

The new masters of management

Developing countries are competing on creativity as well as cost. That will change business everywhere.



THIRTY years ago the bosses of America's car industry were shocked to learn that Japan had overtaken America to become the world's leading car producer. They were even more shocked when they visited Japan to find out what was going on. They found that the secret of Japan's success did not lie in cheap labour or government subsidies (their preferred explanations) but in what was rapidly dubbed "lean manufacturing". While Detroit slept, Japan had transformed itself from a low-wage economy into a hotbed of business innovation. Soon every factory around the world was lean—or a ruin.

Management gurus are always glibly proclaiming revolutions. What happened in Japan qualified, as did the advent of mass production in America a century ago. Now something comparable is taking place in the developing world.

It is hardly news that the world's centre of economic gravity is shifting towards emerging markets. Buy a mobile phone and it will almost certainly have been made in China. Use it to phone a customer helpline and your call may well be answered by an Indian. Over the past five years China's annual growth rate has been more than 10%, and India's more than 8%. Yet even these figures understate the change that is taking place. Emerging countries are no longer content to be sources of cheap hands and low-cost brains. Instead they too are becoming hotbeds of innovation, producing breakthroughs in everything from telecoms to carmaking to health care. They are redesigning products to reduce costs not just by 10%, but by up to 90%. They are redesigning entire business processes to do things better and faster than their rivals in the West. Forget about flat—the world of business is turning upside down.

Competing for the future

As our special report argues, the rich world is losing its leadership in the sort of breakthrough ideas that transform industries. This is partly because rich-world companies are doing more research and development in emerging markets. Fortune 500 companies now have 98 R&D facilities in China and 63 in India. IBM employs more people in developing countries than in America. But it is also because emerging-market firms and consumers are both moving upmarket. Huawei, a Chinese telecoms giant, applied for more international patents than any other firm did in 2008. Chinese 20-somethings spend even more time on the internet than do their American peers.

Even more striking is the emerging world's growing ability to make established products for dramatically lower costs: no-frills \$3,000 cars and \$300 laptops may not seem as exciting as a new iPad but they promise to change far more people's lives. This sort of advance—dubbed “frugal innovation” by some—is not just a matter of exploiting cheap labour (though cheap labour helps). It is a matter of redesigning products and processes to cut out unnecessary costs. In India Tata created the world's cheapest car, the Nano, by combining dozens of cost-saving tricks. Bharti Airtel has slashed the cost of providing mobile-phone services by radically rethinking its relationship with its competitors and suppliers. It shares radio towers with rivals and contracts out network construction, operations and support to specialists such as Ericsson and IBM.

Just as Henry Ford and Toyota both helped change other industries, entrepreneurs in the developing world are applying the classic principles of division of labour and economies of scale to surprising areas such as heart operations and cataract surgery, reducing costs without sacrificing quality. They are using new technologies such as mobile phones to bring sophisticated services, in everything from health care to banking, to rural communities. And they are combining technological and business-model innovation to produce entirely new categories of services: Kenya leads the world in money-transfer by mobile phone, for example.

Hope versus fear

All this is obviously good news for the billions of people who live in the BRICS (see article) and other developing countries. More consumers will have access to goods and services that were once confined to the elite. More than 90% of Indians and Chinese tell pollsters that they are optimistic about the future. Anand Mahindra, an Indian business leader, has described his dreams about the future as “not just colourful, but steroidal”.

What about the slow-growth rich world? Emerging firms are advancing on a greater number of fronts than the Japanese did 30 years ago and also advancing much faster, gobbling up Western rivals. Their charge will upset many established Western firms, which will face increasingly savage price competition, and also overturn many assumptions about the rich world's competitive advantage. Many of globalisation's most vocal supporters have justified the loss of manufacturing jobs in the West on the ground that the rich world will maintain an edge in innovation; the clever jobs will stay at home. Emerging economies are not merely challenging that lead in innovation. They are unleashing a wave of low-cost, disruptive innovations that will, as they spread to the rich world, shake many industries to their foundations. All sorts of chief executives will scream for protection.

Change will indeed be painful for incumbents, as disruptive innovation always is. But cheaper goods and services will be a blessing for Western consumers, who are likely to face years of slow income growth. It could also be good news for rich-world governments, which are plagued with deficits even before the baby-boomers begin to retire. Frugal innovation may well prevent America's health-care system (which already consumes 17% of its GDP) from swamping the rest of the economy. Clever ways of applying economies of scale and scope in new ways could boost public-sector productivity.

Moreover, it is in the nature of innovation to feed upon itself. Innovation in the emerging world will encourage, rather than undermine, innovation in the rich world. Western carmakers learned the techniques of lean production from their Japanese rivals, just as the Japanese had earlier learned the techniques of mass production from the Americans. This great insurrection, like its predecessors, will make us all richer.

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