Informing Country Risk Assessment in International Business

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Abstract

In addition to assessment of commercial risks, when making decisions about assets or activities in other countries, multinational corporations also require to assess political risks such as the stability of government and potential changes in the treatment of non-domestic corporations. Environmental scanning is well covered in the literature. Although country risk assessment may be regarded as a specialist sub-set of environmental scanning, the sources of information in terms of independence, objectivity, accuracy, trustworthiness and absence of bias, to inform this process are not well explored in the literature. This study addresses this gap. We survey multinationals operating from Jordan and examine sources of information within a corporation-specific characteristics framework. The main findings are that multiple sources of information are used, of which internal sources are the most important, both personnel at headquarters and personnel abroad. Analysis of the survey data on the basis of corporation-specific characteristics revealed no significant correlations. There are implications for governments with regard to perceived reliability of the information they collect and make available to multinationals. There are also implications for multinationals in terms of resourcing of personnel, especially those based abroad, and a need for an awareness of the reliance often placed on such sources.

Keywords: Source of information, Country Risk, Multinationals, Environmental scanning

1. Introduction

The rapid growth of international business activity has meant that many corporations are crossing national boundaries to either exploit new opportunities or minimize any potential threats. The rapid growth of trade and investment flows and the need to make decisions about assets or activities in other countries, require multinational corporations (MNCs) to assess commercial risks such as local markets and competition, transportation costs, availability of labour and the level of other relevant local costs. They also require, as

suggested by Alon and Herbert (2009) and Marshall *et al.* (2009), to make an assessment of the country risks such as the stability of government and potential changes in the treatment of non-domestic corporations. Yet, guidance for developing a reasoned and systematic approach to assessing the specific sources and consequences of the political risks facing a firm or its business units has, thus far, been sorely lacking (Alon and Herbert 2009). Little effort, according to Al Khattab (2006) and Al Khattab *et al.* (2008a), has been made to explain the sources of information used to assess country risk in international business. Rather, the main focus of previous studies has been descriptive. The aim of this paper is to address this deficiency and to examine critically the sources of information used by multinationals to assess country risk.

This broad objective of examining sources of information that are used for country risk assessment, is divided into two sub-objectives: a) to analyse current managerial practices in multinational corporations with regard to the sources of information used for country risk assessment and b) to explore the correlations between the sources of information used and corporation-specific characteristics of the multinationals surveyed.

2. Literature Review

The place of risk management in modern organisations is now well established. Formal treatment of risk and uncertainty is needed in all aspects of management including: strategy, investment decisions, projects, asset utilisation, business continuity, corporate security, health & safety, legal liabilities and risk financing (Economist Intelligence Unit, 2007). One leading published standard (AIRMIC, ALARM, IRM, 2002), defines risk management as the process whereby organisations methodically address the risks attaching to their activities with the goal of achieving sustained benefit within each activity and across the portfolio of all activities. This standard highlights the first stage in risk management as risk assessment. The International Organization for Standardization (ISO/IEC, 2002) defines risk assessment as the overall process of risk analysis and risk evaluation. The aim of risk assessment, according to the European Environment Agency (1998) and Waring and Glendon (2001), is to provide information on which decisions may be made about proposed actions, the adequacy of risk controls and what improvements might be required.

It is self-evident that when an organisation conducts business in different countries the range of information needed to assess risk is multiplied. 'Country risk' is the term often used in connection with cross border investments and is analysed from the foreign investor's perspective (Oetzel, 2005). This term is also sometimes referred to as 'political risk' however 'country risk' is a more general term, which generally only refers to risks affecting all corporations operating within a particular country. According to Hood (2001, p. 49), country risk "encapsulates the socio-political and economic factors which determine the degree and level of risk associated with undertaking business in a particular country". For the purpose of this study, country risk is defined as the "risk associated with undertaking transactions with, or holding assets in, a particular country" (Chartered Institute of Management Accountants, 2001, p. 191).

2.1 Environmental Scanning

In the new economy, foreign direct investment (FDI) has become an important contributor to growth (World Bank, 2004). Emerging markets, according to Meyer and Estrin (2004) and Marshall *et al.* (2009) have been among the major target locations for foreign investment. FDI inflows to emerging markets have increased considerably since the 1980s (UNCTAD, 2005). These markets, furthermore, are still unfamiliar to foreign investors. Nonetheless, these countries have become important recipients of FDI as corporations are choosing them not only for their potential as good market sites for investment, but also for their potential as consumers of merchandises (UNCTAD, 2004). The overall attractiveness of a country as a potential market site for foreign direct investment, as suggested by Rios-Morales *et al.* (2009), depends on balancing benefits, costs, and risks associated with doing business in a certain country. Oetzel (2005) continued that although corporations are exposed to a variety of risks, political risk can jeopardize, in a very harmful way, the activities of a foreign corporation. In this new economy, political risk assessment has become an important part of investment assessment (Khanna *et al.*, 2005). Institutional features, like the degree of political stability, are seen as new and significant determinants of FDI decision-making processes (Lambsdorff, 1999).

The need to detect and respond to these rapid changes in the business environment and the challenges associated with such changes, has raised the level of interest in 'environmental scanning' (Ngamkoreckjoti and Johri, 2001). According to Wheelen and Hunger (2006), environmental scanning refers to the monitoring, evaluation and disseminating of information (from the external and internal environments) to key people within a business corporation. This information is needed for decision-making. The literature indicates that, to be successful, environmental scanning must be linked to strategic planning (Costa and Teare, 2000). Indeed, the empirical research findings from the different country context support this argument (e.g. Aldehayyat, 2006; Athiyaman

and Robertson, 1995). Also, Jain (1984) suggested that, when organisations grow in size and complexity, more formal strategic planning is needed to achieve their objectives and their need for a systemic approach to environmental scanning increases simultaneously. The consideration of organisational environment is one of the core steps in all strategic planning processes (Oreja-Rodríguez and Yanes-Estévez, 2007).

According to Costa (1995, p. 5), scanning improves an organisation's ability to deal with rapidly changing environments in a multiple of ways: a) it helps an organisation to capitalise early on opportunities; b) it provides an early signal of implementation problems; c) it makes an organisation more aware of the changing needs and wishes of its customers; and d) it improves the image of an organisation with its public by showing that it is sensitive to its environment and is responsive to it.

Coulter (2002) divides environmental scanning into two components: external and internal scanning. External environmental scanning refers to opportunities and threats that are outside the organisation. The external environment is classified into two parts: the general environment and the specific environment. General environment refers to the external environment sectors that indirectly affect the organisation's strategic decision and action. General environment includes socio-cultural, technological, economic and political-legal sectors. Specific environment refers to external environment sectors that directly affect on organisation. This includes customers, competitors, suppliers and other important industry-competitive variables.

The scanning of the external environment alone is not sufficient for the organisation to achieve competitive advantage. Scanning should also include the identification of internal strategic factors. Internal environmental scanning refers to strengths and weaknesses that are inside the organisation. Strengths and weaknesses determine if the corporation is able to take advantage of opportunities while avoiding threats. Various strategy techniques are available for environmental scanning and forecasting, such as political, economic, sociocultural and technological analysis (PEST analysis), scenario building and Porter's 5-factors (industry attractiveness analysis) which are used for analysis of the external environment. Capability assessment profile, financial analysis, value chain analysis, human resource analysis, experience curve and organisational culture analysis are used for internal environmental analysis (Gunn and Williams, 2007; Aldehayyat and Anchor, 2008; Aldehayyat *et al.*, 2009).

2.2 Sources of information

The key source of information, according to Brink (2004), is the 'business environment' as this continually creates signals and messages that a corporation should consider important. Today's business executives are exposed to vast amounts of environmental information via the web alone – far more than they can possibly perceive and as pointed out by Jogaratnam and Law (2006) (citing Hambrick, 1982) "...executives faced with limited capacity for information processing and bounded rationality must adopt a selective approach to scanning." Gathering information regarding the different business environments in which the corporation operates, according to Al Khattab (2006), is one of the key prerequisites in assessing country risk, since information, further supported by Brink (2004), can help a corporation to convert 'uncertainty' which is not measurable and unmanageable, to 'risk' which is measurable and manageable. As a consequence, decision-making can be taken under 'risk' and not under 'uncertainty'.

A review of theoretical studies (e.g. Albright, 2004; Al Khattab, 2006; Koehler, *et al.* 2009) and existing empirical studies of country risk (e.g. Rice and Mahmoud, 1990; De Mortanges and Allers, 1996; Al Khattab, 2006) reveals that, in the process of gathering information about the political business environment in which a it operates, a corporation can rely on one or more of thirteen sources of information. These sources can be divided into three main categories: internal, external and specialised. The 'internal' category includes a corporation's personnel located at its headquarters or other home country locations, or at locations abroad. The 'external' category includes: banks operating locally and abroad; other corporations operating locally and abroad; the media (e.g. television, radio, newspapers, and the website); international organisations (e.g. World Bank, International Monetary Fund); trade associations; chambers of commerce; home-country embassies; and business magazines. The last category contains a variety of specialised sources: academics; governmental domestic agencies; external consultants (e.g. Overseas Private Investment Corporation, Multinational Investment Guarantee Agency).

Three main means of information are used by the Dutch National Institute for Public Health and the Environment (RIVM): scientific reports, the website and press releases. These can be assessed online by professionals, the public and every other interested party. A detailed review of empirical country risk studies conducted across a range of national contexts revealed that internal sources were viewed as important channels of information about the business environment: Canadian multinationals (Rice and Mahmoud, 1990); North

Atlantic multinationals (Stapenhurst, 1992); US multinationals (Subramanian et al., 1993); UK multinationals (Wyper, 1995); Dutch Multinationals (De Mortanges and Allers, 1996); Swedish multinationals (Kettis, 2004); and Jordanian multinationals (Al Khattab, 2006). This review of empirically-based studies also revealed that one of the most frequent external sources of information is banks, in which corporations rely on a personal network of human sources for gathering information. However, according to Albright (2004), additional information may be used to 'speed up' decision-making and 'improve' performance. Although such a suggestion indicates that multiple sources of information are preferred, specialised information sources, such as external consultants and academics, have been found to be of low importance as a source of information (Al Khattab, 2006). It could be argued that the relative importance of information sources varies from one context to another. For example, Canadian Multinationals (Rice and Mahmoud, 1990) believed that 'embassies' were one of the most important sources of information, while US Multinationals (Subramanian et al., 1993), Dutch Multinationals (De Mortanges and Allers, 1996) and Swedish Multinationals (Kettis, 2004) did not believe so.

One salient point emerging from the literature with regard to the sources of information used by multinationals is, according to Al Khattab (2006), that most of the previous studies have not taken corporation-specific characteristics such as a corporation's size, degree of internationalisation, and industrial category into account when analysing the importance of the source of information. Thus, the correlations, if any, between the sources of information used and the corporation-specific characteristics are unknown.

3. Research methodology

In line with the aim of the paper, a survey strategy was chosen. The principal advantages of the use of a survey include: a) the data collected from the survey may be standardised allowing easy comparison; b) it is simple to undertake and allows for a significant degree of control over the research process; and c) the survey method is a popular and common strategy in business and management research, as it allows for the collection of usable data from a sizeable population in a highly economical way (Saunders *et al.*, 2009).

This strategy is needed in order to describe and verify the relationship between sources of information and corporation-specific characteristics. The descriptive part of this research, in compliance with recommendations suggested by Saunders *et al.* (2009), was used as a means to an end rather than an end in itself. This use, in turn, explains the correlations between variables. Furthermore, a cross-sectional study was chosen for this research because it is, according to Aaker *et al.*, (2009), a common method of descriptive research in business studies since descriptive research is aimed at providing a detailed picture of a particular issue.

The research is conducted in the context of Jordanian multinationals. There is a practical rationale for delimiting the research to a single country. Including multiple nationalities for the purpose of this research, as suggested by Oetzel (2005), can raise practical difficulties with more time and higher expenses incurred to conduct a survey. Jordan is selected because of the location of the researchers and of previous studies that underpin this research (Al Khattab, 2006; Al Khattab *et al.*, 2007). The senior managers who are the target respondents to be surveyed are usually located at headquarters and this process is affordable for the researchers in the context of Jordan.

The selection of Jordan also permits the possibility of unique insights into how multinationals from developing countries use divergent sources of information for country risk assessment. As the paper will show, it also permits comparisons with practices reported in Jordan in previous studies. It provides the possibility of generalising findings to other developing countries and also internationally.

3.1 Data collection methods

The questionnaire was delivered (between February and June 2008) to the entire population of Jordanian multinationals, being fifty-eight in total. The rationale for such a census is to ensure that the sample is representative. The questionnaires were directed specifically to general managers because previous empirical studies by the authors had identified difficulties in locating the person in an organisation responsible for assessing country risk (Al Khattab, 2006; Al Khattab et al., 2007, 2008a, 2008b). Furthermore, Hood and Nawaz (2004) and Al Khattab (2006) emphasise that the designated 'risk manager' might not be the person who is actually involved in country risk management.

Five out of fifty-eight corporations proved to be un-contactable. The questionnaires were then personally distributed to general managers of fifty-three corporations. Four out of these fifty three questionnaires were ineligible since they could not meet the research requirements. A total of thirty-six questionnaires were returned, of which two were unusable. The number of usable returned questionnaires is, thus, thirty-four. The sample is representative of the population and findings can be generalised to the entire population since the output of

Chi-square statistics indicated no statistically significant difference between respondents and non-respondents with respect to industry category.

4. Discussion of the findings

4.1 Characteristics of Jordanian Multinational corporations

According to Al Khattab (2006), the diversity of potential risk and the differences in a corporation's exposure to risk, may lead to different approaches to risk assessment. A corporation's exposure to risk is related to that corporation's unique characteristics (Anchor *et al.*, 2006; Al Khattab, *et al.*, 2007). The literature on country risk suggests that the extent to which Multinational corporations are involved in country risk assessment is correlated with many organisational characteristics. These characteristics include: a) a corporation's size in terms of total assets in US\$million and the corporation's number of employees; b) a corporation's degree of internationalisation in terms of a corporation's number of years in international business, a corporation's percentage of international revenue, and a corporation's number of operating countries; c) a corporation's type of industry as categorised by Amman Stock Exchange (industrial, financial, services) and d) a corporation's ownership (public, private).

In this research, these three characteristics are investigated. The main database used for identifying multinationals is the Jordanian Shareholding Companies' Guide / Amman Stock Exchange for the year 2008. This guide provides an official database of most Jordanian registered shareholding corporations with regard to a corporation's total assets, number of employees, industry categories and a corporation's ownership. The analysis of the characteristics of responding corporations aims to find out whether the responding corporations are representative of the population of Jordanian Multinational corporations and to examine the correlations between the characteristics and the use of information sources. To achieve this, Chi-square based measures, Spearman's rank-order correlation coefficient and Kendall's rank-order correlation coefficient are used.

4.2 The importance of sources of information

Respondents to the questionnaires were required to rate the importance of thirteen literature-derived sources of information about the international business environment on a five-point rating scale from 1 'not important' to 5 'extremely important'. The means of importance within corporations are reported in Table 1. Only two sources had a mean of more than 3.00: personnel at headquarters (mean 3.35); personnel abroad (mean 3.25). The remaining eleven sources, however, had means less than 3.00. Disaggregating the questionnaires' findings by corporation-specific characteristics suggested no significant correlations.

(Take in Table 1about here)

The literature review revealed that country risk assessment information can, according to Al Khattab (2006), be obtained from three main sources: internal to a corporation, external to a corporation and specialised sources. The first category is those sources internal to corporations: personnel at headquarters and personnel abroad. Personnel at headquarters and personnel abroad are still the first most important source of information within Jordanian corporations (Al Khattab, 2006). Likewise, Kettis (2004) addressed the importance of the Swedish 'subsidiaries managers' in gathering information about the business environment.

The finding (i.e. the reliance on personnel at headquarters and personnel abroad) is in line with the view of Albright (2004) who theoretically proposed that most managers get 'much' of their information by 'word-of-mouth' through a personal network of contacts. The tendency of multinationals to rely mostly on 'human' information sources can be explained in the following way. Managers in a dynamic, rapidly changing environment, as suggested by Kettis (2004, p. 145), need more information than do managers in a relatively stable environment. To the extent that 'objective' or 'non-social' means are unavailable, people evaluate their opinions and abilities by comparison, respectively, with the opinions and abilities of others (Kobrin, 1982, p. 134). Hough and White (2004) add that, under conditions of greater uncertainty, decision-makers rely more on their existing knowledge and experience. Empirically, Kettis (2004) and Al Khattab (2006) found that in today's environment, Swedish managers and Jordanian managers were predominantly reliant on personal contact to obtain the information needed for country risk assessment.

Logically, then, this phenomenon could be a characteristic of Jordanian Multinationals when obtaining information regarding the political environment because the uncertainty of the environment, according to Al Khattab *et al.* (2006; 2007; 2008a), is thought to be high. Nevertheless, disaggregating the findings of the survey according to corporation-specific characteristics suggests that the importance of personnel abroad is not significantly nor positively related to a corporation's degree of internationalisation in terms of the number of countries where a corporation operates. This finding is in contradiction to an earlier finding by Al Khattab (2006)

who found that the higher the number of countries in which a corporation operates, the greater the importance of personnel abroad as a source of information. The absence of such a correlation may be attributed to the need for today's world risk managers to possess information they can act on and that personnel abroad are an important source of information that fulfils this need.

The second category of sources is external to the corporations: media; other corporations; banks; international organisations; trade associations; chambers of commerce; Jordanian embassies. Only media, other corporations and banks have a mean above two while the remaining have a mean less than two, indicating that the latter sources are not important to risk managers. These findings are in line with the findings in the context of Jordan in an earlier study by Al Khattab (2006) which suggested two reasons for survey respondents' reliance on such external sources of information. Firstly, banks have more experience in particular international markets. Secondly, other corporations may be within the same industry, so 'have similar interests'; in particular, if those corporation-specific characteristics does not suggest significant correlations with the importance of these external sources. As found by Al Khattab (2006), other external sources of information have a low importance score within Jordanian corporations. Al Khattab (2006) attributed this to a perception that embassies introduce 'good' and 'reliable' information but that it is 'politically oriented' and, thus, is of limited value. Business magazines, on the other hand, are considered one of the least important sources rated by Jordanian Multinationals since such magazines may introduce general information for anybody to read.

The third category of sources when gathering information about the international business environment is specialised sources: governmental domestic agencies; external consultants; academics. Governmental domestic agencies and external consultants are also found by the survey not to be important for Jordanian Multinationals. This finding is in line with the finding suggested by Al Khattab, (2006) in an earlier study in the context of Jordan. Unlike their Jordanian counterparts, Hood and Nawaz (2004) found that many UK multinationals relied on 'outside specialist help' in evaluating country risk, rather than on their own 'corporate risk manager'. The underutilisation of specialised information sources by Jordanian Multinationals, according to Al Khattab (2006), can be attributed to a belief that judging the specialised sources' competence is difficult and once such sources have been found and judged, the application of the assessment to determine likely impacts on a corporation is complex since such application requires a 'special knowledge of a corporation situation'.

Academics, on the other hand, are considered as one of the least important sources by Jordanian Multinationals. This finding is in line with the finding suggested by Al Khattab (2006) in an earlier study in the context of Jordan, the tendency of multinationals to place no reliance on academics as an information source, according to Al Khattab (2006) was attributed to a view that academics may not have the time to understand a business and the way it operates.

5. Conclusions and implications

Information can be obtained from three main sources: internal to a corporation, external to a corporation and specialised sources. For Jordanian Multinationals, personnel abroad still constitute the most important source of information about a corporation's environment, mainly because such sources take into account corporation-specific characteristics when gathering required information. The use of sources of information, however, is not significantly related to any corporation-specific characteristics. Yet, the relative importance of information sources varies from one context to another.

Knowing that they are operating in a politically turbulent environment, these corporations need to access more sources in order to obtain reliable and accurate information. Corporations, therefore, can use different sources of information - in particular those sources deemed to be independent. However, in order to keep up with the ever-changing international environment, information gathering should be continuous since aged data can impact negatively on the outcome of an assessment and can lead to inappropriate decisions.

To generalise wider than the situation for Jordanian multinationals, there are implications for all governments with regard to the nature of the information they collect and make available to multinationals. Well intentioned government efforts to supply useful, objective intelligence may be largely disregarded by multinationals. There are also implications for multinationals in terms of the resourcing of personnel, especially those based abroad, and because of the reliance that may be placed on personnel derived assessments of country risk.

Despite that this research represents one of the first studies to include sources of information in terms of independence, objectivity, accuracy; trustworthiness and absence of bias. The research has been subject to different limitations. For the purpose of this research, the entire population of Jordanian has been studied. Categorising the corporations according to their organisational characteristics resulted in a small number of

corporations in some sub-industries. Knowing that corporations with different industries have different risk profiles which may lead to different environmental scanning tools, the combination has limited the research in that the industry categories are not able to explain the variation in information tools.

However, additional research is needed in order to confirm the Jordanian findings. Specific 'country risk' assessment can learn from ongoing research into environmental scanning behaviour aimed at 'general commercial advantage' over competitors. Our study suggests that future research should consider the possibility of over-reliance on the reputation and reliability placed on corporations' internal informants based at headquarters or abroad. We may question whether such informants represent too narrow a distillation of country risk assessment at the expense of potentially more accurate assessments derived from the employment of information analysis skills to cope with vast and ever growing volume of new information available electronically. Due attention should be paid to examine the correlations between the source of information and corporate-characteristics; a dimension that has been underestimated by most of the previous research.

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Table 1. Importance of information sources for risk assessment

Sources of information	Importance of information		
(thirteen literature-derived sources	(scored on a five-point rating scale from 1: 'not important' to 5: 'extremely important')		
of information about the international			
business environment)			
	Mean	SD	Valid N
Personnel at headquarters	3.35	1.12	34
Personnel abroad	3.25	1.04	33
Media	2.73	1.12	34
Other corporations	2.12	1.32	33
Banks	2.08	1.11	34
Business magazines	1.55	0.84	32
External consultants	1.51	1.14	33
Governmental agencies	1.40	1.01	32
International organisations	1.30	1.05	34
Chambers of commerce	1.26	0.82	33
Trade associations	1.26	1.09	32
Jordanian embassies	1.11	0.63	33
Academics	1.02	1.24	34