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How BRIC MNEs Deal with International Political Risk

by
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Hitherto, political risk has worried developed country multinational enterprises (MNEs) investing in developing country markets. But as more emerging market firms invest overseas, they too must grapple with this subject. *World Investment and Political Risk 2009*[1] looks at this issue for the first time and finds that Brazilian, Russian, Indian, and Chinese (BRIC) firms appear to worry more about political risk than global counterparts. Though these results are based on a small sample of 90 of the largest BRIC investors, they are thought-provoking nonetheless.

Already, emerging market FDI outflows have tripled from US$100 billion in 2000 to US$350 billion in 2008 says UNCTAD, driven largely by burgeoning investments from Brazil, Russia, India, and China.[2] Although the bulk of this FDI has gone into developed economies, BRIC firms have also stepped up the size and spread of their investments in other emerging markets.

Protecting against political risk

As mentioned earlier, survey data suggests that BRIC firms see political risk as more of a concern than global counterparts when investing in emerging economies. This is not surprising, since BRIC firms invest heavily even in those developing economies

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[1] Multilateral Investment Guarantee Agency. *World Investment and Political Risk 2009* (Washington, D.C.: World Bank Group, 2009).The BRIC data are based on a survey conducted by the Vale Columbia Center on Sustainable International Investment (VCC).

[2] Between 2000 and 2008, Brazilian outward investment rocketed from US$3 billion to US$21 billion; Russian from US$3 billion to US$52 billion; Indian from US$336 million to US$18 billion; and Chinese from US$2 billion to US$52 billion.

they consider among "the world's five most politically risky," in contrast to global counterparts who stay clear of the markets they consider most unstable. Brazil, for instance, lists Venezuela as one of its five key emerging markets, even while ranking it as one of the world's five most high-risk markets. China does the same with Indonesia; India with Russia and Africa; and Russia with Kazakhstan and the Commonwealth of Independent States. Also important is that the BRIC sample also had a higher percentage of natural resource firms, which are more vulnerable to political risk.

BRIC firms, like their global counterparts, worry most about breach of contract and transfer and convertibility restrictions. But Russian and Brazilian firms worry most about breach of contract; Chinese firms about war and civil disturbance; and Indian firms about transfer and convertibility restrictions. Also, while just 9% of Indian firms worry about expropriation, an average of 26% of Brazilian, Russian and Chinese firms do.

BRIC firms, like global counterparts, are confident about their ability to assess political risk and implement existing mitigation strategies.[3] However, they are far less so about anticipating new political risks, evaluating new mitigation strategies and assigning roles for political risk management. They also rely on the same non-formal political risk mitigation strategies as global counterparts, according them different priorities. While global firms rely heavily on engagement with host governments and risk analysis, the Russian firms surveyed rely most on host country engagement, the Chinese on risk analysis and the Indians and Brazilians on local tie-ups. Half the Brazilian sample also relies on scenario planning.

BRIC MNEs and political risk going forward

Like global counterparts, few Brazilian, Indian and Chinese firms purchase political risk insurance (PRI), but Russian firms rely heavily upon it. More significant, 27% of the BRIC sample said they were unfamiliar with PRI products and 48% pointed to the lack of appropriate offerings, double the percentages in the global sample. Some BRIC firms said that current PRI offerings define political risk too narrowly to be of practical use. They had thus purchased it only under pressure from financiers. Some said they were deterred by PRI's high cost and cumbersome contracting.

Equally significant, some said that current PRI thinking does not take adequate cognizance of the types of "political" risk challenges they confront. Key among these is the fear of sudden policy and regulatory shift in developed markets which are core to their global competitive strategy, and where they have billions of dollars invested. India's IT globalizers, for instance, have been hurt by sudden restrictions in US visa and outsourcing-related rules. Earlier, developed markets were completely "safe," but they are now subject to worrying protectionist pressures. A sudden reversal in established business rules can abruptly disrupt a global business model, causing as much if not more of a loss as expropriation or terrorism in a less strategic emerging market.

This said, 53% of BRIC firms said they would consider political risk insurance going forward, with Chinese and Indian firms highly enthusiastic, in contrast to just 40% of global respondents.

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[3] However, companies all over the world feel more prepared to deal with financial and business, rather than political, risk. Three-fifths of respondents to *Treasury and Risk* magazine's 2009 Enterprise Risk Management Survey (June 2009 issue) felt "very confident" about identifying, assessing and managing financial risk, but only "somewhat confident" about doing so for political risk. Survey results are available at: http://www.treasuryandrisk.com/Issues/2009/June%202009/Documents/June2009Survey.pdf

Home country governments could respond in two ways. First, they could establish or expand political risk protection for their globalizing firms. While global private sector insurers and international donors offer such protection, many BRIC globalizers find their government agencies more responsive to their needs. They also need to more pro-actively market their PRI offerings, as do private PRI players.

Second is to build local private insurers' ability to provide PRI cover by permitting them to enter into reinsurance agreements with overseas insurers. As yet, few emerging market insurers have independently offered such protection, given that PRI is a specialized product, their insurance capacity is limited and, in some countries, insurance rules are still restrictive.

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The Vale Columbia Center on Sustainable International Investment (VCC), led by Dr. Karl P. Sauvant, is a joint center of Columbia Law School and The Earth Institute at Columbia University. It seeks to be a leader on issues related to foreign direct investment (FDI) in the global economy. VCC focuses on the analysis and teaching of the implications of FDI for public policy and international investment law.

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