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Redefining Global Strategy

Over the past few years, scholars and pundits have proclaimed the "flattening of the world" as globalization erased differences across countries. IESE's Anselmo Rubiralta Professor of Global Strategy, Pankaj Ghemawat, debunked this myth in his book, *Redefining Global Strategy*, which was recently awarded the IESE Alumni Committee's Research Excellence Award.

My book, *Redefining Global Strategy*, which the IESE Alumni Committee has been kind enough to honor with its Research Excellence Award, was based on a decade of researching, casewriting, teaching and consulting about global strategy. Given market conditions, it was positioned as the antidote to books that breathlessly proclaim the end of history, the death of distance, the flattening of the world, and the disappearance of differences across countries. Such proclamations of apocalypse now or in the near term, while helpful in generating headlines, are plain wrong. Consider the cross-border component of various economic flows that can occur within as well as across borders.

- **Products**. Trade accounts for about 27 percent of global GDP, but that percentage recedes towards 20 percent if we strip out double-counting. And it approaches 10 percent if we focus in on cross-regional trade, because most trade occurs within regions (e.g., the EU).
- **Capital**. Foreign direct investment (FDI) was about 12 percent of global fixed capital formation in 2006 (a record-breaking year). More than one-half of FDI occurs within regions as well. And total capital flows are smaller percentages of GDP than 100 years ago, in the heyday of the gold standard.
- **People**. First-generation immigrants, university students studying abroad and international tourists represent less than 10 percent of the relevant (domestic plus cross-border) totals.
- **Information**. Offshoring accounts for only 10-14 percent of currently offshoreable IT services, themselves only a small fraction of total IT services spending. And probably less than 20 percent of the bits transmitted on the Internet cross national borders—a percentage that is generally agreed to be declining.

These data illustrate the continued importance of borders instead of their impending demise. So the gurus of galloping globalization have gotten it wrong. But they aren't the only ones. Most business people also greatly overestimate cross-border integration—a syndrome I refer to as globaloney. Thus, most of the groups I have surveyed guess most of the cross-border percentages above (with the exception of trade) to be more than three times as high as they actually are. And work experience does not seem to help correct such biases: it may even hurt!

That's all very nice, I can see my less patient readers saying, "but how, beyond cocktail party chatter, does all this matter for business?" My answer, very simply, is that globaloney is more than just a harmless way of getting people to pay more attention to the world out there: that if a business really does act as if borders didn't matter, it will run an elevated risk of falling prey to the oldest trap in international business: assuming that a business model that works well at home should also work overseas.

Executive Summary

In this article, Ghemawat explains how overestimating cross-border integration, a syndrome he refers to as globaloney, can seriously undermine business leaders' overseas strategy. "If a business really does act as if borders didn't matter, it will run an elevated risk of falling prey to the oldest trap in international business: assuming that a business model that works well at home should also work overseas," he states. Instead of swallowing the globaloney, the global strategy professor suggests three broad strategies for dealing with international differences: adaptation to adjust to them, aggregation to overcome them, and arbitrage to exploit them.

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This leads, at best, to strategies that are blander than necessary and, at worst, to market exit after often long (and costly) "online learning."

Even businesses that are generally considered to be very well managed risk falling into this trap. Perhaps the most vivid example of this point, and certainly the largest, is provided by **Wal-Mart**, a company that I have studied for more than 20 years now. **Wal-Mart** now sells more than $100 billion in goods *per quarter*, with three-quarters of that accounted for by sales in its home base of the United States, where it is a lean-mean sales machine that accounts for close to 10 percent of total retail sales. But international stores proved more problematic, especially early on. The company's attitude a few years ago, to paraphrase something that outgoing CEO Lee Scott said in 2004, seemed to be, "If we could move from Arkansas to Alabama, how different can Argentina be?" This is how **Wal-Mart** ended up stocking U.S.-style footballs in Latin America. The diagnosis of excessive standardization around a U.S.-centric model derives from my calculation that, of 50 domestic policies and practices at **Wal-Mart**, only 3 weren't carried over, in some form, to international operations. Also suggestive in this regard is the virtually perfect negative correlation, in 2004, between the profitability of foreign markets for **Wal-Mart** and their distance from its headquarters in the U.S!

But having noted those problems, I must add that **Wal-Mart** is a smart company and has since figured out that just because a particular approach worked at home did not mean that it was going to be the way to grow overseas.

- **Wal-Mart International** is more cognizant of the need to *adapt* to local contexts to achieve local responsiveness. This includes but goes well beyond more localization of merchandising. Thus, since India doesn't allow multibrand foreign retailers, Wal-Mart has formed a joint venture there in which local partner **Bharti** owns the stores and Wal-Mart handles the back-end. And its efforts to make its top management more adaptive are exemplified by Mike Duke's turn as head of International before recently being named CEO.

- **Wal-Mart** also *aggregates* across countries to achieve cross-border scale and scope economies that local competitors cannot. Thus, it leverages globally its IT platform, relationships with key global suppliers, and lessons from different store formats. And it has begun setting up regional headquarters, such as the one in Hong Kong that is meant to oversee operations and business development for all of Asia. As John Menzer, who ran **Wal-Mart International** before Mike Duke, explained to me, "We're playing 3D chess: Global, regional, local."

- And finally, **Wal-Mart** *arbitrages* across countries to achieve absolute cost savings through offshoring, particularly by moving production to China. I estimate that **Wal-Mart** saved more than $10 billion last year through offshore procurement, or more than twice as much as the operating income generated by its 3,000 international stores, and on a much smaller investment base. In other words, arbitrage, instead of being peripheral to **Wal-Mart**'s global strategy, is its single most important component.

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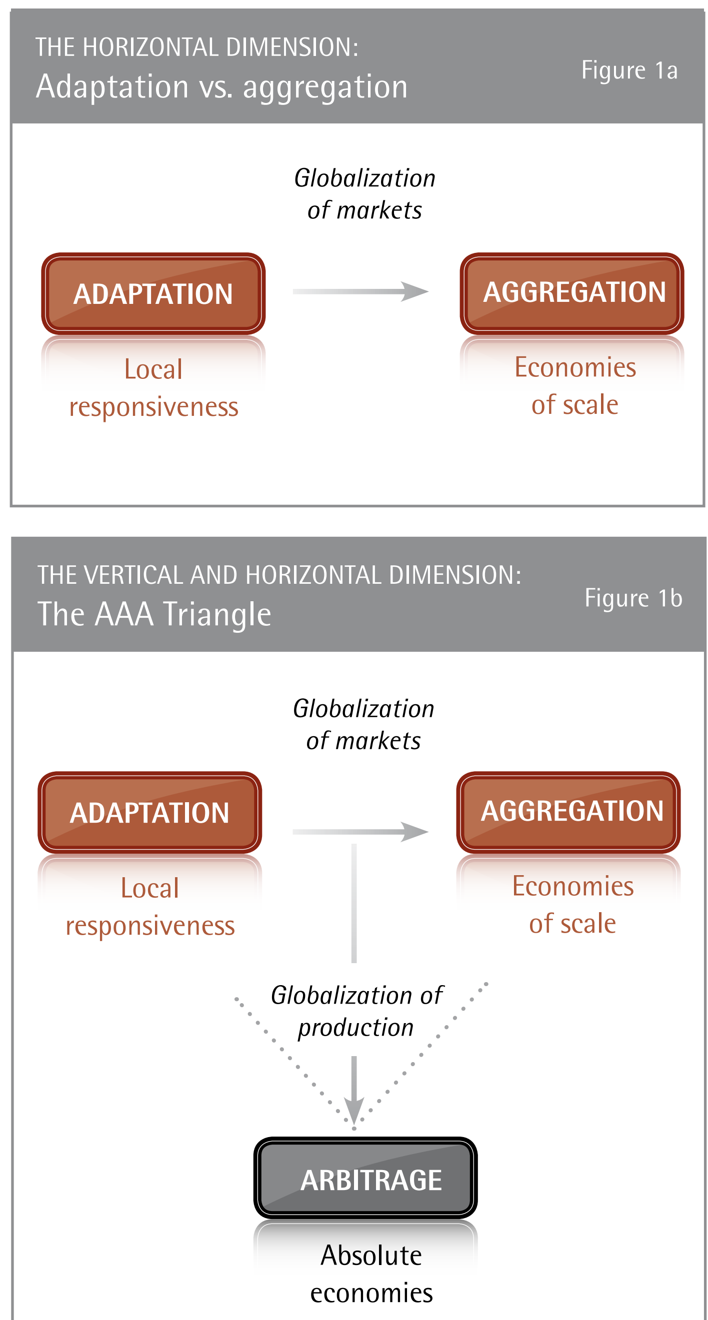
The **Wal-Mart** example illustrates the three broad strategies for dealing with international differences: adaptation to adjust to them, aggregation to overcome them, and arbitrage to exploit them. While the horizontal tension between adaptation and aggregation has long been a staple of research on international business strategy (see Figure 1a), the vertical dimension of arbitrage is a fundamental addition to the strategy set (see Figure 1b), for three reasons.

First, it stretches how we think of differences, as potential sources of value rather than just as constraints on value creation. Second, it fits well with what Tom Stewart, the former editor of the *Harvard Business Review*, neatly encapsulated for me as the shift in interest, over the last decade or two, from the globalization of markets to the globalization of production. The globalization of markets is basically easy to assimilate into horizontal models, but the globalization of production — or what some refer to as trade in tasks — is mostly a vertical phenomenon.

And third, the vertical addition picks up on a fundamental difference flagged by research in economics on the multinational enterprise: vertical MNEs that exploit the differences across countries often have very different operating and organizational characteristics from horizontal MNCs that perform (some of) the same activities in different countries (and that mush together the categories of adaptation and aggregation).

Figure 1b highlights the strategic differences across the Three As. Most fundamentally, the Three As involve the pursuit of different sources of advantage from operating across borders and, relatedly, are associated with different organizational types. If a company is emphasizing adaptation, a country-centered organization is often indicated. 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. And an emphasis on arbitrage is often best pursued by a vertical, or functional, organization that tracks the flow of products or work orders through the organization.

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



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combine elements of more than one pure mode, they carry costs in terms of managerial complexity.

In practice, this conception of strategy as involving fundamental choices collides with the aspirations of energetic managers to do everything well. To reconcile this tension, I typically make three points in discussions with practitioners. First, especially given the headroom that most companies seem to have in making progress along all of the Triple A dimensions, it is useful to set up and use a globalization scorecard—a checklist, if you will—that covers all three dimensions, rather than relying, as often seems to be the case, on just some crude measure of the internationalization of revenues to track progress. Second, the possibility and in fact necessity of progress along all three dimensions does not, because of competitive and organizational constraints, imply attaching equal priority to all three As. Companies that are sensible about their intended positioning either figure out which of the three As

Differences across the Three As — Table 1

Characteristics	Adaptation	Aggregation	Arbitrage
Competitive Advantage: Why globalize at all?	To achieve local relevance through national focus (while exploiting some scale)	To achieve scale and scope economies through international standardization	To achieve absolute economies through international specialization
Coordination: How to organize across borders?	By country; emphasis on adjustments to achieve a local face within borders	By business or region or customer; emphasis on horizontal relationships for cross-border economies of scale	By function; emphasis on vertical relationships, including across organizational boundaries
Configuration: Where to locate overseas?	To limit the effects of cultural-administrative-geographic-economic distance by concentrating on foreign countries that are similar to the home base		To exploit some elements of distance by operating in a more diverse set of countries
Controls: What to watch out for?	Excessive variety or complexity	Excessive standardization/ emphasis on scale	Narrowing spreads
Changeblockers: Whom to watch out for internally?	Entrenched country chiefs	All-powerful headquarters/ business/ regional/account heads	Key functions/vertical interfaces
Corporate Diplomacy: Which external issues might arise?	Relatively discreet, and robust given emphasis on cultivation of a local face	Appearance of, and backlash against, homogenization or hegemonism (especially for U.S. companies)	The exploitation or displacement of suppliers, channels, or intermediaries; potentially most prone to political disruption

Ask more than one senior manager—separately—to prioritize across the AAA strategies. Divergence is, to say the obvious, not a good sign.

will be their principal source of competitive advantage or, if they have the appetite for the additional complexity, which of the three AA tensions they will try to manage particularly well. And third, it is usually a bad idea to try to beat all comers on all three As.

Another example will help animate these ideas, which are developed, along with numerous substrategies for each of the three As, over the course of several chapters of *Redefining Global Strategy*.

Procter & Gamble (P&G) is, according to CEO A.G. Lafley, actually organized in a way that mirrors the AAA strategies: its Market Development Organizations adapt in going to market, its Global Business Units aggregate sourcing, purchasing, manufacturing, branding, and R&D worldwide as well as profit-and-loss responsibility, and Global Business Shared Services arbitrages services like payroll, IT, and infrastructure management through outsourcing.

But at **P&G**—unlike **Wal-Mart**, its largest customer—arbitrage takes a back seat to balancing adaptation and aggregation: as Lafley puts it, "If it touches the customer, we don't outsource it." And while both adaptation and aggregation matter, **P&G** knows that aggregation to achieve greater size economies is a better bet for beating more country-centered competitors such as **Unilever** than adapting to be more locally responsive.

In other words, there is a clear AAA strategic hierarchy at **P&G**: first aggregation, second adaptation, and third arbitrage. In my experience, such clarity is unusual. Check it out for your company, or a company you are interested in: ask more than one senior manager—separately—to prioritize across the AAA strategies. Divergence is, to say the obvious, not a good sign.

Redefining Global Strategy concludes with some advice that, after more than a year of extreme turbulence, seems to make more rather than less sense:

1. Anticipate bumps and detours, even if you do believe that the world will eventually become much more integrated.

2. Prepare for other predictable surprises such as global warming, different kinds of meltdowns in the Middle East, China and India, and the United States, a global liquidity crisis, or a general sociopolitical backlash against globalization.

3. Focus on the risks and questions that are most likely to affect your industry.

4. Recognize the importance of business in shaping broad outcomes—including those related to the future of globalization.

My own attempts to focus on these kinds of issues have led me to write another book, due to be published by Harvard Business School Press in late 2009, that focuses on the real risks around globalization, and what we must do about them. The prestige of the Research Excellence award will help me with its promotion as well. ■