DOLLARS & SENSE

OF TAKING YOUR BUSINESS GLOBAL

When KPMG's Global Enterprise Institute surveyed U.S. middle market companies in late 2007, it found that 58 percent of all businesses surveyed planned to increase their global presence over the next five years, and one-third planned to maintain their current global presence. Interestingly, in the same survey, fewer than half of all respondents said their expansion efforts over the past two years had been successful; therefore, 50 percent were unsuccessful! With failure rates like these, it's time to ask "What are we doing wrong?" More importantly, what must be done differently to improve chances for future success in the global marketplace?

Start With Goals and Objectives

Going global for the sake of going global is a recipe for failure even though a preponderance of evidence and research suggests that cross-border engagement is a critical path for U.S. businesses. Instead, it is important to seek out the "right" opportunity by allowing overall corporate goals and objectives to guide the decision for global expansion. By pursuing global opportunities that correlate directly with the company's overall strategic plan, the entrance into the global marketplace will reflect a long-term commitment that is more likely to generate value and future success.

A few common goals for going global include expanding customer base, lowering manufacturing costs, and creating a competitive advantage in the marketplace. Although these common goals are shared by many businesses, accomplishing these goals may require very different strategies for each individual business. While pursing identical goals, each business needs to identify the unique global expansion opportunity for its product(s) or service(s). This process requires both an internal and external assessment.

Internally, companies have to assess their strengths, weaknesses, motivations, and resources — both financial and human. Externally, the assessment should include a panoramic view of all reasonably viable markets with an in-depth understanding of their local culture, standard of living, infrastructure, business practices, legal environment, and political stability. At some critical point in this assessment process, an advantageous alignment should be revealed that pairs up a business' goals and objectives with unique qualities and opportunities for one or two global markets.

Balance Risk and Rewards

The spotlight of a global expansion program should stay focused on opportunities for growth, increasing profit, enlarging market share, and gaining further competitive advantage. Still, it's important to complete a detailed risk analysis assessment. "The analysis should answer the questions: What is the ROI (return on the investment) for international expansion and will that ROI be sufficient to reward the company for the associated risks?" explains Ed Morris of Clifton Gunderson LLP. "For example, if a company invests $1 million in a plant and equipment domestically and receives a return of $200,000 in additional profits; but could have invested $1 million in a foreign country and received $250,000 in additional profits, that additional $50,000 reward is probably not worth the additional risks associated with global expansion. On the other hand, if the global expansion generated $400,000 of additional profits it is probably worth the additional risks."

Specifically, a thorough risk assessment should be comprised of these following components:

> *Operational risks* such as transportation, distribution, supply chain, information technology and personnel – Each of these operational functions can look different and offer unique challenges from one market to the next. In the Middle East, for example, businesses must consider longer customs waiting periods, and political instability that affect insurance rates and delivery times.

> *Financial risks* such as taxation, transfer pricing, foreign exchange, credit and cash flow – "All too often, firms in the process of international expansion find themselves with little working capital to meet daily operating needs," explains Sami Altaher, executive director at FGI Finance, "and many are unaware of the resources available to them that can help them capitalize on opportunities internationally." Aside from the most basic benefit of increasing working capital, lenders such as FGI have the advantage of extensive global experience that can navigate the challenges of cross-border business transactions.

> *Strategic risks* such as local competition and cultural differences – The role of local brand loyalty can not be underplayed in foreign markets. Also, culturally, many international consumers are very concerned about social status and the allure of using certain brands of cars, computers, telephones and accessories. For this reason, collaboration with established local businesses is often an advantageous market-entry strategy.

> *Legal risks* such as contracting, regulatory and compliance – In addition to political instability, some foreign markets experience a significant amount of legal instability. Regulations, local or national, can change overnight requiring immediate action.

Again, the purpose of a risk assessment is to understand the market specific risks, not to provide justification for rejecting a global initiative. For example, consider a U.S. business that wants to increase its presence in Western Europe. In this case, the risk assessment must include the likelihood of strikes and work slow-downs. While Italy's "lo sciopero" (planned strikes) can bring transportation to a halt during the summer season and disrupt any business, Italy may still be a good market choice. But, the decision must be based on a calculated risk and acceptance of that risk.

Focus the risk assessment process by examining key areas that have caused businesses the most difficulty. In a study conducted by Grant Thornton, respondents were asked to list the three biggest barriers they experienced in cross-border transactions. The five most common areas of difficulty are as follows:

> *Cultural issues* (*39 percent*) – It is important to spend time getting to know local customs and practices.

> *Regulatory environment* (*35 percent*) – Be prepared for unexpected legal and/or regulatory changes and understand the provisions of the Foreign Corrupt Practices Act (FCPA).

> *Legal environment* (*35 percent*) – Make no assumptions based on geography, every legal system is really very different.

> *Intellectual property protection* (*31 percent*) – The ability to protect intellectual property varies greatly in each country.

> *Due diligence* (*27 percent*) – Do your homework with an emphasis on getting actionable data and utilize experts to assist in relating market information to specific business issues.

Opacity Index: One Tool to Measure Risk

One tool that can assist businesses in evaluating potential risks in various countries is the Opacity Index created by the Milken Institute. The Milken Institute is an independent economic think tank whose mission is to improve the lives and economic conditions of diverse populations in the United States and around the world by helping business and public policy leaders identify and implement innovative ideas for creating broad-based prosperity.

Drawing on a decade of research, the Milken institute has created a tool that allows businesses a new way to anticipate, analyze and manage hidden global business risks.

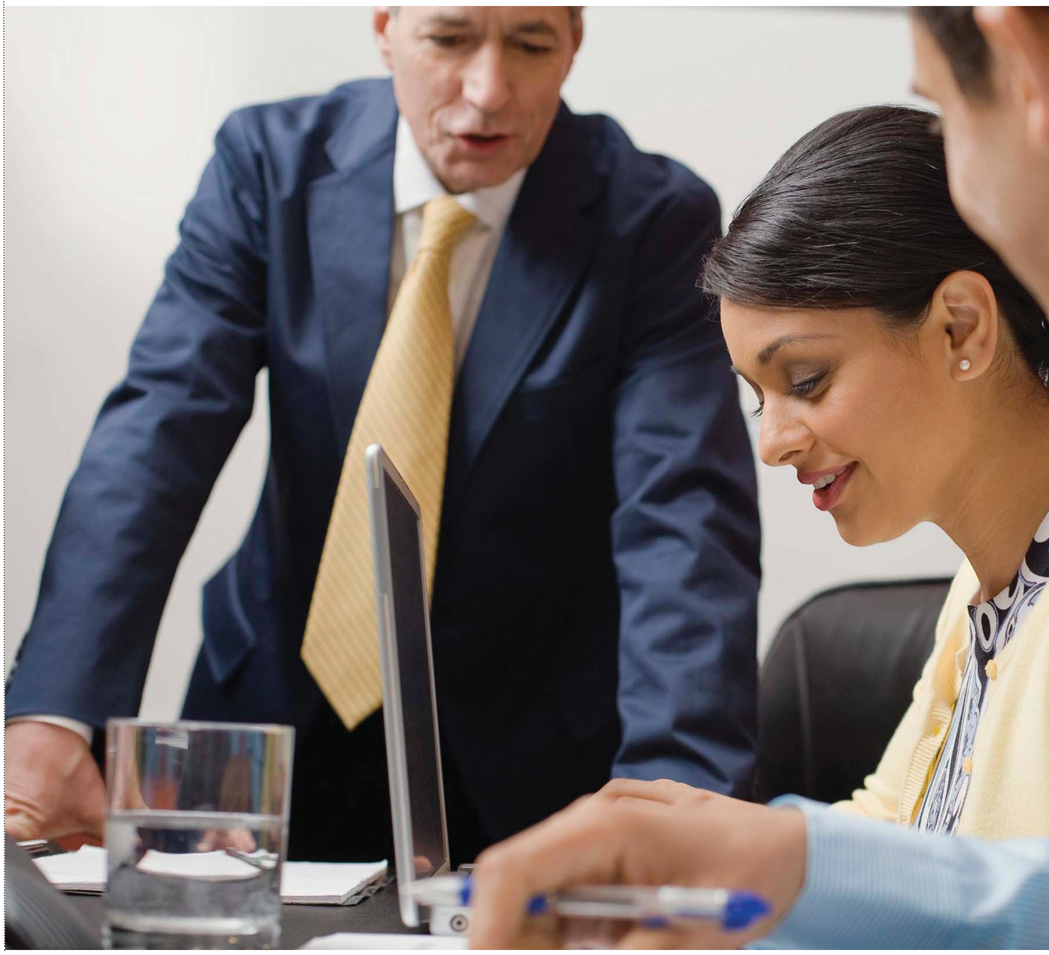
The Opacity Index is a measure of five components identified by the acronym CLEAR:

C - Corruption
L - Legal system inadequacies
E - Economic enforcement policies
A - Accounting standards and corporate governance
R - Regulation.

It is a broad measure of the effectiveness of a country's economic and financial institutions as well as overall risk. To place the tool into perspective, the 48 countries covered in the index account for 65 percent of the earth's land mass, 77 percent of the world's population (in 2007), 94 percent of 2007 world GDP, 93 percent of world financial assets and 99 percent of world equity trading volume.

Higher opacity scores represent a more opaque business environment. For example, the most recent Opacity Index for the year 2007 – 2008 (available at http://www.milkeninstitute.org/pdf/2008OpacityIndex.) ranks the top three countries (i.e. lowest opacity scores) as Finland, Hong Kong and Singapore. The bottom-three countries (i.e. highest-opacity scores) are Venezuela, Lebanon and Nigeria. The understanding of how one country compares to another along these five dimensions is a useful tool for businesses that wish to expand globally.

Essentially, this measures "the lack of clear, accurate formal, clear-cut practices in the broad arena where business, finance and government meets." (Global Edge: Using the Opacity Index to manage the Risks of Cross-Border Business). The index also allows countries to monitor improvements and progress towards eliminating fraud and corruption.



Know the Costs

In addition to patience, planning, and preparation, global expansion requires a substantial investment in financial and human resources. The consequence of underestimating either of these can be disastrous. Instead, it is important to perform extensive research and interpret it accurately. Ideally, this research should eliminate surprises and aid businesses in anticipating potential problems and ensuring that they are equipped with both the money and talent to succeed. In the study conducted by Grant Thornton, 56 percent of all respondents noted that meeting objectives took longer than expected. In other words, more financial resources were needed.

Once an opportunity is identified and the risk analysis is complete, it is critical to perform a thorough analysis of all costs. For example:

> *Opportunity cost* – What is the cost of not expanding globally? It could be higher materials costs, loss of competitive advantage or shrinking customer base. Alternatively, what is the opportunity cost of going global? It may require eliminating existing domestic operations or terminating a domestic product line.

> *Human capital* – Employing the right talent (abroad and at home) to support the expansion and get things done is essential to success. Can existing employees deliver? Do they need training? Will new positions need to be created? Employees abroad will represent the business and have the potential to build-up or destroy the corporate reputation.

> *Transportation and distribution* – This can represent a significant portion of total overhead expense and requires a cost benefit analysis to determine what level of control is acceptable and for what price.

> *Supply chain and global sourcing* – U.S. companies have never had so many choices when it comes to global purchasing opportunities. The decision to manufacture or outsource and the overall coordination of a globally dispersed supply chain are key strategic areas that require consideration and expertise.

> *Taxes, Insurance and Other Costs* – On a local and national level these "other" operating costs must be clearly identified and budgeted.

Both the risk assessment and the cost analysis require global expertise and knowledge that many U.S. businesses do not have. Consequently, it may be necessary to rely on global expansion experts who can oversee and coordinate each component of the plan. Gaining an expert's perspective on globalization can eliminate surprises and costly mistakes.

Plan It Forward and Stay Ahead

Long-term success requires a strategic focus and long-term commitment. If an organization's long-term goal is to penetrate Eastern Europe and the Middle East, establishing a presence in Turkey may be an ideal first step. It is well-positioned geographically because it is located on two continents, and is relatively inexpensive to conduct business. Plus, Turkey offers political stability and gets along with neighboring countries. By establishing relationships in Turkey first, future advances toward Eastern Europe and the Middle East can be made without having to reestablish a local presence.

Another strategy is to identify and act on future trends. Consider the burgeoning middle class in China and India. Imagine each one with a middle class equal to the entire population of the United States! A recent survey by the American Chamber of Commerce in China reports that 80 percent of respondents cited a desire to serve customers in China and elsewhere in Asia as their reason for having a presence in China. Only 16 percent indicated they were in China to export products back to the United States. Any U.S. business already in China with years of experience conducting business in that region is ahead of this trend and uniquely positioned to leverage their existing business relationships.

Get in the Game

The opportunities for global expansion are infinite, and the potential for exponential growth is alluring; however, attaining success demands a well-conceived global expansion plan: A plan that is grounded in accomplishing specific corporate goals through the careful formulation of business development strategies. Regardless of size or ownership structure, companies that take a proactive, strategic approach to evaluating and understanding both risks and costs will stay one step ahead of the competition and reap the benefits of a successful globalization initiative.

Mona Pearl is founder and COO of BeyondAStrategy, based in Chicago, and a regular contributor to *Manufacturing Today*. The firm develops competitive, cost-effective and sustainable global strategies for leading multinational corporations, mid-market firms and entrepreneurs to create significant growth. Pearl is an international business woman who knows that cultural differences can make or break a business deal. She is multi-lingual and can conduct business in English, French, German and Rumanian. She holds a master's degree in global business and marketing from DePaul University. Please call 312-642-4647 or visit www.beyondastrategy.com.