Think Globally, Act Locally  
by Robert F. Bruner

When you take a look around, it certainly does seem as if the economy has gone global. Foreign outsourcing, brands from around the world in car dealers’ showrooms, the World Wide Web, and even globalization protesters all seem to offer proof that globalization has arrived and borders have vanished. New research presented this spring at a Batten Institute conference, “Emerging Markets: Innovations in Portfolio Management,” presents a more complicated world economic picture, with national borders still clearly visible, and underscores the need to think critically about the globalization of the economy, especially seen from the perspective of cross-border equity investing. Stock picking is a telltale of larger economic forces and therefore can help reveal business trends that are otherwise hard to read.

Managers of global stock portfolios use three generic dimensions of selection: country of origin, industry, and company-specific factors. Which has the greatest effect on returns? In a string of studies stretching back to the early 1970s, researchers had found that country matters most, followed by industry. Last came company-specific factors (such as size, technology, and brand), which have always been of interest to stock pickers but whose effect can be reduced by portfolio diversification. Then, according to studies starting in the 1990s, industry rose in significance and dominated country as the main driver of the variation in returns of stocks in developed countries. This seemed to substantiate the conventional wisdom that global integration had arrived: with integration, industries should become vastly more influential in stock picking, and the importance of borders and countries should fade. Unfortunately, the effect proved to be temporary, driven in no small part by the bubble in technology, media, and entertainment stocks in the late 1990s. Still, the partisans of global integration have seen signs of resurgence in the industry factor since 2001.

The most serious test of global integration is among the stocks in developing countries. This was the focus of four presentations at the Batten conference. Consistent with other researchers, Bob Conroy, Wei Li, and I reported that the country factor explains a little more than half of the variance in returns, while industry explains between a quarter and a third. The gulf between the two effects is so great that it will take years for global integration to become the reality in stock picking among emerging markets equities.

Such research, which is just the tip of the iceberg of findings on global integration, poses a hefty paradox: the world is manifestly integrating, yet we are not at a stage where acting on the
basis of perceived integration is the most effective course. We can’t ignore global markets (with their attendant threats and opportunities), yet there is no reliable business model that works everywhere: the unified global capital market does not yet exist. The importance of countries as an explanatory factor tells us that instead of one global market, we still have many local markets. How should we handle this paradox?

Continue to look abroad. The mass of studies presents convincing findings that global diversification pays. Staying at home is simply not an option when competitors are taking advantage of foreign opportunities to increase returns, reduce risks, or both.

Segment the market. From a marketer’s perspective, customer demand in a market is rarely monolithic but consists of segments, each with different appetites; the marketer seeks special insights about specific segments as a basis for tailoring profitable value propositions to them. Thus it must be in dealing with markets beyond our borders. The investment research tells us that the 180-odd countries and numerous regions in the world constitute segments rather than an integrated whole. The thoughtful practitioner should see each segment for its specific needs and opportunities and act accordingly.

Recognize that lack of skill is costly. If you don’t know what you are doing, find someone who does, or stay home. Mark Kritzman, money manager and adviser to the Batten Institute, has argued that the dispersion of returns across countries is greater than it is across industries. More dispersion is good news for skillful investors because it enhances their chances of a profitable payoff. It is bad news for the unskillful, from whom the skillful investors earn their profits. The potential profit (or loss) embedded in the dispersion of returns across countries is large enough to give comfort to the small industry of country specialists, professionals who research local country markets for their latent risks and returns. This industry is in no imminent danger of collapse.

Invest on the basis of truly local knowledge. Fundamental research is the path to superior performance. When you invest outside your home country, you are making a significant “country bet.” The specialists who can help investors make this bet drill into the store of local data to glean insights about economic growth (macroeconomics), productivity and competitiveness (microeconomics), the health of laws and institutions, and culture.

As with the other great contradictions in business, the paradox of global integration requires us to sustain two contrary points of view. In the 1970s, environmentalists did the same, counseling us to think globally and act locally, a worthy course for businesspeople in the international context today. Thinking globally is easy: it is the rare firm not involved in some cross-border purchase, sale, or investment. It is much harder to act locally; doing so requires local insight.

Robert F. Bruner is executive director of the Batten Institute and Distinguished Professor of Business Administration at The Darden School. He can be reached at brunerr@darden.virginia.edu.