

The War in Ukraine: Globalization Takes Another Hit

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Since the crisis in Ukraine began, Protiviti has issued three Flash Reports. The first¹ addressed Vladimir Putin's initial foray into two Ukrainian regions with "peacekeeping forces," the West's initial wave of sanctions and the implications for companies worldwide. The second² reported on the unprovoked all-out invasion of Ukraine, the economic fallout and other actions ostracizing Russia from the global community. The third³ focused on the implications for the global energy market of efforts by the West and other countries to reduce their dependency on Russian oil and gas imports.

As Putin's ground forces remain mired in a stalemate, the situation becomes precarious. The optimal outcome would be a diplomatic "win" for Putin that he is able to "sell" to his inner circle and at home. Absent that, the situation will likely continue to escalate, raising concerns that Putin will resort to chemical or biological weapons, and that China may provide support to Russia. As the conflict rages on, Western leaders will face mounting pressure to do more to assist the Ukrainians in defending their homeland. Miscalculations that send the wrong message about intentions will be costly.

The discussion that follows addresses the war's impact on the forces of globalization. But first some background.

Globalization has taken significant hits

Globalization is a phenomenon that has been evolving for centuries as companies and governments worldwide share ideas and principles, exchange goods and services, and forge alliances to increase leverage in addressing matters of diplomacy and disputes on the geopolitical stage. Driven largely by the pursuit of mutual interests and bounded by the guardrails of national priorities, globalization implicitly recognizes that certain countries

¹ "The Russian Invasion of Ukraine: Its Potential Implications and Impact," Protiviti, February 23, 2022, available at www.protiviti.com/US-en/insights/flash-report-022322-russian-invasion-ukraine.

² "Putin Pulls the Trigger and the West Responds Again: What Happens Now?," Protiviti, February 28, 2022, available at www.protiviti.com/US-en/insights/flash-report-022822-putin-pulls-trigger-west-responds-again.

³ "The War in Ukraine Rages on: The Energy Fallout," Protiviti, March 15, 2022, available at www.protiviti.com/US-en/insights/flash-report-war-ukraine-rages-energy-fallout.

have access to natural resources, technology and capabilities that others do not. It is fueled by motivations to increase quality of life domestically by making available high-quality products and services at lower costs, while it balances the tension between preserving domestic jobs and acknowledging that some countries have advantages that others do not, e.g., countries with optimum conditions for growing crops are desirable trading partners.

Beyond the geopolitical aspects of globalization as pursued by governments, the last three decades have seen many powerful developments that have shaped corporate business models. Increased cross-border sourcing, outsourcing, information technology and shared services centers have encouraged many organizations to consolidate facilities and streamline processes to eliminate nonessential and redundant activities as well as focus and automate remaining activities. The successive waves of total quality management, process re-engineering and six sigma process improvement initiatives have created a bias for strong supplier relationships and tight coupling within supply chains and distribution channels with the objective of driving costs out of processes and products while adhering to established quality specifications. The reality for most companies is that the enterprise has become “boundaryless” rather than an island in and of itself.

All that said, over recent years, globalization has taken some hits that are altering assumptions underpinning its evolution. Following are a few examples:

- **The emergence of environmental, social and governance (ESG) considerations – the “E”:** Institutional investors, activists, consumers, employees and regulators are driving companies to look upstream at their supply chain and downstream to their distribution channels to reduce the carbon footprint in their value chains and product lifecycles. Developments at the recent 26th UN Climate Change Conference⁴ reinforce these pressures. As disclosures become more transparent, these considerations push their way into C-suites and boardrooms.
- **The emergence of ESG considerations – the “S”:** The pressure points noted above have also focused the spotlight on human rights abuses in global supply chains. Hence, conflict diamonds, child labor, working conditions, worker health and safety, gender inequality, human trafficking, and other matters have driven the need for human rights due diligence in supply chain management. This reputation play has become a strategic imperative in today’s transparent world fueled by social media.

⁴ “Developments at and during COP26: The Second Week,” Protiviti, November 15, 2022, available at www.protiviti.com/US-en/insights/flash-report-111521-developments-cop26-second-week.

- **The consequences of excessive reliance on other countries:** Loss of jobs and even whole industries to countries offering low-cost labor has always been a fallout of globalization. But it creates problems when those losses involve areas that become strategically important from a national security standpoint in times of crisis, e.g., semiconductor chips, personal protective equipment, critical commodities, prescription drugs and steel.
- **The increased risk from eliminating buffers:** Decisions to decrease inventory levels, use a sole-source or single-source supplier in countries on the other side of the planet, and adopt just-in-time manufacturing and delivery techniques on the one hand versus higher inventory levels, supplier diversification and other “just-in-case” buffers in the process on the other hand involve trade-off decisions where quality, time and cost considerations often win out over business continuity assessments. Disruption of fragile supply chains by any number of unexpected events is a catalyst to revisit these decisions.
- **The fallout of trade wars, e.g., United States and China:** Concern over alleged unfair economic policies and commercial practices led the Trump administration to impose punitive tariffs on China as well as restrict China’s access to high-tech U.S. products and foreign investments involving security concerns. The Biden administration has doubled down on these policies by strengthening anti-China alliances and implementing additional sanctions. To President Biden, the U.S.-China conflict is “a battle between the utility of democracies in the twenty-first century and autocracies.”⁵ These geopolitical tensions are driving companies to rethink how they do business with and in China.
- **The changing paradigm from the COVID pandemic:** The pandemic made it crystal clear for everyone that there are business continuity risks associated with the interconnectivity from globalization. Companies are now paying more attention to such factors as where key suppliers are located, reliability of second- and third-tier suppliers, availability of qualified, alternative sources of supply, how long suppliers can operate amid a catastrophic event, and how long the companies themselves can operate during a prolonged disruption in the chain. Sourcing of commodities, materials and components that are a priority from a national security standpoint, particularly related to healthcare and other strategic needs, are receiving closer

⁵ “The U.S.-China Trade War Has Become a Cold War,” Yukon Huang, Carnegie Endowment for International Peace, September 16, 2021, available at <https://carnegieendowment.org/2021/09/16/u.s.-china-trade-war-has-become-cold-war-pub-85352>.

attention by both the public and private sectors, as is the concentration of key suppliers in a given country or region.

- **Stakeholder focus on resiliency:** Supply chain disruptions have sharpened the focus on resiliency of various business activities along a company's value chain in which it applies its business model, e.g., the supply chain, customer fulfillment processes, availability of human resources, information technology, key channels, key customers, and ultimately, consumers, among other things. The appropriate assessment of operational resiliency risk suggests the importance of an end-to-end extended enterprise view of the value chain with a focus on understanding the risk of loss of any of the key links in the chain. The question in the C-suite and boardroom is, "What would happen to the organization's business model if any key component of the value chain is taken away or altered in a significant way through either failure or an unexpected catastrophic event?"

To illustrate, what would the business impact be if any of the following value chain elements were taken away – a strategic supplier of essential raw materials or other inputs at a reasonable cost, availability of power at a reasonable price, lines of credit and working capital, key employees on whom the company depends, critical systems and facilities, key distribution channels, transportation and logistics for delivering products, or major customer contracts? At every stage of the value creation process, what are the implications of a shortage, disruption or quality problem in a key input or output along the value chain or the loss of a major customer? How long would the company be able to operate?

Yes, globalization has taken some hits. But an enduring assumption underlying globalization is that economic dependencies lead countries and regions to resolve border, territorial, trade, security and other disputes peacefully. Now that assumption has been rocked.

Russia's invasion of Ukraine is a huge blow to globalization

While the globalization genie will never be pushed back into the bottle, war is a game changer. When a country with the 11th largest economy in the world and armed with weapons of mass destruction decides to wage an unprovoked war on a sovereign neighbor, it must face the consequences of becoming a pariah state and losing the privileges afforded by globalization. That is exactly what is intended by the sanctions and restrictions levied by the West and other nations upon Russia. These actions have but one purpose: to ensure that Putin's initiation of war on Ukraine will be remembered by history as a strategic failure. With the full weight of these sanctions not manifested yet, a tragedy is unfolding for the

Russian people who know the truth and have no desire for war, including those who were reportedly forced by their employers to attend Putin's recent "rally."⁶

Putin's prosecution of the war and threats of nuclear and cyber reprisals as his army remains stalemated has set Russia back for decades. Hundreds of companies have withdrawn completely from Russia or have suspended their operations there. A few have scaled back operations while others have postponed future planned investment, development and marketing activities while continuing to operate. Still others continue business as usual with no apparent exit or cessation plans.⁷ Those companies continuing to operate in Russia are under pressure to stop doing so.⁸ Bottom line, the choice of doing business with or in Russia has become a reputation play on the world stage.

Meanwhile, the Kremlin has threatened to nationalize the assets of Western companies that pull out of their country over its invasion of Ukraine, a decision that will cause significant economic harm to hundreds of businesses (beyond the losses already incurred) while, at least temporarily, preserving the jobs of the tens of thousands of Russians employed by them.⁹ Such actions would likely increase the hurdle rates for new investments and projects in Russia when, hopefully, the shooting stops and peace is finally declared.

More broadly, the totality of the developments constraining the forces of globalization eventually begins to weigh on fundamental assumptions underlying how businesses view the world. For example:

- As disruptive events that reverberate globally seem to occur with greater regularity, manufacturers are faced with strengthening their supply chain resiliency, including diversifying their portfolio of suppliers, production locations and distribution channels. Near-shoring and reshoring options are on the table.
- As geopolitical tensions fester, sourcing critical components and commodities germane to products essential to national security and sustaining day-to-day life enter the

⁶ "Russians Who Attended Putin's Huge Rally 'Were Forced to by Employers,'" Matthew Dresch, *Mirror*, March 18, 2022, available at www.mirror.co.uk/news/world-news/russians-who-attended-putins-huge-26504687.

⁷ "Over 400 Companies Have Withdrawn from Russia—But Some Remain," Yale School of Management, March 19, 2022, available at <https://som.yale.edu/story/2022/over-400-companies-have-withdrawn-russia-some-remain>.

⁸ "Opinion: Stop buying from these Companies. They're Funding Putin's War," *The Washington Post*, March 16, 2022, available at www.washingtonpost.com/opinions/2022/03/16/boycott-companies-business-russia-putin-ukraine-war/.

⁹ "Putin Threatens to Nationalize Western Companies that Exit Russia," Rob Garver, *VOA*, March 14, 2022, available at www.voanews.com/a/putin-threatens-to-privatize-western-companies-that-exit-russia-/6485253.html.

calculus of business leaders. Intel's decision to invest billions in two new factories in the U.S. to boost production to meet surging demand for advanced semiconductors illustrates this thinking. Intel is also entering into partnerships with educational institutions to build a pipeline of talent and bolster research programs supporting its investment.¹⁰

- Putin's reliance on oil and gas exports to fund his war machine, strained relations between the U.S. and Saudi Arabia and United Arab Emirates,¹¹ the issues associated with looking to Iran and Venezuela as alternative sources, and soaring oil and gas prices are creating unmistakable geopolitical realities that warrant assessment. To that end, this week Jamie Dimon, CEO of JPMorgan Chase, called for additional gas production and more liquefied natural gas facilities in Europe to ensure Europe and America energy security and reduce reliance on Russia.¹² Such actions taken to strengthen the West's positioning on the geopolitical stage will likely be viewed by some as contrarian to established and published ESG objectives.
- Since the beginning of the Ukraine crisis, alerts have hit the airwaves for companies and governmental agencies to shore up cybersecurity defenses against Russian cyberattacks, particularly for organizations responsible for critical infrastructure, e.g., utilities responsible for power plants, the electric grid, gas transmission systems, water resources, sewage and sanitation. Yesterday's announcement¹³ of the hack of Okta, which provides authentication services to more than 15,000 organizations, is a wake-up call to double down on cyber protections and incident response capabilities.

These are just a few considerations at the present time. The point is the world is changing, the situation remains fluid and time-honored assumptions regarding doing business in the global economy should be revisited in view of geopolitical realities.

¹⁰ "Intel Announces Nest US Site with Landmark Investment in Ohio," Intel, January 21, 2022, available at www.intel.com/content/www/us/en/newsroom/news/intel-announces-next-us-site-landmark-investment-ohio.html#gs.uwb026.

¹¹ "Saudi, UAE Leaders Declined Calls with Biden Amid Ukraine Conflict," Lexi Lonas, The Hill, March 8, 2022, available at <https://thehill.com/homenews/administration/597436-saudi-uae-leaders-declined-calls-with-biden-amid-ukraine-conflict>.

¹² "Jamie Dimon Calls for Development of Domestic Gas and Energy Resources: A New 'Marshall Plan,'" Ken Martin, FOXBusiness, March 23, 2022, www.foxbusiness.com/business-leaders/jamie-dimon-energy.

¹³ "Hackers Hit Authentication Firm Okta, Customer 'May Have Been Impacted,'" Raphael Satter, Reuters, March 22, 2022, available at www.reuters.com/technology/authentication-services-firm-okta-says-it-is-investigating-report-breach-2022-03-22/.

Concluding comments: Plan for the unexpected

A fundamental tenet of globalization is that countries should not seek to obtain things they want by force. Ukraine has become the front line for sustaining that principle. For sure, globalization is not going away. But its face is likely to shift in important ways.

As the war continues and the world grieves over the death and suffering of the Ukrainian people, companies should be thinking about their contingency plans in response to different scenarios, e.g., a protracted conflict in Ukraine, a broader conflict beyond Ukraine's borders, and the potential for a cessation of essential business activities due to a cyber or other attack. They also should evaluate their long-standing assumptions in view of different realities that may exist in the post-war world. Geopolitical developments and their implications for the business should be an integral part of every C-suite and boardroom conversation concerning the risk landscape.

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