

Technical Note:
Globalization, Globaloney, Semi-Globalization, and the Multinational Enterprise

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Introduction

Multinational enterprises (MNEs), defined as firms that hold assets or employees in more than one country, are powerful economic institutions with the 500 largest MNEs holding most of the world's proprietary technology and commanding close to 30% of the global GDP as of 2012. The expansion of MNEs will continue, at least in the foreseeable future, as corporate managers are increasingly concerned with "going global" and widening the geographic scope of their operations. The impulse to globalize firm operations is largely based on the popular belief on globalization as a process in which the free flow of goods, services, ideas, people, and capital across borders are weaving formerly disconnected locations into an integrated global market.

Yet a detailed look at the empirical evidence reveals a global economic reality that is quite far-fetched from the idea of globalization as a relentless march towards an integrated global market. Not only is the world nowhere near the hypothetical state of total global integration but the overall trend suggests that the prediction of unfettered world-wide integration is grossly inaccurate. Of course, there is no doubt that the global economy has transformed drastically in the past three decades and with it comes great new opportunities for corporations. Many MNEs have indeed succeeded in this transformed world; however, behind all the success stories are many more failures. These failures are in large part due to a misunderstanding of the nature of

the transformation that has taken place in the global economy, particularly the assumption that the global economy will inevitably converge to a point of perfect integration.

Against this backdrop, the purpose of the current note is to provide an alternate understanding of globalization and further explicate its relevance to international business. We begin with a historical description of the debate surrounding globalization and how the discourse has evolved over time. We then demonstrate why and how the world is more accurately described as “semiglobalized” and explain key features of the world encapsulated in this terminology. In the penultimate section, we illustrate the implication of semiglobalization for MNE managers and international business strategy. Concluding remarks follow.

Globalization: The Evolving Discourse and Recent Findings

Globalization is perhaps the most touted buzz word of our times. More than 5000 books have been published on the topic between 2000 and 2004, and it is also a subject of heated debates between those who embrace it as an engine for global prosperity and others who oppose it as a threat to national and individual identity. Regardless of one’s normative position on globalization, most would agree that the world has changed in significant ways in the past three decades and that there is increasing movement across borders. Indeed, while defining globalization is an incredibly difficult task, there are certain common themes that emerge from the discussion on globalization: (i) the mobility of “things” beyond the local; (ii) the increased transaction of goods, services, capital, labor, and ideas across borders; (iii) the transformative power of technological innovations (especially transportation and communications); and (iv) the growing power and influence of MNEs.¹

¹ See Smith, M.K. & Doyle, M. 2013. Globalization: The encyclopedia of informal education, www.infed.org/biblio/globalization.html, for an excellent overview

These themes emerged in the late 1980s and early 1990s when several transformative world-events and technological innovations came together. Specifically, key events such as the rapid collapse of the Soviet bloc, abandonment of import substitution industrialization, founding of the Washington Consensus and subsequent wave of global economic liberalization significantly altered the global institutional status quo. Locations and industrial sectors that were formerly closed for international trade and investment opened up as national governments became much more receptive to the idea of economic liberalization. Along with these macro-political and economic developments came revolutionary innovations in information technology (e.g., internet) and transportation technology which, ostensibly, decrease the spatial transaction costs associated with conducting business in multiple countries.

Many during the 1980s and 1990s took these developments as clear signals that the world will eventually converge to a certain equilibrium point or single institutional model. Specifically, pundits predicted that the power of liberal democracy and market capitalism will inevitably be the single rubric through which all societies will organize their political and economic lives while technological innovations will eventually “flatten” all remaining cross-border differences. The general argument was that because the price of not engaging in this global integration was so high, all societies would ultimately converge towards one equilibrium condition or political-economic system which maximizes the efficiency of a given society.²

These discussions had a profound impact on the scholarly and practical discourse on the management of MNEs. Prominent management scholars urged MNE managers to prepare for the

² See (i) Fukuyama, F. 1992. *The End of History and the Last Man*, New York: Free Press; (ii) Cairncross, F. 1997. *The Death of Distance: How the Communications Revolution will Change our Lives*, Harvard Business School Press: Boston MA; (iii) Frieden, J. A. 1991. Invested Interests: The Politics of National Economic Policies in a World of Global Finance. *International Organization*, 45(4): 425-51

advent of the flat-world where those who operate as if borders do not matter will gain substantial advantage over those who are still stuck in the old paradigm. These “globalists” predicted that customer tastes will converge and the only parameter of relevance will be who can provide the best quality at the lowest price. Such homogeneity on the demand side will enable MNEs to realize benefits through economies of scale not only in production but also in distribution, marketing and management. In this flat-world, MNEs should produce and market everywhere in the same way rather than tailor to local preferences. Indeed, Levitt (1983) declared that only global MNEs that manage to achieve such economies of scale would be able to meet global customers’ needs for reduced cost and survive in the world market.³

Fast forward two decades: the picture looks substantially more complex and at odds compared to the “flat-world” envisioned by the globalists in the 1990s. Of course, the global economy has become more integrated as merchandise trade increased five folds while the aggregate volume of foreign direct investment (FDI) has increased nearly thirty-folds. Other indicators also highlight that cross-border transactions of capital, goods, services, people and information have increased significantly in the past two decades. Yet, a more detailed analysis reveals some serious problems with the “flat-world” vision of globalization. Specifically, all sorts of barriers across geographic units (i.e, cultural, geographic, administrative, legal, political, etc.) continue to matter and, in some aspects, more so than before. As Figure 1 shows, the degree of internationalization of many types of transactions that people commonly believe to be hallmarks of globalization are generally confined to levels below the 10% threshold. Political

³ See (i) Levitt, T. 1983. *The globalization of markets*, Harvard Business School Press: Boston MA; (ii) Ohmae, K. 1999. *The borderless world : power and strategy in the interlinked economy*, Harper Business: New York NY

economist Veseth goes as far as to proclaim that globalization is “globaloney” and that the term has no real connection with the world that we live in.⁴

In fact, recent evidence and analyses indicate that the contemporary global economic geography is characterized by two paradoxical forces reshaping the global economy: one centripetal and the other centrifugal. On the one hand, many corporations are engaged in dispersing their productive activities to ever more distant corners in the world through offshoring/outsourcing and FDI. Innovations in communications and transportation technologies along with supra-national political arrangements (e.g., trade and investment agreements) have drastically reduced the spatial transaction costs involved in dispersing corporate activities. On the other hand, we are witnessing an increasing degree of spatial concentration in terms of high-value corporate activities such as innovation (e.g., R&D) and administrative support (e.g., human resource management, capital management). Indeed, the lion’s share of the knowledge-intensive corporate activities, the key source of wealth in the contemporary global economy, are focused in select central locations within the world such as global cities (e.g., New York, Frankfurt, Tokyo) and specialized clusters (e.g., Silicon Valley in San Francisco Bay Area and Medical Triangle in North Carolina) located in advanced economies.⁵

Indeed, evidence measuring the geographic dispersion of the world’s largest MNEs reveals an interesting picture. Figure 2 shows two measures regarding the geographic scope of multinational activities – (i) Foreign Sales to Total Sales (FSTS) and (ii) Intra-regional Sales to Total Sales (IRSTS) – for the 300 largest MNEs in the world between 2000 ~ 2011.⁶ The first

⁴ See Veseth, M. 2006. *Globaloney: Unraveling the Myths of Globalization*. Rowman & Littlefield Publishers: Lanham MD

⁵ See Florida, R. 2005. The World is Spiky. *The Atlantic Monthly*, October: 48-51 and Sassen, S. 2001. *Global Networks, Linked Cities*. New York: Routledge.

⁶ (i) FSTS = (foreign sales / total sales) / [(world GDP – home GDP) / (world GDP)]; (ii) IRSTS = (home-region sales / total sales) / (home-region GDP / world GDP). The general idea is that a perfectly globalized MNE should have foreign sales around the world proportionate to the share of GDP of each country. For instance, a perfectly globalized

measure, FSTS, quantifies the extent to which MNEs are biased towards the home-market while the second measure, IRSTS, quantifies the extent to which MNE activities are biased towards the home-region. The FSTS show that most MNEs are strongly oriented towards the home-market as we can see from the fact that most values are well-below the value of 1 which indicates a perfectly globalized MNE. Furthermore, high values in IRSTS (larger than 1) across the board indicate that most of the largest MNEs in the world are actually home-regional MNEs with European MNEs primarily active within Europe while U.S. MNEs are strongly biased towards North America (NAFTA) and South America. Also note that both measures remain quite stable over time, indicating that corporations are not moving towards becoming a perfectly “global” MNE, at least in the foreseeable future.

Semiglobalization and International Business Strategy

Several key points emerge from the above discussion: First, the global economy is imperfectly integrated and differences across borders continue to matter greatly despite the fact that aggregate volume of cross-border transactions have increased quite significantly over the past two decades. Such trend seems to be stable over time and there is no indication that the calculus of change is moving towards unilateral integration of the global economy. Second, while there is global dispersion of some types of economic activities (e.g., labor intensive manufacturing) other activities are becoming more spatially concentrated in select locations around the world. Last, even the world’s largest MNEs are strongly influenced by cross-border

UK firm should have 3% of sales in the home-market and 97% of sales from foreign markets since UK constitutes 3% of the world GDP. See Asmussen, C.G. 2009. Local, regional or global? Quantifying MNE geographic scope, *Journal of International Business Studies*, 40: 1192-1205 for more details

distance and differences. They are significantly biased towards the home-country and home-regional market and, again, the trend is stable over time.

The term that captures the current condition then is “semi-globalization” which assesses the integration of the global economy to be incomplete, uneven, and reversible.⁷ Specifically, global economic integration is incomplete in the sense that the world is nowhere near the hypothetical ideal of complete economic integration. Thus, formulating strategies to manage differences and distances across geographic units is critical for successfully managing cross-border operations. Next, integration is uneven as certain pockets of areas within the global economy are well-integrated with each other (e.g., NAFTA, EU) while other locations remain disconnected from each other (South America and Africa). Such uneven degrees of integration across different geographic units require careful cost/benefit consideration of how and where to locate each firm activities in order to maximize the synergy potential inherent in multinational operations. Last, the current state of economic integration is reversible as evidenced by the increase in the aggregate number of government policies that intervene and control commercial activities after the 2008 financial crisis. In fact, history tells us that a worldwide shock or a crisis is inevitably followed by rise in dirigisme, and the contemporary world is no exception to this historical regularity.

The implication of semiglobalization for international business strategy is that corporations need to control and coordinate their international operations through three interrelated strategic tools: (i) Aggregation; (ii) Arbitrage; and (iii) Adaptation which constitute the AAA framework (see Figure 3).⁸ First, *aggregation* refers to exploiting similarities across

⁷ See Ghemawat, P. 2003. Semiglobalization and Internationalization Business Strategy, *Journal of International Business Studies*, 34(2): 138-152

⁸ See Ghemawat, P. 2007. Managing Differences: The Central Challenge of Global Strategy. *Harvard Business Review*. March (1-13)

countries in order to take advantage of economies of scale and centralization of firm operation. One common means of achieving this is to regionalize the operation in order to centralize firm activities among relatively homogenous countries. Toyota, for example, has recently engaged in extensive consolidation of firm activities along regional lines – i.e., North America, Asia, Europe, and Latin America – in order to take advantage of similarities in customer taste and political systems among relatively well integrated countries. Second, *arbitrage* refers to exploiting differences across borders and seeking absolute economies rather than scale economies. A classic example is to build production plants in locations that offer well-educated yet low-cost labor; that is, arbitrage involves making the best out of differences in relative price of factor inputs on the supply side and willingness to pay on the demand side to maximize the benefits of operating across borders. Last, *adaptation* is to customize firm operations to cater to local needs and maximize local revenue. This may involve localizing the product or service by changing certain features and crafting advertisements that reflects the values and norms of the particular country.

These three tools complement and conflict with each other, and the job of the MNE manager is to find the right mixture of these three in order to navigate the semiglobalized world. The three levers enable managers to see which combination of the three strategies would offer the most leverage for their companies. Furthermore, it helps managers avoid the pitfalls of doing too much or too little of one or the other. For instance, too much adaptation may lead to excessive variation in product offerings which could be cumbersome to coordinate from the center and generate unnecessary costs. On the flip side, excessive aggregation at the cost of adaptation could lead to too much standardization and MNE may stifle local innovation or revenue generating opportunities. Lastly, lack of arbitrage could lead to narrow geographic

scope, potentially forgoing chances to increase the efficiency of the firm's international operation.

The general point here is that semiglobalization requires MNE managers to navigate the semiglobalized world through the appropriate admixture of aggregation, arbitrage, and adaptation precisely because the world is unevenly integrated and differences across borders matter greatly for multinational success. In fact, many of the worst mistakes in international business stem from the lack of understanding regarding the relationship between the available strategic levers and the current global economic context. The concepts of semiglobalization and the AAA framework are constructed to help managers gain a theoretically and empirically grounded understanding of the condition of semiglobalization and its implication for corporate managers.

Conclusion

We believe that the message of the current paper is all the more critical as we are witnessing a watershed moment in human history wherein many of the political, socio-cultural and economic certainties that used to provide some regularity in world affairs for decades is now increasingly being replaced by new uncertainties. Specifically, early predictions of a relentless march towards of liberal-market democracy and global economic integration is now being replaced a much more nuanced analysis of the world where societies are evolving towards ever more variegated modes of organizing economic life. Within this context the current paper aimed to provide a brief overview of where the global economy is and how international business strategy is shifting in response to this condition. We emphasize that in an unevenly integrated world where differences across borders still matter greatly for cross-border business activities,

flexible mixture of the three strategic levers are critical to achieving success and avoiding common pitfalls.

The 10 percent presumption

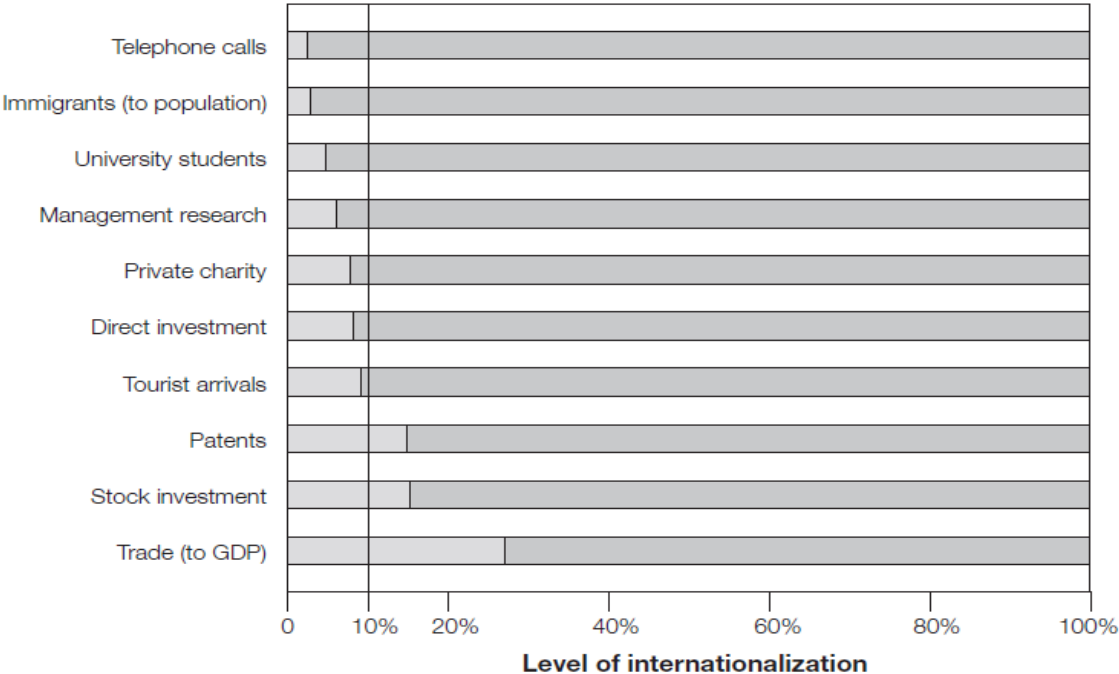


Figure 1 Percentage of Cross-border Transaction for Various Types of Exchanges ⁹

⁹ Ibid

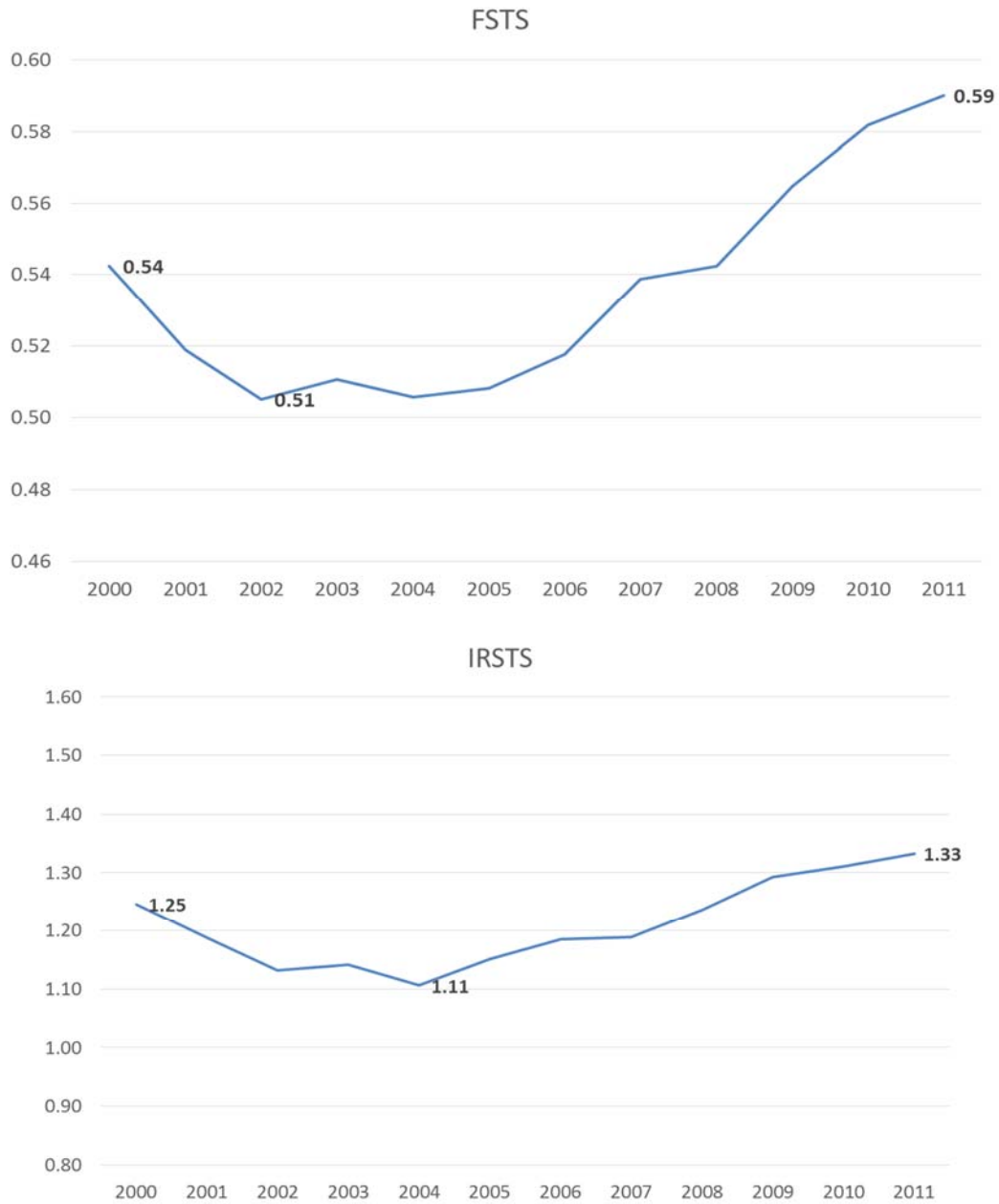


Figure 2 Internationalization and Home-Regionalization of Largest MNEs (2000 ~ 2011)¹⁰

¹⁰ Aguilera, R.V., Kim, J.U., Noh, K.B. & Xiaowei, Y. 2013. Internationalization, Regionalization, and Globalization: Quantifying the Geographic Scope of MNE Activities (2000 ~ 2011). *Working Paper*

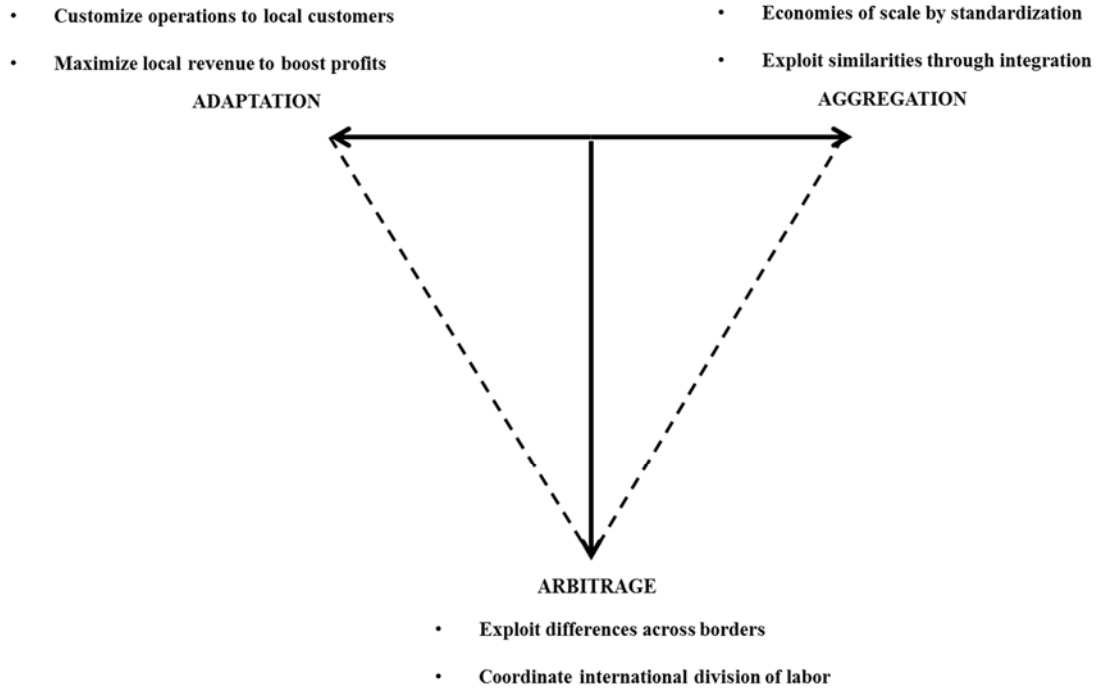


Figure 3 AAA Framework¹¹

¹¹ Ghemawat, P. 2007. *Redefining Global Strategy: Crossing Borders in a World where Distance Still Matters*, Harvard Business School Publishing: Boston MA