

Focusing On Competitiveness

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AT THE END OF JUNE, THE LEADERS OF THE G20 countries will meet in Toronto. They face major challenges including trade imbalances, exchange rate rebalancing, the sovereign debt crisis in Greece (along with the potential for contagion to other countries in the Eurozone) and regulation of the banking sector.

At the same time, the recovery of various economies, in both the developed world and emerging markets, presents both good news and major challenges to the boards and management of Canadian companies.

Some might recall Shakespeare's famous line from *The Tempest*, "what's past is prologue". What is becoming more and more evident as the recovery from the financial crisis unfolds is that a return to the *status quo ante* should not be expected or planned for.

The thesis of this paper, which was presented on April 20th, 2010 at the Deloitte Directors Series, co-sponsored by the Institute of Corporate Directors, is that building competitiveness for success in a transformed world is an important governance priority for boards of all Canadian companies. Mark Carney, the Governor of the Bank of Canada, made this clear in a speech in

Winnipeg on February 4th, 2010 entitled "The Coming Thaw", in which he said:

"The global economy that emerges from the recession will be different than the one that led into the crisis. A powerful and sustained restructuring of the global economy has begun. Canadian business will need to develop new markets as the traditional advantage of relatively open access to U.S. markets becomes less valuable. To seize new opportunities, our productivity levels must improve."

Governor Carney summarized the implications as follows:

"In short, Canadian companies are emerging from the recession to an altered world – one that may require deeper restructuring and bolder strategic initiatives than currently contemplated."

The repositioning of foreign currencies is likely to be a key feature of this altered world. Consider the pressure on China to raise the value of the yuan, the depreciation of the euro against the U.S. dollar (with the risk that the euro might even collapse) and the appreciation of the Canadian dollar against the U.S. greenback. This repositioning of currencies will change the competitive landscape. A recent Conference Board of Canada report "Learning to Live with a Strong Canadian Dollar: Four Options for Business and Government" provides the elements of a potential strategy for building competitiveness in a restructured global economy:

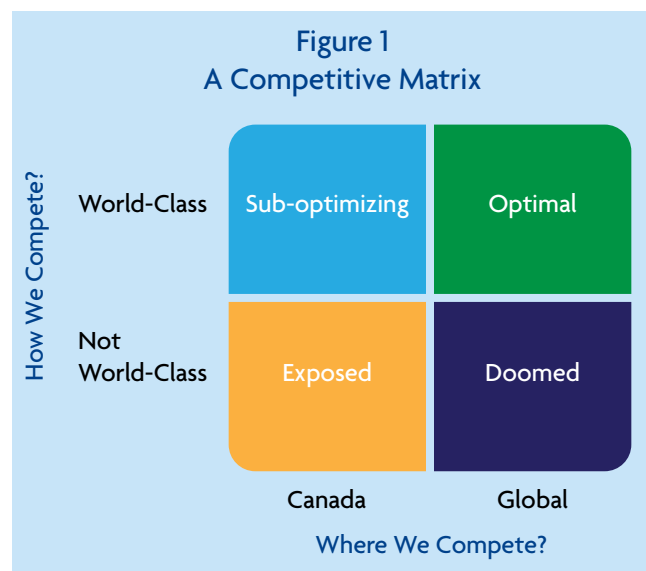
"But for firms that are able and willing to adapt, a strong Canadian dollar may be just the challenge that unlocks a new economic potential – through enhanced innovation, faster productivity growth, and expanded internationalization of their business strategy and operations."

The Conference Board's themes deserve emphasis – enhanced innovation, faster productivity growth, and



expanded internationalization of business strategy and operations. Enhanced innovation and productivity are key factors in “how we do business” and internationalization of business strategy and operations is a key factor in “where we do business”.

The following matrix combines these two factors of “how” and “where”. Companies whose operations, including innovation and productivity, are not world-class can be successful in domestic markets, as long as a competitor with world-class operations does not show up – either physically or on the Internet. Similarly, a company that is not operating at a world-class level is not likely to last very long in international markets against world-class competitors. On the other hand, a company that is truly operating at world-class levels, but only in the domestic Canadian market, may be sub-optimizing its potential by not penetrating global markets.



Canadian companies cannot be complacent and relax in the satisfaction that the Canadian economy has emerged from the recession in better shape than companies in other countries or that Canada’s banking system has shown itself to be among the most stable in the world. Canadian companies must prepare to compete in a restructured world. It is not clear, at least to me, what a restructured global economy will look like. But, three things seem clear:

- uncertainty and volatility will define the restructuring of the global economy;
- competition will intensify; and

- innovation and relative productivity performance will be extremely important.

Building competitiveness that creates a sustained competitive advantage in a restructured global economy has to be the priority of our country, the priority of the management of Canadian companies and the priority of the boards of directors that govern them.

Here is a “top ten” list of things that boards can do to help enhance competitiveness:

- 1. Embrace strategic flexibility.** Make sure your management team and your board monitors and understands the restructuring of the global economy, the drivers of this transformation, and how they affect various industries. Certain industries, like international banking and automobiles, are at the leading edge of this transformation. But nobody can accurately predict the future. On that basis, consider the various scenarios for how this global restructuring could impact your industry and your company. What will you do if the most plausible restructuring scenario does not happen?
- 2. Make productivity and competitiveness a top priority.** Make sure management focuses on, and sets continual improvement targets for, efficiency and productivity. Does your company have a productivity measurement and reporting system? Bench mark your company’s competitiveness against “best in world” competitors – irrespective of whether they operate in your markets or not. Make sure you know where you stand.
- 3. Invest in information technologies.** The Institute for Competitiveness & Prosperity reports that Canada’s businesses invest about a third less per dollar of Gross Domestic Product in information communication technologies than their counterparts in the United States and that this under-investment lowers our productivity. Increasing your company’s investments in technology, new machinery and equipment is likely to be cheaper now with a higher Canadian dollar. Technology is often a critical factor in driving substantive (not marginal) improvements in productivity and competitiveness. Is your company’s capital spending on technology aggressive enough?
- 4. Invest in innovation.** How much does your company really invest in innovation? What priority is innovation really given in its strategic plans? Is your innovation strategy passive or bold? Does

your company partner with other companies and Canadian universities? Michael Porter of the Harvard-based Institute for Strategy and Competitiveness believes that the geographic clustering of firms in the same and related industries increases productivity and innovation. Kitchener-Waterloo is a good Canadian example: located there are several highly advanced technology firms that have a significant concentration of local ownership. These firms have a good working relationship with post-secondary institutions and their graduates comprise a large portion of their executive ranks. They also invest heavily in research and development activities and in the creation of intellectual property.

5. Move beyond risk management to risk intelligence.

Businesses earn profits by taking risks. But they lose money by not understanding or managing the risks they take. Risk intelligence is more than minimizing risk exposures. It focuses on taking the right risks, understanding and quantifying your firm's appetite for risk, and ensuring that there is always an appropriate balance between risk and reward. As Canada's economy moves from the recession into a restructured global economy, a failure to build competitiveness may be the biggest risk faced by firms.

6. Challenge how performance is measured and reported.

We all know "what gets measured gets done". To improve productivity and competitiveness, targets need to be set, performance must be measured and continual improvement should be the watchwords. Boards should ensure the productivity and competitiveness reports they receive provide clear, frank, meaningful, unbiased measures of the company's productivity and competitiveness as well as its financial performance. These reports should measure performance in both how the company competes (e.g., productivity, innovation, talent) and where it competes (e.g., Canada, North America, globally). A great example is Warren Buffet's annual report to the shareholders of Berkshire Hathaway.

7. Make sure you indeed pay for performance.

"Pay for performance" is the mantra of the day, but it begs the question of "what performance should we pay for?" Executives need to be measured and rewarded both for building competitiveness (which requires investment) and for reaping its benefits (profitability). In the past two decades, when the value of the Canadian dollar was low, I suspect that many boards of exporters rewarded executives for harvesting the

benefit of the low dollar, and did not penalize them for not making investments to improve productivity and competitiveness.

8. Leverage Canada's growing diversity.

In the past couple of decades, Canada's major cities have become very internationally diverse, which provides a rich talent pool to hire and develop executive leaders who can identify global opportunities and help the firm attain them. We have a lot of knowledge of foreign markets, right here in our own back yard. Challenge management's human resource strategies. Make sure your company is using our rich diversity to attract and to develop "best in world" talent.

9. Enhance the international experience of your board.

Companies need "best in world" talent in their management ranks. Boards also need directors who have the requisite international experience to provide advice and guidance to executives as they try to penetrate new markets and to challenge them when they do not succeed. There is a lot of talk about diversity in the board room – but often this is focused on only the gender dimension of diversity. Building an international experienced management team is a big challenge. Creating an international experienced board might even be a greater challenge.

10. Be a global leader, not just a player.

The Institute for Competitiveness & Prosperity has assessed the global competitiveness of hundreds of Canadian companies based on certain criteria and determined which of these firms are global leaders in their industries. In 2003, Canada had 87 companies that the Institute considered to be global leaders. In 2008, this number had dropped to 85 and last year it increased by one to 86. Canada has emerged from the recession better than most. Now is the time for Canadian firms to capitalize on this advantage. Canada needs many more boards and managements who strive to be world-class global leaders – our future, and the future of our country, depends on it.

These are some of the things that boards might focus on to help ensure that their companies will be able to compete successfully in the restructured and volatile global economy that Mark Carney and others suggest is emerging from the great recession. I am sure that there are others your board has or can develop to guide your company to success.

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