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**The Institutionalisation of Political Risk Assessment in Central and Eastern
European International Firms**

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The Institutionalisation of Political Risk Assessment in Central and Eastern European International Firms

Abstract

This paper highlights the main issues concerning researchers in the field of political risk assessment (PRA) and presents proposals to develop this research in the context of “the Visegrad Four” Central and Eastern European (CEE) countries; namely the Czech Republic, Slovakia, Poland and Hungary. The main theoretical and empirical studies in this field are summarised and the context and objectives of the proposed research are introduced. A number of firm-specific factors, which in earlier studies have been found to affect the institutionalisation of PRA, are highlighted. Previous studies of PRA in relation to transition and emerging economies have been concerned mainly with inward investment. There are hardly any studies of firms which are based in these countries and which operate internationally. There are none in relation to Central and Eastern Europe. This study will fill that gap in the literature by investigating the factors influencing the institutionalisation of PRA within and between the “Visegrad Four” countries.

The Institutionalisation of Political Risk Assessment in Central and Eastern European International Firms

Political Risk Assessment: an introduction

Political risk assessment (PRA) is the process of analysing and evaluating political risk while undertaking international business activities. The political risk literature suggests that: a) political risk is assessable and helps the decision-maker to avoid or decrease the chance of both property and income losses by the use of appropriate management tools; b) international firms are aware of their exposure to political risk and consider political risk to be one of the most important risks for their international business activities. However the political risk literature indicates that the PRA which is undertaken by international firms is generally of a low standard. This may indicate either a lack of awareness of political risk in international business participants (which seems unlikely), resistance by firms to the notion that political risk is amenable to analysis, or a view that it is potentially amenable to analysis but that such analysis is not possible for some reason (Rice and Mahmoud, 1990; Stapenhurst, 1992a; Stapenhurst, 1992b; Wyper, 1995; Pahud De Mortanges and Allers, 1996; Burmester, 2000; Hood and Nawaz, 2004).

PRA has been described typically as 'informal', 'unsystematic', 'reactive', 'inadequate' or 'subjective'. In view of this, the term institutionalisation is used to describe the process by which PRA becomes "more explicit and systematic" within a firm. 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. PRA begins to be institutionalised when formal responsibility for its performance is assigned to a specific individual or group; is institutionalised further when the process is 'routinized'; and in a more institutionalised setting, there is a greater emphasis on objective assessment, in addition to subjective assessment (Blank et al., 1980; Kobrin et al., 1980; Kobrin, 1981; Kobrin, 1982; Hashmi and Baker, 1988; Wyper, 1995; Pahud De Mortanges and Allers, 1996).

Determinants of Institutionalisation

The diversity of potential risk and the differences in a firm's exposure to risk may lead to different approaches to political risk assessment (PRA). A firm's exposure to political risk is related to its characteristics. The literature on political risk suggests that the extent to which international firms are involved in PRA is correlated with a number of organisational characteristics. These characteristics include: a) a firm's size (Hashmi and Baker, 1988; Stapenhurst, 1992a; Kettis, 2004; Al Khattab et al, 2008); b) a

firm's degree of internationalisation (Hashmi and Baker, 1988; Hashmi and Guvenli, 1992; Al Khattab et al, 2008); and c) a firm's type of industry (Stapenhurst, 1992a; Stapenhurst, 1992b; Wyper, 1995; Pahud De Mortanges and Allers, 1996; Jenney, 2001; Kettis, 2004; Al Khattab et al, 2008). These three characteristics will be investigated, along with a firm's ownership; a variable which was not taken into account in any of the aforementioned political risk research, other than that of Al Khattab et al, 2008 (Figure 1).

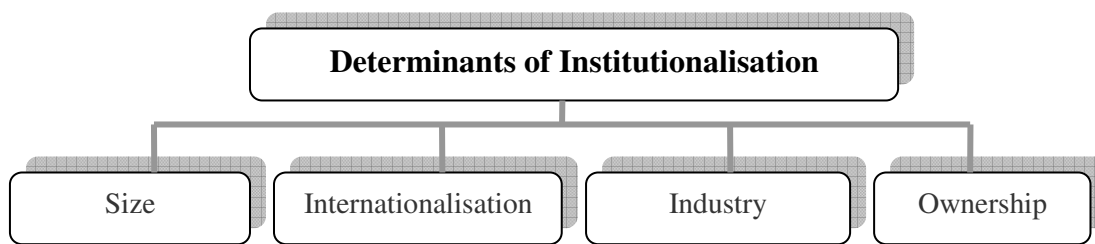


Figure 1: Potential determinants of institutionalisation

The Need for the Study

The political risk assessment (PRA) literature consists of conceptual research, e.g. Desta (1986), Torre and Neckar (1988), Miller (1992), Zou (1993), Clark (1997), Kearns (1997), Stevens (1997), Alon and Martin (1998), Howell (2001) and Brink (2004) and empirical research which is concerned *inter alia*, with identifying the managerial concerns of political risk in different contexts, e.g. Rice and Mahmoud (1990), Agarwal and Feils (2007) and Baas (2010) within Canadian firms; Hashmi and Guvenli (1992) within US firms; Wyper (1995) within UK firms; Pahud De Mortanges and Allers (1996) within Dutch firms; Demirbag and Gunes (2000) within Turkish firms; Zarkada-Fraser and Fraser (2002) within UK firms orientated toward Russian markets; Hood and Nawaz (2004) within UK international firms; Kettis (2004) within Swedish firms; Keillor et al. (2005) within US firms; Nawaz and Hood (2005) in Mozambique, France and Myanmar and Al Khattab, Anchor and Davies (2008) within Jordanian international firms. Most of these empirical studies, however, were carried out in the context of developed countries and offer little by way of analysis of the concept in transition or emerging markets, particularly in relation to firms which are located in such economies. Furthermore, an in-depth review of such literature suggests that few studies have related the managerial concerns of risk to firm-specific characteristics.

The Research Context

The research will be conducted in the context of international firms (i.e. firms operating internationally) based in the “Visegrad Four” countries (Poland, Hungary, Czech Republic and Slovakia) of Central Europe. No previous PRA research has been conducted in relation to Central European firms. This is a significant omission given the specific post-socialist transition market context (Djankov and Murrell, 2002; Makhija, 2004).

The focus on Central Europe will also facilitate the exploration of how international firms from transition countries perceive and assess political risk and ascertain the reasons for any divergent approaches to political risk assessment (PRA) which may be identified. In the same vein, a comparison will be made between the findings in the context of Central European firms and those findings in different contexts. The comparison is possible because other studies also targeted firms from one nationality operating in different countries.

Only international firms will be investigated, to the exclusion of domestic (i.e. non-international) firms. This does not mean that domestic firms are not vulnerable to political risk in the home country. The focus on international firms, however, aims to achieve consistency with the majority of the literature in which exposure to political risk in its many forms is a consequence of undertaking international business activities. This focus was also justified by Eiteman et al. (2000), Kettis (2004), Hood and Nawaz (2004) and Stosberg (2005) who argued that political risk is a special dimension of risk that an international firm has to deal with, in addition to the risks traditionally associated with business activity in the home country.

Research Objectives

The main objective is to examine the institutionalisation of political risk assessment in Central European international firms while undertaking international business activities.

This objective is divided into three sub-objectives:

To describe and explain the political risks identified by managers of Central European international firms.

To compare the political risks that concern the managers of Central European international firms with the political risks which concern managers in different geographical contexts.

To explore the correlations between the political risks identified by the managers of Central European international firms and firm-specific characteristics.

Methodology

This study makes use of mixed methodology: a researcher administered questionnaire and interviews. The data will be obtained in two stages. In the first stage, a researcher administered questionnaire will be used to collect data concerning the types of political risks which are faced by managers in Central Europe, as well as the organisational characteristics of the sample firms. The second stage will be based on the first one, and will provide more in-depth understanding of managerial practices of PRA. In the second stage, semi-structured interviews will be used.

The findings will be explained in terms of exploring potential correlations or differences between managerial concerns and firm-specific characteristics. The qualitative statistics will be based on the interviews and will be presented in the form of discourse analysis. The actual analysis will combine all descriptive, inferential and qualitative statistics. The findings will then be compared with the findings reported in other countries.

Contribution of the Research

Previous studies of PRA in relation to transition and emerging economies have been concerned mainly with inward investment. There are hardly any studies of firms which are based in these countries and which operate internationally. There are none in relation to Central and Eastern Europe. This study will fill that gap in the literature by investigating the factors influencing the institutionalisation of PRA within and between the “Visegrad Four” countries.

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