Redefining Global Strategy

Crossing Borders in a World Where Differences Still Matter

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Introduction

MY FIRST INTERNATIONAL case-writing experience, in the early 1990s, had me visit a Pepsi plant in the strife-torn Indian state of Punjab. Given the political environment—a low-grade civil war—many workers were militants who arrived at the plant each day toting their AK-47s. Pepsi had set up a system whereby these could be checked in and then retrieved at the end of a shift. *Absolutely no AK-47s inside the building,* the HR director explained forcefully—introducing me to the large differences with which international business must contend.

This sense of differences has been sharpened by the years I have spent since then working on globalization and global strategy. As a result, instead of focusing on market size and the illusion of a borderless world, this book reminds managers that if their businesses want to cross borders successfully, they need to pay serious attention to the sustained differences between countries in developing and evaluating strategies. And it provides them with the insights and tools necessary to do so.

To illustrate this perspective on globalization—or what I call *semiglobalization*—I'll use football as a metaphor.[1] U.S. readers may be disappointed that the kind of football that I have in mind is what they refer to as soccer, but that itself makes a useful point about the differences between countries. Although football is supposed to be a global phenomenon—former UN secretary general Kofi Annan noted enviously that more countries belong to FIFA, football's governing body, than to the United Nations—its hold on sports fans is very uneven, and the United States constitutes the single largest exception to its general appeal.[2]

That said, the game has come a long way since English villagers began kicking around pigs' bladders in the Middle Ages. Football began to spread internationally during the heyday of the British Empire, but the sport's globalization went into reverse in the interlude between World Wars I and II, as authorities restricted the international transfer of players.

The years after World War II saw escalating international rivalry, particularly around the World Cup. In the late 1950s and early 1960s, Real Madrid emerged as the first great European club, with players from a number of countries.[3] But until the late 1980s, West European leagues continued to limit the number of foreign players to between one and three per team. East European countries, meanwhile, restricted the "export" of their players. And increasing international rivalry did not supersede intense local competition. Thus, matches between Real Madrid and FC Barcelona reenacted the Spanish Civil War—and continue to do so to this day, as I can testify from living in Barcelona and going to watch them play.

The barriers to labor mobility largely disappeared—for club play but not country play—in the 1990s. Economic pressures in East Europe and other poorer parts of the world led to the abandonment of restrictions and the adoption of export-oriented strategies by many local clubs, as well as by football academies established for that purpose. And on the demand side, a ruling by the European Court of Justice in 1995 lifted restrictions on the number of foreign players allowed in European club play. In 1999, Chelsea F.C. became the first club in the history of the English Premiership to start a game without a single English player on the field.[4] By 2004–2005, an estimated 45 percent of the players in that league's starting lineups consisted of foreigners.[5] Similar internationalization is evident in other European clubs. But for World Cup play between countries, FIFA continues to restrict players to representing their countries of origin or citizenship.

Different degrees of cross-border labor mobility have led to very different outcomes. More or less free cross-border movement of players at the club level has concentrated quality and success at the national and regional levels among the richest clubs.[6] In the European Champions League, for example, the number of different teams that qualified for the top eight slots has decreased significantly in the last twenty years. And a recent report by the accounting firm Deloitte & Touche indicates that the concentration of revenues among the top twenty clubs—all European—is increasing as well, as richer clubs with better players secure proportionately more valuable broadcast rights.[7] Interestingly, the club with the most revenues in 2005–2006, Real Madrid with $373 million, thrived financially not just by building local identity but also by targeting global sales of merchandise featuring an all-star cast of *galácticos*, including David Beckham and Ronaldo. (This seems, however, to have exacted a cost on the playing field: as of this writing, Real Madrid has begun to rebuild its lineup with younger players after a spell of embarrassingly bad performance.)

This story of ever-more-concentrated success is not mirrored, however, at the World Cup level. With players' skills sharpened by European club experience, an increasing number of poorer countries have become globally competitive. Thus, the last five World Cups have each featured in the quarterfinals, on average, two teams that had never advanced that far before. And the arrival of these newcomers has *not* led to more blowouts: the average goal differential, from quarterfinals onward, in the last five World Cups has been one goal, versus an average differential of two goals in the first five postwar cups. Clearly, the lack of cross-border labor mobility has led to very different outcomes from club play.

Increased parity at the country level does not, however, mean that all international differences have been ironed out. Detailed statistical analysis of the determinants of the official FIFA rankings sheds some light on the matter. Generally speaking, large countries with Latin cultural origins rank highly, as do countries with temperate climates and high per-capita incomes (up to a point).[8]

Cross-border movements of capital as well as labor merit consideration. Recent years have seen several English Premiership clubs bought out by foreign investors (e.g., Chelsea by Roman Abramovitch). But attempts at foreign investment in Brazilian clubs, for example, have clearly not worked well. Consider the sad tale of Dallas-based buyout firm Hicks, Muse, Tate & Furst and its 1999 decision to invest in Brazilian football. As a company partner put it at the time: "It's hard to imagine a better sector in which to invest in Brazil. If you add up all the fans of professional baseball, basketball, football and hockey in the United States, that number is lower than the number of Brazilians who are soccer fans."[9] Based on this crude arithmetic, Hicks, Muse, assumed control of business dealings for Corinthians, São Paulo's leading club. And it invested more than $60 million in the team in the first year of a ten-year contract.

Unfortunately for Hicks, Muse, the Brazilian club circuit was as politicized and corrupt as the Brazilian style of play was captivating. Corinthians won the World Club championship in 2000, but its performance subsequently slumped, and fans began to protest bitterly against trades of key players, changes in the colors of jerseys, and the addition of advertising. In 2003, amid a row with its local partners, whom it accused of misappropriating funds, Hicks, Muse exited—as did two other foreign groups that had invested in Brazilian football at roughly the same time.

What does this brief discussion of football tell us about globalization—and about global strategy, which is the focus of this book?

- Football's global progress mirrors that of many economic indicators of globalization: there was a peak before World War I, followed by a reversal during and between the two world wars, and then a revival after World War II. The revival has, along a number of dimensions, led to new records being set. At the same time, football's failure to gain traction in the United States, by far the world's largest sports market, reminds us that despite the new records, globalization remains, in many respects, uneven and incomplete. Chapter 1 applies these themes from football to the broader context of globalization.

- Football's failure, so far, in the United States is just one indicator of the continued importance of the differences across countries. Others include the roles that Latin cultures, reasonable temperatures, and threshold levels of economic development play in explaining various countries' success in the FIFA rankings. And restrictions on cross-border labor mobility in World Cup play but not club play highlight the continuing importance of administrative and institutional factors, as does the more favorable record of foreign investment in English clubs than in Brazilian ones. These factors prefigure a framework for thinking about cross-border differences: the CAGE framework, developed in chapter 2, that highlights the cultural, administrative, geographic, and economic differences between countries.
- The story of Hicks, Muse, Tate & Furst's investing in Brazil also illustrates what is probably the most common bias in evaluating cross-border strategies: an emphasis on "size-ism," which fails to appreciate the persistence of differences between countries. Chapter 3 discusses a general structure for evaluating the cross-border effects of strategic moves—the ADDING Value scorecard—that goes beyond a focus on size and economies of size.
- The strategies followed by football clubs exhibit a range of approaches for dealing with the differences between locations. I refer to these approaches as AAA (adaptation, aggregation, and arbitrage) strategies. Many clubs have focused on forging a local identity, that is, *adapting* to particular locations. But there are also clubs that have *aggregated* across borders (e.g., Real Madrid's global merchandise sales). And some clubs in poor countries feed talent to richer counterparts; that is, the poorer clubs assist in *arbitrage*. Arbitrage is also prominent in at least some cross-border investments and in the manufacture of a specialized input, footballs: the Pakistani city of Sialkot has been a famous production hub for close to one hundred years and still accounts for the bulk of world production.[10] The strategies of adaptation to adjust to differences, aggregation to overcome differences, and arbitrage to exploit differences are the

topics of chapters 4, 5, and 6, respectively. Chapter 7 is integrative: it examines the extent to which it is possible to mix and match across these AAA strategies for dealing with differences, given their different requirements.

- Finally, the description of football has focused on the state of play as of the end of 2006. But changes cannot be ruled out. For example, FIFA president Sepp Blatter has railed against the dominance of the richest European clubs and, relatedly, the free transfer of players across clubs, comparing the latter to slavery.[11] Analogously, there are always negative portents about globalization to fuel debates about whether it will stall or go into reverse. Chapter 8 uses the insights developed in the earlier chapters to discuss how you should think about such debates—and what your company can do *now* to build a path to a better future.

To recap, what is different about this book about global strategy is its focus on the differences across countries. The idea is to help businesses cross borders profitably by seeing the world as it really is, rather than in idealized terms. To achieve this objective, the book embodies what might be called the three Rs. First, the book is *readable* because of its unified point of view, its concision, the provision of boxed summaries for each chapter, and its use of numerous examples. (Additional examples and discussion can be found on my Web site, http://www.ghemawat.org.) Second, the book is *relevant* for business policymakers because I have written it around their needs (although it may also interest public policymakers or others seeking to understand cross-border business) and have kept the discussion grounded in reality by focusing on value creation and capture. Also important in this regard is the ease with which companies from different parts of the world can customize the frameworks presented—which suggests some obvious follow-on exercises. And third, the book is *rigorous* in the sense of drawing on research in a variety of fields—including international economics, industrial organization, business strategy, and international business—as well as extensive interactions with practitioners.

PART 1

Value in a World of Differences

CHAPTER 1 SUMMARIZES evidence that the current state of the world is one of *semiglobalization*: levels of cross-border integration are generally increasing and, in many instances, setting new records, but fall far short of complete integration and will continue to do so for decades. The chapter goes on to explain why semiglobalization is essential for cross-border strategies to have distinctive content—as well as why failing to keep it in view can be a recipe for poor performance.

Chapter 2 collects the reasons that borders still matter and classifies them in terms of the cultural, administrative, geographic, and economic (CAGE) distances between countries. This framework is usually best applied at the industry level because different types of distance vary greatly in importance from industry to industry. But in most industries, countries of origin *do* have important implications for destinations—a point that mostly eludes more established frameworks for country analysis.

Chapter 3 discusses *why*—if at all—firms should globalize in a world in which distance still matters. It presents a scorecard for tracking value creation that includes but goes beyond the familiar components of size and economies of size. It also supplies a set of analytical guidelines and a list of specific questions to ask—and answer. The aim is to foster more realism about how cross-border strategies will add value in the face of large cross-border differences. Such strategies themselves are the topic of part 2 of this book.

1

Semiglobalization and Strategy

The globalization of markets is at hand. With that, the multinational commercial world nears its end, and so does the multinational corporation . . . The multinational corporation operates in a number of countries, and adjusts its products and processes in each, at high relative cost. The global corporation operates with resolute constancy . . . it sells the same things in the same way everywhere.

—Ted Levitt, "The Globalization of Markets," 1983

A QUARTER OF A CENTURY after Ted Levitt's bold pronouncements, excitement about the globalization of markets has given way to excitement about the globalization of production.[1] But what has remained constant is the vision of a globalization apocalypse, sweeping all before it. And this apocalyptic vision leads to a focus on strategies for a post-apocalyptic, integrated world—strategies that inevitably have a one-size-fits-all character. That is why Levitt's definition of global strategy as a strategy for an integrated world still reigns.[2]

And, with apologies to my late colleague at the Harvard Business School, that definition is still as wrongheaded. In this book, I redefine global strategy to describe a broader set of strategic possibilities. I argue that differences between countries are larger than generally acknowledged. As a result, strategies that presume complete global integration tend to place far too much emphasis on international standardization and scalar expansion.

While it is, of course, important to take advantage of similarities across borders, it is also critical to address differences. In the near and medium term, effective cross-border strategies will reckon with both, that is, with the reality that I call *semiglobalization*. The primary goal of this book is to stretch our thinking about cross-border strategies for a semiglobalized world.

This chapter begins by establishing that semiglobalization is, in fact, the real state of the world today—and tomorrow. It does so by taking some data on board, because, as the late Daniel Patrick Moynihan observed, we are all entitled to our own opinions, but not our own facts. The chapter then starts to address the implications for company strategy, using the example of one of the great border-crossing companies, Coca-Cola. Around the time that Levitt's article appeared, Coke embarked on a global strategy of the sort that he recommended. The problems with that strategy took a while to surface, but by the millennium, Coke was adrift in a sea of troubles. Only recently has it started to regain its bearings. Other companies can either learn from Coke's experience or rediscover the same lessons about semiglobalization the hard way, through trial and error.

Apocalypse Now?

According to the Library of Congress catalog, we are positively awash in books on globalization. More than *five thousand* such books were published between 2000 and 2004, compared with fewer than five hundred in the whole of the 1990s. In fact, between the mid-1990s and 2003, the rate of increase in globalization-related titles—more than doubling every eighteen months—surpassed the celebrated Moore's Law!

Amid all this clutter, the books on globalization that *have* managed to attract significant attention have done so by painting visions of a "globalization apocalypse." These volumes tend to exhibit what scholars cite as general characteristics of apocalyptic argumentation: emotional rather than cerebral appeals, reliance on prophecy, semiotic arousal (i.e., treating everything as a sign), an emphasis on creating "new" people, and, perhaps above all, a clamor for attention.[3] The Flattening of the Earth is the globalization apocalypse that occupies center stage as of this writing.[4] Thus, during a recent TV interview, the first question I was asked—quite earnestly—was why I still thought the world was round![5] But other visions of the globalization apocalypse have been propounded as well: the Death of Distance, the End of History, or Levitt's own favorite, the Convergence of Tastes. Some writers in this vein view the apocalypse as a good thing—an escape from the ancient tribal rifts that have divided humans, or an opportunity to sell the same thing to everyone on earth.

Others see it as a bad thing: a process that will lead to everyone eating the same fast food. But they all tend to assume (or predict) nearly complete internationalization.

This is where I disagree strenuously, but on the basis of data rather than opinion. *Most types of economic activity that can be conducted either within or across borders are still quite localized by country.*

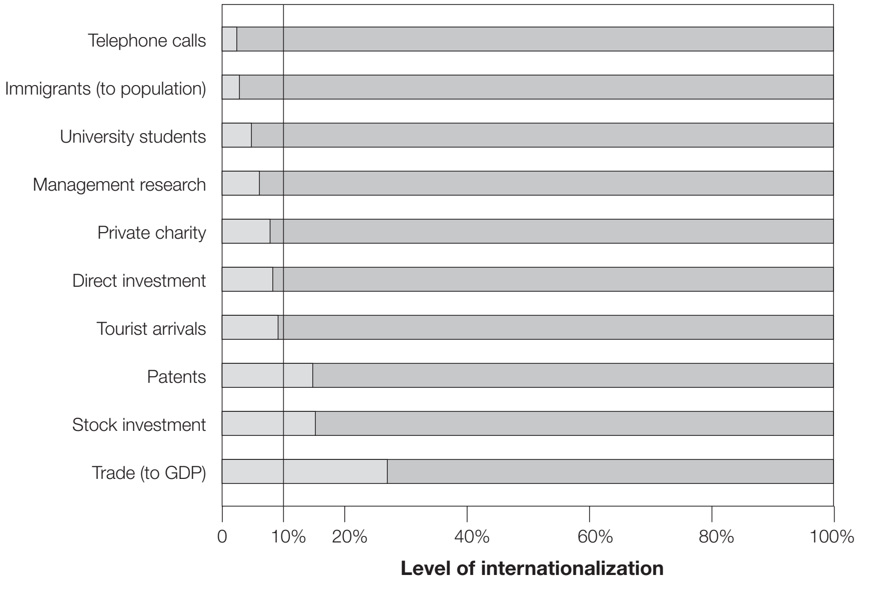
Ask yourself, for example, how large total foreign direct investment (FDI) flows are in relation to gross global fixed capital formation. (To put it another way, of all the capital being invested around the world, how much is being done by companies outside their home countries?) Maybe you've heard the rhetoric about "investment knowing no boundaries," and so on. The fact is, the ratio of FDI to overall fixed capital formation has been less than 10 percent for each of the last three years for which data are available (2003–2005). In other words, FDI accounts for less than a dime out of every capital dollar invested—or significantly less if one recognizes that much of FDI involves mergers and acquisitions, that is, investment that doesn't actually generate incremental capital expenditures. And although merger waves can push the ratio of FDI to gross fixed capital formation to higher than 10 percent, the ratio has never quite reached 20 percent.[6]

FDI isn't an isolated, unrepresentative example. Figure 1-1 summarizes data on internationalization along ten dimensions. As you can see, the levels of internationalization along these dimensions all cluster much closer to 10 percent—which also happens to be the average across the ten categories—than to 100 percent.[7] The biggest exception in absolute terms—the trade-to-GDP ratio shown at the bottom of the figure—probably recedes most of the way back toward 20 percent if you adjust for double-counting.[8] So if I had to guess the internationalization level of some activity about which I had no particular information, I would guess it to be much closer to 10 percent than to 100 percent! I call this the "10 percent presumption."

The 10 percent presumption notwithstanding, I prefer to talk of semiglobalization rather than "deciglobalization." One reason is that 10 percent is not meant to be any kind of global constant: my best guess is that the next few decades will witness increased internationalization of many of the categories in figure 1-1, and a (slow) upward drift in their average. Second, if internationalization levels *are* setting new records in many respects, international activity probably warrants a share of attention that exceeds its current share of total economic activity—it is increasingly important and its surge is taking it into uncharted territory. Third, business interest in internationalization may also exceed general internationalization levels because businesses have some distinct advantages—as well as disadvantages—compared with other channels for cross-border coordination. Thus, the largest companies are significantly more internationalized than

FIGURE 1-1

The 10 percent presumption



Note: The measures are defined as follows. **Telephone calls:** international component of total calling minutes; **immigrants (to population):** stock of long-term international immigrants as a percentage of global population; **university students:** foreign students as a percentage of total OECD university enrollment; **management research:** percentage of research papers with a cross-border component; **private charity:** international component of U.S. private giving; **direct investment:** foreign direct investment flows as a percentage of gross global fixed capital formation; **tourist arrivals:** international arrivals as percentage of total tourist arrivals; **patents:** patents of OECD residents involving international cooperation; **stock investment:** international component of U.S. investors' stock holdings; **trade (to GDP):** global exports of merchandise and nonfactor services as a percentage of global gross domestic product (GDP).

Sources: Data are presented for as close to 2004 as possible and are for that year unless noted otherwise. The figure for phone calls is based on data from the International Telecommunications Union's telecom database and is for 2001, although coverage drops off sharply, as of this writing, for more recent years. The estimate of the stock of long-term international immigrants is based on UNESCO, International Organization for Migration, *World Migration 2005: Costs and Benefits of International Migration* (Geneva: International Organization for Migration, June 2005). The data on foreigners among university students is from and for OECD (Organisation for Economic Co-operation and Development) countries and excludes Mexico and Luxembourg; see *OECD Education Online Database* (English) in OECD Statistics version 3.0. The figure for management research is drawn from Steve Werner, "Recent Developments in International Management Research: A Review of 20 Top Management Journals," *Journal of Management* 28 (2002): 277–305. The (generous) estimate for the international component of private charitable giving is for the United States only and was supplied by Geneva Global. The internationalization of direct investment is measured by dividing FDI flows by gross fixed capital formation; the internationalization of trade (merchandise and nonfactor services) is calculated by dividing FDI by gross domestic product (GDP), with all data taken from the *World Investment Report* issued annually by the U.N. Conference on Trade and Development (UNCTAD). The estimate for tourist arrivals is based on estimates by the World Tourism and Travel Council for 2000. The patent data are drawn from OECD, *Science, Technology and Industry Scoreboard 2005*. Data on portfolio investment are for U.S. investors' stockholdings, as reported and analyzed in Bong-Chan Kho, René M. Stulz, and Francis E. Warnock, "Financial Globalization, Governance, and the Evolution of the Home Bias," working paper (June 2006). Available at SSRN: http://ssrn.com/abstract=911595.