ARTICLE

Geopolitics and Corporate Governance

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This is not only an era of changes; it is a change of an era.

Boards should do an important and urgent work in helping CEOs and senior managers integrate geopolitics in their strategic analysis and business model.

The growing geopolitical tensions between the US and China are changing the global business landscape. Many US and European companies have started to diversify away from China as a key sourcing country and to build an alternative global supply chain that may eventually replace China as a key sourcing country. This is a very painful process led not by economics and business interests but by the reality of conflicting governments' policies. It is also a very complex process for many companies and particularly difficult for firms such as Apple, BASF, BMW, TSMC, or Volkswagen, for whom China has become the key market in terms of sourcing, sales, or both.

Since 2022, the US Administration, particularly with the CHIPS and Science Act, and the Inflation Reduction Act, has developed a new industrial policy that drives US companies towards reducing their dependence on China and increasing the US market as the natural location for manufacturing and R&D. The huge incentives provided by the US Administration to US companies have sparked a reaction in the EU, with the European Commission planning to offer lavish incentives to European companies as well. With the new Chinese industrial policy, we are observing a big clash of industrial policies. The invasion of Ukraine and the energy crisis are two serious but unequivocal steps in that direction. Although the accumulated experience of industrial policy calls for a healthy scepticism about the potential effect of these policies on companies, jobs, and investment, these actions certainly create an important distortion in international trade and define a clear and big step towards a de-globalization and more fragmented world. The outcome for companies, large and small, is that the international context becomes more uncertain over the next few years, and firms can no longer count on international expansion to speed up sales or reduce costs.

These political developments across countries put heavy pressure on boards of directors. They are responsible for the firm's long term orientation and value creation. Geopolitics joins the list of major disruptions affecting companies and their business models, including technology, climate change and social activism, among others. All of a sudden, the assumptions of relative stability in international relations and global interactions based on free trade, comparative advantage and global economic integration are gone, for the time being. Boards should consider that this is not just one more change. This is not only an era of changes; it is a change of an era. In this context, boards should do an important and urgent work in helping CEOs and senior managers integrate geopolitics into their strategic analysis and business model.

The corporate governance experience of some international companies on how to make geopolitics an important pillar of strategic discussions suggests some steps that boards can follow.

The **first** step is to identify and review all the geopolitical risks that have or may have a potential impact on the firm's strategy, business model, balance sheet, Profit and Loss, and global value chain. A good understanding of the major friction points and vulnerabilities is indispensable to deal successfully with those risks.

The **second** step is to understand the historical dynamics of each relevant risk in other industries and countries. By thinking outside of the box, board directors may better understand the potential of a single risk from different perspectives and operating in different contexts.

The **third** step is to classify the major risks in terms of likelihood and potential impact on the firm, including financial and non-financial impact (for instance, the reputational impact of a risk hitting the company). Not all risks are equal; assessing them is key to developing the capability to deal with them.

The **fourth** step is to define a set of policies and actions to hedge, avoid, or mitigate the risk's impact. Boards can help management teams develop some contingency plans aimed at addressing a crisis when its unraveling is different from the initial planning. Scenario planning and thinking are useful methodologies in this time of major disruptions.

Finally, boards should make sure that the firm's strategy and business model are solid enough in the face of some potential geopolitical crises. As a result, it should adopt the necessary policies to help make the firm's strategy more resilient.

Boards in firms under important regulatory regimes should make sure that they share insights and perspectives on geopolitical risks with governments, in particular, with the one of the firm's country of origin. This is not about lobbying or regulators' capture. In this new world where national politics trumps economics, boards of directors should understand well their own governments and interact with them to get a deeper level of analysis of some major international events.

In the end, boards of directors should develop the competence to better understand major political and economic international developments, help develop scenarios at the company level that adapt to the new situation, and foster a necessary new mindset among board members and senior executives, making sure that they see the world as it is, not as it was yesterday or as they would like to see it. Geopolitics has probably become a disruption even bigger than technology for many companies today. Boards should understand this new international context well and help their management teams develop the mindset to lead their companies in this new world so that they can create economic and social value. By doing this, boards will provide useful bridges for international cooperation. At the same time, they help their companies create and share prosperity. ■

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