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Organizing the government-affairs function for impact

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The value at stake from government and regulatory intervention is huge. Companies that approach external engagement in a disciplined way capture more of it.

The business value at stake from government and regulatory intervention is huge: about 30 percent of earnings[1] for companies in most industries, we estimate, and higher still in the banking sector, where the figure tops 50 percent.[2] Translating those percentages into euros, dollars, or yen can yield eye-popping results: one European utility found that the ongoing value at stake from regulation was €1.5 billion, or about €30 million for every employee involved in handling the company's regulatory affairs. Another large global company estimated that in a major acquisition, it was €500 million a year over a decade.

Since there's so much money on the table, you might assume that companies would organize government relations as carefully as they do other business functions. Surely, for example, companies have people in place to understand the relevant economics, structures, and processes to drive this understanding into important business activities, and regulatory-affairs professionals who work in a collaborative and integrated fashion with business-unit leaders to capture value.

Yet the reality is quite different. In our most recent annual survey, fewer than 30 percent of the executives responding said that their external-affairs groups had the organizational setup and talent necessary to succeed.[3] Only about 20 percent of executives reported frequent success at influencing government policy and regulatory decisions—a proportion that has not increased in the four years we've conducted the survey. Our conversations with external-affairs executives at global companies highlight the challenges:

- "The government-affairs team in our company is buried under a support function, with limited clout and without the business leaders really understanding what they do."
- "We have separate government-affairs and external-communications functions. They operate independently and don't report to the same executive. We don't always communicate on key regulatory issues as much as we should."
- "Within the company we have different functions involved in external engagement; identifying the number of employees involved at the corporate, business, and country levels is a gigantic exercise for us."
- "Our public-policy team works in the shadows, so no one really knows what the worst outcome could have been if they had not engaged stakeholders smartly. Tracking and quantifying impact is very difficult."

In this article, we'll highlight three organizational principles that we've observed leading companies apply to decrease the likelihood of such problems and to increase the value they get from their regulatory functions. The importance of these groups will only grow as industries such as food and beverages come under new forms of regulatory scrutiny (say, related to issues of obesity), while others (notably the extractive industries, such as mining) receive heightened attention from regulators in resource-rich emerging markets.

1. Clarify scope and structure

Regardless of what the groups are called (public affairs and government affairs are common choices) top companies make sure that these organizations excel at economic analysis and stakeholder engagement, not just at lobbying and industry-group participation. By having staff dedicated to handling tasks such as identifying issues, developing positions, and gathering compelling international benchmarks, leading government-affairs units can anticipate a much broader range of possible regulatory outcomes. Notably, leading groups quantify the impact of these outcomes on all parties involved, not just their own companies, by including the regulator and even the broader industry in their analyses. This approach dramatically improves the quality of engagement and can even break through seemingly deadlocked situations—for example, when a company can quickly and accurately show a regulatory proposal's negative consequences for national employment rates or tax revenues.

Top companies identify important stakeholders up front and work with them using a key account management–style approach that borrows from best-practice sales organizations. Designating senior executives as "owners" for important relationships, including those in social media, allows for smoother scheduling and coordination of day-to-day activities. More important, this approach makes it easier for a regulatory-affairs group to provide consistent, coherent, and proactive communication supporting a company's regulatory strategy.

One telecommunications company learned the hard way how important it is to map connections, when its regulatory-affairs team discovered, after the fact, that one of its business-unit heads was often golfing on weekends with the president of the country in which it is based. To avoid such missed opportunities in the future, it explicitly mapped out its most important relationships and designated executives as either primary or secondary contacts to manage them. A mining company in an African country adopted a similar approach after learning that each of its business units was engaging separately with an important government minister—an arrangement that made it impossible for the company to communicate a consistent message.

All of the companies we studied tend to structure their government-affairs units in one of four ways (exhibit). Yet they face a host of design considerations, such as the size of the team, as well as its physical location (including special ones chosen for strategic reasons, such as Brussels; Washington, DC; and, increasingly, Beijing). In situations where decentralized regulatory-affairs teams are required—say, in highly regulated industries calling for deep country-level expertise—we've seen companies successfully create dual-reporting relationships to link external affairs with both the country head and the corporate function. The home office helps quantify the value at stake, shares best practices, and makes sure the company's broader interests are accounted for.

An alcoholic-beverage maker, for instance, designates corporate-level "champions" responsible for regulatory issues involving taxation and marketing rules. These executives gather best practices in areas such as engaging stakeholders and assessing strategic options, and then bring them to countries or regions as needed.

Regardless of how the government-affairs function may be structured, Exhibit

Companies tend to structure their government-affairs units in one of four ways.

Concentration of stakeholders (+ to –)

Corporate function—eg, utility operating in 1 country • Single unit in corporate center shared by all business units, regions, or both • Reports to CEO or "CEO minus 1"	**Virtual team—eg, conglomerate** • Small unit in corporate center forms virtual teams to manage cross-functional efforts on project basis (eg, involving finance, country, and R&D experts) • Central unit reports to CEO or "CEO minus 1"
Embedded function—eg, global telecom • Central unit ensures alignment on priorities, best-practice sharing, and engagement with global stakeholders (reports to CEO or "CEO minus 1") • Regional teams "own" local engagement and report to country head, central unit, or both	**Matrix function—eg, natural-resources company** • Central unit ensures alignment and engagement with global stakeholders, reports to CEO or "CEO minus 1" • Local operations have both regional and product-specific units; regional unit coordinates locally to ensure that the company speaks with one voice

Complexity of product/service portfolio (– to +)

companies that take its role seriously typically give it some prominence on the organizational chart. Engagement with high-level stakeholders (such as government ministers), after all, is a CEO-level concern, so having the function's leader report to the chief executive, or at most one level down, is appropriate.

2. Orchestrate activities across the business

When ties to the CEO are more distant or ambiguous, regulatory-affairs groups risk losing touch and becoming disconnected from important business issues. Once isolated, the function may even come to seem as if it speaks a language different from the one the business units use—a common complaint. Such disconnects are deadly, since the ability to convene and collaborate across functions on regulatory issues is vital for success. When regulatory-affairs units aren't viewed as good partners, they can't help the businesses to engage with regulators, coordinate the development of positions proactively, monitor social media, or profile stakeholders, among other activities.

Regulatory-affairs functions can also become alienated from organizations by getting involved with issues too late—for example, reviewing proposals from other departments after they are completed. This often breeds misunderstandings and casts the regulatory group in the role of naysayer, a perception that's tough to overcome. Late involvement can have substantial economic costs as well, if, for example, a product is developed without input from regulatory affairs and later fails to get approval from regulators.

By contrast, an airport-management company we studied views the regulatory-affairs group as a "broker of intelligence" and has processes to ensure that it works closely with other functions. For example, biweekly meetings at the middle-management level bring together representatives from strategy, pricing, legal, finance, operations, and safety to work with regulatory affairs on pressing concerns. Individuals are designated to lead the necessary analyses on an issue-by-issue basis.

Similarly, a large European insurance company holds ongoing roundtables to help colleagues in other functions understand how to address and respond to regulatory issues. These forums are popular among managers and help the regulatory group remain part of the company's inner circle of management decision making.

The European arm of a diversified manufacturer aims to avoid organizational disconnects by maintaining a small group of geographic and topic experts who help the business units with priority issues, project by project. When the company wants quick but deep engagement on an issue (say, the taxation of a category of offerings in a particular geography), product and country experts can join colleagues from the local finance and operations teams to work with the relevant business unit.

3. Build talent and accountability

Once a company clarifies what the external-affairs group will do, how it should be structured, and how it should collaborate with other functions, the next task is staffing it with good people. Among most companies, we have observed three types of leaders: industry veterans, with deep legal or economic training (the role's classic profile); high-profile lobbyists or former politicians, who bring credibility and clout (useful when companies face pressure on a particular issue); or internally promoted business insiders (useful in strengthening cross-functional connections and gaining buy in).

Even among companies that otherwise excel on the talent dimension, nearly all struggle to measure the impact of regulatory affairs.

Any of these three can work well, so long as the leader coordinates effectively across business units while getting—and keeping—the respect and attention of senior management. Increasingly, leading companies tap all three types—for instance, by choosing people who are strong in one area and complementing their skills with those of others outside the function, including providers such as specialist lobbying firms.

Moreover, some companies are starting to use rotation programs that move staffers between the regulatory function and the business units to give these employees experience and improve the odds that their insights will be relevant to the businesses. Companies that combine the regulatory and strategy functions, as some utilities do, tend to be best at this approach. The instinct to cross-pollinate talent is a good one: among low-performing companies, very few external-affairs personnel have line experience. At one company we studied, only the department head had it; more junior colleagues played supporting roles. Such arrangements not only deny these employees valuable opportunities but also put companies at considerable risk if experienced staffers decide to leave.

By contrast, more sophisticated companies appear to view the relationship between the businesses and the government-affairs function as a two-way street. A European telecom operator, for example, integrates regulatory skills into the training that every C-suite occupant receives upon promotion. Similarly, a tobacco company holds regular academies for its marketing and sales personnel to keep their engagement skills sharp.

To increase understanding of the regulatory function's importance, a European power company publishes an internal newsletter that keeps senior management abreast of evolving regulatory topics and aware of the considerable value at stake. The newsletter keeps the group more connected to business issues and improves morale by raising its profile in the company.

Even among companies that otherwise excel on the talent dimension, nearly all struggle to measure the impact of regulatory affairs in a structured way and thus provide meaningful incentives for staffers. While few best practices have been identified so far, some companies are taking the same analyses they use to understand the regulatory value at stake for a given issue and adapting them to their performance-management systems. These quantitative measurements are then complemented by more indirect indicators, such as the quality of relationships with important stakeholders or changes in the level of access to them over a period of time. Such approaches, while still in their early days, could prove a useful means of linking performance to real business outcomes.

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Good regulatory management starts with good organizational design. Companies can increase the odds of getting more business value from this important function by picking the right design and making the most of it, breaking silos and building bridges with other functions, and developing talented people and quantifying their impact.

[1] Earnings before interest, taxes, depreciation, and amortization (EBITDA).

[2] For more, see Robin Nuttall and Sergio Sandoval, "The new value at stake in regulation," January 2010, mckinsey.com.

[3] From January 29 to February 8, 2013, we surveyed 2,186 executives on external affairs at their companies. The respondents represented the full range of regions, industries, company sizes, tenures, and functional specialties.

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