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Shifting geopolitics and the role of the board

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Geopolitical complexity

Geopolitically, the world is a dramatically different place from what it was even just five or ten years ago—and many of the changes it has undergone have directly affected the business landscape. It's clear from our conversations with companies and boards that the 2018 US–China trade wars and the dislocations from the Covid-19 pandemic that wreaked havoc on global supply chains are still fresh on the minds of many international companies. Structurally, at a macro level, the world is seeing a continued shift from an era of convergence—a coming together on trade, capital and labor flows, and accounting standards—to one increasingly defined by fragmentation.

On other fronts, environmental, social, and governance (ESG) issues have gone from niche interest to an area that many investors, customers, and employees care strongly enough about for large majorities of companies to now have ESG initiatives in place.[1] Growing political polarization—exacerbated in part by the use of social media and the prospect of AI-driven mis- and disinformation—has pressured companies to enter the fray (including facing the consequences of staying silent).

National security–driven supply chain and investment restrictions—and indeed, more-muscular efforts behind national industrial policy—have constrained key industries and made future planning more challenging. The escalation of the Russia-Ukraine war has further affected supply chains (especially for agricultural goods) and has forced companies to move some or all of their operations from Russia. At the same time, expanded governmental sanctions against Russian individuals, companies, and officials have complicated business decisions for some.

The impact of these developments is not limited to a handful of companies, nor is the impact merely a nuisance. In 2022, 93% of all multinational companies surveyed reported that they had lost money due to geopolitical turbulence.[2] In the same year, 68% of companies purchased geopolitical risk insurance, up from 25% just three years earlier.[3] "Companies recognize they can no longer operate above the fray of international relations," notes Alex Kazan, Chief Commercial Officer, Eurasia Group. "Understanding the far-reaching impacts of geopolitics on the business is imperative, and it requires a disciplined process."

That said, in our experience interacting with companies and their boards, it's still uncommon to see a holistic approach to managing and overseeing geopolitical risk. Key risks affected by geopolitics may be front and center in the C-suite and on board and/or committee agendas—e.g., the supply chain; data privacy; climate and other ESG issues; tax and regulatory compliance; and business disruption and continuity concerns. Yet, understanding the interplay of certain risks, monitoring international developments and structural shifts, gaming out scenarios, and connecting critical dots requires an astute and focused geopolitical lens.

Boards have a pivotal role to play in assessing how effectively the company is monitoring and managing geopolitical risk, identifying gaps, and strengthening the board's own geopolitical acumen and risk oversight processes, with the endgame being a robust geopolitical risk governance framework.

> "The geopolitical landscape is changing fast. When I started Eurasia Group back in 1998, only a few country-level risks benefited from updates beyond once a year. Today, most significant areas of geopolitical risk require regular reviews. Corporations should appoint a senior executive responsible for them, and for monitoring sudden changes (and alerting accordingly)—all of which should be regularly presented to boards of directors.
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> **– Ian Bremmer, President and Founder of Eurasia Group and GZERO Media**"

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1 "Global Survey Finds Businesses Increasing ESG Commitments, Spending," Navex Risk & Compliance Matter Blog, Feb. 23, 2021.

2 Elisabeth Braw, "Companies Thought They Could Ignore Geopolitics. Not Anymore." Foreign Policy, April 19, 2023.

3 Braw, "Companies Thought They Could Ignore Geopolitics."

Board oversight of geopolitical risk

Nearly three quarters of companies surveyed said that their boards discuss geopolitical issues more frequently now than they did just two or three years ago.[4] Indeed, directors indicated that key geopolitical factors will have "a significant or some" impact on the company's strategy, including supply chain disruptions (88%), the war in Ukraine (70%), trade policies (60%), and the political environment (80%).[5] Despite this increasing board-level focus on various geopolitical issues and risks, many boards continue to wrestle with how best to oversee the company's efforts to manage geopolitical risks and opportunities holistically and proactively.

"Boards can often understand and digest the macro implications of world events," notes John Rodi, leader of the KPMG Board Leadership Center, "but it can be difficult to translate those developments into clear strategic and operational implications for the business."

It's understandable that many companies and boards are playing catch-up on geopolitical risks; the notion that geopolitics can be a primary driver of business outcomes has not been widely adopted apart from the largest companies in a handful of sectors. Geopolitics has long been seen as more of a diplomatic arena for policymakers than a key factor in corporate performance.

Every business will face unique challenges operating in a global environment, but several basic steps can help boost every board's effectiveness in helping the company navigate geopolitical risk and opportunities more systematically and cohesively. Namely, three areas of focus are key to assessing the company's governance structure and processes for managing geopolitical risk:

Helping to ensure that management has robust processes in place to manage geopolitical risks, including processes to:

- Identify the key geopolitical risks and their potential impacts on the business.
- Establish clear responsibility for developing a mitigation plan for each risk to a specific individual and hold those individuals accountable.
- Provide robust, periodic reporting to the board on the company's key geopolitical risks—including current risks, future scenarios, and crisis-readiness plans.

Obtaining a diversity of perspectives, including third-party expert views, regarding the company's geopolitical risks and management of those risks.

Considering the board's own geopolitical acumen and oversight framework.

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[4] "Geopolitical and economic risks: Board oversight in an evolving world," Corporate Secretary, January 5, 2023.

[5] What Directors Think 2023 Survey, Diligent and Corporate Board Member, February 2, 2023.

Helping to ensure that management has a governance framework and robust processes in place to manage geopolitical risks

Different organizations will have different levels of exposure to geopolitical risk, from occasional effects to existential threats. Sometimes the risks will be in plain sight and the key question is around the likelihood of the risk actually coming to pass. In other cases, there might be exposure hidden deep in the supply chain that only a thorough scan can effectively surface.

Boards should understand the company's processes for identifying and managing geopolitical risks and their impact on the company's strategy and operations. Is there an effective process to monitor changes in the external environment and provide early warning that adjustments to strategy might be necessary? How has the company's risk profile changed as its supply chain has been reshaped?

Organizations that have robust risk management and control capabilities with well-thought out business continuity plans in place may be prepared for a range of risk outcomes, but they may also be overconfident and exposed to unknown unknowns. Understanding current processes and gaps is essential. If management already has a geopolitical risk governance framework and processes in place, what is working well, and what isn't? Where are the sticking points? What are the blind spots? Are crisis plans linked to other risk functions and to strategic plans?

For organizations that do not have a robust geopolitical risk governance framework and processes in place, two elements are foundational for building a view of the geopolitical landscape and the company's positioning: understanding the kinds of geopolitical risk that should be on the company's radar and how those risks can impact the business.

Risk events matter, but it can be more important and productive to think about the broader structural environment that raises and lowers the probability of risks. Understand the different possibilities. Focusing on events is reactive. An optimal approach is to be forward-looking without trying to forecast specific risks. "Understand how the world is changing in a structural way rather than starting with a risk event," said Kazan.

Companies may lack the capacity to assess and plan around every geopolitical risk, so prioritization is key, and it's achieved through a combined assessment of the likelihood of a risk and the relevance of a risk to the business. Focusing on the right level of granularity in the risks is important: If the risks are too high-level, the potential to yield tangible insights will be limited; if too granular, the risk management exercise becomes unwieldy.

Mapping geopolitical risks to "owners" in the business

Different leaders will view geopolitical risk through different lenses. Many will naturally think about how geopolitical risks affect each of their business units. Others break things down geographically, but for many, a business function lens makes the most sense. How will geopolitical issues affect operations, supply chains, human resources, and recruiting, etc.?

This is an important mapping exercise and it should be guided by two principles. First (and perhaps, most obvious), **risks should be mapped to key revenue and cost drivers,** with risk implications linked to revenue streams and cost drivers. Second, **risks should be mapped to units or functions that have clear accountability and the ability to act.** The intent is to identify a single individual or team that can be tasked with developing an action and mitigation plan. These two principles are essential pieces of an effective geopolitical governance framework; they identify the kinds of geopolitical risks the company needs to be prepared for and how those risks could impact the business.

Providing robust, periodic reporting to the board

Every corporate board should have a geopolitical conversation at least once a year—and perhaps quarterly or semi-annually for multinationals and larger companies. Key areas of focus should include an update on the company's top geopolitical risks—including current and emerging risks, future scenarios, crisis-readiness plans, and resilience. Are crisis response plans robust, actively tested or war-gamed, and updated as needed? Do they include communications protocols to keep the board apprised of events and the company's response?

Make business continuity and resilience part of the discussion. Resilience is the ability to bounce back when something goes wrong—with viable strategic options for staying competitive and on the offense in the event of a crisis.

Hearing a diversity of perspectives

Make sure the board is hearing diverse perspectives about the geopolitical landscape and the key risks facing the company. Be systematic, organized, and disciplined about getting a variety of views and helping to ensure that the right people are part of the geopolitical conversation in the boardroom.

When discussing a risk that is subjective and difficult to quantify, it's important to take a broad view and diversify the inputs. But it's also important to have consistency in the methodology. We've seen many boards combine both by bringing in a variety of third-party experts to provide unique and divergent views while working within the existing risk management and oversight framework. We also know from real-world experience that the surest way to challenge the company's views—to help uncover more scenarios and potential outcomes than an organization could envision on its own—is adding third-party perspectives.

"Third parties are able to raise novel and difficult ideas that may be too 'out there' or too hypothetical for management to consider very deeply," notes Kazan. "To prepare for unforeseen situations, you need to have unexpected ideas put in front of you. A bit of discomfort on the part of the board members is actually a good thing. It's about having the company's worldviews challenged and its perceptions of the business' risk exposure stretched."

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Considering the board's geopolitical acumen and oversight framework

The effort to sharpen the board's engagement around geopolitical risk should be championed by a boardroom leader—lead independent director, board chair/CEO, or committee chair—who has a good understanding of the board's skillsets, processes, and each committee's risk oversight responsibilities. This effort should also be undertaken with key members of management who have significant involvement in managing geopolitical-related risks—e.g., CEO, business unit leaders, and C-suite executives responsible for risk (chief risk officer, corporate and government affairs, compliance, finance, technology and digital strategy, internal audit, supply chain, ESG, etc.).

How globally experienced and aware are the current directors? What depth of expertise do they collectively bring to geopolitics and the implications for the company's strategy and operations in current and target markets? How many directors have real experience with the geopolitics of business? Recognize that the value of diversity in the boardroom extends to international diversity—of experiences, perspectives, and cultures.

Also consider the board's framework and processes for overseeing geopolitical risk:

- How is geopolitical risk currently addressed?
- Which committees have responsibility for overseeing key geopolitical-related issues—supply chain, tax and legal and regulatory compliance, technology and digital privacy, and ESG and reputational issues?
- How is the oversight of these risks coordinated across multiple committees?
- Does it make sense to allocate "geopolitical risk" to a single committee?
- How robust are committee reports to the full board?

Shifting from reactive to strategic

An enterprisewide approach to monitoring, assessing, and mitigating geopolitical risk is imperative to shift from a reactive stance of crisis management to a proactive, long-term planning approach that can turn geopolitical risk into smart risk-taking and opportunity. As discussed above, the board plays a vital role in helping to ensure a well-defined geopolitical risk governance framework is in place to help maximize efficiencies and clarify accountability.

Integrating geopolitical risk governance with strategy and performance is key. Geopolitical discussions and assessments can be a fascinating exercise, but they have little business value if the learnings are not incorporated into the company's strategic decision-making and tactical playbooks.

Indeed, the pace and impact of geopolitical developments have raised the stakes on a company's ability to systematically identify and prioritize a broad range of geopolitical threats and to assess their impacts in a targeted way. The approaches described in this paper can help boards deepen their engagement, including helping management establish or strengthen a geopolitical risk governance framework and processes to respond to geopolitical events and turbulence, and understand the unfolding structural changes that are reshaping the geopolitical landscape and the implications for the company's future.

About the KPMG Board Leadership Center

The KPMG Board Leadership Center (BLC) champions outstanding corporate governance to drive long-term value and enhance stakeholder confidence. Through an array of insights, perspectives, and programs, the BLC—which includes the KPMG Audit Committee Institute and close collaboration with other leading director organizations—promotes continuous education and improvement of public and private company governance. BLC engages with directors and business leaders on the critical issues driving board agendas—from strategy, risk, talent, and ESG, to data governance, audit quality, proxy trends, and more.
Learn more at kpmg.com/us/blc.

About Eurasia Group

Eurasia Group is the world's leading global political risk research and consulting firm. By providing information and insight on how political developments move markets, we help clients anticipate and respond to instability and opportunities everywhere they invest or do business. Our expertise includes developed and developing countries in every region of the world, specific economic sectors, and the business and investment playing fields of the future. Headquartered in New York, we have offices in Washington, DC, London, San Francisco, Sao Paulo, Singapore, and Tokyo, as well as on-the-ground experts and resources in more than a hundred countries. "Politics first" grounds our work: Politics is the lens through which we view the world, and we are committed to analysis that is free of political bias and the influence of private interests. www.eurasiagroup.net.

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