The final implication of the CAGE framework that I wanted to talk about is this notion that ultimately, thinking deeply about differences and taking them seriously, can be a huge help with the holy grail of global strategy. Developing strategies that deal with differences. So here, let me use another case study, another case study of a very large, and very domestically successful firm that has had significant issues with its international strategy. So the company I'm going to talk about is the only company in the world that sells more than $100 billion of goods each quarter.

And Wal-Mart, as a company that I started writing about in the mid 1980s, is a company that, while it has some issues in terms of how it deals with communities and labor in the US, is generally very well-managed domestically. In contrast, international hasn't worked out nearly as well for Wal-Mart, to the point where to, ten years ago, a journalist from the Financial Times had the temerity to ask Lee Scott, then the chairman and CEO. What made him think, Wal-Mart could be successful internationally? This was Lee Scott's response. To paraphrase, if Wal-Mart could move from Arkansas to Alabama, how difficult was Argentina going to be?

I found this a remarkable point of view, and so in 2004, the year that Lee Scott made this statement, I thought it might be interesting to just look a bit more closely at Wal-Mart's profit, performance outside the US. So I prepared this little chart. On the x-axis, the horizontal axis, I have distance from Wal-Mart's corporate headquarters in Bentonville. And, on the vertical axis, I have the estimated profitability of different parts of Wal-Mart's international operations. And the circles you're going to see simply reflect how much revenue Wal-Mart was doing in various geographies back in 2004, 2005.

So let's look at Wal-Mart's foreign markets as of 2004 in the order in which it entered them. Mexico, Puerto Rico, Brazil, Canada, Argentina, the UK, Germany, South Korea, and China. This makes for a really interesting pattern. Of course, there are only nine data points so one can't do a regression. But there is a suggestion of a negative slope. So, at least back in 2004, Wal-Mart was doing better in geographies that were physically proximate to corporate headquarters, than geographies that were physically distant from corporate headquarters. But it's not just geographic proximity that stands out. So if we look at the profitable markets, the profitable markets here are Mexico, Canada, Puerto Rico, which Wal-Mart, at that point, classified as a foreign operation even though it's a part of the US, and maybe the UK. Although the price tag on the acquisition that mark that Wal-Mart made to build up its UK operations was so high that I'm not quite sure whether UK has ever added economic value for the company. So, but let's say it has, what separates these four profitable operations from the five unprofitable operations?

Well, the profitable ones include the only two English speaking countries in the sample, culturally close. They include the only two members other than the US of NAFTA, making for administrative closeness and Puerto Rico, of course, is part of the US, it doesn't get more administratively close than that. We've already talked about geographic proximity, and finally, while there are obviously some differences in per capita income between, say, the US, and Mexico. The differences are relatively narrow compared to, say, the differences, especially back in 2004, between the US and China. So relatively, one could argue, relatively limited economic distance as well. In other words, one could argue that in terms of the CAGE framework, the four profitable countries are the ones that are really close. The five unprofitable countries are the ones that are relatively far.

And notice that the implication is not that Wal-Mart shouldn't have gone far away from home. Rather the implication is if you believe every place is just like home, the farther away from home you get. The more trouble you're going to find yourself in. And so, the CAGE framework, is as I've already mentioned, a little bit of a reminder as to what's close, versus what's far. And what kinds of differences one might need to pay attention to, if moving from, say, Bentonville to China. Beyond that, looking at these differences, at these categories of differences can help suggest valid, valuable, strategic responses. And so, I wanted to conclude this discussion of Wal-Mart by talking about some of the things that the company has managed to do since 2004 that make it more adept at dealing with differences than it was back when it didn't really even notice them.

So, if we look at Wal-Mart's strategies since 2004, one of the things that stands out is there's much more attention to adaptation than there used to be in the old days. And adaptation isn't rocket science. This is nothing more than the idea of when in Rome, do as the Romans do. But what's interesting is how fundamentally it's changed some of the aspects of how Wal-Mart operates overseas.

To take just one example, in the old days, when Wal-Mart entered a new market. Headquarters in Bentonville would send a suggested merchandise list to the country manager. And while the country manager was allowed to suggest modifications, in general, what headquarters proposed pretty much was what ruled the day. This was a system that continued for a while until there were mishaps. Like Wal-Mart stocking US footballs shaped like this in Brazil where footballs are shaped like this. Footballs had sounded good both the people in Bentonville and the people in Brazil as something worth stocking. It's only when inventory built up that it became clear that two different types of footballs were actually being talked about. So, small example, but it sort of forced a significant change in how Wal-Mart actually merchandises.

Now, when Wal-Mart enters a new geography, it first starts off using competitors' merchandise lists as a reference list and then thinking about how to how to impose a Wal-Mart accent on those kinds of competitive offerings. And so, that results in merchandise that arguably is more effectively tailored to the local geography. So, that's one generic strategy for dealing with differences, that taking differences seriously can help you spot possibilities for adaptation.

A second strategy for dealing with differences has to do with aggregation. The idea that some, while countries are different, they're not always equally different and sometimes you can overcome at least some of the effects of cross-country differences by grouping countries in interesting ways. So again, to take an example from Wal-Mart in Asia. What Wal-Mart has been doing in Asia is, it set up a bunch of different country operations, but more recently it actually put in a regional office. Because the idea was that from a managerial perspective, it's much more efficient to think of somebody based in the region travelling regularly to all these country operations than somebody based in Bentonville. Who would probably spend most of their time, if they were coming in from and heading back out to Bentonville, on the plane. And so, having the regional headquarters in Asia has permitted some economies in terms of managerial bandwidth, managerial scope, et cetera, in a way that doesn't pretend that all Asian countries are alike. But does recognize that geographically and otherwise, they're closer to each other than they might be to Wal-Mart's operations in South Africa or South America, or other parts of the world. So that's the second broad strategy for dealing with differences. The notion that while countries are different, they aren't always equally different, and you often can group them in ways that help you achieve at least some cross-border economies of scale.

The final of the three strategies for dealing with differences, that thinking carefully through the CAGE framework can help identify, has to do with arbitrage. The notion that differences sometimes aren't constraints to be adjusted to, or overcome. But, that selected exploitation of differences along particular dimensions can actually be a huge source of value creation. And here, the example par excellence has to do with Wal-Mart's sourcing of goods from China. I estimate that Wal-Mart sourced somewhere between 50, maybe as much as $70 billion worth in merchandise from China last year, directly and indirectly, through its other suppliers. If one applies the usual figure for cost savings from China procurement, to that number. You end up with cost savings several times as large as the total operating profits from Wal-Mart's international stores, and on a much smaller investment base to boot. So the idea is, look, although a lot of discussion of Wal-Mart's internationalization actually focuses on the store operations. When we think about where the big value drivers are, the big value drivers really are on the back end rather than on the front end. They really are around, are around arbitrage and procurement from China rather than they are about running stores in markets other than the US. And so, while it's not obvious to many of the people who follow the company arbitrage isn't just the tail of the global strategy dog at Wal-Mart, it's the main thing. It's the international stores whose contribution to Wal-Mart's economic value has been more modest.

So again, Wal-Mart today is a company that pulls much more aggressively on these three different strategy levers for dealing with differences, but again, to get there, it had to start off by acknowledging the reality of differences. And, we're going to come back and talk further about these strategies towards the end of the course.