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CIPS White Paper

Globalisation

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Where it all began

The world did not proclaim the dawn of globalisation the moment McDonald's opened its doors in Beijing, or when Vietnamese factories reeled off their first Nike trainers. The term entered popular consciousness in the 1980s, but people, their economies, religions and cultures were interacting long before that.

Centuries before the slow boats from China were filled with cheap electronics and clothing, they carried spices for the Roman Empire and tea for the British middle classes of the early 18th century. Spanish or Portuguese would not be spoken in South America if it had not been for the influence of colonial powers in the 16th century. Islam would not have made its way to Africa without the region's long trading history with the Sinai Peninsula and Egypt.

Neither is globalisation a novel concept for today's procurement professional. The benefits of low-cost country sourcing are well known to buyers who have outsourced back office functions or manufacturing to the Far East. Whilst the concept may not be new, in today's corporate climate it is having a changing effect on business. Some argue that globalisation is changing the fundamental concept of the modern business.

This is because the world's economies and societies have never been so interdependent. Barriers that once prevented the flow of work, capital and information are falling away with the arrival of the internet and reduction of trade barriers. There is now plentiful and cheap mobile capital and easier access to a burgeoning global workforce.

It is now up to procurement professionals to see their role within this global business context and to take a wider view. As Ian Davis and Elizabeth Stephenson from McKinsey pointed out in 'Ten trends to watch in 2006,' not only will business developments shape the future corporate landscape but also macroeconomic, environmental and social issues.

Global economies make global businesses

A number of factors, over recent decades, have accelerated the move towards globalisation.

In 2003, Goldman Sachs predicted in its influential report, 'Dreaming with BRICs: The Path to 2050', that Brazil, Russia, India and China (or the BRIC economies as they have since become known) would together eclipse the riches of the G6 within 40 years. Working together, China and India would become dominant global suppliers of manufactured goods and services, and Brazil and Russia the suppliers of raw materials.

If businesses in the new shrinking part of the world economy were to compete, they needed to rethink how they worked on a global scale. IBM is one company that has adapted to meet the forces of globalisation. Speaking at the INSEAD Business School in October 2006, CEO Samuel Palmisano illustrated the impact the internet, free trade, a global labour force and a shift to a service-based economy has had on business. For the first time in human history, he said, "everything is connected".

At this "historic inflection point", he argued that a new model for the multinational business was emerging.

The multinational's development began, he said, with the "international" model in the 19th century. Back then, the company was based in its home country, but sold and distributed its goods through overseas offices. Then came the “multinational” model of the 20th century, where a firm created smaller versions of itself in countries around the world. IBM Spain, IBM UK or IBM India were all mini-versions of its head office, each with their own sales, procurement, HR, finance and IT functions.

But this model has now become redundant. He argues, it is both expensive and cumbersome to replicate the business so many times, in so many countries around the world.

The next evolution of the multinational is the “globally integrated enterprise”. Rather than having mini-versions dotted around the globe, IBM has created one global entity and then locates operations and functions anywhere in the world based on the right costs, skills, and business environments. They have one global supply chain and they deploy their human capital as one global asset.

“When everything is connected,” he said, “work flows to the places where it will be done most efficiently and with the highest quality.”

"Procurement professionals that continue to see China and India as the “globe” in “globalisation” risk cutting themselves off from opportunities elsewhere."

More to globalisation than just cost-savings

IBM currently has more than 43,000 employees in India. They also plan to increase investment from $2 billion over the last three years to nearly $6 billion over the next three. This investment is not about finding cheaper workers, but using the expertise of the country’s labour force to undertake research and development, and write research and development software.

As IBM’s case demonstrates, offshoring is no longer just about cutting costs or sending the most basic jobs overseas. Savings remain an important driver for globalisation (Hackett Group calculated last November that companies in the FT Europe 500 could save a combined total of £32.3 billion per year (€48 billion) through offshoring) but there are other factors at play.

The 230 manufacturers interviewed by Economist Intelligence Unit (EIU) for KPMG’s report ‘Globalisation and Manufacturing’, said it was the availability of skilled labour, not labour costs that was of most concern to them. Similarly, the 2006 Offshoring Research Network Survey conducted by Duke University’s Fuqua School of Business and Booz Allen Hamilton, also reveals a shift in the rationale behind offshoring. No longer is it about moving jobs elsewhere, but about “sourcing talent everywhere”.

But it is not just the rich countries’ universities or science parks that are producing all the talent or innovation. As Demos explains in its 2007 report, ‘The Atlas of Ideas’, US and European pre-eminence in innovation can no longer be taken for granted. Growth in markets, increased state spending on research and expanding pools of skilled labour are all contributing to the growth of innovation in countries such as China, India and South Korea.

As the report highlights, India produces 2.5 million graduates in information technology, engineering and life sciences each year. And the number of engineers flooding the world market every year could treble by 2015. Since 1999, China’s expenditure on research and development has increased by more than 20 per cent each year. In December 2006, the Organisation for Economic Cooperation and Development (OECD) announced that China had moved ahead of Japan for the first time, to become the world's second highest research and development investor after the US.

In 2006, Taiwan won 146 international awards for product design including Japan's Good Design Award, Germany's iF design award and IDEA Design Award in the USA. As a result of this investment into R&D, companies are not only happy to pass manufacturing to the Far East, but also product design. Dell for example now designs its notebooks in Taiwan and desktops in China.

For procurement professionals, therefore, globalisation should not only mean lower costs but also new products, new services, and better processes. Additionally, given purchasers' experience in handling relationships and links throughout the supply chain, they are in the best position to help their businesses see global innovation as a source of collaboration, not competition. As the authors of the Demos report argue, more innovation in Asia does not mean less in Europe. And alongside new sources of competition, there will also be new opportunities for collaboration.

"Purchasers could be wise to take such a balanced approach to their purchasing decisions, mixing local with global supply where possible."

Globalisation and the emerging markets

Procurement professionals that continue to see China and India as the "globe" in "globalisation" risk cutting themselves off from opportunities elsewhere.

Last year, Professor Richard Lamming, director of the School of Management at the University of Southampton and one of CIPS 'Foundation' Professors, urged purchasers to remember that low-cost country sources only remain competitive for two years.

Once a country has enjoyed the initial influx of foreign investment, a local boom ensues. This forces wages to increase and employee attrition rates to increase. Bearing this in mind, procurement professionals need to be ready to switch between countries readily.

The vast majority of respondents to the EIU and Atradius report, 'Succeeding in second-tier emerging markets', said they have made investments in second-tier emerging markets. These include Vietnam and Indonesia in South East Asia; Poland and Romania in Eastern Europe; Mexico and Venezuela in Latin America; and South Africa and Nigeria in Africa.

The Asia Pacific region was their top choice for investment where they saw opportunities for low-cost labour and resources as well as growth and expansion.

When considering offshore locations, purchasers must factor in the availability of skills, labour costs and technological infrastructure. In the case of manufacturing, this should include the price of raw materials and the location of the country.

China may win on supply of labour now, but could countries in Africa with higher birth rates take over in the future? Could Poland beat the Far East given its proximity to the UK and lack of barriers due to its membership in the EU?

There are also the new spending powers of the world to consider. By setting up operations and forming ties with countries such as India, companies also gain access to an emerging middle class with a healthy appetite for goods and financial services. Respondents to McKinsey's 2006 survey on business trends said that the most important development to affect global businesses over the next five years will be the growing number of consumers in emerging economies.

Risks and challenges of globalisation

Taking a balanced approach and building a portfolio of sources will allow purchasers to hedge some of the risks that are inherent in global supply, because when it comes to risks, there are many.

First there is the damage to brand reputation sustained as a result of using suppliers with unethical employment practices. Since the sweatshop scandals of the 1990s, companies have been laid bare to accusations of child labour, low wages and horrific working conditions in their suppliers' factories. With the growing consumer and media interest in corporate social responsibility, this spotlight looks set to continue.

Many buying organisations now sign up to codes of conduct, such as the Ethical Trading Initiative's Base Code of Conduct, that set out ethical principles their suppliers have to meet.

Purchasers are warned they cannot hide behind these codes and on-site audits, safe in the belief they are doing the best they can to improve the conditions for workers in their supply chains. Factories will continue to cheat on labour standards as long as buyers continue to lower prices and shorten lead times. Buyers need to review the impact of their core decisions on their suppliers' ability to meet their standards.

There is growing evidence that brands and their buyers are making steps in the right direction.
To protect Starbucks from some of the backlash it has received from anti-globalisation activists in the 1990s, the coffee retailer set about changing its buying practices to ensure farmers were fairly paid for their coffee.

In 2004, they produced guidelines which became known as the Coffee and Farmer Equity Practices (C.A.F.E.).These set standards for producers which, if achieved, guarantee them a premium price for their coffee crop. The guidelines cover environmental considerations (shade-grown and bird friendly crops), social issues (labour practices), economic transparency (ensuring everyone is paid fairly) as well as quality. In order to qualify for a premium price commitment from Starbucks, producers must provide independent verification that they meet the guideline requirements.

BT has won two CIPS Supply Management awards in four years for its work to improve corporate responsibility in the supply chain. Since 2001 it has carried out more than 2,000 supplier risk assessments of environmental and labour standards. Buyers are now working with 191 suppliers to improve their impact on the environment and they are helping 148 suppliers to improve working conditions for employees. Not only does good practice pass between BT and the supplier, it also filters down the supply chain.

With suppliers dotted around the globe, buyers must be on the lookout for everything from shortages, late deliveries and supplier closings to weather changes and port strikes, as well as disruption from natural disasters or acts of terrorism. Local issues soon become global: consider the impact on supply routes of the contamination of livestock through avian flu, or mad cow disease."

"Climate change should also be on the radar...few companies have considered the potential effects of a future shortage of natural resources."

Climate change should also be on the radar. McKinsey argues in its article 'Going from global trends to corporate strategy' that few companies have considered the potential effects of a future shortage of natural resources.

Beyond a lack of energy, businesses should also consider the potential impact, for example, of scarcity of water or deforestation. Which businesses will win and which will lose? Will large-scale shipping of water become viable for the cargo industry, asks the report? Can biotechnology companies grow crops that require less water or trees that grow faster?

Then there is the impact of debt and trade deficits, and currency fluctuations on global economics. Buyers should consider the impact of a potential revaluation of the Chinese renminbi in reaction to trade imbalances between China and the West. If such a move were to happen, China could quickly become more expensive to trade with.

Global supply chains also provide a healthy market for counterfeiters. The Medicines and Healthcare Products Regulatory Agency announced in January it was investigating twice as many cases of fake drugs as it was five years ago. An estimated £30 million worth of counterfeit electrical products reaches the UK each year, according to electrical products trade body BEAMA Installation. This includes products that could put lives at risk such as fake fuses, sockets, cables and surge protectors.

As they point out, many products from China go through the Middle East, where there are examples of genuine products being mixed with counterfeit products.

Buying organisations still frequently fail to protect the intellectual property rights of their products manufactured overseas.

As Ian Bremmer and Fareed Zakaria pointed out in 'Hedging Political Risk in China' (Harvard Business Review, November 2006), many foreign corporations may pursue legal action to protect their patents. However, due to the nature of China's legal system, this could pose problems for outsiders.

Some firms, they said, have found innovative solutions. These include releasing existing computer code and patents for public use, forming alliances with Chinese partners for joint production, and intensifying lobbying efforts with influential Chinese government officials.

"Involving Chinese stakeholders in the benefits that flow from technical innovation may, over time, promote greater enforcement protection," the article says. Some foreign firms have found success in this area by pooling their efforts.

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Political unrest and globalisation

A growing risk to global supply comes from new threats such as terrorism and political violence

Respondents to Atradius's Succeeding in second-tier emerging markets said the most common challenges to investing in emerging markets were political, with 55 per cent saying that poor rule of law and political stability were the most significant.

A report published in May by insurance company Lloyd's, revealed that over a third of companies avoid investing in overseas markets for fear of political violence. The report, 'Under Attack: Global business and the threat of political violence', also found that one in five of the 154 board-level executives interviewed have turned away from otherwise promising business opportunities for the same reason.

Using Côte d'Ivoire as an example, the report demonstrates how recent political unrest, including rioting and threats against foreigners, led the African Development Bank and a number of foreign businesses to relocate. Likewise in Nigeria, political violence subsequently caused a number of firms to rethink their investments in the country.

The research also found that only 37 per cent of business leaders have a strong understanding of the political violence risks. Perceptions of risk appear to be driven by media headlines rather than rigorous analysis.

Other sources of information, the report suggests, for analysis of political risks include business-to-business forums; government briefings; NGOs; local media sources in potential trouble spots; information from employees; and research by private companies and academia.

Companies should continually monitor the political and economic performance of the participating countries to look out for signs of turmoil, dissatisfaction, or religious and social tensions. In China, for example, fast growth, public resentment over land redistribution, the widening gap between rich and poor and industrial accidents all have the potential to fuel social instability. This can lead to governmental action to disrupt supply chains or erode investor confidence.

As Atradius points out, managing political risks requires companies to combine hard data with more relationship-based information that comes from contacts on the ground among peer companies, governments and local communities.

The future of globalisation and procurement

Another risk for purchasers is the potential backlash against globalisation. The concept has always had its critics. Some have argued that it only favours corporations of the West, promotes unequal distribution of wealth and homogenisation of brands and Western culture.

A growing interest in localisation could intensify this backlash. The impact of carbon emissions from transportation on climate change is now high on the political and public agenda, which means companies are having to justify the distance goods have travelled to reach their end destination.

Companies, especially in the retail sector, are already responding to this trend by rethinking their global purchasing strategies in response to this. “Food miles”, or the distance from field to plate, has long been a concern for the food sector. As a result, supermarkets, such as Waitrose have launched “locallyproduced” ranges and Tesco announced in March 2007 that it is introducing carbon labelling to measure the carbon footprints of its products.

Purchasers in other sectors could be wise to take such a balanced approach to their purchasing decisions, mixing local with global supply where possible. Doing this now could pre-empt future damage to a brand once the media and consumer attention has spread beyond the clothes stores and supermarkets.

Globalisation often puts unlikely sectors in the line of fire. As Oliver Balch pointed out in the Financial Times in November 2005, human right issues such as child labour or sweatshops are not the everyday preoccupations, for example, for the UK utilities industry. But as its supply chain becomes increasingly global, its exposure to such risks grows rapidly.

Outsourcing of the procurement function overseas is also on the rise. Booz Allen Hamilton noted in ‘The Globalization of White-Collar Work’ that India and more recently, China are now the preferred locations for the offshoring of procurement functions.

A study by the Everest Research Institute into the procurement outsourcing market in 2007 suggested that foreign procurement service providers, such as Wipro in India, were also set to expand in 2007.

Working on a global scale was never meant to be easy and it is impossible to truly predict what the future holds. But if purchasers are to seize opportunities as well as avoid the risks of globalisation, they need to take a wider look around them. In a world where everything is connected, everything matters.

"With the growing consumer and media interest in corporate social responsibility, this spotlight looks set to continue."

Secrets of success

A less-discussed but crucial impact of globalisation is on the procurement function itself. As companies spread themselves around the world, buyers follow. As a result multi-site purchasing teams are now common.

IBM

Last year IBM took a step further in this respect by moving its procurement chief to China to run the firm's global purchasing operation. This is made up of around 5,000 employees in more than 80 countries and has a $40 billion worldwide spend.

This was the first time such a senior purchasing figure had been relocated to China and for many it was the beginning of a trend.

IBM's CPO, John Paterson, told Supply Management magazine that the motivation for the move was to improve relationships with suppliers and form new ones. By having a CPO in China he said they also hoped to tap into a "talent pool" and to be well-placed if and when China becomes a customer base as well as supply base of IBM. "To be successful, we need to develop a deeper internal procurement team and external supply chain in Asia that will support this offering."

HSBC

International secondments have helped HSBC to set up its purchasing teams around the world. The HSBC Group Purchasing International Resourcing programme, launched in 2002, won the purchasing team a CIPS Supply Management award in 2006. This programme involves seconding buyers to purchasing departments overseas in locations as varied as Hong Kong, Canada and Saudi Arabia. The bank estimates that around 4 per cent of its purchasers are on a secondment at any time.

The project gives purchasers the opportunity to develop their procurement skills, swap best practice with buyers in other countries, spread HSBC's corporate ethos, and give those employees who have been identified as having "high potential" a chance to broaden their international business skills.

Case study

Pittards plc has been making leather in the UK for over 180 years. Up until two years ago their two factories in Leeds and Yeovil supplied global brands with material to be made into shoes, gloves and luxury leather goods.

All this was to change in 2006. The company shut down its operations in Leeds and moved production to Yeovil and a sub-contracting facility in Teh Chang, Taiwan.

Previously in 2005 it also took responsibility of the management of Ethiopia's largest state-owned leather production facility, Ethiopia Tannery Share Company. The move to the just-emerging economy of Ethiopia may have involved risks, uncertainty and disruption, but the company is already demonstrating its successes.

By managing leather production in Eastern Africa, Pittards has been able to access lower labour and production costs, as well as tighten its supply chain by being closer to its main source of its sheep and goat skins.

Pittards' move to Taiwan likewise enabled the business to improve the efficiency of its operations. Most of its shoe leather was already being sent to factories in Mainland China, Vietnam and Cambodia to be made into finished goods for its customers. By moving its operations nearer to these facilities, they could improve communications and reduce lead times.

Pittards sent out UK staff to its offshore locations to ensure the company's high standards were maintained. But these UK staff will not stay permanently, says Pittards' chairman, Stephen Boyd. "You can't stand behind people for ever and a day; otherwise you might as well do it yourself. You have to train them to achieve it." Boyd acknowledges that in Ethiopia this may be a long-term process, as there is significant work to be done in raising standards and expertise. "They were used to doing the first stage of processing," he explains. "But the idea of producing a finished product, to a very specific individual customer requirement is a big cultural change."

Even in Taiwan, which has far more sophisticated manufacturing operations, there was also a lack of experience of meeting specific customer requirements, to tight deadlines and to high quality standards. "We had to put enormous time in to achieve results," he points out.

Despite the challenge of meeting the UK's standards, for example in shipping documentation or banking systems, Boyd says Ethiopia is showing an "enormous willingness to learn". This is evident right from the top of the country to the staff in the tannery.

Pittards has worked with the local team to reorganise the factory layout, improve the workflow and make room for new machinery. "By introducing standards and requirements for quality and outputs, we have been able to cut staffing by two thirds and yet improve output by 50 per cent."

In the six months to December 2006, turnover increased by 8 per cent on the budget agreed with the Ethiopian government who own the Tannery. Profitability has also improved.

Globalisation is central to Pittards' ongoing strategy and they are looking to expand in other countries including Africa and Indian Sub-continent. But Yeovil will always be its "centre of excellence", says Boyd. "We will continue to develop new products and technologies here and use it as a centre for commercial and financial operations."

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