

THE MEASUREMENT AND MANAGEMENT OF POLITICAL RISK

THE MEASUREMENT AND MANAGEMENT OF POLITICAL RISK

CHAPTER OVERVIEW:

- I. MEASURING POLITICAL RISK
- II. COUNTRY RISK ANALYSIS
- III. MANAGING POLITICAL RISK

THE MEASUREMENT AND MANAGEMENT OF POLITICAL RISK

Basic Management Approach:

1. Identify political risk/consequences
2. Develop policies in advance to cope

I. MEASURING POLITICAL RISK

A. Two Approaches

1. Country-specific perspective
-use country risk analysis

THE MEASUREMENT AND MANAGEMENT OF POLITICAL RISK

2. Firm-specific perspective

-use a more micro approach

B. Political Stability: First Approach

1. Measured by:

- a. Frequency of government changes
- b. Level of violence
- c. Number of armed insurrections
- d. Conflict with other states

THE MEASUREMENT AND MANAGEMENT OF POLITICAL RISK

C. Economic Factors

1. Indicators of political unrest

- a. Rampant inflation
- b. Balance of payment deficits
- c. Slowed growth of per capita GDP

THE MEASUREMENT AND MANAGEMENT OF POLITICAL RISK

D. Subjective Factors

1. General perception toward private enterprise
2. Business Environment Risk Index
 - a. Usefulness:
an indicator of general level of political risk
 - b. Economic standpoint:
political risk=uncertainty over property rights

THE MEASUREMENT AND MANAGEMENT OF POLITICAL RISK

3. Capital Flight

a. Definition:

the export of savings by a nation's citizens because of safety-of-capital fears.

b. Measurement: use the balance-of- payment account

THE MEASUREMENT AND MANAGEMENT OF POLITICAL RISK

- c. Causes of capital flight
 - 1.) Inappropriate economic policies
 - 2.) Expectations of devaluation
 - 3.) High political risk

THE MEASUREMENT AND MANAGEMENT OF POLITICAL RISK

E. THE MICRO APPROACH

firm-specific perspective used in light of the shortcomings of previous models

1. Weakness of Political Risk Models
assume all firms face the same risk
2. Expropriation
 - a. Is highly selective
 - b. Higher probability for extractive, utility, and financial industries.

THE MEASUREMENT AND MANAGEMENT OF POLITICAL RISK

II. COUNTRY RISK ANALYSIS

Primary focus: How well is the country doing economically?

A. Fiscal Irresponsibility

- high government deficits

B. Controlled Exchange Rate System

- currency usually overvalued

C. Wasteful Government Spending

- inability to service foreign debt

THE MEASUREMENT AND MANAGEMENT OF POLITICAL RISK

D. Resource Base

- lack of strong work ethic

E. Country Risk and Adjustment to External Shocks

1. What are the impacts of external shocks:
 - how well a nation responds varies

THE MEASUREMENT AND MANAGEMENT OF POLITICAL RISK

2. Five Common Characteristics of Economic Health
 - a. Structural incentives
 - rewards productive ventures
 - b. Legal structure
 - stimulates growth of free markets
 - c. Minimal government regulations

THE MEASUREMENT AND MANAGEMENT OF POLITICAL RISK

- d. Clear incentives to save and invest
- e. Open economy

III. MANAGING POLITICAL RISK

A. Preinvestment Planning

1. Four Policy Options

- a. Avoidance (no risk)
- b. Insurance(shift risk)
- c. Negotiate environment
- d. Structure the investment

THE MEASUREMENT AND MANAGEMENT OF POLITICAL RISK

B. Operating Policies

Five Post-Investment Policy Options:

- a. Planned Divestment
- b. Short-Term Profit Maximization
- c. Changing the Benefit/Cost Ratio
- d. Developing Local Stakeholders
- e. Adaptation
 - create a post-confiscation management contract