At first glance, few people would describe government involvement in private business activities as a game changer. After all, the government for more than two centuries has played a part in business activity. The Commerce Clause in the U.S. Constitution granted the federal government authority to regulate certain types of commerce.

Yet what if government’s role in business operations is increasing and even at an all-time high? That might prompt astute observers to call the government-business relationship a game changer.

One way to answer that question would be to find a smart way to measure the magnitude and impact of government actions on business.

Government Impact from a Company Perspective

Some people have already tried to measure the magnitude of the government-business nexus. They’ve counted the number of regulations enacted, tried to assess the rules’ monetary impact, or tracked legislation cleared by Congress. Yet none of these measures, together or alone, provide an absolute answer to the question of magnitude, and all of them focus solely on the government side of the relationship.

A better measurement would reflect the business perspective and might provide a deeper understanding of the effect. One way to do that is to evaluate what companies actually say about the impact of federal government actions on their business models.

In 2005, the Securities and Exchange Commission (SEC) implemented a rule for publicly traded companies to report “risk factors” in their 10-K filings, which are annual reports required by the SEC that give a comprehensive summary of a company’s performance. Any risk factors that are known and material to the company or its industry must be cited in a specific section of the document, which ensures a more complete disclosure of risks to investors.

While a multitude of risk factors are typically mentioned—such as the macroeconomic environment, litigation, the competitive landscape, customer or supplier concentration, and reliance on key personnel—the single risk factor that appears in almost every company’s 10-K is government or political risk.

These carefully considered words, shared with investors and the public, have meaning. Bloomberg Government (BGOV) decided to evaluate and analyze these 10-K risk factors across 60 companies.

These businesses are split evenly among the defense, energy, finance, health care, industrial, and technology industries, as well as between large and small companies. BGOV reviewed the risk factors listed from 2005 to 2011 and paid special attention to:

• How much of the section is devoted to U.S. federal government risk;
• The comparative location of the first time government risk is mentioned; and,
• The specificity of the government risk language.

The analysis showed that company perception of government risk is growing, and that the magnitude of the relationship is significant. That means government action is a game changer.

In particular, the close study of the 10-K filings revealed five primary findings.
1 **GOVERNMENT ACTION HAS A MATERIAL EFFECT ON BUSINESS**

In 2011, for five of the six industries evaluated, 25% or more of the risk factor section was devoted to government risk. When one considers that there are often at least 20 risk factors listed in each 10-K filing, having over a quarter of the section devoted to just one factor highlights its importance. No other discrete risk factor garnered as much attention as government risk.

2 **GOVERNMENT RISK IS GROWING RELATIVE TO OTHER FACTORS**

Apple Inc. devoted more than five times the number of words to government risk in 2011 filing than it did in 2005. MetLife used more than 8,000 words in 2011 compared to only about 2,000 words in 2005. Even more telling than absolute growth, however, is the relative growth of government-related risk compared to the total risk factor section. For the 60 companies in aggregate, U.S. government-related risk words accounted for 25% of the section’s words in 2011, an increase from 17% in 2005.

3 **GOVERNMENT RISK IS GROWING RELATIVE TO OTHER RISK FACTORS IN EVERY INDUSTRY**

In 2011, 47 of the 60 companies allocated more words to government risk, relative to total words, than they did in 2005. That trend was observed across all six industries and company sizes. On average, all industries showed a material increase in allocation of government risk words relative to overall risk-related words.

4 **ADDRESSING GOVERNMENT RISK IS A HIGHER PRIORITy**

Almost 75% of the 60 companies moved government risk higher, or kept it as the first item, in the risk factor section in 2011 compared with 2005. The more material risks are generally listed toward the beginning of the section.

5 **GOVERNMENT RISK IS REAL THREAT**

Companies over time are using more targeted government risk language in filings by citing specific pieces of legislation and regulations that pose risk. For example, in ExxonMobil’s 2005 10-K, only three general government-related risks were discussed, and no discrete threats were cited. In ExxonMobil’s 2011 10-K, seven regulations or pieces of legislation were discussed in terms of each one’s potential impact on the company’s operations.

These findings show the magnitude of the government-business relationship is growing. That trend is easy to understand for a company such as Lockheed Martin, which derived 82% of its 2011 sales from the U.S. government and faces the threat of shrinking contract spending. It’s not as clear for Schlumberger, an oil and gas services company, which in 2011 sold nothing to the U.S. government and derived 68% of its sales from non-U.S. operations. Yet that year Schlumberger dedicated half its risk factor section to U.S. government risk, a dramatic increase from about 30% in 2005. The two main drivers the company cited: the overall political landscape and market events.

When certain conditions surrounding one or both of these factors exist, there is a high probability of government action which often leads to significant business impacts.

The groundbreaking Dodd-Frank Act is a perfect example. This law, passed by a Democrat Party controlled Congress and White House in the wake of the recent...
financial crisis, certainly affected that industry and altered the way it conducted its business. The Act’s business impact goes well beyond the financial industry though. For example, a Dodd-Frank provision requires energy companies doing business overseas to disclose detailed competitive information about payments made to foreign governments for the right to explore and produce oil or natural gas. That’s a major unanticipated business impact of government action. In addition, the landmark Affordable Care Act of 2010 has also had wide-ranging effects on companies outside the health care industry.

While Dodd-Frank and the Affordable Care laws were enacted when Democrats controlled Congress and the White House, the impact of government actions on business can be significant even under a divided federal government. That’s important, particularly with the current hyper-divisive atmosphere in Washington.

Sometimes a significant market event alone can drive government action. For example, the Sarbanes-Oxley Act, a response to the accounting fraud at Enron and WorldCom more than a decade ago, cleared a divided Congress in 2002.

Other market-driven and political events will continue to affect corporate risk. Continued globalization, for example, leads to increased interdependencies and higher systemic risk of a market event occurring that will drive government action. Additionally, the introduction of new technologically-driven external threats, such as cybersecurity breaches, may lead to more government action. Further, with near certainty, unanticipated market events, like the 2010 Gulf of Mexico oil spill, which led to a moratorium in offshore drilling permits, will arise and result in government actions with corresponding business impacts. Two major issues that are currently high on the agenda of both Democrats and Republicans—an immigration overhaul and corporate tax changes—will have far-reaching business impacts across nearly every industry.

At one time, perusing risk factors in a 10-K filing was a task for equity investors. Today, those same words can be used to measure the critical relationship between government and business, an acknowledgment of the fact that government action has become a true game changer for corporate America.

As Bloomberg Government’s senior managing analyst, Anthony Costello is in charge of overseeing analytical content. BGOV is a comprehensive Web-based information service, providing data, analytical tools, timely news, and in-depth analysis on the business impacts of government actions.