



Business Trends 2014

Navigating the next
wave of globalization

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Navigating the next wave of globalization



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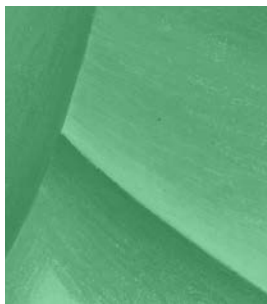


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Preface

WELCOME to Deloitte Consulting LLP's second annual *Business Trends* report. The purpose of these reports is straightforward: to provide business leaders with clear, concise, and well-informed perspectives on important dynamics that are currently reshaping the business environment. This year we have selected nine trends, all directly related to a major question many clients have been asking us recently: What is going on with the global economy?

Sadly, we don't have a crystal ball, and we can't predict the future. But we do have the privilege of serving clients who are creating the future; almost 200,000 talented colleagues globally who are helping them, including many outstanding thought leaders; privileged access to some of the best minds on the planet; relentless curiosity; and a commitment to intellectual integrity and rigor. We have drawn upon all of these in the creation of this report—along with a survey of more than 400 senior executives from around the world.

There are many critical uncertainties in the global economy today. The challenging recovery from the financial crisis and subsequent recession in the developed economies, the current slowdown of the BRIC (Brazil, Russia, India, and China) economies, mounting geopolitical tensions, and the continuing rise of “back-door” protectionism are among the more obvious sources of confusion—and concern. We are committed to tracking and anticipating the consequences of these and other forces on behalf of our clients.

But in this report, we have identified key trends that are firmly rooted in longer-term and probably irreversible shifts. Over the last 15 years or so, the balance of the global economy has fundamentally changed. The distinction between a “developed” and an “undeveloped” world has blurred, as “emerging” nations have very much emerged. The global distribution of wealth that had been diverging since the Industrial Revolution has started to converge again. Stark differences still exist, of course, but the old order is rapidly dissolving—along with many previously safe assumptions about the global business environment.

The trends in this report fall into three distinct categories: the emergence of a large, new, and unfamiliar consuming class; increased opportunities for collaboration with newly empowered and influential actors; and new sources—and imperatives—of leadership. Some combination of these trends will increasingly influence the strategic priorities of most companies. We sincerely hope that our perspectives are helpful as you develop your own approaches to . . . “Navigating the next wave of globalization.”



Mike Canning
Principal and National Managing Director
Strategy & Operations
Deloitte Consulting LLP



Eamonn Kelly
Director and Chief Marketing Officer
Strategy & Operations
Deloitte Consulting LLP

Introduction

Navigating the next wave of globalization

By Eamonn Kelly

GLOBALIZATION—broadly defined as increasing worldwide integration and interdependence, based on the flow across national borders of goods, services, capital, people, ideas, cultures, and values—has been an enduring driver of change and development. While the overall trajectory of increased worldwide engagement and interaction has been sustained over many hundreds of years, the process has not been smooth or continuous. A hundred years ago, in the buildup to World War I, many decades of global economic integration—sometimes referred to as the “Golden Age”—were rapidly reversed: Meaningful globalization did not resume for around 40 years.

Most senior leaders today cut their managerial teeth during a period of deep and rapid global integration. From around 1980, and for almost three decades, global trade increased at about 7 percent per annum on average—twice the rate of growth of global GDP.¹ This extraordinary dynamic was empowered by the interplay of three key factors: falling transportation costs coupled with increasingly efficient logistics; radically faster, better, and cheaper communications, including the rise of the Internet from the mid-1990s; and increasingly supportive policy regimes, especially after the collapse of the Soviet Union. Despite growing resistance in some quarters to the impacts of globalization—especially related to charges of growing inequality and the exploitation of people and the environment—a strong consensus emerged in the worlds of policy, economics, and business regarding both its “rightness” and its apparent inevitability. But today, serious and legitimate questions are again being posed regarding the future of globalization.

The widely respected chief international economist of Morgan Stanley, Joachim Fels, recently put forward a “tentative thesis” that 2013 might prove analogous in some respects to 1913. He points to the rush of liquidity into emerging markets (fueled by Western monetary policies after the 2008 financial crisis)—a trend that is now clearly reversing—and the recently growing evidence that many Western companies are repatriating parts of their production processes.² However, these are not the only reasons to question the current status of globalization.

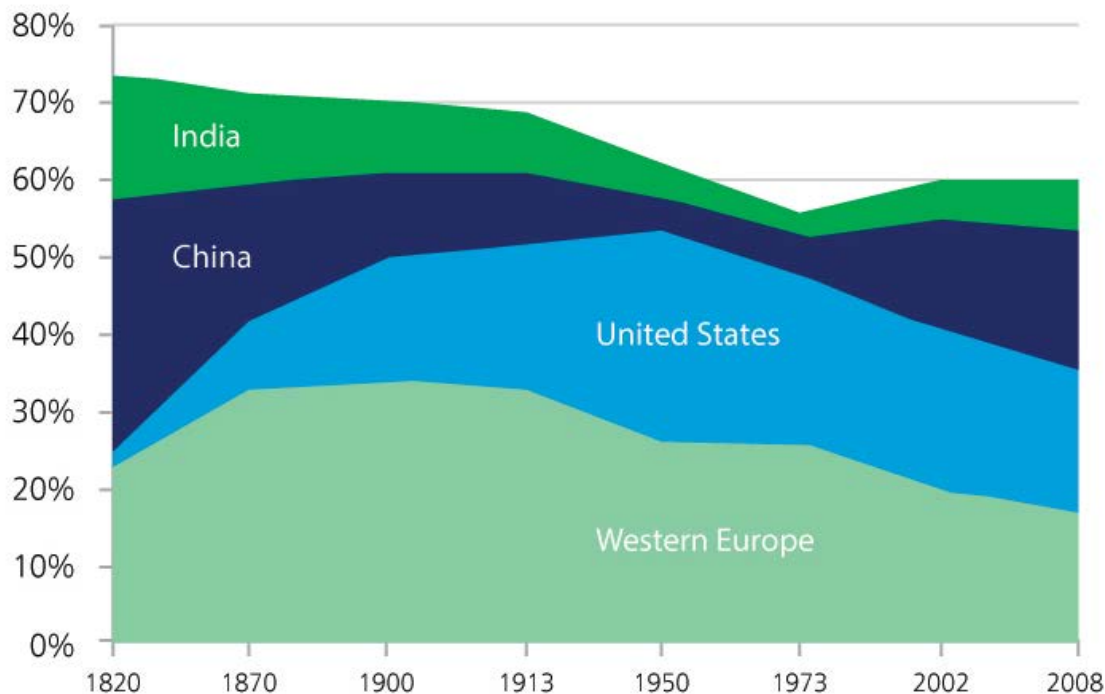
In 2009, following the financial crisis and during the consequent recession, global trade plummeted, and while it has subsequently bounced back, it has not been increasing much faster than global GDP—far below the long-standing trend line. Capital flows have decreased even more substantially, and have still not returned to their pre-financial-crisis levels. While there has been no significant resurgence in traditional tariff-based protectionist measures, less blatant impediments to free trade have been growing: A recent report by Global Trade Alert identified 431 new

“backdoor” protectionist moves—in a single one-year period.³ China, India, and others are becoming increasingly important rule- and norm-makers, not simply takers—notably in industries such as life sciences, where they are actively challenging Western intellectual property and pricing standards. The United States, motivated by security concerns, has blocked recent market entry attempts by Chinese companies.⁴ Notwithstanding the modest success of the December 2013 Bali summit of the World Trade Organization’s (WTO’s) Doha round of trade liberalization reforms, most trade agreements in recent years have been regional or “preferential” rather than global. Bearish scenarios for the future of the hugely

consequential BRIC economies are gaining support as each shows signs of weakness along with a recent slowdown in growth. The short-term impact on some emerging-market economies of the US Federal Reserve’s imminent “tapering” of asset purchases could prove highly disruptive.

Given these clear indications of uncertainty and possible disruption ahead, it would be foolish indeed to predict a single scenario for the future of the global economy. Yet business leaders must continue to act with conviction, even in an era of growing complexity and disruption. The opportunities and challenges are too great to adopt a “wait and see” stance.

Figure 1. Percentage of world GDP, 1820–2008



Source: Angus Maddison, “Statistics on world population, GDP and per capita GDP, 1-2008 AD (horizontal file, copyright Angus Maddison, University of Groningen),” 2010, <http://www.ggdc.net/maddison/oriindex-.htm>, accessed March 3, 2014.

The purpose of this report is to inform such action through the identification of important and robust trends that will certainly matter for years to come—in all but the most extremely catastrophic scenarios for the future of globalization.

Two critical and related foundations underpin most of these trends. First, the center of gravity for the world economy has obviously shifted profoundly over the last 20 years, blurring the previously stark distinction between the developed (primarily Western) economies and what was until relatively recently described as “ROW”—the entirety of the rest of the world. Second, this rebalancing of economic might is inevitably creating a far more complex and diverse environment for business. The “next wave of globalization” includes powerful new actors, and it is multipolar, not a straightforward rollout of Western practices, standards, and values.

In many respects, both of these foundational shifts are obvious—but the magnitude of the changes underway, and the extraordinary scale of their implications, challenges many deep-seated assumptions and can be hard to comprehend fully. Here, a brief historic overview is helpful.

Look back five hundred years, and we witness a very different world. In 1500, global differences in per capita wealth were extremely small.⁵ China overtook India after 1700 as the largest economy in the world (and would remain so well into the 19th century).⁶ China had also been, for well over a thousand years, a source of remarkable innovation: the compass, paper, printing, porcelain, gunpowder—the list of Chinese inventions is impressive and long. Indian scholars created the concept of “zero,” upon which the Islamic universities of the Middle East had subsequently built modern mathematics. Those same universities also constructed the modern method of scientific discovery, based on hypothesis setting and iterative experimentation. Discovery, innovation,

and invention were widely distributed—and Europe was, since the fall of the Roman Empire in the eighth century, a relative backwater: violent, divided, and fragmented. But that continent was entering a period of “renaissance” and would soon drive the creation of the modern world.

In the 18th century, Europe was home to the twin forces of modernity—the Enlightenment and the Industrial Revolution—and a remarkable period of global transformation followed. Europe—followed by North America—enjoyed astounding levels of economic growth and separated rapidly from the rest of the world. Economic historian Angus Maddison obtained telling data from his research, represented in figure 1.

This massive divergence of “developed” and “less developed” economies continued throughout the 20th century, leading to a growing disparity between the richest and poorest countries—a ratio of about 10 to 1 in 1900, increasing to around 60 to 1 by 2000.⁷ One important consequence of this sustained dynamic was a fundamental shift in global demography. As people become wealthier and receive higher levels of education, they have fewer children—a process greatly reinforced by birth control techniques. As a result, population growth has stalled—and in some cases, significantly reversed—in the richer countries, and accelerated elsewhere. For example, in 1950, the population of Europe was about two-and-a-half times the population of Africa. By 2000, the population of Africa was the larger—and it is projected to be almost three times that of Europe by 2050.⁸

The resulting state of the world by the latter years of the 20th century—sometimes caricatured as rich old millions in the West and poor young billions in the rest—was, arguably, unsustainable. And it has of course been transforming, in large measure as a direct consequence of the decades of intense globalization dating from around 1980.

In the first decade of this century, the world changed profoundly. Twenty-one countries (all of them developing economies) more than doubled their GDP.⁹ The BRICs—home to around 3 billion people¹⁰—collectively quadrupled their GDP,¹¹ emphatically dwarfing growth in the United States (18 percent GDP growth over the same decade), the United Kingdom (18 percent), and Germany and Japan (both less than 10 percent). In aggregate, developing economies grew at an average annual rate of 4.4 percent. They have contributed substantially more, even in absolute terms, to global GDP growth than the developed economies for more than a decade.¹²

These rapid gains have been matched in other critical areas beyond economic growth. For example, in China, life expectancy has increased by more than 30 years since 1960, while participation in secondary education has increased from little over one-third as recently as 1990 to over 80 percent today.¹³ Business start-up rates during the five years between 2006 and 2010 were an astonishing 40 times greater in the BRIC economies than the rest of the world.¹⁴

Massive inroads have also been made in the radical reduction of extreme poverty around the world. The infographic in figure 2 illustrates the reduction of poverty now forecast between 2005 and 2015—and this follows on the heels of similar reductions that have taken place for the past 20 years. In fact, according to research by Chandy and Gertz of the Brookings Institute, the percentage of the

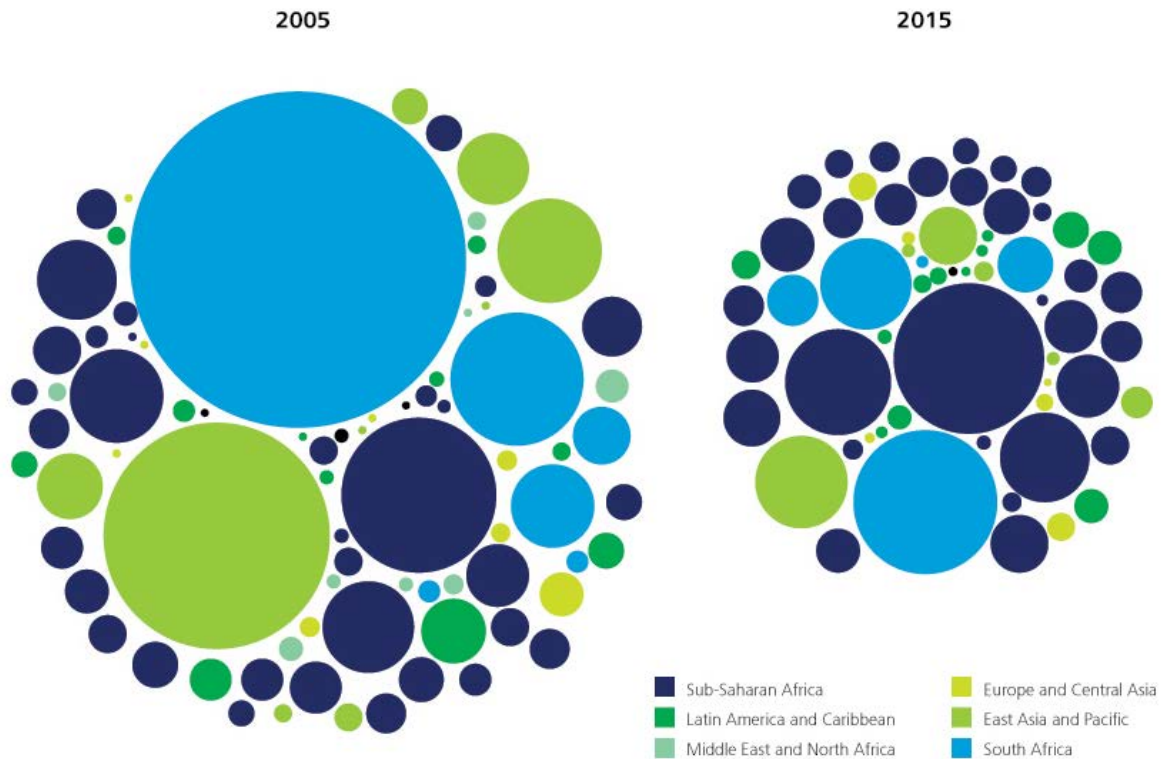
world's population living in extreme poverty could be on track to reduce from over 40 percent in 1990 to as little as 10 percent next year¹⁵ (though other commentators anticipate a more modest reduction, to just below 15 percent¹⁶). The 1.2 billion people in extreme poverty as of 2010 constituted 20.6 percent of the developing world's population—that is, 700 million fewer than in 1990, more than halving the poverty rate in just 20 years.¹⁷

It would be foolish, of course, to suggest that the gap between the developed and developing economies has closed, or will do so soon. The US economy is still almost twice as large as China's, and Germany's almost twice as large as India's—and the gaps remain vast on a per-capita basis. The worst impacts of the Western financial crisis and recession appear to be over. The United States' economy grew by 1.9 percent in 2013 and is expected to grow by 2.8 percent

This spread of prosperity and opportunity is welcome and a potential source of long-term growth for enterprises from all parts of the world.

in 2014, and while the Eurozone has only recently emerged from recession and had negative growth of 0.4 percent in 2013, it is also expected to resume growth at a rate of 1 percent in 2014.¹⁸ Moreover, each of the BRIC economies has slowed down recently, and each displays signs of stress. China's shadow banking system and the prospect of a speculation bubble bursting; India's overdue labor law reforms and governance weaknesses; Brazil's infrastructure problems; Russia's commodity dependency—all are legitimate and well-documented causes for concern.

Figure 2. The changing landscape of global poverty (millions of poor)



Source: Brookings Institution, *Poverty in numbers: The changing state of global poverty from 2005 to 2015*, February 2011, p. 1, http://outreach-international.org/wp-content/uploads/2013/11/Brookings_Global_Poverty.pdf, accessed February 26, 2014.

But it would be even more foolish to assume that the seismic shifts witnessed over the last 20 years are over. The “slowing” economy of China grew at 7.7 percent in 2013, and it is forecast to show roughly equivalent performance in 2014; India grew at 4.4 percent, with a 2014 forecast of 5.4 percent.¹⁹ And the BRICs are hardly the only show in town. With the exception of 2009, sub-Saharan Africa has averaged annual growth rates of more than 5 percent over the past decade—and its growth is forecast to continue at around that level.²⁰ Jim O’Neill, former chairman of Goldman Sachs Asset Management, originated the BRIC acronym.²¹ He recently created a new one—MINT

(Mexico, Indonesia, Nigeria, Turkey)—which he identifies as additional high-growth and high-potential economies.²² Thailand, Vietnam, Poland, and the Pacific Coast nations of Latin America—as well as many others—might also hold real future promise. Meanwhile, demography continues to favor many developing economies over the more mature nations. They are enjoying the “demographic dividend” associated with a healthy “potential support ratio” between those of working age and those of non-working age—which is heading into uncharted low territory in many industrialized countries, most notably Japan, Italy, and Germany.²³ The fundamental rebalancing of

the global economy is likely to remain a persistent dynamic for many years to come.

This spread of prosperity and opportunity is welcome and a potential source of long-term growth for enterprises from all parts of the world. But it is also substantially increasing the level of complexity and uncertainty in the business landscape. Twenty years ago, it appeared plausible to many that the “Washington Consensus”²⁴—essentially an agenda and rule set established primarily by Western governments and Western-led global institutions—might provide a permanent framework for the future of the global economy. That scenario appears far less credible today. China, having recently overtaken the United States as the world’s largest trading nation,²⁵ is central to new alliances and partnerships that have no Western involvement—including, importantly, a rapidly growing and deepening relationship with the continent of Africa. Many important trade, cultural, and political linkages are decreasingly led by or dependent upon Western actors. Recently released UN data show that the share of South-South trade in total world exports doubled in the last 20 years. Its share now stands at 25 percent, and is set to rise further.²⁶

Perceptions of the appropriate role of government vary substantially, too. The rise of so-called “state capitalism”—a model that co-harnesses the power of markets with powerfully interventionist government practices—is historically, culturally, and philosophically more resonant in many developing economies than purer free market capitalism. The

result is a trend toward increasingly divergent policy regimes—and a rise in preferential, if not openly protectionist, behaviors as governments around the world seek to promote a growing portfolio of “strategically important” industries, sustain and create employment for their population, and promote their national security. Standards and practices around the protection of intellectual property (which naturally tends to advantage incumbents) are also being challenged and might well continue to diverge in the years ahead.

These shifts in relationships and rules might also be accelerated by growing challenges related to sustainability, linked in particular to climate change, food production, energy, and water. These have already been important contributing factors in the difficulties encountered in the WTO’s Doha round, and are set to become increasing sources of tension. Over the next 15 years, the

Today, serious and legitimate questions are again being posed regarding the future of globalization.

global population will likely increase by more than a billion; food and energy requirements are both forecast to rise by 50 percent and 40 percent, respectively; and water requirements (already under enormous stress in many parts of the world) will increase by around 30 percent.²⁷ Each of these challenges will be compounded to an unknown degree by climate change—which is in part caused by current carbon-intensive, fossil-fuel-based energy sources, and which will almost certainly impact water availability and food production.

The next wave of globalization will bring fresh challenges on many levels for businesses and the people who manage them. As

a consultant to many of the world's largest enterprises, Deloitte is in a position—and has the obligation—to see the unfolding patterns of change. In this report, we offer a set of nine trends with real implications for managerial decision making and action. Do these represent the entire story of change? Not at all. Our selection of these particular trends reflects our conviction that, amid the turmoil of many ongoing and dynamic changes, it is possible to put some stakes in the ground. These managerially relevant trends are very robust and can be acted upon with confidence as organizations seek to grow, innovate, and achieve breakthrough performance in a changing world.

In choosing this year's trends, we are not claiming that these shifts are products of the past 12 months or that they reached their peaks of impact in 2014. Quite the contrary: All are changes that have been many years in the making. Nor do we make a conscious attempt to cover the waterfront and describe how the new wave of globalization will hit every aspect of business management.

Nonetheless, the trends we describe end up falling into three major categories of impact, and that has prompted us to present them in the order we have. The first three relate to the very deep changes companies are beginning to encounter in the nature of global *consumers*. The second three all reflect a fascinating shift in how business gets done, focusing on *collaboration* both inside and outside the walls of the enterprise. The final three identify key ways in which *leadership* is being challenged and changed by the next wave of globalization.

Welcome to the next wave of globalization. There will be more change to contend with than could possibly fit into one report's exploration of major trends. We are confident, however, that these nine trends will remain highly relevant for years to come and deserve companies' strategic attention. The winners in this new age will be inspired by new consumers with new needs, enabled by new collaboration models, and guided by new leadership with a focus on the future.

Author

Eamonn Kelly is a director with Deloitte Consulting LLP in the US strategy service line Monitor Deloitte, and chief marketing officer of the Strategy and Operations practice.

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New consumers

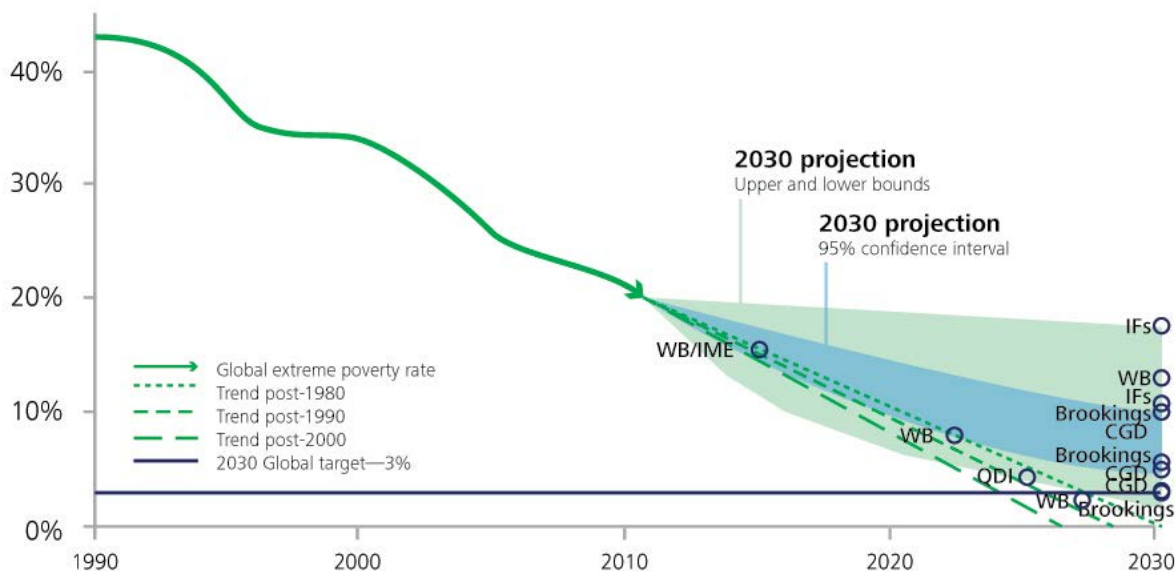
Section overview

For, as Peter Drucker so simply put it, “the purpose of business is to create and keep a customer,” then nothing could have more impact on a business than a large-scale change in its customer base. The first three trends unleashed by the next wave of globalization go straight to this core issue. Global businesses will need to comprehend the growth of consumer markets

that are geographically and socioeconomically dissimilar to their traditional ones. The consumers they serve will have different needs—and higher expectations of the businesses they choose to patronize.

The first trend we note is the emergence of **another billion**. As noted above, extreme poverty has been in steady and meaningful decline

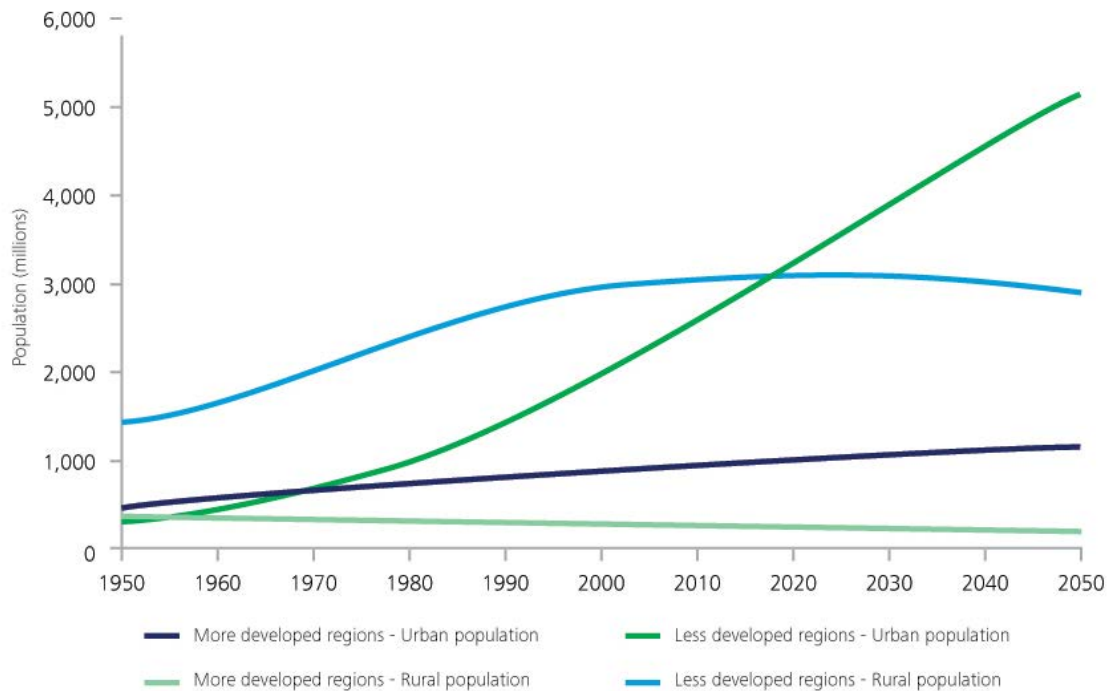
Figure 1. Ending extreme poverty: Recent progress and future projections



* Published poverty projections: Brookings Institution (Brookings), Chandy, Ledlie, & Penciakova, 2013; Center for Global Development (CGD), Karver, Kenny, & Sumner, 2012; Pardee Center International Futures (IFs), Hughes et al., 2009; Overseas Development Institute (ODI), Kharas & Rogerson, 2012; World Bank (WB), Ravallion, 2013; World Bank & IMF (WB/IMF), Global Monitoring Report, 2013.

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Figure 2. Urban and rural populations by development group, 1950–2050

Source: United Nations, Department of Economic and Social Affairs, Population Division, *World urbanization prospects: The 2011 revision, highlights*, March 2012, p. 3, http://esa.un.org/unup/pdf/WUP2011_Highlights.pdf, accessed January 30, 2014.

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over the last 20 years—both as a percentage of global population and, remarkably (given the continued rise in overall population), in absolute numbers of people as well (figure 1). This reduction in poverty, the direct result of economic growth, is giving rise to a greatly expanded “consuming class.” In the near term, expect to see it expand by roughly another billion people. What consumer-serving company could fail to be excited about that growth?

The problem for many, however, is that all this growth will take place in parts of the world they have not traditionally served. It is in the emerging markets of Asia, Africa, and Latin America that growth rates over the past two decades have raised income and consumption

to unprecedented levels. By 2020, it is estimated that the number of people in the global middle class will amount to 3.2 billion (up from 1.8 billion in 2009).¹

As consumers coming out of poverty in emerging markets increasingly shape global demand, managers will need to understand the types of products and services they seek. Understanding the complex demands of this diverse cohort will be a difficult task—they are geographically and culturally diverse, more youthful, and less affluent than their Western counterparts. But given their scale and contribution to overall global growth in consumption, the task is an essential one. Our discussion of this trend explores the needs of

this consumer group and discusses the ways in which businesses must rethink their market and growth strategies to reach and serve them effectively.

Exploring the changing nature of demand points us toward another consumer-oriented trend. In emerging markets, in particular, companies' abilities to serve the new consuming classes often depend on their helping to solve the social problems that impede commercial activity. In large part because of the new wave of globalization, there is a far more powerful connection between **business and social impact**.

The global ambitions of large companies demand a new approach to social and environmental concerns. In the absence of stable infrastructure in many locations, businesses are working with other stakeholders to find and maintain solutions. While the motivations for attention to social challenges can range from risk mitigation to competitive positioning to achieving market differentiation and growth, a commitment to finding socially based solutions will increasingly be a requirement for success in serving an array of markets. Our exploration of this trend describes the new business imperative and offers examples of businesses that are addressing broader social goals as they pursue success.

Meanwhile, there is yet another dimension to the dynamic of new consumers. Not only are these new consumers citizens of emerging economies, they are also increasingly urban. Our third trend notes that, today, we exist on a **city planet**. This creates the need for forward-thinking companies to pay far more attention to their city strategies—because urban areas are so rich in opportunity but so complex and challenging to serve. We are living through

the largest wave of urbanization in history, and have already reached the point where the majority of the world's population lives in urban areas (figure 2).² (The crossover from mostly nonurban to mostly urban populations occurred in 2009.) By 2030, urban populations will reach almost 5 billion, with growth concentrated in the cities of Asia and Africa. Urban populations are more prosperous; for example, 80 percent of Africa's total GDP emanates from urban centers, yet currently only 30 percent of the population lives in towns and cities.³

Global megacities such as Shanghai and Mumbai are powerful, recognizable symbols of this urbanization. They are taking their place alongside the long-established global cities of the developed world to exert powerful influence, especially as centers of talent and innovation. However, such vast cities are only part of the new urban story; collectively, they account for less than 10 percent of global city dwellers. It is cities with populations of less than a million that are growing most quickly, and that are home to 60 percent of the world's urban population.⁴

Our discussion of these vibrant urban centers emphasizes the need to approach them with multifaceted strategies. Smart business leaders recognize cities as much more than just sources of concentrated and growing demand. They see them as hotbeds of talent and innovation, and as the setting for some of the most interesting and important problems that businesses could help to solve. A promising approach we have observed is the treatment of individual cities as "learning labs," where strategic engagement can proceed experimentally and yield keys to replicating successes in other locations.

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Another billion

By Glenn Goldman and Eamonn Kelly

Overview

TWO decades of rising prosperity have reshaped and reoriented the global economy, but the effects have been remarkably uneven. The rising tide has created a new class of extremely wealthy individuals across the world, and vast numbers have been brought out of extreme poverty, yet the relative incomes of many in the affluent advanced economies have stagnated, and elsewhere far too many still languish in the direst imaginable circumstances. But perhaps the most surprising story has been the steadily growing wealth of huge numbers of previously very low-income consumers in Asia, Latin America, and Africa.¹

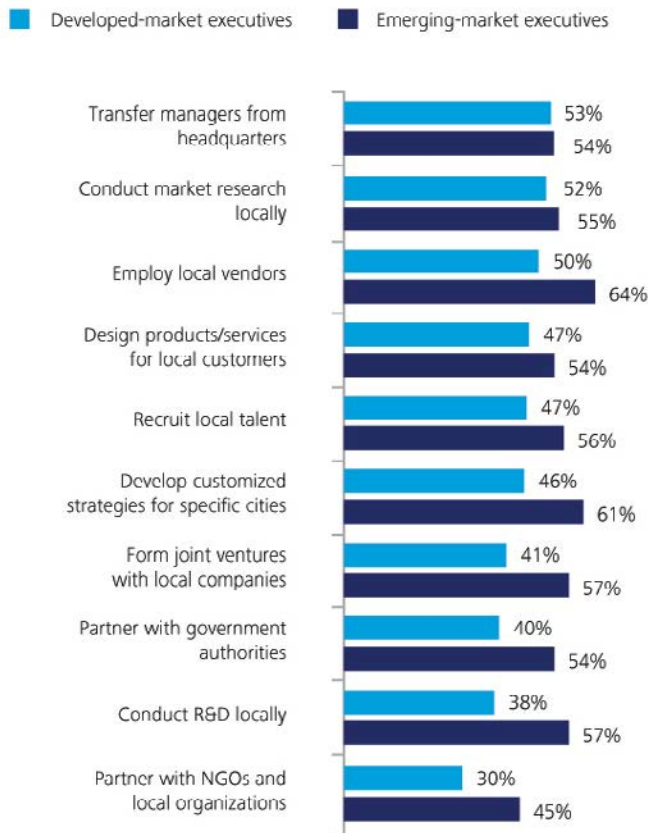
This is a trend that will continue and grow in importance. It is projected that by 2020 3.2 billion people will be “middle class,” up from 1.8 billion in 2009.² Almost none of this growth will come from advanced economies; instead, the increase will happen in Asia, Africa, and Latin America.³ As a rough (and prudent) estimate, a billion new people will be critical in shaping global demand over the next five years or so.⁴

Welcome to the “next billion”—and a huge chance to serve a vast new set of consumers. Will they have the discretionary spending power of traditional middle-class customers in advanced economies? No—they are poorer, less familiar, live in different conditions, and need somewhat different products and services. But they will provide the single biggest growth opportunity in many global companies’ portfolios.

As businesses turn their attention to the next billion, they’re finding that the past strategies of reducing costs and then exporting affordable, scaled-down versions of successful products or services may not suffice. But they also know that customizing for every local market is both impractical and expensive. New approaches and new ways of thinking—about categories, cultures, and commonalities—are needed. Serving the next billion is a tantalizing prospect, but reaching them profitably is anything but straightforward.

Figure 1. Strategies used in emerging markets (percent used extensively)

To what extent does your company use each of the following strategies when operating in emerging markets?



Source: Deloitte Consulting LLP, *Deloitte Globalization Survey 2013*, 2013.

Graphic: Deloitte University Press | DUPress.com

What's behind this trend?

In 2013, the United Nations Development Programme called its annual report on human progress *The Rise of the South*. It reported: “The South is developing at a pace unprecedented in human history, with hundreds of millions of people being lifted out of poverty in developing nations and billions more poised to join a new global middle class.”⁵

The Organisation for Economic Co-operation and Development (OECD) concurs that a massive shift is underway. In a 2010 report, it looked at household-level data in 145 countries and found that Asia accounted for less than a quarter of the global middle class in 2010. Its projections, however, have that share doubling within a decade—which will mean that by 2020 the majority of the world’s middle class will be Asian.⁶ The report’s author, Homi Kharas, explains: “This is because a large mass of Asian households have incomes today that position them just below the global middle class threshold and so increasingly large numbers of Asians are expected to become middle class in the next ten years.”⁷

This is a remarkable story of economics and demography. Between 2000 and 2013, the real GDP of non-OECD countries grew by an average annual rate of 6.5 percent. In contrast, the advanced nations of the OECD saw real GDP growth average around 2 percent per year.⁸ At the same time, the ineluctable momentum of demography guarantees that the young and growing populations of emerging markets will be the dominant drivers of demand growth. Between now and 2025, a billion more people will be born, almost all in emerging markets.⁹

High urbanization rates are also contributing to the emergence of the next billion. Urban populations are more prosperous than rural ones (for example, 80 percent of Africa’s total GDP emanates from urban centers, yet currently only 30 percent of the population lives in towns and cities).¹⁰ As emerging-market urbanization continues over the decades ahead, wealth and consumption will inevitably grow.

With the emergence of the next billion, however, the playing field will increasingly shift from the largest and most attractive markets (rich megacities such as Shanghai and Mumbai) where doing business and getting to scale are—relatively speaking—much easier. Now, companies will also need to compete in smaller cities, towns, and rural areas where the absolute numbers of emerging middle-class consumers may not justify the degree of localization and investment made to date. This will require new approaches.

Implications

When Deloitte surveyed developed-market executives of global firms in 2013, the most common strategies reported that were related to operating in emerging markets extensively were employing local vendors, conducting market research locally, and transferring managers to local markets (figure 1).¹¹ Emerging-market executives reported that the most common strategies used extensively when operating in emerging markets were forming joint ventures with local companies, conducting R&D locally, developing customized strategies for specific cities, and employing local vendors (figure 1).¹² As companies build on these steps, our research and client experience suggest four more actions they should consider. All involve reframing the challenges of emerging markets, and rethinking how to address them.

Fully understand and shape how categories evolve

The first major implication of a new market opportunity as large as the next billion is that many firms will need to relearn—or learn for the first time—how to compete in unfamiliar emergent categories. Of course, new categories of goods are born every year (from smartphones and e-readers to single-serve coffee brewers and jeggings), and the science of management is growing ever more

sophisticated with regard to the dynamics involved as products move from their introductory stages to maturity. But since most of the needs and desires of the next billion relate to categories that are mature in the developed world, Western managers sometimes assume that emerging markets need little in the way of product development or nuanced pricing. They take a Western brand and make slight variations so that it will appeal to those consumers who most resemble middle-class buyers at home. They too often regard emerging-market consumers as merely the latest of “late adopters” in categories that have largely played out.

In contrast, look at how Nestlé is growing its business in Central and West Africa. First, it innovated with the needs of these new consumers specifically in mind: Its Maggi-brand bouillon and other seasonings are fortified with the very micronutrients—iron, vitamin A, iodine, and zinc—that are deficient in the diets of over a third of people in developing countries.¹² Then it created a “Cooking Caravan” program that traveled throughout Cameroon, Côte d’Ivoire, and Nigeria, raising awareness of the importance of balanced diets, micronutrients, and culinary hygiene.¹³ This is classic early-stage category marketing, geared to educate and mobilize an underserved consumer base.

To achieve real leadership in markets relevant to the next billion, companies will often have to invest materially in such category development. And many will learn that there is a world of difference between market entry (competing in an existing category that consumers understand and are familiar with) and market development (competing in a nascent category that consumers have limited understanding of and experience with). Creating demand will often require moving further upstream in consumers’ buying processes—for example, “influencing influencers” such as local doctors and respected members of traditional communities.

Strategies will need to be informed by a rigorous understanding of how increasing wealth shapes consumer behavior and drives category growth. For most categories, there are reasonably reliable empirical relationships that predict when adoption and significant growth will occur in a market's socioeconomic development. Leading companies are rethinking how best to manage their category adoption curves. For example, Sony has recently announced its plans for a distinct pricing and portfolio approach in tier II and tier III cities in India. It plans to introduce small-screen Bravia televisions priced starting from 15,000 Indian rupees to tap demand in these smaller cities and towns across the country, while relying on sales of high-end products in tier I markets to support its margins.¹⁴

This strategy of “volume from the bottom, value from the top” will certainly become more common, but executing it will require much deeper consumer understanding, as well much more precise timing and execution, than most companies have yet shown. Managers should study which economic and demographic factors determine the adoption curves and tipping points for their categories. In particular, they will have to manage the tricky trade-off between prices and volumes, so that they do not forestall category growth by taking price increases too early, or miss value-creation opportunities by introducing new offers or stock-keeping units too late.

Segment consumers with global consistency, but local relevance

Corporations understand the value of segmentation—grouping their prospective customers into categories according to common needs and how they respond to marketing actions. They also know the power of standardizing what they do to leverage their scale. Many, therefore, have attempted to use the segmentations developed in their home

markets to think about consumers, opportunities, and go-to-market strategies globally. The segmentations usually don't travel well, as the Africa division of a consumer packaged goods company discovered. The categories rolled out by the global market development team covered only a small part—in Kenya, for example, just 10 percent—of what this division knew to be

its addressable consumer base.¹⁵

How can a company gain the benefits of consistency in global segmentation without the hazards of a one-size-fits-all approach? Some marketing leaders are rethinking their segmentations to encompass a wider span of consumer types, and to recognize commonalities that exist across many developing economies. For example, in markets that are rapidly urbanizing, the “young adult who moves from a small village to the big city” is common enough, and strategically important enough, to be called a segment. Whether they are moving to Nairobi or Bangalore (also known as Bengaluru), the people in this segment share a set of behaviors

How can a company gain the benefits of consistency in global segmentation without the hazards of a one-size-fits-all approach?

and beliefs that affect what and how they buy. At the same time, companies are allowing more flexibility through a more modular approach that allows for the creation of “made to assemble” segmentations chosen from a set of predetermined segments that are relevant, to varying degrees, in different types of markets.

Look beneath the surface to find meaningful—and predictive—cultural similarities and differences

While companies must look for commonalities across geographies, they should be careful not to assume them within any given region. The next billion consumers often live in territories woven of many cultural threads. Their heterogeneity will require companies to look beyond surface-level commonalities, such as language and income levels, to find the deeper drivers of consumer behaviors. Recognizing variety at this level can help companies make choices about the attractiveness of different consumer groups, and about how to market and sell to them.

Cultural factors exert a huge influence on how consumers perceive and use brands, and on which types of marketing messages are more likely to work with them. For example, the perception and role of luxury brands is very different depending on whether or not people implicitly accept large imbalances in political and economic power. For one group, the brands serve as especially strong signifiers of status; for the other, they are investments in enduring quality.¹⁶ In fact, even when companies market their brands with great discipline and consistency globally, consumers from different cultures still interpret these brands differently (as shown by a study of Red Bull in 2008—the result has been replicated many times before and since).¹⁷

Cultural factors have been shown to influence everything from adoption rates for new products to the types of marketing messages

that will resonate with consumers. By understanding how cultural factors drive consumer behavior for their categories, companies can choose their markets more strategically, and can develop a handful of tailored marketing approaches that will appeal to consumers with similar cultural drivers, even when they are from markets that appear to be very different.

Modify organizational structures

As we’ve outlined, greater commonalities often exist across borders than within them. What is required to win in Lagos is much more similar to what is required to win in Mumbai than, say, Kaduna. Yet organizational structures will (likely) have to reflect national and regional lines because of differing tax and regulatory regimes. Smart companies will find organizational solutions that allow them to transcend the barriers and capitalize on cross-border commonalities.

For many large companies, this is very hard to do. At best they transfer personnel who have cut their teeth in one emerging market to another that is at an earlier stage of economic development. The logic is that, for example, “Africa is like Latin America was 10 years ago,” so the people who experienced the earlier change are well equipped to navigate the newer one. More companies are at the stage where they are simply trying to create a management cadre that isn’t purely Western. Reckitt Benckiser, for example, moved the leadership of its Latin America operations from Miami to Sao Paulo. The senior vice president for Latin America said the company was “staffing up people in the developing markets and moving much more talent from the developed to the developing geographies.”¹⁸

As companies gain more experience in emerging markets, expect to see them do more with the structure of the organization to improve knowledge transfer and coordination

across regions. For example, they will establish reporting matrices and virtual centers of excellence consisting of teams with expertise in specific types of submarkets. Best-in-class companies will increasingly have cross-national teams with expertise in how to understand and address specific types of markets, consumers, and cultures.

Competitive advantage will accrue to companies that first group and categorize submarkets with similar economic, demographic, and cultural characteristics and then develop ways to reliably execute in those kinds of submarkets, regardless of which national borders they happen to sit in.

Looking ahead

Economic growth almost never follows a straight-line projection. Emerging economies can suffer periods of slowdown and possible

stagnation. But overall we can expect to see continued and sizable growth in emerging-market consumption—with a billion new consumers emerging from the “base of the pyramid” to enter the middle class, and steadily gaining purchasing power.¹⁹

Some global firms will be able find the commonalities that let them strike the right balance between standardization and localization. These companies will reap the rewards of this unprecedented growth. And then the companies that have distinguished themselves in this era will be better positioned to meet the demands of the next wave of growth. They will find that the strengths they forged in this decade—the 2010s—can serve them for many years to come, and allow them to profit from the *next* next billion consumers that will be brought along by the continued growth of emerging markets.

My take

By Kishore Mahbubani, dean and professor of public policy of the Lee Kuan Yew School of Public Policy at the National University of Singapore

The rise of the middle class in the developing world has been well documented in recent years, but the explosive growth that we are about to see in many Asian societies is truly unprecedented. The implications of this extreme growth on business, politics, and the environment continue to be a topic of heated debate, but what is clear and undeniable is that a significant and irreversible shift is occurring within the global economy.

As Asia and much of the developing world drive forward into a new age of growth and prosperity, the different cultural classes of the West have acknowledged and accepted these changes to varying degrees.

Business leaders from the West have for the most part recognized the importance of the Asian middle class for their future growth, although even some of the best managers continue to have strategies for Asia that are relatively pale reworkings of strategies they have deployed elsewhere. Still, they show promising signs of adjusting plans to accommodate this new global demographic.

Governments have also begun to understand the significance of this global shift, but have lagged in changing their perspectives and policies. Other groups, including the intellectuals and the media, appear to be slower in acknowledging the shift, although they too seem to be waking up to the international implications of the growth in the developing world.

What can we expect out of this new and powerful middle class? In the rise of the previous middle class, we saw a boom in the consumption of Western goods. In an effort to display their newfound wealth, consumers became avid customers of Western products. Expensive red wines and Louis Vuitton handbags became quite common. However, I expect these preferences to change quite dramatically with the emergence of the next wave of middle-class consumers. Rather than blindly purchasing Western goods, I see these new, more sophisticated Asian consumers looking for products that they can more closely identify with. They will begin to purchase products that not only meet their needs but also reflect their own cultural values and identities. Western businesses have begun to take note, but they will need to make significant investments to update their knowledge and understanding of Asian cultures, in order to ensure they are creating products that meet the needs of the new middle class.

At the National University of Singapore, where I am the dean of the Lee Kuan Yew School of Public Policy, we publish a quarterly magazine, *Global-Is-Asian*. Those who understand this idea will be the ones who lead us into a radically different world, while those who do not will be playing catch-up for years to come.

The bottom line

The expanding consuming classes of emerging economies have been an exciting area of growth for marketers. Thanks to economic and demographic growth, the global consumer demand has shifted dramatically toward emerging markets—and that shift will continue.

But capitalizing on the next billion consumers may require companies to reach beyond their past strategies of reducing costs and then exporting affordable, scaled-down versions of successful products or services—yet customizing for every local market is both impractical and expensive. To succeed, companies should look for and find commonalities and patterns across markets and consumers. Finding such commonalities will allow them to gain the economies of learning and scope necessary to capture the “next billion” opportunity at an acceptable cost and level of investment.

Successfully reaching the next billion should require investments in new capabilities. But the opportunity is too great, and the longevity of the rewards for success too enduring, for many companies to ignore.

Authors

Glenn Goldman is a senior manager with Deloitte Consulting LLP in the US strategy service line Monitor Deloitte.

Eamonn Kelly is a director with Deloitte Consulting LLP in the US strategy service line Monitor Deloitte, and chief marketing officer of the Strategy and Operations practice.

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Business and social impact

By Rhonda Evans and Tony Siesfeld

Overview

THROUGHOUT the developing world, water, sanitation, and hygiene are matters of life and death. Every 20 seconds, a child under five dies from a waterborne illness. Eighty percent of diseases are related to contaminated water, and more than 780 million people do not have access to clean drinking water.¹

Unilever has ambitious goals to address these problems: By 2020, it wants to bring safe drinking water to half a billion people around the world and help improve the hygiene habits of twice as many. It established hand-washing education programs in 16 countries, reaching 11 million in Africa alone, and now works with the Millennium Villages Project to develop more scalable water, sanitation, and hygiene interventions.²

Unilever's actions are not philanthropy; they are key elements of the company's global business strategy. Fifty-five percent of Unilever's global revenue now comes from emerging markets.³ Its CEO Paul Polman declares, "We cannot thrive as a business in a world where . . . nearly 1 billion go to bed hungry every night, 2.8 billion are short of water and increasing numbers of people are excluded from the opportunity to work."⁴ Unilever's Lifebuoy soap has experienced double-digit growth, in part as a result of the company's education campaign, and it is one of Unilever's fastest-growing brands.⁵

This is the new face of corporate social performance in the next wave of globalization. Companies operating in emerging markets must address the challenges of serving low-income consumers and rural communities, and must adapt to the limitations that impede commerce. The prospects are exciting—look out for a period of experimentation and innovation as organizations advance their core business objectives by addressing existing social and environmental issues.

What's behind this trend?

The global economy has reached a tipping point where emerging markets are no longer simply a rising force but are now taking center stage. Even companies with a strong existing market presence must grapple with how to expand their reach into new countries and segments, including second-tier markets and rural areas.

In these markets, the scale and diversity of social needs provide rich commercial opportunities. But they also present major challenges to service and business operations. Throughout emerging markets, the gap between aspiration and met needs are often substantial with regard to issues of poverty, access to sanitation and clean water, food security, and the social infrastructure of housing, education, and health care.

At the same time, rapid emerging-market growth is exacerbating resource constraints and environmental challenges such as water quality, deforestation, and pollution. In parts of Africa, water scarcity and quality are material issues for beverage producers and manufacturers of other consumer products.⁶ And more than a million people in China die prematurely each year from air pollution.⁷

In Deloitte's recent globalization survey of 423 global executives, 72 percent of emerging-market executives indicated that minimizing negative environmental impacts in emerging markets is an extremely or very important issue for their company, more than any other social issue.⁸ But natural resources are not the only inputs that a growing business must secure a steady supply of. A business needs capable employees. It needs reliable suppliers and resilient supply chains. It needs a well-governed economy in which people play by the rules. And it needs consumers with the means and confidence to buy. Providing a living wage, improving the local community, and enhancing the local infrastructure were considered

extremely or very important when operating in emerging markets by more than 60 percent of emerging-market executives (figure 1).⁹ Companies that do not address these issues may take on operational risks or have market share taken by competitors that do.

Implications

Where companies once viewed social challenges such as poverty, poor sanitation, and unskilled labor through the lens of corporate social responsibility or philanthropy, these issues increasingly operate as real constraints to business expansion and long-term success in emerging markets.

Of course, the stories vary depending on the company and due to the considerable differences among emerging-market regions, countries within regions, and areas within countries. Nigeria, one of the most important anchors of the sub-Saharan African regional economy, consistently scores in the bottom 10 percent of countries ranked on the Social Progress Index for indicators such as primary education rates, piped water, and nutrition and basic medical care. India falls in the bottom 20 percent for improved sanitation facilities and the bottom 40 percent for primary education enrollment. Brazil resides in the top third for access to piped water and in the middle for primary education rates.¹⁰ Depending on where a company is doing business, different social needs take priority. This wave of globalization demands a more granular and local focus even as companies spread into new markets and market segments.

Increased innovation

We're seeing more innovation by organizations attempting to find growth by addressing the needs of poor and aspirational market segments, including "frugal innovation" to create sustainable and affordable products. Rather than stripping existing products of features,

frugal innovation focuses on turning constraints into advantages.¹¹

Indeed, there is often an extra benefit to inventing something that fills a basic need with extreme affordability: It can travel to other markets, including mature markets. A portable ultrasound machine that GE developed in China, for example, offered very basic functionality, and sold well there. Then it found a new market segment among US emergency room doctors and paramedics who would not have invested in a high-end machine, but could use an inexpensive one to improve initial diagnoses.¹² Imagine all the places that could benefit from innovations by the Indian health care service provider Narayana Hrudayalaya. It manages to bring high-quality care to Bangalore at very low prices by applying mass production and lean manufacturing principles to the hospital setting. For the types of surgeries it conducts on patients with heart disease, the hospital's mortality rates are lower than the state of New York's. The cost is less than \$3,000.¹³

Sustaining local producers

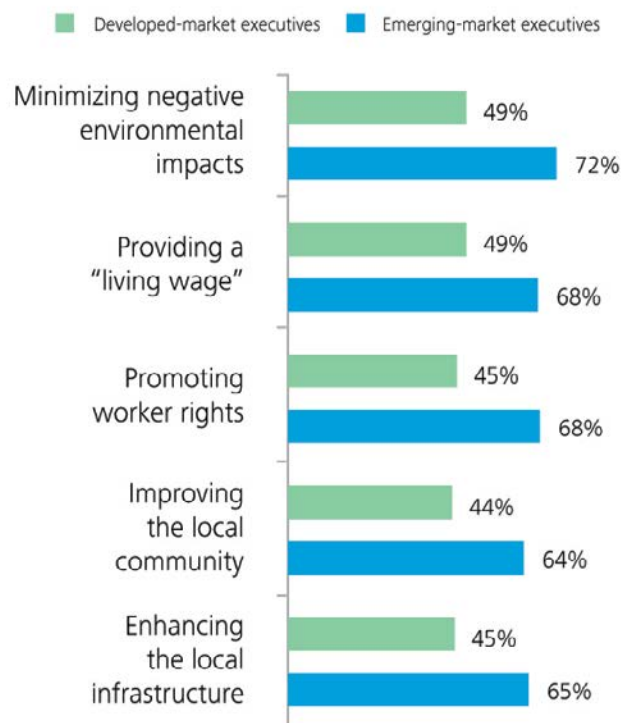
Corporations are paying more attention to the viability of local producers and supply chains. In Vietnam, the Philippines, and Cote D'Ivoire, for example, cocoa-producing farms are in trouble. With their trees ageing, their soil becoming depleted, and their crops under constant assault from pests, farmers struggle to keep yields from falling. It's an agricultural challenge, but also a social one, as people who have worked the land for generations increasingly leave for the cities, seeking easier ways to make a living.¹⁴

Mars Inc. and other major buyers of cocoa are tackling the problem. In the past several years, Mars has established 17 Cocoa Development Centers in the Ivory Coast to provide research-based techniques and tools for more productive and sustainable farming,

Figure 1. Importance of social issues in emerging markets

When operating in emerging markets, how important is each of the following considerations when your company makes business decisions?

Executives responding extremely/very important



Source: Deloitte Consulting LLP, *Deloitte Globalization Survey 2013*, 2013.

Graphic: Deloitte University Press | DUPress.com

and training in how to use them.¹⁵ This is a bottom-line business issue: The companies know that unless something is done to help these farmers, the demand for cocoa will dramatically outstrip supply in the coming decade, raising its costs and limiting its growth.

Partnering and collaboration

Partnering among global organizations—even among competitors—has become more commonplace as businesses encounter issues that are too large or complex to handle on their own. We're seeing pre-competitive activities between companies in industries where there are industry-wide supply, natural resource, or infrastructure problems. For example, companies such as Nike and Adidas joined the Better Cotton Initiative to transform cotton growing to reduce its environmental impact and improve livelihoods. The initiative promotes the adoption of better cotton practices, trains and supports farmers, and develops support for higher cotton standards throughout the supply chain.¹⁶

Perhaps the biggest change for many organizations will be partnering more with NGOs and the public sector. Whereas once businesses and nonprofits viewed each other largely as antagonists, they are increasingly finding places where they can bring complementary

knowledge, experience, and skills to bear on social problems. Meanwhile, government can play an important role as anchor buyer, coordinator, and implementation partner for market-based solutions.¹⁷

One way that partnerships between companies and nonprofits are proving valuable is in developing new market opportunities. Operating in new markets or with new market segments can carry considerable risk, particularly where firms confront strong local brands,

unfamiliar consumer preferences, and distribution challenges. Partnering with nonprofits and foundations provides a way of sharing the risk; businesses benefit from the credibility of trusted nonprofits and from access to local knowledge.

For their part, businesses provide these partnerships with market solutions and the capacity to scale. For example, Swiss Re worked with Oxfam, Rockefeller Foundation, and others to provide weather insurance for poor farmers in the Horn of Africa.¹⁸ Barclays, CARE International, and

Plan UK have teamed up to provide access to basic financial services to 400,000 people in 11 countries. Their “Banking on Change” partnership consists of microfinance projects that support the creation and development of microfinance groups that are managed by local communities.¹⁹

In the future, companies with a global agenda should assume that nonprofits and philanthropies will be involved in helping to develop and adapt new operating models and technologies.

In Tanzania, a unique alliance among multinational companies, non-state actors, and the government is working to improve the country's generally low agricultural productivity, address insufficient infrastructure, and promote policy changes. The goal of the Southern Agricultural Growth Corridor of Tanzania (SAGCOT)—whose partners include Unilever, the fertilizer company Yara International, SAB Miller, Monsanto, and the government of Tanzania—is to create an efficient agricultural value chain, with the expectation that they can triple the area's agricultural output.²⁰ By providing this kind of local-market support and technical assistance, foundations and NGOs can work with companies to improve the economic viability of production in these regions.

While there are ample opportunities for doing well while doing good, making the business case for solving social needs requires a change in mindset and new ways of doing business. The specific needs of underserved consumers, the social challenges facing local suppliers, and the limits of infrastructure and education require a sustained commitment to serve a particular market. This might require longer-term planning horizons, changes in the product development process, new forms of collaboration, and innovative business models.

Looking ahead

Adapting to the new wave of globalization poses challenges for companies. Changing how and where product development is done, being attuned to local market needs, and grappling with the challenges of working with local supply and distribution chains for poorer market segments require innovation and commitment. Companies that do not address these issues risk failing to capitalize on market opportunities and being undercut by competitors, while

proactive companies have the opportunity to shape the market they compete in.

We can also expect to see increased attention and debates around the appropriate role of the private sector in addressing social challenges. The expectation that responsible businesses will use their scale to have a positive impact will only grow. However, one crucial question that has already emerged in microfinance centers is about appropriate expectations for short-term profit and profit growth over the long term when companies serve poorer customers.²¹ This raises larger issues about what constitutes public goods and who decides how social needs should be addressed. The social license to operate may come from governments or, crucially, from civil society actors, who can influence popular perceptions of a company's role and value to the community.

Hand in hand with that expectation will come efforts toward better value and more aggressive monitoring of impacts to address social and environmental issues. Today, this is a challenge because data can be difficult to obtain and assessment of social impact can be difficult to parse. But we are already seeing creative efforts, from standards for quantifying the value of ecosystems to technologies that use satellite imagery to estimate water availability and quality.²² We anticipate more widespread and coordinated efforts to assess the value of social initiatives for threshold investment decisions and to evaluate impact.

There are no longer clearly delimited boundaries between the private, public, and nonprofit sectors. In future, companies with a global agenda should assume that nonprofits and philanthropies will be involved in helping to develop and adapt new operating models and technologies. Philanthropies and nonprofits are increasingly important members of business ecosystems.



My take

By Judith Rodin, PhD, president of The Rockefeller Foundation

At The Rockefeller Foundation, we have a vested interest in understanding how finance can be used to solve problems that affect the world's poorest or most vulnerable people. Philanthropy and donor governments alone no longer have the resources to solve these challenges. So we must engage the talents, resources, and expertise of the private sector. We see innovative finance as a way to energize market building, healthy and sustainable economic activity, and new opportunities for achieving our dual strategic goals: building more inclusive economies and greater resilience.

We see two pathways for innovative finance to create these opportunities.

Pathway 1 is led primarily by businesses themselves and involves direct investment in local business creation. This route to market building relies on global corporations that understand that, in much of the world, markets must be built before they can be served. Forward-thinking business leaders who embrace this reality make explicit commitments to enter new global markets both as economic opportunity zones as well as community spaces requiring nurturing and support.

Pathway 2 is led by public sector capital and foundation investments, such as those from The Rockefeller Foundation, which pave the way for later business investments. This path acknowledges that some investments are too risky for private capital to take independently. Incentives and assurances must be provided before businesses can step in. We view these seed investments as risk capital that prime the pump and “de-risk” the downstream capital inflows.

As businesses increasingly look to engage the developing world, we generally see their approach to market-building investments unfold in three ways.

First, businesses are thinking intentionally about new ways to secure and maintain quality across global supply chains. These increasingly depend upon an explicit commitment to improve the lives and livelihoods of communities that may be fragile and prone to disruptions due to underinvestment, and to protect the environmental resources on which they depend.

Second, businesses are recognizing that, to successfully enter new markets, they need access to skilled on-the-ground labor that both understands local value webs and can help translate product and service offers to better meet local conditions. This requires investment.

Finally, businesses are realizing that skillfully investing in local NGOs as partners can unlock critical local market knowledge—about why things work the way they do and how to get things done—and in some cases provide an important sales force to reach local consumers. This goes beyond businesses giving money to an NGO because of their good work to also seeing them as a business resource.

Philanthropy can help unleash private capital by de-risking investments from investors, as well as fund and support the testing of new business models. Businesses increasingly see that success in the future will depend on products, partnerships, and innovations that improve the wellbeing of workers, customers, and distribution chains. The Rockefeller Foundation's goal is to foster innovation, share our knowledge, and build the innovative finance landscape to ensure these investments and business transformations generate the biggest possible impact on human well-being.

The bottom line

Forward-looking companies are driving experimentation and innovation as they try to figure out how to successfully tackle a range of social challenges. We see efforts involving cross-sector partnerships, business and product innovation, assistance to local suppliers and distributors, and industry-wide collaboration. In the process, they are transforming the relationship between companies and the communities they serve.

To find effective strategies for growth in the next wave of globalization, companies will need to engage with the social needs and complexities of emerging and frontier markets. Social and environmental issues are no longer simply the government's responsibility or part of a company's philanthropic efforts. Any global business looking for an effective path for growth should bring social impact into the core of its strategy and operations.

Authors

Rhonda Evans is a specialist master at Deloitte Consulting LLP in the Monitor Institute, a practice serving foundations and nonprofits.

Tony Siesfeld is a director at Deloitte Consulting LLP and a senior leader of Monitor Institute, a practice serving foundations and nonprofits.

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City planet

By Eamonn Kelly, Jennifer Lacks-Kaplan, and Jonathan Star

Overview

CITIES feature as a key dimension of many companies' strategies to serve the world's new consumers. The ever-increasing urbanization of our planet constitutes, after all, one of the biggest trends in the history of civilization. Most strategies have considered cities as places richly packed with consumers, closely considering the particular needs and desires of urban dwellers and the logistical challenges of serving them. These questions have become more pressing as companies continue to look to emerging economies for growth; the current migration from rural areas to cities in China and India and across the developing world is unprecedented in its scale and speed.

But the emerging trend we are seeing is that companies are going beyond thinking of cities only as consumer capitals and beyond engaging with them only through their marketing strategy. Some are also developing more holistic city strategies, within which consumer marketing is just one component. Cities are also being recognized as hotbeds of talent, crucibles of innovation, and centers of society and culture—as cauldrons of society's most pressing problems and seekers of solutions in and of themselves. It requires a sophisticated and multi-dimensional strategy to engage with all of this, and to realize the full value that urbanization offers to a business.

Adopting a more integrative, strategic approach to cities is especially important because the urbanization of the developing world is an intensely disruptive and dynamic process. Not only are newly important cities springing up at a speed never seen in the West, they are doing so with much greater self-awareness. Today's civic leaders, wherever they are, have the benefit of decades of study of urbanization and its impacts. Many of them have well-informed views of the roles corporations have played, and can play, in their growth. As their powers—and problems—grow, they are looking for similar thoughtfulness from business leaders.

What's behind this trend?

Business and cities have gone hand in hand since the beginning of trade. Commerce helped give rise to cities, and industrialization has accelerated their growth. As centers of economic power, they act as magnets for the most enterprising among us. (Almost two-thirds of college graduates aged 25–34 in the 2010 US census stated that they decided where to live before they sought employment opportunities in their city of choice.¹)

Across the mature economies of the West, urbanization is a well-established phenomenon; even before the year 1950, more than half their populations lived in metropolitan areas.²

More recently, what was already true of developed economies became true of the world. In 2009, the turning point occurred—more than half the Earth's human population now lives in urban areas³—and we truly became a “city planet.” The change reflects the massive shifts underway in China, India, and other emerging economies, where urbanization has occurred at a breathtaking pace in recent decades. In 1950, less than 18 percent of the population of emerging economies lived in cities; today, almost half do.⁴ Between 1980 and 2010, Asia added more than a billion people to its urban population, with another billion set to join city life by 2040.⁵ By 2050, it is estimated that 2.6 billion more people globally will have become

urban dwellers—almost all of them in the emerging economies.⁶ This massive movement of workers to increasingly productive cities has been a fundamental ingredient of the global rebalancing of economic power.

With the rise of cities has also come the rise of powerful city leaders, often at least as pragmatic and capable of action as politicians at the national level. Cities are driving new demands for solutions in areas such as in education and health care and providing the conditions for

innovation in how they are designed and delivered. As they put new pressures on infrastructure and sustainability, they are the laboratories for the development of the smart new approaches required in housing, energy, water, and transportation. Their growing power has made them important influencers of a new regulatory environment that features challenging divergence and specificity based on local circumstances—and

at the same time, some surprising convergences through alliances and the rapid sharing of best practices.

Innovation of all kinds now flows quickly from city to city, facilitated by growing networks of innovators, city managers, and corporate players. Cape Town in South Africa, for example, recently adopted an approach developed by the City of York in the United Kingdom for effectively “crowdsourcing” solutions to citywide problems. One of the designers of the York model said, “We immediately

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recognized the parallel between Cape Town's desire to develop an 'innovation ecosystem' between the business community, residents, and city administration and our very own initiative."⁷ In 2013, a New York-based think tank unveiled 15 policy solutions, developed in cities around the world that could benefit New York.⁸

City leaders are also much more aware of the knock-on effects of urbanization, which have been thoroughly studied. Many of these are positive. For example, women's roles in families and communities are often fundamentally transformed when they leave rural areas for urban centers. They have far fewer children on average, and by gaining economic remuneration for their work, gain new standing. This partly explains why female earnings have grown twice as fast as male earnings in BRIC economies since 2007.⁹ Women in emerging economies also increasingly resemble their developed-economy counterparts as buyers: They now control two-thirds of consumer spending decisions. Urbanization has also changed the gender breakdown of educational achievement. The majority of tertiary degrees in BRIC countries now go to women.¹⁰ Aspirations reflect this momentum: Women employees of large companies in Brazil, China, and India are more than twice as likely as women in the United States to aspire to "the top job."¹¹

Many city leaders have promoted the dynamism of their regional economies by explicitly setting out to encourage entrepreneurial activity and the development of industry "clusters" (sectors of many players collectively building specialized capabilities). Singapore, for example, has successfully become home to Asia's fastest-growing bio-cluster, presenting opportunities for new arrivals to partner with research institutes, corporate labs, and public hospitals to develop new medicines and future therapies. Already, more than 30 of the

world's leading biomedical sciences companies (including GlaxoSmithKline, Novartis, and Takeda) are leveraging Singapore and its dynamic networks to drive innovation.¹² Beijing, Shanghai, and Shenzhen/Guangdong are also specifically targeting biotech, and have dedicated parks to house and incubate more than 5,000 smaller enterprises, supported by tax incentives and close links to publicly funded academic research.¹³ While connective technologies have diminished the importance of physical proximity in many ways, the "cluster effect" still matters greatly for innovation and research.

Such developments have influenced how globalizing companies think about cities, too—especially in emerging economies. Many first saw them as sources of cheap labor. Later, multinational consumer goods companies began seeing them as markets. Now they see them as sources of innovation and talent. Take Xerox, for example. In 2010 it launched an ambitious "Innovation Hub" in Chennai, India. The "hub" in the name reflects the notion that Chennai can be central to an open innovation system which accesses talent from many other points around India, including the Indian Institute of Technology in Madras and the Indian Institute of Science in Bangalore.¹⁴

For some companies, cities are now seen as customers in their own right. They are the centers of some of the most challenging economic, environmental, and social issues in the world today—and their leaders demonstrate growing commitment to the use of technology and innovative policy to address these issues. Global corporations, local businesses, and municipalities are partnering to deliver innovative, integrated solutions to problems endemic in many cities—crime, environmental decay, pollution, congestion, and inequality. Business has a vital role to play, and the rewards for smart participation in the "city planet" are vast.

Implications

With the growing and increasingly multifaceted importance of cities, some companies have been rethinking their approaches, and starting to connect all the dots into comprehensive city strategies. Deloitte's Globalization Survey 2013 revealed that around 50 percent of companies already develop customized strategies for specific cities.¹⁵

As this more systemic approach evolves, it is likely to typically include several important dimensions. The first is the choice of cities to target, both for market scale and the sequencing of expansion. Second is where—and how best—to grow and tap into networks that support innovation. And finally, organizations should consider how to design a portfolio of city-based experiments that will accelerate learning to be applied beyond urban areas.

Where to play?

Firms are making their prioritization decisions based on an increasingly sophisticated taxonomy of factors: density, size, shared cultural characteristics, cluster effects, specializations, and the established power of locally based competitors. Certainly the world's highest-profile cities, still mainly in developed markets, will continue to be prominent in multinationals' portfolios. In a recent ranking of globally competitive cities, New York and London ranked highest, and cities from the United States and Western Europe accounted for 24 of the top 30 places. They are hard to beat in terms of their institutional effectiveness, their social and cultural character, and their ability to attract talent.¹⁶

But global firms will also continue to focus on the “megacities” of emerging markets. Much attention has been devoted to these urban agglomerations of more than 10 million people (all but four are located outside of developed economies). This is justified: Places like Kolkata, Lagos, Rio de Janeiro, and Shenzhen are breeding grounds of change and

growth in the world today, and their numbers are set to rise from 23 today to more than 37 by 2025.¹⁷

For forward-looking companies, it is important, too, to strategize about the next tier of cities—the fastest-growing urban environments that make sense for businesses to operate in. Collectively, the megacities account today for less than 10 percent of global city-dwellers, while more than 60 percent live in cities with populations of less than 1 million.¹⁸ These smaller cities are proliferating and growing in importance. According to some forecasts, companies that want to touch 80 percent of the middle class in China will have to play in more than three times as many cities by 2020 as was required in 2005.¹⁹ For example, Walmart is looking far beyond the biggest cities. As reported by Bloomberg BusinessWeek in the fall of 2013, Walmart plans to open 110 stores during the next three years in Chinese third- and fourth-tier cities.²⁰

Connecting with networks

Cities also provide companies the opportunity to engage with rich networks for regionally and globally relevant innovation and learning. A growing number of cities are bases of distinctive ecosystems fueled by local institutions, infrastructure, culture, and government. These are not always intentionally designed as formal clusters, but are the result of unique combinations of past decisions, present capabilities, and local needs.

For example, like Silicon Valley before it, Bangalore emerged as India's dominant IT ecosystem, when entrepreneurial outsourcing providers took root there and attracted others. Wipro, Tata Consulting Services, and the start-up Infosys were early business settlers in the city, and Texas Instruments the first foreign technology company to establish a strong research-oriented presence.²¹ By 2000, Bangalore was sufficiently established, with distinctive networks of venture capitalists,

incubators, and local universities for General Electric to choose it as the home for its John F. Welch Technology Center—the company’s “largest integrated multidisciplinary research and development center, and the first to be located outside the United States.”²²

Elsewhere, powerful economic networks are being generated primarily from servicing particular local needs. For example, in Brazil, the consumption capacity rise from emerging classes and economic growth over the last decade has fueled demand for mobile services. The Latin American region’s mobile market is dominated by Brazil, with 112.5 million unique subscribers by mid-2013, accounting for over a third of the mobile users in the Latin American region as a whole.²³ The networks that have emerged through this need for wireless services have spurred innovation and new business models—today, Brazil is already a global leader in providing m-health and m-education services.²⁴

Experimentation and learning

As companies engage with more cities, it will make sense to conduct pilots to refine approaches that will serve them in many other locales (understanding, of course, that variations will always exist and need to be accommodated). For example, South Africa’s Standard Bank launched a remarkably successful banking service for low-income customers living in its own country’s largest urban areas. It offered a secure and affordable

cellphone-based banking program, and reaped the rewards as customers opened 90,000 new accounts a month. But its approach was not just to offer an affordable technology to customers. It also recruited city residents to create a network of mobile sales consultants, recruiting mainly from the ranks of the unemployed, providing training, and supporting them to sell the accounts back in their communities.

This multifaceted engagement with urban energy and talent proved so successful that Standard Bank is replicating it in cities in Kenya and Nigeria, and plans to do so in other countries later.²⁵

Other companies are using urban centers (mostly in emerging markets) as living laboratories to develop, launch, and test products and services, build new channels, design new business models, attract new talent, create new partnerships, and learn to adapt to new challenges—cultural, infrastructural, and regulatory. The smartest of them are

embracing discovery—and learning-oriented approaches more usually associated with science or innovation; they are establishing hypotheses, designing, and running low-cost experiments, learning fast from failures (and successes), and repeating and scaling what works. Given the variability, unfamiliarity, and dynamism of the growing number of urban centers that matter, this exploration and experimentation-based approach is sure to become increasingly important across multiple dimensions of the city strategies of many corporations.

Cities also provide companies the opportunity to engage with rich networks for regionally and globally relevant innovation and learning.

Looking ahead

As businesses focus more on cities and cities look more to businesses for solutions we can expect to see much more in the way of public-private partnerships to address social ills.

Consider the experience of the city of Medellín in Colombia, which has used its investment in transportation infrastructure as a key lever to change a city of violence and despair into one of opportunity and hope. This resulted in the homicide rate plunging nearly 80 percent between 1991 and 2010.²⁶ Medellín metro cable system, for example, has revolutionized mobility and accessibility for residents of the poorest—and often most violent—communities that line the valley of Medellín’s mountainous region. Residents enjoy new parks, schools, hospitals, and police services—many integrated into the infrastructure of the metro system itself. Accessibility to the mountainside communities has also infused a new stream of commerce, services, and tourism to the favelas.²⁷

Transport challenges are also inspiring new models of mobility such as Skybus in Lavasa, India.²⁸ Challenges of food quality and security might be met by investment in “vertical farming,” while city-based skills and employment concerns could be alleviated by urban-based tool-sharing centers and communities like Tech Shop.²⁹

It is not only in the emerging economies that cities are using technology to address

issues of mobility, energy use, and sustainability. Amsterdam is working with corporate partners to help residents reduce energy costs and curtail greenhouse gases. Projects under the wide-ranging initiative have included chargers for electric cars, advanced residential electric meters, networks that connect home appliances to an energy management system, and a “climate street” that links tram stops and street and store lighting with meters to reduce energy use along a crowded shopping route.³⁰ The city of Seoul’s government has introduced smart meters for home, office, and factory owners. The aim is to reduce the city’s total energy use by 10 percent.³¹ New York City is building innovative and sustainable access points to electricity through the development of Street Charge, a free solar mobile charging station. Telecom provider AT&T has partnered with portable solar power systems developer Goal Zero and Brooklyn design studio Pensa for the roll-out of Street Charge public solar charging stations in New York.³²

In both the well-established, relatively stable cities of developed economies and the dynamic, fast-growing cities of emerging economies, we are sure to see far more use of technology and partnerships to help in a wide range of innovations directed at critical infrastructure and quality of life. Those businesses that commit to participating in such activities will weave themselves into the essential fabric of the future.

My take

By Enrique Peñalosa, former mayor of Bogotá, Colombia

If New York, Paris, or London could erase half of themselves to rebuild anew, quite a few things would be done differently the second time around. These megacities have embedded infrastructures that handicap them in some ways.

Many of the cities in developing countries are relatively young. With fewer infrastructures, there is more flexibility to design the city to support the outcomes that people seem most deeply engineered to seek—happiness and well-being. So these youthful cities have a historic opportunity to organize themselves based on lessons learned from the successes and failures of their older siblings. They will flourish by understanding that well-designed cities provide a form of direct compensation to people that is often just as important to them as the size of the salary they draw from a job.

In the next 60 years, there will be three to four times more square meters of cities across the globe than currently exist. The tone of that development will certainly be influenced by the United States, which will build more than 70 million new homes over the next 40 to 50 years (this is more than the number of homes that currently exist in France, Britain, and Canada put together). But it will be more powerfully shaped by urban development preferences in developing countries. The population of India, for example, is currently 33 percent urban but will likely become 80 percent urban over the next 50 to 60 years. These startling projections suggest that we are amidst a phase-shift.

When we design cities, we design a way of life. Cities in developing countries are migrating from an era in which much of the services delivered by them were survival-based—the delivery of food, sanitation, and shelter—to a phase in which survival is largely guaranteed. Therefore, cities are aiming higher. The next phase of urban development will emphasize who we want to become, rather than what we must do to endure.

When cities are at their best, they foster a protective, beautiful, inclusive, and stimulating way of life. They serve as learning laboratories, magnifying the flow of ideas through which people exchange perspectives and compare values. They enable human contact, which allows rich flows of information that cannot be substituted with emails or text messages. Cities are entering an era which may become known as a kind of golden age, and the best urban environments will unlock the best in human nature and potential.

The bottom line

Cities, with their dense and diverse populations, feature commingling and interaction of talent and offer access to many perspectives. They have given rise to civilizations, enabled specialization, created markets, spread opportunities, generated economic growth, produced entrepreneurs, sparked innovation—and have thereby driven human progress and improved lifestyles and standards of living.

Companies are learning to approach cities as more than simply reliable sources of market expansion, instead thinking of them as vital talent centers, innovation hubs, learning laboratories, and “proving grounds” for solutions to some of the world’s toughest problems. Their leaders have noted the phenomenon of urbanization, realized that it is a massive trend reshaping the business environment, and recognized that cities are far too complex to be addressed by any simplistic, one-dimensional approach.

As part of their “city strategies,” companies must figure out when, where, and how to insert themselves into dynamic and rapidly evolving city networks of relevance to their business. Many will need to extend their reach well beyond the megacities of the world into second- and third-tier cities. Those who engage with urban centers with a mindset of constant learning, exploration, and engagement will discover the strategies that work and that can be replicated elsewhere. The very best of them will commit to participate as full partners in an era of remarkable city-based innovation, challenge, and change.

Authors

Eamonn Kelly is a director with Deloitte Consulting LLP in the US strategy service line Monitor Deloitte, and chief marketing officer of the Strategy and Operations practice.

Jennifer Lacks-Kaplan is a principal with Deloitte Consulting LLP.

Jonathan Star is an independent researcher and workshop facilitator.

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New collaborations

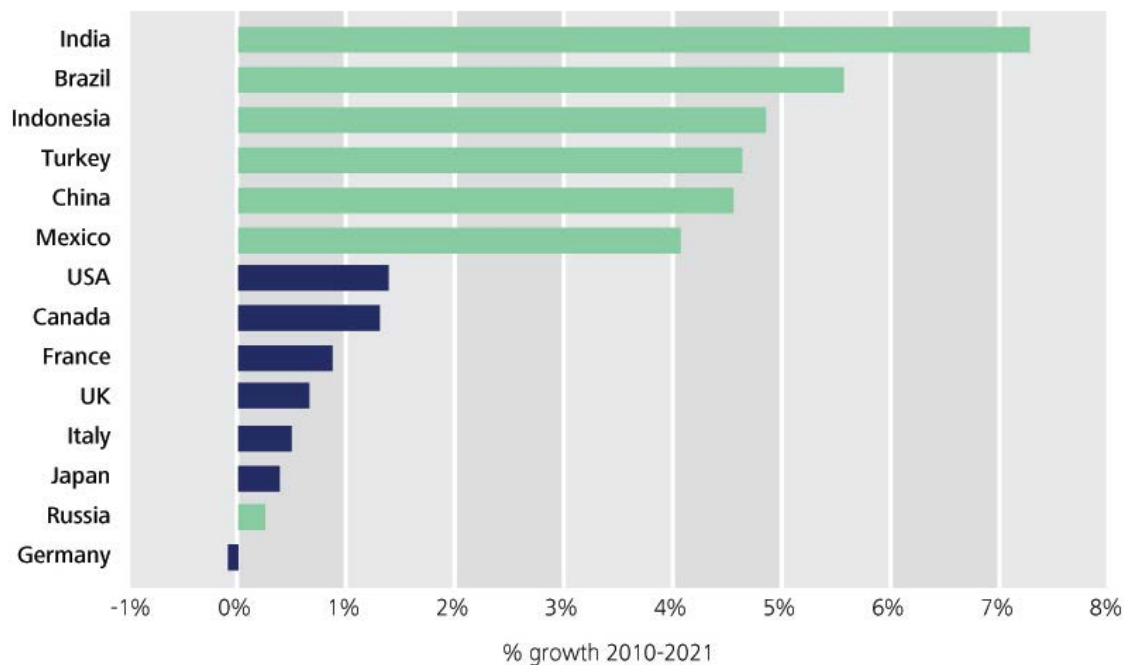
Section overview

THE fast-paced change of today's business world puts a premium on innovation and agility—and therefore, as many companies have discovered, on collaboration capabilities. In an increasingly interconnected global economy, more businesses will discover the power of looking beyond their own organizations and their familiar markets for the inspiration

for their next products and services. They will recognize that the best use of a toolkit they have been using in marketing communications—social media—is actually to connect and collaborate across many areas of the business and with all manner of stakeholders. And, leveraging the richer connections they have made with supply chain partners over the past

Figure 1. Growth in the college-educated talent pool

Tertiary-educated ("talent"): E7 and G7 countries



Source: Oxford Economics, *Global talent 2021: How the new geography of talent will transform human resource strategies*, 2012, p. 8, <http://www.oxfordeconomics.com/publication/open/231866>, accessed January 30, 2014.

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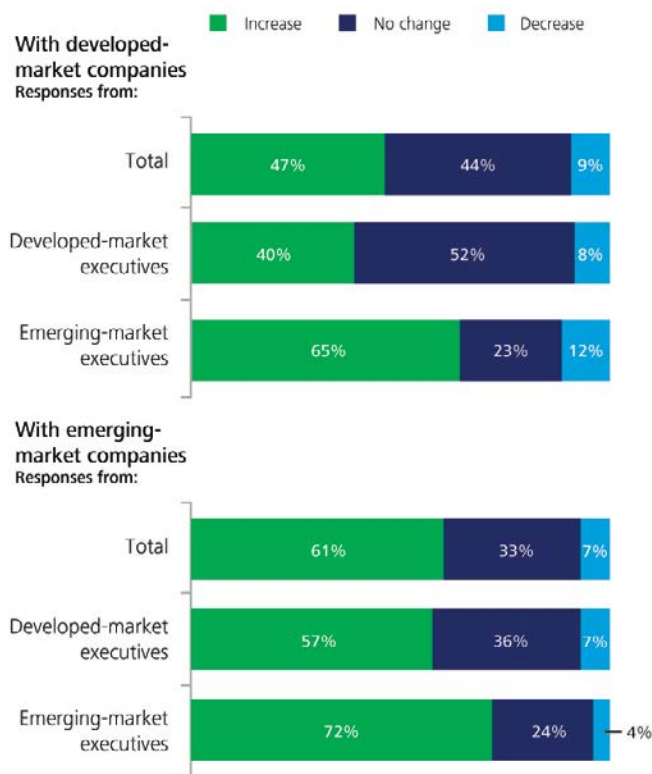
two decades, they will develop the ability to respond flexibly and efficiently to changes in demand wherever they occur in the world.

The first of the trends we explore in this section is the fact that, increasingly, **innovation happens everywhere**. The phrase is true in two senses. First, the Western-centric multinationals that have traditionally developed innovative offerings for their home markets, then adapted them (or didn't) for foreign customers, are now recognizing the limitations of that approach. We survey how the world of innovation is becoming globally dispersed, broadly moving eastward as a result of the pull of new consumers and new talent. We see the evidence of this in the gleaming new technology parks of Shanghai, and in the research labs multinationals have located in Asia. R&D expenditure in the developing economies grew in their share of the global total from 17 percent to 27 percent between 2002 and 2009.¹ Asia's share of the global researcher population increased from 16 percent in 2003 to 31 percent in 2007, a direct consequence of improving educational output (figure 1).² While the West might still have advantages in many high-tech fields, emerging markets may promise at least equal dynamism in future years, given the motivation of the population and the lack of legacy systems.

But the second sense in which innovation happens everywhere, and the even more powerful trend, is the shift from reliance on innovators employed by companies and solely devoted to R&D. Today, the whole process of innovation is moving—from “walled gardens” to open spaces, from protecting knowledge stocks to encouraging more collaborative knowledge flows. Interestingly, these two shifts in the locus of innovation seem to fuel each other. In a recent survey by Deloitte of global executives (figure 2), emerging-market executives were more likely to state that they anticipated increased collaborative efforts, both with developed-market companies (with which

Figure 2. Expected changes in collaboration over the next three years

How do you think the amount of collaboration by your company with each of the following will change over the next three years?



Source: Deloitte Consulting LLP, *Deloitte Globalization Survey 2013*, 2013.

Graphic: Deloitte University Press | DUPress.com

65 percent of emerging-market executives expected more collaboration) and with other emerging-market companies (with which 72 percent expected more collaboration).³

While a growing attitude of openness to more people, companies, and institutions greatly broadens the range of collaboration opportunities, technology continues to offer the means for such connection and cocreation, within and beyond corporate and national boundaries. These factors combine to create new horizons, in a trend we call **social business, global business**.

The ongoing increase in high bandwidth connectivity, coupled with a tremendous expansion of highly effective social media technologies, continues to increase collaboration capabilities. Until now, social media has been used mostly by individuals, and the result has been an explosion in growth in the use of social platforms across the world, creating a truly global phenomenon. In the next few years, we expect to see businesses use social media to extend their connections with customers, suppliers, partners, and employees, and to become more globally connected. Our discussion of this trend highlights the ways in which companies are using social technology to maintain a balance between local intimacy and global reach, and hence are becoming more effective global organizations.

There is much progress to be made. In both developed and emerging markets, 61 percent of surveyed executives expected social media

to become somewhat or much more important to their business over the next three years.⁴

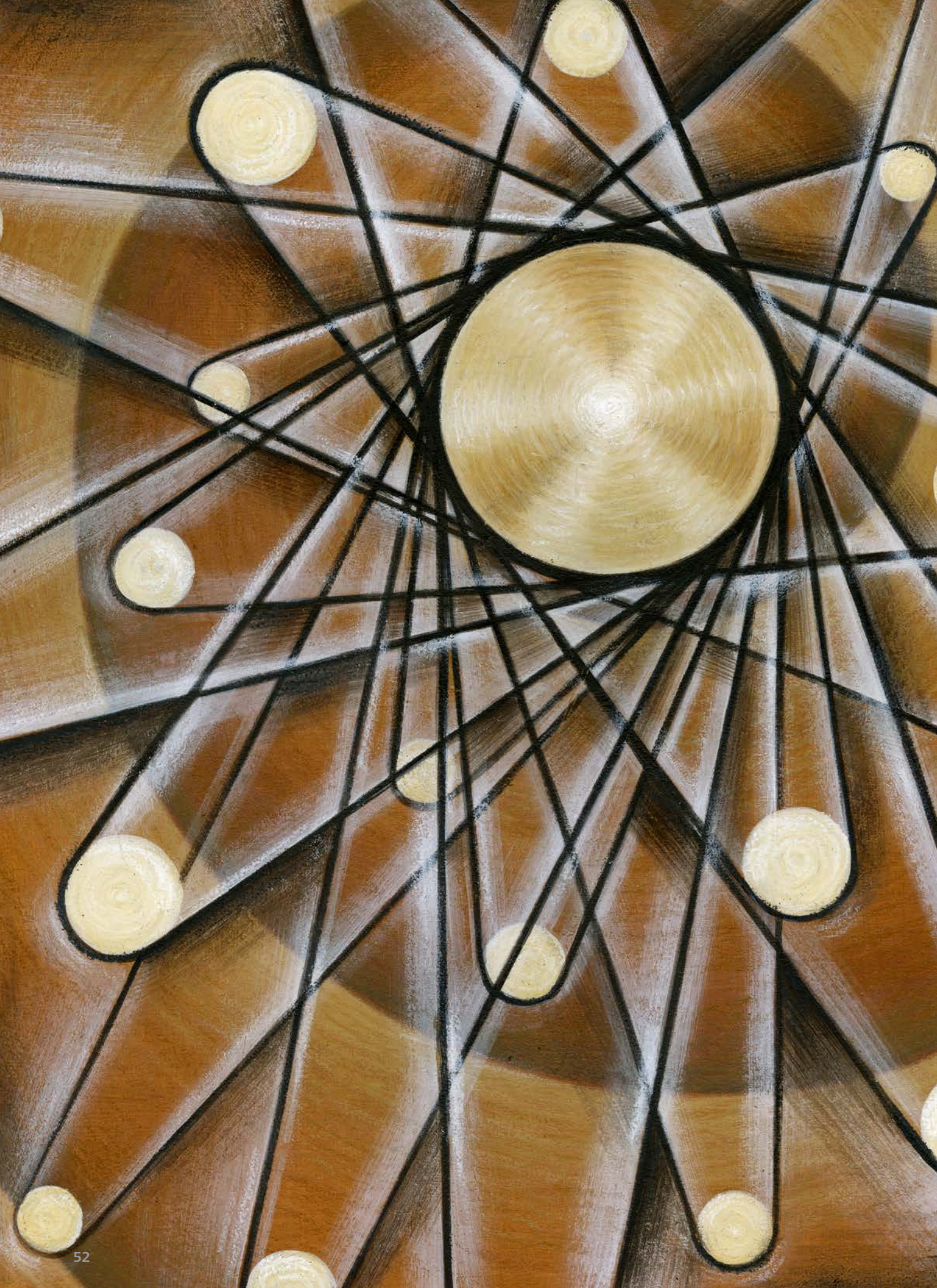
As social technologies have evolved, though, they have become much more than simply an advertising platform or a place to connect with consumers. As sophisticated use increases, companies are finding that social media provides benefits in operational efficiencies and collaboration opportunities. The effects may be so profound that it could reshape how we think about organizations in the years to come.⁵

Global supply chains are critical areas where collaboration and information combine together. They have been central drivers of successful globalization throughout history.

In the chapter on **anticipatory supply chains**, we describe the changes happening in the world of global supply networks, and the critical role that data, strategy, and collaboration should play in success. In recent years, optimal supply chains were designed, in principle, for standardization and cost-efficiency. But as the next wave of globalization is characterized by change and uncertainty, many businesses are finding their supply chains to be less than fit for purpose. We know that successful global businesses now construct supply arrangements that encourage adaptability and flexibility; supply networks of the future will be designed to anticipate changes and respond to them accordingly. Working seamlessly with partners to develop anticipatory supply chains will require more powerful predictive analytics and a far closer connection with strategy.

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Innovation from everywhere

By Thomas Jankovich, Eamonn Kelly, and Duleesha Kulasooriya

Overview

INNOVATION has always been important to humanity—it's the driver of increased prosperity and well-being. It has also been steadily increasing in importance to business in a fast-changing, opportunity-rich, and highly competitive world. The evidence is plain, for example, in MBA programs, where innovation courses for the next generation of managers are rapidly proliferating. Bill Gates expressed the point in stark terms: Companies must “innovate or die.”¹ So where does innovation come from?

For the last few centuries it came mainly from the West. Certain key ingredients necessary for innovation to flourish were in place in the societies and economies of the Western hemisphere far earlier than elsewhere. This advantage became such a powerful, self-reinforcing phenomenon that many in the West came to view their innovation advantage as something like a birthright, an intrinsic relative strength that could never be taken from them.

But in an enormously important trend for business, that is changing. Now, thanks to spreading economic growth, shifting national priorities and new “open” technologies, innovation comes from everywhere. Players based in emerging economies—and, in the West, many other players who lack the assets of large-scale firms—are becoming forces to reckon with in global innovation systems.

For those responsible for corporate innovation, this shift is challenging much of how they do their work. To keep evolving their offerings and ways of operating, companies are looking beyond their internal research and development functions and connecting with innovators at the fringes of their businesses. This will require different aptitudes and, perhaps harder to put in place, different attitudes. But if they can learn to embrace what is “not invented here,” organizations of all kinds can participate in an exciting new world of innovation possibilities.

What's behind this trend?

If you think about what is required for innovation, it comes down to a few basic elements and conditions. Raw *intellect* is required to produce novel ideas. But ideas are only a small first step in the innovation process; there must also be *incentives* for inventors to turn those ideas into reality. Putting them into production and bringing them to market at scale requires substantial *infrastructure*. And since that requires investment far in advance of the hoped-for returns, there also need to be *infusions of capital*.

These came together in the West, both at the level of the economy and within the closed systems of firms. Corporations like Xerox and General Motors pulled together high-intellect groups in lab settings to cook up inventions, all kept tightly under wraps.² Governments put a priority on fundamental scientific research, and made it easy for commercial entities to capitalize on the publicly funded and “best-in-class” work of universities. Managers devised standard processes by which the most promising possibilities were selected and funded, and leveraged their infrastructure to get them engineered, manufactured, and marketed in a consistent, high-quality fashion. Firms were able to profit handsomely from the bets that paid off. With every subsequent successful innovation, a company's infrastructure gained scale, improving the chances that the next one would be a success. With such self-reinforcing systems in place, some nations' economies matured at faster rates than others'. It was hard to see how to break the lock that Western corporations had on innovation.

Hard, that is, until now.

A key change is in the infrastructure now required—or rather, *not* required—to bring a good idea to fruition. We are now decades into the revolution unleashed by information and communications technology, and the effect on industries has been a radical

“de-verticalization” of the elements required to launch new offerings. Capabilities that were once exclusive to large businesses are now available on efficient open markets. Innovators no longer need to assemble large organizations, let alone make enormous capital outlays for plant and equipment, because infrastructure is available to them on an as-needed basis. Open platforms that enable collaboration are the new infrastructure of innovation.

Indeed, infrastructure these days could even be a liability—the millstone that limits agility. Players with the largest infrastructure in place could find themselves at an innovation disadvantage. We have already witnessed the phenomenon of “*leapfrogging*”—the upside of having essentially sat out an era of infrastructural investment and, unencumbered by legacy systems, being able to jump more quickly into the next era. This happened 20 years ago in emerging economies with respect to telephony, as their adoption of mobile phones far outpaced mature economies', thanks to their lack of land lines.³ With new, potentially transformative technologies coming online every few years, from DNA sequencing to 3D manufacturing, there will surely be many other opportunities for seeming laggards to leapfrog leaders.

But infrastructure is not the whole story behind today's more accessible and democratic innovation. Managers are now more generally knowledgeable about the processes by which ideas are transformed into profitable offerings. “Innovation is revealing its secrets,” as our colleague Larry Keeley, Deloitte Consulting LLP, puts it—among them, that the word innovation has been applied to what are actually multiple different ways and realms in which companies create new value.⁴ It is not simply about creating new products and services, but also involves systemic changes elsewhere—including financing and business models, new processes, and enhancement to delivery systems and client experience. And scores of tried and

tested tactics to drive these changes have been identified and are now available to all.

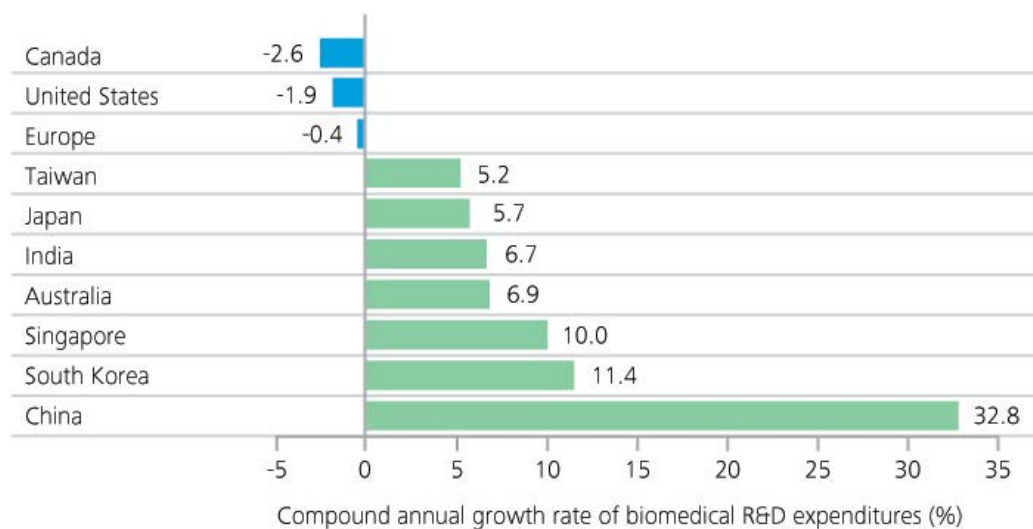
Would-be innovators are also being fueled by new incentives as governments put new emphasis on innovation. The encouragement goes far beyond specific market interventions such as tax subsidies for pioneers in next-generation technologies like solar power. Particularly in emerging economies, where businesses have prospered by being “fast followers” or suppliers to Western firms, policymakers are encouraging homegrown innovation in numerous ways. See for example figure 1, showing how various countries’ investments in biomedical R&D have grown over time.

The strong resolve of Singapore, South Korea, and especially China could not be more evident.

Companies are sending the same signals to their employees. When Deloitte surveyed senior executives of global firms in 2013, roughly 60 percent or more of developed-market executives and emerging-market executives reported that company employees, external partners, and company R&D centers are extremely or very important sources of innovation and new ideas for their organizations (figure 2).⁵

As for the infusion of capital into new ventures, the importance of that hasn’t gone away—even in an era of what Keeley calls “lightweight innovation.”⁶ New developments in this area also contribute to the shift we’re describing. Microfinance was a huge early development; it turned people in villages across the developing world into entrepreneurs. More recently, consider the advent of

Figure 1. Compound annual growth rate of biomedical R&D expenditure by country



The compounded annual growth rate was calculated on the basis of total inflation-adjusted biomedical R&D expenditures in US dollars for 2007 and 2012.

Source: Justin Chakma, et al., “Asia’s ascent, global trends in biomedical R&D expenditures,” *New England Journal of Medicine* 370, no. 1, p. 5, copyright © 2014, Massachusetts Medical Society.

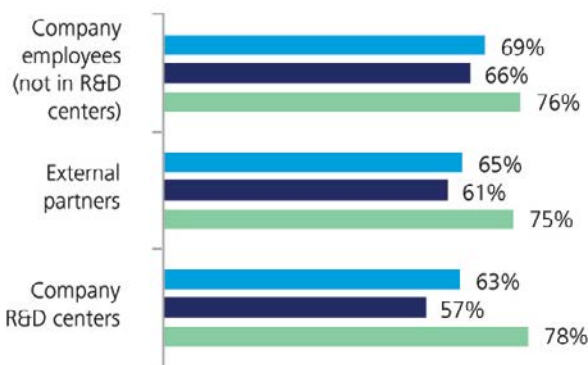
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Figure 2. Importance as sources of innovation (percent considering each source extremely/very important)

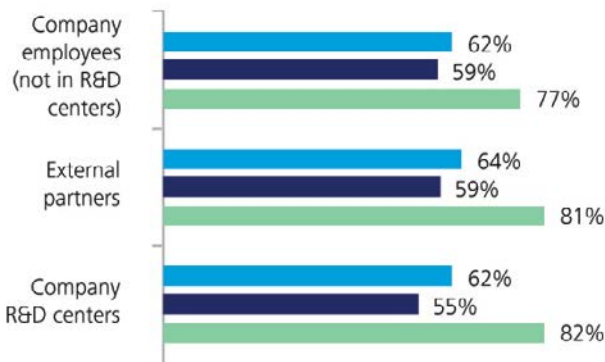
How important for your company are developed markets/emerging markets as sources of innovation and new ideas for your organization?

■ Total ■ Developed-market executives ■ Emerging-market executives

In developed markets



In emerging markets



Source: Deloitte Consulting LLP, *Deloitte Globalization Survey 2013*, 2013.

Graphic: Deloitte University Press | DUPress.com

crowd-funding. Using a tool like Kickstarter, which essentially asks customers (or stakeholders) to pitch in small amounts that collectively enable the development of an idea, an innovator can get a project off the ground that, for whatever reason, isn't a fit for conventional forms of funding such as venture capital. In 2012, the total raised across 308 global crowd-funding platforms was \$2.7 billion, an 81 percent increase over 2011, suggesting that this model is still in the earliest stages of explosive growth. When the numbers come in on 2013, the crowdsourcing research firm Massolution expects them to show that some 600 global crowd-funding platforms raised over \$5 billion.⁷

Of course, all the infrastructure, incentives, and infusions of capital in the world can't achieve innovation if there aren't good ideas to begin with. When it comes to intellect, no one would claim that the West ever had a monopoly; raw brainpower is evenly distributed in the world. Much of the trend we're describing is about tapping historically underutilized pools of it. There are also new developments making these pools larger.

The developed world may not have had bigger brains, but it did have huge advantages in education. Note, however, that by 2030, China will have 200 million college graduates, a number that exceeds the entire US workforce. By 2020, India will be producing four times as many college graduates as the United States.⁸ This dynamic is also reflected in fundamental science: In the 1980s, Asia Pacific accounted for 14 percent of total world science publications; by 2011, the proportion had doubled to 28 percent.⁹ The most recent rankings from the OECD's Programme for International Student Assessment (PISA) put Asian education systems on top, especially with regard to math and science. According to these rankings, the top seven regions of the world in math performance are all in Asia (with Shanghai taking first place.)¹⁰ Moreover, as economic

opportunities grow in emerging economies, talent is more likely to stay there, or return after periods of work or education overseas. The Chinese Ministry of Education tracks the numbers of these returning “sea turtles” and reports ever-rising figures.¹¹

Also propelling the talent shift is the rise of digital natives—a global cohort that, thanks to fundamental demographics, is increasingly dominant in the developing world.¹² This youthful source of strength will grow along with expanding Internet penetration. (Today, more than 60 percent of the world’s population still lacks reliable Internet access—but that is changing fast.)¹³ It is clear that emerging-market Millennials are attracted to innovative businesses: In a recent Deloitte survey, more than 86 percent of respondents from this cohort claimed that their employment choices were strongly influenced by a company’s reputation for innovation—a higher proportion than that reported by developed-economy Millennials.¹⁴ As they attain positions of leadership, expect to see more creative exploitation of the opportunities inherent in 21st-century technology.

Together, these developments are likely to reshape the global business landscape, steadily undermining the historic advantages of incumbents while empowering new actors. As innovation thrives outside large firms, it will also escape its long-time association with the institution-rich economies of the West (figure 2). It will become ever more accessible and

open as organizations around the world gain greater (and lower-cost) access to the elements that drive it. Larry Keeley calls it “the biggest revolution in innovation that I have seen in 30 years.”¹⁵ Innovation will now come from anywhere—and everywhere.

Implications

Managers will need to respond thoughtfully and strategically to this transformation of the innovation ecosystem. First, from a defensive standpoint, they should acknowledge that the threat of disruption—of their products, processes, and business models—is very real, and likely to come from an unexpected direction. More positively and proactively, they should find ways to make the unfolding developments work in their favor.

Make open innovation part of your innovation strategy

Business leaders today realize that the smartest people in the world don’t all work within their organizations. How are for-profit companies tapping into the ideas of broader swathes of consumers and idea-generators? Through a growing range of methods. For example, Innocentive, Kaggle, TopCoder, and Gigwalk all allow them to engage external talent to help research and solve problems at a fraction of what it would cost to employ full-time resources, and with many more

[The] biggest obstacle to innovation is not the scarcity of ideas—rather, it is the lack of capabilities to engage far-flung and unusual sources of perspective on a regular and ongoing basis.

options than would typically be suggested by expert advisors.¹⁶

XPRIZE is in the business of innovation, and it aims big. Its mission: “To bring about radical breakthroughs for the benefits of humanity, thereby inspiring the formation of new industries and the revitalization of markets.”¹⁷ How does it do it? By announcing grand challenges with handsome prizes (funded through donations to its nonprofit organization), it has elicited thousands of entries globally to solve complex technological challenges from private space flight to environmental cleanup. These entries have come from major research and traditional innovation hubs, but also from rank amateurs and dilettantes.¹⁸

But being “open” is more than issuing challenges to all comers. It calls for a broader intellectual curiosity that involves listening in and observing as creative people address the problems they consider important and interesting. Companies should consider, for example, connecting with the “hackers” in its space. The “maker movement” around the world consists of a vibrant community pushing each other’s skills and ambitions in small-scale fabrication, and some claim that it could form the basis for the next industrial revolution. We know of Western entrepreneurs who have spent months in Shenzhen, the capital of the hacker culture, immersing themselves in the flow of all the component parts of manufactured goods and the know-how of masters in manipulating them.¹⁹

Serve as a platform

Apple’s and Android’s success in pursuing “platform” strategies has been widely observed.²⁰ They provide a foundation on which many external parties can build by designing applications that will run on it. This makes it easy for these parties to create and capture value, and as they do so, the platform itself will become more valuable and its

creator more profitable. But to date, relatively few leaders have seriously explored how their own companies could potentially emulate this model.

Platforms, after all, can come in many forms. Take Quirky, a company that was envisioned from its inception to be a platform for independent inventors. Would-be entrepreneurs submit ideas for useful new consumer products, which Quirky engages a crowd to evaluate. For the three product innovations it launches per week, it provides full support from engineering to marketing, and splits any profits between itself, the inventor, and the voting crowd. At the time of writing this article, Quirky has developed over 420 products in this fashion.²¹

A valuable platform in a more familiar industry context can be found in Chongqing, China, the epicenter of the world’s biggest and most dynamic region engaged in the production of motorcycles.²² One of the largest manufacturers there, Dachangjiang, found itself short of high-quality local suppliers. Rather than try to build a single, verticalized channel of suppliers, however, it broke its design into several modules and, for each, awarded two to three suppliers the responsibility for developing parts.²³ The suppliers worked under common, tight timeframes, but were given great latitude to fashion the different modules, and assurance that Dachangjiang would support innovative designs with investments in the appropriate equipment and processes to build them. The suppliers responsible for each module found modes of collaboration that worked for them, and they varied; there were vertically integrated state-owned enterprises, traditional joint ventures, and more loosely coupled arrangements.²⁴ Interestingly, these collaborations didn’t end with participation on Dachangjiang’s platform. Some of them parlayed their new expertise into growth in adjacent markets, such as automotive.²⁵ Thus, not only was Dachangjiang’s need for a vibrant

supplier network met, but the network proved capable of far more innovation than would have occurred had it been directed and controlled by a single entity.

In each of these cases, the platform offers standardized interfaces and a plug-in architecture that can be leveraged by third-party innovators. Most of the costs of doing business are already embedded in that infrastructure, making it easier for smaller entrants to participate, either by targeting niche or emerging opportunities, or by offering something better to the platform's core market. And in each case, the platform thrives because everyone participating in it has a stake in its success. It's an arrangement that looks increasingly sensible as it becomes harder for individual firms to assemble and own the complete set of capabilities and knowledge required to sense and respond to market opportunities. Platforms are the bases of "business ecosystems," and a key dimension of future approaches to innovation.

Focus less on stocks of innovation than on flows

These dynamics point toward a similar conclusion: Leaders today might do well to reprioritize mastering "flows" of innovation over owning "stocks" of intellectual property. Economists have long recognized the important distinction between stocks and flows in terms of capital. But intellectual capital features both, as well. Traditionally, most businesses have focused on the stock—the patents a company owns, for example, and how to protect them. As John Hagel has observed, however, the dynamics of today's innovation advantages suggest greater focus on the flows—figuring out how to ensure a steady influx of new ideas and a process by which they will rapidly yield value.²⁶ Recall the motorcycle industry example cited above. Dachangjiang prospered more by facilitating flows than it would have

by protecting and exploiting existing stocks of industry-relevant knowledge.²⁷

Looking ahead

Various technology executives claim that by the end of this decade, everyone on earth will be connected.²⁸ We can therefore expect further acceleration of the tremendous changes already underway, with a continued rebalancing of the contributions to global innovation from emerging economies. The vectors, velocity, and variety of innovation can be altered fundamentally and permanently.

Today, awareness of the power and potential of this shift is limited. After all, it challenges more than a hundred years of history, and undermines deeply embedded assumptions. But the business world is adapting, and can, in the years ahead, rapidly adjust to the new reality. It will become an increasingly important agenda item for organizations to track, sense, and act upon. Businesses will likely work to develop more accurate sensing mechanisms in order to discover the innovations brewing around the world, and will embrace new models and innovation systems themselves.

The conventional wisdom around keeping a tight hold of ideas could become a drag on organizations that are too slow to let go of it. But as they necessarily engage in new forms of collaboration, many more will discover greater returns from facilitating flows of innovation through open networks. And they will come to recognize that their biggest obstacle to innovation is not the scarcity of ideas—rather it is the lack of capabilities to engage far-flung and unusual sources of perspective on a regular and ongoing basis. And successful innovation will continue to become far less mysterious, as what was once seen as "lightning in a bottle" is increasingly parsed, researched, codified, and turned into reliable (if never foolproof) methods.



My take

By J. P. Rangaswami, chief scientist, [Salesforce.com](https://www.salesforce.com)

Innovation is being democratized away from the insulated confines of the corporate lab and outwards toward the edges of social and market value webs. This transformation is being driven by three factors: the golden age of the platform, rivers of data being shared between connected consumers, and a growing awareness that the final value of things often expands tremendously when users are free to customize, collaborate, and recreate.

The golden age of the platform can be thought of as one of many small operating systems loosely connected. These coupled ecosystems are being developed in ways that allow for individual components to be constantly monitored, tested, altered, swapped out, or shut down. The resulting architectures are cohesive without being deterministic, allowing for rapid innovation at lower cost and without interruption. Success over these platforms is not dependent on accumulated knowledge or embedded infrastructure, so much as on the ability to swarm emerging problems and solutions quickly. Distributed networks of innovators are enabled by the very platforms that they now have the ability to change and improve. And those self-forming bands of problem solvers are essentially location-free.

Increasingly, we live within the so-called Internet of Things, a world in which everyone and everything is connected, with data being the essential lubricant. “Big data” and “analytics” have been buzzwords in the technology and corporate worlds for some time now, but the measurable impact and potential of this data is now starting to become clear. The truly stunning thing about big data is not how much of it there is, but its breadth of distribution. Current sensing, pulsing, and polling devices built into our digital worlds allow us to see one another, both as individuals and collectively, with the clarity that makes smart, data-driven, innovation possible practically everywhere.

As these ecosystems have developed, and as the amount and quality of data has improved, an enormous opportunity zone has opened. Salesforce has over 1 million developers, most of whom are not on our payroll, who customize the Salesforce platform at the point of usage to unlock value which often remains hidden to us at the hub. Rather than fight that, we run the company to magnify the innovation quotient at those distant transactional edges. End users might now find themselves delighted by the contributions of the whole ecosystem—customers, partners, and ISVs—augmenting the innovation they’re used to, delivered by the folks at [Salesforce.com](https://www.salesforce.com).

The bottom line

For centuries, Western developed economies have enjoyed an extraordinary set of advantages in innovation. But this is now, truly, a global game. After centuries of near uni-directional innovation—from the West to the rest—we are today in the early days of a massive rebalancing. As the nature and means of innovation changes dramatically, there will be new models, participants, and approaches, and amazing opportunities for established incumbents and emerging players alike.

Authors

Thomas Jankovich is chief innovation and growth officer for Deloitte Africa.

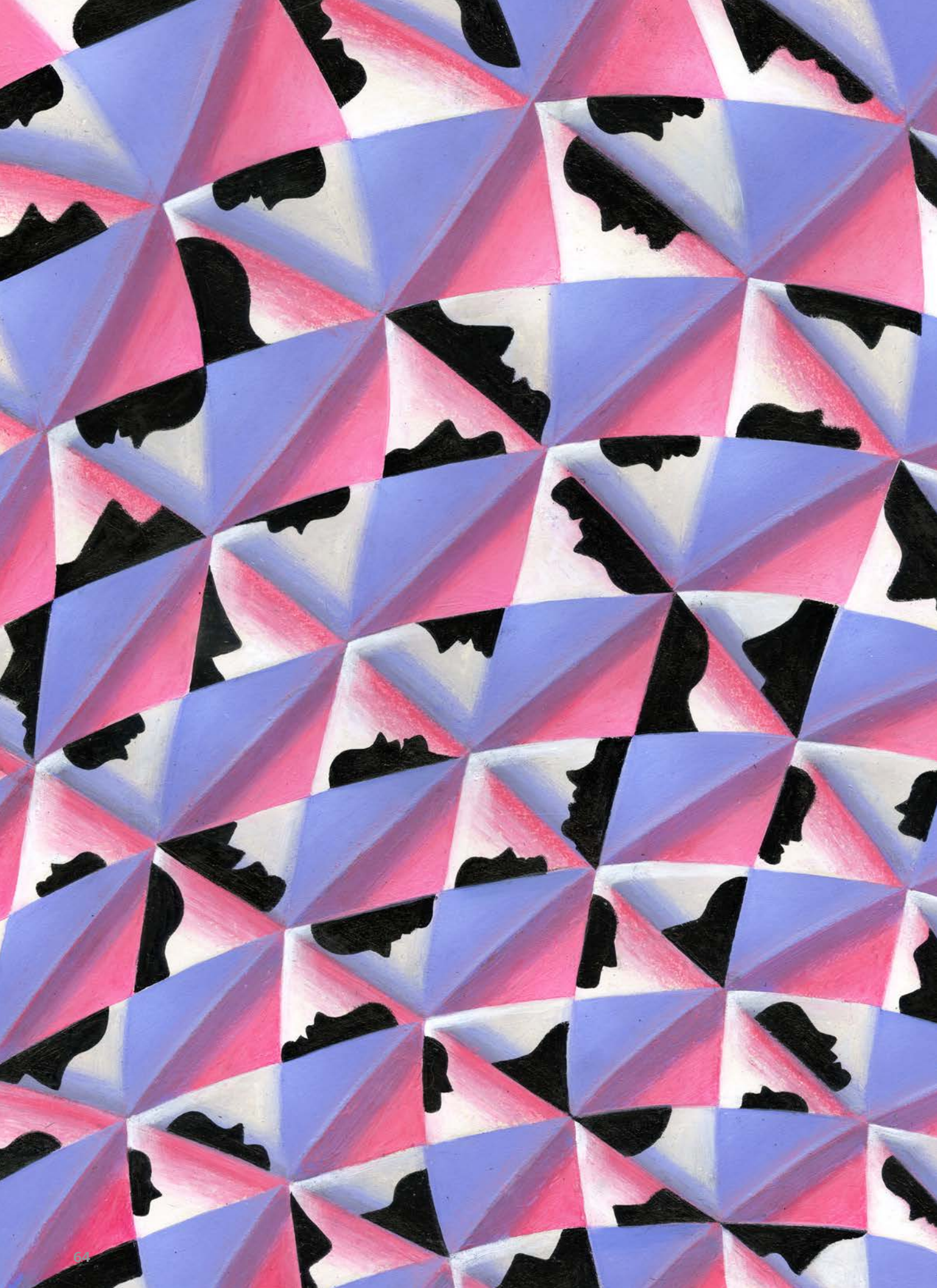
Eamonn Kelly is a director with Deloitte Consulting LLP in the US strategy service line Monitor Deloitte, and chief marketing officer of the Strategy and Operations practice.

Duleesha Kulasooriya is head of strategy at the Deloitte LLP Center for the Edge.

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Social business, global business

By Dr. Doug Palmer and Jonathan Star

Overview

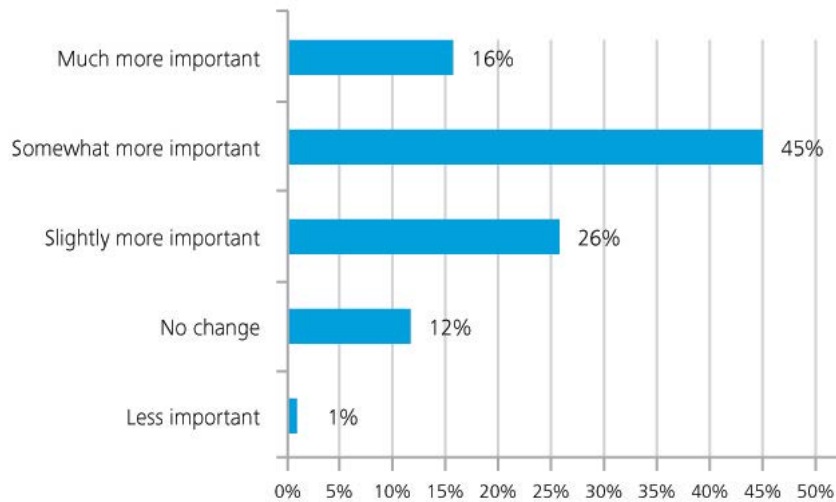
GLOBAL companies are maturing in their use of social engagement tools. They are going beyond seeing social as “media” they can use to broadcast marketing messages and, in a very important business trend, weaving social tools and interactions more into their everyday, global operations.

In line with this shift, business executives’ assessment of the value of social is changing rapidly. In a 2011 survey by Deloitte and *MIT Sloan Management Review* (of 2,500-plus managers across 99 countries and 25 industries), only 18 percent of responding executives said they considered social “important today.” When the study was repeated in 2012, that figure doubled to 36 percent. And most of the rest saw social capabilities quickly becoming more vital: More than half of the 2012 respondents said that social would be “important within the next year.”¹ The finding was supported by Deloitte’s 2013 Globalization Survey, a separate polling of 423 global executives. It found that 61 percent of these executives expect social media to become much more or somewhat more important to their company over the next three years (figure 1).²

To succeed in the years ahead, businesses will likely need the right balance of global reach and a local footprint. They will require a sharp awareness of problems when they arise and the flexibility to quickly reconfigure operations in response. Leading companies will innovate by collaborating with others. An increasing number of executives now recognize that “social business”³ offers a promise of progress across all of these dimensions. As corporate ambitions grow, so will the use of social tools. They can allow organizations to “be global” while removing many of the hurdles associated with “going global.”

Figure 1. The growing importance of social media for business

Looking ahead three years from now, do you think social media will become more important or less important to your company in the following locations?



Source: Deloitte Consulting LLP, *Deloitte Globalization Survey 2013*, 2013.

Graphic: Deloitte University Press | DUPress.com

What's behind this trend?

The foundational change driving companies' social engagement is the explosive growth in social media over the past decade, and most recently, on mobile devices. In just one year, between 2012 and 2013, the total global social media audience increased by an estimated 18 percent, from 1.47 billion to 1.73 billion—meaning that nearly a quarter of the world's population is now online using social networks.⁴ Facebook and YouTube are the largest social platforms, while China's QZone is third.⁵

An important consequence of this proliferation is the connection of people globally. While North America and Western Europe are the regions with the highest social media penetration on a percentage basis, the fastest increases in social user population are occurring in India, Indonesia, Mexico, China, and Brazil.⁶ Already, 86 percent of Facebook's

users are outside the United States,⁷ while nearly 20 percent of LinkedIn's users are in Asia.⁸ Unsurprisingly, given its overall population, Asia-Pacific overall has the highest raw numbers of active social media users. Within three years, the region comprising the Middle East and Africa is expected to have the second-largest social media user population.⁹ More interesting is the intensity of use in the Asia-Pacific region. For example, 82 percent of Thai smartphone owners access social media on their phones daily.¹⁰

A process of maturation

Despite the explosion of social networking taking place all around them, it has taken a number of years for executives in general to finally "get" social networks and the many ways they can contribute to business performance. Meanwhile, however, individual, ordinary people have embraced the full range of activity

available through social networks. They have used them to interact richly, to share content from others they like, to deepen relationships, to express themselves, and to take collective action. Ironically, businesses—which possess the highest-speed networks, the largest networks of contacts, and the deepest histories of interaction in traditional communication channels such as in-person, telephone, e-mail, and web—are today playing catch-up with their own consumers and employees as they try to tap into social networks for business value.

In a recent global study, Deloitte and MIT researchers concluded that companies progress through three stages in their use of social tools:

- **Early stage** organizations have established a social media presence, such as a Facebook page, a Twitter account, and/or participation in other platforms, and use it to share marketing messages or basic product information and respond to customer concerns and complaints. Over 50 percent of the organizations surveyed fell into this category.¹¹
- **Developing stage** organizations monitor the social networks in which they participate, listen to their audience's conversations, and compile data to discover patterns. They measure returns on their social investments, and they identify new ways to address business problems and improve processes with social tools and approaches. About 30 percent of the organizations surveyed were at this stage.¹²
- **Maturing stage** organizations build social capabilities into many aspects of their operations. They not only track what's being said, but they engage actively with ongoing conversations about their products, partners, industries, and issues. Their approach ensures that the marketing group isn't the

only part of the organization engaging with outsiders via social media. 17 percent of the organizations surveyed fell into this category.¹³

In a nutshell, most companies experience a social evolution from *listening* to *conversing* to *collaborating*, getting better along the way at managing each of these activities.

Increasing levels of collaboration

The jump in enthusiasm, and the more expansive thinking about the power of social networks, is likely the result of managers and leaders gaining more experience participating in them. Businesses began their social journey by using the new toolkit in limited, linear ways. By now, many have graduated to connections that are more rich and creative. In most industries today, there are innovative leaders whose experimentation with social is paying off, and with every smart, social move they make, their following grows.

Companies are embracing “enterprise social” platforms that provide organizations and their employees with a similar functionality to those provided by social networks like Facebook and Google+. Virgin America, for example, saw the need for an “enterprise social” platform to help address the challenges of business growth while maintaining its reputation for customer experience. Virgin America replaced its existing intranet with VXConnect, a network built on the Salesforce platform. Chatter groups let users collaborate and share critical, time-sensitive information such as weather-related issues and delays—which was used to good effect during recent storms on the East Coast of the United States. Ninety percent of Virgin America's employees never sit at a desk or in front of a computer, yet they are able to interact regularly, creating a collaborative culture and enhancing the customer experience.¹⁴

Because the functionality of Virgin America's Chatter is so similar to the social

networks that employees use in their personal lives, adoption was instantaneous and natural.¹⁵ The same was true at Fairfax Media in Australia when, as part of a larger 2012 transformation program, it moved its corporate email to Google's Gmail platform. During the mandatory changeover to Gmail, employees were also encouraged to adopt other Google applications at their discretion and begin using them to collaborate with their teams.

Fairfax Media employees who had used the tools in other settings were invited to act as "change champions" and help their peers understand how to get value from various apps. Within three months, Fairfax Media saw 50 percent of its employees adopt Google Apps—an impressive uptake for a toolkit that was purely voluntary.¹⁶

Some companies are pushing further with proprietary social tools to include external parties, and thereby creating broader collaborative networks of customers, strategic partners, and other stakeholders. A good example of an advanced social model is the use of crowdsourcing—going beyond traditional employees as sources of ideas and seeking the input of outsiders through distributed online communities.

Global scale, local feel

Today's global businesses may have hundreds of different forms of social media presence comprising multiple blogs, platforms, and sites. This large digital footprint presents

challenges. It makes brand consistency more difficult to manage. Organizations may not be getting the right information to the right audience. They may lack the resources or infrastructure to monitor sites effectively. The sites might not be engaging their intended audiences or generating the returns the company had hoped.

Some businesses are learning how to unify these campaigns and work at a global scale

while still presenting a local feel to the customer. MasterCard, for example, has issued more than 1 billion payment cards worldwide through 25,000 financial institutions in 210 countries.¹⁷ Rather than attempt to coordinate all the data on its own, MasterCard used Adobe Social, a tool that enables marketers to collect and monitor social feedback as well as interact through established platforms such as Flickr, Foursquare, Instagram, and

Today's global businesses may have hundreds of different forms of social media presence comprising multiple blogs, platforms, and sites.

LinkedIn. The system allows Mastercard to assess the effectiveness of social campaigns and manage social strategies. MasterCard now has 140 people worldwide using the platform to publish on Facebook, Twitter, and Google+. More importantly, it collects all the information in one streamlined system, giving MasterCard a global view of all social activities in the company.¹⁸

Cisco Systems Inc. now incorporates social data into its overall data strategy. Because it knows it is important to monitor, triage, and

respond to conversations as they happen across the global organization, it has created a kind of radar screen it calls the Social Media Listening Center. This capture of social activity is configured to allow viewers to focus on whatever aspect of Cisco's business they are curious about, from products to business unit performance to branding campaigns.¹⁹ The scale is global, but the benefits are local.

Implications

Deloitte's study with *MIT Sloan Management Review* found that many organizations encounter common barriers as they venture into social business. These include a lack of overall strategy, security concerns, and limited understanding by management.²⁰ The result is that more than four in every five businesses has substantial room for development. In a survey conducted by Adobe of 750 marketing professionals, 88 percent of respondents said they couldn't accurately measure the effectiveness of social campaigns, and the majority responded that determining the true return on their social investments was their biggest challenge.²¹

To make progress, many organizations will need to institute a strategy, a governance structure, and an education process for aligning their social efforts. They should be thinking creatively about how social business could pervade every major function and goal of the global organization.

In sales, the biggest challenge is to capture the information gained from social conversations with customers and prospects—from personal interests to experiences with competitors' offerings to usual buying habits—and link it to the enterprise data contained in customer relationship management (CRM) systems. When the dots are connected, a sales force can gain the insight it needs to anticipate customers' needs, enhance service and support, and

even automate the delivery of tailored content and promotions.

In HR, social shows its other side—as a network of connections not to customers but to talent markets. Social engagement tools are now used heavily by recruiters and also play an increasingly important role in employee engagement and retention. In a Deloitte survey in the Asia Pacific region, we found a gap between consumers' and employees' needs for social tools and businesses' ability to provide them. For example, employees without access to flexible IT policies (such as social media access) are less satisfied with their jobs. Data from Australia and New Zealand also suggest that access to social business tools could be a pivotal factor in attracting and retaining key talent.²²

In many other functional areas, companies will also continue to find ways to work more effectively as social businesses. They will likely become more collaborative and open in their innovation, more empathetic and responsive in their customer service, more adept in crisis response, more transparent in social responsibility, and more engaged in investor relations. On this last point, an example is the tweet that eBay's CEO posted on January 22, 2014 as the news swirled that activist investor Carl Icahn was applying pressure on his company to sell its payments processing unit: "Spoke w/Icahn abt PayPal spinoff idea. We believe it's more valuable as part of @ebayinc. More on call today."²³ Clearly, social business is beginning to transform the practice of leadership.

Looking ahead

The company GiffGaff shows how different a business can be when it is designed with a clean slate in the social era. GiffGaff sells prepaid SIM cards in the United Kingdom. It has just 14 employees and no call centers, yet it competes effectively against giant mobile phone providers. GiffGaff took a four-stage

approach to social business, starting with a customer dialogue that helped it define and refine its product. All the company's customer service is online, and it keeps support costs low through notice boards, customer generated "tips and tricks," and peer-to-peer support. Users are encouraged to participate through a payback scheme that awards them "kudos points," which can be redeemed for phone service or donated to charity. Kudos points also are awarded to customers who promote GiffGaff through social networks, which are the channel for most of the company's marketing.²⁴ Almost nothing about GiffGaff's business, in other words, is untouched by social.

We see the same in the world's most dynamic organizations and movements—those that are recognized for fundamental innovation. They now use social tools to leverage networks of partners and co-creators to generate value. As globalization continues, and the business environment becomes more complex, most businesses with global ambitions will become increasingly social, both to improve connections and collaboration internally, and to exert influence in networks and communities externally.

Will we see a next level of maturity in the use of social networks and tools? There will

be mounting expectations by stakeholders for engagement, transparency, and accessibility, and the effects of these on the shape, management, and mission of the typical organization will be far-reaching. Leadership hierarchies featuring rigid roles and relationships to stakeholders will be examined with a focus on the need for greater flexibility. Organizations will need to define appropriate governance structures for managing their social activities—and global organizations will find this challenge to be multiplied. Indeed, our research shows that those firms claiming the greatest value from social business are also experiencing the most significant challenges with culture, language, and business process issues as they work across countries and regions.²⁵

Social business encourages transparency and distributed innovation, where anyone is empowered to create value. By breaking down functional, organizational, and global barriers, it will upend the nature of work. Business interactions are no longer bilateral conversations with co-workers or customers, but an ongoing dialogue with the world. In the years ahead, social business will likely lead to remarkable shifts in how we define our organizations and their place in the world.



My take

By Lisa Gansky, entrepreneur, investor, speaker, chief instigator of Mesh Labs, and author of the bestselling book *The Mesh: Why the Future of Business is Sharing*

As organizations mature and embrace social tools, it is important that they see social as the start of something, not just a milestone to reach. Social business means that communication becomes personal, authentic, and timely. It means that the boundaries of businesses get reshaped, the “surface area” increased, so that there are more touchpoints with the world outside and more ways to create value with others. And it means organizations can become pollinators of ideas, both locally and across geographic boundaries.

I see social business as the core asset for improving the connections between different interests and communities within organizations. Even more powerfully, there is more capacity and necessity to interact with the environment outside. Today, global corporations exist within ecosystems along with communities of customers—individuals with incredible talent and investment coming from many different places. Social business creates a semi-permeable membrane that allows ideas to flow more freely than before. We are living in a time when “many-to-many” connections promote vitality and resilience of brands, communities, and our economy.

General Electric is a great example of a well-established, traditional organization that is using social tools in a sophisticated fashion. Look at the company’s website today, and you’ll find it surprising. Instead of an “industrial” outward face describing its technical products and services, the home page invites engagement through Twitter feeds, children’s art, and 3D printing stories. This is a powerful illustration of how conventional value chains are dissolving and how design and manufacturing are being transformed. In 2013, General Electric launched a jet engine bracket challenge on its website. They asked participants to submit designs to optimize an existing bracket. Seven winners were announced (none of which were from the United States), and their designs were prototyped and additively manufactured. The result was a much lighter product, providing promising savings in materials and fuel costs.

General Electric, along with many other organizations, is building its “muscles” around social business. Like exercising, they are starting programs, learning what works, refining their approaches and, over time, building their reputations. Define, refine, and then scale what works. It is also quite likely that no product or business model scales globally without geo-specific modifications. In this way, platforms enable an iterative and continuous cycle of defining and refining models, offers, products, and teams.

I think that global organizations have a tremendous opportunity—and responsibility—to be effective curators and connectors of ideas across both industry and geographical boundaries. We know that there are talented people in all corners of the world—how does one discover, build trust with, and effectively connect with them? There is now an imperative for global organizations to explore how they can utilize social tools to build trust and engagement with pockets of local talent. There is an obvious partnership between nimble and highly specialized independent talent and the reach of a well-established, global corporation. Companies that learn first about how effectively to build trust and pollinate winning ideas will likely reap the benefits for themselves and for the broader ecosystem and community.

The bottom line

While “social media” caught on instantly and globally, “social business” has taken longer to get going. There are few truly sophisticated corporate users of social. But as social media, technologies, and data are more broadly used within global companies, maturity is growing. Executives are realizing that establishing a social media presence and acquiring the associated technology is simply the first step of the journey. They are building the processes and the organizational structure to succeed as social businesses.²⁶

For many, the development of social business will mean very real and radical changes—not only to businesses’ relationships with customers, but to their operations and to the very nature of their organizations. With each year, more businesses will invest in and grow their social business capabilities. They should—both to facilitate coordinated activities across the global enterprise, and to forge connections to the communities and ecosystems that will determine their future success.

Authors

Dr. Doug Palmer is a principal at Deloitte Consulting LLP and the leader of Deloitte’s Social Business practice.

Jonathan Star is an independent researcher and workshop facilitator.

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Anticipatory supply chains

By Kelly Marchese and Bill Lam

Overview

TOYOTA got a wake-up call in March of 2011, and by extension so did everyone else who believes in disciplined operations management. That was when an earthquake registering 9.0 on the Richter scale hit northern Japan, unleashing a massive tsunami. In the coastal communities directly in its path, the human toll was devastating and the rebuilding task a monumental challenge. The world watched nervously as the damaged Fukushima nuclear power plant threatened to melt down. Later, for Toyota, it became evident how awful this natural disaster was for its global business. The company had recently attained the position of best-selling automaker worldwide, in part because of its tightly managed supply chain. Over the course of many years, it had taken the slack out of its operations, using just-in-time delivery of parts to keep inventories to a minimum. But having pruned its supplier base severely, in some cases to single suppliers of certain parts, it now found itself more vulnerable than it imagined. The disabling of a few parts makers in Japan meant that assembly lines ground to a halt as far away as China and North America. Globally, March production dropped by 29.9 percent. It took six months for suppliers to get back to delivering products in required volumes.¹

Stung by the experience, Toyota set out to revamp its supply chain in such a way that the time required to recover from large-scale disruption would be reduced to at most two weeks. It wasn't possible to get to that goal simply by learning to mobilize better in the aftermath of disaster. Toyota's supply system had to learn to *anticipate* problems—if not always the catastrophic event itself, then the knock-on effects it would have. Management embarked on an initiative to expose vulnerabilities and rank them in terms of likelihood and potential impact. The company worked with more than 500 suppliers to create greater visibility throughout a multi-tier supply network and to either spread production across multiple locations or maintain larger inventory buffers. Most strikingly, the automaker decided to reengineer many of its 4,000–5,000 vehicle components so that across different models, common parts could be used. The point was to raise the order volumes of those parts to the point that suppliers could justify building additional manufacturing facilities, providing a hedge in case one went offline.² Put the changes together, and Toyota now has a more forward-looking, prepared, and effective supply chain.

Toyota's example offers an extreme form of a problem many others are experiencing, and a particularly rich version of a solution that other leading companies are pursuing. In all kinds of product businesses, supply chains that were first formed accidentally, then optimized for efficiency, are now being reworked with an important goal: to make them anticipatory.

What's behind this trend?

Increasingly, supply chains are being designed and built to anticipate disruptions and reconfigure themselves appropriately to mitigate their impacts. What's behind this major trend in operations management? Certainly, advances in information and communications technology are making it more possible. At the same time, a volatile business environment is making it more necessary. Whether it's a spike in demand for a particular product in a locale, act of war or terrorism, labor dispute, regulatory change, or supplier bankruptcy, companies are learning to count on the unexpected.

More than anything, the trend reflects a growing belief that operations management in the past has overemphasized certain themes. A decades-long focus on optimization, seeking ever-lower costs, has resulted in supply chains that are too lean and too brittle. Even the more recent emphasis on resilience, while important, casts companies in too much of a reactive mode.

Like so many realms, supply chain management has been marked by eras of theory and practice. To appreciate the importance of the current trend, it is useful to review that evolution.

The accidental supply chain

It is easy to forget that before the 1980s, the term *supply chain* was not in common use. The first era of supply chain management came about as information and communications technologies were invented that enabled better

coordination of activities taking place in different facilities. As coordination costs dropped, operations that had been most economical to keep under one roof splintered into separate functions and then further into independent, subcontracting businesses. Meanwhile, products themselves grew in complexity. As "de-verticalized" organizations produced more component-packed offerings, traditional logistics managers suddenly had many more "links" to worry about.

As globalization and other developments complicated their operations further, managers made hundreds of adjustments. Serving a new market, working with a new acquisition, or accessing a new resource location required that things be changed about where goods were made and moved. In most cases, managers made pragmatic decisions that were right for the particular moment and allowed the company to meet each new challenge. However, the cumulative effects of these stopgap, piecemeal measures were "accidental supply chains"—unintentional mixtures of components that often worked at cross-purposes.

The optimized supply chain

For many organizations, the 1990s brought a strong focus on operational processes and supply chain rationalization. Effective management of extended supply chains was perceived as a technical, optimization problem. Major overhauls were undertaken, targeting greater overall performance and maximum cost efficiency. Where tradeoffs were involved and a balance had to be struck, there was a strong new understanding that operations decisions must be guided by the product strategy spelled out by top management. For suppliers, there were often more rigid contractual terms, such as service level agreements. Supply chain managers focused on transactions that were narrowly defined and highly structured and recognized clear distinctions among buyers, suppliers, and competitors.

As a result, most organizations had supply chains built to support an existing strategy—they identified the value drivers and aligned the supply chain with them. Global control was exercised from central locations, which worked well in an environment in which companies faced infrequent changes or disruptions. Organizations created “backbone systems,” which instilled a form of predictable order to a supply chain, but also created inflexibility.

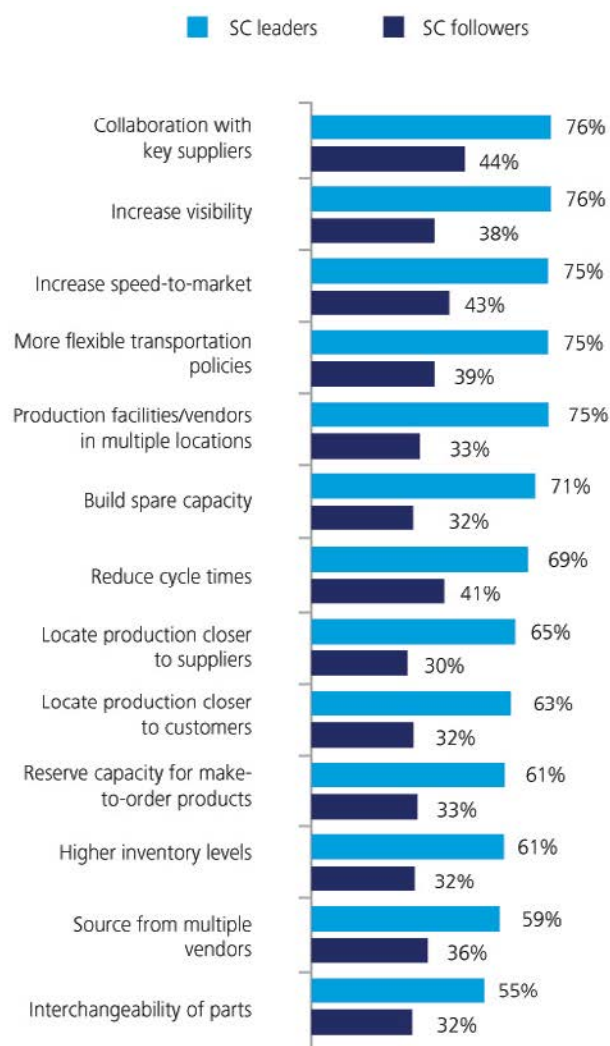
Increasingly, supply chain success was driven by the organization and management of data. Integrated systems afforded an overarching view, and businesses began to realize the value of this improved visibility. As they gained the ability to share information instantaneously within and across enterprises, managers realized that a system traditionally based on a “push” model could flip to a “pull” model. That is, rather than predicting what would sell where, and translating those inevitably flawed forecasts into manufacturing and distribution schedules, producers could wait for demand to reveal itself, then respond in an agile fashion, facilitated by “just-in-time” arrangements with suppliers. System-wide inventories could be minimized in very lean chains.

The adaptive supply chain

After a series of shocks heightened the awareness of supply chain risks, companies moved into a new era of operations management. The “backbone” approaches to supply chains had proved too rigid and slow to respond to the dynamism of the global marketplace. The theme now was to make the supply chain more adaptive and resilient. Supply organizations evolved, in both their structure and their goals, from linear supply “chains” into broader and more complex supply “networks.” Supply chain top-performing companies, “supply chain leaders,” are roughly twice as likely as other organizations to take steps to increase the flexibility and resilience of their supply chain to respond to disruptions or unexpected changes in demand (see figure

Figure 1. Steps used to increase supply chain resilience

Which of the following steps has your company taken to increase the flexibility and resiliency of its supply chain to respond to disruptions or unexpected changes in demand?



Source: Deloitte Consulting LLP supply chain survey (forthcoming in 2014).

Graphic: Deloitte University Press | DUPress.com

1).³ These steps usually focus on collaborating better with key suppliers, increasing speed to market, and implementing more flexible transportation policies.⁴

At the same time, sustainability imperatives found their way quickly into supply chain agendas. The need for closer tracking on this front led to new investments in collaboration and transparency. Heineken, for example, implemented a new IT platform to store and share data on suppliers in 100 countries. The system rates each supplier's performance against 21 environmental and social criteria.⁵ Nike committed to zero discharge of hazardous chemicals throughout its supply chain by 2020. To assist with that commitment, Nike has partnered with Bluesign Technologies in order to use more sustainable materials and chemicals in its products. These tools improve and hasten Nike's ability to evaluate its suppliers on sustainability performance. In addition, the Bluesign tool can be used by Nike suppliers to improve their sustainability results by accessing data from pre-screened, sustainable textile preparations including dye systems, detergents, and other chemicals used in manufacturing processes.⁶

While most companies focused on recurrent, low-impact risks, some also worked to protect themselves against improbable but massively consequential events—the kind of occurrences Nassim Taleb refers to as “black swans.”⁷ Their analyses and simulations led them to urge component makers and sub-assembly service providers to disperse their manufacturing geographically and for any given set of parts to avoid concentrating facilities in single countries or regions. The more adaptive supply chains they built helped their organizations compete amid rising uncertainty in the global marketplace.

Fast-forward to today, and leading global corporations are building resilient supply networks not just to withstand but to expect shocks. They know that in order to succeed in

the next wave of globalization, it is important to embrace this new era of operations management—the anticipatory supply chain.

Implications

For other organizations, the implication is very clear: Competing successfully will depend on keeping pace with this trend. The details of how to create an anticipatory supply chain will vary from sector to sector and even company to company. However, a few principles will apply in general. Going forward, supply chains must rely more on advanced analytics to gain predictive power. They must not only be aligned with business strategy after it is set, but be integral to its formulation. They will require new kinds of leadership, and diversified talent in the ranks. And paradoxically, in businesses that are more truly global than ever, many will benefit by being more regionalized.

A tighter connection with strategy

In the past, supply chain arrangements were kept separate from conversations about strategy. The supply chain team had to determine the best method for meeting a product strategy's requirements once the big goals had been set—which, of course, gave rise to “accidental supply chains.” Driven by greater global complexity, supply chain considerations are becoming central to strategy-making. Leading supply chain companies acknowledge the critical connection between supply chain and strategy; less successful companies focus more on how the supply chain contributes to operational performance. In Deloitte Consulting LLP's 2013 supply chain survey, 98 percent of “supply chain leaders” said that achieving global growth objectives was an extremely or very important objective of the supply chain.⁸

Particularly given their focus on risks, anticipatory supply chains should be thoroughly integrated with the formulation of business strategy. An interesting implication

of this is that executives at the highest levels of an organization may likely expect and demand greater leadership of supply chain functions.

New kinds of talent

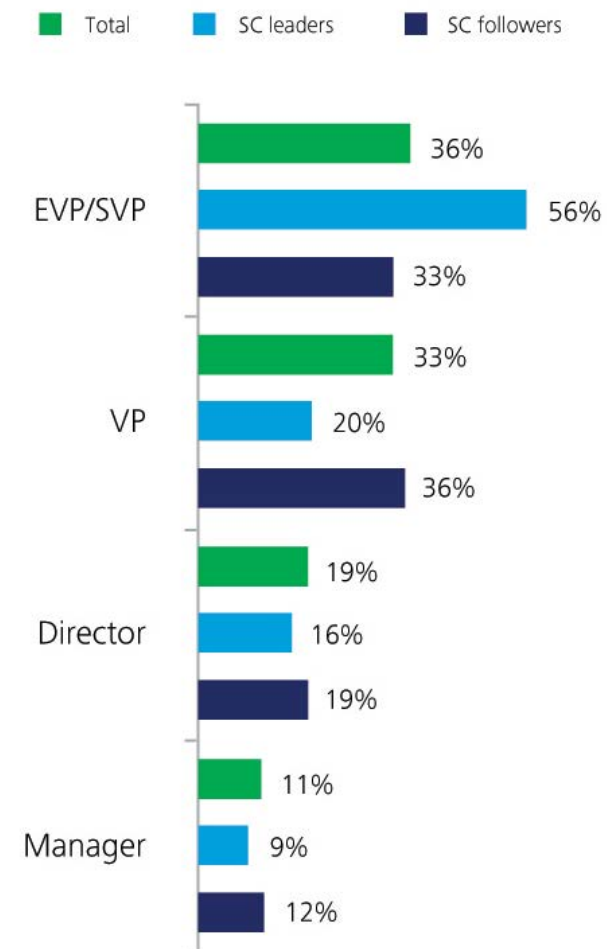
A new type of leader, and new types of talent, may be required in many companies' supply chain organizations. In the recent past, an executive could make a brilliant career out of managing supply networks and heroically responding to periodic supply disruptions. Not much deeper into the past, supply chain leaders tended to be veteran managers steeped in industry and institutional knowledge and interested in mentoring junior staff in the long-established ways of doing things. No more was needed when supply chains confronted a limited number of repeatable risks that could be managed through annual risk mitigation processes.

But the age of the anticipatory supply chain will require a more integrated background—executives who combine global experience with creative problem-solving and analytical skills—true innovators who are also disciplined operators. Already, many companies are giving more authority and responsibility to supply chain executives because they are recognizing that supply chains are vital to the future of the organization. Increasingly, top supply chain executives have gained that coveted “seat at the table” in strategy development. The results of Deloitte's recent supply chain survey underscores this phenomenon. Fifty-six percent of supply chain leaders' companies are headed by a supply chain EVP or SVP, versus only 33 percent among supply chain followers (see figure 2).⁹

Career paths like Marillyn Hewson's may become more common. In 30 years with the aerospace company Lockheed Martin, she has held a variety of roles, including vice president of global supply chain management. In January 2013, Hewson was named president and CEO.¹⁰

Figure 2. Head of supply chain function

What is the title of the most senior executive in your company's supply chain function?



Source: Deloitte Consulting LLP supply chain survey (forthcoming in 2014)

Graphic: Deloitte University Press | DUPress.com

Regionalization

As multinational corporations embark on a new wave of globalization, it is interesting to see that the drive to make supply chains more nimble and adaptive is leading to greater regionalization.

In the new wave of globalization, the simple trade flows familiar to most managers—that is, low-cost producers in the East supplying

products to rich consumers in the West—are giving way to far more complex patterns. In parts of the world that have been centers for low-cost manufacturing, new wealth has been created and consumption is rising rapidly. The trend is most evident in Asia, where powerful productive capacity now sits alongside growing market demand.

Corporations spotting revenue growth opportunities in these markets are scrambling to adapt supply arrangements. In general, they are redesigning supply networks to be able to match demand and supply within the same region. For that matter, as wage rates rise in Asia, more companies are backing away from the sourcing arrangements that made China the “workshop to the world.” The trend is toward “near-shoring,” tapping into production capacity closer to prime markets.

Even in markets not known for low-cost inputs to production, companies are reweighing the costs and benefits of more localized supply networks. Most of the suppliers for blender manufacturer Vitamix, for example, are within 100 miles of its headquarters in Olmsted Township, Ohio. The company sees the proximity as essential to maintaining dialogue with its suppliers about its growth plans and strategic issues. Mutual understanding and commitment are essential because, in some cases, Vitamix asks suppliers to make capital investments before the growth actually occurs.¹¹

Looking ahead

We expect that the vision of the anticipatory supply chain will take years to realize fully. At every step, the most effective organizations will be those applying cutting-edge technology to enhance their real-time understanding of activity in complex supply networks, and to improve the economics of having production capacity closer to consumption locales.

As the Internet of Things expands and companies’ analytics become more sophisticated,

predictive supply decision making will increasingly become automated. Sensors signaling disruptions or unexpected activity in remote corners of the world will trigger appropriate adjustments in the flows of materials and energy.

Other technologies will reshape global supply chains. The evolution of additive manufacturing, or 3D printing, has the potential not only to transform the manufacturing process for some goods, but to greatly reduce or even eliminate the need for shipping them across long distances. Much of the excitement about the technology is based on the prospect of being able to manufacture replacement parts rather than having to stock large varieties of them “just in case”—or else incur delays while they are shipped from centralized warehouses.

Ever more sophisticated robotics will also allow for manufacturing schedules to turn on a dime. This is why Apple is investing a reported \$10.5 billion in advanced production automation. The company is striking deals that will give it exclusive access to technologies for all kinds of tasks, from polishing the colored plastic of iPhone® 5c mobile device cases to laser-cutting the aluminum bodies of MacBook® computers.¹²

In late 2013, Jeff Bezos, the Amazon CEO, used the opportunity of a *60 Minutes* interview to unveil what he sees as an inevitable development in package delivery technology:¹³ unmanned aerial vehicles, akin to those employed by the US military for targeted strikes on enemies, used to drop parcels at consumers’ doorsteps. Given Amazon’s dozens of huge fulfillment centers scattered across the United States, the drones could enable a customer placing an online order to have it in hand within half an hour.

New technologies like these—and this is only a sampling—will guarantee that supply chains grow ever more anticipatory, and that the ideal way to buy, make, and move a given product will perennially need rethinking.



My take

By Kurt James, VP of supply chain, McDonald's Japan

McDonald's' supply chain is designed to be efficient, adaptive, and collaborative, providing a unique competitive advantage that has enabled McDonald's to enter new markets at a scale and pace that is unmatched by our competitors. From my perspective, the heart of an outstanding supply chain is trust and transparency, features that contribute to natural resilience and provide a level of nimbleness not possible in more guarded systems.

We talk about the supply chain at McDonald's as a *shared* system, rather than as *our* system. This mentality of joint ownership allows us to work as one efficient organization with our suppliers, planning for the future and adapting to the present in a cohesive and integrated way. Whereas a traditional supply chain may show cracks under the pressure of unforeseen political, environmental, or competitive changes, I view the McDonald's supply chain as having a fundamentally cooperative core that can absorb the shocks produced by unforeseen circumstances and rapidly adapt to frequently changing demands, specifications, and volumes. The flex comes from mutuality and collegiality. It is resilience built from trust.

This flex, and the trust it is anchored in, is produced by the interplay of a few factors, including our open protocol policy, an infrequent use of contracts with suppliers, and the type of people we choose to hire into supply chain leadership at McDonald's. Our open protocol policy creates a two-way street of transparency, allowing McDonald's clear views into the operations of suppliers and, in turn, providing suppliers with equally clear sightlines into our operations. When hiring, we look for people with character traits uniquely suited to our supply chain—namely, an innate sense of fairness and an ability to consistently empathize with the challenges suppliers face in meeting our often aggressive deadlines, standards, and evolving needs. Instead of gravitating toward contract reviews as the essential means of adjusting our supplier agreements, I often encourage my colleagues to approach negotiations through open and honest conversation followed by handshakes and good-faith commitments to doing the right thing.

The resulting system is one of unparalleled connection, collaboration, and mutuality—a deeply human system enabled by state-of-the-art technology and information flows—that has allowed McDonald's to set and achieve aggressive growth targets, test innovative supply chain practices, and ultimately provide the quality expected by our customers regardless of location, external environment, and other potentially disruptive factors. I often feel as though I can make demands of my suppliers that our competitors cannot, because our suppliers understand the strategic underpinnings of our demands and trust that we all ultimately share the same goal—consistent adjustment of the system toward the better. I've learned that doing the right things for the system as a whole provides all participating players with the highest odds of long-term success.

The bottom line

For companies competing on a global scale, things can change quickly, and not only due to unexpected breaks in the supply chain. Sometimes it's a disruptive technology or abrupt market shift that forces a reconsideration of how a company operates. Five years ago, Dow Chemical, a US chemical company, was moving its domestic manufacturing to the Middle East to take advantage of cheap natural gas and proximity to Asian markets. Gas prices in the United States were expected to keep rising along with labor costs. The advent of new drilling technologies such as hydraulic fracturing, though, unleashed an abundance of cheap, domestic natural gas. As US prices plunged, the company moved quickly to shift manufacturing back to its home soil. It's now spending \$4 billion to build a plant in Freeport, TX, and to reopen another in Hahnville, LA.¹⁴

Companies can't rely on supply chains they built piecemeal as they grew. Nor can they expect that simply adapting or reacting, however quickly, to disruptions or market changes will keep them ahead of the competition. As linear supply chains evolve into rich supply networks, the companies that are best positioned for growth may be those that see these networks as core to their business strategies. Their supply chains will not only perform efficiently under normal conditions, or recover quickly from disruptions, but may also be able to spot risks and avert them, and help leaders throughout organizations to anticipate the future.

Authors

Kelly Marchese is a principal with Deloitte Consulting LLP and leader of the Supply Chain Strategy practice.

Bill Lam is a senior manager with Deloitte Consulting LLP in the Supply Chain Strategy practice.

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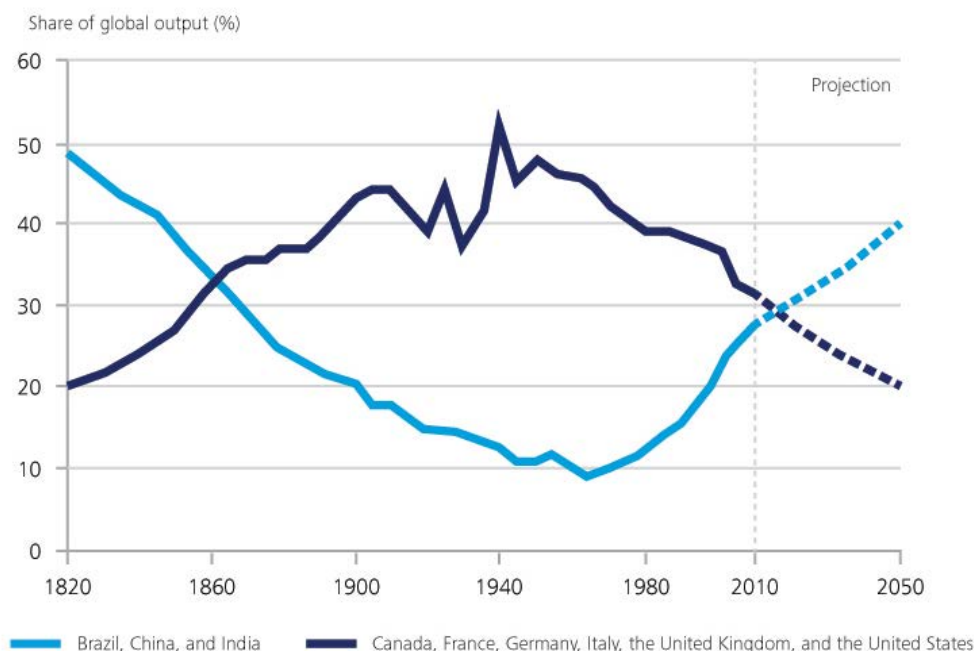
New leadership

Section overview

PERIODS of turmoil, disruption, and uncertainty have been, almost invariably, accompanied by shifts in leadership—of industries and institutions, and at the individual level—due to the creation of new imperatives. The three remaining trends we highlight for 2014 touch on all these levels. At the level of global industries, we are seeing new organizations

emerge as leaders, challenging the influence of established players. The powerful influence of developed-economy (and primarily Western) institutions—including corporations—is being eroded. For the first time in 150 years, the combined output of the developing world's three leading economies—Brazil, China, and India—is about equal to the combined GDP

Figure 1. Brazil, China, and India combined are projected to account for 40 percent of global output by 2050, up from 10 percent in 1950



Note: Output is measured in 1990 purchasing power parity dollars.

Source: UNDP, *Human development report 2013: The rise of the south: Human progress in a diverse world*, 2013, figure 3, p. 13, <http://www.undp.org/content/dam/undp/library/corporate/HDR/2013GlobalHDR/English/HDR2013%20Report%20English.pdf>, accessed January 30, 2014.

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of the long-standing industrial powers of the North—Canada, France, Germany, Italy, the United Kingdom, and the United States (figure 1).¹ In the next wave of globalization, leadership and influence—and new business practices—will emerge from new corporate players.

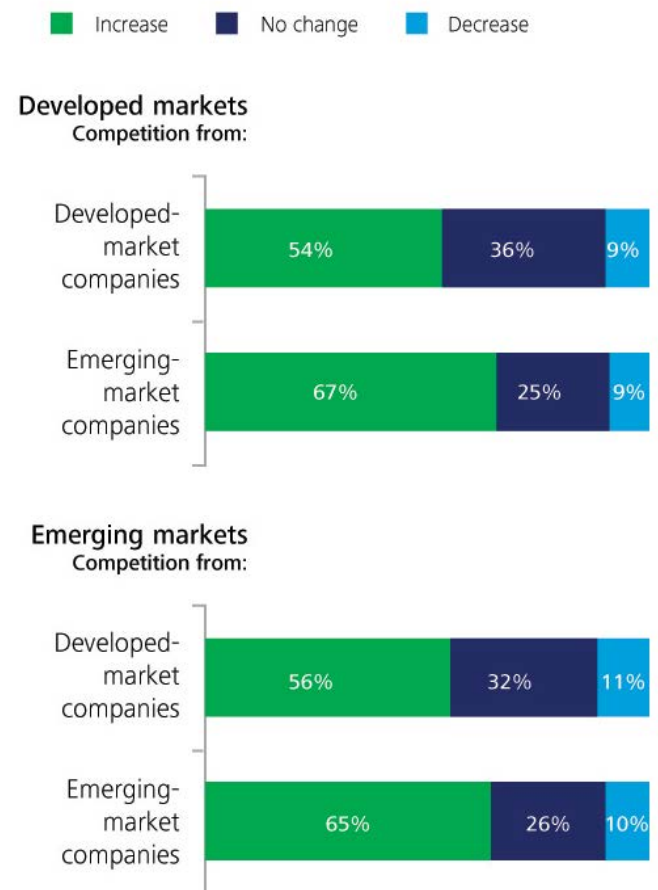
Leadership in the next wave of globalization will be made up of a much more global and diversified group of companies than ever seen before, with much of the ideas and influence emanating from emerging markets. Western corporations have long provided almost unchallenged leadership in most industries—and have in fact created most of them. That is no longer the case. In our survey, over the next three years, business executives expect competition from companies headquartered in emerging markets to become more intense, exerting more of a leadership influence than ever before (figure 2).²

In the chapter on **giants, old and new**, we describe how “new global giants,” grown from the soil of emerging markets, are gaining the leading capabilities and reach formerly enjoyed almost exclusively by Western multinationals. We expect to see the global business landscape change as companies from very different backgrounds, cultures, and systems compete with each other. The chapter outlines the arguments that highlight how new corporate players are becoming globally influential, and also discusses the challenges that these emerging-market giants will face. As rivalry becomes more intense, both emerging giants and established players have much to learn from each other as they strive to become truly world-class global organizations.

In quite a different sense, leadership is transforming for individual business executives, as the changing business scene compels them to shift their attention to new priorities. As the most striking example, **the chief financial officer (CFO) becomes the chief frontier officer**. One notable consequence of the changing global policy landscape is that we are

Figure 2. Expected change in competition over the next three years

Looking ahead over the next three years, how do you think competition in developed markets/emerging markets from the following types of companies will change?



Source: Deloitte Consulting LLP, *Deloitte Globalization Survey 2013*, 2013.

Graphic: Deloitte University Press | DUPress.com

likely to see divergence in regulatory environments affecting businesses—with implications for tax, audit, capital market, and other finance functions. Thus CFOs of growing global companies are increasingly being called upon to understand and manage a much broader set of business issues than they often oversee in their home or core markets. While the chief executive officer (CEO) is ultimately accountable for the successful growth of the company, the CFO is often the person to assume the helm of strategic decision making abroad, particularly in emerging economies where little organizational infrastructure is in place. Exploring new frontiers needs the objective, quantitative skill set intrinsic to CFOs. However, CFO roles will often go beyond the traditional market entry analysis to also lead on-site business operational needs.

Our final chapter also describes a shift within organizations' top leadership cadre, but here we argue that the need for change goes

beyond changing responsibilities for particular executives. Instead, we ask whether it is time for **C-suite version 3.0**. This chapter explores the composition and role of the group of senior-most executives who routinely convene to chart the strategy of the enterprise and ensure its implementation. Between the mid-1980s and mid-2000s, the size of the C-suite doubled from five to ten, with approximately three-quarters of the increase attributed to functional managers rather than general managers.³ This disaggregation of leadership and decision making along functional lines was appropriate as organizations expanded their reach and influence. However, in this chapter, we argue that this model might be less suitable for the complex, integrated challenges that lie ahead for global companies. Additionally, we outline the dilemmas that the new model C-suite must master and describe a number of critical new roles that CXOs must play.

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Giants, old and new

By Pedro Arboleda, Don Derosby, Eamonn Kelly, and Kishore Rao

Overview

IN the 1970s, American and European auto executives were shocked by the rapid appearance in their home markets of powerful Japanese competitors. In the following decade, new players from fast-growing Asian economies arrived on the global stage in several industries. And over the past 20 years, many “new global giants” have grown up in the fertile soils of emerging markets—firms such as Embraer, Tata, CEMEX, Grupo Bimbo, JBS, Bharti Airtel, Mahindra & Mahindra, Lenovo, and Haier. They have become serious, regular competitors to the Western multinationals that had long dominated their industries.

This time around, the emergence of powerful new players should be no shock. In many industries, from beer brewing to automobiles to IT consulting, companies whose names were largely unfamiliar in the West just a decade ago are now firmly established in the top pack of global leaders. But it is not yet clear who will hold the advantage in the years ahead, as the newer players progressively increase their focus on winning in mature, developed-economy markets. As many Western businesses have experienced, expanding from one’s accustomed home markets to less familiar new ones is far from straightforward. Will the distinctive strengths of the new giants prove to be well-suited to the demands of the future? Or will the advantages of the longer-standing incumbents help them prevail?

The answer is likely to be “neither.” For we are seeing a trend: Market leaders from both the developed and emerging worlds are seeking to learn from each other to master a multi-dimensional game. They use certain moves as they venture into new territories, others as they compete with familiar rivals in their home markets, and still others as they defend those traditional markets against invasions by new entrants. To resort to a sports analogy, it’s as though some managers have been boxing and others wrestling, but now all are finding themselves in a mixed martial arts match. The best of them are learning fast. The least agile may go home losers.

What's behind this trend?

The first generation of large, powerful industry leaders essentially emerged from developed economies. In the closing decades of the 20th century, these same players were also the early beneficiaries of the steady growth in globalization, having cut their teeth in demanding and sophisticated markets. Companies like Yum!, Colgate, and Unilever led the charge, pushing vigorously into emerging markets that provided them with substantial new growth opportunities—and that today account for the majority of their sales.¹

Coming from similar business environments, these players had broadly comparable strategies, management methods, and theories of competition. And for a while, it appeared that the developed economies had perhaps discovered the ultimate formula for global business success. Indeed, as growth in emerging markets created opportunities for ambitious local competitors, many of these new players succeeded in part by becoming avid students of Western and Japanese management practices, often proving to be fast learners. However, these learners were also creating their own tricks, developing new and different capabilities as they served their own challenging markets. Over time, many have used these skills to

become serious rivals to more established firms in markets all over the world.

Take, for example, a classic strength of emerging-market giants: their ability to bring straightforward, no-frills solutions to customers who cannot afford or do not value premium offerings. Many have learned the art of “frugal innovation.”² For example, JBS, originally based in Brazil, is the world's biggest processor and exporter of beef, pork, poultry, and lamb.³ Its chief executive credits the company's rigorous pursuit of efficiency for its success: JBS has developed techniques that allow it to take more “prime” meat off of the bone and leave fewer scraps (which sell for roughly one-tenth the price).⁴ The company has used this efficiency to gain a global advantage over better-capitalized peers based in advanced economies. According to Rajeev Batra, a marketing professor at the Ross School of Business, we can expect to see more of the JBS-style formula from other emerging giants in the future.⁵

Emerging-market multinationals often have a better understanding of customers in the fastest-growing parts of the world.⁶ Haier's electronic appliances, including refrigerators with rodent-proof wiring and clothes washers that can also clean potatoes, have been a hit with rural and middle-class consumers

In Deloitte's globalization survey, 43 percent of emerging-market executives surveyed indicated that their firms partner extensively with nonprofits and local organizations when operating in developed markets, versus 33 percent of developed-market executives.¹¹ And emerging-market executives are far more likely than developed-market executives to identify social and political issues (for example, environmental impacts, worker rights, or local community improvement) as critical factors in company decisions.¹²

in China.⁷ The company, China's number-one brand for the 12th year running,⁸ is now driving its unique approach into developed markets. One of its breakout products in the United States has been a low-end wine cellar (essentially a small refrigerator with special racking and humidity control). By addressing an underserved market segment previously not prioritized by domestic companies, this product has captured a 60 percent market share in the United States.⁹

Emerging-economy giants often view the relationships between government and private enterprise as symbiotic and constructive—a consequence of the typically close links between the two sectors. Histories of partnering with governments, donors, and civil society allow emerging-market companies to envision new opportunities to pursue business *and* social objectives—for example, by serving underdeveloped markets. As Grupo Bimbo grew in Mexico, the company needed a credit system for smaller, less creditworthy customers shunned by other companies. It turned to Fincomun, a community bank that provides micro-lending within local communities. Bimbo placed Fincomun loan officers on Bimbo delivery trucks to set up credit arrangements for store owners. As a result, Bimbo sold more baked goods, Fincomun processed more loans, and small businesses were able to grow.¹⁰

Finally, emerging-market giants are resourceful in tough business environments—a point emphasized by Mauro Guillén, director of the Joseph H. Lauder Institute at the University of Pennsylvania. In a recent interview, he noted that the new giants are accustomed to dealing with inconsistent regulations, unpredictable supplies of raw goods, infrastructure gaps, different standards and definitions of corruption, and substantial political and economic instability.¹³ There are balancing factors, obviously—for example, they often

have less experience in dealing with tight environmental and labor regulatory regimes—but overall, the newer players often have “thicker skins” owing to the unique uncertainty and change with which they have been forced to contend. Family-owned business might have an additional advantage: greater flexibility to deal with these challenges, as they are sometimes more able to make fast decisions, take risks, and accept longer-term returns.

The skills and capabilities forged in challenging home environments often translate into powerful advantages elsewhere. CEMEX provides one well-known example. Given the notoriously unpredictable traffic of Mexico City, wet cement too often solidified in delivery vehicles before reaching construction sites. So CEMEX developed one of the first GPS-enabled real-time truck routing systems.¹⁴ The innovation worked at home and in other traffic-choked capitals across the developing world—which helped fuel CEMEX's global growth for more than a decade.¹⁵ Bharti Airtel, the Indian telecom giant, followed a similar pattern. After notable success in India, Bharti extended its operations into dozens of other emerging markets, mostly in Africa. Its innovative business model has allowed it to offer inexpensive but high-quality wireless service to less affluent consumers.¹⁶

The new giants seem mature and prepared. They have built obvious and distinct strengths in their home markets. Many are already deploying these in other emerging markets—potentially a profound advantage given the growth in South-South trade, which between 1980 and 2011 increased from approximately 8 percent of total global trade to over 26 percent while North-North trade declined from 46 percent to less than 30 percent.¹⁷ And today, some of these players are already competing effectively in developed markets too, with many more starting to make inroads.

Implications

The die is cast . . .

The global mix of true industry leaders is far richer and more diverse than it was even a decade ago. Today, India's three major IT consulting firms (TCS, Infosys, and Wipro)¹⁸ are among the largest in the world. The Tata Group is the United Kingdom's largest industrial employer; Mexico's Bimbo is the largest baker in the United States; and Lenovo has become the world's largest PC maker.¹⁹ Brazil's Embraer is the world's third-largest aircraft manufacturer, drawing the majority of its revenue in 2012 from the United States and Europe.²⁰ The list of the world's largest and most influential companies is geographically distributed. The number of North American companies in the *Fortune* Global 500 fell from 215 in 2001 to 141 in 2013. The number of companies on the list based in Asia (excluding Japan) increased from 30 to 109 over the same period. And great businesses in other parts of the world, especially Latin America, are also on the rise.²¹

This shift is not over yet. Deloitte's 2013 globalization survey suggests that it could continue apace: Two-thirds of executives expect competition from emerging giants to become more intense in both developed and emerging markets (figure 1).²²

. . . and the game is afoot

For the first time, global competition features organizations from a range of remarkably different backgrounds, traditions, and geographies. Given the shift in the location of economic power, some argue that the advantage has now switched firmly in favor of the new giants. Certainly, the distinctive strengths they have built are impressive. But the new story of global competition is very unlikely to be a one-sided onslaught from the emerging-market leaders.

Established players from advanced economies have decades of experience operating in broadly competitive markets, with a focus on delivering value to shareholders—consistently, and sometimes against the odds. Comfortable with the sophisticated needs of customers in advanced economies, they have demonstrated outstanding capacity to manage their brands successfully.²³ In the Interbrand 2013 list of leading global brands, only one of the top 100—Mexico's Corona—came from outside the developed economies.²⁴ Developed-market companies also benefit from deep reservoirs of intellectual property and enjoy privileged access to most of the world's leading educational institutions. Partly as a result, they have created most of the “high end” innovations that secure premium prices from the wealthiest of the global middle class.

Advanced-economy companies benefit from a long history that has allowed them to build strong organizational, management, and leadership capabilities. Many have also moved faster than their new rivals to reduce hierarchical and sometimes rigid structures that can hinder agility. They have invested heavily in multicultural, globally experienced, and cosmopolitan leadership—and place high value on diverse perspectives and viewpoints across their talent systems. And they typically have deeper experience in penetrating new markets, working with multiple cultures, and adapting to different regulations. In short, they are seasoned campaigners, used to overcoming serious challenges, with a history of evolving as they find themselves in new circumstances.

Learning to win

So are the new giants outgunned? Are the most ambitious of them overshooting by attempting to grow share in their local markets, take advantage of their relative strengths in other emerging markets, and aggressively penetrate the developed world too? Not

necessarily. They might have to be smart about their sequencing and priorities: Learning and competing globally simultaneously is hard. But the game today is wide open. For companies of all kinds and origins, the years ahead hold substantial opportunity and challenge. For giants both new and old, learning will be at a premium—learning about new customers, competitors, regulatory regimes, business models, management styles, and more. In fact, the winners are likely to be the fastest learners, including those who can identify and replicate the most critical capabilities of their rivals.

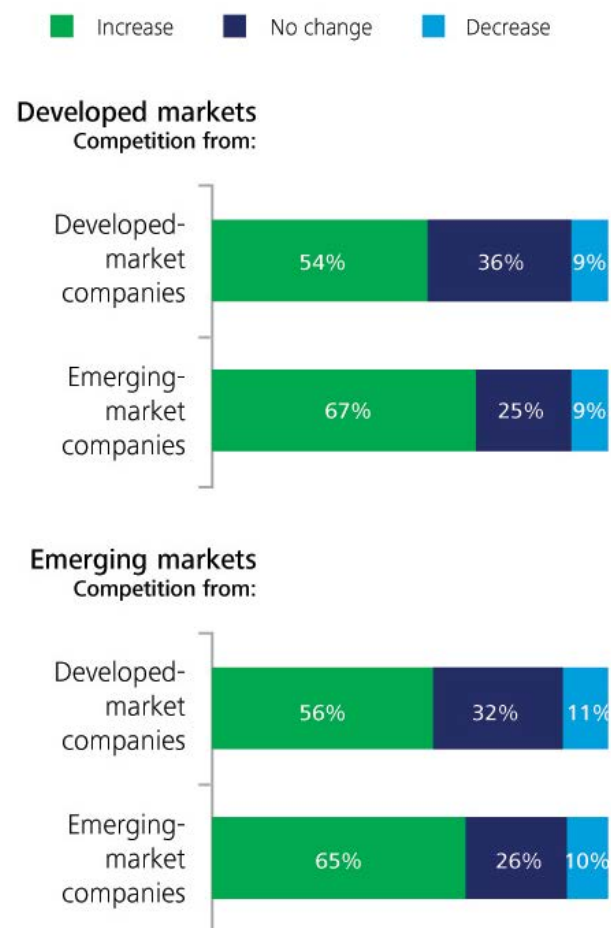
One obvious source of learning is through collaborations, joint ventures, and partnerships. In Deloitte's recent globalization survey, 59 percent of emerging-market executives surveyed said they often form joint ventures with local companies when operating in developed markets.²⁵ They are not alone: Western corporations have also been nimble on this front. For example, General Motors has partnered with SAIC, China's largest auto manufacturer, not only in China but also in other emerging markets with strong potential for growth.²⁶

The value of such across-the-globe collaborations can extend beyond simple access to local knowledge and best practices. Smart collaborations can also create new insights and capability. For example, in 2012, the United States' Boeing and Brazil's Embraer forged a technology-led alliance to enhance the safety and efficiency of military aircraft. This working relationship is likely to help both parties as they look for new opportunities. Embraer is seeking to secure further US defense contracts, while Boeing hopes to increase its presence in South American markets.²⁷

Global players from everywhere will also build essential new capabilities directly by watching and learning from their foreign competitors. Many new giants have realized that their traditional management approaches might be limiting their flexibility and

Figure 1. Expected change in competition over the next three years

Looking ahead over the next three years, how do you think competition in developed markets/emerging markets from the following types of companies will change?



Source: Deloitte Consulting LLP, *Deloitte Globalization Survey 2013*, 2013.

Graphic: Deloitte University Press | DUPress.com

speed—and addressed the challenge head-on. Haier, for example, reduced its focus on traditional hierarchy and levels of command, and redirected its orientation towards fast, effective project delivery—a move that was probably key in enabling its global expansion.²⁸ And this isn't a one-way process: Many of the best Western firms have also made intelligent moves based on their awareness of the growing strengths of new competitors. GE has built its own deep capabilities in innovating for less affluent customers.²⁹ Unilever was quick to learn the critical importance of addressing social impact issues in emerging markets, and has become widely admired as a world leader in this regard.³⁰

These companies are all faster, smarter, and more effective today than they were 10 years ago. But the requirement for continued learning, greater range, and new skills will persist and intensify. As markets become global, companies' standards of ethics and transparency must become higher and more universally applied. Some companies have decided to move their headquarters from their traditional home base. Others, wherever they are headquartered, are already benefiting from more balanced management and leadership systems composed of both home-country and in-market talent.³¹ Many leaders will have to challenge their habits of mind and learn to question their assumptions. Faced with such varied competition, they might have to rethink their risk appetites, realizing that aggressive entrants focused more on opportunity and less on protecting existing share often have a different risk calculus.

Crucially, many companies might also have to learn how to engage more constructively with regulators, governments, and civil society. As Professor Khanna, Jorge Paulo Lemann Professor at the Harvard Business School and director of the Harvard University South Asia Institute, observed in a recent interview, there

is a growing symbiosis or “*détente*” between the public and the private sectors that is likely to be increasingly important.³² However, regulatory requirements, consumer product and service standards, and political expectations can be extremely challenging in unfamiliar markets. More broadly, business might also be expected to contribute on topics that have often been regarded as the primary purview of governments—either through “direct” contributions to job creation, education, and health or “indirect” contributions to broader issues, such as addressing income distribution or immigration reform.

There is an additional complication: The new era of competition might also be leading governments to construct policies that advantage native players. In recent years, there has been a clear rise in “back door” protectionism— or preferentialism—using novel mechanisms seemingly outside WTO norms and regulations.³³ Possibly, learning to anticipate, influence, and adapt to regulatory change will become one of the most critical competences of all.

Looking ahead

Most emerging-market players are in the relatively early stages of learning to operate in cultures beyond their home markets. For many, success is very far from guaranteed, especially as they enter the developed markets. But their unique strengths are matched by a willingness to try many different paths to global success³⁴ and a confident mindset.

Deloitte's 2013 globalization survey confirms the mood: The surveyed emerging-market executives were more confident than their developed-market counterparts about future success (figure 2).³⁵

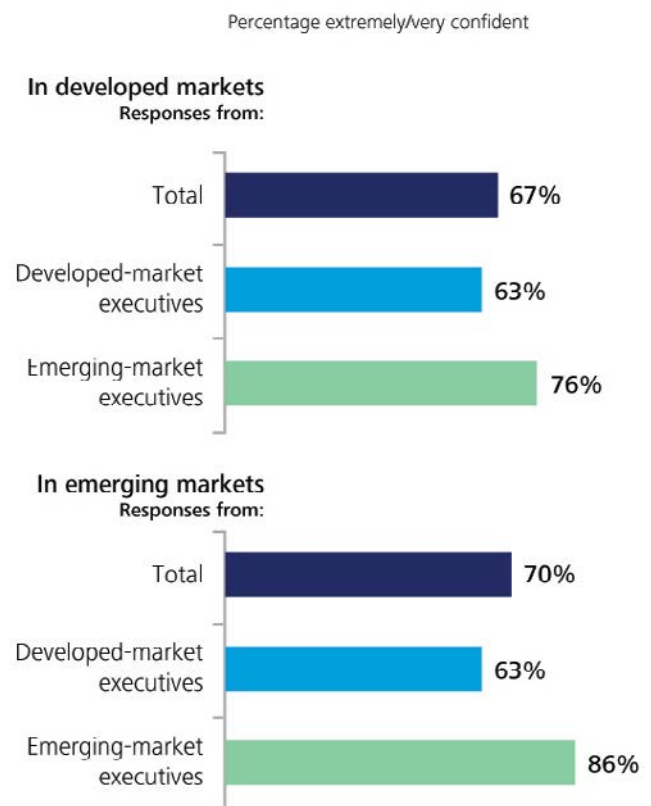
Whether this confidence is fully justified remains to be seen. But there are well-established precedents. For example, when Tata Motor Group acquired Jaguar Land Rover,

these two iconic brands had been previously owned by premier Western companies and managed by well-proven leadership systems and approaches. Yet within Tata, they have flourished with remarkable speed, not only as a premium brand in emerging markets, but also back in Europe and the United States.³⁶

In the coming years, we will no doubt see similar successes—and also examples of failure. This will be true for both new and established global players. All will likely require a new approach to competing globally, one that draws from a fuller repertoire of homegrown and learned capabilities. This “best of both” orientation will reach beyond the traditional model of adopting “best practices”; it will generate new insights and a whole suite of “next practices,” too. And who knows where that might lead? Perhaps, a few years from now, we might see a new trend in management science: the emergent field of *hybrid studies*, defining how best to “mash up” and repurpose winning bits and pieces of insight and technique drawn from both near and far.

Figure 2. Confidence in success of company over the next three years

Overall, how confident are you that your organization is well-placed to succeed in the following locations over the next three years?



Source: Deloitte Consulting LLP, *Deloitte Globalization Survey 2013*, 2013.

Graphic: Deloitte University Press | DUPress.com



My take

**By Ruzbeh Irani, chief group communications and ethics officer
and member of the group executive board, Mahindra Group**

The birth of the Mahindra Group predates India's independence. Founded in 1945 as a steel trading company, we entered the automotive space in 1947 by bringing the iconic Willys Jeep onto Indian roads. Over the years, we have diversified into many new businesses in order to better meet the needs of our customers. Our driving force—the thread that unites our diversified group—is our core purpose to challenge conventional thinking and innovatively use all our resources to drive positive change in the lives of our stakeholders and communities across the world: to enable them to rise. “Rise” is also Mahindra's brand promise, connecting us to a remarkably diverse set of global stakeholders who share the desire to seize and shape their future.

Our emerging-market roots have equipped us with many valuable capabilities. Having lived through the “license-raj” in India, a period when growth was limited by quotas and price was often controlled, Mahindra has mastered the art of frugal engineering. The ability to design and manufacture a distinctive range of mobility solutions packed with accessible technology while keeping costs to a minimum continues to energize our global expansion.

The rugged DNA of Mahindra vehicles makes them suitable for and attractive to many markets, especially those where affordable durability is considered essential. As an end-to-end mobility player, we have the potential scale to become a major competitor in international markets. Mahindra has also developed significant capabilities in the electric vehicle space, which we will bring to markets across the world.

Three lessons seem particularly important to Mahindra's past and future success.

- First, market-appropriate product portfolios are a precondition of success. Exporting products developed primarily for India is a legitimate starting point, but will not guarantee success beyond India-like markets.
- Second, market success typically comes with onshore presence. This is required not only to drive and grow the business, but also to gain an in-depth understanding of consumers and to stay abreast of regulatory changes. While there is a role for expats in such operations, the need to build a strong, locally recruited management team, as is the case with Mahindra USA and Mahindra South Africa, cannot be underestimated.
- Last, entrenched powerhouses—who benefit from their global platforms, scale, presence, and advanced product development capabilities—have made large investments in manufacturing and branding. Newer global players like Mahindra must find creative ways to compete.

Looking to the future, Mahindra believes that competition will remain fierce as companies from emerging markets try to capture increased market share, particularly in relative white spaces like Africa. Given the importance of scale in our industry, we expect that strategies involving collaboration and acquisition (for example, between Renault and Nissan, Geely and Volvo, Tata and Jaguar Land Rover, and Mahindra and Ssangyong) will remain critical and continue to shift competitive dynamics.

The bottom line

Many firms from the emerging world have arrived on the global stage at an impressive speed and scale. Most bring with them significant strengths that have served them well in their home markets, and that in many cases also position them for expansion into growing markets elsewhere. Some are already experiencing success in developed markets, too—but, to date, the new giants have a more limited track record in this arena. Meanwhile, more established global corporations have important, hard-won, and long-standing advantages of their own—and they have not been slow to acquire new capabilities as well. The field is set for a new, highly competitive game between giants with different legacies and advantages.

The outcome ahead is unclear. It's impossible to say which firms will prevail. But one result of this new competitive reality is quite predictable: The winners will be increasingly impressive and effective companies. They will learn fast and create new capabilities, often by spotting and themselves creating the advantages held by those from different geographies. They will be networkers, collaborators, and partners, aligned with societies' needs and governments' goals. They will be diverse in their management ranks and quick to question their managerial habits of mind. They will, in short, be those who truly step up to the new reality of being global giants.

Authors

Pedro Arboleda is a director with Deloitte Consulting LLP in the US Strategy service line Monitor Deloitte.

Don Derosby is a specialist master with Deloitte Consulting LLP in the US strategy service line Monitor Deloitte.

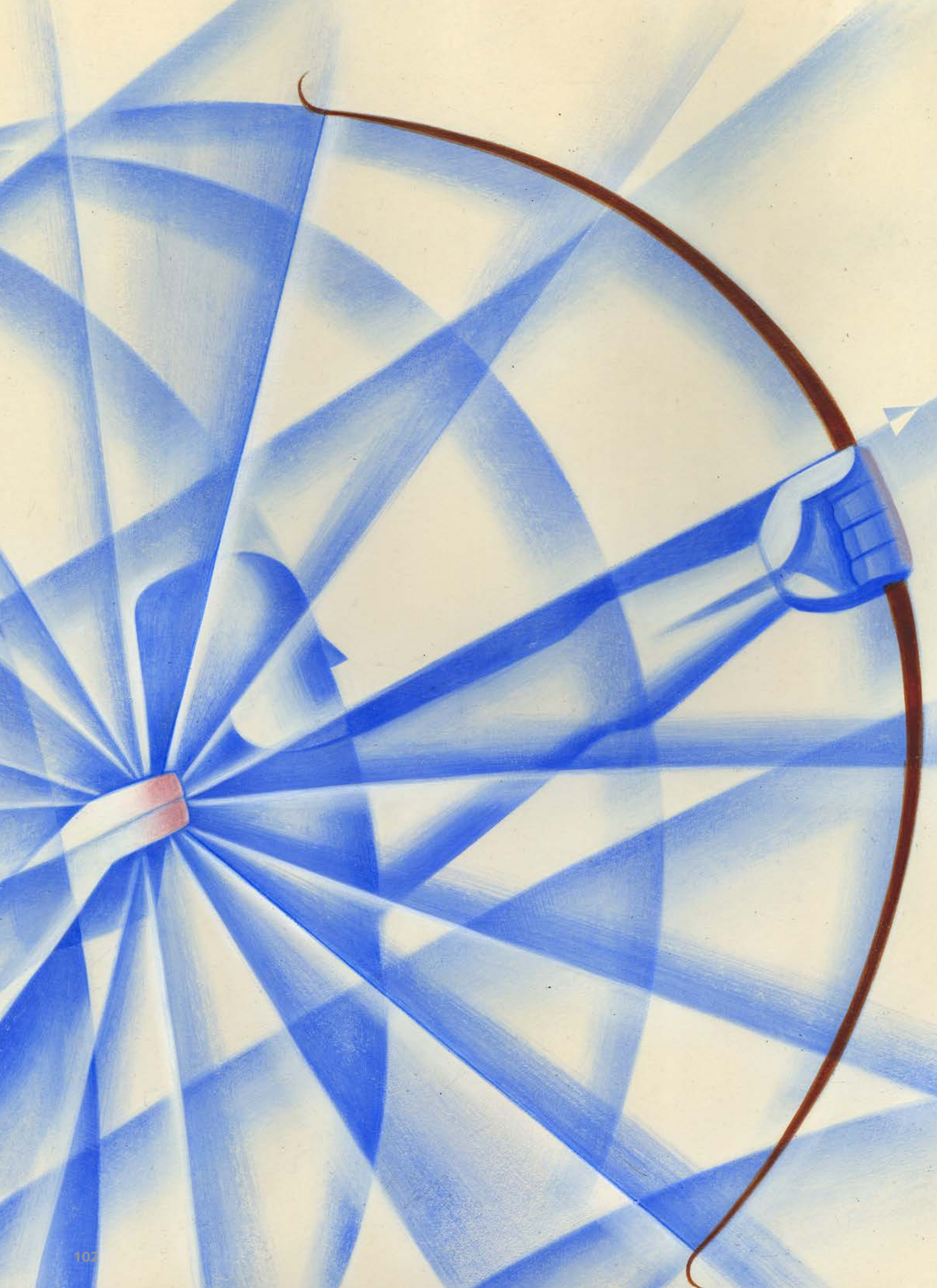
Eamonn Kelly is a director with Deloitte Consulting LLP in the US strategy service line Monitor Deloitte, and chief marketing officer of the Strategy and Operations practice.

Kishore Rao is a principal with Deloitte Consulting LLP in the Federal Strategy practice.

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CFO as chief frontier officer

By Bob Comeau, Sam Silvers, Rich Rorem, and Steven Ehrenhalt

Overview

AS organizations move into a new era of globalization, they face ever more complex dynamics and decisions. One result is that the role of the chief financial officer is shifting in many companies to focus on making global initiatives succeed. Soon, in fact—given how central global growth is to an organization's strategies—CFO could equally stand for *chief frontier officer*.

Look, for example, at Starbucks CFO Troy Alstead. When he joined the coffee seller in 1992, it consisted of fewer than 170 shops; it would still be four years before the first Starbucks appeared outside North America. When it came time to expand overseas, however, what was needed most was deep knowledge of global financial management, decision support, planning, and business development—all strengths that Alstead and his colleagues in finance and accounting could offer. By 2013, Starbucks was operating some 5,000 stores in over 60 countries, and the company formalized the duality of Alstead's leadership: Already CFO, he was also named group president of global business services. In a statement announcing the change, the company said: "Alstead's promotion is a recognition of the increasing responsibility and complexity of his role overseeing Starbucks global financial, technology, and supply chain operations, and ensuring that the company's overall business infrastructure is optimized to support the company's global growth."¹ Starbucks CEO Howard Schultz stressed that Alstead's rise was as much about future needs as about past accomplishments.² In fact, in February 2014, Alstead saw his role expand further as he was promoted to chief operating officer (COO).³

We're seeing many CFOs stepping up to understand and manage a broader set of business issues than they've faced at home or in core markets. But as leading the charge on globalization initiatives becomes an expected part of the CFO's scope, not all are equipped to take on the new responsibilities. Many financial executives will need to hone their approaches to financing, investment, operations, and valuation. More broadly, many will need to adopt a new mindset on their work.

What's behind this trend?

Part of the reality of modern business is the imperative to operate beyond domestic markets. This is hardly news; globalization has been an advancing trend since at least the 19th century. Yet today's version of globalization is far more complex than the forays companies made in the past—even up to just a handful of years ago. Traditionally, managers looked to foreign lands to supply inputs to production that were either unavailable or more expensive to procure at home—or they saw them as new markets for their offerings, managing to sustain revenue growth as domestic demand ebbed. Now, a new era of globalization is dawning. As the world, in general, throws up fewer restrictions on trade, multinationals are transforming into truly “anywhere” enterprises. Many are abandoning their old ways of managing huge flows of goods to and from a home country. Now they overlay the globe with a multitude of point-to-point connections, meeting customer needs in one region by tapping capabilities in another region—or within the same one.

This new era demands new capabilities in a senior management team. Innumerable opportunities present themselves, each involving distinct consumer tastes, supply considerations, regulations, and ground rules for investment. Complexities abound in managing the legal frameworks for corporate expansion, complying with local regulations and contractual obligations, adhering to local content provisions, and adjusting pricing and product strategies based on customer tastes and competition. Achieving growth goals is a much more analytical exercise than has traditionally been engaged in by business unit heads pushing for geographic expansion.

The question then becomes: Where does this new management capacity develop? Certainly, CEOs are ultimately accountable for the success of global forays—but the complexity growing on every other front of

management simultaneously makes it unlikely that the CEO can devote the necessary attention to this one.

It is the CFO who, in many organizations, is becoming the go-to person to translate global ambitions into practical reality.

This marks an intersection of a rising need with an organizational role that was itself already on the rise. Elsewhere, Deloitte has described the trajectory of the CFO's role.⁴ CFOs were not always considered so critical to strategy setting and execution. Indeed, the title of the senior-most financial executive didn't always include that exalted word “chief.” Today, however, the CFO in a typical large-scale organization is among the most important players in devising and executing strategy. The unprecedented size of financial functions today also means that many CFOs, by the time they reach that office, have acquired strong leadership skills.

The CFO's training and toolkit are highly relevant to the new era of globalization. In particular, the CFO's strong background in deal-structuring and a deep understanding of regulatory, environmental, and operational impacts on financial performance can put finance in an ideal spot to drive market-entry strategies, target specific customer segments, and pick the optimal product mix for success in the local market. Today's forays into new markets call for finance to be actively involved from the outset, not only to fulfill traditional financing and valuation responsibilities, but to also guide investment and operations decisions.

Finance's increasingly global lens enables the function to apply its ability to structure and execute good deals across borders and mitigate enterprise-wide risks. Consider, for example, the leadership exercised by CFOs of US-based multinational life science and consumer product companies dealing with the problem of increasingly volatile foreign exchange markets. Their solutions to these problems yielded many

important outcomes, including a natural hedge on multiple currencies and protection from currency swings between order and delivery. These solutions provided significant economic benefits while reducing risk.⁵

The importance of well-managed compliance also brings the CFO's organization and its capabilities to the fore. We know of a large US-based Internet retailer that, having decided to enter the Brazilian market, discovered that regulations there demanded localized information systems; a country-specific operating model; adherence to certain invoicing, payment, and collection rules; stringent foreign exchange controls; and extensive documentation.⁶ Someone had to own the complex responsibility of translating all these requirements into viable operations—someone who could also keep the overall goal in mind: to maximize the economic benefit and minimize the risk of entering Brazil. The company's CFO was tasked with that.

CFOs offer many attributes that fit the emerging need for a chief frontier officer. Finance tends to be the only operating function within a company that looks at all data both singly and on a consolidated basis. As part of their responsibilities, finance lead-

ers objectively weigh the pros and cons of investment decisions across business units and provide an unmatched level of rigor in the analytical process. These capabilities, as

well as the trust CEOs typically have in them, may position CFOs as the organization's go-to leaders for comparing performance across markets and ensuring that global initiatives are ultimately successful.

Implications

As part of this shift in finance leaders' purview, expect to see the reach of the finance function extended in four key domains: financing, investment, operations, and valuation (figure 1).

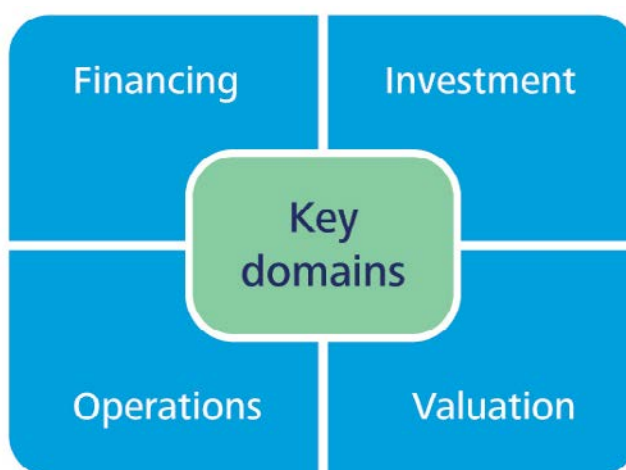
Financing

Companies perceive the benefits of raising capital outside their home economy, and of being listed on alternative stock exchanges. But issues such as cash repatriation add a new layer of complexity, demanding advanced tax policies measured in the risk-adjusted cost of capital for each potential capital source.

Managers find it more difficult to determine what type of financing will support future growth as they move beyond markets where they have established track records and ready access to market information. Companies must now take into account new risks that could threaten

liquidity in these countries. They need to ensure there will be enough access to cash to weather such disruptions, and devise contingency plans in the event operating cash flow is compromised.

Figure 1. Four key domains for finance leaders



Investment

When an organization expands to new markets, whether emerging or mature, it finds that no single metric is sufficient for governing investment decisions. So in addition to fulfilling its traditional role of identifying tax-efficient strategies for reallocating assets between geographies, finance is increasingly asked to do two things: determine whether the organization is adequately funding expansion into new geographies and measure the progress of such investments. This is only a natural extension of the strategic oversight the function provides to investments in the home market; on top of analyzing whether the organization's business units are generating appropriate returns, finance is now charged with applying the same analysis to overseas markets. But taking on this new level of oversight puts CFOs in a more strategic position. They are helping their companies identify cross-border opportunities for fueling growth, and determining that country-specific investments are aligned with the company's planning priorities in each market.

Operations

Individual markets have idiosyncrasies that can affect an organization's ability to deliver consistently good business performance. As organizations expand into new markets, finance is being asked to drive better operating results by working with regional and business unit leaders to identify and respond to those particular traits. The CFO's organization is equipped to help determine the right pricing strategy, identify the most profitable customers, design the optimal mix of mature and new product offerings, and project how much growth the existing infrastructure can support. Throughout these efforts, finance is helping the business to analyze the unknowns in each market, such as how pricing changes would affect demand in each market, and to spot developing trends, such as how demographics are shifting.

Valuation

In the first wave of globalization, companies moved manufacturing facilities and other assets to emerging markets to take advantage of lower costs and taxes. Even as subsequent waves of globalization focus on revenue-generating opportunities, businesses still need to ensure they are being tax-efficient. Finance should be driving this effort. It knows how to enhance the company's overall tax position through an appropriate legal entity structure while taking advantage of available tax opportunities in each individual market and ensuring compliance with local tax rules and regulations.

Companies are finding that every country or region is different in this regard. What works in one locale doesn't translate to another. If the last wave of globalization was about building a business case for entering a new market, this wave is about bringing together the deployment issues that come after that case is made. Even in multinational corporations with extensive global experience, this new era demands a ringleader with the skills and background to manage investments and risk at a high level across business units and geographies.

Adopting a new mindset

Some finance leaders will be challenged by these new responsibilities, as they have rarely been asked to leverage their capabilities outside the domain of finance. If their expanded duties were limited to the domestic market, they could turn to their internal network of relationships for support. But in many of these markets, such support doesn't exist. Finance professionals aren't just involved in picking locations and staffing up—they are often literally turning the lights on.

The CFOs who capture this opportunity will be those who develop a new mindset as well as new capabilities. They will recognize they are shifting from a controls-oriented

environment to one in which *influence* is equally, or even more, important to exert. Many will see new value in gaining greater exposure to other facets of the commercial enterprise. Finance leaders who have spent a year or two in the business, perhaps in an overseas market, may be more likely to earn the CEO's confidence that they can lead the globalization agenda. This kind of "lattice" career development may not be a prerequisite to success, but it can provide an advantage. As CFOs' duties broaden, having non-traditional operational or global experience in their backgrounds will inform their perspectives.

Looking ahead

If the larger trends behind CFOs' expanded responsibilities continue, and we believe that they will, then companies will increasingly call on finance to manage the complexities that come with exploring new frontiers. In all likelihood, this evolution will dovetail naturally with business transformation initiatives that seek to reposition business processes, operating models, and methods for interacting and engaging with customers. These changes will force business leaders to move beyond traditional interactions by integrating their

strategies and capabilities. In this, the CFO may have to manage new relationships within the C-suite and assume a wider strategic role within the organization. Even those finance leaders at companies just starting to think globally should get ahead of these organizational shifts, and begin building the capabilities and relationships that will help them succeed in an expanded role.

It stands to reason then that the CFO will enjoy a higher profile within many organizations, accelerating the trend we have seen in recent years. And as CFOs' spheres of influence expand, they will have to consider regional and business line CEOs with vested interests in calling the shots and protecting their turf, particularly when it comes to decisions involving investments and operations. They may even have to serve as international emissaries for the company, visiting countries and winning over local officials and other stakeholders whose views are often not aligned with the company's strategic goals.

Within some companies, these efforts will strengthen the CFO's candidacy for the top spot. At the very least, the CFO's expanded scope will bring more recognition of the value finance can bring to the overall organization.

My take

By David Carney, principal and national service line leader for Finance, Deloitte Consulting LLP

In recent years, CFOs have dealt with an ongoing series of “small explosions” that have created new opportunities and posed new challenges. The rise of spending power in emerging markets has transformed the growth prospects for many global companies. The opportunity to sell products and services has grown rapidly, and CFOs are expected to prepare their organizations to capitalize on these conditions. At the same time, major regulatory changes are testing the capabilities of the finance function like never before.

These dynamics of growth and regulation affect every sector, but each industry has its own set of unique challenges that the CFO must contend with. Look, for example, at the banking and securities industry. The CFO’s agenda focuses on raising capital and keeping compliant with new capital standards across different regions and jurisdictions. In the energy industry, CFOs must navigate a complex shift in the economics of the business as new sources of supply combine with technology advances. CFOs also need to be fully aware of the proliferation of new energy policies and mandates in different jurisdictions across the world. In the technology industries, CFOs deal mostly with enabling growth and taking opportunities. Compliance and regulations are—as yet—less of a focus here.

No matter what the industry, today’s business environment is far more dynamic than in the past. Given these complexities, what will make CFOs particularly well-suited to lead organizations into new frontiers?

Nearly every global CFO must have deep industry knowledge coupled with a core finance background. These skill sets are critically important and help create credibility when interfacing with investor and analyst communities.

Beyond this, I see tomorrow’s global CFO providing real value when they are able to directly affect the performance of their organizations. Increasingly, performance management systems will involve the use of large operational datasets to help predict revenue and cost streams. The CFO should embrace the use of “big data,” but should also use his or her experience to interpret it wisely and hence make informed decisions.

Lastly, global CFOs should be adept at working with individuals from many different backgrounds. This cross-cultural competence is critical for CFOs to master as they operate and lead diverse, multinational teams into the future.

The bottom line

At a large hospitality company, the CFO and finance team recently managed a transformative initiative. By engineering a new legal entity structure for the company, they allowed it to move a key business unit's headquarters from the United States to Europe, simultaneously connecting it more closely with its growth markets, reestablishing the company's brand, and substantially reducing its overall effective tax rate by domiciling profits in a low-tax jurisdiction.⁶ It was an effective example of the kind of multifaceted, high-profile assignment that is vaulting the CFO into a new position of influence: the chief frontier officer.

It should come as no surprise that CFOs are well positioned to lead such efforts, given their well-honed abilities to manage risk, provide objective counsel, and bring analytical rigor to strategic decision making. CFOs can accelerate this shift by more deliberately seeking opportunities to apply their competencies, by increasing their exposure to the organization's global operations, and by developing the leadership skills to exert influence and inspire confidence. In doing so, they might keep in mind the five "Cs" of influential leadership:

Curiosity: They should constantly ask "why" questions, be eager to understand how things really work, and both generate and welcome fresh ideas.

Capacity for surprise: They must be willing to set aside preconceived notions, and challenge things that they "know" but might not still be valid.

Courage: They must learn to deliver hard news and be willing to take unpopular stands. And they must see risk as something not to be avoided, but to be managed for reward.

Character: High ethical standards and unwavering integrity have always been essential in a leader; in an era of heightened scrutiny and transparency, they are only more so.

Collaboration: They must be accessible and eager to listen to colleagues, and convinced that better solutions emerge when different perspectives are brought to bear on a problem.

These skills may or may not already be evident in a CFO's direct line leadership of the finance function. But they will be needed as he or she plays a leadership role beyond that controls-focused domain, and in aspects of the business that have been traditionally managed by others.

CEOs with global aspirations understand how important it is to have a partner with them at the helm who is attuned to risk in its many forms and can navigate the new terrain with integrity. In fact, companies that don't have a CFO overseeing their push into new markets may be taking unknown risks.

Authors

Bob Comeau is a principal with Deloitte Consulting LLP in the Finance service line of the Strategy and Operations practice.

Sam Silvers is a principal with Deloitte Consulting LLP in the Finance service line of the Strategy and Operations practice.

Rich Rorem is a principal with Deloitte Consulting LLP in the Finance service line of the Strategy and Operations practice, and US practice leader for the Finance Transformation integrated market offering.

Steven Ehrenhalt is a principal with Deloitte Consulting LLP in the Finance service line of the Strategy and Operations practice.

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The C-suite: Time for version 3.0?

By Eamonn Kelly

Overview

CHIEF executive officers today have more direct reports than at any time in the past. The positions that collectively make up the “C-suite” in large businesses (so named because of the tendency for all of their titles to feature the word “chief”) have, according to one authoritative study, doubled since the 1980s.¹ But the trend at the top of organizations is not just a matter of numbers—it’s also about composition. In C-suites today, functional specialists—including chief financial officers, chief marketing officers, chief human resources officers, and more—far outnumber the generalist heads of business units.²

If the original top leadership group of a handful of general managers constituted “version 1.0” of the C-suite, the prevalence of functional specialists puts us solidly in the “2.0” era. The problem is that this model is ill-matched to a business environment in which companies must transform themselves, and continue transforming themselves, to remain competitive. In the new era of globalization, teams of functionally oriented executives sometimes struggle to formulate and act on integrated, coherent strategies for future success.

For many businesses, it’s time for another reconfiguration of the top leadership team—here comes C-suite 3.0.

What's behind this trend?

The C-suite is and will likely continue to be an evolving construct. The origins of a small executive team responsible for overarching enterprise leadership date back to the 1920s, when businesses were gaining unprecedented scale and regulators and shareholders demanded more management accountability. Alfred Sloan, whose years at the helm of General Motors turned it into the world's largest company, created the prototypical model when he distributed profit-and-loss responsibility across managers of key business divisions and regularly assembled them to decide on matters above the divisional level.³ Other corporations followed suit, establishing centralized leadership groups to make critical decisions, allocate resources, provide for execution through clear hierarchical structures, and monitor performance. The typical executive team included a financially oriented CEO and several key general managers of the firm, and was empowered by a growing suite of financial tools and control and measurement systems. This leadership system endured for about 60 years. It's fair to call it "C-suite 1.0."

Around the 1980s, the general manager-packed C-suite came under real pressure as businesses increasingly found themselves competing on particular dimensions of performance. There were new technologies to master and competitors excelling along new lines (for example, Japanese manufacturers attending to "total quality management"). Markets were globalizing and being deregulated. GE's Jack Welch famously warned in the 1990s that "if the rate of change on the outside exceeds the rate of change on the inside, then the end is near."⁴ The work of driving "change on the inside" fell mainly to executives with technical and functional specialist backgrounds. The result was a radical shift in the composition and role of the executive team—the rise of C-suite 2.0.

A recent Harvard Business School working paper reports that there were two primary characteristics to this shift. First, the span of control broadened. As scholars Maria Guadalupe, Hongyi Li, and Julie Wulf find, "From the mid-1980s to the mid-2000s, the size of the executive team (defined as the number of positions reporting directly to the CEO) doubled from 5 to 10." Second, the vast majority of the new additions have been "functional managers rather than general managers."⁵ This leadership system, with its expanded and far more specialized composition, provided essential professional depth and strength, and contributed substantially to the ability to deliver complex and often highly technical change. By now, it has become so prevalent that the model goes unquestioned. Few can imagine that 30 years ago many large firms did not have in place chief financial officers, let alone chief marketing officers, given the critically important roles both now usually play.

Having functional specialists in the C-suite has sharpened companies' capabilities on many fronts. Professionals in information technology, marketing, finance, human resources, sales—and more recently, knowledge management, innovation, risk management, and sustainability—have been able to continuously hone their craft. It has been mainly within functional realms that new "best practices" are identified and shared. Aiding this development is the fact that business-school curricula and in-house management training by firms are often also organized along functional lines.

But functional depth has come at a cost. Increasingly, we recognize that organizations are complex systems whose many elements interact in a dynamic fashion. When change is underway outside, it rarely means that only one function inside the business must keep pace. Many interdependent changes may be required and the need is for them to be mutually reinforcing. How is this necessary coherence and alignment achieved? It is the

responsibility of senior leadership. So a serious tension exists in many leadership teams: They need to implement specific (and often technically complex and mission-critical) changes and simultaneously achieve systemic coherence in transforming the overall business.

If anything, the necessary integration seems to be getting harder to achieve. For example, one of the most obvious points of mutual interdependence in many C-suites is between the CIO and the CMO. As data-driven customer insights grow in volume, availability, and importance, the ability to capture and act on them becomes a competitive necessity. Yet, as research undertaken by *Forbes* and Forrester in 2013 confirms, the relationships and collaborations between those two critical executives, and their respective teams, are typically challenging and underdeveloped.⁶

The strain shows across the organization. In a recent Economist Intelligence Unit survey, global executives identified C-suite buy-in and

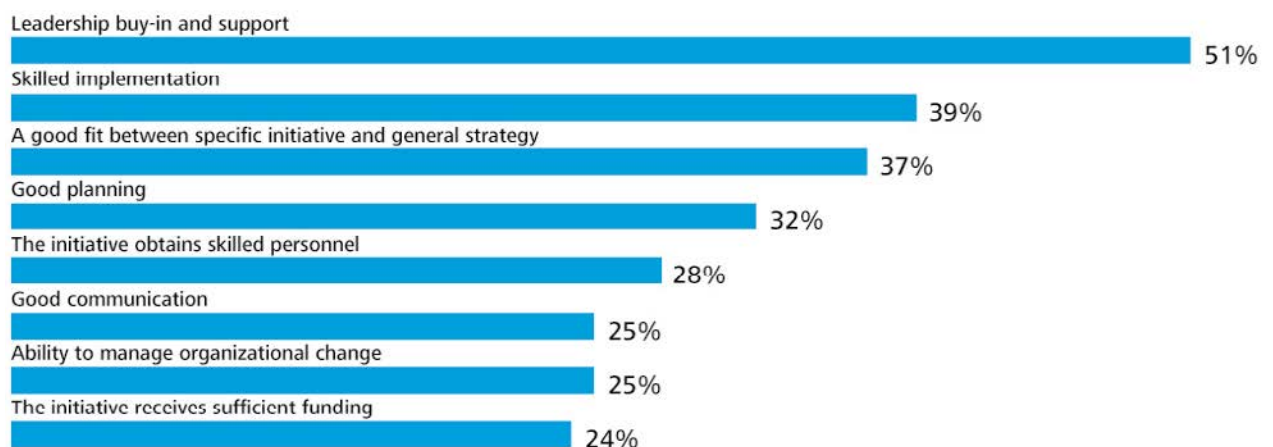
direct support to be by far the most important determinant of success for important initiatives (figure 1)—yet, answers to other questions showed how hard it is to get unified support from the top.⁷ For example, half reported insufficient collective attention from that team to the implementation of strategic priorities. Moreover, “A majority of respondents say that their companies’ activities are only somewhat aligned with their strategy across every element of the business model. Worse, the number saying they are unaligned to some degree is greater in each case than those saying they are extremely well-aligned.”⁸

If the 1.0 era is now easy to dismiss as “command and control,” it might be time to also fault the 2.0 C-suite’s tendency to “divide and conquer.” It has created challenges of alignment and coherence, as different forms of functional expertise—and their associated worldviews, priorities, and language systems—have been brought together at the cost of the

Figure 1. Main reasons for strategic initiatives succeeding at an organization

When strategic initiatives do succeed at your organization, what are the main reasons?

Please select up to three.
(% respondents)



Source: Economist Intelligence Unit, *Why good strategies fail: Lessons for the C-suite*, 2013, p.8, http://www.pmi.org/~/media/PDF/Publications/WhyGoodStrategiesFail_Report_EIU_PMI.ashx, accessed February 10, 2014.

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natural integration once provided by a small team of general managers.

Given today's constant need for well-integrated transformation along many dimensions of the business, the leadership team will surely evolve—but not revert to the original C-suite 1.0 model: The business environment is decreasingly suited to centralized, hierarchical control. The need for greater coherence and alignment across multiple geographies and functions is matched by the need for agility, adaptation, “localization,” openness, and fast learning. C-suite 3.0 should address both—and master the inevitably growing tensions this balancing act will create.

Implications

Chief executives and their boards of directors already recognize the challenges facing their existing C-suite configurations. Many are asking individual members of the C-suite to extend their roles, and make higher-level, more strategic contributions. But not everyone can become the new “hero” of the firm. Some are adding new “chiefs” to take care of complex new imperatives—witness, for example, the emergence of “chief experience officers” and “chief data officers.” But adding more players, even to take on cross-cutting responsibilities, is unlikely to bring tighter integration to the team. Others are placing new emphasis on integrative business skills alongside functional expertise when promoting new members to the top team. But that is a long-term replacement process.

These moves are smart—but they focus mainly on changing the configuration of the C-suite and individual roles with it. Looking forward, the more fundamental questions probably relate more to the overall role, collaboration, focus, and collective agenda of the top team. There are no simple, and certainly no universal, answers. But a good starting point for many will be to pose a sharper question: “In the turbulent, opportunity-rich,

and challenge-laden world ahead, what is the unique role that only we can perform, and only together, for the sustained success of our business?”

Many of the answers can probably be found in the following four key areas:

- Ensuring coherence across multiple strategies
- Nurturing and protecting the organization's most critical strategic capabilities
- Recognizing and empowering informal networks of power and influence
- Decision making supported by the “three Ds”: data, diversity, and dialogue

Let's look at each of these in turn.

Ensuring coherence across multiple strategies

The growing importance of specialist and focused functions has not only reshaped the C-suite over the last 20 years or so—it has also reshaped the role and locus of strategy-making. Over the last decade, strategy has largely devolved from the corporate level to more specific areas of enterprise endeavor. Most firms today have a broad array of distinct strategies—for example, talent strategy, customer strategy, technology strategy, finance strategy, innovation strategy, and government relations strategy—each typically “owned” by a C-suite executive. There have been substantial benefits from this more granular approach to strategy—but it has often resulted in a trade-off between strategic and operational excellence at multiple functional levels, and strategic coherence at the enterprise level.

The resolution of that tension certainly does not lie in a return to the often heavy-handed and over-centralized strategic planning practices of the past. But the C-suite is typically

the only team that has access to the information, insight, skills, and influence to establish and communicate the overall strategy for the business—a critical set of integrated choices that help secure alignment and integration. To be clear—this is never a comfortable exercise in reaching easy consensus, but a tough-headed and robust process of sharing, debating, and converging.

Procter & Gamble has long deployed one pragmatic approach to heading off fragmentation without disempowering either its specialist functions or the next levels of leadership and management of its businesses. CEO A. G. Lafley and Roger Martin, long-time dean of the University of Toronto's Rotman School, describe it in their recent book *Playing to Win* as a “Choice Cascade.”⁹ A set of choices at the highest level of strategy—regarding the business's long-term goals and aspirations (mission, purpose, and vision)—is followed by clear definitions of “where to play” (in what markets, geographies, and customer segments) and “how to win” (with what differentiated capabilities, which must be created and sustained).¹⁰ In a period of growing disruption and proliferating options, part of operating in the C-suite 3.0 mode will mean using a process like this to regain the power of a clear, shared, and choice-based corporate-level strategy.

Nurturing and protecting the organization's most critical strategic capabilities

Various schools of thought regarding strategy have focused on differentiated capabilities as a foundational source of sustained advantage. Michael Porter described the role of “activity systems,”¹¹ Hamel and Prahalad defined “core competencies,” and Kees van der Heijden pointed to the cohering “business idea.”¹² All these concepts call for the identification, development, and protection of

strategic capabilities that are hard to replicate and that work together systemically. These can be surprisingly enduring—some corporations' activity systems described by Porter almost 20 years ago remain powerful strengths today. But they are hard-won, and need to be carefully nurtured: They are sometimes eroded by well-intentioned initiatives, narrowly defined efficiency moves and cost-reduction programs.

In a disruptive environment, fresh emphasis must also be placed on the development of new organizational capabilities. These vary, obviously, from industry to industry and from firm to firm. But, for example, a company might recognize the advantage it could gain from a strong capability to collaborate or engage in co-creation in its innovation efforts. It might develop a distinctive capability in gathering (and interpreting) data from multiple sources. Or it might

If the 1.0 era is now easy to dismiss as “command and control,” it might be time to also fault the 2.0 C-suite's tendency to “divide and conquer.”

cultivate strength in attracting and mobilizing nonprofit or public sector partners.

Very rarely can the most critical strategic capabilities be created and sustained entirely from a single function or part of the enterprise: They are built from smart, cross-cutting configurations of assets and involve high interdependence and collaboration. It therefore will be an increasingly vital role of C-suite 3.0 to ensure that enterprise-level capabilities are clearly identified, their dependencies crisply defined—and any high-impact initiatives scrutinized in terms of whether they will enhance them or, at a minimum, protect them from degradation.

Recognizing and empowering the informal networks of power and influence

Seasoned C-suite advisor Bob Frisch has described the typically dominant sway of “the team with no name”;¹³ business writer Art Kleiner identifies the massive influence of the “core group.”¹⁴ Both are describing a reality seldom made explicit: The formal leadership system is invariably shadowed by powerful, informal networks and relationships of consequence. This is a fractal phenomenon in most organizations, with a repeating pattern of “kitchen cabinets” surrounding individual senior executives. One of the most important groups is the one structured around the CEO, usually including several (but seldom all) C-suite members along with other insiders and, often, external advisors.

The ongoing evolution of the C-suite and the critical integrative role it must perform are likely to have far-reaching implications across many firms.

The effective C-suite response is usually not to attempt to “remedy” this by reclaiming its rightful status, but to embrace the reality of the firm’s power and influence dynamics. Failure to understand and acknowledge these undocumented, distributed, trust-based arrangements often causes frustration and dysfunction. But when recognized and incorporated into the leadership processes, they can add considerable value. The most senior “team with no name” can help the CEO make quick decisions with confidence and conviction. The fractal

networks of such teams can help scale and disseminate those choices, and help align and integrate action in their support rapidly and pervasively.

The executive committee of heavy building materials firm CEMEX understands these networked dynamics well, and has established distributed global leadership networks to promote more collaboration, information sharing, and the spread of best practices for each of its primary strategic priorities. The company

has also designed and integrated all of its leadership development processes around strong network principles, systematically connecting the top executive team, its direct reports, and high-potential populations in all leadership training programs.¹⁵

When networked leadership arrangements are carefully designed and incorporated, bewildering obstacles to clean implementation of important changes often evaporate. Add the growing prevalence of top leadership support to informal “communities of practice” and

other emergent networks, all enabled by social media, and the energy to be tapped is impressive. The “off the chart,” invisible organization can greatly enable any innovation, adaptation, and dissemination of good practices that the C-suite 3.0 hopes to catalyze in a period of disruption and change.

Decision making supported by the “three Ds”

In an increasingly volatile and uncertain world, companies are likely to rely more, not less, on the judgment of managers in making critical decisions and choices. A fundamental and unique role for most C-suites is the application of collective knowledge and experience in exercising judgment on the most critical issues—and enabling others in the enterprise to do likewise. To do this more effectively, top management should consciously review their approaches to decision making, and determine how these might be enhanced by thoughtfully designed support from the “three Ds”: data, diversity, and dialogue.

From the worlds of social psychology, behavioral economics, and most recently, neuroscience, a great deal has been learned about the reality of how humans make decisions, individually and in teams. It is typically a far less rational process than assumed. The power of heuristics and biases, the dangers of certitude, the risk of reliance on experts—these and other factors are well understood. But with the convergence of disciplines, and an increasing focus on techniques for better team-based and individual decision making, this is a field starting to move from the world of theory into the world of practice.

Then, there are the opportunities afforded by exponentially increasing access to hard data. The hype around big data reflects real promise in the form of greater transparency and insight, delivered through executive dashboards and powerful and intuitive visualization technologies. Judgment will never be replaced by data—but it will be increasingly supported. Access

to sound information in close to real time can enable the C-suite to agree on necessary course correction, focusing on facts from the field rather than the specific (and sometimes competing) interests of different functions and executives.

But data are sometimes tortured to “reveal” whatever the interrogator wishes to learn: They do not always overcome inevitable cognitive biases. Two other opportunities for enhancing judgment come from the “softer” domain of social science. Few executive teams today are as diverse in their composition as their talent base and the markets they serve. But that is changing, with global experience and background becoming more highly valued, and the evidence mounting of the benefits of designing leadership systems to accommodate greater diversity.

Difference also brings challenges—of conflict, misunderstanding, and misalignment. Here, a great deal has been learned, and codified, about the skills that underpin productive dialogue. These are learnable skills that can transform the effectiveness and outcomes of senior executive communication and interaction—and some leading firms are already investing heavily in building such leadership capabilities.

Looking ahead

The ongoing evolution of the C-suite and the critical integrative role it must perform are likely to have far-reaching implications across many firms. A recent *Harvard Business Review* article reports that some CEOs are already “double hatting” key executives, giving them significant responsibilities beyond their official jobs—for example, a functional chief leading an integrated operational initiative.¹⁶ Some specific “chief” roles are likely to evolve and grow. Relationships between leadership teams and boards will perhaps realign. Promotion paths to top leadership will likely take on some new contours. It is even possible that

belonging to the “top team” will cease to be the permanent destination (which results in potential calcification of the team), but become a time-bound tour of duty for executives prior to returning to their own specialist areas.

It will be up to top leadership, too, to address the perennial challenge of balancing different time horizons. Top executives carry unique responsibility for both short-term performance and long-term stewardship of the firm. Intense pressure from capital markets for immediate results, coupled with a shortening average tenure for some senior executives (especially CEOs), have underscored the former in many Western corporations. Two factors are likely to enforce a more balanced

perspective here. First, axiomatically, discontinuity demands anticipation—to avoid catastrophic and irreversible missteps. Second, in most industries, the competitive set now includes powerful new players who might secure advantage from a traditionally stronger orientation toward longer-term horizons, enabled by the more patient capital support of their state- and family-owned legacies.

Finally, one of the most profound changes in the years ahead might well come in the area of executive incentives and metrics designed explicitly to encourage more aligned and collaborative leadership, and to help ensure a balanced focus on short- and long-term imperatives.



My take

By Roger Martin, Premier's chair in productivity and competitiveness and former dean at the Rotman School of Management, University of Toronto

As companies have gotten larger, more complex, and more globally distributed, the job of managing them has become harder. Creating sustainable competitive advantage is also more difficult. And against this need for managerial innovation, the last major organizational breakthrough arguably was the move from functional structures to product-line structures. That shift is now almost 50 years old.

Given the gap between the tools that management has and its growing challenges, we have seen a greater level of disquiet in the C-suites of global firms. It is a generalized level of discomfort—and I don't think there is a shared sense of the problem behind it. However, executives feel increasingly buffeted and have a general awareness that they may need some capability that they have yet to develop.

I've been suggesting for some time that the competency most required by senior executives is integrative thinking. Integrative thinking is a way of holding multiple conflicting points of view at the same time, and rather than being overwhelmed by the discomfort and ambiguity that results, leveraging it to formulate new, better answers. It's a mindset and a practice that seeks to link models and perspectives, even when those points of view openly contradict one another or are based on opposing logical structures. When practiced well, integrative thinking allows leaders to develop strategies that are elegant even in the face of the fuzziness that inevitably exists at the intersections of functional domains.

To take one example: The reason why it is hard to think about marketing and operations simultaneously is because each of these disciplines has a truly distinctive set of inputs, outputs, underlying assets and theories. There is some overlap, of course, but not that much when you get right down to it. Operations links to the factory and to operations research theory, while marketing links to the buyer and to the discipline of psychology. When they come into conflict—and they do—there are very few C-suite executives in the world who have the capacity to really pull together and knit the best of the warring perspectives into a higher understanding that productively cuts across both.

As a starting point, the C-suite will need to get comfortable with being uncomfortable. The CEO has a special role to play in modeling that behavior, but so does the board of directors. If the board says, "Only bring me things that are free of ambiguity," they are setting a tone that is hostile to integrative thinking. The C-suite must become the place where uncertainty is not only acknowledged, but embraced. And the dialogue among the board, the C-suite, and the rest of the organization must be one in which choices can be made as wisely as possible, by accepting both the known and the unknown, the knowable and the unknowable, and creating strategy in the face of both.

The bottom line

The bottom line is that if a company sticks with the C-suite model it probably has in place today, it might find it hard to remain competitive. The next wave of globalization is bringing unfamiliar opportunities and challenges, along with increased diversity and complexity. These dynamics are intertwined with rapid technological change and fast-evolving business models, industry structures, and organizational forms. Plotting the course forward will test the limitations of the typical team of functionally oriented executives.

A key requirement for the next-generation C-suite will be the ability to secure alignment and coherence across multiple dimensions of essential change, without defaulting back to the command-and-control arrangements of a bygone era. Achieving deeper integration and coherence is unlikely to be achieved by C-suite 2.0 fragmentation—but neither will it be accomplished by a return to the smaller, tightly centralized C-suite 1.0 model. Boards and CEOs might make this a subject of discussion and debate, and come up with their own definition of their future C-suite 3.0.

Author

Eamonn Kelly is a director with Deloitte Consulting LLP in the US strategy service line Monitor Deloitte, and chief marketing officer of the Strategy and Operations practice.

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About the authors



Pedro Arboleda
Deloitte Consulting LLP
+1 617 437 3802
parboleda@deloitte.com

Pedro Arboleda is a director with Deloitte Consulting LLP in the US Strategy service line Monitor Deloitte. He has successfully led life sciences and health care-related commercial strategy projects since 2001 for leading pharmaceutical, biotechnology, medical devices, and health care payer companies as they seek new customers and markets in North America, Europe, and emerging economies such as Mexico, Brazil, and China. He currently focuses on strategic options related to changes in national health care systems in the United States and emerging economies as these take hold, creating complex corporate/marketing strategy and license-to-operate issues.



Bob Comeau
Deloitte Consulting LLP
+1 703 251 4257
rcomeau@deloitte.com

Bob Comeau is a principal with Deloitte Consulting LLP. He serves as a senior advisor to the Deloitte CFO and as a principal in the Finance service line of the Strategy and Operations practice. He focuses on advancing the chief financial officer (CFO) agenda and building scale in business impact and solution-based offerings. He is also a member of the US CFO Program leadership team and is an established and experienced subject matter professional/specialist in the area of finance strategy.



Don Derosby
Deloitte Consulting LLP
 +1 212 829 6186
dderosby@deloitte.com

Don Derosby is a specialist master with Deloitte Consulting LLP in the US strategy service line Monitor Deloitte. He is an acknowledged specialist in strategy, scenario planning, risk assessment, problem framing, and system dynamics as leadership tools. Since becoming a strategy consultant in 1996, Derosby has focused on consulting, training, and coaching both corporate and public sector leaders in four industry sectors: health sciences, professional services (including finance, law, and management consulting), economic development, and national defense. He has also done extensive project work on the theme of globalization and regarding the Internet as a commercial platform, as well as within commodities, natural resources, and retail.



Steven Ehrenhalt
Deloitte Consulting LLP
 +1 212 618 4200
hehrenhalt@deloitte.com

Steven Ehrenhalt is a principal with Deloitte Consulting LLP in the Finance service line of the Strategy and Operations practice. He is the global leader of the Finance Transformation practice and has led and/or enhanced Deloitte's offerings aimed at improving the finance function so that it can better contribute to the success of the enterprise. He has authored numerous publications and has been quoted on topics of interest to CFOs in *CFO* magazine, the *Financial Times*, and the *Wall Street Journal*.



Rhonda Evans
Deloitte Consulting LLP
 +1 415 932 5320
rhevens@deloitte.com

Rhonda Evans is a specialist master at Deloitte Consulting LLP in the Monitor Institute, a practice serving foundations and nonprofits. She has over 10 years of consulting experience in corporate social responsibility, international working conditions and labor issues, and trade policy impacts. She also has extensive experience in rating and standards development for environmental, social, and governance and financial metrics.



Glenn Goldman
Deloitte Consulting LLP
+91 124 679 2075
glgoldman@deloitte.com

Glenn Goldman is a senior manager with Deloitte Consulting LLP in the US strategy service line Monitor Deloitte. He has helped some of the world's largest beverage, tobacco, and personal care companies achieve accelerated rates of profitable growth through innovative, granular, and actionable approaches that enable more effective targeting, brand building, portfolio deployment, and consumer activation and engagement programs.



Thomas Jankovich
Deloitte Africa
+27824943120
tjankovich@deloitte.co.za

Thomas Jankovich is chief innovation and growth officer for Deloitte Africa, a role that leverages his 13 years of experience in growth and innovation strategy, innovation process, commercialization, and corporate development. While much of his time is spent on helping Deloitte innovate, he still maintains a significant client portfolio across Africa and internationally. He is a sought-after innovation and growth specialist, having been engaged by Fortune 500 executives across the globe.



Eamonn Kelly
Deloitte Consulting LLP
+1 415 932 5358
eakelly@deloitte.com

Eamonn Kelly is a director with Deloitte Consulting LLP in the US strategy service line Monitor Deloitte, and chief marketing officer of the Strategy and Operations practice. He advises senior leadership at leading corporations across multiple industry sectors, key global and national public agencies, and major philanthropic foundations. Prior to joining Deloitte, Kelly held a wide range of leadership positions. He was a Monitor Group partner and member of its global executive team with leadership responsibilities for thought leadership, marketing, and client experience. He also served as CEO of Global Business Network (GBN), the pioneering scenario planning consultancy and futures think tank, where he led GBN's thought leadership about the future and the development of insights, tools, and methodologies for mastering change and uncertainty.



Duleesha Kulasooriya
Deloitte LLP Center for the Edge
 +1 415 783 4991
dkulasooriya@deloitte.com

Duleesha Kulasooriya is head of strategy at the Deloitte LLP Center for the Edge. He leads the development of the Center's ecosystem and contributes to core research that explores the edges of business and technology. Over the past few years, he has explored how the world is changing in very dramatic ways as a result of ever-evolving digital infrastructure and liberalizing public policy, as well as the implications for individuals and institutions. Kulasooriya led the team that developed and authored Deloitte's inaugural Shift Index report. He has written and spoken extensively on the use of new technologies to drive business performance and on pathways for moving from static to dynamic ecosystems.



Jennifer Lacks-Kaplan
Deloitte Consulting LLP
 +1 212 829 6182
jenkaplan@deloitte.com

Jennifer Lacks-Kaplan is a principal with Deloitte Consulting LLP focused on consumer and marketing strategy and execution. She works with companies to develop and enable winning growth strategies and marketing transformation. Prior to joining Deloitte, Lacks-Kaplan was a senior partner at Monitor Group. She has over 20 years' experience serving many of the world's leading companies in a range of industries, including consumer products, retail, financial services, and telecommunications. Her recent publications include *Precision marketing* (a Conference Board publication), *Smarter spend on marketing*, and *Megacity growth strategy*.



Bill Lam
Deloitte Consulting LLP
 +1 404 942 6730

Bill Lam is a senior manager with Deloitte Consulting LLP in the Supply Chain Strategy practice with over 12 years of experience leading large, complex supply chain strategy and operational improvement projects cutting across multiple industries and geographies. He focuses on supply chain transformation, organizational redesign, inventory optimization, integrated business planning, material requirements planning, cost-to-serve analytics, strategic sourcing, and reverse logistics.



Kelly Marchese
Deloitte Consulting LLP
+1 404 631 2240
kmarchese@deloitte.com

Kelly Marchese is a principal with Deloitte Consulting LLP and leader of the Supply Chain Strategy practice. She has over 20 years of experience leading projects in complex manufacturing industry sectors. Marchese leads the Global Supply Chain Risk service offering. She is a Master Black Belt in Lean/Six Sigma and is a thought leader in engineering effectiveness through manufacturing operations excellence.



Dr. Doug Palmer
Deloitte Consulting LLP
+1 703 251 3774
dpalmer@deloitte.com

Dr. Doug Palmer is a principal at Deloitte Consulting LLP and leads the Social Business practice. He advises clients in areas related to social media, digital strategy, collaboration, gamification, and the adoption of emerging technologies. His research and thinking on the topics of social business and gamification have been cited in leading publications such as the *Wall Street Journal*, *MIT Sloan Management Review*, *Time* magazine, and *USA Today*.



Kishore Rao
Deloitte Consulting LLP
+1 571 882 5550
kisrao@deloitte.com

Kishore Rao is a principal with Deloitte Consulting LLP in the Federal Strategy practice. For over 25 years, Rao has been helping clients realize the potential of global emerging and frontier markets. He helps governments devise and implement strategies to enhance competitiveness by building industry clusters, attracting foreign investment, and building trade and transport infrastructure. In tandem, he works with US and global companies in the manufacturing, real estate, BPO/IT-enabled services, agribusiness, energy, and infrastructure industries to help them build business models and strategies to enter, locate facilities in, and expand in global emerging markets. Rao speaks and writes widely on emerging-market business strategies, industrial and innovation cluster development approaches, and special economic zone development.



Rich Rorem
Deloitte Consulting LLP
 +1 206 716 6229
rrorem@deloitte.com

Rich Rorem is a principal with Deloitte Consulting LLP in the Finance service line of the Strategy and Operations practice, and US practice leader for the Finance Transformation integrated market offering. He serves clients across industries in the areas of finance strategy and transformation, integrated performance management, and finance operations. Rorem has been heavily involved in the design and implementation of the technologies that support finance organizations, including enterprise resource planning (ERP), financial planning and analysis, and business intelligence solutions.



Tony Siesfeld
Deloitte Consulting LLP
 +1 617 437 3583
tsiesfeld@deloitte.com

Tony Siesfeld is a director at Deloitte Consulting LLP and a senior leader of Monitor Institute, a practice serving foundations and nonprofits. He has over 25 years of experience in for-profit and for-impact advisory work. Recently, he worked in the areas of impact investing and financing social innovation. He focuses on social action strategy, measurement and evaluation, and bringing leading practices from for-profit businesses into the social sector. His work has been noted in *Harvard Business Review*, the *Financial Times*, and the *Wall Street Journal*.



Sam Silvers
Deloitte Consulting LLP
 +1 215 982 6596
ssilvers@deloitte.com

Sam Silvers is a principal with Deloitte Consulting LLP in the Finance service line of the Strategy and Operations practice, as well as East regional managing partner. Previously, Silvers was the global leader of the Finance Transformation practice. He is also the former leader of the US Finance Transformation practice.



Jonathan Star

Independent researcher and workshop facilitator

jstar@scenarioinsight.com

Jonathan Star is an independent researcher and workshop facilitator. He specializes in scenario planning, helping clients to identify future trends and explore the implications for their business.

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