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Understanding the importance of political risk today: Insights for thriving in a global, unstable, turbulent landscape

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Lorenzo CORONATI & Frédéric JALLAT
ESCP Business School

ESCP RESEARCH INSTITUTE OF MANAGEMENT (ERIM)

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Lorenzo Coronati*
Frédéric Jallat, PhD.**

ESCP Business School

Abstract

Despite remarkable advancements in understanding the importance of political risk in recent years, its conceptualisations remain erratic or vague. This article aims to offer an overview of how political risk is defined, identified, and developed by organisations in relation to the current volatile landscape. The article tries to explain why political risks represent a significant hurdle for businesses and organisations in today's globalised world, explores the key concepts and features of political risk, and analyses emerging trends, highlighting its growing importance in our economy. We bring to the readership's attention the multifaceted elements of political risks encompassing a broad range of factors we seek to investigate (Sottilotta, 2016). We try to define the future landscape of political risk, which is likely to be shaped by prospective trends, and underline the economies' growing interconnectedness, which produces more instability that can quickly cascade from one region to another. Our findings demonstrate that for enterprises and organisations, managing political risk consciously is crucial for long-term success. In a nutshell, identifying and understanding the global political landscape, anticipating potential disruptions, and developing contingency plans remain essential for navigating this complex terrain, which unforeseen events can jeopardise. The article argues that by acknowledging the complexity of political risks and their evolving nature, businesses and organisations can build resilience, mitigate the effects of unpredicted threats, and ensure their continued viability in an increasingly uncertain world.

Keywords: Political risk, Risk management, Decision-making, Global insecurity

* Attorney/Consultant PhD. Program, ESCP Business School
** Professor, ESCP Business School

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Introduction

Businesses face many challenges and uncertainties in today's increasingly interconnected and globalized world. The rapid shifts in the world's production centres in recent decades (from the West to the Far East) and extent of conflicts generated by the interpretation of new paradigms of military, financial and social world orders are having repercussions on the strategic future of the economy and on old powers, creating an increasing sense of global uncertainty (Kennedy, 2010). Among these multiple challenges, political risk has emerged as one of the critical factors in shaping business strategies. Therefore, its management is a leading priority for leaders in their decision-making process (McKinsey, 2022; PwC, 2018). Broadly speaking, political risk refers to the potential impact of social or political events, decisions, and policies on a company's operations, investments, and profitability. Due to the ethical damages (brand, IP, or reputation) or financial effects (decreasing revenue, missed business opportunities and asset loss), the implications of political risk in business management cannot be overlooked. The study of the nature of political risk, the knowledge of its inner dynamics, the engagement necessary and its relevance in contemporary business management provide valuable guidance for firms operating in today's turbulent political landscape (Frynas & Mellahi, 2003).

Political risk defined

The concept of political risk is complex and elusive. It evolves over time and involves new actors (with a recent increase of non-state ones such as consumers, NGOs, or terrorist groups). It encompasses many features, including legislative changes, shifts in government policies, geopolitical tensions, regulatory instability, natural resources manipulation, and social unrest. In addition, recent trends outline as potential political risks all those uncontrolled dynamics that are triggered by unjustified interpretations of an economy, which find its raison d'être more in ethical and moral perspectives rather than the pure interest of organisations' profits. That is, risks nurtured by the driving motive of a general widespread sense of commitment to justice and fairness that, with incorrect approaches, translate into a loss of market value and attractiveness for companies involved in this justice mass activism (Davies, 2019). All these elements produce a multifaceted and intricate notion of political risk. It is thus characterised as a hybrid phenomenon that can be positioned between a typical company's business function and the theoretical performance of risk management theory concepts. However, it must be treated as a prominent concern in contemporary global affairs, particularly in a world characterised by the interconnectedness and interdependence of business systems. All these elements contribute to shaping the intricate political risk landscape in which economic stakeholders operate, affecting leaders' strategic decision-making, policies, and investment strategies (Rice and Zegart, 2018; World Bank Group 2018).

Table 1. Main Factors of Current Political Risks

Geopolitical dynamics	War, nationalism, coups, international sanctions, internal violence or conflicts, and shift of power.
Normative or legislative factors	Unbalanced and unilateral rules application or imposition of unfair laws and policies; "Gray zone" aggression.
Corruption	Systemic bribery and fraudulent conduct
Social media interference or fairness activism	Social media activism and collective action by "viral social-media influence"
Terrorism	Indiscriminate use of violence against goods, people and political symbols
Cyber war or crime	Online criminal or sabotage activity
Climate change	Global warming and natural disasters
Economy globalisation	Periodical economic shifts and shocks; Deglobalisation threat
Corporate reputation	Self-inflicted risks by wrong internal firm culture and practices

This plethora of risk dimensions (table 1) has a variety of repercussions on firms' operations and presents heterogeneous characteristics both in their consequences and the nature of measures necessary to cope with them. The essence of each political risk stems from its capacity to derail a company's operations, erode its profits, and damage its reputation. Companies must adopt a systematic approach to reduce those risks, implementing a culture of threat identification and management in their daily processes, allowing organisations to prevent "black swans" (Taleb, 2008) and recover better from serious, lasting effects.

Why is political risk management instrumental today?

Identifying political risks and understanding their effects is vital for organisations. They directly or indirectly impact their ability to operate, expand, and thrive in the business ecosystem (Jakobsen, 2010). The reasons for this destabilising impact are multiple and can be harmonised into four main groups:

1. **The globalisation and interconnectedness of the business.** In today's globalised economy, businesses are more intertwined with international markets and supply chains than ever. This interconnectedness or dependence makes them susceptible to political, social, or economic developments,. A financial dispute in one country, a reputational conflict, a sudden change in tariff regulations, or a geopolitical competition can all have cascading effects on businesses that rely on these geographically interconnected systems. This multiplies risks (Alicke et Al., 2022).
2. **Uncertainty and volatility.** Political risk adds a layer of uncertainty and volatility to the business environment. It can lead to sudden and unpredictable changes in market conditions or increased unforeseen variables, making it difficult for companies to plan or react for the long term. Uncertainty without preparation can deter investment and disrupt operations, leading to substantial financial losses. Instead, developing suitable processes to implement risk mitigation reduces shocks, and companies can thrive even when exposed to volatility, randomness, and disorder, if they embrace risk and uncertainty with systematicity (Nassim Taleb, 2012).
3. **Relevance in diverse sectors.** Political risk is not limited to specific industries or regions. It can affect businesses in diverse sectors such as finance, technology, and manufacturing, or impact several company departments that are not directly

linked. On the other hand, the importance of the political risk components may vary depending on the board of directors, divisions, and company experiences in managing unexpected events. This extension of dynamics explains that what works for one firm may not work for others during the internationalisation process (Jimenez, 2010). This aspect is particularly relevant in emerging or developing countries where political stability, transparency of institutions and the rule of law may be less assured, giving leaders less operational certainty.

4. **Reputation and stakeholder concerns.** How a company responds to political risk can significantly impact its reputation and relationships with stakeholders (such as investors, clients, etc.). A firm that is poorly prepared for political risk events usually faces negative backlash from customers, sponsors, and public opinion, resulting in decreasing corporate brand value and assets. In contrast, proper management of these risks can enhance a company's image and build trust, thereby mitigating potential adverse effects and generating positive feedback from the market with optimistic outcomes in the long run.

The above clusters underline that contemporary political risk continually intertwines, evolves in the business context through elements of interconnection and can differ from what businesses have traditionally faced. Understanding these changes and its multiple nature is crucial for effective risk management strategies.

Combining scientific studies and practitioner knowledge, some novel insights can be extrapolated for business purposes (Rice and Zegart, 2020; Jakobsen, 2010):

1. **Technology and information flows matter**. The web, the media and digital-age tools have transformed how information spreads and influences our environment. Social media, in particular, play a significant role in shaping (and sometimes manipulating) public opinion. The power of social activism generates sudden and extensive risks, posing challenges that can mobilise any social movement. Businesses and institutions must contend with events that, once the news of them goes viral, can reshape the notion of threat. Corporations must be tuned with measures in multiple locations and synergy-ready actions to prepare for these changes, as they can affect political or economic outcomes and, consequently, the risks companies face.
2. **Presence of non-state actors and cyber threats.** Today's political risks' triggers exist in a crowded landscape of different, often unrelated, players. It is essential to emphasise the growing influence of new local or transnational entities and non-state actors, such as terrorist groups, activists, unions and ethnic or religious communities. They generate risks within borders or across them and, as these overlap, can amplify the political risks effects. The development of AI and the spread of digital applications are transforming traditional political risks, forcing businesses now to consider as a priority the impact of cyber threats, which can disrupt operations, compromise sensitive data, and harm a company's reputation, affecting profitability and market value.
3. **Social responsibility of the private sector.** Businesses are increasingly called upon to play a "non-only managerial role" in addressing global challenges. Governments, NGOs, and the public expect companies to be socially responsible and contribute to solving pressing issues, such as climate change and income inequality. Companies are expected to play an active and social role within the community in which they operate, which posits that making corporate social responsibility (CSR) evident to the audience (the more, the better) gives an undisputed trust or sort of moral capital that safeguards the firm in case of an unexpected adverse event. Hence, firms

exposed to more political risk must engage in CSR activities to exploit its hedge effect.

4. **Flexibility and adaptability approach.** The continuous flow of new dynamics highlights the importance of flexibility and adaptability in managing political risk. Companies should develop and assess a range of scenarios to anticipate potential political developments. Scenario planning is becoming a fundamental and irreplaceable element for preparing corporate managers to design strategies to respond effectively (Schwenker and Wulf, 2014). The goal is not to predict unexpected events but to improve the data collection, the tools for integrating the analysis suitable for better decisions within the organisations. This proactive approach is essential in navigating the current dynamic landscape.
5. **The importance of public-private partnerships.** Our modern society is more interconnected than ever, which results in a complex business ecosystem that allows and assumes the systems' and organisations' interdependency (and mutual efficiency). For this reason, it is imperative to highlight and foster the paradigm of public-private partnerships in addressing political risk. It is the most promising form of value creation. Collaborative efforts between governments, businesses, and civil society can lead to more resilient and sustainable solutions (Chironga, Leke, & Desvaux 2018). These partnerships can mitigate political risks by promoting stability and shared mutual responsibility.

Political risk: future trends

Given the speed at which markets are changing, the complexity and the nature of events that globally will persist, making predictions about the next political risks with international influence is almost impossible (UNCTAD, 2022 ; Taleb, 2012). Despite this unpredictability, some trends can be outlined (table 2):

Table 2. Political Risk Main Trends

Type	Descriptions	Likelihood	Action plan	Impact/where
Social instability, geopolitical or conflicts risks	Regional or international conflicts escalates, threatening infrastructure and increasing volatility in the business context	High	Identification, assessment and protection of critical assets and vulnerability	High/ major developed and/ or developing economies
Inflation and economic uncertainty	Inflationary pressures lead to a populist resurgence and economic volatility.	High	Hedge plans and improvement of firms efficiency	Medium/ developing countries
Supply chain instability	Disruptions by event or situation that affects the normal flow of goods or services.	Moderate	Build entities with flexible organisational capacity	High/ developed economies
Cyber-crime	Web attacks that cause disruption to critical physical and digital infrastructure.	Very high	Cyber Risk "boot camp" periodically/cyber assessment	High/ major states or economies
Economic de-globalization	Economic trade and investment between countries decline affirming a new business paradigm that create uncertainty	Moderate	Adjusting political and commercial policies for more cooperation	Medium/ developing countries (mainly non-Western)
Energy security	Secure the supply of energy exploiting new resources	High	Diversification/impleme ntation of new technologies	High/ mainly Western countries

Social instability and geopolitical conflicts

Regional conflicts worldwide will continue, and in some areas, such as the Sahel in Africa, the Far East around Taiwan, and the Red Sea, are expected to intensify. This uncertainty will impact trade, supply chains, commodity prices and political stability, producing even more market tensions and fluctuations. Besides, the social conflicts arising from the rising cost of living or environmental concerns push politicians and policymakers to adopt populism or nationalism as ideological political views to cope with the population's demands. This growing disaffection increases tensions and pressure on the internal agenda, affecting the economic ecosystem and creating leadership concerns (Coronati & Jallat, 2024).

Inflation and economic uncertainty

The rising inflation is still a possible disruptive political risk trigger. Although central banks in the EU and the US control the end of the hiking cycle, the remaining general policy is that governments will take a cautious approach to reducing interest rates. The political consensus will likely cause rates to remain around 3.5% - 4% during 2024. This measure will impact economic growth and put financial pressure on households and businesses, which may generate unexpected events with negative global economic applicability.

Supply chain instability

The perception of general and constant insecurity can produce disruptions that affect not only goods but also services across regions and industries in the medium term. Furthermore, regional and global political or financial events or a new health crisis may impact businesses, disrupting the entire supply chain (especially for food) as was the case with the Covid -19 pandemic. The availability of services may also be jeopardized with the increase of social and geopolitical risk, threatening the fragile corporation's supply chain even more. These aspects cannot be overlooked by leaders who want to prepare an alternative scenario to mitigate those risks.

Cyber-crime

Any company that relies on IT infrastructure is vulnerable to cyber-attacks. Hackers can manipulate any connected device within companies (from mobile to desktop) or use it as a vector for attacks on company networks and internal data. The increasing size, complexity, and tenacity of cyberattacks pose a significant future economic threat. It increases the range of political risks for individuals, companies and national security agencies. As a result of the digitalisation of critical national infrastructure, several essential services, such as power grids, water supply networks, hospitals, and transportation systems, are frequently exposed and susceptible to devastating cyberattacks (Gaubert & Jallat, 2023). All those systems are prone to severe repercussions, including theft, spying, disruptions in operational activity, and financial loss. Recent, extensive attacks show the vulnerability of those infrastructures, where ransomware attacks have become increasingly prevalent. Additionally, the trend is in expansion in conflict areas or during particular circumstances (especially before elections), posing a danger to democracy and putting pressure on public opinion. Corporates, with the assistance of national security agencies and dedicated staff, need to be more vigilant and always plan new countermeasures.

Economic de-globalization

Several crises and the adoption of new policies have led decision-makers to reduce the impact and dependency across economic system stakeholders. A new economic paradigm is emerging, allowing organisations to implement integrations and a less holistic perspective of assets and resources. In particular, emerging economies and small, isolated markets are reorienting their commercial and political alliances (i.e. from the West to China, Saudi Arabia and India). This shift is disrupting traditional capital and goods flows, accelerating the competition among governments to secure access to crucial materials and political control over trade routes, even in regions far from organisations' usual spheres of influence, forcing businesses to adapt to this new market reality. In addition, the rise in protectionism, triggered by nationalist parties and populist movements that exploited the increasing inequality in our society, is creating an environment of aggregate uncertainty. These resentments, often duly piloted, can potentially disrupt globalisation as we know it today, posing a threat to economic growth and international relations. This formula and the tendency to reject multilateral trade by important players remain a real geopolitical risk trend.

Energy security

Energy is essential to economic development and is critical for countries' growth and security. Controlling energy sources, such as fossil fuels, is a strategic advantage. The politics of energy tends to be associated with the risks tied to specific industries and resources (oil, gas, and coal). However, their geography and limited availability shape the relationship between modern nations because most critical assets are located in politically unstable countries. The lack of a complete transition to renewable energy, which balances new powers and increases competition among players, damages the positive effects on energy supply and security. Governments must facilitate diversification and encourage reforms to increase the possibility of accelerating this transition by the private sector, which could allocate more resources to renewable energy projects, stabilising the geopolitical landscape. This would permit responding to challenges and overcoming conflicts and cross-border ecological disputes. A deeper global collaboration is required to develop renewable energy exploration that can alleviate uncertainty ahead.

Some insights and practical implications for business

As discussed, several variables undermine a company's preparation, response, and confidence in its ability to navigate risks successfully, specifying that company or managerial experience and performance always matter (Jimenez, 2010). Thus, this article tries to recommend some practical steps to manage this volatile contemporary landscape (McChrystal, 2021; Grant et Al, 2022).

The first one should be a comprehensive risk assessment conducted with a dedicated staff by identifying, analysing, and controlling data available, together with a thorough evaluation of political risk factors that could impact operations. This includes evaluating social or political stability, regulatory frameworks, and geopolitical conditions in target markets. A suitable risk assessment procedure is recommended for executing so-called scenario planning. Developing scenarios anticipating potential political events and their impacts is an exercise that helps formulate adequate response strategies in advance.

The second is the implementation of cross-functional teams. Establishing cross-functional teams within the organisation helps to monitor political developments and assess their potential impact. It can reduce exposure and prepare the organisation for the unexpected. These teams should include geopolitics, legal affairs, CFO and risk management experts. Maintaining open lines of communication with stakeholders, including government officials, regulators, and local communities, or engaging in public-private partnerships to address shared challenges allows firms to collect helpful information. This will enable the capability of establishing robust stakeholder engagement, filtering perceptions or emotions to frame future problems and determine whether insights have emerged or remained hidden (Giambona *et Al*, 2017).

The third helpful practice is diversification. Companies should continuously diversify their market presence and supply chain to reduce dependence on a single region or country. A lack of diversification of the main economic drivers is associated with increased vulnerability, exposing firms to sector or market-specific shocks. Hence, diversification can help manage volatility and provide a more stable option for identification and response, spreading the risk mitigation effect over more alternatives and making the business more resilient to distress.

Finally, companies can adopt more insurance and formal risk mitigation approaches as a good practice. Political risk insurance and other risk mitigation strategies to protect investments and operations in high-risk areas can be a solution to cover a wide range of potential risks. They are also designed to mitigate corporate loss.

Conclusion

In an increasingly intertwined and unpredictable world, political risk identification and assessment has become critical for businesses across various industries and sectors. The concept of political risk offers valuable insight into how companies can adapt to navigate this challenging ecosystem. By recognizing its significance and diversified essence, embracing scenario planning, and engaging in public-private partnerships, companies can proactively manage and mitigate the uncertainties posed by unexpected events. In the 21st century, acknowledging the importance of political risk is not just a prudent option. Rather, it becomes essential for businesses' long-term success in a complex and ever-changing world.

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