

MANAGEMENT LESSONS
IN THE NEW LOGIC OF THE
GLOBAL MARKETPLACE

THE BORDERLESS WORLD



POWER AND
STRATEGY IN THE
INTERLINKED
ECONOMY

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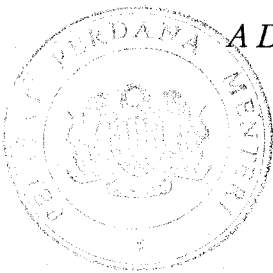
THE BORDERLESS WORLD

*Power and Strategy
in the
Interlinked Economy*

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Preface

One of the lessons I've learned from writing books and articles is that writing about management is safe. But writing about international trade is dangerous. When I published *Triad Power* in 1985, the *Financial Times* called it "one of the most succinct and elegant descriptions of the forces behind the growing globalization of industries and products." A year or two later they ran a headline that called me "Japan's Only Management Guru."

But when I wrote about trade issues in *The Wall Street Journal*, things were different. Some of my friends, even a few American colleagues at my consulting firm, McKinsey & Company, worried that I had become an apologist for Japan, that I wasn't being objective about Japan's protectionism and other matters. People even accused me of being an agent for the Ministry of International Trade and Industry.

When in 1983 I outlined in *Japan Business: Obstacles and Opportunities* the many new kinds of alliances and collaborative ventures being formed in autos, electronics, and other industries, some argued that not one of these alliances had worked and that they were really Trojan horses that let the Japanese get into foreign markets. I wasn't believed when I stated in an interview with *Fortune* magazine that the problem for semiconductor manufacturers wasn't the Japanese but the fact that it was becoming a high-fixed-cost, process industry. Yet today Malaysia is the largest exporter of commodity chips.

Why does a nuclear engineer turned management consultant write about trade? It wasn't to defend Japan. I was reacting to

forces at work that were becoming very powerful and changing the way our clients operated.

About fifty Japanese companies account for 75 percent of its exports to the United States. My colleagues at McKinsey and I know them very well either as clients or as competitors of clients. As their position has changed, so has the focus of our work as management consultants.

Initially we worked to help develop products, strategies, organizations, people, and management systems. Our goal was to develop good products and sell more for less cost. And if we were successful, our clients would export those products to some overseas countries. But for the most part, our planning horizon did not extend beyond national borders.

The deregulation of the financial markets complicated the situation. After deregulation, corporations could use alternatives to create wealth in key regions of the world in addition to simple manufacturing and selling. To help them gain a market share it was necessary to learn about macroeconomics as well as currency and financial markets.

Protectionism or the threat of it accelerated corporations' efforts to transfer key components of their business systems away from headquarters. That development forced us to think about organization on a global scale and the nature of protectionism itself. I've worked with many large corporations, helping them move from the export-oriented stage of organization to local production and product development, and from the one-headquarters to a four-regional-headquarters model. I have worked with European, American, and Asian corporations to help them establish better and stronger positions in Japan as well. The speed with which the psychology of key managers in these corporations has moved—from local to global, from a nation-based to universal value system, from a headquarters-driven management style to local, market-driven decision making—has been surprising. Words such as overseas operations, affiliates, and subsidiaries are disappearing. Nothing is "overseas" any longer. I was in the right

place at the right time to observe impressive groups of managers—not all Japanese—achieve these transitions in a relatively short period.

This book, then, pulls together my understanding and experience of business strategy and competition with my beliefs and analysis of macroeconomic issues. It starts out as a book about strategy and the organization of international companies. Then it attacks the bureaucrats in our governments, who are losing their power but causing great problems on their way out the door. Finally, it begins to describe the economic world toward which we are moving.

By “strategy” I mean creating sustaining values for the customer far better than those of competitors. It therefore means first of all invention and the commercialization of invention. Most people in big companies have forgotten how to invent. They know how to buy and sell businesses or produce me-too products, but they don’t develop products that are really better. Nor do they develop new businesses to support these new ideas.

I don’t mean just large-scale, high-tech development projects like High Definition Television (HDTV), but products used everyday by most men and women. How do you make a coffee-pot, for example, that actually makes better coffee? Or a bubble bath that really is good for your skin? How many product managers staring at their computer screens do you think could do that? Not many. They’re too worried about competition and market-share and profitability figures. I believe it’s time for big companies to relearn the art of invention. But this time they must learn to manage invention in industries or businesses that are global, where you have to get world-scale economies and yet tailor products to key markets.

Companies have to do that because more informed and demanding customers are coalescing in all developed countries. It is they who really have the power, not the organizations who sell to them. Most people probably don’t realize this yet despite the many articles and books on globalization. They still think of giant

multinationals forcing their will on people in the countries in which *they choose* to operate. If this book has another purpose besides helping its readers understand the fundamentals of strategy and commercialization, it is to show how multinational companies are truly the servants of demanding consumers around the world. It is these customers who are driving them to operate, develop, make, and sell in many countries at once and who in the process are helping to create a borderless economy where trade statistics are meaningless.

If it does that, you will agree that it is time to throw the bureaucrats out. There is a role for governments—to protect the environment, to educate the work force, and to build a safe and comfortable social infrastructure. When governments are slow to grasp the fact that their role has changed from protecting their people and their natural resource base from outside economic threats to ensuring that their people have the widest range of choice among the best and the cheapest goods and services from around the world—when, that is, governments still think and act like the saber-rattling, mercantilist ruling powers of centuries past—they discourage investment and impoverish their people. Worse, they commit their people to isolation from an emerging world economy, which, in turn, effectively dooms them to a downward spiral of frustrated hopes and industrial stagnation. By looking outward with almost paranoid suspicion, fearing that exploiters will make off with whatever of value they have, they ignore the needs of their people and destroy the value—the human capital—the people represent. In both the political and the economic arena, as recent events in Eastern Europe have shown, the people—as consumers and as citizens—will no longer tolerate this antiquated role of government.

There are bureaucrats in the United States and Japan as surely as there are in Eastern Europe. They miscount the trade figures and get them wrong month after month, and in the process they provide the weapons for economic war between nations. But their time will come too, just as it has for bureaucrats elsewhere.

An isle is emerging that is bigger than a continent—the Inter-

linked Economy (ILE) of the Triad (the United States, Europe, and Japan), joined by aggressive economies such as Taiwan, Hong Kong, and Singapore.

It is becoming so powerful that it has swallowed most consumers and corporations, made traditional national borders almost disappear, and pushed bureaucrats, politicians, and the military toward the status of declining industries.

The emergence of the ILE has created much confusion, particularly for those who are used to dealing with economic policies based on conventional macroeconomic statistics that compare one nation against another. Their theories don't work anymore. While the Keynesian economist would expect to see jobs increase as an economy picks up, the ILE economy sometimes disappoints them. Jobs might be created abroad instead. If the government tightens the money supply, loans may gush in from abroad and make the nation's monetary policy nearly meaningless. If the central bank tries to raise the interest rate, cheaper funds flow in from elsewhere in the ILE. For all practical purposes, the ILE has made obsolete the traditional instruments of central bankers—interest rate and money supply.

In the ILE most interest-bearing instruments have taken a backseat to noninterest-bearing (and often speculative) instruments such as real estate, stocks, and currency exchange markets. These latter markets have absorbed the enormous excess liquidity produced by vote-buying, deficit-ridden governments, thereby curbing inflation. The ILE is flooded with superliquidity, but thanks to fact that these speculative markets have large buckets, the excess money has been contained and has not done evil (inflation) to ordinary people.

This flow of funds is largely invisible. The traditional way of looking at the trade statistics, based on a nation's balance with another nation, has become obsolete, because ILE residents have learned to move their production and other functions around. Old-fashioned bureaucrats, trying to correct the imbalance figures, make decisions that are comparable to pouring oil on a fire. They create barriers and artificial controls over what should be

the free flow of goods and money. Some even try to fix the figures by fiddling with the currency exchange rate. Currency, being the conversion factor of all tradable goods, services, and assets, changes the balance of power within the ILE as wealth thus redistributed is dramatically different from the national economy-based balance of power.

According to the old macroeconomist's view, the exchange rate should change to adjust for the differences in purchasing power of tradable goods and in rates of inflation and interest between the two countries in question. The emergence of the ILE has made this concept obsolete. Assets are now traded across the (old) national boundaries. Companies change hands across borders as easily as paintings, patents, and real estate.

The ILE has a resident body of approximately 1 billion people, enjoying on average \$10,000 per capita gross national product. It is in the ILE that most of the wealth in the world is created, consumed, and redistributed. Participation in the ILE is key to prosperity for traditionally isolationist nations. Only through establishment of a healthy two-way pipeline can a developing nation prosper, for the ILE is where nations can get the best value for what they produce. Wealth is now created in the marketplace, rather than in colonies and in soils that contain natural resources.

In this interlinked economy, there is no such thing as absolute losers and winners. A loser becomes relatively attractive as its currency gets weaker and an unemployed work force emerges that is available at reasonable cost. Winners' economies, on the other hand, are adjusted downward toward the mean of the ILE by changes in their currency and wage rates.

Looking into the 1990s and toward the twenty-first century, the ILE is certain to grow faster. It will encompass most East European countries, most of Asian newly industrialized economies (NIEs), and some Latin American countries, if they adopt ILE policies. Interdependencies of economy create security, and that is going to be the governing thought in the ILE as opposed to the military-based security of the Cold War regime.

The policy objective for the ILE will be ensuring the free flow

of information, money, goods, and services as well as the free migration of people and corporations. Traditional governments will have to establish a new single framework of global governance. Toward that end, the first and most important step is to understand the global economy accurately. That's the purpose of this book.

People are global when as consumers they have access to information about goods and services from around the world. But these same people could support protectionist representatives if all they read is rhetoric based on archaic nationalistic sentiments. Students, even today, are learning old economic theories that do not work in the ILE. Most of these theories were created at the turn of the century when the national model—the closed economy—was *the* model. Most statistics are still gathered based on this old framework, and hence macroeconomic analyses tell little about what is happening or what will happen in the world, or even in a country.

It is time for us to look at the real economy of an interlinked world. I cannot now propose a new academic theory of economy governing the ILE. What I have done here is to share the perspective I gained over the years working as a practicing consultant, in the hope that readers will appreciate the view and the potential power of the new world, toward which we are heading. Some might be able to articulate a more rigorous economic model to explain the dynamics of the ILE. Some might extract the political implications of the ILE and propose a new regime to govern the world based on today's economic realities, rather than on the old postwar regimes of the United Nations, the Organization for Economic Cooperation and Development, the General Agreement on Tariffs and Trade, the UN Conference on Trade and Development, and even European Community—1992, most of which are based on the Cold War model or on the idea of North-South Clubs.

I will not be surprised if someone comes up with a proposal for a supergovernmental structure, with a taxation system for ILE residents being evenly divided, such as one-third to the world

outside of the ILE, one-third to the immediate community in which they live, and one-third to the country. This would reflect the view of the world I've developed over time—as a global citizen, as a resident of my community, and as a Japanese (in that order).

Other readers might find good ideas to develop products, strategies, and organization for the company for which they work. As an author and management consultant, I hope that is where this book's value will be most immediate. I would also like students to read this book before they hear all the old theories and become so fixed in their perspective they cannot see the world as it is and insist on trying to explain everything with the tools they have at hand.

Trying to cover everything from product development to international organization, from currency and trade discussions to developing country issues may seem to be too broad an agenda. However, my feeling is that we need to pull these traditionally isolated subjects together to describe the characteristics of the ILE in a borderless world. My belief is we will accumulate more and more evidence in the 1990s to describe the new ILE that is far bigger than nation-states today, and that we will all gain legitimate citizenship in it before long.

What follows, then, is a prediction or at least a hope that utility will triumph over ideology. It is based on my faith in man as inventor and in the power of informed customers to triumph over man as regulator. It's the regulators we have to fear.