SECOND GLOBALIZATION

How it is reshaping corporate governance and CEOs' agenda

OC&C
Strategy Consultants

Contents

09/2012

FOREWORD

In the course of 2012, Wendel has asked OC&C Strategy Consultants to assess the effects of the globalization of economies on both management practices and governance models of major multinational corporations.

In fact, for Western groups, the transformation affecting competitive models, human challenges, and financial risks is not only accelerating, but also completely changing its span. This transformation disrupts many companies and forces them to radically reform their management principles as well as their governance. This transformation is precisely the subject our study has focussed on. Its objective was to practically understand the materiality of these evolutions and to draw lessons for the conduct of our business. The caliber of the executives who were interviewed and their acute interests in the process do definitely value our initiative. In short, what the executives OC&C met during our survey did acknowledge is their need both to reassess their governance models and to reorganize their agenda. They did more than just suggest directions to explore: they actually helped us weigh priorities and measure urgency. We are grateful to them for their invaluable input and feedback.

Ultimately, this worldwide research led by OC&C in a rigorous and pragmatic way provides the proper distance to consider the complex and changing dynamic of globalization. We do hope that this synthetic document will help those who are already facing or anticipating the choc of the “Second Globalization”.

Bruno BOUSQUIÉ
OC&C Strategy Consultants
Partner

Patrick TANGUY
Wendel
Managing Director

François CHAILLOU
OC&C Strategy Consultants
Partner

KEY WORDS

By “**Second Globalization**”, we mean the second wave of globalization, which is now reversing the roles of so called “developed” economies and “emerging” countries. The globalization launched about twenty-five years ago under the sole initiative of developed countries is now being transformed by the relentless expansion of major emerging countries, such as China and India. For almost a decade, this Second Globalization has dramatically intensified and changed the nature of the world economy. While opening formidable markets, globalization is fostering fierce and powerful competitors.

This study was structured to define a frame of references and a set of probing yardsticks useful for both CEOs and professional investors. This approach had led to the identification of about 300 “**insightful observations**” through the interviews of more than fifty CEOs, corporate executives, board members and advisors (see list below*), among the largest and most advanced companies in the world. These observations were carefully weighted and reformulated, then aggregated around seven major themes that deeply reshape the outlook on corporate governance and the CEO’s agenda. About 30 “**markers**”, eventually identified as indicators of the transition between the First and Second Globalization, enable to benchmark corporate practices.

**** List of companies interviewed***

Corporations: *BB, Access Industries, Aditya Group, Air France, Air Liquide, Alstom, ArcelorMittal, Cable & Wireless, Cott, Danone, Diageo, Eutelsat Communications, Fives, Gap, Godrej, HCL, HP, Lafarge, Larsen & Toubro, Next, Pernod Ricard, PPR, PSA Peugeot Citroën, Reed Elsevier, Renault, Rio Tinto-Alcan, Sainsbury’s, Samsung, SAP, Schneider Electric, Shell, Tata, Total, Vallourec*

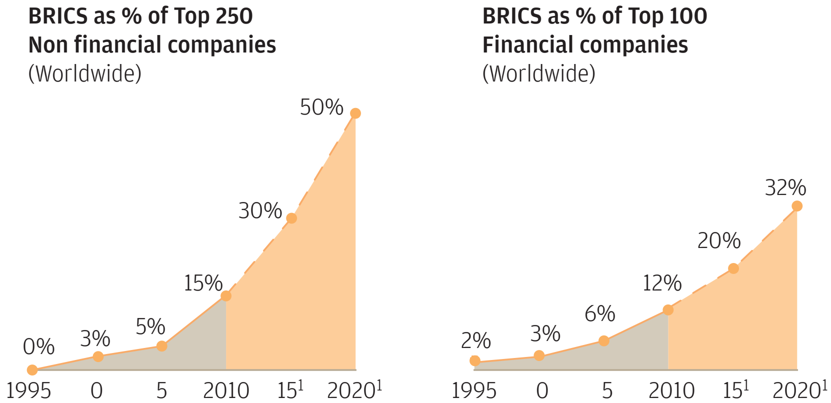
Corporate Advisors: *Barber Hauler Capital Advisers, Boyden, Eric Salmon & Partners, FICCI, Hoffmann & Baretti, Jouve & Associés, Korn/Ferry International, Morgan Stanley, Ness, Odgers Berndtson, Rothschild & Cie, Russells-Reynolds Associates, Société Générale*

A MASSIVE SHIFT IN THE GLOBAL ECONOMY

Large emerging countries, led by China and India, are becoming the core engine of the Second Globalization and- to use an image - this recent shift is provoking a real "geomagnetic reversal": investments have changed their center of gravity from West to East, and consumer expenditures are markedly increasing in emerging regions.

Among the whole set of available data, some key figures:
First, formidable competitors are unexpectedly emerging. Although analysts do not share the same opinion about the sustainability and resilience of BRICs, they usually do agree that the emergence of new global players will continue to significantly increase in the next decade.

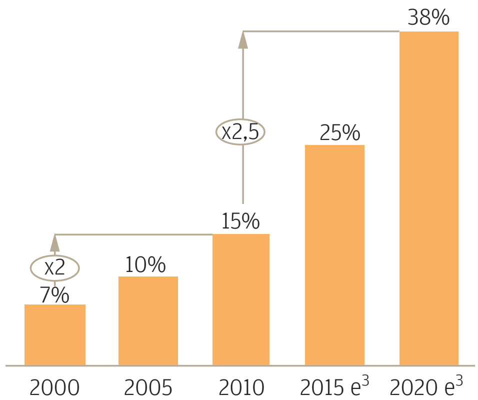
Share of BRICS in leading world corporations



NB: Ranking based on turnover
1. Median scenarii
Sources: Fortune Global 500, Forbes, annual reports, OC&C analyses

Second, the share of Asian markets in the major global groups' turnover is growing at an impressive annual rate. OC&C's analyses of the top global corporations (excluding finance and energy) show the scale of an undisputable evolution that will carry on for at least 10 or 15 years.

Top 15 world Companies' sales generated in Asia



1. Analysis of sales in Asia exclude domestic market (e.g. Samsung sales in Korea not taken into account)
2. Top15 world companies excluding financial and energy industry: Wal-Mart, Toyota, GE, GM, Samsung, Daimler, Ford, HP, Carrefour, Hitachi, Nestlé, Siemens, Honda, VW, Nissan
3. Median Scenarii
Sources: Fortune Global 500, annual reports and business press, OC&C analyses

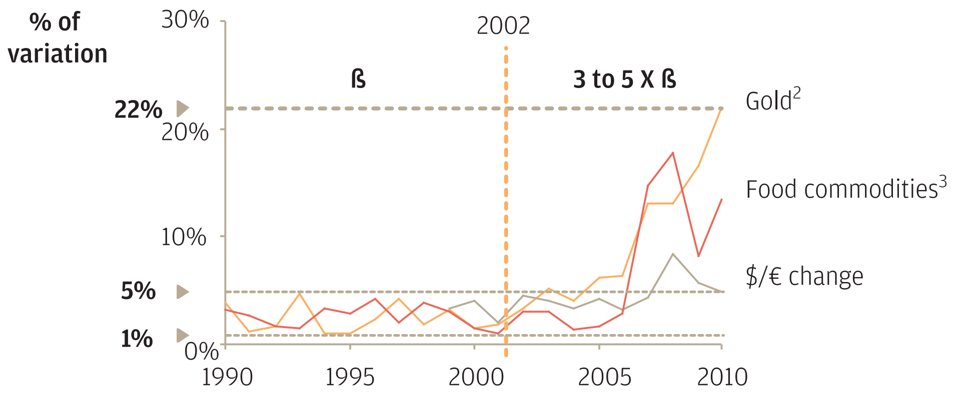
A LASTING UNSETTLED PATTERN OF BUSINESS

For Western corporations, the "structured" share of the markets they address is rapidly shrinking, reducing their short term certainties accordingly while challenging their ability to anticipate the future. (We define as 'structured' those markets where the Top 5 players control a combined share in excess of 35%). As aggressive emerging players are trying to radically change the game, Westerners must face the challenge while reassessing their levels of risk and their operating models. There are numerous examples which can make the case, including in the construction materials industries. For example, while Western companies were, in the 80s, operating on markets which could be then qualified as "structured" up to 70-80% they are now experiencing a reverse situation: today, due to the roaring development of emerging countries, more than 70% of their addressable market is not "structured" anymore.

Moreover, such a "geomagnetic reversal" is also interacting with severe climatic disturbances: interest rates, commodity prices, stock and bond prices, have never been fluctuating so widely since 2001-2002: the swing factor has been multiplied by 3 to 5 since 2002! Such volatility, although partly decoupled from the globalization phenomenon, adds to the risk of business and investments in emerging markets and increasingly in developed economies as well. And overall, the implied level of uncertainty can no longer be considered as a temporary phenomenon, but as a normal and lasting characteristic of the business environment. In brief, for most sectors, competition is no longer a "zero-sum" game, based on a steady profit pool. Conditions for maintaining relative strategic stability are vanishing.

This new situation challenges many corporate cultures, behaviors, systems and governance. Western large oligopolies and "peaceful competitive coexistence" will be gradually disturbed. Although new ones will most likely emerge, the timing is uncertain and we are not sure that they will follow our old rules of the game! Certainly those patterns have been adjusted or partly changed, but for most companies, the center of gravity has remained in the West and in the North. For any keen observer, competition is obviously going to rise and risks will simultaneously grow, as the game is increasingly uncertain and instable. Today the question is: how will Western corporate practices, built during the First Globalization in the 1980s and 1990s, survive the Second Globalization? If they don't what are the new ones to be expected and what are the lighthouses one can discern in the Second Globalization fog?

Volatility of main economics indicators



1. Coefficient of Variation (CV) = ratio of annual standard deviation of average monthly prices to the mean of the period (INSEE method)
2. CV based on price of gold ounce ($)
3. CV based on ratio of FAO food price index for cereals, oils, meat, milk, sugar to their average monthly share in exports
Sources: INSEE, Food and Agriculture Organization, FMI, OANDA, World Gold Council, OC&C analyses

A LACK OF FRAME OF REFERENCE

Is there an available frame of reference for executives and organizations addressing the changes and risks imposed by the Second Globalization? What has academic research to teach us? Academia, primarily based in North America - in conjunction with leading Strategy Consulting Firms - has been supporting business and management breakthroughs since approximately forty years. Over time, new theories and new tools have appeared in management intelligence. But what about today? Have new approaches been developed to help us understand and anticipate emerging countries-driven transformations? The answer is no, or not yet.
"Thinkers50", the global ranking of management thinkers published every two years by Harvard University, theories and fashions in the field of business strategy, even bestsellers on Amazon, show that academic research has been surprised by the Second Globalization. Four points must be made:

1. INERTIA

Western research is stalling: thesis awarded by HBS and the Times in 2011 are dated; they do not demonstrate any interest towards the upheaval brought by the Second Globalization. But remember, in 2001, notwithstanding the bubble of the dot.com companies, Peter Drucker (1954) and Michael Porter (1985) were still respectively on the first and third place of this ranking.

2. RESILIENCE

Strategy is not a recently updated field: tools, concepts & models that had, with the Boston Consulting Group, "conceptualized" strategy in the 1970s and fueled the portfolio management theories and the associated planning processes, have shown remarkable resilience. Under the First Globalization, organizational efficiency has been optimized with the same tools in a stable environment. "Enough thinking", was the motto, "now is the time for action".

3. REFOCUS

Academic research's focus has shifted on performance: (i) it has focused on financial engineering, mainly with the LBO and the securitization tools, as new ways to "create value"(ii) it has explored all sort of new means to optimize short term operational efficiency, and (iii) it has also wandered between technological blissfulness and New Age theories, far away from the brutal reality of the Second Globalization.

4. NEW PUNDITS

Today, three main authors among the few who actually address our subjects are Indian: Pankaj Ghemawat, Tarun Khanna and Krishna Palepu .Their fact-based stories and out-of-the-box perspectives refresh, if not outdate, our vision of globalization. They are not just smart and successful authors describing a new momentum, they are participating to a brand-new vision of the world.

THE REVIVAL OF ENTREPRENEURSHIP

Although this Second Globalization seems to blur our academic marks, there is one thing visibly emerging in this fuzzy landscape: entrepreneurship is back. After “businesses portfolio management” in the 1970s, and the “value creation” paradigm (1980s and 1990s), it seems we now enter an era that puts the entrepreneurial pragmatism into a new light. In the current age, risk management is repositioned at the core of management practices. After the “how” and the “what”, the “who” is regaining its place. Also, the entrepreneur- who is at the heart of the dynamism of the new economies - is regaining prominence in the Western countries. This shift in values is taking place certainly as the environment is becoming more unpredictable but also as the new BRICS competition is frequently incarnated by its companies’ founders or owners.

In this context, expectations regarding managerial qualities go far beyond the usual set. Performance must no longer be reduced to “short term results”. Managerial qualities now combine:

- A capability of building a strong “local” vision
- A passion for development
- A capacity to manage broad and diverse risks
- An agility to manoeuver locally
- A capability to motivate multicultural teams

These qualities simply characterize the entrepreneur. And this period shows the success of entrepreneurs in the BRICs, determined to take advantage of the Second Globalization. The “intrapreneur” managing his business unit on his market as if he was running his own company is the profile that should gain more importance in global groups if they want to compete on markets with high growth and prevent the entry of new players on their established markets.

	1970 1980	1990 2000	2010
Major phases	Opening-up of developed economies	First Globalization "Western centric"	Second Globalization "BRIC centric"
Paradigm	Tools and Business portfolio	Efficiency and value creation	Entrepreneurship & Risk management
Focus	What?	How?	Who?

SEVEN KEY THEMES RESHAPING THE CEO'S AGENDA

The set of our 300+"insightful observations" can be structured around seven key themes, that are notionally redesigning a new agenda for the CEO.

1. Be bold and aim high: winners combine broad comprehensive strategic anticipation with swift deployment on selective markets

2. Acculturate leadership to a multipolar world: advanced companies drop monolithic models to adapt to multifaceted globalization

3. Become truly indigenous: successful companies experience radically new conceptions of local organization and management

4. Reset governance and management systems: new models allow to adapt to Second Globalization permanent upheavals

5. Refit financial functions: efficient organizations recalibrate financial systems and talents to better match the new imperatives

6. Revive and reinstall strategic discipline: truly global organizations exhibit both forward looking strategic rigor and down-to-earth pragmatism

7. Fully leverage boards: boards can play a vital role as strategic driving force, away from their sole statutory and prudential functions

1 Be bold and aim high: winners combine broad comprehensive strategic anticipation with swift deployment on selective markets

a. Enter emerging markets as early as possible in order to:
- Take the time to adjust to and experience the markets before scaling up
- Hold the best position to react early and decide the accurate timing of investments
- Avoid being “out of the game” or having to pay the expensive “entry ticket” of the last player
- Practice economic intelligence, an asset that has been crucial for many pioneers

b. Balance global options to avoid three risks:
- Too much focus on a narrow array of countries
- Too broad a scope and scattered targets
- “Wait & see” attitude pretending learning from “others’ mistake”

c. Invest single-mindedly and act swiftly:
- Develop advanced capabilities ahead
- Hedge your bets by discouraging local short term strategies
- Establish rapid market leadership

2 Acculturate leadership to a multipolar world: advanced companies drop monolithic models to adapt to multifaceted globalization

a. Through local, agile and aggressive units built on a few key bearing points:
- A local R&D able to develop products and services adjusted to local needs, either through “Western” quality under Western brand or “good enough” standard under local brand
- Local operations combining appropriate costs, flexibility and compliance with local standards of production
- An “intrapreneur style” of management, directly reporting to the EXCOM and fully mastering local dynamics (markets, competitive environment and business rules)
- An adjusted governance, empowering management with true local independence and responsibility through new KPI and associated incentives.

b. Through a hybrid management, enabling a tighter “grip” of the organization on the market:
- Appointment of local but company acculturated managers
- Integration of high potential executives after acquisition or joint venture
- A proactive Human Resource process of development of “global” managers coming from the Emerging Countries, substituting to the usual expatriation of Western managers

3 Become truly indigenous: successful companies experience radically new conceptions of local organization and management

a. Give a global dimension to the Board by appointing businessmen from emerging countries and by holding important board meetings out of headquarters, in high growth economies

b. Open the EXCOM to a variety of profiles and to managers coming from different geographical backgrounds

c. Relocate executives in high growth countries, even for temporary periods; “headquarters” is a function, not a specific location

d. Appoint to the EXCOM managers in charge of developing China, India, etc.

4 Reset governance and management systems: new models allow to adapt to Second Globalization permanent upheavals

a. Stability and efficiency of traditional organizations are challenged by the “flexibility imperative”:

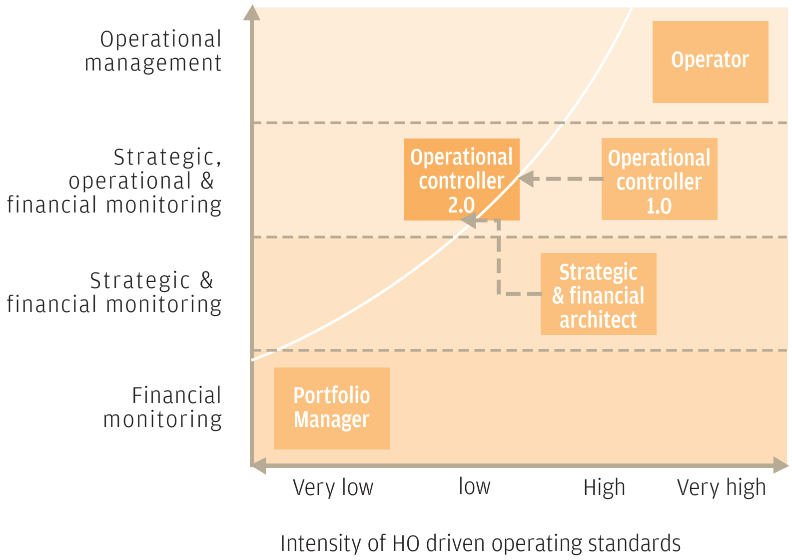
- Matrix organizational structures are not always adaptable, especially in terms of operational efficiency
- They are difficult to move and usually not adopted in emerging markets, as they lack the required maneuverability and reactivity.

b. The supremacy of the “strategic and financial architect” model comes to an end:

- Headquarters require more managerial interactions on short-term stakes, fewer managerial levels and shorter decision-making cycles.
- A new “operational controller” model is emerging, far from old technocratic practices, as based on management entrepreneurial qualities & values and frequent & informal interactions between CEO-COO and local MD

With regards to internal governance, one dimension deserves to be highlighted here: *The “Strategic and Financial Architect” model that appeared about 20 years ago seems to have run its course. It is now perceived as being clearly inadequate to deal with the Second Globalization. However, advanced corporations do not envision returning to the traditional “operational controller” model: it does not fit anymore, neither the new ‘intrapreneur’s culture nor the corporate need to empower local executives. In fact, Head Offices tend to adopt a new governance model , we call “Operational Controller 2.0”.*
Such a model favors interactions between the CEO and key geographies’ BUs Executives ; it makes them more frequent and more informal while refocusing them on local business matters at the expense of strict centrally defined, operating rules. This evolution seems also possible thanks to the efficiency of new information systems which better secure performance indicators’ availability and integrity. For those companies involved in this Second Globalization, key words are: anticipation, risk assessment, advanced indicators and reactivity. This predicament, in any case, triggers in-depth internal debates on governance and control systems.

Governance Practices : simplified mapping
Head Offices missions



5 Refit financial functions: efficient organizations recalibrate financial systems and talents to better match the new imperatives

a. New CFO’s profile and experience must fit the new demand:

- As markets disintermediate, CFOs should rather be “deal makers” than “reporting officers”; able to manage high risk in complex situations and to handle transactions on very short notice
- Speed and flexibility are key for those professionals whose experience in the job represent – for the companies - the ultimate security to counterbalance the volatility of factors

b. New control and monitoring systems must secure increased autonomy of BUs:

- First, through a greater density of interactions between Headquarters and Units and a tighter monitoring (e.g. KPI including backlogs risk levels, macro-economic indicators, competitive environment)
- Second, through a practical translation in the processes of the “agility imperative” (e.g. reporting fixed/ variable costs, ”liquidity” of assets) through more frequent reviews involving top management (control is the price to pay for more autonomy)

6 Revive and reinstall strategic discipline: truly global organizations exhibit both looking forward strategic rigor and down-to-earth pragmatism

a. Strategy provides rationality against macroeconomic and (de)regulation chaos:
- Economic upheavals invite shareholders and Boards to renew their approach and practice of strategy
- The need for anticipation – although changing the rule of the game - revives the very notion of “Plan”, as a new platform of interaction with managers
- The medium-term strategic plan should however not be too “connected” to budgeting processes, otherwise managers could be discouraged to take risks

b. Strategic BUs should be strong and audible and serve on the EXCOM

c. Decentralization is a guarantee of cohesion and alignment between strategy and execution: local units are given three roles previously held by headquarters
- Pilot: local agents are most apt to initiate and monitor local moves
- Sensor: they can detect any signal in the competitive environment
- Translator: they understand specificities of local cultural stakes

7 Fully leverage Boards: boards can play a vital role as strategic driving force, away from their sole statutory and prudential functions

a. Globalization invites Boards to reconsider not only their corporate strategy but their own role per se: complexity, volatility, long term horizons and magnitude of risk make their missions very demanding. Most Boards are shouldered by one or several counsels, which are independent from the EXCOM

b. Advisory boards can also provide complementary and relevant assistance at all levels, as a way to challenge operations, as close to the field as possible. Large corporations systematize their use in emerging countries

c. Interaction between Board and top management (Top 50) are more and more vital to:
- Create and maintain positive dialogue and challenging business discussions
- Protect the EXCOM from overreacting to short term pressures
- Push management to project in medium to long term outlooks
- And incidentally, allow for the Board to identify tomorrow leaders

d. Boards have to adapt to companies’ growing exposure to institutional environment. As business concentrates and regulations firm up, they are more and more requested to play an advocacy role vis-à-vis Governments, in particular those of emerging countries

THE MARKERS OF THE SECOND GLOBALIZATION

From a western standpoint, although this shift is perceived by most actors as a "geo-magnetic reversal", reality of course varies according to geographies, sectors and products involved. But overall, corporate advanced practices sketch out the new imperatives of this Second Globalization for the CEOs. They actually design a new agenda and revamp traditional governance patterns. Overall the 300+ "insightful observations" recorded throughout the study, crystallize in 30 markers which practically acknowledge the shift towards the Second Globalization, when compared with the First Globalization.

Thanks to this study, Wendel has firmed up its own convictions and structured a first frame of reference facilitating experience sharing across corporations with regards to their management & governance practices.
On its side, OC&C would like to extend its grateful thanks to all contributors who, directly or indirectly, helped make this study both a success and an enjoyable initiative.

30 markers redesigning the CEO's agenda

	First Globalization	Second Globalization
Be bold, aim high	– Investment in emerging geographies as diversification – Observers to track opportunities – Cautious settling with a "campsite" mindset	– Investments in new economies as core investments – Entrepreneurs brought in to scale-up – Committed and visible move with still a "bivouac" mindset
	– Focus on BRICs only	– Multipolar focus
	– JV "just to see" – "Soft": prudence, distance and "politeness"	– JV controlled or reciprocity – "Bold": relocalization of corporate decision centers
Become truly local	– Marginal local R&D to serve western need at low costs – Priority: secure low cost & re-export – Local managers: expats acculturated to country	– Local R&D for local needs and global markets – Priority: achieve leadership in local markets – Local managers: nationals acculturated to company
Acculturate leadership	– Institutional board "symbolically" opened to local culture – Board meetings held at Headquarters – Home country language used at the Board	– Entrepreneurial board open to local business in emerging countries – Board meetings relocated outside home country – English to ease discussions and exchanges
	– "Center is in headquarters"	– "Center stands where business is" (a function, not a place)
	– BRIC executives: N-2, or N-3, reporting to RoW (Rest of the World) division	– Heads of BRICs being ExCom members
	– Global managers coming solely from parent company	– Local managers are promoted to global positions
Reset governance and management systems	– Search for efficiency mainly based on matrix structures – Numerous management levels	– Flexible and short chain of command – Priority is given to agile local actions
	– Domination of the "Strategic & financial Architect" Model – Rational, systemic and processes based models	– "Operational Controller 2.0" model is preferred – Hybrid, pragmatic and human relationship-based models
Refit financial functions	– Focus on planning, control & "compliance" – Reviews are normative, formal and regular – Reporting are mainly focused on financial indicators	– Focus on shareholders, risks and transactions – Reviews are more informal, frequent and action oriented – Reporting are oriented on simulations and advanced KPIs
Revive and reinstall strategic discipline	– Stable environment discount strategic thinking necessity – Strategic and financial planning processes are bundled to ensure consistency	– Widespread instability rehabilitates and challenges strategy – Strategic & financial planning processes tend to be unbundled to accommodate disruptions
	– Global company defined an homogeneous unit	– Global company defined as a multipolar federation
	– Emerging countries reporting to division or branch	– Each priority country is a full-fledged "Strategic Business unit"
Fully leverage Boards	– Board's role still limited to statutory, conventional and prudential – Board's composition: stable, institutional and rather disconnected from strategic changes	– Primary Board's role is to serve the company AND the shareholders – Board's composition: business driven, and able to adapt to strategic challenges
	– Directors distant from Management and remote from operations	– Directors kept closer to business by Management
	– Board deals with statutory and financial matters only, through ad-hoc committees (Audit, Remuneration)	– Board enrolls seasoned Directors able and willing to also challenge the strategy

For further information on this article, please contact

Ludovic Broutin
T +33 1 58 56 18 93
ludovicbroutin@occstrategy.fr

Bruno Bousquié
T +33 1 58 56 18 41
brunobousquie@occstrategy.fr

François Chaillou
T +33 1 58 56 18 58
francoischaillou@occstrategy.fr

www.occstrategy.com

OC&C Offices

Belo Horizonte
T +55 31 3481-0092

Boston
T +1 617 896 9900

Düsseldorf
T +49 211 86070

Hamburg
T +49 40 4017 560

Hong Kong
T +852 2201 1700

London
T +44 20 7010 8000

Mumbai
T +91 22 6619 1166

New Delhi
T +91 11 4051 6666

Paris
T +33 1 58 56 18 00

Rotterdam
T +31 10 217 5555

São Paulo
T +55 11 3053-0434

Shanghai
T +86 21 6115 0310

Warsaw
T +48 22 826 24 57

OC&C Strategy Consultants