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ONE YEAR ON

THE RUSSIA-UKRAINE WAR

The OECD estimates that the Russia-Ukraine War will cost the global economy $2.8 trillion over the course of 2022 to 2023. Senior Editor **Jacob Ambrose Willson** asks a collection of **Criticaleye Board Mentors** their thoughts on how the conflict is reshaping the world and what it means for business strategy

On the morning of February 24th 2022, Russia launched a full-scale invasion of Ukraine. President Vladimir Putin's announcement of a 'special military operation' marked a major escalation in the regional conflict which began with the 2014 invasion of Crimea and the subsequent seizure of parts of eastern Ukraine's Donbas region by Russia-backed paramilitaries.

The immediate aftermath of the invasion and the following months of unrestrained warfare has led to tens of thousands of deaths on both sides and generated the largest humanitarian and refugee crisis in Europe since World War II. About 8 million Ukrainians were displaced within their country by late May, and a similar figure had fled its borders by January 3rd 2023.

Russia's invasion of a sovereign nation was met with widespread condemnation from international bodies such as the United Nations and the International Court of Justice, while diplomatic and economic sanctions were imposed by various governments around the world. In response, over 1,000 companies left Russia and its regional ally Belarus, but this is just one example of how the War in Ukraine has drastically altered the landscape for global business.

As we approach the grim one-year milestone of Russia's invasion, now is a pertinent time to reflect on the impact the war has had on the global economy, geopolitics and key industries, and how businesses should reconsider scenario planning and risk management moving forward.

Mark Spelman, Non-executive Director at Buro Happold and a Board Mentor at Criticaleye, frames the effects of the war on the macroeconomic environment within two categories: "Most of what I call the 'first order' effects of the Russian-Ukrainian war played through in 2022. We're now actually witnessing the 'second order' effects."

Short-term Shocks

A spike in the prices of several commodities, most notably oil and gas, occurred soon after the full-scale invasion commenced, as the prospect of Russian supply being cut off by imminent sanctions began to be priced in. With wholesale energy prices across Europe already escalating prior to the war, businesses and consumers braced themselves for even higher energy costs over the course of the year.

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Many companies with operations and trade partnerships in Russia were forced to make a decision on the immediate and future viability of those commercial divisions, taking into account ethical considerations and the grave risk of being trapped in a sanctions violation issue.

"I think businesses pulled out for their own reputational risk," says Non-executive Chair at Ecom Express and Criticaleye Board Mentor **Venkataramanan Anantharaman**. "We've seen the negative press received by companies that have decided to stay put. It's largely been reputational risk and the potential risk of violating sanctions that's been driving it [exit decisions]."

The War in Ukraine also generated negative 'first order' effects across financial markets and aggravated global supply chain bottlenecks in key commodities from oil and gas to grain, minerals, metals and fertilisers, all of which are produced and exported in large quantities by Ukraine and Russia.

In recent months, global oil and gas prices have begun to recede back to pre-war levels, while the other short-term shocks have largely been absorbed by businesses. But there remains a much more significant matrix of 'second order' effects that have exacerbated existing weaknesses in the global economy and will continue to play out in the coming years.

Final Straw for the Economy

"The world was already heading towards an inflationary environment," **Ananth** stresses. "Thanks to years of quantitative easing and the amount of money moving >

around, it was only a question of time. With the financial crisis, Covid and a continuous period of low interest rates, it was just waiting to happen. I think the conflict really pushed it [the global economy] over the edge."

The double-edged sword of high inflation and high interest rates has led to a large number of financial analysts predicting that a recession will hit most economies in 2023 with varying degrees of intensity and length, dependent on the local or regional context.

"I would argue that 2023 will be consumer-led downturn," says **Mark**. "This is because the higher energy and commodity prices of 2022 essentially reduced real incomes and disposable consumption.

"The reason why Ukraine is so important is because we are now seeing the secondary impacts of higher energy and commodity prices flowing through into many other products and services. These secondary effects are sustaining inflation levels and are compounded by higher interest rates and a tight labour market.

"The longer those secondary effects last, the longer inflation will remain high. And as long as inflation stays relatively high, I think real disposable incomes will continue to stay low and any economic recovery will be weak."

Mainland Europe has been left most exposed, in terms of regional trade. Germany, the EU's largest economy, suffered a significant hit to its export business in the aftermath of the invasion. "Germany's exports fell by 41% last year and its imports rose by 15%," explains **Dariusz Kucz**, Non-executive Director at PZ Cussons and a Board Mentor at Criticaleye.

> *"Geopolitical risk should always rank high on corporate risk registers... The risk is perpetual, so should be the readiness"*
>
> Mary Jo Jacobi

"For the very first time in many years, Germany had a trade deficit. This is going to have a knock-on effect for many businesses in central and eastern Europe, because a lot of these businesses are highly dependent on the strength of the German economy."

A US Perspective

The war has also placed significant extra strain on the already stretched budgets of governments that have stepped up to support Ukraine with military, financial and humanitarian aid. To date, the West has sent around $100 billion to the nation, of which about half has come from the US Government.

Mary Jo Jacobi, a Non-executive Director at Savannah Resources and a Board Mentor at Criticaleye, understands that the pressure on the US budget is real amidst the ongoing situation in Ukraine, which is developing into a war of attrition that could escalate at any moment or even spill out into other regional nation states.

"The US deficit is unsustainable at current levels. I think it's currently at 120 percent of GDP. But it's not just national budgets, there's pressure on corporate budgets and personal budgets. If the Ukraine conflict persists, there's a real risk that people and policymakers will lose interest and political will, resulting in less support for Ukraine."

While the US has been untroubled by the loss of Russian oil and gas in the global market – indeed the North America region could be energy self-sufficient if it chose to be – the conflict has thrown up a number of questions in terms of energy security, the global energy transition and international trade partnerships.

Businesses across Europe should pay close attention to developments in the natural gas market following the removal of Russian supply, which accounted for approximately 40% of the EU's natural gas in 2021. What was once a regional industry is now becoming a global one, according to Chair of the North Sea Transition Authority and Criticaleye Board Mentor **Tim Eggar**, with the cost of this shift likely to be felt for the next several years.

"On almost any scenario you care to mention, gas will become unstable and expensive in Europe going forward," he says. "The reason for that is because >

the only alternative source of gas, which cannot be quickly substituted for by renewables, is liquified natural gas (LNG), which is a much higher cost way of importing gas to the region."

Clandestine attacks on European underwater gas pipelines last year should only hasten the EU's pivot to importing LNG on a larger scale. However, there is the matter of building out relevant infrastructure, such as LNG import terminals and storage facilities, which would take several years and require major investment with those costs being passed down to consumers and businesses.

In response, Europe has rapidly increased LNG imports from the US, Norway and Qatar over the last 12 months, with the process of weaning itself off Russian natural gas almost certainly leading to a growing interdependence between European and North American economies, according to **Mark**. The US, in particular, is a top three global producer and exporter of LNG.

"It also provides incentives for Europe to accelerate decarbonisation and further develop its green economy. There are clearly downside risks, but there are also some quite interesting opportunities," he highlights.

The Energy Transition

There's no doubting the conflict has brought into sharper focus the need for greater energy self-sufficiency and hence alternative sources of fuel, particularly those that are low emitting or renewable as governments seek to meet carbon reduction targets set out in the Paris Climate Accords. While investment in renewable energy continues to rise globally, some nations have resorted to reviving coal-fired energy plants to plug the near-term demand shortfall.

Looking beyond the potential environmental damage of reverting to fossil fuels, **Ananth** is confident there will be a renewed thrust towards addressing the issue of energy security and climate change, which will manifest in several ways across the business sphere.

"Governments and entities are looking at alternatives – not just renewables but also nuclear power and the use of ammonia and hydrogen in thermal plants – so the energy transition will start to gather pace. You'll also probably find that carbon credits will become far more expensive as people try and figure out ways to reduce carbon emissions," he predicts.

> *"All businesses are exposed... Upgrading cybersecurity systems should be an order of priority"*
>
> Dariusz Kucz

The War in Ukraine will also lead to a significant rewiring of trade partnerships and supply chains, based on Russia's growing perception as a pariah state by most industrialised nations, albeit with a few notable exceptions. Anticipated global shortages of key goods – ranging from various food products to critical minerals required for the energy transition – indicates a need for greater resilience and optionality within global supply chains.

Mary Jo highlights the West's reliance on Russia and, increasingly, China for strategic minerals as a significant risk factor to European and North American businesses. "What would be the reaction should China use the distraction of Ukraine to make mischief in the Taiwan Strait?"

Varicoloured Swans

Being smart from a business point of view is understanding how authoritarian regimes are changing the dynamic for how entities compete on a global basis, says **Mark**. "The war reinforces the need for resilience which requires a diversified approach to sourcing through a combination of local, regional and global suppliers. To give one example of the latter, computer chips will remain a globally traded product for the rest of this decade."

The risk of overseas cyber-attacks on public and private data infrastructure has also been elevated to the forefront of the agenda for businesses by the War in Ukraine. This type of cyber >

warfare could wreak havoc on attempts to increase openness and connectivity in Western economies.

"All businesses are exposed," says **Dariusz**. "It's a cat and mouse type of game that is never going to stop, so it must be part of the ongoing cost of doing business. Upgrading cyber security systems should be an order of priority."

The wide-reaching ripple effects of Russia's invasion and the ongoing War in Ukraine will undoubtedly reverberate through the global economy for some time, but what lessons can be taken by business leaders to mitigate those effects and be better prepared for similar geopolitical events? Or, from a different perspective, what opportunities can be grasped by fast moving organisations?

Ananth believes the War in Ukraine was not a 'Black Swan event', but rather a 'Grey Swan event', and therefore calls for businesses to undertake urgent reviews of their risk registers. **Mary Jo** agrees wholeheartedly: "Geopolitical risk should always rank high on corporate risk registers. Businesses need to listen more to local leaders where they operate, to the big geopolitical players, to think tanks and to those with foreign policy experience."

HIGH-IMPACT LEADERSHIP PODCAST

Mary Jo Jacobi recently spoke with Criticaleye CEO Matthew Blagg about the current landscape for leadership.

To listen to the podcast, click here

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In fact, every corporate Board should have at least one director with expertise in international relations, according to **Mary Jo**. "The risk is perpetual, so should be the readiness," she advises.

As the global economy lurches into a negative growth environment exacerbated by the second order effects of the War in Ukraine, all businesses face a squeeze on multiple fronts, not least from continuously volatile inflation and interest rates. Therefore, highly leveraged companies born in an era of cheap debt will have to work very hard at deleveraging, according to **Mark**. "I also think that the smarter companies will be looking at how they make strategic investments in 2023 for 2024 and 2025."

Tim says: "We've essentially been outside of an inflationary environment for 25 years, and so it [business modelling] needs a complete rethink. Relatively young growth businesses will be asking how do we manage our staff? How do we manage unexpected cost increases?

"A time of turmoil is very difficult and a lot of companies will be very adversely affected. But the nimble ones will seize opportunities, and there will be more opportunities that would otherwise not be there."

What's clear after hearing from an assortment of Criticaleye Board Mentors is that business leaders who are extremely attentive to the shifting sands of geopolitics and the global economy will put themselves in a significantly stronger position to navigate this period of heightened instability, in which events like Russia's invasion of Ukraine seem all the more likely. ■

Featuring Commentary from the Following Board Mentors:

Venkataramanan Anantharaman
Chair, Ecom Express

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Chair, North Sea Transition Authority

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