

Grassroots Globalization: The Value Chain

By Richard J. Scaldini

Are there any useful lessons for the smaller company in the global marketplace? For that matter, with economic conditions as they are, will the global marketplace be with us much longer?

A recent New York Times article (“Shipping Costs Start to Crimp Globalization,” Aug.3, 2008, by Larry Rohter) discussed both issues, especially how global companies are dealing with high transportation costs. From the article it is clear that some large company strategies are also relevant to smaller companies that may not consider themselves global players. Regarding the first issue, we are all subject to the effects of the global economic environment; it may therefore contain some useful models for us. As for globalization’s demise, the obituary is probably premature, but the question prompts us to consider the necessary conditions for globalization.

The Times article reports that global manufacturers - accustomed to “diffuse global supply chains” permitting materials sourcing, production, and sales in countries distant from each other - are now shortening their supply lines. For example, Tesla Motors modified its plan to manufacture its electric cars in Asia and brought production back to the United States, its main customer market. The Times asserts that “(G)lobalization may be losing some of the inexorable economic power it had for much of the past quarter-century, even as it faces fresh challenges as a political ideology.”

No doubt, the pace and scope of globalization will vary with changes in economic and political conditions. Costs still matter, and the business cycle is alive and well.

Government policy is the critical factor. Globalization's sustainability depends on the willingness of governments to reduce trade barriers and to permit the free flow of capital, currencies, and product. They must also ensure stable and predictable legal, political and tax systems. If states allow disruption in these areas, they jeopardize the necessary foundation for global competition.

Although the rise of anti-NAFTA rhetoric in U.S. politics and recent impasses in agricultural and environmental trade talks have the potential to revive protectionism, most countries still have more to gain than to lose from free trade. Some retreat from the free trade model is likely in those countries experiencing economic downturns, but it is probably safe to count on the persistence of globalization with cycles of high and low activity.

Consider then how global companies deal with these fluctuations. Exploiting business opportunities worldwide depends on a complex of factors: technological advances, access to adequate information, and the capacity to mobilize talent in a variety of cultures, as well as government forbearance. Most significantly, the same technology and knowledge that make worldwide operations possible also make global companies flexible, opportunistic, and adaptable.

Globalization is not about deciding whether to operate at home or abroad; it is about finding the optimal mix of production costs and added value for the environment at hand. Until recently, historically cheap transportation allowed companies to range far afield in search of cost advantages and markets, but a spike in those costs does not mean the game is over. Tesla brought manufacturing back to the home country. Facing the same problem, other companies moved production closer to their selling market, but not to the home base. These responses to rising transportation costs do not signal a retreat from globalization. They affirm a fundamental attribute of the global competitor: rapid adaptation.

To achieve such flexibility, the global competitor works with a set of variables constituting what Harvard's Michael Porter christened the "value chain." The value chain analyses the business operation from its beginning in the sourcing of materials, through marketing and production, to its end in serving the customer. Raw materials, human resources, production technology, functional services, distribution, and capital are among the key components of the value chain. The concept applies mainly to adding value, not cost reduction, but the cost of doing business is woven through it. As conditions change - either through technological improvements that increase value-added, or through changes in the external environment that increase or diminish relative cost - the adaptive company reassesses the chain and its component relationships in order to exploit the opportunity or mitigate the disadvantage.

Value chain analysis is not a luxury reserved for the big players. It is an intuitively accessible concept built on the notion of the business model. As a defensive tool, it helps to identify and correct inefficiencies. As an offensive tool, it assists in identifying opportunities created by changes in economic conditions. For example, the Times cites the sudden good fortune of furniture manufacturers in the southern United States. Nearly done in by Asian competition, these companies are winning business from American furniture retailers who are sending production to them again because domestic transport savings offset the Asian advantage in labor costs. While no company can control all the variables in the competitive game, every company can control some of them. The key is to know your value chain and re-examine your competitive advantage on a regular basis.

You can learn more about the value chain by going to some tried and true sources:

Michael Porter's "Competitive Advantage: Creating and Sustaining Superior Performance" (The Free Press, New York, 1985) and Jim Collins' "Good to Great" (Harper Collins, New York, 2001). Collins studies a wide array of superior companies in order to understand how they have been able to outperform their peers. Mr. Collins' great company leader is a relentless student of his organization, zeroed in on enhancing its fundamental competitive attributes. Both authors demonstrate that focus and a continuous appetite for learning are the indispensable leadership qualities for players large and small on this global playing field.

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