Lecture Text

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Getting Globalization Right

(*edited for clarity*)

Globality and Globaloney

Globalization is a little bit different from some of the things that we've looked at, because it is something that people tend to have strong intuitions about, not just from their business experience, but from the non-business components of their lives. And in particular, globalization is something that seems to inspire very binary images. And we can think of a number of different binary images of this sort. There's Tom Friedman's *The Lexus* (as in a modern product) *and the Olive Tree* (a traditional product). There's Benjamin Barber's "Jihad vs. McWorld," and you can guess what that is about. My two personal favorites are this opposition between globality and what Claire Booth Luce originally talked about as globaloney, a notion subsequently recycled by Paul Krugman. And these are frequently very helpful at sorting out people in terms of the attitudes they bring to bear to globalization. Let's just take a little bit of the data before we roll forward and think about what this means for strategy.

Trade

Here we have some trade data charted. And again, the reason for putting these data up is to just get some empirical perspective on globality versus globaloney. And what we see—this is a pretty long time frame, 1820 to the present day—what we see is that there have been fairly huge increases in trade intensities, trade as a percentage of world GDP over this period, and that, in particular, this particular variant of globaloney that says, "Nothing much has really changed since 1913"—which is favored by historians and other such people—is something that isn't quite borne out by these data. Because if we look at where trade intensity was in 1913, yes, there was a little bit of a peak there. There was a drop off in the inter-war years, but we're comfortably past where things used to be back in 1913. There probably is something new, at least in terms of trade intensity, relative to what the world was like before the onset of World War I. So that's one piece of data on trade.

Now, interestingly enough, when economists look at trade data they aren't focused so much on the new records being set. What they're really focused on, as a profession, is the mystery of why there is so little trade, rather than so much trade. And what I have up on the slide are the results of a study that really inspired a lot of people in the profession to start thinking very hard about why trade was so small, rather than why trade is so large.

People in particular took Canadian data on the extent to which Canadian provinces trade with each other, and compared it with the extent to which Canadian provinces trade with U.S. states. And they did multi-variate regressions, controlled for the size of the states, controlled for physical distance, all the usual kinds of things. What they found after that, back in 1988 when NAFTA was just unfolding, was that Canadian provinces trade twenty times as much with each other, after normalizing for all this variation, than they do with U.S. states at a similar distance, of a similar size, etc. NAFTA has reduced that number a little bit. That multiple had come down to twelve by the mid-1990s. But the interesting thing to remember here is that the multiple still seems like it's in double-digits. And this is really remarkable because if you think of the United States and Canada, these are almost natural trading partners, right next to each other, common border, general friendliness—despite some recent tiffs between Prime Minister Chrétien's people and the Bush administration—and the largest bilateral trading relationship in the world.

So if trade within Canada is so much better developed than trade across this apparently porous border with the United States, that really suggests to us that the levels of trade that we're observing, while much higher than in the past, stopped very far short of being at the level that we would expect to see them at if there wasn't a national border between Canada and the United States. Now this is not a proposal for the two countries to unite. That's not what I'm suggesting here. The only purpose for putting this slide up is to demonstrate that although there have been these rapid increases, if we take as one of our benchmarks this benchmark of globality, of perfect integration across national borders, we're very, very far from that still.

Foreign Direct Investment

And we can do the same thing with the FDI data. This foreign direct investment data has a slightly shorter time frame. It only starts in 1909, and continues on through the present day. And some of this is really very similar to the trade statistics that we've seen. So things looked pretty good back in 1913 because there was a bunch of imperial powers that controlled much of the world. There was the Gold Standard, etc.—lots of investment money flowing back and forth. Big drop off in FDI stocks between the two wars, then a pick up. And it was really only in the 1980s that foreign direct investment levels got back to the level that they had been at back in 1913.

So it's a little slower emergence from the turmoil of the inter-war years than we saw in the case of the trade statistics, which had eclipsed previous records by the 1960s or 1970s. But, again, it casts doubt on the hypothesis that nothing much has changed since 1913. We now are substantially farther ahead than we were back in 1913.

Market Integration

What I've tried to do on this slide, on the horizontal axis, is to depict countries by their share of world gross fixed investment. And on the vertical axis, I've taken some summary measure of FDI intensity, the fraction of investment taking place in the country that's accounted for by Foreign Direct Investment. Let me explain the dashed lines that we have up there. The idea is that if this characterization of globality, of a sea of capital unsegmented by national boundaries of any sort, actually were correct, we'd expect countries to lie, depending on how large they were in relation to the world economy, somewhere along this line.

So, for instance, suppose that there were a country—there is none—that had 75 percent of world gross fixed investment, which accounted for 75 percent of the world's gross investment resources. Now if the investments being made in that country were being drawn from a global pool of capital without attention to what the source of that capital actually was, you'd expect 75 percent of it to be funded by domestic capital, because that's the share of domestic capital in world capital, and about 25 percent to be funded by foreign capital, because that's how much capital the rest of the world has. And so that's why I've drawn this dashed line suggesting that a country that accounted for 75 percent of world gross fixed investment would, if we really believed in globality, be something that we would expect to have a foreign direct investment intensity of about 25 percent.

For instance, a country with a 10 percent share of world gross fixed investment might, according to a measure like this, be expected to have an FDI intensity of 90 percent. If things really were perfectly integrated, and I'm living in Upper Ruritania, I don't really care where my capital is coming from, whether it's from Upper Ruritania or the rest of the world. So if Upper Ruritania is really small, and we're global, most of my capital investment is going to be coming in from overseas.

What Data Tells Us

So let's try and summarize where we've been with these data before we move on to talking about strategy. And it's fairly clear that, as I've said a couple of times, this notion that there's nothing new out there is a little bit too jaded. It does seem, when you look at these measures that I've put up, it does seem that in general, along most of these dimensions, the world seems substantially more integrated than it was ninety years ago. On the other hand, it also seems that we're very, very far from a situation where we can just ignore national borders, where we can just say capital markets are all interconnected, labor markets are all interconnected; and we live in this e-mail driven, hyper-reality that Dan Yergin was talking about during his definition of globality.

So neither of those two extreme characterizations really does seem to apply very well. Instead, where we seem to be, as a description of our current state and as a likely predictor of where we're likely to be over the next ten, twenty years, is in this intermediate zone. Somewhere between total isolation of markets and total integration of markets is where we currently seem to be. And I wanted to point out two further corollaries to that. The first thing is that if we extrapolate past trends, whether it be trade intensity, FDI intensity, even if we believe that the level of integration of markets is going to continue to increase, as most of this group did in its responses to the questions, it is going to be a long time before those levels of integration approach the levels corresponding to globality, where we can just ignore boundaries.

And the second corollary or caveat that I'd like to highlight is that we do tend generally to have faith in monotonic progress. So if this is progress, we probably expect monotonic, unidirectional increases in globalization over time. It's worth remembering from the experience of the inter-war years that there is potentially a reverse gear to the process as well a forward gear, and that whatever else may happen, even if the long-run trend is towards increased globalization, the likelihood that it's going to be a smooth path, with no shocks, no reverses, seems to be a very low likelihood indeed. And this is, perhaps, a little bit more obvious in 2003 than it was, say, back in 1999 or 2000, if we think of the events we've seen in the world over the last two or three years. So, that's the introductory part of just where we are.

Implications for Strategy

The reason it matters for strategy is that, in some sense, there's a non-linear relationship between the level of cross-border integration of markets and the scope for international strategy, to have content distinctive from what we usually call mainstream strategy, which, basically, just means single-country strategy. And what I'd like to do is try and explain that using this little bell curve that I have up on the slide.

If markets really were completely localized, if countries were totally separated from each other, you could probably chunk up your strategic problem, basically take the tools and apply them, country by country by country, to your choice of problem. And similarly, if markets were totally integrated, all we would have left is one large country. And presumably, the same logic applies. We just take out our standard single-country strategic analytical tools, apply them to the world at large, and we're done.

So if we're really looking for where there's got to be something that we have to add to the basic tools, the condition under which it's necessary to go beyond those very basic single-market tools is the situation of intermediate integration across borders that I've called semi-globalization. Other people have different names for it. But that basically is what gives us the possibility for a range of internationalization strategies that might make sense.

In contrast, at the extremes, strategic choice is actually very straitjacketed. If markets were totally separated, your strategy should probably be one of total localization. When in Rome, do as the Romans do. When in Madrid, do as the Madrileños do, etc. Similarly, if things were totally integrated across borders, then the obvious strategy would be one of standardization. You make the same thing, and sell it exactly the same way everywhere around the world. So the reason international strategy is challenging and interesting and offers some degrees of freedom is intimately related to our diagnosis of the levels of cross-border integration being at intermediate levels. So we can't ignore the barriers amongst countries, but we can't ignore the linkages amongst them either.

Academic Debate

So some of this may seem very obvious to you, and it's worth pointing out that there are still serious debates going on about this topic. Just last week, I found myself at a colloquium here at the school talking about the twentieth anniversary of the publication of this very famous article by Ted Leavitt called "The Globalization of Markets." And Ted's pitch was very much an early—he didn't use the term globality—but that's one way of thinking of what he's talking about here. His pitch was we're already in a globally integrated world or soon will be. Therefore, the only strategy that companies should be thinking of following across borders is one of doing the same thing in exactly the same way in each location in which they compete around the world.

In case you're curious, this went the way many academic colloquia do. People who came in thinking that this was correct left thinking that this was correct. And people who came in with the opposite opinion also departed essentially with their opinions intact. So the debate continues, at least in academia, which is one indication that what we've been through so far is probably worth thinking about a little bit further.

Having said that, some of you are probably not too surprised that academics continue to debate things like this, because there is a certain impression that academics have a lot of time to waste on topics like this. So it's perhaps a little bit more reassuring if we shift from academia to the world of practice.

The Case of Coke

So let's take a company that many people regarded, still regard, as an exemplar of sophistication when it comes to thinking about issues of globalization. Let's think about Coke. And, in particular, let's think about what's happened at Coke over the last eight to ten years, because the company has gone through some very interesting strategic changes in terms of how it's thinking about globalization and how it's dealing with globalization.

So first in this abbreviated chronology was Goizueta, as CEO through 1997. And under Goizueta, Coke was, to marketing mavens, the exemplar of global standardization. Lots of centralization in Atlanta, lots of standardization of the brand message everywhere around the world, progressively less and less autonomy left for the country managers to actually decide anything in the local context. And so the official mantra of the company at this point was, as you might guess, "think global, act global."

Now this worked pretty well for a while. And Goizueta certainly retired at the height of the success of his strategy. But afterwards, things really didn't go so well. And there's a CEO who succeeded Goizueta, Doug Ivester, who weathered a lot of these problems and basically came to the conclusion that Coke's traditional strategy wasn't working, given the number of different challenges that they faced in different parts of the world.

So Ivester resigned, and next we had Douglas Daft, who had run bottling operations in Asia-Pacific and was very strongly of the view that the big problem at Coke was not with the countries. The big problem at Coke was with headquarters in Atlanta, and that bureaucracy needed to be cut down. And so in March 2000, Daft published a truly extraordinary article on the same day in both the *Financial Times* and the *Wall Street Journal*—it would be a nice trick if I could manage that—which was titled "Think Local, Act Local." And this was, basically, a mea culpa, that while the world is fragmenting and demanding progressively more diverse product offerings, Coke, for far too long, continued to centralize what it was doing, continued to standardize what it was doing, and really created some huge bottlenecks in terms of being responsive to the market.

So Daft announced a couple of changes. Most notably there were firings, but most of them were concentrated in Atlanta rather than out in the field. Second, remarkably for Coke, the people running the regions were actually sent out to live in the regions, which was a little bit of a break, as well, with past policy. But most remarkably, there was for a while a decree that there would be no more global advertising campaigns, none of the sort of carefully coordinated, multi-country, "Here's what the product is about" pitches for which Coke had earned such accolades early in the 1990s when it pioneered that approach. So that was March 2000.

By December 2000, we have Daft again, not really discussing the strategy in terms of "Think Global, Act Global," or "Think Local, Act Local," but approvingly citing somebody else who described Coke's strategy as post-global. Now this sounds, at least to me, very intriguing. I teach a course on globalization. I'd better find out what this post-global organization is, that seems to be the cutting wave of the future.

So based on talking to industry analysts, looking at clippings, current and former Coke employees, we tried to track what all of these changes have actually meant on the ground at Coke, particularly in terms of marketing, because those were the choices that were affected the most by these changes in direction. So under Goizueta, a very uniform strategy, a lot of the key things were basically all done at Atlanta. Daft came in, and you actually do see some attempt to push these things out from Atlanta, into the field. And this is early in the Daft period.

If we look at the most recent two years, well, the last column isn't entirely identical to the first column. There's a little bit of a difference around promotions policies under Goizueta versus promotions policies later on in the second part of Daft's reign. But it doesn't look like post-global is very, very different from the original "Think Global, Act Global" message that Goizueta was so fond of and that got repudiated in such dramatic fashion by Daft.

So what are we to make of this? Several possible interpretations. There is the view that, basically, these sorts of reorganizations are what keep people within organizations on their toes. This is part of the great circle of organizational life, and it just has to happen over time. A slightly more nuanced—if this can be called nuanced—view of this is that Coke is such a big beast that you've got to whack it over the head very, very hard for it to notice anything, and that that's what this, "Think Local, Act Local" initiative that Daft announced was really supposed to do. So that's the benign interpretation.

Dinosaur or Dodo

I have a slightly different interpretation, and this is really non-judgmentally characterized in terms of two extinct animals not noted proverbially for their intelligence. What I see Coke doing is, to me, almost like the stylized image I have of how many companies set their global strategies. There's a period in which people get over-enthused by the prospects of integration across markets. They say, "Aha, we're operating in the realm of globality. Complete integration of markets is either at hand or nigh. Let's put everything together and come up with something that functions very well as an entire unit, without too much internal differentiation." And predictably, in most industries, what happens is that that doesn't quite work out, because the underlying reality is somewhere else. The underlying reality is somewhere in the middle. And so as the organization hits that particular wall associated with trying to achieve successful dinosaur economics, it bounces back and frequently goes shooting off in the other direction into dodo economics, which is sort of the complete opposite. This is, "I'll hunker down in my own little patch, hope that nothing really bothers me, and really focus on localizing what I do to each local territory in which I operate."

And we know what Dodo's localization strategy on the island of Mauritius yielded once the Portuguese brought in dogs and pigs. Something analogous might happen here, or you might just run into basic problems associated with the fact that in Coke's case, the marketing expenditures shot up tremendously once they gave all the countries the power to make their own ads. And so Coke is sort of a little bit, or seems to be, on the rebound from some of excesses of thinking that the world really is localized rather than globalized. They've kind of come back to where, in effect, they were earlier on before they got carried away, first in the direction of overestimating globalization, and then second in the direction of underestimating globalization. So that is one little characterization of the Coke strategy.

The reason I have put these images up is that I wanted to highlight the possibility that the focus on whether the world is really global or really local distracts managerial attention from the important task, which is figuring out how to manage in the middle. Notice that Coke was using a very limited set of instruments to deal with the challenges of configuring itself appropriately in this context. It was, basically, "Do we centralize decisions or do we decentralize decisions?" And what I'd like to spend most of the rest of the period doing is getting us to think a little bit about how companies can expand the strategy space associated with this middle region of semiglobalization. Because, if after looking at the data out there we conclude that we are in this middle, intermediate state, it might be useful to have a couple of tools, rather than just centralization/decentralization, as our way of trying to create strategy under a context where we can't assume either complete globalization or complete isolation.

Three Strategy Options

And so, what we're going to run through are a couple of different strategy options for competing in the middle. The first and most obvious one is adaptation. And this will sound pretty familiar. The thing that I want to highlight for now, which I will elaborate on in a few minutes, is that this is a lot broader than decentralization/centralization or decisions about tweaking product features. But there are a range of specific mechanisms that one can think about that may make it easier to actually adjust a business model to some of these differences across countries. So that's generic strategy number one for this middle zone.

The second strategy that we're going to talk about is a strategy of aggregation. And the notion of aggregation is the following: One of the big problems with adaptation strategies is that by the time everybody within a global company has finished adapting its business model to their local situation, frequently the sense is that the very reason for being global has been given up, that the economies of scale that the company was originally built around have been destroyed. And so one of the issues with adaptation is whether it comes at too high a cost in terms of your ability to really exploit global economies of scale. And aggregation is the notion that maybe country-by-country adaptation is not the best way of simultaneously trying to be responsive and to tap economies of scale.

While countries are all different, for example, some countries are more alike than others. So, instead of doing country-by-country adaptation, one might, for instance, think of pursuing a regional strategy. One might think of other bases of aggregation, which we're going to talk about, all of which have the common characteristic of involving much more strenuous attempts to achieve economies of scale than a purely passive country-by-country adaptation model might actually entail. So if adaptation is, in some sense, succumbing to differences, aggregation is trying to overcome those differences, to some extent, and still tap some additional economies of scale.

Finally, the third strategy that we'll look at is very, very different. Because if we think about both aggregation and adaptation, these are both strategies that ultimately, in terms of the sources of value creation that they target, are still really focused on the similarities across countries. In many situations, one can conceivably think of differences not just being a source of constraint on a company's strategy, but actually serving as sources of economic value from cross-border operation. And so arbitrage strategies, which tend not to get talked about a lot in international business or discussions of globalization, are attempts to go out and make a virtue out of the necessity of recognizing that countries differ by trying to figure out ways to hook them together that allow some value-adding functions to be performed. So let's just sort of whiz through these strategies and some brief characterizations so that you get a little bit of a sense of the different varieties of each of these kinds of strategies that exist beneath these three overall labels that I've slapped onto them.

Case of GE Medical Systems

One case to keep in mind, since it both fits and is the case we've had most recently in this room, so it should be relatively easy to access, is GE Medical Systems. This, to me, is a wonderful example of a company at least operating very close to the leading edge in terms of trying to use all these different mechanisms for value creation. So aggregation, of course, was very important in this business because R&D to sales ratio of 8 or 9 percent of sales puts this particular business probably in the top .1 percent of all businesses in terms of the extent to which it's driven by R&D and economies of scale. And so under Immelt, which is when the strategy really seemed to come together, there was this tremendous push to figure out how we build up the volume that will allow us to amortize our fixed R&D costs effectively and give us the ability to be the technological leaders but not have economics that, in terms of R&D to sales ratios, look prohibitively costly from a technological standpoint. So that was aggregation.

The big discussion of GPC, the Global Product Company, was all about arbitrage and whether there was much play left in the arbitrage strategy on the manufacturing side for GE, or was it time for GE Medical Systems to say, "OK, we've done as much arbitrage or close to as much arbitrage as we can. Now that we're starting to talk about shifting plants from one low-cost location to another, this is probably kind of reaching its end as a big lever for us to pull on." But that clearly hadn't happened by the time of the case. Their plans still called for big increases in the fraction of purchases, the fraction of their own production coming from less-developed countries.

And then finally under Immelt, there was also an attempt to try and adapt and present a little bit more of a local face for GE, which was critical given who the buyers were and who was involved in the buying process: hospitals, governments, various other kinds of regulatory authorities. So simply saying, "We're the leading global competitor, and we're here because our equipment is best," was deemed insufficient, but with some attention to trying, as the case put it, to be more German than the Germans in Germany, as a way of actually selling effectively into the markets that GE Medical Systems operated in.

So those are just thumbnail sketches of each of these strategies at work. Let's just whiz through each of them and try and think more broadly in ways not confined to the specifics of the GE Medical Systems case of what some of these strategy levers are that one can pull under each of these rubrics: aggregation, adaptation, and arbitrage. Basically, what I'd like us to keep in mind as we walk through these is that although we're talking about aggregation, adaptation, and arbitrage one at a time, most global companies with any significant degree of global operation face the challenges of achieving at least a minimal level of performance along each of these dimensions. So you can't be totally unresponsive locally. Typically, you can't totally give up on economies of scale, and typically, you don't want to ignore the fact that there are important arbitrage opportunities across different markets.

Adaptation

We'll start with adaptation, which is probably the most familiar of these three strategies. This is often the default strategy for dealing with globalization. So think of how Wal-Mart has gone overseas. They first went and said, "OK, standardization worked really well for us in the United States, and people said we couldn't move from the Southeast to the Northeast, and the West Coast, and so forth. We showed them that this could be done. So as we go to Latin America, presumably the same basic approach should be something that works for us." In the event it became very clear, very quickly in Latin America that having people in Bentonville, Arkansas decide how to merchandise Brazilian supermarkets was not, perhaps, the optimal way of getting to a merchandise lineup that Brazilians were actually interested in buying.

So what Wal-Mart has basically done is focus very heavily since then on trying to figure out the right amount of adaptation to undertake in each of its markets. It's fine-tuning the same basic lever that Coke has been playing with over the last two decades in between these fits of getting over-excited about globalization or localization, etc.

So let's move on and think of what specifically this adaptation category might include. The most obvious bases of adaptation, which we don't really want to spend much time on, are first of all the idea that you might want to adjust your product offerings to the markets in which you operate. And, second, as we saw in the Coke case, this whole notion of decentralization as a way of dealing with very different managerial challenges associated with local responsiveness in different environments.

There are a couple of other less-familiar approaches to adaptation that it might be worth mentioning briefly, and discussing some examples of. One good example of modularization is Yahoo, which has managed to expand and broaden its scope very, very substantially both across horizontal dimensions and across geographic dimensions because they basically have a very modular structure to their business. The basic organizational unit at Yahoo is a property. Properties are given tremendous autonomy in terms of what they do, with the exception of a couple of kinds of interfaces with the outside world. They have a standard reporting structure in to Yahoo Corporate, so that somebody can actually look at these hundred things and try and figure out which of those are adding value and which ones are not.

They have a standardized look and feel for the user, which helps Yahoo's global brand image. And the other common restriction imposed on these properties by Corporate is that the guidelines under which they can enter contracts with joint venture partners, etc., are all determined centrally, as well. That was prompted by an earlier situation where no such policies were in place, and Yahoo got into a number of unfortunate entanglements in a number of foreign markets. So what they've created is the ultimate plug-and-play structure. There are some common interfaces with the outside world that have to be met, that have to be respected, but beyond that, a lot of decentralization, down to how the local managers operate within the confines of those parameters, and decide, given those constraints, what the right strategy actually is.

Recombination is the idea that sometimes adaptation involves more than just taking what you already have and making some minor modifications to it. Sometimes it involves something much more extensive in the way of taking elements of your existing business model and combining them with elements of what the market that you're going into really demands in a way that results in much more far-reaching changes than simply tweaking a few product features. A particularly interesting example in this context is that of Star TV, which, the last time I looked, was just breaking even after incurring total investments that in present value terms came to about $4 billion. So it's been about ten years and, in present value terms, $4 billion since the Murdocks got started with Star, and mostly what they managed to do over this period was realize that expecting Asians to prefer English-language programming to programming in the languages that they're used to speaking was not a very saleable proposition. So they've switched from being a broadcaster of basically pre-existing English-language fare all over Asia to having a bunch of customized, adapted local-language offerings.

It hasn't worked that well because the whole point of the original strategy was to avoid the fixed costs of creating programming for each market. The one place where it's worked well—and this is the star in Star's portfolio—is in India, where they have show called "Kaun Banega Crorepati." And I look around and that means nothing to any of you—well, there may be one or two exceptions—because it's a Hindi language program. This is, basically, the Hindi-language version of "Who Wants to be a Millionaire." And this is the single most popular program, by far, in India. Now it might seem that Star just took a preexisting format and changed it a little bit, but when you actually talk to Star about what they did to take this format—which they did not own, it was licensed to them by a U.K. company called Celador—and really make it fit with the Indian context, this is pretty amazing stuff that they tried.

They recruited the leading Hindi-language actor of this generation to serve as the person who is the announcer. They took all of these people for a couple of weeks, if not months, to the sets on which this show was being shot in the U.K. to understand what the basic look and feel was supposed to be, and they engaged in a huge promotional campaign. This goes a little bit beyond garden-variety adaptation. This literally is taking what Celador had, some of the unique things that Newscorp had in terms of its game show production and modification expertise, and some of the needs of the Indian market, and creating something that looked very significantly different from the version that they were starting out with. So that would be an example of recombination.

More broadly, one can think of innovations, one can think of transformations, that are much farther reaching than just the standard, "Let me take my existing products and figure out how to sell them in new context." The basic point here is that while adaptation is sometimes thought of in very limited terms, there are actually a bunch of different strategy levers that you can think of pulling if you've decided that this is the principle way in which your company is going to deal with the challenges of operating across countries that are very different from each other. So that's adaptation.

Aggregation

Now aggregation, as I mentioned earlier, is this idea that sometimes doing everything country by country—and this is the problem with the rest of Star—is just very expensive. So how do you simultaneously make some attempt to address that complexity without sacrificing so much in the way of economies of scale that you basically end up in the position of a local competitor who cannot spread his fixed costs across multiple markets either? And there are many possible ways of aggregating, and rather than go through all of them, again, it seems more fun to work through an example.

So here I have the example of ABB. This is now a five-act play because we can sort of talk about five different periods in ABB's history. Market valuations started out at the same level back in the late 1980s that it currently is in the early 2000s. And in between, what happened is actually profoundly interesting, though, because this company was talked about more than any other company all through the 1990s as the model of how to manage a global organization in a complex environment. And while that's a rich and nuanced story, I've basically reduced it to the little table at the bottom in terms of the different bases of aggregation that successive CEOs at ABB tried.

So before Asea and Brown Boveri merged in the late '80s, both were essentially run with country structures not unlike many other European multinationals. The basic idea is that countries are so different in communication between headquarters and a country limited by technology that the best thing to do is to give the country managers a lot of power to adapt the business model as they see fit. Percy Barnevik takes over as the CEO of the combined entity, and says, "This isn't really tapping the economies of scale that we need. So I'm going to do two things. I'm going to fragment all of these companies that I've inherited into these really small operating companies, 500 to 1,000 people in each. And then I'm going to make sure that we coordinate across those companies by putting in two bases of aggregation." The head of each operating company is going to report both to a country manager, which is the old basis of aggregation, and a business area manager, which is the new thing that Barnevik was trying to force in order to get some economies at the level of product divisions.

And this worked really well, as celebrated in the business press. And so by the mid-1990s, Barnevik added a third layer onto this, a regional structure to make sure that stuff that wasn't being picked up by the countries or not being picked up by the business areas still didn't fall through the cracks. Barnevik stepped down with a healthy retirement package, after which Lindal stepped in as the next CEO and said, "This regional stuff isn't working, so let's can that. But I really like global account management as another way of engaging in cross-border aggregation. At least for our largest customers, we may be able to fulfill their needs much better by having dedicated global account teams than by simply relying on country managers or business area managers to do the right thing by these very important customers." So that was Lindal.

Lindal was succeeded by Centerman, and Centerman didn't like the aggregation scheme that he started out with either. Over this period, ABB stock price has peaked and is starting to feel some pressure. So Centerman says, "The IT companies have figured this out. And

ABB is basically becoming an IT company. So let's move to a front-end, back-end structure. We'll have four front ends, which are different customer verticals, and we'll have two back ends, which are the technological units. We'll achieve the economies of scale in the back end, and we'll achieve the local customer responsiveness in the front end." Centerman—and this table is not drawn in proportion to time spent in office—Centerman had the briefest tenure of any of the CEOs that we've talked about so far.

And he was succeeded by Dorman, and Dorman said, "The Centerman IT structure isn't working. These bases of aggregation aren't going to work without good linkage mechanisms. Given how much trouble we're in, let's just scrap this whole thing and go back to two broad areas of business: power systems and automation. And I'm going to set up a horse race between the two people running these two parts of the business. Whoever does the better job is going to get to succeed me, and maybe we can fix this mess that we've inherited."

The last time I checked the results on the progress towards fixing the mess were still quite unclear, but the stock price continued to hover roughly where it is on this particular slide. And the interesting thing about the ABB case is that it really suggests some very valuable, broader lessons about aggregation. I think the first thing, and the most important thing to remember from this case, is that even though we all have a tendency to periodically get excited about new organizational forms that are going to be the panacea or silver bullets that take care of all our cross-border coordination problems, there is no such thing. The matrix that was acclaimed back in the early to mid-1990s worked great at ABB while demand was growing rapidly, but after the Asian crisis, after the slowdown in demand, after other competitors started to arbitrage much more aggressively, these units ended up hopelessly high cost and incapable of coordinating offerings of product systems to customers.

So the matrix definitely had its time and place, but the idea that this one way of aggregating things, having one basis of aggregation be the country and the other one be the business units or product divisions, is the right one for every company probably isn't correct. It's not clear that it was even the right structure for ABB over the entire period in which it was actually in place at the company.

Part of the big subsequent decline was that as part of this very aggressive acquisition program they bought Combustion Engineering in the United States and have ended up with a bunch of asbestos liabilities that, at this point, are the biggest single millstone around the neck of the company and one of the reasons why there's some question about what form ABB is going to survive in. So some of the downturn really is the surprise discovery of the asbestos liabilities. So that's the case of ABB.

Arbitrage

Let's turn very quickly to arbitrage. And this is one that I do want to spend a little bit of time on because this is the one that, although it's the original strategy that firms applied to cross-border trade and commerce, seems to get lost in a lot of the discussion on how you add value by competing across borders. I have an *HBR* article on this topic coming out, and so strong was this theme that this strategy is not being given enough attention that my editor proposed titling the piece "The Global Strategy that Dare Not Speak Its Name." I countered with "The Rodney Dangerfield of Strategies: Doesn't Get Any Respect." And then we discovered, to our relief, that neither of us was serious, and that we'll probably pick something a little bit different as a title.

So there's a reason why arbitrage is the Rodney Dangerfield of strategies, or the strategy that dares not speak its name. And this has to do with the sense that this is somehow kind of a low form of competition. Maybe if you're stuck in such a mundane pursuit as manufacturing apparel or footwear, you have to think of where in the world do I find the optimally located sweatshop for myself. But if you're anywhere beyond that level of competition, this just seems to be of interest.

So the first thing I wanted to point out was that even old-fashioned labor arbitrage, which is by far the most commonly thought of form of arbitrage, seems to have lots of legs to it, even in sectors we'd regard as high tech. So here I have a stylized rendition of the two major competitors in regional jets, Bombardier from Canada, and Embraer from Brazil. And the diagrams aren't drawn to scale, but basically, Embraer earns about $30,000 less per employee than Bombardier, but Embraer pays about $40,000 less per employee than Bombardier. So Embraer's profitability—and Embraer is a Brazilian company—can be more than entirely explained by the fact that the average Bombardier employee costs $63,000 a year and the average Embraer employee costs about $26,000. Big differential. And this doesn't just apply to the actual assembly of the aircraft. What Embraer has done is focus on design and assembly, so that it's the systems integrator for the whole piece. Again, you get similar differences when you're talking about new plane development budgets.

If you have a big engineering challenge, and you're Bombardier, and you have to pay your aerospace engineers $40, $60+ an hour, and Embraer is paying their aerospace engineers, in terms of direct salaries, about $10 an hour, you can sort of understand that this is a huge source of leverage in an apparently high-tech industry.

So an illustration that arbitrage works not just in footwear and apparel, not that there's anything wrong with those industries, but in industries that we tend to regard as sexier, as well. The only point that I want to emphasize on this slide is that while adaptation and aggregation are ultimately about finding things that are similar, arbitrage, to some extent, is really about finding things that are different that can be taken advantage of.

The next slide talks about different bases of arbitrage. That's all that I'm going to say about it beyond noting that economic arbitrage is not the only thing that you might practice. You could, like McDonald's, be selling the Chinese a vision of life in America and eating in America, which is what McDonald's does in East Asia. You could be like Newscorp, keeping your tax rate below 10 percent, at a time when all your major global media competitors that are publicly held pay closer to 30 percent. And you can even take advantage of residual distance by, for instance, doing what cable and wireless does in its businesses, which are these Caribbean Islands where they have nice telecom monopolies. These are still, in some sense, the most remote places on earth, and this business has proven much more profitable than the cable and wireless investments in broadband capacity that everybody else was investing in. So there are lots of bases of arbitrage.

Multiple Levers

Can you do more than one of these things? Can you, if you're Embraer, and you've managed to unlock a big arbitrage advantage for yourself? Does that also allow you to go build a brand, and, in some sense, aggregate across different markets by building a global brand image? A complicated question. We saw GE Medical Systems actually doing elements of all three. So as I said earlier, they were aggregating, they were arbitraging, they were adapting. And that's one of the things that makes that case so remarkable, from my perspective—that they're actually managing to do a reasonable to very good job along all three of these dimensions.

More generally, I think we've talked about a couple of different things. One is, just think back to the characterization I put up of Coke trying to deal with all its issues with centralization/decentralization. What we've done is open up the strategy space here a little bit by saying, OK, centralization/decentralization is just one kind of adaptation approach. And then adaptation isn't the only thing you do in these situations of semiglobalization in the markets that you're involved in. You can pursue aggregation strategies; you can pursue arbitrage strategies. And, by the way, those all come in their own variants.

So in a climate where many firms' international operations are less profitable than their domestic operations, it seems useful to have more levers or tools in our toolkit to think about how value can actually be added by operating across borders.

Second, some of the same things that facilitate adaptation probably also facilitate the ability to do more than one of these three strategies at the same time. So if you can chop up your business model the way GE managed to by saying, "OK, marketing and sales is front facing, and that's relatively clean, and we'll let that do adaptation; manufacturing can be separated from pretty much everything else, and we'll do arbitrage there," that's a big help.

The third thing that helped GE was that it's great if you're dominating your market and so far ahead of your competitors that you can beat poor Phillips both on arbitrage and on aggregation because you're just a couple of times larger than they are. So that's a little bit of part of the explanation, I think, as to why GE was able to do these things so effectively.

Having said that, usually you do have to choose. By the end of the GE case, they're wrestling with in-China/for-China. And that's really a conflict. Do we adapt to the Chinese context, or do we continue our arbitrage strategy very strictly and say, "No, according to the global product company concept, we are not going to manufacture this equipment in China. So by the end of the GE case, you see them struggling a little bit as well with the notion that it's not always possible to push all three of these approaches at the same time to the hilt.

Conclusion

There is one thing that I'd like to stress in conclusion, in terms of thinking about how you choose amongst these strategies. Again, if you look at your organization, chances are that if it has a significant global presence, there are probably elements of each of these three things that your organization currently does. However, it's unlikely that all three of them are as integral to your organization's attempts to create a competitive advantage for itself by operating across borders. And so you typically do not have to choose whether to do a little bit of this and a little bit of that. Some threshold level of each of these three approaches probably makes sense in most strategies. Where you have to choose, more typically, is in terms of what your primary basis for outperforming your competitors as you compete in a global world is going to be.

And sometimes, like GE, you may have the luxury of having competitors that are so far behind that you can literally beat them in all the dimensions that you care about. Unfortunately, if you aren't so lucky, choices are going to have to be made. And to make the right choices, it's certainly helpful to start out with the full menu of levers that are available to be pulled in a cross-border context.

