Global tectonics:
Part 10

Economic Integration:
Tech-Enabled Synthesis

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EXECUTIVE SUMMARY

The world is shrinking, and companies can no longer count on thriving, let alone surviving, by isolating themselves. Both countries and companies grow more rapidly through integration, so it behooves organizations to devise management strategies to track political developments and monitor the productivity of employees worldwide.

12 TRENDS
changing the world

A five-year research project reveals that the future of commerce worldwide will be greatly influenced by a dozen "global tectonics" that will affect business leaders across all industries:

1. Biotechnology
2. Nanotechnology
3. Information technology
4. Population
5. Urbanization
6. Disease and globalization
7. Resource management
8. Environmental degradation
9. Knowledge dissemination
10. **Economic integration**
11. Conflict
12. Governance

Once upon a time, businesses were either national or regional, and even international companies were apportioned into divisions that acted independently of one another. Countries too tended to be isolated, with foreign direct investment and even trade playing a relatively small role in their economies. Like a modern-day fairy tale, the characters in this global story have had to leave their respective enchanted forests and interact with each other. Simply insert the modern momentum of technology into this yarn, and we can see the entire picture unfold in which businesses and countries work together to solve their economic challenges.

More or less, the story can be summed up in this simple phrase: The world is shrinking and interconnecting. Economic integration has led to the interaction and cooperation of companies and countries through migration, trade in goods and services, and the free movement of capital, knowledge, and technology.

It should be no surprise that corporations and countries grow more rapidly when integrated. In fact, a number of these integrated corporations have grown so fast that of the 100 top economies in the world, 51 are global corporations and 49 are countries. In fact, Norway, listed at number 30, is bested by General Motors (at 23), Wal-Mart, Exxon Mobil, Ford Motor Co., and Daimler Chrysler (at 25 through 28, respectively). This would never have been possible without the benefits of economic integration.

One can even say that business has reached a time when a company cannot survive on its own. It must companion with not only local partners but, more important, with international corporations. Most countries and organizations do not have the internal resources — labor force, natural resources, and technology — to compete with increasingly complex global environments. The more effective method in meeting global economic opportunities and challenges is to create an economic alliance or network through cooperation, collaboration, flexibility, adaptation, risk and cost reduction, shared interest and objectives, closeness, openness, and commitment between entities. These economic relationships result in a state of synergy in which the combined output of the components is greater than the effort of each individual.

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The Airbus consortium is a perfect example of a company that collaborates with other entities in various countries. Airbus started as a partnership between European aviation companies to compete with the U.S. giants, but in 2001 Airbus formally became a single integrated company. The autopsy of the integration is as follows: Companies in Britain export the aircraft's wings, while German suppliers provide the fuselage and the tail. Spanish companies manufacture the doors, and French companies oversee cockpit production and final assembly. More than 800 American companies supply in excess of 35 percent of the consortium's aircraft components, with 1,500 other providers located in approximately 30 additional countries.

Airbus changed the face of the airline business and encountered immense success by doing so. It reaped the benefits of real competition by overcoming boundaries, sharing development costs, and agreeing to a common set of measurements and even a common language. Airbus is now one of the world's leading aircraft manufacturers and accounts for almost half of all orders for airliners with more than 100 seats.

It is clear that the forces of globalization have shaped the world's economic environment and led to the increased importance of economic integration. These forces include faster communication, more efficient transportation, increased flow of goods and services, labor mobility, and more rapid financial flows — all resulting in shortened product life cycles. These have all been facilitated by the extensive advancement of technology.

While the costs associated with developing new products and services have increased over the past few decades, the life cycle of these products has shortened substantially. Television sets were first introduced in 1947. It took Korea until 1963 to be able to reproduce the same technology. Nowadays, LG develops flat screen TV technology that is copied and brought to the marketplace by all its industry competitors in just a matter of months.

Other effects of globalization that have influenced economic integration include the tendency of entities and societies to take advantage of declining costs in transport and communication as well as, quite significantly, differing public policies. Public policies can affect the pace and volume of economic integration. For instance, during the second half of the 1980s, when nations were leaning toward liberalization and democratic freedoms, Cuba was doing quite the opposite. Instead of encouraging global relations, it has stymied integration efforts by not joining the principal subregional economic integration arrangements in the Western Hemisphere.

Regional synergy has been evident in increasing amounts, as evidenced by the North American Free Trade Agreement, the European Union, the Southern Cone Common Market in Latin America, the Association of Southeast Asian Nations, and the Southern African Development Community. These all promote regional integration between countries of a local area through economic integration — that is, free movement of goods and services, capital, labor, and common guidelines for those markets. All of these factors promote greater efficiency and productivity among the connected economies. For example, breaking down barriers through free trade can increase a country's income, standard of living, efficiency, and productivity through specialization and comparative vs. absolute advantages. Corporations can use regional cooperation to understand their markets and formulate their strategies accordingly.

Dell Computers is another company that has been at the forefront of the business integration revolution. It has become famous for having immense success by implementing the build-to-order business model. Dell uses external companies to supply parts for its computers, thereby having countless relations with local and foreign companies. Samsung supplies such parts as the CD-ROM drive, Intel supplies processors, and Federal Express provides shipping. Each company benefits the other. Dell would not be the No. 1 supplier of personal computers in the world if it operated in isolation.

Nevertheless, economic integration is not a novel feature of our globalizing world. After World War II, Secretary of State George C. Marshall produced the Marshall Plan, which offered Europe $20 billion in aid on the condition that the United States and Europe decide jointly how the money would be used. This forced European countries to unite and act as a single economic unit. At that time, integration was seen more as a strategy for development than as a synergic relationship.

Even further back in history we know that communication and trade took place between ancient civilizations. However, undeveloped forms of transport and communication limited the ability for groups to benefit fully from this crude type of globalization. Horses, wind, and steam power were inefficient mechanisms for the trade of goods, services, and information. It wasn't until the development of sophisticated technologies in the form of telegraphs, telephones, computers, satellites, and the Internet that our current global economy was truly born.

With the advancement of technology comes the increase of speed — one of the most important factors in economic integration. John Chambers, chief executive officer of technology company Cisco Systems Inc., claims that the digital revolution is not won by those who are big, but by those who are fast. Cisco has become a worldwide leader in providing hardware, software, and other services that enable company networking. In 2002, it was a pioneer in running every aspect of its own business on the Web, a goal that almost every company now finds itself shooting for.

By using the Web to run its business, Cisco successfully outlasted the technology sector collapse in late 2002, primarily due to the fact that

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41 percent of its revenue came from outside the United States. Like many other companies, most of Cisco's manufacturing is outsourced, and it uses the Web to tell foreign factories when and where to ship certain goods, but Cisco is also able to cycle through its business processes without an employee ever touching a piece of paper. Cisco Chief Financial Officer Larry Carter estimates that the company has saved about $500 million per year by operating solely on the Web.

Now even Christie's, a 234-year-old fine art auction house, has started using the Internet for sales. It is able to keep a finger on the pulse of consumer tastes in different parts of the world and can respond immediately by sourcing what it predicts will be in high demand.

The increasing use of the Web for business is only the beginning of economic integration. It leads to the integration of international businesses, where thousands of companies can be interconnected in a symbiotic relationship. The car that now drives globalization consists of international flows of goods as well as capital and foreign direct investment. Human migration, trade in goods, services and knowledge, and the globalization of individual economies fuel this car.

Benefits of integration

The beneficial influence of these factors is evident in many examples. Each member of the European Union, for example, finds ways to profit from the economic relationship. Spain and Portugal were granted membership in the European Community, the predecessor of the European Union, in 1986 to preserve their new democratic societies. Prior to joining, their per capita income was 49 percent and 27 percent, respectively, of the income of the large European countries. By the turn of the century, the two countries saw those numbers rise to 67 percent and 38 percent — a significant increase due to economic integration. Ireland also saw a rise in its income and efficiency due to the integration with the EU. Also, the poorer southern European countries saw a decline in the income gap between them and the rest of Europe. The reasons behind these countries' developments are simple: an increase in trade, foreign direct investment, and other financial flows — the driving forces behind economic integration. All this was happening while the richer countries were getting even richer.

Outside of the EU, countries such as Mexico have benefited from integrated groups and agreements such as NAFTA. Before NAFTA's creation in 1994, Mexico was a closed economy with restrictions on currency and trade. With NAFTA, the value of trade between the United States and Mexico trade has almost tripled, from $81 billion to $232 billion. Mexico has also seen a rise in the diversity of its economy, transitioning from being primarily based on oil to manufacturing. Mexico moved from being 26th in the world in exports to 8th, growing at a rate of 4 percent. Moreover, the influence from being integrated with two democratic nations led to the removal of the Institutional Revolutionary Party, which had been in power for more than 70 years.

The first feature of economic integration is the flow of goods and capital. This was as far as the ancient civilizations were able to proceed up on the ladder of economic integration. The second feature of integration is foreign direct investment — one of the most important factors in global economic integration, as well as the connection of international entities.

In 2002, almost all of the net equity capital that came to the United States was foreign direct investment, which has helped finance the current account deficit. Besides the obvious monetary benefits, foreign investment provides human capital development for the receiving countries, as employee training is almost always a by-product of new businesses. The ensuing transfer of technology is another benefit that cannot be achieved through direct trade or simple financial investments alone.

Countries such as Singapore that have a high level of cross-border integration and foreign direct investment have been the success stories of recent years. However, countries that do not have the resources or the business climate to attract investment, such as many sub-Saharan African nations, have continually experienced a steady decrease in gross domestic product per capita. The successful countries in this age of economic integration have been the ones with an open economy that are therefore attracting most of the investment.

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Fortunately, countries can affect how much investment they attract. The biggest factor that affects foreign direct investment is stability — political, social, and economic. Political policies play a big role in investment. For instance, the U.S. embargo toward Cuba forbids investment, yet the end of the Cold War brought about a friendlier and safer environment for investing into other emerging market countries. Current turmoil in the Middle East defers direct investment, but a possible shift to a democratic nation would make it much easier.

Among the most attractive foreign direct investment destinations in the world right now are China and India. This development of the middle-income economies and the subsequent explosion of wealth have been directly due to globalization and integrated economies.

The world is also shrinking in terms of connectivity. An order can be placed from anywhere on the planet and the item shipped to anywhere on the planet all in a matter of days.

Again, this is primarily due to the proliferation of technology — faster communication, more efficient transportation, and the subsequent labor mobility. Other factors in this shrinking world include an increased demand brought about by growing populations and increasing wealth per capita in the burgeoning middle-income economies such as China and India.

These middle-income economies are becoming the new focal point of international trade, especially in information technology and textiles. No longer isolated from the rest of the world, these countries are using the free movement of goods, services, labor, capital, technology, and knowledge to assume a key role in economic integration. When China joined the World Trade Organization, it was the start of the regional integration of East Asia into the global economy. As stated by Mayor Xia, a Chinese Communist official, "First we will have our young people employed by the foreigners, and then we will start our own companies. It is like building a building. Today, the U.S., you are the designers, the architects, and the developing countries are the bricklayers for the buildings. But one day I hope we will be the architects."

The growth in this region has affected global business and has immense implications for the future. Although the United States is losing service and manufacturing jobs to India and China, that growth has been one of the key factors in the success of the East Asian countries. And in turn, their blossoming economies have created a greater demand for American goods. In fact, total exports from U.S. companies have grown from $2.5 billion in 1990 to $5 billion in 2003.

Even Africa, the poorest continent in the world, is realizing the necessity of economic integration. The Abuja Treaty calls for cooperation between individual nations through the promotion of intra-African trade and a common currency. As stated before, trade and common currency are keys to becoming economically integrated. It is amazing how quickly an entity or country grows once economically integrated.

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Management strategy

Based on current trends, integration into the global economic system will remain a top priority for corporate and country leaders. Companies with assets abroad must monitor closely the economic vitality of their foreign affiliates. Exchange rates and financial crisis are direct results of capital market integration, and firms must carefully track country indicators for signs of economic competitiveness. This will not be easy for commercial players such as the Airbus consortium, which maintains operations around the globe.

To respond to this global tectonic of economic integration, corporations will have to devise a constellation of new management strategies to track political developments and monitor the productivity of thousands of employees in any number of countries. Despite the risks associated with global integration, over the past 30 years the benefits of free trade, open capital markets, and international expansion have far outweighed the costs. Integrated economies have grown at rates two to three times that of economically isolated nations.

This story is far from over, and it may not conclude with, "And they all lived happily ever after." Companies should anticipate and prepare for the continued integration of financial and goods markets as well as the development of stronger economic ties among companies and countries around the world. ❖