1 Globalization and its challenges

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While debates about globalization rage in the media, at international conferences, and in the streets, managers still have work to do. They need to create profitable businesses and generate returns for investors by entering global markets, compete against international rivals, make investments, and find opportunities in the shifting tableau of a world in continuous transformation. And they need to do this in a way that is environmentally and socially responsible. The global arena is where the extraordinary opportunities lie, but it is also where complexity and risk abound.

Although some government leaders may feel they have a choice about whether to participate in this process of globalization, it is not a matter of choice for businesses. All but the most insular business leaders recognize that in a world in which markets are global, they need to be actors on the world stage. In fact, apart from a few wealthy individual investors, firms are the economic entities that *must* create value across national boundaries. Firms are responsible for producing and delivering the goods and services that benefit the people of the world. And firms are the actors that can create new opportunities for sustainable economic development.

Even as the political debate continues between proponents of *globalization* and its "discontents,"[1] companies are wrestling day-to-day with the process of *globalizing*. The debate over globalization is itself part of the context for world business, but managers of global corporations face other complex problems. They need to lead and govern far-flung international enterprises, enter diverse international markets, and manage risks and uncertainties that range from global supply chains to financial risks to geopolitical risks.

Our objective in this book is to illuminate and understand more fully the challenges that confront managers today in firms that are globalizing. To this end, faculty from Wharton and INSEAD probe deeply

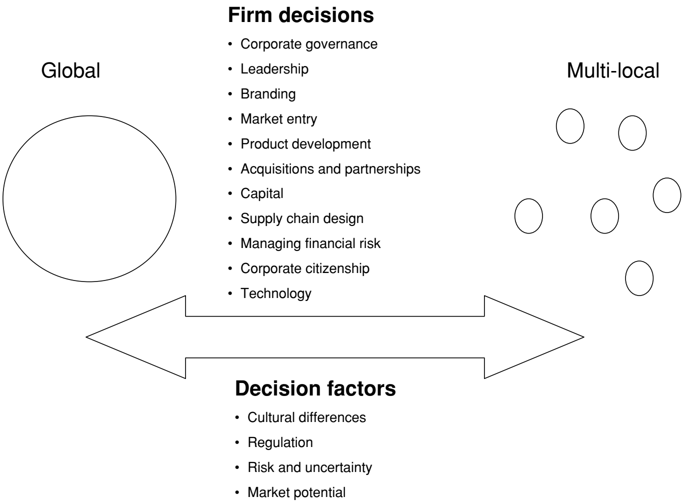

Figure 1.1. Globalizing decisions.

into issues of leadership, finance, marketing, operations, mergers and acquisitions, and entrepreneurship that are encountered as firms globalize.

Decisions without borders

To consider just one dimension of globalizing, managers need to decide whether to pursue a global or multilocal strategy in a variety of business areas, as summarized in Figure 1.1. Should the company develop global brands or tailor branding to the quirks of individual markets? To what extent can the company create more uniform global products? What are the opportunities and risks of establishing global supply chains? How can the company successfully complete a merger that joins together diverse organizational and national cultures? How can the company be a good "corporate citizen" when it is expected to be a citizen of so many different nations? How should its leadership be tailored to the demands of individual cultures while addressing the concerns of global investors? Among the factors that might influence such decisions are the extent of cultural differences across regions in which the company operates, the regulatory regimes that apply, perceptions of risk and uncertainty, and estimates of market potential. These and many other factors in the environment and within the organization will shape the choice of strategy for globalizing.

As complex as the decisions presented in Figure 1.1 may be, the figure itself is a heuristic that necessarily oversimplifies the reality that managers face. In practice, they are faced with a wide array of options, from creating a wholly owned subsidiary to becoming a small shareholder with one partner.[2] They may create a portfolio of brands and products, some of which are global and others of which are local, depending on factors such as the specific products, cultures, and targeted segments. Furthermore, decisions about globalizing occur within the context of broader business considerations such as ensuring returns on investment, recognizing organizational constraints, or addressing competitive threats.

Global challenges represent complex and interwoven puzzles. Although each of the following chapters of this book focuses on a different set of decisions, in practice these decisions are closely linked. Leadership and governance, for example, cannot be separated from regulation. Product development must go hand-in-hand with supply chain design and management. Listing the firm on different international exchanges affects the role of investors in shaping governance. Advances in telecommunications and other technologies have facilitated the rise of global outsourcing, with an estimated 3.3 million white-collar jobs and $136 billion in wages being expected to move from the United States to other countries by 2015.[3] As security has become a greater national priority for the United States and other nations, the "Washington Consensus" of the 1990s, which promoted increasing globalization and the establishment of a "new world order," has begun to unravel (accelerated by the tragic events of September 11, 2001). The emerging "new world disorder" has increased political, economic, and financial risks,[4] raising the importance of companies' tactical, globalizing decisions in areas such as market entry, branding, or operations.

To add further to the complexity, the global environment is not static. For example, once a company has made a decision to enter a specific market, managers might then need to rethink their decisions about other issues such as product development, supply chain and financial risks, or corporate citizenship. There are dynamic changes in the environment, including economic crises, new regulations, or political rebellions that can have a significant impact on these decisions over time. Regulatory changes such as the passage of Sarbanes–Oxley in the United States, for example, have had significant, and often unexpected, impacts on firms in Europe and other parts of the world.

Understanding the process of globalizing

The process of "globalization," which has grabbed the headlines, refers to the big-picture process that draws products, services, and markets around the world closer together. It is a process that involves a complex array of actors and institutions, including firms, governments, NGOs, and consumers. This process is typically analyzed at the macroeconomic level, where the country is the unit of analysis. The primary focus of the often strident and heavily rhetorical debates about globalization has been on macroeconomic policies, as exemplified by the discussions on the Tobin tax, on the role of international institutions in influencing these policies, and on what some see as the exploitation of underdeveloped countries and their labor forces (or, from another perspective, the threats of outsourcing from these countries to domestic economies).

Globalizing, in contrast, refers to the process by which a given firm becomes increasingly global in its objectives and operations. Few, if any, firms are truly "global"; many, however, are globalizing. In our view, globalizing is a process that unfolds not at the level of the country but at the level of the firm, and consists of the actions firms have to take as they become more engaged in that process. This book focuses on the business side of the global challenge: managing the process of globalizing in today's increasingly interconnected, fast-moving international environment.

Globalization creates the context for globalizing

To understand the process of globalizing, we certainly cannot ignore the broader process of globalization. Our global political and economic systems create the context for our business enterprises. As Thomas Friedman writes in *The Lexus and the Olive Tree*, "the slow, fixed, divided Cold War system that had dominated international affairs since 1945 has been firmly replaced by a new, very greased, interconnected system called globalization."[5] This global system is quite different from the period of globalization that preceded World War II. In contrast to the pre-war global economy based on shipping, the current era of globalization is facilitated by technology and has made the flow of information and capital nearly frictionless. As Friedman points out, the post-Cold War global economy is also different politically, because it is based on an open international trading system. Technological advances combined with political openness have forged a dramatically different environment for business. While the process of globalization that Friedman chronicles has changed the world in significant and, sometimes, irreversible ways, recent political shifts may have begun to slow or even reverse what once appeared to be a rapid and relentless march to greater economic integration.

With the maturing of a global economy, there remains a basic mismatch between global financial markets and our political institutions, a gap that places deeper demands on business leaders to fill in the missing pieces. As George Soros notes in his book *On Globalization*, "the development of our international institutions has not kept pace with the development of international financial markets."[6] He points out, for example, that while capital can move freely around the globe, people cannot. As a result of this mismatch between regional regulation and global economic activity, current institutions such as the World Trade Organization have come under attack from both the left, where activists protest the destructive impact of globalization on local economies and cultures, and the right, where there are worries about the impact of these global institutions on restricting open markets.

This lack of global infrastructure also means that companies sometimes have to step into the gaps to create their own infrastructure or policy, or work as partners with global organizations and governments to create conditions in which they can conduct business. The relationships between government, NGOs, international agencies, and companies can be quite complex, particularly in the developing world. For example, the Chad–Cameroon oil pipeline project in Africa was developed through the cooperation of the World Bank, national governments, NGOs concerned about impact on the environment and indigenous cultures, and a consortium of major oil companies, who compete fiercely against one another in this region and other parts of the world.

Companies can and do influence the process of globalization in a variety of ways, although the extent of their impact is debatable. The highly visible success of global firms such as McDonald's and Disney has been a lightning rod for protesters concerned about cultural dominance and economic imperialism by US multinationals. Because firms can profit from globalization, they may contribute to the pressures on governments and international organizations to liberalize exchanges, a criticism that has been made of the influence of American lobbies especially on the negotiations of the World Trade Organization.[7] However, as we will see, other forces are probably more significant.

While the concept of giant multinationals practicing global corporate imperialism may be appealing to the popular imagination, these firms still depend upon a democratic process of attracting consumers who are free to vote with their dollars, rupees, euros, roubles, or yuan. Unless these global companies bring benefits to local markets and populations, their long-term prospects will be limited. Even as protesters around the world were targeting the storefronts of Western megabrands, consumers in these countries were continuing to purchase US products. For example, while students were protesting the US-led war in Iraq in 2003, they still headed to the theater in the evening, driving overseas box office receipts for American movies to near-record highs.[8] And although there will inevitably be highly visible instances where a firm's managerial practices clash with local cultures, part of the success of global firms is derived from the application of management practices developed elsewhere (and ideally adapted to local circumstances). Questions about the protection of a culture may fall largely into the political domain, but firms must take these cultural differences into account in the development of their strategies and in managing their operations. Adapting and responding to local markets is not only good global citizenship; it is good business.

This global context is dynamic and uncertain. The breakdown of WTO negotiations in Cancun and the vote in Sweden against adopting the euro have a significant impact on integration of global and European markets. The agreements that are forged at these meetings, or fail to be forged, not only affect the progress of individual nations but can also rapidly improve or limit the prospects for specific and even local global firms.

Global economic interdependencies and opportunities continue to increase with the rapid rise of offshoring of service operations. Through business process outsourcing (BPO), companies are shipping out call centers, transaction processing, claims processing, data entry, MIS reporting, cash-flow forecasting and insurance yield and risk analysis.

Gartner Research estimates that offshore business process outsourcing services will grow from $1.3 billion to $24.3 billion from 2002 to 2007, an 80 percent compound average growth rate.[9]

These shifts have tremendous impacts both at home and abroad. As Marcus Courtney, an organizer with the Washington Alliance of Technology Workers, an affiliate of the Communications Workers of America, told *Knowledge@Wharton*, "America's leading high-tech companies such as Microsoft and IBM are exporting our country's best-paying high skilled jobs in order to slash labor costs. This trend will only increase job insecurity, lower wages and mean fewer benefits for America's white-collar professionals."[10]

Even if businesses are not actively engaged in the debates over globalization themselves, they cannot ignore them. In this book, we explore how firms can best respond to the opportunities offered by the globalization of world markets for the good of the people of the world as well as for their own sustainable economic development. We also discuss how firms must take into account the implications of less positive trends such as the highly visible and sometimes violent reactions of protest groups, even if these reactions are frequently more directed at governments and international organizations like the IMF than at individual firms. To understand the context for globalizing decisions, we begin with an analysis of some of the forces that are driving globalization in general.

Forces driving globalization

To understand the dynamic unfolding of globalization, we need to consider the complex forces that are driving this process. While recent writings on globalization have focused more narrowly on the proactive role of international organizations such as the IMF or the WTO in the liberalization of markets,[11] many other factors are impelling or impeding this process of globalization, including:[12]

- *Liberalization of capital markets:* With the digitization of capital, investments have flowed ever more freely across international borders. Much of the attention has focused on problems resulting from this liberalization, such as financial crises in Asia in 1997, the Russian crisis, and the Argentinian crisis of 2002, which sparked criticism of IMF policies. Opponents of liberalization criticized the free movement of capital across countries and, most particularly, the hot money characterized by short-term speculative cross-currency movements. Proposals such as the Tobin tax or the Chilean tax on short-term capital have been made to limit these speculations. Without in any way denying the problems of speculation and the macroeconomic remedies that may be applicable, there have also been benefits from this liberalization. For example, one of the benefits of liberalization is greater access to funds for individual entrepreneurs or small and medium-sized firms. Outside of the United States, banks are very often under the control of governments that favor lending to institutions they control more or less directly or formally.[13] This has been the case in South Korea,[14] and also in France, as the scandals of the Crédit Lyonnais during the 1980s illustrated. While more government controls may be placed in the future, as recommended by highly respected economists, it will be difficult, considering economic history over the long term and the increased flow of goods and services across nations, to prevent further liberalization of the capital markets. This liberalization of capital markets has clearly created many opportunities for investment, but also increased risks from currency fluctuations and interlinked financial markets.

- *Advances in technology and accelerating information flows:* Rapid technological progress has had direct and indirect impacts on globalization. Among its direct impacts has been the shift to manufactured products from agriculture, especially for the developing countries that have difficulty in competing in food products with heavily subsidized rivals from the United States and Europe (receiving 20 percent to 35 percent subsidies, respectively).[15] Communication and information technologies have facilitated exchanging information and conducting transactions quickly and cheaply, diminishing the barriers of distance and international borders. These changes have spawned new industries and created new opportunities, as well as sparked debate about legislation to control them. The flow of information, in turn, accelerates the diffusion of innovation between countries. Diffusion occurs at different rates in different countries, and business leaders need be concerned about the rate of transfer of technologies between countries to manage cross-border innovation, develop new products and services for a global market, and protect intellectual property. They also need to look at the potential opportunities and threats created by the Internet and other technologies, particularly their second-order and third-order effects in transforming business models and markets. The costs and risks of moving too slowly or too quickly can be enormous, as telecom companies found in sky-high bidding for G3 wireless licenses in Europe at a time when the industry was retrenching.

• *Mobility of people:* While people, at present, remain for the most part bound to their homeland, we can expect a sharp increase in labor movement over the coming decades. The movement for a free labor market started with the unification of Germany and the dismantling of the Communist bloc.[16] Several factors support a continuation of this trend. The populations of industrialized countries are getting older, creating a demand for labor, while poorer countries with young, active populations have a labor supply growing beyond what they can absorb. Moreover, these cheaper workers in some emerging countries have received the best education, which makes them competitive in the world labor market. The populations of the most industrially advanced countries are more diverse than ever. Migration is increasing, driven by factors such as wars and political dissent as well as economic opportunities. Some have argued that an increase in the freedom of labor movement will be indispensable in the future.[17] A smaller, but nevertheless critical phenomenon is a significant increase in passenger traffic for business and tourism. Increasing movements of people around the globe have obvious implications for human resources decisions of companies, and also affect the diffusion of products, ideas, and culture.[18]

• *Mobility of products:* Barriers to trade are falling, in large part because of the role of the GATT and the World Trade Organization. There are still limitations, mostly due to the effects of lobbies, either for business or for cultural protectionism or both. Nevertheless, in general, the possibility of selling any product anywhere in the world is becoming a reality. This creates opportunities for businesses to enter diverse markets more easily. But competitors have the same opportunities so it has led to new threats from aggressive global competitors who can move much more easily into an established firm's markets at home and abroad. Competition can come from unexpected quarters.

• *Decline in transportation costs:* Part of the reason for the mobility of people and goods is the decline in transportation costs. Increased capacities and new technologies have reduced costs to the point that materials that were too bulky to transport long distances are now manufactured in a single location and shipped to the rest of the world. The new Beetle, produced in Puebla, Mexico for export around the world is a good example. Reduced transportation costs have major implications for the localization of manufacturing facilities and global sourcing. As long as energy costs are low, this trend is likely to continue.

• *Global regulatory harmonization:* Two major factors motivate a greater harmonization of regulations. First, as firms transact more across country boundaries and compete on a global basis, the need for homogeneous regulation increases, as seen in the standardization of international accounting rules. Second, greater diffusion of concerns about environmental issues such as the emission of toxic gases in industrialized countries and deforestation in developing countries is leading to greater harmonization of global regulations in this area. Businesses often feel the greatest impacts of these regulations, both positively and negatively. On the one hand, clear and uniform regulations can help reduce uncertainty and level the playing field across international markets. On the other hand, new regulations can restrict a business or destroy it, or impose significant additional costs, from environmental compliance or from taxation, on companies.

• *Cultural convergence (cultural context and identity):* Similarities among cultures can be expected to increase in the future on account of sharing of products, experiences, travel, and communications, and the use of the English language as an international mode of communication. This does not mean, however, that all cultures will move towards a single culture. While globalization is sometimes accused of leading to cultural hegemony, or at least homogenization, it is not clear what is the cause and what is the effect.[19] There are clearly a number of factors which explain cultural convergence – such as economic development, urbanization, and mass media coverage – that have nothing to do with globalization. History and languages are also intimately linked to cultures and are very resilient. There may also be greater differences among groups of people within countries than across. For example, rural populations in a given country may be more similar to rural dwellers in other nations than urban populations in the same country. Increasing uniformity can facilitate the development of mass markets, while awareness of cultural differences can help companies identify niche opportunities. Cultural convergence is also a key concern of critics of globalization, and companies need to be aware of and respond to these concerns about respect for local cultures as they build global businesses.

• *Emerging markets and economic development:* During the last two decades, a number of countries have reached levels of development