



Semiglobalization and Country Context

Given the note on “Economic Evidence on the Globalization of Markets,” the cross-border integration of product and resource markets, while up significantly in recent decades, remains seriously incomplete. We don’t live in a global village and won’t for a long time to come—irrespective of whether we view this outcome with regret or relief (i.e., how you answered question 3 on the globalization profiling survey).

Incomplete cross-border integration underlines the critical role of location-specificity in the prospects of distinctive content for cross-border strategy relative to mainstream business and corporate strategy, as schematized in **Table A**. Most of your Strategy course (with the exception of the module on competing across locations, on which more below) focused on Quadrant A of the table. Quadrant B is the traditional domain of corporate strategy. Quadrants C and D both offer the opportunity to stretch thinking along a different dimension: location-specificity or nonspecificity. Quadrant C, which emphasizes issues of location-specificity but not business-specificity, is what this course focuses on, for a number of reasons:

- We have to start somewhere
- It seems more logical to start with the simpler case, especially since little is know still about the complex case (Quadrant D)
- It is helpful to be able to continue to apply basic competitive analysis from Quadrant A, and that carries over better to Quadrant C than D.

Table A: Strategy Domains

Focus		Increasing Attention to Business-Specificity/Nonspecificity	
		Single Business	Multiple Businesses
Increasing Attention to Location-Specificity/Nonspecificity	Single Country/ Location	A. (Mainstream) Business Strategy	B. (Mainstream) Corporate Strategy
	Multiple Countries/ Locations	C. International Business Strategy	D. International Corporate Strategy

The second module of G&S has focused on location-specificity or, more broadly, country analysis, and has been more framework-focused than the other modules in the course will be. Many ideas for country analysis, often aimed at diagnosing international competitiveness, have been proposed and at least some of them are so widely used that anyone who works in international strategy has to have a point of view about them. Two such frameworks—Porter’s “diamond” framework for assessing international competitiveness and the World Economic Forum’s International Competitiveness Index—were studied in this module in the specific context of Finland and Nokia and Turkey and its garment industry respectively. Other frameworks were or will be reviewed as well, including the readings from your Strategy course.

The overall objective of the second module in G&S is to achieve a better sense of how to fit together different strands of thinking about country-level effects rather than to rank these different schemes for analyzing countries.

I. Generalized Country Analysis

One approach to country analysis is exemplified by the note on “Country Analysis” that was an optional reading for your BGIE course. That note focuses on how to build a holistic picture of the national business environment, in terms of three interrelated components:

- Strategy: a nation’s implicit and explicit *goals* and the *policies* designed to achieve those goals. Respects in which policies are distinguished include (a) the extent to which they emphasize *laissez-faire* as opposed to the state’s role and (b) in terms of their impact on whether a country is inward- or outward-oriented.
- Contextual components: the *resources* at the nation’s disposal and the “*players*” and “*rules of the game*” that define a national system and structure the incentives to mobilize and allocate those resources. The relative abundance or scarcity of resources is emphasized, but so is the idea that the performance outcomes achievable from them depend critically on the players—firms, governments, nongovernmental organizations—and the formal and informal rule systems that shape their interactions.
- Performance: the *economic, political, and social outcomes* that flow from national strategy, constrained by country context.

These components of generalized country analysis serve, obviously, as useful ways of organizing information for country analysis (see **Table B**). After actually assembling the information, the country analyst is urged to examine the interrelationships among components, drawing upon theory and knowledge of similar empirical relationships in other times or places, with the ultimate objective of being able to evaluate policy and policy packages from a country-level perspective. This was, for instance, the primary focus of our discussion of Finland in the context of the case on “Finland and Nokia.”

Table B: Organizing Information for (Generalized) Country Analysis

Strategy	Context	Performance
<i>Goals:</i>	<u>National</u>	<i>Economic</i>
Higher per-capita income level and growth, equality of income, stability, autonomy, defense, etc.	<i>Resources:</i> Labor, capital, natural resources, technology, geography	GNP National income accounts Prices (wages, interest rates) Inflation Unemployment, etc.
<i>Policies:</i>	<i>Players in the Game</i>	
Fiscal, monetary policies	Firms	
Exchange rate policies	Government actors	<i>Social</i>
Trade and investment policies	Non-state organizations	Income distribution
Sectoral policies	Unions, employer assoc., religious groups, political parties, etc.	Fertility, mortality, Literacy, etc.
Industrial policies	<i>Rules of the Game</i>	
Social Policies	Formal rules - economic (e.g. property rights, contract law), political (e.g. federal system, sep. of powers), treaties	<i>Political</i> Political stability, political freedom, etc.
Constitutional reform	Informal rules - conventions, culture, religious beliefs, ideology	
	<u>International</u>	<i>International</i>
	Location	Balance of payments Exchange rates
	International Organizations	Tariffs, quotas
	Treaties on Trade and Investment, international monetary system	

Source: "Country Analysis: a Framework to Identify and Evaluate the National Business Environment," HBS case # 7978-092, p. 9.

II. The WEF's Country Competitiveness Rankings

A second approach to analyzing the differences among countries is supplied by the World Economic Forum's country competitiveness rankings in its Global Competitiveness Report. The empirical base of the WEF rankings has expanded over the years, both in terms of numbers of countries covered (to 75 at last count) and the types of information provided (e.g., related to information technology), and there have also been significant changes to the actual formula for aggregating all this information into some ranking of the overall "competitiveness" of countries as places to do business. In the last application in particular, the approach assumes the existence of a single, simple yardstick for mapping the wealth of information assembled by the WEF into a scalar measure of each country's performance or potential. The yardstick is partially based on variables suggested by economic theory and calibrated from historical experience.

Table C summarizes the principal factors built into the WEF rankings and some key subfactors. But a better sense of how the ranking process actually works is provided by revisiting our class discussion of how

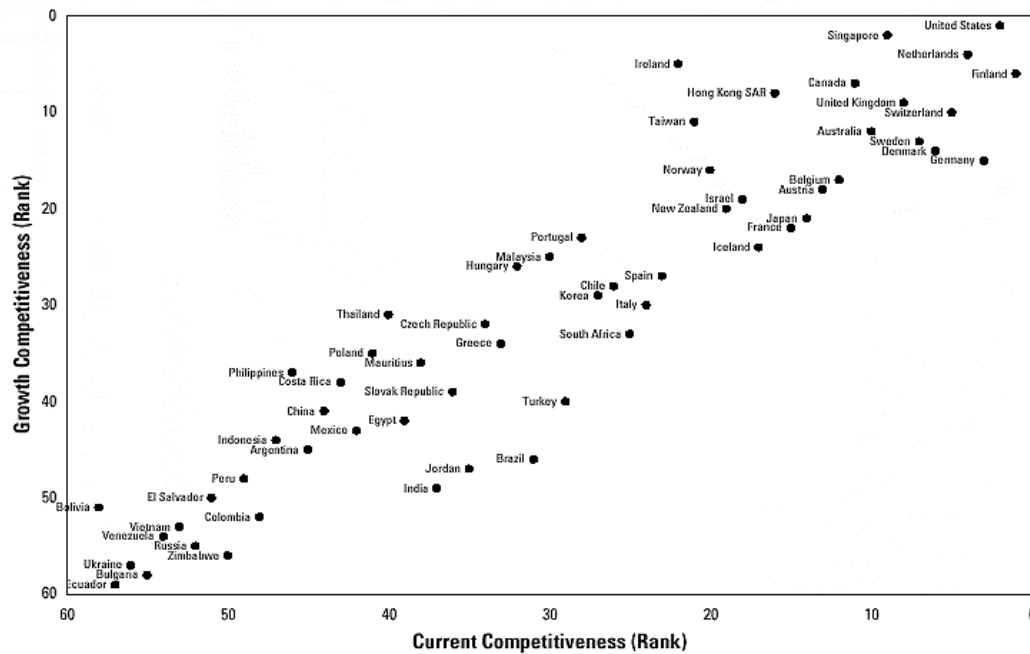
Turkey was ranked 36th out of 53 countries in 1997. The rankings then relied on 170 criteria on which each country was assessed if possible. Raw scores on these criteria were aggregated into subindices for eight “factors” that were supposed to be the key determinants of long-run economic growth: openness, government, finance, technology, infrastructure, management, labor, and institutions. For openness, government, finance and labor, three-quarters of the weight was assigned to hard data and one-quarter to subjective data obtained from the WEF’s Executive Survey; for infrastructure and technology, the weights were reversed; and for management and institutions, exclusive reliance was placed on subjective data from the survey. The Executive Survey that supplied the basis for the subjective data involved measuring the opinions of 3,000 business executives around the world about the country in which they operated. The overall Competitiveness Index was calculated as a weighted average of the eight factor sub-indices: weights of one-sixth each were assigned to the four factors whose values rested primarily on hard data, of one-ninth to the two whose values rested primarily on subjective data, and of one-eighteenth to the two whose values were entirely based on subjective data. The WEF also reported on subfactors that grouped some of the criteria used to construct its rankings.

Table C: The WEF’s Country Competitiveness Rankings

- ◆ **Openness**
 - Tariffs & hidden import barriers
 - Export Promotion
 - Exchange rate policy
 - Joint ventures, FDI
- ◆ **Government**
 - Level of state interference
 - Competence of government
 - Tax burden & evasion
 - Size of government
- ◆ **Finance**
 - Extent of intermediation
 - Efficiency & Competition
 - Financial risk
 - Investment & saving
- ◆ **Infrastructure**
 - Telephones
 - Support for infrastructure
- ◆ **Technology**
 - Home-grown technology capacity
 - Transfer via FDI or foreign transfer
- ◆ **Management**
 - Non-human resources related
 - Human resources management.
- ◆ **Labor**
 - Skills and productivity
 - Regulatory flexibility & efficiency
 - Industrial relations
- ◆ **Institutions**
 - Competition indicators
 - Quality of legal protection
 - Police protection & mitigation of organized crime

Perhaps the most significant substantive change to the rankings recently has been that the version released in September 2000 recast the index used in previous years into a “growth competitiveness” index, and supplemented it with a “current competitiveness” index.¹ The former can be thought of in terms of productivity growth potential and the latter in terms of current productivity. The relationship between the two measures as of 2000 is depicted in **Figure 1**.

Figure 1 Growth Competitiveness versus Current Competitiveness



Source: *World Economic Forum*

III. The Diamond Framework

A somewhat different way of thinking about the influence of country attributes on international competitiveness is provided by the “diamond” framework proposed by Michael Porter. According to this framework, a country/region is likely to prove to be a home base for internationally successful competitors in a particular industry if it is characterized by the following conditions:

- Factor advantages, especially highly specialized pools of skills, applied technology, infrastructure, and sources of capital (as opposed to general purpose inputs that are inherited as opposed to created, and whose dearth may even be a spur to innovation)
- Demanding local customers who are among the most sophisticated buyers in the world for the industry’s products or services, or who have unusually intense needs for specialized varieties that are in demand elsewhere
- Strong related and supporting industries, as reflected in a critical mass of competitive, home-based suppliers of the specialized components, machinery, and services that are essential to innovation
- Vigorous rivalry and, more broadly, strategies and organizational structures that induce innovation and dynamism

Porter also emphasizes that the diamond is a system, i.e., that all four conditions, not just vigorous rivalry, must hold for true innovation, dynamism, and upgrading. The countries favored with the best diamonds or innovation systems in a particular industry are supposed to wind up as the home bases for the

internationally successful competitors within it. A corollary is that location-specificity is very high. In Porter’s own words,

In a global economy where it is easy to move goods and information around the world, these things become givens available to any enterprise. As a result, they are no longer a source of competitive advantage. The decisive, enduring advantages, therefore, become unique local centers of innovation.²

Note that the assumption of a sharp dichotomy between products and information that can be sourced from a distance at relatively negligible cost and those that are embedded in the local context to the extent of being effectively immobile lets Porter suppress issues of transnationality, such as the ability to tap into foreign diamonds, and focus attention on home base characteristics. Nevertheless, the framework can be used to identify countries other than Finland that looked as if they would contain important local centers of innovation and in which, therefore, Nokia had to participate in ways that went beyond simply selling its mobile phones.

IV. The Institutional Voids Framework

The framework for thinking about competition across locations that you studied in the first-year Strategy course, in the note titled “Local Institutions and Global Strategy” (from which this section draws), focused on “institutional voids”: the absence of specialized intermediaries (see **Table D** for examples) that make markets work well by reducing transactions costs. While one might talk of institutional differences rather than voids, and while institutional factors can shed light more broadly on issues of industry structure, firm positioning and sustainability, that broader terrain should have been covered in first-year Strategy course, for which this note was assigned. The part of the note that is of particular interest here is the part that focused on the geography of competition.

Table D: Specialized Intermediaries within a Country

Market for Finance	Venture Capital Firm Private Equity Provider Mutual Fund Bank Auditor
Market for Management Talent	Management Institute/ Business School Certification Agency Headhunting Firm Relocation Service
Market for Products	Certification Agency Consumer Reports Regulatory Authority (e.g. Food & Drug Administration) Extra-judicial dispute resolution service
All Markets	Judiciary (Property Rights Enforcement)

Source: Tarun Khanna, “Local Institutions and Global Strategy,” HBS case #702-475.

The implications are summarized succinctly in the same note:

The availability of specialized intermediation varies drastically by location—to caricature, “advanced,” i.e. well-functioning, market economies rely on deep pools of specialized intermediaries in product, labor and capital markets, whereas poorer countries—“emerging markets,” are characterized by “institutional voids.” This is not to imply that there are no institutional differences among so-called advanced market economies or among emerging markets...[But] to continue our previous caricature, companies from developing countries must choose ways to compensate for the extensive institutional voids in their environments [i.e., “adopt organizational structures to mitigate effects of voids” or “access overseas institutions as substitutes for domestic ones”], whereas companies in developed countries can choose to capitalize on their superior institutional environments to exploit opportunities in less advantaged locations.³

In addition to mitigating voids, organizations from developing countries or “emerging giants” can also capitalize on them, as suggested by our brief discussion of the caselet on EGS acting as intermediary for the Turkish garment industry in dealing with Turkish customs officials.

V. The CAGE Framework

A somewhat different approach to country analysis, explicitly rooted in semiglobalization and keyed to understanding the underlying differences or similarities across countries by looking at them on a bilateral (or multilateral) basis, rather than one-by-one or unilaterally against a common yardstick, is suggested by the CAGE (an acronym for cultural, administrative, geographic, and economic) framework. Since a separate reading will be assigned later on the CAGE framework, it is discussed relatively briefly here—although, since you haven’t been exposed to it before, at slightly greater length than the frameworks discussed above.

The CAGE framework highlights the attractions of thinking of countries in relation to each other by thinking of them as existing in space with different amounts of “distance” between them: distance defined broadly to include not only the physical distance between countries but also the cultural, administrative, (other) geographic, and economic differences between them. Its components and use can be illustrated by reconsidering the question of why Turkish garment exports were so heavily focused on West Europe (70% of the total in 1995, with East Europe accounting for another 11%). See **Table E**.

Table E: The CAGE Framework for Distance Analysis

CAGE Component	Cultural Distance	Administrative Distance	Geographic Distance	Economic Distance
Country-level differences/ similarities	-Heaviest concentration of Turkish diaspora, particularly in Germany -German language skills	-Customs union with Europe	-Proximity: affects not only costs but more importantly shipping lags (1 week versus 4-7 for other exporters) -Also suitcase trade (East Europe)	-Higher willingness to pay and, especially, higher labor costs in W. Europe
Industry-level significance	-Independent stores run by Turks overseas originally important channel	-Trade generally restricted in the garment industry by MFA	-Compression of fashion cycles in the garment industry (“Zara” case)	-Comparative advantage based on cheap labor critical here

The CAGE framework is grounded in research that suggests that cultural, administrative, geographic, and economic differences or similarities have powerful effects on, and collectively explain very well, variations in bilateral trade intensities (and in some studies, the intensity of flows of investment and portfolio capital) between country pairs. **Table F** presents the results from one statistical study (using multivariate regression analysis). Note that while physical distance depresses trade—other things being equal, each 1% increase in distance between a pair of countries reduces bilateral trade by 1.1%—there is a broad range of factors with even more dramatic effects. Thus, other things being equal, countries that speak the same official language are estimated to trade three times as much with each other (200% more) on average as otherwise similar countries with different languages from each other. Of course, these effects are averaged across all industries; in most business situations, one has to push down a level or two and analyze whether the effect of CAGE differences/similarities at the country-level is likely to be large in a particular industry setting or even a particular firm’s circumstances and strategy.

Table F: Country-level Influences on Bilateral Trade Flows

Dimensions of Distance/Prox.	Determinant	Change in Trade ⁽¹⁾
Cultural	Common Language	+200%
Administrative	Common Regional Trading Bloc	+330%
	Colony/Colonizer	+900%
	Common Colonizer	+190%
	Common Polity	+300%
	Common Currency (after controlling for previous 3 variables)	+340%
Geographic	Physical Distance: 1% increase	-1.1%
	Physical Size: 1% increase ⁽²⁾	-0.2%
	Landlockness ⁽²⁾	-50%
	Common Land Border	+80%
Economic	Economic Size: GDP (1% increase)	+0.8%
	Income Level: GDP per capita (1% increase, holding GDP constant)	+0.7%

(1) Estimates based on a gravity model estimated by Jeffrey Frankel and Andrew Rose, "An Estimate of the Effects of Currency Unions on Growth," Unpublished working paper, May 2000.

(2) Based on a specification estimated without the last four variables in the administrative category.

Several additional aspects of the CAGE framework are worth mentioning here. First, measures of distance or, inversely but equivalently, closeness are often correlated across the cultural, administrative, geographic, and economic domains. For example, it is hard to imagine countries being close administratively—e.g., part of a free trade area—unless they also happen to be close culturally, geographically or economically. The distinctions among the four domains are retained, nevertheless, because they rely on distinct mechanisms for sustaining international difference.

Second, while the differences or distances flagged in **Table E**, in particular, had an essentially bilateral character, one can also integrate the unilateral influences—i.e., influences specific to individual countries rather than to country-pairs—on cross-border economic activity into the CAGE framework. The conceptual link is that *isolation*, which captures country-specific attributes that generally reduce a country’s involvement in cross-border economic activities, can be treated as a common component of that country’s distances from others. In other words, really isolated countries (e.g., characterized by unique cultures, closed administrative policies, physical remoteness, et cetera) can be thought of as distant from everywhere else, whereas central ones tend to be relatively close to others. Note that this common-component approach can

also be used to handle certain multilateral as well as unilateral measures, e.g., whether a particular country generally is or isn't a member of the usual international organizations. The coverage of unilateral attributes is, nevertheless, abbreviated here, because these attributes were already stressed in the other frameworks for country analysis presented above.

Finally, it is also worth noting that the CAGE framework, while pitched at the national level, can also be applied in some respects to differences within nations. This and other applications will be elaborated on in the reading assigned for later in the course on the CAGE framework.

VI. Postscript

In our class session on Wednesday, September 25, we will focus on comparing and contrasting the frameworks presented in this note so that we arrive at some common conclusions about how we are going to approach country analysis in the rest of the course—and, hopefully, when we encounter real-world problems where it is important. This will wrap up the second module of G&S, on frameworks for country analysis, after which the primary emphasis of our class sessions will shift to looking at cross-border issues from industry- and firm-level perspectives.

Endnotes

- ¹ There a number of other new lists as well in the latest *Global Competitiveness Report*, including country-by-country indices for economic creativity and the stringency of environmental regulatory regimes.
- ² "Porter's Paradox," *Harvard Business School Bulletin*, April 2000, p. 27. Note the similarity with Porter's argument in his article, "What is Strategy?," that was assigned for the Strategy course, in which operational efficiency is taken as a given, implying a focus on tradeoffs.
- ³ Tarun Khanna, "Local Institutions and Global Strategy," HBS case #702-475.