

Political Risk Strategy Formulation

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Political risk management is often regarded as a series of stop-gaps, plugging holes (or points of exposure) in an operation or strategic initiative. It is seldom seen as a mode of strategy, with its own formulation process and reflective of the firm's unique identity and ambitions. We suggest here that political risk can be managed strategically, and that the concept of political risk strategy is both valid and valuable. There are valid approaches to developing a strategy to address political risk, and one is suggested here.

First we outline the strategy formulation process, then characterise political risk strategy at a conceptual level.

Contextual Variables

In order to understand and interpret its political risks, a company first needs to understand some of its own attributes.

First, what is the global growth strategy? How important are emerging markets, and what are the pressures and opportunities for going beyond current comfort zones? This establishes the strategic rationale for engaging with potentially high-risk emerging markets.

Second, what is the company's tolerance for political risk? Risk tolerance means a firm's willingness to expose itself to potentially hazardous environments and indeed to periodically incur manifested risk, which of course entails a degree of loss or liability. Risk tolerance is a factor of: competitive pressure to enter emerging markets; corporate culture with respect to risk, and people's willingness to endure risk; the expectations of key stakeholders with respect to the company's risk exposure; and the company's ability to develop and manage the resources required for risk management. A useful benchmark in assessing risk tolerance is where a firm currently operates versus the highest risk environments where leading and adventurous players in similar sectors are present: Do we need to remain where we are? Are we ready to stretch ourselves to these new limits?

Third, we need to understand our the profile of our current global portfolio. Mapping our overseas operations in terms of strategic relevance and risk in the operating environment yields a macro-

picture of the level of exposure we currently face. Our strategic intentions aside, does this map indicate that we have been risk averse in selecting growth initiatives? Is there room to take on more risk? Or, conversely, are we overexposed, and therefore vulnerable to strategic disruption if several operating environments did become untenable?

Fourth and finally, we need to consider what specific assets we currently expose and how this would change in the near future as we roll out our current growth plans. In terms of the firm's critical assets (people, reputation, and performance as a factor of continuity and control), what have we exposed to potentially unstable environments? What is at risk? These variables form the backdrop of a meaningful risk assessment: We know what any risk is in relation to, and we know how to interpret risk in our own unique context.

Risk Assessment

Knowing our own attributes, we can move onto to assess our operating environment in terms of political risk. First we develop hypotheses about relevant risk factors. These are not risks per se, rather trends and conditions which would be risks if we were exposed to them.

Hypotheses derive from two exercises. First we try to understand the political actors (civil society, governments, NGOs, opposition groups etc) who are likely to have an interest in our operations. Those who regard our success as antithetical to their own interests, or whom we might negatively affect, would likely react to our presence, and their potential reactions become risk factors. Second, we examine the exogenous political terrain, independently of our operations. What is going on in the environment in terms of instability, weak governance and conflict? If we did enter a certain region or market, what risks would we be exposed to? These too are added to our list of risk factors.

We then assess these factors against our exposed assets. Where a factor could have a negative effect on an asset, it becomes an actual risk. We then assess actual risks in terms of their impact on us if they did manifest, and in terms of the probability of their manifesting. Risks are then mapped using impact and probability as the primary axes. The intersection of impact and probability reveals our priority risks.

At this point we understand our current and near-future risks, but we also need to consider how the whole operating environment, whether global or operational, might shift over time, and the implications of potential shifts for political risk. We can apply scenario analysis to map relevant future states, and to derive indicators and warnings which we can monitor to be forewarned of the emergence of a given scenario. In a risk management context, the intersection of plausibility and negativity defines our priority scenarios.

Intelligence to Action

At this point we understand our priority risks and priority risk scenarios. Priority risks require near-term risk management planning, and priority scenarios require regularly updated contingency plans to align our risk management capabilities with plausible future states. We assess the risk mitigation options, including portfolio management, security, relationship-building and risk transfer, and we select relevant options on the basis of cost-effectiveness. Then we define specific initiatives to manage our priority issues. Near-term risk management initiatives will be on-going programmes aimed at avoidance and at ensuring preparation to minimise the impact of a risk if it did occur.

Contingency planning initiatives will likely entail periodic reviews of the situation and periodic projects to adjust our preparedness for priority scenarios.

We assign leaders for each initiative, and they in turn recruit teams to provide the necessary expertise for implementation. The heads of each initiative form the core political risk management task force, which in turn would report to either the senior corporate executive responsible for international operations, or, at the operational level, the country or project manager. The role of oversight would be to ensure that there were no significant gaps or overlaps in the risk management approach, that each initiative had reasonable performance indicators, and that all initiatives were integrated as one coherent risk management strategy.

Although we have conducted a risk assessment, we continue to monitor priority risks and the evolution of the political environment, and regularly adjust our risk management plans in accordance with significant changes.

Finessing the Outcome

A logical process led us to programmes and initiatives to manage priority risks. To the extent that this process can be scientific, we have made it as objective as possible, and necessarily so to provide a baseline indication of risk management imperatives. But what about our intuitive sense of how we should approach risk? Should we ignore that in the face of process and logic? At our own risk.

The outcome of the Intelligence to Action process might yield a baseline approach, but ultimately we can assume that it, like most human to human assessments (political risk is caused by the interaction of us, people, and other people, in the end), is open to interpretation, not just our mechanistic adherence to analytical outcomes. In light of the experience of ourselves and others, and pure gut sense, we will probably need to tailor, or finesse, the results.

We already know our interpretive stance in terms of the context of our business and our philosophy to risk, as elucidated by a consideration of the contextual variables. We can add to this the experience of other firms in comparable circumstances. How did they fare, and what did they do in response to risk? What worked, what did not? What is our own intuitive sense of what would mitigate risk in our given context (global / corporate or operational)? What measures are we prepared to live with, and which would we prefer not to be associated with?

There is much left over from the bare-bones assessment of risk and the definition of risk management initiatives. We are people, and as a company we have our own culture. A scientific (or pseudo-scientific) analysis provides a baseline, but we will have our own, often valuable, ideas on how to tailor and apply this baseline in practice.

We therefore have an opportunity to tailor our response to political risk in accordance with our gut sense of the right responses, and our own culture. If we stray too far from the logical baseline, we enter the realm of guesswork and unfounded hope, but if we adhere strictly to the analytical outcome, then we will be responding to risk as anyone else, in the absence of a unique identity. There is a necessary balance, and in the end a firm's strategy to address political risk needs to be its own.

Strategy

Political risk management strategy is a firm's unique learned response to political risk evolving from experience and intuition, and aligned to our strategy, culture and identity. Two firms in the same sector, operating in similarly risky regions, might both have effective risk management strategies, but these are likely to be very different. For example, one firm might prefer to outsource security and to make risk transfer a lynchpin in its approach, in order remain maximally agile and to keep management attention focused on business execution.

Another might see its acceptance in its host communities as key to both risk mitigation and to market penetration, and might emphasise relationship-building, including corporate social responsibility, as the major element of its risk management strategy. Although some risk management measures will be essential to any firm in a certain operating environment, there is still considerable room to tailor one's approach to political risk in accordance with the firm's own unique insights, character and ambitions. We need to listen to and address the outputs of sound analysis, but we need to balance this with our own characteristics and experience-based intuition for an optimal strategy.

We can draw a comparison with business unit or corporate strategy. All companies aspire to profit, via growth and efficiency. Yet no two companies, even in the same sector, will have the same way of achieving these goals. The strategy that they apply to pursue them will be aligned to the company's unique competencies, culture and identity. So too with political risk strategy. And just like business strategy, political risk strategy must be regularly reviewed against the changing attributes of the company and the external environment, to ensure that it does not ossify or become an impediment over time.

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