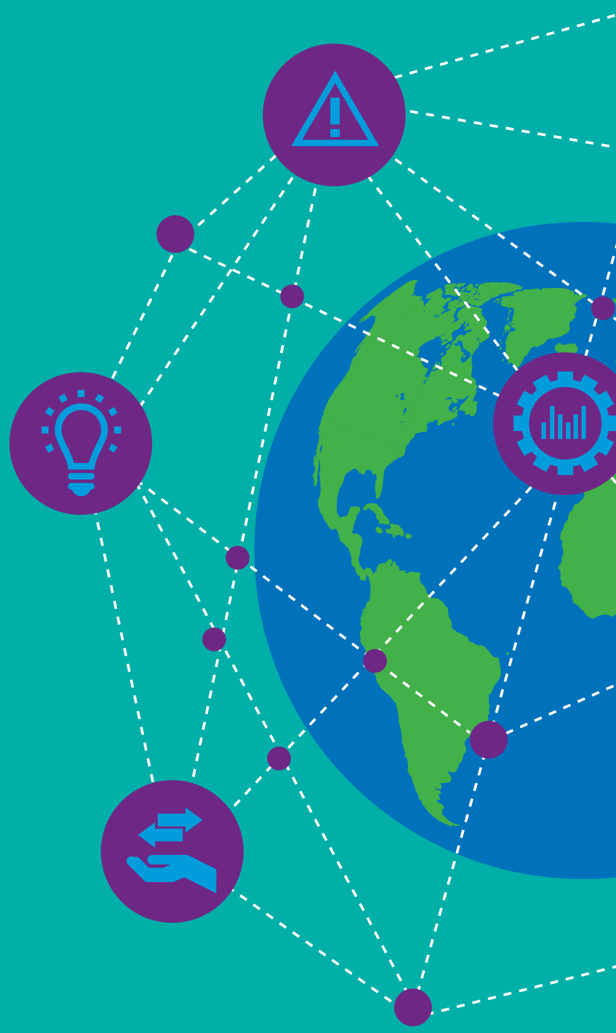
# Growth in a G-Zero world



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The global order is unravelling. In every major country, our societies are more divided than ever into ‘us’ vs. ‘them’ camps — and it is changing the rules of the game for business.

Yet this geopolitical upheaval has sown seeds for new forms of growth that should give much cause for optimism to those that cut through the noise to seek it. In the following pages, we look at how you can transform and grow your business to take full advantage of opportunities in this politically turbulent world.

Define : eurasia group politics first

## Given the state of the world today, we all risk getting stuck in a geopolitical doom loop.

It is true that much of the world order as we've known it since the fall of the Soviet Union is disentangling in front of our eyes. Friends are becoming foes as alliances unravel. Zero sum has replaced shared value as the main organizing principle for key trading relationships. And in every major country, our societies are more divided than ever on virtually any issue into 'us' vs. 'them' camps. In these times, it's easy to feel chronically negative about the state of the world and the prospects of the businesses we seek to grow. Risks can feel omnipresent and outcomes hard to control. Action suffers, and with it, hope fades.

Trust inequality has hit record highs, with a 16 point gap between the informed public and mass population.[1]

## Yet, there's an antidote: data and fact.

Hans Rosling in the now widely-popular book Factfulness uses data to reveal the secret silent miracle of human progress. He shows how on virtually any development indicator, the world is improving by multiples of what even the most informed amongst us guess it is. That's unequivocally a good thing. The same is true for prospects for business growth. This period of a 'geopolitical recession' has been accompanied by the most expansive economic boom in the last half century.[2] Even the geopolitical upheaval has sown the seeds for new forms of growth that should give much cause for optimism to those disciplined enough to cut through the noise to seek it.

As hyperbolic as media coverage around these issues can be, there are three reasons why things are not as bad as the news cycle may make it seem.

**Firstly**, it is true that the global economy has felt the effects of current trade frictions, with the IMF expecting overall GDP growth to drop from 3.7 percent in 2018 to 3.5 percent in 2019.[3] Yet two vastly bigger trade pacts made significant progress in 2018 that will make it easier to do business across borders.

1. The first, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) came into force the beginning 2019. The 11 countries that make up the CPTPP constitute 13.3 percent of global GDP and the agreement reduces 95 percent of tariffs between them.[4]

2. The second, the Regional Comprehensive Economic Partnership (RCEP), is an even bigger deal, literally and figuratively. It is a trade agreement comprising 16 countries, including ASEAN plus six states (Australia, China, India, Japan, New Zealand, and South Korea). The deal covers around 30 percent of global GDP and 46 percent of the global population, which makes it the world's largest trade bloc.[5] While not yet finalized, there are positive signs towards its implementation in the next 12 months, with India's participation being the key unresolved matter.[6]

1 Edelman (2019). 2019 Edelman Trust Barometer.
2 World Bank (2018). GDP current US$.
3 IMF (2019). World Economic Outlook Update, January 2019.
4 New Zealand Foreign Affairs and Trade (2019). Comprehensive and Progressive Agreement for Trans-Pacific Partnership.
5 World Bank (2019). GDP current US$.
6 The Hindu Business Line (2019). ASEAN Trade Ministers persuade India to speed up talks on RCEP.

## Business across borders

Two mammoth Pacific trade pacts are advancing.


Source: Bloomberg (2018). TPP is a big deal with or without the US.

**Second**, current trade frictions are creating positive externalities in terms of the direct opportunities created for third countries. Take Vietnam for example. It stands to gain in a variety of sectors from the shift in supply chains that would have previously bypassed it in favor of Chinese-domiciled manufacturing. South Korean investment in the country came to US$1.97 billion in the first half of the year, exceeding South Korean investment in China — US$1.60 billion over the same period — for the first time.[7] Notably, Samsung Electronics, the world's largest mobile phone maker, closed its China network equipment manufacturing unit in Shenzhen and moved a production base to Vietnam.[8] Other countries, such as Malaysia and Thailand, have already shown similar gains in sectors like automotive and ICT.[9]

And this is not simply an Asian play. Countries in Europe and Latin America too stand to gain from the dislocations in trade patterns. Mexico for one is well placed to substantially grow its exports of electrical machinery to the US, which amounted to US$62 billion in 2017.[10] Similarly, manufacturing in Germany is expected to see a boost as a result of these changing trade and demand patterns, particularly in the chemicals and plastics industry.

Further, as Chinese economic growth — even in the low 6 percent range — continues, its trade relationships will give the global economy sustained impetus.[11] The chart on the opposite page shows the largest trading partner for countries around the world by value; China's rise to be the world's largest economy can be a source of demand-led growth in a number of economies around the world.

The **third** and final reason is populism — or the expanding group who believe their political systems can't meet their needs. High levels of social inequality, empowered by social media, has created political momentum for candidates willing to push for redistributive policies, and there has been a clear political tilt in advanced industrial economies away from more progressive social and free-market economic issues towards social and economic nativism.

Yet whilst 'populism' has begun to be used interchangeably with nationalism, the phrase has come to encompass all matter of political leanings: left and right; anti and pro-immigration; inclusion versus exclusionist. Whilst this polarizing trend is being politically exploited, it is a force for change, and is playing out in a much more nuanced way across social, security

[7] The Export-Import Bank of Korea (2019) Statistics of Foreign Direct Investment.
[8] Reuters (2018). Samsung to shut mobile phone plant in China's Tianjin.
[9] Economist Intelligence Unit (2010). Creative Disruption: Asia's winners in the US-China trade war.
[10] Financial Times (2018). Rivals seek to profit from US-China Trade War.
[11] The State Council of The People's Republic of China (2019). China sets 2019 GDP growth target at 6-6.5%.

## China’s economic reach grows

Largest trading partner by total trade values


Source: UN comtrade and Eurasia Group

and economic policies. While disenfranchisement of local populations in countries like Spain and Greece have led to similar spikes in anti-establishment sentiment, it has resulted in left-oriented parties seeking reforms that amend the social contract with citizens, at the same time as supporting (broadly) progressive economic policies within stronger governmental and supranational institutions.

Even in those countries exhibiting more nationalistic tendencies, we have continued to see support for pro-business reforms like multilateral trade agreements and anti-corruption initiatives (think Mexico and Brazil). We have also seen a motley assortment of non-state actors (mayors and governors, private sector leaders and philanthropists) emboldened to align in a longer-term strategic way towards global challenges — the most obvious being climate change — effectively acting as a brake against nationalist policies.

Of course, there’s much more to this ‘G-Zero’ multi-polar world and the impending economic slowdown than just populism and trade; we explore a number of those other issues in other sections of the report.

> But it is worth remembering that if on issues this emotive and sensationalized we can find reasons to be hopeful, then perhaps there’s much to feel positive about in many other parts of the world.
>
> — **Rohitesh Dhawan**
> Macro Strategist, Eurasia Group

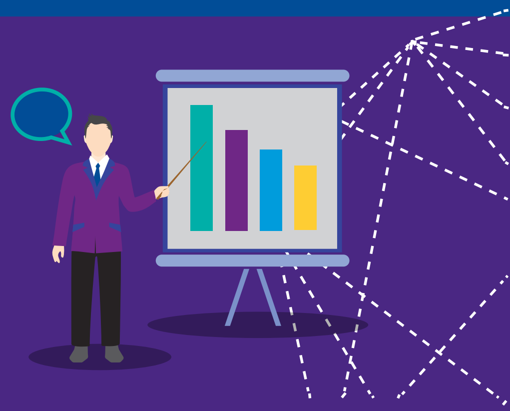
# Transform

"Businesses have come to realize that with geopolitical uncertainty comes either paralysis or opportunity. Most are now choosing opportunity — and those that can read the interconnected proverbial 'tea leaves' and are willing to take unflinching action are coming out ahead."

— **Doug Zuvich**
Global Trade and Customs Lead

Without falling prey to the geopolitical doom loop mentioned by Eurasia Group, the politics may hit the economics soon enough. We were lucky in 2018 — global growth was good (enough) and our economic powerhouses were largely (but not totally) shielded from the politics playing out on the global stage. But increased friction from country-first trade, immigration and investment policies across the developed world has the potential to drag on economic growth. When combined with the skyrocketing levels of public and private debt, governments may have arguably less room to manoeuvre and address the structural issues that gave rise to populist sentiment and policies to begin with. Which could mean a more uncertain and volatile environment for business to grapple with — both economically and politically.

The total global debt burden has hit 225 percent of GDP.[12] It is higher still for countries with systemically significant financial sectors at 250 percent of GDP (from a mere 210 percent in 2008).[13] In the private sector, more than a quarter of firms in the S&P 500 have a net debt exceeding three times gross operating profits.[14]



The shift from global convergence to divergence with borders rising in some parts of the world and barriers falling in others is a trend that could continue. As Eurasia Group points out, the resultant tectonic shift in the global business environment offers as much opportunity as it does risk. Our key take-away? **It has the potential to fundamentally transform the rules of business**.

[12] WEF (2019). World Risks Report 2019.
[13] IMF (2018) Global Financial Stability Report: A Decade after the Global Financial Crisis: Are We Safer?
[14] The Economist (2019) The World in 2019.

## The rules of the game are changing

We have seen business increasingly swept up in geopolitical stand-offs, both as pawn and player. This changes the game in two main arenas: **reputation management and long-term business resilience.**

### Reputation management

Public backlash in a world of 24/7 news cycles and social media creates an even more make or break reality for companies. We see two main themes playing out for reputation management:

1 **Regulation by the people matters more.** Brand risk and crisis management has in the past tended to lean pretty heavily on demonstrating regulatory compliance. But government legislation is not exactly well-known for proactively addressing innovation (think cyber security and data privacy to digital platforms and e-commerce). With more power in the hands of polarizing parties and weaker centrist forces (take the most recent EU Parliament elections as an illustrative example), you can expect more initiatives to be blocked and regulation to become stuck. This will become most obvious with respect to the global commons: climate; space; the cyber domain; and the polar regions.

**What's the risk?** Social movements will step up in setting the tone for regulating business. There have been plenty of recent examples where business has followed public action without needing the letter of the law: from multinationals being 'tax-shamed' to Google withdrawing from a military contract on the basis of employee action. In some of these cases, local, national or even supranational regulation followed — but miss the warning signs and you could first face anything from a media takedown to a #boycott.

**Where's the opportunity?** Strong and fast social movements driving consumer behavior is not always a bad thing. There has never been a better time to go viral on certain issues that can dramatically increase sales by resonating positively with target consumer bases. Think about what proactive brand association programs (like plastic free) you can focus on to resonate with customers. Not only could consumer bases reward first-movers, but investors are increasingly being drawn to companies that establish a clear social compact. This isn't necessarily about companies embracing environmental and social responsibilities on moral grounds, but rather reflects a recognition of reengineered business models that can be sustainable in the longer-term.

The world's largest sovereign wealth fund, managing over US$1 trillion of Norway's oil wealth, recently announced a planned divestment from oil and gas exploration and production companies: an action stated to be motivated by its exposure to oil prices, rather than climate concerns.

At a similar time, 1.4 million students from more than 100 countries took part in a walkout from classes to protest against government (in)action with respect to climate change, as part of a movement started by a Swedish 16 year old in 2018.

> "The CEOs and companies I'm talking with are acutely aware of how quickly their brand reputation can go from 'hero' to 'zero', and of the need to continuously challenge the resilience of their organizations to risks in order to future proof their brand."
>
> — **Gary Reader**
> Global Head of Clients and Markets, KPMG International

**The people's voice:** less than half the world's population live in some form of a democracy (47.7 percent). A mere 4.5 percent live in a country classified as a 'full democracy', whereas over a third live under authoritarian rule.[15]

At a global level, voter turn-out and membership of political parties actually increased in 2018. And in 2019, over a third of the world's population will have the chance to take part in democratic elections (in India, Indonesia and Nigeria, among others).

Will this offer the chance to reverse the decline of democracy — and market capitalism — or will it further embolden populist sentiment (in its various forms) and state intervention?

**2** **Being a 'Made in X' company can turn you into a target** at home — and from further afield. Commercial decisions aimed at optimizing supply chains and increasing operational productivity can push you into the spotlight when it hits a political nerve — whether it be a loss of jobs in an incumbent's supporter base or a (perceived) opposing political stance. And it can be particularly difficult to navigate when these decisions are part of planning for politically-driven scenarios, like a 'no-deal' Brexit.

Then there are threats from further afield, with business becoming proxy (or accidental) targets of everything from trade and economic policy through to cyber warfare. For example, some telecomms and technology firms may be excluded from participation in the roll-out of 5G on the grounds of national security concerns.

**What's the risk?** Stakeholder management is increasingly difficult. While companies typically court both sides of government in markets they serve, today's landscape is scattered with political leaders challenging the status quo. This requires careful navigation not only through fiduciary duties, customer care, and regulatory requirements, but also political personalities (at home and abroad) as well as public sentiment. Add in identity politics, populist governments (not parties, governments), and curated newsfeeds and you may not be able to anticipate — or prevent — the next bout of public finger-pointing.

**Where's the opportunity?** This friction is likely to continue with Industry 4.0, and there will be increasing expectations from the public on business to upskill and retrain workforces accordingly. Whilst there are plenty of examples of companies around the world shedding jobs whilst aggressively hiring into expansion areas such as 5G, AI, cloud computing and blockchain, those that invest in long-term strategic workforce planning may gain a competitive advantage — or at the very least avoid fall-out.

It is estimated that by 2022, 75 million jobs are expected to be displaced in 20 major economies — but technological advances and new ways of working could create 133 million new roles.[16]

[15] The Economist Intelligence Unit (2019). Democracy Index 2018: Me too?

[16] WEF (2018). The Future of Jobs Report.

### Business resilience

It is increasingly difficult for companies to invest in longer-term business resilience.

**1 Crossing borders (digital and literal) is more costly.** The continued convergence of national security and economic policies is impacting the capacity of business to innovate by using valuable resources on defence rather than offense. Tensions are hitting not only through trade (where cross-border trade in goods and services is becoming more costly), but also flows of capital and the broader macroeconomic (read: stock market) outlook for key markets. For example, governments are imposing constraints on inorganic growth through blocked mergers, or on workforces via visa restrictions.

**What's the risk?** In 2018, we talked a lot about tariffs. Going forward, digital and regulatory restrictions will continue to increase in key markets on capital, labor, intellectual property, data and tax obligations — representing a more complex and more costly operational challenge for business. While public scrutiny rests largely on matters of national security, the technologies of the future are increasingly getting caught in the middle (like 5G).

**Where's the opportunity?** It is increasingly likely that businesses will need to 'pick a side' in technology and capital — a number of advanced markets will likely adopt tightened trade controls and investment screening mechanisms (if they haven't already). But for some companies, sectors and markets, the resulting trade diversion could allow them to break into previous strongholds. This also creates major opportunities for countries in South East Asia (e.g. Vietnam), Africa (e.g. Ethiopia), and Latin America (e.g. Mexico).

The size of China's domestic market, combined with state-directed and supported investment (among other measures), may influence technical and regulatory standards in some markets abroad.

**2 The illusion of competition has turned data into the new oil.** Despite best efforts by government, given the speed of regulatory change, much of the digital realm operates under much less competition globally than what would have been allowed even a few decades ago (think of the unicorn disruptors: Google for internet searches, Amazon for e-commerce — both as distributor and seller — and Facebook for social media).

Why? The benefits associated with (uniform) connectivity: the value of these platforms lies in the extent of their networks. Which in turn, results in data oligopolies.

**What's the risk?** Data can be a private and/or public power; with it, entities can facilitate anything from better targeted advertising (monetizing data) to, much like natural resources before it, national strategies. Yet the concentration that has been allowed to grow in both state and market capitalist models not only encourages complacency at best, but a shift in power balance towards business (away from the consumer) at worst: the consumer (public) becomes the product sold to the benefit of advertisers (government).

A lack of competition also makes it incredibly challenging for smaller companies (that could become big) to break in — which tend to be those more innovative and productive. The presence of 'national champions' for example makes it harder to compete both at home (if foreign state support is involved) and abroad (with markets effectively closed to foreign companies through formal and informal measures) — further encouraging counter-protectionist measures and the erosion of true competition.

**Where's the opportunity?** Data is also the means by which companies can break into the market: treat data like a king to unlock innovation and new opportunities for growth. Of course, there is a delicate balance of protecting privacy while also leveraging economies of scale and giving users products that benefit with uniform connectivity, but those that get their hands on the most data will certainly be at the top of the competition with technologies such as AI only improving with the more data available.

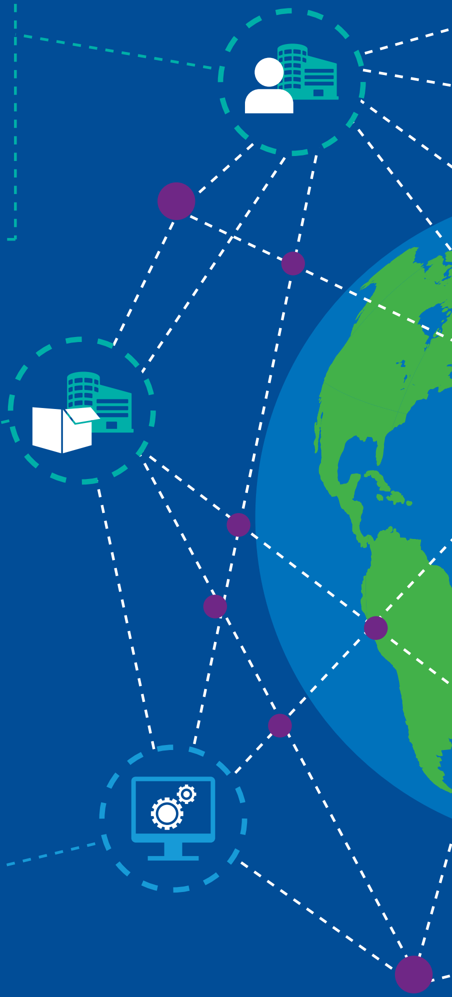
# Grow

To take advantage of opportunities in a politically turbulent world, we suggest adopting the following three mantras:

## Contracts matter

**Between business and the public:** get comfortable with going beyond legal compliance into the sphere of social contracts. But in doing so, you need to break the echo-chamber; personal views can (un)knowingly impact your ability to adequately assess the likelihood and impact of a political risk. Regular touchpoints with the likes of ethnographers and social leaders to political, behavioral and climate scientists will help you better understand linkages with seemingly outside risks and the speed at which they could crystalize for your business.

Challenge yourself to truly understand all perspectives of sometimes sensationalized issues to avoid an 'us vs. them' feeling and to ensure your business continues to be attractive to the widest possible consumer base. Define ethics principles and guidelines that go above and beyond what is lawfully required to show the full integrity and vision of your business to help the communities in which it operates. Then ensure you're being disciplined about behaving within those principles and guidelines.



**Between business and supplier:** For those in more sensitive sectors (and expect the definition to continue to expand), ensuring transparency and flexibility in your supply chain and consumer base is critical. Also, be careful who you do business with. Are you comfortable with the level of due diligence on third-parties associated with your brand both in terms of customers and through partnerships?

## Take accountability yourself

**On the cyber domain:** don't rely on rules to protect you, but expect to be held accountable to them. On the one side, there is limited support against cyber warfare: government protection is limited, and the development of global international standards around cyber warfare is stymied. On the other hand, business faces two big, costly problems when things go wrong: public backlash, and tightening regulatory enforcement on data privacy worldwide.

Cyber deterrence and protection is hard, and it is not a question of 'if' you will have data stolen, but 'when' — and most importantly, 'what' and 'how much'. Cyber security should be a C-Suite priority, both in focus and resources: when people say 'data is king' it doesn't only refer to the power it holds, but also the delicacy and respect it must be treated with. Increasing domestic regulation will make it more important than ever to have a local model for how you store, access, and protect the data you've been entrusted with.

**On markets:** the world's biggest markets are sometimes ideologically different and security competitors, and this will start to matter more to business. If you are looking to new markets, country fundamentals are more important than ever. Identify geographic hotspots that can 'go it alone' compared to those more reliant on the uninterrupted flow of labor, goods and capital. Consider not only the usual regulatory and economic exposure, but also interconnected environmental and political risks, and consider which markets are most likely to be able to weather the world turning inwards.

Just be aware that competition for these 'safer' havens are likely to soon erode their cost advantage — in Vietnam, industrial land costs near deep-water ports have reportedly increased by 25 percent in the past year alone.

## Go deep (on your footprint)

**Become more local:** more than ever, geography is influencing a company's identity (brand and strategy) as a result of identity politics and nationalism. Consider when to be local and when to be global: for example, can you bring your customers and products closer together by reducing the number of countries involved? Are there data center models that enable you to keep more data within the borders of users' home countries?

But be clear what 'local' means to you: localized technology can mean large-scale industrialization without equivalent job creation, which may not play well in the domestic market (or fulfill conditions of access). Where possible, job creation narratives are almost always well received!

**Consider your tangible and intangible footprint from every angle.** Relatedly, as global operations become more complex — and likely more localized — it is even more important to avoid considering these issues in isolation. Maybe you want to utilize 3D printing to localize production for brand or content purposes — but will data flow freely and systems remain interoperable across that border going forward? Eastern Europe may seem like an attractive market to remotely service consumers — but the combination of populist governments, GDPR and the digital tax deadlock may point to a very different business model than in the past.

So 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, companies can map out a more certain path in an uncertain business world.

## About the KPMG and Eurasia Group Alliance

KPMG International has formed an alliance with Eurasia Group, one of the world's leading global political risk research and consulting firms, to develop solutions that help businesses deal with geopolitical challenges. Through our alliance, KPMG professionals can bring the political insights of Eurasia Group's analysts across 100+ countries together with KPMG's nuts and bolts understanding of your business covering from the macro to the most granular of analysis.

We can help business:

**Anticipate what is coming** by drawing on non-traditional data to pinpoint 'around the corner' trends.

**Plan for the longer-term** through in-depth political and economic scenarios to help with investment frameworks, financial models and strategic planning.

**Decide where to go** by helping prioritize your next big market via a high-level assessment of overall potential and fitness for investment based on your strategic priorities.

**Decide how to get there** through end-to-end market entry strategy, including issues like localization, partnerships and local stakeholder management.

**Understand the big picture** by ensuring regulatory, locational, reputational, political and financial risk is included not only at the operational level, but is also integrated into every strategic decision you make. We can also provide you the necessary transparency over partners, suppliers, customers or your next acquisition in terms of commercial, political and ethical risk exposure.

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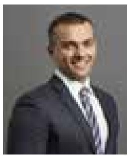

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