

# MULTINATIONAL COMPANIES' RISK MANAGEMENT STRATEGIES EVOLVING ON THE BRINK OF THE NEW ECONOMIC ERA

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**Abstract.** In today's dynamic macroeconomic environment, multinational enterprises (MNEs) must have a well-defined approach to risk management in order to survive and thrive. The risk management strategies employed by MNEs must adapt to the ever-changing global economy and the associated geopolitical and climatic changes. Furthermore, the clear prospects for further developments in risk management research create new determinants for the evolution and development of corporate governance systems in MNE. This is especially true in the New Economic Era, where globalization has opened markets to new opportunities and threats. Risk management is a critical factor that impacts the financial, operational and strategic success of MNE. Therefore, it is imperative that MNE invest in developing robust risk management strategies that can keep pace with the ever-changing world economic system. Failure to do so could encourage potential business risks such as financial liabilities, low customer satisfaction, or reputational damage. It is clear that risk management is an essential part of ensuring success for MNEs in today's dynamic macroeconomic environment. The *subject* and *object* of research are defined as corporate strategies of risk management of MNE (including the approach to work with uncertainty, randomness and probabilistic thinking) and the process of their determination through the prism of influence of global economic determinants and the emerging New Economic Era. The reliability of the obtained results and conclusions of the research is substantiated by the choice of a natural methodological strategy, which includes description, explanation and prediction. *Research methodology* is based on a combination of methods: theoretical analysis, synthesis, comparison, systematization, and generalization of scientific literature. The *aim of the research* is to identify the main corporate strategies of risk management in MNEs, taking into account global economic changes, and to develop recommendations for their implementation. The studied risk management focusing exclusively on the past financial indicators of MNE activity and the conducted analysis of the emerging global challenges of the New Economic Era show a gap between the existing approaches to the formation of risk management strategies, which are based only on international standards (including reporting standards), and the urgent needs of MNEs dictated by global economic determinants. The research also creates clear prospects for further developments in the area of risk management strategies. It is suggested that more advanced approaches should be developed that take into account the dynamic nature of the international economic environment and its influence on the risk management strategies of MNEs. In *conclusion*, the research shows that existing corporate risk management approaches are not effective enough to respond to global economic, geopolitical, technological and social changes. Therefore, it is imperative for MNE to develop more advanced risk management strategies that can better address these changes. In addition, it is important for MNE to consider incorporating predictive analytics into their risk management processes to better anticipate potential risks before they occur.

**Key words:** risk management strategies, risk management, globalization, new economic era.

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## 1. Introduction

In today's dynamic macroeconomic environment, a clear approach to risk management is more important than ever. Regardless of industry, how quickly and effectively risks can be identified and managed will determine how successfully multinational enterprises (MNEs) can recover and rebuild. The current challenges of the world economic system, geopolitical and climatic changes that MNEs are facing, create a number of new determinants for the evolution and development of MNE corporate governance systems, the key component of which should be an effective risk management system based on effective risk management strategies.

Modern MNEs, as they strive to achieve their strategic, operational, financial and other goals, need to clearly understand the profile of risks they face. It is also important to view risk in the context of MNE value creation and to move away from the traditional view of risk as something to be avoided. It is necessary to determine the optimal risk appetite and manage risk in all parts of the organization to keep risk within the defined appetite that will allow the MNE to achieve its strategic goals.

The MNE risk management process should be systematic, comprehensive and holistic in nature. Therefore, as part of the MNE risk management strategy, it is important to reflect both approaches to the risk management process, as well as risk assessment criteria and models for the clearest formation of the MNE risk profile.

## 2. Risk management as a core MNE management competency

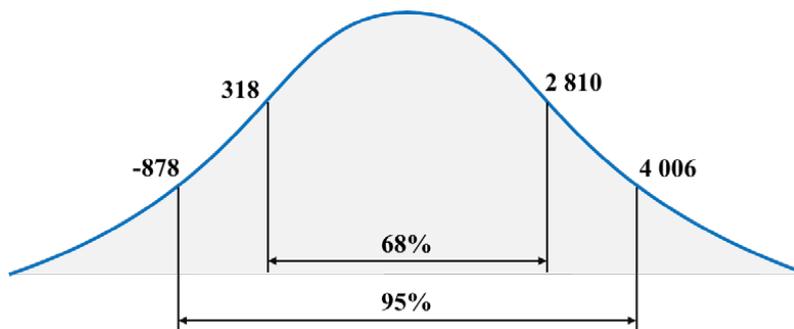
American scientist Thomas Coleman sees risk management as the art of using the lessons of the past to mitigate adversity and capitalize on future opportunities. In other words, it is the art of avoiding yesterday's mistakes, recognizing that nature can always create new ways for things to go wrong. Thus, risk management is much more than numbers; it is the art of using numbers and quantitative tools to truly manage risk. For Coleman, risk is a central component of MNE management. In assessing the overall risk of a company, Coleman focused on the variability of profits and losses, which provides a structure of risk for different levels of MNE management. He notes that risk management requires comfort with uncertainty, randomness, and probabilistic thinking. Coleman argues that such an approach requires quantitative analysis to understand and deal with uncertainty, especially to inform and correct intuition. Thus, the focus of risk managers should be on the critical evaluation of quantitative tools and mechanisms of their analysis (Coleman, 2011).

In addition, Coleman argues that risk is associated with money – profits & losses and their volatility. The future results of the MNE can be summarized in terms of profits & losses, and the uncertainty in profits & losses can be described by a distribution function that can represent many possible outcomes of profits or losses. For risk management, the main contribution of the distribution of profits & losses is to understand how variable they can be. In other words, if the distribution of profits and losses is known, that is, the possibilities of their correlation and the formation and reasons for this distribution are known, then almost everything about the financial risk of the MNE becomes clear (Coleman, 2011). The most important aspect of the distribution is its variability or spread. A common, well-known measure used to summarize the variability or spread of a distribution is volatility, also known as standard deviation. For most normal distributions, one standard deviation above or below the expected outcome indicates that the outcome will be out of range approximately 32% of the time. Two standard deviations above and below the expected outcome indicates that the outcome will be outside the range about 5% of the time (Coleman, 2012).

One of the main objectives of risk management is to avoid a significant deviation or outcome from the expected one, i.e., a wide spread. Although surprises do happen, the biggest surprise, good or bad, creates challenges for risk management. If the standard deviation of the distribution is known, MNE management can predict the range of outcomes with the best and worst possible values for both the 68% and 95% confidence intervals, as shown in Figure 1.

Knowing the endpoints of these ranges shows how good or bad the result could be. A result outside the 68% confidence interval would be a surprise, which could happen 32% of the time. An outcome outside the 95% confidence interval may occur only 5% of the time, but these surprises will be much better or much worse than the expected outcome. MNE management needs to know how much better or worse the outcome could be in order to plan responses to such significant deviations.

According to Coleman, risk management should be the core strategic competency of any MNE. He believes that the ability to manage risk effectively is the single most important characteristic that distinguishes successful MNEs that survive over the long term from those that do not. In successful MNEs, risk management has always been and remains the responsibility of management – from the board of directors to the managing director to the individual line manager. Volatility risk measurement is retrospective, based on historical performance, but as Coleman notes, understanding the past is extremely important because understanding current risks and



**Figure 1. An example of the distribution of financial results for an MNE for confidence intervals of 68% and 95%**

how they would have behaved in the past is the first step to managing them in the future (Coleman, 2011).

Because risk measurement techniques require knowledge and experience to be used properly, managers, board members and investors have a responsibility to understand their businesses and investments. Existing risk management methods can assess risk, but cannot adequately represent extreme or unexpected "black swan" events. Managers, board members and investors must learn to live with this uncertainty and avoid a false sense of security.

Coleman focuses on the risks when profits and losses change on the income statement. However, this narrow focus on profitability should be broadened to include consideration of liquidity with volatility of operating cash flows from the MNE cash flow statement and a focus on solvency with volatility of cash flows from the MNE balance sheet. This is emphasized by another US scholar, Howard Schilit (Schilit, 2010). He notes that in this way, all three main MNE financial statements can contribute to the risk management process.

Schilit believes that these three initial focuses of risk management are expanded to assess additional volatility as follows:

- the focus on net income is expanded to include the margin ratio;
- operating cash flow liquidity is extended to take into account the quality of the MNE's earnings and revenues. Earnings quality is calculated by dividing operating cash flow by net income, while revenue quality is calculated by dividing cash collected from customers by revenues.

According to the results of the analysis of the above three risk management focuses, taking into account additional volatility, Schilit recommends considering the effectiveness of converting these indicators into cash within the framework of MNE financial reporting.

In developing Coleman and Schilit's views on the focus of MNE solvency by means of cash, it is appropriate to consider the fixed cost coverage ratio, the Sloan ratio, and Altman's bankruptcy model.

The fixed cost coverage ratio of MNEs was studied by the American researcher Emanuel Miller according to the formula 1 (Grove, Clouse, 2017):

$$FCCR = \frac{EBITDA - CAPEX - Cash\ Income\ Tax}{Interest + Debt}$$

*FCCR* – Fixed Cost Coverage Ratio

*EBITDA* – Earnings Before Interest, Taxes, Depreciation and Amortization

*CAPEX* – Capital Expenditures

Calculation of FCCR can be used as a risk management tool when carrying out investment activities within the framework of the global economic system. From Miller's point of view, the optimal value of FCCR for MNE should be 1,15 or higher, depending on the level of risk appetite of the company. At the same time, in the banking system, a typical loan condition may provide for an FCCR value not lower than 2.0.

In 1996, American researcher Richard Sloan analyzed the efficiency of MNE stocks based on their accrual ratio. Sloan found that the financial performance of MNEs with low accrual ratios outperformed their counterparts with high accrual ratios. According to the results of the study, Sloan proposed to calculate the accrual ratio according to formula 2 (Robinson, 2007):

$$Sloan\ Ratio = \frac{Net\ Income - CFO - CFI}{Total\ Assets}$$

*CFO* – Cash From Operations

*CFI* – Cash From Investments

A value of Sloan Ratio between (-)10% and 10% means that MNE is in a safe area for working with accruals. On the other hand, deviations from the specified range may mean problems with accruals in MNE.

In 1968, the American scientist Edward Altman developed a model of the bankruptcy of multinational companies according to the values of the zeta index (ζ). The developed model is a numerical measure used to predict the probability of MNE bankruptcy

in the next two years. According to the Altman model, the zeta index ( $\zeta$ ) is calculated using formula 3 (Altman, Hotchkiss, 2005):

$$\text{Zeta index } (\zeta) = 1,2A + 1,4B + 3,3C + 0,6D + 1,0E$$

*A* – ratio of working capital to total assets;

*B* – ratio of retained earnings to total assets;

*C* – ratio of earnings before interest and taxes to total assets;

*D* – ratio of the market value of equity to total liabilities;

*E* – ratio of total sales to total assets.

According to Altman's model, the lower the zeta ( $\zeta$ ), the higher the probability that the MNE is headed for bankruptcy. A zeta ( $\zeta$ ) below 1,8 means that the MNE is in financial distress and has a high probability of going bankrupt in the next two years. On the other hand, a score of 3,0 and above means that the MNE is in the safe zone and is unlikely to file for bankruptcy. A score of 1,8 to 3,0 means that the MNE is in the gray zone and has a moderate chance of filing for bankruptcy.

### 3. On the brink of the new economic era

The past two and a half years have been extraordinary in terms of increasing macroeconomic uncertainty and business cyclicality. The troubling combination of a global pandemic exacerbated by energy shortages, high inflation, and geopolitical

tensions poses serious challenges for MNEs in managing emerging risks and opportunities.

The global economy faced similar challenges in the 20th century: immediately after World War II (1944–1946), during the energy (oil) crisis (1971–1973), and during the collapse of the Soviet Union (1989–1992). Each of these global economic challenges created a set of powerful determinants that defined a new economic era: the postwar boom (1944–1971), the era of discord and strife (1971–1989), and the era of markets (1989–2019), according to the McKinsey Global Institute classification (Bradley, Seong, Smit, Woetzel, 2022). Table 1 shows the main differences between the eras through the prism of five main directions.

The energy (oil) crisis of the 1970s has some common features that resonate with today: an energy crisis, a negative supply shock, the return of inflation, a new monetary era, the rise of multipolar geopolitics, competition for resources, and a slowdown in productivity in the West. The return to stability after the energy (oil) crisis of the 1970s required non-OPEC countries to invest in energy independence and tight monetary stabilization, including double-digit interest rates and recessions.

However, the main feature that distinguishes today's challenges from the 1970s crisis is the political, economic and financial globality of the

Table 1

The main differences between the eras through the prism of five main directions

	Postwar Boom 1944–1971	Era of Discord and Disputes 1971–1989	Era of Markets 1989–2019
<b>Compound annual growth rate (CAGR) of global GDP per capita (Groningen Growth and Development Centre, 2020)</b>	2,9%	1,5%	2,4%
<b>World order</b>	Decolonization of the world and the transition to two competing blocs and the doctrine of mutual assured destruction	End of the Cold War, development of non-Western economies, introduction of fiat money	A globally connected world based on factor cost arbitrage and cooperative economic rules
<b>Technological platforms</b>	The Golden Age of Engineering: the world becomes mobile, mechanized, and energetic	Developing consumer electronics and laying the foundation for digital technologies	Digitization: Connected and Enabled
<b>Demographic forces</b>	Explosive population growth, radical inequality between the "first" and "third" worlds	Fertility rates are falling around the world and are below the reproduction rate in the West. At the same time, life expectancy continues to rise	Global convergence to the small urban family with better health and education
<b>Resource and energy systems</b>	Oil boom supports rapid expansion of energy sector	Acute oil supply crisis, energy diversification, including nuclear energy	A world rich in fossil fuels with global access, but harmful to the climate
<b>Capitalization</b>	The rapid growth of "first world" countries as part of the transition to a peaceful life. Industrialization, reconstruction and debt relief	Active growth of the Chinese economy as Western countries struggle with stagflation	Substantial debt growth with low inflation, supply and demand shocks as billions enter the global market economy

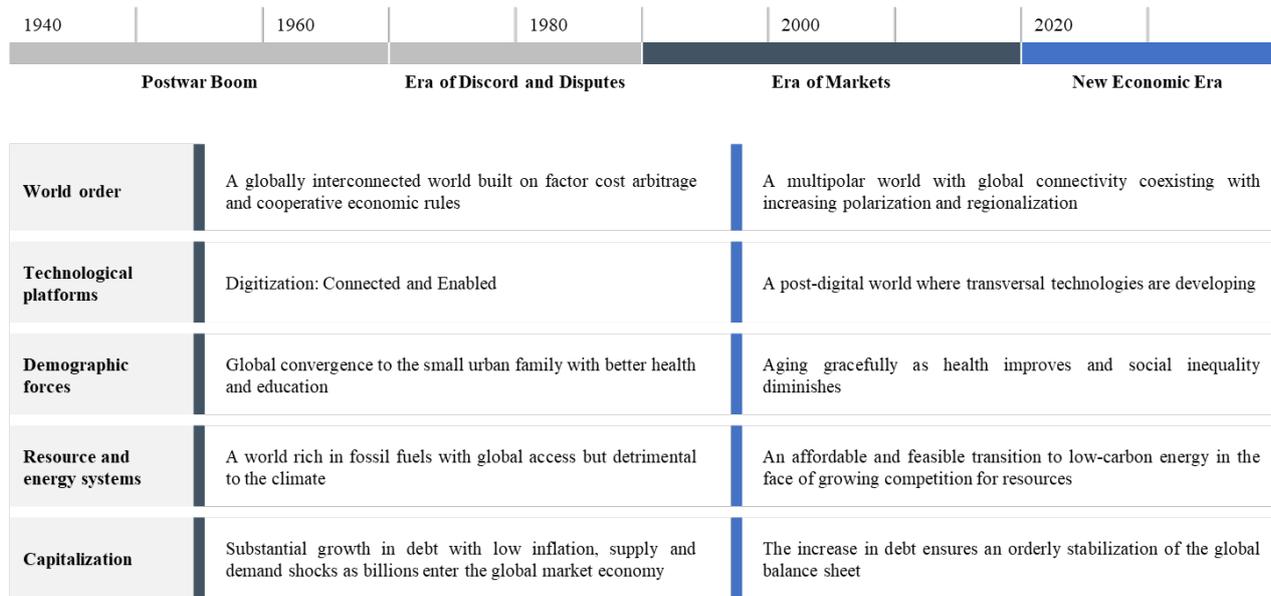


Figure 2. The concept of the theory of the New Economic Era in the context of the main directions

global economic system. Today's supply crisis also differs from previous macroeconomic shocks, such as the 1997 Asian financial crisis, the 2000 dot-com crash, and the 2008–2009 global financial crisis, which were mostly demand-side and largely contained within a region or sector. Figure 2 presents the theory of the New Economic Era in the context of the five main areas defined above that mark its differences from previous eras.

The factors described in the theory of the New Economic Era can create uncertainty in the operational and strategic activities of MNE in the following directions:

- **The world order** is moving toward multipolarity, which can mean regrouping into regionally and ideologically aligned groups. Such multipolar changes and regionalization create new risks for multinationals operating in different countries;
- **Technological platforms** see the rapid growth of transversal technologies, particularly artificial intelligence and bioengineering, which, when combined, could create another great wave of progress in the New Economic Era. Such technological advances may be at the forefront of geopolitical competition, creating new risks and opportunities for multinational corporations and global institutions;
- **Demographic forces** will transform a young world into an aging urban one, an era of infectious diseases may give way to an era of non-communicable diseases, and inequality within states may increasingly challenge the social fabric and the multinational corporations that support it;
- **Resource and energy systems** face the vulnerability of energy security in the age of markets and the direction of investment in low-carbon energy that

must simultaneously meet growing energy demand. The transition to a carbon-neutral economy will be accompanied by geopolitical tensions between global producers and consumers of energy resources, creating a number of risks for energy MNEs;

- **Capitalization** in the New Economic Era will involve an increase in the debt obligations of global participants in the world economy, with a potential shift in geographic focus from Europe to Asia, affecting the cash flows of MNEs operating on different continents.

### 3. Conclusions

The studied risk management focusing exclusively on the past financial indicators of MNE activity and the conducted analysis of the new global challenges of the New Economic Era show a gap between the existing approaches to the formation of risk management strategies, which are based only on international standards (including reporting standards), and the urgent needs of MNEs dictated by global economic determinants.

This gap must be addressed by the risk management functions and top management of MNEs in order to shape the resilience of the MNEs' business – a characteristic that is becoming extremely important in the current conditions of global economic and geopolitical uncertainty. Over the past three decades, going global has meant unlocking specialization and scale, developing markets, and creating multinational corporations. In 2021 alone, the Federal Reserve's low interest rates and abundant funds forced U.S. companies to spend \$506 billion on foreign mergers and acquisitions (Grant, Haider, Mieszala, 2022).

Today, however, the foundations of globalization are facing major destructive factors, a recent example of which is Russia's military aggression against Ukraine. The management of MNEs is faced with the serious question of whether their companies can still remain global players, and if so, in what way.

According to the U.S. National Intelligence Council's Global Trends 2040 report (The National Intelligence Council, 2021), competition for global influence is likely to reach its highest level since the Cold War over the next two decades. In the midst

of these challenges, the value of business resilience is growing. In addition, a study by international consulting firm McKinsey, "Resilience for Sustainable Inclusive Growth" (Brende, Sternfels, 2022), found that MNEs rated as more resilient created more shareholder value than their less resilient counterparts throughout the lifecycle of major economic shocks over the past two decades.

All of this adds up to clear prospects and determinants for further developments in the field of risk management strategies.

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