MANAGEMENT OF POLITICAL RISKS IN INTERNATIONAL BUSINESS AND POLITICAL RISK INSURANCE

ULUSLARARASI İŞLETMELERDE POLİTİK RİSKLERİN YÖNETİMİ VE POLİTİK RİSK SİGORTASI

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ABSTRACT

Political risk is the sum of the economic losses that businesses may suffer as a result of the ineffectiveness or influence of public authorities. It is the most important risk that international businesses may face abroad. Since international businesses do not operate in only one country, they may be exposed to varying degrees of political risk through the approaches of various governments. The presence of political risks stands as the biggest obstacle to foreign investments of enterprises. One of the arguments used for the management and minimization of political risks is political risk insurance. Political risk insurance is a type of insurance that businesses take out in order to secure risks such as changes in the political order in the foreign country where trade or investment is made, political instability or crises. Companies and distributors doing contracting works abroad also prefer this insurance. In recent years, political risk insurance has emerged as the most preferred type of insurance in Turkey in order to secure the investments of contractors, trade and industrial organizations abroad in terms of political risk and to prevent damage to export and import agreements. With this insurance, war and political violence, expropriation, breach of contract, transfer restrictions etc. risks can be covered under insurance. The providers of this insurance are not only private insurance companies, but also reinsurers, export credit institutions and insurance providers in international organizations.

In this study; The management of political risks in international businesses, the general conditions of the political risk insurance, which is put into practice under the name of Single Risk Insurance against political and commercial risks, the direction of implementation and the latest developments are discussed.

KeyWords: *Multinational Business, Political Risk, Single Risk Insurance, Political Risk Insurance*

ÖZET

Politik risk, kamu otoritelerinin etkisizliği yada etkisi neticesinde işletmelerin uğrayabilecekleri ekonomik kayıpların toplamıdır. Uluslararası işletmelerin yurt dışında karşılaşabileceği risklerin en önemlisidir. Uluslararası işletmeler sadece bir ülkede faaliyet göstermedikleri için çeşitli hükümetlerin yaklaşımlarıyla muhtelif derecelerde politik riske maruz kalabilmektedirler. Politik risklerin varlığı işletmelerin yurtdışı yatırımlarının önünde en büyük engel olarak durmaktadır. Politik risklerin yönetimi ve riskin en aza indirilmesi konusunda kullanılan argümanlardan bir tanesi de politik risk sigortasıdır. Politik risk sigortası ticaret yada yatırım yapılan yabancı ülkedeki politik düzenin değişmesi, politik istikrarsızlık yada krizler gibi riskleri güvence altına almak amacıyla işletmelerin yaptırdıkları sigorta türüdür. Yurtdışında müteahhitlik işleri yapan firmalar, distribütörler de bu sigortayı tercih etmektedirler. Türkiye'de müteahhitlerin, ticaret ve sanayi kuruluşlarının yurtdışındaki yatırımlarını politik risk açısından güvence altına almak, ihracat ve ithalat anlaşmalarının zarar görmesini engellemek amacıyla son yıllarda politik risk sigortaları en fazla tercih edilen bir sigorta türü olarak karşımıza çıkmaktadır. Bu sigorta ile, savaş ve politik şiddet, kamulaştırma, sözleşme ihlali, transfer kısıtlamaları vb. riskler sigorta kapsamında teminat altına alınabilmektedir. Bu sigortanın sağlayıcıları yalnızca özel sigorta şirketleri değil aynı zamanda reasürörler, ihracat kredi kuruluşları ve uluslararası kuruluşlarda sigorta sağlayıcıları arasında yer almaktadır.

Bu çalışmada; Uluslararası işletmelerde politik risklerin yönetimi, politik ve ticari risklere karşı Tek Risk Sigortası adı altında uygulamaya konulan politik risk sigortasının genel şartları, uygulama yönü ve son gelişmeler ele alınmıştır.

Anahtar Kelimeler: *Çokuluslu İşletme, Politik Risk, Tek Risk Sigortası, Politik Risk Sigortası*

1. INTRODUCTION

Political risk has started to have a significant impact on companies in the internationalization phase. In particular, companies operating in the international arena carry out transactions in many different countries and as a result, they enter into relations with many different governments. Governments are like the governing bodies that run a country, and they have legal power. This results in companies having good relations with governments. Although in good relations, businesses often face some political difficulties. Being able to foresee such difficulties provides very important advantages for companies that make international transactions. The existence of such risks brings with it the result of pre-examination of them. This assignment includes political risk and international agreements (World Bank, 2011).

Companies go through the process of internationalization in order to gain competitive advantage and increase their profitability, ensure stability and gain a strong place in international economic integration. In addition to these advantages, multinational companies face some dangers in the international arena: legal, ethical, cultural, political, etc. that may occur in the country of investment. Disputes that may arise due to reasons are some of them. Companies have to take some precautions and use tactics in order to deal with such risks, which are generally gathered under the name of Political Risk and arising from international trade, and to suffer minimum damage (Kim, 2017).

Political cooperation between the countries is one of the most important factors that make it possible for their businesses to internationalize and carry out their foreign activities in a stable manner. The organizations to which the countries are affiliated and the international agreements they are involved in play an important role in opening the way for the enterprises of that country to international business. Political instability, import bans, customs duties, quotas and embargoes in the country of investment create a politically unsafe and high-risk environment (World Bank, 2011).

Political risk in international management is the limitation of foreign investment by multinational companies by the policies of the host country. Political risk is usually defined by developments such as elections, government changes, tax changes, strikes, legal regulations, public demonstrations, and structural collapses. Violent political activities, e.g. Terrorism, kidnapping, military coup, ethnic and racial wars, civil war are some of the events that create political risk.

When multinational enterprises invest in a country, they have to examine the environmental conditions of that country. This is because; to enable them to make correct predictions and decisions on issues such as political situation, competition, technological development level, socio-cultural changes, and to provide correct approaches to issues including long-term plans based on this information.

2.CONCEPTUAL FRAMEWORK

Political risks at country level The following elements should be questioned in the assessment of political risks at country level in terms of economic, political and legal system (Betz, 2019).

- The general attitude of the government/opposition to foreign investment,
- The relationship between the investor's home country and the host country (such as unresolved disputes),
- Legal protection assurance of investment within the scope of domestic law,
- Existence of an investment protection agreement with the host country,
- Institutional continuity, especially the openness of the relationship between the executive, the legislature and the judiciary (separation of powers) (Kim, 2017),
- Representability, voice of non-governmental organizations within the political system,
- Political and economic instability,
- Currency control regime,
- Liquidity situation, balance of payments, foreign exchange reserves,

• The degree to which the country's reserves can meet the debt service,

• Transfer and convertibility experience,

• Possibility of armed conflict with another country, current insurrection, revolution or violence,

• The existence of tensions that could erupt as politically motivated acts of violence.

Political risks at the project level Despite being in the same country, the various characteristics of the projects can create differences in the political risk factors to which they may be exposed and the probability of being affected by them. Some of the project-based risk assessment criteria are as follows (Ross, 2012).

• Sector (especially oil and gas, mining, utilities, other national resources), the importance of the sector for the host country's economy and the scale of the sector in the host economy,

• The degree of competition in the host country's economy,

• Contribution to the host's economy, especially import substitution and production of export revenues,

• Economic viability of the project and foreign exchange earnings,

• Adherence to trade restrictions or incentives,

• Subject to host country legislation in terms of capital market legislation and labor legislation, environmental protection, tax regime, performance requirements, import and export quotas, price controls,

• Ownership and control, especially if in a joint venture;

• Amount of expected transfers and schedule of work (eg earnings estimates, reimbursement schedule),

• Existing agreements with the host country on the accumulation of export revenues in offshore accounts and the use of offshore accounts,

• The importance of the investment project for the host country,

Presence of shareholders, local partners and long-term creditors, primarily domestic public institutions, export credit institutions and international institutions (Betz, 2019),

• Financial profitability ratio and foreign exchange earning potential,

• Strategic importance for both the host country and potential competitors, Geographical location in terms of hostilities,

• Visibility as a project belonging to foreigners,

• Safety arrangements in place.

The increase in political risk has various effects on a country and the companies operating within its borders. While the most noticeable effect is the fall in stock prices, many countries facing higher political risk factors are experiencing reductions in foreign direct investment (FDI), which can lead to instability.

A reduction in FDI can lead to slower economic growth overall and potential social problems. Social problems such as wage differentials, inequality and corruption can devalue international stocks.

These issues can affect other asset classes as well. For example, sudden slowing economic growth can affect a country's or company's ability to pay its debts, which in turn can affect bond markets.

Slower economic growth or a crisis can also lead to problems with the currency. A decline in the value of a country's currency can, in turn, lead to slower exports and reduced economic growth.

The first step in managing political risk is to understand that these risks are often worth taking in order to maintain a diversified portfolio. Even if you keep all your investments in the US, you are still subject to decisions made in Washington DC.

Investors should maintain a diversified portfolio to avoid any specific political risks that significantly affect the overall portfolio. Diversification should include the hedging inherent in international investments.

International investors can manage risk by protecting their portfolios against future problems. For example, an investor who senses problems arising in Brazil may decide to buy put options (a put option at a set price) on the iShares MSCI Brazil Index ETF (NYSE Arca: EWZ). If your put option is placed at the correct value, you can significantly reduce your losses if the index falls or makes gains elsewhere in your portfolio (Pond, 2018).

3.MANAGING POLITICAL RISKS AND POLITICAL RISK INSURANCE

The existence of political risks is defined as one of the most important obstacles to investment and project development abroad for many organizations. The increase in direct capital investments and exports to abroad and especially to developing countries increases the importance of the correct management of risks both for the company and for our macroeconomic balances. There is not much they can do to manage the general political risk environment (war, turmoil, economic instability, etc.) on a country basis. On the other hand, governments of investing countries and host countries also support investor companies in preparing the legal infrastructure for international arbitration by signing bilateral agreements for the resolution of possible disputes. The existence of bilateral agreements is an important element for providing collateral and pricing (Wilson and Wright 2017).

Political risk can be defined as the prevention or damage to the activities of companies with international activities due to reasons beyond the control of the company, originating from the country in which they do business abroad, their own country or a third country. These are subjects that may be exposed to political risks such as export/import contracts, contracting projects, foreign investments, machinery and equipment, letters of guarantee, supply chain, loans, war, political violence, expropriation, contract violations (Ross, 2012).

Political risk insurance is an important risk transfer tool. Provides longer-term financing on better terms. They provide financial institutions with flexibility in terms of country limits and an important support in risk management. It helps in resolving disputes.

Investors: Companies that make partnerships or direct investments in a foreign country, bring capital, produce products or services. Companies that carry out construction, assembly, projects in a foreign country: Non-permanent companies returning from the country concerned with the completion of the construction, manufacturing, assembly operations with their own employees and/or employees and personnel supplied from the relevant country in foreign countries (Pond, 2018).

Exporters and importers: Companies that sell from their own country to a foreign country, have a credit risk, or have a risk of purchasing goods from a foreign country to their own country.

Financial institutions: Institutions engaged in foreign trade finance, project finance, structured trade finance and banks with branches abroad.

Political risk insurance includes a significant portion of risks other than commercial risks. It covers the uncompensated losses incurred by the investment, project or trade through the direct or indirect actions of the governments of the countries of investment and trade. Under the umbrella of political risk insurance, sub-insurance products of expropriation, transfer restrictions, breach of contract and political violence are generally offered. These guarantees can be taken individually or, if desired, in the form of packaging of two or more risks. Some markets may present the risk of receivables from the public and the risks of unfair recall of letters of guarantee under the political risk umbrella (Wilson and Wright 2017).

Risks that you can cover with political risk insurance:

Equal acts such as civil war, sabotage and destruction between states or within states,

Legislation is not impartial,

Changes in domestic legislation,

Privatization or expropriation,

Cancellation of the license

Contracts not being approved by the state,

Changing the political regime

change of government,

Changes made within the scope of tax laws,

Experiencing some problems in the supply of raw materials due to embargo or war.

CONCLUSION

The existence of political risks makes investment abroad for many organizations.

and it is defined as one of the most important obstacles in front of project development.

direct foreign exchange, especially to developing countries.

increase in capital investments and exports

increases the importance of management in terms of both the firm and our macroeconomic balances.

For the projects of companies active in foreign investment and trade

in the management of risks;

• Detailed analysis (due diligence) with internal and advisory organizations,

• Relationship management (with local governments, non-governmental organizations)

relationship development)

• Partnerships with local well-known companies,

• Outsourced financing from local banks.

to balance,

• Risk transfer (political risk insurance, cds credit default swap),

use methods such as Managing the general political risk environment (war, turmoil, economic instability, etc.) on a country basis

There is not much they can do about it.

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