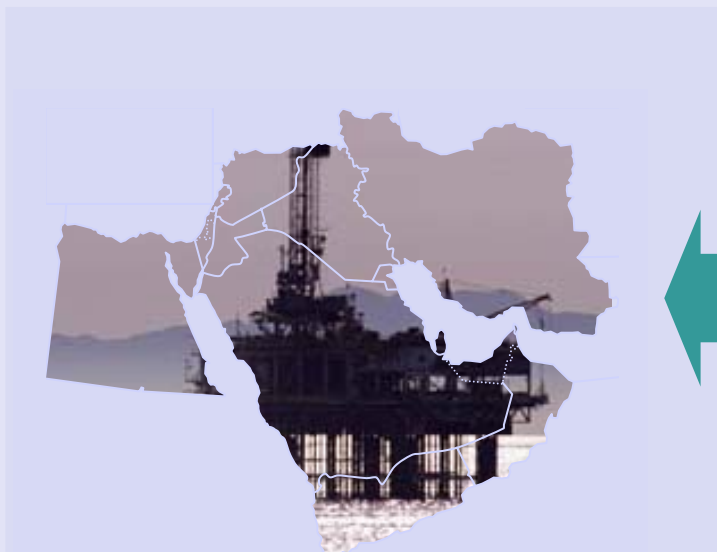


# Political Risk Analysis and Investment Decisions

Session D11

**John Maltby**, Associate Director and Head of Political Risk,  
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**Matthew Horrox**, Political Risk Consultant,  
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# Session D11: Political Risk Analysis and Investment Decisions

## KEY QUESTIONS / TODAY'S AGENDA

- What is political risk?
- Why are political risks important for investment decisions and are decision makers doing enough to assess them?
- What tools can we use?
- How do we do it?
- Your turn: a case study



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## Session D11: Political Risk Analysis and Investment Decisions

### WHAT IS POLITICAL RISK?

**A traditional narrow definition:** often used by insurance providers.

*“Political risks arise from **the unforeseen actions or inaction of a foreign or third country.**”*

*These risks can frustrate the **payment and profitability** of all types of contract and investment. They can also affect the safe repayment of facilities and loans to financing banks and lenders.”*

**AON Crisis Management - 2004**

## Session D11: Political Risk Analysis and Investment Decisions

### WHAT IS POLITICAL RISK?

**A broader definition:** perhaps more relevant to companies planning to invest abroad.

*“Political risks, as defined as **all non-commercial risks**, are inherent and often hidden in a country’s political, business and cultural environment. They can have **financial, operational, security and reputational impacts**.*

*Corruption, direct action, bureaucracy, poor stakeholder relations, political shifts, terrorism, legal and regulatory irregularities, religion and health can all be sources of such risks.”*

**Control Risks Group - 2004**

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### WHAT IS POLITICAL RISK?

#### Some example sources of political risk

- **Political:** Shifts in power
- **Terror:** 9/11, Turkey, Russia, Spain....
- **War and Civil Conflict:** Iraq, Kashmir, Africa, Middle East
- **Finance:** Asian & South American financial crises
- **Health:** disruption from SARS, Asian Bird Flu, HIV/AIDS
- **Business Trends:** Greater corporate social responsibility, transparency and fair trade
- **Environmental:** Shell Brent Spa, Baku-Ceyhan pipeline

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## Session D11: Political Risk Analysis and Investment Decisions

### WHY ARE POLITICAL RISKS IMPORTANT FOR INVESTMENT DECISIONS?

#### Investment destinations often in:

- Unstable, unpredictable, complex or hostile countries
  - Politically
  - Economically

#### Investments often require:

- Large sunk costs upfront
- Staff to relocate to project site
- Reliance on local infrastructure, institutional safeguards and inputs (material and labour)

## Session D11: Political Risk Analysis and Investment Decisions

### WHY ARE POLITICAL RISKS IMPORTANT FOR INVESTMENT DECISIONS?

#### Investment concerns:

- Stability, predictability and ethical standards of business environment over project life
  - Reliability of local labour force, infrastructure, partners (including suppliers, customers and distributors), government, legal system and bureaucrats
  - Safety and security of assets, personnel and proprietary information
- Affecting H&S of personnel, reputation, finances

## Session D11: Political Risk Analysis and Investment Decisions

### ARE DECISION MAKERS DOING ENOUGH?

- Over estimate government action and over reliance on political risk insurance, which:
  - Provides cover for highly unlikely action (e.g. expropriation)
  - Excludes cover for possible actions (e.g. war with nemesis)
- Under estimate other stakeholders, institutional or cultural norms
- Poorly understood political risks
  - Too difficult and perhaps “woolly” or subjective → therefore ignored
  - Economics more straight-forward and “scientific” → therefore central to decisions
  - Economists, bankers or project sponsors often assume they are qualified to make political assessments

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## Session D11: Political Risk Analysis and Investment Decisions

### WHAT TOOLS CAN WE USE?

#### For Comprehensive Project Risk Assessments:

- Political risk assessment
- Stakeholder analysis
- Due diligence on partners
- Security survey
- Business continuity, crisis management planning

As well as:

Financial / economic feasibility study / modelling

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# Session D11: Political Risk Analysis and Investment Decisions

## HOW DO WE DO A POLITICAL RISK ASSESSMENT?

### Total Risk Assessment Methodology (TRAM)

- Identifies risks
- Puts risks in context
- Looks at impact
- Looks at likelihood
- Looks at controls
- Arrives at recommendations



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## TOTAL RISK ASSESSMENT METHODOLOGY (TRAM)



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## IDENTIFYING RISKS

- Starting point for analysis
- List possible risks using category checklist:



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## ASSESSING IMPACT AND LIKELIHOOD

- Plot identified risks
- Use knowledge and judgement
- Facilitates risk prioritisation

IMPACT	EXTREME			CRITICAL		
	MAJOR	SERIOUS				
	MODERATE	LIMITED				
	MINOR			SERIOUS		
	INSIGNIFICANT	ROUTINE				
	RARE	UNLIKELY	CREDIBLE	LIKELY	ALMOST CERTAIN	
	LIKELIHOOD					

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### **FURTHER STEPS**

For each risk you would go on to:

- Identify the triggers for each risk
- Identify controls (security provisions, contingency plans etc.) in place or proposed
- Determine possible and desirable controls
- Undertake a gap analysis
- Prioritise action to be taken and make recommendations

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# Session D11: Political Risk Analysis and Investment Decisions

## CASE STUDY

In 20 minutes, in groups:

- Review case study project documentation
- Identify potential risks (using wheel of risks for ideas)
- Assess impact that each risk have on investor, and the likelihood of it manifesting
- Plot risks on an Impact-Likelihood Matrix
- Groups will feedback at the end

# QUESTIONS

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