How managing political risk improves global business performance*

PwC Advisory and Eurasia Group
Performance Improvement

Table of contents

Situation

What is the best way to manage political risk?

Companies are drawn to expand into international markets in search of lower costs, new opportunities, and access to resources. When they arrive, however, they often find that the politics of foreign environments adds risk and complexity to business performance. A question for companies operating internationally thus becomes how best to manage political risk.

Multinational companies as a group are making efforts to manage political risk, but most are not doing it as well as they think they should. In a recent PricewaterhouseCoopers and Eurasia Group study, the vast majority (83%) of respondents said they engaged in ongoing monitoring of the political environment after an investment had been made, but nearly as many (73%) did not feel that they had effective political risk management processes.[1]

Risk managers, chief financial officers, and international division heads contacted for our survey said frequently that the complex web of information that would enable them to assess political risk was difficult to obtain and evaluate. Many expressed frustration that when they were able to glean information from local sources, the information was inevitably biased. Moreover, funding for specific risk management techniques (e.g., risk mapping) was often lacking within their organizations, because the benefits were not well understood. As a result, CEOs and boards of directors were not getting the timely, accurate information they needed to make good decisions about international exposures—or, conversely, information was not effectively communicated and utilized to manage risk in the field.

Executives of global companies are clearly challenged regarding how best to assess political risk, factor it into their investment decisions, and use the knowledge to help improve global business performance.

1 PricewaterhouseCoopers and Eurasia Group survey; see Methodology and Appendix sections.

Our perspective
Political risk management starts at the top.

Experience tells us that there are two fundamental ways in which managing political risk improves global business performance:

1. Protecting new and existing global investments and operations
2. Capitalizing on opportunities resulting from political change

It is our belief that by establishing a systematic approach to political risk management, multinational companies can drive business performance improvement.

We know that the task of managing political risk is not easy. Not only do political changes pose direct risks to firms, but politics is also a component of other external risks. Regulatory changes have the potential to promote or inhibit market competition, social risks often have political bases and responses, and political mismanagement can turn natural or human-made events into catastrophes. Moreover, political risk is often perceived to be outside of management's control, making it difficult to define, predict, and align with objectives. Given the complexity of these issues, it is no wonder that corporations often fail to address political risk in a systematic way.

PricewaterhouseCoopers and Eurasia Group believe that political risk can be managed effectively. We believe that doing so requires integrating political risk management into a systematic process embedded in a company's business processes and characterized by the same principles or components that apply to effective enterprise risk management.[1] The underlying principles of the systematic political risk management process we advise are:

1. Political risk management starts at the top
2. Managing political risk directly impacts performance
3. Evaluating political risk optimizes decision making
4. Assessing risks before taking action delivers value
5. Systematic political risk management protects investments

Companies operating internationally would do well to examine their current approach to political risk management and determine whether it is contributing as effectively as it could to business performance. Chances are, those who do so will find areas for improvement—just as the majority of companies in our survey did.

1 Several principles and concepts of political risk management referenced within this document correlate to the components of enterprise risk management as described in *Enterprise Risk Management—Integrated Framework*, released in 2004 by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Political risk management starts at the top

Senior management needs to be mindful that politics is a driver that creates both risk and opportunity. Executives must accept responsibility for managing political risk, set guidelines for approaching it comprehensively, and factor political risk assessments into decision making about global strategy and ongoing operations.

Guidelines and responsibility for political risk should be set and accepted at the senior management and board level. This includes establishing and implementing a risk management framework in which management's tolerance for risk is communicated to decision makers and rewards are measured on a risk-adjusted basis. In other words, management must ensure that international expansion is strategically deliberate, not a "close your eyes and cross your fingers" bet.

While our survey found that the board and/or senior management were, in a majority of cases, ultimately accountable for shaping international strategy and political risk guidelines, responses were less uniform around the question of who has ongoing responsibility for monitoring and managing political risk. Many respondents indicated some oversight was conducted by a risk management function, but few were able to point to ownership of political risk management at a business unit level. Understandably, new and unfamiliar parts of the organization and its operating environment are generally less transparent to corporate management and thus require more care and oversight from the corporate center. Overall, the effort must begin at the top of the organization and continue to have visible executive support. However, within these oversight mechanisms, creating meaningful accountability at the business unit level for international operational performance supports the business case for going global.

Managing political risk directly impacts performance

Most companies manage political risk in order to avoid financial surprises, but effective risk management can also enable companies to capture opportunities they may not otherwise have seen.[2] Indeed, while corporate leaders are often acutely aware of the potential downside risks of international investments, changes to the political, social, and economic environment can also produce windfalls. For example, as part of China's World Trade Organization (WTO) accession, the Chinese government promised to gradually open previously protected sectors at the end of 2005, including the lucrative express delivery market. Being attuned to this policy allowed one foreign company to buy out its joint-venture partner, gain direct access to interior cities once closed to foreign firms, and shift its Asian regional logistical hub to mainland China. The investment will not only significantly upgrade the company's ability to serve China's domestic market, but will also greatly increase its corporate profile among local and central government stakeholders. In this case, the company took advantage of a changing regulatory environment in order to expand its existing operations and increase market share.

Evidence of the impact of successful political risk management on performance is compelling. One European firm saved millions by anticipating political changes in Argentina in 2001 and Venezuela in 2005. Thanks to this firm's political risk monitoring process, the senior vice president in charge of risk received early warnings that the political situation in the two countries was beginning to deteriorate. As a result, he was able to repatriate the firm's equity and shift to local financing before each country went through its political and economic crisis. In a win/win outcome, the company avoided losses and maintained operations in those countries.

2 The survey indicated that 75% of respondents evaluate political risk primarily to avoid financial surprises and incorporate a measure of political risk into their financial projections for new investments; 39% monitor political risk to anticipate national leadership and policy changes; 19% monitor political risk with an eye toward influencing policy; and 18% do so to participate in social change.

In another case, a technology company with operations in more than 120 countries has begun setting up an early-detection system to identify political events that may affect its suppliers, many of which are privately held firms in politically volatile countries. It takes the company at least six months to find and establish production with a new supplier—an expensive and time-consuming process. Moreover, the company finds it difficult to assess a private supplier's financial integrity or ability to withstand external shocks. The company's strategy, therefore, is to forecast political events that could affect supplier balance sheets. With its new system in place, the company hopes to be able to take steps to realign supplier contracts before political crises precipitate shortages.

Although all multinationals may improve performance by better managing political risk, not all companies should approach political risk management in the same way. The potential business impact of political risk varies with a company's international exposure and is influenced by the company's industry, size, and location.

Not surprisingly, the PricewaterhouseCoopers and Eurasia Group survey found that companies in industries with a large capital asset base and raw material requirements that constrain their location choices are more strongly attuned to long-term political risks. These firms also tend to be in heavily regulated industries, such as energy, mining, and telecommunications. With limited agility, they seek to monitor legal and regulatory trends as well as the likelihood of major political events such as changes in regime. By contrast, firms with more flexible operating platforms, such as retail and consumer products companies, are more concerned about short-term risks such as protests, strikes, and near-term reputational risks that could affect brand image. These considerations should and do influence the approaches a company uses to identify, evaluate, and manage political risk.

Contrasting industry examples from our studies and work in the field illustrate this point. One major oil company has a dedicated political risk function that develops 20-year scenarios showing how potential shifts in global politics could impact its operations. The company's representatives work with local political leaders to ensure that the company's needs are known and well represented in the political process. Their efforts are supported by the strong reputation the company has built through its comprehensive approach to social responsibility.

By contrast, consumer products companies often focus their concern on the political components of supply chain risks, reputation, and market penetration. For example, social unrest could block transportation routes to and from sources of raw materials, and labor strikes could stop production. Such companies, even if they have no international locations of their own, need to develop contingency plans to weather potential disruptions to supply chains and distribution channels. The ability to gain market share also has a political component: A major retailer entering a new market wants to ensure that its brand is perceived as culturally sensitive, effective, and sustainable, which requires an understanding of local culture and customs. Positive relationships with local political leaders are no less a part of the equation for these types of companies than for those with large capital asset bases, but the stakes are different when a company is not bound to specific locations.

Ultimately, risk takers should be informed about the risks they take. In general, the more a company ventures beyond its home country—physically or through outsourcing—the more it increases its exposure to political risk. Companies should keep in mind, however, that even a minor investment involving a major risk or opportunity can have a material impact. Among the companies in our survey, those with a higher proportion of international operations (including European firms and firms with revenues of at least $12 billion) consistently exhibited more systematic political risk management processes. Because European firms typically have relatively small domestic markets and higher labor costs than in other parts of the world, these companies have been more likely to expand into international markets than their North American counterparts. Greater international exposure as a result of revenue size or headquarters location leads companies to seek to institutionalize the political risk management process. European companies, for example, were almost twice as likely to have formal processes in place to channel information from local staff upward. They were also more likely to use leading practices, such as generating regular political risk reports and holding boards of directors and senior-level executives responsible for setting political risk guidelines and for risk accountability. Companies that have a higher ratio of international to domestic assets or revenues and/or that rely on a global value chain need to be more sophisticated in their political risk management.

One thing all of these companies have in common: an increasing recognition that political risk can directly impact the bottom line.

Even a minor investment involving a major risk can have a material impact.

Evaluating political risk optimizes decision making

In addition to return on investment, management should also consider political and other types of risk when making capital allocation and strategic and operational decisions. This improves alignment with corporate objectives and risk appetite, yielding better decisions.

When making performance-related decisions, management should also consider its portfolio of political risk. Viewing political risk in terms of a portfolio can mean two things:

1. Risks do not occur in isolation, and their potential business impacts should not be considered in isolation. This is especially true for political risk, which is commonly viewed as an external risk factor but can have a significant impact on internal risk factors. For example, a regime change that portends increased social hostility to foreign-owned businesses can lead to burdensome changes in regulation but can also negatively impact credit risk, affect employee attitudes, and shrink the local customer base.
2. A portfolio view of risk can mean looking at political risk across the globe as an investment portfolio rather than as isolated, country-by-country investments. A high-risk/high-reward potential venture in an untested market, while possibly outside management's standard risk tolerance (the acceptable level of variation regarding objectives), can be a wise investment if there are offsetting, low-risk ventures being undertaken that effectively serve as a hedge against excess volatility.

Consider, for instance, the discrete go/no-go decisions that management typically makes about foreign investments. By not weighing a range of investment opportunities in a target country and its neighboring states, companies end up under- or overexposed in certain markets. However, if risk managers develop an understanding of how political shifts in one area of the world can tilt their overall risk portfolio (a goal reported by risk managers in our survey), management could improve strategic positioning and overall decision making.

A diversified European company's approach illustrates how a firm can construct a portfolio view of political risk and use it to identify which areas in the world need to be monitored more closely. This company recognizes that political events often prefigure economic risks. For example, a weak prime minister or divided parliament may be unable to pass economic or social reforms in times of crisis. Therefore, the company employs what the risk manager refers to as a "weighted, weighted average cost of capital" to assess its ideal country exposure. The firm's goal is to spread its portfolio as evenly as possible across its target countries, taking political risk into account. If the firm's level of investment is below the preferred amount—a function of the firm's country-risk rating, the country's GDP, and the firm's market capitalization and current country exposure—the company tries to increase exposure. If the firm's exposure is near or above the preferred amount, risk managers keep a close eye on political developments in that country. Because this company's model focuses on overall risk exposure, the company ends up monitoring empirically stable countries as well as those less stable. The risk manager reassesses the company's international exposures on a continuous basis. The method also serves as an early-warning system, and has helped the firm repatriate equity and shift to local funding sources as country risk increased in several nations.

Systematically gathering and processing information is more important than the choice of quantitative versus qualitative analytical methods.

Assessing risks before taking action delivers value

Companies need a comprehensive framework for identifying and assessing all of the risks they face, understanding interdependencies, and assessing the impact of risk. Such a framework enables development of mitigation strategies that support company operations through crisis and change. The formal process of gathering and assessing data on political developments should be overseen by a risk manager and disseminated at the corporate, operating unit, and regional level.

The level of analysis applied to the information gathered should vary with a company's international exposure. Firms facing less severe potential impacts commonly use rules of thumb to adjust earnings expectations for foreign investment to reflect the level of risk. On the other hand, firms facing significant business impacts (energy companies are a good example) typically develop more nuanced pictures of political risk, creating scenarios that synthesize several indicators of risk and varying their risk weightings in concert with real-time changes in the political landscape.

Having a systematic way of gathering and processing information is more important than the choice of quantitative versus qualitative analytical methods. Companies in our survey use a variety of methods to evaluate political risk, and neither qualitative approaches (used by 80% of respondents) nor quantitative (used by 33% of respondents) were definite indicators that a company was effectively managing risk.[3] A more significant indicator of risk managers' sense of effectiveness was whether the company was regularly collecting risk information and building it into scenarios for the future.

Most companies do not need to be convinced that they should enter new markets with their eyes wide open, but different companies use different levels of systematic analysis in their investment strategies. Up-front assessment of an investment's risks and opportunities makes good sense, and it should be accompanied by the implementation of mitigation strategies, where risks have been identified in order to protect the upside.

3 The sum is greater than 100% because some firms use both methods.

Systematic political risk management protects investments

We advocate that management evaluate and manage political risk when making investment decisions, and then continue monitoring such risk routinely in support of ongoing operations. Most companies do not do this today. Sixty-nine percent of the companies we surveyed incorporate a measure of political risk into their financial projections for new investments. Yet once operations are established, those same companies are less focused on ongoing monitoring of political risk, with only 27% of our respondents producing formal reports two or more times a year.

After market entry, managers tend to shift their attention to internal operational concerns, even though political risk can make or break operational viability. Because both political risk and its impact on the business are subject to change, it is not enough to evaluate risk only once, prior to the decision to invest. Companies must monitor political risk on an ongoing basis and use this information proactively to inform investment, operating, and divestment decisions. Hence, it is essential that management of political risk be embedded into operating business processes, in order to protect investments.

Communication of risks and their business impacts is a central component of embedding political risk management into operating processes. Our survey shows that in 40% of companies, information moves informally via social networks that connect in-country management and headquarters. This informal communication of risks gives corporate leaders a sense of the issues, but the information is rarely translated into clear metrics that allow managers at all levels to gauge its significance or the efficacy of mitigation efforts. Inadequate communication networks, combined with decentralized organizational structures, often prevent companies from using risk information effectively in operational decision making. Information either gets stuck at the top or gets mired at the bottom, and does not permeate through the organization. As a result, decision making fails to adequately weigh the risks, leaving investments increasingly exposed over time.

Accumulation of reliable information and accurate interpretation of business consequences are often stumbling blocks for firms seeking to improve decision making through evaluation of political risk. Therefore, we advise the use of multiple sources of information and periodic third-party vetting of analyses prepared by risk managers as part of an ongoing, systematic approach to political risk management. In our survey, 70% of respondents reported that they rely most heavily on internal resources (such as their M&A group and in-country contacts) when entering new markets. Lawyers (55%) and bankers (42%) are the second most frequently consulted sources of information. Those monitoring political risk rely most heavily on the media (89%), followed by the company's home country government (80%), local employees (68%), and independent research firms (61%). Because each of these sources has its merits and limitations, companies should weigh information from several outlets.

The degree of reliance on local sources for information warrants special attention in most companies because, as we have found, long-term expatriates and local employees rarely provide an objective view of the political environment. Their biases are largely unintentional, but are inherent to their roles within the company. Expatriates may perceive lower risks because of the level of comfort they have developed working in a country. As one risk manager said with exasperation, "I have many people who want to put another plant in the Philippines [where the political situation is deteriorating], because they've been there. That's the only reason they use."

Long-term expatriates and local employees rarely provide an objective view of the political environment.

Local employees, for their part, may be prohibited from voicing their true political opinions (in countries with repressive regimes); they may be inured to the risks that arise in their countries; or they may be too strongly tied to the country's ruling elite to provide an objective view. Similarly, companies that look directly to a country's political leaders for insight are getting a strongly subjective perspective. Another risk manager commented that despite the volatile political situation in Venezuela, "I've got my guy in Caracas telling me everything is fine!" With limited ability to gauge the veracity of informal reports, management at headquarters cannot make sound decisions that can help protect long-term investments.

In the face of these difficulties, management should establish a program for actively monitoring and managing political risk. Such a process would operate across business lines, establishing effective, formal procedures for gathering, interpreting, and evaluating political information from multiple sources, and—when the stakes are high—submitting analyses to third parties for evaluation.

When communication networks are not formalized, the failure to deliver information upward to senior management or downward to field operations can obstruct effective and timely decision making. Companies that intend to systematically monitor political risk must take steps to ensure that political risk information is available where it is needed and that it is used to support decision making. Monitoring routines and opportunity-identification must take place both centrally and in the business units. This means communicating political risk analyses into the field, soliciting field-based information and analyses, and providing guidance on how to use information to assist local managers in their strategic planning and tactical operational decision making.

Once companies commit to an international presence, they should do all they can to assure sustainability. Understanding the political environment and operating as good corporate citizens can take companies a long way toward achieving that goal.

Implications

Embed political risk considerations in normal business processes.

Companies expand across borders in search of greater value. Yet our survey findings and experience clearly indicate the struggle many companies experience in trying to reap the benefits of globalization. A key factor: issues related to managing political risk.

Long-term sustainable success internationally depends in good part on a company's ability to grasp the implications of political risk and apply them to business risk. This means moving beyond avoidance and anxiety about political risk toward a structured way of seeing it as a precursor of both economic risk and opportunity. By embedding political risk considerations in normal business processes, companies enable management to make better decisions regarding global expansion, sourcing, branding, intellectual property protection, community and government relations, operational structures, and other business issues that arise in complex international markets.

Sustainable success internationally depends in good part on a company's ability to grasp the implications of political risk and apply them to business risk.

Managing political risk improves global business performance in two fundamental ways. First, it protects new and existing global investments and operations by helping management anticipate the implications of political change or instability on business risk. Prepared and aware, management can, where possible, exit markets that are in danger of growing too unstable. Where short-term instability does not dampen management's appetite for pursuing long-term opportunity, management can implement risk mitigation and operational oversight to control against shocks. Second, for a company constantly on the lookout for new opportunities, monitoring political risk within target regions or across continents can help management hone in on political developments that foretell a business boom, beating competitors to the punch. The BRIC countries (Brazil, Russia, India, and China) are a lesson in this regard. Many large multinationals now regard a presence in these countries as a competitive imperative, but companies that entered late or were unaware of political risk factors have had a wild and sometimes unpleasant ride. Many are still waiting to realize the promised opportunity.

Of course, the degree to which a company stands to gain from effectively managing political risk depends in significant part on the extent of its risk exposure. Any one or more of the following factors can characterize a corporation for which political risk ought to be a central concern:

- Large capital asset base abroad
- High ratio of international to domestic revenues
- Dependence on a global supply chain
- Heavy concentration of assets and/or operations in a single country or region
- Strategic reliance on international growth

Political risk exposure is also a function of where a company is invested, such as in:

- Developed, rather than emerging markets
- Locales where the company and its management have a successful track record and dependable relationship networks
- Communities where the presence of a foreign multinational is not an automatic liability

In dynamic political environments, a profitable past does not necessarily portend ongoing success—one reason why a strong reputation for good corporate citizenship can smooth the transition for a company operating in a region undergoing political change.

Because all companies, even primarily domestic ones, are affected by politics to some degree, all need a baseline of political risk management activity. At a minimum, company management should be aware of how political risks affect business processes, and they should factor these risks into both investment decisions and general risk management.

The table on pages 29–31 provides a framework prescribing increasing levels of political risk management structure for companies with increasing levels of political risk exposure. However, because large institutions have been ravaged by failures even in seemingly minor markets, any company would benefit from raising its response to political risk or expressing its current situation or expansion opportunities on a risk-adjusted basis.

Companies may want to formally assess their current political risk management process to determine how well it adheres to the structured principles we have outlined here. This assessment can be undertaken with the following steps:

1. **Map the politics**
   Does the current process identify country-by-country operations, relative exposure or potential exposure in each jurisdiction, a portfolio cross-country view of risk, and political risk factors that can affect business operations?
2. **Evaluate the risks**
   Is there a structured approach to translate the business risks that may arise from potential political change and analyze their potential business impact?
3. **Assess controls and plans**
   Is the quality of controls and risk mitigation plans sufficient relative to those business risks?
4. **Determine the acceptability of residual risk**
   How are decisions made about the risk that remains after mitigation steps have been taken, relative to management's risk tolerance or other possible responses to those risks?

The pervasive influence of political risk on other risks and the complexity it introduces into a global expansion strategy pose unique risk management challenges, but the challenges of predicting and measuring political risk should not be taken as reason to discount it. Rather, such challenges validate the need for a more comprehensive understanding and systematic processing of political risk and its impact on a company's global strategy, operations, and competitive landscape. Managing political risk systematically makes new markets more transparent. By implementing a political risk management framework, corporations are better equipped to realize the benefits of globalization while protecting against unwanted surprises.

What kind of a risk taker are you?

All companies, even those with limited international operations, are exposed to political risk. Levels of political risk exposure grow as firms expand internationally or as the countries of operation themselves become more risky. Companies with one or more of the political risk exposure factors listed below should be taking a closer look at how politics influences their organization. Special attention should be paid to political risk if a firm has a great number of these attributes or high sensitivity to any particular factor. The factors are:

- Large international capital asset base
- High ratio of international to domestic revenues
- Dependency on international supply chain
- Concentration in one country or region
- Expansion plans
- Limited experience with international business or new locations
- Dependency on international growth
- Operations located in nascent or emerging, not developed markets
- Reputation sensitivity

Changes in the political environment itself can also increase a firm's exposure to risk. While the political risks that can affect a firm are many and varied, companies should pay particular attention to the political environment when one or more of the following occur:

- Change in government leadership is imminent
- Economic environment is deteriorating or improving rapidly
- Political bodies are debating regulatory changes
- Multilateral agencies are considering changes to trade agreements
- Social unrest is common or imminent

The following table highlights the actions of informed risk takers in relation to the level of political risk exposure their company faces.

Political risk management starts at the top

Low exposure

- Assess how political risk affects corporate strategy and business processes.
- Develop guidelines to factor political risk into decision making processes, such as investment and divestment decisions.

Moderate exposure

- Assess how political risk affects corporate strategy and business processes.
- Develop guidelines and procedures to factor political risk into decision making processes, such as investment, divestment, and operational optimization decisions.
- Conduct periodic assessments of political risk to evaluate exposure, opportunities, and impact on existing operations.

High exposure

- Understand how political risk creates opportunities, impacts returns, and alters overall risk profile.
- View politics as a predictive tool for economic shifts and growth indicators.
- Establish political risk management guidelines, accept accountability for risk at the C-suite and board level, and demonstrate visible executive support.
- Define guidelines and processes that allow political risk information to be used proactively to inform investment, operating, and divestment decisions.
- Develop a procedure to evaluate compliance with political risk management guidelines.

Managing political risk directly impacts performance

Low exposure

- Assess how political risks impact global expansion plans, existing investments, and ongoing operational performance.
- Develop a process to take timely action in cases where political risks provide opportunities and/or challenges.

Moderate exposure

- Define a risk-tolerance measure that will guide actions when political risks provide opportunities and/or challenges.
- Use political risk information to determine tactical strategies such as investment type, in-country relationships, operational setup, capital allocations, and commitments.
- Develop a method to factor political risks into risk-adjusted rates of return; regularly review and adjust expected rates of return based on shifting political risks.

High exposure

- Design a process that weighs political risk in relation to investment objectives, risk tolerance, and potential returns and opportunities, and results in timely action regarding international investments and operations.
- Develop a method to factor political risks into risk-adjusted rates of return; regularly review and adjust expected rates of return based on shifting political risks.
- Use political risk information to determine tactical strategies such as investment type, in-country relationships, operational setup, capital allocations, and commitments.
- Define political risk performance metrics to assess ongoing performance of investments and operations against target goals, expected returns, and political risk considerations.

Evaluating political risk optimizes decision making

Low exposure

- Understand political risk exposures across operations.
- Monitor relevant political environments to determine international investments, and adjust capital management and expected returns across existing international investments.

Moderate exposure

- Understand political risk exposures across operations.
- Monitor relevant political environments to adjust capital management, expected returns, and political risk exposure based on international portfolio, business objectives, and risk tolerance.
- Factor political risk into financial and operational performance metrics.

High exposure

- Develop an iterative approach to managing political risk and international investment portfolio.
- Monitor relevant political environments to adjust capital management, expected returns, and political risk exposure based on international portfolio, business objectives, and risk tolerance.
- Measure international investment options on a cross-country, intra-country, and regional basis to weigh risk and return options as aligned with strategic objectives and risk parameters.

Systematic political risk management protects investments

Low exposure

- Develop a process to regularly collect and report on political risk to C-suite and board.
- Disseminate political risk information to operating units in a form that is usable and relevant.

Moderate exposure

- Gather political risk data from multiple sources including in-country networks, on-site management, and objective third parties.
- Develop a process to inform C-suite and operational levels of relevant political risk information on a regular basis.
- Use political risk information proactively to inform investment, operations, and crisis-preparedness decisions and plans.

High exposure

- Gather political risk data from multiple sources including in-country networks, on-site management, and objective third parties.
- Develop a process that evaluates political risk information and translates it into meaningful, actionable, and tactical data regarding business risks and opportunities.
- Communicate political risk information on a proactive, timely basis throughout the organization, especially to decision makers at the corporate and operating unit levels.
- Provide guidance on how to use political information to assist corporate, business unit, and regional managers' strategic planning, operational processes, and crisis preparedness.
- Embed political risk management and monitoring processes in the organization as part of overall business risk practices.

Assessing risks before taking action delivers value

Low exposure

- Establish guidelines and responsibility for political risk at senior management and board level.
- Integrate political risk management into ongoing business risk management and monitoring procedures.
- Understand and assess internal capability to operate in new, international environments.

Moderate exposure

- Establish guidelines and responsibility for political risk at senior management and board level.
- Assign ownership of political risk monitoring and management at the corporate and business unit level.
- Develop a formal method to assess political risks quantitatively (where appropriate) and qualitatively.
- Evaluate political risks routinely for ongoing operations, and disseminate reports on political risks throughout the organization.

High exposure

- Designate a risk manager responsible for managing political risk in coordination with business units and geographies at the headquarters level and make this manager accountable to a C-suite executive.
- Assign responsibility for political risk monitoring and management at the operating unit and regional level.
- Implement a formal process, overseen by a risk manager, to gather and process data on political developments and disseminate this data at the corporate, operating unit, and regional level.
- Analyze political risk issues comprehensively (quantitatively and qualitatively) and regularly. As appropriate, vet with third parties.
- Track shifts in the external environment over time, and use to anticipate changes to operations, revenue streams, and international strategy.
- Establish ongoing political risk monitoring routines and early-warning systems to identify opportunities and challenges, with efforts coordinated centrally and with responsible business unit and regional managers.

Methodology

PricewaterhouseCoopers and Eurasia Group conducted a survey of how more than 100 multinational firms understand and manage political risk. Our initial survey was followed by in-depth interviews with 13 respondents who volunteered to participate in further discussions. The PricewaterhouseCoopers and Eurasia Group political risk survey was conducted between December 2005 and February 2006. The target population was PricewaterhouseCoopers' largest clients worldwide (not including financial services organizations, which because of their unique exposures to political risk warrant separate attention), where English is generally spoken in the business community. By region, 62 interviews were conducted with North American companies, 43 with European companies, and one with an Asian company. Forty respondents were in the industrial products industry; 19 were in retail and consumer products; 18 were in energy, utilities, and mining; 12 were in technology and telecommunications; and 17 were in professional and personal services. Thirty-three respondents generate less than $3 billion in revenues, 45 companies generate between $3 and $12 billion in revenues, and 24 generate in excess of $12 billion. The revenues of four companies were unavailable.

Appendix

There is significant room for improvement in managing political risk.

Senior management feels that political risk is important, but is not integrated effectively into analysis of new ventures or ongoing business unit performance.

	%
We don't consider political risk	3
Political risk is important, but we don't manage it in a systematic way	29
Political risk is part of our risk management process, but is not integrated as effectively as it could be	42
Political risk is a major concern, and we approach it in an effective, systematic manner	24

Percentages do not add up to 100% due to rounding.

Political risk management starts at the top.

Firms with greater international exposure, e.g., European firms, are more likely to set political risk management guidelines at the board and C-suite level.

	North American %	European %	Total %
Board of directors	53	63	57
CEO	32	48	39
CFO	32	38	34
Chief risk officer	21	28	24
International division director	15	20	17
Regional manager	6	10	8
Functional manager	6	10	8
Risk manager/risk management board	13	0	7
Department/divisional heads & management	2	10	6
Legal counsel	19	10	15
Finance director/treasurer	2	5	3
Chief operating officer	4	0	2
Business development office	0	3	1
No one is assigned this specific responsibility	4	5	5

Percentages do not add up to 100% due to multiple responses.

A more systematic approach is required.
Firms infrequently generate formal reports on political risk for management.

	%
Reports generated irregularly as events occur	33
We don’t generate formal reports	20
Quarterly	15
Annually	10
Monthly	6
Daily or weekly	3
Biannually	3
Don’t know	9

Percentages do not add up to 100% due to rounding.

Managing political risk impacts performance.
Firms manage political risk primarily to avoid financial surprises.

	%
Avoid financial surprises	75
Anticipate changes in political leadership and government policy	39
Influence government policy	19
Participate in social change	18
Lower insurance premiums	18

Percentages do not add up to 100% due to multiple responses.

Assessing risk before taking action delivers value.

Despite wide belief in the importance of risk assessment, companies do not use political risk information extensively in the evaluation of new acquisitions and ventures, and most use it even less after the investment has been made.

Use political risk information in ongoing international business unit performance	%
To a great extent	19
To some extent	32
Not really	25
Not at all	20
Don’t know	4

Use political risk information in new acquisitions and ventures	%
To a great extent	26
To some extent	43
Not really	19
Not at all	9
Don’t know	2

Percentages in bottom table do not add up to 100% due to rounding.

Methods companies use to evaluate political risk.

Companies use a variety of methods to evaluate political risk, but neither qualitative nor quantitative approaches were in and of themselves guaranteed indicators of effectiveness.

	%
Qualitative assessments	80
Quantitative assessments	33

Percentages do not add up to 100% due to multiple responses.

Systematic political risk management protects investments.

Multiple primary sources are used to gather information on political risk.

	%
News sources (newspapers, wire services, magazines)	89
Government sources in the country where your company headquarters are located	80
Local employees	68
Independent research firms	61
Sell-side research from banks	58
Local political leaders	41

Percentages do not add up to 100% due to multiple responses.

Information sharing tends to be mainly informal.

Firms use various methods to pass information about a country's political environment to top management.

	%
Informally via social networks between in-country management and headquarters	40
Formally via a process that channels information from local staff upward	33
Internal staff at global HQ monitor political developments with minimal input from international offices	15
External experts brought in as board members or consultants	2
Combination of the four options above	5
Monthly committee	1
None/missing	2
Don't know	2

Due diligence starts internally.

Companies rely most heavily on their internal resources when conducting due diligence to enter new markets.

	%
Internal resources	70
Bankers	42
Lawyers	55
Accounting or audit firm	31
Non-audit consulting firm	24

Percentages do not add up to 100% due to multiple responses.

For further information, please visit:
www.pwc.com/politicalrisk
www.eurasiagroup.net

or call:
Fred Cohen
Partner
PricewaterhouseCoopers
1.646.471.8252

Ian Bremmer
President
Eurasia Group
1.212.213.3112