INTERVIEW

Hurdling Old Obstacles to Development

One great hope for equitable globalization is that the revolutions in telecommunications and electronic commerce that define the so-called economy may subvert conventional wisdom about the necessary stages of national economic development. The economist Albert Hirschmann and others have propounded a set of necessary stages of growth and consolidation that all emerging economies must pass through in order to reach economic maturity. Now the hope is that some stages may be hurdled more rapidly, or omitted altogether, thanks to e-commerce and the vast potential of the Internet and wireless communications to overcome difficult terrain, scattered commercial centers and aged or absent infrastructure dating from the bygone era of the railroad and the telegraph.

Globalization, growth, telecommunications, and e-business represent just a few of the forces transforming today's business environment. In Wisdom of the CEO, *co-edited by Grady Means, a partner at PriceWaterhouseCoopers, 29 corporate leaders explain how they deal with these forces. Means's second book,* Meta-Capitalism: The e-Business Revolution and the Design of 21st-Century Companies and Markets, *published in July, explores changes wrought by the e-business revolution.*

ERT: *In your first book,* Wisdom of the CEO, *you assert that business cycles have accelerated. What brought this change about?*

G. MEANS: The cycle of change has been accelerating over the past 20 years and that is transforming the rules of business. Globally, business change used to be reckoned in long periods—a century, 50 years, 20 years. Now those eras of transformation occur every two to three years, changing the way a business leader must think about the company. It also changes the way in which you think about how business and public institutions operate in your country.

In the 1980s and 1990s, several waves of change led to today's situation. You can't understand this environment without grasping how the large economies restructured capital markets during the 1980s. With inflation under control, people instead worked on tax reform, deregulation and reducing government deficits. Controlling inflation was positive because it led to real interest rates on borrowed capital. That forced companies to stress productivity and working capital management, which in turn led to process redesign and supply chain management.

This change was accompanied by an aggressive influx of imports and capital from developing countries to the developed economies. Companies in Asia and elsewhere gained market share, built plants and equipment and took major capital positions during the 1980s. In turn, multinational companies grew more interested in international strategy. By the end of the 1980s, only about 50% of US companies focused on their domestic markets, down from 80% earlier. That was a big shift, emphasizing international business in the form of trade and direct investment.

Enormous political change occurred in the early 1990s as countries all over the world began adopting the same economic model of privatization, democratization, lower trade barriers, and the demise of vertically integrated capital markets. Tremendous flexibility in the world economy occurred everywhere—in Eastern Europe, Latin America, certainly in the US and UK—as policymakers continued to deregulate and open up markets. New bilateral and multilateral trade deals were designed for the most part to attract capital investment and lower trade restrictions. Very homogeneous worldwide capital and trade markets now allowed capital to flow across borders with fewer restrictions, freeing companies to create global strategies and structures.

From 1993 to 1996 the global economy began to integrate. A tremendous number of corporate acquisitions led to global sales strategies, supply platforms and distribution systems. This changed the nature of companies that had formerly relied on their local markets and brands. Now they had to have global reach and far more capital.

Technology accelerated this trend. People were suddenly able to buy more powerful information technology at much cheaper prices, so companies began reengineering their entire supply chains. Today this has moved into Internet applications and business-to-consumer strategies.

ERT: How would you define the new economy?

MR. MEANS: The new economy builds upon the past two decades of change I've described. It's characterized by improvements in capital markets, supply chains and processes. Key concepts of the new economy include outsourcing, decapitalization and capital leverage. Finally, there are overall improvements in technology applications to run companies and fully exploit the Internet.

The new economy unites all these factors to transform every industrial sector. Governments are also applying these techniques to become far more efficient in service delivery. This new approach pools many kinds of improvements to yield a transformational approach to any large-scale enterprise, public or private.

Interestingly, everyone recognizes they have about a two-year window in which to successfully transform. If they don't get it right someone else will win by having lower transaction costs, a more efficient supply chain and better access to customers. A lot of slow people in the middle will suddenly be superfluous, and many information and brokerage functions will be wiped out. The whole nature of brand identity also has changed. That's the new economy.

You see this transformation most visibly in the United States because we're ahead with network technology and most of the trends I outlined. But change is rolling globally very fast.

ERT: Much is said about business-to-business strategies and how they will shape the new economy. Can you explain?

MR. MEANS: Business-to-business strategies create very interesting opportunities because they differ significantly from the small retail transactions seen in business-to-consumer transactions. "B to B" means the leading players in every industrial sector are figuring out how to transform their large industrial manufacturing organizations to much smaller capital-based institutions by outsourcing and selling off segments. They will outsource or spin off all the manufacturing, controlling it through networks they'll create, much as Cisco Systems has done.

Cisco is the most valuable company in the world. It's come from nowhere in two years because it is completely decapitalized and manufactures very little itself. Nonetheless, it's a manufacturing company producing a clear manufactured product, network and IP switches. Cisco can quickly design new products; engage people to make them fast; and control those outsource networks while maintaining strong brand identity. Customers can order directly through Cisco, know when their order is being made and when it will be delivered. This lowers transaction costs dramatically. The company's success comes from that flexibility, plus its ability to design new products and bring them speedily to market.

This flexibility opens up the opportunity for other players to bid on making Cisco products. Even in 1999 the supply chain generally stood inside the four walls of the company. Now the supply chain is outside those walls. Cisco is seeking good smaller-scale players to participate in parts of the supply chain. Such outsourcing to suppliers can extend to other functions like financial accounting, and suppliers can even become the back room of your company. The Internet, the decapitalization of big companies and the creation of business-to-business networks have changed a closed game to an open one.

ERT: How does a developing or transition country take advantage of these changes?

MR. MEANS: Players from developing countries can now participate in many of the manufacturing and service functions. Countries such as India, for example, can prosper because they have extremely bright, well-trained human capital. These countries were handicapped in the past because back then they needed good physical infrastructure such as roads and ports, as well as a sound trade policy, to participate in global markets. Now you can simply put up a building, hire a thousand smart people to work there, find enough electricity to power computers, install a good satellite antenna—and you're the back room to any company in the world. It doesn't matter if the roads leading to the building are dirt roads.

In this way developing countries can now generate revenue, which can be transferred electronically. Exchange controls are lower now, so local entrepreneurs can make serious money, invest and play a global role. Enterprise no longer has to wait for somebody to privatize, use privatized funds to build infrastructure and then deploy that infrastructure to create a competitive manufacturing advantage. Consequently, we'll see tremendous expansion of economies worldwide.

ERT: What kind of policy environments must developing and transition countries create in order to take advantage of the new economy? How will this determine the winners and the losers?

MR. MEANS: Developing and transition countries must understand that economic nationalism does not serve them at all anymore. They have to restructure away from vertical capital markets through which capital moves inefficiently into local companies that may not be competitive in a global market. Barriers to expanding network technology must be lowered, network construction accelerated and telecommunication systems privatized. These nations also must ensure that investors can repatriate profits. Finally, they have to make sure that the leadership of their companies is up to speed on the precise transformational effects of network technology—and the huge opportunities it represents for these nations to emerge big winners.

If developing and transition economies don't make these changes, they're hurting themselves by resisting the irresistible trends going on in the world economy now. Laggards will simply fall behind.

Some countries, such as Poland or South Africa, are in a situation not unlike that of India and Russia. They have a significant number of well-educated workers, which are valuable in this new market. While these nations may need industrial transformation, if that infrastructure is built to participate in the network, it's faster, requires less capital and leverages intellectual and human capital better. I am relatively optimistic about Poland and South Africa.

> It's impossible for countries to sustain growth in (the new economy) without the alignment of political freedom with economic freedom.

A real surprise, in my view, will be Russia, which has suffered during privatization. There have been glitches during this period of privatization in trying to figure out how to get all the investment capital lined up and build industry that is competitive. I think the country will have fewer difficulties in the future because of the speed with which the new economy allows new players—and the way in which entrepreneurs can circumvent normal capital market and investment structures.

Countries that lack well-educated human capital as well as physical capital, raw materials or other major assets will still have problems. We need to find solutions for those countries. In an expanding world economy, I'm convinced solutions can be found; with the leverage of network technology, we may also find solutions easier to come by.

ERT: How important is intellectual property rights protection in developing and transitional countries?

MR. MEANS: It's hard to predict anybody's intellectual property rights on the Internet. Ideas come and go very, very fast, so you can't assume that you have a patent on an idea that you can milk for eight to ten years. There's no chance of that unless you've created a company that continues to innovate, improve its ideas and raise its value propositions, as well as augments its brands and intellectual property. You cannot sit still, no matter how successful. To some degree, lack of protection of intellectual property rights has become more of a moot point than it was a decade ago.

On the other hand, if countries clearly persist in violating intellectual property rights, contract law and conventional standards of business, investors will be less inclined to work in those nations. India is changing, for example, in that it recognizes the value of playing by the rules. I think the business community recognizes that India's policymakers are working to open up the economy and ensure that its major local business players understand that they must compete without special protection. The payoff for solving the problem will be India's chance to become a strong player in the world economy. The nation has made enormous changes in the past ten years by transforming capital investment and capital control policies and making substantive changes in its trade policy. India has made many improvements in the past few years, and it could use better press getting credit for the reforms it's made.

ERT: How do you address antiglobalization concerns, not just from the protesters at the recent WTO and IMF/World Bank meetings but also from some leaders in the developing and transition countries?

MR. MEANS: If economies can move forward and grow, they are in a better position to address a wide range of issues, including environmental and labor issues. Without growth, environmental and labor problems still exist, but an economy has no way of solving them. The country is left with grinding poverty and very little opportunity to address its problems. Excessive regulation of the liberalization process, which may curtail opportunities for economic growth, doesn't strike me as a very good answer to real problems.

The new economy and globalization allow developing countries to tap vast new markets. Frankly, I don't grasp why anyone but a cynic would oppose globalization. It is difficult for me to see why it is anything but a pure net benefit for most countries.

ERT: How relevant is the WTO to this process?

MR. MEANS: I think very few public institutions have fully thought out the implications of the transformation of major industrial sectors, the economic growth that might ensue, or worldwide market integration and what may come out of all these changes. No nation has adequate policy frameworks to address this entirely new set of issues. Nor have we even thought about managing this level of growth potential or about the national and foreign policy implications of the changing labor and capital balances that will occur as a result of this type of industrial transformation.

The new economy is not on the public policy radar screen, even though it will be in the next two to three years. Policy will lag behind changes in the private sector because change in the private sector is occurring extremely fast, and the adjustment of our public debates is moving more slowly.

ERT: Do you think that there's a role for regulation?

MR. MEANS: Sure. Markets must be fair. Information that is supposed to be accurate on financial situations must be accurate. If financial or operating data goes up on the Internet, it should be audited. But this means that financial accounting must shift from a historical view of the data to a forward-looking view. It has to look at real-time information, not quarterly or annual information, because that's how fast people now make decisions and use information.

Certainly we need new regulation, just as we need new levels of business discipline. Cisco, one of the notable big players, closes its books daily rather than on a quarterly or annual basis. It closes them daily so it can do deals, know its financial position and have daily discipline running the company. The well-run, big business-to-business companies, such as Cisco, that enjoy high valuations are not accidents. They're some of the best-run companies in the world.

ERT: What role has democratization played in moving the new economy forward?

MR. MEANS: Without political freedom there is no game based on economic liberalization—at heart it involves free movement of capital, free exchange of ideas, aggressive entrepreneurship, and capital flowing to its best use. Countries that think they're going to manage themselves into this new economy will not fare well.

Transformation will be difficult for countries such as China. They may find some angles that work for them, but, in general, they won't realize the potential for their citizens to be entrepreneurial and to participate in new markets. It's impossible for countries to sustain growth in this new game without the alignment of political freedom with economic freedom.