3. Adaptation Strategies

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The previous sections of this casebook established the context of semiglobalization and developed a framework for thinking about differences across countries (CAGE) as well as a template for evaluating cross-border strategy options in light of such differences (ADDING value). The rest of this book focuses on what to do about differences, starting, in this section, with the strategy of adaptation, or adjusting to differences.

Adaptation is the most obvious strategic response to differences, and variation the most obvious lever for achieving it: as the adage has it, when in Rome, do as the Romans do. So the focus on the differences between countries should already have underscored the need for variation. This section makes three additional points, which are captured in exhibit 3-1. First, variation should be thought about more broadly than simply tailoring products or services to local market requirements. Second, since variation is costly, smart adaptation typically involves not only appropriate decisions about the amount of variation but use of one or more complementary levers—focus, externalization, design, and innovation—that help improve its effectiveness. Finally, the sheer variety of the levers and sublevers for adaptation suggests room to broaden strategic discussions beyond the usual tug-of-war between headquarters and the field over centralization versus decentralization.

Exhibit 3-1 Levers and Sublevers for Adaptation

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To clarify their content, consider each of the five levers and the various sublevers listed in the exhibit in a bit more detail.

Variation

Variation encompasses changes in products, but also in policies, business positioning, and even metrics (e.g., target rates of return). Researchers have long stressed the critical role of variation in achieving improvements over time though the cycle of variation, selection, and retention. From a strategic standpoint, variation needs to be guided actively through, for example, the use of controlled experimentation and sharing of results across markets).
Products

Product variation is conceptually straightforward, but what is notable is that even products that are supposedly standardized vary a great deal in practice. Thus, Unilever offers more than a hundred variants on its global Lux brand of soaps worldwide. In fact, branding guru Martin Lindstrom reckons that Pringles potato chips is the only major consumer product that is widely available and totally standardized—and that Procter & Gamble imposes significant penalties on itself by insisting on that much uniformity.3

Policies

The need to vary policies across countries can be less obvious than the need to vary products. To appreciate the scope for policy variation, think about a company’s internal policies at the functional level. Human resource policies typically present particular challenges. Companies must contend with administrative differences such as different laws about hiring and firing employees, collective bargaining practices, and legal requirements to provide benefits such as health care and pensions. Cultural and economic differences also loom large as employees in different countries can expect very different things from the same company. Even geographic distance makes itself felt through the complexities of expatriation, the burden of travel, and conferences calls at odd hours to accommodate different time zones. Compounding these challenges is the fact that variation itself can lead employees to question the equity and fairness of a management system.

Other functional areas also present important adaptation requirements. Will a company vary its cash management policies when operating in countries with higher inflation rates? Does a company have to adjust its IT systems to comply with foreign privacy laws? Will factory designs and production methods be adjusted in countries with lower labor costs to substitute labor for capital equipment? Will workplace safety and environmental standards be applied uniformly or will these be varied in accordance with local laws and norms? For each function, think about mixing and matching policies in a way that strikes the best balance possible between internal consistency across locations and fit with the external (local) environment.

Repositioning

Changing the overall positioning of a business is somewhat distinct from, and broader than, changing products or even policies. The case of Coke in China and India provides a useful example. Like most foreign multinationals, Coke entered these markets primarily serving wealthier consumers who were already familiar with the company’s brand and were prepared to pay high prices for its products. Later, Coke conducted a major repositioning to move beyond skimming the top of these markets. Coke lowered price points and margins, reduced costs by indigenizing inputs and distribution, increased availability, particularly in rural areas, and dramatically grew sales volume. This type of repositioning to broaden market penetration is often an important step for foreign multinationals aspiring to become major players in big emerging markets.
Metrics

A final sublever here concerns the adjustment of metrics and targets across countries. Just to focus on the bottom line, average profitability—even within the same industry—often varies greatly across countries. Thus, in one sample of more than forty countries, firms from countries in the top half of the profitability table averaged returns on assets of 9 percent, versus 1 percent for firms from the countries in the bottom half. Although some of this dispersion reflects accounting differences rather than real economic differences, its size does suggest that profitability targets may have to be set at different levels for different countries if a company is serious about penetrating all of them. Obviously, other metrics may require adjustment as well.

To summarize, variation as a lever for adaptation affords multiple possibilities, not just the tailoring of products or services that it most commonly evokes. But that said, variation is costly, and in the extreme, it results in operations that are so different and fragmented across countries that there is no value gained by keeping them together in a single company. As a result, smart adaptation typically involves not only appropriate decisions about variation but also use of one or more of the complementary levers discussed next—focus, externalization, design, and innovation—to help improve its effectiveness.

Focus to Reduce the Need for Variation

Focus involves narrowing scope so as to reduce the amount of variation required. Consider four specific forms of focus: by product, geography, vertical stage, and segment.

Product Focus

Product focus is a potentially powerful sublever for dealing with adaptation challenges because there are often tremendous differences within broad product categories in the degree of variation required to compete in local markets. For example, among TV programs, nature documentaries require much less adaptation than do comedies.

Geographic Focus

Deliberate restriction of geographic scope can permit focus on countries where relatively little adaptation of the domestic value proposition is required—as well as raising the odds of success by permitting managers to concentrate on adaptation requirements for a particular part of the world. Focusing on the home region is particularly common.

Vertical Focus

Companies can also focus on particular vertical “value slivers” and thereby greatly simplify their cross-border operations. For example, the internationally successful
Brazilian food companies Sadia and Perdigao started off exporting raw meat before moving downstream into frozen or processed foods subject to more cultural variation. And the company that resulted from their merger in 2009, Brasil Foods, plans to continue that focus: it is already the world’s largest poultry exporter and has announced plans to become the largest pork exporter as well.

**Segment Focus**

Another option is to focus on market segments that are relatively homogeneous across countries. Premium segments in a number of categories provide examples: they may, for instance, include buyers who travel frequently and develop preferences more attuned to global than local trends. And companies as diverse as Indian packaged foods suppliers and Mexican media operations have penetrated the United States by focusing on their respective diaspora, thereby limiting the need for adaptation.

**Externalization to Reduce the Burden of Variation**

The lever of externalization is related to the lever of focus. However, instead of narrowing scope, externalization splits activities across organizational boundaries to improve organizational effectiveness by reducing the internal burden of adaptation. Externalization subsumes multiple subleviers, of which we will focus on four: strategic alliances, franchising, user adaptation, and networking.

**Strategic Alliances**

Strategic alliances can provide access to local knowledge that would otherwise be hard to purchase, to links in the local value chain that would otherwise be inaccessible, or to local connections, including political ones. Alliances are particularly likely to be used to compete in markets that are distant from one’s home base. In addition, they can reduce certain kinds of risk by permitting commitment in stages rather than all at once. Of course, strategic alliances also impose their own costs and risks, including financial insecurity, lack of control, and misuse of intellectual property. For these reasons, alliances must be treated as a possible sublever for reducing the burden of adaptation and not, as enthusiasts would have it, as a panacea.

**Franchising**

Similar logic applies to other forms of interfim collaboration. Consider the example of franchising. It can help relax internal constraints to growth, increase local responsiveness, contribute to innovation, and inject some reality checks into company decision making. Also, mutual learning between company-owned and franchised locations can be valuable, although it requires extensive coordination.
User Adaptation and Networking

Going even farther out on the spectrum of externalization, one can think of involving customers and other ostensibly independent third parties in the challenge of adaptation. Various approaches to doing so that have been emphasized recently include lead-user development, “mashups,” and “innovation jams.” Perhaps the ultimate example along these lines is the development of open-source software, such as the Linux operating system.

Design to Reduce the Cost of Variation

Design decisions can be used deliberately to reduce the cost of variation. Common, interrelated sublevers in this regard include flexibility, partitioning, platforms, and modularization.

Flexibility

Flexibility is the idea of designing business systems so as to reduce the fixed costs associated with producing different varieties. For example, plants and production systems can be designed for efficient operation at a smaller scale or with shorter production runs. Changes in inventory storage and distribution methods can also increase flexibility.

Partitioning

Partitioning can occur at multiple levels, but at its simplest, it involves clearly separating elements that can be varied across countries from core elements that are not to be tampered with on a piecemeal basis. McDonald’s is generally acknowledged to be a master in this regard. Consumers, particularly in the United States, often think of McDonald’s as a ruthlessly consistent purveyor of Big Macs and the like. But if one visits the company’s outlets around the world, it is obvious that its product offerings vary widely from country to country. To cite just a few examples, McDonald’s offers the Burger McDo (a sweeter burger) and McSpaghetti in the Philippines (but not in Italy!), and it offers “lamb-burgers” in India to avoid offending Hindu sensibilities. Such one-off alterations to a system known for extreme operating consistency clearly require McDonald’s to split choices into those where local adaptation is feasible and those where adaptation would compromise system performance.

Platforms and Modularity

Another approach to cost-effective customization is through designation of a small number of basic platforms per product category that can be elaborated into hundreds of different SKUs. Modularity blurs into platform approaches but, conceptually, involves defining standardized interfaces between all choice elements, rather than just between a platform and the components that sit atop it, so that all elements can be mixed and matched.¹⁸
Innovation to Improve the Effectiveness of Variation

Some of the levers and sublevers discussed above—such as repositioning and design for adaptability—could also be characterized as instances of innovation. While innovation is conceptually a very broad lever, cross-border differences often imply innovation that is somewhat narrower in scope, as illustrated in this section’s discussion of progressively more radical sublevers: transfer, localization, recombination, and transformation.

Transfer

One of the advantages of operating in multiple, varied contexts is that experience may yield innovations or insights in one context that can be transferred to others. And it is important to remember that useful innovations need not originate in a firm’s largest or most advanced markets. For example Disney, Latin America—which accounts for less than 2 percent of Disney’s total revenues—has been a major source of insights into improving Disney International’s efficiency by sharing services and, more importantly, enhancing customer appeal by aligning the Disney experience across major business segments. This is precisely because it has to deal with an often challenging macroeconomic environment without the benefit of cash flow from a theme park.\(^9\)

Localization

Compared to transfer, localization involves more explicit focus on innovation in a targeted geography. One notable example of localization is presented by the Indian arm of Unilever. Though perhaps best known for its extensive local distribution network, it has created local innovation capabilities to leverage that network to great effect. Its product innovations include detergent bars for people who wash their clothes manually, toothpaste to be used with fingers instead of toothbrushes (traditional in India), a skin-lightening cream, and a unique shampoo-and-hair-oil product. Other innovations to cater to price sensitivity include low-unit-price packs, localization to cut manufacturing costs, and the use of advanced technology to coat one side of a soap bar with plastic (so it takes longer to wear down).

Recombination

Recombination involves melding elements of the parent business model with opportunities that arise in new contexts. Star TV’s adaptation of the show *Who Wants to Be a Millionaire?* (licensed from a third party) to the Indian market—key to its building a profitable position there—is a good example. Star opted to use the same basic set, music, and rules in the Hindi version as in the original but decided that the participants, questions, and marketing had to be adapted to the local context. So it hired the dominant Bollywood actor of the era, flew him to London to watch the British version being taped, and worked with him to develop key catchphrases in Hindi. What resulted was perhaps the single biggest blockbuster in Indian television history.
Transformation

Transformation is a way in which firms may directly reduce the need for adaptation by seeking to shape or transform the local environments in which they operate instead of trying to enhance their abilities to fit in. Starbucks provides an interesting example. Although the Seattle-based coffee chain is frequently cited as being in the vanguard of American cultural imperialism, CEO Howard Schultz paints a fascinating picture in his autobiography of his original attempt to recreate an Italian espresso bar experience in the United States—right down to recorded opera music and bow-tied waiters.\(^{10}\) Although the opera music and bow ties soon disappeared, Starbucks transformed U.S. coffee drinkers, who now expect easy chairs, hip music, and a smoke-free environment to enhance their coffee-drinking experience.

Conclusion

Adaptation adjusts to differences across countries, but typically comes at a cost, particularly in terms of diminished scale economies and increased complexity. Thus, the central challenge is determining the appropriate amount of adaptation and finding the most efficient way to achieve it. Fortunately, a comprehensive perspective on adaptation levers and sublevers tremendously expands the headroom to adjust to differences.

However, even with full exploitation of the possibilities, adaptation as a strategy for dealing with semiglobalization still suffers from two distinct sets of limitations. First, associating centralization with decisions made at the global level and decentralization with decisions made at the country level fails to account for cross-border aggregation mechanisms that operate at levels intermediate to individual countries and the whole world. Second, adaptation strategies, almost by definition, treat differences as constraints to be coped with and thereby ignore the possibilities of capitalizing on them. The types of global strategies explored in the next two sections, aggregation and arbitrage, explicitly target those two limitations of adaptation strategies.

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3 Martin Lindstrom, private communication to author, November 24, 2006.
4 See Anita M. McGahan and Rogerio Victer, “How Much Does Home Country Matter to Corporate Profitability?” *Journal of International Business Studies* 41(2010): 142–165. The calculations here are based on data kindly supplied by these authors.

