


CIFE Centre international de formation européenne
PARIS BERLIN BRUXELLES ROTTERDAM

GLOBAL RISK MANAGEMENT: HOW TACKLING POLITICAL RISK?

INTRODUCTION



CIFE SEMINAR NICE MAY 6-8, 2020
MICHEL-HENRY BOUCHET

POLITICAL RISK ASSESSMENT

► **Origins?** Political risk stems from the **threat** related to the exercise of power by a government, its ramifications, and private domestic agents.

► **Impact?** Arbitrary political decisions, conditions, and events will affect the business climate in such a way that investors, exporters, creditors, as well as domestic residents will confront risks and losses

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AMBASSADOR PAUL BREMER

(US STATE DEPARTMENT)

► *Political risk analysis is both an art and a science but many types of risk are amenable to rigorous analysis:*

- How resilient is the political system?
- Is there a tradition of peaceful transitions of power?
- How robust are the social shock absorbers that provide buffers between individual citizens and governments?

Harvard Business School Review, 2002

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Political risk and Threat materialization

THREAT

► Contract repudiation, capital controls, currency inconvertibility, sham contracts and bribery, corruption, blocked funds, ideological shift, wealth gap, political upheaval, expropriation, coup d'état, martial law, revolution, civil strife damage, terrorism, war damage, kidnapping, crimes....

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Three Sources of Political Risk

Direct «hard risks»

- Risk materialization directly hurts the institution: Nationalization, expropriation and confiscation, contract repudiation, sham contracting, bribery and corruption, blocked funds, kidnapping, crimes

Indirect «surrounding risks»

- Risk materialization stems from the hostile environment: Revolution and civil unrest, martial law, terrorism, war damage, ideological and cultural shifts. Capital and dividend remittance constraints, ineffective legal and regulatory systems, non-compliance, strikes, currency inconvertibility, regional crisis and volatility spill-over

Collateral «soft risks»

- Risk materialization is the byproduct of unfavorable interactions between power groups: Legal and ethical risks, reputational risk, protectionism, fiscal uncertainty, wealth gaps, bureaucracy and weak institutions, hostile pressure groups, ethnic/linguistic fragmentation

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Wars and armed conflicts all over the world



THE COST OF GLOBAL POLITICAL RISK

The Annual Economic Impact Of Global Violence

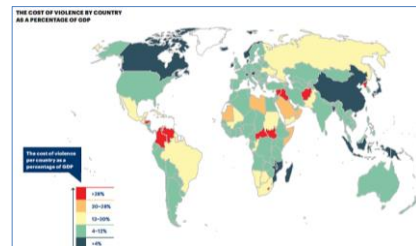
Economic impact of violence/conflict to the world economy (in trillion U.S. dollars)



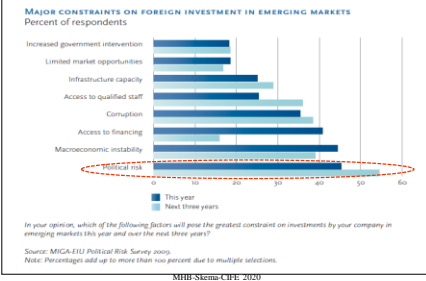
<https://www.statista.com/chart/3948/the-annual-economic-impact-of-global-violence/>

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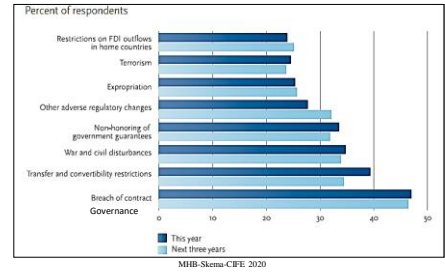
THE COST OF VIOLENCE IN % OF GDP (WORLD ECON FORUM: THE ECONOMIC VALUE OF PEACE REPORT)



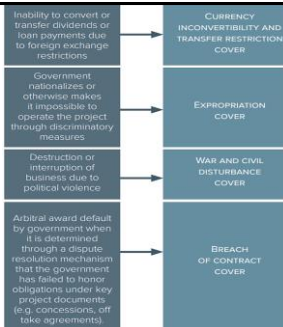
MIGA: THE KEY CHALLENGE OF POLITICAL RISK



MIGA: TYPES OF POLITICAL RISK OF HIGHER CONCERN TO MNCs IN EMCS

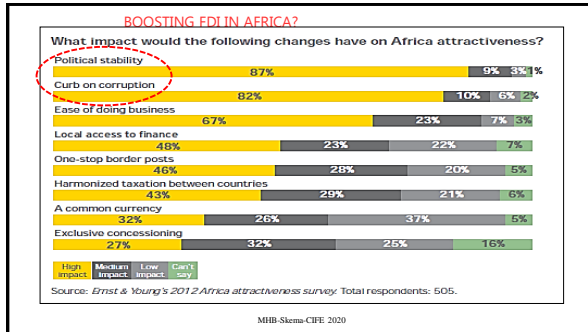


A FEW EXAMPLES OF POLITICAL RISK CONSEQUENCES TACKLED BY MIGA



RANKING OF TOP RISKS REPORTED BY FTSE 100 FIRMS (FT)





TECHNIQUES TO ASSESS POLITICAL RISK

1. Economic intelligence: in-depth socio-political analysis
2. Checklist approach
To examine key political factors that affect a country's risk: the **Prince Model**
3. Delphi technique
 - establish surveys
 - collect information and independent opinions
 - analyze results and make predictions
4. Ratings
5. Consultants on political risks



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1. INFORMATION SOURCES ON POLITICAL RISK: KEY ROLE OF ECONOMIC INTELLIGENCE

- | | |
|--|--|
| <ul style="list-style-type: none"> ▶ PRS-ICRG ▶ MIG (UK) ▶ HISCOX ▶ PLATUS ▶ AON ▶ Global Risk Assessments ▶ EIU ▶ Howell International ▶ Control Risks Group: www.crg.com ▶ WMRC | <ul style="list-style-type: none"> ▶ COFACE, OPIC, MIGA, EULER ▶ Frost & Sullivan ▶ US State Department + CIA ▶ Marsh Crisis Consulting ▶ University of Maryland Center for Conflict Management ▶ Muir Analytics (Threat Watch, Threat Report, Threat Survey) ▶ NYA International ▶ TAC (France) |
|--|--|

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2. POLITICAL RISK ANALYSIS

Mapping out the **power structure** and identifying the roots of political legitimacy:

- ▶ ideological (North Korea)
- ▶ charismatic (Cuba)
- ▶ economic/financial (Brunei)
- ▶ authoritarian populism (Thailand)
- ▶ ethnic (Ivory Coast, Ghana)
- ▶ religious (Iran)
- ▶ military (Burma, Venezuela)
- ▶ patron-client relationships (Togo, Congo, Gabon)

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3. POLITICAL RISK ANALYSIS: PRINCE MODEL

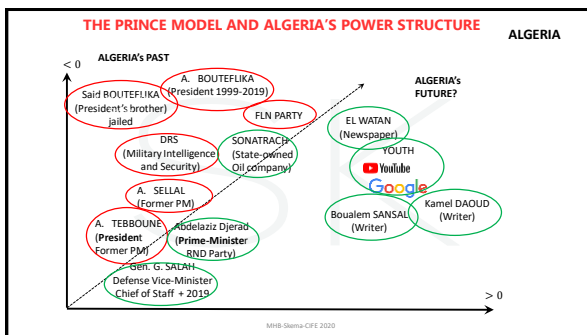
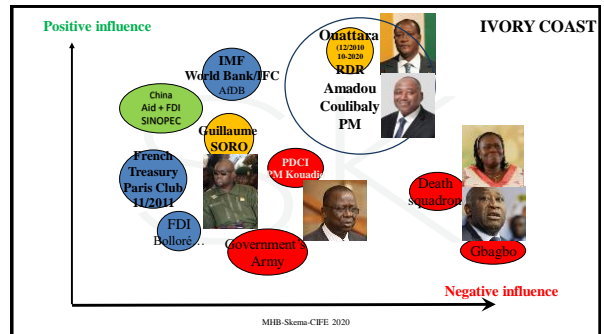
Frost & Sullivan: William D. Coplin and Michael K. O'Leary of the firm Political Risk Services.

PRINCE = Probe, Interact, Calculate, and Execute

Emphasis on the power structure of a nation by identifying key individuals or groups that can influence a specific risk outcome: destabilization, nationalisation, expropriation...

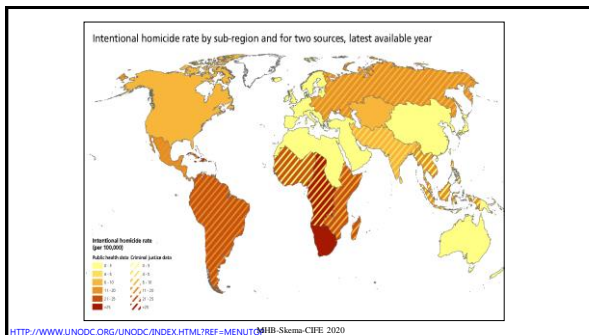
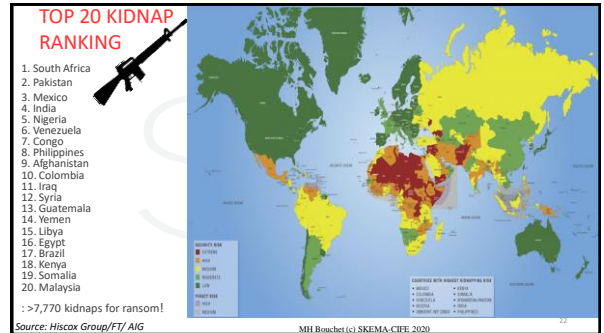
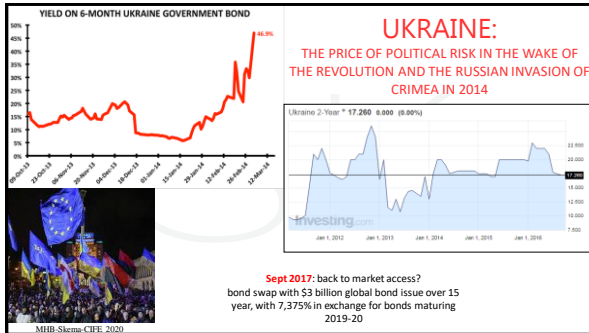
Political risk forecasting model to produce probability of loss from political instability by relating relative importance in decision-making and relative political orientation towards radical or incremental change (+/-)

DATA= <https://www.cia.gov/library/publications/world-leaders-4/world-leaders-4/cote-divoire.html>



MEASURING SOCIO-POLITICAL RISK

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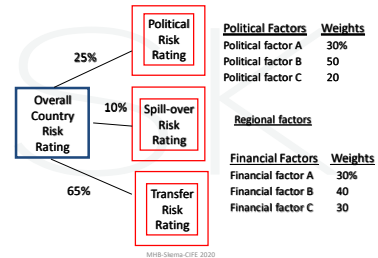
4. QUANTIFYING COUNTRY RISK

► Ratings and Rankings:

- Can one boil things down to numerical indices, when dealing with culture, politics, and ethnic tensions?
- *Problem of “usability” of rankings: number fetishism leads astray by focusing on statistical Delphi-based analyses that are often subjectively biased, misleading and overly narrow.*
- *Lack of insight and qualitative research?* (www.useit.com Jakob Nielsen's website)

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QUANTIFYING COUNTRY POLITICAL RISK



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POLITICAL RISK INDICES

- Heritage Foundation
- Freedom House
- Cato Institute
- Fund for Peace: Fragile States Index
- Transparency International CPI
- PWCs: Opacity Index
- Marsh
- World Bank (Governance)
- University of Maryland
- Ibrahim Index of Governance
- Euromoney (25%)
- Institutional Investor
- IMD
- ICRG-PRS
- MIG
- WMRC
- Peace & Security Index
- FRASER INSTITUTE
- UNDP/HDI
- TI/CPI
- LB: Legsi
- Asiarisk

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ICRG CROSS-COUNTRY POLITICAL RISK INDEX

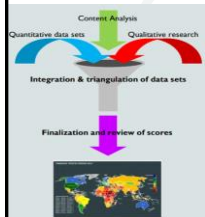


- 140 countries
- Composite risk rating
- Monthly rating since 1980
- 22 variables
- 3 categories:
 1. Socio-political (100)
 2. Financial (50)
 3. Economic (50)
- Political Risk Rating = 12 weighted variables (100)
 1. Government Stability 12
 2. Socioeconomic Conditions 12
 3. Investment Profile 12
 4. Internal Conflict 12
 5. External Conflict 12
 6. **Corruption** 6
 7. Military in Politics 6
 8. Religious Tensions 6
 9. Law and Order 6
 10. Ethnic Tensions 6
 11. Democratic Accountability 6
 12. Bureaucracy Quality 4

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THE METHODOLOGY BEHIND THE **FRAGILE STATES INDEX**

The Fragile States Index produced by The Fund for Peace is a critical tool in highlighting not only the normal pressures that all states experience, but also in identifying when those pressures are outweighing a states' capacity to manage those pressures.

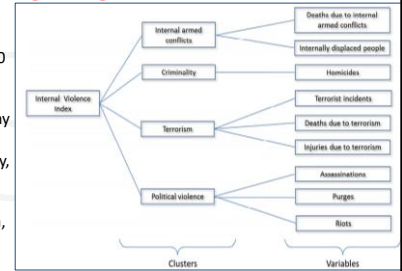


Annual ranking for 178 countries with 12 political, economic and social indicators and >100 sub-indicators, coupled with qualitative analysis and expert validation:
Economic decline, uneven development, brain drain, state legitimacy, public services, human rights, demographic pressures, refugees, external intervention, rule of law...

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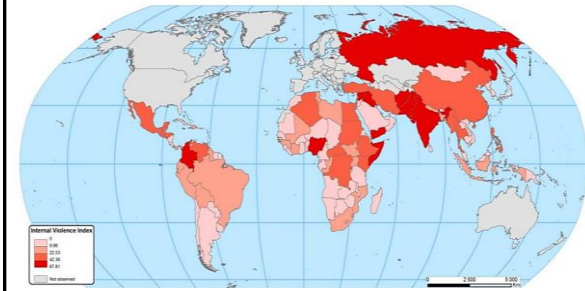
THE INTERNAL VIOLENCE INDEX

The composite index measures a narrow concept of fragility for 130 developing countries through their level of violence in its many different forms: internal armed conflicts, criminality, terrorism, and political violence: Iraq, Pakistan, Afghanistan, Yemen, Syria, and Nigeria.



MMB-Stemata CFE 2020. SOURCE: FERDI April 2016: Feindouno / Goujon /Wagner

THE INTERNAL VIOLENCE INDEX



AON POLITICAL RISK MAP

► The Aon Political Risk Map measures political risk in 163 locations and territories.

► Risk ratings are standardized across each location, on a six-point scale ranging from low to very high, with all risks updated once per quarter.

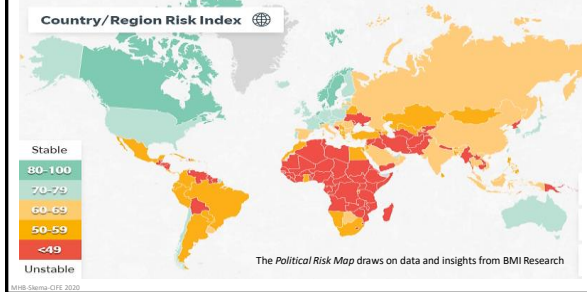
► EU and OECD countries are not rated in the map!!

► Political risk is calculated as a simple average of six core risk measures :

1. • Political Violence
2. • Exchange Transfer
3. • Sovereign Non-Payment
4. • Political Interference
5. • Supply Chain Disruption
6. • Legal & Regulatory

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MARSH RISK MAP 2020



THE HERITAGE FOUNDATION: ECONOMIC FREEDOM INDEX

Q.3. How do you measure economic freedom?

We measure economic freedom based on 12 quantitative and qualitative factors, grouped into four broad categories, or pillars, of economic freedom:

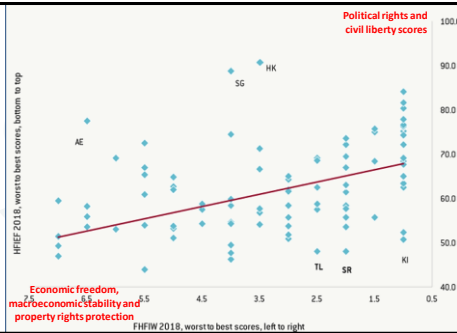
1. Rule of Law (property rights, government integrity, judicial effectiveness)
2. Government Size (government spending, tax burden, fiscal health)
3. Regulatory Efficiency (business freedom, labor freedom, monetary freedom)
4. Open Markets (trade freedom, investment freedom, financial freedom)

Each of the twelve economic freedoms within these categories is graded on a scale of 0 to 100. A country's overall score is derived by averaging these twelve economic freedoms, with equal weight being given to each. More information on the grading and methodology can be found in the appendix.

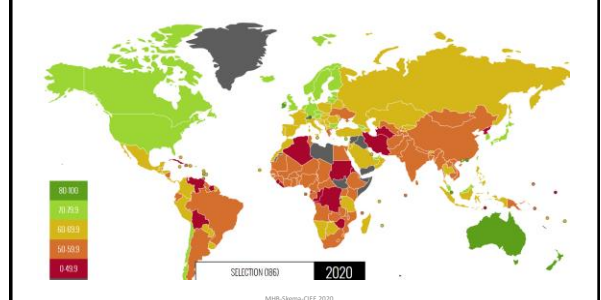
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IS THERE A CORRELATION BETWEEN POLITICAL FREEDOM & ECONOMIC FREEDOM?

Source: Bruegel, 2018
BMIB-Sigma CFE 2020



ECONOMIC FREEDOM INDEX



INDEX OF ECONOMIC FREEDOM					
Top 10 Countries				REPRESENTED (49.9-480)	
RANK	COUNTRY	OVERALL	CHANGE	RANK	COUNTRY
1	Singapore	89.4	0.0	150	Niger
2	Hong Kong	89.1	-1.1	151	Sudan
3	New Zealand	84.1	-0.3	152	Chad
4	Australia	82.6	1.7	153	Central African Republic
5	Switzerland	82.0	0.1	154	Angola
6	Ireland	80.9	0.4	155	Ecuador
7	United Kingdom	79.3	0.4	156	Suriname
8	Denmark	78.3	1.6	157	Timor-Leste
9	Canada	78.2	0.5	158	Togo
10	Estonia	77.7	1.1	159	Turkmenistan
				160	Mozambique

FREEDOM HOUSE: FREEDOM IN THE WORLD ANNUAL REPORT (1972-)

► Since 1972, Freedom House has published an annual assessment of the state of freedom in all countries in the world, based on a checklist of questions on political rights and civil liberties that are derived from the Universal Declaration of Human Rights. Each country is assigned a rating for PR and a rating for CL based on a scale of 1 (best) to 7 (worst).

► <http://www.freedomhouse.org/ratings/index.htm>

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