

## EY Center for Board Matters

# How boards can support a geostrategic response to new political risks

In a [recent survey](#) of more than 1,000 global C-suite executives, nearly 60% said their board was spending more time on political risk than it was two years ago, when political risk was measured at a post-World War II high. Political risks are quickly on the rise, especially as governments around the world change policies, regulations and tactics in response to the COVID-19 pandemic. The pandemic has also intensified and accelerated the transformative long-term geopolitical forces that were already at play, further expanding global political risks.

Political risk encompasses four elements, the first being geopolitical risks arising from conflicting country interests and transformation in international systems. Political risk also includes country risks arising from national politics as well as risks related to changing local, national or international regulations. The fourth element comprises societal risks flowing from public activism. The word “risk” often has a negative connotation, and while risks do pose threats, many business leaders also see opportunity. Companies may be able to better identify opportunities presented by political risks if they incorporate these risks into their broader approaches to risk management, strategy and governance.

In these contexts, we highlight certain areas of interest for boards and steps they can take to help guide their companies in formulating more effective geostrategic responses to current and emerging political risks.

## Understand the current geopolitical forces

In our [2020 Geostrategic Outlook](#), we highlighted the primary forces that are transforming the global business outlook:

### Globalization

The rise of China, ongoing changes in US foreign policy and efforts by governments and economies to exert and consolidate power in the EU and elsewhere have increasingly raised questions about globalization. The rise of populism in recent years has further contributed to growing anti-globalization sentiments and a shift toward regionalization and fragmentation of economic and political systems. Traditional “rules of the game” are now in flux, and new regional power centers around China, the US and blocs within the EU are emerging. The COVID-19 pandemic is accelerating global power rivalries, shifts away from globalization and changes to the global trading system. These issues raise all four components of political risk: geopolitical, country, regulatory and social.

### Technology

National competitiveness, national security and geopolitical competition are amplified by the COVID-19 pandemic, in particular as organizations have exponentially accelerated their digital strategies and capabilities to enhance their operational, remote working, e-commerce and communications functions. Countries and companies that dominate in new technologies

such as automation, cybersecurity, AI and advanced robotics are empowered to dominate global political and business environments. This is what is driving the current global race for 5G technology dominance: technological innovation accelerates geopolitical competition among power blocs, and such competition accelerates innovation. At the same time, the politicization of science and technology is intensifying, particularly with regard to vaccination and privacy.

### **Demographics**

The aging of societies is a fundamental trend globally. But this aging is not equally distributed, creating risks to domestic political stability in countries with populations overweighted to either the older or the younger. Older populations face greater health and financial risks than younger populations. Younger populations, particularly in emerging growth economies, may face greater challenges to opportunity. Countries with large concentrations of older or younger populations face workforce imbalances and intergenerational conflict over key policy issues, such as globalization, health care systems and the environment. Taken together, such countries face heightened political risks, including economic hardship and inequality and related social unrest.

### **Environment**

Climate change and other environmental issues have become a dominant political issue around the world, with businesses feeling increasing societal pressure to take action to reduce greenhouse gas emissions and other environmental pollutants. While the COVID-19 pandemic may have temporarily shifted political focus away from environmental issues, it has also highlighted those issues as emissions globally have been dramatically reduced by economic and societal shutdowns – resulting in clear skies over cities that previously were covered by smog. The science and societal forces behind environmental activism persist and are likely to expand, meaning countries, governments, businesses and societies globally will need to attend to them. That said, environmental issues are transnational issues that call for a globally collaborative policy response – similar in certain ways to how the COVID-19 pandemic calls for a globally collaborative policy response. The current inability of governments to collaborate on such global issues impedes the mitigation of risks and development of solutions.

Besides these forces, global economic conditions, financial market conditions, and other political developments can be expected to have the biggest impact on the global business outlook.

## **Understand and safeguard the global supply chain**

Globalization and just-in-time single supplier or single country supply are under closer scrutiny. Companies have been reassessing their supply strategies with China because of rising costs, a challenging business environment and US-China trade tensions. The COVID-19 pandemic has rapidly accelerated many companies' pursuit of "China-plus-one" and other supply chain diversification efforts. The identity of the "plus-one" is unclear, with India and Mexico being cited as potential country suppliers even as challenges to that status are apparent for each country. Certain industries, such as medical, pharmaceutical and technology, may lead the way in so-called nearshoring, or "in-market, for market" to better bear risks from continuing restrictions on the movement of people, goods and technologies. Companies in all sectors must consider more closely their role in the global supply chain and understand how to protect and mitigate the loss or reduction of key supplies and assets, including adopting strategies for alternative and local sources of supplies.

## **Address changing and conflicting customer expectations**

Governments, businesses and people are all consumers. Technology has already dramatically changed the way societies globally live and work over the last decade, and the economic and social lockdowns driven by the COVID-19 pandemic have had an immediate and explosive impact on consumer needs and expectations. Consumer demand may be expected to shift even more rapidly toward digital solutions and services and to address health care concerns even as demand is constrained and transformed by financial and other challenges. New perspectives on consumerism, trade, supply chain and globalization that were already changing are changing even more as a result of the pandemic. Questions around corporate purpose, globalization, economic opportunity and prosperity, the environment and future societal priorities make consumer demands and expectations even harder to predict.

## **Consider reputational risk and stakeholder impacts**

Political risk both impacts and is driven by governments and society. These circular relationships heighten the risks to corporate reputation where governments and or society perceive corporate missteps. A single discrete action can trigger widespread condemnation (or, less likely, praise) by governments, regulators, employees and consumers. As stakeholder capitalism gains ground globally, investors, employees, consumers and other key stakeholders will

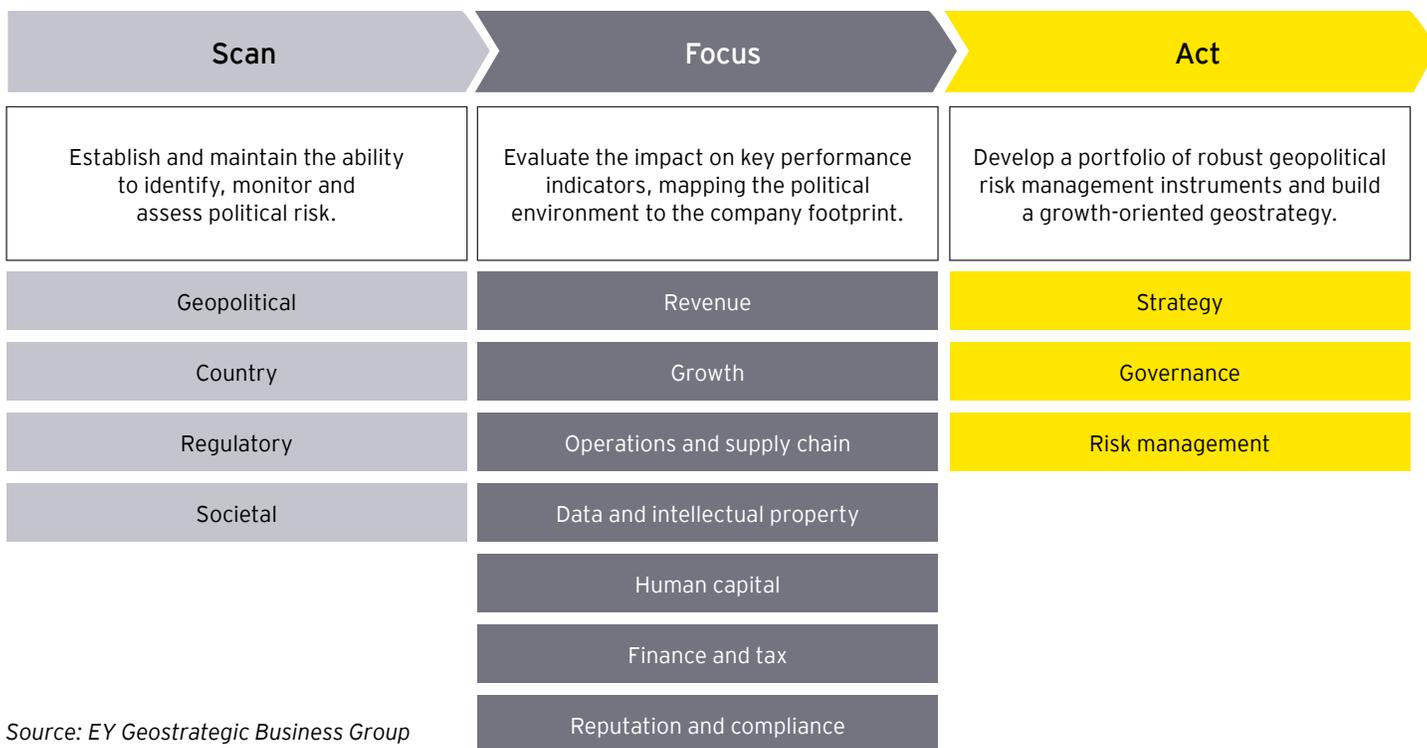
increasingly judge companies based on how they act toward them, the communities where they do business and the environment. Regulators will also continue to scrutinize corporate behavior, facilitated by technology that can enhance detection of legal and compliance violations and fueled by societal demands. A strong corporate culture to drive the right standards, communications and behaviors is necessary for companies to help maintain and enhance their sustainability, reputation and value in today's social media-driven world. The conditions created by the COVID-19 pandemic significantly heighten the need for companies to consider stakeholders as they act to reopen and expand business.

### Scan, focus and act to manage political risks

The multidimensional impacts of political risks can be felt across the entire spectrum of corporate activity. Companies therefore need to identify their core political risks, including threats and opportunities. Boards can offer effective help by seeing that

political risk is assigned to a specific individual, committee or function at the management level and that such assignee is empowered to work cross-functionally across the company to identify, assess and appropriately address those risks. Political risk management generally is best assigned to people or functions that already serve a cross-functional role, such as finance or risk management officers.

Assigning political risk to the appropriate empowered person or function is only the first step. The second is to ensure that effective political risk management tools are being used. Given the rapidly shifting elements in all the four components of political risk, boards should see that appropriate resources are available to allow management to collect data and conduct scenario analysis around political risk and developments. Boards should also see that their companies adopt a geostrategy that incorporates political risk assessment into risk management, strategy and governance. Scanning, focusing and acting on political risks will help avoid the threats and seize the opportunities they raise.



Source: EY Geostrategic Business Group

## Questions for the board to consider

- ▶ Is management regularly providing the board with data and forward-looking insights related to geopolitical risks, country risks, regulatory developments and societal risks?
- ▶ Are political risks and opportunities appropriately evaluated in the company's strategic planning and enterprise risk management processes?
- ▶ Are political risks integrated into the company's scenario and business contingency plans?
- ▶ Does management have the appropriate skills and processes to evaluate and manage political risks? What internal processes and tools enable political risk management? What external providers are being used to augment management's point-of-view?
- ▶ What changes to the company's supply chain should be considered due to the changing nature of political risks and opportunities?
- ▶ How are political risks impacting the company's key stakeholders?
- ▶ What exposure does the company have to its reputation related to its political risks?

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