



**BUSINESS
ENVIRONMENT
RISK
INTELLIGENCE**

BUSINESS RISK SERVICE (BRS) USER GUIDE

BENEFITS FROM USE OF THE BUSINESS RISK SERVICE

BRS monitors 50 countries three times per year. General uses include: ① A subscriber can follow important developments in a country and have BERI S.A.'s qualitative analyses and forecasts. ② A quantitative assessment of risk is provided that is comprehensive and that has survived over two decades of testing. ③ A table of historical statistics and political information shows trends that assist in providing an independent view of a country's future.

Use of Qualitative Content. The key applications include:

- ❖ Improvement in the quality of decision making about existing operations in a country from frequent updating of knowledge and perspective. The incisive content presented on two pages per country makes the task relatively easy.
- ❖ Perspective from the analyses and forecasts prepared by professional staff that is independent of mainstream viewpoints and those of large corporate clients. Their insights are refined by the many times per year reports are prepared for BRS and other services.
- ❖ Language and style in the paragraphs consider that English may be a second or third language for many subscribers. Short sentences that minimize use of specialized jargon facilitate comprehension of a quick review of BRS country reports.

Use of Quantitative Content. The *Composite Score* for each country involves 57 criteria, three separate indices that move independently of each other, and hundreds of calculations to apply time-tested weightings. The results offer subscribers:

- ❖ Ratings that are comparable over two decades. Historical data by index and *Composite Score* are available in each issue for the 1990s, and ratings for the 1980s and part of the 1970s can be provided upon request.
- ❖ Quantitative risk assessments to provide a means of ① comparing risk exposure and return on investment for existing operations, ② structuring the composition of global or regional asset deployment that is compatible with executive management's preferences on risk exposure, ③ deciding on proposed projects, comparing net cash flow, resources required, and risk exposure, and ④ judging the merits of divestitures.
- ❖ A ratings basis for short-term decisions on extending trade credits, specifying the type of letters of credit, requesting insurance, hedging for foreign exchange rate risk, and level of security required for facilities and personnel.
- ❖ A signal from discontinuity in the trend of ratings between Present and +One-Year and/or +Five-Year forecasts that provides an alert about an anticipated major event.

General Use of Content.

- ❖ The statistics, whether in the paragraphs or the table, are from such reliable sources as the International Monetary Fund, World Bank, etc. Information provided by magazines, newsletters, or newspapers is checked for accuracy at two levels of the BERI staff.
- ❖ If the BRS is provided on disk for use on a companywide information system, the service becomes a common asset for several departments.
- ❖ Three supplements to BRS are optional and expand the benefits of subscribing. The *Labor Force Evaluation Measure* (LFEM) assesses employed workers in a country. The ratings for 50 countries in addition to the 50 in the services are published at mid-year. The *Market Opportunity Rating* (MOR) provides an appraisal of quality, scope, and trends in country markets.

PRINCIPLES OF COUNTRY RISK ASSESSMENT

1. The three primary causes of risk for international companies are assessed. The *Political Risk Index* (PRI) measures sociopolitical changes. The *Operations Risk Index* (ORI) measures the degree to which complex operating conditions affect production and profits earned in the local currency by a foreign firm. The third is the risk affecting access to foreign exchange and remittances of profits and repatriation of capital in a convertible currency; the *R Factor* measures this risk.
2. Forecasts of the three measures of risk are integrated into an overall assessment, the *Profit Opportunity Recommendation* (POR). The time needed to bring a venture from a feasibility study to actual operation can be years, and a "+Five Year" forecast of the three measures of risk is used for assigning a POR rating. A "+One-Year" forecast is also provided.
3. The quality and continuity of information are fundamental. Comparability over many years is essential. BERI S.A.'s system includes qualitative judgments by two panels of experts, and the quality of these judgments is the foundation for PRI and ORI. Also, the approach selected includes the Delphi method, which reduces bias and conflict of interest in the results. Economic and financial statistics for the *R Factor* are taken from reliable, regularly published sources.
4. Results of the three measures of risk serve as parameters for qualitative evaluations in addition to assigning the POR rating. Explanations giving the background on events and the reasoning behind forecasts are required to supplement quantitative ratings. Two-page summaries are given in each subscription issue for the 50 countries regularly monitored by the service.

Users of the BERI S.A. service should consider the following two factors in applying the information:

1. Ratings and recommendations apply to general conditions. It is necessary to distinguish between risk exposure of a capital-intensive facility involving a huge investment at one end of the spectrum and an assembly operation using leased equipment at the other end. Extractive ventures depleting nonrenewable resources have been targets for nationalization, and this adds to the risk of a capital-intensive investment. The criteria scores, from which ratings are derived, are provided in statistical appendices, and adjustments can be made that fine-tune the system to the profile of the business involved.
2. In some cases, a specific industry within a country justifies a better rating than the country's rating. Less frequently, a company may have a special relationship with a country. Consider, however, that the three measures are sensitive indicators of risk exposure and that relationships change as governments and economic conditions change. Nevertheless, specific operations can be evaluated by country risk analysts and other company personnel, and adjustments to the POR can be made.

OPERATIONS RISK INDEX (ORI)

The objective of ORI is to gauge the business operations climate. There are two variables being measured: ❶ the degree to which nationals are given preferential treatment and ❷ the general quality of the business climate, including bureaucratic and political continuity.

Definition of the Index. A permanent panel of ±105 experts around the world rate present conditions for the 15 criteria that measure the country's business environment from 0 (unacceptable conditions) to 4 (superior conditions). The criteria are weighted to emphasize critical success factors, and this expands the 15 to a weighted total of 25. A rating of 4 on each criterion gives a perfect environment of 100.

❖ The quality of the panel members is the foundation of the concept. Executives in companies, banks, governments, and institutions volunteer their ratings. All have extensive international experience. Geographic distribution is worldwide.

❖ A version of the Delphi method is used. Data are from a permanent panel. The first reply prepared by a panel member requires research and care in matching the rating with the definitions of the criteria. A panelist is supplied with his previous reply and the overall panel average per criterion as input for decisions on current ratings.

Criteria and Weightings. The following have been used for over twenty years. ORI ratings are comparable since 1974.

Criteria	Weighting	Criteria	Weighting
Policy Continuity	3	Labor Cost/Productivity	2
Attitude: Foreign Investors and Profits	1.5	Professional Services and Contractors	0.5
Degree of Privatization	1.5	Communications and Transportation	1
Monetary Inflation	1.5	Local Management and Partners	1
Balance of Payments	1.5		
Bureaucratic Delays	1		

Economic Growth	2.5	Short-Term Credit	2
Currency Convertibility	2.5	Long-Term Loans and	
Enforceability of Contracts	1.5	Venture Capital	2

Forecast of ORI. Each panel member rates a country for a +1 year and +5 years period by giving a whole number for the overall rating, such as 70, 62, etc. The high and the low ORI forecasts are discarded, and a panelwide average is used for a country.

Guidelines on Risk. The categories below have been developed to assist in interpreting the ratings.

- ❖ 70-100 Stable environment typical of an advanced industrialized economy. Problems for foreign businesses are offset by the country's efficiency, market opportunities, financial system, and advanced infrastructure.
- ❖ 55-69 Moderate-risk countries with complications in day-to-day operations. Usually the political structure is sufficiently stable to permit consistent operations without serious disruption. Dynamic economic expansion often has the potential for attractive profits.
- ❖ 40-54 High risk for foreign-owned businesses. Only special situations should be considered, e.g., scarce raw materials or unusual profit potential. Selection of management is critical to success in this risk range.
- ❖ 0-39 Unacceptable business conditions for foreign-owned businesses.

POLITICAL RISK INDEX (PRI)

The concept focuses wholly on sociopolitical conditions in a country by:

- ❶ Creating a multicomponent system with flexibility to weigh key factors.
- ❷ Utilizing a permanent panel of experts with diplomatic careers and training in a political science.
- ❸ Providing data that can move independently of other BERI S.A. risk measures.

Four time periods are involved:

Present Conditions	+1 Year Conditions	+5 Years Conditions	+10 Years Conditions
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First step in the System. The expert rates the present conditions for each of the 8 causes shown on the following page from 7 (no problems) to zero (prohibitive problems). Then, the two symptoms are rated on the same scale in the present. The perspective is from the viewpoint of an international bank rather than private enterprise owned by nationals. This subtotal involves a maximum of 70 for the perfect country.

Six Internal Causes of Political Risk:

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| ❖ Fractionalization of the political spectrum and the power of these factions. | ❖ Mentality, including xenophobia, nationalism, corruption, nepotism, willingness to compromise, etc. |
| ❖ Fractionalization by language, ethnic and/or religious groups and the power of these factions. | ❖ Social conditions, including population, density and wealth distribution. |
| ❖ Restrictive (coercive) measures required to retain power. | ❖ Organization and strength of forces for a radical government. |

Two External Causes of Political Risk:

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| ❖ Dependence on and/or importance to a major hostile power. | ❖ Negative influences of regional political forces. |
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Two Symptoms of Political Risk:

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| ❖ Societal conflict involving demonstrations, strikes, and street violence. | ❖ Instability as perceived by nonconstitutional changes, assassinations, and guerrilla wars. |
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Second Step in the System. One or more of the causes may have an overwhelming impact on the overall political stability. The second subtotal of the system allocates a total of 30 points to causes (not symptoms) to reward especially advantageous situations. The expert can apply the points to one, two, etc., causes or opt to allocate no additional points. The lowest risk country could receive a rating of 100 as a result of steps one and two.

Forecast of PRI. Steps one and two are repeated for the +1 and +5 years period. The points given to a country under present conditions serve as a basis for changes in the future.

Interpretation of the Ratings. Four categories of political risk have become apparent from usage. Judgment is necessary because country ratings near the threshold of another category, e.g., 53 and 56, are likely to be very similar in degree of risk.

- ❖ 70-100 **Low Risk.** Political changes will not lead to conditions seriously adverse to business. No major sociopolitical disturbances are expected.
- ❖ 55-69 **Moderate Risk.** Political changes seriously adverse to business have occurred in the past, but governments in power during the forecast period have a low probability of introducing such changes. Some demonstrations and strikes have a high probability of occurring.
- ❖ 40-54 **High Risk.** Political developments seriously adverse to business exist or could occur during the forecast period. Major sociopolitical disturbances, including sustained rioting, have a high probability of occurring periodically.
- ❖ 0-39 **Prohibitive Risk.** Political conditions severely restrict business operations. Loss of assets from rioting and insurgencies is possible. Disturbances are part of daily life.

R FACTOR

The purpose of the **R** (for remittances and repatriation of capital) **Factor** is to estimate a country's capacity and willingness for private foreign companies to ① convert profits and capital in the local currency to foreign exchange and transfer the funds and ② have access to convertible currency to import components, equipment, and raw materials. The computer program manipulates over 14 000 cells of data and makes hundreds of calculations for each R rating and the four subindices described below.

Legal Framework Subindex (20% of R Factor). Each of the six criteria are rated from 5 (best case) to zero (worst case) and weighted by either four or three. The weighted total of 20 times 5 equals the perfect legal framework.

<u>Laws as Written</u>	<u>Weighting</u>	<u>Actual Practices</u>	<u>Weighting</u>
Dividend, Profit, and Salary Remittances	4	Practices on Dividends, Royalties, and Other Periodic Compensation	4
Royalties, Fees, and Remuneration for Nondividend Cash Flow Services	3	Practices on Repatriation of Capital Hedging Opportunities Against a Devaluing Currency	3
Repatriation of Capital	$\frac{3}{10}$		$\frac{3}{10}$

Foreign Exchange Generation Subindex (30% of R). IMF data published in *International Financial Statistics* (IFS) are used. Certain statistics were converted to "standard normal variates." This technique makes meaningful comparisons possible despite an immense range in the data across countries.

- ❖ Current Account performance is half the subindex, or 50 points. Breakeven is 25 points. A rolling average is used to dampen the impact of unusual years.
- ❖ Three measures are used to award the 50 points for capital flows. First, capital account points up to a maximum of 30 are awarded by establishing breakeven as 15. Second, portfolio capital flows attracted by the potential for capital gain and high interest rate differentials earn a maximum of 10 points. Third, "safe haven" currencies also attract capital, and a maximum of 10 points is awarded.

Accumulated International Reserves Subindex (30% of R). First, months of coverage for imports of merchandise and services are used as a means of relating hard currency reserves to scope of needs. The country with the most coverage each year receives 50 points; the country with the fewest months of coverage earns zero. Second, the international reserve total is added to the London valuation for gold holdings to give a complete total on reserves. A ratio is then calculated using total public foreign debt as the numerator.

Foreign Debt Assessment Subindex (20% of R). The developing country data for public foreign debt published by the World Bank are the basic sources. Industrialized countries require several sources.

- ❖ A ratio using gross domestic product converted to US\$ as the denominator is used to put the debt into perspective with the economy. Creditor nations receive all 50 points; the largest result receives zero.
- ❖ Capacity to service debt is measured by a ratio of annual public foreign loan obligations (numerator) and foreign exchange earned (denominator). Fifty points go to creditor nations.

Riskiness and the +5 Years Forecast. Risk categories are the same groupings as for ORI and PRI. Data used for the forecast are the result of regression analyses, trends in the ratings, and senior staff judgment. Wholly quantitative forecasts proved unrealistic.

EXPLANATION OF THE SYSTEM FOR BUSINESS RISK ASSESSMENT

Divisions for each of the nine Profit Opportunity Recommendations (POR) have been revised. Changes will enable clients to take full advantage of investment and other business opportunities expected in the late 1990s. The POR is based on a composite score derived by adding the (1) Operations Risk Index (ORI), (2) Political Risk Index (PRI), and (3) Remittance and Repatriation Factor (R Factor), and dividing by three.

Investment Quality - Conditions merit commitment of equity and incurrence of debt to be serviced from operations in the country. Expectations for currency convertibility and dividend remittances are good.

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| 1A | The POR composite score is 75 - 100. | ↓Increasing Need |
| 1B | The POR composite score is 65 - 74. | ↓for High Early |
| 1C | The POR composite score is 55 - 64. | ↓Remittable Profits |

Nondividend Cash Flow - Conditions generally merit minimum commitment of financial resources. Profits, however, can be earned from fees for transfer of technology, training of nationals, management, and sales of other professional services. Multiyear relationships are involved in the contracts. In addition, a few ventures will generate extraordinary profits and justify a major commitment of financial resources.

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| 2A | The composite score is 55 or more, but investment is not recommended due to such special conditions as excessive taxation. |
| 2B | The composite score is 45 - 54. |
| 2C | The composite score is 45 - 54, but the receiver of technology and services has the potential to use the assistance as a means of penetrating markets traditionally held by the supplier. |

Trade Only - Conditions merit only a transaction by transaction relationship.

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| 3A | The composite score is 40 - 44.
Payment delays are probable. | ↓Increasing
↓Level of |
| 3B | The composite score is 35 - 39.
Extreme caution about obtaining payment is required. | ↓Problems with
↓Payments |

No Business Transactions - Conditions merit no business relationship of any kind except those involving cash payments or valid third party guarantees.

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| 4A | The composite score is less than 35. |
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