Understanding Globalization – I

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Introduction

These days, it has become fashionable for companies to talk about going global. Prestigious business schools are covering globalization in great detail in their curriculum. Consultants have set up lucrative practices to advise their clients on how to go global. And venerable journals such as Harvard Business Review are featuring scores of articles on the subject.
In this article, we briefly look at globalization and understand what exactly it means. Our attempt will be to remove some common misconceptions. This is important because treating globalization as a fad will result in limited benefits and may indeed turn out to be more harmful than beneficial for companies. On the other hand, by exploiting the opportunities available in the global business environment, companies can significantly strengthen their competitive position.

Globalisation is not a recent phenomenon

At the outset, we need to understand that globalization is not a new phenomenon, though it has become more written and talked about in recent times. History is full of multinational races such as the Aryans who spread across the world looking for new opportunities. Then there have been multinational religions such as Christianity, Islam, and Buddhism. Many of the well known empires of both ancient and recent times, such as the Roman and the British were also multinational. And we have clear evidence of atleast one global company which was incorporated a few hundred years ago, The East India Company.

It is generally accepted that in the late 19th century and early 20th century, a high degree of integration of national economies was taking place. Many restrictions on trade and capital movements had been removed. Unfortunately, the first world war created tension and distrust among members. Subsequently, the second world war and the Great Depression strengthened the protectionist mindset of most countries. Only after the collapse of the Bretton Woods Exchange rate system in the early 1970s, could the unfinished agenda of the pre war years resume in right earnest.

The current emphasis on globalization is the result of three broad trends. The first is the tight integration of national economies due to both removal of trade barriers and restrictions on capital flows. As a result, new opportunities to enter overseas markets have been created. The second is the use of information technology in general and the internet in particular. This has made location less relevant than earlier. Even a small company operating from a single location, can tap markets all over the world. A third reason behind globalization is the remarkable success of global companies such as Sony, Unilever and Coca Cola. Companies are realising that to compete with such global players, they themselves have to globalise.

Understanding globalisation

In this article, we shall focus on globalization from a corporate perspective. Our attempt will be to understand the implications of a truly global company and how it differs from domestic/regional players in the same industry. While the study of global companies is fascinating, enough cannot be covered in just one article. Serious students will need to read books on the subject written by eminent authors. One such book has been written by Christopher Bartlett and Sumantra Ghoshal and is called 'Managing Across Borders'. Much of what is covered in this article in drawn from this book. Another excellent book on the subject is 'Total Global Strategy' written by George S Yip. The websites of the Financial Times, the Economist, the McKinsey Quarterly and the International Institute for the Management Development (Lausanne) also have rich resources on the subject. Students can also visit my web site www.ismindia.org\avv where I have loaded my power point slides on Globalization.

The study of global companies is fascinating because of the way in which they take risk and manage their operations on a worldwide basis. Many of these companies (like Coca Cola) not only have the capabilities to compete in any market but are also typically technology leaders (like Sony) in their business. In addition, they configure their value chain activities across the world (A good example is Arrow Shirt) to generate the maximum leverage. Global companies may not be successful in all the markets in which they compete. What is however remarkable about them is their staying power thanks to their ability to absorb losses and recapitalize. Citicorp, could write off huge losses resulting from the various loans it had made to Latin American countries in the 1970s and early 1980s and yet emerge all the more stronger from the crisis. Coca Cola is making losses in India but can be expected to continue for as long as it is necessary to consolidate its competitive position.

For students of management, it is necessary to understand the meaning of a truly global or transnational company. Here, it becomes useful to consider the framework developed by Ghoshal and Bartlett, who have attempted to bring out a distinction between , International and Multinational companies. A global company essentially attempts to build a strong cost advantage through centralised large scale operations. One of the best examples of a global company is Matsushita of Japan, in its early phase of globalisation. An international company disperses its operations to a greater degree than a global company but essentially transfers the parent company's knowledge with marginal adaptation to individual countries. A good example is General Electric's appliances business. A multinational company operates by building a strong local presence through sensitivity and responsiveness to differences across countries. Philips of the Netherlands, till the 1980s was essentially following this approach. In general, though there are important exceptions, Japanese companies have followed the global model, American companies, the international model and European companies, the multinational model, especially in the early years of their globalisation.

We can summarise by saying that the strength of a global company lies in generating economies of scale while that of a multinational corporation lies in enabling efficient responsiveness to local needs. An international company is good at transferring knowledge from headquarters to subsidiaries. The other side of the coin is that each of these models suffers from certain structural weaknesses. A global company is poor in terms of local responsiveness. A multinational company finds it difficult to generate global synergies and transfer knowledge across the worldwide system. The international organization lies somewhere in between and find it difficult to use effectively the knowledge generated by subsidiaries.

The need for a flexible approach

In today's business environment, the organizational capabilities required to operate globally have become more complex. Generating efficiencies, responding quickly to local needs and knowledge sharing have all become important though the relative importance varies from business to business. Bartlett and Ghoshal define a transnational corporation (TNC) as a company which can simultaneously build all the three capabilities and use them judiciously based on the specific requirements of each business activity. In other words, a TNC has a multidimensional approach in which a particular dimension(s) is emphasised, based on the requirements of the business.

Take the case of Unilever. In a business such as detergents, Unilever pursues a centralised approach to product development. On the other hand, in the foods business, tastes tend to vary across regions and product development must have a strong local orientation. At the same time, in the case of detergents, local manufacturing would be needed and in the case of foods, basic research may still be centralised at one location. And for both businesses, activities such as distribution have to be managed as per the local requirements.

Another example of a TNC is Asea Brown Boveri (ABB). This company combines a blend of global and multinational styles based on the nature of the business. Some activities (such as electrical installation and service) which are extremely local in nature are managed with a great deal of autonomy by the concerned subsidiaries while others (such as combined cycle power plants) where global synergies are important are centrally coordinated. Former ABB CEO, Percy Barnevik is famous for having remarked that ABB needed to be "global and local, big and small, decentralized but with central control."

In other words, a TNC does not start with a rigid mindset about centralisation or decentralisation. It examines each of its businesses individually and breaks them into functions. Within each function, it examines the scope for centralisation and the need for local responsiveness. And most importantly, a TNC develops the capability to transfer knowledge generated in one part of the system across its worldwide network of subsidiaries, to ensure that resources are not wasted by reinventing the wheel.

The evolution of Transnational Corporations

The evolution of a TNC is a fairly long drawn out process. Most TNCs start off, typically by focusing on their domestic markets. Once they have developed some core capabilities, they venture abroad, typically through exports. In the next stage, they set up a full fledged exports department to handle overseas sales. As export volumes pick up, they appoint consignment agents and establish warehousing facilities in foreign markets. Once they have a thorough understanding of the overseas markets, TNCs set up assembly plants, followed by full fledged manufacturing facilities in key markets. From this point onwards, the challenge for a TNC is to achieve global coordination, maximisation of synergies and elimination of unnecessary redundancies. For example, a TNC may set up research centers in different countries based on the local competencies available. Such centres may carry out basic research on a worldwide basis while local centres can customise the products to suit customer tastes. In the case of automobile companies, it makes sense to design the cars in countries such as the US, Germany and Japan which have sophisticated markets. On the other hand, component manufacturing can be done on a regional or global basis. Assembly can be done locally. Honda, for example, does much of its design in Japan but uses engines imported from Thailand for the City model it assembles in India. Ford does most of its design in the US, Europe and Japan (through its subsidiary, Mazda) but has manufacturing facilities all over the world.

In other words, in its final stage of globalisation, a TNC uses a highly sophisticated network of country subsidiaries to manage its global operations. It is wrong to equate the TNC with a company which exports much of its output (as in the case of many Indian software companies) or one which has several overseas manufacturing facilities. The hall mark of a TNC is the ability to integrate global operations through a judicious blend of standardisation and customisation along with efficient knowledge sharing. If individual country subsidiaries are managed on a stand alone basis, it is not a transnational. Indeed, a company may very well operate in all countries of the world. But if what it does in one country has no meaning for what it does in others, it is no different from the domestic companies, in those markets.

For the benefit of students, let me now attempt a working definition of TNC:

"A Transnational Corporation operates across the world, configuring its value chain activities in different countries to achieve the twin needs of efficiency and local responsiveness. It has the capability to pool together the resources available to it in its entire worldwide system and use them not only to enter new markets but also to strengthen its competitive position in existing markets."