Distance still matters

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The Hard Reality of Global Expansion

by Pankaj Ghemawat

Included with this full-text *Harvard Business Review* article:

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The Hard Reality of Global Expansion

The Idea in Brief

Why did U.S. media giant Star TV lose $500 million trying to deliver TV programming to Asia? Like many companies, it was so dazzled by the foreign market's immensity that it ignored the difficulties of pioneering new territories. For example, it assumed—wrongly—that Asian viewers wanted English-language programming.

How to avoid this fate—and select the right targets for your firm's global expansion? Look beyond a country's sales potential (as expressed by national wealth or propensity to consume)—and analyze the **probable impact of distance**.

But don't focus only on distance's *geographical* dimension. Consider three other dimensions as well: *cultural factors* (religion, race, social norms, language); *administrative factors* (colony-colonizer links, currencies, trading arrangements); and *economic factors* (income, distribution-channel quality).

The more two countries differ across these dimensions, the riskier the target foreign market. By contrast, similarities along these dimensions suggest great potential. Common currency, for example, boosts trade more than 300%. Also, types of distance affect industries differently. Religious differences, for instance, shape people's food preferences but not their choices of cement or other industrial materials.

By analyzing the possible impact of distance—in all its dimensions—you sweeten the odds of investing in *profitable* foreign markets.

The Idea in Practice

How to decide whether to expand into a particular foreign country? Consider distance's four dimensions—and ask how they might affect your industry. The table provides examples.

	Cultural Distance	Administrative and Political Distance	Geographic Distance	Economic Distance
Distance between two countries *increases* with. . .	• Different languages, ethnicities, religions, social norms • Lack of connective ethnic or social networks	• Absence of shared monetary or political association • Political hostilities • Weak legal and financial institutions	• Lack of common border, waterway access, adequate transportation or communication links • Physical remoteness • Different climates	• Different consumer incomes • Different costs and quality of natural, financial, and human resources • Different information or knowledge
Distance most affects industries or products. . .	• With high linguistic content (TV) • Related to national identity (foods) • Carrying country-specific quality associations (wines)	• That a foreign government views as staples (electricity), as building national reputations (aerospace), or as vital to national security (telecommunications)	• With low value-to-weight ratio (cement) • That are fragile or perishable (glass, fruit) • In which communications are vital (financial services)	• For which demand varies by income (cars) • In which labor and other cost differences matter (garments)

By considering the potential impact of distance on your industry, you may identify highly promising global-investment opportunities.

▶ Example:
Suffering limited cash flow and high debt-service obligations, Dallas-based Tricon Restaurants International (TRI) had to select its global-expansion investments carefully. An analysis of per-capita income and fast-food consumption suggested Japan, Canada, and Germany as the most promising countries in which to invest—with Mexico ranking 16th among 20 possibilities. But when TRI included the four dimensions of distance in its analysis, Mexico leapt to 2nd place.

Why? Mexico's geographic proximity to TRI's headquarters, the common land border, and membership in a trade agreement with the U.S. reduced geographic and administrative distance between the two countries. If TRI hadn't considered these dimensions of distance, it might have neglected this core market.

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Distance Still Matters

by Pankaj Ghemawat

When it was launched in 1991, Star TV looked like a surefire winner. The plan was straightforward: The company would deliver television programming to a media-starved Asian audience. It would target the top 5% of Asia's socioeconomic pyramid, a newly rich elite who could not only afford the services but who also represented an attractive advertising market. Since English was the second language for most of the target consumers, Star would be able to use readily available and fairly cheap English-language programming rather than having to invest heavily in creating new local programs. And by using satellites to beam programs into people's homes, it would sidestep the constraints of geographic distance that had hitherto kept traditional broadcasters out of Asia. Media mogul Rupert Murdoch was so taken with this plan—especially with the appeal of leveraging his Twentieth Century Fox film library across the Asian market—that his company, News Corporation, bought out Star's founders for $825 million between 1993 and 1995.

The results have not been quite what Murdoch expected. In its fiscal year ending June 30, 1999, Star reportedly lost $141 million, pretax, on revenues of $111 million. Losses in fiscal years 1996 through 1999 came to about $500 million all told, not including losses on joint ventures such as Phoenix TV in China. Star is not expected to turn in a positive operating profit until 2002.

Star has been a high-profile disaster, but similar stories are played out all the time as companies pursue global expansion. Why? Because, like Star, they routinely overestimate the attractiveness of foreign markets. They become so dazzled by the sheer size of untapped markets that they lose sight of the vast difficulties of pioneering new, often very different territories. The problem is rooted in the very analytic tools that managers rely on in making judgments about international investments, tools that consistently underestimate the costs of doing business internationally. The most prominent of these is country portfolio analysis (CPA), the hoary but still widely used tech-

nique for deciding where a company should compete. By focusing on national GDP, levels of consumer wealth, and people's propensity to consume, CPA places all the emphasis on potential sales. It ignores the costs and risks of doing business in a new market.

Most of those costs and risks result from barriers created by distance. By distance, I don't mean only geographic separation, though that is important. Distance also has cultural, administrative or political, and economic dimensions that can make foreign markets considerably more or less attractive. Just how much difference does distance make? A recent study by economists Jeffrey Frankel and Andrew Rose estimates the impact of various factors on a country's trade flows. Traditional economic factors, such as the country's wealth and size (GDP), still matter; a 1% increase in either of those measures creates, on average, a .7% to .8% increase in trade. But other factors related to distance, it turns out, matter even more. The amount of trade that takes place between countries 5,000 miles apart is only 20% of the amount that would be predicted to take place if the same countries were 1,000 miles apart. Cultural and administrative distance produces even larger effects. A company is likely to trade ten times as much with a country that is a former colony, for instance, than with a country to which it has no such ties. A common currency increases trade by 340%. Common membership in a regional trading bloc increases trade by 330%. And so on. (For a summary of Frankel and Rose's findings, see the exhibit "Measuring the Impact of Distance.")

Much has been made of the death of distance in recent years. It's been argued that information technologies and, in particular, global communications are shrinking the world, turning it into a small and relatively homogeneous place. But when it comes to business, that's not only an incorrect assumption, it's a dangerous one. Distance still matters, and companies must explicitly and thoroughly account for it when they make decisions about global expansion. Traditional country portfolio analysis needs to be tempered by a clear-eyed evaluation of the many dimensions of distance and their probable impact on opportunities in foreign markets.

The Four Dimensions of Distance

Distance between two countries can manifest itself along four basic dimensions: cultural, administrative, geographic, and economic. The types of distance influence different businesses in different ways. Geographic distance, for instance, affects the costs of transportation and communications, so it is of particular importance to companies that deal with heavy or bulky products, or whose operations require a high degree of coordination among highly dispersed people or activities. Cultural distance, by contrast, affects consumers' product preferences. It is a crucial consideration for any consumer goods or media company, but it is much less important for a cement or steel business.

Each of these dimensions of distance encompasses many different factors, some of which are readily apparent; others are quite subtle. (See the exhibit "The CAGE Distance Framework" for an overview of the factors and the ways in which they affect particular industries.) In the following pages, I will review the four principal dimensions of distance, starting with the two overlooked the most—cultural distance and administrative distance.

Cultural Distance. A country's cultural attributes determine how people interact with one another and with companies and institutions. Differences in religious beliefs, race, social norms, and language are all capable of creating distance between two countries. Indeed, they can have a huge impact on trade: All other things being equal, trade between countries that share a language, for example, will be three times greater than between countries without a common language.

Some cultural attributes, like language, are easily perceived and understood. Others are much more subtle. Social norms, the deeply rooted system of unspoken principles that guide individuals in their everyday choices and interactions, are often nearly invisible, even to the people who abide by them. Take, for instance, the long-standing tolerance of the Chinese for copyright infringement. As William Alford points out in his book *To Steal a Book Is an Elegant Offense* (Stanford University Press, 1995), many people ascribe this social norm to China's recent communist past. More likely, Alford argues, it flows from a precept of Confucius that encourages replication of the results of past intellectual endeavors: "I transmit rather than create; I believe in and love the Ancients." Indeed, copyright infringement was a problem for Western publishers

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well before communism. Back in the 1920s, for example, Merriam Webster, about to introduce a bilingual dictionary in China, found that the Commercial Press in Shanghai had already begun to distribute its own version of the new dictionary. The U.S. publisher took the press to a Chinese court, which imposed a small fine for using the Merriam Webster seal but did nothing to halt publication. As the film and music industries well know, little has changed. Yet this social norm still confounds many Westerners.

Most often, cultural attributes create distance by influencing the choices that consumers make between substitute products because of their preferences for specific features. Color tastes, for example, are closely linked to cultural prejudices. The word "red" in Russian also means beautiful. Consumer durable industries are particularly sensitive to differences in consumer taste at this level. The Japanese, for example, prefer automobiles and household appliances to be small, reflecting a social norm common in countries where space is highly valued.

Sometimes products can touch a deeper nerve, triggering associations related to the consumer's identity as a member of a particular community. In these cases, cultural distance affects entire categories of products. The food industry is particularly sensitive to religious attributes. Hindus, for example, do not eat beef because it is expressly forbidden by their religion. Products that elicit a strong response of this kind are usually quite easy to identify, though some countries will provide a few surprises. In Japan, rice, which Americans treat as a commodity, carries an enormous amount of cultural baggage.

Ignoring cultural distance was one of Star TV's biggest mistakes. By supposing that Asian viewers would be happy with English-language programming, the company assumed that the TV business was insensitive to culture. Managers either dismissed or were unaware of evidence from Europe that mass audiences in countries large enough to support the development of local content generally prefer local TV programming. If they had taken cultural distance into account, China and India could have been predicted to require significant investments in localization. TV is hardly cement.

Administrative or Political Distance. Historical and political associations shared by countries greatly affect trade between them. Colony-colonizer links between countries, for example, boost trade by 900%, which is perhaps not too surprising given Britain's continuing ties with its former colonies in the commonwealth, France's with the franc zone of West Africa, and Spain's with Latin America. Preferential trading arrangements, common currency, and political union can also increase trade by more than 300% each. The integration of the European Union is probably the leading example of deliberate efforts to diminish administrative and political distance among trading partners. (Needless to say, ties must be friendly to have a positive influence on trade. Although India and Pakistan share a colonial history—not to mention a border and linguistic ties—their mutual hostility means that trade between them is virtually nil.)

Countries can also create administrative and

Measuring the Impact *of Distance*

Economists often rely on the so-called gravity theory of trade flows, which says there is a positive relationship between economic size and trade and a negative relationship between distance and trade. Models based on this theory explain up to two-thirds of the observed variations in trade flows between pairs of countries. Using such a model, economists Jeffrey Frankel and Andrew Rose[1] have predicted how much certain distance variables will affect trade.

Distance Attribute	Change in International Trade (%)
income level: GDP per capita (1% increase)	+0.7
economic size: GDP (1% increase)	+0.8
physical distance (1% increase)	-1.1
physical size (1% increase)*	-0.2
access to ocean*	+50
common border	+80
common language	+200
common regional trading bloc	+330
colony-colonizer relationship	+900
common colonizer	+190
common polity	+300
common currency	+340

1. Jeffrey Frankel and Andrew Rose, "An Estimate of the Effects of Currency Unions on Growth," unpublished working paper, May 2000.

**Estimated effects exclude the last four variables in the table.*

political distance through unilateral measures. Indeed, policies of individual governments pose the most common barriers to cross-border competition. In some cases, the difficulties arise in a company's home country. For companies from the United States, for instance, domestic prohibitions on bribery and the prescription of health, safety, and environmental policies have a dampening effect on their international businesses.

More commonly, though, it is the target country's government that raises barriers to foreign competition: tariffs, trade quotas, restrictions on foreign direct investment, and preferences for domestic competitors in the form of subsidies and favoritism in regulation and procurement. Such measures are expressly intended to protect domestic industries, and they are most likely to be implemented if a domestic industry meets one or more of the following criteria:

• *It is a large employer.* Industries that represent large voting blocs often receive state support in the form of subsidies and import protection. Europe's farmers are a case in point.

• *It is seen as a national champion.* Reflect-

The CAGE *Distance Framework*

The cultural, administrative, geographic, and economic (CAGE) distance framework helps managers identify and assess the impact of distance on various industries. The upper portion of the table lists the key attributes underlying the four dimensions of distance. The lower portion shows how they affect different products and industries.

	Cultural Distance	Administrative Distance	Geographic Distance	Economic Distance
attributes creating distance	different languages	absence of colonial ties	physical remoteness	differences in consumer incomes
	different ethnicities; lack of connective ethnic or social networks	absence of shared monetary or political association	lack of a common border	differences in costs and quality of: • natural resources • financial resources • human resources • infrastructure • intermediate inputs • information or knowledge
	different religions	political hostility	lack of sea or river access	
	different social norms	government policies	size of country	
		institutional weakness	weak transportation or communication links	
			differences in climates	
industries or products affected by distance	products have high linguistic content (TV)	government involvement is high in industries that are: • producers of staple goods (electricity) • producers of other "entitlements" (drugs) • large employers (farming) • large suppliers to government (mass transportation) • national champions (aerospace) • vital to national security (telecommunications) • exploiters of natural resources (oil, mining) • subject to high sunk costs (infrastructure)	products have a low value-to-weight or bulk ratio (cement)	nature of demand varies with income level (cars)
	products affect cultural or national identity of consumers (foods)		products are fragile or perishable (glass, fruit)	economies of standardization or scale are important (mobile phones)
	product features vary in terms of: • size (cars) • standards (electrical appliances) • packaging		communications and connectivity are important (financial services)	labor and other factor cost differences are salient (garments)
	products carry country-specific quality associations (wines)		local supervision and operational requirements are high (many services)	distribution or business systems are different (insurance)
				companies need to be responsive and agile (home appliances)

ing a kind of patriotism, some industries or companies serve as symbols of a country's modernity and competitiveness. Thus the showdown between Boeing and Airbus in capturing the large passenger-jet market has caused feelings on both sides of the Atlantic to run high and could even spark a broader trade war. Also, the more that a government has invested in the industry, the more protective it is likely to be, and the harder it will be for an outsider to gain a beachhead.

• *It is vital to national security.* Governments will intervene to protect industries that are deemed vital to national security—especially in high tech sectors such as telecommunications and aerospace. The FBI, for instance, delayed Deutsche Telekom's acquisition of Voicestream for reasons of national security.

• *It produces staples.* Governments will also take measures to prevent foreign companies from dominating markets for goods essential to their citizens' everyday lives. Food staples, fuel, and electricity are obvious examples.

• *It produces an "entitlement" good or service.* Some industries, notably the health care sector, produce goods or services that people believe they are entitled to as a basic human right. In these industries, governments are prone to intervene to set quality standards and control pricing.

• *It exploits natural resources.* A country's physical assets are often seen as part of a national heritage. Foreign companies can easily be considered robbers. Nationalization, therefore, is a constant threat to international oil and mining multinationals.

• *It involves high sunk-cost commitments.* Industries that require large, geography-specific sunk investments—in the shape, say, of oil refineries or aluminum smelting plants or railway lines—are highly vulnerable to interference from local governments. Irreversibility expands the scope for holdups once the investment has been made.

Finally, a target country's weak institutional infrastructure can serve to dampen cross-border economic activity. Companies typically shy away from doing business in countries known for corruption or social conflict. Indeed, some research suggests that these conditions depress trade and investment far more than any explicit administrative policy or restriction. But when a country's institutional infrastructure is strong—for instance, if it has a well-functioning legal system—it is much more attractive to outsiders.

Ignoring administrative and political sensitivities was Star TV's other big mistake. Foreign ownership of broadcasting businesses—even in an open society like the United States—is always politically loaded because of television's power to influence people. Yet shortly after acquiring the company, Rupert Murdoch declared on record that satellite television was "an unambiguous threat to totalitarian regimes everywhere" because it permitted people to bypass government-controlled news sources. Not surprisingly, the Chinese government enacted a ban on the reception of foreign satellite TV services soon thereafter. News Corporation has begun to mend fences with the Chinese authorities, but it has yet to score any major breakthroughs in

How Far Away Is China, Really?

As Star TV discovered, China is a particularly tough nut to crack. In a recent survey of nearly 100 multinationals, 54% admitted that their total business performance in China had been "worse than planned," compared with just 25% reporting "better than planned." Why was the failure rate so high? The survey provides the predictable answer: 62% of respondents reported that they had overestimated market potential for their products or services.

A quick analysis of the country along the dimensions of distance might have spared those companies much disappointment. Culturally, China is a long way away from nearly everywhere. First, the many dialects of the Chinese language are notoriously difficult for foreigners to learn, and the local population's foreign-language skills are limited. Second, the well-developed Chinese business culture based on personal connections, often summarized in the term *guanxi,* creates barriers to economic interchange with Westerners who focus on transactions rather than relationships. It can even be argued that Chinese consumers are "home-biased"; market research indicates much less preference for foreign brands over domestic ones than seems to be true in India, for example. In fact, greater China plays a disproportionate role in China's economic relations with the rest of the world.

Administrative barriers are probably even more important. A survey of members of the American Chamber of Commerce in China flagged market-access restrictions, high taxes, and customs duties as the biggest barriers to profitability in China. The level of state involvement in the economy continues to be high, with severe economic strains imposed by loss-making state-owned enterprises and technically insolvent state-owned banks. Corruption, too, is a fairly significant problem. In 2000, Transparency International ranked the country 63rd out of 90, with a rating of one indicating the least perceived corruption. Considerations such as these led Standard & Poor's to assign China a political-risk ranking of five in 2000, with six being the worst possible score.

So, yes, China is a big market, but that is far from the whole story. Distance matters, too, and along many dimensions.

a country that accounts for nearly 60% of Star TV's potential customers. Murdoch of all people should have foreseen this outcome, given his experience in the United States, where he was required to become a citizen in order buy the television companies that now form the core of the Fox network.

Geographic Distance. In general, the farther you are from a country, the harder it will be to conduct business in that country. But geographic distance is not simply a matter of how far away the country is in miles or kilometers. Other attributes that must be considered include the physical size of the country, average within-country distances to borders, access to waterways and the ocean, and topography. Man-made geographic attributes also must be taken into account—most notably, a country's transportation and communications infrastructures.

Obviously, geographic attributes influence the costs of transportation. Products with low value-to-weight or bulk ratios, such as steel and cement, incur particularly high costs as geographic distance increases. Likewise, costs for transporting fragile or perishable products become significant across large distances.

Beyond physical products, intangible goods and services are affected by geographic distance as well. One recent study indicates that cross-border equity flows between two countries fall off significantly as the geographic distance between them rises. This phenomenon clearly cannot be explained by transportation costs—capital, after all, is not a physical good. Instead, the level of information infrastructure (crudely measured by telephone traffic and the number of branches of multinational banks) accounts for much of the effect of physical distance on cross-border equity flows.

Interestingly, companies that find geography a barrier to trade are often expected to switch to direct investment in local plant and equipment as an alternative way to access tar-

Industry Sensitivity *to Distance*

The various types of distance affect different industries in different ways. To estimate industry sensitivity to distance, Rajiv Mallick, a research associate at Harvard Business School, and I regressed trade between every possible pair of countries in the world in each of 70 industries (according to their SIC designations) on each dimension of distance.

The results confirm the importance of distinguishing between the various components of distance in assessing foreign market opportunities. Electricity, for instance, is highly sensitive to administrative and geographic factors but not at all to cultural factors. The following table lists some of the industries that are more and less sensitive to distance.

CULTURAL DISTANCE
Linguistic Ties

MORE SENSITIVE

- meat and meat preparations
- cereals and cereal preparations
- miscellaneous edible products and preparations
- tobacco and tobacco products
- office machines and automatic data-processing equipment

LESS SENSITIVE

- photographic apparatuses, optical goods, watches
- road vehicles
- cork and wood
- metalworking machinery
- electricity current

MORE SENSITIVE ←

get markets. But current research suggests that this approach may be flawed: Geographic distance has a dampening effect, overall, on investment flows as well as on trade flows. In short, it is important to keep both information networks and transportation infrastructures in mind when assessing the geographic influences on cross-border economic activity.

Economic Distance. The wealth or income of consumers is the most important economic attribute that creates distance between countries, and it has a marked effect on the levels of trade and the types of partners a country trades with. Rich countries, research suggests, engage in relatively more cross-border economic activity relative to their economic size than do their poorer cousins. Most of this activity is with other rich countries, as the positive correlation between per capita GDP and trade flows implies. But poor countries also trade more with rich countries than with other poor ones.

Of course, these patterns mask variations in the effects of economic disparities—in the cost and quality of financial, human, and other resources. Companies that rely on economies of experience, scale, and standardization should focus more on countries that have similar economic profiles. That's because they have to replicate their existing business model to exploit their competitive advantage, which is hard to pull off in a country where customer incomes—not to mention the cost and quality of resources—are very different. Wal-Mart in India, for instance, would be a very different business from Wal-Mart in the United States. But Wal-Mart in Canada is virtually a carbon copy.

In other industries, however, competitive advantage comes from economic arbitrage—the exploitation of cost and price differentials between markets. Companies in industries whose major cost components vary widely across countries—like the garment

ADMINISTRATIVE DISTANCE **Preferential Trading Agreements**	GEOGRAPHIC DISTANCE **Physical Remoteness**	ECONOMIC DISTANCE **Wealth Differences**
gold, nonmonetary	electricity current	*(economic distance decreases trade)*
electricity current	gas, natural and manufactured	nonferrous metals
coffee, tea, cocoa, spices	paper, paperboard	manufactured fertilizers
textile fibers	live animals	meat and meat preparations
sugar, sugar preparations, and honey	sugar, sugar preparations, and honey	iron and steel
		pulp and waste paper
gas, natural and manufactured	pulp and waste paper	*(economic distance increases trade)*
travel goods, handbags	photographic apparatuses, optical goods, watches	coffee, tea, cocoa, spices
footwear	telecommunications and sound-recording apparatuses	animal oils and fats
sanitary, plumbing, heating, and lighting fixtures	coffee, tea, cocoa, spices	office machines and automatic data-processing equipment
furniture and furniture parts	gold, nonmonetary	power-generating machinery and equipment
		photographic apparatuses, optical goods, watches

LESS SENSITIVE →

and footwear industries, where labor costs are important—are particularly likely to target countries with different economic profiles for investment or trade.

Whether they expand abroad for purposes of replication or arbitrage, all companies find that major disparities in supply chains and distribution channels are a significant barrier to business. A recent study concluded that margins on distribution within the United States—the costs of domestic transportation, wholesaling, and retailing—play a bigger role, on average, in erecting barriers to imports into the United States than do international transportation costs and tariffs combined.

More broadly, cross-country complexity and change place a premium on responsiveness and agility, making it hard for cross-border competitors, particularly replicators, to match the performance of locally focused ones because of the added operational complexity. In the home appliance business, for instance, companies like Maytag that concentrate on a limited number of geographies produce far better returns for investors than companies like Electrolux and Whirlpool, whose geographic spread has come at the expense of simplicity and profitability.

A Case Study in Distance

Taking the four dimensions of distance into account can dramatically change a company's assessment of the relative attractiveness of foreign markets. One company that has wrestled with global expansion is Tricon Restaurants International (TRI), the international operating arm of Tricon, which manages the Pizza Hut, Taco Bell, and KFC fast-food chains, and which was spun off from Pepsico in 1997.

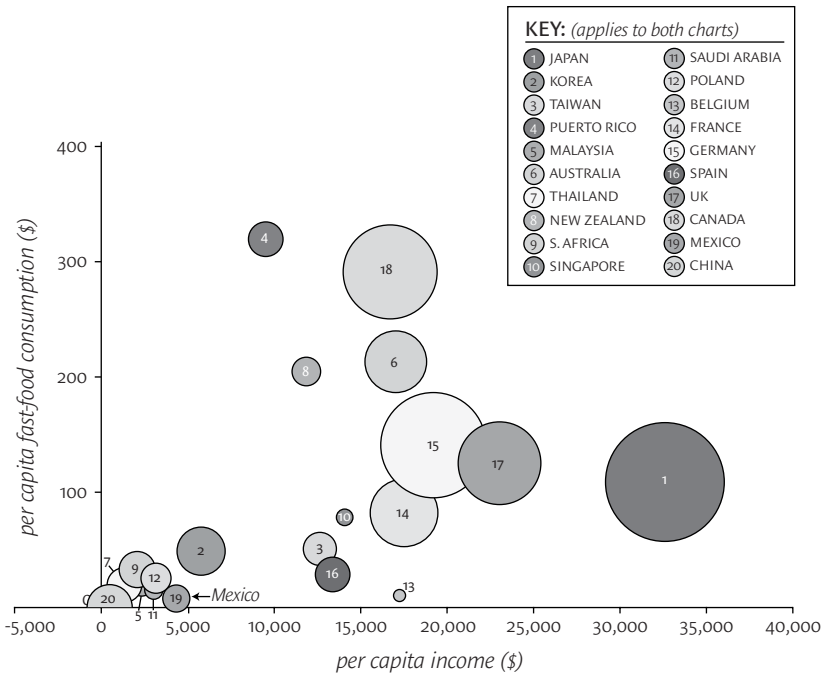
When Tricon became an independent company, TRI's operations were far-flung, with restaurants in 27 countries. But the profitability of its markets varied greatly: Two-thirds of revenues and an even higher proportion of profits came from just seven markets. Furthermore, TRI's limited operating cash flow and Tricon's debt service obligations left TRI with less than one-tenth as much money as archrival McDonald's International to invest outside the United States. As a result, in 1998, TRI's president, Pete Bassi, decided to rationalize its global operations by focusing its equity investments in a limited number of markets.

But which markets? The exhibit "Country

Country Portfolio Analysis: *A Flawed Approach*

Here's how country portfolio analysis (CPA) works. A company's actual and potential markets are plotted on a simple grid, with a measure of per capita income on one axis and some measure of product performance, often penetration rates, on the other. The location of the market on the grid reflects the attractiveness of the market in terms of individual consumer wealth and propensity to consume. The size of the bubble represents the total size of the market in terms of GDP or the absolute consumption of the product or service in question. The bubbles provide a rough estimate of how large the relative revenue opportunities are.

This CPA map compares a number of non–U.S. markets for fast-food restaurants.



Portfolio Analysis: A Flawed Approach" provides a portfolio analysis of international markets for the fast-food restaurant business, based on data used by TRI for its strategy discussions. The analysis suggests that the company's top markets in terms of size of opportunity would be the larger bubbles to the center and right of the chart.

Applying the effects of distance, however, changes the map dramatically. Consider the Mexican market. Using the CPA method, Mexico, with a total fast-food consumption of $700 million, is a relatively small market, ranking 16th of 20. When combined with estimates of individual consumer wealth and per capita consumption, this ranking would imply that TRI should dispose of its investments there. But the exhibit "Country Portfolio Analysis: Adjusted for Distance" tells a different story. When the fast-food consumption numbers for each country are adjusted for their geographic distance from Dallas, TRI's home base, Mexico's consumption decreases less than any other country's, as you might expect, given Mexico's proximity to Dallas. Based on just this readjustment, Mexico leaps to sixth place in terms of market opportunity.

Further adjusting the numbers for a common land border and for membership in a trade agreement with the United States pushes Mexico's ranking all the way up to second, after Canada. Not all the adjustments are positive: adjusting for a common language—not a characteristic of Mexico—pushes Mexico into a tie for second place with the United Kingdom. Additional adjustments could also be made, but the overall message is plain. Once distance is taken into account, the size of the market opportunity in Mexico looks very different. If TRI had used the CPA approach and neglected distance, the company's planners might well have ended up abandoning a core market. Instead, they concluded, in Bassi's words, that "Mexico is one of TRI's top two or three priorities."

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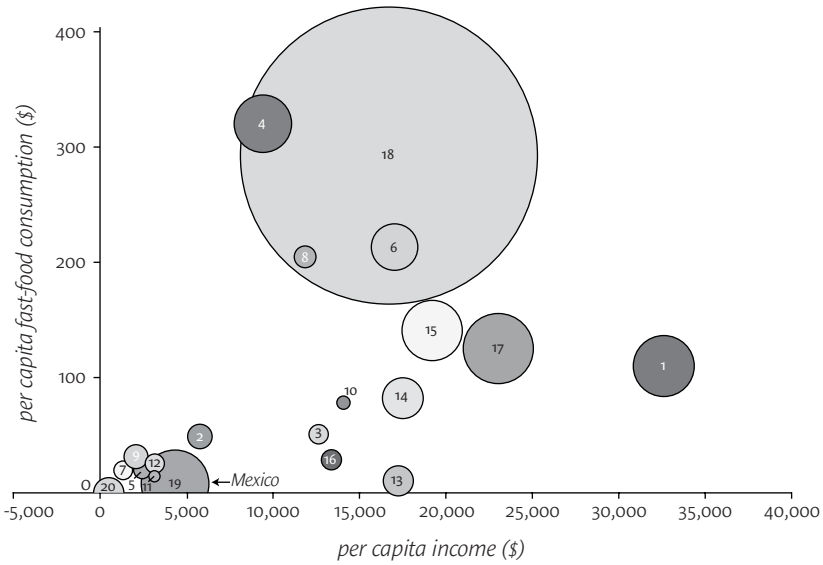
Factoring in the industry effects of distance is only a first step. A full analysis should consider how a company's own characteristics operate to increase or reduce distance from foreign markets. Companies with a large cadre of cosmopolitan managers, for instance, will be less affected by cultural differences than companies whose managers are all from the home country. In TRI's case, consideration of company-specific features made Mexico even more attractive. The company already owned more than four-fifths of its Mexican outlets and had

Country Portfolio Analysis:
Adjusted for Distance

Taking distance into account dramatically changes estimates of market opportunities. In the chart at right, each of the fast-food markets has been adjusted for a number of distance attributes, based on the estimates by Frankel and Rose. The relative sizes of the bubbles are now very different. For example, Mexico, which was less than one-tenth the size of the largest international markets, Japan and Germany, ends up as the second largest opportunity. Clearly, the CPA approach paints an incomplete picture, unless it is adjusted for distance.



a 38% share of the local market, well ahead of McDonald's.

Consideration of the interaction of company-specific features and distance is beyond the scope of this article. But whether the analysis is at the industry or company level, the message is the same: Managers must always be conscious of distance—in all its dimensions. The CAGE distance framework is intended to help managers meet that challenge. While it is necessarily subjective, it represents an important complement to the tools used by most companies seeking to build or rationalize their country market portfolios. Technology may indeed be making the world a smaller place, but it is not eliminating the very real—and often very high—costs of distance.

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by James K. Sebenius
Harvard Business Review
March 2002
Product no. R0203F

Sebenius explores an additional cultural difference that can create distance between two countries seeking to do business together: the varying ways in which people from different regions manage the negotiation process. Numerous promising deals have failed because the people involved ignored or underestimated these differences. How to avoid this fate? Prepare for a cross-border negotiation by mapping out each party's decision-making process—including who is involved, what formal and informal roles participants play, and how the agreement will be reached. Then design a negotiation strategy that anticipates obstacles *before* they arise. Your reward? A negotiation that leads to a meaningful "Yes."

Clusters and the New Economics of Competition
by Michael E. Porter
Harvard Business Review
November–December 1998
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Porter agrees that distance—in all its dimensions—can hamper business dealings between companies from different regions. Geographic, cultural, and institutional proximity provides companies with special access, closer relationships, better information, and other advantages that are difficult to tap from a distance. Such proximity gives rise to "clusters"—critical masses of linked industries and institutions (think Silicon Valley or Hollywood) that enjoy unusual competitive success in a particular field.

Clusters affect competition by 1) increasing the productivity of companies based in the area, 2) driving the direction and pace of innovation, and 3) stimulating formation of new businesses within the cluster. Clearly, local assets—knowledge, relationships, and motivation—provide a competitive edge that distant rivals can't replicate.

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