

SEMIGLOBALIZATION AND COMPETITIVE STRATEGY

Pankaj Ghemawat

Harvard Business School

Soldiers Field Road, Morgan Hall 227

Boston, MA 02163

Phone: 617/495-6275

Fax: 617/495-0355

E-mail: pghemawat@hbs.edu

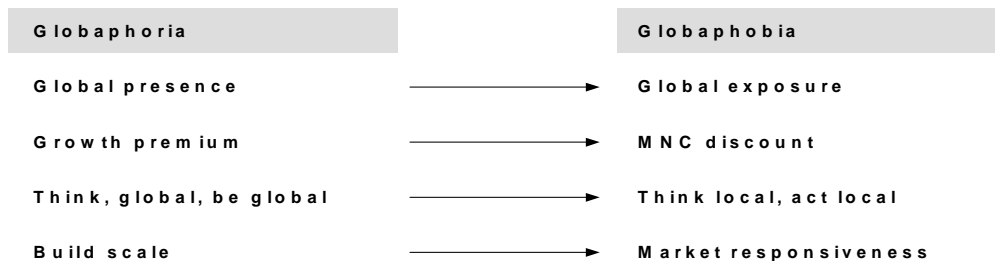
March 2003

Rev. June 2003

SEMIGLOBALIZATION AND COMPETITIVE STRATEGY

Through the 1980s and much of the 1990s, globalization was on a roll—one pursued energetically by many large companies. But towards the end of the 1990s, this unbridled enthusiasm for globalization appeared to wane as a number of “global shocks” were experienced, including the Asian currency crisis starting in 1997 and the backlash against globalization that first achieved mass visibility with the “Battle in Seattle” in late 1999. As a result, there has been a slowdown if not reversal of liberalizing tendencies in many of the countries that began to “open up” in the 1980s and 1990s. In the first few years of the new millennium, these doubts seem to have been reinforced by the global tech crash and stock market slump, the general global economic slowdown, the aftershocks of September 11, 2001 and the (still) looming clouds of war with Iraq, among other developments. Since 2000, there has also been a significant slide in the profitability of the foreign operations of the world’s largest multinationals relative to their domestic ones. Many companies’ globalization initiatives are on hold, and some have even announced significant deglobalization. Even long-standing icons of globalization, e.g., Coca-Cola and McDonalds, both of which are discussed below, have come under significant pressure. It is probably not too much to say that there has been a shift from globaphoria to globaphobia in a few short years (see Figure 1).

Figure 1: From Globaphoria to Globaphobia



Rapid shifts in sentiments of this sort would not be much of an issue if cross-border strategies could be changed quickly and cost-effectively. They seem, by all indications, however, to embody significant commitment or irreversibility. And so managers face a dilemma: how are they to think about cross-border strategies for the long run if the context in which they have to make their decisions seems so changeable?

One way of beginning to get a handle on this question is through a case study of a company that is considered one of the bellwethers of globalization, Coca-Cola, with a particular focus responded to some of the changes since the Asian crisis struck.

I. The Case of Coke

Coca-Cola's soft drink operations outside the United States date back to 1902—the year archrival Pepsi-Cola was founded—when it entered Cuba. By 1929, five years before Pepsi set up its first foreign venture (in Canada), Coke was already sold in 76 countries around the world. Coke's international presence was enormously strengthened by World War II, during which supplying U.S. troops with the drink became an official priority. Coca-Cola, exempted from wartime sugar rationing, built 63 bottling plants around the world. U.S. troops who stayed on after the war helped cement Coke's presence in key international markets: to this day, Germany and Japan are two big markets in which Coke has a crushing market share lead over Pepsi.

By the time that Roberto Goizueta took over as Coca-Cola's CEO in 1980, international operations accounted for slightly more than half of total Coke sales and income but mostly continued to be localized. Goizueta set out to change that: as he put it, "The labels international and domestic...no longer apply."¹ His globalization program included an unprecedented amount of standardization, orchestrated from headquarters in Atlanta, of TV advertising, a consolidation of 17 regional divisions into five—also headquartered in Atlanta—to facilitate interdivisional coordination, designation of "anchor" bottlers who would operate in more than one country and in which Coca-Cola took equity stakes of 20-49%, and, in conjunction with these partners, heavy investments in infrastructure, particularly in developing countries. By the time Goizueta stepped down, in 1997, Coca-Cola derived 67% of its revenues and 77% of its profits from outside North America, its market value had increased from \$4 billion to \$145 billion and the company was considered *the* exemplar of global standardization, often summarized under the tagline "Think global, act global."

But this global strategy started to run into turbulence—the globophobia discussed above—when the Asian currency crisis hit in the late 1990s. The crisis directly clouded Coke's long-term growth prospects in large, potentially important markets such as Indonesia; it also led the same analysts who had previously assigned valuation premia to Coke because of its sheer global presence to mark down their valuations of the company because of its global exposure. Douglas Ivester, who succeeded Goizueta as CEO, presided over slowing sales growth (which actually turned negative in certain markets), an antidiscrimination suit by current and former employees in the United States, a major product contamination scandal and an inquiry by the European commission, and large write downs. By the time he resigned at the end of 1999, Coke had experienced seven

¹ Chris Roush, "Coke Executive John Hunter Calling It Quits," *Atlanta Journal and Constitution*, January 12, 1996.

straight quarters of earnings decline and the evaporation of nearly one-half of its market value.

Douglas Daft, a native of Australia who had previously presided over Coke's operations in the Middle East and Far East, took over as CEO and immediately began to reassure shareholders, analysts, and the general public that he was aware changes had to be made. "The world in which we operate has changed dramatically," he stated in late January 2000, "and we must change to succeed." Daft's new mantra was to "Think local, act local." "No one drinks globally," he insisted. "Local people get thirsty and go to their retailer and buy a locally made Coke."² In March 2000, he contributed a surprisingly frank article, under the tagline of "Think local, act local" to *The Wall Street Journal* and the *Financial Times* that read, in part as follows:

As the century was drawing to a close, the world had changed course, and we had not. The world was demanding greater flexibility, responsiveness, and local sensitivity, while we were further centralizing decision-making and standardizing our practices, moving further away from our traditional multi-local approach... We will not abandon the benefits of being global. But if our local colleagues develop an idea or strategy that is the right thing to do locally, and it fits within our fundamental values, policies, and standards of integrity and quality, then they have the authority and responsibility to make it happen.

The years Daft had spent in Coke's regions—thousands of miles away from its Atlanta headquarters—had clearly left him with an indelible impression that the way to win in the marketplace was to transfer strategic decision making to local executives. Concurrent with the unveiling of his new strategic direction, Daft ordered 6,000 layoffs at Coke—nearly half of them at headquarters in Atlanta—and a massive reorganization that would see executives responsible for Asia and Europe sent to live in the regions they managed. Europe, in particular, was disaggregated into 10 geographic subregions, 9 of which were to be run by non-Americans. But what attracted even more attention was the announcement that no more global advertisements would be made.

Instead, advertising plans were overhauled, placing creative and ad budget decisions in the hands of delighted local executives. These changes caused immediate shockwaves in the global marketing community. In the words of one noted academic commentator, John Quelch, "For the new CEO of what many would consider the bellwether global brand to be quoted in that vein suggests that many companies have found it difficult to penetrate country markets, beyond just skimming off the segment of the population that happens to be enamored of global brands and is willing to pay a price premium for them. Once they've done that... the standard global marketing program is

² Betsy McKay, "Coke's Daft Offers Vision for More-Nimble Firm," *The Wall Street Journal*, January 31, 2000.

simply not going to be adequate.”³ Journalists, of course, were less measured: more than one cited the shift at Coke as a leading example of the death of global branding.

Internally, the changes sparked an exodus of top marketing talent. Coke pressed ahead, nonetheless, replacing “Always,” its theme for the previous seven years, with “Enjoy,” which was supposed to anchor a campaign to give the cola a “multidimensional view” with a “plethora of messages.” Five worldwide agencies collaborated to offer the regions a menu of 13 new advertising spots. If none of the spots were to their liking, local execs were told, they could create their own. This process spawned a slew of bizarre advertisements, including one showing people streaking across a beach (Italy) and another depicting a wheelchair-bound grandmother riding away from a backyard family reunion when her granddaughter can’t produce a bottle of Coke (the United States).

By July 2000, it was becoming evident that sales were not improving. Coke’s marketing chief, Stephen Jones, asked the agencies to rework Coke’s advertising strategy for the rest of the year. In December 2000, Coke announced that it would only hit 75% of its growth target for the fourth quarter. It then signed up Interpublic to help define the “brand essence” of Coke—a role that had been brought inhouse, to Coke’s own internal agency, Edge Creative, under Goizueta. Coke and Interpublic formed a “marketing communications advisory council” to establish consistent standards and messages for the Coke brand, with local managers still supposed to make all decisions about how those messages were conveyed. But Coke’s reduction in the number of its marketing regions, back down to five, sparked rumors of a wholesale shakeup of agencies and a reversion to centralized control.

After just a year, Coke replaced the “Enjoy” theme with “Life Tastes Good,” a change that company spokesmen described as a reassertion of the magic of brand Coke. On March 7, 2002, the *Asian Wall Street Journal* reported, “...after two years of lackluster sales and some embarrassing ads, the ‘think local, act local’ mantra is gone. Oversight over marketing is returning to Atlanta...” The 100 marketers who reported to Jones had effectively been reconstituted as the apex of a global marketing group charged with setting strategy for core brands and agency engagement, developing marketing talent and helping local markets share best practices. While Jones insisted that locals are still directly in charge, a company source confirmed that “the pendulum has swung back to centralized control.”⁴

Coke’s market valuation stagnated; however, as growth continued to be sluggish and was thought to be behind the announcement, in December 2002, that the company would no longer issue quarterly earnings forecasts. Cost-cutting measures at the beginning of 2003 removed another thousand workers from Coke’s ranks, half of them from its headquarters in Atlanta. Another sign of continuing trouble was the unveiling of yet another advertising theme, “Real,” mostly crafted by Berlin Cameron/Red Cell, a unit

³ Quelch, J., “Global Marketing Guru,” Interview by Randall Rothenberg. *Strategy & Business*. Booz Allen & Hamilton (Third Quarter 2000):93-100.

⁴ Clare Conley, “Coke U-Turn Sees O&M on UK Roster,” *Campaign*, October 5, 2001.

of WPP rather than Interpublic, to replace “Life Tastes Good.” On February 7, 2003, Berlin Cameron became Coke’s agency of record for creative work.

II. Beyond the Globalization-Localization Yo-Yo

Pause for a moment to reflect on the case study. Do you really think that Coke has (finally) managed to solve the global versus local tension that it has struggled with for so long? It seems at least as plausible a diagnosis that all that it has managed to do since 2000 is to cycle along that continuum—yo-yo is an alternate description—by shifting its official posture from “Think global, act global“ to “Think local, act local“ (through somewhat greater decentralization) and at least part of the way back again. And while it is sometimes argued that such yo-yoing might be a natural, even necessary part of the great circle of an organization’s life, the costs of the yo-yoing at Coke, particularly in terms of market confusion and internal churn, and the frequency of roughly one change per year raise serious administrative questions.

The obvious follow-up question is, why did all this happen? Here, the shift in Coke’s official rhetoric, from “global“ to “local,“ is highly suggestive. It seems that by the time Daft took over, Coke had pushed the logic of treating the world as if it were globalized or integrated too far and that as a corrective mechanism, Daft and his top management team were drawn to the opposite approach of treating the world as if it were localized (i.e., allowing more local variation by decentralizing some decisions). But localization apparently turned out to be an even poorer descriptor of the realities of Coke’s situation than globalization had proved, so the changes were at least partly reversed.

What the Coke case suggests, then, is that globalization in the sense of completely integrated markets and localization in the sense of completely isolated markets both tend to be unhelpfully extreme characterizations of the conditions that prevail in most industries where cross-border linkages are important. And that continuing to use globalization and localization as the only reference categories anyway raises risks of yo-yoing between extremes. It seems more sensible to look for a middle path that permits more constancy of purpose over a longer time frame.

The first step in finding such a middle path is to understand that the world itself does not yo-yo between being globalized and being localized quite the way Coke’s thinking about the matter recently has: rather, it is stuck in a state of “semiglobalization“—a situation in which neither the bridges nor the barriers between countries can be neglected. It is important to take semiglobalization seriously, for at least three sets of reasons.

Empirically, the cross-border evidence indicates that we are in a state of semiglobalization and will, extrapolating from the historical experience of the last few decades, stay there for the next few decades. The integration of markets for products,

capital, labor, and knowledge has increased in recent decades, in many instances to all-time highs, but falls far short of the economic ideal of perfect integration.⁵

Logically, semiglobalization is necessary for international business strategy to have content distinctive from (single-country) mainstream business strategy. To see why, consider the polar market conditions of complete localization (zero market integration) and complete globalization (total integration). With complete localization, output and input markets would be entirely insulated across country boundaries and strategy could presumably be set country by country, using the single-country tools and frameworks of “mainstream” business strategy. At the other polar extreme, complete globalization, there would be such seamless integration of markets in different countries that, once again, the single-country approach would suffice: the world could simply be treated as one big country. It is only with intermediate levels of cross-border market integration—i.e., semiglobalization—that cross-border strategy has the potential for content distinctive from the single-country case that is the baseline for most strategic thinking: otherwise firms could effectively carve up their strategies into country-sized chunks.

Practically, semiglobalization focuses attention on the here and now, rather than on the distant shore of complete globalization (or complete localization), and does so in a way that enriches the menu of strategic choices open to managers. To see this, note that the polar conditions of complete localization and complete globalization both straitjacket strategic choice: local customization is the dominant strategy in the former case, and global standardization in the latter. The (broad) intermediate case of semiglobalization offers a richer menu of choices—which is what makes cross-border strategy challenging but also exciting, as elaborated in the next section of this article.

To summarize this section, the case of Coke illustrates that perhaps the first step in improving the practice of global strategy in an environment where sentiment has swung sharply from globaphoria to globophobia is to get off the globalization-localization yo-yo and recognize that semiglobalization is where things are currently at, and will be for decades to come. To take semiglobalization seriously is to view the globalization glass as half empty *and* half full. This is operationally very distinct from seeing the globalization glass as empty or as full, as will become clearer in the course of the next section’s discussion of generic cross-border strategies for coping with and even capitalizing on semiglobalization.

III. Generic Strategies for Semiglobalization

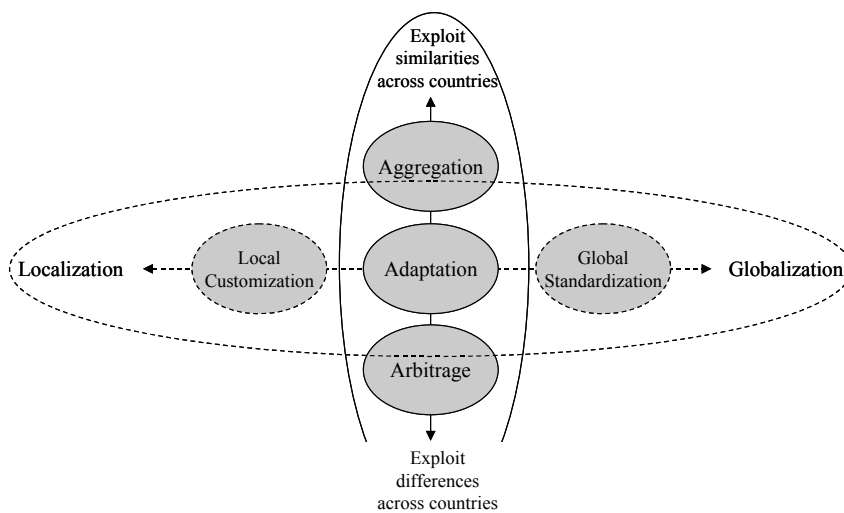
If the first step in improving the practice of global strategy is recognizing semiglobalization, the second step is to think through strategies for dealing with it. Such strategies can be classified generically in terms of how companies make money from

⁵ See Ghemawat, Pankaj. “Semiglobalization and International Business Strategy.” *Journal of International Business Studies* 34, no. 2 (2003): 138-152 and Ghemawat, Pankaj. “Distance Still Matters: The Hard Reality of Global Expansion.” *Harvard Business Review* 79, no. 8 (2001): 137-147.

their cross-border operations: by exploiting similarities among countries vs. differences across countries. (Obviously, the former approach wouldn't work with complete localization or the latter with complete globalization). This new axis of choice can be superimposed on the market conditions axis described earlier in the discussion of the localization↔globalization continuum to suggest three generic strategies, specific to semiglobalization, sandwiched between the polar (and generally impractical) extremes of local customization and global standardization: adaptation, aggregation, and arbitrage.

To preview these distinctions, **adaptation** is the generic strategy for dealing with semiglobalization that is most often talked about and practiced: it presumes some adjustment of global business models to local conditions on a country-by-country basis, i.e., combination of elements of the strategies of local customization and global standardization. Strategies of **aggregation** have attracted somewhat less attention: through various grouping devices, they make more strenuous attempts to capitalize on

Figure 2: Strategies for Semiglobalization



some of the similarities across countries than pure country-by-country adaptation. And finally, strategies of **arbitrage**, the mainspring of the earliest attempts at internationalization and of continued importance, are often ignored: they differ from the two other generic strategies in their attempts to capitalize on the differences among countries instead of simply coping with them in the pursuit of similarities. Consider these three generic strategies in turn—in some detail, so as to gain a rich sense of the diversity of the levers for cross-border value creation that companies can seek to pull. Table 1 foreshadows this diversity and provides an outline of the following section.

Table 1: Levers for Cross-Border Value Creation

Adaptation	Aggregation	Arbitrage
Decentralization	Aggregation across one or more of the following dimensions:	Cultural arbitrage: exploiting country-of-origin effects
Partitioning	-Country	Administrative arbitrage: optimizing vs. different taxes, regulations, institutional protections; rulemaking vs. ruletaking
	-Region	
Modularization	-Product/business	Geographic arbitrage: overcoming vs. taking advantage of residual distance
Recombination	-Function	
Innovation	-Platform	Economic arbitrage: exploiting differences in the prices of products, costs of labor, capital, raw material, knowledge and other inputs, availability of complements/ infrastructure
	-Competence	
Transformation	-Client industry	
Scope selection	-Key accounts	

Adaptation

Adaptation is often thought of narrowly, as tweaking product features. It should actually be thought of much more broadly, as a cross-border strategy in which higher-order strategic beliefs and specific policies predicated on them are developed at a global level, and some of the latter are adjusted in light of local—traditionally national—conditions. Or adaptation as a strategy involves, in other words, thinking globally and adjusting or adapting locally.

Adaptation tends to be the default—and often implicit—strategy of firms that don’t explicitly recognize semiglobalization for actually dealing with it. Thus, even though the official rhetoric at Coke has recently oscillated between “think global, act global“ and “think local, act local,“ adaptation, with its flavor of “think global, act local (and adjust),“ can be characterized as the cross-border strategy actually in place at Coke for much longer.

Adaptation, in addition to being widely practiced, has been widely discussed in the academic field of international business, most prominently under the rubric of the national responsiveness↔global integration tradeoff. That literature focuses on adaptation as a middle path between local customization and global standardization and, while mostly focused on organizational roles and processes for managing the global vs. local tension, establishes some of the key comparative properties of adaptive models.

Adaptation's key potential advantage is that it involves strategic action at both the global and local levels—unlike global standardization, under which all the action is at the global level, and local customization, under which it is all at the local level. Its key potential disadvantage is that the middle path may turn out to be a recipe for getting stuck in the middle: incurring higher complexity costs than a strategy of global standardization would entail without reaping commensurate benefits in positioning versus players, typically local ones, pursuing even more localized strategies. The higher-level lesson that applies to both adaptation and standardization is that instead of assuming that a business model that is successful domestically can also successfully be implanted in some form abroad, would-be globalizers need to test for competitive advantage versus local as well as global competitors.

TV programming provides a cautionary example. While content from the United States traditionally dominated the airwaves in many markets (when allowed to do so), trends over the last 5-10 years have been in the direction of localized programming. Even where foreign broadcasters have conquered the airwaves, they have tended to do so with localized fare. Thus, in Asia, Rupert Murdoch's Star TV, originally intended to recycle western fiction programming with minimal adaptation, but has been forced to invest heavily in developing new local language programming to counter emerging local competitors. Similar stories surface in Europe: MTV Europe, for example, started off with U.S.-based fare but has had to make more of an effort to Europeanize its offerings. Yet only a few years ago, Bill Roedy, president of MTV Networks International, used to explain MTV's global appeal and strategy of standardizing across continents by saying "A-lop-bop-a-doo-bop-a-lop-bam-boom means the same thing in any language!"⁶

What have attracted less attention than the national responsiveness↔global integration tradeoffs are ways of improving the relative effectiveness of adaptation strategies. Successes in this regard indicate that such adaptation-enhancers often involve going beyond the traditional focus on *fitting* a (partially) prefabricated business model to the local context to the exploitation of other levers for value creation: decentralization, partitioning, modularization, recombination, innovation, transformation, scope selection, et cetera.

Decentralization is the mode of adaptation that has been discussed the most in the past. The logic of decentralization is that if it is costly or infeasible to move information and, especially, knowledge from the field to headquarters, that enhances the relative attractiveness of moving decision rights from headquarters to the field. Thus, the shifts at Coke can be summarized as primarily influencing the level of centralization/decentralization of decisions concerning the development of consumer insights, the creation and selection of storyboards, and the actual shooting of commercials as well as, apparently, promotional activities (see Table 2). This example is also a reminder that the devil in adaptation strategies lies in the details of which decision rights will be centralized versus decentralized—around which Coke has yo-yoed in recent years—rather than whether to decentralize.

⁶ Edward Shelton, "Tailoring TV," *Marketing*, July 17, 1997.

Table 2: Centralization/Decentralization at Coca-Cola

	Goizueta (through 1977)	Daft (2000-2001)	Daft (2002-2003)
Consumer Research and Ad Creative	Central →	Local/Central →	Central
Advertising Commercials	Central →	Local/Central →	Central
Promotion	Central →	Local →	Central/Local

Decomposition refers to the clear separation of choice elements from each other, particularly ones that are autonomous from others and can therefore be varied from country to country from ones that are strongly linked to enough other choices to be integral parts of a complex system that should not be tampered with piecemeal (for fear of inducing a “complexity catastrophe”). McDonalds is, despite its recent problems, still an acknowledged master in this regard. The image of the Big Mac as the iconic global product notwithstanding, McDonalds’ product offerings actually vary considerably across countries: to take just some Asian examples, it offers the Burger McDo (a sweeter burger) and McSpaghetti (*not* offered in Italy) in the Philippines, Chicken Tatsuta and the Teriyaki McBurger in Japan, and in India, “lamburgers“ instead of hamburgers to avoid Hindu sensitivities about beef consumption. But underlying this product variation is an ability to achieve consistency and standardization in core processes that is still the benchmark against which competitors measure the progress of their own efforts. Perhaps the single most dramatic illustration is the McDonald’s operating manual, which has gradually evolved to specify increasingly detailed procedures to be followed, raw materials to be used, the end-products to be produced, and the services to be provided, e.g., that french fries have a sugar content of 21%, that 32 slices be drawn from a pound of cheese and so on. McDonalds clearly knows how to split choices into those where local adaptation is feasible and those where such adaptation would compromise system performance. While this may not seem hard, recall the difficulties that Coke had in this regard.

Modularization has the potential to further enhance the efficacy of adaptation by not only partitioning choices and organizing around them but by also clearly defining standardized interfaces between organizational elements. Modularization can be reinterpreted somewhat loosely as “design for adaptability,“ to which there are at least as many approaches as functional areas or core processes. For example, in terms of product technology, one can cite platform strategies (recently adopted in automobiles and some categories of major home appliances) which specify critical physical features in the form of a basic product platform that can be readily customized along the remaining dimensions. In terms of process technology, the attempts by a number of automobile and other manufacturers to develop reasonably efficient modular production platforms that facilitate entry into and expansion in currently small but rapidly growing markets (e.g., China) come to mind. Yahoo! provides a good example of how such modularization can be used more broadly, in organizational design. Yahoo! has (so far) managed to grow both horizontally and geographically into the dominant destination on the web by setting up a plug-and-play structure in which individual “properties“ (more than 100) have the resources and skills necessary to pursue particular target sets of customers but controls on

their interfaces with the external environment—especially specification of the “look and feel“ of the services provided, the interface between these services and Yahoo!’s core directory search platform, and the contractual terms useable in signing content deals with partners—regulate their impact on each other.⁷ Obviously, such modularization can enhance adaptability, although flexibility of this form often has to be purchased at some cost in terms of efficiency (partly because of failure to coordinate across organizational units, as will be discussed below).

Recombination involves melding elements of the parent business model with some of the new possibilities implicit in new contexts. The objective is to devise more innovative responses to the challenges of adaptation than are summoned up by the stock image of taking an existing product or service and tinkering with it to achieve better fit with a local market. Thus, India is STAR TV’s one major success in terms of ratings, and that performance is largely anchored by one hit, *Kaun Banega Crorepati*. This may not sound familiar, but it is the Hindi-language adaptation of the show “Who Wants to Be a Millionaire?”⁸ licensed from the British production house of Celador. STAR used the same basic set, music, and rules in the Hindi version as in the original but decided that the participants, questions, and marketing had to be adapted to local conditions. In particular, it hired the dominant Hindi-language actor of the era as host and took him and other talent to the United Kingdom to see the local version of the show being taped, on the basis of which the actor developed key catch phrases that might work in Hindi. Heavy investments were made in marketing as well, which ensured that the debut of the show was a major event in Hindi broadcasting. And while the success of *Kaun Banega Crorepati* inspired imitators, none fared very well, including erstwhile local leader Zee TV’s attempt to up the monetary ante tenfold in its own show of this sort. The bottom line is that while any foreign or local competitor could have licensed the show from Celador for the Hindi-language market—as James Murdoch, CEO of STAR TV noted, “We all go to the same fairs“⁸—STAR’s specific knowledge of local viewers’ preferences and its/News Corporation’s production expertise (which included other game shows) gave it an edge at identifying and investing in what was, in many respects, more an attempt at recombination than adaptation, conventionally construed.

Innovation involves more deliberate efforts at engaging in local-for-local innovations than simply recombining elements of two different contexts. Thus, Hindustan Lever, the Indian arm of Unilever, has built innovative capabilities—and the important complementary asset of a truly extensive distribution network that penetrates even the rural areas—that allow it to go well beyond the approach taken by many other consumer packaged goods multinationals in emerging markets of simply skimming off the small top of the local population pyramid. Some of Hindustan Lever’s notable product innovations include the development of detergent bars for people who wash clothes manually, toothpaste to be used with fingers—traditional in India—instead of

⁷ Alan MacCormack, “Venture Design: An Evolutionary Perspective,” Module 1 of *Managing Technology Ventures*, Harvard Business School course, April 10, 2002.

⁸ Author’s interview with STAR TV CEO James Murdoch and COO Bruce Churchill on May 1, 2001.

toothbrushes, a cream, “Fair and Lovely,” to whiten skin color (for which there is considerable local demand), and a shampoo-and-hair oil product that tripled the size of the addressable market. Other efforts, on both the product and the process side, directly address the extreme price-sensitivity of the Indian market: the introduction of sachet shampoos that by significantly lowering the unit price, expanded the target consumer base to include lower income groups, the indigenization of R&D to cut manufacturing costs (e.g., the development of a vegetable oil-based process for low-cost soap production from available India oils) and, recently, the use of advanced technology to coat one side of a soap bar with plastic, so that the bar doesn’t wear down as quickly. As a result, high profitability has been attained in a very price-sensitive market: one estimate pegs Hindustan Lever’s recent return on capital employed at 125%! And these returns have been achieved on a large base of business that is growing rapidly compared to most of Unilever’s businesses in its other markets. Of course, these outcomes reflect not only Unilever’s strategy in the Indian market but propitious market conditions (e.g., potential size) and timing advantages: it is hard to imagine Procter & Gamble or Johnson & Johnson, as relative latercomers to the Indian market, doing quite as well now with a similar strategy (in large part due to the difficulties of building up a comparable distribution network).

Transformation is a way in which firms may directly try to reduce the *need* for adaptation—by seeking to shape or transform the local environments in which they operate—instead of seeking, as above, to enhance their abilities to adapt. McDonalds is often credited as being one of the first successful practitioners of this strategy on a global scale by developing markets around the systems that it had built up rather than the reverse. A more recent example is provided by Starbucks, the coffee chain. Although Starbucks is sometimes criticized as an archetypal illustration of Americanization obliterating local cultural differences, what is perhaps most extraordinary about the autobiography of CEO Howard Schultz is the paranoia that he describes when starting out in the United States about recreating the Italian espresso-bar experience as exactly as possible, down to recorded opera music, bow-tied waiters and the name *Il Giornale*. While this prototype was refined—opera music and bow ties were eliminated, and chairs introduced—what resulted was a new version of the coffee bar that was hard to describe as an adaptation to preexisting local conditions. Deliberate limitations on adaptation made more sense in this context than in many others because Shultz was seeking to transform the traditional tendency in the (small) U.S. specialty coffee trade to treat coffee as produce (i.e., not to be sold by the cup) by focusing on the important associations between coffee drinking and communal rituals, particularly conversation, and using them to provide a “third place” for people, between home and work. Similarly, when Starbucks moved to Japan, it and its 50-50 joint venture partner, Sazaby, agreed not to make too many adjustments in advance of actually opening the first store. This implied not only imported inputs but also much the same menu and product names and even propagation of Starbucks’ non-smoking policies. While the latter were derided as cutting Starbucks off from the chain smoking businessmen who crowded Japanese coffee parlors or *kissaten*, they did fit with a strategy of not trying to serve up a variation on that existing format but of trying to transform the local coffee-drinking context. It turns out that no-smoking has helped Starbucks Japan—a large organization that had a highly successful IPO although it has more recently experienced some problems—attract more

female traffic. As in the case of McDonalds, the amount of adaptation required was limited by a strategy of proactively trying to reshape or transform the local context.

Scope selection is another, perhaps even more powerful lever that firms can pull on to directly try to reduce the need for adaptation. Deliberate restriction of geographic scope can permit a focus on markets where relatively little adaptation of the domestic value proposition is required to be successful. It does, however, require deep internalization of the idea that ubiquity is not usually the best policy: that while there are more than 200 countries in the world, rarely do as many as 20 of them matter much individually, even to large, mature multinationals. Similarly, deliberate restriction of vertical scope to the appropriate “value slivers“ can simplify involvement in cross-border operations: thus Sulzer, the Swiss-based designer of low-speed marine diesel engines, makes a few engines for purposes of testing and knowledge development but otherwise relies on licensing to underpin its leading share of these enormously large seagoing products from its landlocked home base. However, such narrowing *is* subject to issues of control/coordination and the risk of disintermediation/bypass. Finally, segmentation can be a helpful device as well: Indian packaged foods suppliers and Mexican media operations, for example have penetrated the United States by focusing on their respective diaspora as a way of easing the challenge of adaptation. (Note that these diaspora, while smaller than the respective populations at home, have higher per capita incomes and therefore account for aggregate incomes comparable to home country GDPs). More generically, teenagers and the high-end luxury niche are generally said to constitute the two most global/globalizable segments. But the residual need for adaptation can easily be underestimated even with such targeting, as the MTV example reminds us.

From all these examples, then, adaptation clearly subsumes a range of different approaches, all of which must be thought through, instead of being a single, rather mechanical process to simply be worked through. That is the good news about the possibilities afforded by adaptation. The bad news is that even with full exploitation of adaptation-related possibilities, adaptation as a strategy for dealing with semiglobalization suffers from two distinct sets of limitations. First, in assuming that centralized decisions are made at the global level and decentralized decisions at the local level, adaptation fails to take adequate account of cross-country aggregation mechanisms that operate at levels intermediate to the country and the world. Second, adaptation strategies almost definitionally treat differences across countries as constraints to be coped with and thereby ignore the possibilities of capitalizing on them. The two types of generic strategies for dealing with semiglobalization that are discussed next, aggregation and arbitrage, explicitly target these two limitations of adaptation strategies in that order.

Aggregation

Adaptation, as noted above, leaves room for another class of strategies for dealing with semiglobalization involving cross-country aggregation mechanisms that operate at levels intermediate to one country and the whole world. Indeed, country-by-country adaptation can be seen as a degenerate form of aggregation. Generally speaking, aggregation strategies attempt to exploit the linkages, particularly similarities, among

countries more aggressively than traditional adaptation strategies, but less aggressively than globally standardized strategies would. In terms of their comparative properties, aggregation strategies are supposed to facilitate the achievement of greater economies of scale/scope than country-by-country adaptation without compromising local fit to the extent that global standardization might.

For a concrete example of the gains from aggregation, consider the reorganization of Toyota's global product development efforts around "centers" in the second half of the 1990s.⁹ Before the reorganization, Toyota had 16 functional engineering divisions, subdivided into different departments and employing 7,000 people who worked on up to 15 concurrent projects at any point in time, under a matrix structure whose complexity had increased along with numbers of people, departments and projects. After analyzing the functional relationships between components and subsystems used in different projects, Toyota allocated the engineering staff to one of three centers, based on platform similarity (e.g., a center was established for rear-wheel-drive vehicles). Instead of having to coordinate up to 15 projects, some of them unrelated, functional managers only had to deal with 5 projects each, all related in the sense of being based on the same technical platform. Note that while the example involves aggregation by platform similarity, it actually helps tie together the work of the functional departments more effectively. The effectiveness of such aggregation is likely to be maximized when grouping automotive offerings in this way captures most of the observed variation in terms of differences between groups/centers, i.e., limits within-group/center variance.

Opportunities to improve in this fashion on adaptation in particular—to do better than just picking a particular point along a predetermined trade-off between local responsiveness and global integration—have not passed unnoticed. In academia, they have perhaps been emphasized most by Christopher Bartlett and Sumantra Ghoshal in their theory of the transnational: an organizational form characterized as being capable of relaxing the trade-off between local responsiveness and global integration. According to Bartlett and Ghoshal, the contemporary challenge for the large, relatively successful multinationals that they had studied was "not to define a strategy, but to overcome the unidimensional organizational capabilities and biases that stood in the way of building a new, more complex, and dynamic transnational posture."¹⁰

While transnationality is supposed to be more a state of mind than a mandate for any specific sort of organizational structure, this notion, and its connections to aggregation, are best explored with the help of the concreteness afforded by a pertinent case. The case that will be discussed in some detail here concerns ABB, whose organization design, according to one authority, "probably received more attention in the 1990s than was given to all other MNEs combined, both from the business press and

⁹ This example is drawn from Michael Cusumano and Kentaro Nobeoka, *Thinking beyond Lean*. (New York: Free Press, 1998), p. 53.

¹⁰ Christopher A. Bartlett and Sumantra Ghoshal, *Managing across Borders: The Transnational Solution*, 2nd ed, (Boston, Mass: Harvard Business School Press, 1998).

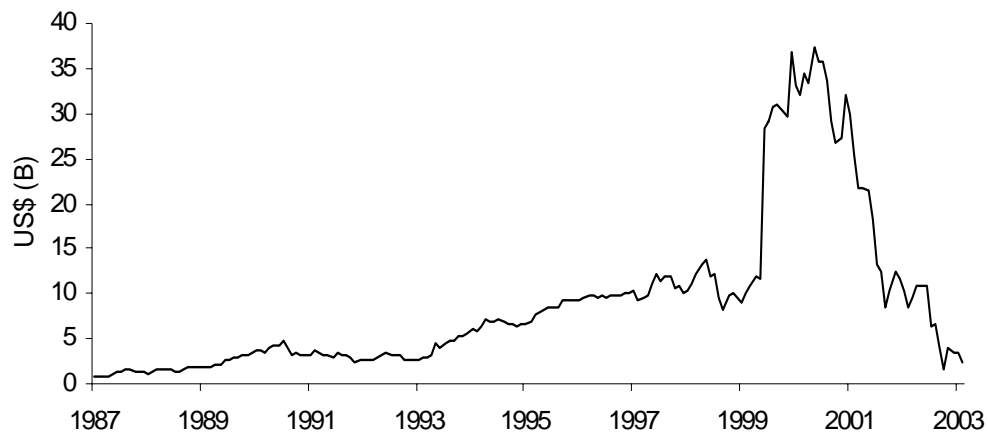
from academics.¹¹ Not unrelatedly, ABB was considered an exemplar of the transnational model for much of that decade (although CEO Barnevik, in an interview in HBR in 1991, described the model he had in mind for the company more as “multidomestic”).

Given the reams written about ABB in what are now many different contexts, all that will be provided here is the briefest characterization of changes in its design over the last 15 years; also see the accompanying graphic for a summary of the primary dimensions of aggregation targeted over time and other information. In 1988, after the merger of electrical equipment and machinery manufacturers Asea of Sweden and Brown Boveri of Switzerland, ABB’s new CEO Percy Barnevik decided to break up the bureaucracy and geographic fiefdoms he had inherited by flattening the organization and fragmenting the company’s businesses into small, local operating companies that would report both to a country manager and to a business area manager (“the matrix”). Accompanied by modularization of interfaces, this approach also helped facilitate the digestion of additional acquisitions and the reconfiguration of business areas over time.

The business-country matrix itself wasn’t new, but ABB was one of the few companies that seemed to be able to make it work. Pathbreaking work was done at the company in the 1990s in establishing a common management information system and many other linking mechanisms, primarily to further break down country-related barriers by enhancing cross-border integration within the business areas. In 1993, Barnevik added a regional overlay to the geographic dimension of the matrix by clustering countries into three regions; his successor as CEO, Goran Lindahl, removed this overlay for being too costly in 1998. Under him, ABB moved towards a more traditional global business unit structure, and also developed a global account management structure on top of its sales organization. But pressures on the company continued to mount as a result of the demand slowdown after the Asian crisis, plunging prices and escalating efficiency requirements, challenges associated with marketing systems that integrated products from different business areas or for which the key customers were global or regional, not local, and other problems intertwined with the autonomy of the local companies.

¹¹ D. Eleanor Westney. “Geography as a Design Variable.” In *Future of the Multinational Company*, edited by Julian Birkinshaw, George Yip, Sumantra Goshal, Costas Markides and John Stopford. (New York: Wiley & Sons, 2003).

Figure 3: The Case of ABB



CEO	Premerger 1880s-1987	Barnevik 1988-1996		Lindahl 1997-2000	Centerman 2001-Aug 2002	Dormann Sept. 2002-
Primary Bases of Aggregation	Country	Business Area Country	Business Area Country Region	Business Area Country	Technologies and Customer Industries	Business Areas (restructured)

In 2001, new CEO Jorgen Centerman replaced the matrix with a front-end/back-end organization that effectively chopped up ABB’s businesses by function. Specifically, four main customer or front-facing units, defined by customer industry rather than geography, were supposed to enhance ABB’s capabilities for creating value for global and regional customers in particular and to drive—under the assumption that an appropriate set of linking mechanisms could be created—two back-end technological units, Power Technologies and Automation Technologies, that were supposed to integrate technology development across the businesses in ABB’s two main areas of technological competency. But Centerman was forced out in 2002, amid pressures associated with the asbestos-related liabilities picked up in the US with the acquisition (under Barnevik) of Combustion Engineering as well as the sluggishness of the new organization. His successor as CEO, Jurgen Dormann, dismantled the front-end/back-end organization, sold off portions of the front-end, and reintegrated the remaining businesses into two divisions, power systems and automation, thereby reducing the number of primary dimensions of aggregation back to one. But losses widened from \$691 million in 2001 to \$787 million in 2002, and questions persisted in early 2003 about whether a turnaround was really at hand.

The ABB saga is rich in implications for organization design in general and aggregation in particular. Consider just a few.

There is no perfect aggregation scheme for relaxing the integration-responsiveness trade-off. Specifically, the matrix may make sense in some situations but

not in others. More generally, bursts of optimism about new approaches to the problems of complex organizations—the transnational, the differentiated network and, most recently, the metanational—should not be allowed to obscure the fact that the hunt for an all-purpose organizational panacea represents a triumph of hope over experience.

That said, the challenge of aggregating across multiple dimensions clearly remains an important and interesting one. The strategic challenge is magnified by the fact that there aren't just two potential bases of aggregation—geography and product—but many others as well: function, competence, client industry, key accounts, et cetera. (ABB briefly used some of these as well.) The focus on a particular subset of the possible bases of aggregation should ideally have a rationale as opposed to being taken for granted.

What is probably more important than the number of dimensions of aggregation selected is how effectively they are managed. One can think of successful three and even four dimensional matrixes (particularly in the IT sector) as well as cases where companies have been challenged to manage even a single dimension of aggregation effectively. Appropriate linking mechanisms that go well beyond the formal structure are very important in this regard.

Shallow analogies sometimes play a more important role in the choice of aggregation approaches than they should. Thus, Centerman's institution of a front-end/back-end structure apparently emulated IT companies. But did he take account of the differences between them and ABB? Many of the IT companies served a broader range of industry verticals, arguably enhancing their need to explicitly span and aggregate across this dimension. And most of them moved to the front-end/back-end structure from a functional structure—an easier transition than for ABB, which was organized around businesses.

Appropriate choice among aggregation approaches can depend on industry dynamics, firm heritage, and firm performance. Thus, the matrix came under pressure at ABB because of industry dynamics—the slowdown in demand, pricing pressures and the increasing emphasis induced for global integration as opposed to local responsiveness. ABB's heritage militated against the shift to the front-end/back-end structure in the sense that ABB was starting out with a business organization that would have to be chopped up into functions. And the bare-bones divisional/business structure to which Dormann has retreated may make sense right now given the urgency of rationalizing ABB's core.

In the long-term, the single most powerful basis for selecting an aggregation approach is enhancement of the competitive advantage that is being targeted through cross-border operations. One senses that ABB may need a more clearly defined value proposition in its evolving environment if it is to hope to get off the reorganization merry-go-round that it is now on.

What matters, ultimately, is aggregation for action rather than aggregation for purposes of monitoring. Embedding the primary bases of integration in the formal organizational structure is a necessary but not sufficient condition for the former to

happen. And pushing boxes around on the organizational chart should only be done from a purging sense of necessity: the costs, in terms of time lags in changing organization behavior, disruption et cetera, are very high.

While there is no all-purpose panacea, and although appropriate choices are highly contingent, some general tendencies do appear to be discernible in recent shifts. On the geographic dimension, there seems to be heightened emphasis on the part of many multinationals—the earlier flip-flop in this regard by ABB, ostensibly on the grounds of cost, notwithstanding—in overlaying *regional structures* on their operations in Europe and Asia, on the grounds that most cross-border economic activity actually takes place within rather than across regions. Thus GE bucked its own emphasis on minimizing bureaucracy by creating, in December 2001, a new post of CEO of GE Europe. This move was dictated by subpar profitability in Europe—as CEO Jeffrey Immelt recently put it to Harvard Business School students, “Europe is a big focus of mine basically because I think we *stink* in Europe today.”¹² Poor performance despite \$30 billion in acquisitions since the late 1980s reflected both the constraint that most of GE’s toughest competitors in its nonfinancial businesses were European and the choice that GE had made to run its European businesses as standalone operations that reported up through their business structures to U.S.-based “global headquarters” run by “global leaders,” many of them Americans who had never lived or worked outside the United States. In addition, after the European Union blocked GE’s attempted merger with Honeywell, GE felt the need to develop more of a European face and to set up a significant presence in Brussels. There was also the perceived need to dedicate more corporate infrastructure and resources to Europe, partly as a way to attracting, developing, and retaining the best European employees. The European regional overlay meant to help with these needs has reportedly attracted praise from GE’s customers and business units and the company followed up in January 2003 by announcing a new post of CEO of GE Asia.

Of course, having cited the apparent tilt towards regionalization, it is worth adding that this is by far the only basis for aggregating countries. Countries can also be aggregated in terms of size, level of development, and even colonial ties (e.g., Raytheon has a marketing group focused on the countries of the British Commonwealth), to name just a few possibilities.

A second (often partial) basis of aggregation that has spread in recent years is *global account management*, national account management extended across national borders in order to provide multinational customers with a single point of contact, coordination and standardization.¹³ The potential benefits of global account management are obvious and have resulted in some of the same claims being made about this arrangement that were offered earlier about the transnational (relaxation of the trade-off

¹² Jeffrey Immelt, Town Hall Meeting, Harvard Business School, September 25, 2002.

¹³ David B. Montgomery, George S. Yip and Belen Villalonga, 1999, “Demand for and Use of Global Account Management,” Marketing Science Institute Report No. 99-115.

between global integration and local responsiveness, and so on).¹⁴ But these benefits must be weighed against the costs and limitations of this mode of aggregation. Some worry that a global account management structure effectively increases the bargaining power of customers designated as global, reducing a firm's availability to appropriate value. (Note that in a domestic context, it is already a running joke among sales reps that large, unprofitable customers are called strategic accounts to justify continuing to serve them.) Others highlight the challenges of managing organizations in which global accounts exist side-by-side with local accounts. And then, as always, there are the issues associated with complexity and fragmentation (in this case, the risk, absent adequate linking mechanisms, of creating customer silos).

To summarize, aggregation represents a potentially powerful way of going beyond country-by-country adaptation strategies. But aggregation always carries with it the risk of creating silos that disrupt organizational functioning and often increases organizational complexity, particularly when account is taken of all the linking mechanisms necessary to make aggregation—especially along multiple dimensions—effective.

Arbitrage

The discussion so far has focused on capitalizing on the similarities among countries as a means of cross-border value addition. In this regard, one might even array the generic strategies of local customization, adaptation, aggregation and global standardization along a continuum involving increasingly aggressive attempts to capitalize on cross-country similarities as opposed to capitulating to cross-country differences. But what has been missing is any discussion of the prospects for cross-border value addition offered by differences across countries—of taking advantage of differences as opposed to treating them as constraints—or what is referred to here as the generic strategy of arbitrage.

Arbitrage is the original cross-border strategy—not unreasonably given that differences among countries were progressively much larger 100, 200 and 500 years ago. The great trading companies of the 17th and 18th centuries got their start trading luxuries subject to extreme differences in absolute costs/availability: e.g., spices that could initially be sold for several hundred times as much in Europe as in their Asian source countries or furs that were abundantly available only in northern America. Similar, essentially geographic, differences drove the global whaling fleets of the late 18th century, and the vertically integrated agricultural and extractive (mining) companies that emerged relatively early in the 19th century. The free standing enterprises that dominated British foreign direct investment at the end of the 19th century attempted to arbitrage across differences in administrative structure (and power) by pursuing foreign investment opportunities under British law. Exports of labor-intensive, capital-light

¹⁴ David Arnold, Julian Birkinshaw and Omar Toulan, 2000, "Implementing Global Account Management in Multinational Corporations," Marketing Science Institute Report No. 00-103.

manufactures by countries with relatively low labor costs—e.g., textiles and garments—that took off in the 19th century, starting with Japan, involved arbitrage as well, but across economic differences rather than geographic or administrative ones.

Despite its historical dominance of international trade and investment, arbitrage has been virtually invisible in recent discussions of globalization and strategy. (Thus, there is no mention of it Percy Barnevik’s interview with HBR in 1991 about his global strategy for ABB.) An important part of the reason may be the sneaking sense that the activities underlying traditional forms of arbitrage—hunting, fishing, farming, digging, and weaving in the cases cited in the previous paragraph—are, to be blunt, backward. Relatedly, there is the sense that arbitraging fundamental factors such as capital or labor offers only limited opportunities for competitive advantage since these are generic factors that, in the words of a leading guru, can be sourced efficiently with the click of a mouse and are therefore “givens“ for any well-run global enterprise. This may seem like a reasonable approach, but what the evidence actually indicates is that the markets for capital and labor are still semiglobalized or, in other words, that even the apparently unspecialized factors of capital and labor are specialized at the level of location, if in no other respect. Thus, they can assume strategic importance in an international context and should be attended to.

The even broader point that should be emphasized at this juncture is that arbitrage is much more than just cheap capital or labor and that new forms of arbitrage, with more contemporary accents have emerged as some of the older forms discussed above have receded. The scope for arbitrage is, in some sense, bounded only by the range of the differences among countries, and the evidence indicates that multidimensionality in this regard continues to be high. The brief survey of the diverse forms of arbitrage that follows is organized around the CAGE framework for classifying differences among countries into their Cultural, Administrative, Geographic and Economic components that was introduced in my 2001 HBR article, “Distance Still Matters.“

Cultural Arbitrage

Cultural arbitrage involves exploiting the cultural differences among countries to create value through cross-border activities. Favorable effects related to country or place of origin have long supplied a basis for cultural arbitrage. For example, French culture or, more specifically, its image overseas has long underpinned the international success of French haute couture, perfumes, wines and foods of certain sorts. Other examples—with place names embedded in them—include cheddar cheese, balsamic vinegar, and pilsner beer.

These are, of course, relatively traditional products. Cultural arbitrage can be applied to newer products and services as well, however. Consider, for example, the extraordinary international dominance of U.S.-based fast food chains which, at the end of the 1990s, accounted for twenty-seven of the top thirty fast food chains worldwide and for over 60% of global fast food sales. In their international operations, these chains exploit—to varying extents—the general global surge of American popular culture by serving up slices of Americana along with their food. Thus, in less developed markets

such as China, many of the relatively upscale customers are attracted by the American “style“ and experience afforded by U.S. fast food chains rather than fast or cheap food *per se*.¹⁵ Similarly, Starbucks’ hopes in China, currently its fourth largest market after the United States, Japan, and Taiwan (and likely to become the third largest), depend importantly on cultural arbitrage: it is targeting fashion-conscious Chinese urbanites with an “American-style“ coffee-bar experience (somewhat ironic, given the Italian origins of the Starbucks design). As Starbucks has penetrated the Chinese market, it has realized that some strong pull of this sort is required to overcome all the dimensions of difference highlighted by CAGE framework:

- Culturally, many Chinese prefer tea and find coffee foul-tasting.
- Administratively, foreign chains in China have to seek central government approval to open stores.
- Geographically, China is very far from Starbucks’s coffee roasting facility in Seattle, which affects both costs and quality.
- Economically, a \$3 cup of coffee is affordable by a much narrower segment of the population in a country with an average per capita income of \$1,000 (China) than in one with an average per capita income of \$30,000 (the United States).

Conceptually, strong country-of-origin effects that cut across countries should be thought of as a vertical differentiation that makes customers in (at least some) different countries rank the same reference set of products in the same (vertical) order rather than differently. Most discussions of cultural differences focus, instead, on horizontal differentiation that would make customers in different countries rank the same reference set of products differently. It is useful to remember this difference while analyzing cross-country variations in preferences and the possibilities for cultural arbitrage.

The scope for cultural arbitrage is sometimes said to be decreasing over time, that is clearly not true for all countries/product categories. Consider some examples. Prospective policy changes such as the push by the European Union to tighten rules for geographical indications (GIs) on food products would reinforce the natural advantages of particular countries/places of origin. The subjective component of Finland’s recently-developed reputation for excellence in information technology is, to an important extent, a spillover from Nokia’s success and indicates that in certain product categories, such advantages can now be created much faster than before: in a few short years rather than decades or centuries. The consistent association of Brazil with football, carnival, beaches and sex, all with tremendous resonance for youth-oriented products and services— illustrates the unexploited potential of some countries, even relatively poor ones, to become important platforms for cultural arbitrage. Reduction in other dimensions of difference—e.g., tariffs or transport costs—can also increase the viability of arbitrage along the cultural dimension. And finally, globalization in the sense of greater

¹⁵ Yunxing Yan, “McDonald’s in Beijing: The Localization of Americana,” Chapter 1 in *Golden Arches East: McDonald’s in East Asia*, Ed. James L. Watson (Stanford University Press, 1997).

connectedness among countries may directly lead to increases rather than decreases in the demand for (cross-border) variety. Ted Levitt himself, although best known as a prophet of greater standardization as a result of globalization, acknowledged as much when he noted that global demand might result for such previously local products such as Greek salad.

Administrative Arbitrage

Administrative arbitrage involves exploiting the administrative, legal, institutional, and political differences among countries to create value through cross-border activities. Such differences open up a host of cross-border options such as optimizing across different tax systems, regulatory regimes, and institutional protections for foreign investors.

News Corporation, the parent of STAR TV and controlled by Rupert Murdoch, is a widely-cited example of tax arbitrage. While taxes have not been an issue recently given large writedowns, through the 1990s, News Corp paid income taxes at an average rate of less than 10%, compared to statutory tax rates of 30-36% in the three main countries in which it operated (Britain, America, and Australia) and average rates close to that range for major competitors such as Disney. Given the profit pressures on News Corp—net margins consistently less than 10% of sales in the second half of 1990s and an asset-to-sales ratio that ballooned to 3-to-1—these tax savings may have been critical to News Corp’s attempts to earn more than its cost of capital. News Corp’s tax rate fell dramatically in 1986 (to 9% from 30% in 1984 and 23% in 1985) and then basically stayed there through the end of the 1990s. This coincided with its expansion into the United States with the purchase of Twentieth Century Fox and the Metromedia television stations that anchored the start-up of the Fox television network. The structuring of these U.S. operations as holding companies in the Cayman Islands let News Corp deduct interest payments on the debt used to finance these deals against the profits being generated elsewhere (mostly from newspaper operations in Britain). STAR TV was incorporated in the British Virgin Islands for apparently similar reasons (although until very recently, there were no profits to shield), and overall, News Corporation has approximately 100 subsidiaries incorporated in havens with no or low corporate taxes and limited financial disclosure laws. The intangibility of its informational assets has helped in this regard: as one accounting authority put it, “There’s absolutely no reason why a piece of paper, which is the right to show something, couldn’t sit anywhere, so it could be sitting in the Cayman Islands.”¹⁶

No suggestion is being made here that News Corp’s tax management is in any way illegal. Tax-avoidance can, however, easily turn into tax evasion and even when it doesn’t, tends to be a sensitive matter, which is why, in a reversal of the usual saw, nobody talks about it but everybody—or at least many large companies—do it (and an

¹⁶ Comment made by Rick Krever from University in Melbourne on “Not Shaken, Not Stirred: Murdoch, Multinationals and Tax,” Australian Broadcasting Company aired March 22, 1998, transcript available at: <http://www.abc.net.au/rn/talks/bbing/stories/s10609.htm> (accessed March 2003).

important reason why the legal structures of large companies often diverge from their operating structures). But the opportunities for such “racing to the bottom“ extend well beyond the tax channel: insofar as labor is concerned, possibilities include the relocation of operations to countries with weak health and safety legislation or otherwise limited protections for workers. Of course, movement in this last direction ends up, in the limit, at the same place as “purely“ economic arbitrage to minimize labor costs.

In terms of capital rather than labor, administrative arbitrage is observed not only in cross-border activities to reduce capital costs (through foreign listings and the like), but also—with a more purely administrative than economic cast—in the phenomenon of national capital that masks itself as foreign capital to secure better legal protection, tax concessions, or otherwise favorable treatment (e.g., “recycled“ FDI into—and out of—China and India). Thus, about one-half of the FDI in China is estimated to be “recycled“ in the sense of having originated in China, and similar considerations are thought to be part of the reason that Mauritius has recently been one of the top two sources for FDI into India. While such recycling raises legal and ethical questions, its existence cannot be ignored.

For similar reasons, it is important to mention the clearly illegal, often criminal, activities of cross-border smuggling, counterfeiting, and extortion that can also be thought of as arbitraging across administratively distinct jurisdictions. To focus just on a few examples of smuggling, until a crackdown at the end of the 1990s that was orchestrated by the Chinese government and enforced by its Peoples Liberation Army, cell phones smuggled in from Hong Kong and elsewhere to evade China’s 15% tariffs and 17% VAT were estimated to account for over one-half of the total market, and there have been reports that such smuggling has risen again. Similarly, it is reported that more than half of the regular filter cigarettes smoked in India are smuggled in from elsewhere—given the taxes and tariffs evaded, they can be sold for 30-50% less than cigarettes that are legally produced and sold there—and that more than one major international tobacco company allegedly connived in such activities to boost profits and market penetration. And while cell phones and cigarettes are products with high ratios of value to weight or bulk, even less obviously portable products offer opportunities for those inclined to exploit them. Thus, according to the CEO of a candy manufacturer, while India has high tariffs, “there is always Dubai“ (a major entrepot and smuggling hub).

Finally, while the examples of administrative arbitrage discussed so far concern companies taking the administrative rules of the game as given and deciding how to optimize around them, there are cases in which companies act more as rulemakers than rule-takers. Thus, in 1994, four big Swedish corporations—ABB, Volvo, Ericsson, and Stora—threatened to send up to \$6.6 billion of investments overseas as a way of putting pressure on the Swedish government to limit tax rates. Or powerful home governments can be used to build pressure for favorable treatment by foreign governments (or, for that matter, by nongovernmental organizations): Enron enlisted the help of the (Clinton-era) State Department to threaten one of the poorest countries in the world, Mozambique, with a cut-off in U.S. development assistance if it failed to sign a gas deal with an Enron-led consortium in preference to a South African competitor. In fact, some observers such as Jeffrey Garten, who details anchoring some initiatives of this sort as Undersecretary of Commerce for International Trade, think that such company-plus-governmental competition is likely to be an increasingly important feature of cross-border interactions

in politically salient industries (which I characterize as Boxed Insert A).¹⁷

Boxed Insert A: Politically Salient Industries

- Producers of staple goods (electricity)
- Producers of other “entitlements” (pharmaceuticals)
- Large employers (agriculture)
- Large suppliers to governments (mass transport)
- National champions (aerospace)
- National security concerns (defense)
- Exploiters of natural resources (oil, mining)
- High sunk costs (infrastructure)

Source: Pankaj Ghemawat, “Distance Still Matters: The Hard Reality of Global Expansion,” *HBR*, September 2001.

Whether one agrees with Garten or not, it is clear that one should be skeptical of the claim that the significance of governments for cross-border competition is fading away.

Administrative arbitrage across borders, particularly but not only national ones, is likely to continue to be important in real terms

despite the ethical and legal dubiousness of some of its more extreme manifestations. And places where there are sharp disjunctions or fractures between geography and administrative jurisdiction (or deformations of local geography)—entrepôts, tax havens, foreign enclaves, free-trade areas, ports of trade, export processing zones, cross-border twin cities and the like—are likely to continue to play a disproportionately important role in it.

Geographic Arbitrage

Geographic arbitrage has attracted much less attention than the alleged death of distance, often argued on the basis that transportation and, especially, communication costs have dropped sharply in the last few decades. But actually, this drop in cost levels does not necessarily translate into a decrease in the scope of geographic arbitrage

¹⁷ Jeffrey E. Garten, *The Big Ten* (New York: Basic Books, 1997).

strategies. Consider the case of air transportation, the cost of which has declined more sharply—by more than 90% in real terms since 1930—than older modes of transportation. The estimate that about 40% (by value) of the merchandise traded internationally is now transported by air should indicate how much the scope for companies such as DHL has expanded in the last few decades. And in the process, new opportunities for geographic arbitrage have been created in particular categories, as witness the Aalsmeer international flower market in the Netherlands, where more than 20 million flowers and 2 million plants are auctioned off every day, with blooms flown in in the morning (e.g., from India) being sold to customers (e.g., in the United States or Europe) on the day of purchase.

And while communication costs have dropped more sharply than transportation costs (e.g., by more than 99% in the case of international phone calls), even that sector affords examples in which the returns to focusing on residual distance have been higher than those attained by building or exploiting global connectivity. A particularly striking example is supplied by Cable & Wireless (C&W), a highly internationalized and once high-flying telecom company headquartered in London. C&W has two main areas of business, organized into a regional unit and a global one. The global unit, in which £6 billion was invested since 1999, is considered essentially worthless—because competitors invested in much the same kind of long-haul (over)capacity and global connectivity. The regional unit, reflecting C&W's historical roots as operator of the British Empire's international telegraph and telephone networks, consists of companies providing a full range of telecommunications services to both consumer and business customers in 33 relatively small countries around the world—more than three-quarters of them islands, with Caribbean islands (strung together with a submarine cable) and Panama accounting for 79% of the revenues for the regional unit and 87% of EBITDA. In most of its small, generally isolated markets, C&W has historically enjoyed local monopolies, particularly on connections with the outside world, which has let it generate EBITDA margins of more than 40% of sales. And while many of these exclusive licenses began to be renegotiated in the late 1990s, it is noteworthy that this business—the part that emphasized dominating services in and, particularly, into and out of markets that are geographically remote or poorly connected in informational rather than physical terms—is the valuable part of the company. Note that this too is a form of geographic arbitrage in the sense of taking advantage of residual differences/distances between countries.

The one instrument of geographic arbitrage that seems to have ceded some of its traditional importance in recent decades consists of the great general trading companies of the past, which can be thought of most basically as taking advantage of large geographic variations in the prices of a broad array of products by getting them from market A to market B (and in the process, somewhat eroding those price differentials). Trading companies continue to be important cross-border intermediaries, however, even though the complexity and (as a result) the specialization of the most successful ones seemed to have increased over time. Thus, Hong Kong's largest trading company, Li & Fung, derived 75% of its turnover from apparel and the remainder from hard goods by setting up and managing multinational supply chains for retail clients through its offices in more than 30 countries. For example, a down jacket's filling might come from China, the outer shell fabric from Korea, the zippers from Japan, the inner lining from Taiwan,

and the elastics, label, and other trim from Hong Kong; dyeing might take place in South Asia and stitching in China, followed by quality assurance and packaging in Hong Kong; the product might then be shipped to the United States for delivery to a retailer such as The Limited or Abercrombie & Fitch, to whom credit risk matching, market research and even design services might also be provided. Of course, capitalizing on economic differences is the underlying reason for slicing up the value chain geographically in this fashion.

Economic Arbitrage

Ultimately, for cross-border arbitrage strategies, whatever their basis (e.g., cultural, administrative/political, et cetera), to yield competitive advantage, they have to improve the would-be-arbitrageur's economics relative to competitors that fail to exploit cross-border arbitrage opportunities. In that sense, all successful arbitrage strategies have identifiable economic components. But it does not seem particularly helpful to reduce all arbitrage to the economic category. Instead, economic arbitrage is employed here to refer to exploitation of the differences core to traditional economic discussions of arbitrage: differences in the willingness-to-pay for products; the costs of labor, capital, natural resources and other, more industry-specific inputs (including knowledge); the availability of required complements/infrastructure, et cetera.

Economic arbitrage will be more familiar than the other categories of arbitrage discussed above, but typically only in the narrow guise of exports of labor-intensive, capital-light manufactures by countries with relatively low labor costs—e.g., textiles and garments. Strategies of this sort are often stereotyped with sweatshop imagery and dismissed as rudimentary, shallow, or unsustainable. But even if one sticks to the category of labor, this seems to be wrong. And once one looks more broadly, the scope for economic arbitrage—for capitalizing on the economic distance between countries—seems to be vast indeed. For obvious reasons, the more dramatic examples are to be found across the developed/emerging country divide.

For an example of how labor arbitrage can underpin a high-tech strategy, consider the case of Embraer, the Brazilian company that designs and assembles regional jets, among other aircraft. In 2002, Embraer achieved estimated revenues of \$238,000 per employee, compared to an estimated \$266,000 for its leading rival, the Canadian company, Bombardier. But employment costs per employee—base salaries plus benefits—came to \$26,000 at Embraer versus an estimated \$63,000 at Bombardier's regional jet business. If Embraer had Bombardier's employment cost structure, its operating margin would fall from the 21% of revenues it has attained with the success of its first family of regional jets to 7%, and its net income would turn negative. Clearly, labor arbitrage has been critical to Embraer's ability to profit from the commercial success of its regional jets.

The Embraer example also illustrates that intuitions about the activities subject to labor arbitrage may need to be broadened. In 2003, Embraer is preparing for the certification and first delivery of the first new model, a 70-seater, in a new, larger family of regional jets that, when it was announced in 1999, was projected to cost \$850 million

to develop and more than double the company's sales. The head of Embraer's industrial area guessed that the 10 million engineering man-hours involved in developing the new family might have made Embraer's development effort cost \$100 million more had it been carried out in Canada, where aerospace engineers cost more. To see the \$100 million figure in proper perspective, note that Embraer structured the development program so that it effectively paid for less than half the total development cost (\$300-400 million); suppliers shouldered the rest. So labor arbitrage applied to technology development as well as assembly operations, with advantages being derived in both R&D and operating costs in ways that justified Embraer's focus on internalizing these functions while outsourcing the supply of entire systems (not just components) to a global network of dozens of partner-suppliers.

Similarly, it would also be mistaken to conclude that strategies based on labor arbitrage are necessarily shallow or unsustainable. Thus, the top Indian software services firms have, in recent years, been posting returns on capital employed in the range of 50-75% as well as growing at 30-40% per year. To say that this story is not very interesting because it basically involves using cheap Indian software programmers to displace more expensive ones elsewhere is to miss the real point of the story: the software industry has already become the single biggest wealth creator in the Indian economy and the prospects are for continued, profitable growth despite (or some would even say because of) the slump in tech spending. The experience of East Asian economies such as Taiwan reminds us that even if one grants long-run convergence of labor costs (or costs adjusted for productivity levels), the period between now and then can extend into decades.

The final point worth emphasizing in the context of labor arbitrage is that it deserves to be taken seriously even if it involves relatively cheap, unskilled labor or affords no prospect for sustained competitive advantage. In an environment in which your leading competitors are outsourcing manufacturing to China and back office operations to India, can you afford to hold back on the grounds that the sources of competitive advantage tapped in this fashion are likely to prove impermanent?

Turning from labor to capital, the maximum cross-border cost differentials in the world are to be measured in percentage points rather than multiples of 10, 20 or even more. But against a backdrop in which most companies (at least within the United States) have tended over the long run to earn returns within two to three percentage points of their cost of capital, such capital cost differences *can* be consequential. Companies evidently think so: consider the rush, at least until recently, to list on foreign stock exchanges, to the point where foreign firms now account for nearly one in seven of the nearly 2,800 listed companies on the New York Stock Exchange (although according to the Exchange, new U.S. corporate governance rules threaten to damage this business). In at least some cases, the benefits of such capital arbitrage have been very large. Thus, CEMEX, the global cement company headquartered in Mexico seems to have been able to shave capital costs by several hundred basis points—in a very capital-intensive industry—by looking for foreign sources of capital and collateralizable assets exempt from “Mexico risk.” Of course, this diversification of capital sources embodies elements of administrative as well as economic arbitrage.

The CEMEX case also illustrates the advantages that can be derived from product arbitrage, i.e., trading. In addition to being the third largest cement company overall, CEMEX is the largest international trader. Through trading, underpinned by a network of 54 marine distribution terminals and hundreds of land distribution centers around the world, CEMEX capitalizes on (mostly cyclical) price differentials in allocating its output across national boundaries, diverts low-priced imports away from its own markets, broadens its options for dealing with particular competitors, and manages to study local markets and their organization at minimal cost before deciding whether to make more of a commitment to them by acquiring capacity locally.

Finally, two other bases of economic arbitrage (very different from each other) should also be mentioned explicitly: differences in the prices of raw materials and the availability of knowledge. Cheap raw materials may seem, like cheap labor, to be too obvious a basis of competition to be interesting, but it is worth remembering that the global oil companies are organized around exactly this kind of arbitrage (even though the very largest upstream producers today, as a result of nationalization et cetera, are a handful of national/local production companies). According to a ranking by the UN Center on Transnational Corporations, the global oil majors accounted for 3 of the world's top 10 non-financial transnational corporations in 2000, and 6 of the top 20—which tied oil with autos for salience in this regard.

More subtly, companies can also try to harness knowledge differences across countries and, more broadly, geographically dispersed knowledge by making asset-seeking (rather than asset-exploiting) investments in critical locations. Nucor, the minimill that has become the leading U.S. steelmaker, is predominantly focused on serving the domestic market, but has looked internationally for raw material inputs and for technology. Nucor is trying to retain a global outlook in these respects even while it has evidently decided to focus on consolidating the U.S. steelmaking industry instead of expanding into manufacturing overseas. (Note that the decision to focus on operating manufacturing capacity in the United States seems to make some sense given the likely country-specificity of its incentive-intensive HR model as well as its still limited share of the U.S. market relative to leading international competitors' shares of their respective home markets.)

Some assert that having such a “metanational“ mindset is critical in an era in which the knowledge sources relevant for many industries are increasingly dispersed around the world instead of being concentrated in one or two locations. Whether that is true or not, the role of internationalization in broadening horizons is worth emphasizing. Forget, for a moment, the tangible aspects of CEMEX's international operations and focus on its cognitive internationalization—an emphasis on recruiting graduates of leading business and other professional schools (CEO Lorenzo Zambrano himself has an MBA from Stanford) and creating career paths for them, including cross-border endeavors and immersion in foreign cultures, utilization of foreign (mostly U.S.) management and technical consultants, benchmarking versus best-in-class foreign companies (e.g., Federal Express in logistics), a heavy emphasis, while growing through acquisition, on an elaborate post-merger integration process to facilitate two-way learning (a challenge that was simplified by product specifications and production processes that

were more or less globally standardized), and even such organizational devices as the rotation of the monthly meeting of CEO Zambrano, the regional directors and all the country presidents across Monterrey (the corporate headquarters, in Mexico), New York and Madrid. Observers see these international influences as critical to CEMEX's decision to expand its geographic scope within cement rather than its horizontal scope across industries (the model followed by most other Mexican groups) and its heavy emphasis on information technology, for example.

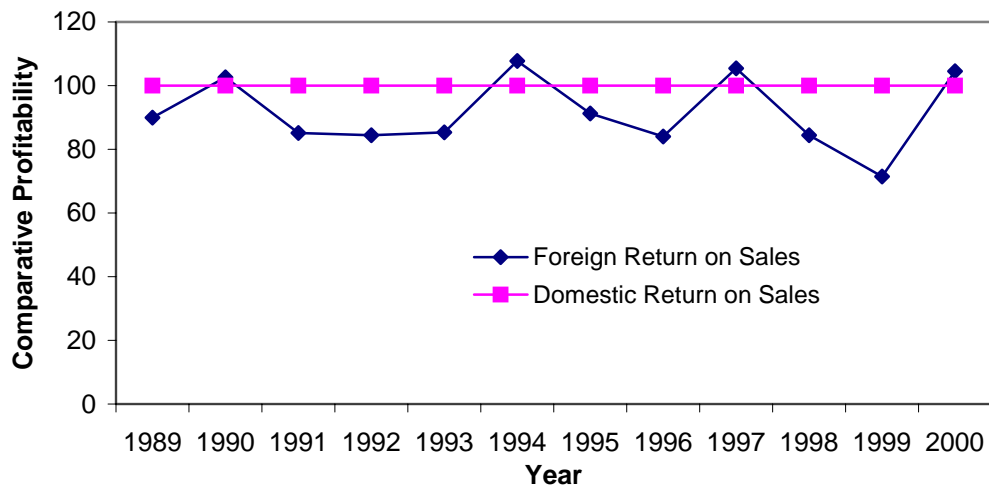
To summarize this subsection, arbitrage is often ignored and even the economic arbitrage that is most often attended to is often underplayed because of inadequate attention to the location-specificity of factors such as labor and capital—actually most factors of production apart from knowledge (which *has* attracted considerable attention)—on the grounds that they are generic factors of production incapable of sustaining firm-specific advantages. However, the evidence on semiglobalization cited towards the beginning of this article indicates that markets for such factors—and for products—continue to exhibit significant barriers to cross-border integration. As a result, even the apparently unspecialized factors of capital and labor are specialized at the level of location, if in no other respect. Thus, they can assume strategic importance in an international context and should be attended to strategically.

IV. Either Or?

The intent behind the detailed treatment of the three generic strategies for dealing with semiglobalization—adaptation, aggregation, and arbitrage—in the previous section was to convey a rich sense of the diversity of the levers for cross-border value creation that companies can seek to pull. Enrichment in this regard should be useful in and of itself, especially given the general profitability gap between even the largest multinational companies' domestic and foreign operations (see Figure).¹⁸ The chronic nature of this performance gap (interrupted only sporadically by the rough equalization of profitability between the two spheres) is illustrated by XXXX hints at issues regarding the performance of foreign operations that go beyond the current climate of globophobia. The importance of these issues has increased over time with the increase in the average share of foreign sales in the total: from 36% in 1990 for the companies in the index to 44% by 2000. Another general cause for heightened concern is related to the increasing variation in foreign-to-domestic performance among the companies included in the Templeton index. Thus, the rough (and short-lived) equalization of profitability in 2000 was largely driven by exceptional performance in foreign markets on the part of a handful of firms rather than by broad improvements in the relative performance of foreign operations. In such a context, it is presumably more useful than ever for companies to make sure that they are thinking of the full bag of tricks as they consider how to create value through cross-border operation.

¹⁸ The data in this paragraph are based on Michael V. Gestrin, Rory F. Knight and Alan M. Rugman, "Oxford Executive Briefing: Templeton Global Performance Index 2001," p. 24.

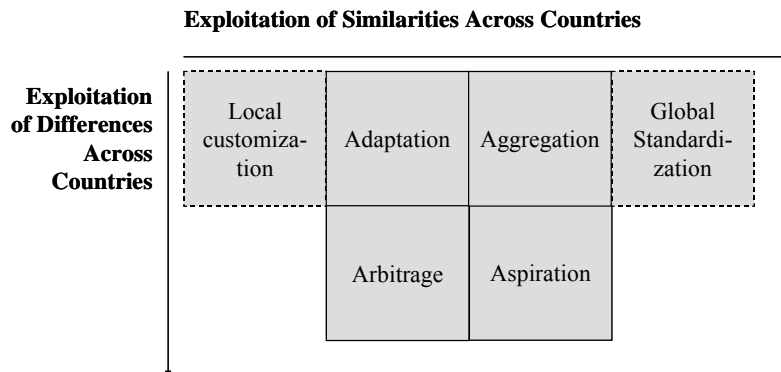
Figure 4: Foreign vs. Domestic Profitability



Source: Recalculated from data in “Templeton Global Performance Index 2001.”

But it would be useful to go beyond the identification of a rich menu of strategy levers for cross-border value creation to consider the relationships among them. Specifically, to what extent is it possible for companies to mix and match across the three strategies of adaptation, aggregation, and arbitrage? To answer this question, it is useful to begin with the reminder that while this article has identified five generic cross-border strategies in total, four of them—local customization, adaptation, aggregation and global standardization—can, as noted above, be arrayed along a continuum involving increasingly aggressive attempts to capitalize on cross-country similarities (as opposed to capitulating to cross-country differences). But the arbitrage dimension is not collinear with this one, since it involves attempts to take advantage of cross-country differences as opposed to treating them as constraints. The implications are summarized in the global gameboard in Figure 5.

Figure 5: The Global Gameboard



Given semiglobalization, the two extreme cells (marked off by dashed lines in the figure) of local customization and global standardization aren't usually of interest: that is confined to the boxes in the two-by-two matrix that are enclosed by solid lines. Adaptation can be seen as a standardized way of dealing with the difficulties wrought by differences among countries for attempts to take a (presumably advantaged) strategy—or business model, relationship network, knowledge base, learning capability, or something along those broad lines—and propagate it geographically by localizing it to some extent. Aggregation and arbitrage involve going beyond adaptation, but in different directions: aggregation further in the direction of exploiting similarities across countries (by pushing more strenuously for economies of standardization than generally implied by country-by-country adaptation), and arbitrage in the new direction of exploiting differences rather than similarities. Finally, there is an aspirational box that can be interpreted as combining elements of all three strategies for dealing with semiglobalization discussed so far.

To explore such aspirations, it is useful to begin by noting that it is at least somewhat plausible to argue that most global companies must incorporate elements of all three generic strategies into what they chose to do. The first two elements are the ones that have mostly been emphasized in writings about the organization of global enterprises, and make obvious sense. Local responsiveness is important for all the deep reasons—summarized in the CAGE framework—that countries can differ from each other: in terms of business systems, infrastructure, relative costs, et cetera even if the products being sold are identical across borders.¹⁹ And aggregation strategies pursue more economies of standardization/scale than permitted by decentralized adaptation while trying not to give up too much local focus in their quest to improve the trade-off between the two over time.

Arbitrage strategies, as noted above, are mostly missing from prior writings—with the exception of the rarefied category of knowledge arbitrage—but their emphasis on economies of specialization (absolute cost economies) and intermediation seems indispensable as well. Thus, it is hard to imagine a global enterprise maximizing value by being entirely insensitive to tax management or various other ways of arbitraging administrative differences. Just as clearly, however, discretion is called for, given both the blurry boundaries between legal tax reduction and illegal tax evasion and the risks that the minimization of taxes can carry for other determinants of competitive position (e.g., Xerox's manufacturing investments in Ireland, which were intended to reduce tax rates but turned out not to generate much in the way of earnings). Similarly, arbitrage around variations in labor costs or other economic differences seems to be an important part of the agenda for most global enterprises. To reiterate a point made in the previous subsection, this insight is not confined to low-end manufacturing: the fact that a product development engineer might cost \$100 per hour in San Jose, \$40 per hour in Singapore

¹⁹ This is most likely to be true in arenas with high design costs relative to number of units demanded, industrial customers, high value per transaction (and high value relative to shipping cost), limited regulation, and “system externalities“ as well as (definitionally) in pure commodities. But the overall number of such product categories seems to be limited.

and \$10 per hour in China surely matters at the high-end as well. And labor arbitrage may even be starting to occur for the first time in many basic service activities (e.g., back office processing, customer service, et cetera), given the new possibilities for offshoring them with the help of information technology.

But there are clearly also tensions across adaptation, aggregation, and arbitrage as generic strategies. A few of the broadest ones—concerning what positions to target, where to locate, and how to organize—are laid out in the table, and it is easy to think of others. With adaptation strategies, one must typically guard—often via strategic control and management intervention systems—against sacrificing too many economies of scale/standardization. With aggregation strategies, excessive standardization or complexity is a key potential problem, and with arbitrage strategies, one must watch out for convergence that threatens the basic approach of playing the spreads. In terms of nonmarket challenges, adaptation strategies are relatively discreet whereas aggregation strategies can stir resentments against homogenization and hegemonism (particularly on the part of the United States in the perceptions of many other countries) and arbitrage strategies are most often challenged on grounds of exploitation or displacement.

Table 3: What, Where, and How: Generic Strategies for Semiglobalization

	Adaptation strategy	Aggregation strategy	Arbitrage strategy
Competitive Advantage: What position to target?	Focus premia/cost reductions; market access requirements	Economies of standardization (scale economies)	Economies of specialization (absolute cost economies) and intermediation
Configuration: Where to locate?	Most dispersed: location of more or less self-contained business systems in different countries	Mixed dispersed/ concentrated: emphasis on cross-border coordination of scale-sensitive activities	Most concentrated: location of activities from which advantage is derived in one or a few countries
Coordination: How to organize?*	Country: focus on local action (subject to centrally developed strategic templates) and learning	Business/matrix/ network: greater emphasis on horizontal relationships across businesses in different countries	Functional: focused on vertical cross- border relationships (e.g., efficiently matching supply and demand internationally)

Such tensions and differences across the columns of the table, coupled with their vertical logic, suggest some limits on the ability to mix and match across strategies. Confirmation comes from the large economics literature on the multinational enterprises, which distinguishes sharply between horizontal multinational enterprises that offer broadly the same line of products or services from their operations in each geographic market (i.e., seek to tap the similarities among countries) and vertical multinational enterprises that produce outputs in some of their geographically dispersed operations that serve as inputs to their other operations (i.e., seek to exploit the differences among countries). How, given these tensions, should firms make their choices? There has been a limited amount of academic research on this topic (see Boxed Insert B for an example). But given the partial state of such research, it seems more broadly useful to look and see what is actually happening at the frontiers of global management.

One interesting example of leading-edge practice in recent years is provided by GE Medical Systems (GEMS), the division that Jeffrey Immelt built up between 1997 and 2000 before he was tapped to take over from Jack Welch as CEO of GE. Immelt pushed for acquisitions to build up scale since an R&D-to-sales ratio of 8%-plus for the leading global competitors created enormous pressures for aggregation/standardization to tap potential scale economies. But he also implemented a Global Product Company (GPC) concept that was intended to arbitrage cost differences by concentrating manufacturing—and ultimately other activities—wherever in the world they could be carried out most cost effectively to GE's exacting standards (six sigma, et cetera). By 2001, GEMS obtained 15% of its direct material purchases from and had located 40% of its own manufacturing activities in low-cost countries and had set itself the target of pushing those numbers up to 50% and 60% respectively. The faster pace of migration to low-cost production bases than GEMS' leading competitors, Philips and Siemens, was facilitated by a pitcher-catcher concept, developed elsewhere in GE, in which for each move, a pitching team at the site of the existing plant worked with a catching team at the new site, and the move was not considered complete until the performance of the catching team met or exceeded that of the pitching team. And Immelt invested in a local face for the business by building up marketing and sales organizations within key markets, in part through new activities such as hosting symposia that deepened relationships with local opinion leaders. In sum, GEMS moved to enhance the effectiveness with which it performed adaptation, aggregation, and arbitrage, i.e., towards the fourth box (enclosed by solid lines) in the global gameboard, labeled Aspiration.

More broadly, many managers, when introduced to this way of thinking about the levers of value creation from cross-border strategies, tend to aspire to the same box as GEMS—to improve simultaneously on all dimensions. This is probably reasonable given the need for managerial action to break or relax compromises between local responsiveness, economies of standardization and economies of exchange over time

Boxed Insert B

COMPLEXITY THEORY AND CROSS-BORDER STRATEGIES: SIMULATION RESULTS

My colleague, Giovanni Gavetti and I have used complexity theory to simulate the relative fitness of local customization, adaptation, aggregation and global standardization. (Note that these generic strategies can be arrayed along a continuum in terms of the strenuousness of the efforts made to exploit similarities across countries; bringing arbitrage into the picture would involve adding a second dimension, so it is left out of this exploratory analysis, which focuses on improving our formal knowledge about the first dimension in the global gameboard above.) Our simulations structure and analyze the interaction of two kinds of complexity: the internal complexity of achieving reasonable coherence across dimensions of choice that interact in complex ways (which can arise even in the single-country baseline assumed in “mainstream“ business strategy) and the extra external or environmental complexities associated with operating across borders.

One set of findings concerns comparisons of adaptation with the polar extremes of local customization and global standardization. In our simulations, adaptation turns out to be the best strategy option more often than not. But just as critically, even when it is best, it tends not to beat the next best alternative by very much. The zone of maximum advantage for adaptation is with intermediate levels of cross-border heterogeneity and potential economies of standardization. But if either dimension is unimportant *or* overpowering, adaptation’s performance advantage fades away or turns negative. The overall implication is that adding adaptation to the global enterprise’s repertoire of strategies typically doesn’t offer much of an improvement, in performance terms, on the dichotomous local customization/global standardization view of the world. This suggests the need to look for alternative strategies for dealing with semiglobalization that *do* promise more significant enhancements in performance. Aggregation is one such alternative that is studied within our simulation structure, and arbitrage is the other.

Our second set of findings concerns aggregation, which we model as taking the specific form of grouping similar countries into clusters. Aggregation into clusters does seem to be the best strategy in the expanded set of four when there is a relatively low or even medium level of within-cluster heterogeneity. More broadly, the potency of aggregation strategies is related to the extent to which collecting and classifying markets along one or a very limited number of dimensions—or bases of aggregation—can capture most of the variation observed in terms of differences across the groups, i.e., limit within-group variance. The returns to clustering, in particular, depend on countries being highly variable in terms of their distance (along the CAGE dimensions) from each other rather than subject to uniform (pairwise) heterogeneity. Note that the pattern of variation of heterogeneity tends to matter more for success with this strategy than does its absolute level.

instead of simply treating the strategic function of (top-level) cross-border management as picking a point off a predetermined possibility frontier. What can be offered here are four principles that may help with the managerial challenge of continuous improvement.

Principle #1: Some of the same approaches that help with adaptive challenges can also be helpful with the meta-adaptive challenge of melding elements of adaptation, aggregation and arbitrage. Thus, GEMS managed to pursue all three approaches partly because it was able to decompose its operations into relatively autonomous clumps of activities where local responsiveness was key (marketing, sales and service), where economies of scale/standardization were essential (product development, among others), and where arbitrage economies were essential (procurement and manufacturing). Similarly, deliberate restriction of the geographic breadth of a company's factor/product market presence permits a focus, in many industries, on creating deep, multifaceted advantages rather than shallow ones. So can the deliberate creation of cross-border integrative capacity (e.g., the pitcher-catcher concept at GE) and the orchestration of a multinational mindset (through activities such as the ones discussed in the context of CEMEX's cognitive internationalization.)

Principle #2: Even under favorable conditions (e.g., ease in splitting up the value chain), there are no perfect solutions for simultaneously adapting, aggregating, and arbitraging. As a result, even aspirational strategies typically end up allotting varying levels of attention to and achieving varying levels of performance with these three approaches. Thus, GEMS's strategy, while more imaginative than most, has encountered its own share of turbulence in the last two years, most notably around the issue of whether to deviate from the Global Product Company (GPC) concept by investing in some "In China for China" manufacturing to boost penetration there. Note that this issue pits the type of arbitrage strategy that is efficient from GEMS's overall perspective against the temptation of being locally responsive (i.e., adapting) to opportunities in a juicy potential market. And that it has real implications for GEMS's resource portfolio, since the GPC concept emphasizes moving procurement and capacity from high-cost to low-cost countries, whereas deliberate creation of capacity in China for the Chinese market could be expected to cannibalize capacity in other low-cost countries. It also seems to have been difficult to decide the issue cleanly since GEMS managers offer "yes and no" characterizations of how the issue of creating "In China for China" capacity was resolved.

Principle #3: While global companies typically perform activities that range across the categories of adaptation, aggregation and arbitrage, it is possible to classify them more cleanly in such terms if one focuses on the cross-border activities *critical* to the creation of competitive advantage (instead of looking at all cross-border activities performed).²⁰ Consider the case of Zara, a highly successful—and internationalized—Spanish retailer of fashion apparel with a business system built around extremely quick

²⁰ Note that the incomplete, variable coverage of adaptation, aggregation, and arbitrage by actual strategies (principle #2) is helpful in this regard since it implies the possibility of multiple distinct strategies per industry rather than one dominant strategy.

response. Zara operates in a vertical chain marked by extensive cross-border labor arbitrage and itself sources some of its apparel from low cost countries. But its competitive advantage rests on the fashion-sensitive items that it makes internally, in its medium cost home base, so as to be able to originate a design and have it in the stores within two weeks for modifications (or restocking) of existing products and four to five weeks in the case of entirely new designs (versus average industry cycles of up to six months for design and three months for manufacturing).²¹ Fast cycle times facilitate continuous manufacture of new merchandise, so that Zara can refresh its offerings during a season based on what is selling instead of locking into them well ahead of time, i.e., can be a fashion follower rather than fashion leader—critical in a category as fickle as women’s fashion apparel. While Zara clearly engages in some arbitrage, that is not what distinguishes it from competitors such as The Gap and H&M. Instead, the distinctively valuable elements of what Zara does are best described in terms of a regional aggregation strategy given the limited effective distribution radius of its manufacturing-and-logistics hub in northwestern Spain and the derived emphasis on deepening its presence across Europe instead of expanding toeholds in other continents.

Principle #4: The key distinction to be drawn clearly is between competitive strategies that principally capitalize on the similarities across countries (typically, aggregation/standardization strategies) and those focused on some of the differences across countries (arbitrage strategies). Acer of Taiwan, one of the world’s largest computer manufacturers, supplies a cautionary example of what can happen with muddles in this regard. Acer entered early into the contract manufacturing of personal computers, and made good money with that arbitrage play. But in the early 1990s, it began to push to implant Acer as a global brand (and basis for aggregation) across countries, particularly developed ones—apparently because of the not uncommon bias towards seeing one’s own brand as a higher basis for multinational competition. In any event, this two-track approach turned out to be problematic. The branded own-product business did grow to significant volumes, but continued to generate losses. And customers for its contract manufacturing arm worried about the spillover of business secrets to and cross-subsidization of Acer’s offerings under its own brand. Matters came to a head in 2000, when IBM cancelled a major order, reducing its share of Acer’s total contract manufacturing revenues from 53% in the first quarter of 2000 to only 26% in the second quarter of 2001. In response, Acer finally made some hard choices. Arbitrage-based contract manufacturing would continue to focus on customers in advanced countries and would gradually be spun off, and aggregation-based branded sales would henceforth focus on the East Asian region, particularly Greater China. Note that this finally aligned the organization’s profile with the simple principle that arbitrage strategies can target countries distant from a company’s point of origin but aggregation strategies should target similar ones. That said, one wonders what Acer’s prospects in mainland China really are like at this point, especially given local competitor, Legend’s, commanding lead. Perhaps if Acer had cut through the confusion between arbitrage and aggregation sooner...

²¹ One corollary of this entire discussion is that diversity of strategic approaches may be observed within the same industry.

V. Summary

Today's globophobia may turn into globaphoria again, and in short order. In such a situation, it would be manic-depressive to continue to use globalization and localization as the only reference categories. It seems more sensible to look for a middle path that permits more constancy of purpose over a longer time frame.

The first step in finding such a middle path is to understand that the world itself does not yo-yo between being globalized and being localized; rather, it is stuck in a state of "semiglobalization"—a situation in which neither the bridges nor the barriers between countries can be neglected.

The second step in improving the practice of global strategy is to think through the generic strategies for dealing with semiglobalization discussed in this paper that are sandwiched between the polar (and generally impractical) extremes of local customization and global standardization: adaptation, aggregation and arbitrage. A grounded review of these possible strategies should yield a rich sense of the diversity of the levers for cross-border value creation that can be pulled.

After thinking through these diverse strategies for dealing with semiglobalization, the next step is to pick and choose as necessary. The extent to which it is possible and profitable to think of melding two or more of these generic strategies is almost always an issue. While global companies typically perform activities that further the objectives of each of the three generic strategies—respectively, local responsiveness, global standardization, and global exchange—it *is* possible to classify companies more cleanly in terms of such strategies if one focuses on the cross-border activities critical to the creation of competitive advantage (instead of looking at all cross-border activities performed). The critical distinction, as emphasized earlier, is between creation of competitive advantage through exploitation of the similarities across countries versus exploitation of the differences.

As a final note, this article has deliberately focused on the strategic rather than organizational challenges of globalization, even though the two obviously intertwine. The reason is that, for more than a decade now, discussions of global management have been dominated by questions of structure and process—how to link far-flung units, build global networks, leverage global learning, find and train global managers, create truly global corporate culture, et cetera. But to decide how to organize without first understanding what an organization is trying to achieve through its cross-border activities seems a little bit like putting the proverbial cart before the horse. Unless, of course, one denies that global companies face meaningful strategic choices, i.e., believes that there is one best global strategy. The discussion in this article should have convinced you otherwise.

REFERENCES

- David Arnold, Julian Birkinshaw and Omar Toulan, "Implementing Global Account Management in Multinational Corporations," In *Marketing Science Institute Report*, 2000.
- Christopher A. Bartlett and Sumantra Ghoshal, *Managing across Borders: The Transnational Solution*, 2nd ed, (Boston, Mass: Harvard Business School Press, 1998).
- Clare Conley, "Coke U-Turn Sees O&M on UK Roster," *Campaign*, October 5, 2001.
- Michael A. Cusumano and Kentaro Nobeoka, *Thinking Beyond Lean: How Multi-Project Management Is Transforming Product Development at Toyota and Other Companies*, (New York: Free Press, 1998).
- Jeffrey E. Garten, *The Big Ten: The Big Emerging Markets and How They Will Change Our Lives*, 1st ed, (New York: BasicBooks, 1997).
- Michael V. Gestrin, Rory F. Knight and Alan M. Rugman, "Oxford Executive Briefing: Templeton Global Performance Index 2001." Templeton College, Oxford, 2001.
- Pankaj Ghemawat, "Distance Still Matters: The Hard Reality of Global Expansion," *Harvard Business Review* 79, no. 8 (2001): 137-147.
- , "Global Product Standardization? A Case Study and a Model," 2000.
- , "Semiglobalization and International Business Strategy," *Journal of International Business Studies* 34, no. 2 (2003): 138-152.
- Pankaj Ghemawat and Rajiv Mallick, "The Industry-Level Structure of International Trade Networks: A Gravity-Based Approach," 2003.
- Jeffrey Immelt. Town Hall Meeting, Harvard Business School, 2002.
- Alan MacCormack, "Venture Design: An Evolutionary Perspective." Module 1 of Managing Technology Ventures, Harvard Business School course, 2002.
- Betsy McKay, "Coke's Daft Offers Vision for More-Nimble Firm," *The Wall Street Journal*, January 31, 2000.
- Rick Krever from University in Melbourne, "Not Shaken, Not Stirred: Murdoch, Multinationals and Tax," Australian Broadcasting Company aired March 22, 1998, transcript available at: <http://www.abc.net.au/rn/talks/bbing/stories/s10609.htm> (accessed March 2003). 1998.

David B. Montgomery, George S. Yip and Belen Villalonga, "Demand for and Use of Global Account Management," In *Marketing Science Institute Report*, 1999.

John A. Quelch, "Global Marketing Guru Interview by Randall Rothenberg," *Strategy & Business* (2000): 93-100.

Chris Roush, "Coke Executive John Hunter Calling It Quits," *Atlanta Journal and Constitution*, January 12, 1996.

Edward Shelton, "Tailoring TV," *Marketing*, July 17, 1997.

D. Eleanor Westney. "Geography as a Design Variable." In *Future of the Multinational Company*, edited by Julian Birkinshaw, George Yip, Sumantra Goshal, Costas Markides and John Stopford. (New York: Wiley & Sons, 2003).

Yunxing Yan. "McDonald's in Beijing: The Localization of Americana." In *Golden Arches East: McDonald's in East Asia*, edited by James L. Watson. (Stanford, CA: Stanford University Press, 1997).