

Clarifying the Meaning of “Political Risk”

Insight paper by Harmattan Risk

October 2023

After being relegated to the exotic bin for a while, political risk has been back on corporate radars. Unfortunately, being pulled back to the forefront has not led to a clearer picture of what political risk means, and indeed this latest foray into fashion was rather rushed, with far more attention to headlines than to conceptual clarity. In the absence of clarity, urgency to address political risk leads to missed opportunities and inefficiencies. This paper does not yield answers, and even if it did then those answers would be subject to considerable debate. But it has a crack at clarifying the meaning of political risk, thereby hopefully contributing to a stronger thought foundation for political risk management.

Political risk can be seen as the political variable in organisational health and performance

Foundational political risk theorists long predated ERM and risk management as an explicit process and practice. The “risk” in political risk was debated and conceptualised, but in more common sense terms than we see in ERM. However, after the widespread uptake of risk management, anything with “risk” in the label has been under pressure to conform to current risk doctrine. Thus, we now see political risk as one among several types in categorisation schemes, and in mainstream conceptions “risk” has now become a significant facet of political risk.

We suggest that while political risk can be about risk, the term is more usefully understood simply as the political variable, or factor, in organisational health and performance. All organisations anywhere are subject to the rule of governments, the jolts and pressures from political contestation, and the attitudes and reactions of socio-political actors. Politics can be a peripheral factor when dynamics thereof are quiet and the organisation is uncontroversial, or it can be a critical one that bears explicit consideration in planning and engagement. The political factor can be a risk driver, and when we plan ahead we would examine the risks and scenarios that could derive from it. But it is also germane just to learning how to navigate a new context or environment, and to diagnosing and solving current problems that arose from past dynamics and organisational mistakes.

On one level, ERM has created the space and awareness to discuss uncertainties and potential downsides, and that is useful because companies in particular can be prone to excessive positive thinking and “can do” cultures. On the other, though, it has injected considerable conceptual and

process clutter into what used to be just common sense, forward thinking, informed decision-making, and a healthy dose of pragmatism when testing assumptions. If political risk is only about risk, it becomes encumbered by and crammed into risk-speak, when all we really mean is that we co-exist with the political world and need to manage that co-existence. That is stating the obvious, but the obvious has become rather obscure.

Political risk management is not a thing in itself

A good proportion of articles, papers and books on political risk management position it as a process in its own right, from analysis to plans, and seem to elevate that process to the same status as strategic or operational planning. Yet no organisation aside from militaries and intelligence agencies solely exist to manage political risk, and there is not really such a thing as a political risk manager running around implementing the political risk management plan.

Just taking a company as an example, its mission is profit-making. Its core activities, or processes, follow from that. Political risk management is a modification to core processes to account for the political variable, rather than being a separate process in itself. There are processes and functions which are a step removed from the core ones, like legal, security, external affairs and CSR, but in most organisations these too only support core activities and are strongly linked to them. They too consider the political variable when it is relevant, and account for it in their own service to core activities.

The above interpretation of political risk management leads to two significant implications. One is that political risk management is the job of a lot of different functions and people. Thus, depending on the context, an awareness and understanding of relevant political dynamics should be quite widespread in the organisation. People need to know about and act on variables that affect their work. The second is that political risk specialists need to know how their insight and advice will feed into core activities and how core activities could be adaptable to account for political risk. Both indicate a third implication: political risk knowhow is most effective when it is integrated into the organisation, specifically into how people and functions think, plan and engage.

Political risk management, then, is not a parallel process that imposes itself on how an organisation works. It is simply how the organisation works when it is aware of and responsive to the political variable.

Political risk is not just what it is out there

Risk maps, country ratings, indices and even news headlines about corruption scandals or coups can position a place as politically risky. It is actually not uncommon for a political risk analysis to posit a

prevalent or acute dynamic in an environment as a severe risk, just based on prevalence and intensity.

Here is a politically risky situation. A company goes to the Netherlands, one of the most stable and liberal countries in the world, to launch a new terrestrial TV channel, *The Satanic*, which will indeed be about Satanism and provide guidance on how to be good adherents. The company managers are very enthusiastic, and when their local advisors tell them to expect a backlash, they brush them aside and tell them that gumption trumps dithering. A national news channel gets wind of the initiative, and in an interview a company director shrugs off questions about cultural sensitivities and reiterates that the channel is entirely legal. Six months after opening, the company's Dutch office is under siege by protesters, and local politicians, concerned about public criticism for having approved the channel, tell regulators to look very carefully for any compliance breaches, hoping for a justification to shut the channel down.

Here is a less politically risky situation. An international retailer sees a strong opportunity to launch a chain of stores in Nigeria, a country with high levels of corruption and political violence. The company carefully plans locations based on cultural and security considerations. It consults with host communities and small local shopkeepers to understand the effects its business might have, and plans its operations and CSR initiatives to smooth potential friction. The company vets security providers for human rights performance and trains and incentivises them for compliance with the Voluntary Principles. The firm explains to local politicians that it will not pay any bribes, but that the jobs and management training schemes that it provides would reflect well on any supportive stakeholder. Local managers are hired prior to launch to internalise local knowhow and cultural sensitivities. A year later the company is actually expanding its Nigerian presence.

The examples are caricatures, but degrees of them manifest across organisations working internationally. Simply put, political risk is as much about our own vulnerability as it is about what is going on around us. If we make ourselves less vulnerable, for example by learning and adapting, then we face less damage and can better exploit opportunities. Additionally, our overall political risk in a given environment depends very much on what we do, where we are situated and what / whom we rely on. Two operations in the same country can have dramatically different risk profiles. A country might be red on a risk map, but for one of the operations it might only be yellow or even green in practice.

In summary, political risk is not just about the environment. It is about what the organisation decides to do and its own knowledge and behaviour, both in the here and now and as a reputation garnered over time. Thus, any approach to managing the political variable will fail to have much effect if it

does not include a strong dose of introspection, and overcoming shortcomings which are, or could become, vulnerabilities.

Practical implications of the three clarifications

Perhaps while challenging the clarifications, readers will no doubt draw a number of conclusions not considered here. That said, we can indicate some practical implications, or in a sense recommendations, that fall out of the three points.

One is that although an organisation will not always need to explicitly think about political risk and manage it, a foundation of organisational awareness about the political variable is still valuable. Without it, people will not know when political risk is particularly relevant and hence when to make consideration of it explicit. Then once it is identified as critical in a given context, shared organisational awareness enables more rapid coordination around political risk intelligence and planning exercises. These exercises flow much more easily into actual adaptations and initiatives when frontline operational personnel are already aware the relevance of the political variable. Thus, even when the political variable is quiescent for a given organisation, a baseline awareness of it is a critical enabler, given that the factor is seldom quiescent for long and that international organisations seldom sit still.

If awareness is important, we come to the question, “awareness of what?”. Definitions and taxonomies of political risk will seldom catch variations that are directly relevant to a specific organisation. Organisations thus need to develop their own operational definition of political risk, on the basis of the organisation’s unique aims and attributes and the contexts in which it operates. Since these variables are dynamic, so too should be the concept of the political variable. The fact that this exists does not equate to awareness. That can only come through cross-functional dissemination, discussion, and clarification.

When it comes to political risk specialists, whether fulltime and dedicated or manifesting as part of a corporate support function, it might seem ironic, but their role is not political risk management. That is undertaken as adaptations in core activities, as discussed. Rather, specialists are intelligence providers and advisors. They provide the picture of the political variable in a given context and assess what aspects of it are most relevant to the organisation’s health and performance. Then they support core functions in developing and testing adaptations for political risk management. The impact that specialists have depends on their credibility, how well they shape insights for application by core functions, and their relationships with core functions. Most importantly, though, it depends on wider organisational awareness of the political variable. If that is low, then specialist insight and advice will

sound arcane no matter how well it is communicated. If it is high, then people across the organisation can more readily understand the relevance and meaning of specialist guidance.

Conclusion

This short piece cannot do much justice to the question of what “political risk” really means, and in turn what that means in practical terms. Perhaps the key point is to keep the answer simple.

Organisations exist within and alongside the political domain, and must be adept at managing the relationship with it. That relationship is not managed as a standalone add-on to what the organisation does, rather it is adaptations of core activities to reduce and manage friction with the political domain and to safeguard the organisation from more hard-knock political behaviours.

Political risk is not just about political behaviour, but also an organisation’s awareness, sensitivity, and adaptability, which, if low, can actually create political risk even in stable political environments.

Finally, widespread awareness of the political variable and its potential relevance to organisational health and performance is a robust starting point for competence in political risk management, a capability that is becoming fundamental given the intersection of continued globalisation and increasing political volatility across and within regions.

Copyright: Harmattan Risk 2023