University of Huddersfield Repository

Al Khattab, Adel, Anchor, J.R and Davies, Eleanor M.M.

Managerial perceptions of political risk in international projects

Original Citation


This version is available at http://eprints.hud.ac.uk/3837/

The University Repository is a digital collection of the research output of the University, available on Open Access. Copyright and Moral Rights for the items on this site are retained by the individual author and/or other copyright owners. Users may access full items free of charge; copies of full text items generally can be reproduced, displayed or performed and given to third parties in any format or medium for personal research or study, educational or not-for-profit purposes without prior permission or charge, provided:

- The authors, title and full bibliographic details is credited in any copy;
- A hyperlink and/or URL is included for the original metadata page; and
- The content is not changed in any way.

For more information, including our policy and submission procedure, please contact the Repository Team at: E.mailbox@hud.ac.uk.

http://eprints.hud.ac.uk/
MANAGERIAL PERCEPTIONS OF POLITICAL RISK IN INTERNATIONAL PROJECTS

Adel Al Khattab
Al-Hussain Bin Talal University, College of Business School, Department of Business,
PO Box 260, Ma’an, Jordan
Tel: +962 3 213 2324
adel.alkhattab@yahoo.co.uk

John Anchor
Huddersfield University Business School,
Queensgate, Huddersfield, HD1 3DH, United Kingdom
Tel: +44 (0) 1484 472462. Fax: +44 (0) 1484 473148
j.r.anchor@hud.ac.uk

Eleanor Davies
Huddersfield University Business School,
Queensgate, Huddersfield, HD1 3DH, United Kingdom
Tel: +44 (0) 1484 472121. Fax: +44 (0) 1484 473148
e.davies@hud.ac.uk

MANAGERIAL PERCEPTIONS OF POLITICAL RISK IN INTERNATIONAL PROJECTS

ABSTRACT

This paper examines the vulnerability of international projects to political risks. A brief review of the literature on general risks – natural, financial, cultural and political – is undertaken and then a more detailed review of the literature on political risk is presented. It was found that relatively few studies of political risk, particularly in the context of international projects, have been carried out. More particularly the focus has been almost exclusively on developed, rather than developing, countries.

Questionnaires were distributed therefore to the entire target population of Jordanian international projects. The findings suggest that the political risk associated with international projects poses a threat to the majority of respondents and that the vulnerability to political risk is related to a firm’s
degree of internationalisation. International projects are more concerned about host-society and interstate related risks than host-government related risks.

**Keywords:** Political risk, managerial perceptions, developing countries, firm-specific characteristics.
INTRODUCTION

The aims of this paper are a) to describe and explain the political risks that concern the managers of international projects who are operating within an international business environment and b) to explore the correlations between those managerial perceptions of political risks and various firm-specific characteristics. The specific context is international business projects operating in Jordan in 2005.

Despite the fact that political risk studies are “more relevant than ever” [31, p. 2], there has been relatively little effort made to investigate this topic, in particular in developing countries, including Jordan. Political risk literature, consists of conceptual discussion [25] and [8] and empirical research which is concerned inter alia, with identifying the managerial perceptions of political risk in different contexts [40], [22], [53], [17], [24] and [31]. Most of these theoretical and empirical studies, however, were carried out in the context of developed countries and offer little by way of analysis of the concept in developing countries.

An in-depth review of such literature suggests that few studies have related the managerial perceptions of risk to firm-specific characteristics. Consequently, the aims of this paper are: a) to describe and explain the political risks that concern the managers of Jordanian international projects while undertaking international business activities and b) to explore the correlations between the managerial perceptions of political risks and firm-specific characteristics.
LITERATURE REVIEW

Risk Defined

There is, according to Rockett [41], no single accepted or correct definition of risk and there are as many definitions of risk as there are people capable of defining it. Risk, moreover, is usually misunderstood and used interchangeably with other related terms such as harm, hazard, threat and uncertainty.

Risk can be seen as a combination of the probability that an event will occur and its consequences. Risk may result in losses or gains and may affect all forms in a class or particular firms. If risk results in gains (eg taxation), the risk is uninsurable and if risk affects all forms (eg interest rate changes) the risk is undiversifiable.

General Risks in International Business

A review of a wide range of literature on risk serves to categorise risks that face international business and identify the specific components included in each category. However, there is, according to Nawaz and Hood [35], no universally accepted typology for categorising risks in international business. A number of such studies, as illustrated in Table 1, have reported a number of different components. Miller [35] argued that international firms are exposed to five types of international risk: natural, legal, societal, political and governmental. Daniell [16] confined such risk to four components: financial, cultural, legal and political. Similar components were reported by Hill [23], excluding financial risk.
Political risk in its wider context, contains societal and legal risks. Therefore, the classification of general types of risks in international business, as shown in Figure 1, is reduced to four main types: political, financial, cultural and natural. The rationale of this division is a need to examine what general types of risk concern Jordanian international firms. The division of risks into four types does not mean that this typology is exhaustive nor are the components of each category.

Figure 1: Classification of General Types of Risks in International Business

Political Risk Defined

Throughout the literature there is little consensus on a ‘clear-cut’ definition of political risk [51]; [18]. The concept of political risk seems to have plagued both academicians and corporate decision-makers due to its nature, as political risk is subjective and hard to quantify [1]. Wilkin and Zonis [51] explained that the challenge of identifying political risk lies partly in the diversity of risks covered by the term, which covers a variety of threats, with impacts that vary according to a firm’s specific exposure. Like Burmester [11], Wilkin and Zonis [51, p. 6] continued that this diversity of risks and their effects mean that “operationally political risk carries very different connotations for different firms” and all too often for different people within the same firm.

In business terms, however, the general body of the literature which is concerned with political risk definitions can be divided into two main approaches. The first and most common approach defines political risk in terms of government interference with business operations [12], [10] and [14]. Butler and Joaquin [12] defined the term as the risk that a sovereign host government will unexpectedly change the ‘rules of the game’ under which a business operates. This approach to defining political risk emphasises governmental action(s), such as ‘forced divestment’ as a sole source of risk. This emphasis [38], may be far too narrow for the complexities of modern international business. Moreover, risk not only contains negative but also positive variations [24]; [45].

Political risk, as suggested by Brink [8] and Stosberg [44], arises not only from governmental, but also societal, sources. The second approach, therefore, defines political risk as occurrences of any political or societal events imposed upon the international project, as implied or explicitly stated by Howell [25] and Zarkada-Fraser and Fraser [54]. Howell’s [25, p.4] definition is representative for this approach who referred the term political risk to 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. Despite the fact that the second approach takes societal events into account, it is not clear exactly what risk elements are included or excluded. The next section, therefore, attempts to identify such elements.

Classification of Political Risk

International projects can be harmed by a variety of political and societal events (threats). In focusing on political risk, as defined by Howell [25], there is a need to identify and classify the categories of such risk. Examples of political risks under the first approach include: expropriation; inconvertibility; import and/or export restrictions; ownership and/or personnel restrictions; taxation restrictions, while political risks under the second approach include: terrorism, riots, coups d’état, war, insurrection, kidnapping. It is also useful to classify political risks from the perspective of political risk insurance agencies since such agencies provide lists of potential losses to international projects that stem from political and societal sources and not commercial ones. Typically, political risk insurance, as reported by Bradford [8], covers assets against expropriation, confiscation, contract repudiation and currency inconvertibility. Although many types of political risk can be insured through private insurers, some losses that stem from political sources cannot. Reviewing some main political risk insurers revealed that ownership restrictions and taxation, for example, are not among their lists of possible insured sources of loss. Furthermore, Howell [25] suggested other types of uninsured losses that result from government attributes (rather than decisions) like racial quotas in the hiring of personnel.

As has been noted, political risk can be classified as: a) governmental, such as import restrictions, or societal such as demonstrations, riots and insurrection; b) intrastate, such as expropriation or interstate, such as war; c) insurable such as expropriation or uninsurable such as taxation. Classifying political risks according to one of the aforementioned categories does not encompass all aspects of the risks to international business that are contained in its political environment. Furthermore, some events can be classified into two categories such as expropriation, which can be governmental, and insurable. Political risk, meanwhile, a) should encompass all political and societal events that can harm international projects, internal or external, insurable or uninsurable and favourable or unfavourable [50]; [8]; b) should not focus exclusively on the most extreme forms of political risk, such as forced divestment; rather it should include the more common, but milder risks, such as imposition quotas [38]. Arguably, then, the best approach to understanding the concept of political risk is to classify such events according to their sources. Such a classification, as outlined in Table 1, introduces three main categories of the sources of political and societal events: host-government risks, host-society risks and interstate risks. Applying the source of threats approach to classifying political risk has resulted in a mutually exclusive list of political risks covered by this paper.

These three risk categories will now be discussed in more detail. The coverage of the three categories is not even, due to the differing number of risks in each category.

<table>
<thead>
<tr>
<th>Source of threat</th>
<th>Threats (source of harm)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Host government</td>
<td>Expropriation and/or confiscation</td>
</tr>
<tr>
<td></td>
<td>Contract repudiation</td>
</tr>
<tr>
<td>Host society</td>
<td>Terrorism</td>
</tr>
<tr>
<td>--------------------</td>
<td>-------------------------------</td>
</tr>
<tr>
<td></td>
<td>Demonstrations, riots and insurrection</td>
</tr>
<tr>
<td></td>
<td>Revolutions, coups d'état and civil wars</td>
</tr>
<tr>
<td>Interstate</td>
<td>Wars</td>
</tr>
<tr>
<td></td>
<td>Economic sanctions</td>
</tr>
</tbody>
</table>
**Host-Government Risk**

Governments, according to Burmester [11], are extremely influential actors in international business. A government has a variety of interests and may pursue a course of action that affects the business environment for good or bad. The government of a country, on the one hand, is usually keen to encourage the development and growth of commerce and industry [14], [36]. The government, as a result, might offer incentives to encourage new investment from abroad, for example by offering tax incentives or cash grants towards the building of factories. To the host government, as explained by Brink [8], international projects can represent an important source of funds, technology and expertise that could help further national priorities such as regional development, employment, import substitution and export promotion. The government of a country, on the other hand, may also intervene in the business environment for a variety of reasons. Such reasons include: protecting national industries from external competition; limiting foreign exploitation; increasing national welfare; redistributing wealth [2] and [36].

There are six types of such actions a host government can pursue: taxation restrictions; currency inconvertibility; contract repudiation; import and/or export restrictions; ownership and/or personnel restrictions; expropriation and/or confiscation, and industrial espionage. These risks are called host-government, since they are originated by host governments and can have unfavourable consequences upon international projects undertaking any form of international business activities in a country’s soil. Oetzel [39], nevertheless, argued that a host-government’s policy priorities are changing, particularly the policies which favour some industries over others. A firm’s political risk is not only different from firm to firm but also varies over time. By way of illustration, Oetzel [39] suggested that foreign firms operating in industries outside of those targeted by the host country will face significantly greater political risk in the short term than firms operating within industries targeted by the host country.

As has been noted, there are seven types of host-government risks. The first risk is that of taxation restrictions. Brink [8] suggested that higher taxes on corporate profits in developing countries restrict profit-making. Taxation can also be used either to encourage or restrict particular industries or nationalities. In the event of imposing taxation restrictions, a firm’s expenditure increases and, as a consequence, its profits decrease. However, as a result of the importance of foreign investment to a country’s economic growth, a government may encourage inward investment by, inter alia, offering tax incentives [14] rather than imposing tax restrictions. The importance of foreign investment to a country’s economic growth may, therefore, explain the little attention paid to taxation restrictions by international projects, while operating internationally [40]; [22]; [45] and [17].

The second risk is that of currency inconvertibility. A government, when it experiences shortages of hard currencies, may take such actions. International projects, as a consequence, can be negatively affected by such restrictions taken by the government to prevent conversion of local currency to some form of foreign exchange (exchange control) and/or prevent the transforming of ‘hard’ currency out of the host country (transfer risk). Nonetheless, in recent years, as suggested by Hussey [27], there has been a gradual movement towards dismantling exchange controls by many countries. In Jordan, currency exchange control has been liberalised and repatriation of profits and capital has been authorised. In spite of this gradual movement towards dismantling exchange controls, Stosberg [44] proposed that some international projects still feel that they are
vulnerable to such risk while operating in developing countries. Empirically, a political risk study [24] in the context of UK firms found that most respondents perceived ‘currency or trade controls’ as a potential problem while conducting international business activities.

The third risk is that of contract repudiation (sometimes called a breach of contract). A government may terminate contracts without compensation for existing investment for reasons related to contract performance. Since such risk can have devastating impact upon firms, the breach of contract, according to Moran [37], is considered as an important risk of concern to international projects. In this context, firms with large fixed assets are more vulnerable to such risk and still ‘worry’ about the terms of their operating agreements being changed [31].

The fourth risk is that of import and/or export restrictions. A government can impose import restrictions for balance-of-payments reasons, to reduce spending on imports [4], or for industrial policy reasons; to protect domestic producers of import substitutes [30]. In the event of imposing import restrictions, international projects, inter alia, will not be able to obtain some material (e.g. chemical substances, spare parts, drugs) so this will impact on their sales and profits. A government may also restrict the export of raw materials to encourage the growth of domestic processing industries. Nevertheless, export controls can have a negative impact upon both a host country and international projects operating in the host country. For the host country, export restrictions have an immediate adverse effect on a country’s balance of trade while international businesses will not be able to export goods which, in turn, affect their profits. The adverse effect of such restrictions on a country’s balance of trade may explain why international businesses were not concerned with this risk while operating internationally [40]; [22]; [45].

The fifth risk is that of ownership and/or personnel restrictions. These restrictions arise when a host government demands that: a) government entities, or local nationals, own part of the international projects operating on a country’s soil, and/or b) that local nationals, regardless of experience, be hired in such firms [8]. This risk is considered to be particularly problematic because, such restrictions threaten the ability of the firm to make its own strategic decisions and frequently have a direct impact on revenue [30]. International investors, according to Brink [8], may agree upon such actions by host governments in turn for expeditious government approval of their operations. Such governmental interference, however, aims to increase the proportion of locals in the management functions of the international projects in the host country. The interference, nevertheless, can have adverse impact upon the host-government’s business environment, which can explain the little attention paid to such risk in both theoretical and empirical political risk studies [40], [17]. Other studies [45] and [31] did not even include this variable as a risk for international projects.

The sixth risk in the host government category is expropriation and/or confiscation. Expropriation, according to Howell [25], is the seizure of an investment by host government. Although the International Law recognises the sovereign right of any country to expropriate foreign investment, this can only be enacted if such an action is lawfully compensated [8]. In an extreme situation, outright nationalisation or confiscation without compensation might occur. A government may expropriate investments, however, to prevent the exploitation of the country by international projects [14]. Accordingly, exploitation firms which have large fixed assets exposure and have more capabilities to exploit a host country, such as oil firms, are more vulnerable to expropriation than firms that have minimal asset exposure [44] such as service firms. Indeed, in a study of
political risk exposure within UK firms, Hood and Nawaz [24] found that the only respondent who believed that expropriation was a high risk was from an oil firm. Wilkin [50] proposed that ‘low’ technology industries face higher risks than ‘high’ technology industries. Moran [37] explained that ‘high’ technology industries, such as aerospace or electrical are less vulnerable to expropriation since a host country needs the technology and skills that such firms provide. If a host government expropriates a high technology industry, the government and local firms will, inter alia, no longer have access to sophisticated technology.

A review of the cases of expropriation in the context of the Middle East revealed that most of the expropriation cases targeted oil firms. Although such risk can have a devastating impact upon firms, the negative impact upon a host country is thought to be higher. Therefore, a host country, as suggested by Hood and Nawaz [24], may not resort to such seizure nowadays due to the unfavourable situation that such an action may create for that country in the long term. According to Hood and Nawaz [24] the unfavourable situation could be in the form of international economic isolation and cessation of support from the International Monetary Fund and the World Bank, which may also mean an unfavourable business environment for that country. Despite this argument, Burmester [11] insisted that expropriation is still a potential risk for international projects. Minor [36] reiterated this proposition explaining that prior to the 1980s, nearly two thousands expropriation occurred around the globe and the 1980s produced at least as many expropriation claims for insurers as the previous decade did.
**Host-Society Risk**

Despite the risks posed by host governments which, according to Burmester [11], exemplify political risk at its extreme; political risk implicates many other actors in the immediate and global non-market environments of the international business project. Political risk, as suggested by Brink [8], arises from both political and societal sources. Iankova and Katz [28] defined societal risk as risk arising from political actions of non-governmental organisations which include revolutions, coups d’état and civil wars. Nevertheless, political risk studies use different terms to refer to such non-governmental risks. For Gurr [20], the term political violence, also known as ‘civil violence’, referred to all disruptive forms of internal opposition to governments, including revolutions, terrorism, assassinations, riots and demonstrations. Jeannet and Hennessy [29], on the other hand, used the term social unrest which contains revolutions, coups d’état, riots and demonstrations.

The common theme of these risks is that they are undertaken against a constituted authority and can have a negative impact upon international and domestic investments. Minor [36] and Brink [8] suggested that the impact of such threats can be in the form of limitations in supplies necessary for production, interrupted government services, damage to physical property, personnel loss, or even complete abandonment of the operation. Host-society related risks, however, are likely to be of greatest concern to firms operating in developing countries rather than those firms operating in developed countries; Rice and Mahmoud [40], Subramanian et al. [45] and De Mortanges and Allers [17].

As revealed by both the theoretical and empirical studies previously identified, there would seem to be neither agreement, regarding the definition of, nor the components of, threats that can stem from, the host society. For this reason, and to avoid confusion, the different threats are taken separately for the purpose of this paper. Thus, a host society can introduce the following risks: a) demonstrations, riots and insurrection; b) revolutions, coups d’état and civil wars; and c) terrorism.

The first category of host-society risks is that of demonstrations, riots and insurrection. It can be argued that the borderlines between the three risks are not clear, in particular between riots and insurrection. In an attempt to differentiate among these terms, Tareq [47] argued that a demonstration can turn into a riot if a demonstration results in sabotage and riot can turn into insurrection if arms are used. The second category is revolutions, coups d’état and civil wars. Brink [8] and Tareq [47] differentiated between a revolution and a coup d’état in that the former risk is staged by a larger group and radically changes the political system, while the latter risk is usually done by a small group which just replaces the top power ‘figures’. Brink [8] continued that the leader of a coup is often very close to the centre of power, a member of cabinet, and often a minister of defence. Tareq [47] added that the distinction between a civil war and a revolution or other related terms is arbitrary; a civil war can also be categorised as revolution if a civil war results in a major societal restructuring. Although civil war poses threats to foreign investors in the form of malicious damage to property, looting or personal threats [8], the risk seems to have received little attention in previous risk studies.

The third host-society risk is terrorism. Terrorism is a term with no agreed definition among governments or academic analysts, but is ‘almost’ invariably used in a pejorative sense [13].
According to Czinkota et al. [15], the central meaning of terrorism is the use of terror for the furthering of political ends. Halliday [21] added that the range of activities which the term covers has been wide, but four main forms of actions tend to be included: assassinations; bombings; seizure of individuals as hostages; hijacking of planes. Czinkota et al. [15] explained that terrorism poses threats to the operations of the firm, including: declines in buyer demand; interruptions in value and supply chains; new policies, regulations and laws and deteriorating international relations that affect trade.

In recent times, terrorism is receiving increased attention in risk studies [15]; [9]. Hood and Nawaz [24] added that recent developments in terrorism are bringing a new dimension to political risk; while terrorism in the past may have been identified as a country risk, the 21st century has seen the growth of terrorist groups who are not associated with a specific country or geographical region. As a consequence, the action of such groups, as argued by Hood and Nawaz [24], may disrupt a business across a range of activities and locations, rather than disrupting operations in a specific country. Furthermore, current trends in terrorism, as suggested by Brodsky [9] indicate an increasing desire and ability to cause mass destruction. Brodsky [9] explained that about 81.0 percent of all suicide-bomb attacks since 1968 have occurred after 11th of September. As a consequence, firms, as players in such environments, are in a period of heightened risk.

Terrorism is increasingly associated with religious affiliation – most prominently in the case of Islamic terrorism. However, religious motivation may lead to other cultural and/or societal changes or pressures for change which may pose significant risks for international projects. For instance, pressure for the introduction of Islamic Sharia Law in countries or regions of countries such as northern Nigeria may increase the risk associated with operating in such geographical areas by changing the terms and conditions associated with, for example, the charging of interest for commercial loans.

**Interstate Risk**

The discussion to this point has concentrated mainly on risks identified within the context of national analysis. However, the international society of countries, as suggested by Burmester [11], is as liable to experience conflict and change as any other society, and the effects on international projects may be profound. Similarly, Brink [8] suggested that international projects are exposed to risks occurring within and among countries. This suggestion indicates that political risk places some emphasis on interstate (as opposed to intrastate) political conflict, such as wars and economic sanctions. In the event of war, a firm can be exposed to non-payment, loss of income, business interruption, loss of equity investments, or damage to physical assets.

Sanctions usually take the form of restrictions on imports or exports, or on financial transactions. In the event of sanctions, as suggested by Burmester [11], the target country is exposed to loss of external trade (import and/or export) and less foreign investment inflows. Sanctions can also disrupt the local industry, in particular if the industry relies on foreign material. Despite the importance of this risk, there would seem to be, however, little attention paid to economic sanctions in previous risk studies, primarily due to the fact that such studies were mostly written within the context of developed countries.
Managerial perceptions of Risk

Risk is a combination of the probability of an event occurring and its consequences. Sarewitz et al. [42] distinguished between two components of risk, which they called ‘event risk’ and ‘outcome risk’: event risk is the occurrence of any particular event, say war, whereas outcome risk is a particular outcome, say GB £ one million in losses, from a particular war. Outcome risk (and not event risk), according to Sarewitz et al. [42], integrates both the characteristics of a subject and the chance of the occurrence of an event that, jointly, result in losses.

The in-depth reviews of political risk literature [32] and [19] emphasise that the impact of political risk is via firm-specific characteristics. This emphasis was also reported by most recent political risk studies, including [51], [31] and [39]. In addition, Kobrin [32] and Fitzpatrick [19] were the first researchers to make the now common division of political risk into ‘macro’ risks and ‘micro’ risks. 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).

In identifying the ‘perceptions’ of such outcome risk, Millstein and Halpern-Felsher [34] suggested identifying the degree of concern an individual has about a particular outcome (e.g. how concerned are you about the impact of war?), which is also referred to as ‘perceptions of vulnerability’ or ‘feelings’. The term vulnerability, however, cannot be divorced from the term risk with regard to the different views of definitions in the academic literature [42]. One of the easiest, and at the same time comprehensive, definitions of vulnerability, as suggested by Bogardi [6], is the likelihood of injury, death, loss, disruption of livelihood or other harm in an event. Millstein and Halpern-Felsher [34] further classified such perceptions into conditional versus non-conditional. Conditional perception of vulnerability is one in which explicit mention of an antecedent condition such as a situation or behaviour is made (e.g. when undertaking international business activities, how concerned are you about the impact of war?). In contrast, non-conditional perception of vulnerability is one in which no explicit mention of an antecedent condition, such as a situation or behaviour, is made.

Although measuring the perceptions of vulnerability has something to say about respondents’ sense of risk, the outcome of such measurement is subject to three drawbacks. Firstly, there would seem to be, according to Bogardi [6], p. 363), no “agreed indicators to measure the individual components of vulnerability” nor “agreement upon methodology; how to collect the subjective information on vulnerability”. Brink [8] reiterated this point, arguing that in political risk, “terms such as likelihood, chances and probability are judgements rather than mathematical calculations”. Secondly, perceptions of vulnerability are influenced by the potential cost of events should they arise [5]; [32]; [52]. The cost of an event, in turn, depends on the extent of assets exposure [39], the value of the particular market [32] and the like. Thirdly, the vulnerability of a firm to political risk, as proposed by Burmester [11] and Wilkin [50], depends on the size of facility (e.g. subsidiary, affiliate, branch), the degree of international competition and the technology implicated in the investment. By way of illustration, Wilkin [50] proposed that ‘wholly owned’ projects are more than three times more at risk for expropriation than minority joint ventures. For this paper, variables of cost and the type and size of facility have not been taken into account since the firms in the sample were required to rate the vulnerability to the impact of political risks in different countries rather than on a country-to-country basis. It follows, therefore, that, examining
the impact of such variables on the vulnerability to political risk, inevitably, requires precise assessment not only on a country-to-country basis but also on an event-to-event and a firm-to-firm basis. This is because the vulnerability to the impact of political risk is not only a firm-specific but also country-specific [33].

For the aforementioned reasons, and to avoid confusion, throughout this paper managerial concern is referred to as the degree of concerns managers have about risks in terms of their unfavourable consequences upon managers’ firms. Measuring risk with regard to its impact, however, is consistent with most political risk empirical studies, including Kobrin [32], [40], Hashmi and Guvenli [22], Subramanian et al. [45], De Mortanges and Allers [17] and Oetzel [39].

**METHODOLOGY**

Since the 1970s, an increasing number of Jordanian firms have become involved in international business. Many of these firms would not survive without such an involvement. Nevertheless, as a consequence of the internationalisation, firms are exposed to a wide range of risk [38], of which political risk is the most threatening [39]; [48]; [49]. For Jordanian international projects, the exposure to political risk is intensified since they are operating in a politically volatile region: the Middle East.

In line with the paper objectives, a survey strategy was selected. Primary and secondary data were also used. Self-administered questionnaires *(see Appendix)* were distributed between January and April 2005 to the entire target population of Jordanian international projects. This consisted of 79 firms registered on the Amman stock exchange. All of the projects were of the private-private variety. In order to obtain a more homogenous sample of these firms, only the headquarters were included, eliminating subsidiaries, divisions and plants. Each questionnaire was accompanied by a covering letter asking that the questionnaire be filled in by general managers themselves unless there were particular personnel responsible for political risk.

Forty-four out of seventy-six questionnaires (the entire target population) were returned. The response rate, 57.8 %, is ‘high’ and ‘adequate’ to carry out the data analysis, as suggested by Saunders et al. [43, p. 284]. Such an adequate response rate is also an indication of management interest in the topic.

The firm-specific characteristics examined included: a) the total assets in US $ million as proxy to a firm’s size; b) the number of years in international business, the percentage of revenue generated by international business activities and the number of countries in which the firm operates as proxies to a firm’s degree of internationalisation; c) a firm’s type of industry (industrial, banking, service); d) a firm’s ownership (governmental, private). The latter characteristic has not been taken into account in any of the political risk research.

The outputs of a Normal Quantiles-Quantiles chart (Q-Q chart plots) test of many of the research variables indicated that the distribution in question was significantly different from a normal distribution (i.e. the distribution is non-normal). Consequently, non-parametric statistics were used to analyse the data obtained. To test whether the sample was representative and not biased, the Chi-square test was used. The output of Chi-square statistics 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 a firm’s total assets ($X^2 = 5.583, p = 0.061, 2$-sided). The sample, thus, is representative of the population and the findings can be generalised to the entire population.

RESULTS

Respondents to the questionnaires were presented with a list of the four literature-derived general risks of the international business environment and requested to rate their concerns about each risk on a five-point rating scale, in which 1 stood for ‘not concerned’ and 5 stood for ‘extremely concerned’. Based on the means of risk scores, as shown in Table 2, respondents were concerned about political risk first (mean 4.05), financial risk second (mean 3.79), cultural risk third (mean 3.12) and natural risk last (mean 2.21). This finding corroborates the views of earlier writers [11], [31], [8] and [44] who argued that political risk is one of the most important categories of risk for international projects.

Table 2: Relative importance of general risks by mean

<table>
<thead>
<tr>
<th>General risks</th>
<th>Importance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mean</td>
</tr>
<tr>
<td>Political</td>
<td>4.05</td>
</tr>
<tr>
<td>Financial</td>
<td>3.79</td>
</tr>
<tr>
<td>Cultural</td>
<td>3.12</td>
</tr>
<tr>
<td>Natural</td>
<td>2.21</td>
</tr>
</tbody>
</table>

a: The percentage of respondents who scored 4 ‘very concerned’ and 5 ‘extremely concerned’.

In line with the international business literature, Jordanian international projects have expanded into environments that are culturally and geographically closest to the home country; 75.3 percent of countries where Jordanian international projects operate are within the Middle East. The conduct of international business activities in such a politically volatile region suggests that the risk of first most concern to respondents is likely to be that of political risk. In spite of the fact that all business is exposed to risk, some characteristics of firms can make them more or less vulnerable to the impact of risk in the event of its occurrence. Calculating means for managerial perceptions of political risk (mean is derived from a five-point rating scale, where 1 stands for ‘not concerned’ and 5 stands for ‘extremely concerned’) revealed that high-internationalised firms in terms of the number of operating countries (those which operate in > 11 countries) are more concerned about the impact of political risk than are medium-internationalised (those operating in 6-10 countries) or low-internationalised firms (those operating in < 5 countries) (mean 4.36 versus 4.00 and 3.85, respectively). This finding supports the views of Howell [25] and Stosberg [45] who suggested that the more widespread the international involvement, the stronger the potential impact of the political risk.

Respondents to the questionnaires were also presented with a list of eleven literature-derived political risks and requested to rate their degrees of concern on a five-point rating scale, in which 1 stood for ‘not concerned’ and 5 stood for ‘extremely concerned’. Based on the means of risk scores, as presented in Table 3, the political risks that concern respondents, in descending order,
were: demonstrations, riots and insurrection (mean 4.35); wars (mean 4.23); economic sanctions (mean 3.98); revolutions, coup d’état and civil wars (mean 3.55); terrorism (mean 2.98); taxation restrictions (mean 2.98); currency inconvertibility (mean 2.95); contract repudiation (mean 2.74); import and/or export restrictions (mean 2.72); ownership and/or personnel restrictions (mean 2.60); expropriation (mean 2.37).
Table 3: Relative importance of political risks by mean

<table>
<thead>
<tr>
<th>Political risks</th>
<th>Mean a</th>
<th>SD</th>
<th>% b</th>
<th>Valid</th>
</tr>
</thead>
<tbody>
<tr>
<td>Demonstrations, riots and insurrection</td>
<td>4.35</td>
<td>0.72</td>
<td>86.0</td>
<td>43</td>
</tr>
<tr>
<td>Wars</td>
<td>4.23</td>
<td>0.95</td>
<td>86.0</td>
<td>43</td>
</tr>
<tr>
<td>Economic sanctions</td>
<td>3.98</td>
<td>1.24</td>
<td>78.5</td>
<td>42</td>
</tr>
<tr>
<td>Revolutions, coups d’état and civil wars</td>
<td>3.55</td>
<td>1.11</td>
<td>61.9</td>
<td>42</td>
</tr>
<tr>
<td>Terrorism</td>
<td>2.98</td>
<td>1.26</td>
<td>34.8</td>
<td>43</td>
</tr>
<tr>
<td>Taxation restrictions</td>
<td>2.98</td>
<td>1.14</td>
<td>37.2</td>
<td>43</td>
</tr>
<tr>
<td>Currency inconvertibility c</td>
<td>2.95</td>
<td>1.11</td>
<td>32.5</td>
<td>43</td>
</tr>
<tr>
<td>Contract repudiation d</td>
<td>2.74</td>
<td>1.20</td>
<td>27.9</td>
<td>43</td>
</tr>
<tr>
<td>Import and/or export restrictions e</td>
<td>2.72</td>
<td>1.44</td>
<td>41.8</td>
<td>43</td>
</tr>
<tr>
<td>Ownership and/or personnel restrictions</td>
<td>2.60</td>
<td>1.15</td>
<td>23.8</td>
<td>42</td>
</tr>
<tr>
<td>Expropriation and/or confisciation</td>
<td>2.37</td>
<td>1.09</td>
<td>16.2</td>
<td>43</td>
</tr>
</tbody>
</table>

b: Mean is derived from a five-point rating scale, where 1 stands for ‘not concerned’ and 5 stands for ‘extremely concerned’.

c: The percentage of respondents who scored 4 ‘very concerned’ and 5 ‘extremely concerned’.

d: There are significant positive correlations between the degree of concern as to currency inconvertibility risk with each of a firm’s total assets in US $ million (Spearman’s Rho = 0.413, p < 0.01, 2-tailed) and the number of countries of which a firm has facilities (Spearman’s Rho = 0.316, p < 0.05, 2-tailed).

e: There is a significant positive correlation between a firm’s total assets and the vulnerability to contract repudiation risk (Spearman’s Rho = 0.460, p < 0.01, 2-tailed).

f: The vulnerability to import and/or export risk is significantly related to a firm’s type of industry (Cramer’s V = 0.530, p < 0.01).

Host-government risks received the lowest concern rating among all the political risk types by Jordanian respondents. This finding is in line with the view suggested by Nawaz and Hood [38] who believed that the role of governments in regulating businesses has decreased. The low concerns relating to such risks can be attributed to the fact that the government of a country certainly wants to encourage the development and growth of commerce and industry and so might offer incentives to encourage new investment from abroad rather than impose restrictions. This finding has four implications.

Firstly, some traditional sources of political risk, such as expropriation and taxation restrictions, are diminishing. This result is in line with the finding of Hood and Nawaz [24] in the context of UK firms. Consequently, a political risk in the past does not necessarily mean a political risk in the future and the view that political risk is much more than the obvious expropriation risk is reinforced. Secondly, if the probability of a political risk occurring is low but its unfavourable consequence is high, the managerial concern of such risk can be low as well. Consequently, the most drastic political event, i.e. expropriation is not necessarily the most frequent or most threatened. Thirdly, host-government policy priorities, particularly those which favour some industries over others, change; so a firm’s host-government risk can change as well. Thus, a firm’s
host-government related risks not only can be different from industry to industry but also vary over time. Fourthly, a host-country government can have an important role in minimising risks that can face international projects operating on its soil.

In this paper, the vulnerability to the impact of three host-government related risks is found to be related to firm-specific characteristics. Firstly, firms operating in a number of countries need to make a series of financial transactions between the home country and host country(s) and, therefore, are particularly concerned about the risk of currency inconvertibility (Spearman’s Rho = 0.316 p < 0.05, 2-tailed). Secondly, firms with larger total assets are significantly more concerned about the breach, or unilateral revision, of the investment by a host government (Spearman’s Rho = 0.460, p < 0.01, 2-tailed). Thirdly, industrial firms are significantly more concerned about import and/or export restrictions than banks or service firms (X² = 12.071, p < 0.01; Cramer’s V = 0.530, p < 0.01), mainly because industrial firms are those concerned with importing and/or exporting goods.

Respondents, however, are more concerned about the political risk which arises from host society than those which arises from the direct actions of a host government. Demonstrations, riots and insurrection are the risks of first and most concern to respondents, followed by revolutions, coups d’état and civil wars. These risks are commonplace events in the Middle East and their consequences, in the event of their occurrence, are at the country level and expected to be severe. Nevertheless, terrorist activities are also commonplace events in the Middle East, yet they have received the least concern rating among all the host-society related risks.

This finding, however, contradicts the general theme of other political risk studies which called this era the age of terrorism [26] and a period of terrorism risk [15]; [9]. This can be attributed to the fact that those studies which addressed terrorism as an important variable in international business were mainly USA and/or European. In the context of the Middle East, it is suggested that mainly ‘western’ targets are vulnerable to such risk [3]. Kettis [31, p. 116] further explained that one source of such a political risk is Al-Qaeda, which works as a decentralised network governed by common values and is characterised by “aggressiveness and very low risk aversion and has global reach”. Kettis [31] added that Al-Qaeda’s values and objectives are not only in extreme contrast with those values and objectives of the ‘western world’, but also in opposition to them. Minor [36] suggested that the Iraq war will trigger increased anti-USA sentiment; intensifying an upsurge in terrorist acts on US interests.

Czinkota et al. [15] found that tourism related services (hotels, travel agents, restaurants), meanwhile, tend to be particularly affected by terrorism. A review of some of the main terrorist acts in the Middle East in the year 2005 revealed that, excluding those acts in Iraq, they had targeted tourists. Furthermore, in the context of the Middle East, including Jordan, terrorist acts seem to target tourism related services and particular nationalities. It is appropriate, then, to conclude that what political risk is to one particular nationality does not have to be a political risk to another.

In the context of interstate risks, wars are the risk of second most concern to respondents and economic sanctions are the risk of third most concern among all the political risk types. The high
degree of managerial concern about interstate risks can be attributed to the fact that these risks are commonplace events in the Middle East. The degree of concern about interstate risks is not significantly related to any firm-specific characteristics, suggesting that these risks are ‘macro’. This finding implies that managerial perceptions of political risk in developing countries can be different from those in developed countries.

CONCLUSION

The findings of this research suggest that the political risk associated with international projects poses a threat to the majority of companies and that the vulnerability to political risk is related to a firm’s degree of internationalisation. International projects are more concerned about host society and interstate related risks than host government related risks.

Although this paper has contributed to the understanding of the managerial perceptions of political risk in both developed and developing countries, it has also created a need for further research. There is a need, in particular, not only to describe but also to understand the managerial perceptions of political risk within the firm-specific characteristics framework. Future research might use a multi-method of data collection since validity is raised as a quality data issue with regard to the use of quantitative methods.

As firms are become international they are exposed to new risks, of which political risk is the most obvious. Although political risk can be categorised precisely, the division of political risk into three main categories does not imply that this typology is exhaustive nor are the components of each category. Political risk, however, varies across firms, varies across countries and changes over time. It is, thus, practically hard to achieve a general understanding of political risk and its impacts on firms. Therefore, the view that political risk should be considered within a firm-specific characteristics framework is reinforced.
REFERENCES

1] Bach D. Testing the waters for signs of political risk, as well as investing in practical measures to reduce the risk of political instability and terrorism, companies would do well to engage the communities in which they work. Financial Times 2005; London, 9 September: p. 2.


9] Brodsky M. Forecasting the face of terrorism. Risk and Insurance 2005; December: 10


39] Oetzel J. Smaller may be beautiful but is it more risky?: Assessing and managing political and


------------------------------------

Cultural Risks
Financial Risks
Natural Risks
Political Risks
General Risks