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Investing in the Emerging Economies (The Next -11 Countries) and How Do These Countries' Political Risks Affect One's Investment

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Abstract

The **Next 11 (N-11 countries)** is a list of fast-growing countries with promising outlooks for investment and future growth. These countries are **Bangladesh, Egypt, Indonesia, Iran, Mexico, Nigeria, Pakistan, Philippines, Turkey, South Korea and Vietnam**. This paper discuss about investing in these countries and how political risk affect one's investment. Political risk analysis in N-11 countries is an important instrument that can help investors avoid losses and increase investment returns. Since political events can rapidly change the value assets and undercut the traditional financial and economic frameworks that are used to build investment strategies, political risk analysis should be fully integrated into the investment decision-making process for investors.

Keywords: Emerging Economies; Next-11 Countries; BRIC; Political Risk; Investment.

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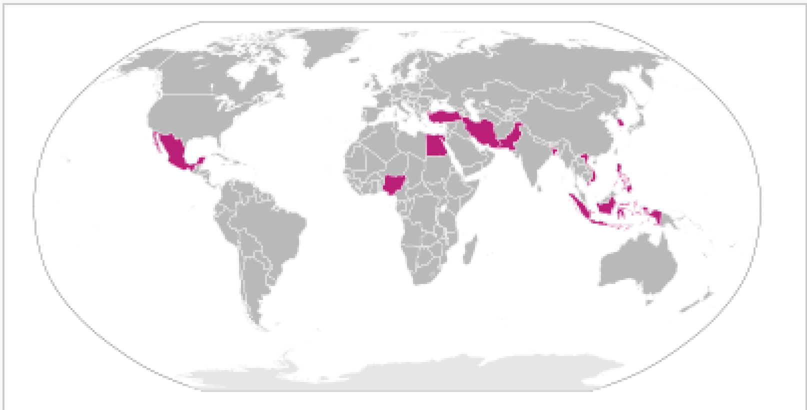
1. Introduction

An emerging market economy needs to calculate the local social as well as political factors because it endeavors towards opening up its economy to the entire world. The participants of the emerging market, who are usual to being safe and secure from the outside world, can frequently be wary of foreign investment. Most of the time the Emerging economies have to face certain challenges of nation pride. It is because the citizens get opposed towards foreigners trying to own the part of their local economy.

Besides, opening up an emerging economy implies that it will likewise be presented to new working standards and ethics as well as to new cultures. The introduction of the fast food in local markets has been the derivative of the foreign investments. Over the eras, this can change the texture of a general public and if a population is not completely trusting of progress, it might compete back energetically to stop it [1].

Even if emerging economies might have the capacity to anticipate brighter opportunities as well as offer new regions of investment for developed economies including foreign nations but local authorities in N11 nations need to consider the impacts of open economies on natives. Moreover, before investing in these nations, investors need to identify the associated risks. However, the procedure of emergence might be troublesome, moderate and frequently stagnant now and again. What's more, despite the fact that emerging markets have survived local and worldwide challenges previously, they needed to defeat some extensive hindrances to do as such.

2. The Next 11 Countries (N-11)



N-11 nations in red. From left: Mexico, Nigeria, Egypt, Turkey, Iran, Pakistan, Bangladesh, Indonesia, Vietnam, South Korea, Philippines

Figure 1: N-11 Countries

The **Next 11 (N-11)** is a list of fast-growing countries identified by Goldman Sachs as potentially good investments in the coming years. These countries are Vietnam, South Korea, Turkey, Philippines, Bangladesh, Indonesia, Egypt, Iran, Nigeria, Pakistan and Mexico. The bank picked these countries all with promising standpoints for investment and future development. The criteria used by Goldman Sachs were the political maturity, macroeconomic stability, investment policies and openness of trade, political maturity, openness of trade and investment policies, and the education quality. These countries were selected in addition to BRICs .BRIC is an acronym coined by Goldman Sachs a few years ago to describe four top emerging markets: China, Brazil, India and Russia. These countries have a huge part of the world's economy and natural resources. And together, they account for about 25 percent of the world's land mass and 40 percent of the global population. As big and influential as they are, however, the BRICs are already well-known among professional investors. And that's where the Next- 11 countries come in … they're the next big growth stories – the future of the global markets…Business, Finance and Investment. While they aren't on the scale of the BRIC nations, the Next -11 countries all have large populations. Indonesia is the largest at about 229 million, while South Korea is the smallest with around 48 million. More important, their populations are growing — not shrinking as is the case in many developed nations. Other things being equal, more people usually means more business opportunities .When you combine a good-size, growing population with a modern industrial base you get a critical mass: The ability to produce consumer goods, and the consumers who can afford to buy them. All of this creates the potential for major consumer and business growth and investment opportunities [2].

Developed countries

 **South Korea:** High Income economy, Advanced economy (both IMP and CIA), High-income OECD member, superior human development, Developed market (in: FTSE index, S&P index and Dow Jones index,), Development Assistance Committee member, Full democracy, G-20 major economies, EAS founding member, Four Asian Tigers, ASEAN Plus Three founding member, KORUS FTA, APEC founding member, European Union-Korea FTA, Visa Waiver Program participant and MIKT country.

Newly industrializing countries

**Iran**: High human development, Upper-middle-income economy, authoritarian Islamic Republic, Developing 8 Countries, GECF and OPEC founding member, Group of 15 member and ECO founding member.

**Mexico:** High human development, Upper-middle-income economy, OECD member, EAS founding member, Advanced Emerging market, APEC member, G-20 major economies, NAFTA, G8+5 member and MIKT country.

 **Philippines:** Medium human development, Lower-middle-income economy, G-20 Developing Economy, Secondary Emerging market, Tiger Cub Economy, Flawed democracy, APEC Founding member, 3G country, ASEAN founding member and EAS founding member.

 **Turkey:** High human development, Upper-middle-income economy, democracy, EU Customs Union, OECD founding member, G-20 major economies, ECO member, Advanced Emerging market, MIKT country, Developing 8 Countries and EU associate member.

Developing countries

Indonesia: Medium human development, Lower-middle-income economy, Secondary Emerging market, 3G country, Flawed democracy, Tiger Cub Economy, MIKT country, G-20 major economies, APEC founding member, EAS founding member, ASEAN founding member and Developing 8 Countries.

Egypt: Medium human development, Lower-middle-income economy, Secondary Emerging market, 3G country, Regime in transition, G20 developing nations, CAEU founding member, AU member, COMESA member, Developing 8 Countries and ENP member,.

Nigeria: Low human development, Lower-middle-income economy, Frontier market, Flawed Democracy, AU member, 3G country, OPEC member, Economic Community of West African States member and Developing 8 Countries.

Pakistan: Medium human development, Lower-middle-income economy, Secondary Emerging market, G20 developing nations, Hybrid Regime, ECO member, SAARC founding member and Developing 8 Countries.

Vietnam: Medium human development, Lower-middle-income economy, Frontier market, Fast emerging, Authoritarian regime, ASEAN member, 3G country, EAS founding member and APEC member.

Least developed countries

Bangladesh: Medium human development, Low-income economy, Strong growth rate, Frontier market, Flawed democracy, SAARC founding member, 3G country, BIMSTEC member and Developing 8 Countries [3].

3. Targeting Differences

Though the N11 nations share certain attributes, they are not at a similar level of monetary developments hence consumer centered businesses must focus on these business sectors in various ways:

A. The N11 countries are categorized in two manners: newly industrialized economies and developing economies. Both of these are ‘emerging economies’, yet the first one have more noteworthy industrial capacity and are regularly starting to trade manufactured or refined items, while the latter are still to a great extent dependent on primary exports with a little industrial capacity. Usually, newly industrialized economies have higher standard of living than developing economies.

B. Out of N11 countries, Iran, Bangladesh, Nigeria, Vietnam and Pakistan can be considered as developing economies. Whereas all other countries except South Korea is considered as newly industrialized economies.

Among the N11 economy, South Korea is the only country that can be considered as a developed economy because of its stable macroeconomic fundamentals and great level of industrialization. For instance, South

Korea is highly technological country, exporting manufactured products and enterprises service. By differentiate, Nigeria an exporter of low level manufactured products and oil while Bangladesh is an exporter of primary products.

C. In 2007, South Korea was having the maximum GDP per capita (PPP: purchasing power parity). Moreover, South Korea has lower population than other N11 countries, with well-paid as well as most skilled population. On the other hand, in 20007, Nigeria had the most minimal GDP per capita with $1,328, with lower skilled but bigger populace and lower rate of development in the country [4].

4. Why Invest in N-11 Countries?

For individual investors, investing in N-11 nations is a reasonably new option. On the other hand, is investing in the emerging economies a good decision? An object of investment plays an important role in deciding to invest or not in foreign countries [5].

The key rule of investing is to look for the most elevated risk-balanced return for their investment. Fundamentally, you need to expand benefit made beyond the measure of risk taken in specific investment. Developing countries are fast becoming the key drivers of global economic growth. Investing in these markets gives investors the opportunity to generate exquisite returns by allocating assets in places where growth is today and in the foreseeable future. Notably, the IMF (International Monetary Fund) estimates that emerging economies are expected to grow up to three times faster than developed nations like the U.S.

- ***Geographically Diversified:***

Contrary to developed economies which were faced with a national economic crisis solely due to the side effects periphery sovereign issues, the N11 countries are non-correlated in terms of their geographical presence. In European Union for instance, every country is in correlation and the 2012 debt crisis has been a clear evidence of how this can affect portfolio on a negative way. This means that in effect, there are no direct inflicting economic, monetary or fiscal issues. Each of the N11 nations is independent and unique, offering outstanding diversification.

- ***Growing Populations:***

N11 countries have a large population and a young, motivated workforce. Indonesia for example has a population of 230 million- which means it almost makes up three quarters of the Unites States. Such economies are therefore colored by multi-decade secular trends of rising consumer classes and strong equity class performance. To mention, the stock market in Egypt is up by 45 % this year alone.

The rise of the consumer class means that durable goods such as cars and property become more attainable. Over all, consumer disposable income increases and so will their purchasing power. Ultimately, manufacturing companies will benefit from a sudden increase in demand and generate more marginal profits.

- ***Low Debt Levels:***

Low debt to GDP levels in the N11 countries will help emerging economies forge ahead in the rally for economic growth versus their developed counterparts. Such strong macro fundamentals and economic management will continue to push these rapidly-growing countries forward onto the global investment radar.

Primarily, the N-11 nations are known for conceivable economic growth that offers assistance to multiple companies to flourish their business. However, we can say that developing nations are prone to higher risks and on the other hand they have the ability to manage long-term growth successfully. Each country is known for specific resources that are exclusively found in that country. Such as, Nigeria is well known for offshore-oil. The Philippines is endowed with natural resources, service industries such as tourism and Business Process Outsourcing (BPO) have been identified as areas with some of the best opportunities for growth for the county. Goldman Sachs estimates that by the year 2050, it will be the 14th largest economy in the world. It is also projected that the Philippine economy will become the 5th largest economy in Asia and the largest economy in the Southeast Asian region by 2050. Iran ranks second in the world in natural gas reserves and third in oil reserves. It is OPEC's 2nd largest oil exporter and is an energy superpower. Turkey has a large automotive industry, which produced 1,072,339 motor vehicles in 2012, ranking as the 16th largest producer in the world. Every nation has its own ranges of economic focus as well as risk-to-compensate profile for investors.

5. Risk

Risk is not necessarily a bad thing. Every investment has risk. A common definition of risk is deviation from an expected outcome. That deviation can be positive or negative. To achieve higher returns in the long term, investors generally must accept greater volatility in the short term. The amount of volatility an investor is willing to accept is often referred to as "risk tolerance." Your capacity to accept volatility is based on your specific financial circumstances, while taking into account your psychological comfort with uncertainty and the possibility of incurring short-term losses[6]. Investors must consider many types of risk, including credit risk, market risk, liquidity risk and political risk:

- **Credit risk** is the risk of borrowers defaulting on their loan obligations.
- **Market risk** is the risk that the value of a portfolio will decrease due to market conditions.
- **Liquidity risk** is the risk that a given asset cannot be traded quickly enough in a market to prevent loss or make a profit.
- **Political Risk**

5.1. The Significant Risks of Investing in N-11 countries

There are certain risks associated with the investment in any market or nation therefore it is important to create a diversified portfolio. For instance, if the U.S. committed an error in fiscal approach and the dollar spiraled descending, wouldn't it be pleasant to be put investment into different nations that aren't influenced?

Be that as it may, there are multiple risks particularly associated with domestic as well as foreign investing [7].

Here are some of the important risks:

- **Currency Exchange Rate Risk:** The income and sales of the foreign companies are generated in terms of their local currency such as Swiss francs or Euros. Subsequently, financial specialists from the U.S. must change over these monetary forms into U.S. dollars sooner or later. Shockingly, the conversion scale between monetary forms changes after some time, and can prompt surprising additions or misfortunes.
- **Economic and Credit Risk:** The foreign firms are regularly subject to the wellbeing of their host nation's economy. However the U.S. has an AAA credit score, there are numerous nations that have investment ratings that range from close-perfect to well-beneath investment review. Also, unfavorable economic occasions in these nations could affect organizations operations.
- **Geopolitical/ Political Risk:** Some foreign companies operate in countries that may face geopolitical risks, such as terrorism or potentially hostile neighbors. For example, South Korea faces the risk of an attack by North Korea. As a result, investors should carefully consider the risks associate with the countries in which they invest.

6. Political Risk

Political risk is a type of risk faced by investors, corporations and governments because of what are commonly referred to as political decisions. Generally speaking, political risk is a risk that your investment objectives will not be achieved as a result of such nonmarket factors as changes in macroeconomic and social policies, as well as political instability. It is a risk that can be understood and managed with reasoned foresight and investment.

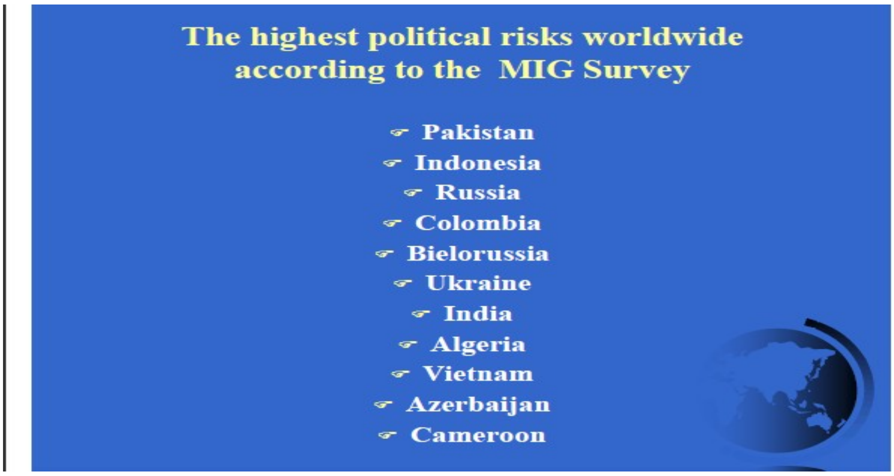


Figure 2: Countries with highest political risks

*MIG – Merchant Investment Group

While many foreign investors normally associate political upheavals such as coups, civil wars and insurrection with third-world countries, and they may associate expropriations and currency devaluations with unstable economies, they don't have to go beyond the borders to find evidence of political risk. Here is a rundown of some political risk factors that investors should consider:

- High unemployment
- Political rancor over debt and deficits
- Political gridlock

Political risk is the risk that an investment's returns could suffer as a result of political changes or instability in a country. Instability affecting returns could stem from a change in government, legislative bodies, other foreign policy makers, or military control. It is also known as "geopolitical risk" and becomes more of factors as the time horizon of an investment gets longer.

Political risks are notoriously hard to quantify because there are limited sample sizes or case studies when discussing an individual nation. Some political risks can be insured against through international agencies or other government bodies. The outcome of a political risk could drag down investment returns or even go so far as to remove the ability to withdraw capital from an investment.

A number of recent, high-profile political events have significantly impacted financial markets and heightened investor's sensitivity to political risk issues. The political-economic crisis in Europe, revolutions and rebellions in North Africa and the Middle East, and tensions in the South China Sea and Persian Gulf, to name a few, have garnered the most attention but more ubiquitous political risks such as regulatory changes, new tariff barriers, and currency controls also adversely affected cross border investments over the last two years. Political risk is any event that can directly or indirectly alter the value of an economic asset. This definition is quite broad but it is important for investors to understand all the ways that political risks can affect an investment and not just focus on those events that make the news [8]. Political risk actually applies to both developed and undeveloped countries. It is important to consider the political risk associated with those investments and the effect that risk can have on your portfolio. From an investment portfolio perspective, unexpected changes in actions and policies taken by a country's leaders can greatly impact that country's financial markets. Nowadays, the actions taken in one country will often reverberate through other financial markets around the world. This risk is referred to as political risk. For instance, the press reports that a Chinese government official raises concerns over how high and fast stock prices have risen. Traders around the world speculate that the Chinese government may take action to control the market. China's stock market has a massive sell-off, erasing 10% of its value in one day. That speculation then reverberates through the world's financial markets. The major U.S. stock markets decline 3% in one day. At one point during the day, the Dow Jones Industrial Average drops over 150 points in one minute. The average investor loses thousands, maybe even tens of thousands of dollars in one day. But it doesn't stop there. The worldwide market correction causes investors to reassess the amount of risk in their portfolios. They are concerned and take action to reduce their exposure. So the markets don't just drop one day, but a down-cycle lasting weeks or months develops. Example is the coup in Thailand, which affects foreign investors.

Hugo Chavez, the President of Venezuela, announces the government is taking control over various industries with substantial foreign ownership. Stocks of companies with investments in Venezuela are immediately affected. Political changes are a risk to a portfolio, but they can also be an opportunity. Having the foresight to anticipate political changes and the effects it will have on a country will allow you to buy in before everyone else does. For instance, countries issue bonds just like companies do. The interest rate paid on those bonds (how the bonds are priced) depends on the financial and political stability of the country. Several years ago, Brazil was in serious financial trouble. Its bonds paid a very high interest rate to reflect that risk. The government took steps to improve the financial condition. It changed tax policies and opened markets to foreign investment. As those policies took effect, the country became more stable. As the risk associated with owning Brazilian bonds decreases, so does the interest rate those bonds pay. If you purchased one of the bonds when it was paying the high interest rate and sold it after the country became more stable you would have made a handsome profit [9]. For years, most industries in China were government owned and controlled. Foreign investment was restricted and there wasn't a viable means of trading stocks. In the past several years China has made it easier for foreigners to invest. It has also been privatizing government owned companies. That process is still in the early stages. Although there continues to be significant risks associated with investing in China, there are also great potential rewards. Assessing political risk is difficult and requires a systematic approach in order to be successful. One of the factors that complicate the incorporation of political risk into financial risk analysis is the fact that political risk assessments must be done for both individual investments as well as at the portfolio level. Assessments for individual projects are important to prevent losses -- a significant short-term loss on an investment (20-30%) will impair long-term returns -- and create opportunities. By assessing the political risk of the entire investment portfolio, some higher risk investments, which offer attractive returns, may be advisable if the risks are fully known and less correlated with lower risk investments also in the portfolio. An analytic challenge nonetheless persists because political risks will vary depending on the type of investment (portfolio or direct investment), time horizon and country where the investment will take place and the best tools to assess political risks will also vary depending on those same factors. As a result, each investment must be assessed individually. Furthermore, political risk analysis must be continuous as country dynamics and the international political environment are constantly changing. The international environment is fraught with political risks – some are well known while others are often harder for investors to identify. These risks are complex and evolving. Investors have diversified their investments to mitigate political and financial risks. This, however, has exposed their investments to new threats. Investors can prosper in this environment if they deploy their investments in a robust fashion and integrate political risk into their investment strategies.

7. Concluding Remarks

In a business the suggestion for political risk is that there is a measure of probability that political occasions may entangle its quest for profit through direct impacts (for example, fees and taxes) or indirect impacts (for example, opportunity cost renounced). Accordingly, political risk is like a normal esteem with the end goal that the probability of a political occasion happening may decrease the attractive quality of that investment by lessening its foreseen returns.The NEXT 11 (N-11) group of countries has been identified by the global financiers of major trading and investment institutions as the emerging economies of the next decade where investment opportunities for the shrewd will abound. The remit of Next-11 is to provide the investor and the relevant authorities with the faster access to the real time options available. A low level of political risk in a given country does not necessarily correspond to a high degree of political freedom. Long-term assessments of political risk must account for the danger that a politically oppressive environment is only stable as long as top-down control is maintained and citizens prevented from a free exchange of ideas and goods with the outside world [10].Political risk analysis in N-11 countries is an important instrument that can help investors avoid losses and increase investment returns. As noted above, political events can rapidly change the value of assets and undercut the traditional financial and economic frameworks that are used to build investment strategies. As such, political risk analysis should be fully integrated into the investment decision-making process for investors. Political risk analysis can help investors:

- Uncover and highlight knowable but obscure risks (such as discriminatory taxation). With this information the investors can make informed decisions about whether or not they should invest in a country and how to structure their investment if they decide to enter a market.
- Limit losses (and perhaps realize gains) when faced with fat tail events by identifying risks that could cause significant losses, monitoring triggers that would cause significant political disruptions, and developing plans to shift investments as soon these events surface.
- Anticipate changes in government policies.
- Identify social-economic forces that could lead to political or labor unrest.
- Determine political risk insurance requirements.

Remember that there is a trade-off between risk and reward. An investor's goal should not be to avoid all political risk. If you do, you will have to settle for lower returns. Lower returns mean you will have to save more to provide for retirement. Lower returns mean that you may not get the income from your portfolio that you need to live on during retirement. Instead, there are three things that you need to do. First, understand that political risk exists. Even if you only invest in any of the N 11 countries, your portfolio will still be impacted by the actions of political leaders around the world. Second, try to identify the political risks associated with the investments you own. The risk associated with equity investment in emerging market economies is different than those of developed countries. The risk associated with bond investments is different from those of equity investments. Third, take steps to manage that risk. Alter your investment strategy. Broadly diversify your portfolio to reduce country-specific risk. Utilize both stocks and bonds. And have an exit strategy in place in case something unexpected occurs. However, the bigger the risk, the bigger the reward, so emerging market investments have become a standard practice among investors aiming to diversify while adding risk.

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