THE ENTERPRISE OF THE FUTURE

IMPLICATIONS FOR INDUSTRIAL PRODUCTS COMPANIES

IBM

GLOBAL CEO STUDY

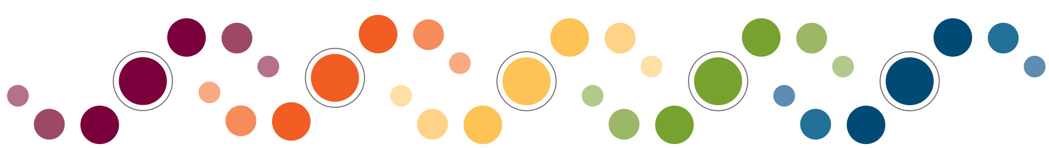
INTRODUCTION

SURVEY SAMPLE

Our industrial products survey sample includes CEOs from industrial manufacturing companies, metals companies, mining companies and forestry companies. Sixteen percent are based in the Americas; 27 percent in Europe, the Middle East and Africa; and 57 percent in Asia Pacific. Almost all of these leaders were interviewed by IBM executives in face-to-face meetings lasting one hour.

What will the Enterprise of the Future look like? We spoke with 1,130 chief executives, general managers, business leaders and public-sector heads in the course of completing the research for our third biennial Global CEO Study, which aims to answer that question.[1] The views of the CEOs whom we interviewed were surprisingly similar, irrespective of the industries, countries or size of the organizations they represented: the Enterprise of the Future is hungry for change; innovative beyond customer imagination; globally integrated; disruptive by nature; and genuine, not just generous.[2]

We have taken a closer look here at the implications for industrial products (IP) companies, drawing on the responses of the 54 IP CEOs who participated in our study (see sidebar). Each section of our report concludes with some ideas about how IP organizations can prepare to become Enterprises of the Future.



HUNGRY FOR CHANGE

INNOVATIVE BEYOND CUSTOMER IMAGINATION

GLOBALLY INTEGRATED

DISRUPTIVE BY NATURE

GENUINE, NOT JUST GENEROUS

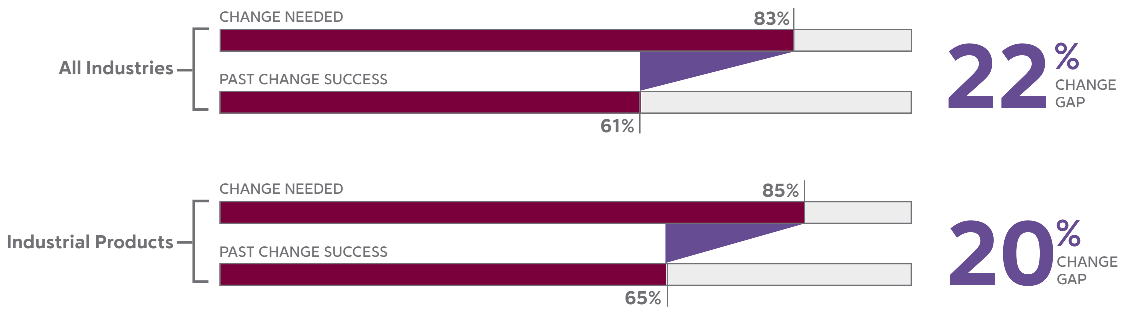
HUNGRY FOR CHANGE

IP CEOs foresee major change ahead, but they are uncertain about how best to manage it. How can they cope with soaring commodity prices and environmental challenges? How can they find people with the skills they need?

IP CEOs anticipate even more change than their peers in other industries, as external forces reshape the environment in which they operate, dictating the need for new skills and organizational structures. However, they are also slightly more confident about their ability to manage change than their fellow business leaders. Although 85 percent of IP CEOs believe that the next three years will bring substantial alterations, 65 percent say that they have managed change successfully in the past. So the gap between those who expect major change and those who have previously succeeded in managing it is marginally smaller than it is in the total survey population (see Figure 1).

FIGURE 1 THE CHANGE GAP

IP CEOs anticipate more change than the total survey population, but are marginally more confident about managing it.



Nevertheless, IP CEOs share the prevailing view that both the speed and scale of the external changes they confront are growing. In 2004, market factors dominated the boardroom agenda – and 54 percent of respondents still believe that they are very important. This is understandable, given the soaring cost of fuel and commodities. Between August 2007 and June 2008, for example, energy prices rose by more than 86 percent.[3] Now, however, IP CEOs worry almost as much about environmental issues, shortage of talent and the challenges associated with operating on a global basis.

Implications

IP industries face more changes than ever before – and the pace of change is accelerating. If they are to prepare their companies for these upheavals, IP CEOs will need to invest more effort in developing the skills of the people they employ, creating a workforce that can adapt rapidly to new ways of working, and establishing standardized processes that can be easily adjusted to exploit viable new ideas as quickly as possible.

They will also have to build a flexible IT infrastructure, and collaborate with companies in other industries to develop new products and technologies. Lastly, they will have to enhance their change management skills by recruiting people with prior experience in managing change and visionary thinkers who can challenge the status quo. In short, if they are to close the change gap, they will need to become masters at anticipating change and determining how best to respond.

Case study

CONTINENTAL: RIDING ON A STRATEGY OF CHANGE

During its first hundred years, German automotive components manufacturer Continental AG was known as a tire company. But over the past decade, it has become much more than that – thanks to its ability to change.

Already one of the world's largest tire makers, Continental realized in the mid 1990s that it would need to move beyond its mainline business to continue to grow. As it watched the electronics content of the typical vehicle climb by almost 50 percent in five years, the company decided to focus its expansion in that area.[4] However, Continental did not leap headfirst into lines of business in which it had no experience. Instead, it followed a progressive change strategy, steadily expanding from one adjacent area to the next – from tires to brakes to the electronics that controlled the brakes and eventually to other electronics components.

Through a series of acquisitions over the past decade – including ITT Automotive, Temic, Motorola's automotive electronics business and Siemens VDO – Continental has transformed itself from tire manufacturer to strategic automotive supplier.[5] Its future is no longer riding solely on the success of its tire business; its capabilities extend throughout the vehicle – from brake controls to telematics to infotainment.

Continental is now the fourth largest auto supplier worldwide.[6] Between 1998 and 2008, its automotive sales grew more than 30-fold, from US$750 million to US$24 billion.[7]

INNOVATIVE BEYOND CUSTOMER IMAGINATION

IP CEOs are keen to capitalize on rising demand for new roads, buildings and other infrastructure, as the world becomes more affluent. So how can they understand the needs of different markets and collaborate to become more innovative?

IP companies typically serve business-to-business customers and business-to-government customers; their relations with the end consumer are less direct than those in many other industries. These differences are reflected in their customer relationships and investment priorities.

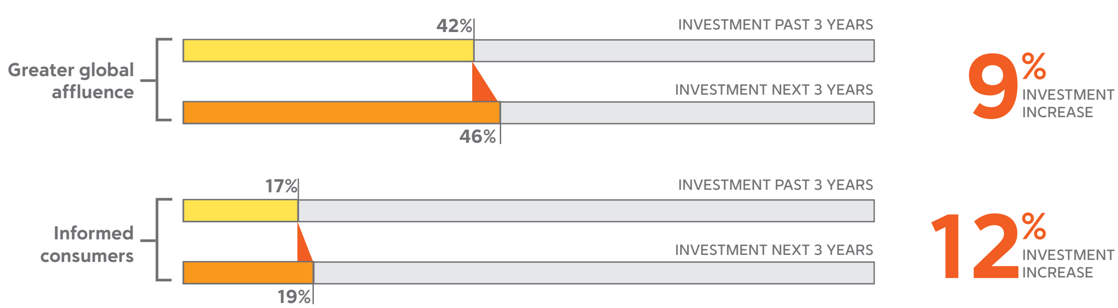
IP CEOs are very optimistic about the rise in the purchasing power of middle-class consumers in rapidly developing economies and asset-rich baby boomers in developed countries, recognizing that greater global prosperity drives investment in new roads, vehicles, buildings and other infrastructure. Ninety-one percent of IP respondents believe that the world's increasing wealth will have a positive impact on their companies, versus just 67 percent of the total survey sample.

In fact, IP CEOs have already invested much more heavily in this trend than their peers in other industries; over the past three years, they have devoted 42 percent of their expenditure to reaching more affluent developing and developed markets, which is nearly twice the overall average of 23 percent.[8] They also propose to increase the amount they spend by nine percent over the next three years.

However, far fewer IP CEOs anticipate a positive impact from the emergence of increasingly sophisticated and collaborative customers. Thanks to the Internet, customers now have many more sources of information. They can also broadcast and share their views worldwide. But these changes have typically had more impact on companies that serve consumers directly than those that sit in the middle of the value chain. IP CEOs have therefore invested much less in reaching these customers, and plan to devote only 19 percent of their total investments to doing so over the next three years (see Figure 2).

FIGURE 2 THE INVESTMENT PRIORITIES OF IP CEOS

IP CEOs believe greater global prosperity will have a more profound impact on their companies than the advent of increasingly well informed consumers.



Implications

If IP companies are to become more innovative, and serve more prosperous and more knowledgeable consumers in developed and developing markets more effectively, they will need to acquire a better understanding of those customers. Such information is essential both to improve a company's awareness of its role within its community and to help it devise the new products people want.

IP enterprises will also have to collaborate with their business customers, since collaboration often produces better, faster solutions than anything one company can produce on its own, and ensure that such alliances enhance their understanding of their end customers. So IP companies should focus on proactively pursuing opportunities to co-develop ideas for mutual benefit; creating repeatable processes for managing their relations with external partners; and utilizing technology to support co-development.

Case study

BASF SE: PARTNERING TO INNOVATE

Leading chemical and IP manufacturer BASF has learned to take advantage of partnerships to increase its revenue. Its customer premise is: "We help our customers to become more successful."[9]

The company collaborates with customers to develop new solutions that are unique to their specific requirements and to strengthen their competitiveness, as well as its own. These partnerships have yielded several new ideas:

- BASF Coatings' paint specialists worked with Ford to develop the brilliant signature color "Electric Orange" for its Focus ST. The partnership also resulted in the development of a new paint application process that preserves the finish and minimizes the physical space required to apply the paint.[10]
- At Renault Revoz, BASF improved painting process efficiency and is paid for each perfectly painted vehicle rather than for the paint itself.[11]
- BASF and adidas partnered to develop a specialized sole for the a3: running shoe that meets the requirements for both endurance and cushioning.[12]

BASF has parlayed its operational, design and technical skills into mutually beneficial partnerships with its customers. Since 2002, the company has nearly doubled its sales, and profitability is up 1.7 times.[13]

GLOBALLY INTEGRATED

Most IP companies are global but not yet globally integrated. How can they acquire the right capabilities and partners, globalize their products and brands and optimize their operations around the world?

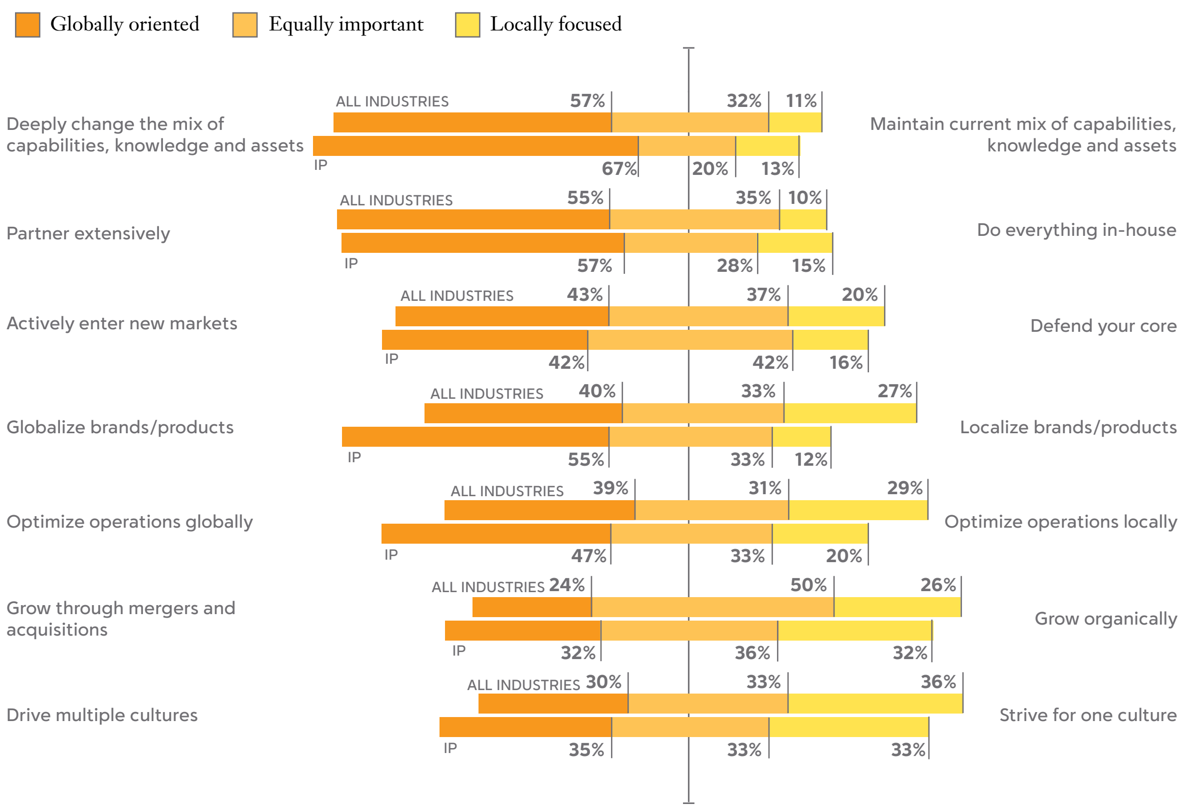
The majority of CEOs, regardless of the industry in which they operate, plan to make sweeping changes in their companies over the next three years, recognizing that a more connected world will require new business designs that facilitate faster and more extensive collaboration and the ability to reconfigure rapidly when new opportunities emerge. However, many IP CEOs believe that their companies are already quite globalized, even if they are not yet globally integrated.

We used data clustering techniques to analyze the responses of all the CEOs who participated in our survey. Sixty-four percent are either "globalizers" or "extensive globalizers." The remaining 36 percent are "blended thinkers" or "localizers." Across IP industries, by contrast, 72 percent of respondents are "globalizers" or "extensive globalizers," and only 28 percent "blended thinkers" or "localizers."[14]

Moreover, IP CEOs are focusing on almost every aspect of global integration to a greater extent than the total survey population. They are particularly keen to change the mix of capabilities, knowledge and assets their companies possess, but they are also putting much more effort into globalizing their brands and products, optimizing their operations globally, growing through mergers and acquisitions and developing multicultural organizations (see Figure 3).

FIGURE 3 IP CEOS ARE DEEPLY COMMITTED TO GLOBAL INTEGRATION

They are primarily focusing on developing new capabilities, forming new partnerships and globalizing their brands and products.



Nevertheless, IP CEOs face a number of barriers to global integration. By far the biggest of these obstacles is the shortage of talent at every level, from skilled factory-floor workers to senior executives with global management experience. Seventy-six percent of IP CEOs say that lack of people with the competencies they need is a major problem (versus 57 percent of the total survey population).

The aging of the workforce is taking its toll; in 2006, for example, nearly 60 percent of the employees in the global steel industry were over the age of 41, a historically high figure.[15] But the struggle to attract new talent is also particularly acute in the manufacturing sector because young graduates often perceive it as rather staid and prefer to work in more "exciting" areas of business.

Implications

The growth of the developing economies will fuel demand for new products and services – and capturing a greater share of this business will require effective global execution, not just a global presence. IP CEOs already understand how important it is to have standardized global processes and information standards. But the fact that they place so much emphasis on globalizing their companies' products and creating an optimal global operating environment suggests that they still have some way to go on the path toward global integration.

One way of promoting the development of standardized systems, standards and processes – both within and across companies – is to establish global centers of excellence. These can also be used to foster differentiating capabilities, knowledge and assets. However, IP companies will have to take other steps, too. They will, for example, have to design and build global supply chains. They will also need an adaptable workforce capable of working virtually and across diverse cultures. Effective leadership is critical, as is an integrated talent management model that addresses the entire employee lifecycle.

Case study

DOW: GLOBALLY INTEGRATING INTELLECTUAL ASSETS

Dow is a diversified chemical company with annual sales of US$54 billion and 46,000 employees worldwide that deliver products and services across 160 countries.[16]

Dow, a top research firm, has a rich and diverse portfolio that included more than 29,000 patents in 1992. The company decided, at that time, to explore new ways to pull together and mine its intellectual property (IP) from across the company using a center of excellence type model. By standardizing their IP business practices and information, Dow created a way to exploit its significant intellectual assets.[17]

The company formed a geographically diverse team to leverage IP both internally and externally, evaluating which of two paths each patent might follow:

- Patents for internal use to support increased competitive positioning for Dow, enhance core competitive advantage and strengthen its available technology
- Patents for use by third parties in noncompetitive opportunities.[18]

For third-party commercialization, a cross-functional team evaluates licensing opportunities for the unused patents. As a result, fees and royalties increased from US$25 million in 1994 to more than US$125 million in 2005.[19] By integrating IP across the corporation, Dow has enabled not only its own innovative processes, but also those of its partners and increased revenues as a result.

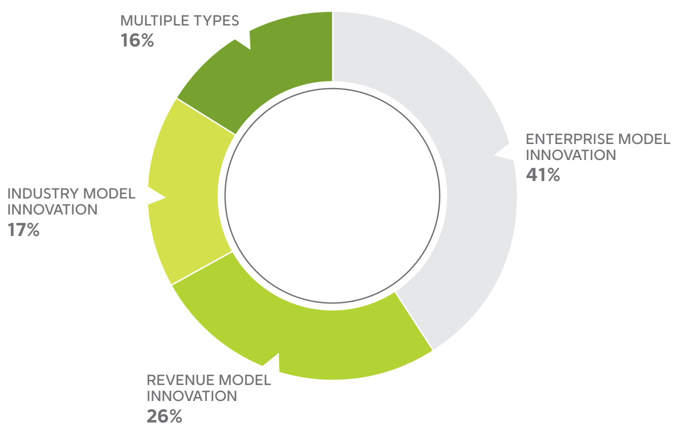
DISRUPTIVE BY NATURE

IP CEOs plan to alter their business models extensively over the next few years. So how can they broaden their companies' expertise and creativity? How can they encourage an entrepreneurial spirit?

All the IP CEOs participating in our survey plan to alter their business models over the next three years, and two-thirds of them plan to do so extensively. Forty-one percent of these business model innovators intend to alter their enterprise models, mainly by making internal improvements, differentiating their companies more effectively and building closer links with external partners. Another 26 percent aim to alter their revenue models by reconfiguring the mix of products and services they offer or adopting new pricing structures (see Figure 4).

FIGURE 4 ENTERPRISE MODEL INNOVATION IS MOST COMMON CHOICE

More than two-fifths of IP CEOs plan to change their business models by specializing and forming new partnerships.



However, only 17 percent of IP CEOs intend to change their industry models. This is not particularly surprising. It is generally more difficult to redefine an existing industry, enter a new industry or create an entirely new industry than it is to make internal improvements, form alliances with other organizations or develop new value propositions; hence the fact that only 19 percent of the total survey population plans to make industry model innovations. Even so, given the scale of the changes IP companies face, some CEOs may want to explore more radical options, such as entering into alliances with companies operating in different markets or industries. Examples of this approach include oil companies moving into the provision of water and electronics stores offering computer maintenance services in the home.

TYPES OF BUSINESS MODEL INNOVATION CONSIDERED

Enterprise model
Specializing and reconfiguring the business to deliver greater value by rethinking what is done in-house and through collaboration.

Revenue model
Changing how revenue is generated through new value propositions and new pricing models.

Industry model
Redefining an existing industry, moving into a new industry, or creating an entirely new one.

Moreover, bold measures sometimes yield the best results. We compared the revenue and profit track records of those IP companies with publicly available financial information against the industry average across our sample.[20] Our research shows that only one-third of the underperformers (the companies with a financial performance lower than the overall average) intend to make major business model innovations. Conversely, almost two-thirds of the outperformers have ambitious plans for altering their business models.

Implications

IP companies will need to broaden their expertise and innovativeness by developing a bigger network of alliances, some of them beyond the traditional boundaries in which they operate, and listening to the views of increasingly sophisticated consumers. The growing pressure on natural resources like energy and water is likely to promote greater collaboration among companies in different areas of business. The intersection between industries can also stimulate the development of joint ventures to create new products and services.

IP companies should therefore monitor other industries for concepts and business models that could transform their own markets. They may also have to redefine what is core to their businesses, as new growth strategies and business models emerge in the various industries with which they collaborate. Lastly, they will need to create space for entrepreneurs who can help them prosper in the future without comprising their current performance.

Case study

APACHE: DOING WHAT IT DOES BEST

Apache Corporation is an oil and gas independent with the strategy "Grow, succeed, innovate – and do it faster than the guys down the street."[21] The company currently operates in the United States, Canada, Egypt, the North Sea, Australia and Argentina.[22]

In the early 1980s, Apache began acquiring non-operated interests in the Gulf of Mexico.[23] At the time, Gulf of Mexico drilling was considered relatively mature, with rapid decline rates and exposure to weather interruptions. And most companies were deciding to reduce their exposure in the area. Apache utilized its experienced staff, effective management and incentives to become experts at low-cost operations. From Shell, for example, Apache acquired non-operated interest in over 70 federal leases on the continental shelf. By 1995, the offshore region had become Apache's most productive and profitable area and generated the cash to fund its future acquisitions and investments.[24]

Its low-cost business model positioned the company to embark on an acquisition strategy. The company grew across multiple regions with five acquisitions from 1999 to 2004, including more in the Gulf area, the North Sea and Egypt.[25] Apache was able to profit from these acquisitions, thanks to its repeatable practices and flexibility in areas others thought were not economically feasible.

GENUINE, NOT JUST GENEROUS

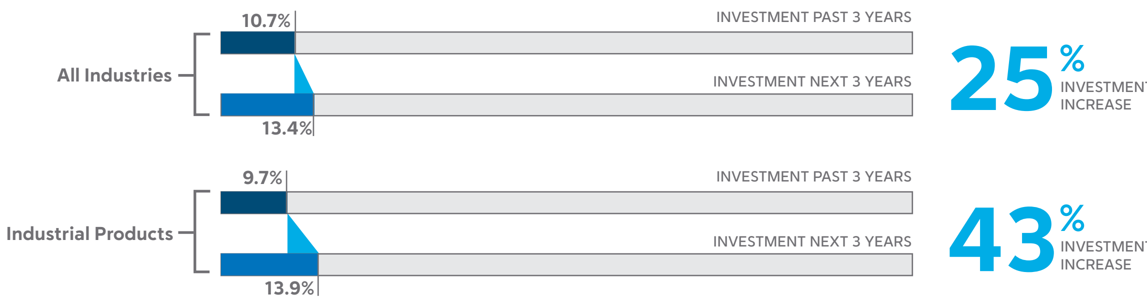
IP companies are working hard to reduce their environmental impact. But are they ready to manage other aspects of corporate social responsibility?

As customers, employees, investors and other stakeholders become more socially aware, CEOs everywhere are increasingly concerned about corporate social responsibility (CSR) – by which we mean acting in an ethical fashion that considers the needs of the workforce, society and the environment, as well as those of investors. IP CEOs are no exception; 73 percent regard the growing importance of CSR as a positive trend.

Collectively, they also intend to raise the amount they invest in CSR initiatives by 43 percent over the next three years (see Figure 5). This is significantly more than the overall average, and four times more than the percentage by which they plan to increase their expenditure on more prosperous and knowledgeable consumers.

FIGURE 5 IP CEOS ARE GENERALLY POSITIVE ABOUT CSR

They plan to increase the amount they invest in CSR by significantly more than the average for the total survey sample over the next three years.



It is no surprise that the environment is a source of special concern – and ranks far higher than socioeconomic factors on the list of issues that trouble IP CEOs. They are acutely aware that climate change is now high on the international agenda and that the regulation of carbon emissions is becoming steadily more onerous. Some industries also suffer from a negative image in this respect. Most IP executives recognize that they have a duty to design sustainable production processes that minimize their companies' environmental footprint and ensure that their suppliers behave in an equally conscientious fashion. "CSR is not an investment; it is a responsibility," the head of one Asian manufacturing company noted.

Implications

IP companies will have to understand and address environmental issues more proactively, and make CSR an intrinsic part of their day-to-day activities. They will, for example, have to monitor their customers' expectations, invest in the development of clean technologies and collaborate with other organizations to create environmentally friendly production and packaging solutions. They will also have to measure, and report on, their performance.

However, the environment is not the only aspect of CSR that they will need to consider. IP companies, like other companies, are obliged to provide fair working conditions for the people they employ – either directly or indirectly, through their supply chains – and to ensure the quality and safety of the products they make. Several high-profile product recalls have already raised questions about the quality of manufacturing in a number of developing countries.[26]

Case study

CHEVRON: INVESTING IN THE PLANET AND ITS PEOPLE

U.S. energy producer Chevron strives to operate responsibly, in line with the vision and values it has articulated in its code of ethics, called "The Chevron Way." In 2007, the company took several major steps to improve its CSR performance:

- It launched a new Environmental, Social and Health Impact Assessment (ESHIA) process to evaluate all new capital projects for their potential impact on the environment, society and health.
- It invested US$119 million in community engagement initiatives; 68 percent of this money was spent addressing basic human needs, education and training, including training for the leaders of 46 non-governmental organizations in the United States and Venezuela.
- It became the first Corporate Champion of the Global Fund to Fight AIDS, Tuberculosis and Malaria, and has undertaken to provide US$30 million over the next three years to combat these diseases.

Chevron also continues to implement its own action plan to combat climate change, as well as working with governments in various countries to build consensus on climate change policy and regulations. And, in early 2008, it established a joint venture with Weyerhaeuser to develop renewable transportation fuels from non-food sources – one of several major renewable power and energy efficiency projects on its books.[27] Chevron's efforts recently earned it top place on the list of publicly quoted Californian companies reporting on sustainability, ahead of other eco- and socially minded companies, such as Google.[28]

BUILDING YOUR ENTERPRISE OF THE FUTURE

IP CEOs fundamentally agree with the CEOs in our overall survey sample about the characteristics that will distinguish successful businesses in the future. Their responses suggest that the Enterprise of the Future – as we have called it – will be hungry for change, innovative beyond customer imagination, globally integrated, disruptive by nature and genuine, not just generous.

However, the challenges IP CEOs face differ from those of other CEOs in various respects. They anticipate more change, are more worried about recruiting and retaining people with the skills they require and are much more concerned about becoming globally integrated. They are also under tremendous pressure to become more environmentally responsible.

So how can they prepare their companies for these challenges? How can they hire skilled labor and managers with international experience? Create an adaptable workforce and infrastructure to manage more change at a faster pace, and capitalize on the new opportunities that globalization, increasing affluence and greater connectivity are creating? Find the partners they need to innovate? Make their global operations as efficient as possible?

We look forward to learning more about where you think your business and industry are heading – and working with you, as you build your Enterprise of the Future.

For additional information about the Global CEO Study or to discuss these industry implications further, we invite you to e-mail one of the following contacts:

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NOTES AND SOURCES

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2 For readability, we have referred to all respondents as "CEOs" throughout the remainder of our report.

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14 In analyzing the responses of all the CEOs who participated in our survey, we identified four distinct clusters: "globalizers" (companies that aim to operate globally and have already acquired some of the capabilities, knowledge and assets they need); "extensive globalizers" (highly networked businesses with a global approach to every element of integration); "blended thinkers" (companies that are trying to optimize their businesses through a mix of global and local approaches, with multiple cultures); and "localizers" (companies that are focusing on their core markets and doing everything in-house).

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[25] Ibid.

[26] Between January 2005 and September 2007, Chinese-made products accounted for 48 percent of the 932 product recalls or dangerous product notifications issued within the European Union. The situation was similar in the United States, where products manufactured in China accounted for 67 percent of product recalls announced in 2007. Many of these products were consumer goods, but electrical products and tires also accounted for a significant percentage of the recalls. For further information, see: Tait, Nicki. "Unsafe goods at record high." *Financial Times*. October 1, 2007. http://www.ft.com/cms/s/0/16775206-6fd1-11dc-b66c-0000779fd2ac,dwp_uuid=9c33700c-4c86-11da-89df-0000779e2340.html; Allen, Lucy P., Comolli, Dr. Renzo & Heumann, Dr. Simona. "China: China Product Recalls: What's At Stake And What's Next." NERA Economic Consulting. February 22, 2008. http://www.nera.com/Publication.asp?p_ID=3399; Yali, Lin. "The 'Made-In-China' Danger." *The Epoch Times*. October 5, 2007. http://en.epochtimes.com/news/7-10-5/60440.html

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