GLOBALIZATION

Are Businesses Ready for Deglobalization?

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As we enter a new decade, characterized by rising economic complexity and geopolitical divisions — U.S.-China tensions, populism and nationalism in Europe, and the looming risk of a global recession — forward-thinking business leaders are developing strategies to mitigate the longer-term risk of deglobalization. They are concerned about trade protectionism, and the revenue a company could lose in any tariff wars.

However, there is a more hidden risk associated with deglobalization: that global corporations are not structured in a way that is fit for purpose to compete in a deglobalizing world. It is increasingly understood that this ever-more siloed world directly impacts three key pillars of global corporations: technology, global recruiting, and the finance function.

The "Splinternet"

In recent years corporate leadership has rightly prioritized cyber risks, the threat of technological obsolescence, and the rise of the jobless underclass stemming from increased automation. However, there are now mounting concerns about the emerging "splinternet" — an increasingly fragmented internet with competing China-led and U.S.-led platforms.

Such a technological fragmentation would disrupt global supply chains — which enable global corporations to gain a competitive edge by selecting the most cost-effective solution at each stage of the production process. And the move away from such centralized procurement raises the costs of and reduces the efficiency gains from shared global services.

Furthermore, a balkanized internet promises to increase the complexity of a company's operations, which erodes a corporation's ability to respond quickly to market forces. In such a world, companies will need to choose between the U.S. and China camps or bear the costs of operating in two adversarial technological worlds, each with their own regulatory and operating standards.

Already, the first signs of such divergence are being felt across corporations concerning the issue of data privacy. Most western companies make every effort to protect individual privacy — a stance that arguably places U.S. and European corporations at a distinct disadvantage versus their Chinese competitors, who are able to operate in a less stringent data privacy regime. The relatively light data-privacy rules in China enable access to large data sets with more individual information. This can speed up innovation, including cutting-edge drug discovery, which in turn helps push costs down for the end consumers and drive higher company values.

The Intensifying War for Talent

Greater immigration controls are another offshoot of the move toward a more siloed world. The recent shift in the political mood in the U.S. and Europe toward more stringent immigration intensifies the war for global talent. The risk of further restrictions on immigration has climbed in importance on the leadership agenda as it threatens the corporation's ability to hire across borders.

Recruitment, particularly at senior levels, depends on access to global pools of talent, as those executive teams that draw on different nationalities and backgrounds are widely seen as a source of competitive advantage. In the wake of President Donald Trump's April 2017 executive order to "Buy American and Hire American," the U.S. Citizenship and Immigration Services (USCIS) has held up record numbers of H-1B visa petitions, so that the denial rate for first time H-1B applications has increased from 10 percent in 2016 to 24 percent in 2018 and 32 percent in the first quarter of 2019.

Mounting restrictions on immigration limit the opportunity for tomorrow's business leaders to learn how to navigate across cultures and differing social norms. Some might argue that these skills will matter less in a more siloed world, but a more fragmented world also means fewer opportunities to share and transfer best practices and transformational ideas.

More Complicated Corporate Finances and Regulatory Regimes

A more fragmented world also makes managing corporate finances globally more complicated and adds considerable costs to corporate treasuries. Global companies derive enormous benefits from a centralized finance function. Today many companies raise capital relatively cheaply in financial hubs, such as New York or London, and distribute the proceeds as investment across their global operations. In most cases, this more centralized model means corporations are able to borrow at a lower cost than they would if their regional and national subsidiaries had to confine themselves to local currency markets, which tend to carry greater risk and volatility. A more siloed world means corporations will struggle to extract their investment capital and return profits to shareholders.

The shift from a more centralized to a more federated model brings additional complexity, as business leaders must contend with the move from a harmonized rule-making business landscape towards an increasingly complicated web of independent processes and regulations in different jurisdictions. To reasonably manage or mitigate threats in a siloed world will require extraordinary levels of highly specialized knowledge at the local level — making it near impossible to understand the necessary risk budget, let alone adequately hedge these local risks.

As power continues to move away from multilateral organizations such as the EU, WTO, and NATO and devolves to local governments, global corporations will likely find it harder to maintain effective government relations across a myriad of different countries. Growing complexity on matters of taxation, tariffs, quotas, and environmental regulations, for example, will force global corporations to contend with the question of whether their organization structure ought to follow the power shift and become more diffused.

Of course, multinationals already need to abide by the various regulations of the markets in which they operate, and therefore require deep local knowledge in order to be effective. However, as protectionism leads governments to subscribe less to global rules and regulations, and business rules become less systematized, national regulatory bodies will become paramount. In turn, local knowledge requirements will almost certainly become more demanding as corporations will need ever more detailed and specific know-how to operate and succeed.

Do We Need to Rethink Org Structures?

At its core, the rationale for global corporations is that such a structure would increase the opportunity of those that sit atop these organizations to observe the world and arbitrage capital, labor, and production in ways that lower costs, increase efficiencies, and thereby enhance the inherent value of the corporation. As it is becoming increasingly difficult to transfer these factors of production across borders, it's reasonable to ask whether a global corporation is the right structure in a deglobalizing world. Furthermore, global corporations across such sectors as consumer goods and finance are seeing their fiercest competition come from large local country or regional competitors rather than other traditional global companies.

One alternative to a global structure is for businesses to operate as a collection of independent, loosely affiliated, locally run companies. These "subsidiaries" would garner the benefits of knowledge transfer from being affiliates to a larger network of companies, but most capital allocation and human capital decisions are delegated to the local entities. Perhaps these independent companies could even list and trade as independent entities on local as well as global exchanges.

Ultimately, the way forward will depend on whether a company's leadership views deglobalization as an enduring phenomenon or a passing fad. If business leaders believe deglobalization is here to stay, then real consideration must be placed on upending the prevailing global corporate structure to make it better match the deglobalized world. If, however, corporate leaders believe that the push toward a more fragmented world is temporary and will soon pass, then their responsibility is to navigate the deglobalization risks, even while retaining their global structure. Nevertheless, business leaders should be alert to the idea that if they are wrong, the corporations they serve may not survive.

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