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8 Questions to Ask About Your Globalization Strategy Right Now

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Summary

In a new era of globalization marked by geopolitical rivalries, supply chain vulnerabilities, and nationalist politics, Western companies must rethink their strategies. Answering eight questions will help managers address vulnerabilities and consider how their companies should regionalize production, reduce the scale necessary to achieve efficient production, hone their core differentiation strategies, and more. Despite the challenges, maintaining a presence in China will remain crucial.

Companies around the world are confronting a new era of globalization. The combination of geopolitical rivalries, sweeping supply-chain vulnerabilities exposed by the Covid-19 pandemic, and the rise of nationalist-centered politics foreshadows a much more challenging global trading environment. In addition, the recent U.S. election of Donald Trump as president points toward a more transactional approach to foreign relations and trade.

All this means that managers need to rethink their globalization strategies, starting with a deep understanding of their vulnerabilities, followed by a rethinking of many ideas that have been taken for granted for far too long. Here are eight questions they should strive to answer.

What are the sources of our inputs — and not just the obvious items?

While many vulnerabilities will be obvious, it's the surprises that tend to be the most difficult to cope with on short notice. For many companies who rely on foreign suppliers, these surprises will likely be buried in more distant tiers of those suppliers' supply chains. During the pandemic, critical shortages of generic pharmaceuticals exposed more than the U.S. dependence on Indian generics manufacturers; it also revealed that many of them relied on Chinese providers of [active pharmaceutical ingredients](#), some of whom were based in Wuhan, China, the epicenter of the outbreak. Automakers were [caught short of semiconductor chips](#) when they didn't understand that their distant suppliers used Asian production capacity that supported multiple sectors. As a result, high consumer demand for consumer electronics and computers and the surge in the amount of chipmaking capacity dedicated to make chips for those industries meant automakers' lead times to get their chips suddenly jumped to a year. The many tiers in supply chains make many vulnerabilities hard to spot. If you consider the hundreds of parties who can be involved in total, mapping an entire supply chain to expose vulnerabilities can be very challenging as well as expensive, especially since most suppliers would rather you not know who their suppliers are.

A recent research project that I conducted highlighted one such surprise. Many U.S. domestic manufacturers of breakfast cereals, enriched breads, flours, pastas, rice, and other grain products enrich their products with folic acid, a form of folate also known as vitamin B9. They likely purchased their folic acid from food ingredient companies, often in a formulation that includes other ingredients. But our unpublished study found that 58% of all folic acid imports (by number of shipments) and 78% of overall vitamin imports into the United States came from China. That probably comes as a surprise to some manufacturers and consumers.

The key to understanding vulnerabilities is to ask questions about the source of core ingredients. This means going beyond the obvious critical items like semiconductor chips and critical minerals and also looking at things like organic chemicals and specialty materials — and anything whose production is concentrated in one or two countries. It's hard work, but not enough firms are doing this.

2. How can we regionalize our strategy?

This means producing within a trading bloc for markets within that bloc. Produce in North America for North America, in China for China, in Europe for Europe, and so on. If trade barriers and tariffs go up, this will prove to be a good defensive measure, and it will also provide some insulation from currency volatility.

Some companies already do this. For example, medical device company BD manufactures in the United States for the U.S. market and in China for the Chinese market. Companies such as Danfoss and Grundfos that are from small countries such as Denmark have long done this as well. Airbus has regionalized its assembly of narrow-body jetliners and has final assembly lines not only in France and Germany but in China and the United States as well. This strategy has helped it immensely in both markets.

It might still be possible to source key components in one region as long as there is some supplier diversity or a stockpiling strategy in place. Novo Nordisk manufactures a significant percentage of the world's supply of insulin in Kalundborg, Denmark, but it keeps many years of supply on hand as a safety stock. It has been regionalizing its fill and finish capacity, which is used to package final doses.

The unpredictable part is defining the blocs, which may become more volatile down the road. Chinese companies' moves into Mexico could have an adverse impact on that country's trading relationship with the United States. This foreshadows potential future trade tensions. Hungary and other Eastern European countries that have attracted Chinese investment because of their access to European Union markets could face similar issues. This is especially the case for electric vehicles but could spill over to auto parts more broadly.

3. How can we reduce the scale required for efficient production?

There will be significant benefits to investments that reduce the minimum amount of manufacturing capacity needed to efficiently serve individual or regional markets. These would allow a company to decentralize production — in other words, distribute it more broadly in regions around the world. This is an argument for companies investing in [process innovations](#) such as continuous-flow chemical manufacturing that make it possible not only to reduce the size

and start-up costs of production sites but also can harness new machine-learning technologies that can improve yields and reduce waste.

This appears to be what [Rapidus](#), the Japanese semiconductor startup backed by Toyota, NTT, SoftBank, Sony, NEC, Denso, Kioxia Holdings, MUFG Bank, and the Japanese government is attempting to do in leapfrogging to advanced generation chips. It's a risky strategy, but it could have a huge payoff if it works.

4. Where can we move our production of labor-intensive products that would be safer?

Items whose production requires a large amount of labor that cannot be replaced by automation are likely to be a challenge to regionalize. Moving production from a high-cost country like the United States to a low-cost one like China was easy. The costs of setting up a factory in China, hiring a workforce, and establishing a supplier network was paid for by savings immediately realized in the form of dramatically lower production costs; the payback periods could be a year or less.

While turning to Mexico on the surface may look like the logical way to serve the U.S. market, risks are increasing. Over the last year, ocean and air cargo carriers have significantly grown their direct services from China to Mexico. The U.S. [trade deficit](#) with Mexico has been growing steadily as well. If Mexico is perceived as simply an alternate channel for Chinese goods to enter the United States, it will undoubtedly inflame trade tensions and could lead to more tariffs or barriers.

The choices of sites with lower labor costs that could serve the European market are more varied. They include Eastern Europe, North Africa, and Turkey. Sub-Saharan Africa and South Asia could work as well, although companies would have to recognize the risks of shipping through the Red Sea and Suez Canal and whether the current situation foreshadows ongoing troubles.

Developing sourcing in other countries, especially the Global South, can have geopolitical advantages over time. In addition to Central and South American countries, this would include India, Bangladesh, and Indonesia, as well as countries in Southeast Asia, and Africa. These carry varying degrees of political risks, as we have learned over the last three decades from China. Foreign direct investment and trade are ways that Global South countries [can raise their standards of living for millions of their people](#), which could reduce emigration from those countries and enable developed countries to cement ties with them.

But for all this to happen, the Global South countries would have to have relatively honest governments with broad public support.

5. Would tariffs allow us to bring production from low-cost countries back to the United States?

Pronouncements that “we will bring manufacturing back to the United States” will one day face the reality that no amount of tariffs can protect a fundamentally uncompetitive cost position over time. Adam Smith’s [power of free markets](#) and David Ricardo’s model of [comparative advantage](#) have not been repealed. Unless consumers are willing to pay more — and there is no indication of such a willingness — we will eventually have to face the contradictions currently voiced in so many political arguments.

In the end, production in high-cost regions must be focused on products for which the labor content is a lower percentage of the overall bill of materials. This means highly differentiated products where design or engineering is central, like aircraft engines or advanced biomanufacturing processes, where knowledge and capabilities are key, or in processes that benefit from extensive automation or high labor productivity.

6. What is our core differentiation strategy?

In the face of the fragmentation of globalized markets, it will pay to review your core differentiation strategy and how it will play in different regions. Is there a critical component or technology, and if so, where are you going to produce it? If it is built on semiconductor chips or a critical technology, will you face export controls in sending components or subsystems across borders?

One of the things many Western companies have learned is partnering with local Chinese companies in joint ventures as required by the Chinese government sowed the seeds of future competition. Often it was competition in areas that were not core to Western companies. When Motorola was one of the largest feature phone sellers in China, it helped BYD improve its battery production so it could have a local source that would increase its domestic content to reap tax and import benefits. Volkswagen’s entry into China motivated it to set up supplier networks, which ultimately served its Chinese competitors well. And Apple’s contracting with firms like Foxconn and Quanta Computer ultimately helped their suppliers improve their hardware-manufacturing skills.

These examples hold two lessons. First, this kind of knowledge diffusion is inevitable because it is transmitted through the hands and minds of workers. One can slow it down by trying to protect IP through patenting and enforcement, but in the end, ongoing investments in innovation are one of the most important ways to stay ahead. Aerospace component suppliers in China understand this quite well. They know they will be copied, but they invest heavily to keep ahead.

The other thing we can learn (from Apple, in particular) is the differentiation power of software and a strong software ecosystem. Even though many Chinese competitors can now produce excellent smartphone hardware, Apple has managed to hold on even in China's domestic market because of its well-executed software and ecosystem of apps. This is a powerful barrier to imitation, though Apple has had to adjust its offerings to meet the requirements of the China market — for instance, by not offering some apps and storing consumer data in-country.

It is also worth rethinking the long-term implications of offshoring engineering and technical work. American companies have long been conscious of the [impact of offshoring on manufacturing](#). But they haven't really started thinking about the impact of outsourcing engineering design.

A case in point is the offshoring of semiconductor chip design to Asia and India over the last two decades by American fabless companies like Qualcomm and others. As India tries to ramp up its own domestic semiconductor-production capability, American fabless companies should consider what investments they should be making in their domestic capabilities to remain at the leading edge. Indian firms will have growing capabilities to design sophisticated chips using American design tools, and because Indian engineers are so much less expensive to hire, there will be a temptation by companies such as Qualcomm, Broadcom, AMD, and Nvidia to outsource more and more design work to them, which could hollow out American domestic capabilities. This could be very consequential over the next decade; it would follow the same path taken in the 1990s and 2000s to outsource and offshore chip manufacturing, which the United States is only now attempting to correct with the [CHIPS Act investments](#).

7. Should shipping and logistics factor into the design of supply chains?

All the things I have discussed so far point towards a rethinking of tradability, which is the extent to which a good or service can be produced at location that is distant from where it is consumed. For the past 30 years the world has

experienced an unparalleled expansion in the tradable sector, but that was predicated on ever-lower tariff and non-tariff barriers and the continued evolution of larger container ships and low-cost transoceanic shipping. This has probably reached a turning point not only in terms of rising trade barriers; shipping costs are also likely to remain elevated or increase as transport companies face the cost of compliance with emissions restrictions embodied in the [International Maritime Organization's environmental regulations](#), or the air transport industry copes with the cost of its [2050 net-zero goals](#). It's time to revisit assumptions that might have been made decades ago, when labor arbitrage was the driving force for globalization.

Shipping and logistics can no longer be taken for granted. Low-cost and reliable transport have been assumed in the design of far-flung supply chains, but repeated crises — the latest of which is the Gaza War, which [has drastically reduced traffic through the Suez Canal](#) — point out that logistic links are essential parts of any supply chain analysis. Bottlenecks like this, or [labor strife at U.S. ports](#), which consistently rank lowest in terms of productivity, adds cost, and such factors should change some of the static assumptions about the tradability of physical goods.

8. Should we give up on the Chinese market?

This admittedly gloomy picture on the future of trade and the fragmentation of globalization might suggest to some leaders of Western companies that their companies should retreat from China — something that some [automakers](#) are [contemplating](#). But as the world's second-largest economy, it is important to maintain a presence there — both because of its importance as a market and as a source of innovative products and ideas. Chinese firms' [aggressive efforts to move abroad](#) means they will participate in the U.S., European, and Global South markets irrespective of barriers, which makes gathering market intelligence on them all the more important.

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It's time for leaders of Western companies to revisit many of their long-standing assumptions about trade and globalization and to prepare their businesses to be more flexible as events unfold. The volatility of trade patterns in the last five years — and the surprises that have fueled it — have made that need readily apparent. Business leaders should not dismiss it as an aberration; they should treat it as the new normal.



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