The Globalization of Markets and the Rule of Three

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Metaphors come in many forms: absolute, active, complex, compound, implicit, mixed, root and submerged... They are insightful, and enable us to make uncanny connections. They are powerful tools of rhetoric. Geniuses use them. The rest of us love them. However, a metaphor can also be "dead," that is, so widely used that it can be dangerously misleading. Globalization is one such dead metaphor. Merriam-Webster defines it rather paradoxically:

> "the development of an increasingly integrated *global* economy marked especially by free trade, free flow of capital, and the tapping of cheaper foreign labor markets" (italics added).

Globalization is often attributed to Theodore Levitt and his seminal article "The Globalization of Markets" (*Harvard Business Review* 1983), however this is incorrect, the word entered the Marriam-Webster dictionary in 1951. The true origin of the phrase is unknown but its remnants can be traced all the way to Genghis Khan and his Mongolian empire of the 13th century. In modern management era, it was certainly covered by Peter Drucker earlier in his exploration of multi-national (non-national) corporations.

The reason why globalization is a dead metaphor is because it has proven so successful: it simplified a very complex phenomenon for the masses. For the consumer, it has come to mean a unified world, one (consumer) culture, one language (English), one glorious brand for all, one alluring way of life… McDonaldization. For the business, it has come to mean vast new consumer markets, savings in manufacturing, distribution, and promotion, one glorious brand for all (enter your brand here), and one strategy… aggressive acquisition.

It is as if that globalization has single-handedly transformed the rules of competition and marketing. But the fact to the matter is globalization does not benefit every firm, and a global brand should not be the be-all, end-all of marketing. There is a structure through which the forces of competition are organized. In this essay, we deal with two key aspects of globalization in two parts: First, we describe why globalization must be understood better and why it is such a prevalent drive especially at this juncture of time. We present our views on the pending social responsibilities of global corporations. Second, we introduce the "The Rule of Three" theory to enhance this understanding, provide our views on the future of global markets, and exemplify which brands are likely to be the surviving global brands at the end of the century. This part deals with the managerial realities that firms intent on succeeding in an inevitably global world must consider.

Globalization: A Social and Economic Imperative

In order to supplement our views on globalization, we undertook an exploratory examination of the construct using netnography. In doing so, we examined hundreds of quotes regarding globalization available on the Internet.[1] Our analysis revealed that the quotes tend to fall under three main categories.

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[1] Netnography is basically described as ethnography research on the internet, and is becoming a widely used method for marketing research. The quotes come from the following web links:
http://thinkexist.com/quotations/globalization/;
http://www.brainyquote.com/quotes/keywords/globalization.html;

The first category of quotes emphasizes the positive influence and benefits of globalization:

"This is a very exciting time in the world of information. It's not just that the personal computer has come along as a great tool. The whole pace of business is moving faster. Globalization is forcing companies to do things in new ways."
Bill Gates

"Globalization has changed us into a company that searches the world, not just to sell or to source, but to find intellectual capital - the world's best talents and greatest ideas."
Jack Welch

"Outsourcing and globalization of manufacturing allows companies to reduce costs, benefits consumers with lower cost goods and services, causes economic expansion that reduces unemployment, and increases productivity and job creation."
Larry Elder

It is noteworthy that the claimed benefits of globalization go beyond trade and reach deep into the social fabric through innovation, human resource mobility, and cultural influence. Thus, globalization is beneficial to more than developed nations and multinational corporations. For example, the marketing of Vietnamese textile products in the U.S. generates employment and economic growth for Vietnam. On the other hand, there are many who do not agree with this assessment. In this second category, anti-globalization sentiment appears to be even stronger, at least on the Internet:

"The essence of globalization is a subordination of human rights, of labor rights, consumer, environmental rights, democracy rights, to the imperatives of global trade and investment."
Ralph Nader

"The standardization of world culture, with local popular or traditional forms driven out or dumbed down to make way for American television, American music, food, clothes and films, has been seen by many as the very heart of globalization… So is it always nationalist to resist US globalization? The US thinks it is, and wants you to agree; and,

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http://www.cultureofpeace.org/quotes/globalization-quotes.htm. Additional quotes are provided in Appendix A.

moreover, to consider US interests as being universal ones… For when we talk about the spreading power and influence of globalization, aren't we really referring to the spreading economic and military might of the US?"
Fredric Jameson

"Globalization, as defined by rich people like us, is a very nice thing... you are talking about the Internet, you are talking about cell phones, you are talking about computers. This doesn't affect two-thirds of the people of the world... If you're totally illiterate and living on one dollar a day, the benefits of globalization never come to you."
Jimmy Carter

These views seem to equate globalization to American/corporate imperialism. However, they also rightly point out that it is important to pay attention to the distribution of the benefits of globalization more evenly. Global firms cannot simply benefit from cheap labor through outsourcing but ignore the poor working conditions or corruption in developing nations. Finally, there are those who point out that globalization is inevitable:

"Globalization is not something we can hold off or turn off . . . it is the economic equivalent of a force of nature -- like wind or water… To realize the full possibilities of this economy, we must reach beyond our own borders, to shape the revolution that is tearing down barriers and building new networks among nations and individuals, and economies and cultures: globalization. It's the central reality of our time."
Bill Clinton

"It has been said that arguing against globalization is like arguing against the laws of gravity... Globalization is a fact of life. But I believe we have underestimated its fragility... We must ensure that the global market is embedded in broadly shared values and practices that reflect global social needs, and that all the world's people share the benefits of globalization."
Kofi Annan

"People have accused me of being in favor of globalization. This is equivalent to accusing me of being in favor of the sun rising in the morning."
Clare Short

The quotes in this third category are pragmatic in the sense that they argue that globalization with its virtues and flaws is a fact of life, and is a major process that must (be attempted to) be managed globally. In that respect, both the American or European consumers and the Vietnamese assembly line workers are better off because of globalization. However, globalization also has cultural, social and humane implications. The primary focus of globalization to date has been on the benefits to shareholders. Global firms will simply have to learn to treat their stakeholders (e.g., employees, customers, distributors, and suppliers) the way they do in their home countries. It would be naïve to think this can be simply achieved through standardization. Cultures are unique and diversity is essential to our human heritage. Historically, trade between different nations (with different resource advantages) has been the single most important source of human development. However, nations do not trade, merchants do. These merchants not only generated financial wealth, but also served as a bridge for new inventions, social innovations, and culture. For example, pasta as well as gunpowder found their way to Europe through trade. When it comes to development, trade works much better than direct foreign aid. Merchants of today are increasingly global corporations. Waiting for the world government to set the rules is a terrible way to build relationship and brand equity in a global world. Lobbying just for the interests of shareholders is even worse. The global corporation will be much better-off in the long run if it starts to live up to its social responsibility. This means bringing quality of life to all of its stakeholders in planned, systematic ways.

Why Globalization Now?

During late 19th century, there was a great deal of openness and trade between nations across the globe. However, the nationalism movement and the subsequent two world wars greatly deterred the evolution of free trade in the first half of the 20th century. After these wars, several world leaders across the globe became preoccupied with self-sufficiency through tariff and non-tariff barriers rather than building upon sustainable competitive advantages. However, it became increasingly apparent that their approaches were not working. Therefore, the era of globalization resumed its inevitable rise. Communism collapsed, economic pragmatism took over, privatization of public firms accelerated the process, creating value for investors as well as consumers. Decreased tariffs, increased movement of people, adoption of new innovations in telecommunications, the Internet, and marketing communications also contributed to cultural acceptance of foreign goods. Consumers came to appreciate diversity and variety in the marketplace. Turkish doner became the most consumed fast food in Germany, the home of Hamburg-ers. Indian curry became the flavor of choice in England. Salsa sells more than ketchup in the U.S. As a result of trade liberalization, particularly after 1987, the level of trade between and among NAFTA, EU, and ASEAN has been increasing. Overall, there is a great deal of evidence that the economic growth engines of the global markets of tomorrow will be large emerging nations such as China, India, and Brazil rather than the historical U.S. or European power bases.[2] These emerging nations are already moving away from being exporters of raw materials and inexpensive mass produced goods, to manufacturing of high value-added goods and services by importing

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[2] For more on the force and magnitude of globalization see Sheth, Jagdish N. and Rajendra S. Sisodia (2006), *Tectonic Shift: The Geoeconomic Realignment of Globalizing Markets*, Thousand Oaks: CA, Sage.

more machinery, equipment and know-how from their developed counterparts. Their next phase in globalization will be to create global brands. Transforming a regional brand to a global brand is a particularly challenging strategy with very high stakes. Putting a company's faith simply on anecdotal lessons from others' success and failures is not wise. Managers need to have a grasp of the underlying structure and the big picture to put the risks and rewards into perspective. The Rule of Three theory precisely provides such insight.

The Rule of Three

"The Rule of Three" theory suggests that cyclical and systematic market forces make it possible to predict the evolution of competitive industries.[3] During the early growth stage, there are many competitors. For example, there were close to three hundred automobile manufacturers in the U.S. alone by 1915. As the industry matures, three firms that adapt better survive and thrive, and typically command 70-90% of the market share (i.e., General Motors, Ford, and Chrysler). These become the three generalists (that each have more than 10% market share) and co-exist with numerous product/market/niche specialists (that each have between 1-5% market share). The Rule of Three structure is optimal because the big three act as the tripod that stabilizes the industry against hyper-competition or collusion. In other words, it offers optimal mix of competition (innovation, quality), collaboration (efficiency, profitability), customer satisfaction (variety, affordability, accessibility, value co-creation). Those firms with 5-10% market share (i.e., ditch dwellers) can neither benefit from economies of scale and efficiency of being a

[3] For more on this theory see Sheth, Jagdish N. and Rajendra S. Sisodia (2002), *The Rule of Three: Surviving and Thriving in Competitive Markets*, New York: NY, Free Press. Our discussion of the Rule of Three also draws heavily from this book.

generalist, nor can they can they gain from the effectiveness and focus of serving a niche market. They are expected to perform worse than their generalist or specialist counterparts. Figure 1 illustrates the Rule of Three theory.

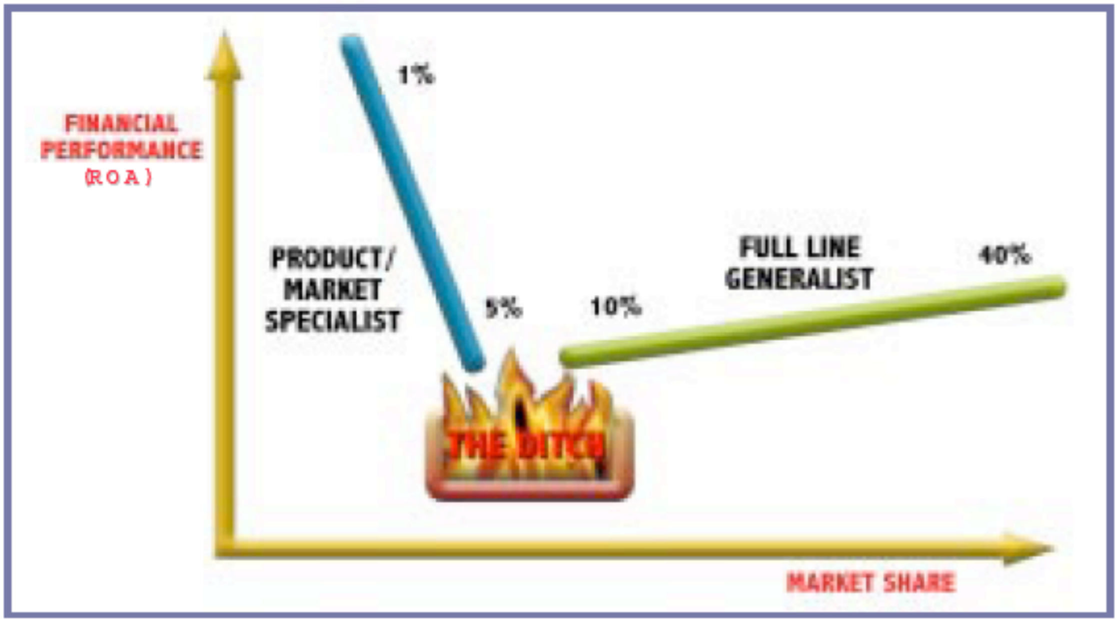

Figure 1: The Rule of Three

Note: Figure adopted from the Rule of Three (Sheth and Sisodia 2002, p.4).

There are plenty of U.S. industries where the rule of three structure has already emerged: burger chains (McDonald's, Burger King, Wendy's), pizza chains (Pizza Hut, Domino's, Papa John's), television networks (NBC, ABC, CBS), beer companies (Anheuser-Busch, Miller, Coors/Stroh), batteries (Duracell, Energizer, Rayovac), consumer reporting agencies (Equifax, TransUnion, Experian), credit card networks (Visa, Mastercard, American Express), banks (Bank of America, Chase Manhattan, Banc One), cereal makers (General Mills, Kellogg, Post), jeans makers (Levi Strauss, Lee, Wrangler), pharmaceutical companies (Merck, Johnson & Johnson, Bristol-Myers Squibb), and the list goes on…

The application of the Rule of Three is not limited to the U.S. markets. International examples include: French automakers (Renault, Peugeot, Citroen), Japanese automakers (Toyota, Honda, Nissan), Japanese brewers (Kirin, Asahi, Sapporo), South Korean automakers (Hyundai, Daewoo, Kia), German banks (Deutsche Bank, Dresdner Bank, Commerzbank), U.K. banks (HSBC, Barclays, Lloyd's TSB), Australian banks (Westpac, National Australia bank, St. George Bank), Japanese electronic manufacturers (Matsushita, Sony, Toshiba), and the list goes on… Obviously there are also exceptions to the Rule of Three. However, most of these can be explained by the role of regulation (i.e., DOJ's blocking of airline mergers or monopoly power of utility companies), or the maturity stage of the industry (i.e., online retailers).

The Global Rule of Three

The Rule of Three has fundamental corporate, marketing and investment implications. However, the interest in these implications has been predominantly at the national level to date. It is rather illustrative to examine a the following cases to contemplate the global implications.

Aviation Industry: Boeing, McDonnell Douglas and Lockheed Martin have been the traditional three generalists in the U.S aviation industry. However, the intensive competition between the top two players pushed Lockheed Martin into the ditch in the seventies with less than 10% market share (and it was ultimately acquired by Boeing), leaving two major players. Building upon the financial strength and know-how of its investing European government partners, Airbus capitalized on this gap in the market and became the number two player during the eighties. This development effectively created a global triad. During the nineties, the intensive competition between Boeing and Airbus pushed McDonnell Douglas into the ditch. McDonnell Douglas attempted to get out of the ditch by establishing a presence in Asian markets with an alliance with Taiwan Aerospace. When this effort was blocked by the Clinton administration, it also was forced to merge with Boeing. The gap in this strategic industry remains to this day with Taiwan, Spain, and potentially Russia competing for the third spot globally.

Tire Industry: The automobile tire industry did not begin its journey toward globalization until the seventies. Goodyear, Firestone, and Goodrich in the U.S., Michelin, Pirelli, Continental, and Dunlop in Europe, Bridgestone, Sumimoto, Toyo, and Yokohama in Japan were the respective generalists. Michelin, building upon the success of the radial tires that it invented, began its journey towards globalization by opening a manufacturing plant in the U.S. in 1975. It took several years for the U.S. manufacturers to brace the Michelin threat competitively. Several players including the U.S. #3 Goodrich decided to exit or diversify. Michelin acquired Goodrich in 1989, and with subsequent acquisitions in Poland, Hungary and Columbia catapulted itself to the global number one position. In the meantime, Bridgestone of Japan also announced that it had global leadership in mind. It outbid Pirelli to acquire U.S. #2 Firestone (which also had a European presence) and is currently the #2 global player after Michelin. Goodyear is not far behind as the global #3 after its acquisition of Dunlop operations in Japan. Amidst all this, specialists remained highly successful. For example, Cooper Tire and Rubber of U.S. remained its focus as a product specialist (of bias-ply tires) and thrived with its 2% global market share. Cooper spends little on R&D and uses independent retailers instead of costly company-owned stores. Other international players (e.g., Continental and Pirelli) have ongoing merger discussions to be able to get out of the ditch.

Home Appliance Industry: The globalization of the home appliance industry can be dated back to world leader AB Electrolux's (Sweden) acquisition of White Consolidated (U.S.) in 1986. White was the #3 generalist in the US behind GE and Whirlpool. Whirlpool retaliated by purchasing the appliance division of Philips to become the #2 European player over Bosch-Siemens (Germany) and Merloni (Italy). Whirlpool also acquired Maytag for $1.7B in 2006 to reinforce its U.S. position. However, we fully expect Qingdao Heier (already the most valuable brand in China) to challenge both Whirlpool and Electrolux for global leadership. It is conceivable for Heier to purchase GE's appliance business in the process given GE's "#1 or #2 or out" strategy. It should not be surprising to see Heier (#1), Electrolux (#2), and Whirlpool (#3) as the top three global players by 2020.

These three industry cases clearly indicate a convergence from a national rule of three (i.e., three/four generalists in each of the triads, North America, Europe, and the Far East) toward a global rule of three. Because of the fragmentation in Europe (U.K. *versus* EU) and historical regulatory intervention against consolidation, we tend to observe four generalists in Europe. In the Far East, Japanese firms have historically taken the lead with strong competition from South Korea and China. For example, it can be said that three Japanese firms, Citizen, Seiko, and Casio dominate the global market for watches whereas the Swiss have resigned to a high margin niche position. During the convergence to the Rule of Three, several corollaries apply. Next, we summarize the take-aways:

1. The #1 player in each of the triads is best positioned to become one of the global three players since each can build upon their dominance in their home markets.
2. #3 domestic player is typically forced into the ditch during foreign entry.
3. To become a successful global player, a firm must established itself in at least two of three triads as a major generalist.
4. The management has to make a decision on whether or not they want to become a generalist in their respective industry. There is typically room for only three generalists in a mature industry. This tends to be four in Europe where regulatory forces have slowed down the consolidation process and the convergence to three.
5. Financial performance of the market leader benefits from increases in market share. However, diseconomies of scale and additional antitrust scrutiny play a role and hinder performance beyond 40% market share.
6. Specialists' performance is enhanced when they grow their market share in their specialty but not necessarily when they grow their overall market share. As such successful niche players can be considered to be monopolists in their niche while maintaining a miniscule market share of the overall industry.
7. If the #1 generalists dominates the industry with more than 70% market share, there may not be room for a third generalist. This is typically a temporary condition however, another player makes room for itself to become the #3 player either via innovation or after the patent protection of the incumbent expires.

8. If the #1 generalist possesses less than 40% market share there may be room for a fourth generalist (typical phenomenon for Europe). Convergence to three is usually slowed down when industry consolidation/ M&A activity is blocked.
9. When a generalist falls into the ditch, it should either attempt to re-gain over 10% share (organic growth or growth through merger) or divest to become a specialist. Both are tough propositions.
10. The Rule of Three theory suggests that when the top two firms engage in intensive price competition, the third player usually ends up in the ditch. For example, Chrysler has historically been forced into the precarious position more than once. Lee Iacocca salvaged the situation with the minivan innovation in the eighties, and Daimler-Chrysler merger in the nineties was the more recent but ultimately unsuccessful solution to an ongoing strategic problem. On the other hand, specialists do not suffer from price competition due to their dedication to serving their niches.
11. Generalists that acquire and try to manage specialists separately typically fail.
12. The #1 generalist may have the biggest R&D budget but tends to be the least innovative of the top three players. Fast-follower strategy seems to work best for them.
13. The #3 generalist tends to be the most innovative. However, these innovations are quickly adopted by the top two when possible.
14. Firms in the ditch display the worst financial performance and are candidates for bankruptcy or acquisition.

15. The top three generalists are typically valued at a premium in the stock market. This can be observed by their Price / Earning ratios which have higher multiples than their smaller rivals.

There are several rules of engagement for firms that want to become a global top three player:

1. These firms have to conquer the domestic market first: a weak domestic base hinders international expansion.
2. They need to craft the right attack strategy: a better product at a lower price, rather than a better product at a premium price seems to increase adoption.
3. They need to time their market entry right: it is best if the industry is preoccupied with issues such as regulation or undergoing a major investment period.
4. They should not go to foreign markets alone: You can benefit from your traditional suppliers, distributors and even your competitors entering about the same time. This helps the entrant trigger a paradigm shift in the industry's landscape and carve a piece for itself.

Exception to the Rule of Three: As mentioned before patent protection or regulatory forces sometimes slow down the progression toward the Rule of Three. In addition, the Rule of Three appears to take place at the product category / brand level for consumer goods. For example, Coca Cola Classic is #1, Pepsi is #2, and Diet Coca Cola is #3 for carbonated beverages globally. However, Nestle is the global leader in bottled water. The reason for this phenomenon is because packaged consumer goods firms are highly diversified. For every product category they have a different set of competitors, even though their products may utilize the same distribution channels.

Prospecting the Future:

It is possible to predict the global future of industries by applying the principles summarized above. We end with three industry predictions:

IT Services: We believe that the U.S. will continue to dominate the high-value added IT services industry with #1 IBM, and #2 Accenture. TCS of India will occupy the third spot. Recognized names of today (e.g., Wipro) will become specialists.

Television sets: We expect the Far Eastern block to continue to dominate this industry globally. The U.S. has no leading brands left and European powerhouses such as Philips and Thomson are either shifting to outsourcing or are for sale. Drastic consolidation is to be expected across the globe. Predicted winners: #1 LG, #2 Samsung, #3 TTE China, Others such as Sharp and Sony will be better off by focusing on the high-end LCD segment of the market.

Telecommunications Industry:

a) Cellular phones: #1 Nokia, #2 Motorola, #3 Samsung. Siemens, Ericsson, and Lucent have already become ditch dwellers…

b) Service operators: #1 China mobile, #2 Vodafone, #3 will fought out between Telefonica and AT&T Wireless

Conclusion:

While its virtues and limits are being contemplated by the governments, managers must realize that globalization is an inevitable phenomenon. As such, all corporate/marketing strategy must be re-evaluated and re-constructed with global, long term objectives in mind. The Rule of Three provides profound guidance for crafting strategy and positioning in a global world. However, execution of strategy is just as important: firms must equitably distribute the economic and humane wealth of their countries with developing parts of the globe. This requires going beyond debating corporate social responsibility and engages the firm in global social responsibility. This way, globalization can be raised from the "dead metaphor" jargon it is today, and become the dominant business paradigm of the century.

Appendix A: Additional Quotes on Globalization

<u>*Positives:*</u>

"What I've been trying to say … is that this image of globalization that is all about push - what the United States and these global multilateral institutions are pushing onto the developing world - really misses the whole new platform, which is increasingly about pull."

Thomas Friedman

"NAFTA recognizes the reality of today's economy - globalization and technology. Our future is not in competing at the low-level wage job; it is in creating high-wage, new technology jobs based on our skills and our productivity."

John F. Kerry

"As often as I listen to the worries about China eating the jobs of the West, I hear the concern about the influence of the American way of life in the East. The question is: "Does globalization mean Americanization?" My short answer is no. In measuring globalization, we can count telephone calls, currency flows, trade sums, and so on, but the spread of culture and ideas cannot be so easily measured. Embedded in the present is the unrecognized paradox that culturally, America itself is changing more dramatically than America is changing the world. It is the world that is changing the world. Immigration is reshaping America more profoundly than America's influence around the world."

John Naisbitt

"Globalization and free trade do spur economic growth, and they lead to lower prices on many goods."

Robert Reich

"We also have a cultural phenomenon: the emergence of a global culture, or of cultural globalization."

Peter L. Berger

"Globalization could be the answer to many of the world's seemingly intractable problems. But this requires strong democratic foundations based on a political will to ensure equity and justice."

Sharan Burrow

"People now realize that globalization is not only for the multi-nationals and the circulation of money."

Lakhdar Brahimi

Negatives:

"The threat to globalization is not the wasted American dollars but Washington's readiness to mix US commercial interests with its self-appointed role as global protector."
William Greider

"We are in a struggle against a globalization that has no place for principles, values and standards."
Bill Jordan

"Globalization presumes sustained economic growth. Otherwise, the process loses its economic benefits and political support."
Paul A. Samuelson

"The negative side to globalization is that it wipes out entire economic systems and in doing so wipes out the accompanying culture."
Peter L. Berger

"The great, unreported story in globalization is about power, not ideology. It's about how finance and business regularly, continuously insert their own self-interested deals and exceptions into rules and agreements that are then announced to the public as "free trade.""
William Greider

"We must take care that globalization does not become something people become afraid of."
Gerhard Schroeder

"Globalization is also playing a role helping drugs trafficking and terrorism which now circulate in a global network."
Lakhdar Brahimi

"Globalization, far from putting an end to power diplomacy between States, has, on the contrary, intensified it."
Omar Bongo

"There is a huge shift taking place in the global awareness in the last 5 years with strong views about globalization and the power structures of major corporations."
David Korten

"In its current form, globalization cannot be sustained. Democratic societies will not support it. Authoritarian leaders will fear to impose it... Our task is not to make societies safe for globalization, but to make the global system safe for decent societies... From the suites of Davos to the streets of Seattle, there is a growing consensus that globalization must now be reshaped to reflect values broader than simply the freedom of capital."
John J. Sweeney

Inevitable:

"Accordingly, globalization is not only something that will concern and threaten us in the future, but something that is taking place in the present and to which we must first open our eyes."

Ulrich Beck

"Instead of saying that globalization is a fact, that it's inevitable, we've also got to demonstrate that while the growing interdependence of the world economy is indeed a fact, it's not uncontrollable."

Peter Mandelson

"Globalization is a bottom-up phenomenon with all actions initiated by milions of individuals, the sum total of which is "globalization." No one is in charge, and no one can anticipate what the sum of all the individual initiatives will be before the result manifest. A global economy can only be the result of "spontaneous order.""

John Naisbitt

"This is a basic requirement the meaning of globalization is that we should admit that the economy of each country is dependent on the economy of all the others."

Richard Grasso

"It is people who are the objects of globalization and at the same time its subjects. What also follows logically from this is that globalization is not a law of nature, but rather a process set in train by people."

Tarja Halonen