2013

How Global are We?

Pankaj Ghemawat

26. BOOK OF THE YEAR

"Not only are our markets not completely globalized, whether we are talking about trade, people flows or exchange of information, but we also have a tendency to overestimate how global the world has become."

IEDC
Bled School of Management
A School with a View

GENERALI

Opening Words by Prof. Danica Purg

Dear Mr President of the Republic of Slovenia,
Dear Mr Mayor of Bled,
Dear Excellencies,
Ladies and Gentlemen,

It is my pleasure to welcome you to the 26th Presidents' Forum of IEDC-Bled School of Management, entitled "How Global Are We?".

We have all heard the saying "Think global, act local". As a result, we are glocal. Is this a dilemma or just a description of reality? Is it just a peculiar period in our history? Will the future be full of Marco Polos? It is remarkable that many companies that claim to be global have chosen the name of this explorer for their activities.

Big companies, such as McDonald's, Coca-Cola, and Honda, are successful on a global scale but their products have to be tailored to the requirements of individual countries. Are the Internet and social media - Facebook, Twitter, and LinkedIn - making us more global?

In addition to integration, the European Union is generating a wave of new local and regional developments. This is quite visible in the field of communication: local TV and radio stations, promotion of local culture, use of local dialects and languages. What kind of processes are behind this phenomenon? How can business and other organizations respond to these seemingly contradictory developments?

Today we have the privilege to think about these issues while listening to one of the greatest management thinkers and global strategists in the world, Professor Pankaj Ghemawat.

Professor Ghemawat devised the renowned DHL Global Connectedness Index - a comprehensive analysis of the state of globalization around the world, tracking the range and depth of the flow of trade, capital, information, and people across more than a hundred countries. He is the author of numerous books and award-winning case-studies. Some of his books are ***Commitment, Strategy and the Business Landscape****, the award-winning* ***Redefining Global Strategy****, and* ***World 3.0: Global Prosperity and How to Achieve It****.*

On the subject of globalization, I am proud to mention that our school has 70,000 alumni from 78 countries from all continents. In this network, the Alumni Achievement Award each year distinguishes up to five of the most successful IEDC alumni for demonstrating and representing the highest ideals that personify outstanding individual career achievement, leadership, innovation, and service to the community, as well as a contribution to our *school's development. This year, the Commission has selected five individuals who will receive their awards tomorrow. My sincere congratulations to the winners!*

Dear guests, I wish you a beautiful and inspiring day at IEDC!

Prof. Danica Purg
President

Opening Address by Mr Borut Pahor, President of the Republic of Slovenia

Dear Ladies and Gentlemen,

Globalization is a reality of the modern world. And it has good and bad sides. The issue is not whether it can be prevented; that is the wrong question. The question is whether it can be regulated to benefit the majority of mankind.

If we cannot answer this question in the first half of this century, globalization will spiral out of control, holding the fate of the world in its unpredictable hands. However, if we do find appropriate political, economic, social, cultural and humane answers to this question, it is possible that the world, mankind, will be able to shape globalization, at least to a certain extent.

Over the centuries, the world has become increasingly interconnected and interdependent. And after the Second World War, this process unfolded at a truly impressive pace with the information revolution. The increasingly urgent interconnectedness of the world is only one of the manifestations of the phenomenon commonly known as globalization. I believe that the most important aspect of globalization is the fact that it is not value-neutral. When speaking of global dissemination, we are actually speaking about the global dissemination of a development model. Each development model has its own values. The concept underpinning the currently prevailing model that is being globalized is the market economy.

The heart of this type of economy is profit. If countries are socially concerned, this profit is redistributed in such a way as to maintain or enable social equality at a legitimate level with the greater involvement of the state. Today, the global economy is almost five times the size it was half a century ago. If it continues to grow at this rate, it is estimated to be eighty times larger by 2100. One-fifth of the world's population earns only two percent, and the wealthiest twenty percent receive over seventy percent of the global income. The underlying principle of this type of economy, development model and globalization is economic growth. Should warnings on the limited possibilities of growth prove correct, it will be necessary to consider the possibility of a global collapse of this development model in the future. Due to its globalization, the model could actually collapse if the globalization process is not sufficiently regulated. We all agree that the world's natural resources are limited. In this sense, theories on limited growth and speculations about the collapse of this development model seem attractive, although, in my opinion, not necessarily correct. I believe that while natural resources enabling our progress may indeed be limited, our intellectual resources are far from limited to the same degree.

Thus, instead of speculating about when global capitalism might collapse, I would rather ask the question of how we can control its development in order to manage its economic assumptions and social consequences. Regarding the country I represent, I ask myself as its president: how can Slovenia adjust to global changes and co-create them? From Slovenia's standpoint, the fundamental answer to this question lies in the development of human resources, particularly knowledge and science. And since neither of these is value-neutral, attention must be paid to maintaining legitimate social equality, or this system will collapse not because of the limitation of its economic assumptions, but because of its social consequences, which will spiral out of control. I believe that we must make every effort to protect natural resources through the sustainable development model, while continuing to develop the resources of knowledge and science at a much more intensive pace. This is where the true potential of the whole world, including Slovenia, really lies. It is in our knowledge that the greatest potential and the so-called window of opportunity lies. Knowledge is not something only large countries can afford; small countries can afford it too, and perhaps the best idea, which will change the world, will be ”born“ right here. Why should the next technological revolution not begin in Slovenia? This is possible; if we use our minds, instead of succumbing to the belief that we cannot do it.

Thank you.

HOW GLOBAL ARE WE, AND WHY DOES IT MATTER?

Prof. Pankaj Ghemawat
IESE Business School, University of Navarra, Spain

Dear Mr President of the Republic of Slovenia,
Dear Excellences,
Dear Professor Purg,
Ladies and Gentlemen,

It is a great pleasure for me to speak at the IEDC's Presidential Forum. I am going to start out by talking about globalization inside out. While there are some problems associated with globalization, a lot of them are not out there: they are inside our heads. That will be the focus of my first lecture. In my second lecture, I will focus on what globalization means for business. As we are at a business school, this seems like an appropriate thing to spend some time on.

Globalization versus Globaloney

The first question that we are going to address is "How global are we?" – and how does that compare with our intuitions. We will start this analysis by looking at the world. Then, we will focus on the country level, and on Slovenia in particular. I will also discuss the globalization of companies – and of individuals. The latter is important because it seems that there are some major stumbling blocks at the individual level. If we are to make further progress, we need to address these.

Consider three very different characterizations of globalization. Which of these most accurately reflects your understanding?

A. Local decision – making, productivity-enhancing technological change, and the growing demand for services will be the key forces shaping our futures – not globalization. – Bruce Greenwald (professor at Columbia University) and Judd Kahn (COO of Hummingbird Management)

B. There is a balance on the spectrum between "local" and "global" that represents the "sweet spot"…[and makes for] "the race to the middle." – Rick Wagoner (former CEO of General Motors)

C. The world got flat…[creating] a global, Web-enabled playing field that allows for…collaboration on research and work in real time, without regard to geography, distance or, in the near future, even language. – Thomas Friedman (Journalist and Author of *The World is Flat*)

A few years ago, I asked readers of the blog I write for Harvard Business Review to vote on these characterizations. The first one – a world in which national borders are so important that very little passes across them – was chosen by about 11 percent of the roughly one thousand people who voted. The third characterization – a world in which borders matter so little that effectively we can ignore them – was the one that attracted by far the most support: it was chosen by 61 percent of respondents. The second characterization – national borders matter but there are interesting things that happen across them – came in as a distant second.

If we start off with such heterogeneous views about the world that we live in, it might be useful to look at some data before we discuss the implications of globalization. Let us start with telephone calls. Of all voice calling minutes spent last year only two percent were accounted for by cross-border phone calls. These are plain old-fashioned phone calls. If I add in Skype calls, this proportion rises to perhaps five percent but not much higher than that. This is one measure of cross-border information flows. Later I will talk about other informational measures.

Let us now look at a measure of people flows. What percentage of the world's population consists of first generation immigrants? About three percent. As for capital flows, let us take all the foreign direct investment that happened in the world last year and divide it by all the gross fixed capital formation that happened in the world as a proxy for all investment – domestic and foreign. What percentage of all investment in the world last year was accounted for by foreign direct investment? About 10 percent.

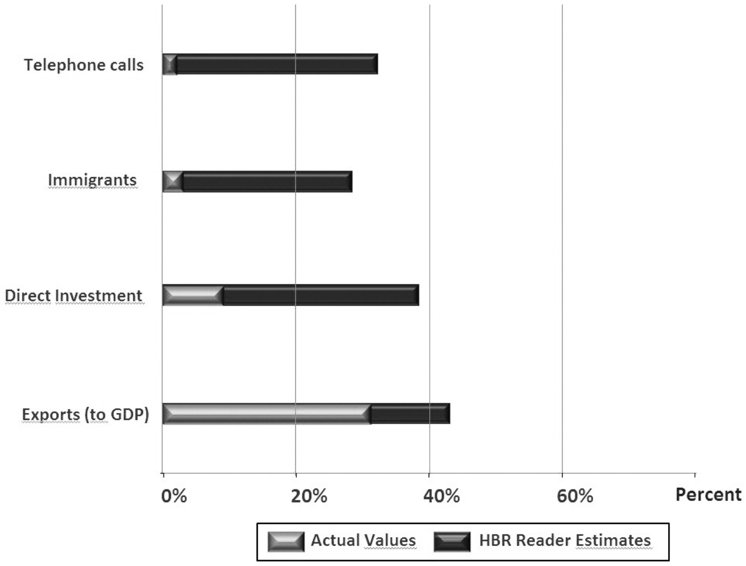
The export-to-GDP ratio of the world is a bit higher – 32 percent. But I should add that this is somewhat exaggerated. For instance, when an iPod component gets shipped from South Korea to China and then to Europe, it is counted twice. If we take the latest data from the World Trade Organization and eliminate double counting, that will depress the percentage to about 23 percent.

If the characterization that attracted the most support, Thomas Friedman's vision of what he calls a flat world, were correct, we would observe ratios in the excess of 80 or even 90 percent. Clearly, we are not there.

Second, it is not just Friedman who has exaggerated how global we are. I ran another survey of Harvard Business Review readers asking them to guess these percentages; the results are included in

Figure 1. Surveys that I have undertaken with several dozen groups around the world indicate similar results. There is a robust tendency to overestimate the extent of globalization, a tendency I refer to as "globaloney".

Figure 1. Actual globalization indicators versus HBR reader estimates (international proportions of global totals)



As an economist, I am very used to the notion that we might be wrong in our estimates. But when I see the extent of the overestimation of indicators like international phone calls, I am quite concerned. Tenfold errors are alarmingly large. Why do we have this strong tendency to overestimate the extent of cross-border interactions? I think that there are a few different reasons and it is worth thinking about them so that we can find out how we can get rid of our biases. [07]

The first reason is a basic lack of reliance on data. When I first presented some of the percentages cited above in Foreign Policy magazine a few years ago, one of the people who wrote in was Thomas Friedman. Since the title of my article was "Why the World Is Not Flat," this wasn't entirely a surprise. What did come as a big surprise was his criticism: "Ghemawat's data are narrow". I went back to Friedman's book, The World Is Flat – and, as I recalled, its 450 pages, contained not a single figure, chart, table, graph, reference, or footnote. Since we are talking about a book that has probably sold more copies than all other books about globalization ever written combined, I do not think that it is too much of an exaggeration to say that the bulk of the discussion that occurs around globalization takes place in a data-free zone. That is one of the reasons why our intuitions about the data are so bad.

A second reason for globaloney is projection bias. Usually, the kind of groups that I ask these questions of tend to be more globalized than randomly selected samples of people. That is probably another reason for the exaggerations. Take the example of my students at IESE Business School in Spain. They are particularly bad on their guesses about phone calls: they sometimes guess as high as an average of sixty percent, which is off by a factor of 30 rather than just 10. Why? Probably because 80 percent of them are not Spanish and so, when they look at their phone bills, in terms of money spent if not minutes, 60 or 70 percent might easily be for international calls. The point that I make to my students is that their estimates may be true for them but if they assume that everybody in the world is just like them, they are going to have some nasty surprises.

Third, French fable writer Jean de la Fontaine once said, “People believe what they want most or what they fear most”. When MBA students who have to read several hundred case studies during the two years of their studies are told by their professors that reading all of these cases will make them capable of solving management problems anywhere in the world, the students want to believe: it justifies all the investment. At the other extreme, if you are a manufacturing worker in the France who is worried about losing your job, you just know that all manufacturing jobs are going to China, no matter what the data actually suggest. Ultimately, such beliefs are about a lot more than just data: they also reflect psychological predispositions. For a diverse set of reasons, we sometimes have predispositions to believe exaggerations.

Fourth, there is significant social pressure around discussions of how global we are. If you believe that the world is completely integrated, you are fashionable and with it. If you do not, you are thought to be behind the times. In fact, I decided to write my “Why the World Is Not Flat” article because of a TV interview I gave in India. The interviewer's first question to me was, “Professor Ghemawat, why do you still believe that the world is round?” I started laughing, but even as I did so, it occurred to me that it would be better to have a more coherent response to that kind of question, which is why I decided to write my article. But what I cannot quite reproduce are the tones of pity and disbelief with which the question was asked. The interviewer's perspective was “Here is this poor professor who clearly does not get out much. No wonder he thinks that the world is still round”. If you assert that the world is flat and borders do not matter much, you come across as a modern person. If you suggest otherwise, you are a bit behind the times, maybe even a dinosaur.

Finally, the last reason that I want to highlight has to do with what I call techno-trances. The analogy is with a phenomenon that some of you may have experienced personally: that listening to techno music for a long period affects brain activity. Something similar happens with exaggerated discussions of technology sweeping aside all kinds of borders. If you really are a technological determinist, if you really believe that technology trumps everything associated with culture and politics and geography, it is a little easier for you to buy this vision of a completely integrated world than if you take all factors seriously.

People have been prey to techno-trances for a very long time. The first instance that I can find involves David Livingstone, the great explorer of Africa, explaining that the railroad, the steam ship, and the telegraph were uniting East Africa perfectly with the rest of the world. That was in the 1850s. What a visionary that man was! East Africa is still not well integrated with the rest of the world.

By the interwar years, the excitement had shifted to the airplane and the radio. After World War II, Heidegger started a conversation about television and how it was making everything equally close and equally far – which Marshall McLuhan popularized with his notion of the global village. The focus had shifted from physical to electronic connectivity. Friedman is just the latest in this long line of prophets, using current technology to argue that the world will soon be united – even if it isn't already.

My first counter-argument to techno-trances is that they have been with us for a while. None of the previously talked-up innovations has globalized the world. This track record doesn't inspire much confidence in contemporary assertions to the same effect.

Second, we can also look at what we are actually doing with some of this technology as opposed to what it might enable. Perform the following thought experiment. Suppose you are going online, looking at news sources. What percentage of the time do you look at foreign news sources as opposed to those from your own country? Technically, it is as easy to click on foreign news websites as domestic ones. Unlike the phone call example, you do not pay more to get the foreign news source. So, what percentage of our time do we use to look at foreign sources? I should add that if I asked this question in the United States, somebody clicking on the BBC website would be counted as going to a foreign news source even though the BBC makes a strong effort to adapt what it presents to US viewers to their local tastes and expectations.

In China, the percentage of foreign news websites visited is 0.1 percent. This is a special case because there are some official restrictions in that country on access to foreign news sources. In Brazil, it is nearly one percent. In South Korea, a very wired country, it is just above one percent. Germany, France, and Japan are in the one-to-two percent range. Oddly, Russia is a little higher. Then, we see the English-speaking countries in the four-to-six percent range. If you are from an English-speaking country you may get a lot of content in your own language that is not from a domestic news site.

This is one illustration of what the Internet has and hasn't done. Despite the potential for connectivity, it still has not made us perfectly connected. We still go to very different news websites. I think of the same thing in the context of Facebook. It is a technology that allows us to connect to people around the world as easily as with those next door. What percentage of people's Facebook friends are located in foreign countries? Less than 15 percent. The reason is that this technology is superimposed on a pre-existing set of relationships. None of us make friends on Facebook purely at random. We rely on past connections, commonalities, and similarities to connect ourselves.

So far, I have focused on the global level. Let us drill down to the country level. I expect that the interests of the group in this room are focused on Slovenia and other countries in this region. Is Slovenia more globalized than the world at large or less? An answer is provided by the globalization index that I prepare every year with Steven Altman that ranks, in the latest version, 139 countries in terms of their connectedness with the rest of the world through trade, capital, information, and people flows. The latest edition is available on my website at www.ghemawat.com/dig. You can look at Slovene or Croatian data there. Slovenia is more globalized than the world's average on some dimensions and less so on others. Slovenia is in the top 10 percent of countries in terms of trade intensity, a result driven by merchandise rather than services trade. However, it is close to the bottom 10 percent in terms of attracting foreign direct investment inflows.

I was also partly disappointed to see – although this is doubtlessly due to the existence of excellent educational establishments in this country – how few Slovene university students study overseas. This is one of the measures of people connectivity that we use. Thus, the Slovene picture is somewhat mixed. We know that small countries tend to be more integrated than large ones. After controlling for country size and for country income level – since richer countries tend to be more integrated than poorer countries – we find that

Slovenia has roughly the level of globalization that we would expect, given the country's small size and the fact that it has a relatively developed economy. It also happens to be close to some really large markets in Europe.

So Slovenia is, overall, an average country in terms of globalization. The notion of the world not being completely integrated is not something that applies mostly to other countries “out there”. It is certainly something that applies here as well.

Another thing about Slovenia that I would like to flag for later is that about 90% of Slovenia's merchandise exports go to other parts of Europe, which is the most globalized part of the world. There is nothing wrong with that. But it matters. The basic issue for Slovenia and many other European countries in this regard is that the European Union has already seen very large reductions in its share of the world's gross domestic product. Measured at purchasing power parity, it was about 27 percent in the early 1990s. It is now down to 20 percent. It is forecast to drop to 15 percent by 2030. This means that there is going to be a need to not just increase the depth of globalization but also its breadth and look much farther in terms of where Slovene companies do business. This is one of the things that I will focus on in my second lecture: How Slovene companies might do a better job of penetrating the new markets that are growing at a faster speed than those within Europe on which Slovene companies have been so focused historically.

Going back to the global level, let me explain why such data matter from a social perspective. I think that one of the reasons to stress that globalization is limited is that there is potential for additional integration. If we thought that the world was already completely integrated, there would be nothing more to be done. But if we realize that the current levels of integration are not final, we might see that there are gains to be made from additional integration. This highlights the importance of continuing to press on with difficult multilateral integration efforts, such as the WTO’s attempt, still ongoing as I write this, to resuscitate its Doha round of global trade negotiations.

Second, I think that being realistic about levels of integration helps reduce at least some of the fears that people have about globalization. Most of my book World 3.0 is devoted to these two points and, specifically, contains seven chapters on the second one. Here, let me simply provide some examples.

What kind of fears might we get rid of if we actually had a more accurate perspective on cross-border flows rather than an inflated one? In the United States there is a big concern about jobs being shipped to China. But a careful study by the Federal Reserve Bank of San Francisco suggests that products made in China account for between two and three percent of United States personal consumption expenditures. While a lot of people are surprised by how small this percentage is, recall that about two-thirds of US personal consumption is of services, which are traded much less intensively than manufactures. Given the two to three percent estimate, it is hard to see how you will fix a range of US problems, such as the unemployment rate, by simply curbing imports of Chinese goods (not to mention that the Chinese might respond by refusing to continue to finance the American economy).

This is one example of why if you have data, and if you are willing to believe them, you might feel a little better about international relations than you might otherwise.

Or to take another fear, isn't globalization destroying the environment? International air transport, in particular, has attracted a lot of flak because of such suspicions. But it accounts for one to two percent of total greenhouse gas emissions. Still, if you ask air travelers what percentage air transport contributes, the usual answer is 20 to 25 percent. If we are serious about greenhouse gas emissions, we should think more about the impact of driving, which is mostly a domestic activity. A full 74 percent of transport-related emissions were caused by ground transportation. If you overestimate the contribution of international air transportation to greenhouse gas emissions, you are likely to overlook more cost-effective ways to reduce emissions than banning international air travel.

If you ask Americans what percentage of the federal government's budget is devoted to foreign aid, the average response is 31 percent. When you point out that the real proportion is about one percent, they become marginally more willing to consider increases in foreign aid. I think that a lot of the issues that we see around globalization are magnified by the globaloney that I was talking about earlier: the assumption that international interactions are much deeper than they actually are.

These examples also suggest that many of the "problems" with globalization reside at the individual level and, specifically, in our minds. Along these lines, there is also a lot of globaloney nowadays about the cultural tsunami that is supposedly swamping the world, making people buy the same products and think the same way. However, cultural exports still account for a limited portion of global output. Based on UNESCO data, for example, exports of "cultural products" amount to 5% of their total worldwide production!

Further corroboration comes from the World Values Survey. Among other things, it asks people about their identities. What do you consider yourself: a citizen of the world, a citizen of your continent, or a citizen of your country, your (within-country) region, or your locality? It turns out that roughly 15 percent of respondents say that they are first of all citizens of the world or of their continent. For the remaining 85 percent, the primary self-reported type of identity is still their nation or a smaller area within their nation.

It is possible to connect such attitudes to the limited amounts of cross-border flows that I pointed out earlier. I have some Eurobarometer data for Europe, unfortunately a little dated, about the results of asking citizens of the then 16 (Western) European Union member countries about whether they trusted people from their own country and from other countries. It turned out that in general about half the people reported that they tended to trust people of their own country "a lot". Only about twenty percent expressed the same level of trust in people from other Western EU member countries and only 13 percent trusted people in the set of other countries covered in the survey (mainly Eastern European countries but also the United States, Japan, China, and Switzerland. For example, about 57 percent of German citizens said they trust other Germans a lot, yet only six percent of Germans said they trust Turks a lot. Interestingly, Italians are an exception to the general rule that people trust citizens of their own country the most: they report trusting Swiss people more than they trust Italians. Yet, generally speaking, there is a very robust pattern: people tend to trust people from their own country more than foreigners, especially those from faraway countries.

Economists have devoted a lot of attention to the effects of such variations in trust levels. Statistical studies suggest that moving from lower to higher levels of bilateral trust can increase trade, direct investment, portfolio investment, and venture capital investment by 100 percent or more. You can derive a lot of amusement by looking at country stereotypes. But at the same time, this is really a tragedy in terms of opportunities lost because of ignorance, mistrust, and fear.

Let me close this discussion of individuals with a philosophical reflection, on cosmopolitanism. The standard wisdom from millennia of discussion is that a cosmopolitan is somebody who treats all people equally, irrespective of whether they live next door or far away. I thought it would be interesting to look at the data associated with this idealization – and recognize how removed it is from reality.

Let us look at news coverage of foreign disasters versus domestic ones. Think about this in the following way. The Asian tsunami killed nearly 100 times as many people as Hurricane Katrina, but Katrina still got far more news coverage in the United States. This idea is picked up in McLurg's law, named after a legendary British newspaper editor, according to which 1 dead Briton is worth 5 dead Frenchmen, 20 dead Egyptians, 500 dead Indians and 1000 dead Chinese.

A study of 5,000 natural disasters in the Quarterly Journal of Economics confirmed this pattern; it is not just the Asian tsunami versus Katrina. In general, to receive the same amount of coverage as one dead person at home, roughly 100 people have to die far away. This is another indication of how quickly our sympathies decay.

Finally, I have some calculations from Branko Milanović from the time when he was at the World Bank. His data indicate that across fourteen advanced (OECD) economies, governments spend about 30,000 times more per person on assistance to the domestic poor than on official development assistance for the foreign poor. It is worth noting that asking rich countries to fulfill the promises they made in 1992 at Rio de Janeiro – to give 0.7 percent of GDP as official development assistance – only implies changing this factor to 15,000.

Given the data, the whole discussion about cosmopolitanism and equal treatment of everyone strikes me as missing the point. The critical thing is to recognize how quickly our sympathies slope off as distance increases. While radical openness might be excellent, even incremental openness to what is unfamiliar might make a huge difference in the world that we live in.

So the motivation underlying this first lecture is that if we can find some way of addressing the critical stumbling blocks that I have been talking about, we might be able to promote more trust, have more globalization, and further increase our willingness to trust people unlike ourselves. The problem is not technological connectivity. If we look at the Internet, that is actually focusing on the pipes rather than on what is traveling through them. It is not even about the flow of knowledge. We can know a lot about people and still be very distrustful of them. Personal interactions across national borders are still very limited, which contributes to making us more suspicious of people from far away than we are of people close to home.

Again, this is pitched at a global level. How, specifically, do Slovenia and Slovenes figure in this regard? First of all, in terms of connectivity between people, Slovenia scores somewhat low, whether we talk about university students studying abroad or longer-term migrants (although it certainly is relatively well-connected in terms of tourist flows. The history of the country and how it emerged in the early 1990s led to the imposition of controls in terms of who could qualify for Slovene citizenship. That history has probably left a legacy worth thinking about.

Second, experience shows that sentiments toward foreigners turn negative when things really turn bad macro-economically. We know from the history of our species that when we are in a bad situation, we tend to look at those who are unlike us and think that they must be responsible for what is happening to us. For this reason, I am worried about the current macro-economic crisis in Slovenia.

Third, there are some undeniable pressures from immigrants, particularly from countries that are still poorer, moving to Slovenia as a destination or as a transit point to the West. Structurally, this makes the situation even more difficult to manage.

Finally, think back to Europe's shrinking share of the world's gross domestic product. Not only are there obvious challenges here but there is also a need to start doing business with countries far away rather than focus on the former Yugoslav republics, Austria, Germany, and Italy as Slovenia's main trading partners. That superimposes an urgent need for more openness on a situation that is structurally difficult.

So what is to be done? There are some obvious levers we could pull on to change our mindsets and align them better with the imperatives of the future. First of all, we need to start with the facts about globalization. This is really important. Without facts, we tend to engage in stereotyping and exaggeration. That usually hurts instead of helping.

Second, we need to recognize that people can have multiple identities. As Nobel laureate Amartya Sen so eloquently described, “Civilisational or religious partitioning of the world population yields a ‘solitarist’ approach to human identity, which sees human beings as members of exactly one group…This can be a good way of misunderstanding nearly everyone in the world. In our normal lives, we see ourselves as members of a variety of groups – we belong to all of them.” It is not a matter of either-or. If you acquire a new identity, that does not mean that you have lost some of the previous ones. Embracing a European identity, for example, does not imply becoming any less rooted in Slovenia.

Third, a lot of work in neurobiology and psychology suggests that what really transforms people is having personal interactions rather than just reading about other people and trying to understand them.

I imagine an institution like IEDC can help people get together more than when we run into each other at an airport coffee shop. That is a real contribution to mutual understanding.

Fourth, there is evidence suggesting that people are more malleable – more susceptible to having their worldviews shifted in a particular way – when they are young. This may be bad news for those of us who are over 50 but does mean that it is particularly important to ensure that young people start out with a view of the world that is fundamentally accurate and fair rather than one that is essentially fearful.

There are also many implications for companies that I will touch upon in my second lecture. But to recap this one, I wanted to point out, first of all, that the world is far from completely globalized. Second, our mindsets might have something to do with where we are. If you accept that, it follows that the place to start is inside us. We need to change our mindsets before negotiating the next generation of free-trade agreements or passing new laws governing immigration. For that, we need to pay attention to differences that divide us and understand why they need to be addressed. This is much more likely to guarantee a better outcome than pretending that we live in a flat or completely globalized world.

The Business Agenda

Having started on a philosophical note on how fragile the process of globalization may prove unless we have some changes in mindset, I want to focus now on what I normally talk about to business audiences – such as the one at the IEDC's Presidential Forum. What does all this mean for the business agenda?

To this end, I would like to supplement the discussion in my first lecture about what globalization is not – it isn't complete – with what we know about flows that do cross national borders. I also want to talk about the challenge facing many European companies at this point in world economic history: how to reach beyond the borders of Europe and participate in growth opportunities in other parts of the world that are expanding faster.

In my first lecture, I talked about markets and people. But companies are not extremely globalized either. Fewer than 5 percent of US firms (excluding those without any employees) actually engage in exports. And the percentage that have foreign direct investments is less than 0.1!

Focusing just on this top 0.1 percent, ask yourself the following question: for multinationals – the firms that have made foreign direct investments – what is the median number of foreign countries in which they operate? Based on US data, the median number is two and only five percent of multinationals have operations in more than two dozen countries.

Narrowing the set further, let us look at Fortune's Global 500. These are the biggest beasts in the corporate jungle. What percentage of them derive more revenue from outside of their home region than within it? Just 12 percent. Eighty-eight percent get more than half of their revenues from the continent or region in which they are headquartered.

Finally, what percentage of the Fortune Global 500 are so globalized that they get at least 20 percent of their revenues from North America, 20 percent from Europe, and 20 percent from Asia – the three so-called triad regions? Based on the ones for which the regional distribution of sales is available, the answer is about 3 percent!

Furthermore, even when sales are broadly distributed around the world, operations and (a fortiori) top management often aren't. Consider BMW, which – at least in terms of units sold – does derive more than 20% of its sales from each of the three triad regions. But more than 60 percent of their cars are made in Germany and 80 percent in Europe. And their workforce is even more concentrated in Germany!

There is a clear reason for this focus on Germany. Cars made there, especially luxury cars, command a price premium around the world. But that said, German-centricity does raise some issues. Imagine that the eurozone broke up and Germany ended up with something called "the golden mark". Think of what would happen to that currency and how competitive BMW would be in world markets with a drastically appreciating exchange rate.

The point is that even if you take the world's most globalized companies in terms of sales, they often have some clear national roots which they need to pay attention to in figuring out their strategies. In the case of BMW, we are talking about a company that for a long time refused to put coffee-cup holders in its cars for the US market despite persistent requests from American consumers. The reason for that was that coffee-cup holders were, in the view of BMW's (mostly German) management, not an appropriate feature for the "ultimate driving machine." Made in Germany has some clear implications, negative as well as positive, and they are worth acknowledging, instead of pretending that BMW is perfectly globalized or "stateless" because of its broad sales footprint.

The Boston Consulting Group published a very interesting report in September, pointing out that companies that had more than two of their top-20 executives located in emerging economies did significantly better in those markets than companies that did not have such representation. At the end of this presentation, I will talk about how unglobalized companies are in this respect. The more I talk about this, the more I keep coming to the cultural barrier that I started out with. This is one of the key roadblocks. Even if a company has all the material resources that it needs, it might still have trouble devising an effective global strategy.

Why is it helpful to be aware of such data and beware of globaloney? There is evidence that if you have exaggerated notions of how globalized the world is, you are more likely to agree with dubious propositions about global strategy. Consider, once again, the online survey of Harvard Business Review readers that I cited earlier.

Forty percent of the respondents thought that given globalization, "truly" global companies have to compete in uniform ways around the world. Fifty percent thought that the truly global company is from nowhere in particular. Close to two-thirds thought that a truly global company has to be present in all parts of the world. Finally, there was also a strong sense that all globalizing industries are getting more concentrated and consequently the way to play the game is by focusing on scale economies, which ties in with the emphasis on uniformity mentioned earlier.

There is evidence – some of which I presented earlier and more of which was discussed in my 2007 book, Redefining Global Strategy – that all of these propositions are wrong. To see how hazardous such globaloney can be, consider the case of a company that ostensibly subscribed to these beliefs in uniformity, statelessness, ubiquity and concentration. And since it is always easy to find some hapless company somewhere that did not do well and say that it failed because its managers did not follow one's prescriptions, let me pick my target a bit more ambitiously. Let us look at a company that operates in 200 countries. It has been globalizing for more than 100 years. It owns one of the world's most powerful brands by most metrics. Look at how much trouble globaloney got Coca-Cola into.

Coca-Cola chief executive officer Roberto Goizueta addressed a celebration of the company's centennial in 1986. He said, "At this point in time in the United States, people consume more soft drinks than any other liquid, including ordinary tap water". He predicted that not too many years into the company's second century, "We will see the same wave catching on in market after market until the number one beverage on earth will not be tea or wine or beer. It will be soft drinks. Our soft drinks!"

Twenty years after this speech, Coca-Cola's strategy got totally flipped around. Let us compare what Goizueta talked about in his speech, of which I quoted only a short excerpt, with what Neville Isdell had to do, starting in 2005-2006 to get Coca-Cola back on track. Let us look again at the four propositions about globalization that we discussed earlier. Clearly, back in the 1990s, there was huge faith that uniformity would allow Coca-Cola to compete the same way around the world. Several times in his speech, Goizueta talked about "one system, one way". Second, in 1996, Goizueta officially canceled the distinction between domestic and international at Coca-Cola. He said that labels like "domestic" and "international" no longer adequately described their business structure. Coca-Cola was a global company that just happened to be based in the United States.

Another telling quote from Goizueta was, "We have four of the five top soft drink brands [in the world]…I cannot think of one business that is in a better position to succeed than ours…in a time when trade barriers are tumbling". He passed away unexpectedly in 1997, and was succeeded by chief financial officer Douglas Ivester. When he was asked about his strategy, Ivester affirmed that he would maintain the course set by Goizueta, "No left turns, no right turns." Roughly at that time, the Asian crisis hit. There were also problems with regulators in Europe. By late 1999, Coca-Cola's market value had fallen 70 billion US dollars versus its peak. Ivester got sacked after less than two-and-a-half years as CEO and was replaced by Douglas Daft. His approach was entirely the opposite. Instead of complete standardization across the world, he said that Coca-Cola was going to think local and act local.

That was the period of funny Coke ads. For a long time, country managers had wanted to make country-specific ads that had not been allowed by headquarters. Daft told them that they could make their own ads. The Italian classic from that period is people running along a beach wearing nothing but Coke bottles for cover. An American ad showed a grandmother in a motorized wheelchair nearly running over her grandchildren when she was told that no Coke would be served at an outdoor barbecue. She was so anxious to go find her Coke somewhere else.

This did not work out well. Daft got the boot shortly afterwards. It was Neville Isdell and his successor Muhtar Kent who repositioned the company. The first thing that they realized was that the company's growth would have to be driven by emerging economies. But Coca-Cola's approach to those markets had been very passive. The company just skimmed the top of the market – the urban elite. That was the time that a new strategy started to be developed for emerging economies. It involved cutting prices, reducing sizes, indigenizing the packaging, and investing heavily in distribution beyond the major cities and in rural areas as a way of building up volume. Until that time, Coca-Cola had maintained a single strategy and entered emerging economies when they were ready for that strategy. Now, the company realized that it needed to change its strategy if it was serious about driving growth in India and especially China.

On the 10th anniversary of the dissolution of the organizational boundary between international and US divisions, Isdell reinstated it. Coca-Cola sold 30 gallons per person in the United States but only three gallons per person on average across the rest of the world. Consumption in the United States was so large that it was hard to imagine the average American drinking much more Coke. But profits abroad were higher and growth potential was significantly greater. Separate divisions enabled organizational units to focus on the distinct challenges and opportunities posed by different markets.

Internal changes also extended beyond structure to involve processes. Coca-Cola has been thinking hard in recent years how it could cultivate variety, especially as soft drink markets in Western Europe and the United States change. A couple of months ago, I asked someone at Coca-Cola to tell me the most interesting change that had happened in the last two years at the company from a globalization standpoint. The answer I was told was getting product development people from around the world together for two days every year to swap new product ideas. This is not rocket science. What is remarkable is that this kind of activity was not taking place before, which serves as another reminder about how far off-course you can get if you believe globalization is erasing cross-country borders and differences.

Coca-Cola is still present in more countries than any other company in the world. But it is not as keen as before on penetrating new countries at any cost. I have heard that they no longer assume that they will establish a presence in North Korea. This change in thinking also extends beyond geographic areas to brands. While the company still likes to stress its mega-brands, the trend toward more product variety mentioned above also has implications for branding. This shift is motivated by the sense that the soft drinks market is fragmenting. Thus, instead of selling just Coke, the company offers water, fruit juices, nectars, and energy drinks.

Look at Coca-Cola in Japan. It offers 200 products, most of which are not sold anywhere else in the world. The company's leading seller in that country is Georgia Coffee, which was reportedly developed by bottlers over objections from headquarters and given its name as an ironic comment on how helpful headquarters – located in the US state of Georgia – had been. They also sell all sorts of other products you probably have not come across before. Real Gold is a hangover cure. Love Body is a tea that some believe increases bust sizes. A lot of these products are very idiosyncratic to Japan, which turns out to be Coca-Cola's most profitable major foreign market.

Similarly, Coca-Cola bought the Thums Up brand in India and decided to phase it out and make Coke the leading brand. Indians were not happy with that. As a result, Thums Up is still the leading Coca-Cola brand in India. Coca-Cola executives have abandoned the idea that different markets want exactly the same drinks.

In China, Coca-Cola had to contend with the belief that drinking dark-colored fluids can be bad for you, causing birth defects and other negative consequences. Inevitably, the company's strategy there also had to be different; it could not be just about selling dark Coke. In the mid-1990s Coca-Cola did not understand these facts as well as it does now.

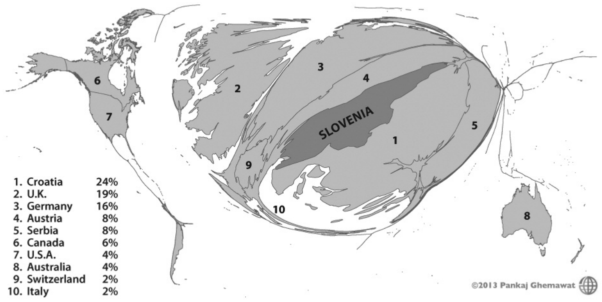
Coca-Cola's market value hit a low of 70 billion US dollars under Daft but it has since recovered. For the typical company that does not own one of the world's most powerful brand names and does not have operations in 200 countries, it is probably a lot better to figure cross-country differences out early on, rather than go through the same learning experience as Coca-Cola: over-standardization in the 1980s and 1990s, followed by some of the changes that they had to make to get back on track. Even large companies can benefit from recognizing that globalization is not as advanced as some people think.

So, the Coke case is a good illustration of why it is important – even for very large, powerful companies – to avoid globaloney and recognize that globalization is far from complete. Having made that point, which continues from my first lecture, let me switch gears. I have so far focused on what globalization is not. But we also know quite a lot about what globalization is and what kind of cross-border patterns of interactions do take place across the world.

If you go to my website (www.ghemawat.com) and look at the maps page, there are more than 500 maps available there. The first map you will see is a clickable map of the world. If you click on any of the countries shown there in blue – which are the ones for which we have data, unlike the ones in red – the rest of the world will get resized in proportion to how much the country you just clicked on exports to every other country. It is useful to first consider these types of trade maps for a few countries to get a visual sense of what trade relationships look like before moving on to foreign direct investment and other kinds of international interactions.

Let us start with Slovenia's merchandise exports. Here, we see a very European story, as I pointed out during the first part of my talk. Europe fills up almost the entire map area: recall that about 90 percent of Slovenia's exports go to European destinations. And within Europe, the map highlights Slovenia's close trading links with countries of former Yugoslavia and the former Austro-Hungarian Empire. Another important partner – Italy – is also right next door.

Map 1. Slovenia Merchandise Exports, 2011

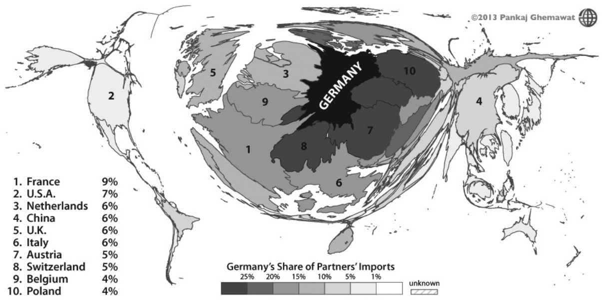


Source: Generated based on data from IMF DOTS and UN Comtrade databases

Slovenia's focus on exporting to nearby countries also shows up in the shading of other countries on the map, which reflect the proportion of other countries' imports accounted for by exports from Slovenia. There is a tenfold variation between the darkest and the lightest shading. If the world were flat, every country would show up in exactly the same shade of gray.

The observation of a highly regionalized and distance-sensitive export pattern is not at all unique to Slovenia. What European country comes to mind first as a "global" export powerhouse? Germany is the world's largest merchandise exporter in value-added terms. The map of Germany's exports is indeed somewhat less regionalized than Slovenia's, but not very much so. In a typical year, 73-75% of Germany's exports go to destinations in Europe and to Turkey. This is why I like to point out, when I am in Germany, that it is hard to think of a resolution of the Eurozone's problems that is bad for the rest of Europe but is good for Germany.

Map 2. Germany Merchandise Exports, 2011



Source: Generated based on data from IMF DOTS and UN Comtrade databases

The importance of cultural and historical ties also shows up clearly in Germany's exports map, especially when one focuses on the shading. Places where German is spoken or used to be spoken are still some of Germany's main export destinations.

[Due to space limitations, the additional maps referenced below could not be printed here. Readers may access them at www.ghemawat.com/maps.]

Turning to Asia, let's look at the world's leading exporter, China. It is very different from the countries we have already looked at. It has a significant export share around the world. This is interesting and worth thinking about, especially if you are in Europe. You may think that you see enough Chinese imports in Europe but from the Chinese perspective, this is the part of the world that they have not penetrated enough. East Asia is disproportionally large as a destination for Chinese exports, so there is a significant regional effect even in the case of China. And its region would be even more salient in an import map: China is, for many product categories that it exports (e.g., iPhones), only the final assembly point of East Asian production chains.

It is also worth mentioning – since this isn't evident from the map – that China has gone through some significant rebalancing. In 2007, China's merchandise exports accounted for 35 percent of the country's gross domestic product. By now, this figure is down to 25 percent. Export volumes are still growing in absolute terms as China's GDP continues to expand but they have fallen in relative terms. There has been much talk in the West about the need for China to rebalance its economy and it is important to recognize how much has actually happened in that regard.

Looking at Russia's map, we see another fairly broad export pattern. However, energy resources account for most of Russia's exports. If you exclude that sector, the rest of Russia's exports are much more concentrated in countries such as Belarus, Kazakhstan, and Ukraine. This example provides a useful reminder that, generally speaking, commodities tend to get exported farther than other goods, especially cultural products. We already saw that the intensity of cultural exports is only a fraction of the export-intensity of all products taken together.

We have not looked at the Americas yet. Mexico's largest trading partner, by far, is the United States. This is the topic of much discussion in Mexico. As for the United States, it has been losing share in export markets, and its main markets are now all in the Americas and north of Panama. And it is worth adding that Mexico and Canada show up as leading US partners not just in trade but also in terms of cross-border information flows and movements of people.

Most of the countries I have highlighted are large countries. One typically finds that smaller countries tend to export their merchandise even less broadly. Thus, it is not surprising that Slovenia’s export pattern is more regionalized than that of Germany, China, or the United States.

It should also be obvious by now that countries tend to export far more intensively to others that are close to them than those that are distant. What is worth emphasizing, based on a whole body of work in international economics, is that distance should be thought of multidimensionally rather than in purely geographic/physical terms. In 2001, I synthesized this research into my CAGE distance framework (now widely taught at leading business schools), where CAGE is an acronym for “cultural, administrative, geographic, and economic”. The idea is simple. If you take two countries that are close to each other on the CAGE dimensions, they are likely to have much more interaction than countries that are far apart.

To help illustrate the CAGE framework, think of the world's largest bilateral trading relationship. Which two countries trade the most with each other? It is the United States and Canada. Last year, merchandise trade between them was worth about 620 billion US dollars versus 550 billion between the United States and China. Why? The United States and Canada speak the same language and have similar cultures. They also have similar historical origins. They were both colonized by the British and have some similarity in legal systems that make contractual disputes a bit easier to handle, should they occur. They also have a common border. Actually, most Canadians live within 250 kilometers of that border. Moreover, the two countries have roughly similar levels of personal income. This helps boost trade in categories such as automobiles. If two countries have very different income levels, their citizens probably want (or, at least, can afford) very different types of cars.

To systematize these effects, I extracted the value of goods traded from 2005 to 2012 between all available country pairs in the UN Comtrade database. Then, I analyzed trade between country pairs as the dependent variable in a multivariate regression (more precisely, a gravity model incorporating country fixed effects), looking at the effects of having the same language, being members of a common regional trade bloc, having a former colonial relationship, and sharing a land border (along with other variables of interest). Each of these commonalities alone had the effect of increasing trade by between 50 and 150 percent. And if two countries shared commonalities along all four of these dimensions, they would trade 17 times as much with each other than if they did not have any such commonalities.

Foreign direct investment patterns are also shaped by cultural, administrative, geographic and economic "CAGE" distance effects. Consider all of the US companies that have foreign direct investment in just one country. Sixty percent of the time, that country is Canada. The next country is the United Kingdom, accounting for 10 percent, followed by Germany, Japan, and Mexico.

Even intangible interactions requiring no physical transportation at all, such as who follows whom on Twitter, conform to this regularity. Twitter ties are far more national than international. In fact, most interactions on Twitter occur over very short geographic distances, i.e., are local rather than national, let alone international. Note that this falsifies the argument that there are global cities that are more connected to each other across national borders than they are to their intranational "hinterlands."

With the help of Tata Consultancy Services, I analyzed several million Twitter accounts. We found that the factors affecting patterns of international links on Twitter are broadly the same as those that matter for trade and FDI, even though the effect sizes are somewhat different. We found that having a common official language more than doubles the number of foreign followers. The colony-colonizer relationship also has an impact, and a common border still matters, as does geographic proximity. Similar levels of national income also seem to boost personal ties on Twitter.

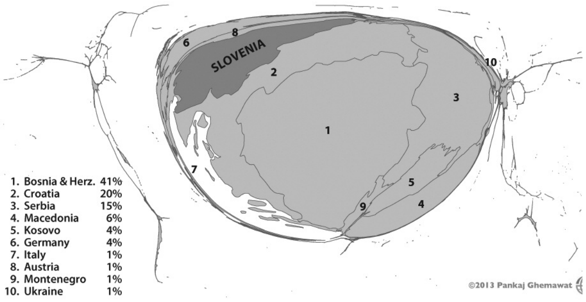
I have undertaken similar analyses for all the trade, capital, informational and people flows covered in the globalization index that I prepare annually with Steven Altman. The variables included in the regression (which, again, incorporated country fixed effects) end up jointly accounting for 70-90 percent of the variation that we observe in bilateral interactions between pairs of countries. These are very strong regularities.

To make these analyses more vivid, let us look at some more maps of Slovenia's international interactions. Note that they are all based on official data from international agencies, so complaints about inaccuracies should be directed at them, not to me. Looking at inward foreign direct investment stock, we observe that Austria is the largest investor in Slovenia. Most of the other investors are also in Western Europe. As for Slovenia's outward foreign direct investment stock, it goes mostly eastward, to former Yugoslavia and Eastern Europe.

Map 3. Slovenia Inward
Foreign Direct Investment Stock, 2011

Source: Generated based on data from OECD

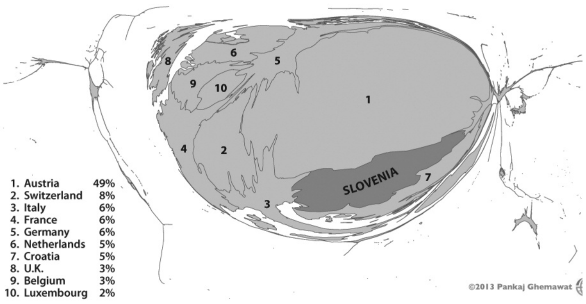
Map 4. Slovenia Outward
Foreign Direct Investment Stock, 2011



Source: Generated based on data from OECD

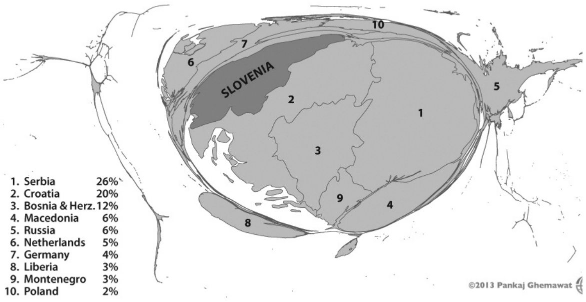
We can also look at cross-border movements of people. The official data clearly suggest that most immigrants to Slovenia come from former Yugoslav republics. But on the map of emigrants, Slovenia is oriented more westward than eastward.

Map 5. Slovenia Immigrants, 2013



Source: Generated based on data from OECD

Map 6. Slovenia Emigrants, 2013



Source: Generated based on data from OECD

This starts to suggest how we can use the patterns observed – which I summarize under the rubric of the "law of distance" – to boost business. If the challenge is to boost exports, for example, are the links with emigrants from Slovenia living overseas, especially those who headed westward – e.g., to the United States-being exploited? There is a lot of cross-country evidence suggesting that the overseas presence of people from a particular country helps build commercial relationships. When I look at the map of emigrants from Slovenia and compare it with the localization evident in the map presented earlier of Slovenia's merchandise exports, I start to wonder if there are some bridges being overlooked here, bridges that could help open up some faraway markets. And Peter Kraljič supplied some corroboration with his comments at the Presidential Forum:

"I was head of McKinsey France for eight years. I had contacts with the chief executive officers of the top-25 French companies. But in my time in that position, I was never asked by a Slovene politician or businessman if I could help in any way. Similarly, the head of Strategic Purchases of Volkswagen was Slovene but nobody in Slovenia knew that. We just do not follow our people."

Of course, such insights, while valuable, are pitched at the national/governmental level. For the rest of this discussion, I want to focus specifically on how the law of distance can be applied for business purposes. I have written extensively about this topic elsewhere: it is, for instance, the primary topic of my 2007 book, Redefining Global Strategy. Here, let me focus on the specific challenge of helping Slovene companies do better in emerging economies, with which their levels of engagement are still limited.

The focus on this challenge is motivated by the observation made earlier that the EU's share of world GDP is likely to shrink significantly while that of emerging economies will increase. For companies focused on the EU, the big shift to emerging economies is therefore particularly significant. Even a company like BMW, which has a broadly diversified sales footprint and has good reasons for keeping its production in Germany is concerned about its level of German/Eurocentricity. For companies that lack the broad presence in world markets that BMW has already developed – a characterization that would cover virtually all Slovene companies-the challenge is even more formidable.

And this challenge isn't just something to be addressed in the long run. Despite the IMF's reductions of its emerging market growth forecasts in medium run in October 2013, emerging

economies are still supposed to grow at 5.2 percent per year between 2012 and 2018, versus 2.2 percent for advanced economies – and to account for 53 percent of world economic growth over that period – or 65 percent in Purchasing Power Parity terms. Parenthetically, given the gloom-and-doom around the world economy, it is worth remembering that the implied growth rate for the world as a whole is – thanks to emerging economies – still forecast to be higher over 2012-2018 than it was during the 1980s, the 1990s or the first 10 years of this century.

While the IMF's growth forecast may not materialize given demographics and other factors in advanced economies, it is hard to imagine a scenario for the world that is not driven by emerging market growth.

That said, emerging economies do present difficulties, especially for companies that have no prior experience of them. So I wouldn't simply urge companies to charge ahead blindly – even though managers do sometimes work themselves up into that mental state. An illustration: in the online survey of readers of the Harvard Business Review cited earlier, I also asked people if globalization is an imperative or something to be subject to a cost-benefit analysis. 88 percent of the respondents opted for the former approach which, when you think about it, is truly remarkable. As a friend of mine who is a philosopher pointed out, it is hard to think of anything apart from legal or moral codes that should be treated as an imperative rather than something to be evaluated. The responses to that survey – and I continue to get similar ones even after the global financial crisis – doubtless reflect globaloney.

So what one might term the Nike approach to globalization – Just do it! – is pretty common. I also think that this is perilous. I am convinced that emerging economies are important but I am not sure that all opportunities there make sense for all companies at all times. Therefore, I would like to suggest five specific do-s and don't-s for companies from Slovenia – or elsewhere – that are contemplating emerging economies:

1. Don't fixate on market size; go beyond market size to consider distance. Companies have been making this mistake for more than 150 years around the markets that we now call emerging: I came across a suggestion from back then by a Manchester mill-owner that all of the Manchester textile industry's capacity utilization problems could be solved if all Chinese simply wore shirts that were one inch longer. There are many modern versions of this kind of "thinking." Thus, I am regularly approached by companies interested in developing Chinese or Indian growth strategies. The first thing that I tell them is, "If you have figured out that there are lots of Chinese and Indians, that is fine but it is not a proprietary insight. You need something more original than that before you decide that this is the right direction for you".

Consider the example of Marks & Spencer, which recently decided that it should focus on India rather than China. Is there a good reason for this focus? This is the kind of decision you would expect given the colony-colonizer linkage and the fact that English is a common language. Thus, instead of saying, "China is an even larger market than India", from a standpoint of a British company, India may be worth taking comparatively more seriously than China than for a French or German company. Instead of just saying that India and China are large, try to look at the notion of distance that I talked about. A serious consideration of distance implies that where you are coming from should have some impact on where you decide to go.

2. Don't stay only at the macro level; recognize industry-specificity. It is worth remembering that the discussion so far has mostly been at the macro-level. But it is really important to get down to the industry level in trying to figure out what is close versus what is far. Different industries are more versus less sensitive to different types of distance. And different industries are moving to emerging economies at different rates. In 1998, the automotive industry had 85% of its production and consumption in advanced economies. By 2012, that share was down to roughly 50%. The pharmaceutical industry, in contrast, has shifted comparatively little, still retaining approximately 90% of production and 80% of sales (in value terms) in advanced economies. If you are in the pharmaceutical sector, you cannot completely neglect emerging economies but you have a bit more time than companies in the auto industry to figure them out.

So one kind of industry contingency to consider is how fast your industry is moving from the advanced economies to the emerging economies. Where the speed is fast the urgency is great. Elsewhere you might have more time.

In addition, there are also product-idiosyncratic characteristics that matter. Think of a high-end chocolate manufacturer. Does it really want to focus on China? There are a few problems in that country. One is that many adult Chinese are lactose-intolerant which caps sales of milk chocolate. Second, in traditional Chinese gastronomy chocolate is considered a fiery element that you should not eat to excess, particularly in summer. As a consequence, although economies in the Middle East and Russia are not as large as

the Chinese economy, given what a chocolate producer is trying to sell, those markets may make more sense. This approach – adopted by Belgian specialty chocolate manufacturers such as Galler – is better than just saying that China is the largest economy in the world and it needs to be conquered by all means.

Or to take another such example, I discussed this point in Chengdu in June 2013, at the Fortune Global CEO forum. One of the other panelists was Carlos Gutierrez who, before becoming US commerce secretary, used to run Kellogg's, the breakfast cereals multinational. His reaction: "If we had read your article before we made a huge investment in breakfast cereals for China, maybe we would have thought harder about it and saved ourselves a billion dollars".

More broadly, it is better to look at what is close versus what is far from the standpoint of your sector. If you are in the cement sector, geographic distance matters a great deal. But if you are an Indian software vendor, it is language that counts. Geography is not that important because you can sell your products over the Internet. To make this analysis useful, you have to think in this way: "Given the industry that I am competing in, what type of distances really stand out?"

3. Don't focus just on other MNCs; expand the competitive set to consider emerging competitors. Multinationals have a tendency to focus only on other multinationals when doing this analysis. It is essential to remember that there are other important competitors in some of the emerging economies. To illustrate this, let me summarize the results of some surveys that McKinsey did recently. They analyzed about 200 multinational companies from advanced and emerging economies. Over time frames from 1999 to 2008, they found that emerging economy companies not only grew 10 percentage points faster annually at home than companies from developed economies (18% vs. 8%) but also enjoyed a similar edge (22% vs. 12%) in advanced economies and an even bigger one in other (foreign) emerging economies (31% vs. 13%)!

A Boston Consulting Group survey provides more striking insights. They surveyed about 150 multinationals. Seventy-eight percent of them said they expected to gain market share in emerging economies. However, only 13 percent said that they had a competitive advantage. The asymmetry is truly astounding.

The same study found that executives at major multinationals were not worried about advanced-country multinationals or even multinationals from emerging economies. They worried mostly about locally focused companies that understand the local market particularly well.

In other words, just because you see a market out there, that does not necessarily make you its "natural owner". And rather than think of who you normally compete with as your only competitor, it is worth recognizing that each market has its own competitors. Whether you intend to compete with them or cooperate with them, it is better to take their existence into account than to ignore them and assume that everything that comes from advanced economies is necessarily going to be better than anything that already exists in these markets.

4. Don't overstress strategic consistency; adapt to or exploit differences. This is a strange point for a professor of strategy to make. However, given the differences that I have been highlighting, it is better not to say, "This is the way we have always done this at home, so this is how we are going to do it there as well". This is not a great idea. You have to think hard about your strategy for dealing with different places rather than stressing basic consistency because that is the way you have always done things.

Let me give you an example. As it is too easy to give examples of small companies, let me look at a large one. It is the only company that I know of that sells more than 100 billion US dollars worth of products every quarter. I wrote my first case on Walmart back in 1986. It is a company that I have tracked for more than 25 years. Initially I looked at their operations in the United States. Despite some missteps, this is a pretty well-run company. They organize their logistics efficiently and they do their distribution well.

Some time ago, a journalist from the Financial Times asked Walmart chief executive officer Lee Scott, "What makes you think that you will be successful overseas?" Scott's response was, "People said we would struggle when we left Arkansas and got to places like Alabama, 600 miles from Arkansas. We even hired a person to work on the cultural differences between Arkansas and Alabama. Then we were told that in New Jersey or New York, our style wouldn't be successful." Scott's response provides another example of how even very seasoned executives are prone to underestimate the differences between domestic and international expansion. So, I decided to look at the profitability of Walmart's international operations. It was clear that the profitable countries were generally closer to the United States. Also, the profitable countries include the English-speaking nations and those that have a trade agreement with the United

States. Even though Mexico has a lower income than the United States, it is still shares far more commonalities with the US than, for instance, China does.

The point is not that Walmart should never go far away from home. Rather, it is that if you believe that every place is just like home, the farther away from home you get the more trouble you should expect. The idea is not that Walmart should not have gone to distant emerging economies but that they should not have gone there with the mindset that we are from the United States, the toughest retail market in the world, so we can surely succeed here with the same business model. Of course, Walmart is a smart company and has learned and improved over the course of its international expansion. It has figured out that it should either adjust to the differences that it has run into or find a way of taking advantage of them.

Here is an example of adaptation. In the old days, when Walmart went to a new market, headquarters would dictate a merchandise list and send it to the country manager. If he wanted to change anything, he would have to write back to headquarters. Naturally, career-minded country managers were reticent to propose too many changes.

That is how Walmart ended up stocking American footballs in Brazil. Footballs sounded good to the folks in the United States and to the Brazilian country manager. Only when the inventories started piling up did it become clear that they were thinking about fundamentally different products.

At present, when Walmart enters a new country it considers local competitors. Then it thinks how it can put a Walmart accent with more of its usual focus on hard goods on the merchandise list instead of having headquarters instantly figure out from several thousand kilometers away what needs to be merchandized in a particular location. This is now part of Walmart's international strategy.

Sourcing products from low cost locations is, perhaps, an even more important part of Walmart's international strategy than its overseas stores. When you apply the usual cost-savings associated with procurement from China to the best estimate I have been able to generate of Walmart's China sourcing, you end up with savings that are several times as large as the total profit from the international stores. And this is achieved on a much smaller investment basis. The lesson here is that differences can sometimes become a source of value creation rather than just being a constraint that the company needs to adjust to. But again, you have to be open to differences in the first instance to even notice the possibility.

5. Don't rely only on strategy as the solution; transform the organization. It is not clear that strategy is the only problem that a lot of these companies have. A lot of the problems seem to stem from organizational mindsets. In one recent survey, corporate leaders from advanced economies said that they were missing key opportunities in emerging economies because they did not understand local business practices. The problem here doesn't seem to be as much about strategy as about organization, and specifically, about lack of global bandwidth at the top of many multinationals, even experienced ones, that prevents them from understanding what it is that is really different about emerging economies. Look at how even the largest companies are run and who is at the top. A typical Fortune Global 500 company derives 60 percent of its sales from outside its own country – mostly from its region but not from home. Yet, only 14 percent have a chief executive officer who is from another country. Top management is significantly less globalized than the company's sales.

The Boston Consulting Group looked at companies that derive 28 percent of their revenues from emerging economies but wanted to derive more than 50 percent of their growth from those markets.

Typically, as I mentioned before, they have fewer than 2 of their top-20 managers based in emerging economies. The BCG data suggested that companies with 2 or more of their top 20 managers based in emerging economies tended to do better there. And according to data from McKinsey about Western multinationals, two percent of the top-200 managers were from key Asian growth markets.

Even more dispiritingly, academic work suggests that for all the rhetoric around emerging economies, it still takes longer to get promoted if you spend time in a far-off place than if you stay close to headquarters. People in organizations are smart and realize this quickly. As long as this continues to be the reality, the chance of getting your top talent to work in these markets will not be very good.

So a lot of my work these days is about what organizations can do to increase global bandwidth so as to deal better with such differences. For many of the companies that I work with, the answers to their challenges lie in a combination of strategy and organizational development rather than one or the other.

To wrap up, my five do-s for competing more effectively in emerging economies can be summarized using the acronym "GREAT": **G**o beyond market size to consider distance. **R**ecognize industry-specificity. **E**xpand the competitive set to emerging competitors. **A**dapt to or exploit differences. **T**ransform the organization.

The organizational emphasis of my fifth suggestion also provides a fitting connection back to the beginning of my first lecture on which to conclude. Human rather than technological constraints do the most to hold back both corporate and societal gains from globalization. The barriers are, to a great extent, inside ourselves rather than only out there in the world. In business, as in most every other kind of human endeavor, reaching out across boundaries entails risks. But in light of the limited levels of globalization that still prevail, the opportunities for profit and for personal enrichment available from broadening our horizons are far larger than commonly presumed.

Pankaj Ghemawat

Prof. Pankaj Ghemawat is the Anselmo Rubiralta Professor of Global Strategy at IESE Business School in Barcelona. Between 1983 and 2008, he was on the faculty at the Harvard Business School where, in 1991, he became the youngest person in history to be appointed a full professor. Ghemawat is also the youngest "guru" included in The Economist's list of the greatest management thinkers of all time.

Ghemawat's books include Commitment, Games Businesses Play, Strategy and the Business Landscape and Redefining Global Strategy, which IBM Chairman Sam Palmisano, described as "both visionary and pragmatic – aware of the broader historic trajectories of globalization, but grounded in the real kinds of decisions business leaders make." The magazine Strategy+Business rated Redefining Global Strategy as one of the 10 most notable books of the last decade.

Prof. Ghemawat's most recent book, "World 3.0: Global Prosperity and How to Achieve It" won the Thinkers50 award for the best business book published in 2010-2011.

Prof. Ghemawat also devised the DHL Global Connectedness Index and has written over a hundred research articles and case studies, and is one of the world's best-selling authors of teaching cases. He served as the department editor for strategy for Management Science between 2003 and 2009 and is the Chairman-Designate of the Strategy Research Foundation. He also served on the AACSB taskforce on the globalization of management education, and authored its recommendations about what students of business should be taught about globalization, and how.

Pankaj Ghemawat is a fellow of the Academy of International Business and of the Strategic Management Society. Other honors include the McKinsey Award for the best article in the

Harvard Business Review and the Irwin Educator of the Year award from the BPS (Business-Policy-and-Strategy) division of the Academy of Management.

IEDC Books of the Year

2013 Pankaj Ghemawat, *How Global are We?*

2012 Henry Chesbrough, *With Open Innovation to Success*

2011 Creating the Future: *25th Anniversary of IEDC*

2010 Stéphane Garelli, *Business as Unusual; A Competitiveness Outlook for 2011, and Beyond*

2009 Hermann Simon, *Role Models of Leadership beyond the Crisis*

2008 William A. Fischer, *New Generation Innovation*

2007 Jean-François Manzoni, *How to Avoid the Set-Up-To-Fail Syndrome*

2006 Ichak Adizes, *What is a Leader?* (a video lecture)

2005 Peter Drucker, *Manage Yourself and Then Your Company: Set an Example*

2004 Manfred Kets de Vries, *The Bright and Dark Sides of Leadership*

2003 Fons Trompenaars, *The Challenge of Leadership – Visions, Values, Cultures*

2002 Jean-Philippe Deschamps, William George, Milan Kučan, *Leadership for Innovation*

2001 Peter J. Rohleder, Peter Kraljič, Milan Kučan, *Competitiveness of Companies in Central and Eastern Europe*

2000 Paul Strebel, *Focusing on Breakthrough Options*

1999 John M. Stopford, *Harnessing Organizational Knowledge for Strategic Innovation*

1998 Pedro Nueno, *Maintaining Your Personal Value*

1997 Lecture by Peter F. Drucker on the occasion of the 10th IEDC Anniversary: *"Manage Yourself and Then Your Company: Set an Example"*

1996 10 years of IEDC

1995 George Taucher, *How to Succeed with Strategic Alliances*

1994 William A. Fischer, *The New Faces of Manufacturing*

1993 The European Presidents' Challenge; Beyond Restructuring

1992 Developing Managers for Eastern and Central Europe

1991 Thomas J. Peters, *The American Way of Managing – A Model for the Whole World?*

1990 Arnoldo C. Hax, *Redesigning of Strategic Concepts and Processes*

1989 Derek F. Abell, *Management in the Organization of the Future*

1988 Peter Kraljič, *Ways to Industrial Success*

About IEDC–Bled School of Management

The IEDC–Bled School of Management, founded in 1986 as the first business school of its type in Central and Eastern Europe, is one of the leading international management development institutions in Europe. It is a place where leaders come to learn and reflect, an international center of excellence in management development, a business meeting point, and a unique place where works of art complement a creative environment for creative leadership. Some of the world's most eminent professors and consultants teach here, and participants attend from all over the world.

The IEDC–Bled School of Management is an award-winning school. In 2012 the Executive MBA Program of IEDC–Bled School of Management was recognized by the Association of MBAs (AMBA) as one of the four most innovative MBA programs in the world, among 700 MBA programs accredited by AMBA in business schools in over 75 different countries. The IEDC–Bled School of Management won this recognition for innovation in combining the arts with leadership and management education. This year, Prof. Purg became the Chair of the UN Global Compact PRME (Principles of Responsible Management Education) Steering Committee, bringing together nearly 500 business schools and universities from 80 countries. In 2010 she was named Dean of the Year by the Academy of International Business (AIB) for her outstanding achievements in international business education. In 2009, the IEDC was the only institution from Central and Eastern Europe to be named among the 100 top business schools worldwide in the Aspen Institute's Beyond Grey Pinstripes ranking, for having demonstrated significant leadership in integrating social, environmental and ethical issues into its MBA program. In 1999 the IEDC–Bled School of Management was one of the first two business schools to be awarded the IQA (International Quality Accreditation), while in 2005 it received international accreditation from the Association of MBAs (AMBA).

The IEDC–Bled School of Management is also the headquarters of the Central and East European Management Development Association (CEEMAN), the International Management Teachers Academy (IMTA), the European Leadership Centre (ELC), and the UN Global Compact Slovenia.

Along with its highly-ranked International Executive MBA, Presidents' MBA and Doctoral programs, the IEDC offers short executive seminars for top management, customized programs for corporate partners, and a wide range of general management programs including a five-week General Management Program and an International Summer School for Young Managers.

IEDC–Bled School of Management
Prešernova cesta 33, 4260 Bled
Telephone: +386 4 57 92 500
Fax: +386 4 57 92 501
info@iedc.si
www.iedc.si

The publication of the Book of the Year has been supported by:

Photos: IEDC-Bled School of Management
AD & D: Eduard Čehovin
Circulation: 4000 copies
Printed by EDNAS PRINT on biomat by Papirnica Vevče, Slovenia

2013

IEDC-Bled School of Management

Prešernova cesta 33

4260 Bled, Slovenia

Tel: +386 4 57 92 500

Fax: +386 4 57 92 501

info@iedc.si

www.iedc.si

26. BOOK OF THE YEAR