

STRATEGY AND GEOPOLITICS

Understanding Global Complexity
in a Turbulent World

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in a Turbulent World

BY

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INVESTOR IN PEOPLE

To my family, friends, and colleagues for supporting me, helping me find the time and space to think and write, and for sharing their ideas with me.

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Introduction

Many firms today are living in a schizophrenic period. On the one hand some of their largest and most profitable markets are faced with a sluggish economy, intense competition, and the need for constant innovation coupled with relentless cost cutting.

At the other extreme, these same companies are investing enormous sums to acquire or grow positions in emerging markets in Asia, Latin America, and Africa which are all about growth and in many cases are years away from showing significant profits. These investments are often made based on available data on economic growth and optimistic forecasts showing rising prosperity.

The problem is that such decisions do not always look deeply enough at the political and geopolitical issues at play in many of these countries. Often it is these kinds of issues, as opposed to more conventional business concerns, which can upset the forecasts and cause serious problems.

The ups and downs in the price of oil, Brexit, the election of Donald Trump to the Presidency of the United States, and continued tension in the South China Sea are only a few of the geopolitical issues that currently threaten the status quo upon which many businesses have crafted their international operations and global supply chains.

Today, more than ever, companies need to be able to navigate these issues and build resilience into their way of doing business. Unfortunately, the men and women who run and govern most large international companies are ill equipped to do this.

One of the reasons is that although they possess vast industry expertise and functional knowledge, many of the senior executives and members of Boards of Directors often do not know enough about such issues and how they play out in some of the countries and regions that they do business in.

In the first place, many such people have studied business or engineering and simply do not spend their time reading history or studying comparative cultures and languages. Furthermore, their 24/7 schedules and wide ranging responsibilities make dedicating time to deep reflection extremely difficult. Faced with overwhelming global complexity it is also hard to even know what they should look at if they could squeeze out a few hours or days for the task. The result is that too often they rely on consultants or oversimplified frameworks to make decisions about critical investment decisions.

Typically, senior executives fly into a foreign country, are picked up at the airport and divide their time between hotels, restaurants, and meetings with colleagues, clients, and partners. During such trips, they rarely have time to see the country around them or to appreciate important cultural, political, and geopolitical issues.

To make matters more complicated, once investments are made, many large companies rely on complex matrix organizations to make things happen. The matrix will have business unit heads with global responsibility, other executives managing large parts of the world such as Asia Pacific, and global functional heads responsible for finance, human resources, and the global supply chain. What they often no longer have are Country Managers.

In the past, it was often this figure who would reliably inform headquarters about local issues and also act as corporate ambassador at the national level. Even when companies do have a local representative today, many of these people are on rotational assignments and sometimes do not find the time to learn the local languages or dig deeply into the country's history and political situation. Others are simply too junior to play either role effectively.

When critical events do happen executives and the companies they lead are often taken by surprise.

Attacks by terrorist groups such as Boko Harum in Nigeria and Al-Shabaab in Kenya are neither anticipated nor even remotely expected. Larger events such as the civil war in Syria, the *de facto* partition of Iraq or Brexit have also taken managers by surprise as did the election of Donald Trump.

The objective of *Strategy and Geopolitics* is to offer Executives and Board Members of international companies a geopolitical perspective on the world as it is today as well as a tool kit to think through the issues affecting their businesses in the parts of the world in which they operate. The purpose of the book is not to replace deep analysis and the work of specialized consultants but to give decision makers sufficient grounding in the field so that they can ask better questions and decide for themselves what to do when faced with contradictory information.

In his book, *Power Rules*, Leslie Gelb relates a story about U.S. President John Kennedy who, in 1963, listened to reports from a General and another from a diplomat on the situation in South Vietnam. After the General said the South was doing well and the diplomat said the situation was hopeless Kennedy felt compelled to ask if they had “visited the same country?”¹

The problem is that many of the people tasked with doing such analysis have incentives built in to show things in a favorable light. It is, moreover, easier and more politically acceptable to show how an investment can be made to work rather than point out problems with a specific course of action or potential risks such as civil unrest or war.

For senior executives and Board Members of firms pursuing international expansion, *Strategy and Geo-politics* provides a framework with which they can approach global complexity at a deeper level and make up their own minds. Specifically the book will:

- Underline the need to go beyond a simplistic understanding of different countries and territories

1. Gelb, L. H. (2009). *Power rules: How common sense can rescue American foreign policy*. New York, NY: Harper Collins..

- Discuss geopolitical issues that can be the cause of success or failure in different markets
- Provide rich examples and illustrations of how geopolitical and nonmarket issues can affect business success in different places around the world
- Provide a strategic framework for dealing with global and local complexity and introduce innovative ideas on strategy formulation, organization, and governance which can improve the situation

Strategy and Geopolitics begins with three chapters that endeavor to unpack the global complexity facing business. Chapter 1 begins with a discussion of a series of well-known examples of recent events including Brexit, the Arab Spring, the nationalization of YPF, and the evolving situation between Russia and Ukraine.

The various examples were chosen to deal with different parts of the world and illustrate geopolitical forces at play. The key idea is that while many of the business interests involved were essentially surprised by what happened, the underlying geopolitical logic was plain to see.

Chapter 2 goes into detail on the logic of global expansion and explores five aspects of the present phase of globalization which make it particularly difficult for Senior Management and the Board of Directors to foresee the kinds of events described in Chapter 1.

Chapter 3 offers a framework for business leaders which can guide them in looking at the geo-politics which is inspired by looking at the way business people look at assets. The framework deals with the *fixed* aspects of a country or region's geopolitical situation which will not change over time, *semi-fixed* aspects which might change in 20–30 years and finally *current* issues which are in play in the present and over the next five years.

The next seven chapters then apply the framework outlined in Chapter 3 to different parts of the world and spells out the most critical issues facing the countries and the business community in each place. The structure is designed to allow readers to use the

book to focus on the countries and regions they are most interested in.

Chapter 4 looks at Europe in its broadest sense including the 28 member states of the European Union as well as other countries in the region and the Russian Federation. Chapter 5 deals with North and South America as both a region in and of itself and also in terms of the United States' particular role in the current world order which has been highlighted by the election of Donald Trump as U.S. President .

The next three chapters cover China, East Asia, and India in turn due to Asia's increasing importance in the world today and potentially determinant role tomorrow.

Chapter 9 focuses on Africa and makes an attempt to synthesize the very complex situation in the 54 countries that cover about one-fifth of the earth's surface and represent one-seventh of humanity.

Chapter 10 discusses the Middle East defined as the region around the Arabian Peninsula extending to Egypt (also discussed in Chapter 9) in the East, Iran to the West, and Turkey to the North. The geopolitics in that region revolve around the continuing tension between Israel and its neighbors, the looming Shia — Sunni conflict, and the rise of radical groups such as the Islamic State.

After looking at different parts of the world through this geopolitical lens, Chapter 11 then builds on that analysis to offer a path forward for international firms and the men and women who run them. This has to do with developing strategy that will withstand geopolitical shocks, building organizations able to implement such a strategy, and working effectively on the governance and process issues which are increasingly required.

As the world gradually shifts to a multipolar and less stable geopolitical structure, only those firms which acquire a better capability to foresee and prepare for change will prevail over the long term. Firms with such resilience, moreover, will be in a better position to make a positive impact on the world as it develops.



Taken by Surprise

When extraordinary events occur on the political or geopolitical front which have an enormous impact on an industry or specific business, the reaction of business leaders is too often characterized by surprise and bewilderment. The nature of the event is sometimes so far beyond their planning horizons, or the scenarios they have contemplated, that they may find themselves with essentially no roadmap in place and are therefore forced to react to events on an ad-hoc basis.

Part of the rationale for writing this book is that – in many cases – such events do seem to have a certain inevitability about them, at least when examined with hindsight. The following examples have been chosen to illustrate this idea.

The first example is the outcome of the referendum to leave the European Union realized in the United Kingdom (U.K.), which includes the regions of England, Scotland, Northern Ireland and Wales, on June 23, 2016, which was 52% in favor of what has come to be called “Brexit”. Although polls had predicted that the vote would be close, the actual result came as a surprise to civil society as a whole, as well as the country’s business community, key trading partners, and even leaders of the *Leave* campaign itself.

The second example involves the tourism industry in the Middle East, and in particular in Tunisia and Egypt, both of which were hit hard by the Arab Spring, and are also under considerable ongoing pressure from Jihadist terror. Egypt, for example, was the location of the brutal killing in 1997 of 62 people at Deir el-Bahri

near Luxor. By 2010, however, the tourism sector had moved on and enormous investments had been made in both Luxor itself and also the Red Sea beaches in and around Sharm el-Sheikh – only to see the cycle begin anew.

The third example is from Latin America and focuses on the specific case of the nationalization of Repsol's 51% or YPF in Argentina. After Hugo Chavez came to power in Venezuela, there was a spate of nationalizations in the energy sector in the region and yet Repsol, to some degree, appeared to be taken by surprise by the actions of Argentina's government.

The fourth example is Russia's annexation in 2014 of Crimea and its conflict with Ukraine. What is interesting about this example is that while some international companies had responded to the Russian demand for consumer goods by investing in local production and acquiring local firms, others had not, and relied on importing their products. The renewal of intense geopolitical tension between Russia and the West, coupled with the enactment of international sanctions and Russian countermeasures, have created clear winners and losers.

After looking at the four examples, the last part of this chapter will discuss the common threads that can be seen in these cases, and will return to the question of the role of senior management with respect to such issues.

The idea that this book seeks to put forward is that a deeper understanding of geopolitical risks on the part of a firm's leadership could have made a difference for some of the companies caught up in these events.

Brexit

The United Kingdom joined the European Union (E.U.) in 1973 some six years after its founding and 16 years after the signing of the Treaty of Rome by other European nations in 1957. A first referendum was held in the United Kingdom in 1975 and 66% of voters chose to remain in what was then called the European Economic Community.

Over the next 40 years, European integration proceeded in fits and starts with the landmark Maastricht Treaty of 1992 bringing a single European market into being and calling for additional integration of the different member countries. This included open immigration, common borders, and a common currency, the Euro, which was introduced in 2002.

The United Kingdom did not participate in the open border policy or the currency union but was bound by a number of the other measures enacted by the European government in Brussels.

From the point of view of business and the economy, most experts agree that being part of the European project has been of tremendous benefit to Britain. The country's industry and business leaders were overwhelmingly supportive of the *Remain* campaign. These same leaders, however, appeared to take it for granted that the country would vote to stay in the EU despite opinion polls in the months leading up to the vote indicating it was too close to call.

Big businesses finally took last-minute steps to redouble their efforts in the weeks before the vote to make the positive case for *Remain*, but by then the messages of the *Leave* campaign had taken hold in the minds of enough voters to swing the vote toward *Leave*.

After the vote world stock markets lost an estimated \$2 trillion of their value as they reacted to the news. U.K. companies were the hardest hit with Virgin Group, for example, losing a third of its value.¹ The Pound was also affected, dropping to a 31-year low against the U.S. dollar the day after the vote.²

What is striking about the Brexit story, and the belated response in support of *Remain* by business leaders, is that they did not appear to see it coming and seem to have been very ill-prepared for the result.

In hindsight the possibility that *Leave* could win seems obvious. For the last few years Nigel Farage, the flamboyant leader of the

1. See Lash, E., & Krudy, E. (2016). World stocks tumble as Britain votes for EU exit. *Reuters*, June 24; Holden, M. (2016). Branson says Virgin Group loses third of its value after Brexit. *Reuters*, June 28.

2. Lash, H., & Krudy, E. (2016). World stocks tumble as Britain votes for EU exit. *Reuters*, June 24.

United Kingdom Independence Party (UKIP), had been constantly attacking Europe from his seat in the European Parliament and was particularly critical of Europe's handling of the Syrian refugee crisis and the perceived negative impacts of Germany's initial response to allow a massive influx of refugees for humanitarian reasons.

Another highly entertaining politician, former London Mayor Boris Johnson, was also very active in the *Leave* campaign and, while much of its claims were highly exaggerated or factually incorrect, they did play on a sense in the electorate that the country was out of control and that the U.K. was rapidly becoming a multicultural entity – a concept with which many people were very uncomfortable.

Deep-rooted attitudes about British sovereignty, and nostalgia for the “lost” Empire, became mixed up with dubious statistics and genuine resistance against immigration to produce the end result. Although it will take years for the details of Europe's exit to be worked out, the immediate impact on businesses and the business climate has been very negative.

From a deeper perspective, it should come as no surprise that Britain finally decided to leave the E.U. Since Roman times Britain has been separate from the rest of Europe and its governments have resisted many aspects of European integration since the very beginning of the project in the 1950s.

The UKIP was founded in 1991 in response to the Maastricht Treaty which the Party felt was going too far in terms of a potential loss of sovereignty. As integration continued to advance, and the mechanism of the European government became increasingly slow, bureaucratic and complex; a growing number of politicians from the Conservative Party (colloquially known as “Tories”) joined the Eurosceptic camp.

What is interesting is that an eventual exit, in 2016 or whenever, was apparently contemplated seldom, if at all in business circles. If British industry had carried out detailed scenario analysis of what its exit from the European Union would mean, then they would likely have shown more vigorous support for the *Remain* campaign and, perhaps, the result might have been different.

The Arab Spring and the Tourism Business

Starting in Tunisia at the end of 2010, a series of protests and demonstrations rocked the Arab world, eventually bringing about changes of government in Tunisia, Egypt, and Libya; the civil war in Syria, and different levels of protests and civil unrest in more than a dozen other countries in the region.

When it erupted, the wave of protests caught the international community and business world by surprise, despite the fact that tensions in each of the countries affected were well-documented and had been discussed at length in the press as well as the intelligence community.

In Tunisia, where the initial spark took place, unemployment amongst the country's youth, many of whom were university graduates, was over 30%³ due to the global economic crisis. In addition, people were angry about the outrageous behavior and corruption of President Ben Ali and his wife's family.

Tunisia's founder, Habib Bourguiba, had controlled Islamic fundamentalism and placed economic growth at the center of his agenda for many years, creating one of the most liberal and prosperous Arab countries. His successor, Ben Ali, followed the same path until greed and corruption came to dominate his agenda.

In Egypt, President Hosni Mubarak had become increasingly violent and arbitrary in his decisions over his 30 years in power. With about 25% of the Egyptian population living in poverty,⁴ people who knew the country well such as the English journalist John Bradley⁵ felt it was only a matter of time before the situation blew up.

According to Bradley, authoritarian governments in many countries in the region systematically protected elites and people close

3. Haouas, I. (2012). Youth unemployment in Tunisia: Characteristics and policy responses. *Topics in Middle Eastern and African Economies*, 14(September), 395–415.

4. Central Intelligence Agency. (2016). Egypt. *The World Factbook*. Accessed in January 2017.

5. Bradley, J. (2012). *After the Arab spring: How Islamists hijacked the Middle East revolts*. New York, NY: St. Martin's Press.

to the ruling family, while also supporting radical Islam and ignoring the aspirations of civil society.

When economic problems developed as a result of the worldwide financial crisis and other factors, the situation came to a head, provoking first protests and then upheaval. The wave of unrest that swept the region caused in turn further negative economic impact which hit the bottom lines of many organizations that had invested in these countries.

Egypt's tourism business, in particular, took an enormous hit with the number of foreign tourists dropping from approximately 15 million per year prior to the revolution to just over 9 million today. International companies such as Hyatt, Accor, The Four Seasons, etc. had spent hundreds of millions on new resort complexes in Luxor and Sharm El Sheikh, only to see occupancy rates drop to single digits in some cases.

Across the region companies which had won contracts with the ruling parties and/or made significant investments were forced to scramble to make sure their expatriates and local people were safe and that their assets would be protected.

In Syria, an unprecedented drought that began in 2006 had impoverished the population and converted much of the country into a dustbowl. As the Arab Spring spread from country to country in 2011, Syrians took to the streets asking for relief. When the government responded with a fierce crackdown, the country eventually descended into a brutal civil war. The war has dragged on for five years, killed approximately 450,000 people,⁶ driven millions more out of the country, and devastated the economy.

In October 2015, a terrorist bomb destroyed a Russian airliner as it left Sharm El Sheikh airport killing all 244 people aboard, allegedly in response to Russia's active support for the Syrian government. The attack caused international airlines to suspend traffic to Sharm El Sheikh, further damaging the region's tourist industry, which had only just begun to recover from its collapse in 2011.

6. Syrian Observatory for Human Rights. (2016). *About 450 thousand were killed and more than two millions were injured in 69 months of the start of the Syrian revolution*, December 13.

The region's tourist industry had already been affected in 2015 after two attacks targeting tourists occurred in Tunisia. The first was in March when the Bardo National Museum was attacked and 22 people killed, and the second in June 2015, when a lone gunman spent almost an hour shooting tourists on the beach in Sousse, killing 38.

While the geopolitical fallout from the Arab Spring and ongoing civil war in Syria will be discussed in some depth in Chapter 10, the idea that something was bound to happen in Egypt and other places across the region back in 2010 seemed likely.

What is most striking about this example, however, is that only a few years after the Arab Spring, the industry had gone back to business as usual until the next wave of attacks struck in 2015.

Repsol and YPF

In February, 1999, Hugo Chavez was elected President of Venezuela and his election was followed by the election of Néstor Kirchner in Argentina in May 2003 and Juan Evo Morales Ayma in Bolivia in January 2005.

Echoing past leaders such as Argentina's Juan Perón, these politicians offered a brand of populist nationalism and personal leadership by appealing directly to the have-nots of Latin American society, and promising them a share in their countries' mineral wealth.

After 100 days in office, Morales moved to nationalize Bolivia's oil and gas sector and used increased tax receipts to bolster the country's social services. In 2007, Chavez followed suit and nationalized majority stakes in the assets of international oil and gas companies including Total, Satoil, ExxonMobile, and ConocoPhillips operating in the Orinoco oil basin after having already nationalized the telecommunications and energy industries.

In Argentina, Néstor Kirchner had inherited a crushing \$84 billion debt from his predecessor Carlos Menem. After first failing to reschedule the debt, he went on to unilaterally exchange it for new bonds leaving the country's creditors with few options. After his

death in 2010, Kirchner was succeeded by his wife, Cristina Fernandez de Kirchner, who followed her husband's populist policies and made a similar bonds for debt exchange during her first year in office.

Repsol was formed in 1997 through the privatization of the energy sector in Spain and moved to increase its international prestige and overall size by the acquisition of three companies in Argentina – including YPF which was formerly state-owned and had been privatized in 1995.

The move was part of a pattern of large Spanish companies moving into Latin America in the banking, telecommunications, and energy businesses. The compelling logic, which will be discussed further in Chapter 2, was that international companies need to acquire scale to compete in the global market. For the largest companies in Spain, Latin America offered a logical choice due to language and cultural affinity as well as a perceived regional competitive advantage with respect to their European competitors.

The new entity, Repsol YPF, became the 10th largest oil company in the world. It then merged its three holdings and controlled half of the country's gasoline stations, and 50 and 60% of its oil and gas production respectively.⁷

After the election of Néstor Kirchner, relations between Repsol and Argentina began to break down after the President raised taxes on what had become the country's second largest company. As oil prices rose around the world, Kirchner's government placed price controls on Repsol in the Argentine market and there were reports that the company was selling gas to its subsidiary in Chile at below market rates to avoid paying Argentinian taxes.

In 2011, Argentina ended up being a net importer of oil and Repsol was accused of deliberately reducing production. The perception was that Repsol and its partners had chosen to take YPF's profits as dividends rather than reinvest them in Argentina and the development of the country's energy industry.

7. Vedavalli, R. (2007). *Energy for development: Twenty-first century challenges of reform and liberalization in developing countries*. London: Anthem Press.

In April 2012, Ms. Kirchner's government expropriated 51% of the company taking only shares owned by Repsol and describing the move as in the "national interest". The purpose of discussing the YPF nationalization is not to try to argue either side of the case but to underline the indignation and dismay felt in Madrid when the announcement was made.

For Repsol, YPF was the key to its strategy in Latin America and it was using YPF to finance the company's regional expansion plans rather than further increasing its exposure in Argentina.

In his letter to shareholders published in 2012, Repsol Chairman Antonio Brufau refers to the nationalization as "the seizing of our 51% of YPF by the Argentine Government",⁸ and proceeded to use every legal and political instrument available to fight the move, until finally agreeing on a \$5 billion valuation and payment in 2014 for the stake.

Company executives in Argentina, however, are reported to have been resigned to the move and more or less expected it. The Argentine government had made similar moves before, for example expropriating Aerolíneas Argentinas in 2008, which it felt was being mismanaged by the Spanish travel group Marsans, which was at that time in control of the airline.

The renationalization of YPF had also been widely expected in Peronist circles and reported in the Argentine press so its expropriation should have come as no surprise to the company's leaders in Madrid.

Russia, Crimea, and Ukraine

Between 2000 and 2013, the GDP per capita in the Russian Federation grew from under \$1,800 to over \$15,500⁹ creating a boom in consumer spending and causing international exports to Russia to increase across the board. In 2013, European Union exports to Russia were in excess of €115 billion and included

8. Brufau, A. (2012). Carta del Presidente Ejecutivo. *Repsol: Informe Anual 2012*.

9. <http://data.worldbank.org>, accessed in January 2017.

machinery, cars, chemical products and medicines, electronics, and agricultural goods.¹⁰

In the agricultural sector, Russian imports of food products had grown from approximately \$7 billion in 2000 to almost \$40 billion in 2012, with about a third of that coming from the European Union.¹¹ Large international food companies reacted in different ways to the trend with some, such as Danone and Pepsico, making increasingly important investments in Russia, and others choosing to export from their home countries.

Danone first came to Russia in 1992 and gradually built a strong business in the country and then increased its market share sharply in 2010 by merging its local subsidiary with Unimilk, one of the leading Russian companies in the arena.

The relationship with Pepsico and Russia goes back to a famous photograph of Nikita Khrushchev drinking a Pepsi at a trade show in 1959. In 1972, Pepsico agreed to a barter deal exchanging Pepsi brand soft drinks for Stolichnaya vodka and in 1974 the company opened its first bottling plant in Russia which was, according to Pepsi, the first Western consumer product sold in the then Soviet Union (U.S.S.R.).

Like Danone, Pepsico built its Russian business steadily for many years and then acquired two thirds of Wimm-Bill-Dann, another dairy company – which also had a juice business – in 2011. The \$3.8 billion acquisition was the largest in Pepsico's history outside of the United States and made it the largest food and beverage company in Russia.¹²

The logic of both deals was the increasing purchasing power of Russian consumers and the projection that the Russian dairy market would continue to grow in double digits for the foreseeable future.

10. Directorate-General for Trade. (2016). European Union, Trade in goods with Russia. *European Commission*.

11. Wegren, S. K. (2014). Russia's food embargo. *Russian Analytical Digest*, 157(December), 8–12.

12. Geller, M., & Kiselyova, M. (2010). Pepsi sweet on Russia, in \$3.8 billion WBD deal. *Reuters*, December 2.

A number of European food companies such as Finland's Valio and Atria, as well as Denmark's Crown, enjoyed spectacular sales growth in Russia but chose to pay the tariffs and logistics cost and continued to import rather than invest in local production.

Farmers in countries such as Poland and Spain also enjoyed access to the Russian market through cooperatives and importers.

While the tensions between Russia and Ukraine go back to the collapse of the former Soviet Union and beyond in historical terms, the latest series of problems can be traced back to the protests which erupted in the Euromaiden square in Kiev in late November 2013. Much of the protesters' anger was directed at the President of the country, Viktor Yanukovich, who fled to Russia in late February 2014 after 82 people were killed and thousands injured by security forces.

The events in Kiev triggered a Russian response in Crimea which had been ceded to Ukraine in 1954 by former Russian Premier Nikita Khrushchev, but still served as the base for the Russian Black Sea fleet and also had a significant Russian minority population.

Over the next week thousands of unidentified Russian soldiers occupied Crimea and, subsequently, the Crimean parliament voted the leader of the relatively obscure pro-Russian party as its new Prime Minister. He then went ahead with a referendum in May resulting in the province leaving Ukraine and becoming part of Russia.

In the United States and Europe, the takeover of Crimea was seen as naked aggression on the part of Russia and economic sanctions were declared to protest the action. In the months that followed, war broke out between Ukraine's new government and separatist militias in the Eastern Provinces of the country which had risen up to also demand their independence from Kiev and allegiance to Moscow.

Russia supports these militias, who – it is widely believed – shot down Malaysian airlines Flight17 killing all 298 people aboard in July 2014. As a result of the conflict, additional sanctions were placed on Russia, which then retaliated with a number of counter-sanctions against Western interests including a ban on

imports of specific agricultural products including meat, dairy, and fruits and vegetables.

The impact of the counter-sanctions on European food exporters has been catastrophic and, while alternative markets have been found for much of the produce, producers maintain that prices have collapsed in certain categories affecting large companies as well as small farmers and cooperatives.

During the 12 months ending in August 2015, when the counter sanctions were extended, for example, Russian imports of the agricultural products dropped to €6.3 billion from €11 billion in the previous year.¹³

The sanctions, on the other hand, do not appear to have caused much trouble for either Danone or Pepsico as most of their products are made in Russia and thus not affected by the ban.

There is, however, some evidence of political opposition to both companies from government officials such as Russia's agricultural minister, Nikolai Fedorov, who made a statement in November 2014 questioning the integrity and safety of their products.

In April 2015, President Putin himself promised to look into the claims from small farmers that they were not being treated fairly by large firms such as Danone and Pepsico and, looking ahead, both companies must be concerned about their long-term prospects in Russia.

Fiduciary Responsibility and Geopolitics

In different parts of the world companies are structured and owned in different ways. There is, however, almost always some governing entity to which the management of the firm reports which is responsible for its medium- and long-term future and this will be referred to as the Board for the purposes of this book (see [Box 1](#)).

13. Szczepański, M. (2015). Economic impact on the EU of sanctions over Ukraine conflict. *European Parliamentary Research Service*, October.

Box 1: The Board of Directors

In the United States, the Board of Directors is the body that represents the interests of the shareholders of the company. In the United States and the United Kingdom it is quite common for a firm to be widely-held by thousands of shareholders and without any particular person, company, or financial institution owning a majority or anything close to it.

This arrangement is, however, quite exceptional around the world¹⁴ and the practice of corporate governance varies from country to country.

Germany, for example, has a two-level structure with key senior managers of the company being members of the *Vorstand* or Management Board. Shareholders, union officials, and government representatives make up what is called the Supervisory Board to which the *Vorstand* answers.

In Asia, it is common for wealthy families to build pyramid structures such that they own an investment company which in turn has significant percentages of banks and industrial firms which own shares of yet more firms. The net result of these cross holdings is to give such families control over significant parts of their country's economies.

Companies are also owned by banks in some parts of the world such as in Spain, the government or even the military in others such as China, and even by the King, as in the case of Saudi Arabia. In other countries the President or members of his or her family own significant shares of large corporations and in some cases this was the result of privatization processes of dubious transparency.

In virtually all cases, however, there will be some groups of people who get together on a regular basis to talk about the strategic direction of the company. For the sake of convenience this body will be called the Board and person running the business on a day-to-day basis the Chief Executive Officer or CEO.

Normally a CEO is a member of the Board which is run by a Chairman although in some cases individuals play both roles. The relationship between a CEO and the Board of a particular company depends on its ownership structure, its location, the type of activity it is engaged in, and even the personalities of the people involved.

14. Morck, R. (Ed.). *A history of corporate governance around the world*. Chicago, IL: University of Chicago Press.

There is also a number of academic, legal, and practitioner-oriented material on this topic which explores the nuances mentioned above. One such set of recommendations was made by a Task Force put together by the Conference Board in 2013.¹⁵

That panel suggested that although the “ultimate goal of a public corporation is to maximize shareholder value,” the Board has three key tasks:

To ensure that the company is sustainable over time and that all of its stakeholder’s interests are taken into account.

To manage itself such that it provides sufficient oversight.

To appoint and monitor the performance of the CEO.

Fulfilling these and other legally determined functions such as those defined by the Sarbanes–Oxley legislation in the United States are normally referred to as the board fulfilling its fiduciary responsibilities. Board members who do not fulfill such obligations can face criminal prosecution in some jurisdictions.

A key issue is what is the appropriate time frame for such thinking and, while there has been a tendency for taking a shorter-term view in Western public companies over the last few years, there is increasing interest¹⁶ in increasing the time frame and some companies, such as Unilever, explicitly plan on a 10-year time horizon.

Another way of defining the role of the Board is that it must approve the strategic direction of the firm and look in depth at strategic issues. Strategic issues are those that have a material impact on either the medium- and long-term viability of the firm and/or its basic size and scope in terms of geographies and market segments. Strategic issues can be differentiated from operational questions, which, while important, do not pass such a test.

15. The Conference Board. (2014). Governance Center White Paper.

16. www.fcltglobal.org, accessed in January 2017.

The main theses of *Strategy and Geopolitics* is that issues of sovereignty, war, peace, and radical political upheavals can affect a number of strategic issues for a firm in a specific country or region of the world. When such events happen companies can lose overnight their legal and social license to operate, have their assets confiscated or nationalized, and can even have their people's lives put in jeopardy.

Because of the strategic importance and potential impact of geopolitical issues, one of the themes of this book is that they belong on the agenda of the Board of Directors.

Common Threads

The four examples shown previously all include elements of how such events can affect strategic issues for specific companies and sectors. Common threads include deep links between the history of the different regions and the examples raised, the economic importance of the events themselves, and a spatial or geographic aspect which business leaders and the general public use to make sense of the changes they see.

The first common thread has to do with the underlying logic for geopolitical change being deeply connected to a region's history and its politics. To get ahead of such trends requires an in-depth understanding of the country or region.

The history of England and that of Europe has certainly been linked, but the U.K.'s separateness and aloof relationship with the continent has been a feature of English history since Roman times. From a historical perspective, the truly revolutionary idea was that the U.K. would fully integrate with the European Union in the first place!

An understanding of the motivations behind the Arab Spring and Jihadist terror requires some familiarity with the origin of many of the Arab countries after the first World War and the complex internal politics that have led each country to its current form of government.

In a similar vein, the populist tradition in Argentina and Latin America runs deep as does the nationalist fervor that fuels such

movements. Latin America's colonial past with Spain also played a role both in the entrance of Spanish companies into the region also the push-back that some, such as Repsol, have since received. Finally, the situation in Ukraine is also largely driven by Russian history going back to the Crimean War, fought in the 1850s.

The second common thread is the economic importance of each of the four examples mentioned above and the role that economic issues have in such events. While the immediate impact of the Brexit vote was severe, the long-term impact is still to be determined.

While the Arab Spring has elements of Islamic fundamentalism and also a genuine desire for more freedom of expression by some parts of the population, most analysts agree that the primary motivation behind the protests was the economic frustration felt by an important part of civil society combined with the perceived corruption of the ruling elite.

Much of the rise of populist movements in Latin America also had to do with marginalized classes pushing for a bigger slice of the pie and, in the specific case of nationalizing energy assets such as YPF, it was the perception that Repsol was taking unfair advantage of the natural wealth of Argentina that justified the operation in the eyes of the public.

The protests in Euromaiden in Kiev were also driven to a large extent by the economic desperation of average Ukrainians and the perception that President Yanukovich had taken corruption to a new level. Russia's annexation of Crimea can also be understood in economic terms as the importance of the Black Sea region to Russia's economy as a whole. Another aspect of the Ukrainian crisis is that Russia needs Ukraine to be able to transport natural gas to the West and, while a new pipeline has been built to the north of the country, it has nowhere near sufficient capacity and the new southern streams are years away from completion.

The last common thread is the link between these types of events and the underlying geography of the regions and a certain spatial understanding of the world. The U.K. has always been separated from Europe by the English Channel and the

North Sea. The Arab Spring was seen to jump from country to country across North Africa and the Middle East like a virus. Likewise, there was a moment when it seemed that populist governments would dominate South America or that governments closer to Europe and NATO would “encroach” upon Russia’s traditional sphere of influence.

Seeing geopolitical events in a spatial context and providing a story line that links them together is called geopolitical discourse and will be discussed in more depth in Chapter 3.

What to do?

The purpose of highlighting geopolitical risk is not to argue for inaction and encourage firms to shy away from the opportunities that international expansion bring. In fact, as will be discussed in Chapter 2, such expansion is a strategic imperative in many business sectors.

In business, reward always comes with risk and the job of Senior Management is to mitigate such risks and to develop sound strategies for dealing with them if and when the need arises. Thus the essential idea of *Strategy and Geopolitics* is to deal with such risks head on and in an informed way, so that sensible strategies can be carried out and organizational models be developed which can best serve to protect a firm’s medium- and long-term interests.

The basic idea is not to be taken by surprise by such events and to avoid some of the pitfalls that have led Senior Management to miss such tectonic shifts. Those pitfalls are discussed at some length in Chapter 2 and a geopolitical framework for business presented in Chapter 3.

Chapter Summary

- Geopolitical events such as wars, revolutions, and economic sanctions can have a huge impact on business.
- When such events happen, business leaders are often caught off guard without having foreseen them or developed contingency plans.
- These events, however, are almost always the results of underlying geographic, historical, and economic trends that are well known to specialists and security analysts.
- Business leaders would be well-advised to increase their understanding of the geopolitical issues that are connected with the countries and territories in which they operate.
- Not engaging with geopolitical issues can set a company up for being taken by surprise and could be understood as fiduciary negligence.

Recommended Reading

Shipman, T. (2016). *All out war: The full story of how Brexit sank Britain's political class*. William Collins.

Bradley, J. (2012). *After the Arab spring: How Islamists hijacked the Middle East revolts*, St. Martin's Press.

Ostrovsky, A. (2016). *The invention of Russia: From Gorbachev's freedom to Putin's War*. Viking.