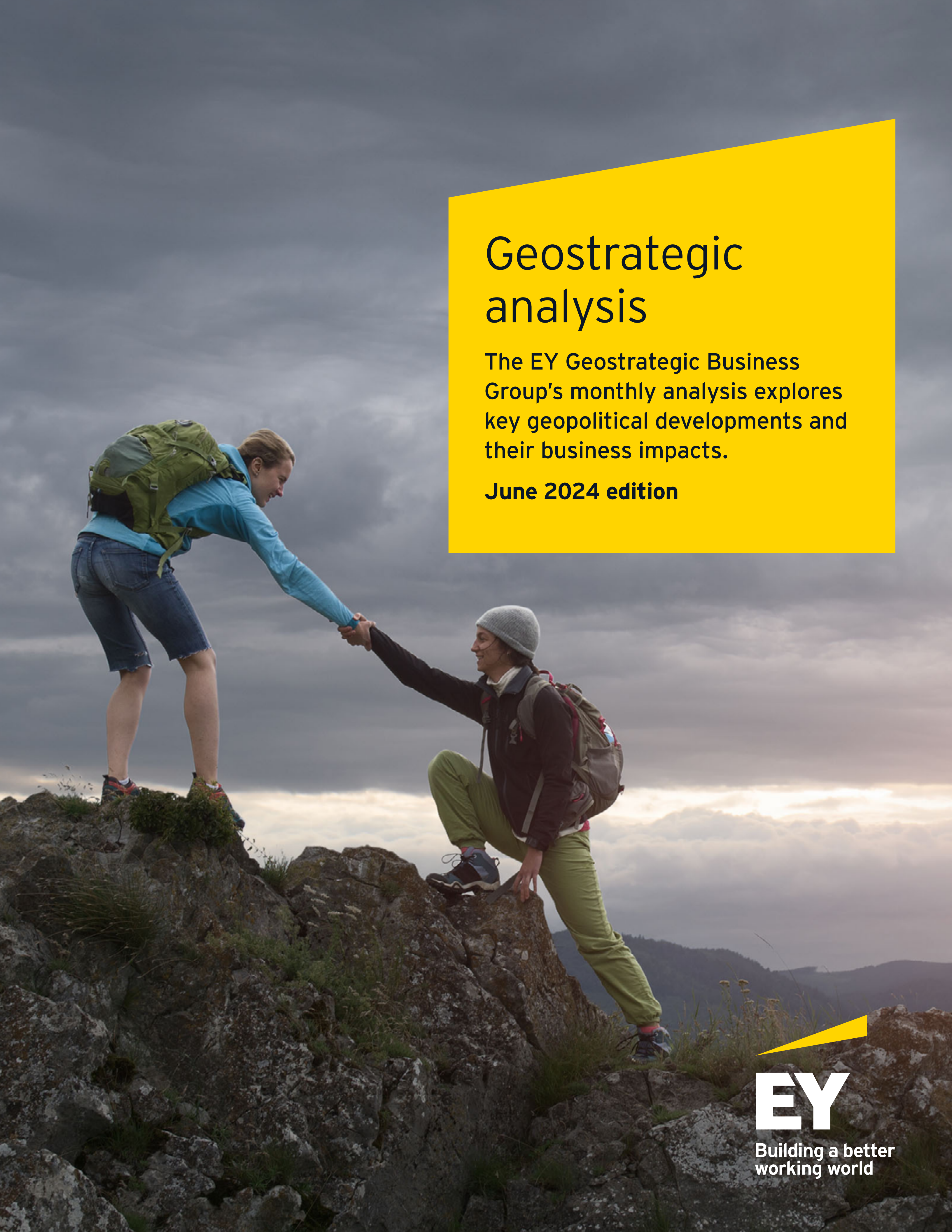
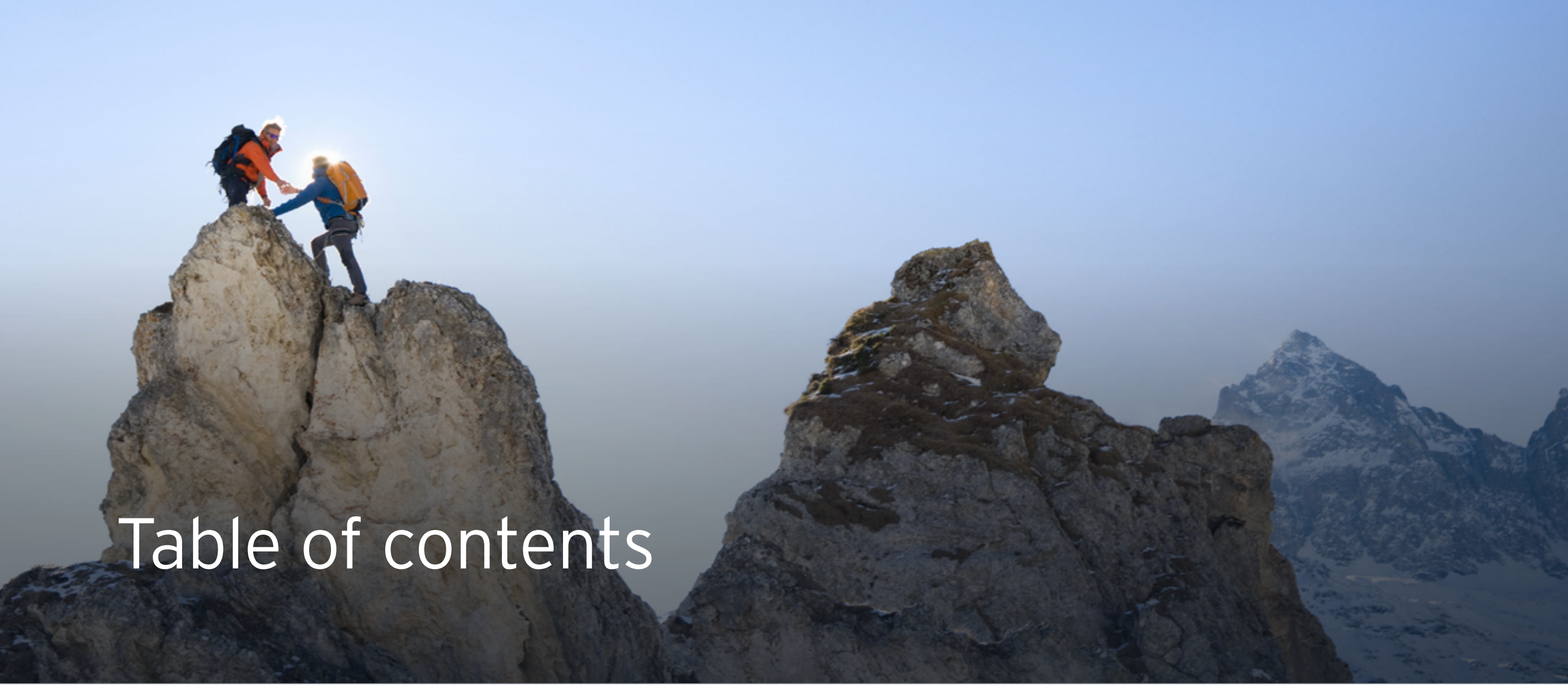


Geostrategic analysis

The EY Geostrategic Business Group's monthly analysis explores key geopolitical developments and their business impacts.

June 2024 edition

Building a better working world



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EY Geostrategic Business Group (GBG)
Translating geopolitical insights into business strategy

Read more.

Top development

Geopolitics is increasingly shaping the landscape of cross-border mergers and acquisitions (M&A)

What happened

Heightened tensions and trade conflicts between major economic powers in recent years have led to increased scrutiny and regulatory barriers for cross-border deals involving sensitive industries or technologies. Governments are becoming more proactive about protecting their strategic industries, hampering the free flow of capital and investment across borders.[1]

Cross-border M&A is decelerating. Since 2000, 30% of deals by value have been cross-border, but this has been trending downward in recent years. Between 2007 and 2011, cross-border M&As accounted for an average of 34% of annual totals by value, but only 26% from 2020 to 2024.

What's next

As more governments seek to build and expand strategic industries, geopolitical influences on cross-border M&A are likely to persist and potentially intensify. There will be further pressure on cross-border deals between geopolitical and economic adversaries. But this situation could also increase investment flows between more closely aligned countries.

New and more stringent policies are in process in many jurisdictions. In the US, for instance, a recent proposed rule would expand the scope of information the Committee on Foreign Investments in the United States (CFIUS) can demand regarding inbound transactions not filed with CFIUS.[2] And changes to Australia's foreign investment regime will tighten rules for deals involving infrastructure, resources and technology.[3]

Following an executive order in August 2023, the US may issue regulations to restrict outbound investment.[4] The EU recently concluded a consultation period regarding potential restrictions on outbound investments in critical technologies.[5] These and other policy changes globally will create extra uncertainties for multinational corporations seeking to expand through acquisitions.

Other geopolitical risks — such as the potential for new sanctions, tariffs and export controls — have made it more challenging to assess the potential risks and rewards of cross-border deals. This uncertain environment will likely continue to extend the timelines for deals to get approved and lead some companies to adopt a more cautious approach.

Business impact

Major sectors affected include Defense, technology, critical infrastructure, energy (especially renewables), automotive, industrials and agriculture.

As governments prioritize national security and economic sovereignty, the regulatory environment will continue to be increasingly complex and unpredictable. Companies should prepare for an increasingly political approval process, making due diligence more intricate and time-consuming.

Companies in the most strategic sectors need to understand not only current regulatory requirements but also the direction in which policy is heading and incorporate that into decisions about the location of operational assets or capital allocation.

Companies in sectors that are becoming more strategic for governments should consider making acquisitions now before greater scrutiny and higher barriers are introduced.

For more information, contact Barry Perkins

Additional reading: Prepare now for the new era of selective globalization

1. Much More Than a Market (europa.eu) https://www.consilium.europa.eu/media/ny3j24sm/much-more-than-a-market-report-by-enrico-letta.pdf
2. Federal Register (treasury.gov) https://home.treasury.gov/system/files/206/2024-07693_0.pdf
3. Australia's foreign investment framework | Foreign investment in Australia https://foreigninvestment.gov.au/investing-in-australia/foreign-investment-framework
4. Executive Order on Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern | The White House https://www.whitehouse.gov/briefing-room/presidential-actions/2023/08/09/executive-order-on-addressing-united-states-investments-in-certain-national-security-technologies-and-products-in-countries-of-concern/
5. Monitoring and risk assessment of outbound investment — European Commission (europa.eu) https://policy.trade.ec.europa.eu/consultations/monitoring-and-risk-assessment-outbound-investment_en

2 Sector in focus: Life sciences

Pharmaceuticals and biotechnology are increasingly targeted as a geostrategic sector

What happened

China included biological medicines and medical devices as key industries in which it aims to become self-reliant in its 14th Five-Year Plan (2020-2025). In the "two sessions" legislative plenaries in March 2024, President Xi Jinping emphasized the importance of "new quality productive forces" including biotechnology.

In mid-May, a US House of Representatives committee passed an amended version of the US BIOSECURE Act, which, amongst other provisions, bars companies from US government contracts if they do business with prohibited entities, with a 2032 deadline to wind down any existing relationships.[6] A Senate committee passed similar legislation in March.

In February, President Biden issued an executive order to prevent the bulk transfer of Americans' sensitive personal data, including genomic data, biometric data and personal health data, to countries of concern.[7]

What's next

Governments are likely to continue to treat biotechnology and advanced pharmaceuticals as a strategic sector, leading to more de-risking and economic security policies affecting the sector.

In the US, the BIOSECURE Act will continue to move through the legislative process and is likely to be enacted in some form later this year. Washington could also introduce more restrictions on cross-border trade and investment in biotech with countries seen as geopolitical competitors, and possibly industrial policies to promote greater domestic innovation in and manufacturing of these products.

China will continue to build the infrastructure to develop its domestic biotech industry, including a talent pool, investment and regulatory policies that support the growth of home-grown corporations. In response to US actions, China could consider introducing export restrictions for the raw ingredients needed for key drug supplies (it manufactures about 40% of the global supply of active pharmaceutical ingredients or APIs).

India and Vietnam stand to benefit from the diversification of life sciences manufacturing. The United States-India Trade Policy Forum, for instance, recently focused on the opportunity to de-risk and diversify the global pharmaceutical supply chain.[8] And Vietnam will continue to implement a 2023 initiative to develop the country's pharmaceutical industry by 2030.[9]

Business impact

Pharmaceutical companies should evaluate their global manufacturing and supply chain strategies and assess whether they need to adjust to emerging geopolitical dynamics. Establishing or expanding supply chains with contract drug manufacturing organizations (CDMOs) in countries with favorable ties to governments in their consumer markets is likely to be a common strategy.

There may be M&A opportunities associated with the implementation of the BIOSECURE Act or similar legislation in other markets, as such laws could result in some foreign companies selling facilities to third parties — private equity, competing CDMOs, or another biopharma company — to continue operating.

For more information, contact Lisa LaMotta

Additional reading: Top 10 geopolitical developments for 2024

6. BIOSECURE Act (house.gov) https://wenstrup.house.gov/uploadedfiles/biosecure_bill_text.pdf
7. FACT SHEET: President Biden Issues Executive Order to Protect Americans' Sensitive Personal Data | The White House https://www.whitehouse.gov/briefing-room/statements-releases/2024/02/28/fact-sheet-president-biden-issues-sweeping-executive-order-to-protect-americans-sensitive-personal-data/
8. Joint Statement on India — United States Trade Policy Forum — India Ministry of Commerce and Industry https://commerce.gov.in/international-trade/joint-statements-and-minutes-of-the-meetings/joint-statement-on-india-united-states-trade-policy-forum/
9. National strategy for developing Vietnam's pharmaceutical industry until 2030 — Vietnam.vn https://www.vietnam.vn/en/chien-luoc-quoc-gia-phat-trien-nganh-duoc-viet-nam-den-nam-2030/

Other issues we are watching

European Parliament outlook; Mexican election; South China Sea tensions

New European Parliament likely to increase strategic investment and regulatory uncertainty

On June 6-9, EU citizens will elect a new European Parliament. Populist right-wing parties are expected to gain ground over center-left and green parties, capitalizing on a growing populist trend which could also translate into higher-than-usual voter turnout. The center-right European People's Party (EPP) — expected to remain the biggest party in the parliament — is expected to continue working with center-left (S&D) and liberal (Renew) parties to advocate for more investment in domestic defense and clean technology production but could occasionally side with the populist right to push back on unpopular legislation, such as around new environmental rules.

Business impact: EU-based companies should expect continued support for investment in strategic sectors including clean technologies (e.g., electric vehicles, renewables), advanced technologies and defense through both EU-wide and national-level funding and regulatory incentives. In parallel, the EU will likely continue to defend domestic strategic industries from certain foreign competitors and restrict foreign investment in critical products. Moreover, delays to some environmental legislation (e.g., ESG reporting) could provide some companies with more time to adjust their business to the new rules but would also increase uncertainty for financial projections and long-term investment strategies.

For more information, contact Famke Krumbmuller

Mexican election may affect nearshoring trend

The Mexican elections on 2 June were the country's largest ever, with more than 20,000 federal and local seats up for grabs and all 32 states holding concurrent elections. In the presidential race, Claudia Sheinbaum of the ruling Morena party won against her main rival, Senator Xóchitl Gálvez of the Broad Front for Mexico coalition.[10] Morena and its coalition parties also won a majority in both houses of Congress — although it is not yet clear if Morena and its allies secured a two-thirds "supermajority" of seats in both houses. A supermajority in Congress would allow Morena to amend the constitution, which would be necessary to enact some of the reforms on its agenda.

Business impact: Sheinbaum is expected to continue many of the policies of current Mexican president Andrés Manuel López Obrador (also known by his initials, AMLO), including an emphasis on public security, infrastructure development and expansion of executive power. Sheinbaum has also discussed the importance of promoting the transition to renewable energy — in part as a way to continue to attract foreign investment and maintain the momentum of the nearshoring trend. Investment opportunities associated with the nearshoring agenda are therefore likely to persist in the manufacturing and technology sectors. However, the market's initial reaction to Morena's victory suggested there may be hesitancy among investors due to the party's potential to pass significant reforms.

For more information, contact Ari B Saks Gonzalez and Alexander Acho

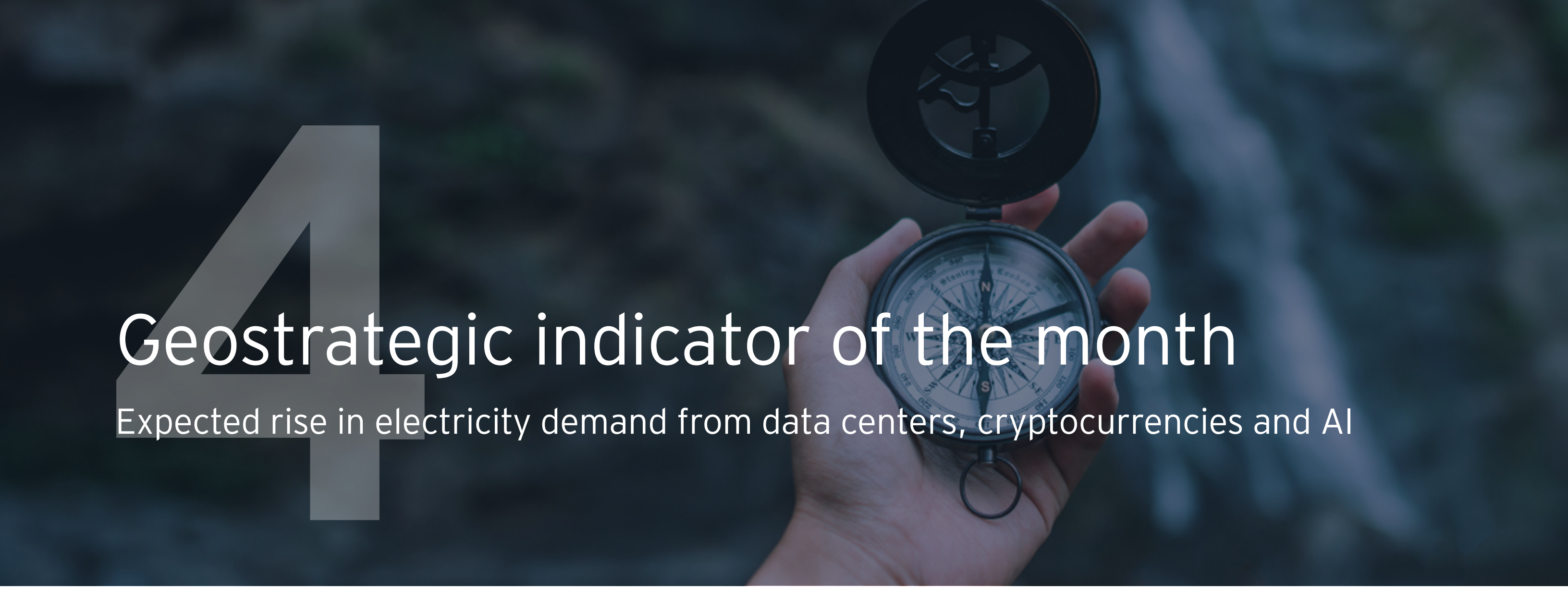
South China Sea tensions heighten potential shipping risks

Accelerating geostrategic competition over access to key maritime terrain and natural resources is heightening tensions in the South China Sea. Over the past few months, China and the Philippines have intensified efforts to reinforce their respective claims to locations in the Spratly Islands and Second Thomas Shoal.[11] Concurrently, some countries in the region are trying to increase access to local natural resources. For example, growing energy demands are prompting Malaysia to expand oil exploration and production at locations in disputed waters.

Business impact: Roughly one-third of global maritime trade passes through the South China Sea. Recent incidents at sea and the increasing presence of ships from various countries have soured diplomatic relations and prompted escalation concerns. A rise in shipping insurance coverage rates is possible, which would impose higher global shipping costs for companies heavily reliant on maritime deliveries. Companies may also face shipping delays and damage to or loss of cargos and vessels if tensions escalate. Businesses dependent on shipping through the sea should both closely monitor what remains a dynamic, evolving situation and ensure that transportation contingency plans are up to date.

For more information, contact Jay Young

10. Presidential Polls — POLITITO MX https://polls.mx/presidencia/
11. Explainer-South China Sea: Why are China and Philippines tensions heating up? (straitstimes.com) https://www.straitstimes.com/asia/explainer-south-china-sea-why-are-china-and-philippines-tensions-heating-up



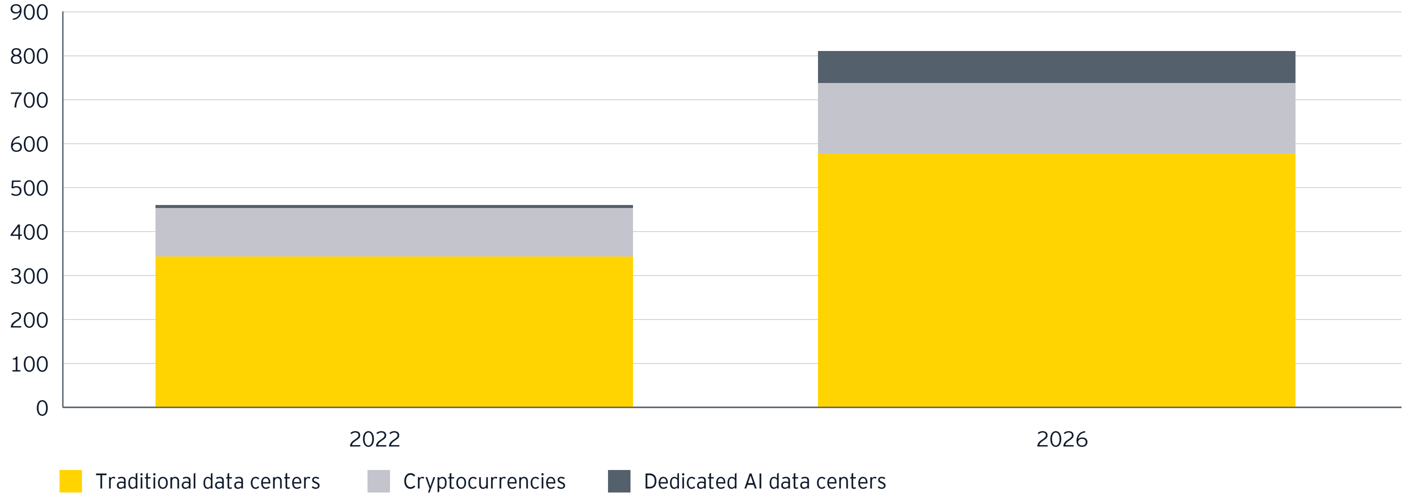
Geostrategic indicator of the month

Expected rise in electricity demand from data centers, cryptocurrencies and AI

The indicator:

According to the International Energy Agency (IEA), in 2022, data centers, cryptocurrency operations and artificial intelligence (AI) accounted for about 2% of the world's electricity usage, consuming 460 terawatt-hours (TWh).[12] The rapid integration of AI into software development across various industries is driving up the energy requirements of data centers. The IEA projects that by 2026, the power usage of data centers, including those serving cryptocurrency and AI, will nearly double.

Expected rise in electricity demand from data centers, cryptocurrencies and AI could create sustainability challenges
Estimated electricity demand, terawatt-hours (TWh)



Source: Electricity 2024: Analysis and forecast to 2026 Report, International Energy Agency, January 2024
Note: Data center electricity demand excludes consumption from data network centers.

Business impact:

The EY 2024 Geostrategic Outlook similarly highlights that the technology sector's energy consumption is likely to increase significantly due to AI's intensive data processing requirements. This raises some risks associated with sustainability and broader environmental impacts.

Sustainability challenges could impact companies in other sectors that rely on data centers, particularly if they are required to report scope 3 emissions. In response, some tech firms are investigating in alternative energy options, including the construction of their own zero-emission power facilities. More broadly, the surging electricity demands of data centers creates the need for an expansion in renewable energy sources and improvements in power grids.

Additional reading: EY 2024 Geostrategic Outlook

12. Electricity 2024 – Internatinoal Energy Agency (iea.org) https://iea.blob.core.windows.net/assets/6b2fd954-2017-408e-bf08-952fdd62118a/Electricity2024-Analysisandforecastto2026.pdf

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