



University of Navarra

Center for Globalization and Strategy

Notes on Globalization and Strategy

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BEYOND GLOBALIZATION AND ITS MYTHS

Learning to Love Diversity



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In our book *From Local Champions to Global Masters*, we make the case that the slogan "internationalize or die" has rushed many businesses into going global without pausing to think either how or why.

Let us begin with some of the "givens" that underpin thinking on globalization and that have created a climate of "go global or go bust." First, we're told, the volume of trade between countries around the world has never been so great and trade and communications barriers are falling. At the same time, clients want and buy the same products around the world. Companies are stateless, and possess a generic management style, such that it no longer matters where a company comes from.

Fact or Fiction?

But are these facts little more than myths? It has been cogently argued that the world is no more integrated than it was in the 19th century, that globalization is only picking up from where it left off in 1914, that the process is neither new, nor advanced nor irreversible. Furthermore, there is

The many myths about globalization have led businesses to believe it is a case of "internationalize or die," causing them to rush into going global without pausing to think how or why.

as much evidence of divergence as of convergence in consumer tastes, and that globalization can actually serve to strengthen national differences rather than erode them.

And not only are there still significant differences in the corporate cultures of, say, Japanese, German and U.S. multinationals. The image of companies as "stateless" does not hold up either, not in terms of the composition of the boardroom, the nationality of major shareholders or the "transnationality" of their operations. Companies such as Coca-Cola, McDonald's and AOL are directing their efforts towards more localization.

Why Go Global?

When companies say they are going global, do they know why? Or what they need to do or how to do it? Our view is that internationalization is a process of change and transformation. There are many symptoms of strategic malfunction among some companies. In many cases, internationalization has not brought growth; profits may be up, but not profitability; local managers complain

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Internationalization is a management challenge. It involves changing objectives, on paper and in the heads of people.

Growth and internationalization “for the sake of it” is dangerous and risky. Achieving growth should not be the basis of strategy. It should be the result or the measure of a good strategy.

Those who reduce globalization to “one-size-fits-all” approaches have clearly missed or will miss most of the message of the global market place.

that HQ doesn't understand the local market; the organization seems too (de)centralized. Any one of these scenarios suggests that the why-what-how paradigm needs to be addressed.

Many companies today merely employ a variety of slogans, such as: “There is no more growth in our home market, so we have to go abroad,” “only a few large, international players will survive in our industry,” or “our clients are internationalizing, so we have to follow them.”

Is Bigger Always Better?

Even in so-called “global” industries, non-global companies will survive and may even outperform the global companies. On the other hand if, like Gillette, you invest \$700 million in developing the new Mach3 razor, the only way you can recoup your investment is through global marketing and... the rest is history now, as Gillette was taken over by P&G, which backtracked from a simplistic global strategy towards renewed attention to local markets.

The key is not what type of player you have to be. When you ignore the other strategic, often real bases for success in your business, you risk the syndrome of “internationalize and die.”

If you expand for scale reasons, you still have to ensure that the economies materialize to their full extent. A company is a living mechanism, where a lot of things can happen to prevent getting the maximum economies of scale. “Management, not mass, is what matters ... It is critical men rather than critical mass that matters.” (*Financial Times*, March 28, 1998).

This notion of being where the market is resembles a portfolio approach to business. You go to all geographies where you think there is a market for your services or products. The question remains: how does it add value for you to be in these different markets? Being there could be nice, but is it crucial? And will it provide you with a true advantage over local competitors over there or over your local competitors back home? Growth and internationalization “for the sake of it” is dangerous and risky. Growth should be the result of doing something right. The trigger, we believe, lies in identifying what it

is you can do right or better by entering foreign markets. The list of those who have got it wrong is long and should sound a cautionary note – and many companies that are household names have appeared on this list at some points in time. They include Daf trucks, Saatchi and Saatchi, Marks & Spencer, Procter & Gamble, Coca-Cola, ABN-Amro, Daimler-Chrysler and ING.

Nor does the now or never approach to expansion make for clear thinking. The image of the endgame has frequently been used to dramatize developments in the European markets. We saw it with the hype of “Europe 1992”: Europe was supposedly going to become a borderless market as of the magical January 1, 1993. But Europe did not change overnight. A climax swelled around the introduction of the euro in January 1999. The expectation was that Europe was going to change into an integrated market because of a new accounting unit and currency. Mature reflections indicate that for many companies, it remained to a large extent business as usual.

Managing Diversity

In conclusion, we contend that globalization has more to do with managing diversity than with standardization. A real globalization of your business will allow you to explore your capacity to manage complexity and to enter new markets conscious of their differences and nuances. Globalization is strategic for the simple reason that it forces you to analyze the essence of your strategy, your management structures and practices, and to ask what are your criteria for success.

Those who reduce globalization to “one-size-fits-all” approaches have clearly missed or will miss most of the message of the global market integration. We believe there are as many opportunities for localization, leveraging diversity, maximizing rather than minimizing differentiation and developing “multi-whatever” strategies.

The global masters will be those companies that succeed in managing different degrees and speeds of internationalization and globalization across different units, departments, functions, products, client segments, processes or other dimensions.

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From the Gold Standard to the Gold Card

Globalization is not a new phenomenon but there are crucial differences between the first, and imperial, era of globalization and the contemporary picture.



Niall Ferguson
*Laurence A. Tisch
Professor of History,
Harvard University.*

Between 1880 and 1914, the world experienced an era of globalization (“globalization one”), that was in fact a more extraordinary phenomenon than the current situation (“globalization two”). The most striking difference between now and the last period of globalization was there was so much mobility; with migration at a higher level than today. “Globalization one” was more global, because capital flowed to the whole world, including very poor countries, whereas today most capital flows are actually within the rich world.

There are many similarities between the two ages of globalization, but there are also many important differences. One of them is that there were many fewer people; this was not a world of 6 billion people but of 1 billion. Monetary issues were very different. A hundred years ago most countries, with very few exceptions, were on the gold standard. We today live in a world of paper money and nobody knows from one day to the next how much the dollar is going to be worth.

The Age of Empire

The first stage of globalization was an age of empire. Twenty-five percent of the world’s population was under some kind of British rule; a third of the world was under European rule. Most people, or 80 percent, lived in empires, if you include the Chinese and Ottoman empires. But the most important was the English-speaking empire and one reason this empire was so powerful is that it was a capital exporter; it was the world’s banker. London was a channel through which money poured to the rest of the world in the form of portfolio and direct investment, and the British had the power that the lender has.

Now today we live in a different world. The empires have largely gone but there are still

shadow empires, and the United States is clearly one. China is another, Russia a third and you might also include Iran as the heir of the Persian empire. But in a way the American empire is weaker than its predecessor, because the American empire is not a creditor but a debtor empire. Billions and billions of dollars have to be borrowed abroad by the United States to finance its current account deficit. We are now in the situation where the United States, which claims to be the big power, is in fact running an overdraft at the People’s Bank of China.

Multiple Futures

It’s important to understand that there is no such thing as the future, there are only futures. The important thing is to be contemplating more than one future. Those who say that China will be equal to the U.S. in GDP in 2027 are really only offering one future and this future is a linear one. It is based on the idea that China will continue to grow at rate of 9 or 10 percent and the U.S. between 2 and 4 percent. The idea is that we will get there as though by drawing lines. That is not how history works. In every Asian economic miracle there has been at least one major financial crisis that has set back the country.

But aside from financial crises, there are other things that can go wrong. The Chinese environmental situation is dire, as a consequence of breakneck industrialization without private property rights. Nobody in China can stop the state or a private enterprise from causing lethal environmental damage because nobody has any private property rights to protect. My sense is that, even before a financial crisis, China may face an ecological crisis of its own making. And they will look back from 30 years hence and laugh that we thought they would overtake the U.S. – remember, we thought that Japan would overtake the U.S. back in the 1970s and 1980s.

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Pankaj Ghemawat
Professor of General
Management, IESE

When it comes to global strategy, most business leaders and academics make two problematic assumptions.

How to Choose Your Global Strategy

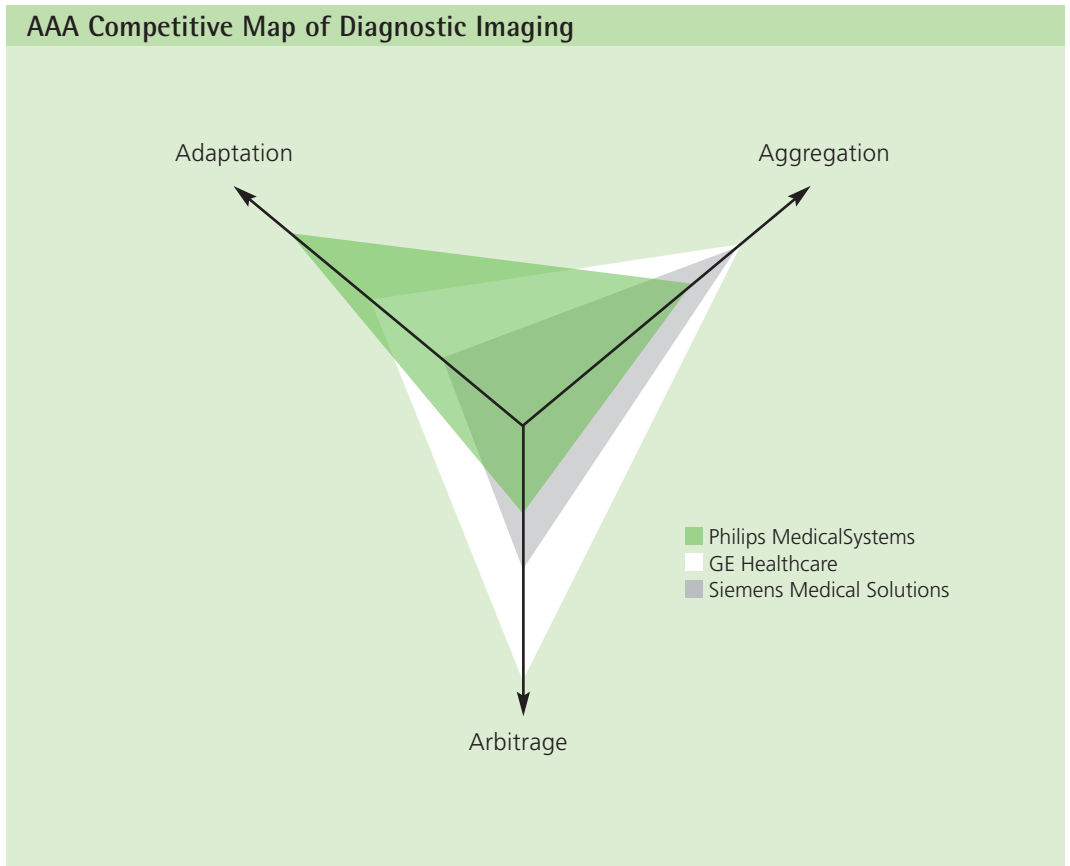
Pankaj Ghemawat proposes a framework for approaching global integration that he calls the AAA triangle – Adaptation, Aggregation, Arbitrage – in order to strike a balance between economies of scale and responsiveness to local conditions.

When it comes to global strategy, most business leaders and academics make two assumptions: first, that the central challenge is to strike the right balance between economies of scale and responsiveness to local conditions; and second, that the more emphasis companies place on scale economies in their worldwide operations, the more global their strategies will be.

These assumptions are problematic. The main goal of any global strategy must be to manage the large differences that arise at borders,

however they are defined. Moreover, assuming that the principal tension in global strategy is between scale economies and local responsiveness encourages companies to ignore another viable strategy: arbitrage.

In this article, I present a new framework for approaching global integration that gets around the problems outlined above. I call it the AAA Triangle. The three A's stand for the three distinct types of global strategy. *Adaptation* seeks to boost revenues and market share by adapt-



Source: Ghemawat, P., "Redefining Global Strategy", Harvard Business School Press, 2007.

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ing the firm's products or services to the local context. *Aggregation* attempts to deliver economies of scale by creating regional or sometimes global operations; it involves standardizing the product or service offering, grouping together activities such as development, production and marketing at a regional level or by languages, etc. *Arbitrage* is the exploitation of differences between national or regional markets, often by locating separate parts of the supply chain in different places – for instance, call centres in India, factories in China and retail stores in Western Europe. Different ways of operationalizing these three broad strategies are discussed in detail in my book, *Redefining Global Strategy* (Harvard Business School Press, 2007).

Because most border-crossing enterprises will draw from all three As to some extent, the framework can be used to develop a summary scorecard indicating how well the company is globalizing. However, because of the significant tensions within and among the approaches, it's not enough to tick off the boxes corresponding to all three. Strategic choice requires some degree of prioritization—and the framework can help with that as well.

Understanding the AAA Triangle

The three As are associated with different organizational types. If a company is emphasizing adaptation, it probably has a country-centered organization. If aggregation is the primary objective, cross-border groupings of various sorts — global business units or product divisions, regional structures, global accounts, and so on — make sense. An emphasis on arbitrage is often best pursued by a vertical, or functional, organization that pays explicit attention to the balancing of supply and demand within and across organizational boundaries. Clearly, not all three modes of organizing can take precedence in one organization at the same time. And although some approaches to corporate organization (such as the matrix) can combine elements of more than one pure mode, they carry costs in terms of managerial complexity. A few leading-edge companies are pursuing AA strategies, such as Tata Consultancy Services (aggregation and arbitrage) and P&G (adaptation and aggregation).

Some companies have emphasized different As at different points in their evolution. For example, IBM traditionally focused on adaptation and was organized into small, fairly complete branches of IBM in different countries. Subsequently, when its activities increased at a much larger international scale, IBM chose to aggregate the different countries into regions. It is only more recently that IBM has been involved in arbitrage, specifically, in exploiting wage differences.

Strategic Choices

Philips Medical Systems (PMS) offers a good opportunity to see how the AAA triangle can help companies devise good global strategies in lieu of its competitors. PMS is much smaller than its other two major competitors in the diagnostic-imaging industry. PMS has been focusing largely on connecting its disparate parts and it has also lagged behind its competitors in arbitrage activities. For example, PMS began its manufacturing joint-venture in China in 2004, with the export operations scheduled for 2006 at levels that were achieved by its competitor GE in 2001.

Given its historical emphasis on adaptation and its competitive position, it would be very difficult for PMS to beat its competitors, GE and Siemens, in terms of aggregation or arbitrage front. Two AA strategy choices – adaptation-aggregation or adaptation-arbitrage – are probably more promising. In addition, of course, there is always room for creativity in changing the game: thus, PMS has also tried a lateral shift to a new business area, personal medical devices, which combines its strengths in medical systems and in consumer electronics. The broader point of this example is that the appropriate emphasis across the AAA strategies depends on industry conditions and competitive position.

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Pankaj Ghemawat
Professor of General
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The world isn't flat because most types of economic activity that could be carried out within or across national borders are actually still quite concentrated domestically.

The World is Not Flat

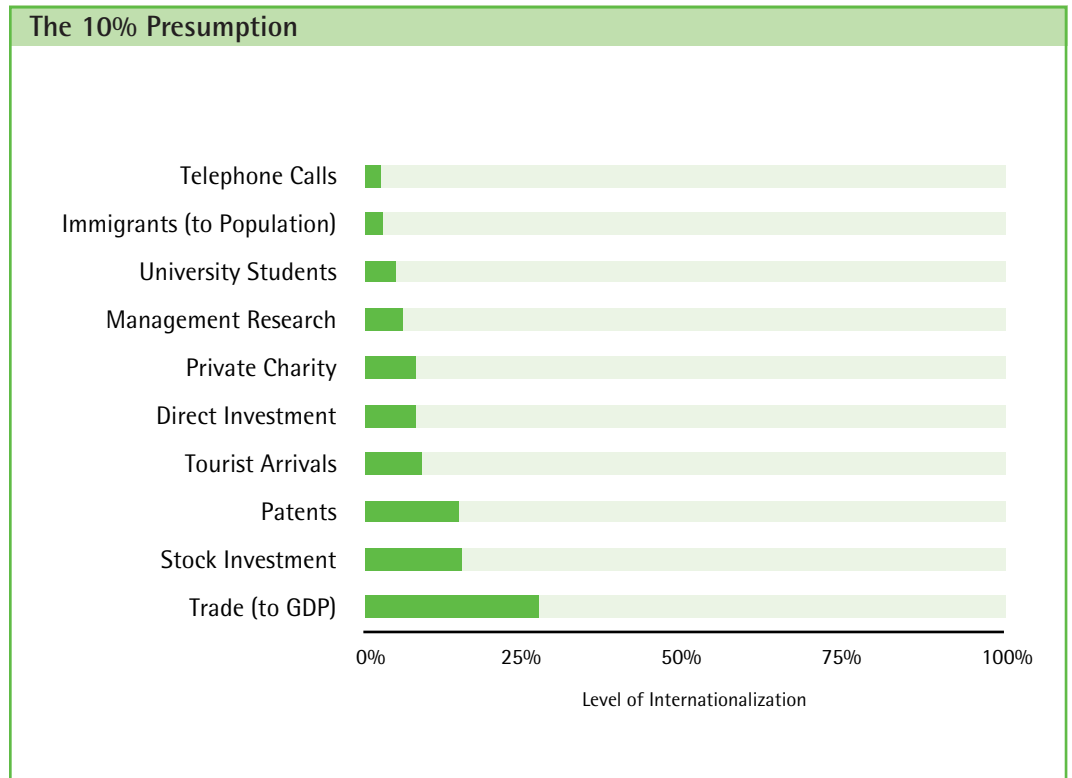
Prof. Pankaj Ghemawat comments on New York Times writer, Thomas L. Friedman's latest book, *The World is Flat*. Prof. Ghemawat makes clear that we continue to live in a world with frontiers and cultural differences where the field of global competitiveness is far from level.

Why Isn't the World Flat?

The world isn't flat because most types of economic activity that *could* be carried out within or across national borders are actually still quite concentrated domestically. Consider a few examples (that you may want to test out your intuitions about, before looking at the answers below).

As the chart below demonstrates, the levels of internationalization associated with telephone calls, cross-border migration, direct investment, stock investment, and trade as a fraction of

gross domestic product (GDP) all stand much closer to 10 percent than the levels close to 100 percent predicted by many globalization gurus. The biggest exception in absolute terms – the trade-to-GDP ratio shown at the bottom of the chart – recedes most of the way back to 20 percent if you adjust for double-counting. So if someone asked me 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 – also the average for the 10 categories of data in the chart – than to 100 percent. I call this the “10 Percent Presumption.”



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But Doesn't Globalization Have a Levelling Effect?

Some measures of internationalization, e.g., immigration, appear to have peaked before World War I. For others, e.g., direct investment, new records are being set, but this has happened only relatively recently. And finally, while there are measures along which pre-World War I levels of integration were surpassed relatively early in the post-World War II period, e.g., trade, note that the trade-to-GDP ratio has increased from 20 percent in 1979 to 27 percent by 2004. Extrapolating over the next 25 years would imply a trade-to-GDP ratio of less than 35 percent by 2030 – or perhaps closer to 30 percent, if one stripped out the effects of double-counting. Unprecedented yes, but hardly apocalyptic. Which is why international economists still focus on explaining shortfalls from complete integration rather than rapid progress towards that extreme state.

Is There a Magic Formula to Resolve the Local-Global Dilemma?

My redefinition of global strategy as being about differences actually represents an attempt to get around the rhetorical and conceptual limitations of the local vs global perspective on global strategy. From a rhetorical perspective, slogans such as “think global, act local” are meant to steer companies towards a sensible middle ground, but their vagueness has allowed them to be hijacked to promote extreme agendas. For example, Roberto Goizueta, the late Chairman of Coca-Cola, used that slogan to justify extreme standardization while, at the opposite end of the spectrum, Orit Gadiesh, the Chairman of Bain and Company, uses a variant to encourage extreme localization. Since people now apply “think global, act local” to the full spectrum of possibilities, from the most standardized to the most localized, it no longer means anything in particular.

A second, even more fundamental problem with framing the challenge of global strategy as striking a balance between the extremes of local customization and global standardization is that these extremes do not so much span a strategy continuum as correspond to two singularities in

which cross-border complexities can be finessed and simple single-country approaches applied. To see this, note that if markets were *totally segmented* from each other, single-country approaches to strategy could be applied country by country and would imply complete localization; at the other extreme, if markets were totally integrated, there would be the equivalent of one very big country, and single-country approaches would work once again, although complete standardization rather than localization would be the implied strategy. These extremes – and linear combinations of them – are not, therefore the best reference points for a strategy that seeks to take cross-border complexities seriously.

Have Advances in Telecommunications Rendered the World Flat?

No. I've already mentioned above that the percentage of telephone call minutes accounted for by cross-border calls is less than 5 percent. To cite another example, the best available estimates indicate that only 20 percent of the bits transmitted over the Internet – an allegedly totally global medium – actually cross borders. Furthermore, there is general agreement that the international and particularly intercontinental share of Internet traffic is actually decreasing over time!

In addition, even where telecommunications reduce the effects of geographic distance, other kinds of distance that loom large at national borders in particular continue to matter: *cultural* (language, customs, religion, ethnicities, etc.), *administrative/political* (laws, trading blocks, colonial ties, currency, etc) *geographic* (physical distance, lack of land border, time zones, climates, etc) and *economic* (income levels, cost of natural resources, financial resources, human resources, infrastructure, information, etc.). It is important to take a broad view of such differences, to figure out the ones that matter the most in your industry, and to look at them not just as difficulties to be overcome, but also as potential sources of value creation.

From a rhetorical perspective, slogans such as “think global, act local” are meant to steer companies towards a sensible middle ground, but their vagueness has allowed them to be hijacked to promote extreme agendas



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THE CENTER REPORTS

The **Colloquium on Globalization of Business Education** was held October 4-6, 2007 at the IESE campus in Barcelona. The key organizer of the event was Pankaj Ghemawat, IESE professor and chair of the Anselmo Rubiralta Center for Globalization and Strategy. During the sessions, participants analyzed and debated the challenges faced by business schools in the wake of economic globalization. One of the first topics under discussion was how to incorporate our knowledge of globalization into the syllabus of both MBA and executive education programs. Among those who attended the conference were 40 representatives of leading business schools, including Ann Von Glinow, from Florida International University, and Sourmita Dutta, from INSEAD Business School, both of whom chaired sessions.



The **Offshoring Research Network** project is embarking on its second phase. Following its first report on the offshoring of services in Spain, the IESE team now hopes to explore the subject in greater

depth and breadth. If you wish, you can participate in the study by completing a questionnaire whose main goal is to identify the key factors involved in offshoring decisions, and their risks and outcomes. If you are an executive contributing toward your company's strategy, and would like to participate, please contact ftorres@iese.edu.

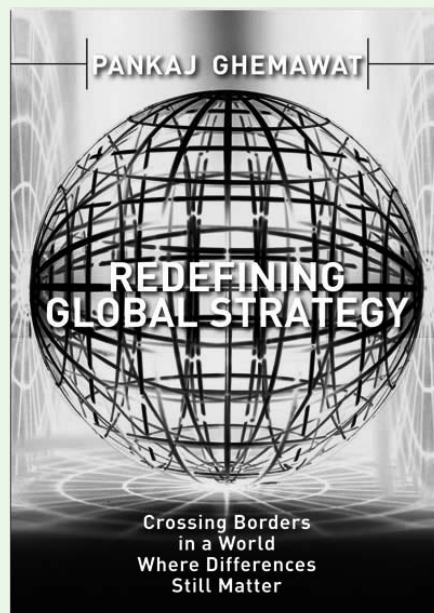
For more information: www2.iese.edu/offshoring

The Center for Globalization and Strategy of IESE and KPMG has started a new research project on **Strategic Alliances and Joint Ventures**. The project is coled by Prof. Africa Ariño and Prof. Pinar Ozcan, both of IESE Business School. One of the aspects of strategic alliances that is still underexplored is the pre-operational stage. While it is relatively easy to observe the development of an alliance and the changes it goes through over time, it is much more difficult to lay out the decision-making process that leads to the operationalization of the alliance. Understanding this pre-alliance process is important because the choices made at that stage are arguably among the most critical in obtaining maximum benefits at the later stages.

This study therefore focuses on the pre-operational stage of strategic alliances in order to identify:

- Key criteria in the pre-alliance decision-making process.
- Key factors for success in global strategic alliances.

Latest publications: Pankaj Ghemawat has just published his new book, *Redefining Global Strategy*, a work which breaks away from the widespread myth that globalization has created a flat and interconnected world. His book argues that borders are still of great importance in the present world, and that as long as businesses continue to ignore this fact they run the risk of encountering problems that could, and should, have been anticipated. Professor Ghemawat also talks about the forces shaping globalization and proposes strategies for succeeding across borders.



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