The CEO as Chief Geopolitical Officer

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Today's geopolitical environment is nothing like what we've seen in the past. CEOs are beholden to the outputs of an increasingly complex geopolitical system that moves at an accelerated pace, with few guardrails. Outcomes are hard to predict without careful focus. Time to react is limited. Only by moving politics to the forefront of strategy, and personally being the point (wo)man for geopolitics can a CEO lead their organization to success in turbulent times.

Geopolitics: a boardroom issue

Adapting to today's changing landscape.

Politics is nothing new — companies have long seen their fortunes rise and fall on the decisions of lawmakers and the onset or cessation of wars. Many have become quite good at reacting to events or at least buying insurance to limit risks like expropriation. Teams of lobbyists and public relations companies fight for the opportunity to express the wishes of their client businesses and react to limit damaging events.

However, today's geopolitical environment is nothing like what we've seen in the past. CEOs are beholden to the outputs of an increasingly complex geopolitical system that moves at an accelerated pace, with few guardrails. Outcomes can be hard to predict without careful focus. Time to react is limited. Downside risks may often be too esoteric to adequately insure away. Plus opportunities from political shifts can be exploited by competitors before a CEO even understands what is occurring.

This report reasons that only by moving politics to the forefront of strategy can a CEO adequately steer today's global businesses. Such thinking starts with an acceptance that global companies are assumed political entities and CEOs de-facto political players. It means recognizing that a different approach is required, one that elevates politics in the boardroom and puts it on a par with other strategic challenges. Furthermore it requires CEOs to personally play the role of Chief Geopolitical Officer (CGO), using specialized insights and stress-testing tools to focus the company's attention on managing an increasingly uncertain environment.

> "We need to **reposition our businesses more deliberately given a very polarizing political environment.** We must be more nimble, recognize the shifting client sentiment in terms of pricing, cyber security and regulatory transparency as well as consumer and corporate activism."
>
> Mitchell Harris
> CEO, BNY Mellon Investment Management

New world: new rules or no rules?

Speed and interconnectedness are hallmarks of 21st century society, and the intersection of geopolitics and business is no different.

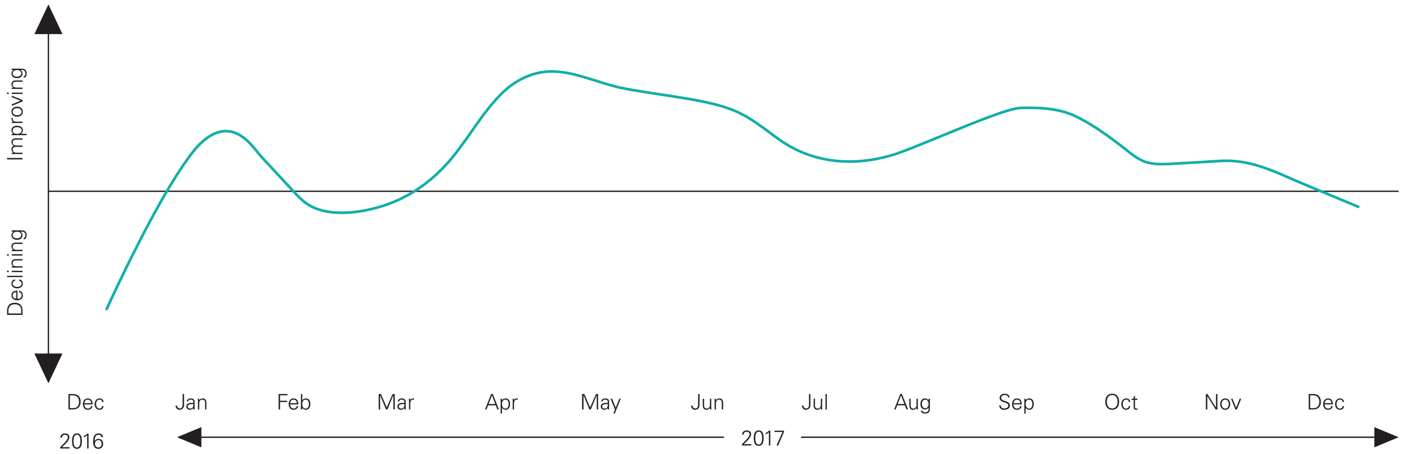
In the past, high politics would play out over months and years of negotiations at the United Nations, or the G20. There were rules of engagement and competing interests to be balanced. When all else failed, the country with the upper hand could simply impose its will. For businesses caught in the middle, they had time to react and reposition — and often could insure away core business risks like civil war or political violence.

Today, politics moves at the speed of social media. Rifts are instantly public, and opinions are shifted and shaped in hours. Politically expedient labelling of other countries can fundamentally change the playing field for an entire sector virtually overnight. Even within a nation's boundaries, shock-and-awe political moves like demonetization in South Asia or a corruption purge in the Middle East can unleash a decade's worth of change in days.

In essence, the global economy is more exposed to political instability than at any point in recent memory. Figure 1 is one way to think about this. The line represents whether the impact of politics on the business environment in countries that make up most of the world's GDP is improving or worsening. Admittedly, it is a small slice of data in a particularly turbulent political time, but the variability and trajectory may not be far off the new normal for the short-to-medium term.

> "**Investors today are confronted with a dramatic increase in the political risk profile** of what were supposedly low-risk, or indeed risk-free, developed markets. A dozen years ago it seemed geopolitical risk was a thing of the past, and that the apparent dominance of the liberal economic and political model had indeed heralded the end of history. Now **geopolitical risk has returned as a great shadow on the horizon of all significant investment decisions.**"
>
> Duncan Wales
> CEO, Exotix

Figure 1: Impact of Politics on the Global Economy[a,1]



Legend: Periods where the impact of politics on the global business environment is positive (above the line) or negative (below the line)

While opinion may be diverging on the current speed and future forecasts for globalization, it has undoubtedly added to the complexity of today's corporate world. Companies have transitioned from national, to multinational and for some, to global corporations. CEOs find themselves facing new, unfamiliar and complex situations — often resulting from geopolitical issues — which they may have had limited exposure to in their previous core markets. Exposure to this political instability can be particularly marked for businesses that have expanded into frontier and emerging countries with potentially weaker institutions, civil unrest and low resilience. At the same time, previously 'stable' developed markets can also become politically turbulent from the rise of populism, nationalism and country-first approaches to international trade.

For the global CEO, the odds are increasing that it is a geopolitical event they must explain as the root cause for a performance challenge.

a. The line graph summarizes a GDP-weighted diffusion index of all Political Trajectories. At points above 0, most of global GDP is represented by countries with improving Political Trajectories (month/month); below 0, most of global GDP is represented by countries with declining Political Trajectories (month/month).

1. Eurasia Group analysis of proprietary, International Monetary Fund (IMF) and World Economic Outlook (WEO) data.

The modern CEO: business (wo)man or politician?

In addition to geopolitics imposing new threats, CEOs are being held to new standards.

Many companies are larger economic entities and with potentially greater influence than the countries in which they operate. According to one estimate, 69 of the top 100 wealthiest economic entities in 2016 were corporations, not countries[2]. As a result, they have essentially become political actors assumed to have political agendas. The 'revolving door' between CEOs and top political appointments in developed and developing countries alike has further reinforced this perception. If top business roles are seen as stepping stones to political careers, the public will expect a CEO to behave like a politician even while they simply occupy a business seat.

Corporate leaders are looked to for social media comments and responses to political events almost in real time. In a world without social media, 'no comment', 'we are monitoring the situation' and 'our company does not take political positions' were previously reasonable public positions. This is no longer the case, and any CEO who appears unprepared on political matters of public interest may be seen as aloof at best, and inauthentic at worst.

> "Earlier, you would communicate if asked, so you had a lot more time to think about it and respond. Now, **you have to have an action plan pre-emptively ready.**"
>
> Former president of a global beverage company

> "**During these times of profound political and economic change, business leaders cannot sit on the sidelines and watch.** We need to be a force for change, and draw on our missions and our values to make a difference — and we need to partner across the public and private sectors to address the economic pain points."
>
> Dan Schulman
> CEO, Paypal

2. 10 biggest corporations make more money than most countries in the world combined, Global Justice Now, 12 September 2016. (https://www.globaljustice.org.uk/news/2016/sep/12/10-biggest-corporations-make-more-money-most-countries-world-combined)

> "**Political risk is the new fox in the chicken coop.** Boards that are used to routine dashboard-style reporting of operational and financial risk find there is now a more dangerous and apparently less predictable factor in play — politics."
>
> Lord Malloch-Brown
> former UK and Global Civil Servant and now Senior Member of multiple Boards

Beyond the general public, Boards are also increasingly unwilling to accept a shift in 'external conditions' as an explanation for failing to deliver results. Many companies whose earnings were affected by the volatility of the British Pound in the wake of the Brexit vote report having tough conversations at Board level about whether they could have prepared and mitigated better. Boards have grown in confidence in their responsibility to act on non-traditional business risks such as climate change, cyber security or ethics. No longer is the ability of management to fully measure or forecast a 'new' risk seen as an acceptable response and having a list of 'known-unknowns' can be seen as shirking away from the issue. CEOs can expect Boards to want to see geopolitics appearing on the risk register, as well as mature mitigation and response plans.

Perhaps the thorniest issue of all is connecting with employees and customers by taking public positions on politicized issues. Some will expect the company to take a public position — and those that do might be on opposite sides of the issue — while others would rather see it kept quiet.

> "There were many political decisions I did not agree with and wanted to speak out against. But I knew that if **I went public with my views, I would alienate a significant portion of customers and employees.** So I tended to keep my head down, but if asked, would give my honest opinion."
>
> Former head of a global insurance giant

How smart companies are responding

Three proactive responses to today's geopolitical uncertainties.

1 Appoint a Chief Geopolitical Officer

A CGO is a member of the senior leadership team with single-point accountability for managing the impact of politics on the company's business interests. They work closely with functional experts (particularly government/public affairs teams) and other executive portfolios (particularly Strategy & Risk) to maintain a whole-of-company view.

This is a job for the CEO personally. In times past, having a dedicated government/public affairs team was in itself a sufficient response. Now it is simply the start. Those professionals are highly effective when issues are well defined, lines of engagement with government are clear and open, and government counterparties have capacity. Issues of industry regulation and technical operating standards still largely present this way.

Yet, those teams need cover and connections to be effective in today's world of greater geopolitical noise. Cover means that CEOs need to be willing to be the face of government/public relations instead of delegating public engagements to the team, with acts such as taking meetings with officials and being visible in the media. This gives the government affairs team credibility externally and within the organization.

A strong government affairs team may remain severely under-utilized unless joined at the hip to strategy, business planning, risk and public relations functions. Generally only someone sitting in the CEO's seat has the visibility and influence to do this successfully. Signs that this collaboration is tight and working as it should include:

— having an 'all bets are off' business plan scenario

— geopolitical considerations at the center of market entry/rationalization decisions (rather than an afterthought) and

— a risk register where geopolitics is incorporated into other risks rather than a standalone line item.

In short, companies could do better in the current geopolitical environment if someone is responsible for navigating through political volatility. Else, business strategy will be anchored on business metrics like market sizing without discounting for the likelihood of execution and realizability due to politics.

> "Firms need to recognize that the PR department cannot influence real change, and the **Chief Executive needs to be talking to the relevant political actors personally.** This matters especially when it comes to regulators, who generally — despite best intentions — tend to try and stymie nimble and flexible behavior by large corporations."
>
> Former head of a global financial services firm

2 Conduct a geopolitical stress test

Getting a handle on current levels of activity and exposure to geopolitical developments is an important building block, especially if this hasn't been a subject of active thought for the CEOs.

One way to do this is to conduct a geopolitical stress test on the strategy and planned initiatives.

For example, virtually every company would be gravely affected by a global outage of transport or communication networks, which is not a far-fetched scenario in a time of heightened geopolitical tension. A stress test could help evaluate the impact of such disruption. A CEO could take their company's 3-year business plan and model the following scenarios (individually or collectively) to get an idea of their exposure and resilience:

Figure 2: Evaluating the company-wide impact of geopolitical risk

Area of disruption	Examples
Financial model Key fundamentals of the financial model — interest rates, tax rates, tariffs etc. — could face significant change following political or regulatory shifts.	— 2x increase in operating expenditure of transacting across borders (financial hedges, professional fees, regulatory compliance, travel costs and the like). Consider that such a doubling of expenditure is in the ballpark of what many businesses contending with Brexit are accounting for. — Monetary measures or geopolitical tensions leading to large swings in global currencies, stock markets or commodities.
Business model The attractiveness and feasibility of aspects of the business model, such as geographical footprint, product attractiveness and customer profile, may also be challenged by geopolitics.	— The loss of access to a key geographic market, perhaps as a result of sanctions, damaging political interference or even loss of cross-border passporting arrangements. — Restrictions imposed by new product regulation or issues product/ material supply chains. — The impact of a significant deterioration in customer sentiment.
Operating model Key components of the operating model — core processes, technology and operations infrastructure etc. — could be significantly destabilized by a geopolitical event.	— 72-hour outage of information backbone (website, online gateways, encrypted messaging services and similar). For reference, if a major cloud provider went down in a cyber-attack, the economic damages are estimated to be similar in scale to that of a physical event such as Hurricane Sandy or Katrina (an estimated US$50-120 billion[3]). — Zero cross-border travel for one week (no plane, train or road journeys across international borders). Consider for example, the very real threat of an imminent global flu pandemic[4] or perhaps the impact of a sudden change in a country's immigration restrictions or governments' travel advice by country. — Double transport time (and/or cost) of transporting goods (sea, air, road, rail). Such an outcome is wholly plausible in the Strait of Hormuz, through which one-fifth of global oil is transported, given current geopolitical tension in the region. — Potential restrictions on the movement of people which may impact staff availability in scenarios like Brexit.

3. Emerging technologies drive more risks than firms can protect against, Global Trade Review, 17 January 2018.(https://www.gtreview.com/news/global/emerging-technologies-drive-more-risks-than-firms-can-protect-against/)
4. We're not ready yet for a flu pandemic, Gulf News, 10 January 2018.(http://gulfnews.com/opinion/thinkers/we-re-not-ready-yet-for-a-flu-pandemic-1.2155062)

Such exercises can be highly instructive and do not require significant resources to perform. One way of building them into the slipstream of ongoing health checks is to frame them in the spirit of an assurance exercise. Geopolitics is now well placed to be included in the scope of a company's core risk management framework alongside other 'new' risks such as climate change and cyber security. However companies choose to do this, a regular stock take of the geopolitical risks and opportunities is now essential to business resilience. Perhaps more importantly, businesses should aim to develop appropriate responses or contingency plans for different scenarios, and embed them into their strategy as appropriate.

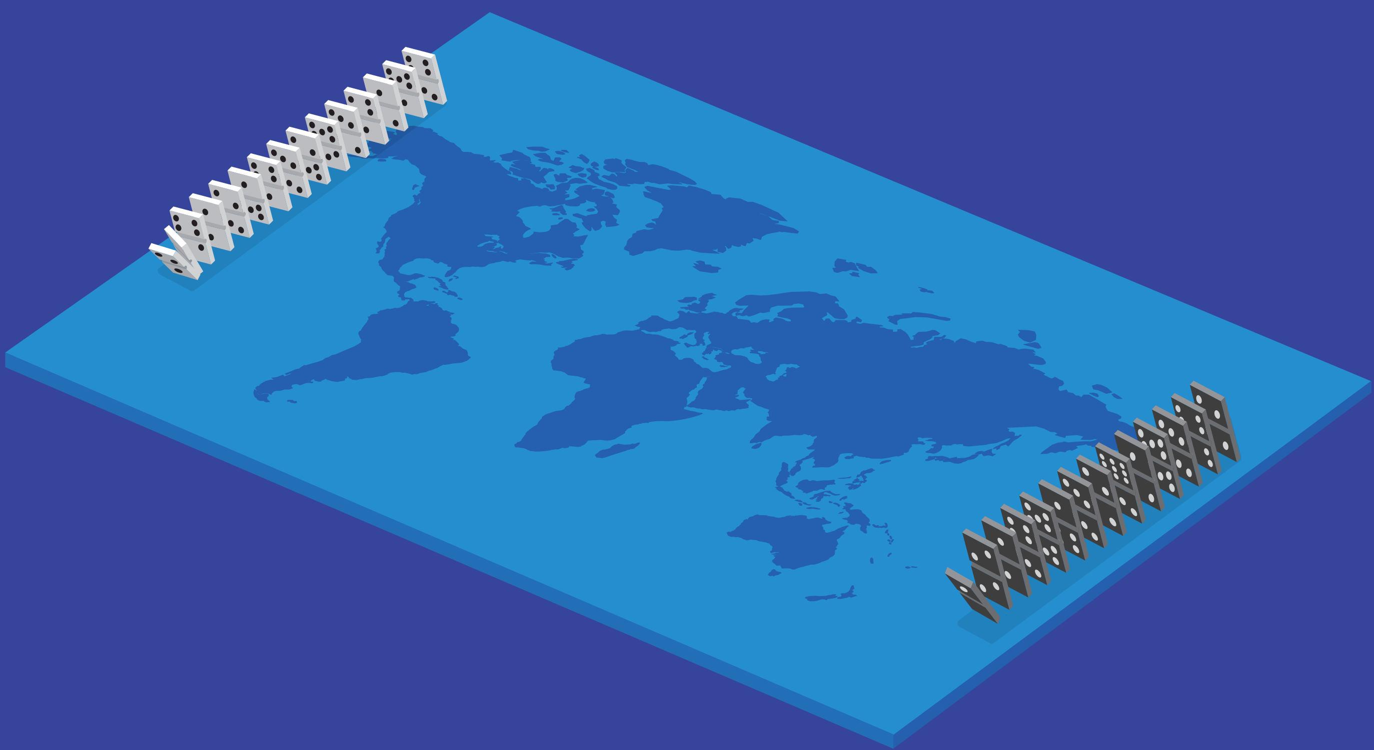
3 Implement a geopolitical forecasting and monitoring solution

For companies to truly feel like they have a handle on geopolitics, they should go beyond relying on mass media for information and invest in specialized geopolitical forecasting and monitoring capabilities.

It can be tempting to feel covered on the basis of easy and costless access to news coverage and analysis. However, it is precisely the 24/7 news cycle and the over-abundance of current affairs coverage and commentary that makes it more important to be discerning. In a noisy world, it can be harder to separate fact from fiction, sentiment from strategy, and decisions from drama. However, there are tools available to help companies navigate this landscape in real time, and support available from specialized teams of political analysts focused on covering politics in real-time and translating those into business implications.

If the core argument made here that politics is central to business decisions holds true, then it is only appropriate that the data and insights that teams have access to are of the same standard as in other areas. For example, just as investment teams would have access to specialized financial information feeds and not rely on internet searches or ad-hoc meetings, anyone in decision-making positions should be equipped with the best geopolitical insights from within and outside their organization.

Similarly, it is not just the fast-paced and changing geopolitical environment which needs to be monitored. It is becoming increasingly important for businesses to truly understand and get to know not just their customers, but other stakeholders with influence over their business. What are their sentiments and how are they changing? Which geopolitical risks would be most material to their behaviors? What can be done to minimize risks and capitalize on any opportunities this may present?



Kick-starting the discussion

Is your business wired for geopolitical change?

Geopolitics is nothing new, but to succeed in today's charged environment, companies are going to have to do things differently. It starts with recognizing that politics influences the business environment more than it has for decades.

While it might be easy for CEOs to have a relatively informed view on this new geopolitical landscape, it's hard to be a specialist — particularly when economic logic is seemingly no longer a constraint on politics and companies can take nothing for granted. Furthermore, while a 'wait and see' approach might be seen as the easiest route — especially given the range of known-unknowns or unknown-unknowns defining the current social, political and economic environment, the signals can be predicted if you look in the right places, risks managed if you know how, and opportunities exploited if you can turn foresight into action.

In this paper we have explored three proactive responses to the current geopolitical environment which should help make CEOs view themselves and the companies they lead in a different light; as takers of political risk and opportunities, but also as shapers of societal outcomes. There are also a range of boardroom questions which should be high on the CEO agenda to kick-start the discussion and identify geopolitical implications for financial, business and operating models.

While geopolitics has the potential to disrupt, for those that are prepared and ready to act, it can also create opportunities. Armed with a well thought through strategy, analysis and information, an effective CEO acting like a Chief Geopolitical Officer can help lead the company towards a more certain path in an uncertain business world.

Financial model:

- What business planning assumptions could be derailed by geopolitics?
- Have your financial forecasts and business plans been stress-tested for geopolitical disruptions?
- What does increased geopolitical uncertainty mean for the availability and cost of capital and resources?

Business model:

- How resilient is your business to the loss of a key customer as a result of a geopolitical event?
- How could your distribution network or product portfolio be impacted by major geopolitical changes?
- Which new or alternative markets should be explored in light of possible political trajectories?

Operating model:

- Who in the business is responsible for monitoring, analyzing and interpreting geopolitical events?
- Is your operating model sufficiently agile to respond to a surprise geopolitical event?
- Is your geopolitical intelligence of comparable quality to financial and operational data?

About Eurasia Group

Eurasia Group is one of the world's leading global political risk research and consulting firms. KPMG International has formed an alliance with Eurasia Group to develop solutions that help businesses deal with geopolitical challenges.

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