

Rethinking Business Risk

-How should we name and manage Globalizing Risks?

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【要約】

海外で事業を行う企業が直面するリスクとして、契約当事者間に限定される商業リスクに加えて、1970年代以後「カントリーリスク」が重視されるようになり、21世紀には「地政学リスク」が意識されるようになった。このような用語法の変化はビジネスのグローバル化と並行しており、今一度これらのリスクの意味するものを検討することによって必要な対応策も見えてくるのではないかと。

今日のビジネスリスクはスケールが各国レベルから複数国家、地域のレベルを経てグローバルなリスクに発展する傾向を示している。同時に、原因は経済、政治のみならず複雑で特定しがたい様相を呈している。スケールと原因を軸にビジネスリスクのグルーピングによって、リスクについて、ある程度適切な表現に近づくことができるかもしれない。スケールについては「カントリー」「クロス・ボーダー」「リージョナル」「グローバル」の4段階、要因としては「経済的」「政治的」「特定不能」の3つから成るマトリックスによってリスクを分類したい。

企業の自己解決努力に並行して、多様なステークホルダーとの広い連携（水平的アプローチ）によってリスク分散を一層効率的なものとする試み、またグローバルに思考することの意義が出てきたと考える。

【Contents】

1. Terminology on Business Risk
2. Country Risk to Geopolitical Risk
3. Definition
4. Change of World, Business and Risks
5. Redefinition
6. Unidentifiable Risks
7. Risk Management-Horizontal Approach
8. Conclusion

1. Terminology on Business Risk

‘Geopolitical Risk’ is a popular description of the business risk seeing the latest case of Tunisia, Egypt and Libya. It is Federal Reserve Bank of US who has used the word for the first time in 2002ⁱ. The terrorists’ attack on 9.11, 2001 was a hot issue at that time, and businesspeople might have seriously expected business with foreign countries may accompany risks of unprecedented and unpredictable scale.

In 1980’s, however, ‘Country Risk’ was a popular concept to describe the economic and/or political risk of each country. What was changed during 80’s to the 21st century?

I would like to hereunder firstly follow the change of the terminology to define the risk of each country or region, which is naturally based on the change of perceptions of businesspeople

on risks accompanied at overseas business broadly.

Terminology is not just for description of the objects but trials to as completely and correctly as possible grasp them. As a devil of a Grimm's fairy tale lost his magical power as he was called with his right name.

There are many references on Country Risk while it is still hard to find ones on Geopolitical Risks which is sometimes used something similar to or more serious than Country Risks, and there are some awareness of necessity to define risksⁱⁱ. In this short thesis, I will mostly rely on my own personal experiences at a trading firm in Japan during 1980's to 90's to focus on changes of perceptions of risks by businesspeople especially in Japan, refraining from ambitions to offer universally useful substitutes for the current terminologies to readers.

2. Country Risk to Geopolitical Risk

Soon after Oil Shock in 1973, businesspeople and economists of the developed industrial countries noticed the risk arising from political affairs independent of commercial risks which could be hedged by means of meticulous contract or insurance.

The Iranian Revolution in 1979 had a devastating effect on Japanese petro-chemical project in Iran (IJPC) resulting in the loss of about 600 billion yen at Mitsui & Co., Japanese key project manager. This has attracted attention of the business community. The trading companies ('Shosha') proud of initiating export of Japan started using the word 'Country Riskⁱⁱⁱ'.

About 30 years later, besides Country Risk, Geopolitical Risk is often mentioned by business people today. Energy Business Group of Mitsubishi Corp. starts their self-introduction in the home page of today in 2011 with the following sentence;

'Rising prices for crude oil and natural gas along with mounting geopolitical risks have brought about major changes within the Group's operating environment.'

I picked out the above as Mitsubishi Corp. Japan has already faced a critically big risk in 2006, namely Russian government had suddenly requested Mitsubishi to revise the contract of natural gas project in Sakhalin. Russia insisted on more dominant shares though the contract had been already concluded. There was a possibility that the project would be suspended. If suspended, Japanese side might have to accept the loss amounting to the level of IJPC in 1979. The crisis has been finally settled through negotiation between Russia and Japanese side.

What to close up here is whether this is a case of Country Risk or Geopolitical Risk. Some call it Geopolitical Risk and it was indeed Russian government who has intervened in the contract but the place was limited to Russia only. Then may we call it Country Risk?

Besides, it is also possible to see this case as a commercial dispute as far as it has started and ended between contractors, namely it might have been a kind of 'Commercial Risk'.

3. Definition

I would like to define the words respecting the original meaning of each, but prior to this trial, considering Geopolitical Risk is popular today, I had better clarify what Geopolitics is. I do not mean its definition but a general background thought of Geopolitics.

Geopolitics is a combination of geography and politics. It is assumed that each country aims geographical expansion namely on the surface of the earth chasing geographical advantages and benefits such as the access to natural resources or politically (militarily) advantageous positions. In Geopolitics, invasive nature of each country is presupposed and it inspires that politics and diplomacy of each country is doomed by each location on a map. The history of invasive Germany in late 19th century to 20th century can be explained in relation to her position in the center of Europe to some extent, and long-lasting Russian and Chinese power owe much to their dominance in the heart of Eurasia. The geographical positions of these countries determine their politics to neighbors and peripheries. Thus Geopolitics is usually handling the relations of more than two countries with expansionary ambitions hidden or open. The area considered in geopolitics is where such countries exist, including countries without ambitions but involved in the potential conflict there. The typical cases of today are Caucasus between EU and Russia, Eastern China Sea including Taiwan between US and China, Korean Peninsula, and chain zone connected by Iran, Afghanistan and Pakistan, where the interest of more than two countries are concerned.

Definition of geopolitics may be on the way but

as far as I trace back to classical but still popular theories of geopolitics.

Noting the above, I summarize the wording on risks expecting less confusion.

Commercial Risk:

1) Scale

Limited to individual overseas business partners such as companies or persons

2) Trouble

Breach of contracts such as default, non-delivery, quality claim due to the partners' inability or intention

3) Settlement or Countermeasures

Definite contracts, insurance measures, legal procedures, negotiations etc.

Country Risk:

1) Scale

Between private companies and individual overseas business partners including state-owned companies and governments

2) Trouble

- Breach of contracts due to governmental policy, political changes, societal unrest, terrorists' attack and war
- Danger of human life of workers involved

3) Settlement or Countermeasures

Insurance measures, legal procedures, negotiations etc.

Geopolitical Risk:

1) Scale

Among private or governmental companies, individual overseas business partners including state-owned companies and governments behind them plus the other countries related

2) Trouble

Breach of contracts and/or danger of human life of those involved due to the confrontation of the partners' country with other powers such as war or terrorists activities

3) Settlement or Countermeasures

Insurance measures (if possible), legal procedures (if possible), negotiations

On Geopolitical Risk, I add some additions taking Iran-Iraq War broken out in 1980 as an example. In case of Iran-Iraq War, the trouble can be summarized as follows:

1) Scale

Some of ongoing business contracts at that time was breached or revised by Iraq, and the influential party in this case was Iran, too. Contractors had to pay attention to the development of the war namely the movement of both Iraq and Iran and even Israel. In Geopolitical Risk, there should be violent movements of one country or influential groups at least or sometimes more as the background.

2) Trouble

The trouble was caused by the war initiated by Iraqi invasion to Iran, namely by the intention of more than one country or organization. Businesspeople stopped business activity and their family had to evacuate from Iraq tentatively. (10 years later, in case of Gulf War, the trouble has totally and decisively damaged the existing business.)

3) Settlement or Countermeasures

There was no valid insurance as war was

defined as force majeure (Act of God).

For businesspeople having contract with Iraqi partners had no choice but to patiently try negotiations on respective trades and projects.

The above definitions are just tentative as I just picked out the prevailing risks only. I will redefine business risks later, but would like to see a short history of risks. The core of above definitions is scale while trouble and countermeasures are the matter of risk management. Only with scale as a criterion, it is hard to think of management. We need another criterion.

4. Change of World, Business and Risks

The difference between Commercial Risk and Country Risk is clear. Geopolitical Risk includes more political and/or military factors than Country Risk. Social unrest of one country should be limited to Country Risk, though it may lead to the political upheaval as in the latest case of Tunisia and Egypt. The case of Sakhalin already quoted should be classified as Country Risk as far as Russia at that time intended revising contract only.

My final goal here is not to clarify the correct terminology of risks but why/how business people especially of Japan (it should basically include all the trading countries of today) have gradually faced the higher level of risk since 1970's. Such a review will provide us with clear understanding on the change of Japanese business and the world Japan is facing, and probably some hints for risk hedging.

In 1960's, Japanese major target countries for export were USA / Europe and there was no

serious risks caused by political or social changes in these countries. In 1970, however, Japanese business people needed to exploit new markets in Asia, Africa and Middle East. Until then, export and import was almost exclusive missions of trading companies specializing in foreign trades endowed with human resources capable of international communications and trading procedures defined by INCOTERMS. It was mainly big scale trading companies called 'Shosha' who exported the products of domestic manufacturers to overseas^{iv}. The trend has changed gradually as Japanese manufacturers have obtained the skill of international trading to USA / Europe and they became less dependent on trading companies who have been just in-between for Japanese makers and overseas users taking brokerage with almost no risk of default or claims of buyers. Trading companies who noticed the necessity to exploit new markets with which ordinary Japanese manufacturers are not yet familiar.

These markets (or potential markets) were candidates of emerging markets in Africa, Middle East or communistic countries such as Russia, Russian peripheries and China. We should note Mitsui & Co., involved in the trouble of the Iranian Revolution (1979), was a major Shosha. Country Risk has become the common risk for all companies trading with Africa, Middle East and communistic countries.

There were more than ten major Shosha in 1970's, but around five in 1990's. Those who failed to find other business models than commission taker as in-between for manufacturers and users were forced to reduce

the commission rate and finally lost attractiveness to manufacturers.

The end of Cold War and development of globalization urged some Shosha to study the feasibility to invest their human and financial resources on emerging markets for export and major suppliers of rare natural resources for import. Shosha stopped sticking to obsolete business-model of brokers and changed into suppliers of natural resources.

This change naturally leads Japanese traders to have firm assets on the exporting countries, not only offices but also lands, mines, plants, fields, warehouses, logistics facilities and people. Then the risks they experience are not defaults only but various with wider range and bigger scale. They could quickly withdraw if they are just exporting or importing firms, but they cannot as they have owned fixed assets and became more vulnerable to any political or societal changes in countries they invest.

On the general process of disappearance of broker business in 1990's, Japanese trading companies initiating overseas business were forced to face higher degree of risks. It matters not only trading companies but also the users relying on them for procurement of overseas products and resources. Meanwhile, we had better note this change has been accompanied by another mega-trend of globalization.

5. Redefinition

Since 1970's, overseas business risks was not limited to default of individual trade partners or governments, and extended to include both economic and political risks, while the geographical range has shown the enlarging

tendency beyond the borders of each partner country of investment and trade. To cover the trend, Geopolitical Risk was introduced, but it is not enough as it can be applied to the places where certain countries have geopolitical interest and intentions, namely will of hegemony beyond their borders. Geopolitical Risk is originally suitable to the area over which some big powers stare at each other to gain control or influence, such as periphery of Russia (ex. Georgia) and Korean Peninsula.

These risks are summarized as sorts of military conflicts or wars. There should be hegemonic intention as background. In this sense, Sakhalin affair of 2006 could be named as Geopolitical Risk if we assume Russia might have intended to obtain some influence over the territory at that time, but it was not so.

Someone may call today a new Cold War era, in which China and US are seeking a equilibrium over some areas. Cold War stays cold when confronting players have reached a stable equilibrium such as the case of US and USSR till 1989. We need not simply discard Geopolitical Risk, but the risk of today is not always military sort or one caused by hegemonic intentions. Besides geopolitical one, there arises a risk easily to develop into global scale economic crisis such as Sovereign Risk prevailing in Europe and potential bubble burst in the emerging markets. Even natural or biological factors such as climate changes and epidemic diseases should be counted as major risks as it will critically damage the supply of agricultural products and can cause social unrest. These are causes of risks and we should not mix them with scale of risks.

For simplification, let me summarize causes

into 'economic', 'political' and 'unidentifiable'. 'Unidentifiable' means the following causes.

- Mixture of economic and political causes
- Causes difficult to distinguish
- Causes beyond human intention such as biological or natural disasters.

Meanwhile, scale of risks shall be categorized with 'Country', 'Cross Border', 'Regional' and 'Global' omitting 'Commercial Risk', of which I regard as a part of political risk. Cross Border Risk involves more than two countries and Regional Risk is one not limited to a few countries but extended to regions such as Middle East. Even Regional Risk is not enough if we consider risks extending into much wider global scale such as terrorism, environmental pollution, climate changes and biological threats. Such risks should be categorized as 'Global Risk'.

Image:

(Scale)	Economic	Political	Unidentifiable
Global	G-e	G-p	G-u
Regional	R-e	R-p	R-u
Cross Border	B-e	B-p	B-u
Country	C-e	C-p	C-u
	Economic	Political	Unidentifiable
	(Causes)		

In the above Image, the part marked with an oval line should correspond to 'Geopolitical Risk', namely I redefine Geopolitical Risk as caused by political intention and geographical characters, which involve more than two

countries, sometimes extending to regions and have possibility to be globally critical. Geopolitical Risk is a part of Cross-Border or Regional Risk. In this framework, Sakhalin trouble between Japan and Russia on the natural gas project can be categorized as 'Country Risk caused by political factor'(C-p). Cause of European sovereign risk is economic (B-e) but can grow into Regional (R-e) and further into Global (G-e) as Lehman Shock of 2008.

The latest case witnessed in Tunisia and Egypt ended with political upheaval and they shall be regarded as political risk (C-p) from a viewpoint on consequences as of the mid of February 2011, but it is said the background of people's demonstration was extremely high unemployment and sharp rise of food prices, namely they can be seen as C-e. If we define the risk of Tunisia and Egypt before 2010, we had to name it C-u as there had been both economic and political risk. At present, the issue is what kind of situation will prevail in these two countries and whether and how their political movements influence on neighbors in Middle East. In this sense, the current risk is B-p or R-p. If there joins other factors than political, economic, cultural or tribal factors, the risk is R-u.

If the risks can be focused on respective countries and their cause are identified as economic or political, there will be some countermeasures to C-e, B-p, B-e or B-p, but if we assume the risks whose causes are unidentifiable, accordingly scales are unpredictable (ranging from C-u to G-u), we need to think of new types of hedging methods.

As for terrorism, if we assume a persistent

political intention at terrorizing organizations and characteristic in the certain regions, we may call it Geopolitical under G-p or R-p, but if it is volatile and lacking in political targets like pirates of Somalia, we had better include them into R-u^v. Besides, the category in Image is not fixed. Each type of risk can change and develop into different one. For instance, motivation of Somali pirates is not political but economic at present but there is no denying it may change into unidentifiable one. Risks usually realize with unknown causes and gradually visible whether they are economic or political, but they may be again reshaped into unidentifiable one with change of scale, escalation or convergence.

This is not for a wording game but to mean two things.

- 1) Type of business risk can be defined with scale and cause, and each risk has a possibility of escalation or convergence
- 2) Scale of business risks is showing a growing tendency, and their causes tend to be various and hard to identify

6. Unidentifiable Risks

I left unidentifiable cause just as 'unidentifiable', but I should try to refer more about it.

Unidentifiable cause is not categorized into economic or political and includes non-human factors as natural disaster, while I am tempted to rephrase it as 'social', or 'cultural'. However, the range 'social' or 'cultural' covers is too wide and ambiguous. For example, religious conflicts can be included in it, but if the religious conflict has been dominant, there may be influenced by

not a few political factors as in case of Iraq after 2003. Meanwhile, political and economic causes are sometimes not purely political or economic and accompany cultural or social factors. If we leave ourselves in this vague border of wording, we will finally lose any means to see the risks. It is too ambitious and unrealistic if I eliminate 'unidentifiable' and regard all risks as identifiable such as 'social' or 'cultural'. Then there arise more factors claiming to be representatives, such as 'religious', 'historical', 'traditional', 'ethical', and so on. Each of all the candidates contains again further factors such as political or economic^{vi}.

'Unidentifiable' is a conceptual pocket to avoid confusion, but it is convenient because political or economic risks sometimes turn out to be religious or social and finally reveal themselves influenced by political or economic factors. For instance, religious conflict becomes visible when one religious group is badly oppressed economically and politically by another ruling one, or the both confronting groups are politically forced to be obedient to the autocratic government (as in case of Iraq under Saddam Hussein). Generally, economic and political factors play the role of trigger to develop the existing risks into visible troubles. Economic and political factors tend to be finally ignitions in a room filled with gas of many unaccountable factors.

Besides, though I concentrated on human factors as social or cultural, there are many non-human factors such as natural disaster (ex. earthquake, climate changes, etc.).

With this consideration, I confine the causes to 'economic', 'political' and 'unidentifiable'.

7. Risk Management – Horizontal Approach

Scale-up of the business risk as symbolized in the risk terminology is attributable to globalization especially in economy at first. Every businesspeople have learnt to easily access to the new market and new supply sources since 1990's, but it means business managers are entering the unknown world where nobody is sure what to appear and happen. The partner countries and regions are also changing. Newly emerging markets are prosperous but we should not ignore it has just emerged in the 21st century. In this situation, what kind of risk management is possible and realistic?

If we consider basically, we will be able to find some countermeasures. For this consideration, the categorization as in above section 5 suggests that the risk has a trend to have more dimensions, namely not limiting to a commercial dimension but involving political, economic and unidentified dimensions. Then the hedging of these risks should be also multidimensional or 'horizontal'.

The followings are just simple examples.

(1) Improvement of Conventional Measures

Insurance by public or private sectors are available to some extent, and letter of guarantee issued by major banks is still one of the best means, but we should note what these can cover is mainly default of the partners and some portions of the loss.

Uncontrollable factors cannot be covered by ordinary insurance. It is nevertheless worthwhile for business people to try negotiations with insurance and financing institutions. For such negotiations, the

categorization as Image will be some guidance.

(2) Regional Experts

Old type of brokers taking commission for easy trading is disappearing in many fields. But their substantial function should not be underestimated. They originally functioned as shock absorbers for manufacturers and the users unfamiliar with overseas business. If business community views the current world as unpredictable, it is worthwhile to reconsider employing a new type of broker who vigorously works for the benefit of the client. New ones must be consisting of 'regional experts' with sufficient intelligence of politics, economics, culture and skill of hard negotiations based on their long experience in the region. They have to be well acquainted with culture and mentality of the region as conflicts based on cultural difference can be serious today. Companies have an option to bring up and train regional experts instead of outsourcing if time allows.

(3) Networking

Considering the risks of today are becoming cross boarder not limited to the partner countries only, companies with global networking are in the position of providing the information and advices to others trying to start business with new overseas partners.

Such networking companies should amplify the network further through these works, and their consulting works will develop into a partnership, which is similar to good

brokers as mentioned in (2). It is not impossible for them, with the integrated actions, to negotiate with governments and insurance companies to invent more advantageous insurance means as (1).

(4) Global Thinking

Before entering the contract, there should be one rule, i.e. we must be careful about autocratic countries. If these countries are large, the scale of the risk is proportionately large and the cause is hard to locate. If they are small countries, they are usually relying on big sponsors as North Korea on China or Tunisia on France. It means we must be sensitive to Cross-Border or Regional Risks even on the business with large and rich countries^{vii}. Before outsourcing the hedging means, it is required to think globally.

As far as risks of today are developing in various dimensions not limiting to the core of projects and trades only but involving surroundings to enlarge the scale and seriousness, the countermeasures should be horizontal, not satisfied with vertical approach of intensifying the protective measures for the project or trade only in a country where business is going on. The integrated collaboration is desirable among companies, organizations and governments, who have the common benefits of minimizing the risk in the region. Some think-tanks researchers or institutes can be members of this network, too.

With these horizontal alliance and collaborations, businesspeople will be able to

exchange information and sometimes take preventive, preparatory and containing actions as a basic crisis management^{viii}, to finally save the life of people involved. It may cost more and bring less profit to business people than the case of protecting the own business alone, but it will consequently contribute to dispersion of the risk.

8. Conclusion

Globalizing trend of business risks is in parallel with the change of business patterns in the globalizing world. Diversification of scale and causes is also going on with the development of globalization in the field of economy. Effective countermeasure to the globalizing risks will require the horizontal integration of higher grade by companies, organizations, governments and individual experts. For this, business communities will need recruit and train the brains who can appropriately tackle the risks and settle the troubles, without confusion by inappropriate description of the risk they face.

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