

Globalisation – challenges and future prospects

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Outsourcing, off-shoring, insourcing, work-flow-software, open-sourcing etc. are all phenomena that increase global competition. Developments during the 1990s dramatically 'flattened' the world thereby creating what is now recognised and referred to as 'globalisation'. But what lies beneath this widely used term, and what are the consequences of globalisation? What kinds of challenges and strategic considerations do companies face? And what does the future hold?

The history of globalisation and outsourcing

Outsourcing with low-cost production in mind is not a new phenomenon. For some decades now, companies have attempted to strengthen their competitive position by taking advantage of lower wage levels. However, it was not until the late 1980s that the term 'globalisation' was introduced and acknowledged on a worldwide basis.

From the outset of the outsourcing era, the strategy as such has been viewed as defensive, i.e. as a last resort after all other cost-reducing alternatives have failed. Also, outsourcing has been frowned upon and questioned by traditional players in the business sector – this was

especially the case in the 1980s.

During the 1990s, the view upon outsourcing changed. A lot of companies chose to 'go global' and the general attitude towards the outsourcing strategy took a turn towards a more moderate skepticism, based on a wide acknowledgement of the fact that outsourcing was simply a necessity for some companies. Furthermore, in line with the revolutionary development of the internet and the emergence of a global logistics system at the end of the century, low-cost production suddenly became equal to other strategic options.

Today, setting up production in low-cost areas is no longer a question of 'if' but rather a question of 'when, where and how.' Outsourcing has now manifested itself as *the* strategy of the 21st century. Not only has outsourcing become an obvious choice - for many companies it is an absolute necessity in order to survive within the framework of global low-cost competition. However, not every outsourcing plan turns out successfully, since head-over-heels establishments lacking strategic considerations often result in nothing more than shattered illusions and poor economic returns.

The geographical choice

Globalisation makes it possible to obtain the best from two worlds, as it enables

companies to strengthen their competitiveness and at the same time operate close to their costumers.

The real challenges for companies attempting to benefit from these advantages are 1) exercising global management across geographical and cultural borders, 2) converting the strengthened competitiveness into stable financial profits, and 3) taking full advantage of the low-cost effects on all possible levels.

In considering how to overcome these three challenges, the choice of outsourcing-destination in terms of country/region becomes a vital strategic decision. Many factors - both rationally and emotionally driven - play a role when choosing between e.g. the Baltic area and other EU-states, or between Ukraine and China.

However, in the decision process, decision-makers should keep their main emphasis on four different factors: wage level, logistics, market proximity, and internal company discipline. In addition to these, further considerations should include cultural diversities, the pace of economic development and the extent of available human capital.

Obviously, the geographical distance from the company's country of origin to the new location is another important factor. The reason why 'distance' is not pointed out

separately as a fifth factor, is due to the fact that distance is implicitly included in a number of the above-mentioned factors. However, it is worth noting that the distance-factor is often interrelated with the management and economic capacity of a company, which means that larger companies can be expected to perform better over longer distances.

What does the future hold?

What are the future prospects for outsourcing and the structures of the global market? The coming years are likely to encompass a polarisation of the globalised industry-sector with local service oriented 'seven-eleven' units at one end, and globally operating business enterprises at the other.

Furthermore, the division of labour currently in progress will spread to all levels supported by the virtual connection between regions, companies, and businesses. This virtual connection will become more and more significant and practicable as a consequence of new technologies supporting a better and faster internet.

If these expectations hold up, the main future challenge for companies wanting to outsource will be how to reconfigure their domestic and international set-up, without these reconfigurations becoming somewhat constraining.

The 'game' of outsourcing - Internal rules

Internal discipline

An unhealthy company is not likely to survive the outsourcing process – and it certainly will not become any healthier during such a resource-demanding procedure.

A certain magnitude is required

Though the wage level is lower, there are still considerable costs involved with the establishment of production in Eastern Europe. Thus, profitability requires a certain magnitude of the company.

Competences

Management and the ability to 'master the distance' require more resources than what is generally expected. Consequently, outsourcing is not a 'rush job'. Thus, it should be drawing all disposable attention.

The 'game' of outsourcing - External rules

Identifying the framework conditions

Not only is it of great importance to identify the framework conditions 'on location'. It is also important to recognise the conditions as an advantage rather than a disadvantage.

Culture and management

Acceptance and understanding of local culture and management structures is needed - especially regarding phenomena that relates specifically to a Western context (such as 'equality before the law').

Awareness of the business myths

- 'Mafia and corruption go hand in hand' – not only Mafia-affairs but also corruption is illegal and creates a 'snowball-effect'. So stay clear of both!
- 'Productivity and quality is low' - No, productivity and quality are related to technology and management and are not contingent on the skills of the locals.
- 'Private property does not exist' - Yes it does; however, it is a new concept both culturally and legally.
- 'Eastern Europe is underdeveloped and poor' - Maybe it is when compared to Western standards, but it is not going to stay that way!

Ukraine proves experts wrong

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Russia's decision to increase transit fees on gas supplies to Ukraine will eventually up the price level to that of world market standards. As a consequence, many experts have predicted a natural stagnation of the Ukrainian economy in 2006 and 2007. So far however, this scenario has proven to be wrong - especially in terms of macroeconomic development.

The background

In March 2005, Russia's state-owned gas monopoly Gazprom informed Ukraine that gas prices – over time - were to be raised to international market rates.



Ukrainian President Viktor Yushchenko

Although Ukraine could to some extent accept Russian demands to pay at the going rate, they strongly objected to the short period of time in which the steep increase in gas prices was to take place. After great media interest and political discussion in the two countries - and in the EU and the U.S. - a compromise was agreed, in which gas prices were roughly doubled. Consequently, Ukraine faced increased transit fees, partly

offsetting the country's increased costs. There is no doubt however, that Ukraine will eventually have to pay the world market price, which amounts to five times the initial gas price.

Ukraine avoids feared economic stagnation

Such an extraordinary surge in price of energy would in almost every other country be considered a serious threat to further economic development. However, the expected stagnation of the Ukrainian economy has yet to materialise; on the contrary, the economy seems to have benefited from these developments.

Although the development has had a negative influence on especially the Ukrainian citizens on a short-term basis, there are two main reasons as to why the county's economy as a whole will benefit from

the gas price increase.

First of all, due to the many years of artificially low gas prices in Ukraine, parts of the industrial sector have become energy-wasters, and therefore, the companies already performing poorly are going to be put out of business. This will include both the companies that are not willing - or able - to decrease their consumption of gas, and those who have only survived until now as a direct consequence of the artificially low gas price level. Secondly, those companies who actually manage to actively decrease their energy consumption and stay in business are likely to perform much better than before. This is due to the fact that decreased energy consumption will make the companies much more cost-competitive – not least compared to their Western European competitors.

This development is already taking place, and due to the expectation - and fear - of a

further increase in gas prices, the development is likely to continue to move forward at a notable pace.

Investment in renewable energy – a clear message

On 15 March, the Ukrainian president Viktor Yushchenko will visit Denmark, but in contrast to previous presidential visits, the Danish capital of Copenhagen will not be the only destination. The starting point will be the provincial city of Aarhus, where the president and his entourage are going to take a closer look at the facilities of the world's largest windmill manufacturer, Vestas. By doing so, the president sends out a message on three different levels:

First of all, he makes it clear to the Ukrainian citizens that he is actively seeking to lessen their hardships following the increased gas prices. Secondly – addressing Russia - the visit stresses Ukraine's willingness to explore energy

sources other than the existing ones, i.e. to become less dependent on Russia and Gazprom.

Thirdly, the president underlines his pro-EU attitude by signaling a willingness to increase the consumption of renewable energy. Such an increase should make Ukraine able to decrease its CO₂-emission in order to meet the environmental demands set up by the European Union.

To sum up, the increase in gas prices seems to lead to an improvement in Ukrainian competitiveness. Furthermore, Viktor Yushchenko's upcoming visit to Denmark will indicate whether the rising gas prices might also improve Ukraine-EU relations.