

Should You Have a Global Strategy?

A globally integrated strategy isn't right for every company. One important factor to consider is the combined market share of the largest companies in your industry—and how that's changing.

BY CHRIS CARR AIMD DAVID COLLIS

Senior executives weighing strategies appropriate for today's global economy will hear contradictory advice. Some say you need to move quickly, before competitors, to establish a worldwide presence; others cite data showing that this approach is often less profitable. Those making the case for taking a global approach, including Thomas L. Friedman in his book *The World Is Flat*, argue that success requires treating the world as a single entity. Those advocating a more geographically restricted, regional strategy say that the world is, at best, semi-integrated, and that smart companies can capitalize on regional and country differences. The reality is that neither approach is appropriate for every circumstance. Therefore, executives need to understand when to pursue one route and when to pursue the other.

In our view, the criteria need to be tied to the dynamics of the particular industry, specifically the concentration levels of the four largest competitors (what we call the global concentration ratio, or CR4). Our analysis of 50 industries reveals extremely high global concentration ratios — averaging 50%, which is 1.5% higher than eight years earlier. The small increase does not by itself say that industry is becoming more global. In fact, it conceals dramatic differences from industry to industry: Some, such as steel and cement, have seen huge increases in concentration; others, such as autos, have actually seen declines. To appreciate the strategic implications, we frame and describe four competitive scenarios, according to the level of the global CR4, and whether it has been rising or falling. (See "Global Concentration Trends By Industry," p. 22.) Each scenario offers a different opportunity for profit and different implications for how companies can compete.

A Case for Globalization

Economists such as Frederic M. Scherer and David Ross found that by the time the four largest players in a domestic industry achieved a combined market share approaching 40%, they had fully recognized their interdependence. Attempts by one company to increase market share would spur responses from rivals, encouraging oligopolistic collusion. Similarly, by the time global industry concentration reaches the 40% point,



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we think leading players need to acknowledge their interdependence and adopt a global strategy. Even where the level of concentration is lower but where the CR4 is increasing and beginning to approach the 40% threshold, managers can still make a compelling case for globalization.

When airplanes first broke the sound barrier, test pilots had difficulty controlling their aircraft (indeed, several crashed) until engineers realized that control principles as we approach and surpass the sound barrier are different from those below it. We see an analogous phenomenon occurring with companies' understanding of industry concentration. Traditionally, economists treat

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falling global concentration as a sign of international fragmentation and competition that is not truly global. However, once industries approach the critical 40% threshold, the decline can also mean that global incumbents are being challenged by new competitors and that global competitive wars are breaking out in earnest.

In the context of the global economy, concentration levels tend to decrease when countries that had been outside the established international marketplace become major markets. Indigenous companies often succeed at developing strong positions within their home markets and then use those positions to gain global market share. For example, Haier Group, the Chinese consumer electronics and home appliance maker, parlayed its domestic

cost advantages and business model, developed to meet market needs in China, into a growing market share elsewhere. Such gains don't foreshadow the demise of globalization; rather, they suggest that incumbents need to develop global strategies to confront threats from emerging global competitors.

The world automobile industry offers a useful example. This market has become slightly less concentrated in the past two decades. However, if anything, the current level of competition in Asia and the extent to which competitors such as South Korea's Kia and Hyundai have made market inroads in Europe and North America point to an increasingly dynamic industry. Indeed, the cozy global oligopoly that provided a protective umbrella to weaker

international players has given way to all-out global war.

Reading the Data

Global concentration levels and changes in these levels can help point companies to the most effective strategies. Based on our analysis of industry data, we have identified four contexts and likely evolutionary paths:

Global oligopolies. Industries with global concentration ratios above 40% and increasing concentration levels are "global oligopolies." In such industry environments, oligopoly power is both high and increasing as incumbents attempt to leverage their scale advantages.

Global wars. Industries where the concentration is above 40% but where the concentration level is decreasing have a different dynamic, one we call "global wars." In these settings, incumbent global champions are ceding market share to aggressive new rivals.

Regional and national terrains. Industries where concentration levels are below 40% and where concentration is low or declining (as is common in the service sector) tend to be organized either regionally or nationally as opposed to globally.

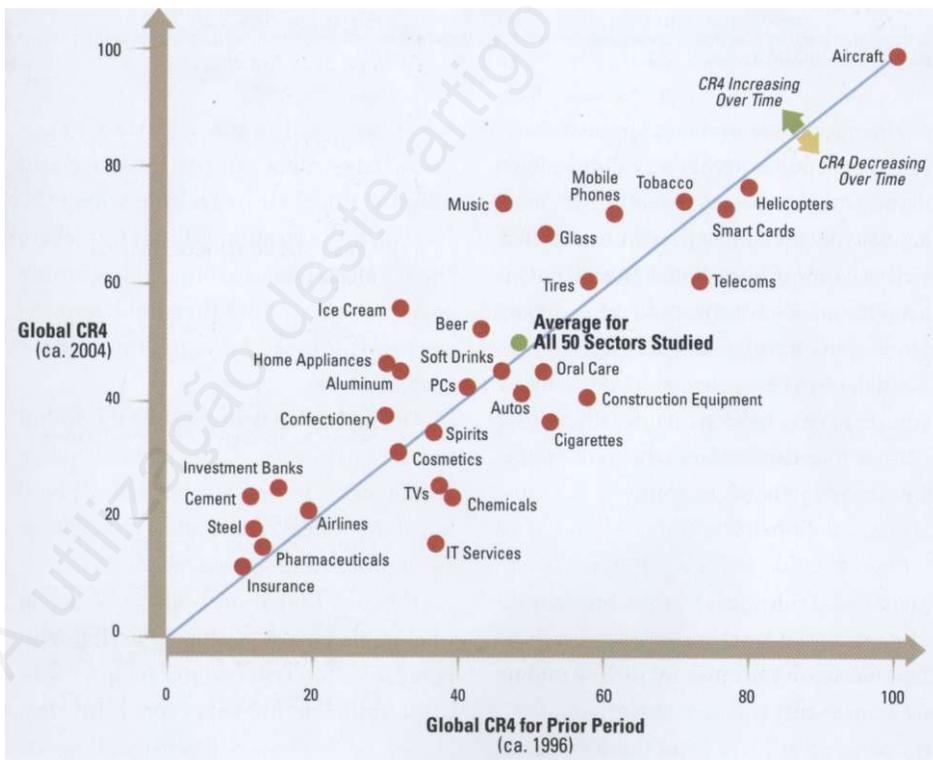
Shifting terrains. Industries where changes are in motion and concentration, while modest, may be growing rapidly (for example, steel) can be described as shifting terrains. In these sectors, companies should pay careful attention to the shift from local to global strategy.

Since the nature of competition differs from industry to industry, the strategy recommendations vary. However, managers should be wary of dismissing scenarios other than their own as irrelevant. Patterns of evolution are dynamic; terrains often undergo significant changes as globalization proceeds.

Global oligopolies. The global oligopolies terrain is a relatively forgiving environment for companies at this stage of industry evolution. Indeed, given the generous profit

GLOBAL CONCENTRATION TRENDS BY INDUSTRY

Industry concentration levels are defined by the cumulative global market shares of the top four players (the CR4). The more recent CR4s are shown on the vertical axis. Time periods vary, but we show the concentration levels from an earlier period (about eight years prior) on the horizontal axis. If a sector is above the 45 degree diagonal line, global industry concentration levels have been increasing. (Note: Not all industries studied are displayed here.)



margins, it could even prove hospitable to weaker international players. There are three main ways to become a participant in this industry structure, each of which requires international integration.

The first way to become a major player is through innovation in developing new industry sectors. For example, in digital technologies, Microsoft, Google and Facebook were quickly able to establish dominant positions. Each scooped up a huge global industry profit share through winner-takes-all effects, although outright monopolies are not permitted and advantages based on innovation are difficult to sustain.

The second way is to leverage scale and specialization, as is often demonstrated by incumbents in capital-intensive businesses such as aerospace, glass, domestic appliances and tires. In appliances, Whirlpool and Electrolux, for example, leveraged domestic scale before expanding their geographic footprints to further economies of scale; Haier, for its part, has more recently leveraged its focus on smaller and lower-priced products, together with its labor cost advantages and scale, afforded by China's huge, fast-growing market, to become No. 4 in appliances, following the purchase of Sanyo's appliance division.

The third approach is ambitious global consolidation using mergers and acquisitions. The beer industry provides a good example. Until the 1990s, beer was largely a domestic business; national players such as Bass in the United Kingdom and Anheuser-Busch in the United States were extremely profitable. Then a few players, such as Scottish & Newcastle in Europe and South African Breweries in Africa, began to build regional market positions through acquisitions. Within a few years, global consolidation reshaped the industry. SAB acquired Miller; Heineken and Carlsberg divided up S&N; Brazil's AmBev merged with Belgium's Interbrew, then Anheuser-Busch. Every substantial national player in the United Kingdom, France and the United States has disappeared.

Overall, the first approach still tends to be the preserve of highly innovative players from advanced "Triad" regions (the United States, Europe and Japan/Korea); but notice how new emerging country champions are increasingly following suit on these second and third approaches to exploit any complacency by traditionally powerful incumbents.

Global wars. Even while global concentration falls within an industry, the total number of industry incumbents often declines in this scenario. In competitive global businesses, there have to be losers; while the market leaders might only lose share, companies that managed to survive as national or regional champions find it increasingly difficult to hold on, largely because of overcapacity. Such industry reshaping has recently occurred in autos. Indeed, the total number of auto manufacturers has declined steadily since World War II even as the new competitors from Japan, Korea, China and India have gained share.

Regional competitors in this scenario can improve their ability to compete through international alliances and acquisitions, but to be credible players, they must commit themselves to genuine cross-border integration. Ultimately, they need to be prepared to join forces with a global leader. Chrysler will almost certainly fare better in a global partnership with Fiat than under Cerberus' ownership. Loss of sovereignty is a tough decision for any management team, but life does not end after integration.

For new contenders in such globally competitive markets, learning to leverage innovative domestic business models through organic growth can be the most successful globalization path. Toyota and Honda provide good examples. Indeed, given the challenges of post-merger integration across continents, the last thing newcomers should attempt to do is imitate traditional players.

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Regional and national terrains. Global consolidation is still not appropriate in many parts of the economy where the underlying economics support small, localized competitors owing to low-scale economies, greater logistical costs, differences in cultures and consumer tastes, or most importantly, continuing regulatory or governmental barriers. These include home building, railways and service businesses, such as hairdressing and

case study. Long a fragmented and regional industry, it has recently become a battleground for global concentration, with Cemex of México going head to head with Lafarge of France and Holcim of Switzerland for international market leadership. A similar dynamic is being played out in steel, where Mittal Steel of India has dramatically transformed the geography of competition and strategy in just the past decade. Never-

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dental services. It is highly unlikely that any single player would have the ability to alter the industry terrain. Attempts to pursue global strategies are risky; indeed, they could destroy shareholder value.

Shifting terrains. In some sectors, global concentration may not yet have occurred, but change may be under way. Even in sectors that economists have considered national or regional, including steel, confectionery, airlines, spirits, cosmetics and cement, we see increased jockeying for global market position, as the top four players close in on 40% concentration levels.

Companies in sectors experiencing change should anticipate the effects of global concentration. Players with deep pockets have opportunities to make early moves to expand their market positions and sustain profits for many years. Some strategies rely almost exclusively on internal growth. For example, Spanish fashion retailer Inditex (owner of Zara) has expanded from Europe to stores in 78 countries to become the world's largest, most valuable publicly listed fashion retailer, according to the *Financial Times*. However, the need for rapid increases in scale may argue for growth through acquisitions.

The cement market offers an interesting

theless, companies pursuing global strategies need to be attentive to the needs of local customers and the business culture — and recognize that having standardized practices across the whole enterprise might not be the right approach. Wal-Mart, for example, spent nearly a decade trying to establish itself in Germany before finally selling its German operation in 2006.

Anticipating Turning Points. Examples of companies that held firm to their local or regional strategies in the face of indications that their industry was becoming more concentrated and suffered accordingly are fairly common. In the traditional mobile phone market, for example, the global CR4 increased from 49% in 1988 to 73% in 2008. Nokia successfully leveraged its innovation-based strategy to build a global market share of 40%, with even stronger market positions in India (57%), Asia (46%) and Africa (66%). Motorola, by contrast, struggled, having largely restricted itself to the United States and South America, where both it and Nokia each held 26% of the market. Globally, Motorola's share declined to around 10%. Despite Nokia's relative strength globally, the rapid emergence of the smart-phone market is forcing it to raise its competitive

game to a new level. In early 2011, Nokia's global share was just 29%, compared with Samsung at 18%, and it also faces challenges from BlackBerry, Apple and Google. This could mark the transition to a global war scenario.

Since different industries are facing different circumstances, managers need to keep tabs on current conditions and what is likely to unfold. For example, it's important to recognize the difference between a steady-state "global oligopoly" and a "global war," where global CR4 concentration levels fall as leading incumbents cede ground to new overseas challengers. It's also important to monitor the number of significant players in your sector. If incumbent numbers are falling, you may be entering a highly competitive scenario. Misinterpreting these turning points can be dangerous.

Finally, managers should keep in mind that full geographical integration doesn't occur overnight. First, as successful companies such as Honda have shown, you need to develop a road map for international expansion. We have provided an overview of the global concentration landscape and some initial measures, but beware: In the sharply defined business segments where most companies compete, global concentration may already be a lot higher than in more broadly defined sectors. For example, the CR4 of stainless steel today is 36%, twice as high as that of the steel industry overall. More carefully segmented analysis may point to the need to reshape your global strategy all the more urgently.

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