CROSSBORDER
PMI ADVISORS

Your Guide to Globalization

Introduction

The world is much smaller than it used to be. You cannot go through a day without coming across foreign brands, without hearing news of events elsewhere in the world, even without hearing the language of other countries. Even though you may sit in your own country, you, as an individual, and your company are citizens of the global economy.

Throughout history, people have looked beyond their own borders, with trading along the Silk Road and the discovery of the New World. However, today with international air travel common place, with the advancements in communications, and with the internet in most homes and businesses, Globalization touches us all.

Curiously, the word "Globalization" was first used only in the 1930's, and was confined to the academic world through the 60's and 70's, only being first used in the press from the 80's. Globalization has hit today's business world like a tidal wave and shows no sign of abating. But tidal waves are dangerous and destructive, and so before you embark on your global journey, or take that next step down the path, it is important to do so in full knowledge and preparation, with a clear plan, and with a robust approach.

WHAT is Globalization?

To ask what do we mean by globalization at first appears counterintuitive. However, the definition of globalization is itself subject to debate and may take on different forms. One of the clearest definition of globalization is that of the International Monetary Fund (IMF), which proposes:

Trading: The buying and selling of goods and services around the world; the importing and exporting of countries, companies, and individuals. These can either be visible products, or invisible trade such as finance, insurance, and tourism.

Capital and Investment: The investment in companies outside of your home country, overseas acquisitions, and infrastructure investments.

People: The movement of people across borders, either by cultural migration, or through increased global mobility.

Knowledge: With all the above trends, there is a dissemination of knowledge, an increase in the level of common technology.

All of these drive new opportunities for companies, but at the same time present new challenges. However, no one can deny, that each of these facets of globalization is happening.

WHY Globalize?

Aligned with the above definition, the reasons for embarking on the globalization path are increased revenues, reduced costs, access to talent, access to technology, and strengthening of your brand.

For companies the prospect of global trading appears very attractive. You can boost your top line, by selling products into the global market place, which for many offers almost limitless opportunity in the near term. At the same time you can reduce cost through importing cheaper products or offshoring services to cheaper locations. What you may not realize is that there is no middle ground, your global competition will begin to eat into you home market, which may already be shrinking due to aging or other demographic changes. Your cost saving may be temporary as your cheaper manufacturing or cost of supply begins to increase with growing global demand. This has been already seen with the companies first entering China setting up facilities close to the then low cost Shanghai, who now find themselves less competitive than later entrants, who located further inland. At the same time your cost cutting measures can also impact the one thing that is the slowest to globalize...your home country national economy.

To access the global market place, practically you need to be in those markets. You need to be able to access your new customers and understand his needs. To supply your customer in a cost effective manner, you need an efficient supply chain and a global footprint which is consistent with your business needs. To realize cost savings, you need to have manufacturing in low cost countries. Easily said, but can you manage these operations effectively, which have different cultures, different languages, and different time zones. Are the cultural differences so wide that you are unable to communicate, or overseas management do not share the vision and direction, that you have set out for your group. People you know, are more reliable than those you do not, so will your overseas factories meet the high quality standards you need.

The globalization of people is often the most sensitive and practically complicated. However, in many countries it is common place to see people from overseas in a wide range of jobs. Other countries often impose strict visa requirements and restrictions on working for overseas nationals. Differences in culture and national pride, sadly often prevent the full integration of new people into society, and they are often referred to derogatorily and sidelined. But “new blood”, can bring new ideas, or do things differently, that provides a positive contribution and improvement to your overall business performance. Offshoring of R&D and other functions, or investing in or acquiring local companies, goes part of the way to accessing talent, but retaining such talent is often challenging as that talent aspires to rapid career advancement in the globalizing world.

Ultimately technology comes from the knowledge and innovation of people, and so access to new people brings access to new technology that enables you to upgrade your product portfolio at a faster rate. Similarly by the globalizing of markets brings about a convergence of technologies on a global scale, in addition to across related product groups. Technology or knowhow is not just product innovation, but can be the “Best in Class” global standard for business processes, manufacturing or quality assurance, all of which are a necessity for the global player or the emerging Transnational Corporation.

Expanding your global reach, and becoming recognized in multiple markets worldwide, particularly in consumer product circles, greatly enhances the value of your brand. Your brand becomes a familiar face to customers, who may travel within many markets, and so globalization provides a synergistic step up to your overall performance. Having said that, brand recognition alone is not the key to success, your sales and product strategy should be flexible enough to accommodate local needs and tastes, you need to be able to sell burgers in markets that do not eat ham or beef.

WHO should Globalize?

The answer to the question of who should globalize is simple: Those who are ready. Each company has its own strategy, some industries are more global than others, and to embark on a global path you need scale, so there will be differences in the speed in which globalization happens, but fundamentally all companies big and small from virtually all industries should consider globalization or how globalization of their peers and competitors affects them.

A quick look back at history shows the change happening. Two hundred years ago, the entire world was agrarian, with some international trade in commodities, and a lot of countries fighting each other. A hundred years ago, the fighting continued, but industry had taken over the economy. Fifty years ago people began to travel internationally across the Atlantic and the Pacific, speak to each other by telephone, and multinational companies began to appear. Less than 20 years ago the internet and mobile phones appeared, linking businesses and people globally. Today, from your office in Tokyo, Japan you can complete a transaction with a business in a small town in Peru in a matter of seconds, and be able to check their background and reliability, find out precisely their location, and even see a photograph of the front of their office. Will you be able to rely on your existing customer base alone to survive in 20 years from now?

WHEN to globalize

If the answer to who is those who are ready, then the answer to when should be when you are ready. Determination of when depends on a number of internal and external factors. It is of course important to consider the economic and political climate faced at home and the location of where you intend to invest or trade. Globalization is an arduous journey, and so you do not want to go to the wrong place at the wrong time. Before you begin you should understand the circumstance of your destination, will you face any restrictions now or in the known future, is the government about to change and will that make it more or less favorable, are local taxes or tax treaties about to change, what are your legal rights, what are the true costs of doing business. Doing your homework beforehand is key.

These external factors will also be core to many of your internal ones too. Globalization needs to be part of a strategy, or a well thought out plan for your business. A strategy will is not about determining where you want to go, it is about determining where you need to go in order to maintain your competitive advantage and to grow your business. You will need to consider market trends, product/service trends, competition, costs of execution and operation, key objectives and measures of success.

However, above all when should be determined by your readiness and your ability to execute on your plan. Consultants may play a key role to help you on your way, but in the end it is you who has to deliver and manage your new business expansion.

If you are trading globally, can you deliver cost effectively, meet the customers' quality standard expectations, collect your money, and return it home without excessive tax or FX loss.

If you are investing and expanding globally either through a greenfield operation or through acquisition, then do you have the infrastructure or your investment have the infrastructure for you to manage the risk of that investment effectively. Do you know what you have gotten into, are your assets secure, can you access your profits, do you understand and can you comply with regulations, can you get accurate reports on a timely basis, and can you manage your employees, customers and suppliers operating in a different language and a different culture.

Being ready and prepared to face these challenges is the key to success. Being ready could include recruiting people with the right experience, or to learn yourself over a time period, by phasing your globalization plan, such as using agents or distributors before going direct, or to form an alliance or JV, before creating or buying a subsidiary.

WHERE to go to Globalize

Your globalization strategy will lay out your prioritized geographic expansion. If your target is revenue expansion then you will want to be in the markets closest to your prospective customers, these may be brand new or customers of your home location who you wish to follow to supply them in each of their overseas locations.

If your overall objective is cost reduction then you will be considering a move into a low cost country. Here you will face the challenge of balancing cost reduction against the availability of local skills, and if you plan to source materials or parts local in addition to labor you will want to consider increased level of quality assurance required. As is the experience of many in China, if not well planned the cost saving measures can be less effective than hoped, can be costly to properly implement, and may be temporary due to inflation in developing regions.

Other than business factors you will also want to carefully consider fiscal or trade related issues. From an entity structuring perspective, no doubt you will consider tax, tax haven locations and transfer pricing. However, you will also need to consider the investment incentives available and investments zones, in addition to the macro level consideration of blocs or trade agreements such as the EU, ASEAN, NAFTA or the Trans-Pacific Partnership. Careful planning can lead to significant reductions in you tax cost, your supply chain costs and your ability to operate overseas efficiently.

HOW to Globalize

No book or manual can truly prescribe a recipe covering all aspects of “how to globalize”. There are so many variables and things to consider. The easiest way to look at it is through the stage of globalization. Below Globalization is analyzed stage by stage: Before you go, getting there, upon arrival, and longer term.

Before you go

Each step of your globalization journey needs to be planned thoroughly. The questions raised in the early sections need answering, beginning with what is the motivator for your plans, which should derive from your overall business vision and strategy. Globalization for the sake of it is not good enough, the drivers of why you should go down this path should be clear. Drivers could include increased revenues, reduced costs, acquiring talent or acquiring technology. There could be one single driver or it could be a case of “all of the above”, but even in the latter case this needs to be clear as the potential approach and considerations are likely to differ for each.

Next comes the where. This clearly depends on the driver. If it is sales, talent or technology, then you will be considering the geographies where such can be found. If it cost reduction then the discussion would be about LCCs. Then the real work begins of validating your hypothesis through deep research of the market. This needs to be thorough, and the challenge here especially dealing with unfamiliar territories is getting access to reliable data. The more you rely on second hand or third hand analysis the weaker your validation will be and the higher the risk of incorrect assumptions. In addition too this you have the language challenges which could result in misinterpretation. Without your own resource, this is an area where a local market entry consultant can be useful. Even if you have an established globalization plan already, this validation step should not be ignored before you jump into execution mode.

At this early stage, a number of other factors are also important. Firstly, are you a leader or a follower, or it may be the case that you are not sure, thinking you are a leader but finding out differently in the process. The importance of this fact is another factor in the validation. If you are a leader, then how soon will you be followed and in that case what would be the impact on your assumptions. If you are a follower, how will you maintain a competitive advantage and again the impact on your assumptions.

Secondly, and where many companies miss, is to undertake a full inventory of your own capabilities and reconcile these with the skills required to execute on the globalization plan and manage the investment. These could include M&A skills, language skills, or global leadership skills. Where skills are lacking, these may also may need to be recruited potentially adding another level of cost. Some capabilities of course could come from the company that you acquire, but you will at least need the skills to get you there, and additional effort will need to be placed in the due diligence and transition process to assess and motivate the target management and retain them. Will such people fit culturally into your organization, and in the medium to long term what are their motivators. Retention arrangements can fill a short term gap, but underneath if the management are already thinking about next steps, then their reliability and effectiveness could be reduced.

Getting There

The other consideration at this stage is the method of getting there, or the “buy or build” decision. If the plan is to buy, there is the complex selection process. What capabilities or specifications are you looking for and can you validate these in advance? Is the target likely to “fit” with your own organization? How much are you likely to have to pay, is that within your budget, and would this provide a sufficient return on capital? Importantly, what would be the costs of acquiring and fully integrating? And do not forget the question of availability. It is sometimes said that private equity owners are more willing sellers. This may be true, but such owners do have high return expectations and in many cases these temporary owners squeeze cash and strictly control investment, leading to greater than expected cash needs following change of ownership. Many deals these days take the form of competitive auctions. These provide easier access to deals in the market, but at the same time your ability to undertake deep due diligence is likely to be restricted and given the fact that you will have spent less time evaluating the target in the selection you due diligence needs are likely to be higher than normal. This mismatch leads to increased risk and the potential of redundant cost in lost or aborted deals.

If the your decision is to build, then the question the form, and in addition your strategy to maintain flexibility should a buy opportunity come along part way through the build process. The lowest form of commitment if finding a trade partner, a sales agent or distributor. This has the benefit of supporting your sales growth aspirations, but limits you in terms of future development of product, market knowledge and overall level of control over brand positioning and promotion. Strategic alliances and joint ventures are becoming very popular by enabling you to tap into to complimentary skills and also share come of the investment burden. The challenge, however, is with properly setting up the alliance in the first place. Many companies make the mistake of treating joint ventures like regular M&A, and trying to win an advantage over the joint venture partner. A joint venture is “joint”, a win-win arrangement, and this means both inside and outside the joint venture. Hidden reasons for entering the joint venture, such as expectations of increased sales of a product/service not part of the joint venture, will lead to misunderstanding. Formation of the joint venture should include an open dialogue of what each sides expectations are of the joint venture and also the impact of the joint ventures activities on each parties existing business. Only in such a way can each party understand the respective performance of the venture.

Whether you buy or build, the execution phase is the time for due diligence. The level of due diligence you undertake varies case by case on the level of commitment being made, the complexity of the deal, the deal value, and your perception of and appetite for risk among other. Due diligence should be an analytical process and assessment, and not just a tick the box fact finding exercise. Facts do need to get established, but the implications on the future operations or your risk position are much more important. Examples of due diligence areas and related objectives are listed in the table below:

Illustrative Due Diligence Area

Area	Objective
Commercial	Market trends and marketing strategy. Consistency of business plans with external factors at both a macro and micro level, Business concentrations or similar post deal business risk.
Operations	The status of the underlying operations and performance indicators when benchmarked against peers. Potential opportunities or investment needs. Assessment of quality standards against parent and market
Finance	The normalized earning potential, excluding one time or other abnormal factors. The level of potential unrecorded liability, commitment or other financial exposure.
Tax	The status of tax compliance, exposures or other tax risks, and also opportunities possible during deal structuring or post deal
Legal	The status of legal compliance, contractual or other legal risks, status of ongoing litigation
IT	The status of IT enabling functions to support the current and planned future business. Future IT investment requirements and estimates of integration costs
Technology	If not covered elsewhere, the status of current technology sales, procurement, production, product design and other compared with current and upcoming market standards
HR	HR compliance, demographics, benefit benchmarking, financial exposures, labour relations, key person identification and workforce quality and capabilities.
Environmental	Environmental compliance, level of contamination and or remediation needs, know or unknown.
Compliance	Compliance framework both absolute compared with market and against parent, Business practice exposures, relationships (anti-social forces or embargo countries) or similar risks
Fiduciary	Personal checks on key target management and vendors, for integrity, undesirable affiliation or other risk
R&D and IP	Status of R&D, and product pipeline. Level of patent or similar protection, ownership or access.

Finally, while you may be eager to undertake a thorough diligence, it is important to remember the target management, will use the opportunity of the due diligence phase to begin to form their own assessment of you and whether you are the type of employer they would like to continue working for post deal. As such, your approach and behavior during the due diligence phase should be controlled and professional, to avoid demotivation, especially in the cases, where you have limited direct personal contact with the management on an individual basis.

Upon Arrival

While integration is often called post merger integration, planning for the integration should really start pre-deal and even as early as the strategy phase. As mentioned earlier, at the outset it is important to inventory and assess your own capabilities, this extends to your capability to integrate the business into your own. Companies sometimes say that they are not going to integrate and leave the business as a standalone for a while, but even in this case there is control including financial reporting which will need rolling out and the transition of various activities and functions from the former owner to the new.

PMI is a broad subject and not a one size fits all issue. Integration or at least the scale of integration is driven by your overall strategy. What was the rationale for the deal, what are the intended outcomes. Underneath this comes the real value drivers being the operational synergies and the risk reduction. Many companies focus just on synergies, but exerting control and putting in place a governance structure over your new subsidiary is important to reduce risk, which goes to support or enhance the value.

The price you pay for the Target will be based upon a business plan, which may have been discounted for risk factors, but also there may be a premium paid to secure the deal which should be supported by validated synergies. There will also have been a risk assumption going into determining the discount rate in the cash flow valuation. If the actual value realized by the target is lower than the price then you have a loss situation, but even if greater but the returns are less than your expected returns on capital you will face downward pressure on you stock price. Also remember you will also need to ensure you recover any transaction costs (banker, lawyer and due diligence fees), and also costs of integration, each of which can easily amount to 3-5% of the deal price. Integration is about preventing all of these matters ie.

a. Taking steps to ensure the business plan is met, or if discounts have been made to manage performance within the downside adjustments made.

b. Realizing synergies or operational improvements to recover transaction and integration costs, and to realize the synergies that made have been included in the price to justify the premium

c. Putting in governance and controls to maintain the risk position within the levels considered in your valuation hypothesis.

It doesn't stop there though, because in the realization of synergies and managing the risk, there will be likely modifications required to the enabling functions to support the synergy and risk actions. These enabling functions often include IT and finance function, but could extend to any function enabling the business to be operated as intended.

Finally there is the transition of ownership. If you are buying a business division in a carve-out transaction the need for transitional services from the vendor, and the actions required to replace these vendor services by in-housing or using another third party provider are plain to see. However, if buying a subsidiary of a large group, it can be fairly common for the group to provide central services, some of which may be hard to see and even the Target management may not fully appreciate the support they are receiving, especially if it is not charged for. Some of the more difficult areas to evaluate include brand name, the group strategic direction, or even senior parent management, such as the CEO, being well connected in the industry of the Target. Much of these will require the new parent to replace, which may prove very difficult when entering new territories.

The key to success if a long though out plan addressing each of these areas, with clear business case analyses to prioritize activities by considering size of impact and ease of implementation. Planning for this should begin long before completion of the deal, though some aspects of the plan will need to be completed after there is ready access to target management to achieve there buy in and support during the integration phase. You blueprint should contain a base message taking your vision to your strategy and deal rationale, to your goals, and the specific actions function by function, initiative by initiative with a timeline as to what happens on or around day one, first 90 days, first year and the end state.

There is much emphasis in PMI literature on the realization of synergies. We have said above the equal importance of risk reduction, but in addition to that, it is important to appreciate the core business in most cases comprises 80% of the value. So clearly a balance needs to be maintained on continuing the core business uninterrupted and the realization of synergies. Given limited resource these is where the business case analysis and prioritization becomes important, such that 80% of the impact can be achieved by 20% of all activity using small agile cross functional integration teams.

Globalization by its nature means the interaction of management from different countries and cultures. People always judge things and taken decisions on what is or what is not important from their own perspective. The success of PMI depends on the concentrated execution of various tasks buy people, and so if those people are judging the importance of integration activities differently, issues will arise and the integration will not run smooth and in many cases fails.

Unfortunately, core national culture attributes cannot easily change. However, what can change is peoples understanding of cultural differences. During any crossborder business transaction but especially in M&A, gaining a deep understanding of each parties cultural drivers is very important. These may not be changeable, but where there are areas of commonality, these can be used immediately to drive change. Where there are differences, having a mutual appreciation of the differences and creating a plan to work around these differences goes a long way to minimizing the impact. What is very important is to smash the stereotypes and misconceptions at the outset so that cultural differences serve as a driver of diversity in the organization having a positive impact as opposed to a negative one.

Longer Term

Globalization is a continuous process, and will follow the development of your business strategy over time. You may begin your journey exporting your products and services to a limited number of countries, you may begin to expand using the buy or build approach building out subsidiaries or other relationships maybe firstly in one or two, but then in many more countries. There is no clear definition of what constitutes a Multi-National Company (MNC), but if you are recognized and have operations in more than one country then you technically become an MNC. However, an MNC is probably recognized as a company with HQ is your home country. As you expand your global footprint to many other countries your company may begin to lose its home country identity, and slowly you become recognized as being truly global, the Transnational Corporation. (TNC).

As you expand, so will your global governance model and organization need to evolve. First, you may have HQ, with an autonomous country management. Then you may deploy expatriates to manage on behalf. Later, you may regionalize or globalize certain corporate functions, or take the alternative route to organize globally across business unit lines, or even both. Which route you take will depend on the nature of your business and your growth strategy. Your final metamorphosis will be to break down the barriers of nationality and location, and implement a management structure which draws on your full capabilities regardless of nationality, regardless of where they entered your group, and regardless of where they are currently located. The early stages of the drawing on your best talent are encouraged way before you are branded a TNC, as this ensures you fully utilize the capabilities you have within your group, and moreso break those actual or perceived glass ceilings motivating subsidiary management.

Globalization is a continuous process, and this does not necessarily mean you are forever adding. In all types of business relationship it is also important to have a continuous review process. In particular, when going overseas, things may not go as well as intended, circumstances may change, the global economy moves. With this each business relationship, alliance, joint venture, acquired business, technology or talent, and all business units should be reviewed to see if the original strategic objectives are being met, if group strategy shifts, do these businesses continue to align. These reviews are particularly important in joint venture situations where you also need to consider the strategic objectives of your joint venture partner. Based on these reviews your next steps in your journey can be planned, which could mean further acquisitions, addons, spin-offs, disposals or other reorganization. The world is continually changing and as a global company so must you.

In Summary

Globalization goes under many different guises, but we are no longer in the age where we can ignore what is happening outside of our national boundaries. This especially so in countries with shrinking demographics. While economics and politics are forever pushing and pulling on global trade, global trends effects the strategies of virtually all companies. Twenty years ago, only around 6% of the global population could contact each other, now that has grown to 55% with the global user population of the internet estimated at 4.2 billion people. That amounts to a huge potential customer base accessible at the push of a button. It also means the world has similar access to your customers.

The Why, What, Where, When of your global strategy is a complex subject, but these are easy compared to the challenges of How. Thorough planning, flexibility, and pragmatism are amongst the factors leading to success, together with a disciplined approach to continuous progress, and a open-minded approach to global cultural obstacles. Consider Globalization of one of metamorphosis. Let your journey begin.

How we can help

Crossborder expansion is an inevitable part of globalization and brings with it exposure to unfamiliar rules and regulations, different languages, and people from different cultures who think and act much differently than yourself. Crossborder PMI Advisors helps our clients navigate these challenges and to engineer success.

Crossborder PMI Advisors offers a wide range advisory services on both the buyside and sellside of cross-border deals. All services are specifically tailored to working in a multicultural crossborder environment, and range from cultural and overall PMI advisory services, to a modular approach to PMI, Carve-outs, Joint ventures and alliances, and other related areas. As such we offer a flexible approach to working with our clients, including working with your other PMI advisors in a cross-border SME capacity.

At Crossborder PMI advisors, our mission is simple: To help our clients succeed in cross border M&A. The key to crossborder success is to do the right deal, to pay the right price, and to manage your investment through realizing synergies, reducing risk through effective governance, managing people across cultures, and global leadership. We look forward to working with you on your global journey. Please contact us any time for further information and to discuss your needs at: **info@xbpmi.jp**

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