

SPOTLIGHT ON STRATEGY IN A WEAK RECOVERY

Spotlight

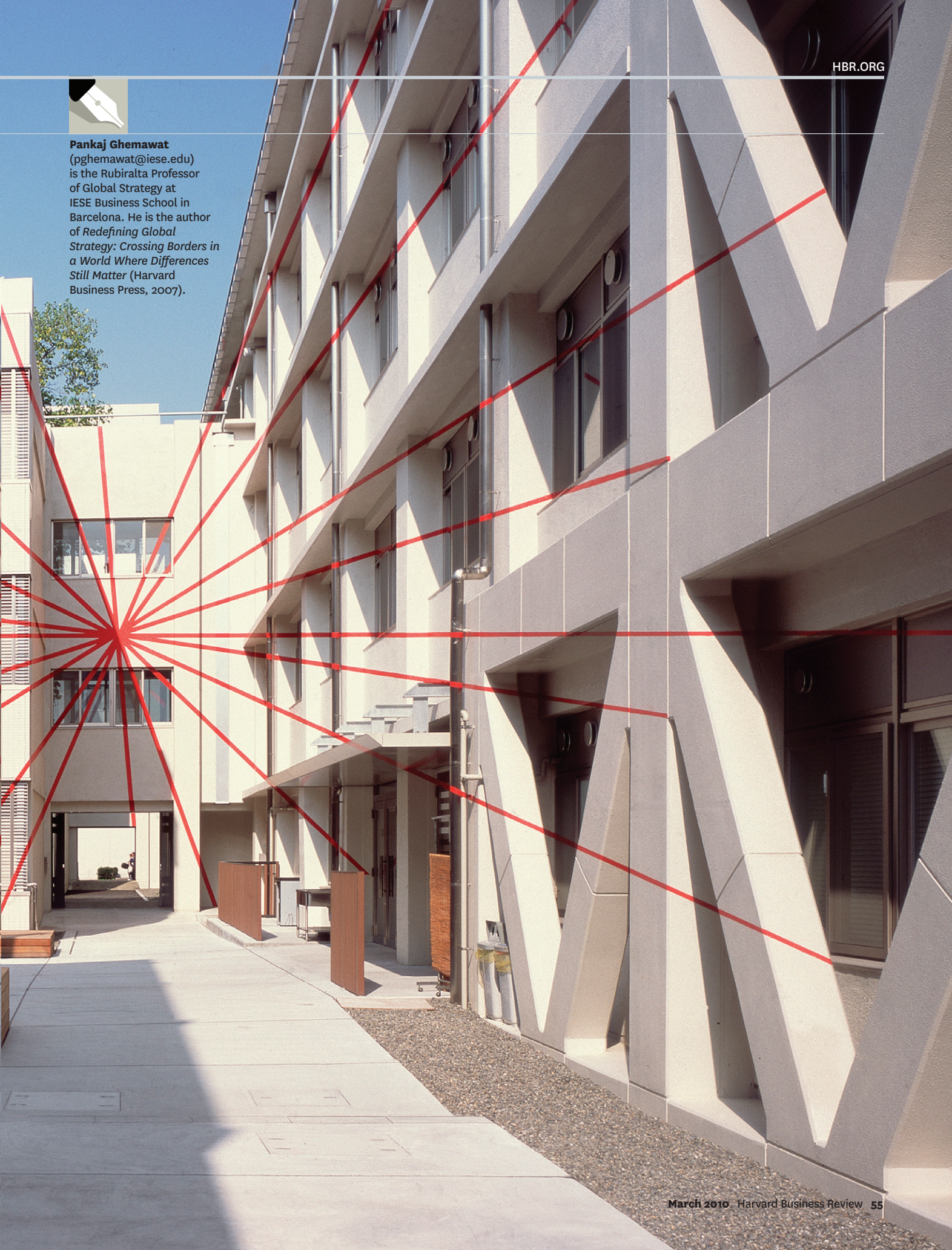
ARTWORK Felice Varini, *Twenty Points for Ten*
Straight Crossing, 2008, Nagoya University, Japan

***The postcrisis world demands a
much more flexible approach to
global strategy and organization.***
by Pankaj Ghemawat

Finding Your Strategy in the New Landscape



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The 2008 crash hit cross-border business hard. The value of international trade was projected to decline by as much as 9% in 2009. Foreign direct investment has plunged even more: After dropping 15% in 2008, it fell by more than 40% in 2009. Though we may have reached the bottom, the prospects for the medium term don't look promising. For much of the next decade, we can reasonably expect to see weak global growth, pressures from overcapacity, persistently high unemployment, volatility in the financial markets, costlier capital, a greatly expanded role for governments, a much larger burden of regulation and taxation for all, and maybe even increased protectionism. If we experience a second crash, as some experts worry, these conditions could all worsen.

It goes without saying that global firms must factor these developments into their strategies in the new decade. For some, the response will be to retrench and focus on home markets. This already seems to be happening: If you look at the annual reports of the world's 100 largest companies, you'll find that the percentage of firms in developed economies that emphasized international or global business in their letters to shareholders declined from 51% in 2006 to 31% in 2008. (In contrast, the percentage increased among the few companies from emerging economies in the group.) And use of the words "global" and "globalization," while up significantly, was mostly in references to the economic slowdown and its impact on company performance.

Becoming homebodies, however, may be a bad idea for firms based in the developed world. Early data for 2009 indicate that China accounted for 66% of global growth in GDP (excluding countries with negative growth) and India for 11%. Indonesia accounted for the third-largest portion, 4%. Though 2009 was an abnormal year—developed economies will snap back—the economic clout of big emerging markets, particularly China and India, is likely to increase over the next few decades, not just the next few years. According to recent World Bank projections, by 2050 China and India will together account for nearly 50% of global GDP—about the same as the G7's current share, which is expected to decline to 25%. (These GDP figures are all nominal and not adjusted for purchasing power parity.) And since per capita incomes in China and India

are projected to be only one-half to one-third the size of those in advanced economies, there's room for even higher growth rates in these markets after 2050. The same holds true in many other emerging markets as well.

That said, managers cannot afford to ignore the risks of pursuing a global strategy in the uncertain years ahead. To successfully negotiate the rockier path before them, they must change their strategic approach in several dimensions. My purpose in these pages is to suggest what direction they might take across this new, more rugged terrain. I'll look first at how the crisis affects a company's basic strategic environment and then explore how that translates into changes in product and market focus, organizational and supply chain structures, talent management choices, and, of increasing importance, the management of corporate reputation and identity. In other words, I'll take you through the hub and spokes of a typical strategy wheel, outlining the steps that firms should consider taking with each. (See the exhibit "New Strategy Directions.")

Strategy and Competition

 Most companies' global strategies have been based on a vision of a world that's steadily, even rapidly, becoming more integrated, where the key challenge is keeping up with that integration. But given what we've witnessed in the past two years, it makes more sense to adopt a vision in which national differences remain pronounced (and may become even more so), and managing those differences is the primary challenge. Companies whose strategies currently emphasize smoothing differences and achieving economies of scale across national boundaries may need to shift toward adapting to local conditions. Companies whose strategies emphasize arbitrage—taking advantage of differences—may need to make the same shift; now is not the time to be perceived as an exploitative foreigner.

Resource allocation processes will have to change, too. During the years of rising asset prices, many companies came to think of global strategy as one long asset-accumulation play that involved relatively little risk. The idea was to invest abroad and, if that didn't work out, resell at a capital gain. That may be why, according to a survey of HBR readers, 88% of managers in precrisis days thought of global strategy as an imperative, almost an article of faith, rather than as a set of options to be carefully evaluated.

Idea in Brief

In the aftermath of the 2008 crash **demand will remain weak for several years**, with governments taking a more active, possibly protectionist role. Many companies will need to try harder to adapt to local norms. Firms also must be more discriminating about investments and pay more attention to emerging-market competitors and to rebuilding their own reputations.

The large developing economies still represent the best market opportunities, but companies will need to expand into underserved segments in richer countries. This will mean offering more-customized products at lower prices. Emerging economies will also play a bigger role in both process and product innovation.

The organizational power of the local country unit will grow, and firms will transfer more key functions away from the home base. At the same time they will have to cultivate a more diverse talent pool to reflect the new organizational reality. Managing a more diverse workforce will require a strong corporate identity and investments in communication technologies.

In a postbubble world, firms must be more ruthless about terminating loss makers.

Now that the bubble has burst, many firms are being reminded that a significant portion of their global operations subtract, rather than add, economic value. This isn't just a result of the crisis; it was true in the years leading up to the downturn. Of course, some global investments will pay off in the long run. Nevertheless, in a postbubble world, where the cost and even the availability of capital are issues, firms will need to be more ruthless about terminating long-standing loss makers—and more selective in pursuing new opportunities. Some of this selectivity can be imposed by raising hurdle rates and tightening assumptions around terminal values. Some firms are also trying out other approaches, such as allocating resources according to their articulated strategic priorities. A number of large companies have turned on the investment spigots in China and, to a lesser extent, India—and for other platforms for growth—while tightening the financial taps elsewhere. Other companies have responded to resource constraints by offshoring, outsourcing, and forging strategic alliances (which seem to be on an upsurge).

Many companies from the developed world also need to widen their competitive focus. Last year, in the space of two weeks, I spoke with the two market leaders in a particular product category about globalization. It was clear that the two companies were mostly focused on each other. I tried to point out that if they considered China to be their major area for growth, it behooved them to pay at least as much attention to local Chinese competitors as they did to each other, especially since their sector was not R&D- or advertising-intensive (the two clear mark-

ers of multinational advantage). As the economies of China and other developing nations surge, they will produce formidable homegrown rivals, of ever larger size and reach—an issue that Thomas Hout and I reviewed in “Tomorrow’s Global Giants? Not the Usual Suspects” (HBR November 2008).

Let's turn now to how these strategic shifts play out in the functional components of a multinational's strategy.

Markets and Products



When it comes to customers and product choices, three main changes are likely.

First, multinationals from advanced economies will have to rethink their customer targeting. In large emerging markets they have traditionally focused on the urban elite, who can buy premium products in upscale retail outlets. Going forward, companies will need to penetrate more geographies, channels, and income levels. Within China, many successful multinationals have already developed strategies at the provincial level and are now working at the level of clusters of cities and rolling inland from the coast. India is seeing a similar pattern.

At home, multinationals should also look for ways to target underserved segments. Wal-Mart, for example, has begun a major push into U.S. urban markets. The top 15 metropolitan areas represent more than a third of the total U.S. market, but Wal-Mart's share in them is only 4%, compared with 10% in the United States overall. The company's new urban strategy involves smaller store formats and more attention to mobilizing local political support.

Second, most markets will experience pressures on pricing. Economic weakness and extra capacity, and possibly a shift in the zeitgeist from excess to frugality, have already pushed prices downward. Expansion into poorer markets at home and abroad will intensify this trend. This will require companies to do some repositioning—even in the luxury products sector in booming markets such as China. According to *Forbes*, Tiffany has faltered in China because its stores are small and offer only a limited range of high-end products. Louis Vuitton and Gucci, in contrast, have prospered with larger stores that offer many items at price points of several hundred dollars, which appeal to the luxury “entrants” and to gift buyers, who account for a large portion of luxury purchases in China.

Finally, multinationals will have to develop products and services that are fundamentally different from what they’re used to selling, as well as regional varieties of offerings, as local differences in, for instance, taste, price sensitivity, and infrastructures for service and delivery become more important. This is obviously a challenge: If it’s hard for a company to recognize that what worked in New York isn’t working in Mumbai, it will be even harder for it to recognize that what worked in Mumbai may not work in Nagpur. But the savvier players are already trying this approach. Nokia’s 1,000-plus-employee R&D force in India has engaged in extensive product adaptation, some of it focused on rural and other lower-income markets. The results include a basic mobile phone that doubles as a flashlight for use during power outages and a phone designed to be shared by multiple people.

Operations and Innovation



On the supply side, several interrelated shifts are taking place. The pressing need to reduce global trade imbalances from record and clearly unsustainable levels, the rise of protectionism, and concerns about the environment are undermining the traditional “Chimerica” model, in which the United States imports large volumes of goods from China. Before the crisis, companies became accustomed to offshoring, but they should at least take a second look at the practice now. It’s noteworthy that the U.S. global giants that were financially healthy and confident enough to make major operations investments recently have stressed that they made those investments at home. Intel, for example, has talked up its new U.S. semiconductor

plants, and GE its new U.S. wind turbine facilities. Of course, these are just two particularly vivid examples; both companies continue to invest substantially if quietly overseas. But that holds its own lesson: When offshoring does make sense, managing the discourse around it is more important than ever.

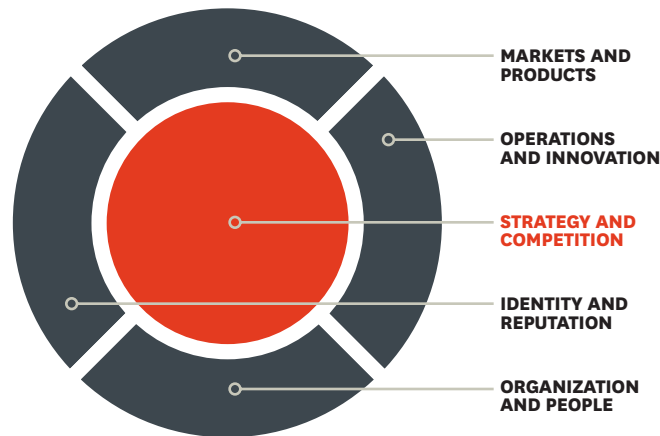
Unless protectionism spikes, significant offshoring will most likely continue. But supply chains will need to become shorter, simpler, and more robust, which means they’ll require major reconfiguration. In the recent past the division of tasks across countries became ever finer and more complex; the manufacture of some garments, for instance, might have involved as many as 40 processing steps in a dozen countries. Now increased concerns about the environment and sensitivity to energy prices, not to mention the possibility of protectionism, appear to be reversing that trend. A 2009 survey of logistics providers revealed that nearly one-quarter of North American and European clients had taken steps to shorten their supply chains during the previous year. In the airline industry, international carriers continue to debate the sustainability of flying empty aircraft to developing countries in Asia and Central America, where costs are lower, for routine maintenance.

Perspectives on skills and process innovations are also changing. Traditionally, companies tended to transfer older, less-automated technology to plants in less-developed countries. Those plants didn’t contribute to technological advances. But recent reports on manufacturing firms—for instance, the global components survey sponsored by the Alfred P. Sloan Foundation—reveal that many Western multinationals have actually started to import some of their less-automated processes back into plants in high-wage regions. Their experience in low-wage countries has shown them that labor-intensive plants can be more flexible than, yet just as reliable as, more-automated plants. It also turns out that the gain in flexibility can more than compensate for the higher wage bill. The flow of knowledge and innovation in operations has begun to reverse, with plants in places like Mexico becoming models for plants in the United States.

A reversal is happening in product innovation, too. It’s clear from labor projections that technical manpower is growing rapidly in emerging markets and that multinationals will have to shift the locus of R&D there. The projections forecast a shortfall in the global supply of many categories of engineers and other technical personnel, in a field already dominated by graduates of universities and techni-

New Strategy Directions

Companies need to rethink their strategies in response to the changed economic landscape. This wheel describes the adjustments they should consider for each component of strategy.



cal schools in India and China. Consequently, large high-tech firms with interests in emerging markets are starting to think hard about basing their R&D efforts in those countries. Intel, in fact, has already designed one chip almost entirely in India: the Xeon 7400 processor, which it rolled out in 2008.

Organization and People

As operational norms and patterns in learning and innovation begin to reflect the new opportunities and constraints, so too will norms around organizational structure and talent.

Before the crash, many companies were moving toward globally integrated structures. But the notion that we live in a world where the constituent parts of enterprises can and should be bound ever more tightly together has been challenged by contagion, economic volatility, and changing political sentiments. We may therefore see some organizational power flow back to country managers as companies tone down their attempts to eliminate or exploit cross-border differences and instead look to adapt to local conditions.

But in view of the other new priorities on the agenda—bringing lower-end products to market sooner; dealing with local rivals more aggressively; taking out costs in design and manufacturing; and expanding faster into new segments and territories—more changes are called for. Because local knowledge has become critical and the need to shorten learning and action cycles more urgent, companies must go beyond simply setting up local operations and start building deep local connections. A number of companies have begun moving some key functions out of headquarters. IBM's global procurement office, for instance, is now located in Shenzhen, China. Cisco set up Cisco East as a second headquarters in Bangalore. Perhaps the most dramatic example is provided by the GM reorganization. The company's Mexican and Canadian operations will continue reporting to the person overseeing the United States, but operations pretty much everywhere else apart from Europe will now report to the head of China, which last year overtook the United States as the automaker's largest market in terms of number of vehicles supplied. This is a basic realignment of the power structure within a hitherto U.S.-centric GM: The China operation is now regarded by many as the more interesting part of the company. Looking forward, people are talking of more multinationals with dual headquarters, one in the West and one in Asia (most likely China).



STRATEGY AND COMPETITION

Adapt to local differences

Invest more selectively
Watch for emerging-market competition



MARKETS AND PRODUCTS

Focus on underserved segments everywhere

Recognize price pressures
Cultivate requisite variety



OPERATIONS AND INNOVATION

Rethink the scope of offshoring

Simplify supply chains
Import process innovations from emerging economies
Move R&D to where the researchers and the market growth are



ORGANIZATION AND PEOPLE

Re-create country manager functions

Relocate key functions
Develop a globally representative talent pool
Exploit communication technologies



IDENTITY AND REPUTATION

Build a strong corporate identity

Emphasize corporate citizenship
Restore the reputation of business in general

Such organizational power shifts will demand fundamental changes in the diversity of management ranks. The profile of most large U.S. corporations still reflects past patterns of operations, rather than intended future patterns. Their management is still dominated by Americans, and few have really come to terms with diversity. A Boston Consulting Group study of large multinationals and their aspirations in 16 rapidly developing economies conducted before the crisis found a gross mismatch between the amount of growth targeted in these geographies (about 33% then, and probably more now) and the percentage of top personnel from or located in them (less than 10% then and probably now as well). Clearly, this is not sustainable.

Finally, we have to become much smarter about the way we manage interactions among diverse, far-flung employees. Although companies have globalized their footprints, their managers still communicate across geographies mostly by traveling to and fro, holding conference calls, and, to a lesser

In a recent survey by Pew Research, only 21% of respondents thought business executives contributed a lot to society.

extent, e-mail. Companies rarely exploit the new collaborative tools of the web, such as chat rooms and online bulletin boards, to build a stronger sense of community.

The challenges of cross-border communication can be quite subtle. Language barriers, for example, are less of a problem for those providing information than for those receiving it; it's easy for a Chinese manager to make a comprehensible presentation in English but harder to get people listening to it to invest in comprehension. Research shows, for example, that people very quickly tune out when they have trouble understanding an accent. Companies could do far more to take advantage of modern communications to close not only geographic but also cultural and demographic distances.

Identity and Reputation



Establishing a strong one-firm identity will be key to managing long-distance interactions in the days ahead. Firms that have clear and well-understood values and communication norms but also respect diversity are likely to deal better with cultural and national differences in developing, communicating, and executing strategies. Strong global leadership-development programs can also help—although in the present environment these seem to be subject to the same kinds of cuts as, say, golf tournament sponsorships. The general point is that firms will need to invest in organizational glue if they are to remain more than the sum of their parts.

The identity challenge posed in the new environment is not only internal. With government taking on an expanded role as investor, customer, regulator, and tax collector, corporate diplomacy is becoming a more important component of strategy in the postcrisis world. In such an environment, the insistence that the marketplace should completely dictate outcomes is unlikely to win friends and influence people. CEOs and other executives will need to spend more time managing government relationships.

Beyond simply dealing with the government, however, companies need to come to grips with the fact that the general reputation of business is at an all-time low. In a recent survey conducted in the United States, the Pew Research Center asked the public how much people in 10 occupations contributed to the well-being of society. Business executives were ranked at the very bottom of the group. Only 21% of respondents thought they contributed a lot, while 23% thought lawyers, the second-least-favored occupation, did. (The military and teaching professions ranked the highest; with scores of 84% and 77%, respectively.)

Though attitudes look a little bit more positive in emerging markets, the standing of capitalism and private business enterprise is being challenged in fundamental ways. Any company that wants to thrive in this environment has to reassess its efforts to bolster its reputation in particular and the reputation of business in general. Because it's not going to be business as usual!

Rebuilding the reputation of business may also help with the broader challenge of protectionism. Since studies show that protectionism flourishes when trust in economic institutions is low, the restoration of trust in business may help contain it.

THAT CONCLUDES our whirl around the strategy wheel. If there is one overarching message to take away from the trip, it's that for the typical multinational the postcrisis world requires a somewhat looser approach to strategy and organization than was popular just a few years ago. A second important message is that multinationals must increase diversity in their ranks but, at the same time, build cohesive corporate cultures and tighten their talent management practices. That creates a tension, of course. Nevertheless, developed-world companies have to become more cosmopolitan in their worldview and more discriminating in their investment choices. They still have time—but not much—to make that adjustment and to exploit what remain strong advantages in many sectors. ▀

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