Commentary

Linking Globalization to Intellectual Capital

In 2003, re-evaluate the purpose of globalization strategies and focus on business process outsourcing opportunities in countries that have the potential for effective intellectual capital management.

Successful business globalization depends on several factors. Some of these — such as the educational status of a given population, tax and regulatory structures, and IT infrastructure — are obvious; but some are more subtle. Five of these less-obvious factors relate to intellectual capital management (ICM) and will have a direct effect on whether or not a given location is a good place to outsource business processes, production and IT functions.

- The judicial infrastructure must demonstrate the means and the willingness to consistently enforce a body of commercial law that includes intellectual property (IP) rights.
- A commercial and civil legal framework must reinforce the primacy of institutions over individuals in power.
- Legally sanctioned discrimination on the basis of race, creed or gender eliminates intellectual capital from the economic equation.
- Ownership rights must be well-documented and available to all, but not mired in arbitrary "make-work" processes.
- Changes in law and practice must evolve to protect both national and foreign interests while reflecting the needs and realities of the local culture.

These predictions are based on an understanding of ICM in a given country or region.

Prediction: China and India

India and China have 40 percent of the world's population, with huge pools of active intellectual capital, largely untapped. Each presents a different risk/reward profile and both countries remain generally misunderstood and misrepresented with respect to their global economic impact. Both are in a position to benefit directly from the influx of Western capital, rather than be exploited as part of commercial "globalization."
By 2007, India’s potential will be globally recognized and it will be the No. 1 destination for global, knowledge-intensive businesses and low-cost, high-quality customer service organizations (0.7 probability).

Through 2006, India’s potential to achieve the leading position as a global business process outsourcing (BPO) center will be hampered by political infighting, bureaucratic approval processes and declining growth in foreign direct capital (0.8 probability).

Piracy rates for software and other digitized content in the Chinese business-to-business (B2B) space will drop at least 5 percent in 2003 (0.8 probability).

Piracy rates will drop to 85 percent in the B2B space by 2006, allowing vendors to make a profit (0.8 probability).

In the Chinese business-to-consumer space, digital media and software piracy rates will continue to be more than 97 percent in 2003 (0.8 probability).

Impact in 2003

India

In 2003, Western businesses will continue to overestimate the risk profile in India, while underestimating the potential rewards. Those that correctly assess the risk/reward profile will be able to realize short-term cost reductions in outsourcing midtier knowledge base tasks, such as call center operation and claims processing. Higher value activities, such as R&D, especially software R&D, should also be considered as candidates for outsourcing to India. India will also enhance its long-term strategic potential to be regarded as partners in an emerging "powerhouse" economy.

China

In 2003, Western businesses will continue to underestimate both the risks and rewards of doing business in China. China’s economy is rapidly moving up the value chain and it should no longer be viewed as simply "the world's factory floor." At the same time, IP protection remains untested and enforcement is patchy. Despite the Chinese government’s efforts to enforce the rights of IP owners, China’s cultural history does not support the “ownership of ideas” — it regards ideas as free to all.

Reacting in 2003

India is still largely an untapped source of ICM for BPO, software R&D and manufacturing. All of the fundamentals for the continued development of knowledge-intensive and information-intensive industries have been established. In the long term, India can expect sustainable, although inconsistent, economic growth and increasing stability. Knowledge-based businesses should look to India as an outsourcer.

China is already seen as a place to locate labor-intensive businesses, but enterprises should also consider investing in knowledge-intensive businesses in the area. Because the IP situation is still evolving, the approach should be a cautious one. The powerhouse software vendors have already invested heavily in China and China’s domestic software players are beginning to realize that IP protection is necessary for their own continued growth. The best opportunities for sustained growth and intellectual capital protection in China are in urban areas — Beijing, Shanghai and the southern province
of Guangdong. Here, economic growth, a generation of reform and anticorruption laws, and domestic advantages from World Trade Organization participation are most in alignment.

Prediction: Eastern Europe

The Czech Republic, Estonia, Hungary, Poland, and Slovenia are all set to enter the European Union (EU) in 2004. EU membership will improve a country’s general economic condition and help ensure market stability. If all else fails, the European Court offers a place of appeal. The EU will insist that obligations regarding copyright laws are fulfilled, which is a key issue in the software industry. The EU also facilitates software development by funding specific aid programs.

These Eastern European countries include many well-educated science and engineering professionals who are not yet as expensive as their Western European competitors. Manufacturing migration will increase by 25 percent in 2003, as cost-effective production moves to Eastern European countries (0.9 probability). Software development activities will be sited in Eastern European countries and 2003 will see the emergence into Western Europe of the first Eastern European players (0.8 probability).

Impact in 2003

Labor-intensive industries are already relocating from the United Kingdom and other Western European countries to Eastern European ones. This trend will accelerate in 2003. Cost pressures on manufacturers will increase and those that do not reduce labor costs will suffer price pressure. Knowledge-intensive industries will begin to locate R&D in Eastern European countries to take advantage of lower costs there.

Reacting in 2003

Investigate the possibility of moving some operations and processes to Eastern Europe. Software vendors and systems integrators should look for opportunities in the small-to-midsize sector, if that is appropriate to their business model. Many of these countries are very small and, to some extent, the markets there are already saturated. Leading-edge enterprises will need to start looking at the next group of Eastern European countries, which may or may not eventually join the EU. Countries such as Croatia are expected to be in the next wave of economic development and expansion and these markets still need to be developed.

Prediction: Latin America

In 2003, Latin America will continue to receive continuous investments and training from powerhouse IT organizations and services providers, not only from the United States and Europe, but also from India. By the end of 2003, at least two software development centers located in the region will reach Level 4 of the Capability Maturity Model (0.8 probability). Because enterprises are shifting IT services and operations to Latin America, the region will experience at least a 5 percent increase in end-user IT spending in 2003 (0.7 probability).

Impact in 2003

IT services in Latin America mainly focus on data center management and software development centers. IT skills and infrastructure must improve in 2003 to cope with competition and regulations regarding workforce contracts, and IP rights and incentive plans for IT education must be updated.
Powerhouse IT vendors doing business in Latin America have learned how to benefit from the constraints imposed on IT investment by the local economy and politics. Opportunities in nearshore data management services and operations will be transformed into added value. In Latin America, software R&D and implementation will be the most important accelerators for global IT powerhouse vendors, while local players will take advantage of the need for continuous services, such as maintenance.

Outsourcing will be a normal, commonsense activity for all competitors. End-user enterprises in Latin America will use elements such as ICM, productivity, quality of service, service-level agreements, costs and performance to differentiate between competing global and local IT players. End-user enterprises should revisit their IT strategies to gain additional value from these opportunities.

**Reacting in 2003**

Global enterprises in Latin America must plan strategically in the mid-to-long-term and use alliances, mergers and acquisitions to their advantage. Local enterprises can gain, domestically and globally, by emphasizing their flexibility, creativity and innovation. Both local and global enterprises need long-term vision and knowledge management — transferring and multiplying intellectual capital (such as foreign experts and communities of practice) — to guide, leverage and expand intellectual capital in the region.

Latin America is close enough to the largest economy regions (North America and Europe) for them to invest in IT services. Services rely on people and processes more than on products. Local and global value chains that cross Latin America must focus on education, training and decision making strategies. In the long term, Latin America’s challenge is to show consistent and significant market share growth, improve its social, political and economic "scenarios" and move from being an emerging to a developed region.

**Prediction: South Africa**

Despite some political risks associated with its transformation, South Africa has potential as a place to do business. With a strong rule of law and above-average IP protection for a developing nation, South Africa, once regarded as an unsafe place to conduct business, will grow in importance as an outsourcing location for information-intensive businesses. BPO in financial services will increase by 25 percent through 2005 (0.8 probability).

**Impact in 2003**

As cost pressures continue, Western European financial services businesses must find additional ways to cut costs.

**Reacting in 2003**

European and American enterprises should investigate the opportunities for outsourcing and direct investment in South Africa.

**Bottom Line:** When free markets fail to bring benefits locally, globalization looks like colonization. India, China, Eastern Europe and South Africa have the internal structures to benefit from market-driven capitalism. Enterprises should investigate IT and business processing outsourcing opportunities in the countries that have the foundations for effective intellectual capital management.