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EXPERT insight

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CRAFTING YOUR VANTAGE POINT

Escape the Low-Cost Trap & Enhance Value for Your Business

By ALEJANDRO RUELAS-GOSSI

At the start of 2016, the Trans-Pacific Partnership, a trade agreement brokered at the end of 2015, was being hotly debated by the 12 signatory governments. Proponents hailed it as a boon for economic development, especially for the emerging economies of Chile, Malaysia, Mexico, Peru and Vietnam. But critics argued it might simply do more to advance the interests of the richer nations involved: Australia, Brunei, Canada, Japan, New Zealand, Singapore and the United States. Instead of the economic rebalancing being promised by an integrated value chain representing 40 percent of global trade, critics predicted more of the same: an offshoring of low value-added activities to less powerful members of the chain in a distribution that would be neither fair nor equitable.

To some extent, the critics may be right: The "global factory" model can engender a vicious

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cycle of underdevelopment where countries specialize in low-cost activities and fail to accumulate the skills and resources necessary for sustained long-term growth. The country effectively surrogates itself to externally generated knowledge and becomes an industrial outpost of developed economy multinationals.

Development strategies that are narrowly focused on reducing costs in export-oriented factories, exploiting natural resources to the point of depletion, providing low value-added services (such as call centers) and prolonging a country's dependence on unsophisticated industries (extractive and agricultural sectors) often condemn nations to a bleak future of sliding salaries and contracting revenues.

This article proposes an alternative – what I call the "Vantage Point." This approach emphasizes a country's natural advantage, taking those resources owned and developed by a given country and enhancing their sophistication to create an inimitable value proposition. By replacing – or at least complementing – traditional low-cost strategies, the Vantage Point framework allows societies to enhance the value of their outputs and, by extension, per capita income. It sets in motion a self-perpetuating virtuous circle of development in which valuable skills are accumulated and the country's primary sources of competitive advantage are strengthened.

For almost two decades, I have been doing research and consulting in firms around the world and across a wide range of industries. In particular, my work with the Mexican cement giant, Cemex, in four continents and my in-depth studies of Spain's Basque Country while directing the think-tank Orkestra led me to develop the concepts described in this article. Apart from Mexico and Spain, I have identified examples of these concepts among firms in Bolivia, Brazil, Chile, China, Colombia, Egypt, Finland, Holland, Indonesia, Ireland, Japan, Peru, Singapore, South Africa, Sweden, the United Kingdom and the United States.

For the purposes of this article, I will focus on examples from the Basque Country, Mexico and Colombia to illustrate how the Vantage Point process works for businesses there – and how it might likewise inspire your own.

Time for a Rethink

Adopting the Vantage Point approach requires a drastic rethink of the role of foreign direct investment (FDI) in economic development. Rather than serving to create and perpetuate low value-added industrial functions and temporary, low-paid jobs – as is often the case – FDI would be drawn to a country to enhance and develop its economic potential, in addition to generating returns for commercial partners.

This redefinition entails an enormous shift in relations between developed and emerging markets. For emerging economies, a Vantage Point model offers the chance to develop in a more sustainable way that is more advantageous to the broader population. However, to pull it off, they need the sophisticated knowledge of a developed market counterpart. In the long term, developed and emerging economies both benefit enormously.

For example, promoting genuinely sustainable economic development in emerging and

EXECUTIVE SUMMARY

Many discussions of raising national competitiveness take the "global factory" model as their starting point. This model essentially assumes that the primary way for less developed economies to catch up is to carry out low value-added activities within the global supply chain. The inevitable result is a frantic race to the bottom, where being competitive means being the lowest cost provider.

This article proposes a markedly different approach based on the orchestration of an economy's "Vantage Point." Rather than cutting costs (and living standards), countries should instead focus on enhancing the value of the goods and services they naturally produce. Examples from Spain's Basque Country, Mexico and Colombia illustrate how intense collaboration and innovation in the production process – even in the production of what may seem to be basic commodities – can lead to a virtuous circle of value optimization and economic development.

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developing economies would help stem the mass exodus of people fleeing the troubled regions of the Middle East and Africa for the more stable regions of Europe. If emerging economies began to enjoy the benefits of economic specialization and sophistication, fewer people would be motivated to move elsewhere.

Many of the beggar-thy-neighbor forms of arbitrage that became popular with the explosion of global trade in the 1990s, such as offshoring, are no longer fit for purpose in a world where shared prosperity and development are the only guarantors of shared security and stability.

Meanwhile, the global commodity bubble is well and truly over, leaving one to wonder just how the nations and regions that grew dependent upon it will get back on their feet. The answer is by bringing value, not volume, to the equation; by enhancing the sophistication of what nature gave in abundance to each of the world's regions. Time is of the essence, especially with the Great Global Recession beginning to bite in emerging markets.

Strategic Orchestration

Much strategic thinking takes a narrow perspective, where the main goal is the maximization of company profits – and by extension national GDP. The starting point is almost always the individual firm, which exists to create, capture and sustain economic value. As such, firms largely focus on opportunities from which they alone can benefit.

The Vantage Point approach advocates a more *allocentric* view (from the Greek *allos* meaning *other*). The name of the game is collaboration and orchestration, rather than competition and domination.

Try to think of the myriad links beyond the value chain as players within an orchestra. It is the task of the *orchestrating* node – the conductor that initially identifies and develops an opportunity – to get all the other nodes to play along to its tune. To do that, it must find a way of engaging all the other nodes, i.e., the individuals, business units, companies or even governments that control relevant resources and make them available for use to fill a gap in the market.

The two dominant streams of strategy today – industry structure and the resource-based view of the firm – perceive strategic choices from a predominantly individualistic perspective. As long as the firm is maximizing its profits, most other concerns are moot.

As part of this approach, firms are encouraged to improve their weaknesses, investing more resources to make up for what they lack internally. Their strengths may go untouched and they fade into a landscape of mimicry.

By contrast, the Vantage Point principle of allocentrism seeks to orchestrate the strengths of the market players according to the particular strengths that the firm is bringing to the relationship. Every node will be playing at its best, always enhancing its particular strengths. Weaknesses must be orchestrated, not improved. One's weakness is a strength of another node.

Consider how Apple has mastered this approach, orchestrating millions of developers in the process of enhancing its allocentric value around its strengths in design and ease of use. Apple is not an isolated example. Facebook, Alibaba and peer-to-peer pioneers Uber and Airbnb have also adopted an allocentric orientation, seizing opportunities by orchestrating a network. To make it work requires a seismic shift in how managers establish and develop relationships.

In the traditional view of the firm, the firm maximizes its own value, often at the expense of other players in the value chain. The orchestration approach, by contrast, assumes there are unlimited opportunities to create new value, as long as there is cooperation between the network nodes and the pie is carved up in a manner that satisfies all participants.

Allocentrism Not Altruism

This cooperative model is not altruistic. It acknowledges the self-interested desires of each human being – indeed, that is what makes the network work. As the economist Adam

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Smith argued almost three centuries ago, what makes societies function successfully is each participant's innate egoism. However, instead of allowing egoism (from the realm of philosophy) to morph into egocentrism (from the realm of economics), the orchestration approach turns it into allocentrism.

This philosophical difference can be explained with the help of the Nash Equilibrium. Using the classic "prisoner's dilemma," the mathematician John Nash showed that it is precisely the non-cooperation of parties that results in equilibrium. The possibility of getting a reduced sentence is so strong an incentive for the prisoner that betrayal of his partner in crime – the most selfish choice – becomes his best option. However, Nash extended the two-party, zero-sum scenario to any situation with *n* number of participants. He argued that there are games in which players coordinate their choices and negotiate among themselves. He called this phenomenon "the bargaining solution."

An orchestrated network is an allocentric game of *n* number of participants that reach an ideal bargaining solution. For example, Apple did not establish itself as a platform for millions of developers to create apps and reap millions of dollars in profits in the process in order to help them out of the goodness of its heart. It did it to engage them in its own game while increasing the value of Apple's ecosystem.

In contrast to the resource-based view of the firm, the Vantage Point framework sees firms as porous entities. As such, companies are able to enhance value through the integration and coordination (orchestration) not only of their own resources and capabilities but also of external ones.

To enhance the Vantage Point of each geographic region, firms and governments will need to play an allocentric game to organize and coordinate all the nodes that play an active role in defining a distinctive value proposition. The core strategy of a region would then be the development and orchestration of the necessary skills and attributes to enhance the value and competitive advantage of its products and services.

Putting Value Before Cost: Basque Country Development

A fitting illustration of the benefits of value enhancement and allocentrism is the development of the Basque Country, an autonomous region in northern Spain. In the early 1990s, the region had an unemployment rate of around 25 percent and GDP per capita income roughly equivalent to $13,000. Over the past 20 years, the Basque Country has steadily outperformed the rest of Spain. Today it boasts the second lowest level of unemployment and the highest per capita income level for any region in Spain, closer to that of more advanced economies around the world. (See **Exhibit 1**.) Local political and business leaders achieved this by enhancing value, not by reducing costs.

More than half of the region's workers are employed in industrial sectors, in particular the steel industry. However, rather than trying to make the cheapest steel in the world, the Basques have concentrated on enhancing its value. Just after signing the third stage of the Basque Economic Agreement, in 1981, the Basque Country's regional government began orchestrating an allocentric game, bringing together public sector and private sector players around mutually beneficial objectives, igniting the early sparks of an industrial renaissance that continues to this day.

ABOUT THE AUTHOR

Alejandro Ruelas-Gossi is a professor of Strategy at the University of Miami School of Business Administration and a visiting research professor at New York University Stern School of Business. He has consulted for a number of Fortune 500 companies including Sony, Microsoft, IBM and Philips. Prior to going into academia, he was a senior executive at Cemex and Deere & Company. He also served for a number of years as the founding director of Orkestra, the Basque Institute of Competitiveness, in Spain.

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Also key to the region's economic development was Spain's membership of the European Union, in 1986, which resulted in the elimination of tariff barriers and greater exposure to international competition. In addition, the common monetary policy prevented Spain from engaging in competitive devaluations.

Basque industry had little choice but to raise its game as fast as it could. To do that, however, it did not slash prices – indeed, there was no point: the price of steel is set in international markets and is subject to high cyclical variations. Instead, it focused on product and process innovations, which helped to minimize exposure to price volatility. Indeed, between 2005 and 2008 the Basque Country was able to increase the value of its exports, even as labor costs rose.

To support this race-to-the-top process, the Basque autonomous government leverages public policy to foster private initiative. It does this in two key ways. First, it encourages entrepreneurs and business leaders to contribute toward industrial development through the implementation of new competitiveness policies. It also identifies opportunities for new technological development (such as graphene). It is constantly on the lookout for new investment opportunities in R&D, as a means of constantly renewing the region's productive structure.

Changing Fortunes EXHIBIT 1

BASQUE PER CAPITA INCOME HAS STEADILY OUTPERFORMED THE REST OF SPAIN.

	1995	2005	2014
BASQUE COUNTRY	€21,303	€29,423	€29,142
SPAIN	€17,869	€23,484	€22,357

* in constant euro rate for 2010

SOURCE: Orkestra, the Basque Institute of Competitiveness, based on Spanish Regional Accounts from the Spanish Institute of Statistics (INE).

The regional government has created a web of nonprofit institutions linked to public and private universities. Their role is to support world-class research and innovation in the region. To ensure effective knowledge transfer, private sector participants are invited to join the boards of these R&D programs and institutions, some of which, including Tecnalia, Ikerlan and IK4, have developed a strong presence on both sides of the Atlantic.

At the heart of the Vantage Point concept is the understanding that every geographic region has distinct characteristics, and it is much better to direct FDI toward creating supportive, productive structures that enhance those strengths and orchestrate the weaknesses, leading to a unique value proposition. This act of "bricolage" – the construction or creation of a work from a diverse range of available things – is a much better path to development than reaching for unavailable things, which is costlier and riskier. The Basque Country's recent development may be impressive, but it is by no means alone, as illustrated by the next example from Mexico.

Avocados From Mexico: Healthy Growth

In February 2015 Avocados From Mexico (AFM) took the world by surprise when it presented its first ever NFL Super Bowl commercial. Some people in the audience might have wondered what exactly they were doing watching a commercial for avocados. After all, avocados are just a basic food commodity – or so they might have thought.

For Mexico, or to be more precise the Mexican state of Michoacán, the avocado is not just a basic commodity, it is a clear Vantage Point. Michoacán's rich volcanic soil, abundant sunshine and timely rainfall provide the perfect microclimate for producing tasty, creamy avocados all year round. Since 1997, the Mexican Hass avocado industry has achieved rapid growth in the United States, representing around 70 percent of the U.S. market today.

> Producers have taken a readily available local resource, but rather than letting it become a commodity in someone else's value chain, they have turned it into their own natural Vantage Point.

What's more, consumer trends are decidedly in the company's favor. Food consumers are becoming a lot more sophisticated in the health choices they make. Retail stores dedicated to health-conscious food have been growing at double-digit rates for the past decade. AFM has a particular advantage in this regard – avocados contain nearly 20 vitamins and minerals, including vitamins B6 (offering 4 percent of the recommended dietary allowance), C (4 percent) and E (4 percent); niacin (4 percent); folate (8 percent); and fiber (4 percent). AFM has also been able to garner the support of celebrated gourmet chefs on both sides of the U.S.-Mexican border, and guacamole – a Mexican dish – has become popular the world over.

Rather than serving as a cheap link in global supply chains, AFM has harnessed its strengths and orchestrated a host of other players. In 2009, the company invested in state-of-the-art technology that allows it to trace each avocado back to farm in less than one hour. Meanwhile, Mexico's Avocado Producer and Exporting Packers Association (APEAM) has adopted rigorous industry standards to support the production of avocados with unsurpassed taste, food safety and quality.

Producers are also constantly working to improve their health and environmental impact by participating in voluntary audits that verify that the fruit and vegetables produced have been grown, packed, handled and stored as safely as possible to minimize risks of microbial food safety hazards.

Like the Basque Country, AFM has taken a readily available local resource, but rather than letting it become a commodity in someone else's value chain, it has turned it into its own natural Vantage Point. Think about it: California also grows avocados but only accounts for 20 percent of its home market. This shows there can be a viable alternative to the *maquiladora* model that has sprung up along the U.S.-Mexican border, where Mexico simply provides cheap labor and assembly factories to U.S. parent companies.

Juan Valdez Coffee: Raising the Stakes

Another emerging market multinational that has learned to maximize its value proposition is Juan Valdez Coffee. In 2014, the Colombia-based company enjoyed a prolific year as coffee prices jumped 50 percent, making it the year's best-performing commodity.

However, like Avocados From Mexico, Juan Valdez refused to make do as a commodities trader heavily exposed to the whims and vagaries of the global markets. To that end, the company has carved out a lucrative niche in domestic and foreign retail markets. It now enjoys a presence across 13 countries, with 309 outlets, and its donkey-and-farmer icon is recognized the world over.

The basic arithmetic behind JV's decision to expand into retail was a no-brainer. The average price of a cup of coffee in a JV outlet is $5. You get 70 cups of coffee from every pound. The total coffee production of Colombia is 11 million sacks of coffee. Every sack of coffee contains 132 pounds. JV consumes only 24,000 sacks, which is only 0.2 percent of total production. The price per pound of most of the coffee production is $2. In other words, taking a grain of coffee all the way to a JV outlet increases revenue by 175 times (70 cups x 2.5 times of price/cup).

It is no surprise that coffee has far more value as a high-end retail product than as a basic commodity. However, like Nespresso, Juan Valdez understood that the beloved brew is fast gaining the sophistication and cachet normally reserved for alcoholic beverages like wine or whisky. It even calls its outlets "boutiques." Despite fierce competition in the sector, the JV brand is extremely well positioned, and in some countries, such as Chile, its prices are higher than Starbucks'. There is also ample room for further growth.

For its home market of Colombia, Juan Valdez has pried open a value proposition that is well worth exploring. That proposition is to attract some of the world's best coffeemakers to the country to enhance the value of the nation's coffee – just as the Basques enhanced

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the value of their steel – as well as cultivating and spreading a coffee culture across the whole country. One of my Colombian students who works for Juan Valdez recently suggested setting up the world's first ever "coffee university" in Colombia, which could serve as a repository of knowledge on global coffee-making cultures, traditions and businesses.

What my student realizes that many business executives do not is that deep knowledge is key for creating long-lasting value. The aim is always to increase a product's numerator. While a handful of supranational institutions are coming round to the vital role of upgrading, diversifying and skilling in achieving more sustainable development in the Global South, most developing countries continue to adopt denominator-driven rather than numerator-driven strategies. Denominator-driven strategies – what I call *Maquiladora* Syndrome – focus all efforts on just three variables: delivering the best quality, on time, at the lowest cost. As a result, these countries are left cruelly exposed to the volatility of foreign direct investment, and unable to accumulate the skillsets necessary to free themselves from the commodity trap.

In studying primitive cultures, anthropologists and archeologists have argued that the fate of early human societies depended on their ability to farm their own food, providing their people with enough idle time *to think* about how to build a better future. Other societies that did not farm continued to hunt and gather, using up most of their time searching for food just to survive. This left little opportunity *to think* about new ways of doing things.

EXHIBIT 2

The Vantage Point Matrix

MANAGERS SHOULD MOVE FROM LOW-COST, EGOCENTRIC TO HIGH-VALUE, ALLOCENTRIC BUSINESS MODELS.

	Egocentric		Allocentric	
High Value	■ Most innovative firms from developed economies ■ R&D is decisively egocentric, typified by "not invented here" syndrome, silo culture, incremental innovation and imitation	**Example** ***Samsung**, which is a global tech leader but is also frequently accused of copying others' inventions*	■ The sweet spot, where orchestrating the strengths of others enhances the firm's own value in the process	**Examples** ***Apple**, **Google** (aka Alphabet) and the German insurer **Allianz**, which has launched an innovation accelerator center in Munich, orchestrating Google as a node*
Low Cost	■ Typical for emerging economies ■ Competitiveness = the cheapest option	**Example** *Maquiladoras along the U.S.-Mexican border*	■ Firms expand their value mindset by orchestrating the relevant nodes in their natural ecosystem ■ This is the next progressive step for companies that would find it more difficult to switch immediately to high value	**Example** ***H&M** orchestrating consumers to bring old clothes back to the store to recycle while at the same time buying new ones*

For emerging markets to adopt the Vantage Point approach, the public and private sectors must work closely together to identify which industries make the best candidates for value enhancement.

Many developing and emerging markets face a similar dilemma. They can take a more proactive approach to their national competitiveness agenda by focusing all their energies on value enhancement, or they can resign themselves – surrogating their *thinking* – to serve the short-term needs of Western multinationals ad infinitum. If they take the first path, they should have a good stab at achieving sustainable economic growth and development. The second option can only mean more of the same – stagnation, exploitation and ever lower standards of living.

The matrix in **Exhibit 2** illustrates the stark contrast between these two development models. The content of each quadrant can be seen in both retrospective and prospective ways.

For instance, retrospectively, the low-cost, egocentric quadrant is typical for emerging economies. Arbitrage is the obvious strategy of choice for most emerging market companies. Firms spend less on R&D than traditional MNCs, have lower rates of new product development, less coordination across the region and less engagement in strategic planning and budgeting, not to mention relatively limited corporate control and reporting requirements.

Prospectively, the matrix offers prescriptive implications. Perhaps most important, the farther that companies are able to move their products away from their basic origins as possible, the higher the value of their outputs. For emerging markets to adopt the Vantage Point approach, the public and private sectors must work closely together to identify which industries make the best candidates for value enhancement.

A Change of Course

Over the past three decades, several management principles have become so widespread that they now practically constitute absolute truths. Among them is the determination to offer the lowest possible prices, along with relentless attempts to follow the rhythm set by competitors and the constant (but limited) analysis of the value chain.

While these strategy principles may be a source of interesting ideas of where and how to go, they are often misapplied, doing nothing more than promote a culture of sameness by curbing differentiation. And what are the consequences of these precepts on global living standards? Even in a market as supposedly developed as the United States, the number of people now living in poverty there is at record-high levels – and climbing – and the contagion is spreading throughout emerging economies.

We cannot go on like this forever. In addition to recognizing the unsustainable practices that have contributed to the problem, we have to resolve not to apply more of the same old approaches that have led to this state of affairs. In short, we need to change the way we think – we need a dramatically different Vantage Point. I urge you to redefine "competitiveness" – from meaning "low cost" to playing a new allocentric game of strategic orchestration. □

TO KNOW MORE

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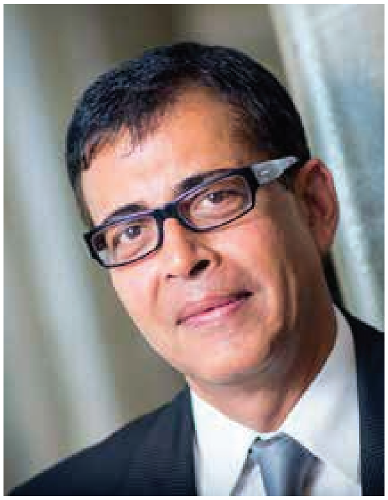
The Vantage Point in Perspective

Global strategist **Pankaj Ghemawat** highlights three strategic basics that he sees underpinning Alejandro Ruelas-Gossi's article.



"Orchestration is a fresh evocation of an alternative to asset ownership."

The last few decades have seen tremendous increases in the sophistication with which strategic alternatives are evaluated. Not nearly as much systematic attention has been allotted to the complementary question of how to generate better sets of strategic alternatives to evaluate.

While there are many routes to improvement, I read Professor Ruelas-Gossi's article as an argument, powerfully illustrated, that one way of getting to better strategic alternatives is by revisiting some strategy basics – which sometimes get lost in the process of coming up with the annual strategic plan and linking it to financial and other performance measures.

In this sense, I see three strategic basics underpinning the argument, in a way that stands out particularly sharply in the international context on which the article focuses:

1. THINK (HARD) ABOUT UPGRADING. The need for upgrading is a standard strategic mantra. It gains additional force in the international context from theoretical models that indicate that increased cross-border integration will generally raise the capability hurdles that companies must clear just to remain in operation. And empirical evidence suggests that the companies from emerging economies that are intent on surviving will generally have to focus on improving the numerator of the differentiation-to-cost ratio by building up their intangible assets in terms of marketing and technological know-how.

2. WHERE YOU ARE FROM AFFECTS WHERE YOU SHOULD GO. The "Vantage Point" notion applies in domestic strategy in a somewhat abstract way, in terms of the need for a company to focus on its (cumulated) distinctive competence. Professor Ruelas-Gossi stresses the same point in the international context from the perspective of a country or region. At the firm level, the notion has an additional, quite literal interpretation: firms that engage in foreign direct investment typically – and with good reason – tend to invest in markets that are close by before they turn to ones that are farther away.

3. RECOGNIZE THAT OWNERSHIP IS NOT THE ONLY ALTERNATIVE. Once again, this point applies both domestically and internationally but is more in evidence in the latter context. In particular, theorizing about international business has long stressed that even if a firm has a competitive advantage at home, it should think about a range of alternatives for exploiting it overseas, including exports, licensing, joint ventures and so on, as well as direct asset investments. *Orchestration* is a fresh evocation of an alternative to asset ownership that platform-based business models such as Airbnb and Uber have popularized because of their quick, asset-light global rollouts.

In sum, there is still gold there in some of those basics, and Professor Ruelas-Gossi's article reminds us of that in a way that should get creative juices flowing.

To read more on the first point in the context of globalization, see *Competing in Capabilities* by John Sutton (Oxford University Press, 2012). I elaborate on the second and third points in my forthcoming book *The Laws of Globalization* (Cambridge University Press, 2016).

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