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Voice of the CFO

Navigating Geopolitics: Uncertainty and Instability

Geopolitics compels CFOs to de-risk and retool businesses and supply chains, amid traditional end-of-year CFO tasks

Senior analysts with Eurasia Group's Global Macro-Geopolitics practice—Ali Wyne and Graeme Thompson — provided a group of chief financial officers (CFOs) convened by KPMG with an overview of the current geopolitical environment. While there was discussion of the Russia-Ukraine war and the Israel-Hamas war, the emphasis was China. Wyne stressed that the end of 2023 presents a level of tremendous uncertainty and systemic instability not seen since the end of the Cold War, while Thompson noted that the US/China dynamic is the biggest driver of increasing economic instability. Specifically, growing risks with China will impact supply chains, contribute to an evolving or rewiring globalization, and alter China's market potential.

Editor's Note: These comments reflect a discussion held on two separate occasions in November 2023. Our perspectives, as well as perspectives shared by representatives of Eurasia Group, may change given the fluid and evolving geopolitical environment.

De-risking, not decoupling

It is a popular view in the US media that nations around the world should consider decoupling or disengaging from China. Wyne explained that it would be difficult to do so given China's deep integration into the global economy, noting that China is still the largest trading partner for over 120 countries.

The CFO of a logistics provider spoke for many. "China is a big market for us, and we have been there a long time. We have a fair amount of dependence that we are trying to protect ourselves from so our supply chains are more resilient."

At least one CFO has ties to China that span decades. The CFO of an international energy company said, "I am also head of our company's risk committee, and we signed deals with an energy company in China that run until 2050."

China's slowing growth

Historically, many companies have focused on doing business with China since it has been a fast-growing market. Wyne said that the era of double-digit growth is over, citing forecasts that China might average between just 2 percent and 3 percent growth through the middle of the century. He views this trend as an opportunity for allies, partners, and middle powers to rely less on China over time.

"If a systemic slowdown materializes in China, I think CFOs might be able to reduce their exposure more confidently than they would have otherwise, even as doing so would still take a long time," said Wyne.

For our CFOs, this news does not fundamentally change their companies' direction. The international energy CFO said, "I think declining is possible, but, for companies like mine, China is a big catalyst that will continue to grow." For a computer manufacturing CFO, the challenge with China is twofold: "There is the supply chain dependency, and then there's the revenue stream. We are trying to navigate both simultaneously and we're not alone."

Trouble with region

The Taiwan region is strategically important to the US. The island nation manufactures 90 percent of the most advanced semiconductors. According to the *Economist*, the Taiwan region powers everything from mobile phones to electric cars.[1]

Our CFOs are fully aware of the business impact should the Taiwan region's chip market be disrupted. A computer drive manufacturing CFO said, "If anything disrupts the supply chain, not only will we not get notebooks, we also won't get cars. The hit to the US economy would be devastating."

An auto parts manufacturing CFO took preemptive action when tariffs took effect in 2019. "We moved a lot of our manufacturing to our US or Mexico operations. Some manufacturing was moved to Europe. Our exposure has been greatly reduced."

The rise of supply chain alternatives

Thompson sees China-related risk as an opportunity for other countries to step up. India, for example, "wants to be a free-flowing global power, but the country is also highly interested in strategically balancing against China." Thompson's list for rerouting supply chains includes India, Indonesia, and countries in Latin America. In many cases, countries are making the shift to gain access to alternative sources of critical minerals used in high-tech devices.

For a CFO of a global supplier of equipment technology, Latin America sounds promising but comes with risks. "The security, stability, and political climate in Latin America are getting worse and creating more risk for our employees there, even though we would like to invest more in the region."

"How do we protect ourselves?" queried a CFO of a world leader in supply chain, electrical, and distribution services. "Eighty-eight percent of our revenue comes from the US and Canada. However, serving large technology customers around the world means our suppliers leverage global supply chains, including in Asia." To minimize risk, the company is considering adding terms and conditions to contracts and debating how to protect the asset base employed within each specific market.

2024 planning

While geopolitics dominated the CFO discussion, the calendar had everyone thinking about the year ahead and the need to set budgets and targets and work through compensation issues. For most of the CFOs, uncertainty and instability are the biggest challenges.

A power and utilities CFO put it this way: "From a compensation-setting perspective, we are considering having wider ranges based on the expected achievement of goals next year."

For another CFO, the pandemic years have been good for business. For 2024 planning purposes, they are looking back at 2018 for a more realistic baseline. Other CFOs want the ability to revisit their numbers in the first quarter.

The global supply chain CFO spoke for the group on why planning is critical to avoid disaster. "Depending on how December shapes up, you could be out of money for your new plan. We are making sure we can go back and reframe based on actual results."

A look ahead

Despite geopolitical volatility, Wyne and Thompson stressed that CFOs should keep an eye on the medium and long term.

Carl Carande with KPMG added that there is still time to plan and strategize how organizations can position themselves to lower risk and maximize opportunity as they do business globally within the realms of the current geopolitical environment. Potential approaches could include multicountry cash management strategies, business unit audits, reengineering the supply chain, or a digital transformation plan to present to the board.

[1] "Taiwan's dominance of the chip industry makes it more important", *The Economist*, March 6, 2023

Additional insights

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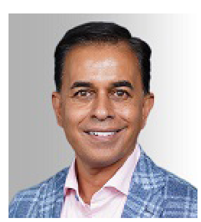

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