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Igniting Growth

Tony Manning talks to Pankaj Ghemawat

Pankaj Ghemawat is a professor and head of the Strategy Unit at the Harvard Business School. In 1991, he was appointed the youngest full professor in the School's history. His current teaching and research focus on globalization and strategy, and he has written more than a dozen cases and a dozen articles or working papers on this topic. He is currently writing a book on this broad area. He is also the author of *Commitment* (Free Press, 1991), *Games Businesses Play* (MIT Press, 1997) and *Strategy and the Business Landscape* (Addison Wesley Longman, 1999). Tony Manning interviewed him in his office at the Harvard Business School.

Manning: What in your view are the major challenges facing companies in developing countries like South Africa?

One issue is whether firms expand north into the region, or look farther afield. And clearly it varies by product.

There might not be a whole lot of growth out there – the opportunity to double in size – for many companies that are already big in South Africa. And recent geopolitical developments can not have made this look a much a rosier prospect, but rather the reverse. So the question of where to go is not an obvious one.

A key issue is what resources are needed to attack the rest of the world. And that requires a lot more than, "We're going to go global; we're going to be everywhere."

There is a misguided sense that everything is converging at a relatively rapid rate, that the stopping point is global ubiquity, so it's not that important where you go because ultimately it's all going to be one big thing. My guess is that we're still a long, long way from that. Questions about where you're going to go outside of your home market are a lot more interesting than extreme globalisers would have us think.

There's a very large body of literature in international economics that does what we call "gravity modeling." It's based on Newton's law, and says that the amount of trade or economic activity you should expect between a pair of countries is probably related to how large they are, divided by some measure of the distance between them. Not just geographic distance, but also cultural distance, administrative distance, economic distance.

Manning: And your fundamental question is, "Can we actually do this? Is China, for example, really feasible for us?"

Yes. And the answers are clearly going to be different according to the industry you're in.

If you're selling cement, you have one set of challenges. The product is standardized. You don't face much in the way of cultural issues. So it's really a matter of geographic optimization, of how you control the trade flows, what kinds of markets are interlinked in terms of having seaborne

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shipment possibilities, and so on. TV programming, on the other hand, is all about culture and political sensibilities.

Manning: Does it make sense to focus on regions, rather than take a global view?

In most regions, two-thirds or more of international trade occurs *within* the region. So while regionalization sounds like an old strategy, it is actually an unexploited tool. A growing number of companies are thinking about strategy in regional rather than global terms. There's a lot of discussion about how much variation you should allow across various regions, what kind of structure you should put in place, and particularly how the role of regional headquarters is changing.

Manning: How are companies changing?

There are a couple of models. You might disperse resources across regions and have coordinating links across those regions, with the regional HQ acting as a facilitator. Or you might confine your primary strategy to one region and deal with everything else opportunistically – which means that you need a differentiated structure within the organization. One regional setup will look different from the others.

There are also platform approaches, where you might have global product development, but a very significant regional overlay that gives you some of the benefits of customization without all the costs of a localization strategy.

Manning: So you need a very serious look at how you reconfigure the organization?

It's a question of how you relax some of the trade-offs between global integration and national responsiveness. Of how you push that frontier out, by aggregating countries so there's relative homogeneity within each clump. You need to get beyond the very simple question of whether to standardize worldwide or let country managers decide what to do.

Manning: You need processes that "travel"?

Yes. In Africa, for instance, with the exception of Nigeria, very few countries are individually likely to be large enough to support any major expansion. The size of markets is a constraint. There are sub-scale penalties in a country by country approach. So you need to ask, are there possibilities for grouping activities, for doing things differently.

Manning: How important is infrastructure?

It's absolutely fundamental. But in developing economies, the importance of enabling institutions – and of understanding what the institutions are that permit businesses to thrive – is often unappreciated. Poor institutions can have a chilling effect on growth, on foreign trade, on FDI.

I've been to Nigeria several times, and I really enjoy it because I learn a lot more there than if I go to Omaha. It reminds you how important institutions are. When they're almost absent, you realize how much of what we take for granted is essential to making business work. Without it, things just collapse.

Manning: What's the role of business in developing these institutions?

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The notion that government by itself will ensure that the right infrastructure will be created is just silly. The role that De Beers has played in Botswana – one of the African miracle cases – has clearly been very important. However enlightened the government was, it didn't do everything on its own. There's been a vital private sector component too.

Manning: So corporate social investment might well be a strategic necessity?

Absolutely. Businesses have to step in and do something – especially where government capacity is lacking.

Manning: What about government challenges?

Infrastructure, obviously. Then there's the need to figure out how far integration is compatible with domestic political constraints of various sorts.

The notion that countries can have political independence and be economically integrated doesn't seem to work that well. You do have to surrender controls over capital flows, and so forth, for complete integration to occur. I think this is a little more obvious now, compared to the heady days after the Berlin Wall fell. Economic realities might not trump political constraints, but it helps if people understand these things.

Manning: And what about people? What's needed there?

From the government's side, the first couple of years of education bring enormous social returns. Business has a role to play in developing more specialized skills. Business has a role to play in helping seed and support business schools. Partnerships between businesses and business schools are essential. Research needs to be fostered that's relevant to the local context.

Academics care mostly about their research community. That community – at least at the top end – is international. The amount of attention it will pay to issues of "local interest" is relatively low. So it's unrealistic to expect really interesting research to come out of business schools without much more business involvement.

Manning: What about governance issues when you travel across boundaries?

Well, one question is, to what extent do you apply the same standards across regions? Is there some common denominator that you're working towards?

What happens when regulations, or even norms, differ across jurisdictions? Do you apply the same ethical standards? The answer in the U.S. is, "Of course. Ethics knows no boundaries." But what if there's a big difference between environmental standards in your home country and those in your host country? Do you hold yourself up to that higher standard, or do you realize that you're pricing a whole bunch of people out of jobs?

One of the big puzzles in international finance is why so many companies hold so much cash in so many places around the world as opposed to having a centralized treasury function that optimizes everything.

So how do you set yourself up to optimize financially across jurisdictions? This is administrative arbitrage. What minimal internal standards do you want to set up? Can you feel comfortable taking advantage of the differences?

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There is enormous institutional variation and all kinds of stickiness in terms of capital transfers. So even though financing becomes closest to being the activity that you should take a global perspective on, it's dependant on local regulations, tax consequences, and so on.

The notion that governance choices can be made independent of knowing what some of the barriers are to money moving back and forth is a little naïve. You can't do it in a strictly idealistic or moral sense without thinking very realistically about the financial constraints that companies face.

Indian software firms have had to push governance hard – and that's been a major force for improvement in governance – because they want to tap foreign capital markets. Companies like Wipro, Infosys, and TCS have all had to consider very different standards of behaviour.

Internationalization occurs across many dimensions. These things have potentially serious consequences for how you're governed and organized.

Manning: How do you see the impact of affirmative action?

Time and time again, we set targets that ignore the realities of pipeline effects. What I'm always struck by even in small organizations is how long the time line is. It's easy to underestimate the difficulty of the process and just how big the lags are. It's hard to achieve numerical targets for "stocks" by tinkering with "flows" that aren't very large.

In India, the process started off back in the mid-80s, well motivated by a Prime Minister who decided he was going to reserve 40 per cent of jobs for our backward or scheduled castes. This meant that for years the government wasn't supposed to hire anybody, except from those castes. So it was an enormously divisive thing.

We had many, many people getting jobs who were not very competent. That had nasty social ramifications. There's also been a total mismatch between what we have and the jobs that need to get done. And there have been all kinds of unproductive things going on.

You've had upper class Hindus getting themselves into some kind of backward class status just as a way of gaming the system. The states where this has been pushed most energetically are also the ones – partly, but not entirely for this reason – where we've had some of the worst economic stagnation, corrupt state governments, and so on.

I'm a supporter of affirmative action. But it's my sense that when people set targets, they usually do not think dynamically about stocks and flows.

Manning: There has to be some trade-off between consequences.

Of course. It has to be very carefully thought out. It's not too hard to get outcomes that are nearly as bad as what you started with by simply having numerical goals that do not take account of time lags.

The other thing that I've observed about affirmative action is that we all wind up chasing after the very small number of people who meet the guidelines. So there's a distributional issue. A small number do very well.

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The quick fix says put in a target, but the longer-term social fix is much harder. You have to avoid 15 years of leakage early on in the educational process that reduces you to a very narrow pool that everyone's fighting over. You have to focus on expanding the talent pool, not just on chasing the same talent pool.

Manning: How tightly should a firm be embedded in its local environment?

There's a presumption that sectors with strong linkages with the rest of the economy are the ones that really help a country upgrade, and therefore are the ones a government should concentrate on. Something like steel for example, with lots of vertical linkages. So governments rush in, screw up the steel industry, and manage to condemn the entire industry. In the process, they also condemn entire downstream sectors.

When you have a generally uncompetitive institutional and physical infrastructure, it's the industries that can technologically detach themselves form the rest of the economy that have the best hope of raising their heads above the water line. Industries with very tight linkages have real difficulties.

Michael Porter and I spent a lot of time looking at India in the mid-1990s and what we found was that the industries that were the real success stories, in terms of international expansion whether through exports or FDI were actually sectors with relatively weak linkages to the rest of the economy.

Tony Manning is an independent consultant in competitive strategy and change management. He was formerly Chairman of the IOD. His latest book is *Tony Manning's Management Toolkit*. He can be contacted at strategist@tonymanning.com.