

Political risk analysis

A Guest Article by John Everard
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What is political risk analysis?

Political risk analysis is the systematic assessment of the political factors likely to affect a company's ability to export to, source from or invest in an overseas market. It provides businesses with a tool to alert them to potential political problems and often to suggest ways of countering them.

Why do political risk analysis?

A company that does not carry out adequate political risk analysis is often placing its operations at sometimes considerable, and often avoidable, risk.

Failure to conduct proper political risk analysis can have disastrous consequences. In relatively mild cases companies can find that the political environment can inflict unexpected costs on a business (for example in entertaining political decision makers, in "voluntary" contributions to local good causes requested by local decision makers, or simply in unbudgeted executive travel to a country).

Worse, I have more than once had to advise companies on emergency exit plans from markets that they had entered, either as exporters or investors, and where they had conscientiously carried out due diligence on the financial strength of their commercial partners but failed to weigh up adequately the political risks of involvement in those markets.

Costly consequences

Although proper political risk analysis costs time and money (but probably no more than adequate financial risk analysis), an emergency exit from a market, which can be the consequence of inadequate political risk analysis, costs a great deal more – and will usually dent a company's reputation as well.

Although government political risk analysis is routinely carried out in most foreign ministries, curiously, and even though globalisation is accelerating, political risk analysis is far from universal among companies. I have been dismayed to discover how often companies – including large companies – that analyse financial risk in great detail, and with professional rigour, nevertheless make judgements of political risk based on the flimsiest of analyses and sometimes on the basis of nothing more than a senior manager's gut instinct.

Even where a political risk assessment is backed with analysis, it is rare to find that it has been tested against different scenarios or otherwise stress tested.

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How do you do political risk analysis?

In an article of this length I can only give the sketchiest outline of what is involved in correct political risk analysis. But I have found that three basic rules apply to the great majority of cases.

- **RULE 1: All countries are different, and often parts of the same country are different**

A common mistake is to try to analyse the political risk in one country using techniques that have worked in another, without taking account of the cultural, political and social differences. For example, in Chile all three dynamics are different from those in Argentina, while Brazil works quite differently from any other South American country. Applying measures that produce robust results in the case of Japan will produce gibberish in the case of South Korea (let alone North Korea).

Similarly, it rarely makes sense to conduct a political risk analysis of the whole of China. Most commercial operations focus on particular parts of China and analysis needs to be tailored to the particular place concerned. The political dynamics of China's north east, for example, are quite different from those of Shanghai, while a company considering investment in Tibet or Xinjiang will need to take account of ethno-political complexities that do not apply to most other areas.

In Brazil, do not assume that politics work in the same way in Maranhão as in São Paulo.

- **RULE 2: Do not assume that what worked yesterday will work today**

The western world has been mesmerised by the economic changes in East Asia and in South America, but has not focused on the social and political changes that have accompanied these.

Those who did business with China when it first started to open its economy often found that it was sufficient to cement a handful of key relationships with influential officials to secure their business against political risk.

That age has long passed, although not all companies seem to have realised this. The constituencies with which companies now have to deal in China are much more varied and complex than they were.

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Some countries undergo game-changing step change (there is little point in approaching Chávez's Venezuela with a toolkit that might have worked in the days of Carlos Andrés Pérez), but more often these changes occur gradually, sometimes almost imperceptibly, leading incrementally to changes that oblige companies to change the way they deal with their political environment.

- **RULE 3: Do not blindly follow the herd – do your own analysis**

Company boards (and not just UK company boards) often seem to decide to enter a market because other companies have done so. Sometimes this is a considered competitive response to a rival's move. In my experience, though, it is at least as frequently the case that companies have entered a market simply because they regard the presence of other companies there as a kind of security blanket.

Too often I have watched the blind leading the blind into political situations that nobody in the herd has properly understood. The results have often been unhappy.

What are the techniques of political risk analysis?

So how do you set about a thorough political risk analysis of a market in which you might become involved? In very rough outline, the first steps usually involve asking the following three questions.

1. Who is making what decisions that might affect your business?

Often the first thing an analyst will generate is a primary name-list of those who have it in their power to make your business prosper or to cripple it. Depending on the location, senior politicians will often figure, as will municipal leaders, trades unionists, environmental groups and civic opinion leaders.

2. Who or what is making them make those decisions?

Political decisions have contexts. In South American democracies a company's main interlocutors will often have to answer to party committees – or sometimes to full parliaments – for their actions. In China, even the most senior decision makers have their decisions endorsed (and, more often than is usually realised, challenged) by party committees. Who is on those committees, and who is influential?

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This step will also cover non-personal factors. For example, what are the decision maker's aspirations? To what code of rules is he or she bound?

3. What put them there, and what might take them away?

In democracies senior decision makers are often elected, and a company will want to know whether they are likely to survive the next vote. In more closed societies different procedures apply, but these too can be analysed and likely outcomes considered.

In some environments this step might consider the possibility of forcible, sometimes violent, removal of decision makers by rivals.

At this point the analysis will typically have changed from lists of names to a matrix of interacting factors. From there, an analyst will often start to suggest ways in which the identified risks can be mitigated.

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If you would like more information on any of the points covered in this Guest Article, please contact **TCii** on **020 7099 2621**.