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The 'country effect' on business strategy

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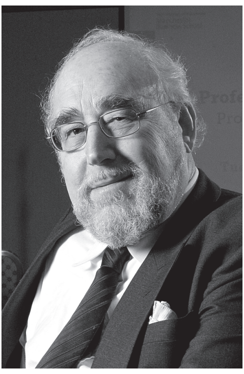

Not long ago, the leader in the field of strategy theory, Michael Porter, after decades of distinguished work of a kind that implied the laws of economics apply everywhere, posed the question: Why is it that the leading firms in most global industries come from just one or two countries? He acknowledged that somehow there seems to be a cultural effect, but that it was little understood.

What he said was true. Leaving aside industries with large government subsidies and staying with those that compete fairly in the global market place, if you want great cars you buy from Japanese or German companies. If you want pharmaceuticals, the leading firms are American or German. For professional services in finance, or consultancy, America dominates. On software it will be the US or India. In advanced engineering Germany or Japan, for trains France and Japan, for cement Mexico and France, for fashion design Italy, for OEM China. This is not a matter of resources. It is a matter of how things are organized.

But the organizing that matters here is not just inside the firms. It is the organizing of the national business system that makes societies better at some industries than others. That system has three main parts: (1) The way firms pull together the resources needed; (2) The ways in which the society handles access to the resources of capital, human talent, and trust; and (3) The culture that gives people an understanding of the basic rules of conduct and the basic reasons for doing things. This is of course complex, but so is a society.

Taking China's dominance of global OEM as an example, this happens because a number of things come together into a pattern that then reinforces itself and expands. There are small and medium enterprises, run by owners very efficiently, and using low cost labour that can learn skills quickly. Technology is medium or low. Design is largely imported. Distribution and marketing is done by other firms in the global chain. Firms become specialized – and so efficient – by specializing, and operating in networks of strong but still flexible connection.

Three cultural features specific to China make the system work better than it would in most other countries. The entrepreneurs who own the firms are driven by a desire to accumulate family wealth – a sacred duty in a Confucian society. They also trust their partners in the network and can do away with lawyers and excess formalities over contracts. They also employ people who fit well into paternalistic organizations. The entrepreneurs largely rely on their own capital, or that of friends or family. The government stands back and let's them get on with it, providing the background infrastructure.

This combination only occurs in China and that is why the workshop of the world is there and not in Morocco, or Brazil, or Poland. The strategy of a firm is already largely shaped by where it is. Sensible managers can work that out for themselves. But the theory is still catching up.