

How retail and consumer companies can improve global business performance with better political risk management*

Managing the risks inherent in globalization isn't a new challenge for retailers and consumer products manufacturers (retail and consumer companies). After all, they have been pioneers of international trade and retailing for centuries. In recent years, retail and consumer companies have been steadily capitalizing on rising consumer purchasing power throughout Asia, Latin America, and both Eastern and Central Europe while also taking advantage of cheaper labor and capital costs to keep prices low for Western consumers.

But in spite of their experience, retail and consumer companies today are facing a much more complex global risk environment—for a host of different reasons. The most prominent include the following:

- Greater dependence upon an increasingly complex global supply chain is heightening vulnerability to disruption risk.
- Domestic market saturation is creating growing dependence on international market expansion as a primary platform for growth.
- Subtle but crucial differences in local, national and regional tastes and behaviors can significantly lower projected sales or erode expected economies of scale.
- Host-country competitors with inherent advantage and growing sophistication are beginning to threaten international market expansion goals.
- The new fluidity in global communications now means that criticism from even small activist groups or individual host government officials can reach worldwide audiences within minutes and potentially cause significant damages to brands and reputations.

These trends are increasing what PricewaterhouseCoopers and Eurasia Group classify as “political risks.” A political risk is any change to the government, economic, social or security environment that alters the expected outcome of an economic action by changing the probability of achieving business objectives. While political risks can arise from the policy, social, economic and security environments in a country or from interaction between political entities, every one of these trends has been looming on the sector's planning horizon for a long time.

What's different today is a crucial and growing gap between the willingness of retail and consumer company executives to accept rising levels of geopolitical risk in search of greater economic rewards and their ability to adequately protect business performance and economic value by managing this risk in a consistent, efficient, and systematic manner.

Our point of view

Since political risk can be anticipated, it can also be monitored and managed.

At PwC and Eurasia Group, we believe that while retail and consumer company executives are well versed in executing global operations, they have not embedded a sufficiently thorough approach to assessing how geopolitical risk can impact business performance.

With better insight and information into the risks and opportunities created by changes in the political environment, they can direct their risk analysts and country or segment managers to anticipate and prepare for the risks most likely to affect strategic market entry, ongoing business operations, market performance, and ultimately, shareholder value.

As a result of their need to find low cost sources of supply, their aggressive push into non-traditional foreign markets, and their high brand visibility, retail and consumer companies face the greatest levels of risk in the following three critical areas.

Supply chain risk

Perhaps more quickly than any other strategic driver of performance, pressure to maintain low cost and reliable supply networks forces companies continually to adapt their global sourcing strategies to changing global conditions. Supply chains can be disrupted by events such as politically-driven changes to macroeconomic conditions that raise suppliers' costs; inadequate response to natural disasters; and disputes that impact customs regimes or shipping channels.

For example, companies sourcing from China today are facing new risk as Beijing tries to cope with an overheated economy by curbing foreign investment. China's most powerful ministry, the National Development and Reform Commission (NDRC), has proposed raising the tax rate for foreign invested firms to levels comparable to those applicable to local firms. At the same time, Beijing is strengthening the rules governing technology transfer, which means that manufacturers have even less certainty that competitive advantages apart from price will be maintained.

Market entry risk

Retail and consumer companies entering new markets also need to be more attuned to the social and political environment. Many companies are looking to capitalize on the growing middle class in non-Western markets and the growing wealth of oil-producing states. But taking advantage of these opportunities also means that retail and consumer companies confront a greater range of risks than in their traditional markets.

As several retailers have discovered, understanding the social and political context in which they establish operations can be as important as developing culturally-sensitive advertising when building a new market presence. Retailers in new markets tend to underestimate key factors such as the strength of local competition, differences in consumer buying habits, and market-specific norms and models for management and customer service. American retailers also tend to misinterpret the role of unions in foreign markets. In one recent case, a global retailer's approach to importing home country business practices sparked challenges in several foreign markets and triggered confrontations that required intense political negotiations to resolve. Awareness of these issues and planning for how to address them can streamline market entry and promote sustainable long-term growth.

Reputational risk

One of the most important challenges in managing the risks in globalization is complying with home-country regulations affecting business conduct in host countries (e.g., the U.S. Foreign Corrupt Practices Act). Another is addressing the potential impacts to brands and reputations posed by underestimating or misaligning corporate approaches to social, environmental and ethical issues reflected in consumer attitudes and preferences.

Corporate initiatives in this area are typically focused on monitoring for policy compliance and finding ways to rectify supplier performance. While these represent essential priorities, they're not enough by themselves, to protect retail and consumer companies from the risks that their brands and products will sustain damage in the eyes of the buying public.

Companies need to supplement these initiatives with a coordinated set of local strategies such as emergency response plans, and training and education. They also need to look beyond the boundaries of public relations and rethink the important role large business plays in developing economies. In parallel, retailers, manufacturers and other supply chain participants need to begin embracing enterprise-level strategies that embed political risk management more deeply within critical business processes.

How retail and consumer companies can better manage the risks of globalization

Make better, more timely decisions about international investments and operations.

Here are several key steps that retail and consumer companies can take to establish a more systematic approach to managing the geopolitical risks of globalization and improving performance.

- Start by identifying the critical business processes that your company uses to develop and deliver its products or services to any planned or existing international market. (A graphic example of such a process framework is provided on the following page.)
- For each of these critical business processes, assess your organization's political risk exposure along the risk analysis dimensions most appropriate to your business model and global operations. Make sure that you consider at least the following four dimensions:
 - **Local Taste & Customs "Fit" Analysis**—Does your proposed product mix match local tastes? Have you consulted with local experts on your designs and services? Do your store concepts and other channel strategies suit local shopping habits?
 - **Incremental Opportunity Analysis**—Are there opportunities arising from changes in the social or regulatory environment that you're missing, such as product, segment or sourcing opportunities? Are there inventory placement opportunities, sales or service offerings that you're missing?
 - **Productivity Analysis**—How do your global product plans, designs and marketing decisions affect total value chain productivity? How about your store and channel operations or your sales and services practices? How do your inventory levels factor in the risk of global disruptions?
 - **Threat Analysis**—Which political risks (such as macro economic changes that impact pricing) could impact your ability to sell, produce, source or deliver your products as planned? What threats exist to your local image as well as your global one? Which political risks could impact your store or channel strategy?
- For each of these processes, examine the quality of existing controls and the adequacy of risk mitigation plans relative to the business risks you've identified.
- Using the political risk information that emerges from this analysis, 1) develop methods for the risk-adjusted evaluation of international risks and opportunities through scenario planning and 2) use the results of this analysis to develop and implement the most efficient and cost-effective steps to mitigate risks and capture benefits identified.
- As a general rule, be diligent in finding better and better ways to embed political risk considerations into your strategic decision-making, risk management frameworks, and ongoing business operations. This long-term focus will help you and your organization make better and timelier decisions across the full scope of your international investments and operations.

PwC retail and consumer value chain overview

This analysis should be performed for all countries in which there are any existing or planned operations.



Conclusion

Understanding the risks in globalization—and managing them—impacts returns, alters risk profiles, and reveals opportunities.

As new risks and opportunities continue to evolve in emerging markets, we believe the absence of a comprehensive framework for managing the risks in globalization will become increasingly expensive.

The best way for retail and consumer companies to manage this risk effectively is to embed geopolitical risk management into every critical process that impacts global business performance.

For more information please visit:
www.pwc.com/politicalrisk

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