Globalization has made the world a smaller place economics essay

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In the last two decades the automotive business has become a global, multi-location industry. The pace of this transition from largely national markets and national manufacturing to global manufacturing for increasingly global markets has been astonishingly rapid and today’s economic crisis, accompanied by sharply falling sales and pro¬ ﬁts, is only likely to speed up this transition as companies seek ways to increase revenues and reduce costs.

The ¬ ﬁnancial and economic turmoil of recent months has hit many businesses hard, but none harder than the automotive industry. Suppliers in particular are under intense cost pressure, forcing them to look for new low-cost patterns of sourcing and manufacturing. Latest research into Location Strategy suggests that if suppliers cannot devise integrated location strategies that embrace risk as well as cost, in the longer term they may lose out. Although overall capital ¬, ows to emerging economies fell in 2008 amid economic crisis, foreign direct investment actually increased* and continues to grow today. Understandably auto suppliers making these investments are driven primarily by growth and cost considerations.

Since 2005 the potential of emerging markets as operational locations has grown, as suppliers and assemblers see increasing sales, manufacturing and R&D opportunities in potentially growing markets such as China, India and Russia. Interest in established emerging market destinations such as Brazil has revived. And the traffic of globalization flows in all directions.

Strategies

It is likely that the current downturn will cause many manufacturers to look for lower cost locations, and to refocus operations on regions where there is still economic growth. But costs and growth are not the only factors that should drive location strategy: companies should also look at their innovation needs, and at the opportunities for balancing risk in global businesses.

Lower risk makes globalization more attractive: it is a ‘ pull factor’. Higher costs make globalization a necessity: this is a ‘ push factor’. Costs have also risen sharply. Despite recent falls, the average costs of industrial raw materials and energy are high and likely to remain high. In the longer term the cost of innovation has continued to rise while the return from individual product models has declined. In the context of recession and falling sales in many large economies, companies have to seek ways of achieving drastic improvements in their long-term cost and revenue structures. Globalization of operations remains one of the most important ways of meeting this cost pressure.

Recent research within the automotive industry with suggests that while cost pressure remains a very significant driver of globalization, it is not the most significant. The most important driver in the auto supplier industry is the imperative of growth. Even amid a global slowdown, the BRIC economies are predicted to continue growing considerably faster than the OECD economies where growth is expected to be barely positive in 2012, according to World Bank forecasts released in December 2011, China is expected to grow by 11. 5 percent in 2012, while India will grow by 8. 8 percent. The rest of the developing world will grow at 4. 9 percent, the World Bank believes.

Companies therefore need to globalize their operational footprint to capture that growth.

Growth, cost, innovation, and risk are the key factors that influence a location strategy. The relations between all four factors create complexities; there is no simple answer to the question of how a company should shape its global operational structure.

This acceleration of globalization has been facilitated by a perceived reduction of location risk. Brazil, India and China, for example, have all improved their reputations for stable economic management over the past decade. Political and financial risk is now rising once more as the global recession spreads to emerging economies, but it still remains historically low.

How much of this massive relocation of corporate resources has been informed by long-term location strategy as opposed to short-term pressures is another question. The most striking case is the relocation of facilities to South America. During the 1990s there was a surge in auto investment in the region, accounting for 7. 9% of all new supplier plants worldwide (compared with 3. 4% during the previous decade). Plants were established particularly in Chile, Argentina, and Brazil. Chile’s production business however was profitable only through direct government support and thus disappeared virtually overnight when this support was withdrawn. Manufacturing in Argentina collapsed in the aftermath of the country’s official debt crisis and default in the late 1990s. In Brazil erratic growth and confidence meant that

despite the continuing potential of the market, many companies found they had over-invested.

If companies are to manage such pressures and form a viable long-term location strategy, they should analyse the business drivers that determine the real benefits available in specific locations. They should also assess the potential for finding new growth, for cutting existing costs, for facilitating innovation, and for limiting risk.

History of globalizing the automotive market

Globalization is nothing new; the automotive industry has been expanding across borders for the last 100 years. Chevrolet, for example, began manufacturing passenger automobiles in India in the 1920s. Nevertheless, volume migration of supplier manufacturing is a contemporary phenomenon. Up to around 1980, the supplier industry remained heavily concentrated on domestic production in North America, Europe and Japan.

This era of domestic production ended quite suddenly after the 1970s, when in the first wave of globalization (roughly 1981 to 1990) manufacturing began to shift from the aforementioned mature triad regions, towards emerging economies in Asia. Before 1980 European suppliers had concentrated on investing across borders within Western Europe. Suppliers in the U. S. concentrated on investing in Europe, and to a lesser extent in Japan. Japanese suppliers meanwhile extended their operations primarily by investing in the U. S.

In the first wave of globalization suppliers in the triad regions began to make investments and build facilities in fast growing economies of Asia such as

Thailand, Malaysia, the Philippines and South Korea. During this period China, South America and Eastern Europe attracted a very small proportion of total auto manufacturing investment. During the 1990s the second wave of globalization began to embrace the ‘ new’ emerging economies of Asia, namely China and India, as well as the developed but neglected markets of South America. In this period (1991-2000) the number of plants built in China rose dramatically compared to the previous decade. The proportion also rose in South America. The third phase of globalization, from 2000 onwards, has seen an even greater concentration of plant building in China and Eastern Europe, but at the expense of the rest of Asia, South America and Western Europe. The proportion of plants built in China has risen to 22. 7 percent, and that in Eastern Europe to 14 percent. While it is still true that U. S, European and Asian suppliers all continue to own and operate the majority of their manufacturing plants in their home region, they also now own a very significant proportion in new markets.

U. S. suppliers remain the most concentrated in their domestic region; nevertheless the proportion of U. S. ownership of all manufacturing facilities in Europe is now close to 40%. U. S. suppliers also own the single largest share of supplier manufacturing capacity in India (47%) and the second-largest share in South America (42%), when compared with Western European and Asian suppliers. European suppliers investment in manufacturing is most concentrated in Asia (for example European suppliers own 45% of plants in China, compared with 26% for U. S. makers and only 29% for all Asian suppliers). They also own 50% of plants in South America and 62% of plants in Africa.

These are the patterns of globalization over the last three decades; a clear trend of the migration of manufacturing across borders, led by European and U. S. suppliers, and, over time, favoring Asia above other alternative locations.