Global strategy in an age of turbulence

NITIN PANGARKAR looks at why some firms do well even in a global meltdown

O

LY a few years ago, before the sub-prime crisis erupted, globalisation and global strategy had become common buzzwords among managers. Few would have disputed that global strategies were good for them, while many were aspiring to increase their companies' international scope and coverage - in other words trying to become more global.

However, given the events of the past year, some managers may be forgiven for thinking that global strategies have exposed their businesses to tremendous risks and volatility. For example, Singapore property companies have seen their share prices plummet as their foreign property holdings (especially in emerging markets such as China and Vietnam) are devasted.

Yet, even in these dark times, it is useful to note that not all companies are suffering. Indeed, some have continued to perform quite well. Asia Pacific Breweries, for instance, increased its profit (before interest and taxes) by 28 per cent in the quarter ending June 30, 2008, and by 10 per cent over the first nine months of its current fiscal year.

Singapore Airlines, meanwhile, has grown its revenues by 14.1 per cent in the quarter ending June 30, 2008. Although its profits dropped by 25.9 per cent due to industry headwinds, they amounted to a healthy $343 million.

Even in the US banking sector, which is the eye of the current storm, Wells Fargo Bank not only sports a relatively healthy stock price, but was also in a unique position to beat larger rivals, such as Citibank, for the purchase of Wachovia Bank.

So what differentiates the companies that can perform well even in a turbulent environment such as the current crisis from those which are susceptible? I will address the question in two parts: by identifying key risk factors and then specifying several pointers for aspiring globalisers.

Broadly, four factors determine a firm's vulnerability to market turbulence:

- Market position. Firms with weaker market positions (e.g., lower market shares) are especially vulnerable when demand goes down or competition becomes intense. In contrast, market leaders, such as Asia Pacific Breweries, often have the depth of expertise and the reservoir of skills to tide over the difficult times.
- Capital structure. In a downturn, a debt-heavy firm is especially exposed since its inability to service debt because of lower profits or cash flows might sound the death knell. A cash-rich company, like Singapore Airlines, is able to come out of even the most challenging environmental crises (e.g., Sars or the rapid rise in oil prices to $140 per barrel in March last year) stronger than before.
- Country/market mix. Just as with a personal investment portfolio, where an investor seeks growth as well as stability, a global firm should seek an appropriate balance of geographic countries that provides future growth (e.g., developing countries) as well as stability (e.g., developed countries, with some exceptions). A heavy emphasis on emerging markets will expose a firm to very high levels of volatility which may sometimes be deemed unacceptable by key constituents such as investors.
- Industry. Some industries are more subject to volatility, for instance, property and financial services companies have borne the brunt of the recent sell-off. Despite its strong track record, as at Oct 30, 2008, the shares of Singapore Exchange have fallen by more than 60 per cent, relative to their peak, as the company is expected to suffer due to lower trading volumes. In contrast, manufacturers of consumer necessities (such as food products) face lower volatility. Firms in volatile industries must take special care to offset the greater volatility associated with these sectors through strong market positions, appropriate portfolio of markets, and a debt-light capital structure.

Most companies will not exhibit the two extreme scenarios - the presence of all or none of the risk factors. However, the greater the number of risk factors applicable to a firm, the higher will be the firm's vulnerability. The risk factors identified suggest the following takeaways for aspiring globalisers:

Avoid the domino effect. In the domino effect, prior failures in an industry increase the possibility of failure of a particular firm. For instance, an unbalanced portfolio coupled with a volatile industry can make a firm the next domino to fall. Although its share price has taken a tumble, Capitoland has a real estate and hospitality portfolio spanning 90 cities in 20 countries. As at June 30, 2008, the company reported that it had S$3 billion of cash which would enable it to take advantage of bargains available in a turbulent environment, and also make it less likely that it will be the next domino to fall.

Avoid dangerous cocktails. Dangerous cocktails imply a combination of circumstances that dramatically increase the risk level of a company. For example, high debt levels and weak market positions can be a lethal combination which might jeopardise a company's very survival. Of the five highly leveraged US investment banks, only the two erstwhile leaders, Goldman Sachs and Morgan Stanley, remain independent today.

Stay the course. Successful global firms have a long-term vision and stay the course even in the face of short-term dips. They realise that temporary setbacks may be inevitable but rewards go to those who remain committed to their vision. Soon after its entry into Vietnam, Asia Pacific Breweries faced dim market prospects due to the eruption of the Asian financial crisis. The company put its local market plans on hold without foreclosing the option of restarting the build-up at a later date. Today, Vietnam is one of the key markets for the company, contributing strong sales growth and healthy profits.

Despite the on-going crisis, globalisation is here to stay and global strategies are as relevant as ever. Many firms that have suffered in the recent turbulence failed to heed some of the important lessons for would-be globalisers. Singapore firms following appropriate strategies, on the other hand, might emerge from this crisis stronger, and better positioned than ever before.