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Are You Enjoying Globalization Yet?

The surprising implications for your business

By Adrian Slywotzky, Peter Baumgartner, Larry Alberts, and Hanna Moukanas

Globalization is changing the nature of competition and value creation in ways more subtle and fundamental than simply cost. By incubating scores of new business models that can unseat established companies, globalization is creating opportunities for new value creation and highly profitable growth at the two ends of the value chain—new customer connections at one end and new models of innovation at the other.

Haier, the Chinese household appliances manufacturer, is enjoying the fruits of globalization. Israel-based Teva is as well in pharmaceuticals. So are Rolls-Royce in engines and turbines, Toyota in automobiles, and Infosys in information technology.

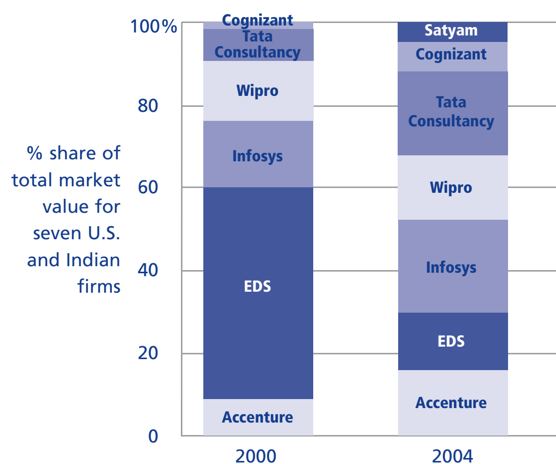
Consider how Infosys, based in Bangalore, India, has been global in design from its start in 1981. Early on, it prospered because of the difference in cost of IT employees in the U.S. and India. Infosys then moved up the food chain by continually adding higher-value business process outsourcing, IT services, and consulting to its offerings. That strategy has been taken to an extremely broad client base, 98% of which are outside India. Infosys uses its global client relationships and its intellectual capital to start new ventures, such as an R&D center opened jointly with the French engineering group Alstom. Most people view Infosys as a low-cost play, without seeing the unique business model behind the low-labor-cost facade.

The result has been stunning growth in revenues and net income, with an operating margin currently near 29%. And investors foresee a bright future for this business: Infosys has been gaining relative market value (Exhibit 1), and its market capitalization has reached $19.3 billion on $1.6 billion in revenues, a ratio that far surpasses those of competitors Accenture and EDS. This has created the same kind of extreme disproportion in value that we saw in computing 15 years ago.

In contrast, most companies are a couple of years behind the globalization curve. Although they may know that building a global business model is fundamental to success, they're not yet clear how it matters, how it's dangerous, and how big the upside could be.

What do we mean by "globalization"? Hasn't it been occurring for the past 50 years?

Exhibit 1 **Value has shifted in IT outsourcing**



Source: Compustat data, Mercer Management Consulting analysis

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Brand Investment Traps

The proven antidote is an integrated approach to brand management and brand science

By Andrew Pierce and Adrian Slywotzky

Brands have become increasingly fragile and difficult to sustain. Failure to invest in the right mix of activities at the right time risks eroding the brand. On the other hand, those companies that anticipate and avoid the common investment traps can reap superior growth in brand value over a long period of time.

When Mercedes Benz USA announced its 2004 sales this past February, the volume was the highest in its 40-year history. Spurred by investment in the entry-level C-Class line (priced as low as $26,000), overall sales rose 5% percent for the year. Yet five of Mercedes' high-end luxury models actually posted sales declines of up to 25%. Mercedes has slipped in the U.S. luxury car market, falling to third place behind Lexus and BMW, and its management has been wrestling with the tradeoff between preserving equity in a luxury brand and raising volume at lower price points, which risks diluting the value of the brand.

History shows that even great brands, from A&P to Howard Johnson to Polaroid to Zenith, are vulnerable to sudden collapse or to slow and devastating erosion. While each troubled brand has its unique story, the common theme that unites them is "misinvestment"—the company's failure to invest wisely for long-term growth of brand equity.

Some organizations ignore the necessity of brand investment altogether, using the brand as a cash account from which value can be drawn to improve the next quarter's numbers. The lack of visible bad effects in the short term encourages more borrowing, so that after years of deferral the cost to rebuild the brand becomes enormous. Failure to invest leads to a point of no return, where the cost or time to revitalize or reposition the brand outweighs the expected additional revenue. Such neglect may destroy the brand and even the company, since for many firms brand equity—the price or volume premium enjoyed by the branded product or service over a non-branded equivalent—can translate into as much as one-third to one-half of the company's total market value.

Failure to invest is just one of the common traps that can kill brands. The wrong mix of investments, the wrong investment sequence, failure to adapt an investment strategy over time, and other traps can also push brands toward the point of no return (see Exhibit 1).

The proliferation of investment traps over the past decade has made brand management quite complex. Branding has moved beyond the traditional sphere of packaged goods to become vital in almost every business sector, as indicated by the explosion of ad spending

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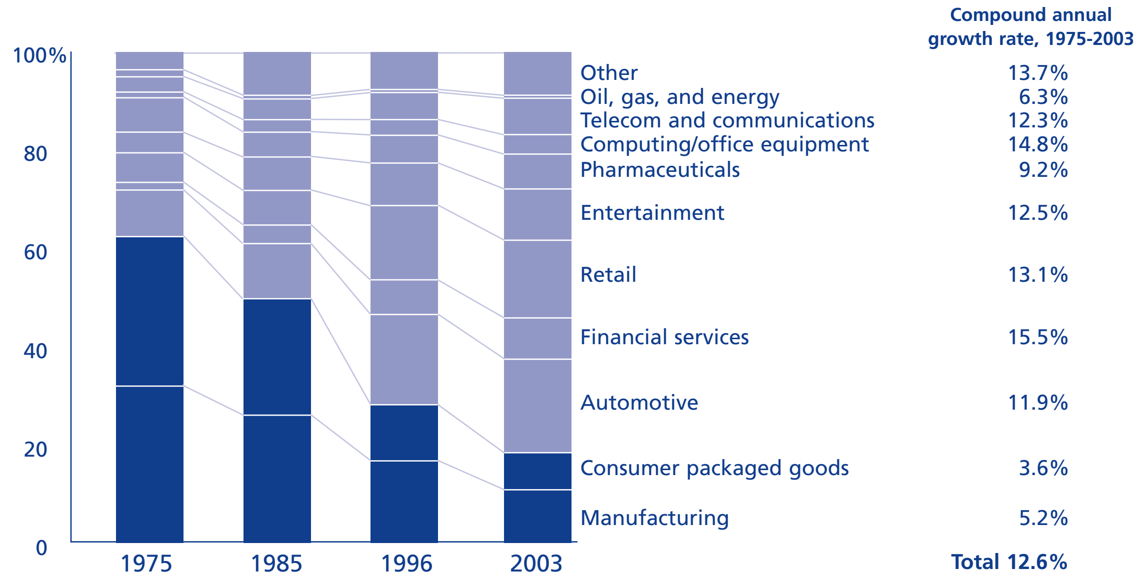
Exhibit 1 **Brand investment traps**

Trap	Description
1. Failure to invest over time	Assuming that the brand's value is largely self-sustaining, a mine to be exploited rather than an asset to be nurtured
2. Wrong investment mix	Overinvesting in advertising, promotion, sponsorships, or product marketing programs that do little to create brand value and distract from more urgent needs
3. Wrong sequence	Investing in marketing initiatives with a lower expected payoff in terms of increased customer revenue versus programs with a greater expected payoff
4. Myopic focus	Focusing only on a narrow set of brand dimensions or audiences, while ignoring other factors that are essential to building brand value
5. Wrong touchpoints	Investing to improve customer touchpoints of marginal relevance while neglecting others that are crucial to building brand equity
6. Wrong positioning	Emphasizing components of brand equity that do not drive customer behavior, while ignoring other components that do
7. Failure to adapt	Emphasizing brand dimensions that have become irrelevant to customers over time or have taken on negative connotations among customers
8. Spending too little on too many brands	Spreading investments across too many brands with minimal value, that operate in stagnant or shrinking markets, or that are rapidly becoming commoditized
9. Overstretching the master brand	Maintaining a single overarching brand to save money when several brands focused on different markets would attract more customers
10. Dilution	Licensing the brand to gain market share and access to new customer segments but diluting price premiums
11. Wrong metrics	Failing to measure the key indicators of brand health; choosing measures that have little or no real significance; or ignoring, denying, or rationalizing the warning signs that the metrics reveal
12. Trying to turn around a dead brand	Trying to revitalize a struggling brand in a situation where a new brand could achieve greater visibility and acceptance among customers in a shorter time and at lower cost
13. Failure to follow through	Overlooking the need to support a brand after a successful revitalization has occurred

by the telecommunications, pharmaceuticals, financial services, and other industries (see Exhibit 2). Other developments have further complicated brand management, including the multiplication of channels for advertising, marketing, and sales; the emergence of powerful new competitors thanks to globalization, venture capital, and technological advances in communication and logistics; and greater access to information among customers, suppliers, and competitors. As a result, brand premiums have become increasingly fragile and difficult to sustain.

Exhibit 2 **Branding for all**



Note: Media spend for telecom and financial services based on industry revenues multiplied by estimated industry ad spend-to-sales ratios.

Source: LNA, Schonfeld & Associates, Lippincott Mercer analysis

In this tumultuous environment, the classic model of brand management falls short. It assumes that brands matter primarily in packaged goods; yet, as we've seen, branding applies to most business sectors. In the classic model, brand management is a stand-alone function centered in the marketing department; as we'll explain, *integrated brand management* now must involve many other parts of the organization. Traditional brand management tends to focus on advertising and other traditional marketing or communications media, and it assumes that once funds have been allocated for next year's ad campaign, the brand investment strategy is complete. We'll show why this approach is short-sighted, because today's investments must be made in the context of a company's overall business design.

Finally, the discipline of brand management has been largely qualitative, the province of image-makers and pulse-takers. Creativity remains important, of course, but it should be supplemented with quantitative tools drawn from the emerging field of brand science, which allow companies to measure the strength of specific elements of their brand equity, brand value, and branded customer experience with greater precision than in the past.

This more effective integrated brand management approach combines sophisticated metrics with analytically based investment decisions and ties them directly to the company's busi-

ness design and economics. The approach also helps managers not just to anticipate and avoid the traps that can destroy their brands, but also to grow the brand's value over a sustained period.

The elements of brand equity

Integrated brand management starts by defining which elements of the brand create differentiation and influence customer behavior. This knowledge emerges from market research or in-market experimentation that shows how existing and prospective customers make choices in a competitive marketplace. This data can be augmented with brand image and customer experience data, which captures how customers perceive the brand at each touchpoint. Once collected, the list of 50 to 100 image and experience dimensions can be winnowed to a subset of six to ten of the brand's equity elements—attributes that shift the demand curve, all else being equal.

Certain equity elements apply to any brand, such as trust, reliability, and ease of doing business. Others apply to particular brands or types of brands. For example, innovation is an essential element of Sony's brand equity, but not of Coca-Cola's; family friendliness matters to Disney, but not to Harrah's; upscale image is crucial to Louis Vuitton, but not to the Gap. It's important to define the equity elements accurately and precisely as they apply to a given market. For example, in the automotive space, performance means something different to most European drivers (defined, agile, smooth) than it does to U.S. drivers (adroit handling and raw power).

Each equity element can have a positive or negative value, depending on whether it makes an individual customer more or less likely to buy. For Sony, innovation has a positive value to the extent that customers associate it with "the best and latest products"; it has a negative value if customers think of "products that are complex and hard to use." For Disney, family friendliness has the positive meaning of "fun for the whole family" and a negative meaning of "too bland for single, young adults." Getting the equity elements right is a critical prelude to the subsequent aspects of integrated brand management.

Having accurately defined the equity elements that matter most for the brand, it's also essential to monitor how their relevance changes over time and adapt the brand strategy as needed. The long-term decline of the venerable Oldsmobile and Plymouth brands occurred because General Motors and Chrysler did not adapt to the steady decay in the relevance of their brand attributes. Consumer perceptions of Oldsmobile and Plymouth didn't change drastically, but over time the number of car buyers who cared about their brand elements dropped consistently. GM's and Chrysler's marketing spend on those brands could have been put to more productive use for other brands in the portfolio.

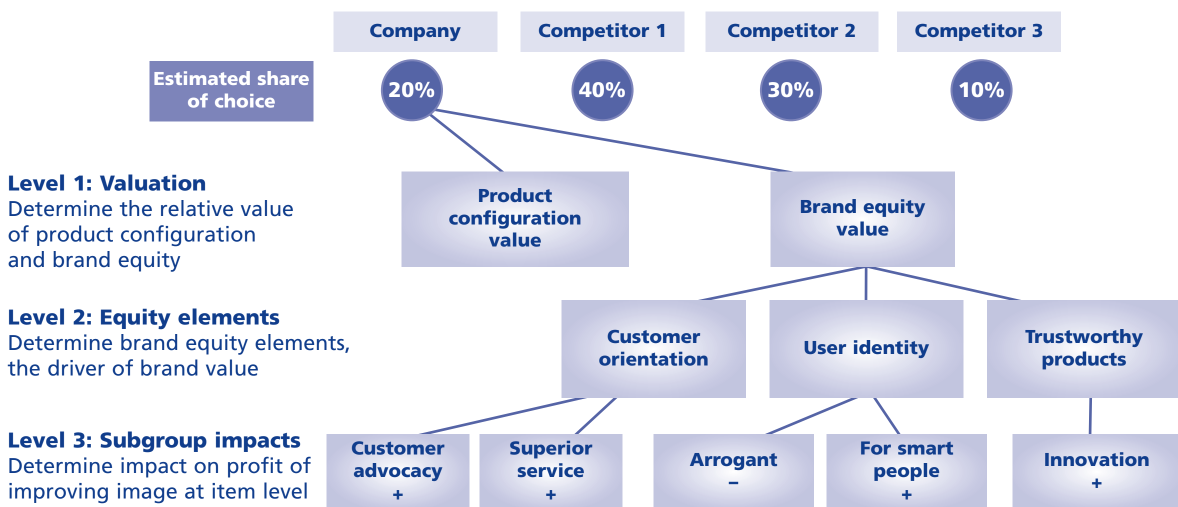
Customers' priorities vary, so one must distinguish the attitudes of different segments of existing or prospective customers toward the equity elements. Loyal and high-value customers who love a brand form a core group. Around that center, regular customers occupy the next ring; prospective customers the third ring; and those who have rejected the brand a fourth outer ring. Moving out along the successive rings, how quickly do positive perceptions about the brand fall off? At what point do negative perceptions dominate? Are there specific positive or negative attributes that pop up at a particular point?

Addressing such questions can help define the extent to which it is possible to expand the customer base and extend the brand without alienating the loyal core. To take an extreme case, when considering the polarizing Hummer brand of SUV, the outermost circle of rejectors contains people who dislike the Hummer for being huge, gas-guzzling, and militaristic. While it's unlikely that the Hummer brand could be reconfigured in a way to satisfy these people, GM was successful in building a brand that has broader appeal without running the risk of brand dilution.

Defining the brand's key equity elements and the value they have for specific customer groups (see Exhibit 3) thus reveals the many dimensions of the brand and informs decisions about extending it to new products, customers, or markets.

Exhibit 3 **How brand equity analysis works**

Determine which equity elements actually influence customer choice (illustrative)...



...then optimize investments in those equity elements

Customer segment size	Customer segment name	Equity elements	Five-year NPV (net assets)
2%	High value	Customer advocacy	
8%	Active investors	Superior service	
15%	Mass affluent	Innovation	
65%	Mass	For smart people	
10%	Retiree	Arrogant	

The right metrics to track brand health

With the profile of equity elements in hand, managers then need a system of metrics to track the brand's vital signs.

Just as established tools and guidelines track debt, working capital, and other components of a firm's financial health, there is a developing science of brand metrics that offers powerful diagnostic tools for measuring and monitoring changes in brand health. These tools go beyond the traditional measures of awareness, consideration, and preference to include data on brand premiums, brand as a percentage of shareholder value, brand extendability, and employee commitment scores. Well-designed metrics allow managers to measure the value of a brand, the return on marketing investments, and the elements of the customer experience that build or dilute equity in the brand. Thus, they can help managers take corrective measures or reallocate investments for the greatest positive impact on the customer experience.

For example, the Microsoft brand is widely respected in the software arena, including business-to-business markets. But certain metrics tracking perceived trust and perceived corporate intentions have revealed the danger lurking in one component of the brand's value. Executives from some other companies have publicly voiced their opinions characterizing Microsoft as a rapacious competitor and a dangerous ally. This reputation makes it harder for Microsoft to develop the partnerships it will need to succeed in new arenas such as entertainment. As one possible move, Microsoft might invest more in its relationship with an important constituency, and it could potentially benefit from improving its brand metrics system and developing a range of responses to the early warnings that the system raises.

Leading indicators of brand health, when correctly identified and assiduously monitored, can unearth very valuable information. For example, based on studying ten years' worth of customer data, one leading manufacturer of electronic components can define how customer loyalty, employee commitment, and brand equity are interrelated, and can link these relationships to operating and financial measures. As the company invested more to communicate its business strategy, it also saw a rise in employee commitment, customer perceptions of sales force knowledge, and brand consideration. Now the company knows that if employee commitment slips in the first quarter, customer satisfaction will slip in the second quarter and brand value will decrease in the fourth quarter.

Metrics point to the areas that need investment at any given moment. As the brand moves through its life cycle, as new competitors enter the market, and as customer priorities shift, the way a company invests in its brand will need to change. For instance, Hewlett-Packard is pushing deeper into digital entertainment as a brand known best for printers and PCs. The company could spend differently to reposition its brand in this new space or leverage investments in the Photosmart sub-brand to pave the way. At the same time, HP's investment in certain sponsorships may do little to help push the brand into this space, and may also increase the risk of overstretching the master brand.

A recovered brand poses its own special investment demands, since revitalizations are remarkably fragile. From 1998 to 2001, Volkswagen simultaneously redesigned several of its car models, redesigned its dealer network, and launched an aggressive marketing campaign, thereby revitalizing its brand and increasing annual sales by 150%. Since 2001, however,

VW has launched no new models and has reduced its marketing investment by 25%. As a result, sales have begun to slip back toward the levels of six years ago.

As these examples illustrate, the dynamic nature of brands, as well the fluid environment in which brands compete, means that brand investment calls for continual rebalancing.

As the business design goes, so goes the brand

Brand management doesn't stop with investment choices. A common mistake that many companies make is failing to consider brand strategy within the broader context of the business design. All the marketing and advertising in the world won't build or sustain a powerful brand if the business design around which the company is organized fails to deliver on the brand promise. Conversely, a company with a great business design is capable of developing a powerful brand through excellent customer experiences, even without significant spending on marketing and advertising—but that will happen only if the business design and the brand are aligned.

It follows that for every change in the business design, there should be a corresponding change in brand strategy (see Exhibit 4). If you change the target customer set, refine the value proposition, change pricing strategy, or make an acquisition that changes your scope of the business, you must make a corresponding adjustment to the brand strategy. Fail to make those adjustments and you will end up with a business design and a brand that no longer match.

Exhibit 4 **Keep them in synch**

If you change...	How should you adjust...
Business design components	**Brand strategy elements**
• Customer selection	• Target audience
• Value proposition	• Positioning
• Value capture/profit model	• Brand architecture and portfolio
• Scope of business	• Brand identity
• Strategic control	• Brand experience
• Organizational systems	• Brand metrics
	• Marketing mix

Consistency between brand and business design involves much more than marketing or advertising. It means adjusting investment in any area of the business that's dissonant with the brand promise. For example, when we studied ten years' worth of sales performance for all the brands competing in the mass-market, non-luxury U.S. automotive segment, we found that nearly 90% of the variation in sales among brands could be explained in terms of six key variables. Only two of these variables pertain to traditional marketing; the other four relate to product development and sales channel management. Yet all should be considered by automakers as they determine the optimal mix of brand investments, and all must be executed effectively in order to achieve sustained sales growth. The recent turnaround of Nissan in North America can be explained by Nissan's ability to use all six of the business and brand levers.

For many service companies, the most fruitful forms of brand investment may lie not in marketing but in areas such as R&D, customer service, or employee hiring and training. One bank that was struggling to revive the value of its flagging brand determined that the key problem was an inefficient complaint resolution process. A set of angry customers spread the word to others about their experiences. This crucial discovery surfaced only after the bank had identified its key customer points of contact and analyzed the relative impact of each touchpoint on customer perceptions of its brand. As a result, the bank could be confident that investing to fix the problem would yield a greater return than investing to expand the customer base through product introductions or advertising. Careful ROI analysis steers resources to those touchpoints that matter most.

Note, too, the importance of choosing the right sequence of brand investments. In the bank's case, if it had invested in marketing and advertising before improving its customer service system, the spending would have been counterproductive. Many of the potential new customers attracted by the marketing campaign would have been turned off by the bank's inability to serve them properly and would have abandoned the bank.

The tight link between brand and business design means that every strategic move must be considered in the light of its impact on the brand. A move that appears smart for the business in the short run might eventually hurt the brand. We see an increasing tension across industries between the need to redesign the business and the imperative to not change the brand.

The tradeoffs now being faced by the managers of American Express offer an illustration of this. In an effort to expand both the customer base and the merchant affiliations of its venerable charge card so as to compete more effectively against Visa and MasterCard, American Express has been making deals with mass-market retailers including Amazon, McDonald's, and Costco. These deals will open up large, low-cost customer acquisition channels, putting

Brand investment tradeoffs

Because brand investment choices are so complex, they often involve difficult and painful tradeoffs. Here are some classic dilemmas:

New versus old. Should a company extend an existing brand to include new product or service offerings, which risks diluting or confusing the brand image, or should it commit the resources required to build a new brand? Nissan and Toyota recognized the difficulty of extending their high-reliability, basic transportation brands into the luxury end of the market. They made the right decision and committed the necessary resources to build the Infiniti and Lexus brands instead, and Toyota recently added Scion to target young drivers.

Change versus continuity. As current customers age and new customer groups emerge, should a company emphasize change or continuity in its brand? IBM has adroitly managed the route of change over the past decade, transforming its brand image from "hardware maker with a tradition of conservative quality" to "information services provider with unmatched depth and breadth of expertise."

Promoting the brand versus escaping the box. An established company that has built a powerful brand may find itself boxed in by the brand. To expand its markets, should the company extend the brand or launch a new brand? On either course, how will it avoid alienating or confusing existing customers? Marriott realized that it could not reach the luxury market with the Marriott brand and decided instead to acquire Ritz Carlton.❖

pressure on the brand to resonate with several audiences. In addition, American Express is opening its network so that partner banks can issue American Express cards much as they currently issue Visa cards or MasterCards.

What impact will these moves have on the American Express brand, whose strength has long derived from its status as an exclusive, aspirational brand? When everyone can get an American Express card, issued by any bank rather than directly from American Express, and can use it to buy a cheeseburger rather than a Caribbean vacation, what will happen to the perceived value of the brand? The devil is in the details: Lacking careful measures, a strategic move that may be beneficial to the business in the short run can have a devastating long-term effect on the brand, one that may not become obvious for years.

A team sport

A brand is more than a promise. It's also a major financial commitment and, as we've seen, the mix of investments required to build and sustain a brand extend far beyond the traditional marketing sphere. If all the moving parts of the business don't synchronize to deliver the right experience to customers, then the long-term value of the brand surely will erode.

That is why brand management must be part of the senior executive agenda, starting with the CFO and CEO. And it is why the group designing an integrated brand investment plan should include people from human resources, production, finance, customer service, quality control, and other departments that contribute to delivering on the brand promise. The role of the brand manager expands as well, to be an educator and agenda-setter for an ongoing discussion about the brand.

Integrated brand management has become a team sport, not a one-department show. Even brand masters such as Richard Branson, who embodies his Virgin brand, cannot be truly effective unless all the moving parts of their business designs are fully aligned with the brand promise. Tomorrow's most successful companies will be those that integrate brand strategy throughout every department and level of the organization. ❖

Yes—but it's now different in nature and intensity. Globalization is no longer an extrapolation of past experience in textiles, apparel, steel, electronics, and so on. It's not just about low costs or outsourcing.

Instead, it's more useful to think of globalization as the second modern wave of Value Migration®—the flow of value from old, obsolete business designs to new, more economically effective ones. By business design, we mean the fingerprint of the (hopefully) unique way a company does business—which customers it chooses to serve, which unique value proposition it offers to customers, which profit models it employs, which scope of activities it engages in, which forms of strategic control it develops to protect profits and customer relationships, and which organizational architecture it uses to implement these decisions.

The first phase of large-scale value migration occurred in many industries from 1975 to 2000, when a cumulative $300 billion in venture investment helped give rise to many new types of business designs. Recall how Nucor seized value from traditional steelmakers, Swatch from traditional watchmakers, Southwest and Virgin from traditional airlines, Dell from traditional PC makers, and Nokia from traditional cell-phone makers.

Over the next decade, a second and much larger wave of value migration will be fueled by the spread of broadband communications, customer access to information, and more than $500 billion of foreign direct investment in China and India alone. Just as in the first wave, the major opportunities today lie in the proliferation of ways to design a better business—not just ways to source materials and labor, but also to create new customer segments, collaborate with other firms, and accelerate relevant and cost-effective innovation.

Globalization will tend to make strong business designs stronger (through global sourcing, selling, and science). It will make weak business designs weaker (through more competition, reduced differentiation, and a greater disconnect from customers). And it will create more no-profit zones for companies and even entire industries.

For many companies, their current position is sobering: They have the wrong business design and the wrong organization. On a global economic stage, the areas where companies can create value are moving away from the traditional activity chain. Much of the guts of this chain, such as fabrication and back-office processes, will migrate away to specialists operating at remote locations.

What work will be done "at home"? For many established players, the pressures of globalization on the middle (fabrication, office functions, and so on) will drive them toward two fundamental routes to create new value, as shown in Exhibit 2:

- *Deeper customer connections* – understanding and addressing local customer priorities more deeply than competitors do

- *Higher impact, customer-relevant innovation* – stepping up the pace of university alliances and global talent sourcing while finding new ways to protect intellectual capital

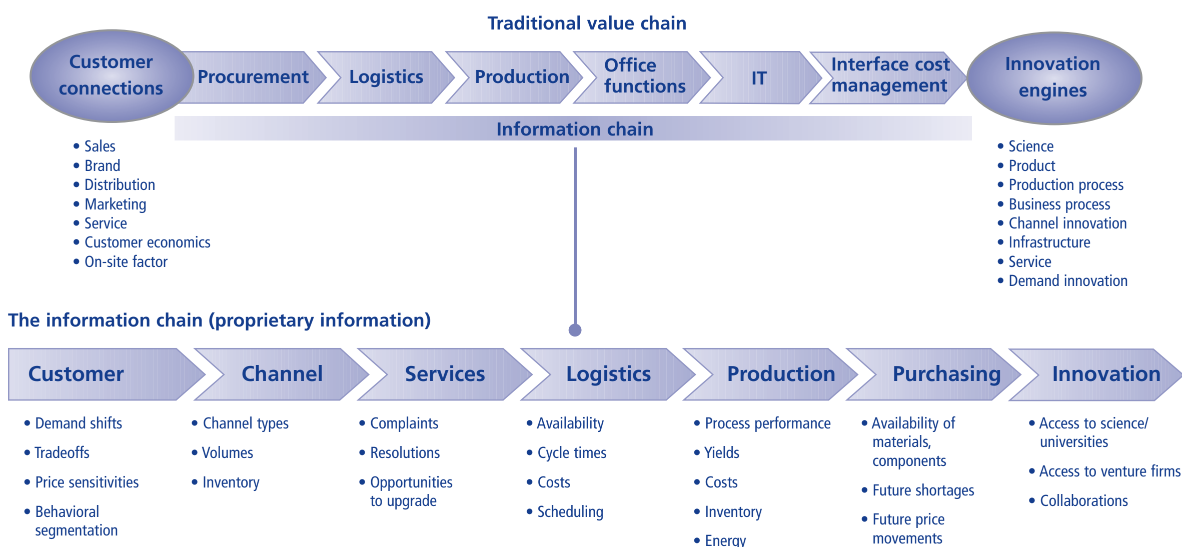
Connecting customers with innovation is a chain of information (on customers, logistics, purchasing, and so on). Superior information chains––those that themselves add value ––derive from better data combined with better applications systems and a culture that knows how to use them.

Customer Connections and the New Age of Segmentation

In a radically globalized world, managers will have to excel in the full array of customer connections owned and managed by the firm. These include activities in sales, service, solutions, branding, and other areas touching customers.

Customer connections are rising in relative importance for most companies, as the ability for a company to differentiate itself through parts of the traditional activity chain in the middle is waning. The key for managers, then, will be to move from a B+ to an

Exhibit 2 **Creating value at either end**



A+ performance in customer connections.

There will be many more customer connections because globalization leads to large-scale growth in income and redistribution of income in emerging economies. Globalization involves greater heterogeneity (different income pyramids, behaviors, and customer priorities in each geography) plus greater complexity (different infrastructure such as telecommunications networks, highways, and distribution channels) multiplied over many more customer segments.

Playing global growth is a new game—call it the Cambrian explosion of new segments—with new rules. If you're now addressing 12 to 15 truly different segments, expect to have to manage 90 to 100 segments in the near future. This will mean a deeper knowledge and more specific management of distinct customer types and segments.

Incomes among the huge populations of countries such as India, China, and Brazil remain relatively low, with the majority of people earning less than $2 per day (Exhibit 3 compares national GDP per capita). But as Prof. C.K. Prahalad of the Univ. of Michigan points out, there's gold to be found at the bottom of the pyramid if you get the business model right.

Moreover, the customer segment structure of many markets will change radically over the next five years, as income generated from global sourcing finds its way into the middle of the pyramid and ignites the growth of different segments within the middle class. For example, the percentage of households in China that can afford to buy a car is projected to grow from under 4% in 2002 to 13% by 2010.

Companies with weak segmenting capabilities will struggle in this new environment. Strong, sophisticated segmenters will find abundant new opportunities for profitable growth, if they are prepared to adjust their business models to the unique requirements of different and strangely morphing markets. They know that the right offerings for the base and the peak of the pyramid will not be the right ones for the rapidly expanding middle tiers (Exhibit 4).

A handful of companies have already built businesses abroad that are even more profitable than those in their home markets, including 3M's specialty dental materials for wealthy consumers in Brazil, Toyota's Lexus brand in the U.S., and Gucci and Louis Vuitton luxury goods in Japan and China.

Other companies have created new, ultra-low-cost businesses that match the opportunities presented by the current income structure of emerging markets. A leading office equipment company's model in China is flourishing as the "one step above low-price" brand. Lever sells cleaning and personal care products in India through new

Exhibit 3 **So many markets**

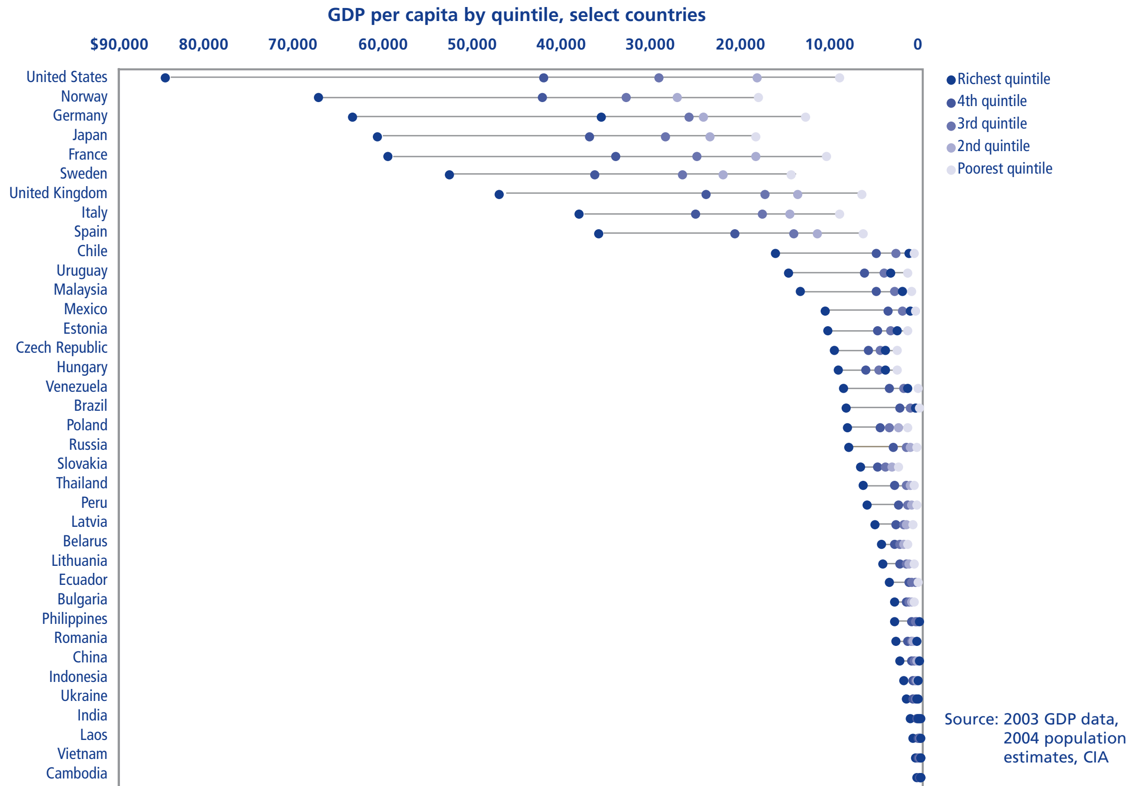
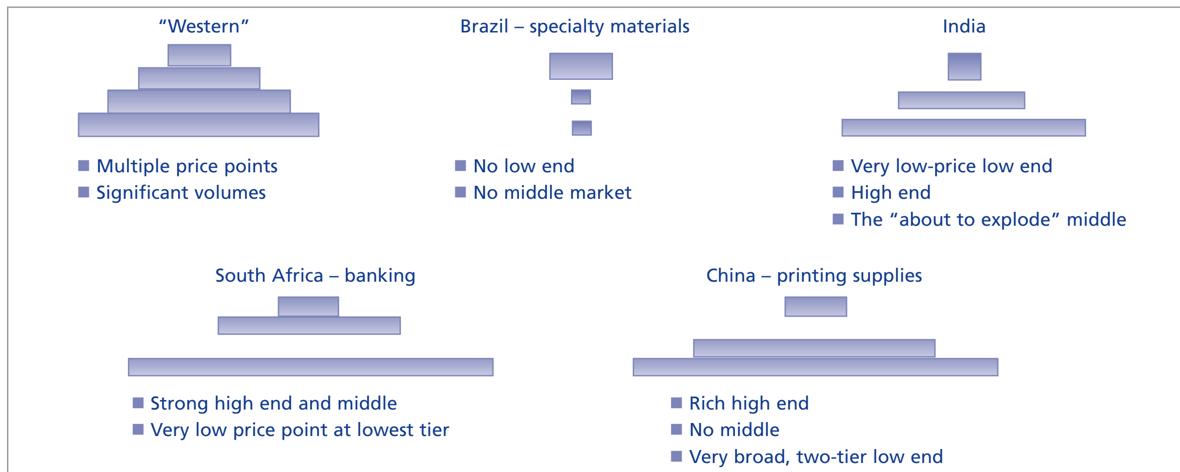


Exhibit 4 **What's your customer pyramid?**



packaging, price points, and distribution systems. And Capitec has been highly profitable in South Africa by designing a consumer banking model that matches the needs of the poorest stratum of the market.

The Common/Custom Dilemma

The explosion of segments will require a multi-mode approach to new markets because the customer pyramids in each market are so different. Therein lies a major economic problem. Developing highly customized models is a good way to go bankrupt quickly, because customers never want to pay for the full cost of customization.

An important issue, therefore, will be effectively managing and adjusting the common/custom ratio. You'll need to ask which parts

of a Brazil, or China, or India model should be exactly the same as your core business design, and which parts should be altered to resonate with local market conditions and customer priorities.

Consider the automotive industry. Among many auto makers, there is too much sameness on the outside of the vehicle and too much variety on the inside. Toyota is at the performance frontier: Its Lexus ES330 and Toyota Avalon are designed for different customers and price points, yet the majority of the parts inside the cars are common.

Renault has also adroitly managed the common/custom ratio with its Logan, launched in 2004. The car was originally designed for Eastern Europe with an entry-level price of €5,000 and caught on among consumers there. Renault then made a series of customizations to position the Logan as an affordable car for 65 other countries, including India, China, and Turkey—and the French market as well. Renault hopes that by 2010 the Logan will account for one out of five cars that Renault sells.

Getting the common/custom ratio just right is a sensitive calibration. Customize too much and you'll go broke. Customize too little and nobody will buy. Customize in the wrong places and you'll go broke even more quickly because the costs are too high *and* no one wants to buy.

In many markets, the shape of the income pyramid is the primary driver of customization. But it's not the only one. Markets will also differ by product mix (Nike sells a different mix of sportswear in the U.S. than it sells in Thailand), by product need (Yamaha builds different pianos for Boston, Berlin, and Beijing because of different climates and home heating conditions), and by wants (Nokia makes different combinations of software, systems, and features for phones in Japan versus the U.S. versus Brazil).

Nike's variations are cheap, while Nokia's are expensive. Both companies, however, work hard to balance customer response with business model economics.

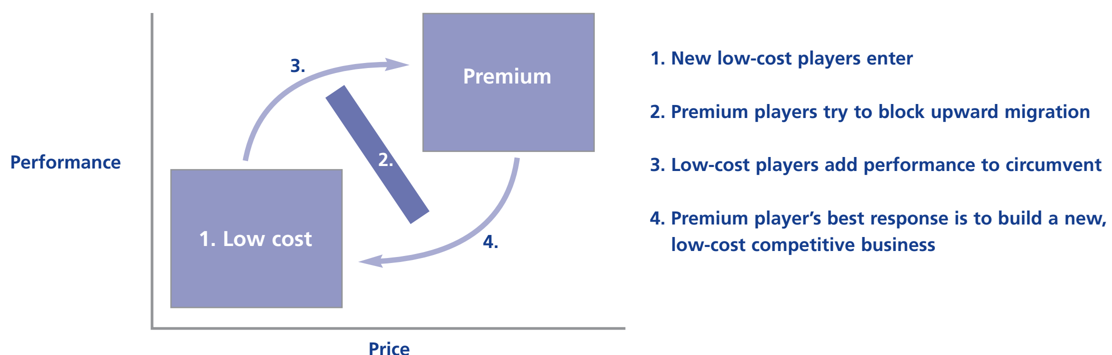
There are important exceptions to these rules. Companies such as McDonald's, Haribo, and Starbucks seek not to conform to the market, but to have the market conform to them—to have customers acquire a taste for the Big Mac, the Gummy Bear, or the Frappuccino.

Most companies, however, will have to learn to play the super-segmentation game by managing the common/custom ratio and modifying their business designs segment by segment, to get the combination of response rate and cost structure just right.

Market Takeover Ahead

The proliferation of new high-growth zones at the bottom of the income pyramid in many countries represents risk as well as opportunity. The risk is that entrepreneurs are developing new, ultra-low-cost business designs to cater to the base segment profitably. They start in the lower left corner of the price/performance map (Exhibit 5), but the powerful magnet of high profitability will pull them to the upper right corner. Although they will meet resistance from established competitors,

Exhibit 5 **The fundamental globalization dynamic**



the newcomers will add performance levels faster than price in order to travel up the diagonal. This phenomenon will threaten established business positions from machinery to retailing to media to banking.

Forward-looking companies see this risk clearly and are already working to own the low end, not by discounting but by building new business designs that closely and cost-effectively match the priorities of that segment. In the 1980s, this was done perfectly by Swatch in the watch market. Today, it is being done by Lever in India and General Motors with its minivan business in China.

Building a low-cost business design is not the only way to respond. The U.S. furniture industry provides an example of "market takeover" and different reactions by domestic incumbents. Chinese furniture imports to the U.S. grew at 27% a year in the 1990s. In 2000, U.S. furniture employment began to drop and within three years fell 23%.

There were three possible responses to this shift: Most companies petitioned legislators for protection. A few moved sourcing to China. Even fewer reinvented their business designs.

Furniture Brands was one of the few that did the latter, moving downstream to focus on retail. It improved its U.S. operations, developed a better production system, and then shifted sourcing to China. Furniture Brands had roughly 200 stores in the U.S. last year and plans to open 425 stores by 2007. It has protected its value, while that of many domestic competitors declined.

New competition will not stop at the initial advantage of low price. The second advantage—low price combined with high technology—will hit many markets over the next three to four years.

Two Manufacturers Choose Their Spots

In a globalized economy with far-flung facilities, customers, and suppliers, value creation becomes so complex that no firm can master all the activities required. So a key decision for managers is which parts of the activity chain to keep in-house and which to outsource. Two companies, Philips and Rolls-Royce, illustrate how manufacturers can focus on high-value areas by partnering with other firms and institutions.

In the market for liquid crystal display (LCD) screens, Philips has narrowed its focus to advantage. Traditionally, manufacturers of LCD screens for devices such as laptop computers and televisions outsourced a significant share of the manufacturing to suppliers in low-cost countries. Philips decided to move upstream and manufacture key elements such as LCD panels that use thin-film transistor (TFT) technology. In 1999, Philips formed a joint-venture with Korea-based LG, named LGPhilips, to manufacture and sell TFT-LCD panels. Since 1999, LGPhilips has built over seven plants.

This upstream move has proven quite successful: LGPhilips' operating margin reached 18% in 2003 and 21% in 2004, while most consumer electronic manufacturers post margins of 3% or less.

Rolls-Royce makes turbines for aircraft, ships, and power plants. Once a largely U.K. company, it now has customers in 120 countries and employs people in 50 countries. It outsources and offshores about 75% of its components to its partners in a global supply chain.

Because so many components are outsourced, CEO Sir John Rose defines one of the firm's strongest capabilities as partnering. Just a decade ago, for instance, Rolls-Royce did 98% of its research and technology in the U.K. Today, it does less than 40% there, and the rest is done abroad, including many partnerships with universities.

The 25% of components that Rolls-Royce continues to make in-house "are the differentiating elements," as Rose explains (in the book *The World Is Flat* by Thomas Friedman). "These are the hot end of the engine, the turbines, the compressors and fans and the alloy, and the aerodynamics of how they are made.

"We still own the key technologies, we own the ability to identify and define what product is required by our customers, we own the ability to integrate the latest science into making these products, we own the route to the market for these products, and we own the ability to collect and understand the data generated by those customers using our products, enabling us to support that product while in service and constantly add value." ❖

One leading indicator of this type of competition is Huawei, the $6 billion router and communications equipment company based in Shenzhen, China. Huawei already competes for major accounts around the globe. Of its 24,000 employees, almost half are engaged in development. Many of those are assigned to specific customer accounts. Huawei's value proposition is evolving rapidly: no longer just a lower price, but also technical innovation and dedicated development activity.

Competitor evolution will not stop at low cost plus high technology; it will also include extensive acquisition. For many of the new players, the combination of low cost and high technology is generating enormous amounts of cash, which they will use to acquire facilities, brands, sales and service networks, customer sets, and entire companies.

The start of this process is exemplified by TCL, the Chinese TV and cell phone manufacturer. TCL acquired German-based Schneider Electronics in 2002, acquiring key sales and distribution channels. Techtronic Industries, a $1.4 billion Hong Kong-based manufacturer of power tools and outdoor products, acquired Ryobi North America's power tool business in 2000, its European and Australian businesses in 2002, Deere's Homelite lawn and garden products division in 2001, and Royal Appliance (maker of Dirt Devil vacuums) in 2003. Some analyst have noted that TCL may be acquiring faster than it can digest; nevertheless, TCL demonstrates the rapid pace at which low-cost competitors can evolve.

In thinking about this new wave of value migration, there is one important caution: With $500 billion of foreign direct investment and wide press coverage, it would be easy to develop China-India myopia.

That would be a mistake, as business design innovation is a genuinely global phenomenon. Philippines-based Jollibee is beating McDonald's at the fast-food game in its home market. The Dutch financial services firm ING has muscled into U.S. savings accounts with

Exhibit 6 **From every corner**

Sample business design innovators

Company	Industry	Location
Aldi	Grocery	Germany
Bang & Olufsen	Electronics	Denmark
Capital One	Credit card	United States
Capitec	Micro lender	South Africa
Cemex	Cement	Mexico
Cirque du Soleil	Entertainment	Canada
Huawei	Telecommunications	China
Ikea	Furniture	Sweden
Infosys	IT outsourcing	India
ING	Financial services	Holland
Jollibee	Fast food	Philippines
LVMH	Luxury goods	France
Octopus	Transportation services	Hong Kong
Samsung, Nokia	Mobile phones	Korea, Finland
SAP	Enterprise software	Germany
Shanda	Online gaming	China
Singapore Airlines	Airlines	Singapore
Tetra Pak	Packaging	Switzerland
Teva	Generic Rx	Israel
Toyota	Car	Japan
Tsutaya	Video distribution	Japan
Virgin	Consumer brands	United Kingdom
Whole Foods	Grocery	United States
Wipro	IT outsourcing	India
Yamaha	Pianos	Japan
Zara	Apparel	Spain

its online-only business. ICICI Bank, based in India, is moving into Canada and the U.K. Mexico-based Cemex is the most sophisticated and fastest-growing major cement company in the world. The Spanish clothing retailer Zara has spread throughout Europe with its lightning-fast ability to respond to changing fashion tastes. The best generics pharmaceutical business design comes from Israel's Teva; the best furniture business design from Sweden's Ikea; and the best packaging machinery business design from Switzerland's Tetra Pak. As Exhibit 6 suggests, great new business designs are being created in every corner of the globe.

What proprietary information do you know about customers and suppliers?

Winning Through High-Impact Innovation

At the other end of the new value chain is the innovation network. Here, too, we find a metrics and performance gap, as well as underinvestment, even greater than that found on the customer connections side.

We have a science gap caused by two decades of underinvestment, marked in the U.S. by the gradual disassembly of Bell Labs, Xerox Parc, and the Defense Advanced Research Projects Agency, as well as by cutbacks by most companies in fundamental research. The backlog of unsolved science problems, meanwhile, is as great as ever. Smart companies will collaborate with others to close this gap, since they cannot afford to do it on their own.

They will also redefine the concept of innovation. It is no longer R&D on product and process alone, but rather any mode of innovation that creates value for the customer and the investor. This includes innovation in science, product, production process, infrastructure, business process, channel, service, and demand innovation.

Companies will carefully adjust the balance of their investments among these categories, based on which ones will be the most productive in the next two to three years. Bottlenecks in an industry's economic system will move once today's problems are solved. Breakthroughs in product and infrastructure innovation may be followed by channel innovation. Production process innovation may give a company the highest returns over the next year or two, followed by several years of high returns in service innovation. Therefore, companies will periodically rebalance the investment mix to generate the highest returns.

General Electric was one of the first established companies to see the innovation gap and move to fix it. GE managers recognized they had been "squeezing the orange" of existing technologies for the past two decades. It was time to get some new oranges. CEO Jeffrey Immelt started to pump new levels of investment into R&D.

The shift in strategy was not just about more dollars, but also more leveraged dollars that were put to work. The impact of R&D dollars was magnified by changing the source of talent. New talent markets such as India, Russia, Ukraine, and China provided world-class technical talent at steeply discounted prices, and GE took advantage. For example, its R&D center in Bangalore is staffed by 1,800 scientists who work on fields as diverse as optics, jet engines, and imaging. It is the largest GE R&D facility outside the U.S. and is still growing rapidly, lowering the average labor cost of R&D for GE and giving the company access to the capabilities it needs. GE's Shanghai R&D center was the next to open, in 2003, and the process is just beginning.

Of course, going global is not the only way to create R&D leverage; it can be done in the home market as well. One example is the alliance between DuPont and the Massachusetts Institute of Technology (MIT). Initiated in 2000, the alliance is a 10-year effort and the largest corporate research program at MIT, in which DuPont invests $60 million in a joint research program to develop

advanced materials. The agenda includes nano-materials, alternative energy technology, and protective materials. (One current project is developing a "liver-on-a-chip" to test new drugs for toxic side effects before clinical trials.)

For many companies, then, the most powerful moves will be to take advantage of university alliances and global talent sourcing. Every company today, large or small, has to draw the global map of the key talent pools for its business, whether that talent consists of software programmers, machinists, biotechnologists, materials scientists, cinematographers, financial analysts, medical technicians, call center operators, or electronics engineers.

The key point is to spend more on the highest-impact activities. One way is to practice the "open innovation" approach as described by Prof. Henry Chesbrough of the Univ. of California at Berkeley, which advocates building on the innovations of others. There is tremendous leverage in shifting your thinking from "not invented here" to "invented elsewhere, monetized here."

Reckitt Benckiser, a U.K.-based company, has taken this approach to product development in household products such as cleaners and bug sprays, which partly explains why its profits are soaring while rivals are issuing warnings. The company tends to go for less expensive, low-tech innovations. Although Reckitt's R&D budget is just 1.5% of sales (while rivals spend 3%), its profitability is higher than competitors' and it has posted average annual growth of 20% for the past four years.

Keeping Track of It All

Between the customer connection activities at one end of the activity chain and the innovation engines at the other end, there will be a few physical or back-office activities that remain where a company can add value. These should be kept and strengthened. Most of these physical activities, however, are becoming commodity processes.

Value is shifting instead to the proprietary information chain that connects customers to innovation. The information chain includes the purposeful generation, dissemination, management, and revision of information pertaining to a variety of customer, logistics, technology, and purchasing issues.

Firms with highly sophisticated information chains seek to create proprietary information (Capital One asking: "What do we know about customers that others don't?"), actionable information (Club Med asking: "When do we intervene in the customer's process?"), and continuous information (not quarterly probes, but weekly or daily movements, that give early warnings of big shifts). They gain an advantage in value creation by concentrating not on being the first to deploy a technology but on being the best at designing and using their information.

Some of these players are globalizing already. Japan's Tsutaya, a video and music chain, has moved to Thailand and other emerging markets; U.S.-based Harrah's is preparing to expand its casino hotels to Macau and other Asian markets; French-based hotel chain Accor is growing in Morocco, Iberia, and Asia. These firms have demonstrated that proprietary information—better data combined with better application systems, and a culture that knows how to use them—is as potent an advantage as low manufacturing cost, patents, proprietary technology.

Riskier

The globalized economy feels more like a jungle than a country club. Managers will confront new risks, more risks, or a different combination of risks, including supply chain vulnerability, overcapacity, accelerated or more unpredictable price movements, and theft of intellectual capital (see the sidebar on page 15, "Piracy Defense"). Effective risk management was always valuable; it has now become critical.

One of the universal risks is anticipating and adjusting to a new competitive game. How much time do companies have to make the transition?

Piracy Defense

One of the greatest risks of globalization is intellectual capital theft. In the software market alone, the total value of pirated products worldwide reached $32.7 billion in 2004, according to the Business Software Alliance. This is not just a phenomenon of China and India, which have few laws to protect the copyright and patent owners; indeed, 37% of the piracy occurred in the European Union.

The problem goes beyond the well-publicized areas of software, music, films, and pharmaceuticals. New computer technologies make it possible to reverse-engineer a car or a piece of sophisticated machinery down to the smallest details. GM in South Korea is suing Chery for using a GM design as the basis for Chery's QQ car in the Chinese market.

Crafting creative and effective new IC defense systems should now become a high priority. The countermeasures that can be applied include these:

- Divide R&D activities worldwide, then integrate and synthesize at home.
- Move downstream to make technology a smaller piece of the overall customer success equation.
- Move from components to full systems, where systems management, rather than individual high-tech pieces, controls the value.
- Create proprietary information that becomes an indispensable layer of new value that sits on top of the technology layer.
- Redefine innovation far beyond the scope of the traditional science and technology definition to include business design, channel, service, and infrastructure innovation. ❖

The answer depends on the rate of economic evolution in your industry and how it compares to the speed of your internal organizational clock. Externally, the time to market takeover by emerging competitors can be as short as two to four years (DVD players), growing to five to eight years (textiles), seven to ten years (furniture, IT services, ten to 12 years (machine tools), and 15 to 20 years (automotive).

Among the most important factors accounting for a fast market takeover are large labor cost differences, wide retail distribution, and relatively low proprietary technology.

To start getting ahead of the game, ask:

- Do we have the right global business design to play? (See the sidebar on page 16, "Business Design Audit.") What is our current investment and outsourcing plan?
- What changes do we need to make in our mix of people and our organizational structure?
- What is our performance level for customer connection activities? For all our innovation activities (economic as well as technical)? How powerful is our proprietary information chain?
- How do we evolve our risk management system to anticipate and respond to the new waves of risk brought on by globalization?

Because the global world is a riskier world, it will be harder to protect your business. In fact, globalization will turn established companies into start-ups again, with no cushion from yesterday's success, just a focus on creating new success tomorrow. ❖

Business Design Audit

Assess how well your company is prepared

By Phyllis Rothschild and Richard Balaban

Let's say you've made headway in globalizing your company by increasing international revenues each year through local sites, identifying cheaper sources for raw materials, and outsourcing certain low-skilled labor processes. Is this reflected in your financial performance? Are you aware of all the new opportunities and risks? Do you understand which aspects of your business can benefit from globalization and which are under threat?

Major corporations serve many customers, make many offers, participate in many value chains, compete against many threats, and make money in many different ways. In short, they execute many business designs across many geographies. It used to be that going global meant doing the same abroad as what you do domestically and, to some extent, behaving more like a local player. In the next wave of globalization, however, the ability to manage a multi-business-design global portfolio will become a critical source of advantage.

To assess how well your company is prepared for globalization, it's useful to perform a business design audit. This can be done at two levels: First, you can audit an individual business unit to assess how the unit is exposed or advantaged by globalization trends. Second, you can audit the portfolio of business designs within the entire company.

Unlike other audits, this one is prospective rather than retrospective. It can be done quickly and lead to valuable new strategic moves in the near term. More depth and detail can be added as you go along, but initially it covers these issues:

- At both the business unit and the portfolio levels, which economic neighborhoods will be most profitable for you?
- At the portfolio level, which of your current business designs will likely be successful elsewhere?
- Which ones will atrophy?
- Which business designs need to be created and grown in new environments?

Exhibit 1 **Build the fact base ...**

Research	Process	Principles
• Customer interviews	• Strategy refresh: 20-40 customer interviews/feedback • Milestone: feedback from 5-10 customers	• Gather insights from customers and non-customers, satisfied and dissatisfied customers. • Put extensive thought into what will be asked: Ask the hard questions to learn the hard truth. • Infer what is and what is not meant by customers' comments. • Primary "unfiltered" customer data, not merely a reflection of sales force perceptions.
• Customer segmentation	• Dividing and identifying customers based upon the most important unique characteristics – Emerging – Buying patterns – Level of power – Types of assets – Types of work • Use sales force data and analysis, including pricing and invoice data	• The data must be thorough and iterative with the interview process. • Cut the data in a multitude of ways. • Trends are as important as a static view; look forward as much as backward.
• Competitive research and analysis – New offerings – New technology	• Use field personnel knowledge, analyst interviews, and customer interviews to recognize current and potential threats	• Assessments of competitors must be honest evaluations. • Consider potential competitors and extensions of current competitors.
• Industry data	• Technical, demographic, regulatory, substitute products/offers data to determine potential opportunities	• Determine what trends and characteristics will drive purchase and potential value creation in the market.

Starting at the business unit level, globalization calls for a thorough review of all of your business design components from two perspectives: First, is the business design effective today? And second, how will the business design fare in five years, given that price will likely fall and the value of the offering, as well as asset efficiency, will likely rise? Here are the components:

- *Customer selection:* How many countries and segments will you serve? What is the total number of distinct segments you will be managing? What is the common/custom ratio in each segment?
- *Unique value proposition:* How is the value proposition modified by segment? Is the value proposition for leading markets evolving quickly enough to stay two steps ahead of the global IC theft rate?
- *Profit model:* Do you make money the same way in each customer segment? Geography? Are there new profit models available? How many different profit models will you need to manage?
- *Strategic control:* What is the full repertoire of mechanisms to protect your business position, customer relationships, and profits? What are you doing to prevent reverse engineering or outright piracy of products? Do you have close connections to customer segments in every geography?
- *Scope:* What activities do you do yourself? What do you outsource to others—and do you understand the hidden risks involved, especially when dealing with different cultures and time zones? When and why do you go offshore? Whom do you partner with? What collaborations do you want to join or catalyze?
- *Organizational architecture:* How will each development generated by globalization (new value chain, new markets, new styles of innovation) challenge you to develop new

...through external and internal questions

Customers	Market trends	Our strategy
Current customer selection • What is our revenue mix by customer? • Where does profit come from? • Is the origin of revenue and profit changing? • Who are our most profitable customers? • Which customers are showing growth? • Which customers are integral to our strategy?	*Customers* • Who holds the power in the market? Why? • What do they want? • Where is the power going? • Where is the value going? • What can we learn from our most demanding or innovative customers about the future?	*Customers* • What do customers buy from us? Why? • Is our strategy aligned with customers? • What skills must we develop to better service customers? • What unique skills do we have that customers value?
Customer service • Which types of customers choose us? • Why do those customers choose us? • Are we making money off that differentiation? • Why don't customers choose us?	*Competition* • Who is our primary competition? • What do they know that we don't? • Why are they beating us? • Who will be our primary competition in five years? • Where could we compete that we aren't?	*Trends* • What are the implications of the major trends for our strategy? • What are we recognized for? • What could we be recognized for?
Strategic direction • Are our current customers the ones that we want? • Will they be who we want in five years? • What customers are similar to our current customers that we could also satisfy?	*Markets* • What is the nature of the environment in which we work? • What trends exist in the market? • What are the risks? • What new markets are developing?	*Competencies* • What are we recognized for? • What could we be recognized for? • Are these the same as the competencies that the customer desires? Why not?

organizational mechanisms to be effective in hiring, training, and assembling the right mix of people?

In short, does the current business design work? If so, for how much longer? When will you need to reinvent it?

Turning to the corporate portfolio, because large companies typically run many business designs there will be many answers to these component questions. Arraying the answers according to the different ways you make and protect profits will reveal a portfolio of business designs. The portfolio audit has three steps.

1) Think "outside-in."

The first tenet of successful portfolio management is defining the environment in which you participate (or wish to), assessing what it will take to win customers and beat the competition, and then designing and sequencing the right set of strategic moves to create value. For each region, create a solid fact base that covers details on customer priorities, key market trends (technology, regulatory, geopolitical) specific to your industry, sizes of markets and potential growth rates, and competitors and emerging players.

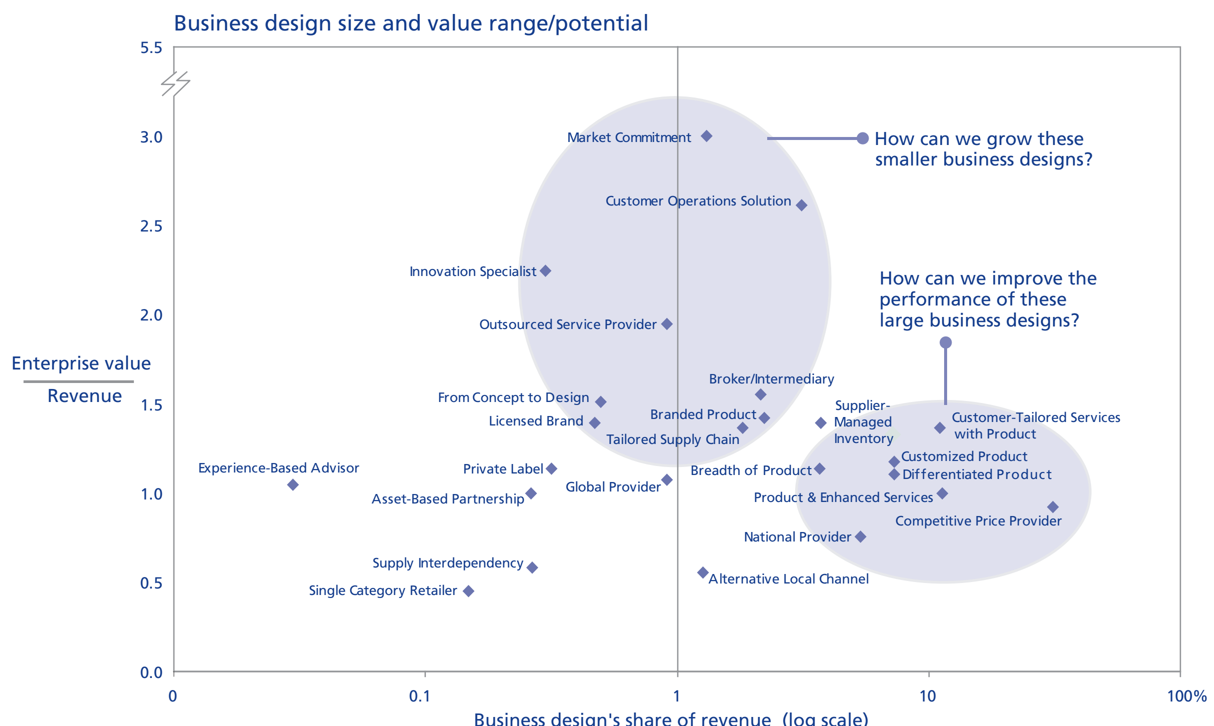
In addition, determine how your company is positioned in each market along such dimensions as incumbency, customer authority, and brand power. Exhibit 1 shows how a global oil-field services company develops its regional fact base and then repeats these questions annually to ensure the answers are fresh. This fact base shows where value has been and will be created and what trends will drive economic profit in the future.

2) Catalog your current business designs.

Now that you have a robust answer about where money will be made, look internally at how you make money today. Figure out which customers you serve, what drives your economics, and what you do to deliver and sustain value. These questions can be sorted into the components of business design listed earlier.

Large companies typically operate many business designs, so there will be several answers for each of these components. For instance, one set of customers buys on a pure commodity basis; for them, the driving factor is lowest price. In this case, customer selection would be high-volume purchasers and the value proposition is lowest delivered price, guaranteed. The value capture could be a long-term fixed contract or spot rates. Scope would include low-cost operations and outsourcing of non-critical functions to cheaper third parties. Strategic control would be the company's low-cost systems and processes or an advantaged

Exhibit 2 **Portfolio performance summary (illustrative)**



input source. Finally, the organization to support this business design would be no-frills and limited custom services. You might call this your "Low Cost" business design.

At the same time, the company may also target higher-value customers with a more solutions-oriented offer. The profit model here would be a function of the customer's enhanced economics; higher levels of service and customer intimacy would be required to make the offer credible. Switching costs would be high because of the firm's access to customer operations. Organizationally, a skilled, high-touch sales force would be required to deliver on the value proposition. This is your "Solutions" business design.

It's important to determine which business designs drive the majority of revenue, which drive profitability and shareholder value, which represent future growth opportunities, which are threatened by their growing irrelevance, and which new business designs have yet to be developed (Exhibit 2). This last group represents "white space" and becomes very important in a global market, because the opportunities to evolve business designs and the sheer number that you might have to manage increase exponentially. And since your competitors will no doubt also recognize that a new region offers growth potential, you must create innovative business designs to capture that new growth.

3) Synthesize steps 1 and 2.

You've looked outside to see where money will be made and inside to see how you make money today. Next, determine which of your business designs you can replicate in a new geography because they have strategic relevance in those markets (these could include money losers in your domestic market). Also, decide which business designs you must discontinue in these uncharted territories because customers are not ready or the local incumbent is too powerful. Finally, identify which new business designs need to be crafted in order to enter valuable white space.

This audit benefits from regular monitoring. As with any successful strategic planning and managing effort, keeping the process evergreen ensures that you can anticipate shifts in the environment and respond early. Apply at least the same level of rigor to crafting your global business design strategy as you do to your manufacturing or technology outsourcing strategy and the payoffs will follow. It's daunting to build and run a complex enterprise with many businesses, geographies, and sources of value. But there is little real choice, since that is how competition is evolving. A business design audit can help overcome that complexity and convert it into new profit growth, as well as calm your nerves and bolster your arsenal for leading the next stage of value growth. ❖

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