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The Forgotten Strategy

Key ideas from the [Harvard Business Review](#) article By Pankaj Ghemawat

The Idea in Brief

Multinationals' global operations consistently underperform their domestic operations. Why? These companies' strategies focus mostly on *similarities* across their markets: whenever possible, global companies standardize their business models to achieve economies of scale. They view regional differences as obstacles to be overcome—not opportunities to be leveraged.

This perspective, says Ghemawat, blinds firms to a contrasting strategy: **arbitrage**, the exploitation of *differences* (in culture, administrative practices, geographic distance, and labor or capital costs) across markets. Top-notch companies seize advantage of such differences *while also* leveraging similarities that create scale.

Consider Cemex. The Mexico-headquartered cement maker arbitrated differences in the cost of capital across Mexico and the United States by listing itself on the New York Stock Exchange (thereby mitigating "Mexico risk"). Yet it also standardized its production-to-distribution chains in major markets. Today, Cemex is the world's most profitable international cement manufacturer.

The Idea in Practice

Ghemawat suggests considering four arbitrage strategies:

Cultural. Cultural arbitrage exploits differences in culture across countries or regions.

Many consumers associate Brazil with football, carnivals, beaches, and sex. Canadian brewer Molson exploited this cultural difference by launching in the Canadian market "A Marca Bavaria"—a superpremium beer imported from Molson's Brazilian subsidiary. Molson uses the product's association with Brazil's high-energy, sensual image to target 19- to 24-year-old men.

Administrative. Administrative arbitrage exploits legal, institutional, and political differences across countries.

Through the 1990s, Rupert Murdoch's News Corporation incorporated about 100 subsidiaries in havens with no or low corporate taxes and limited financial disclosure laws. Result? It paid income taxes at an average rate of less than 10%—compared with the statutory 30% to 36% rates of the three main countries in which it operated (the United States, Britain, and Australia). And by placing its U.S. acquisitions in holding companies in the Cayman Islands, the company could deduct interest payments on offshore debt against the profits generated from its home operations in Britain.

Geographic. Geographic arbitrage takes advantage of the impact of physical distance on transportation and communication costs.

The cost of air transportation has declined more than 90% in real terms since 1930—more sharply than older modes of transportation. The drop has enabled the Netherlands' Aalsmeer international flower market to thrive. Every day, more than 20 million flowers and 2 million plants are auctioned off through this market. Blooms flown in from as far away as India are sold to customers in the United States or Europe on the day they arrive.

Economic. Economic arbitrage strategies exploit cross-country differences in economic factors such as cost of labor.

Headquartered in a cheap labor market, Brazilian regional jet manufacturer Embraer focuses its internal operations on final assembly, which is the most labor-intensive part of the production process. It outsources other activities (such as R&D) to its supplier partners. Its employment costs came to \$26,000 per employee in 2002, versus an estimated \$63,000-per-employee cost of its chief rival, Canadian-based Bombardier.

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Further Reading

Article

[Beyond Offshoring: Assess Your Company's Global Potential](#)

Harvard Business Review

December 2004

by Diana Farrell

This article focuses on economic arbitrage—moving jobs to lower-wage locations to take advantage of differences in labor costs—as a complement to standardization. As Farrell explains, this strategy can save your company significant money. But be sure that its allure doesn't distract you from the bigger advantage offered by an expanding global economy: translating cost savings into new forms of value for customers—and generating explosive revenue growth.

How to achieve these gains? First slash costs by streamlining production processes and supply chains globally. For example, a payments processor in a low-wage environment could hire people to input checks into a computer rather than purchase expensive imaging software. Next, use the resulting savings to serve customers better or reduce prices on your offerings. You'll fan desire for your products, attract new customers, and break into fresh markets. For instance, after establishing

lower-cost offshore call centers, U.S. financial institutions found they could profitably provide personalized phone support even to small-account customers.

About the Author

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