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Can your company remain global and if so, how?

Geopolitical uncertainty is forcing global companies to take a hard look at the decades-long strategy of geographic expansion.

by Andrew Grant, Michael Birshan, Olivia White, and Ziad Haider

Rising geopolitical tensions are testing the resilience of global organizations and challenging existing growth strategies. Wars in Europe and the Middle East and escalating US–China competition have the attention of the executive suite and the boardroom. Global business leaders are asking, "What is the future of the global corporation? Do we need to fundamentally shift strategies and structure?"

These questions are being asked amid a measurable decline in global cooperation on peace and security and slowing cooperation in other areas, as reflected in a new global cooperation barometer released by the World Economic Forum and McKinsey in January (Exhibit 1). The intensity and duration of conflicts worldwide are at their highest levels since before the end of the Cold War[1]: 183 active conflicts in 2023, with violent events last year increasing by 28 percent and fatalities by 14 percent.[2]

Moreover, 2024 is the year of national elections, with more than 60 countries and nearly 50 percent of the global population heading to the polls.[3] Even if only a subset of these elections lead to shifts in leadership and policy, business leaders cannot ignore political uncertainty against the backdrop of an evolving global order.

Unsurprisingly, business leaders view geopolitics as the top risk to global growth and view political transitions as the leading emergent risk, according to our latest global economic survey (Exhibit 2). Business leaders tell us diverging regulatory requirements, increased in-market risk in multiple geographies, and the need to establish local bona fide units without generating undue risk to the parent are the reasons that now, as one executive we spoke to put it, "Geopolitics trumps capital markets."

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[1] Emma Beals and Peter Salisbury, "A world at war: What is behind the global explosion of violent conflict?," *Foreign Affairs*, October 30, 2023.

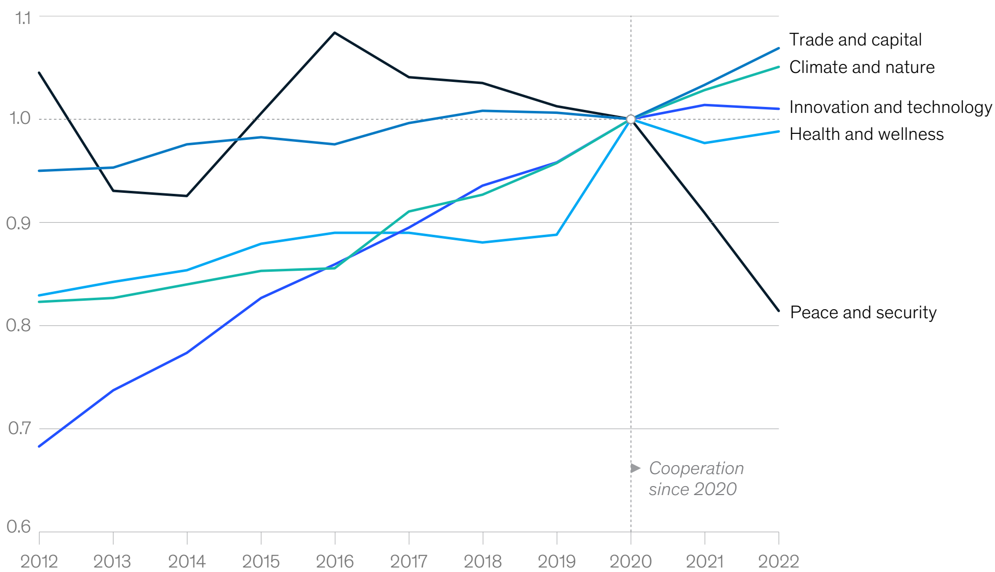
[2] *The Armed Conflict Survey 2023*, first edition, Abingdon, United Kingdom: Routledge, 2023.

[3] Koh Ewe, "The ultimate election year: All the elections around the world in 2024," *Time*, December 28, 2023.

Exhibit 1

Peace and security among nations have eroded sharply since 2020.

Average index of cooperation metrics, 2020 = 1



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Given this environment, one of the biggest strategic questions confronting global business leaders today is, "How global can my organization remain?" The cost of getting this question wrong is high; assets, growth, value creation, and, most importantly, people may be at risk. At the same time, there is a real advantage to getting it right. In a changing geopolitical landscape, organizations can differentiate themselves through the strategic courage with which they navigate this era of volatility.

Our analysis shows that business leaders can take a systematic approach to building what we call geopolitical resilience. One element of that approach is conducting geopolitical-scenario planning, thinking through a set of "black swans, gray rhinos, and silver linings"—unpredictable and probable high-impact events, as well as potential opportunities amid the storm clouds. A second element involves upgrading board capabilities on geopolitical risk.

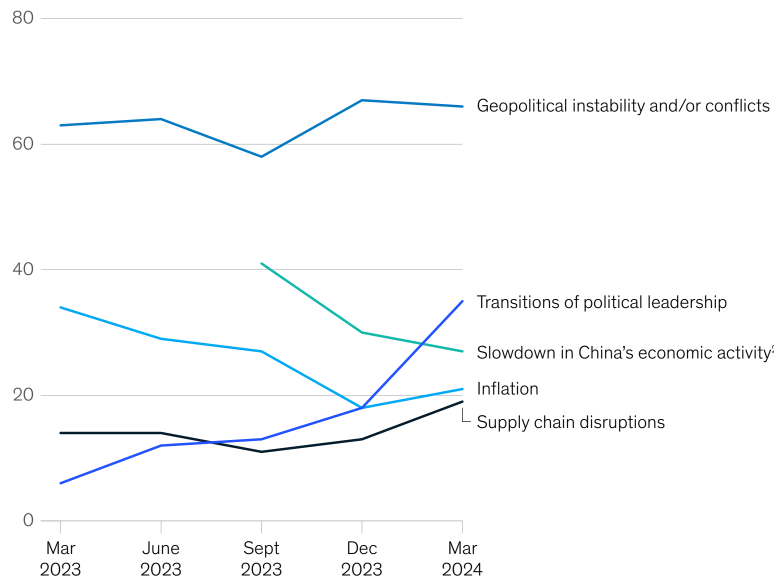
There is another emerging aspect of geopolitical resilience that increasingly arises in our conversations with business leaders—one that we refer to as "structural segmentation." Structural segmentation describes a cluster of moves that global corporations are considering to mitigate geopolitical exposure, to enable locally informed decision making, and to clear a pathway to safe, stable growth.

In what follows, we define structural segmentation, identify questions for global companies to consider as they calibrate their operating models, and outline specific

Exhibit 2

Geopolitical instability tops the list of concerns for global business leaders.

Biggest potential risks to global economic growth, next 12 months,[1]
% of respondents



[1]Out of 15 potential risks that were presented as answer choices. Respondents were able to select up to 3 answer choices. Mar 27–31, 2023, n = 871; June 5–9, 2023, n = 1,044; Aug 31–Sept 8, 2023, n = 997; Nov 27–Dec 1, 2023, n = 942; Mar 4–8, 2024, n = 957.
[2]Not included in the list of potential risks in the Mar 2023 and June 2023 surveys.
Source: McKinsey Global Surveys on economic conditions, 2023–24

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examples of how firms are implementing a segmentation approach. The findings are based on our and our colleagues' conversations with business leaders across the world, as well as on analysis of more than 100 global organizations' strategic moves.

Structural segmentation for geopolitical resilience

During the past 25 years, geographic boundaries have faded for companies. Many built complex supply chains that shipped components and products across the world, often crisscrossing it multiple times. Wisely, they established global R&D hubs, forged enterprise-wide technology stacks, democratized access to data, consolidated legal entities, and fostered one-firm cultures.

The premise of a fully globalized world, which underpinned these moves, is now in question, and companies should respond. Legal, regulatory, economic, political, and social contexts are shifting. Companies are increasingly seeking an integrated approach to taking coordinated action across six domains: operations (that includes production and supply chains), R&D, technology and data, legal entity structure, capital, and people. Across each of these domains, we find that organizations typically contemplate either (re)committing to globality or structurally segmenting activities across geopolitically distant markets.

Structural segmentation can take several forms across a continuum. Full structural segmentation involves localizing parallel activities in multiple locations across the world. Factories, for example, may produce only for the regions in which they are located (often in a region or regions that have higher “geopolitical distance”[4] from the company’s home market).

As an alternative, some companies are relocating toward home or geopolitically aligned countries, at least in select domains. In general, this involves preserving global connections—for example, housing most technologies in a home country, while creating a minimal viable footprint in geopolitically distant countries. In its most extreme form, however, this might include a major move, such as housing all R&D in the home market.

The intent is to respond to geopolitical realities while preserving the benefits of global reach and seizing opportunities for resilient growth. Just as scenario planning is not a crystal ball, so structural segmentation is not a magic wand. It is, however, a strategic and operational choice that companies may contemplate to survive and thrive in a new era. Although there is a range of ways multinationals can employ segmentation, there are six main areas:

Reshaping production and supply chains for resilience

Escalating geopolitical competition and disruptions induced by COVID-19, weather, and conflict have made supply chains a top priority issue for C-suites and boardrooms. Organizations are deploying or exploring a variety of segmentation strategies, considering both geopolitical exposures and concentrated production or supply chain footprints.

Some companies have responded by recommitting to a global approach. This typically does not mean ignoring a changing world order but rather moving toward greater strategic diversification, whereby a company moves away from a concentrated global supply chain to a model that sources from and produces in a greater range of markets across the world. The idea is that a broader and arguably more global web of connections adds resilience, since it is not dependent on any one region or country.

Multinational companies that instead opt for structural segmentation in operations seek to make sure that production and supply could survive if one region were to be cut off. So far, companies have attempted to localize across multiple regions to various degrees. Some have declared an “in market, for market” strategy, building localized production and supply chains so that in-market supply meets in-market demand as much as possible. Others have opted for a market-plus strategy, which entails a substantial footprint and supply chain—for both domestic and export purposes—in one region, supplemented by imports and exports as needed from other geographies.

Few companies are considering complete localization or the relocation of their entire production from one geography to another. Those that do so tend to only have a few affected product lines and focus on only the most sensitive portions of their supply chains. Indeed, as all goods supply chains start where resources come out of the ground, there is a natural limit to how much of a supply chain a company can practically relocate.

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[4] Geopolitical distance between countries can be measured by examining the countries’ observable behavior on foreign policy issues, such as through their voting behavior in the United Nations General Assembly.

Many firms are considering some degree of structural segmentation, however. A recent European Central Bank survey of multinationals with significant operations in the European Union, for instance, reports that 42 percent of firms plan to "friend-shore" production over the next five years, in contrast to only 11 percent that reported having done so in the past five years.[5] Similar trends emerge in supply chains. Our 2023 survey of supply chain leaders found two-thirds of respondents sourcing more from suppliers located closer to their production sites last year.[6]

While reshaping footprints and supply chains can segment geopolitical risk, it comes with costs and complexity. Some organizations may struggle to replicate supplier networks in new markets because of factors such as labor shortages and infrastructure limitations. For others, diversification efforts may only shift concentration risk from one tier of suppliers to another, without significantly reducing overall risk. A third challenge is the stickiness of supply chains. Even as many multinationals, for example, are expanding their footprints in geographies such as Southeast Asia, China's export share to ASEAN economies is also continuing to grow. That results in the deepening use of components made in China by multinationals in some supply chains.[7]

Ring-fencing research and development

With technology top of mind for business and world leaders, multinationals are having to adapt their R&D footprints. They can no longer rely on open access to talent and should balance geopolitical, regulatory, reputational, and commercial factors. Organizations may wrestle with questions such as where they should conduct R&D, who is conducting it, and with whom they should share it.

On one end of the spectrum of structural segmentation, some companies are seeking to fully localize their R&D in multiple regions. A leading life sciences company, for example, has opted to build parallel R&D efforts in two different markets that are geopolitically distant from each other. That way, it can sustain access to top talent in each market and preserve—and possibly enhance—its flexibility to develop products that meet varying local requirements.

Other companies are moving assets toward their home markets. Leading US technology companies are home- and friend-shoring researchers in sensitive technology domains, fully moving them away from markets that are geopolitically distant from the United States.

In the middle of the spectrum, some companies are maintaining R&D operations in markets that are geopolitically distant from the location of their headquarters. But they are introducing strict guardrails, including restrictions in technology arenas that are part of the strategic competition between nations or have multiple use applications like quantum computing and applied AI.

Companies that use these strategies often find they can not only mitigate risk but also gain a competitive advantage. A local R&D presence can make products more

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[5] Maria Grazia Attinasi et al., "Global production and supply chain risks: Insights from a survey of leading companies," *ECB Economic Bulletin*, 2023, Volume 7.

[6] Knut Alicke, Tacy Foster, Katharina Hauck, and Vera Trautwein, "Tech and regionalization bolster supply chains, but complacency looms," McKinsey, November 3, 2023.

[7] *Geopolitics and the geometry of global trade*, McKinsey Global Institute, January 17, 2024.

tailored to market-specific consumer preferences, fueling a global organization's local growth strategy. While the approaches vary, the motivating factor is the same: to build geopolitical resilience while preserving an edge in innovation.

Derisking technology stacks and data lakes

A unified global technology stack was once seen as a source of competitive advantage as companies sought to win through scale at low cost. Now, this strategy is under stress from multiple sources: the proliferation of data protection, privacy, and localization laws around the world; the increasing threat of data theft, malevolent-technology insertion, and espionage; and concerns about the overconcentration of data in markets where threats are present.

As a result, companies are revisiting their enterprise technology stacks and considering rebalancing their traditional approach to technology and data management. Some businesses are opting to adopt a globally optimized footprint, subject to local regulations, even if this involves hosting technology services in high-risk markets and accepting the associated additional geopolitical risk. A leading consumer company, for instance, took a local regulatory change as an impetus to localize its e-commerce stack, thereby improving in-market customer experience while managing compliance with the new regulation.

Increasingly, other companies are structurally segmenting their enterprise technology stacks in various forms. Collectively, the moves seek to adapt technology and data location to geopolitical and regulatory demands. Many are shifting toward structural segmentation not just to accommodate individual geographies but also to take a holistic approach to managing broader geopolitical risks, including those related to intellectual property theft and data appropriation.

One approach is to invest in a fully localized IT domain and separate sensitive data from high-risk markets. Our research shows many US companies, from private equity to professional services, are actively exploring or executing on efforts to fully decouple their tech stacks in sensitive regions. These moves follow escalating geopolitical competition and new expectations from customers and public stakeholders.

Even firms that have stopped short of full localization are introducing architecture changes, storing data in states that are geopolitically close to the location of their headquarters—subject to local regulations. Companies taking this approach aim to create a minimal viable technology footprint in geopolitically distant countries that then complies with the data and privacy laws of those countries. Cloud providers, for example, are developing new platform governance processes while disconnecting some markets from their global infrastructure backbones. Software companies in advanced fields like AI, the Internet of Things, and edge computing are separating these sensitive capabilities from their global offerings, often in partnership with local providers, to manage information security.

Creating decision-making distance through legal entities

Organizations are rethinking the role of legal entities and the part they play in navigating geopolitical challenges. Business leaders who have revisited their entity structures cite diverging regulatory requirements, increased in-market risk, and the intent to be seen as a local player.

One example of legal segmentation is an international defense company that redesigned its entities to enable it to operate as a local contractor in each of its major markets. Leadership and decision making are handled locally, while equity remains with the global parent.

Creating distance from the parent, however, can come with its own set of new challenges: functions are duplicated, costs rise, risk appetite between the parent and local units diverges, global culture can erode, and efficiencies are traded off.

In addition to these ramifications, there is a risk that entity segmentation may not be enough to offset geopolitical risk. The parent and segmented entity may still be viewed as one and the same—albeit now with potentially inadequate governance and risk controls.

Some companies have therefore gone further, judging that a continued overall parent was untenable. A leading law firm, for instance, has established a stand-alone unit for its in-country operations. Leading venture capital firms also have split off their regional businesses into new entities with distinct brands and local boards. In these cases, of course, the benefits of operating globally will be lost, and in some cases, a fully separated business unit has also turned into a major competitor in some markets.

Sometimes the same company has had to make more than one of these moves across the globe in a market-differentiated manner. One of the world's largest food and beverage companies, for example, is seeking to reacquire global ownership over one of its local franchises in the Middle East. It entered into a minority stake in a joint venture partnership with a local operator in China and later increased its stake, noting the need to anchor its partnership structure and to continue capturing increased demand in an important market. Lastly, the company fully exited and sold off its operations in Russia following Russia's invasion of Ukraine, citing the humanitarian crisis caused by the war and the unpredictable operating environment that rendered continued operations untenable and inconsistent with its values. From global ownership to local strategic partnerships to wholesale exit, this company has had to contend with multifactorial geopolitics and customize and evolve its approach across essential markets—a level of agility that global companies may need to develop.

Safeguarding capital invested in geopolitically distant regions

Geopolitical shifts affect capital flows. The International Monetary Fund, for example, reports that increases in geopolitical distance between two nations are associated with reduced investment.[8] Since 2015, direct investment in China and Russia has dropped precipitously, as a result of decreased spending from advanced economies in Asia, Europe, and the United States.[9] However, flows into other developing economies have increased, notably into Africa, India, and developing Europe (Exhibit 3).

[8] *Global financial stability report: Safeguarding financial stability amid high inflation and geopolitical risks*, International Monetary Fund, April 2023.

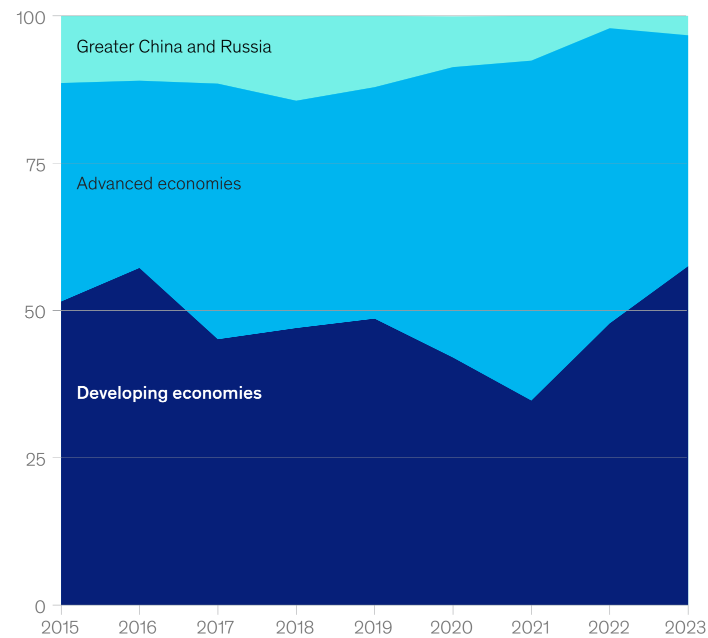
[9] *Geopolitics and the geometry of global trade*, McKinsey Global Institute, January 17, 2024.

Exhibit 3

Global investment is shifting.

Capital flows have moved to Africa, India, and developing Europe

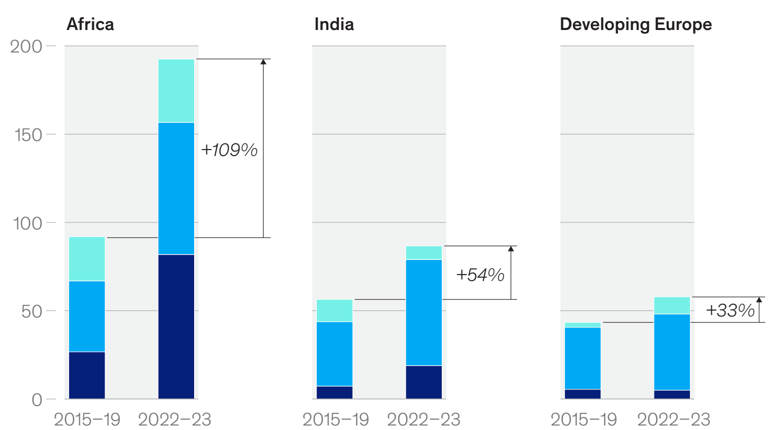
Share of global announced investment inflows, %



Announced greenfield investment in developing economies, nonexhaustive, $ billion

Source of investment:

- Greater China and Russia
- Advanced economies
- Developing economies



Note: Data for 2022–23 is through Oct 2023.
Source: fDi Markets (a service from the Financial Times 2023; all rights reserved); McKinsey Global Institute analysis

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In this environment, many global companies are selecting some form of structural segmentation, strengthening the geopolitical lens through which they examine capital decisions—be it the capital intensity of their business models or the capital structures by which they are financed.

Some companies are using a localization strategy, adjusting financing so cash inflows and outflows are exposed to similar geopolitical conditions: for example, financing the purchase of aircraft leased to airlines in a country with debt from banks in that same country.

An alternative approach is to move toward home, shifting capital away from more geopolitically distant regions. To retain connections in these markets, some firms have shifted toward partnerships and ecosystem plays and away from direct, tangible capital investment. The aim is to mitigate the risk of stranded or written-off assets, while bringing a local market's talent, networks, and capital to a venture. Other companies are taking capital off the table in higher-risk markets through liquidity events—such as IPOs, private sales, and share sell-downs—including to other international investors that are less geopolitically distant from the market in question. A number of global consumer goods companies, for example, have sold or leased fixed in-country assets, such as manufacturing plants and warehouses, to trusted local partners; these exchanges are underpinned by long-term contracts to enable supply chain stability.

Securing people and connections

The extent to which an organization can remain global is a question that is most delicate when it concerns people and culture. In keeping a workforce secure, organizations should find balance. They should preserve long-standing and cherished principles of global connectivity and a one-firm culture. But at the same time, they should address the crucial need to maintain robust screening and insider risk programs and reassure geopolitically concerned stakeholders of adequate people-related processes.

The reality is many multinationals do not have a choice in instituting some measure of structural segmentation with people; stakeholders ranging from government officials to customers increasingly expect them to do so. Some approaches include shifting the staff's home office locations, changing travel policies and protocols so that staffing pools are more localized by region, segmenting access to data on global networks from certain markets, and creating firewalls for certain communications outside market.

Organizations that conclude they need to implement such approaches should do so with care to avoid singling out a set of colleagues and, thereby, eroding the global fabric of the organization. Previous McKinsey research has shown that organizations that can operate as "one firm" are 2.3 times more likely to be in the top quartile of health and high-performing organizations.[10] Accordingly, multinationals may, for example, choose to limit discussions on geopolitically sensitive topics to senior leaders in headquarters, as well as to the top in-country leadership, to avoid inflaming internal sentiment and risking leaks that could trigger a market backlash.

Additionally, given the internal scrutiny that such segmentation approaches can generate, many multinationals are having to think equally hard about how to continue fostering a sense of global connectivity not only for cultural reasons but also for talent retention. One leading US firm that we spoke with has sought to shore up cultural cohesion by purposefully bringing the entirety of its incoming class of employees from a geopolitically distant market to global headquarters for shared learning and connectivity.

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[10] Blair Epstein, Caitlin Hewes, and Scott Keller, "Capturing the value of 'one firm,'" *McKinsey Quarterly*, May 9, 2023.

Business leaders know that healthy organizations that are inclusive and deeply connected can better deal with external change and crises. The challenge today, however, is fostering that sense of inclusivity and connection when geopolitical risk mitigation can demand segmenting the organization's global operating model in ways that create purposeful distance.

Emerging playbooks for structural segmentation

Broadly, we find that businesses typically adopt one of two postures—recommitting to a single global strategy or moving toward structural segmentation—and use it to guide decision making across each of the six dimensions. That said, companies do have the flexibility to follow a singular approach across all areas or otherwise adopt a more mixed set of tactics.

While every company's circumstances—and, hence, optimal response—are different, some archetypes are emerging. Asset-light companies require limited assets in-market to generate large revenues. These businesses might decide to follow a global approach to operations and capital, as their risks are inherently lower, while potentially segmenting technology stacks and legal entity structures to support agility in a volatile geopolitical context. More capital-intensive companies are progressively introducing (or at least thinking hard about how to introduce) greater segmentation across multiple dimensions, notably operations and supply chains, often with a market-plus strategy. Financial franchises present a special case: delegating decision making to semiautonomous regional entities and sourcing capital locally allows segmentation that both reduces geopolitical risk and accelerates growth.

Businesses with long-standing presences in geopolitically distant markets have more complex choices. Their de facto postures emerged out of decisions made during the last three decades. Given the costs incurred to establish their presences, these firms are more likely to stick with their current postures or change more incrementally—with segmentation occurring around the edges, dimension by dimension. The result is a mixed strategy: for example, implementing a segmented tech stack but doubling down on a global approach to people, R&D, and capital.

In setting their postures, business leaders should consider both risk management and growth strategy, as well as execution feasibility, of course. While they are more commonly reported on, not all structural-segmentation decisions have been made to reduce risk; quite a number have been made to, at least in part, enable more locally tailored and therefore resilient growth strategies in geopolitically distant markets.

Finally, these dimensions of structural segmentation play out at the market level, but deciding where a market starts and stops requires thought. Is the segmentation meant for a single country, a few countries—and if so, can they be treated together, or does each require distinct postures against the segmentation dimensions—or a broad swath of the world?

For leaders dealing with today's volatile geopolitical environment, Peter Drucker's maxim is more apt than ever: "The greatest danger in times of turbulence is not the turbulence; it is to act with yesterday's logic."

Structural segmentation is today's logic, one that business leaders are exploring both to navigate geopolitical headwinds and to potentially secure growth. Indeed, navigating the new geopolitics and geometry of global trade requires business leaders to conduct multifactorial calculus and at times develop market-differentiated approaches to structural segmentation. What structural segmentation is not, however, is a magic formula to eliminate all risk. Geopolitically distant regions by their nature present risk, as well as opportunity. Multinational companies must be prepared for greater scrutiny of their operating models globally, no matter how thoughtful a segmentation approach they may employ. Q

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