How are leading companies managing today's political risks?

2021 Survey and Report

A report produced for Willis Towers Watson

Oxford Analytica

Willis Towers Watson

About this report

Oxford Analytica is providing this survey report for Willis Towers Watson.

Oxford Analytica is an independent geopolitical analysis and advisory firm that draws on a worldwide network of experts to advise its clients on their strategies, operations, policies and investments. Oxford Analytica's trusted insights and seasoned judgements on global issues enable its clients to navigate complex markets where the nexus of politics and economics, business and society is critical to success.

Founded in 1975, Oxford Analytica is the pioneer of geopolitical risk analysis, and today works with the world's most influential businesses, governments and international organisations.

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01 About the research

It has become an annual tradition: in January and February, the world's leading geopolitical analysts publish their lists of the top global risks for the year ahead. Each year, Eurasia Group publishes its top ten; Control Risks produces a top five. The World Economic Forum undertakes perhaps the most comprehensive effort, ranking a long set of emerging risks based on a survey of more than 1,000 global leaders.

Last year, the novel coronavirus played havoc with these lists. Only a few weeks after the risk lists were published, countries worldwide imposed unprecedented lockdowns and restrictions on exports of food and medical products. None of the risk lists, including ours, anticipated this development, of course. Some risk lists were updated midyear to take account of the pandemic's impact.

That said, the top ten risks in last year's survey proved to be a prescient guide to the political risk threats that the pandemic brought to the fore. Risks from US trade policy, new ESG expectations for companies, and US-China strategic competition were identified as top ten perils, even before the pandemic intensified each of these issues. Perhaps most strikingly, our risk list last year identified emerging markets fiscal crises as a top risk. While pandemic-related economic downturns were not foreseen, the hidden dangers posed by an already-significant emerging market debt burden were. In 2020, despite global bailout programs by the IMF and G20, there were more emerging-market debt defaults or restructurings than in 2008, the year of the global financial crisis.

Of course, the credit for this foresight goes not to us, but to the external affairs and risk management professionals who joined last year's panel. Clearly, these individuals knew their business.

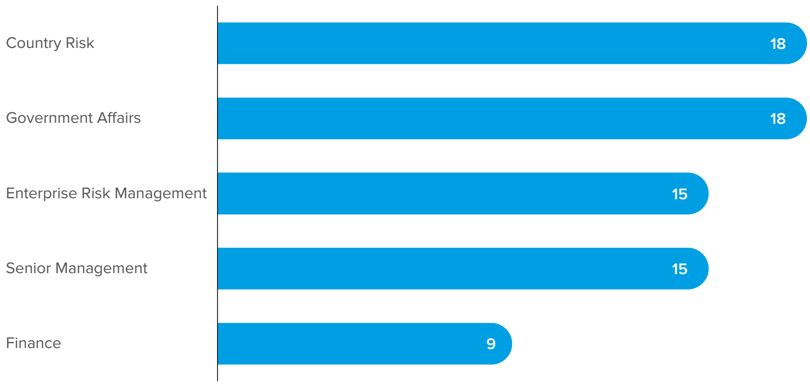
As with last year's study, this year's research combined in-depth panel interviews with a broader survey of more than 30 major corporations. We expanded the size of the panel slightly, from ten members to fourteen, and conducted longer interviews. Because the executives who joined the panel and survey were primarily clients of Willis Towers Watson and Oxford Analytica, they should not necessarily be seen as representative of typical firms worldwide. Rather, our study participants tended to represent companies that have extensive international operations and invest heavily in the management of political risk.

Perhaps partly as a result, our sample was biased towards larger firms. More than 70% of respondents worked for companies with revenues of $1 billion or more. In terms of job functions, the largest set of respondents worked in country risk management or external affairs (at 18% each); risk management and finance functions were also well represented. The sample was widely distributed across industries, with about a quarter from the natural resource sectors, a quarter from manufacturing, and the remainder from the technology or service sectors.

We thank the survey participants and panellists for their time and insights. We hope you enjoy this 4th annual edition of our political risk survey and find the contributions of these expert analysts to be as valuable and thought-provoking as we have.

Job function of respondents (%)

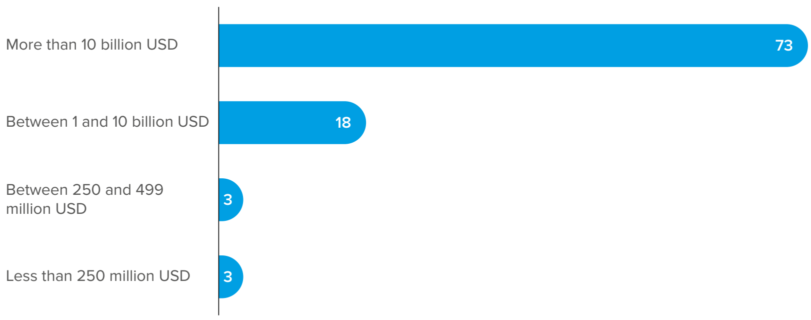
Note: all respondents, n = 33; 'other' not shown



Source: Oxford Analytica

Annual revenues of company (%)

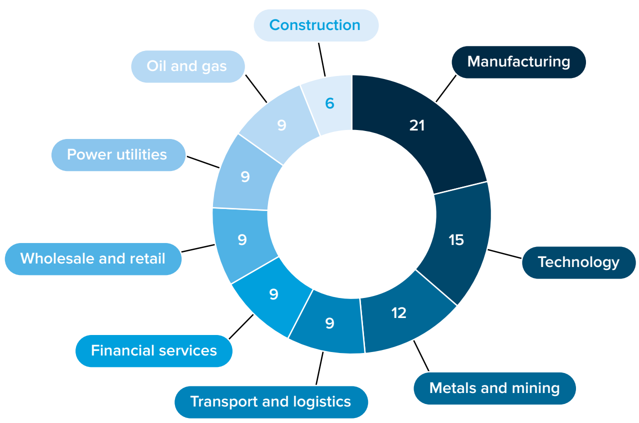
Note: all respondents, n = 33



Source: Oxford Analytica

Industry of company (%)

Note: all respondents, n = 33



Source: Oxford Analytica

02 The political risk impacts of the pandemic

The geopolitical impacts of COVID-19 have already been far-reaching. Within a few weeks after the pandemic was officially declared, more than 70 countries had imposed restrictions on the export of pharmaceuticals or medical supplies and at least 10 countries had imposed restrictions on the export of food or agricultural products believed to be scarce. There was violence as protesters opposed lockdowns and police sought to enforce them.

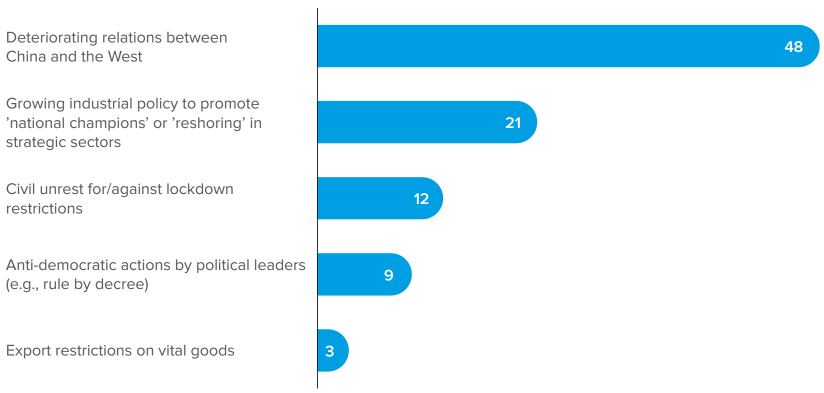
As the months stretched on, other geopolitical consequences became apparent. Political and economic relations between China and the West deteriorated significantly. Some governments that postponed elections or awarded themselves emergency powers to deal with the pandemic were accused of doing so opportunistically. In a similar vein, there was growing alarm that measures adopted to limit the spread of the virus – such as new biometric monitoring technologies or restrictions on "dangerous" speech – could potentially be used by authoritarian-leaning regimes as instruments of political repression.

The impact of the pandemic can be seen in the responses to nearly every question on this year's survey, from the top global regions of political risk concern, to the types of risk of concern, to the notable uptick in pressure from investors regarding management of political risk.

In what must have been a challenge, we asked our survey respondents to identify the single most significant political risk impact of the pandemic, from among a set of options. Perhaps surprisingly, there were only a few votes for the issues that dominated concern in the first half of 2020, such as export restrictions and protests against lockdowns. It appears that survey respondents were looking ahead to longer-term threats: the growing trend towards economic nationalism, including the promotion of reshoring and national champions, was the second-most popular response at 21%; the top response was a deterioration in relations between China and the West, at 48%.

Most important political risk impact of COVID-19 (%)

Note: all respondents, n = 33



Source: Oxford Analytica

It will come as no surprise, then, that when we asked about regions of concern, Asia-Pacific topped the list. Over the course of 2020, there was a dramatic worsening of relations between China and many of its main trading partners. The US and China escalated their struggle for dominance in the technology sphere; the UK and China fell out over Hong Kong; Europe contemplated sanctions against China relating to perceived human rights issues; China and India engaged in a short high-altitude conflict in the Himalayas; China appeared to retaliate against Australian firms following a diplomatic dispute regarding the handling of the pandemic.

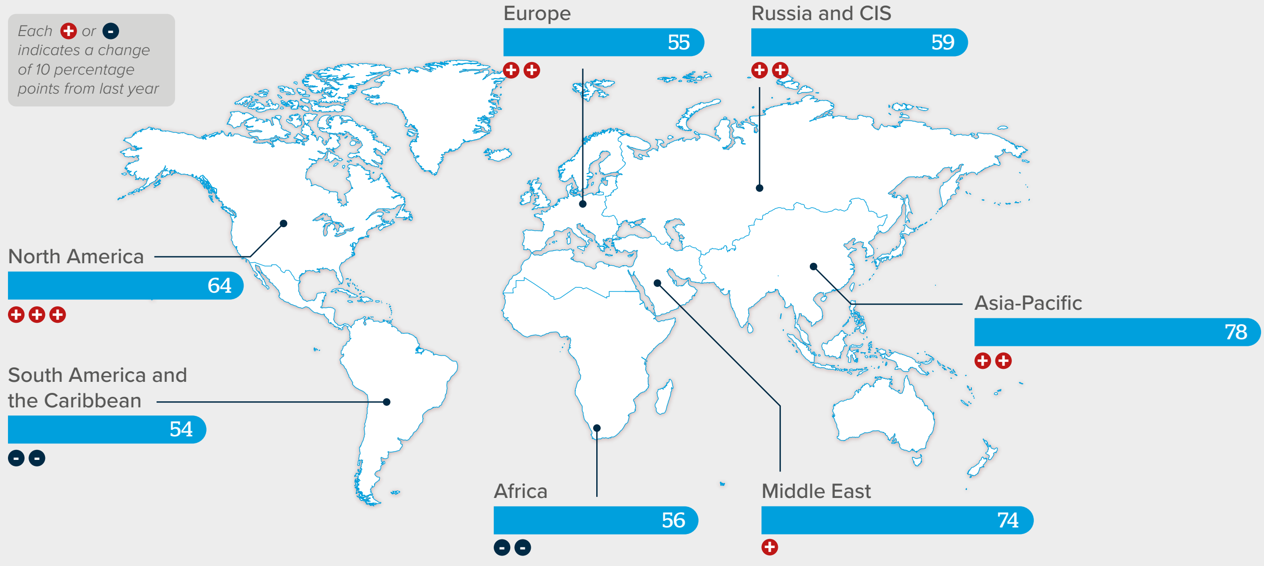
By comparing this year's responses with those from last year regarding the regions of political risk concern, we can provide another view on the pandemic's impacts. Last year, the Middle East was the top region of concern. This year, the Middle East remained near the top, and there was remarkably little change in the proportion of respondents expressing concern about risks in the region. We might conclude that the political risk challenges facing companies operating in the Middle East have been driven mostly by pre-pandemic trends.

By contrast, there was a dramatic increase in concern regarding political risk in the United States. It is possible that the summer's social unrest in many US cities, as well as the worldwide focus on the dramatic US election contest, influenced this result. That said, one can think of many reasons why respondents would have identified the US as a source of political risk. Perhaps some respondents placed part of the blame for the deteriorating relations between China and the West on the US, rather than China; perhaps other respondents had suffered political risk losses due to US sanctions policies. We will return to these issues in more detail in the next section.

One last observation regarding the top regions of concern: last year, for roughly half the regions we asked about, a majority of respondents said they were not concerned about political risk. That was true for North America, Europe, and,

Regions of political risk concern (%)

Note: asked of respondents operating in each region; for Asia-Pacific, n=30; for Middle East, n=27;for North America, n=29; for Russia and CIS, n=19; for Africa, n=31; for Europe, n=25; for South America and Caribbean, n=30



Source: Oxford Analytica

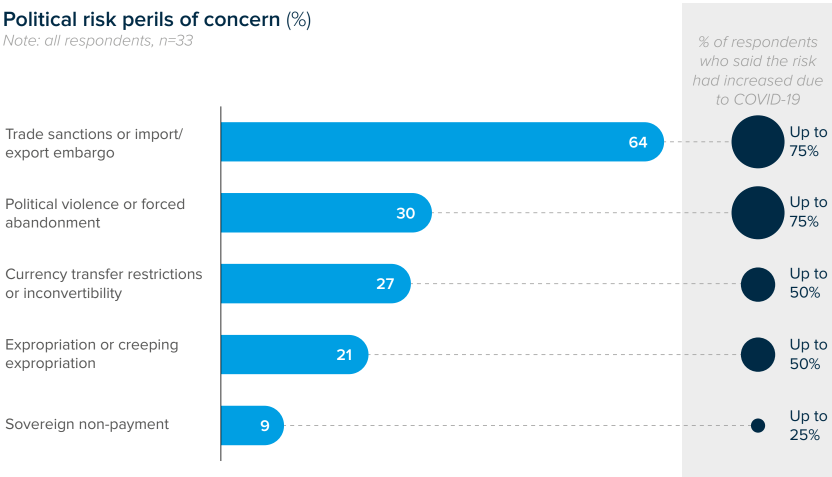
perhaps surprisingly, Russia and the CIS. This year, in regard to every region of the globe, a majority of respondents indicated that they were concerned about political risk. That comprehensive concern about geopolitical threats is surely another legacy of the pandemic.

The last question in this section of the survey addressed perils of concern. The survey results reveal not only the impact of the pandemic but also the continuity that enabled last year's panel to be so prescient about the top political risks of 2020. Trade-related risks were already the top peril of concern in last year's survey, perhaps unsurprisingly given that many trade-related risk issues, including the US-China trade war, increasing US use of sanctions, and significant trade disputes between the US and Europe, predated COVID-19. Alarmingly, this year's survey found that an overwhelming majority, nearly 75%, thought that such trade-related risks had only increased over the course of 2020. For political violence as well, a majority of respondents believed the risk had increased as a result of the pandemic (an issue discussed further as a "political risk aftershock of COVID-19," below).

In the next section, we will turn to the interviews with our expert panel for a more in-depth view on the political risks that 2021 might bring.

Political risk perils of concern (%)

Note: all respondents, n=33



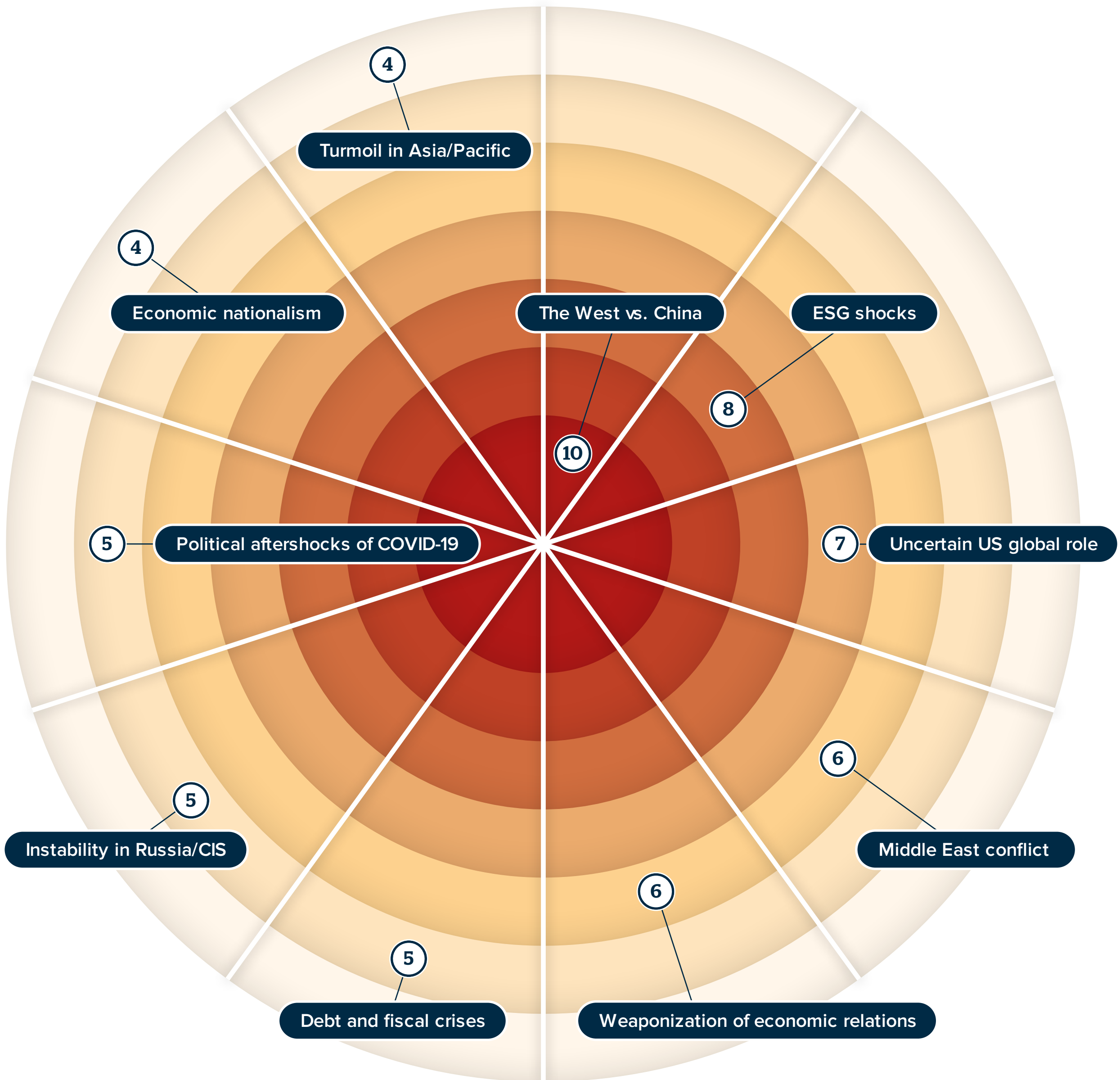
Source: Oxford Analytica

03 What next?

Each year we have conducted this study, we have asked the panel members an open-ended question about emerging political risks in the coming year. The results have been consistently prescient. Three years ago, panellists' top concerns related to an end to the globalization consensus of the past several decades – an issue that surely has only increased over time. Two years ago, panellists worried about the growing use of trade sanctions. Last year, as noted above, panellists identified the hidden threats from emerging markets debt. So, what are our panellists worried about for 2021?

In first place is "the West vs. China," a geopolitical threat that topped our risk list last year and only rose in prominence over the course of 2020 (despite some

Top risks 2021 (number of mentions)



Source: Oxford Analytica

yearend good news on trade negotiations between China and Europe). Ten out of the 14 panellists with whom we conducted in-depth interviews this year mentioned political risks arising from China's relationship with the West. (By contrast, last year the issue was mentioned by 5 out of 10 panellists.) The concerns this year were varied. Panellists in the natural resource sector worried about strategic competition between Chinese and Western companies, while those in the technology sector worried about technological decoupling. In all sectors, panellists were concerned that a strategic miscalculation could lead to outright military conflict.

An oil sector executive summarized neatly: "US-China strategic rivalry is more than a threat – it is a schism with an impact that reaches everywhere." Other panellists pointed out that the pandemic year had led to worsening relations not only between China and the US, but between China and many key economic partners – specifically mentioning Australia and India. Seemingly minor diplomatic disputes could have severe financial consequences for unlucky companies caught in the middle. If "Australia … adopts a more hostile posture towards China, that could lead to risks for our business and our people," a mining sector panellist noted.

The risk in the second position in 2021 was also at the top of last year's list: ESG (Environmental, Social and Governance) shocks. Last year the panel was chiefly concerned about changing expectations regarding the relationship between business and society. ("Populism is leading to anti-business movements," said one of last year's panellists. "Obviously, more recent ESG efforts are a form of risk management.") This year, concerns centred on two issues. First, as governments have begun to intervene in response to such pressures, there was rising worry about the direction of ESG policy and legislation. Second, there were concerns about sectors becoming political targets. For instance, as one technology sector panellist contended, "Issues related to the use of technology to undermine democracy and support authoritarian regimes [could] threaten the sector [so that] trust in the sector declines."

The next risk is new on our list: the "uncertain US global role." Analysts have for many years speculated about the shift to a so-called "multipolar world" from a world of US dominance. This geopolitical shift was expected to occur gradually as other powers rose – particularly China, but also, just possibly, a more unified Europe. In 2020, it became apparent that the US might seek to bring its own unipolar moment to a hasty end via a disruptive exit from global institutions (such as, dramatically, the World Health Organization and the Paris Agreement on climate change).

Some panellists were cautiously optimistic that a new US presidential administration might reverse course. One panellist mentioned "a renewed opportunity for dialogue – and even collaboration." That said, other panellists felt the die had been cast. As a panellist in the consumer goods sector explained, the world had woken up to the reality of the US president's control of foreign policy. While the extent of executive power gives the new administration a great deal of apparent leeway, it also makes it hard for any US administration to make lasting commitments. Any international deal could be quickly undone by a successor – and world leaders will have no difficulty envisioning what such a successor administration might look like. As the panellist put it: "I think we overestimate the extent to which the [incoming]

US administration will be able to reassure partner countries (e.g., on environmental, trade, Iran sanctions issues) that future agreements with the US will be long-term and worthy of the time and effort to negotiate." Trust in America's global leadership, he said, is gone.

The next risk is a regional concern – but one with global impacts. Concerns about "conflict in the Middle East" follow on from last year, when that risk was at the top of the list. This year panellists were overwhelmingly concerned about either Iran, Saudi Arabia, or both. For the former country, concerns focused on its nuclear ambitions; for the latter, on political stability; and for both, the struggle for regional dominance that could potentially lead to miscalculation and even military conflict. One panellist in the defence sector mentioned concern regarding Turkey – both its internal stability and its regional interventions.

Another new risk for this year's list is the "weaponization of economic relations." This risk expands on the sanctions concerns of previous years, and reflects the growing reliance of countries, especially but not only the US, on economic retaliation to achieve foreign policy objectives. In a globalized world, threats of sanctions, "entity lists" of firms that cannot by traded with, or exclusion from markets or payments systems, are increasingly effective diplomatic weapons, because such measures inflict significant economic pain. Much of this pain, however, is borne by private companies caught in the middle. "Sanctions used to be a last resort," as one panellist complained with some pathos. In some cases, the international agreements necessary for companies to operate across borders have become political tools. "The use of aviation [agreements] to help leverage different political outcomes has probably never been more prevalent than it has been right now," an airline sector panellist contended.

The next risk (tied with several others in terms of number of mentions) is another regional concern, this one relating to instability in Russia and the former Soviet states. As our interviews were being conducted, a remote but intense conflict had broken out between Armenia and Azerbaijan. In addition to concern about relations within the region, many panellists worried about Russia, both its internal stability and its relations with Europe. Taking the panel's comments together, the list of alleged Russian activities included cyber warfare, international assassination of political opponents, election interference, and efforts to control the high Arctic – any one of which could become a flash point "destabilizing great power relations and creating further risks for our business," as one panellist put it.

Tied with the above risk is "debt and fiscal crises," retitled this year to reflect the fact that concerns were not limited to emerging markets. It may seem surprising to mention concerns about debt crises. As of this writing, in December 2020, financial markets appear to have decided that the worst is past, and capital is flowing back into the emerging markets. Nonetheless, fighting the pandemic has been extraordinarily expensive, and poor fiscal positions can produce political risks. Resource sector panellists worried about tax and royalty policies as countries "look to repair the fiscal damage of COVID." A manufacturing sector panellist noted that certain countries were still in dire straits: "currency inconvertibility has been a significant issue in Venezuela, Argentina, Turkey and Nigeria." A utilities sector panellist worried about "sovereign debt issues," noting particular concerns in South Africa and Egypt. In a similar vein, a panellist in the defence sector worried that countries selling to governments would face straightened times ahead.

In a similar vein, panellists were concerned that governments' weak fiscal positions could lead to political turmoil – hence the next risk on our list: "political aftershocks of COVID-19." Purchasing power will matter in countries' attempts to fight the virus, and inequitable access to vaccines could be a future diplomatic powder keg. Wealthy countries where vaccines were developed, and which have substantial purchasing power, may monopolize distribution of vaccine doses – even as some poorer countries struggle to manage higher infection rates.

In addition, several panellists worried that austerity resulting from the pandemic economic shock could spark political unrest (as one put it: "political instability is our greatest low probability, high impact concern"). There was significant uncertainty regarding the pandemic's impacts on current political issues such as inequality, populism and authoritarianism ("people are looking for effective governance, whether authoritarian or democratic," was one view). A panellist in the technology sector expressed concern that, because many technology companies had thrived even as the rest of the economy contracted, there could be a backlash: "attention will turn to those who have been less impacted. The tail of COVID will be very long on economics and politics."

This long tail of COVID brings us to the next risk: "economic nationalism." Perhaps because the pandemic has been so unsparingly global in its impacts, many countries have begun to seek greater economic self-reliance – however costly that objective may be in a globalized world. ("Supply chains are not as fungible as people think," as one executive commented.) Such initiatives can have impacts that stretch across the business, from supply chains (e.g., rules to promote reshoring) to access to talent (e.g., immigration restrictions) to data security (e.g., limits on the international transfer of data).

For our final risk, mentioned by four members of our panel, we turn back to Asia (the region that topped the risk list). Here, the concern was that the struggle between China and the West could destabilize the broader region. In addition to tensions in the South China Sea, there were worries about relations between China and India, the possibility of a conflict over Taiwan, and the perennial issue of the Korean peninsula.

It is a long and varied list of threats. In the next section, we consider how companies can manage such threats, and look to our survey respondents to assess the impact of political risk on the bottom line.

04 Responding to risks, and losses

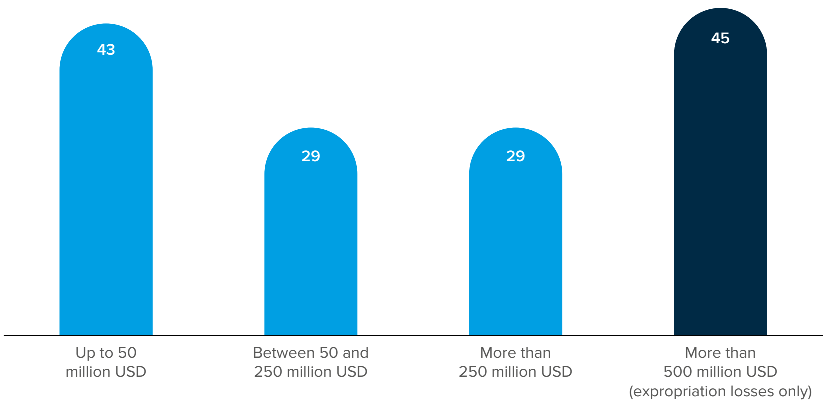
A unique element of this survey is that every year we ask our respondents to indicate not only their top risks and regions of concern but also – anonymously – their political risk losses. Each year we find it striking how large the reported losses are. While roughly half of respondents (42%) rely on political risk insurance to address such losses, that leaves about half of respondents who presumably have set aside significant amounts of capital to deal with this type of risk.

In previous years, we have found that political risk losses tend to follow a U-shaped distribution (there are lots of small losses and lots of large losses). For instance, last year we found that the two most frequently-reported categories of political risk loss were $9 million or less and $250 million or greater, while losses in between those two extremes were relatively infrequent. This year, we can provide further insight into such findings. While losses reported this year once again followed a U-shape, looking at expropriation losses in particular, nearly half (45%) exceeded $500 million. It appears that catastrophic losses from this type of risk are skewing the distribution.

But what about recoveries? This year, for the first time, we asked our survey respondents to let us know what proportion of their political risk losses they had been able to recover, for instance through legal action (a good portion, a third of respondents, said they did not know how much had been recovered). Of those reporting a figure, we found another U-distribution: 39% were only able to recover a quarter or less of their financial loss, while 22% were able to recover more than half, with answers in the middle being relatively infrequent.

Distribution of political risk losses (%)

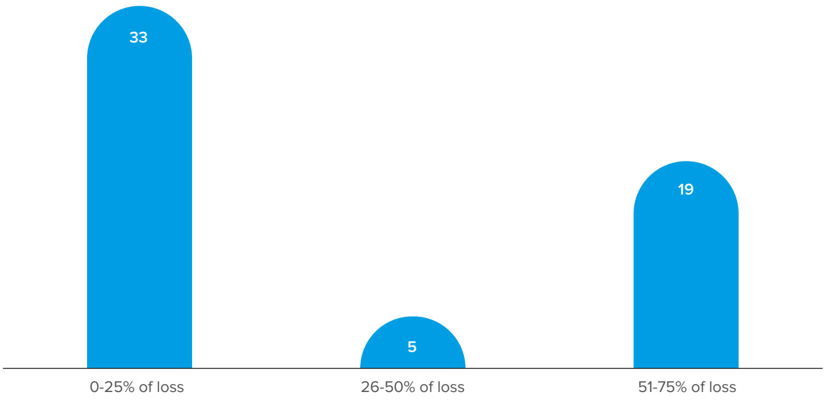
Note: respondents experiencing a political risk loss, n = 21; for 'expropriation losses only,' respondents experiencing an expropriation loss, n = 7



Source: Oxford Analytica

Distribution of political risk recoveries (%)

Note: respondents experiencing a political risk loss, n = 21; 'don't know' not shown

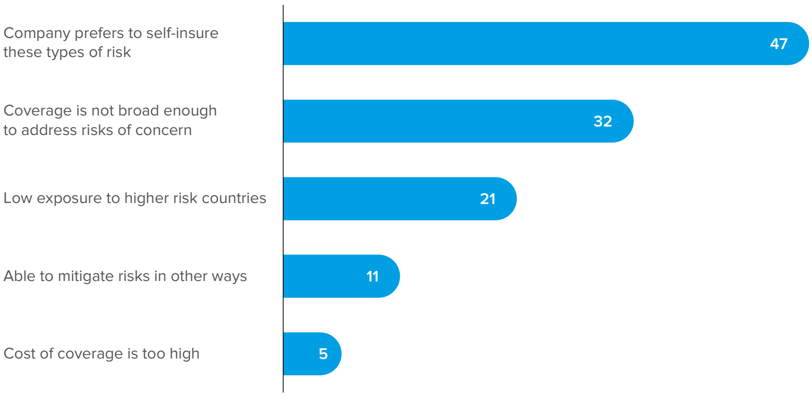


Source: Oxford Analytica

In light of these significant losses and limited recoveries, we asked about insurance solutions. Among those respondents who do not currently buy political risk insurance, self-insurance was a popular choice (at 58%). But why? Most frequently, respondents said current political risk coverages were not broad enough (40%) or they believed they did not have sufficient exposure to warrant the purchase of coverage (25%).

Why not use political risk insurance? (%)

Note: respondents not currently purchasing political risk insurance, n = 19; multiple responses permitted



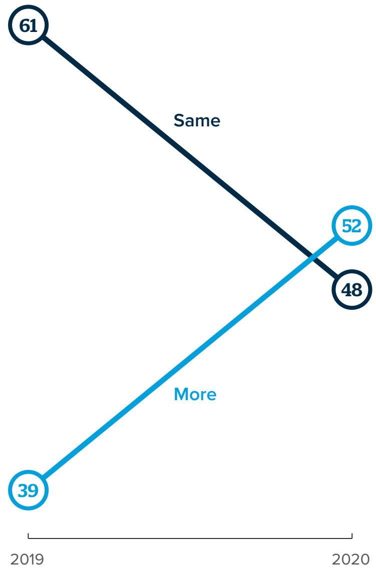
Source: Oxford Analytica

Of course, the perceived importance of exposures can change when risk levels change. As noted above, this year, for the first time, in every global region, a majority of survey respondents indicated that they were concerned about political risk. Hence some companies may adjust their view on their exposures of concern as they adjust to this perceived increase in risk.

In addition, another force may drive companies to review their risk management strategies in 2021: pressure from investors. In both this year's survey and last year's, we asked whether there was rising pressure from investors to communicate

Has there been more pressure from investors regarding political risk management? (%)

Note: all respondents, n=33 for 2020, n = 41 for 2019



Source: Oxford Analytica

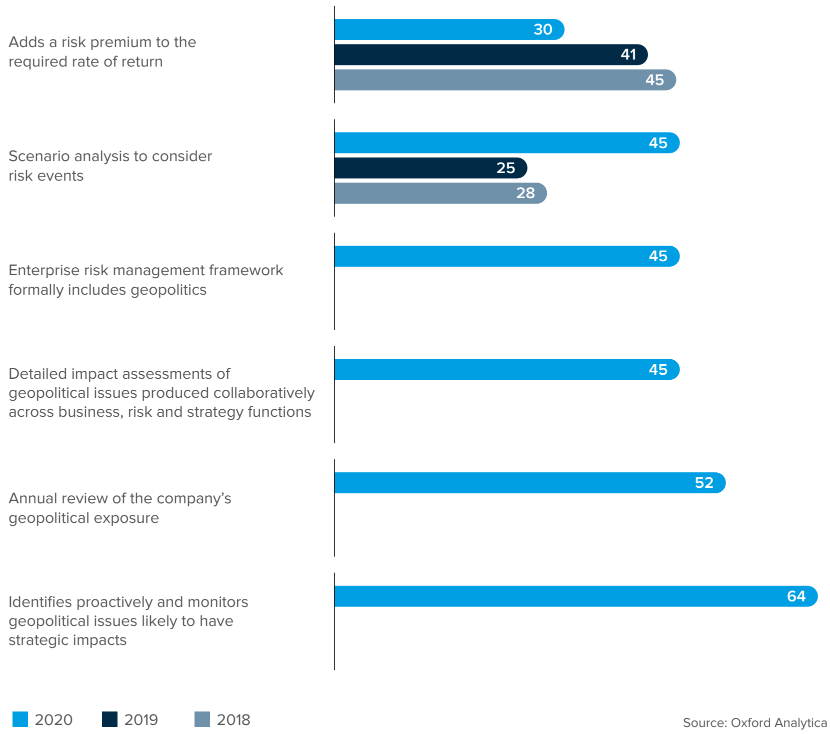
regarding prevention of political risk loss. This year, a majority (52%) said so, up from an already-significant 39% last year.

Of course, a political risk insurance program is not the only way to address such investor concerns. Indeed, the best-managed insurance programs do not exist in a silo – they are "embedded" in an organization, supported by structures and processes that enhance the value of the coverage. We asked respondents about how they organize their responses to political risk. In comparison to the surveys from previous years, we added more options to the set of possible responses.

We found that a sizable majority (66%) of respondents reported a proactive monitoring process with regard to geopolitical issues, and that a majority (59%) undertook such a process at least annually – emphasizing that our survey sample is, as noted in the introduction, skewed towards companies that are global leaders in this area and already invest in political risk management. This year, we did note a dramatic increase in the popularity of scenario analysis. That said, even among this elite group, only a minority of respondents reported including geopolitical risk in ERM (Enterprise Risk Management) or using an integrated approach across multiple business functions (45% in both cases).

Techniques companies use to manage political risk (%)

Note: all respondents; n=33 for 2020, n = 41 for 2019, n=40 for 2018; multiple responses allowed



Source: Oxford Analytica

Each year in our political risk survey we ask about specific countries of concern. Respondents can identify as many countries as they wish. The data shown in the chart are based on the number of times each country is mentioned. This year we asked respondents to identify three sets of countries: those where they had experienced political risk losses; those where they had avoided investment due to political risk concerns; and those where they had reduced investment due to political risk concerns.

Last year, high-risk countries dominated our results, both in terms of losses and in terms of loss avoidance (the top countries in 2020's study were Iran, Libya, Argentina and Zimbabwe). This year we saw a new trend emerge. Many of the top countries for 2021 are large markets, including Russia, Egypt and South Africa. While these countries may be risky, they are also attractive markets and extremely popular destinations for foreign direct investment. This development may well correspond with the generalized concern about rising political risk in many regions relating to the pandemic.

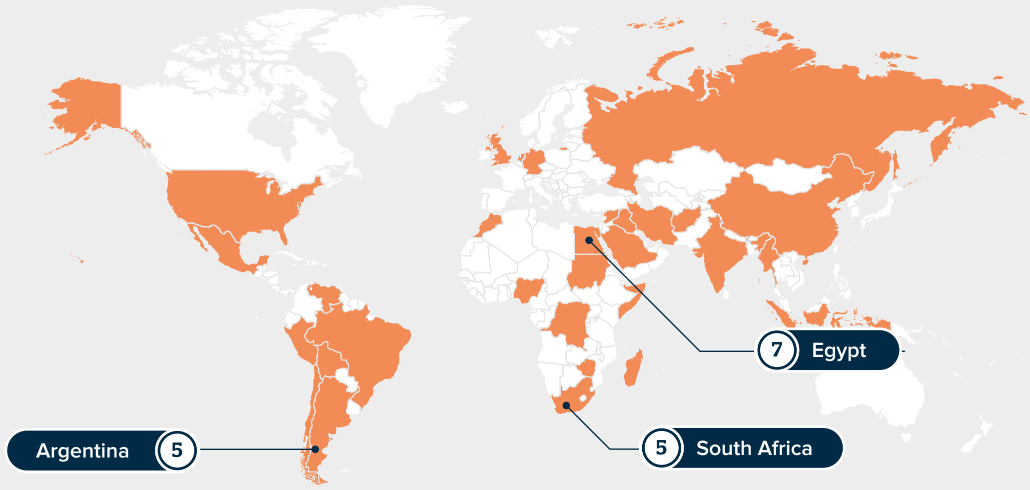
The presence of some countries on the chart may also reflect specific risk issues. The UK is mentioned frequently as a country where companies reduced investment, presumably due to Brexit-related uncertainty; China also appears high on the same list, very likely reflecting new concerns about China's relationship with the West.

Countries where respondents experienced a political risk loss (number of mentions)

Note: number of mentions; for countries of loss, companies experiencing political risk losses only, n = 19; for countries where investment was avoided or reduced, all respondents, n = 33. Top three are labelled

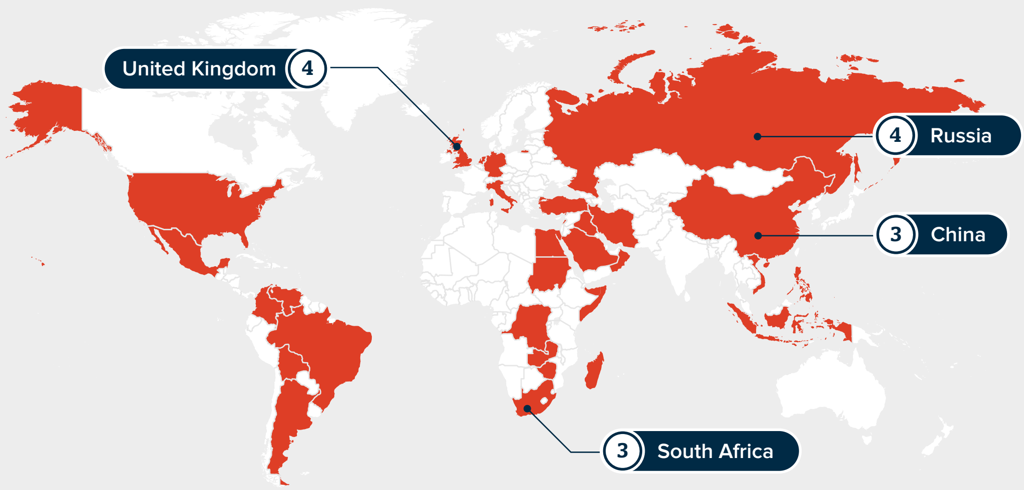
Countries where respondents avoided investment due to political risk concerns (number of mentions)

Note: number of mentions; for countries of loss, companies experiencing political risk losses only, n = 19; for countries where investment was avoided or reduced, all respondents, n = 33. Top three are labelled



Countries where respondents reduced investment due to political risk concerns (number of mentions)

Note: number of mentions; for countries of loss, companies experiencing political risk losses only, n = 19; for countries where investment was avoided or reduced, all respondents, n = 33. Top three are labelled



Source: Oxford Analytica

05 Conclusion

Overshooting is a natural tendency for even the most experienced executives and analysts. When times are bad, we all too often expect them to get worse; conversely, we tend to expect good times to continue even when such optimism is not necessarily justified. After the shocks of 2020 – which layered a pandemic and related global recession on top of deteriorating international relations – our panel and survey respondents had alarming views of what 2021 might hold. Most political risk perils were seen to be increasing; political risk was seen to be a concern in every world region in the year ahead; the pandemic was seen as likely to produce a wide range of political risk aftershocks.

Might these concerns reflect some overshooting? One risk from last year's radar that vanished from this year's top ten list was "European de-integration." Indeed, over the course of 2020, Europe appeared to find its political feet, agreeing an unprecedented budget deal, and, towards the close of the year, making significant progress in trade talks with Asia. There were, to be sure, one or two panellists who continued to worry about Brexit and populism. But many of the executives we spoke to thought that, despite a poor year economically, European integration had turned a corner.

It is a useful reminder that, even in a crisis, there can be positive developments – and often, we might surmise, commercial opportunities for those companies able to manage the associated political risks.

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