

CEO Imperative Series

Critical answers and actions to reframe your future

Geostrategy in Practice 2021

A survey of global executives reveals more proactive political risk management enables companies to pursue bolder strategies





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Executive summary

Executives may be discounting the likelihood of some political risks.

About half of global executives expect political risk to be higher in the coming year, with geopolitics being the highest area of concern (see About the survey on page 30). This follows similar results in our 2020 survey. But most companies' approach to risk identification is reactive and relies primarily on enterprise-level processes, which may expose them to regulatory or societal risk surprises. In fact, more than 90% of global executives say that their company has been affected by unexpected political risks in the past 12 months.

Political risks will continue to have impact across the enterprise.

Executives expect the largest political risk impact on companies' growth and investment, operations and supply chain, and revenue in the coming year. They may be underweighting the potential impact of political risks on reputation and compliance, though. This underscores the need for companies to improve their assessment of political risk impacts across the enterprise – which is executives' top priority for improvement this year.

Political risk management is disconnected from enterprise risk management (ERM).

Only one in five global executives (23%) say their company integrates political risk management into broader ERM on a regular basis. This is problematic in the wake of the COVID-19 crisis, which emphasized the need for more strategic risk management practices to maintain enterprise resilience. While 94% of executives say their companies moderately or significantly changed political risk management approaches, more investment in political risk management processes and governance structures is needed.

Proactive political risk management enables bolder strategic decisions.

The most significant driver of executives' confidence in their ability to manage political risk is the extent to which they are taking proactive actions to identify, assess and manage it. Political risk is proactively included in strategic decisions – including market entry and transactions – by about half of companies. And higher confidence is motivating proactive companies to pursue bolder, political risk-informed, growth-oriented strategies.

Companies should take five steps to put geostrategy into practice.

Each company will have a different set of priorities to develop its geostrategy and strengthen its ability to manage political risks in a more strategic way, but these survey results reveal common challenges and priority investments. Companies should take five steps to engage in more proactive and strategic political risk management:

1. Identify and collect quantitative political risk indicators
2. Develop or acquire the ability to assess the business impact of political risk
3. Integrate political risk into ERM
4. Engage the board and C-suite to incorporate political risk into strategic planning
5. Set up a cross-functional geostrategic committee





Political risk management is in flux

The COVID-19 pandemic has been the world's worst public health crisis in a century. It has also been a dramatic test of companies' risk management capabilities. Risk management and crisis response systems had to adapt in real time to a rapidly changing global business environment. Political risks rose as governments around the world dramatically shifted policies and regulations in response to COVID-19. And the [geopolitics of COVID-19](#) – including export controls and industrial policies to increase “self-sufficiency” in critical products, vaccine nationalism and vaccine diplomacy – is creating new head winds for globalization and exacerbating strains in the global rules-based order.

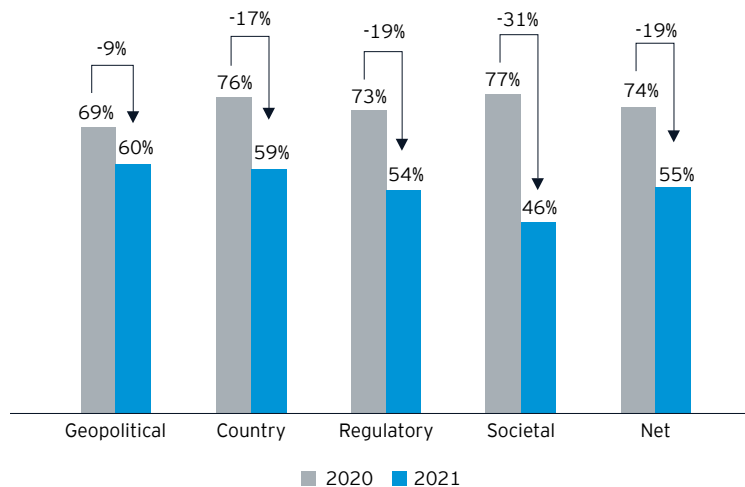
This volatile political risk environment has generated significant unforeseen outside risks for companies. More than 90% of executives in the *EY Geostrategy in Practice 2021* survey say that their company has been impacted by unexpected political risks in the past 12 months. About one-third of companies did no better than a coin flip in terms of identifying political risk events that would impact them – that is, they were surprised by political risks about half the time. Perhaps this is not surprising in the COVID-19 era, but it points to a strategic opportunity to improve political risk identification and monitoring.

It is not only risk *identification* that is a challenge. Executives' confidence levels about their companies' ability to *manage* political risks are significantly lower than in the *EY Geostrategy in Practice 2020* survey. Pre-pandemic, 74% of global executives were highly confident about their company's ability to manage political risks. Now only 55% of global executives display similar confidence levels (see **Figure 1**). The biggest drop in confidence is in companies' ability to manage societal risks. And although executives are most confident about managing geopolitical risk, there has still been a nine-point drop in confidence since the start of the pandemic.

Figure 1

C-suite confidence in managing political risks has plummeted

How confident are you in your company's ability to manage the following types of political risk?



Source: *EY Geostrategy in Practice 2021*, *EY Geostrategy in Practice 2020*

Executives' confidence in their company's ability to manage political risk going forward is driven by a variety of factors. A regression analysis reveals the most significant driver by far is the extent to which companies are taking regular or proactive actions to identify, assess and manage political risk. The more proactive a company is in its political risk management, the more confident its executives are in their ability to manage whatever political risks come their way.

Companies pursuing a proactive approach to political risk management make up about 29% of survey respondents, while about 40% of companies take a more ad hoc or reactive approach and the remainder have a mixed approach or take only limited actions to manage political risk (**see sidebar below**). Proactive companies appear to be more aware of their exposure to political risks and are more likely to identify the need for additional investments in managing it, while those in the reactive group seem overconfident in their political risk management abilities. This overconfidence could be at their peril, as reactive companies are also less likely to have experienced revenue growth in the last fiscal year than those in the proactive group.

Proactive companies' political risk activities provide a way forward for executives seeking to improve their company's political risk management. While 94% of executives say their companies moderately or significantly changed political risk management approaches in the past year, proactive companies are much more likely to have made significant changes. This is part of a broader shift in risk management approaches due to companies' experiences with the COVID-19 crisis, which reflects a growing recognition of companies' exposure to outside risks that can have a significant impact on business performance. This dynamic external environment and internal reassessment of risk management presents a strategic opportunity for C-suites to emulate proactive companies' approach to political risk management.



Sidebar

Political risk management approaches

Using latent class segmentation, four distinct groups of companies were identified based on the way in which they approach political risk activities. The analysis in this report focuses on the different perceptions, strategies and outcomes of the first two groups of companies.

- 1. Proactive companies.** These companies take the greatest number of proactive measures to identify, assess and manage political risks. They comprise about 29% of the sample.
- 2. Reactive companies.** The actions that these companies take to identify, assess and manage political risk are done primarily in a reactive way. They make up about 40% of the sample.
- 3. Mixed activity companies.** These companies take a mix of proactive and reactive measures to identify, assess and manage political risk. They account for about 17% of the sample.
- 4. Less active companies.** These companies take the fewest number of measures to identify, assess and manage political risk, and the measures that they do take are primarily reactive. They comprise about 14% of the sample.

Political risks are rising but risk identification systems are not fit for purpose

Global executives expect political risk to remain elevated in the year ahead, with geopolitical risk as their biggest area of concern. While geopolitics will continue to be volatile, executives seem to be overlooking political risks driven by regulatory shifts and social unrest. This could be due to companies conducting most of their risk identification at the enterprise level – which would tend to focus on macro-level political risks (such as geopolitics) rather than more localized ones (such as regulation changes and social risks). Indeed, executives at proactive companies have higher levels of concern about regulatory and societal risks than do executives at reactive companies – while the opposite is true for geopolitical and country risks. Companies should verify that their political risk identification systems are fit for purpose in today’s volatile geostrategic environment to avoid being caught off guard by these risks of lower concern.

Geostrategy recommendation 1: identify and collect quantitative political risk indicators

Executives are most concerned about geopolitical risks

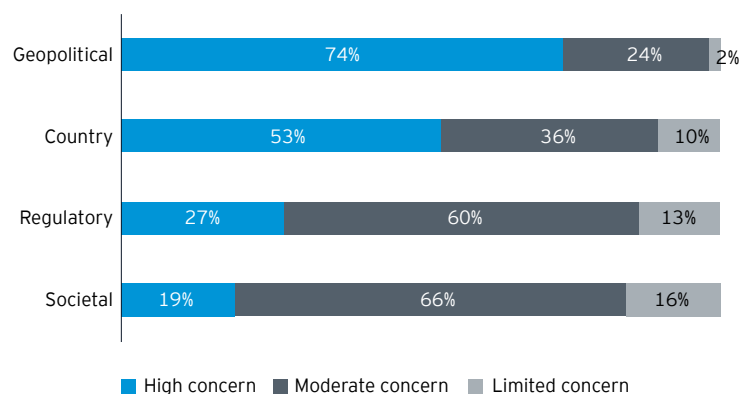
About half of global executives (49%) expect political risk to be higher in the coming year than it was in the last year. And a similar share (43%) expect it will remain at the same level. This is striking given that global [political risk recently hit a post-World War II high](#). While these heightened political risk expectations hold across the global C-suite in the survey, executives in Asia-Pacific are particularly likely to expect higher levels of political risk this year. This may reflect the centrality of the broader Indo-Pacific to global geostrategic competition and ongoing geopolitical tensions within the region.

Geopolitics reigns as the political risk of highest concern over the next 12 months (**see Figure 2**). Concerns about geopolitical risk appear to be driven by US-China tensions and the geopolitics of COVID-19, as the specific risks of most concern are worsening relations between major powers (60%), the shifting role of major powers in the international system (59%) and restrictive trade or investment policies (42%).

Figure 2

Geopolitical risk is what keeps the C-suite up at night

How concerned are you about the following types of political risk impacting your company in the next 12 months?



Note: Figures may not add up to 100 due to rounding.
Source: EY Geostrategy in Practice 2021

C-suites are concerned about a range of country risks, but it appears executives believe country risks will be driven primarily by the increasing role of government in domestic economies and commerce. The top three country risk concerns are expropriation and nationalization (49%), industrial policies and protectionism (44%) and unstable macroeconomic policies (43%). Indeed, the [2021 Geostrategic Outlook](#) argues that these risks will likely intensify as countries seek greater self-reliance in strategic sectors in the wake of COVID-19.

Executives’ top three regulatory risks also align with risks highlighted in the [2021 Geostrategic Outlook](#): environmental or climate change regulations (48%), data privacy or localization (46%) and health and safety regulations (41%). But executives’ top regulatory risk concerns differ by sector in predictable ways. For instance, executives in the telecommunications, media and technology (TMT) and financial services sectors are most concerned about data privacy and localization. And those in advanced

manufacturing and mobility (AMM) are most concerned about climate change regulations, while health sciences and wellness (HSW) sector executives are most concerned about health and safety regulations.

Big-picture issues are the front-of-mind societal risks for the global C-suite. Executives overwhelmingly perceive declining trust in institutions as the biggest driver of societal risks in the year ahead (65%). They are also highly concerned about shifting expectations regarding the role of business (56%). Similarly, one-third of CEOs in the EY *CEO Imperative* study point to responsible business and stakeholder capitalism as a key trend impacting their business; and one-third say the same about the emergence of new business models. This focus is understandable given increasing public attention to stakeholder capitalism and companies' role in *long-term value* creation.

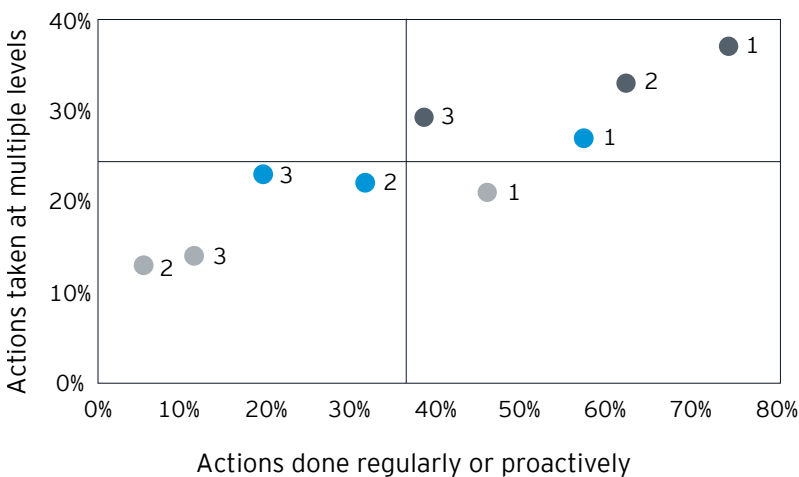
Companies' efforts to identify political risks are tilted toward qualitative macro insights

Almost all companies take actions to identify political risks, but the majority of these actions are reactive. The one exception is processes to identify new or emerging risks, which 57% of companies do on a regular or proactive basis. While this is encouraging, the more ad hoc or reactive inclusion of quantitative data and external insights calls into question whether companies are casting a wide enough net when trying to identify new or emerging risks. The differences between the proactive and reactive companies' activities in these areas are particularly striking. Almost two-thirds of proactive companies regularly collect and integrate quantitative data on political risk, for instance, while only 6% of reactive companies do so (see **Figure 3**). Proactively integrating quantitative indicators and insights from external sources could assist further in emerging risk identification – which is likely to become more crucial to political risk management as the world enters a new era in the COVID-19 crisis.

Figure 3

Proactive companies lead across the board on political risk identification activities

Does your company do the following to manage political risk? For each of the actions you take to manage political risk, at what level in your company is that action primarily carried out?



Activities to identify political risks

1. Engage in new processes to identify new and emerging risks
2. Collect and integrate quantitative data on political risk
3. Collect and integrate political risk insights from external sources

- All companies
- Proactive companies
- Reactive companies

Note: Data show percentage of executives in each group responding “on a regular or proactive basis” to the first question and “at both the corporate or enterprise level and the functional, business unit or country level” to the second question.

Source: EY *Geostrategy in Practice 2021*

Another way in which companies could improve their risk identification is through diversifying the areas of the company that contribute to this process. Currently, almost two-thirds of companies rely primarily on enterprise-level identification of emerging risks – including almost three-quarters of reactive companies. This may expose companies to unnecessary surprises that functions or business units are best positioned to identify – particularly in terms of regulatory and societal risks. Given proactive company executives' greater concern about these risk types, it is no surprise that they are far more likely to conduct emerging risk identification at both levels or at only the functional or business unit level.

For many companies, political risk identification processes should not only be devolved to functions or business units, but also elevated to the board. At only 16% of companies surveyed does the board receive regular geopolitical briefings from an external subject matter expert. And fewer than one-quarter of boards engage in scenario planning around political risks and the broader macro environment. This lack of board focus on political risk strategy could be related to who the directors are. Only 18% of companies have a board member with government or political experience, suggesting a lack of leadership experience or acumen to understand and design an effective political risk strategy.

Despite these deficiencies, global executives are broadly pleased with their companies' ability to identify political risks as only 32% see this as in need of improvement. Executives at reactive companies seem to recognize their challenge on this front, though, as 36% of them say political risk identification needs improvement (compared to only 26% of proactive company executives). For all executives that prioritize improving political risk identification, quantitative political risk data is seen as key. Collecting and integrating quantitative data on political risk is pointed to by these executives as the most important action their company could do – or do more of – to improve political risk management. Such data would not only help with risk identification. It would also help companies make strides in other priority areas, such as assessing political risk impact and integrating political risk into enterprise risk management systems.





The significant materiality of political risk necessitates better impact assessments

Executives expect the highest political risk impact in the next 12 months to be in the same three areas of the business that were most affected in the past 12 months: growth and investment, operations and supply chain, and revenue. This reflects an understanding of where risks have manifested but may also suggest a lack of imagination about how evolving COVID-19 political risks and other new emerging risks may impact companies in the coming year. In particular, global executives may be underweighting the potential impact of political risks on reputation and compliance. This area was at least moderately impacted for 90% of companies surveyed in the past year. But only about half of executives point to it as a high impact area in the next year, despite likely significant shifts in regulation in key markets. This underscores the need for companies to improve their assessment of political risk impacts across the enterprise – which is executives’ top priority for political risk management improvement overall.

Geostrategy recommendation 2: develop or acquire the ability to assess the business impact of political risk

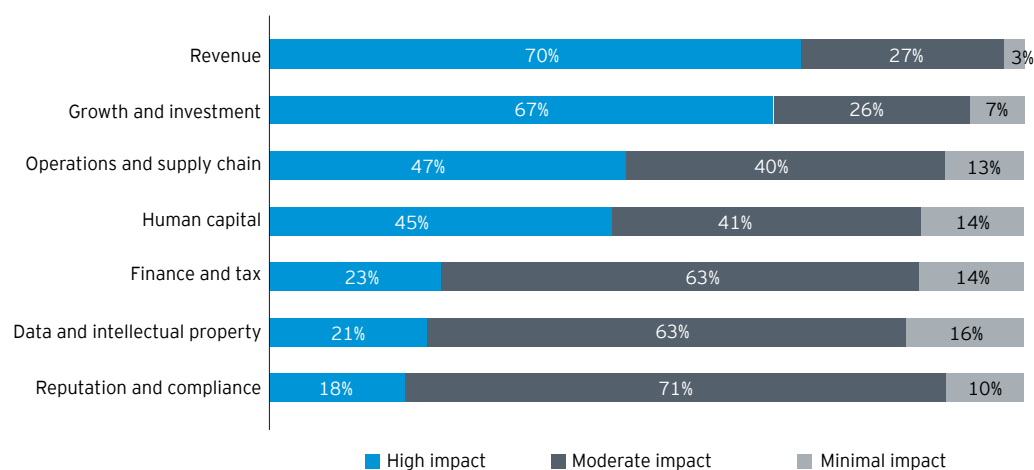
Political risks have impact across the enterprise

The high level of political risks in the past year resulted in a high level of impact on companies. Global executives report that political risk events that occurred in the past 12 months had the greatest impact on revenue and on growth and investment (see Figure 4). This is unsurprising given the COVID-19 crisis drove many of the political risks that impacted companies in the past year, such as pandemic lockdowns, export controls on strategic products affecting operations and supply chains, and travel restrictions affecting human capital.

Figure 4

In the COVID-19 era, political risk has had the most significant impact on companies’ revenue and growth

For political risk events that occurred in the past 12 months, please rate the impact that these events actually had.



Note: Figures may not add up to 100 due to rounding.

Source: EY Geostrategy in Practice 2021

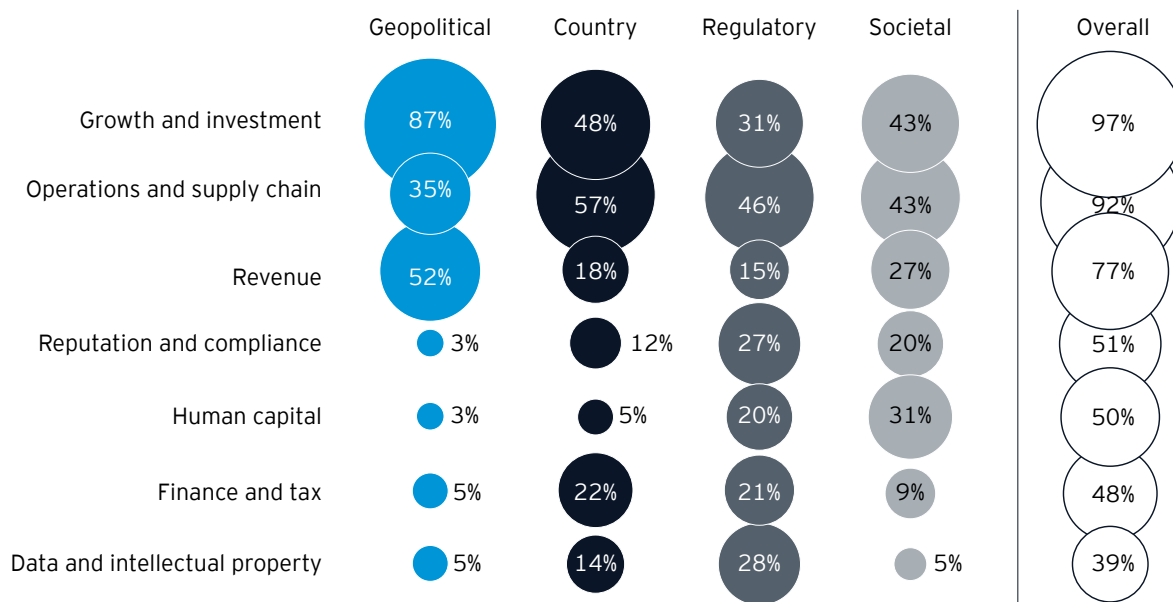
Looking ahead to the political risks the C-suite is most concerned about in the coming year, executives expect the largest impact on companies' growth and investment, operations and supply chain, and revenue (**see Figure 5**). Geopolitical risks are expected to overwhelmingly hit companies on the topline strategic areas of growth and investment and revenue, which helps to explain why executives are so concerned about this risk type. In contrast, business operations and supply chains will be most affected by country and regulatory risks, which have been on display throughout the COVID-19 crisis. Societal risks similarly are expected to have a large impact on operations and supply chains overall, although the societal risks about which executives are most concerned – declining trust in institutions and shifting expectation about the role of business in society – are expected to have the most significant impact on growth and investment.

The impact of regulatory risks is more distributed across the enterprise, which reflects the divergent nature of risks within this category. Executives expect regulatory risks across the board to have a high level of impact on operations and supply chain. This is also the biggest area of impact for two of the top three regulatory risks in the year ahead – climate change and health and safety regulations. But the C-suite expects data privacy and localization to primarily impact companies' data and intellectual property. It seems executives at proactive companies have a greater understanding of these potential data impacts, as 35% of them expect a significant impact in this area over the next 12 months, compared to just 21% of reactive company executives.

Figure 5

Political risks will continue to have impact across the enterprise

For the top political risks in each risk type, in what area(s) of your business would they have the greatest impact if they occurred?



Note: Data presented are a summary of individual risk impacts with each risk type. "Overall" data represent the total share of companies that would be impacted in each area across any risk type.

Source: EY Geostrategy in Practice 2021

Companies assess political risk impacts in an ad hoc way at the enterprise level

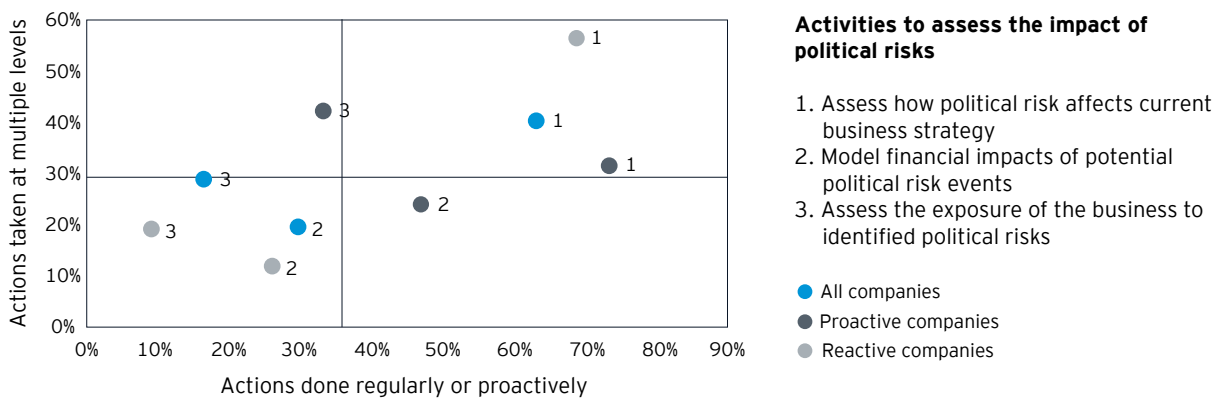
While most companies can identify political risks, determining how these risks will impact their business is more difficult. Global executives point to assessing the impact of political risks as the most important area of improvement to overcome challenges and seize opportunities associated with political risks. The majority of executives (58%) identify the need for enhancements in this area – a focus that holds across all geographies and sectors. Specifically, among executives that prioritize improvements in risk assessment, they want to improve how they model the financial impacts of political risks (47%) and develop a better understanding of the exposure of the business to identified political risks (39%).

It is easy to see why so many executives are seeking improvements in political risk impact assessment: Companies' current assessment of political risk impacts are mostly ad hoc. Even the most proactive companies struggle in this regard (see Figure 6). This is true not only within management but also at the board level. Global executives report that only 26% of boards receive regular geopolitical briefings from company functions. The lack of more proactive impact assessments is likely part of the reason that 94% of companies experienced unexpected political risk impacts in the past 12 months.

Figure 6

Companies' approach to political risk assessment leaves a lot of room for improvement

Does your company do the following to manage political risk? For each of the actions you take to manage political risk, at what level in your company is that action primarily carried out?



Note: Data show percentage of executives in each group responding "on a regular or proactive basis" to the first question and "at both the corporate or enterprise level and the functional, business unit or country level" to the second question.

Source: EY Geostategy in Practice 2021

Another area of opportunity is to confirm that political risk impact assessment happens at all levels of the organization, not just at the enterprise level where it mostly happens today. The low share of companies that include business units or functions in modeling financial impact (35%) raises questions about whether the impact analysis includes adequate business context. Reactive companies have the most opportunity to improve in this area, as only 12% of them model financial impacts of political risks at both the enterprise and functional or business unit levels.

The one area where companies are showing progress is assessing the impact of political risk on current business strategy. Two-thirds of companies already do this on a proactive or regular basis, and 40% conduct these assessments at both the enterprise level and the functional or business unit level. The board is also more engaged in this activity, with 40% of executives saying their company's board regularly assesses the impact of political risk on strategy.



Political risk management is disconnected from enterprise risk management

Strikingly, only 23% of global executives say that their company integrates political risk management into broader risk management on a regular or proactive basis. Proactive companies really stand out in this area, as almost half of them regularly integrate political risk into ERM. This provides a clear area in which other companies can improve their political risk management practices to better mitigate downside risks and seize upside opportunities. Executives recognize this imperative, as 44% of those focused on improving political risk management say that integrating political risk into ERM is the most important action their company could take.

Geostrategy recommendation 3: integrate political risk into ERM

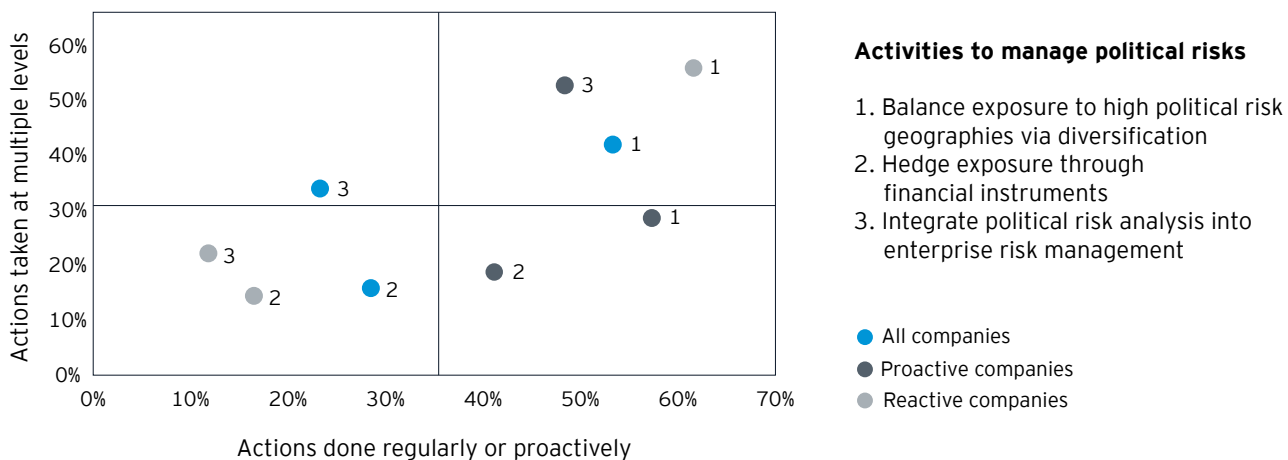
In fact, across all political risk actions that companies carry out, those in the area of political risk management are most reactive. On average, only 35% of executives say they take political risk management activities on a proactive or regular basis. This is particularly problematic in the wake of the COVID-19 crisis, which demonstrated that proactive and strategic risk management is critical to maintaining enterprise resilience. More proactive management can also help to shift potential political risk events **from challenges to opportunities**. The proactive companies seem best placed to remain resilient in the face of political risks today based on their approach to managing these risks (see Figure 7).

While political risk management is more reactive than other areas, it tends to be more integrated throughout the enterprise.

Figure 7

Reactive political risk management approach may mean companies miss turning potential risks into opportunities

Does your company do the following to manage political risk? For each of the actions you take to manage political risk, at what level in your company is that action primarily carried out?



Note: Data show percentage of executives in each group responding "on a regular or proactive basis" to the first question and "at both the corporate or enterprise level and the functional, business unit or country level" to the second question.

Source: EY Geostrategy in Practice 2021

On average, almost one-third of companies globally conduct political risk management activities at multiple levels. Importantly, the regular activity in political risk management extends to the board as well. About one-third of global executives say their company's board has a committee that is responsible for political risk management oversight (the second most common area of board oversight). This comprehensive approach could be the result of a more established risk management function being able to coordinate these activities in many companies. It could also reflect the necessity of coordinating between the enterprise and functional or business unit levels on these activities, such as balancing exposure to high-risk geographies via diversification.

Despite this relatively comprehensive approach, enterprise resilience would benefit from greater integration of political risk management within the risk function in many companies. Indeed, executives point to political risk management as the second-highest priority area to improve their company's ability to overcome challenges and seize opportunities associated with political risks. And the rank-order of the specific risk management activities in need of improvement aligns with the actions companies are taking on the least proactive basis today. This suggests executives view all these political risk management activities as important to pursue.



Strategy and transactions are heavily influenced by political risk analysis

As revealed in the *EY Capital Confidence Barometer*, geopolitical challenges are forcing about 80% of companies to alter their strategic investments. The EY *Geostrategy in Practice* survey similarly finds that companies are making a variety of strategy shifts in response to COVID-19 political risks, including on their supply chains and international footprint. The high degree of influence that political risk has on strategic decisions is likely the result of the significant impact it has had on topline growth and investments. This interconnectivity also explains why companies incorporate political risk analysis into strategy more proactively than any other area. Nevertheless, many companies still have significant opportunities to improve the resilience of their strategies to political risk events.

Geostrategy recommendation 4: engage the board and C-suite to incorporate political risk into strategic planning

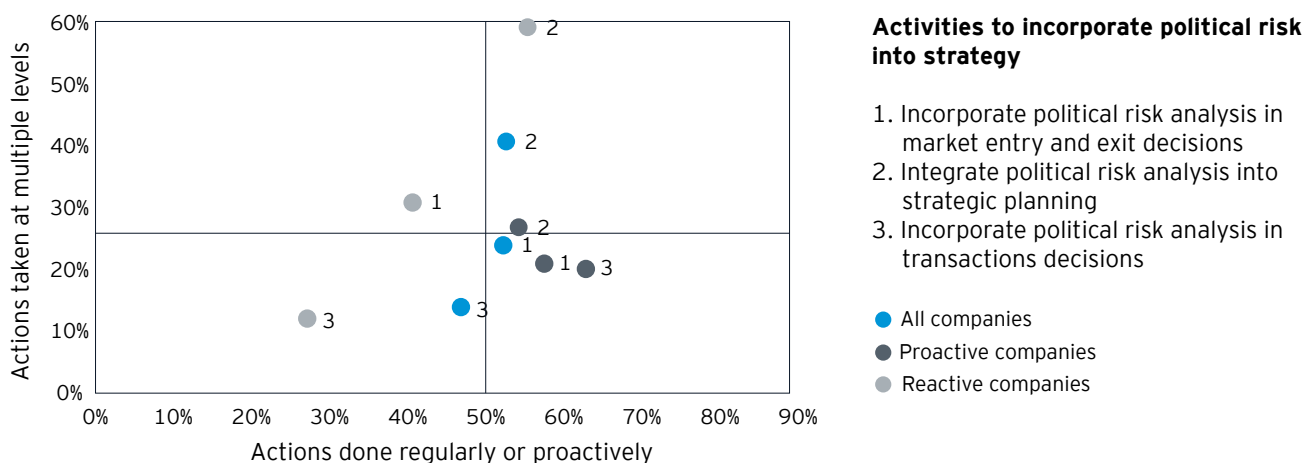
Strategic decision-making is the most proactive political risk activity

Strategy is the most proactive area of political risk activity within companies globally. Political risk is proactively included in strategic decisions – including market entry and transactions – by about half of companies (see **Figure 8**). This level of activity is even higher at proactive companies, 63% of which proactively incorporate political risk analysis into transactions decisions and 58% of which do the same for market entry decisions – compared to only 27% and 41% of reactive companies, respectively.

Figure 8

Most companies take a more proactive approach to incorporating political risk into strategy

Does your company do the following to manage political risk? For each of the actions you take to manage political risk, at what level in your company is that action primarily carried out?



Note: Data show percentage of executives in each group responding “on a regular or proactive basis” to the first question and “at both the corporate or enterprise level and the functional, business unit or country level” to the second question.

Source: EY *Geostrategy in Practice* 2021

Strategy integration is also the area of political risk management that is pursued by the highest share of companies, with only 2% of executives saying that their company does not incorporate political risk analysis into market entry and exit or transactions decisions. This is likely due to such strategic decisions having long-term implications for company performance and providing a discrete opportunity to assess the political risks associated with them at the outset.

Integrating political risk into broader strategic planning is the least widely pursued activity in this area. While 53% of companies globally do this on a proactive basis, 10% of executives report their company does not do it at all. And integrating political risk into strategic **planning** remains far less proactive than companies assessing the impact of political risk on **current** strategy (66%). Boards have a similar focus, as they regularly pay more attention to the impact of political risk on existing strategy (40%) than on incorporating political risk **into new business decisions** (25%). This suggests companies are taking a more reactive approach to strategic political risk analysis than they could be, presenting an opportunity to move beyond short-termism and inform more proactive strategies.

In fact, despite 90% of companies already incorporating political risk into strategy, more than one-third of global executives point to this as a key area for improvement. Among those focusing on this area, market entry and exit decisions (44%) and strategic planning (36%) are the activities executives believe would benefit most from incorporating political risk analysis. Executives' interest in better integrating political risk into market entry and exit decisions is likely driven by increasing geopolitical tensions and shifting country policy environments – all of which are in flux due to the political risks generated by the COVID-19 crisis.



COVID-19 political risks are driving strategy shifts

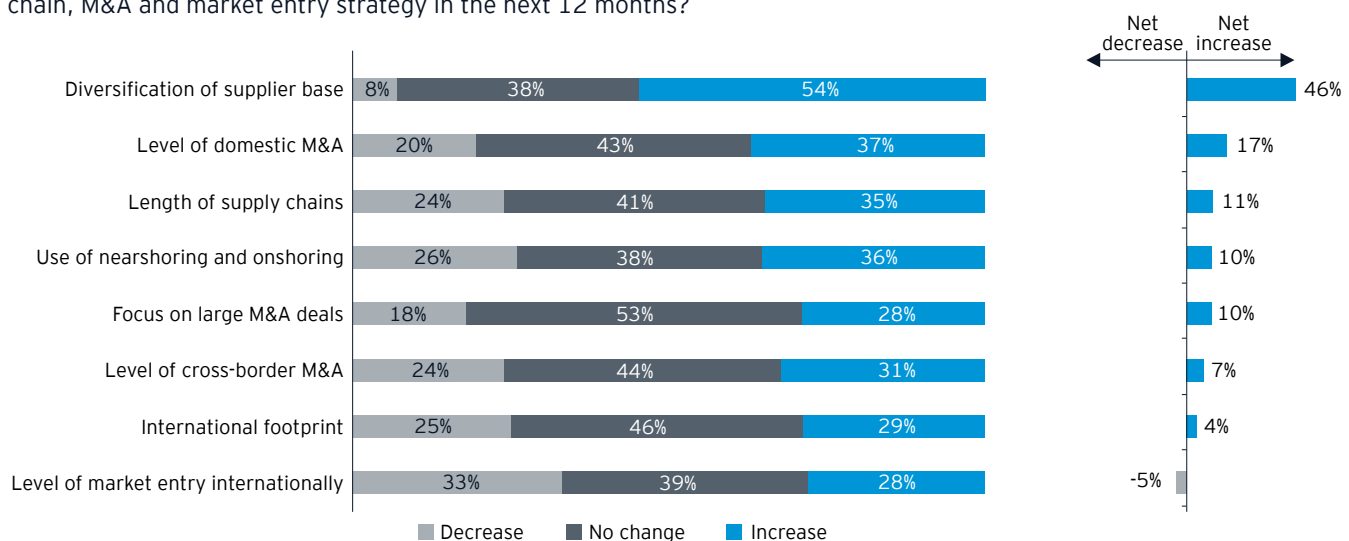
In recent years, there has been a shift from a laissez-faire approach to a greater role for state intervention in many economies. COVID-19 has accelerated these trends, driving many countries to tighten foreign direct investment (FDI) regulations, impose export restrictions on critical medical supplies, and incentivize the reshoring or nearshoring of strategic supply chains in the pursuit of “self-reliance.”

These government policies in response to COVID-19 – as well as the experience of the pandemic itself – are driving many companies to seek greater supply chain resiliency. The largest change that executives expect to make in the year ahead is diversifying suppliers, as almost seven times more companies plan to increase the diversification of their supplier base than decrease it (see Figure 9). At the same time, 10% more companies plan to increase their use of nearshoring or onshoring in the coming year. But about one-third of executives expect their company’s supply chains to become longer over the same time period. Overall, pandemic-era political risks are creating more complex supply chains across a range of strategic decisions.

Figure 9

Government policies in response to COVID-19 are driving companies to seek supply chain resiliency

How do you anticipate trade protectionism and industrial policies in response to COVID-19 will affect your company’s supply chain, M&A and market entry strategy in the next 12 months?



Note: Figures may not add up to 100 due to rounding.

Source: EY Geostategy in Practice 2021

Another strategy shift in response to trade protectionism and industrial policies is an apparent retrenchment to domestic markets. Almost two times more companies plan to increase domestic M&A than decrease it in the year ahead, while there is a more even split between those planning to increase or decrease cross-border M&A. There is a similarly even split between companies planning to expand or contract their international footprint in the year ahead, as well as those decreasing or increasing their level of market entry internally. These shifts likely reflect companies adapting their strategies to governments’ increasing use of industrial policies amid a focus on domestic economic resilience and self-reliance.

The strategic choices that proactive companies are making in response to the COVID-19 crisis are revealing. In aggregate, proactive companies plan to increase the diversification of their supplier base while decreasing the length of their supply chains and expanding their international footprint. Large M&A deals will figure prominently in this strategy. This mix of actions suggests proactive companies are implementing a regionalization strategy to counter industrial policies and trade protectionism – which should enable them to continue to pursue international growth opportunities while managing political risks. In contrast, reactive companies appear to be retrenching to domestic markets by increasing domestic M&A more than international M&A, decreasing international market entry and nearshoring or onshoring supply chains. Such a defensive strategy may help companies to mitigate risks but could cause them to miss out on strategic opportunities for which proactive companies are likely better positioned.

Political risk governance is crucial but often overlooked

A company's political risk governance structure can influence its identification, assessment and management of political risks. Proactive companies outperform their peers in terms of proactive and comprehensive governance of political risks – which appears to translate directly into how they approach the rest of their political risk activities differently than other companies. But while governance structures appear to be central to improving political risk management and a company's confidence in its approach, executives do not prioritize investments in this area. This is shortsighted, as expanding and coordinating political risk governance across levels within a company could help to improve many other aspects of political risk management as well.

Geostrategy recommendation 5: set up a cross-functional geostrategic committee

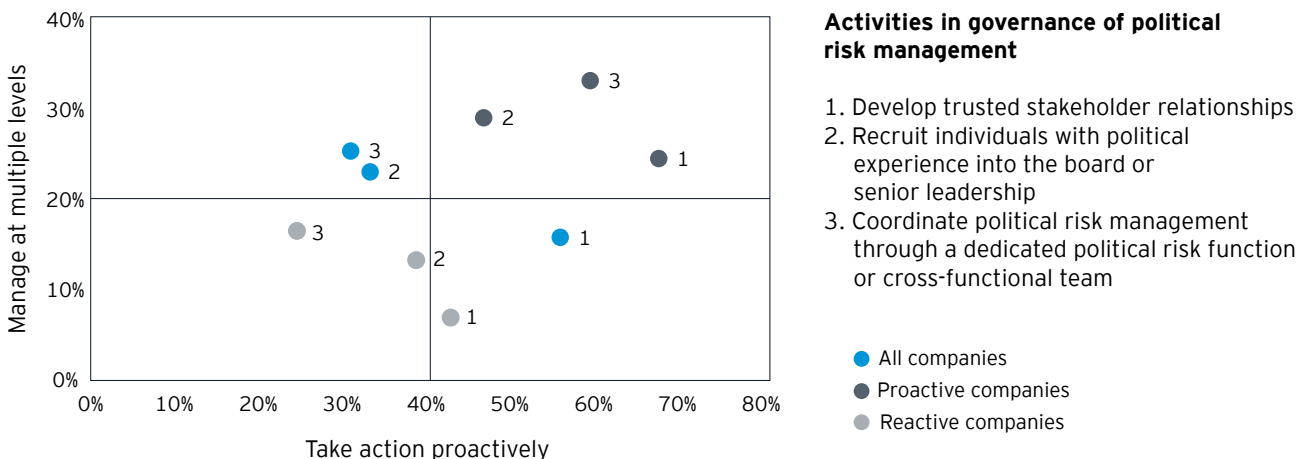
Governance of political risk management is overly centralized

Of all political risk activities, corporate governance of political risk management is the least balanced between the enterprise and functional or business unit levels. Fewer than one-quarter of companies conduct any of the political risk governance activities at both the enterprise and the functional or business unit levels (see Figure 10). Instead, around two-thirds of companies rely on governance solely at the enterprise level. While enterprise-wide governance may have made sense in a more globalized, less politically risky world, the current global environment calls this approach into question.

Figure 10

Proactive companies excel at political risk management governance

Does your company do the following to manage political risk? For each of the actions you take to manage political risk, at what level in your company is that action primarily carried out?



Note: Data show percentage of executives in each group responding "on a regular or proactive basis" to the first question and "at both the corporate or enterprise level and the functional, business unit or country level" to the second question.

Source: EY Geostrategy in Practice 2021

Companies may be missing an opportunity to use country-level or localized stakeholder relationships to manage political risks. Although 55% of executives say they proactively develop trusted stakeholder relationships to manage political risks, only 26% of them do so at the functional or business unit level. This reliance on stakeholder relationships will likely serve them well amid an evolving shift toward **stakeholder capitalism**. But the simultaneous shift toward more nationalized and localized production means stakeholder relationships at the functional or business unit level will increase in importance.

Political risk governance is siloed

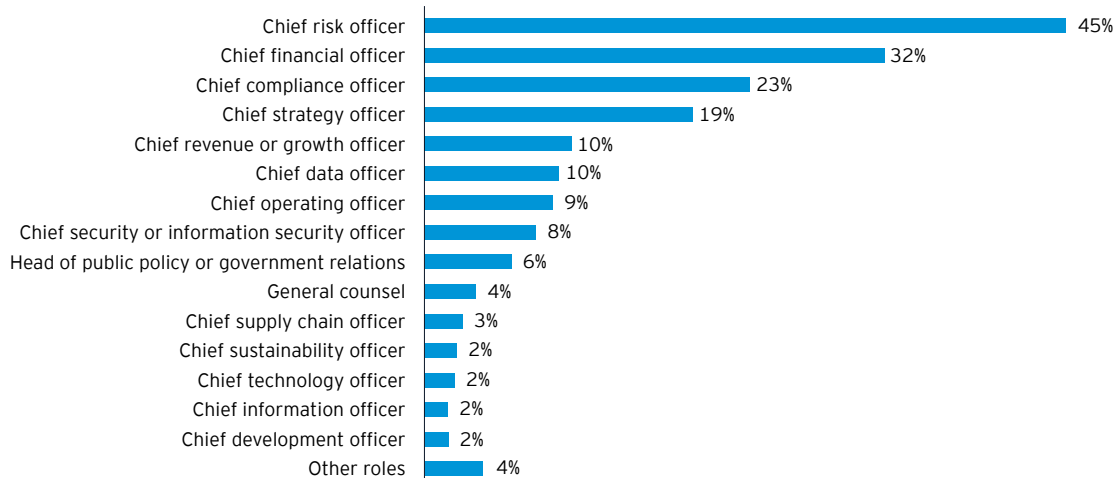
Almost all executives say their company assigns responsibility for political risk management, and about 90% say their company coordinates political risk management through a dedicated political risk function or cross-functional team. This stands in contrast to findings from interviews that the EY GBG and the Political Risk Lab at the Wharton School of the University of Pennsylvania conducted with global executives and EY client work. The disconnect may be explained by only about one-third of executives report that their company does so on a proactive basis – meaning in most cases these teams are only assembled intermittently or in response to a political risk event.

Political risk governance also appears to be siloed in many companies. Only about 40% of companies use a committee to govern political risk management, indicating that political risk management responsibility resides within a single function or individual in the majority of companies. This varies by region however, with companies in the Americas preferring a committee approach while those in Asia-Pacific tend to assign responsibility to a function or business unit.

Figure 11

The CRO is the senior executive most commonly involved in political risk management

Who at the senior management level is responsible for political risk management (either as an individual or part of the relevant function or committee)?



Source: EY Geostrategy in Practice 2021

Unsurprisingly, the chief risk officer (CRO) is the senior executive most commonly involved in political risk management (**see Figure 11**). The chief financial officer, chief compliance officer and chief strategy officer are also often involved. This mix of roles suggests that companies' political risk management should be relatively strong on financial hedging, regulatory compliance and strategic planning. Political risk is no longer a job primarily for the CRO, though. There is a need for a broader set of CXOs to be involved to implement a more enterprise-wide approach to political risk management.

Two roles – and their associated areas of expertise – are notably absent. The first is the head of public policy, public affairs or government relations, which raises the question of whether companies' political risk management teams include sufficient political expertise. Without the inclusion of public policy, it is unlikely political risk mitigation and strategic decision-making will be adequately tuned to the risk exposure of the company.

The second missing member from political risk teams is the chief operating officer or chief supply chain officer, who would be best placed to evaluate how potential political risk events would impact a company's operations and supply chain. Their exclusion from political risk management responsibilities could help explain why political risk management is so reactive on impact assessments – and why this is the area of political risk management global executives point to as most in need of improvement.

Boards are dedicating more time to political risk – but still not enough and not in the right areas

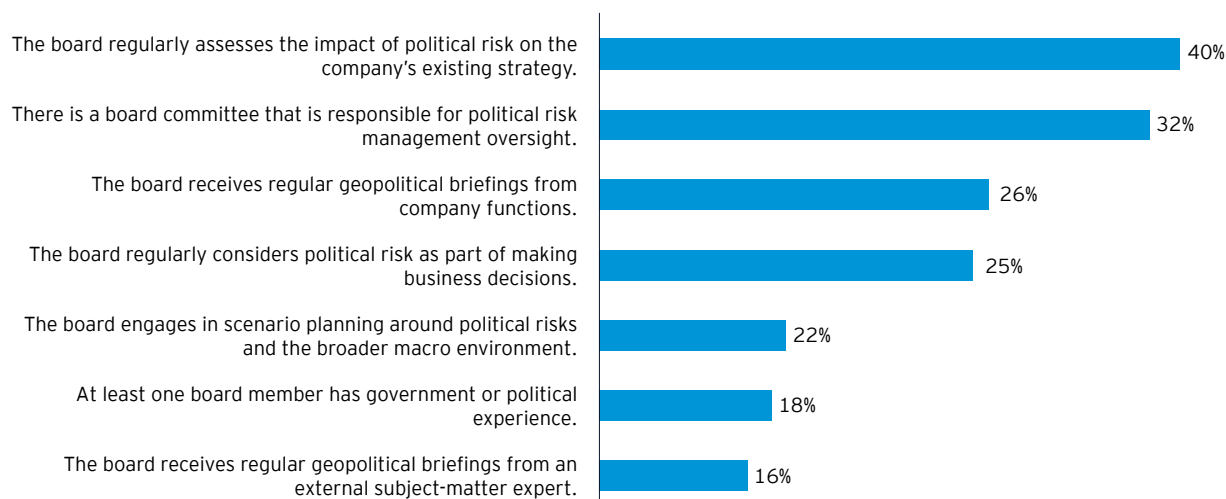
Given its strategic nature, political risk governance requires board involvement. Encouragingly, more than half of boards are dedicating additional time to political risk now compared to 12 months ago. This is the continuation of a trend, as 58% of executives said their boards were increasing time spent on political risk in *EY Geostrategy in Practice 2020*. This year it is boards in Asia-Pacific that are most likely to have increased the amount of time they dedicate to political risk, which could reflect rising geopolitical tensions throughout the region.

Although they are dedicating more time to political risk, boards still appear to have a reactive approach to political risk management. As with overall company actions to manage political risks, boards pay the most attention to its impact on existing strategy (see **Figure 12**). Boards may be missing new or emerging political risks, though, as fewer than one-quarter regularly receive political risk briefings from external experts or engage in scenario analysis on political risks and the macro environment. And boards are not helping management assess how political risks are likely to impact the business, as only 25% of them receive regular briefings by company functions.

Figure 12

Boards appear to have a reactive approach to political risk management

Which of the following does the board do to assess and manage political risk?



Source: *EY Geostrategy in Practice 2021*

Governance improvements aren't prioritized

Despite the fairly ad hoc or reactive nature of political risk management governance, improvements in this area are a low priority, and there is a lack of C-suite consensus on the way forward. Only 14% of executives point to governance as a key improvement area in political risk management. And among those that do prioritize this area, there is a fairly even split in terms of prioritization across governance actions. But executives' seeming confidence in their governance structures is likely misplaced. It appears they may not realize what governance deficiencies they have and how important they are to improving political risk management overall.

Proactive companies' political risk governance reveals why governance improvements are so crucial for other companies to make. Governance is the area of political risk management at which proactive companies excel most relative to other companies (**see Figure 10 on page 20**).

Proactive companies also include a more diverse set of executives in political risk governance. The roles that proactive companies include at the highest rate relative to reactive companies are the chief data officer, chief security or information security officer, chief strategy officer, and chief compliance officer. The influence of these roles is clear on proactive companies' political risk management, as they are far more likely than reactive companies to identify regulatory risks as an area of high concern; assess that political risks will impact their data and intellectual property; and incorporate political risk analysis into transactions and M&A decisions. It is therefore clear that governance matters when it comes to how companies approach political risk management.



Investing in a balanced political risk management approach

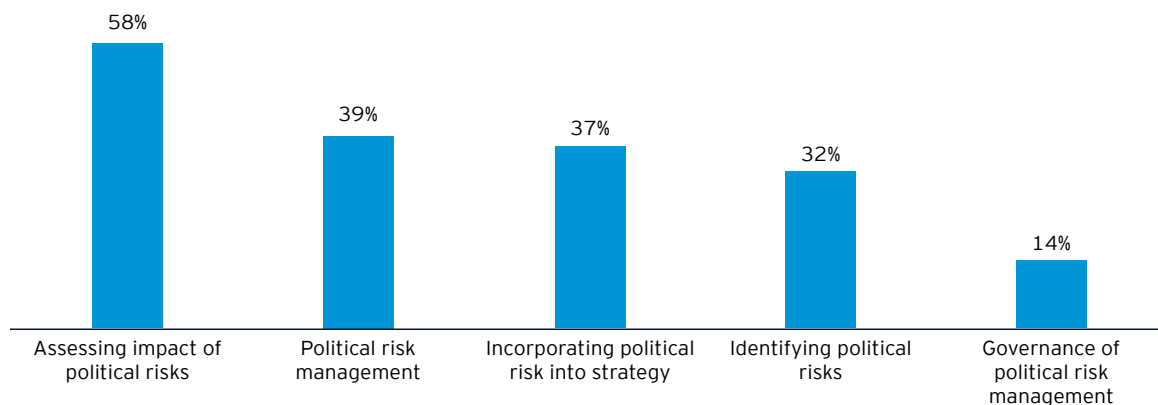
Only about half of executives globally (52%) say their company invests enough in political risk management. The other half of executives assess that their company is not investing enough at either the enterprise (9%) or the functional or business unit level (39%). This lack of funding may explain why so few companies have political risk capabilities at the functional or business level and may contribute to more ad hoc risk management.

But which activities are most in need of investment? Executives say improvements in how companies assess the impact of political risks would do most to enhance overall political risk management capabilities (see **Figure 13**). This focus on needing to improve political risk impact assessments holds across all geographies and sectors. And the results throughout the **Geostrategy in Practice 2021** survey, as well as earlier interviews that the EY Geostrategic Business Group and the Political Risk Lab at the Wharton School of the University of Pennsylvania conducted with global executives, support this assessment. Many companies have strong capabilities at identifying political risks – particularly proactive companies – and there is a vibrant political risk analysis consulting industry to support these efforts. But most companies (and political risk analysts) struggle to translate how these political risks will impact business across specific functions and performance metrics.

Figure 13

Executives prioritize improvement in political risk impact assessments

Which areas does your company most need to improve to overcome challenges and seize opportunities associated with political risks?



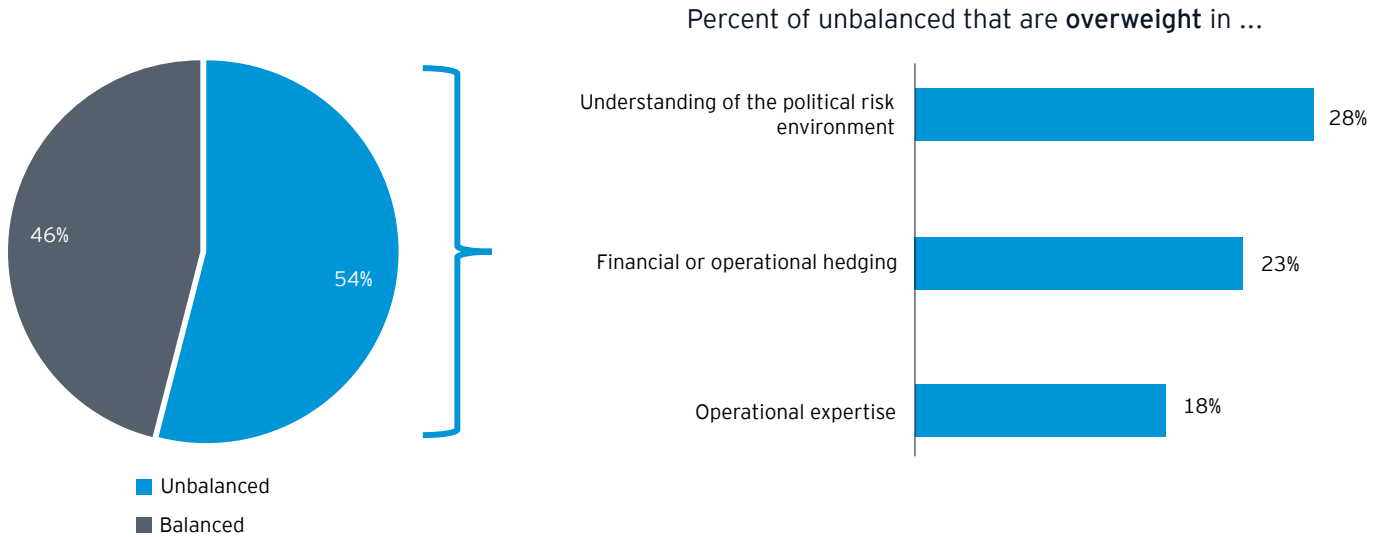
Source: EY Geostrategy in Practice 2021

Companies' limited political risk impact assessment capabilities are clear in terms of their overall approach to political risk management across three key competencies: understanding the political environment (i.e., identifying political risks), operational expertise (i.e., assessing political risk impact), and financial or operational hedging (i.e., risk management). More than half of executives say their company takes an unbalanced approach to political risk management, meaning they are overweight or underweight in certain competencies (see **Figure 14**). The most underweight competency is operational expertise. Executives' prioritization of improving political risk impact assessments suggests they recognize the need to bolster their operational expertise relative to other areas. Executives also seem to realize that relatively less improvement is needed in identifying political risks, as the political competency is the most frequent overweight area of political risk management.

Figure 14

More than half of companies have an unbalanced approach

How much does your company's political risk management rely on each of these approaches?



Source: EY Geostrategy in Practice 2021

Indeed, the goal of additional investment in political risk management should be to target the competencies in which companies are currently underweight so that political, operational and financial expertise becomes more balanced. EY research in collaboration with the Political Risk Lab at the Wharton School of the University of Pennsylvania revealed rapid growth or leadership in one competence can undermine growth and development in the others – leading to underperformance in political risk management overall. A balanced approach enables a company to translate political acumen into financial models and other systems that influence strategic planning, promoting more proactive and strategic political risk management.



Proactive companies offer one example of how to invest in political risk management to promote better balance between the competencies. Just over half of proactive companies (52%) are imbalanced, and of those, 60% are overweight in the political competency. This aligns with proactive companies' standout performance on proactively doing political risk identification activities across levels. Relatively little investment is needed in this competency. On the flip side, imbalanced proactive companies tend to be somewhat underweight on the financial competency (24%). More significantly, 49% of them are underweight in the operational competency – which aligns with the finding that political risk assessment activities at proactive companies are more similar to those of other companies. Proactive companies therefore should target their political risk investments in bolstering their operational competency. Executives at proactive companies recognize this imperative, as 65% of them pointed to political risk assessment as a key improvement area.

And what is the path forward for reactive companies? Of the 57% of reactive companies that have an imbalanced political risk management approach, 33% are overweight on the financial competency. And 61% of them are underweight on the political competency, while 17% of them are underweight on the operational competency. Reactive companies should therefore prioritize investment in the ability to better identify political risks and, to a lesser extent, improving their ability to assess the impact of political risks. Executives at reactive companies also recognize these as the top two improvement areas, although they prioritize political risk impact assessment (47%) over identifying political risks (36%).

It is not enough to simply invest in a company's underweight competencies though. Developing these three competencies in a siloed way will not achieve more proactive and strategic political risk management. The board and C-suite also need to put in place governance structures for the political, operational and financial competencies to communicate and collaborate – both with each other and with senior leadership and strategy teams. Such coordination will foster a shared understanding of the universe of political risks a company faces, how those risks are likely to impact the business, and how the company holistically is managing political risk – all of which will enable the C-suite and the board to better incorporate political risk into strategic planning and strategic transactions decisions.

But executives are not prioritizing improvements in political risk governance structures, as discussed above (**see Figure 13 on page 24**). Without a shift in focus, governance structures at many companies are likely to remain fairly ad hoc and overly centralized (**see Figure 10 on page 20**). The governance approach of proactive companies demonstrates that more collaborative and strategic political risk management governance is possible, though. For many companies, putting in place more proactive and cross-functional governance structures for political risk management should be the first step toward making improvements across the other areas of political risk management activity.



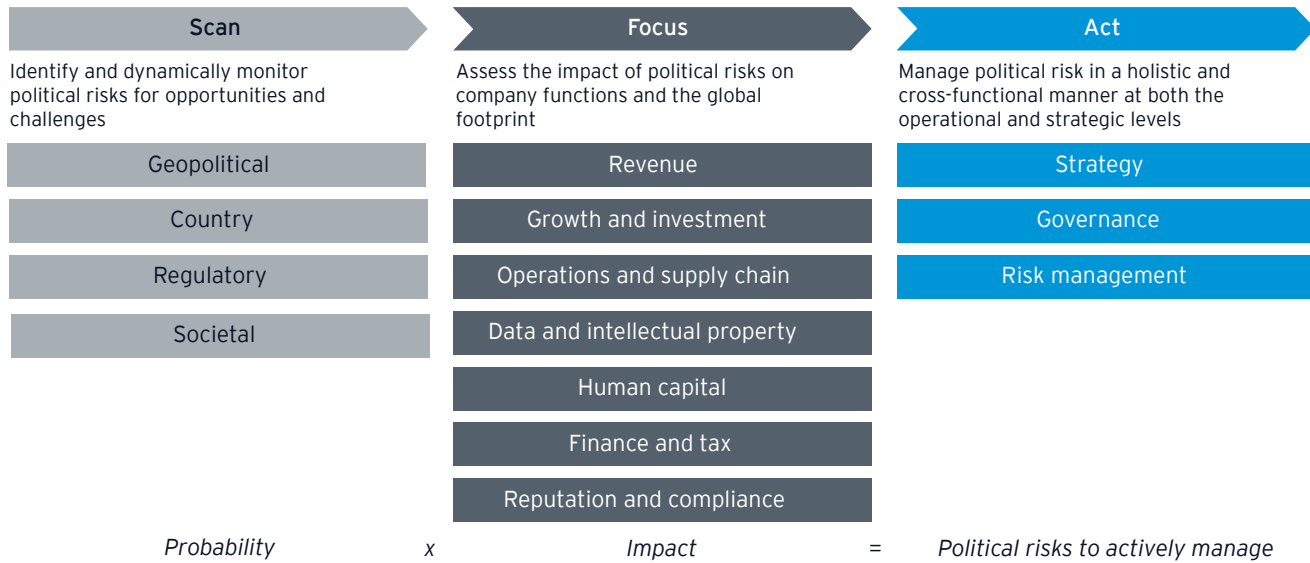
Putting geostrategy into practice

To maintain enterprise resilience in today's volatile global environment and prepare for the next disruption, all companies need a **geostrategy** – the holistic and cross-functional integration of political risk management into broader risk management, strategy and governance (see **Figure 15**). Companies need to engage in education efforts from the board to the operational level, and then put that shared understanding of political risk into action. Based on its current governance structure and political risk competencies, each company will have a different set of priorities to develop its geostrategy and strengthen its ability to manage political risks in a more strategic way. But the Geostrategy in Practice 2021 survey results provide useful step-by-step recommendations for how executives should consider putting geostrategy into practice at their company.

- 1. Identify and collect quantitative political risk indicators.** While political risk will always involve qualitative analysis, companies should do more to collect and integrate quantitative indicators into their political risk identification and monitoring systems. Quantitative indicators will help to expand the political competency's efforts to identify new and emerging risks, and monitor the political risk levels in key markets. And such indicators will also be useful in modeling the potential impacts of political risk on the company, incorporating political risk into ERM, such as with a political risk dashboard, and assessing the political risks associated with strategic decisions such as market entry and exit.
- 2. Develop or acquire the ability to assess the business impact of political risk.** Companies should strengthen their operational competency by investing in political risk impact assessment at the functional or business unit level and verify that these assessments are shared in aggregate with the C-suite on a regular basis. These functional or business unit impact assessments should also inform an enterprise-wide assessment of potential political risk impacts on a regular basis. Both levels of assessment should seek to incorporate the quantitative political risk indicators that the company monitors into their models and to report impact assessments in a tangible way (e.g., financial impact on revenue) to the C-suite and the board.
- 3. Integrate political risk into ERM.** Companies should integrate political risk into their ERM process to gain a more holistic view of the outside risks that they face. Such integration can be particularly impactful if it leverages the political risk identification outputs from the political competency and the tangible estimations of political risk impact developed by the operational competency. The ERM team responsible for political risk should seek to target financial and operational hedging strategies that help minimize the impact of downside political risk events while also proactively identifying strategic opportunities the company could pursue related to upside political risk events.
- 4. Engage the board and C-suite to incorporate political risk into strategic planning.** Companies should confirm that all of the insights and risk management activities in the steps above are translated into business strategy. This should include not only a regular assessment of how political risk developments affect current strategy, but also the proactive inclusion of political risk analysis in M&A, market entry and exit, and international footprint decisions – as well as in forward-looking strategic planning. The C-suite and the board should receive political risk training and engage with external subject-matter experts on a regular basis. They should then be actively involved in assessing political risk in strategic decisions to demonstrate that there is buy-in from the top on the strategic importance of incorporating political risk into company culture.
- 5. Set up a cross-functional geostrategic committee.** Companies should establish a cross-functional geostrategic committee that includes representatives from across the political, operational and financial competencies. Country and functional teams are more aware of local political risks, but there often isn't an effective aggregation of such risks at the global level. So committee members should come from both the C-suite and relevant functions and business units. The committee should meet on a regular cadence to discuss the political risks the companies faces, how and where those risks are likely to impact the business, and what the company is and should be doing to manage them. This committee should also report to the board of directors on a regular basis.

Figure 15

The EY geostrategy framework lays out the incorporation of political risk management into broader risk management, strategy and governance



Source: EY Geostrategy in Practice 2021

Companies that take these steps to invest in their political risk competencies will be able to develop a more proactive, comprehensive and balanced approach to political risk management. And taking more proactive actions to identify, assess and manage political risk will improve executives' confidence in their ability to manage political risk going forward. As seen by the strategic choices that proactive companies are making in the current volatile political risk environment, this increased confidence is likely to motivate executives to pursue bolder, political risk-informed, growth-oriented strategies.



About the survey

The EY Geostrategy in Practice Survey explores how senior executives of companies perceive, identify, assess and manage political risk. The survey was in the field during January and February 2021 and was conducted by Thought Leadership Consulting, a Euromoney Institutional Investor company.

The survey captures the views of 1,009 C-suite level executives from companies across 7 industries and 32 countries. Approximately 25% of survey respondents are CEOs, about 25% are CFOs, about 25% are CROs, and the remaining approximately 25% are other C-suite executives, heads of departments or business units, heads of public policy, government affairs or government relations, or board members.

Respondents represented companies from the following seven industries, with roughly even representation across them:

- ▶ Advanced manufacturing and mobility
- ▶ Consumer
- ▶ Energy and resources
- ▶ Financial services
- ▶ Health sciences and wellness
- ▶ Real estate, hospitality and construction
- ▶ Technology, media and telecommunications

By region, respondents' primary work location was split between the Americas (35%); Europe, the Middle East and Africa (33%); and Asia-Pacific (32%).

Surveyed companies' annual global revenues were grouped in the following way:

- ▶ Small: \$250m-\$999m (20%)
- ▶ Mid-sized: \$1b-\$4.9b (30%)
- ▶ Large: \$5b-\$14.9b (26%)
- ▶ Largest: \$15b or more (24%)

The survey defined political risk as the probability that political decisions, events or conditions at the geopolitical, country, regulatory or societal level will impact the performance of a company, market or economy. The four types of political risk were defined as follows:

- ▶ Geopolitical risk: emerges when the foreign policies of countries or international relations more broadly affects markets and companies
- ▶ Country risk: emerges when the national political environment, the stability of the government and institutions, or legislation affects companies
- ▶ Regulatory risk: emerges when governments – at the local, national or international level – change the rules or implementation of environmental, health and safety, financial and other regulations
- ▶ Societal risk: emerges when tensions arise between groups or when groups, from trade unions to consumer bodies, launch public activism such as boycotts or protests that affect markets and companies

Political risk management was defined as the governance and processes that adapt risk management practices to overcome challenges and seize opportunities associated with political risks.

Throughout this report, “executives” refers to the group of individuals who completed the EY Geostrategy in Practice 2021 survey and “companies” refers to the organizations at which those executives work.

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About the EY Geostrategic Business Group

The EY Geostrategic Business Group (GBG) teams help organizations translate geopolitical insights into business strategy. Geopolitics affects every global organization, from strategy to supply chain. Yet many companies struggle to assess and manage this disruption and the impacts it has on their business. The GBG teams harness the EY global footprint and local knowledge, and collaborates with third-party firms to bring an added independent political risk perspective. With the breadth of our strategic and operational knowledge, our teams develop actionable plans to help organizations better monitor, assess and manage political risks.

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