ECN230 SRP session 18. Readings on Internationalization Strategy

Emerging-market companies are trying to build global brands

Lenovo, a Chinese computer firm, was founded in 1984 by 11 engineers at the Chinese Academy of Sciences who wanted to supplement their meagre stipends. It spent years building its business in China. Then in 2005 it burst onto the global scene—and rattled the US's Congress—when it bought IBM's ThinkPad personal-computer business. The company is now the second-largest PC maker in the world and hoped to grab the top spot from Hewlett-Packard [1]. Lenovo is one of several emerging-market firms striving to become global brands. They are no longer content to do the grunt work for Western firms, for two simple reasons: non-branded companies typically earn gross margins of 3-8% and are constantly at risk of being undercut by cheaper rivals. Branded firms enjoy fatter margins (15% or more) and more loyal customers [1].

Yet becoming a global brand is exceedingly hard. Emerging-market firms must struggle with limited budgets and unlimited prejudice. GfK, a consumer-research company, found that only one-third of Americans were willing even to consider buying an Indian or Chinese car. Wipro, a successful Indian outsourcer, pointed out that its total sales were roughly the size of IBM's marketing budget. In 2012, only four emerging-market brands made Interbrand's list of the world's 100 most valuable: Samsung and Hyundai of South Korea, Mexico's Corona beer and Taiwan's HTC [1].

How can others make the leap? First, they must exploit their two basic advantages—economies of scale and local knowledge—to expand into new markets. Some have become so dominant in their home markets that they can hardly avoid expanding abroad. Turkey's Arcelik, for example, controls 50% of the Turkish market for domestic appliances and is now expanding rapidly in Europe. Lenovo gets 42% of its sales from China and has 40 times more stores there than Apple has worldwide. Some firms use their understanding of local markets to expand globally: India's Marico produces shampoo suited to the highly chlorinated water that flows from Middle Eastern taps. Others move swiftly to exploit opportunities: Turkey's Evyap established itself as a leading seller of cheap soaps and scents in Russia when the Soviet Union collapsed [1].

Emerging-market companies need to add three more ingredients to these basics. The first is focus: they should define a market segment in which they have a chance of becoming world-class. Natura Cosméticos, a Brazilian cosmetics-maker, zeroed in on the market for "natural" cosmetics with ingredients extracted from the rainforest. Lenovo focused on computers for corporate clients before expanding into the consumer market. Haier, a Chinese maker of dishwashers and fridges, focuses on consumers that many of its rivals neglect [1].

The second ingredient is innovation: firms need new products and processes that generate buzz. HTC produces 15-20 new mobile-phone handsets a year. Natura releases a new product every three working days. Haier keeps producing new ideas such as fridges with locks on them (to keep dormitory mates from snaffling your tofu), compact washing machines (for clothes for pampered Japanese pets) and freezers with compartments that keep ice-cream soft (for impatient gluttons). Ranbaxy, an Indian drug firm, developed controlled-release systems that allow patients to take only one pill instead of several small doses [1].

The third ingredient is old-fashioned brand-building. Emerging-market bosses must grapple with many traditional branding puzzles. Should they slap the company's name on the product (as Toyota does) or another name (as Procter & Gamble does with its stable of brands, from Gillette razors to Pampers nappies)? How can they market themselves effectively in multiple countries without busting the budget? Lenovo has hired an expensive US marketing boss, but saves money by doing most of its advertising work in Bangalore [1].

Building a brand is easy to botch. The quickest way to build a brand is to buy one—but bought brands can be difficult to integrate (as Lenovo discovered with IBM's ThinkPad) or can take a long time to pay off (as Tata Motors is discovering with Jaguar). Building a brand from scratch can take decades. Managing a portfolio of brands is complicated and demanding: people who made their fortunes manufacturing things may not be suited to the airy-fairy world of brand management [1].

There is little doubt that emerging-world brands are on the rise. HTC is one of the biggest-selling smartphones in the US. Huawei, a Chinese firm, overtook Sweden's Ericsson to become the world's largest maker of telecommunications equipment. BYD, another Chinese company, produces 85% of the world's lithium-ion batteries for mobile phones [1].

Emerging-market firms are evolving in much the same way as Japanese firms did in the 1960s and 1970s, from humble stitchers to master tailors. In 1985 Philip Kotler of Northwestern University's Kellogg School of Management observed that Japanese companies had shifted from "injuring the corners" of their Western competitors to attacking them head-on. The same pattern is beginning to repeat itself, but on a much larger scale [1].

Smaller rivals are assaulting the world's biggest brands

THEY make some of the world's best-loved products. Their logos are instantly recognisable, their advertising jingles seared in shoppers' brains. For investors, they promise steady returns in turbulent times. They seem to be getting ever bigger: on June 30th Mondelez International made a $23 billion bid for Hershey to create the world's biggest confectioner; and on July 7th Danone, the world's largest yogurt maker, agreed to buy WhiteWave Foods, a natural-food group, for $12.5 billion. Yet trouble lurks for the giants in consumer packaged goods (CPG), which also include firms such as General Mills, Nestlé, Procter & Gamble and Unilever. As one executive admits in a moment of candour, "We're kind of fucked" [2].

For a hint of the problem they face, take the example of Daniel Lubetzky, who began peddling his fruit-and-nut bars in health-food stores: his KIND bars are now ubiquitous, stacked in airports and Walmarts. Or that of Michael Dubin and Mark Levine, entrepreneurs irked by expensive razors, who began shipping cheaper ones directly to consumers five years ago. Their Dollar Shave Club now controls 5% of the US's razor market [2].

Such stories abound. From 2011 to 2015 large CPG companies lost nearly three percentage points of market share in the US, according to a joint study by the Boston Consulting Group and IRI, a consultancy and data provider, respectively. In emerging markets local competitors are a growing headache for multinational giants. Nestlé, the world's biggest food company, missed its target of 5-6% sales growth for the three years running to 2016 [2].

For a time, size gave CPG companies a staggering advantage. Centralising decisions and consolidating manufacturing helped firms expand margins. Deep pockets meant companies could spend millions on a flashy television advertisement, then see sales rise. Firms

distributed goods to a vast network of stores, paying for prominent placement on shelves [2].

Yet these advantages are not what they once were. Consolidating factories has made companies more vulnerable to the swing of a particular currency, points out Nik Modi of RBC Capital Markets, a bank. The impact of television adverts is fading, as consumers learn about products on social media and from online reviews. At the same time, barriers to entry are falling for small firms. They can outsource production and advertise online. Distribution is getting easier, too: a young brand may prove itself with online sales, then move into big stores. Financing mirrors the same trend: in 2015 investors poured $3.3 billion into private CPG firms, according to CB Insights, a data firm—up by 58% from 2014 and a whopping 638% since 2011 [2].

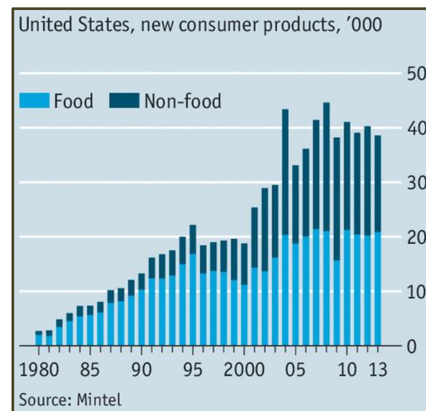
Most troublesome, the lumbering giants are finding it hard to keep up with fast-changing consumer markets. Ali Dibadj of Sanford C. Bernstein, a research firm, points out that some consumers in middle-income countries began by assuming Western products were superior. As their economies grew, local players often proved more attuned to shoppers' needs. Since 2004 big emerging economies have seen a surge of local and regional companies, according to data compiled by RBC. In China, for example, Yunnan Baiyao Group accounts for 10% of the toothpaste market, with sales growing by 45% each year since 2004. In Brazil Botica Comercial Farmacêutica sells nearly 30% of perfume. And in India Ghari Industries now peddles more than 17% of detergent [2].

In the US and Europe, the world's biggest consumer markets, many firms have been similarly leaden-footed. If a shopper wants a basic product, he can choose from cheap, store-brand goods from the likes of Aldi and Walmart. But if a customer wants to pay more for a product, it may not be for a traditional big brand. This may be because shoppers trust little brands more than established ones. One-third of US consumers surveyed by Deloitte, a consultancy, said they would pay at least 10% more for the "craft" version of a good, a greater share than would pay extra for convenience or innovation. Interest in organic products has been a particular challenge for big manufacturers whose packages list such tasty-sounding ingredients as sodium benzoate and Yellow 6 [2].

All this has provided a big opening for smaller firms. In recent years they contributed to a proliferation of new products (see chart, US consumer products). For instance, the US now boasts more than 4,000 craft brewers, up by 200% in the past decade. Big companies have been trying to respond. One answer is to focus more. In 2014 Procter & Gamble said it would sell off or consolidate about 100 brands, to devote itself to top products such as Gillette razors and Tide detergent. Mondelez, the seller of Oreo biscuits and Cadbury's chocolate, is spending more to understand who snacks on what, and why [2].

The most notable strategy has been to buy other firms and cut costs. 3G, a Brazilian private-equity firm, looms over the industry. It has slashed budgets at Heinz, a 147-year-old company it bought in 2013; then Kraft, which it merged with Heinz in 2015; as well as Anheuser-Busch InBev, a beer behemoth poised to swallow SABMiller. Heinz's profit margin widened from 18% to 28% in just two years, according to Sanford C. Bernstein [2].

Big firms are also acquiring or backing smaller rivals. In 2013 two US food companies and a French one—Campbell Soup, Hain Celestial and Danone—each snapped up a maker of organic baby food. Coca-Cola and Unilever, an Anglo-Dutch titan, have long bought companies outright or invested in them. Both General Mills and Campbell have launched their own venture-capital arms [2].



Such strategies may eventually make CPG firms even more like big pharmaceutical companies. They may invent few products themselves and instead either acquire small firms or join up with them, then handle marketing, distribution and regulation. That has worked decently well for drugmakers. Yet consumers are more fickle when buying skin cream than a patent-protected cancer drug. A CPG firm may pay a bundle to buy a startup, only to see its products prove a fad. And cutting costs expands margins, but may depress sales [2].

Despite such conundrums, executives remain bullish. Tim Cofer, Mondelez's chief growth officer, maintains that wise cuts and reinvestment will position the firm well. "This is about the scale of a $30 billion global snacking powerhouse," he declares, "and at the same time the speed, the agility, the dexterity" of a startup [2].

Others are gloomier. EY, a consultancy, recently surveyed CPG executives. Eight in ten doubted their company could adapt to customer demand. Kristina Rogers of EY posits that firms may need to rethink their business, not just trim costs and sign deals. "Is the billion-dollar brand," she wonders, "still a robust model" [2]?

Global Vertical Integration

APPLE and Tesla are two of the world's most talked-about companies, and two of the most vertically integrated. Apple not only writes much of its own software, but designs its own chips and runs its own shops. Tesla makes 80% of its electric cars and sells them directly to its customers. It is also constructing a network of service stations and building the world's biggest battery factory, in the Nevada desert [3].

A century ago this sort of vertical integration was the rule: companies integrated "backwards", by buying sources for raw materials and suppliers, and "forwards", by buying distributors. Standard Oil owned delivery wagons and refineries in addition to oil wells. Carnegie owned iron-ore deposits and rail carriages as well as blast furnaces. In his 1926 book "Today and Tomorrow" Henry Ford wrote that vertical integration was the key to his success: "If you want it done right, do it yourself." He claimed he could extract ore in Minnesota from his own mines, ship it to his River Rouge facility in Detroit and have it sitting as a Model T in a Chicago driveway—in no more than 84 hours [3].

Today this sort of bundling is rare: for the past 30 years firms have been focusing on their core business and contracting out everything else to specialists. Steelmakers sold their mining operations and carmakers spun off their parts suppliers. Controlling it all made sense, the argument went, when markets were rudimentary: when supplies of vital materials were limited or contractors could cheat you.

As markets became more sophisticated these justifications fell away. Thanks to globalisation, companies could always find new resources and better suppliers [3].

Yet a growing number of companies are having second thoughts. This is most visible in information technology. The industry's leaders were at the heart of the contracting-out revolution. Vertically integrated companies such as IBM outsourced as much as possible in order to lower costs. Upstarts such as Microsoft prospered by focusing on a narrow—but exceptionally valuable—slice of the pie: the operating system of personal computers. Now many startups in Silicon Valley pride themselves for being "full stack". But re-bundling can be found everywhere, from fashion to manufacturing [3].

Reasons for the reversal abound, but five stand out. The most important is simplicity. Consumers are willing to pay a premium for well-integrated products that do not force them to deal with different suppliers or land them with components that do not talk to each other. They want to be able simply to press a button and let the machine do the rest. This is largely why Apple opted for integration, as did Nest, a maker of wireless thermostats [3].

A second reason is that firms operating on the technological frontier often find it more efficient to do things in-house. Companies that are inventing the future frequently have no choice but to pour money into new ventures rather than buy components off the shelf. This explains Tesla's "gigafactory" for batteries: their availability is the biggest constraint on the firm's growth. Boeing tried to cut its production costs by outsourcing 70% of the production of its 787 Dreamliner to hundreds of different suppliers—more than any airliner before. The result was a disaster: parts came in late; bits didn't fit together; deadlines were missed. The firm reversed course, bringing manufacturing back in house and buying a factory [3].

A third reason is choice: the more the market has to offer, the more important it is to build a relationship with customers. Netflix and Amazon now create their own television shows in order to keep their viewers from buying more generic content elsewhere. Harry's, an US company that sends its subscribers a regular supply of razors and shaving cream, spent $100m to buy a German razor-blade factory [3].

Choice is reinforced by speed: fashion brands such as Spain's Zara have resisted contracting out everything. Instead, they operate their own clothes factories, employ their own designers and run their own shops. This gives them a big advantage: they can turn the latest trend into new product, often in small batches, and have it in stores in a couple of weeks. Less vertically integrated brands such as Gap and American Apparel find they are stuck with yesterday's creations because they cannot get supply chains to produce new wares quickly [3].

Then there is a combination of old worries about geopolitical uncertainty and new worries about the environment. In 2014 Ferrero, an Italian confectionary-maker, bought Oltan Gida, which produces one-third of Turkey's hazelnuts, the vital ingredient in Nutella. In 2015 IKEA, a Swedish furniture company, bought nearly 100,000 acres of forests in Romania and the Baltic region. Earlier this year ChemChina, a state-owned company, purchased Syngenta, a Swiss seeds and pesticides group, for $43 billion, driven by the government's quest for food security. Cruise companies such as Costa Cruises and Disney have bought islands in the Caribbean and the Bahamas so that they can guarantee that their passengers will have somewhere empty and unspoiled to visit when they sail past [3].

The renewed fashion for vertical integration will not sweep all before it. For the most mundane products the logic of contracting out still reigns supreme. Today's bundling is less ambitious than Henry Ford's: Apple, for instance, contracts out a lot of production to contract manufacturers such as Foxconn (though it keeps them on a tight leash). Integration is also hard to pull off: Tesla lost some of its shine on 11 April 2016 when it recalled 2,700 of its sport-utility vehicles because of a glitch. That said, striking the right balance between doing things in-house and contracting things out is clearly much more complicated than it was in the days when Tom Peters and his fellow gurus told companies to focus on what they do best and outsource the rest [3].

Re-modeling for local tastes and preferences

Kraft celebrated the 100th birthday of its Oreo biscuit in Shanghai yesterday by turning the waterfront into a vast Oreo advertisement. It was a celebration of one of history's most successful global brands – and of how that brand has reinvented itself in China, where Oreo is the mainland's best-selling biscuit [4].

The way Kraft has transformed this most quintessentially American cookie is a model for how successful multinational brands are approaching the China market, retail analysts say (see case study in text box below). For what passes for an Oreo in China these days often bears only a glancing resemblance to the black and white sandwich biscuit first sold in Hoboken, New Jersey, in 1912. Since then, Kraft has sold 452bn Oreos, global revenues for the brand last year topped $2bn [4].

In a bid to please Chinese taste buds, Kraft had to make an Oreo with Chinese characteristics. Some changes are subtle. The original Oreo is less sweet on the Chinese mainland than in the US. Other changes are nothing short of revolutionary, at least for Oreo aficionados. Some Oreos in China are shaped like a straw, or like a wafer, and even the traditional round ones come in flavours such as green tea ice-cream, grape-peach, mango-orange and raspberry-strawberry. Kraft says some of these flavours, first developed in China, have since become global hits. Kraft calls it "reverse innovation" [4].

Oreo, introduced into China in 1996, largely languished until Kraft made changes in distribution and advertising to boost sales – and created new flavours and tastes suited to the local market. "Any foreign company that comes to China and says, 'there's 1.5bn people here, goody goody, and I only need 1 per cent of that . . . [is] going to get into trouble'. You have to understand how the consumer operates at a really detailed level", says Lorna Davis, head of global biscuits for Kraft and former head of Kraft Foods in China [4].

She says non-traditional Oreo shapes – long and thin, or rectangular wafers – are only a small percentage of the China market, with the bulk still taken by round Oreos. But introducing new flavoured fillings for the round biscuit was crucial to boosting its success, along with new Oreo adverts that "struck a chord with one-child families", she says, creating an emotional attachment to the brand, in a country where big displays of emotion are rare [4].
Kraft is not alone in turning local adaptations into profit in China. Torsten Stocker, partner in the China practice of Monitor Group, points out that PepsiCo's Lays potato crisps come in flavours including cucumber and blueberry [4].

The story.
Kraft Foods' flagship Oreo brand first went on sale in China in 1996, but sales were lacklustre. By 2005 it was clear that one of the world's largest biscuit brands was falling far short of expectations in a fast- growing retail

market. Shawn Warren, regional head of biscuits, and his team knew they had to take radical action or risk the distinctive black-and-white-layered round biscuits being pulled off the shelves in China.

The challenge.
Growth was stalling at a time when the biscuit sector overall was experiencing record growth in China. Apart from a small rise in 2003, Oreo sales had been sluggish from the outset, and shipments into China were projected to drop by more than 10% in 2005. To make matters worse, the company was losing money on each Oreo sold. Even a near-40% rise in marketing yielded no boost in sales.

Research revealed that Kraft's positioning of the brand had missed the mark. First, its sales and marketing strategy had simply been replicated from the US. Advertising and in-store displays were translated directly, and the pricing structure and packaging were largely the same as in the US. Second, Kraft had paid too little attention to what Chinese consumers prefer. For example, the biscuit was too sweet. It seemed that Oreo's product was dictated by the manufacturing process, not by the market. Mr Warren recognised that without a significant strategic reorganisation, the company might have to pull Oreo from China altogether. He and his team needed to challenge decisions that had been made at Kraft's Illinois head office and convince it to make Oreos more suited to Chinese consumers.

The strategy.
The Oreo China team adopted a multi-pronged approach:

- It introduced a less sweet version called LightSweet Oreo. The team convinced headquarters to reformulate the original Oreo – for the first time in its 93-year history – to adapt biscuits on sale in China to local tastes.
- The size of the packet was reduced; the team also introduced another, smaller packet so consumers could get a first taste of Oreo biscuits at a lower cost. The smaller packets required changes in the manufacturing plant. Similarly, marketing promotions that relied on bonus packs (extra biscuits for the same price in a bigger pack) were replaced with more economical in-store samples.
- The team expanded distribution beyond grocery stores and hypermarkets to include convenience stores, a fast-growing outlet for consumer packaged goods. Carrefour in Shanghai offered to sell Oreos by weight, which gave customers more control over how much to buy.
- Recognising the popularity of wafers in China, the team introduced chocolate-covered wafer sticks. Convincing senior management to introduce a new product was not easy, but Oreo sticks were a big hit and soon gained 30% of wafer sales overall. Wafer sticks later launched in some other oveseas markets.

The results.
Manufacturing, packaging, distribution and marketing were aligned with the Chinese market and sales soared from $20m in 2005 to more than $400m in 2012. But the shift in mindset from rigidly relying on orders from the US to harnessing the local team's sense of consumers' tastes was also a significant outcome.

The lessons.
Oreo's experience illustrates the dilemma faced by a multinational brand entering a new market. There are different consumer tastes and local sensibilities to cater to but international brands often rely on the parent product's strategies because they have worked well over long periods in established, familiar markets. By launching new products in China that were recognisably Oreos but were sensitive to local preferences, the brand ensured sustainable growth by balancing traits that made the global Oreo brand successful while adapting to the local market.

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VALUE ADDED AND SUPPLY CHAINS

Companies have split the production of goods and services among many countries, creating supply chains that reduce overall costs

The average car has thousands of components that are produced by hundreds of suppliers located in dozens of countries. For example, a Volkswagen might have an engine made in Germany, Mexico, or China; a wiring harness from Tunisia; and an exhaust filter system from South Africa [5].

Declining trade, transport, and communication costs have allowed companies to splinter their production lines geographically. Not only does each stage of production occur in a different facility, but each facility is often in a different country. This type of production, which results in the movement of goods and services from country to country through a supply chain, is a major reason that global trade in goods and services has grown so fast. Since 1950, the volume of world trade in goods and services has grown 27-fold, to about $20 trillion, three times faster than global GDP. Much of that growth has been in intermediate products and services that move from country to country in a company's international supply chain. Value is added to a product in each of the countries that are part of the chain (a process called vertical trade or vertical specialization). By locating activities and tasks in different countries according to their comparative advantages, the total costs of production can be reduced [5].

Developing countries in Asia, transition economies in Europe, and a number of other countries, such as Mexico, have become active participants in supply-chain trade—not only for cars, but for such products as computers, cell phones, and medical devices. Overall, the share of manufactured goods in the total exports of developing economies has increased from 30 percent in 1980 to more than 70 percent in 2013, with parts and components representing a substantial portion of the increase [5].

Supply-chain trade can bring great benefits but also new risks and policy challenges, as seen in 2008 when the

volume of international trade collapsed during the financial crisis. The dramatic reduction in credit and demand caused by the crisis disproportionately hurt countries that were heavily dependent on supply-chain trade. An unexpected shock in a country that processes products used by plants in economies located “downstream” may have major negative repercussions—floods in Thailand in 2011, for example, affected a wide range of products, such as electronics, cars, and shoes [5].

Helps poorer economies

The supply chain allows poor countries to engage in manufacturing for the global market, because firms can locate labor-intensive and low-skill tasks in those economies—for example, the assembly of laptop computers and cell phones in Cambodia or Vietnam. Although the share of the value of a product that is added by the processing activities in a low-income country will generally be small, the employment and income that are created can generate significant benefits. Over time, as countries increase their engagement in such trade, they may be able to increase the share of total value that is generated locally. China and other developing economies that are big players in supply-chain trade have been generating an increasing share of global manufacturing value added (see Chart 1) [5].

Most of Africa and much of Latin America and the Middle East have not shifted toward the vertical specialization and supply-chain trade that have helped drive trade growth in east Asia, North America, and Europe. Fostering greater participation in such trade by more developing economies is important. Supply-chain trade offers countries the opportunity to exploit their comparative advantages without having to develop vertically integrated industries that provide the producers of final goods with the intermediate inputs they need [5].

One reason for the skewed pattern of supply-chain trade is that the costs associated with international transactions—such as transportation, infrastructure, trade barriers, and border policies—are much higher in low-income countries than in richer ones (see Chart 2). In part, this reflects geography, but in many cases it is also a result of policies—such as product regulation—that raise trade costs. Reducing trade costs and improving connections to regional and global markets are preconditions for expanding investment in supply-chain activities and involve not just trade facilitation (such as reducing delays at border crossings), but also improving transport-related infrastructure services and the operation of regional transit regimes (WEF, Bain & Co., and World Bank, 2013; Arvis and others, 2012) [5].

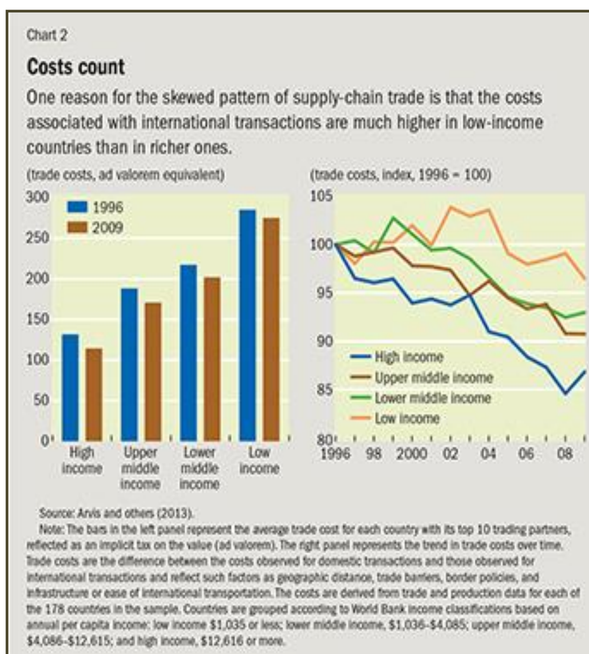
Supporting supply-chain trade

The expansion of supply-chain trade and the associated flows of foreign direct investment in production facilities have greatly reduced countries’ incentives to use trade policy instruments like tariffs. Supply-chain specialization requires that firms be able to import products and services that they then process and export. Significant levels of import protection would increase costs and make firms uncompetitive [5].

The fear of losing competitiveness helps explain the trend toward lower import tariffs in supply-chain–intensive countries and the differences in the participation in supply-chain trade across countries. Many of the countries that participate much less in this type of specialization have higher barriers to trade—reflected not only in average tariff levels, but also in the use of measures to restrict exports of natural resources that are “upstream” inputs into global value chains. More generally, however, domestic policies that increase trade costs may hurt the efficiency of supply chains or impose costs on firms in other countries that are located either upstream or downstream along the supply chain and preclude supply-chain investment in a country [5].

Governments may not necessarily be aware of the effect of policies on investment incentives and operations. Existing trade agreements and similar forms of international cooperation usually are not designed with supply-chain trade in mind. But dealing with policies that affect such trade has implications for the design of trade agreements and trade cooperation—for both advanced and developing economies. Policies that raise the cost of international flows of goods, services, knowledge, and professionals—all core elements of supply-chain trade—are increasingly of a regulatory nature. Among them are product safety and health regulation, licensing requirements, and assessment procedures. It is hard to achieve international cooperation on regulatory policies because regulators worry that such efforts will impede regulatory objectives. Matters are complicated further because many agencies may have a role in setting and enforcing product and process regulations that, generally, were designed without consideration of how they might affect supply-chain incentives [5].

From the perspective of supply-chain trade, international trade negotiations are less effective than they could be in facilitating trade because they deal with specific policy areas—such as product standards, customs valuation, and import licensing—in isolation. But for a supply-chain



operation, what matters are all the regulatory policies that affect the chain as a whole. An item-by-item approach may leave some important policy areas unaddressed, suggesting that trade officials should do more to "think supply chain" when designing trade agreements (Hoekman and Jackson, 2013) [5].

Public-private partnerships

A first step to putting in place a broader approach would be to select a half dozen or so supply chains and create a mechanism—a supply-chain "council"—that brings together businesses, regulators, and trade officials from the countries concerned to identify the policy constraints that most hurt their operations. Active involvement and participation by businesses is critical because regulators and officials generally will not understand how a supply chain works and how policies affect it [5].

Regulatory policies presumably have a rationale, such as ensuring human health and safety. But it may be that there are redundancies in the regulations and overlapping requirements from different agencies that do not communicate with each other. For example, a chemical company that imports acetyl—used in making aspirin and paracetamol (also called acetaminophen)—into the United States must, on average, comply with similar regulations from five different agencies that often fail to coordinate and communicate effectively with one another. As a result, one out of three shipments is delayed—at a cost to the company of $60,000 for each day of delay (WEF, Bain & Co., and World Bank, 2013). By focusing on the supply chain, the council could help identify such redundancies and possibilities for consolidation [5].

A key task for supply-chain councils would be devising a plan to address the most detrimental policies. The participation of the relevant regulatory bodies and those in government responsible for economic policy is necessary for the council to decide what can be done to reduce compliance costs for business without derailing regulatory objectives. The business community can help identify potential solutions [5].

These public-private supply-chain partnerships should establish a policy performance baseline for each supply chain to allow monitoring of the effect of changes in policies. This baseline would be based on data on specific outcomes—such as delays, variability in clearance times, and the use and efficiency of dispute-resolution mechanisms. Measurement is important because removing one source of duplicative or redundant regulatory cost may not help if other policies continue to impose excess costs. Businesses must contribute the data needed for performance monitoring [5].

A number of issues must be addressed to make these suggestions work.

- Firms may not want to provide relevant data because of competitive concerns and generally will be disinclined to incur additional costs associated with collecting data that they do not already compile. Thus, the more the performance indicators build on data that firms already gather, the more straightforward it will be for supply-chain councils to monitor outcomes over time.
- Governments may not trust data provided by firms, while enterprises may worry about providing information that could be used by competitors. This calls for aggregating data so that individual businesses cannot be identified as the source of information. There are good models—such as those that have been developed for firm and household surveys—that can be used to address such concerns. The data must be compiled and processed by an organization that is technically competent and independent of industry [5].

Supply-chain trade offers new opportunities for low-income countries to become part of the "global factory." Facilitating such trade requires more than reducing domestic trade costs, although that is a critical precondition for participation in many types of such trade. International cooperation is needed to reduce the trade-impeding effects of duplicative regulatory policies. Whether in the context of the World Trade Organization, regional trade agreements such as the Transatlantic Trade and Investment Partnership being negotiated by the European Union and the United States, or agreements involving developing economies, a new approach that is based on closer partnership between the public and private sectors can help enhance the relevance of trade cooperation in supporting supply-chain trade [5]. ■

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