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Twenty Hubs and No HQ

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A new form of global organization grounded in "gateway" countries can allow a company to operate profitably around the world.

by C.K. Prahalad and Hrishi Bhattacharyya

Illustration by Lars Leetaru

Growth prospects for multinational corporations (MNCs) are expanding enormously. In Asia, Latin America, Africa, and Eastern Europe, there are more than 4 billion new potential customers whose rising incomes and aspirations have created an unprecedented market for all manner of goods and services. They want to own homes, to eat nutritious food, and to have varied entertainment options. They want toothpaste, cell phones, and motorcycles. To cater to these needs, business-to-business enterprises will be called upon to provide chemicals, cement, machine tools, electricity, and much more.

Many corporate leaders recognize this opportunity, but few are developing the capabilities or the management focus that they will need to realize its full potential. They persist in thinking of these new markets as "emerging markets," separate from their existing customers in the industrialized world. Many companies have not reorganized their operations to serve a fully global economy.

For example, one large, well-established MNC has an annual growth rate of 9 percent in developing countries, and only 2 percent in mature, developed-country markets. Already, almost one-third of its revenues and nearly two-fifths of its profits come from emerging markets, and those percentages are increasing every quarter. Relative to other companies' leaders, the top executives of this company are advanced in their thinking; they say they aspire to sell their products around the world. But their actions tell another story. Their center of gravity remains in North America and Europe: That is where three-fourths of the company's assets are located and where 88 of the top 100 senior executives grew up. These executives have lived their lives primarily in developed markets; they socialize largely with people from similar backgrounds; at work, they put individuals who resemble them on the fast track for promotion; and they all share a dominant logic in the way they make decisions. It is no surprise that they think of developed and emerging markets as distinct from one another, and that they have neither a structure nor a strategy to integrate them.

What if a company's executives truly took seriously the new middle class emerging in so many countries? How would they organize their companies to provide products and services for those new consumers? They could start with the 20 countries in the world that best serve as *gateways* to nearby regions. Drawing on capital, talent, and resources from those gateway countries, companies would establish their own corporate *hubs* in each of them: offices with enough capabilities in marketing, manufacturing, and logistics to maintain a powerful presence in all the markets of that region. Companies would then integrate these hubs into a global network that distinguished their company from its competitors around the world.

Through this type of organization, all the countries of the world could be served with only about 20 basic offices, with networks that linked the manufacturing, research and development, and logistics functions. And these companies, rather than acting as if their central management were rooted in their home countries, would also build a global senior management pipeline from their 20 or so hubs, treating all hub executives as equally important to the company's future. Although no company is yet fully organized this way, there is reason to believe that most successful companies in the future will craft such a gateway–hub structure.

Out from Complexity

Leaders of multinational corporations have heard ad nauseam that entering emerging markets will require them to leave their comfort zone. But the biggest challenge is not unfamiliarity. It's complexity. For example, there are more than 190 countries around the world. Each has its own history, culture, and regulatory regime. People speak different languages, eat different foods, and observe different religions. There is considerable diversity of occupation, income, social mores, and attitudes among them. And the more clearly this complexity is recognized — the more clearly businesspeople see the need for local understanding as the key to global reach — the more daunting the challenge of entering emerging markets becomes.

For multinationals, the biggest challenge to entering an emerging market is not unfamiliarity. It's complexity.

Currently, most companies attempt to "go global" in one of two ways: centralization or decentralization. Those that decentralize configure themselves with a single headquarters, four or five regional offices (perhaps one each for North America, Latin America, Europe, Asia, and the Middle East and Africa), and separate managers for each country. They let the country managers make most decisions, becoming the locus for all marketing and government relations and

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for some of the manufacturing in that nation. Often, the country managers tailor products and services to meet their population's needs. This structure tends to produce huge bureaucracies and unnecessarily complex portfolios. One consumer products firm has introduced more than 50 variants of tomato soup just within Europe. Even as these companies overextend themselves in some markets, they restrict themselves in others, marketing only to some customer segments (often just the wealthiest) and writing off the lowest 50 percent of income earners.

Other MNCs centralize. They seek a unified approach to all markets around the world. But centralization is equally problematic. For example, there are more than 50 countries in Africa alone. If a large, remote corporation tries to manage all these countries with one approach from headquarters, rather than responding to the specific needs of local markets, the lost opportunities could be immense.

Fund classifies 31 countries as developed (or industrialized) nations, but just 10 of these countries account for 90 percent of the economic activity and 70 percent of the population of the industrialized world. These countries are the United States, Japan, Germany, the United Kingdom, France, Italy, Spain, Canada, Australia, and the Netherlands. With those 10 countries serving as gateways, it is possible to provide products and services to customers in all the other countries of the industrialized world.

Similarly, in the developing world, 10 countries — China, India, Brazil, Russia, Mexico, South Korea, Indonesia, Turkey, South Africa, and Thailand — represent 3.1 billion people (70 percent of the population and 80 percent of the economic strength of the developing world). These 10 countries have several qualities that make them valuable as gateways to the regions around them. They have a large current market for goods and services, and a much larger potential market.

Together, 20 gateway countries account for 80 percent of the world's economic activity.

The gateway–hub structure represents a third alternative: a hybrid that reduces the tension between global integration and local responsiveness. Corporate leaders who are based in business unit–style organizations in selected gateway countries have a natural base from which to extend their footprint into nearby markets.

It is relatively clear which countries are the most promising gateways. The International Monetary

They are also well equipped as producers of goods, with quality and innovation that can compete with, or surpass, those of Western nations. They have workers available, both at low cost and with a high-level skill base. They can provide global firms with a reasonably well-developed logistical and educational infrastructure: roads, ports, power, and schools. They also have an emerging institutional infrastructure (laws and regulations), and a societal willingness to be part of international regulation and trade. Many of these countries are equipped to serve as a base for R&D, manufacturing, and back-office activities. Finally, each gateway country is naturally aligned to its surrounding nations.

Together, the 20 gateway countries — 10 from the industrialized world and 10 from emerging markets — account for about 80 percent of the world's economic activity, and 70 percent of its 6.6 billion inhabitants. An MNC could most effectively expand its operations around the world by making it a priority to set up hubs in these gateway nations. The hubs would have authority over most of the managerial elements of business: supply chain management, product development practices, product launches, marketing, branding, acquisitions, and recruitment of talent. The leaders of the hubs would then report directly to the office of the CEO, meeting regularly as part of the most senior executive team.

Each hub would take primary responsibility for serving the gateway market, plus other markets in the regional footprint (often five to 10 other countries), all with local logistics expertise and cultural awareness that a faraway corporate staff could not provide. For example, the German hub might manage Switzerland, Austria, and Hungary; Brazil might support Argentina, Uruguay, Paraguay, Bolivia, and Chile; and Mexico might cover Colombia, Venezuela, Peru, and Ecuador. In the non-hub countries, there would be only a front-end organization for customer contact and service. Everything else would be handled through the hubs. For example, a hub might oversee 15 or 20 manufacturing locations — providing cost and scale advantages while retaining enough local autonomy to succeed in local markets. Some hubs, like that in India, might cover all aspects of corporate activity — marketing, manufacturing, research and development, logistics, and shared services — for a region, whereas other hubs, such as those in Turkey or Indonesia, might start with a customer-centric supply chain and gradually build capabilities in other functions. Hubs in the largest markets, such as the United States, Brazil, or China, might create their own regional brands. Mozambique and Kenya might receive products developed in South Africa, just as Austria and Denmark currently accept products developed in Germany.

In the aggregate, this gateway approach would allow an MNC to serve customers on every level of the income pyramid, from wealthiest to poorest, in every country where it operates. In addition, in most MNCs, a gateway–hub structure would reduce sourcing costs by 20 percent and corporate overhead costs by two-thirds. Although many companies would probably ease their way into this setup by establishing hubs in just some of the 20 gateway countries, the most successful competitors would soon be drawn to establish hubs in all of them. And in the next few years, other countries, such as Vietnam and Nigeria, may become fullfledged gateway countries as well.

Many companies have experimented with this type of structure for marketing, organizing their product lines in North America and Europe through "lead" countries. Other companies, such as GE, Siemens, Philips, and Intel, have moved their manufacturing, shared services, and R&D to China and India, with the clear intent of building a presence in the region around hublike structures in those nations. But no company that we know of has yet taken the concept to its most powerful end, operating most or all functions under a hub structure, and creating a seamless global network to integrate it all together.

A gateway–hub structure can be flexible. A Chinese hub could manufacture goods for Greater China, other Asian markets, the Middle East, Europe, and the U.S. Conversely, a vibrant consumer market need not depend on a single hub: A hub in the U.S. could draw in goods from Brazil, China, and Mexico. All the hubs would probably be involved in manufacturing, but only some might incorporate research and development. The configuration of these R&D hubs does not have to match the manufacturing and logistics footprint; R&D and services are more talent intensive, and concerns about protecting intellectual property are greater in the R&D arena.

Perhaps the greatest advantage of this structure has to do with the changed role of the center. In a fully realized gateway–hub MNC, the topmost executive committee contains leaders from all the hubs; management is diversified across the key countries of the developed and developing world. For the first time, the people at the top of the global hierarchy are close to where the action is — they are physically near their customers and markets. It is now far more possible to promote talented individuals all the way up to the CEO's position, no matter which hub they come from. Core corporate platforms for manufacturing, marketing, and R&D now exist around the world, extending the business day to 24 hours without a reliance on outsourced services. This is the modern version of an empire on which the sun never sets.

Western corporate strategists consistently underestimate the value creation potential of developing nations.

Metrics for Emerging Markets

Admittedly, many corporate leaders may find the very concept of the gateway–hub structure discomfiting. Some may seek to avoid it altogether by remaining in their home regions. But they run a terrible risk if they do. Western corporate strategists have understood in principle the importance of a global strategy, but they consistently underestimate the value creation potential of developing nations. The assumptions persist that emerging countries do not represent viable markets, because their consumers cannot afford to buy products and services sold by MNCs. Western managers also tend to underestimate the skill base and talent in these countries, often on the grounds that potential employees lack the education and training to meet Western standards. And they overestimate the prevalence of corruption, quality flaws, risky supply lines, and unreliability when sourcing from these nations. (For example, Western managers may treat the recent quality scandals in toys and pharmaceutical ingredients from China as symptomatic of the entire country.)

Most important, Western managers typically misjudge the relative profitability of activity in emerging markets. One reason for this is a flaw in the way that national economic activity is typically measured. The most generally accepted metric, the gross domestic product (GDP) — the financial value of all goods and services produced in a country in a given year — is converted from local currencies into U.S. dollars for comparison. It is thus distorted by exchange rates. A more accurate conversion measure, representing the purchasing power of consumers in that local market, is purchasing power parity (PPP), which is based on a comparison of the prices of a typical basket of goods in different markets.

When looked at in PPP dollars, the GDP data tells us how significantly the world has changed since 1997. In that year, no emerging nation was included in the International Monetary Fund's list of the world's highest-ranked 10 economies (by volume of activity). In 2007, China, India, Brazil, and Russia made it onto that list. In these PPP-based rankings, China has a higher GDP than Japan; China and India are both ahead of Germany, the U.K., France, and Italy; and Brazil, Russia, and Mexico all outrank Spain, Canada, Australia, and the Netherlands in GDP. And the economies of the developing world are growing at more than 5 percent per year, which is twice the rate forecast for the developed nations. China and India are growing at a rate of more than 9 percent.

If nothing else, this data challenges the traditional categorization of economies as rich and poor. That distinction is rapidly becoming a thing of the past, as the "poor" economies of emerging markets grow rapidly in scale and sophistication. The purchasing power of households in South Korea, South Africa, Mexico, Russia, and Brazil is not much different from that of households in Spain or Portugal.

In a gateway–hub model, risk can be spread over 10 or more locations, with manufacturing and R&D in multiple hubs.

The growth opportunities are especially evident when it comes to products that are normally associated with a vibrant economy: cell phones, cars, televisions, and personal computers. Similarly, the opportunities to profit by serving the economic "bottom of the pyramid" no longer exist just in emerging markets. For example, people in the U.S. who cannot afford health care are not just a political constituency; they are a market for low-cost preventive health-care services, which a few retailers, like Wal-Mart, are beginning to serve with in-store clinics.

There is one more financial implication, often forgotten by corporate strategists. When revenues or returns from an emerging market such as India are computed in U.S. dollars or euros, they often appear smaller than they should because of currency exchange rate conversions. In other words, most companies do not incorporate the effect of PPP and foreign exchange in evaluating their investments.

To understand the significance, consider an MNC that invests US$1 million in fabrication technology in the U.S., versus the same US$1 million in India. One dollar converts to about 40 rupees (Rs. 40) in India at the exchange rate in December 2007. But it takes only Rs. 9 to buy goods in India that would be worth $1 in the United States. A $1 investment in India is thus the purchasing-power equivalent of (or buys the same amount of production as) about $4.40 in the United States. This index, 4.4 to 1, is the *investment multiplier* for India. Every developing nation has its own investment multiplier. Even when it isn't noticed, the investment multiplier is operating. That is why it makes far more sense to manufacture products in India for sale in the United States, rather than the other way around.

The investment multiplier in effect represents a final nail in the coffin of the old mercantile ideal of sourcing raw materials from developing nations, manufacturing in industrialized nations, selling the finished products back to an elite group of customers in the developing nations, and bringing the profits back home. It is much more cost-effective for a multinational to source, manufacture, and sell around the world from a global network that includes developing markets. In other words, it makes sense to treat developing nations as an integral part of a global system, transferring profits through products rather than currencies.

Reach and Risk

Executives considering the gateway–hub structure have raised two other objections. Some ask, Can marketing hubs really reach consumers in other nearby nations? Won't they face the same cultural barriers that block global firms? Experience suggests, however, that hub-based marketers are more likely to find the commonalities that transcend those differences. For example, a children's food and drink company entering the Chinese market conducted a study that showed that most parents made decisions based on their aspirations for their children's quality of life, rather than their goals for themselves.

On the basis of this research, the company developed a brand promise that focused on children's betterment. The products would help children become healthier and more alert, and grow taller and stronger. All of the food and drink contained at least 10 percent of the daily protein requirements suggested for children by nutritionists; the benefits were all clinically proven and endorsed by doctors. The products were also based on natural ingredients such as milk, fruit, cereals, grains, and soya. The food was packaged in a form that could be eaten at home, at school, or on the playground. And it was priced to be affordable for people with very low incomes in developing countries — even while it was marketed with an image of international standards and high quality. Although the specific products varied geographically (ice cream was popular in one country; soya drinks in another), the basic brand identity was universal enough to apply throughout the region, and the idea is now spreading to markets across Asia, Africa, and Latin America.

The second question that skeptical executives raise about the gateway–hub configuration has to do with the risk of changing to this structure. And, to be sure, there are always risks in managing far-flung enterprises, such as the risk of losing access to critical supplies. Indeed, most firms, in making ad hoc decisions to outsource parts of their business processes and manufacturing operations, have already put themselves at risk.

Today, for example, all personal computer manufacturers are sourcing primarily from China. By contrast, in a gateway–hub model, risk can be spread over 10 or more locations, with manufacturing and R&D in multiple hubs. Disruptions in any one location can be compensated for by other parts of a seamless network. The U.S. market may be served from Brazil as well as China. Hubs can also provide multiple centers for innovation, along with the opportunity to learn from one another.

Underlying the gateway–hub structure is a basic management principle for worldwide enterprise: Neither local responsiveness nor global integration should be based on ideology. This represents a new model for global corporations based not on the priorities of home, but on the needs of the marketplace and on locating work wherever it can be conducted most efficiently and managed most profitably. +

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