

5.8: From A to AA to AAA

Although most companies will focus on just one “A” at any given time, leading-edge companies—such as General Electric (GE), P&G, IBM, and Nestlé, to name a few—have embarked on implementing two, or even all three of the “A”s. Doing so presents special challenges because there are inherent tensions between all three foci. As a result, the pursuit of “AA” strategies, or even an “AAA” approach, requires considerable organizational and managerial flexibility. This discussion draws on Ghemawat (2007b), Chapter 7.

Pursuing Adaptation and Aggregation

P&G started out with a focus on adaptation. Attempts to superimpose aggregation across Europe first proved difficult and, in particular, led to the installation of a matrix structure throughout the 1980s, but the matrix proved unwieldy. So, in 1999, the then CEO, Durk Jager, announced another reorganization whereby global business units (GBUs) retained ultimate profit responsibility but were complemented by geographic market development organizations (MDOs) that actually managed the sales force as a shared resource across GBUs. The result was disastrous. Conflicts arose everywhere, especially at the key GBU-MDO interfaces. The upshot: Jager departed after less than a year in office.

Under his successor, A. G. Lafley, P&G has enjoyed much more success, with an approach that strikes a better balance between adaptation and aggregation and that makes allowances for differences across general business units and markets. For example, the pharmaceuticals division, with distinct distribution channels, has been left out of the MDO structure. Another example: in emerging markets, where market development challenges are huge, profit responsibility continues to rest with country managers.

Aggregation and Arbitrage

VIZIO, founded in 2002 with only \$600,000 in capital by entrepreneur William Wang to create high quality, flat panel televisions at affordable prices, has surpassed established industry giants Sony Corporation and Samsung Electronics Company to become the top flat-panel high definition television (HDTV) brand sold in North America. To get there, VIZIO developed a business model that effectively combines elements of aggregation and arbitrage strategies. VIZIO’s contract manufacturing model is based on aggressive procurement sourcing, supply-chain management, economies of scale in distribution.

While a typical flat-screen television includes thousands of parts, the bulk of the costs and ultimate performance are a function of two key components: the panel and the chipset. Together, these two main parts account for about 94% of the costs. VIZIO’s business model therefore focuses on optimizing the cost structure for these component parts. The vast majority of VIZIO’s panels and chipsets are supplied by a handful of partners. Amtran provides about 80% of VIZIO’s procurement and assembly work, with the remaining 20% performed by other ODMs, including Foxconn and TPV Technology.

One of the cornerstones of VIZIO’s strategy is the decision to sell through wholesale clubs and discount retailers. Initially, William Wang was able to leverage his relationships at Costco from his years of selling computer monitors. VIZIO’s early focus on wholesale stores also fit with the company’s value position and pricing strategy. By selling through wholesale clubs and discount stores, VIZIO was able to keep its prices low. For VIZIO, there is a two-way benefit: the prices of its TVs are comparatively lower than those from major manufacturers at electronics stores, and major manufacturers cannot participate as fully as they would like to at places like Costco.

VIZIO has strong relationships with its retail partners and is honored to offer them only the most compelling and competitively priced consumer electronics products. VIZIO products are available at valued partners including Wal-Mart, Costco, Sam’s Club, BJ’s Wholesale Club, Sears, Dell, and Target stores nationwide along with authorized online partners. VIZIO has won numerous awards including a number-one ranking in the Inc. 500 for “Top Companies in Computers and Electronics,” *Good Housekeeping*’s “Best Big-Screens,” *CNET*’s “Top 10 Holiday Gifts,” and *PC World*’s “Best Buy,” among others. <http://www.vizio.com/>

Arbitrage and Adaptation

An example of a strategy that simultaneously emphasizes arbitrage and adaptation is investing heavily in a local presence in a key market to the point where a company can pass itself off as a “local” firm or “insider.” A good example is provided by Citibank in China. The company, part of Citigroup, has had an intermittent presence in China since the beginning of the 20th century. A little more than 100 years later, in 2007, it was one of the first foreign banks to incorporate locally in China. The decision to incorporate locally was motivated by the desire to increase Citibank’s status as an “insider”; with local incorporation, the Chinese government

allowed it to extend its reach, expand its product offerings, and become more closely engaged with its local customers in the country.

China's decision in 2001 to become a member of the World Trade Organization (WTO) was a major factor in Citibank's decision to make a greater commitment to the Chinese market. Prior to China's joining the WTO, the banking environment in China was fairly restrictive. Banks such as Citibank could only give loans to foreign multinationals and their joint-venture partners in local currency, and money for domestic Chinese companies could only be raised in offshore markets. These restrictions made it difficult for foreign banks to gain a foothold in the Chinese business community.

Once China agreed to abide by WTO trading rules, however, banks such as Citibank had significantly greater opportunities: they would be able to provide local currency loans to blue-chip Chinese companies and would be free to raise funds for them in debt and equity markets within China. Other segments targeted by Citibank included retail credit cards and home mortgages. These were Citibank's traditional areas of expertise globally, and a huge potential demand for these products was apparent.

Significant challenges remained, however. Competing through organic growth with China's vast network of low-cost domestic banks would be slow and difficult. Instead, in the next few years, it forged a number of strategic alliances designed to give it critical mass in key segments. The first consisted of taking a 5% stake in China's ninth-largest bank, SPDB, a move that allowed Citibank to launch a dual-currency credit card that could be used to pay in *renminbi* in China and in foreign currencies abroad. In the following years, Citibank steadily increased its stake to the maximum 20% allowed under Chinese law and significantly expanded its product portfolio.

In June 2007, Citibank joined forces with Sino-U.S. MetLife Insurance Company, Ltd., to launch an investment unit-linked insurance product. In July of 2008, the company announced the launch of its first debit card. Simultaneously, it signed a deal with China's only national bankcard association, which allowed Citibank's debit cardholders to enjoy access to the association's vast network in China. The card would provide Chinese customers with access to over 140,000 ATMs within China and 380,000 ATMs in 45 countries overseas. Customers could also use their debit cards with over 1 million merchants within China and in 27 other countries. Today, Citibank is one of the top foreign banks operating in China, with a diverse range of products, eight corporate and investment bank branches, and 25 consumer bank outlets. Citibank's Co-Operative Strategy in China (2009).

Developing an AAA Strategy

There are serious constraints on the ability of any one company to use all three "A"s simultaneously with great effectiveness. Such attempts stretch a firm's managerial bandwidth, force a company to operate with multiple corporate cultures, and can present competitors with opportunities to undercut a company's overall competitiveness. Thus, to even contemplate an "AAA" strategy, a company must be operating in an environment in which the tensions among adaptation, aggregation, and arbitrage are weak or can be overridden by large-scale economies or structural advantages, or in which competitors are otherwise constrained. Ghemawat cites the case of GE Healthcare (GEH). The diagnostic imaging industry has been growing rapidly and has concentrated globally in the hands of three large firms, which together command an estimated 75% of revenues in the business worldwide: GEH, with 30%; Siemens Medical Solutions (SMS), with 25%; and Philips Medical Systems (PMS), with 20%. This high degree of concentration is probably related to the fact that the industry ranks in the 90th percentile in terms of R&D intensity.

These statistics suggest that the aggregation-related challenge of building global scale has proven particularly important in the industry in recent years. GEH, the largest of the three firms, has consistently been the most profitable, reflecting its success at aggregation through (a) economies of scale (e.g., GEH has higher total R&D spending than its competitors, but its R&D-to-sales ratio is lower), (b) acquisition prowess (GEH has made nearly 100 acquisitions under Jeffrey Immelt before he became GE's CEO), and (c) economies of scope the company strives to integrate its biochemistry skills with its traditional base of physics and engineering skills; it finances equipment purchases through GE Capital).

GEH has even more clearly outpaced its competitors through arbitrage. It has recently become a global product company by rapidly migrating to low-cost production bases. By 2005, GEH was reportedly more than halfway to its goals of purchasing 50% of its materials directly from low-cost countries and locating 60% of its manufacturing in such countries.

In terms of adaptation, GEH has invested heavily in country-focused marketing organizations. It also has increased customer appeal with its emphasis on providing services as well as equipment—for example, by training radiologists and providing consulting advice on postimage processing. Such customer intimacy obviously has to be tailored by country. And, recently, GEH has cautiously engaged in some "in China, for China" manufacture of stripped-down, cheaper equipment, aimed at increasing penetration there.

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