Friedman's Follies: Insights on the Globalization/Regionalization Debate

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Abstract

In this paper we deconstruct the popular book by Thomas Friedman which argues that the world is integrated through the advent of a new form of globalization based on the Internet. We use the logic of international business strategy to demonstrate that Friedman's examples of world-wide integration are special cases which ignore the empirical realities of multinational enterprises (MNEs). We provide empirical evidence to demonstrate that the world's largest MNEs do not operate globally, but sell and produce the vast majority of their output within their home region of the triad. We develop a new analytical framework to explain the limited nature of Friedman's thinking, and we contrast this with the more robust frameworks available in international business. The latter frameworks, which take into account country level and regional level barriers to integration, are better at explaining the activities of MNEs. We conclude that, from the viewpoint of international business strategy, the prescriptive thinking from Friedman is misleading if it is believed that a global strategy is feasible. Instead, MNEs need to develop strategies to accommodate the realities of intra-regional integration and to overcome the liabilities of inter-regional expansion across the triad.

KEYWORDS: globalization, regionalization, international business strategy, multinational enterprises

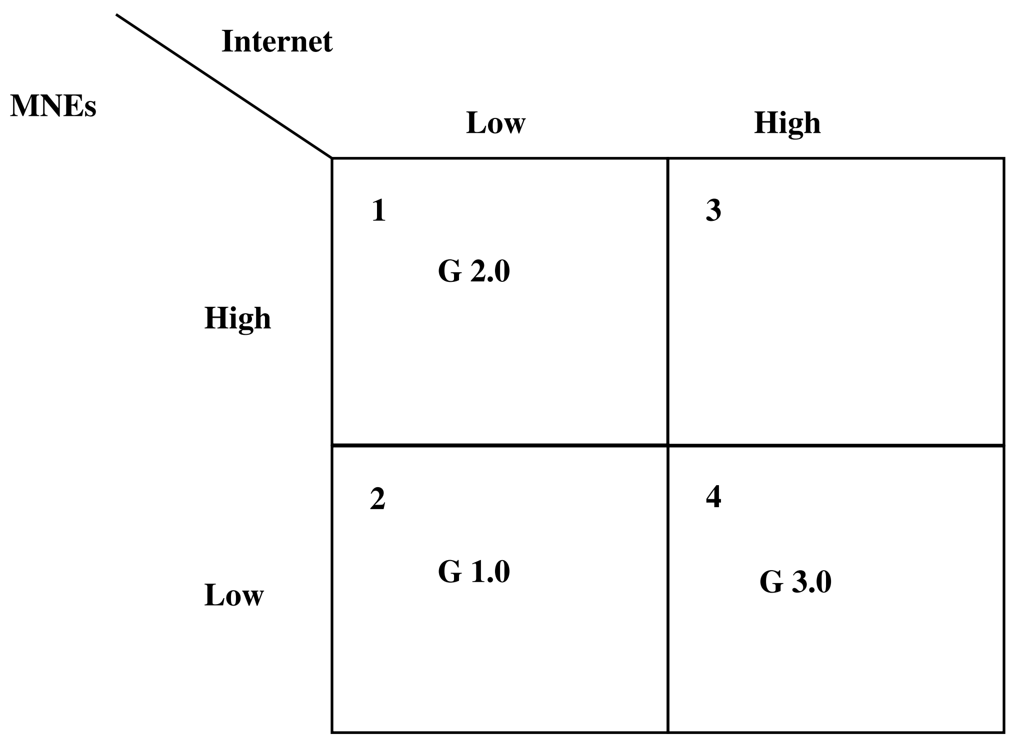
Introduction
A large academic literature in the international business field suggests that multinational enterprises (MNEs) are the key drivers of globalization (Rugman 1981, 2000; Dunning 1993, 2001). Yet many popular books on globalization fail to recognize the nature, extent and business reality of MNEs as leaders of globalization. Perhaps the most influential of these books is *The World is Flat* by New York Times journalist Thomas Friedman (Friedman 2003). It has been reported that over three million copies have been sold; yet this book is based upon a faulty understanding of globalization. It lacks any insight and balance into the underlying empirical context of world business. Friedman's thinking is consistent with analysis by some business school professors who advocate a global strategy for multinational firms (Govindarajan and Gupta 2001). However others have advocated that firms follow regional strategies (Rugman 2005 and Ghemawat 2007). Here we will examine the debate about globalization versus regionalization from the viewpoint of strategies of the world's largest firms, which are the main vehicles for economic integration either globally or regionally. This provides further insight into modern issues in international political economy along the lines of, for example, Ravenhill (2005).

A Framework for 'The World is Flat'
Basically, Friedman makes one point in his book: today a large proportion of international business takes place through offshoring (outsourcing across national borders). There are two main sites for offshoring. First, much manufacturing and cost innovation takes place in China. Second, many service sector activities, especially in information technology sectors, take place in India. While both types of offshoring certainly exist (and are explained by factor cost conditions) it is apparent that Friedman vastly exaggerates the importance of offshoring beyond the information technology related area. His book largely consists of interesting and well-written anecdotes referring to this particular sector.

To explain offshoring, Friedman develops an argument that today the world is characterized by globalization 3.0. This is a situation where individuals are empowered to run global businesses. They can process information and organize activities with the use of personal computers and the Internet. This type of globalization has replaced globalization 2.0 in which multinational enterprises organized international activity. During this era of globalization 2.0 which lasted from 1800 to 2000, MNEs grew and benefited from falling transportation costs (the development of railroads, bulk shipping lines, jet aircraft) and falling telecommunications costs. Previous to this type of globalization, according to Friedman, there existed globalization 1.0. This lasted from 1492 to 1800. International exchange was organized across and between countries. International trade was largely explained by labor cost differentials and the existence of natural resources.

The theoretical logic behind Friedman's flat world model (to the extent that there is any theory) would be as follows: globalization 1.0 is largely explained by international economics and the principle of comparative advantage. Countries specialize in the export of goods that use intensively their abundant factor (e.g. cheap labor or mineral deposits). Globalization 2.0 is explained by theories of international business (MNEs internalize knowledge advantages and control these firm-specific advantages within wholly-owned subsidiaries). Globalization 3.0 essentially has no theoretical support. It appears to assume that information exchange is free and that there are no barriers to entry in doing business anywhere in the world. Clearly globalization 3.0 presents many challenges, and these are discussed in more detail later in this paper.

Figure 1. Friedman's Three Types of Globalization



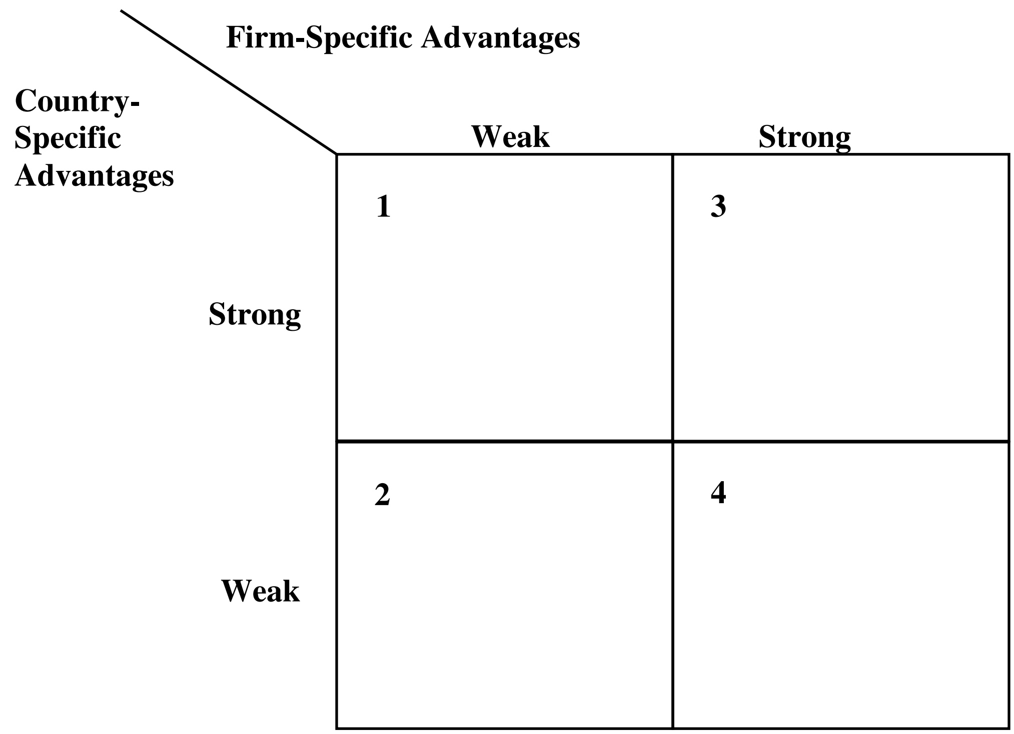
In Figure 1, these three types of globalization are synthesized in a new matrix. On the horizontal axis I put the Internet, which is available to a low or high degree. On the vertical axis I present the presence of multinational enterprises, again, to a low or high degree. In cell 2 Friedman globalization 1.0 appears; neither MNEs nor the Internet are important. In cell 1, globalization 2.0 appears. Here the role of MNEs is predominant, while the Internet is unimportant. In cell 4, globalization 3.0 appears. Friedman argues that only the Internet matters and that MNEs have been replaced by individual business activity.

In Friedman's book cell 3 is not discussed; yet, this is clearly the cell where international business activity now takes place. In reality, individuals lack the financial resources, institutional learning advantages, and managerial expertise to build global businesses. Instead, in cell 3 both MNEs and the Internet are important. MNEs are better equipped than individuals to overcome the remaining frictions that constrain world business. These frictions are in the form of government regulations, cultural and religious differences, and the persistence of historical and nationalist tendencies. While the Internet provides information on these issues it does not provide a mechanism to overcome them. In contrast, the MNE is better equipped to analyze and respond to such persistent differences. As shown below, the business world is largely divided into three broad regions of the triad. Doing business between the triad regions is extremely difficult. Only MNEs are able to tackle these triad barriers.

Building on this analysis, it is useful to reinterpret Friedman within the basic model used in the field of international business. This is the matrix relating country to firm factors, as first developed in Rugman (1981). This is reported in Figure 2 where country-specific advantages (CSAs) are shown on the vertical axis and firm-specific advantages (FSAs) on the horizontal axis. It is incorrect to generalize the country effect (the CSA axis in my Figure 2) and make it the sole explanation of globalization. Instead, the firm effects need to be brought together, as in cell 3 of Figure 3. It can be seen that Friedman's book is mainly about cell 1, and that he presents no evidence of the way FSAs can be developed such that CSAs in China and India are transformed by emerging economy MNEs into cell 3 firm-specific attributes.

This analysis counters the simplistic notions of writers such as Thomas Friedman. The world is not flat. International business suggests that there remain strong barriers as a business attempts to cross the boundaries of triad regions. It is pointless to assume globalization; instead, it is necessary to investigate the manner in which a firm's business model may need to be adapted such that its FSAs can overcome the liability of inter-regional foreignness.

Figure 2.
The FSA/CSA Matrix

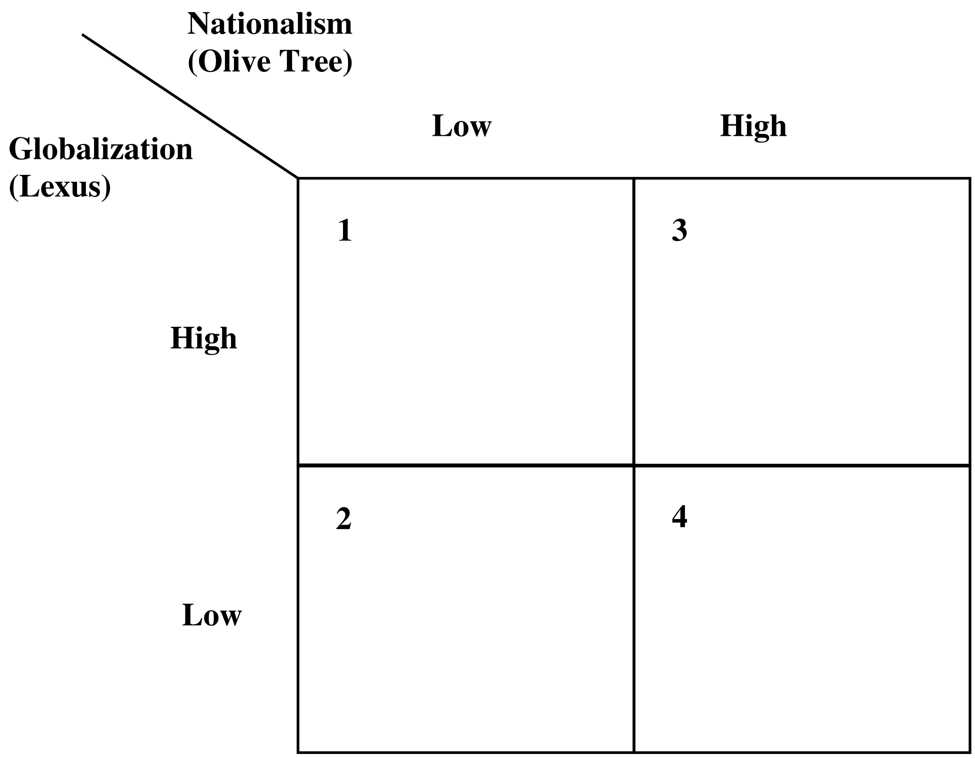


Source: A.M. Rugman and S.C. Collinson, *International Business*, 4th ed.. London: FT Pearson, pp. 49-52, based on A.M. Rugman, *Inside the Multinationals*. New York: Columbia University Press, 1981.

The Lexus and the Olive Tree

In an earlier influential book, *The Lexus and the Olive Tree*, Thomas Friedman uses the Lexus as a symbol for economic integration. In contrast, the olive tree is a symbol for the historical, political, religious and social aspects which present obstacles to economic integration. Therefore, the logic of the Lexus view of globalization would fit on the vertical axis of Figure 3, whereas the olive tree would be assigned to the horizontal axis representing a need for national responsiveness. Friedman himself discusses the extreme cases of the Lexus in cell 1 and the olive tree in cell 4. However, based on our analysis of Figure 3 it is apparent that cell 3 represents another interesting case where both globalization and national responsiveness are equally important. The other point is that Figure 3 is a strategy diagram to be put into operation by managers of MNEs (or other firms). Therefore, it is the interpretation of the Lexus and the olive tree axes which is important for strategic management. A potential for strategy in cell 3 would require that an MNE is able to organize itself to cope with both axes.

Figure 3. Globalization and Nationalism



The Empirical Evidence on Regionalization

In order to examine the empirical relevance of the Friedman focus upon worldwide economic integration we can now examine data on the actual performance of the world's 500 largest firms. Over the last ten years the majority of them have started to report the broad regions in which they operate, such that in their annual reports there is now stated the broad geographic regional dispersion of their sales and foreign assets. We can use these data to detect the extent of their global versus regional activity, and if there is a trend toward globalization or regionalization in recent years.

Table 1 reports the geographic sales of the world's 500 largest MNEs, based on the logic of the data bank in Rugman (2005). Briefly, in this databank there is information for 2001 on the geographic sales of 380 of the world's 500 largest firms. Of these 380 firms for the year 2006, 348 provide information on their sales in North America. Of these firms, 154 are North American MNEs (mostly from the United States). These 154 firms average 75 percent of their sales in North America; 15.6 percent in Europe; and 7.5 percent in Asia Pacific. In contrast, the 194 European and Asian MNEs average 17 percent of their sales in North America. Of these, 127 European MNEs average 64 percent of their sales in Europe. The 67 Asian MNEs average 76 percent of their sales in Asia Pacific.

Table 1. Sales of Multinational Enterprises in North America

Company Name	Number of MNEs	Revenue in bn US$	North America % of total	Europe % of total	Asia-Pacific % of total
Total 500 MNEs	348	44.4	42.6	35.1	26.3
North American MNEs	154	44.1	**75.1**	15.6	7.5
European and Asian MNEs	194	44.8	17.0	47.2	37.8
European	127	48.2	19.6	**64.3**	9.8
Asian	67	38.4	12.1	9.6	**75.9**

Source: Authors' calculations based on Rugman (2005*) The Regional Multinationals: MNEs and Global Strategic Management*.
Note. The values are calculated only when an MNE reports its regional sales in North America.

Data are for 2006. Due to the fact that some firms do not report regional sales of foreign region, the sum of three regions cannot be equal to 100%.The average size of the two sets of firms is approximately the same. The 154 North American MNEs average $44.1 billion in sales, whereas the 194 non-U.S. MNEs average $44.8 billion in sales. We will now analyze the sales of these firms in more detail. There are over 40 North American firms with 100 percent of their sales in North America (i.e. they are purely home triad region based). These include retail firms like Kroger, Walgreen, Sears Roebuck, Target, Federated Department Stores, and Safeway; financials like State Farm, Allstate, Aetna, Wachovia, U.S. Bancorp; and utility firms like Sunoco, EnCana, Exelon, etc.

Over half of the set of 154 North American firms have over 80 percent of their sales in North America. Only two European (Delhaize 'Le Lion' and Royal Ahold) firms can match their focus on North America. Indeed, many European and Asian firms have less than 20 percent of their sales in North America, which is too low a percentage to be of much strategic significance to these firms.

However, some 70 non-U.S. firms have more than a 20 percent presence in North America. These firms are the firms which are the key rivals of North American firms in the North America region.

In Table 2 there is analysis of the sales of the top 50 of the 194 large foreign MNEs active in North America. Thirteen of these foreign firms have total sales of over $100 billion. Of these DaimlerChrysler has total sales of $190 billion of which 52 percent are in North America; Toyota has sales of $204.7 billion of which 35.4 percent are in North America; BP has worldwide sales of $274 billion of which 35 percent are in North America; Shell has sales of $318.8 billion of which 33.1 percent are in North America.

Table 2. Regional Sales of 50 Foreign MNEs in North America

Company Name	Region	Revenue in bn US$	N. America % of total	Europe % of total	Asia-Pacific % of total
Royal Dutch Shell	Europe	318.8	33.1	42.8	na
BP	Europe	274.3	35.2	43.2	na
Toyota Motor	Asia-Pacific	204.7	35.4	12.2	44.2
DaimlerChrysler	Europe	190.2	52.2	33.1	8.2
Total	Europe	168.4	8.5	70.2	14.8
ING Group	Europe	158.3	37.9	37.7	18.8
AXA	Europe	139.7	21.6	63.3	6.4
Crédit Agricole	Europe	128.5	8.0	85.7	5.9
Allianz	Europe	125.3	14.0	85.8	na
Fortis	Europe	121.2	4.6	91.6	3.7
HSBC Holdings	Europe	115.4	30.6	33.0	25.5
ENI	Europe	109.0	7.3	76.1	6.5
UBS	Europe	107.8	38.1	53.5	8.4
Deutsche Bank	Europe	96.2	28.1	59.5	11.9
Honda Motor	Asia-Pacific	94.8	55.3	10.1	29.1
Nissan Motor	Asia-Pacific	89.5	34.6	12.6	41.1
Samsung Electronics	Asia-Pacific	89.5	21.1	25.1	53.2
Credit Suisse	Europe	89.4	42.3	50.7	6.9
Hitachi	Asia-Pacific	87.6	8.7	4.9	85.1
Société Générale	Europe	84.5	12.3	80.6	3.4
E.ON	Europe	81.0	2.8	96.3	na
Royal Bank of Scotland	Europe	81.0	17.0	82.2	na
Nestlé	Europe	79.9	34.1	29.1	16.8
Deutsche Post	Europe	79.5	18.4	70.9	9.2
Matsushita Electric	Asia-Pacific	77.9	15.6	12.5	71.9
Deutsche Telekom	Europe	77.0	22.3	77.1	na

Table 2. (Continue)

Company Name	Region	Revenue in bn US$	N. America % of total	Europe % of total	Asia-Pacific % of total
ABN AMRO Holding	Europe	71.2	14.6	63.2	7.8
Peugeot	Europe	71.0	6.7	73.6	7.2
Sony	Asia-Pacific	70.9	26.2	23.0	29.0
LG Electronics	Asia-Pacific	68.8	20.5	21.6	50.3
Hyundai Motor	Asia-Pacific	66.7	24.2	13.4	62.4
Statoil	Europe	66.3	10.1	86.4	na
Prudential	Europe	66.1	23.6	61.1	15.3
BASF	Europe	66.0	24.6	53.4	15.4
Barclays	Europe	65.6	13.2	69.6	na
Fiat	Europe	65.0	12.2	67.8	na
Zurich Financial Services	Europe	65.0	29.3	64.3	na
BMW	Europe	61.5	25.2	59.3	na
Toshiba	Asia-Pacific	60.8	14.9	11.0	71.4
Munich Re Group	Europe	58.2	19.1	71.0	5.5
ThyssenKrupp	Europe	57.9	24.6	61.6	8.7
Royal Ahold	Europe	56.9	73.9	26.1	0.0
Suez	Europe	56.7	9.4	79.9	4.9
Robert Bosch	Europe	54.8	19.1	65.3	14.1
Mitsubishi Tokyo Financial	Asia-Pacific	52.1	16.5	5.4	74.9
EADS	Europe	49.5	23.9	43.6	19.9
Enel	Europe	48.3	0.5	98.4	na
Nippon Oil	Asia-Pacific	48.0	0.8	0.6	98.6
Aegon	Europe	45.9	44.7	49.1	na
Ito-Yokado	Asia-Pacific	45.6	38.9	na	60.1

Source: Authors' calculations based on Rugman (2005*) The Regional Multinationals: MNEs and Global Strategic Management*.

Note. The table excludes European and Asian MNEs that do not report their geographic sales in North America. Data are for 2006.

Table 3 further decomposes Table 2. We can find (in the last column of Table 3) that the sales presence of Shell in North America is $106 billion; DaimlerChrysler's sales in North America are $99.3 billion; BP in North America is $96.6 billion; Toyota has $72.6 billion; ING Group is at $60 billion; Honda is at $52.4 billion; Royal Ahold is at $42 billion; UBS at $41 billion; Credit Suisse is at $37.8 billion, etc. In Table 3 there are 49 foreign firms identified, each with over ten billion dollars of sales in North America in the year 2006. Data for the other foreign firms, with sales over two billion but below ten billion in North America are not reported.

Table 3. The Sales of Large Foreign Firms in North America

Company Name	Country	N. America % of total	Sales in N. America in bn US$
Royal Dutch Shell	Netherlands/U	33.1	105.6
DaimlerChrysler	Germany	52.2	99.3
BP	UK	35.2	96.6
Toyota Motor	Japan	35.4	72.6
ING Group	Netherlands	37.9	60.0
Honda Motor	Japan	55.3	52.4
Royal Ahold	Netherlands	73.9	42.1
UBS	Swiss	38.1	41.1
Credit Suisse	Swiss	42.3	37.8
HSBC Holdings	UK	30.6	35.3
Nissan Motor	Japan	34.6	31.0
AXA	France	21.6	30.1
Nestlé	Swiss	34.1	27.2
Deutsche Bank	Germany	28.1	27.0
Aegon	Netherlands	44.7	20.5
GlaxoSmithKline	UK	47.8	20.4
Zurich Financial Services	Swiss	29.3	19.0
Samsung Electronics	Korea	21.1	18.8
Sony	Japan	26.2	18.6
Novartis	Swiss	48.4	17.9
Ito-Yokado	Japan	38.9	17.8
Allianz	Germany	14.0	17.5
Delhaize Group	Belgium	71.4	17.5
Deutsche Telekom	Germany	22.3	17.2
BASF	Germany	24.6	16.2
Hyundai Motor	Korea	24.2	16.1
Prudential	UK	23.6	15.6
BMW	Germany	25.2	15.5
Deutsche Post	Germany	18.4	14.6
ThyssenKrupp	Germany	24.6	14.3
Total	France	8.5	14.3
AstraZeneca	UK	53.7	14.2
LG Electronics	Korea	20.5	14.1
Roche Group	Swiss	39.7	13.8
Royal Bank of Scotland	UK	17.0	13.8
Wolseley	UK	53.4	13.5
Sanofi-Aventis	France	34.3	12.7

Table 3. (Continue)

Company Name	Country	N. America % of total	Sales in N. America in bn US$
CRH	Ireland	52.3	12.3
Matsushita Electric Industrial	Japan	15.6	12.1
EADS	Netherlands	23.9	11.8
Munich Re Group	Germany	19.1	11.1
Canon	Japan	30.9	11.0
Groupe Caisse d'épargne	France	26.5	10.9
Bayer	Germany	26.9	10.7
Robert Bosch	Germany	19.1	10.5
ABN AMRO Holding	Netherlands	14.6	10.4
Société Générale	France	12.3	10.4
Crédit Agricole	France	8.0	10.3
Volvo	Sweden	28.9	10.2

Source: Authors' calculations based on Rugman (2005*) The Regional Multinationals: MNEs and Global Strategic Management*. Data are for 2006. Note: Ranking is by sales in North America as measured by revenues.

Table 4 shows that most industry groups (made up from the world's 500 largest firms) in North America now have more foreign-owned MNEs than "home" firms. These are computers; construction; energy; motor vehicles; banks; telecommunication and utilities. Another sector, chemicals and pharmaceuticals, shows an even split of foreign and North American firms. Overall, these data demonstrate that foreign owned firms have a considerable presence in the North American economy and that they contribute to international business activity along regional triad, rather than global, lines.

Regionalization and Globalization over Time

The above data are for MNEs for one year, 2006. We have been able to update these data for the world's largest 500 MNEs for the seven-year time period 2000-2006. These data are summarized below. In this section we provide new data across two dimensions. First, we update the sales data from 2000, up to and including 2006. This now provides data for a seven-year period for a large number of the world's largest 500 firms. It helps us answer the question about whether there is a trend toward globalization or regionalization. Second, we provide data on assets as well as sales. This is done in order to provide clues about the nature of the upstream (backend) activities of these firms. Some theories suggest that there may be a possible global supply chain and the asset data should therefore provide some more details about this aspect of globalization than the sales (downstream) data previously reported in Rugman and Verbeke (2004) and Rugman (2005). Yet, as will be seen, the addition of information on assets provides essentially the same conclusion as for sales: most large firms are home-region based.

Table 4. Multinationals in North America by Industry Group

Industry	North America	Europe	Asia-Pacific	Total
Manufacturing Industry	**64**	**57**	**38**	**159**
Aerospace and Defense	8	3	0	11
Chemical and Pharmaceuticals	10	9	1	20
Computer, Office and Electronics	11	4	14	29
Construction and Natural Resources	8	13	5	26
Energy, Petroleum and Refining	8	12	4	24
Food, Drug and Tobacco	7	3	0	10
Motor Vehicle and Parts	7	9	11	27
Other Manufacturing	5	4	3	12
Service Industry	**90**	**64**	**35**	**189**
Banks	12	19	6	37
Merchandisers	23	6	12	41
Other Financial Services	19	12	3	34
Telecommunication and Utilities	10	11	3	24
Other Services	26	16	11	53
Total	**154**	**121**	**73**	**348**

Source: Authors' calculations based on Rugman (2005*) The Regional Multinationals: MNEs and Global Strategic Management.*

Note: The values are calculated only when an MNE reports its regional sales in North America. Data are for 2006.

In Table 5 for each year we break the data into two categories: manufacturing and services. We only include firms remaining in the population over the seven-year period. In Table 5 (Panel A) there are 389 firms with sales data and in Table 5 (Panel B) there are 310 firms providing data on their geographic segments for assets.

Table 5. Intra-Regional Sales and Assets of the 500 Firms

Panel A. Intra-regional Sales

Year	Intra-regional Sales (%)		
	All industries	Manufacturing	Services
2000	76.24	66.93	83.62
2001	75.57	65.96	83.19
2002	75.12	64.99	83.15
2003	75.29	64.77	83.63
2004	75.25	64.29	83.94
2005	74.95	63.96	83.67
2006	74.63	63.34	83.59
Weighted Average	75.29	64.83	83.56
Number of firms	389	172	217

Panel B. Intra-regional Assets

Year	Intra-regional Assets (%)		
	All industries	Manufacturing	Services
2000	77.64	70.76	83.78
2001	77.10	70.35	83.10
2002	76.82	69.23	83.57
2003	77.25	69.18	84.44
2004	77.54	69.08	85.07
2005	77.21	68.79	84.70
2006	77.07	68.07	85.08
Weighted Average	77.23	69.35	84.25
Number of firms	310	146	164

Source: Authors' calculations based on annual reports for 2000 – 2006. Firms are those listed in any year of the *Fortune Global 500* over the 2000-2006 period . We only include firms that report intra-regional sales or assets for the entire seven years.

In Table 5 (Panel A) it is shown that the average intra-regional sales figure for all firms is 75.3 percent with a plus or minus variation by year of less than 2 percent. There is no evidence of a trend towards the globalization of international business activity. However, services average 83.6 percent home-region sales as against 64.8 percent for manufacturing. This is a statistically significant difference. In Panel B of Table 5 there is, again, no trend towards globalization on intra-regional assets, which average 77 percent. There is a similar statistically significant difference in the average intra-regional assets of services (84 percent) and manufacturing (69 percent).

The interpretation from both panels of Table 5 is that services are even more home-region oriented than manufacturing across both downstream (sales) and upstream (assets) activities. These data are for the world's largest 500 firms, and, as shown earlier, there is no reason to believe that the large North American MNEs differ in any respect from these findings. All the evidence is that MNEs in both services and in manufacturing remain based in their home regions. There is no evidence to support a trend towards globalization, in either the upstream (production end) or downstream (customer end) of MNE activity in North America.

Conclusions

In his recent work Thomas Friedman ignores olive tree thinking and, instead, examines the implications of economic integration for globalization. In *The World is Flat* Friedman is mainly interested in outsourcing and globalization, where the latter is driven by the Internet and individual use of personal computers such that business is assumed to operate globally. By reverting to analysis of only the vertical axis of Figure 3, Friedman has ignored the complexities of globalization and vastly exaggerated the flat nature of the world's economy. Data presented here confirm the fact that the world's largest firms are regional, not global.

To summarize, in this paper evidence has been presented to demonstrate that globalization as popularly understood does not exist. For example, there is no evidence that U.S. firms operate globally. Instead, they both produce and sell on a home region basis, as do MNEs from Europe and Asia. There are also present in North America a large set of foreign-owned MNEs that contribute to economic output, but compete with the "home" U.S. MNEs. North America is a battlefield for the world's corporate giants, but with a strong intra-regional effect. There is a similar picture of triad rivalry between MNEs in Europe and in Asia; again the home MNEs dominate in their home region of the triad (Rugman 2005). The strength of the regional effect is such that analysis of international business strategy needs to focus on regional strategy rather than global strategy. In turn, international political economy needs to take on board this strong regional effect.

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