Globalization: Are We There Yet?

Thomas A. Stewart
Booz & Company’s Mission

To serve the senior agenda of the world’s leading organizations
Ideas have consequences

Booz & Company Vision

Supremacy of Ideas  Practical Impact of Ideas  Collaborative Nature  Global Reach in How We Operate

Today: To Help You

See the Future First  Know What Really Works  Take on Your Toughest Problems  Become a Better Leader
The bumpy road to a flat world

Three challenges to globalization
  Downturn
  Gaining speed and losing altitude
  King customer and usurping competitors

The third stage of globalization and the new Right to Win
The world is flat ...

1983

“A powerful force drives the world toward a converging commonality, and that force is technology… Gradually and irresistibly it breaks down the walls of economic insularity, nationalism, and chauvinism… The earth is round, but for most purposes it’s sensible to treat it as flat.”

Theodore Levitt,
“The Globalization of Markets”
_Harvard Business Review_
flatter ...

2005
or is it?
The World at Night

© 2005 Pankaj Ghemawat
More trade stays within national boundaries than would be expected from the flat-world hypothesis

Source: Pankaj Ghemawat
Come to think of it, how global are you?

Source: Pankaj Ghemawat
Investment in innovation is anything but equal
The bumpy road to a flat world

**Three challenges to globalization**

- Surviving the meltdown
- Gaining speed and losing altitude
- King customer and usurping competitors

The third stage of globalization and the new Right to Win
Challenge #1: **SURVIVING THE MELTDOWN**
There is doubt among respondents for their leadership’s plans for the crisis — even among the leaders who wrote the plans.

“My company’s senior leadership has defined a credible plan for navigating through the crisis”

<table>
<thead>
<tr>
<th>Agree</th>
<th>Neutral</th>
<th>Disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td>60%</td>
<td>26%</td>
<td>14%</td>
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</table>

40% of all respondents express doubts about their company’s plan.

<table>
<thead>
<tr>
<th>Agree</th>
<th>Neutral</th>
<th>Disagree</th>
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<tbody>
<tr>
<td>66%</td>
<td>24%</td>
<td>10%</td>
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</table>

Even among CEO/CXO who presumably created the plan, 34% express doubt in plan’s credibility.
Companies struggle to cope simultaneously with cost and strategy

- SG&A costs
- Materials and sourcing
- Rightsizing
- Reducing complexity

- Industry logic
- Portfolio choices
- Investment decisions
Depending on financial strength, companies should respond to the recession in different ways

### What actions would one expect companies to be taking?

<table>
<thead>
<tr>
<th>Financial strength</th>
<th>Competitive Advantage</th>
<th>High</th>
<th>Low (Perform better on 2 or fewer dimensions)</th>
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</thead>
<tbody>
<tr>
<td>Strong</td>
<td></td>
<td></td>
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<tr>
<td>Invest in capabilities that secure and expand strengths</td>
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<td></td>
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<tr>
<td>Be careful with cash</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stable</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Increase strengths with focused capability investments</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Be careful with cash</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Failing</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Conserve cash to buy time to find right buyer</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Polish and look for exit</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Struggling</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Conserve cash and hold on for better times</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Consider merger with “Strong” or “Stable” company</td>
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</tbody>
</table>

**Financial strength** Based on response to “My company is financially strong today and is not in immediate need of external financial support”; High includes respondents who agreed; Low includes respondents who neither agreed nor disagreed.

Our latest research suggests that a large number of companies are not making the right moves during the crisis.

Evaluation of Actions by Cluster

- **Stable**
  - 24% Inappropriate actions
  - 76% Appropriate actions

- **Strong**
  - 28% Inappropriate actions
  - 72% Appropriate actions

- **Failing**
  - 62% Inappropriate actions
  - 38% Appropriate actions

- **Struggling**
  - 67% Inappropriate actions
  - 33% Appropriate actions

Total across all clusters performing inappropriate actions = 36%

Source: Global survey on senior manager response to economic crisis - Booz & Company December 2008
Effective large scale restructuring focuses on LPS: liquidity, performance and a sustainable strategic position

Restructuring Program Modules

I  SECURE LIQUIDITY
   L1 Reduce Capital Expenditures
   L2 Secure Funding/ Credit Line/ Government Support
   L3 Adjust Staffing Levels/ Labor Cost
   L4 Reduce Working Capital
   L5 Manage Pricing/ Currency Risk
   L6 Sell Assets/ Businesses
   L7 Adjust In/Outsourcing-Mix

II  IMPROVE PERFORMANCE
   Purchasing/ Sourcing:
   P1 Safeguard Suppliers
   P2 Reduce Material Cost
   P3 Cut non-product-related Cost Engineering/ Manufacturing:
   P4 Incr. Engineering Efficiency, Quality and Maturity
   P5 Design to Cost/Variant Mgmt.
   P6 Incr. Production Efficiency
   Sales/ Aftersales:
   P7 Increase Sales/ Sales Network/ Aftersales Eff.
   P8 Realize Prices
   IT
   P9 Build the 1% IT Organization Overhead
   P10 Reduce Overhead to 5%

III  STRENGTHEN STRAT. POSITION
   S1 Consider Strategic Acquisitions/ Business Build-up
   S2 Optimize Footprint
   S3 Review Product/ Brand Portfolio
   S4 Supply Base Restructuring
   S5 Analyze Capabilities to Establish Right to Win
   S6 Build Capability Coherence

Short Term (up to 6 months)  Long Term (more than 12 months)
Challenge #2: **GAINING SPEED AND LOSING ALTITUDE**
Speed is increasing across almost every dimension of business

- Product innovation
- Customers
- Communications
- Capital
- Speed to scale
Speed challenges our ideas about decision-making

Business Faster Than the Speed of Thought

BILL GATES
BUSINESS @ THE SPEED OF THOUGHT
USING A DIGITAL NERVOUS SYSTEM
Challenge #3: **KING CUSTOMER** and **USURPING COMPETITORS**
Historically, more and more value is created from our minds, not extracted from our mines.

**COMMODITY PRICES:**
A VERY LONG-TERM PERSPECTIVE

Real * Raw Industrials Prices (In USD Terms)
- Trend**
- Trend +/- Two Standard Deviations

Very Long-Term Bear Market But More Upside Is Likely Over The Next Several Years

* Adjusted By US GDP Deflator
** Time Trend From 1800 To 2004

© BCA Research 2006
When competition changes dramatically, go back to basics

WHAT DO CUSTOMERS PAY US FOR?

WHAT WE SELL THAT IS UNIQUE AND VALUABLE?
The assets on which modern companies depend are intellectual

The Intellectual Capital Model

- Tangible assets
- Intangible assets
  - Human Capital
  - Structural Capital
  - Customer Capital
Challenge #4: CREATING A RIGHT TO WIN IN THE THIRD STAGE OF GLOBALIZATION
Globalization has entered a third stage—a new era

- Globalizing markets—selling anywhere

- Globalizing sources—buying or building where it is most advantageous
  (Thomas Friedman, The World Is Flat, 2005)

- Globalizing the intellect of the company—going where the best brains are
At the business level, combination of assets and capabilities create a ‘right to win’ — capabilities are increasingly important

As the intrinsic value of assets has diminished, the importance of capabilities has become greater

- Pace of technology evolution compromises both defensibility and scale benefits of assets
  - Partnerships/ Outsourcing create virtual scale
  - Market of assets is competitive (20-40% acquisition premium)
The right capabilities should be selected to support a ‘Right to Win’

Booz & Company ‘Right to Win’ Framework and Example

<table>
<thead>
<tr>
<th>'Right to Win' Criteria</th>
<th>Assets</th>
<th>Capabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Differentiators</strong></td>
<td></td>
<td></td>
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<tr>
<td>Consumer Value from Brand Superiority</td>
<td>Brand</td>
<td>Premium / luxury brand management</td>
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<tr>
<td></td>
<td></td>
<td>Brand Communication - in-store messaging</td>
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<tr>
<td></td>
<td></td>
<td>Direct consumer engagement</td>
</tr>
<tr>
<td>Consumer Value from Product Superiority</td>
<td>Design</td>
<td>Design capabilities that can be trend-setting</td>
</tr>
<tr>
<td></td>
<td>Access to high quality materials</td>
<td></td>
</tr>
<tr>
<td>Technology &amp; Innovation</td>
<td>Patents - materials and designs</td>
<td>Frequent innovation - materials and quality of products</td>
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<tr>
<td></td>
<td></td>
<td>Breakthrough innovation</td>
</tr>
<tr>
<td>Delivery</td>
<td>Supply chain network with ability to handle demand variation</td>
<td>Retail Execution - to handle demand variation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Customer Relationship - to enter new channels to enhance penetration</td>
</tr>
<tr>
<td>Cost</td>
<td>Manufacturing facilities with ability to handle high quality production</td>
<td>High quality manufacturing</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Market ‘Right to Win’ Assessment</th>
<th>Company (Self)</th>
<th>Competition</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Relatively strong brand</td>
<td>Strong brand recognition - established as a luxury brand owner (other categories)</td>
</tr>
<tr>
<td></td>
<td>However, weak direct consumer engagement</td>
<td></td>
</tr>
<tr>
<td></td>
<td>High design capabilities</td>
<td>High design capabilities</td>
</tr>
<tr>
<td></td>
<td>Access to high-end materials and frequent innovation capability</td>
<td>Low innovation capability / access around high-end materials</td>
</tr>
<tr>
<td></td>
<td>Strong retail execution capabilities</td>
<td>Weak retail execution capabilities - given the low coverage / scale</td>
</tr>
<tr>
<td></td>
<td>Weak presence in fast emerging convenience channel</td>
<td>Weak presence in fast emerging convenience channel</td>
</tr>
<tr>
<td></td>
<td>Access to high-quality manufacturing, with reasonable scale</td>
<td>No in-house or dedicated production facility</td>
</tr>
</tbody>
</table>

Note: Differentiators in right to win analysis will differ by section -- consumer example shown

Right to Win | Right to Play | Disadvantaged
Strategic outsourcing decisions manage both cost and capability dimensions

Savings or value added

Outsource

Capability coherence

Own
You can’t have a Right to Win without having, also, a chance to lose

“[Globalizing the intellect of the company] means using Russian engineering and Indian software—not to arbitrage labor costs, but because these are the best people you can find.

“It’s the hardest thing a company can do, because no one is safe then.”

—Jack Welch
Bottom line

- The world *is* getting flatter
- Slowly
- A level playing field means *you* don’t have an advantage, either
- Find the bumps, and use them