How are leading companies managing today’s geopolitical risks?
HOW ARE LEADING COMPANIES MANAGING TODAY'S GEOPOLITICAL RISKS?

ABOUT THE RESEARCH

The years since the global financial crisis have been tumultuous, not only in emerging markets such as Ukraine and Venezuela but as a result of unexpected election results in North America and Europe. How are the world’s leading companies managing such challenges? To find out, Willis Towers Watson and Oxford Analytica conducted a series of twenty structured interviews with panellists representing some of the world’s leading firms.

These companies are clients of Willis Towers Watson and Oxford Analytica. They are not intended to represent global companies, but rather, are a leading group that have a strong focus on and track record in political risk management. The majority are Forbes Global 500 companies; three-quarters are Forbes Global 2,000 companies; the remainder are smaller or privately held. The companies are mainly headquartered in North America, Europe and Japan and have significant on-the-ground assets and operations in “risky” regions. We also spoke to a few emerging market multinationals and domestically-oriented companies to provide a point of comparison.

The companies represent a cross section of industries including food and beverages, oil and gas, mining, pharmaceuticals, automobiles, and utilities. The majority of the panellists work in specialised political risk functions including government relations and corporate intelligence. The remainder of the panellists perform risk management roles, including enterprise risk management.

We found that these companies are taking active steps to mitigate political risk as they understand it, and that investors are increasingly holding management accountable for losses experienced due to political risk exposure.

At a glance

Believe political risk levels have increased over the past five years  89%
Use superior intelligence and analysis as a tool to mitigate political risk  68%
Have experienced a financial loss from political risk recently  63%
Mentioned rising investor pressure and scrutiny regarding political risk management  47%
Mentioned the US as a region where political risk was rising  47%
Mentioned the Middle East as a region where risk was rising  42%

Source: Oxford Analytica

Note: all charts based on structured interviews with panellists from 20 leading companies; not a representative sample.
Questions were posed in an open-ended format. Not all answers shown.
RISK CONCERNS
FINDINGS

1. Political risk levels and volatility have risen and are expected to remain elevated in part due to a lack of clarity about global leadership.

Political risk has always existed but, particularly in Europe and the US, political change has historically tended to be predictable and transparent. Changes in international relations have tended to be slow and incremental. The developed world had “legal reliability”, as an energy industry panellist put it.

Such certainties have evaporated, producing a new and difficult-to-classify geopolitical threat (listed as “end of globalisation consensus” below). As one panellist put it, “there is major uncertainty among the major industrial territories and how they will interact with each other”. A panellist in the automotive industry noted that “opinions, regulations, and initiatives are not being built from the same base”. It is hard to say how a shift so fundamental will play out and what related political risk perils might arise. In the near term, many panellists expressed concerns around trade policy and protectionism, and particularly the future of NAFTA.

Other oft-mentioned geopolitical threats were more conventional, such as regional tensions in the Middle East. That said, the nature of the threat in the Middle East is evolving and impacting companies in new ways. As proxy conflicts heat up in Iraq and
Libya, Middle Eastern countries are increasingly choosing sides. As a panellist from the energy sector put it, “an Arab Cold War’ has emerged following the Arab Spring – countries are picking sides and companies may be forced to do so as well”. A number of panellists mentioned the standoff between Saudi Arabia and Qatar as a possible source of near-term political risk losses.

The most frequently-mentioned specific geopolitical threat was US sanctions on Russia. Of course, risks from sanctions policy are nothing new for companies that do business globally. The twist in this case is the possibility of Russian retaliation and the implications for the US-Russia relationship, which elevates this regional risk into a top global concern.

2. Politically motivated regulatory change is having a significant impact on corporate risk exposure, with implications for tax rates, cross border trade and exchange transfer risk.

When asked about the most important types of political risk facing corporations today, panellists mentioned regulatory risks most frequently. Tax reform, cross-border trade and currency inconvertibility risks are also making it hard for multinationals to plan strategically.

Of course, the large corporations on our panel tend to find it easy to manage certain categories of political risk that smaller firms would find a challenge. As one energy sector panellist put it, “if things get tricky in one place, you concentrate your efforts somewhere else until things settle down a bit”. Another panellist noted that with sufficient investment and in-house capability, security risks can always be managed – the challenge is that the cost of managing these risks may make operations in a particular country unprofitable.

One surprise in the list of perils was cyber attack – not a traditional type of political risk. That said, cyber risks can increasingly have political origins including war and terrorism. “We were impacted by the NotPetya ransomware attack, which started in the Ukraine”, as a food and beverages panelist noted.

<table>
<thead>
<tr>
<th>Top political risk perils (mentions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulatory risk</td>
</tr>
<tr>
<td>Security/violence</td>
</tr>
<tr>
<td>Tax/royalty changes</td>
</tr>
<tr>
<td>Inconvertibility</td>
</tr>
<tr>
<td>Change in political regime</td>
</tr>
<tr>
<td>Breach of contract</td>
</tr>
<tr>
<td>Sovereign default</td>
</tr>
<tr>
<td>Cyber terrorism/cyber warfare</td>
</tr>
<tr>
<td>Confiscation</td>
</tr>
</tbody>
</table>

Source: Oxford Analytica.
3. Conflict between business and governments will increase as governments pursue redistributive agendas.

Since the financial crisis, low and negative growth in Europe and North America has created an environment of uncertainty and a focus on inequality. In response, one panellist argued, it is unsurprising that governments are using regulation as a policy tool to address differences between the haves and have-nots. As noted above, shifts in taxation policy were one of the most frequently-mentioned political risk perils. Such threats are not limited to developed markets. One panellist forecast that in an environment of lower resource prices many developing countries would increasingly become concerned with questions of redistribution.

Such risk pressures run contrary to the spirit of globalization that dominated and propelled global, regional and national agendas for the last 30 years. During this period – marked by integration, increasingly free movement of goods and capital, and international cooperation – governments often sought to lure investors with advantageous tax packages.

Perhaps as a response, several of our panellists mentioned localisation strategies as being central to their political risk mitigation toolkit (see the next section for more on mitigation strategies). “In many countries where we do business, people think we are a local company”, as one food and beverages panellist noted. A mining panellist said: “in-country holding companies should be a means to bring in independent locals and establishing good relations”. Several panellists mentioned the crucial importance of having in-country government relations teams in each market where the company operates.

4. Political risk concerns are rising, and many companies have experienced recent political risk related losses.

Countries where panellists had experienced a political risk loss (mentions)
Nearly nine in ten of our panellists noted that political risk had risen over the past five years, and more than six in ten had recently experienced a political-risk-related loss. Types of losses varied dramatically. While not traditionally a type of insurable political risk, several panellists reported experiencing losses from the collapse in the value of the pound that followed Brexit (“politically-driven exchange rate losses”, as one panellist put it). Losses reported in Venezuela, Russia and Egypt tended to result from more conventional political risk perils, such as civil commotion, contract abrogation and inconvertibility.

5. Political risk inverted: It's the world, Jim, but not as we know it.

A dramatic sign of the changing times was that the United States had the most mentions as the global country or region where political risk was rising. Many panellists mentioned the unpredictability of US policy. One executive took the view that the United States “is withdrawing from the world stage”, which is creating challenges for corporate strategic planning and supply chains. For instance, if one’s Asia headquarters is centred in Singapore, “is that still a wise decision if the US approach to the region may be changing?”

More broadly, as an energy sector panellist noted, it has been “a largely unspoken but widely held assumption” that the main corporate risk exposure in developed markets is economic risk, and in developing markets is political risk. The aftermath of the 2008 financial crisis at first appeared to confirm this assumption. “But the subsequent response to austerity measures adopted after 2008 in developed economies has led to a situation where risk there is very much political now”, he noted.

These novel challenges include Brexit, which netted the United Kingdom two mentions as a region of rising risk. Perhaps the only bright spot was Europe, where sovereign default risks appear to have declined after a lengthy Eurozone debt crisis. That said, one panellist mentioned risks from populism in Italy.

*Politics in the US and Europe is increasingly uncertain. By contrast, somewhere like Nigeria, though risky, is relatively predictable*
FINDINGS


Of course, the leading companies we interviewed were not taking a passive response to the changing risk environment. Many had already made major changes to their political risk management approaches, and created new corporate capabilities. In several cases, these new capabilities involved technology (discussed below). Other changes involved new processes that enabled corporations to marshal their organisational resources effectively, bringing intelligence from one part of the company to another, or bringing risk management staff together with government relations or external affairs.

For instance, one company had created a “central risk forum that addresses macro and interconnected threats,” as a result of the new pressures from the end of the globalization consensus, discussed above. Another had created a team within government affairs that issued a regular and widely-distributed “significant issues report”, which had proved its mettle with daily updates on the situation in Ukraine.

Other panellists noted changes in reporting and responsibility. For instance, a panellist in the building materials sector noted that the enterprise risk management function was no longer simply a source of intelligence and advice; it played an active role in devising solutions and reported to the board of directors. A panellist in the food and beverages sector noted that the executive board had been made directly responsible for political risk – an increasingly popular approach.

7. Mounting stakeholder pressure: Investors and the board are asking more questions because of the link between risk and valuation.

Events such as the Arab Spring, Brexit and the results of the US and UK elections have underscored limitations to existing risk mitigation strategies. As one respondent put it, “Investors are beginning to ask: if you don’t understand home market risks, imagine what you don’t understand in developing markets on which upside potential is premised”. One reason so many panellists reported that political risks have increased in recent years, as noted above, is that corporate exposure to these risks has increased, as companies increasingly rely on emerging markets to generate growth.

Most of the panellists noted rising pressure from external stakeholders regarding political risk management. About half specifically mentioned investors; roughly four in ten mentioned the board. As a result, the CEO and CFO increasingly appreciate that political risk is one of the factors that can be crucial in determining the success of country and global operations. Furthermore, investors want predictability and, given market and financial losses and volatility stemming from political risk, there is an expectation that CEOs will increasingly be measured on their ability to manage political risk. “Investors see us as a stable stock and expect us to manage this kind of risk as a matter of course”, as one panellist put it.
A number of panellists mentioned a growing pressure, both internal and external, for quantification. “One issue is that the technical people who tend to be in management at this organisation like numbers” noted one energy sector panellist. “They want to quantify political risk”. A panellist from the mining sector said: “Questions about how changing risks affect calculations around the value of the company are being asked by investors, and the company needs to show quantitative answers”.

<table>
<thead>
<tr>
<th>Sources of pressure to enhance political risk capabilities (mentions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investors</td>
</tr>
<tr>
<td>Board</td>
</tr>
<tr>
<td>Regulators</td>
</tr>
<tr>
<td>Home government</td>
</tr>
<tr>
<td>Internal staff</td>
</tr>
<tr>
<td>Banks</td>
</tr>
</tbody>
</table>

8. **Pressure in new directions: The expectations of governments and investors are changing.**

The recognition that effective management of political risk is a crucial component of business success is both a result of, and a reason for, the growing formalisation and professionalisation of internal risk management. But stakeholder expectations are not only rising, they are also shifting.

For instance, several panellists mentioned a shift in the viewpoint of investors and governments. As one energy sector panellist put it, “there has always been a divide between the extractive sector and civil society – what has changed recently is that regulators have moved over to join the civil society side, as have investors, in terms of their concerns”. Another panellist said that “one thing which has changed recently is the extent to which climate change is now an issue for investors, not just NGOs”. This theme of investors and regulators behaving more like NGOs in terms of their issues of concern was echoed by many of the panellists. In addition, two panellist mentioned that their home governments, the UK and Canada respectively, were increasingly concerned about reputational issues, and therefore seeking to exercise control over companies’ choices of business partners and locations.

9. **Technology and geopolitical risk: Get it before it gets you.**

A number of panellists reported a growing link between technology and geopolitical risk. For instance, as discussed above, cyber war and cyber terrorism are increasing threats. In addition, one mining sector panellist hypothesised that an indirect but important driver of the rise in regulatory risks was technology. “As a result of technology, citizens and communities are less isolated than ever before”, he said. “Technology has given them a voice and, in turn, more influence on legal requirements”.

“The chances we took in Russia just would not fly today”
But technology is not only a risk; it is also an increasingly important element of mitigation strategies. A number of panellists mentioned technology-enabled tools and systems. For instance, one panellist noted “we now have data on political risk which you can get in real time”. He reported the experience of tracking social disturbances in Bangkok live via a map derived from social media. Another panellist noted “we are moving towards the professionalisation of the function, including using data to support decisions”, referring for instance to guiding local risk mitigation strategies using public opinion research.

---

10. The imperfect solution: Corporates recognise the need to do more, but a more concentrated focus on political risk may neglect broader trends.

Political risk is still, in many cases, regarded as a cost of doing business, not an enabler of higher profitability by opening up new potential markets to the company. This view has translated into the political risk function being relatively isolated in most organisations; a complaint that even our panellists from leading organizations reported.

This siloed and disjointed approach to political risk management is partially apparent in what was not mentioned in response to some of our questions. For example, no government affairs respondent identified cybersecurity as a leading political risk concern. One consequence of a siloed risk function is that few people think about political risk at a firm-wide level.

As such, to become more effective, the political risk function will need to engage beyond existing high level silos. At the moment, as one executive stressed, “so much of risk involves a combination of political, economic, social and environment issues that it can be hard to analyse them together within a process-driven approach”. To overcome this issue, a minority – but a substantial minority, about one in three – of our panellists reported adopting a coordinated organisation-wide process to either share intelligence or coordinate responses on political risk (such as the central risk forum mentioned above).
11. Thinking differently: Countercyclical political risk management.

Many of the companies we interviewed adopted financial strategies to manage political risk. These included strategies that reduced corporate exposure to risky countries, such as using joint ventures or operating via services companies (an approach labelled “exposure minimisation”, above).

Sometimes, however, it pays to go against the grain. As one panellist pointed out, “assets on the ground increase our risk exposure, but they also increase our political leverage”. Another panellist contended that the success of their business in Russia today had been, ironically enough, partly a result of the country’s 1998 currency crisis. “When the currency collapsed we continued to provide our distributors with product even though they could not pay for it”, he said. “After the recovery, many were actually stronger, and our market position had improved”.

12. Political risk assessments needs to become not just more responsive but more persuasive.

Another complaint of even our panellists in large organisations was that even accurate analysis is sometimes not acted upon. Many companies’ approaches to political risk management continue to be reactive rather than proactive, and intelligence-oriented rather than mitigation-oriented. A frequent complaint from our panellists is that geopolitical analysis is often valuable but rarely actionable in the short term.

As one panellist – from a company with extremely well-developed capabilities – put it: “the first test of the analysis is: how did you do in anticipating what happened? The second is: did management take any action specifically as a result of your work? One inevitably scores less well on the second than the first”.

The incorporation of political risk into operational decision-making will require an increasing mix between qualitative and quantitative analysis in order to “inform, warn and persuade” different internal and external stakeholders, one panellist noted. Learning a lesson from the financial crisis, one automotive sector panellist pointed out that “risk management is difficult if: 1. The numbers are positive and as such do not yet reflect rising risks; and 2. A negative outlook is a non-consensus view”. In such circumstances, the political risk function’s influence can be limited to stakeholders that “speak the same language”. A major part of improving political risk analysis is improving not just its accuracy, but its persuasiveness.

“An unspoken assumption is that there is a solution to every problem if you work hard enough – this is not always the case with geopolitical risk, which often involves adjusting to new realities”
CONCLUSION

The nature of political risk is changing, with the apparent end of the US-dominated globalisation system, a growing regulatory reaction to inequality, and an ongoing challenge from populism. Leading companies have suffered political risk losses, and agree that geopolitical risk levels and volatility have risen, but are responding proactively, building new capabilities and adopting new mitigation techniques. Crucial to the success of this transition will be the extent to which the political risk function can integrate itself into decision-making processes across the organisation by effectively supporting business risks and opportunities.

Externally, growing investor pressure is likely to mean that companies will increasingly be compelled to benchmark such capabilities against their peers. Our structured interview research provided us with a great deal of food for thought as we contemplate today’s rising geopolitical risks. We would like to thank the panellists for their time and insights.
We combine our global network of over 1,400 experts with high-calibre in-house analysts to deliver authoritative and relevant analysis and advice.

A rigorous process of validation ensures timely and impartial insights. Our empirically proven methodology results in heightened prediction accuracy.

Oxford Analytica is a global analysis and advisory firm which provides an edge in understanding the impacts of political events, and economic and social trends.

– The Oxford Analytica Daily Brief®
– Global Risk Monitor
– Advisory Services
– Training and workshops
– VAPOR (Value at Political Risk)
– The Oxford Analytica Conference

www.oxan.com