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The Institutionalisation of political risk assessment (**IPRA**) IN JORDANIAN  
**INTERNATIONAL FIRMS**

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## **ABSTRACT**

This paper investigates the determinants of the institutionalisation of political risk assessment (IPRA) within publicly traded international firms in Jordan. The aim is to contribute to the development of IPRA theory by identifying indicators of institutionalisation; by describing and explaining their determinants; and by investigating their relative importance. The paper also represents one of the first studies of political risk assessment of firms in a Middle East context.

The study focuses on firm-specific characteristics and extends previous research by investigating firms' size and degree of internationalisation. A survey strategy was adopted and self-administered questionnaires were distributed to the entire target population of Jordanian international firms. 44 usable responses were obtained (54.9%). Non-parametric statistics were used to test the research hypotheses.

The main findings are that the level of institutionalisation of PRA within firms is significantly and positively correlated with a firm's total assets, international revenue and number of operating countries. Of the three significant determinants of institutionalisation, the number of operating countries is found to be the most important. The more countries in which a firm operates, the more likely it is to face significant risks, and so to institutionalise political risk assessment.

# THE INSTITUTIONALISATION OF POLITICAL RISK ASSESSMENT (IPRA) IN JORDANIAN INTERNATIONAL FIRMS

## 1. INTRODUCTION

Political risk is defined as “the possibility that political decisions or political or societal events in a country will affect the business climate in such a way that investors will lose money or not make as much money as they expected when the investment was made” (Howell, 2001, p.4). Political risk assessment, meanwhile, is defined for the purpose of this study as “the process of analysing and evaluating political risk while undertaking international business activities”. Instability in the international political environment has provided significant credence to the importance of assessing potential risks in international business. International businesses, thus, must assess the risks of doing business in such an environment since successful firms are those which are sensitive to change in an international context (Davidson, 1991). Kobrin (1981a; 1982) and Fitzpatrick (1983) were the first researchers to make the now common division of political risk into ‘macro’ risks and ‘micro’ risks; a division also supported by most of the recent political risk studies, including Minor (2003), Brink (2004), Hood and Nawaz (2004), Oetzel (2005), Tsai and Su (2005) and Stosberg (2005). Macro-risk occurs when risks affect all foreign firms (e.g. revolutions, coups d’état, civil wars) while ‘micro’ risk occurs when risks are intended to affect only selected business activity (e.g. import or currency controls directed at specific industries). Specific projects, firms and industries face distinctly different risks within a given country and can have widely varying impacts on firms operating in that environment (Alon et al., 2006). It is therefore appropriate to study IPRA from a firm-specific characteristics perspective.

The literature on political risk has suggested that the standard of PRA undertaken by international firms is generally low (Rice and Mahmoud, 1990; Stapenhurst, 1992a; Stapenhurst, 1992b; Wyper, 1995; Pahud de Mortanges and Allers, 1996; Burmester, 2000; Hood and Nawaz, 2004). Burmester (2000, p27) goes as far as to suggest that no academic discussion of political risk ‘is complete without a complaint about the generally low standard of political risk analysis’ undertaken by international firms. This suggests either a lack of awareness of political risk in international business participants, resistance by firms to the notion that political risk is amenable to analysis or that existing political risk assessment techniques have not worked well for managers (Cosset and Roy, 1991; Oetzel, et al., 2001)[1].

The political risk literature suggests, however, that a) political risk *is* assessable and helps the decision-maker to avoid or decrease the chance of both property and income losses by suggesting appropriate management tools; b) international firms are aware of their exposure to political risk and consider political risk as one of the most important risks for their international business activities (Anchor et al., 2006). Nevertheless, the use of PRA in practice is described as ‘informal’, ‘unsystematic’, ‘reactive’, ‘inadequate’ or ‘subjective’ in many cases.

In this context, the political risk assessment literature (e.g. Blank et al., 1980; Kobrin et al., 1980; Kobrin, 1981; Kobrin, 1982; Hashmi and Baker, 1988; Wyper, 1995; Pahud de Mortanges and Allers, 1996) has used the term “institutionalisation” to describe the process by which political risk assessment becomes more explicit and systematic within a firm. This paper will use the term “institutionalisation of political risk assessment” (IPRA) to formalise this.

The aim of this paper is to contribute to the development of a theory of IPRA by examining and explaining the institutionalisation of political risk assessment in publicly traded Jordanian international firms. This is achieved via pursuit of three objectives: a) to identify indicators of IPRA; b) to describe and explain the determinants of IPRA; and c) to investigate the relative importance of, and the correlations among, the determinants of IPRA.

## **2. LITERATURE REVIEW**

### **1. Institutionalisation in Organisations**

Organisational theorists have sought to explain the development of routines, structures and processes in organisations. The behavioural approach posits that changes to organisational routines are triggered in response to a failure to meet organisational aspirations or low performance (Cyert and March, 1963). This approach considers that performance is the key feedback mechanism which is used to indicate success or failure: where there is a decline in performance, a change in the organisational procedure or routine is stimulated. For Chandler (1993), changes in the structure of an organisation follow or result from changes in strategy; changes take place when the existing structure becomes dysfunctional and no longer facilitates the achievement of objectives. Chandler (1993) assumed that changes in strategy are caused ultimately by changes in a firm's environment, by new opportunities and needs created by changing population, income, technology and the like. Strategy, structure and the environment, according to Wheelen and Hunger (2002) and Brink (2004), need to be aligned closely; otherwise, organisational performance is likely to suffer.

Institutionalisation theory offers an alternative explanation of the emergence of structures and routines in organisations. In this perspective it is observed that firms in a similar organisational field model themselves on one another, a phenomenon referred to as isomorphism (Di Maggio and Powell, 1983). Organisational isomorphism can be stimulated through three processes: coercive isomorphism (the use of power and sanctions to bring about organisational conformity), mimetic isomorphism (where organisations copy one other in their field) and normative isomorphism (which is linked to professional standards in the field) (DiMaggio and Powell, 1983). Staphenurst's (1992b) reference to the 'rise and fall' of the political risk assessment 'function' in the USA in the 1980s suggests a process of organisational mimicry .

In the context of political risk assessment, Kobrin (1982, p. 69) suggests that institutionalisation of political risk assessment requires "stimulus exogenous to the process itself" and is "most unlikely to arise spontaneously". As environments become more turbulent, perceived uncertainty increases (Oetzel, 2005). Increased environmental uncertainty requires increased information acquisition and processing in relation to the environment (Sarewitz et al., 2003; Xu et al., 2003). Such information acquisition and processing is critical for success in the international market because of the increasing level of uncertainty and complexity in firms' multiple and geographically dispersed operating environments. Firms, thus, must adapt to their environment if they are to survive and prosper. Given the complexity of organisations and the environments in

which they operate, effective managers must be sensitive to environmental signals through constant assessment (Albright, 2004) which typically comprises political and societal assessment (Brink, 2004). To this end, the ‘institutionalisation’ of PRA can be seen as an ‘adaptive’ response by firms in circumstances where there is a greater probability that potentially significant risks will arise from the political environment (Blank et al., 1980; Kobrin, 1982; Stapenhurst, 1992a).

## **2. Institutionalisation of Political Risk Assessment (IPRA)**

The term “institutionalisation”, in the context of political risk assessment, was introduced by Blank et al. (1980, p7) and is used to describe the process by which PRA becomes “more explicit and systematic” within a firm. They stated that in a ‘traditional’ firm there is no formal assignment of responsibility for PRA nor is any effort made to assess political risk associated with international business activities. Similarly, Kobrin (1982) suggested that institutionalisation, as a minimum, entails the specification of responsibilities attached to a position. However, he highlighted that firms may also conduct PRA but without assigning such responsibilities to an individual or group. Blank et al. (1980, p7) emphasised that “related activities are carried out instead by various individuals”, usually “senior managers” on a “need basis”. Both approaches suggest that: a) PRA begins to be institutionalised when formal responsibility for its performance is assigned to a specific individual or group; b) PRA is further institutionalised when the process is routinized; and c) in a more institutionalised setting, there is a greater emphasis on objective assessment in addition to subjective assessment. Indeed, the Risk Management Standard (2002) suggests that, for firms to be in compliance, they need to meet the following conditions: they must conduct risk management ‘in-house’; they must set out responsibilities for risk management; and they must conduct risk management on a continuous basis.

Institutionalisation, according to Blank et al. (1980, p. 7), is a gradual process and there is a ‘grey area’ in which a particular firm may appear to have institutionalised the process from one perspective but not from another. Despite early work suggesting that institutionalisation is a bipolar continuum rather than a discrete or binary classification Kobrin (1982, p. 69), most subsequent empirical political risk studies have dealt with institutionalisation as binary. That is, such studies, have classified firms into institutionalised versus non-institutionalised and have relied on one indicator; either the existence of a PRA department (Pahud de Mortanges and Allers, 1996), or the tendency of firms to initiate the process too late (Burmester, 2000). Consequently, one firm cannot be somewhere between these two categories. This approach to institutionalisation is flawed however because risk management, as noted by Hood and Nawaz (2004), contains no implicit assumption of the need for a specific risk manager or risk management function. Indeed, the Risk Management Standard (2002, p. 2) suggests that risk responsibilities should be assigned throughout the organisation with each manager and employee responsible for the management of risk as part of their job description. A firm may assign formal responsibility to personnel to conduct the process but such a process is performed as part of another department (Williams and Heins, 1985). In such a case, although a firm has no specialised department for risk or political risk, it still has some level of institutionalisation.

The creation of a standard institutionalisation model is almost impossible (Howell, 2001), since firms have different managerial structures and philosophies and indeed, as Williams and Heins (1985) have noted, the optimal method of risk management within the firm is debatable.

Although the Risk Management Standard (2002) represents best practice against which firms can measure themselves, it is not intended to produce a prescriptive approach which leads to “box ticking” or a certifiable process. The rationale for not introducing a prescriptive approach, according to the Risk Management Standard (2002), is attributed to the many ways of achieving the objectives of risk management and it would be impossible to try to set out all such ways in a single document. Nonetheless, by meeting the various component parts of such a standard, albeit in different ways, firms can report their compliance with the standard. In addition, the diversity of potential political risk and the differences in firms’ exposure to risk make selection of an appropriate PRA and management strategies complex (Iankova and Katz, 2003).

### **3. Determinants of Institutionalisation**

The micro-political risk literature emphasises that the impact of political risk is related to firm-specific characteristics (Wilkin and Zonis, 2000; Kettis, 2004, Green, 2005; Gorjaev and Sonin, 2005) and that different multinational firms need to adopt their own political risk-assessment and risk-mitigation strategies (Alon et al, 2006). That is to say, the nature of political risk assessment is dependent on the nature of the risk exposure of the company. The literature suggests that the extent to which international firms are involved in PRA is therefore correlated with many organisational characteristics. These characteristics include: a) a firm’s size (Hashmi and Baker, 1988; Stapenhurst, 1992a; Kettis, 2004); and b) a firm’s degree of internationalisation (Hashmi and Baker, 1988; Hashmi and Guvenli, 1992).

#### ***1. A Firm’s Size***

A firm’s size has an impact on both its capability to identify, assess and manage risk and also its vulnerability to risk. From the capability perspective, Kobrin (1982, p. 22) suggested that larger firms are more capable of engaging ‘formally’ in PRA, while smaller firms tend to utilise ‘simpler’ structures (i.e. PRA on an ad hoc basis). By way of illustration, Stapenhurst (1992b), Kearns (1997) and Kettis (2004) reported that many international firms considering PRA are hindered by the initial and continuing high fixed costs of such a process. In addition, PRA results in extra responsibilities for top management who, according to Albright (2004), do not have ‘much time’ to devote to search systematically for the information needed. Brink (2004) reiterated this point, arguing that the shortage of time which firms experience hinders a systematic PRA. Smaller firms are at a resource disadvantage when compared with larger firms and may, therefore, not be able to invest in the hiring of personnel (Calof, 1994). A counterargument however is proposed by Gerry (1996) who asserts that reducing a firm’s size facilitates risk management because managing a ‘big’ firm poses particular difficulties. Small firms can often react to the market more quickly (Fitzpatrick, 2005). Small firms also have a competitive advantage via their cost structure, effective labour and material control and ease of delivery. In order to survive, Gerry (1996) concluded, smaller firms have to exploit their potential advantages to be more competitive and efficient than larger firms.

The vulnerability perspective focuses on the extent to which firms are exposed to risk: large-sized firms face different risks from those faced by small-sized firms. For example, larger firms are

more likely to attract the attention of sovereign authorities (either positively or negatively) and this is likely to affect their exposure to risk (Henisz, 2000). Smaller firms are much less likely to attract attention. Larger firms, which have a greater capability to exploit a host country, e.g. in large infrastructure projects or the in the oil industry, are more vulnerable to some political risks, such as expropriation (Stosberg, 2005). The micro-political risk literature suggests that firms employing a large number of employees, are more likely to attract government attention (Wilkin, 2001).

The size of the firm also has an impact on the degree of bargaining power which firms are able to exert in the local context. Multinational companies are not necessarily passive observers of their host environment in which they invest, but in some cases are able to exert influence (Alon et al, 2006; Frynas and Mellahi, 2003). Oetzel (2005), in the context of Costa Rica, found that a firm's size is an important determinant of its political exposure and that small firms are more vulnerable to some political risks than large firms. For instance, larger firms may be more able to gain access to local officials or lessen the impact of bureaucracy and red tape (Oetzel, 2005). However, to exert such influence requires effective and active management and control of the PRA process, thus necessitating a more structured and institutionalised PRA process.

The political risk literature therefore (e.g. Stapenhurst, 1992b; Kearns, 1997; Kettis, 2004) tends to suggest that larger firms are more likely to institutionalise PRA than smaller ones. Consequently, the following hypothesis is suggested in the context of Jordan:

- 1: There is a positive relationship between firm size, measured by its assets and by its number of employees, and the level of IPRA within the firm.

## ***2. A Firm's Degree of Internationalisation***

Three variables are used frequently in the risk literature to measure a firm's degree of internationalisation: years in international business; international revenue; and number of operating countries.

The number of years in international business has been investigated by Rice and Mahmoud (1990), Wyper (1995), Pahud de Mortanges and Allers (1996), Keillor et al. (1997), Keillor et al. (2005) and Oetzel (2005) and measures the extent of international experience. On the one hand, it could be expected that the greater the years the firm has been operating in international business, the greater the likelihood that it will be aware of risks that may stem from the political environment, and so pay more attention to risk assessment. It could be expected also that the fewer the years the firm has been operating in international business, the lower is the likelihood that the manager will be aware of risks that may stem from the political environment and, as a consequence, have a less formalised structure for political risk assessment. Nevertheless, experience is also likely to reduce perceptions of risk over time (Kobrin, 1982; Oetzel, 2005): as managers gain more experience of operating in diverse countries, they may become desensitised to risk, and so they may pay less attention to risk assessment. In contrast, firms with less



international experience may be less familiar with international environments. Therefore, they may pay more attention to political risk assessment (Green, 2005). Interestingly, Wyper (1995) found no significant correlation between the number of years of international experience and the institutionalisation of political risk assessment (PRA) within UK international firms. Despite this finding, it is appropriate to suggest that the existence of such a correlation may be found in different contexts.

The second variable is the percentage of revenue generated by international business activities (Hashmi and Baker, 1988). The percentage of sales generated abroad also has been used by a number of empirical political risk studies, including Kobrin (1982), Rice and Mahmoud (1990) and Pahud de Mortanges and Allers (1996). Total revenue, according to Kobrin (1982), measures the relative importance of international business activities to international firms. Firms that rely heavily on international revenue may pay due attention to assessing risks facing this revenue since the consequence of losses may be severe. Indeed, Hashmi and Guvenli (1992) found that US firms with high international sales (more than 20.0 percent of the total) were more likely to institutionalise than firms with low international sales. In this context, Green (2005) emphasised that regardless of a firm's revenue from international business, today's business environment demands thorough PRA.

The third variable is the number of countries in which a firm operates (Blank et al. (1980); Kobrin (1982); Rice and Mahmoud (1990)). This variable measures the diversity of a firm's environment (Kobrin, 1982). According to Keillor et al. (1997), the first stage of internationalisation involves only irregular export activities, followed, sequentially, by export via independent agents, export via established international sales subsidiaries and, finally, foreign direct investment via production / manufacturing facilities. Keillor et al. (1997) stated that by gaining experience abroad and venturing into less familiar environments, firms begin to realise that political risk may be a problem. According to Hashmi and Baker (1988), the more countries in which a firm operates, the more likely it is to face constraints as a consequence of political variables, and so pay more attention to risk assessment.

The literature therefore suggests two possible explanations about the degree of internationalisation. The first explanation suggests that firms which are 'heavily' involved in international business "have a great interest at stake"; as a consequence such firms "place more emphasis on assessing political risk than do other firms with low foreign involvement" (Hashmi and Baker 1988, p. 193). In a study of political risk mediation strategies by international firms in Bulgaria, Iankova and Katz (2003) concluded that firms which had minimal political risk exposure had little interest in risk assessment. This view was confirmed by Pahud de Mortanges and Allers (1996) in that the higher the potential exposure to political risk, the greater the tendency to institutionalise the assessment. Thus, one can assume that firms with a higher degree of internationalisation are more likely to institutionalise.

The second explanation emphasises that operating in different international markets is one of the main strategies available to firms in managing risk since such internationalisation spreads investments across markets with the aim of offsetting gains and losses (Chartered Institute of

Management Accountants, 2001). Thus, firms with high international involvement can offset gains and losses since such firms spread investments across different markets. As a consequence, such firms can be exposed to fewer risks and may place less emphasis on PRA. To this end, the following hypothesis is developed in the context of Jordan:

- 2: There is a positive relationship between the degree of internationalisation of the firm, measured by its years of experience in international business, by its percentage of revenue generated by international business activities, and by the number of countries in which it operates, and the level of IPRA within the firm.

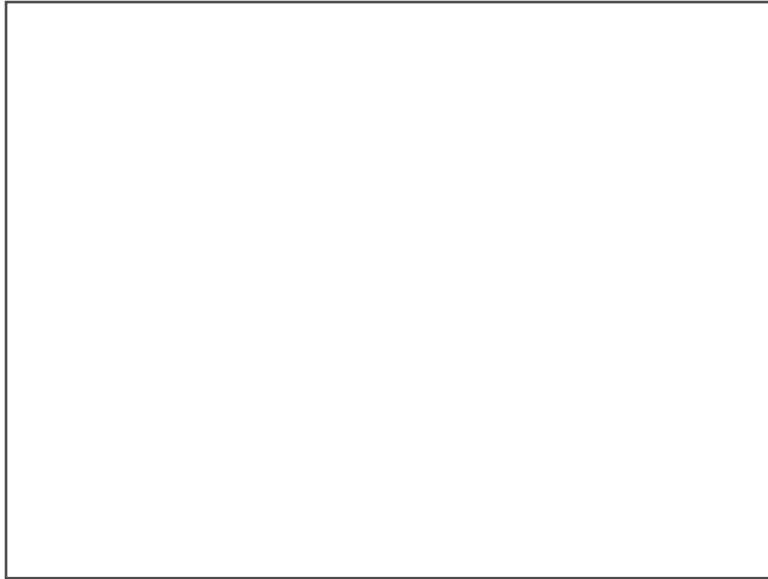
#### **4. The Relationship Between Determinants**

Studies concerned with the correlations between organisational variables and the adoption of risk management practices (e.g. Stapenhurst, 1992a; Wyper, 1995) deal with organisational variables as independent of each other and have not investigated their relative importance. It has been noted that there is more than one possibility concerning the direction of the impact of the degree of internationalisation of the firm on IPRA. This is likely then to weaken the impact of this variable. On the other hand, there are strong theoretical grounds, as outlined in section 2.3.1, for assuming the relationship between size and institutionalisation. It is predicted, therefore, that size will be the most important determinant of the institutionalisation of PRA.

Additionally, it is unlikely that the determinants are independent. Firms with larger total assets tend to have larger numbers of employees. They are also likely to operate in more countries than firms with fewer total assets. Firms operating in more countries generate more revenue from international activities and have more experience in international business. That is, to the extent that a correlation between two variables is a function of a third intervening variable, one would expect the correlation to diminish when controlling for the intervening variable. Consequently, the following hypotheses can be formulated in the context of Jordan:

- 3: The size of the firm is the most important determinant of IPRA.
- 4: The determinants of IPRA are not independent of one another.

Figure 1 summarises the hypotheses to be tested:



**Figure 1:** Hypothesised determinants of IPRA

## 2.5 The Jordanian Context

Previous studies have focused on Canadian firms (Rice and Mahmoud, 1990), North Atlantic firms (Stapenhurst, 1992a), US firms (Stapenhurst, 1992b), UK firms (Wyper, 1995) and Dutch firms (Pahud de Mortanges and Allers, 1996). However, very few investigations have been conducted into the topic in developing countries and specifically, the Middle East, a region whose international business activities are growing, but which is characterised by a high degree of political volatility.

There have been a number of studies of the business environment in Jordan and other Middle Eastern countries which have alluded to or explicitly examined issues which are either associated with or which contribute directly to political risk (e.g. Knowles, 2005; El-Said and Becker, 2001; Zeitun and Tian, 2007). However, most of these studies have been undertaken in the context of wider investigations of either factors influencing inward investment in the countries concerned and/or of economic development, including aid (e.g. Harms, 2002; Chan and Gemayal, 2004; Busse and Hefeker, 2007).

Some of these studies have made explicit reference to political risk assessment, often via construction of a political risk index (e.g. Hasan et al., 2003). Others have dealt with the close links between political risk and financial risk (Abumustafa, 2007; Zaher, 2007; Bilson et al 2002). However, none of these studies has examined the institutionalisation of political risk assessment (IPRA) or the factors influencing it – either in Jordan or in the Middle East as a whole.

This study is the first to focus on political risk assessment in publicly traded Jordanian international firms, in any context. The following are key features of its institutional environment

Jordan is a small (population 6 million), landlocked, country with few natural resources. It also depends on external sources for the majority of its energy requirements, unlike some of its neighbours. Both poverty and a high rate of unemployment, at least in relation to the countries in which earlier PRA studies have been undertaken, are significant features of its economic and social fabric. Jordan is a constitutional monarchy with the King also being the Executive Head of Government. The Parliament, which is elected every four years, exercises mainly a scrutiny role. Jordan's economic difficulties, growing population and relatively open political environment (in a Middle East context) have led to the growth of a number of small political parties. (US Department of State, 2008). Nevertheless the political scene remains relatively stable in spite of sporadic protests, for example relating to the lifting of fuel subsidies in February 2008. (Business Monitor International, 2008).

The political risks facing Jordanian firms are therefore partly a reflection of the wider political risks facing all firms in the Middle East region e.g. terrorism and economic difficulties arising from underdevelopment, especially since Jordanian international firms tend to operate mainly in Middle Eastern markets. Jordan-specific political risks have their origins in economics e.g. natural resource limitations rather than in politics per se. Although levels of political risk are lower in Jordan than in many other Middle East countries, the country is potentially highly vulnerable to external shocks, given its size and resource endowment.

## **RESEARCH METHODOLOGY**

To test the hypotheses, a survey strategy was adopted. In line with previous studies in the field (Kobrin et al., 1980; Kennedy, 1988; Rice and Mahmoud, 1990; Stapenhurst, 1992a; Subramanian et al. 1993; Pahud de Mortanges and Allers, 1986; Wyper, 1995; Demirbag and Gunes 2000; Hood and Nawaz, 2004), a self-administered questionnaire was the principal data collection method used.

The sampling frame used was the group of international companies listed on the Amman Stock Exchange for the year 2004. The list can be considered to equate to the total population of Jordanian international firms which are based in Jordan (Amman Stock Exchange, 2004). Previous research (Oetzel, 2005) found that managers at subsidiary level do not engage in risk assessment. Thus this study is limited to the Jordanian firms' headquarters and it excludes subsidiaries and plants. Subsidiaries of firms of other nationalities, operating in Jordan, are excluded to ensure the country-specific nature of the study. 75.3 percent of countries where Jordanian firms operate are Arabian countries located in the Middle East.

Although English is an official language in Jordan and is spoken widely, the questionnaire was written in both English and Arabic. To overcome issues of social desirability respondents were asked to tick the same response boxes irrespective of the language in which they had read the questions.

The questionnaire was delivered by hand to the population of the sampling frame (79 firms). The active response rate (excluding ineligible and unreachable respondents) was 59.4%. Of the 44 usable responses, 20 (43.2%) were from industrial firms, 12 (29.7%) were from the banking sector and 12 (23%) were from service firms. The Chi-square test was used to test for bias in the sample. The output of the Chi-square statistic indicated no statistically significant difference between respondents and non-respondents with respect to industry category ( $X^2 = 2.552, p=0.279$ , 2 sided) and to a firm's total assets ( $X^2 = 5.583, p = 0.061$ , 2 sided). The sample, is representative of the population therefore and the findings can be generalised to the entire population.

## 5. Measures

### 1. Size

Two variables were used to measure the size of the organisation: the total assets in US \$ (ASSETS) and number of employees in the firm (EMPLOY). Data were collected from published sources on the population of Jordanian international firms (listed on the Amman Stock Exchange).

The total assets for Jordanian international firms ranged from US\$ 7.466 million to US\$ 20,513.857 million. The number of employees ranged from 68 to 6195 (see Figure 2). For each variable, the firms were placed in order of size and divided into three equal groups (trichotomous method) which were labelled small-, medium- and large-sized firms. Figure 3 shows the classification of firm size by total assets and number of employees. These classifications were used subsequently to categorise firms from the survey sample.

Valid N = 75 firms					
Size	Minimum	Maximum	Mean	Median	SD
Assets (US \$ million)	7.466	20,513.857	483.136	29.013	2,382.321
Employees	68	6195	517.7	213	941.68

**Figure 2:** A firm's size in terms of total assets and number of employees

- **Analysis of data obtained from: Jordanian Shareholding Companies' Guide / Amman Stock Exchange for the year 2004; the Jordanian Export Development and Commercial Centres Corporation (JEDCO) publishes data (i.e. web sites, annual reports) on a firm-by-firm basis.**

Variables of size	Size categories		
	Small	Medium	Large
Total assets US \$ (million)	? 17.3	17.4 - 45.6	? 45.7
Number of employees	? 186	187 - 312	? 313

**Figure 3:** Classification of a firm's size by total assets and number of employees

### ***3.1.2 Degree of Internationalisation***

Three indicators of degree of internationalisation were used: number of years in international business (YEARS), international revenue (REVENUE) and number of operating countries (COUNTRY).

YEARS was used by Rice and Mahmoud (1990), Wyper (1995), Pahud de Mortanges and Allers (1996), Keillor et al. (1997), Keillor et al. (2005) and Oetzel (2005). Following Pahud de Mortanges and Allers (1996), the Jordanian firms are classified into three categories: low-internationalised firms have less than ten years' experience in international business, whereas high-internationalised firms have more than twenty-six years' experience. Allocating the responding firms to YEARS reveals that fifteen out of forty-three firms (34.9%) are low-internationalised, seventeen firms (39.5%) are medium-internationalised and eleven firms (25.6%) are high-internationalised.

Whilst a number of political risk studies have measured internationalisation according to the sales generated abroad (Kobrin, 1982; Hashmi and Baker, 1988; Rice and Mahmoud, 1990; Pahud de Mortanges and Allers, 1996), this research uses international revenue (REVENUE). Revenue is suitable as it indicates the extent to which firms rely on international business activities, which in turn indicates the importance of such activities to a firm. Jordanian firms in this study were classified into three main categories regarding their REVENUE. Low-internationalised firms generate less than 10.0 percent of their revenue from international business activities, whereas the percentage for high-internationalised firms is more than 26.0 percent. Allocating responding firms according to REVENUE reveals that seventeen out of forty-three firms (39.5%) are low-internationalised, ten firms (23.3%) are medium-internationalised and sixteen firms (37.2%) are high-internationalised.

The third variable is the number of countries in which a firm operates (COUNTRY) as used by Blank et al. (1980), Kobrin (1982) and Rice and Mahmoud (1990). This variable, as suggested by Kobrin (1982), measures the diversity of a firm's environment. Following the classification by Blank et al. (1980); Kobrin (1982) and Rice and Mahmoud (1990), Jordanian publicly traded firms are classified into three main categories with regard to COUNTRY. Low-internationalised firms have such facilities in fewer than five countries, whereas high-internationalised firms have facilities in more than eleven countries. Allocating the responding firms according to their number of operating countries reveals that forty-three firms (46.5%) are low internationalised, nine firms (20.9%) are medium internationalised and fourteen firms are high internationalised (32.6%) .

### ***3.1.3 Institutionalisation of Political Risk Assessment (IPRA)***

This research conceptualises IPRA as a bipolar continuum from 'less institutionalised' to 'more institutionalised'. Operationally, in order to establish a rank order of firms, a three-stage process was adopted based on the following indicators: a) responsibility assignment; b) frequency of conducting the assessment; and c) risk assessment techniques.

The allocation of responsibility for PRA is considered to be a minimum indicator of IPRA (Blank et al., 1980; Kobrin, 1982). Therefore, in the first stage, respondents were asked to choose between three levels of responsibility assignment: (a) no formal assignment of responsibility for an individual(s) for PRA *nor* any effort made by any individual in the firm to do so; (b) no formal responsibility for an individual *but* related activities are conducted by various individuals; (c) the firm assigns formal responsibility for an individual(s) to evaluate the potential risks associated with the firm's international business activities. Firms in each response category were coded 'not institutionalised', 'less institutionalised' and 'more institutionalised' respectively.

The allocation of firms on the basis the assignment of responsibility is shown in Figure 4.

Classification	Valid N = 43 firms	
	Number of firms	Percentage
Non-institutionalised	5	11.6
Less institutionalised	23	53.5
More institutionalised	15	34.9
Total	43	100

**Figure 4:** Risk assessment responsibilities within Jordanian firms

**Source:** Analysis of questionnaire data.

In the second stage, firms in the categories 'less-institutionalised' and 'more institutionalised' were ordered independently on the basis of the frequency of conducting the assessment process. (The 'non-institutionalised' category could not be ordered using either this indicator or the third indicator as, by definition, these firms are not involved in such practices.) Firms were asked how frequently they conducted political risk assessment. The response categories were: never, occasionally, yearly, quarterly and day-to-day. The more frequently firms conducted assessment, the greater the degree of IPRA and the less frequently assessment was conducted, the lower the degree of IRPA.

In the third stage, respondents were asked to identify which PRA techniques their firms used from a literature-derived list (judgement and intuition of manger, expert opinion, Delphi technique, standardised checklist, scenario development and quantitative techniques). Firms that used both qualitative and quantitative techniques were rated as more institutionalised than those firms which used qualitative techniques alone. The use of these techniques was then used to order the firms within the groupings identified in stage 2.

Using the procedures described above, a rank order of firms was generated which placed them on a continuum of IRPA from 'less institutionalised' to 'more institutionalised'.

## 6. Statistical analysis

Analysis of the outputs of a Normal Quantiles-Quantiles chart in the current sample demonstrated

that certain variables were not normally distributed. As normally distributed data are one of the basic underlying assumptions for the use of parametric statistics (Field, 2000), it was not appropriate to use parametric statistics. The decision was made therefore to use more conservative non-parametric statistics. Non-parametric statistics are less powerful than their parametric counterparts in that if there is a significant effect in data, then a parametric test is more likely to detect it than a non-parametric one. There is therefore an increased chance of a Type II error (i.e. accepting the null hypothesis when the alternate hypothesis is true). Nonetheless, employing non-parametric statistics with valid assumptions is methodologically ‘safer’ than employing ‘robust’ statistics with invalid or violated assumptions (Hollander and Wolfe, 1999). Furthermore, the ‘robustness’ of using a particular statistic lies in whether or not a statistic’s assumptions are met; if so, the statistic yields generally valid results (Leedy and Ormrod, 2001).

### 3. RESULTS AND ANALYSIS

#### 1. Determinants of Institutionalisation

The output of a Kruskal-Wallis test indicated a statistically significant difference in the level of institutionalisation across the three categories of a firm’s total assets ( $X^2 = 6.221$ ,  $p < 0.05$ ) (Figure 5). Accordingly, the hypothesis of statistically significant differences in the level of institutionalisation across the ASSETS categories was accepted. An inspection of the mean rank for the ASSETS categories indicates that larger firms had the highest institutionalisation scores, with the smaller category reporting the lowest (mean rank 28.29 versus mean rank 16.57).

ASSETS			Mean rank	Kruskal-Wallis test
Categories	N	Total assets		valid N = 43 firms
		a		
Small	14	? 17.3	16.57	$X^2 = 6.221$
				$p = 0.045$
				(df = 2)
Medium	15	17.4 – 45.6	21.20	
Large	14	? 45.7	28.29	

**Figure 5:** A firm’s total assets and the level of institutionalisation

**Note a:** Total assets in US \$ million.

• **Analysis of questionnaire data.**

With regard to the second measure of size, EMPLOY, the output of a Kruskal-Wallis test indicated no statistically significant difference in the level of institutionalisation across the three categories of a firm’s number of employees: EMPLOY ( $X^2 = 1.868$ ,  $p > 0.05$ ) (Figure 6). Thus, the hypothesis of statistically significant differences across the EMPLOY categories was rejected.

EMPLOY	Mean rank	Kruskal-Wallis test
		valid N = 43 firms



Categories	N	Number of employees		
Small	9	? 186	17.00	$X^2 = 1.868$ $p = 0.393$ (df = 2)
Medium	15	187 - 312	22.77	
Large	19	? 313	23.76	

**Figure 6:** A firm's number of employees and the level of institutionalisation

- **Analysis of questionnaire data.**

The output of a Kruskal-Wallis test indicated no statistically significant difference in the level of institutionalisation across the three categories of a firm's international experience ( $X^2 = 3.067$ ,  $p > 0.05$ ) (Figure 7). Thus, the hypothesis of a statistically significant difference across the YEARS categories was rejected.

YEARS			Mean rank	Kruskal-Wallis test
				valid N = 43 firms
Categories	N	Number of years		
Low	15	? 10	17.87	$X^2 = 3.067$
				$p = 0.216$
				(df = 2)
Medium	17	11 - 25	22.79	
High	11	? 26	26.41	

**Figure 7:** A firm's number of years in international business activities and the level of institutionalisation

• **Analysis of questionnaire data.**

There was a statistically significant difference in the level of institutionalisation across the three categories of a firm's international revenue: REVENUE ( $X^2 = 9.183$ ,  $p < 0.05$ ) (Figure 8). An inspection of the mean rank for the REVENUE categories indicates that high-internationalised firms had the highest institutionalisation scores, with the lower category reporting the lowest (mean rank 27.97 versus 15.06). Consequently, the hypothesis of statistically significant differences across the REVENUE categories was accepted.

REVENUE			Mean ranks	Kruskal-Wallis test
				valid N = 43 firms
Categories	N	Classification		
Low	17	? 10 %	15.06	$X^2 = 9.183$
				$p = 0.010$
				(df = 2)
Medium	10	11 % - 25 %	24.25	
High	16	? 26 %	27.97	

**Figure 8:** A firm's international revenue and the level of institutionalisation

**Note b:** The percentage of revenue generated by international business activities.

• **Analysis of questionnaire data.**

In the case of the third measure of internationalisation, there was a statistically significant difference in the level of institutionalisation across the three categories of a firm's number of interested countries: COUNTRY ( $X^2 = 15.302$ ,  $p < 0.01$ ) (Figure 9). An inspection of the mean rank for the COUNTRY categories indicates that high-internationalised firms had the highest institutionalisation scores, with the lower category reporting the lowest (mean ranks 31.96 versus 14.90). Consequently, the hypothesis of a statistically significant difference in the ordinal

institutionalisation variable across the three COUNTRY categories was accepted.

COUNTRY			Mean ranks	Kruskal-Wallis test
Categories	N	Number of countries c		valid N = 43 firms
Low	20	? 5	14.90	X <sup>2</sup> = 15.302 p = 0.01 (df = 2)
Medium	9	6 - 10	22.28	
High	14	? 11	31.96	

**Figure 9:** A firm's number of countries and the level of institutionalisation

**Note c:** Number of countries in which a firm operates.

• **Analysis of questionnaire data.**

High-internationalised firms, in terms of the number of operating countries, are more likely to institutionalise than medium-internationalised firms and medium-internationalised firms are more likely to institutionalise than low-internationalised firms. As none of the previous PRA empirical studies have related institutionalisation to a firm's number of operating countries, no comparisons with these findings can be made. Nevertheless, Hashmi and Baker (1988) and Pahud de Mortanges and Allers (1996) proposed that the more countries in which the firm operates, the more likely the firm is to face constraints as a consequence of political variables, and so pay more attention to risk assessment. This proposition seems to be the case in the context of Jordanian firms.

## 2. Correlation between determinants

Three out of five potential determinants of institutionalisation are significant: a firm's total assets in US \$ million (ASSETS), the number of countries in which a firm has facilities (COUNTRY) and a firm's revenue from international business activities (REVENUE). The rank order correlation coefficients (all variables were measured on an ordinal scale) between each of these determinants and the level of institutionalisation is shown in Figure 10. The outputs of the test revealed that COUNTRY was first (Kendall's Tau = 0.424, p < 0.01, 2-tailed), ASSETS was second (Kendall's Tau = 0.294, p < 0.01, 2-tailed), REVENUE was third (Kendall's Tau = 0.289, p < 0.05, 2-tailed). Neither YEARS and EMPLOY were significant.

Determinants	Kendall's Tau (2-tailed)		Valid N
	Coefficient	Significance	
COUNTRY	r = 0.424	0.01 (2-tailed)	43
ASSETS	r = 0.294	0.01 (2-tailed)	43
REVENUE	r = 0.289	0.05 (2-tailed)	43
EMPLOY	r = 0.278	Not significant (2-tailed)	43
YEARS	r = 0.206	Not significant (2-tailed)	43

**Figure 10:** Relative importance of determinants of institutionalisation (Kendall's Tau)

• **Analysis of questionnaire data.**

Figure 11 shows the inter-correlations between the significant determinants. There were significant positive correlations between the determinants, COUNTRY and ASSETS (Kendall's Tau = 0.231,  $p < 0.05$ , 2-tailed) and COUNTRY and REVENUE (Kendall's Tau = 0.252,  $p < 0.05$ , 2-tailed).

Determinants	Kendall's Tau (2-tailed)	
	ASSETS	REVENUE
ASSETS	–	$r = 0.127$ , $p = 0.249$
COUNTRY	$r = 0.231$ , $p = 0.034$	$r = 0.252$ , $p = 0.026$

**Figure 11:** Correlations among determinants

• **Analysis of questionnaire data.**

In order to test for a positive association between two variables and a third variable, Kendall's partial correlation coefficient was used. The first consideration is the relationship between the level of institutionalisation (INSTITUT) and the degree of internationalisation as measured via the two variables: COUNTRY and REVENUE. The correlation between COUNTRY and REVENUE was significant (Kendall's Tau = 0.252,  $p < 0.05$ , 2-tailed) and the correlations between COUNTRY and INSTITUT (Kendall's Tau = 0.424,  $p < 0.01$ , 2-tailed) and REVENUE and INSTITUT (Kendall's Tau = 0.289,  $p < 0.05$ , 2-tailed) were also significant. The correlation between INSTITUT and REVENUE, controlling for COUNTRY, was compared with the correlation between INSTITUT and COUNTRY, controlling for REVENUE (Figure 12). The Kendall's Tau for INSTITUT and REVENUE, fell to 28.0 percent of its value when controlling for COUNTRY (Kendall's Tau 0.289 versus Kendall's partial correlation 0.208). The degeneration of the correlation between INSTITUT and COUNTRY, on the other hand, was only 10.6 percent when controlling for REVENUE (Kendall's Tau 0.424 versus Kendall's partial correlation 0.379). Of the two measures of internationalisation, COUNTRY was the most important determinant of INSTITUT.

Kendall's Tau correlation between:	Value	Controlling for	Kendall's partial value	Degeneration in value %
INSTITUT and COUNTRY	$r = 0.424$	ASSETS	0.383	9.0
	$p < 0.01$	REVENUE	0.379	10.6
INSTITUT and REVENUE	$r = 0.289$	COUNTRY	0.208	28.0
	$p < 0.05$			
INSTITUT and ASSETS	$r = 0.294$	COUNTRY	0.222	24.4
	$p < 0.05$			

**Figure 12:** Correlations among the determinants of institutionalisation (Kendall's Partial correlation)

- **Analysis of questionnaire data.**

The second consideration is the correlation between COUNTRY, ASSETS and INSTITUT. As shown in Figure 11, the following variables are correlated significantly: COUNTRY and ASSETS (Kendall's Tau = 0.231,  $p < 0.05$ , 2-tailed); INSTITUT and COUNTRY (Kendall's Tau = 0.424,  $p < 0.01$ , 2-tailed); INSTITUT and ASSETS (Kendall's Tau = 0.294,  $p < 0.05$ , 2-tailed). The correlation between INSTITUT and ASSETS, controlling for COUNTRY, was compared with the correlation between INSTITUT and COUNTRY, controlling for ASSETS. The Kendall's Tau for INSTITUT and ASSETS fell to 24.4 percent of its value when controlling for COUNTRY (Kendall's Tau 0.294 versus Kendall's partial correlation 0.222). On the other hand, the degeneration of the correlation between INSTITUT and COUNTRY was only 9.0 percent when controlling for ASSETS (Kendall's Tau 0.424 versus Kendall's partial correlation 0.383). Therefore COUNTRY was the most important determinant of INSTITUT.

#### 4. DISCUSSION

The aim of this study was to contribute to the development of IPRA theory by examining and explaining IPRA in publicly quoted Jordanian companies. The study contributes to theory development in three areas: conceptual domain of IPRA; determinants of IPRA; and the relationship between the determinants of IPRA.

##### *Conceptual domain of IPRA*

The first contribution to the literature of this study is that it conceptualises and measures IPRA on the basis of three indicators (responsibility assignment, frequency of conducting assessments and risk assessment technique) rather than a single indicator. One advantage of this approach is that at the conceptual level it better captures the construct of IPRA by representing it as a continuum of arrangements within an organisation instead of a binary concept. This study places firms into a rank order and subsequently into ordinal groups. This has the further advantage that the IPRA construct can then be investigated statistically. Therefore, this work extends, in this context, the

work of earlier studies (e.g. Hashmi and Guvenli, 1992; Pahud de Mortanges and Allers, 1996).

### *Determinants of IPRA*

The second contribution of the study is to identify and investigate empirically determinants of institutionalisation by examining firm specific characteristics. A firm-specific characteristics framework is used to investigate two principal determinants of IPRA: size and degree of internationalisation. The study found support for the hypothesis that the size of the organisation is positively related to IPRA, when measured by the firm's total assets (ASSETS), but not by the firm's number of employees (EMPLOYEES). (The study did find however that the number of employees and its total assets are correlated). Therefore, in terms of total assets, larger firms are more likely to institutionalise their PRA than medium sized and smaller firms.

These findings support those of Stapenhurst (1992b) who found that larger firms tended to be more likely to have formal PRA units than smaller ones. Kobrin (1982, p22) argued that larger firms tend to use more 'complex structures' because they have greater resources to support such a structure. Stapenhurst (1992b) contended that the high initial and fixed costs of environmental scanning hindered the adoption of PRA. Likewise, Kettis (2004) explained the lack of systematic PRA in Swedish firms as being due to the cost of having 'in-house' PRA exceeding the benefits. There is a developing consensus in the literature therefore that it is primarily larger firms which have the resources and capabilities to embed the process of PRA within their structures.

The study also investigated the degree of internationalisation of PRA in the context of the Jordanian sample. Degree of internationalisation was measured by three indicators: number of years in international business (YEARS), revenue from international business (REVENUE) and number of countries in which the firm operates (COUNTRY). In line with the findings of Wyper (1995), in the context of UK firms, the number of years in international business was found to be not significant. It is arguable that it is the nature of international experience rather than the quantity of that experience which is important. (For example, ten years experience in the UK market before 2003 would be markedly different from one year's experience in the Iraqi market in 2003).

Statistical support was found however for the two other indicators of internationalisation. The level of revenue derived from international business (REVENUE) was positively related to IPRA suggesting that the higher the level of revenue generated by international business activities, the more likely the firm is to institutionalise its PRA. This finding in the Jordanian context is in line with the finding of Hashmi and Baker (1988) that US firms which generated more than 20% of their sales from international business activities were more likely to institutionalise their PRA than those with less than 20%.

Statistically significant differences in the level of institutionalisation were also found across the three categories of a firm's number of countries of operation (COUNTRY). This variable has not been studied previously and therefore no direct comparisons with earlier literature can be made. However, Hashmi and Baker (1988) and Pahud de Mortanges and Allers (1996) do propose that the more countries in which the firm operates, the more likely it is to face constraints as a consequence of political variables and so is more likely to pay attention to PRA. The number of countries in which a firm operates therefore increases its exposure to political risk and so it is more likely to pay attention to political risk (Hashmi and Baker, 1988; Howell, 2001; Stosberg,

2005).

Additionally, the greater the number of countries in which a firm operates in, the greater the complexity of the task of PRA. Alon et al. (2006) reinforce the point that each nation needs to be looked at as a unique operating environment and therefore merits its own individual analysis. Therefore, the increase in the number of countries in which the firm operates increases the complexity of PRA and *ad hoc* and informal assessment of political risk may become more difficult and unmanageable within the firm. In such circumstances, firms are more likely to embed structures and systems to assess political risk within the firm.

The investment destinations in this sample were predominantly other Arab countries. This might serve to increase the exposure of PRA for Jordanian international companies because the nature of hazards (e.g. terrorism, coup d'états, insurrection) have the potential to have extremely severe consequences. On the other hand, the relative geographic and cultural similarities between the countries in the region might in fact reduce complexity due to a shared understanding of political and economic contexts.

Although no direct comparisons can be made with other studies, it is useful to speculate whether the relationship between IPRA and internationalisation might be strengthened or lessened by the overall the Middle Eastern context of this study in comparison with other, say, Western environments.

#### *Relationship between determinants*

In addition to identifying the determinants of IPRA, this study also contributes to theory by establishing the relative importance of the determinants of IPRA. It was hypothesised that the size of the organisation would be the foremost determinant of IPRA. However, this hypothesis was not supported and the study revealed that in fact the number of countries (COUNTRY) in which a firm operated was the strongest determinant, followed by its total assets (ASSETS) and then the revenue derived from international business (REVENUE). Moreover, the study developed theoretical knowledge in the field by establishing that the determinants of IPRA were not independent.

## **6. CONCLUSIONS**

This paper offers some important insights into the institutionalisation of political risk assessment. In particular, it conceptualises and measures IPRA on the basis of three indicators, rather than just one. It also presents IPRA as a continuum of arrangements, rather than as a binary concept. It also uses a firm specific characteristics framework to investigate at two principal determinants of IPRA: size and degree of internationalisation. In addition, it contributes to knowledge by establishing the relative importance of the determinants of IPRA.

This study is the first to attempt to examine IPRA empirically in Jordan or indeed in any Middle East country. It is a region of growing economic and geo-political significance and therefore it is

important that the behaviour of firms in this region is better understood. Jordanian international firms, in line with the international business literature, have expanded into business environments which are culturally and geographically closest to their home country i.e. into other Middle East countries.

Although the research does fill some of the major theoretical gaps in the previous literature, there are limitations which arise from the sample size. The number of firms in the sample (n= 44) precludes further types of analysis (for example, a subdivision into industry classification). Secondly, the study uses non-parametric statistics rather than their more powerful parametric counterparts. If the sample size of Jordanian international firms had been larger, the use of parametric statistics would have been possible.

There remains a relatively limited amount of empirical work concerning IPRA in organisations and it is important to examine state-of-the-art political risks to determine where the field stands today and the trends which are emerging (Hood and Nawaz, 2004; Kettis, 2004). There is a need to undertake to develop a more robust theoretical understanding of the influences on the level of IPRA in firms. Further research might identify, for example, the differential impact of micro political risks on a firm's IPRA (Alon et al, 2006). It might also address cross-national designs. It is notable that the majority of studies, including this one, have been conducted in a single country context. Multi-country studies using a common methodology might help to explain cross-national differences within a firm-specific characteristics framework. In this context it would be interesting to investigate inward investment in Jordan by other Middle East firms.



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## Appendix A – Questionnaire items

### **Firm profile**

1. How much are the firms' total assets (in Jordanian Dinar) in the last fiscal year.
2. How many employees does your firm currently employ
3. How many years has your firm been involved in international business activities
4. In how many countries does your firm have facilities such as representative offices, subsidiaries, branches, affiliates, joint ventures and licensing / franchise agreements?
5. What percentage of the previous fiscal year's revenues was attributed to international business activities

### **Institutionalisation of political risk assessment**

6. In the process of analysing and evaluating the potential risks associated with the firms' international business activities such as importing and /or exporting goods and services and / or producing goods and services in countries other than Jordan, please tick the box that best describes your firm.
  - a) The firm has never assigned formal responsibility for an individual(s) to analyse and evaluate the potential risks associated with the firm's international business activities NOR is any effort made by any individual in the firm to do so.
  - b) The firm has never assigned formal responsibility for an individual(s) to analyse and evaluate the potential risks associated with the firm's international business activities BUT the related activities are conducted by various individuals.
  - c) The firm assigns formal responsibility for an individual(s) to analyse and evaluate the potential risks associated with the firm's international business activities.

(Respondents who did not tick a) above were not required to complete the remainder of the questionnaire.)

### **The practices of political risk assessment**

7. In conducting the process of political risk assessment, please tick the box that best describes your firm's behaviour (tick one box only).
  - a. The firm conducts such a process internally; using the firm's personnel only
  - b. The firm conducts such a process external; using external specialised institutions only
  - c. The firm conducts such a process internally as well as externally
8. How often is the process of political risk assessment conducted (Never, occasionally, yearly, quarterly, day to day)
9. In the process of conducting the political risk assessment, different risk assessment techniques are available for firms. Among the following, please indicate which technique(s) you use and to what extent such a technique(s) is/are successful in analysing risks (0 = not used, 1 = used with no success, 2= used with a moderate degree of success, 3 = used with a great deal of success).
  - a. Judgement and intuition of manager: conducting the assessment intuitively relying on the competence of the firm's manager(s)
  - b. Expert opinion: conducting the assessment by an outside consultant who is expert on a certain country or area.

- c. Delphi technique: conducting assessment by a group of experts, initially independently and subsequently by consensus
- d. Standardised checklist: systematically reviewing items in a list regarding political risks
- e. Scenario development: developing a number of possible scenarios for a certain country
- f. Quantitative techniques: assessing risk by any analytical procedure that is based on data that can theoretically lend itself to statistical or mathematical operations (e.g. regression analysis)

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[1] We are grateful to an anonymous referee for raising this point.