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Turning global presence into global competitive advantage

Global presence does not automatically ensure competitive advantage.

For example, in the early 1990s PepsiCo Inc established an ambitious goal to more than triple its international soft drink revenues - from \$1.5bn in 1990 to \$5bn by 1995. Charging boldly in pursuit of this goal, Pepsi had built an extensive global presence by the mid-1990s.

Still, this global expansion did not translate into growth and profitability. In fact, by 1997, Pepsi was withdrawing from some major markets such as South Africa and had to face a nearly \$1bn loss from international beverage operations.

While the global market for beverages continued to expand rapidly, Pepsi's international market share and revenues were actually shrinking, in sharp contrast to the situation of an aggressively growing Coca-Cola (see "Battered PepsiCo licks its wounds", Richard Tomkins, Financial Times, 30 May 1997, p. 26 or www.ftmastering.com).

Turning global presence into global competitive advantage requires a company to exploit the value-creation opportunities generated by global presence and to meet related challenges. This article identifies those opportunities and suggests a framework for analysis and action.

Four of the most significant sources of global competitive advantage are listed in Figure 1 and discussed below.

Adapting to local market differences

Being present in multiple countries means that a company must respond to different markets through local adaptation of products, services and processes.

For example, Baskin-Robbins offers green-tea-flavoured ice cream in Japan and McDonald's offers burgers made from lamb rather than beef in India. Such necessary adaptation has the potential to yield three major benefits for a company:

1 Increased market share

Offering standard products across countries restricts the market to only those customers whose needs are met by these products. It follows that local adaptation of products will expand the market by capturing those customers whose needs are better met by tailored products.

2 Improved price realisation

Tailoring for customers increases the value delivered to those customers and thus justifies higher prices.

3 Pressure on local competitors

One of the natural advantages that most local competitors enjoy is their deep understanding of and single-minded responsiveness to the needs of the local market.

When a global company also starts to customise its products and services to satisfy local needs and preferences, such a move constitutes a frontal attack on the local competitors in their primary area of possible advantage.

To reap these benefits from local adaptation, management must do the following:

- Find the right equilibrium in the trade-off between localisation and cost structure. In many, though not all, cases, local adaptation of products and services will increase a company's cost structure.

- Understand when local adaptation is unnecessary. In some instances, local adaptation may actually impede popular acceptance. For example, when it entered the South Korean market, US restaurant

Summary

Just having a global presence does not guarantee that a company will enjoy global competitive success. It has to exploit the opportunities for value creation that its global presence offers. **Vijay Govindarajan** and **Anil Gupta** detail the four main opportunities that a global presence offers and explain how managers can best exploit them. They conclude by offering a framework for how a company can create the best global network for its value chain.

chain TGI Friday incorporated many local dishes such as *kimchi* in its menu. Analysis of the reasons behind the tepid market performance of TGIF in South Korea revealed that customers anticipated going to TGIF as "a visit to America" and were disappointed when they found the same old local dishes on the menu.

These benefits almost never materialise automatically. Geographic concentration of facilities and activities to reap scale economies poses some significant challenges that must be met if the benefits are to materialise. In particular, management must do the following:

- Weigh the benefits from concentration against increased transportation and tariff costs. Firms must export manufactured goods to various markets and incur extra costs that must be kept in mind in decisions regarding facility location.

- Ensure frictionless co-ordination. Isolating manufacturing operations from their targeted markets poses the risk of inadequate or delayed response to market needs unless operations are perfectly co-ordinated.

- Build world-class competencies at the location(s) where the activities will be concentrated. The rest of a company becomes dependent on the location(s) where an activity is concentrated and will wind up with global mess instead of global competitive advantage unless world-class competencies are developed there.

Exploiting economies of global scale

A primary effect of building global presence is that companies enjoy a larger scale of operations (larger revenues, a larger asset base and so forth).

This can create competitive advantage provided the company systematically undertakes the tough actions needed to convert larger scale into economies of scale. Exploiting economies of scale can result in one or more of the following benefits:

1 Distribution of fixed costs over larger volume

Generally, this benefit matters most in the case of activities such as research and development and advertising. For example, Merck can spread R&D costs over its global sales volume and thereby reduce its per-unit costs of development.

2 Reduction in capital and operating costs per unit

This benefit results from the fact that doubling the capacity of a production facility typically increases the cost of building and operating that facility by a factor of less than two.

3 Pooling of global purchasing power over suppliers

As a global company concentrates its purchasing power over any specific supplier (for example as Marriott might do with PepsiCo), it generally benefits from volume discounts and lower transaction costs.

4 Creation of critical mass in selected activities

A larger scale gives the global business the opportunity to build centres of excellence for the development of technologies and/or products.

Tapping the optimal locations

Every firm has to perform a number of activities along its value chain - for example, research and development, manufacturing, marketing and distribution. Tapping the optimal locations for executing each activity can yield three strategic benefits:

1 Performance enhancement

Microsoft's decision to establish a corporate research lab in Cambridge in the UK is a good example of a location decision guided almost exclusively by the goal of building world-class excellence in a selected activity.

2 Cost reduction

Nike's decision to manufacture athletic shoes in Asian countries such as China, Vietnam and Indonesia is an example of a location decision founded predominantly on cost-reduction considerations.

3 Risk reduction

A critical basis for cost competition between Caterpillar and Komatsu has been their relative ingenuity at managing currency risks associated with the wild swings in exchange ratios among the dollar, yen and other major currencies. For these competitors, one of the ways to manage such currency risks is to spread the high-cost elements of their manufacturing operations across a few carefully chosen locations around the world.

Management must do the following if location decisions are to create global competitive advantage:

- Ensure that location-driven advantages are neither squandered, nor neutralised by competitors, as a result of weaknesses in productivity and quality of internal operations. The choice of a seemingly optimal location can only guarantee that the quali-

Coca-Cola

PEPSI



Figure 1

Further reading

"The Right Way to Go Global: an Interview with Whirlpool CEO David Whitwam", Regina F. Manuca, Harvard Business Review, March-April 1994, p. 145.

ty and cost of factor inputs will be optimal. Management skill is required to convert these inputs into value-added outputs.

● *Ensure that today's location decisions do not create inflexibility with respect to the likely need to shift locations at some point in the future.* For any particular activity, today's optimal location may not still be optimal three years down the road. Because countries evolve over time at different rates and in different directions, factor inputs may become cheaper and/or of higher quality somewhere else. It follows that a relentless pursuit of optimal locations requires the global company to remain "footloose".

● *Excel at co-ordination across dispersed locations.* Optimal locations will generally be different for different resources and activities; thus co-ordination will be required.

Maximising knowledge transfer

To exploit the resource and/or market opportunities of the local environment, every subsidiary has to accumulate some unique knowledge. Some of this knowledge may be relevant across several countries and if leveraged effectively can yield benefits:

1 Faster product and process innovation

All innovation requires the incorporation of new ideas. These can either be generated internally or acquired from others. If a company is skilful at knowledge transfer across subsidiaries, subsidiaries can benefit from the innovations of their peers.

For example, Whirlpool's development of an award-winning super-efficient chlorofluorocarbon-free refrigerator incorporated compressor technology from its Brazilian operations, insulation technology from its European operations, and design and manufacturing expertise from its US operations.

2 Lower cost of innovation

A second consequence of not reinventing the



wheel is considerable savings in the costs of innovation. For example, the efficient "stocklist-based" distribution system developed by Richardson Vicks' Indian operations has found ready applicability in the company's Indonesian and Chinese operations. Such cross-border replication of an innovation significantly reduces the costs associated with "from-the-ground-up" experimentation.

3 Reduced risk of competitive pre-emption

A global company risks becoming a fount of new ideas for competitors if it demands constant innovations from its subsidiaries but is weak at transferring innovations across subsidiaries. Transfer of knowledge across subsidiaries significantly reduces the risk of competitive pre-emption.

Most companies tap only a small fraction of the potential economic value inherent in the transfer

and leverage of knowledge across borders. To capture the full potential, management must:

● *Ensure that subsidiaries are enthusiastic to share what they know.* At least some subsidiaries will view uniquely valuable knowhow as the currency through which they acquire and retain political power within the corporation. Later we suggest some mechanisms to encourage sharing instead.

● *Make subsidiaries eager to learn from peer units.* Like the "knowledge is power" syndrome just cited, the "not invented here" syndrome also afflicts many organisations. It is driven by ego defences that induce some managers to block information that suggests the greater competence of others. Power struggles can also lead some managers to pretend that the knowhow of peer units is neither unique nor valuable. Again, mechanisms to counteract this are discussed below.

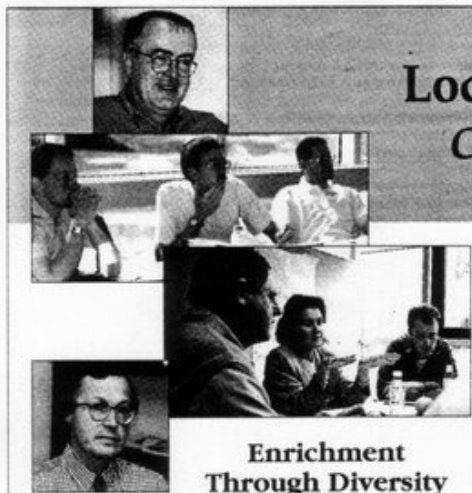
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