Fundación
de la Innovación
Bankinter

11 Competing in Challenging Times

New Rules and the Role of Innovation

Alto rendimiento. Hecho realidad.

Fundación Accenture has worked with the Bankinter **Foundation of Innovation** on the production of this Future Trends Forum (FTF) study and also helps to disseminate the work of this leading independent voice in the field of prediction and innovation. The consultancy firm has placed all its knowledge at FTF's disposition, together with its extensive expertise in turning companies and institutions into high performance organisations.

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Fundación de la Innovación Bankinter
Ms. Andreea Niculcea
Ms. Julie Slama
Ms. Marcelina Cancho Rosado
Ms. Teresa Jiménez Herradon

Accenture
Ms. Eva López Suárez
Ms. Cynthia Gregsamer Montes
Mr. Santiago Espinosa
de los Monteros Madrona

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Executive Summary

The process of globalization is entering a new stage. Globalization traditionally involved business expanding out from developed economies to emerging economies. Today, however, the process flows in both directions and emerging economies are now gaining ground on the developed countries. Presently, emerging countries account for 49% of the world's GDP, 10% more than in 1990. In fact, experts say they will likely overtake developed countries over the next two decades. These emerging economies are rapidly gaining importance on the world stage in aspects as diverse as investments, natural resources, and even talent development. The growing recognition of these countries is evidenced by the G8 inviting Argentina, Brazil, China, India, Indonesia, Mexico, Russia, Saudi Arabia, South Africa and South Korea to attend its recent summits. Meanwhile, the world is immersed in a period of major changes and uncertainty that could forever change the process of globalization as we have known it up until now. The crisis situation has accentuated the trend toward **State intervention**. Some interpret the "rescue" measures as a tacit admission that the capitalist system, as we know it, has breaches. Added to that is the inevitable feeling that a lack of ethical and moral conduct has pervaded in the events that triggered the crisis in the financial system.

This context, which points toward a **new, multipolar world order** characterized by the heightened importance of emerging economies, also presents a series of escalating **geopolitical challenges** (i.e., shortage of resources, aging of the population, etc.). At the same time, we are seeing the emergence of **new values in society** that demand greater international cooperation to ensure solidarity in the national and global order, as well as a readjustment to a way of living and doing business that is based on innovation and sustainability. In short, it is a time to **redefine the new rules of the game** that will determine the dynamics of the markets where investors, companies, governments and consumers coexist. In order to survive, companies must strive to create competitive advantages in the different areas that will mark the future of the globalization process in the multipolar framework:

Mis notas

- Globalized trade.
- International capital movements.
- Human capital.
- Sustainability.
- Innovation.

A survey was carried out for this publication in order to identify those rules and frame them within each of these topics.

Globalized Trade

World consumption is in crisis. For the first time in decades, we are seeing a reduction in the international flow of goods and services. This is compounded by economic recession, the aging of the population of developed countries and new global challenges, resulting in greater pressure on resources. The hope is that emerging markets will revitalize world consumption. All signs suggest that the **new consumers** from emerging countries will give rise to new business opportunities. For that to happen, emerging countries must not fall into the temptation of establishing protectionist measures that entail a step backward in their market dynamics. In this context, Spain presents a **structural deficit in its balance of payments** that has only been sustainable as a result of the push coming from an internal demand that has compensated its scarce exports. The lack of competitiveness of Spanish goods and services, and the meager internationalization of the Spanish firm are two issues that the country must effectively deal with. With that objective, Spain should put more resources into promoting its image abroad, particularly in Asia.

International Capital Movements

The tide is turning with regard to international investment flows. Whereas a few years ago investments originated from developed economies, they are now increasingly coming from emerging countries. Over the past few years **sovereign wealth fund** investments have become highly valuable in developed countries, arousing suspicion as to their true motivations. While these operations could potentially alter the capital of many companies, the need for liquidity has opened the way for them. Meanwhile, we have also seen an increase in the flows of capital among emerging countries (E2E). The trend is for emerging multinationals to invest first in neighboring countries with cultural similarities and established trade ties. Spain has also focused its investments on destinations with kindred political and cultural makeups, primarily within the euro area and Latin America. Nevertheless, the fast-growing markets, East Asia in particular, play a vital role in the new, multipolar order while having played a minor role in terms of the destination of Spanish investments and exports. As such, **boosting the volume of investments in emerging markets** should be a top priority on Spain's investment agenda.

Human Capital in the Multipolar World

The battle for the **scarce talent resources** has begun. **Talent** to change the ethical values of companies, talent to innovate, talent to deal with the major challenges that will be handed down to future generations, namely: global warming, demographic changes and the sustainability of the capitalist system. In an environment in which changes take place in a heartbeat, talent springs up from a variety of sources and relocates. The countries that successfully create, attract, develop and retain talent will hold a prominent position in the new power structure. China and India understand this and climb up each year in the international talent rankings. The success of different countries and economies depends on several factors, such as the prestige of their universities, the research opportunities available and the professional supply offered by their business sector. Achieving this will require successful cooperation across the board, from families to the educational system, business and government. For Spain, talent management is perhaps even more important: talent is needed to increase the low productivity and competitiveness of its production model.

The Challenge of Sustainable Development

Sustainability is in vogue. With emerging countries adopting the production and consumption patterns of developed countries, the pressure on resources is increasing and thus the problem is worsening.

From the ashes of the crisis, we are seeing the emergence of a new type of sustainability which is, in fact, the basis for the rest: "**ethical**" sustainability. Executives are accused of having a lack of principles and the capitalist system, of having prioritized speculation over effort, responsibility and ethics. The feeling that something must change puts additional pressure on business and government practices. No company can single-handedly resolve the issue of climate change, however the principles of Corporate Social Responsibility (CSR) could make a difference when defining the organizations and leaders whose responsibilities extend beyond the profit and loss statement. **Spain** has a long road ahead to achieve sustainability. Reducing its heavy foreign **energy dependence**, increasing the importance of renewable energy and investing in energy efficiency are just a few of the measures needed. An even more ambitious but equally necessary objective is to **change** the Spanish **production model** in order to increase its productivity and competitiveness, which must happen if the country wants to guarantee economic sustainability in the new, multipolar world.

Innovation

Major innovations come at times of recession. Hard times require companies to transform their businesses to adapt to an ever-changing environment, and even more so in times of crisis. When the recession cycle ends, the countries and companies that have innovated demonstrated a long-term vision will be better prepared to face the next few decades. The trend seems to indicate a change of direction and that developed countries will be the ones progressively adopting the innovations of **emerging countries**. Singapore, South Korea, Hong Kong, China and India are establishing themselves as **innovative countries** with internationally renowned research centers. **Spain**, for its part, is in danger of stagnating halfway between the highly innovative economies (e.g., United States, Japan) and those that, up until now, have been considered low-cost producers (e.g., China, India, Poland). Cooperation between Government, University and Business must be improved in order to create a more effective R&D and Innovation strategy, increase technological innovation and improve human capital.

Predicting the future is not only difficult but in fact risky. Nevertheless, this publication aims to offer some insight into the impact of the crisis on the evolution of the capitalist system. In addition, the following chapters will explain the changes that are shaping a multipolar world with respect to the aforementioned factors (globalized trade, international capital movements, human capital, sustainability and innovation). We will approach the subject from a macroeconomic point of view before discussing in depth the rules that will allow companies to successfully deal with the new situation, differentiating between the companies of developed and emerging countries. Finally, we will explain the situation of Spain in each of these areas and the specific rules for Spanish companies.

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CHAPTER 1

Foreword

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Foreword

It is no secret that the world is in the grips of a difficult and perhaps protracted financial and economic downturn. For most of us, it is the first time we have observed a problem of this magnitude, especially one occurring on a global basis. Since September 2008, when the Lehman Brothers went under and AIG was bailed out by the US Treasury, I have traveled around the world several times talking to people in places as diverse as Bogota, Singapore, Paris, Moscow, Madrid, New York, Las Vegas, Dubai and Tel Aviv. And yet, while the countries and cultures I visited are very different, the level of knowledge expressed in each place was considerable. Nearly everyone, no matter where they might live, understands what is going on.

From my own analysis, I have observed that today's global economy is roughly 25 times larger than the economy of early 1930's, when the world entered the Great Depression. Per capita incomes in Europe and the United States are at least 10 times greater than they were in those dark days. Today's population is far larger and there are so many qualitative differences between the way we live today and the way people lived back then, that real comparisons are very difficult to make.

Such large increases in wealth –physical and financial– are providing policy makers around the world with more wherewithals to fight the world's problems than ever before. And, while Europe, Asia and the United States may differ by degrees about how to fix the world's problems, it is only by degrees. No one from any major country is advocating policies like those bellicose, "go it alone" policies of the 1930's. No one in a position of responsibility is arguing for the abandonment of the markets. Ideology, for the most part, is on the backburner.

What that means is that the world is facing its worst economic and financial calamity since the 1930's, in a spirit of cooperation. The world has not devolved into "camps," parties or hegemonies. Instead, policymakers have been able to deliberate in ways that would have been unheard of a generation or two ago.

At the same time, everyone seems to recognize that the world's fate is now a collective one and that the livelihoods of factory workers in Shanghai, Prague, Stuttgart or Monterrey depend on the shopping habits of consumer in Los Angeles, Madrid, Tokyo, Mumbai and Oslo. We are all linked in ways that people discussed glibly under the epithet of globalization but now feel daily as they wonder about the strength of their pension funds, banks, and companies for which they work. People everywhere understand in ways that are irrefutable that this time we are all in it together.

But as we fight to correct the global economy, there is something even more powerful than today's cooperative approach and the world's increase in physical and financial wealth. We are facing this global "test" with more knowledge at hand than we have ever had before.

Mis notas

As futurist and scientist Ray Kurzweil argues, Moore's law, which says that the power of computer chips doubles each two years while the costs of computing halves, now applies to everything. It does so because of knowledge has been growing at an exponential rate. As a result, decisions are no longer made on the basis of a senior person's experience, but on the basis of facts and knowledge.

Policymakers struggling to fix the world's problems do so armed with more information and knowledge than at any time in history. If a policymaker from one country sits in a meeting and does not like the conclusions of a policymaker from another country, that policymaker has only to click on one smart device or another to check an assumption, verify data, test a conclusion or run a simulation.

Just compare today's wired and wirelessly enhanced economic and financial deliberations with those that took place during other periods of financial stress from 1907 to 1933. No matter how smart the people in the room might have been, they framed their arguments based on thousands of times less information than we have today.

The great John Maynard Keynes, with all his erudition, intelligence and insight, represented Britain at the end of World War I and II, with maybe 1/1,000,000 of the economic information that a high school student has access to today. And, while he no doubt had a brilliant mind, he didn't have computers or databases to assist him, let alone the ability to model a situation or use a mobile phone to call for help. Nor did he, nor any of his peers, have the ability to create, trade, move or invest money electronically —anywhere in the world— at the speed of light. It is no surprise, given today's circumstances that a number of economists have said that when the economic recovery begins it is likely to proceed far faster than ever before.

What all this means is that if we have to have a crises and human nature suggests we will have them from time to time, then this is the best time so far to have one.

The world has come together, it is richer than ever and people know more than at any time in history. With resources like that, it seems that having hope for the future is not based on naïve optimism, as it might have been in the past, but on a realistic appreciation of where the world is today.

Joel Kurtzman
Chairman of the Kurtzman Group and former editor-in-chief of *Harvard Business Review.*

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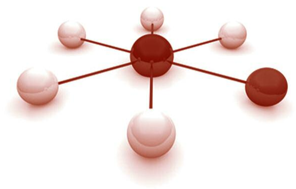
CHAPTER 2

Introduction

2 Introduction



In a constantly evolving world, being able to anticipate the changes and possible impacts awaiting us in the medium and long term is vital for success. This enables us to identify and take advantage of the business opportunities that present themselves in the future. In order to achieve this, it is essential to have tools that are as useful as an analysis of future trends.

Bankinter created the **Foundation of Innovation** with a clear objective in mind: to influence the present by looking into the future, and to stimulate the creation of business opportunities based on the cutting edge of both technology and management, in order to promote innovation in Spanish business. It is an ambitious and innovative project, which **Bankinter** is making available to society as a whole to foster the creation of business opportunities arising from a situational change. A project that involves over 200 multidisciplinary, international experts who are opinion formers from all over the world, along with an exceptional board of trustees, and one that also aims to reinforce **Bankinter**'s commitment to society.

The Future Trends Forum (FTF) is the main and most well-established project of the **Foundation of Innovation Bankinter**. It showcases the **Bankinter** culture: innovation and a commitment to cutting-edge thought. This is the first forum on futurology and innovation in Spain, and features the participation of leading international scientists and intellectuals. It is the only multidisciplinary, multisector, international forum in Europe. Its mission is to convey the objectivity of a forum that has been enriched by various points of view and that is not biased by any type of vested interests.

It is a forum that seeks to anticipate the immediate future, by detecting the social, economic, scientific and technological trends that can change the way we act and live today, by an analysis of the possible scenarios and impact on current business models in the sectors that are most affected, so as to obtain recommendations on how wealth can be generated from this situation, which must then be passed on to the various strategic focus areas of society.

The subjects debated at the meetings are freely proposed and chosen by a vote of the FTF members. The end result of each of these processes is the dissemination of the conclusions of this research work from entrepreneurs, professionals, senior managers, companies and institutions. The dissemination includes this publication as well as a series of conferences held in Spain's largest cities.

This latest publication, produced in collaboration with Accenture, presents the conclusions of the Future Trends Forum concerning the changes taking place in the international economic landscape.

We begin by analyzing the trends that will define the new world order of the future. First, by studying the effect of the current crisis on the progression of the

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capitalist system. Then, by examining the incipient shift of world power from the United States to a new constellation of emerging countries, which has come to be known as the “new, multipolar world order.”

That is followed by an in-depth look at trends in the five areas that will determine the future of the globalization process: globalized trade, international capital movements, human capital, the challenge of sustainable development, and innovation as a key for the future. Each of these topics will be addressed separately. In each case, we will present, from a macroeconomic perspective, the current situation and the trends that will determine its global progression, with a specific section dedicated to Spain. This analysis will later serve as the basis for proposing the rules that will help guide for businesses in their mission to be successfully in the future in each of those areas. Though fundamentally different, these rules will have many points in common, for enterprises in both developed and emerging countries, so that they are more suited to the particularities of the environment in which they operate. Recommendations are also given concerning the specific rules for at Spanish companies that respond starting position.

The **Bankinter Foundation of Innovation** trusts that this new publication will once again be a source of knowledge and, above all, a stimulus and guiding light for professionals and entrepreneurs from different sectors, so that they may capitalize on the advantages and opportunities that arise in such a time of economic uncertainty. Now, more than ever, the companies that are able to understand and respond to the changing landscape will not only endure, but will in fact come away from this crisis stronger and better prepared to successfully ride the next wave of growth when it comes to pass.

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CHAPTER 3

Toward a New World Order

3 Toward a New World Order

Presently, emerging countries account for 49% of the world's GDP, 10% more than in 1990[1]. In fact, experts say they will likely overtake developed economies in the next two decades. These economies are rapidly gaining importance on the world stage in aspects as diverse as investments, natural resources, and even talent development. The growing recognition of these countries is evidenced by the G8 inviting Argentina, Brazil, China, India, Indonesia, Mexico, Russia, Saudi Arabia, South Africa and South Korea to attend its recent summits.

The process of globalization is entering a new stage. Globalization traditionally involved business expanding out from developed economies to emerging economies. Today, however, the process flows in both directions and emerging economies are now gaining ground on the developed countries with respect to the creation of business opportunities. South-South investments, i.e., capital flows between emerging countries, are also on the increase.

In this context, which points toward a new, multipolar world order, the international crisis that has unfolded in the last few months appears as a disruptive element which poses new questions, since an analysis of history is frequently made in times of crisis, but not so often in periods of prosperity. This leads us to recall that at the end of the 19TH century there was a clear movement toward greater global economic integration, ending dramatically some years later in the Great Depression of 1929, the consequences of which were felt throughout the 1930s. The financial press is currently full of comparisons between then and now, awakening old ghosts of the past, and this only serves to heighten the crisis of confidence.

There are many theories that predict which path the globalization process will take in this new unfavorable economic scenario. The most optimistic observers talk about a restoration of confidence and the application of monetary and financial measures that will prevent the crisis from becoming unnecessarily prolonged. In this way, globalization could follow its course with the integration of developed and emerging economies. The middle ground is occupied by those who see the crisis as having a varying impact on different countries, which will cause the integration achieved to date to stagnate as a result of the lack of confidence generated and growing protectionist sentiment. Finally, in the worst-case scenario, the global economy will experience a long-term recession, in which globalization will take a backward step, encouraged by the rise in nationalist fervor, and this would put a brake on trade and capital movements.

What does seem clear is that there has been a change in the ground rules that determine the dynamics of the markets where investors, companies, governments and consumers coexist. The theory of Darwin's finches serves as a good example to illustrate the behavior of companies when faced by changes in the economic, social and political environment. Just like the species of birds that—as the famous scientist concluded—had adapted the size and shape of their beak to

[1] *The Rise of the Multi-Polar World,* Accenture (2007).

the different food sources depending on the area in which they lived, companies must embrace continuous change in their strategies and business models, if they wish to survive in an environment in which the ground rules are being rewritten at breakneck speed.

At the same time, decision making with a view to emerging from the crisis has become more complex due to escalating geopolitical challenges (shortage of resources, aging of the population, etc.). A short-term approach focused on solving the economic problems of the moment could lead to structural problems in the longer term, which would only exacerbate the situation.

Predicting the future is not only difficult but in fact risky. This chapter aims to offer some insight into the impact of the crisis on the evolution of the capitalist system. Thus we will seek to explain both the changes that are taking place in the centers of global economic power, which point toward the establishing of a multipolar world, and how the crisis is accelerating this process. Finally, a brief presentation will be made of the fronts that will determine the future of globalization. Our ultimate and ambitious objective is to offer a compressed view of the environment in which we live, in order that we may anticipate the future.

3.1. The Collapse of Capitalism

> "The market—the dominant institution of our times—is not a substitute for responsibility, merely a mechanism for sorting the efficient from the inefficient. "
> Charles Handy

In most parts of the world, and throughout the course of history, capitalism has stamped its mark on human lifestyle and the way in which business is conducted. Attracted by the prosperity of Western nations, emerging countries also sought to reduce State intervention in the economy. However, the rapid expansion of what began as a financial crisis focused on the United States has shaken the foundations of the global model of economic growth established in recent years.

In view of the systemic risk that the consequences of the crisis may represent for the economy, governments in the European Union and the United States have taken "rescue" measures, in many cases designed to safeguard those companies whose failure could have a cascading effect on other players and, in short, lead to the collapse of the global economy. Some interpret these political decisions as a tacit admission that the capitalist system, as we know it, has breaches.

The current trend of increasing the degree of State intervention challenges the traditional framework of free markets and private decision in the market economy established in developed countries. The crisis has revived the old debate about the role of the State in the economy. This is difficult ground, in which—if we are realistic—finding a consensus is nothing short of utopian, and world economic history offers conclusive proof of this.

Firstly, it is important to remember that the way in which markets operate is not completely free, as the economists Milton Friedman and Friedrich Hayek pointed out. Basic prices, such as the interest rate, i.e., the price of money, do not respond freely to the laws of supply and demand. Macroeconomic and fiscal policy is one of the tools available to governments to influence markets, and it is a tool they use. At this stage of affairs, no one questions the role of the State in correcting inherent market failure (sustainability, environment, etc.) and in providing public goods (health, education, etc.) or assistance for certain groups (disabled persons, large families, etc.). Therefore, an acceptable degree of coexistence between the laws of the market and State participation is not just a possibility: it is something that has worked, at least until now. The difficult aspect is setting the limit of government intervention, for once this is overstepped, the foundations on which the capitalist system is built would be threatened. Once again, this limit is debatable, since it does not follow a mathematical rule, and it is a matter that is liable to generate conflicting opinions.

History reveals models of capitalism that vary according to the degree of direct State intervention in a country's economy. The hegemony of the United States served as proof of the triumph of Anglo-Saxon capitalism, characterized by minimal intervention. The crisis has led some experts to advocate the need to adopt the French model of capitalism and increase the presence of the State in the economic arena.

Some consider recent events and see the "beginning of the end of capitalism." However, the conclusions of the G20 are emphatic in this respect: Our work will be guided by a shared belief that market principles, open trade and investment regimes, and effectively regulated financial markets foster the dynamism, innovation, and entrepreneurship that are essential for economic growth, employment, and poverty reduction."

This declaration of principles also reflects the need to regulate financial markets. There is a consensus that one of the principal errors has been their lack of regulation and transparency. Sadly, evidence of the latter can be seen in the "Madoff case," which has affected the financial elite around the world and has launched the debate about the excessive complexity of financial assets. The problem became "more democratic" when the financial crisis forced its way into the real economy, leaving alarming unemployment figures and decline in its wake. This situation is exacerbated by the growing lack of confidence among citizens, which has led to a greater reluctance to spend, damaging growth even more. Indeed, psychology also plays a very important role in the economy.

With this outlook, there are those who assert that, although the capitalist system will continue to govern the world economy, a profound change is necessary. In their opinion, a new form of capitalism is emerging, and although it is impossible to predict the way in which it is going to operate, the form that it is taking is already visible. Is the new capitalism an irreversible process or will it return to capitalism as we know it today? A headline in *Barron's* read "Is This Capitalism? Or is it the Invisible Hand of government in the taxpayer's pocket?"[2] in reference to the debate over whether it is really fair that the whole of society should pay for the rash behavior of large companies. In the end, if the consequences are not borne as a taxpayer, they will be as an employee.

The idea that the State must intervene in order to correct the failure of the market was recognized by Keynesian economists as part of the customary dynamic for improving the capitalist system, and therefore it should not be interpreted as a step toward the end of the free market. In recent months, governments have attracted attention with their "rescue plans" in every corner of the globe. Although these measures have some characteristics in common and they flourish within the framework of a globalized world, they differ from one country to the next. Governments have been criticized for a lack of coordination when designing their rescue plans. It is thought that although the details of the plans may differ, they should be based on the same principles. In this way, sight would not be lost of the globalization process and the common good.

Obviously, all eyes are now on Obama's economic stimulus plan; given that the crisis originated in US markets, comparisons with the Great Depression are inevitable, and for many observers the role played by Roosevelt's New Deal offers a glimmer of light at the end of the tunnel. The question is whether this new, more active role played by the State will be merely temporary, or whether it will become a standard element in the dynamics of the economic system.

Throughout 2007 and 2008, government initiatives were announced, with the primary aim being to stem the rampant financial crisis at both a national level and within the framework of transnational institutions. One example is the historic cash injection of 94.841 million made by the European Central Bank (ECB)[3], exceeding the 69.300 million injected after the attacks of September 11. The objective was to revive interbank operations, which were brought to a standstill by the banks' lack of confidence following the subprime mortgage collapse.

When executives[4] were asked about the fiscal and monetary policy that governments should pursue to revitalize the economy, they said that infrastructure should be the main focus for investment (see figure 1).

[2] «Is This Capitalism? Or is it the Invisible Hand of government in the taxpayer's pocket?», Thomas G. Donlan (21/07/2008).

[3] «El BCE realiza una inyección de liquidez histórica ante la crisis hipotecaria en EE.UU.», *El Mundo* (10/08/2007).

[4] *Economic conditions snapshot: February 2009,* McKinsey.

Figure 1. What role should governments/key central banks should play in fiscal and monetary policy?
Source: *Economic conditions snapshot: February 2009,* McKinsey.

Besides these government measures that are being taken in response to the crisis, there are other reasons why some countries decide to intervene in the free operation of markets. Within the new world order and in view of the dramatic growth of emerging economies, commercial formulas have come into play that appear to threaten the position of the leading industries of developed countries. These are the so-called sovereign wealth funds*,* through which governments of emerging countries can invest large currency reserves that they have accumulated. This type of investment has been viewed with suspicion by the governments of developed countries, for fear that their strategic purpose is to gain entry into key sectors, rather than serve as simple high yield investments. Contrary to the principles of free competition, governments have sought to block operations of this kind, in order to prevent the inflow of controlling equity into emblematic national companies. Both movements imply a higher profile of the State in the economy, whether it is managing sovereign wealth funds or protecting local markets.

At the same time, in recent months governments have been accused of putting pressure on banks to arrange more of their loans in the markets of their countries of origin. British Prime Minister Gordon Brown warned at the Davos summit in January 2008 that this practice, which he described as "financial mercantilism," could exacerbate the current economic downturn.

In this respect, the World Trade Organization also alerted delegates at the same meeting to the risk of a rise in protectionism in international trade. All the politicians were in agreement that this is currently the greatest threat to the world economy. Earlier, Director-General of the WTO Pascal Lamy, in a speech to the International Chamber of Commerce on 2 February 2009, warned members about the risk of "sliding down a slippery slope of tit-for-tat (protectionist) measures," and he cited the words of Mahatma Gandhi: "an eye for an eye makes the whole world blind." Lamy urged the business community to support the Doha Round (to liberalize world trade), which "can be part of the solution to the economic downturn."

According to the experts of the Future Trends Forum, the increase in State intervention will be the characteristic trend in economic affairs in the future. Volatility will also be a determining factor. Some experts consider that this volatility will not be a transitory phase, but will become an intrinsic part of the economic scenario, given its growing complexity and the current interdependence between countries (see Figure 2).

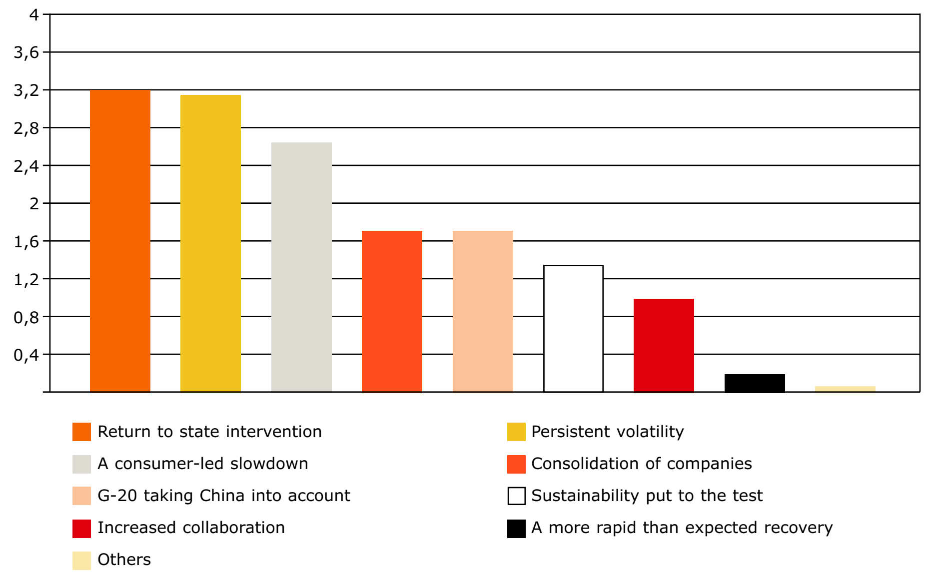


Figure 2. Factors that will have an impact on the international scenario
Source: Drawn from the conclusons within the Future Trends Forum.

The Future Trends Forum experts view it as positive that governments should become involved in national economies, taking measures that aim to:

- Regulate financial markets, ensuring their transparency.
- Urge banks to offer funding to companies.
- Share loan risk with the banks, if necessary.
- Invest in infrastructure projects to achieve the dual objective of investing in the future and creating employment in the short term.
- Create incentives and offer financial assistance to companies and other entities so that they invest in continuous training and retraining of unemployed persons.
- Incentivize corporate sustainability and investment in innovation.
- Invest in RDI to ensure long-term growth.
- Ease the financial burden on companies by reducing the taxes payable.
- Help those persons who are suffering the consequences of unemployment and poverty.

In view of recent events, are we changing the course of capitalism by increasing the involvement of the State in our economy? Furthermore, are the effects purely economic and financial, or are there more permanent consequences for our system of values? At the Davos summit in January 2008, Indra Nooyi, president of PepsiCo, spoke of a loss of equilibrium in those elements that create wealth and development in fair capitalism: competition, laws and regulation, and ethics and values. The search for ways in which the society of the common, fair and equitable good may advance is already being undertaken by some companies within the framework of new forms of capitalism. This chapter will include an analysis of the present situation and of the theories that anticipate these new forms of capitalism. Consideration will also be given to the debate about the need for a new regulatory framework. Finally, an examination will be made of how emerging economies have integrated into a context to which they have been dispatched for the purpose of participating in a global forum.

The Ethical and Moral Crisis

According to many analysts, the roots of the financial crisis are to be found not only in an inadequate regulatory system, but particularly in the lack of ethics and morality that has characterized the financial system in recent times. They believe that through excessive exploitation and the unscrupulous pursuit of profit, people have pushed business ethics into the background.[5]

At the same time, some governments are criticized for not having been sufficiently strict when they established economic regulations at the highest levels. Now they are being asked to collaborate with large international agencies to ensure solidarity on both a national and a global scale.

Recently, the permanent observer of the Vatican issued the following reminder: "It must not be forgotten that at the edges of the financial system there are retired

[5] http://parroq-sagradafamilia.blogspot.com/2008/11/la-crisis-financiera-hunde-sus-raices.html

persons, small family businesses, cottage industries and countless employees for whom savings are an essential means of support. Financial activity needs to be sufficiently transparent so that individual savers, especially the poor and those least protected, understand what will become of their savings. This calls not only for effective measures of oversight by governments, but also for a high standard of ethical conduct on the part of financial leaders themselves."[6]

It is also thought that a lifestyle and a model of economic growth based on high consumption and debt, to the detriment of saving and the creation of productive capital, have endangered the sustainability of the recent capitalist model. Furthermore, the pressure on natural resources has exacerbated the problems of environmental sustainability.

The "Historic Threat" to the Globalized Capitalist System

At the end of 2007, Manuel Freytas, a journalist, researcher and analyst, wrote an article in which he sought to shed some light on the economic crisis that was being forecast. He outlined the most probable causes of the widespread market slump and the beginning of the "world crisis in the development of the *model"* in reference to American "imperial" capitalism.[7] The causes that he cited were the following:

- The collapse of the dollar.
- The subprime financial crisis in the United States.
- The rise in oil prices.

In this scenario, the United States, which is the principal purchaser and consumer of products and energy resources, goes into recession and drags the entire capitalist system with it, because the world economy is "dollarized" (the dollar is the currency standard for all commercial and financial transactions on a global scale). The author's *model* has three axes:

A) Exporting mining/agro-energy axis (emerging countries that export raw materials, led by Latin America).

B) Exporting industrial axis (exporting industrial countries in Asia, led by China and India).

C) Importing "speculative" financial axis (United States, European Union and central countries that import and consume the majority of goods and services).

Since the United States and the European Union are the "principal purchasers" of goods produced in the equation, the economic recession and the devaluation of the dollar lead to a drastic reduction in their purchases from China, which in turn reduces its raw material and oil imports from emerging countries. In this way, all the axes are involved due to a domino effect, and the capitalist growth model collapses on a world scale. Furthermore, the increase in demand for oil

[6] http://oclacc.org/noticia/crisis-financiera-falta-etica-moral 5/11/2008.

[7] «¿Se derrumba el Imperio? El dominó global de la crisis capitalista: Cómo se bate el cóctel USA-China-petróleo-dólar», Manuel Freytas (27/11/2007), journalist, researcher and analyst, specialized in intelligence and strategic communications.

from both developed and emerging countries, together with a weak dollar, only makes the situation worse with an inflationary process. A rise in oil prices causes a worldwide increase in the prices of basic foods, which, according to the experts, may culminate in *stagflation* (a combination of economic decline, rising unemployment and inflationary pressure[8]).

The cycle is maintained because the "dollarization" of the global capitalist economy continues to infect the system through the reserves in US currency and the pricing in dollars of commodities such as oil. The solution does not lie in inverting this situation, because "if the powers were to decide to 'de-dollarize' their reserves and convert them into another currency, the North American economic and financial system (the reigning economy of the capitalist system) would collapse, dragging the remaining economies in the 'globalized' capitalist world in its wake."[9]

The Paradox of John Locke's Sock

"Nothing is as permanent as a temporary government program," Milton Friedman.

In view of the measures that are being proposed to improve the operation of the capitalist system and overcome the global crisis, a question arises: if we change so many determining aspects of the capitalist system, can we still call it capitalism? The English philosopher John Locke put forward a paradox that serves to illustrate this point. He posited a situation in which our favorite sock develops a hole and he pondered whether the sock would still be the same after a patch was applied to the hole. If so, would it still be the same sock after a second patch was applied? And would it in fact still be the same sock several years later, even after all of the material of the original sock had been replaced with patches?

The first patch that governments have applied to the capitalist sock has been to cover the hole in the financial system. Several headlines have presented the debate about whether the innocent should pay for the sins of others in this crisis. Given the size of the problem, if no help is given to companies in difficulties in sectors that are considered critical to the economy, gradually the whole of society will be affected in one way or another; business leaders, when their customers cannot pay them, and employees, when they lose their jobs as a result of cost-cutting measures. On the other hand, if the government intervenes and helps certain companies, this may be interpreted as an example of excessive risk-taking going unpunished, and it inevitably leads to controversy over why some companies and sectors are assisted, while others are not.

In Spain, news emerged on January 27, 2009, that some entities had raised the possibility of the State buying up so-called *toxic assets,* i.e., loans with a high risk of default, a proposition that the Government refused. That same day, the following was published in the editorial of *El Mundo:* "this intervention using

[8] Defined by Rafael Pampillón, professor of Economy at Instituto de Empresa, in the article «¿Estanflación en España? La economía no se estancará y la inflación bajará», *El Economista,* (28/01/2009).

[9] «¿Se derrumba el Imperio? El dominó global de la crisis capitalista: Cómo se bate el cóctel USA-China-petróleo-dólar», Manuel Freytas (27/11/2007), journalist, researcher and analyst, specialized in intelligence and strategic communications.

everyone's money should not be cost-free for those who have brought their bank to ruin as a result of mismanagement." It was suggested that the only way in which the Government should take an equity stake in these entities (as we understand, according to the precepts of capitalism) would be by purchasing shares on condition that the entities in crisis changed their boards of directors.

The second patch for the capitalist system is independent of the crisis. It corresponds to occasional action taken by governments to avoid an increase in the power of foreign capital in national companies through sovereign wealth funds, instruments for the investment of large currency reserves accumulated by countries thanks to their natural resources (oil-producing countries), a large export volume of industrial products (one example being China, as mentioned earlier) or the devaluation of their national currency. The largest sovereign wealth funds are those of Abu Dhabi, Norway, Singapore, Kuwait, China and Russia. They have received considerable publicity in recent years, because companies such as Merrill Lynch, Citigroup and UBS have accepted equity stakes of thousands of millions of dollars from these funds, the role of which appears to be growing in importance. Indeed, in March 2009, Morgan Stanley estimated that, before long, sovereign wealth funds could exceed the foreign currency reserves of the central banks. One example to be found in Spain is Norway's sovereign wealth fund, which tripled its stake in Banco Santander during 2008.

Following attempts to gain a foothold in key companies by countries with emerging economies, particularly countries in Asia, developed economies have taken blocking action in defense of threatened sectors. Federico Steinberg,[10] a researcher at the Real Instituto Elcano, professor at the Universidad Autónoma de Madrid, and one of the experts of the Future Trends Forum, describes the policy implemented by developed countries as *strategic trade policy,* defining it as "the trade policy that a government deploys through intervention and regulation, whose objective is to modify the strategic interaction that takes place in certain sectors between national and foreign companies in the international arena. These actions, usually implemented through industrial policy, seek to give advantage to national companies over their foreign rivals." This measure comes dangerously close to economic nationalism, discrediting the triumph of capitalism, but several such cases have occurred on the international stage in the last few years. One of the last examples in Spain was the attempt made by Lukoil, the largest Russian oil company, to take an equity stake in Repsol YPF, one of the jewels in the crown of Spanish industry. Although Russia alleged that "if Lukoil were to acquire a stake in Repsol, it would be positive for bilateral relations,"[11] critics of the operation claimed that it was a part of a strategy to control the Spanish energy market. Enel-Suez, Abertis-Autostrade and BBVA-BNL are just a few of the operations between European companies that have been frustrated due to the resurgence of protectionism. In the United States, the China National Offshore Oil Corporation (CNOOC) lost its bid for Unocal when the latter was sold to Chevron in 2005, in spite of the fact that it offered 3 billion more.

[10] *La nueva teoría del comercio internacional y la política comercial estratégica,* Federico Steinberg (2004).

[11] *Expansión* (18/01/09).

The growing power of sovereign wealth funds has sparked fear among politicians, because there is mistrust of the State resources of countries with a clear trade surplus that are buying assets at a price above their true value. The fear is that rather than seeking a financial return, their aim is to gain control of strategic sectors. This was confirmed by the European Commission when it established its proposals for sovereign wealth funds in February 2008:

"The Commission's communication on sovereign wealth funds proposes to EU leaders a balanced and proportionate common EU approach, to protect legitimate policy interests without falling into the trap of protectionism." The aim here is to maintain "an open investment environment while enhancing the transparency, predictability and accountability of the investments of sovereign wealth funds.".

Finally, the third patch to be applied to the globalized capitalist system would take the form of protectionist measures designed to prevent competition from foreign countries at a time when national economies are seriously damaged. In the last few years, companies from emerging countries have experienced a boom. In some sectors, such as steel and cement for example, the world leaders are no longer companies from developed countries. Mark Foster, a partner in Accenture, does not see the arrival of new competitors as a threat, but as "a significant opportunity to continue improving and a rich source of new ideas, capital and business practices." The survival of the large multinationals from developed countries will depend on their capacity to adapt to these new rivals in an increasingly competitive environment and not on the help provided by the State when things go badly. In parallel with this, the term "financial mercantilism" is beginning to be used to describe the action of governments when they put pressure on the banks to lend money within national boundaries.

All these protectionist measures represent a desperate attempt by States to safeguard jobs and get the economy back on its feet. Employees ask their State to intervene so that they can keep their jobs. Social conflict is an increasingly real threat. Strikes and demonstrations are beginning to be organized in those countries most affected by the blight of unemployment. In short, although the fight to keep citizens' jobs may be a good argument for increasing protectionism, it should not be forgotten that this has a damaging effect on the economy in the medium term.

The practice of trade protectionism as a means of mitigating the effects of the crisis threatens to interfere with the dynamics of the capitalist system. Therefore, the G20 made the following declaration at its meeting in November 2008: "We underscore the critical importance of rejecting protectionism and of not turning inward in times of financial uncertainty. In this regard, within the next twelve months, we will refrain from raising new barriers to investment or to trade in goods and services, imposing new export restrictions, or implementing World Trade Organization (WTO) inconsistent measures to stimulate exports."

Multilateral relations between world economies are in danger. World international trade could decrease this year for the first time since 1982 (see Figure 3). Although policies are not being implemented against globalization, clearly it is suffering the biggest reverse of the modern era. All eyes are focused on the decisions that the politicians are taking to provide a response to this situation, and they feel obliged to adopt measures, with all that this implies. On the street, there is a feeling that the free market has failed and that something has to change; for the sake of fairness, it is hoped that the State will instigate this change. Measures are being taken to save national economies, but we are getting caught in a vicious circle that may cause a slump in the global economy.

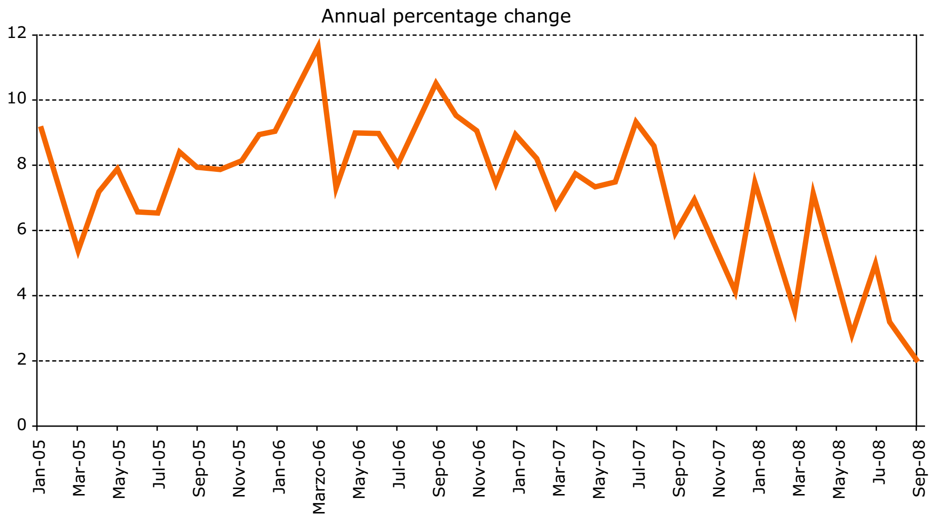


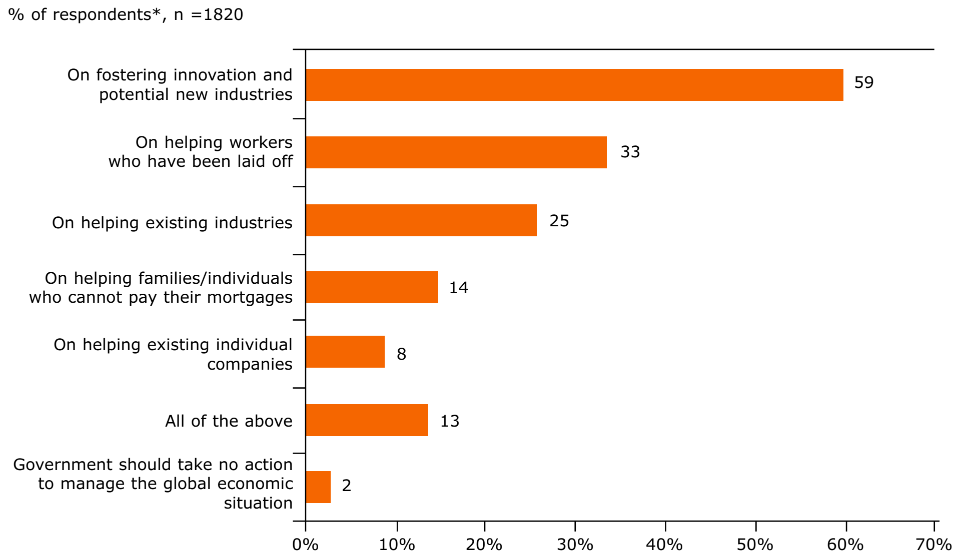
Figure 3. Figure 2005. World trade growth (January 2005-September 2008).
Source: World Economic Situation and Prospects 2009, United Nations, New York, 2009.

Innovation is seen as a good alternative to protectionism for improving the balance of trade. Federico Steinberg argues that strategic trade policy can be implemented by means of programs that foster both public support for R&D and coordination of the actions of private companies and research centers with the Government. Along these lines, people have begun to talk about a form of capitalism which, through practices such as these, benefits a greater number of people while new sustainability formulas for companies are being designed.

A commitment to innovation as the most effective way to overcome the crisis is clearly supported by the business world. The executives surveyed recently by McKinsey[12] considered that governments should focus their efforts on support for innovation rather than help for existing sectors or industries. Only 2% of

[12] *Economic conditions snapshot: February 2009,* Mckinsey.

those surveyed were of the opinion that the government should not intervene to improve the situation (see Figure 4).



* Respondents who answer «others» or «don't know» are not shown.

Figure 4. ¿Figure 4. Where should governments focus their actions to manage the current global economic situation?
Source: Economic conditions snapshot: February 2009, McKinsey.

As Charles Leadbeater suggests in his book entitled *We-Think: Mass Innovation, Not Mass Production*, the new era of capitalism would give priority to "mass innovation" over the already-obsolete mass production that characterized the first stages of the capitalist system.

Returning to Locke's paradox, *a priori* it would appear that the patches applied to the capitalist system to cover up the holes caused by the crisis will not change its essential free market principles, although they will initiate a lengthy period of transformation.

New Forms of Capitalism

"Hard times give you the courage to think the unthinkable," Andy Grove.

In economics, each change of cycle (upturn, downturn, recession and reactivation) has its origin in a crisis. Roosevelt's New Deal, in response to the crisis of

1929, started off a progressive cycle of State intervention in the economy that lasted half a century. This period is known as the Golden Age of Capitalism, in which there was considerable growth and the most advanced countries built their welfare state.

Each new crisis spawns a capitalist cycle that is different from the previous one, and in which growth is determined by various elements. Those companies that manage to understand the characteristics of the new cycle and adapt their strategy to it ultimately have a competitive advantage over the others.

Therefore, the crisis that we face now is not new, though it is unknown to us, as the Austrian economist Joseph Schumpeter observed in 1935: "each economic fluctuation constitutes a historical unit that can only be explained by a detailed analysis of the numerous factors that come together in each case." History shows that the various crises that have arisen, and which have marked the beginning of a new capitalist cycle, have significantly changed the operation of the market economy. Without a doubt, we stand before a new moment in history and there is considerable speculation as to what form the system will adopt.

William Baumol, Robert Litan and Carl Schramm, in their book entitled *Good Capitalism, Bad Capitalism and the Economics of Prosperity and Growth,* identify four main models of capitalism in the world, according to the particular agent guiding its operation: entrepreneurs, large firms, oligarchic groups (dominated by small groups of individuals) and the State. Most economies have a mixture of at least two of these models. According to these authors, the form of capitalism in the most efficient economies is guided by both entrepreneurs and large firms. The worst possible combination would be oligarchic and state capitalism, two models which predominate in emerging markets.

In a speech made at the 2008 World Economic Forum in Davos, Microsoft founder Bill Gates spoke of the appearance of a system of *creative capitalism,* a new form of capitalism that generates profits and, at the same time, resolves global inequalities. In this way, companies in developed countries would come across markets that are yet to be discovered. Harvard University, in its publication *A Road Map for Natural Capitalism*, also advocates this concept, although it gives it a different name. Some observers look at environmental problems, such as climate change, and they see innovation opportunities that will lead to new products, processes, markets and business models. With this in mind, companies must implement technologies that prolong the usefulness of natural resources, design production systems that eliminate costly waste, and reinvest in the recovery, protection and expansion of the natural habitat. The State can contribute with representatives on boards of management and support innovations with low-cost loans that transfer the saving to the whole of society. The question is whether adopting these measures in the interests of sustainability is compatible with companies making a quick recovery in the current economic situation.

Exponential pressure on natural resources is endangering the future of the capitalist system, that is to say, its long-term sustainability is not guaranteed. This is one of the market failures cited by the State to justify its intervention, which aims to offset the negative impact of this pressure. Some of its causes include the consumption habits of developed countries, the spread of these habits to emerging countries, and the growing population. Statistics relating to world reserves of natural energy resources or essential resources, such as water, are not very encouraging. Now that emerging economies have jumped on the bandwagon (they are responsible for 85% of the increase in energy consumption, estimated at 23% between 1995 and 2005[13]), the shortage of these resources is a growing problem. Companies face the challenge of finding business models that will take account of this situation and at the same time allow them to respond to social demand that greater respect be shown for the environment. At a later juncture, we will look in greater detail at the impact of the present crisis on corporate social responsibility.

In a more critical tone, Mario Soares, former President and Prime Minister of Portugal, uses the term *casino capitalism* to refer to the current phase of speculation, which permitted "years of uncontrolled globalization, without ethical rules or the slightest social or environmental concern. This type of capitalism, which believed in a kind of invisible hand and in the self-regulation of the market, has led, most ingloriously—and account must be taken of this—to the extremely serious financial crisis that is currently afflicting the United States, the crisis of a model that this country sought to impose upon the world."[14]

At the same time, the theory of the emergence of *distributed capitalism* is also worth highlighting. Shoshana Zuboff, a Distinguished Professor at Harvard Business School and one of the experts of the Future Trends Forum, considers that the new period of capitalism is determined by the prevalence of individualism. In her opinion, a change has taken place from managerial capitalism to a distributed capitalism that is capable of covering the needs of the individual more effectively. She asserts that the gulf that exists between organizations and individual consumers, who cannot succeed in satisfying their needs, is a great opportunity for the creation of wealth on a global scale (see Figure 6).

Evidence of this is the appearance of the P2P (peer to peer) economy. People will no longer talk about B2B or B2C relationships, but rather about P2P relationships, in which the parties are individuals who form a social network with the capacity to offer services on the same scale as multinationals. *Blogs*[15] and free marketing areas are found everywhere on the Internet, and the members of these online communities are beginning to set up obstacles or firewalls to defend themselves from the sales pitches of companies outside the P2P framework.[16] The skill with which individuals can create as well as consume Internet content has led to a change in the rules of the game, and even the area of financial services has been conquered. *Microbanking* communities have appeared in which capital funds are created between people who know each other in order to issue loans to people who belong to the social network, even to con-

[13] *The Rise of the Multi-Polar World,* Accenture (2007) with data from *The Economist.*

[14] «El Fin del Capitalismo de Casino», Mario Soares, *El País* 08/10/2008.

[15] Represents a community website where users write and interact regularly connected via links, comments, indexing and references.

[16] http://ebtdesign.com/.

sumers in emerging countries. This P2P economy, which is largely based on co-operation and trust among those who are part of it, also accepts payments in a virtual currency whose value is established according to the reputation and size of the social network.[17]

[17] *Here Comes the P2P Economy,* Harvard Business Publishing (26/02/2008).

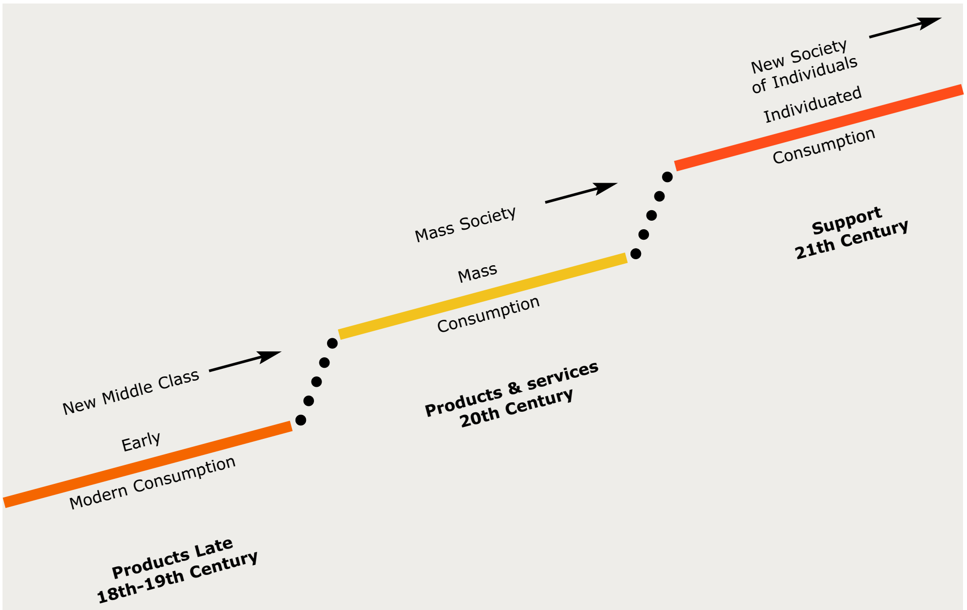


Figure 5. Three centuries of consumption.
Source: © Zuboff/Maxmin 2008

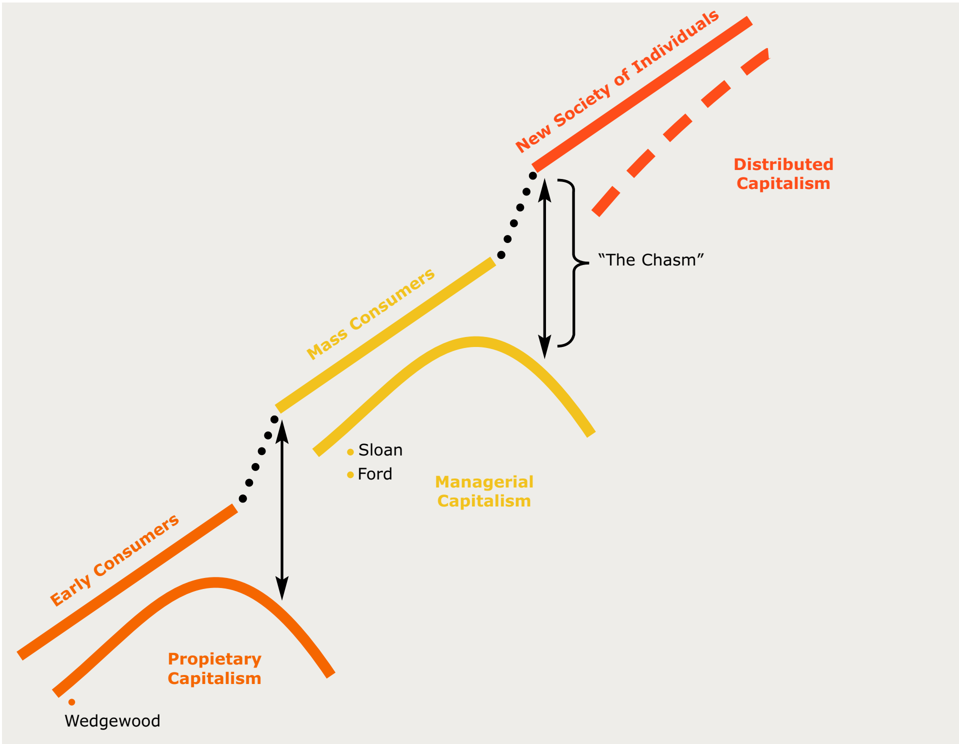


Figure 6. Capitalism is a book with many chapters.
Source: © Zuboff/Maxmin 2008.

The business management gurus Jonas Ridderstråle and Kjell Nordström provided the following definition of what they see as contemporary capitalism: *Karaoke Capitalism,* characterized by the coexistence of individuals with infinite possibilities of choice and companies which succumb to the principle of least effort and spend their time copying rather than innovating. In the opinion of these authors, only imagination and innovation bring companies, organizations and individuals to the center of the stage. Under these premises, knowledge, talent and investment in R&D are key aspects for establishing a position in the market. They believe that even in times of crisis such as the present time, an innovative business can be successful.

The experts of the Future Trends Forum questioned whether it is possible to place emerging countries on the same rung of the capitalism ladder as developed countries, and they concluded that it was not. Whereas in developed countries it makes sense to talk about advanced stages of capitalism with a focus on individual needs, as Shoshana proposed, emerging countries such as China would be at an earlier stage in which mass production seeks to meet the needs of society. This distinction is of vital importance for companies, which will have to adapt their business models to the satisfaction of both types of consumer, if they wish to be successful in both markets.

All the theories that point toward the beginning of a new type of capitalism share a belief in the emergence of new values in society as one of the dynamos of change. At the Davos summit of 2008 it appeared to be the recurring theme, since in the opinion of the experts we are witnessing a change in the social and economic model, and, even, a mutation of values.[18] This situation is the result of a game in which the rules were becoming increasingly risky and unfair. Gandhi had a test to diagnose the seven social sins, which can also serve to measure the atmosphere of capitalism; he considered that the waters of a nation would become murky if the following were present in the atmosphere: politics without principles, wealth without work, commerce without morality, pleasure without conscience, knowledge without character, science without humanity, and worship without sacrifice.[19] The present economic climate could be said to suffer from several, if not all of these sins. At Davos, there was consensus on the need for a green and technological capitalism that will foster sustainability, a State that is vigilant of the economic and social order without falling into the trap of economic nationalism and protectionism, the promotion of multilateralism and aid for development, a curb on energy consumption, and disarmament.

We are All Capitalists

The concept of capitalism has changed. It is a long time since capital has been associated with the ownership of work tools as in the industrial era. The modern company operates in the information era; the worker takes his capital (his knowledge and his skills, his human capital) and invests it in the company in which he works. The boom in "human capital" also implies constant demands on individuals, and it represents a symbol of the social dissemination of corporate values. The war for talent is becoming increasingly fierce and knows no frontiers.

To date, the United States is the country which has attracted most talent. The great minds of emerging countries, Europe and elsewhere have ended up thinking for the US. There appears to be a clear relationship between talent and power. Where will talent go in the near future? Without a doubt, this will determine the configuration of the new map of power. Talent moves capital.

Another basic change in the conception of capitalism is related with the ownership of capital. There are no longer owners in the traditional sense. Thousands of anonymous capitalists invest their savings in pensions, shares in private companies and other types of investment. Kjell Nordström and Jonas Ridderstråle, in their book entitled *Funky Business Forever,* urge readers to: "Look behind a big company name and you will now find another big institutional name. Look behind that and you will find another institution, and another. Until you come to thousands of anonymous individuals. Soon, there will be meetings at which attendees begin by admitting: 'My name is Kjell. I am a capitalist.'"

In a world in which information is not restricted by borders, the owners of the companies in a given country may live thousands of miles away and be inca-

[18] «La magnitud del desconcierto», Lluís Bassets, *El País* (01/02/2009).

[19] «¿Capitalismo saludable?», *vanguardia.com* (02/02/2009).

pable of pronouncing the country's name. Sovereign wealth funds are just one example. Capital takes the form of investment funds, pension funds and funds in banks, which are entrusted to achieve a return on the savings of demanding depositors, be they great or small. The logic of "financial performance" has gained the upper hand over that of economic performance.

The Spanish journalist Joaquín Estefanía reflected on this in one of his articles[20]: "Investment funds represent the heart of 21ST century capitalism and the core of the international financial system. The managers of these funds deal with more money than the total budget of some of the richest countries in the world. This is why it has been said that if the current crisis of confidence now affecting these funds were to spread, it would be the most serious crisis of the last 50 years, and, of course, much more significant than the commotion that has damaged other areas of the financial system."

Renewing Old Acquaintances: Bretton Woods 1.0 and Basel 2.5

"Every kind of peaceful cooperation among men is primarily based on mutual trust and only secondarily on institutions such as courts of justice and police," Albert Einstein.

Other experts do not share the vision of the spontaneous dawn of a new type of capitalism, but they advocate a far-reaching reform of the type of capitalism that we are already familiar with. The roof over the house of capitalism is leaking and extensive renovation is required. In Europe, the voices can be heard of those who believe that the refounding of capitalism will serve to offset the crisis.

Starting with the foundations, is it justified to maintain the power structures that were defined at Bretton Woods? Which countries should lose or gain influence with respect to multilateral decisions? The recent inclusion of emerging countries at the G7 meeting may offer some clues here. These countries are demanding the conversion of the G20 into a permanent group of countries that govern the world, to replace the G7. Obviously, this would imply a change in the distribution of power, which the major world powers may be reluctant to accept. However, whether they like it or not, "money talks," so if the emerging countries put forward more capital, these powers will probably have to give way to their demands.

The walls of the capitalist house also have to be repointed. There is open recognition of the need to reform the world's financial system, and reasons abound for this reform. However, positions differ on this point. On one hand, the European Union and emerging countries are calling for greater control. They propose the creation of regulatory and supervisory institutions on an international scale, over and above the central banks, even the US Federal Reserve (the Fed). On the other hand, the United States, supported to some extent by Canada and Aus-

[20] «Cuando el capitalismo pierde la cabeza», *El País,* 07/12/2008.

tralia, considers that regulatory and supervisory measures must be moderated, for otherwise there would be a risk of hindering the optimum operation of the financial sector and of slowing down the recovery of the economy. Some analysts interpret the position of the former as a clear attempt to increase their political influence on the world, and the position of the latter as seeking to preserve the supremacy of their financial sector.

Many countries such as Britain and France propose an enhanced role for the International Monetary Fund, in order to improve surveillance of financial markets and avoid situations of excess akin to the present situation. This would demand a more equitable share of representation among the members of the G7 and new emerging countries, which would undermine the dominant positions of the major world powers. In this way, international institutions would adapt to the new, multipolar reality of the world, which is more evident than ever due to the crisis.

As a reaction to the error of not having increased the degree of regulation when there was still time, several “palliative” measures were taken at the Washington summit on November 15, 2008.[21] Firstly, there was discussion of the need to intensify international cooperation between the regulators and to reinforce international regulations, with the participation of emerging and developing economies. Particular attention was also drawn to the idea of increasing the transparency and responsibility of financial markets, demanding more information about complex financial products. Outstanding action to be taken includes the far-reaching improvement of regulation, reinforcing risk surveillance and management, but without inhibiting innovation and the exchange of banking products and services. In short, the aim is to promote the integrity of financial markets, protecting the interests of investors and preventing abuse in the field of financial risk.

Nicholas Sarkozy, the President of France and President of the European Union at that time, declared that “we must rethink the financial system from scratch, as at Bretton Woods.” Indeed, experts are pondering on whether the current international panorama requires new institutions, or if, on the other hand, the operation of the existing institutions should be salvaged and redesigned.

In this respect, on January 16, 2009, the Basel Committee, which supervises the coordination of the central banks, announced its measures for confronting the financial crisis, which included improvements in the regulation of risk, and the demand that banks follow the new risk management framework. The purpose of this was to ensure that banks worldwide comply with similar requirements with relation to reserves held to cover risks assumed. It is seen as desirable to avoid at all costs the excessive risk assumed and the lack of guarantees offered by our financial system in recent times. Above all, it is necessary to restore public confidence in institutions and to reform the regulations that they promote. The crisis has shown quite clearly that the regulations in place have not been sufficient to prevent chaos.

[21] «Bretton Woods II – five key points on the road to a new global financial deal», *The Guardian* (14/11/2008).

The majority of the experts of the Future Trends Forum do not consider it necessary to create new global institutions. Instead, they believe that the operation and composition of the existing institutions should be reviewed. In the opinion of the experts, institutional reforms would seek to:

- Include emerging countries in the present international institutions.
- Strengthen the World Trade Organization so that it carries more weight in the international arena.
- Review and improve the operation of the United Nations.
- Increase the transparency of operation of national central banks and achieve a higher degree of coordination through the International Monetary Fund.

In its predictions of what the world will be like in 2025, the United States National Intelligence Council (NIC) forecasts that "by 2025, nation-states will no longer be the only—and often not the most important—actors on the world stage. The international system will have morphed to accommodate the new reality. But the transformation will be incomplete and uneven. Although states will not disappear from the international scene, the relative power of various non-state actors—including businesses, tribes, religious organizations, and even criminal networks—will grow as these groups influence decisions on a widening range of social, economic, and political issues.

Emerging Economies within the Framework of Capitalism

The center of gravity of the capitalist system is shifting from Europe and North America to Asia, where increasing wealth is being generated. Economic hegemony appears to be moving toward a constellation of powers in Eastern Asia, and this process may be reinforced by the present crisis. As indicated earlier, crises are times of profound transformation of capitalist development. For this reason, the fact that the United States is in the process of financing a way out of its financial difficulties with substantial deficits, and that these are largely being covered by countries with a savings surplus—Japan, China, South Korea, Taiwan and the Gulf States—brings this change into sharper focus. The flows of wealth are changing in two directions: on one hand, from the West to the East; and on the other hand, from private hands to the state coffers of Asian economies.

In most cases, emerging economies reflect a series of values and laws that differ considerably from the practices of western capitalism. However, these economies have had to adapt to a framework that they were not hitherto familiar with, in order to be able to operate and compete on a par with developed economies. The question emerges as to what combination of the various types of capitalism described by Messrs. Baumol, Litan and Schramm in their book *Good Capitalism, Bad Capitalism* the leaders of these countries will choose. The governments of some of the largest of them, such as Russia and China, appear to have opted for a mixture of state capitalism and, to a certain extent, oligarchic capitalism, rather than the powerful blend of entrepreneurial capitalism which has driven the United States, Great Britain and other wealthy countries. In principle, and unless demonstrated to the contrary, sovereign wealth funds are not a means for these governments to gain power in the strategic companies of developed countries, and in this respect the evolution of their capitalist systems should not have a direct impact on the countries that receive their investments. Furthermore, some governments—even undemocratic ones—appear to understand that it is in their interest to move toward a capitalist system that maximizes wealth, because they have reached the conviction that in this way the quality of life of their citizens will improve, although they may not play a very important role in economic decisions.

It could be said that the term BRIC (Brazil, Russia, India and China) in reference to the emerging countries has become obsolete. This argument is based on two factors: firstly, the initials do not include all the countries that are growing at a considerable rate; and secondly, some observers believe that economies such as that of China should be recategorized from "emerging" to "developed," given that China is now the fourth world power. Multinationals such as Haier (the Chinese domestic appliance manufacturer), CEMEX (the Mexican cement company), Embraer (the Brazilian aircraft manufacturer) and Infosys (the Indian software giant) are key global players in their particular fields.

The growing importance in the world economy of countries rightly or wrongly referred to as "emerging" cannot be denied. Some observers are fearful of the possibility that these countries will be carried away by an "anticapitalist wave" as they try to avoid being led by the free market economy into the same situation in which the principal world powers —their models to date—now find themselves. Ironically, the greater involvement of governments in Western economies as a result of the crisis may strengthen the preference of emerging countries for increased State intervention and a mistrust of free market laws.

At the United Nations General Assembly, there was considerable criticism of speculation with food commodities, and delegates debated about the impact that the crisis may have on capital flows for emerging countries. The raising of transnational loans is now a reality in all countries, and this trend is hitting emerging countries hard. The Institute of International Finance (IIF) estimates that net private capital flows will increase from US$929 billion in 2007 to US$165 billion in 2009 (see Figure 7).

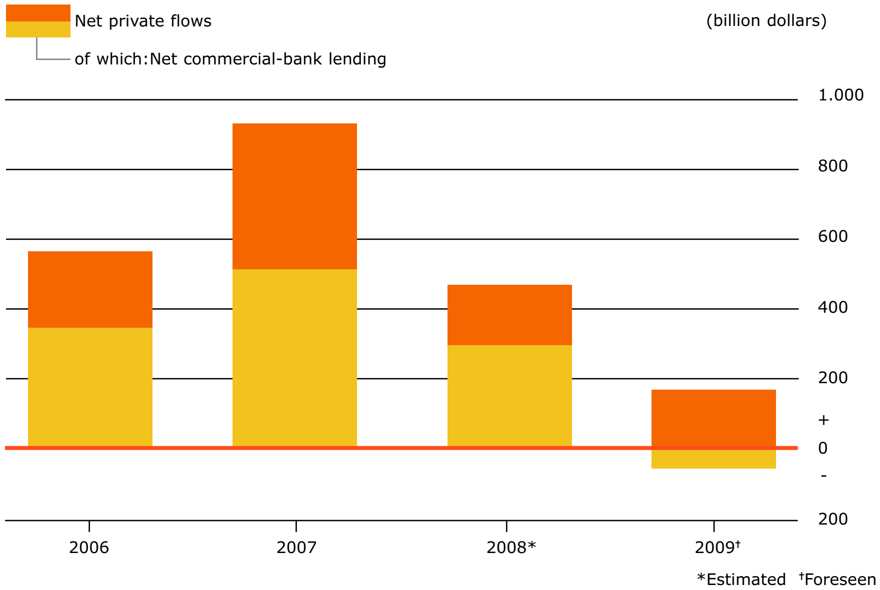


Figure 7. Figure 7. External financing of emerging economies.
Source: Institute of International Finance.

The most vulnerable countries are those that have opened up most to international capital. This is a further argument for the "anticapitalists." Even so, the emerging countries will all suffer the credit crunch to a greater or lesser extent. This is why the International Monetary Fund has created a short-term lending facility for emerging countries affected by cash flow problems in capital markets.[22] The IMF has offered large upfront financing with no conditions attached to emerging countries that demonstrate a strong track record. The objective is to restore confidence and to avoid financial contagion. Likewise, at the London meeting in April 2009, the G20 agreed to make available an additional US$850 billion of resources through world financial institutions to support the growth of emerging and developing countries.

The proper response to the crisis from emerging countries would be to put reforms on the table that seek to improve financial regulation and avoid the errors committed by developed countries. Instead of this, however, some of the existing reforms that addressed past problems are being dismantled. In India, for example, some practices that ruined the credit culture in the past are reappearing, pushed through for political reasons.

In the next few months, the banks of these countries will face an increase in bad debt caused by the slowing down of their economy. In response to this threat, the governments of emerging countries are drawing up plans to inject capital into their banks. The BRIC countries have jumped on the bandwagon of increased State intervention in financial affairs.

[22] IMF quarterly magazine (December 2008).

The economic growth of these countries has a clear dependence on international trade. To gain an idea of the problem, one need only consider how many "Made in China" products can be found in the average European or American home. The greatest threat to emerging economies is the proliferation of protectionist measures on a global scale.

In order to compensate for the possible fall in exports due to increased protectionism, emerging countries have the possibility of stimulating their forgotten internal demand and promoting trade between one another.

At the same time, emerging countries are questioning whether it is fair that the new sustainability demands now being made of the capitalist system (limiting the consumption of natural resources, waste emission, etc.) should be imposed on them at their moment of maximum growth, when, to a certain extent, developed countries had the opportunity to grow without such restrictions.

Having debated about how State intervention will evolve in different parts of the world, the experts of the Future Trends Forum conclude that it will increase most in developed countries in Europe and in the United States (see Figure 8). The majority of the experts also expect to see an increase in emerging countries such as India, China and Brazil, albeit to a lesser extent, since the level of protectionism is higher there. In their opinion, this greater degree of intervention will mainly take place in the country's banking sector and in key industries as a transitory measure to overcome the crisis.

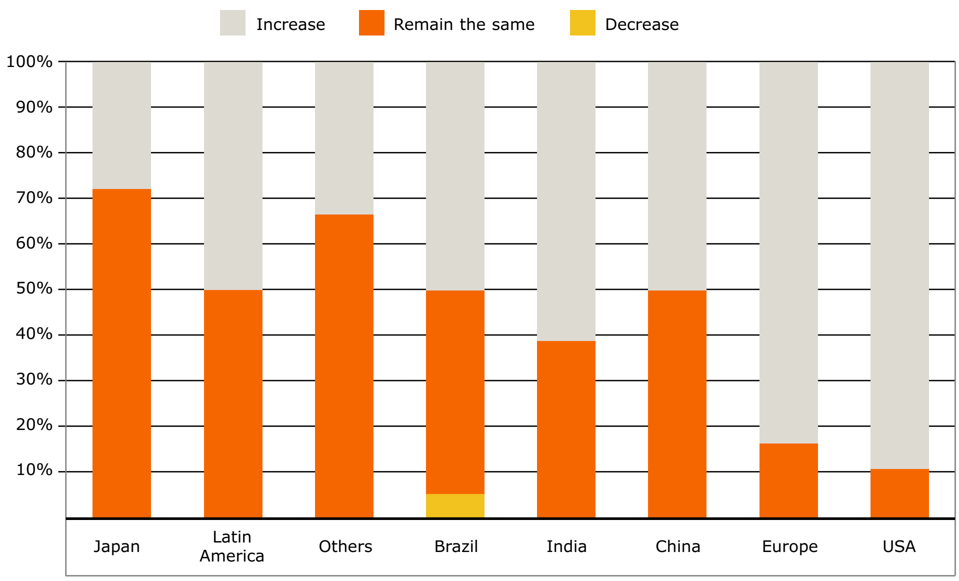


Figure 8. In which of the following geographic areas do you think that interventionism will vary as a result of the present economic situation?
Source: Drawn from the conclusons within the Future Trends Forum.

Final Reflection

Carlos Bhola, Managing Partner of Celsius Capital and one of the experts of the Future Trends Forum, outlined the conversation that he had had with the American politician Henry Kissinger about the present international panorama. They talked about the importance of understanding, in the historical context, what happened after the Second World War. Firstly, the political, economic and social systems were directed on the basis that a common adversary existed. For the West, this adversary was the East, communism, and vice versa. This map of power established very different priorities for each of the sides ("the distribution of wealth was very important for Russia, but for the United States it was being wealthy"). Today's reality is that the idea of a common objective has disappeared. Carlos Bhola observed that, contrary to what some people thought, the United States had not become that adversary through the Iraq War, because we all "continue eating McDonald's" in some way.

The second fundamental change they discussed was the transfer of power from the Atlantic to the Pacific. This fact has had a defining influence on the configuration of the current geopolitical situation.

Finally, rather than a financial crisis, a crisis of confidence or a state of panic, what is taking place is a "rebalancing" of the international financial system: 60% of the world's population have become part of capitalism in the last 18 years (it must be remembered that the total population of India, China, the Eastern bloc and parts of Latin America which were not previously democratic easily add up to 60% of the population). These three points encapsulate the profound transformation that has occurred and which affects the path that is currently being taken by capitalism and the forces of power.

3.2. The Coming Multipolarity

The triumvirate formed by the United States, Western Europe and Japan was the precursor of a globalization period characterized by the opening of markets and the liberalization of global economies. In a new era of globalization, with a higher degree of integration and coordination than ever before, a two-way process is underway. Before the transformation, it was multinationals from developed countries who exported their products, services and business models with cheap resources from the emerging economies. Now it is the emerging economies that are the engines of global growth, contributing to the international flows of trade, capital and people. In October 2008, the press published a news item about Iceland receiving a 4 billion euro credit from Russia to save its banking system. It is surprising that a BRIC country would be the one coming to the rescue of Iceland. This is proof that the world's forces are indeed changing.

(Contributions to global growth, at PPP adjusted exchange rate)

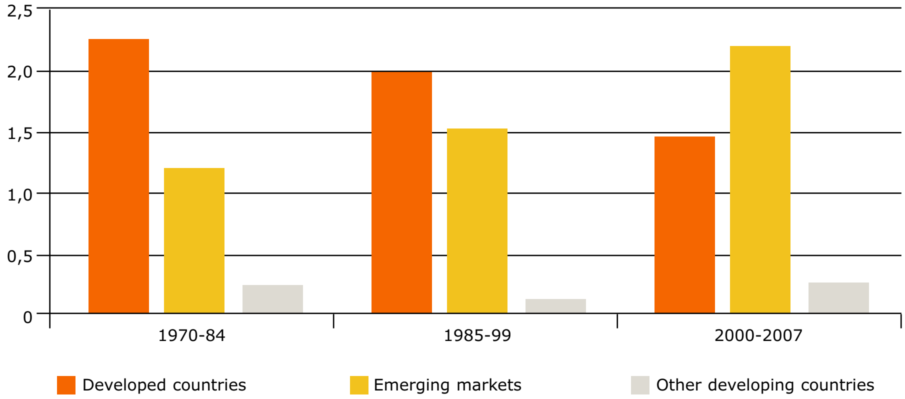


Figure 9. The growing world economic clout of emerging markets.
Source: "How much decoupling? How much converging?" *Finance & Development* (June 2008).

Figure 9 shows the increasing clout of emerging markets adjusted to reflect the purchasing power parity (PPP), which is almost one percentage point higher than that of industrial countries during 2000-07. In short, the gradual loss of economic clout of industrial countries is compensated by the rise of the emerging economies. Other developing countries have recovered despite a slumping during 1985-1999, though with a much smaller contribution to global growth than that of emerging countries.

The dichotomy of emerging countries versus the United States is often used to give a simplified representation of world power forces. The United States is considered the dominant world power, but it seems to be losing ground to emerging countries. Does this mean we are witnessing the end of the US economic hegemony as we know it? There are different opinions on the subject. Some argue that the United States will remain a key player on the international scene, but will lose its hegemonic power. Meanwhile, others believe it will remain the world's largest economy due to its military power and political influence. An intermediate hypothesis would be that "the US will remain the global superpower. The fact is that the rest of the world is catching up".[23] The United States clearly has competitive advantages, such as innovation and the ability to attract talent, but the large populations and unprecedented growth of emerging economies portend a major power shift in the world order.

To Decouple or not to Decouple?

Another heated debate involves whether or not we are currently undergoing a process called *decoupling*. This phenomenon occurs when emerging economies detach themselves from the negative impact of developed countries, especially the United States. According to the article "How much decoupling? How much converging?" published in *Finance & Development* in June 2008, there is no

[23] «El Fin de la Hegemonía Americana», Francis Fukuyama, *El País* (31/07/08).

doubt that international financial markets are closely tied together, but whether the increasing spillovers of financial market shocks really translate into spillovers in terms of real macroeconomic variables, such as GDP, remains an open question. "The fact that emerging markets have themselves become engines of global growth suggests that developments in the United States and other industrial countries should have smaller spillover effects because growth in the emerging markets partly insulates the world business cycle from downturns (and booms) in the industrial countries"[24]. Proof of decoupling was that emerging market growth has remained strong despite industrial countries' relatively tepid growth.

However, the crisis has triggered trends that prove otherwise. Undoubtedly, the economic and financial instability of the United States has rubbed off on the rest of the world: in the five years prior to 2007, emerging economies saw an average yearly growth of 7%. Throughout 2008, average growth remained above 6%, but recent predictions by the private sector suggest it may fall below 4% this year.

[24] «¿Cuánto desacoplamiento? ¿Cuánta convergencia?», *Finanzas & Desarrollo* (June 2008).

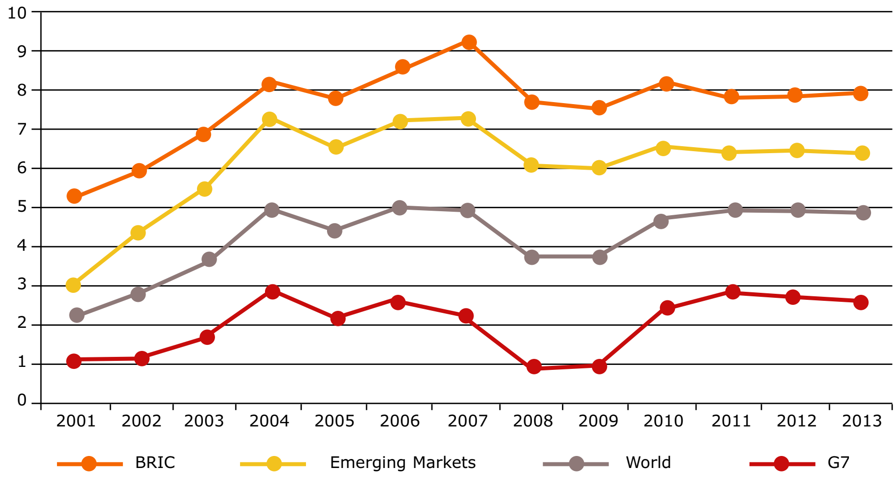


Figure 10. Real GDP growth (2001-2013).
Source: IMF's World Economic Outlook.

Figure 10 shows the real GDP growth for different groups of countries. Although it is true that both the BRICs and the emerging countries have much higher growth rates than both the G7 nations and the world average, it is apparent that their fluctuations follow a very similar pattern. The domino effect is clear. The argument between the supporters of decoupling and those who still think that "when the US economy sneezes, the rest of the world catches a cold" now centers on the degree of contagion that emerging countries suffer from due to the crisis in developed countries.

The conclusion may be that, after specific periods of decoupling, the existing interdependence and subsequent global domino effect may be swelling. Will emerging economies keep growing thanks to the boost of their domestic markets, or is the economy too interconnected to accommodate the spectacular numbers of these countries? The Future Trends Forum experts argued that the crisis will not stop the rise of emerging countries in the new multipolar landscape (see Figure 11).

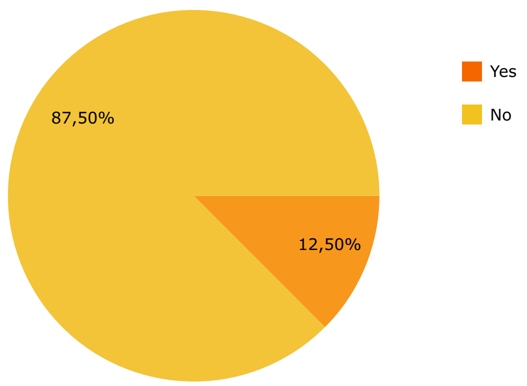


Figure 11. Will the rise of emerging countries put the brakes on the current crisis?
Source: Drawn from the conclusons within the Future Trends Forum.

Meanwhile, another question arises: could there come a time when the BRICs sneeze and developed countries catch a cold? As a matter of fact, as mentioned at the start of this chapter, this is already happening, and there is data to corroborate that forces operate in both directions—even in multiple directions.

First, with trade, where we have seen increasing activity between emerging economies. Moreover, production is specialized by countries in inputs or components, but those products are later shipped to other countries to be processed and assembled before reaching the end consumer.[25] Consequently, a deeper economic integration is being developed.

Capital is another factor that supports the theory of greater interdependence between countries. Emerging and developing countries had a long history of finan-

[25] *Emerging Market Economies and the Global Financial Crisis: Resilient or Vulnerable in Turbulent Times,* Emerging Markets Forum (2008).

cial dependence from developed countries. That ended with the financial crises of Latin America in the 1980s and Asia and elsewhere in the following two decades. It was during those crises that the emerging economies began to apply more orthodox macroeconomic policies, regulatory organizations grew stronger, etc. That, along with the negative savings of the US, caused the diversion of capital and the dependence thereof between countries.[26] This was reflected in the aforementioned loan from Russia to Iceland.

Finally, the rising price of commodities brought on by the fast growth of emerging economies—which in many cases own said resources—has further complicated the way countries interact. If prices remain high, exporters of commodities will have large surpluses in the immediate future. If prices fall, the surplus increases will be seen in Asian exports of manufactured products.[27]

Over 92% of the Future Trends Forum experts feel that there has been no economic decoupling between emerging countries and the United States. In fact, they point out the crisis to support the notion that when "the US sneezes, the rest of the world catches a cold" (see Figure 12).

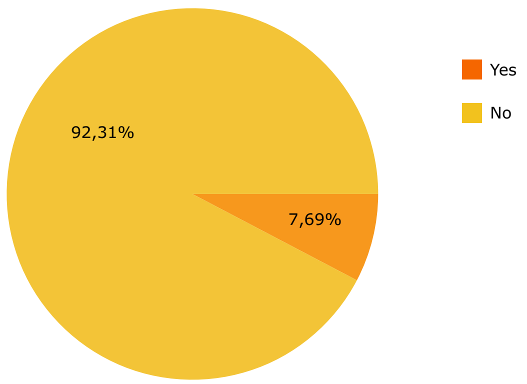


Figure 12. Do you think there has been an economic decoupling between emerging economies and the United States?
Source: Drawn from the conclusons within the Future Trends Forum.

The Multipolar World

That very complexity and multidirectionality lead to discussion of a concept that predated the crisis, one that started gaining momentum among expert circles: the appearance of "a world characterized by multiple economic centers of power and activity,"[28] a concept that Accenture calls "multipolar world." One of the great stories to come out of the G20 summit in November 2008 involved seat assignments: Brazil's Lula da Silva to the right of George Bush, and China's Hu Jintao to his left. This arrangement could be an indication of a new economic

[26] *Emerging Market Economies and the Global Financial Crisis: Resilient or Vulnerable in Turbulent Times,* Emerging Markets Forum (2008).

[27] «The Rise of Sovereign Wealth Funds», *Finance&Development,* International Monetary Fund (September 2007).

[28] *La Empresa Multipolar,* Accenture (2007).

world order. The recent downturn of the US economy, along with various concessions to emerging countries in international organizations as a result of their rise in power, support the emergence of the concept of a new multipolar world.[29]

In the multipolar environment, economic interdependence continues to increase and we must compete with everybody, everywhere, for everything.[30] Market barriers are falling, which facilitates the movement of goods, services, people, capital and information at the global level. Whether or not a multinational benefits from this no longer depends on its geographic location, thanks to the advances in telecommunications that offset time and space limitations. In order to survive, companies must strive to work in order to create competitive advantages in the five areas to emerge from the new world order: globalized trade, capital flow, human capital, resources and innovation.

Accenture, in its study *The Rise of the Multi-Polar World*, identifies three main causes that explain the emergence of the *multipolar world*:

- **The power of information and communication technologies.** Challenging the barriers of time and space has been possible thanks to the speed of communications achieved, which has been driven by the Internet and fiber-optic networks. Many multinationals are moving part of their business to emerging countries to take advantage of competitive factors such as talent. They are also investing in R&D in software and information technologies, especially in Asia.

  Just as during the second half of the 20TH century the railroad was a significant factor in boosting and intensifying information exchange, telecommunications have played a major role in developing the world economy. Some argue that the development of telecommunications has sped up the globalization process, while others argue that telecommunications advancements have responded to the need to keep up with globalization.

  In any case, it is clear that the new information technologies and the changes in the world economy are closely linked. Thanks to the Internet, email, mobile phones, videoconferences and VoIP,[31] multiple people can work on the same project despite being thousands of miles away from one another. New economic theories, trend forecasts and statistics from experts are available in a fraction of a second. The combination of these factors has made for unprecedented coordination, which is exactly why the current crisis is not having the same repercussions as that of 1929. Indeed, it is the coordination between organizations and the prompt decision-making by politicians that accelerates change, and this is largely due to telecommunications. Not to mention the implications for companies that have managed to reduce transaction costs and enter a market that is still up for grabs and fully open to new possibilities. Who would have imagined that there would be companies that only operate virtually?

[29] «Radical Perspectives on the Crisis: Impact on Emerging Markets», *Daily News Summaries from the Financial Press* (18/11/2008).

[30] Hal Sirkin, Senior Partner at the Boston Consulting Group, in an interview with Wharton School defined *Triple E threat* as the need to compete with everyone, everywhere, for everything.

[31] Voice over Internet Protocol, use of an IP protocol to transmit voice data via Internet. One of the most-recognized applications is Skype.

- **Economic liberalization policies** Despite talk of increasing protectionism in developed countries as a measure against the excessive growth of trade and capital flow in emerging countries, the fact is that over the last few decades trade and investments have been liberalized considerably around the world. Countries like China, Brazil, Vietnam and Russia have joined or are about to join the World Trade Organization (WTO). Since its inception in 2001, the Doha Development Round is still in negotiations to eliminate tariffs and restrictions on free trade. In addition to the ongoing expansion of the European Union, other free trade areas have been created, such as MERCOSUR in Latin American and ASEAN in Southeast Asia, connecting emerging economies to one another and to a broader global economy.[32]

  During the Davos summit of 2008, importance was placed on reaching a consensus in Doha despite the lingering disagreements, particularly in the agricultural sector. It is in the best interest of the European and US economies to keep their trade borders open. Being a supply-based economy, factors such as the policies aimed at impeding imports to Europe or competition pressure will lead to increased costs and prove extremely detrimental to world trade.

  According to the World Economic Forum, no country has successfully grown without expanding its trade. Well-connected countries gain access to many more markets and consumers. For those that are not well-connected, the cost of exclusion is substantial and in fact increasing, and they run the risk of missing out on good opportunities.[33]

- **Increased size and reach of multinational companies** Telecommunications have allowed multinationals to increase their geographic presence and generate greater economic profits thanks to the diversity of markets, the economies of scale and the new sources of capital and labor. We have seen multinationals from emerging economies begin to prosper, as well as the emergence of new forms of investment for multinationals from developed economies. Throughout this study, the data provided on these new multinationals from emerging countries differ a great deal from the traditional concept that prevailed in past decades.

  Thomas Friedman also analyzes the globalization process in his book *The World is Flat*. He says we are witnessing a new era of globalization *(Globalization 3.0)* led by individuals. After a period spanning 1492 to the beginning of the 1800s, during which the driving force behind the globalization process was the conquering of other countries to gain more territory (the era of the Great Empires), and after another globalization period (1800-2000) led by the great multinationals, we are currently living at a time in which any individual anywhere in the world (not just in developed countries) becomes the new engine for the process. Friedman argues that the economic playing field is being leveled or "flattened" in the globalization context.

[32] *The Rise of the Emerging-Market Multinational,* Accenture (2008).

[33] *The Global Competitiveness Report 2008-2009,* World Economic Forum (2008).

The New Players

"The Chinese word for crisis, wei-ji, consists of two characters: the first means danger and the second opportunity."

In a multipolar context, one of the main determining factors is the growing clout of emerging economies. It is undeniable that these new players are gaining more and more clout internationally. Leaving aside for the moment the possible disturbances caused by the crisis (which we will discuss later), we have already seen forecasts as to when the emerging countries will catch up with developed economies. Figure 13 shows the dates when it will take place, specifically in terms of the BRICs relative to the G6 nations.[34] Goldman Sachs estimates that this will happen around 2040. However, more than 30 years prior to that, countries like China have already caught up with all of the G6 countries, or are on their way. Another significant piece of information is the fact that China will surpass the United States around 2042. Some of the statements made during the Davos summit in 2008 were: "Foreign capital reserves in emerging economies have tripled since 2000 to a whopping three billion dollars" and "India has 630 million people of working age. In ten years it will be 830 million."[35] With these numbers, it is not surprising that in 2005, and for the first time in the industrial era, emerging economies were responsible for more than half of the global PPP-adjusted GDP.

Up to now, the BRICs have been referred to as the new players. That acronym was coined by Goldman Sachs to refer to fast-growing economies that could collec-

[34] G6 is the group of countries consisting of Germany, France, Italy, Japan, United Kingdom and USA.

[35] *The Emerging Strength of Emerging Markets,* Evan Carmichael.

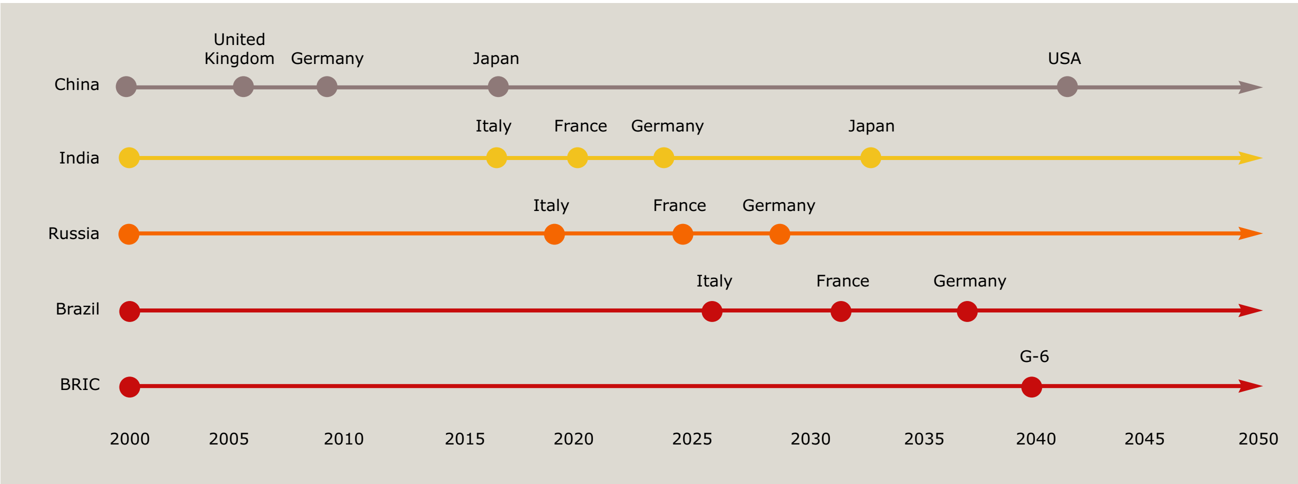


Figure 13. According to forecasts, BRIC economies will surpass those of developed countries in the next three decades.
Source: *The Rise of Globally Adapted Organizations,* Forrester (2006).

tively surpass the combined economies of the current richest countries in the world by 2050. However, at the current rate of change we cannot longer refer to the BRICs as emerging market components, since we can expect both consumers and producers from very diverse origins to keep appearing. In that regard, countries with large populations and fast-growing economies—e.g., China, India, Egypt, Mexico, Poland, South Africa, North Korea and Turkey—are approaching. It is clear that the direction and pace of globalization are not determined by market forces alone, but rather by geopolitical and sociocultural factors due to its unpredictable dynamics.[36]

The next question we must address is: are the emerging countries ready to lead the world as the United States has done in the past? Most Future Trends Forum experts consider that they are not ready to lead the world. They do feel, however, that they will in fact gain power at the international level (see Figure 14). They justify this opinion by pointing to the lack of resources and military power in these countries. Moreover, they consider that they have too many domestic problems (as the United States did in the 1930s) to consider world leadership. The minority who believe that these countries are indeed ready, consider China to be the ideal candidate, but they also add that the leadership of emerging countries will not be unipolar but rather multipolar, i.e., led by several countries. They say that it will be decades before this change of leadership takes place. In order for it to happen, they consider it vital for emerging countries to increase their negotiating capacity on international issues.

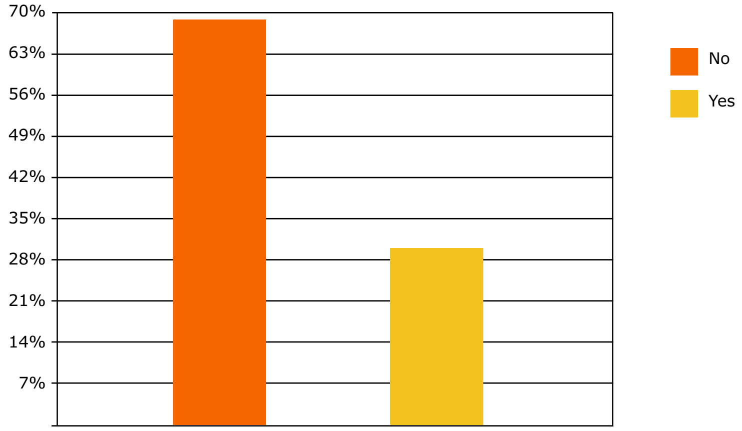


Figure 14. Are emerging countries ready to lead the world?
Source: Drawn from the conclusons within the Future Trends Forum.

[36] *The Rise Of Globally Adaptive Organizations,* Forrester (December 2006).

Spain in the New Multipolar Order

Spain is currently the world's eighth-largest economic power, and it has had the world's seventh-largest nominal GDP. The relevant part of those statistics is not the rank that Spain has achieved, but rather where it started from, and thus the speed at which this transformation has occurred. So much so that the term "the Spanish miracle" was coined to refer to this process. In the last decade, Spain's GDP increased by 3.7%, surpassing considerably the growth rate of the euro area countries. However, this newfound international economic clout has not been accompanied by increased Spanish presence in international organizations. The initial exclusion of Spain from the G7 meeting in 2008 opened the debate about the position that Spain should have in the new international order, given its radical transformation over the last decades.

No member of the Spanish Government went to Davos in 2009 and the Spanish delegation consisted of just 10 people, which included most notably the President of BBVA, Francisco González, and Ana Patricia Botín, representing Banco Santander. Joaquín Garralda, Corporate Strategy professor at the Instituto de Empresa Business School, tried to explain the causes behind Spain's scarce representation at Davos: "I don't know if it could be a problem with the language, but I don't think that really matters [...]. Or that we don't have a lot of clout internationally, nor are we an emerging country that needs to be seen… Spain is halfway between the two. Nor do we stand out in raw materials or research and development, nor do we have world political clout."[37]

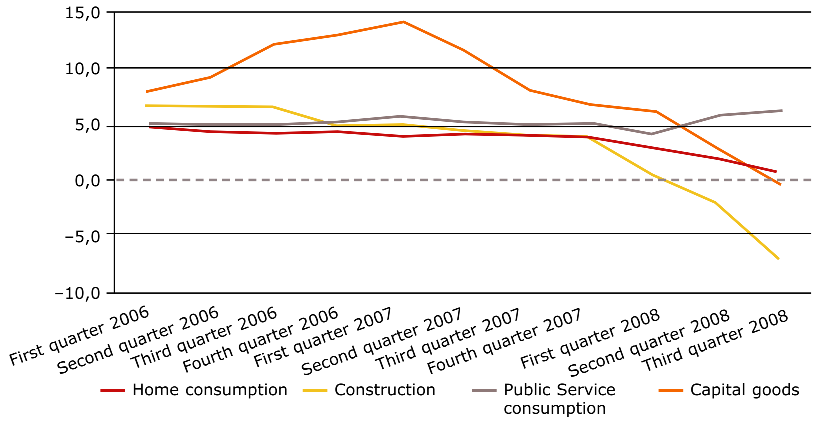
The truth is that when the numbers seemed to indicate that the Spanish economy was on a par with the world's most powerful countries, the devastating effects of the crisis raised doubts about the sustainability of its growth model. Structural problems that have been there for years now reveal their ugly side. Among the most flagrant is the low structural productivity of an economy that is overly centered on traditional sectors and demonstrates a medium-low technological performance. Added to that list are growth based on an increasing domestic demand, a high foreign deficit and a high degree of indebtedness (see Figure 15). In fact, some experts fear that Spain is suffering from the "Argentinean syndrome," referring to the fact that "after the little *sorpasso* (progress) that Spain had when it joined Italy in the club of the rich for the first time, Spain could think that its work is done, just like Argentina did."[38]

In this context, the strengthening of the emerging economies in the international framework is a double-edged sword for the Spanish economy. On one hand, there is fear of increased competition and the uncertainty of Spain's role in the new power map. On the other hand, it appears to be what the country and its companies needed to attain greater international presence and take advantage of the opportunities in the new multipolar world.

[37] http://www.cotizalia.com/cache/2009/01/28/noticias_26_espana_lleva_davos_misma_representacion.html.

[38] «Juan Velarde teme que España pueda padecer el "síndrome argentino"», *ABC.es* (9/11/07).

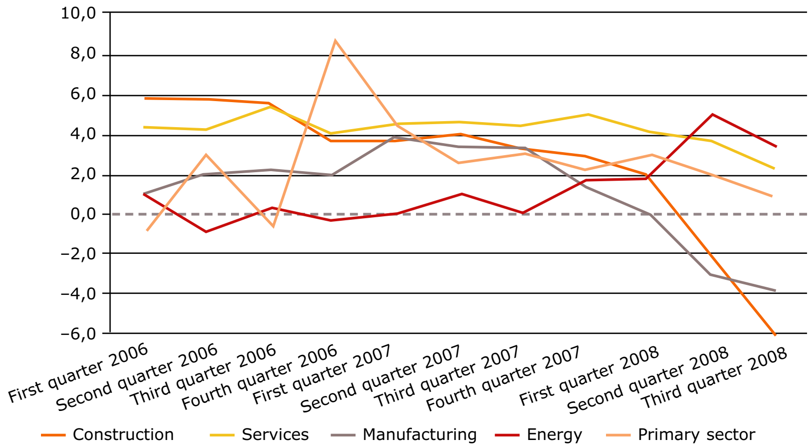
GDP Components (demand)



Yearly change evolution — Component - Last Data - Importance

Home consumption −0,1% −56,5%
Construction −6,4% −16,5%
Public Service consumption 5,9% −19,3%
Capital goods −0,6% –

GDP Components (supply)



Yearly change evolution — Component - Last Data - Importance

Construction −5,0% −10,4%
Manufacturing −3,4% −13,3%
Services 2,4% −62,9%
Energy 2,9% −2,7%
Primary sector: 0,6% −2,7%

Figure 15. GDP components based on supply and demand.
Source: INE.

The competitiveness of the Spanish economy will greatly determine its place in the new order. The World Economic Forum’s yearly Global Competitiveness Report[39] ranks Spain among the economies that must base their growth on innovation, and ranks it 29th on a list of 125 national economies from around the world. The results are based on several financial indicators. Spain earns its best scores in market size (24th), technology (29th), infrastructures (22nd), higher

[39] *The Global Competitiveness Report 2008-2009,* World Economic Forum.

education and training (30th) and macroeconomic fundamentals (30th). It fails in organizations (43rd) and innovative potential (39th), factors that could clearly contribute to improving the economy. It is alarming that the report ranks the Spanish job market efficiency last on the list due to its scarce flexibility. This piece of data is critical when considering Spain's growing unemployment rate (see Figure 16).

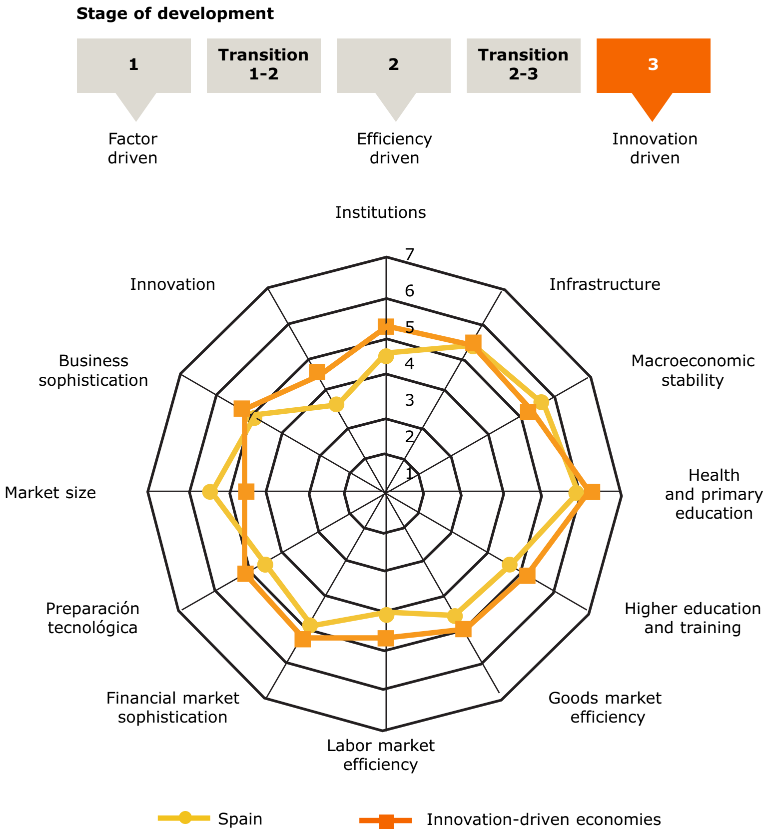


Figure 16. Spain's global competitiveness in comparison with the average values of innovative economies.
Source: *Global Competitiveness Report,* World Economic Forum.

Spain's leadership in terms of its generation of wealth (the world's seventh-largest nominal GDP) is in contrast with its ranking of 29th in competitiveness. This low foreign competitiveness is reflected in a permanent structural trade deficit. The fact that countries such as China, Malaysia and Chile are considered more competitive is even more worrying. Multipolarity is already here, and it is here to stay. This poses the question: how long will Spain maintain its place among the world's most powerful countries?

1	Germany	26	Mexico
2	France	27	India
3	United Kingdom	28	Hungary (tie)
4	Canada	28	China (tie)
5	Japan	30	Poland
6	Italy	31	Czeck Republic
7	United States	31	Egypt
8	Switzerland	33	South Korea
9	Australia	34	Thailand
10	Sweden	35	Taiwan
11	Spain	36	Turkey
12	Netherlands	37	South Africa
13	Norway (tie)	38	Chile (tie)

Figure 17. List of brands by country.
Source: Anholt-GfK Roper.

Spain's image abroad will also play an important role. It will have a great influence on the level of exports and on the attraction of foreign capital or talent, among others. Unfortunately, the reality is that Spain's image is in a relatively bad position, at least in comparison with its neighboring countries.[40] The results for Spain from the last *Nation Brand Index*[41] study rank Spain 11th out of 50 countries, behind Germany, France, Italy and England, etc. (see Figure 17). The positive image of Spain's culture contrasts with its negative trade image, where Spain receives its lowest scores despite the laudable efforts of such important organizations as the Spanish Institute of Foreign Trade (ICEX). Consequently, the analyzed studies highlight the urgent need to undertake public and private actions to improve Spain's image abroad.

A survey carried out by the ICEX[42] in 33 countries to evaluate Spain's image abroad reflected a negative perception in aspects such as: innovation and technology, the prestige of companies and brands, and the internationalization of companies and brands (see Figure 18).

[40] http://www.realinstituto elcano.org/analisis/809.asp.

[41] http://www.gfkamerica.com/practice_areas/roper_pam/nbi_index/index.en.html/.

[42] *La Imagen de España, Sus Marcas y Empresas en el Mundo,* ICEX, March 2008.

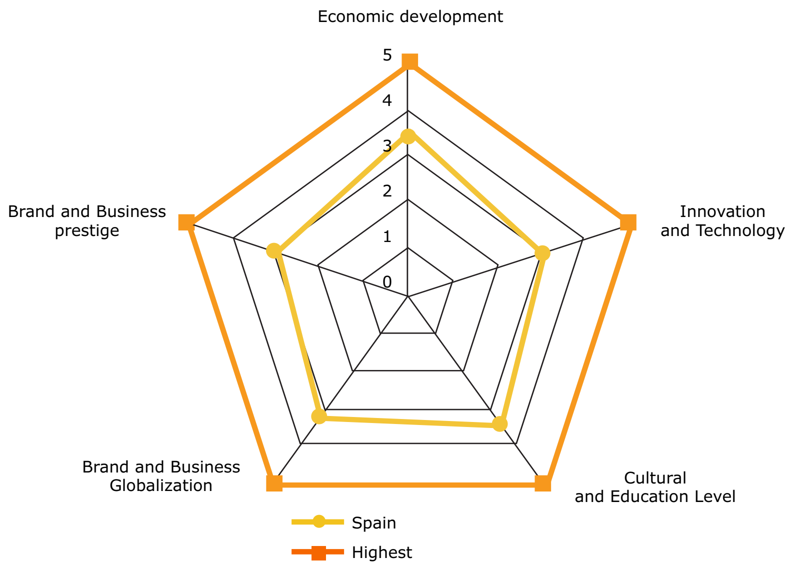


Figure 18. Spain's image abroad.
Source: Spain's Image, its Brands and Companies in the World, ICEX, March 2008.

Several factors seem to indicate that Spain is in a relatively unfavorable position to face the new multipolar order. Therefore, the risk of disappearing from the world's power map should not be overlooked. Over the next few chapters, Spain's situation in the most important areas to derive from the new globalized world will be examined in order to identify the main threats and opportunities facing the Spanish economy in the near future.

3.3. The Engines of Globalization in the Multipolar World

Globalization is understood as the integration of national economies into the world economy through the liberalization of flows of capital, people, goods, services and information. Globalization has advanced inexorably over the last few decades and has proved to do more good than harm, especially in developing economies.

However, the world economic crisis has set off alarms about the threat of a backward movement in the globalization process. Future Trends Forum experts debated on this phenomenon, with most concluding that the flows of capital, people, goods and services will decrease due to protectionist currents (see Figure 19).

Capital flows
Person flows
Goods and services flows

Decrease
Remain the same
Increase

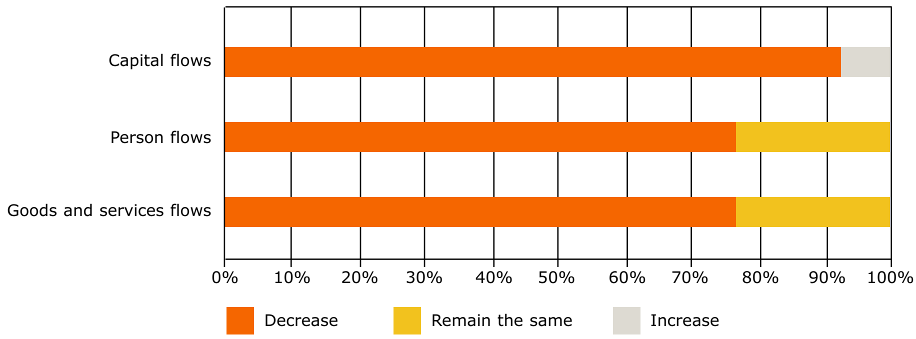


Figure 19. Evaluation of the effect of the crisis on different aspects of the globalization process in the future.
Source: Drawn from the conclusons within the Future Trends Forum.

History teaches us that protectionist measures adopted in times of crisis involve long negotiations afterwards to remove them. Moreover, the smaller these measures are, the easier it is to restore international flows when the economy starts to turn around, and the faster the recovery.

Leaving aside the effects of the crisis in the globalization process, it is clear that whether a multinational benefits or not in this context no longer depends on its geographic location. In order to survive, companies must strive to create competitive advantages in the different areas that will determine the future of the globalization process in the multipolar framework:

- Globalized trade.
- International capital movements.
- Human capital.
- Sustainability.
- Innovation.

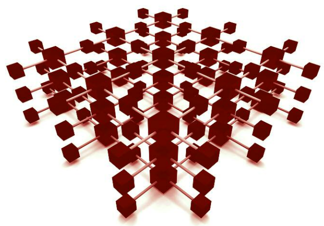
In the following chapters, we will delve deeply into the current situation and future prospects in each of these areas. We will approach the subject from a macroeconomic point of view before discussing in depth the rules that will allow companies to successfully deal with the new situation, differentiating between the companies of developed and emerging countries. Finally, we will explain the situation of Spain in each of these areas and the specific rules for Spanish companies.

4

CHAPTER 4

Globalized Trade

4 Globalized Trade



The international economic recession has led to an international rise in protectionist feeling and a fear of globalization. Some experts predict that this rejection will increase significantly in emerging countries.

When the World Trade Organization's Doha Round of talks was launched to deregulate the global market, soon after September 11, 2001, goodwill was the order of the day. However, its progress is being hindered by national security concerns, unease over possible food shortages and the desire to protect domestic employment and the environment.

The Director-General of the World Trade Organization (WTO), Pascal Lamy, sees international trade as an essential factor in overcoming the crisis: "Doha does not have the answers to the financial crisis, but it would be an important step forward in reinforcing international confidence at a time of uncertainty. Stability in trade relations has always been one of the WTO's main contributions to the world economy."[43]

The ministers of trade who attended the World Economic Forum at Davos in 2009 promised to rescue the Doha Round in order to revive the world economy, and to refrain from creating new trade barriers. They also pledged "to refrain from raising new trade barriers [...], imposing new restrictions on exportation or applying measures incompatible with the World Trade Organization (WTO) to stimulate their exports." As a result, Obama's decision to reconsider the Buy American clause that would prohibit the use of foreign steel in major infrastructure projects was widely praised.

Behind these attempts to promote free trade lies the conviction that it will increase the welfare of millions of people, particularly the inhabitants of developing countries. Taking advantage of the benefits of free trade is one of the great challenges in the new multipolar order.

The experience of countries like Korea, China, India and Chile suggests that trade liberalization leads to an increase in annual economic growth rates of several percentage points for some years. If that is true, doing away with subsidies and trade barriers would result in resources being used more efficiently, thereby creating more scope for the reduction of inequality and poverty, social tension, environmental damage, malnutrition and disease. However, the recession has made it clear that the outlook is not completely positive. The countries most open to international trade are also the most vulnerable. This argument could foster anti-globalization and anti–free market feeling, which could have a harmful effect. It could mean not only the failure of Doha, but also an increase in barriers to trade and immigration.

[43] http://www.aol.es.

Did you know?

According to the WTO, the highest tariffs applied to agricultural imports in developed countries are 350% for tobacco, 277% for chocolate, 171% for oilseed and 134% for poultry, which harms exports by developing countries.[45]

Meanwhile, the trend toward signing bilateral and regional trade agreements may also be a threat to the international trade regime, which has been built up with a great deal of effort over the last 60 years[44] (see Figure 20). Fear of losing the privileges stipulated in these agreements may be a barrier to the liberalization of international trade.

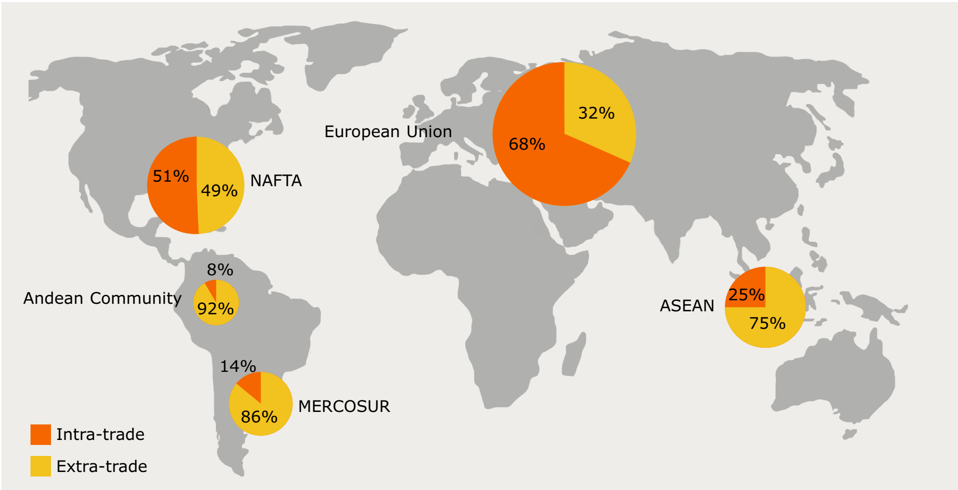


Figure 20. Distribution of intraregional exports, 2007.
Source: World Trade Developments, World Trade Organization 2008.

The New Consumers

Regardless of the trade agreements reached at the international level, the sudden drop in demand will lead to an irreparable decline in the volume of international trade[46] in the coming months. Consumption is falling, not only in the developed countries, which are undergoing a recession, but also in the emerging countries.

When the financial crisis began in the rich countries, the large multinationals thought that developing economies, where demand was still increasing at a brisk pace, would be an easy route to continued growth. It seemed that the flourishing middle class in those countries would absorb excess production from the developed countries at a faster rate than has in fact occurred. Despite this, the transfer of consumer power from the developed countries to the emerging countries is nevertheless taking place. In fact, the crisis seems to have increased the need to seek consumers in these countries (see Figure 21).

[44] *Dialogue on Globalization,* Joseph E. Stiglitz y Stephany Griffith-Jones.

[45] http://www.fao.org/docrep/007/y5419s/y5419s04.htm.

[46] *Global economic prospects 2009: commodities at a crossroad,* The World Bank.

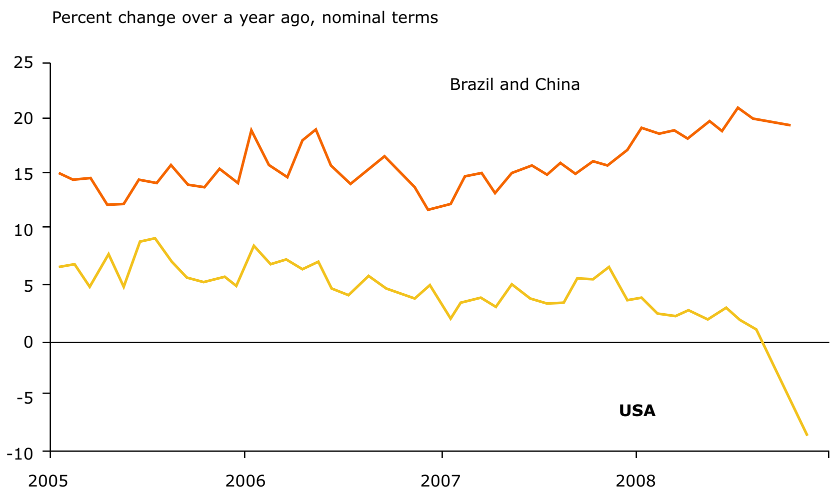


Figure 21. Percentage changes in retail sales.
Source: *Emerging Markets Outlook for the business environment,* Deloitte.

Most emerging countries—including the largest, China and India—anticipate continued growth in the next two years, although at considerably lower levels than in the period 2000-2007. A symptom of the vitality in these economies are their retail consumption figures, which remained relatively high in 2008. Furthermore, the drivers of growth in Asia, such as the increase in productivity, the adoption of new technologies and cultural and institutional changes, were not halted by the 1997 financial crisis. This seems to suggest that the new consumers will be able to boost international trade in the coming years.

The hopes placed on emerging countries as the regenerators of international consumption lie in their rapid population growth as well as their solid economic performance. This is an opportunity for the developed countries, where population trends point toward imminent decline and aging. Estimates suggest that by 2030, the population aged over 65 years old will have increased by a billion people, with the fastest growth taking place in the developed countries, with an increase of 140% by that year.[47]

The new consumers in emerging countries would be part of a growing middle class, consisting of hundreds of millions of people with an annual income of between 6,000 and 30,000 dollars per capita. According to the calculations by the Indian economist Surjit Bhalla, the Asian middle class is now larger than the Western middle class for the first time since 1700 (see Figure 22).

[47] *Global Demographics 2008: Shaping Real Estate's Future Reports Aging, Urbanization and Migration Set to Dramatically Affect Real Estate,* Urban Land Institute (2008).

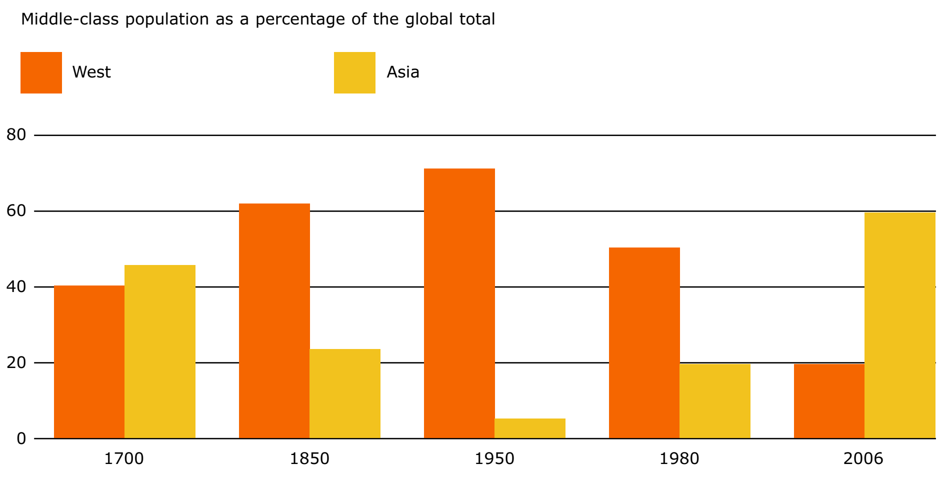


Figure 22. The middle-class population in Asia as a percentage of the global total.
Source: *The Middle Class Kingdoms of India and China,* Surjit Bhalla.

These people will change their dietary habits, make improvements to their homes and increase their spending on education, technology and financial services. This will lead to new business opportunities and to new global challenges arising from greater pressure on resources at the same time. Mark Foster, Accenture's Group Chief Executive of Management Consulting and Integrated Markets, estimates that in 2025, China will have the world's highest number of consumers (see Figure 23).

Did you know?

The Chinese middle class increased from 15% to 62% of the population between 1990 and 2005.

	2005	2025	CAGR
China	3.088	14.527	8,0%
United States	7.335	12.512	2,7%
India	1.924	4.264	4,1%
Russia	749	2.489	6,2%
Japan	1.780	2.291	1,3%
United Kingdom	1.058	1.707	2,4%
Germany	1.180	1.512	1,2%
Brazil	757	1.465	3,4%
France	917	1.374	2,0%
Italy	836	1.168	1,7%
Mexico	648	1.139	2,9%
Canada	539	1.045	3,4%
Spain	560	945	2,7%
South Korea	413	914	4,1%
Australia	339	592	2,8%

Figure 23. The 15 largest consumer markets in 2025.
Source: Mark Foster, Accenture.

Some go even further, and see the four billion people living on less than two euros a day as potential consumers. The idea of providing commercial services to these people at the "base of the pyramid" has been endorsed by authors including C.K. Prahalad, professor at the Ross School of Business at the University of Michigan, who is recognized as one of the world's top ten management experts. According to his line of argument, these people on low incomes may be the driving force behind the next chapter in international trade and prosperity, and a source of innovations that would benefit both rich and poor countries. Microloans in India are an example of this type of business. However, critics of this theory say that this market is very small, and is not a real business opportunity.

Nonetheless, new consumers with medium and low incomes in emerging countries are not the only segment that is attractive to business. The World Luxury Association predicts that consumption of luxury goods in China will account for 32% of the international total in 2015.[48]

[48] «Noticias de la Red de Oficinas Económicas y Comerciales de España en el Exterior: 25/06/08», *China Economic News.*

Did you know?

The International Monetary Fund and the World Bank have classified 42 states as Heavily Indebted Poor Countries (HIPC). Thirty-seven of these receive over half of their goods export income from basic primary products.[49]

Contraction in the Volume of International Trade

Coupled with the problem of fallen international demand is the strong restriction on credit internationally, which also has a bearing on the contraction of international trade. This will have a serious effect on private investment, which is the most cyclical component of GDP, and is most closely related to international trade. At the same time, this marked decline in credit is reducing financing for exports. Commercial banks are restricting credit to businesses, which are finding it increasingly difficult to insure export operations. Finally, the crisis is leading to sharp and unpredictable swings in exchange rates, which can also be an obstacle to trade.

Several factors which have compensated for the effect of the decline in demand from the United States in international trade have converged in recent years. However, this situation may not arise again in the near future. Some exporting countries have focused on markets in developing countries with higher growth rates. For example, despite the United States' share of India's exports falling from 17.1% in 2004 to 15.3% in 2007, China's share of India's imports increased from 5.5% to 8.4%.

Likewise, the rise in prices of basic commodities compensated for the slowdown in exports from several countries (many of them in Latin America) due the lack of growth in American demand.[50] The robust growth in intraregional trade in East Asia—which was to a large extent generated by China's integration into international markets—also contributed to the improvement in the overall trade balance. China's imports and exports have increased by over 20% in recent years.

Unfortunately, the decline in international demand for goods and services as a result of the recession means that there are few centers of growth left for redirecting exports, and the prices of basic products are falling. As a consequence, the developing countries will experience a sharp, albeit probably temporary, fall in their income from exports.[51] The countries that will be most affected are those that have opened up to international trade to the greatest extent, such as Singapore, where exports account for 86% of GDP, and Taiwan (60%).

The Transfer of Power to Asia in International Trade

American consumption levels had begun to decline even before the beginning of the world recession. According to some experts, the country's future as the driving force behind international trade is in doubt. The baby boomer generation's massive consumption during the 1980s and 1990s will decline as this group retires, with the consequent decline in income, which will be depleted even further by the decline in housing prices and the fall of the Stock Exchange.

Businesses will increasingly have to look toward the Asian market. The recession has accelerated a process that had already started, albeit at a leisurely pace.

[49] *Global economic prospects 2009: commodities at a crossroad,* The World Bank.

[50] http://www.fao.org/docrep/007/y5419s/y5419s04.htm.

[51] *Global economic prospects 2009: commodities at a crossroad,* The World Bank.

Did you know?

Thirty years ago, the United States produced 80% of what it consumed, and today it produces 65%.[52]

Despite the slowdown in the growth rate in emerging countries, it is unlikely that it will cease altogether. If they do not succumb to the temptation of establishing protectionist measures leading to a regression in their market dynamics, the transfer of power will continue in the direction in which it is already moving.

4.1. Business Strategies and Globalized Trade

In the new globalized trade landscape, the speed of adaptation required by businesses is constantly increasing. The strategies that have recently made it possible for businesses all over the world to survive and prosper by adapting to the changes, and which will continue to enable them to do so, are listed below in the form of rules. These are based on the hypothesis that strategies for businesses in developed countries should not be the same as strategies for businesses in emerging countries, as their starting points are very different. Spanish companies, whose internationalization process has been outstanding in recent years, will be looked at in particular detail.

Globalized Trade Strategies for Companies from Developed Countries

The opportunity for companies arising from the increasing demand from emerging countries has been discussed above. In order to take advantage of this opportunity, it is necessary for companies to understand these new consumers' needs and preferences. They must adapt their business models and strategies in order to design value proposals in local terms, which meet the demands of these new consumers. By doing so, they will be in a good position to absorb a demand which forecasts suggest will be crucial.

Jagmohan Raju, Marketing Professor at the Wharton School, suggests that the distribution of the middle class all over the world will continue to change, as developing countries remain competitive within the world economy. "Due to economic pressures, more and more companies in developed nations are seeking educated workforces in emerging markets to outsource manufacturing and service jobs. [...] More economic pressures in the West mean more jobs in emerging markets and a bigger middle class that has higher buying power."

As a consequence, the multinationals that have so far to a large extent thought of developing countries in terms of a source of cheap labor will once again benefit, as many workers that they pay to manufacture products will be increasingly in a position to purchase them. "Countries like India consist of young consumers who are ambitious and save quite a bit, but are also willing to spend on small luxuries like Western brands of consumer packaged goods."[53]

Those at the base of the pyramid in these economies could also be a business opportunity for companies that are able to adapt their products and sales strategies to this group's conditions. Finally, the outlook for sales of luxury goods is also favorable, although it has worsened due to the current economic situation.

[52] Manufacturers Alliance/MAPI.

[53] http://wharton.universia.net/index.cfm?fa=viewArticle&id=1549

Despite the strength of emerging market economies, businesses that decide to focus on them should take into account the inherent volatility of these regions, and the risks involved in investing there.

There are various models that companies can use in their internationalization process. The Future Trends Forum experts consider that over the next three years, companies in developed countries will mostly follow a "global sellers" model, which involves manufacturing and supply domestically, while seeking new consumer markets for sales abroad (see Figure 24). They also believe that these companies will be global sourcers that, in a very similar way, are businesses mainly interested in selling in their domestic market, but must obtain supplies internationally due to the their country's limited resources. To a lesser extent, and at the bottom of the list, the Future Trends Forum experts believe that companies in the developed countries will tend to be smaller, and in many regions will be multiregional niche players, in sectors based on technology or innovative processes.

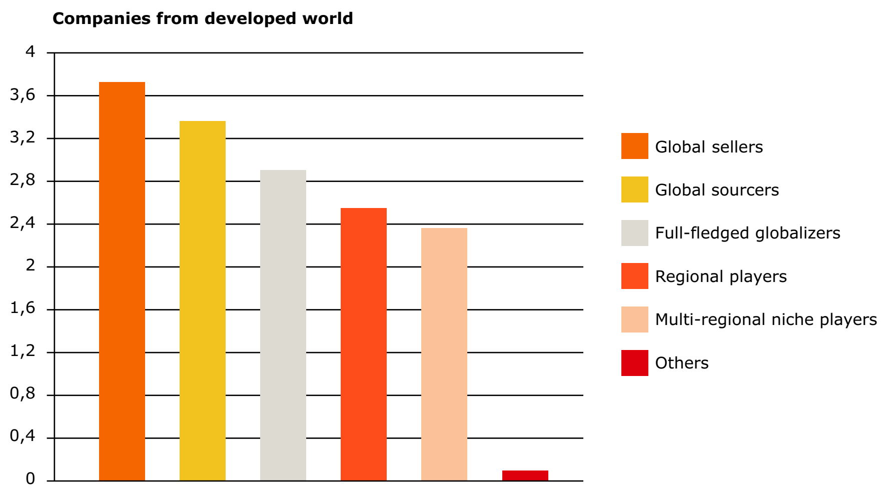


Figure 24. What will be the most common internationalization models for businesses in developed countries in the next three years?
Source: Drawn from the conclusons within the Future Trends Forum.

Rule 1: Business is Good for Development and Development is Good for Business[54]

C.K. Prahalad believes that one of the alternatives open to multinationals for survival in the modern environment is "to discover how to convert the [world's] poor into consumers and introduce them to the global market." This expert feels that the large companies have so far overlooked a market which accounts for around 70% of the world's population, encouraged by the mistaken idea that a

[54] Ian Johnson, World Bank Vice President for Environmentally and Socially Sustainable Development.

lack of resources is synonymous with low profitability. In his opinion, the key to overcoming this challenge lies in "learning from emerging markets and developing a balanced business model of products that are affordable and have acceptable quality."

Prahalad summarizes his "oblivion curve" theory by saying that, "We are all used to thinking in one way. For example, we believe that poor people are not a market because they don't have money to spend. But if we devise a new business model, such as [selling] tickets that are pre-paid [by customers] through cellular phone service, we can convert those sorts of people into effective consumers. This new model has opened the cellular phone model to three billion people. We have to be aware of the limitations involved in looking at opportunities and threats through our [usual] 'management lenses.' What concerns me is that we recognize these tendencies and we change them. That is the 'line of oblivion': it's about learning to forget the old ways of doing things."

One of the most successful ideas for high-yield companies has been to create business models involving local entrepreneurs, backed by microfinancing programs that facilitate access for these low-income customers. The Nokia-Siemens project in Africa is an example of successful deployment of this tactic. The telecommunications giants carried out the "Village Connection" program in countries like Uganda and Rwanda, and involved various agents, starting with local business leaders, whose task was to find customers. Then they sought an operator to provide the services and finally, a microfinancier to manage the supply. The program succeeded in reducing fees, and having a cellular phone these days costs three dollars a month.

Above all, it has been companies in the telecommunications and financial sectors that have used this tactic. However, Unilever's penetration in India, another clear example of a successful strategy, is very similar. The Anglo-German consumer goods company uses local microenterprises to reach rural communities. In India, it used Hindustan Unilever as its local subsidiary. It is repeating this model in Bangladesh, Sri Lanka and Vietnam, and considering it for the Latin American and African markets. 50% of Hindustan Unilever's income now comes from the rural market, thanks to "Project Shakti," which consisted of providing microloans to achieve direct distribution of their products in homes.

Products and services must also undergo a profound transformation to meet the needs at the base of the pyramid. With this objective in mind, Hindustan Lever (Unilever) sells a shampoo that works better with cold water in the Indian market.

When designing products and services for this group, their needs must be given careful consideration. Many businesses are allocating resources to this task, in order to serve this segment and obtain privileged positions. Nokia organized multidisciplinary teams with non-governmental organizations and universities in Kenya, South Africa and Uganda in order to improve its understanding of Africans' needs in mobile communications. Other multinational tech firms, such as Google and Microsoft, are working on designing products directly for the Indian rural market. Google is developing a new search product that uses voice, as well as the unusual feature of being able to understand the various Indian accents, so that people without a computer can also have access to their services.

In rural areas in India, there are thousands of soy farmers who do not sell their crops without first visiting a communal center with Internet access. There, they can see the price of the product, not only on the local market but also on the international markets, and can decide whether to sell that day, or to wait for prices to rise. They can also see information about the weather or look at studies on fertilizers or pesticides. The project is called e-Choupal and the company behind it, ITC, saw an excellent business opportunity as well as the chance to provide service to a group that has traditionally been excluded from any technological means. This situation is also a win-win scenario. The farmers benefit from selling their crops at better prices, and ITC gains access to thousands of farmers to whom it can sell its products, and becomes an intermediary between these people and the international markets.

Also in India, the life-insurance company Max New York has developed an adapted insurance policy to attract customers on low incomes, with a payment of 20 dollars when it is arranged and a minimum premium of just 20 cents. It is also possible to make payments in any store in the country.

Other projects with win-win strategies for businesses and low-income consumers include those launched by GrupoNueva, who learned to distribute products more directly to low income markets, and created a competition for producing other business ideas focused on these markets in mind; Suez, which found new partners for distributing water in Brazilian communities; Procter & Gamble, which is committed to developing consumer products that meet the needs of the poor; Vodafone, which developed a new franchising method for telephone services in isolated communities; and SC Johnson, which obtains ingredients for its products by buying them from poor farmers in Kenya. In the future, other large oil and mineral companies such as Shell, BP and Rio Tinto may create business opportunities in low-income countries and communities.[55]

Rule 2: New Consumers are Concerned about the Price

Although millions of individuals are currently joining their countries' middle classes, they have yet to reach the same income levels as their counterparts in mature economies. In order to win over consumers in these markets, businesses need to create new products that take price sensitivity into account. In the specific case of China, consumers appear to have no brand loyalty and their main motivation is often the price, rather than any perception of quality or the prestige that may be associated with the product.[56]

The aim of multinationals in emerging countries has traditionally been to sell premium brands because they have larger profit margins. However, they have

[55] http://www.wbcsd.org/web/publications/sl-fieldguide-spanish.pdf.

[56] «Los desafíos de vender en Asia», *Knowledge@Wharton* (9/01/2009).

realized that the main business lies with a broader market, which they must focus on by means of a pricing strategy that competes with local brands. This strategy also usually requires personalized products, and even new ones, in order to meet the specific needs of the market concerned.

One example here is Coca-Cola, which has designed a successful strategy for adapting prices to the needs of new consumers. To do so, it prices its product slightly lower in urban areas than in Western markets. The price is even lower in rural areas, but consumers have to drink it immediately and return the bottle to the supplier, as part of a strategy that saves on costs and cuts prices. The bottles are also smaller than in the West.

Despite this significant price sensitivity, there are more expensive products (i.e., the premium products mentioned above), for which new consumers would be willing to pay more, which resembles Western patterns of consumption. The baby-food segment is an example. Mike Booker, a partner at Bain & Co. in Singapore, says: "Nobody wants to be seen as not spending money on their child, so infant formula is very premium. When you raise the price, sales go up. This will likely remain a premium product, so there's no reason for [companies] to water down their lines with less expensive offerings."[57]

Likewise, Ellen Hu, Global Marketing Director of Estée Lauder skin care products in Asia, says that Chinese women are prepared to pay for high-quality products like those marketed by her company. However, they are not loyal to a brand and change if the competition offers them a good discount. "In terms of cosmetics, the Asian market is extremely sensitive to promotions […]. One question that is always on the consumer's mind is: what type of promotion is it offering me? We had to work hard to find a way to respond and preserve our brand's tradition at the same time." Unfortunately for the multinationals, the premium segment in these countries is still small.

Rule 3: Create Alliances between Sectors

Businesses' strategies have always ultimately aimed to maximize their share value, i.e., to meet the demands of their investors. To do so, it is essential to manage and meet the demands of two of the cornerstones of all businesses: customers and employees. These three groups (investors, customers and employees) have historically been the base on which business strategies have been established. In capitalist market economies, these strategies are an appropriate response to the market situation. However, in many markets in emerging countries, governments and other social agents have a great deal of influence, which means they must also be taken into account when establishing strategic plans. Obtaining these groups' loyalty is crucial when entering these markets, and in subsequent positioning vis-à-vis competitors.

Governments and Non-Governmental Organizations (NGOs) are becoming increasingly interested in working with businesses for mutual profit. By involving

[57] http://wharton.universia.net/index.cfm?fa=viewArticle&ID=1461.

development organizations that share similar objectives, companies can benefit from their basic experience and additional resources. An intersectoral vision can also lead to innovative alliances that involve companies in various sectors, tackling a range of needs holistically.[58]

At present, multinationals are failing to meet this tactical objective. Although they invest vast amounts of resources in CRM (Customer Relationship Management) applications to exploit all the opportunities provided by consumers, investments in seeking alliances in target countries are at an all-time low.

The case of Carrefour clearly shows how obtaining approval from the government or social communities is by no means unimportant, and definitely not a tactic that can be repeated in the same way in every emerging country. The French retail group had a highly successful entry into the Chinese market, but was unable to repeat that success in the Indian market. This may have been due to a lack of planning, as it was feeling the pressure of Wall Street's short-term expectations of rapid growth for emerging countries. Or it may simply have been the complexity of the target. Carrefour had everything in its favor: there were vast amounts of consumers, it could cut prices by up to 10% thanks to its optimized supply chain, and it had a job-creation proposal that would have been quite attractive to any government. However, it did not take into account the pressure from a pro-labor group that succeeded in making the Indian government backtrack on its decision. Finally, it granted 100% of the wholesale market in India to the German company Metro, Carrefour's direct competitor, and in so doing severely restricted Carrefour's right to sell in supermarkets.

Another case of a failed entry into the Indian market due to a lack of commitment from various communities or governments involved both Coca-Cola and PepsiCo. The Indian Government informed the two soft-drink companies that they would have to reveal their secret recipes in order to do business on government premises in several Indian states. They obviously declined, and were thus prevented from entering this market. The Indian government's demand was the result of studies undertaken by a local NGO, which declared that the products of both companies contained levels of pesticides up to 24 times higher than those considered safe for consumption.

Some companies, such as Procter & Gamble (P&G), have learned the importance of these strategies from experience. In 1999, P&G decided to focus on the needs of consumers in some emerging countries. The company firmly believed it would be able to make money and benefit the communities where it was operating. It initially focused on products that met dietary deficiencies, while offering consumers a product that was appealing and affordable.

It created a product called NutriDelight, an inexpensive powdered drink that contained all the essential micronutrients, and also tasted good. It was introduced in the Philippines using launch strategies and tactics similar to those of many other P&G products in developed countries. The results were disheartening, but provi-

[58] *Oportunidades de negocios para reducir la pobreza,* World Business Council for Sustainable Development.

ded an important lesson. The product had been designed for a problem in the developing world, but based on a developed country's mentality. This product included all the latest technology, instead of being designed for a low price. P&G also realized that its infrastructure in the country was insufficient to offer this product in the lower market segment, or in the poorest communities.

P&G changed the name of NutriDelight to NutriStar, and launched it in Venezuela. It changed its approach to "Let's do it all ourselves" and began to seek new partners among businesses and in other sectors, with firmly established local roots. It built up a network of alliances with NGOs, multilateral agencies and local pediatric associations in order to make people aware of the need for the product. It also included local business leaders and entrepreneurs as allies to form a chain of coordination from the producers to the distributors. P&G gave the license for the product's formula to local businesses, thereby spreading the risk and reducing the capital investment. Local businesses benefited from the technology transfer, and P&G from the early positioning of the brand in markets with a potential for future growth.

These cases highlight the importance of establishing strategic alliances in local markets. This is even more necessary as a consequence of the economic recession. The increase in protectionism will lead to further difficulties for businesses, which will have to make even greater efforts to convince governments and other social agents of the contribution made by their business to the economies of the target countries.

In emerging regions such as Latin America, some governments are placing increasing obstacles in the way of European multinational companies. Countries such as Argentina, Bolivia and Venezuela are trying to re-establish their presence in business areas in which foreign companies such as Repsol YPF, Grupo Marsans, Endesa and Telefónica competed.

Rule 4: Consider the Diversity of Tastes

Before embarking on the adventure of serving new consumers in emerging countries, the particular features of local tastes must be studied, and the range of products and services adapted to them. According to Bain & Co.,[59] local businesses have advantages in terms of consumer loyalty, lower costs and more favorable government regulation. Multinationals attempting to enter emerging markets must overcome these obstacles in order to obtain a competitive advantage. Substantial changes must often be made to the products offered. For example, Procter & Gamble realized that in order to obtain a share of the Chinese market, it had to adapt more to local tastes. It launched new flavors of toothpaste onto the market, such as fruit, tea and herbs. This helped the company to obtain 25% of the market in 2007, when its presence was practically nonexistent ten years beforehand.

[59] «Winning in Emerging Markets», *Bain & Co. Newsletter* (17/06/08).

Many manufacturers are starting to adapt their products to local tastes. The telecommunications companies in the Indonesian market analyzed consumption patterns in mobile services and discovered that their income from the middle- and lower-income classes came almost exclusively from text-messaging services (SMS). These companies are focusing their efforts on designing new services for sending data and wireless broadband devices.

A yogurt manufacturer launched a version of its product which combined the flavors of cucumber and kiwi, because the product obtained good results among some Chinese consumers. Meanwhile, McDonald's always adapts its product range to suit local tastes. For example, in India it does not sell its international flagship hamburger, the Big Mac, replacing it with vegetarian products that it does not sell in other countries.

It is important to remember that Asian markets in general—and China in particular—are much more diverse than many companies assume. Professor Fred Young, team leader of the Asian division of Swain Tours, a tour operator specializing in exotic destinations and tailor-made itineraries, says: "There's no such thing as one China. In Shanghai, people prefer having a separate MP3 player and phone. In other cities, people want one device. In Shanghai, people want carousel loaders for their CD players. Down south, one-CD trays are fine because they're cheaper. And tastes can be completely different when you drill down to the small cities."[60]

Rule 5: Dress up in Local Culture

It is necessary to go a step beyond simply adapting the range of products and services, and obtain an image as a local business. The transformation must be far reaching and sometimes affects the corporate image, processes, the supply chain, the organizational model, etc.

According to Diana Farrell, Director of the McKinsey Global Institute[61], distribution is an important consideration for companies hoping to reach the emerging middle classes. The infrastructures in many countries are underdeveloped and businesses often forget the importance of the distribution system. Placing a product on the market with the right distribution in these cases can be a major challenge (although it can also be a great business opportunity). Many companies start in the big cities, where behavior, perception and attitudes are more similar to those in developed markets. However, conditions in small towns are very different, despite their rapid development, because more value is placed on the face-to-face relationship with the vendor. For this reason, it is easier for companies to reach this type of consumer through small shops.

The British supermarket chain Tesco made its sales format more flexible in order to adapt to the idiosyncrasies of the local business in the Asian countries where it was expanding. In these countries, consumers prefer to buy small amounts of fresh food on an almost daily basis, instead of buying supplies for longer periods

60 *Knowledge@Wharton* (9/01/2009).

61 «Las dos caras de la nueva clase media global», *Knowledge@Wharton* (23/07/2008).

in larger stores. In their eagerness to adapt to local tastes, the supermarket even started selling live tortoises and toads, which are common items in food stores in China. Meanwhile, McDonald's adopts the style and architectural image of some countries where it wants to increase its presence. In the end, what companies seek is to build their brand, and it is only possible to establish a long-lasting relationship with the consumer in the target country by presenting a long-term project, with a network of recognized and trusted distributors. Investment must be focused on the long term, and be persistent. Having a subsidiary working exclusively on the market means that more specialized strategies can be defined. Another strategy is to purchase a local player, which can facilitate entry into an emerging market in the following ways: successfully adding local brands to the business line, reinforcing product distribution, reducing operating costs and hiring scarce local talent. In 2007, Coca-Cola bought the Russian company Aquavision in order to increase its production and presence in that country.

Another factor related to local culture that may influence the sales of multinationals in emerging countries involves the political measures taken in their countries of origin. Given the world population's access to international information and news, in many cases there is an immediate rejection of multinationals' products when their countries of origin make a decision that is unpopular in the target country. The most obvious example was when the United States invaded Iraq in 2003. Many consumers rejected all companies they identified as American, such as McDonald's and Coca-Cola, which were deemed the main American brands to boycott. There was even a parallel product launched in Muslim countries to compete with Coca-Cola, called "Mecca-Cola." In view of multinational companies' inability in most cases to influence the political measures introduced in their countries of origin, and the difficulties in softening their impact in the countries where they operate, trying to disguise themselves culturally as local businesses is an alternative.

Rule 6: Know your Competitors

While competition between companies offering the same products or services is certainly nothing new in business, it is a key factor to consider when contemplating entry in emerging countries, given the differences between them and developed countries. The relative poverty of these countries is offset by their lower competitive intensity and better prospects for growth.

The characteristics of the "enemies" must be studied before entering a country. Some companies, for example, have a department focused exclusively on assessing the specific features of each emerging market and designing entry strategies adapted to the situation. Furthermore, once positioned in the target market, it is also necessary to analyze the entry of new competitors in the same way.

However, what are the competitors in these developing countries like? Obviously, multinationals expanding their services in other countries also want to take up a position in rapidly growing markets. An article by Bain & Co. warns that some of the leading organizations in mass consumption, such as Coca-Cola, Unilever and Danone, already get 9%-15% of their total income from the world's three main emerging markets— China, India and Indonesia—but these competitors are already well known.

There are also local competitors who start with the advantage of greater knowledge of consumers' needs and tastes. Hence it is worthwhile to study the way they operate, their processes and strategies, which although probably improvable, are currently efficient.

In many emerging countries, such as India, it is increasingly common to find business conglomerates—such as Tata and Reliance—which are giants in their country's economy. The distinguishing competitive factor of these large companies operating in various sectors is their diversification of businesses and risks. Furthermore, they achieve synergies between one another, optimizing resources, knowledge and talent. They are sometimes powerful enough to drive competitors out of the market with temporary price wars, while being supported by their other businesses. These conglomerates are normally owned by extremely wealthy families that decide to diversify, thereby obtaining a competitive advantage over other companies.

One of the latest Indian conglomerates to emerge is Bharti, the company established by Sunil Mittal, which operates in agriculture, financial services, insurance, telecommunications and retail sales. Its target income is up to 10 billion dollars in 2010.

Globalized Trade Strategies for Companies in Emerging Countries

The globalization process has entered a phase in which business opportunities are not exclusively taken by multinationals from developed countries in emerging economies. The trend is shifting toward these investment flows taking place in both directions, and to an increasing extent, even between some emerging economies and others. Mark Spelman, Global Head of Strategy at Accenture, highlights the interdependence between these flows. He feels that much can be learned from the strategies of multinationals in developed countries, but also from those in emerging economies. What formulas have led to the growth rates seen by the emerging economies and their multinationals? What strategies will sustain the rise of multinationals from emerging countries?

In the opinion of the Future Trends Forum experts, the search for new markets will be the main factor behind the internationalization of companies from emerging countries (see Figure 25).

Companies from emerging markets

Which of the following factors do you believe are going to act as a motor for the internationalization of the companies from developed and emerging countries in the following 3 years?

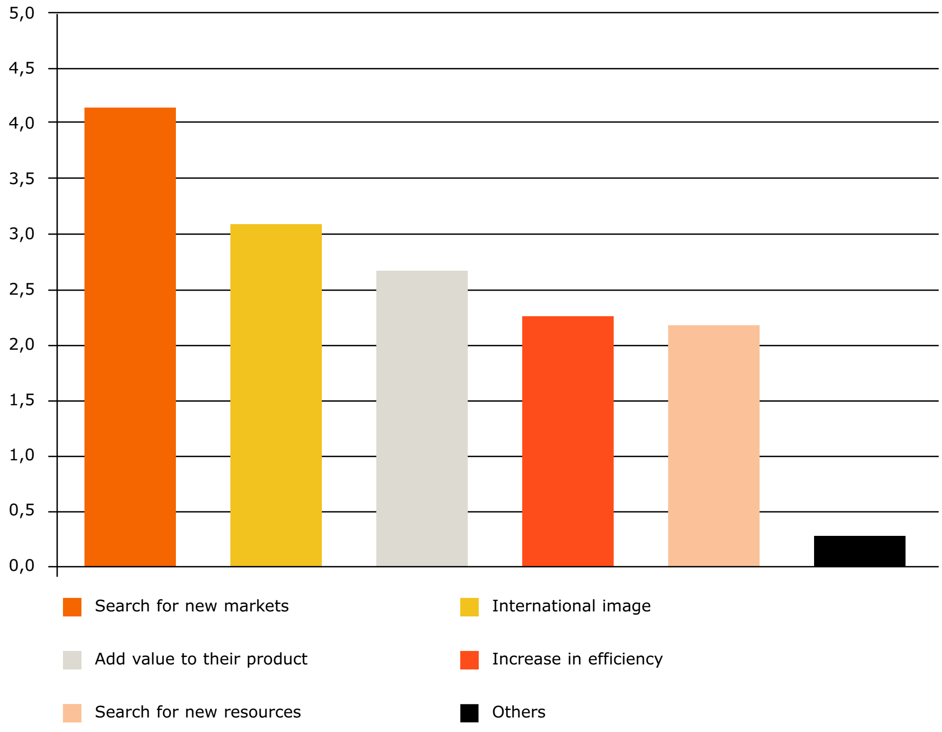


Figure 25. Factors encouraging the internationalization of companies from emerging countries.

Various types of barriers will arise in this internationalization process toward developed economies (see Figure 26). Indeed, the main barrier cited by the Future Trends Forum experts will be the high level of competitiveness in the global market. To overcome this barrier, these companies can use their experience in their local market for their international expansion and adopt strategies involving mergers, takeovers and joint ventures with businesses in developed countries. For example, Hyundai Card, the result of a joint venture between Hyundai Motor (South Korea) and General Electric (the United States) is planning to expand to the United States, China and India.[62] The trend toward more ambitious mergers and takeovers is increasingly applicable to multinationals in emerging economies.

[62] «To save, South Koreans use credit cards», *International Herald Tribune* (13/12/2007).

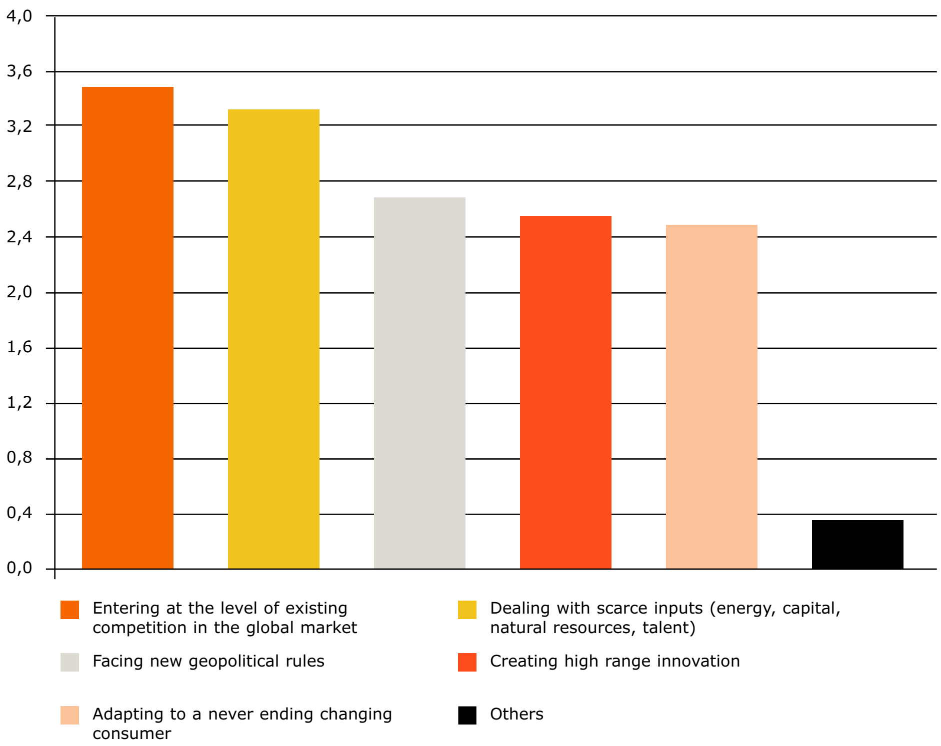


Figure 26. The main barriers on the path toward global competition for multinational companies from emerging markets.
Source: Drawn from the conclusons within the Future Trends Forum.

As for the most common internationalization models to be adopted by businesses in emerging countries, the Future Trends Forum experts point to "regional players" and "global sellers." The former seek out new consumers in nearby emerging countries for reasons of cultural affinity and proximity. The latter seek consumers elsewhere, despite producing goods using local resources in the source markets (see Figure 27).

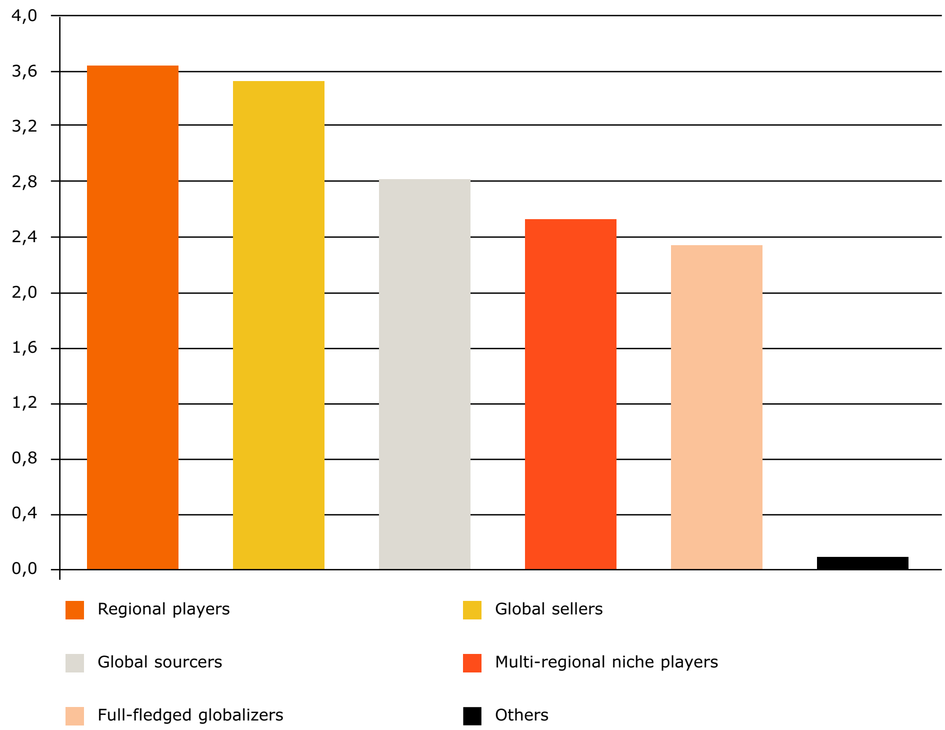


Figure 27. The most common internationalization models adopted by companies from emerging countries.

Rule 1: Withstand the Crisis in Western Consumption with Local Demand

One noticeable phenomenon occurring in emerging countries is the "return home" of major export companies that originated there. The sharp drop in demand from developed countries has led them to foster the neglected local demand in their own markets. These companies' competitive advantage, and the key to their success, lies in knowing how to use their employees' knowledge of the tastes and needs of consumers in their own country. There are several cases of traditional Chinese exporters adopting this strategy. These include the advertising campaign by Lenovo, the Chinese personal computer manufacturer. The company, looking to refocus on its domestic market, was aided by its staff's extensive knowledge of that market, which is only now being explored by the company.[63]

Chinese mobile handset users have also been offered a wider range of advanced services, such as video calls and wireless broadband connection. In January 2009, the Chinese government granted 3G licenses to three national operators: China Mobile, China Unicom and China Telecom.[64] Competition in the market is thus being encouraged, as well as the opportunity for users to compare the technology in each range of products.

[63] «Chinese exporters look to sell in the home market», *Business Week* (12/02/2009).

[64] *«China business: 3G era opens», Economist Intelligence Unit* (14/01/2009).

Accenture uses the concept of "incubating local demand" to refer to the way in which businesses can create purchasing power so that consumers with fewer economic opportunities can become part of their clientele. There are three strategies for "incubating demand"[65]:

- **Developing infrastructure.** Some companies in emerging countries have invested in the infrastructure necessary to promote new markets in the areas of telecommunications, transport and financial formulas. Prospéritas, a microfinancing institution that won first prize in the IE Business School 2008 entrepreneurial project, offers microloans to Colombia's low-income population.[66] Cell Bazaar, the company founded by Kamal Quadir, one of the Future Trends Forum experts, uses wireless technology to create a virtual market that provides a means of communication between farmers and traders in Bangladesh and potential buyers. The vendors advertise their products by price and location in a market with transparent information. Both Prospéritas and Cell Bazaar are creating a group of potential consumers.

- **Innovating.** Access to the right technology also plays an important role in winning over "hidden" demand. Many businesses have included new technology in their products and services. In Bolivia, a new debit card has given many people access to the banking system for the first time, by means of over 50,000 cash machines. The machines talk to users instead of communicating through written text, which is very useful considering that 25% of the customers are illiterate. By selecting the color on the screen, users can even choose the language in which they want to be served: Aymara, Spanish or Quechua.[67] The project was developed by Prodem, a local organization with expertise in microfinancing, and has proved beneficial to both sides. The company earns money with the seven dollars it charges each customer annually for maintenance, and the users have banking services that they previously had no access to, along with the advantage of having their money available 24 hours a day, seven days a week.

- **Adapting products.** Businesses in emerging economies are often forced to adapt their products to comply with the needs or preferences of new consumer segments. A case in point is Arvind, one of the world's largest manufacturers of denim garments, which was unable to corner the Indian low-income segment because its prices were too high. The company ultimately decided to market a kit for making denim garments for only six dollars. It was distributed to local tailors in rural areas, thereby reaching a largely inaccessible consumer group.

Rule 2: The Recession Makes Low-Cost Products Fashionable

As a result of the economic crisis, consumers have started to tighten their belts and although they have not stopped buying, they want to do so more cheaply. The difference is in the price, and whoever offers the most competitive products will increase their market share. Low-cost flights, low-cost computers, low-cost

[65] *The Rise of the Emerging-Market Multinational,* Accenture (2008).

[66] «Prospéritas, espíritu emprendedor con vocación social», *Knowledge@Wharton* (11/03/2009).

[67] http://www.iadb.org/NEWS/detail.cfm?language=Spanish&id=1904.

Did you know?

Despite the effect of the recession on consumption and the figure for automobile sales in the United States being 16% lower than a year ago, in global terms it reached a record high of 59 million in 2008. This was largely due to the emerging economies.

cars... more and more sectors are joining the trend toward cheap prices. The pioneers in the new sectors that have jumped on the bandwagon are merely continuing on a path that others have trodden successfully. Low-cost companies in sectors such as fashion, household goods, and food are taking advantage of the decline in consumption to increase their turnover. Companies from emerging countries have an initial advantage, which is their lower production costs in their countries of origin.

Starting with low-cost cars , the Indian company Tata Motors launched its European version of the Nano low-cost car in March 2009. It costs around 100,000 rupees (approximately 1,930 dollars) in India. The European version has been adapted with improved specifications, and the price is around 5,000 euros.[68] There is even a model with lower cylinder capacity to appeal to consumers who want to cut down on their fuel costs. This shows that companies must include aggressive cost cutting in their business models if they are to compete on price in a market in recession. Companies from emerging economies will find this strategy much easier to apply, thanks to their lower production costs. Tata's Nano was supposed to compete with the motorcycle market in India, but has succeeded in adapting to the needs of consumers in developed countries. These needs, specifically in the automobile sector, take the form of cheaper and more ecological means of transport. There are Chinese models already competing with the Japanese hybrids because they have managed to cut costs while also reducing their environmental impact.

In the technology field, Lenovo aims to overcome the economic crisis by focusing on regions with emerging economies. The company's new strategy is to sell low-cost computers in rural areas in China.[69] Meanwhile, the Brazilian factory Tectoy in Manaus and the largest wireless chipset manufacturer, the US firm Qualcomm, have launched the Zeebo console onto the market. The novel feature of this new video game console is that it is designed for sale in developing countries, specifically Brazil, India, China and Russia, where promoters see a market niche of 800 million young people wanting to play with something cheaper than the devices currently available.[70]

Rule 3: Aspire to "Global Localization"

Companies must strike a balance between business strategy at a global level and adapting to local tastes and expectations. McDonald's was a pioneer in offering fast food at an affordable price and also serves wine in France and beer in Spain. Korea's Samsung is a company from an emerging country that has followed the same example: it launched washing machines onto the market in India that had a memory-recovery function to compensate for power outages, as well as a special wash cycle for saris (the traditional dresses worn by Indian women).

Another example is Brilliance China Auto, which has set up factories for car production in Russia, Egypt, Vietnam and North Korea. In the first six months of 2007, its international sales increased by 85% compared to the same period in

[68] «Tata hopes the time has come for a Western Nano», *Times Online* (2/03/2009).

[69] http://www.vnunet.es/es/vnunet/news/2009/03/06/lenovo_enfoca_su_mercado_de_portatiles_low_cost_a_los_campesinos_chinos

[70] http://www.elpais.com/articulo/ocio/Zeebo/consola/low/cost/paises/desfavorecidos/elpeputeccib/20090326elpciboci_3/Tes

the previous year.[71] The Chinese carmaker has succeeded in reproducing a model that competes with other companies from emerging economies in terms of price, but is also appealing to the lower segment of the market in developed countries.

As a result of the crisis, a trend is starting to become apparent in which companies from emerging economies avoid depending on income generated by the United States. It is therefore no surprise that the two largest telephone operators in Russia, having saturated their own market with an increase from 1 to 170 million users, are implementing sales strategies in India and Vietnam.[72] Meanwhile, Mexican "maquiladora" assembly plants[73] are seeking to increase their sales in countries like Chile, Peru and Brazil.[74]

Rule 4: Acknowledge Differences in Emerging Consumption Habits

One conclusion reached by the Future Trends Forum experts was that consumers in emerging countries are undergoing a phase of consumption prior to that of developed countries. Whereas "mass" consumption products meet the needs of the inhabitants in emerging countries, consumers in developed countries are not satisfied with the standard products that appeal to the vast majority. They are increasingly demanding more varieties, leading to what is known as "mass customizing" or product personalization. As the development of the emerging countries continues, they will follow the same path. Acknowledging this process will be crucial to the success of companies from emerging countries.

In fact, the markets in countries such as China are so large that these differences in consumption habits can be found within their borders. While in some parts of the country, businesses merely meet basic demand, in other areas—mainly in the cities of the East—they satisfy a far more sophisticated emerging demand. Companies such as Youngor, one of China's largest firms, designing, manufacturing and selling menswear, use their "mass customizing" process to reach the high end of the market. The company offers tailor-made suits in the Chinese market for 320-378 dollars.

Other examples of China's slow progress toward "customizing" can be seen in the automobile sector, where it is possible to order an "à la carte" car, something unthinkable in markets like the United States. In 2002, Haier also offered the opportunity to customize refrigerators. Although this was not very successful among individual consumers, it worked well among local businesses, who saw it as a means to distinguish themselves from the competition.

C.K. Prahalad feels that part of a strategy's success depends on whether it "includes the user community in the process of creating new products and services, as in the video-game industry. This is the first time that the human race has been connected together, thanks to the advance of new technologies ranging from the BlackBerry to cellular phones to television. This connectivity makes it easier for customers to be closely connected to the company and to work together." For Prahalad, "it is the customer who now decides what can be done and

[71] «Brilliance to set up factory in Russia», *China Daily* (2/11/2007)

[72] «Russia Telcos look to Asia for growth», *BusinessWeek* (22/04/2008).

[73] Businesses that import materials without paying tariffs, with a product that will not be sold in the country. Most of these factories are in Mexican cities located on the United States border. The capital for the "maquiladora" factories tends to be entirely foreign; the proprietors are generally American companies, although there are also some important emerging-economy companies.

[74] «Mexico's manufacturers seek new markets», *Financial Times* (12/02/2008).

what cannot be done." It is the customer who "defines where the value of the product is; not the company that does so, as in the past."[75]

As well as creating systems for customers to participate in product development, and updating products and services in response to the market's rapidly changing tastes and needs, "corporate strategy has to go beyond fulfilling the expectations" that customers reveal through this interactivity.

Rule 5: The Importance of the Brand

Emerging markets do not have a history of brand marketing and management as developed markets do. However, the rapid growth of their economies—with the subsequent availability of money to spend and the increased sophistication of their consumers—represents a great opportunity from the commercial standpoint.

The challenge for emerging markets is to adapt their marketing strategies to changes taking place in society and therefore among the consumers. The Indian "1298" service (the number for calling an ambulance) received unexpected attention when images of their bright yellow vehicles were broadcast internationally after the terrorist attacks in Mumbai. Without realizing it, the service was capitalizing on its television appearance.[76]

Who wins among consumers in emerging markets when a local brand comes face to face with an international rival? Forty-seven percent of South Africans believe that the quality of locally produced brands matches that of international brands.[77] Furthermore, almost 60% of consumers in emerging markets would be more likely to buy a local brand than an equally priced international brand (see Figure 28).

[75] http://www.wharton.universia.net/index.cfm?fa=viewArticle&ID=1361.

[76] «The Value Of Brand In Emerging Markets», *The Inspired Economist* (15/01/2009).

[77] Study by Synovate, a market research company belonging to the communications group AEGIS.

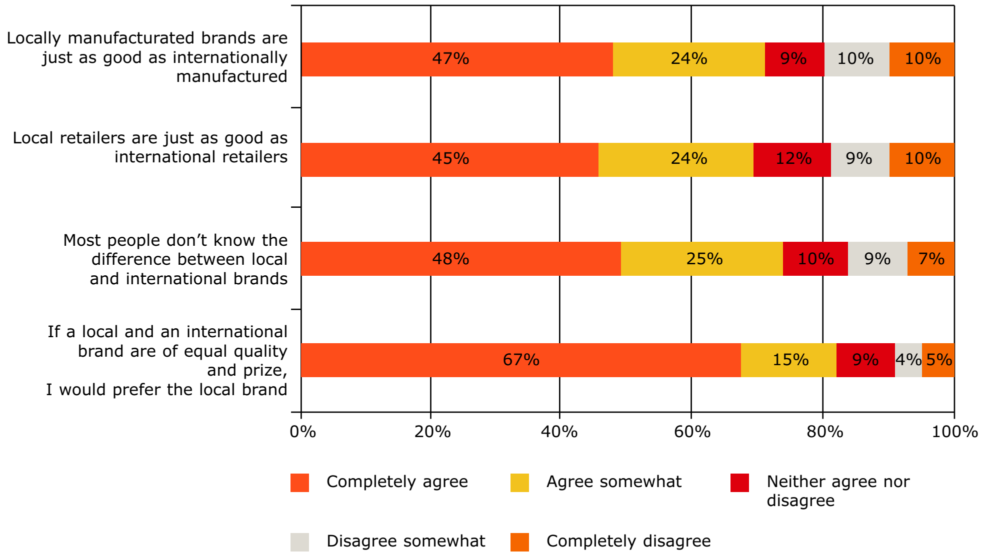


Figure 28. Brand perception by consumers in emerging countries.
Source: Synovate Hotspots Report (South Africa).

Meanwhile, on their way toward internationalization, Asian economies aim to silently but swiftly shed their image of manufacturers of cheap products of dubious quality, and start competing with their own high value-added brands.

In recent years, markets worldwide have started to receive products from emerging countries that are not commodities competing exclusively on price, and which aim to compete on equal terms with the established international brands. In all cases, the main objective of the Chinese brands is to repeat the success of their Japanese counterparts 30 years ago, when they began their international expansion with an image associated with quality and technological breakthroughs.

The TCL television and air-conditioning brand began manufacturing in a plant in Argentina a few years ago. Its sales director says that, "with televisions and electronic products, there was a very big change 15 years ago in the market, when all the major manufacturers moved to China, meaning that today quality is associated with the brand and not the origin of the product."[78]

One of the strategies used by companies from emerging markets is to purchase Western brands in order to penetrate the market. This occurred with the Taiwanese multinational Acer, and China's Lenovo. However, there are companies that have decided to enter the Western market on their own account, without a partnership with another business. Asus, another multinational Taiwanese elec-

[78] http://www.lanacion.com.ar/nota.asp?nota_id=1086956.

tronics manufacturer, decided to change its image to become an up-market international brand within its sector.[79]

Another example is the Chinese car brand Chery, which is taking its first steps in Argentina, in partnership with the entrepreneur Franco Macri, at almost the same time as entering the United States. The cars sold domestically are assembled in a plant in Uruguay, although a second factory is scheduled to open in 2010 in Argentina, with an investment of 500 million dollars. Chery's objective is to follow in the footsteps of Lenovo, which quickly positioned itself among consumers in Argentina and the rest of the world by taking over IBM's PC division in December 2004.

The tobacco sector is another in which Chinese brands are taking their first steps. To enter the Chinese market, Philip Morris reached an agreement with the country's tobacco monopoly, which includes production of Marlboro in China and the expansion of Chinese brands in various markets throughout the world. In Argentina, the Harmony brand was chosen, being aimed at the upper segment of the market.

In the near future, additions to this list could include other Chinese brands that are starting ventures abroad, such as the sportswear line Li Ning Sports (which has already become the shirt sponsor of the national basketball team), Tsingtao beer, and Haier refrigerators and washing machines.

Rule 6: "Green" is Fashionable

A study by the National Geographic Society and the company GlobeScan presents a new method for measuring and comparing the individual behavior of consumers in terms of their relationship with the environment. The study,[80] entitled *Greendex 2008*, highlights significant differences between consumers in developed countries and those in developing countries, in terms of environmentally sustainable behavior in the areas of housing, transport, food and consumption of goods. One revealing part of the analysis is its focus on the individual behavior of each consumer, factoring in both consumption habits that are determined by active decisions (such as repairing something instead of replacing it, washing clothing in cold water, etc.) and those that arise due to circumstances (such as the availability of "green" products or public transportation). The results show that Brazilian and Indian consumers score highest on sustainability. They are followed by consumers in China, Mexico, Hungary and Russia. Among the European countries, Spain ranked slightly above Great Britain and Germany. The countries with the worst scores are the United States, Canada and France. The main conclusion of the study is therefore that the behavior of people living in developing countries is more sustainable. The fact that consumers in developing countries usually live in smaller homes, use public transportation, and own fewer electronic devices could be attributable to their lack of alternatives due to income levels. However, another study by Accenture[81] shows that 50% of citizens in emerging countries would be willing to switch products if it meant reducing

[79] «ASUS aims for the "gorgeous" market», *The Guardian* (16/10/2008).

[80] Servicio de Información y Noticias Científicas (May 2008).

[81] http://www.ecologiaverde.com/los-ciudadanos-de-los-paises-emergentes-son-los-mas-concienciados/.

the negative impact on the environment. However, only 24% of those living in developed countries shared that willingness.

This analysis, together with other studies, gives a very good idea of which countries have the most sustainable consumption from the environmental point of view, because the fact is: green is fashionable. Concern about the devastating effect of human beings' habits on Earth is nothing new, as "green" practices have been part of business strategy for decades. However, in reality companies are increasingly incorporating respect for the environment into their marketing and advertising. Two years ago, a company in Malaysia built a natural gas pipeline that crosses South Vietnam in order to carry cleaner alternatives and meet the growing demand for energy, which is forecast to increase by 15% in 2010. The countries of Southeast Asia have also discovered the profits available in the biofuel sector, as well as its advantages in terms of environmental protection, cost cutting and job creation. Indeed, in Indonesia the sector employs 1.5 million people.[82] Meanwhile, China has become one of the economies with the world's highest growth rates, which are accompanied by a pollution problem. After the United States, it is the country with the highest level of carbon dioxide emissions. That is why in 2006 it adopted the GreenWatch program, on the advice of the World Bank's Development Research Group, to publish information on the Internet about factories' emissions in order to encourage their reduction.[83]

4.2. The Situation of the Spanish Economy in the Globalized Trade Landscape

Spain is facing the challenge of competing in an increasingly global, multipolar trade landscape. Businesses must deal with the current decline in domestic demand due to the recession, as well as the reduction in talent in the medium term due to the aging of the population. Faced with this twofold problem, the internationalization of companies and the conquest of new consumers in emerging countries should be a prime concern.

Internationalization has not been a priority among Spanish companies in recent years. The robust performance of domestic consumption has been sufficient for them to obtain good results. In fact, growth in the Spanish economy has mainly been based on the continuous increase in domestic demand (40% growth between 2002 and 2006). Private consumption and construction (housing and public works) were the driving forces behind domestic spending, based on favorable financial conditions and job creation.

The high level of household and corporate debt to finance this demand led to further vulnerability in this growth model. At the same time, the strength of domestic demand was counteracted by the gradual decline in net foreign demand. This development can be explained by both the slower growth in exports of Spanish products and services, and the increasing penetration by imports. The foreign trade deficit thus highlights the low levels of competitiveness in the Spanish economy.

[82] http://ifcblog.ifc.org/emergingmarketsifc/green_investments/.

[83] *Polluters in China Face Public Scrutiny*, The World Bank (17/05/2006).

A Growth Model Based on Domestic Consumption

The recession has cleared up all the doubts concerning the medium-term sustainability of this growth model. The sharp rise in unemployment, the marked decline in domestic demand and the credit drought have brought the Spanish production model to its knees. The Spanish economy therefore faces a dual challenge. First, immediate measures must be implemented to stimulate the economy in the short term. Second, structural reforms must be undertaken to change the production model in the medium term and improve its competitiveness and productivity.

The drastic decline in domestic demand arose from the fall in consumer and business confidence to record lows, according to data published by the European Commission (see Figure 29). If this situation is to be counteracted, the outstanding issue of increasing exports and improving Spain's position in the field of international trade must be addressed. To do so, improvements must be made in the Spanish economy's productivity and competitiveness by reforming the cornerstones of its production model. If these areas are not improved, the risk of the Spanish economy sliding down the international ranking, while more competitive emerging countries move up, is becoming increasingly apparent. The opportunity to serve the new consumers in these markets must also be seized. As mentioned above, in the new multipolar landscape, consumers must also be sought beyond Spain's frontiers. The recession heightens the dependence of localized markets on emerging economies. Exports to these areas must therefore be promoted. The euro area currently accounts for approximately 45%[84] of Spanish goods and services exports, while markets with high growth rates play a minor role.

[84] International Monetary Fund, 2008.

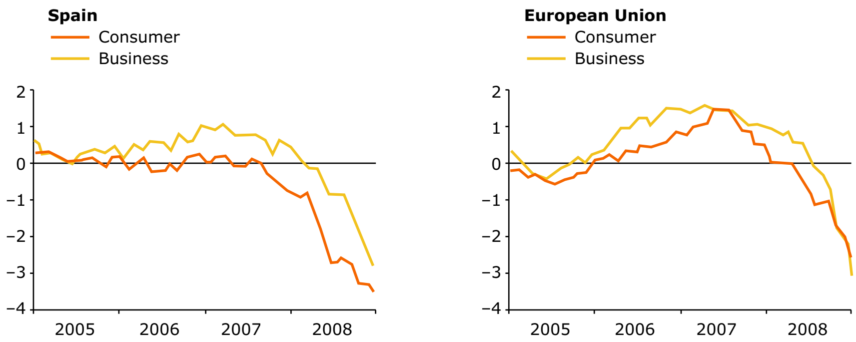


Figure 29. Indicators of consumer and business confidence (standard indicators—difference between indicator and its average, divided by standard deviation).
Source: European Commission.

Did you know?

Spain is the world's 17th largest exporter and 11th largest importer of goods, while as exporter it ranks 5th worldwide and 8th as an importer of services.

The Major Challenges of the Spanish Economy in a Globalized Trade Landscape

The specific influence of industry in the Spanish economy is lower than the average for countries in the euro area, and the majority of products consumed domestically are therefore produced abroad. This combination of high imports and low exports leads to a deficit in the trade balance that has been a normal feature of the Spanish economy for some decades, and hindered its growth. The increase in the foreign trade deficit and the divergence between the development of the domestic market and the production levels of Spanish companies highlight the difficulties faced by Spanish industry in terms of successfully meeting the new challenges raised by globalization.

José Luis Leal, an ideologist, politician, Spanish entrepreneur and Future Trends Forum expert, describes the scale of the problem in the following terms: "our trade balance's current account situation is unsustainable in the long term. The fact that the cost of financing the foreign debt exceeds the tourism revenues gives some idea of the magnitude of the problem that we must solve. Unless we strongly promote our exports of goods and services, it will be impossible to maintain growth rates higher than those of the euro area and, consequently, the convergence of our living conditions and those of more advanced countries will cease, or even fall back."[85]

In order to increase its volume of exports, Spain should invest in improving its "country brand," given its adverse position compared to neighboring countries. A strong country brand not only attracts tourists and investors, but can also increase the sale of products. Products with a country brand can have a significant influence on preexisting perceptions and increase awareness, create an image and influence opinions on product quality. In the final analysis, the stronger a country's brand, the more advantages its products will have in terms of preferences, price and loyalty.[86]

The survey carried out by ICEX to assess Spain's image abroad[87] identifies Spanish products' strong points as being the price-quality relationship of its products and services, and design/style (see Figure 30).

[85] http://www.elpais.com/articulo/economia/olvido/sector/exterior/elpepieco/20090318elpepieco_6/Tes/.

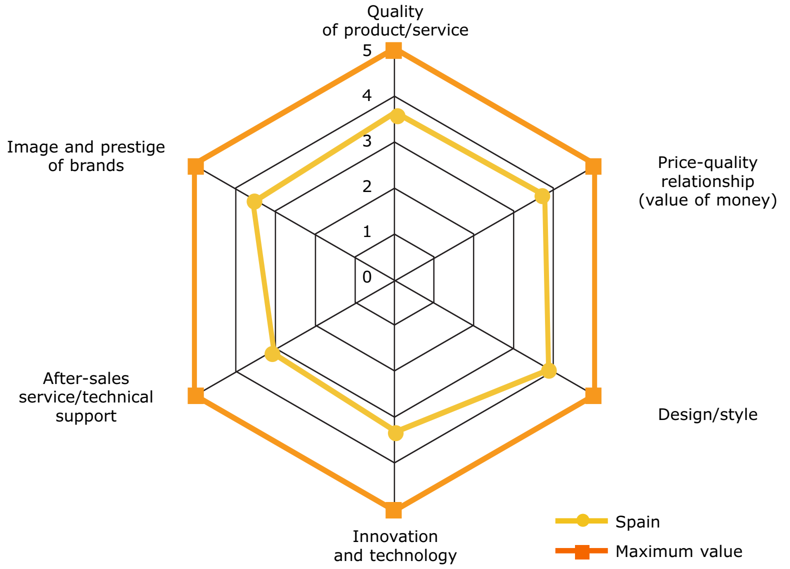
[86] http://www.countrybrandindex.com/resources/pdf/CBI08_Spanish.pdf

[87] *La Imagen de España, sus Marcas y Empresas en el Mundo*, ICEX, March 2008.

Did you know?

There are "filters" that can distort a country's image abroad. Examples of filters that affect Spain's image abroad are:

- The British filter creates an image of Spain as a country of flamenco and bullfights.
- Americans are influenced by their confusion over what is Spanish and what is Mexican.[88]



(1) Very negative; (2) Negative; (3) Nor positive, nor negative; (4) Positive, and (5) Very positive.

Figure 30. Assessment of Spain's brand image in other countries.
Source: *The Image of Spain, Its Brands and Businesses in the World,* ICEX, 2008.

The same study shows that the business sectors most closely associated with competitiveness in Spain are tourism, food and drink, and fashion and accessories. The main competitors in these sectors are France in tourism, and Italy in the other two sectors. Spain will need to design an image that gives it a different and unique positioning in the market compared to these strong competitors. The Future Trends Forum experts believe that Spain should invest more resources in promoting its image abroad, mainly in Asia. They also believe that more publicity should be given to the achievements of Spanish companies that have successfully become international players.

Meanwhile, the aging of the Spanish population will change the nature of domestic consumption in the medium and long term. If present trends continue, the decline in the birth rate will lead to a reduction in domestic demand. Immigration will help to relieve the situation, but it will not compensate for its effects completely (see *New consumers: Aging Population and Immigration* by the Bankinter Foundation of Innovation). These are further grounds for improving the trade deficit by increasing exports.

Spanish companies are facing major challenges in this new context characterized by the globalization of trade, a topic we will discuss in the following section, which looks at the trade strategies of Spanish companies. The telecommunications, transportation, retail and financial services sectors, all of which are crucial in the new multipolar landscape, appear to be the best prepared to meet the in-

[88] *La imagen de España en Asia-Pacífico,* Real Instituto Elcano.

> **Did you know?**
>
> The National Statistics Institute calculates that Spain will stop growing by an average of 720,000 people a year to only half that figure after 2010.

ternational challenge. The emerging countries in Latin America are the ideal place to begin international operations, due to the natural advantage of a common language and culture. Meanwhile, the Asian countries are a matter pending in the internationalization process of Spanish companies, and an opportunity that must not be missed.

As regards the tourism sector, which has historically been one of the cornerstones of the Spanish economy, the Future Trends Forum experts feel that efforts should be made to attract more tourists from Asia in the medium term, mainly from countries like China and India, which have enormous potential in terms of numbers.

In short, the economy must be restructured in order to improve its productivity and competitiveness if Spain is to take advantage of the new cycle of economic growth when the world economy is back on its feet. Reforms in education, research, the labor market, the energy market and competition are some of the tasks that must be carried out in Spain if this is to happen, and if high added value products and services are to be designed that win over new consumers in the globalized trade landscape.

4.3. Spanish Companies' Strategies for Globalized Trade

Few countries have made as much progress as Spain has made in the last 30 years. However, a vast difference remains between the perception of the country and its businesses abroad and the real socioeconomic and business conditions. In this context, it is necessary to define the strategies that provide sustainable growth. A distinctive positioning in international trade will undoubtedly contribute to this objective. Some of the formulas that can help Spanish companies to deal successfully with the globalization of trade and thereby improve the Spanish trade deficit are listed below.

Rule 1: Sell "Made in Spain"

Spain, and Spanish companies by extension, must work together to improve the image of "Made in Spain" products, as stated in the previous point.

In order to take advantage of Obama's economic stimulus plan, the Spanish government has recently begun to implement strategies to sell "Made in Spain" in the United States.[89] This program by the Spanish Foreign Trade Institute (ICEX) has been given a budget of 44 million euros. The plan's outlines were presented by a hundred Spanish companies, with the minister of Industry, Miguel Sebastián, and the Prince and Princess of Asturias in New York. As the minister put it, "we have the world's largest company in construction and use of wind power; the second largest in wind turbines, and six of every ten companies specializing in motorway concessions are Spanish."

[89] «España pretende vender el "made in Spain" en Estados Unidos», *El Economista* (17/03/2009).

Did you know?

Spain is a world leader in holiday tourism.

In order to sell *typical Spanish* products and service in the United States and the rest of the world, foreign consumers' perception of what Spain has to offer and the sectors that could make a more significant contribution at the global level must be taken into consideration. The Future Trends Forum experts discussed the most attractive investments in Spain in the future, and came to the conclusion that these were renewable energy and tourism. Spain is in a very good position in renewable energies, nanotechnology, high technology, tourism, infrastructures, urban building construction, and operating concessions for freeways, airports, hospitals and tunnels. Companies that work in these sectors must therefore take full advantage and reinforce the good "Made in Spain" brand image even further, to counteract the lack of awareness of the Spanish brand. "Although the connotations of 'Made in Spain' are not negative—because they are not associated with poor quality—the country's products do not have a very high profile," according to a study carried out by the researchers Javier Noya, Beatriz Rodríguez and Antonio María Ruiz Jiménez, of the Elcano Royal Institute, which takes an in-depth look at Spain's overall image in American public opinion.[90] "The new icons in the public eye in the United States, such as actors, athletes and chefs, are also not sufficiently associated with Spain."

Seat, Zara, Freixenet, Osborne, Rioja and Serrano and Iberian ham, in that order, are the brands that most Germans mention when they are asked to name a Spanish brand, product or service. Mango, Telefónica, Camper, Santander, Chupa Chups, Tío Pepe and Codorníu are also mentioned by up to one in every ten Germans, according to a study on Spanish brands' strategies in Germany by the consultancy Ingo Rütten.[91] In terms of geographical areas, Spain has yet to raise its profile in emerging countries, which have so far accounted for a minority of its exports.

"Made in Spain" products are not clearly identified in some countries, and neither is Spanish culture. The British writer Michael Eaude said in his book *Barcelona:* "No one has been able to explain to me why so many English tourists come back to Manchester from the Reus [Catalonia] airport wearing Mexican hats." Attempts to differentiate Spanish culture and products date back a long time. Many will remember the famous tourism promotion campaign with the slogan "Spain is different," which highlighted the Spain's diversity of landscapes and exotic nature. This difference should be passed on to the business sphere, to distinguish Spanish products and services in the new, multipolar context.

Rule 2: Become Visible on the International Landscape

The internationalization of Spanish companies was a process that began in the early 1990s. In 1990, direct Spanish investment abroad accounted for barely 3% of GDP, while in 2002 it was 34.3%, exceeding the average figure for the other industrialized countries.[92]

One of the most well-known Spanish success stories abroad is the Santander Group, which has risen from being a local bank which was sixth in Spain and

[90] «"Made in/Made by Spain": La forja de la marca España en EEUU», *Knowledge@Wharton* (25/03/2009).

[91] «El "typical spanish" todavía pesa en Alemania», *Expansión* (11-04-2008).

[92] «"Spain" también "is different" cuando valora las inversiones en el extranjero», *Knowledge@Wharton* (08/02/2006).

number 152 in the world, to the global group that it is today—number two in Europe, seventh in the world and the leader in Latin America.[93] This all took place thanks to a strategy "based on the search for new levers for growth and on diversification when the domestic market was mature, striking a balance between mature and emerging markets, and prior knowledge of the markets where investments are going to be made and where sufficient critical mass is available."

According to the *2007 Spanish Business Internationalization Yearbook,* by the Wharton School Circle of Entrepreneurs, one of the major challenges for Spanish companies was visibility in the international media. According to its indicators, this has improved thanks to businesses like Endesa, Telefónica, BBVA, Santander and Repsol. It is important for Spanish companies to have a good reputation in international financial circles because they need financing, and this is to a large extent obtained from institutional investors, bond placement, etc. An example is Santander's involvement in the largest bank takeover in history with the acquisition of the Dutch ABN-AMRO bank.

The inevitable question is: if the recession is a global problem, how does the current situation affect companies' internationalization? The recession may be a double-edged sword, because as well as its negative consequences, it may also create a number of opportunities. Investing in the United States currently makes sense in view of the low asset prices and the euro's strength compared to the dollar. It is wise to take up a position in a market which will in all likelihood recover and undergo future growth.

One of these impending opportunities is in China (and in emerging economies in general), where aggressive policies to maintain their growth rate by means of fiscal stimuli are being implemented. Infrastructures will play a key role in these policies, and Spanish companies in the sector should position themselves there. As far as the future is concerned, the internationalization of Spanish companies toward emerging countries will be crucial.

Rule 3: Follow the Formulas for Success

What is the top-ranked international company in terms of growth in the food distribution sector? The answer is relatively easy: Wal-Mart. And what is the second-place company? This answer is a little more surprising: Mercadona, which is also the leader in the Spanish supermarket segment. Mercadona starts with a universal assumption: "in order to be satisfied, you first have to satisfy others."[94] Its business model therefore focuses on total customer satisfaction and increasing value to them by means of a policy of low prices, instead of temporary offers and discounts. It uses meetings with local residents, courses on its own brand's product lines, open days, blind testing and efforts to increase the nutritional quality of its range to build up trust among its customers, which keeps them loyal. Its slogan is "Supermarkets you can trust" for a reason. They also say that "overall revenues have grown nearly twelve-fold over the last 10 years, and at an average annual rate of 22%," thanks to the policies mentioned above and the de-

[93] *La empresa española en el mundo multipolar. Retos y oportunidades ante el nuevo escenario,* Accenture (2008).

[94] «Para Mercadona, líder del segmento de supermercados en España, el modelo GCT ha sido una inversión excelente», *Knowledge@Wharton* (30/04/2008).

sign of their stores, which aims to minimize the customer's shopping time. In other words, the opposite strategy to large outlets.

This does not mean that a business model can be imitated perfectly. The Silicon Valley formula has been reproduced many times (Silicon Alley in New York, Silicon Glen in Scotland and Silicon Roundabout in London, for example) but they were not as successful as anticipated.[95] However, there are some models for business initiatives that have been repeatedly proven to work. *The Economist* describes some of these in its article "The Magic Formula." First, there is the anchor-firm model, which is when a large company creates other small ones, giving them the money necessary to start them on their way. A second model, currently very popular, is driven by crisis. This takes advantage of a consequence of the recession and makes it into an opportunity. An example is companies that hire people with specific talent and skills who have lost their jobs. The example given in the article is the hundreds of highly trained scientists that were recruited by local start-ups in San Diego in the 1990s, after the end of the Cold War. The third model is that of the local hero who sees an opportunity, starts up a business and makes it into a goldmine. An example of this is Zara, which began in 1975 with one shop in A Coruña in Spain, and has become a leader in international textiles as a result of its international expansion.

Rule 4: Change the Rules of the Game

The Inditex group is the Spanish success story par excellence. Its Zara, Pull and Bear, Massimo Dutti, Bershka, Stradivarius, Oysho, Zara Home and Uterqüe retail chains have more than 4,200 outlets in 73 countries. The group's flagship, Zara, has shown that it is able to adapt quickly to customers' tastes all over the world. By keeping its means of production in-house (Zara produces 60% in its own factories and the fabrics come from Spain, the Far East, India and Morocco) and operating with virtually no stock, it can take almost immediate advantage of the changing opportunities in the market. Zara dyes its collections with new colors, sends out new designs within two weeks, and even scraps a product line completely if it fails to sell. In short, it has revolutionized the way in which textile companies operate by challenging the concept of fixed fashion seasons.

The Inditex group was in the news once again in February 2009 with the announcement of an agreement with the Tata group to open shops in India from 2010 onwards.[96] This joint venture strategy shows that one of the formulas for penetrating the market in a new country is to form a partnership with a company with experience and knowledge there.

To return to the recession, who would have said that uncertainty in the markets would have boosted the business of the large auditing companies? Until 2007, the lucrative business was giving advice on corporate operations. At that time, it was the numerous movements taking place on the Spanish business scene (with the successive takeover bids with Endesa playing a leading role) that enabled these companies to increase their turnover, which was boosted by the increase

[95] «Magic formula», *The Economist* print edition (12/03/2009).

[96] www.inditex.com.

in the demand for financial advice[97]. The rules of the game have changed since 2008, and the trend is now for large companies in the sector to seek assistance with feasibility plans, detailed analysis of their clients' credit risk and debt restructuring, and advice on downsizing plans and redundancies. Flexibility to adapt to the constantly changing situation is a sine qua non for survival, especially in times of crisis.

Rule 5: Join the "Low-Cost" Fashion

Spain is one of the low-cost paradises. Brands and companies including McDonald's, IKEA, Primark and Ryanair have succeeded in this market, which has seen the emergence of local brands based on the model of mid- or low-price positioning, such as Dia and Zara. The central role of leisure and consumerism in Spanish culture, as well as income limitations, make the country a great testing ground for these models.[98]

This price awareness is typical of American culture, with its slogan "Why buy one article of clothing when I can buy three for the same price," which has reached Spain with the force of a hurricane. The recession has made things difficult for conventional businesses, as consumers will think much more about where they spend their money. This phenomenon is turning low cost into an increasingly common trend and a magnificent opportunity for businesses able to increase their productivity. What is most surprising is that these businesses' incomes are increasing in the middle of the recession. For example, in 2008 McDonald's Spain (in the middle of a recession) saw its income increase by 7%, to 755 million euros.

Primark shops, the new fashion distribution phenomenon, were invaded by hordes of shoppers in Spain. Why? Because there is not a single product in their shops that costs more than 35 euros. However, let there be no misunderstanding. These are not liquidation sales or cheap, low-quality goods. Primark fashion does not appeal to the middle class for price reasons alone. Its designs are all the rage. It is the new "low-cost chic."

In view of these results, it is not surprising that many large companies, especially those starting to feel the pinch of the recession, are adopting the low-cost model. Inditex, a pioneer in low-cost chic in Spain, has understood that cutting its prices in Zara or Pull and Bear is no longer enough. In the last two or three years, it has intensified the opening schedule of the outlets of its subsidiary Lefties, a type of factory outlet with which it plans to halt the unstoppable Primark invasion. Lefties, which sells pants for as little as 9 euros, increased from 38 stores in 2006 to 63 in October 2008. In fact, some Zara stores have been closed in order to become Lefties. Not even El Corte Inglés has escaped the carnage. Along with its house brand, it has the recently launched Aliada. In the air transport sector, Iberia has high hopes for the new Vueling-Clickair brand.[99]

In this area, new business models and a change in travelers' attitudes make quality low-cost hotels possible. These combine affordable prices and facilities

[97] «Los servicios anticrisis impulsan el negocio de las grandes auditoras», *Expansión.com* (12/03/2009).

[98] http://www.gaceta.es/negocios/11-03-2009+low_cost_arrasa_espana,noticia_1img,68,68,50034

[99] http://www.gaceta.es/negocios/11-03-2009+low_cost_arrasa_espana,noticia_1img,68,68,50034

that are very similar to those found in classic four- and five-star hotels. An example is Room Mate, a Spanish hotel chain founded in June 2001. Room Mate hotels, which have over 700 available bedrooms, are more like real hosts, and their customers, rather than guests, are roommates. The concept is that they are "homes" that open their doors to travelers who have arrived in the city in search of comfort, quality and the warm welcome that all hosts offer their guests. The most important thing when attracting consumers is the price-quality relationship.

There are currently a wide variety of companies in Spain promoting themselves as low-cost. There are real-estate agencies such as Modainmobiliaria.com, carwash services like Living, construction companies like Inverborche, consultants like Rhino Consulting and legal services like Legálitas—all sectors have been caught the fever. There are even low-cost jets (which fly at 1 dollar per kilometer). Not even restaurants have escaped this phenomenon. Sergi Arola has decided to follow in the footsteps of Ferran Adrià (with Nhube, in partnership with NH) and is developing several luxury fast food chains. One of these is D'E Sergi A.

Despite it all, several marketing professors say that low-cost has acquired such prestige that many undertakings of this type owe more to marketing than to the possibility of providing a genuine service at a low price. Joaquín Garralda, of the IE Business School, emphasizes that "low-cost has become a magnificent label for attracting consumers." In fact, some companies that declare themselves to be low-cost apply similar prices to the others. Francesc Valls of ESADE says: "One of the characteristics of these businesses, especially those applying dynamic pricing, is that they advertise the lower price, despite subsequently selling part of their range at prices similar to conventional companies."[100]

[100] http://www.gaceta.es/negocios/11-03-2009+low_cost_arrasa_espana,noticia_1img,68,68,50034

5

CHAPTER 5

International Capital Movements

5 International Capital Movements

Financial globalization has taken place thanks to the proliferation of international financial flows. Although trade liberalization is generally acknowledged as beneficial by the various theoretical schools of thought, there are conflicting opinions on the effects of the free international circulation of capital.

The economist Stanley Fisher is among those who feel that financial globalization enables capital to be allocated more efficiently, and that it is vital for low income countries. It is emerging countries that would in principle benefit from financial globalization, as they have less capital.

According to the opposite school of thought, led by the economist Joseph Stiglitz, Nobel Laureate for Economics in 2001, among others, the free flow of capital without any restrictions is detrimental to international financial stability. Furthermore, Stiglitz maintains that the crisis on Wall Street clearly shows that the model of free market fundamentalism does not work, and he is critical of the complexity of the financial products that caused the crisis, as well as the incentives for risk in the payment scheme for senior executives.

In the current circumstances, in the midst of collapsed markets and bankrupt businesses, the developed countries are being accused of having failed to establish sufficient checks in order to prevent a speculative bubble. Capital surpluses, which in many cases come from emerging countries, fueled the speculation by investing in complex financial products which hid the risks of subprime mortgages, among other hazards. The spread of these products was encouraged by the AAA rating assigned to them by the rating companies. That is why "conservative" investors were affected by the collapse in the markets as to the same extent as "bold" investors. The rest is history.

The financial crisis has focused the spotlight on the regulatory services and rating companies*.* The Future Trends Forum experts believe that "the rating companies had a great deal of power, but the problem was not a lack of regulation, but rather that the regulation in place was poor." As a result, it is crucial to deal with this new complexity by means of effective risk management in companies, and greater financial and political coordination on an international level.

A crisis of confidence in the markets arose at the same time as the financial crisis, but more importantly, the conduct and morality of executives is being called into question. During his inaugural speech, President Obama himself did not hesitate to point to the "greed and irresponsibility on the part of some" as one of the causes of the crisis. He referred to "greed and arrogance on Wall Street," and has even described the payment of bonuses amounting to billions of dollars to senior staff in financial institutions which remained solvent thanks to the help of taxpayers' money as "shameful."

Ángel Cabrera Izquierdo, president of the Thunderbird School of Global Management in Arizona and a Future Trends Forum expert, recently emphasized the need to define a new ethical code for capitalism: "The time has come for business managers to adopt their own Hippocratic oath of business. We must define the obligations and rights of managers as regards society."[101] Behind this proposal lies the criticism that companies focused more on increasing financial yields to their investors than on generating employment, value for customers, their suppliers, new technologies and other factors.

Indeed, innovation in financial products was the main factor responsible for the tremendous economic growth of recent years and also for many of the losses in the global economy. It is now vital to restore confidence in the markets and ensure that they are transparent. There are growing calls for more regulation, but if this is not established properly, protectionism may rear its ugly head, with the resulting influence on how the markets function and the efficient allocation of resources.

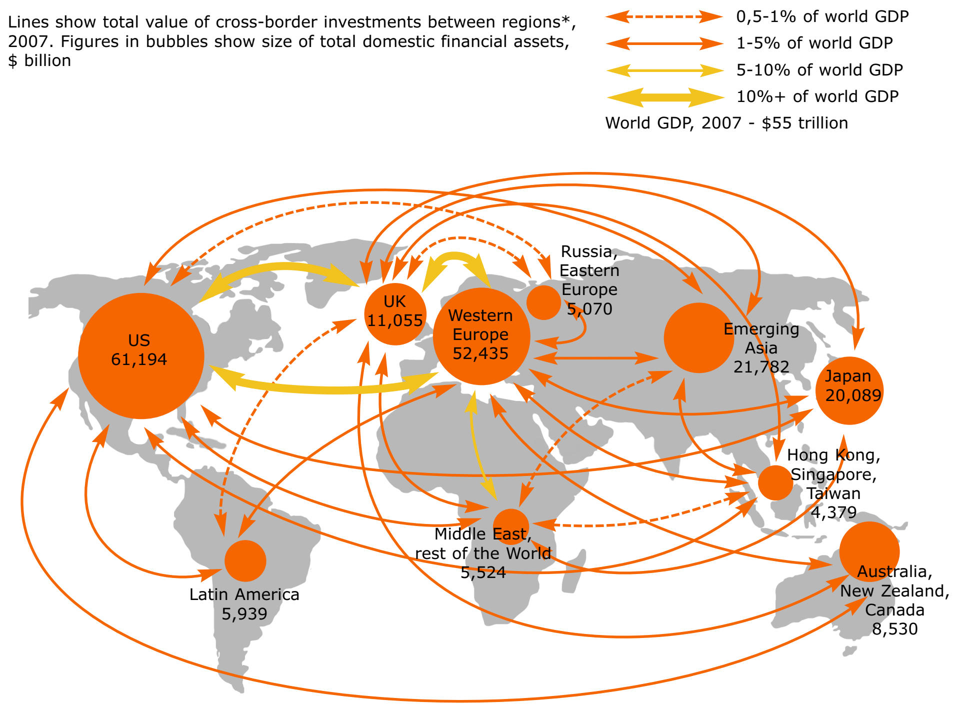
During an interview at the World Economic Forum in Davos in early 2009, Gordon Brown warned of the danger of a rapprochement between the international economy and financial protectionism: "What you are seeing is the withdrawal of banks from a number of emerging-market countries with a pretty weak domestic banking system [...]. What you've got then is a form of financial mercantilism. What you've got is people retreating to their home-based banking systems. It's the first stage of a financial protectionism that will lead eventually to the kind of trade protectionism that we've seen in the past if we are not prepared to do anything about it."

These barriers would halt the great progress made in the flow of international capital. The speed with which the crisis spread and the lack of confidence it created in the banking sector are unprecedented. The closely linked nature of the international financial markets was apparent. This trend toward the multipolar globalization of capital has become apparent in recent years. What is most important is that whereas some years ago, investments originated almost exclusively in developed economies, investments from emerging countries are now increasingly common. These investments are being made in both developed countries and other emerging countries (see Figure 31).

[101] «Un nuevo código ético para el capitalismo», *El País,* 02/03/2009.

Did you know?

Between 1996 and 2006, subprime mortgages in the United States increased from 9% of the total to more than 20%.



*Includes total value of cross-border ivestment in equity and debt securities, lending and deposits, and foreign direct investment.

Figure 31. International cross-border investments.
Source: McKinsey Global Institute analysis.

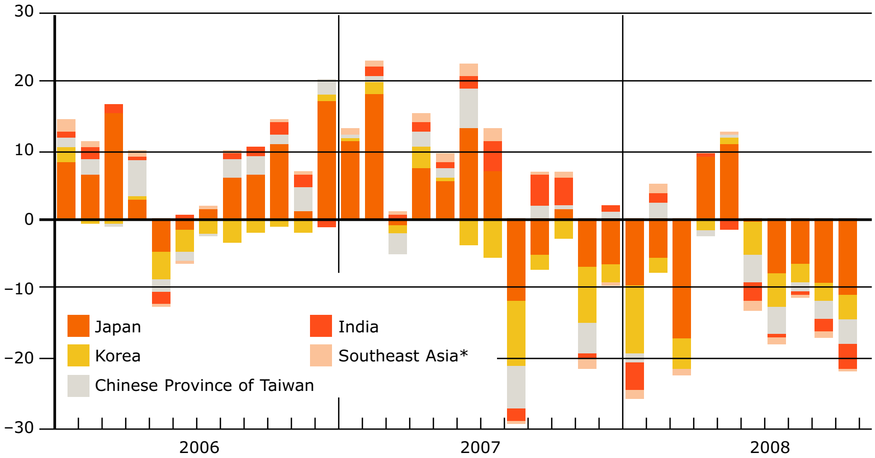
Countries with large foreign capital reserves or low levels of debt will be in a better position to face the future. However, those that are most dependent on international capital flows will have the highest levels of exposure to fluctuations in capital markets, as is now apparent in the countries of eastern Europe. If they do not pay back the debt they have incurred with other European countries, they may endanger the financial systems of the lending states. Iceland's situation at the end of last year, when it was on the verge of bankruptcy, is well known. In the US, the states of California (the world's 8th-largest economy in its own right) and Kansas are also on the verge of bankruptcy, due to their excessive financial leverage and abuse of debt. As a result, the trend will be toward a reduction of debt by both countries and the companies within them.

Flows from Developed Countries to Emerging Countries

Approximately 30% of international direct investment flows from developed countries toward emerging countries. Asia is now more integrated within the international capital markets, and attracts around 40% of the net private capital heading for emerging markets. Foreign direct investment accounts for two thirds of the private capital going to Asia. These capital inflows, and the region's current account surplus, have led to a significant build-up of reserves.

However, these investments have gradually been withdrawn during the financial crisis. There is some evidence of an incipient financial protectionism which would make countries give priority to injections of capital within their frontiers to deal with the lack of liquidity. The supply of capital to emerging countries is declining as a result (see Figure 32).

Since the outbreak of the worldwide credit crisis, investors have progressively withdrawn their capital from Asian stock markets.
(Net equity flows, million dollars)



* Philippines, Indonesia, Thailand and Vietnam.

Figure 32. The flight of foreign capital.
Source: Bloomberg.

The flow of capital from rich countries toward developing countries—in the form of remittances sent by immigrant workers—is also being affected by the financial crisis. As all the sectors in the economy of the countries in recession become involved, this group's income will decline, and these capital flows will fall even further as a result. The estimated figure for remittances sent to developing countries in 2008 was 283 billion dollars,[102] with a decline in the second half of the year, followed by a sharp fall in 2009.

The Future Trends Forum experts found that this trend is becoming apparent in various Latin American countries, such as Mexico. Many Mexican immigrants who used to work in the construction sector in the United States are now unemployed, and this will have a profound effect on the volume of remittances.

[102] *Global Economic Prospects 2009,* The World Bank.

The reduction of the flow of remittances will have an effect on the GDP of developing countries. The scale of the decline will also depend on exchange rate fluctuations, which will become particularly important in the near future.

Capital from Emerging Countries to Developed Countries

The tables have turned, as the enormous power of investments from emerging economies looking for sectors in weak situations in developed countries becomes apparent. It is therefore obvious that in a globalized and multipolar world, the so-called "rich" countries also need investments from "poor" countries, which means that the distinction between them is becoming increasingly vague.

The spectacular growth in the foreign currency reserves of countries with emerging economies, and especially those in Asia (see Figure 33), is explained by what Ben Bernanke, President of the Federal Reserve, calls a "saving glut." The high savings rate in these countries is a result of their comparative advantage in labor costs and other inputs compared to the countries that provide these currencies. According to experts at Wharton, the United States, the world's richest country, now finances its trade deficit by borrowing from poorer countries.[103]

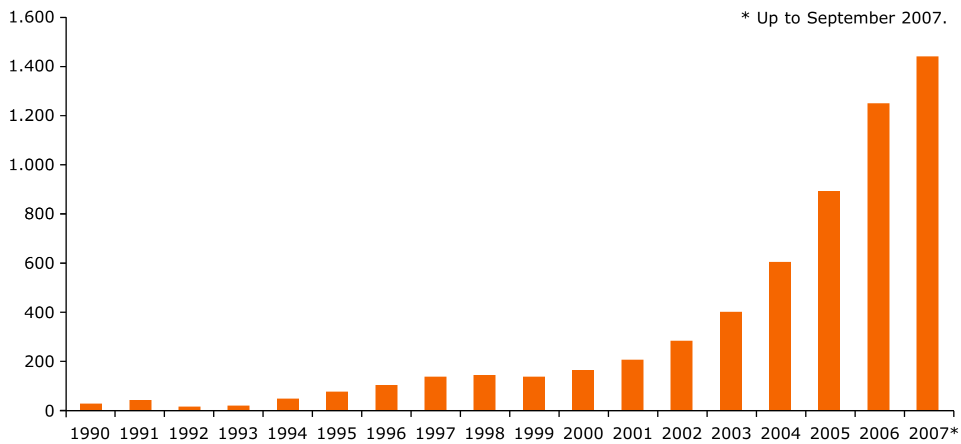
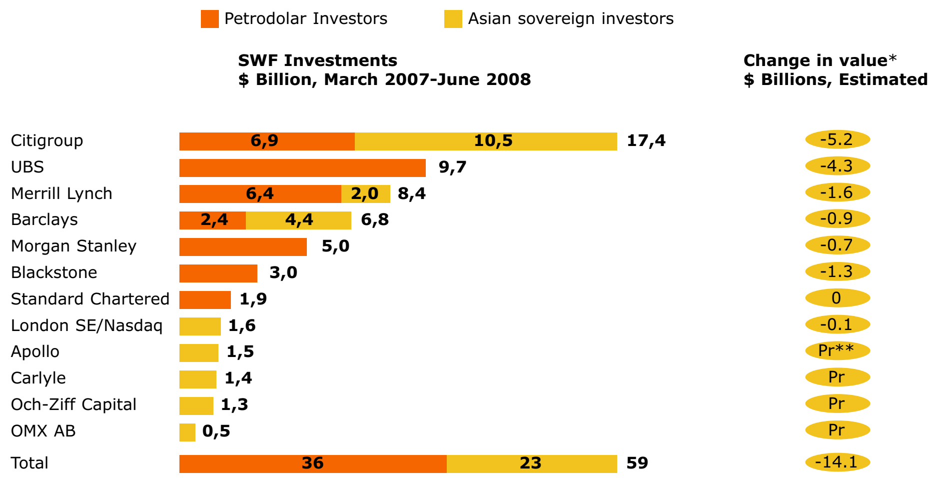


Figure 33. China's foreign currency reserves (at the end of the year, in billions of dollars).
Source: *The Rise of the Emerging-Market Multinational*, page 13, Accenture (2008).

Furthermore, investments in United States Treasury bonds are no longer attractive to Asian countries, due to their low yield. As a result, they are seeking new foreign investment formulas. It is increasingly common to hear on the news of attempts by Asian businesses to merge with and takeover European and North American companies on the news. These are a source of some controversy—does this mean that the emerging countries are taking power in business? These

[103] «Huge Reserves, Emerging Market 'Challengers' and Other Forces Are Changing Global Finance», *Knowledge@Wharton* (15/10/2008).

strategic operations are carried out through sovereign wealth investment funds that can lead to alterations in many businesses' capital structures (see Figures 34 and 35).



Note: Numbers do not add up due to rounding
* Estimated based on change in price of common stock from first day of month when transaction took place and June 2, 2008; in the case of Blackstone, change in price from IPO to June 2, 2008.
** Pr denotes private companies that do not trade in public markets. OMX AB went private due to transaction.

Figure 34. Sovereign wealth funds invested 59 billion dollars in Western financial institutions.
Source: Dealogic; Datastream; press reports; McKinsey Global analysis.

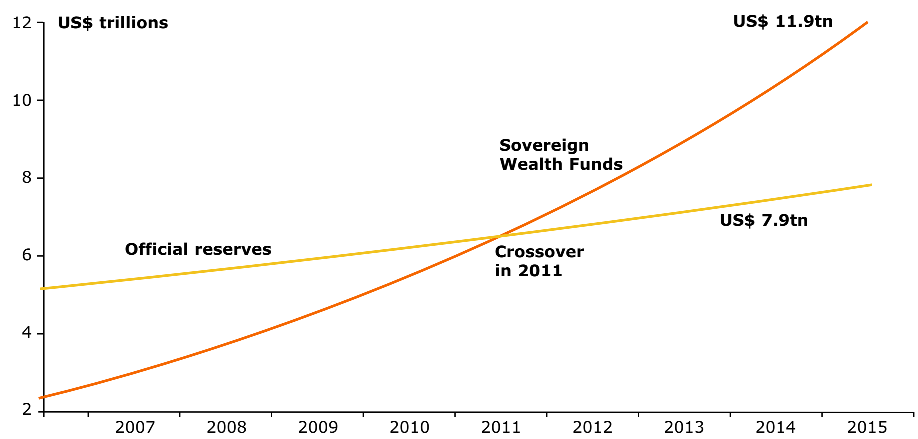


Figure 35. Forecasts for sovereign wealth fund growth.
Source: Rankia Comunidad Financiera.

The appearance and growth of these sovereign funds is a change in the world economy. The financial players in emerging economies are now on equal terms with their counterparts in developed economies. The position of new financial centers such as Singapore, Dubai and Shanghai, which operate independently from the traditional centers, has been strengthened. Estimates suggest that sovereign wealth funds will continue to grow and become the key players in financial development. In the coming decades, 10% of the sovereign wealth funds' portfolios will be located in emerging and developing economies.

The Future Trends Forum experts believe that in the near future, developed countries must prepare to attract and compete for investments by sovereign wealth funds, in order to overcome their current liquidity crisis.

Capital Flows Between Emerging Countries

Figures for foreign direct investments are difficult to obtain, due to problems with the statistical systems in many countries, the flight of capital to evade taxes or regulation, and the offshore location of financial centers that do not report flows of foreign direct investment (FDI) in other countries. An example is Cyprus, which has become an off-shore platform for a large proportion of Russian capital outside the country, and is now the main source of foreign direct investment in Russia.[104]

Despite these difficulties, estimates suggest that since 2003, the growth rate of FDI in developing countries has been higher than that of flows coming from developed countries. According to the United Nations Conference on Trade and Development (UNCTAD), developing countries accounted for 17% of international FDI in 2005. The usual scenario is that emerging country multinationals invest first in neighboring countries due to cultural similarities and existing commercial links. Examples are China and India, which concentrate their investments in other Asian countries.

In China, the trend among sovereign wealth funds seems to be reversing, with interest focused on purchasing shares in Chinese banks on the open market. Meanwhile, the China Development Bank, which is still state owned, is negotiating to take control of the Shenzhen Development Bank, one of the few foreign-controlled financial institutions.[105] Indeed, just at the point when the results of the privatization of state-owned companies became apparent, the recession has led to the rise of precisely the opposite trend. China Eastern Airlines received a capital injection of 7 billion yen (approximately one billion dollars) from the Chinese government, as well as tax deductions on oil.[106] With events like these, is the process of adopting capitalism in China finally coming to a halt?

A study published in late 2008 *(Sovereign development funds: Key financial actors of the shifting wealth of nations,* OECD Development Centre Emerging Markets Network Working Paper, 2008), forecasts a combination of two significant movements in sovereign wealth funds in emerging countries: more invest-

[104] "Las Multinacionales en Países Emergentes" ("Multinationals in Emerging Countries"), Andrea Goldstein and Zenaida Hernández (9/17/2008), a blog about US foreign policy, the emergence of the New International Powers and the shift in the International System.

[105] «So Much for Capitalism», *The Economist* (5/03/2009).

[106] «China Eastern Airlines suffers $2.2 billion loss», *Google News* (16/04/2009).

ments in their domestic bases and more investments in emerging economies. On one hand, the sovereign wealth funds are suffering from domestic pressure to bring liquidity back to their national and regional bases. On the other, the current recession has showed them that there are no catch-all solutions for investments.[107]

Meanwhile, Latin American multinationals are expanding in their own region in order to take up the position left vacant by the withdrawal of other multinationals in sectors such mobile communications, oil and gas. The exceptions are CEMEX and the Brazilian minerals giant CVRD, which completed its takeover of Canada's Inco in October 2006.[108] South African businesses are also investing in neighboring countries such as Mozambique, and emerging countries like Turkey are undertaking FDI, particularly in Central Asia.

The Post-Crisis Capital Market

In conclusion, what is clear is that the capital market has undergone a profound change. The growing range of sources of capital, such as hedge funds, venture capital investments and sovereign wealth funds, have led to a shift in the balance of the global financial system. There are a number of fresh challenges in this new environment. First, addressing the problem of a lack of effective regulation and transparency for new forms of investment. Second, there needs to be increased cooperation in the supervision of large international banking groups. Finally, there must be greater intervention in the brokerage and non-banking institutions market.

According to Joel Kurtzman, President of the Kurtzman Group, former editor of the *Harvard Business Review* and a Future Trends Forum expert, the "new capitalism" that we are starting to build will largely depend on the environment left behind after a severe crisis, which he compares to a great battle by referring to "victims of war:"

- The idea that the domestic market has disappeared, because the global financial system is interrelated and nobody is safe.
- The "portfolio theory" has failed because prudent investors with balanced portfolios suffered as much as those who took more risks.
- The existence of "black swans" in risk management has been confirmed by the crisis. These are events with a major impact that are difficult to predict and which cannot be anticipated by normal expectations.

Apart from the current economic situation, the study published by *The McKinsey Quarterly*, *Long-term trends in the global capital markets*, identifies a series of trends anticipated in the coming years:

- First, it expects the growth of international capital markets to continue as investors invest in equities, debt, deposits and other types of positions all over the world.

[107] http://www.elpais.com/articulo/semana/fondos/soberanos/crisis/elpepueconeg/20090208elpneglse_11/Tes.

[108] "Las Multinacionales en Países Emergentes" ("Multinationals in Emerging Countries"), Andrea Goldstein and Zenaida Hernández (9/17/2008), a blog about US foreign policy, the emergence of the New International Powers and the shift in the International System.

- Likewise, growth rates in emerging markets will continue to increase, and in Asia, China and other emerging countries will replace Japan in terms of financial influence. However, the link between emerging countries and developed countries will persist.
- Meanwhile, the euro area countries will increase their financial influence, and the importance of the euro in the international market will also grow.
- Finally, countries rich in oil will flourish as suppliers of capital and new financial centers will emerge—as mentioned above—in the Middle East, complementing the centers in London and Asia.

All these factors will encourage the transfer of financial power from the United States to other parts of the world.

5.1. Business Strategies for Positioning within International Capital Movements

The multipolar nature of the new world order is most apparent in the capital sphere. The trend toward global integration goes hand in hand with the increasingly intense battle for capital due to the growth of companies from developing economies. Not only is there more money flowing from emerging economies toward their stock markets, but their companies are also choosing to be listed on stock markets in developed economies in order to obtain greater access to capital.[109] In other words, emerging economies are both a destination and a source of foreign direct investment. The implications of this in business terms will depend on the ability of companies to consistently take advantage of where capital is coming from, where it is headed, and its inevitable scarcity.

In his book *The World Is Flat*, Thomas Friedman explains how the offshoring of factories to cut costs has been one of the main forces behind the "leveling" of the international economic playing field. These capital flows lead to direct investments in emerging countries, normally in search of lower costs or cheap labor.

The trend toward offshoring arises from companies' inherent need to find new ways to produce their goods, optimizing costs and exploring new markets that are attractive and sustainable over time. In situations like the present, in which budgets are being cut, this option is winning converts.

Obviously, the recent crisis and the consequent loss of confidence in the capital market are also factors to take into consideration, in terms of both their negative effects and the opportunities that arise for more entrepreneurial spirits. So this raises the question: what are the main trends that are appearing as a consequence of the current economic-financial conditions and how can they be taken advantage of in investment terms?

[109] *The Rise of the Multipolar World,* Accenture (2008).

Did you know?

Global investments are expected to double … to 300 trillion dollars in just a few years. 60% of this growth will come from new global markets, which will account for more than double that of mature and developed markets like the United States and Japan (Economist Intelligence Unit).

Companies in Developed Countries and International Capital Movements

The crisis that has battered the financial markets since 2007 has unbalanced the traditional models of debt and capital financing for companies in developed countries. Consequently, many of those companies are looking at emerging markets as a way of improving their financial situation.

Rule 1: Invest in BRICs

Yields on investments in emerging markets used to be below average. When they entered these markets, venture capital investors used to find economically and/or politically unstable situations, a lack of favorable agreements in the country concerned, and problems related to intellectual property laws and even to security. However, the outlook has changed because the perception of emerging markets among foreign investors has improved, due to structural macroeconomic reforms such as privatization, lower taxes, deregulation in markets and integration in international trade. These factors have led to an increase in the yield on investments in emerging markets, and a spectacular decline in inflation rates.

In short, high rates of economic growth, the opening up of their stock markets and the increasing globalization of investors are making emerging markets a more attractive investment. Furthermore, competition in the Europe and United States makes obtaining higher rates of return more difficult, so businesses from these regions must improve their access to capital and diversify risk. Thirteen BRIC investment funds were traded by seven financial institutions in Spain in 2007. These accounted for total assets of 645 billion euros, according to Spain's national securities commission (CNMV). These institutions take their customers' financial resources and invest them on the major stock exchanges in Brazil, Russia, India and China. This means that the yield for the customer is higher than the average offered by more conservative types of investment. The advantage is that they are accessible to small investors. However, the disadvantage is that despite offering higher yields, they are "high" or "very high" risk, meaning that real yields can vary across a very wide spectrum. This spectrum is influenced by the likelihood of Brazil, Russia, India and China being able to become strong and stable economies.

One way that developed countries invest in BRIC capital is by means of strategic alliances and joint ventures. Obstacles to investment abroad can be overcome, and access to the advantages of new markets and international expansion thus becomes possible. Japan is an example of a country that can no longer depend solely on its domestic market. According to an article published in November 2008, its companies were spending more than a trillion dollars a week on merger and takeover operations.[110] Among their BRIC investments is Nomura Holding's outlay of 2 billion dollars for the Asian and European operations of Lehman Brothers, and the buyout by Daiichi Sankyo of Ranbaxy Laboratories, India's largest generic pharmaceutical company, which was valued at 4.6 billion dollars.

[110] «The one big buyer», *Newsweek* (15/11/2008).

A recent survey by the United Nations Conference on Trade and Development (UNCTAD) showed that East, South and Southeast Asia remained the preferred regions for foreign direct investment (FDI), followed by the European Union, North America and the emerging European markets. It also predicted that FDI in 2009 will remain at acceptable levels, although countries like China are now much more selective in their investments and give priority to internal projects.[111]

Finally, there is the "Bangladesh Paradox," a term coined by the World Bank. Bangladesh was named "the least developed nation" in the world by the United Nations in 2003. However, banks such as Citigroup, Goldman Sachs, J.P. Morgan and Merrill Lynch consider the country to be a "key investment opportunity" because the Dhaka Stock Exchange Index rose by 66% in 2008, making Bangladesh the country with the highest yield after China, and even ahead of India. The sustained 7% growth of its GDP strongly suggests it will soon be an "Asian tiger."[112]

Rule 2: Attract BRIC Capital

The rise of sovereign wealth funds as a means for emerging countries to invest in companies in developed countries has been discussed throughout this report. Sources of capital in emerging markets are a great opportunity for multinationals in developed countries to improve their poor financial situation. In this respect, Accenture[113] feels that "Developed-market multinationals need to recognize the emergence of a new cast of players in global capital markets—not only emerging market multinationals but also private equity, hedge funds and sovereign wealth funds, many of which also originate from emerging markets. Companies are therefore subject to an increasingly competitive market for corporate control, with corporate strategy and shareholder objectives in progressively closer alignment. This also means that developed-market companies face increasing competition for assets, thus potentially bidding up prices for acquisition targets."

An example of governmental action to attract these funds occurred in the United States in December 2008, when steps were taken to facilitate the entry of Chinese financial institutions attempting to invest in the country. The United States aims to encourage foreign investment via bilateral agreements in order to gain access to credit markets that have been "frozen" by the crisis. The sovereign wealth fund China Investment Corp. alone has lost 6 billion dollars since mid-2007 with its purchase of shares in Morgan Stanley and Blackstone Group.[114] The US government therefore wants to encourage investments by Chinese sovereign wealth funds at all costs, and especially commercial investments.

Siemens, the German engineering group, met investors from sovereign wealth funds from the Gulf and Russia in the summer of 2008 in order to enlarge its long-term investor base. By doing so, the company would be entering markets with rapid growth, which would provide it with potential profits. However, the trend

[111] http://www.unctad.org/en/docs/wesp2009_en.pdf.

[112] «Buoyant Bangladesh: An Emerging Investment Destination», *DinarStandard* (3/03/2008).

[113] *El auge de las multinacionales de países emergentes,* Accenture.

[114] «US to speed investment from China banks, state fund», *Qatar Tribune* (12/12/2008).

toward protectionism is once again a threat, as Germany had announced its intention to approve a law allowing investments in German businesses with more than a 25% shareholding by non-members of the EU to be blocked. At the opposite extreme, Barclays in the United Kingdom preferred to accept capital investment from Qatar rather than from the British government, despite the Qatari sovereign wealth fund increasing its shareholding to 15.5%.[115] In March 2009, Daimler AG justified selling its shares to Aabar, an investment fund controlled by the Abu Dhabi government, by citing its need to guarantee funds that enabled it to maintain its current levels of spending on R&D, and to prepare the company for the (long) transition from today's internal combustion engines to new technologies.[116] In early 2009, Abu Dhabi and Kuwait jointly controlled 16% of the German automobile group. Despite this, companies such as Barclays and Daimler are choosing opportunities for growth and capitalization, rather than worrying about a decline in strategic and operational capacity.

Although sovereign wealth funds have existed for decades, their appeal increased considerably with the onset of the credit crisis. International Finance Services London (IFSL) has calculated that the annual average growth in assets managed by sovereign wealth funds in the last three years was 18% (see Figure 36). Although this growth rate probably will be affected by the crisis, the IFSL projections suggest that they will double their total amount to 8 billion dollars in 2015.

[115] «Barclays looks to Gulf for $12 billion capital raise», *The Guardian* (1/11/2008).

[116] «Dinero de Abu Dhabi para consumir menos petróleo», *El Mundo* (24/03/2009).

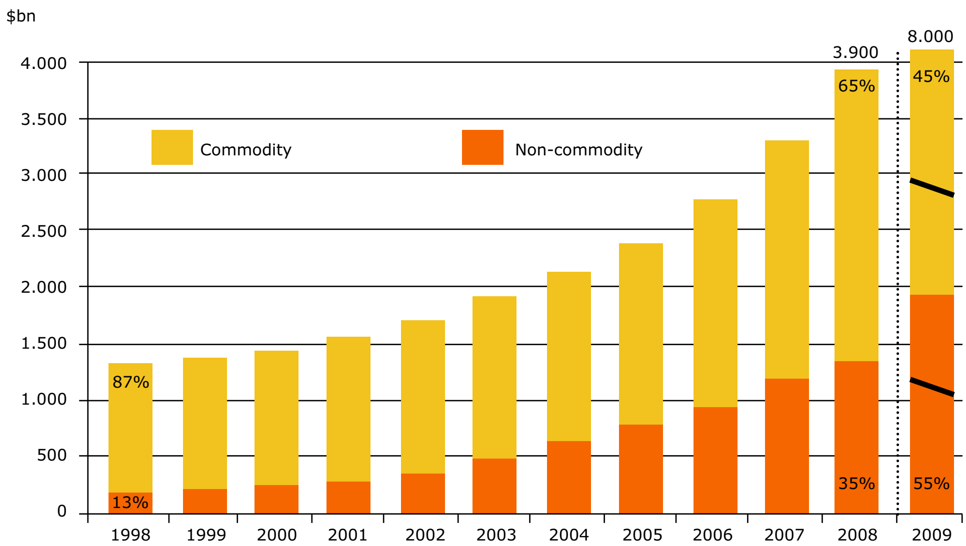


Figure 36. Sovereign wealth fund assets.
Source: IFSL.

Rule 3: Consider the Various Investment Formulas

The emerging market for foreign direct investment (FDI) has business models with assets with low costs and high productivity rates. The competition in emerging markets forces multinationals from developed economies wanting to invest there to adopt more flexible and innovative business models. Despite all the difficulties involved in crossing frontiers, companies are particularly willing to increase their investments abroad. They overcome some of the barriers to doing so by means of strategies such as opening new offices in foreign markets, investing in businesses with a local presence or creating strategic alliances with firms established in the region.

As far as direct investment is concerned, while India is the star of outsourcing, China is the leading player in offshoring. The world's largest communist country also receives the most foreign capital for the production and preparation of products from thousands of companies seeking quality and low manufacturing costs. While outsourcing consists of taking some of a company's work and subcontracting it to someone somewhere else, offshoring "is when a company takes one of its factories that it is operating in Canton, Ohio, and moves the whole factory offshore to Canton, China. There it produces the very same product in the very same way, only with cheaper labor, lower taxes, subsidized energy, and lower health-care costs."[117]

The possibility of using mergers/takeovers and joint ventures as a means of investment has already been discussed. These operations are all over the news, and involve some of the world's leading companies. It has also become apparent that, to an increasing extent, one of the parties involved is a company from an emerging country. For example, General Electric joined forces with Mubadala, a financial arm of the Abu Dhabi government, to invest in a "carbon dioxide-free" city as a pilot experience for the company's *ecomagination* clean-energy program. This agreement shows that even an investment between a private company and the public sector in an emerging country can lead to expectations of investments totaling 40 billion dollars, like those anticipated of the present and future projects by this partnership. This case is related to the so-called greenfield investments, which are a means of foreign direct investment in which a parent company builds up an industry's installations "from scratch," creating employment in the target country. Multinationals in developed countries see this investment as a way to penetrate the market in emerging countries, where governments even offer tax breaks, subsidies and other incentives in exchange for these projects being carried out. Indeed, China has encouraged foreign companies to invest in its economy in this manner, rather than by purchasing existing Chinese companies directly. Some examples of greenfield investment are the construction of tourist resorts and golf courses in Croatia with public and private capital.

[117] http://www.luismaturen.com/2008/10/sexto-aplanador-traslado-de-fbricas.html.

Rule 4: Take Advantage of Adversity

Times of crisis also lead to the appearance of investment products that can lead to profits. In this case, a new one, known as distressed debt, has risen out of the ashes of the crisis. These are debts owed by companies and/or countries that find it difficult to meet payments, and which are probably going to fail in the near future. Why would investors—in most cases venture capital companies—be interested in bonds that seem unlikely to be paid? Like many attractive investments, the greater the risk, the higher the potential yield. The strategy consists in becoming the largest creditor of businesses at risk of bankruptcy, by buying bonds at a very low price. If the company is wound up, its investors take priority for payment over the owners of assets, and recover their investment, or at least make a small profit on it. However, the best result is when the company is restructured and bankruptcy is avoided. The investor companies then write off the target company's debt in exchange for shares. Companies such as Goldman Sachs are already planning to invest their surplus funds—in this case 15 billion dollars—in distressed debt.[118]

Another effect of the crisis experienced by the banking sector in recent months is that the banks appear to be determined to go back to basics in order to survive, rather than maintaining their aspirations toward international expansion. In a survey by the Economist Intelligence Unit,[119] almost two thirds of those surveyed expressed their intention to focus mainly on domestic markets and curtail their product lines. Alpha Bank, the second largest bank in Greece, is promoting its All-In-One campaign, which consolidates customers' entire debt in a single account to help them meet interest payments. Despite the campaign being launched in 2006, the bank feels that the current situation could not be better in terms of offering this product.

Rule 5: Invest in "Green," Commodities and Emerging Consumption

The energy and environment sectors have been identified as those that will attract the most investments in the coming years, due to the international problem of the lack of natural resources. Venture capital companies will also seek out opportunities to overcome the global lack of food and energy in industries such as biotechnology. In many cases, it is a question of developing techniques that genetically alter crops to increase production. In the energy field, the never-ending search goes on for alternative sources that are sufficiently lucrative to make investment in research worthwhile. Government support for RDI projects is a major incentive for businesses—especially in the pharmaceutical and biotechnology sector. Barack Obama aims to allocate part of the national budget to supporting a legal means of approving the generic versions of biotechnological medication. In March this year, the German pharmaceutical company Merck also announced its intention to finance a venture capital fund of 40 million euros specializing in biotechnology in emerging countries over the next five years.[120] This would focus on the therapeutic areas of neurodegenerative, autoimmune and inflammatory diseases, as well as oncology.

[118] «Goldman fund eyes distressed debt market», *Financial Times.com* (16/03/2009).

[119] «Beyond the home market, the future of crossborder banking», Economist Intelligence Unit.

[120] «Merck launches biotech venture capital fund», *International Herlad Tribune* (23/03/2009).

At the same time, international demand for commodities is on the rise, meaning that some investors will want to take advantage of their climbing prices. Despite having to withstand possible initial losses, there are favorable factors, such as strong demand for agricultural material in emerging countries and the weakness of the dollar, which lowers the transaction costs—i.e., transport—on which the prices of these products depend. The demand for gold also reached a record high of 32 billion dollars between July and September 2008.[121] Gold is chosen by investors in times of crisis, or periods of inflation, or when there is concern over the volatility of currencies. However, Jeremy Siegel, professor of Finances at Wharton School, says in his book *Stocks for the Long Run*[122] that gold is not a good long-term investment. "A dollar invested in gold in 1801 would have grown to just $1.95 at the end of 2006, while a dollar put into a basket of stocks reflecting the entire market would have grown to more than 755,000 dollars."

Another type of investment that has become very important entails finding countries with a sharp increase in their middle class, such as China or Brazil, and focusing on the housing sector and retail trade. This investment usually prioritizes long-term operations, and is not attempted without the participation of a local partner. We all know "someone" who invested in construction in Eastern Europe. However, other destinations, such as Brazil, are starting to become popular. With 320 days of sun a year, long stretches of beaches, fiscal stability and massive growth in tourism (as well as having been named the host of the 2014 World Cup), the country has become one of the main targets for investment. Equity International, a specialized private investment company that focuses on businesses related to assets located outside the United States, announced its purchase of approximately 20 million shares of the Brazilian company Construtora Tenda in March 2009, just four months after another investment of 46 million dollars in the Shanghai Yupei Company, a Shanghai-based industrial property company owned by private capital. With this investment, the company began operations in the Chinese logistics and storage sector.

Companies from Emerging Countries Regarding International Capital Movements

As liberalization and technological breakthroughs lead to increased integration in the international capital markets, investors from emerging markets are becoming increasingly important, and account for growing proportions of both foreign direct investment and portfolio investment.[123]

The Future Trends Forum experts were asked the question "Which of the following factors will be most important for companies in emerging economies in the next three years?" They felt that the priority will be the search for capital (see Figure 37). Emerging countries are subject to serious capital pressure, due to the decline in demand for their exports, the slowdown in the rate of investments and the refusal to provide loans across frontiers. Considering that most large banks belong to developed economies, the fragmentation of the capital market has a direct impact on emerging countries, as it is more difficult

[121] World Gold Council.

[122] «Gold May Glitter, but It Doesn't Stack up as a Long-term Investment», *Knowledge@Wharton* (30/04/2009).

[123] *El auge de las multinacionales de países emergentes*, Accenture.

for them to obtain the loans that they have been depending on to boost their growth. All the BRIC countries have suffered from the results of the crisis in Western markets, but this is especially true of Russia, which has also been affected by the fall in its oil and gas income.

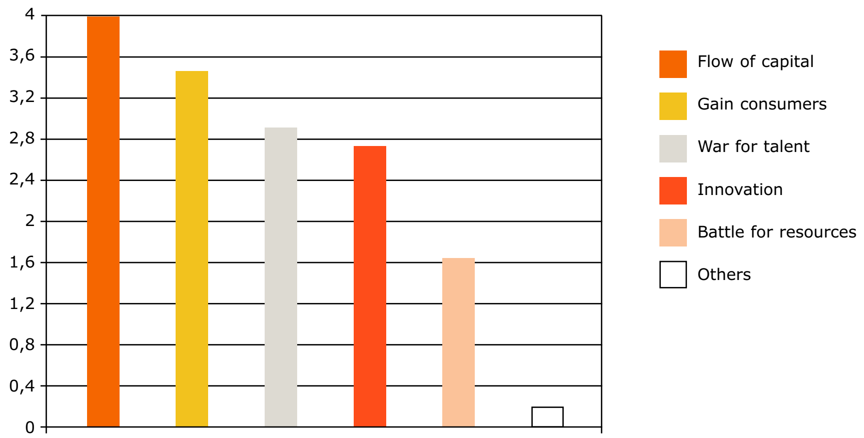


Figure 37. Main factors for companies in emerging economies in the next three years.
Source: Drawn from the conclusons within the Future Trends Forum.

Some of the trends that will govern the strategies of companies in emerging countries in terms of international capital flows are set out below.

Rule 1: Begin to Expand Internationally in other Emerging Countries

Competition from companies in emerging countries is an international fact of life. After a period in which they cornered their domestic markets by buying up the assets left behind by businesses from developed countries, they began their internationalization process after the crisis of the late 1990s. However, the trend among multinationals from emerging economies appears to be focused on expansion by means of E2E investments: "emerging to emerging." The figures show that over 96% of the flows of foreign direct investment from the four BRIC countries go to other emerging economies[124] (see Figure 38). Accenture believes that this is due to a variety of factors, such as the existence of regions that are rich in resources and consumers, the lack of services and cheap labor. E2E investments put these countries on the path toward international expansion, but also enable them to gain experience in more familiar markets and to refine their business models before expanding further.

[124] «El auge de los mercados emergentes», Accenture (2008); data from Economist Intelligence Unit; analysis by Accenture.

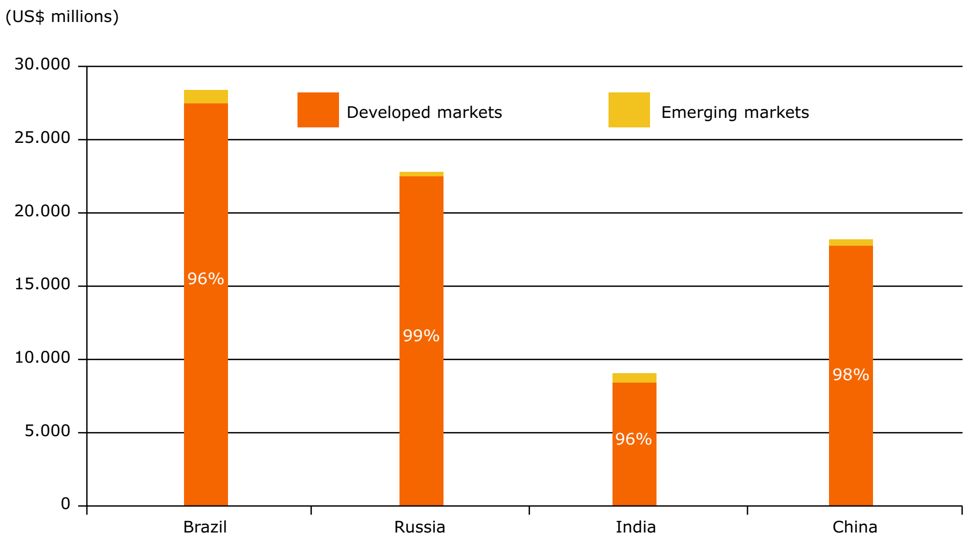


Figure 38. Destination of foreign direct investment from BRIC economies (2006).
Source: Economist Intelligence Unit; analysis by Accenture.

Huawei, a Chinese manufacturer of networking devices, used its experience in Southeast Asia during its subsequent expansion to South Africa, Latin America and Eastern Europe. According to the company itself, "we have established a global network, placing great importance on localization. We try to be as close as possible to our customers. We believe that to really understand customers' needs, we need to be right there with them, working hand in hand in their own location. That way we can always be sure of providing our customers with the finest global technology tailored perfectly to their local needs."[125] After initially expanding in geographical areas that are more familiar due to the limitations on infrastructures and income levels, the company is continuing its growth by penetrating similar regional markets all over the world.

Indeed, the limited infrastructure in emerging countries—or even the lack of infrastructure—is an attractive investment opportunity. The trend toward multi-channel banking in developed countries is a way of cutting costs on physical offices, as well as enabling a larger market to be reached by means of the Internet, automatic cash machines and mobile phones (see Figure 39). Banque Libano-Française (BLF) says that the Internet has given it a competitive advantage in its domestic market of Lebanon and in foreign markets such as Switzerland, France, Syria and Cyprus.

[125] http://www.huawei.com.

Figure 39. Which of the following multichannel banking areas will be your bank's main focus in foreign markets in the next three years?
Source: The Economist Intelligence Unit, 2009.

Another example of an emerging country that chooses other emerging countries for its investments is China's projects in Africa. An article by *The Economist* stated, "according to a recent study by the Institute for Public Policy in London, China has become the third-largest trading partner behind the United States and France."[126] China is present in 48 African countries, most notably in Sudan, followed by Algeria and Zambia. The telecommunications industry in Africa was dominated by British Vodafone, France Telecom, Vodacom and MTN (the latter two are South African). However, Chinese public companies such as Equipments Company Limited (ZTE) and Huawei, the private multinational mentioned above, have established themselves in the arena, and have bid for telecommunications operations in Nigeria, Niger and Zambia. CNOOC also acquired a 45% holding in Offshore Oil-Mining License (OML) in Nigeria in early 2006. The China National Petroleum Corporation is the largest foreign oil producer in Sudan.[127] It is also involved in infrastructure construction projects in numerous African countries in the road and railway transport sectors, and other post-war reconstruction work.

In short, Africa has been a place for China to gain experience, encouraged by trade agreements and the fact that there is a market niche in which Chinese businesses can manufacture products at a price that African consumers can afford. Some examples are refrigerators that are smaller than the standard size, produced by Haier, and Lenovo's laptops for small and medium enterprises.[128] Oddly enough, the African mobile phone operator MTA operates in countries in the Middle East such as Iran, Afghanistan, Syria and Yemen, as well as in Africa. This is another symptom of a multipolar world in which the new players come from all over the planet, and in which they are also interrelated to a greater extent than ever before.

Rule 2: Take on the Global Market

Despite the first step toward international expansion by multinationals from emerging countries usually taking place in other emerging countries, many are deciding to expand globally. A few years ago, nobody would have imagined that CEMEX, a company from Monterrey (Mexico), would become the leading cement

[126] «¿Realismo mágico? China e India en América Latina y África», Javier Santiso http://www.oecd.org/dataoecd/37/55/38447180.pdf

[127] «China Advises Sudan Not to Let Darfur Crisis Worsen», *Bloomberg.com* (18/03/2009).

[128] «China's Emerging Multinationals in Africa», *The Africa Journal*.

producer in United States by taking over several competitors, nor that Thailand's CP group would be the largest foreign investor in China. It would also have been difficult to believe that as well as having a significant presence in north Africa, Iraq and Bangladesh, the Egyptian telecommunications company Orascom would organize Europe's largest leveraged buyout to acquire the operator Wind in Italy. These days it is hard to find an edition of any international financial newspaper that does not contain news of another operation carried out by an emerging multinational. One example of this is the dispute between an Indian and a Brazilian company over the purchase of Corus, the giant iron and steel company formed by the merger of British Steel with a Dutch rival.[129]

Multinationals from emerging countries became a topic of discussion 25 years ago. At that time, a small group of developing economies were starting to become a source of foreign direct investment: Argentina, Brazil, Korea, Hong Kong, India, Singapore and Taiwan. Since the late 1980s, other emerging countries, including Chile, China, Egypt, Malaysia, Mexico, Russia, South Africa, Thailand and Turkey have joined them as significant sources of foreign direct investment.

Most of the flows of these investments from emerging countries are to Asia. Indeed, the largest emerging multinational is Hutchinson Whampoa, a Hong Kong conglomerate that is very active in telecommunications and logistics services, and is 17th in the ranking of the world's largest multinationals published by UNCTAD. The top 100 also includes a Korean company (Samsung Electronics), one from Singapore (SingTel), one from Malaysia (Petronas) and one from China (CITIC).

The expansion of foreign direct investment from emerging countries is also a reflection of the rise in flows of capital toward these countries as the sophistication and size of their businesses increases. Globalization raises the levels of competition faced by businesses in emerging countries, in terms of sales, access to resources and strategic assets. Emerging multinationals therefore have no alternative other than to become international in order to strengthen their competitive advantages. Unlike traditional multinationals, their emerging country counterparts do not usually have resources such as their own technology, established brands, access to financing and management teams with international experience. They generally expand slowly, with frequent changes in direction as lessons are learned through experimentation.[130]

Investment operations by emerging multinationals are leading to complex and highly diverse businesses. For example, the headquarters of Mittal Steel, one of the world's largest steel producers, which recently took over Arcelor in Europe, is in the Netherlands, it is controlled by an Indian citizen who lives in London and its executives are mostly Indian. The South African multinationals, such as SABMiller, which are listed on the Johannesburg and London stock markets, with two leading shareholders that are an American group and a Colombian family, are another complex case. Another example is the acquisition of OECD companies' assets by emerging multinationals in exchange for a significant stake in

[129] http://www.mobbingargentina.com.ar/Files/RRII/Las%20multinacionales%20de%20los%20pa%C3%ADses%20emergentes.pdf.

[130] http://www.mobbingargentina.com.ar/Files/RRII/Las%20multinacionales%20de%20los%20pa%C3%ADses%20emergentes.pdf.

their capital, as occurred with the Chinese company Lenovo's purchase of IBM's personal computer division.

Rule 3: Use Mergers and Takeovers to Overcome Frontiers

News of merger and takeover operations are featured in the media every day. Companies from emerging markets have recently been participating in these agreements to an increasing extent. According to A.T. Kearney,[131] companies in India, Malaysia and China were responsible for 56% of this type of agreement between 2002 and 2007 (see Figure 40). In previous chapters, we discussed the increasing number of sovereign wealth funds that are accumulating international assets on an exponential basis. According to the same publication, these assets were valued at a total of 2.5 billion dollars in 2007, but this figure will have reached 12 billion dollars in 2015.

[131] «The Rise of Emerging Markets in Mergers and Acquisitions», A.T. Kearney (2008).

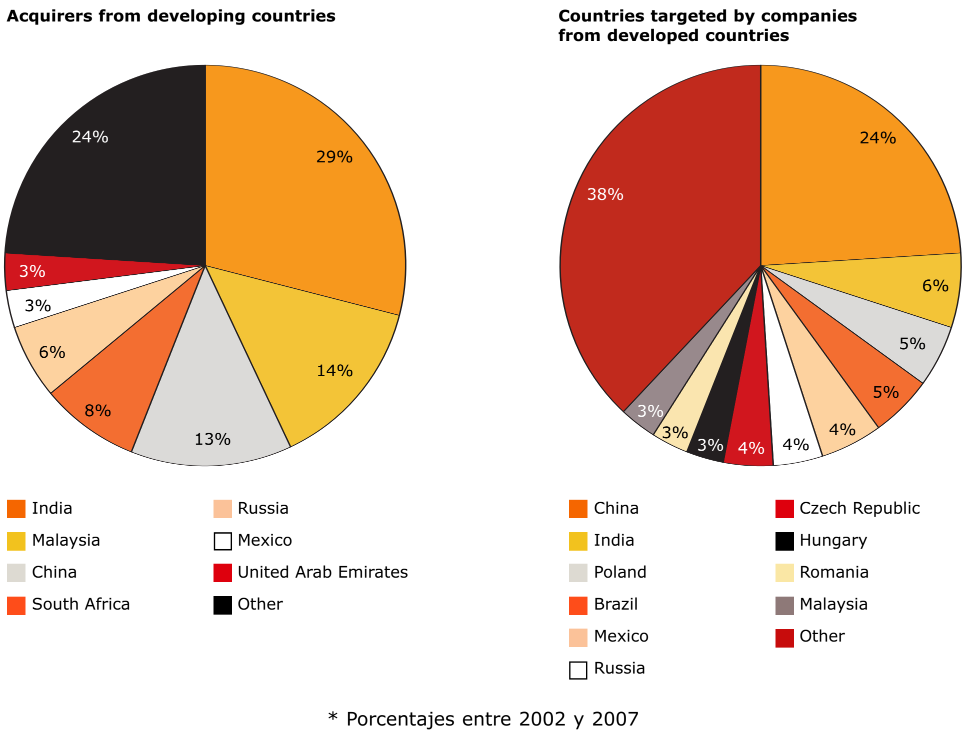


Figure 40. China, India and Malaysia led the way in mergers and takeovers between 2002 and 2007.
Source: "The Rise of Emerging Markets in Mergers and Acquisitions." A.T. Kearney (2008).

Although the objective behind the merger and takeover strategies in developed countries is to cut costs and obtain competitive advantages, companies from emerging economies want to improve their access to production and new technologies. For example, Tata Motors took over the British crown jewels Jaguar and Land Rover in early 2008. It has so far only produced compact and cheap models, but the takeover gives it access to technology, means of production and distribution channels, which are very important in its expansion to Western markets, as well as changing the perception of the brand.

The strategy of carrying out mergers and takeovers enables companies from emerging markets to penetrate markets with more sophisticated consumers, to take advantage of synergies with businesses on the international scene, and to acquire transparent corporate governance habits. As the saying has it, "when in Rome, do as the Romans do." When international expansion strategies are undertaken and interaction with global players begins, it is necessary to operate within a regulatory framework with regional and international laws that affect trade, investment, the environment and even specific sectors such as banking.

India's ICICI bank began its European operations in 2003 by establishing itself in the United Kingdom, largely because of the country's population of 1.3 million Indians, 200,000 of whom are ICICI customers. Its objective of becoming a "community bank for Indians" in all the countries where it operates has been a success, because it chose the right partner when embarking on its path toward internationalization.

Despite mergers and takeovers being a very wise strategy for emerging countries, KPMG published a study in March 2009 which said that the number of companies in emerging economies that merged or took over others in developed economies fell by 28% in the second half of 2008.[132] The recession undoubtedly has a great deal to do with this decline. India remained the leader in takeovers of companies from developed economies.

Finally, the inevitable question is: why are there hardly any joint ventures between companies from emerging economies and developed economies when mergers and takeovers have become the norm? According to an article in *The McKinsey Quarterly,*[133] the answer lies in the difficulty in overcoming the vast differences between them in order to successfully establish an alliance. Among the differences mentioned are size, financial capacity, structure, business objectives, culture and the different management teams. The alliance must have a common objective and strategy, and the company from the emerging country will not be able to tackle them in the same way as the developed country company, for obvious reasons. The article gives an example of a leading multinational company in the perishable consumer goods sector and an Indian company. They formed an alliance that tripled their market share in four years, and became the third-largest competitor in the sector. However, the multinational wanted to add more capacity and make the Indian company the regional supplier for Asia and Africa. The Indian company would have had to make an investment estimated at

[132] «M&A Deals In Emerging-Markets Hit Multi-Year Lows», KPMG (2/03/2009).

[133] «Emerging Market Alliances: Must They Be Win-Lose», *The McKinsey Quarterly.*

17 million dollars, or a quarter of its annual turnover. In the end, when the Indian company refused to invest, the multinational took it over.

Rule 4: Adapt Financial Practices to Local Conditions

In their analysis of financial practices in emerging countries, the Future Trends Forum experts came to the conclusion that they do not currently meet the needs of the population. The main characteristics of these countries that should be taken into account when designing financial products for them are: their large populations (a large proportion of which lives just above the poverty line), the informal nature of their labor market and their banking mediation channels, and their lack of infrastructure in terms of networks, communications and public services. Another very important aspect is the high level of self-employment, due to individuals' need to improve their financial situation. These microenterprises are their only means of improving their living standards, but they lack financing in most cases. They normally depend on informal groups of moneylenders, kinship networks and family members to meet over half their financing needs (see Figure 41). Experts believe that this problem could aggravate the income divide between rich and poor countries, as well as social problems.

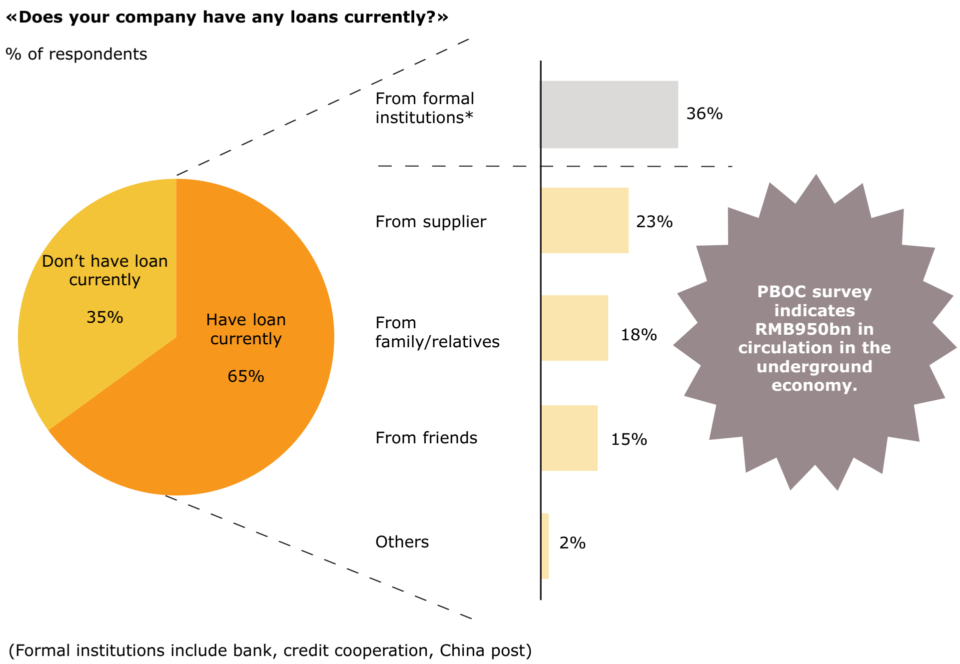


Figure 41. Financing sources for companies in China.
Source: 2004 Survey by the People's Bank of China on informal financing, Team Analysis, August 2007.

The good news for local financial companies is that this area has yet to be examined in depth by global companies (see Figure 42). Furthermore, despite the expansion by these local and global companies, access to financial services in emerging markets is still low level and uneven, meaning that there is a clear business opportunity in this area.

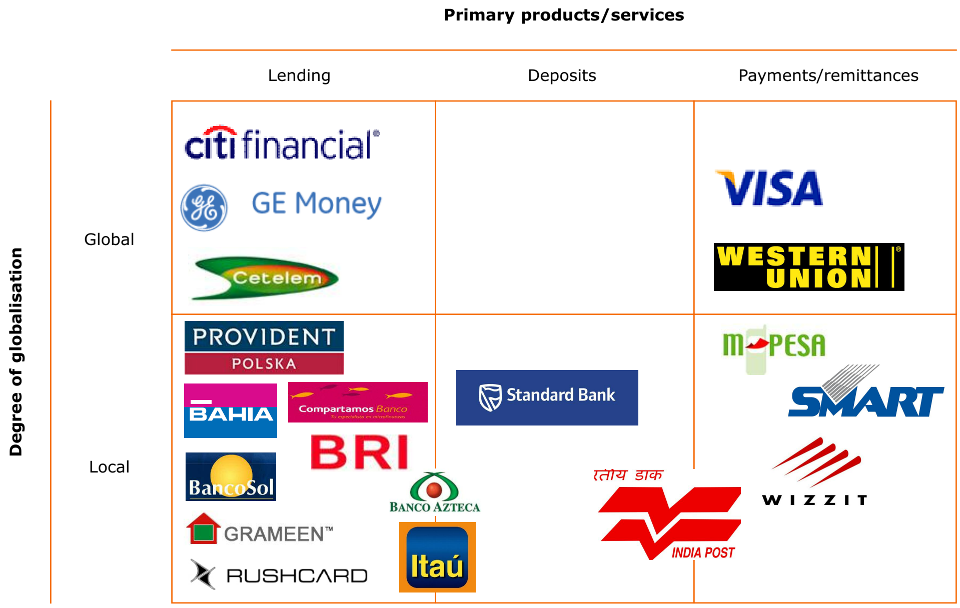


Figure 42. The competitive landscape in China's financial-services sector.
Source: Fullerton Financial Holdings.

For the experts, if companies that want to serve consumers (businesses or individuals) in emerging countries are to be successful, they must innovate in terms of their business models in order to adapt to these conditions. Bearing this in mind, the financial-services company Singapore Fullerton bases its business model on in-depth knowledge of the customer, extensive investment in research and commercial relations at the most basic levels.

This has led to a network of offices that is fully integrated into local life. In Indonesia, for example, they have extended their sales network to the *Pasar*, or local market. They also recruit sales staff from the communities in which they o-perate, taking advantage of their knowledge of local customs, dialects and cus-tomers. At the same time, a commitment to the communities they serve is part of the company's mission, and one of the reasons for its success.

In this type of market, optimization of costs is vital because the operating margins are very narrow. Some measures for achieving this include designing variable payment schemes for employees, optimizing the size of the sales network and exploiting new technologies.

There are many opportunities in this market. According to Bain & Co.,[134] the Vietnamese government liberalized the financial services sector in 2006 as a result of the World Trade Organization's regulations concerning global competition. This was a great opportunity to enter a market of 85 million people in which only 6% have a current account and only 2% have asked a bank for a loan.

There are precedents, such as the Indian bank ICICI mentioned above, the country's second largest, which uses a combination of technology and local partners to reach customers in rural India. The bank has provided low-cost premises to rural sales staff for them to offer loans, insurance and investment products to the inhabitants of the region. Among these are farmers who need loans to cover the period between the last crop sale and buying seeds for the next season. The bank charges an annual interest rate of 9%-11%, compared to the monthly rate of 2% charged by local moneylenders, who also charge an additional commission on sales.

Rule 5: Consider the Possibility of Obtaining Liquidity from Venture Capital

In the vast desert of liquidity surrounding the market, venture capital has become one of the few oases where cash is still available. The crisis is forcing entrepreneurs to be more willing to accept venture capital funds when financing their projects. This means that good operations that did not take place in the past due to the entrepreneur's indecision are now more common.[135]

Another factor is the difficulty in completing the transaction due to the venture capital funds' unwillingness to invest when they see a target company that previously presented a good track record, with sales and performance which were attractive in 2006 and 2007, but with results that decline significantly during the investment process and after analysis of the most recent financial statements for 2008. This makes future plans more difficult and less credible.[136]

In any event, increasing numbers of investors are starting to feel that investing during this downward cycle could be a good move if the investment is made with a view to recovering it in five years' time, when the situation has improved. This is despite the uncertainty involved in the "lean years" of 2009 and early 2010.

For example, notwithstanding the crisis, the business conglomerate Anil Ambani will invest a billion dollars in a venture capital fund in India. Its aim is to invest between 75 and 100 million dollars in Indian logistics, communications and cosmetics companies which are expanding internationally.

A recent study by KPMG[137] showed that venture capital investors in China are willing to enter the consumer products and services, retail sales and production sectors (see Figure 43). Thirty-five percent of the investors surveyed said that

[134] «Lessons from India for banks in Vietnam», *Bain&Co. Newsletter* (09/10/07).

[135] «Lessons from India for banks in Vietnam», *Bain&Co. Newsletter* (09/10/07).

[136] http://www.onetoone.es/index.php/blog-de-ramon-requeni/195-consecuencias-del-entorno-de-crisis-para-el-capital-riesgo.

[137] http://www.kpmg.com/SiteCollectionDocuments/Private-equity-China-market-sentiment.pdf.

the consumer sector will be the most attractive in the future. The Chinese companies operating in these sectors will be able to assess the possibility of obtaining financing by means of this type of operation.

In any event, the plentiful liquidity available from venture capital has a darker side: the customers that provided it could decide to recoup their money before it is invested.

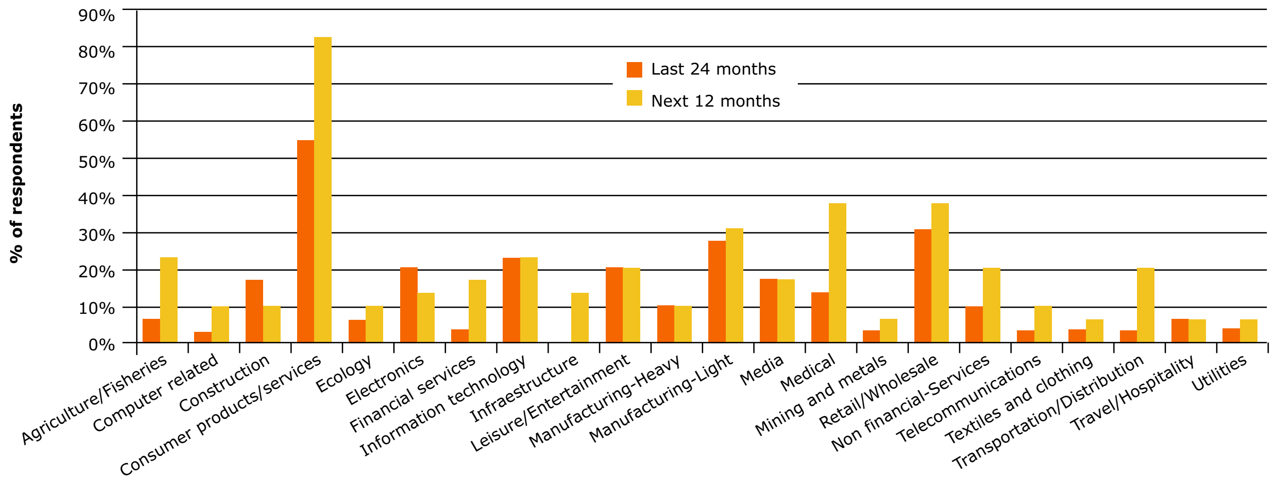
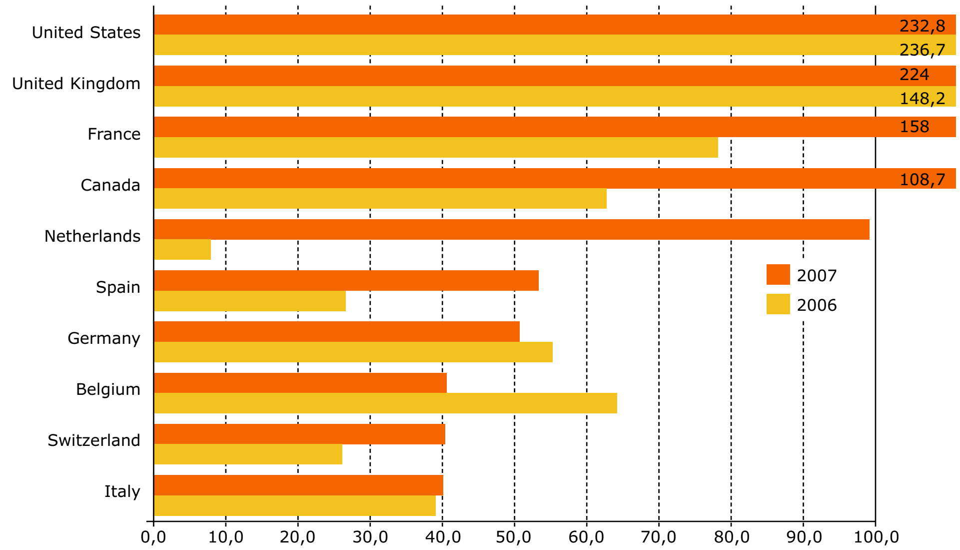


Figure 43. Which industries have you invested in over the last two years, and which do you anticipate investing in over the next dozen years?
Source: *Private equity in China,* KPMG.

5.2. The Situation of the Spanish Economy and International Capital Movements

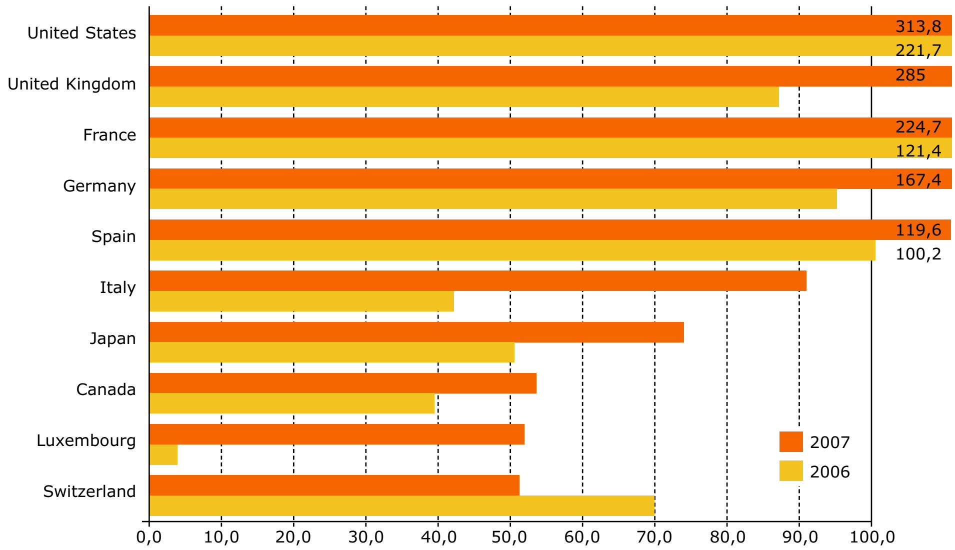
Capital flows are increasingly multidirectional, due to the new multipolar world order. Emerging countries are becoming increasingly attractive destinations for investment. These countries are in turn increasing their capital in the rest of the world. Changes in the source and destination of capital are therefore further evidence of a change in the international order.

In this context, in the mid-1990s Spain ceased to be a country that was a net recipient of investments, and become a source. It is now consolidated as the fifth-largest direct international investor in overall terms, behind the United States, the United Kingdom, France and Germany, ahead of technological and business powerhouses such as Japan, Sweden and Italy. Spanish companies continued to expand internationally in 2007, with 4% of the world's foreign direct investment, while the Spanish economy accounts for barely 2% of international GDP. However, its activity as an issuer country has remained at satisfactory levels. The flow of foreign direct investment increased by 7.3% in 2008, according to initial estimates by the United Nations Conference on Trade and Development (UNCTAD). Spain received 57 billion dollars in 2008, compared to 53.4 billion dollars in the previous year, making it the world's sixth-largest recipient of FDI and the third largest in the European Union (see Figures 44 and 45).



Note: Classified according to the extent of the incomings of FDI in 2007.

Figure 44. Developed countries: 10 leading FDI recipients, 2006-2007 (figures in billions of dollars).
Source: *World Investment Report 2008: Transnational Corporations and the Infrastructure Challenge, UNCTAD.*



Note: Classified according to the extent of the incomings of FDI in 2007.

Figure 45. Developed countries: ten leading FDI sources, 2006-2007 (figures in billions of dollars).
Source: *World Investment Report 2008: Transnational Corporations and the Infrastructure Challenge,* UNCTAD.

Credit difficulties and the economic downturn will undoubtedly have a negative short-term effect on the figures for Spanish direct investment. Spanish companies have become more indebted than those in other countries in recent years and the lack of credit will affect their investment plans to a greater extent as a result. It will therefore be crucial for not only the large multinationals, but also medium-sized businesses to have the necessary financial resources to operate internationally and carry out their investment plans. It should be borne in mind that these investments increase exports and therefore employment.

Spanish investments have so far been mainly in the Euro area. Latin America has been another key destination since the 1990s. However, rapidly growing markets, especially in East Asia, have played a minor role in their exportation targets. Spain's limited presence in terms of trade and investment in Asia is striking not only because of the continent's increasing importance in the world economy, but also because of the current level of internationalization in the Spanish economy, for which a more global profile would be anticipated. In 2007, Asia only received 1.5% of Spanish investment abroad. China is a particularly noteworthy example, as it has become Spain's trading partner par excellence in this economic area. The central role assumed by China in Spain's trade with Asia has increased in tandem with the Spanish trade deficit with the Asian giant. The Spanish trade balance with other Asian countries like India and Japan has also deteriorated.[138]

[138] *España y la nueva arquitectura económica y financiera internacional. El desafío del G-8*, Fundación de Estudios Financieros.

According to a study by KPMG,[139] the trend seems to suggest that Brazil and China will be the main focuses for investment by Spanish companies in the next 12 months (see Figure 46). Spanish investors are planning to make direct investments in Brazil, while in China companies are more inclined to invest in joint ventures. In the United States, Spanish investors do not participate in joint ventures and prefer direct investment or takeovers of established companies.

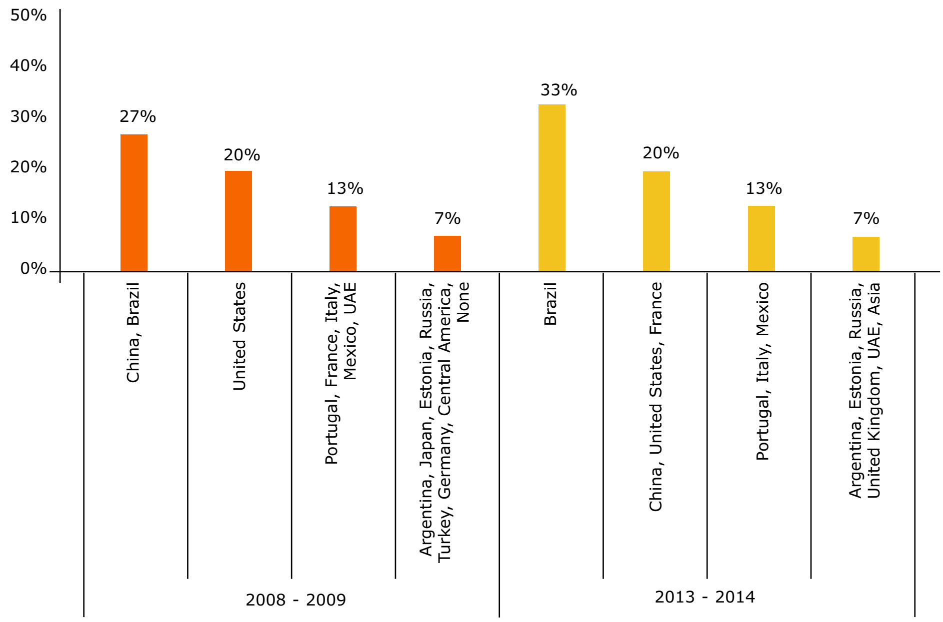


Figure 46. Spanish corporate investment plans.
Source: *Global Corporate Capital Flows, 2008/9 a 2013/14,* KPMG International.

If Spain wants to take advantage of the opportunities in the new multipolar order, it seems reasonable to suggest that it should increase its volume of exports to Asia, while simultaneously increasing Asia's share of total exports. According to the conclusions of a study by the Fundación de Estudios Financieros, "achieving this objective only appears to be possible if direct investments in the area by Spanish companies are encouraged. This in turn appears to be difficult, due to the minimal level of investment in Asia in Spanish investment policy abroad. The fact is that Spanish companies find Asia very difficult, which explains the weakness of their investment in the region." The role of Spanish companies in these countries will be analyzed below.

The internationalization of the Spanish economy toward unexplored areas is therefore an opportunity. Cuba is an attractive target for investment. Spain has

[139] *Global Corporate Capital Flows, 2008/9 to 2013/14,* KPMG International (june 2008).

some trading experience in Cuba, which may be a competitive advantage in the event of entry becoming possible in the near future.

Meanwhile, foreign investment in Spain has been a driving force behind the country's growth for decades. Foreign investment in Spain in 2008 totaled 37.55 billion euros, 0.4% more than the previous year. The financial crisis has led to some stagnation, but the larger fall in investments in the world as a whole meant that the Spanish share increased to around 4.5%.[140] However, at a time like the present, when internal demand is weak, it is vital to attract foreign capital oriented toward exportation, which is what generates employment in the country. However, for this to happen, the appeal of investing in Spain must be increased by increasing the Spanish economy's productivity. If this does not happen, the flows will continue to head toward more competitive economies, such as the United States or the emerging countries.

On this subject, the economists and Future Trends Forum experts F. Guillén and Emilio Ontiveros said in the newspaper *El País*: "What is most important, however, is not the total amount of investments but rather the proportion of them that will be focused on creating new jobs rather than taking control of the most attractive Spanish infrastructures and services companies."[141]

Nevertheless, sovereign wealth funds from emerging countries are playing an important role in injecting liquidity into developed countries during this crisis. Late last year, Spain offered public debt to sovereign wealth funds in the Arab countries to give the financial system more liquidity. In an interview with Reuters, Miguel Sebastián, the Minister for Industry, Tourism and Trade, declared: "Spain is a very attractive country for investment, and that is why we are offering these sovereign wealth funds the opportunity to buy Spanish bonds, not only in Spanish companies but also in Spanish public debt."

This type of measure has been praised by those who see protectionism as the greatest threat to overcoming the crisis. The OECD General Secretary Ángel Gurría recently highlighted what he saw as the correct response by the Spanish Government, one that was far removed from the protectionist urges in other countries that have been revived by the economic crisis, such as the Buy American clause in the United States, and he encouraged his audience to resist them as much as possible.[142]

As mentioned above, in the near future countries will have to compete internationally to attract capital from emerging countries that have high levels of savings. In this respect, the lowering of Spain's credit rating from AAA to AA+ by Standard & Poor's will not only make State financing more expensive, but will also restrict the number of potential investors in Spanish public debt. Many sovereign wealth funds, central banks, pension plans, insurance companies and investment funds have strict internal regulations that oblige them to invest a specific percentage of their assets in bonds with the highest rating (AAA). Furthermore, in some cases, this restriction is complete, and institutional in-

[140] «La inversión extranjera en España se estancó el pasado año», *CincoDías.com,* (24/03/2009).

[141] «Globalización en crisis», *El País,* (28/09/08).

[142] http://www.noticias.com/noticia/espana-logra-situarse-septimo-puesto-ranking-competitividad-ocde-di9.html.

vestors are prohibited from investing in assets without a AAA rating. For this reason, the lowering of Spain's rating will not only prevent them from buying Spanish debt, but will also force them to sell the debt they already have.

These investments by emerging countries in developed countries are viewed with misgivings in the rest of Europe. French President Nicolas Sarkozy recently proposed that the European Union countries create their own sovereign wealth funds and coordinate them in order to invest in EU companies, in order to prevent them from being taken over by foreign capital, at a time when their stock market prices were at record lows due to the financial crisis.

However, in this race to attract foreign capital, most of the large economies in the European Union have decided to make formalities easier for multinationals deciding to establish themselves in the country. With that objective in mind, several countries have applied the directive that waives the requirement for dual accounting in cases where in the group's parent company resident in another country has already prepared them elsewhere. As a result, there has been some concern at the Spanish government's decision to oblige multinationals to produce and audit consolidated financial statements for their Spanish-based holding companies, despite these also being produced and audited for the group's parent company in its country of origin.

At the same time, the current trend for sovereign wealth funds to invest in their own countries or in other emerging countries could also favor businesses from the OECD area with a strong presence and operations in emerging markets. With this in mind, Spanish companies have some advantages, as many of them—such as banks (BBVA, Santander), telecommunications operators (Telefónica) or the energy sector (Iberdrola, Gas Natural, Endesa, etc.)—have strong commitments in emerging markets, mainly in Latin America. As well as being able to become potential investments for sovereign wealth funds from the Gulf, these companies could also take advantage of their presence and unique knowledge of the region to promote or encourage interest in Latin America. Forums such as Latibex could also become a showcase for attracting these potential investors, from both the Middle East and Asia. Similarly, companies from the Gulf could also be partners in joint investments in the Middle East and North Africa, as suggested by the agreement signed in 2008 between Iberdrola and the Abu Dhabi National Energy Co. (Taqa).[143]

The Future Trends Forum experts concluded that the best opportunities for investment in Spain in the next three years will be in the fields of renewable energies and tourism (see Figure 47).

[143] http://www.elpais.com/articulo/semana/fondos/soberanos/crisis/elpepueconeg/20090208elpneglse_11/Tes.

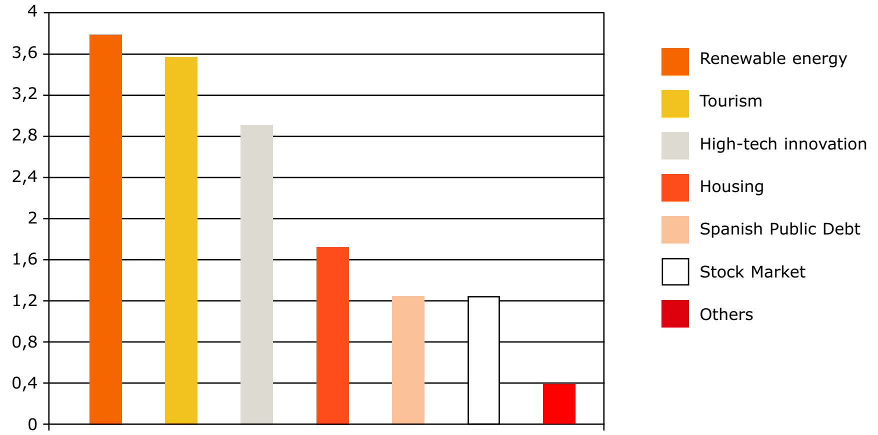


Figure 47. The most attractive investment opportunities in Spain in the next three years.
Source: Drawn from the conclusons within the Future Trends Forum.

In conclusion, Spain is facing the same difficulties as other nearby countries. It is an economy that is fully integrated and open to the world, with a dynamic business sector. However, Spanish companies are much more heavily leveraged than their competitors, and their capacity for attracting foreign investments is undermined by slow growth in productivity and by the inflation differential. In this situation, sustainable growth will be possible if the investment flows in both directions increase.[144] For this to happen, the structural problems that weaken the Spanish economy's competitiveness and dynamism must be solved.

5.3. International Capital Movements and Strategies for Spanish Companies

In recent years, Spain has become the world's seventh-largest international investor, after the United States, the United Kingdom, France, Germany, China and the Netherlands.[145] From a geographical standpoint, Spain started as an investor focusing on emerging countries in Latin America and increasingly concentrated on rechanneling its companies' investments toward countries with higher levels of economic and technological development. The internationalization of Spanish companies has entailed a strategic shift to a more long-term approach, with foreign direct investments and subsidiaries established abroad, instead of mere export sales. In general, this leads to higher levels of debt among Spanish companies. In the current economic and financial situation, this debt is an added risk for companies. Despite these difficulties, some of the investment trends followed by Spanish companies abroad are listed below, together with an analysis of Spain as a recipient of investments from foreign companies.

[144] «Globalización en crisis», *El País,* (28/09/08).

[145] «La Expansión de la Multinacional Española: Estrategias y Cambios Organizativos», Observatorio de la Empresa Multinacional Española (OEME).

Rule 1: Use Internationalization to Soften the Impact of the Crisis[146]

The internationalization process among Spanish companies is a topic of debate now that it is time to analyze the effects of the world recession, consider the next steps that should be taken to overcome instability, and meet the challenges of the future, while taking advantage of the opportunities that have been created. As the Future Trends Forum experts pointed out, "recessions are not just about problems, they also create opportunities." As such, many companies will have to restructure their debt and even sell off some assets. Meanwhile, as in all recessions, the price of assets falls, which may make them attractive to those wanting to seize the moment to make investments. This is added to the fact that "if the Spanish economy enters a phase of much lower growth than in recent years, having an international profile due to exports or foreign investment is a cushion, and a way of diversifying geographically."

The infrastructures sector in China is first on the list of investment targets for Spain mentioned by María Jesús Valdemoros, Director of the Economics department of the Entrepreneurs' Circle, and Mauro F. Guillén, Director of the Lauder Institute at the Wharton School and a Future Trends Forum expert. The 4-trillion-yuan stimulus plan (464 billion euros) presented to the National Assembly in early 2009 is an opportunity, because according to the experts, Chinese businesses have neither the experience nor the knowledge necessary to undertake the projects which the Government wants to use to stimulate the economy. Second, despite the effects of the recession, everything suggests that India and Brazil will continue to grow and are therefore attractive countries for investment. Of course, there is also the United States, where asset prices are very low and the euro is still holding strong against the dollar, despite a slight fall. In short, Spain must take up positions in markets where there are expectations for high growth.

The trend in Spain has been to carry out operations abroad and new frontiers have recently been opening up with lower levels of activity in comparison to other countries. The Eat Out Group, a subsidiary of the Catalan company Agrolimen, works in the hostelry business with ten restaurant brands, including Pans & Company, Bocatta and Dehesa Santa María. In 2007, it opened four Pans & Company outlets in Saudi Arabia and will have at least 80 within 10 years.[147] Efforts have been made to adapt the menu to local tastes with softer bread, the addition of local sauces and spices and the replacement of pork for beef, and all the meat is halal, due to the requirements of the Muslim diet. According to the manager, Ignasi Ferrer, new technologies have been an essential tool in this expansion. "Before we started opening in other countries, we computerized our entire business. It is important that all information can be accessed from anywhere."

The Netherlands have been another target for Spanish geographic and sectoral diversification, accounting for 28.6% of the total. This was basically due to the acquisition of the Dutch bank ABN-AMRO. The next country on the list is the

[146] Interview in *Knowledge@Wharton* with María Jesús Valdemoros, Director of the department of economics at the Círculo Empresarios, and Mauro F. Guillén, Director of the Lauder Institute at the Wharton School (11/26/2008).

[147] «Bocadillos en el país del petróleo», *ElPaís.com,* (15/07/2007).

United Kingdom, with 23.9%. The OECD countries as a whole accounted for 95.2% of gross Spanish investment, and the 27-country European Union accounted for 75.5%.[148] Iberglobal's Spanish Foreign Investment Valuation Index contains assesses the investment conditions in 23 countries or regions of particular importance for Spanish companies. According to the study, the most highly rated region in the world by Spanish companies is the European Union, followed by Canada and United States, although China and India also appear in eight and ninth place respectively. The Indian model is attractive due to legal factors and the strength of its institutions, while the Chinese model's appeal lies in its political stability and economic strength.

International operations by Spanish companies have become more significant since the start of the recession. For example, around 90% of the revenues of Acerinox—which has plants in the United States and South Africa—in first six months of 2008 were generated abroad. For Cintra, this figure is over 70%, while for Abengoa, Telefónica, Ferrovial and Santander it exceeds 60%, and for Repsol YPF and Iberdrola, it is over 50% (see Figure 48). Sales in Inditex's international outlets accounted for 65.2% of its total. The group's eight retail formats opened 249 stores all over the world between February 1 and July 31, and began trading in two new markets: Ukraine and South Korea. The proportion of total sales in shops in Asia and Eastern Europe has increased from 11% to 17% in the last two years.[149]

[148] Interview in *Knowledge@Wharton* with María Jesús Valdemoros, director of the department of economics at the Círculo Empresarios, and Mauro F. Guillén, director of the Lauder Institute at the Wharton School (11/26/2008).

[149] «Las multinacionales españolas cosechan los beneficios de sus estrategias», William Chislett, *ARI,* number 114/2008, Real Instituto Elcano.

Company	Sector	% of total
Acerinox	Steel	89.2
Grifols	Medical equipment and pharmaceutical products	71.8
Cintra	Management of toll highways and parking facilities	70.9
Inditex	Textile manufacturer and retailer	65.2
Abengoa	Biofuel, information technology and engineering	64.4
Técnicas Reunidas	Engineering	64.1
Telefónica	Telecommunications	63.3
Ferrovial	Infrastructure Operator, construction	63.2
Santander	Financial group	61.3
Iberia	Airline	59.6
Repsol YPF	Oil and natural gas	54.7
Gamesa	Wind turbines	52.5
Iberdrola Renovables	Renewable energy	52.2
Iberdola	Electricity	50.8
Abertis	Infrastructure management	49.4
Ibex 35	Main index of the Spanish Stock Exchange	48.9
Unión Fenosa	Electricity	48.4
BBVA	Financial group	47.9
OHL	Construction	46.5
Endesa	Electricity	44.7
FCC	Construction	39.5
Mapfre	Insurance	36.2
Gas Natural	Natural gas	35.2
Acciona	Energy, infrastructure, water	33.4
Indra	Information technology and defense systems	33.0
ACS	Construction	26.4
Sacyr Vallehermoso	Construction, concessions	18.5

Figure 48. Spanish companies and banks: percentage of total sales abroad (first six months of 2008).
Source: figures sent by the companies to the Spanish National Securities Market Commission.

Although there are numerous Spanish small and medium enterprises—many of which are not listed on the Stock Exchange—doing business abroad, most international business is done by about a dozen companies, all of which are listed on the IBEX 35 stock market index. The inherent risk here is that it makes the entire Spanish stock exchange vulnerable to recessions in the areas of the world where these companies do a significant part of their business, such as Latin America. This was particularly true a few years ago, although in the end there was no cause for alarm. Since then, there has been a diversification away from Latin America toward Europe and Asia, making important players, such as Santander, Telefónica and Repsol, less dependent on one particular region.[150]

What has encouraged Spanish companies to expand abroad and toward foreign direct investment, which let us remind ourselves, increased by 7.3% in 2008? The main reasons are given in the report *The Expansion of Spanish Multinationals: Organizational Strategies and Changes* by the Spanish Multinational Company Observatory (OEME).[151] First, companies in the textile, footwear and leather, and plastic sectors find the reduction in costs arising from moving their production plants abroad attractive. They can thereby sell under better conditions in the Spanish market. Second, alliances through joint ventures or by directly taking over foreign companies in advanced sectors enables technology and know-how to be acquired. Third, the search for economies of scale in larger markets leads to increased profits and a better position for competing in the global economy, especially among financial companies. Finally, the report describes how many companies in the public services sector—such as gas, electricity and water distributors—decided to seize the opportunity to purchase public companies that were privatized in the 1990s.

However, although the offshoring phenomenon is one of the opportunities available to Spanish companies to cut costs, it has many detractors, especially during a recession, as the decline in employment is directly attributed to it. However, its advocates believe that this is not true. They believe that transferring production to other countries can also have positive consequences due to the increase in employment and its impact on the level of development in the destination countries and in the countries of origin, such as Spain in this case. Among the arguments in favor of offshoring is the fall in the prices of industrial products internationally, as businesses save on many labor costs. Examples are the clothing, footwear and electronic sectors, in which prices have stabilized (or even fallen) in the last 20 years. Furthermore, savings on these articles leaves more money for consumption and enables jobs to be created in other activities (especially trade and tourism) which replace those lost in industry. For this reason, its advocates say, offshoring does not destroy jobs in developed countries, but instead replaces industrial employment with other jobs in the services sector. An example is Spain, where unemployment had not increased in the previous 10 years—in fact, quite the opposite. It also improves the living standards of the majority of the population in developed countries, which does not work in industry, and benefits from the fall in prices.[152] Furthermore, offshoring does not in theory completely destroy any industrial sector, as the offshore factories specialize in

[150] «Las multinacionales españolas cosechan los beneficios de sus estrategias», William Chislett, *ARI,* number 114/2008, Real Instituto Elcano.

[151] Published in cooperation with Banesto, PricewaterhouseCoopers, ESADE Business School and ICEX.

[152] http://es.wikipedia.org/wiki/Deslocalizaci%C3%B3n.

cheap low quality products, leaving European, Japanese and North American producers to manufacture expensive higher quality articles, which remain on the market and continue to be consumed by whoever wants them.

An example of offshoring in Spain—in Galicia to be specific—is described by several Galician economists in a book published by the Xunta, Galicia's regional government.[153] The first part of this study of the impact of globalization on the Galician economy emphasizes that "rather than a calamity, offshoring of investment by Galician entrepreneurs would be evidence of dynamism." The study found three types of offshoring in Galicia. A good example of the first type, sector offshoring, is in the shipping sector, with the decline of the Astano shipyard and the migration of work toward Japan, Korea and China. The second type is offshoring to increase demand, such as the opening of car part factories in northern Portugal, for example. This process is based on cheaper industrial installations (due to lower costs of land, licenses and taxes) and lower personnel costs. The offshoring of Citroën's subsidiary businesses has led to the opening of ten large Galician-owned production factories in Portugal. Finally, the prototype for offshoring due to segmentation of the production process in Galicia is the closure of textile workshops and fish processing lines (tuna) for preserves. In the textile sector, the preparation workshops have been replaced by factories in the Third World; in the preserves industry, the Galician plants have seen losses in production and employment, which has been transferred to new factories in Morocco and Central America.

Rule 2: Exploit the Triad of Infrastructures, Construction and Renewable Energies

The triad of the infrastructures, construction and renewable energies sectors is Spain's great hope for the future, because there is still room for these industries in emerging countries, and Spanish companies are in a good international position in these sectors.

In the construction sector, for example, Spain has extensive knowledge and the domestic standstill in the sector calls for a new strategy for overcoming the slump. Many experts have suggested taking the lead in expanding construction to targets in emerging countries. According to José Antonio Pérez, Real Estate Chair at the Instituto de Práctica Empresarial, it is necessary to analyze the needs for first homes of the social classes that are starting to have a constant income, especially in large cities. As regards second homes, it is necessary to invest in places with legal, economic, political and tourism safeguards that enable competition on an "all-inclusive" basis, with better quality/price relationships, based on journey times and climate. As regards real estate allocated to the tertiary sector, it is advisable to look for cities with an emerging middle class with purchasing power.[154]

The potential for development in this sector to a large extent depends on the governmental measures that are approved to stimulate it. The Brazilian govern-

[153] http://www.elpais.com/articulo/Galicia/Deslocalizar/calamidad/dinamismo/elpepiautgal/20080526elpgal_4/Tes.

[154] «Los países emergentes entran en la escena inmobiliaria», *ElMundo.es* (24/10/2009).

Did you know?

Moscow is the world's second most expensive market for offices.[155]

ment of Lula da Silva has made considerable investments in infrastructures and tourist development, and several Spanish companies have already taken up positions in Brazil, especially in the northeast. In Mexico, the government's state plan includes the construction of a million homes with sustainable criteria by 2012. The Indian government has announced the need to build 20 million homes in a short time, and its aim is for 30% of the financing to come from the private sector, by encouraging tax breaks. In other countries, such as Russia, the boost to the market is the result of the need to build higher quality homes, as the buildings there mostly date from the Communist era, and offices to meet the expansion requirements of the tertiary sector. In the Middle East, Spain can use its experience in holiday and timeshare complexes. In Africa, Spanish investors have focused on Morocco, but there is still an entire continent waiting to be discovered. The United States is also an opportunity for contracts for all types of infrastructures in the future. There is also the impetus in Portugal from the country's infrastructure plans, and the opening up of the United Arab Emirates and Libya.

The major Spanish construction companies are being forced to seek business abroad as the only way to compensate for the marked decline in their business at home. Companies such as ACS, FCC, Acciona and Sacyr ended 2008 with a new record in contracts for projects abroad, with a total volume that will reach 12 billion euros, 9% more than the previous year.[156] Furthermore, the opportunity involved in the Panama Canal enlargement project is also on the horizon, and ACS, FCC, Acciona and Sacyr are bidding through two consortiums. The four groups are pre-authorized to bid for what will be one of the world's largest engineering civil works, with an estimated budget of 3.8 billion euros.

The renewable energies sector will be analyzed in more detail in the chapter "The challenge of sustainable development," as the current scarcity and the threat of depletion of traditional energy sources means that it is a business opportunity for Spanish companies.

Finally, Spanish investment in properties abroad reached 2.937 billion euros by November, an increase of 43.7% compared to the previous year, according to figures from the Bank of Spain.

[155] Aviva Investors.

[156] http://www.eldiadevalladolid.com/noticia.cfm/Econom%C3%ADa/20090118/grandes/constructoras/capean/crisis/obras/extranjero/E6416765-1A64-968D-593A2BE9D7BE4517.

Country ranking	Company	Rank in the *Fortune Global 500*	Revenues (millions of euros)	City
1	Grupo Santander Central Hispano	58	89,295	Madrid
2	Telefónica	76	77,254	Madrid
3	Repsol YPF	92	67,006	Madrid
4	Banco Bilbao Vizcaya Argentaria	134	51,449	Bilbao
5	Endesa	258	30,018	Madrid
6	ACS	270	29,171	Madrid
7	Cepsa	313	25,853	Madrid
8	Iberdrola	339	23,910	Bilbao
9	Grupo Ferrovial	424	20,062	Madrid
10	Fomento de Construcciones y Contratas	440	19,267	Madrid
11	Grupo Mapfre	463	17,984	Majadahonda

Figure 49. Ranking of Spanish companies in the 2008 Global Fortune 500.

Rule 3: Attract Foreign Investment

The flow of foreign direct investment in Spain increased by 7.3% in 2008, according to initial estimates by the United Nations Conference on Trade and Development (UNCTAD). Spain received 57.3 billion dollars in 2008, compared to 53.4 billion in the previous year, making it the sixth-largest recipient in the world and the third largest in the European Union. It ranked eighth and fourth, respectively, in 2007 .[157]

Spain's appeal for any type of direct investment therefore persists, as can be seen by the figures for greenfield projects (new investments generating wealth and jobs) undertaken in 2008; 450 investment projects took place between January and November 2008, an increase of 14.6% compared to the same period in the previous year. Of particular note was the increase in this type of project in high added value sectors based on innovation, the knowledge society and RDI. At the same time, Spain saw major merger and takeover operations by foreign investors in 2008.[158]

Opportunities for foreign companies have proliferated in the Spanish economy for some years. The automobile industry, for example, has been completely owned by multinationals since 1986, when the Spanish automaker SEAT, founded in 1950 with the help of Fiat, was sold to Volkswagen.[159] The multinationals also have a strong presence in the sectors of cement (Portland and Lafarge Asland), electrical household goods (Sony, Philips and Electrolux),

[157] http://www.mityc.es/es-ES/GabinetePrensa/NotasPrensa/Paginas/npunctad.aspx.

[158] http://www.mityc.es/es-ES/GabinetePrensa/NotasPrensa/Paginas/npunctad.aspx.

[159] http://www.realinstitutoelcano.org/wps/portal/rielcano/contenido?WCM_GLOBAL_CONTEXT=/Elcano_es/Zonas_es/DT47-2007#_ftn6%23_ftn6.

electronic parts (Siemens and Robert Bosch), electronics (Philips and Honeywell), information technologies (IBM and HP) and consumer products (Unilever and Procter & Gamble). Estimates suggest that foreign companies control half of the food producers, a third of the chemical companies and two thirds of the cement sector. Several foreign banks (Barclays, Citibank and Deutsche Bank) took over the networks of retail banks from the weakened Spanish banks, although their total market share remains small, and foreign companies control a significant part of the insurance market (Allianz, Axa, Aviva and Generali). The French groups Auchamp (known as Alcampo in Spain) and Carrefour led a revolution in the Spanish distribution sector, by opening hypermarkets on the outskirts of towns and attracting customers that until that point had normally used the shops in their neighborhood. Not even the wine sector has been immune to foreign takeovers: in 1994, Allied-Lyons purchased Pedro Domecq, Spain's leading liqueurs company, and in 2001 the newly renamed Allied Domecq took over Bodegas y Bebidas, the largest wine producer. Many of Spain's main product exporters are multinationals, especially in the automobile industry, which accounts for over 20% of total exports of goods (vehicles and parts).[160]

These foreign investments have been vital to Spain's growth. The economist Juan Velarde Fuertes predicted that "if the flow of foreign capital stops, the Spanish economy would come to a standstill, there would be a suspension of payments."[161] For this reason, the decision by Standard & Poor's on January 19, 2009, to lower the long-term rating of Spanish debt from the highest rating (AAA) to a lower rung (AA+), due to the "structural weakness" of the Spanish economy, was viewed with some concern. The State may not be the only party to suffer from the lowering of the credit rating. The market is now wondering whether S&P will lower the rating of Spanish companies. There is currently not a single company in Spain with a triple-A rating. Those with the highest rating are BBVA and Santander, with AA, the third level.[162]

Juan Mascareñas, a professor at the Complutense University of Madrid and an expert in financial markets, says that "normally, no corporate debt has a better rating than sovereign debt, and if this sort of debt is downgraded, so is all the corporate debt, including debt from banks, which means that if [companies] want to finance themselves with outside money they will have to pay more for it. [...] Financial costs are getting higher for corporations, and if they want to compete—not simply by raising prices for their products and services—they will have no choice but to earn lower profits. Lower profitability leads to the flight of investors from these companies, and toward other companies that are similar but which are more profitable," he argues. In conclusion, he says, "our companies will be worth less."[163]

Meanwhile, Sergio R. Torassa, a professor at Pompeu Fabra University, feels that there are two reasons behind the higher cost of financing companies after the drop in the Treasury rating. "First, the growing needs of governments will drive up investor returns. Second, the higher volume of public-sector issues, coming at a

160 http://www.investinspain.org/icex/cma/contentTypes/common/records/viewDocument/0,,,00.bin?doc=4061086.

161 http://www.abcdesevilla.es/hemeroteca/historico-09-11-2007/sevilla/Economia/juan-velarde-teme-que-espa%C3%B1a-pueda-padecer-el-sindrome-argentino_1641315575285.html.

162 http://www.wharton.universia.net/index.cfm?fa=viewArticle&ID=1663.

163 http://www.wharton.universia.net/index.cfm?fa=viewArticle&ID=1663.

time when liquidity is scarcer, will lead to a 'crowding out' effect. The private sector will have greater difficulty attracting financing, compared with the public sector," he explains.[164]

Rule 4: Learn from Triangulation Experiences

Triangulation is described in a Casa Árabe publication as "Spain's role as a bridge between Asia and Latin America, taking into account the increasingly close relations between the two continents, on one hand, and the linguistic and business links between Spain and Latin America, on the other. Their involvement enables transaction costs such as trade barriers, transport times and costs, tax treatment and even linguistic and cultural differences to be minimized."[165] The study analyzes the opportunities for triangulation available in Spanish-Arab relations, and the cases of success among Spanish companies. It acknowledges that the Arab markets still account for a relatively small proportion of sales (around 8-10%) among the companies interviewed (they reach just 40% in LV Salamanca). However, the report says that the outlook for growth is significant because the rise in oil prices and the spending associated with it increase sales in Spanish companies, and the preference for up-market and advanced technology products. Some outstanding examples of the Spanish business presence in the Arab world are the latest generation video intercoms that Fermax sells in the Gulf, the sophisticated buses that Hispano Carrocera will present for public transportation tenders in Dubai and Abu Dhabi, and LV Salamanca's exportation of complex engineering, architecture and construction management services (see Figure 50).

[164] http://www.wharton.universia.net/index.cfm?fa=viewArticle&ID=1663.

[165] *La empresa española en los países árabes: experiencias de inversión y triangulación [The Spanish company in the Arab countries: experiences in investment and triangulation],* Jacinto Soler Matutes, Casa Árabe. This publication explains that the concept of "triangulation" emerges as an embryonic idea from such Spanish diplomats and educators as Manuel Montobbio, Pablo Bustelo and José Ángel Sotillo. An approach to the theory of triangulation from a strictly economic perspective is Coase and Williamson's theory of transaction costs to explain the appearance of countries, cities or companies as "bridges" or intermediaries in global businesses.

LV Salamanca	Financial	Services provided to customers in the Gulf for their investments in Maghreb, Lebanon and Egypt.
	Corporate	The Dutch chain Makro commissioned LV to design supermarkets in Arab countries through its Spanish subsidiary.
Vivesa *(Vanity Fair)*	Commercial	Tunisia as the production hub for Europe, thanks to association agreements.
	Cultural	Attempts to use Tunisia as a platform for expansion in Maghreb and the Middle East, from commercial and production standpoints.
Fermax	Cultural	Indian manager of the Dubai subsidiary coordinating recent opening of factory in India.
	Logistics	Buffer warehouse in Dubai to serve Middle East (including Iran) and India.
	Commercial-financial	Management and collections for exports to Iran through Dubai.
Casademont	Cultural	Halal certification in France for selling to Middle East and Africa.
	Logistics-cultural	Lebanese distributor trading in Syria and Jordan.
Cemex España	Corporate	Spain as a natural market for enterprises and a bridge toward Arabian world.
	Fiscal	Dubai as the headquarters for enterprises of trading. Spain as the headquarters of a global holding.
	Logistics	Air connections from Spain to Mexico.
Hispano Carrocera	Corporate	Hispano-Tata alliance with Arab countries as the setting: exchange of market share (Tata in India and the Middle East, Hispano in Europe and Northern Africa).
	Cultural-corporate	Tata opens the door to the Middle East market thanks to its distributors and relationships with ruling families.
Aresbank	Financial	Libyan capital financing Spanish exports to the Arab world.
Mango	Cultural	Lebanese franchisees in the Gulf. Indian franchisees discover Mango in Dubai and take it to India and Southeast Asia.
	Cultural-financial	Saudi franchisee opens dedicated stores for the Mango brand in Algeria, Morocco and Jordan.
Premo	Commercial	Trading from Morocco to the United States thanks to free-trade agreement.

Figure 50. Summary of triangulation experiences.
Source: Spanish companies in Arab countries: investment and triangulation experiences, Jacinto Soler Matutes, Casa Árabe.

Some of Spain's advantages in the Arab world are clearly explained using the example of the Mexican company CEMEX, which uses its subsidiary CEMEX España as a regional management and coordination center for the whole region (Europe, the Middle East and Africa), as well as Asia. The reasons behind this are its use of the Spanish language, tax breaks, air links and direct contact apart from time differences.

Hispano Carrocera is an example of a strategic Spanish-Asian alliance with Arab countries as the main setting. With annual sales of around 40 million euros, the company specializes in the design and construction of accessories, and bodywork decoration for buses. Its main customers are municipal transportation companies and scheduled or private passenger-transportation services. It also has extensive know-how in the safety area, such as in roll-protection systems. Today, Hispano Carrocera's international business is highly focused on Europe, from where it receives regular orders, as well as Northern Africa. In 2005, it signed an agreement with the Indian group Tata Motors to concentrate its sales efforts on the United Arab Emirates and Saudi Arabia. From Morocco, Hispano Carrocera will increase the sales of its lower-range products in nearby markets such as Algeria, Libya, Tunisia and sub-Saharan Africa. It is even considering the possibility of exploiting synergies with Tata in South Africa. As a result, Hispano Carrocera is a model of business cooperation between Spain and Asia, with the Arab countries as the backdrop and Latin America on the horizon.

Rule 5: An Exportable Banking Model[166]

Santander, the euro area's leading bank in terms of market capitalization, and BBVA are two of the global banks that are riding out the crisis. Despite the turbulence on the markets, Santander made an attributed net profit of 8.876 billion euros in 2008, 2.03% less than the figure of 9.06 billion euros in the previous year, due to the bank making increased provisions to deal with the recession, which amounted to 10.16 billion euros. BBVA posted an attributable net profit of 5.02 billion euros in 2008, a fall of 18.1% compared to the previous financial year, although its core earnings remained stable and increased by 0.2% to 5.414 billion euros. These figures are in sharp contrast to the huge losses recorded by the top American banks. The difference is no coincidence, as both institutions focused on retail banking and avoided investments in toxic products, following instructions from the Bank of Spain.

Fifty-four percent of Santander's profits in 2008 came from continental Europe, while in 2004 this figure was 59% thanks its purchase of the British building society Abbey, the sixth-largest in the country. The United Kingdom generated 14% of its profits, while Latin America contributed 32%, Brazil 11%, Mexico 8% and Chile 6%.

At a dinner in London in July 2008, when *Euromoney* magazine named Santander as the world's best bank, its President, Emilio Botín, gave a slightly ironic speech (via a pre-recorded video) about basic banking principles, which the

[166] «Las multinacionales españolas cosechan los beneficios de sus estrategias», William Chislett, ARI, number 114/2008, Real Instituto Elcano.

presidents of failed banks must bitterly regret not having taking into account. "If you don't fully understand an instrument, don't buy it. If you would not buy for yourself a specific product, don't try to sell it. If you don't know very well your customers, don't lend them any money," he said. "If you do these three things, you will be a better banker, my son." This advice has worked wonders for Santander.[167]

While many banks were having difficulties dealing with the aftermath of the subprime crisis and other problems, Santander took on in the United Kingdom a new challenge in retail banking, a world it knows very well, and last July it reached an agreement to take over the then-troubled building society Alliance and Leicester (A&L) for not much more than its nominal value, after the value of the complex debt securities in the A&L treasury portfolio had fallen. Santander anticipates that this business will lead to a yield of 19% on its initial investment in three years. In September, Santander bought the distribution channels and retail deposits of Bradford and Bingley (B&B). Together with the acquisition of A&L, this enables it to achieve critical mass in the United Kingdom, increasing its estimated share of Personal Financial Services from 6% to around 10%. After these acquisitions, which provided 450 branches, the Abbey network will include 1,286 offices, which are distributed well in geographical terms. It is also an operation that involves no increase in credit risk, as all of B&B's client credits and treasury assets, including 41 billion pounds of mortgage assets, remain state owned.

In the United States, Santander paid 1.4 billion euros to acquire the remaining 75.6% of Sovereign Bancorp that it did not possess. That amounted to one tenth the amount it paid for a minority interest in the bank three years ago. Sovereign, badly hit by the increase in mortgage default, in September became the largest savings and loan bank in the United States after the collapse of Washington Mutual and its ensuing takeover by J.P. Morgan Chase.[168]

Santander also strengthened its presence in Latin America as a result of its participation last year (with 19.8 billion euros) in the consortium led by the Royal Bank of Scotland which took control of the Dutch bank ABN-AMRO. By doing so, it also acquired Banco Real, AMRO's subsidiary in Brazil. The combination of Banespa, owned by Santander, and Banco Real created the second-largest bank in Brazil in terms of deposits, and the third in terms of network size (with a market share 12%). Santander's total market share in Latin America increased by between 10% and 15% in all its main products.

Meanwhile, BBVA's bank in Mexico—the largest in the country—generated 32% of its total profits (excluding extraordinary profits) in the first six months of 2008, while its banks in the United States accounted for 5.6% and those in South America accounted for 12%. While Santander has recently focused on Europe for its new acquisitions, BBVA increased its presence in Asia in June, when it agreed to pay 800 million euros to increase its stake in two units of Citic Group, a Chinese financial group. It practically doubled its stake in Citic Bank, China's

[167] «Las multinacionales españolas cosechan los beneficios de sus estrategias», William Chislett, ARI, number 114/2008, Real Instituto Elcano.

[168] «Las multinacionales españolas cosechan los beneficios de sus estrategias», William Chislett, *ARI,* number 114/2008, Real Instituto Elcano.

seventh-largest credit institution in terms of assets—to almost 10%—and is maintaining its stake in Citic International Financial Holdings, a Citic Group subsidiary which is listed on the Hong Kong Stock Exchange.

However, the two banks are aware that 2009 is going to be a difficult year. At Santander, they insist that profits and dividends will remain stable. They both have large provisions available. However, the quality of credit is declining rapidly. Santander is exposed to two of Europe's most stressed economies—Spain and the United Kingdom—and the Brazilian economy, where it carries out major operations, is slowing down sharply.[169] Furthermore, the effects of its investment of 2.3 billion euros in funds managed by Bernard Madoff are being felt. In an attempt to limit the damage to its image, private-banking customers will be reimbursed 100% of their investment ("net [after deduction of] reimbursements"). Institutional clients, however, are not covered by this measure. The investments that Santander is to return amount to 1.38 billion euros.[170]

Meanwhile, BBVA will be largely dependent on the developments in Mexico, which is entering a recession. It also lost 300 million euros in the Madoff Case, having acted as a structurer for other organizations and institutional investors for products linked to funds that invested in Madoff's products.

[169] http://www.economist.com/finance/displaystory.cfm?story_id=13110701.

[170] http://www.expansion.com/2009/01/27/inversion/1233095656.html.

6

CHAPTER 6

Human Capital in the Multipolar World

6 Human Capital in the Multipolar World

The free circulation of individuals, capital and goods and services is the key factor in the process of international globalization that has accompanied the latest wave of prosperity. We are in the midst of a serious economic crisis, and in a context in which commercial and capital flows have seriously declined, making human capital a key factor in overcoming this situation. Human capital will also be vital when future generations have to face major challenges ranging from global warming, demographic changes and the sustainability of the capitalist system.

The importance of human capital is even more marked as many feel that recent events highlight a decline in values and ethics in the business sphere in particular, and in society in general. This was one of the ideas discussed in the Ágora International Forum on Talent[171]: "The current crisis is certainly a crisis of values and ethics rather than a crisis of the financial markets. It can only be overcome with a new ethical compass that changes behavior, and our societies in the final analysis, by creating new and modern foundations based on talent: talent dedicated to ethics, sustainability and the creation of shared values."

The competitiveness and the future economic development of countries must therefore involve taking up a key position on the talent map in the multipolar world. The way to achieve this will be to prioritize the creation, attraction, development and retention of talent. All the agents in society must play their part in achieving this aim: the family, education system, business and government (see Figure 51).

[171] http://www.agoratalentia.es/primera-edicion/primera-edicion_presentacion.asp.

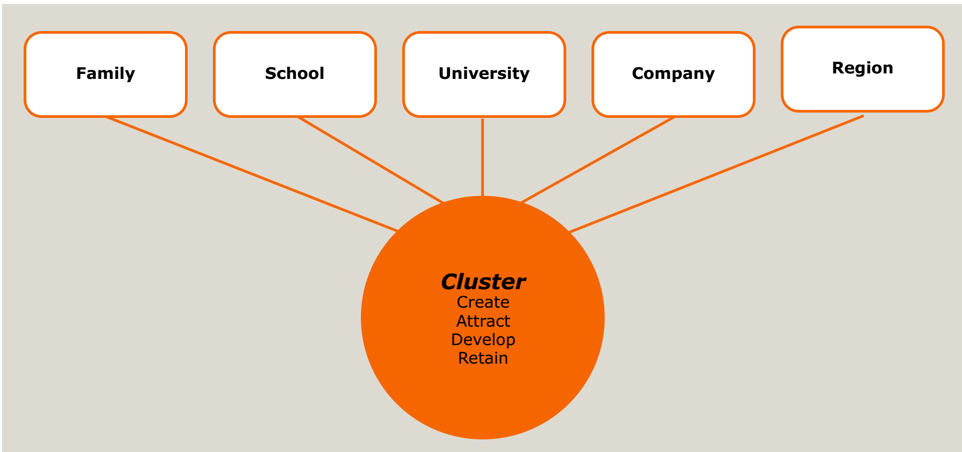


Figure 51. The Future.
Source: Ágora Talentia, Navarra.

Demographic trends will have a profound influence on the talent map of the future. The most important of these is the imminent aging of the world's population. Forecasts suggest that in 20 years' time, only a third of the total of the world's population will be under thirty years old (see Figure 52). The regions that are today the most prosperous will be the most seriously affected by this process (see the study *New consumers: Aging Population and Immigration* by the ninth edition of the Bankinter Future Trends Forum).

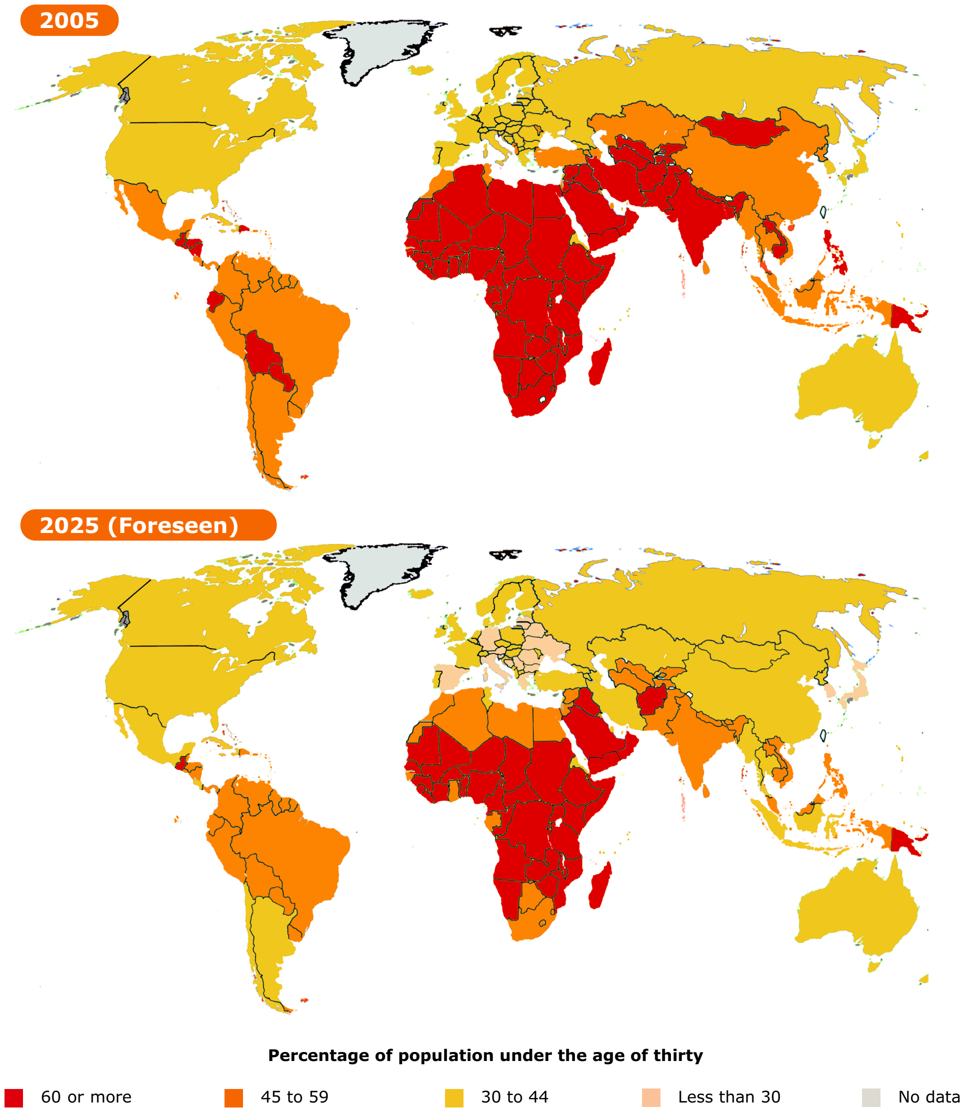


Figure 52. Changes in the age structure of the world's population.
Source: United States census figures.

As well as this aging phenomenon, there is also the uneven distribution of the world's population. In twenty years' time, approximately 16% of the population will live in Western countries, compared to 25% thirty years ago. The main areas of high birth rates and population increases will be China and India.[172]

These demographic trends will have significant implications for talent management. First, they will make the international struggle to attract talent even more acute, as older and less populated countries are forced to seek professionals beyond their borders. Second, they will force societies to design strategies that enable them to develop talent on an ongoing basis.

Attracting International Talent

The battle for talent has begun. Although various countries and economies are meeting this challenge to different extents, they are starting to compete in this global struggle. Their success will depend on various factors, such as the prestige of their universities, the opportunities for research they provide, and the professional opportunities in their business sector.

Talent is emerging from all over the planet, and new technologies are enabling it to link up with the countries that need it, over distances of thousands of kilometers. While developed economies watch their birth rates fall at the same time as early retirement increases, the emerging economies have a surplus of young talent. In fact, they have twice as many professionals with university qualifications as there are in developed countries.

More and more new talent (or at least previously unknown talent) is therefore coming out of emerging economies, but the doubt raised by Mark Foster, Accenture's Group Chief Executive for Management Consulting & Integrated Markets, is: will this talent have the skills needed?

According to the studies produced by The Lisbon Council in collaboration with Accenture,[173] the skills required in the future will be a combination of specific knowledge and interdisciplinary abilities (see Figure 53). The specific knowledge areas required will include sciences and engineering, math, languages and business knowledge. Among the interdisciplinary abilities in demand will be the use of technology, communication skills and problem solving, flexibility and teamwork.

[172] *Global Trends 2025: A Transformed World,* National Intelligence Council (november 2008).

[173] *Skills for the Future,* The Lisbon Council y Accenture.

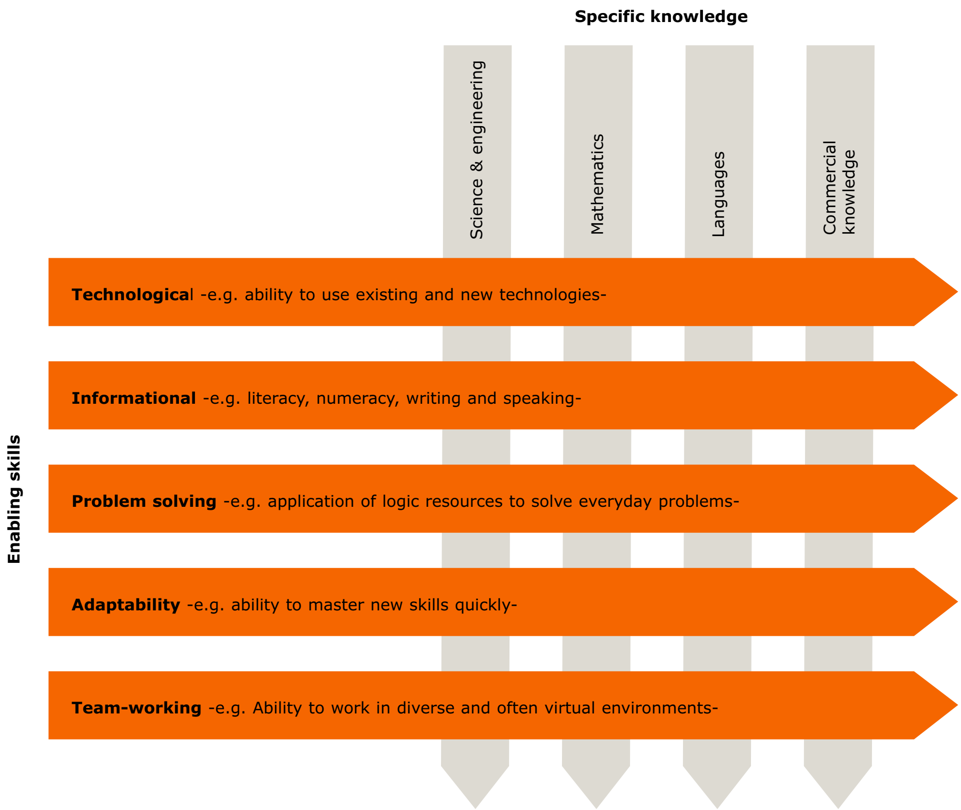


Figure 53. Skills in greatest demand in the future.
Source: *Skills for the Future,* The Lisbon Council and Accenture.

Another factor that must be taken into account is the profile of the future generations, and those which companies will be trying to attract. People born after 1980 are known as Generation Y, and typically have extensive knowledge of technologies and are skilled in using the Internet. In their working conditions, they demand more flexibility, meaningful jobs, high payment and a better balance between work and personal life. This profile will to a large extent determine the job offers that companies design in order to obtain the most highly skilled talent.

However, the migration of talent accounts for just a small proportion of the migrations taking place. Most migratory movements are by people who are either unskilled or who are in jobs for which they are overqualified. A report on migration and developing countries published by the OECD Development Centre concluded that migratory movements can make a significant contribution to the fight against global poverty, whether the people concerned are skilled or otherwise. However, many experts consider that emigration by skilled workers, known as "brain drain" is a risk for their countries of origin, which are usually developing nations.

Did you know?

In response to the lack of employment opportunities in their regions, some the most prestigious business schools in the United Kingdom and United States, such as the London Business School and the Wharton School, are organizing trips to the United Arab Emirates for students interested in working there.[174]

The OECD suggests that in the field of science and technology, the movement of professional experts benefits both the source and recipient countries. These migrations lead to networks of knowledge being established between countries, contribute to the distribution of "unwritten" or tacit knowledge, and can improve international diplomatic relations.

These migratory movements will be reduced by the recession. In fact, the first return journeys to countries of origin have already taken place. Many workers that found jobs in the construction sector in the United States and other countries like Spain have returned home. The globalization process is taking a step backwards in this area.

The Continuous Development of Talent

It will be necessary to develop and deploy talent on an ongoing basis in order to reinvigorate societies which mostly consist of people who have been out of the education system for some time. As the population ages in many countries, these people's contribution to the economy will be increasingly important. The scourge of high unemployment, which is exacerbated by the current recession, will also be a serious problem in many countries, and may affect their volume of talent. Various studies have shown that most people acquire most of their skills at work.[175] An unemployed person is therefore probably not acquiring new skills, thus creating a vicious circle in which the persistent failure to acquire new skills leads to structural unemployment. Everyone concerned (individuals, families, educational institutions, businesses and governments) must work together so that lifelong learning among individuals flourishes in society.

Furthermore, in a context of international crisis, in which some of the foundations that have sustained the world's economic and productive structure are trembling, innovative alternatives must be sought. To that end, both the private sphere and business must be aware that investing in the development of talent is essential. However, the temptation to rein in spending, optimize resources and wait for the storm to pass is too great. These policies will only make the situation worse.

Governments must make sure that the foundations for knowledge in their countries are firmly laid, by designing a competitive education system that meets the needs of society. Businesses are increasingly dependent on knowledge, especially technical knowledge, which makes it essential to have a solid higher-education system.

[174] http://www.businessweek.com/bschools/content/dec2008/bs2008 1223_342745.htm.

[175] http://www.agoratalentia.es/documentos/DeclaracionNavarra sobreTalento.pdf.

Did you know?

Approximately 85% of fast-growing companies founded in the United States in the last 20 years were established by university graduates.

The Future Trends Forum experts see the main challenge for countries in the coming years as creating skilled and unskilled jobs, both to overcome the recession and to grow economically on a sustainable basis. In their opinion, innovative solutions must be sought for the exclusion of people without training from the labor market, which is partly fostered by globalization. One of these measures, proposed by President Obama during his election campaign, involves giving grants to businesses that hire unskilled workers on that condition that they provide them with training, so that if they do not ultimately want to keep them on their payroll, at least they would return to the labor market with some training. The experts feel this measure would be more productive than the training programs provided by Latin American governments and other European countries.

The Talent Map

The consultancy Heidrick & Struggles and *The Economist* have carried out a study in twenty countries to measure where talent is today, and where it will be in 2012. According to this study, a country's talent must be measured based on the following indicators:

- Demography.
- Quality of the compulsory education systems.
- Quality of the universities and business schools.
- Quality of the environment for cultivating talent.
- Mobility and relative transparency in the labor market.
- Trends in foreign investment.
- Ability to attract talent.

A study was produced based on these indicators, which forecast the ranking of countries' talent in 2012 and shows the changes since 2007 (see Figure 54).[176]

According to their forecasts, countries such as China and India would rise in the ranking due to their high demographic rate and the growing potential for talent and development within their frontiers. The United States will hold onto first place, although it will face strong competition from China. Sweden, the Netherlands and Germany will also be at the top of the list thanks to their excellent flows of foreign investment, the quality of their universities and the mobility of their talent.

[176] *Global Talent Index 2007-2012,* Heidrick & Struggles.

Range 2012	Country	Score		Variation since 2007
1	United States	52.8	■	0
2	United Kingdom	47.7	▲	2
3	Canada	47.5	▼	1
4	Netherlands	46.0	▼	1
5	Sweden	44.7	■	0
6	China	43.8	▲	2
7	Germany	43.6	▼	1
8	Australia	43.3	▼	1
9	France	42.8	■	0
10	India	40.6	■	0
11	Spain	37.3	■	0
12	Malaysia	37.1	■	0
13	South Korea (Republic of)	36.6	▲	2
14	Japan	35.8	▲	2
15	Poland	34.9	▼	2
16	Italy	34.2	▼	2
17	Ukraine	34.1	▲	2
18	Russian Federation	33.9	■	0
19	Mexico	33.0	▲	2
20	Greece	32.5	■	0
21	Argentina	32.1	▼	4
22	Thailand	29.8	■	0
23	South Africa	29.8	▲	1
24	Egypt	29.5	▲	1
25	Brazil	29.2	▼	2
26	Turkey	29.0	■	0
27	Saudi Arabia	25.6	▲	1
28	Nigeria	22.7	▼	1
29	Indonesia	22.3	■	0
30	Iran	20.5	■	0

Figure 54. Ranking according to the global talent index.
Source: *Global Talent Index 2007-2012,* Heidrick & Struggles.

6.1. Business Strategies to face the Globalization of Human Capital

The term *workforce* traditionally referred to the people who worked in a company. With the rise of human-resource management, the term "human capital" came into use, in order to make it sound less anonymous and impersonal, and to stress the value of a company's employees. Today, "talent" is the differential value par excellence and companies' competitiveness is directly related to their capacity to attract, retain and develop talent. Talent is valuable because the value of intangibles[177] has increased from 20% of companies in the S&P 500 in 1980 to 70% today, for example. We are at a time in which knowledge is the new capital, and knowledge is intangible. When the foundations of an economy change, those who control wealth also change. The organizations which have the best talent become the strongest, and it is they who really control an intangible factor companies are trying to use to build their management structure in order to generate wealth.[178]

In its book *The Talent Powered Organization,*[179] Accenture defines this new focus for businesses: "A talent-focused organization is an organization that invests in building distinctive capabilities in managing talent to produce extraordinary results for the organization. Managing talent therefore used to be to an organization's capacity to continuously create and optimize the talent resources necessary to carry out business strategies. This capacity is even more relevant in the current crisis" (see Figure 55).

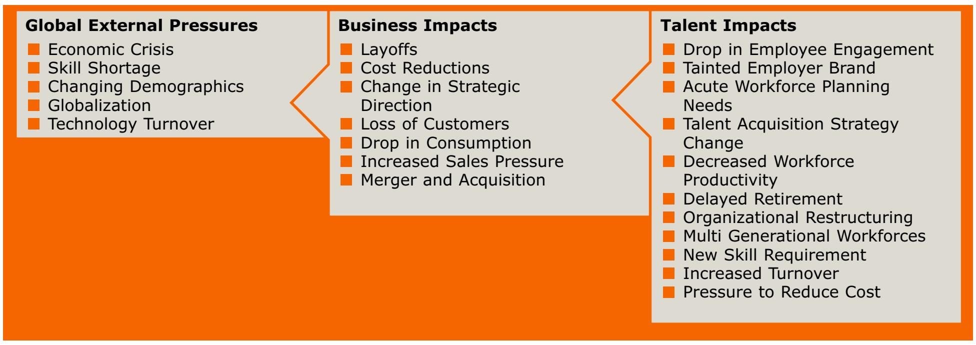


Figure 55. Talent management in business.
Source: *Managing Talent in Uncertain Times,* Accenture
(https://publishing.accenture.com/MCIMNews/Research+and+Insights/default.htm).

[177] There are three essential intangible assets: customers and services; people and image; and reputation and prestige.

[178] «El imperio del talento: los TATA», José Manuel Casado, *Harvard Deusto Business Review* (februay 2008).

[179] *The Talent Powered Organization,* Peter Cheese, Robert J. Thomas and Elizabeth Craig.

The arrival in Spain of Starbucks, one of the world's leading coffee retailers and roasters, brought a revolution in terms of its mission and the way business is done. The company's mission, as stated on its website, is "to establish Starbucks as the premier purveyor of the finest coffee in the world while maintaining our uncompromising principles while we grow," putting six principles into practice, including two that are covered by the subject under discussion in this chapter:

- "Embrace diversity as an essential component in the way we do business."
- "Develop enthusiastically satisfied customers all of the time."

The first principle refers to one of the main requirements of talent: attracting and keeping culturally diverse employees in the company is an excellent organizational capacity. The second principle is connected to the opportunity for improving the company's performance by combining human capital with the optimum level of commitment. Both ideas will be considered below as strategies that companies must use to succeed in managing the talent of their human capital.

Returning to the example of Starbucks, Orin Smith, its President and Chief Executive Officer, undertook to plan his own succession, stating that he would leave the company in 2005, when he was 62 years old. Smith soon saw that the internal candidates would not be ready to take over the position of chief executive officer by the time he left. He realized that Starbucks had to develop its leaders at the same pace as its international expansion, from 8,500 outlets all over the world to almost 30,000, half of which were outside the United States. The Starbucks experience shows the importance of including the development of talent, as in many cases, an organization's ability to undertake strategic initiatives in the future depends on this.

The strategic importance of talent does not only affect senior management positions. "Nurturing and developing talent is everyone's concern in the organization. The HR function is a key enabler, but best practices and a talent mindset and culture must be embedded and sustained throughout your business."[180]

However, what are the challenges involved in the talent management of the future? José Manuel Casado, the Senior Partner responsible for Accenture's Talent and Organization Performance in Spain, thinks that the most important will be placing appropriate value on the company's human capital, adapting to the new features of the increase in international talent, concentrating on technology and adapting to the demographic characteristics of staff and globalization (see Figure 56).

[180] *The Talent Powered Organization,* Peter Cheese, Robert J. Thomas and Elizabeth Craig.

Evaluation of human capital	■ Costs and profitability. ■ Economic aspects of intangible assets. ■ Higher productivity ■ Talent multiplier
New growth	■ Concentrated on the shortage of knowledge. ■ Competition for talent. ■ Rate of change.
Concentrated on technology	■ Usability ■ The knowledge worker as the objective. ■ e-HR, e-Training, e-KM (virtual knowledge management, Web 3.0, Facebook...), etc.
Demographic characteristics of the staff	■ Aging of the population. ■ Multiple generations at work. ■ Shortage of skills. ■ Commitment problems. ■ Capturing knowledge. ■ Women and work.
Globalization	■ Labor arbitration. ■ Virtual teams. ■ New models of organization. ■ Corporate culture.

Figure 56. New challenges in talent management.
Source: *La gestión del talento en tiempos de crisis (Talent management in times of crisis),* José Manuel Casado, Accenture.

In the current crisis situation, companies may be tempted not to allocate sufficient resources to talent management. José Manuel Casado believes that crises are temporary rather than structural, and "therefore do not last forever. It is necessary to take advantage of the situation in order to concentrate on what is important and not on what is urgent, and to get ready to leave the crisis behind—sooner or later—under the best possible conditions."[181] Other factors, such as the globalization of the labor market, the aging of the population and the lack of talent will continue to have an impact on companies when the economic situation improves. Managing talent is undoubtedly a vitally important strategy for companies with a long-term outlook.[182]

Some ideas for successfully managing talent in organizations are outlined below. A distinction has been made between companies from developed and emerging countries, as although many of the ideas are applicable to both conditions, some are more relevant in one sphere than the other.

Companies from Developed Countries and the Globalization of Human Capital

The problem faced by the developed countries is obvious: the talent shortage. The aging of the workforce will become more acute in the future, as it is not

[181] http://www.toptenms.com/Archivos/Descargas/SalónCapitalHumano2008Cataluña.pdf.

[182] *Managing Talent in Uncertain Times,* Accenture.

completely replaced by the next generation. A further problem is the increasing complexity of work. This all means that talent management is a priority for companies wanting to succeed in the multipolar world.

Rule 1: Multiply Talent

Bill Gates, the founder of Microsoft, summarized the importance of talent to his organization in a single sentence: "If 20 people were to leave Microsoft, the company would face bankruptcy."[183] Judging by Microsoft's results, it would initially appear that recognizing the importance of talent contributes to a company's success.

As mentioned at the beginning, Accenture defines the talent-based organization as one that combines a capacity for managing talent with other skills. All the while bearing in mind that the objective of all companies is to maximize profits. This maximization is achieved by defining strategies leading to a high performance. During their research, Accenture discovered that just 62 of the Fortune 500 companies in 1992 were still on the list in 2005. The conclusion to be drawn from this is that the difficulty lies not in achieving high performance, but in maintaining it. Accenture believes that the "high-performance anatomy" is a mixture of the following factors:

- **Leadership:** talent in creating the market and the capacity to lead in execution.
- **Personal development:** a way of thinking based on talent and the necessary skills to multiply talent.
- **Technology:** acknowledgement of information technologies as a strategic asset.
- **Performance:** assessment of all the essential areas and establishment of parameters for measurement.
- **Flexibility and innovation:** the capacity for ongoing renewal.

Some of the points above are linked to the multiplication of talent. Companies must maximize performance by investing in human capital: "When companies create capabilities for multiplying talent, they succeed in generating the greater efforts, creativity and results appropriate to a talent-based organization."

However, what are the specific measures that a company can take in terms of talent management in the new geoeconomic landscape? Most of the Future Trends Forum experts suggested that the key will be the development of comprehensive programs for improving the skills of current personnel (see Figure 57).

[183] http://www.rrhhmagazine.com/articulos.asp?id=247.

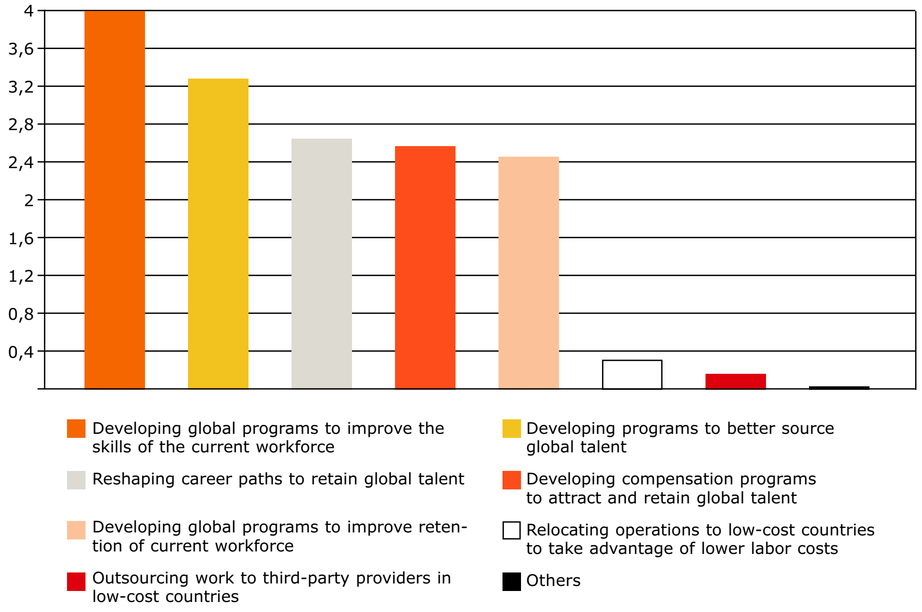


Figure 57. Most effective measures for talent management in the future.
Source: Drawn from the conclusions within the Future Trends Forum.

Companies like Sun Microsystems and KPMG have included global projects in their human resources strategies, such as social responsibility programs for employees and training aimed at all professionals, from the newest recruit to senior managers.

Rule 2: Think Globally, Hire Locally[184]

"An intelligent man is someone intelligent enough to hire people more intelligent than he is." – John F. Kennedy

Attracting talent will be one of the major challenges for companies. Around 97% of the 438 million people who will be joining international payrolls in 2050 will come from developing countries[185] (see Figure 58). The figure is astonishing: the workforce in the B6 is more than three times as large as that of G6 and the rest of the European Union combined.[186] Furthermore, these people are no longer considered "cheap labor," because their level of education has substantially improved, as can be seen by the figure of 33 million university graduates in developing economies, compared to 14 million in the developed countries.[187]

[184] *Bain and Company Brief,* www.bain.com.

[185] The Economist Inteligence Unit.

[186] *B6* refers to the "Big Six": Brazil, China, India, Mexico, Russia and South Korea. *G6* refers to France, Germany, Italy, Japan, the United Kingdom and the United States.

[187] *World Competitiveness Yearbook,* International Institute for Management Development (IMD) 2006, p.50.

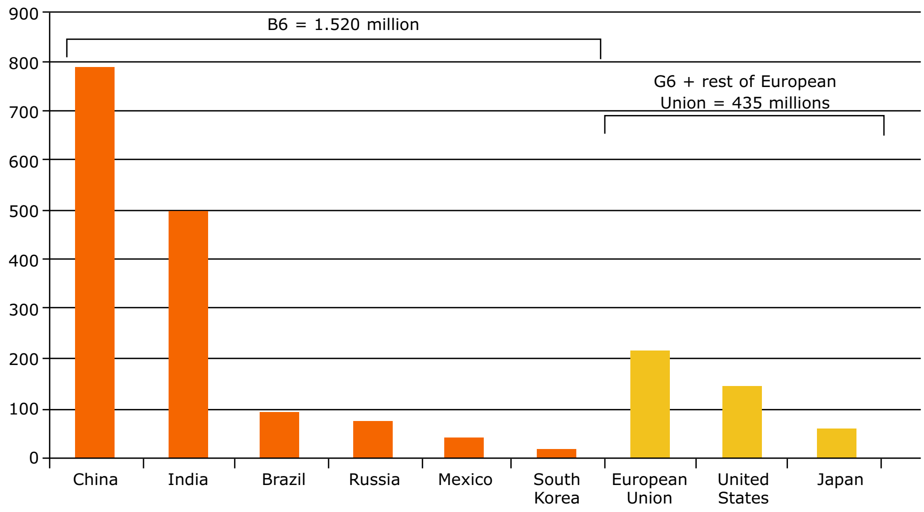


Figure 58. The global workforce in 2005 (figures in millions).
Source: *La Empresa Multipolar,* Accenture (2008).

What impact does the increasing supply of talent from emerging countries have on multinationals from developed economies? What could appear to be a "threat" could become a great opportunity. The example of Lenovo, the Chinese company that purchased the IBM personal computer division, illustrates this. Its chief executive officer, Bill Amelio, explains that managing the diversity of the company's professionals is vital in the conquest of new consumer markets. The purchase forced Lenovo to form a high-level management team that included 10 different nationalities.

As part of its entry strategy in emerging countries, Bain & Co recommends "thinking globally, hiring locally." Many multinationals put their trust in expatriates to guide them during the entry phase in developing markets, with disheartening results. By promoting cultural diversity, some of the multinationals that wanted to enter emerging markets could have avoided marketing problems. In Asia, Coca-Cola used a translation of the advertising slogan "Coke adds life" from its advertising in the United States and the message that reached the consumers was "Coca-Cola returns your ancestors from death." Obviously, this would not have happened if local experts had participated in the campaign. It is no wonder, then, that 98% of Procter & Gamble's employees in China are Chinese. The reason is that the local team has more visibility in the Chinese market in terms of product design, promotion and distribution.

Finding people with the specific knowledge and skills to corner emerging local markets remains a major problem. Some companies have tried to solve it by designing an operating model based on the lack of a central headquarters, so as to

Did you know?

As well as jointly accounting for 2.4 billion new consumers, China and India ("Chindia") also have a growing pool of talent in engineering, science, R&D areas and IT services. The average cost of a biotech drug in Western countries is 1.2 billion dollars, while in India it costs 100 million dollars.

ensure that the senior-management team is spread culturally and geographically throughout the world, thereby avoiding physical ties.

At the same time, there are possible sources of talent that have yet to be exploited in emerging countries. For example, there is a great deal of potential among women and in rural areas. Unilever trained more than 5,000 women in rural areas in India to work as distributors, extending its range to 80,000 villages. The program generates 250 million dollars a year in villages which would otherwise be too expensive to serve. PepsiCo India has formed an alliance with the employment portal Jobstreet.com to advertise jobs that are only available to women. There were also plans to expand the project to other companies such as businesses Microsoft India, IBM India, RPG Group and Fidelity Fund Management.

Similarly, business models are becoming more complex and in many cases, the offshoring of work or subcontracting of jobs to talent located in emerging countries is common. This trend makes management of this talent more complex. Transferring some of the vital operations in multinationals' supply chains to countries like India is increasingly common. For example, around 30% of Yahoo!'s global research is currently undertaken in an R&D center in India. Microsoft and Cisco have transferred many of their senior managers to India to lead the company's strategic operations, due to the growing number of potential customers in the country.[188]

Rule 3: Rethink the Age Criteria

For the first time in history, there are four different generations within the same staff structure. Each generation has different characteristics and needs a specific approach to talent management (see Figure 59).

The future of organizations will be in the hands of the so-called Generation Y and the Net Generation. This label covers the group of people who are distinguished by their knowledge of technology and the Internet. When they begin their first job, young people from Generation Y expect to be heroes and heroines who are given opportunities to climb the ladder quickly, and who are always supported by people who tell them how well they are doing their job. Everything has to be immediate, almost like a video games, because they find it difficult to defer gratification.[189] They are also people who change job several times during their life, and by doing so change their business culture and the way they work without any problems in adapting to the technological environment.

[188] «Global firms draw on India for ideas», *livemint.com* (19/01/2009).

[189] «The Echo Boomers», *CBS News Online* (4/09/2005).

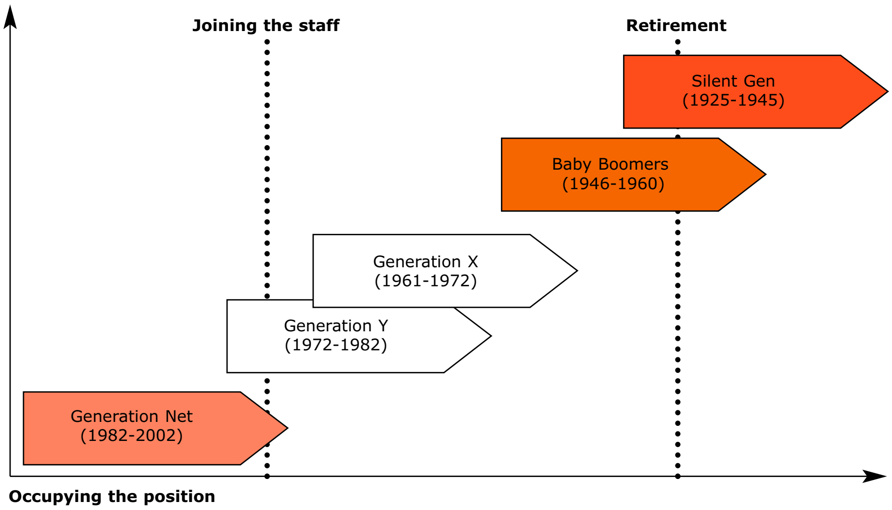


Figure 59. The challenge of generational coexistence in talent management.
Source: *La gestión del talento en tiempos de crisis,* José Manuel Casado, Accenture.

However, this description also varies a great depending on the country concerned. A recent study by Gallup among Chinese young people showed that the priority of more than two thirds of those surveyed was to "work hard to get rich." However, young Westerners preferred to dispense with the first part of the equation.[190] Another factor is the recent recession, with effects on the attitudes on current and potential employees that have yet to be confirmed. Whether the instability of the situation and the lack of confidence lead to a return to the emphasis on security and predictability of previous generations remains to be seen.

Companies must consider the new makeup of society very carefully in order to attract new talent. PricewaterhouseCoopers began a recruitment campaign with an advertisement that said: "If u wnt 2 b 1 of us, vst http://jobsite.pwc.es. People like you". The use of text-messaging language is a nod to the Net Generation in an effort to attract talent to the company. Another way in which companies try to attract the attention of possible candidates is through websites such as Facebook. It is well known that many companies and headhunters carry out controversial searches for their candidates in this type of forum, in order to find out what type of person they would be recruiting.

At the other generational extreme are the oldest workers. The population in all the developed countries—and in some developing countries—is aging at an unprecedented rate. The short-term trend is that the age group between 45 and 65 years old will gradually account for a higher percentage of the working population. As the baby boomers start to retire, there will be a lack of young workers entering the labor market and compensating for the exodus of talent that is leaving it. In Western Europe, where the birth rate is considerably lower

[190] *The Talent Powered Organization,* Peter Cheese, Robert J. Thomas and Elizabeth Craig.

than the replacement rate, the scarcity or lack of workers will arise earlier, and will be more severe and chronic.

In the next 5-10 years, organizations will therefore have to deal with two problems: the large number of workers that are retiring and the lack of talented workers to replace them. This is a significant risk for businesses. Meeting this challenge appropriately will require ways of thinking and acting different from those in the past. In this situation, José Manuel Casado suggests taking advantage of this "irreversible longevity" by hiring older workers, implementing "flexible" retirement and advocates the reform of retirement and benefit laws.

An example of good practices in managing older workers is the MITRE Corporation, which directs R&D programs for the United States government, and its *Reserves at the Ready* program, which gives retired people the opportunity to work part-time or on a project by project basis. The Home Depot also hires people over fifty years old with very good results, because of their maturity, motivation, work ethic and knowledge.

Rule 4: Provide Freedom of Choice; How to Work, Where to Work, When to Work

In the fight for talent, companies that are able to adapt to the preferences of new professionals will have an advantage over the others. Offering workers greater freedom of choice and giving them greater freedom and therefore responsibility in the management of their work could be a good argument when trying to win them over.

Technological breakthroughs and changes in the way companies think have enabled the growth of formulas such as telecommuting. The opportunity to gain access to talent anywhere in the world at any time is a big change in working models. People in the Net Generation have enough technological skills to stay in contact with their company using the numerous tools available. This also leads to a better balance between work and personal life, which is a major incentive for this generation. The airline JetBlue established a network of booking agents that worked from home all across the United States. The company cut costs and increased satisfaction among its employees, as shown by a very low level of employee turnover in 2003 (4%).[191] Best Buy, an American equivalent of Media Markt, created the *Results-Only Work Environment* program, in which employees are free to decide upon their own working hours and workplace. So long as productivity objectives are met, nobody cares when, how or where work is done. Thanks to this strategy, commitment and loyalty rates have risen and productivity has increased by an incredible 35%.[192]

Rule 5: "When I Grow Up, I Want to Be Like Facebook."

"It's not just about the money. I want to work in the hottest place on earth, and right now that's Facebook,"[193] was the explanation given by an ex-Google

[191] *The Talent Powered Organization,* Peter Cheese, Robert J. Thomas and Elizabeth Craig.

[192] «Potenciar el activo competitivo más importante», *Outlook,* Peter Cheese, Robert J. Thomas and Elizabeth Craig (2008).

[193] http://paul.kedrosky.com/archives/2007/06/15/facebook_really.html.

employee as to why he had changed job despite his rapid professional progress and high salary. Companies have to reinvent themselves to be cool in the eyes of the new generations. The workplace must be fun, and training must be entertaining. If not, attracting or keeping hold of the best talent is impossible.

However, how can this talent be effectively attracted and retained in the company? One way is to link up the human resources and marketing areas. The result: employer branding, which consists of a range of ideas for presenting a good corporate image to external professionals and candidates. The "employer brand" can become a competitive advantage, given that there is a lack of skilled workers and payment is not the main incentive within the change in values among new professionals. The company's process for attracting and retaining talent must focus on its differential aspects compared to others and also be expressed in commercial terms.

The commitment to the company that employees acquire will depend to a large extent on it meeting their expectations, which will vary depending on the employee's gender and position. At the organization's higher levels, most men value personal development and payment, while women prefer to enjoy a working environment with good relationships and communications. However, middle managers prefer empowerment, i.e., decision-making being devolved to lower levels of the corporation. Likewise, men in these positions seek leadership and being responsible for their actions (see Figure 60).

Level	Woman (%)	Man (%)
Upper management	Work relationships (14.3) Customer quality (9.5) Communication (9.5) Working tools and conditions (4.8)	Professional development (19.4) Compensation (9.7) Stress, balance personal/professional life, workload (6.5) Image (3.2)
Middle managers	Empowerment (23.8) Supervision (19) Professional development (9.5) Stress, balance personal/professional life, workload (9.5)	Leadership (27.5) Compensation (17.5) Image (15) Safety (5)

Figure 60. Factors for commitment by gender and position in the company.
Source: *Igniting Gen B and Gen V: The New Rules of Engagement for Boomers, Veterans, and Other Long-Termers on the Jog,* Nancy S. Ahlrichs.

The example of employer branding par excellence is Google, which has made its offices in cities like Zurich "the best place to work." There are at least two rest areas with free food and drink on each floor. There are themed relaxation rooms themed (such as the "water lounge" with baths to lie down and watch the aquariums) and massage rooms. There is a slide that connects the office area with the cafeteria and gymnasium. New recruits are made to slide down it for their "coming out." Apart from material facilities, each employee manages their time and work as they wish. There are no fixed working hours and during breaks staff can play Guitar Hero, pool or a board game. Nonetheless, delivery and development deadlines must be kept.

However, future success in this field is not guaranteed. Until recently, jobs at Google were the most coveted among workers in Silicon Valley, but Facebook has now become a magnet for new talent in the sector and is "stealing" some of the key managers from the search company.[194] This shows that if long-term commitment from professionals is not achieved, the company's most important assets will be lost.

That is why there are companies that help others to transform their working environments into excellent places to work. According to the Great Place to Work® Institute's "Trust Model, "a great place to work is one in which you trust the people you work for, have pride in what you do, and enjoy the people you work with."

Álvaro Salafranca, Chief Executive Officer of Starbucks Coffee in Spain, summarizes the ultimate aim of employer branding strategies: "If our employees don't feel important, they are unlikely to make our customers feel important. What makes our business fun is that we work with people."[195]

Indeed, the crisis is encouraging companies to include additional incentives, because higher salaries do not tally with widespread reductions in costs. In order to attract talent at a global level, the value proposal must be expanded at employee level, and increased development and training opportunities must be provided. Social responsibility and sustainable activities that are an incentive for choosing the company as a place of work must also be included.

Rule 6: The Power of Talent Lies in the TATA

José Manuel Casado suggests that the key to organizations' success is in TATA: "Those key people in companies who have to be attracted and retained in the ranks of our organizations if we want to conquer the empire of competitiveness. These are the people who ensure the present and future success of our companies; in short, our talents." TATA is an acronym that stands for "Talent is to Aptitude what Temper is to Attitude;" only the best, or extraordinary individuals, have both ingredients.

[194] http://www.que.es/tecnologia/noticias/todos-quieren-trabajar-en-facebook.html.

[195] «Starbucks no cree en el café para todos», *El Mundo* (29/06/2008).

Good talent management should be based on hierarchical structuring of groups according to their capabilities, knowledge, motivation and performance. Each group or person should be managed individually based on these results. This leads to the identification of key employees, or TATAs, for whom specific human resources and talent management policies are designed. These policies are aimed at maintaining their commitment to the organization, and maximizing their performance.

General Electric carries out a meticulous ranking of all its professionals based on their capacity to take up management positions. In the mid-1950s, the company founded its own corporate university in Crotonville, near New York. Jack Welch, GE's legendary Chairman, spent half his time on developing individuals and visited Crotonville every two weeks.[196]

Rule 7: Training, Training, Training

Higher education has become a global industry, and universities compete to attract the best talent. Countries like Australia and New Zealand are making it easier for foreign students to stay, while France hopes to increase its ratio of foreign students from 7% to 20% and Germany wants to create the Teutonic Ivy League to make courses there more international. In the United States, meanwhile, the Michigan Skills Alliance was established to provide training paid for by the government for possible candidates to cover vacancies in companies. Grow Wisconsin, another US project, aims to increase the state's appeal as an ideal place to work by investing in training and infrastructure, changing legislation, etc. The Obama Administration wants to promote university education by measures including making the first 4,000 dollars free for the vast majority of citizens, or by paying for two thirds of fees in public or community universities. The beneficiaries would receive these grants in exchange for doing hours of community service.[197] Scotland in fact cites the high cost of university education in the United States in an effort to attract American students by offering more affordable alternatives.[198]

It is no good promoting higher education in a country if the candidates do not end up working for that country's companies. Despite the increasing mobility of individuals entering the labor market, companies must distinguish themselves as a brand of global employer that provides on-the-job training opportunities, as that is what these people without any experience but with excellent academic training are looking for. Three of every ten European university students plan to leave their country of origin to find work and generally tend to prefer large internationally renowned companies.[199] Intel has created Intelpedia, a type of corporate Wikipedia that enables employees to share knowledge, cooperate with colleagues and help integrate new recruits who are unfamiliar with the organization's jargon and projects. Training at Accenture presents a return on the investment of 353%, and its communities of practice allow for information to be exchanged between employees. Meanwhile, IBM's Basic Blue program is a series

[196] «El imperio del talento: los TATA», José Manuel Casado, *Harvard Deusto Business Review* (February 2008).

[197] http://www.whitehouse.gov/agenda/education/.

[198] «Going off to college for less (passport required)», *New York Times* (1/12/2008).

[199] «Springboards for life in careers elsewhere», *Financial Times* (13/10/2008).

of measures for training new managers by e-learning, simulations, coaching and experiences in workshops and fieldwork.[200]

More than 1,600 companies have their own corporate university as a strategy for providing skills, integration and creating an emotional bond, and for achieving higher value and employability among their professionals.[201] Companies that have opted for this training model include: UBS, FedEx, Comcast, Verizon, Motorola, Vodafone, Avaya and Cerner Corporation.

Rule 8: Socialize Knowledge

Fluid communication, the exchange of experiences and interpersonal relationships among employees are an increasingly important factor in the development of internal talent and a company's overall success. In this respect, social knowledge networks are becoming more influential within companies. Accenture has found that high-performance companies improve the transfer of ideas using these new means of communication.

Companies are made up of the professionals who work for them, and Web 2.0 brings this idea a little closer to reality. The involvement of employees and the other agents present in the company's ecosystem in organizational social networks can create important synergies for the company, and contribute to the personal and professional development of the people that are part of them.

Spaces such as the Telefónica Group's *Somos Azules* (We are Blue) are examples of the new social networks that are being created in the organizational arena. They involve employees with ideas and the desire to carry them out without needing a mandate from management to do so, communities for sharing opinions on topics of interest for the development of new businesses, forums on the Internet for colleagues from different areas or countries, or with different points of view, or even a space where it is possible to relate on a personal level with customers, suppliers, etc.[202]

This social experience is providing tangible results (cooperation projects that have emerged from the professional relations created as a result of the platform, agreements with customers arising from this interaction, etc.). However, its intangible results are perhaps even more important. These include more in-depth knowledge of employees, the generation of ideas and reinforcement of the human side of professional relations by sharing interests and pastimes.[203]

Rule 9: Uncertain Times Call for Innovative Thought

Companies that are market leaders outperform their competition even during a crisis. One of the reasons is that they are constantly innovating. An outstanding pool of talent is needed for this innovation to flourish. Hence the talent in organizations is vital at all times, but even more so in times of economic uncertainty.

200 «The Revolution In Corporate Training», *Corporate-eye.com* (13/06/2008).

201 «El imperio del talento: los TATA», José Manuel Casado, *Harvard Deusto Business Review* (febrero 2008).

202 http://www.infonomia.com/if/articulo.php?id=434&if=65.

203 http://www.infonomia.com/if/articulo.php?id=434&if=65.

Companies must be able to adapt their talent-management policies to market conditions, ensuring that their professionals achieve the strategic objectives by promoting innovation. A recent study by Accenture[204] shows that companies adopt three types of strategies in crisis periods: for survival, to obtain a competitive advantage or to grow (see Figure 61).

Positioning for Survival	**Positioning for Advantage**	**Positioning for Growth**
Workforce rightsizing	Acelerating innovation	M&A integration
Labor cost optimization	New operating models	Culture alignment
Operational efficiency improvement	Critical skills upgrade	HR integration
Back to basics	Talent acquisition	Organization architecture
	Strategy agility	Governance models
	Engagement and alignment	

Figure 61. What preparations do companies make in order to identify, obtain commitment and deploy the resources and programs that enable them to maintain high performance during difficult times?
Source: *Managing Talent in Uncertain Times,* Accenture
(https://publishing.accenture.com/MCIMNews/Research+and+Insights/default.htm).

Many companies largely overlook the long-term consequences of quick-fix solutions. These companies end up regretting their decisions once time has passed and the situation has improved, because they watch their employees leave for other, more attractive options, and run into difficulty when trying to attract employees later on. This leads to significant shortcomings in key areas of the labor force that are vital for spurring on future growth.[205]

Regardless of whether a company is positioning itself in order to survive, to acquire competitive advantages or to grow during a crisis, it is clear that in times of uncertainty, an innovative mindset is necessary in all areas of the company, including human resources. Applying innovative (and more efficient) approaches to deal with key aspects of talent management in times of crisis can help companies get out of trouble and position themselves for high performance when the situation improves.[206]

Rule 10: Technology and Talent, a Marriage of Convenience

New technologies are transforming the nature of work, the skills required, recruitment on an international scale, and cooperation between professionals in carrying out processes and in innovation programs. All these trends make talent even more important and complex.[207]

The adoption of new technologies to support talent-management processes is on the rise. These IT-based solutions help a number of processes, including: hiring,

[204] *The Talent Powered Organization,* Peter Cheese, Robert J. Thomas and Elizabeth Craig.

[205] http://www.accenture.com/Countries/Spain/Services/GestionTalento.htm.

[206] http://www.accenture.com/Countries/Spain/Services/GestionTalento.htm.

[207] http://www.accenture.com/Countries/Spain/Services/GestionTalento.htm.

evaluation, pay, succession planning, training, human resources self-service and scorecards. The importance placed on talent management led 2,300 companies to adopt some form of technology in the field in 2007.[208]

Collaborative tools based on Web 2.0 are becoming increasingly relevant in the field of talent-management technology. For this reason, Facebook and Career-Builder.com joined forces in order to find candidates to occupy the vacant positions in the companies offering employment opportunities through the latter website. Virtual training also meets the needs of an increasingly global human capital and the habits of new generations (i.e., the Net Generation).

At the same time, the ongoing adoption of new technologies in all areas of companies requires new talent to exploit its possibilities to the full. Technology in itself does not create competitive advantages that are sustainable in the long term. In short, technology without talent cannot generate extraordinary results.

Companies from Emerging Countries and Globalization

[208] «El imperio del talento: los TATA», José Manuel Casado, *Harvard Deusto Business Review* (February 2008).

The recognition of talent management as a business priority is backed not only by managers in developed countries, but also by those in emerging economies, according to a study by the Boston Consulting Group (see Figure 62).

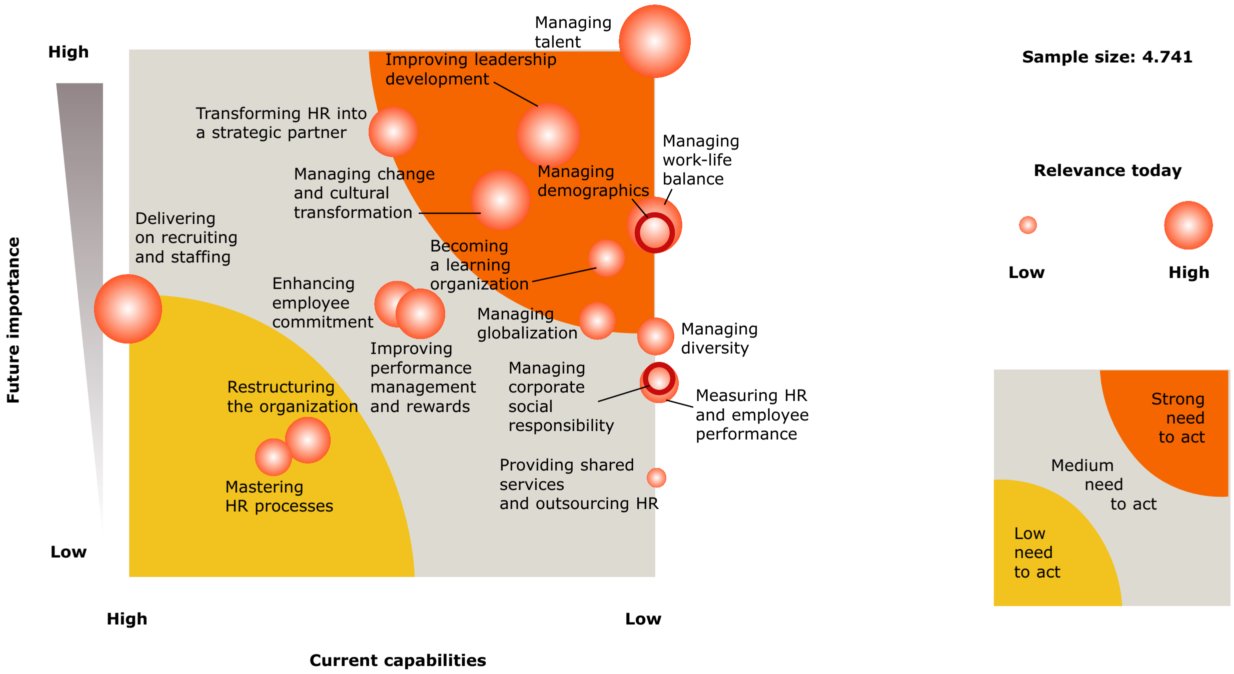


Figure 62. Eight international issues demanding the most attention and immediate action.
Source: Exclusive website survey with responses from 83 countries and markets; analysis by BCG/WFPMA.

Emerging economies, such as China and India, are starting to create a niche for themselves in very specialized activities with high added value. Until recently, their entire strategy was based on competing on cost. Now, however, things have changed and they are threatening the main bastion of companies in the Western world, where they have developed their most important competitive advantage. For this reason, they are already preparing for the tough confrontation ahead; victory will only be achieved by investing in training and skills, i.e., in teaching, talent and leadership. In India alone, 300,000 people earn IT degrees each year, five times more than in the United States, and they have to compete to obtain 10% of the best graduates.[209]

Diego Sánchez de León, Head of Talent and Organization Performance Practice at Accenture, emphasizes that in this change, "the education strategy used by emerging economies will lead to a transfer of investment to those countries," and complains that the desire to learn is being lost in Europe.[210]

While talent management is a discipline in which ideas and contributions still have some ground to cover, the rules that have been defined for companies in developed economies can mostly be used for those in emerging economies. Nevertheless, the next section focuses exclusively on meeting the challenge of talent in emerging countries, taking the unusual profile of its human capital into account.

Rule 1: Mobilize Against the Loss of Talent

In the 1990s, 650,000 people migrated from emerging markets to the United States with a working visa, and more than 40% of the foreigners in this country have some type of university education.[211] These movements meet the needs for talent in the recipient countries, which were suffering from an aging population, and the needs of those seeking jobs that their countries of origin are unable to offer them (see Figure 63). The flight of talent to developed countries offering skilled jobs with salary incentives, along with opportunities for promotion and a long career, is a fact of life. In the long term, one of the threats facing economies in emerging markets is the inability to retain their domestic talent.

[209] http://www.rrhhdigital.com/ampliada.php?sec=46&id=49448.

[210] http://www.expansion yempleo.com/2008/01/02/mercado_laboral/1072904.html.

[211] «Brains Abroad», *The McKinsey Quarterly* (diciembre 2001).

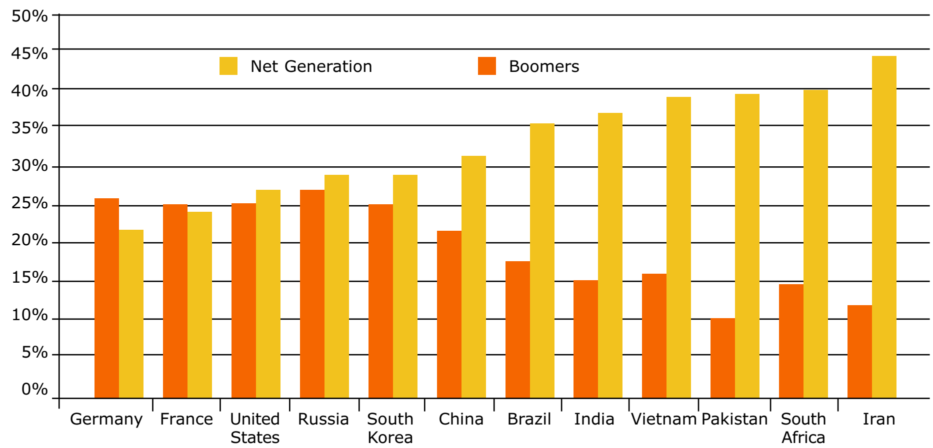


Figure 63. Global plenty versus local shortage.
Source: *La gestión del talento en tiempos de crisis,* José Manuel Casado, Accenture.

However, it seems that the trend may be reversed and emigrating talent will return to the emerging markets. This is known as *brain recovery.* The rapid growth and increased range of skilled employment opportunities attract increasing numbers of emigrants to their countries of origin. The crisis in most developed countries is contributing to this migration. According to 87% of the Chinese and Indians surveyed, the main factor in the decision to return home is that their skills are in greater demand in their native country. Almost half of those surveyed plan to set up a business in their own country because the business opportunities are better than in the United States.[212] Even some professionals, such as specialists in financial IT, are moving from New York and London to Asian markets because there are many opportunities in Hong Kong, Shanghai and Singapore.[213]

Organizations can contribute to preventing the brain drain by promoting attractive talent-management policies that provide people with interesting opportunities for professional development within the country, or the opportunity to work abroad with companies from the country of origin. This latter option is a rising trend. This would lead to two types of talent migration, called brain circulation and brain exchange. According to Manpower,[214] brain circulation involves people who migrate as part of institutional plans for developing multicultural skills in international companies. This type of migration encourages the creation of an incipient pool of specialized talent in emerging countries. Meanwhile, brain exchange could make it easier for countries to retain talent, as it is a non-physical migration of skills that will increase in the coming years. This is common practice in companies seeking to increase productivity in their operations by intelligent localization, by means of telecommuting, for example.

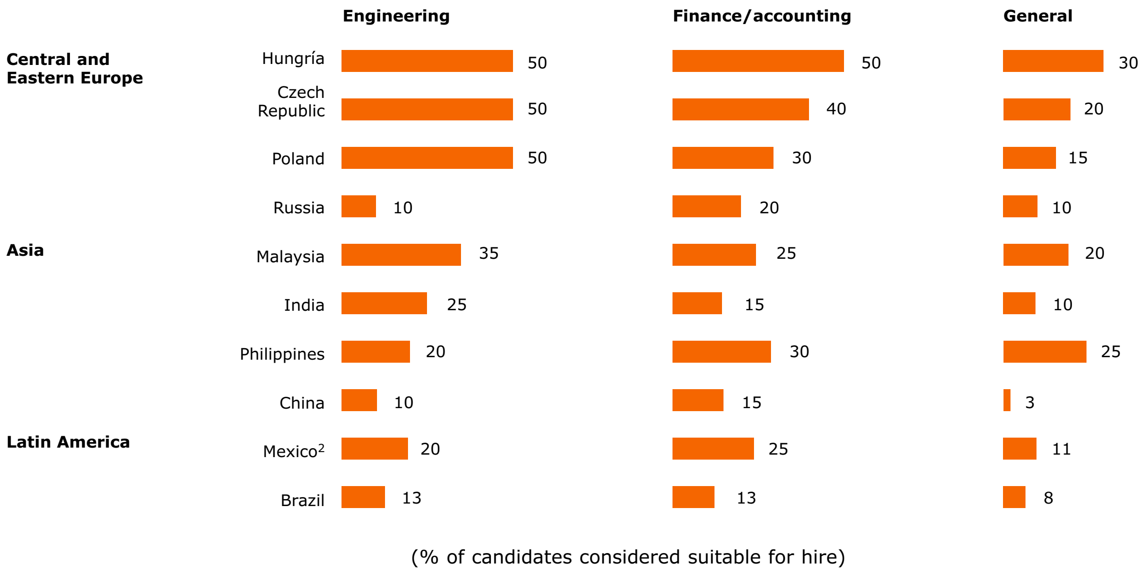
[212] «Why skilled immigrants are leaving the US», *BusinessWeek* (2/03/2009).

[213] «Financial techies bank on jobs in Asia», *BusinessWeek* (30/07/2008).

[214] *Manpower Newsletter,* february 2007.

Rule 2: Foster Professional Skills

The aging of the population and low birth rates in developed countries have led to a global battle for talent. The growing number of university graduates in e-merging economies is very attractive to global multinationals. However, HR professionals from multinationals in emerging markets such as China, Hungary, India and Malaysia have acknowledged that candidates for engineering and management posts in some cases present what they refer to as "dubious educational qualifications," with shortcomings in areas such as English language skills. There are also cultural problems, such as a lack of experience in teamwork and an unwillingness to take the initiative or assume leadership roles. The figures speak for themselves: under no circumstances would the professionals surveyed hire more than 50% of graduates in any of the emerging economy areas specified (see Figure 64).



[1] Suitability rates empirically based on 83 interviews with human resources professionals working in countries shown.
[2] Mexico is the only country where interview results were adjusted –to 20% (from 42%) for engineers and to 25% (from 35%) for finance/accounting employees– since interview base was thinner and risk of misundestandings high.

Figure 64. Of every hundred professionals with the right qualifications, how many could your business recruit if it needed all of them?
Source: interviews with human resources managers, human resources agencies and directors of global resource centers; analysis by the McKinsey Global Institute.

In order to change this situation, several companies in emerging countries are investing in developing their professionals' skills. Groups like Tata in India, Ayala in the Philippines and Koç in Turkey are developing training programs in their various business areas and collaborating with universities. The Tata group's TAS program was conceived as a way of providing opportunities for professional growth for talented young Indians. It creates a pool of talent by recruiting postgraduate students from leading business schools and offers them a career based on mobility across different companies, sectors and jobs. In short, the group offers a degree based on personal and professional growth as part of a brand associated with values like integrity, excellence and national prosperity.

Furthermore, in former Soviet republics such as Russia, some companies lack the management skills and business practices that are typical of market economies. That is why the business community in Russia is investing in the Skolkovo Moscow School of Management, in order to attract foreign students and teaching staff and become one of the world's best business schools by 2020.[215]

Rule 3: Diversify Talent Sources

The countries of Eastern Europe are strong in heavy industry, construction and engineering. Together with Malaysia and the Philippines, they are becoming hubs for outsourcing services. China also has many engineers and workers in heavy industry. Latin America is emerging as a center for talent related to industries specializing in commodities. In other words, emerging economies have a clear competitive advantage in some areas of talent. Experience has shown that a successful strategy for companies in emerging economies could be to recruit local experts in talent areas where they are strong, and to hire international talent for management positions or other business areas where they are weaker.

An example of this strategy is India's Bharat Forge, the world's largest metal forging company, which seeks candidates internationally for leadership positions in its company. Lenovo also uses a worldsourcing strategy to recruit talent globally. In cities such as Dubai, Abu Dhabi and Hong Kong, there is a growing trend toward seeking talent from developed countries among companies providing legal services. These companies have sharply increased the number of lawyers they hire from the best American law firms.[216]

The recruitment of international talent by companies in emerging countries will increase due to the recession and consequent job losses in Western markets. Many students from prestigious business schools and managers in Western multinationals are looking at emerging markets given the lack of opportunities in their countries of origin.

Companies from emerging countries must also not rule out the option of hiring talent from other emerging countries that are not internationally seen as a source of recruitment. As well as the traditional reserves of Chinese and Indian

[215] «Russia's lessons in capitalism», *The Times* (16/11/2008).

[216] «Lawyers wanted: Abroad that is», *New York Times* (23/11/2008).

professionals, 84 million people in Vietnam are under 25 years old and there are 80,000 IT graduates, a figure that is increasing by 9,000 every year.[217]

As for recruiting local talent, other companies such as Brazil's Petrobras, which has made that country the world's second-largest oil exporter, prefer to seek talent in their country's own universities to fill their vacant positions, such as the 14,000 engineers, geologists and well drillers that the company planned to hire in mid-2008.[218]

Among these sources of local talent, employing people who have worked abroad and have decided to return to their home country is particularly appealing. This phenomenon is increasing with the recession. In China, they are known as "sea turtles." The Chinese government aims to attract this diaspora, which includes a group of professionals with international experience and which is used to working in global multinationals. Likewise, at the end of 2007, the European Bank for Reconstruction and Development (EBRD) predicted that rapid economic growth in Eastern Europe would attract people from that area currently working in Western European countries.[219]

Rule 4: Use New Technologies

Talent uses new technologies as a means to maximize its performance. Although countries like China and India are world leaders in developing technological solutions, their user level is much lower than that of developed countries.

China and India are world leaders in the production of technological products and services, although the other emerging countries are still lagging behind in this sector.[220] The UNCTAD (United Nations Conference on Trade and Development) *Information Economy Report 2007-2008* showed that in 2004, China overtook the United States as the world's leading producer and exporter of information and communication technologies (ICT) products. Meanwhile, India is the world's largest exporter of ICT services and the leading supplier in the processes subcontracting field. These countries have many talented academics and aspiring entrepreneurs, who want to form partnerships with multinationals in order to develop and launch innovative technological solutions meeting socio-economic needs.

Other countries, such as Thailand, Malaysia and Singapore, are specializing in creating industries that complement the products produced in China and India. According to the report, the value of South-South trade in ICT products exceeded that of South-North trade in 2004.

However, in general, apart from the countries mentioned above, many emerging economies are still on the fringes of this sector. Faced with an imminent lack of highly skilled researchers, the Taiwanese Government last year invested more than 200 million dollars to attract expatriates living in Silicon Valley to train graduates in corporate R&D.[221] This measure highlights the increasing im-

[217] *El auge de las multinacionales de mercados emergentes,* Accenture (2008).

[218] «Brazil's Petrobras plans hiring spree; Up to 14.000 people needed after huge find», *Calgary Herald* (8/05/2008).

[219] «Eastern European Growth is Tempting Its Workers Home», *The Guardian* (8/11/2007).

[220] http://www.co.terra.com/tecnologia/interna/0,,OI2364018-EI4130,00.html.

[221] «Taiwan's tech sector bent on attracting talent», *Financial Times* (7/02/2008).

portance of technology and its relationship with talent in the creation of added value in manufacturing processes.

The most important factor in terms of support for technology in talent management is that, except for some Asian countries such as South Korea or Singapore, the level of technology use in developing economies is far below that of developed countries. The high level of production in countries such as China or India is not matched by their use or consumption of ICTs.

Some businesses are trying to change this situation. The Indian bank ICICI has formed an alliance with NIIT, a company providing IT training services, in order to establish the Institute of Finance, Banking and Insurance. This has led to the adoption of the latest techniques and technologies to improve employees' skills in the sector. In general, companies are using videoconferencing and online training as measures for cutting costs of face-to-face training and taking advantage of new technologies.[222] Falling costs of information and communication technologies have created an accessible market for training in emerging economies that can use the knowledge and experience of businesses in developed markets.

6.2. Human Capital in the Spanish Economy

Human capital is the new dynamo of contemporary capitalism. Where talent settles in the coming years will give the countries that succeed in attracting it a considerable advantage. Its influence on the new map of power is indisputable. At a time of transition toward a multipolar environment, which has been accelerated by the recession, positioning in this area will be vital for the future role of countries in the international arena.

For Spain, attracting talent is even more important, considering the low levels of productivity and competitiveness that characterize its production model. As well as these factors, there is also the increasing aging of the Spanish population, which could lead to a talent deficit in the future. In order to overcome the lack of talent, combining a strategy for the development and retaining of internal talent with one for attracting international talent is therefore crucial.

As regards the development of domestic talent, Spanish investment in the generation of knowledge is the lowest in the group of countries made up of the euro area and the United States (see Figure 65). Spanish public investment in education, which equates to 4.3% of GDP, is significantly lower than the OECD average of 5.4%. Spending on education in Spain has increased at a slower rate than the GDP since 1995, meaning that the difference between the OECD and Spain has increased from 0.7 points to 1.1 (according to the 2006 figures).[223]

[222] «Corporate training in India goes high tech», *BusinessWeek* (26/09/2008).

[223] *50 propuestas para mejorar la productividad española,* Instituto de la Empresa Familiar.

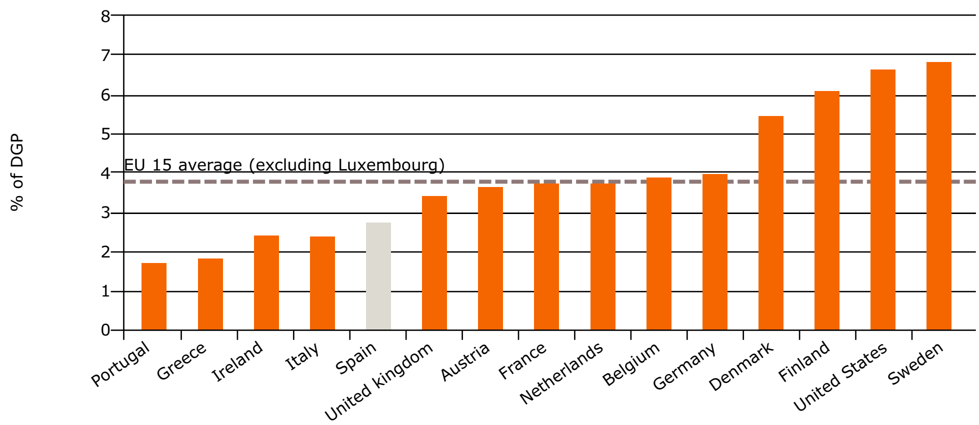


Figure 65. Investment in knowledge in the EU-15 (except Luxembourg): comparison with the United States in 2002.
Source: *Skills for the future,* Accenture.

According to José Manuel Casado, the Senior Partner in Talent and Organization Performance at Accenture Spain, education is the main factor in the competitiveness of nations, companies and individuals. He feels that many changes, revisions and reinventions are about adapting to changes taking place in other areas, and yet what makes up the country's DNA—i.e., the Spanish school and educational system—is still based on obsolete and outdated principles. He is convinced that the battle between countries will be a battle between educational systems. He believes the problem with the Spanish education system is that, "in general, what it creates is more of the same: people and managers with a great deal of analytical ability, who repeat, preserve and maintain what exists, and very few people willing to change the status quo."[224] In view of this situation, he calls for an overhaul of the education system. Meanwhile, Spanish entrepreneurs believe that university education does not meet their needs.[225] In their opinion, the relationship between the two areas has not been as close as it should have been for decades.

These shortcomings will theoretically be improved with the implementation of the Bologna Plan in the Spanish universities. The ultimate objective of this plan is to improve the quality of higher education, adapt it to business needs, and foster research. One of its aims is to achieve greater involvement by businesses in university life, and to encourage internships. Its goal is to create an education system with common foundations at a European level, which is flexible and focused on continuing education and the acquisition of skills using study formulas based on teamwork and research. It is an opportunity for university students to complete their studies in various European countries, learn languages and come into contact with people from different cultures. Despite the controversy in Spain surrounding the convergence of university education at a

[224] http://www.toptenms.com/Archivos/Descargas/Reeducación.pdf.

[225] *50 propuestas para mejorar la productividad española,* Instituto de la Empresa Familiar.

European level, it is undoubtedly necessary to rethink Spanish education in order to take up a position in the new multipolar order.[226]

An additional factor is that in Spain, unlike the world's more advanced countries, technical training is subject to chronic disdain, which makes it an unattractive option within the education system. International experience shows that not even the country with the best university system in the world can be competitive without high-quality technical training. In order to change this situation, entrepreneurs suggest "establishing policies that promote this educational discipline as a valid option when the family decides what path their children's education is to take. This objective will not be met if the right budget provisions are not made."

Paradoxically, Spain has the highest proportion of both university graduates among young people and early dropouts among the countries with which it wants to compete.[227] In recent years, many young people have left the education system as a result of the opportunities in the construction sector, which required no prior training. The crisis and the end of the real estate bubble have had a devastating effect on this sector's very high employment rate. For this reason, it is necessary to design active policies that provide employment mobility for people who are mostly in jobs with minimal qualifications. Young people can return to the education system, but for those who are older, the problem is more acute due to the lack of continuous education among this group.

At the same time, the aging of the population means that in order for the economy to remain competitive, older people must remain economically active. However, as shown in Figure 66, the rate of continuous education in Spain is low. The business sector and the Government must work together to change this

[226] http://es.wikipedia.org/wiki/Plan_Bolonia.

[227] «Sobre crisis, retrasos y reforma laboral», Florentino Felgueroso and Sergi Jiménez, *El País* (22/02/2009).

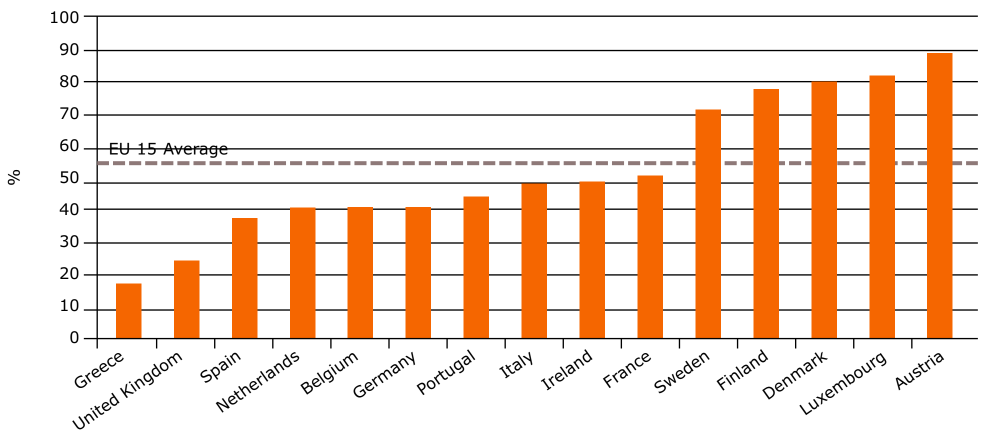


Figure 66. Continuous education in the EU-15.

situation. The ideal solution is to design flexible training programs (e-learning, etc.) that adapt to the lifestyle of these groups.

The crisis will have a negative effect on the accumulated talent among older people. As on other occasions, the likelihood is that the crisis will be used as an excuse for large-scale redundancies by means of early retirement (usually involving a phase of unemployment), which are often designed to guarantee this group's income, albeit at the expense of them permanently losing their jobs. An article by Florentino Felgueroso and Sergi Jiménez in *El País* suggests that "in an era in which aging predominates, there are many reforms of the benefits or pensions system, or both, which would constitute a means of preserving that valuable asset, such as separating the payment of pensions from the decision to leave the job market. This would not only enable the income of the workers shed to be guaranteed, but furthermore, as the situation improves, it would enable them to accept jobs again, perhaps on a part-time basis."[228]

The effect of the flight of talent on Spain's competitiveness should also be taken into account. Among the figures that highlight this phenomenon are the United States census, which shows that the percentage of Spaniards holding PhDs living there doubled in the 1980s. Today, Spanish citizens are among the nationalities that apply to the United States for the most visas for highly qualified professionals.[229]

To date, Spain has not been an appealing destination in terms of attracting international talent. Its universities are not among those in most demand by foreign students: According to the ranking of the world's top 500 universities produced by the Shanghai Jiao Tong University Institute of Higher Education, the highest-ranked Spanish school was 170th.[230] Private business schools have a better reputation, and are among the highest rated internationally.[231]

According to figures from the *3rd Immigration in Spain Yearbook*, 100,000 immigrants will be needed each year until 2012 to occupy skilled jobs, especially in the health and engineering fields and in technological sectors such as the Internet, although migration levels will fall to less than half within three years due to the economic situation. The study shows that at least 430,000 skilled workers will be necessary to maintain the economy's competitiveness in the coming years.

As well as the problem of attracting international talent, there is the fact that immigrants who decide to go live in Spain end up holding jobs for which they are academically and professionally overqualified. A recent OECD ranking highlighted that Spain is in a leading position in terms of immigrant underemployment. Forty-three percent of the foreign working population are in jobs for which they are overqualified, while in Europe this figure is between 20% and 25%. The standardization of all the European education systems, and not only the university system, will enable immigrants with various levels of training to be hired to meet technical and professional needs. Underemployment of

[228] «Sobre crisis, retrasos y reforma laboral», Florentino Felgueroso and Sergi Jiménez, *El País* (22/02/2009).

[229] *España y la nueva arquitectura económica y financiera internacional,* Fundación de Estudios Financieros.

[230] http://ed.sjtu.edu.cn/rank/2007/ARWU2007TOP500list.htm.

[231] http://www.economist.com/markets/rankings/displaystory.cfm?story_id=12328207.

Spanish professionals is also high, at 24.2%, or almost half the rate among immigrants. This gap is a missed opportunity to improve the Spanish economy's competitiveness. In short, the full potential of Spanish and foreign talent is not being exploited.

The OECD believes that Spain still has a long way to go in employing its people, both Spaniards and immigrants, in jobs for which they are qualified. It recommends reducing temporary employment and promoting professional mobility among Spanish professionals, which is currently very low. Both factors have led to an increase in "overqualification" in jobs. According to a study by the economist José García Montalvo, workers between the ages of 16 and 30 are 50% more likely to have jobs for which they are overqualified if they live with their parents, and are twice as likely to have a temporary contract.

Another important aspect is that the salaries established in most wage agreements are based on professional categories rather than levels of training, which increases "overqualification." If the wage costs of a university graduate or a person with technical training are the same when they work as an administrative assistant, there will always be a preference for university graduates, to the detriment of those with technical training.

Many studies have shown the impact of the lack of labor mobility on Spanish companies' competitiveness. This is due to cultural factors and the nature of the real estate market, in which rentals are an infrequent choice. So far, it has not affected the development of most companies, as they operate within Spain, but this lack of mobility may be become a burden as the level of internationalization increases. However, no government has implemented policies to increase it. Quite the opposite, as the law prohibits immigrant workers from moving to production centers located in towns other than where their work permits are issued.[232] This resistance to moving home is decreasing due to the crisis. A study by InfoJobs showed that 70% of candidates were willing to move home under the right conditions.[233] It remains to be seen whether this increase in mobility is a temporary or permanent feature of Spanish society.

Meanwhile, businesses complain of a lack of policies that promote the attraction and retention of foreign talent, and propose some measures, such as: "Identifying a list of the world's best business schools, as occurs in more advanced EU countries, and allowing anyone who can prove that they hold one of those qualifications to work in Spain without having to go through the complex bureaucratic procedures that other foreigners normally have to undergo."[234]

They also have misgivings about the fact that Spanish executives who have to work abroad, or those that come from abroad to work in a Spanish company, have to make pension contributions twice (in both countries), which may prevent talent from being attracted. In this case, the solution would involve establishing agreements with other countries to prevent double contributions.

[232] *50 propuestas para mejorar la productividad española,* Instituto de la Empresa Familiar.

[233] http://www.elmundo.es/mundodinero/2009/02/11/economia/1234348378.html.

[234] *50 propuestas para mejorar la productividad española,* Instituto de la Empresa Familiar.

The business and academic sectors are calling for government-implemented incentives for the attraction of international talent. Diego Sanchez de Leon, Head of Talent and Organization at Accenture, said in an interview: "Either you compete on your own initiative to attract skilled immigrants as a country, or you end up having to compete anyway, but you start late and reluctantly."[235]

Another factor restricting the employment of international talent is salary levels, which are lower than in other developed countries. Of the countries analyzed by the Bank of Spain's Studies Service, Germany and Spain have undergone the biggest decline in salaries in recent years. According to the Bank of Spain, technological changes have led to a smaller workforce being required. At the same time, the services sector, where in general the influence of salaries on the end product is lower, has increased in importance in the Spanish and European economy. Recent employment reforms—in Spain and in Europe—have also contributed to making labor cheaper, as have other factors such as immigration (with salaries that are generally lower than those of Spanish workers).

Some experts feel that another of the reasons behind the less competitive salaries is the lack of flexibility in the labor market, which does not fluctuate in accordance with the laws of the market, as it does in countries like the United States. For the Spanish economy as a whole, the labor market is a factor that is a competitive disadvantage internationally when doing business, according to the World Economic Forum.[236] This could be a problem when trying to attract foreign companies and encouraging them to establish themselves in Spain instead of in other countries where the conditions for doing business and therefore for offshoring are better. Difficulties with recruitment and dismissal, the high cost of the latter and a lack of flexibility in the labor market are some of the problems in Spain (see Figure 67).

[235] http://www.accenture.com/NR/rdonlyres/CC1A8AFF-1B5A-4988-AC0D-D41F685EE214/0/08Universia.pdf.

[236] *The Global Competitiveness Report 2008-2009,* World Economic Forum.

Did you know?

One of every three Spanish secondary-school students leaves school with no qualifications, double than the European average.[237]

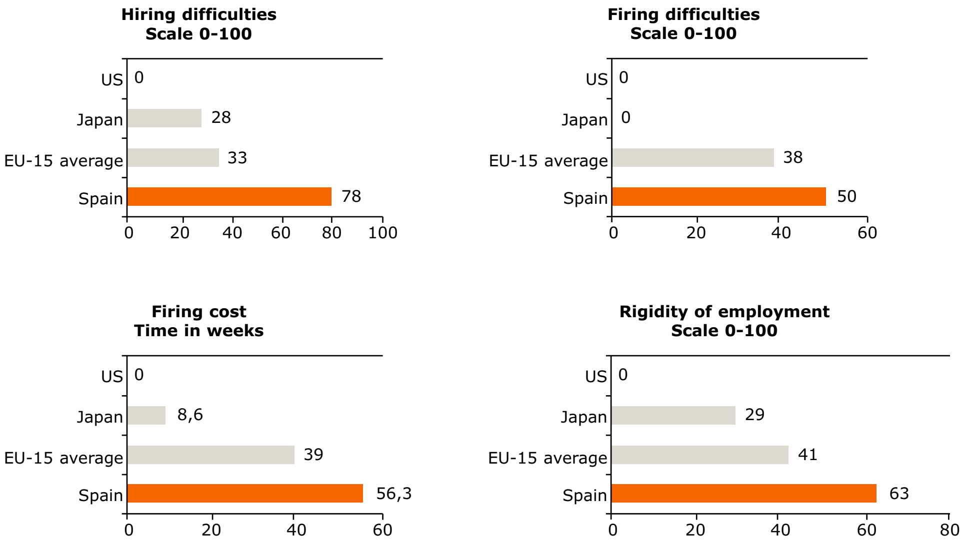


Figure 67. Main barriers to employment in Spain.
Source: http://blogs.cincodias.com/inversion/2007/05/la_flexibilidad.html.

The lack of flexibility in the job market reduces the Spanish economy's ability to react in times of crisis. The measure most frequently adopted by companies is to lay off temporary workers. Miguel Ángel Fernández Ordóñez, Governor of the Bank of Spain, said in his opening speech to seminars organized by the Federation of Savings Bank Users, that "the Spanish economy's mechanisms for the redeployment of labor do not work properly, as they encourage unemployment and have damaging effects on productivity." He also believes that contrary to what might be expected, "the current system does not protect workers, but instead is detrimental to them."[238]

José Luis Leal, former Minister of economics and a Future Trends Forum expert, analyzed the relationship between job insecurity and low levels of training, and as a consequence, Spain's low levels of competitiveness. "The decline in employment has to do with deeper and more complex roots: competitiveness; if we want to overcome the crisis, we must consider the worker's training in its broadest sense. The countries that are coming out of the crisis, or dealing with it well, have much higher levels of training than we do, and that is because job insecurity is a barrier to technical training. We must think not only about overcoming the recession, but about what our position in the world will be once the crisis is over. And it is impossible for us to continue to believe that we must carry on building more homes."[239]

In short, fostering the creation, retention and attraction of talent in Spain requires effective cooperation between the Government, the business community, the education system and society in general. The progress made in recent

[237] http://www.expansion.com/2009/04/15/economia-politica/1239807308.html.

[238] http://www.telemadrid.com/contenidos/html/elcirculo/pagina_joseluisleal.htm.

[239] William Chislett, Real Instituto Elcano.

decades has been outstanding, but it is insufficient if Spain's aim is to compete successfully in the new multipolar world.

6.3. Strategies for Spanish Companies in Managing World Talent

The President of Accenture Spain, Vicente Moreno, maintains that the talent shortage is possibly one of the greatest challenges facing Spanish companies, because "Spain runs the risk of becoming isolated in this multipolar world." For this reason, he recommends that improvements in R&D be implemented, links established with Public Authorities, investments made in innovation and research, and the completion of high school education encouraged. He points out that the country "is well positioned to make progress in industries such as renewable energies."

The need to change the Spanish productive model by placing greater emphasis on innovation affects Spanish companies directly. This pressing requirement answers all doubts about the need to invest in talent in the current climate. Many experts believe that promoting innovation will be the gateway that will allow Spanish companies to join the new wave of growth when it does occur.

In fact, 87% of Spanish top executives are in some agreement or a great deal of agreement that the administration of human capital and the proper management of talent represent a strategic priority. Teamwork, knowledge management and the improvement of synergies and interaction between the different departments of a company are key factors in enabling organizations to adapt with flexibility and intelligence to changes imposed on them by the markets.[240]

In this instance, the rules listed are a response to measures that should be implemented as strategies for Spanish companies to improve their management of talent and to become highly profitable organizations.

Rule 1: "Carpe diem": Take Advantage of the Crisis

Many companies stop the recruitment process in times of crisis. Accenture is of the opinion that, while it is certainly necessary to ease up on recruitment when the economy is in trouble, if it is stopped completely this will halt the entry of the talent necessary for when business activity picks up again. During these periods it is essential for companies to adhere to recruitment planning processes (headcounting) to allow them to align their recruitment strategy with their business strategies. One approach is to draw up talent maps that mainly enable the monitoring of the availability of talent worldwide. This will lead to a better understanding of changes in the global talent map, and will make it possible to take advantage of any surplus of qualified talent caused by the crisis that, in times of economic growth, would have been very difficult or expensive to recruit.[241]

[240] http://www.wharton.universia.net/index.cfm?fa=viewArticle&ID=1597.

[241] *Managing Talent in Uncertain Times,* Accenture.

Leadmans, a consultancy group specialized in leadership management, has analyzed the situation facing companies recruiting top executives in times of crisis; they advise them to take advantage of the situation by headhunting good professionals who are freed up as a result of the economic situation.[242] The current climate provides an attractive opportunity to take experienced executives on to the team at a reasonable cost and who will also be available quickly, unlike what usually happens when signing on top executives during boom times. This period can thus be turned into the perfect opportunity to take on executive talent in line with the company's longer-term business strategy and increase its innovative capacity, which is of such importance in improving its positioning in times of crisis.

It is also is true that at the moment executives are more reluctant to change companies. They opt for making their jobs secure in preference to the risk entailed by a change in times of upheaval. The rules of the game have therefore inevitably changed and companies now need to draw up their projects in much greater detail. In this way, they can present a more complete and attractive offer to the candidate that will specify the company's positioning and objectives, its strategies and the actual job that the candidate will hold, with both salary terms and prospects for advancement, guarantees for the future, etc.

Another formula used in times of economic turbulence entails assessing the value of the company's internal candidates. The best executive does not always come from outside; very often they can be found in-house. In this respect, it is essential to have effective methods for comparing staff performance in order to pick out the best.

Rule 2: Get Prepared to Succeed in the Competition for Talent

Despite the Spanish economy currently suffering from a diminished demand for talent, it should not be forgotten that other factors—such as the globalization of the labor market, the aging of the population and the shortage of talent—will continue to have an impact on companies when the situation improves.

When this happens, the demand for talent in Spain will continue to grow. According to data published in Accenture's *La Empresa Española en el Mundo Multipolar* [The Spanish Company in the Multipolar World], employment in knowledge-intensive sectors has increased 70% over the last decade, compared with a 42% increase in other sectors. Nevertheless, forecasts suggest that the supply of highly qualified new Spanish professionals will fall 4% over the next few years. How should the country, and Spanish companies, deal with the growing gap between talent demand and supply?

Given that the competition for talent will extend worldwide, new strategies will be needed for placing Spanish companies in a position to attract and retain national and international talent. This will not be an easy task since, as previously discussed, there is a diminishing supply of highly qualified professionals in Spain.

[242] http://www.aprendemas.com/Noticias/DetalleNoticia.asp?Noticia=4270.

Moreover, the immigrant population, which might serve as a major source of human capital, is not providing a sufficient number of qualified workers to satisfy current demand.

So what can Spanish companies do to attract and keep talent? Simon L. Dolan,[243] professor at the ESADE business school, believes that the first thing to do is identify the human capital inside the company that is of strategic significance, because it will be these people who must be held in. Attracting and retaining such personnel is achieved by offering labor conditions that are competitive in terms of personal and salary aspirations. In order to deal with the future shortage of talent, it will be necessary to mine every source of highly qualified professionals; human resources departments will have to get used to seeking out new talent in every corner of the world.

Likewise, they will be forced to ensure that their offers meet the needs and aspirations of various ethnic groups and nationalities, women and older employees. Furthermore, a different culture must be evolved. The task of each executive is to ensure that the people in his or her team are motivated and enthusiastic.[244] In addition to sound human resource practices, it must be ensured that the intangibles (for example, people's values) are properly in line with the company's mission and business vision.

It is necessary to find out what the motivations of candidates are and work to improve the conditions of Spanish companies in this area. According to a recent study carried out by the consulting firm Hay Group, the main reasons for attracting talent in Spanish companies are: professional development (20%), leadership in the sector (14%), and innovation (13%), superseding other factors that had traditionally been considered as decisive, such as salary (7%).[245]

From the point of view of the senior management of Spanish companies, the data indicate that six out of every ten executives at that level feel that the recruitment, motivation and the development of employees must be improved. Senior managers hope that this task can be led by the human resources departments, an approach that is quite unusual in those cases where they do not benefit from the trust of top management.[246]

Rule 3: Recognize the Strategic Importance of Human Resources

The effort made by Spanish companies to incorporate these new guidelines into the management of human resources has been considerable, but there is still a long way to go. A late start was made and building an awareness that human capital is a competitiveness factor, and as such must be managed, entails making changes in management methods.[247]

The importance of people in organizations (both as regards organizational behavior and the labor market) has converted the role of human resources into

[243] http://www.wharton.universia.net/index.cfm?fa=viewArticle&ID=1597.

[244] http://www.wharton.universia.net/index.cfm?fa=viewArticle&ID=1597.

[245] http://www.wharton.universia.net/index.cfm?fa=viewArticle&ID=1597.

[246] http://www.wharton.universia.net/index.cfm?fa=viewArticle&ID=1597.

[247] http://www.wharton.universia.net/index.cfm?fa=viewArticle&ID=1597.

the corporate gearbox, capable of ensuring that all processes are mutually coordinated along the different time scales: long-term, through the formulation of objectives and corporate strategies; medium-term, through the planning and design of management processes; and short-term, by taking charge of the implementation and monitoring of specific plans and processes.[248]

Miguel Sanz, General Manager of Human Resources for Banesto, defines the philosophy of this department as follows: "To contribute to achieving business profit by treating people as a goal, and managing our commitment on the basis of mutual trust between the bank and the employee, and between the employee and the bank." To achieve this, Banesto launched a project that internally went by the name *Guggenheim*, to symbolize the state of the art in human resources and the innovation that was built into this ambitious renewal project, unprecedented in Spanish banking. Banesto's intention is for its Guggenheim project to have the same effect on its bank that the arrival of the namesake museum had on the city of Bilbao: a before and an after. José Manuel Casado elaborated on the nature of this project in an article on talent management: "Nevertheless, it should also be pointed out that this is not a human resources department project; I don't even consider it to be a project, but rather a philosophy and a strategic undertaking to which top management has made a commitment, since it is convinced that the commitment of its professionals is the key in enabling Banesto to 'make the leap forward' so that it can become one of the foremost banks in Europe."[249]

It is surprising to find that there are Spanish business sectors (albeit a minority) where the human resources manager is not a member of the management committee (see Figure 68).

[248] http://membersbenchmarking.ie.edu/wp-content/uploads/2008/04/separata-estrategiarrhh.pdf.

[249] «El imperio del talento: los TATA», José Manuel Casado, *Harvard Deusto Business Review* (February 2008).

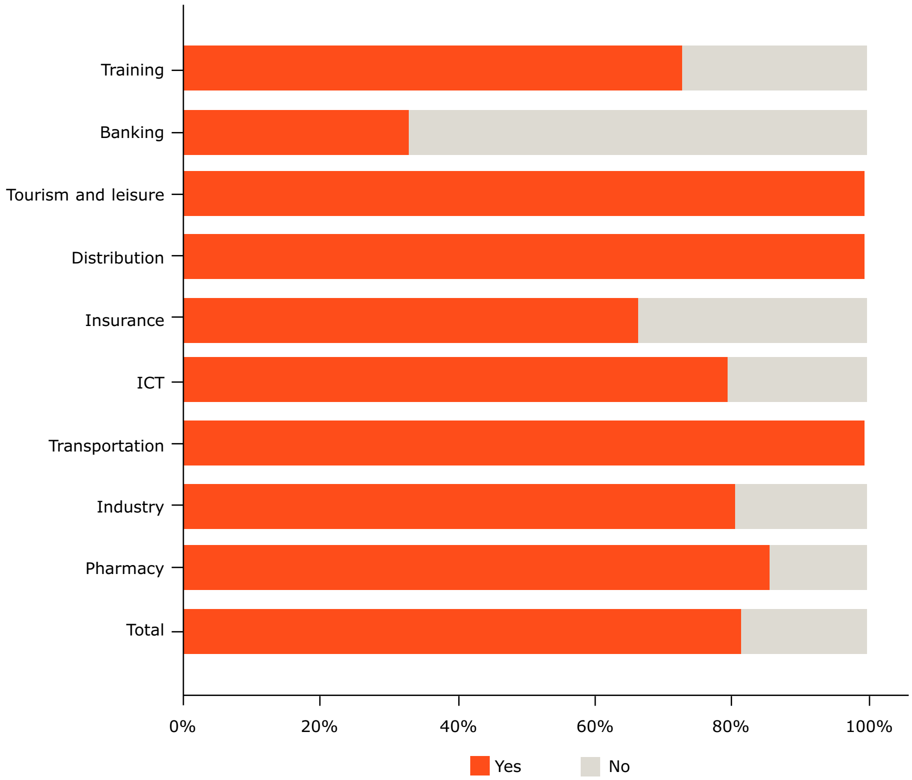


Figure 68. Participation of the HR manager in the management committee
Source: «Estrategia de RR.HH.», *Apuntes de Benchmarking,* no. 8, 2007, Instituto de Empresa.

In an article by Accenture, it is shown that less than 30% of performance in the workplace is related to knowledge or skills. The other 70% stems from the influence of informal learning and other factors in the working environment: feedback, coaching, leadership, incentives, targets and clear work processes, etc.[250] It is for this reason that the task of the human resources department as the instigator of this kind of project is fundamental for properly managing the talent inside organizations and achieving a competitive advantage.

Talent is one of the cornerstones of sustainability for Spanish companies and must therefore be treated as a strategic element. Companies must implement corporate human resources strategies that respond to the importance of talent management with an international approach, as well as being properly in line with the company's mission and business vision.

Some Spanish companies are aware of this and are already putting such plans into action. Telefónica, for example, besides its corporate university, has a talent-management division. Likewise, other Spanish cases, such as those of BBVA and

[250] *Transformar el talento en alto rendimiento por medio de la especialización,* Accenture (2008).

Morgan Stanley—described by their respective human resources managers, Juan Ignacio Apoita and Javier Blanco, in the book *Gestores del Talento [Talent Managers]*—, are excellent examples of how Spanish companies are handling talent management.[251]

In Spain, companies still need to view their human resources policy as a competitiveness factor that will allow them to attract and retain talent more effectively than other companies. They still need to develop the full potential of practices such as defining selection processes, training programs, remuneration policies, performance evaluation and job descriptions, to name but a few, without taking into account the cost of a bad hire.

Rule 4: Be Proactive, Create Talent

Talent is created by promoting training within the company, encouraging the interaction between professionals so that knowledge can be shared, stimulating enterprising activities, building up commitment within the organization and, of course, by means of a well-designed training program. Furthermore, in order for this talent to remain alive and active, a culture of competitiveness and innovation must be fostered.[252]

Technological advances can play their part in all the points of action mentioned above thus helping to create talent within the company. The new information and communication technologies are undergoing constant change and companies must adapt efficiently to the challenge of incorporating the new trends in this area. One of these new trends is Web 2.0, which permits new channels of collaboration to be incorporated that make it possible for staff to take part in global networks. The fact that the users can create their own content and participate actively is a double-edged sword. On one side, a large amount of information is available from different sources throughout the world. On the other, they are faced with "the challenge of separating the wheat from the chaff."[253] As discussed in the article "Web 2.0, un reto para la educación" [Web 2.0: a Challenge for Education], training centers are making use of the learning tools offered by the Net: master classes and tutorials via videoconference or webcam, the YouTube channel, teacher and student blogs, and social networks such as Facebook and LinkedIn.

As regards training content, Spanish companies are dedicating more and more resources to skills training. A study undertaken by the training and development consultancy Más Talento, with the collaboration of *Capital Humano*, indicates that Spanish companies view the five most important skills as being: leadership and team management; teamwork; communication, creativity and innovation; customer orientation and change management (see Figure 69). Significant changes are being noted in the order of importance for the next three years in comparison with the current year. Although leadership and team management will continue to occupy the same position, being cited by 68% of interviewees

[251] «El imperio del talento: los TATA», José Manuel Casado, *Harvard Deusto Business Review* (February 2008).

[252] http://www.wharton.universia.net/index.cfm?fa=viewArticle&ID=1597.

[253] «Web 2.0, un reto para la educación», *El Mundo* (29/03/2009).

(down from 92%), creativity and innovation and change management will gain ground over other management skills. This last detail shows that companies are aware that they must prepare in-house talent for the important changes that the future will offer and that they must create a culture of innovation if they wish to achieve a competitive advantage.[254]

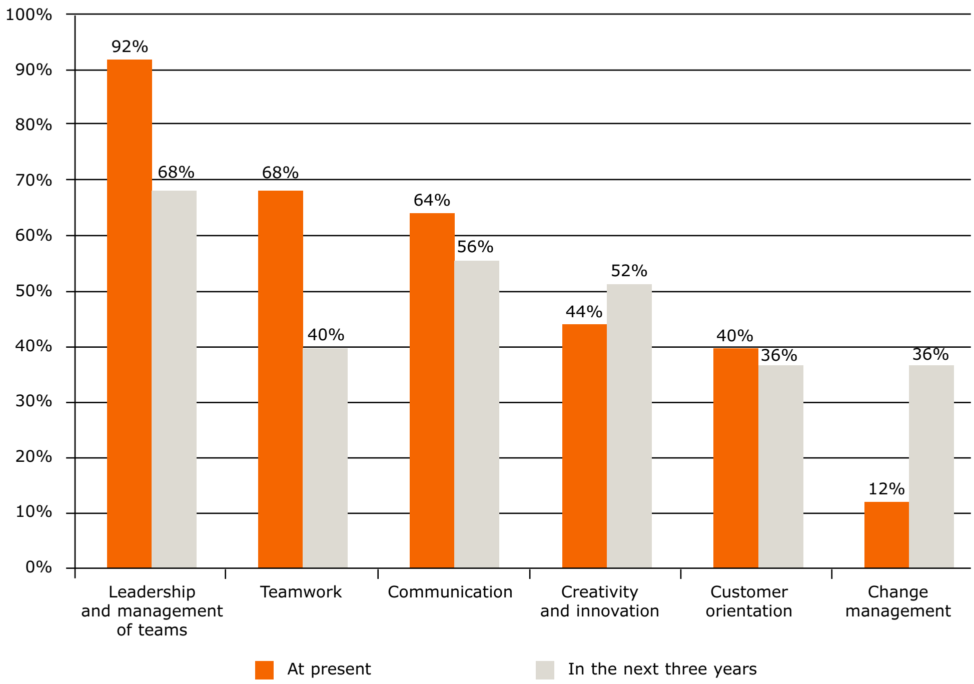


Figure 69. the five most important skills: comparison between present and future.
Source: Más Talento, 2008.

The same study highlights the fact that more than 75% of the companies surveyed, all of which are listed on the IBEX 35, allocate a considerable portion of their budget to skills training for their employees. In other words, the IBEX 35 companies invest in the development of human talent.[255] The problem is that, in many cases, the budget is being affected by contingencies such as current restrictions due to the international crisis.

Spanish companies are investing in innovative training programs: the Telefónica Group invests a considerable proportion of its capital every year in the development and implementation of online training for its workforce; similarly, the Banco Santander has set up a virtual channel for professional development; IBM is pioneering a classroom and online training program for all employees, offering a range of courses to develop the abilities necessary to perform their job properly.

[254] http://www.capitalhumano.es/ver_pdf.asp?idArt=48300.

[255] «Presente y futuro de la formación en habilidades en las empresas del IBEX 35», *Capital Humano* (may 2008).

Unión Fenosa, Telefónica, BBVA, Accenture and Ferrovial are some of the companies that have made the commitment to form their own corporate university, a solution that enables them to design training programs in line with the strategic objectives of the company. The executives in charge of them assure that they are an effective tool for retaining talent.[256]

Languages are the Achilles' heel of Spain, and represent a glaring hindrance on their ability to gain a strong position on the global talent map. One of the reasons why foreign languages have failed to gain a foothold in the country can be attributed to the dubbing of films and television programs. Obligatory film dubbing was first instituted by Benito Mussolini in October 1930. This linguistic patriotism was copied by Hitler and later, in April 1941, by General Franco. Nevertheless, in other European regions (such as Scandinavia, the Netherlands, Switzerland, and the Slavonic countries) the public generally prefers subtitled films, which has evident repercussions on their level of English. According to the Spanish Sociological Research Center (CIS), just 27% of Spaniards consider themselves capable of expressing themselves in English, versus 89% of Swedes or 87% of Dutch. As companies become more international, Spanish employees have increasingly become obliged to use English and other languages in their job; for this reason, the learning of these languages has become more widespread and company-sponsored language learning programs are more and more common. Nevertheless, there is still a long way to go: 75% of Spanish companies are planning to set up business overseas, but only 44% offer courses to their employees to be able to communicate in English, according to the study undertaken by the United Kingdom Centre for English for the European Commission.[257] Rudimentary English is no longer enough to get by in the business world.

Rule 5: Create Talent "Hubs"

According to the entrepreneur Christopher Pommerening, partner and co-founder of Active Capital Partners, Barcelona has the ingredients enabling it to become the next entrepreneurial hub of Europe along with Silicon Valley, Boston and London. These focal points of talent owe a great part of their success to the proximity of good universities.[258]

Jaime Ferrer, Partner of Accenture and specialist in strategy, management and supply chain, believes that "we need more creative and original strategies to spread talent, to share it and seek it out wherever it can be found." For this executive, the example of certain emerging countries demonstrates that this is viable when companies create talent hubs, which was impossible before information technologies developed. "Today, leading companies are developing talent centers to cover their needs in each region or even worldwide, in fields such as finance, logistics, marketing, and research and development."[259]

A very strong trend toward global information hubs can be observed. The reason for this expansion is based on the fact that, because countries can be innovative

[256] http://www.expansionyempleo.com/2007/06/27/desarrollo_de_carrera/1010099.html.

[257] Notici@scadadía (09/04/2007).

[258] «Barcelona será el siguiente "hub" de emprendedores en Europa», *Expansión.com* (29-04-2008).

[259] http://management.infobaeprofesional.com/notas/66489-Que-hacen-las-multinacionales-de-mercados-emergentes-para-atraer-a-los-mas-talentosos.html?cookie.

in every sector, they are in competition and are investing large sums of money in the creation of specialized innovation centers to attract multinational companies, since not even the very largest can permit themselves the luxury of letting all their developments be made in-house, but instead have to outsource them.

Depending on the sector and the country, in some cases these hubs can be planned and official, while in other cases they have grown more spontaneously and have sprung up from the installation of a group of companies. India, for example, allocated public money to create hubs in the IT field, whereas Spain did so in biomedicine and solar technologies, like the renewable energy in Barcelona and its surrounding areas. In fact, considering its successful record in specific industries such as infrastructure, biotechnology, renewable energies and the tourism sector, these would be the best options for Spain. There are also some towns in Valencia, such as Elda, that are centers for the design and manufacture of women's shoes. It is a homegrown industry that for the most part originally started as family companies, now with three generations behind them, and that have produced shoes for brand names as well known as Lanvin and Yves Saint Laurent.[260]

Another Spanish project for the creation of talent hubs is "Málaga Valley,"[261] which aims to attract and retain talent for the city, as well as winning over companies and investments in R&D, with the aim of being a point of reference in European technology. This project, which has just started up and has demonstrated only 10% of its potential, can already claim the support of one hundred partners that belong to this club. It includes the presidents of the main Spanish and international companies in the digital and new technologies sector, including: César Alierta, President of Telefónica; Santiago Cortés of HP, Marieta del Rivero of Nokia, and Javier Rodríguez Zapatero of Google. It has already started achieving the goal of bringing Málaga into the most important area of technological excellence in Europe, with the support of Málaga City Hall and the University of Málaga, of the Technology Park of Andalucía, of the Advanced College of Telecommunications Engineers, and such important associations as ASIMELEC (the Spanish Multisector Association of Electronic Companies) and the Spanish Association of Internet Users.

[260] «Spain's shoe industry looks homeward», *International Herald Tribune* (8/10/2008).

[261] http://www.techweek.es/empresas/soluciones-negocio/1002884002701/atraer-talentos-convertirse-referente.1.html.

7

CHAPTER 7

The Challenge of Sustainable Development

7 The Challenge of Sustainable Development

Increasingly, sustainable development represents a fundamental challenge for companies and the public sector. The concept involves the pursuit of various ambitious aims: to constantly improve the quality of life of the world's inhabitants and of generations to come; to preserve Earth's ability to sustain life in all its forms; and to respect the law and basic rights. Equally, we seek to ensure solidarity between present-day inhabitants and future generations.[262]

In the new, multipolar order, emerging countries will gradually adopt the production and consumption models of the developed countries, which will increase the pressure on resources. Against this backdrop, the collaboration between the public and private sectors in facing up to such new tests as climate change, population growth, the protection of human rights and the depletion of resources, will in the future become essential. However important the advances designed to confront this new situation within each country, of no less significance will be the international cooperation between the different countries to resolve these worldwide problems.

The idea of sustainability may therefore be approached from three dimensions: social, economic and environmental (see Figure 70). These three aspects should be used to guarantee economic prosperity, ensure environmental protection, promote greater social cohesion and join in solidarity to contribute to the development of more unfortunate countries, with a view to building global sustainability.[263]

[262] http://www.la-moncloa.es/NR/rdonlyres/96270D48-C981-430E-8C19-352904495879/0/folleto_desarrollo_sost_DEF.pdf.

[263] *Estrategia Española de Desarrollo Sostenible,* Ministerio de la Presidencia.

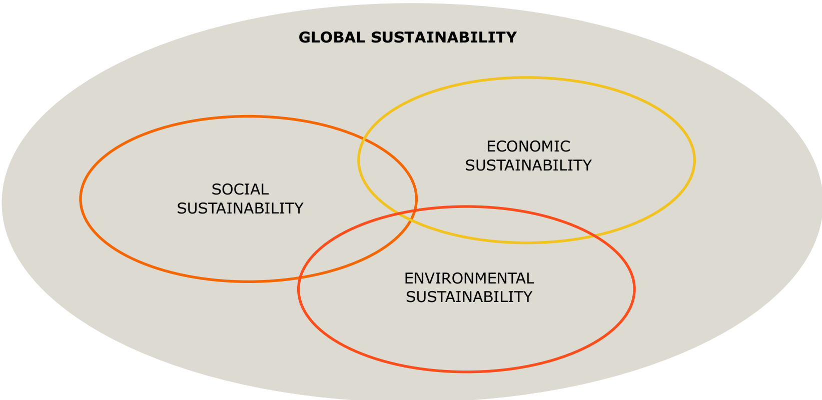


Figure 70. The different aspects of sustainability.
Source: *Estrategia Española de Desarrollo Sostenible,* Ministerio de la Presidencia.

The Difficulties of Sustainable Global Development

The growing concern with sustainable development has caused doubts to be raised regarding the viability of GDP as an indicator of social welfare*.* Economics Nobel Laureate Joseph E. Stiglitz declared in this regard: "…the current yardsticks [GDP] only reward governments if they increase materialistic production. […]. It doesn't measure changes in well-being, it doesn't measure comparisons of well-being across countries. The standard measures of GDP do not measure the degradation of the environment, the depreciation of natural resources."

These criticisms of the GDP as a yardstick have led to the proposal of alternative measures that factor in such aspects as negative externalities and the effect of economic activity on the environment. These measures would provide an indicator that is more inclusive and more directly related to social welfare. One of these alternatives would be the Index of Sustainable Economic Welfare (ISEW).

What is certainly true is that in recent years, the word "sustainability," although sometimes quite ill-defined, is recurrently mentioned in all the business and institutional forums. However, the crisis has caused people to question the foundations of the sustainability of the development achieved in recent years. Some analysts draw attention to the fact that over the past few years speculation has replaced the culture of effort, ethics and responsibility. Therefore, the commitment to future generations seems relegated to the background.

In fact, the economic crisis will test our real commitment to sustainable development. In an unfavorable economic climate, companies are forced to adopt what could be termed "survival" strategies and adapting them to the requirements of sustainability would entail additional cost. At the same time, governments will have to demonstrate their commitment and intervene if corporate efforts are not made to work toward sustainable development.

A recent article in *The Economist* discussed the test facing governments at the Copenhagen summit at the end of 2009, where they will have to renegotiate a post-Kyoto agreement on the reduction of greenhouse gases: "Already pressure is growing to avoid the growth-inhibiting restrictions needed to meet ambitious carbon-cutting targets. Failure to reach a deal will mean, in effect, that the world gives up seriously seeking to stop global warming. Instead, attention would turn to ways the world might adapt to climate change rather than prevent it."

The same article suggested that, "In 2009 *sustainability* will take on a new meaning in boardrooms: staying in business. As recession bites and growth slows, bankruptcies will soar. To sustain profits, companies will slash costs and cut jobs, while consumers will be even less prepared to pay extra for organic food or air-travel offsets."[264]

[264] «The year of unsustainability», *The Economist,* (19/11/08).

We will go on to examine in greater depth the current situation and future forecasts for the environmental and social aspects of development.

Environmental Sustainability

The sharp growth of the emerging economies is accompanied by the adoption of the production and consumption patterns of Western countries, distinguished by their high demand for natural resources. In addition, the increase in world population and the growing move into the cities both constitute factors that exacerbate this effect.

This has unleashed a worldwide struggle for natural resources, in particular energy and water, as well as an increase in emissions of carbon dioxide (CO_2), which contribute to climate change. Mark Foster, Accenture's Executive Director of Management Consulting and the Integrated Market, considers that the competitiveness of those countries playing a part on the multipolar stage will depend to a great degree on their net balance of natural resources: "If you have access to natural resources, you are in a strong position in the multipolar world, and if you don't, you are in a weak position and are trying to get hold of them."[265]

In the case of oil, the fact that the producing countries are frequently exposed to geopolitical risks (terrorism, war, corruption, organized crime, etc.), represents an additional risk for the developed countries with high degree of dependence on this resource (see Figure 71). These countries would therefore have a very strong motivation, quite apart from environmental reasons (reducing carbon emissions), to reduce their degree of dependence on such countries.

[265] «Multi-Polar World and Resources Impact», Accenture.

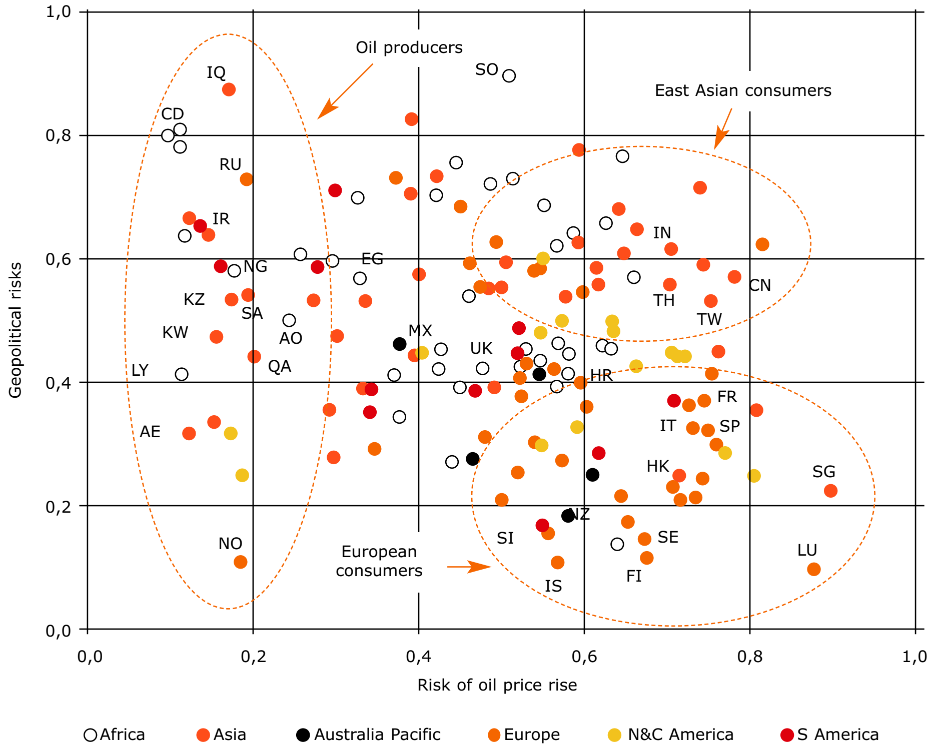


Figure 71. Geopolitical risks and oil dependence.
Source: Zurich Financial Services, 2008

The study *Global Trends 2025: A Transformed World* by the United States National Intelligence Council forecasts that concerns about resources on the international front will continue to grow. The study indicates that "economic growth—positive in so many other regards—will continue to put pressure on a number of highly strategic resources, including energy, food, and water, and demand is projected to outstrip easily available supplies over the next decade or so. For example, non-OPEC liquid hydrocarbon production—crude oil, natural gas liquids, and unconventionals such as tar sands—will not grow commensurate with demand. Oil and gas production of many traditional energy producers already is declining. Elsewhere—in China, India, and Mexico—production has flattened. [...] oil and gas production will be concentrated in unstable areas. As a result of this and other factors, the world will be in the midst of a fundamental energy transition away from oil toward natural gas, coal and other alternatives."

Other studies undertaken by various international organizations agree on a number of forecasts or trends in world energy for the future[266]:

- The first is that the global energy consumption will grow steadily, albeit with significant differences between the various regions of the world.

[266] *La energía en España 2007,* Secretaría General de la Energía.

- It is also estimated that the consumption of all primary sources will rise, but that fossil fuels will remain the most important resource, especially oil, because of its widespread use in the transport sector.

- Likewise, developed countries will increasingly rely on imports for their energy supply.

- It is believed that raising energy efficiency is an essential factor in achieving all other energy policy objectives.

- Another trend is that renewable energies are being viewed as a top priority in securing supply and achieving environmental targets. Many experts forecast that the proportion of this type of energy will increase in the mix of energy resources of developed countries.

- Lastly, there will also be a trend toward the use of clean technologies in the use of fossil fuels, since they are essential in meeting environmental targets.

With this outlook for the future, these organizations are presenting as priority energy targets the guarantee of sufficient supply to meet demand, the reduction of external dependence by diversifying sources, and the combating of climate change.

There are some experts who consider the economic crisis as an opportunity to make progress in this area and to design a new economic model that is environmentally sustainable. James Leape, Director General of the WWF (World Wildlife Fund), has declared: "Now that we have to rebuild the world economy, we have an enormous opportunity to create a new economic model based on economic as well as environmental sustainability." In his speech at the Davos summit in 2008, he warned that if the final solution chosen to emerge from the crisis is to rebuild the same economic model, we would be going up a blind alley by failing to overcome our heavy reliance on oil prices and not facing up to their repercussions on climate change.

The debate has also been reopened on the advisability of resorting to nuclear energy, which is seen as one of the means of achieving the highly desired self-sufficiency and the sustainability of domestic consumption. There are many critics that reject it on account of its danger and the contaminating effect of its waste. As an alternative to nuclear power, they propose sources of clean energy. Meanwhile, its advocates claim that it is a necessary—and more economical—choice, in order to stop the dependence on international supply. It is foreseeable that as the struggle for natural resources becomes more acute, this option will continue to gain supporters. A study undertaken by PricewaterhouseCoopers reveals that most experts and business leaders consulted consider that over the next five years the production of nuclear energy will increase.[267]

[267] http://kc3.pwc.es/local/es/kc3/PrensaR.nsf/V1001/DDECCCDAAD1502BCC125756600398206/$FILE/Consenso_primerQ_2009.pdf.

Did you know?

About 2.8 billion people, more than 40% of the world's population, live in water catchment areas with some sort of water shortage.[269]

As for other natural resources such as water, pressure on supply is also increasing. The cause lies in more intensive farming methods, growing industrialization, higher energy demand, residential development and growing consumption in emerging countries. In global terms, water consumption is divided as follows: 69% for agriculture, 23% for industry, and the remaining 8% for domestic consumption.[268] Hence, if moves are made to improve agricultural productivity in some countries then the consumption of water will be increased, unless efficient consumption techniques are employed. In any case, the struggle for water and fertile land will continue to increase in tandem with population growth. Countries such as Saudi Arabia and China have invested a great deal in infrastructure and agricultural productivity to gain access to fertile land in Kazakhstan and Mozambique, respectively.

Private companies are also starting to become involved in this area. Water has become yet another asset. Some US and Turkish companies have begun to use—or at least consider the possibility of designing—pipes for long-distance water transport to meet demand in areas of shortage. It is worth noting that certain hedge funds (also known as high-risk funds) have purchased rights on the glaciers in Scandinavia.

Among other risks, the shortage of water leads to an increase in food prices. These changes mainly affect the emerging countries, where spending on food represents 30%-40% of consumption, compared to 17% in the G7 countries.[270] The increase in basic food prices could have a devastating effect on people with low incomes, which would give rise to a risk situation in these countries, not only economic, but also political (see Figure 72).

[268] *Global Risk 2009,* The World Bank.

[269] http://www.un.org/spanish/millenniumgoals/pdf/MDG_Report_2008_SPANISH.pdf.

[270] *Global Risk 2009,* The World Bank.

Did you know?

It is likely that by the year 2050, 75% of the Alpine glaciers will have disappeared[271] and 80% of the Maldives will be submerged under the sea as a result of climate change.[272]

Node size: denotes severity.

Node colours: *yellow* – economics; ***orange*** – geopolitics and environmental; ***black*** – technology; ***dark orange***– society.

Lines: line thickness denotes the strenght of the interlinkage. The direction of a thicker line segment indicates when one risk is the stronger in the relationship.

Proximity: the map shows risks that are tightly interlinked to many other risks as closer to one another.

Figure 72. Water: at the center of many risks.
Source: World Economic Forum 2009.

The forecasts are not very optimistic: it is estimated that within 20 years, 36 countries with a population of over 1.4 billion will swell the current list of 21 that are suffering from a shortage of water and cultivable land.[273]

The shortage of resources and the struggle to obtain them will be aggravated by climate change, although the gravity of the repercussions will differ from region to region. The supply of water and agricultural production will be the resources that are most affected. The impact on countries whose economy is based on agriculture will be extremely negative. Paradoxically, the developed countries are mainly responsible for the current accumulation of greenhouse gases in the atmosphere and, at the same time, they are the ones that have the necessary financial and technological resources to reduce their emissions. Nevertheless, it is forecast that in 2020 the emissions of developing countries will exceed those of the developed nations. Therefore, the need is clear for a change in the focus

[271] http://ec.europa.eu/environment/climat/campaign/what/fightingcc_es.htm.

[272] http://www.laprensa.com.bo/noticias/16-03-09/16_03_09_mund2.php.

[273] Data provided by the World Bank.

Did you know?

Nearly one billion people still do not have access to drinking water.

of the Kyoto Protocol, whereby only the developed countries made undertakings to reduce emissions.

Social Sustainability

The social aspect of sustainable development not only responds to arguments for human justice, but can also be justified by the obvious relationship between environmental degradation and the production and consumption patterns of the developed countries, as well as their impact on developing countries.

The World Bank identifies three social aspects of development on which a basis can be established for more equal, productive and sustainable societies: empowerment, social inclusion, and the safety of peoples. The empowerment of nations would seek to increase their assets and capacities with the aim of improving the influential capacity of all people and social groups. As for social inclusion, this consists of eliminating institutional obstacles while promoting incentives that increase the access of different peoples to development opportunities. Lastly, guaranteeing safety is an essential part of guaranteeing social welfare.

In this context, the World Social Forum, from its first meeting in 2001, set itself up as the counterpoint to Davos. In 2009, a year in which all countries are being hit by the crisis, the antagonism has become more evident. At the conference, many argued for a search for alternative systems to that of capitalism. Others proposed the alternative of "socially responsible capitalism."

The journalist Juan Arias wrote in the newspaper *El País*[274] that "along with the quandary of what should be done about capitalism, another question is resounding loudly in the Forum of Belém: Where have world governments been hiding those billions of dollars that they are now pulling out of the hat to save the financial system and which they did not have available when it was a matter of investing in education or healthcare?"

The world financial crisis, in conjunction with the energy and food crises, will cause a reversal in our progress toward poverty reduction and achieving the Millennium Development Goals. The credit squeeze and the slowdown in growth will reduce public revenues, shrinking the investment capacity of governments in developing countries to attain their education, health, and human development targets. Unless effective social protection networks are set up, it will be the poor who suffer most from the crisis. It is calculated that about 125 million people in developing countries have slipped into conditions of extreme poverty as a consequence of the worldwide rise in the prices of foodstuffs from 2006 onwards. The lessons to be learned from the major financial crises emphasize the importance of safeguarding (public) investment in infrastructure and social development in order to avoid reversals in human development and achieve high-quality economic growth in the medium term.[275]

[274] «¿Qué hacemos con el capitalismo?», *El País* (27/01/2009).

[275] http://www.un.org/esa/policy/wess/wesp2009files/wesp09es_sp.pdf.

Did you know?

Approximately one quarter of the children in developing countries are underweight and run the risk of their future being compromised by the long-term effects of undernutrition.

7.1. Sustainable Global Companies

In the corporate sphere growing media, social and political pressure "to do things right" can be observed, even more so in light of the financial impact arising from the lack of regulation and the excessive level of risk taken on by entities. Individuals—whether acting as citizens, consumers, investors or employees—and regulators insist that companies must observe the social and environmental aspects of sustainability. Companies, for their part, must imprint sustainability onto their DNA, by means of complementing their strategy with a corporate social responsibility (CSR) program.

For Michael Porter and Mark Kramer,[276] CSR may even constitute part of a company's competitive advantage if it is implemented at the heart of every operation. Nevertheless, experts such as Christine Arena, former Managing Director of Poense Clancy, a Boston-based communications company, are not of the same opinion. Arena believes that as soon as the majority of companies begin to invest in CSR to stand out from their competitors, this advantage will be lost. She considers that, over and above competitive differentiation, one of the chief secondary effects of CSR policies is innovation, because the companies that make that commitment produce high-quality products, services, business models and operational innovations and thus ensure a lasting competitive advantage.[277] Ford Motor Company, on the heels of a workplace accident, decided to transform one of its factories into a "model of 21st-century sustainable manufacturing." The factory was redesigned with plant-covered roofs considered ecological because they absorb storm-water runoff, filter emissions and insulate the structures from thermal shock and UV degradation.

However, many argue that CSR has become "fashionable" in a period of worldwide economic prosperity and that high corporate profits have encouraged practices of solidarity and policies of social responsibility. But will these companies still be just as "responsible" when profits are reduced?

The experts on this subject say that the answer varies depending on each company. According to Antoni Ballabriga, Director of Corporate Responsibility and Reputation for the BBVA, "when you have a CSR strategy that is not properly in line with your business, the first thing that the shareholders will ask you (in a period of crisis) is that you start making savings in that department." Therefore, he adds, "I would say that real CSR is one that survives in hard times."[278]

Most of the experts of the Future Trends Forum believe that the financial crisis will increase the degree of CSR, in part because sustainability and "good governance" will be key requirements demanded by shareholders (see Figure 73).

[276] «Strategy and Society: The Link Between Competitive Advantage and Corporate Social Responsibility», *Harvard Business Review* (December 2006).

[277] *The High Purpose Company*, Christine Arena.

[278] http://www.noticias.com/reportaje/crisis-identificara-empresas-verdaderamente-responsables-5d6.html.

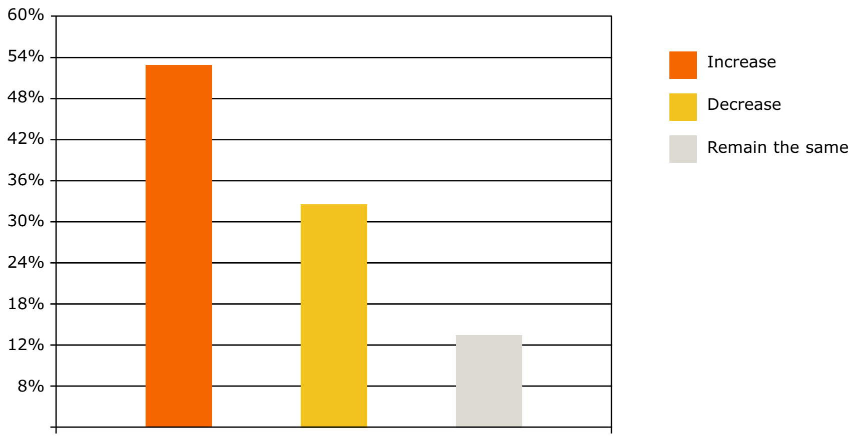


Figure 73. What impact will the financial crisis have on the concern for corporate social responsibility?
Source: Drawn from the conclusions within the Future Trends Forum.

Nevertheless, the main justification is that companies have an increasingly clear perception of the relationship between economic sustainability and CSR. Peter Lacy, Accenture's Managing Partner for Sustainability for Europe and Latin America, emphasizes the need to make an investment in sustainability in spite of the current economic slowdown, "as it brings certain intangible assets whose value is hard to calculate."[279] According to a study produced by the consulting firm, the aspects affecting companies' sustainability strategy may be divided into three dynamic groups: those relating to supply, demand and regulations (see Figure 74). The study also reveals that sustainability practices and high corporate performance are entirely compatible.

[279] http://www.europapress.es/epsocial/rsc/noticia-accenture-defiende-ventajas-competitivas-sostenibilidad-ya-conlleva-creacion-valor-20090130111959.html.

Figure 74. Sustainability's Business Drivers
Source: *Compatible Aims: Sustainability and High Performance,* Accenture (2009).

A company may implement strategic changes on various fronts in order to make a commitment to sustainability. In the next section we will examine these measures, firstly from the point of view of companies in developed countries, followed by those of emerging economies.

Sustainable Companies in Developed Countries

More than a decade ago, John Elkington suggested that *cash capital* (profits), *natural capital* (the planet), and *social capital* (people) made up the *triple bottom line* for 21st-century businesses. This refers to the results of a company measured in economic, environmental and social terms. This indicator enables the success of a company to be measured based on these three aspects. Any company that demonstrates that it has a strong *triple bottom line* will not only be profitable, but is also socially responsible.

The easiest way to explain the concept is to imagine a tripod: one leg is the economic aspect, which involves maximizing long-term financial profits. The second leg is the environmental aspect, which not only requires that the impact of the company's operations and products on the environment be minimized, but which goes beyond this to create added environmental value by repairing the damage that has been caused in the past. The third leg is the social aspect, which in turn has two facets: the internal, which relates to promoting the welfare and quality of life of the company's employees, and the external facet, which relates to making a contribution to the welfare of the communities and countries in which the company is active. In order for the tripod to work, all three legs must function correctly.[280]

This new concept changes the focus of corporate responsibility from the companies to the groups of interested parties (stakeholders) rather than the shareholders, "interested party" meaning any person affected directly or indirectly by the company's actions. As for the shareholders, they are becoming increasingly committed to closely monitoring the financial return of leading companies in sustainable development, as demonstrated by the creation of indices such as the *Dow Jones Sustainability Index* (DJSI) in 1999.

Therefore, CSR is now viewed as being something far more than traditional philanthropy. It offers stability and prosperity for the markets in which the companies operate and reduces its bottom-line environmental impact, that is, the difference between the negative impact of its operations and the positive impact of its environmental efforts.[281] Below are listed some ideas that companies should take into account in order to present themselves as sustainable global companies in the new order.

Rule 1: Welcome to the Era of Corporate Social Responsibility

Joaquín Garralda, Professor of Strategy at IE Business School, in an interview with *Knowledge@Wharton* argued that "in the short to medium term, corporate

[280] http://www.revistamyt.com/articulo.php?id_seccion=1&id_articulo=5097.

[281] *Social Responsibility Of The Global Corporation,* Forrester (May 2007).

responsibility (CR) is going to be a management principle in some sectors, due to certain structural characteristics. In the long term […] I believe that it will be a management principle for all companies in the developed markets, regardless of sector or size. In countries where poverty prevails as the social condition, or where the social system is strongly influenced by an autocratic religion or ideology, it may be that this long term never arrives, as long as these circumstances are in place."[282]

The crisis will undoubtedly help to refine these predictions and will have the effect of clarifying positions: those companies that were not fully convinced that CSR makes a contribution to their sustainability will cut costs and will forget about the idea to concentrate on their own survival. Nevertheless, those companies that have understood responsibility as an intrinsic part of their strategic DNA will carry on with their investment in CSR and with their sustainable performance. Manuel Escudero, Director of the Research Center for the United Nations Global Compact, considers that "for [these companies] CSR will become a clear, new competitive advantage factor: today's social innovators will certainly be the market leaders in the not too distant future."[283]

The fundamental role of enterprises in global development is recognized by the international organizations. At the Davos Forum in 1999, Kofi Annan launched the Global Compact, a response to the desire of multinational companies to demonstrate their commitment to the values embodied by the United Nations and to become an instrument for international development. Since then, companies of all sizes and sectors have joined this undertaking, accepting its principles and rendering accounts on their progress in CSR. The current crisis situation represents an opportunity to create worldwide platforms where truly responsible companies can have their voice heard on global policies that are now going to be redefined in the new, international multipolar order.

At the same time, the crisis has increased society's awareness of the entire question of corporate responsibility. Business scandals and the lack of ethics have had widespread coverage in the media. Some columnists have even declared that right now there is considerable expectation of "corporate irresponsibility," and for that reason being a socially responsible corporation is doubly advantageous.[284]

It is certainly true that to be included in the list of the most socially responsible companies worldwide that is compiled by *Fortune* every year can have a positive effect in marketing terms. What is notable is the wide variety of sectors to which the top companies on the list belong: oil, banking, electronics, automobiles, etc. (see Figure 75).

[282] «La crisis pone a prueba el paradigma de la responsabilidad social corporativa», *Knowledge@Wharton* (21/01/2009).

[283] http://www.diarioresponsable.com/blog/Manuel%20Escudero.html.

[284] «Corporate Giving is Good Business; Social Responsibility Needed in Tough Times», *The Mercury News* (6/03/2009).

Rank		Company	Global 500 rank	Acountability score	Sector	Country
2008	2007					
1	5	Vodafone	85	77.7	Computers and electronics	Britain
2	13	General Electric	12	70.2	Utilities and diversified industrials	USA
3	4	HSBC Holdings	20	67.7	Financial	Britain
4	46	France Telecom	84	67.3	Computers and electronics	France
5	8	HBOS	45	66.2	Financial	Britain
6	N.D.	Nokia	88	63.8	Computers and electronics	Finland
7	20.	Electricité de France	68	62.3	Utilities and diversified industrials	France
8	N.D	Suez	97	61.8	Utilities and diversified industrials	France
9	1.	BP	4	61.6	Oil and Gas	Britain
10	6	Royal Dutch Shell	3	61.2	Oil and Gas	Netherlands
11	24	Hewlett-Packard	41	61.1	Computers and electronics	USA
12	2	Barclays	70	60.1	Financial	Britain
13	43	AXA	15	58.8	Financial	France
14	15	ING Group	7	58.2	Financial	Netherlands
15	38	Toyota Motor	5	57.8	Automotive	Japan

Figure 75. Annual ranking of the companies with greatest corporate responsibility.
Source: *Fortune Most "Accountable"* Companies 2008.

There are many companies that invest time and money in the interests of sustainability. Ben & Jerry's, Newman's Own, Patagonia, and The Body Shop are among the companies that are particularly noteworthy for their long-term CSR record through the sale of products linked to environmental and social causes. Crédit Agricole has stood out from competitors by offering environment-related financial products, such as specialized packages for energy-saving home improvements or audits certifying certain farms as organic. Nestlé embarked on the business of milk production in India. In spite of the controversy over its sale of baby milk in Africa, the company has carried out numerous projects in developing countries. In a rural area of India, for example, it entered the market by investing in the necessary infrastructure, in turn bringing enormous benefits to the Indian farmers. The company built refrigerated milk plants employing the expertise of veterinarians, nutritionists, agronomists and other specialists in quality. It imported drugs and nutritional supplements for sick animals and offered monthly training to the farmers on the importance of the diet received by the cows. The company also put in work on the crop irrigation system to improve the diet not only of the animals, but also of the inhabitants of the region. This resulted in a 75% drop in the mortality rate of the cows and a much larger increase in the standard of living in the region compared with others thanks to the introduction of electricity, telephones and primary and secondary schools, in addition to more doctors to treat the population.[285]

General Electric undertook to "offer imaginative answers to the growing challenges presented by the ecosystem." It used its "ecoimagination" to develop environmentally friendly materials, products and operational changes, such as energy-saving dishwashers and aircraft engines with lower fuel consumption; these have brought the company ten billion dollars in profits and are forecast to generate a further 20 billion up until 2010.

Rule 2: Think Green

Companies cannot stay sidelined in the international struggle for natural resources. Their goal will be to develop in a sustainable way, exploiting resources below the limit at which they can be renewed. They must make efforts to find the balance between the capitalization of domestically available natural resources and the acquisition of other natural resources abroad. The French oil and gas company Total is implementing a strategy to diversify the natural resources used and the geographical region from which they are obtained. To achieve this it resorts to countries in situations of instability with difficult access for resource exploration. In addition, it will begin to supply liquid natural gas from the Gulf of Aden in Yemen. The company is the second largest Western oil company in Africa and the Middle East.[286]

Most of the experts at the Future Trends Forum believe that, in order to satisfy the scarcity of natural resources, companies must seek new raw materials instead of geographically diversifying their sources for natural resources (see Figure 76).

[285] «Strategy & Society: The Link Between Competitive Advantage and Corporate Social Responsibility», Michael E. Porter and Mark R. Kramer, *Harvard Business Review,* December 2006.

[286] «Total, the French Oil Company, Places Its Bets Globally», *New York Times* (22/02/2009).

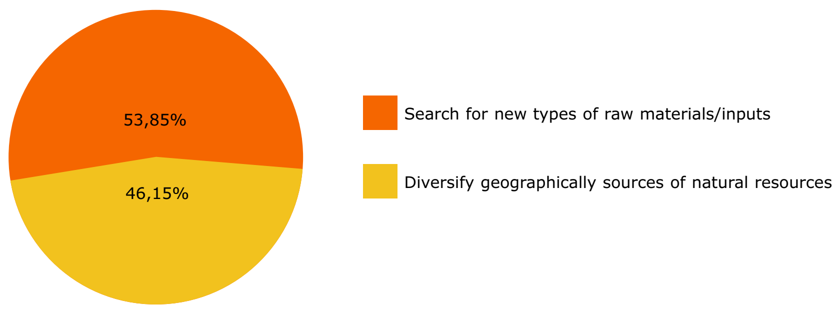


Figure 76. Corporate strategies against the scarcity of natural resources.
Source: Drawn from the conclusions within the Future Trends Forum.

Gradually, some companies are making efforts to diversify the energy they use by including renewable sources and transforming their production processes. One very good example can be found in the automobile sector. Faced with the volatility of oil prices and the social awareness focusing on responsible energy consumption, the sector is adapting to these changes by applying ecological technologies with low emissions. At this year's Geneva Automobile Salon, the models on display were cleaner and less dependent on oil. Many car brands focused on hitching themselves to the ecological revolution with low-emission Eco versions (BMW's Efficient Dynamics), smaller engines (VW's Bluemotion) and *Start&Stop* systems—which stop the engine in traffic jams—(Peugeot and Citröen, among others). Others presented hybrid models (Toyota's Prius, Honda's Insight, Lexus' 4x4) and it was also confirmed that the research into electric propulsion cars continues.[287]

In other sectors, IKEA will promote the use of cellulose because, in the words of their Swedish designer Maria Vinka, "whereas it takes nearly 2,800 liters of water to grow one kilo of cotton, the same amount of cellulose requires only 100 liters. What's more, over 95% of this water can be reused afterwards." IKEA designers also travelled to Vietnam to work with local craftsmen in the manufacture of new articles made of bamboo. In addition, the company is putting greater efforts into ecological packaging and to maximizing truck space by going for flat packaging in order to reduce carbon-dioxide emissions.[288] In the case of Coca-Cola, the company has identified water conservation as a critical factor in its future, and it is therefore collaborating with the global environmental organization World Wildlife Fund (WWF) in the conservation of seven of the largest river basins. It is also working in conjunction with Greenpeace to eliminate emissions from its vending machines.

Nevertheless, a lack of corporate financing may undermine many projects for environmental sustainability investment. The crisis has led to a decline in private investments and the "clean energy" sector is producing gloomy forecasts for 2009. In spite of a 53% increase in income for this sector, growth is expected to decrease significantly in the course of this year.[289] Programs promoted by governments are worthy of note, such as the Obama Administration, which has included expenditure in clean technology and transport as one of the items in the US stimulus package, valued at 70 billion dollars.

C.K. Prahalad asserts that companies that focus their efforts on green products and services will have a better long-term future, because "they will become very profitable if they learn how to find the right balance between price and sustainability." It is the customer who now has power over the company and not the other way round, and people are prepared to pay a little bit more to get an ecologically sound product, although this surcharge must be moderate and in line with the market.[290]

[287] «Coches para después de una crisis», *ElPais.com* (14/03/2009).

[288] «Rsc. Ikea apuesta por materiales sostenibles en sus nuevos productos», *elEconomista.es* (1/04/2009).

[289] «Despite gloom, promising clean-tech trends», *The New York Times* (12/03/2009).

[290] «Advice from Management Guru C.K. Prahalad: "Never Try to Manipulate a Customer"», *Knowledge@Wharton,* (13/06/2007).

Rule 3: Preach by the Example of Good Corporate Governance

Many experts see the root of the crisis as stemming from poor corporate governance and from the lack of transparency. There has been much talk about this lack of transparency because of the concealment regarding toxic financial products that some banks have practiced on their investors, shareholders and society. However there has been considerably less talk of corporate governance.

The financial scandals have undermined trust in the organizations and the importance of rebuilding this trust calls for the development of a specific plan for improved control on corporate activities.

The European Union has brought top executives' salaries under the microscope because of their influence in aggravating the international financial crisis. The Eurogroup, consisting of the Finance Ministers of the euro area, analyzed at their last meeting how the executive compensation based on short-term profits can lead to the assumption of disproportionate risks and an imbalance in the financial system. A number of European countries, including Germany and Holland, are preparing measures against multimillionaire bonuses and perks.[291]

Criticism of "super salaries" had already been raised within the Eurogroup, for ethical and moral reasons, by its president, Prime Minister Jean-Claude Juncker of Luxembourg, the leader of the country's Christian Social People's Party. Last summer, Juncker brought up the need for a debate on the distribution of income by pointing out the contradiction in the proposals put forward by political and economic leaders. "We are asking social interlocutors for wage moderation, but workers see that while we are proposing that they should show restraint, other actors in the economy are enjoying unlimited increases."

The President of the Eurogroup thus added his voice to the point of view argued by the President of the European Central Bank, Jean-Claude Trichet, and to the stance of the European Parliament. The European Parliament has also expressed its concern over the policies on pay for top executives, which is tending to grow out of all proportion to ordinary salaries. This sends the wrong signal and discourages support for a responsible wage policy.

Rule 4: Being Sustainable Sells

There is no doubt that social marketing is clearly beneficial in the perception people hold of a company. And this in the long term means a good brand image and favorable appreciation by society of business leaders and directors. That is why so many consider the efforts invested in corporate social responsibility to be justified by the return. In these times of fierce competition, social marketing gives the brand added value and differentiation by associating it with social projects.[292]

[291] http://spanish.safe-democracy.org/2008/06/06/el-buen-gobierno-corporativo-es-negocio/

[292] http://www.cincodias.com/articulo/opinion/Responsabilidad-social-corporativa-marketing-social/20041229cdscdiopi_2/cdsopi/.

Increasingly, the pressure on companies to justify their corporate social responsibility projects is not imposed only by NGOs or social pressure groups. Awareness started growing among consumers some decades ago, though only recently have they begun to influence the market with their decisions. According to the *2009 BBMG Conscious Consumer Report,*[293] 77% of the US consumers surveyed agree that they can make a positive difference by buying the products of companies that demonstrate social and environmental accountability. Nevertheless, one in four believes that there is no way of knowing if the product is really "green" or if it complies with the cause advocated.

Nevertheless, in regards to sustainable consumption, as with everything else, there are varying degrees. Companies increasingly segment consumers according to the impact that corporate sustainable action has on their purchase decisions. In this context, the Natural Marketing Institute has identified five market segments[294]:

- **LOHAS *(Lifestyles of Health and Sustainability)*.** This group of consumers (19% of consumers in the US) has a "healthy and sustainable lifestyle": not only do they buy "green," but they also support similar projects and collaborate actively in the protection of the environment.

- **Naturalist.** Another 19% of US consumers are counted in this segment inclined to buy food products packaged as natural/organic. Nevertheless, they do not proclaim political commitment with the environment, nor do they buy ecological goods of other types.

- **Weathervane.** 25% of consumers in the United States have good intentions, but these are not put into practice because there are other factors that they find more important, such as price or following fashion.

- **Conventional.** A further 19% of consumers belong to a segment that does not claim to have "green" views but does demonstrate a certain degree of environmentally conscious behavior in recycling or energy saving.

- **Indifferent.** The remaining 17% have no responsible attitudes toward the environment.

More recently, some companies have been successful in combining—for marketing purposes—the concepts of crisis and social responsibility, which has rewarded them with free advertising in all the media. The campaigns being carried out include, for example, giving away free products to the unemployed affected by the crisis. In some cases, employees themselves lend their weight by giving up their wages for one day a month in order to finance the cost of the "anticrisis" promotions, as in the example of Bocatín.[295]

[293] Branding and Integrated Marketing, http://www.bbmg.com/.

[294] The Natural Marketing Institute, http://www.nmisolutions.com/reports.html. Datos recogidos en *Sustainability and its Impact on the Corporate Agenda,* Accenture (2009).

[295] http://www.pymesyautonomos.com/marketing-y-comercial/el-marketing-de-la-crisis-y-la-responsabilidad-social-corporativa.

Rule 5: Safeguarding Energy Security Affects Everyone

Energy security is one of the problems considered of greatest international importance for oil-importing countries and their companies. The sharp rise being experienced in Asian demand for oil and gas has been the principal cause of the upward pressure on international prices suffered over the last few years. In addition, the presence of energy companies from Asia has also increased dramatically in the international energy market, creating the widespread impression of far fiercer competition between the public and private gas and oil companies of the world, and evoking the specter of geopolitical competition for energy resources, both in Asia and in the rest of the world.[296]

An article produced by the Real Instituto Elcano (Elcano Royal Institute) maintains that in this context geopolitical rivalries for energy resources do exist and that the strategic maneuvering has already started. The article identifies three current fronts: firstly, the political clashes for the gas and oil pipelines in the Middle East, Central Asia and Russia; secondly, the growing competition between the national oil companies (usually referred to by their initials, NOC) and the international oil companies (IOC); and, lastly, the number of strategic agreements signed between the main Asian consumer nations and the producing states of the "great and small crescent."

How does this affect the business world? Companies depend largely on energy resources to maintain profitable levels of production. The growing lack of global energy security in countries demonstrates the importance that corporate action can have in reducing the consumption of energy and diversifying it into renewable sources.

Nevertheless, the expansion of renewable energies and technologies to improve energy efficiency requires heavy investment. Even though the outlook is promising, there are various obstacles holding back the participation of private-sector investors, and these projects and companies have difficulty in sourcing risk capital as a means of financing. Seeing that the financial crisis is making it even more difficult to obtain loans, the authors of a report prepared by the Economic World Forum called for world governments to pool their stimulus packages with "green" investments.

There is a great deal of money to be discovered behind the sustainability agenda. Financial products designed for investment in companies that meet the criteria of corporate social responsibility have grown exponentially in recent years. Merrill Lynch produces an Energy Efficiency Index (EEI) covering 40 companies from four sectors that should benefit from this strategy. Other companies, for example Société Générale, offer a range of products benchmarked to a number of indices drawn up in collaboration with the company STOXX which are linked to the environment. These indices are: the Wowax, which tracks the companies specializing in water treatment; the Solex, for

[296] http://www.realinstitutoelcano.org/documentos/264.asp.

investment in solar power; and the Erix, which extends the listing to all renewable energies.

Investors in this type of asset obviously have a long-term profile. The problem is that companies are not obliged to report their social or environmental practices in their accounts. Despite the fact that they can potentially be strong indicators of a company's performance in the future, they are not included on the balance sheet.

Rule 6: No Ethics, no Business

The business world is clearly sensitive to public opinion. A financial scandal such as Enron, the *Prestige* oil spill or the controversy over textile companies exploiting child labor can destroy the reputation of a company in a matter of hours. News travels fast on Internet and there are ever more *rankings* that compare companies with each other using innumerable criteria, including their implementation of proper environmental and social management. When it comes to the moment of truth, most activity related to the reputation of a company revolves around risk management.[297]

Mattel has been meticulous in monitoring its production since it was obliged to withdraw millions of toys manufactured in China from the market for safety reasons. The pharmaceutical companies were accused of a failure to heed the needs of millions of Africans dying of AIDS, which is why GlaxoSmithKline and Merck, among other companies, joined a program to provide the drugs at cost. De Beers endeavors to certify itself by means of the *Kimberly Process,* which champions the fight against the "blood diamonds" of countries such as Angola, the Ivory Coast, the Democratic Republic of the Congo and Sierra Leone. All of these are projects that the companies have instituted to mitigate the disrepute caused by practices that clearly failed to meet CSR criteria. Nike, for example, was one of the first companies to come under the CSR microscope. Its reputation was seriously damaged in the 1990s by its reported use of child labor in its factories in Asian countries. Nike's Vice President for Corporate Responsibility speaks of "return on investment squared" to investors and to the community. She insists that now corporate responsibility is viewed as a source of innovation and she joins entrepreneurial social networks instead of the typical CSR conferences.

Rule 7: Communicate and Demonstrate that you are a Responsible Company

More and more companies are producing sustainability reports. Nevertheless, according to a survey carried out by KPMG, the experts in corporate social responsibility in charge of preparing this type of report admit that not too many people find them interesting. First, because they are generally too long, and also because most of their target readership does not even know that they exist, because the content simply is of no interest, or because they believe that the reports lack credibility.

[297] «How companies manage risks to their reputation», *The Economist* (17/01/2008)

In spite of this discouraging outlook, most large companies already produce a report of this kind every year. In many cases, because it serves as a useful tool for the company to systematize its own information, but, more importantly, the people who prepare sustainable reports consider that they are most useful for comparison purposes. Sustainability reports are felt by these experts to be a valuable mine of information on strategies and sound practices evolved by other companies.[298]

With a view to standardizing this information, the Global Reporting Initiative (GRI) has been created as the main international standard for the preparation of corporate social responsibility reports (see Figure 77). GRI works together with the United Nations Environment Program on assessing companies in reference to laws, regulations, performance standards and voluntary programs.

[298] http://www.cincodias.com/articulo/empresas/empresas-ensayan-comunicar-mejor-RSC/20070416cdscdiemp_17/cdsemp/.

Section	Dimension	Aspects
Economic	Economic	Economic Performance
		Market Presence
		Indirect Economic Impacts
Environmental	Environmental	Materials
		Energy
		Emissions, Effluents, and Waste
		Products and Services
		Compliance
		Transport
Social	Labor practices and Decent Work	Employment
		Labor/Mangement Relations
		Occupational Health & Safety
		Training and Education
		Diversity and Equal Opportunity
	Human Rights	Investment and Procurement Practices
		Non-Discrimination
		Child Labor
	Society	Comunity
		Corruption
		Public Policy
	Product Responsibility	Customer’s Health and Safety
		Marketing Communications
		Customer Privacy

Figure 77. Aspects of the GRI report.
Source: 2004-07 Sustainability Report, GRI.

On March 10, 2009, the GRI drew up the Amsterdam Declaration on Transparency and Reporting, in which governments are asked to require less-than-transparent companies to justify why they refuse to publish GRI reports. The declaration also notes the importance of requiring GRI reports to be published by large state-owned companies, pension funds and public authority-controlled investment agencies. In the view of the signatories, one of the causes of the current economic crisis is the "transparency deficit."

It is for this reason, the document declares, far beyond measures to contain the financial crisis, "new disclosure policies on sustainability, social impact and governance" must be included throughout the world. In this context, it is suggested that it might be appropriate to impose a "political requirement," as the time has come "to go beyond voluntary action" in CSR.[299]

Some experts stress that companies wrongly believe that by increasing the volume of CSR reports they show that the company is extremely active in this area.[300] However, if accountability is not understood as a strategy by the company, the increased amount of information does not demonstrate a continuous cycle of corporate improvements directed toward social and environmental issues.

The corporate website is the most usual way of informing *stakeholders* on corporate social responsibility projects and the reports that measure their social and environmental impact. The Bankinter corporate website, www.bankinter.com, gathers and organizes the information on CSR and is accessible throughout the financial year, not only during the notice period to attend the General Meeting. The section covering corporate responsibility includes information regarding social action, environmental policy, the Bankinter Foundation of Innovation and the Corporate Responsibility Annual Report.

Rule 8: Start with the Employees

According to Accenture,[301] sustainability also affects the positioning of companies in the fight for talent. The talent pool, especially the youngest segment of recent college graduates, pays more attention to the stance of companies with regard to sustainability or seeks a connection between their job and sustainability. According to Thomas Cooley, Dean of the New York University Stern School of Business , "demand for CSR activities has just soared in the past three years." Consequently, many business schools are adding the subject and specialized departments for its MBA students.[302]

According to Jan Phillips, author of *The Art of Original Thinking*, professionals are "in pursuit of purpose-driven lives and principle-driven workplaces." She believes that they are searching for meaningful workplace experiences, looking for organizations whose commitment runs deeper than the traditional focus of CSR. In short, they want to align their purpose with businesses that are socially driven as well as profit driven.

[299] http://www.diarioresponsable.com/20090408-esade-se-suma-a-la-declaracion-de-amsterdam-del-gri.html.

[300] *The High Purpose Company,* Christine Arena, 2007.

[301] «Sustainability and its Impact on the Corporate Agenda», Accenture (2009).

[302] «Just good business», *The Economist* (17/01/2008).

The Director of the Joint Prevention Department of Endesa, Segundo Caeiro, considers that work safety and employee health constitute the cornerstone of CSR in his company, since in a sector such as electricity this aspect is "extremely important." Caeiro explained that the idea of CSR has been introduced into Endesa in the prevention of occupational hazards, in human capital and the environment.[303] The Values in Action campaign from Novo Nordisk, the Danish pharmaceutical company, has raised the concept of sustainability to the level of company strategy, thus achieving a reduction in staff turnover to 5%, half the average figure for the sector.

IKEA maintains a strong corporate culture, encouraging a team spirit among its employees. To achieve this, it has set up workdays during which the senior managers work at the checkout counters or in the warehouses. In addition, it offers social and environmental training to all its staff. Maintaining this culture, which is impossible to dissociate from the lifestyle that they represent, has been the key to IKEA's long-term success and consolidation as a socially responsible company.

Sustainable Companies in Emerging Countries

The spectacular growth of the emerging economies has taken place in an environment that challenges sustainable development. The problems that hinder continued growth in the long term are related to the lack of appropriate infrastructure, the shortage of water, respect for human rights and the dependence of some countries on energy sources for their rapid industrialization. For all these reasons, sustainable development policies are a commitment practically obligatory for the survival of the companies in the emerging markets.

Social responsibility, often considered the domain of business in the developed economies, is gaining ground in developing countries. Some emerging market companies are already reaching the levels of their counterparts in developed countries in environmental matters, but still lag behind on human rights.[304]

In addition, the companies in emerging countries need to boost their CSR practices when they set up in other developing countries in order to protect the employees, the communities and the ecosystems of these host countries. If the companies in emerging countries do not feel the need to observe good corporate governance or social responsibility principles, there is the risk that they will adopt questionable strategies when investing abroad, especially in matters connected with corruption and respect for human rights.

Nevertheless, these South-South investments have a very positive aspect in contributing to development. To take one example, given that the advantages of multinationals' presence depend on the difference in the technological capacities of the countries of origin and destination, this gap is not as wide in the case of investment between developing countries and, therefore, the benefits can be greater. It also seems likely that the emerging multinationals are less risk-averse

[303] «BBVA, galardonado con el I Premio a la Mejor Práctica Responsable del Club de Excelencia en Sostenibilidad», *Media Responsable* (21/04/2008), http://www.empresaresponsable.com/articulos/detail.php?id=3964&sec=.

[304] http://www.ecodes.org/pages/areas/rsc/evento.asp?ID=5464.

and open the gates of globalization to countries where the traditional multinationals are unwilling to invest. After the signing of the peace agreements in Sierra Leone, the first to arrive were Chinese investors. Their positive experience served as a sign for European companies that have recently become established. South-South investment flows also represent an opportunity for lower-income countries meaning that they offset the fluctuations in investment from developed countries.[305]

Nevertheless, any regulations that may be laid down to guarantee sustainability will not be sufficient in themselves. China, India, Brazil and other countries will continue to grow, with hundreds of millions of people eager to join the Western way of life. The swift growth of the ecological footprint and the imminent exhaustion of some resources demonstrates that the Western lifestyle cannot be replicated throughout the world because of the ecological limits. Responsible consumption, energy efficiency and the search for alternative sources may represent a few of the keys to achieve this.

Rule 1: More Responsible Means More Money

A report on corporate social responsibility by the International Finance Corporation, a body under the aegis of the World Bank, argues that the companies of emerging economies based in China, India or Brazil could increase their returns many times over if they apply good governance policies.

Even so, the level of exigency in these countries is lower than that required of companies in the developed world because the concept of good governance is not so widespread. "Having a leader whose consciousness is raised, responsible policies integrated right from the start, differentiation or the quality of relations with all the interested parties, these are all ingredients that would make up a good list for businesses to make the economies of their countries more developed. Other studies, focusing on developed countries, claim that it is not possible to speak of CSR as a specific factor in economic growth. Despite this, they reveal a positive link between CSR indicators and those of economic growth."[306]

In regard to general spending patterns, the results of several studies indicate a wide disparity in the general attitudes toward CSR between the emerging and mature markets. 85% of consumers in Indonesia claim to have bought a product or service specifically because it was produced responsibly, compared with 72% in Spain and just 52% in the US.[307]

If these data are taken into account, it appears that for those emerging-country companies, climbing aboard the CSR train can help improving their profits. For example, the Chinese company Dequingyuan undertook to provide healthy, high-quality products during the bird flu crisis. Their guarantee of quality and safety allowed them to increase their revenue by 0.3 million to 4.6 million in four years. The Indian pharmaceutical company Jubilant increased its profits

[305] http://seminariordenmundial.blogspot.com/2008/09/las-multinacionales-de-los-pases.html.

[306] «Las empresas de países emergentes mejoran con políticas responsables», *CincoDías.com* (11/02/2008).

[307] http://www.tns-global.es/docs_prensa/nota_prensa_107.htm.

elevenfold in 2007 (from 3.4 million to 37.9 million), thanks to the transparency of its activities and the environmental audits that it passes every year. These companies from the emerging countries have managed to align their business strategies with a solid environmental and social commitment, in this way obtaining a clear competitive advantage. In short, they have succeeded in creating value both for their company and for society.

The contribution of companies from developed countries to the economies of those countries where they operate is also important, and the implementation of CSR policies guaranteeing their respect and commitment toward such countries is essential. In 2005, Unilever estimated that its business in Indonesia supported the equivalent of 300,000 full-time jobs, generated a total of 630 million dollars and contributed 130 million dollars in taxes to the Indonesian Government. Nokia at the beginning of this year collected three tons of waste from mobile devices (telephones, batteries, chargers, accessories, etc.) in 45 days.[308] This recycling project is an attempt to raise the consciousness of Indian consumers about the usefulness of components that can no longer be used. A survey revealed that only 3% had recycled their old cellular phones and 44% said that they still had them around the house. In other markets, the main telephone providers have collection campaigns as part of their CSR.

Rule 2: CSR Attracts Investment

Socially Responsible Investing (SRI) has become fashionable over the last decade. It consists of investing in companies because of their commitment to socially responsible practices or, on the contrary, ruling them out for ethical reasons.

Following the lead of the US Dow Jones Sustainability Index and the British *FTSE4Good*, India in February 2008 launched the stock market index *S&P ESG (Environmental, Social and Corporate Governance),* which only lists Indian companies that have a good environmental, social and governance record. Thus the listing of the 50 Indian companies that make up the index is linked to social responsibility and investors are able to decide where to place their capital using CSR criteria.

Traditionally, investment results have been assessed on the basis of financial return, but there is a growing number of investors who prefer to take other criteria into account, such as environmental, social, or even religious strategies. For some it is a question of not providing capital to the tobacco, alcohol, or arms companies. For others it is a matter of investing to alleviate market inefficiencies, the management of intangible value and technological diversification. The benefits of investment in social responsibility for companies in emerging economies are the following[309]:

- Positive differentiation of their equity compared with issuers from other emerging markets. This brings them an advantage when competing worldwide for quality long-term investment.

[308] «Nokia collects 3 tonnes mobile waste in 45 days», *The Hindu Business Line* (2/03/2009).

[309] *Sustainable Investment in India,* The Energy and Resources Institute (TERI) Europe (May 2007).

- Efficient capital allocation to business models capable of overcoming the problems raised by sustainable development goals.

- Additional market incentives for companies that meet national ESG targets (Environment, Social and Corporate Governance) and adopt corporate responsibility programs that go beyond what the law requires.

- The creation of business models that make capital out of opportunities and know-how in sustainable development, and that can serve as an example to companies in the future.

- The investment in R&D devoted to various causes, for example, the generation of alternative energy, which could provide a solution for sustainable development that is threatened due to lack of resources.

At the same time, emerging countries are proving increasingly selective regarding the direct investment of multinationals inside their own borders. Decades ago, when they were poor countries with no capital savings, they would accept any type of investment, but now more and more they require the multinationals to give account of their contribution to the country's development. For example, the Government of China is interested in companies that introduce technological advances that Chinese companies are unable to develop. They are also seeking investments that impact on the training of the country's human capital, that is, they want the multinationals to provide training to local staff in highly qualified tasks. In short, they want investment in aspects that can improve their economies in the long term.

For this reason, the directors of the multinationals must think of a strategy that allows them to combine the earning of profit with a contribution to development in the emerging countries where they operate. The next step will be to convince the governments of those countries.

Rule 3: Go for Energy Efficiency

With the rise of energy prices, as well as of emissions of greenhouse gases, together with the simultaneous increase in demand from China, India and Brazil, the world has enormous interest in the success of efforts to reduce the emissions of the major developed nations, as detailed in the book published by the World Bank, *Financing Energy Efficiency: Lessons from Brazil, China, India, and Beyond*.

China, India and Brazil are three of the world's top 10 energy consumers. Taken together, these countries constitute the home of 40% of the world population and represent over half of the entire energy requirement of developing countries. Before the year 2030, they will be responsible for 42% of the increase in the demand for energy throughout the world. The World Bank warns that if major advances are not achieved in efficiency efforts, China, India and Brazil will

310 http://www.worldbank.org.in/WBSITE/EXTERNAL/COUNTRIES/SOUTHASIAEXT/INDIAEXTN/0,,contentMDK:21665223~pagePK:1497618~piPK:217854~theSitePK:295584,00.html.

311 *Promoting energy efficiency in the developing world,* McKinsey Global Institute (February 2009).

more than double their use of energy and greenhouse emissions in less than one generation (before 2030).[310]

According to a study by the McKinsey Global Institute,[311] if the developing economies were to increase their energy productivity, they would be able to cut their demand growth by at least half in the next twelve years. This reduction would be greater than the total current energy consumption in China (see Figure 78).

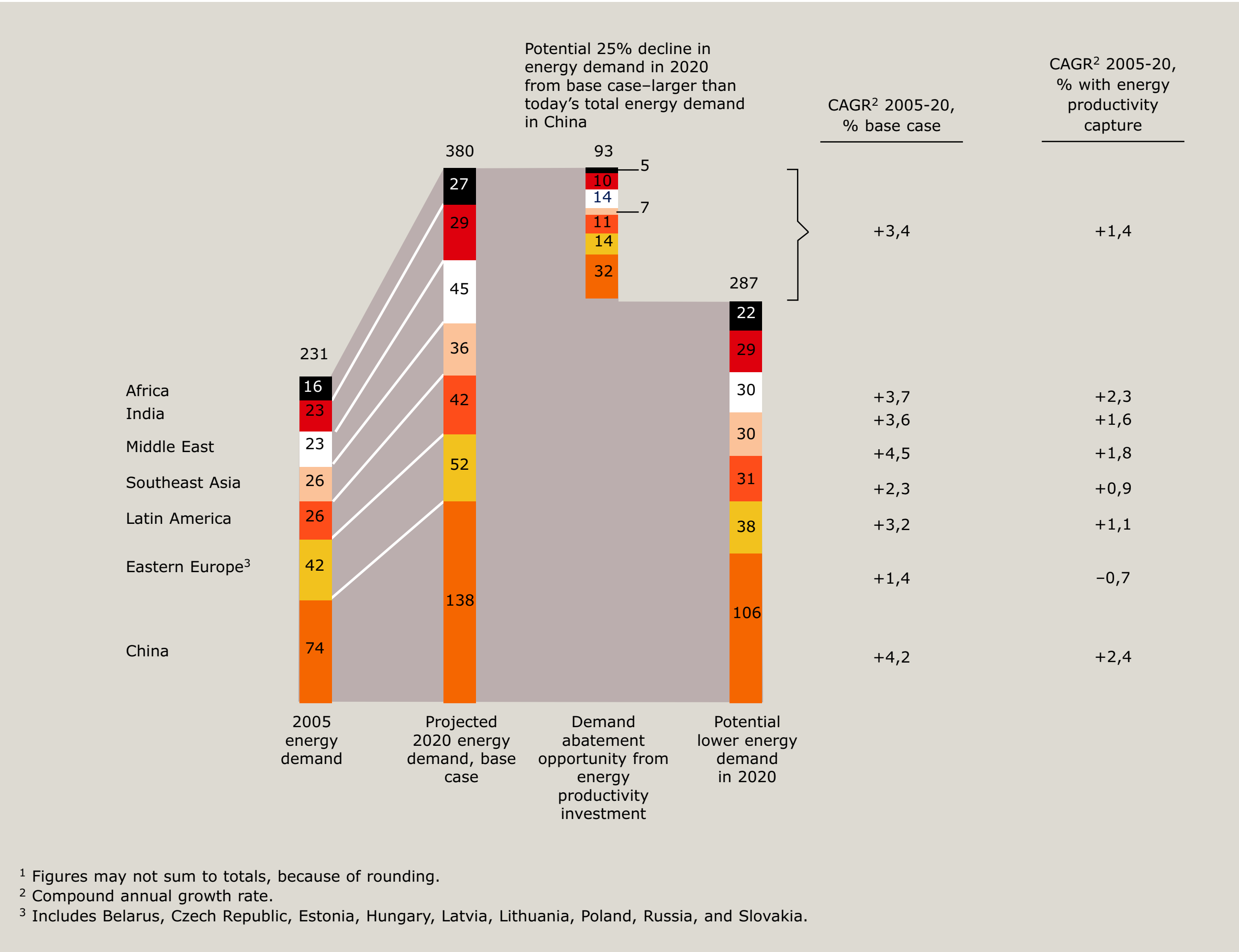


Figure 78. Higher energy productivity.
Source: Standard & Poor's Index Factsheet.

According to the same study, the cost of investing in energy productivity is on average 35% less in the countries of emerging economies than in the developed countries, because of lower labor costs. The World Bank considers that there is enormous untapped potential for progress in energy efficiency, in particular in Brazil, China and India, with many solutions that could work as long as financing and investment is available. It also highlights the great commitment that exists on the part of the authorities in charge.[312]

Nevertheless, the lessons learned over the last ten years show us that the main obstacles preventing energy efficiency from taking off are deficiencies in the organizational and institutional systems, as well as lack of access to the necessary funding. Businesses and banks must convince themselves that investing in more efficient boilers, in waste-recovery systems or in energy-saving lighting has its rewards and justifies the risks.[313]

In spite of this, in the high energy consumption countries such as China, India and Brazil, efficiency is gradually improving. In China, a commercially viable sector has started up dedicated to energy efficiency after a decade of strong government support. In India, the banks launched programs for small projects of this type in some industries, which will now begin to be expanded. And in Brazil an energy efficiency fund built from utility company profits offers a platform to make more sweeping improvements. Nevertheless, even though these advances are hopeful, the World Bank believes that if we consider the booming energy demand that only one of these countries will have over the next 10 years, the need for action and much faster progress becomes evident.[314]

One example of this investment in productivity may be seen in the glass factory at Gostomel, Ukraine, which produces bottles for drinks, perfumes and pharmaceutical products. Coca-Cola and PepsiCo are among its clients, not to mention numerous Ukrainian companies. The US Energy Department commissioned a laboratory to identify energy efficiency opportunities for the factory after the energy loss suffered due to the closure of Chernobyl. After the audit, it was estimated that a number of changes in the facilities, including the replacement of one of the furnaces with a new model, would lead to considerable energy saving and would greatly increase the volume and quality of the production. After the successful implementation of some of the measures, Gostomel is now looking for financing for the rest.[315]

It should not be forgotten that many companies in emerging markets are commodities exporters, and so have benefited from the rise in prices. However, the crisis has opened up a new era of volatility in natural resource prices. According to Accenture, in order to maintain their competitiveness, they will have to "set up efficient cost structures against a fall in prices."[316] Moreover, they will have to make advances in efficiency in order to comply with environmental legislation, which is becoming stricter as a result of climate change. Companies will be challenged to reduce carbon emissions, to redesign some phases of their supply chain, to adapt to the price volatility of commodities and

[312] http://www.worldbank.org.in/WBSITE/EXTERNAL/COUNTRIES/SOUTHASIAEXT/INDIAEXTN/0,,contentMDK:21665223~pagePK:1497618~piPK:217854~theSitePK:295584,00.html.

[313] http://www.worldbank.org.in/WBSITE/EXTERNAL/COUNTRIES/SOUTHASIAEXT/INDIAEXTN/0,,contentMDK:21665223~pagePK:1497618~piPK:217854~theSitePK:295584,00.html.

[314] http://www.worldbank.org.in/WBSITE/EXTERNAL/COUNTRIES/SOUTHASIAEXT/INDIAEXTN/0,,contentMDK:21665223~pagePK:1497618~piPK:217854~theSitePK:295584,00.html.

[315] Ukraine: Emerging Market for Industrial Energy Efficiency Opportunities http://www.pnl.gov/aisu/pubs/EnEngineering.PDF.

[316] *El Auge de las Multinacionales de Mercados Emergentes,* Accenture (2008).

to secure demand in the market. The paint industry in Brazil bears witness to the importance of excelling, by improving quality while simultaneously adopting environmentally friendly practices, thanks to the production of water-based paints and the promotion of their ecological packaging in a sector where competition is becoming fiercer, the price of the raw material is increasing and environmental requirements are becoming more rigorous.[317]

Rule 4: Invest in Scarce Resources

The demand for resources by the global economy has increased exponentially with the growing requirement from the emerging economies. While it is true that companies of the developed economies have had access to these resources for longer, the faster than forecast rate of inclusion of the emerging economy companies makes it necessary to examine the action that can be taken today to avoid problems tomorrow.

In a world situation of scarce resources, the companies of emerging economies must secure their supply in order to ensure their survival. This way, they can minimize the impact of fluctuating supply and volatile prices. In addition, investment in this type of resource is a rising stock, given the progressive worsening of the shortage.

Following this direction, China has ramped up its purchasing of many resources throughout the world. The new world superpower is exploring oil deposits in Africa and Central Asia, drilling gas deposits in Burma, building hydroelectric dams in the Mekong region, carrying out mineral prospecting in the Congo and felling wood in Indonesia. China's hunger for raw materials has contributed to the rise in the price of oil and other commodities at certain times.[318]

China has joined the party at a time when other countries and companies already control most of the world resources, and its response has been to explore areas that other players have considered too risky. Chinese companies are exploiting oilfields, mines and dams in regions that are geographically distant, politically unstable and ecologically fragile, often ignoring environmental human rights and the impact of its investments.

A Chinese company is building a large dam on the Kafue River in Zambia that puts important marshlands at risk, including two national parks. The dam will generate energy for copper and cobalt mines destined for Chinese industry. When Western investors hesitated over whether to finance the Kafue River project on account of the environmental concerns, a Chinese developer swiftly took over the project, urging the Zambian authorities to cut short the environmental assessment process.

Just like any long-term investors, Chinese companies have an interest in avoiding human rights abuses and the destruction of the environment in their host countries. The Chinese Government has issued guidelines to its companies

[317] «Frost & Sullivan Observes That the Brazilian Paints and Coatings Market Vendors Are Reshaping Strategies to Deal With a Changing Market Environment», www.foxbusiness.com (31/03/2009).

[318] http://internationalrivers.org/en/todos-somos-chinos.

to protect the rights of employees, local communities and the environment. Some Chinese companies have begun to adopt the environmental regulations, but they still need to put them into practice effectively.

Agricultural products are also attracting investment. Demand for them remains high in spite of the world recession, partly due to the ever-increasing demand from emerging markets. While it is true that prices have fallen from their highs of mid-2008, they are still well above the average for the last decade. This is shown in an article in *The Economist* with such data as the following: in comparison with the figures of a decade ago, China currently consumes twice as much vegetable oil, 60% more poultry products, 30% more beef and 25% more wheat.[319] Investments in the agricultural sector have not been slow in coming. Black Earth Farming, a Russian company, has invested heavily in agricultural farms, and Chinese investors have done the same in Brazil and Argentina.

Another resource that has been targeted for investment is lithium. Bolivia has nearly half of the known world reserves of this chemical element. Its use is growing because of its application in batteries for hybrid and electric cars. The state agency Comibol has invested 6 million dollars in a plant where it is planned to extract and process lithium on an industrial scale. The economic nationalism of Bolivia could hinder interested Japanese and European companies from gaining a foothold in that market. Meanwhile, countries with fewer reserves, such as China, are taking advantage of the economic climate to position themselves as prime producers.[320]

As was noted in the chapter "The Difficulties of Sustainable World Development," water has also become yet another asset. Coca-Cola's operations in India have been impeded due to lack of access to water and the serious pollution of that country's water sources.

Rule 5: "When in Rome, do as the Romans do"

On their path toward globalization, companies in emerging economies are exposed to wider markets and a new range of consumers. Thus, they must adapt to the customs and laws of those locations, which entail more transparent tax information systems and a different kind of relationship with the stakeholders. Twenty-two percent of the managing directors polled by McKinsey believe that the varying definitions of corporate social responsibility in various regions and cultures represent a barrier to the global implementation of a comprehensive and strategic approach to environmental and social issues by the company (see Figure 79).

[319] «Agriculture: green shoots», *The Economist* (19/03/2009).

[320] «Bolivia has lithium, and the president intends to make the world pay for it», *International Herald Tribune* (2/02/2009).

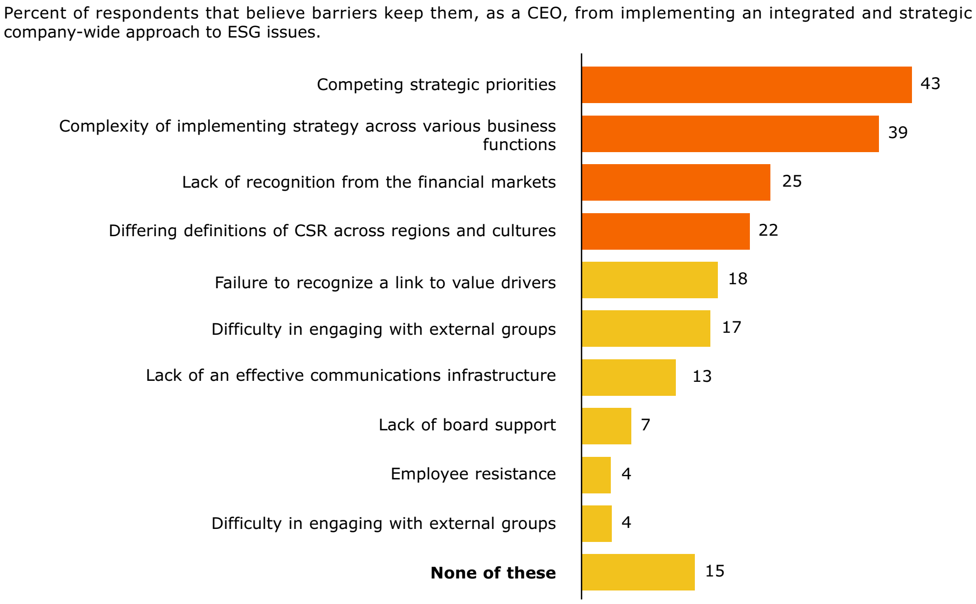


Figure 79. Barriers to managing directors' commitment to CSR.
Source: Feb 2007 Mckinsey survey of 391 UN Global Compact participant CEOs.

It is vital that companies of emerging economies manage to adapt to the concept of CSR as it is generally understood in international markets if they wish to maintain their competitive position. For example, in some of their home countries receiving bribes is not socially unacceptable, and corruption can affect even certain grades of public authorities. For this reason, mechanisms of self-governance are not necessarily suitable on the global scene. This self-governance is the result of actions taken by companies on their own initiative or under the pressure of interest groups or sectoral agreements.

An analysis[321] on sustainability reporting provided by specific sectors of emerging economies concluded that 87% of companies in the study present some type of reporting in this regard but only 51% publish an individual sustainability report, that is, in downloadable PDF format or in the annual company report. Many companies undertake to report using the standards of the Global Reporting Initiative (GRI), to publish separate CSR reports and to support programs such as *2000 UN Global Compact* or *The Equator Principles.* We have already mentioned the GRI, which serves as a framework for companies to standardize their CSR reports with regard to ten principles of human rights, labor legislation, forced labor, discrimination, environmental responsibility and anticorruption. It has over 5,200 participants, including 4,000 businesses in 120 countries. *The Equator Principles* framework requires its 60 signatory banks to assess projects on the basis of their social and environmental impact before making investment decisions. The adoption of best practices offers them benefits in terms of reputation and differentiates these companies from the rest. If the

[321] «Sustainability Reporting in Emerging Markets», Siran, KLD, Social Investment Forum (January 2008).

most recent CSR reporting and the standards followed are easily accessible, this can increase the credibility of the organization.

7.2. The Sustainability of the Spanish Economy

The Spanish Sustainable Development Strategy (EEDS) was developed within the framework of the European Union Sustainable Development Strategy, which was renewed at the Council of Brussels in 2006 with a general principle to: "Define and devise measures aimed at the continuous improvement of the quality of life for present and future generations by creating sustainable communities capable of managing and using resources efficiently, in order to take advantage of the potential for ecological and social innovation that is offered by the economy, ensuring prosperity, the protection of the environment and social cohesion." This objective took shape as seven priority areas for the European Union: climate change and clean energy; sustainable transport; sustainable consumption and production; public health; management of natural resources; social inclusion, demography and migration; and the fight against global poverty.[322]

The economic reasons for bringing into question the sustainability of the Spanish development model of recent years have already been discussed. Juan Arias, journalist, philologist and writer, has had harsh words to say on the subject: "The recently ended economic boom (14 straight years of strong growth) has been based on a real-estate bubble, on speculation. Unbridled urban development has barely returned any dividends in education and civic-mindedness. But sustainable development is not possible without caring for the environment and education. Our external deficit—the second largest in the world—the aging of the population and our extreme energy dependence is also burdening the country with a mortgage that we shall bequeath to future generations."

Environmental Sustainability

Regarding environmental sustainability, the need to make an efficient and rational use of natural resources is recognized—in particular energy, water, biodiversity and soil resources. It is also acknowledged that we must develop proactive policies to alleviate the determining factors in climate change in all production sectors, particularly in those of energy and transport, as well as instigating policies to adapt to this climate change. The international struggle for resources, in particular energy, will be decisive for the future of countries in the multipolar world, as has been discussed previously. The high external-energy dependence and vulnerability that Spain suffers from makes this situation even more sensitive.

This dependence exceeds the European Union average. The degree of primary energy self-sufficiency (relationship between interior production and total energy consumption) in 2007 was 20.9%, which means that in Spain 79.1% of primary energy consumed is imported. Indeed, as a result of the economic growth re-

[322] http://www.la-moncloa.es/NR/rdonlyres/96270D48-C981-430E-8C19-352904495879/0/folleto_desarrollo_sost_DEF.pdf.

gistered over the past 14 years, this dependence has increased steadily and it is expected that the trend will be maintained.

Forecasts indicate that if the energy markets pursue the current tendency, the dependence on imports in the European Union will grow from 50% at present to nearly two thirds in 2030.[323] 93% of oil and 84% of gas will have to be imported, and there is no certainty that the sources for these imports can be diversified, especially in the case of gas. The growing dependence of the European Union on energy imports threatens not only the security of the supply, but also implies higher prices. A price increase would have extremely unfavorable repercussions on the already worsening competitiveness and employment in Spain.

	2006	2007
Coal	33.8	29.0
Oil	0.2	0.2
Natural gas	0.2	0.2
Nuclear	100.0	100.0
Hydraulic	100.0	100.0
Renewable energies	100.0	100.0
Total	**21.7**	**20.9**

(relationship between internal production and total consumption of energy)

Figure 80. Degree of self-sufficiency energy in Spain.
Source: Secretariat-General for Energy.

Almost more important than the external dependence is the high vulnerability of Spanish economy and society to a possible cut in sources of supply or of a price crisis in raw energy materials.[324] This degree of vulnerability stems from a high percentage of oil in the energy mix and a below-average domestic electricity production (non-storable energy), together with far fewer electrical interconnections than those of other countries with a similar level of dependence. Only countries like Greece, Italy and Portugal, of the developed economies, are in more critical situations.

The energy deficit has represented on average 39.6% of the total trade deficit for the last eight years. The rise of oil prices, in part due to the increased demand from the emerging countries, has only served to worsen the Spanish trade balance, with the consequent negative effect on the growth of the Spanish economy (GDP).

[323] *La Energía en España 2007,* Ministerio de Industria, Turismo y Comercio.

[324] http://www.revistasice.com/cmsrevistasICE/pdfs/BICE_2928_43-48__DA4BF380721A84BD13E60ED0BEF583E6.pdf.

To invert this trend and prevent these possible negative effects of the energy markets on the Spanish economy, efforts must be made in three areas. First, investment and RDI must be boosted in nonpolluting energy sources in order to increase the contribution of renewable energies to the national energy mix, which is distinguished by high dependence on oil as primary energy source (see Figure 81). Spain, because of its natural conditions, has a competitive advantage and a high potential to develop sources of hydraulic, wind and solar power. Not surprisingly, it is now the third-largest producer of wind energy, with 16% of the total installed power, trailing only Germany and the United States. Along the same lines, the European Union commitment to renewable energies is firm. The target for the European Union countries to derive 12.5% of the electricity produced in that country through renewable energies seems easy to reach, or even to better, in the case of Spain.

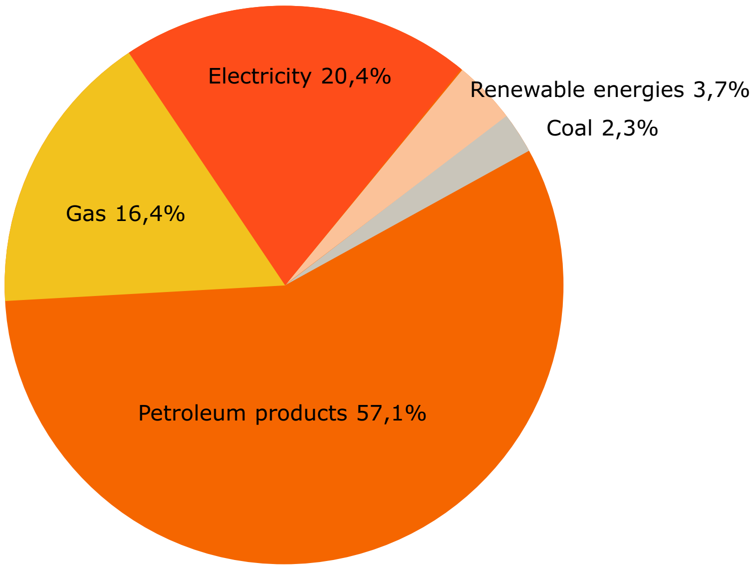


Figure 81. Energy consumption in Spain in 2007.
Source: *La Energía en España 2007,* Spanish Ministry of Industry, Tourism and Trade.

Many are of the opinion that Spain should increase the proportion of nuclear energy in the mix of national production, as is happening in other European Union countries. This is backed up by 75% of a panel of 317 experts and business leaders consulted at the beginning of 2009 by PricewaterhouseCoopers.[325]

In parallel, steps to improve energy efficiency must be implemented. Despite the fact that energy consumption per inhabitant in Spain (3.2 tons oil equivalent per year) is below the EU average (3.6 tons), and is far below that of the US (7.8 tons), the percentage of energy consumption in relation to GDP is considerably

[325] http://www.abc.es/20090224/economia-economia/espana-deberia-incrementar-peso-200902241303.html.

Did you know?

Spain is the EU country at greatest risk of desertification.

higher than that of the European Union (Spain consumes 18% more oil for every 1,000 euros produced).[326] Awareness regarding responsible and efficient consumption will be fundamental in the future. If the demand for energy could be reduced, there would be lower exposure to possible economic destabilizations.

Lastly, measures must be devised to improve the connection with the energy markets of Europe, Asia, America and Africa, to enable a diversification of the risk arising from the overdependence on the imports of oil and gas from specific countries. Many resources come from geopolitically unstable regions which, in some cases, use their natural advantage as a bargaining tool. These bring uncertainty to the supply and the prices, which has negative repercussions on the Spanish economy.

In short, increasing investment in energy efficiency, in renewable energies and in new technologies, would help to maintain competitiveness and employment, while simultaneously improving the balance of trade, creating new jobs and improving the whole of the economy.

Social Sustainability

As was noted at the start, some imbalances have been observed between Spain's economic position in GDP terms (8th) and other indicators, such as that of competitiveness. From a social viewpoint as well, there is an imbalance, given that Spain holds 13th place in the Human Development Index, established by the United Nations Development Program in accordance with other standard of living criteria. In addition, Spain has been the major beneficiary of the European budget, but its pockets of poverty and exclusion continue to exist, and will now spread with the economic downturn.[327]

The rising unemployment rate as a consequence of the crisis represents a new challenge for social welfare. The immigrants residing in Spain are in an extremely vulnerable situation. In the first quarter of 2009, immigrant unemployment was at 28.4%, whereas in the Spanish population it was at 17.36%.[328]

Cáritas, the official confederation of the Church's charities and social projects in Spain, saw a 75% increase in requests for assistance made to it in 2008. A new feature of this recession is that those seeking help normally are unable to pay for their housing and many are immigrants. Victor Renes, Research Director of Cáritas, is concerned that a wave of racism might start up.

According to the European Commission annual report on social protection, in Spain 28% of the elderly and 24% of children are at risk of poverty. The percentage of the population at risk of poverty is 20%, a figure only exceeded by Latvia (21%) and at the same level as Italy and Greece.[329]

[326] *50 propuestas para mejorar la productividad española,* Instituto de la empresa familiar.

[327] http://www.iceta.org/jr1603 09.pdf.

[328] www.ine.es.

[329] http://www.ekoos.org/es/bloog/post/index.php?id=719.

Did you know?

In Spain, one in five people live on the poverty threshold.

The recommendations of the European Union are clear: reduce the school drop-out rate to break the cycle of poverty, emphasize the inclusion of the elderly, the young and immigrants, reform pensions to make them more sustainable and improve the application of the Dependency Law and access to public healthcare, among others.

7.3. Sustainable Spanish Companies

The growing internationalization of Spanish companies has led to concern among society about their behavior beyond the national borders. Thus, interest groups have been exerting pressure and have gradually transformed the values and outlook of business activity. Nowadays, Spanish business leaders are increasingly convinced that commercial success and long-term profits for their shareholders are not obtained only through maximizing short-term profits, but also through market-guided, yet responsible, behavior.

To the same effect, the Spanish Government undertook at the beginning of this year to instigate the State Council of Corporate Social Responsibility, a body entrusted with supporting and giving impetus to public policies to promote social responsibility in Spain, including the development of tools to prepare sustainability memorandums and reports. The subjects that the Council must deal with include the economic crisis, education, consumption, socially responsible investment and transparency.[330]

Clearly there is still a long way to go for the Spanish business community in terms of CSR. Of the 35 companies listed on the IBEX 35, only four presented relevant information in 2007 on aspects of CSR, according to the conclusions of a study by the Corporate Social Responsibility Observatory (see Figure 82).[331] These companies were: Acerinox, Altadis, Bolsas y Mercados Españoles, and Colonial.

[330] «Arranca el Consejo Estatal de Responsabilidad Social», *Expansión* (26/01/2009).

[331] http://www.observatoriorsc.org/.

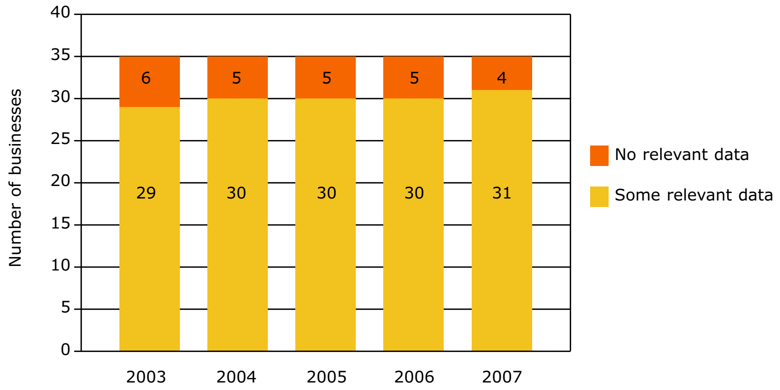


Figure 82. Number of IBEX 35 companies that present relevant information on aspects of CSR.
Source: Corporate Social Responsibility Observatory.

The study, which assesses aspects relating to the management, corporate governance and the social and environmental impact of the operations of IBEX 35 companies, highlights the differences that exist between the information provided to shareholders and potential investors and which is aimed at other interest groups. Serious imbalances occur between the financial reporting and the social and environmental information. In the analysis made, cases are identified of companies that in their sustainability reports advocate contributing to the socioeconomic development of the most disadvantaged regions, while in their financial information it can be clearly shown that their tax payments in these regions is reduced and the cost of access to services raised.[332]

One of the main problems to be faced by Spanish companies in environmental sustainability will be how to respond to the shortage of resources. Although the economy's extreme energy vulnerability represents a threat, a great opportunity is also offered to exploit its competitive advantage in the field of renewable energies as energy efficiency gains international importance. Madrid was chosen to host the 12th Genera trade fair, taking place in May 2009, and attended by representatives from various sectors: solar power (thermal and photovoltaic), cogeneration, biomass, wind, hydraulic, waste, hydrogen and fuel cell, coal, gas, oil and other energy sources (marine, geothermal, etc.). This type of program will help the Spanish economy take its position as a point of reference in a field with enormous growth prospects.

We only have to analyze the environmental market revenues, 10,818 million euros, and those for employment, 200,000 employees, to realize the beneficial side effects of this sector into the Spanish economy as a whole.

[332] http://www.observatoriorsc.org/images/documentos/publicaciones/notas_de_prensa/np_informe%20del%20ibex_290109.pdf.

Did you know?

Spain is currently about 81% dependent on imports to meet the country's energy consumption while the average for Europe is 52%.[333]

Rule 1: Diversify Energy Sources

Spanish companies, especially those working in the secondary sector, must find the optimum combination of energy sources to enable them to compensate growing demand with more efficient consumption, in order to counteract their high external energy dependence. They also have to commit to the search for alternative sources of energy, such as renewable energy. In this context, Spain first experienced the awakening of wind power; it then saw the deployment of photovoltaic farms and now it is the exploitation of thermoelectric solar energy that is seeing an unusual impetus. The favorable climate conditions in the southern half of Spain, the financial incentives and technological development have sent the number of projects soaring.[334] For example, the Spanish company Rotartica, based in the Basque Country, is collaborating with the Italian firm La Fabbrica del Sole on a pilot project in Italy that envisages obtaining air conditioning from solar power.[335] The domestic application of a technology that up until now has been used in industry covers the growing demand for air conditioning during the hottest times of the year. The systems are supplied with hot water from thermal solar panels that reaches about 90 degrees centigrade, before being turned into cold water.

In addition, projects to promote the use of nuclear energy have been implemented. Along with eight other Spanish companies, Iberdrola attended the 10th International Nuclear Energy Fair in Peking in order to initiate collaboration between Spain and China in the nuclear field.[336] In addition, this company imports liquid natural gas from Nigeria, Algeria, Egypt, Qatar, Trinidad and Tobago, Libya and Norway, in order to secure a sufficiently diversified and flexible supply. In February 2009 in Madrid, the Intereconomía Conferences hosted the conference "Mix Energético en España. Desafíos y Soluciones" ["Energy Mix in Spain. Challenges and Solutions"]. High points of the agenda were issues such as the current situation in the energy sector, the forecasts for development, a debate on the optimum energy mix, the role played by electricity and transport as principal energy consumers, and the short- and long-term steps to be taken to guarantee supply. The conference highlighted as sustainability measures nuclear technology, waste treatment, the integration of renewable energies into the grid, energy storage, and CO_2 capture in the use of coal for electricity generation. Another subject for discussion was the end of the Protocol of Kyoto and the Copenhagen meeting in December 2009. In this respect, Spain needs to reduce its greenhouse gas emissions, because unless it mirrors the rate of reduction followed by the EU-27, its competitiveness will be seriously affected by the internalization of environmental costs.

Rule 2: Bad Times for Renewable Energies[337]

In a visit to Spain, the former US Under Secretary of State for Democracy and Global Affairs, Paula Dobriansky, praised the Spanish renewable energy system, which places it in top position in this sector. She also emphasized the international leadership of Spanish wind energy companies.[338] Nevertheless, an article

333 «Mix Energético en España: Desafíos y Soluciones», Conferencias Intereconomía, Madrid, (26/02/09).

334 «La energía solar termoeléctrica se dispara en España», *La Vanguardia* (04/04/2009).

335 http://www.energiadiario.com/publicacion/spip.php?article7032.

336 http://www.eleconomista.es/empresas-finanzas/noticias/418336/03/08/Economia-Empresas-Iberdrola-y-otras-ocho-empresas-espanolas-buscan-oportunidades-en-energia-nuclear-en-China.html.

337 Headline on *Expansión.com* (31/03/2009).

338 http://www.energiayrenovable.es.

in *Expansión* at the end of March 2009 stated that half of the biodiesel plants were at a standstill and the four existing bioethanol plants were functioning at 60% of capacity.[339] The closure of installations and employee layoffs seem likely to be the direct consequence of a whole set of circumstances: the increase in supply, the fall in demand, the fall in prices and the widespread crisis.

One of the problems causing this situation is that US biodiesel, which enjoys a tax subsidy at origin, reached the Spanish market at an average cost 30% lower than the Spanish product. As a deterrent to dumping,[340] on March 13, 2009, the European Union imposed a customs duty on the entry of these exports from the United States. Despite this measure, the producers of biofuels are faced with surplus production capacity in the Spanish market. In 2008, installed biodiesel capacity amounted to over two million tons and the demand from the Spanish market in the same year did not even reach 600,000 tons. In the case of bioethanol, the figures for consumption and production are more balanced. The four bioethanol plants installed are functioning at 60% of capacity and in 2008 some 273,377 tons of this fuel were put on the market, of which 34% went for export.[341]

The producers believe that the excess of national supply over demand in the biodiesel market is a temporary imbalance. They are hoping that once the tap is closed on the flood of US biodiesel into Europe, the situation will return to that of 2006, when 50% of Spanish biodiesel production was exported to Germany or France, although there is the suspicion that this is unlikely to happen again. Nevertheless, while all this is taking place, some companies have decided to withdraw from the biofuel business. Such is the case for Ebro Puleva, which, after investing 10 million euros to build a plant in Jerez de la Frontera, ended up abandoning the project.[342]

The use of this type of energy is obviously being dictated by the law. In Spain there is a market share reserved for these fuels, of 3.4% in 2009 and 5.83% in 2010.[343] Nevertheless, for the companies in the sector this official support is proving insufficient. They feel that this, together with the low levels of demand from the Spanish market, is checkmating an industry in which Spain was starting to be a major player. Carlos Navarro, President of Siliken, a corporate group involved in the development of solutions applicable to the renewable energy sector, considers that "the problem is that competitors such as Germany, Japan, France... will end up being better than us. In the end we will have to buy the installations from them. And this is despite having a cutting-edge industry that was creating employment."[344]

The fact is that it is one lot of bad news after another in this sector. In March 2009, BP Solar, the subsidiary of the British energy group BP, announced the closure of its solar cell manufacturing plant at Tres Cantos (Madrid) and of the module assembly factory at San Sebastián de los Reyes (Madrid).

339 «Malos tiempos para las energías renovables», *Expansión.com* (31/03/2009).

340 Trade practice that consists in selling a good at artificially low prices to displace the competitors and widen control over the market. On the one hand, this can be performed by one enterprise to get rid of excessive stocks or as a measure of unfair competition. On the other hand, this can be done as a result of governmental subsidies.

341 «Malos tiempos para las energías renovables», *Expansión.com* (31/03/2009).

342 http://www.expansion.com/2009/03/31/empresas/energia/1238527152.html.

343 «Malos tiempos para las energías renovables», *Expansión.com* (31/03/2009).

344 http://www.ecoticias.com/20090405-fotovoltaica-yo-acuso-al-gobierno.html.

To offset the diminished perspectives at home and in order to survive, companies have launched themselves with frenzy into the overseas markets. This is the case of Gamesa Eólica, which has opened two wind parks in Italy and is planning to start on six more. Isofoton, a company that develops technological solutions for the generation and use of photovoltaic and thermal solar power, which in early 2000 exported 80% of its production and today only 30%, has redirected its activity abroad, in particular toward Germany, Italy and the United States. It has just signed a contract for a production facility in Ohio to assemble cells manufactured at its factory in Málaga. Siliken also hopes to find respite in the internationalization started a year and a half ago. However, some experts believe that Spanish companies will take at least two or three years before they are able to substitute their previous turnover with exports, since they will have to face problems like the financial crisis and the slow progress some countries such as Italy, Greece and the United States are making with their photovoltaic programs.[345]

Rule 3: Sound Practices Affect a Company's Reputation

The Spanish Corporate Reputation Monitor (MERCO) is a useful tool that makes an annual evaluation of the reputation of Spanish companies, similar to the *Fortune* list. In its compilation, the poll is made of a selection of business leaders (those who carry the most weight), experts, NGOs and consumer associations; they are asked which of the companies with over 50 million euros in annual revenues have the best reputation in Spain, and are also asked to list the factors on which they made their selection.

Corporate reputation is the way in which the stakeholders in a company recognize their corporate behavior depending on how far they fulfill their undertakings to their customers, employees, shareholders—if there are any—and to the community in general. In the 2009 edition,[346] Inditex headed the ranking for the second year running. The only change in this year's top ten compared with the previous year was the rise of MAPFRE from 13th to 10th place. The two sectors that suffered most from a loss of ranking were the banks (despite the fact that the Banco Santander, La Caixa and BBVA were among the top ten) and the construction industry. Conversely, the insurance sector and the information technology companies gained ground. Of these companies, Mutua Madrileña was notable for climbing more than 20 places (from 70th to 34th).

The Inditex corporate website explains its model of sustainability based on good faith, dialogue and transparency in its business, and states that "although the commitments we undertake on sustainability are movable, our Internal Code of Conduct lays down the ground rules and influences all of our manufacturing distribution, and marketing activities all over the world." Inditex was one of the first Spanish companies to adopt the GRI 2002 standard. In the case of MAPFRE, the company sets out the three main lines behind its model. First, compliance with the laws in force and with the international commitments entered into (United Nations Global Compact and UNEP Protocol). Second, service to society,

[345] http://www.ecoticias.com/20090405-fotovoltaica-yo-acuso-al-gobierno.html.

[346] http://www.empresaresponsable.com/articulos/detail.php?id=4428&sec=111.

striving to achieve progress and acting in a spirit of solidarity. Third, the comprehensive management of social responsibility by those involved in corporate decision-making at any level. It establishes an extremely extensive interest group on two levels: in the first place, shareholders, employees, mutual insurance companies, suppliers and collaborators; and second, public opinion, competitors, NGOs, labor unions, public authorities, consumer organizations and the media. It should also be emphasized that for over 20 years MAPFRE has allocated a percentage of its annual net profits to financing non-profit activities of general social interest, through its six private foundations.

The case of BBVA is noteworthy; it was awarded the 1st Prize for Best Responsible Practices by the Club of Excellence in Sustainability. The award was granted on the basis of the methodology employed, the facilities for the introduction of these responsible practices, the results obtained, the organization of benchmarking between companies and, lastly, the effectiveness of the measure with regard to returns on investment. L'Oréal España made the commitment to the construction of an intelligent and environment-friendly building, combining the four divisions of the holding company.[347] The key to energy saving was solar panels and low-consumption fluorescent bulbs. The application of sustainable technologies has reduced water consumption by 27%, electricity by 17% and CO_2 emissions by a spectacular 92%.

In 2009, Acciona was granted the Corporate Sustainability Prize awarded by the European Business Awards (EBA) organization.[348] The Basque company Fagor has also received an award this year for its responsibility toward society and its employees in its internationalization processes, granted by the Gipuzkoa Social Responsibility Forum. In 2007, Metro de Madrid was awarded the "2007 Prize for the best CSR solution in the Environment category" with its solution "Environmental Management in Metro de Madrid" at the CSR MarketPlace. Its CSR model is built on three fundamental cornerstones: increasing customer satisfaction, promoting sustainable mobility and improving the experience of employees.

As a final observation, Justo Villafañe, Head of the Department of Audiovisual Communication and Advertising of the Universidad Complutense, giving classes in corporate image, declares that "it won't reach the point where (CSR) certification will be required to be able to do business, but the force of the facts will ensure that those companies with irresponsible behavior are excluded: they are going to be excluded because it will no longer be tolerated."[349]

Rule 4: CSR is a Powerful Talent Magnet

As has been discussed in the rules for developed companies with regard to sustainability, employees are increasingly sensitive to the CSR policies of the companies in which they work. Spanish companies will be even more exposed in the international competition for talent for the reasons that have been explained previously. One of the most effective factors in attracting and retaining talent

[347] «L'Oreal España se tiñe de verde con su nuevo "edificio inteligente"», *El Economista* (17/03/2009).

[348] «Acciona, galardonada con el Premio a la Sostenibilidad Corporativa», *eleconomista.es* (8/04/2009).

[349] http://www.serresponsable.es/modulos/mod_periodico/pub/mostrar_noticia.php?id=102.

within organizations is having a good reputation internally. In this way, the people who work in the company will feel corporate pride when they find that they are aligned with corporate objectives and strategy.

The new generation born after 1980 is less committed to the company but more committed to their work. These young people desire stability and regularity, as well as fixed hours. In addition, a study by PricewaterhouseCoopers indicates that "87% of college graduates aspire to work in a company with whose CSR values they are in agreement."[350] So it is not surprising that companies must design a strategy that focuses on this group, given the scarcity of talent in the future when the world economy picks up again. It is precisely through its human resources that a company must seek sustainability because "the present must be managed in order to plan for the future, since nowadays we suffer from a scarcity of talent and for two or three generations immigrants will not be able to meet these requirements," comments the human resources expert Manuel González. He points out that opting not to cut costs by laying off employees in times of crisis sends a message of commitment to staff, which can have the effect that the company comes out stronger from the crisis.

Rule 5: Foster the Virtuous Circle of Sustainability

Companies must seek those aspects of CSR that complement their business and that feed corporate capacities, allowing competitive advantages to be created in a virtuous circle of sustainability.[351] This is the case of the dairy producer Ebro Puleva, which makes donations of the various food products in the group's product range. The collaboration agreement with FESBAL, the Spanish Federation of Food Banks is intended to administer and distribute the products donated by Ebro Puleva among the provincial food banks. In addition the company's foundation carries out development education projects in the sphere of agriculture in Third World countries, always with a view to enabling these communities to achieve self-sufficiency.

Grupo SOS—Spain's second-largest food group in terms of revenues among the companies in this sector listed on the Spanish Stock Exchange—shows its commitment through its Strategic CSR Plan started up in 2003, named "Alimentando un Futuro" ["Feeding the Future"]. Its actions focus on various core themes, among which the following are notable as projects that complement the group's business activities:

1. "Commitment to Nutrition," which sets out to offer consumers healthy products that suit their needs.
2. "Our Social Action," which is aimed at meeting the basic needs of the disadvantaged in the environment in which the group operates.

In short, these Spanish companies have succeeded in integrating their CSR policies with their corporate strategy, creating synergies between their business and society for the benefit of both.

[350] http://www.losrecursoshumanos.com/contenidos/3417-el-87-de-los-titulados-aspira-a-trabajar-en-una-empresa-con-la-que-coincida-en-sus-valores-de-rsc.html.

[351] «La responsabilidad social corporativa como necesidad estratégica: casos prácticos», Francisco Trullenque, *Harvard Deusto Business Review* (March 2008).

Rule 6: Embrace the Principles of Transparency and Good Governance

There is room for improvement among Spanish companies in good corporate governance. The data of the Sustainability Observatory study carried out among companies listed on the IBEX 35 are revealing:

- 57% of IBEX companies do not disclose details regarding the individual compensation of their directors. Furthermore, they do not always itemize these amounts within the payment package.
- Only 20% openly report golden-parachute clauses. It is usual to inform on the number of beneficiaries, but not on the amounts in favor of each one, nor their names. It is not usual to find information indicating that the golden parachute clauses are approved by the general meeting of shareholders.
- There continues to be little evidence of the presence of women in top corporate management and in particular on the board of directors.
- Only 40% of companies stipulate that their non-executive directors should not hold this office for longer than 12 years.

In regard to a debate that has been well-aired during the crisis, on the excessive salaries of top executives, the warning by the Spanish Prime Minister—"This is not a time of high profits or high salaries"—appears to have had its effect. The President of the Banco Santander, Emilio Botín, announced that he was going to reduce the payment established in the bank's charter for directors by 10% and the variable remuneration paid to executive directors by a further 15%. Only hours later, BBVA announced that it was freezing the pay of its 300 top managers. In addition, the President, Francisco González, and the Managing Director, José Ignacio Goirigolzarri, will this year receive 454,400 and 383,400 shares, respectively, as a result of the of long-term share-ownership incentive plan that has just ended, and that covers the years 2006 to 2008.

Rule 7: Be Prepared for Shareholder Activism[352]

Those who are most critical of the effectiveness of CSR practices view investor activism with fresh hope. This new practice, which consists of the participation of NGOs and other pressure groups in the company to ensure that human, social and environmental rights are respected, seems to be gathering force in Spain and becoming customary in major companies.

In this way, organizations such as Intermón Oxfam have taken part in the shareholders meetings of some companies to protect the rights of native populations. In these cases, shareholders are obliged to listen to the NGO's reproaches because they are speaking on behalf of investment funds that have a participating interest in the company's equity.

[352] http://spanish.safe-democracy.org/2008/06/06/el-buen-gobierno-corporativo-es-negocio/.

Shareholder activism has a history that goes back some decades, especially in the English-speaking world. In Spain it is more recent, but has been practiced for seven years. It was introduced by Setem, the NGO that has put it into effect most frequently and that in 2001 surprised everyone by acquiring 120 shares of Inditex—of the float of 630 million.

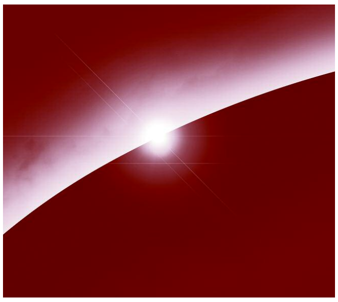
Nevertheless, there are some social agents who do not believe in the effectiveness of this new form of pressure. For example, the Globalization Debt Observatory (ODG), linked to the Universitat Politècnica de Catalunya, considers it more useful to take part in the "counter-summits," even at the cost of burning bridges with companies and ceasing to act as interlocutors with them. This organization believes that there is a danger that the major companies might use the NGOs for their own legitimation. Its analysis turns on its head the notion of shareholders' general meetings being taken over by the non-governmental organizations.

8

CHAPTER 8

Innovation: a Key for the Future

8 Innovation: a Key for the Future



It has often been mentioned throughout this study that we are witnessing a process of change that involves a shift in the forces of power in the international sphere. Countries with developed economies are losing ground in the global market, while those with emerging economies are gradually reaching the necessary capacities for producing the same products and services as developed markets and, moreover, at a lower price.

Given that this shift is eliminating developed countries from certain high-growth sectors, the solution for strengthening their international positioning lies in innovation as the means through which to enhance productivity and competitiveness.

Innovation is more than simply generating ideas. It implies transforming these ideas into economic and social value. If Henry Ford had asked his customers what they wanted, they would have said "a faster horse," not "a car." Likewise, IBM's customers would have wanted "faster mainframes" instead of "a PC."[353]

Committing to innovation entails being prepared to change the way in which things are done at all levels, as an individual, society, company or country. Innovation efforts must be part of the DNA, and all agents must work together to provide the innovators with a safety net that will encourage them to try, even if they fail. Socially penalizing those who fail would hinder innovation.

In recent years, we have witnessed the tremendous power of innovation and how it has revolutionized the economic and business sphere. As the knowledge-based economy advances, innovation becomes increasingly important. Within this context, growth is based on using knowledge to improve performance, and this performance can be boosted with innovation. Thus, the contribution that innovation makes to economic growth and the development of countries is more and more evident.

The Imperative of Innovation

Now, more than ever, innovation is on everyone's mind. Governments and companies are acknowledging the need to create conditions that favor innovation and extend its benefits to all sectors of society. It is no wonder that the G20 leaders focused much of their discussion during the Summit in Washington on innovation as a medium-term measure for overcoming the crisis: "Our work will be guided by a shared belief that [...] innovation and entrepreneurship are essential for economic growth, employment and poverty reduction."[354] When the financial turmoil comes to an end, the countries that have been innovative and showed long-term vision shall be better prepared to face the decades to come.

Developed countries agree with this line of thinking. A study conducted by the US Council on Competitiveness[355] stated that "innovation will be the single most

353 Judy Estrin, veteran executive from Silicon Valley and author of *Closing the Innovation Gap: Reigniting the Spark of Creativity in a Global Economy.*

354 http://www.funciva.org/uploads/ficheros_documentos/1227280229_el_triunfo_de_adam_smith_en_el_g-20.pdf.

important factor in determining America's success through the 21ST century. For the past 25 years, we have optimized our organizations for efficiency and quality. Over the next quarter century, we must optimize our entire society for innovation." In addition, the Lisbon Agenda challenged Europe to become "the most competitive knowledge-based economy in the world, with sustainable development, more and better jobs, and greater social cohesion in 2010."

Emerging countries are also aware of the importance of innovation. Since the late 1990s, their R&D investment has increased by 50%. Even in Africa, governments are trying to use technology as a means of innovation and development.[356]

Nevertheless, according to the opinion of most of the Future Trends Forum experts, R&D investment is expected to drop as a result of the current crisis. Given the lack of available capital, investment will focus on covering basic needs. Innovation is a long-term, high-risk process, and the results can be unpredictable.

Nonetheless, there is a great opportunity for those who invest in innovation. The Future Trends Forum experts concluded that "the strong shall become stronger and vice versa." In fact, innovation during times of crisis is associated more with an opportunistic trend than with investment *per se* in the R&D budget. Some of these examples of opportunity will be covered in the next section.

Within this context, companies will act as a basic engine for innovation activity. Thus, the crisis will probably put new energy into business innovation. As the experts pointed out at the last Future Trends Forum session, significant innovation occurs during periods of recession. This is because tough times force companies to transform their business in order to adapt to such a fast-changing environment. According to Laura González-Molero, President and CEO of Merck,[357] in order to be innovative during times of crisis, businesses "must avoid self-complacency as well as a negative and paralyzing spirit, foster creativity, seek new opportunities, and take risks."

Therefore, the drive toward innovation will help countries and companies improve their situation during the current crisis and ride the next wave of growth. Below is a more in-depth look at the focal points of innovation at the global level.

The Geography of Innovation

Historically, a country's innovation has usually been measured according to specific indicators, such as the number of registered patents or research journal articles, or the percentage of GDP spent on R&D. Although these measurements are useful, innovation is no longer limited to the vertical structures of R&D laboratories and universities, but rather thrives in different ways and takes on various shapes: innovations in marketing (e.g., Swatch watches), in business

[355] http://www.compete.org/.

[356] http://www.managementtoday.co.uk/news/625441/.

[357] Laura González Molero, at the conference "Talento frente a la Crisis" ("Talent Versus the Crisis"), organized by the Asociación para el Progreso de la Dirección (APD).

models (e.g., eBay's success with P2P sales) and even social innovations (e.g., social networks). This idea led the INSEAD Business School to develop an indicator that measures the innovation level in 130 countries (the Global Innovation Index).[358]

This index takes various parameters into account and classifies them into inputs (institutions, human capital, infrastructure, market and business sophistication) and outputs (knowledge, competitiveness, and wealth) of innovation activity (see Figure 83).

[358] Global Innovation Index 2008-2009, INSEAD.

Country	2008-09	Rank
United States	5.28	1
Germany	4.99	2
Sweden	4.84	3
United Kingdom	4.82	4
Singapore	4.81	5
South Korea	4.73	6
Switzerland	4.73	7
Denmark	4.69	8
Japan	4.65	9
Netherlands	4.64	10
Canada	4.63	11
Hong Kong	4.59	12
Finland	4.57	13
Norway	4.47	14
Austria	4.46	15
Taiwan	4.41	16
Luxembourg	4.37	17
Belgium	4.35	18
France	4.35	19
Iceland	4.34	20
Ireland	4.30	21
Australia	4.27	22
Israel	4.17	23
Qatar	4.12	24
Malaysia	4.06	25
United Arab Emirates	3.99	26
New Zealand	3.97	27
Spain	3.81	28
Estonia	3.69	29
Kuwait	3.66	30
Italy	3.65	31
Saudi Arabia	3.65	32
Czech Republic	3.64	33

Country	2008-09	Rank
Bahrain	3.59	34
Slovakia	3.59	35
Slovenia	3.59	36
China	3.59	37
Malta	3.54	38
Chile	3.51	39
Portugal	3.49	40
India	3.44	41
Lithuania	3.43	42
South Africa	3.41	43
Thailand	3.40	44
Cyprus	3.39	45
Tunisia	3.37	46
Hungary	3.34	47
Costa Rica	3.27	48
Indonesia	3.26	49
Brazil	3.25	50
Turkey	3.24	51
Oman	3.23	52
Barbados	3.17	53
Greece	3.17	54
Jordan	3.16	55
Poland	3.15	56
Azerbaijan	3.14	57
Sri Lanka	3.12	58
Uzbekistan	3.11	59
Latvia	3.10	60
Mexico	3.06	61
Croatia	3.03	62
Philippinas	2.99	63
Vietnam	2.97	64
Trinidad and Tobago	2.96	65
Mauritius	2.95	66

Figure 83. Global Innovation Index.
Source: INSEAD Business School

The results are revealing. The United States ranking first is not surprising, as it has led innovation for the last century. Europe has six countries in the *Top 10*: (Germany, Sweden, United Kingdom, Switzerland, Denmark and the Netherlands) and 11 in the *Top 20*. This could be a sign of hope for Europe's future.

Nonetheless, the future of innovation seems to be moving eastward. Singapore is in fifth place, South Korea is sixth, Japan is ninth and Hong Kong is twelfth. China and India occupy the 37th and 41st places, respectively. China has over 300 research centers, exceeded only by the United States, and that number continues to rise.

The United Arab Emirates ranks 26th thanks to the leadership of its respective governments, which have distanced themselves from the neighboring countries through policies specifically designed to attract qualified workers and companies at the forefront of technology. The result, primarily in Dubai, has been the emergence of a concentrated area of innovative companies.

The Future Trends Forum experts have forecasted increased collaboration with regard to innovation among emerging and developed countries. They believe that innovation will no longer follow the usual path from developed to emerging countries. Rather, the future will see a change in this direction as developed countries gradually start adopting innovations from emerging countries (see Figure 84).

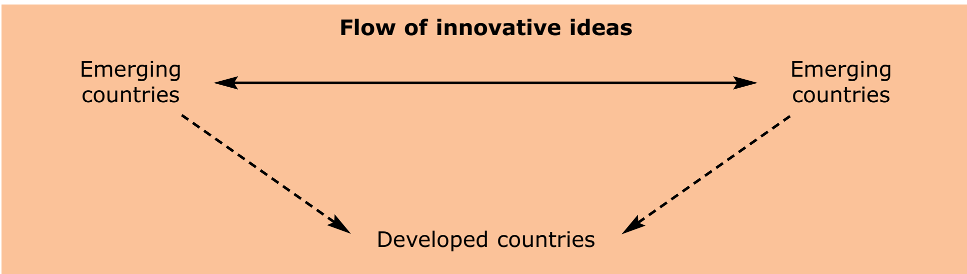


Figure 84.The flow of innovative ideas.
Source: *Appropriate Infrastructure Development Group,* Catherine Laine.

Did you know?

Between 2000 and 2006, patents filed in China rose from 1.8% to 7.3% of the global total.

According to the Future Trends Forum experts, one critical aspect for the development of emerging countries is adopting innovations that were spawned in developed countries, and adapting them to their circumstances. With regard to the geographic areas where innovation will arise from in the next five years, they predict that Asia will lead innovation in the automotive and construction industries, while the United States will lead in technology, aeronautics, and health (see Figure 85).

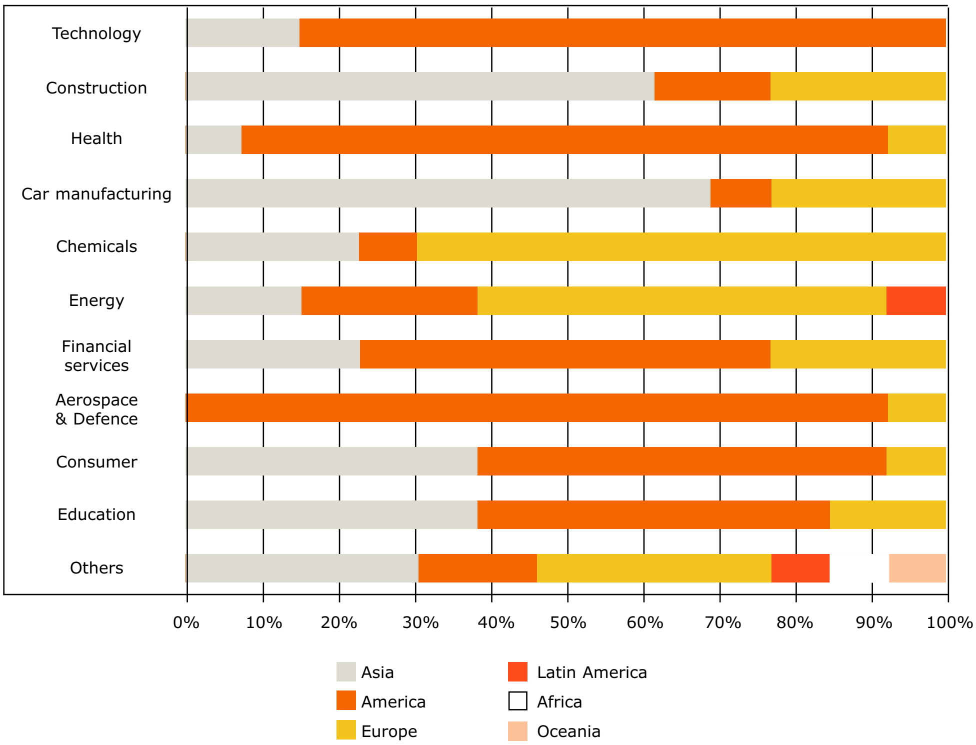


Figure 85. What geographic areas will innovations arise from in the following industries over the next five years?
Source: Drawn from the conclusions within the Future Trends Forum.

A future investment

There is some confusion regarding the concept of innovation and that of R&D investment or "scientific research." The real challenge lies in innovating to create value by making things in a different way or even making things that are radically new.[359] In this regard, R&D investment can be a source of new ideas, but not the only one.

This distinction is important, because if innovation is understood from a perspective that limits it to R&D investment, it becomes difficult to design and

359 Innovación: *The Wealth of Nations,* Fundación de la Innovación Bankinter.

implement measures for managing the elements that hinder its progress. R&D investment can be driven through measures such as increased financing, subsidies, tax deductions, and direct aid. Driving innovation, however, is a complex process that has more intangible than tangible elements.[360]

Amar Bhidé of Columbia University recently published *The Venturesome Economy*, a book in which the author defends the notion that a country's economic growth does not stem from its investment in technology, but rather primarily from its capacity to innovate. Bhidé argues that technology has played a crucial role in most of the greatest business successes to come out of the United States in recent decades (e.g., Amazon, Google, Apple), but that the capacity to innovate and transfer an innovative project to the real world has played an even larger role.

In this regard, it is true that different studies appear to show that companies with greater R&D investment clearly outperform the market average in the long term. However, the mere fact that they are investing in R&D does not necessarily mean they are more innovative. Innovation can occur without massive R&D spending; when the focus changes and investment is made in innovation, the results are much more powerful than those achieved through mere R&D investment.[361]

The capacity of many companies to compete at the international level has not been the result of extensive investment in technology or an allocation of additional resources to research. In most cases, their success has lied in their ability to define an innovative business model.[362]

At the national level, commitment to innovation is crucial for increasing the standard of living of citizens and resolving difficult challenges regarding energy, climate change, healthcare and national security. After the November 2008 presidential election in the United States, many countries turned their attention to Barack Obama's stimulus package in hopes of imitating the measures adopted by the "great giant." Of the 819-billion-dollar budget, Obama has earmarked a total of 37 billion for: digitizing medical records (20 billion dollars); a more efficient energy grid (11 billion); and a high-speed Internet infrastructure (6 billion). The broadband investment fulfills the role of the railway and road networks that were a significant engine for the economy in the past.[363]

[360] http://thoughtineuskadi.wordpress.com/2009/01/12/sobre-la-diferencia-entre-la-innovacion-y-la-id/.

[361] http://www.intelectium.com/blog/?p=11#more-11.

[362] http://reggio.wordpress.com/2008/12/28/innovacion-y-crecimiento-de-jordi-canals-en-la-vanguardia/.

[363] http://reggio.wordpress.com/2008/12/28/innovacion-y-crecimiento-de-jordi-canals-en-la-vanguardia/.

Did you know?

Between 1997 and 2007, the most innovative companies grew 10.56 times faster than the *S&P 500* index, while those which invested most in R&D grew only 1.63 times more.[364]

Sweden and Finland are among the leading countries in R&D investment, while the Slovak Republic and Greece are trailing at the end (see Figure 86).

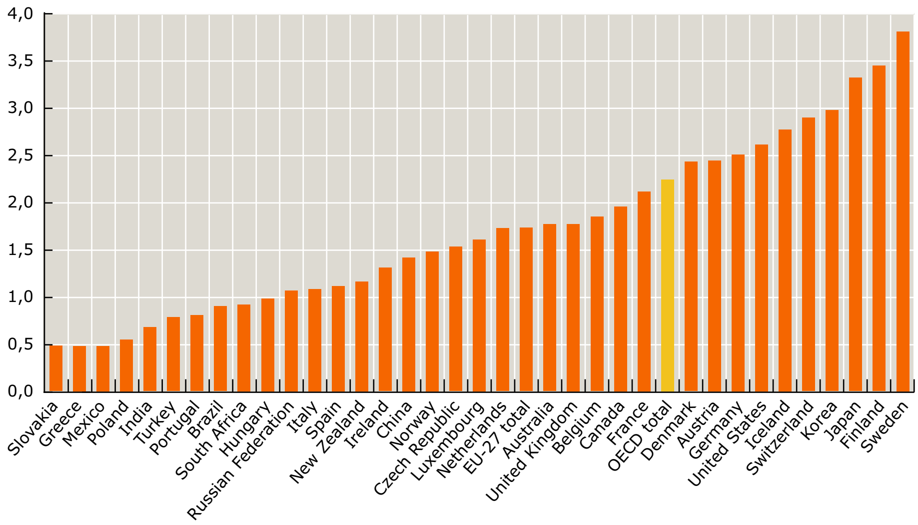


Figure 86. RDI as percentage of GDP in the year 2006 (or last year available).
Source: *OECD Factbook 2008: Economic, Environmental and Social Statistics.*

More proof that innovation is not always linked to R&D investments can be found, in an increasingly evident manner, in social innovation. The trend is that innovation is undergoing a "democratization" process because users, supported by improvements in the telecommunications field, are becoming increasingly capable of developing their own new products and services. Furthermore, they tend to freely share their innovations, creating communities and shared knowledge networks.[365] We have previously referred to this as the "P2P economy."

Innovation Support Policies

A series of key messages was launched during the OECD seminar on February 16, 2009, which focused on sustainability and innovation policies in the current situation.[366] Among these messages, the fundamental role that innovation policies are expected to play in the fight against the economic crisis is particularly noteworthy. These policies are expected to be of great importance and based on good governance and strong political leadership. Short-term stimulation of innovation will result in long-term growth. The quality of national intervention is very important throughout the entire transformation process. Thus, continued support must be actively provided to those entrepreneurs and businesses that are willing to take innovation-related risks.

364 http://www.intelectium.com/blog/?p=11#more-11.

365 *The Sources of Innovation,* Eric von Hippel, professor at the MIT Sloan School of Management.

366 «Informal Seminar on Sustainability and the Role in the Current Financial Crisis», OCDE.

Many OECD countries are already implementing policies aimed at stimulating and fostering innovation. The country's volume of innovation will be determined by a variety of different factors: entrepreneurial activity, investment, information and communication technology networks, knowledge (through human capital), green technologies, etc. The OECD has warned that a great deal of knowledge is being lost because the best practices being carried out by the different countries are not being documented. Since sharing these practices can help establish new policies, the OECD has proposed to act as facilitator, guaranteeing transparency and fostering international cooperation.

All these governmental measures must be carried out while considering the needs of entrepreneurs and newly created businesses, which have long been considered the prime examples of innovation of each country. Supporting them with innovation-fostering policies will boost the creation of new companies. Once this is done, innovations can be marketed, which will in turn generate wealth for the nations. In fact, innovative entrepreneurs contribute more to generating wealth because they create more jobs; a small number of innovative startups generate a disproportionately large number of new jobs.

Another way to boost the country's entrepreneurial activity, and thus innovation, is to open the country to immigration. This is the main idea of a recent article in *The Economist*: "Immigrants have always had more entrepreneurial drive than those who stay in their country of origin. The most entrepreneurial places of modern history have been those inhabited by Jewish, Chinese and Indian individuals who have left their homeland. In today's knowledge society, qualified immigrants play a leading role in innovation. They create more companies, circulate ideas, money and capacities…."[367]

As a final thought, **Soumitra Dutta** (Future Trends Forum expert and advisor to the World Economic Forum in innovation-related matters) summarizes some useful ideas in a paper on what must be done in order to be more innovative. For this author, one must have **inspiration** (associated with **leadership**), **aspiration** (associated with **success**), **transpiration** (associated with **hard-working spirit**) and **respiration** (associated with **reflection**).[368]

8.1. Innovative Business Strategies

The rules of the game in the multipolar world are also changing with regard to innovation. It seemed that, despite the growing presence of emerging economies, the United States would always have innovation with which to stand out in the international arena. Nevertheless, even in this realm reserved up to now for the most advanced countries, emerging countries such as China are taking the lead. Emerging industries are now at the forefront of the return to innovation as it was in its first stages in developed countries: with no restrictions of risk and costs.

[367] http://www.economist.com/specialreports/displaystory.cfm?story_id=13216077.

[368] http://www.pasionporinnovar.com/2008/03/soumitra-dutta-best-practices-in-world-class-innovation.html.

Even so, during times of crisis, many make the mistake of reducing the budgets allocated to innovation in order to use the available money for company survival. Nevertheless, it is precisely a company's capacity to innovate that can bring it out of a recession with a clear competitive advantage. Today, innovation goes beyond the mere implementation of quality and cost controls. It should be viewed as an opportunity to improve efficiency and strengthen the company's sustainable growth. Nonetheless, despite the benefits it brings, it is a risky and frustrating process with high failure rates.

Many companies suffer from the "always doing everything the same way" syndrome, which prevents them from reacting to the threat of competition. Investors and analysts partly contribute to this situation, as they often prefer to have companies maximize the value generated for the shareholder, doing things just as they have always been done. As a result, large companies, primarily those which everyone expects to earn profits and distribute stable, predictable dividends (i.e., companies with "income-generating shares") are rarely viewed positively on the stock market for introducing new technologies or radical innovations. The main reason is that obtaining a return on an investment in innovation takes longer than the distribution of dividends or may never occur at all. On the contrary, they may be punished with a drop in the price of their shares and market value. For this reason, it appears that innovation is relegated to new companies financed with venture capital. Some experts suggest that the outsourcing of innovation may become the trend in a not so distant future and that many of the truly radical innovations may shift from large companies to newly founded smaller ones.[369]

When considering which business strategies will be most effective for investing in innovation in the next three years, the Future Trends Forum experts indicate that "improving products, processes and management" and "strengthening technological capacities" should be the two priorities for companies (see Figure 87).

[369] http://www.wharton.universia.net/index.cfm?fa=viewArticle&ID=1616.

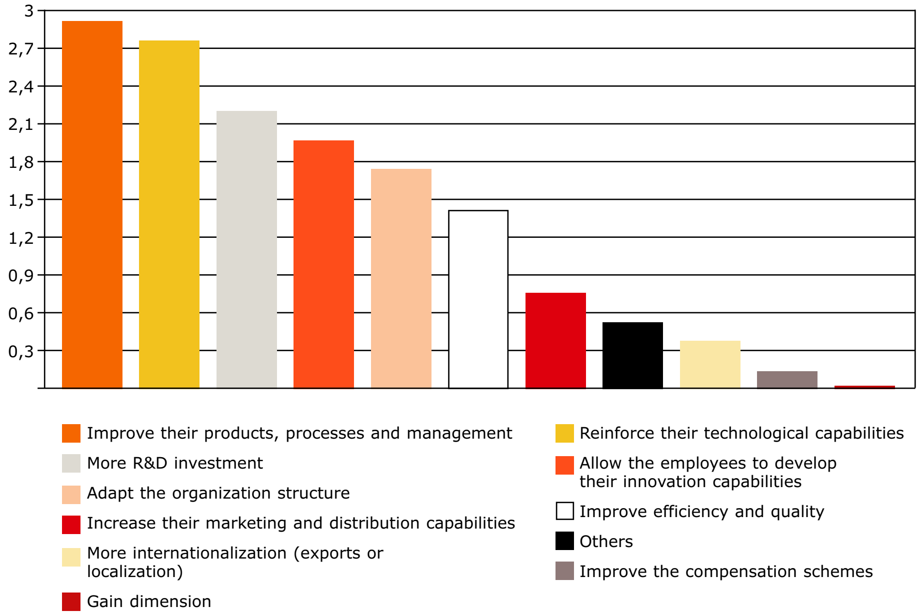


Figure 87. What are the most effective ways for companies to invest in innovation in the next three years?
Source: Drawn from the conclusions within the Future Trends Forum.

Experts believe that these two priorities are the appropriate response to an environment that is becoming increasingly competitive with regard to innovation, which has gone from being generated within countries (generally within their companies) that would assume ownership to being relocated and globalized. A clear example of this is Skype, the Internet service that allows customers to make calls, including video calls, and send instant messages free of charge. Today it belongs to eBay. Its headquarters are in Luxembourg and its founders are of Scandinavian origin. While its development center is in Estonia, it also has local offices in London, Tartu, Prague, and San Diego.[370] Innovation programs are gaining in scope and becoming more global. In this new economic context, innovation policies can no longer be based on the R&D subsidies of a country's leading companies. These companies can no longer be classified as Swedish, American, or Spanish, as a large part of their control and activity takes place outside the country. Today, their strategic address is, for example, in the United States or United Kingdom, their work language is English and much of their manufacturing is located in China.

Nevertheless, and especially as a result of the crisis, we are seeing the opposite reaction, which leans toward protectionism, with governments and companies creating difficulties for global competition in innovation, especially with regard to attracting talent. Although companies no longer have flags, economic policies cannot escape from them. There is a need for innovation policies that have a

[370] http://www.sideinternational.com/index.php?option=com_content&task=view&id=135&Itemid=61.

greater scope and are more global. In this regard, regulations related to innovation policies and funding from the European Union within the Seventh Framework Programme are crucial. The future competitiveness of European companies will not only depend on the creation of "unrelated knowledge societies" but also on the generation of meta-territories in which there are strong flows of knowledge, technology, people, and capital. Future innovation policies must make an effort to catalyze these flows.[371]

In this regard, Vijay Govindarajan and Chris Trimble,[372] world-renowned strategy and innovation experts, believe that even leading companies will end up reaching their maximum growth. This is what makes the emerging sectors so attractive. These markets offer tremendous opportunities for growth and a competitive advantage in the long term. However, given that there is no proven formula for obtaining profit, these are businesses that require a high level of investment and risk. They claim that the survival of all organizations depends on strategic experiments, the aim of which is unexplored markets. But they do recognize that there are few companies that know how to optimally conduct these experiments. There are too many executives who believe that having a good idea is enough to create a business plan and earn profit. Thus, most organizations fail in the middle of the innovation process. They highlight exactly what is needed to build a profitable business without negatively affecting the company's central economic activities. Basing their observations on an in-depth study carried out over several years on the innovative projects of ten large companies, the authors identify three main prerequisites for strategic innovation: forgetting certain key assumptions that have led the company's central business to success; borrowing resources from the established organization to supply the new business; and learning how to successfully maneuver through an emerging and uncertain market.

Innovative Companies of Developed Countries

The Future Trends Forum experts believe that an increase in international competition as a result of the globalization of trade and capital will encourage companies to innovate instead of simply reducing cost and price.

Nevertheless, the experts were quick to indicate that the crisis would definitely have an impact on innovation. This is where the opinions begin to diverge. Some believe that R&D investment will significantly decrease with consequences, even in the long term. Others indicate that innovation offers the opportunity (or obligation) to certain companies to come out stronger, because they will be able to adapt to the emerging markets in a more flexible manner. There are also those who use the difference between R&D investment and innovation activity to explain that, even though the former will be affected like any other area of the budget, the latter will continue.

During a time of change like the one we are currently experiencing, it is necessary to explain the term "disruptive technology," which became popular

[371] http://www.sideinternational.com/index.php?option=com_content&task=view&id=135&Itemid=61.

[372] *Ten Rules for Strategic Innovators,* Vijay Govindarajan and Chris Trimble.

during the late 1990s after the publication of *The Innovator*'s *Dilemma* by Clayton Christensen, a Harvard Business School professor. This type of innovation is related to those ideas that "cause a collapse or breakdown of the process of adapting to the environment's new conditions, due to the fact that it is necessary to control a new portfolio of basic competencies that render tangible and intangible assets, infrastructures, and other patents of existing companies useless."[373] In the case of technologies and disruptive innovations that are radical by nature, the strategic implications are significant, to the extent that they could directly interfere in the enhancement or change of a company's activity.

These disruptive technologies will result in discontinuous, radical innovations that in most cases will spread through the market slowly, given the resistance to change that can arise in potential consumers that are unwilling to change their consumer habits. Indeed, the initial performance of disruptive technologies is lower (in profit and functionality) than that of technologies developed by existing companies. This lower performance, in principle, does not attract most potential customers. Subsequent, more effective performance makes these disruptive technologies more appealing to users and results in a migration toward new technology. The lack of accumulated competencies associated with these disruptive technologies among the sector's established companies can lead to their abandonment and disappearance.[374] Film photography versus digital photography and landline phones versus cell phones… companies such as Kodak and Telefónica have managed to define their business strategies around these sudden changes.[375]

History has provided us with numerous examples of companies that have been able to adapt to the market in extreme situations. The multipolar world is a source of many "collapses" and "breakdowns" of the known system. Companies must come to terms with this reality in order to overcome the numerous obstacles that cross their paths: new emerging markets, fast changes, experimental social networks, and many more. Within the realm of innovation, these changes are especially important if one takes into account that the fastest one tends to be the winner. Below are some of the current trends in innovation that can serve as a guide for securing a place in the innovation "race."

Rule 1: Bring R&D Closer to the Local Market

The beginning of this chapter presented the idea that innovation in the multipolar world is also becoming more geographically scattered and has numerous power centers. R&D has become a global activity and thus is subject to offshoring strategies. Offshoring aims not only to reduce costs and reap the tax advantages and incentives provided by the destination country, but also to meet the need of being closer to the new markets it strives to serve, gaining a better understanding of their needs and taking advantage of local experience. Some 40% of the executives of companies that sell new products in emerging markets state that these have been designed locally.[376]

[373] http://www.madrimasd.org/revista/revista21/aula/aula1.asp.

[374] *Innovación y tecnologías disruptivas en sectores tradicionales: una aproximación al sector español de las telecomunicaciones,* Redondo, J., Interuniversity Doctorate in Innovation Management. Universidad Complutense de Madrid (2003).

[375] http://www.madrimasd.org/revista/revista21/aula/aula1.asp.

[376] *Laboratories of Innovation: Leveraging Emerging Markets for Commercial Success,* Deloitte (2006), http://www.deloitte.com/dtt/cda/doc/content/Innovation%20in%20Emerging%20Markets_ExecutiveSummary_Final_2006(4).pdf.

The phenomenon of offshoring R&D centers to emerging countries is partly due to the growing experience in sciences and engineering at much more competitive costs. Almost two hundred companies in the *Fortune* index have set up R&D centers in India.[377] Dell Computer transferred a large part of its R&D center, related to technological products, from Austin (United States) to Taipei (Taiwan), Singapore and Shanghai (China). The benchmark centers boast engineering, *software and marketing experts that work to take advantage of the synergies of end-to-end design*.[378] In 2005, Nokia set up an R&D center in China. One year later, this center was expanded to develop more products, specifically infrastructure networks for cell phones.

The R&D offshoring trend has become even more evident with the crisis: in March 2009, all signs pointed toward 5,000 layoffs in the United States of positions that were going to be absorbed by India.[379] It appears that the crisis and globalization have intensified and sped up the phenomenon of offshoring to low-cost countries. As a result, China and India are in first and third place (separated by the United States) in the ranking of the most attractive prospective R&D locations, according to a survey by UNCTAD[380] (see Figure 88).

[377] «Offshoring won't stop», *Khaleej Times Online* (26/03/2009).

[378] www.dell.com.

[379] «Manifest destiny?», Reuters (4/04/2009).

[380] http://www.unctad.org/Templates/webflyer.asp?docid=6333&intItemID=3369&lang=1.

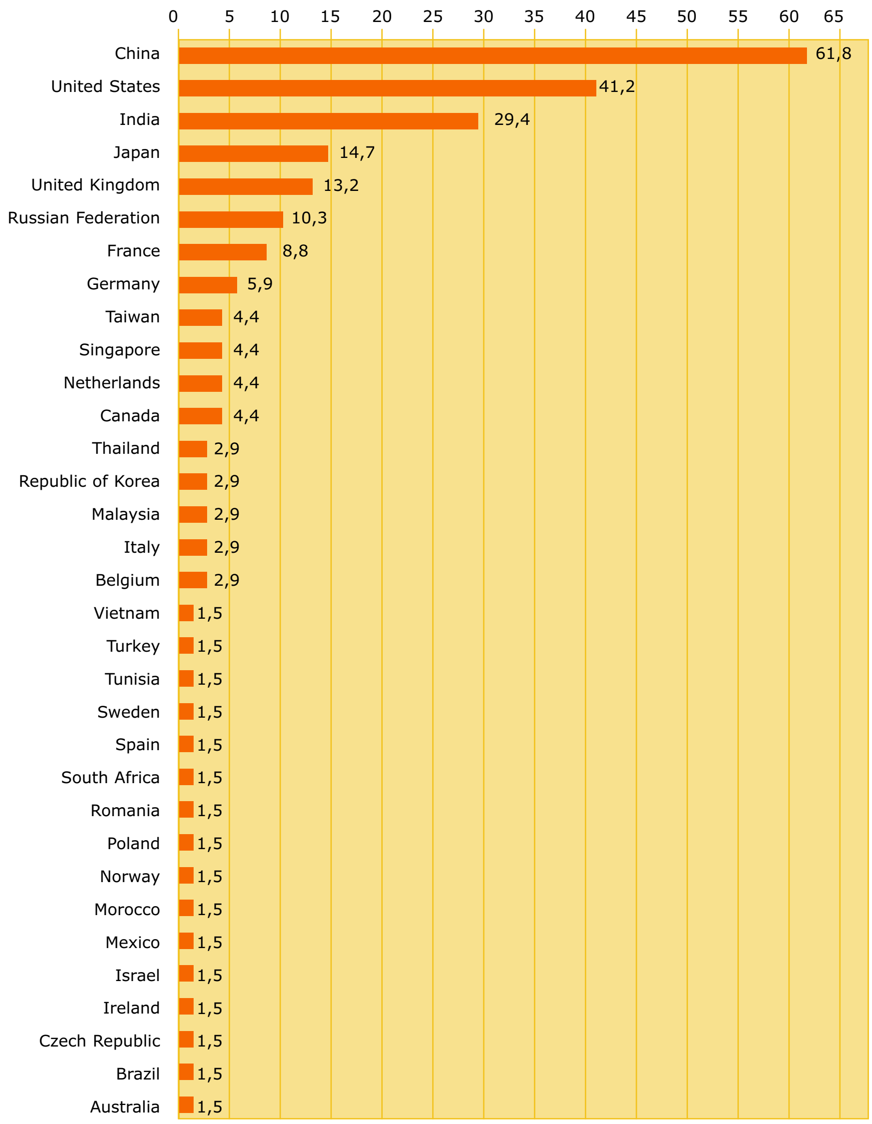


Figure 88. The most attractive prospective R&D locations, 2005-2009.
Source: World Investment Report 2005, UNCTAD

When a company decides to take on the challenge of offshoring part of its operations (like R&D to an emerging country), it must take certain obstacles into account. First, there is the complexity of harmonizing work processes and systems between countries. Second, although the emerging countries are trying to align themselves with international criteria, there are some in which there is still inadequate protection of intellectual property and where copies are rampant. The WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights

(TRIPS) came into force in 1995 and fosters competition in innovation with the protection of patents for end products and production processes. Lastly, many companies relocate part of their R&D to emerging countries, keeping another part in their country of origin. Managing a development team is no easy task and the "not invented here syndrome"[381] often arises, which is the tendency of central office developers to scorn innovations from foreign subsidiaries, generating internal competition. Problems also arise when the initial approach of a global innovation network only really fulfills the goal of penetrating local markets, instead of taking advantage of collaboration and synergies at an international level.

Some successful examples are Wal-Mart and Carrefour, which have been innovative with their local business model. They invest with products packaged in smaller containers in order to cater to the preferences of local demand, providing free bus transport to customers and adopting the practices carried out in the traditional markets, such as cutting the meat in front of customers in order to sell the image of fresh products. In 2006, McDonald's opened an R&D center in Hong Kong, the Food Studio, in order to design fast food adapted to the local market.[382]

Although the R&D centers of multinational companies in emerging markets initially focused on adapting existing products and technologies to local markets, some companies such as Procter & Gamble, Motorola, and IBM, among others, are using these centers to develop products for the global market. One in every ten Nokia phones sold in the world was designed at the Product Development Center in Beijing. Motorola has sixteen R&D centers in five Chinese cities, with a cumulative investment of 500 million dollars and over 1,800 Chinese engineers on staff.[383]

Rule 2: Know the Threat of New Players

It was mentioned earlier that the United States' R&D leadership is being challenged by new development centers in this area. Asia is one of the areas that is gaining ground on the United States in terms of R&D spending. The OECD has released the figures: every year, approximately one billion dollars are spent worldwide on R&D in computers, telecommunications, and electronics, and more than a third of this amount is US investment. Nevertheless, while the R&D of companies in the United States and Europe grew between 1% and 2% from 2001 to 2006, in China it rose 23%. China is about to surpass Japan in total R&D spending. Moreover, corporate R&D in China is almost on par with that of the European Union in terms of GDP (approximately 1%).[384]

Within Asia, there is also competition between the so-called "old Asia" (Japan and Taiwan, among others) and the "new Asia" (China, India, and South Korea). In 2007, the South Korean conglomerate Samsung spent more than IBM on R&D. Now, this country has more researchers in leading-edge technology than the United Kingdom and Germany (see Figure 89).

[381] «R&D Offshoring: Is it Working?», *BusinessWeek.com* (10/05/2006).

[382] *Managing the challenge of innovation in a multi-polar world,* Accenture (july 2007).

[383] «Low Costs, Plentiful Talent Make China a Global Magnet for R&D», Kathy Chen y Jason Dean, *The Wall Street Journal,* (14/03/2006).

[384] «Rising in the East», *The Economist* (30/12/2008).

Rank		Company	R&D Spending			Headquarters Location	Industry
2007	2006		2007 in US$ millions	Change from 2006	As a % of sales		
1	1	Toyota	8,386	7.6%	3.6%	Japan	Auto
2	6	General Motors	8,100	22.7%	6.5%	United States	Auto
3	7	Pfizer	8,089	6.4%	16.7%	United States	Health Care
4	18	Nokia*	7,727	9.0%	11.1%	Finland	Computing and electronics
5	4	Johnson & Johnson	7,680	7.8%	12.6%	United States	Health Care
6	3	Ford	7,500	4.2%	4.3%	United States	Auto
7	7	Microsoft	7,121	8.2%	13.9%	United States	Software and Internet
8	16	Roche Holding	6,985	27.3%	18.2%	Switzerland	Health Care
9	11	Samsung	6,536	6.3%	6.2%	South Korea	Computing and electronics
10	8	GlaxoSmithKline	6,476	–6.4%	14.2%	Britain	Health Care
11	14	Novartis	6,430	20.8%	16.9%	Switzerland	Health Care
12	13	Sanofi-Aventis	6,208	2.4%	16.2%	France	Health Care
13	10	IBM	6,153	0.8%	6.2%	United States	Computing and electronics
14	12	Intel	5,755	–2.0%	15.0%	United States	Computing and electronics
15	25	AstraZeneca	5,162	32.3%	17.5%	Britain	Health Care
16	20	Honda	5,142	6.5%	4.9%	Japan	Auto
17	19	Merck	4,883	2.1%	20.2%	United States	Health Care
18	17	Matsushita	4,850	–4.1%	6.1%	Japan	Computing and electronicsa
19	15	Volkswagen**	4,757	25.9%	3.2%	Germany	Auto
20	21	Sony	4,553	–4.3%	5.9%	Japan	Computing and electronics
		Total	**128,493**	**8.0%**	**7.6%**		

Figure 89. *Top 20* of innovation spending.
Source: Booz & Company

Some companies, far from seeing the innovation potential of emerging countries as a threat, are taking advantage of this potential. For example, the Swiss pharmaceutical companies Novartis and Debiopharm have created an alliance with the Shanghai Medical Institute, which is part of the Chinese Academy of Sciences. They are researching traditional Chinese medicine with a view to finding treatments for malaria and Alzheimer's, among others diseases.

Rule 3: Move Fast

A joint survey by BusinessWeek and The Boston Consulting Group (BCG)[385] focused on the largest obstacles today's executives are facing in terms of innovation. While 72% of the senior executives named innovation as one of their top three priorities, almost half claimed they were not satisfied with the performance of their investment in this area. According to the survey, the largest obstacle was that development time was too slow. Businesses have to go through a complicated process in order to reorganize themselves for adaptation to markets that change at an exponential rate in various areas, such as consumer demand, new technologies, and business models in which operations like global outsourcing predominate. Speed, or time to market, is especially important in those cases in which being the first to launch in the market is a significant competitive advantage. One example of this is the case of software companies, for which speed and the appearance of their products take precedence over other aspects such as proven quality.[386] According to George Stalk, Senior Vice President of BCG, the speed of these changes requires a coordination that the fastest innovators achieve by organizing the company to drive growth.

One of the keys to Google's success has been its ability to put innovative ideas into practice without faltering whatsoever in its position as the market's top search engine. With that said, Google's corporate culture can be summed up in five points: continuous innovation and swift execution, instead of absolute perfection; "reverse thinking," the company is convinced that the business models will appear over the course of time and prioritizes technology over business; ongoing work on beta versions so that customers join in the product learning process; rejecting formal marketing; and creating its own rules, as it demonstrated with its online auction-based IPO.

There is another fundamental reason for being fast. The current crisis is a period during which companies can reposition themselves in the market. In fact, the Future Trends Forum experts believe that the steps that companies in developed countries should take in order to effectively survive the global economic confusion are to first, reduce operation costs, and second, invest in innovation (see Figure 90). These two strategies are not necessarily contradictory, since innovation can increase productivity, which can ultimately reduce costs. However, innovation is obviously a longer-term task.

[385] «The World's Most Innovative Companies», *BusinessWeek.com* (24/04/2006).

[386] *Guía práctica de la innovación para PYMES,* Juan Ramis Pujol, ESADE Business School.

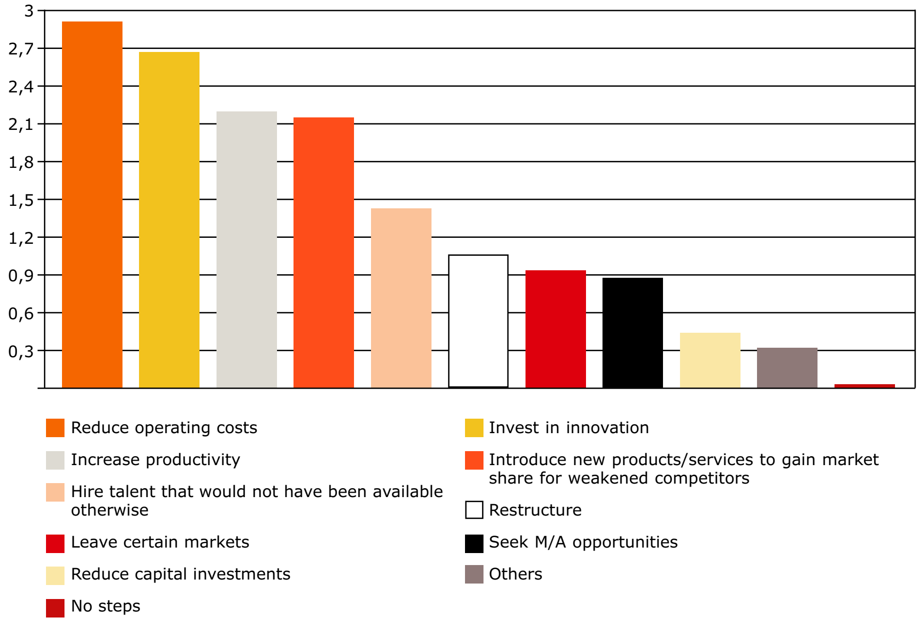


Figure 90. Which of the following steps will be more effective in helping companies to survive the global economic crisis?
Source: Drawn from the conclusions within the Future Forum.

Many of the great entrepreneur stories seem to have taken place during times of crisis. Cisco Systems was established in the late 1980s, when investment in an entrepreneurial business focusing on new technologies sounded too risky. In 1939, at the end of the Great Depression, two engineers set up Hewlett-Packard in a garage in northern California. Silicon Valley is the result of the agglomeration, in the mid-1970s, of innovative industries that are very profitable today: videogames (Atari), PCs (Apple) and biotechnology (Genentech).[387] Investing in R&D during times of recession has its advantages. This is because a competitive advantage can be established against other companies that are not focusing on innovation, in addition to the fact that talented individuals are available after layoffs from companies that have downsized their staff. Entrepreneurs, in turn, can use their innovative ideas to take advantage of the situation and win over the small customers that large companies tend to abandon so they can concentrate on their bigger customers and maximize their revenue.

Rule 4: Work the Innovation Culture into the Organization's DNA

Innovation tends to be somewhat associated with accidents. However, the fact is that companies must foster an environment in which innovation is effectively performed. There are aspects of a company's DNA that have a tremendous impact on the way in which its business progresses, its employees act, and certain skills are fostered. Hiring and promotion practices, leadership styles, the

[387] «Startups in a Downturn», *BusinessWeek.com* (23/02/2009).

way in which performance is measured, and corporate values are all factors that influence an innovation climate.

There is no universal innovation model. What is important is that it has to adapt to the nature of the company and the business. One fundamental element is commitment to the innovation projects at all levels of the organization: from their start as a corporate strategy and management team involvement, to the existence of project managers that dedicate the time and effort necessary for setting objectives and managing participating teams, to project groups, which must be motivated and structured according to the organization's strategies (see Figure 91).

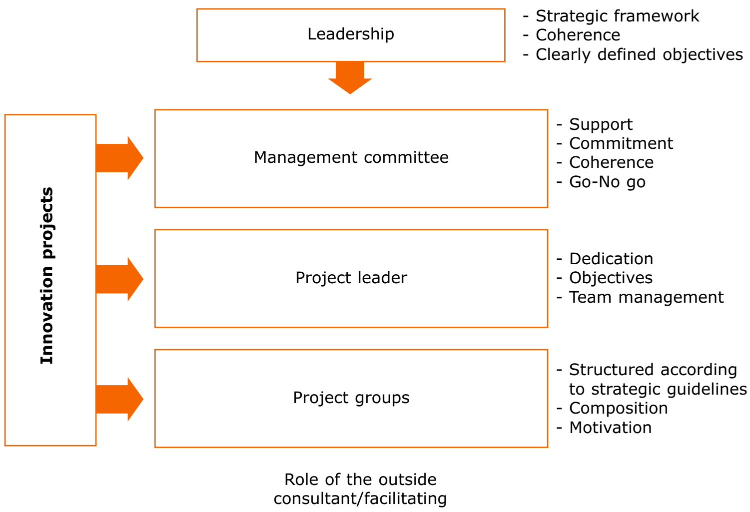


Figure 91. Organization of innovation projects
Source: Operations Management Course, ESADE 2005, Miguel Ángel Heras.

According to Vijay Govindarajan, biological and organizational DNA are very similar. Both are difficult to observe directly and they have a powerful influence on behavior. However, there are also substantial differences. Biological DNA is inherited and unchangeable; whereas organizational DNA is created early on and can be changed with effort.[388] He also points out that a company should not bother carrying out strategic innovation if it does not believe that an organizational subdivision aimed at innovating is necessary, because it will fail.

Companies with innovative cultures tend to reinforce innovative behavior among the members of their organization. In turn, the innovative efforts of these members reinforce this culture. One way of implementing innovation in the organizational DNA is to form a multidisciplinary team in which the members of

[388] http://mx.hsmglobal.com/notas/43341-adn-organizacional-la-innovacion-estrategica.

various departments participate, even though the innovation program belongs to an independent department and has its own budget. From brand marketing, product development, market research, design, sales, logistics, and engineering to finance, the range of possibilities for setting up a team that contributes its experience and talent in each of the areas is very broad. This enables the organization to avoid redundancy in the participants' profiles, takes advantage of specialization, and fosters the creation of new business opportunities that are approved by most of its departments.

Going back to the Google paradigm, it is worth analyzing its "innovative innovation model." Google has set up a simple but effective framework for developing new projects: it keeps the groups small—from three to five people. That way, there are myriad simultaneous projects whose resources need to be prioritized. That's where the 70/20/10 rule comes in: 70% of the resources are allocated to the basic search-engine business, 20% to related projects and 10% to more distant projects. Products like Google News, Gmail and the social networking site Orkut have all come out of this innovation formula. Despite its efforts at internal innovation, Google acknowledges that good ideas often come from the market, and thus has developed a keen sense for acquiring small but promising companies.[389]

Another way for companies to promote innovation activities is to focus on employee recognition, which of course does not have to be solely related to pay. Nokia welcomes engineers who are responsible for at least 10 patents to its "Club 10" at an annual awards ceremony.[390] Each year, 3M awards grants through its Genesis Grants program, which consists of funding the development of products that have not been able to be financed through any of the company's business units. The grants (in the amounts of 50,000 and 100,000 dollars) make it possible for researchers to get their ideas, which would otherwise be left behind, off the ground. Some ninety grants are awarded every year and the "winning" product is given the opportunity of being developed by a work team.[391] Philips promotes the publication of studies and the filing of patents among its employees, presenting awards at a global level for innovative work.[392] Accenture also celebrates and values the innovative work of its employees through the Ken Ernst Innovation Award program. This year, it has received 425 entries and will present monetary awards to the winners.

In short, innovation should be part of a company's DNA because it is a strategy that can provide a sustainable competitive advantage. It is important to remember that aspects such as quality and customer service are no longer differentiating elements, but in fact market prerequisites.

Rule 5: The Power of Collaborative and Open Innovation

In his book *The Global Brain*, Satish Nambisan states the three basic characteristics of innovation: it is global, multidisciplinary, open, and collaborative. This last characteristic is undoubtedly the most important. In order to

389 http://www.voypormas.com/Casos-de-Exito/Cultura-corporativa-innovacion-=-Google.html

390 «The World's Most Innovative Companies», *BusinessWeek.com* (24/04/2009).

391 http://multimedia.mmm.com/mws/mediawebserver.dyn?6666660Zjcf61Vs6EVs666IMhCOrrrrQ -.

392 www.philips.com.

achieve it, different agents must participate in the innovation process, such as universities, laboratories or even the government. For example, Procter & Gamble makes use of NineSigma, YourEncore and yet2.com, which connect these types of agents through a social network with no time or space limitations.

Within the field of collaborative innovation, open innovation is also known as crowdsourcing, in which innovation is established as an open system in which agents both inside and outside of the organization participate. The reasons this phenomenon has arisen are the globalization process, democratization and the accelerated rate of technological advances, increasingly demanding customers, and a fine line between professionals and aficionados.[393] The example par excellence is *Wikipedia*, a free encyclopedia whose content is created by Internet users all over the world with varying levels of experience in the topics covered.

According to Juan Carlos Rosean, Director of Ideo Génesis and Professor of Creativity and Innovation at the National University of Technology in Buenos Aires, "based on the traditional paradigm of innovation management, ideas must originate inside the company (and especially at its R&D centers). However, this focus only offers a limited view of innovation. In fact, most ideas are generated by an inquisitive group of thinkers who rarely work for a company. Thus, as its search is restricted to its boundaries, the company misses out on excellent opportunities to create value."[394]

In many cases, open innovation also occurs when a company sets out a problem and then compensates those who solve it. Sometimes, companies allow workers to propose their own projects.[395] InnoCentive is a company whose business model and mission is open innovation in and of itself. The company establishes contact between the company's workers and aficionados all over the world. These individuals compete to solve problems in the areas of science, engineering and business, simply for the right to boast of their achievements and often in return for a symbolic award. Most companies are not looking for spectacular innovation that will result in a surprising advance. On the contrary, what they want is a fast solution to a specific part of a larger puzzle.[396]

Every year since 2001, L'Oréal has called students all over the world to contribute their ideas to its E-Strat program. Participants then become future candidates for jobs at the company. Once again, Google also serves as an example of open innovation. The company's technological innovation map is open to a public that is increasingly contributing suggestions. The functionalities of the Google page tend to be the result of the union of ideas by the users.[397] It is thus no surprise that companies are increasingly turning to the Internet in search of ideas and trends.

General Electric Healthcare asked the students of one of the worlds' best design schools (Art Center College of Design in Pasadena, California) to contribute their ideas for expanding the business into the rural areas of Africa for 2016. The innovation prototypes that were presented were completely adapted to the

[393] http://www.slideshare.net/abediaga/innovacin-abierta-ms-all-de-la-innovacin-tradicional.

[394] http://www.materiabiz.com/mbz/capitalhumano/nota.vsp?nid=40831.

[395] http://www.materiabiz.com/mbz/capitalhumano/nota.vsp?nid=40831.

[396] «Crisis económica, una oportunidad de innovación "disruptiva"», *Knowledge@Wharton* (10/12/2008).

[397] «The World's Most Innovative Companies», *BusinessWeek.com* (24/04/2009).

environment and solved everyday problems. All had medical uses: an ultrasound device in the form of a blanket for conducting checks on pregnant women in countries short of technicians with experience in the equipment normally used for this procedure; a malaria detection scanner that is less invasive as the test is carried out by simply examining the skin of the patient's hand (normally a needle is used, which frightens patients and as a result they put off the necessary tests); a radio-bracelet that warns when a pregnant woman is experiencing complications (the model would be similar to African jewelry and called "Akuaba," a word related to fertility).[398]

IBM Jam, created as a system for the internal exchange of ideas, evolved toward a new model called Collaborative Innovation, which invites participation from external agents such as customers, suppliers and academics. From IBM's perspective, "collaborative innovation" is set up like the "ABC" building blocks. The "A" represents alignment; the strategy and organization must be aligned in order to be able to support innovation within the company. The "B" stands for the boundaries by which defined limits are established in the strategic relations that are developed for optimal collaboration. Lastly, the "C" refers to commitment, i.e. the organization's commitment to foster a collaborative climate in the company's innovation.

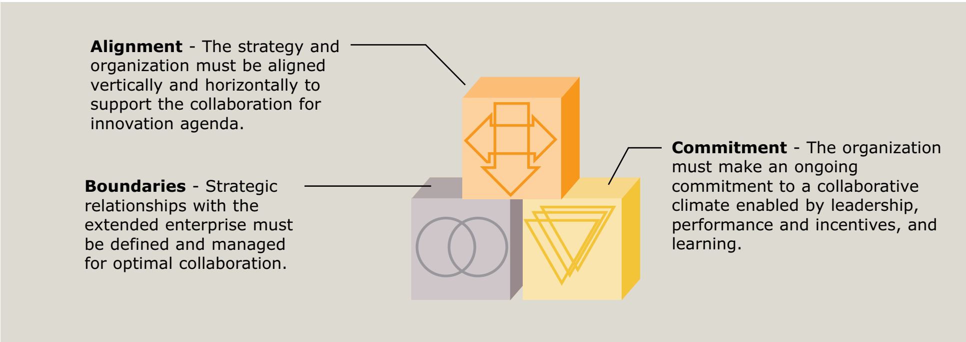


Figure 92. The ABCs of successful collaboration
Source: http://www-935.ibm.com/services/us/index.wss/ibvstudy/gbs/a1027449?cntxt=a1005266.

One of the main themes of the World Economic Forum in Davos in 2008 was the power of collaborative innovation. It is interesting that the forum in and of itself is a collaboration platform that has the collective knowledge and experience of leaders from the academic world, businesses, governments, and the media, among others.[399]

[398] «Innovation Case Study: GE», *BusinessWeek.com* (12/03/2007).

[399] http://www.netvibes.com/davosconversation#About_Davos%3A_Videos.

Rule 6: Innovate Beyond Products and Services

Although innovation has traditionally been associated with the creation or improvement of products and services, this is only one of its many facets. Today, innovation is much broader than that; it is the reinvention of business processes, the building of new markets that meet consumers' unmet needs, changes in the use of distribution channels, the introduction of a new organizational structure, etc.

Nevertheless, a study conducted by The Boston Consulting Group indicates that companies allocate most of their innovation investments to the improvement of existing products and services. While executives state that the most important goal of innovation is the development of new products and services for existing customers, companies actually spend more on developing incremental improvements for existing products and services.[400]

In practice, we can find good examples of these types of innovation. Toyota is known for innovating in its production processes. Thanks to its Prius model, it has also proven to be innovative in its products. In 2005, the company launched the "Value Innovation" strategy, with which it sought cost savings in the design stage instead of cutting back on the individual pieces from the suppliers. With regard to innovation in business models, the Virgin Group incorporates its lifestyle into businesses as diverse as airlines, financial services, and life insurance. It also appears that Apple's iPod includes seven different innovations, two of which are particularly noteworthy: networking with music companies by means of an unprecedented agreement to sell music online (a new business model through which songs are sold for one dollar); and branding in the design of the device and its accessories.[401] The following cases are also noteworthy: Harley Davidson selling a lifestyle; Dell's focus on direct sales of customized computer equipment and solutions at a low cost and with fast delivery; and the current low-cost business model for passenger air transport.[402]

Many of these ideas find their inspiration by treating the world like a laboratory. Starbucks takes its product development teams on trips in order to observe customers and trends in different cities with a view to learning about cultures, behavior, and local trends. It also receives ideas from employees working in its stores, who are constantly in contact with consumers. Along these same lines, the Vice President of 3M's Office Supplies Division, Jack Truong, ensures that "we listen very closely to what consumers don't say and we observe what they do," referring to the example in which they asked consumers to look at photographs that they had taken. They had to show them one by one with the digital camera or carefully search for them in a box. Months later, a marketing employee and two scientists from the company thought of the idea of Post-it Picture Paper, i.e., photo paper with adhesive so it could be hung on the wall.

With a view to gaining further knowledge about its potential customers, Nokia conducted an ethnographic study over a long period of time in order to

[400] http://www.netvibes.com/davosconversation#About_Davos%3A_Videos.

[401] «The World's Most Innovative Companies», *BusinessWeek.com* (26/04/2009).

[402] *Guía práctica de la innovación para PYMES,* Juan Ramis Pujol, ESADE Business School.

understand how illiterate individuals in China, India, and Nepal felt in a world of numbers and letters. As a result, they designed a cell phone for emerging markets in which the address book is made up of images. The phones were also adapted to various types of climates, featuring greater resistance to humidity and screens that were easier to read in direct sunlight. The reason for this study was that consumers in emerging countries wanted cell phones that lasted longer, since they were often expensive.[403]

Rule 7: Innovation Model Feedback

A study conducted by The Boston Consulting Group highlights the importance of systems for measuring the performance of business innovation processes. Without a doubt, measuring innovation is a challenge, as confirmed by this study. Nevertheless, it is also a necessity, considering the growing amounts that most companies are investing in innovation and the competitive implications of obtaining a poor return on the investment. Even so, few companies measure their innovation efforts with a sufficient degree of thoroughness, rigor or accuracy. How can they improve? In two ways: alignment of measurement with the innovation strategy and a focus on a combination of indicators that covers the three components of the innovation process: inputs, processes and results.[404]

The BCG study indicates that measuring innovation is a major challenge for many businesses and that most companies' potential to improve their measurement practices and, consequently, increase their return on innovation spending is significant. In most cases, innovation is not well measured. Few companies believe that their efforts are sufficiently thorough or exact. In fact, most companies (63%) use only a handful of indicators (five or less) to supervise and rate their innovation performance, which is more difficult to measure than other areas, such as cost reduction. However, a large number of companies do not measure their innovation processes at all, which implies that innovation, a top priority for almost all organizations, cannot be managed by many organizations.[405]

The best way to measure innovation is to use the appropriate indicator for assessing the invested effort. In this way, according to a study by Accenture,[406] the chances of creating "winning" products as opposed to "losing" products are maximized. The same study explains some of the indicators that are more commonly used by companies to measure their innovation effectiveness. One is the time that elapses until the product is introduced on the market, which reflects the product development team's performance. The cash cycle is a variation on the first indicator that enables the company to set goals for the team with a view to minimizing this time. The next step is product sales and market share, which give an idea of the product's acceptance on the market. ROI (Return On Investment) is a classic indicator that works costs into the equation, making it possible to measure the product's profitability. Lastly, some companies measure their efforts in terms of patents: the percentage of revenue-

[403] «The World's Most Innovative Companies», *BusinessWeek.com* (26/04/2009).

[404] http://www.nrgconsultores.net/apps/_turpialPortalSoftwareLibre.php?pag=artVerDetalle&bi_add=32.

[405] http://www.nrgconsultores.net/apps/_turpialPortalSoftwareLibre.php?pag=artVerDetalle&bi_add=32.

[406] *Building the Capabilities to Foster and Sustain Profitable Innovation,* Accenture (2007).

generating patents that belong to a company and the number of times that a company's patent is used as a reference for use at another company, which represents the patent's importance for the products of third-party companies.

In their research study *Innovation Strategy and the Use of Performance Measures*, Professors Tony Davila from Stanford University (now at IESE) and Marc J. Epstein and Sharon Matusik from Rice University study the innovation process and conclude that, surprisingly, measurement systems can result in a competitive advantage, although it may not always be the case. Another problem is that few companies link their employee incentives to the innovation indicators. This is possibly the result of a lack of confidence in the accuracy of their measurement systems with regard to innovation inputs, processes, and results.

Innovative Companies in Emerging Countries

Today, many companies seem to be making R&D another stage in their production process. This is also true for companies in emerging countries within the context of the multipolar world. We mentioned earlier that certain emerging countries are spending more on R&D than some developed countries. Countries such as China are making innovation a national priority. A survey published by *The McKinsey Quarterly*[407] indicates that experts see clear signs of change in Chinese companies, but that they still have a long way to go. One sign of this is that the only Chinese company in the list of the Top 50 innovative companies compiled by the World Intellectual Property Organization is Huawei Technologies.

Nonetheless, the Chinese government plans to increase its spending even more for 2020, from 1.2% of its GDP to 2.5%, through tax incentives and strategies for boosting local creativity. China strives to become an innovation-oriented society and has set the year 2050 as its deadline for becoming the world leader in science and technology. The measures of its long-term plan include increasing the contribution to economic growth through technological advances to more than 60%; reducing dependence on foreign technology to less than 30%; and becoming one of the five leading countries in terms of granted patents.[408]

Innovation is crucial for achieving increased efficiency. Nevertheless, companies in emerging countries must overcome various obstacles along their path toward this goal. The shortage of technicians, engineers, and researchers, the lack of a tradition fostering innovation in companies, and minimal resources allotted to programs that create a favorable atmosphere for innovation among employees are just some of the factors that will be explained on the following pages, which focus on companies in emerging countries as drivers of innovation.

Rule 1: Innovation is a Long-Term Business Strategy

Companies in emerging countries must view innovation as a long-term business strategy. To do so, they must ask questions like which objectives will be set,

[407] «What executives are asking about China: From entry to execution», *The McKinsey Quarterly* (June 2006).

[408] «Managing the challenge of innovation in a multi-polar world», Accenture (July 2007).

what strategic requirements must be met in the current competition scenario, on which innovation models will the efforts be focused, and how will this innovation objective be aligned with the rest of the organization. Furthermore, the approach must include how to react to the possible successes and failures, as well as the next steps to follow in each case.

According to Bain & Co.,[409] companies at the forefront of innovation start by defining the strategic role that innovation will play in the company's drive to grow globally, setting clear objectives related to the percentage of income that should come from the new products introduced on the market and compensating executives when these objectives are met. The Chinese electrical appliances manufacturer Haier was on the verge of bankruptcy before it began focusing its objective on three key skills: the internal ability to design, manufacture, and distribute products. To reach this objective, the company did the following: it made use of imported technological innovations in order to improve local products, developed an innovation process taking into account appropriate costs and quality, and set out to improve its existing products as well as to create new ones. Thanks to its innovation strategy, it has managed to position itself as a global competitor with sustainable growth in the market and be present in thirty countries. The Chinese e-commerce company, Alibaba, is another example of a company that has based its strategy on long-term innovation. It has periodically reviewed its strategy in order to offer new services, such as *online* payment and a search tool aimed at its customers so that it can maintain the innovative spirit that it advocates.

One of the key elements of an innovation strategy is hiring available talent. In order to attract and retain this talent, companies in emerging countries must create innovation cultures that are appealing to potential candidates. The culture must be complemented with training programs and incentives to encourage the professionals' creativity. For example, Alibaba invested in recruiting talent from outside the company, in addition to providing training opportunities abroad to existing employees. Every year, the Indian company Infosys selects young stars from the IT sector to attend its board meetings and present their innovation projects. On the one hand, the company's senior executives are being exposed to fresh ideas, and on the other hand, younger participants have an opportunity to pitch their ideas before a team of industry leaders.

Another key element is ongoing investment. Even if an innovation strategy is established in the company and there is talent on staff, innovations require strong investments in order to be effectively launched and introduced to the market. Haier and Alibaba are setting an example for other Chinese companies that do not allot enough funds to R&D investment. In 2006, Haier had already applied for over 7,000 intellectual patents since its incorporation.

After establishing the innovation-based strategy, having the talent necessary for its execution and maintaining a long-term, ongoing investment approach, the only thing left is to create a process flow, from start to finish, that guides inno-

[409] «From "Made in China" to "Invented in China"», Paul DiPaola and Jerry Li, *Bain Brief* (27/08/08)

vation from its design to its introduction to the market. Bain & Co. explains the five steps that companies must follow to excel in innovation. First, it must define what successful innovation means to the business. To do this, the appropriate indicator must be used. This indicator should measure the results obtained in comparison with the set objectives in such a way that the company is able to continuously improve and stay ahead of the competition. Tata Motors stated that "a promise is a promise" when it launched its 2,500-dollar car on the market and revolutionized the auto industry as part of its business strategy. The second step is to draw up an extensive list of ideas. This is where all the theory we have seen up to now of various types of innovation and different ways of generating great ideas comes into play, for example, through disruptive technology, among many others. Third, the ideas must be prioritized establishing a series of "doors" that make it possible to shorten the list using criteria such as profitability, potential leadership, alignment with the corporate strategy, and the complexity of the existing structure. Everything boils down to the appeal of the idea as a growth driver versus the company's current capacity to use the innovation to improve profitability and market position. Fourth, the idea must be validated, proving that it can be turned into a feasible project. This step can include the development of a prototype. The fifth and final step is to market the idea. The business must consider the aspects related to the innovation's distribution and the improvements to be made based on consumers' reactions. For example, the innovation's distribution was key for Comat Technologies, an Indian company that joined forces with the satellite supplier Hughes India in order to supply 10,000 broadband terminals to rural areas, providing civil registry access to areas that were lacking in services.

Rule 2: Be Aware of the Innovation "Gaps"

Companies in developed economies have a clear advantage in innovation compared with those of emerging countries. To date, the main reasons are lower product design quality, a lack of elements such as quality standards, absence of incentives for developing innovation, shortage of quantitative and qualitative consumer data, and the difficulties encountered when trying to solve market-related problems. In short, the systems that support innovation are less mature and less systematized. Let us take a look at the example of the innovation process in India, based on the analysis in Figure 93.[410]

1. Access to intellectual capital is very limited or nonexistent. The talent is there, but the process of transforming the ideas from a concept to a reality in a company fails because the talent is unable to access the knowledge and experience networks that enable them to execute their ideas. Although talent in India tended to leave the country in search of opportunities, the most recent trend indicates that they are either returning home or not leaving in the first place.

2 There is no venture capital sector in India. There are foreign companies that invest in opportunities in the country, but they stick to high-profit investments.

[410] «Where Are India's Innovative Companies, Products and Solutions?», *Seeking Alpha* (8/05/2008).

3. The media culture does not focus on conveying messages that foster the creation of great ideas, accepting risk, and coming to terms with failure. Only the "largest ones" are promoted in India.

4. An in-depth understanding of the Indian consumer is lacking, as is government support for the projects of entrepreneurs and innovators. The challenge is the three civilizations, each one with its own cultures and needs, in addition to the existence of two completely opposite extremes: some who are wealthy, have traveled extensively, and are highly educated; and others who live on two dollars a day. The business opportunities are there, but there is no methodology for obtaining market data. This is where the government would step in, encouraging certain initiatives to speed up the innovation process.

5. There is no competition, and thus there is no innovation. Opening the country's top-priority sectors to global competition would force them to innovate more aggressively in all areas: products, services, business models, organizational structures, etc. Up until now, India has been satisfied with competing with low-cost products and no innovation at all. In the multipolar world, a profound change in this trend seems to be occurring, given the increasingly important role that India is playing in the global arena.

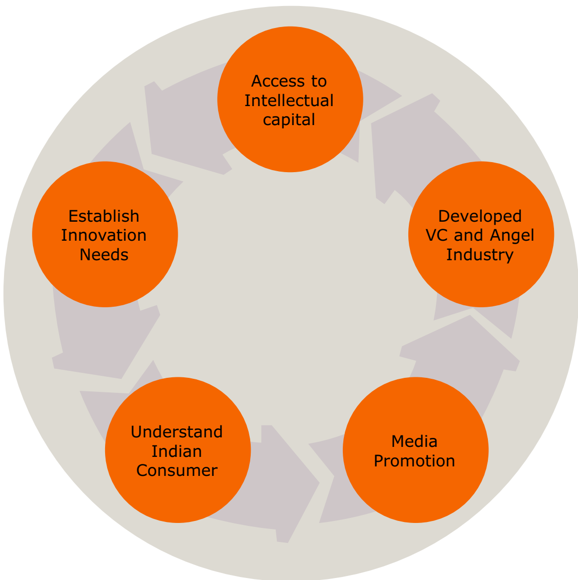


Figure 93. The absence of an innovation system in India.
Source: "Where Are India's Innovative Companies, Products and Solutions?" *Seeking Alpha* (8/05/2008).

Another example of an ecosystem that is lacking the drive to fuel the innovation cycle is the situation in China. Historically, important inventions have been attributed to this country, such as gunpowder, the wheelbarrow, the magnetic compass, etc. Today, China is the one that turns to emerging countries seeking inspiration to strengthen its own innovation capacities.[411] The country is aware that innovation could solve some of its problems in order to maintain sustainable growth and stability following progress that has exceeded expectations. The following must be attended to: motivating the talent's entrepreneurial spirit, meeting universities' needs, supporting scientific and technological publications, establishing knowledge transfer mechanisms, equal R&D investment in both cities and rural areas, stimulating national and regional social networks, and following intellectual property regulations. With regard to this last point, it is worth noting that China is part of TRIPS, the WTO's agreement on the trade-related aspects of intellectual property rights. However, irregularities still exist today. Many of the necessary reforms appear to be associated with the change from a communist to a market-driven R&D system.

Although it is true that India and China have significantly improved in the areas listed below, many emerging countries (always taking into account the particular characteristics of each one) have yet to make use of the following investments as a way to innovate:

- **A national energy supply network:** investments must be made in R&D in order to exploit clean, renewable, and reliable energy sources. Frequent failures in supply and dependence on highly polluting resources hinder sustainable development.

- **A communications, transport, and logistics system:** the movement of people, products, and services throughout the entire country by means of roads, railway networks, and air transport must be made easier. Communications should be adapted to new cell phone and Internet technologies.

- **Primary and secondary education:** education based on a standardized system with the appropriate infrastructure and assessment methods is necessary.

- **Accessible housing:** the population needs low-cost housing, but with adequate related utilities and infrastructures (gas, electricity, water, access roads, etc).

- **Health:** the population also requires a hospital network and healthcare services that will enable them to remain healthy.

These areas are capable of significant change through tax incentives and the initiative of private companies willing to invest in long-term projects that guarantee national security and sustainable growth. Some companies that have

[411] «Chinese Innovation», *OECD Observer* (October 2007).

already done this are among the most innovative of India and China.[412] Huawei Technologies is revolutionizing the broadband devices industry in China. Air Deccan is India's first low-cost airline. The Indian company Mahindra & Mahindra offers vehicle models adapted to the country's different terrains, both in cities as well as in rural areas. WuXi PharmaTech is a company dedicated to the pharmaceutical industry, biotechnology and medical R&D with operations in China and the United States and more scientists on staff than Pfizer, not to mention the well-known Indian pharmaceutical company, Ranbaxy Laboratories. In medicine, Aravind Eye Care and Narayana Hrudayalaya are two particular noteworthy Indian companies that have been able to minimize costs and thus, charge their patients less by means of innovative business models that maximize the number of patients seen each day in ophthalmology and cardiology. MeritTrac Services is an Indian company that creates human resource programs which assess candidates through knowledge and skill tests. Its clients include Google, Honeywell, HP and IBM.

Rule 3: From the Low-Cost "Made in China" to "Invented in China"

Bain & Co. asked global business leaders whether innovation was more important than cost reduction for their long-term success. A total of 88% of Chinese executives stated yes, in comparison with 75% of those from the rest of the world.[413] The 2006 survey seemed to forecast what was to happen in the years to come: China is no longer the low-cost production leader. The article "China - No longer the world's low-cost manufacturer?"[414] explains it in a summarized manner: the scarcity of Chinese workers is giving them the power to negotiate with companies, which must work to attract and retain talent (of course, this paves the way for countries such as Vietnam and Cambodia). What is causing the scarcity of workers? Some of the reasons are the one-child-per-family policy, a quickly aging population and the production capacity rivalry between the Yangtze Delta Region and the region of the Pearl River Delta and Guangdong. It is also worth noting that the approval of a new employment law in 2008 has made it more difficult to dismiss employees and has established salary regulations. The companies' response has been to raise salaries and improve the employees' working conditions, which automatically results in increased production costs. However, the final impact has yet to be seen. That cost increase will in turn raise the price of a Toys"R"Us toy or Wal-Mart socks.

In a broader sense, Asia has also become less "low-cost" with regard to labor. The chapter on human capital explained that workers in emerging countries are no longer considered cheap labor, but rather highly qualified, innovative human capital. More and more, students in emerging countries are choosing to stay in their country in order to receive higher education, as the latter improves. Venture capital companies in the Silicon Valley are looking for entrepreneurs from China, India and other parts of Asia because they know the market needs best. And some countries have true gurus in certain sectors, such as Indian professionals in *software* innovation. This is good news for those entrepreneurs who are seeking financing, but not such good news for investors that have to

[412] «Top Innovative companies in China», www.fastcompany.com.

[413] «From "Made in China" to "Invented in China"», Paul DiPaola and Jerry Li, *Bain Brief* (27/08/08).

[414] http://seekingalpha.com/article/2079-china-no-longer-the-world-s-low-cost-manufacturer.

compete with many others through reduced agreements. Competition is also beginning to appear within Asia. High-tech companies in South Korea used to receive three times more venture capital investments than China. Now the trend has reversed itself as high-tech companies in China received 600-700 million dollars in investments in 2007, versus the 290 million received by Korean companies.[415] It must be recognized that the phenomenon of transition from simple manufacturer to generator of innovations is something that not only applies to Asia, but to other emerging countries as well. Recall the case of Embraer in Brazil, which has managed to become a benchmark of the aeronautics sector.

Endeavor Global is an organization whose mission is "to transform the emerging market economies, identifying and supporting high-impact entrepreneurs."[416] Its website has a portfolio of entrepreneurs from emerging countries with innovative ideas transformed into a business. One of the companies is redBus, a revolution in the India's bus industry. It is a centralized ticket sales system whose portal covers 420 operators, more than 4,000 buses and over 5,000 routes. Purchasers are offered the options of getting their money back, paying with a debit or credit card, and organizing an itinerary by Internet or cell phone. Today it has 150 employees.

There is one sector in which everything indicates that countries such as China and India continue to be low-cost: medicine sales. Large volumes of medicine are provided that require little technological specialization in their manufacturing and tend to be generic or over-the-counter. Currently, there are almost 350 varieties/compositions of anti-depressants, heart medication or antibiotics, among others, bought by those in the United States and manufactured by Indian companies. The US Department of Commerce estimated the amount of drugs and drug ingredients imported last year at over 42 billion dollars.[417] The controversy arose from the fact that the United States Food and Drug Administration did not conduct enough inspections in order to ensure the quality of these medicines.

Rule 4: Take Advantage of the R&D of Wealthy Countries

It is logical that emerging economies would find inspiration in the business models and innovations of companies from developed countries. Satish Nambisan, author of The Global Brain, states that "more and more companies are shopping outside their organizations for innovation, whether it's raw ideas or market-ready businesses." In the five previously detailed steps for being a leading company in innovation, marketing the idea was the last step. If an idea has not been sufficiently developed and marketed, the organizations that are looking to invest in innovation can take advantage of the opportunity in order to meet these requirements.

The companies of emerging economies tend to acquire leading edge technology from developed countries with a view to creating a favorable atmosphere for

[415] «Good Times for Asia's Young Entrepreneurs», *BusinessWeek.com* (16/11/2007).

[416] http://www.endeavor.org/.

[417] «China, India expand low-cost drug sales», *The Washington Post* (17/06/2007).

innovation in their countries, since they tend to invest too little in R&D during the initial steps. Countries with emerging economies such as Singapore, Chile and Vietnam are focusing their efforts on attracting innovative talent from all over the globe in order to get ahead with their own patents and intellectual property. To do this, they are setting up R&D centers with special appeal for renowned scientists and international post-graduate students, which are expected to total 4,000 by the year 2015. Biopolis is a biomedical R&D center in Singapore, which attracts thousands of experts from all over the world. It has become a center of global prestige thanks to its research and publications in the field of cellular medicine. Surrounding this center are gourmet restaurants, top brand stores, adventure sports facilities and extensive cultural activity, which provide all the more incentive for the community of collaborators. In addition, Biopolis maintains close relations with government agencies, venture capital companies, international pharmaceutical companies, academic institutions and laboratories. GlaxoSmithKline and Novartis are among the companies that have established themselves there. The government has committed to innovation in the scientific research field through a program that aims to increase the GDP percentage allocated to scientific R&D projects, clean technology and digital media from 2.6% to 3% by the year 2010, despite the current recession. This means that if a company conducts research in the mentioned areas, the government will study the possibility of providing tax advantages, top-quality infrastructures, training for staff technicians and research grants that cover up to 40% of expenses.

In the automobile sector, companies from emerging countries have also tried to take over in industries which up to now have been led by developed countries. In a manner very similar to General Motors and Ford, the Chinese company BYD (*Build your Dreams*) launched a hybrid vehicle on the market. It features an electric and gasoline engine, in order to compete with companies that have been in the energy-efficient car market for a long time. With its price set at 149,800 yuan (15,850 euros), the goal is to begin exporting it to Europe and the United States in 2011. The company is not inventing anything new, but thanks to its experience in battery manufacturing and monitoring the global sector's innovation, it has managed to create a large-scale hybrid that can be recharged without special infrastructures.

The opposite also occurs, as there are sectors with business models in emerging countries that appeal to developed countries. A BusinessWeek[418] article indicated that banks in the United States could imitate the Chinese model by setting up "innovation banks" which focus on supporting entrepreneurs and creating employment. The Chinese banks are divided into different categories, some of which are private and others which are protected by interest and governmental influence. The latter, for example the China Development Bank and Agricultural Bank of China, were set up to grant loans for infrastructure projects, among those the building of the largest dam in the world. These types of projects would not have been possible if the government had not stepped in and made greater contributions to the investment. Following this innovative

[418] «Innovation: Learning from China's Banking System», *BusinessWeek.com.*

bank model, developed countries such as the United States (and even more now with the current economic and financial crisis) could set up banks dedicated to specific development projects, taking advantage of the space left by entities that have been declared bankrupt and creating jobs. The unemployed would have the opportunity to become entrepreneurs thanks to the loans granted and the government would receive part of the earnings in exchange, not to mention the social benefits that these operations would generate. Other examples for developed countries are the Indian banks HDFC Bank, whose quick growth has not affected the quality of its assets, and ICICI Bank, which currently leads the country's sector thanks to the innovation of its financial products.

Rule 5: Focus Innovation on Social Networks

It was mentioned that one of the obstacles that emerging countries faced when integrating innovation into their companies was the lack of governmental support for entrepreneurial and innovation-related projects. In the multipolar world, the traditional concept of innovation that occurs at the heart of the company and which is carried out in a centralized manner is being replaced by an innovation model based on global social networks. This approach is especially beneficial for emerging companies which, in many cases, cannot bear the costs and complexity of innovation amidst global competition, in addition to the difficulty of finding national talent. Surely, the example that comes to mind for many readers is the previous case of Biopolis. Indeed, this center demonstrates the advantages of having talent that is specialized in research areas as well as geographically diverse. In this way, emerging economies are investing in RDI talent pools in order to create global competencies and take advantage of the strengths of different countries. Nevertheless, science parks have often turned out to be ineffective in creating industrial innovation networks and especially in transferring and making the citizens the central figure of this innovation, i.e., user-centered innovation.[419]

The "living labs" concept was created at MIT (Massachusetts Institute of Technology) with Professor William Mitchell from Media Lab and the School of Architecture. It is a focus on innovation in which all the agents of the value chain participate: university-governments-company and citizens. Both the infrastructures as well as the assessment methodologies are placed at the disposal of all these agents, thus offering greater equal opportunities and favoring and supporting innovation where it is most likely to arise, in many cases the small, medium or very small-sized companies.[420] In short, the goal is to have the agents interact in a real setting where innovation is stimulated as a social process of idea dissemination in the field of information and communication technologies. In a multipolar world in which emerging countries are global players, certain formal organizations must be implemented which foster the relationships with international institutions in order to create a global social network of innovation. To do this, the Finnish project that launched the European Network of Living Labs can be used as an example. When will the version for

[419] http://www.citilab.eu/actualitat/opinio/europa-i2010-innovacion-y-living-labs.

[420] http://www.citilab.eu/actualitat/opinio/europa-i2010-innovacion-y-living-labs.

emerging countries be in operation? Well, it already is: in Slovenia since 2007 and in various rural and developing areas in South Africa.

8.2. Innovation in the Spanish Economy

Spain faces several challenges in completing its internationalization process in the new multipolar environment. It is in danger of coming to a standstill halfway between the highly innovative economies (like the United States and Japan) and low-cost producers (like China, India and Poland). As was already mentioned, the first point on the agenda must focus on improving the competitiveness of the Spanish economy, for which fostering innovation is essential. Much effort has been made during the last decade regarding the factors that affect productivity (human capital, physical capital, innovation, ICT, new technologies, etc.) in order to enhance competitiveness. Nevertheless, Spain is still in a relatively unfavorable position in comparison with the more advanced countries, especially with regard to technological RDI processes.

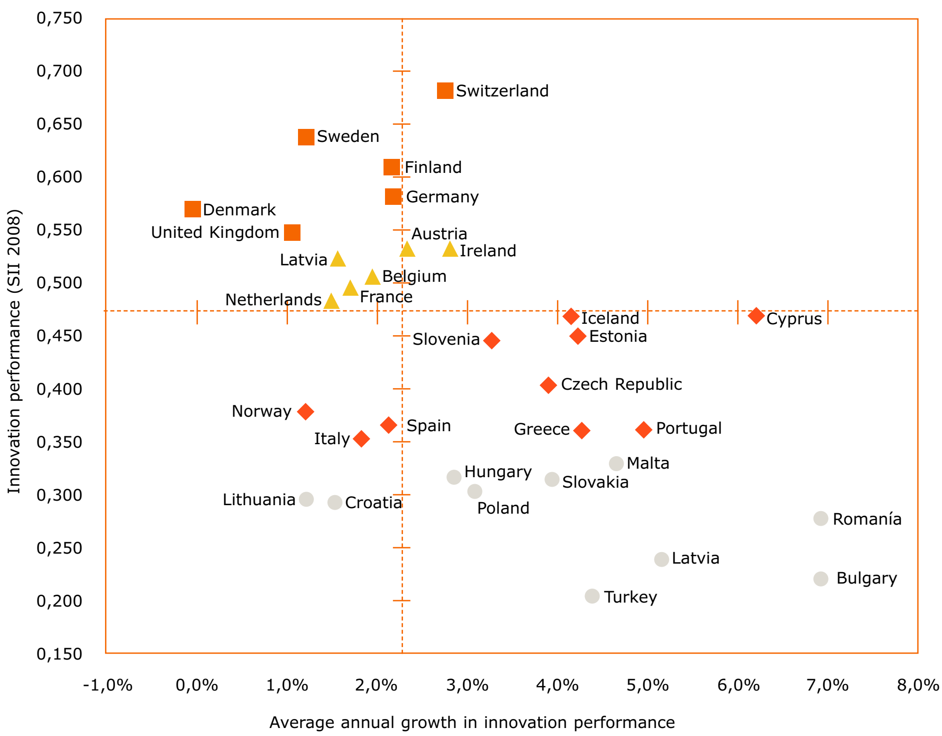
During the most recent company forum organized by Accenture, Pedro Luis Uriarte, President of Innobasque, asked "How can the seventh-strongest economy in the world, without natural resources or its own energy sources and with poor demographic outlooks, high salary costs and low productivity compete in the future?" The answer is to address the factors that affect productivity and competitiveness. It is necessary to generate many ideas and know how to convert them into added value; in short, it entails innovating. This is a medium-term commitment which, combined with the situational measures for surviving the crisis, will enable Spain to position itself on the new growth wave in the medium-term.

Innovation as a way to improve the productivity of the Spanish economy

A commitment to innovation entails a review of the bases of the Spanish production model, which has been centered on traditional sectors of low-medium technological intensity. In general, cost and localization advantages which are favorable with regard to the European markets have been reaped, and more importance has been given to the final price than to innovative content and product quality. This competitive advantage is difficult to maintain when faced with the competition of new players with low labor costs and, above all, with the process of technological change at an international scale. The limited production of new technologies in Spain has hindered its participation in booming markets in recent years. It has also influenced the slow progress of productivity. Improvements in this field must focus not only on producing the same more efficiently, but also efficiently producing new innovative products. As was previously mentioned, one of the ways to achieve this is to increase RDI spending.

[421] *50 propuestas para mejorar la productividad española,* Instituto de la Empresa Familiar.

Despite the fact that it is not exactly known how the productivity-innovation partnership works, it does seem to demonstrate that countries with greater RDI spending also have higher productivity growth rates. Some examples are the United States, Finland, Japan and Germany.[421] This data can provide a better understanding of Spain's intermediate position in the international framework (see Figure 94). Resources in Spain allocated to financing these activities are noticeably lower, in terms of GDP, than the euro area average. Even though it is the country in the entire European Union with the highest rate of overqualified individuals among those with science and technology degrees, the distance with the countries which are more advanced in RDI is still highly significant. In short, it has excellent human capital, but lacks innovative capacity.



Orange are the innovation leaders, yellow are the innovation followers, dark orange are the moderate innovators, gray are the catching-up countries. Average annual growth rates as calculated over a five year period. The dotted lines show EU performance and growth.

Figure 94. Convergence in innovation performance.
Source: *European Innovation Scoreboard 2008,* INNO-Metrics.

Did you know?

According to 2007 OECD data, the Spanish subsidiaries of foreign multinational companies carry out 35% of all the R&D of the companies in our country.

Despite its position behind other countries, Spain's RDI investment has consistently increased in recent years. This trend is a promising sign that Spain could position itself among the elite of innovation. Unfortunately, the fast progress being made by the science and technology systems of other countries outside the European Union that began even further behind Spain, like China and India, are casting doubt on its future positioning in this area. In order to avoid the displacement of the Spanish economy, an adequate innovation strategy for changing the current situation must urgently be developed.

In spite of the increase in RDI investment, the results of the 2008 Innovation Scoreboard published by the European Commission indicate that Spain is below the European average in the area of innovation. It ranks 16th in the EU with regard to the efforts that have been made in human resources, broadband access, venture capital availability and governmental support, among other indicators (see Figure 95).

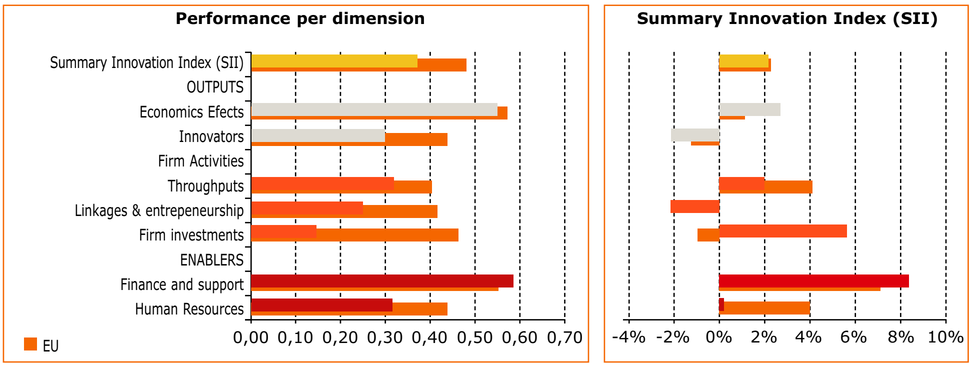


Figure 95. Spain's placement in Europe according to the innovation indicators.
Source: Innovation Scoreboard, European Commission.

One certainty is that the increase in RDI investment has not been matched by productivity gains in recent years, nor in the creation of high value-added products and services. One example of this is the deficit of the technological balance of payments. Many experts believe that low technological production is among the direct causes of the vast Spanish trade deficit as a whole. In order to put a stop to the problem, the Family Enterprise Institute (IEF) proposes that "faced with the policies traditionally followed by the Spanish administrations, which have tried to support a very broad range of sectors and projects, in order to resolve this situation, a policy is needed in which high-tech products with high development potential take precedence. In this way, the financial resources managed by each researcher or technologist, which at this time are an average of half of those managed by their counterparts in the EU, can be increased."[422]

[422] *Crecimiento y Productividad,* Instituto de la Empresa Familiar (July 2008).

Barriers to Spanish Innovation

One of the reasons that the increase in R&D investment is not passed on to productivity and competitiveness is that, unlike more advanced countries, in Spain the weight in its performance in the business sector does not reach two thirds of the national total.[423]

The greater relative weight of SMEs in the Spanish economy in comparison with its surrounding countries could hinder innovation. In reality, there is no clear and exact conclusion regarding the relationship between a company's size and its degree of innovation. This decision often depends more on the type of company and its philosophy than on its number of employees. Nevertheless, it can be confirmed, based on statistical data, that on average the company's size is proportional to the level of innovation it carries out.[424]

Moreover, the absence of an entrepreneurial spirit in Spanish society significantly affects the lack of innovation. Entrepreneurs generate and drive innovation, and bring greater flexibility and adaptive capacity to the economy as a whole. The Spanish economy sits at the bottom of the EU-25 rankings related to activity indexes and entrepreneurial climate, compiled by the European Commission.[425]

One of the factors explaining the scarcity of entrepreneurial activity is that Spanish society demonstrates higher risk aversion than its surrounding countries, as well as a greater stigmatization of failure. Furthermore, Spain has an ambivalent view of entrepreneurs and their activity. Thus, despite acknowledging that companies generate wealth and jobs, the social prestige and recognition of the work of entrepreneurs are less than those observed in other developed countries.

Another explanation for Spain's weak innovation lies in the insufficient connection between the science and technology system, and the global knowledge networks. This situation is partly due to the still-subpar level of internationalization of its companies and national universities. It is also apparently caused by a shortage of institutional support for these types of projects. This is evidenced by the lack of public resources that the international technological cooperation projects receive from the items allocated to support RDI.

The Crisis as an Opportunity for RDI

The minister of Science and Innovation, during the *Cinco Días* forum "Innovación Empresarial: el motor de la empresa española" (Business Innovation: the driver of the Spanish company"), indicated that "the crisis is viewed as an opportunity for a profound transformation of the system and that research and innovation will survive and even come out stronger as a result of this crisis because, among

[423] *50 propuestas para mejorar la productividad española,* Instituto de la Empresa Familiar.

[424] Eurostat, New Cronos.

[425] *El espíritu emprendedor: elemento esencial para afrontar la crisis económica española,* Círculo de empresarios.

Did you know?

European SMEs account for:

- 99.8% of all European companies.
- 67.1% of employment in the private sector.
- over 80% of the jobs in certain industrial sectors, such as metal product manufacturing, construction and furniture manufacturing.

other reasons, the investment and job creation in R&D of recent years are much less volatile than financial investments, which makes them an anchor for the future development of our economy."

The Challenges of Spanish Innovation

In the future, countries must compete among themselves in order to attract foreign innovation. Many companies are setting up their innovation centers in other countries. Along these lines, the Spain Innovation Foundation (Fundación Innovación España) was started by seven multinational companies from a wide variety of sectors and geographical areas. They all have two important features in common: they are innovative multinational companies that play a leading role in their respective sectors and have strongly committed themselves to Spain, setting up representative R&D centers with large investments.

The wind and solar energy sectors, where Spain has excelled thanks to its innovations, present an opportunity to continue fostering a competitive advantage and position itself on the world innovation map (see Figure 96).

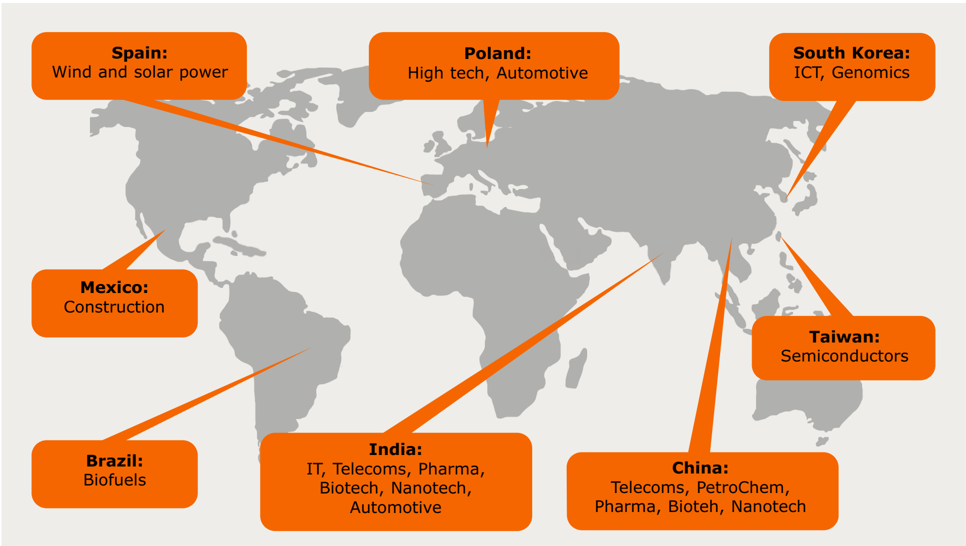


Figure 96. The focal points of emerging innovation.
Source: Multipolar World, Accenture.

In conclusion, increasing innovation activity is one of the bigger challenges that the Spanish economy is facing in the short term if it wants to carve out a place for itself in the multipolar world. To do this, it must address a variety of problems. The main issues here include: scarcity of resources; institutional rigidity; lack of entrepreneurial incentives, culture and spirit; and insufficient transfer of knowledge and research among the different agents that participate in the innovation process. Cooperation between Government, University and Business must be strengthened—in order to create a more effective R&D and Innovation strategy—while also increasing technological innovation and improving human capital.

8.3. Innovative Spanish Companies

Spain continues to fall below the European average in R&D investment: 1.2% of the GDP in 2006, in comparison with 1.84% for the European Union.[426] Part of the problem lies in the low investment that Spanish companies make in innovation. Proof of this is the low productivity, which results in the lower competiveness of the country's companies. In a multipolar world, where competition is coming from more and more places all over the world, it is important to remain competitive at a global level and, to do so, follow the path of constant innovation. Raising R&D spending to 2% of the GDP in 2010, involving companies that assume 66% of that cost, incorporating 50,000 new researchers in eight years and providing a greater transfer of technology among companies and research bodies. Those were four of the objectives set by the Minister of Science and Innovation and Future Trends Forum expert, Cristina Garmendia, during her first appearance at the lower house of the Spanish parliament (Congreso de los Diputados). They will all be implemented by means of a new Science Act, the first draft of which was prepared by a committee of 22 experts and presented at the end of February. Also noteworthy is the agreement announced by the Minister between the Center for the Development of Industrial Technology (CDTI) and the President of the New Energy and Industrial Technology and Development Organization of Japan.[427] Through this agreement, Spanish companies will be able to access the main technological markets and promote joint RDI projects with one of the world technological powers.

According to the report *Impacto de la I+D+i en el sector productivo español*, (Impact of RDI on the Spanish production sector), prepared by the CDTI and presented by the Minister of Science and Innovation, innovative companies are capable of increasing their productivity by 16%, in comparison with those that are not innovative. Furthermore, they increase their exportation capacity by 18%, which boosts their level of internationalization, and are capable of generating 2% more employment, a percentage that rises to 3.5% in the case of SMEs, in comparison with non-innovative companies. In general, the differences between innovating and not innovating are more noticeable in SMEs[428] (see Figure 97).

[426] «La innovación 'made in Spain' no logra alcanzar la media europea», *Expansión* (26/01/2009).

[427] «España y Japón sellan un acuerdo de cooperación en proyectos innovadores», *cincodias.com* (04/12/2008).

[428] «Impacto de la I+D+i en el sector productivo español», CDTI (April 2009).

Did you know?

Spain ranks 28th in terms of competiveness, according to a study conducted by the World Economic Forum. This is due, among other factors, to the country's low scores in the areas of innovation, patents and intellectual property protection, among other reasons.[430]

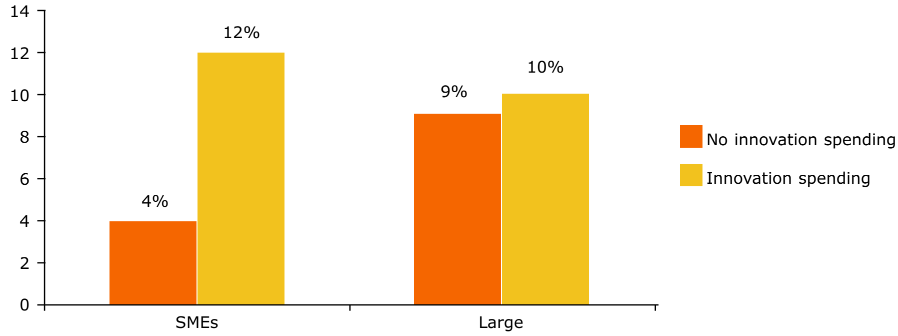


Figure 97. Average rate of variation in sales during the 2005-2006 period: comparison between innovative and non-innovative companies.
Source: Impacto de la I+D+i en el sector productivo español, CDTI.

The advantages of innovation are more noticeable in SMEs due to their size, which allows them to react more quickly and thus reap the advantages acquired through innovation. This ability to adapt makes it possible to efficiently modify the production processes or manners of working. Furthermore, as they have a closer relationship with their customers, they can anticipate the changes in consumer demand and, thanks to innovation, adapt their offering. According to a publication by the World Bank,[429] the financing of SMEs to foster innovation can play a very important role in the improvement of economic productivity.

A new economic model based on a greater weight of investment in innovation and technology is the future driver of growth in the midst of a global crisis that has revealed excessive dependence on sectors with low RDI spending, such as construction. In general, Spain still has some adjustments to make with regard to fostering innovation in Spanish companies. The President of Microsoft in Spain and Portugal, María Garaña, criticized that "in Spain, money invested in innovation is distributed among all the companies which, in her opinion, fosters the 'coffee for everyone' *('café para todos')* culture that does not support competitiveness between companies."[431] Nonetheless, it is possible to highlight some of the trends that can offer the necessary push in the Spanish business environment so that it can position itself in the new multipolar market thanks to the incorporation of innovation as a top priority.

Rule 1: Seek Support for Innovation Activity

The European Commission published the innovation ranking at the beginning of this year and placed Spain very far from the Community average, behind countries such as Cyprus, Estonia, Slovenia and the Czech Republic. Despite this, it is one of the member states where R&D investment rose the most between 2000 and 2006, at an annual rate of 12.9%.[432] According to the same report, Spain's strong points with regard to innovation are availability of financing and governmental support for these types of activities. Nevertheless,

[429] http://ifcblog.ifc.org/emergingmarketsifc/2007/06/creating_the_co.html.

[430] *El Reto de la Innovación en España*, Santiago Llorente García-Borbón.

[431] http://www.mujeresycia.com/index.php?x=nota/6371/1/maria-garana-de-microsoft-critico-la-espana-del-cafe-para-todos.

[432] «La innovación 'made in Spain' no logra alcanzar la media europea», *Expansión* (26/01/2009).

companies continue investing very little in R&D and are not collaborating among themselves or with the public sector in order to generate innovation.

Now more than ever, there is the challenge of innovating during a period characterized by the austerity of investment. Peter Kroll, Vice President of the consulting company Capgemini in Spain, believes there are two fundamental aspects for companies to survive: innovation and technology. He states that "in the short term, the most important thing is to generate liquidity that makes it possible to invest in "business technology" solutions, with a view to directly supporting the business objectives."[433]

One of the indicators of the European Innovation Scoreboard[434] is the percentage of companies that receive public funds at the national or European level in order to foster innovation. Spain is ranked 10th, but in terms of percentages, it is not too far from the lead country, Austria. Some 10% of Spanish companies receive public funds, while in Austria that number climbs to 17%. In compliance with the Community guidelines, the public administrations usually dedicate specific budgetary items to fostering innovation in companies, especially SMEs, something which more companies should take advantage of. ENISA (Empresa Nacional de Innovación, S.A.) is a government capital company assigned to the Ministry of Industry, Tourism and Trade, whose activity is dedicated to the search for and use of new financial instruments in order to support SMEs. Private banks also offer special conditions in order to foster innovation in these types of companies. BanesPyme is a Banesto project aimed at promoting the entrepreneurial spirit, business growth and the adoption of new technologies in Spanish SMEs. The organization states that "for most SMEs, an analysis of the resources that they will need and the development of an innovation constitute 50% of the effort. The other half goes to the search for financing, through private sector investments or public grants. This percentage goes up to 90% in the case of newly incorporated companies."[435]

Innovation financing in Spain comes from public aid programs such as PROFIT (Promotion of Technical Research), which is part of the National RDI Plan (Plan Nacional de I+D+i), and the financing of innovation projects offered by the CDTI. PROFIT is an instrument through which the government issues calls for public aid aimed at fostering technological R&D projects within the business environment. The aim, above all, is international cooperation in scientific research and technological development, in addition to energy savings and efficiency measures.[436] Likewise, CDTI is a public entity that works to promote innovation and the technological development of Spanish companies. To do this, it furnishes its own grants and facilitates access to financial aid from third parties. It also supports the international promotion of technologies developed by Spanish companies through a network that includes countries such as Canada, China, South Korea and India. Furthermore, CDTI issues reports that provide greater legal security when obtaining tax deductions for expenses incurred due to R&D activities.[437]

[433] «En gran parte de las empresas españolas no existe una cultura innovadora», Euskadi+innova (11/03/2009).

[434] «España, a la cola europea en innovación tecnológica», *ElPais.com* (29/10/2007).

[435] http://www.banespyme.org/.

[436] www.tecnociencia.es/.

[437] http://www.cdti.es/.

At the same time, Spanish companies can reap the advantages offered by the government thanks to the establishment of agreements with universities. In this regard, they can follow the example of the Universitat Politècnica de Catalunya (UPC) and Microsoft Ibérica, which have collaborated on numerous occasions with a view to fostering technological innovation and carrying out joint RDI projects in Catalonia.[438] One examples is the collaboration between the two entities at the Center of Productivity Innovation of Catalonia (Centre d'Innovació en Productivitat de Catalunya), where it has been demonstrated that the use of technological tools can result in significant increases in productivity. Also noteworthy is the research carried out in the area of supercomputing at the Barcelona Supercomputing Center. In short, its aim is to promote activities that reward research talent that applies Microsoft tools in an innovative manner. There are also the grants and financing offered by Microsoft Research, access for university students to Microsoft's latest technologies and tutorials through the Club.Net network, and post-graduate courses on the Microsoft Dynamics tools in order to overcome the current shortage of qualified professionals.

Universia and Matchmind also signed a framework agreement in 2007 for promoting innovation activities arising from collaboration between the academic and business worlds. Some of the noteworthy projects include the participation of representatives from technological companies and universities in order to identify the competencies and skills required of those who have recently graduated in this field.[439]

Rule 2: Follow the Recommendations of the European Commission

It appears that the European Union's recommendations in the area of innovation will be of special importance when fostering the rate of innovation in companies. The goal of becoming an Information Society will force many organizations to digitize their operations and change the nature of their relationships with customers through the introduction of e-commerce.

The European Union's Lisbon Strategy was devised as the strategic objective of turning the Union into a competitive society and economy, one that is better prepared to meet the needs of an Information and R&D Society. One such strategy is i2010, launched in 2005, which places a special emphasis on the capacity of countries to produce and absorb technologies, especially ICT (information and communication technologies). As part of the benchmarking of the countries in accordance with the objective of reaching an R&D spending that is 3% of the GDP in the year 2010, the Commission analyzes three basic indicators: the broadband lines, the availability of online services, and the level of ICT in the economy.[440] The number of broadband lines has continued to grow during the last year at a rate that is below the European Union's average. It is measured in terms of penetration and, despite the fact that it grew a little over 3% in one year (reaching 18.3% in January 2008), the EU-27 average was 20%. What is truly noteworthy is that Spanish companies position themselves second in relation to the rest of the EU's countries in terms of high-level broadband

[438] http://www.upc.edu/saladepremsa/al-dia/mes-noticies/la-universitat-politecnica-de-catalunya-y.

[439] http://www.universia.es/portada/actualidad/noticia_actualidad.jsp?noticia=92448.

[440] http://ec.europa.eu/information_society/eeurope/i2010/docs/annual_report/2008/i2010_mid-term_review_en.pdf.

connections. Household use, however, falls significantly below. The availability of Spain's online services has improved significantly in the last year, but there is still much to accomplish in the area of e-Government, one of the objectives of the *Plan Avanza*, the Spanish version of the program for developing the Information Society. The problem lies in the existence of services that are poorly integrated and whose quality is inconsistent across the various areas of the Administration. Lastly, the ICT in Spain are behind that of the rest of the countries, generally due to the scarce use of e-commerce and e-business applications. The ICT skills of the Spanish population are on par with the rest of the European Union, but the systems are highly fragmented and there is little interaction between the different players, especially between the public bodies and the university-industries union.

This data is useful for setting goals for Spanish companies based on the level of innovations that will be seen in the European Union in the coming years. If Spanish companies want to maintain their competitiveness, they will have to work to make improvements in accordance with the European Union's guidelines: greater broadband penetration, better online services (especially those related to public services), and greater use of ICT systems. In addition to serving as goals for companies, the described areas are also good business opportunities in Spain. Entrepreneurs can offer services related to consulting and broadband line infrastructure development, online services and ICT. Figure 98 shows the latest figures from the Spanish National Statistics Institute (INE) for quantifying the Information Society in Spanish companies.

Lates Data		
Percentage of companies	**Year 2007-2008**	**Year 2006-2007**
With Internet connection	94.9	94.3
Utilize computers	97.8	98.1
Own website	57.5	51.9
Engage in e-Commerce	11.0	8.8

Figure 98. Deployment and use of information technologies in Spanish companies.
Source: Spanish National Statistics Institute: http://www.ine.es/prensa/tice_prensa.htm.

Despite the fact that the Internet connection and computer team services for companies seem cut off (although the diversification and innovation of products and services is still needed in order to handle the existing competition), the companies that build and maintain websites have an entire market to conquer, not to mention e-commerce. Notable in this regard is Telefónica's announcement that it is sharing its infrastructures and cooperating with other companies such as Vodafone to develop services.[441] With this, they appear willing to contribute

441 «Telefónica, dispuesta a compartir infraestructuras y servicios», *CincoDías.com* (06/04/2009).

to the ICT sector with a view to recovering from the crisis and stimulating investment and innovation.

Rule 3: The Public Sector Must Lead in Innovation[442]

The Spanish public-administration institutions are also capable of implementing changes that result in successful experiences when innovating in their organizations. Innovation is increasingly becoming a management principle for their own activity. Nevertheless, the lack of competition in the sector forces them to learn from the experience in the private sector. Innovation in the public sector is inevitably exposed to a larger public. Thus, orienting itself to offering services in the most convenient and customized manner is the future of the public administrations. In this way, they will be increasing their efficiency and thus, people's well-being.

One example is GoolGis, a service that integrates the Spanish Land Register (Catastro) and SIGPAC (Farmland Geographical Information System), in addition to other maps through the Google Maps platform. This enables city councils to offer all the updated cadastral information via their websites. This gives people access to a low-cost GIS (geographical information system) tool that is easily implemented. E-Participate is an online citizen participation platform offered by the Getafe Town Council. It consists of the online broadcasting of live events with extensive support information and the possibility of participation. The Banco del Tiempo (Bank of Time) is a project by the Zaragoza City Council that creates a "self-help" network, which aims to meet citizens' needs through a service exchange tool. The objective is to promote the services of the neighborhood associations and promote well-being. The successful cases have also included schools: Rincón del Ratón (lit., Mouse's Corner) is a project supported by IBM that seeks to bring ICT to children's classrooms, encouraging professors and students to work with the new information technologies and apply them in class.

Nevertheless, not all projects are centered on ICT. Innovation is also applied to the environment by the public administrations. Delvisol is a company responsible for treating public water for consumption or recovery. These processes reduce and eliminate the nitrate concentrations in wells and aquifers through the use of new clean technologies. Green Data Center is a good practices manual used to obtain sustainable efficiencies and savings in the building and maintenance of a Data Processing Center, regardless of its size, and of its own technological platform. The innovative character of this project lies in its pioneering achievements at an international level.

Rule 4: Generate an Innovative Culture

In 2007, the European Innovation Scoreboard ranked Spain ninth with regard to the indicator that reflects the number of small and medium-sized enterprises that have modified their organization in order to adapt to new technologies. A total of 30% of companies in Spain had made the necessary changes, while in

[442] http://www.clubdeinnovacion.es/.

countries like Luxembourg, Denmark and Germany, over 50% of the companies had done so 50%.[443]

Mihaly Csikszentmihalyi, renowned Psychology Professor at American universities such as the University of Chicago, uses Renaissance Italy as an example to explain the determining factors of an innovation culture. According to this professor, three conditions are required for the creative phenomenon to occur: first, the human being's innate conditions for innovation; second, the technical knowledge of the medium; and third, society's receptiveness to new things.[444]

Other points of the study have highlighted the importance of the business culture as a driver for fostering innovation. Changing the innovative cultures of a company requires time and must have support from other agents. At the country level, an investment must be made in secondary and higher-level education, especially in the ICT areas. Much in the same way, training must be an ongoing process at the company in order for it to successfully adapt to the changing culture. This is even more important insofar as the population's aging signifies that older individuals should remain active longer. As explained before, it is important that this culture also be implemented in the public sector and that it serve as an example for the rest of the companies and as a sign to those abroad of the country's development. Companies should also be reminded of the potential of women and other minority groups as drivers of innovation so that they their talents are utilized to the fullest. The Commission calculates that the European Union will need 300,000 more qualified engineers for the year 2010 and points out that only one in five computer specialists will be women. According to its figures, the sector has a shortage of 41,800 professionals in Spain alone.[445] This lack of professionals can be partly filled with student and researcher exchange programs.

The Ministry of Science and Innovation is providing grants for stays at educational institutions abroad with a view to acquiring new knowledge and exchanging educational methodologies. The National Mobility Program aims to foster the geographical and interinstitutional exchange of staff associated with RDI activities. It seeks to bring foreign professors and researchers to Spain while sending Spanish professors and researchers to international and national centers.

The innovative culture must become a top priority in both the public and private sectors. Faced with an international crisis, Spanish companies must commit to long-term growth and avoid short-term strategies that generate immediate returns but in the process negatively affect the company's sustainability. This applies to both large companies as well as SMEs. Gamesa is an example of a Spanish organization that has committed to positioning itself in the energy management market, innovating in the interests of energy efficiency and sustainability. It is primarily dedicated to wind energy. Thus, innovation is not an option, but rather a sine qua non condition for competing in the sector. Gamesa has obtained a 15.4% share of this market. As a result, it is third largest in the

[443] «España, a la cola europea en innovación tecnológica», *ElPais.com* (29/10/2007).

[444] http://dialnet.unirioja.es/servlet/articulo?codigo=2080028&orden=77858&info=link.

[445] http://www.mujeresycia.com/index.php?x=nota/6671/1/empresas-tic-fomentan-presencia-de-mujeres.

world and expects to occupy a leading position in the year 2010.[446] Its innovation strategy has been accompanied by a complementary culture and planning. The executive team's commitment, obtaining a climate that is able to uphold the values of sustainability and technology, and taking into consideration a multicultural environment are some of the bases upon which it has built its innovation practices.

Rule 5: Commitment to Technology Parks

The growth of science and technology parks has been a determining factor of Spain's economic development. In March 2005, the Association of Science and Technology Parks of Spain (APTE) signed an agreement with the Ministry of Industry, Tourism and Trade by which the following actions were implemented: the Technology Transfer Network, comprising 22 parks; two technological antennas in Brazil and China; and a Park Seminar in Buenos Aires. These parks are a hotbed of innovation that partly overcome the difficulties that Spanish private companies face when innovating, including: problems generating patents; the smaller size of their companies, which in many cases are limited to imitating instead of innovating in mature sectors that are not technology intensive; human capital that is rarely multidisciplinary, etc. And now there is StepOne, a new company whose mission is to ensure the successful internationalization of Spanish companies dedicated to technological innovation in the United States market, specifically, in the Silicon Valley area. StepOne will provide its services to Spanish companies that work in emerging areas such as ICT, clean-tech, green technologies and biotechnology, all of which, despite their innovation potential, face certain challenges when entering the United States market.[447]

Going back to the proliferation of technology parks (see Figure 99), there are many advantages for companies that decide to join a technology park, which lead some technology-oriented organizations to move into these spaces. Among these advantages are the aid and subsidies granted for getting started, the lower cost of infrastructure and shared centralized services, greater security in the supply of electricity, gas and communications, promotional benefits, and even a management entity that will ensure that the criteria for the admission of companies into the park are established and observed. However, above all else, they facilitate integration and promote projects related to innovation, development and technology transfer. They make direct contact possible with companies that traditionally invest in RDI and establish a connection point with representatives from universities and similar industries. The facilities' location is usually strategic with regard to transport and communications, offering companies the possibility of carrying out a highly technological activity without foregoing the competitive advantage of location.

[446] *La Empresa Española en el Mundo Multipolar,* Accenture (2008).

[447] «Presentan una empresa para garantizar el éxito de la innovación tecnológica española en los Estados Unidos», *EuropaPress.es* (27/03/2009)

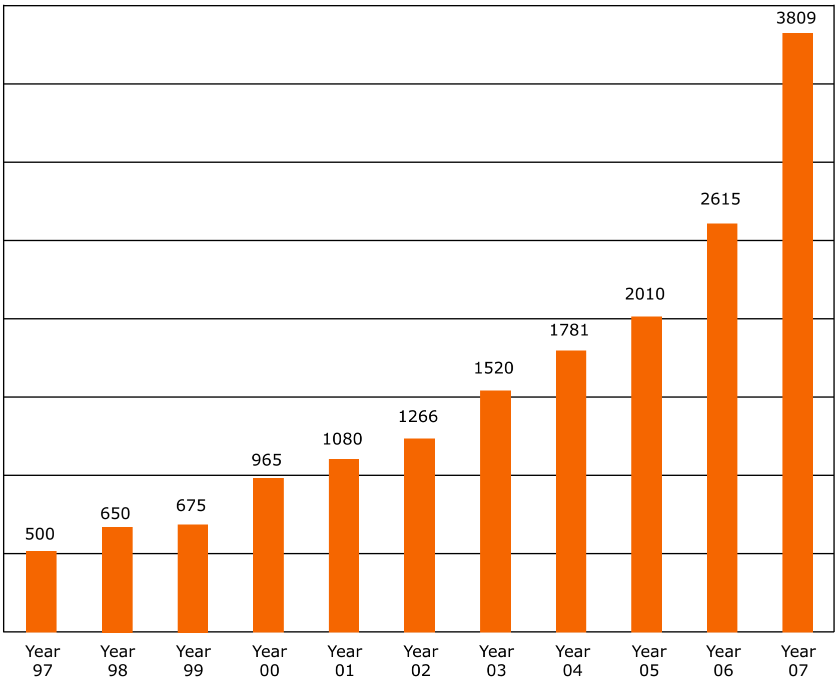


Figure 99: Evolution of the number of companies set up in technology parks.
Source: http://www.apte.org/?url=dinamic_page://13.

Located a few kilometers from Valladolid, the Technology Park of Boecillo is particularly noteworthy thanks to its unusual projects. The unit associated with the Astrobiology Center of the University of Valladolid is dedicated to researching possible signs of life in the solar system, primarily on Mars. Aries Complex, which is also located in the park, has been commissioned to design and manufacture all the components of the vertical stabilizer for the tail of the future A350 XWB, the new aircraft of the European consortium Airbus. The company Deimos Imaging, led by astronaut Pedro Duque, is already monitoring and controlling, in its station, the Earth observation satellite at Boecillo Park. The park is comprised of 6,500 employees, 512 million in investments and a total of 161 innovative companies, of which we have only mentioned a few. In short, technology parks make it possible for companies to reap all the advantages of belonging to an elite group of innovators.

The Scientific Park of Barcelona is of special note thanks to its longevity: established in 1997, it was the first science park in Spain. It has since grown into an international benchmark for the fostering of innovation, with four research institutes, over 50 companies, an incubator of biotechnological companies, more than 70 research groups and a wide technological offering of research support. It currently employs 2,200 professionals, although its area will increase in 2011.

Rule 6: Innovation in the Services Sector is Crucial for the Spanish Economy

Spain is a strong country in the tertiary sector, with almost 70% of its working population employed in this area.[448] Nevertheless, according to Guido Siebiera and Juan Ramis from ESADE, "the services sector is a trap for companies that fail when innovating"[449] because the sector's entry barriers are the lowest and services are relatively easy to copy. In fact, R&D spending in Spain for the services sector (14.6% in December 2006, see Figure 100) does not do justice to its relative weight in the Spanish economy.

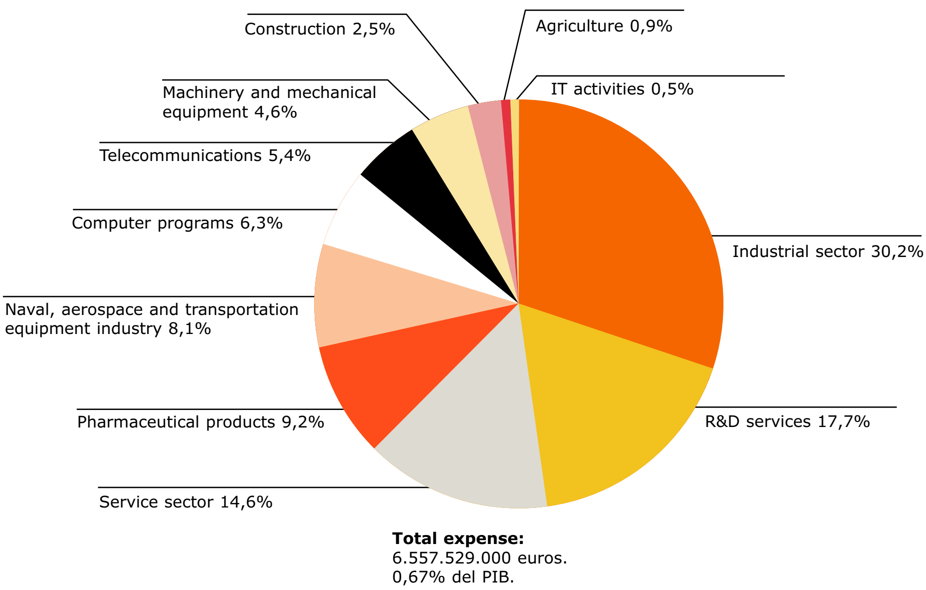


Figure 100: R&D investment in Spain by sectors (December 2006).
Source: http://enter2.ie.edu:81/graficos/imagenes/275.html.

For this reason, the authors recommend a series of tactics that could help companies innovate in services. First, they mention "doubling the customer's time," which consists of saving time for the customer, providing access to the service. One Spanish case is that of the Círculo de Lectores (Reader's Circle), which is in charge of taking books and music to homes on a bimonthly basis. Second, "customized segmentation" is highlighted, through which companies offer specialized packages in specific segments of their clientele in order to more effectively cover their needs. Sanitas Health Plan is a health insurance designed especially for foreigners living in Spain. Third, the authors state that a company can change the rules of the game if it is able to break with the basic customs of a business which most of the companies of a sector force their customers to accept. In this case, we can once again refer to one of the classic business

[448] Evolution of the working population distributed by economic sectors; INE data from the fourth quarter of 2008.

[449] http://www.materiabiz.com/mbz/estrategiaymarketing/nota.vsp?nid=33492.

successes of Spain: Zara. The textile giant has reinvented the traditional clothing store concept, placing prêt-à-porter fashion within everyone's reach. Lastly, the authors explain "one-stop shopping," which consists of offering additional services to current customers. This diversification must take into account possible synergies, such as companies that advertise online, offering services as varied as live-in or external domestic employees, estate caretakers, private drivers, live-in or hourly cooks, hourly ironing professionals, and many others whose common denominator is domestic assistance.

In the services area, tourism is undoubtedly the star in Spain. This is the service for which the country is best known all over the world and which has driven the growth of the Spanish economy. As a result, Spain headed a European tourism innovation program in 2008, Eureka Tourism, which embarked on managing 60 million in joint business projects in 36 countries with a view to promoting innovation in the tourism sector.[450]

The first thing to understand is that innovation in the tourism sector has given rise to unparalleled supply and demand. Nowadays, it is far easier to travel at a reasonable price, thanks to the large number of operators and packages on the market. In addition, the profile of the tourist is highly diverse and Spanish companies are taking full advantage of the different consumer segments. It could be said that the IMSERSO trips kicked off a long list. For example: República Single, a tourist complex for singles only in the middle of the Pyrenees, and Bicing, which provides the opportunity to see Barcelona by bicycle, avoiding the problems of parking close to the attractions and using simply a payment card. Club Aqua and Chueca Travel are websites that offer information regarding destinations recommended by gay travelers. This latter of these is part of P2P tourism, in which users interact via Internet in order to exchange travel advice and opinions, such as the sites "Opinión y Viaje" and "No Viajar." Private accommodations are also offered, which provide travelers with the chance to meet new people and share common interests, like P2P camping, rentals for garden camping and the case of people living in the host cities of the European Soccer Cup who provided accommodations for fans in their homes.

Consumers are becoming more and more interested in experiences like García Lorca Tours, which organizes trips to the lands of the Granada of Federico García Lorca. In the summer of 2009, PortAventura will open a new themed hotel with its own supermarket and rooms with a kitchen, food pantry and direct access to the park through the Far West games area. Value is also commonly offered by the sector's companies. At the end of 2008, Clickair began offering its companion service for minors between the ages of 5 and 13 who are travelling alone. At the same time, RENFE and Air Europa also began selling the first combination "train+plane" ticket. Easyviajar is launching "Top de cine," a selection featuring destinations where famous movies have been filmed.

[450] «España encabeza un programa europeo de innovación turística», *CincoDías.com* (07/01/2008).

Rule 7: Product Innovation to Reduce the Trade Deficit

Product innovation is a requirement for increasing exports and reducing the trade deficit. Spain is an expert in product innovation, especially in the textile sector. In addition to the famous Zara and Mango, there are some other, lesser-known enterprises that, in some cases, do 20% of their sales abroad. This is the case of Teleno, which exports to countries such as Japan, Saudi Arabia, Mexico, Greece, Germany and England. Despite being a family business that has been in operation for 40 years, the Spanish lingerie and swimwear group is familiar with innovation. This summer it plans to launch Drykini, a swimsuit that dries three times as fast as other swimsuits. The innovation project has been backed by the Textile Technological Institute (Aitex) of Valencia, a private nonprofit company dedicated to innovation in the fashion and footwear sector.[451] Aitex has also witnessed innovations such as a scarf that contains microscopic capsules which, depending on how they move, give off the scent they contain. It specializes in anti-allergic and nanotechnology testing, as well as in the development of antibacterial garments. The institute also awards the "Made in Green" certifications, which assure that the product's manufacturing does not contain any harmful chemical substances and that it respects the workers' human rights.

Nevertheless, product innovation in Spain is not only limited to this sector. In the food and health area, Nutri Up Desarrollo is particularly noteworthy. It is a company specialized in the creation and management of RDI projects centered on specific foods for patients with Down's syndrome, Alzheimer's disease, Parkinson's disease, autism and celiac disease. In the IT sector, NEOSISTEC is a leader in customized solutions for BlackBerry, GPS and Mobility Report Platforms. Another is Seven Solutions, which designs processing systems for various sectors. In the defense industry, Embention is of special note, which develops and markets intelligence systems for unmanned aircrafts.

Rule 8: Innovate in Business Models

Business model innovation is a new way of meeting customers' needs that, in many cases, entails an organizational change and a new way of competing in the market. One example in Spain is Endemol-Gestmusic, a partnership responsible for exploiting the reality-show market, in which there is no audience, only customers. With growing competition to capture the television audience, given the channel-surfing and pay channel phenomena, programs such as Spain's version of American Idol ("Operación Triunfo") have proven to be commercial successes, and all thanks to an innovative business model. The television business joins forces with the music industry, which has been severely hurt by the sale of pirated goods and the P2P exchange of music. This concept is enhanced with a competitive price that is linked to helping an artist that wants to win, diversified distribution on the Internet and in superstores, and a multi-product marketing strategy comprised of books, videos, discs and clothes.

[451] «Teleno reinventa la moda de baño», *CincoDías.com* (04/04/2009)

Did you know?

In 2006, only 22 Spanish companies were included in the European ranking of the 1,000 companies that invest the most in R&D. Telefónica is the first Spanish company to appear on the list (39), followed by the reservation system Amadeus (87), Indra (152), Repsol (184) and Abengoa(203).[452]

Switching sectors, another example of innovation is Telepizza and "the secret is in the sauce": in reality, the secret was imported as a innovative business model from the United States. The company has known how to quickly adapt to the fast-food market, following a rapid-growth strategy in order to achieve economies of scale. The franchise system has established an entire series of opening and quality control requirements, as well as an incentive and internal promotion system.

[452] «Sólo 22 empresas españolas están en el ranking europeo de las 1.000 que más invierten en I+D», *Europa Press* (10/06).

9

CHAPTER 9

Final Summary

9 Final Summary

The globalization process is entering a new stage characterized by a new geopolitical environment and by its departure from the traditional concept of global convergence. As the hegemonic power of the United States diminishes on the world stage, the growth of emerging economies, though weakened by the crisis, has taken on an unprecedented importance. Focus has shifted to the flourishing E2E economy (between emerging countries) and the large Asian conglomerates. Meanwhile, the dynamics of international relations are being affected by the accumulation of financial and natural resources among the countries striving to compete despite the dearth of means. The rise of protectionism as a measure to offset the effects of the crisis could indeed constitute a setback in the globalization process and a catalyst for the capitalist system as we know it.

In this context, many believe that the downturn will merely accelerate the transfer of power from the United States to a constellation of emerging countries. We are at a crucial time in which the decisions ultimately made for overcoming the crisis will be determining factors for the future. Neither countries nor companies can simply operate in survival mode. Instead, they must adapt to an environment with all-new rules, in order to compete with the new players and capitalize on the opportunities to arise from these countries' integration into the dynamics of the market. Competition is taking shape in the dimensions that have been analyzed in depth throughout this study: globalized trade, with the emergence of the new consumers; the proliferating flow of international capital; human capital, with talent as a scarce asset; the challenge of sustainable development; and the innovation race.

The new, multipolar world order portends both challenges and opportunities. To assist the players in reading the new ground rules, the aim of this publication has been to compile the current trends and the success stories of companies from not only developed economies, but emerging economies and the Spanish economy as well. The common thread of the analysis is that, now more than ever, one must "adapt or die." The fact is that, as with any crisis, we are witnessing an acid test whereby the companies to come out stronger will be those that are able to innovate and stand out in the imperatives of competitiveness. Those who do not will be destined for failure.

In short, if we were to envision the world as a great global chessboard with a multitude of players, then we could say that a crucial game is being played with the future at stake. We are witnessing a changing of the ground rules and the appearance of new players from emerging countries that are positioning themselves. The game's outcome will depend on the ability of companies and countries to adapt their strategies to the new rules. This study presents these rules together with a view to helping companies and other social agents to move more swiftly in an environment where changes occur at a blistering pace and constitute a source of threats—even more so with the crisis—but also a source of opportunities.

Appendix

Glossary

A

Anchor-firm model
Business model through which a large company spins off other smaller ones, providing them with the seed money needed to start growing.

Asian Tiger
The "Four Asian Tigers" or the "Four Asian Dragons" refers to the economies of Hong Kong, Singapore, South Korea and Taiwan. These countries have distinguished themselves by maintaining high rates of growth and industrialization, as well as becoming major recipients of foreign investment.

B

Basel Accords
The Basel Committee, composed of the governors of the central banks of Germany, Belgium, Canada, Spain, United States, France, Italy, Japan, Luxembourg, Netherlands, United Kingdom, Sweden and Switzerland, in 1988 issued the first of the Basel Accords, a set of recommendations based around one main idea: to establish the minimum capital that a bank should have in relation to the risks it faces. The primary limitation of the Basel I Accord is that it is insensitive to variations in risk and ignores a crucial aspect: credit quality and, therefore, the varying probability of default by different borrowers.
To overcome this drawback, the Basel Committee proposed a new set of recommendations in 2004. Basel II rests on three pillars: the calculation of minimum capital requirements, the process of monitoring the management of reserves, and market discipline.

Best practice
Any technique or methodology that through experience and research has proven to reliably lead to the desired result.

Black swans
"Black swans" are high-impact events, difficult to predict and occurring outside of normal expectations. Associated with risk management.

Blogosphere
Represents a community website where users write and interact regularly connected via links, comments, indexing and references.

Bologna Plan
The Bologna Process is the name given to the process initiated after the Bologna Declaration, signed in 1999 by the Education Ministers of the European Union in the Italian city of Bologna. This was a joint statement that began a *process of convergence* with the aim of facilitating the exchange of graduates and adapting the contents of university studies to social demands. The Bologna Declaration led to the creation of the European Higher Education Area, which also includes countries from outside the European Union and serves as a reference framework for education reforms that many countries will have to introduce in the next few years of the 21ST century.

Bottom of the pyramid
The bottom of the economic pyramid is composed of new consumers who live on less than two dollars a day. C.K. Prahalad, professor at the Ross School of Business, University of Michigan, and recognized as one of the top ten experts on world management, says that if we stop thinking of the poor as victims or as a burden, and start recognizing them as persistent, creative entrepreneurs and value-conscious consumers, a whole new world will open up. Prahalad suggests that they will be the engine of the next period of global trade and prosperity, and can be a source of innovation.

Bottom-line environmental impact
The difference between the negative impact of business operations and the positive impact of their environmental practices.

Brain circulation
Brain circulation refers to individuals who migrate as part of the institutional plans for the development of multicultural skills in transnational corporations. Such migration favors the formation of a pool of specialized talent in emerging countries.

Brain exchange
Brain exchange could make it easier for countries to retain talent, as it consists of a nonphysical migration of skills that will increase in coming years. This practice is common in companies that seek to raise the productivity of their operations through intelligent location.

Bretton Woods
The Bretton Woods Agreements were resolutions drawn up at the United Nations Monetary and Financial Conference, held at the Bretton Woods hotel complex (New Hampshire) from July 1-22, 1944, which set the rules for commercial and financial relations among the major industrialized countries. It was decided to set up the World Bank and International Monetary Fund, and establish the dollar as an international reserve currency. These organizations became operational in 1946. The Bretton Woods system collapsed in 1973, when the convertibility of dollars into gold was suspended.

C

CAGR
Compound annual growth rate is the average annual growth rate in excess of investment over a specific period of time.

Commodities
Goods or services subject to negotiation (in spot markets, futures or options). Usually raw materials and basic products.

CSR/SRB
Corporate social responsibility (CSR), also known as sustainable responsible business (SRB), can be defined as the active and voluntary efforts made by companies to improve social, economic and environmental conditions, usually with the aim of improving their competitive position, standing and added value. Corporate social responsibility goes beyond compliance with laws and regulations, as it takes for granted they are respected and strictly observed.

D

Decoupling
Phenomenon where emerging economies disassociate or "decouple" from the negative economic impacts experienced by developed countries, especially the United States.

Distressed debt
The name given in financial markets to the debts of companies and/or countries faced with problems and/or difficulties in complying with the original terms of payment in accordance with the conditions under which these debts were contracted, and which have a high probability of not meeting these conditions, neither totally nor partially.

Doha Round
The Doha Round of the World Trade Organization is a series of negotiations whose object is to liberalize world trade. It seeks to reach agreement on an issue that was left pending from a long previous cycle (the so-called Uruguay Round): agricultural trade. During this stage, the developing countries are trying to obtain barrier-free access for their agricultural products to markets in developed countries. This means that the latter will have to eliminate or significantly reduce the protection they give to their agriculture through export subsidies and direct subsidies to farmers. A deadline has been established for the total elimination of agricultural export subsidies: 2013. A sharp reduction in domestic subsidies is also defended, "proportional" to the concessions on trade in industrial goods that will have to be made by developing countries.

E

e-Learning
Concept of distance education that integrates the use of information technology and other pedagogical (teaching) resources for the teaching and training of users or students online. It can be defined as a mode of learning within distance education. It uses various tools and media including the Internet, intranets, CD-ROM, multimedia productions (e.g., texts, images, audio, video).

Employer branding
Consists of a set of steps designed to achieve a good corporate image in the mind of employees and external stakeholders.

Empowerment
Empowerment means delegating power and authority to subordinates and giving them the feeling that they control their own work and decision-making.

G

Global Reporting Initiative (GRI)
The Global Reporting Initiative (GRI) was launched in 1997 to promote the quality, accuracy and usefulness of reports on sustainable development. It became an independent entity in 2002. It is an official partner on the United Nations Environment Program, working in cooperation with the Global Compact Initiative instituted by the Secretary-General of the United Nations. By establishing a common framework, the guidelines promote the comparison of the performance of different organizations in different parts of the world and aim to facilitate interaction between stakeholders.

Greenfield investments
Form of foreign direct investment where a parent company builds installations for an industry "from scratch," creating employment in the destination country. Multinationals from developed countries see this investment as a way to enter markets in emerging countries, whose governments may even offer tax breaks, subsidies or other incentives to carry out these projects.

H

High performance
Accenture has embarked on a major research program to identify the characteristics of a high-performance business. With this undertaking, the firm obtains knowledge about how to harness new and emerging technologies and business practices to create innovative business solutions that open a path toward sustainable growth. Accordingly, Accenture helps make innovation a reality, which enables clients to turn their organizations into high-performance businesses.

Hub
This term is used internationally to identify systems that have a heavy reliance on one central point. Specifically, it has been used to refer to centers of human talent.

I

Index of Sustainable Economic Welfare (ISEW)
Alternative economic indicator designed to replace Gross Domestic Product (GDP) as an indicator of social welfare. The IBES is calculated using similar techniques, but instead of accounting for goods and services in the economy, it measures not only consumer expenditure and services from domestic labor, but also deducts the external costs associated with pollution and resource consumption.

ICT
Information and communication technologies; they are a part of the emerging technologies focused on the use of computer media to store, process and distribute all types of information with all types of goals (education, business organization and management, decision-making and so on).

J

Joint venture
Type of strategic alliance. Implies a commercial agreement for long-term joint investments between two or more stakeholders (usually corporate entities or traders). The purpose of a joint venture may be quite varied, from producing goods or services to searching for new markets or providing mutual support in various links of the production chain. It operates for a limited time, for the purpose of financial profit. To achieve the common goal, two or more companies agree to make diverse contributions to a joint enterprise. Contributions may consist of raw materials, capital, technology, market knowledge, sales and distribution channels,

personnel, financing, products, or, what amounts to the same thing: capital, resources, or simply know-how.

M

Multipolar world
Emergence of a world characterized by multiple centers of economic power and activity. It may be defined as a new and deeper phase of globalization.

O

Offshoring
Consists of moving a factory to a location where it can manufacture the same product, but with cheaper labor, lower taxes, lower insurance and subsidized energy.

Outsourcing
Process where a company identifies a part of its business that could be run more efficiently and/or more effectively by another company, which is hired to develop this part of the business. This gives the first organization the freedom to focus on its main business activity.

P

Peer-to-peer
This term refers to the interaction between different players in order to exchange information and set up a extensive social network able to offer large-scale services. This is possible thanks to technology that allows people to exchange files between computers, via the Internet with little intervention from servers, and without any need for the participants to know each other.

Portfolio theory
The portfolio theory states that investors should deal with portfolios as a whole, evaluating overall risk and performance instead of choosing individual securities according to the expected return of each security in particular. Today the theory is regarded as discredited because cautious investors with balanced portfolios have been just as hurt as those who took risks.

Purchasing power parity
The exchange rate that should be applied to convert the currency of one country to another in order to buy the same amount of goods and services (using data from 2006, Tim Callen, Chief of the World Economic Studies Division in the IMF Research Department, showed that when the market exchange rate was applied the United States was the largest contributor to global growth. However, using PPP-adjusted rates, it was China).

S

Sovereign wealth fund
A sovereign wealth fund (SWF) is a state-owned investment fund that controls a portfolio of national and international financial assets. Generally, the capital comes from the export of raw materials such as gas or oil, and its investments consist of bonds, shares and financial derivatives, though it also includes other investments such as real estate. The biggest, the Abu Dhabi Investment Authority (ADIA), manages assets with an estimated value of 875,000 million dollars, nearly three times the Swiss GDP in 2007.

Stakeholder
Someone who affects or may be affected by a company's activities.

Subprime credit
A form of credit in the US financial market that is characterized by a higher level of default risk than the average for other credits. Most subprime loans are for mortgages.

Sustainability
Refers to the balance between a species and the surrounding environmental resources. By extension, it applies to the exploitation of a resource within the threshold of renewability. Sustainable development can be divided conceptually into three areas: environmental, economic and social policies. The social aspect is seen as the relationship between social welfare, the environment and economic growth.

T

Talent pool
A group of people with differential value within the human capital.

Telework
Literally, "working at a distance." Refers to work done on a regular basis in a different place from the main work center. Often refers to office jobs that require minimal interaction with the customers and do not require physical presence. It is customary to use computer media to communicate with customers and colleagues, to send results and, in most cases, to do the job.

Time to market
The time it takes to develop a product from its conception until it is available for sale.

Triple bottom line
Refers to the results of a company measured in environmental and social terms as well as economic ones. They are presented voluntarily in the corporate reports of companies committed to sustainable development.

Triple E threat
The "triple E threat" is the need to compete with everyone, everywhere, for everything.

W

Web 2.0
Refers to a second generation in the history of Web development, based on communities of users and a range of special services such as social networks and blogs that foster collaboration and agile information exchange among users.

Win-win strategy
Strategy that identifies a business model where the exchanges, the negotiations and, ultimately, the actions being undertaken are favorable for all the parties involved. The "you win, I win" philosophy seeks long-term business relationships based on "if my clients win, I win" or "if my partners win, we all win."

World Economic Forum (Davos Summit)
The World Economic Forum is a nonprofit foundation based in Geneva, known for its annual meeting in Davos, Switzerland. It brings together the top business leaders, international political leaders, journalists and select intellectuals to discuss the world's most pressing problems, including health and the environment. The Forum also organizes the "Annual Meeting of New Champions" in China and a series of regional events throughout the year. In 2008, these included meetings in Europe and Central Asia, East Asia, Africa and the Middle East, and also the Russian CEO Roundtable and the World Economic Forum on Latin America.

Worldsourcing
An innovative way of managing companies as opposed to the traditional idea of outsourcing. It exploits global capacity, responsibilities shared out though all the regions where a company operates, with functions distributed among all the countries involved, approaching markets where business potential is greater, and doing so through a basic network which gives priority to functions rather than location. Using this approach, the company has centers with different functions distributed around the world, but operating as if they were in the same place.

FTF Members

Speakers

Xiang Bing
Dean, Cheung Kong Business School.
Country: China.

Graciana del Castillo
Associate Director, Professor Phelps' Center on Capitalism and Society.
Country: United States.

Salvador García-Atance
Chairman, Fundación Lealtad.
Country: Spain.

Gil Forer
Global Director, Venture Capital and IPO Initiatives, Strategic Growth Markets, Ernst & Young.
Country: United Kingdom.

José Gijón
Head and Chief Economist, Africa & Middle East Desk, OECD Development Centre.
Country: Spain.

Yukon Huang
Senior Advisor and Former Director, World Bank China Program.
Country: China/United States.

Joshua Klein
Founder, Wireless.
Country: United States.

Joel Kurtzman
Chairman, Kurtzman Group; Former Editor, Harvard Business Review.
Country: United States.

Catherine Laine
Deputy Director, Appropriate Infrastructure Development Group (AIDG).
Country: United States.

José Luis Leal
Former Chairman, AEB (Spanish Banking Association).
Country: Spain.

Marc Mathieu
Senior Vice President, Global Brand Marketing; Former Chief Marketing Officer, Coca-Cola.
Country: United States.

Cristóbal Méndez de Vigo
Head of Distribution and Business Development, Foreign & Colonial (F&C).
Country: United Kingdom.

Kamal Quadir
Founder, Cell Bazar.
Country: Bangladesh.

Jeffrey J. Schott
Senior Fellow on International Trade Policy and Economic Sanctions, Peterson Institute for International Economics.
Country: United States.

Federico Steinberg
Senior Analyst, Real Instituto Elcano; Professor, Universidad Autónoma de Madrid.
Country: Spain.

Sng Seow Wah
Executive Vice-President, Fullerton Financial Holdings.
Country: Singapore.

Shoshana Zuboff
Charles Edward Wilson Professor of Business Administration, Harvard Business School.
Country: United States.

Moderators

Carlos Bhola
Managing Director, Celsius Capital.
Country: China.

Christopher Meyer
CEO, Monitor Networks.
Country: United States.

Garrick Jones
Ludic Group.
Country: United Kingdom.

Attendees

Fernando Alfaro
Patron, Bankinter Foundation of Innovation.
Country: Spain.

Alpheus Bingham
Co-Founder, InnoCentive, Inc.; Patron, Bankinter Foundation of Innovation.
Country: United States.

Max Burger-Calderon
Chairman Asia, Apax Partners.
Country: China.

John de Zulueta
President, Sanitas (Bupa Group).
Country: Spain.

Ren Ee Chee
Lead Researcher, Singapore Immunology Network (SigN); Director, Graduate Affairs; Director, Biopolis.
Country: Singapore.

Caroline Firstbrook
Managing Director, Corporate Strategy in Europe, Middle East and Africa, Accenture.
Country: United Kingdom.

Javier García
E-Lilly.
Country: Estados Unidos.

Juan José González
Director of Strategic Development, Indra.
Country: Spain.

Ricardo Gottschalk
Research Fellow, Globalization Team, Institute of Development Studies, University of Sussex.
Country: United Kingdom.

Pedro Guerrero
Chairman, Bankinter.
Country: Spain.

Frank Hawke
Chairman, Kroll Greater China.
Country: China.

John Hoffman
CEO, GSMC
Country: United States.

Andrew Hunt
Founder, Andrew Hunt Economics Ltd
Country: United Kingdom.

Julia Kirby
Senior Editor, Harvard Business Review.
Country: United States.

Germán Lorenzo
Director, Asia-Pacific, Mondragon Corporation.
Country: China.

Brook Manville
Principal, Brook Manville LLC.
Country: United States.

Emilio Méndez
Director, Center for Functional Nanomaterials Brookhaven National Laboratory.
Country: United States.

Carlos Mira
Vice-Chairman, Bankinter Foundation of Innovation; President and CEO, Acalis Systems.
Country: Spain.

Rita Rodríguez Arrojo
Director of Intangibles Management, Bankinter.
Country: Spain.

Michael Schrage
Professor, MIT Sloan School of Management; Senior Advisor, MIT's Security Studies Program; Visiting Professor, Sweden's Royal Institute of Technology.
Country: United States.

Dennis Tachiki
Professor, Department of Economics, University of Rennes.
Country: Japan.

Stephen Joel Trachtenberg
President Emeritus, The George Washington University.
Country: United States.

Carlos Vidal
Former Chairman, Accenture, Spain; Senior Managing Director–Geographic Strategy & Operations, and member of Accenture's Board of Directors.
Country: Spain.

Dali Yang
Professor and Chairman in the Department of Political Science, University of Chicago.
Country: United States.

Bankinter Foundation of Innovation

Mónica Martínez Montes
General Director.
Country: Spain.

Andreea Niculcea
Executive.
Country: Romania.

Julie Slama
Executive.
Country: Belgium.

Teresa Jiménez Herradón
Executive.
Country: Spain.

Bankinter

Marcelina Cancho Rosado
Controller, Bankinter Foundation of Innovation, Corporate Responsibility Team.
Country: Spain.

Main contributors for this publication

Eva López Suárez
Accenture, Spain.

Cynthia Gregsamer Montes
Accenture, Spain.

Santiago Espinosa de los Monteros Madrona
Accenture, Spain.

Fundación
de la Innovación
Bankinter

www.fundacionbankinter.org

Colaborador Principal

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