

## Governing Energy

### It Must Be Spring

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Conventional wisdom holds that every spring a bellicose North Korea emerges from winter hibernation and threatens its neighbors. Seemingly starved for attention it feasts at the table of world fear.

This year marks the 60<sup>th</sup> Anniversary of the beginning of hostilities of this still unresolved conflict on that divided peninsula.<sup>i</sup> What makes this year's "*Korean Spring*" different?

Many observers argue this year's "starved" hunger comes from an unknown North Korean leader. Comfortable paths honed over half a century may be tested by both this unknown player as well as new thinking on the part of South Korea.<sup>ii</sup> The risk profile is thus raised!

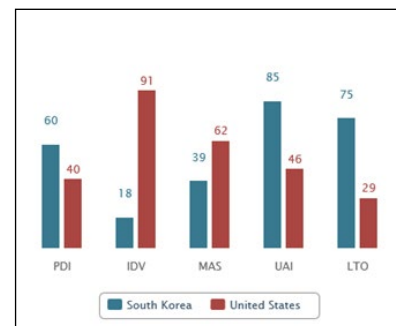
Faced with an earlier nuclear crisis, President John F. Kennedy was influenced by Barbara Tuchman's book, the "*Guns of August*" whereby a set of chain reactions led to World War I.<sup>iii</sup> The lack of communication between parties, be it absence of physical infrastructure i.e., telephone "hotline" or a misunderstanding based on culture differences can lead to geometrically cascading events over an abyss.

### Measureable Latents

Strictly speaking, a latent variable is not directly measureable. However, modern behavior economics provides us with tools that illuminate previously hidden causalities.

Since early 1980s, this author has been investigating cross-cultural issues as they relate to international business deals, particularly in Asia.<sup>iv</sup> Additionally, there is an extensive body of work by this and other authors regarding cross cultural behaviors. One would not be surprised at the conclusion from this effort that there are significant cultural differences between the United States and Asian societies.

For purposes herein, the work done by Geert Hofstede on cultural dimensions can provide a snapshot of some of the issues faced in cross-cultural interactions that can lead to misunderstandings and actions by parties that may be counterproductive. This chart shows the difference of five cultural dimensions between the United States and South Korea (data does not exist for North Korea but is assumed to be similar).<sup>v</sup> Interested readers can visit Professor Hofstede's web site for further information and definitions of his cultural dimensions.



This cursory perspective suggests that there are key differences between these two societies. Perhaps in the normal course of events this delta may simply make negotiations challenging, but when **Brinkmanship** is the game, one hypothesis is they can contribute to disaster. Knowledge of these dimensional constructs can enlighten one about an adversary and his or her emotional drivers.

World War I was not the only historical event resulting from missteps between societies. The 1962 Cuban Missile Crisis is another as well as the 1983 NATO war game, Able Archer which caused the Soviet Union to suspect a preemptive nuclear attack by the western nations.<sup>vi</sup> In both of these cases, cooler heads (on both sides) prevented the unthinkable.

Today, some argue that the United States suffers a similar myopia in contemporary Afghanistan. Behavioral economics suggests the human condition will continue to suffer from cross cultural misunderstandings.

### **Energy Infrastructure Risk**

On the surface and other than the obvious impact of broad hostilities to the global economy, one might not immediately see the events on the Korean peninsula as directly impacting on the oil and gas industry. This assessment would be short sided.

South Korean shipyards are significant suppliers to the global offshore oil and gas community.<sup>vii</sup> One could argue that the industry's risk profile is may be too exposed if there is any significant business interruption in Northeast Asia. Moreover, if the industry cannot deliver the drilling rigs and supporting infrastructure to meet demands for crude oil, a reduction in global economic output is likely.

From a portfolio perspective, one must question whether individual companies and even the industry in general are exposed unnecessarily. As with the Japanese Tsunami of 2011, the impact on global markets from a regional disruption can be broad and long lasting.

### **Market Cap Risk**

Finally, terrorist incidents have a direct and measureable impact on individual corporations and their market sectors. For example, a 2005 study by Ohio State University, "Terrorism and the Stock Market" categorized 75 terror related incidents and found that the average loss for each firm was \$401 million in market capitalization.<sup>viii</sup>

This can be significant shareholder exposure. Incidents subsequent to that study suggest that an environmental impact from catastrophic incidents can raise the market capitalization risk bar much higher.

The greatest risk may be covert. Terrorism aimed at the South Korean shipyards. Is this a worst case scenario?

We raise these issues not as a critic but as part of the global energy dialogue. Geopolitical risk assessment is part of every major organization's enterprise risk management process. The recent

events on the Korean peninsula should cause us all to pause and perhaps rethink our asset portfolio and associated supply chain.

The nature of today's global supply chain processes finds critical components and key knowledge sometimes residing in unlikely places. Make sure your firm's risk mitigation strategy incorporates this perspective.

**Does your firm have more exposure to events in Korea than is readily apparent?**

### About the Author

Dr. [Scott M. Shemwell](#) has over 30 years technical and executive management experience primarily in the energy sector. He is the author of two books and has written extensively about the field of operations management. Shemwell is also the Managing Director of The Rapid Response Institute.; a firm that focuses on providing its clients with solutions enabling operations excellence and regulatory compliance management.

### End Notes

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<sup>i</sup> <http://www.army.mil/koreanwar/textonly.html>

<sup>ii</sup> [http://www.nytimes.com/2013/04/10/world/asia/south-korean-leader-seeks-to-end-vicious-cycle-with-north.html?pagewanted=all&\\_r=0](http://www.nytimes.com/2013/04/10/world/asia/south-korean-leader-seeks-to-end-vicious-cycle-with-north.html?pagewanted=all&_r=0)

<sup>iii</sup> <http://www.washingtonpost.com/wp-dyn/content/article/2006/08/09/AR2006080901514.html>

<sup>iv</sup> <http://www.scribd.com/doc/13395182/Abstract-Cross-Cultural-Negotiations-Between-Japanese-and-American-Businessmen-A-Systems-Analysis>

<sup>v</sup> <http://geert-hofstede.com/countries.html>

<sup>vi</sup> [http://en.wikipedia.org/wiki/Able\\_Archer](http://en.wikipedia.org/wiki/Able_Archer) 83

<sup>vii</sup> <http://www.offshoreenergytoday.com/tag/korea/>

<sup>viii</sup> <http://www.investopedia.com/articles/07/terrorism.asp>