Identifying, assessing and mitigating political risk

Businesses try to avoid investing in countries or areas of an economy where they face a high probability that their investment returns will be reduced or even eliminated completely by political developments. Yet while investors the world over are willing to spend considerable time and money employing lawyers and accountants to carry out 'due diligence' on planned investments, particularly those in foreign jurisdictions, very few resources - if any - are allocated to examining the political factors that may influence the success of the venture.

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Superficial and subjective

It's true that political risk analysis has been receiving more attention in recent years - particularly in Asia - as a result of increased concern about international terrorism. However, while there are some notable exceptions, most political risk assessment remains both superficial and subjective.

Typically, such analysis is very informal, consisting of little more than a few brief visits to the country concerned by the CEO or his trusted lieutenants, supplemented perhaps by looking at a local newspapers and the purchase of a generic country risk report produced by some well-known international consultancy. The CEO then forms an opinion - influenced perhaps by additional input from local dealmakers - and a decision is made. Written reports and presentations (either in-house or by independent experts) - that might force those involved to think through the issues more systematically - are rare.

Even rarer are institutionalised risk monitoring systems designed to identify changes in the social or political environment which might affect ongoing operations.

Political risk analysis not only needs to be thorough; it also needs to be done early. This helps avoid a situation in which political judgements are rolled out in support of decisions already taken on other grounds. Once a proposed investment reaches a certain stage, few managers are capable of responding positively to dispassionate assessments. This is because no one wants to hear about the risks. Such talk threatens the bonuses of dealmakers, and could potentially embarrass senior managers who are already deeply committed to the project.

Risk mitigation strategies

Companies vary in the level of risk they are prepared to accept. They also vary in the extent to which they are able to deploy cosmopolitan country managers reasonably familiar with the social and cultural environment in which the company operates. That said, there are several strategies that can help reduce a foreign company's risk profile. Here are a few of the more common ones:

- Engage in open, competitive bidding, avoiding ‘fast track’ arrangements. Participation in the latter may invite the accusation that you have bribed local officials.
- Examine the political connections of your local partners carefully. Close association with the current regime may be advantageous now, but once key figures are removed from the political stage you could be in for some nasty surprises.
- Be a good corporate citizen, contributing to the host country's economy and culture with worthwhile public projects.
- Cultivate connections with public officials outside the industry in which the company operates. They may become very useful in a crisis.
- Do not limit your discussions to representatives of the national or local government. They may not necessarily be a good indicator of public opinion. Make a point of establishing an informal dialogue with local journalists, as well as human rights and environmentalist groups. The alternative - keeping a low profile - can make you appear secretive.
- Avoid enlisting home government support if the local authorities threaten to break agreements. Such a tactic is often counter-productive, particularly if it is done publicly.

What to do when asked for a bribe

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Bribery is such a common problem in many countries that it merits special attention.

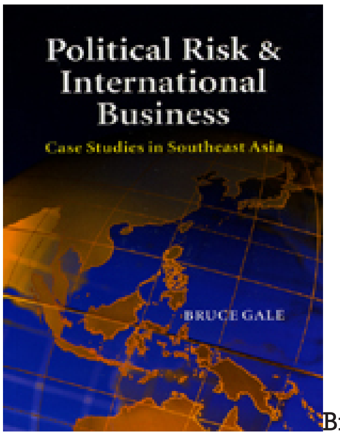
Companies that make under-the-table payments usually argue that they are necessary in order to obtain essential licences or avoid losing valuable contracts. But revelations of bribe payments - often as a result of changes in the political leadership or the development of a free press - can undermine a company's position locally and seriously damage its international reputation.

Most foreign companies try to avoid the problem by using an intermediary, usually the firm's local partner. But this does not always guarantee immunity from either political attack or criminal prosecution. And a company that pays once will almost certainly be approached for more at a later date, particularly if the knowledge of such payments gets around.

Try to find other ways of pleasing local officials. For example, a company faced with demands for protection money from local police could respond instead by donating equipment (such as patrol cars and computers) that help them do their job more efficiently. A similar approach may work with customs officials.

Yet another tactic is for the company to invest in development projects in local communities in ways that ensure that its operations have local support. This will make it difficult for corrupt officials to respond by attempting to undermine the company's position in other ways.

Sadly, many companies that find themselves under political attack have only themselves to blame. Don't let yours be one of them! Identify the risks early, and get an independent consultant (not someone who has a vested interest in seeing the investment proceed) to help you come to a dispassionate assessment about their probability. If the decision is made to go ahead with a project, work with the consultant to draw up risk mitigation strategies. Finally, institutionalised mechanisms for monitoring changes in the business environment, which could alter the company's risk profile, should be put in place.



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