



Geopolitical Face-Offs

Polarization is changing
the politics of business



KPMG International

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Last year, we wrote that our societies were dividing into 'us' vs. 'them' camps in every major country and territory.

Fast forward and macro forces — economic, technological, environmental, political — are interacting with a widening gap in societal values, ideologies and perceptions of equality. Global challenges (like COVID-19) are politically presented as divisive zero-sum games, within and between borders.

Societal polarization will redefine the way we think about productivity, economics, and the purpose of a company. In the following pages, we look at five geopolitical 'face-offs' that are likely to change the politics of doing business — for better and for worse — and how you can turn the less predictable to your advantage.



Redefining history

Humans seek certainty from uncertainty by imposing patterns over ambiguous situations. So to explain the present, we often look to the past: the 1930s, to forecast The Great Lockdown (Depression); the 1960s, to make sense of recent public protests in major developed economies; the 1980s, to analogize the 'Digital Iron Curtain' and 'Technology Cold War'.

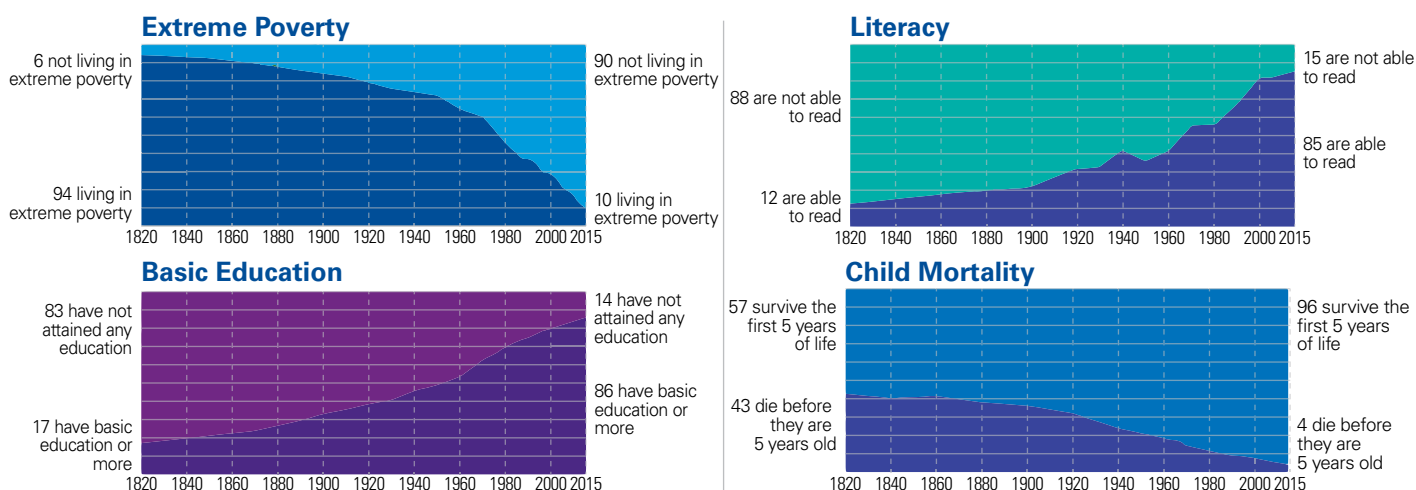
Our view? **These events may hold valuable lessons but are not accurate predictors of things to come.** The world has radically altered in the intervening period, moving from relative economic isolation to globalization. Underpinned by a widespread 'Western' belief in market economics and

democratic politics, even the last three decades alone have connected the world in ways underappreciated by the past: long-haul, low-cost travel, ever-faster telecommunications, liberalized trade agreements, efficient, specialized supply chains, and digital social networks.

With this came record-breaking development: reduced child mortality¹ and global hunger²; extreme poverty at the lowest levels in recorded history³; literacy⁴ and access to the internet⁵ at the highest. The democratic, capitalist model was widely perceived to 'work'.

The World as 100 People

Over the last two centuries

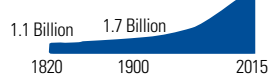


Data sources:

Extreme Poverty: Bourguignon & Morrison (2002) up to 1970 — World Bank 1981 and later (2015 is projection). Education: OECD for the period 1820 to 1960. IASA for the time thereafter. Literacy: OECD for the period 1820 to 1990. UNESCO for 2004 and later.

Child mortality: up to 1960 own calculations based on Gapminder; World Bank thereafter

The world population increased 6.8-fold over these 2 centuries.



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September 2018 marked a global tipping point: for the first time, the majority of the world's population were classified as "middle class" or "rich"⁶.

Yet across the OECD, income inequality is at its highest level of the past half century: the average income of the richest 10 percent is 9x that of the poorest 10 percent. The benefits of growth have not been evenly distributed, even in emerging economies that lifted millions out of absolute poverty.⁷



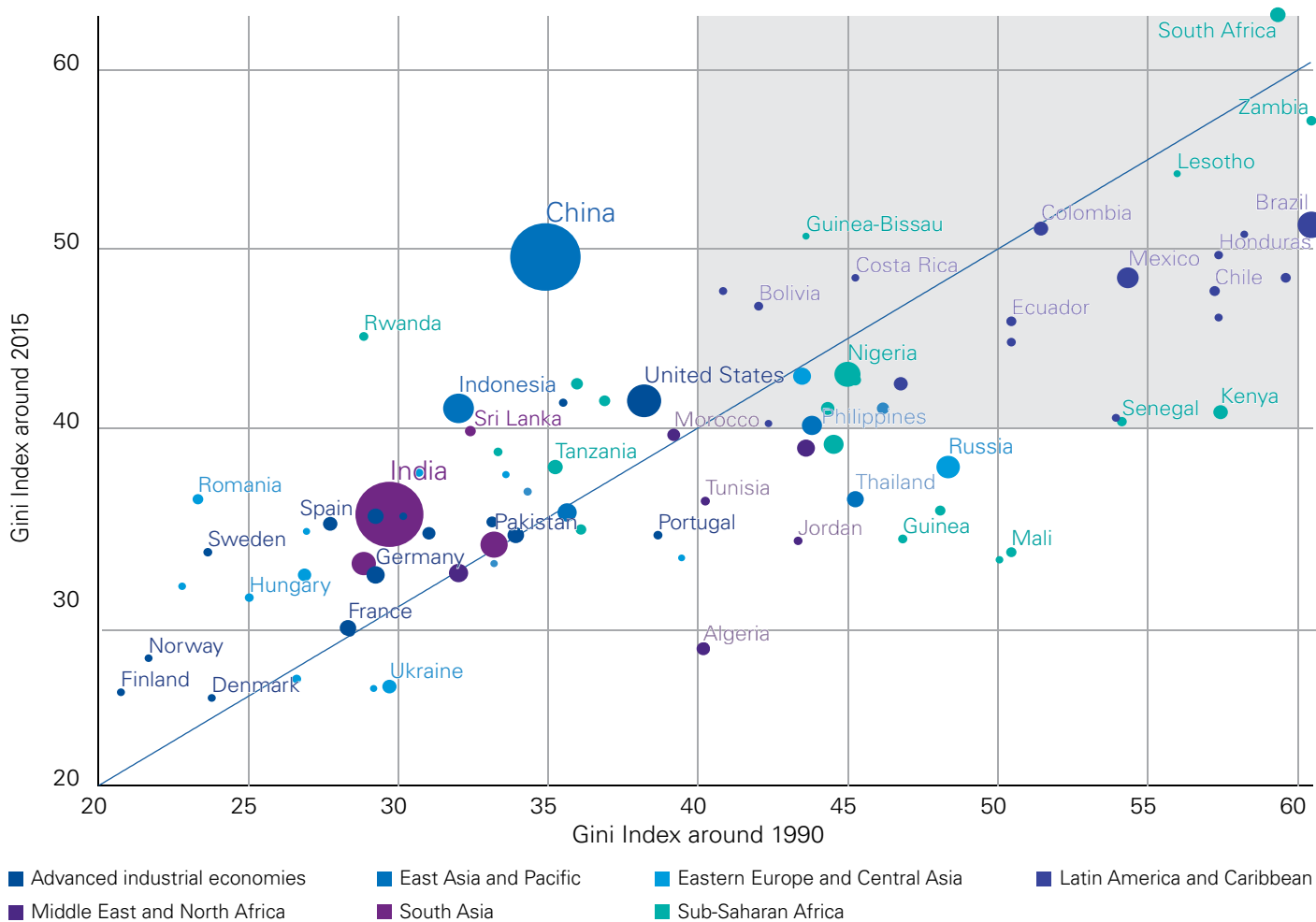
¹ Both the under-five mortality rate and the number of under-five deaths have fallen by more than half since 1990. UNICEF Data (2019) Under-five mortality.
² The share of the overall population that is undernourished was 13.0% in 2017, down from 18.2% in 2000. IFPRI (2017) Global hunger index: the inequalities of hunger.
³ World Bank (2018) Year in Review: 2018 in 14 charts.
⁴ Our World in Data (2016) Global Education.
⁵ ITU (2020) Statistics.
⁶ Brookings (2018) A global tipping point: Half the world is now middle class or wealthier.
⁷ OECD (2019) Inequality.

Until, arguably, now. It was not just the Financial Crisis of 2008, or even COVID-19 at fault, but we find ourselves in a world of high (and arguably increasing) social inequality, and widespread discontent with the political and economic systems that are seen to have led to this.

In many ways, **the middle class no longer considers itself to be net beneficiary of globalization.** Not the globalists, concerned about the state of commons (climate, cyber, human rights), nor the localists, concerned about the resilience of their communities and meeting the costs of their day-to-day.

Inequality in 1990 vs 2015

Countries above the blue line experienced a rise in income inequality; countries in the top right quadrant exhibit the highest levels of income inequality.



Source: Povcal (2018), The Chartbook of Economic Inequality (2017), Kandbur et al. (2017) Table 1.B

Note: Estimates are based on household survey data of either incomes or consumption. All countries for which comparable surveys within five years of each reference year were available are shown.

Major macro forces are propelling and being shaped by this social polarization — the widening gap in societal values, ideologies and perceptions of equality in emerging and developed markets alike. If the past cannot be relied on to predict the future, how could this play out?



*“The next decade is going to be marked by a **deepening geopolitical recession**. Where international governance is more uncoordinated and lower quality, and existing institutions will become weaker and less relevant as they become less naturally aligned to a **rapidly changing geopolitical, economic and technological balance of power**.”*

— Ian Bremmer, Eurasia Group



Countries will have less stake in each other's wellbeing. They will fight more over how the pie is shared, rather than work together to enlarge the pie for all. It will be a less prosperous world, and also a more troubled one."

— **Lee Hsien Loong**
Prime Minister of Singapore⁸

Let's start with the macro force that hits first, last and hardest: **Economic**. As a result of COVID-19, more economies are expected to be in recession now than in recorded history⁹. Even pre-COVID-19, businesses were facing global economic conditions once thought unfeasible: record levels of global public and private debt¹⁰, and low inflation with low or negative interest rates — meaning healthcare and pension obligations will soon come due at a time that many cannot afford them.

This changes the **Political** equation, where both 'Eastern' and 'Western' political and economic models alike are structurally fragile to the coming shock. COVID-19 has redefined public acceptance of once less-feasible policies, as the uncertainty of the global environment boosts ruling parties' overall authority (even the decline of full democracies). Yet governments still face a dilution of power through political polarization; incumbents fear losing power and turn to policies to assuage a polarized public. 'Today' is prioritized over 'tomorrow' (think climate change, public debt to GDP ratios), and a mixture of 'safety net' and nativist policies become the norm.

These trends are accelerated by rapid advancement in **Technology**, which quickly changes market dynamics and the comparative productivity of an economy. It also remains the centre stage for geopolitical power plays. With technology is seen to come political and military superiority, yet unlike the space and arms races before it, the competitiveness of a country is dependent on not just the private sector, but also the public — a further challenge for Western models.

This further constrains the **Environmental** agenda. Despite the (surprising, but welcome) 'build back better' public policy shift with a raft of 'green' COVID-19 stimulus packages, the world remains on a trajectory inconsistent with keeping global temperatures from rising by more than 1.5 degrees. The resultant polar ice-melts, sea levels rising and the loss of biodiversity has political — not to mention potentially socially existential — consequences. For some countries, the perceived short-term costs of the radical measures needed to achieve a climate-resilient world outweigh the longer-term, more costly consequences of climate change.

The EU may be ahead of the curve in terms of policy approaches, but the coming global order is going to be mostly made by the climate decisions and artificial intelligence breakthroughs made by the US and China.



Which brings us back to what will likely be the most dominant macro force of our generation: **Social** populism, or the ever-expanding group of people around the world who believe that the system is no longer meeting their needs. Internal tensions intensify and become less manageable, with political and economic ideologies coming under pressure — and not just in Western global, liberal, capitalist, democratic models. Meanwhile, the lack of leadership and policy coordination of a G-Zero¹¹ world makes it much harder to come up to solutions to global concerns, like climate migration and technological displacement.

It can feel sometimes like we are at the edge of a precipice facing an upcoming series of simultaneous and cascading crises. **Globalization has lowered physical and digital borders — not just to the flows of goods, services, investment, people, and even ideas, but also risk.** Global networks, whether physical or virtual, are inherently more fragile and exposed to 'fat-tail' risks (i.e. greater-than-expected probabilities of catastrophic events) due to 'contagion'. With far less natural containment and global governance weakening, macro forces are more volatile, more fragmented, less efficient and less predictable.

These challenges, like much of those faced by generations past, are unique to our time, and redefine our view of the environment we operate in. The acceleration of societal polarization will make us question the way we think about productivity, economics, and potentially even what we mean by a 'company'. In the following pages, we consider **five geopolitical 'face-offs' that will change the politics of doing business —** for better and worse — and how you can turn the less predictable to your advantage.

⁸ Bloomberg (2020) Singapore could face tougher future as global ties weaken.

⁹ World Bank (2020) The Global Economic Outlook During the COVID-19 Pandemic: A Changed World.

¹⁰ Institute of International Finance (2020) Global Debt Monitor.

¹¹ G-Zero refers to a geopolitical recession, headed into a depression, where there is no clear global leader.

Redefining market economics

Macro forces — most notably geopolitical power dynamics, social discontent and social media — are reshaping mainstream economic theory and policy. Both 'Eastern' and 'Western' political and economic models are under pressure from internal and external forces. We are likely to see a continued shift from multilateralism to bilateral and regional relations (**East vs. West**) and increasing state involvement in private sector activities domestically (**Global vs. Local**). Operating a multinational footprint will become more complex and more costly — but protectionism can be turned to your competitive advantage.

Face-off #1: Global vs. Local

Efficiency is the perfect adaption of a company, sector or market to the existing environment — by its nature, it designs away its 'resilience', or its protection from risk. In contrast, resilience is the ability to adapt to changes in the environment, often with an associated 'insurance' cost.

COVID-19 highlighted the less salient and less predictable cost of efficiency. A supply shock to one market caused chokepoints in the global supply chain — that is, an (otherwise geographically efficient) overreliance caused a cascade reduction in capacity through the loss of access to key inputs. This was bad for business, but arguably much worse for governments, where shortages of PPE and testing kits were directly linked to the effectiveness of the response to the crisis, measured by the media in fatalities.

Some governments will now pursue a model of 'self-sufficiency' in strategic sectors, including agriculture, pharmaceutical and medical supply manufacturing, natural resources and energy. The extent of the response will be partially constrained by market factors, and will vary from the creation of national stockpiles, redundancies in government supply chains and 'trusted' suppliers, to export controls and industrial policies to encourage reshoring or nearshoring of production and R&D. This concept of national resilience is not unique to pandemic risk; governments face pressure to ensure 'self-sufficiency' to any number of perceived threats, including from other countries.

The blurring of national resilience and national security will challenge the notions of comparative advantage and specialisation that has underpinned the liberalisation of trade. Global powers will design each other out of critical supply chains in the name of national security, across a continuum from 'diversify away', to '(geographically) nearshore with an (ideologically) trusted partner' and even 'reshore' capacity. 'National security' extends to 'civilian' applications, like the technology that runs power plants, the financial system, telecommunications networks, and other critical infrastructure.

Since the global outbreak of COVID-19: Russia banned the export of essential medical equipment and products; the US issued new rules for exporting PPE; the European Commission enacted control measures to keep critical goods within member states; and India restricted exports of pharmaceutical treatments.



'Global' efficiency will be subservient to 'Local' resilience under the Venn diagram of three policy buckets:

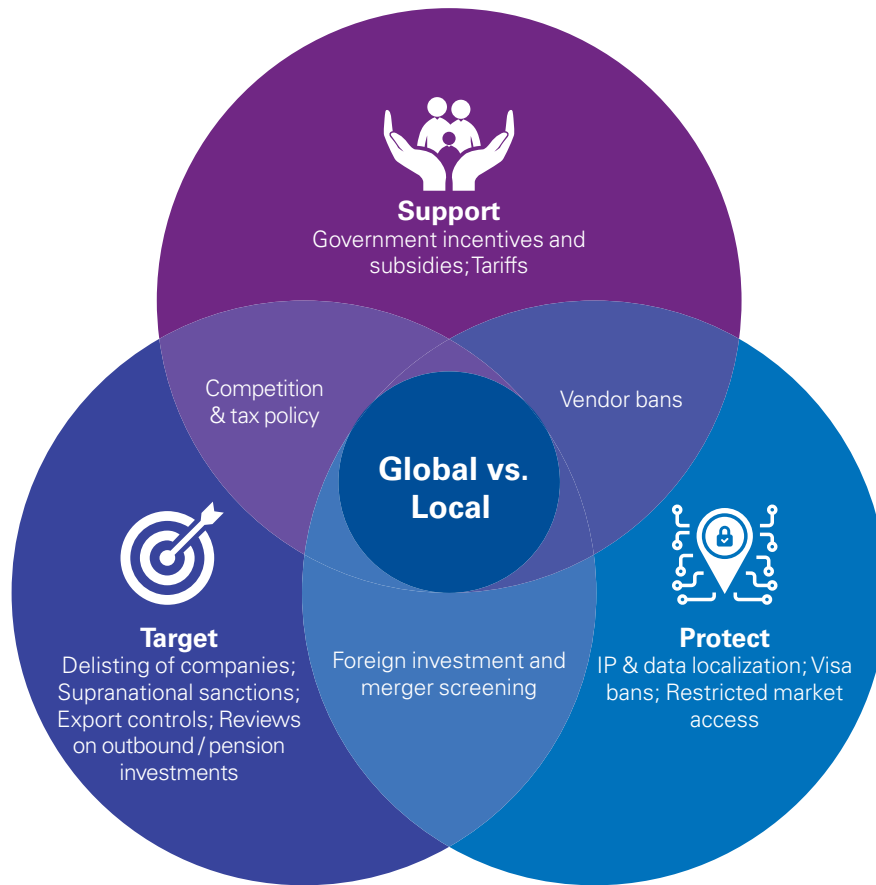
- 1 Support:** a more powerful form of state aid and protectionist policy to home-grow 'national champions', specifically as a way of competing with state market models. This includes the incentivization of domestic production in key sectors (particularly technology), like the recent proposal by the US for US\$30 billion in government incentives to encourage local semiconductor manufacturing. Expect the conversation to soon shift to COVID-19 bail-outs; for example, France's recent EUR€8 bn bailout of the car sector contained the strong suggestion that manufacturing should be re-shored where possible.
- 2 Protect:** new and revamped legislation to minimize exposure to foreign interference in local markets — like foreign investment and merger screening (with Australia, France, Germany, India, the US and Japan adopting new measures)¹², stricter data and IP localization, and even visa restrictions on STEM talent (including university students).



Germany recently purchased a 23 percent stake in CureVac, a German biotech firm, reportedly to **limit the influence of foreign investors** in its upcoming initial public offering.¹³

¹² OECD (2020) Investment screening in times of COVID — and beyond.

¹³ Bloomberg (2020) Germany Moves to Secure Stake in Virus Vaccine Developer.



3 Target: the similar but select use of economic policy to (rightly or wrongly, actual or perceived) focus on or constrain foreign players. This is the most inventive tranche — think supra-national sanctions on individuals and designated entities, delisting of companies over an impasse on audit standards, bans on vendors (and related supply chains) in government procurement, and even the offer of export credits and financing to ensure the purchase of ‘allied’ technology in third countries.

The next move from major players will be enhanced anti-competitive scrutiny, as well as targeted tax policy, particularly as countries look to pay back their COVID-19 bills. Points of contention will (arguably) include the EU’s proposed carbon border adjustment mechanism, which would effectively charge non-EU countries for non-alignment of their climate policies, bolstering Europe’s role as a geopolitical player at the same time as boosting strategic domestic industries (such as batteries). Digital services taxes also fall into this bucket; unsurprisingly, US tech companies tend to be disproportionately subject to DSTs based on the revenue criteria adopted by most countries (often without large tech companies of their own).

What’s the risk? Certainty of regulation matters more to business than flexibility. Legitimacy or otherwise of motivations aside, all of these mechanisms, combined with the increased speed and at times opacity of implementation, heighten uncertainty and decrease efficiency. This ultimately slows investment and accelerates business decisions to align with the objectives of (1) Support and (2) Protect.

Although initially targeted to ‘strategic’ sectors, these policies will impact a broader array of economic activity. Bilateral and regional liberalization of trade may continue between ‘trusted’ countries, but generally expect more friction in terms of trade, investment, labor, data and IP at a global level. This will require more local business and operating models — which can come at a cost.

Where’s the opportunity? Protectionism is not all bad for all companies. Nearly a quarter of the world’s largest firms are state-controlled, and Western state aid for critical sectors and ‘Made in X’ companies is nothing new — just look at the decade-long Airbus versus Boeing decisions being handed down by the WTO (the power of which, incidentally, will ossify with the shift away from multilateralism). While the ‘nationality’ of your business may limit sources of investment and the markets in which you can play, there is also the potential for increased government support (regulatory and capital) for ‘trusted’ players, both domestically and from allies.

Face-off #2: East vs. West

Global world powers are attempting to shape the behavior of other nations. This is not new — it would be difficult to think of a time in history where this has not been the case. Similarly, the division of the world into ‘two sides of a fence’ with differing political and economic ideological models has happened before.

What is different this time? Countries are more connected, making the process of even partial decoupling more extensive and painful than in the past. And **politics vs. economics will make it difficult for third countries to ‘pick a winner’** this time around.

Economic, healthcare and even data diplomacy will matter even more in a post- or coexist with COVID-19 world. Whilst there is an evolving level of financial support available for Western allies, state capitalism offers an alternate financing model for emerging markets seeking investment — many of which are among the fastest growing markets in the world.

State coordination of private sector investment flows offers potential ‘benefits’ that tend to be broader than what can be offered by a democratic country. The conditionality received in return, and the comparative influence of the lending nation is also higher; ‘non-compliance’ can have more immediate economic consequences, by cutting off state-directed imports (including tourism and education), or through more informal ‘soft control’ measures, such as the coordination of consumer boycotts.

China has more influence per dollar of investment than a democracy has. This influence is considerably greater with poorer countries (who are less moved by higher standards and rule of law and have fewer options for capital), and heads towards parity as countries get wealthier, the rule of law and transparency governs investments to a greater degree, and the softer side of political influence matters more.



As the two global powers continue to take a deliberate decision to diverge, other nations may be forced to follow suit — vendors for 5G being an ongoing example. The bifurcation will be partial — this is not quite the divisive zero-sum game that it is sometimes painted, and there are ‘brakes’ to the extent of decoupling that will take place. Some countries will maintain productive relationships with both sides of the fence, and similarly business can and will continue to operate in both China and in Western countries. India and others across South-East Asia will also seek the ‘third way’: the promotion of local players, technologies and talent.



■ Considering or implemented universal restrictions

■ Considering or implemented partial restrictions¹⁴


■ Unlikely to consider restrictions (4G or 5G)

Current as of September 2020

¹⁴ Includes the EU Toolbox of 5G mitigating measures for member states. Includes strengthened security requirements, application of relevant restrictions to suppliers considered to be high risks, and avoidance of dependencies on high-risk suppliers. It is up to member states to implement the toolbox.

The push to unite the 'D-10' behind a common industrial strategy around 5G, which is being led by the UK, reflects the **need to shore up European and Asian rivals in the short term and a desire to encourage new competitors to enter the industry over the long term**. Crafting a long-term, sustainable strategy will be difficult, however, as governments and companies grapple with challenges including market size, competitive pressures, and concerns about US technology dominance.

It will also hit some sectors harder than others: from tech on one end (the most bifurcated) to a sector such as consumer packaged goods on the other end of the continuum, which is more likely to be only (temporarily) implicated as collateral damage. Energy and commodities are set to be somewhere in the middle over the years to come, mostly unaffected, but occasionally politicized (like steel, aluminium and rare earth metals).

 **What's the risk?** At a minimum, divergent business standards and architecture, and at worst, reputational damage and limited market access. Combined with **Local vs. Global**, in practical terms this could be as simple as (potentially less efficient) local production for domestic consumption. But it could also mean your new global IT system is only interoperable in some markets. Or a critical supplier to your global product is now banned in half your markets. Or the nationality of your IP restricts its usage in particular countries. Or given limitations on the movement of data, your R&D

location decision is made for you. Or, by attempting to straddle the fence, your company is thrown into the political spotlight by (mis)aligning to certain values (a la NBA). For some businesses, it may be easier to retrench to one market and its allies for profitability or political risk reasons.

 **Where's the opportunity?** The commercial appeal and the growth potential of emerging markets will not disappear; Asian consumers will soon become half of all global consumption, while Africa's infrastructure needs sit at around US\$130-170 billion per year¹⁵. The ability to straddle the fence will boost growth potential — some markets will remain unparalleled in terms of size of the skilled labor force, infrastructure, regulatory incentives, and proximity to high-value ecosystems and large consumer markets (including domestic). Rather than picking sides, consider where and how you can create efficient, parallel models that allow for continued access to high-growth markets.

What Next: Anticipate



The right information: reliance on strategic technology (in its broadest definition, including 5G and AI) means resilience is prioritized over efficiency in terms of business and operating model — increase visibility and potentially flexibility in all critical business inputs. Don't only consider your footprint in the traditional 'geographic efficiency' sense — think through the potential political and digital barriers in the 'grouping' of your markets.



To the right people: one of the unique features of our time is speed of change, with equally limited time to react — ripple effects could hit multiple parts of your business hard and fast, so rejig who gets facetime with the EMT and Board. Pending your sector, this could be your Head of Risk, Government Relations, IT, and / or People. Whilst this remains the elusive Holy Grail of many businesses, this will also help adopt a holistic approach — for example, is your compliance team working with trade management and procurement to consider how the broader economic toolkit (beyond mere sanctions, like tariffs) will be weaponized against suppliers / customers / competitors?



At the right time: start with strategy — ask what is changing in the external environment, and frame it in a way that examines the business. A predictive socio-political understanding of the US-China relationship will likely be critical to your growth strategy, regardless of your footprint. Taking a bet on whether Vietnam will remain a cost-competitive supply chain destination? What about the likelihood of the EU imposing financial sanctions on Iran? US-China relations will be central to anticipating the answers to your most strategic questions.

¹⁵ African Development Bank (2018) African Economic Outlook.

Redefining productivity

Geopolitics may be shaping technology, but technology is equally redefining geopolitics; emerging technologies will change the comparative productivity of both countries and companies (**Man vs. Machine**). Productivity is a measure of efficiency; markets and companies can be more or less efficient at producing output using a given level of input. As a necessarily simplistic explanation, countries that specialized in the most important factor of production (low-cost labor, like China and India, or high-skilled talent, like the US and Japan) attracted economic activity and were afforded geopolitical power. As data-rich technology supplants human capital, the resultant economic, social and regulatory shifts will revamp the comparative attractiveness of markets (**Protection vs. Performance**).

Face-off #3: Man vs. Machine

The use of technology to increase productivity is not new, nor is the concern around what it might mean for the labor force (the 'gales of creative destruction' caused by sewing machines, railroads and automobiles being the overused examples for this).

What is fundamentally different, and far more concerning than mere technological displacement, is the shift in importance from human capital to physical capital, in the form of emerging technologies (think everything from self-driving cars and grocery check-outs to AI journalism, e-finance and online education)¹⁶. There is a very real possibility that we may not need artificial general intelligence¹⁷ before humans are surpassed and labor is no longer the most important factor of production (nor of comparative advantage for countries).

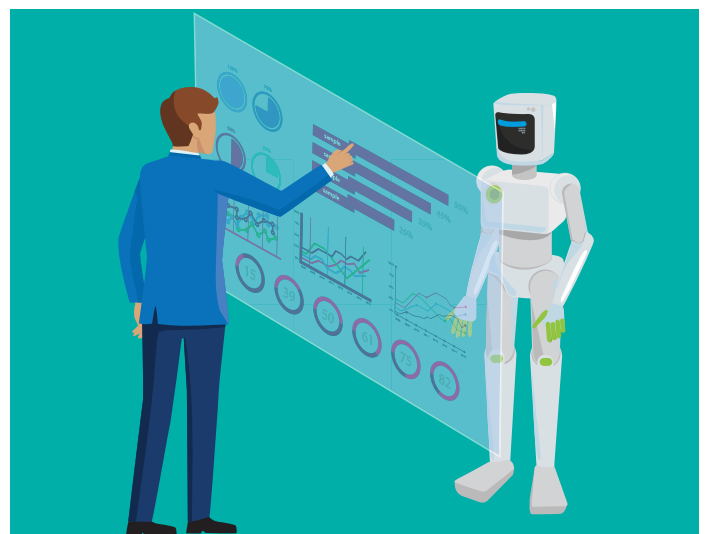
At a minimum, **technology will exacerbate polarization of the labor market, contributing to perceptions of 'rigged capitalism'**. As a credible scenario that could unfold over the next few years: technological transformation increases demand for skilled labor relative to unskilled labor, lowering the wages of the workers unable to adapt. These technologies may allow labor to focus on a skill that is not AI-replicable, creating more jobs than those destroyed. But the economic fall-out from COVID-19 will also disproportionately hit lower wage jobs; structural underemployment becomes a concern as people compete for fewer jobs, driving wages down and inequality up. Labor markets become more flexible; the gig economy increases, with more people working multiple part-time, low-paying jobs¹⁸. The perceived or actual wealth divide increases — leading to new levels of societal discontent and political polarization.

What's the risk? As inequality increases, focus will increasingly turn to the 'S' of ESG. Whilst companies with minimal employees tend to score better on 'traditional' social metrics (like pay gaps, worker disputes and modern slavery), **Global vs. Local** will interact with **Man vs. Machine** to create a laser focus on domestic workforces. You could

argue that has always been the case, but additional power now rests in the hands of ESG-friendly investors, who represent at least US\$1 of every US\$4 under professional management¹⁹. Companies adopting a 'fire and hire' model may face a significant reputational backlash and constraints on future investment and growth.



Where's the opportunity? The Man and Machine model. In the short-term, AI (artificial intelligence) and IA (intelligent automation) are no longer dirty words — to a degree they were the unsung 'heroes' of COVID-19. AI and IA not only helped mitigate initial exposure of companies to the pandemic (after all, robots can't catch a virus), but the pandemic changed the cost-benefit analysis of the adoption of these emerging technologies. The crisis highlighted where human interaction could be easily mitigated, induced the behavioural change (acceptance) around non-human interfaces, and has provided coverage to make otherwise socially and politically unpopular decisions (such as moving manufacturing and automating processes)²⁰.



¹⁶ World Happiness Report (2019) Big Data and Well-being.

¹⁷ A machine capable of understanding the world as well as any human, and with the same capacity to learn how to carry out a huge range of tasks.

¹⁸ Forbes (2019) America's full employment hides a dirty secret.

¹⁹ Morgan Stanley (2018) Sustainable Signals: Asset Owners Embrace Sustainability.

²⁰ MIT and Faethm (2020) Covid-19 and the workforce: Critical workers, productivity, and the future of AI.

Face-off #4: Protection vs. Performance

With AI emerging as the most important technology, the data that fuels it will become the most important resource. As we wrote last year, the value and functionality of the next generation of emerging technology is, in part, dependent on

the type and volume of data. China even recently officially named data as the fifth production factor, alongside land, labor, capital and technology.²¹



There is 25 times as much digital data as when the past decade began; digital data will potentially **now double every two years**²².

Power stemming from control over information is not new. But **the centrality of data to the performance of these technologies creates an intractable challenge for the democratic, capitalist model**. Western states have to balance the strategic need to compete in this arena, with the (democratic) protection of their citizens (data), including:

- 1** The personal right to privacy, as a property right (US) or a human right (EU). This constrains the use and collection of data, and through resultant localization requirements, ultimately may limit the size of the available data pool to the domestic market.
- 2** The perceived abuse of anti-competitive power by a handful of private players. Data favors large-scale information collectors, and ironically, many of the solutions to diluting this monopoly power, like enforced open sharing, are constrained by privacy concerns.

This is not to challenge that democratic protection is needed; it seems doubtful that the average member of the public would understand the realm of potential uses of individual data²³.



135 countries and jurisdictions have enacted legislation to protect privacy, with 49 countries adopting broad privacy laws in the past decade²⁴.



Apple, Amazon and Microsoft together are valued at nearly US\$5 trillion — that's 16 percent of the S&P 500 Index, approximately the size of the Japanese economy, and larger than Germany's²⁵.



In a society where individuals will generate ever-increasing amounts of data, the way in which the data are collected and used must place **the interests of the individual first**, in accordance with European values, fundamental rights and rules. And that **data should be available to all** — whether public or private, big or small, start-up or giant.”

— European Strategy for Data

²¹ People's Daily Online (2020). China unveils guideline on improving market-based allocation of production factors.

²² Brad Smith (2019) Dawn of a Decade: The Top Ten Tech Policy Issues for the 2020s.


²³ World Happiness Report (2019) Big Data and Well-being.

²⁴ Ibid.

²⁵ John Maudlin (2020) Valuation Inflation.

But the regulatory regimes that result can impact the speed of development of technology and comparative performance and competitiveness, particularly with respect to personally sensitive and identifiable data. Take COVID-19, where privacy challenges over centralized apps significantly impacted the overall efficacy of track and trace systems in some countries.

Not all of this data will be monopolized by the technology in question. Nor will it necessarily be deemed sensitive and worthy of protection. But acknowledgement of this 'data advantage' means that the **Global vs. Local** concept of national security now includes the notion of data sovereignty, and in order to effectively 'compete', data-rich emerging technology from abroad will become a target of increased regulatory scrutiny.

 **What's the risk?** We've seen two waves of privacy regulation that has empowered consumers — the first gave 'notice and consent' rights, the second 'access and control', both imposing the burden of self-management. Next, the initial use of the data will be targeted. In combination with **Local vs. Global** and **East vs. West**, regulatory constraints could include stricter data localization, IP, tax and competition policies.

Divergence of data regimes will increase costs of compliance (regardless of sector); the European Court of Justice has already challenged one of the main mechanisms for allowing

Whereas data localization has historically been driven by authoritarian countries that want to control data flows across borders and keep certain types of data stored locally, we are now seeing a mirror trend: the policy of wanting to **prevent the storage of citizens' data on servers in countries whose governments the administration does not trust.**



personal data transfers across borders with the US. In practice, this could mean locational constraints on R&D activity; transferring data across borders may become harder as personal or critical infrastructure-related data is targeted for controls, meaning data sets may need to be partially siloed. This may also require separate centres, delinked from global infrastructure, to handle analysis of some types of data.

 **Where's the opportunity?** Both monopolies and stronger privacy by design can be sources of competitive advantage, particularly at 'home', while the 'data advantage' of respective markets should be taken into consideration in location decisions.

What Next: Prepare

This type of politics will manifest itself into a number of different business risks, which means the type of mitigation strategies you employ might sit outside the traditional realm of the Chief Risk Officer or Government Relations.



Chief HR Officer: workforce planning will become front and central. Identify those at risk ([Faethm's augmentation vs. automation matrix](#) can help) and map appropriate training and career development pathways. Pending geographical footprint, firms reliant on STEM talent may also need to build US-China bifurcation scenarios into the workforce strategy — for example, Tesla has geographically co-located talent and research and development by building local engineering teams to develop the company's self-driving vehicle program in China.



Chief Information (Technology) Officer: firms should consider their cross-border transfer processes to determine what type of data is most likely to be caught by emerging restrictions, and potentially isolate where necessary. Primacy of data to a business model also requires a reflective investment in cybersecurity — use of new technologies (like quantum encryption and blockchain) will become central to the security of sensitive data.



Chief Executive Officer / Chief Financial Officer / Chief Strategy Officer: as data becomes the focus of a broad swathe of regulation, including tax and competition policy, the value of intangible assets should be central to strategy and investment decisions.

Redefining a 'company'

Mainstream political and economic models face an ongoing stand-off about **Today vs. Tomorrow**. Protection of the public from the impact of COVID-19 at the potential cost of a generation of indebtedness. Short-term shareholder primacy versus longer-term sustainable stakeholder value. The redistribution of wealth from the future to today, as pension obligations exceed revenues due to negative bond yields. In the midst of the longer-term economic fall-out from COVID-19, the middle class will redefine the purpose of a company, forcing a corporate safety net for 'tomorrow' even as they push governments towards supporting them 'today'.

Face-off #5: Today vs. Tomorrow

What we have seen from COVID-19 is, rightly or wrongly, the expansion of an inherent systematic mortgage on future generations. Massive government intervention is delaying (not necessarily avoiding) a severe economic depression and potential collapse in some cases. Global debt may surge to 342 percent of global GDP by year end²⁶, with most countries utilising debt to stabilize growth and employment. Even going into the pandemic, Western fiscal and monetary policy was overburdened from the 2008 Financial Crisis, and global debt was growing at a rate far higher than GDP growth or the population rate of most countries or the world²⁷. Whilst interest rates are low, the debt burden is affordable, but under basic economic principles, debt (consumption) today means austerity (less consumption) in the future.

There is no easy or quick fix to this. In a post-COVID **Man vs. Machine** world, there will be little appetite (from the public or government) for increased costs of living or changes in consumption. It may potentially only be eventually corrected by one of two measures: Modern Monetary Theory³⁰ or a Debt Jubilee, both of which come with their own challenges and neither address the high current and future spare capacity in labor force.

On the social side, dissatisfaction with the current system of governance is set to continue from the globalists and the localists. Yet societal polarization has been translating to the political spectrum. 'Economic voting' will matter more; the state of the economy and the financial 'health' of individuals will (empirically and intuitively) determine re-elections³¹. Governments will be less incentivized to enact policy where



Around a third of FTSE 100 and S&P companies paid more in shareholder distributions than they generated in net income in the last financial year.²⁸

The rate of debt growth in emerging and developed markets between 2010 and 2018 was the largest and fastest climb in nearly 50 years²⁹.

there is a perceived or actual financial impact on constituents and will prioritize spend on 'local' support 'today' (healthcare, education etc.).

Combine this with the **Local vs. Global** retreat from multilateralism, and governments will have less capacity and willingness to respond to a range of issues in an effective manner, despite continued pressure from parts of the public. Specifically, **we will continue to see sclerotic policy with respect to the global commons and collective rights.**

This continued lack of political action means greater expectations on the part of business. Questions around social contracts and the role of business in society have been raised over the past decade, most notably with respect to ESG issues. This is particularly evident in the shift from country-driven multilateral institutions to the growing influence of business-driven coalitions in driving the ESG agenda.



Public expectations and scrutiny of businesses has increased sharply over the last few years. Businesses are responding by re-evaluating their purpose, embracing ESG objectives, and being more willing to take a stance on social and environmental issues, especially climate change.

— **Richard Threlfall**
Global Head of KPMG IMPACT

²⁶ Institute of International Finance (2020) April Outlook.

²⁷ Mauldin Economics (2020) Decade of Living Dangerously, Part 2.

²⁸ Baker et al. (2020) Against Hollow Firms - Repurposing The Corporation For A More Resilient Economy.

²⁹ World Bank (2020) Global Waves of Debt: Causes and Consequences.

³⁰ In simplistic terms, MMT suggests that governments that control their own currency can spend freely, by printing more money. Increased government spending will not be inflationary so long as there is unused economic capacity or unemployed labour, but inflation can be curbed through government spending or taxes.


³¹ World Happiness Report (2019) Happiness and voting behaviour.

With governments seen as ineffective at best and inactive at worst, short-term profit incentives will continue to clash with increasing expectations by the public for business to ‘solve’ society’s problems (or at the very least, ‘do no harm’). As consumers and employees seek change, investors and capital will follow, ratcheting up pressure on individual companies.

Society expects a ‘corporate safety net,’ raising the risk of corporate liability from citizen activism across:

 **Human rights:** companies are already held publicly responsible for modern slavery in supply chains far from ‘home’ (with regulation slowly catching up). ‘Ethical’ compliance is set to get even more complex across two main arenas: the ethics of AI, and the rise of identity politics and contagion of ‘isms’ across borders. Should a company take an open stand against sectarianism, despite the likely domestic political backlash? What about an open stand for LGBTQ+ rights, even if these rights are not recognized or acts are illegal in a country in which it operates? Will positive action taken to respond to Black Lives Matter or feminism be universally well-received? Could a post about a social movement be branded as corporate #slacktivism or risk a backlash in different parts of the world?


 **Environment:** private sector actors and the global investment community are acting as imperfect but powerful substitutes for substantive government action on climate change. Parts of the investment community (like the world’s largest pension fund) encourage engagement with companies on climate change, but many (like the world’s largest sovereign wealth fund) have ramped up divestments; this ‘grassroots’ pressure is resulting in a growing investment gap in renewables and ‘dirty’ industries such as shipping, aviation and cement.


 **Cyber:** there remains limited public and government tolerance for cyber breaches (despite a lack of multilateral

The recent violation of major cyber ‘norms’ increase cyber risks for business. Medical facilities — protected by laws of military conflict — are seeing a significant uptick in levels of malicious cyberactivity, while Israel and Iran engaged in the world’s first ever known cyber exchange, following attacks on critical infrastructure. COVID-19 will increase economic and fiscal pressure on state cyber actors already among the leading protagonists in cyber space.



and domestic governance and protection). Cyber risks increasingly go beyond an attack and resultant loss of data — companies are more reliant on connectivity and digital infrastructure, meaning the internet poses a significant risk of a single point of failure.

 **What’s the risk?** (Ethical) scrutiny over partnerships, suppliers, products, and customers, manifested through: heightened employee and shareholder activism; consumer and customer boycotts; and ‘purpose-driven’ company strategies becoming critical to the attraction and retention of talent, and to a degree, investment.

 **Where’s the opportunity?** Business needs to be able to anticipate and respond to public action, not just the letter of the law — not just to survive, but to create a clear social compact that positively resonates with consumer bases and investors to drive growth. Elevating the likes of social issues, climate change and geopolitics can drive a more sustainable business model — like when a multinational consumer goods company utilized local recruitment and microfinancing to successfully expand into India (rather than the usual wholesaler-to-retailer distribution model)³².

What Next: Respond

The current interconnectedness of the world means that a geographically distant or individually insignificant risk could have hidden systemic significance for your business. Yet this interconnectedness equally makes it very hard to anticipate what might come next — like the death of a black man in the US reigniting the public debate around reparations from a UK pub chain and insurance market alike. The impact of these types of risks may be less foreseeable, more intangible, and most importantly, uninsurable (like brand and reputational damage), requiring more investment into different mitigation strategies than in the past.

Here’s some basic questions to get you started:



Have you identified specific geopolitical risks? Has interconnectivity with other business risks been considered? How and when are these risks escalated?



How are geopolitical risks incorporated into your existing strategy, business planning and risk management processes? Does your CRO have sufficient influence and presence to bring the right risk insights into the strategy setting process? Is the Board considering long-cycle trends e.g. populism, nationalism, globalism, megatrends etc. and the resulting impacts?



What prevention / mitigation / recovery controls do you have in place? Have you planned for ‘fat tail’ geopolitical risks? If you miss a risk, how do you react?

³² Harvard Business Review (2015) The Truth About CSR.



That's our take on the five geopolitical stand-offs that will reshape the politics of business.

Yet we are not facing challenges necessarily far greater than those tackled by others throughout history. These challenges are merely unique to our time — and these redefining moments in history can lead to era-defining innovation (just look at Lego³³).

For those who are able to **anticipate, prepare** and **respond** to these macro forces, companies can capitalize on opportunities and map out a more certain path in this less predictable, polarized world.

³³ The now-ubiquitous 'Automatic Binding Brick' was borne from multiple fires, bankruptcy and a World War II-driven shortage of materials.

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 and territories together with KPMG firms nuts and bolts understanding of your business covering from the macro to the most granular of analysis.

KPMG professionals can help business:



Anticipate what is coming by drawing on non-traditional data with the aim of pinpointing '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 advising on the prioritization of 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 market entry strategy, including issues like localization, partnerships and local stakeholder management.



Understand the big picture so that regulatory, locational, reputational, political and financial risks are included not only at the operational level, but are also integrated into every strategic decision you make.

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