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Five priorities for competing in an era of digital globalization

As digital flows command a growing share of trade and economic growth, executives must answer new questions.

by Jacques Bughin, Susan Lund, and James Manyika

Globalization, once measured largely by trade in goods and cross-border finance, is now converging with digitization. Enormous streams of data and information are transmitted every minute—circulating ideas and innovations around the world via email, social media, e-commerce, video, and more. As these sprawling digital networks connect everything, everyplace, and everyone, companies must rethink what it means to be global. Our latest research quantifies the economic impact of this shift and suggests five critical areas of focus for executives and top teams.

THE NEW TRADE IN BITS

To measure the economic impact of digital globalization, we built an econometric model based on the inflows and outflows of goods, services, finance, people, and data for 97 countries around the world.[1] We found that over a decade, such flows have increased current global GDP by roughly 10 percent over what it would have been in a world without them. This added value reached $7.8 trillion in 2014 alone. Data flows *directly* accounted for

[1] The data cover 1995 to 2013, the most recent year for which a large set of countries reported inflows and outflows of migrants.

$2.2 trillion, or nearly one-third, of this effect—more than foreign direct investment. In their *indirect* role enabling other types of cross-border exchanges, they added $2.8 trillion to the world economy.[2] These combined effects of data flows on GDP exceeded the impact of global trade in goods. That's a striking development: cross-border data flows were negligible just 15 years ago. Over the past decade, the used bandwidth that undergirds this swelling economic activity has grown 45-fold, and it is projected to increase by a factor of nine over the next five years (exhibit).

Beyond creating value in their own right, digital flows are transforming more traditional ones. Some 50 percent of the world's traded services are already digitized and that share is growing. About 12 percent of the global trade in goods is conducted via international e-commerce.[3] Digitization is facilitating flows of people too, as Airbnb, TripAdvisor, and other websites provide information that enables travel.

Meanwhile, the growth of trade in goods has flattened. That's a stark reversal from previous decades, which saw it rise from 13.8 percent ($2 trillion) of world GDP in 1985 to 26.6 percent ($16 trillion) of world GDP on the eve of the Great Recession. Weak demand and plummeting commodity prices account for a large part of this recent deceleration, though trade in both finished and intermediate manufactured goods has also stalled since the crisis. In parallel, many companies are reconsidering the risks and complexity of managing long supply chains—and placing greater importance on speed to market and other costs of doing business and less on labor costs. As a result, more production is occurring in countries where goods are consumed. Looking forward, 3-D technology could further erode international trade as some goods are printed at their point of consumption. These shifts make it unlikely that global trade in goods will resume its previous brisk growth.

OPEN PLATFORMS, VIRTUAL GOODS, AND 'DIGITAL WRAPPERS'

Behind the scenes, the largest corporations have been building platforms to manage suppliers, connect to customers, and enable internal communication and data sharing. While many platforms are internal, the biggest and best

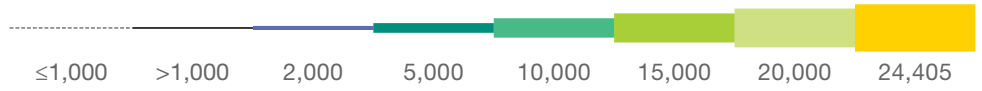
[2] We make the conservative assumption that 12 percent of the impact of other flows on GDP can be accounted for by data flows. This adds a further $0.6 trillion to their direct 2014 impact.

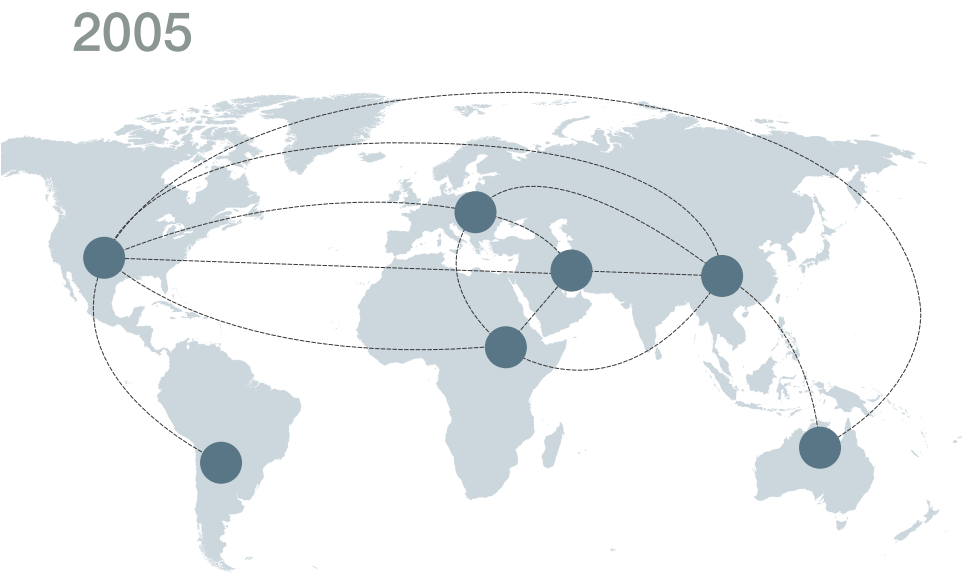
[3] China, pushed by favorable free-trade zones set up by the authorities, is a leader in cross-border B2B commerce. Alibaba.com is the best-known company in the space, but many other players are also important, including Zhejiang China Commodities, which just launched yiwubuy.com, and Zhejiang China Light Textile City Group, which bought the platform globaltextiles.com.

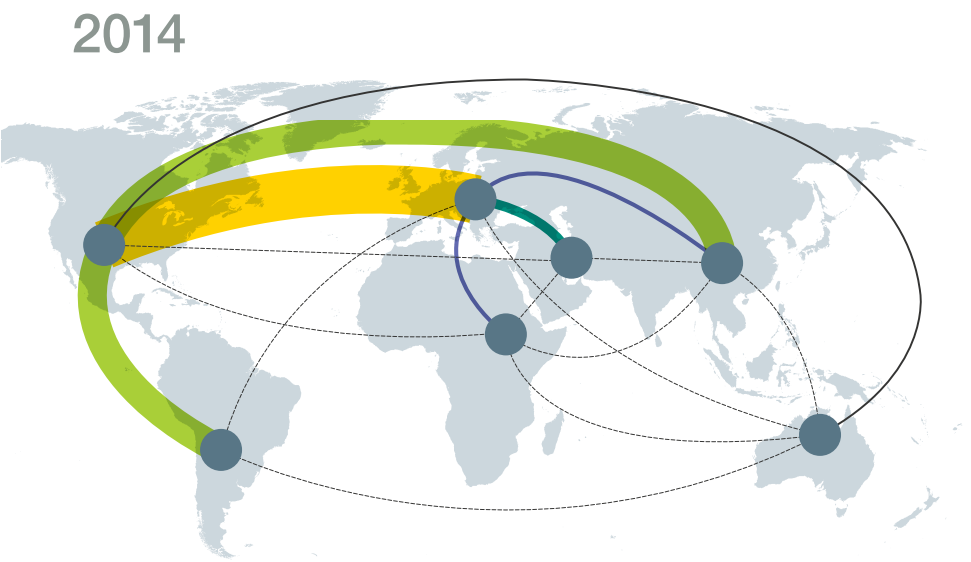
Exhibit

Global flows of data and communications are increasing dramatically.

Used cross-border interregional bandwidth, in gigabits per second







Source: TeleGeography; McKinsey Global Institute analysis

known are more open: spanning e-commerce marketplaces, social networks, and digital-media platforms, they connect hundreds of millions of global users.

These open platforms give businesses enormous built-in customer bases and ways to interact with customers directly. They also create markets with global scale and transparency: with a few clicks, customers can get details on products, services, prices, and alternative suppliers from anywhere in the world. That makes markets function more efficiently, disrupting some intermediaries in the process. What's more, digital platforms are helping companies that deliver digital goods and services to enter new international markets without establishing a physical presence there. They also give millions of small and midsize businesses global exposure and an export infrastructure. On eBay's platform, anywhere from 88 to 100 percent of these relatively modest companies export—compared with less than 25 percent of traditional ones in the 18 countries the company analyzed.

Also growing rapidly is trade in virtual goods, such as e-books, apps, online games, and music downloads, as well as streaming services, software, and cloud-computing services. As the cost of 3-D printing declines, this trade could expand to new categories—for instance, companies could send digital files to output goods locally. A lot of companies already use 3-D printing for replacement parts and supplies in far-flung locations.

Many companies are adding digital wrappers to raise the value of their offerings. Logistics firms, for example, use sensors, data, and software to track physical shipments. One study found that radio-frequency-identification (RFID) technology can help to reduce inventory costs by up to 70 percent while improving efficiency. Case studies in Germany, including the logistics centers of BMW and Hewlett-Packard, found that the technology reduced losses in transit by 11 to 14 percent.[4]

GROUNDING THE DIGITAL DIALOGUE

Business models built for 20th-century globalization may not hold up as digitization gains ground. As leaders take stock of the opportunities and threats, five questions can help ground the discussion:

1. Do we have a clear view of the competitive landscape?

Competition is intensifying as digital platforms allow companies of any size, anywhere, to roll out products quickly and deliver them to new markets.

[4] Nabil Absi, Stéphane Dauzère-Pérès, and Aysegul Sarac, "A literature review on the impact of RFID technologies on supply chain management," *International Journal of Production Economics*, Volume 128, Number 1, November 2010.

Amazon now hosts two million third-party sellers, while some ten million small businesses have become merchants on Alibaba platforms. The growing trend toward "micromultinationals" is seen most clearly in the United States, where the share of exports by large multinational corporations dropped from 84 percent in 1977 to 50 percent in 2013. New digital competitors from all over the world are unleashing pricing pressures and speeding up product cycles.

2. Do we have the right assets and capabilities to compete?

Building digital platforms, online customer relationships, and data centers is not just for the Internet giants anymore. GE, for example, is transforming its core manufacturing capabilities to establish itself as a global leader in Internet of Things technology. Businesses in all industries need to take a fresh look at their assets, including customer relationships and market data, and consider whether there are new ways to make money from them. To do so, they will need advanced digital capabilities, a major source of competitive advantage, and workers with cutting-edge skills are in short supply. Online talent platforms can help companies navigate a more global labor market and find the people they need in far-flung places.

3. Can we simplify our product strategy?

Digitization can simplify the tailoring of products, brands, and pricing for companies that sell into multiple global markets. But there's a parallel trend toward more streamlined global product portfolios. Several automakers have moved in this direction. Apple offers only a limited number of its iPhone and iPad models, all with consistent design and branding wherever they are sold. Airbnb, Facebook, and Uber have simply scaled up their digital platforms in country after country, with limited customization. The media and consumer-technology industries are shifting to simultaneous global product launches, since social and other digital platforms enable consumers around the world to see, instantaneously, what's on offer in other countries. This development creates opportunities for products to go viral on an unprecedented scale. Making smart customization trade-offs, in short, is becoming an increasingly important top-management priority.

4. Should we retool our organization and supply chain?

Digital tools for remote collaboration and instant communication make it possible to centralize some global functions (such as back-office operations or R&D), to create virtual global teams that span borders, or even to forgo having one global headquarters location. Unilever, for example, used

technology solutions to streamline some 40 global service lines and create virtual-delivery organizations with team members around the world who meet via videoconference.[5]

Digital technologies are also reshaping supply chains. Digital "control towers" that offer up-to-the-minute visibility into complex supply chains, for instance, can coordinate global vendors in real time. Since speed to market matters more than ever in a digital world, many companies are reevaluating the merits of lengthy and complex supply chains; logistics costs, lead times, productivity, and proximity to other company operations now have a higher priority. According to a recent UPS survey, approximately one-third of high-tech companies are moving their manufacturing or assembly closer to end-user markets.[6] The wider adoption of 3-D printing technologies could lead more companies to reconsider where to base production, potentially reshaping the world's manufacturing value chains in the process.

5. What are the new risks?

Maintaining data security has to be a top priority for companies in every industry. It's difficult to stay ahead of increasingly sophisticated hackers, but companies can prioritize their information assets, test continually, and work with frontline employees to emphasize basic protective measures. In addition, the Internet and international competition have cut into the window of exclusivity that companies once enjoyed for new products and services; copycat versions can be launched in new markets even before the originators have time to scale up.

The economic impact of digitization is growing, and digital competition often spans borders. As digital tools create new possibilities for building and managing a global presence, business leaders must challenge long-held assumptions about the international competitiveness of their companies. Q

[5] Pascal Visée, "The globally effective enterprise," *McKinsey Quarterly*, April 2015, McKinsey.com.

[6] *Change in the (supply) chain*, United Parcel Service, 2015, ups.com.

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For the full report on which this article is based, see "Digital globalization: The new era of global flows," on McKinsey.com.