Anselmo Rubiralta Center
for Globalization and Strategy

University of Navarra

Working Paper

WP No 532

December, 2003

NEW FRONTIERS IN INTERNATIONAL STRATEGY

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Abstract

This paper is based on a panel we organized at the "First Annual Conference on Emerging Research Frontiers in International Business Studies", organized by the *Journal of International Business Studies* (JIBS), to discuss several new lines of research in international strategy. Four lines of research are developed: The strategic implications of semiglobalization, the impact of institutional voids in international strategy, primitives and levels of analysis in international business, and strategies for the base of the pyramid. Taken together, these studies aim to open a new frontier in our understanding of International Strategy, based on the co-location of firms and places as a key element in international business.

Keywords: international business; semiglobalization; international strategy; base of the pyramid; institutions; competitiveness

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1.- Introduction

This paper is based on a panel we organized at the "First Annual Conference on Emerging Research Frontiers in International Business Studies", organized by the *Journal of International Business Studies* (JIBS), to discuss several new lines of research in international strategy. This introductory section begins with a review of the International Business (IB) literature, followed by an analysis of the key research streams in the literature. The body of the paper describes the main insights presented by the panellists in the discussion entitled "New Frontiers in International Strategy".

International business research has focused on a number of issues directly linked to firm strategy. In the 1970s and 1980s, many of the issues of interest in the strategy field, such as industry environments, market share-performance linkages, positioning and generic strategies, market and customer selection, oligopolistic strategies, and diversification, had their counterparts in the international business literature. In many cases, international business researchers addressed much the same questions as strategy researchers, either with the added complexity of studying management across multiple country operations or performing comparative studies. In other cases, such as diversification, where international business researchers focused on geographic diversification while strategy researchers focused on industry diversification, international business researchers worked on analogous, if not identical, issues. Transaction cost theories of the firm were developed more or less at the same time as transaction cost theories of the multinational firm. The same is true of knowledge-based views of the firm in the strategy field and knowledge-based views of the multinational firm in the international business literature.

In recent years, however, the field of international business appears to have focused more on the management and organization of multinational companies and less on the underlying strategies of the firms involved. Even though several recurrent themes in IB research, including the underlying rationale for the existence of multinational companies, the process of internationalisation and foreign market entry, and the organization and management of multinational firms, have direct links to firms' international strategy, international business research seems increasingly to have focused on "how" multinationals do what they do, rather than "what" they do, or "why" they do it in the first place. The IB literature has accepted the strong belief that the logical response to globalization is the Multinational Corporation. International strategy was to be global strategy, a strategy developed from MNC headquarters' point of view. The world was globalizing, companies needed to respond to globalization by arbitraging on local advantages and exploiting tremendous economies of scale. Defining strategy, and especially organization, for this new beast, the MNC, was to be the key focus of the strategic agenda of international strategy.

In addition to the links identified above, several of the focal issues in IB research have close links to the strategy field, including the rationale for the multinational firm, internationalisation and market entry strategies, locational strategies, and the organization and management of multinational firms.

IB Research Streams

There are several recurrent themes in the IB literature, including the rationales for multinational firms, the process of internationalization, entry modes for international expansion, location decisions, and the management of international subsidiaries. Several rationales for the existence of the multinational firm have been suggested in the literature, including product life cycles (Vernon, 1966), oligopolistic interaction (Hymer, 1976), transaction costs for intangible assets (Caves, 1996; Buckley & Casson, 1976; Hennart, 1982), and the ability to obtain and deploy knowledge across international markets (Kogut and Zander, 1993). The internationalization process also has received attention (Johanson & Vahlne, 1977, 1990), as has the impact of the degree of internationalization on firm performance (Carpano et al., 1994; Contractor et al., 2003; Ruigrok & Wagner, 2003). A large literature on foreign entry modes has contrasted the performance of firms that entered new markets through acquisition, green-field facilities, alliances, licenses, or other entry modes (Root, 1987; Hennart, 1982; Buckley & Casson, 1996; 1998a, etc.). A substantial portion of the international business literature focuses on the organization and management of multinational firms. Issues addressed have included the control and coordination of national subsidiaries, the level of integration across national subsidiaries, and the balance between global headquarters control and autonomy of national subsidiaries (Doz & Prahalad, 1984; Gates & Egelhoff, 1986; Martinez & Jarillo, 1989, 1991; Paterson & Brock, 2002).

The relative importance of the different streams of IB research in recent years can be discerned from Werner (2002)[1], which classifies international management research in top journals from 1996 to 2000. Of the 271 articles classified, 128 are from JIBS, with SMJ, AMJ and JoM far behind. As shown in the table below, some 144 of the papers focus on internationalisation, 104 focus on multinational enterprises, and 23 focus on regulatory changes and international risk management in the global business environment. The articles classified are all those that focus on some aspect of international management. Comparative management studies focused on cross-cultural differences and foreign domestic studies focused on non-US countries were not included in the classification.

Internationalization	**144**
Pure internationalization	34
Entry Mode Decisions	33
International Joint Ventures	25
Foreign Direct Investment	37
International Exchange	15
Multinational Enterprises	**104**
Pure topics	16
Knowledge Transfer	16
Strategic Alliances and Networks	18
Subsidiary-HQ Relations	18
Subsidiary and Multinational Team Management	20
Expatriate Management	16
Global Business Environment	**23**
TOTAL	**271**

1 Steve Werner, "Recent Developments in International Management Research: A Review of the 20 Top Management Journals", *Journal of Management* 2002, 28 (3) 277-305.

The international business literature that does focus on strategy shows particular patterns as well. A search of the *Journal of International Business Studies* archives from 1970 to July 2003 yielded 84 papers with the word "strategy" in the abstract. Of these, 27% focused either on overall international strategy issues such as configuring and coordinating international operations, linking the theory of the multinational to strategy, customer or market selection, etc. (11 papers), or on core strategy issues such as pricing strategies, generic strategies, market share-performance, oligopolistic strategies, etc. (12 papers). The rest focused on multinational activities, on international aspects of functional strategies or on macroeconomics-political influences (see table below). The remaining papers formed a diverse set that included industry studies (4 papers), links between strategy and mindsets or beliefs (4 papers), and even publishing strategies for international business researchers (1 paper) (JIBS Archive, 2003).

Overall International Strategy Issues	**11**
Core strategy	**12**
Multinational Enterprises	**18**
Organizational Structure	5
Location Decisions	4
Entry Modes	4
Alliances and Joint Ventures	5
International Aspects of Functional Strategies	**22**
Human Resource Management	9
Technology Management	4
Sourcing	3
Marketing	2
Control and Accounting	2
Manufacturing	1
Information Management	1
Macroeconomics and political issues	**11**
Miscellaneous	**10**
TOTAL	**84**

While the research agenda was quite complex, the strategic framework was relatively simple. The world was seen as the equilibrium between the two streams of globalization and localization. Technological change was bringing convergence in tastes, customs and products. However, implementation required some degree of localization to respond to local needs and cultures, as well as to benefit from local advantages, be they strong currency, low raw material costs, low labour cost or even fiscal advantages.

In recent years, many forces have combined to change the face of international business. Several of these forces are loosely grouped under the rubric of "globalization." These include the expansion of global finance and financial markets, the spread of knowledge facilitated by improved communication, the widespread availability and use of technology, the active expansion of multinational firms, the decoupling and decentralization of economic activities within and between firms, the blurring of nationality of multinationals, reductions in barriers to trade and investment, the increased importance and power of supranational organizations such as the European Union, and the emergence of regions and regional identities that transcend borders. Added to this list today would be the rise of electronic communities over the Internet and the fact that nations comprising nearly one half of the world's population (including China, India, South Africa, the former Eastern bloc, and the formerly import substitution driven economies of Latin America) have either entered or have dramatically changed their relationship to the world economy (Enright, 1997, 2000a). In some senses, globalization has proceeded to an extent well beyond what Levitt conceived in his famous article on globalization (Levitt, 1983).

On the other hand, the very importance of the forces described above have engendered both backlashes and rethinking. The backlash against globalization has taken on many forms and has forced multinational firms to deal with new political as well as economic realities. At the same time, the forces have resulted in a renewed focus on issues concerning international business and the multinational firm. Globalization has opened new potential markets as it has encouraged the rise of new competitors. Increased competition, the emergence of new locations in the international economy, and the ability of firms to slice their activities ever more thinly has drawn fresh attention to the nature of locational advantages and disadvantages. As a result, firms are taking a new look at their international strategies.

To face the realities of the 21st century we need a different paradigm in relation to IB and International Strategy: a view of the world that goes beyond the tension between globalization and localization controlled by MNCs. Not surprisingly, one of the areas that Werner identifies for future research in IB is MNC strategies. We know a lot about MNCs but not much about how they should define their strategy in a complex globalized environment.

The view of the world we propose is an ecology of places and firms. Firms are not just local firms vs. MNC firms. We have many different types: local firms, regional firms, firms that operate in a few countries, centralized firms, networks of firms, etc. Diverse firms, with diverse characteristics and diverse sources of competitive advantage. At the same time, firms operate in places whose ecology is even more diverse than the firms themselves. IB is the co-location of the two ecologies of places and firms.

This is a complex view to grasp. We do not have all the necessary information to do so yet, although we do have a number of approaches that are moving us in this direction, breaking the old paradigms and bringing us to the new frontiers in strategy.

The next section introduces us to the idea of semiglobalization. The polar view between localization and globalization is not enough. The polarity misses the richness in the ecology of places. Semiglobalization underlies interesting variations in location-specificity and, as such, is logically essential to the possibility of distinctive content for international business strategy.

According to Prof. Ghemawat, given the interest in location-specificity, the fundamental question in international business strategy is, or ought to be, “Why do countries differ?” He notes several distinct types of dimensions along which countries may differ: cultural (religion, race, social norms, language…), administrative (political and economic relationships), geographic, and economic (wealth and income). To deal with this complexity, he proposes that country differences should be studied with integrative frameworks that include bilateral and multilateral as well as indexical measures, paying particular attention to the differences that matter most in the particular industry (or industries) under consideration and offering cross-country perspectives rather than just deep but narrow perspectives on individual countries.

The world is undoubtedly complex. Understanding different places is essential. And a key element is local institutions. Prof. Khanna argues that institutional voids arise where specialized intermediaries are absent. Without the information provided by these intermediaries, key strategic decisions are more difficult to make, affecting industry analysis, positioning and sustainability, the key fundamentals of competitive strategy. Firms acting in different places should be aware of the strategic consequences of institutional voids.

Another key aspect is the need to integrate places into competitive strategy, i.e. use the international dimension as a source of competitive advantage. We can do this by approaching strategy from a competitiveness point of view, as proposed by Prof. Enright. He suggests that competitiveness be analyzed not by integrating boxes that only apply to developed countries, but by integrating different levels, from supranational to macro, meso, micro and firm level. By analyzing all these levels one can reach a better understanding of firm-based and location-based advantages, essentially co-locating firms and places.

Finally, in our last section, Prof. Hart focuses on a particular application of some of these ideas, using place as an ingredient for competitive advantage. MNCs have traditionally focused on serving the top of the pyramid in underdeveloped countries. The central view was to use products and capabilities that had proved useful in developed countries. However, adapting to an unfamiliar place requires a new way of thinking. Learning from the difficulties encountered in serving the bottom of the pyramid can be a way to develop new, untouched markets and a fantastic opportunity for disruptive innovation.

Taken together, these studies aim to open a new frontier in our understanding of International Strategy. Any new frontier is full of uncertainties. But we have learned enough so far to be able to penetrate the unknown and shed new light for managers and companies. Let's go deeper into the new frontier.

2. Semiglobalization and Strategy (P. Ghemawat)

In a previous paper in *JIBS* (Ghemawat, 2003a), I presented evidence indicating that most measures of cross-border market integration have scaled new heights in the last few decades but still fall far short of economic theory's ideal of perfect integration. I called this state of incomplete cross-border integration "semiglobalization" and pointed out that this structural condition of intermediate levels of international integration is what affords room for international business strategy to have content that truly is distinctive from "mainstream" (single country or location) business strategy. In contrast, the polar possibility of zero cross-border integration would imply complete international segmentation of output and input markets, and strategy could presumably be set country by country, using the single-country tools and frameworks of "mainstream" business strategy[2]. And at the other pole, with complete cross-border integration, the single-country approach would, once again, suffice: the world could simply be treated as one big country or melting pot. It is only with semiglobalization that international strategy has the potential for content distinctive from the single-country case that is the baseline for most strategic thinking.

This essay focuses on the realization of that potential for distinctive content. To set the stage, it is useful to begin by parsing the field of strategy into the domains depicted in Table 1 (also discussed in more detail in Ghemawat, 2003a). Note the somewhat paradoxical character

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[2] Admittedly, at this polar extreme there would still be room for interesting cross-country comparative research aimed at correcting for the U.S.-centric approach that continues to pervade most "mainstream" strategic thinking. But such research should properly be classified as a contribution to single-country strategy, i.e., domains 1 or 2 of the matrix in Table 1, rather than domains 3 or 4.

of domain 1, mainstream business strategy: by assuming total specificity, it allots the least attention to actually understanding either business/usage-specificity or location-specificity. As a result, we have to look to domain 2, that of mainstream corporate strategy, for interesting analyses of variations in the extent to which key firm activities, resources or knowledge are business-specific as opposed to generic in the sense of being fungible across businesses. And we must also look to domain 3, that of international business strategy, for analyses of variations in the extent to which activities, resources, knowledge, etcetera are location-specific as opposed to generic in the sense of being fungible across locations. Domain 4, featuring international corporate strategy, combines considerations of business/usage specificity and location-specificity. The point of Table 1, however, is not to celebrate the synthesis in domain 4 but, instead, to make it clear that location-specificity is essential to the possibility of international strategy having distinctive content. The link back to semiglobalization is that with zero integration of markets across locations, location-specificity would be at a maximum, and that at the other pole, with complete integration, location-specificity would be at a minimum. Semiglobalization underlies subtler variations in location-specificity.

Table 1. Strategy Domains

Focus		Increasing Attention to **Business-Specificity/Nonspecificity**	
		Single Business	Multiple Businesses
Increasing Attention to **Location-Specificity/Nonspecificity** ↑	Multiple Countries/ Locations	3. International Business Strategy	4. International Corporate Strategy
	Single Country/ Location	1. (Mainstream) Business Strategy	2. (Mainstream) Corporate Strategy

Source: Ghemawat (2003a).

There are, of course, many ways in which one might think about or study location-specificity. But one particularly obvious approach parallels the fundamental question that has proved fruitful in mainstream business strategy –why do firms differ– by asking why countries or locations differ. In both cases, the focus on firm differences helps differentiate the content of the strategy agenda from that of economics: from industrial organization economics in the case of mainstream business strategy and from international economics in the case of international business strategy. But once again, the overlay of locational differences is what gives international business strategy its distinctive content. Another way of making the same point is that the overlay of locational and firm-level differences is the specific perspective that this essay proposes on the “ecology of places and firms” highlighted in the introduction to this paper.

Why, apart from the parallel with mainstream business strategy, should the question of why countries or locations differ be focused on as fundamental in international business strategy? First, it seems a sensible response to the dearth of “big research questions” in international business that was recently flagged by Buckley (2002, p. 370) in his Presidential Address to the AIB:

> International business has succeeded because it has focused on, in sequence, a number of big questions, which arise from empirical developments in the world economy. The agenda is stalled because no such big question has currently been identified. This calls into question the separate existence of the subject area.

While one can think up other "big questions" –e.g., the question of why industries differ and how that matters that is discussed below– the notion of (variations in) location-specificity that underlies the question proposed here should, for the conceptual reasons discussed above, be expected to be essential to the development of *distinctive* content for international strategy.

A second and related reason for focusing on the question of why countries or locations differ is that it proves helpful in classifying many interesting strands of recent research in international business. The works of the authors in the sections following this one provide salient examples. To simplify, the next section focuses on cross-country differences in terms of the presence or absence of specialized intermediaries and the broader stream of work on international business of which it forms part highlights institutional differences across countries (with specialized intermediaries conceptualized in terms of varieties of institutional infrastructure). Section 4 in this paper takes a somewhat different tack but can be seen as part of a broader research stream on regional strategies, geographic clustering and other topics that has helped bring the geographic dimensions of the differences between countries/locations into sharper focus. And section 5 focuses attention on the (very large) differences in per capita income across countries –or to be more exact, on the very-low-income end of that continuum because that is relatively understudied. The fundamental question of why countries or locations differ is one way of slotting these diverse research thrusts in international business into a common frame– as different ways of answering the same fundamental question. In addition, this question can help international business link to other fields of study that are tackling complementary issues, e.g., the cross-country corporate governance literature (e.g., Rajan and Zingales, 1998 and Beck, 2001). However, the discussion of such linkages goes beyond the scope of this short essay.

The preceding list of possible answers to the question of why countries differ also suggests that the dimensionality of the range of differences across countries is large. Dimensionality is increased further by the consideration that that list is far from comprehensive. Efforts to extend and elaborate the known dimensions of difference across countries occupy a good chunk of the current international business research agenda, which makes some sense. But some attention should also be allotted, this essay argues, to the issue of how to move beyond essentially piecemeal consideration of a large number of individual dimensions of difference. Some insights into how to proceed can be inferred by focusing on what is probably the most systematic and successful class of attempts, so far, to integrate the implications of multiple dimensions of difference for cross-border economic activity: implementations of the "gravity model" (primarily in international economics).

The gravity model in economics bears a rough resemblance to Newton's law of universal gravitation, down to having originally been proposed in the economic context by an astronomer, James Stewart. The model posits that economic interactions between two locations are directly related to the product of their economic mass and inversely related to the geographic distance between them –as well as to measures of distance along other dimensions. Fitted relationships of this sort manage to explain one-half or even two-thirds of the variation in aggregate bilateral trade between country-pairs. Gravity models have also been fitted with some success to bilateral foreign direct investment (FDI) and even cross-border equity flows. As a result, fitted gravity models have been described as supplying "some of the clearest and most robust empirical findings in economics" (Leamer and Levinsohn, 1995:1384).

At least in the context of trade, it is possible to offer some gravity-based assessments of how much different types of differences across countries matter, on average, for cross-border economic activity: see Table 2 for a recent analysis by Ghemawat and Mallick (2003).

While the precise magnitudes of the estimated coefficients in Table 2 are interesting, what are even more important are four emergent insights about how to think –and not think– about the differences across countries:

Table 2. Estimated Effects: A Gravity Model of Bilateral Trade*

Dimensions of Distance/Proximity	**Determinant**	Change in Trade
Cultural	Common Language	+42%
Administrative	Common Regional Trading Bloc	+47%
	Colony/Colonizer	+188%
	Common Currency	+114%
	Differences in Corruption	-11%
Geographic	Physical Distance: 1% increase	-1.1%
	Physical Size: 1% increase	-0.2%
	Landlockedness	-48%
	Common Land Border	+125%
Economic	Economic Size: GDP (1% increase)	+0.8%
	Income Level: GDP per capita (1% increase)	+0.7%

*Estimates are all significant at the 1% level but are, in many cases, smaller than those reported in previous studies, apparently due to correction for censoring.

Source: Ghemawat and Mallick (2003).

1. Integrative frameworks. The estimates in Table 2 are big enough and distributed broadly enough to call into question, at least from the strategic perspective, the research strategy of trying to establish that one category of differences (e.g., institutional, which currently seems to be in an ascendant phase: cf., Acemoglu, Johnson and Robinson, 2002) generally trumps all the rest. Similar considerations also hint at the potential usefulness of a general framework for thinking about why countries differ as a supplement to specialized models of individual dimensions of difference. Table 3a presents my own proposal in this regard, which is implicit in the groupings in Table 2, and which I refer to as the **CAGE** framework (see Ghemawat, 2001 for additional details). The acronym is meant to evoke the **C**ultural, **A**dministrative/political/institutional, **G**eographic and economic dimensions of differences across countries. Others might further unbundle some of the CAGE categories[3] or modify or even recast them. But it is not necessary to pass judgment on competing frameworks for thinking about why countries differ to make the point that *some* such framework for organizing thinking is likely to prove helpful.

2. Inadequacies of Indexicality. Many of the integrative frameworks that *have* been proposed for purposes of understanding the differences across countries (or locations) presume that countries can be assessed one-by-one or unilaterally against a common yardstick –possibly calibrated on the basis of the actual population distribution– to yield meaningful rankings or contrasts. Note that indexicality in this sense encompasses not only cardinal indexes such as the World Economic Forum's Global Competitiveness Indexes (formerly one, now two) or Transparency International's Corrruption Perceptions Index but also ordinal ranking schemes such as Porter's "diamond" framework for diagnosing the (relative) international competitiveness of different countries as home bases in specific

[3] If pressed to unbundle the CAGE framework further, I would probably split the administrative category into institutional precommitments, government policies and interest group politics/political preferences that have the power to influence policies over time. I would also elaborate further on variations in the usage specificity of the relevant economic factors, inputs, infrastructure, et cetera. But the acronym would be a problem.

industries. But the simplicity of indexicality is purchased at a price: the summarization of an entire structure in terms of a simple index number or contrast is, inevitably, Procrustean[4]. For example, the physical distance between country pairs cannot be represented in terms of country-by-country index numbers. More broadly, indexicality is inattentive to the bilateral character of many of the dimensions of difference in Tables 2 and 3a, which suggests that countries be envisioned as existing in (and even occupying) space in relation to each other instead of as an array along a common yardstick. In other words, countries should be represented as nodes in a network rather than as a heap of structurally equivalent objects.

Table 3a. The CAGE Framework: Country-Level Analysis

	Cultural Differences	**Administrative Differences**	**Geographic Differences**	**Economic Differences**
Bilateral Measures	– Different languages – Different ethnicities/lack of connective ethnic or social networks – Different religions – Differences in national work systems – Different values, norms and dispositions	– Lack of colonial ties – Lack of shared regional trading bloc – Lack of common currency – Different legal system – Political hostility	– Physical distance – Lack of land border – Differences in climates (and disease environments)	– Differences in consumer incomes – Differences in availability of: – Natural resources – Financial resources – Human resources – Intermediate inputs – Infrastructure – Information or knowledge
Unilateral Measures	– Traditionalism – Insularity – Spiritualism – Inscrutability	– Nonmarket/closed economy (home bias versus foreign bias) – Nonmembership in international orgs. – Weak legal institutions/corruption – Lack of govt. checks and balances – Societal conflict – Political/expropriation risk	– Landlockedness – Geographic size – Geographic remoteness	– Economic size – Low per capita income – Low level of monetization – Limited infrastructure, other specialized factors

Source: Ghemawat (2001).

The tendency to neglect this point about bilateral (or more broadly, relational) measures is particularly unfortunate because such measures often turn out, at least in gravity models of international trade, to exert effects that are as large if not much larger than unilateral measures'. Having made that distinction, it is useful to add that unilateral influences –i.e., influences specific to individual countries rather than to country-pairs– are by no means incompatible with careful consideration of the bilateral influences to which gravity models, almost by definition, draw our attention. A formal link is supplied by a

[4] For a somewhat more extended discussion of indexicality in a broader social science context, see Abbott (2001), especially pp. 11-12 and chapter 6.

unilateral measure of isolation (or integration), which captures unilateral country-specific attributes that generally decrease (or increase) a country's involvement in cross-border economic activities and which can be treated as a common component of that country's distances from other countries. For example, really isolated countries (characterized by unique, ingrown cultures, closed administrative policies, physical remoteness, etc.) can be thought of as being relatively distant from everywhere else.

3. Industry Context. Common sense suggests that industry context has a profound impact on how much a specific type of difference across locations matters in a particular context. For example, cross-border flows of cement are more sensitive to the effects of geographic distance than cross-border flows of satellite TV programming, but less subject to cultural (as in linguistic) differences or administrative restrictions due to political-sensitivity. Such variation in industry attributes or context has an *enormous* influence on the content of effective international strategies in the two settings: compare Ghemawat and Thomas's (2003) research case on Cemex in the cement industry with Ghemawat's (2004) research case on Star TV in the Asian satellite TV industry. More generally, disaggregated gravity modeling confirms that such industry-level variations in the effects of given differences are important enough that they must be attended to (e.g., Head and Mayer 2000, 2002; Ghemawat and Mallick, 2003). Attention to industry contextuality helps pare down some of the complexity induced by multidimensional (point #1) and relational as well as unilateral (point #2) measures of differences among locations. And it suggests that the ways in which industries differ from each other, and how that matters, constitute another fruitfully fundamental "big question" in international business strategy, just as they do in mainstream business strategy. In the terms used in the introduction to this paper, while the ecology of firms and locations is often discussed in a general way, applications often require that it be looked at from the perspective of specific industries. For an illustrative attempt to relate the salience of different categories of differences across countries identified by the CAGE framework to industry characteristics, see Table 3b.

Table 3b. The CAGE Framework: Industry-Level Analysis

	Cultural Sensitivity	Administrative Sensitivity	Geographic Sensitivity	Economic Sensitivity
Industry Character-istics	-High linguistic content (TV programming) -Local tradition/identity (ego-expressive prod.) -Significant diff. in preferences (hor. diff.) .idiosyncr. tastes (fish sausage, boxer shorts) .design diff. (autos) .diff. in standards (electrical appliances) .diff. in sizes/packages (processed foods) .diff. in target segments (boom boxes-U.S. vs. Japan) -Entrenched tastes -Home bias ("local" preferences) +Strong country-of-origin effects (vertical differentiation)	-High govt. involvement .procurement/funding (mass transportation products) .regulation (healthcare) .state ownership (telecoms) -Strategic industry status .size (autos) .votes/organization (agriculture, textiles) .national security concerns (telecommunications) .anointed national champions (aerospace) -National patrimony effects (natural resources) -Mass consumption/staple products (food, fuel/energy) -Asset specificity and the scope for holdup (infrastr.) -Specific profit restr. on foreign competitors/opportunities	-Low value to weight/bulk (cement) -Hazards/diff. in transport. -Perishability (fruit) -Importance of connectivity (fin. serv.) -Intense local supervision requirements (restaurants) -Other local perform. req. for value activities (many services) **NOTE**: Many of these conditions tend to favor FDI relative to trade	-High intensity of labor, other factors prone to abs. cost or efficiency diff. (garments) -Potential intl. scale/scope/experience effects -Different cycles (cement) -Diff. in willingness to pay/profitability -Income-related differences in demand (automobiles) -Need for variety/agility/responsive-ness (home appliances) -Differences in suppliers/channels/ business systems (insurance)

Source: Ghemawat (2001).

4. Implications for Strategy. In pondering the implications for firm strategy of focusing on the differences across countries or locations, it is useful to start, once again, with a parallel drawn from mainstream business strategy. While the question of why firms differ is a good starting point in the mainstream context, it is far from a good stopping point: how those differences matter is an essential follow-up question to the extent that there is any interest in devising implications for firm strategy. Mainstream business strategy has made some progress in this regard in recent decades because, while it takes the differences across firms seriously, it has generally managed to refrain from overemphasizing them to an extent that might push the clock back to the old days of business policy, in which firms were essentially seen as unique and analytical attention to competitive interactions and pressures was quite limited. By analogy, international business strategy should take the differences across countries seriously, but probably not to the point of focusing on local variation to the exclusion of all else. In other words, it would be useful to be able to offer firms that cross borders advice that goes beyond "Never underestimate the importance of local knowledge" –even if one believes that many firms could still benefit from taking local variation or knowledge more seriously. Or to use the terminology originally introduced to the social sciences by Pike (1954), we need "etic" knowledge –the cross-country perspective of a detached observer– as well as "emic" knowledge –the deep but narrow single-country perspective of a native participant[5]. Ghemawat (2003a) elaborates on some specific proposals for making progress towards the etic objective, including appropriately broad identification of variables that embody location-specificity, and explicit recognition of arbitrage strategies that capitalize on the remaining differences across countries as well as strategies of adaptation or aggregation that try to cope with such differences while seeking to encash similarities as economies of scale or scope. The arbitrage strategy, studied earlier by Kogut (1985a; 1985b), among a few others, is reconceptualized in terms of a broader range of differences across countries and elaborated on in Ghemawat (2003b), who also discusses how it differs from adaptation/aggregation as a strategic approach.

In summary, this short essay started out with the observations that semiglobalization is both characteristic empirically of the level of cross-border integration of markets and essential logically to the possibility of distinctive content for international business strategy. Semiglobalization underlies interesting variations in location-specificity and, in parallel with mainstream business strategy's fundamental question of "why firms differ," directs attention to "why countries or locations differ" as the fundamental (overlay) question in international business strategy. Attempts to answer this question, particularly on the basis of gravity models of international trade, suggest that the differences across countries must be addressed with integrative frameworks that go beyond indexical measures of difference to include bilateral and multilateral ones, pay explicit attention to the industry context (which suggests a third fundamental question, "why industries differ"), and attempt to offer cross-country perspectives on firm strategy. The intent behind ranging so broadly in a short piece has been to encourage additional discussion of and research into foundational issues in international business strategy that seem sorely understudied.

3. Institutional voids (T. Khanna)

Understanding location-specificity is, therefore, fundamental to International Business. This section shows that institutional voids –defined below as the paucity of the

[5] According to Pike, "The etic view is cross-cultural in that its units are derived by comparing many systems and by abstracting from them units which are synthesized into a single scheme which is then analytically applied as a single system. The emic view is monocultural with its units derived from the internal functional relations of only one individual or culture at a time."

specialized intermediaries needed to consummate transactions– are central to understanding such location-specificity, and also to understand the nature of cross-border transactions. Finally, I argue that scholars cannot analyze the sustainability of strategies commonly discussed in the IB field without endogenizing the role, and evolution, of specialized intermediaries.

What are institutional voids?

Institutional voids occur when specialized intermediaries are absent. Intermediaries are economic entities that insert themselves *between* a potential buyer and a potential seller in an attempt to bring them together by reducing potential transaction costs (Coase, 1937; Williamson, 1985).

To appreciate this concept's importance, consider a simple stylized market where there is no role for a specialized intermediary. Then consider adding on a variety of real-world features, each of which ensures the need for (a different kind of) an intermediary.

Two individuals engaged in a barter transaction involving the simplest possible items in an erstwhile primitive economy –a simple article of clothing in exchange for some food. The uses of the items in question are reasonably well specified; that is, there is little ambiguity about the value of the items in question. Further, the exchange has the property of simultaneous satisfaction of the wants of the two individuals. There is no role for a third party to intermediate this transaction.

a) First, consider what happens if the exchange is subject to a time-lag. That is, A has the clothing, but B promises to give the food in exchange later on. Now there is a potential need to ensure that B does not renege ex post and that, if this happens, there is some redress available to A. The redressing mechanism is an example of a contract guarantor that intermediates the transaction. It gives A the confidence to transact and reduces costly bargaining.

b) Second, imagine that the items being exchanged are not simple, but require some third-party expertise in evaluating quality. For the transaction to not break down due to the classic "lemons problem" (Akerlof, 1970), a certification mechanism is needed. This is an example of an information-providing specialized intermediary.

c) Third, consider that A wishes to transact but cannot find B. Then it might need the services of a different kind of information intermediary that matches potential buyers and sellers.

It is straightforward to see why, in the absence of intermediaries of the sort mentioned above, commerce will, quite simply, collapse. Thus, understanding what happens when there is a paucity of specialized intermediation is fundamental to understanding all manner of commerce.

Further note that, while the language used above is that of 'goods,' it applies with equal force to all kinds of markets, including markets for talent, capital, ideas, etcetera. Thus, talent is particularly hard to evaluate, requiring the existence of labor market intermediaries like search firms and business schools. The patent system facilitates, at least partially, contracting on ideas. Virtually all provision of capital is subject to the temporal problem alluded to above, since it typically involves an investor giving something in return for the (uncertain) promise of a future return.

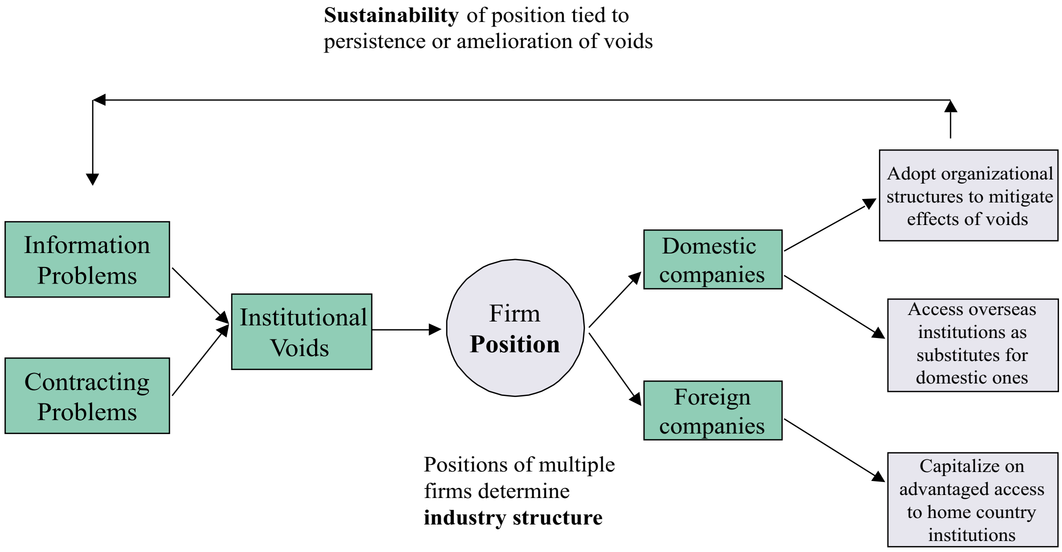
In addition to being a simple lens through which a wide variety of phenomena can be interpreted, the idea of institutional voids points to a variety of un-researched phenomena that are relevant to scholars of international business. In what follows, I will first consider topics conventionally studied by the *JIBS* community –for simplicity, divided between within-country and cross-country issues– and then comment briefly on new research frontiers suggested by this lens. Note that 'country' is used as a summary expression for a geographic unit of analysis, but the reasoning applies equally to sub-national or supra-national units of analysis.

Within-country topics

Scholars of international business have long been concerned about tailoring strategies to particular contexts (Prahalad and Doz, 1987; Bartlett and Ghoshal, 1989). By viewing contexts through the lens of specialized institutions, it becomes clear that contexts vary widely. Further, it is not difficult to imagine that the choice of which activities (Porter 1985) to perform, and the choice of how to perform these, may be quite different if the services provided by specialized intermediaries are missing. In searching for managerial talent, for instance, companies will have to perform extensive screening of outside pools of talent, that is, assuming they can locate and identify such a talent pool in the first instance. Raising external capital requires credibly convincing external capital providers that the money that is being sought will be used in the way that is intended. This would be incredibly difficult if there were no independent auditors to certify that this was indeed so, and if there were no recourse mechanisms available to investors in the face of often unavoidable after-the-fact disputes. Thus, the lens of specialized intermediation points inexorably to the idea of context-dependence of strategy.

One can see how context-dependence affects both industry analysis and positioning (Porter, 1980, 1985). Consider industry analysis first (Khanna, 2002). Porter's five-forces framework is about identifying which economic constituency –buyers of a product, suppliers, or the firms that make the product– have the greatest economic power and, thus, walk away with the maximal rents. But the way in which this division of the pie occurs depends very much on (typically unstated) assumptions regarding specialized intermediation. For example, for talent to bargain away rents, it matters whether it has access to collective representation (unions, for example). It also matters whether capital market intermediaries are present that can facilitate talent leaving and starting its own entrepreneurial venture. Thus, the bargaining power of this particular (important) supplier depends crucially on these specialized intermediaries' presence or absence.

Khanna and Rivkin (2001b) have shown, in a sample of 40+ countries over a decade, that industries do not appear to be structured similarly. They base this on their demonstration that the rank order of performance (measured variously) of industries varies quite drastically from country to country. Further, it varies more when their (admittedly crude) proxies for specialized intermediaries indicate sizeable differences in context.



Similarly, positioning choices are drastically affected by the extent of specialized intermediation. This is easily seen in studies of business groups in emerging economies. Diversified structures that are believed to be value-destroying in some countries (Montgomery, 1994; Lang & Stulz, 1993) are value-enhancing in others (Khanna & Palepu, 2000; Khanna & Rivkin, 2001a). This is because the internal markets available to diversified entities are relatively more useful when specialized intermediaries are absent and the functioning of external markets is thus compromised[6].

An extreme illustration of the dependence of positioning and sustainability on institutional voids is provided by the actions of firms catering to the world's most under-served populations in the 'base of the pyramid' (see Section 5 below). A reasonable characterization of such regions would focus on the complete absence of specialized intermediation. The hard infrastructure –roads, electricity, communications technology– is missing; so, equally insidiously, is the soft infrastructure needed to locate possible transaction partners, and to credibly contract with them. Distributing consumer products to the vast expanses of the inner reaches of the Amazon or the Mekong Delta, for example, has to rely on innovative franchising-style agreements with distributors who might bicycle over large terrains or distribute small quantities of products via waterways. It is not difficult to see that such a distribution system, itself a result of the paucity of (hard and soft) infrastructure, would be positioned quite differently than a distribution system for comparable products in a developed country. Clearly, also, the sustainability of such a position would depend on the persistence of institutional voids, an issue which is intertwined with actions taken by the firm (see comments on endogeneity of institutional voids below).

This influence of institutional voids on firms' choices appears resilient from the little evidence of which we are aware. In the realm of systematic empirical inquiry, a study of positioning by Chilean firms suggests that the active program of market development in that country took the better part of a generation to atrophy business-group-affiliation advantages – derived from the presence of institutional voids; even so, a companion field-data collected

6 Whereas one can posit conceptual links between institutional voids and sustainability, I know of no formal work that establishes whether positions are sustained for differentially long periods based on ambient institutional voids.

study demonstrated continued ability by Chile's largest business groups to continue to buck this aggregate trend and add value by compensating for institutional voids (Khanna and Palepu 1999, 2000b)[7]. Anecdotal evidence having to do with attempts to eliminate institutional voids is consistent with the flavor of these studies. Perhaps the most robust of these is the difficulty experienced by scores of countries around the world to generate markets for risk capital to spur entrepreneurship.

Cross-country topics

This sub-section considers the much-studied (by the *JIBS* community and others) phenomenon of multinationals (and the associated phenomenon of FDI). It also considers less-studied phenomena of cross-border flows of various factor inputs.

Multinationals can add value in the face of cross-border institutional voids (Foley, 2002; Khanna and Palepu, 2002). The particular institutional void thus filled might arise from the absence of executive search firms, financial analysts, a cross-border dispute resolution mechanism, or a global logistics capability. The multinational is in the business of reducing information asymmetries and guaranteeing contracts –in markets for products, talent, capital and ideas. Conceptually, in addition to the usual sources of information problems in any economy, cross-border transactions are accompanied by certain specific sources of information costs. These might arise because of cultural and language differences, for instance, or from differences in accounting standards or other (imperfectly transparent) business practices. Further, the absence of a cross-border fiat authority (of the sort of a well-functioning state within a country) complicates the resolution of cross-border disputes.

Consider, for example, intellectual property rights. An entrepreneur with a path-breaking mousetrap with worldwide applicability can patent her invention under the U.S. system, securing property rights worldwide. Even if the patentee had the resources to ensure that these property rights are respected worldwide, she would still have to contract with independent providers of a range of complementary assets. Production facilities in various countries to make the mousetrap and branding and logistics and distribution agents to disseminate the product efficiently would be needed to realize a return on the invention. On the other hand, if the multinational were the patent holder, several of these functions could be internalized.

Similarly, multinationals might serve to guarantee quality of goods and services that are moving cross-border, when alternative mechanisms to provide information about, and police quality of, such goods and services are under-developed. Samsung's brand-name foreshadows its manufacturing prowess, which translates into reliability of its consumer electronics and other items commonly available around the world.

A second challenge related to the management of multinationals has to do with the extent to which multinationals should localize their business model to suit the particulars of country context. The *JIBS* community has studied a variant of this problem extensively by studying the resolution of the centralization/decentralization debate. That is, extensively locally sensitive business models are probably more consistent with a decentralized management structure with emphasis on local autonomy. For our purposes, this issue is isomorphic to the discussion of context-dependence of strategy from the within-country issues sub-section above.

[7] The field study also reached similar conclusions about Indian business groups during the several years following deregulation of cross-border activity (1991-1997).

Within the cross-border arena, the institutional voids lens directs us to consider questions that have been under-studied by the *JIBS* community. I suggest three categories of such questions here.

a) With whom do multinationals compete? The conventional answer to this question is 'with each other' or 'with local, that, is, single-country firms.' But they compete with all other ways in which there is cross-border movement of factor inputs or end products and services. The extent to which multinationals are substitutes for alternative ends to the same goal –e.g. consider a U.S. investor entrusting funds to a mutual fund that invests in Latin America, versus investing in a U.S.-based multinational that then maintains operations in Latin America– depends on the configuration of cross-border institutional voids. Similarly, the 'outside option' of specialized talent employed by a multinational is to use cross-border specialized intermediaries (websites that provide information on worldwide opportunities, search firms that facilitate matching of talent with opportunity across borders, relocation agencies that accomplish the move) to ensure that her talent is used by the highest bidder even if the latter is in a remote geography.

b) What effect do multinationals have on context? This is a question that has some history of discussion in the *JIBS* community, and has received increasing attention in the last few years (Aitken & Harrison in AER). But the scope for analysis is much wider than the productivity-spillover-measurement guise in which this problem is addressed[8]. Consider the effects of multinational presence on the presence of local capital market intermediaries. To the extent that multinationals, typically listed in their home country exchanges, cause trading to move offshore, the demand for services of local analysts is lowered. This affects the viability of the business model of the analyst, and, ultimately, affects the efficiency with which the local capital market might work. One can posit mechanisms with positive externalities as well. The channel of the effect to which I wish to draw attention is the economic engine underlying specialized intermediation and how it operates, competitively or cooperatively, with multinationals. Research on this issue will help us understand the feedback loop from multinationals to context.

c) Moving outside the realm of multinationals, but squarely within the realm of cross-border issues, how should we understand cross-border flows of talent and people and ideas beyond simply measuring their (lack of) incidence? My contention is that understanding cross-border intermediaries will move forward this research agenda. Especially given the forecasted magnification of cross-border movement of individuals due to demographic changes in the developed and developing world in the coming few decades, this is an issue of paramount importance. Further, the study of hot money, another issue related to cross-border factor mobility, can also be understood as resulting from a paucity of cross-border intermediaries. The connection here is that herd behavior, of the sort that results in money flowing in or out of a country with the speed that earns it the epithet 'hot,' occurs in the absence of specific information regarding investment opportunities.

[8] Outside the realm of economic reasoning that informs this section, the issue of effects of multinationals is one that continues to receive much attention. For example, do multinationals compromise national sovereignty, do multinationals crowd out local culture, etcetera?

The Endogenous Evolution of Intermediaries

Much of the literature on transaction costs has the flavor of such costs being 'given.' They are present as a result of underlying characteristics of the 'technology' (that governs exchange) in question. The institutional voids lens causes one to look upon this conventional focus with some suspicion. If transaction costs result from the paucity of specialized intermediaries, and if one thinks of these intermediaries as having their own business models, it follows that the evolution of transaction costs can be understood better if we study the industrial organization of specialized intermediation. Why do the 'industries' of analysts, business schools, and executive search firms look the way they do? The endogenous emergence of specialized intermediaries, whose presence or absence is the proximate determinant of ambient transaction costs, has received much less attention than it deserves (see Spulber 1996 for some attempts in this direction).

For example, think of an executive search firm as an economic entity that helps bring together (intermediates between, so to speak) supply of talent (executives) and demand for talent (firms). Notice that the intermediary is itself a firm, and has its own industry structure and its own considerations regarding positioning and sustainability. Think, for example, of how the executive search industry is structured in the U.S. (Khanna, Khurana and Palepu, 1999). There is a premium end occupied by the likes of Russell Reynolds, SpencerStuart and others, a more mass-market segment dominated by Korn/Ferry and Heidrick & Struggles, and an internet-search segment with the likes of Monster.com. It turns out to be virtually impossible to think about how the possibility of efficient cross-border movement of talent will evolve without thinking through the business decisions of these specialized intermediaries.

As another example, consider an economy dominated by business groups. These groups rely on internal markets to promote new ventures, a phenomenon that is a response to the absence of external markets. But the very existence of the groups ensures that specialized intermediaries, not seeing a demand for their services, do not enter. Thus, the situation perpetuates itself. A reasonable conjecture, awaiting empirical verification, is that groups might have static efficiency gains, but dynamic efficiency losses (Khanna, 2000).

But the emergence of intermediaries is more than just an economic issue. Consider investment into China and India. China is characterized today by heavy investment by multinationals, India more by vibrant domestically-owned private enterprise (Huang and Khanna, 2003). Intertwined with this equilibrium outcome is the fact that the specialized intermediaries needed to disseminate risk capital to would-be entrepreneurs is far more developed in India than it is in China. In the latter, multinationals generally do not need domestic sources of risk capital, since, in their role as cross-border intermediaries, they rely on cash-flows from operations around the world. But, stepping away from the economics, consider why differences in such equilibria might have arisen in the first instance. The government in China has gone out of its way to lay out the welcome mat for multinationals –thus partially obviating its need to rely on domestically owned private enterprise– whereas India's government has not done so. Understanding why this is so requires understanding the incentives and ideologies of the Chinese state (at the center and in the provinces) as well as the messy coalition politics of modern India (Huang and Khanna, 2003).

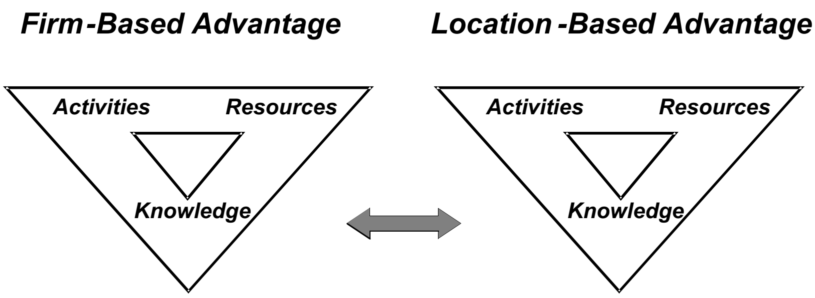
4. The Primitives, Levels of Analysis, and International Business (M. Enright)

International business, by definition, is about the interaction of firms and geographies. The present analysis suggests that international business research can benefit from work that helps us focus on the "primitives" that drive firm-based and geography-based success, introduces new economic and geographic actors to the analysis, and organizes critical research questions according to some relatively simple frameworks for analysis.

The Primitives: Activities, Resources, and Knowledge

The strategy literature tells us that sources of advantage at the firm level are found in activities, resources, and knowledge. The activity-based view of the firm posits that firm performance is influenced by the way they perform activities, the efficiency and effectiveness of those activities, and combinations or systems of activities (Porter, 1985; 1996). The resource-based view of the firm posits that firm performance is heavily influenced by the rents that the firm can earn from its stock of resources (Wernerfelt, 1984; Barney, 1986, 1991; Peteraf, 1993). The knowledge-based view of the firm posits that firm performance is influenced by the ability of the firm to create and exploit firm-specific knowledge (Spender, 1996; Nonaka and Takeuchi, 1998). While it should be obvious that these views of the firm are not mutually exclusive, researchers in the different schools tend to downplay the importance of the others, and rarely bring the different features of the firm together into what we might call the "ARK" view of strategy (Enright, 2002a) in which activities, resources, and knowledge are combined to create firm-based advantages (see Figure 1).

Figure 1. The "ARK" Model of Firm-Based and Location-Based Advantage



Source: Enright (2002a).

Similarly, the economy of a nation or region can be described as bundles of activities, resources, and knowledge bases. An activity-based view of geographies posit that there are some economic activities that might take place outside or partially outside any individual firm, but tied to a particular location (marketplace seeking). A resource-based view of geographies posits that there are resources that may be specific to particular locations rather than any individual firm. A knowledge-based view of geographies posits that there are knowledge bases that might be outside the firm that are tied to particular geographies. Just as they can provide competitive advantages to firms, activities, resources, and knowledge can provide competitive advantages to locations as well. One difference is that the activities, resources, and knowledge that are internal to an area and that might influence firm performance can be rather broad, incorporating natural conditions, institutions, mixes of firms and industries, and other features that influence location-based competitiveness. This suggests that a fruitful line of research for international business scholars is one that traces activities, resources, and knowledge, as well as their interaction, over the appropriate geographies. Of course, this leaves the question of what exactly are the appropriate geographies over which we should examine activities, resources, and knowledge that create value for business (Enright, 1998; Enright, 2002a).

The three different views of the firm also have analogs in the international business literature. An activity-based view of the multinational firm has been proposed by Porter (1986) and Yip (1995). To these authors, the most important aspects of international business are the configuration and coordination of firm activities across nations and regions. A resource-based view of the multinational firm posits that the multinational has resources that can be best leveraged through foreign investment (Vernon, 1992; Dunning, 1993; Caves, 1996). A knowledge-based view of the multinational firm posits that the multinational firm has knowledge that it exploits across international markets (Buckley and Casson, 1976) and that the process of internationalization itself is a knowledge-intensive activity (Johansson and Vahlne, 1977; Kogut and Zander, 1993). Dunning (2000) and Doz et al. (2001) have begun to bring these views of the multinational together in describing the emergence of multinational strategies that use their activities to link important geographically-based sources of knowledge and resources together. However, there is still little work that explicitly tests hypotheses that link the three “primitives” of strategy together explicitly into an “ARK” model of the multinational firm (Enright, 2002a).

Levels of Analysis

In addition to the issue of what “primitives” might be the subject of international business research, there also is the issue of the appropriate levels of analysis. Historically, the strategy literature has emphasized the influence of industry-level and firm-level features on performance. There is a long tradition of research going back to Schmalensee (1985) that tries to decompose the variation in performance of individual business units into business segment, industry, and corporate level effects. The studies in this vein generally conclude that all three levels have significant influences, though they vary in terms of the relative magnitudes of the effects (see Rumelt, 1991; Bowman and Helfat, 2001; McGahan and Porter, 2002; Hawawini et al., 2003).

Some studies use a four-digit SIC or equivalent level definition of “industry,” while others use a three-digit or even two-digit definition. Besides the well-known issues that arise in using SIC-type classifications, the different definitions actually correspond to different economic or business entities. While the four-digit level already tends to be larger than a strategically distinct industry, the three and two digit levels represent entire sets of related industries. Thus evidence of an “industry” effect at the three or two-digit levels is actually evidence of a “meso” level effect on performance rather than a “micro” level effect.

Such results are very much in the spirit of recent work on industrial and regional clusters (Enright, 1998; 2003). The simplest definition of industrial clusters is that they are groups of firms in the same and related industries, including buyers, suppliers, and industries related through shared resources or activities. Regional clusters are industrial clusters that are focused in a particular geographic area. While interest in regional clusters has mostly focused on their potential to support economic development, increasingly they are becoming a focus of interest for firm strategy and international business. There is increasing evidence that industry clusters can positively influence the innovative and financial performance of firms, as well as firm investment decisions (Audretsch, 2000; Enright, 2000b; Dunning, 2000). This is not surprising, given the long-recognized influence of suppliers, buyers, and spillovers from related industries on innovation and performance (Schmalensee, 1989; von Hippel, 1988). All this suggests that the industry cluster or regional cluster also should be a valid level of analysis for international business researchers.

A large portion of existing international business research focuses on the nation as a unit of analysis. In addition, recent efforts in the strategy literature to decompose the variation in firm performance have tried to isolate the impact of national differences as well as firm and industry differences (Hawawini et al., forthcoming). However, distinctions among nations remain peripheral to much of the strategy literature and strategy practice, which is perhaps one reason why firms seem to be blindsided by differences in markets and business practices, public policies, macroeconomics, and institutional environments. When such features are addressed in the strategy literature, they often are viewed as add-ons to traditional strategy frameworks (Narayanan and Fahey, 2001) and, therefore, outside the normal course of analysis.

The traditional geographic units addressed in the international business literature are national subsidiaries and markets, and global headquarters and markets (Paterson and Brock, 2002). Rugman (2000) and Rugman and Verbeke (2001), however, point out that most international trade and investment flows are within large, supranational "regions", such as the Americas, Europe, and the Asia-Pacific, and show that many of the world's largest manufacturing and service industries are characterized by (supranational) regional rather than global production or activity systems. Reasons include the development of regional trade blocs, limits to global economies of scale, regional aggregation and scale economies, communications technologies that facilitate management on a regional basis, the need to serve customers operating on a regional basis, regional differences in customers and culture, and the "tyranny of time zones" that facilitates management on a regional basis (Lehrer and Asakawa, 1999; Enright, forthcoming). In addition, firm performance in a given nation is increasingly influenced by multilateral organizations (such as the World Trade Organization and the IMF), international financial flows (which can cause or exacerbate macroeconomic booms and busts), and the strategies of foreign multinational firms (Brewer and Young, 2000; Chia, 2000; Enright, 2000a). This indicates that there is a supranational level of analysis that also can be critical to firm performance.

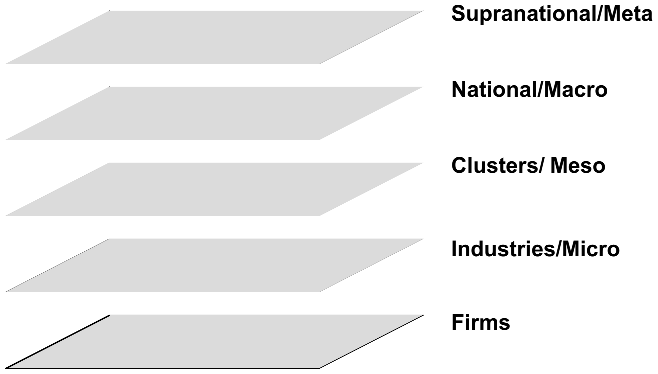
The literature suggests that firm effects, industry effects, cluster effects, national effects, and supranational effects all influence firm performance. The trouble is that in much of the strategy literature, these additional levels of analysis are not integrated into a single, organizing framework, but are used as add-ons to traditional strategy analysis. As a result, strategy research and process tend to have blind spots that only become obvious in the aftermath of financial or business crises.

An Organizing Framework

What is clear from the above discussion is that work on firm strategy is having a substantial influence on international business research. However, we have lacked frameworks that allow us to organize the work that has been done and help us chart a direction for future work.

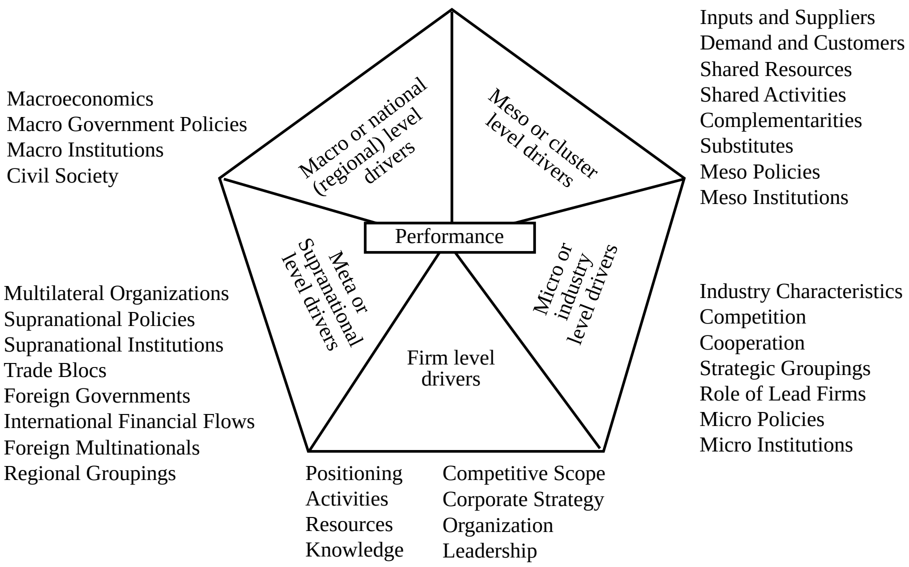
A useful framework to carry this out is found in Figures 2 and 3. In this framework, performance at any level of analysis is a function of drivers at five levels: firm level drivers, industry level drivers, cluster level drivers, national or regional level drivers, and global or supranational level drivers. Firm level drivers include the strategies, activities, resources, knowledge, organisation, management, and governance structures of firms. Micro or industry level drivers include the nature of competition and cooperation in the given industry, policies that are specific to the industry, and skills and capabilities that are specific to an industry. Meso or cluster level drivers include inputs such as infrastructure, materials, components, and capital goods; the linkages between suppliers and buyers; the nature of local demand; spillovers from related industries; and policies designed to enhance cluster development. Macro or national level drivers include macroeconomic conditions, government policies at the national and regional levels, and aspects of society, including goals, interest groups, agendas, and social issues. Meta or supranational level drivers include international financial flows, the influence of foreign governments, the impact of multilateral agencies such as the World Trade Organisation, links with other economies outside the nation, the strategies of foreign multinational firms, and (supranational) regional linkages (Enright, 2002b).

Figure 2. Levels of Analysis



Source: Enright (2000a, 2002b).

Figure 3. Drivers of Business and Economic Performance



Source: Enright (2000a, 2002b).

The key to using this simple tool is to recognize that, in today's economy, forces at each level influence performance at every level. Firm performance is clearly influenced by firm level drivers, micro or industry level drivers, meso or cluster level drivers, macro or national level drivers, and meta or supranational level drivers. Macro or national economic performance is clearly influenced by supranational or meta level drivers, meso or cluster level drivers, micro or industry level drivers, and firm level drivers. And so on. The framework is best viewed as a set of questions that ensure that our analysis is complete, rather than a recipe for firms or for national economies. It helps us identify the interactive forces and strategies that co-evolve with technology, tastes, and competition (as in Lewin et al., 1999).

Using the Framework

Detailed explication of the use of this framework is beyond the scope of this article, though a brief example will provide some of the spirit of its use for examining national economies and firm strategies.

The emergence of Nokia, the Finnish telecommunications equipment company, is usually portrayed as a firm-based phenomenon and *firm level drivers* have been an extremely important part of the story. New leadership dramatically shifted Nokia's strategy, narrowing its industry scope by divesting underperforming units, revamping its positioning to that of a technology and design-driven company, overhauling its activity-resource-knowledge mix to match the strategy, and changing the financial and governance structures by opening up shareholdings to international investors. At the *industry level*, competition on standards among a limited number of lead firms has been supplemented by cooperation among some firms in standards debates, cross-licensing, alliances, and supply arrangments. At the *cluster level*, Finland exhibited early demand for mobile services, including the world's first GSM network, which helped stimulate the development of suppliers and input providers around Nokia. These developments have fostered investments in education and training both by Nokia and authorities where it has located.

At the *macro level*, Finnish policy that opened up competition in telecommunications paved the way for the development of Nokia's first GSM customer. Nokia also was influenced by Finland's decision to enter the EU, the macroeconomic shift in Finland in the 1990s, and national efforts to create a knowledge economy. At the *supranational or meta level,* Nokia benefited from access to the Soviet Union for its pre-GSM businesses, the Nordic countries' decision to settle on a single mobile telecommunications standard, the subsequent European decision to select the same (GSM) standard, the opening of telecommunications markets around the world (which provided customers), and the wide penetration of GSM systems worldwide. Nokia clearly has been influenced by *firm level drivers, industry or micro level drivers, cluster or meso level drivers, national or macro level drivers, and supranational or meta level drivers* (Enright, 2002b; Häikio, 2002).

A Research Agenda

The above discussion provides the outlines of an international business research agenda with several basic features. One is an explicit focus on levels of analysis and a focus on new economic actors. Recent research suggests that firms and nations are not the only relevant levels of analysis, but that industries, clusters, subnational regional economies, and supranational regional economies also have an important influence on firm performance.

It also suggests that all competition is not either national or global. There are lower and intermediate levels that are equally, and in some cases more, important.

A second feature is a focus on a given set of primitives. The present discussion suggests that a firm can be defined as the bundle of activities, resources, and knowledge that are internal to the firm, with all three being essential to firm success. Similarly, the economy of a city, region, or nation can be defined as the bundle of activities, resources, and knowledge that are internal to the location, with all three being essential to economic success. Of course, both firms and locations should be viewed as open systems in the sense that locations can benefit from activities, resources, and knowledge that exist outside the location, but are linked to the firm's operations in the region, and firms can benefit from activities, resources, and knowledge that exist outside the firm, but are linked to the firm through markets, spillovers, and other interdependencies.

The third feature is that a focus on firm level drivers, industry level drivers, cluster level drivers, national level drivers, and supranational drivers can provide an organizing framework for business and economic performance at all of the relevant levels. Analysis that does not encompass all these levels of analysis is bound to be incomplete. This is highlighted in other sections of this paper. Sections 3 and 5 both highlight national-level features that need to be linked with firm strategy in order to better understand the opportunities and challenges that companies face in international business, The present framework shows how many other combinations or interactions also can be important areas of inquiry beyond those highlighted specifically in this paper.

The payoff to the features of the present analysis will come in research that focuses on the interaction of new actors and new geographic levels of analysis. Discussions of the geographic scope of competition and strategy benefit from understanding the forces of globalization and "semi-globalization." The global headquarters-national subsidiary paradigm becomes much richer when one incorporates subnational and supranational regional strategies and organizations into the analysis. The firm location decision becomes much richer when we contemplate the placement of individual activities in specific locations to take advantage of specific firm and location-based resources and knowledge. Firm management and coordination decisions become much richer when the challenge is to coordinate learning and resource development across geographically and culturally dispersed locations in an integrated fashion. The discussion of firm-based sources of advantage is enhanced by understanding that firm strategy is influence by a range of national conditions, including "institutional voids." Similarly, discussions of the opportunity sets for firms are enhanced by an understanding of the institutional voids and market opportunities that exist, even at the "bottom of the pyramid."

A related advantage will be the development of integrated frameworks that will allow the development of pedagogy that more clearly communicates the complexity of existing international strategies and organizations. Instead of providing specific answers, the value of the new framework might be in helping us organize the questions that we should ask in assessing the performance of firms, industries, clusters, and economies.

5. The Base of the Pyramid as a New Frontier in International Strategy (S. Hart)

There can be no doubt that what distinguishes the field of international strategy from its domestic counterpart is that different places have distinctly different characteristics, with important implications for corporate and business strategy. As the introduction to this article suggests, however, the conceptualization underpinning most of the work on global strategy to date has been relatively simple: To find the proper balance between global integration and local responsiveness (e.g. Prahalad and Doz, 1987; Bartlett and Ghoshal, 1989).

Over the past two decades we have learned that industries vary significantly regarding this balance: global consumer products companies, for example, cannot be managed in the same way as global automobile companies. We have also learned that within global businesses, it is important to organize key functions –R&D, operations, and marketing– in different ways to take advantage of the optimal mix of global scale and local differences in each. Furthermore, we have seen that certain industries and businesses may well be evolving toward a "transnational" model that combines aspects of both global efficiency and local responsiveness, and takes advantage of the ability of MNCs to leverage learning across country markets (e.g. Hedlund, 1986).

Important as this work has been, it leaves many stones unturned in our quest for understanding the dynamics of globalization and its implications for international strategy. As the foregoing essays suggest, semi-globalization, institutional voids, and the existence of multiple levels of analysis offer important new lenses for framing research in international business. Each offers the potential for a more nuanced understanding of the "ecology of places and firms" that is so important to the international business research agenda of the future.

However, this work, as important as it is, still suffers from the proverbial "iceberg" problem: It examines only what is readily visible above the surface –the 1 billion or so people at the top of the economic pyramid– while virtually ignoring the majority of the phenomenon which lurks below –the 4-5 billion people around the world living in poverty who have been largely bypassed by globalization. In this essay, I will therefore attempt to articulate the strategic logic for focusing on the "base of the pyramid" as an important new research frontier in international strategy.

Why the Base of the Pyramid?

With the fall of communism in the late 1980s, academic work on emerging market strategy (like its cousin, global strategy) experienced rapid growth, as transition economies opened their markets to foreign investment (see, for example, Hoskisson, Eden, Lau and Wright, 2000). By the late 1990's, however, corporate momentum in emerging markets had slowed considerably. The prospect for millions of new middle class consumers in the developing world was vastly oversold. The Asian and Latin American financial crises put a damper on the rate of foreign direct investment. The events of September 11, 2002 then served to further hasten the retreat. Established markets became increasingly saturated, leaving MNCs wondering where future growth would come from (Prahalad and Hart, 2002).

In addition, there has been a rising tide of anti-globalization sentiment around the world. Demonstrations from Seattle to Cancun have made it apparent that if corporate expansion is seen to come at the expense of the poor and the environment, it will encounter vigorous resistance. Indeed, as MNCs sought to satisfy shareholders by entering emerging markets, they increasingly heard concerns from many quarters about environmental degradation, labor exploitation, cultural hegemony, and loss of local autonomy (Hart and Christensen, 2002). The recent scandals involving major global corporations such as Enron and WorldCom have served only to fan the flames of anti-corporate sentiment.

With the benefit of hindsight, we can now see more clearly why many MNC global and emerging market strategies from the 1990s have been failures: The truth is they were neither very global nor particularly emerging market-oriented. Indeed, the vast majority of FDI over the past decade has been directed at the established markets in the US, Europe and Japan, not the emerging markets of the developing world (Sachs, 1998). Developed countries have also been the context for most international business research over the past decade (e.g. Tallman, 2001). In the developing world, most FDI has targeted only the few "large market" countries such as China, India, and Brazil. And even there, most MNC emerging market strategies have focused exclusively on the elite and emerging middle class markets, ignoring the vast majority of people considered too poor to be viable customers (de Soto, 2000).

Many reasons have been offered to justify and explain MNC preoccupation with the top of the economic pyramid in emerging economies: Hitt et al (2000), for example, suggests that such customers are more similar to American, European, and Japanese consumers, which MNCs are accustomed to serving, and thus present less "psychic distance" than do the impoverished inhabitants of shantytowns and rural villages. Khanna and Palepu (1997) point to the lack of important institutions in the developing world, which makes conventional MNC operations all but impossible. Indeed, there is a healthy literature focusing on how MNCs can address gaps in the business environment in emerging economies through the use of alliances, networks, and interpersonal ties with local players (e.g. Beamish, 1987; Khanna and Rivkin, 2001; Peng and Luo, 2000).

Unfortunately, MNC strategies aimed at tailoring existing products to better fit the needs of the elites and rising middle classes in the developing world have inadvertently resulted in a form of "corporate imperialism" (Prahalad and Lieberthal, 1998). The incremental design changes and cost reductions associated with this strategy have not succeeded in making products and services available to the mass markets in the developing world (Arnold and Quelch, 1998). The net result is that four billion poor at the bottom of the economic pyramid –fully two-thirds of humanity– have been largely ignored both by MNCs and IB researchers. They have been bypassed by globalization, their needs are being poorly met by local vendors, and they are increasingly the victims of corruption and active exploitation (Chambers, 1997).

With stagnation in the established markets and rising antiglobalization sentiments, however, the opportunities for entering the base of the pyramid are becoming increasingly apparent to both managers and scholars. GDP per capita figures fail to capture the dynamism that exists among the aspiring poor. Indeed, it is estimated that well over half of total economic activity in the developing world takes place outside of the formal economy in the so-called "extralegal" sector; this translates into more than $9 trillion in hidden (unregistered) assets among the world's poor (deSoto, 2000).

In short, the emerging market opportunity may be much larger than previously thought. However, the real source of market promise is not the wealthy few in the developing world, or even the rising middle class consumers –it is the billions of aspiring poor who are joining the market economy for the first time (Prahalad and Hart, 2002). However, capturing the opportunity at the base of the economic pyramid will, in all likelihood, require radical innovations in strategic thinking. Indeed, as Dawar and Chattopadhyay (2002) observe, it makes little sense for MNCs to develop homogeneous country strategies in emerging markets (e.g. China strategy). Instead, it would be far more appropriate to craft *separate* strategies for the wealthy, rising middle class, and for poor customers, *across* country markets (Hart and Milstein, 1999). Thus, the base of the pyramid is virtually uncharted territory and opens up an entirely new field of inquiry for the *JIBS* community.

The Base of the Pyramid: A New IB Research Priority

For the past five years, a group of colleagues[9] has begun to pursue this research trajectory. Early work (e.g. Hart and Milstein, 1999; Christensen, Craig, and Hart, 2001; Prahalad and Hart, 2002; Hart and Christensen, 2002; Prahalad and Hammond, 2002) focused on articulating the strategic logic for pursing business strategies aimed at the four billion poor at the base of the pyramid. In 2000, the group of colleagues at the University of North Carolina's Kenan-Flagler Business School created the Base of the Pyramid (BOP) Learning Laboratory. The BOP Learning Lab is a consortium of companies, NGOs, and academics interested in identifying, evaluating and quantifying the critical parameters and interdependencies that govern these market segments and that translate into strategies for value creation[10].

In 2002, the UNC group won a three-year research grant from the National Science Foundation to conduct a longitudinal study of BOP ventures being pursued by the MNC members of the Learning Lab (Milstein and Hart, 2002). As part of this effort, over 30 cases have already been produced detailing the strategies and business models of ventures focused on the BOP. These include local companies and non-profits as well as MNC initiatives. Some of the early findings of this work have now been summarized and placed in the context of the literatures on global and emerging market strategy (e.g. London and Hart, 2003).

Some of the early learnings, based largely upon interviews, case-comparative analyses, and grounded theory building, include the following:

1. Incremental adaptation of existing technologies and products is not effective in the BOP. Successful entry into the BOP appears to require a new approach to product development based upon deep listening and co-development with local partners.

2. The BOP forces MNCs to fundamentally rethink business models. Companies apparently need to transform their understanding of scale, from "bigger is better" to a strategy of distributed small-scale operations married to world-scale capabilities such R&D and learning transfer.

3. The BOP also appears to demand a business model premised upon capital efficiency and employment intensity rather than the conventional MNC mentality of capital intensity and labor efficiency.

4. Given the small-scale and distributed nature of BOP ventures, it appears to be important to build relationships with local governments, small entrepreneurs and non-profits rather than depending upon familiar partners such as central governments and large local companies.

5. Building relationships directly and at the local level contributes to the social capital necessary to overcome the lack of formal institutions such as intellectual property rights and the rule of law.

[9] Colleagues include C.K. Prahalad (University of Michigan), Clay Christensen (Harvard Business School), Miguel Rodríguez (IESE Business School), Sanjay Sharma (Wilfrid Laurier University), Alan Hammond (World Resources Institute), Irma Gomez and Nicholas Guttierez (Tec Monterrey), and Jim Johnson, Ted London, Mark Milstein, Erik Simanis, and Lisa Jones (University of North Carolina).

[10] The BOP Learning Lab's contributing members include DuPont, HP, J&J, P&G, S.C. Johnson, Ford, Dow, Coke, and Tetrapak. Non-profit organizations such as the Grameen Foundation and the World Resources Institute are also actively involved.

6. Since the BOP possesses neither the institutional inertia nor the incumbent density that exists at the top of the pyramid, it offers the ideal conditions for incubating new, leapfrog technologies.

7. The base of the pyramid appears to be especially appropriate for disruptive technologies which dramatically reduce environmental footprint and increase social benefit (e.g. renewable energy, distributed generation, microcredit, wireless IT, biotechnology) given the large populations involved.

8. Business models forged successfully at the base of the pyramid have the potential to travel profitably to higher income markets, offering huge growth potential. It appears to be easier to add cost and features to a low cost business model than to remove cost and features from a high cost business model.

Our early work in this new domain confirms our hunch that the base of the pyramid contains fundamentally new challenges for the field of international strategy and that we have only scratched the surface. Indeed, widening the strategic bandwidth to include the base of the pyramid appears to have significant implications for global and emerging market strategy, innovation theory, and theories of economic development and comparative advantage.

Since the BOP carries with it new and challenging constraints (e.g. need for dramatically lower cost structures, smaller environmental footprint, difficult physical conditions, different cultural traditions) it might help to expand our thinking not only about emerging market strategy (as we have seen), but also enrich our understanding about the nature of lead markets in the innovation process. Rather than focusing exclusively on the most sophisticated customers as the lead markets (e.g. von Hipple, 1988), it might also be productive to focus on the poorest and least sophisticated customers as drivers of the innovation process. Thus, gaining a foothold in BOP markets may turn out to be crucial to long term competitive survival in the coming decades (Prahalad and Hart, 2002; Hart and Christensen, 2002).

With regard to economic development theory, the unique and disruptive character of BOP markets could help to move us beyond the current thinking regarding comparative advantage, where developing countries must follow a predictable course of commodity production, labor cost, and assembly platform strategies before making the leap to technology and knowledge-based capabilities. Indeed, the BOP could serve as an incubator for entirely new and globally competitive enterprises and industries, with developing country companies leading the way. This could provide a new lens for thinking about national economic development strategy (Christensen, Craig, and Hart, 2001).

Some specific research questions regarding the implications of the BOP for MNC strategy include the following:

– Can MNCs realistically serve the bottom of the pyramid? Can they overcome lack of familiarity with these contexts and their liability of foreignness? Can they design business models that compensate for the lack of institutions such as IP protection and the rule of law and avoid the corrosive effects of corruption?

– Can MNCs design profitable strategies and business models to serve the BOP? What are the implications for structure/governance, alliances and partnerships, technology and product development, supply chain and distribution, and knowledge transfer?

– Can MNCs grow and make money while simultaneously catalyzing sustainable development? Can corporations serve as agents of poverty alleviation, environmental restoration and world betterment while simultaneously developing entirely new and profitable markets?

Looking Forward

As we enter the 21st century, the institutions of global capitalism find themselves increasingly under siege. Following the fall of communism in the late 1980s, a decade of economic globalization, privatization, and free trade has produced mixed results at best. While developed countries have grown richer, the vast majority of nations and people in the world have not benefited from the apparent triumph of global capitalism. Furthermore, the underlying natural systems supporting human economies –forests, fisheries, soils, ecosystems, and climate– have all experienced continuing decline. A rising tide of “antiglobalization” has emerged which combines concerns about environmental degradation, inequity, human rights, and loss of local autonomy. And, terrorism –the ultimate form of antiglobalization– is on the rise, driven by poverty, hopelessness, and desperation.

In short, global capitalism –and IB research– finds itself at a crossroads. Will MNCs and academics continue to focus primarily on the needs of the wealthy at the top of the pyramid to the exclusion of the vast majority of humanity? Will we continue to exploit the developing world primarily for its abundant natural resources and cheap labor? Will we move increasingly toward islands of prosperity and abundance in a sea of poverty and despair? Or, will global capitalism seek instead to reach out, bringing the benefits of capitalism to the entire human community of 6.2 billion in a way that respects cultural diversity and the environment?

I believe that the former path is no longer an option –it leads only to oblivion. A more inclusive form of international commerce is the only socially and environmentally viable path to the future. It may also be the ultimate growth engine for the world economy in the coming decades. From an academic perspective, the base of the pyramid offers a host of new and important research questions and contexts that have the potential to add greatly to our understanding of the ecology of firms and places so important to the field of international strategy. It is time that we, as a community of scholars, get on with the research needed to move this great transformation forward.

6. Conclusions

This paper has presented several perspectives to open a new frontier in the understanding of International Strategy. To explore it, we have proposed the analogy of the ecology of firms and places as a way to emphasize that the real problem is the co-location of different places with different types of firms. Locations are in fact the distinctive content of International Business Strategy. As such, the fundamental overlay question is “why do countries or locations differ?”

Answering this question is fundamental. However, differences across countries must be addressed with integrative frameworks that go beyond unilateral measures of difference, pay implicit attention to industry content, and draw out implications for firm strategy, so as to shed light on this fundamental issue in International Business Strategy. The proposed concept of “semiglobalization” and the CAGE model are important steps in this direction.

However, understanding places is very complex. Differences in the development of intermediary markets in a particular place influence firm positioning and industry structure in that place. Furthermore, the impact of institutional voids crosses different places as alternative firm organizations compete to take advantage of these differences. The evolution of these intermediary markets is therefore endogenous to the ecology of places and firms in a systemic, integrative way that makes simplifications extremely risky in the design of competitive strategy in an international context. In fact, it is impossible to discuss the efficient cross-border movement of talent, people, or ideas without thinking through the business decisions of these specialized intermediaries.

Places, firms, and strategies form a complex ecology. Multilateral measures of difference, interrelated with intermediary markets, make the “real” geography of places extremely difficult to understand and use in competitive strategy. The competitiveness literature proves useful for understanding the geography-strategy link. The proposed framework incorporates different levels of analysis, new economic actors and a set of primitives (activities, resources and knowledge), and focuses on the key drivers of economic performance at all relevant levels.

Finally, firms around the ecology of places, and we as scholars in IB, face the great challenge of bringing prosperity everywhere and not just to a small privileged group. It is the challenge of developing strategies and business models to serve the majority of humanity today excluded from world trade. It is the challenge of doing so in a profitable way but also in a way that is socially and environmentally feasible given limited world resources. It is a fundamentally different way to think about the ecology of places and firms: changing firms to impact places in a great transformation for the future.

Moving forward in the new frontier it is not easy. Neither is this the only frontier IB scholars should explore. However, it is an intriguing one, with capacity to impact both research and practice in a field with a great future. It is a way to look for the essential differentiating element in international strategy, the interplay among firms and places: an ecology to be understood.

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