# VISION 2016

## WHERE IS THE WORLD GOING?
## **HOW DO WE GET THERE FIRST?**

JAMES HOGE, EDITOR

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*The views and opinions in this book are solely of the authors and do not necessarily reflect those of Teneo Holdings.*

DECLAN KELLY

FOREWARD

# VISION 2016

## Welcome to the 2016 edition of Teneo's annual publication *'Where is the World Going? How do we get There First?'* In the enclosed chapters, our senior team shares their thoughts on the issues that will demand CEO attention in the year ahead.

There should be no doubt that 2016 is going to be a challenging year for the CEO and the teams that work with them. Political change, economic volatility, continued shareholder activism, pressure from outside stakeholders, cyber security and regulatory scrutiny are only a handful of the challenges CEOs will face. Teneo is very fortunate to work with and advise the CEOs of many of the world's largest companies and I can tell you that I have never seen an environment where so much is demanded of CEO time.

It is in our nature to keep score on how our team does with their predictions each year. While we are never perfect, last year our analysts correctly forecasted the heightened volatility that jarred financial markets. We also predicted the continuing rise of activism by institutional investors seeking higher returns. As for the ongoing technology revolution, we explained how social mobility analytics and cloud computing were quickly impacting business practices. On the geo-political level, we rightly focused on the growing political

dysfunction in the U.S., the mounting difficulties in doing business in China, the adversarial turn of relations with Russia and the instability and stagnation that continues to cripple the Middle East. Our hope is that we continue this trend of accurate predictions in this year's book.

As you will read, in the upcoming year we expect that increased polarization will be the distinguishing characteristic of the 2016 race for the U.S. presidency. Sharp differences separate not only the two political parties but also major factions within each of them. On the domestic front, debate will center on the stagnation of middle class wages, the discord over immigration and decaying infrastructure. In international affairs, there will be hot debates over the effectiveness of the U.S. role and the tense, potentially explosive relations with Russia and China. The Syrian civil war and the flight of millions of civilians will tax international organizations and spawn explosive divisions within European publics. Planetary issues — extreme weather, droughts, energy resources will need heightened attention.

As the campaign for the 2016 U.S. elections heats up, it will be clear that both parties are less friendly to business than historically was the case. For its part, Business will be pressing for regulations relief and lower tax rates. In general, Republicans will support those items while taking issue with incentives they consider corporate welfare. Meanwhile, Democrats will be arguing for national initiatives to increase wages, add benefits and strengthen social policies.

What will not change is the disarray in the political system that is Washington and the public's low regard for its ineffectiveness. Regardless of who is elected President, the prospects for divided government remain high. The debate over spending priorities will be ongoing. With neither party assured of a governing majority, the trench warfare in Congress will continue.

Sometimes elections break up stalemates, signal fresh approaches and produce dynamic new leaders who can marshal public support. The hope is that the 2016 election will be one to fulfill such an action agenda. The country and the world needs a well-functioning America.

Companies around the world are also going to need to continue to be vigilant around shareholder activism. A trend that is spreading with increasing intensity from the U.S. to the UK and the rest of Europe. CEOs and Boards need to be their own activist – taking a look from the outside in – ask the tough questions, test assumptions, apply a fresh eye and leverage the skills around the boardroom that speak to determinants of strategy. Companies need to bring in experts when more information or contradictory viewpoints are needed to achieve long-term shareholder returns. Often, companies that are more likely to be a target are actually the ones who are not thinking about the issues soon enough. Boards, with senior management, need to regularly ask themselves: do we have the right strategy based on a review of all strategic options; does our portfolio mix make sense – does our core business support other less profitable segments; are we allocating capital to its highest value; have we built a strategic partnership with the CEO, are we invested in the strategy beyond the traditional "review and concur" model; do investors, analysts, employees, media, customers, suppliers, and other key stakeholders support and understand the strategy? This issue will be on the radar of the CEO of every public company in the world in 2016.

I hope that you enjoy reading this year's book as much as we have enjoyed putting it together. I would like to thank all of those who have made this book possible including all our authors, our Editor Jim Hoge, Alexandra Rogan, Ashley Tagg and Steve Meahl. Our team is always available to answer questions and help in any way that we can. Thank you.

**Declan Kelly**
CHAIRMAN AND CEO, TENEO HOLDINGS

# EXECUTIVE SUMMARIES

GLOBAL

## A Systematically Less Stable World

THE RT. HON. THE LORD HAGUE OF RICHMOND

Because of the information revolution, political movements of great power are arising quickly, without centralized leadership or deliberate planning. While political side effects of the information revolution have many benefits, a digitally-connected world produces changed habits and expectations that provoke unpredictable instability. The nature of change is most explosive when provoked by sustained corruption and mismanagement that is combined with a denial of economic opportunity to young and expanding populations. The disruptive potential of the information revolution is intensified by two other factors: rising religious intolerance in the Middle East and huge divergence in population trends around the world. Population will boom in much of the developing world, particularly in Africa, while sharply contracting in 48 countries, many of them in Europe. The scale of migration and its consequences are likely larger political issues. Several achievements are grounds for some optimism – massive reduction in poverty, growing economic and business advancements in the Middle East and Africa and the expansion of higher education around the global and continuing human ingenuity.

MARKETS AND TECHNOLOGY

## Higher Volatility and CEO Decision Making

JIM SHINN

Last year we predicted that the era of tamed volatility would shortly end. A year after that right call, we envision higher volatility for the next 12 months. The underlying driver of the return to higher volatility in four important asset markets will be the end of quantitative expansion of the Federal Reserve and the Bank of England. For business executives, higher volatility will amplify the risk of a wide range of business decisions. For example, the complexity of investment decisions for firms with a global footprint will be exacerbated by the ‘differential taper,’ that is the turning off QE spigots by the UK and U.S. and the full flowing of spigots in Europe and East Asia.

Listed firms may become more vulnerable to hostile takeovers when they are on the wrong side of a down tick and CEOs could find their compensation and, in some case, their jobs at stake. A premium will be placed on effective strategic thinking.

MARKETS AND TECHNOLOGY

## Are You Ready for a Recession? ROBERT MEAD

A U.S. recession in the next three years is a significant probability. Factors that make this so include China's reduced rate of growth, weak commodity prices, lagging emerging markets, steep financial volatility and flagging consumer confidence. At this juncture, the Federal Reserve finds itself in a dilemma - raise rates too soon and bring on an unnecessary slowdown or hold off and leave itself unable to fully respond to a real downturn. As for corporate CEOs, they should begin planning for a downturn with strategic plans that are aggressive and opportunistic. Those who plan well can emerge from a down cycle as stronger competitors. Strategic planning should become continuous with strong, separate defensive and offensive teams held accountable.

MARKETS AND TECHNOLOGY

## Frontier States: High Risk, High Reward

MICHAEL MADDEN

Frontier states are those that in some way have been inaccessible to developed world investors, but now can offer high returns for those able to approach them. These states, like Mongolia, Myanmar, Cuba and Iran, are able to re-engage the international business community after a series of political and economic reforms re-opened their borders to international investment. The challenges and risks to operating in frontier states are significant. Legal and bureaucratic hurdles can create a long and painful process when establishing and operating a business in a frontier market. On the upside, many of these states have high growth rates low labor costs and large youthful populations with tech educations. Only after intense and thorough on-the-ground research can investors enter and exit profitably. Today's frontier markets are tomorrow's tech hubs.

# EXECUTIVE SUMMARIES

## Cyber Security Threatened LON AUGUSTENBORG

More and more smart devices are connected to the Internet resulting in unprecedented amounts of data that are vulnerable to criminal and intelligence attackers. Criminal cyber attacks are seemingly endless and for the cyber thief very lucrative and comparatively low risk. Politically-motivated intrusions that are potentially dangerous are the most difficult to contain. State actors openly collaborate with criminal elements against a broader range of targets. Compounding the problem is the continuing changes and advances in cyber penetration capabilities. But despite advances in protective cyber technology, the most devastating breaches result from poor security practices by humans. The scope and seriousness of cyber attacks must be met with a variety of efforts, starting with a company's CEO. He or she must have a close working relationship with their company's security and information officials. It is also wise to put in place a 'ready team' and to spend the necessary funds for cutting edge technology. Lastly, ongoing cooperation between public and private entities is critical.

MARKETS AND TECHNOLOGY

## Customer Power of Millennials TIM BURT

Companies are becoming more intimate with their customers, asking them not just for feedback on existing products and services, but to be involved in developing new ones. Companies that engage millennials in the product development process will be more successful, according to a *Forbes* survey. The millennial generation is prized for two reasons: It is in tune with the rapidly changing consumer trends of the digital age. Secondly, millennials will become the purchasing managers, financial controllers or even CEOs determining what to order for their businesses within a few years. The Internet economy is expected to be worth $4.2 trillion by 2016 with the number of connected users nearing $3 billion. The number of competitors for this market will explode and customer service increasingly will be seen as the key point of distinction.

MARKETS AND TECHNOLOGY

## Embracing Reputation at the Board Level

BASIL TOWERS

Boards are shifting from addressing short-term reputation imperatives and risk to focusing on long-term sustainable and strategic reputations. This places a demand on achieving greater sophistication in the make up and capabilities of those sitting around the table. Driving the shift in emphasis is the recognition that reputation is important to building and sustaining competitive advantage. Specifically, it is recognition that reputation is not secured simply by an advertising campaign. Rather it is implied in all aspect of the business, the supply chain strategy, the procurement strategy and lots more. So boards are strengthening oversight, reporting and review. For a majority of boards, this approach is a work in progress. One of the challenges is focused on debating the right balance between existing structures and new ones within the corporation.

MARKETS AND TECHNOLOGY

## Competitive Edge Goes to Companies With Women on the Board

MEGAN SHATTUCK, PAMELA CRAIG, KIMBERLY B. DAVIS

A number of research reports confirm that companies with women and minorities on their boards outperform those that lack such diversity. In 2015, McKinsey confirmed that companies in the top 25 per cent of racial and ethnic diversity were 30 per cent more likely to have financial returns above national industry median. The higher performance of companies with women on their boards is reflected in return on equity, sales and invested capital. Homogeneity among directors too often produces 'group think.' Women board members bring different skills, prepare well and focus on performance of the team overall. Boards are under serious pressure from activists who question whether the right people and skill sets are in place for maximum performance. Gender diversity is among the criteria examined. Yet U.S. businesses are making little progress at bringing more minorities and women into their boardrooms. Gradual transformation

of boards is no longer sufficient. “It is beyond time for boards and corporations to show up with the right team to stay in the game.”

MARKETS AND TECHNOLOGY

## Why CEOs Make Bad (and Great) Decisions

JOHN MCCREADY

For the most part, CEOs make pretty good quality decisions. But there is no way to avoid some bad decisions in the fast-paced, competitive and risk-prone business world. It matters then how mistakes are dealt with. Great CEOs are those who find ways to overcome mistakes. But along with accomplishments, super-smart leaders can slip into pitfalls. Often they do so by overvaluing information that chimes with their thinking and undervaluing that which does not. Another trip wire is overestimating a firm’s capacity and then, for example, making a questionable acquisition. Timing is everything. The right decision at the wrong time can be much worse than the wrong decision at the right time. Star entrepreneurs, like Richard Branson and Rupert Murdoch, are not deterred by bumps in the road. They enter and exit different businesses in search of new revenues with a focus not on a single deal but on the cumulative impact.

POLITICS AND GOVERNANCE

## The Road to China’s Second Reform and Opening Up

PAUL HAENLE

China’s leadership recognizes the need for greater reliance on market forces to sustain economic growth. But last summer’s badly managed market interventions created doubt that the leaders have the political capital to push through painful reforms. They failed to stem the outflow of capital, or give the market a larger role in setting the RMB value, and further undermined confidence in their leadership. Through the difficult economic transition period, Chinese leadership is favoring the state’s dominant role over a consistent embrace of market mechanisms. Yet despite the government missteps and reluctance, some reforms are showing results. If there is sufficient resolve, China will still offer great opportunities for multinational companies over the long term.

POLITICS AND GOVERNANCE

## Geopolitics of Putin

OTILIA DHAND

Putin 's desire to restore Russia as a great power with its own political and economic bloc of near-abroad countries will determine Russia's actions at home and abroad in 2016. The year will also be marked by Russia 's worsening economy and growing hostility to NATO neighbors. Putin is increasing the military budget, mounting a record number of armed forces exercises and maintaining assistance to Syria's Assad regime and to Russian rebel forces in Ukraine. Western-imposed sanctions are likely to stay in place. This hardening of the confrontation between Russia and the West complicates the operating environment for western corporations. Multinational companies may be easy targets of Russian retaliation whenever relations with their home countries sour.

POLITICS AND GOVERNANCE

## Europe's Year of Transition

CARSTEN NICKEL, WOLGANGO PICCOLI, ANTONIO BARROSO

The major challenge for the European Union (EU) and the European Central Bank is to help economic growth return to the Eurozone while containing the security provocations of Russian President Vladimir Putin. The key player steering the debates on both sets of challenges is German Chancellor Angela Merkel, who will be laying the groundwork for her 2017 campaign for a fourth term in office. As she has done before prior elections, Merkel is likely to avoid bold and potentially divisive pre-election issues. For example, ideas for changing the basic European treaties will be delayed until after the 2017 elections. This applies particularly to proposals entailing the transfer of either financial or decision-making resources to Brussels. The Central Bank President Mario Draghi may launch a further quantitative easing (QE) program given the sluggish economic performance of 2015. Also top of the agenda attention will be the Parliamentary debate in the UK over terms of its European engagement.

POLITICS AND GOVERNANCE

## ISIS and the Islamic Surge CRISPIN HAWES

Within a year, ISIS (the Islamic State) has seized Syrian and Iraqi territory containing six million people, has won the allegiance of jihadist groups across multiple countries and has itself or through adherents launched attacks in countries stretching from Nigeria to Saudi Arabia. In these states, jihadism is now a threat to security, if not yet to fundamental stability. Further afield, the Islamic State is inspiring violent acts by individuals well beyond the Middle East. ISIS's savage ideology devolves from but is more than a derivative of the radical organizations that have been spawned over the past 100 years. Mastery of social media is central to spreading ISIS's call to revive Islamic greatness, to destroy the region's sitting governments and to eliminate Western influence. ISIS's success is also central to its appeal. In both Syria and Iraq, gross malfeasance and corruption have contributed to ISIS becoming an indigenous solution to the failure of contemporary political systems. The next iteration of political radicalism in the region is likely to be more brutal and more dismissive of alternative secular ideologies.

POLITICS AND GOVERNANCE

## Northeast Asia's Leaders Move to Reduce Tensions TOBIAS HARRIS

The lull in the region's longstanding disputes over contested islands, historical memory, North Korean bellicosity and rising nationalisms is likely to continue into 2016. The rise of China and its drive for regional leadership is the central cause for concern. Japan, South Korea and China: The three must be wary that underlying tensions of historical disputes, military modernizations and doctrinal differences don't mushroom into conflicts. The three countries also have to contend with slowing economies and rising social discord. There is hope that a trilateral meeting of Chinese, Japanese and South Korean leaders will help stabilize the region. The United States engagement in the region is far from settled with fresh concerns among allies of U.S. staying power.

POLITICS AND GOVERNANCE

## Southeast Asia's Daunting Challenges

BOB HERRERA-LIM

Southeast Asian countries are facing difficult political and economic challenges that are reducing growth expectations and constraining political responses to emerging economic problems. As a result, Southeast Asian investors are fleeing to less turbulent markets, often in the West. There is criticism of inadequate reform and concerns that further economic shocks could lead to widespread business closures. Despite tough times ahead, the actual risks are probably manageable. The two countries most vulnerable to political unrest are Malaysia and Thailand and China's heavy hand remains a constant concern.

POLITICS AND GOVERNANCE

## Revival of Enduring Ties

KEVIN ROLAND

The rush is on in Dubai to benefit from increased commercial business with Iran. The prospects are enticing because Iran's economy is likely to surge as sanctions are removed in the wake of the nuclear agreement with the P5+1. Already, successive delegations of public officials and private sector executives are making their way to Tehran and to the cosmopolitan commercial center that is Dubai. The movement is an expansion rather than a re-starting of the traditionally strong Dubai-Iran trading relations. For its part, Dubai hopes to further emerge as the hub for international businesses looking to do business with Iran.

GLOBAL OUTLOOK

# A Systematically Less Stable World

*Political movements of great power can arise quickly, fuelled by a demand for accountability and responsiveness in government. This is a product of the changed habits and expectations of a digitally connected world.*

In February 2011, I was the first foreign minister of a European country to set foot in Tunisia after the revolution that overthrew the autocratic government of Ben Ali. Tunis that night was an eerie scene: with a curfew enforced on the streets, I saw only a solitary cat on my journey from the airport to the British ambassador's residence.

The next morning, my first meeting was with 'revolutionaries' – people who had played their part in the downfall of a feared dictatorship. Not so many years ago this would have meant a Lenin-type figure in a secret headquarters, or battle-scarred young men with their rifles on the table, but the revolutionaries of 2011 were something quite different; crucially they were something no security service could fully monitor or control, for these were normal-looking young people with no weapons or wounds; they were mainly women, and their method of overthrowing the entire apparatus of a state had been to sit at home on their laptops.

Proudly, they told me of how they, along with tens of thousands of others, had used the internet to plan a 'couscous party' on a vast scale, knowing that the day of the party would be the time for their brothers and male friends to take to the streets in mass demonstrations. They had been one part of a movement which came together suddenly, without a leader or any conventional organisation, and yet which initiated the most significant change in world events of the 21st

*The Rt. Hon. the Lord Hague of Richmond is a Senior Advisor to Teneo and former British Foreign Secretary and leader of the UK Conservative Party.*

century so far – what was then optimistically called the Arab Spring.

The information revolution has had countless side effects, and one of them is that political movements of great power can arise very quickly without being planned or designed.

Such movements are fuelled by a growing demand for accountability and responsiveness in government, itself another product of the changed habits and expectations of a digitally connected world. They are at their most explosive when provoked by sustained corruption and mismanagement, especially when combined with a denial of economic opportunity to a young and expanding population. Far beyond the Arab world, similar factors can be seen at work in massive demonstrations in Brazil, localised discontent when incompetence causes public anger in China, and the rise of populist parties across Europe's most struggling nations.

*The information revolution has had countless side effects, and one of them is that political movements of great power can arise very quickly without being planned or designed.*

## A Systematically Less Stable World

The information revolution is having a massively beneficial effect on the quality of human life and our capabilities. Its political effect is likely to be positive too, except when misused by authoritarian rulers to try to control minds rather than liberate them. But it is important to recognise that it can also bring increased instability, along with a reduction in our likelihood of predicting it.

This is one of several factors likely to make the world in the next quarter of a century less stable than the same period since the end of the Cold War. That means the period to come will be even more systemically unstable than the time of 9/11 and the wars in Iraq and Afghanistan.

The second factor is one that has become all too obvious since 2001: the rise of religious intolerance in the Middle East. The roots of this are vast and complex, but its poisoned fruits can be seen clearly in the sectarian violence and destruction that plagues Iraq and Syria. When combined with the information revolution, this intolerance spawns the rapid rise, successful recruitment and sinister mass communication of a group such as ISIL, able to broadcast its message and its evil deeds to the entire world in grim detail. Trying to ignore such events is not an option, they make new interventions in the

Middle East unavoidable, but interventions of a new kind, in support of local forces on the ground and accompanied by a counter-narrative in social media.

The effects of both these causes of instability are likely to intensify in the years ahead, and the effect of a third is certain to do so, too. This is the huge divergence in population trends around the globe – trends which are the tectonic plates of all human affairs – all of politics and economics rests on them, their movements are sometimes too gradual to notice, but the ultimate effect of their moving changes the entire shape of our world.

*That means the period to come will be even more systemically unstable than the time of 9/11 and the wars in Iraq and Afghanistan.*

## Global Demographic Trends

That shape is changing and moving apart with unusual speed. It may be well understood in the world that the global population is still growing rapidly and looks likely to reach more than $9 billion by 2050. However, everyone in business and government needs to think hard about the implications of the vast changes within that total.

While the world's population booms, 48 countries are expected to see their own numbers decline, many of them in Europe. At the same time, half the total increase will be in Africa. Looked at another way, half the total increase will be in only nine countries, with five of them in Africa. The other four are India, Indonesia, Pakistan and the United States.

The populations of many emerging economies are ageing much more rapidly than happened in societies which industrialised earlier, leaving them much less time to create the financial and social infrastructure of a fully developed economy.

There are important divergences within continents. For instance, the UK is forecast to overtake Germany as Europe's most populous nation by the middle of the century.

Many countries now face steep falls in their populations, particularly Russia, which is set to lose an average of 250,000 people a year for the next 35 years; Japan, which is set to lose one quarter of its total by 2050, and many of the Eastern European states.

The modern world has little experience of populations in structural

decline, independently of war or natural catastrophe. It is clear that this will have a profound economic effect, with large ageing cohorts dependent on their squeezed younger generation. The effect that a shrinking nation will have on innovation, insecurity, and social attitudes is unknown and will be different in each country. We can be sure, however, since this shrinking will occur in the third and fourth largest economies of the world and in the country with the largest nuclear arsenal, that whatever the effects are they will be of massive importance.

Of course, the most obvious impact of diverging population trends is on migration. For centuries migration has been a central driver of social and economic change. In Europe and the United States, the scale of immigration and its consequences are likely to become still larger political issues, and the number of people trying to migrate to these richer and freer parts of the globe will become greater than ever before contemplated.

## Economic Volatility

It might be easy to conclude from reading this far that the outlook for the next few decades is a terrifying one. And of course it is overlaid with the serious economic uncertainty that flows from the global financial crisis of 2008 and the faltering performance of some of the largest 'emerging' markets. Cheap money has fuelled renewed growth but is no guarantee against a future downturn. It is important to remember that today's central bankers and finance ministers are no more able to abolish economic cycles than their predecessors throughout history.

For those in Europe, there is an additional drain of energy and resources into the crisis in the Eurozone, a crisis that will occasionally sleep but will not die. The creation of the euro without the political and fiscal unity necessary to make it work is not one of the many crises we could not predict: it was predicted in some detail by many people fifteen years ago (including by me). My view is that the agreement reached between Greece and its creditors merely buys time, at great cost, and will prove unsustainable. The Greek crisis is likely to prove the first tragic symptom of the deep flaws in the design of the Eurozone, which will become even more apparent if the gap between

the economic performance of its northern and southern members fails to close – a reasonably likely scenario.

Yet overall I would recommend retaining a sense of optimism about the ability of humans and their leaders to navigate through great uncertainty and instability, provided there is a good understanding of its causes and the need for resilience in the face of the unexpected.

Our optimism should be strengthened by the sheer scale of expansion of higher education around the world, particularly in Asia, and the extent to which scientists have advanced the next potentially massive breakthroughs, in many fields from the storage of energy to ultra-lightweight materials.

*More than ever, business and political leaders will need a deep understanding of local conditions and a presence in more of an expanding number of centres of decision-taking.*

In the same regions of the world as many failed states and festering conflicts, there are countries replete with economic and business opportunity, as the Middle East and Africa are demonstrating.

More than ever, business and political leaders will need a deep understanding of local conditions and a presence in more of an expanding number of centres of decision-taking. They will need to build an enhanced capacity to absorb unexpected shocks into their organisations or countries, while understanding that they will not be able to predict them all. They will also need to build in later flexibility to more of their plans so that they are not locked in to a single course of action.

## Some Causes for Optimism

Our optimism should be further fortified by the record of successful diplomacy, even in the last few turbulent years. In the Philippines, the Mindanao Peace Agreement brought to an end one of the world's longest running conflicts. In Colombia, President Santos has, against all odds and much opposition, brought an end to one of the others within reach. The changed policy of the United States towards Cuba should be counted as another important diplomatic advance, and the nuclear agreement with Iran removes for years to come one of the most serious and imminent possibilities of a new conflict.

Such diplomacy will become even more necessary in the world I have described, but it will also become more complex because of the

more multi-polar nature of that world. A paradox of the globalised society is that success in it requires even more detailed knowledge of local trends and variations, themselves influenced by a mass of connections between individuals, businesses and civil society which are not confined by borders.

The multi-polar world is also bringing a perceived reduction in the willingness and capacity of western nations to intervene elsewhere militarily – a perception that is now accompanied by increased assertiveness on the part of some other powers.

In recent years one of these powers has been Iran, with its proxies engaged in conflict or fomenting instability in Iraq, Syria, Lebanon and Yemen. The nuclear agreement with the government in Tehran does not necessarily mean that there will be any change in its wider foreign policy, although it will provide the opportunity for it to change should it wish to do so. The use of strengthened diplomatic connections to Tehran by western and Arab nations will need to be a major foreign policy priority for them over the next few years.

Relations with Russia are likely to remain extremely difficult. Efforts to revive or 'reset' relations with Russia by the U.S., U.K. and others have come to nought in the last few years over Moscow's obdurate defence of the Assad regime, and, even more damagingly, the annexation of Crimea and destabilisation of Ukraine. The economic retrenchment made necessary by a sustained fall in the price of oil is likely only to reinforce the need of the Russian leadership to show its strength abroad. The continuing casualties of this will be Ukraine, Moldova, and Georgia: each of them prevented from functioning normally as a sovereign country or making their own free decisions by Russian intervention on their territory.

Alarmingly, however, the countries of the western Balkans are also caught up in the new stand-off between Russia and the West. Their progress towards Euro-Atlantic institutions and greater stability is likely to be impaired by Russia's reluctance to see them move away from its own orbit. Longer term, Russia's declining population, excessive dependence on hydrocarbons and widespread corruption must raise serious doubts about its own political direction, but, for

the foreseeable future, it is a powerful nation unwilling to co-operate with European or American diplomacy.

### The Future of China

The next few years will be crucial in answering fundamental questions about the future of China and its relationship with the United States. Many of these questions are internal, but of vast importance to the whole world now that China is the second-largest economy. Internationally, can China pursue ambitions to drive greater prosperity in Asia – the concept of One Belt One Road – without reducing tensions with ASEAN countries over the South China Sea?

China has a tremendous opportunity to win support across the globe if it acts to visibly keep North Korea in check, helps to secure global agreement on climate change and encourages the sensible use of development aid. Such initiatives could allow China to build a strong partnership with the United States while still serving national interests. The alternative is rising tensions over maritime power and cyber-attacks. Such attacks, widely and publicly attributed to China, have already reached a scale sufficient to poison relations.

Vulnerability to cyber-attacks and increased controversy over them brings us back to the point I made at the start of this chapter: the transformation of international affairs by the information revolution. Many businesses and most governments still underestimate the scale of the cyber security challenge, and some will discover that their economic or physical security ultimately depends on rising to it. When millions of employee records of the U.S. Government itself can be stolen, and the U.S. Army's own website can be briefly taken over by a group loyal to the Assad regime, few organisations in the world can afford to be complacent about their cyber defences. Alongside prosperity, freedom and extraordinary opportunity, the information age also brings instability and unprecedented vulnerability. That is the rich mixture that the successful enterprises and nations of the coming decades need to master.

MARKETS & TECHNOLOGY

# Higher Volatility and CEO decision making

*Higher volatility is likely in four important asset markets. The end of quantitative expansion will drive a return to higher volatility in all these indices.*

The global business world is nervously edging into a state of higher volatility and it is going to get even edgier over the next twelve months. With bets on higher market volatility, many are left wondering: what is driving this enhanced volatility, what executive decisions is it complicating and how can thoughtful CEOs anticipate and mitigate these risks?

Volatility is purely a measure of dispersion – of variation in price up and down in asset markets. Higher volatility does not necessarily imply anything about the direction of price movements, but higher volatility does unambiguously inject more risk into decisions being crafted in the C-Suite.

CEOs and CFOs are all looking down the gun barrel of higher volatility in four important asset markets that affect their businesses: the US Treasury 10 year yield; the benchmark "risk free rate" (RFR) against most financial assets are priced, as measured by the CBOE TYVIX index; foreign exchange rates, as reflected in the JP Morgan global FX volatility index (JPMVXYGL); U.S. equity prices as measured by the CBOE VIX index, which tracks dispersion in the S&P; and the price of oil as reflected in the CBOE crude oil volatility index (CBOE OIV).

In last year's Teneo book, we predicted that the era of tamed vola-

*James Shinn is Chairman of Teneo Intelligence, Lecturer at Princeton University and regular contributor to Institutional Investor magazine on political risk.*

tility would shortly end, and we were right on the money. After a flat summer, both the OVX and the TYVIX started to pop in the fourth quarter of 2014, right after last year's book went to press. The TYVIX exhibited the highest intraday volatility since the 2009 financial crisis, and the OVX had its biggest jump since mid-2011. The JPMVXYGL also woke up from its mid-summer slumber, during which it dipped to 5, and shot up to 10 at year end, its highest level since 2013. The VIX alone finished the year sedately, with its volatility dampened by the great S&P bull market of 2014. But that, too, is changing rapidly with the VIX zooming from 13 in mid-August to 28 in just two weeks.

The underlying driver of the return to higher volatility in all these indices is the end of quantitative easing (QE) on the part of the Federal Reserve Bank and the Bank of England (BOE) as well as the first hike in the federal funds rate, which will drag the risk free rate back up to historically normal levels. This normalization process is the trigger of greater volatility across the other asset classes. The vast pools of liquidity that central banks collectively poured into financial markets since the great financial crisis suppressed volatility for eight years running.

Exactly when and by how much the Fed will turn off the QE punchbowl and allow the RFR to return back up to normal levels has every portfolio manager on the planet scratching their head. What is clear, however, is that while the Fed and the BOE are turning off the QE spigots, the European Central Bank (ECB), the Bank of Japan (BOJ) and the People's Bank of China (PBOC) will still be sluicing money into their respective financial markets: dubbed the "differential taper."

### How Risk is Amplified

Higher volatility amplifies the risk of a wide range of business decisions by CEOs. Examples include:

- Higher volatility in the TYVIX and the RFR means that the threshold rate of return for making strategic investment decisions, whether in terms of capital expenditure (CAPEX) or acquisitions, is also edging up. Wall Street analysts are rudely second-guessing CEO's investment decisions and they will continue

to get more aggressive about return on investment criteria. As the RFR goes up, institutional investors are desperate to take advantage of higher yields; they want commensurate returns from their equity portfolio or they want their money back. The differential taper (spigots off in U.S. and UK, spigots full on in Europe and east Asia) means that firms will face different costs of debt capital in different markets, making these investment decisions for firms with a global market footprint even more complex.

- Greater volatility in the JPMVXYGL and foreign exchange rates means that translating revenue and profit figures into the single currency (usually dollar) set of consolidated financial statements introduces greater variability in quarterly reporting, especially for firms with a regionally concentrated sales or production footprint. Since FX volatility will be highest among emerging markets, firms with revenue or production exposure in emerging markets (EM) will experience even greater volatility in reported performance, just as investors and analysts are ever-more-intently scrutinizing which firms meet (or miss) the quarterly EPS targets. The surprise 2 per cent devaluation of China's renminbi on August 11 is a harbinger of more volatility to come.

- Bigger gyrations in the VIX and equity prices is making the timing of stock repurchases very sensitive, and open to potential criticism by shareholders. In 2015, the S&P firms are collectively doing $600 billion worth of share repurchases on an annualized basis. CFOs may leave a lot of money on the table if they end up buying at peaks; investors won't be happy about being bought out at valleys. If CFOs cut back on these share repurchases due to higher uncertainty associated with greater volatility across markets, this will further amplify volatility in the VIX, since share repurchases may be as responsible for the 2015 equity bull market as it was not sustained central bank liquidity.

- Higher volatility in the VIX and stock prices boost the ratio of beta ($\beta$) to alpha ($\alpha$) in any given firm's stock price. CEOs can legitimately claim some credit for a firm's alpha, but virtually none for its beta, which is driven by overall market volatility. Beta related to overall market variation can wash out management's alpha

*The differential taper (spigots off in US and UK, spigots full on in Europe and east Asia) means that firms will face different costs of debt capital in different markets, making these investment decisions for firms with a global market footprint even more complex.*

contribution in more volatile periods. This may make it harder for CEOs to justify their compensation packages and, in some cases, their own perch in the C-Suite.

- Higher equity volatility also makes M&A transactions trickier, especially those funded with stock. This means the daily market price of both firms will see-saw more wildly after an M&A decision has been made and its ratio of buying to acquiring stock has been fixed, leading shareholders on one side of the transaction to be more unhappy. Firms engaged in these transactions are being exposed to this kind of second-guessing as government authorities around the world are increasingly intrusive in asserting approval authority over M&A transactions, whether on competition policy grounds (in Europe and China) or on national security grounds (in the U.S.). These approvals prolong the time it takes to consummate an M&A transaction.

- Listed firms may become more vulnerable to hostile takeovers when they themselves are on the wrong side of a sudden downtick. The large pools of money being mobilized by activist funds mean that all but the largest market capitalization firms can be put in play. The choice of whether to resist or comply is both complicated and extremely time-consuming. A wrong decision can defenestrate the CEO.

Higher volatility in the OVX and energy prices makes it difficult to decide where to locate CAPEX. For example, petroleum or natural gas feedstock will vary more across borders and over time. This isn't limited to industries like plastics: the economics of running a data center for an Amazon or a Google is most sensitive to the price of electricity. Big data centers absorb about 20 gigawatts annually. More variation in fuels costs means more variation in the cost basis and thus, the profit performance of a whole range of transportation industries, including airlines, trucks, railroads, and shipping.

How much more volatile could these four indices get in the next twelve months? The TYVIX at 5.1 in September is just a third of its peak during the financial crisis. If the TYVIX should return to its second highest peak in late 2011 of 10 in response to a normalized

RFR (a sort of "taper tantrum" redux), that's a twofold jump. Using the same reasoning, the JPMVXGL, at the 11 mark in September, would break through 17 if it rose to its second highest historical peak since the financial crisis. The VIX, just shy of 25 in September, would leap to 45, which was its second highest peak in late 2011. The OVX, at 45 in September, would hit 60, which was its second highest peak in late 2011. These are all big ranges.

## Thinking Strategically

So what does one do about this near-certain prospect of higher volatility as a CEO or CFO, other than hunker down? There are several ways to incorporate this into strategic thinking; here are a few examples:

- The taper trigger of higher volatility is so important in terms of the timing and scale of "the return of volatility" that even the CEOs of non-financial firms need to keep their eye on central bank policy. Central bankers deliberate and debate policy timing, including a taper, in technical terms, but it is a profoundly political decision, and the political vectors can be analyzed like any other high profile fiscal or monetary policy decision.

- When making big CAPEX or acquisition decisions or when modeling the profitability of these investments *ex ante*, it makes obvious sense to factor in a wider dispersion of assumptions with regard to interest burden, energy costs, and FX parity changes that can affect both revenue and costs.

- When the CEO and CFO translate the firm's strategy into an investor relations narrative, whether for the quarterly earnings call, to explain an M&A decision, or to justify managerial succession, it is prudent to frankly acknowledge the higher risk environment that this volatility has engendered, and make explicit how management has factored higher volatility into these tough calls.

- Volatility is discontinuous, but it rarely comes out of the blue. Historically, big changes in volatility are preceded by smaller changes that are much larger than mean variation; in other words, a 3 sigma event is often preceded by a 2 sigma event. A number of models have been developed to estimate and predict financial volatility based on a mathematical approach known as general-

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ized autoregressive conditional heteroskedasticity (GARCH). Some predictive analytic systems, such as Predata, sift digital and social media to extract digital conversations, are able to generate event predictions using GARCH-like models. Teneo Intelligence and Teneo Strategy's digital offering can translate these models into useful early warnings for clients.

- The notional trigger for enhanced volatility in any one of these four indices is very likely to be an event that is knowable or at least trackable in advance, since bursts of volatility are often associated with high profile bilateral or multilateral meetings. Oil prices began their dramatic slide in late 2014 when an October OPEC meeting concluded with no agreement to reduce production quotas. This underlines the value of following a detailed risk event calendar - the sort that Teneo Intelligence uses to schedule its research and to regularly alert clients.

*Volatility is discontinuous, but it rarely comes out of the blue. Historically, big changes in volatility are preceded by smaller changes that are much larger than mean variation*

MARKETS & TECHNOLOGY

# Are You Ready for a Recession?

*Proper preparation can equip CEOs to take advantage of volatility and downturns to meaningfully improve the long-term position of their companies. Currently, the focus should be on downturn prospects.*

Business cycles are a fact. Economic downturns are driven by a myriad of factors and their timing is difficult to predict, but there is no doubt that recessions play havoc with societies, companies, investors and workers. Once viewed as an inevitable (many thought healthy) aspect of capitalism, economists and policymakers have invested enormous energy in both analyzing what triggers a turn in the cycle and what steps can be taken to prevent such a turn or emerge from the recessions they cause with less damage to the economy.

Such was the case with the heroic efforts of Ben Bernanke's Federal Reserve to steer the United States (U.S.) economy through The Great Recession, when nearly all asset prices collapsed, business investment evaporated and unemployment doubled. After nearly a decade of "free" money and other extraordinary measures, the U.S. economy has recovered — unemployment has returned close to pre-crisis levels and the stock market has tripled. But clearly, all is not well and policymakers, investors and corporate executives are wary. Why?

After the Great Recession that began in 2008, a weakened U.S. economy faltered and China's came to the fore. China accounted for one-third of global economic growth, while the U.S. managed only 17 per cent and Europe and Japan 10 per cent. China's growth did not come without risk — as debt as a share of its economy grew by 80 percentage points between 2008 and 2013 and now stands at 300 per cent.

*Robert Mead is a Senior Managing Director with Teneo Strategy.*

The centrally-managed Chinese economy and its statistics remain enigmatic to Western economists and investors, but it is now obvious that China's growth rate has slowed rapidly. After a 150 per cent increase in Chinese class-A share prices from June, 2014 to June, 2015, the market has fallen 40 per cent and fears are growing that the Chinese policymakers are taking steps to address the problems that appear confused, if not desperate. Despite such concerns, many market observers have discounted the impact the slowdown will have on the U.S. economy because of limited trade and financial links. While that may be the case, for now, the slowdown in growth in China has slammed the economies of countries that are dependent on China's growth (e.g. South Korea, Thailand) and has led to a collapse in metals and other commodity prices, which in turn has sent producing economies (e.g. Russia and Brazil) into deep recession. In addition, two of its largest trading partners have seized: Canada just entered a recession and growth in Mexico continues to rapidly decelerate.

In an attempt to avoid or reverse downturns, emerging market governments are devaluing their currencies, thus increasing inflationary pressures in those markets. This all comes after risk-seeking behavior that is the direct, and intended, result of the Federal Reserve's effort to drive lenders and investors into riskier assets. It worked: lending to companies and countries outside the U.S. doubled to $9 trillion since the Great Recession and U.S. bond funds loaded up on emerging market debt. According to *The New York Times,* Pimco's unconstrained bond fund has 42 per cent of its assets in emerging market bonds and 21 per cent of the investments in the Pimco Total Return Fund are in emerging market assets.

The damage in the emerging markets is not just economic. The governments of countries sliding into recession come under intense pressure. In defense, these governments make desperate political or economic policy moves that destabilize their markets and their societies, with Russia, Brazil, Turkey, South Africa and Argentina being the most recent examples.

The steadily worsening global macro picture has driven a dramatic increase in volatility in the U.S. equity markets after a remarkably calm and consistent rise. Such spikes in volatility often precede cor-

rections, and indeed the U.S. equity market did reach correction territory in August and again in early September. Valuations are less stretched, but still above long-term averages and investor confidence has clearly been rattled.

In the past, such global events – either on their own or coincident – have triggered a turn in the business cycle without leading the U.S. economy to slip into decline. However, when the equity markets are exuberant, signs of trouble are often ignored or rationalized until they become serious problems. Before Ben Bernanke was right he was wrong; he doubted the existence of a housing bubble in the U.S. and after its collapse he discounted the impact it would have on the overall economy. The actions he took to address what became an existential threat to the U.S. banking system were heroic, but like many emergency interventions, they are bound to have long-term implications, which are still to be determined.

### What Can Change?

Business cycle turns are normally preceded by credit tightening by the Federal Reserve or by a banking crisis. With U.S. banks bulging with capital, a financial crisis seems unlikely. The U.S. economy is not overheating; inflation is subdued as wage pressure has not yet elevated and both declining energy costs and a strong dollar have a dampening effect. However, unemployment has fallen close to pre-crisis levels, reaching the point at which, according to Wells Fargo's James Paulsen, even modest economic growth can produce wage and price pressures, which in his view means we are headed toward an interest rate "reset."

Up until recently, the Fed seemed eager to move. Interest rates are abnormally low and the risks associated with such unprecedented and long-term accommodation clearly weigh on policymakers. It seems obvious that the near decade of ultra-loose monetary policy has caused distortions in asset values that have already begun to revert to mean: the price of oil has fallen more than 50 per cent, landing exactly at its long-term average, and other key commodities have done the same or worse.

As of this writing, the Fed officials now seem visibly trapped – know-

ing the zero bound has gone on too long limits the Fed's ability to respond to a real downturn in the U.S. economy, yet concerned that raising too soon will trigger an immediate slowdown that is not necessary. Therein lies the problem: Fed officials have been unsuccessful thus far in framing the upcoming policy change as a *normalization* of the cost of credit in an economy healthy enough to allow a return to reasonable interest rates. Instead, the Fed has allowed the market to obsess about when it will raise rates to initiate a *tightening* of credit that will cause a slowdown.

*A slowing China, collapsed commodity prices, deflating emerging markets, unprecedented volatility and waning confidence, and the initiation of a tightening cycle all add to a significant probability of a U.S. recession within the next three years.*

As always, the Fed hopes to engineer a soft landing when it begins to move interest rates up. Such elegant solutions are difficult to achieve; ten of the 14 tightening cycles since 1955 were followed by a recession as they require tight choreography and clear communication of intent. Rate regime changes somehow often come as surprises to the market – either in timing, speed or duration. Given the significant divisions among Fed policymakers and mixed signals that result, it seems likely that whenever the Fed makes its move, it will either catch the market off guard or confound it with a steeper and longer slope of change.

A slowing China, collapsed commodity prices, deflating emerging markets, unprecedented volatility and waning confidence, and the initiation of a tightening cycle all add to a significant probability of a U.S. recession within the next three years.

### In Good Shape, Right?

Consumers have significantly reduced their debt and companies have taken advantage of low interest rates to borrow cheaply and on the whole, corporate America is awash in cash and U.S. banks are in rude health.

On the other hand, a benign economic and credit environment has allowed many marginal competitors to keep lingering at the back of their packs without fearing the normal consequences of poor performance or excess leverage. It has been ten years since a rising interest rate environment. A credit shock from a systemic bank failure is generally unforeseeable, as banks are well reserved and lending relatively conservative. But lending has changed – in riskier lending areas,

such as the oil patch, banks are playing less of a role as hedge funds and private equity firms have been more aggressive. Such a change in credit structure will likely make managing a leveraged company through a credit crunch and recession more complicated than before.

However, even with a rate increase, debt will remain cheap for some time. Companies that got too aggressive with leverage will be stressed in a downturn and opportunities will abound. The energy industry is a good example of how a sharp downturn causes enormous changes in the competitive landscape – leverage that enabled rapid ascent now accelerates decline and, equally important, ties the hands of management. Creditors that were once liberal with liquidity now tighten the leash. Suppliers change terms and customers ask for assurance. Market share is up for grabs and buyers become sellers.

## Offense and Defense Preparations

CEOs should anticipate that within their strategic planning horizon, the business cycle will turn and the U.S. economy will enter a recession. Once such an assumption is made, CEOs should step back and take a fresh look at their traditional strategic planning process.

Most companies maintain three-year strategic plans that include various scenarios on economic and market conditions. Our experience is that the strategic playbooks are generic when it comes to business cycle turns and, in the event, any strategic ambitions are hard-checked and companies shift into a defensive mode by cost-cutting through layoffs, squeezing the supply chain, and reducing investment in technology, marketing and other growth initiatives.

Only when they implement the defensive maneuvers and feel conditions have improved enough to see the other side of the cycle do most CEOs return to aggressive/offensive mode and look to take share from a competitor or make acquisitions, at which point they are paying a higher price or are met with a stouter defense.

There are some exceptions: CEOs who buck the trend during a boom and keep their balance sheets strong. These CEOs resist pressure to lever up to buy back their stock at a high multiple or acquire a competitor at the top of the market. Such determination is *not* without risk, at least in the era of activist investors: Teneo research has shown

that activist investors are attracted most to companies with large cash balances and short-term growth challenges. But a CEO with a clearly articulated communication strategy for long-term success can fend off activists and maintain the flexibility to go on offense when the game shifts.

*Thus to create shareholder value, CEOs have kept costs down by tightly managing labor and supply costs and short-arming capital deployment by limiting growth investments and plowing cash into share buybacks.*

Since 2008, global market uncertainties and unreliable growth opportunities have led executives to adopt a conservative approach to strategy and focus instead on having a very strong defense. Strategic planning is often handicapped by the perceived requirement to lock down assumptions of conditions and opportunities; it is difficult to predict the next 12-18 months, let alone 3-5 years, and given macro conditions since the Great Recession, growth at big companies has been difficult to achieve.

Thus to create shareholder value, CEOs have kept costs down by tightly managing labor and supply costs and short-arming capital deployment by limiting growth investments and plowing cash into share buybacks. According to FactSet's Q1 2015 report, in the trailing 12 months, approximately 75 per cent of the companies in the S&P 500 bought back $565 billion in shares – up 18 per cent from the previous year

Even with this level of share buy backs, companies in the S&P 500 for the same period are sitting on a record setting $1.4 trillion in cash.

### Better Playbook

CEOs need to take a more aggressive approach. The strategic game plan has become unbalanced and the offense anemic. To restore balance and opportunistic behavior, leaders must push their teams to adopt a much more continuous mode of strategic planning that leverages this position of strength to take advantage of volatility and downturns to meaningfully improve the long-term position of their firm.

While it seems obvious, it is difficult to power through a recession and take advantage of sectoral weakness to enter new markets, increase product offerings, consolidate market positions, capture new customers, and bury competitors. An aggressive approach to strategic planning requires a very granular predictive view of macroeco-

nomic environment over short-, medium-, and long-term planning horizons.

Agreement is also needed on a set of 'no-regrets' activities that should be pre-funded. This includes entering initial partnerships with companies in attractive markets who are not for sale yet (but might be in a downturn) due on adjacent acquisitions or market entry opportunities, and establishing detailed plans and positioning executive teams in advance to be ready to rapidly respond. Above all, it requires a detailed analysis of the vulnerabilities of direct and adjacent competitors; survival of the fittest entails knowing who will be easiest to catch and eat.

It also requires much more active monitoring of trends to be able to more nimbly and rapidly respond to take advantage of situations. In essence, the strategic "planning" exercise needs to move from an annual refresh of a three to five year strategic plan, and move into a regular executive set of sessions (at least quarterly, and even more frequently as required) for the leadership team to discuss market conditions and developments and decide on proactive actions to position the companies for growth.

This requires a set of changes to the cultures of many firms. Organizations need to be ready and prepared so that course corrections are not a sign of indecision or error, but actually that the firm is adjusting to be more nimble and able to respond to market opportunities given the pace of change and the volatility of the global markets. The language used to guide all stakeholders – investors, employees, customers, business partners – needs to reflect this attitude.

One simple step is to split strategic planning teams into two units, a Red Team and a Blue Team, that are more actively supported by relevant and engaged business heads. The Red Team would focus on shoring up the defense in place before a downturn and a Blue Team would map out an aggressive offense to deploy once things turn down.

The Red Team's efforts should focus on a plan to protect market share, safeguard customer relationships and cut nonessential costs while preserving brand distinction.

The Blue Team's plan should identify vulnerable competitors, prepare to acquire them or to take from them substantial market share or other valuable asserts, strengthen the management team by poaching and purchasing and address any product or geographic weaknesses.

Competition between the teams should be encouraged. Teams should square off when their respective plans are developed to attack and find holes in each other's strategy. Once plans are set, successful communication with key stakeholders is crucial to success. For the defensive plan, CEOs should implement a campaign, branding the cost reduction plan and ensuring that employees, suppliers, customers and investors are well informed and management responsible for its implementation are held accountable. The offensive strategy is best kept under wraps for competitive reasons, but CEOs should be clear enough in outlining broad strategic objectives with investors to ensure that when the strategy is implemented – as with a major acquisition during a downturn, investors can trace it back.

## Who Gets it Right?

There are many examples of CEOs and companies who have routinely out performed their competitors in a down cycle *and* capitalized on the opportunities created by a sharp downturn in their sector, particularly those who recognize (and admit) that they are in a highly cyclical industry. Lee Raymond and Rex Tillerson of ExxonMobil; Ron Williams and Mark Bertolini of Aetna; and Paal Kibsgaard of Schlumberger stand out.

**ExxonMobil** and its leadership have steadfastly held to a long-term view of the energy industry, its cycles, risks and opportunities. Twice in recent memory, the company has responded to a sharp industry downturn with both a strong defense (immediate reductions in overhead and capital expenditures) and opportunistic expansion. In 1999, when oil prices were near a 25-year low, Exxon acquired Mobil for $82 million in what was at the time the biggest merger in history. The strategy was straight-forward: take out a major competitor for new discoveries and properties, eliminate nearly $3 billion in costs and apply Exxon's superior financial and risk management practices to Mobil's assets.

In 2009, at the depth of the Great Recession, Exxon Mobil acquired the giant natural gas producer XTO for $31 billion, a rich price, in a move that Tillerson said reflected his company's strategic planning horizon of 10, 20, 30 years. While the deal was controversial at the time and remains so (mainly because prices are in an extended down cycle), most believe that the very long-term prospects of natural gas in general and the North American market in particular are quite strong.

**Aetna** is in the competitive and cyclical health benefits industry. Down cycles are usually tied to recessions that drive spikes in unemployment and reduce utilization of benefits. In 2010, after a rough year with revenue and margin decline driven by the financial crisis, Aetna implented an aggressive defensive strategy by repricing its book of business to restore margins and by launching a major cost reduction campaign that included a first-ever early retirement program (which had the benefit of increasing productivity). Aetna CEO Ron Williams and his successor, Mark Bertolini, also took personal control of the strategic planning process and set a new course for diversifying into adjacencies (health information technology) and mapping out an opportunistic acquisiton plan. In 2013, still early days in the industry recovery, Bertolini, now CEO, made his move by acquiring Coventry Health, enabling Aetna to spread overhead across a business now 40 per cent larger in revenues, 25 per cent more members. The transaction was significantly accretive and greatly strengthened Aetna's competitive position and capital base. It positioned Aetna to make a bid for the highly-coveted Medicare business of Humana in a $37 billion deal that is pending.

And finally, **Schlumberger**, a 90-year-old oil and gas project management and technology company. In response to the latest and perhaps most painful downturn in the oil industry, Schlumberger immediately reduced headcount by 15 per cent and accelerated its Corporate Transformation campaign to drive further savings. It also soon pulled the trigger on the acquisition of Cameron International in what can only be called a classic case of vertical integration: Schlumberger is the leader in oil and gas production surfaces below the surface, Cameron above. The integration of the two companies, who had long worked alongside each other in partnerships, will re-

sult in far greater cost reduction opportunities than would otherwise be available during the downturn and dramatically strengthens Schlumberger's ability to box out competitors for key long-term customer relationships.

None of these deals were made at the spur of the moment or out of desperation. They came from a strategic playbook that enabled the CEOs of each company to take a well-calculated risk and call a winning play from a position of relative strength. In each case, the company ensured that it emerged, or will emerge, from a down cycle as a stronger competitor.

While it is impossible to know exactly when a recession will hit, the probability of a downturn in the US economy in the next three years has increased. As the next turn in the business cycle looms, we believe that CEOs and their teams should step back from their current strategic planning processes and consider a fresh approach that is more aggressive and opportunistic. Time to get to work.

*None of these deals were made at the spur of the moment or out of desperation. They came from a strategic playbook that enabled the CEOs of each company to take a well-calculated risk and call a winning play from a position of relative strength.*

MICHAEL MADDEN

MARKETS & TECHNOLOGY

# Frontier Stakes: High Risk, High Reward

*To find golden opportunities look to frontier states that have internet connectivity, instant world wide communication, ubiquitous mobile technology and a young, educated work force.*

Rich world countries will not remain rich forever and poor countries will not remain poor. As global economic trends and resource control shifts, so does the smart investor's capital.

As explorers once sailed into the unknown, searching for new land and wealth, today's adventurers take the form of frontier markets investors, seeking countries and opportunities where capital and expertise can yield the greatest returns. Unlike Columbus or Marco Polo, today's capital explorers often arrive to internet connectivity, instant worldwide communication and ubiquitous mobile technology. The world has changed, but the golden opportunities remain abound; the question is how to find them.

Frontier markets are markets that have in some way been inaccessible to investors in developed countries until very recently. Frontier markers are best defined as countries that are on the cusp of 'emerging market' status. These countries were previously blocked off from the rest of the world by Western sanctions, until a recent series of political and economic reforms re-opened the borders to international investment.

After the collapse of the Soviet Union, new nations became 'frontier' states, attracting a host of once-prohibited companies and investors to help build the economies that thrive today. In recent years,

*Michael Madden is Chairman of Teneo Capital and Restructuring. Collaborating on this article were analysts Peter Gall and Oliver Belfitt-Nash.*

the frontier states are those that have re-engaged the international business community that is now open to foreign investment after decades of isolation (such as Mongolia, Iran, Cuba, and Myanmar).

These markets offer high returns for those willing and able to approach them. With little established competition and huge potential to grow an enterprise on fresh and fertile soil, frontier market investments can bring internal rate of returns (IRRs) of 30-35 per cent when executed successfully. But the challenges and risks to operating in frontier states are significant investors can only succeed through extensive and diligent on-the-ground contextual research.

### Untapped Resources

The natural resource boom in Mongolia illuminates the potential rewards available when investing in new markets. Once the established government signed an $8 billion mining deal with the mining giant Rio Tinto in 2010, the country swiftly became the fastest growing market in the world with 17 per cent GDP growth in 2011. The deal was sparked the country's boom, with extraordinary knock-on effects for the economy that supported the mining sector. A USD investor in Mongolia in 2011 could be guaranteed nine per cent on USD deposits at major banks, and up to 15 per cent within the Mongolian financial services.

But metals and mining are not the only untapped resources that frontier states have to offer. Mongolia is a landmass endowed with great mineral wealth and a small population. With only 2.8 million people, Mongolia is the most sparsely populated country on earth – an ideal target for mining projects where fewer communities may be affected by the landscaping alterations.

Myanmar, by contrast, contains 53 million people in a country the size of France, around the world average in terms of population density. After a series of democratic political reforms in 2011, investors began to flock into this once economically-isolated land in the heart of booming Asia. The next few years brought huge developments in telecoms, construction, tourism, and financial services.

Construction boomed in Myanmar's largest city, Yangon, with familiar hotel names and conglomerates itching to get in on the new

market. Shangri-La committed to the development of a huge corporate hotel in the centre of downtown, as well as a newly built serviced apartment block and a soon-to-come serviced office complex. As with many emerging market cities, a visitor cannot turn a corner without seeing a half-built high-rise surrounded by cranes.

The most exciting developments in Myanmar over the past few years are in the telecoms space. Up until 2013, only six per cent of the population had access to a mobile phone. When the government began an auction for mobile network operator licenses in 2013, the world's largest names rushed to tap into Asia's last telecoms market, spending billions on marketing and the construction of network towers. Again, the knock-on effects were felt throughout the country's other nascent sectors and today Myanmar rests on the cusp of a complete technological overhaul. In just under three years 20 million Burmese people have gone from relying on off-grid, isolated pockets of information to having almost immediate access to the world's store of knowledge.

## Organic Growth

Frontier market economies have only one direction to go: up. For investors that can navigate hurdles and challenges, the macroeconomic tide will lift a lucrative opportunity even higher. International development funding, legacy debt write-offs, discounted new debt lines, new bond markets and giant multinational corporate deals often come thick and fast for a newly opened frontier market. Strategic political interests lie at the heart of some funding sources as nations compete for the new nation's favor, thus kick-starting the wider economic progress.

*For investors that can navigate hurdles and challenges, the macroeconomic tide will lift a lucrative opportunity even higher.*

Myanmar, for example, bordering both China and India, has received vast amounts of funding from Japanese Corporations, OPIC and Chinese national conglomerates. Mongolia had a similar balancing act to perform in its boom period. Its third neighbour' policy looked to bring in Western nations to offset the political and economic dominance of its two large, bordering powers: Russia and China.

As the rich world workforce grows older and looks to retirement, the young emerging world is itching to take their place. Many Frontier

economies possess a young, well-educated and technology-driven population. Myanmar has an estimated median age of 27 while in Mongolia it is 27 - the majority of the population takes great pride in being early adaptors of technology and desire to feel part of their country's development. Myanmar and Mongolia both have an estimated median age of 27, with two international mobile network operators granted licences in 2014, the smart phone uptake has been exponential. It is anticipated that 90 per cent of the country will have mobile coverage by 2018. For the youth of Myanmar, having a smart phone and being connected to the world has become a number one priority.

*The lack of international competition coupled with a blank canvas to operate provides the opportunity for an investor to establish early and grow quickly.*

As technology advancements accelerate and take an ever-more important role in global commerce, a young, fresh-minded workforce is essential to the long-term success of a business. Many tech-focused businesses have already outsourced their workload to yesterday's frontier markets. India and China, followed by Vietnam and Taiwan, have some of the most efficient tech labour pools in the world. Tomorrow's tech hubs are today's frontier markets.

Those that take the risk to approach a frontier market first often reap the largest rewards. The lack of international competition coupled with a blank canvas to operate provides the opportunity for an investor to establish early and grow quickly. The question remains: do international investors acquire or build when entering Frontier markets? Often the only answer is to build given the low levels of development and lack of infrastructure. While this provides an opportunity to build economies of scale, it also presents a myriad of additional challenges to navigate through with often nascent legal, banking, investor, regulative and trading environments.

### Economic Contagion

The impact of China's economic slowdown rippled across the globe, proving particularly challenging for a number of low-income and lower-middle-income economies, including Mongolia, that have depended on exports to China. China is Mongolia's biggest trading partner, with 90 per cent of Mongolian exports going to China in 2013. However, consisting almost entirely of coal, copper, iron ore, and crude oil, Mongolian exports have been hit incredibly hard by

the drop in Chinese industrial demand.

The fall in commodity prices has put pressure on Mongolia's currency, the Tugrik. Compared to the U.S. dollar, it reached a record lows in September 2015. Comparing the Tugrik to the Chinese Yuan shows an even more alarming trend: the Tugrik has depreciated by 40 per cent since 2011 relative to the currency of China, its biggest trading partner. Since Mongolia imports many consumer goods, including textiles, the exchange rate has directly impacted Mongolians' purchasing power.

Frontier markets only gain the 'frontier' title on the back of a major political or economic shift in their recent history – meaning their previous state of affairs was extremely unfavourable. Iran, Cuba and Myanmar were once known as 'enemies' of the West, and are only recently emerging from a stifling blanket of economic sanctions that prohibited many forms of trade and commerce. Although these countries are now reforming towards a more open democratic system of governance, many investors fear a stall in reforms and their governments re-imposing the sanctions that would legally mandate them to exit.

Russia, although no longer a 'frontier' market, has stalled in recent years as the government's political rhetoric shifted. Western statecraft now threatens to have dire consequences on the country's long-term economic trajectory, reacting to the conflict in Ukraine and a shift towards state-directed model of development rather than market-based.

A direct consequence of the imposition of these sanctions is the impact on Russia's foreign direct investment (FDI), which dropped 46 per cent in the last twelve months to $2,806 million. Furthermore, Russia's economic performance has been weakening for several years, with GDP growth being in its fifth year of contraction and the International Monetary Fund currently forecasting negative growth of almost -4 per cent for 2015. In addition to its economic and foreign investment woes, Russia's currency has consequently paid the price also, losing over 50 per cent of its U.S. dollar value since January 2013.

Another example of a stall as a result of government meddling is Mongolia's foreign direct investment collapse. At its peak in 2011, Mongolia achieved $4.6 billion in foreign direct investment. By 2014 this had evaporated to the paltry levels of $300 million. The driving factor was a disagreement between the Mongolian government, which owned 34 per cent, and Rio Tinto, which owned the majority stake in Oyu Tolgoi (OT), the vast new copper mine in the Gobi desert. When it is fully up and running, the copper mine could account for one-third of GDP. The $6 billion spent to date account for most of the recent foreign direct investment.

## Legal Grey Areas

The instability of frontier markets governance often casts a shadow over the rule of law. With little precedent for international business practises and few litigation cases to learn from, the correct path to market can seem unclear. This lack of clarity is not debilitating, but heightens the risk that a law may be changed or other players in the market do not abide. Many frontier markets will need reform governing bodies and legislative process that may have not been addressed or are outdated.

For example, with the recent opening of the financial sector to foreign entrants and severe lack of banking services in Myanmar, the Central Bank and Ministry of Finance are scrambling to draft and implement the necessary laws and regulations to governing modern day banking. The entire system is leapfrogging from an old paper-based, cash-driven ecosystem to a modern internet and mobile friendly platform. However, policy makers are struggling to keep pace with laws (such as the Microfinance Law in 2011 and Mobile Banking Law in 2013) being swiftly implemented. Moreover, the country awaits the impending Financial Institutions Law and Dedicated E-money Directive to give better clarity to this rapidly evolving sector.

These legal gray areas can create a long, painful process when establishing a business and operating in a frontier market. The bureaucratic systems in place take time to dissolve, and investors are often faced with unexpected hurdles in the early stages. Some sectors are

deliberately "off limits" to foreign investment, but others are beneath a pile of paperwork, partnerships, and convoluted structuring.

### Single Sector Growth & Brain Drain

Frontier markets led by a single sector, are looking to hire the best-educated native workers. The pool of educated, English-speaking employees is often small: the country has not engaged internationally for generations and salaries are swiftly blown out of proportion. Even in a diverse economy, the pool of educated skilled workers can quickly be drained by new, competing international businesses.

Extractive industries have the power to create huge investment inflows, but reliance on natural resource exports often creates a huge risk for the country that can lead to a bust. The average price for Urals crude oil hovered around $110 per barrel from 2011 to June 2014. Since then, prices have plummeted to under $50 per barrel in 2015, thus exacerbating the pressure on the economy further. Mongolia faced a similar trend off the back of its mining industry in 2010, attracting huge inflows of capital before political infighting turned the tap of capital off and many investors exited as quickly as they'd entered.

### Liquidity Issues

A wary investor will be keeping an eye on their exit. As a frontier market is new and fewer international players are present, finding a timely exit can be a challenge. The typical frontier private equity exit is four to six years, well over the average for developed market deals.

Stock exchanges, if they exist, also have the same liquidity issues. Mongolia's local stock exchange faced low volumes for trade even when the London Stock Exchange group installed the most modern platform to trade. Within the 300 companies listed, only 10-20 gave any real movements even during the boom period, and an investor who wanted to capitalize on the paper returns would have to wait weeks to place large amounts of capital, let alone exit.

Further, frontier markets will often experience economic cyclical challenges. A boom period may often be followed by a settlement lag (or even a dip) after high performance. These swings can alter the envisaged path of an equity investment by either presenting early

or delayed exit opportunities. However, exits are always bound by the illiquid private process. Taking the Mongolian economic example earlier, while the first phase expansion of the OT mining project catapulted the growth up to its peak in 2011, due to a combination of negative factors, the economy has been stunted ever since, with 2015 GDP estimated to only surpass 4%. Internal policy and unattractive reforms to foreign investment law lead to stalls in OT phase two expansion and new foreign direct investment. This damaged investor confidence weakened the currency and halted the Mongolian 'Wolf' economy. For many early investors this also shifted expectation of exit opportunities and liquidity events.

## Lessons Learned

*An attitude of humility and adaption to host nation practises is essential for the long-term success of a placement and solidifying the relationships necessary to secure partnerships.*

There are many lessons to be learned from the emergence of previous frontier markets. The fall of the Soviet Union allowed Russia and some of its surrounding nations to experience the investor boom and subsequent busts. Mongolia attracted a swath of capital before falling into political infighting that put much at risk. Myanmar, now at the height of its boom, still attracts the world's awe in its development. Cuba and Iran are next and North Korea will follow.

To approach these markets successfully, an investor must adapt to a few principles. Many investors have been burned quickly by assuming developed market practises will automatically work in a "less" developed nation, or assuming that their assets, capital and expertise will be accepted and embraced by those looking to develop economically. An attitude of humility and adaption to host nation practises is essential for the long-term success of a placement and solidifying the relationships necessary to secure partnerships.

With little access to certified, reliable information on sector research, government figures, or corporate profiles, a frontier markets analyst will have to widen the margin for error, taking all data with a pinch of salt. What little data can be gathered through conventional sources will need extensive back up from surveys, on-the-ground knowledge, local participation and rumour-driven word of mouth.

Establishing an office early, with one to two years lead time on a major investment, will greatly alleviate some of the issues above. An

arrogant and hasty investor will hit unnecessary pitfalls in frontier markets that can be identified through local engagement, a strong network, and reliable sources of information that may take months to establish.

Incentives to do business in emerging markets may differ from developed nations, and pride may be more likely to win out over profit in major deals. Keeping strong relationships with business partners and offsetting political risk through established business networks is key to maintaining stability.

Frontier markets entice many investors, but a steady approach is essential to maximise the chance of success and alleviate some risks. With fresh opportunities to implement successful first-world models on fertile ground, frontier markets offer huge growth potential for smart capital willing to commit for the long-term and rise with the tide. ■

MARKETS & TECHNOLOGY

# Cyber Security – Dealing with the Growing Threat

*The number of sophisticated cyber attacks is growing. They will require more forceful and coordinated defenses.*

During any 48-hour period in 2010, more data was created than had been created by all of humanity in the past 30,000 years. By the year 2020, that same amount of data will be created in a single hour. The speed at which data will be created will grow exponentially as we connect more and more smart devices to the Internet – The Internet of Things. All that data is becoming increasingly vulnerable as breach of one piece of data leads to access of countless others.

In 2015, there has been a constant and growing stream of devastating cyber attacks reported against major firms and the U.S. Government. The prospects are for more cyber breaches in 2016. Home Depot, Sony, Athem, EBay and the USG's Office of Personnel Management are just the most notable examples, and the Ashley Madison breach demonstrates that prominent people are not getting smarter about privacy protection. Despite the increasing regularity and scale of these breaches, the 'how?' and 'why?' in regards to prevention seemingly remain unanswered.

Companies are scrambling to hire cyber security experts. Hundreds of firms purporting cyber security bonafides have started their own ventures in the past year - each claiming to have the technical solutions to defend enterprises and organizations. Many offer incentives, discounted introductory rates and free surveys with the aim of up-selling costly hardware and IT upgrades. The vexing question

*Lon Augustenborg is a Senior Advisor to Teneo and recently completed a 35-year career in the CIA's Clandestine Service.*

faced by both commercial and government Chief Security Officers (CSO) and Chief Information Security Officers (CISO) is "when will our cyber security infrastructure be sufficient and where is the next attack coming from?" The answer is "basically never" and "hard to know."

### No Immunity

Criminal cyber attacks are seemingly endless and a very lucrative business for the cyber thief. For the lazy, cyber criminal hacking software is a click away and can be downloaded for free off of the internet. State actors openly collaborate with criminal elements (often one in the same) which leads to increasingly sophisticated cyber breaches in far greater frequency against a broader range of targets. No organization or government entity is immune. Simply put, the odds of your organization and/or your family being breached will be substantially higher in 2016.

*State actors openly collaborate with criminal elements (often one in the same) which leads to increasingly sophisticated cyber breaches in far greater frequency against a broader range of targets. No organization or government entity is immune.*

Commercial enterprises and public agencies at every level of government have data that needs to be protected from theft, prying eyes and "Denial of Service" (DoS), the shutting down of an enterprise or interface. The ability of a country to both launch DoS attacks and prevent them from shutting down their own communications and systems will be the difference in who wins and loses cyber battles of the future. Belligerent foreign state actors constantly launch DoS attacks against U.S. Government Defense and Intelligence Agencies, as well as against major corporations in the financial sector, healthcare and the media. The numbers are staggering. The Pentagon reports 10 million attempted breaches a day. The National Nuclear Security Administration, an arm of the Energy Department, also records 10 million hacks a day. Commercially, the multinational oil and gas company BP says it suffers 50,000 attempts cyber intrusions a day.

DoS attacks are now frequently launched against small and large businesses, as well local and state agencies of all sizes. For the common criminal, DoS attacks are a means of holding the victim hostage and extorting money. DoS attacks against emergency services such as police and fire departments are increasingly common. Reports indicate that ransoms are being paid almost immediately by these

emergency services before the public is aware in order to avoid potential public panic. Due to the quick pay offs to these criminals, incidents will continue to increase and hit more businesses every day.

As much as cyber security technology is advancing, investigations following the most devastating breaches show poor security practices by humans (or "insider threat") is by far the most common cause. Examples include contractors installing upgrades being issued "universal passwords" that were blocked after the installation; systems that were not updated with new passwords after major employee layoffs or during periods when labor management confrontations were underway; compartmentalization requirements being ignored; and access shared with unauthorized personnel for the sake of convenience (Edward Snowden). Employees permitted remote access to sensitive data bases, and cell phones and computers left unattended in public locations are also common causes. Other problems include hotel and public servers being virtually all compromised and personal computers being used for business and vice versa.

*However, no firewall or password - no matter how sophisticated - can protect you from the inside threat posed by employees who wittingly or unwittingly open up systems to compromise.*

To be in the best position in the coming year, enterprises and organizations need to reassess risks with the expectations that their organization will be targeted and will take some hits. There must be a willingness to invest in cutting-edge counter measures and also insure against loss. There are countless software systems that claim to secure your information, block penetrations, detect breaches and minimize exfiltration of data. However, no firewall or password - no matter how sophisticated - can protect you from the inside threat posed by employees who wittingly or unwittingly open up systems to compromise. Susceptibility to attacks can be mitigated if employees follow basic security procedures, such as protecting passwords, limiting remote access and closely monitoring and strictly limiting the access to outsiders. In the case of protection, perfect never gets in the way of "good enough."

## Best Practices

Firewalls and passwords are 20th century technologies fighting a 21st century battle. A perfect example of this is a cyber startup company that claims it can penetrate any company's IT systems. The CEO of that startup confided privately that they do not need to em-

ploy hacking technologies, but instead use the old fashioned method of engaging employees who then give them access. Using any number of cover stories, employees share their password(s) and the intruders simply logs in. Ironically the intrusion is then used to convince the client to purchase updated firewall software with improved firewalls. The Department of Defense and the Department of State have both been compromised via unwitting employees being cajoled to willingly reveal passwords or insert thumb drives containing malware despite extensive education efforts to prevent insider threat. The other common tactic is enticing employees to download email attachments containing malware. It is overwhelmingly the case that employees will open emails from unknown persons while at work but would never do it on their home computer.

Standard operating procedures and a disciplined work force will find itself far more secure. The tough part is effectively implementing it for everyone through a combination of positive and negative incentives. For that to work CEOs need to have close working relationships with both their CSO and CISO who work as a seamless team with the Chief Information Officer (CIO). By working together they can establish protocols and procedures that are practical, while ensuring the company remains efficient with employee buy-in and cooperation. It is also essential that the security team closely monitors the inside threat beyond routine compliance to security procedures. Rogue employees exist or can emerge within an instant. Systems are routinely at risk when an employee resigns or is terminated. In addition, contractors or vendors inside the firm pose a potential threat and need to be closely monitored; no external device or software should ever be permitted into your network unless authorized.

The first step to building an organization's cyber security is to retain the services of a dedicated cyber security firm or advisor. The key is to engage a firm that best fits the size and need of your organization. For instance, a law practice with 200 employees will differ from a Fortune 500 company, not only with respect to available resources, but also the requirement. Smaller firms may want direct access to local technicians and key staff of your provider. To that end, a smaller practice with operational experience is ideal. Conversely, multinational enterprises benefit from engaging large consulting practices

that include legal and lobbying components.

The next step is to implement best practices, no matter the size of your firm. Very good analytics and intelligence must be in place. You need to have probes available to get you information either as the data breach is occurring or afterwards to be able to understand the damage.

Next, you must have an incident response team that is trained and ready for the scenario of a breach. This team can be in-house or external, depending on requirement. If you opt for an outside capability, a boutique, cyber - and privacy specific - form may be your best option as opposed to a branded multinational. Recent studies show that companies with a trained response team had an average $12 or $13 less expensive cost of a breach per capita than companies that did not; That is a very significant difference and a lot of money saved.

Third is the use of encryption. We are talking layered encryption for your enterprise and data. So when the bad guys get by your five-year-old, non-updated firewall and your abc123 password, they get a user name and maybe the password, perhaps even a social security number or date of birth. The data they really want, the financial accounts or health records are actually encrypted. So they get the keys to the castle but can't get to the crown jewels. Finally, of course, to mitigate insider threat employee training and Board-level involvement is necessary.

### The Right Insurance

Since no solution can ensure total data security, your cyber risks need to be mitigated through insurance. Over the last few years many firms wrongly assumed they already have it, think they do not need it, or do not believe it is even an option or available at a reasonable cost. These assumptions are dangerous. The insurance industry has made great advances in this area over the last year. By shopping for cyber insurance, your organization should obtain valuable assessments of your company's cyber security posture, give an objective rating of whatever cyber security expertise you have employed and determine how much insurance you need or the ceiling that makes sense. The right insurance companies will also outline what needs to be done

to improve and mitigate risks sufficient to make you insurable at the lowest possible premium. By taking advantage of this basic gap analysis a company can significantly improve its awareness without committing to a finite policy.

A common mistake is assuming a comprehensive or blended policy that includes cyber will be sufficient. While one may assume insurance carriers would be eager to find gaps and sell you more insurance, the cyber world is changing so rapidly and incidents and losses are increasingly significant that it is difficult for insurance professionals to correctly calculate premiums and risk. One only needs to look at the staggering loses by Sony, Target and Home Depot to see how risky a major cyber policy could be for the insurer.

Major insurers often opt to limit coverages and attempt to sell comprehensive or blended Errors and Omissions insurance policies hoping the client will think it sufficient. Before accepting this option, firms should reassess exactly how much cyber risk they are willing to bear and approach their insurance firms and insist on a separate policy and seek out competing quotes. It is very likely that this time of uncertainty could prove to be a real opportunity to buy the most extensive coverage at costs far lower than a year from now. Once a devastating breach occurs, the Board or Directors and shareholders will expect that company is prepared for the worst case. A CEO's future will depend on having an adequate insurance policy when the disastrous breach occurs.

In general, the following are the coverages and benefits that should be included in a cyber insurance policy:

- An option for increased ceilings in coverage as your company grows and changes.

- Security and privacy liability that responds to both 1st and 3rd party claims stemming from a security failure.

- Data breach expense coverage for notification, credit monitoring and engagement of public relations firms, crisis management firms, forensic investigators and outside security experts.

- Business interruption coverages for lost income during or as a re-

sult of a security brief.

- Cyber extortion coverage that will reimburse for costs to quickly respond to extortion threats.

- Coverage for regulatory proceeding claims made against you related to violation of Privacy Law.

- Date recovery coverage for the cost of restoring data and intangible assets that are destroyed by a cyber-attack. Media content coverage that addresses claims related to the creations and distribution of material insuring against anything on your firms websites and media that could damage or injure others.

- Coverage for fines and penalties levied for non-compliance of PCI Data Security Standards.

*The right insurance policy arrangement should be a partnership that truly enhances the company's IT systems and its cyber posture.*

In addition to these coverages, insurance firms should provide assessments of your cyber security posture, and the services of cyber and legal experts to provide on-going consultations and step in following a security breach. They should be able to quickly assess incidents and damage to keep the company moving and public confidence in place. On a full time basis, free access should be provided to websites with daily news on cyber security incidents, developments in cyber defenses, best practices, and cyber security blogs. The right insurance policy arrangement should be a partnership that truly enhances the company's IT systems and its cyber posture.

Every firm should also take advantage of government programs that provide assistance in improving your defensive posture against cyber threats. A positive development in 2015 are new regional cyber security centers that have been created to serve the public and private enterprise. These are resources available at no cost that can greatly assist any business or organization improve its defensive cyber posture. One particularly outstanding resource stood up in May is the New Jersey Cybersecurity and Communications Integration Cell (NJCCIC). This consolidated the state's cyber security efforts within New Jersey's Office of Homeland Security and Preparedness. Through its website *www.cyber.nj.gov*, the NJCCIC promotes shared and real-time awareness of dynamic cyber threats for any business—

small, medium, or large—in New Jersey. The NJCCIC is one of the first Information Sharing and Analysis Organizations—a federal designation indicating an advanced cyber capability—representing a vital step in scaling cyber defense to the local and state level. Firms at all levels need access to cyber threat intelligence that can be automatically integrated into their security architecture to block attacks before they spread.

A number of states have been following New Jersey's lead. California, Delaware, Virginia, Rhode Island, Idaho, Washington State, Kansas, Vermont and New York have stood up commissions and centers to deal with cyber threats at local levels. Louisiana's fusion center has an innovative cyber security program as do centers in Northern California, Kansas City, and elsewhere. Many states and localities are engaged with both federal partners, as well as with each other through mechanisms like the Multi-State Information Sharing and Analysis Center (MS-ISAC), the National Fusion Center Association (NFCA), and the National Governors Association (NGA). In the coming year these developments will undoubtedly boost the pace and scale of cyber threat information sharing to the private sector.

New Jersey has put forward several useful strategies to improve cyber security for citizens and businesses that others need to follow this year to make a real difference nationwide. This includes extensive information sharing between the public and private sector. New Jersey has prioritized working with the private sector and even individuals, and included sectors outside of law enforcement, all of which vastly expanded effective cyber security coordination. Firms can vastly improve defense postures by publicly sharing information on various cyber threat actors, and by providing background on high profile data breaches, as well as attack vectors and exposing tactics from the most basic to the most sophisticated. It is developing into an information clearing house going beyond the state and is leading to a nationwide coordinated effort.

With New Jersey's large financial sector, their cyber security has made it a priority to reach out to key industries such as the Financial Services Information Sharing and Analysis Center. This has resulted in partnership in which cyber threat information is not only shared

but also jointly analyzed and correlated with various global financial institutions to identify trends, adversary tactics and vulnerabilities.

## Staying on Top

Cyber security is a combination of multiple issues and problems. IT issues, crime and privacy issues, national security issues, and industrial and international espionage. All need to be taken into account. Any defensive approach has to utilize a broad range of expertise and disciplines. It is therefore essential to take advantage of all resources available, stay on top of innovations and closely monitor what is being developed in the field in order to mitigate risk. But keep in mind the basics of encouraging and training your work force to support these efforts and not undermined technology through poor human tradecraft. We all leave our doors unlocked and security systems off more times than we would like to admit.

Find the right cyber security firm that takes a broader approach than selling the latest technologies, and is able to encrypt what really counts including access, storage and communication with clients. Find the right insurance provider with the right cyber policy that provides the coverage that minimizes losses and damages across the board. Have a team ready to go that will keep you up and running and protects your brand following a breach. Finally, take full advantage of government programs and institutions which can provide you the intelligence you need to anticipate trends and provide best practices to stay ahead of the threat.

MARKETS & TECHNOLOGY

# The Customer Power of Millennials

*Millennials want intimacy and collaboration with the companies that serve them. In this digital age, customer power has never been stronger.*

Halfway through the second decade of the 21st Century, the Millennial generation is being sought after by companies to help develop products and services attuned to the rapidly changing consumer trends of the digital age.

This could be the era of ultimate consumer power. Companies are becoming more intimate with their customers, asking them not just for feedback on existing products and services, but to be involved in developing new ones. For example, GE is embedding customer intimacy and collaboration into its product development cycle.

*Companies are becoming more intimate with their customers, asking them not just for feedback on existing products and services, but to be involved in developing new ones.*

Beth Comstock, GE's marketing supremo, is encouraging her executives to become 'explorers'. Her staff members are increasingly embedded with customers to test their satisfaction with existing products and their appetite for new technologies. The same marketing intelligence is now applied in R&D and product development to ensure that new technologies are not merely sophisticated and reliable, but also relevant.

In addition, customers are increasingly being asked to collaborate with companies to determine whether a product will make it to market. Senior executives from businesses as diverse as industrial products and services, consumer goods and telecoms, have identified that customer power is reshaping their markets as the digital revolution

*Tim Burt is Managing Partner of StockWell. Teneo acquired StockWell in July 2015*

has paved the way for customer power to be stronger than ever. That power reflects the ease with which products, prices and services can be compared instantly in a virtual marketplace. Business leaders, fighting for every customer in a world of cut-throat competition, have begun to pledge ever greater levels of satisfaction. Within a few years, millennials will become the purchasing managers, financial controllers and CEOs determining what to order for their businesses.

In a survey conducted by *Forbes* earlier this year, more than 40 per cent of millennials said they were interested in helping companies develop future products and services. "In our society, companies usually create products and hope that their target market will consume them," the magazine reported, "when it comes to millennials, they want to be more involved with how products get created. Companies that enable them to be part of the product development process will be more successful."

*...the digital revolution has paved the way for customer power to be stronger than ever.*

This trend is particularly evident in the automotive industry, where nearly all products are identical, with the exception of differing degrees of speed, passenger capacity, design and fuel efficiency. In early 2000, Chrysler asked children to design automobiles using video game technology, reckoning that their preferences could influence future designs of Jeeps, Dodge Rams and other Chrysler models. In an industry of long product cycles, where vehicle platforms last a decade or more, today's video gamer on *Grand Theft Auto* could be tomorrow's SUV driver.

Yet Chrysler may have missed the point. The ironic part of it all is that although millennials want cars to look different, they were not sure they wanted to own cars at all.

A study by the AAA Foundation for Traffic Safety in the U.S. found that from 2007-2011, the number of cars purchased by people age 18-34 fell almost 30 per cent. Whilst this decline partly reflected the consumer downturn after the financial crisis, researchers believe that new devices, mainly smartphones, have replaced cars as the 'must have' for young people and that social media has reduced the need for individual mobility.

Carmakers are racing to adapt to these new trends, which threaten to

change customer relationships dramatically.

Mark Fields, Chief Executive of Ford Motor Company, believes the auto industry is entering an era of mass experimentation, likely to be characterized by new models of transportation and mobility within the next 10 years. Speaking at the Consumer Electronics Show in Las Vegas earlier this year, Fields said: "We see a world where vehicles 'talk' to one another, drivers and vehicles communicate with the city infrastructure to relieve congestion and where people routinely share vehicles or multiple forms of transportation for their daily commute."

Setting out 25 different experiments in which Ford is innovating for this new world, he said the company had to meet three basic criteria: "First, creating a better customer experience. Second, developing more flexible user-ship models for customers. And, third, connecting with every customer in a socially collaborative and rewarding way."

### Global-Local Strategies

The speed with which Ford and other manufacturers are making such changes reflects the priority – some might say *anxiety* – with which companies are trying to keep pace with their customers. This is especially true in the fast-moving consumer goods and retail sectors, where businesses are adjusted to the 'limitless aisle,' the online market-place where customers can search and purchase almost anything from anywhere.

Customer power in the retail sector is increasingly becoming a shared, local experience. Researchers have found that millennials tend to base their purchase decisions on recommendations and social network views of their friends and families. They review products and post pictures – the so-called 'shelfie' – of products before purchasing them, often seeking price comparisons for a better deal.

Retailers and suppliers are, in turn, using such data to adapt products much more closely to local consumption habits. The age of developing global products with vast economies of scale is giving way to localism where items are developed, marketed and priced according to local market conditions. This is having a major impact on the sales tactics for basic items that might appear under the same brand name around the world.

*The speed with which Ford and other manufacturers are making such changes reflects the priority – some might say* anxiety *– with which companies are trying to keep pace with their customers.*

At Henkel, the German company behind products ranging from Persil to Loctite, CEO Kasper Rorsted told me: "Take Persil: in Western Europe or in the US, a consumer expects a number of things; one is cleanliness and the other is aroma. A piece of clothing is typically washed after being worn once. If you start going to Eastern Europe or the Middle East, a person is typically using his or her clothes three, four or five times. The primary objective of washing a piece of clothing is removing odour and making it clean because it is much dirtier. So we have to develop a different product for different markets."

*In other words, customer power is driving the global-local strategies of companies that previously preferred a 'one-size-fits-all' strategy in markets around the world.*

He added, "Take a washing machine, in Western Europe or the US, all the advertising is about how to make things shine. In Eastern Europe you load up your dishwasher with everything you have because you don't care if it's completely shiny. You care about whether all the stuff you put in, including your pots and pans get close to clean. So we are sorting out different problems according to different household trends around the world."

In other words, customer power is driving the global-local strategies of companies that previously preferred a 'one-size-fits-all' strategy in markets around the world.

The trick for manufacturers and retailers is to appear responsive, locally relevant and digitally-smart without incurring such costs in the process that it undermines the economic viability, the basic margin that any product or service can command. In an era where customers are increasingly promiscuous – or less brand-loyal than their forebears – companies are required to build a degree of trust or must-have product capabilities that impact discretionary purchase decision-making.

This is not just impacting basic commodities like washing powder. It is also affecting areas such as technology and communications.

Customer intimacy and sovereignty is rapidly transforming the market, the devices and the networks used for all financial transactions, data consumption, entertainment and social interaction. The Internet economy, which embraces every aspect of digital communications, is expected to be worth $4.2 trillion by 2016, according to forecasts by BCG, as the number of connected users nears $3 billion. But

whilst the overall market is becoming more valuable, the competitive forces and pricing pressures driven by customer trends means that content providers, network operators and device manufacturers are fighting aggressively to differentiate their product offerings.

Increasingly, customer service and anticipating customer preferences is being seen as the key point of distinction for companies facing such threats. In telecommunications, the threat is compounded by fears over data security, privacy and hacking. This, in turn, has prompted operators and manufacturers to place a premium on trust and reliability for their customers.

Interviewed for my recent business book, *2020 Vision*, Augie Fabela, the founder and Chairman emeritus of Vimpelcom, the emerging markets mobile network operator, said: "Network operators need to become trusted partners of their customers. If your service provider has figured out a way to offer things that you want and need, without bombarding you with useless stuff that's intrusive and violates privacy, then that has real value."

"In this industry, you always talk about how to define different parts of the market-place. The ultimate place to be in the mobile market is to be a trusted adviser and lifestyle facilitator to individual customers. We must personalize what people want, with bespoke services. It will not be easy to get there, but that must be our aspiration and ambition: a bespoke provider to a segment of one, anticipating and meeting our customers' needs. This will be the future of our industry."

*In an era where customers are increasingly promiscuous – or less brand-loyal than their forebears – companies are required to build a degree of trust or must-have product capabilities that impact discretionary purchase decision-making.*

## The Little Things

Across industries, the growing focus on customer trust, intimacy or sovereignty reveals an underlying vulnerability for business. Improving product reliability and ubiquitous technological advances means there are fewer genuine breakthroughs that confer competitive advantage. In a world of convergence, with less product or service differentiation, customer satisfaction can separate winners from losers.

The art of satisfying customers and better exceeding their expectations has always been a basic foundation of a strong business reputation, but such reputations are fragile in an information age when

customers can easily switch from one provider to another, or when social media can influence market sentiment. Companies are focusing increasingly on the small incremental differences in their customer offerings. "The trick is to make customers feel special," says the managing director of one famous consumer brand, which has formed a 'special operations' units to focus solely on personalized customer care. "It's the little things that will make the difference. But unfortunately, as we grow, it's easy to forget the little things." He tells his staff: "Always look at things through the eyes of the customer and never underestimate the value of making people feel special."

The problem for many companies is how to marry this sense of premium, personalized, customer service with the sheer volume of demand – especially if your business deals in global markets, commoditized raw materials or business-to-business relationships. But players in every part of the supply chain, whether in a mining company or a clothing retailer, are now tending to treat each other as customers – trying to create the same sort of service differentiation that you might expect as an end-consumer. Companies that get this right tend to be able to charge a higher price for their products, which enables them to generate the cash-flow that can be reinvested in new innovations and which, in turn, can lift margins, credit ratings and stock prices. This virtuous circle includes an enhanced overall reputation, helping secure customer loyalty, which can stimulate discretionary purchase decisions.

*But players in every part of the supply chain, whether in a mining company or a clothing retailer, are now tending to treat each other as customers – trying to create the same sort of service differentiation that you might expect as an end-consumer.*

With margins tight, technology and globalization intersecting, and small differentials in product offerings, corporate success will depend increasingly on putting customers first in every essential business decision. This is no longer a field reserved only for consumer businesses. It is the new mantra for manufacturers, natural resources groups, financial services and technology players. Without a strong and distinctive customer proposition, a company risks running a reputation deficit, which can quickly slide into a crisis.

To avoid that scenario, companies must become both more intimate with their customers by anticipating their every need and becoming more collaborative.

At GE, Beth Comstock sums up the opportunity and the risks. "This whole emphasis on customers must start with assembling relevant data and it ends with understanding how to take a new product to market. To me this brings together, in the company, this marriage of technology and marketing in a very profound way," she says, "Without that, you can build a product that is quite brilliant. But if no one can access it or value it, who cares?"

MARKETS & TECHNOLOGY

# Embracing Reputation at the Board Level

*Boards are at an inflection point in how they steward reputation for value. Awareness is growing that reputation can be a source of competitive advantage.*

Corporate boards have always valued the reputation of their businesses. Traditionally, they viewed reputation as an important asset, which they are expected to protect or fix as and when the business encountered threats. But today boards are at an inflection point, moving from an implicit to an explicit approach based on the growing realisation that reputation is a determinant of value. As such, it is a potent source of competitive and, therefore, commercial advantage.

*But today boards are at an inflection point, moving from an implicit to an explicit approach based on the growing realisation that reputation is a determinant of value.*

The Blue Rubicon Institute's research examines the factors prompting the shift in the way boards are addressing reputation strategically, operationally and culturally (Teneo acquired Blue Rubicon in July 2015). Over 12 months, our research team interviewed chairs, independent directors and board secretaries from 30 private and pubicly-listed companies in a range of regulated and unregulated sectors. It makes a compelling case that boards are moving away from only addressing reputation implicitly and on a case-by-case basis to adopting an explicit and acute focus on reputation.

This desire to better understand reputation and its contribution to growth is fuelled by changes in society, local and geo-politics, regulation and technology. As boards look to the future of their businesses, as they rebuild themselves following the financial crash, these dynamic and complex issues are prompting them to ask whether rep-

*Basil Towers is Director and Special Advisor at Blue Rubicon. Teneo acquired Blue Rubicon in July 2015.*

utation is being rigorously and systematically shaped within their organizations.

## Supporting Growth Strategies

There is evidence that boards increasingly want to stand back and make a broad and deep assessment of stakeholders, their motives and expectations. Boards will always be alert to short-term imperatives, but when focusing on long-term challenges, they are exploring areas where reputation contributes to the business. This includes:

- Sustaining the existing business model and/or the transition to a new one
- Bolstering the value of the corporate brand
- Mitigating risks, reducing costs and limiting regulatory constraints
- Maintaining strategic freedoms and providing the oxygen to execute strategy effectively
- Understanding how reputation is enabling or constraining the effective execution of strategy and limiting the business' options

Boards are exploring the value of taking an enterprise-wide perspective, rather than a narrow issue-by-issue view, by which the leadership may assess the interconnections and impacts from the ground up and across borders and silos. They are also exploring the extent that reputation risks are critical to business dependencies (such as talent, resources and licences) and that they are monitored, mitigated and managed effectively.

Research highlights the level of boards' interest in reputation. The focus is manifesting itself in three ways. First, boards are strengthening their understanding and oversight of a business reputations and their impacts. Second, boards are focusing on reputation as an input and an outcome of strategy, operations and culture. And third, they are strengthening their accountability for reputation.

## Strengthen Understanding of Reputation

Boards are beginning to address some of the challenges that have

hindered leaders' and managers' ability to shape and steward reputation.

First, define what is meant by reputation in a language that works for the business and on the back of that, establish principles through which reputation will be managed. It is only by defining reputation that boards take the fundamental first steps to strengthening their oversight of its management. One independent director told us: "The board should be educated on reputation, so we understand what value is at stake and where the leverage is."

As such boards are starting to give more time (at least once a year) to debating reputation holistically in a way that is increasingly framed by reputation's role in enabling strategic goals, mitigating risks and sustaining business dependencies.

*It is only by defining reputation that boards take the fundamental first steps to strengthening their oversight of its management*

Second, understand that boards have a growing appetite to receive the insight, intelligence and indicators that will in turn strengthen their judgement. Boards have been frustrated by a lack of rigorous reputation analysis. However, a new generation of decision- business intelligence about reputation is emerging and is providing detailed insight built from the bottom up, measuring specific potential impacts on business value. For example, we see an interest in reputation business intelligence that enables an understanding of the impact of reputation on both costs and growth. In a number of boardrooms, there is interest in indicators that review reputation performance, and draws out its strategic goals and business targets.

Lastly, boards are looking to strengthen their relevant expertise and capabilities to assess reputation issues. While boards will look to build on these capabilities it is unlikely that chairmen will bring in new independent directors to the table solely for their reputation expertise. But the profile of board members is increasingly likely to reflect the need for wider and deeper perspectives to help the board and executive teams better understand the externalities that shape stakeholders' expectations. In this respect there is an opportunity for independent directors.

Boards are increasingly seeking outside expertise to help them better understand stakeholders of value and how they interact and in-

terconnect and spot opportunities and risks that have been hidden. They want perspectives that understand both the tools that stakeholders are using and the implications of generational shifts in the public and consumers.

### Address Reputation Questions Strategically and Operationally

Boards are beginning to challenge and help executive teams apply a reputation lens to the process of shaping strategic options, making decisions and allocating resources. For example, they are analyzing the opportunities for reputation to build and sustain competitive advantage over the long term. They are also aligning reputation strategy with the corporate strategy providing a subsequent framework and narrative for divisional, regional and business unit reputation plans. Meanwhile, they are examining reputation risks that may constrain the execution of that strategy or undermine critical business dependencies and as such put in place rigorous reputation risk mitigation.

Underpinning all of this is a need to ensure that the business identifies and establishes the right indicators to monitor and review performance and impacts.

Hard wiring reputation into the business is one of the most significant aspects of the inflection point that boards and leadership teams are experiencing. In essence, it reflects the requirement for every part of the organisation to play its role influencing reputation. It's a point McKinsey recently picked up, arguing that: "External engagement cannot be separated from everyday business; it must be part and parcel of everyday business."

It is a point echoed by many of our interviews. One Fortune 500 independent director said: "Improving reputation has to encompass a 'stepping back' and understanding that reputation is all the things that you do. It's your supply chain strategy, it's your procurement strategy, and it's a lot of other things that you do and not limited to doing an advertising campaign."

Boards are only beginning to think about the elements of an effective reputation framework. Their focus is both on achieving value and

avoiding unnecessary bureaucracy. They are thinking about how to embed reputation into the value chain, the operating model and organizational design across the enterprise.

The importance of culture in determining behaviors is for many boards the biggest driver of reputation. It is seen as the glue to achieving an effective organisational approach. Indicators – such as employee engagement or assessments of leaders and managers and whether they live the values of the business – tell the board the extent to which culture is fit for purpose or alerts them to where systemic problems and reputation risks are.

### Strengthen Reputation Accountability

One of the strongest findings from our research is the heightened sense of the board's accountability for reputation. They are also looking at how to ensure reputation is given the time and space its complexity demands within governance structures and board authorities.

Critically, shareholders ask about the impact of reputation impact on performance beyond the traditional scope of environmental, social, corporate governance and socially responsible investment. And investors increasingly want to understand the extent to which reputation is being managed for competitive advantage and to reduce risk or whether sub-optimal reputations are distracting managers and increasing costs and inefficiencies.

Boards are starting to seek assurance on the reputation capabilities of their executive teams with individual directors under greater pressure to be more accountable. In the words of one FTSE 100 chairman: "board members' personal accountability for reputation is now more intense."

For example, they want to know that they can make effective trade-off decisions balancing the short- and long-term requirements of stakeholders; and they want assurance that they can judge that the business model is fit for purpose from a reputation perspective.

So boards are addressing reputation accountability in three ways: through more effective oversight and reporting; through bolstering reputation risk processes, capabilities and data; and through embedding reputation in both governance and compliance.

The approach to oversight, reporting and review is a work in progress for the majority of boards. However, the desired direction of travel is clear: non-executive directors and chairs want a collaborative conversation about what they see as a critical intangible as they have yet to establish a simple and coherent framework that allows effective reporting from a number of perspectives.

The process should not be a box-ticking, compliance-driven exercise focused purely on risks to reputation but should address building value. It should not be based on rigid top-down reputation drivers but rather assess reputation at a detailed front-line level. Meanwhile, they would wish to see reporting and oversight based on meaningful insight from rigorous systems and relevant sources.

For many boards risk is the entry point to discussion on reputation. The discussion is prompted by questions around whether reputation is a primary or secondary risk or both. The debate is helping them to recognise that they have previously focused more on the symptoms rather than the causes of risks.

The leadership wants to know how effective the business is in applying a reputation risk lens to existing data and joining the dots between apparently unconnected data points. They are also examining the effectiveness of the radar and early warning systems in place and whether authorities and escalation processes are fit for purpose in an age of immediacy.

The governance challenge is focused on debating the right balance between existing structures and new ones to give reputation sufficient focus and time without creating unnecessary tiers of bureaucracy. For example, a number of bank boards have established separate committees or sub committees to ensure the complexities of reputation receive the attention they require. For some businesses this will create valuable space for review and challenge, but for others there is a concern that the proliferation of committees or sub-committees is a cause for concern with the potential danger of missing the wood for the trees.

## Opportunities for the Board

For boards, the shift from addressing short-term reputation imperatives and risks to focusing on long-term sustainable and strategic rep-

utation building that supports value creation is a significant challenge.

We believe the starting point for all boards examining these points can be found in addressing five key questions:

- Where are our reputations valuable; where do they matter to the business?
- What should these reputations be to enable growth?
- What are our reputations now? Are there gaps between current position and optimal reputation?
- Why and what do we need to do to close the gaps?
- How will we know we have been successful?

The answers will indicate to boards the value of defining and debating reputation. Meanwhile, the process will help boards identify the insight they need and the value of applying a reputation filter to the information they already receive.

Most critically perhaps, the process should shape both the board's and executive team's assessment as to where reputation determines value deep in the business, across the value chain and as an outcome of day-to-day processes. These answers should be part of the journey to embed reputation into the organisational framework.

The questions provoke a more forensic focus on whether reputation is or should be more effective in helping the business meet its strategic challenges and the existing and potential reputation risks. And in turn, this leads to the alignment and integration of the reputation strategy with the corporate strategy and risk appetite.

This inflection point is the recognition of reputation's rapidly increasing demand on the board heralding greater sophistication in the makeup and capabilities of those sitting round the table. The net result is that boards will be better equipped to support the business in delivering greater competitive advantage through a more systematic stewardship of reputation.

MARKETS & TECHNOLOGY

# "Jump on Board" – The competitive edge goes to companies with women on their boards

*Multiple research reports make clear that companies with women on their boards outperform those with no women on the board. Investors increasingly judge whether boards represent a corporation's diverse needs, including gender ones.*

As with most things that require a group of people to perform well, it is all about the team. High performing teams deploy members who know their roles and then execute. Company boards are no different. There is a captain (the chair) and the members of the team (directors). The more diverse and complimentary the talent, the better the team performs. Can you imagine a basketball team with all point guards? A high performing team is made up of diverse people who bring different skills and who are committed to the success of the whole.

*"Talent wins games, but teamwork and intelligence wins championships."*
MICHAEL JORDAN

It is no surprise that women on boards bring different skills, prepare well, work hard and focus on the performance of the team overall. What is often underemphasized is companies with female board representation *outperform* those with no women on the board. The research proves it.

The first major study was the Catalyst study in 2007.

We all remember it: *Fortune 500 companies with the highest representation of women board directors attained significantly higher financial performance, on average, than those with the lowest representation of women board directors. In addition, the report points out, on*

*Pam Craig is a Senior Advisor to Teneo and member of the board of directors of Walmart, Akamai Technologies Inc., and VMware, Inc. Megan Shattuck is President of Teneo Talent. Kimberly B. Davis is a Senior Managing Director with Teneo Strategy and the Head of Teneo's Diversity and Inclusion practice**

*average, companies with three or more women board directors have notably stronger-than-average performance.*

**Return on Equity**: On average, companies with the highest percentages of women board directors outperformed those with the least by 53 per cent.

**Return on Sales**: On average, companies with the highest percentages of women board directors outperformed those with the least by 42 per cent.

**Return on Invested Capital**: On average, companies with the highest percentages of women board directors outperformed those with the least by 66 per cent.

In 2012, Credit Suisse published a report on gender diversity and corporate performance that demonstrated that companies with one or more women on the board have superior share price performance.

In 2015, McKinsey shared new research which reinforced that companies with more diverse workforces perform better financially. The report illustrated that companies in the top 25 per cent of racial and ethnic diversity were "30 per cent more likely to have financial returns above their national industry median. Companies in the bottom quartile for both gender and ethnicity/race were statistically less likely to achieve above-average financial return."

Since 2007, McKinsey's Women Matter research has explored the role women play in the global workplace; their experiences and impact in senior-executive roles; and the performance benefits that companies gain from gender diversity. Year after year, the research reinforces that companies with women representation on the boards outperform companies with no women. The 2010 study reported that in terms of return on equity, the top-quartile group exceeds by 41 per cent the group with no women (22 vs 15 per cent), and in terms of operating results, the more gender-diverse companies exceeds by 56 per cent the group with no women (17 vs 11 per cent).

It does not get any better. In the end, what really matters is sustained financial performance over time. That is the score that is kept. That is the score that matters.

And on the homogeneity point (not everyone should be a point guard), the UK research led by Lord Davies bears that out too:

***Boards are often criticized for having similar board members, with similar backgrounds, education and networks. Such homogeneity among directors is more likely to produce 'group-think'. Women bring different perspectives and voices to the table, to the debate and to the decisions.***

## No Time for Gradualism

So what? This all makes sense so why not let things play out over time? Gradually board members retire and when they do, they are ideally replaced with the most highly skilled person. As coaches proactively identify recruits that match their needs and gaps, boards are more proactively identifying capabilities aligned with the current and go-forward business strategy. It is not only a good first step in assembling the best team, it is also good governance. As such, it would make sense to have a few women in the mix.

But here is why that is not good enough: the level of 'required' performance has changed and the bar is set higher. The basketball game your father or mother played is not the same as the one your son or daughter plays. The level of play is higher. The requirements to make the team are much more demanding. Making the team requires up-to-date and honed skills, deeper preparation, and higher commitment in order to be competitive. For different reasons, and it cannot be ignored that activists have been a catalyst here, the same thing has happened with boards. Consider the recent work of Lipton, Rosenblum and Cain (December 2014).

***Companies today are more vulnerable to activist attacks than ever before. Over the past decade or so, several trends have converged to foster an environment that is rife with opportunities for activists to extract value:***

- The steady erosion of takeover defenses;
- The expansion of the ability of shareholders to pressure directors;
- The increasingly impatient and short-termism mindset of Wall Street; and

- A regulatory disclosure regime that is badly in need of modernization to reflect the current realities of rapid stock accumulations by activists, derivative securities and behind-the-scenes coordination among activist hedge-funds and investment-manager members of "wolf packs."

***The number of activist attacks has surged from 27 in 2000 to nearly 250 year-to-date in 2014, in addition to numerous undisclosed behind-the-scenes situations.***

***In this environment, boards and management teams have been spending a significant amount of time preparing for and responding to activist attacks, and proactively considering whether adjustments to their companies' business strategies are warranted in order to avoid becoming a target.***

This is big change. Boards are under increased pressure. Some of this requirement for change is overdue. Activists have moved in because they see opportunities for higher performance by companies. Unfortunately, their objectives may not be well matched with company objectives because their horizon is more for short-term financial gains versus sustained financial performance over time. Activists are also engaging with other shareholders, traditional ones, particularly big institutions. All of this creates a very different environment for boards.

In 2015, Skadden's Insights Governance note by Marc S. Gerber cited board composition as one of four key issues impacting the directors of U.S. public companies as part of a climate of increased scrutiny. Shareholder Activism, Governance Activism and Proxy Access and Risk Oversight are the other three. He describes this trend "as part of the paradigm shift from a more deferential, board-centric model of corporate governance for public companies to a more skeptical, shareholder-centric model." Investors are loudly questioning whether boards have the right people and skillsets in place to oversee management.

## How Do I Make the Starting Lineup?

MEGAN SHATTUCK

One of the questions I hear often is "how do I get on a public company board?" Achieving a reputation for excellence with particular skill sets, developing the right relationships, inclusive of mentors and champions and demonstrating leadership skills and sound judgment are all part of the formula. What you have done, who you are and why you want to serve are all key to not only finding the right board, but to being an effective "team member" who adds value. Finding the right first board takes planning, preparation, training and discipline. It's what Middlebury Women's Lacrosse Coach Missy Foote taught during four years of competitive lacrosse: practice should always be harder than the game.

*"I never left the field saying I could have done more to get ready and that gives me piece of mind."*
PEYTON MANNING

Like in sports, sometimes you may not "make" the varsity team on your first try. Putting a thoughtful plan together that captures who you are, what you know and how you will add value is key. Understanding how your skills match up with in demand expertise such as cybersecurity, risk, and emerging markets experience is part of the process. It's tempting to want to skip "training" and go right to the game but the preparation is important on such a competitive playing field, especially for women. It is a playing field that is starting to change in today's era of governance and reputational risk, however, being proactive with relationships, recruiters, sharing your expertise, demonstrating what kind of teammate you will be are all part of the path. Take advantage of the climate.

One of the questions I am hearing a lot more often is "how do I make sure I have a high performing strategic board?" A thoughtful analysis of board competencies aligned to company strategy is a good place to start. Is the right team on the field? If and when someone leaves the board, do you have a strong bench? What new skills and backgrounds are needed to build the "best team" in the short, mid and long term? What risks are around the corner?

As coaches regularly review the starting lineup, boards should regularly review their makeup in light of the company's strategic direction. Transformation in the form of disruption, pressure from shareholders,

the press, regulation, technology and the activist landscape are challenging boards on this front. Nominating directors and evaluating the effectiveness of a current board is delicate, important work. Having a thoughtful process in place that continuously looks at the state of the board, its reputation, what is best in class today in the context of the company strategy is good governance. A high performing *strategic* board brings a diversity of viewpoints and knowledge, works effectively as a team and is committed to the success of the company.

As finding the "right board" takes training, practice, focus and diligence, so too does "building and sustaining a board" that is a strategic asset in today's environment where businesses are held to higher standards and more attention is being paid to where companies stand in their commitment to diversity, inclusion and responsible business practices. It's not only good governance – it's good for the business.

## Be a Powerful Player

PAMELA CRAIG

*"If you are going to play, you might as well win."*
*BILL RUSSELL*

It is a perfect time for well-qualified women to enter the mix. Despite the fact that activists often want to change out board members, they do not nominate women very often. In my observation (yes I am biased), women make great board members. As in most corporate scenarios, women are aware that they are being scrutinized more than the men; they know they have to play the "game." In my experience as a woman who observed boards in action and then joined several, here are some steps to getting it right:

1. ***Make sure the role is truly attractive***. *Board membership is a team role where members provide guidance and oversight. Outside board members are not in charge. Sometimes their advice is ignored. They may be right but then may have to wait until things go wrong to show that was the case. For some people that would be frustrating. If you are one of those people, don't torture yourself.*

2. ***Network to get a tryout***. *Board placements are done both with and without search firms; utilize both options. A connection and a recommendation often leads to the first opportunity and this requires patience. It has to be the right skill and role match because no one would want to be just a "diversity candidate" and any board that*

*wants just a "diversity candidate" is suspect and likely not a high performing team.*

3. ***Want to listen. Listening is important.*** *The role playing concept can help determine the right balance. Think of an individual sport (singles tennis) versus the team sport (basketball). On a team you play a role and sometimes it is not your turn with the ball. Having a point of view on everything is not as good as having a point of view on the things that count and that reflect your experience and expertise. The role is a specific one that contributes to making the team (board) strong and whole.*

4. ***Show up - be ready, prepared, and bring your "A" game - to every meeting.*** *That means reading everything, doing other supporting research, figuring out the right questions to ask. Not all the times are convenient. Once I was in Europe for a company board meeting that I could not attend in person. I was also on an outside public board that I could not attend in person because of time zones. So that meant showing up on the phone all night and then being present in the other meeting the next day. Schedules are typically very challenging and require sacrifices to cover it all.*

5. ***Expect the unexpected.*** *Like everything else in business and life, sometimes things happen that are odd, especially if you are the lone female on the board. Once I was such a lone female and there was an SUV arranged to transport those of us who were out of town board members from the hotel to the board meeting. Surprisingly, a separate and special sedan was arranged for me because it was thought I "would be more comfortable." I think I laughed, said "no thank you" and piled into the SUV so that I would not miss the pre-board conversation.*

6. ***Sign up to care.*** *One of the primary duties of a director is the "Duty of Care." It is important to "care" about the company served. To "care" that the leadership of the CEO is strong, and to "care" that the company has a strong people culture fostering employees to perform in a competent and caring way. I dare say that women often have a well-developed "caring" gene and this is good for boards. Maybe it has something to do with that superior financial performance over time.*

## Playing to Win - Does Your Culture Stand Up?

KIMBERLY B. DAVIS

*"There are only two options regarding commitment. You're either in or you're out. There's no such thing as life in-between."*
PAT RILEY

As the game changes, and businesses look for differentiation, the face of talent and leadership must respond to this new world order. A report produced by *Oxford Economics – Global Talent 2021*, states: ***"To succeed in the changing marketplace of the future, a high premium will be placed on innovative thinking, dealing with complexity and managing paradoxes. The ability to manage diverse employees is seen as the most important global operating skills over the next five to 10 years."***

It is clear that traditional diversity and inclusion approaches in the boardroom and companywide can no longer be relied on. Creating sustainable growth and profitability requires a higher level of preparation, commitment and focus. *The Wall Street Journal* reported in 2014 that the biggest U.S. businesses are still making little progress at bringing more minorities and women into their boardrooms, partly because some companies prefer to recycle seasoned directors rather than pick untapped talent. In my experience, companies are slow to recruit women and minorities to boards because of the boards' unwillingness to look at candidates who have not yet served on boards; their desire for a traditional definition of "experience" takes precedent over thinking creatively about the highly qualified pool of diverse candidates who may be viable candidates and can bring new and fresh thinking.

What do we really mean by "inclusive?" Are we only talking about gender, race, ethnicity, sexual orientation – or are we talking about 'institutional inclusion' – "the organizational change and "systemic" or "root cause" approaches that a company must embrace to infuse inclusion into the fabric and culture of their workplace. A 2013 McKinsey & Co report confirmed that corporate culture plays a critical role in how inclusion is exercised at the top of organizations. In that report, CEO's agreed that if there's one single barrier that affects women and people of color, it's exclusion from networks and conversations that open doors and build trust and relationships. One CEO said "It's subtle and unintentional, but real and potentially destructive. We, as leaders have to be realistic in recognizing the power that

we hold and use that power to break down barriers that will ultimately limit our success and profits."

In order to guide those in positions of power to ignite change in their organizations and understand how to foster an 'inclusive' environment that is not only reflected on your board but in your C-suite and senior ranks, Teneo partnered with sports legend and human rights activist Billie Jean King in 2014 to establish the Billie Jean King Leadership Initiative (BJKLI).

Billie Jean King is a shining example of a woman who possessed the innate dedication and determination to achieve goals and break barriers on her path to becoming one of the world's most celebrated athletes. Early in her career, Billie Jean was vocal in recognizing that those in power (particularly men) must use that power to effect change and create cultures that encourage and sponsor "differences," reflecting not only where the world is going, but also where the world is today.

*"Champions keep playing until they get it right."*
BILLIE JEAN KING

Billie Jean, through the BJKLI platform, believes that companies have to play to win, and if those in positions of power are not representative of our globalizing world, fresh ideas, diverse talent, and an inclusive work environment cannot prosper. The status quo is already shifting, as people of all backgrounds are being recognized and promoted for their varied skills, experiences, and viewpoints. But more must be done. At the BJKLI, we are working hard to reimagine the image of leadership not just in boardrooms and corner offices, but also at cubicles and desks around the world.

An article in *Forbes* magazine written a few years ago on the business imperative of inclusion said, "It is time to stop minimizing the value of Inclusive Leadership and its influential role on our economy and global competitiveness. The time is now to shift the mindset to an Inclusive culture and give traditional diversity a much needed refresh!" This statement is ever relevant today and it is beyond time for boards and corporations to show up with the right team to stay in the game.

MARKETS & TECHNOLOGY

# Why CEOs Make Bad (and Great) Decisions

*Or, give the guy a break, you ain't no .400 hitter yourself.*

Pity the poor CEO. He (yup still overwhelmingly a he, albeit a tad less than ten years ago) works like a dog for thirty years, then by virtue of sheer talent and application shows enough to pull ahead of his contemporaries to become the Big Kahuna.

Then what? A few years at the top, with every decision second-guessed by the Board; dealing with a squabbling executive committee, half of whom want your job; shareholders who buy in and sell out at the drop of a hat and only care about the next earnings round; media who delight in conducting an in-depth interview, then leading with the obviously light-hearted comment you made in the elevator on the way down[1]; and policymakers who are grandstanding in front of their constituencies. And please, please do not get me started on the customers.

All before being unceremoniously pushed out with an insincere compliment in the Chairman's letter in the annual report or the like. We all wince when we read, "notwithstanding Antony's significant achievements, it became clear to all of us that a new set of skills were required for the period ahead."[2]

Add in a relentless 16-hour, seven-day week schedule; a punishing

1 http://www.businessinsider.com/lloyd-blankfein-says-he-is-doing-gods-work-2009-11?IR=T

2 Barclays press release July 2015

*John McCready is a Partner with Teneo Strategy. John McCready has been sitting in rooms with CEOs for more than 30 years.*

time zone-hopping itinerary that would reduce the average Joe/ Jane to a gibbering wreck; and holidays spent hanging out of a window desperately searching for cell reception[3].

***And all this for what? A mere couple of hundred million.***

We are familiar with the modern morality tales of corporate folly. Of titanic folly. Hubris followed by nemesis. (In)famously, Kodak invented the first digital camera, but did not have the vision to see what they had and ultimately paid the price with Chapter 11. Xerox created all the elements that go to make up the modern personal computer, which they then basically gave away to a young guy called Steve Jobs. DaimlerChrysler lost over half its market cap within a year of closing the merger.

So what makes what seems so obvious to so many of us, so hard for them? Why do CEOs make such bad decisions?

Well, having worked closely with dozens of them, the truth is that they don't. They battle the slings and arrows of outrageous fortune every day. Then they make pretty good quality decisions, almost certainly better than you or I would do in the same position –and for sure with a better strike rate.

We don't say it aloud, but we don't like CEOs because they are better than us. Most of us spend our lives working in businesses, many of us in large corporations. There can only be one CEO and it isn't me. So that says someone thinks this other guy has a better combination of qualities to lead the organization than I do. Being the self-absorbed egotist that ~~we all are~~ I am, I find that quite annoying. Even though rationally I will admit that I am completely unsuited to the job and would be a complete disaster.

Did I mention that CEOs earn over 200 times the average employee? And also that, oftentimes, they are actually talented, smart and charismatic. What's not to hate?

We all love a disastrous decision; large helpings of schadenfreude all round. And even the best CEOs can get it wrong. So what is it

3 'If you absolutely must check your emails or make a phone call at Burning Man, then you really shouldn't be at Burning Man'.

that actually gets in the way of getting it right? How can you avoid joining the role of dishonor? Turns out there are several things that can be thrown in the mix:

### CEOs are Human Beings Too

Humans make mistakes. As biological organisms, we are prisoners, to a greater or lesser degree, of our genetic inheritance. As Popeye the Sailor Man informs us, *"I yam what I yam."*

So fight or flight is hardwired in. But so are more subtle mechanisms like risk aversion, where decision processes play out in complex, non-linear ways. Offer me double or quits on $1 and I'll take it. Offer me the same for a million dollars and I will run a mile. Somewhere in the middle (and your middle is not mine), there's a tough decision.

If you keep up with management literature or even just buy those books at the airport, you'll be familiar with the evolution of Homo economicus to the far-more nuanced creature – Homo sapiens redux – that we recognize today.

We have been introduced to the theory of decision-making, a strange world of game theory, bounded rationality and satisficing. Based on the original insights of Kahneman and Tversky, we all know now that we are nudged along, that we are predictably irrational and that we can make decisions in the blink of an eye. Evolutionary psychology has even shown the same supposedly irrational decision making exists in other animals[4].

I say supposedly irrational. Turns out that much of what we do unconsciously is pretty logical. Researchers at Rochester University found that "once we started looking at the decisions our brains make without our knowledge, we found that they almost always reach the right decision, given the information they had to work with."[5] Of course, the get-out is that qualifier, 'given the information they had to work with'.

The study of how we go about solving problems is heuristics. And

4 http://journals.plos.org/plosbiology/article?id=10.1371/journal.pbio.0020434

5 http://www.rochester.edu/news/show.php?id=3295

our decision-making processes are complex, paradoxical even. One definition of heuristics is that it is "a method of problem-solving that uses math to achieve solutions without understanding why or even how the math works."[6] So when you're standing on first base, you don't need to know the speed the earth is travelling around the sun, the laws of Newton or Einstein, the wind speed, ball speed, rotation, or any data at all. You just catch the damn ball.

We may well be hardwired, but we also have an operating system with a couple of different programs running. And given that being human encompasses emotions and intelligence, it's not surprising we have apps for both gut and mind.

As Nobel winner, Daniel Kahneman, put it, we have two types of decision-making processes going on, one intuitive and one rational. And intuition is "indeed the origin of much that we do wrong… *[but]*… it is also the origin of most of what we do right – which is most of what we do."

### Trust Your Gut, Unless It's Wrong

CEOs are often super-smart, successful humans – which brings its own pitfalls.

Mac Davis and the Muppets sang, *"It's hard to be humble (when you're perfect in every way)."* McKinsey put forward the idea that there are two particular types of human bias that weigh heavily on business decisions: confirmation bias and overconfidence bias, suggesting that these account for bad decisions roughly 75 per cent of the time.

Confirmation bias happens when we overvalue information that chimes with what we know or believe and undervalue information that doesn't.

Overconfidence bias is just that. *"No, you can't! You think you can do these things, but you can't, Nemo!"* (Marlin, *Finding Nemo*).

Or you think your company has the capability and it doesn't, which

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6 http://milesmathis.com/feyn2.html

explains why over-confident CEOs are 65 per cent more likely to make an acquisition.

There are two ways that confirmation bias plays out in companies. First, there's Groupthink, where the team wants to see things only one way and discounts any data that contradicts.

Then there's selective bias, where people consciously or unconsciously hide or ignore the bad stuff and only the good confirming stuff gets sent up the chain.

McKinsey used Blockbuster as an example of these biases in action when it turned down a chance to buy Netflix for $50 million. Netflix is now worth over $40 billion. Blockbuster filed for Chapter 11 bankruptcy in 2010 (re-emerging as a brand).

Smart operators acknowledge these biases and do something about it. That is why Warren Buffet invites a hedge fund that is shorting Berkshire Hathaway to ask real questions at its AGM, and also why the mighty Warren quoted Thomas Watson, founder of IBM in his last shareholder letter, "I'm no genius, but I'm smart in spots and I stay around those spots."

Overconfidence is bad. Do not fall prey to the Lake Wobegon effect – that idyllic (fictional) community where 'all the children are above average'. But conversely, you must also back yourself. J.K. Rowling got rejected by 12 publishers before getting into print.

And let's not forget that CEOs actually have to make real-time decisions – no 20/20 hindsight allowed. Hindsight is such a wonderful thing. We can all see Apple is a superstar today with a share price over $120, but not many of us bought in at a tenth of that when the first iPhone was launched only eight years ago.

Sometimes the decisions you make after the mistake are the ones that matter. JPMorgan Chase bank Chief Executive Officer Jamie Dimon almost got himself harpooned by the London Whale incident, which cost JPMorgan Chase over $6 billion in 2012. After steering the bank through the global financial crisis he had achieved what Bloomberg described as rock star status; there were

plenty ready to see the mighty fall.

Credit then to Dimon. After initially getting it wrong by dismissing the incident as 'a storm in a teacup', he addressed it head on in a barnstorming letter to shareholders. He wrote that he wanted to deal with the issue 'up front' (which really meant on page seven after some stellar figures for business performance and shareholder returns on his watch – just saying).

He apologized and told shareholders that it was 'critical that we learn from the experience'. He then showed that he had taken his own advice by listing a dozen life lessons (and resulting actions) from the incident that the bank had taken on board.

You're not allowed to mention this in polite company, but if you're a banker you are going to lose money sometimes if you're any good, you're just going to make more along the way. The chairman of one of the world's largest banks used to tell me that it isn't making mistakes that mattered in banking. Mistakes are certain; it was how you deal with them. Dimon passed that test.

News Corporation wrote down its digital investments by several hundred million dollars in 2015. Does this make Rupert Murdoch a bad investor? He is the last of the moguls, a man who built a global business empire from transformative deals (literally dozens of newspapers in Australia; *the Sun* and *The Times* in the UK; 20th Century Fox, HarperCollins and Dow Jones/*The Wall Street Journal* in the U.S.). And what that has taught us is sometimes it's not the one deal that matters, it's the cumulative impact. Like Richard Branson, Murdoch entered and exited several businesses in search of new revenues. You win some decisions and you lose some (although to be honest it really helps if you are the founder, or an investment banker).

Even Ted Williams struck out. You will get it wrong sometimes so learn to deal with it. *"I've made lots of dumb decisions. That's part of the game."* Warren Buffett.

### Timing Timing Really Matters

Take Chuck Prince, ex-CEO of Citigroup, who had the misfortune

to be the man on point in 2007 as the GFC was about to steamroller the financial services industry. He famously said, "as long as the music is playing, you've got to get up and dance. We're still dancing."

Which afterwards (key word), everyone takes as evidence that man was oblivious. But you don't get to run the biggest bank in the world by being dumb. In the same interview, he told the *Financial Times* that the party would end at some point, and "when the music stops, in terms of liquidity, things will be complicated."

*"when the music stops, in terms of liquidity, things will be complicated".*

Truth is I'm not sure Citi, Chuck or Buddha could have done much else in July 2007, although, it is interesting that Citi was quietly trying to reduce its leveraged lending – albeit too little too late – as he spoke.

For those of you long-in-the-tooth enough to remember the dot-com-fuelled crash at the turn of the century, you will also recall some fairly average analysts getting super-famous on super-bullish calls and some very smart and respected ones getting killed as the market defied gravity.

Being right is not always enough. As Keynes taught us, the market can remain irrational longer than you can remain solvent. Timing is everything. Jack Welch was CEO of GE at the same time as the longest bull market in U.S. history. Jeff Immelt took over the day before 9/11 and went through the GFC. Both great CEOs at a truly great company, but please don't compare them by the numbers. The right decision at the wrong time can be much worse than the wrong decision at the right time.

### CEOs Make Bad Calls Because They Get Bad Advice

Leaders need help. It's a tough job. They know they need all the help they can get. And in the immortal words of Ghostbusters, 'who ya gonna call'? Your Chairman? Yes, but remember he (again almost always a he) is the one who will likely fire you one day and his job is to be supportive, but it is also to oversee you and hold you accountable. Your direct reports? Yes, sure, but likewise you might be sacking them one day too, and it's not an equal relationship. That confirmation bias can creep in from below as well as above.

Your general counsel - sure. Your finance officer or accountant. Your investment banker. Truth is they all play a key role in some very specific issues. But if you take legal advice on the way to a senate hearing, you will (probably) stay out of jail but you might end up a laughing stock.

And if you don't take proper advice, you might fly there in a private jet when you're in the middle of laying off thousands of American workers and asking for taxpayer dollars. (More generally, here is my free advice: Never ever arrive at a hearing in a chauffeur-driven car. Get a cab, stop around the corner and walk in.)

CEOs need to listen to an alternate point of view otherwise they end up buying MySpace. So choose someone you trust completely; who brings an independent perspective; and gets and supports what you're trying to do.

*"Uneasy lies the head that wears a crown."*

So where does all that leave us? Most of us are just fine and dandy because all we have to do is sit on the sidelines and kvetch. Backseat driving is fun and most of us enjoy it, not least CEOs on other CEOs. Truth is: very few of us would be comfortable wielding power. As the Bard reminds us, *"Uneasy lies the head that wears a crown."*

CEOs are a special breed, like it or not. There is no template. Extrovert or introvert; intuitive or analytical; colourful or grey. Good, bad or ugly (or any other rule of three). They come in all shapes and sizes. So there may be science in becoming the great CEO, but there is also art.

By the way, when Blockbuster was offered Netflix for $50 million, it was a loss-making DVD mail-delivery company and didn't actually get into streaming content for another seven years. Amazon, Apple or Google, all of whom are in that business now, didn't do that deal either.

And the digital camera presented to the Eastman Kodak execs was a mash-up of a super-8 camera, a cassette player, a digital/analog converter and several circuit boards. It took a minute to show the picture. When its inventor was asked how long it would take to

compete with existing cameras, his answer was 15-20 years. Kodak made billions from the patents and its bankruptcy came 37 years after the demo.

Hand on heart, how would you have called those two? So to all the CEOs out there, I leave you with these words of Theodore Roosevelt: *"It is not the critic who counts…. the credit belongs to the man who is actually in the arena, whose face is marred by dust and sweat and blood… who at the best knows in the end the triumph of high achievement, and who at the worst, if he fails, at least fails while daring greatly, so that his place shall never be with those cold and timid souls who neither know victory nor defeat."*

PAUL HAENLE

POLITICS AND GOVERNANCE: CHINA

# The Road to China's Second Reform and Opening Up

*Badly handled market interventions last summer have stimulated doubt that China's leadership will devote the political capital to push through painful reforms in order to achieve faster growth.*

Anxiety over China's economy reached new heights this summer following the crash of the Shanghai Composite Index and botched currency reform, but these fears may be largely misplaced. The collapse of China's equity markets and the government's failed intervention to prop them up seem to have presented little risk to China's real economy or corporate fundamentals. Likewise, while capital outflows continue to pose risks of further currency devaluation in the months ahead, China's largest-ever trade surplus in 2015 should prevent declines in the RMB's global competitiveness.

In both instances of financial volatility, a critical tradeoff between continued progress toward giving the market a decisive role in China's economy on the one hand while preserving the state's dominant role on the other hand appeared to be resolved in favor of the state. In doing so, the Chinese leadership called into question the general direction of China's three-decade-long reform and lost important confidence within the international community that Chinese leaders are committed to pressing forward with this difficult economic transition.

Moreover, for a country that for the past three decades has prided itself on the competencies of its technocrats to generate economic growth and development, the badly mishandled and poorly communicated market interventions in August undermined faith in the

*Paul Haenle is a Senior Advisor to Teneo and Director of the Carnegie-Tsinghua Center in Beijing, China.*

leadership's ability to manage the economy, which could translate into greater risk and volatility in the markets going forward. The crisis of confidence in Beijing's capacity and willingness to achieve this difficult economic transformation is a new and important dimension of the China transition story.

China's leadership recognizes that reforms which provide a greater role for the market are the only path for continued growth and development, and they have a detailed and widely endorsed blueprint in the Third Plenum decision to guide them. The question now is one political will: do China's leaders have the necessary political space, and will they devote the political capital to push through painful reforms in order to get to faster growth? Several important indicators in the months ahead will provide further support and evidence of the general trajectory of China's reforms.

*China's leadership recognizes that reforms which provide a greater role for the market are the only path for continued growth and development, and they have a detailed and widely endorsed blueprint in the Third Plenum decision to guide them.*

Despite the tendency to focus on the crises of the moment and the day-to-day fluctuations in the markets, the adroit executive's eye is concentrated on the mid-term indicators of China's commitment to long-term political imperatives (reform in order to avoid stagnation) in the face of short-term political needs (meeting growth targets and avoiding instability). Successfully navigating the risks going forward will require an understanding of the changes in decision-making under President Xi Jinping and a government relations strategy that aligns with these new realities on the ground. China remains a critical growth market. With the right approach, executives can manage uncertainty. With resolve, China offers an unprecedented opportunity for multinational companies over the long term.

### Summer Shocks

The international community has long admired China's ability to generate high growth and competently manage the economy – now the world's second largest. That confidence was challenged in the summer of 2015 by the collapse of China's equity markets, currency devaluation and weak economic indicators. Through a serious of policy blunders, China's leadership revealed the inexperience of China's economic policymakers and the underdevelopment of its financial institutions to manage the excess volatility and the uncertainty of the future direction of Chinese reforms.

To begin, in the first half of 2014, amid a deepening slowdown of the economy, the Chinese government began encouraging ordinary Chinese to buy stocks. Official statements talked up the stock market and media reports suggested that the government would back its dramatic rise. Prices soared more than 150 per cent with the introduction of margin trading, and although valuations had become wildly out of line with corporate profits, the Chinese Securities and Regulatory Commission (CSRC) never intervened. The bubble peaked on June 12 after it was announced that a decision on China's membership in the MSCI's Emerging Markets Index had been postponed.

Once the bubble burst, the Chinese government stepped in with heavy-handed intervention that included a massive $400 billion program to support stock prices, a virtual ban on short-selling, restrictions on selling by major shareholders and the loosening of margin lending regulations. As many experts have noted, when the government stepped in, the market was still high; the move was poorly timed and was only temporarily effective. In July, Chinese equity markets had lost one third of their total value. Within two months it was clear that the policy had failed to stabilize and prop up prices.

The unexpected devaluation of the RMB and further weak Chinese economic data led to an 8.5 per cent drop in the Shanghai Composite's Index on August 24, later deemed "Black Monday." China's market volatility spread to financial markets across the world, causing a global sell-off. The following day, after further dramatic declines, China's central bank simultaneously cut interest rates for the fifth time since November and lowered reserve requirements for the third time. Officials later announced China had abandoned its large-scale share purchase program. In turn, authorities revved up efforts to blame journalists, traders, and even foreign forces for "destabilizing the market."

As the Chinese October National Holiday arrived, China's stock market finally seemed to stabilize at levels more than 40 per cent below their June high (but still almost 30 per cent above levels one year ago). The fall in Shanghai equity prices by 4.8 per cent in September was the smallest monthly price move in either direction since February 2015. Yet, there are signs that equity purchases by the gov-

*Successfully navigating the risks going forward will require an understanding of the changes in decision-making under President Xi Jinping and a government relations strategy that aligns with these new realities on the ground.*

ernment have resumed. This, along with the arrests of several top securities market regulators and a sharp increase in margin requirements and transaction fees for index futures trading, seem to have prevented further volatility.

Regardless of whether China's markets can sustain longer-term stability in the weeks and months ahead, investor confidence remains damaged. Communication by the government of its intentions throughout the equity crisis was lacking. President Xi made his first public statement acknowledging the stock crash in a speech during his first state visit to the United States on September 22. Despite causing a global sell off and attracting enormous media attention, the Chinese leadership publicly avoided the crisis and ordered Chinese media not to report on it while it was happening. Furthermore, when Xi spoke about the stock market, he never acknowledged the government's complicity in bringing about the bubble, only highlighting and justifying the government's efforts to manage the correction on the way down.

The second botched summer intervention came after the People's Bank of China (PBOC) abruptly announced a one-off, 1.9 per cent devaluation of the RMB on August 11 – the most significant one-day adjustment since the hard peg to the US dollar was abandoned in July 2005. The downward adjustment occurred alongside a change in China's daily rate fixing policy that would allow the market to play a larger role. Instead of the central bank making the decision unilaterally, as had been done in the past, the opening rate is now determined by the previous day's closing rate, although it retains some flexibility according to supply and demand conditions and major movements in other currencies. The daily maximum trading band for the RMB was kept at two per cent.

The policy move was likely motivated by a number of factors. China was trying to make the exchange rate more market-determined to respond to IMF requirements for the RMB's entry into its special drawing right (SDR) currency. Against the backdrop of slowing Chinese growth and weak economic data, the RMB had also become overvalued. Other factors such as concerns about a U.S. Federal Reserve move to raise interest rates likely contributed. But, there is little evi-

dence that the Chinese government was attempting to boost exports.

Nevertheless, the poor manner in which the devaluation and rate policy was communicated once again led to unintended consequences for Chinese policymakers. The abrupt devaluation led to strong downward speculative pressure on the currency thanks to already deep-seated nerves about China's poor economic health. As a result, the central bank has, ironically, been forced to step up its foreign exchange purchases to keep the RMB currency high. The PBOC spent over $90 billion in August alone in currency markets to defend the RMB at a rate of about 6.4 yuan to the dollar. The PBOC appears to have in effect reinstituted a soft peg to the U.S. dollar. Thus, China's policy change failed on three counts: it did not stem capital outflows, nor did it give the market a larger role in setting the RMB value. Instead, it further undermined confidence in the Chinese leadership.

## Two Steps Forward, One Step Back

The series of crises this summer led to a range of reactions by expert observers. The most dire concluded that China's economy is heading quickly for a hard landing; Chinese growth numbers vastly over-exaggerate true economic performance; and Xi and the Chinese leadership's political authority is now in question. While serious challenges exist, these conclusions likely are largely overblown. The performance of China's equity markets is a poor indicator of the health of China's real economy. Domestically, Xi continues to enjoy high popularity and faces no serious challengers to his power. In the short-term, the government has the capacity to maintain a high degree of growth.

The picture is not altogether bleak. While China's economy is slowing, it is also undergoing a structural transition away from export- and investment-led growth to a consumption and innovation driven economic model. The slowdown was anticipated and mostly by design. Although certain sectors and regions in China that are most dependent on resources and heavy industry have slowed dramatically, others are taking advantage of new areas for growth. The services sector grew 8.4 per cent in the second quarter while the industrial sector grew only 6.1 per cent. In 2015, for the first time, services are expected to contribute more than half of China's GDP, highlighting

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the passage of an important threshold in China's shift to a service economy.

Despite weak manufacturing and industrial output, China's consumer middle class continues to see growing incomes and consumer spending remains high. Financial reforms are making solid headway, including the liberalization of interest rates and reform in the banking sector as a result. Further land and housing registration (hukou) reforms could unleash further urbanization, which has fueled China's economic growth and development for the several decades prior. For all of the government's policy missteps, reforms are showing some results.

But the commitment of China's leaders to economic reform has, for the first time in decades, been called into question by events this summer. China's stock market crash and currency devaluation exposed the inherent tensions between the leadership's dual aims to implement market reforms and further opening, and to preserve the state's dominant role in the economy. When the results of giving the market a more "decisive role" – whether in equity markets or currency valuations – created undesired volatility, China's policymakers gave in to the temptation to revert back to government control and intervention.

Although the Third Plenum reform blueprint appeared to indicate that China's leaders were committed to giving markets a "decisive role" in resource allocation, the document also affirmed that the state sector would maintain its "dominant role" in the economy. That contradiction has led to a "two steps forward, one step back" result along China's path to further reform and opening up in many cases in the years since the November 2013 plenum. Over the summer, the contradiction reached a climax, as confidence in the leadership's ability to steer the economy lapsed.

Many are now asking: if the government's political agenda requires the state economy to continue to be the principal component of the overall economy, what will be the driver sufficient to push China's economy forward beyond consumer spending? In order to ensure sustainable growth over the long-term, a conclusive and consistent

embrace of market mechanisms regardless of short-term instability — will be required.

## Looking Ahead

Several events in the coming months will serve as important indicators of the leadership's continued commitment or hesitation to a full embrace of market forces. These include the list that the Chinese side brings to the U.S.-China bilateral investment treaty (BIT) negotiations this fall, the seriousness of the State Owned Enterprises (SOE) reform document and the 13th Five Year Plan released in March 2016.

### BIT negative list

At the Strategic and Economic Dialogue (SE&D) in Washington, D.C. in June 2015, China and the United States each exchanged initial negative lists for negotiation toward conclusion of a bilateral investment treaty. The lists detail the industries that are not open to foreign investment, a fundamentally new approach for China adopted in its Third Plenum reforms. While China's move to this new approach toward market access and investment is welcomed, China remains reluctant to open its economy to foreign investors in a long list of key sectors and industries. Following June's SE&D, both sides agreed to submit a second round of shorter negative lists in early September before President Xi Jinping's visit to the United States. During this second round of negotiations, no major breakthroughs were reached ahead of Xi's state visit to the White House. Many had hoped the BIT would be a major deliverable for the summit, but all that was announced was an agreement to progress work toward the conclusion of a high-standard treaty. While more details will emerge in the weeks ahead, this seems to be a disappointing indication of China's further opening of its markets to U.S. and foreign businesses.

### SOE reform document

On September 15, China's State Council released a new SOE reform document intended to improve the state sector's performance, which has long monopolized resources and bank credit, which would arguably be better employed by private enterprises. Private firms in China have long faced high barriers to entering key sectors, and SOEs' protected positions allow them to keep prices high. The reform of China's state sector has been held up as a critical gauge of the seri-

ousness of China's leaders to fundamental economic restructuring toward market forces.

For international observers, the reform package was underwhelming. The plans called for tried, long-standing policies to encourage more private investment in state firms in order to improve corporate governance. Unfortunately, "mixed ownership" of SOEs has been promoted by Beijing for decades and the results have been mixed. Moreover, great doubt greeted the idea of setting up state capital management companies to independently manage the government's assets. Finally, the reform document devotes considerable attention to strengthening party control in SOEs as a top priority for overall reform.

### 13th Five-Year Plan

In March 2016, the public will see the final version of the 13th Five-Year Plan (FYP), drafted by the National Development and Reform Commission (NDRC), which outlines the government's social and economic priorities and goals. The 12th FYP (2011-2015) outlined specific goals, including achieving a GDP growth rate of 7 per cent, increasing urbanization by 4 per cent , raising incomes by 7 per cent each year, and increasing the use of non-fossil fuel energy. An assessment of the 12th FYP is likely to be released later this year. Plans for the 13th FYP began in April of 2013 and based on precedent, the document will be released to the public in March of 2016. The next FYP is likely to focus on maintaining economic growth and realizing the vision laid out in the Third Plenum reforms. The 13th FYP should serve as a helpful indicator of how the business landscape in China will be shaped through 2020. The annual GDP growth target will set the expectations for the government for the next five years and analysts forecast it will be between 6.5-7 per cent. The One Belt One Road initiative is expected to feature prominently.

## New Realities, New Approaches

It is not just uncertainties over China's commitment and ability to enact market reforms that pose challenges for executives in China. Xi has unleashed the most far-reaching anti-corruption campaign in the nation's history, moved the locus of policymaking from the government to the Party and cracked down on the space for political and intellectual debate. Policy missteps this summer brought to

light some of the weaknesses and unintended consequences of these changes, many of which run counter to Xi's ultimate aims and objectives.

To begin, Xi's sweeping anti-corruption campaign, which enjoys enormous popularity among the Chinese public, has also contributed to reform paralysis. The drive was launched shortly after Xi assumed the role of General Secretary of the Communist Party in November 2012 in response to broad public discontent and resentment over elite corruption and local officialdom. For Xi, corruption is a fundamental threat to the Party's survival. It also fits other objectives, including eliminating political opponents, shoring up control of the main levers of power including the military, and removing vested interests to economic reform.

Yet, the undefined scope and somewhat arbitrary nature of the campaign has paralyzed decision-making within a frightened bureaucracy. Furthermore, eliminating corrupt leaders in reforms areas that have faced resistance from vested interests, such as the oil boss Zhou Yongkang, has yet to translate into progress toward tackling China's bloated state owned enterprises. Instead, risk-averse local leaders have stopped making decisions, including approving new spending projects. Xi's increasing use of Leninist political tactics has compounded the sentiment that it is too risky to do anything. Experts suggest this paralysis is having a real impact on economic growth. Historically, these campaigns produce only temporary effects, as they neglect to strengthen institutions.

Other factors are adding to the decision-making and reform paralysis. As the strongest leader in more than two decades, Xi has concentrated power and decision-making in his own hands. Xi relies less on the formal State Council structure and hierarchy for policymaking and more on a close set of informal advisors and advisory bodies. He has also brought about the rise in influence of twenty-two new party leading groups, six of which he leads, which have assumed great authority within the former policy planning process and play a large role. These bodies now make policy instructions and oversee implementation on issues ranging from economic reform to foreign policy.

With so much authority concentrated with Xi and little movement in the bureaucracies, China's old system of governance is stuck while the new system is not working yet. The government is pushing officials to spend money but bureaucrats are not spending money because the risks are too high. Meanwhile, over-centralization has constipated the system, caused bureaucratic confusion, and led many to ask if Xi has the bandwidth to be in charge of everything. Few see much likelihood of a serious leadership challenge to Xi, but his authority could suffer if these policy-making problems intensify and the economy continues to sputter. The enormous authority concentrated in Xi's hands in the short term, with so few checks and balances, also raises questions for the long run.

These changes in the way the leadership is operating and whom decision makers are asking for advice has important implications for how foreign businesses need to connect and deal with the Party and its agencies and people. In many cases, they will require a revision of government relations strategies. In the past, foreign businesses could go to the ministry that oversees their industry or regulatory overseer and have some sense that if that person told them something about the direction of policy, that they could take that to the bank. Now, executives who are interacting only with government ministries will begin to find that suddenly policy can shift on very short notice.

Multinationals will need to expand their strategic networks from government officials to strategic influencers. In many cases, the interlocutors many executives are used to dealing with on the government side have less influence. Understanding new circles of influence in China and building those relationships will be critical and knowing the key "influencers" in the Party, Chinese government and business circles is more important than ever.

OTILIA DHAND

POLITICS AND GOVERNANCE: RUSSIA

# Geopolitics of Putinism

*In 2016, the geopolitics of Putin will remain the defining feature of Russia at home and abroad. Deteriorating economic conditions may drive the Kremlin to a more extreme position rather than reconciliation.*

Over the past year and a half, the majority of headlines covering Russia were defined by geopolitics. President Vladimir Putin's desire to restore Russia to its former status as a great power has driven not only Moscow's external relations, but also developments within the country itself. The resulting dynamics have shaped the changing perceptions of Russia domestically, and internationally. In the coming months, these will likely translate into more solid structural changes, suggesting that the operating environment for foreign corporations trading with - or operating in - Russia will settle into a new and uncomfortable status quo.

## Geopolitics of Putinism and the new Russian Identity

Moscow's aim to carve out its own economic and political zone of influence and to establish the new narrative of Russian national identity are the cornerstones of the geopolitics of Putinism. Both feed into Russian society's perceived need for the restoration of Russia's dignity as a great power. Recent developments suggest that the divide between Russia and its external interlocutors (including the United States, Europe – led by Germany – and Ukraine) will solidify in the medium-term and that deteriorating economic conditions may drive the Kremlin to a more extreme position rather than reconciliation. This means that the operating environment for multinational companies will remain difficult, since they are cast as representatives of

*Moscow's aim to carve out its own economic and political zone of influence and to establish the new narrative of Russian national identity are the cornerstones of the geopolitics of Putinism.*

*Otilia Dhand is a Senior Vice President with Teneo Intelligence focused on the economies of Central and Eastern Europe.*

foreign powers and are often targeted by the Kremlin in response to a deterioration of Russia's relations with their country of origin.

Putin best described the basis of his geopolitical views in his speech to the Valdai Discussion Club, an annual gathering of international experts on Russia, in October 2014, in which he presented his vision of an emerging multipolar international structure. In such an arrangement, regional powers would create their respective economically and politically integrated blocs and set rules for their mutual interaction on a global scale.

This logic, which necessitates the creation of Moscow's own bloc if it is not to become a periphery of somebody else's zone, is the driving force behind the Eurasian Economic Union (EEU). In this context, Russia's focus appears firmly fixed on what is termed the "near abroad," the countries of the former Soviet Union. Ukraine was expected to be a key part of this bloc although Russia is unlikely to give up its efforts to include Kiev. The practical implications of Russia's drive to construct its own exclusive bloc are not limited to its assertiveness towards Ukraine. The latest proposal that EEU countries should avoid using the U.S. dollar and the euro in trade within the bloc is another example of how the regional blocs theory translates into the real world.

*Tradition, Russian Orthodoxy, historical exceptionalism and cultural mission have become hallmarks of the new national identity narrative; the return to great power status has been its overarching message.*

To substantiate this objective, the Kremlin embarked upon a project of delimiting its boundaries by defining the identity of Russia (or a notion of "us") as unique from everybody else. Tradition, Russian Orthodoxy, historical exceptionalism and cultural mission have become hallmarks of the new national identity narrative; the return to great power status has been its overarching message. The new identity draws a clear dividing line between Russia as an embodiment of traditional virtues on the one hand, and alien and decadent liberal Europe or aggressive and destructive U.S. on the other hand. Military posturing against NATO, where the U.S. is cast as the driver of aggressive policies and Europe as its hapless follower, is a part of the construction of a domestic image of Russia's might – reminiscent of the days of the Soviet Union as a global superpower.

The Kremlin's near complete control of Russian media will ensure

the transmission of the government's message as well as its consistency across all media outlets. In the past twelve months, Putin's popularity surged due to renascent nationalist fervor. The external enemy has also been useful in creating a siege mentality, which limits the likelihood of popular unrest in response to increasing economic hardship. Given the domestic utility of the stand-off with the EU and U.S. for the Kremlin, it is unlikely that mutual relations with Russia will improve even after the crisis in Ukraine is over. For multinational companies this means a return to the pre-crisis status quo is unlikely and they may continue to be an easy target of Russian retaliation whenever relations with their countries of origin sour.

Yet, the focus on the near abroad, for as long as it lasts, will limit Russia's appetite to be actively involved further afield. Overall, Russia will likely remain a cooperative actor on the global stage. Although Russia will continue to support and foster its traditional allies (as seen with its recent military support to Syria's Bashar al-Assad) or seek a more secure foothold in various locations globally, it is unlikely that it would go into an open conflict with the United States or Europe over issues not related to its immediate neighborhood. In handling these issues, Russia will focus on carving space for itself at what Putin sees as the future negotiating table of large regional powers.

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## Beyond the Ukraine Crisis

Moscow's military posturing has shifted the stand-off over the Ukraine crisis to a new level in recent months. While in summer 2014 the issue was largely viewed as a problem related solely to Moscow's effort to reverse Kiev's westward trajectory, less than twelve months later, Russia is perceived as the top regional security threat in Central and Eastern Europe (CEE). Continual Russian incursions into the Baltic airspace and waters have motivated an increase in military spending in countries on the eastern edge of NATO. However, signs show that more fundamental shifts are forthcoming in 2016.

The Russian military has been flexing its muscles over a wider geographical area over the past eighteen months. There have been a record number of Russian military exercises, including drills of strategic missile forces. Searches for suspected Russian submarines have

taken place in Swedish, Finnish and British territorial waters. Near misses between Russian military aircraft and commercial passenger flights have been recorded in skies over several European countries. In response, NATO stepped up its exercise activity in the region and CEE countries have increased their military spending and amended their defense policies. In addition to a series of announcements of material purchases, changes have been registered in the size and nature of military exercises, as well as in the overall structure of military forces in the region. Though perceptions of Russia as the top security threat are not necessarily shared by all European countries, the U.S. announced a commitment to a long-term military presence in the CEE in June 2015. While this was mostly a symbolic statement consistent with existing planned U.S. deployments on the ground, it signaled another step in what will likely become a structural shift in security arrangements in the region. A familiar pattern of the textbook prisoner's dilemma is gradually emerging along the fault-line on the eastern edge of NATO.

The planned security fence on the Estonian-Russian border may become its physical manifestation, but structural shifts, which are gradually emerging on a political level, have more grave implications. NATO has created and fostered its rapid response force and prepares scenarios specifically contemplating the possibility of Russia launching a hybrid war against one of its members. Moscow halted its participation in the Treaty on Conventional Armed Forces in Europe in March 2015 and subsequently overhauled its naval doctrine, identifying NATO as the main possible adversary. These acts solidify the perceptions of new adversity and a stand-off between Russia and NATO in Europe. Once enshrined in official documents and commitments to allied countries, such perceptions are likely to become structural.

Yet, it is unlikely that Russia would take matters as far as risking open military confrontation with NATO. In fact, Moscow's aim is to challenge NATO's position as an effective guarantor of security to Russia's former satellites. Russia may engage in events of non-military character (such as the abduction of an Estonian intelligence officer in September 2014), which are in essence breaches of state sovereignty and security of its neighbors, but will avoid episodes that

are serious enough to trigger responses from the alliance. Such inconspicuous acts are designed to question NATO's practical utility. The aim of Russian policy is to assert Moscow's role as a major power and potentially force a redesign of international security structures in Europe to permit Russia a greater say in high-level discussions. This suggests that even after the Ukraine crisis is eventually over, relations between Russia and NATO countries will likely remain tense.

As a result, the operating environment for western corporations in Russia will remain more complicated than ever before. The continuation of tensions has not have triggered significant policy shifts and the securitization of international relations narratives have entrenched mutual perceptions of strategic rivalry. In addition to negative changes in the business environment, transaction and financing costs may also be adversely affected.

## Economic Outlook for 2016 Remains Challenging

Oil and gas have been a consistent part of Russia's power projection. Energy exports, which typically account for 15% of Russian GDP, are the driving force of the economy, a center-piece of Russian budget revenues and the main source of political patronage in Putin's years in power. Years of high oil prices masked the structural deficiencies of the Russian economy: lack of diversification, low labor productivity and reliance on technological imports, but these deficiencies have been exposed over the past twelve months as a result of low oil price environment and international sanctions.

Yet, rather than addressing structural weaknesses, the Kremlin's policies focus on the stabilization of the status quo to the benefit of the elite. The government's plan to ride out the recession focuses on providing financing for strategic enterprises, systemically important banks and stabilizing the ruble. The economic decline is being portrayed as a result of external forces aiming to keep Russia down and out. Placing the blame on external enemies fits well within the overall narrative of the geopolitical confrontation put forward by the Kremlin. While such a narrative deflects criticism away from the government, it does little to improve the economy's fundamentals. The setup and motivations of the decision-making circle are unlikely to change substantially in the near future. CEOs of multinational com-

*The aim of Russian policy is to assert Moscow's role as a major power and potentially force a redesign of international security structures in Europe to permit Russia a greater say in high-level discussions.*

panies operating in Russia should therefore prepare for more of the same policies in 2016. For now, Moscow has sufficient fiscal reserves and the National Welfare Fund to support both the currency and strategic enterprises until the end of next year, when Russia hopes economic growth will pick up. Meanwhile, the decline in the ruble's value will continue to shelter the state budget from the worst effects of the fall in oil prices and buoy the commodities exporters.

The one idea that aims to induce a restructuring of the Russian economy is the drive for import substitution. This is underpinned by the fact that Russia needs to wean itself off the dependence on vital imports from countries it now considers to be adversaries. The Imports Substitution Commission launched in September 2015 under the leadership of Prime Minister Dimitri Medvedev. Defense and civil engineering will be the initial focus sectors in 2016, as Russia will look to replace key imported components with domestically produced ones.

*Putin's economic policies are unlikely to bring substantial stimulus to the economy in the absence of an oil price recovery.*

The push for the development of domestic capacities will continue side-by-side with the food imports embargo (which expires in August 2016, but may be extended) and the occasional harassment of importers of non-sanctioned items with regulatory checks and temporary imports bans. Similarly, products or operations of U.S. and EU companies in Russia may be the target of regulatory actions for political reasons. Such events are usually in response to a deterioration of Russia's relations with the country of origin of the given producer. While these typically only result in temporary disruptions or fines, they may lead to an increase in operational and administrative costs, or damage to brand reputation.

### Sanctions Easing a Prospect for 2016

Prospects of sanctions being eased will likely improve in 2016, but the effects of their lifting would be felt in the economy with a delay. Such a move would depend on the stabilization of the security situation in eastern Ukraine. Moreover, sanctions easing on the part of the EU would likely be a function of political bargaining among the 28 countries in line with its consensual policy-making model. As a result, all sanctions may not be lifted at the same time. More likely, some sanctions (those concerning the financial and energy sectors)

would be eased, while some (those concerning the defense and dual use technology sectors) would remain.

The U.S. continues to act in lock-step with the EU on sanctions against Russia. There is no obvious reason for this to change in the near future – neither Brussels nor Washington are ready to hand Moscow a strategic victory by splitting their united front against Russia. Therefore, it is likely that, should the EU ease the sanctions regime, some partial easing would also be introduced in the U.S. However, the degree of easing would likely be somewhat lighter and only apply to sanctions introduced by the president's executive order (not those passed by Congress in December 2014). Presidential sanctions to mirror the EU sanctions on financial, energy, defense and dual use technology sanctions, and coordination would therefore be relatively easy.

The lifting of sanctions would create an opportunity for first movers; although, the decision to move back into the Russian market will likely be underlined by economic conditions in the market rather than just political considerations. Putin's economic policies are unlikely to bring substantial stimulus to the economy in the absence of an oil price recovery. Yet, the sanctions easing may only become a prospect in late 2016 if the security situation does not improve early in the year.

The longer the sanctions stay in place, the more impact they will have on Russia's geo-economic positioning. Russia's turn toward China and other Asian neighbors may accelerate since the initial installation of sanctions on Russia, although none of the major projects Russia pitched, especially the gas pipelines to China, have come to fruition. Yet, Russia would be increasingly likely to accept Chinese and Indian participation in major projects if prolonged sanctions intensify the need for an injection of capital. The financing cushion provided by Russia's National Welfare Fund is unlikely to last beyond 2017.

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## Russian Domestic Political Risks Limited in 2016

Putin's geopolitics and its negative economic consequences have raised the possibility of his ousting from power in a palace coup by economic elites or through a public process. However, Putin has so

far proved adept at preventing possible challenges to his leadership. 2016 will see general elections and the Kremlin has again been managing risks in advance.

General elections will likely be held two months earlier than originally planned -- in September 2016 rather than in December 2016. With minimal access to nation-wide media, the non-parliamentary opposition focuses its campaigning on street rallies. By rescheduling elections for September, campaigning is confined to summer months, when the likelihood of public gatherings attracting a large attendance is low. The date change is in direct contradiction to the Russian constitution, which stipulates that the parliamentary term lasts a full five years, but the Constitutional Court allowed the rescheduling regardless. This will further reduce the chances of anti-Kremlin parties entering parliament. In Russia's proportional system, the threshold for entry into the Duma is seven per cent and it is unlikely that any single non-parliamentary party will win enough votes. To redress their individual weakness, these anti-Kremlin parties joined forces under the leadership of Alexei Navalny in April and will run a joint campaign in general elections. However, even on a united platform their prospects for winning seats in the Duma are limited.

Overall, the outlook for the general elections remains unchanged: pro-Kremlin parties will likely secure almost complete control of the parliament again. Nevertheless, the government is not taking any chances, as protracted economic difficulties may gradually erode the establishment's popularity. Besides grass-root opposition, the establishment seems to be increasingly targeting the country's former liberal elite. The criminal case filed against Leonid Melamed (an ally of former deputy prime minister Anatoly Chubais) in summer 2015 is widely interpreted as a step to prevent the potential rise of a viable political alternative in Russia.

Widespread public protests for now appear to be a limited risk in 2016. Economic hardship may eventually motivate anti-government moods; however, the likelihood of such an event is mitigated by the government's control of the media and the message that it transmits: that economic difficulties are a result of external forces and the gov-

ernment is busy mitigating the impact on the population. However, as the new nationalist narrative takes hold, it is the far-right movements that may start to represent a risk for the government. With the radicalization of public opinion, the appeal of existing far-right groups and figures may increase, especially if the economic situation worsens dramatically. In fact, the challenge in terms of the rise of a non-parliamentary political party is much more likely to come from the far-right than from liberal opposition figures. However, even this risk is low in the next twelve months.

## More of the Same in 2016

The emerging dynamics within the Russian Federation and in its relations with Europe and the United States suggest that 2016 will see gradual structural changes that will solidify the geopolitical rift that opened over the Ukraine crisis. Even after the conflict in the Donbass eventually settles, relations will remain strained and the operational environment for foreign corporations potentially difficult. Aside from the obvious implications of bans and sanctions currently in place, disruptions to operations and supply chains as a result of regulatory actions are likely. The developing concept of 'the West' as alien to Russian culture may impact brand perceptions of US and EU companies in the Russian market. Yet, overall, Russia will likely remain politically stable next year, despite an economic growth outlook that is far from rosy. Both at home an abroad, the geopolitics of Putinism will again remain the defining feature of Russian headlines in the coming year.

CARSTEN NICKEL, WOLFANGO PICCOLI AND ANTONIO BARROSO

POLITICS AND GOVERNANCE: EUROPE

# Europe's Year of Transition

*Unlike 2015, the year ahead promises few large political events but some smaller number of ones that greatly matter to business and the markets. Day-to-day politics will be preoccupied with the work lead up to 2017 elections in German, Italy and Great Britain.*

The first thing to note when looking ahead to Europe in 2016 is that big and immediate crises will have been a trend of 2015. Rightly or wrongly, markets have the tendency to focus on big events – for example, this year's early elections in Greece, or the many make-or-break meetings of the Eurogroup and the European Council. The next series of such large-scale events will take place in 2017 when the leaders of the Eurozone's three biggest economies will all seek re-election: Matteo Renzi as the Prime Minister of Italy, Francois Hollande as French President, and Angela Merkel as German Chancellor. On top of this, in 2017, British voters will be called to the polls to decide which way to turn in the difficult relationship between Downing Street and the EU: should Britain, the bloc's third-largest member, remain a part of the Union, or will it embark on a journey towards "Brexit"?

At first sight, 2016 appears to be nothing but a transitory year on the way to the all-decisive 2017. But while markets may indeed frame things this way, the logic of politics is different. Indeed, the outcomes of the four big polls of 2017 will largely be influenced by what happens over the 12 months ahead of us now.

*Carsten Nickel is a Senior Vice President with Teneo Intelligence focused on Western Europe, particularly Germany and the Eurozone. Wolfango Piccoli is co-leader of Teneo Intelligence and Director of Research. Antonio Barroso is a Senior Vice President with Teneo Intelligence focused on the Eurozone and political and economic developments in Southern Europe and France.*

What can the EU and the European Central Bank (ECB) do to help growth return to the Eurozone, and especially to the ailing French and Italian labor markets, thereby enabling the determined reformer Renzi and the embattled Europeanist Hollande to hold on to their posts? Can Prime Minister David Cameron maintain the grip on his rebellious backbenchers at home while also negotiating a deal with Europe that stands any chance of approval with British voters? And how much leeway will domestic German politics (as well as the need to constantly entertain President Vladimir Putin over Ukraine) leave the continent's most influential politician, Angela Merkel, to steer all these debates at the European level?

Day-to-day politics in 2016 will determine the outcome of these questions in 2017. European politics in the 12 months directly ahead of us may offer a comparably smaller number of visible large-scale events, but they do matter greatly for businesses and markets.

## Greece's Less Risky Prospects

To understand how the 2016 political debate will differ from 2015, take a look at 2015's most notorious European crisis country: Greece. As 2015 comes to a close, the country is still a member of the Eurozone, the country's third bail-out has been agreed and the ensuing snap elections have been held. What is ahead now is in many ways a return to the usual — certainly problematic, but less large-scale — trajectory we have witnessed in Greece for years now.

In 2016, program implementation will remain thorny, especially as trust between Athens and its lenders has fallen to a level where any sub-tranches of fresh funding will only be disbursed against prior progress on the domestic reform front. Rather than the outstanding events that took the country to the brink of an exit from the common currency, the biggest risk in 2016 remains delays to the implementation of specific reforms and bailout conditions on the ground. From there, a vicious circle ensues: falling government revenues and rising non-performing loans (NPLs) necessitate further budget cuts, with additionally negative effects on the growth outlook. This, in turn, requires further adjustment, and so on.

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But with Greek Prime Minister Alexis Tsipras and his reformed SYR-

IZA committed to the country's euro membership, it is unlikely that Athens and its creditors would once more embark on a path of direct, large-scale confrontation. Grexit is therefore unlikely to become a real option again soon.

### New EU Terms for the UK?

Another example of the importance of 2016 politics for the following year is the British referendum on EU membership. Following his landslide victory in the general elections this year, Cameron will remain both emboldened by his strong performance and under pressure from his eurosceptic backbenchers. Appeasing the latter will be tough, especially because the British Europe question is not simply about the referendum. Before the Prime Minister can go to the country, he will need to negotiate something that can be put before voters. That conversation, which Cameron will have to have in Brussels, will take place over 2016.

Britain will hold the EU Council presidency between June and December 2017; therefore, conducting a referendum in the second half of 2017 would hardly be suitable. Any window for negotiations between the UK and Europe, therefore, is narrow. Cameron will likely be a tough negotiation partner for his European colleagues. On the flipside, his European partners will have their own domestic political rationales to take into account. Facing Cameron are Hollande and Merkel, who will both be eager to keep any debate about the EU's future architecture out of their 2017 campaigns. On either side of the Rhine, conversations about Europe don't sell well these days, as witnessed by the surge in the eurosceptic vote in France and the unpopularity of Eurozone bail-outs in Germany.

As the UK's most committed European partner, Berlin is principally more sympathetic to many of the British demands than are the French government or convinced federalists like EU Commission President Jean-Claude Juncker. This even counts for controversial issues such as welfare and fiscal transfers. But as a leading EU country, and with a domestic political culture built around consensus rather than confrontation, Germany has always had a much more pragmatic stance on Europe than the UK. The Germans know that the European project can only be maintained if all sides step back from maximum demands – precisely the message that Cameron has

so far found so difficult to convey at home.

This means that there is room for concessions on the margins – potentially on partially repatriating some minor powers on business regulation – but not on fundamental principles such as the freedom of movement, regardless of private sympathies in parts of German politics. On the key issue of migration, the Germans have in the context of the 2015 refugee crisis sided with Juncker's proposal for a European quota solution for the Schengen area (of which the UK is not part), despite Berlin's initial rejection of the plan. Progress on large-scale changes like Berlin and Paris' sudden alignment with Juncker's ideas was brought about, as always, by a joint and coordinated Franco-German proposal. This already highlights the limits of what the continent will be willing to offer to Britain in 2016.

Specifically, Merkel and Hollande will remain unwilling to change EU treaties, given that the French constitution would require a referendum to do so, while a public vote would probably be politically unavoidable in Germany as well after years in which the country has taken on financial obligations on an unprecedented scale in the context of the Eurozone crisis. Winning such votes would be an almost impossible endeavor. This will likely make it tough for Cameron to live up to a key eurosceptic demand at home: boost the role of the UK House of Commons.

Parliament is also a place where the Brexit debate is likely to further intensify in 2016. The government is already struggling to retain its position in the driver's seat, having lost a vote in the House of Commons on the referendum in 2015. Amid a rebellion among Cameron's own, eurosceptic backbenchers, Parliament decided that his government will not be allowed to make public announcements or spend financial resources on campaigning during the last 28 days ahead of the referendum. The backbenchers had feared that the cabinet would use public resources to campaign in favor of British EU membership. As Labour's internal shift to the left – with the election of staunchly far-left Jeremy Corbyn as the party leader in September 2015 – is threatening to push the party into outright irrelevance, the risk of a pro-Brexit vote may rise even further during 2016.

From a business perspective, the risks are clear. If Britain were to decide to leave the EU, this would trigger an economic shock, including a likely GDP contraction on the back of Britain relegating itself to a mere member of the Single Market. Moreover, with migration a key driver for British euroscepticism, the likely ensuing decrease in foreign nationals in the UK would take away a group that has so far greatly benefitted the UK economy, both as workers and consumers. Meanwhile, the repercussions beyond the UK would be no less severe. Berlin's position would be especially altered as Brexit would lead to a weakening of the liberal camp within the EU, leaving Germany almost alone in facing a strengthened bloc of often protectionist and pro-red tape members led by France.

While respective concerns may motivate some European concessions, the British Prime Minister is likely to present new terms of EU membership to the UK public that involve only marginal changes to the current framework. The exact shape and form of these new terms will be hammered out over 2016.

### Merkel's Election Prospects

But the British EU referendum will not be the only case in which a 2017 decision will prompt talks and negotiations already in the year ahead. The case of the German 2017 Bundestag elections may be less obvious, but it will nevertheless already begin to influence European policy-making in 2016. Commentators highlighting the predictability of the 2017 polls, with Merkel poised to sail to an easy victory, do have a point. However, her dominance over German politics is no coincidence but instead the result of strategic positioning. This was clear from the way in which she won her last landslide victory in 2013, when her Christian Union only narrowly missed an absolute majority in the Bundestag: back then, Merkel virtually put policy-making in the Eurozone on ice for months, successfully preventing uncomfortable debates in the run-up to the vote at home.

2016 will be no different. Merkel start to display a limited appetite for bold policy-making in Brussels. At home, a looming series of second-order elections will also begin to limit the scope for political action. Beginning in March 2016, various parts of the German electorate will be called to the polls roughly every six months, including

in regional elections in Baden-Wurttemberg, the core constituency of Merkel's Christian Union, and in North Rhine-Westphalia, Germany's single largest regional state.

Merkel's prospects for a fourth term in office are excellent, as the Social Democrats appear unwilling to utilize a center-left majority to replace her. But the German chancellor will not jeopardize her chances for re-election by bold action in Europe or at home; Merkel knows all too well that Germans support her precisely for her limited activity amid low unemployment and healthy economic data.

## EU Build Out Limited

The degree to which German and French domestic electoral constraints have already been factored-in by decision-makers in Brussels should be obvious to anyone who has read the much-anticipated Five Presidents' Report. This 2015 paper offers a road-map for institutional build-out and closer integration in the Eurozone, compiled by the heads of the European Commission, the European Council, the Eurogroup, the European Parliament and the European Central Bank.

Not only has the idea of treaty change been delayed until after the crucial polls in 2017, but the proposals for immediate steps to be achieved in the meantime are mainly a collection of existing policies that are supposed to be strengthened, among them macroeconomic supervisory tools such as the European Semester. But on tricky issues – those entailing the transfer of either financial or decision-making resources to Brussels – progress will remain very limited. This counts, for instance, for the construction of Europe-wide financing mechanisms for banking resolution and deposit insurance. With immediate market pressure off, the appetite for further integration will remain limited.

## Central Bank Ready to Do More

That market pressure is off is of course thanks to the one institution that has proven capable of putting an effective floor under the worst of the crisis and preserving the unity of the currency bloc: the European Central Bank (ECB). Ever since 2012, the ECB's promise of large-scale bond buying has been respected in the market, as no trader ever dared to test ECB President Mario Draghi's assertion that he would not only

do "whatever it takes" to defend the euro – but that "it will be enough."

In a heroic fight, Draghi managed to save the euro while taking on both markets and skeptical euro members like Germany. But the more entrenched problems of weak growth, high unemployment, and political fragmentation appear to be beyond the central bank's reach. The ECB launched its much-anticipated quantitative easing (QE) program in 2015, but despite some encouraging effects on the margins – bank-lending to the private sector seems to have picked up again – inflation expectations remain low, nowhere near the ECB's target rate of 2 per cent.

*The bottom line is that the big decisions may only occur in 2017. But their outcome will largely be determined by European politics in 2016.*

It is against this backdrop that one 2016 decision will occupy the space in the spotlight: when Mario Draghi launched his QE program in 2015, he promised to run it at least until September 2016 – or until inflation expectations come closer again to the Bank's target. Throughout the second half of 2015, the central bank president has left no doubt that amid risks such as Fed tapering, Chinese growth problems, and global liquidity shortages, the ECB stands ready to do more. But what could and would an enhanced version of QE look like? This will be the debate for the first nine months of 2016.

A mere continuation beyond September 2016 may have already been priced in given the state of the world economy. But any conversation about expanding the asset types under consideration for ECB buying may lead back to the pre-QE debate: Southern European demands and ECB considerations may be met with public opposition in the north, and especially in Germany. Amid the flurry of regional elections in the Eurozone's largest economy, these arguments may better manage to make themselves heard than before. While ECB activity remains a politically desirable path for Merkel, taking the pressure to act away from politicians, Berlin will be eager not to endorse Draghi's plans too enthusiastically, while the ECB will watch its German constraints carefully.

The bottom line is that the big decisions may only occur in 2017. But their outcome will largely be determined by European politics in 2016. For businesses, the biggest risk in the coming year may be to assume that risk is off.

CRISPIN HAWES

POLITICS AND GOVERNANCE: MIDDLE EAST

# ISIS and the Islamist Surge

*ISIS is the standard-bearer of a new era of political violence that has become a daily reality across the Middle East and North Africa. Increased violence is likely unless the region's crisis of human development is addressed.*

It is now over a year since the forces of the Islamic State in Iraq and Sham (ISIS) took over Mosul, the second largest city in the Arab World's fourth most populous state. Despite the combined efforts of the Iraqi military; sundry Iranian-backed Shia militias; the northern Iraqi Kurdish peshmerga; an international coalition of air forces; and a handful of regional states that support the group's opponents in Syria, ISIS still controls most of the territory that it seized in 2014 and governs a population of some six million.

As importantly, since the group it declared its territorial gains in northeastern Syria and northwestern Iraq a caliphate and renamed itself the Islamic State, jihadist groups across multiple countries have declared their allegiance to it. The list of countries in which ISIS itself or its adherents have carried out attacks now extends from Nigeria to Saudi Arabia. In almost all of those countries, jihadism must be considered a significant threat to security, if not yet to the fundamental stability of the state. Farther afield it has proved to be the inspiration behind violent acts carried out by individuals well beyond the Middle East.

*In almost all of those countries, jihadism must be considered a significant threat to security, if not yet to the fundamental stability of the state.*

ISIS should be seen not as a stand-alone movement, but rather as the latest iteration of Islamism, or Political Islam, as it has developed since the collapse of the Ottoman Empire opened the way for the establishment of the current political geography of the Middle East

*Crispin Hawes is a senior Middle East and North Africa political risk analyst focused on the Persian Gulf, hydrocarbons and Islamist politics.*

and North Africa. ISIS's facility with social media, its savagery and its international appeal have obscured the fact that at every level, ideologically, in terms of its narrative and tactically, it has built upon foundations placed over the past 100 years by organizations like the Muslim Brotherhood, Hamas and the Iraq Islamic Party, even the Shia Iranian revolutionaries, a wide range of demagogues and thinkers, as well as its more obvious immediate jihadist antecedents, like Al Qaeda.

## Ideology – the Da Vinci Code Approach

ISIS ideology is more than just derivative; it could scarcely have been better constructed to attract frustrated, disaffected Sunni populations of economically-dysfunctional and corrupt states. It cherry-picks extreme interpretations of classical Hanbali legal thinking, as set out in some of the works of scholars such as Ibn Taimiyya in the 12th century CE, blending it with the work of 20th century thinkers such as Rashid Rida and that doyen of the modern radical Islamist, the Egyptian Sayyid Qutb.

This ideology is compiled with a clear eye on choosing simple ideological hooks from recognizable "name" jurists. In picking concepts like Ibn Taimiyya's jihad against infidels or Qutb's call for relentless righteous violence, ISIS demonstrates a populist touch similar in a way to that displayed by Dan Brown in basing his "Da Vinci Code" around Leonardo's most famous and identifiable works like the Mona Lisa and the Last Supper. The result is a doctrine that flatters the recipient by citing familiar ideas, while imbuing them with authority and an urgent relevance.

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ISIS adds to that concoction by pushing a narrative of self-reliance, encouraging its followers to believe that they have the ability to engineer change in their home countries. This marks the most important difference between ISIS and its immediate antecedent, Al Qaeda. Although many of the current leadership came together under the umbrella of the various Al Qaeda organizations, they have taken an important step away from Al Qaeda's ideological standpoint. Al Qaeda developed out of the Afghan "jihad" against Soviet occupation and the recruitment of, in particular, Arabs to join that fight. As a consequence, the organization had an international outlook hard-wired

into it. It stressed the international dimension of its "jihad," the interconnected nature of the injustices meted out to the global Muslim community, targeting in particular the United States, the "far enemy," along with other states as the root cause of many of those injustices.

Compelling though that approach has proven to be, there has also long been a tug-of-war within Al Qaeda between a leadership with its gaze fixed firmly on that "far enemy," and a rank-and-file that has tended to be at least as consumed by the "near enemy," most often the governments of the states from which those foot-soldiers originally hail.

Moreover, although the radicalized, angry and resentful may have applauded the 9/11 attacks, they still seemed remote. To suggest to the average inhabitant of a small eastern Syrian town like Busayrah, for example, that he or she could aspire to participate in something like the attack on the Twin Towers would have seemed impossible. ISIS brings that same jihad to the doorstep and demonstrates that earth-shattering events can happen in a town in the Syrian Euphrates Valley.

## A Recognizable Narrative

The circumstances of the Syrian civil war and sectarian chaos in Iraq have allowed ISIS to create a narrative to underpin its ideology and to call to its success in carving out an area of territory in those two countries. This narrative describes a group of pure believers, struggling against the corruption of the international "empire" of the West – in particular the U.S. – and its regional allies in territory under its sway and that of the sharia. That this territorial expansion has slowed dramatically since late 2014 is unimportant, it remains compelling because it echoes the narrative of the Islamic expansion in the 7th century.

This narrative is particularly compelling because it is deeply familiar and draws a direct parallel between ISIS's goals and the creation of the original Islamic state under the four Rashidoun "rightly-guided" caliphs, defeating the corrupt and failing empires of Persia and Byzantium. It also allows ISIS to build on the local – and very real – anger at central governments in Baghdad and Damascus, which

are dominated by Shia politicians, reinforcing the strict sectarian Hanbali interpretation that mourns the end of the purest period in Islamic history, the schism that created Shi'ism. For a Saudi national – and many outside the kingdom that have been exposed to Saudi-financed Wahhabi teaching – this also, not coincidentally, references the emergence of the Saudi state, contrasting the failing and corrupt Ottoman Empire. That official Saudi narrative of the creation of the kingdom is of course itself constructed to resonate with the population of the peninsula already familiar with the original story of the foundation of the first Islamic empire.

*ISIS's success is central to its appeal and ISIS has demonstrated skill, tactical acuity and has also benefited from that ingredient that Napoleon so famously required of his marshals: luck.*

ISIS's success is central to its appeal. ISIS has demonstrated skill and tactical acuity and has also benefited from that ingredient that Napoleon so famously required of his marshals: luck. Two distinct, but related, developments specific to Iraq and Syria have contributed to making the ISIS caliphate possible. The first was a tactical decision by the Syrian government in 2012-13. Recognizing its military limitations, it opted to reduce its commitment to northeastern areas of the country. Bashar al-Assad's military command instead focused on attempting to maintain control of key strategic assets in the center, west and north of the country, but most importantly not to expend limited resources in predominantly Sunni Arab areas, taking control where the regime's support base had long been minimal. This tactical decision created a near-vacuum in which ISIS and other radical Sunni groups were able to flourish, and taking control of the Euphrates and Khabur valleys in the east.

The second factor has been the approach of the Iraqi central government to the Sunni Arab communities in the central, western and northwestern parts of the country. When the last U.S. soldier left Iraq in 2011, ISIS was in decline, having experienced a number of severe setbacks. However, its reputation in Iraq was restored as the Iraqi premier Nouri al-Maliki initiated a campaign targeting the leadership of the Sunni Arab community, beginning with the arrest warrant issued against the Vice President of the country, Tariq al-Hashemi. Subsequent purges of Sunni officers from the security forces, bans on demonstrations and further targeting of senior Sunni Arab figures exacerbated the already-tense relations between that communi-

ty and the Shia-led central government. This breakdown of relations between the Sunni Arab community and the Baghdad government has created a fertile environment for recruitment by ISIS's and other extremist groups.

## ISIS Works

This military success has tapped into widespread frustration at the failures of previous strands of Sunni Islamism. In contrast, ISIS' caliphate appears to offer a real and immediate opportunity not merely for martyrdom, but to overturn the status quo now—not in some indeterminate future. This is the concept to which jihadist leaders like Boko Haram's Abubakar Shekau are claiming allegiance. So, ISIS is effective, its ideology is attractive and familiar, the urgency of its jihad is compelling and, most of all it has been successful. It has carved out a piece of territory in the heart of the Middle East, in the very place that the first Islamic Empire originated. That makes it a powerful new stage in the development of the Islamist trend in the politics of the Middle East and beyond. However, it is part of that trend and the infrastructure of the group now in place in Iraq and Syria has developed out of relationships and military experience that have been many years in the making. This organizational structure is limited to this theater and as much as Shekau and those of his ilk would like to pretend otherwise; it is no simple matter to extend this organization into new theaters of operation. Simply declaring oneself to be the West Africa Province of the Islamic State does not make that so. Thus, the actual military threat that ISIS poses outside the Levant varies hugely.

Distracted by the savagery of ISIS's adherents, it is easy to miss the fact that the way in which the organization in Syria and Iraq affects developments elsewhere follows a familiar pattern. Evidence suggests that militia groups such as Ansar al-Sharia and Ansar Beit al-Maqdis in Libya and Sinai contain commanders that have held positions within the ISIS organization in Syria and Iraq, and often before in Afghanistan and elsewhere, such as Chechnya. They tend to be returning nationals of the countries in which the militias are active and bring experience and technical expertise as well as access to financing networks, enabling them to trade in weapons in those countries where significant amounts of materiel—particularly

in the form of commercial explosives, small arms and hand-held artillery—already exist. Although these commanders may have been dispatched to these theaters, these groups maintain independence of action on a tactical basis, making decisions on when and how to launch their own operations. This is ISIS's adaptation of the Al Qaeda model of regional franchises.

Other groups operating in places like Algeria, Jordan and the Arabian Peninsula have historical connections to ISIS's leadership. The Jund al-Khilafa militia in Algeria is a case-in-point. Formed by a number of veteran Al Qaeda in the Islamic Maghreb operatives, the group has carried out attacks that emulate those of ISIS, such as the killing of the French hiker Hervé Gourdel. The group's leadership, including Gouri Abdelmalek, have connections to individuals that hold senior positions within the formal ISIS command structure. Such connections are important and can be the basis of transfers of weapons or money, but claims to have carried out attacks on behalf of ISIS are often intended to secure ISIS's endorsement and, eventually, military and financial backing, rather than being the result of commands issued by a central authority.

One step further removed from Baghdadi's "caliphate" is the example of groups, such as some in Southeast Asia and even in Western Europe, whose allegiance to ISIS is largely aspirational. Personal connections with ISIS figures may exist through past experience in the same conflicts, but the connection is less direct and tends to involve only a single, relatively junior individual that has returned to his or her country of origin intent on putting themselves on ISIS's radar and to exaggerating the threat that they pose. This does not make such groups less likely to carry out individual acts of violence, but it means that they probably lack the organizational infrastructure necessary to maintain active cells for any protracted period.

### The Key is the Caliphate

None of these regional or trans-regional connections are inherently different from anything that has existed before. The key here is the caliphate and its example to this collection of ideological fellow travelers. However, ISIS is not able to call on the resources that rival Cold War governments were when seeking to undermine their opponents'

proxies or install their own in positions of power. Nor can it benefit from the superior capabilities of regional governments like Iran and Saudi Arabia. So how is it so influential and what tactics or strategies can regional and international governments adopt to arrest its advance, and those that seek to emulate it?

The migrant crisis in Europe has put the Syrian civil war back at the forefront of many Western states' priorities, while within the region ISIS has become a primary security and political concern for many states. ISIS would be important were it still merely one of many militias involved in the Syrian civil war but its caliphate has been the game-changer and it is the caliphate that ISIS's opponents need to defeat and dismantle. However, the palate of military solutions that these states are prepared to adopt is unlikely to destroy an organization that has proved extremely resilient to the air campaign without significant escalation.

None of the states that have armies capable, even in theory, of carrying out a successful ground force offensive to eradicate ISIS are yet actively contemplating such a move. It is possible, even likely, that economic pressures on ISIS that are intensified by the progressive reduction in the economic assets that it controls will eventually reduce its capacity. However that is likely to take years and the progress that the Iraqi campaign, for example, has made to capture towns in Anbar is agonizingly slow. Furthermore, there is no guarantee that the Shia militia forces on which the Iraqi government is now dependent can recapture Mosul or would not simply spark another phase of Iraq's sectarian conflict if they were able to do so. Nevertheless, unless it suffers a military defeat and the loss of most of its caliphate, ISIS will continue to function as a beacon for radical Islamists regionally and globally.

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Behind the crafted populist ideology, the military effectiveness, flair for grotesque violence, opportunism and talent for social media, the sad truth is that ISIS's success and influence have been made possible by the consistent and egregious failures of the region's political systems. The sorry history of the modern Middle East and North Africa is all too familiar. Political vacuums created by the collapse of the Ottoman Empire were filled often with monarchies populated by

powerful indigenous families or tribal leaderships with the backing of Western powers. In reaction, outside the Gulf, those regimes were largely overthrown by populist and nationalist movements but the governments that they installed also ultimately failed, without exception, to deliver either economic security or social and political development.

It is the stuff of undergraduate political science essays that following the failure of "imported" political systems political Islam has emerged as an indigenous solution. This is to some extent correct. It is also true that Islamist movements and organizations were for many years granted a relative freedom of movement and association that were denied to secular political organizations. This created a foundation from which more radicalized elements of these organizations could build. It is also true that the tally of intervention in the region has exacerbated animosity towards the West, while the collapse of the Soviet Union and the Warsaw Pact has meant that the governments and sometimes the states that backed and armed autocracies in Libya, Algeria, Iraq, Syria, Yemen and elsewhere no longer exist as the targets of popular ire. That frustration and anger at the West, stoked by long-running political sores like sanctions regimes, the Israel-Palestine question and Western support for overtly-repressive and venally-incompetent governments also finds a natural partner in radical Islamism that portrays the West's intentions as a perpetuation of the Crusades.

## The Future – Grinding Civil Conflicts

After decade upon decade of frustration and anger mounting within these societies, it is no surprise that indigenous Islamist movements have also become progressively radicalized at the same time. That frustration and dissatisfaction has become increasingly manifested in political violence as governing systems have been challenged and reacted with the violence that was always at the core of their capacity to retain power. Political violence has become a daily reality across the region rather than an understood but largely invisible threat. It is no coincidence that ISIS has emerged first in states like Syria and Iraq where the Baath regimes regularly resorted to, and in the case of Saddam Hussein, glorified in the violence that they practiced. However, the tragedy of the region is that decades of violent, coercive re-

gimes have bred increasingly extreme responses. Without seeing to minimize it, ISIS is merely the standard-bearer of this new era of political violence. Moreover, and more depressingly, it is almost guaranteed to breed a successor or splinter-group that will demonstrate brutality on a scale or of a type that puts ISIS in the shade.

Even if the current geographical area that ISIS now controls is reduced to render it an insignificant strategic threat by itself, the organizations that it is inspiring and, in some cases, supporting, will not die with it. Even within Iraq or Syria, particularly the latter, it is highly unlikely that any central authority will be able to re-establish former levels of control or enforced stability for many years, even if the current situation does not lead to the break-up of those state units. The more likely outcome, a sequence of grinding, attritional civil conflicts along sectarian, ethnic or political lines, will provide multiple potential breeding grounds for other groups that espouse a similar ideology and use as extreme tactics.

When considering what steps to take in the region it is hard to escape the idea that, like the Irishman in the story, we would not start from here, but here is where we are. ISIS at present is encouraging a replay of precisely the realpolitik calculations that have helped create it. If policy responses are to address the steady drift towards an ever more radical version of Islamist and sectarian politics, other factors need to be addressed beyond the finessing of military responses. Despite the upheavals of recent years, most populations in the Middle East and North Africa continue to live under repressive regimes that consistently demonstrate incompetence when it comes to their economies, maintain educational systems that fail to produce skilled workforces and stymie real political and social development. Unless this crisis of human development is addressed even a comprehensive military victory over ISIS and all its current adherents and followers in countries like Libya, Egypt and the Gulf would only delay the emergence of the next iteration of political radicalism, which is most likely again to be Islamist given the lack of support that now exists in the region for alternative secular ideologies.

POLITICS AND GOVERNANCE: NORTHEAST ASIA

# Northeast Asia's Leaders Move to Reduce Tensions

*Underlying tensions, including the unresolved territorial and history disputes, modernization programs and doctrinal shifts, and mounting nationalist sentiments within each country will continue to undermine efforts to put the regional order on a more stable footing. Two major flashpoints remain volatile.*

In Washington, D.C. and in capitals across Asia, the approach of the 70th anniversary of the end of World War II was viewed with some trepidation. Would national commemorations of the war's end weaken the tense relationships between Japan and its two major neighbors, China and South Korea? Would Japanese Prime Minister Shinzo Abe, a conservative who in the past has downplayed wartime atrocities, use the anniversary to undercut apologies made by his predecessors or would he use the occasion to promote reconciliation in the region?

As it happened, the 70th anniversary passed largely without incident. While Abe's anniversary statement was not as apologetic as statements issued by earlier prime ministers on the 50th and 60th anniversaries of World War II – and included a problematic narrative of Imperial Japan's road to war – the prime minister nevertheless managed to preserve the growing thaw in Japan's relationships with China and South Korea. Abe is now expected to meet with South Korean President Park Geun-hye and either Chinese President Xi Jinping or Premier Li Keqiang in late 2015, which will be the first trilateral leaders' summit since 2012.

The trilateral summit will be a major step forward in stabilizing Northeast Asia, which has been plagued by longstanding disputes

*Tobias Harris is a Senior Associate with Teneo Intelligence and frequent commentator focused on Japanese politics and implications on foreign and economic policy.*

over contested islands and historical memory for the past five years. The lull in the region's disputes will likely continue into 2016, as Tokyo, Seoul, and Beijing grapple with economic and political challenges that, for the immediate future, will lead all three governments to prioritize regional stability over contestation.

However, sources of underlying tension, including the unresolved territorial and historical disputes, military modernization programs and doctrinal shifts, and mounting nationalist sentiment within each country, will continue to undermine efforts to put the regional order on a more stable footing. Meanwhile, ongoing instability in North Korea and the prospect of a change of government in Taiwan in 2016 suggest that the region's two major flashpoints remain volatile, with the potential of exacerbating tensions between Northeast Asia's great powers and drawing the United States into a regional conflict.

## Troubles at Home Lead to Cooperation

As Tokyo, Seoul, and Beijing hammer out the details for their forthcoming trilateral summit, the three governments face similar predicaments. In China, not only has its leading stock indices fallen precipitously after reaching record highs in June 2015, but its economy appears to be slowing considerably. Chinese authorities have scrambled to respond both to the market crash and, more importantly, the real economy, cutting interest rates, devaluing the renminbi, and providing fiscal stimulus in order to boost growth. If growth slows sharply – the so-called "hard landing" scenario – the Chinese Communist Party could face a domestic legitimacy crisis.

China's struggles have had ripple effects on its neighbors and trading partners. The impact on South Korea, which sends a quarter of its exports to China, more than any other country, has been particularly acute: in August 2015, South Korea's exports fell 14.7 per cent, driven in large part by falling demand in China. Even before August, South Korea's economy had been struggling, prompting forecasters to lower their expectations for growth and forcing the Bank of Korea to cut its key interest rate to a record low of 1.5 per cent. Should China's growth continue to slow, it will put additional pressure on Seoul to combat slowing growth and could erode President Park's approval ratings.

*The trilateral summit will be a major step forward in stabilizing Northeast Asia, which has been plagued by longstanding disputes over contested islands and historical memory for the past five years.*

Japan, a larger economy less dependent on exports, is relatively more insulated from China's slowdown than South Korea but is still vulnerable. China's slowdown comes at a time when the Abe government has already been struggling to jumpstart Japan's economy after its post-tax hike recession in 2014. With wages and consumption stagnant and price inflation slowing to nearly 0 per cent in July 2015, the Abe government's "Abenomics" program, its three-pronged program to overcome deflation, boost Japan's growth potential, and solve Japan's fiscal challenge, has become increasingly reliant on exporters enjoying healthy profits thanks to a weaker yen. If the Chinese economy struggles, it will not only harm the balance sheets of Japanese exporters, but it could also reduce the flow of Chinese tourists to Japan and, more indirectly, could prompt central banks like the Bank of Korea to pursue looser monetary policy, weakening their currencies against the yen and depriving Japanese exporters of the advantage they have enjoyed since the Bank of Japan launched its quantitative-and-qualitative easing (QQE) program in 2013.

In short, the three governments each face threats to growth in the near term that do not have easy solutions and which officials are divided over how to resolve. While in theory this could lead all three governments to rely on nationalistic saber rattling, elevating regional tensions, in practice Tokyo, Beijing, and Seoul have opted for diplomacy as the economic outlook has darkened. The three countries have held a series of working- and ministerial-level bilateral and trilateral meetings over the course of 2015, indicating a serious commitment on the part of all three governments to maintain forward momentum in stabilizing the region that has weathered concerns about Abe's statement; a dispute between Japan and South Korea over Japan's application to have UNESCO recognize sites related to Japan's industrial revolution (that also happened to employ Korean forced laborers); a Sino-Japanese dispute over Chinese drilling activities in the East China Sea; and underlying fears in all countries regarding the others' military capabilities and intentions. It is therefore likely that trilateral cooperation will continue after the leaders' summit. It is not clear whether trilateral and bilateral talks will produce concrete results in establishing mechanisms for communication during crises in maritime disputes, managing or deescalating territorial dis-

putes, or jumpstarting negotiations for a China-Japan-South Korea free trade agreement (FTA), but regular communication between the three governments will expand the potential for coordination.

### Underlying Sources of Conflict Remain

But even as the three governments find opportunities to talk, Northeast Asia remains volatile. The reason, of course, is the rise of China. Even if China's growth slows, China will remain the region's economic heavyweight. Beijing will continue to seek to convert its economic strength into military power – China's defense spending shows no signs of slowing – and political influence through projects like the Asian Infrastructure Investment Bank (AIIB) and the "One Belt, One Road" initiative. China's rise does not mean that war is inevitable, but it has forced every country in Asia to recalibrate its economic and security strategies to account for China's growing military might and economic power.

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Japan feels this pressure more acutely than most. Long dependent on the United States for its security, Tokyo increasingly finds that it cannot, and does not want to, rely solely on the U.S. to come to its assistance in the event of a conflict, particularly over disputed islands in the East China Sea. Confronted with an increased level of Chinese naval and air force activity in the East China Sea and in the waters surrounding Japan, the Japanese government, first under Prime Minister Yoshihiko Noda (2011-2012) and now under Prime Minister Abe, has undertaken a series of steps intended to bolster Japan's defense capabilities. Over the past four years, Japan's Self-Defense Forces (SDF) have increasingly focused on defending Japan's outlying islands in the East China Sea.

The Abe government has increased defense spending every year since taking office in December 2012 and is looking to pass Japan's largest postwar defense budget in 2016. The Abe government has eased restrictions on arms exports, enabling Japanese companies to cooperate with defense manufacturers in other countries, potentially reducing costs. And over the course of two years, the Abe government has reinterpreted Japan's constitution to allow the SDF to assist allied forces that come under attack (the exercise of the right of collective self-defense), worked closely with the U.S. government to

update the U.S.-Japan Defense Guidelines for Cooperation, and has guided legislation governing the SDF's activities to reflect the new constitutional interpretation through the Japanese Diet.

While restrictions remain on the SDF's activities – it is highly unlikely that the SDF will take a front-line combat role anywhere overseas – the aforementioned changes amount to a decisive shift in how Japan will respond to crises in Asia and abroad (in the Persian Gulf, for example). These changes are not necessarily destabilizing, not least because Japan will continue to depend heavily on the U.S. for its security and many of these changes are intended to strengthen the U.S.-Japan alliance's deterrent capabilities, but they do suggest that Japan is ever so gradually adjusting its security policies in response to China's military modernization program.

*...public distrust between Japan and South Korea will likely continue to hinder bilateral cooperation. This distrust will continue to complicate U.S. contingency planning and will therefore serve as a source*

Despite being a neighbor of China on the Asian mainland, South Korea's response to China's military buildup has been more muted than that of Japan, not least because North Korea remains the primary focus of South Korea's defense policies. However, South Koreans are sensitive to the long-term threat China's military could pose, particularly if China were to aid North Korea in a conflict. But China's rise still has forced South Korea to adapt, mainly by seeking to balance its relationship with China and its longstanding alliance with the U.S. At the same time, territorial and historical issues have stymied efforts to strengthen Japan-South Korea and Japan-South Korea-U.S. defense cooperation, though in December 2014 Japan and South Korea signed a General Security of Military Information Agreement (GSOMIA) after a long delay, an important precursor to closer defense cooperation.

Although closer Japan-South Korea defense cooperation, particularly at sea, would enable the U.S. to rely more on its democratic allies in Northeast Asia to deter China and North Korea and deploy its capabilities elsewhere, public distrust between Japan and South Korea will likely continue to hinder bilateral cooperation. This distrust will continue to complicate U.S. contingency planning and will therefore serve as a source of instability in the region for the foreseeable future, diplomatic progress notwithstanding.

Finally, the future of U.S. engagement in Northeast Asia is far from settled. The Obama administration's "rebalance to Asia" strategy has shored up the U.S. military presence in the region, but U.S. allies, especially Japan, will periodically wonder whether the U.S. is willing to invest the resources and the money to defend its allies in the event of a crisis. China's investment in anti-access/area denial capabilities (A2/AD), which are intended to limit the ability of the U.S. and other countries to access China's littoral waters during a crisis, could also lead allies to question the reliability of U.S. security guarantees in the future.

In short, China's rise and its military modernization have set in motion a complex process whereby all of China's neighbors are forced to review their defense policies and alliance relationships, bolster their military capabilities, and prepare for the possibility of armed conflict with China. More robust communication and interaction between militaries – particularly Japan's and China's – could reduce some of the risks of conflict by providing clarity regarding each country's strategic intentions, but no amount of diplomacy will ease the fundamental concerns about China's military felt throughout East Asia.

## Flashpoints

In the near term, the tensions surrounding China's rise are manageable. However, stability in Northeast Asia could be undermined by events in Taiwan and North Korea, which have been the region's two major flashpoints for nearly seventy years. Despite the Sino-Japanese dispute over the Senkaku/Diaoyu islands in the East China Sea, the Taiwan Strait and the Korean Peninsula remain the most potent triggers of armed conflict in East Asia.

The risk in Taiwan is that eight years of stable cross-strait relations could come to an end in 2016. Kuomintang President Ma Ying-jeou, while promising to maintain the status quo (no independence or reunification), focused on deepening economic and political ties with China. Taiwan will hold a presidential election on January 16, 2016 and voters, concerned that Ma and the Kuomintang have made Taiwan too dependent on China, appear ready to elect Tsai Ing-wen, the pro-independence Democratic Progressive Party (DPP) candidate, as president. If elected, Tsai would undoubtedly be constrained by

the intensive economic links forged under Ma, but a change of government in Taiwan could nevertheless result in greater instability in cross-Strait relations, which could in turn complicate China's relationships with the U.S. and Japan. Despite the rapprochement under Ma, China still considers Taiwan as a "core national interest" and would resist any move towards more formal independence.

Meanwhile, although South and North Korea moved to deescalate tensions in August 2015, the potential for conflict on the Korean Peninsula remains. The instability of Supreme Leader Kim Jong-un's regime could lead to attacks like the 2010 sinking of the South Korean naval vessel *Cheonan* and the shelling of South Korea's Yeongyeong Island, and the regime will undoubtedly continue to develop its nuclear and ballistic missile arsenals. Indeed, it may have been the Kim regime's instability that led to the crisis that precipitated the August agreement, as North Korea was particularly interested in securing a pledge from South Korea to halt loudspeaker broadcasts into North Korea that challenged Kim's legitimacy. It may be unlikely that these provocations escalate to outright war, but given that a Korean crisis could pit the U.S. and China against each other and sow dissent between the U.S. and its Northeast Asian allies, the Korean Peninsula will remain the region's most dangerous flashpoint for the foreseeable future.

## Conclusion

Perhaps the lesson learned from the thaw between Japan, China, and South Korea over the course of 2015 is that despite the many pressures that complicate their relations – territorial disputes, arms races, arguments over history, alliance commitments in the region's flashpoints, nationalistic public opinion – Northeast Asia's leaders continue to see the value in maintaining stable, constructive ties with each other. This does not exclude the possibility of conflict, but these factors do not lead necessarily to conflict either. For the time being, Tokyo, Seoul, and Beijing continue to believe that finding ways to preserve the peace and prosperity of the region is a worthwhile endeavor.

POLITICS AND GOVERNANCE: SOUTHEAST ASIA

# Southeast Asia's Daunting Challenges

*Political and economic challenges are mounting and threaten to reduce growth expectations for the region for the next few years.*

Not since the Asian financial crisis has Southeast Asia had to contend with the combination of political and economic challenges that it now faces. Uncertainty in the major western markets and China are leading to currency weakness, anemic export growth and plunging commodity prices are hitting the region's economies almost simultaneously, reducing growth expectations measurably for the next few years.

In the meantime, politics is complicating the region's ability – whether at the country or multilateral level – to respond quickly and cohesively to these emergent economic problems. Governments in Bangkok and Kuala Lumpur are distracted by domestic controversies that could turn into potential instability; a possibly disruptive political transition will take place in Manila next year; and Indonesia's president is attempting to regain his reformist footing after an underwhelming first year in office. Even in Myanmar, which only two years ago seemed to be on the verge of a breakout, questions about the pace and direction of reform have surfaced.

As a result, Southeast Asia's investors have over the past year fled to greener – and often Western – shores. Even normally resilient foreign direct investors are being noticeably cautious, worrying that the combination of financial turmoil and weaker growth outlook compromise the region's economic future, at least for the next few years. This

*Bob Herrera-Lim is a Managing Director with Teneo Intelligence and senior analyst covering political risk in Southeast Asia.*

has fueled speculation of further economic shocks down the road as higher interest rates and weaker demand could lead to widespread firm closures, especially in the small and medium enterprises that are at the core of job creation and growth in many of these countries.

Two regional currencies, the Indonesian ringgit and the Malaysian rupiah, have weakened to levels unseen since the peak of the 1990s crisis. The fear, unspoken but palpable among many who lived through the Asian financial crisis, is that this can cause social unrest to again erupt, particularly in the form of ethnic tensions in Indonesia or Malaysia, where the Chinese, while a minority, hold a significant portion of the wealth, or in urban versus rural constituencies in Thailand, where the latter continue to support former and self-exiled Prime Minister Thaksin Shinawatra.

*...higher interest rates and weaker demand could lead to widespread firm closures, especially in the small and medium enterprises that are at the core of job creation and growth in many of these countries.*

However, while it is tempting to see parallels to the Asian financial crisis, 2016-2017 are unlikely to be 1997-1998. First, Southeast Asia does not have the deep macroeconomic imbalances that existed in the 1990s. Although companies have increased their borrowing over the past few years, including in foreign currency, and some major defaults are possible, the sense of local banks and companies being grossly exposed to weaker currencies and foreign investors calling in their money is low. In many cases, central banks in several countries have also tried to limit bank exposure to traditionally problematic sectors such as real estate to limit overall systemic risk, and warned firms against over-borrowing abroad while earning in the local currency.

Second, the decline has been gradual and not acute, helping avert a similar social shock. When the crisis hit Southeast Asia in the 1990s, the economic shock was so severe that frustrated citizens, many of them having only recently attained middle class status, vented their frustration at long-standing regimes, particularly in Suharto's Indonesia and Mahathir Mohamad's Malaysia.

Third, even assuming that an economic crisis does recur, political systems are more robust than the 1990s. Again, this is particularly evident in Indonesia, where elections since then have consistently and credibly yielded democratically elected governments at both the

national and local government levels, and while citizens can be frustrated by the incompetence of their elected officials, the fact that they did vote them in (and can vote them out) provides outlet for public frustration. In the Philippines, elections in 2016 will help provide a similar safety valve, although the economy is more insulated from a crisis because of the still high level of foreign worker remittances.

In fact, it is both Thailand and Malaysia – the two countries where democratic systems since the crisis have developed the least or even regressed – that face the most difficult combination of political and economic environments today. Malaysia is still run by the United Malays National Organization (UMNO), which is now in danger of being split by a fight between Prime Minister Najib Razak and its long-time iconic leader, former Prime Minister Mahathir Mohamad. UMNO's share of the popular vote has been declining since 2008, down to a minority based on the 2013 general elections, and it only maintains control of parliament through effective gerrymandering of election districts and because of an infirm political opposition.

In Thailand, at least two military coups have undone the political changes since the 1990s, as political elites have attempted to roll back the electoral and political power of former Prime Minister Thaksin Shinawatra. Order today is being maintained by the firm hand of the military and nothing else. A draft constitution was rejected in September by the military and the return to democratic government is unlikely until 2017. Although both countries have among the most competitive industrial and manufacturing sectors in the region, their political systems are proving to be liabilities at times of crisis, rather than sources of strength.

Aside from the politics and economics of crises, the other factor that will define the region in the long term, or at least perceptions of stability in the near term, is the geopolitical balancing act that its individual countries will attempt to play with the U.S., China, and to some extent Japan, Russia and even the European Union. Although it is and will be convenient to view Southeast Asia in terms of spheres of influence, the reality is more complicated – while countries will remain wary of Beijing's regional intentions, they will also recognize that actual conflict over any territorial dispute is not only unrealis-

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tic given the differences in military capability between China and the other Southeast Asian countries, but damaging to both regional and individual country economies. Signals from Washington are also likely to temper even the countries seemingly most opposed to China, such as the Philippines and Vietnam – while the U.S. has cautioned Beijing against expansion of its facilities in the area and emphasized the need to respect freedom of navigation, it has also been similarly cautious in discouraging more risky behavior from Manila.

While all accept the reality of China's rise (and hope to profit from it), they all share concerns about Chinese leadership. As such, although the ASEAN countries will resist being drawn into a U.S.-led bloc, they will still seek to leverage the U.S. military and economic presence as a hedge against regional domination by China. Some countries such as the Philippines will hew more closely to the U.S. position, since taking a more antagonistic stance vis-à-vis China on territorial disputes plays well domestically. Countries on the Southeast Asian landmass – such as Thailand, Cambodia and Singapore – will play a more sophisticated game of balancing economic and security relationships. Indonesia, which has its own goals of regional leadership in ASEAN will also attempt a more nuanced relationship.

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The recent financial market turmoil in China will not significantly affect perceptions or attitudes in the region towards the country's role in Southeast Asia. Despite its recent problems, China's role in Southeast Asia will only grow – in fact, the relationship is deepening from trade to investment and financial flows.

## Differentiation Will be the Key

Therefore, while Southeast Asia will grab the occasional headline, the actual risk within the region is more manageable. Investors that paint the whole region, therefore, in the broad brush of emerging market withdrawal and heightened economic or geostrategic risk, will miss opportunities that the current currency and asset price weakness could provide for longer term investment. The key will be in differentiating the individual countries, as some countries will continue to experience sustained volatility, driven by both their political and economic vulnerabilities. Others will, however, prove to be more robust.

### Where Risk Exists

Arguably the most politically and economically vulnerable country is Malaysia, where Prime Minister Najib Razak is under attack for supposedly mismanaging state development fund 1MDB, including allegations that he siphoned off USD 700mn into his personal accounts. Allegations of missing payments run over USD 1bn. The controversy has severely damaged Najib's popularity and led to an open political battle with the iconic Mahathir. However UMNO's leadership has sided with the current prime minister against its former leader to avoid an open split within the party and to deny the opposition, which is suffering its own internal battles, any additional leverage. The party may also be reluctant to remove Najib while it has not yet chosen a successor who can lead UMNO through the crisis and to the next general elections in 2018. Najib, therefore, retains his position mainly by default, rather than by any successful effort at resolving the 1MDB fund controversy. This will create and sustain overall perceptions that the threats to his leadership have not been removed and that heightened political noise and a weak and distracted government will be the norm for Kuala Lumpur for the foreseeable future.

UMNO's more precarious position has caused the party's leadership to become more conservative as it tries to consolidate its support among majority Malays. Reform that targets affirmative-action pro-Malay policies have become more unlikely. However, this more conservative shift has further alienated ethnic Chinese and Indians, who make up roughly one third of the population. The late August pro-reform Clean ("Bersih") rally, which was the largest of its kind since the movement was launched in 2007, was made up predominantly of ethnic Chinese Malaysians. Throup has been abandoning UMNO since 2008 because of the party's seeming unwillingness to reform the pro-Malay affirmative action policies that have stunted industrial and economic growth. The risk is that the more UMNO attempts to circle the wagons, the more these ethnic divisions and tensions manifest.

Indonesia also faces serious economic challenges, as nationalist and consumption oriented policies and the lack of reform in the natural and industrial sectors have eroded its competitiveness. Among the

Southeast Asian countries, Indonesia is the most vulnerable to an external shock triggered by U.S. Federal Reserve action. Foreigners hold a large amount of domestic debt, which, when combined with the amount of corporate USD debt, can generate volatility during times of high outflows. The current account has worsened over the past year, while foreign exchange reserves are not as high as those of Indonesia's peers in Southeast Asia. Tax collection is also suffering as the economy weakens.

For now, the government is focused on some administrative tweaks that would reduce pressure on the currency. A more adequate response by the government would be strong structural reforms that raise FDI inflows, improve the implementation of long-delayed infrastructure projects, reduce structural rigidities in the economy and mitigate recent distortions introduced by nationalistic policies.

However, with President Joko Widodo unable to assert political control for much of his first year in office – his administration coalition was a minority until September this year and the president himself is occupied by a political feud with his party leader – the probability of significant and far-reaching reform in the near term, while gradually increasing, is still low. Meanwhile, the weak and sometimes confusing political and policy signals from Indonesia through the end of the year are likely to create some volatility on their own, making it difficult for the government to respond quickly to shocks.

In comparison, Widodo does not face any significant leadership challenge, either from inside or outside his party. There is no sense of an overhang of political instability in Jakarta, unlike in Kuala Lumpur. The difference between Indonesia and Malaysia is that Widodo has more political capital than Najib, which is the result of Indonesia having a more democratic system and credible elections. Economic outcomes are still important for leaders' popularity in both countries, and the weakness of the currency and decline in growth are taking their political toll, but what differentiates both leaders' political fate is that voters in Indonesia ultimately see elections as a valid way of removing erring leaders, unlike in Malaysia.

## .. And Where Risk is Less

Neither Thailand, the Philippines nor Vietnam has the potential for a political or economic shock similar to Indonesia and Malaysia. The risks are more in the long term, should they fail to implement structural reforms that keep their economies competitive. Foreign investors will likely see these three countries as the most favorable destination for investment in the near term.

In Manila, it will soon be clear who the main contenders will be for the 2016 presidential election and this will be the variable that will drive the political outlook. Should the surveys show Vice-President Jejomar Binay as the favorite, then risk perceptions are likely to go up, not only on concerns about the potential for corruption and patronage under his administration, but on the apprehension that he will likely have an uneasy and potentially destabilizing relationship with the powerful business and middle class elites in Manila. On the other hand, if an alternative candidate, either Grace Poe or Mar Roxas, gains the upper hand, then risk perceptions will recede as neither candidate is burdened by the same corruption allegations as Binay. Regardless of whoever succeeds Aquino, however, the challenge will be the same – the country needs serious upgrades to its creaky infrastructure, improve rule of law and business regulation and licensing, and reduce corruption.

In Thailand, the military continues to maintain control and is unlikely to allow any form of dissent that could morph into wider and more dangerous forms of protest or mobilization. Although the factions that ousted the government allied with former Prime Minister Thaksin Shinawatra are still broadly in alignment, this transition is now fully associated with the military and coup leader and Prime Minister Prayuth Chan-ocha. The institution's full weight is now being used to assure that the political quiet is maintained. Therefore, while there are important markers and risk triggers ahead such as the drafting of a new constitution and the criminal trial of former Prime Minister Yingluck Shinawatra, the probability of this risk manifesting is low in the near term.

But long-term uncertainty still persists, especially if the negative political environment continues to drag down both consumer and

investor sentiment, and impedes important infrastructure upgrades needed to keep the economy competitive. Thailand's industrial capabilities are among the best in the region, especially in auto and consumer goods manufacturing, but while the country may avoid both political and economic shocks, a longer-term downgrade of its once rapidly industrializing economy cannot be fully discounted.

Vietnam continues to make only very slow progress in resolving the bad debts in the banking system and reforming its inefficient state enterprise system. Yet Prime Minister Nguyen Tan Dung is arguably in his best political position in 6-7 years; the probability is increasing that he will win the position of General Secretary next year, the most powerful post in the Communist Party of Vietnam, and that an ally will succeed him as prime minister. While Dung is mindful of how large capital flows led to the asset bubbles and inflation that undermined his leadership from 2009 to 2011, he still likely sees private capital as being an important component of Vietnam's future growth – which makes a consolidated and wizened Dung a favorable scenario for foreign investors.

*The factors that impact the investment decisions of activist investors are perceptions that shape reputations.*

Similar to other emerging markets, Southeast Asia's currency and asset markets are experiencing the negative effects of the uncertainty generated by the imminent interest rate rise in the United States and China's volatility and potential economic weakness. There is even speculation of a 1990s-style crisis. However, political and economic systems have evolved and systems where the governments have become more accountable have also become more robust, enhancing stability. Investors would, therefore, be better served by not painting the region with such as broad brush, and looking at where governments, accountable to their constituencies, are now putting in place the measures needed for longer term reform and growth.

KEVIN ROLAND

POLITICS AND GOVERNANCE: DUBAI/IRAN

# Revival of Enduring Ties

*The race is on to expand business ties with Iran in the wake of the P5+1 nuclear agreement. The expectation of sanctions relief has energized Dubai's resident multinational corporations, law firms, accountancies and consultants. The lure for Dubai is the potential of Iran's economy to become number one in the region.*

The invitations are coming in fast. The period between mid-September and mid-December is perennially the height of the business calendar here in Dubai, when temperatures cool and visitor numbers rise amidst a myriad of global conferences, trade fairs, and major tourism events. Unlike previous years, however, the conclusion of the P5+1 nuclear agreement with Iran has unleashed a stream of Iran-themed seminars, talks, conferences and symposia into the mix. Law firms, accountancies, trade associations and individual consultants are vying to advise current and potential clients regarding the opportunities and pitfalls of doing business in an anticipated post-sanctions Iran.

*Dubai is playing a key role for those examining what the putative re-opening of potentially the largest economy in the region means for their businesses.*

While some governments and major multinational businesses are sending high-level delegations to Tehran to burnish ties, others are preaching exceeding caution, aware of the complexities surrounding sanctions removal and wary of penalties for missteps. Whichever approach is followed, Dubai is playing a key role for those examining what the putative re-opening of potentially the largest economy in the region means for their businesses. Despite the challenges that will face any firm seeking to successfully transact in Iran in the near term – and they are many and significant – the prospects of a diversified, industrial economy underpinned by a population of nearly 80 million, the world's largest gas reserves (18 per cent of the global

*Kevin Roland is a Managing Director with Teneo Strategy based in Dubai.*

total) and 10 per cent of the globe's proven oil reserves, are highly compelling to say the least.

As a prominent American businessman of Iranian heritage told me shortly after the passage of the deal: "Iran is finally within grasp... the country of the future in the region and beyond." Others, especially European and Asian firms likely to be less impacted by residual U.S. sanctions, seem to agree, and most of them are already in Dubai. There are no shortage of invites...

### The More Things Change...

Resting along the southern shore of Dubai Creek, looking out upon the dhows and abras plying their waterborne trade, one can easily intuit the interwoven history of the communities and peoples connected by the warm, shallow sea that links Persia and the Arabian Peninsula. In one of Dubai's older creek-side neighborhoods, both the locale and its vernacular architecture are known as *Bastikia*, redolent of the region in southern Iran from which the builders of this place departed just over a century ago. They came seeking Dubai's friendlier terms of trade, and ended up integrating themselves, their families and their traditions into what has evolved into one of the world's most vibrant and cosmopolitan centers of commerce. Although the reverie of an ancient scene is likely to soon be broken by the roar of four giant engines bringing an A380 super-jumbo in to what is now the world's busiest international airport, the impression of continuity with times past remains.

Turning away from the Creek, moving southward through the glass canyon formed by tall towers lining the Sheikh Zayed Road and toward the resplendent achievement of the Burj Khalifa, you are entering a new Dubai, one built on global trade, logistics, finance, and luxury tourism – and well-positioned to benefit as the conduit for an Iranian reopening. The Dubai International Financial Center is home to 22 of the world's top 30 banks, while the city's 65,000 hotel rooms play host to over 13 million tourists annually. The port of Jebel Ali is the largest and busiest port in the region, and a modern, fully-automated metro system links the city together.

Reflective of the endurance of those earliest trading ties, certain

family names, undoubtedly Farsi yet seamless amidst this particular Arabian cityscape, adorn office blocks, auto dealerships, and high-rise apartments. Iranian schools, an Iranian hospital, Iranian banks and businesses survived and thrived here despite the recent decades of enmity that characterized Iran's relations with its Arab neighbors and the West following the ascent of the Islamic Republic. Through that period, Dubai remained the point through which Iranians could access the outside world, and the outside world could access Iran.

Looking toward a post-sanctions environment in 2016, Dubai's unique combination of proximity, connections, and familiarity with the Iranian market will see it further emerge as the hub for international businesses assessing or pursuing entry into Iran. In late August 2015, just prior to launching its new five-times-weekly service to Iran's second-largest city Mashhad, Emirates Airlines estimated that it can fly nearly 8,000 tons of freight goods to Mashhad yearly, in addition to the 17,500 tons it already sends to Tehran via its SkyCargo freight division. Trade with Mashhad, Emirates said, would mainly consist of Iranian exports of fruit, vegetables, carpets, saffron, and nuts, as well as its imports of meat, pharmaceuticals, medical equipment, machinery and motor parts - all sectors exempt from sanctions. In some ways it is a far cry from the days of pearls, silks and spices, and represents an expansion rather than a re-starting of the Dubai-Iran trading nexus, but increases in air traffic thus far are significant and a harbinger of things to come.

*"Although there is a 'first-mover' advantage for IOCs when engaging in a new territory or, as in this case, a re-opened territory, Iranian oil and gas officials are extremely keen to engage with US IOCs, particularly the marquee operators."*

## Pent-Up Demand

The potential opportunities in the market are significant and varied. The primary focus thus far, even in a low-oil-price environment, has been Iran's oil and gas sector, and Iran will waste no time in marketing its opportunities to international oil companies (IOCs). Iran's oil and gas road show kicks off in December 2015 in London, with 50 upstream projects already identified as well as the promise of the announcement of a new contract model for upstream investment. European and Asian IOCs are likely to lead the way, although U.S. majors should not be left too far behind. Teneo Intelligence MENA analyst Crispin Hawes notes that, while lagging somewhat in making connections due to uncertainty over the negotiations/sanctions outcomes, U.S. IOCs will still likely find the Iranians receptive when they

are able to enter. Hawes believes that "although there is a 'first-mover' advantage for IOCs when engaging in a new territory or, as in this case, a re-opened territory, Iranian oil and gas officials are extremely keen to engage with U.S. IOCs, particularly the marquee operators." That said, U.S. investment in Iran will likely face the risk of restrictions on U.S. entities trading with Iran being maintained or extended for the foreseeable future.

In addition to the upstream oil and gas projects, the Iranians have announced 170 more investment projects in other sectors to include major infrastructure enhancements, estimating over $80 billion of investment will be required to build new roads and a new high-speed railway. One local Iran analyst reported earlier in 2015 that Iran needed $90 billion in investments in their power sector alone. Iran's existing position as a consumer market will remain large and attractive to international suppliers; Iran spends over $70 billion on food and over $20 billion on clothing. All of the Gulf's petroleum-based economies are executing diversification strategies to drive high-value job growth for burgeoning youth populations and reduce their reliance on oil, to varying degrees of success. Iran, however, will be re-investing into already existing downstream industries, whether it be petrochemicals, automotive or light manufacturing, giving them a distinct competitive advantage against some of their neighbors in spurring non-oil growth.

At a recent seminar in Dubai hosted by the Institute of Chartered Accountants in England and Wales, a regional advisor quoted the Iranian government's Vision 2025 strategy as targeting over 1 trillion dollars of foreign investment by 2025. The strategy highlighted the petrochemical sector, in which Iran aims to triple this sector's value and directly compete with regional players in Saudi Arabia and the UAE. Relatively low wage levels and access to cheap feedstock in the form of its enormous domestic gas reserves will allow it to be highly competitive. The automotive industry currently accounts for 10 per cent of Iran's GDP; Iran currently produces 1.1 million cars per year and over the next decade aims to increase production to 3.1 million per year, with 1 million yearly destined for export. The head of the Iranian civil aviation authority has indicated that Iran must augment its ailing and aging fleet with the purchase of 400-500 new passenger aircraft over

the next ten years. Reflective of this need, Dubai will host Aviation Iran in March 2016, a new global aerospace industry event bringing together key players in airport infrastructure, aircraft, and aviation services.

As successive delegations of public officials and corporate executives make their way to Tehran from European and Asian capitals, the ground work for accessing the Iranian market is being laid by their regional Middle East and Africa operations, many of which call Dubai home. Despite the tantalizing prospects of the Iranian market outlined above, most of those evaluating opportunities in Iran are not blinded by optimism. Those based in Dubai, or who have been elsewhere in the neighborhood for some time, will have an intrinsic sense of the complex geo-politics surrounding Iran's presence in the region, the disputes, and the sometimes violent outcome of Iranian-Gulf rivalries in various locales. Their thinking also will have been tempered by previous false dawns, chastened by unmet hopes for reform in Iran and its policies and stalled efforts toward a thawing of international relations.

## Sanctions... and Other Hurdles

Those managing expectations in terms of the timeline for real opportunity in Iran do so with good justification. Firstly, while most European Union (EU) and United Nations (UN) sanctions will have been lifted as part of the adoption and implementation of the nuclear deal, the bulk of the U.S.' complex sanctions regime, which is related to non-nuclear policy aims, will remain in place for the foreseeable future. (The exception here being the civil aviation sector, which could see an opening in late 2015 based on a review of Iranian compliance with the deal.) This does indeed give European and Asian firms a head start in assessing and entering the market, but regardless of the speed with which non-U.S. sanctions infrastructure can be lifted, one of the biggest challenges prospective entrants are likely to face will be utilizing banking and payment structures. Under the current deal, U.S. banks and related entities will still be prohibited from dealing with Iran or facilitating trade and investment there. Even with a return to the international SWIFT electronic bank transfer system, significant reform and technological advancement will be needed in the Iranian banking sector to fully support investment and grow new business.

Other challenges are numerous. Serious questions remain about the Iranian government's capacity and capability to negotiate and process new petroleum sector deals. Analysts state that because of this, the likely ensuing delays caused by capacity constraints and grievances over the contract model, some large-scale investors in the oil and gas sector in particular may be reluctant to push forward right away, especially if the price of entry is set too high. In other sectors, companies will encounter the pervasive presence of Iranian military and other government entities amongst putative private sector companies as well as deep and ingrained inefficiencies and corruption – the World Bank ranks Iran 130 out of 189 countries in its annual Doing Business report while Transparency International places Iran at 136 out of 175 countries in its Corruption Perception Index. In addition to the published reports, personal anecdotes from those recently returned from Iran are not hard to come by and flow easily along with the coffee at Iran-focused events.

*The factors that impact the investment decisions of activist investors are perceptions that shape reputations.*

## Looking Ahead

Remaining U.S. sanctions, geo-politics, nuclear deal compliance reviews and manifest challenges aside, 2016 will see the further re-emergence of Iran and its reintegration into the regional growth strategies of global businesses. While one cannot ignore the significant challenges and legal complexities associated with accessing the market, governments and businesses are voting with their feet – or via increased daily flights to Tehran as it may be – and that momentum and optimism, appears well-established. Requirements for rigorous due diligence, strategic stakeholder engagement, and robust market intelligence and compliance review will only continue to grow as more firms, both foreign and Iranian, seek new opportunities. No doubt much of this will be happening in and from Dubai.

## Lon Augustenborg

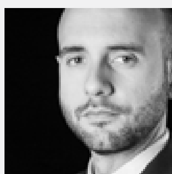
SENIOR ADVISOR, TENEO

Mr. Augustenborg is a Senior Advisor to Teneo. He recently completed a 35-year career in the CIA's Clandestine Service which included nine field assignments. Most recently he headed CIA's largest domestic office, where he worked closely with the US private sector. He served as Chief of Station in CIA's flag ship locations of East Asia and Latin America. Additionally, he was Chief of Operations for CIA's Counter Intelligence Center in Washington, DC. Mr. Augustenborg's other assignments include locations in the former Soviet Union, Europe, the Middle East, Asia and Latin America.

Prior to entering the CIA, Mr. Augustenborg was a Los Angeles Police Officer with assignments in LAPD's Intelligence Division, Public Affairs, and multiple uniform Divisions working felony crimes.

Mr. Augustenborg holds a BA Degree from the University of Southern California in International Relations and Social Studies; and a MA Degree from Pepperdine University in Public Communication. He also completed a year of study at University College, London England in the Center for International Conflict Resolution. Mr. Augustenborg is fluent in Spanish as well as completing full time language studies in Russian, Italian and Hungarian.

A recipient of many exceptional performance and management awards, Mr. Augustenborg chaired the CIA's leadership and teamwork training program for its high performance Clandestine Service officers. He has served on numerous promotion panels and strategic planning boards for the Agency and Intelligence Community. He has also worked closely with countless foreign partners on four continents providing training, assistance, and leadership of joint programs.



## Antonio Barroso

SENIOR VICE PRESIDENT, TENEO INTELLIGENCE

Antonio Barroso is a senior analyst focused on the Eurozone and political and economic developments in Southern Europe and France. He is a regular media commentator on European issues, with frequent contributions to the *Financial Times, the New York Times, the Wall Street Journal, Bloomberg*, CNBC, and Reuters. Prior to joining Teneo, Mr. Barroso was a senior analyst at Eurasia Group where he helped to develop the firm's Western Europe coverage. Previously, he worked for the Center for Political and Constitutional Studies under the Spanish Ministry of the Presidency, where he conducted research about European institutional reform within the framework of a multinational research project. He also worked for the Center for Sociological Research in Madrid, where he

developed public opinion polls and managed the fieldwork of a major international survey.

Mr. Barroso is currently completing his PhD at the London School of Economics. He received master's degrees from Columbia University's School of International and Public Affairs and the College of Europe in Bruges, Belgium. He also holds a diploma in constitutional law and political science from the Center for Political and Constitutional Studies in Spain, an international diploma in political and social studies from the Institut d'Etudes Politiques de Paris, and a bachelor's degree in political science and sociology from the University of Granada, Spain

## Tim Burt

MANAGING PARTNER, STOCKWELL GROUP

Tim Burt acts for leading global companies such as Alcatel-Lucent, Guardian Media Group, Nissan and Universal Music, among others. In the past year, he has advised Kabel Deutschland and ONO of Spain in their separate acquisitions by Vodafone. Other transactions included the sale of RationalGroup/PokerStars to Amaya of Canada; the sale of Trader Media to Apax; and the disposal by Vivendi of SFR and GVT. He co-founded StockWell after six years as a Partner at Brunswick, where he oversaw sectors including media, technology and automotive. He played a central role in Brunswick's international expansion, advising clients on major transactions. At Brunswick, his clients included Google, NBC Universal and Toyota. Tim was formerly an award-winning journalist at the *Financial Times*, where he spent 16 years in roles including Media Editor, Motor Industry Correspondent and Nordic Correspondent.

## Pamela Craig

SENIOR ADVISOR, TENEO

Ms. Craig is a Senior Advisor to Teneo. Ms. Craig served as Accenture's Chief Financial Officer from October 2006 through June 2013. In Institutional Investor's 2013 All-America Executive Team ranking, she was named America's Best CFO in the Computer Services & IT Consulting category by both buy-side and sell-side analysts. Prior to becoming CFO, Ms. Craig served in a variety of management, operational and finance roles in her 34 years with Accenture, including as Senior Vice President, Finance from March 2004 to October 2006, and Managing Director for Global Business Operations from June 2001 when Accenture became a public company until March 2004. Prior to that she held leadership roles globally and regionally with the communications media and technology operating group. Ms. Craig currently serves as a member of the board of directors of Walmart, Akamai technologies, Inc., and VMware, Inc. She also serves as a

member of the board of directors for several charitable organizations, including The Committee of 200, the membership organization of women entrepreneurs and corporate innovators.

## Kimberly B. Davis

SENIOR MANAGING DIRECTOR, TENEO STRATEGY

Prior to joining Teneo, Ms. Davis was Managing Director of Global Philanthropy and CSR, President of the JPMorgan Chase Foundation, and a member of JPMorgan Chase's Executive Committee. Her responsibilities included overseeing the firm's approximately $218 million in annual giving, employee volunteerism, civic engagement, community relations and strategic corporate marketing programs.

Ms. Davis co-founded Springboard, Partners in Cross-Cultural Leadership, a leadership education and consulting company committed to building highly diverse teams. Her passion for the issues surrounding leadership for women prompted her to help develop, design and implement a national leadership center – Spelman LEADS – Center for Leadership & Civic Engagement in collaboration with Spelman College, where she is a trustee and chairs the HR Committee. She also serves on the boards of the Executive Leadership Council and Deloitte's Center for Inclusion and Leadership.

Ms. Davis has been a featured keynote speaker at numerous colleges and universities, guest lecturer at Smith College and a featured panelist at the Forbes' Inaugural Women's Leadership Summit. She has been featured in a number of publications, including *The Business Journal's* 100 Most Influential Women, *Black Enterprise, Forbes, Pink Magazine* and *FastCompany's* 100 Most Creative People in Business. Most recently she was profiled in *Essence Magazine's* "28 Most Influential Black Women" in America.

Ms. Davis earned a bachelor's degree in Economics and Finance from Spelman College in Atlanta. She completed ARC International's Advanced Leadership Program and the Aspen Institute Executive Program.

## Otilia Dhand

SENIOR VICE PRESIDENT, TENEO INTELLIGENCE

Dr. Dhand specializes in political risk of Central and Eastern European countries. Prior to joining Teneo, she was as a CEE region Analyst at Eurasia Group, and previously worked for the Economist Intelligence Unit, compiling global indexes in its custom research unit. Earlier in her career, she held various positions servicing foreign investors entering the market of her native Slovakia.

Dr. Dhand is a member of the International Institute for Strategic Studies and holds a PhD in Geopolitics of Central Europe from King's College London. She also has a master's degree in Russian and East European Studies from St. Antony's College, University of Oxford and a bachelor's degree in International Relations and Diplomacy from Matej Bel University in Slovakia.

## Paul Haenle

SENIOR ADVISOR, TENEO STRATEGY

In addition to his role with Teneo, Mr. Haenle serves as Director of the Carnegie-Tsinghua Center in Beijing, China. Prior to joining Teneo, Mr. Haenle served as the Director for China, Taiwan, and Mongolian Affairs on the National Security Council staffs of former President George W. Bush and incumbent President Barack H. Obama. Mr. Haenle also played a key role as the White House representative to the U.S. Negotiating team at the Six-Party Talks Nuclear Negotiations. From May 2004 to June 2007, he served as the Executive Assistant to the U.S. National Security Adviser. Trained as a China foreign area Officer in the U.S. Army, Mr. Haenle has been assigned twice to the U.S. Embassy in Beijing, China, served as a U.S. Army Company Commander during a two-year tour to the Republic of Korea, and also worked in the Pentagon as an adviser on China, Taiwan, and Mongolia affairs on the staff of the Chairman of the Joint Chiefs of Staff. Some of his early assignments in the U.S. Army included postings in Germany, Desert Storm, Korea, and Kuwait. He retired from the U.S. Army as a Lieutenant Colonel in October 2009.

Mr. Haenle received an M.A. from Harvard University, and a B.S. from Clarkson University.

## The Rt. Hon. the Lord Hague of Richmond

SENIOR ADVISOR, TENEO

Lord Hague of Richmond is a Senior Adviser to Teneo. He served as British Foreign Secretary from 2010 to 2014 and was leader of the UK Conservative Party from 1997 until 2001.

Mr Hague was first elected to Parliament for the seat of Richmond, North Yorkshire, at a by-election in 1989. At 27 years old he was the youngest Conservative Member of Parliament. He was re-elected a further five times to Parliament, on the last three occasions with the largest margin for any Conservative in the country.

Within two years of entering Parliament Mr Hague had become Parliamentary Private Secretary to the Chancellor of the Exchequer. In 1993 he became Parliamentary Under-Secretary of State at the Department of Social Security. He was

promoted the following year to Minister of State with responsibility for Social Security and Disabled People. He introduced the landmark Disability Discrimination Act in 1995.

Prime Minister John Major appointed him Secretary of State for Wales in the same year making him, at 34, Britain's youngest cabinet minister since Harold Wilson in 1947.

Mr Hague became leader of the Conservative Party after the 1997 General Election, making him, at 36, the youngest leader of a major political party in the United Kingdom in 200 years.

He set about reforming his party, including giving local party members a decisive say in future leadership elections. He led his party to victory in the European elections of 1999 and was widely credited for leading a successful campaign against the country joining the Euro. He stood down as leader following the re-election of Tony Blair at the 2001 General Election.

Mr Hague led the negotiations with the Liberal Democrats following the 2010 General Election that led to the creation of the Coalition Government. During his tenure as Foreign Secretary, Mr Hague dealt with one of the most tumultuous periods in modern history with unrest across the Middle East, and crises in Europe.

He set about reviving the Foreign and Commonwealth Office, opening new embassies in Latin America and Africa, expanding Britain's presence in China and India, re-opening the language school, establishing the Diplomatic Academy, and personally visiting 83 countries.

In 2012 Mr Hague launched the Preventing Sexual Violence Initiative with UN High Commissioner for Refugees, Angelina Jolie Pitt, to address the culture of impunity that exists for crimes of sexual violence in conflict, and increase the number of perpetrators held to account.

After four years as Foreign Secretary, in July 2014 he declared his intentions to step down from front-line politics at the 2015 General Election, becoming Leader of the House of Commons in his final 10 months in Government, and retaining his position as First Secretary of State.

Mr Hague has written two very successful and critically acclaimed political biographies: of William Pitt the Younger, which won the History Book of the Year prize in 2005, and William Wilberforce: The Life of the Great Anti-Slave Trade Campaigner.

He has served as an advisor to the JCB Group and Terra Firma Capital Partners,

drawing on his experience as a consultant at McKinsey and Co. for five years before entering the House of Commons. He chairs the International Advisory Board at leading legal firm, Linklaters. He has a first class degree at Oxford and gained an MBA with distinction at INSEAD.

William is currently chairing the United for Wildlife Taskforce which is tackling the trafficking of illegal wildlife products, as part of a collaboration of seven conservation organisations and The Royal Foundation.

## Tobias Harris

SENIOR ASSOCIATE, TENEO INTELLIGENCE

Tobias Harris is a political risk analyst and frequent commentator focused on Japanese politics and implications on foreign and economic policy. Prior to joining Teneo, Mr. Harris was an independent analyst of Japanese politics and creator of the blog Observing Japan. He has written articles on Japanese politics for publications like the *Wall Street Journal* Asia, F*oreign Policy*, and the *Far Eastern Economic Review*, consulted for the Control Risks Group, and provided on-air analysis for CNBC, Bloomberg, NHK, and Al Jazeera International. He has also been an invited speaker at events hosted by the Economist, Morgan Stanley, the Naval War College, and the Japan Society of New York. In 2011-2012, he was a Fulbright scholar at the Institute for Social Science at the University of Tokyo, where he conducted research on the Japanese bureaucracy.

Before working as an analyst, in 2006-2007 Mr. Harris worked on the staff of Keiichiro Asao, at that time a member of the upper house of the Japanese Diet and shadow foreign minister for the Democratic Party of Japan, for whom Mr. Harris conducted research on foreign policy and Japan's relations with the United States.

Mr. Harris holds an M.Phil in International Relations from the University of Cambridge. He received his bachelor's degree from Brandeis University.

## Crispin Hawes

MANAGING DIRECTOR, TENEO INTELLIGENCE

Mr. Hawes has been covering political and investment risk issues in the Middle East and Africa for over 20 years. In addition to two stints leading Eurasia Group's MENA practice, Mr. Hawes has covered the region for Control Risks Group, The Economist Intelligence Unit, Credit Lyonnais Securities and as a partner in Horizon, a boutique upstream oil and gas consultancy.

He has worked on upstream oil and gas investment in countries from Iran to Tanzania, the emergence of Islamist groups from Senegal to Iraq, conducted eq-

uity research on companies ranging from cement producers to breweries, produced security assessments for countries across the region and consulted with government agencies in the U.S., Canada, the UK and Germany. In terms of client bases, in addition to energy and petrochemicals, Mr. Hawes has provided consultancy services across multiple sectors, including asset management, telecoms, insurance, consumer goods, software and heavy industry.

His core specializations are hydrocarbons politics in the Gulf and political transitions in MENA states, particularly Egypt, Syria, Iraq and Libya. He has a BA in Arabic with Swahili and an MA in Middle East Area Studies, specializing in Islamic Law and Modern Islamic Trends, both from the University of London's School of Oriental and African Studies. He also studied Arabic at the University of Alexandria's Faculty of Arts and the Taasisi ya Kiswahili na Lugha za Kigeni in Zanzibar.

## Bob Herrera-Lim

MANAGING DIRECTOR, TENEO INTELLIGENCE

Mr. Herrera-Lim has been covering political and business risk in the Philippines, Thailand, Vietnam, Indonesia, Malaysia, Singapore, Cambodia, Myanmar and Laos since 2002, previously with Eurasia Group. He has advised firms not only with overall risk assessment at the regional and country level, but also developed and helped implement market entry, divestment and risk mitigation strategies for the firm's clients.

Before working in the United States, he was a practicing lawyer in the Philippines, and served in a variety of government and private sector positions. He was the chief of staff of the Majority Leader of the Philippine Senate, where he focused on post-crisis economic policymaking, energy sector privatization and IT and mining sector policy. Mr. Herrera-Lim was also a program fellow for Corporate Governance at the Asian Institute of Management in Manila, where he led research on Southeast Asian corporate social responsibility. With funding from the Asian Development Bank and USAID, he developed and implemented a Supreme Court training program on securities and bankruptcy law for trial court judges.

As a lawyer in Manila Mr. Herrera-Lim worked on tax, family and corporate law; much of his corporate work was focused on due diligence for mergers and acquisitions and securities issuance. He also consulted on communications crisis management for large infrastructure projects in the Philippines.

Mr. Herrera-Lim has degrees in law and economics from the University of the Philippines, and became a member of the Philippine Bar in 1994.

## James Hoge

SENIOR ADVISOR, TENEO INTELLIGENCE

Prior to joining Teneo, Mr. Hoge was Editor of *Foreign Affairs*, a bi-monthly, non-partisan magazine of analysis and commentary on international affairs and U.S. foreign policy. During his 18 years as editor, *Foreign Affairs* more than doubled its circulation to an all-time high of 161,000 and also launched editions in Spanish, Japanese and Russian. The magazine was founded in 1922 by the Council on Foreign Relations to educate the public on key international challenges and to enrich the debate on policy choices.

Prior to joining *Foreign Affairs*, Mr. Hoge spent three decades in newspaper journalism as a Washington correspondent, then editor and publisher of *The Chicago Sun-Times* and finally as publisher of *The New York Daily News*. Mr. Hoge has been a Fellow at Harvard's John F. Kennedy School of Government, the Freedom Forum Media Center at Columbia University and on the American Political Science Association's Congressional program.

He is a former Chairman of Human Rights Watch and The International Center for Journalists, as well as a member of the advisory board of the Center for Global Affairs at NYU-SCPS and of Brown University's Watson Institute.

## Declan Kelly

CHAIRMAN AND CEO, TENEO HOLDINGS

Declan Kelly is the Chairman, CEO and co-founder of Teneo. He is responsible for running all of the company's operations globally across its 12 operating divisions. Mr. Kelly is an advisor to several of the world's leading CEOs and corporations and is recognized in particular for his crisis management experience.

Prior to Teneo, Mr. Kelly served as the U.S. Economic Envoy to Northern Ireland at the U.S. Department of State. Mr. Kelly was appointed Economic Envoy by Secretary of State Hillary Clinton in September, 2009.

In his role as Economic Envoy, Mr. Kelly is recognized as having helped bring significant investment to the region from U.S. corporations. He also played a significant role in supporting the efforts that led to the historic devolution of policing and justice powers to the Northern Ireland Assembly, giving Northern Ireland fully devolved political governance for the first time in its modern history.

Prior to his government service Mr. Kelly served as Executive Vice President and Chief Integration Officer of FTI Consulting (FTI), one of the world's leading international consulting companies. In his role at FTI, then a 3,500 person business with a market capitalization in excess of $2 billion, Mr. Kelly was responsible for the operational integration of the company's various businesses in more than 20

countries around the world. He also had responsibility for corporate strategy, global business development, global client management and all of the company's marketing and communications functions.

Prior to taking an executive officer position at FTI, Mr. Kelly was Chairman and CEO of Financial Dynamics in the United States and Chairman of Financial Dynamics in Ireland.

Mr. Kelly was a member of the senior management team which sold Financial Dynamics (FD) to FTI Consulting in September of 2006. Mr. Kelly had become part of the FD business when he sold his company, Gallagher and Kelly Public Relations, to FD in 2000. Prior to that he held a number of senior management positions with other leading communications companies in Ireland. Mr. Kelly previously worked as a journalist for more than a decade. He was selected as the recipient of the AT Cross Business Journalist of The Year Award in 1994.

Mr. Kelly is a graduate of The National University of Ireland (Galway). In 2012, he was awarded the Ellis Island Medal of Honor, presented to individuals of different ethnic backgrounds who distinguish themselves by their contributions to society in the United States. In 2011, Mr. Kelly received an honorary doctorate from Queen's University, Belfast in recognition of his service to the community and economy of Northern Ireland. In 2008 he became the youngest-ever recipient of the American Irish Historical Society's prestigious gold medal, given annually to one person deemed to have made a unique contribution to Irish American society. He created and continues to underwrite and personally oversee the Northern Ireland Mentorship Program in partnership with the American Ireland Fund. The Northern Ireland Mentorship Program enables young university graduates from Northern Ireland to spend a year working within several leading corporations in the United States with a view to using their experience to embark on new careers in Northern Ireland.

Mr. Kelly serves on the board of Sesame Workshop, the nonprofit educational organization that runs Sesame Street. Mr. Kelly also serves as Chairman of the American Associates of the Royal Academy of Arts, the U.S. board of the Royal Academy of Arts.

## Michael Madden

CHAIRMAN, TENEO CAPITAL & RESTRUCTURING

A successful entrepreneur with a passion for emerging economies, Mr. Madden has been actively involved in the Financial Services business in emerging markets for over nineteen years. He has lived and worked in Russia for eight years on two separate occasions.

In addition to his role with Teneo, he is also currently the Managing Partner and founder of Ronoc an investment and advisory business primarily focused on financial services in emerging economies, which he setup in July 2007. Recently he launched the Ronoc MSME Impact Fund which is focused on transforming Micro and SME financial institution businesses to market leading retail banks.

In 2003, he was the founding CEO of Renaissance Credit Group, where he established one of the largest Consumer Finance banks in Russia from scratch. He established the Renaissance Credit business in over sixty regions across Russia and in 2005 setup a bank in Ukraine. In 2005, he also launched the first retailer financial services joint venture in Russia with IKEA (IKANO) replacing GE as the partner of choice with IKEA and was appointed as Chairman of the IKANO financial services business in Russia. When Michael exited the Renaissance Credit Group in 2007, it was independently valued at $500 million.

Prior to building Renaissance Credit, Mr. Madden had an extensive and successful career with American Express, characterized by innovation into new markets. He joined the company in Ireland in 1988 and worked in their Card and Travel business before moving to Russia in 1993. Having spent four years in Russia establishing the American Express Card business across the former Soviet, he moved to the UK in 1996, first as Director for a portfolio of Franchise Markets and then as Vice President for the American Express Franchise business in EMEA, as well as managing the American Express International Dollar Card business in Europe.

Mr. Madden's success has been built on inventive business intelligence, understanding of emerging economies and most importantly the ability to engage with international partners, cross cultural teams and his extensive international network of contacts.

## Robert Mead

SENIOR MANAGING DIRECTOR, TENEO STRATEGY

Mr. Mead is a Senior Managing Director with Teneo Strategy. He has deep expertise in brand and reputation management and has advised the senior leadership of many high profile organizations and corporations in managing through strategic transformations, acquisitions, financial/legal crises and regulatory challenges. His clients have included the United Nations, General Motors, Caremark, UBS, Rosneft and United Airlines.

Prior to joining Teneo, Mr. Mead was Senior Vice President of Marketing and Communications for Aetna, responsible for Aetna's brand, marketing, communications, public affairs and social responsibility functions as well as the Aetna

Foundation. He was a member of Aetna's Executive Committee, the senior governing body for the company.

Previously, Mr. Mead was a partner at Brunswick Group LLP, an international corporate and financial communications consulting firm. Prior to joining Brunswick, he was the President of Gavin Anderson & Co., a global consulting firm specializing in financial and public affairs; and before that, President of Sawyer Miller Consulting. He spent his early career in politics and government in Texas.

Mr. Mead received his Bachelor's degree and attended the Executive MBA program at the University of Texas; as well as executive programs in finance, management, marketing and product development at Texas, Babson College, Kellogg and MIT Sloan.

## John McCready

PARTNER, TENEO STRATEGY

Mr. McCready has worked in communications across four decades, specializing in reputation management, corporate positioning and thought leadership. Starting as speechwriter to the Chairman and CEO, he spent 15 years at HSBC, one of the world's largest financial services companies, where his final role was Head of Communications Planning, working across media, investor, employee and policymaker communications internationally.

Prior to joining Teneo, Mr. McCready was a strategic communications consultant at ICAP plc, the world's leading interdealer broker, with responsibility for media relations globally. Mr. McCready has written for CEOs and Chairs for companies listed on 10+ stock exchanges, including half-a-dozen FTSE 100 companies. Mr. McCready started his career in communications as a consumer journalist. He currently works with some of the world's leading companies in the UK, the US, Switzerland and Australia.

## Carsten Nickel

SENIOR VICE PRESIDENT, TENEO INTELLIGENCE

Based in Brussels, Mr. Nickel covers political risk in Western Europe, especially in Germany, the eurozone, and regarding EU-Russia relations.

A member of St Antony's College, he also conducts academic research at the Department of Politics and International Relations, University of Oxford. He has been a regular commentator on issues of German and European politics for a variety of print, online, radio and TV media outlets, including the *Financial*

*Times, The Economist, the BBC, Bloomberg,* Reuters, and CNBC.

Prior to joining Teneo, Mr. Nickel served as an Analyst in the Europe practice of Eurasia Group, where he was responsible for the coverage of German-speaking Europe and focused on the eurozone crisis and Germany's energy transformation. Previously, he worked for a reputation risk consultancy in London and for a member of the German Bundestag in Berlin.

Mr. Nickel received an MSc in International Political Economy from the London School of Economics. He also holds an MA in Social Sciences and a BA in Politics and German Philology from Ruhr University Bochum.

## Wolfango Piccoli

MANAGING DIRECTOR, TENEO INTELLIGENCE

Dr. Wolfango Piccoli is a Managing Director with Teneo Intelligence. Based in London, he serves as Director of Research and also covers political risk in Europe, with a special focus on Italy, Greece and Turkey.

Prior to joining Teneo, Piccoli was the director of the London office and head of the Europe practice at Eurasia Group, where he was responsible for advising financial, corporate and government clients on political developments in Europe. Previously, he was an assistant professor in the Department of International Politics and an Economic and a Social Research Council (ESRC) post-doctoral fellow at the University of Wales, Aberystwyth.

Piccoli is a frequent commentator on European politics in major media outlets, including the *International Herald Tribune, the Financial Times, CNN International, CNBC, BBC, Bloomberg,* CNBC Europe and Al-Jazeera English.

He also co-authored the book Turkey at the Crossroads: Ottoman Legacies and a Greater Middle East, which was translated into Turkish.

Piccoli holds a Ph.D. in International Politics from the University of Wales, Aberystwyth, and an M.A. in International Relations from the University of Bilkent (Ankara). He received his Bachelor's degree from the University of Bologna.

## Kevin Roland

MANAGING DIRECTOR, TENEO STRATEGY

Prior to joining Teneo, Mr. Roland served with distinction in the Foreign Service of the United States Department of State, with a focus on Near East and African Affairs. Mr. Roland most recently served as the acting Consul General in Belfast, Northern Ireland, where he led U.S. efforts in support of Northern Ireland's peace process and economic diversification. Prior to his arrival in Belfast, Mr. Roland

served as the Trade and Investment Team Leader at the U.S. Embassy in Baghdad, Iraq from 2008-2009, working with Iraqi government, industry and foreign investors. He previously served as First Secretary for Economic Affairs in Cairo, Egypt (2005-2008), focusing in particular on energy, infrastructure, industrial and labor affairs. From 2003-2004 Mr. Roland served as Staff Assistant to then Assistant Secretary of State for Near Eastern Affairs William J. Burns, during which time he traveled extensively to the Middle East and international fora and engaged with regional leaderships on the U.S.' top policy priorities. Mr. Roland also served as an Economic Officer at the U.S. Embassy in Pretoria, South Africa (2001-2003), where he focused on the restructuring of state-owned enterprises and boosting bilateral and global trade links, and as a Vice Consul and Political Officer at the U.S. Embassy in Amman, Jordan (1999-2001), where he managed the internal political, tribal outreach, and political Islam portfolios. He is an Arabic speaker and alumnus of the Foreign Service Institute's Advanced Arabic Language Field School in Tunis, Tunisia and has received several State Department Superior and Meritorious Honor awards for his service. Prior to joining the Foreign Service, Mr. Roland worked in finance and banking in the Baltimore region.

Mr. Roland received a BA in International Studies and Economics from Washington College in Chestertown, Maryland.

## Megan Shattuck

PRESIDENT, TENEO TALENT

Megan Shattuck is President of Teneo Talent. Previously, she was a Senior Client Partner at Korn Ferry advising clients on how to align talent with overall strategy, assess existing leadership teams, approach succession planning, and manage recruiting needs. As a member of the Board & CEO Practice and Corporate Affairs Center of Expertise for nine years, she specialized in recruiting senior executives for publicly traded, private or private equity backed companies representing a broad range of industries, including financial services, technology, health care and consumer. Ms. Shattuck also played a key role in the growth and expansion of both the Board & CEO Practice and Corporate Affairs Center of Expertise globally. Prior to joining Korn Ferry in 2006, Ms. Shattuck covered The White House for the Cable News Network (CNN). As a White House Producer, she was a member of the press corps reporting on the Clinton and Bush administrations. Her responsibilities included conducting interviews with administration officials, producing long and short form pieces and leading White House coverage during breaking news situations. Her work with John King, CNN Presents: 9/11 was nominated for an Emmy. Previously, Ms. Shattuck was

an associate producer for CNN NewsStand, a long format nightly news program. Earlier in her career, she worked at The American School in Japan.

Ms. Shattuck serves on the board of directors for Children's Rights, a national organization focused on improving circumstances for abused and neglected children in the United States, and Arch Street, The Greenwich Teen Center, a non-profit organization based in Greenwich, CT, established to provide teens with a safe environment in which to connect and socialize with their peers. She received her undergraduate degree from Middlebury College, studied at the University of Chile and is a term member of the Council on Foreign Relations.

## James Shinn

CHAIRMAN, TENEO INTELLIGENCE

James Shinn is Chairman of Teneo Intelligence, Lecturer at Princeton University and regular contributor to Institutional Investor magazine on political risk. In addition to his role at Teneo, Dr. Shinn advises several technology firms.

Jim worked as a general manager and then entrepreneur in Silicon Valley, first at Advanced Micro Devices, a Sunnyvale, California-based integrated circuit producer, and then at Dialogic, a Parsippany, New Jersey-based software firm, which he co-founded. Dialogic did an IPO in 1992. In the public sector, after posts in the U.S. Department of State, he served as the National Intelligence Officer for East Asia at the Central Intelligence Agency. He became Assistant Secretary of Defense for Asia at the Pentagon from 2006 – 2008, where his area of policy responsibility ranged from Herat to Honolulu and included, notably, the War in Afghanistan.

Jim currently serves on the advisory boards of CQS, a London-based hedge fund; Kenshō Financial, a Cambridge-based data analytics firm; and Predata, a New York-based digital signal processing start-up. He has a BA from Princeton, MBA from Harvard, and a PhD from Princeton.

## Basil Towers

DIRECTOR AND SPECIAL ADVISOR, BLUE RUBICON

Basil Towers is a Director and Special Advisor at Blue Rubicon. He leads both research and intellectual property development focused on how corporations organise to manage reputation for value and how Corporate Affairs becomes high performing. Basil worked for Burson Marsteller before establishing up a corporate communications business for the Shandwick Group and for himself (Christow Consultants). In 2004 he established Hesleden Partners, a European and U.S. reputation management research and advisory business, which was acquired by Blue Rubicon in 2014.