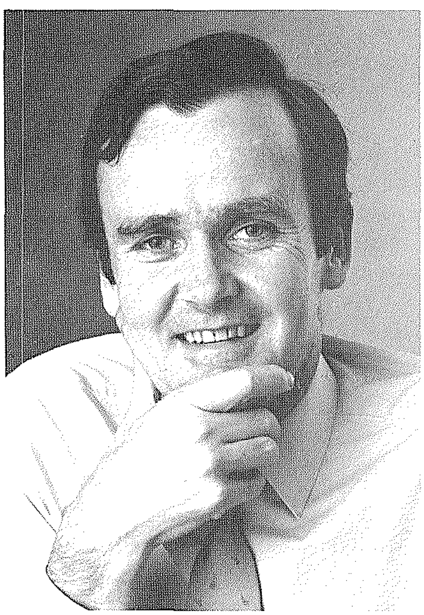
GLOBALISATION: AN IMPOSSIBLE DREAM

WHY MOST COMPANIES SHOULD STAY AT HOME



by R. A. FERGUSON

The lure of overseas expansion can lead to disaster. And in many cases, venturing offshore is unnecessary for Australian companies.

When does offshore expansion, or "globalisation", make sense for Australian companies? My answer to that question would have to be: Not very often!

It is true that we live in a global marketplace in which some players will take advantage of the opportunities to prosper. But I am dubious about the likelihood of Australia being prominent among these players and particularly dubious about our ability to develop – on a large scale – the existing range of Australian businesses offshore.

The Australian banking industry is an example of why I am sceptical, and its experiences may provide lessons that are relevant to other sectors of the economy.

When looking at the strategies that banks are pursuing internationally in response to deregulation and freedom of entry, the similarities in their approaches are easy to detect. Equally notable is the marked lack of success by any bank on a global or multinational basis. There are plenty of success stories about banks in their own domestic territory but few, if any, have been able to reproduce that record in a global market.

The fundamental reason for this seems to be that banks are going global for defensive reasons, rather than to chase growth opportunities. It is a simple matter of protecting their existing corporate customer base. The banks are following their own customers overseas for fear of losing them to the domestic banks of other markets.

They believe they must protect their business with their prime clients against this competition. They also see a threat from multinational organisations, skilled in international financial markets, exploiting the advantages of being able to raise and distribute money in markets other than their own.

The response of banks all round the world to this threat is a decision that they cannot afford to stay within their local markets. They feel they must be internationally competitive, and that they must be ready to follow their clients overseas.

The important point in this is that the banks' motives are primarily defensive – to protect their home market. And typically defensive strategies, if they are designed to protect something precious, do not generally pay for themselves in isolation; they are justified by serving the greater good of the business.

Implicit in this defensive approach is a recognition by world banks that globalism is an overhead and not a return or an asset-booster. This defence-based motivation raises two interesting phenomena:

- First, international banks in their home markets are fiercely competitive in the defence of their business – in much the same way that a soldier will fight more determinedly in his own country. This, of course, makes it harder for an

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international bank to establish a foothold in a foreign market.

Second, their organisational structure tends to be identical. What I term the "globalist's approach" is in reality a "centralist's approach". Most financial institutions tend to be one-dimensional: the overseas branches they establish are little more than geographic extensions of the head office. Managements of these branches are invariably expatriates – for example, an American head of Citibank Tokyo, a Japanese for Sumitomo London, a German for Deutsche Bank Australia and so on.

It is rare to find a local heading a foreign bank. The culture of the branch tends to be an imported culture from head office, not a local culture. And important decisions are made by head office, often by executives who know little or nothing about the particular overseas market.

The approach to business of these overseas branches tends to be predictable. It is a simple-enough process. A foreign bank, say German, sets up in Australia to deliver products and services imported from Germany to German clients operating in Australia. The next step is to deliver these products and services to non-German organisations. Ultimately, the foreign bank seeks to compete by offering Australian products and services to Australian companies and institutions. This is a very difficult step and few do it well. That is, very few foreign bank branches are genuinely strong in the local domestic financial market.

Moreover, these branches are not usually business entities in their own right. Rather, they are "matrixed" organisations with control of business or product lines firmly in the hands of head office.

As with any expansion based on defensive motivations, the activities of international banks outside their home markets are almost certain to dilute their overall return on shareholders' funds. However, the globalist approach of banks in going international is fine in terms of achieving the primary goal of protecting their home markets and servicing their clients operating overseas. If this is the main rationale of the approach, it is a reasonable but limited strategy.

More often, however, the international ambitions of banks, initially based on defensive and client-protection reasons, become much broader in scope. This is where failure is almost inevitable because the fundamental strategy is flawed. The concept of a bank being able, from a central head office, to manage through expatriates a global financial institution which is a leading force in all significant national markets will not be successful. It just will not happen.

We should concentrate on what we do best. If that be mining or agriculture, so be it.

The irony of this situation is that these defensive, but globally expanding, banks are in fear of a "paper enemy". That paper enemy is the truly competitive global bank. There isn't one and there is not likely ever to be one.

Why is the idea of a globally competitive bank an impossible dream? Because all competition is local. Local customs, language barriers, local laws, local power balances, local politics, local geography and weather – all these make each market different, requiring different responses in terms of business strategy.

In theory, these different strategies are possible in a global organisation if there is a preparedness by head office to delegate – but in banking, managements are reluctant to delegate. This reflects the fact that lending is the greatest area of risk in banking and head office, wherever it may be, will not be willing to give up control over lending.

Equally, there is a desire to centralise control over other forms of risk in which banks engage. This need for control ultimately limits the transferability of the banking model on to a global scale.

So what lessons can be learned from banking – and other industries which have expanded internationally from Australia?

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Transport

Probably the best-known successes in globalism have occurred in the transport sector. Here we have TNT, Brambles and Mayne Nickless all globally structured. Brambles is the most successful; TNT has yet to prove the strategy, although it is well on the way with a very valuable network; and Mayne Nickless is engaged in a relatively minor duplication of its security business.

Why have the transport companies been so adventurous and so successful? I believe it is because of the early deregulation of interstate transport in Australia. In 1955 the *Hughes v. Vale* High Court case resulted in deregulation – 25 years before it occurred in the United States.

Thus two successful transport entrepreneurs, Sir Peter Abeles and Gordon Barton, were able to establish a unique advantage over the rest of the world, using their experience of interstate transport to lever off internationally. It enabled them, at least in the case of TNT, to develop world-scale transport businesses that could fund global aspirations.

Building materials

Australia's original overseas expansion in building materials focused on ready-mixed concrete. This was an Australian development, probably reflecting the infrastructure boom of the 1960s, which Pioneer Concrete and others were able to export to many countries, but initially to Europe.

It is worth noting that for many years Pioneer, as did TNT, struggled with the idiosyncrasies of various European markets before achieving an adequate rate of return. This empasises the point made earlier that all competition is local.

In the expansion more recently of building materials the emphasis has been on taking long-standing and proven Australian products such as terra cotta roofing tiles to markets with a similar climate, such as Florida and California.

Beer

In brewing, we have seen Bond's problems with Heilemann, and the jury is still out on Elders. Australia's trade practices laws, plus our prolific thirsts, have permitted the development of world-scale brewery companies which have the financial muscle to go global.

Success will depend on branding, as has been the case with products such as Coke and Pepsi, but the picture is partly confused by the opportunistic nature of our brewery entrepreneurs, which means that Elders' activities in Europe seem as much a property play as a branding play.

Media

The success story here is News Limited, where we have a great entrepreneur who had a singular vision and understood well before most others the global nature of media. Here, the uniqueness of the personality and the timing in the acquisition of what are now cheap assets were the two key factors behind the success.

Banking

Finally, let us look at the banking sector. The ride has been bumpy. The first big global move was the acquisition by ANZ of Grindlays, ironically to minimise the impact of foreign bank entry into Australia.

I think the ANZ now realises that it would have been better to stay in Australia and enhance its strong local franchise against the feeble foreign bank competition it and other incumbent Australian banks have encountered. That seems to be the strategy adopted more recently by ANZ, now that Grindlays, after a lot of hard work, is operating successfully. ANZ is concentrating on the local market but building an offshore network designed to service Australian multinationals in a relatively inexpensive way.

As to other Australian banks' efforts offshore, Westpac is still in the early stages of its global aspirations, and thus it is too early to tell; and NAB doing well with its UK acquisition of Clydesdale. However, the latter seems to be an opportunistic investment that, while well timed, faces the danger of having insufficient size in the UK. This, and the high cost of acquisition, could lead to NAB eventually selling, pocketing a profit and concentrating on Australian domestic retail business. The current efforts by NAB to buy Yorkshire Bank should bring these issues into focus.

ANZ – building an offshore network.

NAB – doing well with Clydesdale.

Westpac – in the early stages.

The response of banks all round the world is that they cannot afford to stay within their local markets.

The common theme in these examples seems to be the need for big added-value in global expansion. Apart from the personality-driven success of Rupert Murdoch, our successful globalisations have been based on some unique advantage – transport deregulation being the best example.

Even if a distinct international competitive advantage is perceived, there are still numerous obstacles in the way of overseas operations. The main one is the Australian tax system.

The imputation system, while a great advance in simplifying taxation, makes it more difficult for companies to succeed internationally. This is because imputation effectively eliminates corporate tax where Australian taxpayers are concerned. Corporate tax in Australia is really a withholding tax refunded to Australian shareholders.

Overseas, no such advantage exists for Australian shareholders. To match the benefits of $100 earned in Australia, a company operating in a foreign country with a tax rate of, say, 30 per cent, would need to earn $143; in a tax haven with, say, 15 per cent tax, $118 would be needed.

Given that overseas expansion tends to be dilutive before tax, the after-tax effect is horrendous.

Another disadvantage of the Australian tax system is the low cashflow retention that arises from our depreciation rules, compared with those of other countries, plus the high dividend payout rates that are a feature of Australian and have been exacerbated by imputation.

A further problem Australian companies face when trying to compete internationally is the high cost of capital, with interest rates and equity costs up to two-and-a-half times those of our competitors.

So there is not much going for us. Distance, high cost of capital, the tax system, a small domestic market – how are we to respond to the globalisation trend?

My simple answer is that we should concentrate on what we do best. If that be mining or agriculture-related, so be it. An important aspect of globalisation is specialisation; there is no point in trying to be good at something in which we have no competitive advantage.

Because of the benign trade practices environment in Australia, many companies reach a point where they believe they have outgrown the opportunities in the Australian market and they feel compelled to go overseas. This is faulty thinking; such a motivation will inevitably lead to failure. There are so many hurdles to overcome that a company must have a very positive advantage to justify going global. The best way to handle this situation is to downscale companies that "feel too big" for the Australian market.

The most important message I can conclude with is a reminder that all competition is local (in the same way that "all war is local" – a lesson the United States and the Soviet Union learned to their cost in Vietnam and Afghanistan).

If you have a product or technology that has a major edge that can overcome the disadvantages of our tax system, cost of capital and distance, by all means go global – but remember: each market is different and what works in one will not necessarily work in another. □