

CAGE Analysis: A primer

Institutional Dissimilarity, or rather, the difference between institutions (including businesses, governments, and ideas), is a fundamental part of what makes international business and foreign relations difficult. In order to work closely with partners throughout the world, it is important to understand the costs associated with working together. This can be summed up as a form of distance. Here at International Business Students Global, we are dedicated to keeping our students invested in understanding and analyzing the distances we must travel in order to create partnerships across the world that are meaningful and useful.

What follows is a short primer for a CAGE analysis, a way of analyzing and measuring the institutional differences that matter most to the global political economy. Although it is drafted in a business context (taken from a model developed at the New School), it has many applications and can be understood in multiple contexts. Each student that travels abroad, in association with the Anderson School of Management, should attempt to use this as an analytical framework that can help others understand our collective experiences as we travel and build relationships with others over time. By building an archive of this sort, we do everyone in the academy, and across public and private sectors the service of learning from our experiences. It also serves as a meaningful professional development tool. Our IKEEP students are trained to work with and understand the value of analyzing distance, and we are dedicated to placing New Mexico and the New Mexican economy in the context of other places. Despite several important distances, it will be quite surprising to you that we share more with those in the world that we normally expect, and this exercise is a way of mapping both similarities and dissimilarities (sometimes the greatest opportunities come to us when we discover the short distances between ourselves and others).

Formatting Guidelines:

IKEEP does not maintain a rigid format regarding a CAGE analysis. Some students are comfortable using matrices, grids, spreadsheets, and visual media to express the distances we must travel. We encourage a diversity of thinking that comes with having engineers, business students, literary critics, and biologists measuring distance in a manner that is most comfortable to them. We do ask however, that at a base level, a short narrative summary be constructed to explain your chosen way of mediating your information.

Here are our basic guidelines:

An executive summary – 2-5 pages that summarizes the major differences between New Mexico, the US, and a given place you will visit. This should have an:

* Executive summary (1-2 paragraphs that explains your major reflections
* A description of cultural distances (focusing but not limited to cultural institutions and ideologies)
* A description of administrative distances (focusing but not limited to bureaucratic institutions and the limits one places on doing business in a specific context)
* A description of geographic distances (focusing but not limited to logistical problems related to travel, navigating landscapes and the impact of that on the flow of “scapes” (see section on “scapes” later in this primer).
* A description of economic distance (focusing but not limited to key factors of economic health, development, and evolution)

Setting up your analysis:

Before you travel anywhere, it would be useful to begin sketching how you would apply the CAGE framework to New Mexico and the United States, identifying at least 2 or three basic indicators for each category that you are particularly interested in measuring. This would allow your visit to another country to have a better sense for what you are looking for. An entrepreneur or a student of entrepreneurial studies may wish to gather information small business indicators in New Mexico using a CAGE framework before travel. This serves also as a very meaningful way of representing yourself and New Mexico as you travel (people may want to know more about where you’re from and may have a shared interest). We do encourage however, that you carry a journal or a way of logging ideas that you may not have considered before your travels. A good CAGE analysis will have pre-determined things to look for, but may include things that you may not have thought was important, but turned out to be vital to your understanding of a certain part of the world.

“Scapes”

Arjun Appadurai, a professor cultural economy at the New School, identified 5 “landscapes” or “scapes” that impact the global political and cultural economy[[1]](#endnote-1). They are:

Ethnoscapes: The flow of people based on social, cultural and political circumstances. This could include anything from refugees and diasporas due to political strife or the flow of tourists due to an increase in economic stability.

Mediascapes: The flow of media within a given region. This may be determined by certain political and social freedom or by the availability of technology.

Technoscapes: The flow of technology within a given region. This may range from the use of old materials for repurposing, and can include very high tech flows or low tech flows (from the internet to types of clothing or healthcare practices)

Ideoscapes: The flow of ideas. This could include the institutionalization of religious beliefs or political beliefs. How are ideas produced and turned into community values in a particular place? In New Mexico, working on the land produces a strong land-based agricultural identity, one that is reinforced socially, that then informs one’s history. This could be true for other places as well.

Financescapes: The flow of capital. Where are the major financial epicenters of a region? What allows for access to capital. In some places, Western Union is important because families send money to one another from abroad, and this is more significant than banks. ATMs often replace banks in some parts of the world.

By paying attention to these flows, your CAGE analysis is greatly improved.

The Inputs into CAGE Analysis

Pankaj “Megawatt” Ghemawat, a Harvard and IESE Business School professor is an international strategy guru who developed the ***CAGE framework*** to offer businesses a way to evaluate countries in terms of the “distance” between them[[2]](#endnote-2).[In this case, distance is defined broadly to include not only the physical geographic distance between countries but also the cultural, administrative (currencies, trade agreements), and economic differences between them. As summarized in Table 8.2. The CAGE (cultural, administrative, geographic, and economic) framework offers a broader view of distance and provides another way of thinking about location and the opportunities and concomitant risks associated with global arbitrage[[3]](#endnote-3).

**Table 8.2. The CAGE Framework**

| **Cultural Distance** | **Administrative Distance** | **Geographic Distance** | **Economic Distance** |
| --- | --- | --- | --- |
| **Attributes Creating Distance** |
| Different languages | Absence of colonial ties | Physical remoteness | Differences in consumer incomes |
| Different ethnicities; lack of connective ethnic or social networks | Absence of shared monetary or political association | Lack of a common border | Differences in costs and quality of the following:• Natural resources• Financial resources• Human resources• Infrastructure• Intermediate inputs• Information or knowledge |
| Different religions | Political hostility | Lack of sea or river access |   |
| Different social norms | Government policies | Size of country |   |
|   | Institutional weakness | Weak transportation or communication links |   |
|   |   | Differences in climates |   |
| **Industries or Products Affected by Distance** |
| Products have high-linguistic content (TV). | Government involvement is high in industries that are• producers of staple goods (electricity),• producers of other “entitlements” (drugs),• large employers (farming),• large suppliers to government (mass transportation),• national champions (aerospace),• vital to national security (telecommunications),• exploiters of natural resources (oil, mining), and• subject to high-sunk costs (infrastructure). | Products have a low value-of-weight or bulk ratio (cement). | Nature of demand varies with income level (cars). |
| Products affect cultural or national identity of consumers (foods). |   | Products are fragile or perishable (glass or fruit). | Economies of standardization or scale are important (mobile phones). |
| Product features vary in terms of size (cars), standards (electrical appliances), or packaging. |   | Communications and connectivity are important (financial services). | Labor and other factor cost differences are salient (garments). |
| Products carry country-specific quality associations (wines). |   | Local supervision and operational requirements are high (many services). | Distribution or business systems are different (insurance). |
|   |   |   | Companies need to be responsive and agile (home appliances). |

To apply the CAGE framework, identify locations that offer low raw material costs, access to markets or consumers, or other key decision criteria. You might, for instance, determine that you’re interested in markets with strong consumer buying power, so you would use per capita income as your first sorting criterion. As a result, you would likely end up with some type of ranking. Ghemawat provides an example for the fast-food industry, where he shows that on the basis of per capita income, countries like Germany and Japan would be the most attractive markets for the expansion of a North American fast-food company. However, when he adjusts this analysis for distance using the CAGE framework, he shows that Mexico ranks as the second most attractive market for international expansion, far ahead of Germany and Japan[[4]](#endnote-4). Recall though, that any international expansion strategy still needs to be supported by the specific resources and capabilities possessed by the firm, regardless of the picture presented by the CAGE analysis. To understand the usefulness of the CAGE framework, consider Dell and its efforts to compete effectively in China. The vehicles it used to enter China were just as important in its strategy as its choice of geographic arena. For Dell’s corporate clients in China, the CAGE framework would likely have revealed relatively little distance on all four dimensions—even geographic—given the fact that many personal-computer components have been sourced from China. However, for the consumer segment, the distance was rather great, particularly on the dimensions of culture, administration, and economics. For example, Chinese consumers didn’t buy over the Internet, which is the primary way Dell sells its products in the United States. One possible outcome could have been for Dell to avoid the Chinese consumer market altogether. However, Dell opted to choose a strategic alliance with distributors whose knowledge base and capabilities allowed Dell to better bridge the CAGE-framework distances. Thus the CAGE framework can be used to address the question of where (which arena) and how (by which entry vehicle) to expand internationally.

CAGE Analysis and Institutional Voids

While you can apply CAGE to consider some first-order distances (e.g., physical distance between a company’s home market and the new foreign market) or cultural differences (e.g., the differences between home-market and foreign-market customer preferences), you can also apply it to identify institutional differences. Institutional differences include differences in political systems and in financial markets. The greater the distance, the harder it will be to operate in that country. Emerging markets in particular can have greater differences because these countries lack many of the specialized intermediaries that make institutions like financial markets work. Table 8.3 illustrates examples of specialized intermediaries for different institutions. If an institution lacks these specialized intermediaries, there is an ***institutional voids***. An institutional void refers to the absence of key specialized intermediaries found in the markets of finance, managerial talent, and products, which otherwise reduce transaction costs.

**Table 8.3. Specialized Intermediaries within a Country or Other Geographic Arena**

| **Institution** | **Specialized Intermediary** |
| --- | --- |
| Financial markets | • Venture-capital firms• Private equity providers• Mutual funds• Banks• Auditors• Transparent corporate governance |
| Markets for managerial talent | • Management institute or business schools• Certification agencies• Headhunting firms• Relocation agencies |
| Markets for products | • Certification agencies• Consumer reports• Regulatory authorities (e.g., the Food and Drug Administration)• Extrajudicial dispute resolution services |
| All markets | • Legal and judiciary (for property rights protection and enforcement) |

Three Strategies for Handling Institutional Voids

When a firm detects an institutional void, it has three choices for how to proceed in regard to the potential target market: (1) adapt its business model, (2) change the institutional context, or (3) stay away.

For example, when McDonald’s tried to enter the Russian market, it found an institutional void: a lack of local suppliers to provide the food products it needs. Rather than abandoning market entry, McDonald’s decided to adapt its business model. Instead of outsourcing supply-chain operations like it does in the United States, McDonald’s worked with a joint-venture partner to fill the voids. It imported cattle from Holland and russet potatoes from the United States, brought in agricultural specialists from Canada and Europe to improve Russian farmers’ management practices, and lent money to farmers so that they could invest in better seeds and equipment. As a result of establishing its own supply-chain and management systems, McDonald’s controlled 80 percent of the Russian fast-food market by 2010. The process, however, took fifteen years and $250 million in investments[[5]](#endnote-5).

An example of the second approach to dealing with an institutional void—changing the institutional context—is that used by the “Big Four” audit firms (i.e., Ernst & Young, KPMG, Deloitte Touche Tohmatsu, and PricewaterhouseCoopers) when they entered Brazil. At the time, Brazil had a fledgling audit services market. When the four firms set up branches in Brazil, they raised financial reporting and auditing standards across the country, thus bringing a dramatic improvement to the local market[[6]](#endnote-6)

Finally, the firm can choose the strategy of staying away from a market with institutional voids. For example, The Home Depot’s value proposition (i.e., low prices, great service, and good quality) requires institutions like reliable transportation networks (to minimize inventory costs) and the practice of employee stock ownership (which motivates workers to provide great service). The Home Depot has decided to avoid countries with weak logistics systems and poorly developed capital markets because the company would not be able to attain the low cost–great service combination that is its hallmark[[7]](#endnote-7).

Ethics in Action

Nestlé’s Nespresso division is one of the company’s fastest-growing divisions. The division makes a single-cup espresso machine along with single-serving capsules of coffees from around the world. Nestlé is headquartered in Switzerland, but the coffee it needs to buy is primarily grown in rural Africa and Latin America. Nespresso set up local facilities in these regions that measure the quality of the coffee. Nespresso also helps local farmers improve the quality of their coffee, and then it pays more for coffee beans that are of higher quality. Nespresso has gone even further by advising farmers on farming practices that improve the yield of beans farmers get per hectare. The results have proven beneficial to all parties: farmers earn more money, Nespresso gets getter quality beans, and the negative environmental impact of the farms has diminished[[8]](#endnote-8)

Key Takeaways

* CAGE analysis asks you to compare a possible target market to a company’s home market or cultural economy based on the dimensions of culture, administration, geography, and economy.
* CAGE analysis yields insights in the key differences between home and target markets and institutions and allows companies to assess the desirability of that market. It also allows foreign relations analysts to understand some of the key institutional differences essential to creating important, meaningful relationships.
* CAGE analysis can help you identify institutional dissimilarity, which might otherwise frustrate internationalization efforts. Institutional differences are important to the extent that the absence of specialized intermediaries can raise transaction costs just as their presence can reduce them.

1. Arjun Appadurai, “Difference and Disjuncture in the Global Cultural Economy,” Public Culture, Aug 2004. [↑](#endnote-ref-1)
2. Pankaj Ghemawat, “Distance Still Matters,” *Harvard Business Review.* 79, no.8, Sep 2001: 1-11. [↑](#endnote-ref-2)
3. Pankaj Ghemawat, “The Forgotten Strategy,” Harvard Business Review, 81, no. 11, Sep 2003. [↑](#endnote-ref-3)
4. Ghemawat, “Distance,” ibid. [↑](#endnote-ref-4)
5. “Macdonald’s In Russia,” Economic Times of India, April, 30, 2010 [↑](#endnote-ref-5)
6. Khann, Papelu, and Sinha. “Strategies that Fit Emerging Markets,” *Harvard Business Review*, 83, no. 6. [↑](#endnote-ref-6)
7. Ibid. [↑](#endnote-ref-7)
8. Porter and Kramer, “The Big Idea: Creating Shared Value,” Harvard Business Review, Jan-Feb, 2011. [↑](#endnote-ref-8)