Geopolitical Disruption Invades the Boardroom

By Erin Essenmacher

Listen to article

100

Directors should plan for risks in talent, supply chain, public health and more.

The notion that every company is a technology company became a popular idea over the past decade, as advancements in software, data analytics and artificial intelligence profoundly transformed the business landscape. Companies of all stripes are now coming to recognize that the same holds true when it comes to thinking globally. The past three years have provided a master class in how quickly events that were once considered black swans can become a cascade of real-time risks that require a significant shift in the approach to both company strategy and risk management.

Every Company Is a Global Company

Overlapping shockwaves of a worldwide pandemic, historic supply chain shortages and war in Europe have reinforced that companies of all sizes, across industries, are impacted by disruptions as far-flung as Wuhan or Kyiv. “The interconnectedness of the world’s economies is significant. This is true despite protective measures countries have taken, starting with the Great Financial Crisis and continuing through the US-China trade wars, COVID-19 lockdowns and the Ukraine conflict,” says Krishna Kumar, VP, international, at the RAND Corporation. “Supply chain risks that had started becoming evident during COVID-19 have been amplified by the conflict in Ukraine. It illustrates how events not exactly in our backyard can cause serious disruptions to companies and societies.” He points out that while the disruption is most immediate for companies that fled Russia either because of sanctions or public pressure, “other companies that do not directly have business in Russia and Ukraine are also impacted due to shortages and increasing prices.”

The need for a geopolitical-centric lens on risk is in many ways the result of converging risk factors that have emerged over the past few decades, says James Lam, president of risk management firm James Lam & Associates and a director for Recology (where he serves as chair) and RiskLens. “In the 1980s, we thought first and foremost about financial risk. In the 1990s, companies started focusing more on operational risk. Then digital transformation meant companies were thinking more deeply about strategic risk. Geopolitical risk compounds and connects all these risks in a way that is very significant, and that I haven’t seen before.”

Russia’s invasion of Ukraine is the latest crisis to reveal the compounding nature of global risk. “It underscores the increasing link between business and economics on the one hand, and geopolitics on the other,” says Kumar. “It means companies might have to pursue strategies that are as geopolitically savvy as they are business-savvy.”

From “Just in Time” to “Just in Case”

Even the boards of larger multinational companies, which may already have geopolitical risk firmly on their radar, have found they must seriously reconsider old assumptions that no longer hold true. “I’m on a Swedish board,” says Nora Denzel, who serves on the boards of Advanced Micro Devices, Ericsson, NortonLifeLock and SUSE. “Five years ago, we still believed that there was global trade. But then Xi Jinping came out with the China 2025 plan and it became really clear that the two big guys were drifting apart. The technical standards are bifurcating and now we have to think about what China wants. What does the U.S. want? And then try to make sure that we stay on the right side with both.”

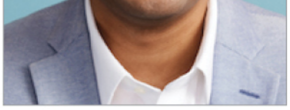
Geopolitical shockwaves have also upended long-held views about supply chain risk. Over the past three decades, the focus on “just in time” manufacturing emphasized efficiency as companies took advantage of interconnected free trade to reduce surplus inventory. The assumption that a lean supply chain was a risk-mitigation best practice has been suddenly — and painfully — turned on its head.

Myrna Soto, who serves on the boards of Consumers Energy, Spirit Airlines, TriNet, Popular Inc. and Headspace Health, has felt the impact of supply disruption across her board portfolio but says the multipliers of that risk are felt most acutely in the energy space, a backbone of critical infrastructure.

“The production of energy requires a lot of heavy equipment that has components that are manufactured all across the globe, so that has become an area of risk that we are focusing on significantly. We look at timelines and timetables for delivery because we can’t just say, ‘Whoops, can’t do it.’ When you are providing critical power services, it has to be done.”

Supply chain woes also mean companies that considered efficiency as synonymous with risk mitigation are taking a very different tack. “Now we’re willing to take on more capital allocation for financial bets that might not have 100% clear return, but we do it just in case,” says Denzel. “We really looked very closely through the supply chain, identifying second sources or third sources. We’ve even talked about whether to make sure it’s all sourced from America, because that’s about the only thing you can trust.”

Kumar recognizes this as well and urges corporate leaders to rethink investments in infrastructure based on inputs from a single source. “There is a company-level parallel to the large investment sunk into the Nord Stream pipeline to transfer natural gas from Russia to Germany,” he says, referring to the construction project that gave Germany a direct line to Russian energy. In tying itself so fully to one country as its primary energy supplier, Germany has been boxed in, making it more difficult for the country to respond as it would like to Russian aggression.



experience officer, Upwork

NORA DENZEL

Board member, Advanced Micro Devices, Ericsson, NortonLifeLock, SUSE

KRISHNA KUMAR

Vice president, international, RAND Corporation

JAMES LAM

Board chair, Recology; audit committee chair, RiskLens; president, James Lam & Associates Inc.

MYRNA SOTO

Board member, Delinea, Headspace Health, Popular Inc., Spirit Airlines, TriNet; founder and CEO, Apogee Executive Advisors LLC

Overlapping Risks

The links between critical infrastructure and geopolitical instability underscore the complex, interconnected nature of the risks most companies face. This has also shown up acutely in the labor market. “We used to base projects end-to-end in one country because it streamlined the workflow,” says Denzel. “Now we realize the strategy of end-to-end projects in one country could give us single points of failure if you have to vacate an entire country.”

The interconnected nature of the global economy means that the knock-on effects of events around the world have big impacts to talent risk here in the U.S., too. “When you think about the pandemic and the Great Resignation, the impact on talent and talent management is very significant,” says Lam. “Voluntary turnover rates are going up significantly, and the employer/employee power balance has really shifted to the employees.”

For Soto, talent is the number one risk that keeps her up at night. “If you look at the industries that I serve in, every single one of them has seen impacts from labor shortages. The airline is a great example. Never in our wildest dreams would we have thought that we would be faced with such a significant labor challenge to the extent it has a direct impact on the number of flights we can complete on a daily basis. Or take the energy board: It used to be that the number of workers in the sector was a result of the career opportunities provided to field workers who provided a wide array of services for the country’s power infrastructure. That has changed, and we’re in a very competitive marketplace for talent. Now we’re talking about apprenticeship programs to get people into certain roles that support the energy company. That’s not something that was on our radar in the same way six years ago.”

The Benefits of Scenario Planning

The interconnectedness of talent and geopolitics underscores another shift in how boards must reevaluate risk oversight to meet the moment. It is no longer enough to consider what risk factors are at play. Now, boards must fundamentally change how they think about risk. “In the past, we just asked ‘What’s the impact?’ and ‘What’s the probability?’” says Denzel. “Five or ten years ago, if you had questioned that approach by asking, ‘What if we have to vacate an entire country?,’ the board would not have taken that seriously because the risk was low probability. That’s changed.” In other words, old-school risk models are not sufficient to fully gauge potential threats in a new world order where shocks don’t come neatly and sequentially but are multiple, cascading and even overlapping.

“Risks don’t live in silos,” says Lam. “So instead of thinking about risk in specific categories, like strategic, financial, operational, geopolitical and reputational, you have to think about risk scenarios. These scenarios would have a confluence of different types of risk. So now that we have Russia in Ukraine, what happens if China invades Taiwan? What kind of situation would that be from a geopolitical business and supply chain perspective? That’s not risk-specific, it’s really scenario-specific.”

Denzel agrees. “We use more data visualization. It’s more nuanced. We used to only look at first-order effects. Now we look at first-, second- or third-order effects. It used to be if a risk was low probability but high impact, we didn’t do much with it. Now it’s more about digging into the consequences.”

All of this means moving from a reliance on basic tools, like risk assessments with probability and severity ratings, to more robust modeling that takes into consideration scenario-planning future states of the world, and the macroeconomic and business conditions for each. “Scenario planning is a good best practice.” says Lam. “But it should be augmented with tools that are rooted in future states, including premortems and backcasting.”

Premortems are based on negative states of the future that start with the end in mind. “Take a very dramatic negative scenario, like China invading Taiwan.” Lam explains. “You ask, ‘What are the conditions associated with that? What if we do nothing? Where would we be as an organization?’ From that future state, then look backwards and ask, ‘What are the conditions that would get us here?’ Internal conditions, external conditions, controllable variables, uncontrollable variables — and then map out the things to measure. What things are we going to monitor and respond to help mitigate those impacts? How does that impact our considerations for risk appetite, our risk management capabilities and our capacity to absorb potential losses?”

Boards should also be careful not to get so overwhelmed with the downsides of a fraught global landscape that they forget the interrelated nature of risk and opportunity. This, says Lam, is where the notion of backcasting comes in. Backcasting is a strategic planning model that assists in envisioning what you want to achieve in the future, including stepping stones toward getting to desired results, such as community engagement and forming a strong team. “Backcasting involves considering positive states for the future, and then working backward to identify what it will take in the present to get there. An example might be a highly successful digital transformation leading to dramatic increases in growth and value. So instead of focusing on the typical three- or five-year plan, management starts with a desirable future state and then asks, 'How do we get here? What strategy and talent do we need? What investments would we make? How do we fail faster? What risk appetite would we set?'"

Kumar also sees potential upside and believes the current state of play is ripe for innovation. "While these factors may seem to create a perfect storm for companies, they are also an invitation to rethink strategies, strengthen resilience and become more innovative in production processes by using alternate input from alternate sources and seeking new markets for their products."

Crises Reveal Board Character

Kumar's point about creating more flexible strategies alludes to a critical risk factor that existing models are less likely to capture. While in many ways U.S. businesses are still grappling with the aftereffects of the pandemic, a picture is beginning to emerge of the qualities that enabled organizational resilience. A common thread? Company cultures built on agility, innovation and people-centered values.

"Every company whose board I serve on that had people in Ukraine, we helped them," says Denzel. "We helped evacuate them, we stayed close to them. We gave them money if they needed it. Not just our people, but their families, pets and grandparents. We understand that if the family's not settled down, your worker isn't going to be."

Sam Bright, a member of the board of trustees at TIAA and chief product and experience officer at Upwork, credits Upwork's strong corporate culture with helping the company secure the safety and livelihood of thousands of the company's freelance talent and team members.

"As an organization, as a culture, we rallied around our shared values," says Bright. "Things like health and safety came first in considering how our decisions would be judged with the passage of time and taking into consideration the impact to all of our stakeholders." Those shared values, coupled with the agility at the core of Upwork's business model, enabled the company to move quickly to build support structures for their affected stakeholders, including accelerating access to payments, creating check-in features for freelancers to easily and quickly let clients know about their safety and work status, and establishing an option for both employees and customers to donate directly to those affected, with no strings attached.

“There is a deep level of empathy embedded in our company and it caused people to act in a really expeditious way. It reaffirmed that our team and our customer relationships are strengthened by our shared purpose and values,” says Bright. “I think crises reveal you. It was inspiring to see all the various functions show up and leverage the resources at their disposal to make a difference for all of our stakeholders. We are an innovative culture, we’re an empathic culture — and it really shows through in moments of stress.”

Erin Essenmacher is a board director and strategic advisor. She spent nearly 10 years in executive leadership at the National Association of Corporate Directors, most recently as president and chief strategy officer.