Resilience
Winning with risk

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Introduction

Welcome to the first issue of PwC's new journal, Resilience. *Since new publications appear and disappear every day, you might legitimately ask, 'Why does the world need another journal'? Our answer is that 'it does because a fast-changing world is forcing executives to take ever more risks to create value for shareholders and the societies in which their companies operate.' In this issue, our authors look at how your organisations can address such key questions as:*

- *What does risk have to do with strategy?*
- *How does risk-resiliency go beyond conventional risk management?*
- *What are the best ways to manage the risk of expanding into new and unfamiliar markets?*
- *How will increasing female literacy change society and generate new business opportunities?*
- *What is the difference between 'playing not to lose' and 'playing to win'?*

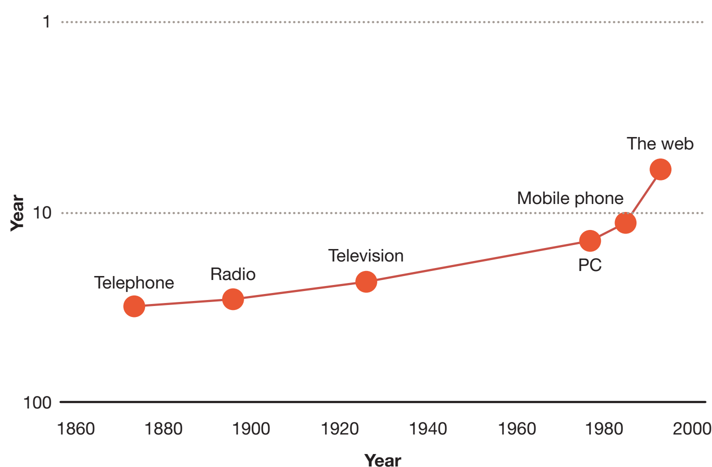
Clearly, risk-taking has always been an inherent part of business, and the more risks you take, the more you stand to win or lose. This fundamental tenet hasn't changed. What has changed is the quotient of risk needed to deliver the target reward. Seeking the same upside several decades ago tended to entail far less downside than it does today, so risk management can no longer be an afterthought; it must be a full part of strategic management. Today's unpredictable conditions also demand a resilient strategy that can adapt to uncertainty and change.

"Seeking the same upside several decades ago tended to entail far less downside than it does today."

And while every society in every time period faces change, it is happening at an accelerating rate today. One indication of this is the length of time it takes for a new technology to be adopted by 25% of the U.S. population. As shown in Figure 1, on the next page, it took 50 years for the telephone, 40 years for electric lighting, 20 years for the television and only 5 years for the Internet. Another indication is volatility in commodity prices. When the rate of change is constant, companies can adapt to it. But when the rate of change is accelerating, the rate of response must change as well.

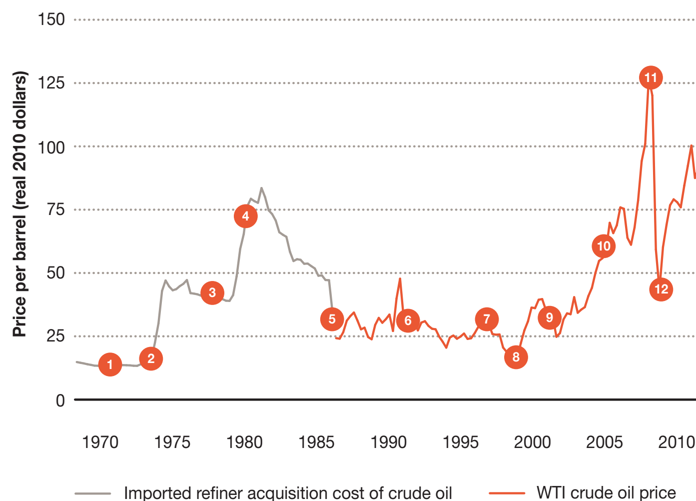
Figure 1 Mass use of inventions

Years until use by 25% U.S. population



Source: Mass Use of Inventions, *The Singularity is Near: When Humans Transcend Biology*, Raymond Kurzweil (Penguin Group, 2005) (http://www.singularity.com/charts/page50.html)

Figure 2 Crude oil prices and key geopolitical and economic events



1: U.S. spare capacity exhausted
2: Arab oil embargo
3: Iranian revolution
4: Iran–Iraq war
5: Saudis abandon swing producer role
6: Iraq invades Kuwait
7: Asian financial crisis
8: OPEC cuts production targets 1.7 mmbdp
9: 9-11 attacks
10: Low spare capacity
11: Global financial collapse
12: OPEC cuts production targets 4.2 mmbdp

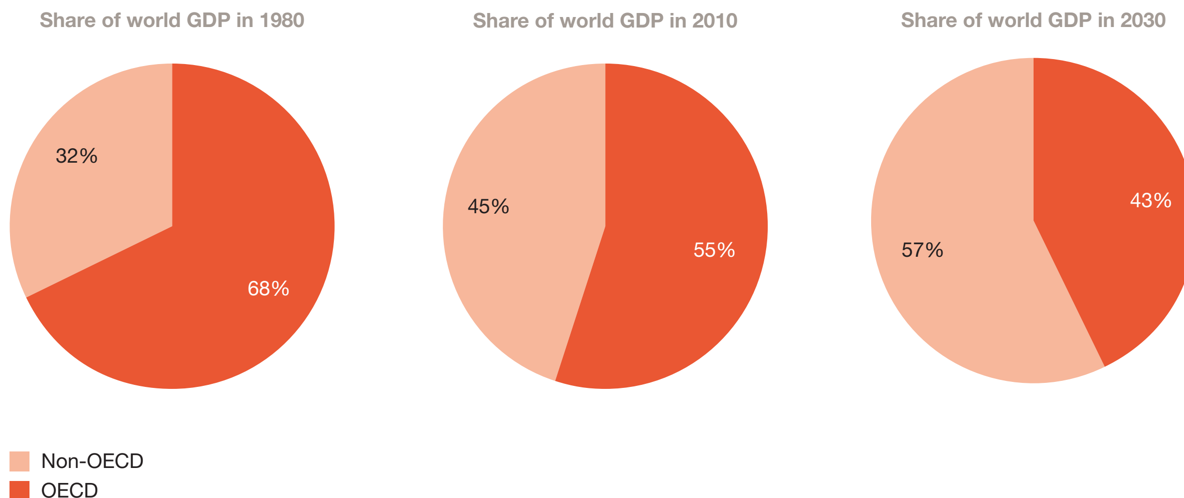
Oil prices have responded to geopolitical and other events over the past 40 years. Events that disrupt supply or increase uncertainly about future oil supplies tend to drive up prices.

Source: U.S. Energy Information Administration. Thomson Reuters.
Updated: quarterly | Last updated: 3/31/2012

The accelerating rate of change underpins a large number of global developments that are forcing companies to adopt strong capabilities for risk-resilience, lest they fall behind their competitors and eventually fail. In particular, this journal will focus on four of the key developments that are transforming society; the global economy and the risk landscape that surrounds it; and the nature, impact and most effective responses to these developments.

The first transformational development is the divergence in the global economy as growth in the emerging and faster-growing markets continues to outstrip that of their more developed counterparts and represents an ever greater proportion of global economic growth (see Figure 3). This has profound consequences for executives who see more and more of their growth opportunities in markets that often entail much different forms of political risk. It also presents challenges in terms of corruption; lack of social (e.g., laws and regulations) and physical (e.g., roads and bridges) infrastructure; radically different demographic profiles and increasing levels of female literacy; and rapidly shifting social expectations. All of these create higher levels of risk. These challenges are compounded by the difficulties Western multinationals face in overcoming restrictions on outside investment and entrenched local competition in many emerging and faster-growing markets. Many corporations from these markets are also emerging as major global players in their own right.

Figure 3 Gross domestic product at purchasing power parity (current international dollars)



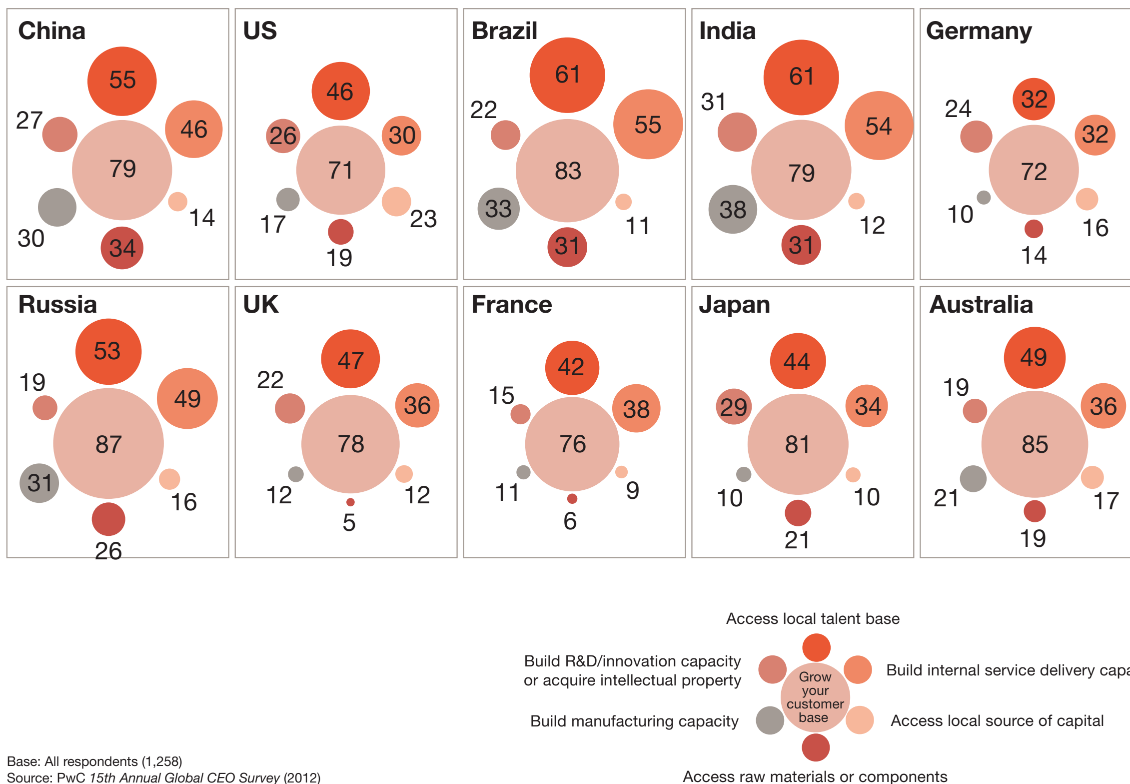
Sources: The World Bank: World Development Indicators: World Bank, International Comparison Program database; and Organization for Economic Cooperation and Development (OECD): Perspectives on Global Development 2010: Shifting the Wealth. Compiled by the Eurasia Group.

The second major development is the desire of governments in emerging markets to move beyond reliance on low-skilled production toward the creation of knowledge-based employment. They will want multinational investors to support this.

Yet, at the same time, governments in developed markets are keen to keep skilled jobs in their own countries and even bring back ('insource') jobs that have been moved overseas. While clearly challenging, multinational businesses' ability to support evolving government priorities is a key element of their 'licence to operate' and hence commercial prospects, as states play an ever more influential role in directing business. As suggested in Figure 4, these forces mean that CEOs' priorities vary significantly across markets.

Figure 4 CEOs have broad objectives in their key markets

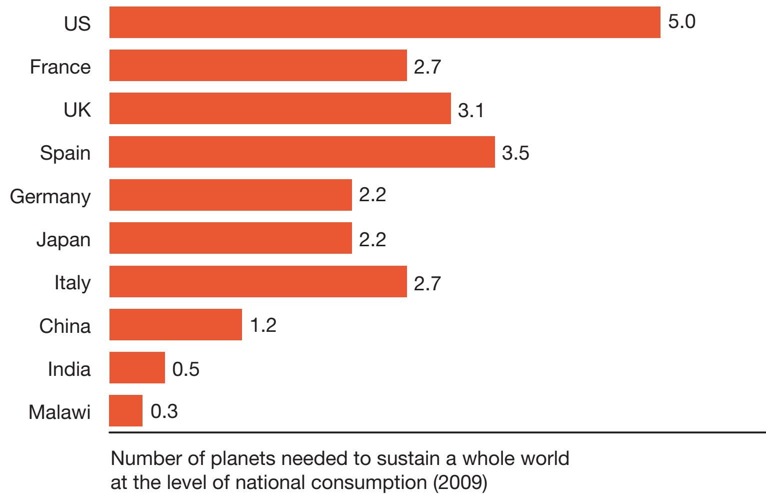
% of CEOs naming objective for the next 12 months, in each of their 3 most important markets



Base: All respondents (1,258)
Source: PwC *15th Annual Global CEO Survey* (2012)

The third development is the growing pressure on energy, water, land, food and other resources. This may only become worse over time as consumption rates increase to developed market levels, as suggested by Figure 5. In the long-term, this will have profound social and political consequences. Nearer term, we are already seeing the effects in rising and volatile commodity prices. These prices not only wreak havoc in countries whose economies are commodity-based, but they also impair corporate efforts to predict and manage costs. Moreover, they contribute to very real concerns about the security of supply of the energy and raw materials needed to make products. They also create the potential for 'stranded assets', an example of which is oil and gas reserves. The value of these reserves will decrease as alternative forms of energy become more economical and as the price of using carbon as a basis of energy increases through regulation, taxes and emission trading schemes. The rapidly growing development toward resource nationalism (recent examples include the nationalisation of energy assets in Bolivia and Argentina) is adding further risk and creating economic quandaries for businesses operating abroad. The panic among governments to secure resources in order to assure their future prosperity has also led to another contentious practice — that of buying foreign resources, like farmland and food supplies. While some argue this is just good business sense, others claim that China's deal to purchase farmland in New Zealand or Qatar's objective to secure its food supply by heavily investing in agricultural projects abroad are evidence of rich nations securing their own future at the expense of those less well off.

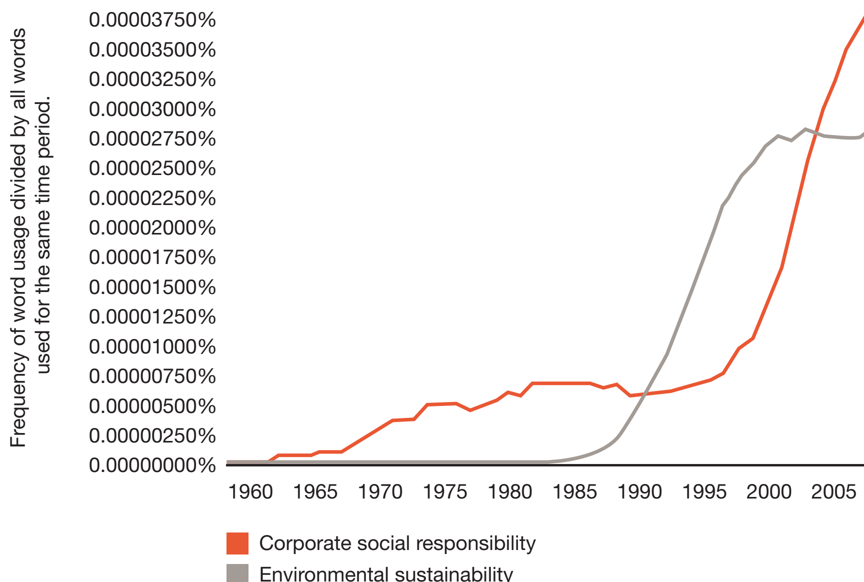
Figure 5 Number of planets needed to sustain a whole world at the level of national consumption (2009)



Source: *The Consumption Explosion*, New Economics Foundation, November 2009 (http://www.neweconomics.org/publications/consumption-explosion)

The fourth development, which stems from the previous three, is the growing interest in 'sustainability' from governments and civil society, as shown in Figure 6. This term means different things to different people and is often used synonymously by some, but not all, with 'corporate social responsibility'. In some places, such as the U.S., it is largely seen as a 'green' issue and manifests itself in programmes for better managing resources like energy and water and reducing the impact of the company's operations, including its supply chain and its customers, on the environment. In other countries, the term has a broader meaning that includes social and governance (of which risk is an important part) issues as well. For us, sustainability refers to a company having a sustainable strategy that will enable it to create value for its shareholders and stakeholders over the long term. People are becoming more sophisticated in how they use technology to gather information and communicate their views and expectations. In responding to these demands, companies have no choice but to consider the ways in which they are or are not contributing to a sustainable society. This requires a careful balancing of many different commercial, social and environmental interests and creates yet another driver of uncertainty and risk.

Figure 6 Increasing interest in CSR and sustainability



Source: Innovating for Sustainability presentation, Bob Eccles and George Serafeim, May 2012

Resilience is critical

How should executives respond to these developments? One way is to become much better at risk assessment and analysis and avoid actions that entail more than moderate degrees of risk. This approach can ensure survival in the short term since the company will avoid major disasters, but it will put its long-term survival at risk since it will lose out to more aggressive competitors who are successful in the risks they take. Instead, we are calling for companies to be strategic in the risks they take, doing so in an intelligent manner by becoming risk-resilient organisations. By risk-resilient we mean the ability of an organisation to recognise, take, and rapidly and effectively adapt to changes and the resulting risk. This requires rapid acquisition and analysis of vast quantities of information; generating knowledge out of this analysis based on recognising patterns; having a flexible and nimble organisation where local units have the autonomy to respond to changing circumstances; and having strong risk governance procedures at the board and executive level. Those organisations that are risk-resilient will prosper and thrive. The cautious ones will die over time. The careless ones will die quickly.

The opening two articles in this edition look at how to deliver corporate goals in a complex and unpredictable world by bringing risk management into the forefront of strategic planning and execution, and the board's role in making this a practical reality. One of the key dilemmas is whether conventional enterprise risk management is fit for purpose in today's world. The first article, 'Building a risk-resilient organisation', argues that it is the application and embedding process that needs overhaul. The second, 'Sharpening strategic risk management', goes further by outlining why ERM needs to extend its ambitions into areas that were once seen as too uncontrollable to feature on the risk register.

The next three articles examine strategic opportunities and their accompanying risks in new, emerging and fast-growing markets. 'Managing the political dimension' adds a new type of risk to those considered in the previous two articles. Political risk, which the authors define as the 'risk that a political action changes the expected value of an investment outcome', is a risk that can be heightened when investing in new, unfamiliar and potentially unstable markets. They suggest performing both a static and dynamic analysis when considering investment opportunities, with growth as one dimension and political risk as the other.

'Dealing with the new world of multinational competition' focuses on the large and increasingly promising emerging market of the 'South' and outlines some of the particular risk and opportunity issues that exist there. While most of foreign direct investment stock in the South still comes from the North, South-South trade flow is becoming increasingly important and is raising the level of competition for companies based in the North to pursue opportunities in the South. The authors provide six pragmatic suggestions for firms in the North wishing to do business in the South — such as engaging in strategic B-to-B partnerships, embracing transparency and being a model of ethics, and pursuing alternative sources of financing — and illustrate their relevance in the particular country example of Myanmar and the particular industry example of athletic footwear.

‘Get it right or stay at home: Managing risk in challenging markets’ focuses on the importance of risk assessment prior to making the decision to invest in an emerging market, asserting that ‘failing to prepare is preparing to fail’. The authors argue that all risks can be considered in terms of one of two types, reputational and operational, and that both must be put in political context, thus echoing the focus of the previous article. This risk assessment must be done on a holistic basis, looking for risk interdependencies, and at both strategic and tactical levels. Like the first two articles, they discuss the role of the board. They also analyse the situations in post-Gadhafi Libya and, complementing the previous article, Myanmar as it faces the 2015 elections, which will be the true test of current economic and political reform efforts.

The remaining articles each address a particular topic related to risk, strategy and sustainability. ‘Making the tough calls on growth’ picks up themes of a fast-changing world of opportunities and risks in a large number of emerging markets. The article provides a framework for exploring the decisions around growth under uncertainty in this environment and discusses advanced predictive modelling and simulation modelling techniques.

‘Tapping into female empowerment’ analyses the leading role of women in the Arab Spring and the role played by education and technology in spurring greater activism, emphasizing that it could not have occurred without rising levels of female literacy that leveraged a broad range of Internet technologies and social media. While female literacy and the Internet pose a clear political risk to country dictators, they also create vast commercial opportunities for companies seeking to enter the fast-growing and often wealthy markets of the Middle East. The author suggests that companies should take advantage of the social media sophistication of Arab women as a way of creating awareness of their company’s brand and its products. As this particular example shows, political risk for some creates economic opportunities for others.

‘Sustaining the supply chain’ focuses on the impact of more globally dispersed and complex supply chains. When combined with the growing social and environmental pressures from investors, employees, customers, governments and civil society, companies need to find more effective ways to overcome the vulnerabilities in their supply chain, both physical and reputational. The article outlines the supply chain management strategies that comprise a continuum from ‘play not to lose’ to ‘play to win’. Such strategies are how a company can become risk-resilient in its supply chain.

As this collection of articles makes clear, becoming a risk-resilient organisation that integrates risk, strategy and sustainability is not something that is easily done. But it is necessary to do so in order to thrive in a global economy that is creating opportunities across developed and especially developing countries. Through this journal, we plan to bring practical insights, frameworks, methodologies and examples that our readers can use to better manage their own companies. Contributions to this journal will come from both the professionals at PwC and expert practitioners and academics. So welcome to our first issue of *Resilience*. We hope you enjoy it and find it useful. We look forward to having you join our community.

Building a risk-resilient organisation By Brian Kinman

Established approaches to risk management are struggling to cope with the speed, connectivity and contagion of unfolding events. How can your organisation develop the risk-resilience needed to adapt to a faster-changing and more uncertain world?

Enterprise risk management (ERM) is an old idea that has gained renewed focus and relevance in the wake of the financial crisis. All industries are now facing unprecedented levels of risk. The pace of change and the speed of information flow are causal factors in the escalation of risk. Advancements in technology have spawned new business models that drive these changes and new threats, ranging from data vulnerability to the viral spread of rumours via social media. This has also resulted in an increasingly interdependent world where the sourcing practices of a manufacturer in Delhi can cause regulatory and reputational consequences for a business in Dallas.

Alarmed by the escalating risks, investors, regulators and rating agencies are challenging companies to be more transparent about their risks and more effective with their ability to manage them. As the bar rises, managing risks in silos is no longer seen as acceptable. The sanctions for failing to meet stakeholder expectations range from market losses and share price declines to enforcement action and lasting reputational damage.

The need for risk-resilience

Survival and success in this uncertain environment demand risk-resilience — being able to anticipate and adapt to change; absorb and recover from a broad range of risk events (including unexpected 'black swan' events); and seize the opportunities hidden within those risk events.

In an environment of relentless change, only the risk-resilient can survive and thrive.

So how can your ERM programme become more risk-resilient? Conventional risk-management frameworks provide guidance for thinking about risk, but they don't say enough about how to execute an ERM programme. That helps to explain why the practical application of ERM often fails to live up to expectations.

When risk management is divorced from strategy, ERM programmes do not help to achieve strategic objectives.

Underlying problems include allowing risk management activities to be managed by personnel who are separated from those who drive the business. This is compounded by an approach to risk that is backward-looking and insufficiently geared to the execution of forward-looking business plans. This can result in an inability to pick up on emerging threats. Incentive systems often add to the problem by rewarding managers for short-term profit generation rather than realising longer-term strategic goals through the anticipation and management of unfolding risks.

With little or no link between strategy and risk management, ERM programmes are static, while the business environment is dynamic. You don't need a new form of ERM to overcome this. But you will need to make sure its operation reflects the dynamic and unpredictable nature of the risk and wider business environment you face. We have developed five questions that will help boards to judge whether their ERM programme is equipped to deal with this environment and move to a more resilient and forward-looking approach (risk is defined as 'any issue that impacts an organisation's ability to achieve its objectives').

Ownership

1 / Who owns risk?

Risk-resilience is only really possible when the people who are responsible for driving business results are accountable for the associated risks.

Organisationally, risk ownership begins with senior management and cascades down to the business units and key functional areas (e.g., finance, treasury, legal, IT and HR). The higher the level in your organisation, the more strategic the risks owned. Senior management should be responsible for macro risks, such as the threat of political instability, while employees in the field will need to manage lower-level risks. The key is assigning responsibility for particular risks to the people who have control over them and training them accordingly. The board is responsible for challenging management's approach to risk ownership and questioning whether they have a programme in place to identify, assess, manage and monitor risk effectively.

Risk-resilience can be achieved only when accountability for risk resides with its natural owners: those who drive business results.

Oversight

2 / How effective is the board in overseeing risk management?

Risk information should be timely, reliable and meaningful enough to allow the board to assess and address the impact on strategy. By being able to judge performance through the lens of risk, boards will have key insights into how to evaluate management's strategy and recommend changes in direction where necessary. All too often, however, boards are deluged with data rather than relevant information on the genuinely critical strategic issues. If lower-level issues are constantly sent up to the board, this may signal that risks are not being handled at the appropriate level in your organisation. Thus the board should also be challenging the risk management process, not only the result.

Business unit risk tolerances should align with the level and types of risk your organisation is willing to accept in pursuit of its strategy ('risk appetite'). Reports should highlight any variations from these tolerances so your board can discuss these with management. All too often there is no dialogue about such variations, leading to a disconnect between the level of risk being taken by the business units and the risk appetite approved by the board.

Agility

3 / How proactively is risk managed?

Many organisations only assess risk intermittently, often after a crisis. Building regular risk updates into the planning process can help your business to anticipate emerging risks more effectively.

Most organisations are reasonably good at dealing with risks they are familiar with. But unforeseen and emerging risks are less well managed. The ability to identify and address unfolding risks would give your business a valuable edge over less proactive competitors.

Forward-looking scenario analysis can help to identify and assess broad areas of change, emanating from both internal and external factors, that might generate new risks. This would allow modelling teams to elevate risk identification to a new level of agility and proactivity.

To encourage managers to look further into the future, forward-looking risk assessments should form an important part of performance evaluations. This will help to make sure that your organisation can meet its long-term strategic objectives, rather than just short-term profit goals.

Integration

4 / Can 'black swan' risks be managed?

Integrating the strategic ERM programme into corporate planning and performance management will provide a solid basis for forward-looking analysis and preparation. This can help your organisation to identify and assess emerging risks and act on them in a timely manner, leading to fewer unforeseen black swan events. Indeed, the financial meltdown was not a black swan for organisations that saw the warnings and were already mitigating the risk before the crash occurred. Similarly, many companies had already recognised the inherent risks of a single-vendor supply chain and had moved to spread the risk across geographically dispersed suppliers, thus mitigating the catastrophic impact of the Japanese tsunami in 2011.

One organisation's 'black swan' is another's identified emerging risk.

When true black swan events do occur (e.g., an earthquake or terrorist attack), strategic ERM can provide a framework for swift and decisive response and recovery. It can also open up opportunities. For example, companies that had built business continuity management into their ERM programmes were able to get back up and running after the Japanese tsunami faster than their competitors and used this advantage to capture market share.

Payback

5 / What is the return on risk management?

Integrating ERM into strategic planning and performance management processes requires little additional cost. Quite a lot of risk mitigation is already in place as a natural part of doing business (e.g., a bank has vault doors, whether or not it has an ERM programme), and these should not be included in considering the cost of implementing a strategic ERM programme. Deploying people to carry out the integration does have some costs. New tools, methodologies and the training to implement them will be needed, but the incremental investment required does not have to be substantial.

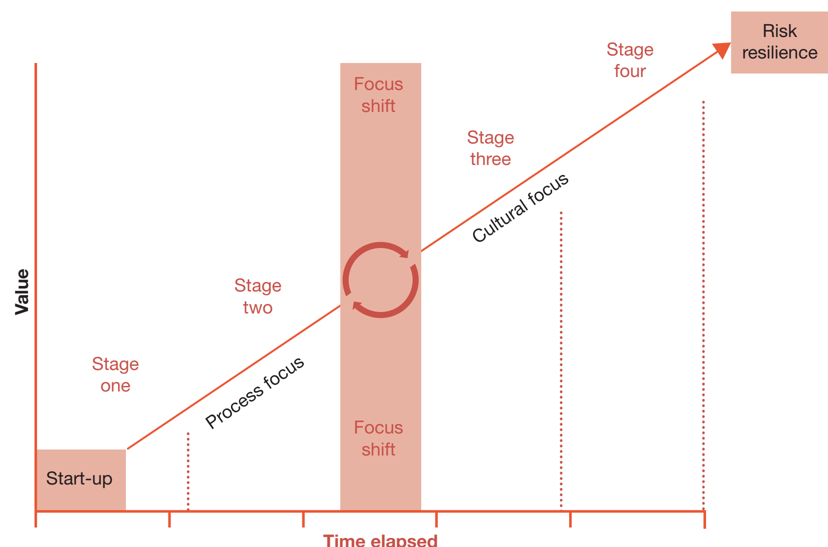
The returns on this relatively modest outlay can be significant and can be measured in several ways. This includes realising your goals more effectively. It also includes fewer surprises or lower interruption and remediation costs after crises. Further payback includes the ability to identify and capitalise on opportunities.

The strategic ERM continuum

Considering these questions can prompt a review and rethink of how to manage risk. The strategic ERM continuum in Figure 1 illustrates the typical evolution of risk management capabilities, from initiation of a strategic ERM programme to achievement of risk-resilience. The continuum moves from a focus on processes and risk management as a function (stages 1 and 2) to its integration into strategic and performance management (stages 3 and 4).

Many companies use the continuum as a basis to gauge their progress in managing risk and as a strategic target for programme enhancements. The further along the continuum, the greater your ability to survive and thrive in a complex and dynamic business environment.

Figure 1 The strategic ERM continuum:
Evolution of enterprise-wide risk management capabilities



Stage 1

Risk is managed by a centralised team. Processes are put in place to identify and record risks within accepted tolerances. ERM documentation tools are deployed to communicate risk profiles and support decision making by senior management and the board. But this may not provide a good foundation for decision making, as the reports are developed from the perspective of internal audit or the risk management department, often without effective ownership from business units and functional groups.

At this stage, the focus is mainly on known historical risks. This is necessary but not sufficient, as emerging risks and potential black swans may have a greater impact on the organisation's ability to realise its strategy.

Stage 2

In stage 2, the organisation begins to focus on emerging as well as past risks, and risks identified in operational areas are linked to those identified at the strategic enterprise level. Consistent methodologies are used to assess risks and to determine risk tolerances. ERM tools are used to complement the strategic planning process, and more robust risk reports are developed. But risk analyses are not yet translated into changes to business operations.

During this stage, your organisation would begin to establish risk ownership at the appropriate levels. Leaders of business units and functions would start to consider their risks in light of how they will affect their ability to meet their goals and how they intend to bring these risks within acceptable levels.

Risk management in stage 2 is becoming more effective but is episodic. It is not performed as routinely as needed to adapt in an environment of constant change and risk volatility.

Stage 3

As organisations move into stage 3, there is a cultural shift toward frontline ownership of risk. Your organisation can become more forward-looking, focusing on emerging risks and black swans as well as past risks. ERM is integrated into business planning. The strategic risk assessments completed in stage 2 are translated into operational plans and ERM becomes a tool supporting performance management.

During stage 3, risks are discussed in connection with specific strategic objectives, and this often brings to light risks that had not been considered before. For instance, if the strategic plan calls for 30% growth in market share, you might find that you do not have enough production capacity to realise this.

By the end of stage 3, risk assessment and management practices have become routine and embedded deeper in the organisation. Planning sessions are held more frequently and the strategic plan is adjusted as needed to reflect changes in the organisational risk profile resulting from internal and/or external change.

The power of scenario modelling

Effective scenario modelling can help your business to anticipate change and prepare for the consequences, whatever they may be.

A dedicated committee focusing on scenario modelling will help to make sure that the analysis is acted upon, rather than allowing it to get lost in all the many other daily responsibilities of the executive committee. It is also important to have a systematic process for reporting model results and to make sure they are fed into strategic plans; otherwise, all this work will be wasted.

In addition to identifying emerging risks, the scenario modelling team can spot potential opportunities. For instance, Amazon was quick to see the transition to digital books and capitalised on this emerging trend with Kindle. Barnes and Noble followed with its NOOK e-reader and built a second-place position in the market. In contrast, Borders failed to recognise the emerging risk of business model innovation that was being driven by Amazon and minimised online sales, focusing instead on maintaining its strategy of selling physical goods. It eventually filed for bankruptcy.

Stage 4

In stage 4, business units develop key indicators and performance metrics to help them manage their operations within defined risk tolerances. Risk management becomes an element of routine management activities.

At this stage you can begin to develop a risk-aware culture. All employees are responsible and accountable for owning the risks related to their roles. They understand that generating profit requires risks and are trained in ways to manage the balance between risk and reward. And if they see risks taken outside of the tolerances, employees are empowered to raise a red flag.

With strategic ERM embedded in the organisation, the board and management can make decisions with greater confidence and clarity. Routine, low-level risks are managed by the business units, and only more complex, emerging risks are escalated to senior management and the board.

In stage 4, scenario modelling capabilities come into their own. Many companies also use 'reverse stress testing' to understand the potential impact of severe risk events and develop mitigation plans. The risk-aware culture that evolves in stage 4 extends beyond the organisation to include suppliers, partners and others, making your business even more resilient to major risks.

Advancing along the continuum

The board of a regional utility wanted to implement an ERM programme. Initially, the company was at stage 1 of the continuum. The next step was to establish appropriate ownership of risks and invite input from leaders of the businesses and functional groups about their view of the risks they face. The company rapidly moved into stage 2 before transferring the entire ERM function into the strategic planning department, building tools and methodologies to integrate risk management into planning.

Today the utility is at stage 4 and is a leading proponent of risk-resilient ERM. All business unit leaders and their teams have taken control by actively monitoring and managing their risks. They also scan the internal and external environment to identify new risks, as well as existing risks that are not being managed well enough. Risk management is a topic of conversation at every management meeting.

Senior managers have developed a scenario modelling process and created metrics they can rely on to help determine the direction of change. Scenario modellers look far into the future to identify risks that could impact the utility or even threaten its survival. The scenario modelling process is linked to the strategic ERM programme. The output of the modelling team is passed down to the businesses so that each unit can assess the impact of future trends on their ability to achieve their goals and adjust accordingly. The company has also incorporated risk management as a key component of performance reviews and bonus setting.

Realising your full potential

While ERM is well established within many organisations, integrating the changing risk profile into decision making at the strategic and operational levels is, in practice, relatively rare.

Moving through the ERM continuum can not only make your business more resilient, but also open up opportunities that less well-informed organisations may miss or be reluctant to pursue. The five questions highlighted in this article can help your business to identify how ERM could be improved and lay the foundations for change.

Developing and executing a solid strategic ERM programme will greatly improve your ability to realise your strategic objectives. However, if your risk management stands still in the face of relentless change, you can expect to face recurring risk events and regulatory crises — and to fall behind your more agile, risk-resilient competitors.

Sharpening strategic risk management

By Armoghan Mohammed and Richard Sykes

While conventional enterprise risk management (ERM) techniques have done a reasonable job in identifying and mitigating financial and operational risks, research shows that it is the management of strategic risk factors that will have the greatest impact on your ability to realise your strategic objectives.[1] Bringing ERM into the forefront of strategic decision making and execution could thus give your business a decisive edge.

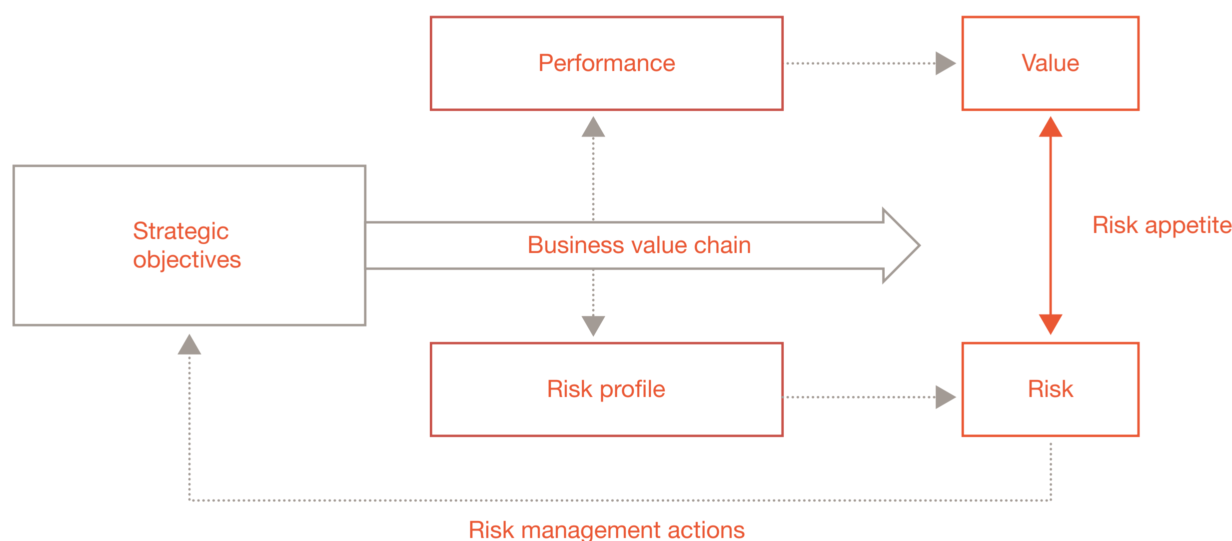
Strategic risks can be defined as the uncertainties and untapped opportunities embedded in your strategic intent and how well they are executed. As such, they are key matters for the board and impinge on the whole business, rather than just an isolated unit.

Strategic risk management is your organisation's response to these uncertainties and opportunities. It involves a clear understanding of corporate strategy, the risks in adopting it and the risks in executing it. These risks may be triggered from inside or outside your organisation. Once they are understood, you can develop effective, integrated, strategic risk mitigation.

Far from holding back the business, strategic risk management is about augmenting strategic management and getting the full value from your strategy. In a typical instance, a conventional approach to setting and executing strategy might look at sales growth and service delivery. Rarely does it monitor the risks of a shortfall in demand.

As Figure 1 outlines, effective strategic risk management is built around a clear understanding of how much risk your business is prepared to take to deliver its objectives, and a timely and reliable evaluation of how much risk it is actually taking.

Figure 1 Managing risk to deliver objectives



1 *Black swans turn grey - the transformation of risk, January 2012* (http://www.pwc.co.uk/governance-risk-compliance/publications/risk-practices-black-swans-turn-grey-the-transformation-of-the-risk-landscape.jhtml)

The problem is that risk management can often be run separately from frontline strategic assessments, decision making and monitoring against plans. Boards can thus improve their focus on risk by integrating risk management into their routine strategic evaluation, debate and challenge.

Figure 2 sets out the main types of risk a business is likely to face. Financial risks are typically well controlled and are part of the routine focus of board risk discussions, with strong impetus coming from the increased regulatory, accounting and financial audit focus. As financial information is a key element of stakeholder communications, performance measurement and strategic delivery, board risk discussions will devote considerable time to these risks.

Operational risks are typically managed from within the business and often focus on health and safety issues where industry regulations and standards require. These internally driven risks may affect your organisation's ability to deliver on its strategic objectives.

Hazard risks often stem from major exogenous factors, which affect the environment in which the organisation operates. A focus on the use of insurance and appropriate contingency planning will help address some of these. However, there is often a danger that as many of these risks cannot be controlled, boards and senior management will not reflect these in their strategic thinking. Confining strategic management to controllable factors will leave your business at risk of failing to address these factors.

Strategic risks are typically external or affect the most senior management decisions. As such, they are often missed from many risk registers. Your board has a responsibility to make sure all these types of risks are included in their key strategic discussions.

Figure 2 Risks to business

So how are risk management frameworks evolving in the face of these gaps in how risk is managed and the need for greater integration with strategic management? Our conversations with boards highlight three major concerns. First, many executives are worried that the risk frameworks and processes that are currently in place in their organisations are no longer giving them the level of protection they need.

Second, boards are seeing rapid increases both in the speed with which risk events take place and the contagion with which they spread across different categories of risk. They are especially concerned about the escalating impact of 'catastrophic' risks, which can threaten an organisation's very existence and even undermine entire industries.

The third shift is that boards feel they are spending too much time and money on running their current risk management processes, rather than moving quickly and flexibly to identify and tackle new risks. As a result, some are not convinced that their return on spending on ERM is fully justified by the level of protection they gain from it.

PwC recently conducted a qualitative research study into how various multinational organisations have responded to these challenges. The study revealed four key findings:

The boards of big organisations do not fully understand the risks that they are running...
... or how the knock-on impacts can spread across risk categories. This in turn makes it harder to manage organisations within their risk appetite.

Checks and balances at the board level are critical.
Does the board have people with enough industry expertise to ask tough questions about executives' decisions? In many cases the answer is no. Even the most sophisticated approach to risk can be undermined by a lack of industry insight.

In the Internet age, speed and prejudice are all.
Information moves instantaneously around the world, and opinion morphs into accepted 'fact'. So corporations must hit the ground running with the right responses delivered at pace. All too often, they are caught unprepared.

Leadership and culture.
There is frequently a gap between what management says about risk and what it does. Are the CEO and board setting the right behavioural example and risk-aware culture, in line with the corporation's strategy? Do rewards encourage risk-based thinking and behaviour?

These shortcomings reveal that current approaches to risk management are no longer fit for purpose. It is important to develop and expand existing frameworks and tools, drawing on outside experience and knowledge wherever possible. Indeed, the external viewpoint that independent directors can bring to the boardroom will play an essential part in ensuring this breadth of risk-thinking enhances the development of strategic thinking. The challenge your and many other boards face is how to make sure the processes used to review and approve strategy can be extended to include an appropriate consideration of risk. There is a range of approaches that may be considered.

A well-defined understanding of how risk impinges on strategy is essential. The achievement of strategic objectives will often be expressed as one or more key strategic intents or visions. Examples include 'increasing revenue by £X in the next year, increasing market share in core markets by Y% or improving customer satisfaction metrics by Z'. In setting these strategic goals, the board intends to increase or safeguard the company's share price for investors (or other types of value for key stakeholders for non-profit organisations).

The impact of risk events can be expressed as an acceptable variation in these strategic goals, which management is prepared to accept to achieve them (e.g., 2% growth with virtual certainty, or 10% growth with increasing risk of

losses). While not all risks can be mapped back to a defined impact on strategic outcome metrics, the discipline of considering risks in this context will help your board to understand the potential impact and define the priorities for managing these risks.

Key questions for the board

The previous article, 'Building a risk-resilient organisation', posed five questions designed to help your organisation judge how effectively key risks are understood and managed. Here, we take this further by putting forward a series of questions aimed at helping you judge how effectively risk considerations are integrated into strategic objectives and their execution:

1 / How well is my strategy actually defined?

A good understanding of the key risks to strategic goals and the share price of the organisation requires a good understanding of the strategy itself. A robust articulation of the key elements of strategy (strategic intent, strategic drivers/actions, the context within which the strategy will be delivered, etc.) will allow your board to define and identify how the strategy will interact with the risks faced by the business.

2 / How broad are the risks that we are considering?

Strategy should be defined in the context of the risk environment in which the business operates. The broader the consideration of the types of risks the business faces, the better the strategy can be developed to respond to or navigate through these risks. Bringing together the internal risk information from the business, with an understanding of exogenous risk exposures as highlighted by senior management and non-executive directors in particular, should be a key focus of the board.

3 / What risk scenarios have we considered to test our plans?

It is often difficult to identify all potential risk exposures and their causes. Those risks that are going to be of most interest to the board will often be defined by the potential impact of the consequences of the risk manifesting. Scenario analysis with board input can encourage management to consider a range of scenarios that can result in significant adverse consequences for the business and help to make sure a wider breadth of risk impacts are considered than is currently the case.

4 / Have we mapped our risks to key performance and value measures?

Where possible, it is useful to consider risk in the context of how shareholders or stakeholders measure value in the organisation. This will help management articulate to stakeholders how the risks they are taking or the risks the business is exposed to may affect the organisation's ability to realise its objectives. Creating common metrics for risk and performance also allows management to define the priorities of risk management activities and focus on the more relevant risks to stakeholders and the board.

Encouraging management to understand risk impacts in the context of key performance metrics can be a complex task. However, if the key value drivers of the business are well understood by management, determining the potential impact of risk events on these value drivers should be achievable and would be considered part of a good risk management system.

Managing the political dimension

By Courtney Rickert McCaffrey with James Chang and Nick Consonery

The Argentine government's expropriation of 51% of the shares of Repsol YPF, the largest oil company in the country, from Repsol, a Spanish oil group, has once again highlighted the political risks facing foreign investments. The case underlines the importance of a full assessment of political risk as a key step in the strategic decision making process. How are political risks evolving, and how can your business gauge the risks against the potential rewards in the most effective way?

Emerging and frontier markets have a stronger growth outlook than developed markets — 5.7% for the former and 1.4% for the latter in 2012[1] — so the former are increasingly attractive to business decision makers seeking production, sourcing and consumer sales opportunities. PwC's *2012 Global CEO Survey* shows that 80% of global executives are hoping to expand their customer bases in China, Brazil or India.[2]

However, business risks and opportunities are determined not only by a country's economic growth prospects, but also by political risks and policy decisions. Political risk — the risk that a political action changes the expected value of an investment outcome — should be a key factor in your strategic investment decisions. This is especially important in certain emerging markets, where investors can come up against opaque and personalised governance, corruption, state capitalism, inequality and social unrest. Governments determine the degree to which they welcome foreign direct investment (FDI), and the stability of the regulatory and taxation environment for businesses operating in their country. These policies — and their efficiency and transparency — determine how much time and capital it requires to invest in a market and how onerous it is to maintain operations there.

Often more important than a static analysis of these issues, though, are the potential business risks arising from future policy changes. Many political, regulatory and tax risks are predictable. Such market-moving decisions are usually made by government officials with identifiable political motivations or known limitations on their authority. However, even unpredictable risks can be managed. Risk managers cannot always know when social upheaval will occur, but an analysis of political risks can predict which markets are more vulnerable to such shocks and how governments are likely to respond when they do hit.

Political risks can be measured, both qualitatively and quantitatively. Qualitative analysis relies on the knowledge and opinion of subject matter experts, while quantitative analysis is based on social, economic and political data to compare risks across countries. Static analysis examines the current political and policy environment in a country, while a trajectory analysis predicts the most likely future direction of these issues and how they will affect the sustainability of investments. In this article, we explore each of these types of political risk analysis. Your board-level decisions are likely to benefit from integrating analysis of these political risk assessments into your long-term growth strategies, helping you to mitigate risks today as well as those around the corner.

The impact of political risk

Political risk can take a variety of different forms. One of the classic examples of political risk is also one of the most draconian: government expropriation of business assets, as seen in the case of Repsol's assets in Argentina. There is also a variety of other less extreme and less direct forms of political risk that can affect the business environment. For instance, government elections can create political and policy uncertainty in both developed countries (such as the presidential elections in France) and developing countries (such as the fractious election process in Egypt). In addition, broad-based social unrest can inhibit business operations, as seen during the Arab Spring demonstrations that began in early 2011. More localised social unrest directed against a particular industry can also affect investment returns, an example of which was the Chilean mining strikes in the summer of 2011.

1 International Monetary Fund: World Economic Outlook (Copyright (c) 2012 by International Monetary Fund. All Rights Reserved.), published on 17.04.12
2 1,250 CEOs from 60 countries were polled at the end of 2011 as part of PwC's *15th Annual Global CEO Survey*, published on 25.01.12

One of the most direct political risks affecting a company's foreign investment prospects is the government's policy and regulatory environment for foreign direct investment. Some governments have implemented policies to attract foreign investment to bolster growth. In contrast, other governments have promoted investment by domestic companies or have burdensome and opaque policy and regulatory environments that inhibit foreign investment. Regardless of the macroeconomic conditions, markets in which governments have chosen the latter policies are likely to present foreign investors with more risks than the countries with more welcoming and transparent policy environments. Companies operating in markets with high-risk policy environments often face longer time frames to start a business; complex and often convoluted tax policies; and weaker property and intellectual property rights.

Sustainable investment decisions should therefore include an evaluation of political and policy risks in addition to the risks and opportunities stemming from countries' economic growth trajectories and other relevant business and market factors. As shown in Figure 1, Eurasia Group has developed a simple yet robust framework for managing country risk by identifying and assessing threats and opportunities in growth markets. Figure 1 outlines a straightforward way to assess a comparative level of risk in high-growth markets, allowing strategic planners to assess the relative ease of operating in markets with similar growth potential. Some of these growth markets are more hospitable to foreign investment, and constraints on or barriers to economic activity are lower. We measure the ease of operating in particular markets with the policy environment risk index, incorporating data on policy stability, the regulatory environment, the government's attitude toward foreign investment, capital movement risk and the protection of property rights. By identifying country positions within Figure 1, the framework provides strategic planners with a tool to evaluate the business risks and opportunities in each country.

Figure 1 Assessing economic growth and policy environment risk

Source: Sources: International Monetary Fund: World Economic Outlook
(Copyright (c) 2012 By International Monetary Fund. All Rights Reserved.), published on 17.04.12; and Eurasia Group.

Static analysis

The upper-left quadrant of Figure 1, 'Forge ahead', includes markets that are growing strongly and that have governments with policies and regulations that are favourable to foreign investment. For instance, Thailand has one of the best regulatory environments among Southeast Asian emerging markets, and the bureaucracy works hard to attract foreign investment, particularly in the manufacturing sectors. After severe flooding in the country last autumn, the government earmarked 350 billion baht (US$11 billion) for implementing a master plan on integrated water management to prevent future flooding and encourage foreign firms to remain in the country. In Australia, which is currently benefiting from a natural resources boom, the government welcomes foreign investment without restrictions on local content or local hiring. In November 2011 there was a clear example of this open door when the government approved the acquisition of brewer Foster's by SABMiller.

In the upper-right quadrant, 'Develop strategies', robust economic growth creates business opportunities, but these governments may favour domestic over foreign investment as a means to promote growth. Depending on the severity of the government's policies, foreign investors may face higher costs of market entry than domestic firms or may be barred from investing in the country altogether. Such policy conditions pose risks to investors, but the strong economic growth also creates opportunities for firms that are able to successfully navigate the policy environment. A potential solution is for foreign companies to partner with domestic firms when investing in such countries.

A similarly mixed investment outlook characterises markets in the lower-left quadrant, 'Seek opportunities'. Countries that fall into this category currently have slow economic growth or are contracting, so their domestic demand is likely to be weak. On the other hand, these governments are implementing policies that are favourable to foreign investors. If they attract enough investment, their internal demand prospects could improve. Such markets could provide an opportunity to make relatively inexpensive investments or acquisitions now, allowing your business to establish a base of operations for future growth. Alternatively, these markets may be favourable sourcing locations, as the policy environment is welcoming and labour and other inputs may be relatively inexpensive. For instance, ongoing tax and labour market reforms in countries such as Spain and Italy are likely to reduce the costs of doing business in those markets.

Finally, the lower-right quadrant, 'Proceed with caution', encompasses countries in which economic growth is weak and the government's policies are largely unfavourable to foreign investors. Investing in such markets involves taking on a high degree of risk. Although such markets may offer only limited opportunities to foreign investors in the short- or medium-term, there may be strategic reasons for attempting to enter them now to set up long-term opportunities. In Egypt, the political situation is volatile as the country continues to deal with the ousting of Hosni Mubarak and as it fitfully attempts to move toward democracy. Despite this ongoing uncertainty about the political environment — and the resulting policy environment for foreign investors — there are still opportunities in this market. For instance, small oil exploration and production firms have made a number of deals and discoveries in Egypt in the past year. The recent political unrest is likely to prompt the exit of some companies, presenting opportunities for established players — for instance, Apache — to consolidate their holdings or for new players to enter.

Trend and trajectory analysis

In addition to a static analysis of these issues, it is important to understand the recent trends and likely future trajectories of policies in individual markets in order to anticipate changes in the business environment. For instance, China has made considerable efforts in recent years to move toward a rule-based strategy to attract investors and improve laws and regulations regarding FDI. Although investors still come up against challenges such as weak protection of intellectual property rights and a lack of regulatory transparency, the business environment is likely to remain stable until the leadership transition is completed in 2013. In contrast, Hungary's government made a number of anti-market moves in the last year, including the introduction of a number of so-called crisis taxes levied against the banking, telecommunications, retail and energy sectors, and the de-facto nationalisation of the country's private pension funds.

In Brazil, the government is open to foreign investment, but protectionist policies in some sectors, such as oil and gas, will limit the opportunities for private investment. Corruption and bureaucratic hurdles can be a burden on companies when navigating the numerous federal, state and local agencies that issue licences required for project approval. Brazil's policy environment for FDI is expected to improve in the long term, albeit slowly, as the government introduces incremental changes to increase economic efficiency. Foreign firms may also find it difficult to enter the Indian market due to the collage of regulations, licences and permits required to operate. Although the government is likely to adopt more positive regulations in the long term, it is making only small steps toward that goal in the short term. For instance, in January the government removed the FDI cap on single-brand retailers, but a similar regulatory reform for multi-brand retailers is unlikely to follow soon.

Sustaining investment in the long term

Businesses are looking further afield as they strive to sustain long-term growth. Increasingly, this means operating in diverse markets around the world, which requires an assessment of the various risks and opportunities. The sustainability of investments depends not only on near-term economic growth, but also on other factors that make an investment sustainable in the long term, including broad political risks and the policy and regulatory environment. As businesses seek growth in new markets, many executives focus on market-entry risks, but underestimate the risks that come with sustained market presence. The political, economic, social, security and policy environment can change rapidly, so decision makers must constantly monitor political risks and assess how business practices should evolve to profit from the changes underway in markets around the world. As such, your organisation should incorporate an analysis of political risks in key markets into your investment strategy framework in order to ensure that business decisions made today remain sustainable tomorrow.

Will economic reform continue in China?

James Chang's view

China's economic development has achieved remarkable success, averaging double-digit GDP growth over the last three decades as a result of a 'reform and openness' policy adopted by the central government in the late 1970s. However, the reform, to a larger extent, maintained a command-and-control political system, evidenced by a direct role of government in allocating resources and deciding business affairs, and significant state ownership stakes in key sectors and enterprises.

To address the increasing social and economic inequities and at the same time keep the economy growing, some Chinese leaders are calling for some reform of the political system, which signals political volatility ahead. Within the Communist party, there is an increasingly visible divide over how to handle these new challenges. On the one hand, the conservatives support a strengthening of China's socialist roots and the use of state intervention to redistribute wealth, the so-called big government and small society. On the other hand, the pro-reformers advocate more opening up through administrative transparency, political diversity, market economy and public participation, or big society and small government.

We have seen a series of recent developments indicating that the country's pro-market leaders and reformers are gaining some momentum ahead of the critical once-a-decade leadership transition later this year. If successful, the breakthroughs will cement the foundations of a market-oriented economy and promote completion critical to China's efforts to achieve sustainable and innovation-driven growth of enterprises and the financial system.

One milestone was the recent release of the China 2030 report before the annual two meetings, jointly issued by the World Bank and the Development Research Center, a government think tank under the State Council, China's top executive body. Subsequent speeches by government officials and leaders have confirmed the reform agenda, including controversial moves to limit the scope of state-owned enterprises and a wide array of financial-sector reforms, including expediting interest-rate liberalisation and the lifting of controls on international capital flows in the near future.

Another example was the announcement of a recently approved plan by the central government to set up a pilot zone in the eastern coastal city Wenzhou, known as the nation's private financing hub, to regulate and develop private financing activities, encourage individual funds to set up rural banks or small lending companies, as well as allow individual investors to make direct overseas investment. The plan signals the central government's willingness and determination to boost the private sector, promote a more versatile and competitive financial sector, and loosen control of the capital account and foreign currency policy.

As China gets close to the leadership change, the country has reached another turning point. The upcoming transition represents a rebalancing of power between two competing factions, and each side has consolidated an impressive amount of power and developed personal strongholds in the state, party and military over the past decade. It will be difficult for the party to apportion power neatly between the internal political divides, as evidenced by different personalities, conflicting reform agendas and different perspectives on the challenges China faces. The politics of determining which side will control the the Politburo Standing Committee is unsettling the preparations for the new leadership generation. Ultimately, whoever 'wins' will shape whether China will further economic reform or will take a harder stance, and inevitably will have a significant financial and economic impact on the nation.

Nick Consonery's view

Investors should not conclude that recent political maneuverings in Beijing, including high-level discussion of economic reform and the ouster of the once high-flying politician Bo Xilai, suggest the relative rise of economic reform as a priority within the Chinese government. Indeed, the reform trajectory in China remains very much unsettled.

The good news is that it appears that reform-minded officials in the government have recently launched a concerted campaign to influence the policies of the next administration, which comes to power in March 2013. Coming amid this important political transition, the recent spate of reform rhetoric is a major sign of life among liberal officials and thinkers in China, who are pushing back against advancing state involvement in the economy and pervasive 'reform fatigue' over the last several years.

The push for reform was best embodied by a recent major policy paper jointly published by the World Bank and the Development Research Center of the State Council. That well-publicized report called for a vast array of economic and political reforms in China, many of which are already contained in China's 12th Five-Year Plan. The report sets a framework for China to avoid the 'middle-income trap' that has bedeviled many developing countries; it is an effort to nudge the Chinese leadership, amid a political transition, past the politics of status quo.

But it is precisely because of the ongoing political transition that any bold reform actions will be deferred. Stability is the overriding objective for top leaders this year, and major reform undertakings would risk that mandate. Instead, over the next year Beijing will continue to muddle through with marginal economic adjustments and hope to keep the economy above the 7.5% growth target set by the government for 2012.

Why is reform so challenging? In China, the notion of 'reform' means different things to different people, many of whom find certain changes detrimental. Indeed, the political and bureaucratic constraints in China are so severe that reform will become the work of a generation. And the risk is that China's political environment could defeat many elements of the reform agenda.

Given the current political climate of caution, proceeding timidly is the most likely outcome for now. Beyond 2013, the success of reform will rest largely with the next generation of leaders. Yet the reality is that change will be borne of economic and political urgency, and China's leadership does not appear to be facing either at the current juncture. Overcoming such hurdles will be the key determinant of how successful China will be in transforming its growth model over the next decade.

Dealing with the new world of multinational competition

By Harry Broadman and Sunita Saligram

Achieving business success in emerging markets has increasingly become a key factor for multinational corporations (MNCs) worldwide seeking new growth opportunities and greater global supply chain efficiency. There is little question as to why this is happening: Over the past decade and a half, the average growth rate of GDP in real terms for emerging markets has been twice that of the advanced countries, and this secular trend shows no sign of abating.

Yet surprisingly few corporate executives, whether from MNCs from the 'North' — the EU, U.S. and other mature, industrialized economies — or MNCs from the 'South' — the BRICS (Brazil, Russia, India, China and South Africa*) and other developing countries — realize this fundamental shift is underway. While the lion's share of international investment and trade with the emerging markets of the South still originates from the North — more than 90% of stock of inward foreign direct investment (FDI) in emerging markets was made by Northern firms[1] — new flows of such commerce are increasingly coming into emerging markets from the South itself. In fact, 'South-South' trade now accounts for a sizeable 20% of all global trade, and one-third of FDI outward flows originating from the South go to the South.

What are the competitive implications of this shift in global investment and trade flows, and how will it affect corporate strategic decisions?

Athletic footwear industry

Most of the major athletic footwear firms are based in the North, but produce a majority of their output in the South, especially in China. And, as it happens, a sizeable portion of Chinese production in this sector is exported to Brazil. The result is that Brazilian athletic footwear manufacturers feel they cannot effectively compete against the Chinese, so much so that Brazil believes these products are being dumped at an artificially low cost into the Brazilian market. As a result, the Brazilian government imposed a duty on imported Chinese athletic footwear. This ensuing trade war among the governments of the large emerging markets has sideswiped the world's major branded athletic footwear companies, cutting their sales revenues and leaving these companies with little recourse for remedies in the short run.

The rapid increase in South-South investment and trade is not a recent phenomenon but dates back several decades and is due to several factors. Firms from emerging markets have intensified interest in integrating into global commerce in order to harness new trade and investment opportunities within emerging markets. This stems, in part, from regional or bilateral trade/investment agreements, as well as the desire to capitalize on the growth of new middle-class populations and employee talent in emerging markets not being served by MNCs from the 'North'. The gap has opened up because Northern firms are charging prices for their products and services that are higher than these markets can bear; they are ill-informed about the existence of such opportunities; or they perceive these markets as too risky.

* For the purposes of this article, South Africa is included in the BRIC acronym.

1 Harry G Broadman, "China and India Go to Africa", *Foreign Affairs*, March 2008

In any event, the growth of South-South commerce creates a challenging environment for Northern firms seeking to buoy growth, while at the same time providing opportunities for maturing Southern MNCs to rival and potentially surpass their Northern competitors. Thus advanced country multinationals are facing a host of new risks and opportunities as they aim to compete not only with their longstanding rivals in the North, but also with emerging world-class MNCs from the South.

First and foremost, Northern firms seeking to compete in this new environment need to consider more closely both the benefits and costs of engaging in commerce in emerging markets. Too often, perceptions of risk in these markets are being overstated and the opportunities are being understated. This is not to suggest that this is the case in all emerging markets; it is quite the contrary. Indeed, there are cases where the perceived investment risks are significantly understated and remain so because of a herd investment mentality.

The rise and growing maturity of multinationals from the South present opportunities for Northern firms to capitalize on new trade-offs while investing in emerging markets. For example, multinationals from the North can benefit from joint-ventures with lower-cost Southern partners who have developing country experience versus potentially greater exposure to reputational and intellectual-property protection risks. Of course, recipient emerging market countries face analogous trade-offs — such as taking advantage of lower costs in procurement from Southern firms versus improving governance, product and environmental quality standards, which can serve to improve the success rate of entry by Northern firms.

Indeed, one of the major risks that Northern firms face through the increased presence of Southern competitors is the outright loss of bids, as companies from other emerging markets can leverage lower-cost products and inputs, lower margin requirements and heavy government support in the form of below-market rate debt and other financing agreements with active Ex-Im banks.

For example, countries dominated by state-owned enterprises (SOEs) often use government agencies to direct money to favoured industries and work closely with their SOEs abroad to help ensure their success, often mixing diplomatic missions with business. Northern companies do not tend to benefit from such state-sponsored advantages, and should they seek to compete with local governments in such deals, they can often run into serious allegations of violations of anti-corruption laws and policies in their home markets. This can lead to significant reputational damage as well as material financial losses. Furthermore, Southern firms often can take on less-than-bankable projects due to interest rate subsidies and other state guarantees. Should Northern firms seek to compete, they can face serious medium-term challenges in projects that become uneconomic with the smallest hike in market rates or commodity prices, creating substantial revenue risk for such projects. As such, Northern firms are in need of new and creative forms of financing projects in emerging markets.

Myanmar

Myanmar offers an example of the significant opportunities that exist in frontier markets as well as the large role South-South trade can and does play. For example, Myanmar's GDP is forecast to expand by 4.8% annually in 2012 and 2013, driven by large investment projects funded by investors from China, South Korea and Thailand in natural gas and infrastructure. Growth is projected to accelerate to an average of 6.5% a year in 2014-16 due to anticipated increases in foreign investment following the expected lifting of sanctions in 2013 as the local government progresses on human rights issues. As Northern firms begin to gain access to this market, the risks and opportunities presented by existing South-South trade and investment will come to fruition.

The way forward

Recommendations for Northern firms:

To manoeuvre successfully through new market trends and Southern competition, Northern multinationals must develop and implement creative growth strategies, and develop new and innovative forms of partnership, financing arrangements and product development.

1. **Engage in strategic B-to-B partnerships**

   Strategic B-to-B partnerships offer a win-win solution for Northern firms. Often, Northern firms can gain credibility in emerging markets by partnering with well-known, reputable Northern or Southern firms, especially firms that have development experience and are willing to take on risk. These partnerships can reduce costs while delivering high-quality products and services. In some cases, successful B-to-B relationships among Northern firms in highly risky markets can be syndicated in other risky markets if strong track records can be developed.

2. **Embrace transparency and be a model of business ethics**

   Northern firms tend to be stronger models of business ethics than Southern firms (although there are, of course, exceptions). When doing business in emerging markets, Northern firms should uphold the highest business ethics standards and should ensure anti-corruption measures are in place in order to avoid penalties down the line. Moreover, Northern firms should always conduct due diligence on potential partners and markets in order to make well-informed business decisions every step of the way and mitigate risk as much as possible.

3. **Bring local talent into the business and take leadership to the streets**

   Northern firms should be integrating locally and using local talent whenever possible. Bringing local talent into the business provides a lower-cost option to Northern firms and helps avoid cultural issues. At the same time, leadership needs to make it a priority to impart company standards and corporate culture from the outset and should be in tune to local cultural practices and shifts in the market.

4. **Pursue alternative sources of financing**

   Now that funding from Southern sources — such as China's Ex-Im bank, China's Development Bank and India's Ex-Im bank — is on the rise, Northern firms should take advantage of these financing options. They should also strengthen relationships with multilateral development banks and other organizations with Southern roots, such as the Asian Development Bank, the Inter-American Development Bank and the African Development Bank, among others.

5. **Consider partnering with the local government and commit to bringing about development impact through your investment**

   Northern companies doing business in emerging markets should always have an eye toward development impact. This helps build a positive reputation globally and helps gain public trust. Northern companies should consider partnering with the government and engaging in public-private-partnerships (PPPs). PPPs offer a mutually beneficial relationship: They help governments achieve development goals and provide services to the public in an efficient manner. In addition, they take away some of the risk for the companies involved, improve the ease of doing business on the ground and help companies develop a long-term presence in the market.

6. **Be an early mover in new growth markets**

   Northern firms should be ready to exploit first-mover advantages in new emerging markets that are being created through regime changes or conflicts. Examples of these new emerging markets can be seen through the breakup of Yugoslavia, the creation of Southern Sudan and, more recently, the shifts occurring in Myanmar. Northern firms should be actively watching shifts in the global marketplace in order to be early movers in new growth markets.

Recommendations for Southern firms:

1. **Engage in strategic B-to-B partnerships**

   As with their Northern counterparts, strategic B-to-B partnerships can offer win-win solutions for Southern firms. Southern firms are able to gain credibility in new markets by partnering with well-known, reputable Northern firms.

2. **Continue to offer new, innovative ideas based on shared experiences and common objectives**

   Southern firms are often able to offer creative, innovative approaches based on lessons learned from shared experiences that distinguish themselves from other competitors. These new approaches are critical in this time of a changing global economy.

3. **Pursue South-South cooperation, rather than just investment**

   South-South FDI goes beyond just investment — developing countries are able to provide support for one another and work together to achieve sustained economic growth and development. Southern investors should pursue the opportunity to partner together to address similar challenges through sharing knowledge, transferring technology, providing training and more. Overall, South-South cooperation provides avenues for regional integration and development through mutual learning and partnership.

4. **Work toward embracing transparency and adopting best business practices**

   Many Southern firms have a long way to go in terms of meeting global anti-corruption standards. To compete on the global playing field and improve credibility, Southern firms should be working toward embracing transparency in all business activities. Furthermore, Northern firms seeking partners will be sure to choose Southern firms committed to improved governance and anti-corruption programs. Southern firms should also work toward adopting best business practices, and invest in and implement information systems — as well as reporting, monitoring and evaluation systems — in order to compete with Northern firms on-the-ground.

5. **Be a model investor in the world's least developed countries (LDCs)**

   South-South trade and investment in LDCs have grown tremendously. In fact, over the last decade, the South has contributed to nearly half of the growth in total merchandise exports in LDCs. Southern firms should continue to invest in LDCs while transferring knowledge, building capacity, providing training and helping advance development.

6. **Strengthen capacity of weak regional organizations and regional economic communities (RECs) that promote regional unity**

   Operational outputs of organizations, such as the African Union, and RECs, such as the Economic Community of Central African States (ECCAS), should be increased. These organizations and RECs have the ability to unite regions, provide opportunities to share knowledge and resources, and offer the chance to successfully go after development goals in an efficient way.

7. **Maintain development initiatives at home**

   As Southern investors tackle problems in other developing countries, they should ensure they are simultaneously working toward tackling problems in their own countries. The provider country should be working with the recipient country to build capacity but ensure they are doing the same thing at home. Furthermore, as emerging economies face similar challenges, Southern investors should use South-South investment as a tool for mutual learning to apply lessons learned in their own country.

Partnership and innovation

Despite the risks involved, emerging markets continue to represent a major opportunity for multinational companies, both from the North and the South. Southern firms should continue to act through shared experiences and commitment to similar objectives and should leverage opportunities for regional integration. Northern firms should embrace new partnering and financing options and be early movers in new markets in order to stay competitive. Overall, partnerships between Northern and Southern firms offer mutually beneficial solutions and should be pursued by both sides.

Get it right or stay at home: Managing risk in challenging markets

By Jamie Hepburn

As developed market growth stalls, fast-growth emerging markets can offer potentially higher rewards. But businesses can also face heightened political risks, which may manifest themselves in a variety of operational and reputational risks. A close understanding of local politics is therefore crucial — not only in shaping strategy, but also in informing practical operational decisions.

Nearly 60% of the business leaders taking part in PwC's latest *Annual Global CEO Survey* said that emerging markets are now more important to their company's future than developed markets.[1]

The path to Brazil, China and India is well trodden. Now emerging from the shadow of the BRICs is a second tier of smaller but increasingly dynamic markets such as Turkey, Indonesia, Nigeria, Kenya and Vietnam. There is also a further rung of 'frontier markets' — those that have up until recently had little involvement from multinational businesses. Iraq, Afghanistan, Libya and Myanmar are just some of the countries that are moving onto the radar of senior executives.

Apart from their commercial potential, the other factor that connects these markets is a range of challenging risks to doing business there. Broadly speaking, the country risks incorporate elements of political, reputational, operational and physical risk, with the political risk underscoring the other three.

Investors in Southeast Asia might worry about how to manage relations with Vietnam's authoritarian government or how to contend with Indonesia's weak infrastructure. In Kenya, political upheaval and social unrest in the run-up to next year's elections could be a concern. In Nigeria, the upsurge in violence in the North associated with Islamist militants could increase the risk to staff deployed there.

Understanding the country risks before investing in a new market is clearly a vital part of any entry strategy. In this article, we outline a broad framework to help your board think about the relevant issues. The aim is to allow you to gain early-mover advantages, while at the same time helping to identify and manage hidden or unforeseen risks.

Libya: Potential for pitfalls in political transition

Post-Gadhafi Libya offers a range of investment opportunities in infrastructure (estimated at some $200bn over 10 years[2]), hydrocarbons, the financial services sector, and services such as health and education. If you are thinking of investing, the central challenge is how to get a grip on the political dynamics of the transition process and how to position your business for future opportunities.

Key dilemmas include how to develop productive relationships when the individuals in ministerial positions will change. What impact will Gadhafi's legacy have — for example, how will the country deal with those deemed to 'have blood on their hands': those who benefitted from Gadhafi's rule and those businesses that were associated with them?

What kind of profile should your business adopt? The answers lie in regular monitoring and assessment of the political situation, careful selection of Libyan associates and, not least, patience. Mapping the new political landscape and conducting due diligence on business counterparts (a challenge given the paucity of reliable sources) will be an important part of that process.

There are also logistical challenges. These include how to obtain visas, how to enter the country (overland from Egypt or Tunisia, or by intermittent air services), how to find secure accommodation with functioning business facilities and how to ensure the security of staff. Although the security situation remains fragile and prone to sudden deterioration, new entrants have been able to establish workable operating procedures in the country.

1 1,250 CEOs from 60 countries were polled at the end of 2011 as part of PwC's *15th Annual Global CEO Survey*, published on 25.01.12
2 Research and Markets – *Libya Infrastructure Report 2012* http://www.researchandmarkets.com/reports/2077125/libya_infrastructure_report_2012

Assessing emerging market risk

There are a number of frameworks for analysing a country before potential entry. They typically cover politics, the economy, society, technology, infrastructure, the environment, legal and regulatory issues, geography and security. In addition, awareness of a country's history and culture is crucial to understanding a new market, albeit an area that is often overlooked. Scenario planning can also be a good way to anticipate what future trends might emerge, as well as their impact and their probability.

Whatever risks are identified, they typically come down to two main types of risk:

- **Reputational risk:** This applies equally in developed economies, but can be especially acute in emerging markets. It stems largely from a failure to manage the typically higher and more varied operational risks present in these markets. It also reflects rising global standards for corporate behaviour and governance, particularly with respect to anti-bribery legislation. Involvement — unwitting or otherwise — with governments that are authoritarian, corrupt or involved in human rights abuses, for example, presents a significant risk to the values that many multinational businesses seek to uphold.
- **Operational risk:** This, too, is a broad term, but encompasses issues that might affect the day-to-day viability of working in the new market and its profitability. These might include political instability; weak policy, legal and regulatory frameworks; graft and petty corruption; poor educational standards; low-quality working practices; and militant trade unionism, to name just a few. Physical risk to staff and assets can also be significant, whether associated with political instability, conflict, terrorism or crime. Post-conflict environments such as Iraq and Libya all require varying degrees of physical security support.

Understanding the political context

For both types of risk, understanding the political context and how it affects the business (or could do so in the future) is vital. This is as true for developed markets as it is for emerging ones. But the relationship between politics and business in emerging markets is often closer — in many cases, political power is synonymous with the control of resources. Patronage and the concentration of power in the hands of a small number of individuals or families, many of whom may have close connections to the government, can create an environment in which nepotism and corruption can flourish.

Moreover, authoritarianism, weak governance, corruption, regional divides, sectarianism, separatism and fractious relations with neighbours can all add to the complexity of an unfamiliar working environment. Many of these issues may not be immediately apparent to an outsider but can create a range of risks to business — from the physical threat to staff to decisions on legislation and the threat of outright expropriation of private assets. Recent examples include the Argentine government's nationalisation of Spanish energy company Repsol's stake in YPF, and Zimbabwe's new mining regulation, which requires foreign mining companies to hand over a 51% stake in their shares to local designated entities.[3]

A thorough initial assessment and regular monitoring is needed. Seeking local views can help, but equally the perspectives of a local associate may not be entirely objective, so it is important to seek a range of input, both local and external, and for the business to make its own judgement on the balance of risk and reward. The nature of the business, and the way it is likely to be perceived in the local context, will need to be a fundamental part of the assessment and will help to determine strategy.

3 *Mining Review*, 10.03.11

Myanmar: 2015 elections will be the true test of reforms

Myanmar has long been 'out of bounds' because of its poor human rights record and broad sanctions against the ruling regime. Over the past year, however, the military-backed civilian administration has driven forward an ambitious reform agenda. Political prisoners have been freed; peace deals with many of the country's separatists groups have been signed; and the opposition National League for Democracy, led by democracy campaigner Aung San Suu Kyi, won by a landslide in by-elections held in April 2012.

Economic reform is also on the agenda. In April 2012, the government floated the currency, unifying the hugely overvalued official rate of the kyat with the black market rate. The U.S., EU and others are moving quickly to re-establish diplomatic relations and ease sanctions to encourage further progress. Interest among businesses has taken off.

But the transformation is far from complete. The military, which has run the country for decades, remains in overall control. Democratic space is limited — only 7% of seats were contested in the April by-elections. The drive for liberalisation may owe as much to self-interest among the ruling elite as an ideological shift, suggesting a real risk of crony capitalism emerging. The capacity of the pervasive state bureaucracy to facilitate change is also likely to be severely limited. The real test of the reforms may not come until 2015, when three-quarters of the seats in parliament will be contested.

As a result, if your company is looking to enter the market, you will need to establish a clear picture of the political landscape. Given the closed and guarded nature of the country's elite, establishing sources of political intelligence and a meaningful assessment will be difficult. Providing adequate safeguards against corruption will also be a significant challenge.

Failing to prepare is preparing to fail

So what are the practical considerations and how can they be addressed? Engagement in a new market demands political understanding and mechanisms to make sure this informs strategic and tactical decisions at all levels of the organisation.

At the strategic level, this framework appraisal, governance and decision making would help your business to judge how to approach a country whose politics are divided by sectarian, religious or ethnic differences. Strategic decisions — over company profile, for example — might also have tactical consequences for the behaviour and security of staff on the ground.

At the tactical level, considerations might include what part of town a company's office should be located in and who should be employed to guard it. Other issues would include whom to engage with locally and how to make sure they have no past political or criminal associations that might pose a reputational risk.

Whatever risks are identified, they are best viewed holistically, rather than in isolation. Your business will need to develop a clear risk appetite and weigh the opportunity against the cost of risk mitigation, which can be expensive.

A risk review board with participation from senior management — typically the project engagement leader and representatives of strategy, security, risk, human resources, legal counsel and strategic communications — will help to ensure the right level and scope of appraisal oversight. The exact make-up of this body will vary from one organisation to another, but ensuring it is an integral part of the business strategy is vital. Failure to establish a thorough assessment and ongoing risk-monitoring process is simply preparing the venture to fail.

Risk review board agenda

- *A formal and comprehensive country risk assessment*
- *What are the political context and drivers?*
- *Seek a range of views*
- *Challenge the country risk assessment*
- *Is there a process for ongoing risk monitoring?*
- *Has thorough due diligence been carried out on business partners?*
- *Is there a strategy to manage identified risks?*
- *What is the public profile of the business in the new market?*
- *If there is a physical risk to staff, how can it be mitigated?*

Getting it right the first time

Recent corporate history is littered with examples of companies that have failed to appreciate the intricacies of a new market, particularly local politics, and have come unstuck as a result. Careful preparation ahead of entry and ongoing monitoring of operations in new markets can help to manage the risks and, crucially, respond quickly and effectively if threats to the business do materialise.

Making the tough calls on growth

By Anand Rao

CEOs have always faced difficult investment choices and potentially conflicting strategic agendas within their organisations. The emergence of new targets for growth in a rapidly changing global economy has heightened the strategic dilemmas. How can CEOs bring together all the different indicators and perspectives to judge the right way forward?

It's a familiar scene that's being played out in multinational companies across the globe: Organisations are casting their net wider in the pursuit of growth. The problem is that the strategic objectives and measures of success being promoted by the various arms of the company could be pushing in different directions.

The following scenario is taken from a financial services group, though much of it would be familiar to other industries. The Chief Strategy Officer has made a recommendation to her senior leadership team on which countries they should expand into, why and with what products. She is faced with opinions from a number of stakeholders, not all of which are consistent. The country managers from China, India and Brazil are pressing for the significant investments needed to turn the company from a small to major player in these markets. The emerging markets leader is arguing for investments in faster-growing but smaller markets like Turkey, Indonesia and Thailand. The product managers are insisting that growth in these markets should continue to be profitable and do not want their products to be loss leaders to build market share. The Chief Financial Officer wants the return on equity targets in these markets to be met within a five-year investment window. The Chief Risk Officer has cautioned the company to be wary of mounting political and sovereign default risks in particular countries. How does the Chief Strategy Officer square all these different perspectives, and how can she convince the senior leadership team that her recommendations are right?

Views on where to invest, the timescales for return and what criteria to use to judge performance vary according to whom you are speaking in the organisation. The underlying challenge is how to keep pace with the transformational technological developments that are facing every industry and how to deal with a more uncertain risk, regulatory and geopolitical landscape. The resulting decisions affect every aspect of the organisation, from marketing, sales and distribution to finance, operations, technology and talent management. Yet the evaluations are often based on inadequate and sometimes inaccurate data, with little or no appreciation for the sensitivity of the assumptions used to project growth and any potential weaknesses in the underlying analysis. Indeed, many decisions are being driven by rudimentary models or straightforward gut feelings, despite the complexities of what is involved in today's investments and the fine line between success and failure. Any resulting success is likely to owe more to luck than judgement. Any failure will see heads roll.

In this article, we look at how to create a more informed basis for decision making by using the latest developments in predictive and simulation modelling techniques. We describe a top-down approach that uses predictive modelling to compute a country attractiveness score, which allows executives to quickly filter their focus down to a handful of countries

for further exploration. Once the high-potential countries are identified, you can dive deeper into each of the markets to build a detailed bottom-up simulation model. This allows executives to visualise market growth and their own market share under changing social, technological, environmental, economic and political conditions in these selected countries. The decision-making considerations under these approaches are examined in light of the Chief Strategy Officer's dilemma described earlier.

Identifying target countries

With more than 190 countries to consider, the decisions on where to focus investments are clearly far from straightforward. While around a third can be quickly ruled out because of the relative size, maturity and growth of their economies, the remainder are likely to demand more involved evaluation criteria.

PwC has been working with a number of companies to help them develop country attractiveness scores for their particular organisation, which are based on three dynamics:

- **Country dynamics** that take into account the economy, politics, demographics, business environment and infrastructure
- **Industry dynamics** that take account of the market potential for different products, customer segments, competition, regulation and distribution
- **Corporate dynamics** that take into account market presence and performance, fit with strategy, fit with assets, risk appetite and corporate culture

The latest models cover more than 150 aspects of the market being evaluated to make sure they take account of the relevant factors and ensure the analysis reflects the particular vision, culture and strategic fit of the organisation. The main advantages of this approach over more traditional strategic evaluation techniques are:

- **Use of quantitative and qualitative data:** The approach uses key quantitative metrics where available, but can also use qualitative data such as political situation, infrastructure availability, regulatory outlook, etc.
- **Judging developments and their interdependencies:** Judging the market potential and possible barriers and interdependencies to gauge how attractive the country will be in the future
- **Use of external and internal data:** The approach uses a number of external sources of data for country and industry analysis and at the same time draws on internal data to capture the corporate dynamics

For the Chief Strategy Officer in our scenario, use of this type of predictive model allows her to work with all of the regional heads and the country managers to develop a comprehensive attractiveness score for each country. She can then take into account specific political and regulatory risks and adjust the weights assigned to different factors based on the investment criteria that the CFO has laid out. The Chief Strategy Officer is thus able to present a comprehensive rationale to the senior management team on the approach she took and recommend they focus on a particular set of countries around the world.

Gauging the risks and rewards

Having filtered the selection down to a dozen or so countries, more complex dynamics can come into play. For example, while countries like China and India may seem attractive because of their size, growth and opportunities for further market penetration, their regulatory and political environment could make it difficult to deliver a target return within a given time horizon. Your organisation may be required to invest for the long term to realise the anticipated returns. On the other hand, countries like Turkey may be much smaller but more attractive in the short term. Also, countries typically go through a tipping point when all the different political, economic and social factors come together to create the 'golden moment' for investment. There is a danger of entering markets too early and laying out a lot of cash without delivering an adequate return at the beginning and then making the wrong call by exiting just as the market is about to reach its 'golden moment'.

Faced with these dilemmas, simulation models can help senior executives to evaluate the growth potential of markets, how much market share they can achieve and the strategic actions and competitive responses that will determine their ability to meet their objectives. The pace of global developments demands models that are robust enough to consider different scenarios. They should also be able to look beyond straight-line development to anticipate rapid movements and deviations such as the tipping points for market take-off or the interactions where government policies, company policies and consumer attitudes all influence each other. In turn, they should be able to take account of the potential for delay in how people, companies and governments react to different situations. For example, by opening up a market and investing in it, a government can spur growth, but there is often a lag before the impact is felt.

The most advanced techniques use artificial intelligence to simulate the interplay between the strategic choices made by governments and corporations on the one hand and the economic developments, consumer behaviour, government policies and other key factors that influence them on the other. The results would allow your business to judge how governments, consumers and individual companies are likely to respond to a variety of interdependent developments and how this would affect the investment environment and likely returns for the organisation over time. The results would also allow your business to shape strategies and target investment more effectively by judging when, why and how consumers make individual purchasing decisions and how the actions of your organisation in areas such as marketing or product design influence such choices.

The main advantages of this multiple-simulation technique over more traditional market evaluations are:

- **Individual insights:** By analysing hundreds of thousands of individual consumers, their purchasing decisions can be simulated over long periods of time (i.e., 10-20 years) while accounting for their economic and behavioural evolution.
- **Emergent behaviour:** The technique captures the interactions between consumers, companies, governments and changes in the environment and the complex behavioural patterns that result from these exchanges (‘emergent behaviour’).
- **Calibrated model:** The simulation model can be repeated and updated (typically weekly, monthly or quarterly) to generate purchase and re-purchase decisions for multiple years. The simulated output is then calibrated with actual historical data to estimate the values of specific consumer parameters using optimisation techniques. You can then explore future consumer behaviour across different economic and social conditions.
- **Evaluating different scenarios:** The calibrated model is used to simulate consumer decisions through their lifetime. The simulation approach would also allow your business to run different scenarios by changing a set of input parameters at any point during the simulation run. Simulating different scenarios provides insights into the impact of a particular strategy or economic condition on the purchase behaviour of consumers.

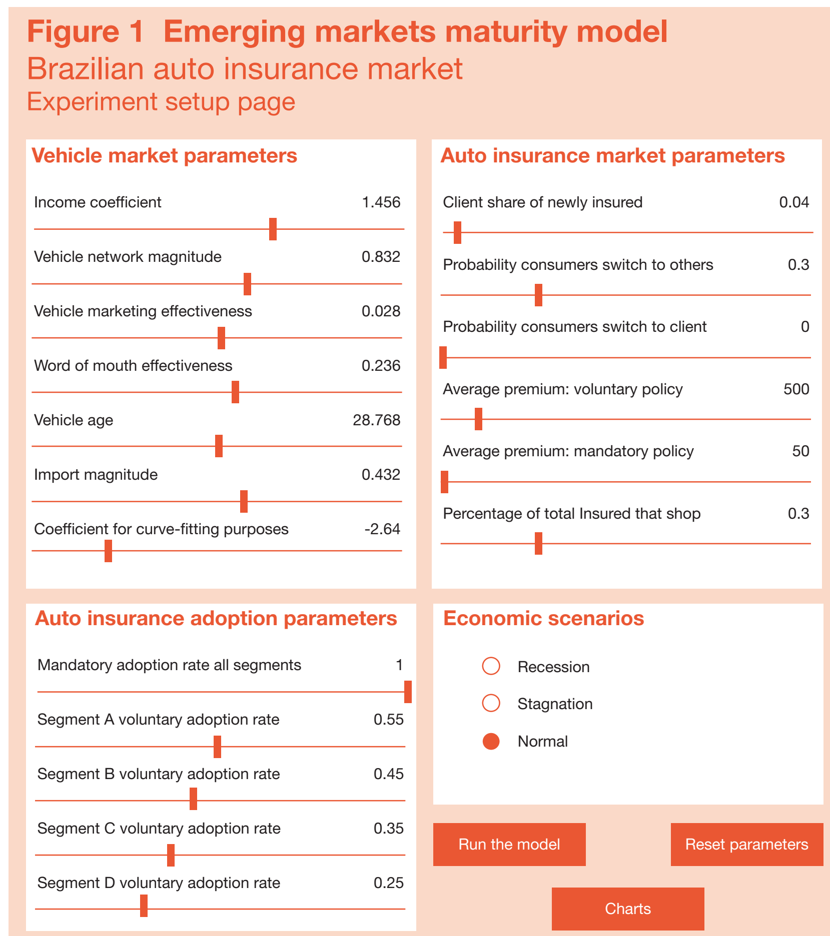
In our scenario, the Chief Strategy Officer is able to use this simulated analysis to work with the country manager from Brazil to evaluate the potential returns from a major investment in a target sector, such as auto insurance, over various investment horizons. The Brazilian auto insurance simulation (see Figure 1) takes into account the historical and future growth of Brazil’s GDP, increasing affluence, projections for vehicle numbers in the country, the road infrastructure and the strategies of existing players in the market. The model thus captures the dynamics of a growing economy and emerging middle class, which is leading to an increase in car sales and reducing prices for vehicles and associated insurance. At the same time, more cars put greater strains on the road network, which may dampen demand for cars and insurance. The model is also able to capture the stimulus to the market and economy overall of trade liberalisation in the early ’90s. Using the Brazilian auto insurance model, the Chief Strategy Officer is able to evaluate the return on

investment over 5-year, 10-year and 20-year periods under different economic conditions, as well as the strategic options for her firm and its competitors. This allows her to demonstrate to the senior leadership team the impact of their strategy in Brazil and also compare it with growth prospects in other countries.

Sharpening decision making

The latest developments in country assessment and strategy evaluation provide senior executives with a way to capture, analyse and reconcile multiple perspectives on what markets to focus on, how to grow, when to enter or exit and, finally, what the expected returns would be under different scenarios. As a result, they can make informed, assured and balanced decisions on their growth strategies, despite the uncertain and rapidly changing environments.

Marie Carr, David Gates, Nirav Bhagat, Marik Brockman, Mark Paich and Jamie Yoder also contributed to this article.



Description of model components

Vehicle adoption

Modeled as a function of:

- Household income quintiles
- Vehicle prices
- Regulatory policy
- Transportation network magnitude*
- Advertising/Marketing effectiveness*
- Maximum vehicle saturation*

Motor insurance adoption

Modeled as a function of:

- Motor insurance adoption rates
- Vehicle age
- Average premium per product

Client share

Modeled as a function of:

- Share of new business captured
- Probability of competitors' policyholders switching to client on renewal by segment by product
- Expiration / Lapse / Reinstatement rates by segment

* Factors not considered in this model

Tapping into female empowerment By Rania Adwan

In the Arab world, a confident and connected generation of women has moved to the forefront of social, economic and political change. Increasing female empowerment lies in the nexus of literacy and innovation, but are business strategies reflecting the opportunities that arise when women learn?

When Mohamed Bouazizi set himself on fire in Tunisia, he ignited a powder keg of resentment against unpopular governments in North Africa and the Middle East. Demonstrations sprang up in cities across the region, enabled and fuelled in large part by the use of social media to communicate information, circumvent censorship and co-ordinate action. Inspired by Bouazizi's brave stand, 27-year-old Asmaa Mahfouz created a video blog asking her fellow Egyptians to protest against the injustices and corruption of the Mubarak regime. Mahfouz's video went viral and helped amass more than 50,000 people in Tahrir Square on January 25, 2011, the start of Egypt's revolution.

Region-wide, the uprisings have toppled three governments and still smoulder in a number of countries, including Syria and Bahrain. Motivations are thought to have been inextricably rooted in high unemployment rates, rising food prices and a general exacerbation with corrupt and brutal authoritarian regimes. The most salient features of the protests were the ferocity and unpredictability with which they spread and the striking role that women played, both online and in the streets.

A common stereotype of Arab women is that they are cloaked, repressed and at the mercy of dominant patriarchs. But, for the most part, that's far from the truth. The stereotype fails to reflect the different circumstances in which an Arab woman finds herself in North Africa, versus the Levant, versus the Gulf. Women in North Africa and the Levant have traditionally enjoyed a more inclusive place in society, with greater rights and access to education. Growing equality and educational opportunities have led to women occupying seats in the Kuwaiti parliament. Even in Yemen, where progress toward emancipation has been limited, a significant number of business professionals are female.

With education serving as the impetus for female empowerment throughout the Middle East, the Internet and social media offered women an opportunity to participate in and even lead social change. The United Nations Population Fund cites education as 'one of the most important means of empowering women with the knowledge, skills and self-confidence necessary to participate fully in the development process'.[1] Education is a stepping stone to economic development and helps women 'to know their rights and to gain confidence to claim them'.

Female empowerment, economically and politically, is expected to transform the global landscape over the next 20 years, at least as much as technological innovation.[2] Mobile devices and social networks are formidable tools, but just as important are the people using them. As Egypt's revolution highlights, a combination of greater education among women and the opportunities to share ideas and information through digital communication are unleashing forces that businesses cannot afford to ignore. As we examine in this article, supporting education for women could help your business to take advantage of these opportunities.

1 United Nations Population Fund (UNFPA) - Promoting Gender Equality (http://www.unfpa.org/gender/empowerment2.htm)
2 NIC Report - *Global Trends 2025* [November 2008]

Benefits of education

Research by the World Bank highlights the benefits of female literacy, including better health and lower child mortality rates, as well as better health and nutrition habits passed on to her immediate family.[3] Literate women are more likely to be politically active and look to exercise their rights as engaged members of society.

From an economic perspective, literate women are also more likely to join the workforce and spend earnings on their children — more so than their male counterparts.[4] For businesses exploring new markets, rising female literacy levels are a useful indicator of investment potential. In helping to boost women's participation in the workforce, productivity increases. Over time, increasing educational opportunities raises incomes and creates a new set of customers waiting to be served. Former World Bank chief economist Larry Summers once reported that women's income can rise by as much as 10%, sometimes 20%, for each year of education gained.[5] And as the Arab Spring shows, female literacy can have a decisive influence on a country's political future, as well as its economic environment.

Writing in *World Economics*, David Bloom argues that the hurdles of globalisation, including the merging of national markets and increased competitive pressures, can be overcome by increasing investment in education. 'Education has been a vital component of the successful globalisers' progress. Those countries that have moved from low to higher incomes — think of Singapore, Hong Kong, Taiwan, South Korea and Ireland — appear to have advanced at least partly on the basis of a strong commitment to education at all levels...China, too, had created a highly literate population through effective primary and secondary education before it began to develop'.[6] When governments invest in education and ensure access for girls and women, they are more likely to play an active role in society. This eventually seeps into the labour market, lowering unemployment rates and increasing productivity.[7]

Literacy rates among Arab women have lagged behind other parts of the world, but that is changing. Tunisia, whose revolution was largely peaceful and quick, boasts a comparatively high female literacy of 70%.[8] This matches women's strong presence in the workforce, where they account for as much as a fifth of the country's earners and almost half of union members.[9] In Egypt, the percentage of literate female adults is about 60%.

Yemen has by far the lowest female literacy rate in the region, with barely a quarter of Yemeni women able to read and write. It is therefore little surprise that only 5% of Yemen's female population are in paid work. Yet Yemeni women in urban centres also account for a quarter of college students and play a vital role in businesses. Tawakul Karmen, a Yemeni journalist and human rights activist, quickly became the voice and public face of the anti-government uprising in that country. It earned her the distinction of a Nobel Peace Prize and has raised aspirations for other women in her country.

The coming together of education and digital communication can create a virtuous circle, with growing literacy rates allowing women to make use of the Internet and, by extension, the Internet and mobile phone access provide channels to support education in remote areas. Notable examples include a pilot programme launched by UNESCO in Pakistan. Over five months, 250 women (aged 15 to 25) were given a cellphone and asked to 'practice reading and writing the messages in their work book and reply to their teachers by text'. They developed basic literacy skills using cellphone-based games and quizzes. By the end of the initiative, grade-A attainment had doubled and fewer students achieved grade Cs.[10]

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3 'Education of women and socio-economic development', Geeta Gandhi Kingdon (published in *Reasons and Revelation: studies in the Babi and Baha'i Religions*, volume 13), 2002.

4 Amartya Sen, *'Missing Women,'* (published in *British Medical Journal*, 304) 1992

5 Lawrence Summers, *The Most Influential Investment*, 1993

6 David Bloom, 'Education in a Globalized World,' published in *World Economics* (Vol. 7, No. 4) Oct - Dec 2006

7 Geeta Gandhi Kingdon, *'Education of women and socio-economic development,'* 2002

8 CIA World Factbook, World Bank, World Development Indicators: United Nations Educational, Scientific, and Cultural Organization (UNESCO) Institute for Statistics.

9 Cole, Juan & Cole, Shahin: 'An Arab Spring for Women: The Missing Story from the Middle East,' *Le Monde diplomatique*, April 2011

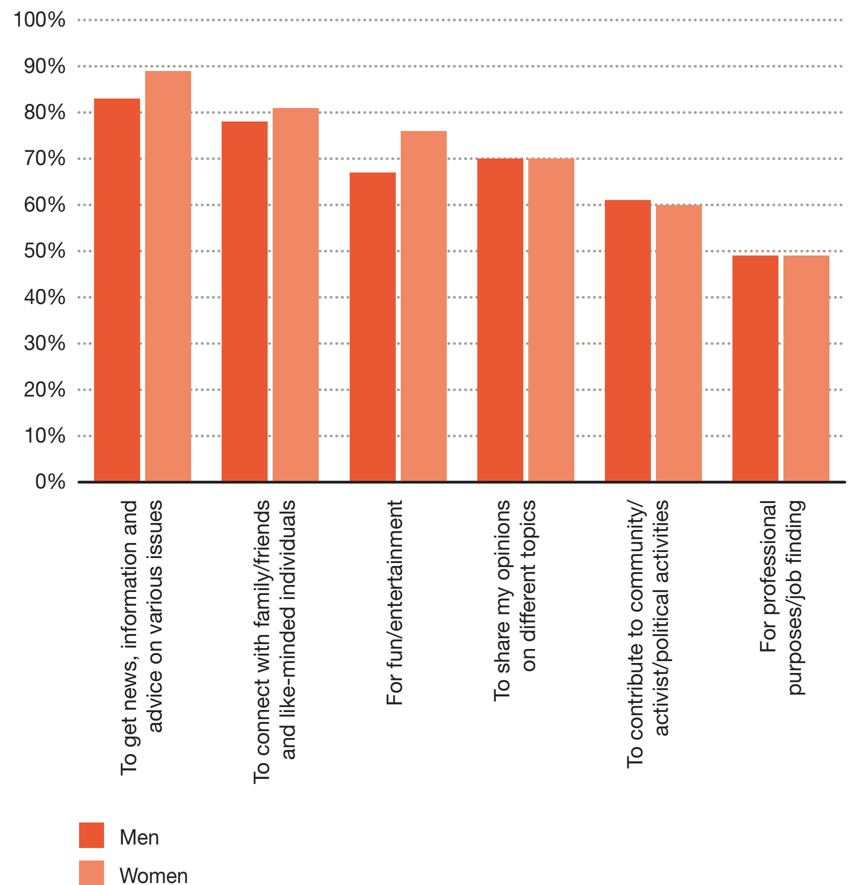
10 'Expansion of women's literacy by mobile phone' programme' (http://www.unesco.org/en/literacy/dynamic-content-single-view/news/expansion_of_womens_literacy_by_mobile_phone_programme/back/11922/cHash/29d9528978/)

Women leading change

Women have long been at the vanguard of protest in the Arab world, playing a prominent role in the independence movements in Egypt, Tunisia and Algeria in the last century. But the number of people who turned out in protest last year dwarfed all previous efforts. While there are a multitude of reasons for the unrest, one important factor is that women are more conscious of their political and legal environment. Armed with Internet access and mobile networks, they were able to not only communicate, but also collaborate and act against civil injustices and human rights abuses. According to *Le Monde diplomatique*, the particular advantage of social media is that it allows women to 'assert leadership roles in cyberspace that young men's dominance in the public sphere might have hampered in city squares'.[11]

The Dubai School of Government's latest *Arab Social Media Report* heralds women as the 'main drivers for regional change', with their social media use far more focused on networking, accessing information, looking for work and, of course, activism. Figure 1, which is taken from the report, compares Internet use by gender, with women equalling — if not surpassing — their male counterparts when it comes to accessing the web for news and information, networking and sharing their views and opinions. The report concludes that social media has the 'potential to be an empowering and engaging tool for women, whether in social, economic, legal, political or civic arenas ... that can trigger changes and offer new approaches for addressing inequalities'.[12]

Figure 1 "What do you use media for?"
(Regional gender breakdown)



Source: Arab Social Media Report Issue 3, produced by the Governance and Innovation Program at the Dubai School of Government

11 Cole, Juan & Cole, Shahin: 'An Arab Spring for Women: The Missing Story from the Middle East,' *Le Monde diplomatique*, April 2011
12 *Arab Social Media Report Issue 3*, produced by the Governance and Innovation Program at the Dubai School of Government

Realising the commercial potential

At a time when opportunities for growth are often limited, tapping into this increasingly empowered and connected customer base offers significant potential for early mover advantage and business growth.

By investing in education, businesses can foster relationships with this new customer base and their communities and help to socialise their brand. These relationships are genuinely priceless. A corporate strategy that combines philanthropic endeavours, such as educating girls and women, and draws on the power of the Internet can capitalise on the convergence of three powerful forces: literacy, social media and socio-economic development.

Lloyd Blankfein, CEO of Goldman Sachs, succinctly assessed the connection between female literacy and business strategy in his opening remarks at the launch of Goldman's 10,000 Women Initiative: "We not only chase GDP around the world; we try to create it".[13]

This concept of a mutually beneficial relationship is the foundation of Coca-Cola's ambitious '5 by 20' programme, an initiative that aims to create 5 million female entrepreneurs by 2020, while also building up the company's Micro Distribution Centres (MDCs) around the world. Women are given funding to begin distributing Coca-Cola products and bolster their business skills, as well as to gain access to mentors and business networks. The women benefit from meaningful opportunities, and Coca-Cola benefits from an important boost for business advocacy and market development, as well as the chance to see through its plans to double business by 2020.

If female literacy in North Africa and other emerging markets continues to bring more women into the workforce and encourages them to connect to the Internet, then the commercial potential is especially promising. Creating content for women is crucial to realising this potential, with the Dubai School study finding that a 'lack of relevant content for women' has been one of the major barriers to Arab women's social media usage. With the growing participation of women as consumers, smart businesses will look to meet this burgeoning demand.

A new force to be reckoned with

Social media gives literate women a strong say in social, political and economic development. They are increasingly finding their way online, as citizens and as consumers. A sound business strategy recognises this influential audience, engaging them through social media and other online channels. Consider the massive protests in the Middle East mobilized through social media. If powerful women can dislodge governments, they can also become powerful advocates for a brand and help shape consumer choices and commercial development within their communities.

Education will continue to be a powerful force in developing countries and regions. Supporting and encouraging female literacy can maximise first-mover advantage by developing a bond between a business and the community it serves, and associating its brand with the benefits of education. Iconic brands like Coca-Cola and Goldman Sachs recognise the potential of empowerment and are combining altruism and hard commercial logic to develop new markets. With some luck, more companies will join them and female literacy will be the norm, not the outlier.

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13 CNNMoney "Goldman sees gold in helping women," March 12, 2008 (http://money.cnn.com/2008/03/11/news/companies/goldman_women_philanthropy.fortune/index.htm)

Sustaining the supply chain

By Donald Reed and Cope Willis

As supply chains become more complex and extended, managing the sustainability risks of disruption and interruption have become ever more critical and difficult. How can your business overcome the vulnerabilities in its supply chain and turn strategic sourcing safeguards into competitive advantage?

Both the mounting costs and heightened vulnerability have brought supply chain disruption to the top of the risk register in recent years. In 2008, a PwC study of 600 companies that had experienced supply chain disruptions showed that, relative to peers, their average share price declined by nearly 20%, share price volatility was higher, and return on sales and return on assets were lower.[1]

As companies become more global in scale and dependent on emerging markets, these risks can only escalate. Social and environmental issues are creating further vulnerability. One recent example of a supply chain disruption attributed to climate change was the unusually prolonged drought in Russia over the summer of 2010. By early August, over one-fifth of Russia's wheat crop had been destroyed and the government banned all grain exports, contributing to wheat price futures reaching their highest point in nearly two years. General Mills was one of many food manufacturers that faced significant price pressure as a result, announcing increases between 4% and 5% in September 2010.[2]

As businesses come under increasing customer, investor, media and other stakeholder pressure, leading companies are developing more proactive strategies to manage sustainability risks and strengthen resilience in their supply chains. This article examines today's leading practices and opportunities for further innovation and development.

Assessing the risks

Sustainability risks take a variety of forms. The primary focus of this article is:

- Climate change and related extreme weather events, such as floods, droughts and forest fires
- Environmental damage, such as critical habitat destruction, threats to iconic species, chemical spills and other pollution
- Social, safety and labour practice issues, including unsafe working conditions, human trafficking, use of child labour and damage to health

The potential impact includes breakdowns in the supply of key parts or commodities, which can disrupt production and core business operations. It also includes swings in the price of raw materials, which can erode margins and revenues. In turn, incidents within the supply chain can tarnish the brand, spurring customers to switch their business and leading to resulting falls in revenues and share values. If such supply chain disruption and reputational damage are not addressed quickly, the short-term financial losses may become more serious strategic issues as competitors move in to seize lost market share.

Figure 1 highlights some examples of social and environmental supply chain disruption that have affected companies since 2010. In the autumn of 2011, for example, unusually intense monsoon conditions in Thailand flooded more than 1,000 factories in the central region of the country, severely disrupting the global supply of hard drives due to the concentration of assembly plants in the affected region.[3] The knock-on impact led to fourth-quarter revenue downgrades by a number of leading global computer manufacturers. This included Acer, the world's fourth-largest PC maker, who cut its fourth-quarter sales projection by 5% to 10%.[4]

1 *From vulnerable to valuable: how integrity can transform a supply chain*, published by PwC in 2008
2 Reuters 22.09.10
3 *New York Times*, 07.11.11
4 *Financial Times*, 28.10.11

Figure 1 Examples of sustainability-related incidents and their impact, 2010-2012

Source: PwC analysis

Pressure from consumer groups has also forced companies to tackle social and environmental issues in their supply chains. For example, cocoa sourcing in West Africa has been contentious for its association with child labor. Some companies have responded to this by working with industry groups and NGOs to source certified cocoa.

In a further example, Apple has faced growing scrutiny over working conditions among its suppliers after two workers were killed and over a dozen injured by an explosion at an iPad manufacturing facility in May 2011.[5] In response in February 2012, Apple hired the Fair Labor Association to conduct audits of its final assembly suppliers.[6]

Some of the incidents outlined in Figure 1 are too recent to fully gauge the commercial impacts. But a 2010 study documented case studies of sustainability-related supply chain incidents affecting six companies between 1999 and 2008. These resulted in direct costs per incident of between $11 million and $250 million, and/or indirect costs associated with declines in stock value of 5% to 18%.[7]

Meeting stakeholder expectations

To safeguard supply chains, stakeholders have pushed for a variety of voluntary and regulatory sustainability standards. These primarily focus on raw material production and sourcing, manufacturing practices and public disclosure of supply chain impacts.

The result has been a proliferation of industry-specific and cross-industry supply chain initiatives that promote voluntary social and environmental standards. Initiatives such as the Electronic Industry Citizenship Coalition (EICC) and the Supplier Ethical Data Exchange (SEDEX) have gained wide participation among companies seeking to demonstrate their commitment to responsible supply chains. In agricultural commodities, consumer groups have brought together relevant stakeholders in the industrial products, food manufacturers, agribusiness and consumer goods industries to develop voluntary sustainability standards for commodity production, including beef, cotton, soy, cocoa, palm oil, coffee, tea and paper.

5 Reuters, 22.05.11
6 Apple Inc media release, 13.02.12
7 *Value of Sustainable Procurement Practices,* PwC, EcoVadis and INSEAD, 2010.

Play not to lose

Companies are implementing a variety of strategies to manage emerging supply chain risks and stakeholder expectations, utilising operational and strategic levers. These strategies often begin with basic risk management measures such as implementing supplier codes of conduct that establish minimum standards of environmental and social performance. These 'play not to lose' approaches seek to protect and maintain existing operational and reputational integrity.

As companies seek more active management of sustainable practices in their supply chains, they often begin to integrate social and environmental criteria into their procurement decision making, selecting suppliers that can demonstrate better performance or products that have been certified as sustainably produced. Some companies have engaged their suppliers to collaboratively tackle particularly challenging sustainability issues.

Play to win

As companies move further along this spectrum (see Figure 2), their supply chain efforts become increasingly 'play to win' strategies, which seek to mark them out from their competitors, enhance the brand and build new platforms for growth. Leading practices combine 'play not to lose' and 'play to win' strategies to manage operational and reputational integrity in an integrated way. This is underpinned by clear goals on tangible (cost reduction, revenue from new sustainable products or services) and intangible (enhanced brand) benefits.

Sustainable growth

Optimising supply chain sustainability and managing the associated risks are still emerging elements of corporate strategy. One lesson is clear — a range of approaches is likely to be necessary to effectively reduce your supply chain risk exposures. However challenging, improving supply chain performance may be the single greatest contribution you can make to reducing sustainability risks, which opens the way to secure growth while improving social and environmental conditions across the globe.

Figure 2 Assessing the techniques for managing supply chain risk

Play not to lose

Supplier codes of conduct

Supplier codes of conduct are now common across a number of industries, setting out minimum performance standards for suppliers on issues like business ethics, environmental compliance, human rights, labour policies, workplace conditions and worker safety.

Supplier codes of conduct are typically built into business contracts, and companies regularly verify supplier codes with announced and unannounced audits of supplier facilities.

We see the code of conduct approach working best when suppliers have a higher degree of sophistication and competence on environmental and social issues, and where suppliers have limited ability to 'opt out' and take their business to other less-demanding customers.

In other types of supply chains, particularly in the agricultural sector, codes of conduct have been less successful. As the key environmental and social issues often occur far upstream in the supply chain, there tends to be a high variability in supplier sophistication and capability, and suppliers have more room to opt out.

Sustainability criteria in procurement

While the supplier code of conduct may be viewed as the 'stick', you can also integrate sustainability criteria into your procurement decision making, providing a 'carrot' to reward suppliers for forward thinking on sustainability.

Traditional procurement decisions have concentrated on cost, quality and performance criteria. Increasingly, companies are seeking to incorporate sustainability into their purchasing decisions. While these criteria tend to be secondary to cost, quality and performance, they can often serve as 'tie-breakers' when two prospective suppliers are coming up equal in other areas. Some companies, like P&G and Walmart, ask their suppliers to complete detailed scorecards to rate their own performance across a variety of environmental categories (e.g., waste, water, energy and packaging).[8] The aim is to reward the high-performing suppliers with greater volumes of business over time. The net effect of this trend is that it puts sustainability on the radar for companies that may have otherwise ignored it, while driving eco-efficiency and product innovation among leading companies.

Play to win

Source certified or alternative raw materials

Many companies are choosing to source third-party certified raw materials to alleviate the reputational risks associated with environmental and social issues. For example, many food manufacturers and retailers have committed to sourcing 100% Roundtable for Responsible Palm Oil (RSPO) by 2015 to avoid the brand risks associated with deforestation and habitat destruction, which have been a pervasive problem in Indonesia, a primary source of palm oil.

In some cases, companies look for opportunities to reformulate products and use alternative raw materials to avoid the sustainability risks altogether. Examples of this strategy include PepsiCo[9] and Unilever[10], who are both exploring alternatives to palm oil — PepsiCo is exploring a sunflower substitute, while Unilever is testing an algal-based oil.

Dedicated or integrated supply chain

For some companies, the supply chain risks are so great that they look for opportunities to take control of components of the supply chain through acquisition or a long-term, dedicated supplier agreement. This allows for a much higher degree of control over all aspects of sourcing, including sustainability. One example of a sustainability leader taking this approach is Unilever[11], who recently announced plans to build a palm oil processing plant as part of its strategy to accelerate its sourcing of certified palm oil. The downsides of dedicated or integrated supply chains are the inherent operational risks and the capital requirements to acquire or set up the operations.

Supplier and stakeholder collaboration

Where the environmental or social risks are pervasive rather than isolated, you may need to take a collaborative approach with the supplier community and relevant stakeholders, including consumer groups, competitors, government agencies and universities, to collaboratively develop supply chain solutions.

Most of the certified commodity standards are examples of this type of multi-stakeholder approach. Walmart's greenhouse gas innovation project is another example of supplier collaboration, where Walmart has challenged its suppliers to propose ideas to reduce the carbon emissions of its products to help Walmart achieve its goal of eliminating 20 million tons of emissions from its global supply chain by 2015[12]. These carbon-reduction initiatives should benefit Walmart and its suppliers by reducing energy and other resource costs associated with the production of the goods.

8 *P&G 2010 Sustainability Report; Walmart 2011 Global Responsibility Report*
9 *The New York Times*, 21.02.11
10 *The Wall Street Journal*, 07.09.10
11 *The Wall Street Journal*, 24.04.12
12 *Walmart 2011 Global Responsibility Report*

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