McKinsey Global Survey results

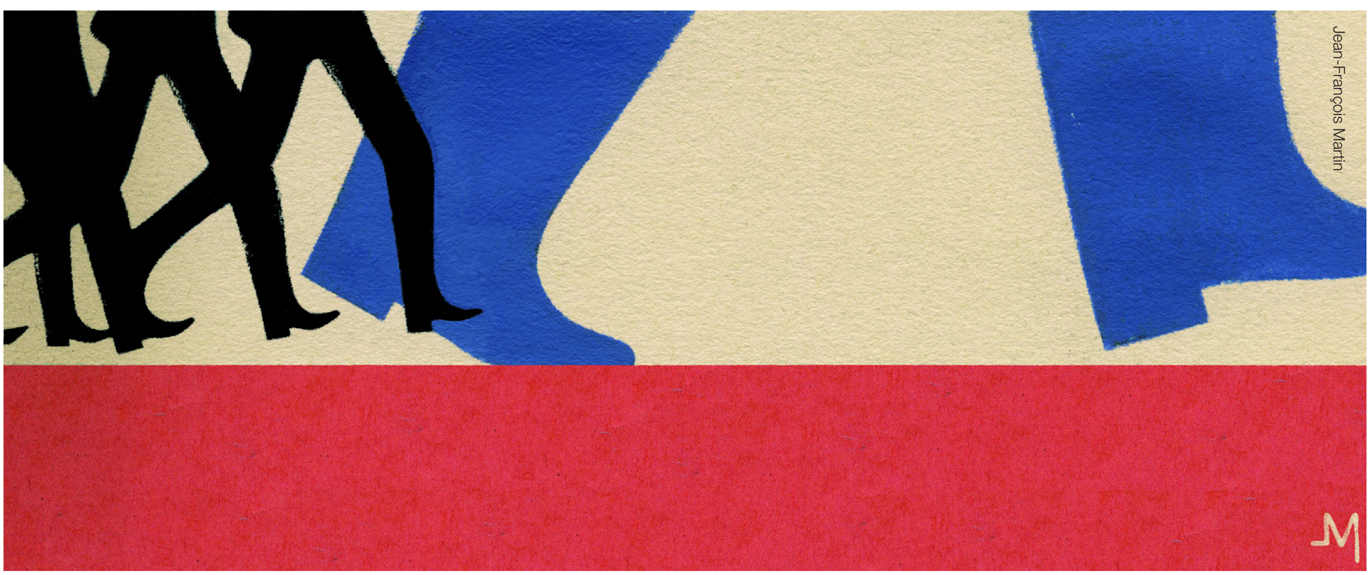
Managing government relations for the future

Companies aren't much more effective at managing their ties with governments than they were in late 2009, though more are engaging in collaboration instead of conflict.

Governments and regulators are second only to customers in their ability to affect companies' economic value, according to the results of a recent McKinsey survey,[1] though respondents are divided on whether that effect will be positive or negative. Most executives in developed economies expect external-affairs issues[2] to decrease operating income; those in the developing world are more likely to expect a boost. Compared with our last survey on these topics, just over a year ago, greater shares of respondents report that their companies are willing to engage with governments and see the value of collaborating with them. Yet whether they hope to mitigate risk or create value, only some 10 percent of all respondents say their companies are frequently able to influence governments or regulators or that those groups seek out and value the companies' opinions.

This survey asked executives a series of questions about the overall impact of governments and regulators, the ways companies manage those relationships and external affairs in general, and their effectiveness at doing so. Notably, since our last survey on these topics,[3] a time that has included economic recovery in much of the world and elections that produced significant change in several countries, executives report that these issues are as important as ever: close to half of all respondents say managing external affairs ranks as one of the top-three priorities on their CEOs' agendas.

[1] The online survey was in the field from January 11 to January 21, 2011, and received responses from 1,396 executives representing the full range of industries, regions, functional specialties, tenures, and company sizes.
[2] These issues include changes in government policy and regulation, as well as other issues affecting a company's reputation.
[3] "How business interacts with government: McKinsey Global Survey results," mckinseyquarterly.com, January 2010.

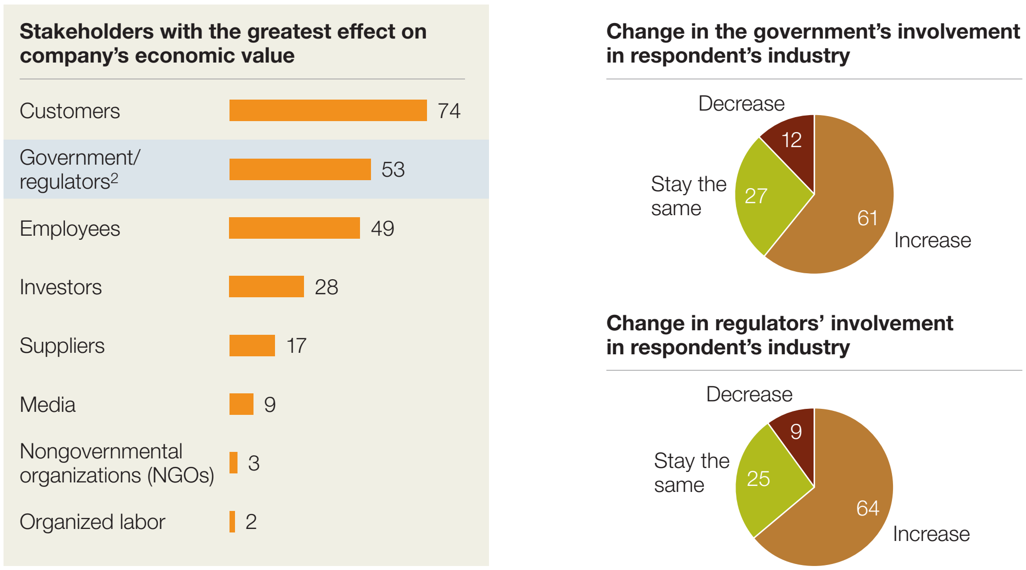


Jean-François Martin

Exhibit 1

Future of government involvement

Expectations for the next 3–5 years,
% of respondents,[1] n = 1,396



[1] Respondents who answered "other" or "don't know" are not shown.
[2] In this year's survey, respondents could select multiple responses to the question and were given "government" and "regulators" as distinct answer choices. Originally, 36% of respondents selected government, and 29% selected regulators. Altogether, 53% of respondents selected government, regulators, or both.

[4] In the previous survey, the question of which stakeholders would have the greatest effect on companies' future economic value offered "government" as one of the answer choices given to respondents, with no separate option for "regulators." In this year's survey, the same question gave respondents "government" and "regulators" as distinct answer choices; altogether, 53 percent of respondents selected either government or regulators, or both.

Where government matters most

Just over half of respondents say governments and regulators will be among the stakeholders with the biggest economic impact on their companies over the next three to five years, and even larger shares expect governments' and regulators' involvement in their industries to increase in the same period (Exhibit 1). These results are consistent with those in the previous survey, in which 52 percent of respondents said governments would have the greatest effect on their companies' value,[4] and 63 percent expected increased government involvement. This consistency surfaced in spite of recent events—such as the 2010 electoral success of

Respondents in North America are likeliest to expect increased involvement from both governments and regulators (71 percent for each group), compared with only 53 and 60 percent, respectively, of respondents in Europe.

the Republican Party in the United States and the Conservative Party in the United Kingdom—that might have caused business leaders to expect less government activity. Executives in developing markets are the likeliest to say governments will have an effect on economic value, with two-thirds of them saying so.[5]

When we asked about the impact of governmental and regulatory actions and other external-affairs issues on operating income, we saw responses that were similar to, but more pronounced than, responses to our last survey, which asked about government actions alone. Forty-seven percent of respondents to this survey say their companies' operating incomes are likely to decrease because of external-affairs issues (Exhibit 2), while 34 percent said the same about government activity in 2009. This year, about a quarter of respondents say these issues are likely to boost their companies' operating incomes, compared with 38 percent who previously said the same. As in the prior survey, executives in developing economies such as China and India are more optimistic.

[5] Algeria, Angola, Anguilla, Bahrain, Bangladesh, Barbados, Brunei Darussalam, Cambodia, Dominican Republic, Dubai, Egypt, Ghana, Indonesia, Israel, Jamaica, Jersey, Kazakhstan, Kenya, Kuwait, Lebanon, Malaysia, Nepal, Nigeria, Oman, Pakistan, Puerto Rico, Qatar, Reunion, Saudi Arabia, South Africa, Thailand, Tunisia, Uganda, United Arab Emirates, Vietnam, and Zimbabwe.

Exhibit 2

Income growth in emerging economies

% of respondents[1]	**Expected impact of external-affairs issues (eg, policy, regulation, and issues that affect reputation) on operating income in the next 3–5 years**		
	Increase	**No effect**	**Decrease**
Total, n = 1,396	26	15	47
China, n = 70	41	4	41
Latin America, n = 98	39	14	36
India, n = 127	37	18	34
Developing markets,[2] n = 98	28	13	43
Europe, n = 424	23	19	47
North America, n = 411	22	14	53
Asia-Pacific, n = 168	20	12	50

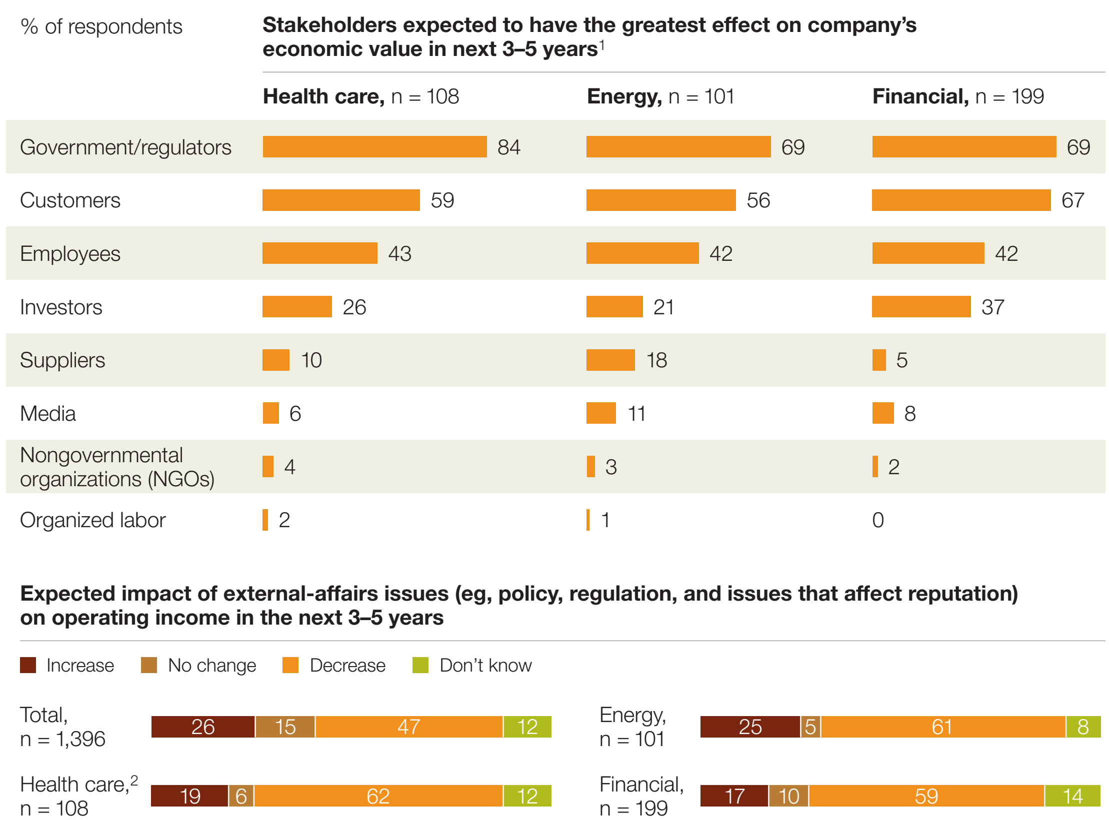
[1] Respondents who answered "don't know" are not shown.
[2] Algeria, Angola, Anguilla, Bahrain, Bangladesh, Barbados, Brunei Darussalam, Cambodia, Dominican Republic, Dubai, Egypt, Ghana, Indonesia, Israel, Jamaica, Jersey, Kazakhstan, Kenya, Kuwait, Lebanon, Malaysia, Nepal, Nigeria, Oman, Pakistan, Puerto Rico, Qatar, Reunion, Saudi Arabia, South Africa, Thailand, Tunisia, Uganda, United Arab Emirates, Vietnam, and Zimbabwe.

Consistent with past results (and with the overall conditions in these industries), executives in energy, financial services, and health care are the only ones to rank governments and regulators as the stakeholders most critical to their companies' economic value, even more significant than customers.[6] Most respondents from these three industries also say operating income is likely to decrease as a result of external-affairs issues (Exhibit 3). Around three-quarters of respondents in each of these industries expect greater government involvement, and it's also worth noting that more than 80 percent of financial-services and health care executives expect greater regulatory involvement—a signal that these industries recognize that government is here to stay.

[6] "Health care" includes respondents who work in health care, social services, and pharmaceuticals.

Exhibit 3

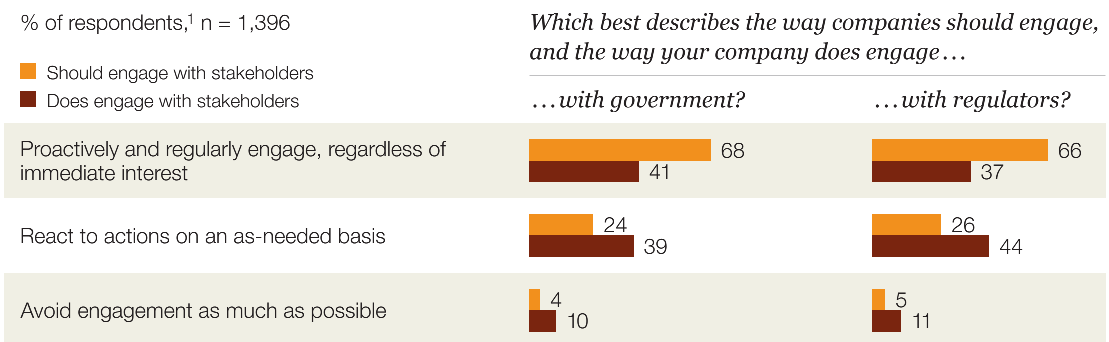
Where external-affairs issues matter most



[1] Respondents who answered "other" or "don't know" are not shown.
[2] Includes respondents who work in health care, social services, and pharmaceuticals.

Exhibit 4

Room for more engagement



[1] Respondents who answered "don't know/not applicable" are not shown.

How companies interact with governments

Two-thirds of executives say companies in their industries should engage with governments and regulators proactively and regularly, regardless of immediate interest, but less than half say their companies actually do (Exhibit 4). This contrast is almost identical to the one we uncovered in our prior survey, when 71 percent of executives said their companies should engage proactively and regularly, but only 43 percent reported doing so. We would have expected to see an increase in proactive, regular engagement since last year, given this year's expectations for growing external involvement.

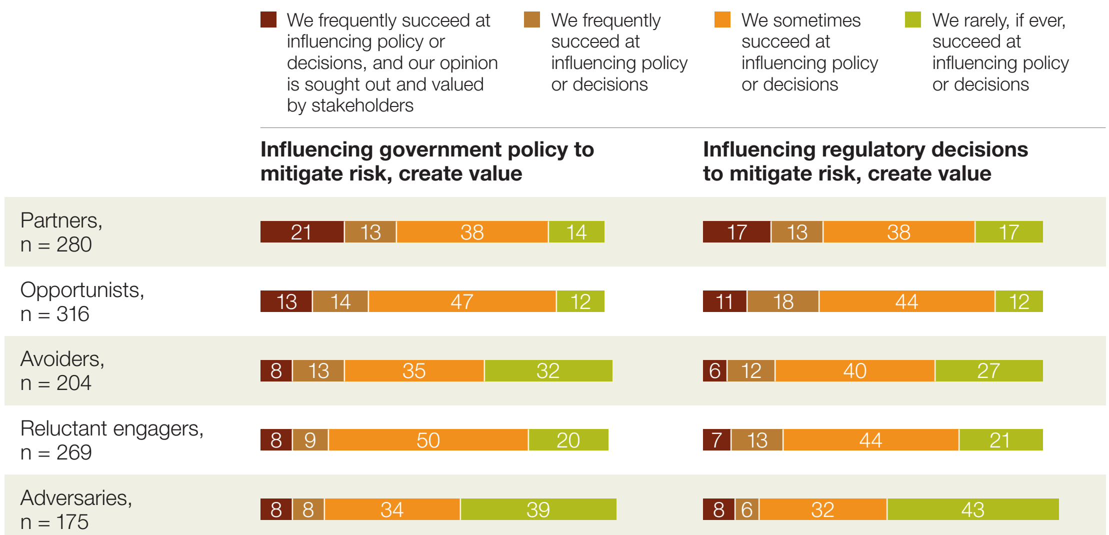
Digging deeper, we looked at executives' attitudes toward government—whether companies benefit from being as transparent as possible with government, and whether greater government involvement is bad for business. Based on those measures, we defined five groups of respondents, which we call opportunists, avoiders, partners, reluctant engagers, and adversaries. Two of these groups are likelier than others to see more opportunities than difficulties in engaging with government: opportunists believe policy and regulation generate new business opportunities, while partners see those specific opportunities along with broader business benefits from transparency and involvement in shaping policy.[7] A quarter of respondents to this survey fall into the opportunist group, and 23 percent are partners—slightly higher than their 20 and 21 percent shares in our earlier survey. Still, this leaves us with more than half of respondents who are more negative than positive about government's role in their businesses.

[7] The remaining respondents are adversaries (14 percent of respondents), reluctant engagers (22 percent), and avoiders (16 percent).

Exhibit 5

More success for partners, opportunists

Company's success in area of influence, % of respondents[1]



[1] Respondents who answered "don't know/not applicable" are not shown.

Not surprising, respondents classified as either partners or opportunists say their companies are more successful at influencing government policies and regulatory decisions to create value or mitigate risk than those in other groups—though overall, the shares of total respondents who say their companies have the most collaborative relationships with stakeholders remain low (Exhibit 5).

Given the regional differences in executives' views on the impact of governmental and regulatory action on operating income, it's not surprising that there are some parallel divergences in which executives are in which group, based on where they work. Respondents in China, India, and the developing markets are likelier to be opportunists, while those in Europe and North America are likelier than their counterparts to be reluctant engagers, who see some benefits from engaging with government but also think government is unfair to businesses. Among industries, high-tech and telecom executives are likelier to be opportunists, financial-services executives are likelier to be adversaries, and those in health care, reluctant engagers.

Building better relationships

We have seen companies use several practices to manage their external affairs successfully, and asked respondents which of these their companies implement effectively. However, the survey results indicate that companies aren't particularly good at implementing any of them. For each of the 15 practices we asked about, no more than 40 percent of respondents say their companies are extremely or very effective at employing the practice. And for four of the practices, no more than one-quarter of respondents say their companies implement it effectively. There are several practices that respondents report their companies use particularly well; these include identifying external risks or opportunities, and prioritizing the stakeholders that are most important for their companies.[8]

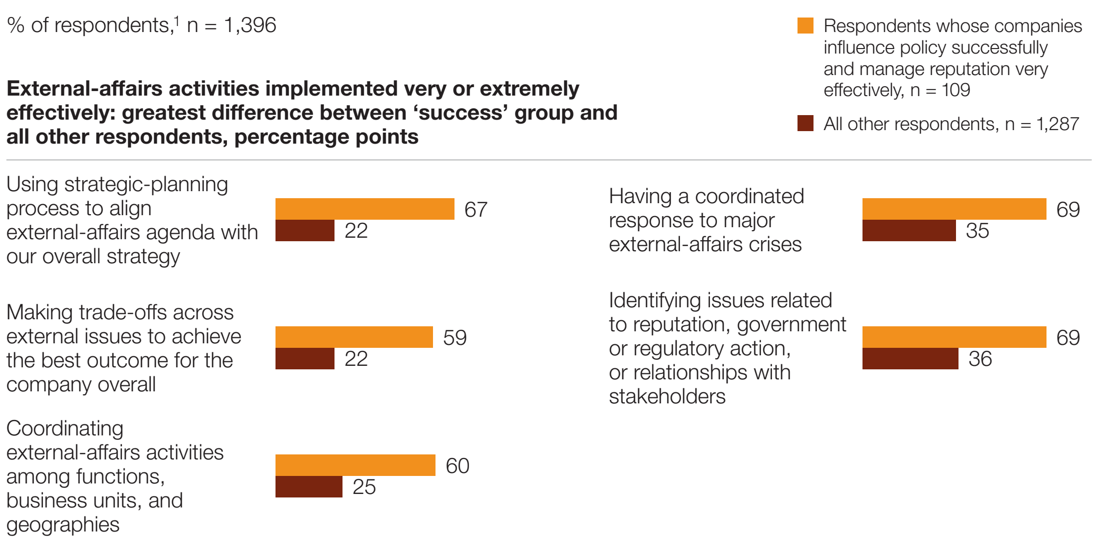
However, we identified a small group of respondents to this survey who say their companies frequently succeed at influencing government policy and regulatory decisions, as well as manage their corporate reputations very effectively so their reputation is a source of competitive advantage. (The 109 respondents in this "success" group are more likely to work in China or Latin America,[9] in the energy or financial-services industries, and at companies earning revenues of more than $1 billion.) Compared with other respondents, these executives are more likely to say their companies employ each of the practices effectively, and by wide margins (Exhibit 6). This finding in and of itself isn't surprising, given

[8] The other practices the survey asked about relate to analysis and prioritization of issues, setting of strategy, stakeholder engagement, implementation, and performance management.

[9] Argentina, Brazil, Chile, Colombia, Costa Rica, Ecuador, Honduras, Mexico, Panama, Paraguay, Peru, and Venezuela.

Exhibit 6

Effective practices, effective outcomes



[1] Respondents who answered "don't know" are not shown.

the well-known halo effect in which survey respondents who report their companies are strong in one area also report that they're good in others.

What's notable, however, are the practices this group says their companies implement particularly effectively—potential guidelines for the companies who struggle to do so—compared with those they indicate they're not very good at. The practices at which the biggest majorities of these respondents excel include aligning the external-affairs agenda with overall company strategy, making trade-offs across external issues, and coordinating external-affairs activities across the company. Tactics where companies in the successful group outperform others but all respondents report particularly low effectiveness include dedicating sufficient talent and resources to external-affairs activities and quantifying and measuring the financial impact of those activities.

Looking ahead

- Our two surveys have uncovered persistent opportunities for improvement in the management of external affairs, as more executives highly regard the potential impact of governments and regulators than report strong, collaborative relationships with these groups. All companies will likely benefit from taking steps now to build the capabilities they need to engage successfully with governments and regulators in the future.

- Companies might benefit most from adopting the same practices used by those that already have good relationships with government. Even the successful companies can improve their overall performance by developing proficiency in many other activities.

- Executives in energy, financial services, and health care indicate that their companies are most at risk from governmental and regulatory action. And though these executives say their companies aren't consistently more engaged with government and regulators than others, they are the likeliest to believe they *should* be. If companies in energy, finance, and health care can translate awareness into action, then future actions by these companies may serve as guides for other industries at risk of losing value through external-affairs mismanagement.

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