

THE NEW WAVES IN GLOBALIZATION AND COMPETITIVENESS

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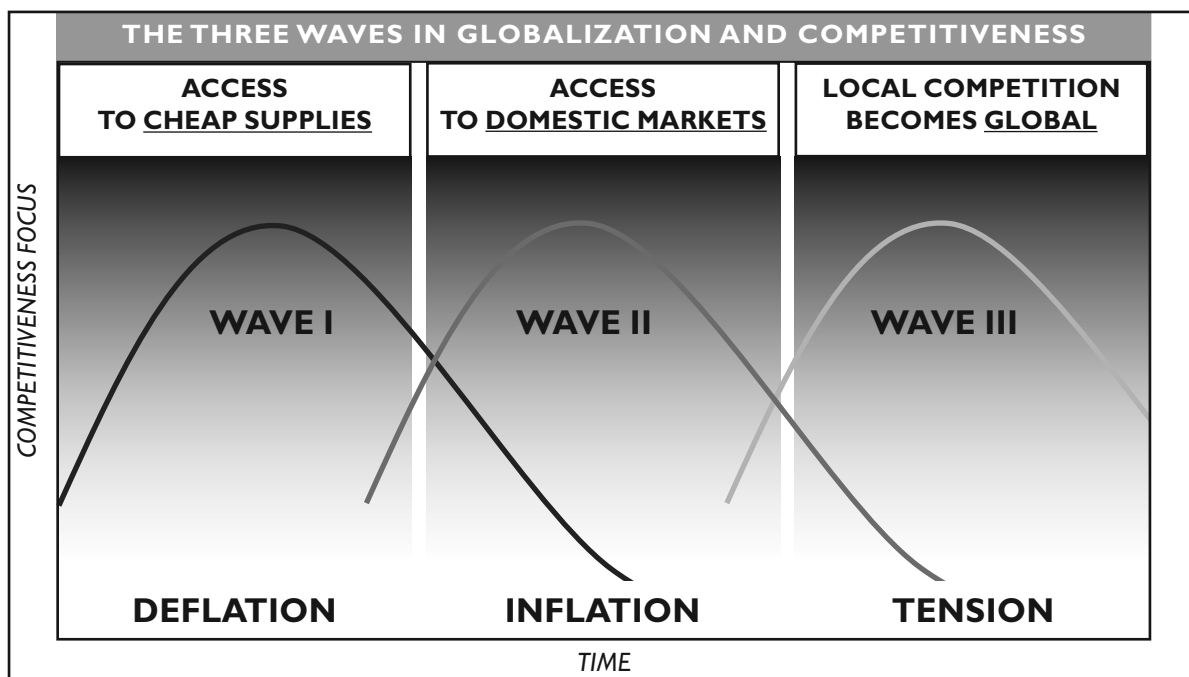
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The financial crisis should not blind us to the fact that the world is not what it used to be! New players have entered the world economy – local brands, sovereign funds, etc. – and they have changed the rules of the game. The power base of the world economy, which used to be centered on the US, Japan and Europe, is now more diluted. Money, work, brainpower and technology can be accessed almost everywhere.

In an early stage, global companies entered emerging markets mainly to lower their costs of supplies. Today, their roles are shifting and they are key players in the development of emerging nations, which are eager to build their infrastructure and develop their domestic consumption. But tomorrow, global companies will have to compete with the homegrown companies and brands that are being born and bred in today's emerging nations. Emerging markets are becoming emerging powers. The partners of today will become the challengers of tomorrow.

Globalization and competitiveness thus evolve in waves. Each successive wave has its own business logic and its own mode of operation. And each wave eventually fades away to be replaced by another. The actors may be the same, but they play different roles.

Carl von Clausewitz, in his book on “war” in 1832, rightly stated: “Strategy is not a lengthy action plan; it is the evolution of a central idea through continually changing circumstances”. The “wave” approach provides an insight into these changing circumstances.



1. The First Wave of Globalization (1985 – 2000)

With the fall of communism, the world economy has opened up and expanded. Twenty-five years ago, it served 580 million people, mainly in the US, Europe and Japan. Today, only a few nations maintain closed markets: North Korea, Myanmar and to a lesser extent Cuba. The world economy now serves 6.3 billion people, a ten-fold increase over a period of only 20 years.

In hindsight, the Iron Curtain era stalled the economic expansion of a significant part of the world. As a consequence, the populations concerned significantly lagged behind the West in purchasing power. Differences in salary levels of 20 to 1 were not unusual. This cost advantage, combined with local policies to attract foreign investments, induced global companies to exploit these new opportunities massively.

In the first wave, Western companies have thus focused on the access to cheap supplies, such as labor, raw materials or logistics (e.g. service centers in India). As a consequence of this strategy, the prices of most goods globally produced have declined. Computers, cell phones, electronic devices and appliances are cheaper today than 15 years ago.

The access to cheap supplies has evolved: In the latter part of this first wave, companies moved from seeking not only cheap manpower but also cheap brainpower. China, Russia and India produce roughly 14 million university students a year, almost as many as the US. These young professionals are competent, cheap and highly motivated. They are very much in demand by global companies.

The main characteristic of the first wave of globalization is thus “deflation”, a persistent decrease in the level of consumer prices. Between 1985 and 2000, the term “inflation” disappeared from the vocabulary of economists, at least in the most advanced economies.

2. The Second Wave of Globalization (2000 - 2020)

The second wave is now in full swing. The priority is not so much to have access to cheap supplies, but rather to have access to the domestic markets of emerging nations. According to the UN, Asia’s population will increase from 4,030 million to 5,266 million by 2050; Africa will grow from 965 million to 1,998 million during the same period of time.

However, just looking at the population numbers does not highlight some very fundamental structural changes that will affect the competitiveness of companies.

The Middle-Class Revolution

One of the most important changes may be the birth of a middle class in Asia, Russia, Central Europe, Latin America and the Gulf region. Since 2000, 600 million people have reached middle-class status; they spend on average some \$4 billion per year. In India, for example, 50 million people are today considered middle class – there will be 580 million by 2030.

This new middle class – just like in Europe and the US in the 20th century – is eager to buy branded products (status symbols) such as electronics, cars, housing, better healthcare, holidays, etc. As a consequence, the private consumption portion of GDP is expanding rapidly: It is still only 40% in China, compared to 60% and higher in most industrialized economies. Companies could thus be well advised to focus their products and services on the needs of this new middle class.

This new class of people will be the engine of world growth during the next two decades. Ayn Rand, the American writer, said, “The upper class is the past of a nation; the middle class is its future!” It will also be a source of political stability – middle classes do not care much about revolutions.

Birth of an Urban Civilization

The middle class is also closely associated with the development of cities. In 1800, only 2% of the world population lived in cities. It will be 60% by 2030. During the 20th century, the population living in cities exploded from 150 million to 2.9 billion.

The world is witnessing the birth of an “urban civilization” and of an “urban economy”. Both have very specific needs, such as better transportation, communications and leisure and there is concern about the environment.

Surprisingly, we have little “management” knowledge on how cities operate. Congestion problems, in cities all over the world, seem to indicate that many authorities still follow a “muddle-through” approach to urban development. Urban planning as a management technique is still in its infancy.

New Products to Serve New Customers

Parallel to the middle-class revolution, a booming world economy – 110 countries have grown above 5% in 2007 – is gradually eradicating absolute poverty. In 1970, 15.4% of the world population was living on one dollar a day. Today, adjusted to purchasing power changes, only 5.5% of the world population is in this category. Most of the eradication of poverty has taken place in Asia; however, it remains at endemic levels in Africa, Latin America, etc.

This massive influx of “new customers” into the world economy has obvious implications. For example, they cannot buy the same products and brands as the middle class. Companies need to develop a new business model, which aims at serving the poorest that are entering the world of consumption. Some products already exist: The \$100 PC, the \$2,500 car (e.g. Tata in India) and micro-credit. This market will attain huge proportions in the future as the world economy continues to expand rapidly.

Consequences

As a consequence of the Second Wave of Globalization – that is the emergence of a middle class that boosts the attractiveness of serving local markets – an explosion in private consumption worldwide has been triggered and raw material and food prices are rising.

Oil prices are above \$100, but all raw materials have been in strong demand since the beginning of the second wave of globalization. Most of it is the result of China’s formidable appetite for most basic commodities. Today, China alone accounts for 19% of world consumption of aluminum, 20% of copper, 27% of steel, 31% of coal and 47% of cement. As a consequence, prices have reached record levels.

As far as oil is concerned, world consumption is expected to soar from 86 million barrels/day in 2008 to 130 million barrels/day by 2030. Almost 45% of this growth will be the direct consequence of increased consumption in China and India. Respectively, they now account for only 8.5% and 3.5% of world consumption; but they are growing at a rate of 11% and 8% per year!

Food prices are also feverish. The Food and Agriculture Organization’s (FAO) food price index for 2007 shows an unprecedented increase of 37%. The prices of rice and wheat have more than doubled during the past 12 months. World stocks of wheat have dropped from 18 to 12 weeks. Riots for rice in the Philippines or the price of pasta in Italy are becoming daily news. Every other food commodity seems to be affected, including fish. In England, the price of the formerly humble codfish has been multiplied by four in five years!

The emergence of a middle class changes consumption patterns, especially for food. The World Bank estimates that world cereal consumption will increase by 50% by 2030, and meat consumption by 85%! The impact on the environment as a result of this could be quite catastrophic. Shortages of water, soil pollution through over-exploitation and pesticides, are

some of the problems that will emerge. For example, one cow produces 300 liters of methane – a gas responsible for 45% of the ozone layer pollution – per day. The complete production cycle for 1 kg. of beef requires 15,000 liters of water!

In the second wave of globalization salaries increase and drive further increases in private consumption, raw material prices, food prices, etc. As a consequence, while the first wave was characterized by “deflation”, the second wave is now struggling with that old demon “inflation”! The latest data available (February 2008) show the US running a consumer price inflation rate of 4.0%, in the Euro area it is at 3.5%, India at 5.5% and China at 8.7%!

The pressure on prices is exacerbated by the fact that most emerging economic powers are now, from an economic point of view, in a “catch-up mode”. They want to regain lost time (during the communist era) and concentrate on high growth rates, almost at the expense of environmental and social issues. Historically, Asia accounted for more than 50% of the world GDP in the early 19th century, compared to 37% today. It may very well reach that level again by the end of the second wave.

For companies, a surge in inflation means reviving the good old cost efficiency strategies. However, most of the management techniques that are available to attain such a goal have already been implemented: quality and reengineering in the 1980s, outsourcing and off-shoring in the 1990s, full globalization in the 2000s. What is left? Today, one of the avenues increasingly explored by companies is to reduce the complexity of their business models. Globalization generates unnecessary levels of complexity in the way companies operate internally and relate to their customers. As Peter Drucker put it: “There is nothing so useless as doing efficiently something that should not be done at all...”

3. The Next Wave of Globalization

What will be the third wave of globalization? Most probably it will feature the emergence of new competitors in currently emerging nations, such as sovereign wealth funds, and local companies and brands that will strive to become global in their own right. After the eras of “deflation” and “inflation” the world will enter the era of “competition and tension”.

New Actors on the World Stage

Who will be the new actors that will attempt to conquer world markets?

The governments of emerging nations will enjoy an unprecedented economic power base. These nations are stacking up foreign currency reserves at an impressive rate: Number one is now China with \$1,647bn, followed by Japan \$1,008bn, then Russia \$502bn, India \$304bn, Taiwan \$278bn and Korea \$262bn. China now holds more than \$450bn in US Treasury bonds and is the second largest creditor to the US government after Japan.

Sovereign funds are managing substantial amounts of money, estimated today around \$3,300bn. The largest such fund, ADIA from Abu Dhabi, is said to be worth more than \$900bn. The strategy of these funds will be threefold: taking financial participation in large industrial and financial institutions, acquiring smaller industrial (or energy) entities and allocating some of their assets to national objectives such as improving the financing of their national pension scheme (eg. Russia).

New companies and local brands are being created at an unprecedented pace all over the world. They grow quickly, both locally and globally. In many instances they have benefited from a partnership with large global companies that have shared technology and management techniques with their local partners. Today, the former local partners are becoming global competitors.

New Billionaires

A middle class also generates entrepreneurs, especially in countries where a tradition of trading and business is part of a nation’s culture. Quite rapidly, these new companies list on the stock exchange and generate a formidable explosion in valuation. As a consequence, the number of high-wealth individuals has increased at a phenomenal rate in emerging countries. Today, there are more billionaires in Russia than in Germany and in India than in England. Of the four wealthiest people in the world, two (Carlos Slim of Mexico and Mukesh Ambani from India) are from emerging nations.

Acquiring Knowledge

Although the third wave of globalization has already started, it is not yet pervasive. The biggest obstacle to the completion of this ultimate stage – aggressiveness in global markets – is the lack of management competencies. The acquisition of large foreign industrial, financial or energy assets is one thing, managing these acquisitions is quite another.

In the first phase, which is already underway, emerging nations will probably focus on taking minority financial participations in blue chip companies in order to obtain a seat on the board. This “learning process” also explains the participation of China in the capital of Blackstone, the US global asset and private equity manager. Once emerging nations have generated enough experience and acquired sufficient management knowledge, the third wave will then move into “full acquisition” mode.

When this happens, the balance of world power – both economic and political – will shift dramatically. Emerging nations will demand more influence and decision-making power in international organizations, as, in all likelihood, they will increasingly finance them. They will also step up the pressure against protectionism in order to gain more access to the domestic markets of industrialized nations.

This will be a time of increased political and economic tension, reflecting the disarray of the governments and populations of the formerly called industrialized nations that will have to fight harder to maintain their standards of living and their influence on world affairs.

We are not there yet – but it is coming fast!