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This report summarizes Global Economics Paper 95, *Getting Globalization Right: Meeting the Challenge of the Century*, which is available through your GS representative

Getting Globalization Right: Meeting the Challenge of the Century

We analyze 27 companies in a bid to find the successful global company—GloCo—of the future

In January we examined globalization through interviews with 15 thought leaders in the corporate, academic and policy worlds. We now follow this up by outlining in detail the key characteristics of a global firm. In an effort to find the successful global company—the GloCo—of the future, we analyzed 27 companies, identified by a survey of our equity sales force. Most of the 27 satisfied some, but not all, of our eight 'must-have' criteria. What follows is a discussion of our criteria and the highlights of our findings. The full version of this study is available through your GS representative.

Defining Globalization

In January, we defined globalization as the integration of capital markets, trade, production processes and political and social interactions that results in the export and import of best practices. Key to this is an ability to change through time, in order to cope with the evolving nature of the world economy and society. Our interviews reinforced this definition and sparked our thinking about what makes a successful GloCo.

Why Is Globalization Attractive?

Companies seeking to be global are presumably motivated by a belief that the profits from this strategy will exceed those achievable from a predominantly domestic focus. Our view, based on a good deal of economics research and on work we have done to estimate the equity risk premium, is that the long-term nominal GDP growth rate is a good proxy for long-term corporate profit growth.

We estimate world real GDP growth at 3.5%, which can be regarded as equivalent to real earnings growth for a truly global company. If we add the implied yield from dividends (currently around 2.2%) and a likely inflation rate (2% in US dollar terms), the subsequent level of expected nominal returns comes out at around 8%. GloCo should aim for better, and we think globalization offers a way to achieve this.

There are of course many ways of achieving long-term above-average returns. Successful companies exist in domestic markets; conversely, companies that do have a global reach may fail to achieve above-average returns. Such companies may fail due to the nature of their industry. The airline industry is one where the number and size of the players and the regulatory complexity of the market make it difficult to believe that above-average returns can be achieved. Autos may be another. Consequently, some of the 27 companies discussed in our survey may not develop into successful GloCos, despite the global nature of their operations.

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Who Meets the Challenge of the Century?
27 Potential GloCos

American International Group, Inc. (AIG)	Nike, Inc.
BP plc	Nokia Corporation
Cisco Systems, Inc.	OAO NK Yukos
Citigroup Inc.	PetroChina Company Limited
Coca-Cola Company	Pfizer Inc
Dell Computer Corporation	Procter & Gamble Company (P&G)
General Electric Company (GE)	Rio Tinto Group
GlaxoSmithKline plc (GSK)	Samsung Corporation
HSBC Holdings plc	SAP Systems Integration AG (SAP)
Hyundai Corporation	Sony Corporation
International Business Machines Corporation (IBM)	Unilever
Microsoft Corporation	Vodafone AG
Nestlé S.A.	Volkswagen AG (VW)
	Wal-Mart Stores, Inc.

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To achieve above-average returns from globalization, companies will likely need to expand into developing countries. Developing nations, especially those with growing populations, offer wide opportunities for both sales and production. For many industries, demographic trends in developing countries are more favorable to higher returns than are the rapidly ageing developed countries.

Yet globalization, in our view, is about more than increased sales. GloCo must do more than simply sell a product around the world. We think all of our criteria increase the likelihood of achieving long-term above-average returns, directly or indirectly.

Our Survey and Analysts' Views

From our original interviews, we developed a list of eight 'must-have' characteristics of a successful GloCo. We then set out to identify which major global firms meet these criteria. To generate a list of candidates, we polled our global equity sales force, asking 'which firms are best placed to benefit from globalization over the next five to ten years?' We asked sales people rather than equity research analysts because we thought the sales force would have a broader perspective across sectors.

Our question generated a long list of potential GloCos, with 27 names cited more than once. This (admittedly odd) number became the basis of our analysis, and we interviewed the GS research analysts covering each of the 27.

The list of companies is interesting on its own. It includes what might be termed 'the usual suspects'—HSBC, Citigroup, Wal-Mart, GlaxoSmithKline, Pfizer, Microsoft and Coca-Cola—but also some that may not be on the forefront of people's minds —Hyundai, Rio Tinto, Yukos and PetroChina. Only one Japanese company (Sony) made the list, which surely would not have been the case had we undertaken this analysis a decade ago.

Roughly 20% of the companies are 'new,' associated with the technology boom and the 'new economy' of the 1990s: Microsoft, SAP, Cisco, Nokia and Vodafone. For all the excesses of the bubble era, our survey suggests that the claims of new-economy boosters may have some lasting merit. These firms have become key players on the global stage in two decades or less.

8 Must-Have Criteria for GloCo
Global Strategy
Global Brand
Local Involvement
Flexibility
Technology
Employee-Friendly Workplace Practices
Strategy for China and Key Developing Markets
Commitment to Social Good

Others on our list are 'old,' dating back nearly a century or more: Procter & Gamble, HSBC, Coca-Cola, AIG, BP, Unilever, IBM and GSK. Most of these have pursued what we would now call globalization from the start.

Our original plan was to decide which companies met each of our criteria, and our initial goal was to identify the best GloCo. It quickly became clear that many of our equity research analysts do not think about their companies in the context of some of our criteria. Some analysts specifically did not consider a commitment to promoting social good to be relevant.

It was also clear during the interviews that no company would be able to satisfy all our criteria—although several come close, including AIG, Coca-Cola, HSBC, IBM, Nike, Nokia, Unilever, Vodafone and Wal-Mart. Hyundai, PetroChina and Samsung show promise as early-stage GloCos, and others will undoubtedly come closer in the future.

Criteria for GloCo

Drawing on our interviews and our definition of globalization, our eight criteria of a successful GloCo are:

1. To focus on globalization as critical to the company's future

Globalization is a strategy, not a by-product. As Samsung's Vice President of Investor Relations indicated in our first paper, Samsung feels compelled to follow the globalization route. 'We really do not have any other options. The only way we can overcome our competitors would be to be better at what they are doing and that is essentially globalization.'

Virtually every firm on our list now considers globalization to be key to the future, although many describe it as an evolutionary process rather than a stark one-time policy choice.

2. To have a global brand

Our ideal GloCo has a globally recognized brand that personifies its products to customers, that is seen as a critical asset in its globalization strategy, and that helps to achieve the above-average returns available from globalization. Analysts for Coca-Cola, General Electric, IBM, Microsoft, Nokia, Samsung and Vodafone view these brands in that way.

To our surprise, however, we found that analysts on the whole regard branding as less important than we do, and not all firms with marquee brands use them as we had expected. AIG operates as a group of strong regional brands; Wal-Mart retains strong local brands following some acquisitions; GSK focuses its branding efforts on individual drugs; and P&G employs a decentralized advertising program for a group of individual brands. Still others, like Nokia and Nike, say their brand values and identity are tied to and tailored for local markets and thus are not necessarily uniform around the world.

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3. To be seen as a local company, not the subsidiary of a foreign one

Our first-round interviewees argued that goods and services must feel 'local,' that management must be drawn from the local community and that partnerships with local organizations are important. A tension undoubtedly exists between the need for global focus and brand on the one hand, and the importance of being local on the other. The challenge for GloCo is to achieve a balance between these two.

The reality from our survey was quite complex. Roughly half the firms remain dependent on foreign managers. When we asked whether goods and services were perceived as local, we received mixed answers. Coke, HSBC, AIG, Unilever and Nestle all gave a definitive yes; Pfizer, Cisco, BP and Rio Tinto said no just as clearly. But the answer tends to be very specific to the industry and in come cases to the company.

Take technology: customers are buying a global product and *want* to buy a global product. But at the retail level, local language and local support are critically important. If you can buy software in your language, with local support, are you buying a local good?

4. To demonstrate flexibility

We looked for companies that focus on capturing and spreading best practices around the company, and we found virtually unanimous agreement that this is critical. Analysts for Wal-Mart, Unilever, BP and Nike cite focus on the spread of best practices as key competitive advantages. We also analyzed the pursuit of best practices: should GloCo buy or build? Most on our list buy, although tech firms favor organic growth.

In the most extreme manifestation of flexibility, GloCo may even undergo sweeping organizational and cultural transformations along the lines of Nokia's shift from Finnish paper company to sophisticated global telecom giant. Vodafone underwent a similar evolution from a subsidiary of the now-defunct Racal Electronics to global mobile telecommunications operator. Samsung and Hyundai responded to the 1997-1998 Asian crisis by radically restructuring. PetroChina offers an interesting example of a transformation now underway.

This leads us to wonder whether some of the other firms on our list—particularly in the autos and food sectors—should consider similar transformations.

5. To use technology to advance the business

Our first-round interviewees and our analysts are virtually unanimous that technology is key to any successful GloCo —not just those in the tech sector. Technological innovation and integration can allow global coordination on a scale unmatched in the past. Technology can be crucially important in employing the most efficient 'just in time' inventory or ensuring customer satisfaction. While the tech companies on our list lead the way on this indicator, Wal-Mart, Coke, Pfizer and GE also have strong tech efforts.

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6. To have employee-friendly workplace practices

If a local and reliable work force is important for a successful GloCo, how a firm treats its employees matters. The globalization of the workforce has led to workplace practices that have both global scope and local adaptability. They also have important implications for corporate reputations and can help to bolster internal cohesion. We look at issues such as training, diversity and contingent work forces. One of our would-be GloCos, Wal-Mart, is the largest private-sector employer in the world. Its workforce of 1.4 million is greater than the population of some small nations.

7. To have a strategy for China and other major developing countries

Given that long-term growth potential is higher in the developing world, particularly in China, than in the developed world, GloCo must have a well thought-out strategy for these markets. The strategy can be one of penetrating these domestic markets or using them as a production location, or a combination of the two.

Which strategy a firm pursues is not critical, but GloCo needs to develop an approach that draws on its best practices elsewhere and its competitive advantages within developing countries. For now, attention is concentrated on China, but in the future, we expect GloCo to approach other major emerging markets—India, Russia and Brazil—in a similar fashion.

Perceptions on the scale of the opportunity in China differ. Our analysts for Cisco, Yukos, Rio Tinto and Coke are very optimistic. But the opportunity for some firms with extensive global operations is relatively small. Citigroup may find a bigger opportunity in capital markets activity than in consumer finance—but even so, China is 'just a drop in the bucket' for the near future.

Even those firms that are most bullish on China, like HSBC, see it as a long-term prospect. Low-cost local competition, intellectual property and pricing concerns will remain daunting challenges. Tech companies on the whole consider China a market for the future.

8. To have meaningful social engagement at the local level

We believe GloCo will only be able to sustain above-average returns by contributing to the broader public good. Helping a broad group of consumers to achieve the knowledge, wealth and desires to join the beneficiaries of globalization is likely to be an important part of the transformation to GloCo.

Many analysts say they do not look at this issue because it is not relevant to the framework they use to evaluate companies. The implication is that the market does not value social-good efforts. Yet a number of clients we speak to, especially those running pension funds, cite this as increasingly important in assessing the potential for long-term above-average returns.

Companies clearly are engaged in efforts to promote social good, regardless of whether analysts focus on this issue. Some firms sell goods or services that can themselves be seen as a good, while others become involved in innovative programs that use their products, expertise or infrastructure to improve living standards. Demonstrating a commitment to social good matters for reputation and for brand, as well as for avoiding an anti-globalization backlash. It may be particularly important for companies with ambition to tap Africa, which is often seen as the loser from globalization.

Who Is GloCo?

Based on the interviews we conducted with outside experts in the first paper, and those with equity analysts for the criteria we have identified, it is difficult to find corporate names that satisfy all eight criteria for GloCo.

A good handful come close, however, including AIG, Coca-Cola, HSBC, IBM, Nike, Nokia, Unilever, Vodafone and Wal-Mart. Hyundai, PetroChina and Samsung show promise as early-stage GloCos, and others will undoubtedly come closer in the future. ■

US Firms' International Revenues By Sector