

Business & Finance

Expanding Horizons: Boeing's Global Business Operations

Interview with Philip M. Condit

If foresight and the ability to manage risk effectively are two of the most important measures of a leader, then Phil Condit and his team at Boeing should take home top honors. Granted, the unprecedented post 9/11 global depression in commercial air travel has hit Boeing hard and is likely to persist well into 2003—disturbing news for a company with roughly fifty-five percent of its business devoted to commercial aircraft manufacturing. However, the Boeing that entered the twenty-first century is markedly different from the one that exited the twentieth, and is much more capable of both weathering the current slump and benefiting from the massive upsurge in military and defense spending.

GJIA recently had the opportunity to sit down with Dr. Condit to discuss the challenges and opportunities Boeing now faces as a result of its mid-1990s transition, as well as some of the broader issues—ranging from business-government relations to foreign competition—that a global CEO must face everyday.

GJIA: Boeing has been significantly transformed since you became CEO in 1996. When did management start thinking about diversification and why?

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Chairman and Chief
Executive Officer of
The Boeing Company.

CONDIT: Management first started having thoughts of diversification in the early 1990s and by 1995 our strategy had pretty much taken shape. It was based on the premise that without diversification, Boeing would be 85 percent commercial airplanes and 15 percent defense. We did not want to be that heavily dependent on the cyclic commercial airplane industry, and it was apparent that a lot of our skills in commercial airplanes would be useful in the military arena. The problem was that our defense program was too small to make a real difference in that sector. Growing the business internally would have been too slow, so we turned to mergers and acquisitions. The first piece was the acquisition of Rockwell's aerospace business, followed by the merger with McDonnell Douglas, and finally the acquisition of a portion of Hughes. This diversification strategy will result in roughly a 50/50 split of our business portfolio between commercial and defense next year. Now this is partially the result of our growth in defense and the overall industry growth post 9/11, but it is also due to a slumping commercial airplane industry. Of course, the two industries will swing back and forth; there is nothing magic about 50/50, and we are looking to build and grow some new business along the way, but those two will probably be our core competencies for quite a while.

GJIA: What are some of the other businesses that you are looking to build?

CONDIT: Well, there are mainly three: *Connexion*, Air Traffic Management, and Boeing Capital Corporation. *Connexion* is a broadband data service for commercial and military airplanes. It will give both passengers and pilots high speed Internet

connection in the cabin or cockpit. Not only will this be a commercial service, it will also facilitate critical communications between pilots and ground controllers regarding passenger health, plane security, and inclement weather, among other things. Air Traffic Management is our initiative to develop services and solutions for the safe and unconstrained growth of the air traffic control system. We have found that Global Positioning Satellites and military communication technologies applied to air traffic management could greatly enhance the current system and move it from a tactical to a more strategic system. With a strategic system, you would know at the start of the day where everyone is, where they want to go, and when they want to get there. Depending on any number of factors, you could more easily and dynamically adjust the entire system, in order to avoid convective weather for instance. The third is Boeing Capital Corp., a financing company with around \$11 billion in assets, 30 percent of which is now in commercial equipment other than airplanes.

GJIA: Does Boeing's role as the United States's top exporter add a level of burden or responsibility to your job?

CONDIT: It certainly adds responsibility, among other things. The title itself does not do much for me. You can hang it on the wall, but it does not buy anything. However, given that we are the beneficiary of extra-territorial income (ETI) to the tune of roughly \$250 million a year, we are deeply interested in export policy. This issue revolves around a subtle nuance in the World Trade Organization (WTO) code. Because of the way the code was written, there can be no indirect tax benefits associated with export. The

United States taxes people and corporations on their income, which the WTO considers an indirect tax. So when a U.S. company receives tax relief for some of its ETI through the Foreign Sales Corporation provisions of U.S. tax law, the WTO regards it as an illegal export subsidy. But since the Europeans use a direct value-

underneath the radar and try to change things if we are not willing to stand up in public and vocalize support for what we think is right. The next step is putting forward your ideas in a thoughtful, cohesive way. Our Washington DC office is staffed by absolutely great people that understand the legislative process. They

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added tax, it is technically legal for European firms to receive export subsidies. Obviously this is an unfair situation and very important to us, but it is also important to a lot of other U.S. exporters; so we generally end up carrying the flag on the issue along with Caterpillar and Kodak. More generally though, Boeing has historically had an advantage over firms in other industries because our products were self-deliverable—you just put gas in them and they delivered themselves—unlike an automobile that you had to ship. Thus, the economic motivation to locate a plant abroad was much smaller for us. As a consequence, we are very vulnerable to, and dependant on the tax regulations of the United States.

GJIA: Since government policies and regulations have such a large impact on your bottom line, how do you go about effectively managing government relationships?

CONDIT: When considering whether or not to enter a debate over public policy, we ask ourselves whether or not we would be willing to testify before congress on the issue. We are not going to run around

understand how the defense budget gets written and where the policies are shaped. In the end, it is all a matter of negotiations, and we will only consider entering a policy debate if we can put together a case that we can defend in court. Recall the extra-territorial income issue for example: If our primary commercial competitor was not advantaged by the way the WTO rule was written and somebody said that the ETI was going to be eliminated, I would have very little argument with that. Granted, I would miss the \$250 million ETI benefit, but if it does not fit into the fundamental concept of building a level playing field then I cannot argue for it.

GJIA: Have business-government relations become even more important now that defense and military products and services are a much larger part of your business?

CONDIT: Yes they have; the U.S. Defense Department is a huge customer of ours. It would be great if the procurement process was based strictly on what is best for the U.S. government. The problem is that there are a lot of conflicting views about what is best and what is needed. If your voice is not heard at all, then you are not

going to be selected. If your voice is heard, then maybe you can balance the scale, but you are probably not going to tip it over in your favor. For instance, we are currently in the middle of negotiations for the potential leasing of one hundred Boeing 767 tankers. Traditionally, the U.S. government has not been a leasee because it can borrow at a lower interest rate than anyone else and buy equipment outright. On the other hand, Kosovo, Bosnia, and Afghanistan all used tankers like crazy—tankers that are on average 41 years old and in maintenance a third of the time. Given the current constrained budget situation and the \$5 billion dollars

should be deployed. For example, we have the contract to deploy explosive detection systems in our airports. It is a joint venture with Siemens, and it allows us an opportunity to also talk about how we can both increase the security at airports while maintaining a level of speed and efficiency for travelers.

GJIA: How has Boeing's international presence affected its ability to negotiate with foreign governments?

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in maintenance cost savings that you could gain from leasing, one can make a very good argument as to why the military should lease rather than buy the tankers.

GJIA: It is obvious that Boeing has a very strong interest in influencing trade policies and the military procurement process, but Boeing has also been significantly affected by terrorism and the global war on terror. Is there any role for Boeing in the policy discussions relating to these issues?

CONDIT: Yes and no. We do not have a role in deciding whether or not we should have a war on terrorism; that is for our government to decide. However, we have enormous technological capabilities to offer in solving a wide range of problems, so we do help to identify the best tools to use and determine how they

global company. We currently have 3,000 employees in Australia; we own 35 percent of Aero Vodochody in the Czech Republic; and we have close to 1,000 people working in our design bureau in Moscow. That allows you to weigh in on the policy debates in those countries respectively. I can go to the Prime Minister in Australia and have a policy discussion because we are an Australian company. I can meet with the Prime Minister of Russia or President Putin, and I just met with the President of the Czech Republic when I was there a couple of weeks ago. Our ability to be part of a country and part of its economy gives us a voice in that country, which is how you would expect it to be.

GJIA: Are Boeing's foreign workers a response to decreased U.S. labor competitiveness?

CONDIT: I am going to go way far astray on this one for a minute. I am convinced that given the state of the U.S. economy, we have the opportunity to create an enormous number of new jobs. I also believe that we will likely destroy a number of jobs in the process. In general, the knowledge content of those jobs will increase as we move up the value chain. I expect that the relatively low value-added jobs will end up moving to places with low labor wages, as has happened in the apparel industry, in much of the semiconductor industry, and to a very small degree in our industry, but I think that that is almost inevitable. At the same time, we need to build a system that accommodates a number of new knowledge-based jobs. We have a tuition-reimbursement program here at Boeing so that any employee can go to any accredited institution and we will pay for the tuition and books on any subject. Some employees will study in fields that are directly related to what they are doing here at Boeing, while others will study non-related subjects. For example, one of our security people is off getting a law degree. Some of the employees will end up leaving Boeing, while some of them will use their new capability inside Boeing. I think in the growing economy, particularly given the information revolution, these changes are going to happen and trying to hold them back is not going to change things. We need to prepare our people for these changes as opposed to seeing how many roadblocks we can put in the way of development. There are a lot of people who would love to keep the status quo, but the world is dynamic and is going to change.

GJIA: There has been some strategic cooperation between Boeing and

European Aeronautic Defense and Space Company (Airbus' parent company) in the defense sector, on missile defense and helicopters. Why is it that there is room for cooperation in defense, yet nothing but rivalry with Airbus on the commercial side?

CONDIT: I think that there are a couple differentiating characteristics. One of them is that there are only two companies in the commercial sector. The other goes all the way back to the origins of Airbus. Much of the aeronautical technology that we have today came out of Europe. The Wright brothers were the first to fly, but just barely. The first jet engines were simultaneously developed in the United Kingdom and Germany; the first jet transport was British; and the first small twin jet transports were French and British. Europe always played a role in the front end of technology, yet the United States was always able to claim significant market share, which provoked a great deal of irritation in Europe. As an example, the British built the Trident three engine transport, and while they sold a total of a hundred, we sold some eighteen hundred 727s. They were first, but we got the lion's share of the market. Eventually, European manufacturers brought all their pieces together into one area as a consortium and said, "We *are* going to compete with the United States in this market," and they were supported by enormous amounts of European taxpayer money, with best estimates in excess of \$30 billion. A lot of the motivation was based on the ideological notion that you cannot be a modern economy without competitive capabilities. That approach to the commercial sector produces a very different competitive environment than found in the defense sector, where sys-

tems interoperability with our coalition partners is paramount. Interoperability is a very compelling justification for cooperation, but that is an over-simplified answer.

GJIA: So is there pressure for cooperation coming from the United States and European governments to insure systems interoperability?

CONDIT: In some cases yes, but now it gets more complicated. The increase in the U.S. defense budget post 9/11 alone is bigger than all the European defense budgets put together. It just places the United States way off the scale. Also, European governments have been relatively inefficient on big military projects—our operations take a long time, but theirs take a *very* long time. While the U.S. government wants to be interoperable with its coalition partners, it would also like Europe to share more of the financial responsibility of that initiative. On an issue such as missile defense, the United States would like to see cooperation from both a political and economic standpoint. However, the emphasis on cooperation and interoperability on the other side of the Atlantic comes more from the private sector than from government pressure.

GJIA: Do you imagine that there is any room for potential Boeing–Airbus cooperation on the commercial side down the road, or would the regulatory authorities prohibit it?

CONDIT: It could only take place in the form of a natural monopoly, meaning that the entire market is too small to support two companies. We actually worked with Airbus for a little while dur-

ing the development of a very large airplane concept since that market is too small to support two companies. Airbus is still working on that project but our group pulled out after we decided that such a large airplane would not be economically viable. This conclusion was based partly on the fact that we believe roughly half of our large 747s were not necessarily purchased because they were the biggest planes at the time, but because they had the longest range. When we first started building them, the only way you could fly long distances was with four engines. Now technology allows us to build smaller long-range planes, and that is where we think the market is going.

GJIA: You mentioned growing the Air Traffic Management business. Is there any hope for a globally unified air traffic management system?

CONDIT: I hope that the answer is yes. It raises some really interesting issues about air space sovereignty and who would hold the reigns of a unified system. Europe is struggling with these issues right now in trying to make Eurocontrol really work. It is extremely difficult to pass off control of airplanes, especially when they are rapidly crossing national borders, as is the case in Europe. It would be like trying to run the U.S. system with every state in control of its airspace. I think the answer is that we will all try to find ways to make an integrated global system that has checks and balances to ensure that it is not misused from a geopolitical standpoint.

GJIA: Assuming that the industry returns to historic growth rates, how necessary is a better working air traffic control system?

CONDIT: You need to have it not only for efficiency but also for added safety. Half of all commercial airplane crashes are what administrators call CFIT (Controlled Flight Into Terrain), which means running a perfectly good airplane into something. Eventually we will be able to place a 3-D map of the world into a database that records the position of every mountain and hill, and we will know the location of the airplane to within inches. If we know where the airplane is relative to the ground then there is no reason someone ought to ever run into it. The system today relies on voice communication, which is error prone for multiple reasons, and mistakes do happen. If you are operating an airplane in the clouds over Taiwan or Mongolia and you cannot understand the controller, you are in deep trouble. A unified air traffic management system based on accurate and accessible location data for pilots will both improve safety and increase capacity.

GJIA: You are Chairman of the United States-China Business Council. What kind of duties or responsibilities does that entail and does your position give Boeing a potential competitive advantage in China or in other Asian markets?

CONDIT: The Council is a body of U.S. companies that are supportive of an economic relationship with China and are interested in developing that relationship, so there is not really all that much in terms of official duties or responsibility. Basically, we are continually asking ourselves how to bring more companies into China; what we and the other companies are interested in; and how to find common ground among those interests. With respect to advantages for

Boeing, we obviously would like to somehow be an important part of every major market, so my position on the Council, and to some degree my PhD that I earned in Japan, open doors for me that might not otherwise be open. On the other hand, I took the position because I really do care about that relationship every bit as much as I care about whether or not the business will benefit from it.

GJIA: What are the biggest challenges in finding new technologies and preventing them from languishing on the lab shelves?

CONDIT: I think the hardest part is the paradigm shift required to identify potential innovations. You need to forget your ingrained mental models and preconditioned conceptual biases. In Phantom Works, our advanced research and development unit, we try to foster new ways of thinking. On the military side we try to determine what the military conflict of the future is going to look like. We are not just going to build faster, higher-flying fighters. Future military conflict will rely on unmanned vehicles, precision weapons, data gathering, and satellite technologies. The challenge is to move from one idea to the next. It would have seemed as though carriage makers would be the natural next step to the automobile business, but they never made the transition. Out of the top twelve companies at the turn of the last century, only General Electric is still around. GE is doing a little of what it did then, but it has developed many new competencies along the way. This ability to truly innovate and think outside the current business trajectory is the hard part.

GJIA: Is there a particular technology in the pipeline that you are most excited about?

CONDIT: Yes, information technology as it applies to what the military would call network-centric operations. Network-centric operations aim to make airplanes, tanks, armored vehicles, and satellites all part of an integrated, networked system. Understanding the architecture of this system is paramount, and we think that Boeing is particularly well positioned for this. It is clear that information dominates and changes everything. If Hitler had known that the Allies were going to land on Normandy instead of Calais, then D-Day would not have succeeded. What you know about your opponent and what you keep him from knowing about you is absolutely crucial. We think that this is where we can play a major role in the future.