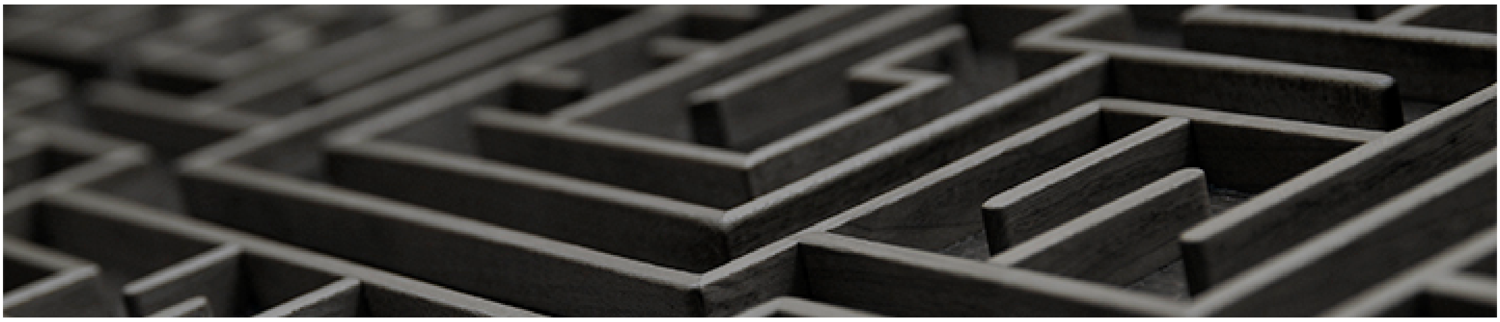
TOMORROW'S CHALLENGES



HOW TO KEEP "LICENSE TO OPERATE" WHILE NAVIGATING THE REGULATORY LABYRINTH

COMPLEX REGULATIONS WILL REMAIN A FACT OF LIFE FOR MOST INDUSTRIES. HOW TO COPE?

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A new era of government activism poses serious challenges to leaders in the corporate world and may lead to unintended consequences in terms of global economic activity. Regulations are on the rise as a consequence of the global financial crisis, increasingly negative public opinion towards large corporations, and scandals involving household brand names.

In the aftermath of the financial crisis (2007-08), there was a rush towards retooling the regulatory environment for the financial sector. Efforts both at national and global levels proliferated with a view to tighten financial regulation and supervision. For example, the Basel Accord of 1988 (Basel I) – the first international prudential regulatory agreement for the financial sector – was only 30 pages long. Basel II (2004) encompassed 347 pages. Basel III (2010), in turn, is 616 pages long. It is not only a question of quantity, but also of increasing complexity as illustrated by the exponential increase in the related calculations required to estimate risk weights for internationally-active banks.

On a parallel track, as many countries entered into recessions and unemployment increased, there was also an increase in governmental interventions, including many beggar-thy-neighbour measures (such as subsidies, localization requirements, and state-aid) that discriminate against foreign companies. These interventions have not only increased complexity, cost and regulatory burdens, but also have often delayed needed structural adjustment.

If one adds to this mix the increasingly negative public perception of large enterprises based sometimes on facts and sometimes on misunderstandings of how markets operate, one can speculate that public opinion will continue to broadly support more regulation. In such an environment, to the extent that the "license to operate" needs to be continuously earned and that it doesn't take much to tarnish a corporate reputation, attention to proper regulatory engagement strategies is a must.

How is business responding to these regulatory challenges and what can one learn from different approaches to regulatory engagement? These questions were asked to corporate public affairs officers, regulators, and academics at the IMD's "Regulation and License to Operate" conference on October 22nd in Lausanne, Switzerland. Here are some of the highlights:

On engagement

A regulatory strategy is an important component of a comprehensive business strategy just as regulatory risk is one of the key considerations in mapping corporate risks. When properly developed, a regulatory strategy should be able to address most of the WHATs, WHYs, WHOs, WHEREs and HOWs of relevance to a company in terms of the regulatory environment. The design starts with a comprehensive stakeholder mapping, appropriate message development, execution planning, and – last but not least – adequate funding for regulatory engagement.

Engagement with the regulator, just as with any other stakeholder, is only effective when based on trust and a professional relationship. That allows adding value through collaboration and providing insights that help regulators understand the ways business operates and the constraints faced by companies in implementing regulations. Staying on message, being consistent over time, and choosing one's battles improves the likelihood of being taken seriously.

Moreover, when an issue gets closer to the decision point in terms of policies to be implemented, mastering the legislative process and the understanding of the surrounding politics becomes key. Building alliances with likeminded businesses, within the industry or outside, will leverage the corporate message and help carry it further. And the message should be backed by evidence and presented with the opponents' positions in mind. A dynamic approach to the engagement will ensure that the business is not taken by surprise with the evolving tactics of other interested parties.

On long term vs short term

While reacting to legislative proposals and regulatory decisions often represents the bulk of public affairs staff work, the proactive engagement before the issue arises is also important. In this way business gets to influence the agenda as it evolves instead of chasing the regulatory runaway train.

This long term commitment, however, means investment in resources when there is no immediate "disaster" on the horizon. Some executives give up on these resources when all seems calm and ramp them up only when the risk is already turning into a clear threat. By which time it is often too late to make a significant difference.

Corporate boards with their mission to protect ongoing concerns are well placed to be the guardians of regulatory strategy, as part of the long term risk monitoring. External networks of corporate and public sector experts may help detect risks early in order to notify stakeholders so they can make adequate decisions. Corporations that miscalculate the danger of regulatory shocks and focus on short-term threats often pay dearly for their mistakes since these engagements require a long-term sustained engagement.

On small and medium size companies

Regulatory risk management is not only for large corporations. SMEs and start-ups also need to develop a strategy to deal with governmental regulations. When resources are scarce, teaming up within the value chain for regulatory reconnaissance, product or service certification can both cut costs and reinforce partnerships. In many countries, regulatory agencies' programs for SMEs offer simplified compliance procedures that ensure staying within requirements while tuning into the needs of smaller businesses.

On some ongoing multilateral initiatives

Businesses also often face differences in regulatory requirements across markets they operate in. Different standards, qualification submissions, approval commissions and agencies add to the cost of doing business internationally.

One of the stated missions of the ongoing TTIP (Transatlantic Trade and Investment Partnership) negotiations between the US and the EU, for example, is the promotion of regulatory cooperation among agencies across the Atlantic. After all, for the countries involved, average tariffs (in the case of manufactured products) have fallen below the 4% range and most of the barriers to trade are non-tariff measures associated with regulatory policies. Most of the benefits, counted in billions of US$, if TTIP were to materialize, would come on one hand from cutting the red tape and making it easier for companies to comply with both American and European regulations in a more efficient manner and on the other hand from addressing similar regulatory objectives in a harmonized administrative manner.

While the objectives are very legitimate and the outcome desirable for all protagonists, the low transparency of the negotiations and the chorus of alarmist concerns pointing to the dangers of deregulation for consumer protection have raised many doubts – particularly in Europe – about the benefits of TTIP. In order to revive the TTIP "brand" the narrative for the public needs to change. The public should be reassured that regulation cooperation can be achieved via consultation and efforts to increase coherence (e.g., adoption of best practices in terms of transparency, consistent implementation of economic impact assessments,…) rather than deregulation per se and that TTIP can deliver substantive benefits in terms of ease of doing business across jurisdictions. Business should focus its efforts in documenting potential early gains since these would be a material proof of the benefits the approach could generate while addressing the fears of hidden agendas.

Another multilateral initiative making headlines is OECD's BEPS (Base Erosion and Profit Shifting), whose recently published action plan still needs to be reflected in national approaches to deter tax avoidance, fiscal arbitrage and aggressive fiscal planning. While most of the action plan refers to recommendations and best practices, it will impact multinational corporations as some of those get adopted by national tax authorities. And the likelihood of implementation is high as governments are still struggling post financial crisis in finding ways to raise revenues and as it is politically easier to clamp on foreign players than on national ones. Needless to say, as long as substantial differences in tax codes across jurisdictions continue to prevail, the incentives to play arbitrage games will remain strong.

On regulation as opportunity

In this new era of government activism, that often ends up in regulatory overreach, engaging the regulator is no more an option. Complex regulations will remain a fact of life for most industries. Learning how to mitigate regulatory risks and to take advantage from opportunities opened by regulatory changes is the right approach. After all, respecting the letter of the law is not only the right thing to do, but it can also become an important source of value creation for companies that develop a proper regulatory strategy.

In sum, regulation can be approached as an opportunity to innovate and to reap benefits of first mover advantage. And for companies active in emerging sectors and industries, there is the ultimate opportunity to help frame the regulatory agenda by positioning themselves as trusted partners for the future.

This article is based on discussions at IMD's recent "Regulation and License to Operate" conference.

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