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Strategy in a semiglobalized world
A review of *Redefining Global Strategy*, by Pankaj Ghemawat

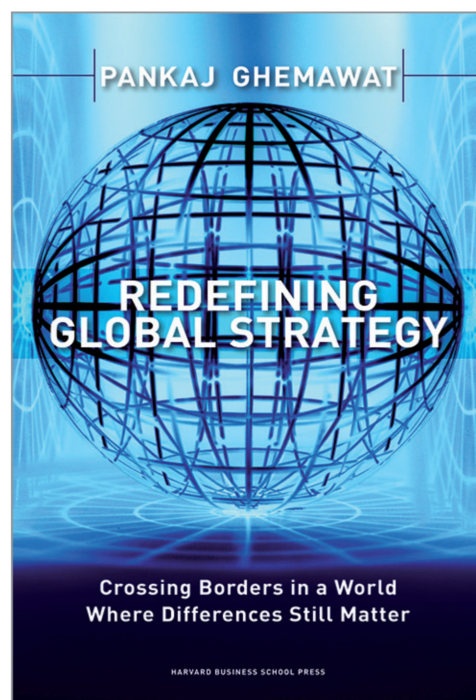
Juliane Engsig
MRM – Université de Montpellier

Introduction

Companies that want to expand internationally are often too caught up in grabbing market shares and the illusion of a borderless world. However this is a delusive approach and instead companies need to take borders and sustained differences between countries seriously when developing and evaluating strategies.

The present book calls into question what it takes for companies to create value when doing cross-border business in a global world. One of the main points is that the world is "semiglobalized", rather than globalized, proven by the fact that most economic activity is done "locally" or "regionally" (even Foreign Direct Investment and Internet activity). This fact should change the companies' global perspective and make them drop the "one-size-fits-all strategy" which is no longer valid. Instead the author presents and explains a set of global strategies by putting differences between countries in the center.

The book is addressed to managers and business or public policymakers, and others seeking to understand cross-border business. It contains statistical measures, tools and future directions for companies wanting to create value by expanding internationally. In doing so it draws on research in various fields such as international economics, industrial organization, business strategy and international business – as well as interactions with practitioners and concrete examples on international strategies from several leading companies.



As the book, this review is structured in two parts. The first part introduces the concepts of a semiglobalized world where differences between countries matter; and two tools which may help decision makers identify and evaluate these differences. The second part treats the question of what to do about the cross-border differences by presenting different strategic options.

Part 1: Value in a world of differences

Part 1 of the book starts off by explaining that most types of economic activity are still localized by country and it emphasizes the importance of seeing the world as semiglobalized rather than globalized (part 1.1). In this context, national differences become crucial for the cross-border collaborations. In order to deal with the country differences the book introduces two tools: the CAGE Framework (part 1.2) which helps identify the different types of distance between countries; and the ADDING Value Scorecard (part 1.3) which helps evaluate the overall value creation of strategic cross-border moves.

Semiglobalization and strategy

Around the millennium there was a boom in the research and literature about globalization which often concluded that the distance between countries was dead thanks to policy changes as well as improvement in both transportation and communication technologies (Levitt, 1983; Fukuyama, 2000; Cairncross, 1997). Either this was presented as a positive thing where one could escape the ancient tribal rifts which have divided humans. Or as a bad thing, often described as a "globalization apocalypse", where everybody would eat the same fast food. Jointly for these approaches was that they assumed a complete internationalization of the world. However this is not completely true as most types of economic activity that can be conducted either within or across borders are still localized by country. Studies show the level of internationalization associated with activities such as migration, telephone calls, management research, tourist arrivals, patenting, stock investment, and trade (measured in gross domestic product – GDP), are in fact closer to 10 percent than 100 percent[1]. Even the Internet seems to have been regionalized with the declining importance of the US as an interregional switching hub.

1. This is known as the "10 Percent Presumption".

We are therefore more likely in a state of "semiglobalization" than globalization. This means that borders between countries are as present and important as ever and cross-border strategies must be aware of the similarities as well as the differences between the partners. This fact inhibits a complete integration of the world. The important question to ask therefore becomes where, and not when, as managers look for strategies to expand.

The point of semiglobalization can be hard for the companies to cope with as shown by the case of Coca-Cola. It is reckoned to be the world's most valuable brand and is ten times more profitable overseas than at home. During the 80s the company expanded internationally with a multi-local approach and a "one-size-fits-all" strategy. Coke believed in similarities across countries and focused on the possibility of international growth and scale economies. It saw the world as stateless where it could penetrate new markets with ubiquity and standardization. This centralized approach backfired and Coke instead took on a "Think Local, Act Local" decentralized strategy in the 90s. However by doing so quality suffered as performance was compromised. Coke then realized that it may not make sense to compete in the same way in all markets and today it operates between the two extremes (centralization versus decentralization) which is in fact the reality of semiglobalization.

However semiglobalization is more than a "middle of the road" conclusion of middling. It is instead the consideration of the barriers and the bridges between countries and not just focusing on one or the other. It is business reality that lies

between "one (insular) country" and "one (integrated) world" and the reward is a richer and more liberating sense of the strategic possibilities for the companies.

Differences across countries: The CAGE distance framework

Instead of treating differences versus similarities in absolute terms, the companies must focus on the degrees of differences. This can be done by separating differences in terms of distance dimensions such as:

- *Cultural* distance: Cultural differences are often understood as informal institutions, produced by interactions between people, where it tends to reduce economic interactions between them. It can be identified as language, ethnicities, religion, values, norms and traditionalism. A way to moderate the difficulties that cultural distance often imposes is through continuous contact where the companies accumulate skills and capabilities, which reduces the liability of foreignness;
- *Administrative* distance: Distance can equally be determined by institutional arrangements in a given country. Companies therefore have to adapt and make their choices from a defined set of legitimate options imposed by the host country, the home country and/or international organizations. This dimension can be translated into national laws and policies, colonial ties, shared regional trading blocs, common currency and political hostility. In fact the policies of national governments raise the most common barriers to cross-border trade;
- *Geographic* distance: Distance measured in kilometers, naturally plays a role in a global strategy. The general assumption is that the farther away a country is from a home country, the harder it is to do business between the two parties. The number of kilometers is however more or less important depending on the industry and the sector of the partners, as it affects the cost for transport and communication. Geographic distance is more than physical distance. Other aspects such as land border, with-in country distance, time zones, climate, access to ocean, typography, disease environment and infrastructure are equally important when considering geographical distance;
- *Economic* distance: This dimension refers to economic mechanisms which affect cross-border activity such as a country's GDP, per-capita incomes and differences in resources (financial, natural, human, infrastructure, information and knowledge). It is shown that rich countries engage more in cross-border activities and mostly with other equally rich countries, than do the poorer countries. However the opportunities of reduced labor costs in poorer countries is often one of the most cited reasons to engage in cross-border economic activity which promotes doing business between richer and poorer countries.

These four dimensions are the basic elements in the CAGE Distance Framework which is used to analyze "differences in differences" on a country level. The framework is a tool built on bilateral measures of distance, based on differences between the home country and the foreign country or countries. It is based on systematic data, from for example the Gravity Model, which has indicated that distance matters concerning international trade[2]. By dividing differences into these four dimensions, the CAGE Framework can help understand the liability of foreignness, compare foreign competitors and markets, and discount market size by distance. The companies can thus distinguish countries that are relatively close, along these dimensions, from those that are relatively far. This is important to understand as "…countries differ greatly in the extent to which they are different from each other" (p. 63).

It is not simply a question of identifying cross-country differences but also to understand which ones matter the most in the industry that interest the given company at a given time. Therefore it is recommended to take industry characteristics into consideration which will bring the analysis from a macro to a micro level.

2. The Gravity Model has for example shown that a 1 percent increase in the size of an economy is typically estimated to lead to a 0.7 - 0.8 percent increase in its total volume of trade. On the contrary, 1 percent increase in geographic distance between the capitals of two countries is predicted to decrease trade between them by about a 1 percent.

Le Pouce de César, La Défense (8 décembre 2015)

The CAGE Framework and the dimension of distance however "…have to complement rather than substitute for thoughtful competitive positioning and other elements of strategy…" (p. 62). By doing so it may give companies predictive power when choosing where to expand internationally. It can help move the discussion beyond unilateral country characteristics by adding a bilateral or multilateral component. However, it is not the only tool presented in the book which may help choosing strategies.

Global value creation: The ADDING value scorecard

Another tool which can complement the CAGE Framework and help companies to make profitable strategies in a semiglobalized world is the "ADDING Value Scorecard". This tool springs from the question of why firms should expand internationally in a world where distance still matters. The answer is that there is a need for a value-focused perspective, such as accounting profits instead of economic profits, when wanting to succeed internationally. The ADDING Value Scorecard is a way to evaluate the overall value creation instead of the standard sort of size-ism. It provides a basis for assessing whether a particular strategic move makes sense and it can therefore help companies decide to what extent they should globalize, if at all. The scorecard consists of the following components which could create value for the companies in different ways:

- *Adding volume*: This is the most common reason for doing cross-border business. In order to calculate if going global is worth the effort the companies must look at the margins affected by global expansion (prices and costs);
- *Decreasing costs*: The second most common reason for expanding internationally is the possibility to lower costs for example regarding service and labor costs. However because of the complexity and operating costs, it is necessary to calculate how adding volume might raise costs in the short to medium run;
- *Differentiating*: Value can also be created by differentiating from the competitors. This can for example be measured in terms of prices and "willingness-to-pay" by the clients;
- *Improving industry attractiveness*: Calculating international differences and industry dynamics on global, regional or country level may help improve the industry attractiveness;
- *Normalizing risks*: Globalization can help manage and reduce risks for example by pooling across markets. This can contribute to the reduction in the costs of capital;
- *Generating and deploying knowledge*: By implanting best-practices learned from global operations the companies may gain value.

The components into which value is parsed add up to an overall value addition or subtraction. The scorecard follows a single-country strategy in the first four of its six value components. The two latter reflect the large differences between countries.

Hereunder the scorecard is illustrated by the case of CEMEX, the Mexican-based cement company. In spite of the fact that cement isn't the easiest product to go global with, CEMEX has managed to become a global actor and the different value components in the scorecard explain why:

- *Adding volume*: CEMEX has since the 90s grown to be the world's third largest competitor. This was achieved mainly by cross-border acquisitions of existing capacity mostly in Europe. CEMEX had to make this move as it already controlled two-thirds of Mexican capacity and there was no room to grow within the home market. By doing cross-border acquisitions CEMEX could create and claim more value than it could do on single-operations from Mexico;
- *Decreasing costs*: CEMEX has higher average prices and therefore higher profit rather than lower average costs. Further, it successfully reduced the post-merger integration costs over time as a result of international experience. And it reduced capital cost as a result of tax arbitrage among other things;
- *Differentiating*: Maintaining higher average prices than their competitors is possible thanks to a strong global brand-building. They, for example, propose a 15-minutes delivery to bulk buyers;
- *Improving industry attractiveness*: CEMEX has a strong bargaining and market power as a result of strategic acquisitions in major markets where it controls a significant share of that market;
- *Normalizing risks*: By pooling across markets with different local and regional construction cycles (which control the cement industry) CEMEX has reduced the standard deviation of quarterly cash flow margins from 22% (1978-1992) to 12% (1992-1997);
- *Generating and deploying knowledge*: The international experiences CEMEX gathered from the cross-border acquisitions laid the fundament for "The CEMEX Way" which it implemented worldwide. The CEMEX Way consists of organizational mechanisms such as the adoption of English as a common language, the rotation of managers on a global scale and the use of international consultants, and investment in information technology.

All components in the scorecard are not equally important in all industries or for all companies. Also different components can become more or less important at different points in a company's history. To help identify each value component several guidelines are proposed. These can be studied more in the book.

After having presented the above mentioned tools and concepts which can analyze cross-border differences, Part 2 of the book considers the development of strategic options for dealing with these differences.

Part 2: Strategies for global value creation

The second part of the book starts by asking what to do about the cross-border differences. The answer is found in different types of cross-border strategies divided into strategies of: Adaptation (part 2.1), Aggregation (part 2.2) and Arbitrage (part 2.3). Hereafter the book introduces the AAA-triangle (part 2.4) which illustrates how the companies can mix the adaptation-aggregation-arbitrage strategies depending on the given context.

Adaptation: Adjusting to differences

Examples of adaptation strategies are differentiation and low costs which can give competitive advantages and can offset some of the pressure to adapt to different markets. However, cross-border implies significant modifications to such strategies.

The strategy of adaptation exploits the similarities across countries as source of value creation – and it treats differences across countries as constraints. In doing so there is a need for variety which is the essence of adaptation and there are levers and sub-levers to help deal with adaptation. Levers and sub-levers help relax the

underlying tension between complete localization and complete standardization – and to know how much one should adapt.

Adaptation as a strategy can be found within the variation of a company's products, policies, repositioning and metrics. However, often variation increases complexity. A way to keep complexity under control is to focus on a narrow scope such as a product focus, geographic focus, vertical focus or a segment focus. Another solution can be to externalize and split activities across organizational boundaries. This solution is often used to enter markets that are distant from one's home basis (often in the shape of strategic alliances). Adaptation as strategy can also be identified as flexibility (adapt to the market), partitioning (give away responsibility to the smaller units where products vary from country to country as the local knowledge creates new and adapted products), platforms (customize to each country's needs).

Before choosing to go with an adaptation strategy when expanding internationally the companies are recommended to use the ADDING Value Scorecard. The benefits of adaptation can in fact have positive as well as negative effects on the components of the scorecard. If adaptation contributes to improving the fit with the local needs or expectations, it also contributes to increase the costs for the firm. More generally speaking, adaptation decisions cannot be made independently of decisions about aggregation and arbitrage.

Aggregation: Overcoming differences

As with adaptation strategies, aggregation exploits the similarities across countries as a source of value creation – and differences across countries are seen as constraints. However the objective is to exploit the similarities among countries more aggressively in order to tap greater economies of scale than traditional adaptation strategies could do (but less aggressively than complete standardization).

It is often an advantage to group things so that within-group differences are minimal compared to between-group differences. This is most often done by focalizing on the geographic dimension (G in the CAGE framework) and concretely, by focalizing on regions: "...regions turn out to be the best unit for expressing and implementing this more modest – but realistic – vision of a semiglobalized world in which neither the bridges nor the barriers between countries can be ignored" (p. 155).

The importance of geographic proximity is closely related to the other dimensions in the CAGE Framework: countries that are relatively close to each other geographically are likely to share commonalities along the other dimensions. The commonalities have been intensified by free-trade agreements, tax treaties and currency unifications – such as the NAFTA and the EU.

The strategy of focalizing on regions is not a "next-best solution" compared to investing in foreign emerging markets. It is rather the result of the stagnation of the globalization. There are a number of regional strategies rather than just one which Figure 1 hereafter illustrates. The six archetypes of regional strategies are built on the different stages which Toyota went through their successful international expansion.

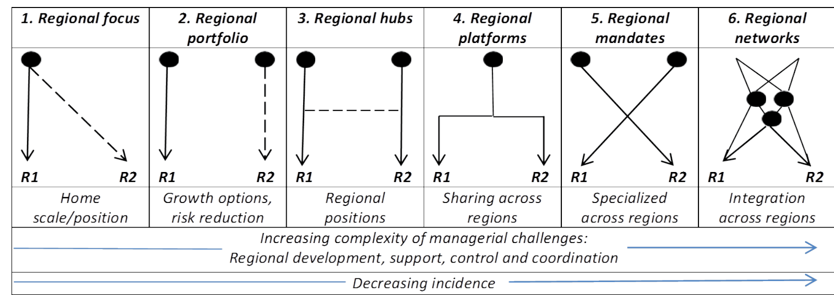


Figure 1.
Regional strategies (Ghemawat 2007)

The solid circle (●) can be interpreted as distinct product types, whereas R1 and R2 represent two regions. Boxes 1-4 are intraregional strategies and 4-6 are interregional strategies. The boxes illustrate progressively, from left to right, more complex and less common approaches of dealing with regional boundaries. There is no natural order of progression through these archetypes; however this is the path Toyota took successfully.

There is no definition of regions in the book and aggregation offers instead multiple possibilities of creating strategies on the local and global level by grouping elements. On the other site, by doing so it may implicate risks such as creating silos that disrupt organizational functioning. It may as well increase complexity when the number of links between units grows. However the strategy of exploiting similarities across countries is not always the best strategic choice and sometimes the value can be found in the differences between countries.

Arbitrage: Exploiting Differences

The strategy of arbitrage expands the toolkit for dealing with differences across countries. This strategy treats differences across borders as opportunities, not as constraints. In fact, arbitrage implies seeking absolute economies, rather than the scale economies, gained through standardization. It is known as a classical cross-border strategy and can be illustrated by the example of selling cheap "exotic" spices from India at much higher prices in the West. However, arbitrage is more than obtaining labor-intensive goods or services from emerging markets and selling them in developed markets, even though these are important forms of the strategy. The CAGE Framework may help reveal the potential of arbitrage according to each dimension of the differences:

- *Cultural arbitrage*: This can be identified as favorable effects related to country or "place of origin". For example, French Champagne or Jamaican reggae;
- *Administrative arbitrage*: Legal, institutional and political differences from country to country can open up to a number of strategic arbitrage possibilities. Tax differentials are perhaps the most obvious example. Hereunder we find grey zones and much of what goes on under "administrative arbitrage" is legal or semi-legal. Companies in fact try to use their political leverage to change rules of "the game" that they do not like;
- *Geographical arbitrage*: Thanks to reduction in transportation and communication costs it is now possible to slice up the value chain ever more finely across geographies, for example: buying flowers in Europe flown in from Colombia the same day, or buying a jacket where the zipper is from Japan and the filling is from China, etc.;
- *Economic Arbitrage*: Even though all arbitrage strategies are "economic", it may also be seen as exploitation of economic differences. More precisely, this might be identified as differences in the shape of cost of labor, capital and

variation in more industry-specific inputs (such as knowledge) or in availability of complementary products. The best known type of economic arbitrage is cheap labor.

By identifying country-specific differences the companies may adapt their arbitrage strategy. However, a particular risk is associated with arbitrage and that is political sensitivity – especially concerning labor arbitrage. For these reasons it is advised to be careful with communication on the subject, both internal and external, and also invest in the local environment, such as job training. Further building a sustainable competitive advantage through arbitrage generally requires a commitment to building firm-specific capabilities which may take years.

After having presented strategic options in the shape of the AAAs (adaptation, aggregation and arbitrage strategies) it is necessary to understand that not all commitments are possible at any one organization at any given point in time. Even though some mixing is possible across the AAAs, pursuing all three or even two of them is not advised. Here the CAGE Framework and the ADDING Value Scorecard are useful tools to help to decide on a strategy.

Playing the differences: The AAA Triangle

The reason why new global strategies have emerged is the swift from the globalization of markets toward the globalization of production. The globalization of production transforms the "adaptation-aggregation tradeoff" into "adaptation-aggregation-arbitrage (AAA) triangle". This is illustrated in Figure 2 hereunder:

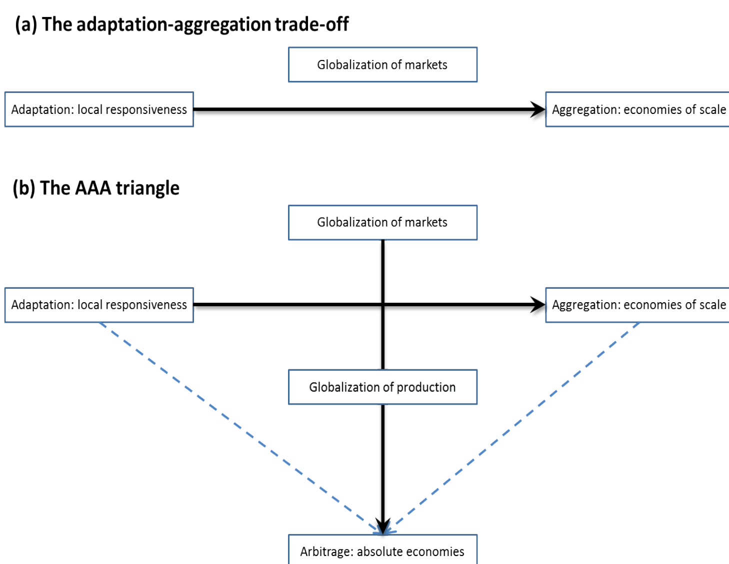


Figure 2.
The globalization of markets and productions (Ghemawat, 2007)

The triangle adds to the range of ways in which companies can plan for cross-border differences. The three As involve the pursuit of different sources of advantage from operating across borders and are associated with different organizational types:

- *Adaptation* is often related to a country-centered organization;
- *Aggregation* often implicates cross-border groupings (global business units or product divisions, regional structures, global accounts, etc.);
- *Arbitrage* is often pursued by a vertical, or functional, organization that tracks the flow of products or work orders through the organization;

For these reasons all three modes of strategies can take place at the same time in a company. However elements of each type can be combined but are very difficult to manage and thus few companies succeed in this. In order to implement one of the three A's strategies, the companies have to be open toward this type of thinking. Three levels of AAA awareness by companies are presented hereunder:

- *Level 0 – AAA Awareness*: Most companies in fact lack any systematic global performance measurement and implant themselves overseas in the same shape as they did in their home country. By using the AAA-triangle the companies may obtain awareness of the different strategic objectives that could be pursued;
- *Level 1 – One A Strategy*: It is recommended to focalize on one of the three strategies which is also the option most often found within a company strategy. In fact every company wanting to create value through border-crossing activities should be able to specify which one of the three As is the basis for their cross-border competitive advantage. For example can the percentage of sales used on advertising indicate how important adaptation is likely to be; the percentage spent on R&D is a proxy of the importance of aggregation; and the percentage spent on labor helps gauge the importance of (labor) arbitrage;
- *Level 2 – Compound (AA) strategies*: Although pure A strategies are the most obvious types of global strategies a number of leading-edge global companies seem to operate two As, such as IBM, Procter & Gamble and Cognizant. These companies have outperformed their competitors on two dimensions or stroken a better balance between two As than their competitors;
- *Level 3 – Trifecta (AAA) Strategies*: This option is very rare to find but few "power houses" of successful companies do manage to do this. One example is the GE Healthcare, in medical diagnostic imaging, which has first of all had success at aggregation, and outpaced its competitors in terms of arbitrage and adaptation.

If a company wants to expand successfully in a world where cross-border differences matter, it is thus recommended to have a minimum of awareness and even better actually implicate one or more of the AAA-triangle strategies. This may help create value based on similarities and/or differences between countries.

After having given tools and proposed strategical options, the book concludes by reflecting on the future as it looked like in 2007.

Toward a better future: Getting started

So what does the future hold for global strategies? The author indicates that even though this is difficult to estimate, one thing is sure, and that is that semiglobalization is likely to persist for the next decade or more. In order to getting started with choosing the next strategic move, it is critical for companies to take a value-focused perspective on an industry level. In doing so, the different tools and suggestions presented here should help make strategic choices.

Since the book has been published in 2007 the world has seen severe changes in the global structure most prominently due to the financial crisis in 2008, but also the Russian lockout by EU as a result of the war in Ukraine and the Chinese Yuan's devaluation. These examples change the way we look on cross-border business and prove to show how difficult a task it is to predict future strategic moves.

Ghemawat has in fact responded to the changes in several publications published since 2007 (Ghemawat, 2011; 2010). Here he treats the consequences of the financial crisis, such as unbalanced and weak growth, volatility in the financial markets and high unemployment. These aspects may lead to protectionism in a divided world as

well as ethnic and religious tensions between the countries. After having seen the critical market changes the conclusion is that differences between countries, and learning to work with them, still matter more than ever.

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