

Is Global Trade a

Globalization of life and trade in the 21st century and beyond is upon us. And, like the Chinese philosophical concept of yin and yang — which describes two opposing but complimentary principles or global forces — open global trade among nations and companies is often viewed from two perspectives: opportunity and threat.

Regardless of which view is held, however, the time and pace of events and developments are driving change in the essence of trade among nations and companies.

By Jim Champy Instead of fighting or avoiding the inevitable, smart companies — and countries — are rapidly expanding their capabilities and know-how to embrace the opportunities and overcome potential threats.

When the National Academies (of Science, Engineering and Medicine) published its 2005 report on U.S. global competitiveness, open global trade certainly looked like a threat to U.S.-based companies and the U.S.

economy. The title of the report, *Rising Above the Gathering Storm*, signaled what's ahead.

A follow-up essay published by Norm Augustine, chair of the committee that developed the *Rising Storm* report, noted (among others) the following alarming conditions:

- The U.S. share in the world's leading-edge semiconductor manufacturing capacity dropped from 36 percent to 11 percent in the past 7 years;
- The U.S. "Big Three" automakers announced the closing of 26 plants in the U.S. over the next several years, while Japan-based companies are opening four new plants in the U.S. between 2006 and 2008;
- Only one of the 25 largest initial public offerings in 2006 took place on American exchanges;
- American companies spend three times on litigation what they do on research; and
- The U.S. ranks 17th among nations in high-school graduation rate and 14th in college graduation rate.

In another reference to the threat

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The age-old argument resurfaces 21st century-style, as modern developments and technology spawn new sources for materials and customers on a scale never before possible. Along with the golden opportunity for expanding open trade among companies and countries, however, many see the other, darker side.

Threat or Opportunity?



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For companies that embrace global trade and build the capabilities to operate globally, open markets will be the key to growth. The U.S. economy alone may no longer support the growth of many companies.

of open global trade, Augustine titled his essay, "Is America Falling off the Flat World?", a nod to Thomas Friedman's blockbuster book, *The World is Flat*. Friedman fairly assesses the impact of open global trade: access to new sources of supply, talent and customers. But the flat world also means new competitors that will change the structure of industries and the basis of competition.

Examples already abound of the force of such new competitors: Nokia Corp., of Finland, in cellphones; Infosys Technologies Ltd., of India, in information services; Lenovo Group Ltd., in China, in personal computing. These companies, and others like them, are providing quality products and services at highly competitive prices.

Many U.S. Companies Are Strong

Not all prognoses for U.S. competitiveness, however, are gloomy. The World Economic Forum has just published its annual assessment of the competitiveness of countries. It ranks the U.S. as the world's most competitive country, up from sixth place a year ago. The good news is that most

U.S. companies continue to be highly innovative, both in the products and services they provide, as well as how those products and services are delivered (see sidebar on the next page).

However, the study's author, strategist Michael Porter, warns that the larger economic condition of the U.S. — balance of payments and dependencies on foreign sources of energy, along with a weakening dollar — puts the U.S. and its companies at risk.

Global conditions aside, a look at individual U.S. companies shows that they can and do compete. The Boeing Co., for examples, continues to write orders for its jumbo jets — in spite of the competition from Airbus. Multiple European governments have helped Airbus grow, while U.S.-based Boeing flies solo.

Boeing is applying highly innovative engineering and manufacturing capabilities to building its jumbo jets. It's reengineered how it sources globally, and its planes utilize the most advanced carbon fiber technologies. These innovations will eventually change how all airliners are manufactured.

For Boeing, global trade means access to more markets and customers. From its position of innovation and competitive strength, it's clear that global trade presents no threat, but rather a big opportunity.

The Opportunity

For companies that embrace global trade and build the capabilities to operate globally, open markets will be the key to growth. The U.S. economy alone may no longer support the growth of many companies.

How will global trade support growth? Information technology now enables access to millions of additional highly skilled and motivated workers. Companies in the information services business are all adopting a global delivery model, a way of operating that puts work onshore, offshore or near-shore — wherever it can best be performed at the best price. And work is moving not only because of price, but

because of talent and skills.

Companies like IBM Corp. and Accenture, for example, would find it almost impossible today to deliver their services solely with a U.S.-based workforce. There are just not enough U.S.-based information technology professionals. The key to growth in the services industry is being "global," both in terms of sourcing talent and in finding customers in new markets.

On the product front, the wonders of modern-day logistics enable products to be manufactured wherever quality and price dictate. Some countries support the export of manufactured goods with purposefully lax controls — even at the cost of product safety, as the U.S. has recently experienced with some "made in China" goods.

These lax controls may first appear as a threat, giving off-shore competitors an unfair advantage. But consumer rejection of faulty products gives hope to the proposition that product quality means something — and that the manufacture of all goods will not leave the U.S. shores, and that U.S. companies will step up their diligence over suppliers for their products manufactured abroad.

Indeed, U.S. manufacturers have proven that they can export products — high-tech machine tools are a good example — and operate globally, from General Motors Corp. making cars in Asia to Kellogg Co. making cereal in Germany.

Global trade also opens up new markets with new customers. The flat world has 3 billion people waiting to become new consumers. As countries like India develop, new classes of customers with buying power are emerging. New consumers quickly acquire new appetites to buy — and U.S. companies just have to develop an appetite to sell into these markets.

Tata Motors of India is developing an automobile that will sell for \$3,000 to a new class of consumer. Why won't GM, Ford Motor Co. or Chrysler LLC do the same? These "Big Three" U.S. manufacturers certainly possess the engineering capabilities.



Innovating to Drive Differentiation, Competitive Advantage

Cargill Inc.'s concept of infusing modern technology into its logistics system has enabled it to deliver fresh food to thousands of customers in four Central American countries. It's also making doing business with Cargill more dependable for owners of "*tiendas*" (comparable to "mom and pop" stores in the U.S.).

When Cargill's Sun Valley Foods business acquired Perry Foods in 1999, it looked at the business as a supply chain challenge, says Greg Good, who leads the Supply Chain practice for Cargill's Strategy and Business Development. Sun Valley handles retail-branded, processed meats and cheeses in four countries — Guatemala, Nicaragua, Costa

Rica and Honduras — the "heart and soul" of which is delivering to its thousands of customers in remote locations, and ensuring freshness of mostly perishable goods.

What they each sorely need, however, is a new operating model and the state of mind that sees the opportunity — for their business and, thus, their customers, employees and shareholders — instead of seeing the situation as a threat.

Looking at its acquisition, Good says, there were three principal issues to deal with: food safety (upgrading where necessary), general plant operations (including employee safety and making sure they were up to Cargill's standards) and the distribution itself.

The Specter of Protectionism

The Perry Foods business (like much of Sun Valley's business in the region) was serving customers who didn't have freezers or large refrigerators to stack with food, and who shopped daily to purchase fresh ingredients that were needed for that day's meal. In turn, the 30,000 tiny stores serving these customers had little refrigerated storage space and, thus, little room to stock inventory.

The challenge, says Good, was "how do you distribute fresh food — within our product line — so the stores can have the right inventory at the right time for customers?"

They selected a "high-service, high-touch customer solution" for improving the delivery system, says Good. For the Guatemalan market, they used a GPS system to map out all 30,000 locations their trucks and motorcycles would service — aiming to find the best routing and best time-frame for getting from store to store.

"We found this approach allowed us to differentiate from competitors in several ways," says Good. First, they became very efficient at laying out paths so that drivers were making the stops that needed to be made in the right order. As a result, Sun Valley became well-recognized for being extremely accurate in timing deliveries. "A shop-owner knew that the Sun Valley truck or motorcycles would arrive with that day's distribution at, say, 9:00 am on delivery day," says Good.

Unfortunately, there are those who see global trade only as a threat to U.S. jobs. The response is a call to government for policies that protect jobs. Some companies also fear the fierce price competition that open global trade often produces. These companies, too, seek government help in establishing trade barriers and leveling tariffs on imported goods and taxing companies for certain offshore business operations.

Second, through the use of handheld computers by drivers, Sun Valley was better able to manage inventories and invoices to its customers.

Another advantage is that the system allowed Sun Valley to make deliveries twice a week, whereas competitors were only delivering once a week. This additional delivery has served to build confidence and trust with the *tienda* owners, and more business has come to Sun Valley because of it.

With changes likely on the horizon in Washington, there is the prospect that these protectionist voices will be heard more forcefully and that the U.S. government will, indeed, take action to create laws and regulations that favor U.S. labor and U.S. companies at the expense of open trade and competition.

Routing was set up so drivers could leave one of the several plant locations where the product was made. The project started with a fleet of refrigerated trucks, pickup trucks and motorcycles equipped with coolers (similar to that pictured above). Due to concern for the safety of the drivers, the motorcycles have been upgraded to small delivery trucks.

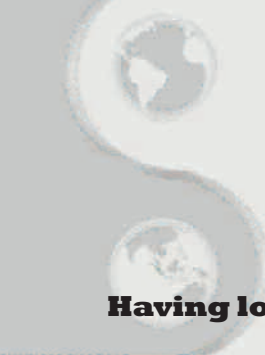
Such policies could prove to be a big mistake and create additional problems. It is appropriate to lobby other countries — and even to apply some subtle economic pressure — to assure fair trade practices and global monetary policies that give all companies a fair chance to compete on the proverbial "level playing field." But strict protectionist measures always result in creating weak country economies and weak corporate competitors.

Since the initial launch, the sales and delivery program has been started in all four Central American countries. Cargill continues to work on improvements — in the areas of enterprise resource planning (ERP) systems and standardizing the back end. The approach of using handheld computers and the GPS modeled-system to deliver on a very tight schedule to *tienda* locations continues to be improved and expanded across the region. The process was touted in print and TV ads for Cargill.

While Cargill hasn't rolled this model out to its business in countries other than Central America, Good says some customers are asking about using the process in places like Thailand, Vietnam and others.

It was not too long ago that a college student in the U.S. shopping for

— Ellen M. Heffes



Having low costs is a requirement to compete globally. Even for those that are now industry leaders, pricing power will not be guaranteed in the long term. Customers will continue to ask for more — and for less.

a first car chose either a Volkswagen or Renault. More prosperous buyers might have shopped for a sleek Citroen or Peugeot. But, unfortunately, there are no longer Renaults, Citroens or Peugeots to be seen on U.S. highways. That's because French protectionist policies have bred companies that are weak global competitors. Companies that do not have to compete on open markets simply become lazy, and workers who do not have to compete for jobs ask — and get — more and more until their companies can no longer afford them.

Now, this policy works for some, as some innovative and quality companies do thrive, even in a protectionist environment. For example, luxury goods manufacturers in France are surviving, although an economy cannot live on \$2,000 handbags and good cognac alone!

Longer term, the U.S. may be saved from any protectionist movement by the strength of consumerism. Consumers and their economic clout rule in the U.S. — even over labor. The fact that much of what Wal-Mart Stores Inc. sells is made in China does not seem to dis-

turb consumers — but if consumers had to pay twice as much for those goods because of protectionism, Congress would likely hear about it.

How Companies Can Seize The Opportunity

Global trade clearly presents enormous opportunity for strong and innovative companies. But companies must embrace global trade in order to not become its victim. The following are some steps that companies and their financial executives can consider:

■ *Develop a Global Business Model.* A company must look at its operations and ask hard questions about where work can best be performed, in terms of both quality and cost. The company must then develop a set of business processes that enables it to operate globally.

Today, for example, a U.S.-based manufacturer of automotive components might engineer its products in Germany, close to its customer; might produce the component in Taiwan; ship it to the Philippines to be tested; then ship the component to the customer to be installed in a vehicle. That vehicle will end up in a driveway in Atlanta. A company today must have processes and systems to manage that kind of work flow.

A real global delivery model also includes the ability to understand offshore markets and how to sell into those markets. This is not the old “hub and spoke” model with “foreign” branches. This is about operating in offshore locations, and living the business and culture of that country.

■ *Be a Low-Cost Producer.* Global trade means new competitors. Some will have the advantage of lower labor costs. Others will have achieved new levels of efficiency through better processes or improved technology. Whatever the case, having low costs is a requirement to compete globally. Even for those that are now industry leaders, pricing power will not be guaranteed in the long term. Transparency and access to multiple markets make customers very conscious

of price. Customers will continue to ask for more — and for less.

■ *Also Focus on Value.* On the “more” side, customers will want value, not just a lower price. A global business model has to deliver both. That's why companies like Nokia are able to compete globally. Each generation of a Nokia phone delivers more value for less cost — more functionality, better design, improved quality.

Also, the Huggies brand disposable diaper you purchase today, made by Kimberly-Clark Corp., is a far superior product to the one originally introduced in the 1950s — in quality, strength, ease of use, etc. And, due to innovation and technology, the cost is about the same inflation-adjusted price for a superior product as it was a decade ago. (Read more on Kimberly-Clark operating globally in the CFO Interview on page 20.)

A company's value proposition also determines its competitive distinctiveness in global markets. Competing on price alone means that a company's products or services have become commoditized — a very unattractive position.

■ *Find the Right Partners.* A company is not likely to have all of the capabilities to operate globally. Finding the right partners is critical, especially if a company for selling or sourcing in unfamiliar markets. But a partner should not be chosen on the basis of cost and capability alone. Business partners must share the same business values — especially across oceans. Global partners must be chosen very carefully.

How will a partner respond to a crisis, an operational breakdown, an unusual customer need? A company must be able to trust how its business partners will behave.

■ *Hire the Best.* In whatever markets a company operates, it must hire the best “athletes.” In the competitive global marketplace, talent is critical, and a company's workforce must have good international sensibilities. A company that is too American in its work style will not be effective in global trade. In Asia, for example, simply knowing how to exchange a

business card with a Japanese partner or customer demonstrates international sensibilities — or the lack thereof.

■ *Maintain One Culture.* A company needs to have a set of consistent internal business values that are shared by all its people — in all its locations. Ethics and behaviors must be consistent. Otherwise, trust breaks down between workers and a company experiences difficulties in global operations.

■ *Dramatically Strengthen Finance Capabilities.* Operating globally requires considerable change in the finance processes of a company. Many more questions need to be answered:

— Where and how should assets and profits be accounted for — and reported?

— What are the accounting and tax ramifications and choices of operating globally?

— What markets are best for raising capital? Are there advantages in borrowing in non-U.S. dollar currencies?

— How do profits get consolidated and repatriated, or do they?

Bottom line, finance requires much more muscle in global markets.

What's a Country to Do?

Companies that follow the steps outlined above will experience vast opportunity in global trade. However, if their home countries fail to support them with sound infrastructure policies, companies could find themselves at a competitive disadvantage. Competing globally requires a home country infrastructure that aggressively supports education — especially in science and engineering — and research that engenders innovation.

That's what the National Academies' *Rising Storm* report aggressively recommends for the U.S. Indeed, the *Rising Storm* report cited the following alarming facts:

— Almost twice as many bachelor's degrees were awarded in physics the year before Sputnik, deemed a time of dangerous educational neglect, as last year.

— The number of engineering doctorates awarded by U.S. universities to U.S. citizens dropped by 23 percent in the past decade.

— In 2002, Asian countries as a whole awarded 636,000 first engineering degrees; European countries awarded 370,000; North America awarded 122,000.

— Fewer than 15 percent of U.S. high-school graduates have sufficient mathematics and science credentials to even begin pursuing engineering degrees.

— The U.S. is graduating more visual-arts and performing-arts majors than engineers.

From the facts above, it appears that U.S. citizens are assured they will be well entertained, but the question remains as to how they will live and compete in global markets.

To truly compete worldwide, the U.S. must undertake aggressive programs to encourage and support students entering technology-related careers. U.S.-based companies are struggling to find the onshore science and engineering talent that they need to compete. IT jobs can no longer be filled just onshore, as the U.S. doesn't have sufficient skills. Educational reform and investment is required at all levels and grades.

Further, the U.S. government must expand its support of basic research — and not shrink it, as it has been doing. There is substantial evidence that basic research leads to innovation and economic profit. The growth of Silicon Valley around the Internet and Cambridge, Mass., around human health and sciences are examples of how research and education fuels economic growth and opportunity.

Companies must also adopt cultures of innovation that seriously support the development of new products and services. The U.S. has demonstrated consistently that it can produce highly innovative companies, but the country is at risk of falling behind.

Hard choices and substantial pri-

The Realities Of Global Trade

- Politics and technology have widely opened the world to global trade
- Global trade means access to new sources of supply and new customers
- Global trade also means fierce new competitors
- Protectionists will make noise and create fear
- The economic benefits of global trade are too great to reverse
- Competing in global trade requires a global operating model
- Countries must also provide a supportive fiscal and educational infrastructure
- Companies that fail to embrace global trade will become its victims

vate and public investment are required so that global trade remains an opportunity. The move to open markets is not reversing, and while we speak of the world getting smaller, its very "smallness" is actually fueling its growth. The benefits of the global economy are just too strong, and the progress and opportunity worldwide are too compelling to go in any other direction.

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TAKEAWAYS

>> The "flat" world spawns new competitors that are changing the structure of industries and the basis of competition.

>> Those who see global trade as a threat call on government for protectionist policies such as establishing trade barriers, tariffs on imported goods and taxing companies for offshore operations.

>> Embracing global trade involves, among others: developing a global business model, being a low-cost producer, maintaining one culture, finding the right partners and focusing on value.