Globalization and stakeholder conflicts: a corporate perspective

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There is considerable confusion and hyperbole about globalization. Disagreements range over whether it is a process or an end-state, over the degree to which it is happening or has already reached, and over its implications for the power and ultimate survival of the state. By examining the micro-foundations of globalization, the pressures that firms feel from their more diverse stakeholders, this article attempts to rectify and to look beyond the simplistic, often implicit, assumption that firms gain, while states lose, from globalization. Both firms and governments face heightened risks and both need new skills to deal with them. *

Globalization is a portmanteau term whose definition is more often avoided than attempted; the perspective of the author clearly matters. For economists, globalization is an advance towards the end-state of a fully integrated world market, a concept which sits comfortably within conventional economic theory. For political scientists, globalization is a march away from their more conventional construct of a system of states with territorial sovereignty over a large number of issues.[1] Business school academics and consultants tend to favour analogies such as the 'borderless world'.[2] However, at the root of all three perspectives is the view that globalization is being driven by private, not public, actors; that is, by firms, not governments.[3] Thus a corporate perspective on globalization may help to shed light on the factors behind it, those that constrain it, and what its implications are for the future division of tasks between private and public actors.

* The author is grateful to members of the World Interdependence Council (Philadelphia) and the UK 2000 Group, where some of the ideas in this article were first explored.

1 Richard Falk describes globalization as a situation where 'the aggregation of states, what has been called "a states system", is no longer in control of the global policy process. Territorial sovereignty is being diminished on a spectrum of issues in such a serious manner as to subvert the capacity of states to control and protect the internal life of society, and non-state actors hold an increasing proportion of power and influence in the shaping of world order'. See 'State of siege: will globalization win out?', *International Affairs* 73: 1, January 1997.

2 Kenichi Ohmae, *The borderless world* (London: Collins, 1990).

3 Susan Strange's work makes this point very clearly. See *The retreat of the state: the diffusion of power in the world economy* (Cambridge: Cambridge University Press, 1996), and reviewed in this issue, p. 573.

A major misconception about the power of firms in the globalization process must first be addressed. Nearly all those writing on globalization agree that it erodes the power of states. However, some erroneously assume that the power of firms, especially multinational enterprises, is correspondingly enhanced.[4] The flaw in this logic comes from ignoring or underestimating the power that globalization transfers to the market—that impersonal, non-state, non-firm set of dynamic competitive pressures that diminish the ability of firms, as much as that of states, to take self-directed action.

I focus on market-led globalization. This is defined as the process by which decisions taken by a firm in one country affect the range of options or outcomes available to a firm or the government in another country. This definition is purposely firm-centric. It makes explicit the central role of the firm as the decision-taking unit. Examining the micro-foundations of globalization—the motivation and incentives at the firm level—should contribute to a more fully developed and well-grounded understanding of the globalization process. Other aspects of that process, such as cross-border crime or environmental spillovers, are not addressed.[5]

A further introductory word is needed with regard to the type of firm envisioned in the definition above. The firm is considered not just as a short-run profit-maximizing enterprise in the neo-classical economic sense, but as a decision-taking unit that considers the interests of all of its stakeholders; i.e. customers, shareholders, employees and the local communities where it operates. Further, it looks to maximize profits over the long run (i.e. to stay in business) and it believes it is in Schumpeter's turbulent world of 'creative destruction' rather than the perfectly competitive equilibrium of microeconomic theory.

Following a brief review of the macro forces driving globalization, the changing expectations of each stakeholder group are analysed. The term 'stakeholder' originated in the frontier days of the United States. As new territory was opened to settlers they were invited to 'stake' their claims by marking out their land with posts or stakes.[6] This term is now used to describe groups who have a legitimate claim on a company or organization. Globalization makes some stakeholder groups more diverse, it enhances the claims of some groups, and erodes those of others. In so doing, globalization sharpens conflicts among stakeholders, making the task of management more difficult, and slowing the globalization process itself.

4 Paul Hirst and Grahame Thompson claim that the core belief of globalization is that it leads to a world dominated by 'uncontrollable market forces' and the 'uncontrolled influence of transnational corporations'. See *Globalisation in question: the international economy and the possibilities of governance* (Cambridge: Polity, 1996). See also Hirst, 'The global economy—myths and realities', in this issue.

5 There is a vast literature on environment, trade and development. For a recent collection of essays see Jacob Werksman, *Greening international institutions* (London: Earthscan, 1996). On global crime, see ch. 8 of Strange, op. cit.

6 Newsletter of the Centre for Tomorrow's Company, May 1997.

This analysis of stakeholder groups also indicates that the usual macro measures of globalization such as trade, direct investment and the production of multinational enterprises (MNEs) fail adequately to capture the power and pervasiveness of the globalization process.[7] They are lagging indicators of what is happening. Microeconomic pressures from globalization are felt through changing stakeholder demands by firms that are far too small or too domestically oriented to be classified as MNEs, or to make a difference to trade or direct investment statistics. At this micro level it is also less clear than at the macro level that the net effects of globalization are positive. Few firms are prepared to deal with the complex stakeholder conflicts that globalization brings. The final section draws implications for governments attempting to achieve their economic and social objectives in a world where their citizens are also employees, customers, shareholders and neighbours of global companies.

Driving forces

Almost every large company that was founded more than 20 years ago feels battered by powerful external forces for change in the way it does business. These middle-aged behemoths are being challenged by nimbler newcomers in greater numbers and with much more success than in previous generations.[8] In response, managers have initiated programmes for downsizing, outsourcing, re-engineering and re-skilling. The individual pain and societal strain that these programmes have brought are a widespread cause for concern, among business leaders as much as among other groups. Yet it is undeniable that the corporate world—in Europe, in the United States and, more recently, in Japan—has embarked on a wrenching fitness programme to reshape itself for the new millennium.

At the macro level there are three primary forces driving the need for change in how companies are organized, how goods and services are produced, and how they are bought by and delivered to customers. These forces create the pressures that managers refer to as globalization.

New information technology

The cost of storing and sending information, as well as of communicating with others across long distances, continues to fall dramatically. A three minute, 3,000 mile telephone call in 1960 cost $50 (in today's prices); now it costs less than one dollar. If the message can be conveyed by electronic mail via the Internet, it is free. Many companies have eliminated their internal communications budget by using the Internet for messages and data transfer between offices in dif-

7 There is a debate over the significance of globalization with some economists claiming that there is little strikingly new or quantitatively different about the degree of market integration today compared with, for example, the 1900–1913 period. (Henderson, op. cit.; P. Hirst and G. Thompson, op. cit.).

8 Arie de Geus, *The living company* (Cambridge, MA: Harvard Business School Press, 1997).

ferent countries or regions. This has brought added savings in storage costs by shifting from filing cabinets (and people to file and retrieve) to computer storage. Fewer secretaries are needed as e-mail and handwritten fax messages have replaced typed letters and forms.

At least as important as the cost savings that information technology (IT) brings, are the savings in time. Even the most elaborate Internet routing is days faster than the post. Computer links between a factory's production line and a supplier's parts department can replace a multitude of forms and clerks with a simple and precise signal to order. This has enabled 'just-in-time' linkages between suppliers and manufacturers that have drastically cut the total cost of manufacturing by reducing the need for expensive inventory.[9]

These 'upstream' IT links within firms and between firms and suppliers are already well advanced and have spawned a wave of fast-growing new companies that specialize in customizing and installing the new IT. The next area to be transformed by inexpensive and user-friendly IT is likely to be the 'downstream' communication between a business and its customers. Already 15 per cent of all Americans use e-mail and 59 per cent of American companies have a site on the World Wide Web.[10] As consumers get used to comparing information and prices on screen, rather than on foot in the high street or shopping mall, the share of purchases made directly with producers, rather than through retail outlets, will increase.

This change in the way people shop and buy will have profound effects on companies and on communities. Businesses that act essentially as middlemen between the producer and the consumer, especially for standardized products or services, will be squeezed most. This diverse category includes retail banking, bookstores and travel agents, among many others. Consumers who use Internet or telephone shopping will benefit from lower prices (due to lower overhead costs), but city centres and towns will lose shops, retail jobs and daytime activity. This will exacerbate one of the stakeholder conflicts discussed below.

Both upstream and downstream uses of IT drive globalization. Faster and cheaper communication makes it easier for companies to internationalize their production; for example, by outsourcing labour intensive activities to firms in countries with lower labour costs. Much of the west European investment in east European firms is driven by this logic. It also makes it easier for a small domestic firm to open a foreign sales office. There are no economies of scale to surmount when a sales presence can be established in a new market for the cost of a phone line and a modem. Such expenditures are not even counted as investment, let alone recorded in balance of payments statistics.

Downstream IT connections with customers are probably the nearest example of the economic ideal of a borderless world market. Cyberspace is actually

9 The effect that this has made in different industries is detailed in Michael Dertouzos, Richard Lester and Robert Solow, *Made in America: regaining the productive edge* (Cambridge, MA: MIT Press, 1989).
10 Intelliquest's World-Wide Internet Tracking Study (www.intelliquest.com), March 1997.

without borders, and the Internet has spawned an explosion in new 'virtual' companies which exist only on a web site. An example is DISC, a graphics design company founded two years ago in Bristol in the United Kingdom. The founder explains:

> We work from purpose-designed offices in our home, where we have high-power computers, scanners and communications, all networked and connected to the outside world, with video-conferencing and e-mail allowing close contact with clients thousands of miles away. DISC functions through a network of 25 contractors, all high quality people with small companies of their own, whom I coordinate on a 'when needed' basis to fulfil specific needs and tasks. This means DISC can negotiate largescale contracts with companies like Microsoft and Hewlett Packard and I can carry them out, using first-class personnel for fixed costs, but with minimal overheads.[11]

This is another example where developments in IT have negated the traditional advantages of company size for entering international markets. Now the established companies in those industries have new 'micro competitors' whose flexibility and speed of response to customer demands are setting new standards that the large company finds hard to match.

New markets

Adding to the IT impetus for globalization is the opening of vast new consumer and investment markets in developing countries. Much has been written about the liberalization revolution in the developing world, following the collapse in 1989 of the planned economy model in the Soviet Union.[12] While there has been a great deal of hyperbole, it is undeniably the case that policy shifts towards lower trade barriers and deregulated or privatized industry have taken place in many developing countries, and that these shifts have begun to bear fruit in the form of higher economic growth and income levels. As a result the number of upper- and middle-income households has grown dramatically, even in countries where per capita income is still very low such as India and China. The demand for consumer goods and tradable services (i.e. foreign films, international air travel) from these new entrants to the middle-income classes has similarly boomed. The effect on firms of all types in the 'old' markets of the OECD countries is that they see much brighter growth prospects in international than in their domestic markets. Profitability may also be higher if they can bring established skills and proven technology into a new market whose domestic firms lag behind, or have been protected from international competition in the past.

The market-pull of faster growth in demand from developing countries is

[11] Interview with Claire Furneaux, 'Small business, big future', *Business Life*, April 1997.

[12] An early and influential view was Francis Fukuyama's *The end of history and the last man* (New York: Free Press), 1992.

reinforced by those countries' new-found desire to attract inward investment. From China to Chile, from India to Indonesia, from Poland to Pakistan, governments have liberalized their trade and investment rules to provide equal, and in some cases even preferential, treatment to foreign firms interested in entering their markets as investors. Once established in those new markets, firms are often pleasantly surprised at the enthusiasm and high quality of local staff, compared with their traditional workforce in the home country. Wage differentials are only part of the story. In many of the East and South Asian countries, decades of investment in public education, supported by strong family commitment, have resulted in a very high level of maths and language skills across the population in the 18–25 age range. As IT links to the home country offices make communication almost costless and almost instantaneous, these staff in developing countries can be set many of the tasks that used to be done at headquarters. An example is the message-editing function on some of its computer reservations and departure control systems that British Airways performs in its Indian offices. Trained computer programmers are more plentiful, more highly motivated for such relatively routine work, and much more cost-efficient in Mumbai than in London. Visiting managers from London have also noted that the newly built office accommodation in India is a more pleasant work environment than their own old and cramped offices near Heathrow airport!

These dual forces—growing demand and lower production costs—are pulling more and more companies across borders into the new markets of the developing world. The successive rounds of trade liberalization negotiated through the GATT and now through the WTO were a necessary, although not sufficient, condition to bring about this change. Such binding undertakings by governments are important to investor confidence that economic reforms will not be reversed. The long-term benefits to the companies, to the consumers in both home and host countries and to the new employees in the host countries are undeniable. But this pull of new markets also raises concern in the home market about a 'hollowing out' of the economy as much of the manufacturing sector shifts into the developing world. While most of this concern is misplaced,[13] it is and will remain the source of growing stakeholder conflict between companies and their more traditional employees as discussed below.

New rules

It is not only in the developing world that government policies have changed. The portfolio of 'shuns'—privatization, deregulation, trade liberalization—has gradually but steadily increased the competitive pressures on firms. This has been especially evident in the service sectors, which account for well over half

[13] Richard Brown and I tackle these arguments in, 'Is manufacturing still special in the New World Order', in Richard O'Brien, ed., *Finance and the international economy* (Oxford: Oxford University Press, 1993).

of the output of advanced countries and which employ more than two-thirds of the working population. In banking, telecommunications, insurance and air transport, to name only a few, the competition today is global in a way that it clearly was not a decade ago. Those markets are much more open and contestable by both foreign and new domestic firms than they were. The 'shuns' have removed many of the barriers erected by governments to protect domestic firms and consumers, and the powerful economic forces for competition across borders are asserting themselves.

The process is a slow one[14] and has not yet reached a competitive critical mass in some sectors or in some countries. Many are in that awkward adolescent stage of having removed some restrictions (or privatized a former monopoly) but have not yet attracted enough competitors to be able to rely on competition in the marketplace to prevent abuse by a dominant firm. This has placed governments in a catch-22 situation: they hesitate to relax regulatory authority, especially over mergers, for fear of allowing market dominance to develop, yet recognition that the relevant market definition has become an international one rather than one coincident with the domestic jurisdiction of the regulatory authority leads to a clear rationale for industry restructuring, which often means mergers. The danger to firms, and ultimately to their home countries, is that a restrictive interpretation of merger legislation at home forces them into a passive role as the industry restructures around them, with their best partners joining other cross-border alliances.[15] Periods of industry restructuring, often instigated by government deregulation, are times of one-off opportunities for firms where zero-sum outcomes are common. To sit on the sidelines—either by choice or by government-imposed handicap—may be to lose advantage that cannot be regained.

New rules are also injecting stricter competitive pressures into the most non-tradable sectors in the economy; for example, health care and local government services. The spur was probably the example of formerly state-owned industries that were privatized. Productivity gains of 30–40 per cent were not uncommon in the telecommunications and transport sectors, coupled with improvements in the quality of service to customers.[16]

The inefficiencies that tend to accumulate in parts of the public sector over decades of government management are not different in character or origin from those in non-core parts of large private sector companies (for example, in-house restaurants or fleets of company cars). The answer in both cases is to

[14] In the banking sector, for example, London's Big Bang followed Wall Street's deregulation by nearly a decade and Tokyo is only now following London after a lag of 12 years.

[15] For a discussion of this point in the airline industry in Canada, see Tae Oum, *The Ottawa Citizen*, 2 Dec. 1996.

[16] These figures are drawn from US and UK experience. Privatizations in some developing countries have achieved even greater efficiency gains. Cases where gains have been lower have generally involved limited competition in the marketplace (e.g. British Gas which was privatized as a single entity, although it is now in the process of breaking itself up), or where major investments needed to be made after years of underfunding by government (e.g. some of the water companies in the UK).

outsource, or at least to reorganize, in order to create (or duplicate as closely as possible) the natural check on costs that comes from separating the purchaser from the provider of the service. The previous British government took this route with the National Health Service, although it is too soon to see its full effect and the policy remains controversial. However, it is not different in concept from what is meant in the private sector when companies say 'the customer is king'. The customer, as purchaser, makes a choice from an array of competing firms which provide the goods or service.

This basic principle of competition, from which springs many of its most attractive properties of efficiency and continuous innovation, has been newly discovered by governments faced with mounting budget deficits and populations reluctant to bear higher taxes. It is worth noting that this principle has little to do with the philosophical and political questions about which services should be publicly funded. Even the government most committed to full state provision of health care, for example, will want to provide that care at the lowest possible cost for the desired quantity and quality of service. If it did not, it would be wasting public funds that could be used for other desirable purposes.

The effects of these three macro forces—new technology, new markets and new rules—are felt by firms and public organizations of all sizes and in nearly all sectors. They act in different combinations and with differing intensity in different markets, and in some they are much further advanced than in others. But their pervasiveness goes far beyond their direct impact on economic statistics, which is why the microeconomic story of stakeholder influence on decision-making is critical to understanding both the strength of and the restraints on globalization.

Stakeholders' changing expectations

Recently in the United States, and for many years in both Europe and Japan, managers have held themselves accountable to a range of stakeholders: customers, shareholders, employees, and local communities. Corporate decision-making is easiest when the interests of these stakeholders coincide—that is the norm for a small local firm. Both customers and employees are likely to live locally, the owner-manager is the sole shareholder, and it is clearly in all stakeholders' interests for the firm to support local community activities and to avoid creating pollution or other negative externalities that would damage its reputation with local customers and staff.

Globalization tends to cause stakeholder interests to diverge. This is partly because each stakeholder group becomes more diverse, and partly because the geographical glue that formerly united them is no longer effective. This is why, as globalization gains strength, firms are increasingly subject to stakeholder conflicts. These conflicts make it more difficult for managers and boards to take decisions or formulate strategies that can be supported by all stakeholders. There has been a renewed interest in business and political circles in the United

Kingdom in the responsibilities of boards of directors. Two recent committees, chaired by leading businessmen, have recommended codes of practice for directors to ensure that checks and balances are in place to protect the interests of shareholders.[17] The 1995 Royal Society of Arts report, *Tomorrow's company*, goes further in recommending measures to check that the company's relationship with its different stakeholders—not only shareholders—is working well. The new British Prime Minister, before his election, floated ideas of a 'stakeholder society' and he may be attracted to mechanisms that ensure companies look beyond their responsibilities to shareholders in taking their decisions. This principle is hardly contentious;[18] although the specifics of any legal mechanism to enforce it surely would be.[19] The difficulty companies face is that globalization is causing stakeholder interests to diverge, both within and across the four categories. I consider them now in turn.

Customers

In every competitive business, large or small, the customer is ultimately the most important stakeholder. The customer's choice of one firm's product or service over that of another firm is what creates the revenue that pays for the salaries of staff, the dividends of shareholders, the taxes to governments and the employment spinoffs to local communities. Firms must take decisions that attract and hold customers, whether that be by lower prices, better quality services, or some other element of the customer's preference ordering.

Globalization affects customers, as a stakeholder group, both directly and indirectly. Directly, as firms have expanded into foreign markets, their customer base has clearly become more diverse. Sometimes this means that the product itself has to change or sprout new variants. McDonald's and Coca-Cola may be able to sell the same product worldwide, but companies in other industries that have tried that approach have generally failed.[20] Even where the product is relatively homogeneous, such as over-the-counter drugs or bottled water, the distribution channels and marketing norms are often very different in different countries. A company with a global brand is particularly exposed, as Perrier found recently when an advertisement that worked in France had to be withdrawn elsewhere after boycotts of its products were organized by women's groups in the United States and the United Kindom.

Providing different variants of a product to suit the differing preferences of

[17] See the Greenborough and Cadbury codes of practice.

[18] However, for a contrary view see Michael Novak's essay, *The future of the corporation* (Washington DC: AEI Press, 1996).

[19] Will Hutton has argued the need for such a mechanism in *The state we're in* (London: Jonathan Cape, 1995).

[20] Ford's recent attempt to produce a 'world car' is an example. Although the car could be mass produced and assembled with interchangeable components made on several continents, consumer tastes in Europe, Japan and North America were so different that customized versions eventually had to be produced which negated the cost advantages of globally sourced components.

customers from different cultures can be surprisingly difficult. For example, it took British Airways many months to get its Japanese food right on the London–Tokyo flights. Because the Japanese routes are the only ones to offer Japanese meals, the priority given to the change by London-based catering staff was lower than that of minor changes in Europe-wide menus. Yet most of the passengers on London–Tokyo flights originate in Japan, and our customer surveys told us that the availability of well-prepared and properly served Japanese meals is of high importance to them in choosing an airline. Unless we can meet those expectations—unique as they are to our Japanese customers—we cannot be successful in global markets.

Even firms that do not sell in foreign markets are affected by globalization indirectly through their customers' expectations. Customers are more sophisticated than they were a decade ago and even in small communities they are used to having a wide array of choice. They are better informed about competitive products and services which makes them less loyal to local suppliers and national brands. New global brands can be created much more quickly today through worldwide advertising and sports promotion.

The next steps are likely to be widespread mail-order shopping, which has already captured nearly one-fifth of the US retail market and is in its take-off stage in Britain and Japan. Mail-order may be rapidly followed, or more likely overtaken, by computer-based home shopping. This will make price comparison easier, and it immediately widens the customer's choice to foreign suppliers who would not find it worthwhile to open a local retail outlet but can advertise their wares on an Internet page at zero incremental cost. Such broadening of customer choice drives even the purely local firm into the realm of global competition.

Employees

Here the potential conflict of interests is stark, and it comes from many directions. Home-based staff feel threatened by the lower wage costs on offer in other countries. They see their jobs being out-sourced across borders. While they understand the gains to shareholders and customers from the lower costs thereby obtained, these gains are offset for them, and sometimes also for local communities, by the job losses they entail at home. The corresponding gains in foreign jobs and for foreign communities do not enter into their personal cost–benefit calculation. At the same time foreign staff in lower-wage countries may feel aggrieved that their salaries and benefit packages do not match those at headquarters. Transfer of staff between home and foreign offices then becomes difficult because of pay differentials. This is overlaid by the inevitable problems of cross-cultural management. Home staff need language and sensitivity training to work abroad effectively, and foreign staff brought into headquarters often feel isolated and excluded.

To overcome these very real difficulties, companies are making great efforts to recruit and train people who have the capability to operate effectively across cultures. It is a gradual process, and the statistics on non-nationals in management positions or on boards of directors are a lagging indicator of the efforts under way. The aim of 'multi-domesticity' (Asea Brown Boveri) or 'world's favourite' (British Airways) is not an easy one to achieve.

There is another dimension to the increasing diversity of staff in global companies. In addition to geographical dispersion, the pressures of globalization have resulted in a greater hierarchical split. Waves of downsizing and re-engineering have stripped many companies of their middle management and outsourcing has rid companies of many non-managerial, but highly skilled and well-paid, technical staff. The result has been a widening wage gap inside the company by the depletion of middle salary ranks. Top management salaries have also been bid up in some sectors by heightened international recruiting. This is most evident in the financial markets, but it has also brought American-style remuneration packages to senior executives at some European companies. Others have tried to climb onto the bandwagon—or perhaps 'gravy train' is a better metaphor—even where there is no international demand for their services. This has generated adverse publicity in Britain and has spread the misconception that globalization favours the greedy.

At the same time, changes in technology and labour markets have reduced the demand for low-skilled employees in high-wage countries, while expanding the supply of semi-skilled and educated workers. This has driven down the real wages of new staff in manufacturing and customer service jobs. Where union agreements exist to protect the wages of staff already employed in those categories, gaps are opening up between the salary and benefits of incumbent staff and those of the new entrants. Competitive pressures on firms to reduce costs will eventually erode that gap in favour of the new entrants, but in the meantime tensions with tenured staff whom the market deems 'overpaid' will be exacerbated. Managing these staff tensions—both vertically and horizontally within companies—and balancing them with the interests of other stakeholders is a challenge that grows with globalization.

Communities

Local community groups are often the most resistant of all stakeholders to change.[21] In Britain obtaining local planning permission for plant expansion, or participating in public inquiries for infrastructure additions, can take longer than the construction itself. If the project is controversial, it consumes large amounts of management time and lawyers' fees to make the case for it. Plant

[21] The link between globalization and community stakeholders, as well as the literature on communitarianism, is explored in R. Barry Jones, 'Globalization versus community', *New Political Economy* 2: 1, 1997.

closure, of course, is still more unpopular and even building a new store on a greenfield site provokes outcries from local merchants who fear their business will suffer from the new competition.

If competition were purely local, these difficulties and delays would be borne equally by all companies, and communities would have a type of monopoly power in deciding their fate. But global competition acts to erode communities' power in two ways. First, and most directly, companies have the choice of expanding abroad rather than at home. The faster demand growth in new markets already pulls them in that direction. Many foreign governments welcome inward investment and assist firms in obtaining the approvals they need from local authorities in the host country, and localities compete for new investment and the jobs it creates. This is often in stark contrast to a firm's reception in its home community, which perceives it has more to lose than to gain from change.

That perception is often wrong because of the second, and indirect, effect of globalization on communities. The dynamic process of competition ensures that local firms that do not change will eventually be overtaken in the marketplace by those that do. Customers and shareholders both will defect to competitors who have found new ways to provide goods and services of higher quality, at lower prices, or both. At that point it is a question of survival for the local firm, and the interests of the community may then realign themselves with the other stakeholders. Unfortunately, it may be too late.

Shareholders

Global capital markets are already a reality and many large firms are listed on more than one country's stock exchange. This can make profit expectations and investor relations harder to manage. But beyond that, globalization creates less diversity of interests among shareholders than among other stakeholder groups, enhancing the power of shareholders over corporate decision-makers.

The key change for company boards is that institutional shareholders, in particular, now optimize their investment holdings over a larger field of competitors. No longer are pension funds captive holders of shares in large domestic firms. If those firms underperform, the fund manager can easily look offshore to satisfy her desire for telecommunications or airline shares.[22] This constant cross-border performance comparison creates a powerful spur on management teams to match or exceed global cost and productivity norms.

Cross-border mergers and acquisitions are both driven and facilitated by developments in the global capital market. The quickest route to international expansion is often for a company to buy all or some of the shares of a foreign firm. A decade ago, this was difficult to do in most of continental Europe and

[22] There have also been examples of more active international intervention in response to poor corporate performance. The successful drive to replace Satchi & Satchi management was led by an American institutional shareholder.

Japan, but it has become much easier as firms and governments in those countries have felt the pressures of globalization, and as their own financial institutions have developed expertise in merchant banking. An international acquisition, at a stroke, creates the potential for stakeholder conflict between local employees and foreign shareholders. In the view of some business observers, it also raises larger questions of corporate governance:

> The complexity of the shareholding structures of most large businesses today accentuates the tendency of the central management to assume dictatorial rights, because there is no one else who can properly oversee the whole corporation. The centre, acting as owner, and under pressure for results, is too often tempted to treat its subsidiary companies as tradable commodities, to be sold on or merged, without regard to the wishes or interests of their inhabitants. This cannot be fair.[23]

This issue of 'fairness' raises a deeper aspect of the problem of shareholder conflict facing firms. It suggests that the current governance structures—essentially the boards and management of firms—lack legitimacy in the eyes of some stakeholders. If that is the case, then firms themselves may have to change in ways most have not yet considered in order to defuse or resolve the stakeholder conflicts that globalization is creating.

The world's largest global company, the Royal Dutch/Shell Group, may be leading the way as a result of the unexpected difficulties it faced several years ago over its decision to use deep-sea disposal for an oil drilling platform (the Brent Spar) that had reached the end of its commercial life. A huge public outcry arose, despite the fact that Shell had spent three years identifying the best practical environmental option, testing its preferred solution with British environmentalists and scientists, and winning UK government approval. When the news broke Shell found that what appeared to be the best option in Britain was not acceptable to the public elsewhere. Environmental pressure groups, especially in Germany, protested strongly and, in some cases, violently, against Shell service stations. Shell was caught between two different approaches to the environment. It decided to retract its decision for deep-sea disposal. It is now engaged in a wider process of consultation on what to do with Brent Spar, and it has re-examined and rewritten its code of business principles to embrace a wider set of values and responsibilities. Meanwhile, the rusting Brent Spar sits in a majestic Norwegian fiord to await its fate: a silent symbol of the complexities of stakeholder management in global companies.[24]

Across the four groups of stakeholders, globalization is increasing the relative power of customers and shareholders and eroding that of employees and communities. Yet firms' prospects are intimately tied to the commitment of their

[23] See Charles Handy, 'The citizen corporation', paper prepared for Seminar 3 of 'The sovereignty seminar', Birkbeck College, University of London, April 1997.

[24] See the speech given in Amsterdam in October 1996 by C. A. J. Herkstroter, 'Dealing with contradictory expectations—the dilemmas facing multinationals' (London: Shell International, 1996).

staff and the support of their local establishment. This has led some to suggest that firms from countries with a high degree of societal trust will be those that succeed in the future.[25] That is probably too deterministic a model. But the job of balancing stakeholder expectations is becoming more difficult, and will take more top management time. It will also slow the globalization process. Corporate leaders with the requisite understanding and diplomatic skills may be as critical to company success in the new millennium as technical and marketing expertise were in the old.

Implications for governments

The globalization process may operate largely through pressures on, and actions by, firms; but this does not imply that the nation-state will wither away. For firms to flourish, whether locally or globally, the private contracts on which they rely must be underpinned and enforced by governments. Legal stability and justice are public goods that can only be provided by governments. Globalization will favour countries whose governments provide such public goods to inward investors efficiently and without bias.[26]

Price stability is in the same category. It can only be provided by governments, but experience indicates that governments are most successful at it when they partially tie their own hands. Germany, the United States and New Zealand do this through a central bank which is constitutionally independent of the political process. The new Labour government in Britain took a widely applauded step in this direction soon after taking office. Other governments choose a currency peg and forfeit control over domestic interest rates. This has worked well for countries as diverse as Argentina, Hong Kong (both pegged to the US dollar), the Netherlands and Belgium (both pegged to the Deutschmark); but it has also produced cases of spectacular failure. The vehemence of the European debate over the single currency is only partly due to misplaced concerns over loss of sovereignty; it also reflects the inherent complexity of the choice to be made. Globalization neither creates this situation nor prescribes the solution. It simply raises the cost of failure and advances the day of retribution.

At the other extreme of governments' traditional roles are a number of formerly public goods which either have been or could be privatized. Many of these are infrastructure services for which the initial rationale for government ownership was the difficulty of persuading private financiers to invest. Today that justification no longer exists in most advanced countries. Private financial markets are well developed and the prior state-provided infrastructure has generated sufficient private demand that incremental investment and upgrading

[25] Francis Fukuyama, *Trust: the social virtues and the creation of prosperity* (London: Hamish Hamilton, 1995).

[26] Conversely, one of the main deterrents to investment in Russia is its weakly developed system of corporate law. The chief fear of investors in Hong Kong is the change in legal system after it joins the PRC.

carry no more market risk for the investor than is present in other sectors. Thus for infrastructure services—telephones, transport, banking, postal services, water, electricity, etc.—the role of governments will change from investment and ownership to regulation of competition and, in sectors with monopolistic tendencies, of prices.

Globalization will spread the pressures for this shift from one country to another, regardless of political rhetoric. Because the outputs of these infrastructure sectors are key inputs to firms in many other sectors, their prices are an important determinant of the competitiveness of firms producing in that country. Private sector ownership and management has been shown to deliver lower prices as well as, in most cases, higher quality service. Thus governments that are slow to privatize infrastructure will increasingly handicap domestic firms and inhibit inward investment. This is a particular example of the general tendency for globalization to cause the laws of economics to act more swiftly.[27]

Between these two extremes of clear public goods such as law enforcement and macroeconomic management, which will remain the purview of governments, and infrastructure services, which will increasingly move into the private sector, lies an array of social services where it is less clear whether they can be more efficiently provided by the public or private sectors. There are many elements of 'market failure' associated with private provision of healthcare, for example. But there are also 'government failures' associated with any administrative system of public provision where price plays no role in regulating demand or curtailing costs. These two types of 'failure' need to be compared case-by-case, taking into account the historical and social circumstances in order to find the best balance between government and private providers. This choice does not depend on the political arguments for or against universal access. It is perfectly conceivable to choose universal access for education and health services, for example, coupled with purely private provision. Tax-supported voucher schemes can reconcile the two. Similarly, the insurance function of protecting everyone against the risks of catastrophic illness and long-term nursing care could be paid for by governments but provided by private insurers, hospitals and nursing homes.

There is unlikely to be much convergence across countries in the role of the state in social service provision. As long as tax revenues and government expenditures are kept close to balance, then price stability targets are not threatened by high levels of government spending and taxation as a share of gross domestic product. High levels of taxation, however, have disincentive effects on decisions to work and invest, thereby creating a 'dead-weight' (uncompensated) loss

[27] The former Soviet system was able to defy the basic microeconomic relationships between prices, marginal costs and marginal productivity for such a long period only because it acted through political means to isolate its economy from the rest of the world. Once those political means collapsed, the inefficiencies and economic waste of the system, as well as the extreme environmental damage it had caused, were fully exposed.

of wealth and jobs that the private sector would otherwise have generated. This provides a general, indirect check on governments that opt for very high levels of state-financed social services.

The net effect of globalization on governments will be to focus their efforts on a smaller set of more critical tasks. This implies a shrinkage in their optimal size (in terms of government employees; not necessarily as a share of GDP) and an upgrading of the technical expertise of the civil servants responsible for monetary, tax, social and regulatory policy. These policies provide a key advantage (or handicap) to domestic firms in the global marketplace. They constitute part of the strategic assets (or liabilities) that create a firm's competitive edge. Speed is a critical determinant of this edge. Governments with rapid regulatory processes, carried out by expert professional staff, able to take account of international as well as domestic considerations, and efficient at providing the social services they choose to keep in the public sector, will be those whose firms have the best chance of competitive success in a globalized world.