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The Business Response to the Global Marketplace

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THE BUSINESS RESPONSE TO THE GLOBAL MARKETPLACE

by Murray Weidenbaum

Introduction

An economist once remarked, in exasperation: "Economic forecasting is not an art or science; it is a hazard." This feeling is underscored by the briefest reconnaissance of recent experience. At the end of the 1980s, who expected the Soviet Union to walk away from the communist party monopoly? And that Gorbachev would be booed at the Moscow May Day parade? Or that Lithuania would have the chance to vote for independence? Or that Poland would move toward the private enterprise system? Or that Russian troops would leave Hungary? Or that the Berlin Wall would come down?

No, I did not forecast any of those good things. Nobody's crystal ball was that good, and that is the point: any one economist can try to analyze what he or she thinks will happen. But each organization must do its own contingency planning, always asking, "What if things turn out differently?"

It is clear that overseas developments are looming ever larger in business decision making. Let us examine the international economy and the changing responses of the individual company.

The Global Marketplace[1]

The global marketplace surely has arrived when villagers in the Middle East follow the Gulf War on CNN, via Soviet government satellite and through a private subsidiary of a local government enterprise. Both public and private businesses

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are involved, and they are located in three different continents.

Here are several more quantitative indicators of the global marketplace. Over one-half of the products manufactured in the United States have one or more foreign components. This development was nicely summed up in a recent cartoon. The customer asks the auto dealer, "Is this car made in the U.S.?" The salesman responds with another question, "Which part?"

A second way of looking at the global marketplace is to consider that one-half of all imports and exports — what governments label foreign trade — is transacted between domestic companies and their foreign affiliates or foreign parents. That is true in the United States, the European Community (EC), and Japan. From the viewpoint of political geography, the activity is classified as foreign commerce. But from an economic viewpoint, these international flows of goods and services are internal transfers within the same company.

One final indicator: despite the massive and well-known U.S. trade deficit, U.S. companies sell to and in other nations as much as, if not more than, "foreign" companies sell in and to the United States.[2] This leads to a related set of questions. Is Honda USA part of the American economy? What about IBM in Tokyo? The consequences of the internationalization of business are profound for many U.S. firms. Half of Xerox's 110,000 employees work on foreign soil. More than half of Digital Equipment's revenues come from overseas operations. One-third of GE's profits arise from its international activities.[3]

Technology and economics are outpacing our traditional way of thinking about international politics. The standard geopolitical map is out of sync with the emerging business and economic map. Economic and technological forces are powerful agents for change.

A dramatic example is the Kuwaiti bank that was moved by FAX machine. The day of the Iraqi invasion, the manager set up three open telephone lines with his office in Bahrain. Over two he transmitted all of the bank's key documents via FAX. Over the third, he checked to make sure that each page was being received. From time to time, the shooting around him slowed the process, but before the end of the day, the necessary transmissions were complete. The next morning the bank opened up as a Bahraini institution neither subject to the freeze on Kuwaiti assets nor to Iraqi control.[4]

On a more aggregate level, fundamental shifts are occurring in national positions in the international economy. There will be three regions of dominant economic power as far into the twenty-first century as we can see. One is North America, led by the United States. Another is Japan and the other Asian rim countries that are doing so well. The third is the reinvigorated EC where change is taking place on an unprecedented scale.

The USSR is conspicuously absent from my list of dominant economic powers. The Soviet Union is still very much a military superpower. But its economy — aside from the military sector — remains relatively primitive. According to the Soviet Academy of Sciences, USSR computer capacity is less than one one-thousandth of that of the United States.[5]

From every available indication, Japan's economic strength will stay at a very high level and continue to increase. The magic formula for economic success in Japan (or Korea, Taiwan, Hong Kong, and Singapore) is quite simple: go to school longer and study harder; work harder and produce more; consume less and save more. And repeat the process into the next generation.

This is a formula that other nations could follow without getting sued for patent infringement. Alas, even if this success formula could be patented, few Americans would likely ever be sued for infringement. Some of the participants in this conference may remember reading last fall about the Michigan factories that had to close down because deer hunting season was starting. Very few people bothered reporting to work. How many Asian factories close down for hunting or fishing?

EC '92

Let us focus most of our attention on Europe this morning. This seems to be the area of the globe where the most radical economic changes will be taking place in the 1990s.

The key structural change in Western Europe is the economic integration of the twelve members of the European Community, scheduled to be completed by the end of 1992. This phenomenon usually is referred to as EC '92 even though the actions being taken constitute an ongoing process that is likely to continue into 1993 and beyond.

The big positive about EC '92 is that the twelve countries are reducing restrictions on business, trade, and labor. People as well as goods and investments will be able to move readily from one of the common market nations to any other. That will make them more efficient as they achieve greater economies of scale and as standardization replaces twelve varieties of many products and services.

However, the big negative — from the viewpoint of other nations — is that the trade wall around the EC is not coming down. Actually, the EC is toughening its external barriers to commerce. Enlightened economists are not supposed to use pejorative terms such as Fortress Europa, so let us cite some numbers instead. In 1960, more than 60 percent of the foreign trade of the EC members was outside of the EC. Now over 60 percent of their trade stays in the EC, a complete reversal.[6] That ratio is bound to rise further because of EC '92.

The Europeans tell American companies not to worry, that their trade restrictions, such as reciprocity and domestic content rules, are aimed at Japan. However, we do not know how good their aim is. The same restrictions that hit Japan can keep out U.S. goods. Moreover, if the Asian rim countries are kept out of Europe, the Western Hemisphere is their major alternate market.

EC '92 will produce winners and losers, on both sides of the Atlantic. Likely winners will include strong U.S. firms with an established presence in Western Europe. High-tech, well-capitalized American companies are accustomed to competing on a continent-wide basis. They can use one EC country as a base to sell to the other eleven. General Motors and Ford have more Europe-wide strength than such European automakers as Volkswagen, Fiat, Peugeot, and Renault. The same holds true for computer manufacturers such as IBM, Digital Equipment, Unisys, and Hewlett Packard compared to their European counterparts.

One loser from EC '92 will be the high-cost European companies who have been sheltered within their national markets. Many of them will be hurt by continent-wide competition. Not all barriers will be down. The French are not going to make a stampede for German wine, for instance. In contrast, the winners will include the stronger European companies who will be enjoying the economies of scale and growing domestic markets.

Finally, many U.S. firms are likely to be losers from the European economic unification. They will find it more difficult to export to Europe. They also will face rougher competition in their domestic markets from the stronger EC businesses. The losers will include many companies who have not yet awakened to developments across the Atlantic. One recent survey found that less than one-half of all American corporations had even heard about Europe 1992. Only a small fraction of U.S. firms are responding to that strategic change.[6]

Moreover, the EC is not a static concept. It started with six countries — Germany, France, Italy, Belgium, The Netherlands, and Luxembourg. Gradually, it has expanded to twelve — adding the United Kingdom, Ireland, Denmark, Greece, Spain, and Portugal. That will not be the end of the line. Many other European nations are seeking admission. Aside from the special case of East Germany, which has now been unified with West Germany, they have been told to wait until 1993 or later.

Austria is a logical candidate for early entry into the EC. Although its economy is modest in size, its admission could be a strategic move, especially since Vienna often views itself as a gateway to Eastern Europe. Most likely, Hungary would then be close behind in the waiting line in Brussels. Czechoslovakia and Poland might be next or, at the least, they could apply to become "associate members."

Other prime candidates for EC membership are the Scandinavian countries, Iceland, Sweden, Finland, and especially Norway, since Denmark is already in. In any event, the trade barriers between the EC and the European Free Trade Association (EFTA) will be disappearing soon. (EFTA includes Norway, Sweden, Finland, Iceland, Austria, and Switzerland.) The EC and EFTA are joining forces to form a trade-barrier-free "European Economic Space."

Now consider the impact of the EC going from 12 members to 16 or 20. Adding all those GNPs together shows that, in the 1990s, Western (and Central) Europe will become the world's largest market area. Japan and the United States will be on the outside looking in. But Eastern Europe really is a wild card.

Business Potentials in Eastern Europe

Four decades of communist rule have left the economies of Eastern Europe in very poor shape. They are experiencing great difficulty converting their inefficient nationalized industries to competitive private enterprises. Because of the Marxian cliché that unemployment does not exist under communism, East European enterprises are notoriously overstaffed. One steel mill in Poland employs 30,000 workers to make the same amount of steel for which an American company uses 7,000 people.[8]

Eastern Europe lacks a business infrastructure, which is something so basic to the efficient functioning of a modern economy that western nations take it for granted. These basic requisites for a private enterprise system include: (1) a body of commercial law which is enforced, (2) a credible accumulation of cost accounting data which can be used both for setting prices and making valuations of assets, (3) personnel who can perform financial analyses, (4) banks to provide credit on the basis of financial valuations rather than political determinations, and (5) organizations to provide insurance of normal business risks.

Incredibly, Eastern Europe is a world with a shortage of lawyers, accountants, and insurance agents! From a positive viewpoint, that large area may provide a major new client base for many service enterprises in the more advanced economies.

Eastern Europe also needs generous supplies of capital from the United States and other capitalist nations. This is brought home by Lech Walesa's response to the numerous (and perhaps patronizing) statements by Americans that, in view of the many Poles — such as General Pulaski and General Koskiosko — who helped the United States during its critical formative period, it is only proper for Americans to repay that moral debt. Walesa on occasion has answered, "OK, so now send us General Electric, General Motors, and General Mills."

Attracting foreign capital in substantial amounts will not be easy. The Eastern Europeans were brought up to hate greedy capitalists and profiteering. But the move to capitalism (which they all seem to want) will be difficult without capital and capitalists.

It also will be necessary for the rank-and-file employees of the Eastern European nations to do a 180-degree turn in their attitude toward work. They must abandon their universal slogan, "They pretend to pay us and we pretend to work." Consider the thousands of former East Germans who have been fired by their new employers because they were not in the habit of returning to work after lunch.

Not all Eastern European nations are likely to make the transition to democratic capitalism. Of course, it would be most heartening if several do demonstrate that a nation can return from communism to capitalism — a move which has yet to be accomplished anywhere.

Those countries that succeed could be tough competitors for our low-tech, high-labor-cost industries. On the other hand, they could also become subcontractors and suppliers to U.S. and Western European firms hard pressed by Asian competitors. The high school education of East European workers is quite good as measured by standardized math and science tests.

Threat and Opportunity for Business

Within the capitalistic nations, the tension between domestic political forces and international economic influences is rising. While private enterprise is increasingly global, government policy remains parochial. Voters still care about jobs in their country, state, and locality and politicians react to those sentiments. Yet there is a third force. Consumers vote every day of the week — in dollars, yen, deutsche marks, pounds, francs, and lira. The same voters, as consumers, buy products made anywhere in the world. They think more about price and quality than country of origin. And they increasingly travel to, and communicate with, people in virtually every land.

Without thinking about it, consumers are adapting to the global economy. After all, if consumers were not so globally oriented, the pressures for restricting trade would not arise in the first place. In the years ahead, the power of economic forces and technological change will increasingly force voters and government officials to adjust to the realities of the international economy.[9]

For business, these developments offer both threat and opportunity. The opportunity arises as more of the developing countries enter the status of industrialized nations. Advanced economies are the best customers of other advanced economies. But at the same time home markets will become increasingly vulnerable to foreign competition.

There is great similarity between the domestic threat of hostile takeovers and the loss of market position due to new foreign competition. In both cases, the firm is forced to review its strengths and weaknesses and to rethink its long-term strategy.

Streamlining, accelerated product development, and organizational restructuring often are responses to both sets of factors.

United Technology exemplifies the reliance on geographic diversification in developing new products. For its Elevonic 411, its French division worked on the door systems; the Spanish division handled the small-geared components; the German subsidiary was responsible for the electronics; the Japanese unit designed the special motor drives; and the Connecticut group handled the systems integration. International teamwork cut the development cycle in half.[10]

When we step back and assume a longer-term perspective, we can see fundamental changes occurring in the nature of business. Joint ventures are no longer an obscure legal form. Strategic alliances are no longer just a theoretical possibility; they increasingly involve companies located on different continents. Often the same companies engage in joint ventures to develop new products, co-produce existing products, serve as sources of supply for each other, share output, and compete.

The automobile industry provides a fascinating array of examples. General Motors has joint ventures with Japan's Toyota and Suzuki and partial ownership of Sweden's Saab, Korea's Daewoo, and Japan's Isuzu and Suzuki. Volkswagen reports joint ventures with America's Ford and Japan's Nissan and Toyota, and has a stake in Czechoslovakia's Skoda.[11] Virtually all of these companies compete with their partners and investors, at least to some degree.

There are some lessons that can be learned from the experience of companies that do well in international markets.[12] First of all, they change their basic corporate goals to conform to a global marketplace; for the most successful, top management leads that process of adjustment. Secondly, they translate a domestic advantage to create overseas opportunities by adapting their established home products to the local markets in other nations. Pall Filters, the major U.S. producers of wine filters, cracked the snobbish French market by designing a new French version of their filters.

They then went on to penetrate the Italian wine market with a third variation of their product.

Third, the successful global firms do not set up large international bureaucracies. One recent survey reported that the cost of the international staff rarely exceeds 1 percent of sales. Moreover, most overseas operations are run by foreign nationals who understand the local markets. Further, they start their foreign operations when the company is still of moderate size, contradicting the widespread notion that only giant companies can succeed overseas. Moreover, a global economy does not mean that every company should try to cater to global markets. Some firms are learning the hard way to focus on specialty products and market niches where they have special advantages.

Finally, global successes encourage foreign subsidiaries to make innovations which can also be used in the home market. Dunkin Donuts established its reputation in the United States by always having fresh donuts and coffee prepared on the premises. In Tokyo, however, land was too expensive so the company started preparing the donuts and coffee on the trucks bringing in supplies. The company is now starting to follow this practice in some of its domestic locations.

All this illustrates an earlier point: in change, there is both threat and opportunity — and the global marketplace surely is changing rapidly.

Notes

1. This section draws on Murray Weidenbaum and Mark Jensen, *Threats and Opportunities in the International Economy* (St. Louis: Washington University, Center for the Study of American Business, 1990).

2. De Anne Julius, *Global Companies and Public Policy* (Rotterdam: RIIA/Pinter, 1990); Kenichi Ohmae, "The Interlinked Economy," *Chief Executive*, October 1990, p. 50.

3. Jeff Shear, "Foreign Investment Is Making a Borderless Corporate World," *Insight*, July 1990, p. 40.

4. Sandra Feustel, "How a Fax Machine Saved GIC," *Institutional Investor*, September 1990, p. 78.

5. Yuri Maltsev, "When Reform Collides With Ideology," *American Enterprise*, March/April 1990, p. 89.

6. Wilhelm Nolling, *Fortress Europa? The External Trade Policy of the European Communities* (Frankfurt, Germany, 1988), p. 31; *Basic Statistics of the Community*, 24th ed. (Luxembourg: Eurostat, 1987), p. 269.

7. "Calls Japan the One to Beat in Europe After 1992," *Electronic News*, September 1989, p. 37.

8. Murray Weidenbaum, "Poland: Another Middle Way?" *Society*, November/December 1990, pp. 51-55.

9. Richard McKenzie and Dwight Lee, *Quicksilver Capital: How the Rapid Movement of Capital Has Changed the World* (New York: Free Press, 1991).

10. "The Stateless Corporation," *Business Week*, May 14, 1990, p. 101.

11. Christopher Sawyer, "The Global Village," *Autoweek*, January 28, 1991, pp. 20-21.

12. William Lilley, "How U.S. Companies Succeed in International Markets," *National Economists Club Summary*, December 1, 1987, pp. 1-3; Booz-Allen Hamilton survey reported by George Anders, "Role of Chief Is Seen Crucial in Going Global," *Wall Street Journal*, November 30, 1990, p. A9.