Anticipate, prepare, respond
Geopolitical megatrends and business resilience

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Resilience is the ability of an entity (person, asset, system, place, as examples) to persist, adapt, or transform from the effects (impacts and consequences) of acute shocks and chronic stresses while maintaining a reasonable level of functioning throughout and beyond the experience, with a view to achieving greater success into the future.”

Mark Crosweller
AFSM - Former Head of the National Resilience Taskforce, Senior Advisor to KPMG

Mark Crosweller authored the report 'Building resilience - lessons from mother nature', published on 17 December 2020.
Understanding the volatile geopolitical landscape puts businesses in a stronger position to anticipate, prepare, and respond – to be resilient.

Resilience means the ability to persist, adapt, or transform in response to a crisis. That is, to hunker down and keep on with what you’re doing until the crisis passes, to change a few things to manage and keep moving, or to fundamentally transform your whole way of operating, overhauling business-as-usual and reshaping for future success. These responses don’t operate in isolation – you may be able to persist by absorbing some shock while you reconfigure to adapt or transform.

A crisis can be something sudden and largely unexpected by non-experts, like COVID-19, or bushfires, or an accident in the South China Sea that escalates rapidly.

A crisis can also be something more ongoing, like climate change. But importantly, a crisis is almost never just a tragic and random bolt from the blue – crises are both geopolitically driven, and in turn, how crises are managed has geopolitical implications.

The geopolitical crisis

The geopolitical moment we are in should be understood as a crisis. We are seeing both sudden shocks and chronic stressors creating turbulence and volatility at the macro system level – think about China-US strategic rivalry, right down to the minutiae of our day-to-day lives – like how we pay for goods and services.

There are four main global geopolitical megatrends creating an environment of considerable risk for business. All of these megatrends intersect and impact each other, and all of them have been exacerbated and accelerated by COVID-19.
It may seem just the normal state of affairs for us, but the international system we operate in was in fact carefully constructed. After the Second World War, the victors created a system of institutions and organisations for, and based squarely on, their own philosophies and ideologies. In that arrangement, countries like China, India and Brazil simply didn’t feature as players. That system, imperfect as it certainly is, is now being challenged. Global economic and political power is shifting, and the international order we have been used to is unravelling. The question is not so much, which state will be the leading power in the system, but rather, what kind of system will we have, and where will the various actors find themselves positioned in that system?

Recent modelling suggests that China is on track to be the world’s largest economy by any measure by the end of this decade. Its weight and role on the world stage is dramatically different from that which was anticipated in the post-WWII global architecture. Reactions by status-quo powers to this shift in global power dynamics have been mixed. The strategic competition between China and the US is already having a dramatic impact, in particular, the ‘trade war’ pursued by US former-President Trump. The perhaps lesser-known ‘tech war’, including in green tech, now underway between the two is creating the real risk of a highly fragmented digital world. The US-China strategic competition also plays out in the Australia-China bilateral relationship, as Australia’s security and strategic alliance with the United States is another source of friction and irritation in our connection with China.
Citizen anger

Around the world, real and perceived inequality is growing. In the United States, workers’ real wages have stagnated for over 20 years. The World Economic Forum found in 2017 that income and wealth disparity, and associated social polarisation, are two of the top three trends determining the shape of the world in the next decade. More and more people feel that the globalisation project has not worked for them, and/or what benefits there are from globalisation are being soaked up by a layer of elites who prevent the increased wealth from reaching the everyday people. The result is a strong sense of anger and mistrust towards the establishment status quo, including political and business elites. COVID-19 is further increasing inequality.

This rising citizen anger has several implications. One is social polarisation and unrest in the form of protests and riots, increasing both in sheer number, as well as scale and intensity, and in previously stable parts of the world.

“This societal polarisation will redefine the way we think about productivity, economics, and the purpose of a company.”

Sophie Heading
Global Geopolitics Lead, KPMG International

Rohitesh Dhawan
Macro Strategist and Head of Partnerships, Eurasia Group

Another is the rise of populist leaders as the lack of trust and anger towards establishment power figures drives people away from the centre to seek alternatives at the outer edges. Populists paint themselves as ‘just one of the people’, a far cry from the status quo elites whose trust has been lost. Populist leaders’ instincts tend to eschew international openness and cooperation and be suspicious of multilateralism. Domestically, populist leaders align themselves with ‘we the people’ and create or intensify social rifts to create an ‘other’ to be blamed for whatever is going on.

This is often a sectarian or ethnic minority group. Positioning themselves in this way allows them to argue that institutions to contain overconcentration of power are unnecessary because ‘we the people’ are the power, and anything that tries to keep that in check is against the will of the people. Free speech, freedom of association, an open media, a vibrant civil society, and the independent rule of law become weakened.

Declining democracy internally, and scepticism of internationalism externally, leads to an unstable political environment and an unpredictable regulatory and policy environment.

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

Lee Hsien Loong
Prime Minister of Singapore
Describing what is happening in the realm of tech, digital and cyber as ‘the Fourth Industrial Revolution’ is not over-dramatising. The depth and breadth of change in tech, cyber, digital and data will fundamentally change every aspect of the average Australian’s life in ways that we can’t even imagine – and indeed, already is. This tech disruption is supremely geopolitical – both driven by, and in turn driving, politics.

There are a number of pressure points in the tech domain, but the exponentially increasing need for cyber security, the implications of AI and machine learning on jobs, and the ‘tech cold war’ between China and the US, are perhaps particularly noteworthy for their potential to create crises, and the need to build resilience. These geopolitical pressures on the tech realm are set to further intensify as countries begin to emerge from COVID-19, cybersecurity challenges mount, governance continues to lag, inequality is deepened, China and the US continue their tech decoupling, and concerns about the power of tech platforms begin to translate into regulatory moves in key markets, as we have seen in Australia regarding news content.
Climate change as a driver of crisis is no surprise. As Paul Dillinger, head of Global Product Innovation at Levi Strauss & Co put it, “anyone with a supply chain is going to be affected by climate change... It’s as much an issue for us as for the Pentagon”\[12\]. Direct environmental impacts are extreme weather events such as an increased incidence and severity of storms, floods, cyclones, bushfires, and droughts. In February 2021, multiple severe winter storms in Texas resulted in at least 82 deaths and more than US$19 billion in property damage.

The effects of the freak weather event were exacerbated by politics, namely, the state’s stance on energy deregulation, as Texas had decoupled from the national energy grids. The direct effects of climate change have many flow-on impacts. For example, as livelihoods suffer, there will be an increase in the movement of people, both migrants and refugees, and both within countries and across borders – which the World Economic Forum describes as the greatest challenge of our era.\[13\]

The melting of the Arctic is creating economic competition over resources and trade routes, and geostrategic competition and tensions among claimants, including Russia, China and the US, as they compete for military supremacy and power.\[15\]

Climate change also means policy change, and as many countries pledge to be net-carbon neutral by 2050 or 2060, the era of fossil fuels is coming to an end. Exports of coal, oil and iron ore are set to fundamentally – if unevenly – decline. Demand for critical minerals and rare earth elements is set to rapidly increase as they are essential for renewable energy technologies – but supply is geographically limited, and highly politically sensitive.\[16\]
What does this all add up to?

The world is in a state of flux. We don’t know when things will settle, or what they will look like when they do. We do know that nationalism and protectionism are on the rise, the line between the online world and the physical world is blurring, cybersecurity is lagging, the planet is heating up, and COVID-19 is exacerbating inequality and social polarisation. We do know that uncertainty and volatility are here to stay. There is no coherent global approach on political models, trade standards, and international architecture.17

Now is a very good time to focus on building resilience into future strategy and operations, for those who haven’t already.

What can companies do to build resilience?

Businesses need to develop the capabilities to be able to persist, adapt or transform in a crisis – to be resilient. Those who can anticipate, prepare for and respond to these global geopolitical megatrends will more effectively navigate this less predictable world, and be in a position to capitalise on opportunities.
Look around the next corner

Conduct a geopolitical stress test to help evaluate the impact of various scenarios on your company’s financial model, business model, and operating model. For example:

— What would geopolitical tensions leading to large swings in global currencies, stock markets or commodities mean?

— What impact would the loss of access to a key geographic market have? This may be as a result of sanctions or other unofficial trade barriers, damaging political interference, or even loss of cross-border passporting arrangements.

Introduce a geopolitical forecasting and monitoring solution to keep up with what is changing in the external environment and analyse according to your business.

— Consider how both economic and political strategic competition among major powers could affect your business plans.

— Ensure a deep and constantly updated socio-political understanding of the major global actors, particularly the US and China, and your own existing and potential markets. Deploy the power of big data to monitor public sentiment and policy updates to better anticipate the direction and speed of change.

— If you are looking at new markets, pay close attention to country fundamentals, for example, how reliant are they on an uninterrupted flow of labour, goods and capital? In addition to the usual regulatory and economic risks, consider interconnected environmental, social and political risks, and ask how resilient the market will be to increased barriers to free movement.

Ensure this information is getting to the right people: given the speed of change and limited time to react, geopolitical risks could hit multiple parts of a business simultaneously, so it is critical that the relevant decision makers, including the EMT and Board, are up to date.

— Depending on the sector, this could be the Head of Risk, Government Relations, IT, and/or People.

— A holistic approach is increasingly important – for example, is your compliance team working with trade management and procurement to consider how the broader economic toolkit (beyond mere sanctions, like tariffs) could be weaponised against suppliers / customers / competitors?
Under these conditions, appropriate governance frameworks and risk planning are essential. Geopolitics will manifest as a number of different business risks, which means the type of mitigation strategies you employ might sit outside the traditional realm of the Chief Risk Officer or Government Relations. For example:

— Chief HR Officer: workforce planning will become front and central.

— Chief Information (Technology) Officer: consider potential vulnerabilities in cross-border data transfer processes and invest in cybersecurity – it is not so much a question of ‘if’ but ‘when’, and also, ‘what’ and ‘how much’.

— Chief Executive Officer / Chief Financial Officer / Chief Strategy Officer:

- As data becomes the focus of a broad swathe of regulation, including tax and competition policy, the value of intangible assets should be central to strategy and investment decisions.

- Ensure geopolitical risk and potential implications are priced into valuations, financial models or strategies. Ask: how will geopolitical uncertainty impact core financial assumptions? What risks might compromise ability to realise future revenue and income? What geopolitical assumptions underpin your business plan?

— Consider appointing a Chief Geopolitical Officer as a member of the senior leadership team, with responsibility for mapping and managing the impact of politics on the company’s business interests.

Watch for policy changes. For example, the definition of ‘Critical Infrastructure’ in Australia is changing, along with the reporting and compliance obligations of a broader range of businesses – do you know how these policy changes affect your business, and what you will do to comply?

Ensure robust due diligence. Who are you working with or subcontracting to? Reputation matters, so consider who will focus on ensuring compliance with rising expectations around ethical behaviour, as social media accelerates the public’s ability to track and ‘name and shame’.

“The CEOs and companies I’m talking with are acutely aware of how quickly their brand reputation can go from ‘hero’ to ‘zero’, and of the need to continuously challenge the resilience of their organisations to risks in order to future proof their brand.”

Gary Reader
Global Head of Clients and Markets, KPMG International
Build your absorptive capacity

In order to persist through a crisis, you need to be able to absorb some shock. How can your business build its absorptive capacity?

Absorptive capacity in business can be defined as a firm’s ability to minimise the long-term negative impacts of shocks and stresses, while developing strategies to adapt and transform.

Global interconnectedness means that a geographically distant or individually insignificant risk could have hidden systemic significance for your business. For example, as we saw with the death of a black man in the US reigniting the public debate around reparations from a UK pub chain and insurance market alike.

Sometimes, and perhaps increasingly, these shocks will be unavoidable. Robust preparation, including risk profiling, scenario modelling and strategic adaptation strategies, and carefully considered ‘plan Bs’ (and Cs and Ds), as outlined above, will minimise the potential damage of geopolitical risks.

“I see companies splitting their supply chains and operations, starting to put 30 percent somewhere else to ensure they have absorptive capacity if something happens. Then they can ramp up their adaptive capacity, but not from zero. It gives them a buffer while they see what develops.”

Professor Anthea Roberts
School of Regulation and Global Governance, Australian National University
Endnotes

1 https://www.weforum.org/agenda/2021/01/china-worlds-biggest-economy-usa-think-tank-covid-coronavirus/


3 https://www.oecd.org/els/soc/dividedwestandwhyinequalitykeepsrising.htm

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11 https://www.theguardian.com/commentisfree/2021/feb/24/australia-facebook-google-global-battle-governments-journalism


15 Eurasia Group Top Risks 2021 https://www.eurasiagroup.net/issues/top-risks-2021


17 https://assets.kpmg/content/dam/kpmg/xx/pdf/2018/03/the-ceo-as-chief-geopolitical-officer.pdf

18 https://assets.kpmg/content/dam/kpmg/xx/pdf/2021/02/top-risks-2021-the-bottom-line-for-business.pdf


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