

Geostrategic risks on the rise

In a new survey on globalization, the share of executives identifying geopolitical instability as a very important business trend has doubled in two years.

Executives are likelier than ever to believe that geopolitical and domestic political instability will affect global business and their own companies in coming years, according to the newest McKinsey Global Survey on globalization.¹ In two years' time, the share of respondents identifying geopolitical instability as a very important factor affecting their businesses has doubled—the largest increase for a given trend since we began surveying executives on this topic a decade ago.

Most respondents expect that geopolitical, political, and macroeconomic instability—which, taken together, we call geostrategic risks—will affect their companies, with decidedly negative implications for profits. Yet a vast majority say their organizations are not yet taking active steps to address these issues. They also say that among the other trends that have risen in importance since the previous survey, technological developments present their businesses with both challenges (such as cybersecurity) and opportunities (such as the use of big data and data-driven management techniques).

An uncertain world

This year's results suggest an even more fundamental shift in the way executives and their companies view globalization. Over the next five years, nearly all respondents expect a disruption in the global economy



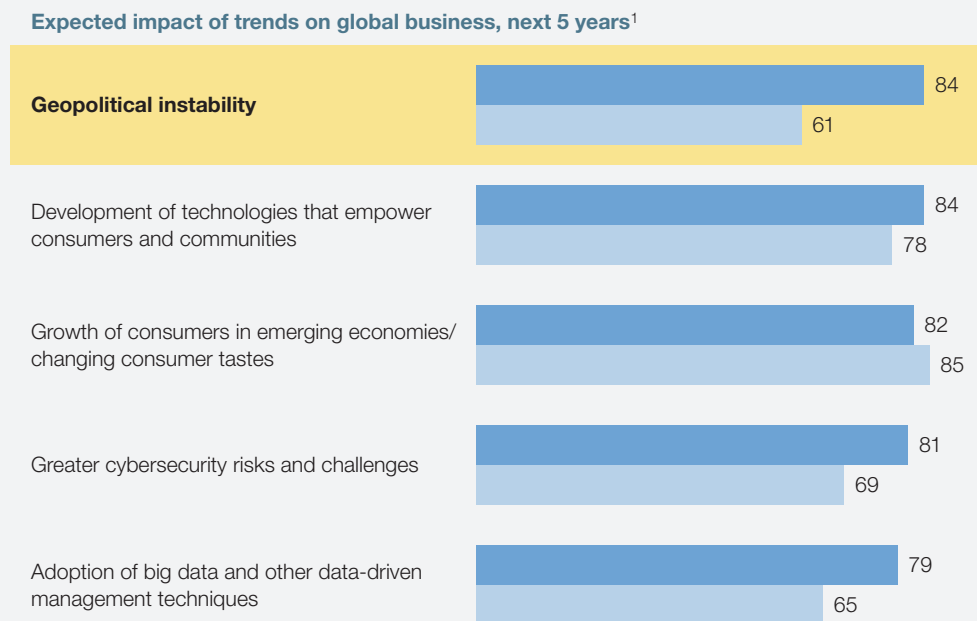
due to volatility. And they are much likelier now—43 percent, up from 29 percent in 2013—to expect that potential disruptions to the economy will be very severe. This is a greater share even than those who expected very severe disruptions in 2010, in the wake of the global financial crisis.

Equally striking is the impact that executives anticipate from rising geopolitical instability, one of two trends that respondents most often believe will have an effect on global business in the next five years. Eighty-four percent of executives (and the largest share in the survey’s history) now believe geopolitical instability will have an important or very important impact on global business, up from 61 percent previously (Exhibit 1). Forty-nine percent cite this trend as very important, more than doubling the share (23 percent) who said the same two years ago. Indeed, geopolitical instability is now just as

Exhibit 1 Respondents increasingly expect geopolitical instability will have an effect on global business.

% of respondents who say each trend is “important” or “very important”

■ 2015, n = 1,316
 ■ 2013, n = 1,393



¹ Out of 13 trends the survey asked about.

important as trends that have ranked highest in previous surveys, such as the growth of consumers in emerging economies (cited most often as an important trend in the past five surveys) and consumer-empowering technologies. Domestic instability, too, is increasingly top of mind: two-thirds cite domestic political instability or gridlock (up from 57 percent previously) as an important or very important trend.

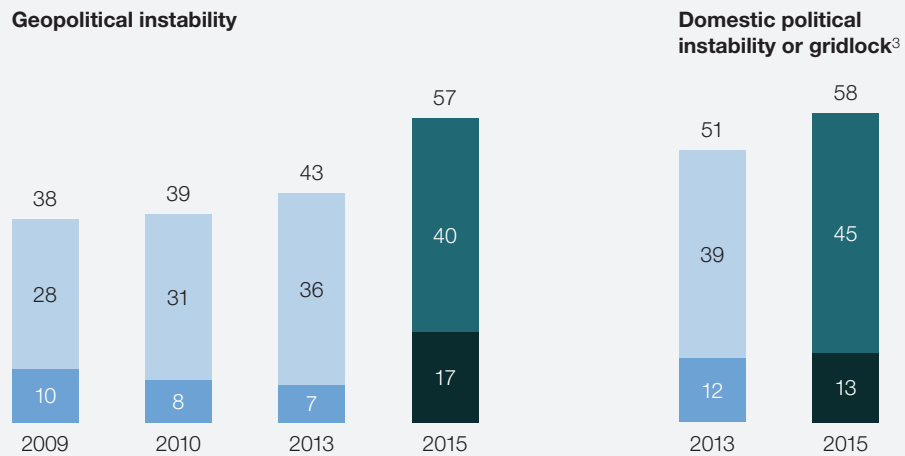
What’s more, executives are likelier than ever to believe that political instability, both at home and abroad, will hurt their companies’ profitability (Exhibit 2). Among the 13 trends we asked about, respondents most often expect that domestic political instability, as well as slowing growth in developed economies, will pose a threat to profits in the next five years.

Exhibit 2 Executives are likelier than ever to believe that political instability—abroad and at home—will hurt company profits.

% of respondents¹

■ Somewhat negative
■ Very negative

Expected impact of trends on company profitability, next 5 years²



¹ 2009, n = 1,088; 2010, n = 1,416; 2013, n = 1,393; 2015, n = 1,316.

² Respondents who answered “neutral,” “somewhat positive,” “very positive,” or “don’t know/not applicable” are not shown.

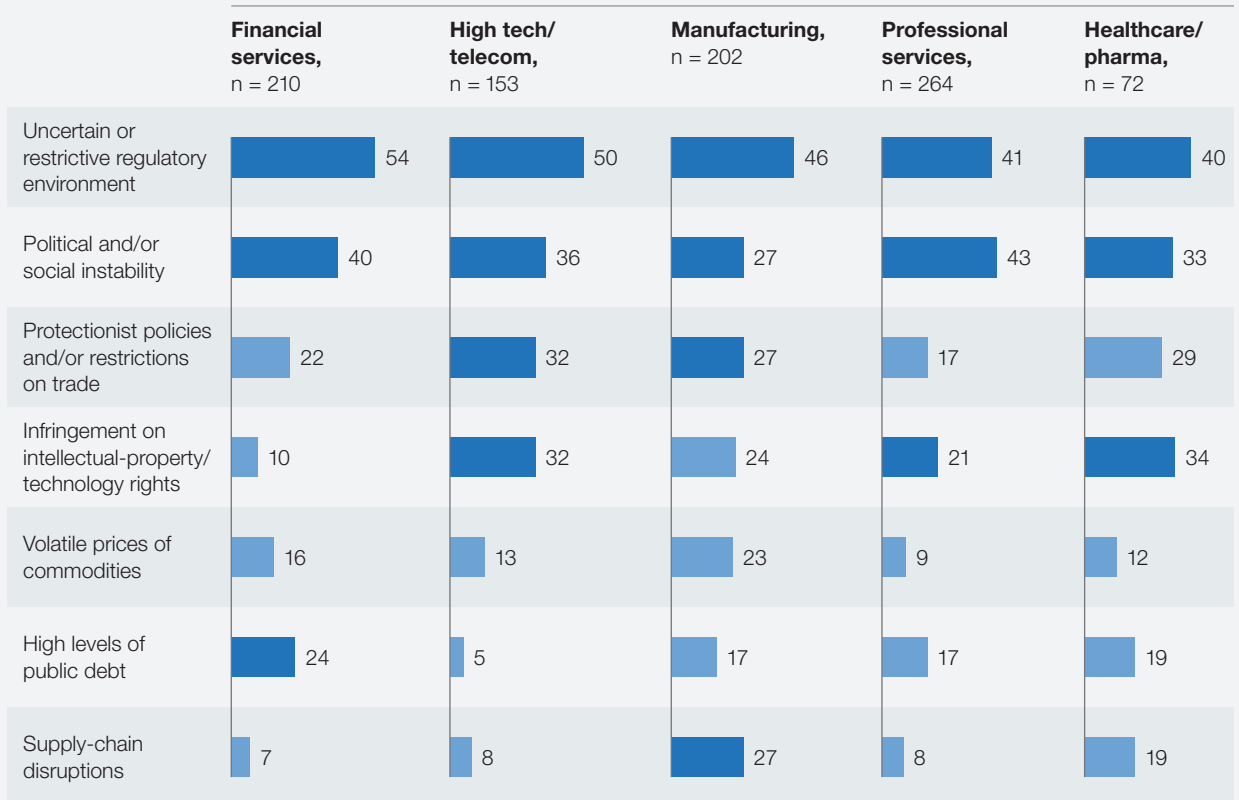
³ This trend was first offered as an option in the 2013 survey.

Exhibit 3 Concerns about specific political and geopolitical risks vary by industry.

% of respondents, by industry

■ Top 3 risks by industry
■ All other risks

Political and geopolitical risks that will most affect organizations in countries where they operate, next 5 years¹



¹ Out of 13 risks that were presented as answer choices. Risks are arranged in descending order, based on the total-level responses to the question.

When respondents were asked about specific political and geopolitical risks, their biggest concerns vary by industry (Exhibit 3). An uncertain or restrictive regulatory environment, cited most often by all respondents, is an outside concern for executives in financial services and in high tech and telecommunications. Political and social instability is, on average, the second-most-cited concern. But those in healthcare and pharma and in manufacturing are somewhat less concerned than their peers.

Inaction on geopolitical risks

Despite the growing focus on political and geopolitical uncertainties, most respondents report that their organizations haven't done much to tackle these risks. Compared with 2013, a greater share now say it is very or extremely important for their organizations to understand these risks. Furthermore, nearly two-thirds of executives say their organizations view geopolitical and political risks as more or much more important than they did five years ago. Yet less than one-third of executives say an understanding of these factors is extremely or very well integrated into overall strategy—and only 13 percent say their companies have taken active steps to address the risks from either geopolitical or domestic political instability (Exhibit 4).

Exhibit 4 Few executives say their companies have taken steps to address geopolitical or political risks.

% of respondents,¹ n = 1,316

Trends that respondents' organizations have taken active steps to address



¹ Respondents who answered "none" or "don't know" are not shown.

By contrast, companies are most likely to have taken action on technology trends: big data, technologies that empower consumers, and cybersecurity. Since the last survey, cybersecurity is the trend where respondents report the biggest increase in action taken.

The inaction on geostrategic risks may owe to the fact that, since 2013, many companies haven't made much progress in developing capabilities or processes to manage the uncertainties that respondents foresee. Executives aren't any likelier now than two years ago to say political and geopolitical risks are well integrated into their companies' overall strategies. This may be because companies tend to evaluate these risks using methods that executives believe are less effective, and they are least likely to use the methods executives consider most effective. On the one hand, ad hoc methods—internal analyses or dialogue with external experts—are the most common approach, cited by 43 percent of respondents (Exhibit 5).

Exhibit 5 The most popular methods for addressing geostrategic risks are often the least effective, according to respondents.



¹ Respondents who answered “none” or “don’t know” are not shown.

² Respondents who answered “somewhat effective,” “somewhat ineffective,” “very ineffective,” or “don’t know” are not shown. This question was asked only of respondents who said their organizations were currently using each method.

Yet just 29 percent of executives rate ad hoc internal analyses as very effective. On the other hand, executives are least likely to report the use of comprehensive scenarios, the approach they most often see as very effective.

The double-edged sword of technological trends

Although political and geopolitical issues now take precedence, they're not the only trends that have risen in importance in the past two years. Executives are increasingly aware, too, of the impact that technological developments could have on global business and on their companies' profitability. There are two sides to these technology trends, which represent both challenges and opportunities for companies in the years ahead.

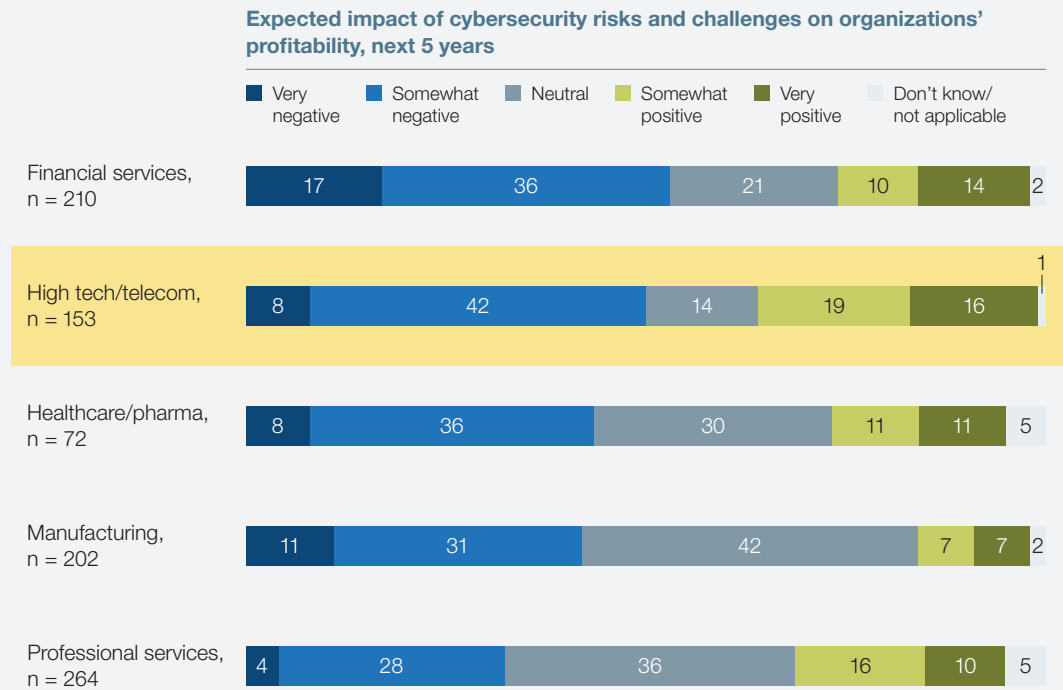
Cybersecurity is one such challenge. Roughly eight out of ten executives say greater cybersecurity risks will have an important impact on business in the coming years, citing this risk most often after geopolitical instability and the development of consumer-empowering technologies. Nearly half of respondents, up from 34 percent two years ago, now rate cybersecurity as a very important trend.

While most executives tend to believe cybersecurity's impact on company profits will be negative, some hold a different view. Across regions, those in India are the most likely to expect cybersecurity will have a positive effect on their organizations' profitability: 31 percent there say so, compared with 22 percent of the global average. Across industries, respondents in high tech and telecommunications hold the strongest

Representing both challenges and opportunities for companies, technology trends (cybersecurity and big data, specifically) will be among the most important to global business in the coming years.

Exhibit 6 In several industries, executives expect cybersecurity will hurt their companies' profits—though in high tech, views are mixed, and few are neutral on the topic.

% of respondents,¹ by industry



¹Figures may not sum to 100%, because of rounding.

views on cybersecurity's profit potential. They are much likelier than their peers in other sectors to expect either a positive or a negative impact over the next five years, and they are less likely to be neutral on the topic (Exhibit 6).

Big data and data-driven management techniques, in contrast, present a much clearer opportunity for companies in all regions and sectors. The share of executives citing big data as an important trend continues to grow: 79 percent now say so, up from 65 percent two years ago and 47 percent in 2009. With respect to profitability, big data is one of the two trends about which respondents express the most optimism. Along with technologies that empower consumers and communities, 68 percent of respondents believe it will have a positive impact on company profits.

The good news is that, according to respondents, many companies have already taken action on each of these technology trends. More than half of executives say their companies are addressing the adoption of big data and data-driven management techniques; majorities also say the same about cybersecurity risks and about technologies that empower consumers.

Looking ahead

- *Get ahead of risks.* While geostrategic risks are complex issues—and may be outside the comfort zone of many executives—they are not fundamentally unknowable or unmanageable business problems. They could even be a potential source of competitive advantage for companies that develop better capabilities to manage these risks. To stay ahead of geostrategic uncertainty, executives will want to take the following steps: identifying trends and disruptions that are specific to their organizations and markets, assessing the potential market impact of risks across a range of scenarios, developing initiatives to mitigate risks or capture opportunities, establishing a decision-making process that prioritizes initiatives *and* ensures executives are aligned on their implementation, and embedding the capabilities for geostrategic analysis into regular decision-making and planning processes. Executives should also monitor these trends for new developments that would require a reassessment of strategic initiatives.
- *Tackle both sides of the technology coin.* Since our previous survey, more executives have come to understand that there are two sides to the increasing collection and use of data. One is the positive force of big data, which is rapidly redefining priorities and opportunities across sectors, and the other is the growing challenge of cybersecurity. While the exact implications will vary by industry, executives must continue to embrace big data's potential and explore new ways to adopt big data and consumer-empowering technologies. Cybersecurity's effects also vary across sectors, but its prominence in the latest survey underscores that security must be a default mind-set for all executives, regardless of what business they're in. While companies tend to guard their technological expertise (and their vulnerabilities in particular), an important way to confront the cybersecurity challenge is collaborating with other companies—even their competitors—by reporting breaches, identifying common trends and technological weaknesses, and sharing best practices on how to address them. ■

¹ The online survey was in the field from November 3 to November 13, 2015, and garnered responses from 1,316 respondents representing the full range of regions, industries, company sizes, functional specialties, and tenures. To adjust for differences in response rates, the data are weighted by the contribution of each respondent's nation to global GDP.

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