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The Laws of Globalization and Business Applications
Unplugged - Book review essay

Pankaj GHEMAWAT (2016), *The Laws of Globalization and Business Applications*, Cambridge: Cambridge University Press.

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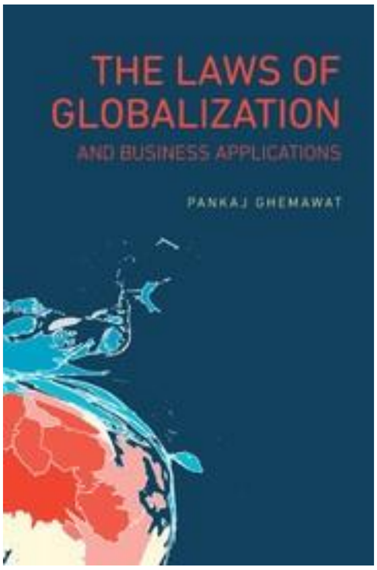

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Abstract. In *The Laws of Globalization and Business Applications*, Pankaj Ghemawat continues to defend his antithesis against the common image of the world as global. He does so by introducing the two regularities of international activity: the law of semiglobalization and the law of distance. Through a range of empirical methodologies, Ghemawat tests these two laws and finds that international business interactions rarely exceed 30%. Based on these results, Ghemawat challenges our assumptions that the world is globalized. He explains that international business interactions continue to be important but that the world is rather semiglobalized. The majority of business flows continue to occur locally, which indicates that different types of distance continue to restrain business activities. These findings should, according to Ghemawat, change both how researchers study international business and how companies conduct business.

Keywords: semiglobalization, distances, international business.

INTRODUCTION

Did UK voters break the laws of globalization? This is the first question asked in Ghemawat's book, which begins at the end of the UK's membership in the European Union. Brexit was (and continues to be) a shock to the European Union as well as to the entire globalized world, and it reinforced the debate about whether globalization is ever-increasing or is actually in retreat. Consistent with the main message of his research over the last three decades, Ghemawat continues in his latest book to argue for the limits of globalization and that national borders still matter. According to Ghemawat, the first question—i.e. whether UK voters broke the aws of globalization—can be answered by specifying two central laws, which also represent the two main content areas of the book:

1) The law of semiglobalization states that international interactions, while non-negligible, are significantly less intense than domestic interactions.
2) The law of distance states that international interactions are dampened by distance along cultural, administrative, geographical, and economic dimensions (known as the CAGE Distance Framework[1]).

Both laws are valid in the case of the UK. Ghemawat shows that even if the international flows of UK people, trade, and capital are unlikely to become irrelevant on a world scale, there are still relatively few first-generation immigrants in the UK (13%), and the UK's (gross) exports account for one-third of its GDP. Throughout the book, Ghemawat shows that the same is true for the majority of the world's countries, which confirms the law of semiglobalization.

Concerning the second law, Ghemawat points to the fact that 45% of the UK's exports went to other European countries (which are geographically close to the UK) and to the USA (which, as an English-speaking nation, is culturally close from a language perspective). In fact, Ghemawat explains that while Brexit may increase the administrative distance between the UK and the EU, UK firms will continue to pursue business opportunities along the other dimensions of distance. Ghemawat thereby argues that we cannot neglect international interactions, but that we do need to revise the assumed level of globalization by paying more attention to borders and to the effects of distances. The UK people, therefore, have not gone against the laws of globalization; they have simply confirmed that we live in a *semiglobalized* world.

The book is addressed particularly at academics but is also easily accessible to practitioners interested in learning how to become more "distance capable." The book's first aim is to refute myths about the intensity of globalization. However, the book can also be read as a reply to critics (such as Thomas Friedman, 2005) who have reproached Ghemawat for not using enough statistical evidence in his research[2.] This latest work by Ghemawat and his co-authors seems to reprise Ghemawat's research on distance from the last 30 years and to combine it with other relevant literature and research to show what globalization is and indeed is not. As a result, the book is full of hard data and statistical information on this issue, especially based on an economic model known as the gravity model; it also includes results from Ghemawat's homepage (www.ghemawat.com). Here, he and his team have completed a massive tool, the DHL Global Connectedness Index (GCI), which is based on interactions among 140 countries and contains data on the flow of trade, capital, information, and people. The book can be read as a summary of the current state of distance research, as it treats past research, paints a picture of today's world (and research), and indicates where we are heading. All this leads to the conclusion that the world is, in fact, semiglobalized.

1. The CAGE Distance Framework is more often addressed to business than to public policy. It helps firms to measure how much cross-border activity there might be in their industries and how the distribution of that activity can be affected differently by cultural, administrative, geographic, and economic (CAGE) distance.
2.www.ted.com/talks/pankaj_ghemawat_actually_the_world_isn_t_flat

Ghemawat has four co-authors: Steven A. Altman, Geoffrey G. Jones, Sebastian Reiche and Thomas M. Hout. The book is structured as three parts divided into 11 chapters. The first part explains the depth of globalization on a country and company level by using the law of semiglobalization. The second part treats the *breadth* of globalization, explained by the law of distance. The two laws are combined in the third part of the book, which looks into business applications when treating each of the distance dimensions of the CAGE Distance Framework in detail.

PART I : THE LAW OF SEMIGLOBALIZATION

Part I is divided into four chapters and begins with suggestions on how to define and measure globalization. Starting with the origins of the word "globalization," it shows that Jeremy Bentham (1823), David Livingstone (1874), and Jules Verne (1873) had already described the world as becoming smaller as a result of improved infrastructure (railroads and steamships) and even referred to international legal relations. Globalization as etiquette, however, is a phenomenon of only the last 20 years, and there has been an enormous increase in publications on this topic since the turn of the millennium. The authors show that globalization has been defined in various ways over the years, but most definitions do not put business and economics center stage. For these reasons, the book chooses to rely on the definition proposed by Held, McGrew, Goldblatt, and Perraton (1999: 16), where globalization is seen as a process: "Globalization can be thought of as a process (or a set of processes) which embodies a transformation in the spatial organization of social relations and transactions – assessed in terms of their extensity, intensity, velocity and impact – generating transcontinental or interregional flows and networks of activity, interaction, and the exercise of power."

Next, the authors explain that the law of semiglobalization can help measure the depth of globalization at all levels of analysis (country, industry, and firm). They begin by confirming the law of distance at country level with the use of the GCI. They report the following findings.

Trade flows: Global exports of goods and services accounted for 31% of the world's GDP in 2014. This is the result of ever-increasing product market integration, but the main question is: Why has it not been increasing even more in a globalized world, where national borders should not affect buying patterns?

Capital flows: When examining the international mobility of capital, the book notes that global FDI was only 7% in 2014 and that the world's international portfolio equity stocks were 36% in 2014. The same percentage (approximately 30%) is found when looking at other types of capital-market integration, such as bank deposits, bank profits, and government debt.

Information flows: This is measured as knowledge flows and presented in Figure 1 below:

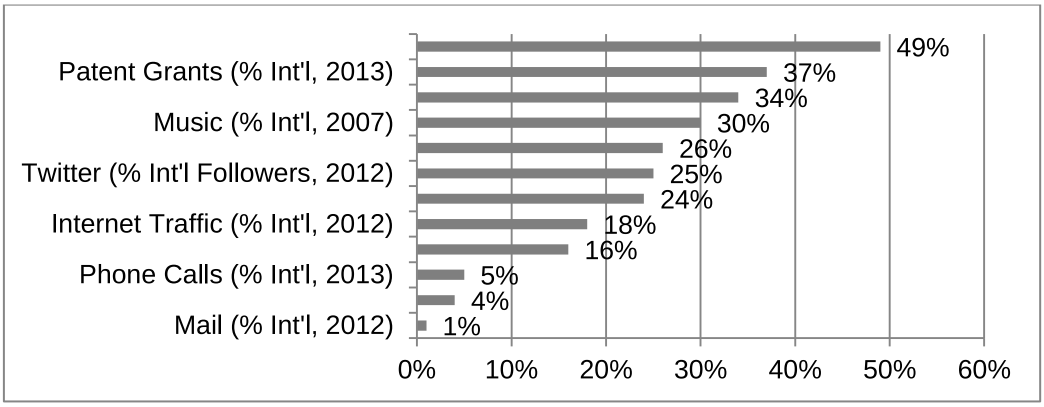

Figure 1: Information: depth ratio (Source: Ghemawat, 2017: 41)

When comparing the different channels of knowledge flow, it is clear that the type of information with the largest depth ratio is the cultural product, such as movies (49%) and music (30%). However, Internet traffic, which presumably knows no borders, remains primarily domestic. Here, it is interesting to note that only 16% of Facebook friends are located across national borders. Additionally, active followers on Twitter are more often situated in the same country, and the sharing of a common language and religion matters a great deal. Finally, knowledge flows are often found in geographical clusters.

People flows: Concerning migration, the proportion of the world's population living outside of their home country is only 3%, which is approximately the same as in 1910. Most often, people flow (over the long term) from relatively less to relatively more developed emerging countries. However, people flows can also be measured in international student mobility; in 2014, 2.2% of the world's university students were studying outside their home country. Furthermore, people flows can also be measured in tourist flows, where approximately 17% of tourist trips were international in 2014. Research estimates that 90% of the world's people never leave their home country!

The examples of economic cross-border activity cited here confirm that international integration rarely rises above 30%, which leads Ghemawat to ask whether we can actually speak of globalization. The authors acknowledge that we cannot ignore cross-border economic activity, but they argue that we should see the world as being in a state of semiglobalization as opposed to globalization. Ghemawat explains that there is a tendency to overestimate the depth of globalization, which he calls *globaloney* (with reference to the slang word *baloney*, meaning nonsense). This may be due to age (younger people tending to overestimate globalization more than older people), level of education (students with more education overestimating the depth of globalization), and location (people from emerging countries overestimating globalization more than those from advanced countries). It is explained that globaloney can have severe social consequences, as—in the worst cases—it can affect global business strategies. The fact that everybody might recognize that the world is semiglobalized leaves the question of what to do about it. This is an essential question, as it has favorable implications for the ways in which firms and their managers think about business.

With this in mind, Ghemawat and his co-authors approach globalization from the perspective of firms, and they show that the law of semiglobalization also applies at firm level. They compare the levels of export and FDI—both of which are often linked to the size of the firm's home country and market—among firms of different sizes. Two-thirds of multinationals are based in advanced economies; these firms more often have a higher level of internationalization. They are also known to drive 80% of the world's trade (Dobbs, et al., 2015). However, they represent only 0.1% of the total number of businesses around the world! Despite the fact that large companies are proven to be more international compared to, for example, SMEs, they still make the majority of their sales in their home countries (Rugman & Verbeke, 2004). In general, the firms on the 2014 Fortune Global 500 index (the world's 500 largest firms based on revenue) earned 54% of their revenue in their home countries, which indicates signs of home bias and the presence of border effects along several distance dimensions; such bias is persistent over time. The authors thus show that relatively few firms, and mostly large ones, are involved in international trade; even fewer are involved in FDI (one of the definitions of multinationals). Instead, their footprints are more often centered on their home markets and regions, as are their workforces.

In the first part of the book, Ghemawat and his co-authors show that the depth of globalization is very limited and that the law of semiglobalization is valid at both firm and country levels.

PART II: THE LAW OF DISTANCE

The second part of the book examines the breadth of the interactions that actually take place across borders. Ghemawat starts by providing empirical evidence for the law of distance at country level.

To measure the breadth of globalization, the authors again use the GCI, this time from 2005 to 2013. They find that larger countries seem to have more diversified export portfolios across countries and industries, and that capital, trade, information, and people actually traverse limited geographical distances. However, these flows are affected by more than geography. To capture the effect of other distance dimensions, the authors integrate the CAGE Distance Framework, which Ghemawat first introduced in 2001. This framework stresses the importance of thinking simultaneously about all four types of distance (cultural, administrative, geographical, and economic) when looking at international interactions. Most often, the framework shows that when the distances become too large, they are negatively related to the different types of flow between country pairs.

Hereafter, the gravity model is introduced as a tool to measure the distance dimensions. The model is often used to measure trade flows between country pairs but is also employed in many other contexts, such as portfolio equity investments, information flows, and international migration (Grogger & Hanson, 2011; Portes & Rey, 2005; Wong, 2008). The model shows a positive relationship between the level of trade and the size of the country pairs, but a negative relationship between the level of trade and the geographical distance between countries, as well as between trade and other factors that might inhibit or promote international interactions. In the book, the gravity model is applied continuously to data from the GCI, with variables corresponding to the different distance dimensions. Using the gravity model, the authors find that countries that are distant from each other when a particular type of interaction is isolated are also often distant from each other when looking at other interactions. What is especially interesting is that the distance effects, especially those of geographical distance, are persistent over time despite a strong increase in the intensity of trade, capital, and information flows. This indicates that borders continue to matter and that the law of semiglobalization is valid at country level.

The gravity model is further used to measure the effects of the CAGE dimensions at both industry and firm levels. The book explains that the effects of the different distance dimensions on investment and trade depend on the characteristics of the product and/or the service involved. In fact, there seems to be a systematic variation in distance sensitivity across industries, with some firms operating across more types of distances than others. The gravity model shows that the CAGE distance dimensions have heterogeneous effects on the different industries, which is why managers should adopt a CAGE perspective on their particular industries.

The second part of the book concludes with an evaluation of the current state of research on distance and offers suggestions on how research should proceed. The authors draw on research in economics, international business, sociology, social psychology, neuroscience, and evolutionary biology. By integrating other research disciplines, the authors indicate that the law of distance reaches far beyond the fields of international business and economics, and show that there is a theoretical linkage with a wide range of disciplines. They also integrate and reflect on critiques of distance measures and theoretical approaches, and offer several recommendations for future research on distance. They recommend that researchers remain open to both subjective and objective measures of distance. In fact, along each CAGE dimension, individual-level perceived distance can vary relative to objective distance. This can be addressed by accounting for multiple facets of distance instead of focusing on single dimensions or by mapping the distance landscape in more detail, e.g. using within-country distances or network effects. The authors also stress the importance of integrating inter-industry variations, and consider how and why some industries are more sensitive to certain distance dimensions compared to other industries. An additional avenue for future research could be intrafirm distance and its moderators.

In the second part of the book, Ghemawat and his co-authors validate the law of distance and find that the breadth of international interactions is limited by the different CAGE distance dimensions at country, industry, and company levels. The last part of the book is devoted to how the CAGE distance dimensions can be used in business applications.

PART III: BUSINESS APPLICATIONS

“Whenever customers, colleagues, suppliers, partners, or competitors from multiple backgrounds are involved, cultural distance matters” (*The Laws of Globalization and Business Applications* (*LGBA*): 239).

In the third and final part of the book, the authors take a closer look at the four CAGE distance dimensions at country level. They start by examining **cultural distance** in detail, which is the distance dimension that has received the most attention in international business research.

In this setting, the authors focus on national cultural differences, which are particularly relevant for international business.

With inspiration from Kluckhohn (1954) and Hofstede (1980), they define culture as “a set of shared values, assumptions, beliefs, morals, customs, and other habits that are learned through membership in a group, and that, influence the attitudes and behaviors of group members” (*LGBA*, p. 240). Culture is thus a group phenomenon that exists on many different levels within organizations, industries, regions, and nations (Leung, Bhagat, Buchan, Erez, & Gibson, 2005). The authors explain that cultural distance can be captured either by observable characteristics or by underlying values. Their analyses show that observable characteristics, such as language, tend to be better tools to help identify cultural differences among countries. Learning and informing others about cultural distance cannot fully determine behavior, as this type of distance can take many shapes across countries. Therefore, managers need to continuously analyze and update their knowledge of cultural differences and not merely rely on personal experiences.

Administrative distance has several overlaps with cultural distance, as it entails both informal constraints, such as traditions and customs, and formal rules through laws and constitutions. When defining this dimension, the authors refer to Douglass North, Nobel Prize winner in economics for his work on institutions, who defines them as “the rules of the game in a society or, more formally […] the human devised constraints that shape human interactions” (North, 1990:3). In the literature, there are two ways of addressing institutions at a country level: from a horizontal institutional perspective (such as legal origin), by which countries *cannot* be ranked; and from a vertical institutional perspective (such as political stability and control of corruption), by which they *can* be ranked. The authors find that the results of vertical institutional variables are somewhat weaker than the results of horizontal variables.

The authors further explain that it is important to understand the administrative context of each country and how large businesses can be controlled by (depending on the country) a family, a business group, the state, or a widely held corporation. The form of control is closely linked to a country’s history and can differ a great deal from country to country. Figure 2 shows the owners of the 20 largest publicly traded corporations (as measured by market capitalization) in each of 27 major economies with relatively well-developed public equity markets.

Country	Widely Held	Family	State	Firms	Miscellaneous
Argentina	0 %	65 %	15 %	20 %	0 %
Austria	5	15	70	0	0
Australia	65	5	5	25	0
Belgium	5	50	5	30	10
Canada	60	25	0	15	0
Denmark	40	35	15	0	10
Finland	35	10	35	10	10
France	60	20	15	5	0
Germany	50	10	25	15	0
Greece	10	50	30	10	0
Hong Kong	10	70	5	5	10
Ireland	65	10	0	10	15
Israel	5	50	40	5	0
Italy	20	15	40	15	10
Japan	90	5	5	0	0
South Korea	55	20	15	5	5
Mexico	0	100	0	0	0
Netherlands	30	20	5	10	35
New Zealand	30	25	25	20	0
Norway	25	25	35	5	10
Portugal	10	45	25	15	5
Singapore	15	30	45	10	0
Spain	35	15	30	20	0
Sweden	25	45	10	15	5
Switzerland	60	30	0	5	5
UK	100	0	0	0	0
United States	80	20	0	0	0
Sample Average	36	30	18	10	5

Figure 2: Owners of the 20 largest firms by market capitalization in 27 major economies in 1995 (source: La Porta, Lopez-de-Silanes, & Shleifer, 1999)

Figure 2 shows that widely held companies are far more common in the US than in the rest of the world, where other forms of concentrated ownership are dominant. Therefore, it is important to understand how these major actors interact with each other, and their levels of power in a country. This can help to clarify their actual objectives, which are not always focused on the maximization of shareholder value (the objective of widely held corporations). This insight also helps us to understand the different administrative arrangements of diverse countries.

Hereafter, the authors turn their attention to the geographic dimension, which—despite being the most tangible dimension of the CAGE Distance Framework—has received the least attention from the international business literature. Geography appears to have a negative effect on the level of international interactions, and it is proposed that physical distance provides a reasonable proxy for overall (relative) distance. Furthermore, physical distance is known to correlate rather strongly with other dimensions of the CAGE Distance Framework. The authors choose to focus on regionalization, which has several parallels with the geographic dimension and which—unlike geographical distance—has been an often-treated theme in international business literature. It is shown that countries located in the same region have more similarities with each other than with countries located in different regions. For example, they are more likely to share a common language, which doubles the level of trade between countries.

Therefore the authors find that region matters and that the bulk of international interactions take place within continent-size regions. However, it is not only at country level that regions matter but also at company level. The authors find that the business activity of multinationals tends to be regionalized, as these companies make the majority of their revenue in their home regions (Oh & Rugman, 2014). There is, therefore, a pattern of international interactions being more intense within than between regions; this is consistent with the law of distance. However, the authors explain that defining regions can be difficult and suggest that the greater similarity within regions than between them should be accounted for in regional business strategies. It is also important to be aware of the global context, and the growth of emerging economies seems to change the importance of regionalization by opening up new and bigger markets.

The book concludes by analyzing economic distance, and explains that this type of distance can both motivate and inhibit international interactions. The authors explain that since the early 21st century, we have seen rapid growth in emerging economies, which has changed the game for the world's leading companies. Research shows that by 2020, 59% of global growth will take place in emerging economies (IMF, 2015). Furthermore, by 2030, 50% of the Fortune Global 500 will be based in emerging economies (Guillén & Garcia-Canal, 2012). All this indicates that change may be coming in "the corporate pecking order" (*LGBA*: 376), even though the Fortune Global 500 is not necessarily global, as it is based on firm size and not on global leadership: "The rising share of economic activity taking place in emerging economies implies that it is along the economic dimension of the CAGE Distance Framework that firms are likely to face the most dramatic changes over the medium term" (*LGBA*: 386). This shift in economic activity forces multinationals from advanced economies to bridge larger economic distances according to customers and their income levels, as well as competitors from both advanced and emerging economies. Firms from emerging economies also face new economic distances and often have little experience with these types of distance impacts. In fact, multinationals from emerging economies face greater challenges in the sense that it is more difficult to move up from a low-end position than down from a high-end position (as is the case for multinationals in advanced economies).

Following the analysis summarized above, and after finding multiple indications of how and why we live in a semiglobalized world, the book concludes by explaining that those firms that can bridge the many distance dimensions between advanced and emerging economies will be tomorrow's global leaders in their respective industries.

CONCLUDING COMMENTS

Compared to Ghemawat's previous book, *Redefining Global Strategy,* which was published in 2007, the present book is more clearly addressed to academics rather than practitioners. Although it is certainly relevant to companies and managers, it does not offer tangible tools for managers, as Ghemawat did in his previous publication. On the other hand, when explaining today's level of globalization, the new book does provide us with a solid assessment of the status of distance research. It is difficult to disagree with Ghemawat's portrayal of the world as semiglobalized based on his and others' research from the last 30 years.

What is left is the question of where we go from here when taking into account Brexit, the election of President Trump, and the candidates for the French presidential election. These events seem to indicate that the world is not becoming globalized and that we are instead moving toward an even higher level of semiglobalization: perhaps even antiglobalization. As Ghemawat (2016) himself has expressed in *Harvard Business Review*, following these events and many others to come, there will be a change in the global economy, but the question is to what extent these events will be sidelined or actually lead to change. Given the current world situation, Ghemawat is convinced that the laws of globalization still stand and that his proposed laws should continue to affect public debate and policy, as well as business strategy (Ghemawat, 2017).

I recommend this book to all who are interested in the subject of distance. It naturally highlights Ghemawat's own contributions to the field of distance, and one should remember that there are other ways to approach this field than from a semiglobalized perspective. The book is, however, still able to embrace the field of distance from many angles, and it integrates a large literature on the subject. It may thus serve as a source of inspiration both methodologically and theoretically, even if one does not agree with the arguments about semiglobalization.

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