.

Globalization is the gradual reduction in the costs of trade. Economic distances are indeed shrinking, but they will not disappear overnight. Globalization is neither an origin nor a destination. It is a journey, and a long and difficult one at that. Contrary to what many believe, we are not there yet.[3] The effects of globalization are earth-shattering because even small changes in the costs of trade can have spectacular effects. These extreme effects do not imply that we live in a borderless world, they are only an indicator of changes to come. Managers need to understand the challenges that lie ahead and prepare for the changing environment.

What makes borders so "sticky"? Global businesses face four types of trade costs or barriers. I refer to these trade costs as "the four Ts":

- Transaction costs
- Tariff and non-tariff costs
- Transportation costs
- Time costs.

These are the costs of doing business across international borders. They preserve the economic contours of the world.

Transaction costs result from the difficulties of doing business across borders. The international business encounters different cultures, customs, traditions, and societies: a handshake can mean something different from place to place. Social relationships form the backdrop of business and the international manager must account for social networks. Business practices and marketing methods are likely to differ substantially. Managers and employees must transact in different languages. They must search for customers and suppliers in unknown markets. Contracts are negotiated and honored in different ways. Customer preferences and incomes are likely to vary considerably.

Government trade barriers are an important source of "sticky" borders. The online virtual universe has opened new channels for international competition and collaboration. Yet, here on earth, the massive tangle of regulations has only begun a slow process of unraveling. Countries are not about to give up their national sovereignty. The nation-state is here to stay. Even in the European Union (EU), with a common market and a central parliament, governments jealously guard their political power. Around the world, trade protectionism continues to erect roadblocks to imports and investment. Economic nationalism defends domestic employment, manufacturing methods, cultural traditions, and local ownership of companies.

Goods, services, and investments do not move perfectly freely. Tariff and non-tariff costs imposed by governments are everywhere. All countries restrict the movement of goods and services to some extent: they charge tariffs at the border, they limit imports with quotas, and they use all kinds of health, safety, and other rules. Even the Internet has barriers, as governments control access and censor content. In addition, governments restrict foreign investment. For example, the US turned back a Chinese oil company, CNOOC, bidding to buy UNOCAL, and blocked Dubai Ports World from managing terminals in US ports. The French government arranged a merger of water and energy utility Suez SA with natural gas utility Gaz de France to head off a bid for Suez by Italy's largest electric company, Enel SpA.

Location and distance still matter a lot. Transportation costs necessarily remain a barrier to trade. The international business not only pays the freight to move parts, components, energy, and final products around the world. It also bears the costs of the complicated logistics needed to coordinate far-flung supply chains and distribution networks. A manufacturer must finely tune its systems to adjust inventories and achieve JIT manufacturing. A retailer or wholesaler must have final products arrive where and when they are needed in response to market demand. Only some international business is virtual; software and services are only a small slice of the pie. Many deals may be online, but the goods still have to reach their destination somehow.

Finally, there is the cost of time. Doing international business simply takes longer than doing business in one's own backyard. Distribution and supply chains are geographically dispersed, leading to longer cycle times. Managers must travel abroad and do business in unfamiliar business environments. Companies must handle government bureaucracies that can impose unexpectedly long delays. Managers need to form new relationships with foreign suppliers and customers and learn about new countries. Adapting to new environments and learning about unfamiliar customers necessarily take more time than testing home markets, and companies can incur increased investment and inventory costs as a result of these delays.

Reaction time is slower in international business. Managers must find ways to adapt more quickly as they compete with many established competitors and creative entrants. Dispersed distribution and manufacturing facilities slow down bureaucratic organizations. Properly deployed and managed, decentralized operations offer faster local response to changing market conditions.

How can we explain globalization? Some barriers to trade are being dismantled by governments. Institutions such as the World Bank aid economic development and the International Monetary Fund (IMF) helps to stabilize currencies and country economies. Countries reduce barriers to trade either unilaterally or through bilateral and multilateral agreements with other countries.

After the Second World War, the General Agreement on Tariffs and Trade (GATT) began a process of trade liberalization, with eight trade rounds over the next fifty years. The final GATT negotiation round, known as the Uruguay Round, developed rules, procedures, and protocols that served as the foundation for the World Trade Organization (WTO). The WTO agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS) established rules for global intellectual property (IP), including copyrights, trademarks, and patents. The Dispute Settlement Understanding (DSU) established a trade dispute system designed to allow countries to bring violations of WTO law before an international ruling body and to provide countries with a way to appeal WTO resolutions. Countries supplement the WTO with multilateral trade agreements such as the North American Free Trade Agreement (NAFTA), between the US, Canada, and Mexico.

It is important to emphasize that the process of reducing trade barriers is not a straight line. Governments sometimes add new barriers as fast as they dismantle the old ones. Tariff reductions may be replaced by import quotas; trade liberalization in one sector may be matched by tightening elsewhere in the economy. For example, while joining in lowering trade barriers within the EU, France established stricter limits on foreign investment.

The political side of globalization captures headlines and attracts heated protests but, contrary to popular belief, it is only one of the forces moving globalization. Perhaps the most important source of globalization is the fact that international business has many incentives to overcome trade barriers. International trade often has grown steadily despite rather than because of reduced barriers. Businesses increasingly find ways to circumvent or adjust to government trade restrictions. For example, they move manufacturing and assembly to countries that face lower trade restrictions from countries where final customers are located. The growth of international transactions itself fosters the learning and trust that helps business to reduce contracting costs.

International businesses also find other ways to overcome the trade barriers associated with costly transactions. Technological change in computers and communications are driving new international business; the Internet lowers transaction costs between buyers and sellers, and has only begun to be harnessed as a means of lowering international transaction costs. Outsourcing of customer call centers and software services is due in large part to the lower costs of communication online.

Technological change also offers ways to lower transport costs. The application of information technology (IT) to logistics has brought substantial growth in international business. There are substantial complexities in dealing with several million international shippers and over 40,000 freight forwarders;[4] the introduction of freight containers has allowed better integration and coordination of trucking, rail, and ocean transport.

To summarize, globalization is the process of reducing the costs of transactions, tariffs and non-tariff barriers, transportation, and time. These changes are very difficult to observe directly. The hidden underlying forces of world change manifest themselves in the growth of world trade and investment. It is much easier to see the effects of globalization.

Since the Second World War, the pace of change has been steady. First and foremost, world trade is growing faster than world output – the ratio of world trade to world output is growing at almost 3 percent per year. The world factory is growing, with inputs and final goods crossing borders, so that the ratio of manufactured goods trade to total manufactured output is growing at well over 3.5 percent per year.[5] Capital is crossing borders, with business and portfolio investment growing faster than the world economy itself.

The size of the global market place is simply staggering. International trade surpassed the $10 trillion mark some years ago – but the global market is not just international trade. It is the sum total of the domestic markets of over 190 countries. Scale economies offered by world markets exceed anything ever achieved in a home-country market. Efficient supply chains stretch across continents. Sources of product innovation are more diverse and imaginative than any single Silicon Valley. International transactions are more complex and creative than deals confined within national borders.

Globalization reaches into the details of our everyday life. What we eat and drink, what we wear, what we drive, and what we use to heat our homes are likely to come from different countries around the world. More fundamentally, our occupations and those of our children are determined by whether our skills and wages are competitive with other people around the world. Managers who adapt to these trends can benefit from a profusion of opportunities.

Global opportunities

Many people feel that the promise of globalization already has been achieved. Some fear that globalization will have devastating effects on their jobs and lifestyles. Others worry about the increasing intensity of competition in world markets. But globalization is a story of increasing opportunity.

To understand what lies ahead, consider some of the differences between countries. There are vast disparities between household incomes in the developed economies and those in emerging and less developed economies. Education levels, standards of health care, nutrition, and housing differ greatly around the world. The historian David Landes has observed that: "Now the big challenge and threat is the gap in wealth and health that separates rich and poor . . . Here is the greatest single problem and danger facing the world of the Third Millennium."[6]

These differences in income between countries will not be eliminated soon. The emergence of a middle class in China and India is a welcome development, yet significant structural changes still are needed for a poor villager in these countries, or in many areas of Asia, Africa, and Latin America, to achieve similar prosperity. It is apparent that wage differences will persist.

Countries differ substantially in technology, whether for manufacturing, agriculture, communications, or information processing. Technical knowledge and research and development (R&D) activities are distributed unevenly across countries. Significant changes in societies, improvements in education and training, and diffusion of innovations must occur before technologies converge. The technological differences that underlie the comparative advantages of nations will continue for a long time to come.

The business environment differs across countries. Legal and political factors join with cultural and social underpinnings to create disparities in the business climate. The organization Transparency International ranks individual countries on the basis of surveys of popular perceptions of corruption, with political parties, legislatures, police, the judiciary, business, and tax authorities among the most corrupt institutions worldwide.[7] The reform necessary to harmonize the business climate across the world is a necessarily slow process, hampered by social differences and by human nature itself.

Training of managers and expertise in business also vary across countries. Regulations and government red tape impact the time needed to establish and develop private businesses. It takes a long time to make the investments needed to improve the transportation and communications infrastructure, so critical to doing business. These differences between countries are likely to continue.

All of these inter-country differences represent vast opportunities. The populations of emerging markets are the untapped consumers of the future. Nigeria has become the third-largest customer country for Guinness beer, behind Ireland and the UK, reflecting a growing market for consumer goods and luxury brands throughout Africa.[8]