

HBR.ORG

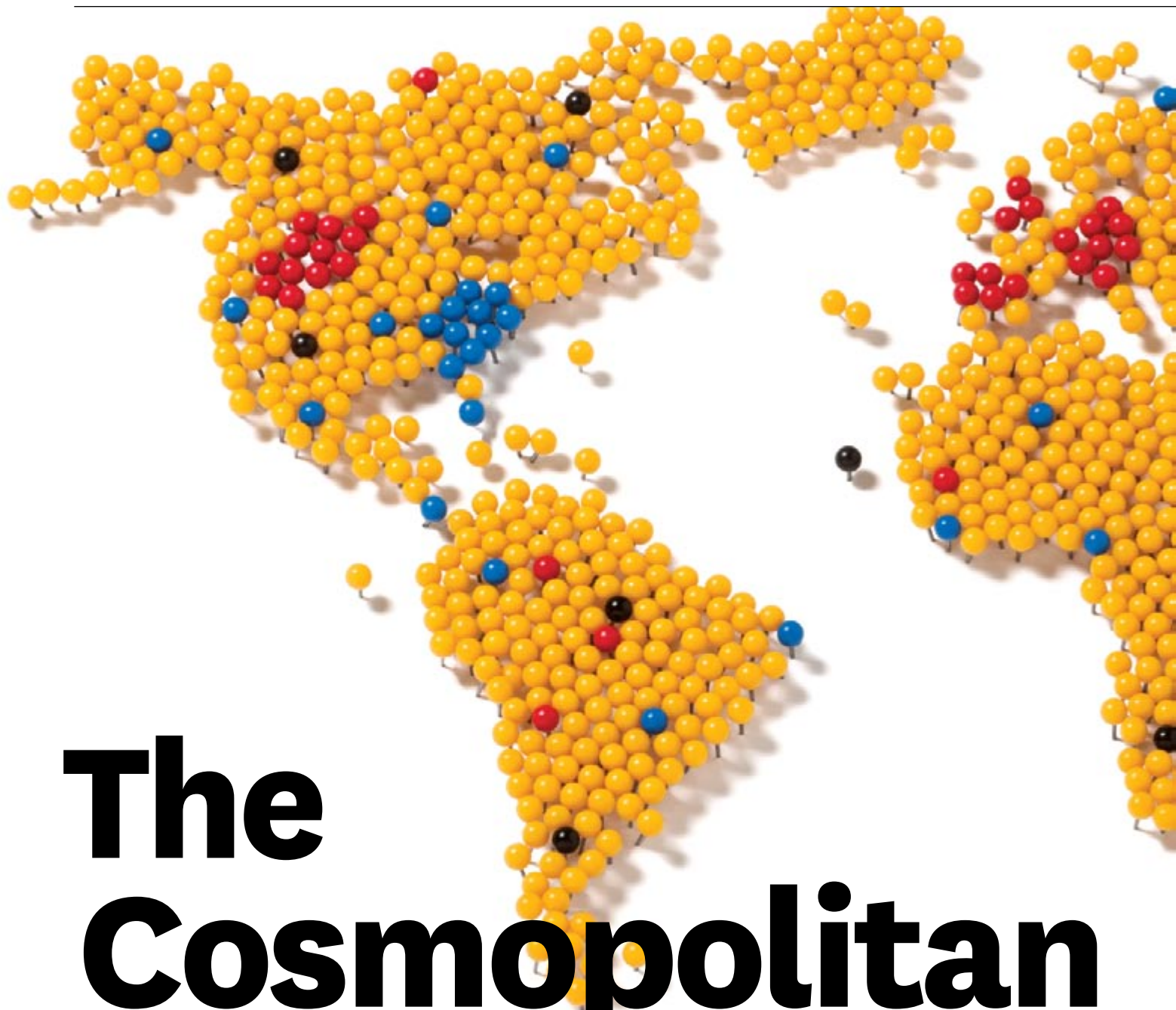
Harvard Business Review



MAY 2011
REPRINT R1105F

The Cosmopolitan Corporation

Global success requires that companies appreciate diversity and distance rather than seek to eliminate them. *by Pankaj Ghemawat*

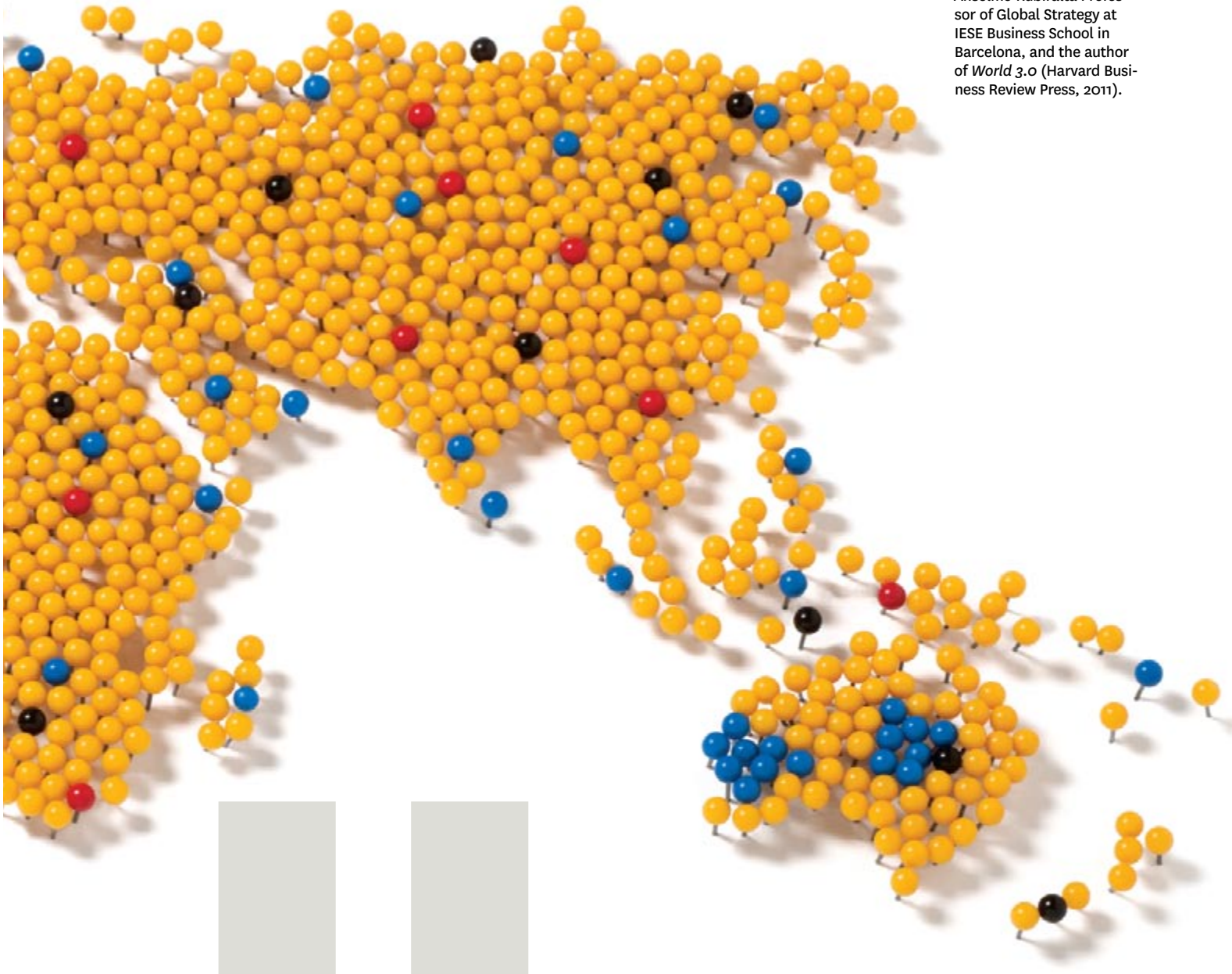


The Cosmopolitan Corporation

Global success requires that companies appreciate diversity and distance rather than seek to eliminate them. *by Pankaj Ghemawat*



Pankaj Ghemawat is the Anselmo Rubiralta Professor of Global Strategy at IESE Business School in Barcelona, and the author of *World 3.0* (Harvard Business Review Press, 2011).



UNBALANCED GROWTH, pockmarked by financial distress. The threat of protectionism brought on by persistently high unemployment, particularly in developed countries. Tensions, in wealthy nations as well as poor ones, around ethnic, religious, and linguistic divides, and talk of a new age of secession or tribalism. These are some of the developments that contradict the story we had just gotten used to—the one about how markets were becoming perfectly integrated across borders, technology was obliterating distance, and national governments were now irrelevant. The aftermath of the financial crisis of 2008 reminds us of the many ways in which differences still matter.

It also calls for a reassessment of what it means to be a global manager or corporation. Much of the management writing on globalism adopts the Enlightenment-era ideal, proposed by the 18th-century philosopher Immanuel Kant, of abandoning all “allegiances to nation, race, and ethnos” in favor of world citizenship. Take the strategy guru Kenichi Ohmae. In 2000 he published his famous book, *The Invisible Continent*, depicting a world in which businesses largely ignore geographic boundaries when serving markets and building supply chains. This kind of thinking isn’t confined to management experts with an avant-garde view to promote: Forty-eight percent

of the respondents to an online survey that HBR conducted for me in 2007 agreed with the proposition “The truly global company has no home base.” And among people with more than 10 years of international experience, 63% agreed.

Unfortunately, enticing though they may be, such beliefs don’t bear up upon closer examination. Of course, they never did.

The Reality of Roots

The vast majority of firms are deeply rooted in their home countries. In 2004 less than 1% of all U.S. companies had foreign operations, and of those, the largest fraction operated in just one foreign country. The median operated in two foreign countries, and 95% in fewer than two dozen. Among the U.S. companies that were in one foreign country, that country was Canada 60% of the time and the United Kingdom 10% of the time.

Even the icons of globalization are less global than the rhetoric suggests. Remember ABB? Back in 1990, when *BusinessWeek* ran the cover story “The Stateless Corporation,” that company, with its global nomad of a CEO, Percy Barnevik, was the lead example. The boundaries between ABB’s Swedish predecessor ASEA and Swiss predecessor Brown, Boveri had ostensibly been broken down by putting the merged company’s headquarters in Switzerland to balance the Swedish nationality of the controlling investors, the Wallenberg family, as well as of some key managers, particularly Barnevik. But the years after the merger were marked by what one insider characterized as internal warfare between the Swedes and the Swiss. Although things seem to have calmed down since then, it’s more accurate to think of ABB as a company with a global presence but with particularly strong roots in Northern Europe and runners or prop roots in other geographies in which it has significant operations. Not as a company without any particular roots. That much is evident from looking at ABB’s directors and top management (although a U.S. CEO was brought in from GE not long ago) and at its geographic distribution of assets and shareholdings.

Or, for an example in Asia, consider Rupert Murdoch and News Corporation’s satellite TV network, Star TV. Murdoch and News Corporation had some elements of statelessness. They were major players from Australia to the United Kingdom to the United States, and Australian-born Murdoch had already become a U.S. citizen so that he could buy a set of American TV stations. But his experience across English-

speaking countries didn’t stop him from making some tremendous blunders in Asia.

Murdoch’s original strategy for Star was to leverage News Corporation’s English-language programming library across Asia, because many Asians of the target demographic spoke English. The company paid no attention to evidence from continental Europe that audiences strongly prefer local-language content, even if they understand foreign languages. Star TV’s travails with language and culture paled in comparison with its political missteps. Shortly after acquiring Star, Murdoch pronounced satellite TV “an unambiguous threat to totalitarian regimes everywhere.” The Chinese government reacted by banning satellite TV dishes. Much of Murdoch’s China strategy has since involved digging out of this hole. The bottom line: Though News Corporation had transcended its Australian origins, it was still deeply rooted in a particular set of Anglo democracies that bore little resemblance to Star TV’s target markets along some important dimensions.

If you’re skeptical about the relevance of a corporation’s nationality or the locations of its owners, ask yourself: Why are large export deals involving private firms often announced at meetings between the heads of national governments? Why do employees of foreign-owned companies often fear their career opportunities will be limited relative to their counterparts from the firm’s home country? Which governments do firms call to represent them in World Trade Organization disputes (and to lead their bailouts in a crisis)? Why do foreign-ownership restrictions persist in industries like media (as well as various others, like airlines)?

It’s not just firms and their business operations that remain deeply rooted. More important, it’s the *people* who are their customers, employees, investors, and suppliers. Ninety percent of the world’s people, it is estimated, will never leave the country where they were born. Two percent of all telephone calling minutes are international. People get 95% of their news from domestic sources, and those sources focus most of their coverage on domestic news. Only 21% of U.S. news coverage is international, and of that, half deals with U.S. foreign affairs. In European countries about 38% of news is international, but almost half relates to stories involving other countries in Europe. Only 5% to 10% of private charitable giving crosses national borders, and rich countries’ governmental aid to the foreign poor, per person, has been calculated to be one thirty-thousandth the size



90%

of the world’s people will never leave the country where they were born.

2%

of all telephone calling minutes are international.

95%

of the news people get is from domestic sources.

Idea in Brief

Much of the management writing on globalism adopts the Enlightenment-era ideal of world citizenship. Unfortunately, this is not realistic. The vast majority of firms are deeply rooted in their home countries. Even more important, so are the firms' customers, employees, investors, and suppliers.

Given this reality, global firms and managers must adopt a cosmopolitan approach of understanding and working with differences rather than against them. This has three implications:

Strategy

In the medium term companies should emphasize adaptation more than aggregation or arbitrage.

Organization

Companies must think about how to reduce or exploit external differences by managing internal, organizational distances.

People

Corporations will have to develop a cosmopolitan mind-set in people who have normal or typical attitudes and biases.

of aid to the domestic poor. As another 18th-century philosopher, David Hume, pointed out, "Sympathy... [is] much fainter than our concern for ourselves, and sympathy with persons remote from us much fainter than that with persons near and contiguous."

This is the reality of what I call World 3.0, a world that is neither a set of distinct nation-states (World 1.0) nor the stateless ideal (World 2.0) that seems implicit in the strategies of so many companies. Home matters in such a world, but so do countries abroad. And instead of everything being equally near or far, as German philosopher Martin Heidegger proposed in 1950, the law of distance continues to apply to many activities. As distances—geographic, cultural, administrative/political, and economic—increase, cross-border interactions tend to decrease. It's certainly possible to have a global strategy and a global organization in such a world. But they must be based not on the elimination of differences and distances among people, cultures, and places, but on an understanding of them. The mind-set, strategy, organization, and employees of these firms will not be oriented toward the global citizenship model implicit in corporate rhetoric. Instead, they'll start with a strong grasp of one's roots and what's distinctive about them, recognize relative similarities and differences, and flag the differences particularly worth watching out for. Because denying the existence of differences doesn't make them any easier to deal with.

Building a Cosmopolitan Understanding

Most executives' opportunity assessments rank markets by size, growth rate, and other indicators of long-term potential, such as demographics. In this approach, distance from a firm's home base or current markets is always a challenge to be overcome.

One way to break out of this trap is to use what I call a *rooted map* to ground your analysis. A rooted

It's not just firms that are deeply rooted in their home countries; it's their employees and customers.

map resembles world maps that size countries according to measures such as population and GDP, but it focuses on measures that reflect a particular country's perspective. An Indian IT services company, for example, might use rooted maps like those in the exhibit "How Important Is Distance?" The first map takes a general Indian perspective by sizing countries according to their share of India's international trade. The second takes an industry view, with each country drawn according to the size of its IT services market. The third map combines the two perspectives, sizing countries on the basis of their purchases of Indian IT services.

To gain insights, you need to make comparisons across maps and think about what kinds of distance influence the patterns they reveal. In this case, the first map shows how India's general trade pattern is sensitive to geographic distance, natural-resource availability, and historical connections. Nearby countries in Asia and along the resource-rich Persian Gulf are among its major trading partners, and we also see the legacy of India's historic ties to the former British Empire. The second map shows, unsurprisingly, that the largest IT services markets are the most advanced economies, whose per capita incomes make them distant economically from India.

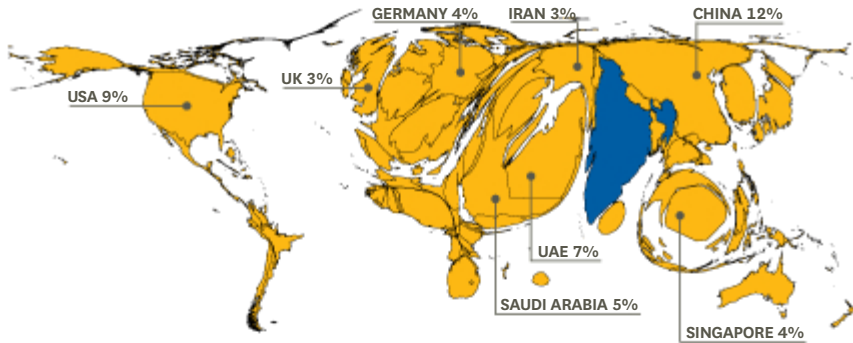
The first two maps suggest that without a more careful analysis, an Indian IT firm might follow India's general trade ties to the nearest major market—continental Europe. Indeed, one of the first large software projects offshored to India was for a Swiss clearinghouse. But the third map reveals that in IT services, linguistic distance matters more than geographic

How Important Is Distance?

The rooted maps below size countries according to their share of trade with India, their share of global IT spending, and their consumption of Indian IT services. They highlight how different kinds of distances matter for an Indian IT firm in search of growth.

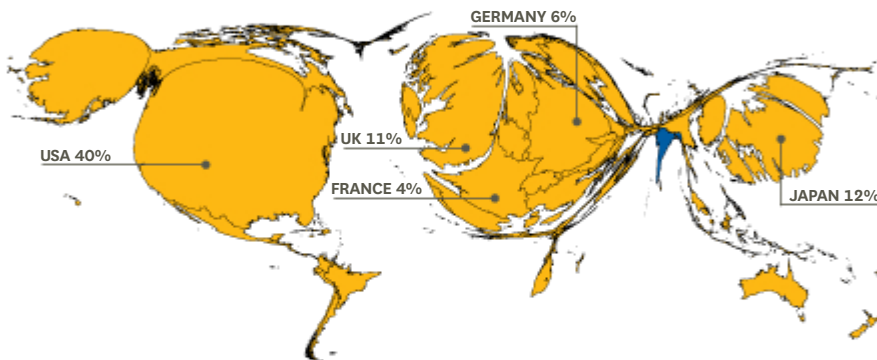
India's Bilateral Trade Pattern

India's general trade pattern is sensitive to geographic distance, natural resource availability, and ties to the former British empire.



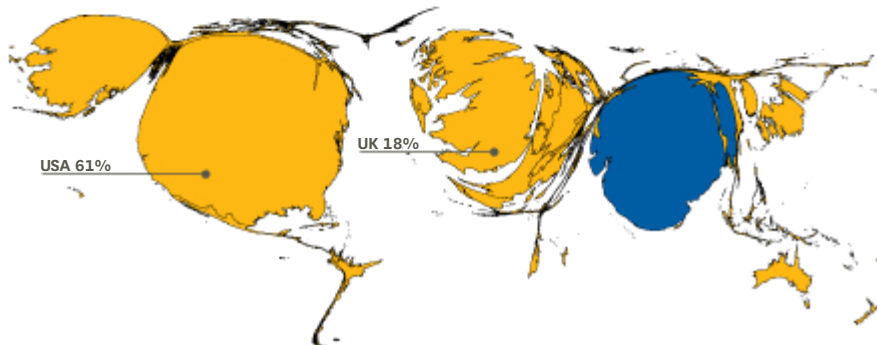
World IT Services Spending

Advanced countries are the largest IT services markets.



Exports and Domestic Consumption of Indian IT Services

For Indian IT firms, linguistic distance is an especially large consideration: English-speaking countries account for most of their business.



distance. Upwards of 85% of India's IT exports go to English-speaking countries. Though that makes continental Europe an obvious area for potential growth, operations there are usually less profitable than those in the major English-speaking geographies.

This example should make clear the importance of considering multiple types of distance and conducting analyses at the industry level. Your sensitivity to 1,000 miles of geographic distance is obviously much greater if you manufacture heavy goods than if you offer an online service. On the other hand it's less important to share a common language if you export cars than if you provide online training.

Rooted mapping is not just a global exercise. You need to analyze differences across regions and within countries as well. Indeed, the bulk of economic activity still takes place within national borders, and large gains can be achieved by carefully managing differences between provinces, ethnic groups, or language communities. For example, though nationalism and separatism are prominent in Spain's Basque Country, that region's trade with the rest of Spain is still 50% greater than its trade with the rest of the world. If tensions between the Basque Country and the central government in Madrid were reduced, Basque trade with the rest of Spain would presumably rise.

Companies and individuals vary in their ability to manage the same external distances. Businesses and executives from small home countries, for instance, are often more accustomed to dealing with cross-border differences than those from large home countries. Since Finnish norms aren't common in most of the markets Nokia sells to, its managers have had to learn how customers in other countries think. Americans, by contrast, are more likely to project their values or feel that other people need to do the changing.

Executives also need to think about how rooted maps are evolving. Which kinds of distances are expanding and which are contracting? What factors are driving those changes? In the current environment of protectionist rumblings and more-assertive governments, administrative and political distances seem to be increasing. And the shift in the locus of growth to large emerging markets—especially to the smaller interior cities within them—also adds distance along several dimensions for a typical U.S. or European multinational, which must learn how to bridge cultural and political differences and vast economic and geographic divides. On the other hand, trade agreements and new communications and transportation technologies can contract dis-



Companies are realizing that widely dispersed, low-cost supply chains make them vulnerable to protectionism, rising transportation costs, and quality issues.

tance (though the impact of new technologies is often overblown). In each case, the insights you glean from a careful analysis will inform your strategic and organizational choices.

Crafting the Cosmopolitan Strategy

In my 2007 book, *Redefining Global Strategy*, I described three fundamental ways that companies can create value across borders: the “AAA strategies” of *adaptation*, *aggregation*, and *arbitrage*. Adaptation strategies try to adjust to differences between countries and respond to local needs. Aggregation strategies attempt to overcome differences to achieve economies of scale and scope across national borders. Arbitrage strategies seek to exploit differences—by, say, buying low in one country and selling high in another. I advised managers to tailor a combination of these strategies to their company’s industry, position, capabilities, and intent.

Though the AAA strategies remain the relevant consideration set for cosmopolitan corporations, in the medium term it may make sense for many companies to emphasize adaptation more than aggregation or arbitrage, given the public’s current sentiment toward globalization. Such medium-term adjustments, however, must be checked against longer-term plans and expectations about how a firm’s industry might evolve, because it can take years for companies to execute meaningful shifts among the AAA strategies.

The rationale for strengthening adaptation is threefold. First, if companies become more respectful of differences, people may be less inclined to demand protectionism. Second, when companies acquire foreign assets with little apparent rhyme or reason, as many did before the crash, they come across to the public as voracious and greedy. Showing regard for the sovereignty, uniqueness, and internal diversity of foreign markets can go a long way toward improving companies’ reputations and, more broadly, the environment in which business as a whole has to operate. The rooted cosmopolitan corporation will be an ac-

tive foreign investor across many locations but will pay careful attention to the cultural, political, and economic impact of its investment decisions. (For an influential conception of rooted cosmopolitanism at the individual level, see Kwame Anthony Appiah’s book *The Ethics of Identity*.)

Finally, and perhaps most important, adaptation strategies are better suited to the opportunities opened by the shift in the locus of global growth. With growth slow in Western markets, Western companies must compete in big emerging markets like China and India. But they can’t force their way in. They also cannot prosper by continuing the old practice of targeting elite customers in big cities, who tend to be more like customers back home. Western firms will need to take local competitors seriously and consider extending their presence to second- and third-tier cities, where more adaptation will be required.

But it is infeasible to invest in every market in the world in an adaptive way. You need to zero in on the places where you’re best positioned to add real value. That requires really understanding selected markets and demonstrating deep commitments there to customers, suppliers, governments, and the public at large—a far cry from the imperialist approach of pushing globally standardized products and pressing others to conform to your way of doing business.

Designing the Cosmopolitan Organization

When making choices about supply chains, organizational structure, foreign investment, and cross-border innovation, a cosmopolitan firm thinks about how to alter internal, organizational distances in response to changes in external differences. Take supply chain decisions. The trend toward significant offshoring will most likely continue. But many companies are becoming concerned that widely dispersed, low-cost supply chains make them vulnerable to protectionist governments, rising transportation costs, and quality



The most critical ingredient in a world that demands adaptation is a diverse management team.

problems. Some are taking steps to make their supply chains shorter, simpler, and stronger, in effect reducing internal distance within their production networks to better manage their exposure.

When it comes to innovation, many firms are similarly readjusting internal distances to reduce their sensitivity to external distances. In some cases this leads to an increase in internal distances. Innovation for emerging markets, for example, often requires different business models, not just whiz-bang technology. Corporate R&D labs located close to home in advanced markets may excel at creating technology, but firms seeking to develop products and business systems for markets abroad will increasingly need the informed creativity that only boots on the ground in those markets can provide. This suggests that Western multinationals may keep research mainly in the West but push development out to the large emerging markets. The street isn't one-way, of course; there's a lot of discussion now about transferring innovations from the emerging markets back to developed countries and adapting them for wealthier customers.

As the mix of a company's activities across countries changes, it's often wise to reexamine reporting relationships. Do they create unnecessary internal distance by routing too much through headquarters? Which decisions should be made at the country level? The regional level? The global level? More adaptation in a strategy might mean giving more authority to country managers. Should some functions be shifted from headquarters into regions where more of the related work actually gets done?

Perhaps the critical organizational ingredient in a world that demands adaptation is the composition of the management team. Most corporations are far from cosmopolitan. Even though GE deploys roughly half its assets in and generates half its revenues from markets outside the United States—and is justly famed for the breadth and depth of its top management—I reckon that about 80% of its top 200 managers are Americans. And among the vast majority of firms from emerging economies, management

teams are much less international. This is true even for the very largest firms.

But simply adding foreigners to the management ranks won't make a firm cosmopolitan. First, their numbers must reach a critical threshold; a few token foreigners will probably have little impact. And second, when you put people of various nationalities together in a single corporation, you have to manage that diversity very carefully. Research suggests that unmanaged diversity is more likely to have negative than positive effects on group performance. People are more inclined to trust their fellow nationals, which often exacerbates tensions between headquarters and managers in far-flung foreign operations. And other research indicates that people's inclination to show sympathy is even more sensitive to cultural similarities.

People whose backgrounds are rooted in multiple cultures—so-called biculturals or triculturals—can play useful bridging roles in organizations. Studies also show that nationalism and suspicion of outsiders both decrease as a person's education level rises; one study found this to be true across the board in 10 countries with quite different educational systems. But large corporations can't rely on filling their management teams with individuals possessing bicultural or tricultural backgrounds and advanced scholarly degrees. They will have to develop rooted cosmopolitanism in people who have an average upbringing and education.

Cultivating the Cosmopolitan Leader

My own perspective is greatly influenced by my participation over the past two years in the Globalization of Management Education Task Force of the Association to Advance Collegiate Schools of Business. I wrote the portion of that group's report that focused on what business schools should teach their students about globalization and how—advice that could also help companies develop more-cosmopolitan managers. (See “Responses to Forces of Change: A Focus on Curricular Content,” *The Report of the AACSB International Globalization of Management Education Task Force*, February 2011.) Four of the levers I identified seem particularly well suited to a corporate context.

Conceptual frameworks. It's overwhelming to try to develop an understanding of diverse places by studying them one by one—not to mention, to develop general knowledge of a variety of places all at once. But a survey of academic thought leaders points to the usefulness of conceptual frameworks

Fostering the Right Mind-set

that emphasize the multiple dimensions of differences among countries. My own CAGE framework, which categorizes distance along the dimensions of culture, administration/politics, geography, and economics, is a fairly widely used one. Such frameworks bring order to masses of facts and fine-tune one's perceptions of foreign countries. Incorporating them into executive training can be very helpful. When businesspeople can make only short trips into a particular country, the ability to draw on frameworks can amplify what they learn on their visits—and help reduce the chances that they'll make costly missteps.

Longer and deeper immersion. Research shows that living abroad expands your mental horizons and increases your creativity. However, merely traveling abroad doesn't produce this benefit. Executives report that it takes at least three months to become immersed in a place and appreciate how the culture, politics, and history of a region affect business there. A number of leading MBA programs therefore incorporate long visits to sister or secondary campuses abroad rather than short visits that are often privately acknowledged to be little more than business tourism. So, though an anti-expatriation bias exists in many companies, it's important for executives to recognize that short-term stays have a limited impact. My advice to companies is to reconsider expatriation, especially for their high-potential managers. Of course, the high potentials may resist leaving their home countries for family reasons—or because it still seems to take longer to get promoted at many multinationals if your career path has taken you far from home base. Senior executives will need to create the right incentives for emerging leaders to invest in a cosmopolitan education.

Projects and networks. Participation in intercultural activities and networks (which corporations can easily facilitate through international projects) tends to soften ethnocentrism. Here, businesses have certain advantages over business schools. They can provide stronger incentives promoting particular behaviors that cultivate cosmopolitanism, have the opportunity to work with key executives over a longer time horizon, and can bind together diverse groups by promoting shared values, culture, and processes. They also have more scope to leverage online collaboration, translation, and social-networking tools, which very few companies (or business schools) fully exploit. But they must be mindful of cross-cultural differences in the use of such technologies; you can't

Companies can help their employees develop cosmopolitan attitudes by pulling on four key levers:



Conceptual frameworks

bring order to the mass of facts about foreign countries and help fine-tune executives' perceptions.



Longer and deeper immersion

is necessary to develop a true appreciation of how the culture, politics, and history of a region affect business there. That tends to require months, not weeks or days.



Projects and networks

that cross international borders soften the ethnocentrism of the executives that participate in them.



Assessment tools

can help companies get a read on managers' global skills and knowledge, and target areas for improvement.

just make a platform available and expect it to be readily embraced worldwide.

Assessment tools. Scholars have created a variety of assessment tools to reinforce programs aimed at improving international skills. In the AACSB report, I propose that every MBA graduate—and presumably, every global manager—have a minimum body of globalization-related knowledge, including:

- A handle on levels of and changes in cross-border integration of markets of various types.
- An understanding of how differences between countries can influence cross-border interactions—and how to look at them at the industry level.
- Awareness of the benefits of additional cross-border integration, and some perspective on the problems it's alleged to produce.

Other assessment tools focus on mind-sets rather than knowledge. One that will allow readers to compare their mental openness to the world with that of a highly international group of MBA students at a top school is the Global Attitude Protocol that I developed, which can be found at www.ghemawat.com.

In addition to pulling on these four levers, companies need to beware of behavioral and cognitive traps. For example, when managers do look at differences, they often focus on the most obvious ones while ignoring smaller ones. Yet smaller differences may be more important. For a Portuguese firm thinking of selling abroad, at least some of the differences and the challenges of the Chinese market will be obvious. But those of the Spanish market may attract less attention, even though Spain is the first foreign target for many Portuguese firms, and many stumble there.

WE SHOULD have been skeptical about the false ideal of statelessness from the start. “The Stateless Corporation” came out only three months after *BusinessWeek* had run another cover story, with the subtitle “Does the U.S. Need a High-Tech Industrial Policy to Battle Japan Inc.?” It's no different today. For every article or book you read about the world being flat, you'll read another that highlights the rise of state capitalism and the economic rivalries between China, India, and the United States. It's worth reemphasizing that the world is neither a collection of autonomous nations (World 1.0) nor perfectly flat (World 2.0), but semiglobalized, with some places being much closer to home than others. In such a world, rooted cosmopolitanism is a more realistic and, ultimately, more useful objective than statelessness. ♣

HBR Reprint R1105F