



Next-generation global organizations

To capture the opportunities of emerging markets and to counter the penalties of operating globally, the next generation of global organizations is beginning to be defined

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Global organizations have a very long history — arguably dating as far back as the Venetian trading empire in the 10th century. In recent years, the importance of being global has increased, driven in part by the rise of emerging markets, which are expected to contribute more than half of global growth over the next decade.

The rebalancing toward these markets is happening quickly, partly the result of ever-improving communications technologies: it took the early Asian corporate globalizers such as Sony or Honda 15 or more years to become global, but only 5 or so years for Tata and Lenovo to do so. Indeed, some of the companies in the most recent waves of globalizers might be said to have been “born global.”

To better understand the changes, we surveyed and interviewed more than 300 executives at 20 of the world’s leading global organizations¹. More than half expect radical change to their business models in the next decade. And with external change picking up pace, these executives also expect that their organizations will have to accelerate their “metabolic rate” — the pace at which they change themselves. Many global leaders believe, as do we, that we may now be entering a new phase of globalization, in which companies will need to explore radically new models and practices.

To win in this new era, companies must understand the value of being global in four domains: strategy, people, cost, and risk. With that understanding, they can then start capturing the opportunities that are opening up to the next generation of global organizations.

The benefits and challenges of being global

We define global companies as those that have a significant proportion of their sales, assets, or employees outside their home market (if indeed they still have a home market). That said, global companies are not homogenous; Citibank has little in common with Boeing, or Tata with Sinopec, other than size and reach. Our ongoing research has identified five broad archetypes, based on the primary way in which each creates value in the global business (see “Five archetypes” on page 3):

- Resource seekers, such as mining and oil and gas companies
- Researchers, such as pharmaceutical and some high-tech companies
- Global offerers, such as luxury goods manufacturers that offer the same product worldwide
- Customizers, such as consumer goods companies that tailor their offerings for local markets
- Networkers, such as airlines, third-party logistics companies, and professional services firms, which derive much of their value from their network.

Despite their differences, companies in all archetypes broadly agree that there is value in being global. In our survey of more than 300 executives, 88 percent said that their global footprint created value for their shareholders, employees, and other stakeholders. Still, even financially successful global companies often find it difficult to maintain their organizational health and agility in local markets, especially in comparison with strong local companies. Our analysis of McKinsey’s Organizational Health Index, a database of nearly 600,000 employee surveys from more than 500 organizations, showed that high-performing global companies

¹ See “Surveys” sidebar on page 5 for details of key surveys underpinning this work.

Five archetypes

The *resource seeker* archetype includes companies such as Rio Tinto and China National Offshore Oil Corporation that globalize to gain access to raw materials or natural resources. In a world where resources are becoming scarcer, this entails operating in disparate and remote environments and running large operations that are concentrated around those resource assets. For these companies, the strategic benefits of being global are considerable. However, so too are the challenges, including engaging and staying connected with employees in those remote locations, grappling with local talent shortfalls, and managing substantial operations in countries that may be unfamiliar, entailing different risks and involving complex relationships with local stakeholders and regulators.

Companies that fall into the *researcher* archetype make significant investments in R&D to create products that address customer needs that are broadly similar across geographies. Pharmaceutical companies, certain engineering and automotive companies, and some high-tech companies are in this group. For example, the fundamental design and engineering of Airbus's A380 are standard for all customers; only minor adaptations, such as changes to the interior layout to meet individual airline needs, are necessary. Typically, these companies have a small number of R&D sites, and each site focuses

on a few highly specialized skills. Historically, companies would have located these sites in their home region, but they are now establishing them in the markets with the most abundant talent. AstraZeneca, for example, has a center of excellence in Bangalore focused on developing medicines such as tuberculosis medication for the developing world. Likewise, the Novartis Institutes for BioMedical Research in Shanghai taps a strong and growing pool of local researchers. Once the product is developed and readily available, companies maximize value by achieving the widest possible geographic reach.

The *global offerer* archetype, like the researcher archetype, includes companies that provide broadly distributed products, but this group does so with lower levels of capital expenditure or R&D investment. It includes luxury goods companies (such as Burberry and the fashion and leather goods businesses of LVMH). The global offerer does not face the same challenges as other archetypes; for companies in this group, core operations are often concentrated in their home market but still linked to a global presence. And insofar as their global offering is a "volume play," the marginal costs of taking an identical product to a new marketplace are, of course, minimal.

A fourth archetype is the *customizer* or local deliverer. The difference between

these companies and the researchers and global offerers is that these companies customize their offer in multiple markets. In some cases, only a part of the product or service is customized, but this tailoring is at the core of the global strategy and requires more substantial in-market operations. McDonald's, for example, offers beer in its French restaurants and a beef-free menu in India. Tailoring is supported by strong, consistent global processes such as standard operating procedures. These companies face the challenges of balancing those global strengths with a local focus, of maintaining much more substantial and often more distributed global operations than researchers or global offerers, and of attracting, training, and retaining local executives and other workers. They can often learn from local innovation, but they also face considerable obstacles in engaging a distributed workforce.

Finally, we have the *networker* archetype. Companies in this group base their business on the network benefits of their global reach. This group includes information providers such as Thomson Reuters, logistics companies such as DHL and UPS, certain financial services firms, professional services firms such as McKinsey, and major airlines. The network can create benefits at different points along the value chain. For example, investment banks can draw on local knowledge in Kuala Lumpur

and Johannesburg and provide clients in London with the ability to access and trade in those markets. DHL and UPS attract customers who want the reliability of a global delivery network owned by one carrier. Like customizers, these companies have local operations (albeit smaller ones) in many locations to maintain and operate the network; they therefore face challenges in engaging widely distributed employees.

Beyond archetypes, we have also found that a company's heritage—that is, whether it grew organically or through M&A—strongly affects its experience of being global. Companies that have grown organically often find it easier to operate consistently across all countries; however, they may find it harder to adjust their products and services to local market needs because they have a strong core. M&A makes local adaptation easier, because local expertise has often been brought in, but it can make it more difficult to achieve the benefits of scale and scope and to create alignment.

It is also worth noting that although we have described these archetypes and sources of growth as separate, some global organizations may contain businesses that match different archetypes or which have grown in different ways, particularly offerer and customizer, are on a continuum.

2 Martin Dewhurst, Jonathan Harris, and Suzanne Heywood, "Understanding your 'globalization penalty,'" *McKinsey Quarterly*, July 2011 (mckinseyquarterly.com).

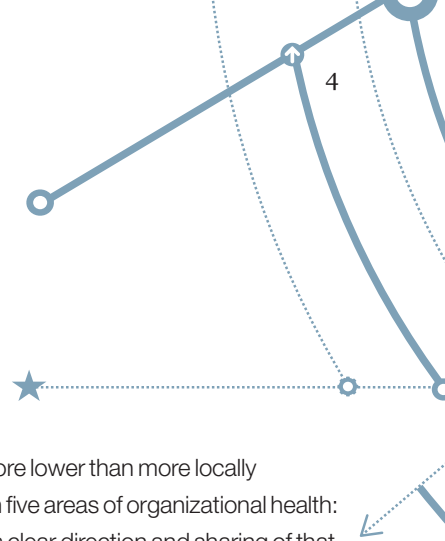
3 Sumit Dora, Sven Smit, and Patrick Viguerie, "Drawing a new road map for growth," *McKinsey Quarterly*, April 2011 (mckinseyquarterly.com).

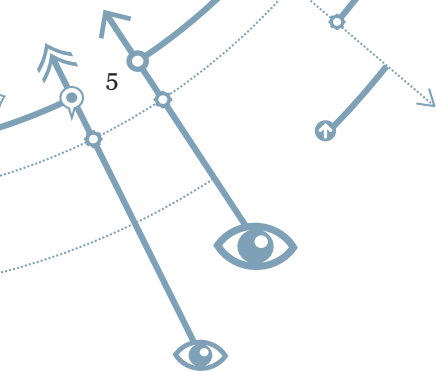
4 Some of these benefits—in particular, cost benefits—can also be captured by a large company that is not global. In reality, however, many large companies need to go global to achieve the scale necessary to capture such benefits fully unless they have an extremely large home market (such as China, India, or the US).

consistently score lower than more locally focused ones in five areas of organizational health: the creation of a clear direction and sharing of that direction; coordination and control; capabilities; innovation and learning; and external orientation (engagement with external stakeholders such as customers, suppliers, partners, and local governments).² And companies headquartered in developed markets seem to face even bigger challenges in emerging markets than their peers headquartered in those markets. When we looked at the growth rates of companies in emerging markets, we found that those headquartered in another emerging market had a compound annual growth rate of 31 percent, far higher than for those headquartered in a developed market, where the rate was 13 percent.³

But what is the true value of being global? And what are the challenges that frustrate firms pursuing the benefits of globalization? We group the benefits and challenges on four axes: strategy, people, cost, and risk. On each axis, there are both benefits and challenges that can come into conflict if they are not handled carefully. For example, taking advantage of the strategic benefits of being global by entering new markets can also make it harder to find the right balance between global standardization and local optimization. Companies should seek a point on each axis that best positions them for sustained success.

Striking a balance can be difficult. In almost all cases, we find that companies are not capturing the full range of potential benefits of being global.⁴ Sometimes they do not appreciate the value that could be captured (for example, most global companies do not realize the full extent of the knowledge and expertise held within the organization); at other times, the challenges and complexities of capturing that value can seem insurmountable.





Surveys

Our initial research which identified the global penalties (see Exhibit 1 opposite) included an analysis of McKinsey's Organizational Health Index database of 600,000 employee surveys from more than 500 organizations.

As a further part of our research, we administered 3 separate but related surveys in a 3-month period to gather data on the benefits and challenges facing global executives.

- The primary survey referenced to most frequently throughout this document is the McKinsey Globalization Survey; it is accompanied by structured interviews of more than 300 executives at 20 of the world's leading global organizations as of November 2011.
- The McKinsey Talent and Organization Imperatives Survey of 120 executives at 17 Indian country organizations within multinationals as of February 2012 was based on the Globalization Survey, however, with a particular focus on talent in emerging markets.
- The McKinsey Quarterly also surveyed more than 4,000 executives worldwide in September 2011, using questions from the Globalization Survey. However, these surveys were not complemented by structured interviews. This data set provides a broader corroboration of our in-depth findings from the Globalization Survey and interviews. See "McKinsey Global Survey results: Managing at global scale," McKinsey Quarterly, at mckinseyquarterly.com.

These surveys are footnoted throughout the document.

Axis 1: Strategy. Benefiting from greater access, opportunities, and reach while remaining agile and relevant

Most companies go global initially to gain strategic benefits from accessing new markets. Once they have become global, however, greater balance sheet depth and a larger geographic footprint can afford them new opportunities. For example, Unilever had a commercial presence in China for many years, then went on to establish a global research center in Shanghai. Networker companies in particular exploit this effect; their strategic returns from geographic expansion increase as they enhance their network and thus provide greater reach and coverage for their customers.

However, there are also strategic challenges to being global. Many companies find it difficult to be locally flexible and adaptable while increasing their global footprint. In particular, strategy development and resource allocation processes may have difficulty coping with the growing diversity of markets, customers, and channels.

These issues were clear in our recent research; only 38 percent of executives thought they were better than their local competitors at understanding the operating environment and customers' needs, and only 39 percent felt that their priority global processes met most business unit- or country-specific needs.

Axis 2: People. Capturing value from diverse experiences and skills while creating engagement and alignment

The second axis focuses on people. There is a huge, frequently untapped benefit in the diversity of ideas, knowledge, and skills within a global company. Of the four axes, the benefits derived from people are perhaps the least appreciated,

Exhibit 1

Do companies pay a penalty for being global?

Factors in organizational health

Statistically significant difference

Alignment

Direction

Leadership

Culture and climate

Execution

Accountability

Coordination and control

Capabilities

Motivation

Renewal

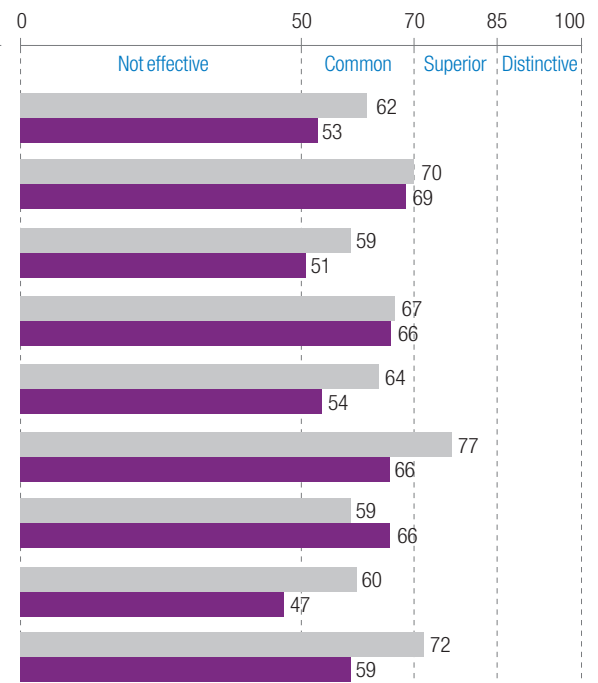
Innovation and learning

External orientation

Organizational health index score, percent

Local champions
Global champions¹

Champions are companies that outperformed their peers in 10-year total returns to shareholders (TRS)



¹ Companies were defined as global based on proportion of sales outside of home geography, proportion of employees outside of home region, geographic diversity of top management team, and proportion of shareholders that are outside of home region.

Source: Organizational health index database; McKinsey analysis

but their value is increasing as many global companies shift emphasis to emerging markets. These markets, which represented only 5 to 10 percent of their business a few years ago, may represent 50 percent or more within a decade. To succeed in these markets, global companies must make sure their employees represent the diversity of their global footprint. They can then make full use of the breadth of insight and knowledge contained in this diversity to allow them to innovate quickly.

A major challenge with the people axis in addition to the challenge of people engaging

with staff who are distributed globally⁵ is how to win the war for talent in emerging markets. For example, in China, attracting and retaining talent is exceptionally difficult. In interview after interview, multinational executives said that they simply cannot find enough people in the country with the managerial skills and ability to work in an Anglophone environment. Another aspect of the problem is the league table of preferred employers. In 2006, the list of the top 10 preferred employers in China contained only 2 local companies (China Mobile and Bank of China); the others were well-known global names. By 2010, the tide had turned;

⁵ This engagement challenge was highlighted in our article in the globalization survey, *McKinsey Quarterly*, July 2011.

7 of the top 10 were Chinese companies. As one executive told us, “Local competitors’ brands are now stronger than they were, and they can offer more senior roles within their home market, which is very attractive to local talent.” The difficulty of retention compounds the problem: annual staff turnover rates of 20 to 30 percent are not unknown for global companies in emerging markets.

For customizers who need to tailor their product or service in each market, this talent challenge creates particular difficulties, as emerging markets often require greater product and service differentiation than established markets do—and this, in turn, necessitates different business models. As an executive at one successful global company told us, “Historically, we only changed either our product or our geography, but to be successful in emerging markets, we need to do both together. This is fundamentally challenging the way we operate. We need to get better at understanding local markets and better at capturing local innovations, and then exporting that knowledge globally.”

Global companies are acutely aware of this challenge. Indeed, only 52 percent of the more than 300 executives we studied in depth thought their company was effective at tailoring its recruiting, retention, training, and development processes for different geographies—and the more geographies a company spanned, the more complicated and pressing the problem was. An emerging-market leader within one global company told us, “Our current process favors candidates who have been to a US school, understand the US culture, and can conduct themselves effectively on a call with the head office in the middle of the night. The process is not designed to select people who understand our local market.”

Axis 3: Cost. Exploiting economies of scale while managing complexity and ensuring flexibility

Global companies gain value from scale-related cost efficiencies. Some of these benefits—those that derive from transactional scale (such as economies of scale in shared services)—are now also available to local companies through outsourcing, access to cloud resources, and so on. However, large global companies can still use their balance sheet strength and business reach to create more sophisticated efficiencies, for example, by building infrastructure that can be used by multiple business units (such as R&D centers and global training facilities).

As with the other dimensions, being global brings cost challenges as well as benefits. In particular, we know that the bigger and more diverse a corporation is, the greater the risk of excessive complexity that creates cost without creating value. The good news is that this value-destroying complexity can be substantially reduced by simplifying processes, clarifying accountabilities, and reducing organizational duplication.

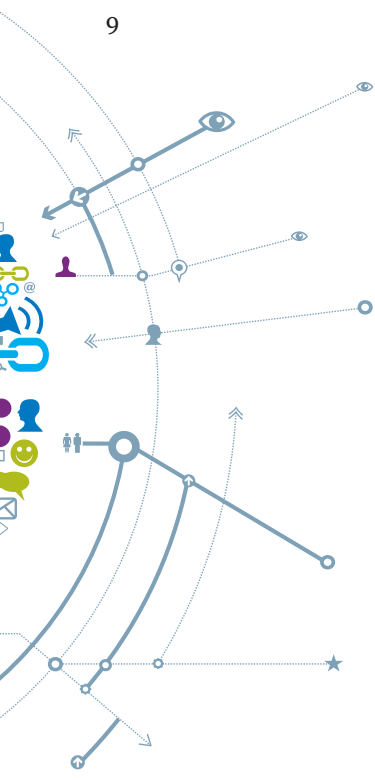
However, some of the other cost challenges of being global can be more difficult to manage. These include allocations of corporate functional costs whose value is opaque at best for far-flung markets, the cost to local businesses of complying with global standards, the higher operating costs that result from global processes that are too rigid, and the costs of management coordination. These cost penalties have been raised frequently in our work with global organizations and are, of course, a consequence of the increased formality of structures and processes that global organizations often require to capture the cost benefits of globalization. One hundred pages of budget guidelines might be acceptable for major

Axis 4: Risk. Locking in process quality and portfolio benefits while retaining a transparent view of risk

reach. In more geographically focused companies, the set of risks is usually narrower, and senior leaders are more familiar with them. Our Organizational Health Index analysis⁶ shows that global champions find it harder than local champions to measure and manage their risk consistently and to address problems when they arise. Many global companies respond by making their risk processes more rigorous and standardized. This, however, can create further tension when a standardized global process overestimates less familiar local risks and undervalues local opportunities. For example, one executive said, “A mindset that ‘this is the way that we do things around here’ is very strongly embedded in our risk process. When combined with the fact that the organization does not fully understand emerging markets, it means that our risk process rejects opportunities that our CEO would approve.”

Leading global companies have the opportunity to reshape their business fundamentally to address the opportunities and challenges on these four axes. As a result, over the next few years, very different approaches to global organization will

6 Martin Dewhurst, Jonathan Harris, and Suzanne Heywood, "Understanding your 'globalization penalty,'" *McKinsey Quarterly*, July 2011 (mckinseyquarterly.com). For more on the Organizational Health Index database, see solutions.mckinsey.com.



emerge. There will be no one solution—what will win will reflect a company's archetype and its unique context. Furthermore, even the most sophisticated companies will discover that reorganizing for global success is an ongoing process; they will have to evolve as the landscape changes, and so the “solution” may actually feel like a work in progress. However, we believe that five emerging approaches will play an important part in shaping the next generation of global organizations.

Approach 1: Making growth markets a center of gravity

Many global companies continue to expand their global footprint across the value chain, from research to operations to sales and marketing. And they are immersing themselves in emerging markets such as Brazil, China, and Nigeria, all of which have different consumer and stakeholder requirements. As companies shift their geographic focus, it will be critical to ensure that the financial resources and talent dedicated to these regions fully reflect the potential value at stake. This is not the case in most companies today. Recent McKinsey research showed significant strategic inertia in the ways that companies allocate capital to new opportunities; it also demonstrated that the companies that reallocated their capital most dynamically earned, on average, 30 percent higher total return to shareholders than their more sluggish peers.⁷ We believe this provides a powerful lesson—not only for capital allocation but also for talent allocation.

Equally critical will be the reshaping of key processes, such as resource allocation, innovation, and risk management, to accommodate the realities of emerging markets. All too frequently, processes are still geared to the developed-market priorities of the past decade instead of the imperatives of the next. In addition,

some companies are exploring structural changes such as managing high-growth regions separately from lower-growth regions rather than clustering regions based solely on proximity. Other approaches we have seen include having key markets report directly to the CEO or appointing a CEO or country president to drive integration across business units in a key geography and thus raise the company's profile with governments, potential partners, and talent.

More fundamentally, many companies are rethinking the role of the corporate center—even challenging the extent to which that concept is still helpful. Increasingly, companies are “unbundling” their structure and establishing corporate functions in the location that best fits their market, cost, and talent needs. IBM's global emerging market business, for example, is headquartered in Shanghai; a conscious decision was made to separate it from the company's central functions in its suburban New York location.

For further details, see “How Western multinationals can organize to win in emerging markets” on page 13 and “Reinventing the global corporate center” on page 41.

Approach 2: Reshaping the global/local operating model to increase the “metabolic rate”

A broader geographic footprint, including more diverse employees, customers, and other stakeholders, naturally increases complexity. The traditional approach to reducing complexity—standardization—may be of only limited use for the next wave of global organizations because it reduces local-market agility. For example, an executive we interviewed described how his company's risk process frequently flagged a new partnership in an emerging market as a risk when, in reality, the partnership was critical to success.

⁷ Stephen Hall, Dan Lovullo, and Reinier Musters, “How to put your money where your strategy is,” *McKinsey Quarterly*, March 2012 (mckinseyquarterly.com).

To address this, global companies must become far more adept at defining the processes that need to be globally standardized because they are core to value creation. For a resource seeker, these might include major contract or investment decisions. By the same token, global organizations must also excel at recognizing those processes that can create more value through local variation. For a customizer, this might mean greater latitude in forging local partnerships. A conscious redesign of these processes with an eye toward improving quality and accelerating their pace will be essential. Companies will also benefit from specifying clear accountabilities at each level in the organization, reducing duplicated accountabilities, and building an ecosystem to foster collaboration and networking. These are not new problems, but they may need to be addressed in new ways—for example, by focusing on customer- or market-back designs rather than on top-down programs.

For further details, see “Structuring your organization to meet global aspirations” on page 29, and “Getting ruthless with your processes” on page 51.

Approach 3: Developing more diverse and dynamic approaches to engage partners, networks, and external stakeholders

To increase strategic agility and reduce risks, global organizations need to explore new forms of external partnerships and collaborations—for example, by working more closely with suppliers, customers, and (particularly in emerging markets) governments and their agencies.

This challenge is important for most types of companies. For resource seekers, the ability to create consortia and win local contracts in increasingly remote locations is critical. For

networkers, the ability to navigate local regulators and governments is essential. Local partnerships may often be the solution, although our analysis suggests that only 50 percent of partnerships meet expectations, with joint ventures proving particularly challenging to balance over time. Customizers also need to mobilize a broad range of partners to tailor products for local customers’ needs. For example, several Japanese and Korean automakers have demonstrated the value of making significant local commitments, building greenfield plants in the US with state support, and becoming so established that they can now promote their products as “made in the US.” Researchers such as pharmaceutical companies can also benefit from partnerships that provide access to the accelerating academic activity in emerging markets.

But an external focus does not come easily to global organizations: their need to standardize processes and manage risk can lead to an internally focused and conservative approach. At a local division of a global company that we interviewed recently, the local staff was overwhelmed by the task of completing 120 different strategy templates, that had been designed for more developed markets.

Setting clear aspirations can help: for example, A. G. Lafley, the former chairman and CEO of Procter & Gamble, set a goal that 50 percent of innovation at the company be externally sourced. Other important transformations include revamping investment management and portfolio management processes, such as Cisco’s “proudly sourced externally” projects, as well as redefining relationships with partners and suppliers to increase transparency and align aims (as BMW has been doing with BASF to create a “cost per painted car”). Technology can also help, as shown by the increasing number of company



Web sites, like those of Nike and the LEGO Group, that allow customers to tailor their own products.

For further details, see “Getting more value from your global footprint” on page 59.

Approach 4: Building the next-generation cohort of global leaders and local teams

Global companies need a cadre of leaders to reflect the diversity of their businesses. This challenge has never been more pressing than it is now, as businesses rebalance toward new markets and customers. Organizations need to accomplish this in the face of intense competition for talent (increasingly from local players), high turnover rates, and relatively small pools of talent with the right cultural and linguistic fit. In this context, strong, committed local leadership is essential.

There are many talent issues for this leadership to address to achieve this diversity. For example we have found that some senior executives in the emerging-market operations of global companies do not have the skills to move up. In other cases, they do not have the opportunity; one executive described this as a nationality-based

“glass ceiling.” Another familiar problem is that companies find it hard to hire senior leaders locally because they are looking for employees just like the ones they have at home, based on traditional skill sets and educational achievements.

To meet these challenges, a few companies are revamping their training at all levels. One example of these efforts is a program at Goldman Sachs designed to help Asian executives overcome cultural barriers that have hindered their promotion. Organizations are also fundamentally altering their recruiting programs so that they are not hiring for familiarity with home office norms but are instead hiring for local-market skills and connections. Additionally, companies are innovating to improve retention, for instance, by offering more attractive career paths and greater access to world-class executive training. And leading companies are rethinking their expatriate programs, seeking to reverse traditional flows and create a new culture of long-term assignments so that these are no longer viewed as “here today, gone tomorrow” stays.

For further details, see “Winning the talent war in local markets by staying global” on page 67.

Approach 5: Capturing the power of knowledge, networks, and skills across the enterprise

Finally, ensuring that companies benefit from the knowledge and skills they already have is a crucial challenge. In our experience, even successful global companies struggle to deploy just a small fraction of their collective expertise. A salesperson in Korea could likely benefit from the experience of a colleague in Brazil in negotiating with a client — but how can the Korean learn what the Brazilian knows? A company intranet or an employee handbook is not by itself enough to make that exchange take place.

Companies must find new ways to capture expertise and spread best practices. There is no one solution. Many look first to technology, which is certainly a key enabler. But technology-based approaches will not flourish without people seeing the value of sharing and exchanging insights. More promising are approaches to retool processes and forums such as strategy meetings that ensure that growth markets are represented adequately.

As is too often the case today, the decision maker on a project team is from North America or Europe. Another option is to reshape incentives. One company asked its local leaders to “search and spin.” Each is challenged to identify ideas from their peers and to discuss the insights and best practices they have shared, or “spun,” with their colleagues.

Beyond individual structures or processes, many global companies have started to find new ways to establish linkages across locations, enabling local knowledge and innovation to be captured and then deployed globally. Often, this is done by creating formal and informal communities of interest. Technology can facilitate these communities. IBM’s internal Beehive Web site, for example, allows more than 100,000 employees to engage in communities of interest on multiple topics. Other companies have chosen more formal approaches, like creating global “functional families” to share knowledge and expertise.

For further details, see “Getting more value from your global footprint” on page 59.



The next decade will see fundamental changes in the organization of global companies. Although each will chart its own path, we believe a map leading toward the next-generation

global corporation is emerging; the rewards for experimentation and boldness, particularly increased agility and a higher metabolic rate, will be considerable.

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