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How to Be a Truly Global Company

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How to Be a Truly Global Company

by C.K. Prahalad and Hrishi Bhattacharyya

Many multinational business models are no longer relevant. Skillful companies can integrate three strategies — customization, competencies, and arbitrage — into a better form of organization.

During the high-growth years between 1992 and 2007, the globalization of commerce galloped at a faster pace than in any other period in history. Now, amid the chronic unemployment and anti-trade rhetoric of the post-financial-crisis world, some observers wonder whether globalization needs a time-out. However, the experience of multinational companies in the field suggests the opposite. For them, globalization isn't happening rapidly enough. Whereas GDP growth has stalled in the industrialized world, consumption demand is still expanding in China, India, Russia, Brazil, and other emerging markets. The 1 billion customers of yesterday's global businesses have been joined by 4 billion more. These customers reside in a much larger geographic area; three-quarters of them are new to the consumer economy, and they need the infrastructure, products, and services that only global companies provide.

C.K. Prahalad, 1941–2010

The problem is not globalization, but the way our current institutions are set up to respond to this new demand. The prevailing corporate operating model does not work well with the structural changes that have taken place in the global economy.

Photo illustration by Holly Lindem, portrait by Martin Mörck

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passed away on April 16, 2010. He was the Paul and Ruth McCracken Distinguished University Professor of Corporate Strategy at the University of Michigan's Ross School of Business and the author of *The Fortune at the Bottom of the Pyramid* (Wharton School Publishing, 2005). This article, which was in progress at the time of his death, is published with the permission of his family.

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Most companies are still organized as they were when the market was largely concentrated in the triad of the old industrialized world: the U.S., Europe, and Japan. These structures lead companies to continue building their global strategies around the trade-offs and limits of the past — trade-offs and limits that are no longer accurate or relevant.

One of the most prevalent and pernicious of these perceived trade-offs is the one between centrally driven operating models and local responsiveness. In most companies, an implicit assumption is at play: If you want to gain the full benefits of economies of scale — and to integrate common values, quality standards, and brand identity in your company around the world — then you must centralize your intellectual power and innovation capability at home. You must bring all your products and services into line everywhere, and accept that you can't fully adapt to the diverse needs and demands of customers in every emerging market.

Alternatively (according to this assumption), if you want locally relevant distribution systems, with rapidly responding supply chains and the lower costs of emerging-market management, then you must decentralize your company and run it as a loose federation. You must move responsibilities for branding and product lineups to the periphery, and accept different trade-offs: more variable cost structures, fewer economies of scale, more diverse and incoherent product lines, and more inconsistent standards of quality.

Some companies try to use strict cost controls to manage these trade-offs. They put in place a decentralized operating model with some central oversight, usually augmented by outsourcing. But this is a tactical move based on expediency, rather than a global strategy. This approach leads to suboptimal results in today's complex world.

Other false trade-offs are visible in the tension many companies experience between their current business model and the needs of the emerging markets they are entering. They wonder:

• Whether to serve existing customers in their home countries or new customers in emerging countries.

• Whether to meet competitive quality standards demanded by consumers in wealthy countries or offer just the "good enough" features that poorer customers can afford.

• Whether to pursue a strategy of premium or discount pricing.

• How to attract and retain resources and talent, which are perceived as draining away from emerging markets to the industrial world whenever employees are permitted to migrate.

• Whether, in using resources strategically, to follow the typical Western orientation (toward reducing labor and accumulating capital) or the view from emerging markets (where labor is inexpensive, capital is difficult to accumulate, and therefore it is worth investing in building large workforces for growth).

Corporate leaders expect to have to make stark choices as they expand. But the time has come to embrace a new business model that encompasses both the established advantages of industrial markets and the opportunities of emerging economies. (Also see "Competing for the Global Middle Class," by Edward Tse, Bill Russo, and Ronald Haddock, *s+b*, Autumn 2011.) Instead of struggling to apply a Western business model everywhere, you can adopt a business model that treats decentralization, centralization, current prac-

Instead of struggling to apply a Western business model everywhere, you can adopt a business model that treats decentralization and centralization not as trade-offs, but as complements.

tices, and potential disruptions not as trade-offs, but as complements.

In a previous article, "Twenty Hubs and No HQ" (*s+b,* Spring 2008), we proposed an essential part of this business model: a global corporate structure with no headquarters. Instead of a single center, companies would establish core office "hubs" in many or most of the 20 gateway countries in the world that house 70 percent of the world's population and account for 80 percent of its income. These 20 countries include 10 from the industrialized world: Australia, Canada, France, Germany, Italy, Japan, the Netherlands, Spain, the United Kingdom, and the United States. The other 10 are emerging markets: Brazil, China, India, Indonesia, Mexico, Russia, South Africa, South Korea, Thailand, and Turkey.

A hub strategy enables a company to provide products and services everywhere. But it will not in itself resolve the trade-offs of globalization. Companies can accomplish this only with a more comprehensive business model that (1) customizes their products and services in hubs around the world, (2) unites business units around a platform of proprietary knowledge and the building of competencies, and (3) arbitrages their operating models to gain cost-effectiveness, productivity, and efficiency.

An Operating Model without Trade-offs

Some companies are already following these three imperatives, pursuing all of them simultaneously. Among those that we have studied in detail are Toyota, Marriott, McDonald's, GE Healthcare, and several global cellular telephone companies. Leaders in these enterprises have trained themselves and their teams to be very deliberate about where to customize, how to build competencies, and what to arbitrage. With this type of operating model, there is no longer a need to choose between a centralized and a decentralized structure, between current and future customers, or between a strategy grounded in industrialized economies and one grounded in emerging economies.

To illustrate these three imperatives, we draw on the experience of GE Healthcare (customization), McDonald's (competencies), and the Chinese and Indian mobile telephone industries (arbitrage). It's important to remember, however, that all these stories involve integrating all three elements — a rare feat. Only with the full operating model can a company gain the benefits of decentralization, centralization, and outsourcing without making compromises.

• **Customization.** The key to this imperative is to deliver products and services in a locally competitive way. That means they must satisfy the needs and wants of diverse customers, in terms of features, affordability, and cultural affinities. Because needs and wants vary greatly among people at different income levels, this objective is complex and expensive to reach in any centralized way. That is why companies must leverage the diversity of a decentralized structure.

Is there a simple and coherent way to deliver customization to customers in 200 countries spread over five continents? The answer is yes, through the hub system: Companies customize only in a maximum of 20 gateway countries. With this limited investment, they can serve customers everywhere, on every level of the income pyramid, from the wealthiest to the poorest. These 20 countries have enough scale in themselves to offer the necessary economies and growth potential.

The menus at McDonald's restaurants vary widely around the world, while unity remains firmly entrenched where it should be — in branding, technology, and business processes.

They are also well equipped with skills: Manufacturers of goods will find the suppliers and employees they need to meet reliable quality standards in operations, and they will also find innovation and R&D facilities already existing there. The logistical and institutional infrastructure is well developed in most of these gateway countries, integrated into international regulation and trade. Each gateway country can independently perform most necessary business activities; when linked together, they make up a formidable network.

Many companies will settle on fewer than 20 hubs; each industry requires a different selection of gateway countries to meet differing tastes and needs. Reducing complexity in this way also dramatically reduces a wide range of overhead costs for large global companies, while enabling them to travel the last mile to customers. For example, by trimming back supervisory layers to only those needed by the gateways, companies can cut overhead costs significantly.

GE Healthcare's story illustrates how expanding through a few gateway countries enabled it to thrive in many locations. Its primary business is high-end medical imaging products. In the late 1980s, GE Healthcare started investing in ultrasound machines, designing separate devices for use in obstetrics and cardiology. Over time, the business became a market leader, with a portfolio of premium products employing cutting-edge technologies, sold primarily to big hospitals in rich Western countries.

Very few devices made by GE Healthcare were sold in China and India in the 1990s, although the medical need was enormous and the region represented a huge potential market. In these large but poor countries, the general population relied (and still relies) on poorly funded, low-tech hospitals and clinics in small towns and villages. None of these organizations could afford sophisticated, expensive imaging machines. There was a significant need for customization: Someone needed to create low-priced machines with basic features that were easy to use. The devices also needed to be portable, so that medical workers could bring the machine to the patient, rather than the patient to the machine.

GE Healthcare started a major effort in 2002 in China to tackle this problem. The initiative was favored by a corporate policy put in place a few years earlier: reorganizing some emerging-market enterprises into semi-autonomous "local growth teams" with their own P&Ls. This meant that GE Healthcare could now create a local business oriented to China's particular needs and advantages, drawing on local talent and combining product development, sourcing, manufacturing, and marketing in one business unit. The price of a conventional Western ultrasound machine is between US$100,000 and $350,000. GE's first portable machine for China was launched at a price of only $30,000, and by 2007 a newer machine was on the market for $15,000. Sales took off in China and then in a few other emerging-market gateway countries.

Soon, customization worked in the other direction. Applications were found for these devices in several rich countries as well, at accident sites and in clinics and emergency rooms. Sales rose from zero to more than $300 million in five years. In 2009 — as recounted by GE chief executive officer Jeffrey Immelt and innovation experts Vijay Govindarajan and Chris Trimble in the *Harvard Business Review* in October 2009 — GE announced that "over the next six years it would spend $3 billion to create at least 100 healthcare innovations that would substantially lower costs, increase access, and improve quality."

• **Uniting around a platform of competencies.** This initiative means aligning your entire global company with a common core purpose, a body of proprietary world-class knowledge, and the competencies that distinguish your company from all others.

The core purpose must be understood equally in all functions and geographies of the corporation. Every individual should know the strategic principles of the business — which are the same around the world, but adapted differently in each locale. For example, providing "everyday low pricing" is the core purpose of Wal-Mart Stores Inc. Although that principle remains constant, the implementation varies considerably; Walmart in India is a joint venture wholesale operation, and Walmart in Mexico operates restaurants and banks as well as superstores.

The core competencies at the heart of this platform include proprietary technology and intellectual property. These are the unique pieces of knowledge and know-how that distinguish any company — not the applications or technologies, but the standards and platforms of knowledge that the company creates and makes its own. They may include manufacturing processes, supply chain and logistics systems, customer insight–gathering processes, or distribution and access systems. They are made available to all operations, everywhere in the world, and are used to customize offerings and arbitrage procurement and costs.

At the McDonald's Corporation in the mid-2000s, this type of unity represented a dramatic shift away from the rigid hierarchies, brands, financial performance metrics, and reporting relationships of its old centralized model. The restaurant chain had embodied the centralization model for many years. Every aspect of the system had been standardized around the world: brand identity, product offerings, packaging systems, franchise arrangements, and the design of the stores. All this had come out of a single manual, and the company's rigidity had helped it prosper, because it was seen as exporting an image of the American lifestyle.

But standardization began to reach its limits around 2001. There was a distinct shift in consumer taste toward healthier, more nutritious foods. In the U.S., fast-food restaurants in general and McDonald's in particular were blamed by many for the emerging obesity epidemic, especially among American children. Customers started switching to other chains. In the rest of the world, McDonald's was identified with American tastes, and seen as being out of sync with the needs of non-U.S. consumers.

The McDonald's leadership responded by creating a new platform on which the company could unite: not standardization, but a common thrust to provide fresh food, healthier menu options, and customized offerings for different cultures. Product offerings were no longer centralized, and the menus at McDonald's restaurants vary widely, while unity remains firmly entrenched where it should be — in branding, technology, and the business processes that gave the company its differentiation, cost bases, and productivity. The brand logo, color schemes, and store layouts are the same around the world. Procurement and distribution systems are centrally managed to ensure that deliveries take place on time to more than 32,000 individual restaurants. Structured training from a common playbook is given every day to store associates in all locations. The company's proprietary knowledge remains centrally and rigidly controlled.

• **Arbitrage.** The final imperative involves gaining effectiveness and reducing cost by finding less expensive materials, manufacturing processes, logistics systems, funds sourcing, or infrastructure. Most companies have addressed this tactically, by offshoring back-office work or moving manufacturing to locations with lower-cost labor. This is generally a defensive or reactive move, rather than a well-considered strategy.

An arbitrage initiative is much more systemic. The business looks at its production flow and disaggregated cost chain as a whole, seeking optimized sourcing, sales conversion, and go-to-market options. The initiative approaches materials, factory locations, and people as part of a single system, taking into account the processes and procedures within the most important hubs, and among hubs as well.

The history of mobile telephony in China and India provides a good example of the power of arbitrage. These two countries together have more than 1 billion cell phone users, and the number of new connections in India alone exceeds a staggering 10 million a month. In the early 2000s, the groundwork for new networks in China and India was laid by a few farsighted telephone companies. At that time, landline networks were sparse, and the number of homes with phone lines was a minuscule fraction of the total households. The only way to build a profitable phone system was to create "network value": access to enough other people and institutions to make the system feel indispensable. This meant providing telephone access to millions of prospective customers who had never used a phone, who lived on $2 a day, who had no money to buy the phones outright, and who lacked the bank accounts and credit cards that would allow them to sign service contracts.

The pricing structures reflected these realities. In India, for example, Reliance Industries Ltd. (a large nationwide conglomerate) sold Nokia and Motorola handsets for as little as $10, lowered call rates to two cents per minute for these phones, and sold prepaid cards that customers could use both to pay for and to ration their telephone use. It took skillful collaboration among cell phone manufacturers and carriers to accomplish the arbitrage needed for them to offer such prices. Manufacturers such as Nokia, Motorola, and Samsung offered their products, product knowledge, and R&D capability at a reduced cost; carrier companies such as Vodafone, China Mobile, and Airtel invested in cell phone towers and switching equipment with minimal return at first. Then Airtel in India took a hugely innovative step. Realizing that its own capital for network expansion was constrained, it brought in Ericsson, Siemens, Nokia, and IBM as network equipment and IT vendors, convincing them to forgo their ordinary fee structures. Instead, Airtel paid these companies on the basis of usage and revenue. Airtel thus converted fixed infrastructure costs to variable costs and improved its ability to offer low prices to customers.

Another form of arbitrage, deploying the most inexpensive marketing and distribution channel available, was an essential factor in creating a mass mobile phone market. Reaching people in remote Chinese or Indian villages was a huge challenge. Little grocery shops, often housed in temporary structures, were often the only commercial channels available to consumers there. These stores sold everyday-use products such as soap, cigarettes, and matchboxes. Instead of creating a new channel of dedicated telephone stores, the phone companies established partnerships with these outlets; they stocked and sold the prepaid cell phone cards. This would never have happened if the telcos had followed their old pricing and distribution models.

Bringing the Elements Together

Some companies recognize the benefits of customization; they are moving into new geographies through gateway countries. A growing number of companies are uniting around platforms of competencies. And, of course, many companies practice arbitrage. But until they join the few pioneers that combine these three elements, most companies will not get the full payoff of the new operating model. Indeed, the three cases described in the previous section are successful precisely because they integrated all three elements.

For example, GE Healthcare had to drop the price of its ultrasound machines by more than 90 percent in order to have its products accepted in emerging markets. Its solution involved not just customization, but arbitrage: It used an ordinary laptop computer instead of proprietary hardware. These machines did not have many of the features of their expensive counterparts, but they could perform such simple tasks as spotting stomach irregularities or enlarged livers or gallbladders. This made them critical tools for doctors at rural clinics. The laptop-based design, in turn, drew heavily on GE's platform of competencies: specifically, experience with other projects that had shifted from using custom hardware to using standard computers. The new devices also incorporated breakthrough ideas from scientists in the GE system with deep knowledge of ultrasound technology and biomedical engineering.

Similarly, the McDonald's story did not only involve unity around a platform. The company also saw the power of customization. Today, McDonald's offers rice burgers in Taiwan, vegetarian entrees in India, tortillas in Mexico, rice cakes in the Philippines, and wine with meals in many European cities. McDonald's also extended its already impressive arbitrage capabilities through sophisticated sourcing and distribution practices, tailored to each location's opportunities.

The arbitrage in the Chinese and Indian mobile phone story also depended on the other two elements. Although the prices were low, the equipment was standard quality; networks had to seamlessly integrate with the world's telecommunications systems. The companies involved, including the vendors such as Siemens, Motorola, and Ericsson, drew upon their platforms of proprietary knowledge to make it work. Everyone customized relentlessly, varying the payment plans, the amounts coded into phone cards, and the services offered to support the different needs and interests of telecom users in each country.

For another example of the way these three elements can be deliberately combined, consider the case of Marriott International Inc. Throughout most of its history, the company followed a centrally driven strategy with tight controls over the look and feel of its properties. But the company was also willing to experiment. For example, in 1984, it was the first hotel chain to offer timeshare vacation ownership.

Like McDonald's, Marriott learned the problems of rigorous centralization firsthand. In 2001, when it opened a timeshare in Phuket Beach, Thailand, the venture failed. Gradually, Marriott realized that the reason had to do with cultural differences: Asian tourists, especially the Japanese, want to visit multiple places during a single vacation. They typically stay two or three days in one location and then move on. This made them very different from Marriott's U.S. and European holiday travelers, who prefer to stay in one place for a week or more. In 2006, the hotel chain launched a timeshare network called the Marriott Vacation Club, Asia Pacific. Customers could hop among locations, spending their annual club dues anywhere in the network. This customization initiative turned a failed project into one of the company's fastest-growing businesses.

In initiatives like this, Marriott draws on its central strengths, including a devotion to knowledge at starts with the CEO (and son of the founder) J.W. ("Bill") Marriott Jr. In his 1997 book, *The Spirit to Serve: Marriott's Way* (with Kathi Ann Brown; HarperBusiness), Marriott wrote, "Our principal product is probably not what you think it is. Yes, we're in the food-and-lodging business (among other things). Yes, we 'sell' room nights, food and beverage, and time-shares. But what we're really selling is our expertise in managing the processes that make those sales possible." This approach is reflected in Marriott's strong "spirit to serve" philosophy and its highly centralized recruiting approach for seeking out dependable, ethical, and trustworthy associates. The company is known in the U.S., for example, for its robust efforts to train welfare recipients to make a permanent transition into the workforce, and worldwide for its extensive profit-sharing practices and human resources support.

The company's collegial culture allows it to pare back the expenses of oversight and supervision; everyone naturally pays attention to cost and efficiency. Marriott also demonstrated its facility for arbitrage through its early adoption of the Internet as a vehicle for making and confirming reservations.

Many CEOs and top managers are still asking themselves when the bad times will end. No one has the answer, and even in a robust recovery, competition will not slacken. A better question is, What can we do now to establish ourselves in the new global economy? Consumer-oriented companies will need to deliver world-class quality in their products and services, customized for purchasers in multiple locales and circumstances, with significant price reductions (affordable to people at the lowest income levels). They must also provide their customers varying forms of access (owning, renting, or leasing equipment). This cannot be done when a company is striving to balance decentralization and centralization. It can be accomplished only by companies that transcend the old trade-offs and seek operating models that allow them to serve the largest numbers of people while meeting the highest possible standards. +

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