



# **The impact of political risk on foreign direct investment decisions by South African multinational corporations**

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## **Abstract**

South African Multinational Corporations (MNCs) are expanding their operations and seeking investment opportunities elsewhere besides South Africa. Some of these opportunities present themselves in unfamiliar environments which are politically risky nonetheless South African MNCs continue to invest in such countries.

The aim of this research paper is to establish the impact of political risk on foreign direct investment decisions by South African MNCs. The paper seeks to establish key political risk factors that South African MNCs consider prior to investing in a country deemed politically risky. Once they have indentified these political risk factors, what are the Foreign Direct Investment (FDI) drivers attracting them to a specific country despite its political climate? The paper attempts to understand the decision making process of MNCs when seeking to invest in a politically risky country and to what extent do MNCs involve the incumbent government and other local stakeholders in this process. Lastly the paper seeks to establish how MNCs manage the impact of political risk in a country.

A qualitative research methodology with an exploratory design was used to collect the data. In-depth face-to-face interviews were conducted with eight representatives from South African MNCs which are doing business in politically risky countries.

The results reveal that political risk has a significant impact on the FDI decision making process of South African MNCs and how they go about conducting this process has a far reaching impact on the success of the MNC in a politically risky country. Conducting a thorough political environment assessment is critical, by engaging the incumbent government and all relevant stakeholders is key when seeking to invest in politically risky countries. Politics drive economics therefore one cannot separate economics and politics.

## **Key Words**

Foreign Direct Investment (FDI)

Multinational Corporation (MNC)

Political Risk

## Declaration

I declare that this research project is my own work. It is submitted in partial fulfilment of the requirements for the degree of Master of Business Administration at the Gordon Institute of Business Science, University of Pretoria. It has not been submitted before for any degree or examination in any other university. I further declare that I have obtained the necessary authorisation and consent to carry out this research.

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Thabo Koboekae

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# 1. CHAPTER 1 :THE RESEARCH PROBLEM

## 1.1 Introduction

Foreign direct investment (FDI) by multinational corporations (MNCs) has grown rapidly in recent decades, and developing countries have attracted an increasing share of it: \$334 billion in 2005 or more than 36% of all inward FDI flows (Buthe & Milner, 2008, p. 741). Lokesha & Leelavathy (2012) acknowledge that in recent years emerging markets have attracted a great deal of interest from MNCs and are seen to have extensive investment opportunities which are yet to be exploited. Similarly Singh (2010) notes that there has been increasing competition among nations and sub-national entities to attract FDI, especially emanating from emerging market multinational corporations (EMNCs). Singh (2010) further cites that in the present world, the developing countries are contending among each other to attract more FDI, which is contrary to the earlier perception of developing countries with regard to FDI. According to Azzimonti & Sarte (2007) good economic perspectives, human capital, and development of infrastructures attract greater investment inflows.

Fedderke & Luiz (2008) suggest that despite the investment attractions in emerging markets, some of the investments in emerging markets reside in countries which are perceived to be politically risky. Also contrary to Azzimonti & Sarte (2007), in his paper Jiménez (2011) notes that greater levels of political risk, measured through scales of political discretion, corruption, and economic freedom, do also attract higher inflows. In his research Jiménez (2011) found that despite the fact that one would expect global FDI flow to fall due to political risk, they have actually done the opposite and have risen, this according to Buthe & Milner (2008) is due to MNCs seeking a first mover advantage, attaining a market niche and optimising their political capabilities to mitigate political risk.

Although political risk has traditionally been thought of as an obstacle to global outflows of FDI, a line of research has recently indicated that MNCs from certain countries actively use their political capabilities to obtain competitive advantages by selecting those countries in which they can benefit from the discretionary power and even the corruptibility of the system (Jiménez, 2011, p. 64).

The assessment of the impact of political risk on FDI is important in investment decision making, Bekefi & Epstein (2008) acknowledge that failure to integrate political risks elements into investment decisions in a meaningful way leaves critical elements out of current resource allocation. Bekefi & Epstein (2008) cite that social, political, and environmental risks are often relegated to the footnotes, which aren't included in financial calculations.

## **1.2 Research Problem**

Today most developing regions in the world are making efforts to attract FDI. Not all of them have managed to attract substantial amounts of FDI, despite having begun to open up their economies, develop infrastructure, and improve the quality of their institutions. Jiménez (2011) cites that Africa, in particular, is one of the least attractive venues for FDI worldwide.

This paper explores the inflow of FDI into politically risky countries emanating from MNCs. This interest is derived from the challenging dilemmas investors face over investment decisions in politically risky countries which at most times have an abundance of natural resources. Given the relevance of the context, the focus of this paper is on variables related to political risk. Jiménez (2011) cites that in order to analyse the approach taken by MNCs when investing in politically risky countries one needs to understand economic and political policy consequences and implications affecting host countries.

Jensen (2008) finds that most existing studies suffer from data problems where researchers can only offer indirect evidence of the relationship between political institutions and political risk and their impact on FDI decision making processes. Although there is consensus on the importance of attracting FDI and the importance of establishing a conducive environment for attracting FDI, MNCs do not give political risk enough attention during the decision making process. MNCs tend to be flexible and mobile in their locations of operations i.e. MNCs are at liberty to invest anywhere in the world. However once MNCs have invested in a specific location there are serious cost of disinvesting due to political risk (political violence, expropriation of assets or renegotiation of contracts by host governments to the detriment of the MNCs).

It thus follows that once MNCs have invested in a country that is politically risky and these risk elements manifest themselves, MNCs react and at times it may be too late to avoid

the adverse consequences. These risks have led to the development of an industry dedicated to providing insurance covering political risks for multinational operations. Political risk insurers charge premiums for political risk coverage against the confiscation of firms' assets (expropriation risk), restricting the repatriation of profits or other capital transactions (transfer risk) or risks associated with war or civil disturbance (political violence risk) (Jensen, 2008, p. 1043) .

None of the above literature articulates the core reasons why MNC invest in environments deemed to be politically risky even in countries which are historically stable MNCs are still faced with the threats of political risk, a case in point in the United States during the 911 attacks, it is therefore important to explore this topic in detail.

### 1.3 Research Motivation

Asiedu (2006) asserts that, in order for Africa to meet its Millennium Development Goals (MDG), it ought to attract a significant inflow of FDI. However the International Country Risk Guide (ICRG) reports that the 10 riskiest countries, 9 are in emerging markets and of the 10, 7 are African countries as indicated in Table 1.1 Risk ratings range from a high of 50 (least risk) to a low of 0 (highest risk), though lowest de facto ratings are generally near 15 (ICRG).

**Table 1.1: List of Countries according to Economic Risk Rating**

Country	Value
Zimbabwe	23.5
Liberia	25.5
Niger	25.5
Syria	25.5
Madagascar	26.0
Sudan	26.5
Yemen	26.5
Tunisia	27.0
Somalia	27.0
Egypt	27.0
Greece	27.0

Political risk is deemed as one of the key elements in making a country unattractive for FDI. This research paper attempts to understand the underlying factors that are considered by MNCs, despite a country being perceived politically risky.

The economic development of emerging markets and developing countries depends to a large extent on the possibility to make profitable investments and accumulate capital. Having access to foreign capital and investments allows a country to exploit opportunities that otherwise could not be used (Busse & Hefeker, 2007). This research paper attempts to explore emerging markets, more specifically those of Africa. African countries are undergoing real economic development and a significant amount of this development is reliant on FDI by MNCs, however MNCs need to understand the political dynamics of the country they seek to invest in (Asiedu, 2006).

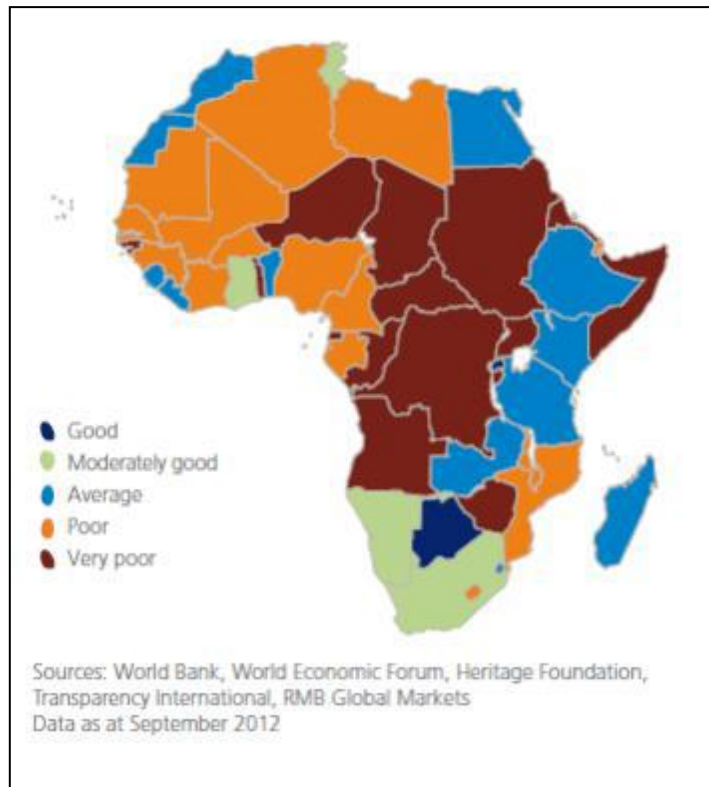
This research paper is important because of increased impact of globalisation and the commodity boom in Africa, telecommunications up surge in Africa and a requirement to transact funds in Africa. A number of South African MNCs are seeking to invest in the rest of Africa and at times invest in politically risky countries. It is therefore important that South African MNCs understand what factors constitute political risk and how these different elements impact the investment decisions which MNCs need to make.

It is important to understand how South African MNCs can identify the threat of political risk in a country, how to go about in managing that particular risk using their capabilities and tools they have at their disposal. This research paper examines three industries namely banking, telecommunication and mining. The assumption is that different industries may be faced with the threat of political instability however the impact of these threats may be different across the different industries.

Figure 1.1 is RMB's composite index of Africa's operating environment, which is a culmination of data derived from the World Bank, World Economic Forum, Heritage Foundation and Transparency International. What stands out in this figure are the countries which are very rich in natural resources (example Angola, Nigeria and Democratic Republic of Congo), have poor to very poor operating environment index yet still attract considerable amount of FDI.



**Figure 1.1: RMB's Composite Index of Africa's Operating Environment**



Source: RMB Global Markets Research (2012)

#### **1.4 Research Aim**

The paper seeks to establish why MNCs from South Africa invest in countries that are perceived to be politically risky like Democratic Republic of Congo, Angola, Sudan, and Kenya UNCTAD (2010), yet thrive. Is there a link between political risk of a country and FDI inflow into that country? South Africa, itself experienced capital flight due to political risk during the apartheid era, more specifically in the early 1980's, when corporate giants like Barclays, Volvo motors and Eastman Kodak withdrew their investments from the country. The events of Marikana in August 2012 in South Africa are of concern to the country's political and economic climate, MNCs seeking to invest in South Africa are now having to think harder before investing in South Africa.

There is an increasing number of South African MNCs that are making inroads and setting up operations in Africa and other emerging markets. Some of these countries are politically risky. Some examples of South African MNCs operating in politically risky countries are presented in the Table 1.2 below:

**Table 1.2: Organisations in Politically Risky Countries**

<b>Organisations</b>	<b>Sector</b>	<b>Political risky country</b>
De Beers	Mining	Democratic Republic of Congo (DRC)
Standard bank	Banking	South Sudan and Democratic Republic of Congo
MTN	Telecoms	Iran
SAB	Manufacturing	South Sudan

Others like retail giants Shoprite Checkers and Massmart are slowly making inroads into the rest of Africa (RoA). It is thus important for South African MNCs to give political risk attention when seeking to invest in those countries that are politically risky.

This paper researches areas of macroeconomics which can be further broken down into the following subtopics under: political economy, social economics, development economics, foreign direct investments, emerging markets and international trade. In the research paper there is greater emphasis on political economy, exploring issues around the influence of government and politics on the economy of a host country and how specific macroeconomic policies if any are formulated. In turn the paper explores how these macroeconomic policies influence foreign direct investments emanating from MNCs.

The paper seeks to contribute to current literature by highlighting the impact of political risk on FDI.

This paper aims to:

- Define what is perceived to be a country that is politically risky in terms of key factors that influence this definition across three sectors namely: banking, mining and telecommunications.
- What political risk elements do South African MNCs explore prior to making decisions about investing in politically risky countries?
- Explore FDI drivers deemed significant by South African MNCs.
- To understand the process followed when deciding to invest in a country that is politically risky.
- Explore strategies that South African MNCs deploy when managing political risk in other countries.

## 1.5 Structure of the Research Paper

This research consists of seven Chapters. Chapter 1 briefly introduces the reader to the research topic outlining the motivation of the paper and its importance to South Africa and more especially MNCs emanating from South Africa and seeking to invest in the rest of Africa. Chapter 1 outlines the aim of the research paper, what the paper seeks to explore, it also documents gaps in current literature which are to be explored in Chapter 2.

Chapter 2 reviews current literature pertinent to the research topic, this chapter explores different theoretical constructs relevant to the topic. The constructs explored in the literature review include – political risk, foreign direct investments, multinational corporations and strategies to manage political risk.

Chapter 3 presents the four key research questions which enabled the researcher to explore the topic in more detail. Chapter 4 describes the methodology that was used. For this research, a qualitative research methodology was used in the form of face-to-face and telephone interviews. The chapter defends that rationale for using the methodology and its appropriateness for the research. Chapter 5 presents the data gathered from the interviews, the data is rich in nature. However in Chapter 5 the data is presented in a logical and comprehensible manner using frequency, content and rank analysis. Chapter 6 is the analysis of the data collected in the data collection phase of the research (Chapter 5). In Chapter 6 an in-depth analysis is conducted in order to explore the theoretical as well as practical aspect of the research and constructs in particular. Chapter 7 is the concluding chapter, linking Chapters from 1 to 6 together.

## **2. CHAPTER 2: LITERATURE REVIEW**

### **2.1 Introduction**

During the past two decades, numerous empirical studies have been undertaken to ascertain the degree to which MNCs heed symptoms of socio-political instability in analysing investment opportunities in foreign countries (Aisen & Veiga, 2010). Busse & Hefeker (2007) state that foreign direct investments are the most desirable form of capital inflows to emerging and developing countries and are of great importance in uplifting Africa out of poverty.

In the first section of this paper it was made mention of the inconsistencies that have prevailed pertaining the FDI emanating from MNCs and flowing into emerging markets, and particularly in countries perceived to have been politically risky. Buthe & Milner (2008) cite that the flow of FDI into developing countries varies greatly across countries and over time. The political factors that affect these flows are not well understood (Buthe & Milner, 2008, p. 741).

### **2.2 Political Risk**

Numerous researchers have defined political risk, in as many ways as there are authors of this topic. In their paper, Aisen & Veiga (2010) mention that political risk is regarded by economists, as a serious malaise, harmful to economic performance. Political risk is disruptive in nature and is a hindrance to macro-economic policy makers in implementing their policies. Lim (2011) segments political risk into three key components, namely: macro, micro and sovereign. Macro-political risks are those risks which are country specific and affect all foreign MNCs seeking to invest in the host country in the same way. Ling & Hoang (2010) cite example of macro-political risks being revolutions, civil wars, nationwide strikes, protests, riots, and mass land expropriations.

Lim (2011) suggests that micro-political risk factors are those elements which are specific to industry and may vary across different industries. Ling & Hoang (2010) give examples of micro-risks including elective expropriations, discriminatory taxes, and import restrictions directed at specific firms.

Sovereign political risk entails events such as political coups, grand corruption, the expropriation or nationalization of property, war damage, and the inconvertibility of

financial assets (Lim, 2011, p. 51). It is the aim of this research to explore what constitutes political risk as perceived by individual MNCs from different industries. Asiedu (2006) suggests that some risk factors affect only certain industries despite various companies from different sectors being located in the same region. Asiedu (2006) attributes this to the level and type of risk differing according to the characteristics of industry and MNC. With regards to sovereign political risk Ekpenyong & Umoren (2010) and Azzimonti & Sarte (2007) are of the opinion that political risk transcends boundaries, if a certain country is politically risky, that risk may have far reaching consequences beyond the country's borders. Feinberg & Gupta (2009) agree with this and further cited that political risk in a country may spill over to neighbouring countries or even to the extent of the region as a whole. Desbordes (2010) cite that this may be evidenced by the fleeing of refugees from the troubled country into the neighbouring country. This section explores individual political risk factors.

### **2.2.1 Government**

Alesina, Özler, Roubini, & Swagel (1996) definition of political risk is focused on political leadership and the transition thereof, they suggest that transition of government power brings about political instability if not handled smoothly. Alesina et al.(1996) further define political instability as the propensity of a change in the executive power, either by constitutional or unconstitutional means. Their paper studies whether a high propensity of an executive collapse leads to slower growth and, conversely, whether low growth increases the propensity of a government change. Aligned with Alesina et al. (1996) definition of political instability is Busse & Hefeker (2007) definition which refers to how countries are governed and the factors influencing foreign investment inflows, these factors tend to be more inward focussed. Busse & Hefeker (2007) suggest that the elements of political instability that influence FDI include the following: government stability, the absence of internal conflict and ethnic tensions, basic democratic rights and ensuring law and order. Blanco & Grier (2009), note that countries with relatively higher levels of democracy-scores have lower political instability and this is indicative of a smooth transition of political power.

Fatehi-Sedeh & Safizadeh (1989) cite that political risk is not only influenced by the internal conflict, but by the collaborative functioning of government entities and inter-governmental relations that could be co-operative or conflictive in nature. Desbordes

(2010) suggests that political risk can be divided into two key areas global and diplomatic political risk, global risk is defined as the general political risk occurring globally in a specific time period, whereas diplomatic political risk is concerned with the political interaction of two countries. Desbordes (2010) is consistent with Fatehi-Sedeh & Safizadeh (1989) description of political risk; they suggest that political instability is not only concerned with the internal political relations of the country but also political relations with other countries, of which Pinto & Pinto (2008) term diplomatic political risk. The transition of governments and ultimately the governing of the country are a key determinants to the stability of a country. Party politics play a key role in the stability of a country, Khachoo & Khan (2012), Blanco & Grier (2009), and Alesina et al. (1996) highlight democracy as a key determinant to the success of transitional governments. Blanco & Grier (2009), also cite political party factionalism as associated with high-levels of political risk.

In their research Clare & Gang (2010) conclude that MNCs prefer regimes of shorter duration than those of longer, Asiedu (2006) suggests that governments which have been in power for an extended period tend to misuse their power and are dictatorial in nature. Drahokoupil (2008) agrees that such a situation can lead to civilian apprising and in turn a country to be unstable.

However Aisen & Veiga, (2010) are of the opinion that frequent switching of governments may lead to frequent changes in policies and therefore creating volatility in the macroeconomic environment of the country. In their study of the construction industry, Ling & Hoang (2010) found that governments may directly influence the construction industry through policies and legislation regarding licenses and permits, building codes, minimum wage rates, corporate taxes, discriminatory taxation, or levies and rules relating to imports of materials and equipment.

Ekpenyong & Umoren, (2010) are of the opinion that elections may be catalyst to political instability, in that elections may signal and change in regime, which in turn may leave some political groups dissatisfied with the outcomes of elections, such dissatisfaction may be displayed by acts of violence.

### **2.2.2 Economic**

While the economic determinants of FDI inflows to developing countries have been analysed to a considerable degree, it is rather astonishing that the importance of changes in political institutions and of other relevant policies in host countries have received relatively little attention (Busse & Hefeker, 2007, p. 1). Blanco & Grier (2009) find close relationship between politics and economic factors exist, in their paper they concluded that income inequality, urban growth, and ethnic fractionalisation all have significant effects on political instability. The higher the income disparities (gini-coefficient), the more unstable a country may be. Blanco & Grier (2009) further suggest that this is more prevalent in mineral rich countries in that the political elites are perceived to be in cahoots with MNCs and get all the riches of the country while the rest of the population does not benefit from investments made in those countries.

### **2.2.3 Violence**

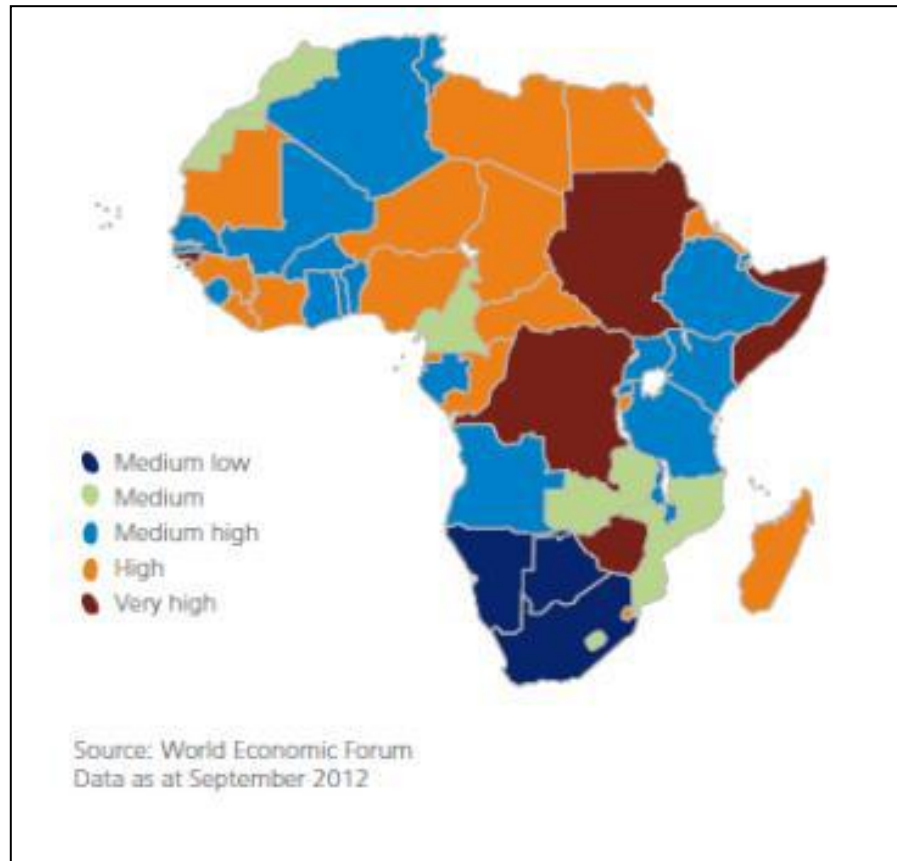
Blanco & Grier's (2009) view pertaining to political instability is more focussed around disruptive and violent activities perpetrated within the host country. Haslam (2007) cite nine different variables are key determinants of political risk and they include assassinations, coups, government crises, anti-government demonstrations, riots, strikes, purges, guerrilla activity and revolutions. Consistent with Blanco & Grier (2009) and Haslam (2007), is Goldstone, Bates, Epstein, Gurr, Lustik, Marshall, Ulfelder & Woodward (2010) who state that civil war is the main contributor to political risk. Goldstone, et al., (2010) do however explore additional types of political instabilities which include adverse regime change as well as genocides and politicides. Adverse regime change includes total change in the ruling party or even the collapse of the state in general as was witnessed in countries like Somalia and the Democratic Republic of Congo in the early 1990s. The overthrowing of a government by a radical revolutionary regime, as in Cuba in 1959 and Iran in 1979; and the contested dissolution of federated states or the secession of a substantial area of a state by extrajudicial means, as occurred in the USSR and Yugoslavia in 1991, or in Pakistan in 1972. (Goldstone, et al., 2010, p. 191). Consequently political risk is primarily thought of during violent periods such as: coups, civil unrest and moments of major political changes, for example nationalisation (Ekpenyong & Umoren, 2010).

#### **2.2.4 Democracy and Political Risk**

Telatar, Telatar, Cavusoglu, & Tosun (2010) highlight democracy as a key when determining factors that influence political risk. Asiedu (2006) cites that progressive countries, are countries that are perceived to be democratic and have government's that have been democratically elected, therefore the more democratic a country is, the more politically stable it will be. However Jensen (2008) suggests that authoritarian governments which are not easily influenced by public pressure are more favoured by MNCs and other investors. Authoritarian governments tend to be those that are in power for a prolonged period of time. The rationale for this is that these governments are stable and so are their policies. This notion is shared by Aisen & Veiga, (2010), who are of the opinion that frequent changes in government engender uncertainty and volatility. It is thus deemed more attractive for MNCs to investment in countries that have had a long standing government because the political environment cannot be easily be disrupted by citizens and other pressure groups. Jensen (2008) goes on to state that in actual fact democracy can lead to political risk in that newly elected governments may manipulate fiscal and monetary policy to suite their own needs. Ekpenyong & Umoren (2010) agrees with Jensen (2008) and suggests that MNCs need to be mindful of parties that come into power as they may have different policies to the incumbent and this may engender political risk. Therefore democratic aspects of government have expansive implications on how politically risky a country may be. Some of the countries (Nigeria and Democratic Republic of Congo) presented in Figure 2.1 have notably high political risk indicators yet still attract considerable amount of FDI. South Africa and Botswana are countries which are viewed to democratic and have medium low political risk indicators



Figure 2.1: Political Risk Indicators



Source: RMB Global Markets Research (2012)

## **2.3 Foreign Direct Investment**

With the advent of globalisation and discovery of mineral resources in a number of emerging market countries more especially those in Africa, FDI has become important in the growth and development of emerging markets (UNCTAD, 2010). Desbordes (2010) defines FDI as the process whereby resident of one country acquires ownership of assets for the purpose of controlling the production, distribution and other activities of a firm in another country (the host country). Lokesha & Leelavathy's (2012) definition of FDI is consistent with that of Desbordes (2010), citing that FDI is widely regarded as an amalgamation of capital, technology, marketing and management. It is an investment abroad, usually where the company being invested in is controlled by the foreign corporation. Moreover, it depends on the factor endowment in the country. For instance, the availability of quality infrastructure, scientific knowledge, human capital, research and development activities, play a critical role in the trickle down process from MNCs to local firms (Singh, 2010).

Depending on the industry, FDI is influenced by different elements, in the service industry market size is a significant element to attracting FDI, this makes sense in that the MNC needs to establish if there is a significant demand for their service. Whereas in mining the attraction for FDI would be the presences of property rights and the rule of law, obligations to mining and contractual rights. International commodity prices and inflation would also play a significant role. On the other hand the banking sector would cite that market size with a potential to grow would be the key determinant to it investing in a country.

### **2.3.1 Importance of Foreign Direct Investment**

FDI has been a topic of keen interest, more especially in emerging markets. Asiedu (2006) cites that more so by New Partnership for Africa's Development (NEPAD) declaration, which seeks to eradicate poverty and views FDI as a salient tool to do so. The NEPAD's declaration stipulates that in order for the continent to achieve the Millennium Development Goals (MDG), the region needs to fill an annual resource gap of US\$64 billion, about 12 per cent of GDP (Asiedu, 2006, p. 64). Lokesha & Leelavathy (2012) state that developed markets have had assistance of foreign finance to supplement their own meagre savings during the early stages of their development, therefore Africa can learn from this approach.

### 2.3.2 Determinants of Foreign Direct Investments

Natural resources alone are not enough to attract FDI. Asiedu (2006), Musila & Sigue´ (2006) and Lokesha & Leelavathy (2012) view good infrastructure, sound judicial system, robust property rights, educated workforce, macroeconomic stability, openness to FDI, and political stability as key factors in attracting FDI. Lokesha & Leelavathy (2012) acknowledge the factors key in attracting FDI include well-articulated government policies. Government considers FDI flows as a means to fight unemployment and enhance national growth rate (Lokesha & Leelavathy, 2012, p. 462). FDI is key in the development of economies in that it brings about a transfer of technology, managerial skills and improves the productivity of the host nation (Awan, Khan, & Zaman, 2010, p. 531)

Lokesha & Leelavathy (2012) cite some of the of the pertinent government policies as being the following: liberal industrial policy, liberal trade policy, foreign exchange policy and exchange rate regime, intellectual property protection regime, and tax policy. Whereas Musila & Sigue´ (2006) cite FDI determinants as being more at a microeconomic level and these include: market size, labour costs, infrastructure quality, openness, political instability and corruption.

Awan, Khan, & Zaman (2010) suggests that there are five key elements that investors consider when looking to invest abroad which include

1. Firstly, FDI mobilises the capital from capital rich countries to capital scarce countries, and both the countries derive benefit from this capital flow;
2. Secondly, FDI enables the foreign investors to take the ownership advantage in the foreign firms and place them in oligopolistic position;
3. Thirdly, foreign investors tend to invest abroad in order to access to availability of cheap raw material and labour force to minimize production cost.
4. Fourth factor is that FDI plays a very important role in strengthening the currencies of home and investing countries.
5. Fifth factor is that political stability in host country or political instability in home country encourages the foreign investors to invest their capital abroad.

Asiedu (2006) categorises constraints on FDI into 3 distinct categories:

1. Policy – infrastructure, human capital, macroeconomic instability and FDI policy.
2. Institutional – corruption, effectiveness of the rule of law.
3. Political risk – assassinations, coups and riots.

Table 2.1 presents results from the World Business Environment (WBE) and World Development Report (WDR) surveys and it reports the average score for each constraining factors on FDI.

**Table 2.1: Constraints on FDI to Sub-Saharan Africa (WBE and WDR)**

<i>WBE (1 = no constraint, 4 = severe constraint)</i>		<i>WDR (1 = no constraint, 6 = severe constraint)</i>	
Corruption	2.80	Taxes and Regulations	4.50
Weak Infrastructure	2.75	Corruption	4.47
Street Crime	2.70	Weak Infrastructure	4.28
Inflation	2.67	Crime	4.25
Financing	2.64	Inflation	4.11
Organised Crime	2.57	Lack of Access to Finance	3.95
Political Instability	2.43	Policy Uncertainty	3.88
Taxes and Regulation	2.24	Cost Uncertainty	3.75
Exchange Rate	2.15	Regulations on Foreign Trade	3.64

Source: World Business Environment (WBE) Survey and World Development Report (WDR) Survey (Asiedu, 2006, p. 66)

Table 2.2 - presents the summary for the World Investment Report (WIR) and The Centre for Research into Economics and Finance in Southern Africa (CREFSA) surveys and it shows the percentage of firms that identified a particular factor as a constraint to FDI.

**Table 2.2: Constraints on FDI to Sub-Saharan Africa (WIR and CREFSA)**

<i>WIR Survey</i>		<i>CREFSA Survey</i>	
Corruption	49	Political Instability	47
Lack of Access to Global Market	38	Macroeconomic Instability	42
Political and Economic Outlook	28	Crime	35
Cost of Doing Business	28	Corruption	35
Lack of Access to Finance	28	Policy Uncertainty	34
Weak Infrastructure	27	Weak Infrastructure	30
Tax Regulation	24	FDI Regulations	24
Unskilled Labour	23	War	19
FDI Regulatory Framework	21	Labour Unrest	17

Source: World Investment Report (WIR) Survey and The Centre for Research into Economics and Finance in Southern Africa (CREFSA) Survey (Asiedu, 2006, p. 66)

From the above survey Asiedu (2006) asserts that two key elements consistently rank high across the four surveys conducted, namely corruptions and macro and political instability. Asiedu (2006) concludes that despite the factors required to attract FDI stated by Musila & Sigue', (2006) (those being large market size and natural resources) sound and robust institutional and policy environments are key determinants too (Busse & Hefeker, 2007).

The next section discusses significant determinants of FDI which have been cited across extensive literature.

### **2.3.2.1 Natural Resources**

Africa and Latin America have seen significant inflow of FDI in the past recent years. Asiedu (2006) suggests that traditionally FDI in resource-rich regions like Africa and Latin America are concentrated in natural resources, and investments in such industries tend not to generate the positive spillovers (e.g. technological transfers, employment creation) that are often associated with FDI. But nonetheless, Kolstad & Villanger (2008) highlight that countries that are rich in natural resources will inevitably attract more FDI into the country. However Nonnemberg & de Mendonça (2004) note that investment in mineral resources is becoming less significant than it was at the beginning of the 20th century. As alluded to by Asiedu (2006) more focus is shifting to other sectors such as technology, pharmaceuticals, finance & banking, manufacturing and infrastructure development. Asiedu (2006) cites that countries that are small or lack natural resources can attract FDI by improving their institutions and policy environment.

### **2.3.2.2 Market Size**

Let us briefly explore the market size as cited by Musila & Sigue´ (2006) as one of the key factors to attracting FDI into a country. Khachoo & Khan (2012) cite that there ought to be a significantly large market size in a country for the MNCs to reap the benefits of investing in that country, a potentially large number of users/buyers of products, commodities or services are important. In agreement with Khachoo & Khan (2012), Monterro (2008) notes that the markets size of the host country receives a great deal of attention from MNCs, especially markets which have a potential to grow. Monterro (2008) cites market size as being measured by the gross domestic product (GDP) or per capita basis of a country, he further mentions that it therefore follows that the host country market size will inevitably attract FDI into the country.

Siddiqi (2007) suggests that the population of the country is a key FDI driver, because the bigger the population the bigger the market size and MNCs can take advantage of this, citing Nigeria and Democratic Republic of Congo as potential destination do business given their population sizes. Larger marketplace allows investors the opportunity to exploit "economies of scale", thus catering for wider markets. Foreign companies are attracted to locations with rapidly expanding urban middle class clientele, boosting high disposable incomes.

### **2.3.2.3 Labour and Skills**

Azzimonti & Sarte (2007) note that lower labour costs attract FDI, this depends on the level of skills required by the MNCs and industry, however an educated labour force is critical. Drahokoupil (2008) asserts that at times having both an educated and cheap labour force is not always mutual, with higher level of skills required comes an associated cost of attaining and retaining these skills. However in emerging markets, where historically the natural resources were the main drive for FDI, cheap labour costs and relatively low-level skills were the only requirements in extracting the mineral resources. In manufacturing and mining cheaper labour cost would be a highly significant factor in attracting investment into the country. Nonnemberg & de Mendonça (2004) argue that, as MNCs move from seeking investments in natural resources to seeking investments in knowledge-intensive industries, more attention will be given to the availability of skills in a particular country. Nonnemberg & de Mendonça (2004) further highlight that a country that has a high standard of education and presents a sustainable education policy that is aimed at increasing the level of education will be more attractive than a country that does not.

### **2.3.2.4 Infrastructure**

Infrastructure is important in order for MNCs to be able to produce and distribute their products with ease. Musila & Sique' (2006) mention that telecommunication networks, roads and railways should be in a condition that it makes it easy and affordable to distribute the MNC's products. Asiedu (2006) is also of the opinion that the cost of doing business in a specific country is a key determinant for FDI inflow into a county, therefore sound infrastructure which includes ports, airports, railways and roads are given special attention by MNCs seeking to invest in a specific country. Azzimonti & Sarte (2007) suggest that transactions cost will be lower with sound infrastructure.

The banking sector tends to favour a country with faster telecommunication network, readily available and fast internet access, this makes trading easier and less expensive within and outside the local economy. With good infrastructure an MNC has the ability to grow its current market and create new markets, in that infrastructure makes it possible for wide markets to have access to the MNCs product (Nonnemberg & de Mendonça, 2004).

Siddiqi (2007) cites that reliable basic infrastructure for supporting output facilities and handling exports is a key FDI driver for MNCs. The host country should have the ability to provide efficient internal and external transport links, utilities, telecommunications and access to IT.

### **2.3.2.5 Trade and Industrial Policies**

Buthe and Milner (2008) cite that developing country governments that seek to attract FDI can use trade agreements such World Trade Organisation (WTO) and Preferential Trade Agreements (PTA). Azzimonti & Sarte (2007) note that these trade organisations are themselves party to international trade regulations and therefore countries and MNCs party to these organisations are in turn party to international trade regulations. Buthe and Milner (2008) further cite that this implies that belonging to trade organisations brings about a platform for negotiations and therefore mitigating investment risk. Musila & Sique´(2006) note that many African countries have also sought to enhance the credibility of their investor friendly policies by becoming signatories to various bilateral and multilateral investment and trade treaties. According to Buthe & Milner (2008), countries establish institutions and trade tribunals which enable trade relations between the host country and MNCs, however despite these attempts contracts between MNCs and sovereign countries are almost impossible to enforce.

In their research pertaining to international trade policies and foreign direct investments, Azzimonti & Sarte (2007) found that strict laws and policies that the host country governments enforce can be a hindrance to an MNC investing in that country such policies may included, excessive taxation, capital controls, manipulation of exchange rates, bribes and permits demanded by government officials. Despite this Awan, Khan, & Zaman (2010) cite that there are a number of ways in which MNCs and host nations can collaborate in order for the two parties to benefit mutually and these include: tax incentives, joint ownership of business venture by MNCs and government of the host country, lower company tax rates, low inflation rates.

Lokesha & Leelavathy (2012) agree with Musila & Sique´(2006) and Buthe & Milner (2008), and state that in order for countries to attract FDI the regulatory and government policies should be open and flexible, yet robust, it is therefore important to strike a balance between the two.



### **2.3.2.6 Expropriation and Nationalisation**

Countries with relatively poor legal protection of assets, and a high degree of political instability, generally exhibit high rates of expropriation and this makes investment less attractive (Azzimonti & Sarte, 2007). Fedderke & Luiz (2008) state that property rights are a key determinant in attracting FDI, because political instability arises under conditions where poorly defined property rights provide perverse incentives to economic agents. According to Fedderke & Luiz (2008) the respect of property rights is perceived to be associated with a stable political setting of a country.

In their research Azzimonti & Sarte (2007) found that there were 575 expropriation acts between 1960 and 1992, committed by 79 developing host countries against foreign multinationals. Africa was the region with the highest concentration of expropriation events in the 1960s and 1970s, but Latin America and Asia became more active during the 1980s.

Political risk may weaken investors' belief in property rights, putting the investors in fear that part of the investment may be wasted due to poor protection. Property rights are fundamental in protecting investors' rights to pursue and retain their investment returns. The investors will not invest if they feel that their rights are threatened (Tu & Bao, 2009). Even in countries with excellent records of contract enforcement, creeping expropriation plagues firms due to the difficulty of specifying complete contracts. In technology joint-ventures, for example, multinationals remain wary of how technological leakages or inadequate enforcement of property rights could threaten an investment (Jensen, 2008).

## **2.4 Impact of Political Instability on Foreign Direct Investment**

The findings of a survey-based study by Busse & Hefeker (2007) indicate that MNCs consider the socio-political stability of the host country as one of the most important elements in allocating funds to foreign projects. Since 1985, FDI into developing countries has grown at a compounded annual rate of 15 percent, well above the growth rate of the gross domestic product (GDP) in these economies (Feinberg & Gupta, 2009, p. 381).

Feinberg & Gupta (2009) note that country risk and FDI are negatively associated, yet considerations such as rapid economic growth and lower factor costs are driving MNCs to significantly increase FDI into high-risk countries. Contrary to the above, in their paper, Busse & Hefeker (2007), reveal the following:

- They found that lower corruption and nationalisation risk levels, and better contract enforcement are associated with higher FDI inflows.
- They found that democratic rights lead, above all, to improved property rights protection, which in turn boosts foreign investments.

The above factors indicate that a stable political condition, where the laws and regulations are abided by, attract more FDI inflows. The above mentioned is also implied by Fedderke & Luiz (2008), who cite that the respect for rule of law and regulations (including property rights, human rights, environmental laws and labour laws) are key determinants to attracting FDI.

A country may undergo leadership transition, yet still attract FDI or even increased FDI inflows to the country. Alesina et al.(1996) suggest that in such a case FDI inflow into the country may be attributed to the manner in which the government leadership is able to manage the transition. The better the transition is managed, the better the perceptions about the country and in turn the more attractive it becomes as an investment destination. There are a number of socio-economic elements that MNCs consider when investing in a country which has undergone political leadership transition. Busse & Hefeker (2007) suggest that these factors include the following: the effects of government stability, socio-economic conditions, investment profile, internal and external conflict, corruption, military in politics, religious tensions, law and order, ethnic tensions, democratic accountability, and the quality of bureaucracy.

However Feinberg & Gupta (2009), in their research, found an increasing number of MNCs are choosing to make large investments in developing countries, many of which continue to experience significant policy hazards and weak legal institutions.

Contrary to Feinberg & Gupta (2009) findings, Desbordes (2010) indicates that political risk deters FDI in primarily two ways:

1. By jointly increasing both costs of doing business and uncertainty since MNCs will only invest if they are sufficiently compensated for the possibility that the profit potential of their project will not be fulfilled,
2. The uncertainty induced by political risk raises the required return on FDI and diminishes the range of projects deemed attractive to foreign investors.

In their study Busse & Hefeker (2007) found that in general, one would expect that at least 12 political indicators are positively related to FDI flows, as less political risk and better

institutions may attract foreign investment due to a lower risk premium, for instance, by enforcing property rights and contracts.

Azzimonti & Sarte (2007) cite that when a country becomes politically risky, there will be a reduction in the injection of foreign capital, into the host country. With a reduction in inflows of foreign capital this will lead to productivity losses and potential country revenues.

## **2.5 Foreign Direct Investment Decisions**

According to Tu & Bao (2009) executives of MNCs play a pivotal role in making investment decisions in emerging markets; their appetite for risk may strongly be driven by the potential of high rewards. Ekpenyong & Umoren (2010) suggest that MNCs should not only look at county which they want to invest in but should also consider the neighbouring countries and the region as a whole. Despite the number of risk elements that an MNC may be faced with, a firm may choose to proceed if it has a plan in place to manage the risks (Lim, 2011, p. 1).

Therefore companies often make decisions about social, environmental, and political risks based on personal biases, or they arbitrarily assign higher risk premiums to projects in unfamiliar locations and thereby fail to focus management's attention on reducing risk (Bekefi & Epstein, 2008).

Today most developing regions in the world are making efforts to attract FDI. Not all of them have managed to attract substantial amounts of FDI, however, despite having begun to open up their economies, develop infrastructure, and improve the quality of their institutions. Africa, in particular, is one of the least attractive venues for FDI worldwide (UNCTAD, 2010). Jiménez (2011) holds this same view, he notes that African countries suffer from lower investment levels because of the perception by investing MNCs of endemic instability on the continent. According to UNCTAD data, only 1.4 percent of global FDI between 1994 and 2001 went to Africa, whereas 14 percent went to Asia and the Pacific and 10 percent to Latin America and the Caribbean (UNCTAD 2003) (Jiménez, 2011, p. 59).

Researchers have identified political risk as a major driver of international capital volatility and of risk premiums on borrowing rates. What this means is that perceptions of political risk condition investors' willingness to invest in developing countries particularly because politics plays a major role in the allocation of aid (Ekpenyong & Umoren, 2010, p. 30).

## 2.6 Managing Political Risk

In their research Feinberg & Gupta (2009) established that there is a trend for MNCs to be engaging rather than avoiding investing in politically risky countries. However Feinberg & Gupta (2009) also note that current research is largely silent on how MNCs deal with country risk on an on-going basis after they have established majority or wholly owned operations in higher-risk countries. Ekpenyong & Umoren( 2010) found that earlier studies, in trying to understand political risk, focused operationally on how companies can identify and mitigate risks associated with a country's political climate.

Feinberg & Gupta (2009) suggest two political strategies of dealing with such risk prevalent in emerging markets.

1. A smaller MNC ownership stake reduces the amount of investment that is at risk in the host country.
2. Ceding the greater ownership stake to local partners is likely to reduce the risk of expropriation; this would be so because the local partners are likely to have stronger political connections with the host country government. Thus, in the presence of greater country risk, an MNC can be expected to maintain a lower ownership stake in a focal subsidiary (Feinberg & Gupta, 2009, p. 383).

According to Ling & Hoang (2010) the goal of political risk management is to protect the assets, reputation, and profits of the MNC by reducing the possibility of occurrence of a loss or reducing the loss before the risk materialises. The management of political risk by MNCs is usually done on an ad-hoc basis, and other types of risks like operational risk, credit risk and market risk are given more attention (Wood, 2009). It therefore follows that when there is the rise political risk MNCs will react instead of being proactive from the onset and at times it could be too late and has far damaging consequences than had initially anticipated. Bekefi & Epstein (2008) suggest that political risks factors are too often ignored, partly because of the complexities of measuring and integrating them into operational and capital investment decision making.

The importance of risk identification is determined by the necessity of knowing the risks facing a firm, such identification could then help the firm develop and implement new programs for risk control (Lim, 2011, p. 55).

Clare & Gang (2010) agree with Lim (2011) and further state that if an MNC is able to identify a potential element of political risk before investing in a country, it will be well positioned to either counter that risk or manage it efficiently in a manner that does not have a far adverse effect. Ekpenyong & Umoren (2010) suggest that decision makers of MNCs must first understand their home country laws and regulations before attempting to deal skillfully with the laws and regulations of the host country government.

When conducting political risk identification and management Kolstad & Villanger (2008) cite the importance of country data collection and analysis. Lim (2011) is of the opinion that if a risk is identified in the process of interviewing experts, gathering data, and filing documents, it is logical to pursue the information on the probability that it would likely occur, its consequences, impact, the time associated with the risk (when it might occur) and the possible ways to address it.

Wood (2009) highlights that it's very rare to find MNCs monitoring risk on a going basis using any sophisticated methodology. They would rather take out political risk insurances in order to buffer themselves against risk. Lim (2011) partially agrees with Wood (2009) and further suggests that rather than dealing with risk an MNC should avoid the risk totally. Lim (2011) further goes on to cite that avoiding or reducing risks involves scheduling or controlling investment volume and the resultant profits by not putting all your eggs in one basket, firms reduce resource commitments in the face of growing uncertainty.

In line with Lim (2011), Feinberg & Gupta (2009) suggest a more proactive way of tackling political risk is for MNCs to take a more proactive stance and form joint ventures with the local corporations. In this way Sharfman & Shaft (2011) cite that firms reduce their total exposure and commitments.

Lim (2011) suggests that firms can employ a wide range of strategies to turn uncertainties and risks in the host country into opportunities and their risk management procedures can help decision makers systematically cope with such risks and uncertainties. As such, firms with a flexible production structure that can accommodate risks such as rising labor and land costs are more likely to take higher levels of risk than those with a less flexible structure (Lim, 2011, p. 55).

At times MNCs opt to outsource their risk by taking out political risk insurances, the providers of this political risk insurance include private market participants, including Sovereign, Zurich, Chubb, Lloyd's of London, Aon, AIG, and government agencies such as the U.S. Governments' Overseas Private Investment Corporation (OPIC), Export Development Canada (EDC) (Jensen, 2008, p. 1043).

## 2.7 Conclusion

The literature review highlights the different sources of political risk which include instability of government, violence, nationalisation, expropriation of assets, civil war and corruption. The literature further suggests that the key political risk determinant is change in government leadership, this change may occur through democratic elections or violent means. Asiedu (2006) suggests that if a transition in political leadership happens in a democratic manner this is typically an indication of the electorate being content with both the results and the manner in which the transition took place. However transition may also take place by means of violent acts this is also indicative of the discontentment of the citizens either with the electoral process or with the incumbent government leadership. At times these political risk elements present themselves in countries which are potentially attractive for investment. MNCs need to familiarise themselves with the political environment of the country which they seek to invest in, doing this is not a trivial exercise and requires them to weight political risk factors against FDI opportunities.

Literature defines FDI as the amalgamation of capital, technology and management to an investment destination in another country (Loksha & Leelavathy, 2012). There are a number of FDI factors cited in the literature and these include political, legal, infrastructure, cost, social and market factors. These are vital to attracting FDI into a country and vary in significance according to the industry. Example infrastructure may be of great significance in the mining industry, whereas the size of the market is more important in the telecoms and banking industry. As stated earlier, here lies the dilemma which MNCs need to deal with when deciding to invest in politically risky destinations. The scanning of the political environment needs to be done thoroughly with the engagement of relevant stakeholder both from within the organisation and external to the organisation and these include government and local representatives. Understanding how South African MNCs go about in doing that is the aim of this research paper.

## **3. CHAPTER 3: RESEARCH QUESTIONS**

### **3.1 Introduction**

The research investigates the impact of political risk FDI decision by South African MNCs. The literature review provided a foundation for the four research questions. It focussed on key constructs which include political risk, FDI and MNCs. Therefore the research questions are aligned with the research problem and aim highlighted in Chapter 1. The research seeks to answer the questions outlined below.

### **3.2 Research Questions**

#### **3.2.1 Research Question 1**

**What are the political risk factors that MNCs consider before investing in a country?**

The question seeks to establish what the key political risk factors are that MNCs consider before deciding to invest in a country. How do MNCs define political risk and what elements, especially in their environment, constitute political risk.

#### **3.2.2 Research Question 2**

**What are the key FDI drivers that attract MNCs into a country?**

This question asks interviewees which FDI drivers are significant for attracting MNCs into a country. What are the FDI spill-overs that MNCs bring into a country and what investment strategies (greenfields, brownfields, mergers, joint ventures or acquisitions) do MNCs use when investing in politically risky counties?

### **3.2.3 Research Question 3**

#### **What decision making processes do MNCs undertake prior to investing in a country deemed to be politically risky?**

This research questions seeks to understand in detail the decision making process of MNCs prior to investing in a politically risky country. It seeks to understand the internal and external processes that happen when deciding to invest in a politically risk country. Which parties/departments are involved in the decision making process. How do MNCs familiarise themselves with the potential host country's legal systems, industry legislation, economic and political environment? Asiedu (2006) asserts that MNCs ought to understand the host country political landscape and government leadership, therefore this question also seeks to understand how MNCs relate with the incumbent government of the host country.

### **3.2.4 Research Question 4**

#### **How do MNCs manage Political Risk?**

This question seeks to understand how MNCs manage political risk, once they have invested in a politically risky country. It seeks to understand the strategies MNCs deploy once politically risky events manifest themselves. Do MNCs have disinvestments strategies, if so what are they? How do MNCs monitor political risks on an on-going basis? The question seeks to understand how MNCs safer guard their assets, capital and profits. Are there forms of political risk insurances which MNCs take out? Jensen (2008) makes mention of the emergence of political risk insurance, where companies transfer their political risk to insurance companies.



## **4. CHAPTER 4: PROPOSED RESEARCH METHODOLOGY**

### **4.1 Overview**

The research aimed to explore the impact that political risk has on FDI decisions by South African MNCs, as well as to investigate how this relationship plays itself out in weak or unstable environments. The research explored literature on politics and its impact on FDI in politically risky markets. Company representatives from MNCs conducting business in politically risky countries were interviewed. As this is an exploratory approach, it sought in-depth insight to factors influencing FDI in political risky countries. These elements have been written about to great extent, however not much has been explored how particular elements of political risk impact FDI. Although MNCs may state that general political and economic factors are vital when seeking to invest in politically risky countries, however some of these factors seek more understanding and in-depth analysis. It was therefore appropriate to use an exploratory approach in conducting this research. This research adopted the qualitative method because understanding the main theme from the perspective of the participants as well as the key constructs, context may be lost when textual data are quantified Struwig & Stead (2001).

### **4.2 Research Design**

An exploratory research design was followed, this entailed conducting interviews in order to investigate the impact that political risk has on FDI decisions in politically risky countries by MNCs. Exploratory research is about discovering general information about a topic that is not understood clearly by both the business and academic world. (Saunders & Lewis, 2002, p.110). The research used a qualitative approach in order to gather the data by way of semi-structured interviews with senior executive representatives of MNCs.

Marshall & Rossman (2010) note that qualitative in-depth interviews typically are much more like conversations than formal events with predetermined response categories. The research explores a few general topics to help uncover the participants view but otherwise respects how the participant frames and structures the responses. Struwig & Stead (2001) note that interviewees are asked a set of pre-defined questions, however they are also given an opportunity to elaborate on their answers and the interviewer has an opportunity to probe the interviewee further.

Marshall & Rossman (2010) cite that the interviewer should be tactful when conducting the interview and should set a scene which is conducive for the respondent to feel free and respond without apprehension. Marshall & Rossman (2010) cite that the interviewer should convey an attitude that makes the participant feel that his/her views are valuable and useful. Despite the method being flexible, Saunders and Lewis (2002) suggest that it ought to have a sense of direction and purpose.

The in-depth interviews with MNCs representatives and experts were aimed at ascertaining more than the just the general political and economic factors which have been cited in the many academic journals. The exploratory design aimed to gather the key elements which individuals in an organisation deem critical to investing in politically risky regions. The individuals ideally had to have had an influence or at least key involvement in the decision making processes of the MNC.

Saunders and Lewis (2002) cite that common ways of conducting an exploratory research include: academic literature, interviewing experts and conducting interviews, this enables the researcher to get rich insight on the topic. While exploratory research provides insights into, and fuller understanding of, an issue or situation, definitive conclusion should only be drawn with extreme caution (Saunders & Lewis, 2002, p. 111).

### **4.3 Scope**

The target organisations were South African MNCs operating in countries which are deemed to be politically risky by International Country Risk Guide (ICRG) listed in Table 1.1. These MNCs were predominately in the sectors of mining, telecommunications (telecoms) and banking. Therefore there were critical criteria that had to be met by the target organisation and these included:

- The organisation must be conducting business in countries which are deemed to be politically risky.
- The organisation ought to fall in one of these sectors: mining, telecommunications or banking

Table 4.1 presents examples of sectors and countries in which the South Africa MNCs operates that were explored included:

**Table 4.1: Sectors and Countries within which South African MNCs operate.**

<b>Sector</b>	<b>Politically Risk Country</b>
Mining	Democratic Republic of Congo (DRC), Mali, Nigeria
Banking	South Sudan and Democratic Republic of Congo (DRC)
Telecoms	Nigeria and Iran

#### **4.4 Unit of Analysis**

The single unit of analysis was an MNC that had significant investments in a politically risky country. The analysis included historical data, was longitudinal in nature and expanded at least two years prior political instability and during the period of political instability. Using a longitudinal approach enabled the researcher to track significant political events in the respective countries. The time period that was researched was between 1990 and 2010.

A purposeful sampling technique was used, Struwig & Stead (2001) suggests that qualitative research focuses primarily on the depth and richness of the data and therefore qualitative researchers generally select samples purposefully rather than randomly.

#### **4.5 Data Collection Process**

The data was collected by means of face-to-face, telephonic and skype interviews with top management representative from the target MNCs. The interviews were semi-structured questions in order to get a general overview and broad insight into the area of research. The open-ended questions allowed the interviewees to share their experiences and opinions without constrained alternatives.

This rationale for adopting a face-to-face interview technique was that it allowed for extensive discussion and immediate clarification of the questions as well as responses (Ling & Hoang, 2010).

The interviews were recorded by means of an audio recorder as well as notes taken by the interviewer. The duration of the interviews was between 40 minutes and 1 hour 40 minutes. Out of 12 invitations sent by the researcher, eight company representatives accepted to be interviewed. The eight respondents (67%) were working for MNCs that were operating in South Africa companies as well as countries which were deemed to be politically risky.

As stated earlier the initial 12 individuals invited were chosen by means of purposeful sampling technique, the organisations which they represented ought to have met the above the criteria mentioned in section 4.3 scope. The individuals themselves ought to have be in a position which they had some influence or insight of the process followed when deciding to invest in other countries. Therefore the target interviewees were typically Business Development Managers who tend to be involved in seeking business opportunities in various business environments. The secondary phase of the sampling was the snowball sampling Struwig & Stead (2001) explain this type of sampling as a type of referral technique, once the researcher has obtained rich information from the initial participants, a participant may suggest another participant to provide information relevant to the research.

The main reasons cited by those who did not want to participate in the study were that their schedules were too busy and/or that the research topic was a sensitive one, this is despite the researcher guaranteeing anonymity and confidentiality. Despite the small number of respondents this did not have an adverse effect on the data collected, as the data that was collected was rich in nature and could be used for the research. Struwig & Stead (2001) cite that qualitative researchers are more interested in the quality of data they collect and are less interested in the number of responses received. Therefore eight respondents were satisfactory for this qualitative research.

#### **4.5.1 Interview Process**

The overall interview process followed a set structure, which entailed the following steps:

1. Introduction of the interviewer (researcher) to the interviewee (respondent), highlighting the purpose of the interview, the process of collecting the data and opportunity for the interviewee to withdraw at any time of the interview (refer to Appendix A – Consent section).
2. The next section pertained to the collection of generic data (refer to Appendix A - Company General Information) which included:
  - Company name
  - Industry
  - Market share/size
  - Global presences

- Subsidiaries
- General history of the organisation
- Other general information
- Work Experience
- Years Current Job

For every qualitative study, data on the background and historical context are gathered. This may not be a major part of the data collection but at least, in proposing a particular setting, the researcher gathers demographic data and describes geographical and historical particulars (Marshall & Rossman, 2010, p. 107).

3. The subsequent section included the research questions (refer to appendix A – Research Questions).

## **4.6 Data Analysis Approach**

Data analysis in qualitative research is a process that is less discrete than found in quantitative research (Struwig & Stead, 2001). Data analysis methods enabled the research to organised and bring meaning to large amounts of data. Before performing the data analysis it is essential that all the raw data (transcripts, field notes and documents) are available and complete.

The approach that was used for data analysis of qualitative data was frequency analysis, content analysis and ranking. These types of analysis are appropriate for a qualitative approach. This was an iterative approach which sought to examine trends, commonalties, anomalies and in depth insight into the topic.

### **4.6.1 Content, Frequency and Thematic Analysis**

Content analysis ensured that an objective and systematic approach could be deployed. Content analysis is a research tool used to determine the presence of certain words or concepts within texts or sets of texts. Researchers quantify and analyze the presence, meanings and relationships of such words and concepts, then make inferences about the messages within the texts, the writer(s), the audience, and even the culture and time of which these are a part (Marshall & Rossman, 2010).

Table 4.2 presents a data analysis template used by the researcher. With content analysis the researcher was able to analyse the information attained during the interviewees and probe the information. The approach helped the researcher establish key trends and extraordinary cases by way of word counts and frequency tables. This systematic approach enabled the researcher to group words, trends and construct themes from the above, these themes were then ranked in order to make sense out of them and their relative importance.

**Table 4.2: Data Analysis Template**

Questions	Discussion	Content Analysis	Frequency Analysis
1 What are the political risk factors that MNCs consider before investing in a country?	Key themes established during the discussions. Free flowing discussion with the interviewee expressing his/her own opinion regarding the topic	How the interviewee actually answered the questions and which words did he/she use when answering the questions	The number of times a common theme is mentioned during the discussion. The themes will be counted and rank from high to low
2. What are the key FDI drivers that attract MNCs into a country?			
3. What decision making processes do MNCs undertake prior to investing in a country deemed to be politically risky?			
4. How do MNCs manage risk in politically risky countries?			

#### **4.7 Data Validity and Reliability**

In qualitative research, reliability is also viewed as being synonymous with consistency (Struwig & Stead (2001)). In order to collect reliable data, an interview guide was drafted and then distributed to the interviewees in order for them to familiarise themselves with the interview questions. In this way the interviewee had ample time to review the questions and had an opportunity to ask the researcher to elaborate on any questions which were not clear to them.

Collecting data by means of interviews was a challenging task and entailed verifying and validating the data collected during the process. In order to collect all the data, an audio recorder was used, this allowed the researcher to play back the recordings of the interviews as many times as needed. Supplementary to the recordings were the shorthand notes that the researcher took during the interviews, important and common aspects were highlighted on the transcripts during the interview. In order to verify the data collected during the interviews, post interview sessions were conducted. These post interview sessions entailed a 5 minute telephone conversation between the researcher and the interviewee.

#### **4.8 Research Limitations**

The research was limited by the following:

- The data collected during the interviews were views and experiences of the interviewee and is not empirical data. Therefore one needs to be mindful of this fact when reading the rest of the research paper. However this paper forms a good basis to conduct a qualitative research using the data and themes presented in Chapter 5.
- The research will only explore Africa, other regions such as South America and South East Asia would have made a very insightful research. Other sectors such as retailing would have made for a comprehensive research, more especially that South African retailers are expanding further into the rest of Africa, these include the likes of Shoprite and Massmart.
- The time to conduct an expansive research was also a limitation

## 5. CHAPTER 5: RESEARCH RESULTS

### 5.1 Introduction

This chapter presents the results attained from interviews with individual interviewees from different companies in the mining, telecommunication and banking sectors. The results are arranged per research question. Not all of the interviewee's responses have been documented verbatim, however those that are deemed significant, affirming or contradicting the literature have been documented verbatim.

This chapter presents findings as per research questions outlined in Chapter 3 – Research Questions and follows the methodology outlined in Chapter 4 – Research Methodology. As the results were attained from conducting exploratory in-depth interviews and respondents were assured of confidentiality and anonymity, this gave them the liberty to express their own views and experiences regarding their companies investing in politically risky countries.

Due to the open nature of the semi-structured interviews, a wide range of views were expressed, therefore key elements needed to be presented and expressed in a comprehensible format, hence the data is presented per research question. A frequency and ranking approach is used to present the data. This approach assisted the researcher to identify common, new and or contrasting themes.

The interviews lasted between 45 minutes and 1 hour 40 minutes. The verification and validation of the interviews was done typically a day or two after the actual interviews. The timing was important, the shorter the period between the interview and the post interview session the better, in that the information is still new and “fresh” in both the researcher and interviewee's mind. The post interview session entailed a 5 minute phone call, briefly outlining what was discussed during interview and also asserting the confidentiality and anonymity of the interviews. The purpose of the post interview sessions was to verify and validate the interview.

The next sections describe the sample used for the data collection, they also document the results attained from the interviews, and are presented per research question.



## 5.2 Description of Sample

A total of eight interviews were conducted with company representatives from three industries namely mining, telecommunication and banking. This was deemed to be a very sensitive topic, the initial target was 12 interviews however a number of potential interviewees retracted citing the sensitive nature of the topic being the reason for their retraction. Another issue was the availability of potential interviewees that held relatively high positions in the organisation and had very busy schedules.

A potential interviewee from the bank and two from a telecommunications sector declined to participate in the interview. The bank interviewee cited confidentially reasons while the interviewees from the telecommunications companies did not give reason for declining the invitation to be interviewed. The research had initially included the manufacturing sector as part of the sample however due to non-responsive interviewee it was eliminated from the sample.

Despite the relatively low number of respondents, the interviews provided rich and in-depth information on the topic. The interviewees were very knowledgeable on the topic and had had exposure at different levels, to the decision making process of their company, more especially decisions pertaining to investing in countries which are politically risky. All the interviewees are or have worked for MNCs that have or are currently operating in countries which are deemed to be politically risky. Table 5.1 presents the list of interviewees, their designation and industry in which they operate.

**Table 5.1: Interviewee List**

<b>Interviewee</b>	<b>Designation</b>	<b>Industry</b>
1	Engineering Account Manager	Mining - Platinum
2	Business Development Manager	Mining – Coal Division
3	Manager – Corporate Business Development	Mining – Iron Ore
4	Mining Manager	Mining –Steel
5	Mining Industry Champion – Development Finance	Development Finance – Mining Sector
6	Risk Manager - Africa	Banking
7	Head of Business Development - Africa	Banking
8	Head of Business Development	Telecoms

The real names of respondents are withheld and have been coded with numbers from 1 to 8, this was purely done for purposes of anonymity and confidentiality. Most of the conversations were conducted face -to-face, below is a break down on the interviews:

- 6 face-to-face,
- 1 telephonically
- 1 via Skype

### **5.3 Research Question 1: What are the political risk factors that MNCs consider before investing in a country?**

#### **5.3.1 Research Question 1**

The question sought to establish what the key political risk factors are that MNCs consider before deciding to invest in a country. How they would define political risk and what elements, especially in their environment, constituted political risk. The purpose of the question was to establish the below:

- The key indicators of political risk and how they are established or identified by the individual companies.
- The duration of the operations of these companies in countries deemed to be politically risky.
- Did political risk arise before, during or after the company had been operating in that country.

#### **5.3.2 Research Question 1 Results: Political Risk Factors**

Table 5.2 below indicates the political risk factors which the individual respondents 1 to 8 identified to be significant. The individual scores indicate both the frequency and weighting of each individual political risk factor per interviewee. The higher the score, the more significant that particular political risk factor is. Example “0” zero indicates that the political risk factor was not mentioned and “4” means it was mentioned and greater emphasis was made on the particular political risk factor. A number between 0 and 4 indicates moderately low and moderately high emphasis respectively.

**Table 5.2: Political Risk Factors – Frequency and Weighting**

Political Risk Factors	Interviewees								Total
	1	2	3	4	5	6	7	8	
civil uprising	1	0	0	0	1	0	1	0	3
civil war	0	0	0	1	1	0	0	1	3
corruption	2	3	4	1	0	3	3	4	20
coup d'état	0	1	1	1	0	0	1	1	5
discriminatory taxes	0	0	1	1	0	0	0	1	3
ethnic tensions	0	0	0	0	0	1	0	0	1
expropriation of Land	2	2	1	1	2	1	2	2	13
genocides	0	0	0	0	0	1	1	0	2
government instability	3	2	1	3	3	4	4	3	23
legal system	1	3	2	2	1	3	4	1	17
inability to convert assets	1	1	1	1	1	3	3	1	12
lack of freedom of political parties	1	2	1	1	2	2	1	1	11
lack of freedom of the press	1	0	0	0	1	1	0	0	3
manipulation of economic policy	2	0	0	3	1	0	3	1	10
nationalisation of assets	1	2	2	1	3	2	2	1	14
no democracy	3	2	1	1	3	1	3	3	17
political assassinations	0	0	1	1	1	0	1	0	4
rigged elections	0	0	1	1	1	0	1	0	4
riots	1	1	0	0	0	1	1	1	5
security lacking	1	1	0	0	0	1	1	0	4
strikes	1	0	0	0	1	1	0	0	3
violence	1	1	1	0	0	1	2	0	6

Table 5.3 below includes a new column “Themes” where political risk factors are grouped in certain theoretical themes also known as thematic approach (Marshall & Rossman, 2010).

**Table 5.3: Political Risk Factors and Themes – Ranking**

Rank	Political Risk Factors	Frequency and Weighting	Themes
1	government instability	23	Government
2	corruption	20	Economic
3	legal system	17	Legal
3	no democracy	17	Government
4	nationalisation of assets	14	Nationalisation and Land Expropriation
5	expropriation of Land	13	Nationalisation and Land Expropriation
6	inability to convert assets	12	Economic
7	lack of freedom of political parties	11	Government
8	manipulation of economic policy	10	Economic
9	violence	6	Violence
10	coup d'état	5	Violence
10	riots	5	Violence
11	political assassinations	4	Violence
11	rigged elections	4	Government
11	security lacking	4	Violence
12	civil uprising	3	Violence
12	civil war	3	Violence
12	discriminatory taxes	3	Economic
12	lack of freedom of the press	3	Legal
12	strikes	3	Violence
13	genocides	2	Violence
14	ethnic tensions	1	Violence

From Table 5.2 and Table 5.3 five major themes were established which are presented and ranked in Table 5.4.

1. Government
2. Violence
3. Economic
4. Legal
5. Nationalisation and Land Expropriation

**Table 5.4: Political Risk Themes – Ranking**

Ranking	Frequency and Weighting	Political Risk Themes
1	55	Government
2	45	Economic
3	36	Violence
4	27	Nationalisation and Land Expropriation
5	20	Legal

### 5.3.3 Research Question 1 Discussion: Political Risk Factors

During the in-depth interviews a total of 22 political risk factors were identified which are presented in Table 5.2. The numbers indicate significance and emphasis the interviewee put when he/she mentioned the specific political risk element as either a definition or a political risk element important in the context of the industry or personal experience. The top three political risk elements identified:

- Stability of the government
- Corruption
- Legal system and the legislation

The least significant political risk elements were:

- Strikes
- Genocides
- Ethnic tensions

#### 5.3.3.1 Government Instability

Government instability is the most significant political risk element mentioned by the eight interviewees, it has a frequency and weighting of 23. Below are quotes from some of the interviewees.

**Interviewee 1:** *“I think for us the key indicator of political risk is how smooth the transition of governments takes place. If you have a democratically elected government then the threat of political risk will be relatively low.”*

The above interviewee cites the transition of governments as being a key determinant to political stability, this would infer that a country ought to have free and fair elections in order for electorate to be content with both the procedure and results of the elections, this will be discussed in more detail in Chapter 6 – Data analysis.

**Interviewee 3:** *“The most important (political risk) element to us is the governance of the country and the government of the day, who is in control of the government, secondly legislations and statutory laws around the industry which can totally change the way we do business in a country.”*

Interviewee 3 also defines the governance of the country as a key indicator to political risk. The interviewee indicates how important the leadership is in a country as it sets the tone for governance and determines the strength of public institutions. Interviewee 3 suggests that strong public institutions are a result and an indicator of a strong incumbent government. With strong and accountable government institutions there tends to be equity and fairness in the country and in turn this lessens the threat of any political risk.

### **5.3.3.2 Nationalisation of Assets**

Nationalisation of assets as a political risk element was an element which was more prevalent in the mining sector.

**Interviewee 6:** *“We are currently operating in Zimbabwe and the government of Zimbabwe is in a process of passing legislation that wants it to have at least 51% ownership of the assets, so they are taking the nationalisation approach. So we need to determine if it’s worthwhile to continue conducting business in the country”*

MNCs invest a huge amount of capital into starting up operations, therefore they typically need assurance that they will have total ownership of the minerals they mine or ownership of operating assets they bring into to country. If they do not have total ownership of their assets (as in the case of Zimbabwe, as alluded to by interviewee 6) they need to determine if it’s worthwhile investing in that particular country.

### 5.3.3.3 Corruption

Corruption was noted as one of the top three political risk elements, below are some comments about corruption as a political risk factor. Corruption is closely linked to government instability, when a country has weak leadership and institutions which are unable to enforce the rule of law, corruption tends to be rife.

**Interviewee 6:** *“At times corruption can work for you, however it is not sustainable, it’s wrong and we don’t get involved in such activities. Organisations that get involved in corruption are short-sight and are typically small players, that can easily start another company with a different name should they be found guilty of corruption. Therefore corruption is one of the biggest factors we are faced with in politically risky countries.”*

### 5.3.3.4 Ethnic Tension

Although ethnic tension was not made mention of frequently, it is quite an interesting factor to explore. During the interview, interviewee 4 made mention of religious tension being a hindrance in Nigeria, below is what he had to say.

**Interviewee 4:** *“We are in Nigeria as you would understand what is happening in Nigeria at the moment, there are tensions between the Muslim north and the Christian south, and we consider this as an element of political risk”*

## 5.3.4 Research Question 1 Results – Operations in Politically Risky Countries

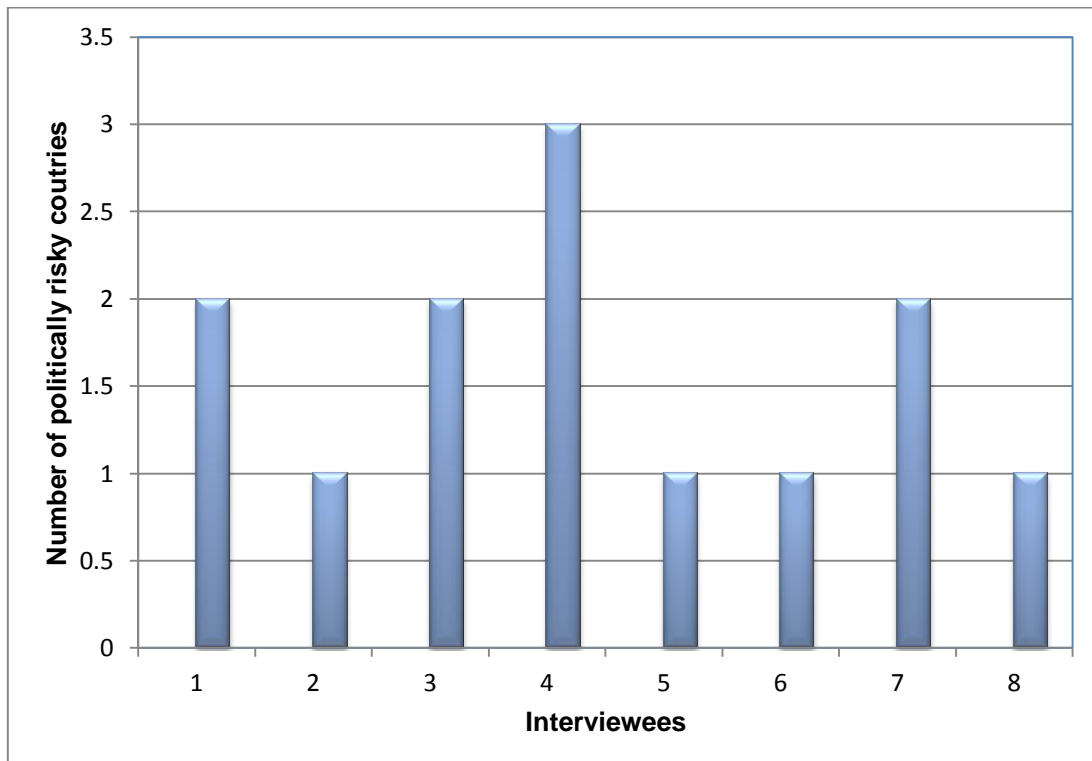
**Table 5.5: Operations in Politically Risky Countries**

Operations in politically risky countries	Interviewees								
	1	2	3	4	5	6	7	8	average
Number of countries operating in which are political risk	2	1	2	3	1	1	2	1	
Average duration of operation in politically risky country (years)	5	12	5	6	10	6	6	8	7.25
Did the political risk manifest itself before (B), during (D), after (A) you started operating in that country	D	B	D	D	A	D	B	B	

The interviewees were asked how many politically risky countries their MNCs operate in. The results are presented in Figure 5.1 below. Out of the 8 interviewees:

- 1 MNC operates in 3 countries each which are politically risky.
- 3 MNCs operate in 2 countries each which are politically risky.
- 4 MNCs operate in 1 country each which is politically risky.

**Figure 5.1: Number of politically risky countries operating in.**

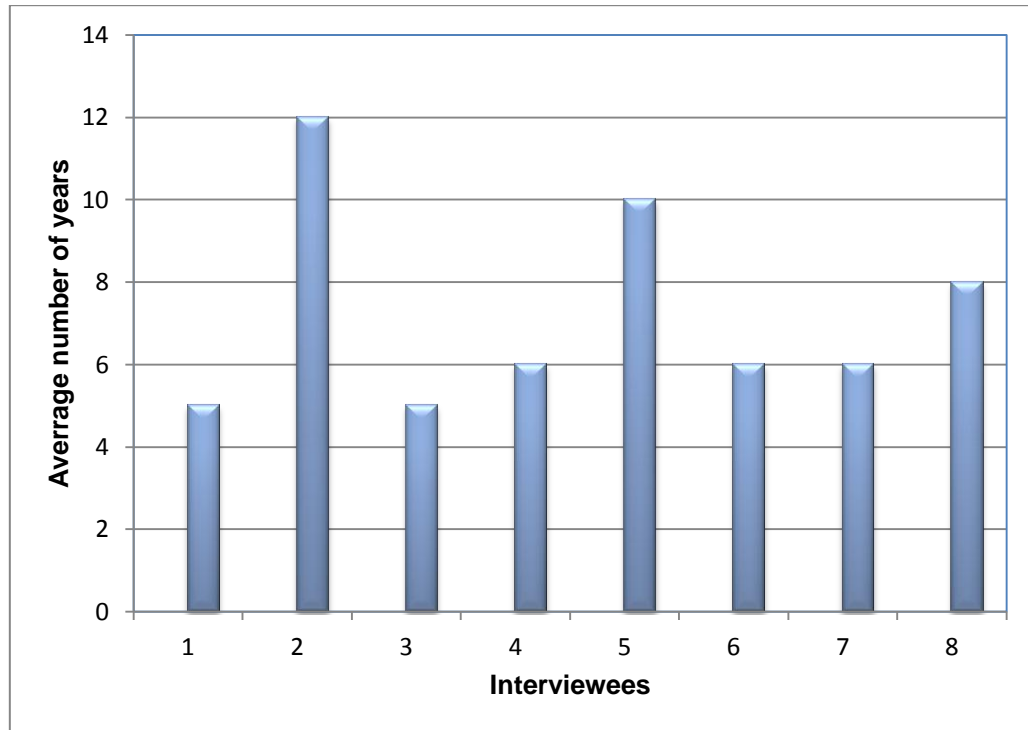


The interviewees were asked the average durations of operation in a politically risky country. The results are presented in Figure 5.2 below

- 2 MNCs had operated for 10 or more years in a politically risk country.
- 6 MNCs had operated between 5 and 10 years in a politically risky country.
- The average number of years the MNCs has operated in a politically risky country is 7.25 years (7 years and 3 months).



**Figure 5.2: Average number of years operating in a politically risky country**



The interviewees were asked whether the political risk arose before (B), during (D) or after (A) they had started operating in a politically risk country.

- 3 MNCs operated in the politically risky country before (B) a political risk factor manifested itself.
- 4 MNCs operated in the politically risky country during (D) a political risk factor manifested itself.
- 1 MNCs operated in the politically risky country after (A) a political risk factor manifested itself.

### 5.3.5 Research Question 1 Discussion: Operations in Politically Risky Countries

#### Interview 5:

*“We went into the Mozambique 4 years after the civil war had ended, although the civil war had ended it was a risky country to go into, the political risk element was still there”*

## **5.4 Research Question 2: What are the key FDI drivers that attract MNCs into a country?**

### **5.4.1 Research Question 2**

This question asks interviewees which FDI drivers are significant for attracting MNCs into a country.

The questions encompasses the below elements:

- How have they invested in a country that is politically risky, is it via Infrastructure, technology skills etc.
- What investment strategies were employed in the politically risky countries: greenfield (projects starting from scratch), brownfield (where there was some activity however the opportunity was not fully optimised), mergers or acquisitions (of local companies or other foreign companies), or joint ventures.

### **5.4.2 FDI Drivers**

Table 5.6 presents five key high level FDI drivers as well as sub-drivers under each high-level FDI driver namely:

1. Cost factors
2. Market factors
3. Infrastructure and technological factors
4. Political and legal factors
5. Social and culture factors

### **5.4.3 Research Question 2 Results: Foreign Direct Investment Drivers**

Table 5.6 presents the FDI drivers per frequency and are ranked in Table 5.7. Out of the five main FDI drivers, political and legal factors were the most mentioned with a frequency count of 61. The political and legal factors are made up of political instability, international trade agreements and tax reduction in host country and benign environmental legislation towards FDI. Political instability was the most mentioned sub-political and legal factor of FDI drivers with a count of 23 as presented in Table 5.6. International trade agreements was second with a count of 18, tax reduction in host country was third with count of 8 and fourth was benign environmental legislation towards FDI.

**Table 5.6: Foreign Direct Investment Drivers – Frequency**

FDI Drivers	Interviewees								Total
	1	2	3	4	5	6	7	8	
<b>1. Cost factors</b>									<b>46</b>
Labour costs	1	1	1	2	2	0	0	2	9
Transportation/ logistic cost	3	3	3	2	3	0	0	1	15
Low cost of raw materials	1	0	1	0	1	0	0	0	3
Return on investment	3	3	2	2	2	3	3	1	19
<b>2. Market factors</b>									<b>42</b>
Large size of host markets	0	0	0	0	0	4	3	4	11
Demand in host country	1	0	0	1	1	4	4	3	14
Level of competition in host market	0	1	1	0	1	3	4	3	13
Economic stability	1	0	0	1	1	0	1	0	4
<b>3. Infrastructure and technological factors</b>									<b>43</b>
Level of infrastructure	2	3	2	2	4	2	1	2	18
High industrial concentration (Clustering)	0	0	0	0	1	0	0	1	2
Availability of well quality of work force	1	0	1	1	1	4	4	1	13
Access to reliable and corporative suppliers	1	1	1	1	2	1	0	3	10
<b>4. Political and legal factors</b>									<b>61</b>
Political stability	3	2	3	4	3	3	3	2	23
International trade agreements	2	1	3	2	2	4	1	2	17
Tax reduction in host country	1	1	1	1	2	3	3	1	13
Benign environmental legislation towards FDI	1	2	2	1	1	0	0	1	8
<b>5. Social &amp; Cultural factors</b>									<b>21</b>
Cultural distance	0	1	0	1	1	1	0	0	4
Attitude of the local community toward the firm	4	3	4	2	0	2	2	0	17

**Table 5.7: Foreign Direct Investment Drivers – Ranking**

Rank	FDI Drivers	Frequency
1	Political and legal factors	61
2	Cost factors	46
3	Infrastructure and technological factors	43
4	Market factors	42
5	Social & Cultural factors	21

## 5.4.4 Research Question 2 Discussion: Foreign Direct Investment Drivers

### 5.4.4.1 Political and Legal

This FDI driver ties back to the political risk factor mentioned in section 5.3.3.1, which cites government instability as a major determinant of political risk. Political and legal factors are ranked as the first FDI drivers indicated in Table 5.7. MNCs are attracted to countries which have sound government leadership, political stability, public institutions, robust industry regulations and independent legal systems. An interviewee makes mention of how they went into agreements with the government pertaining to labour allocation and preferential tax breaks, indicative of the importance of collaboration with the incumbent government. Interviewee 7 said the following “.....we got into agreement with the government and agreed on tax breaks, there were no import duties and we agreed that we will use 60% of local labour, we actually surpassed that number and are now using 95% of local labour”.

### 5.4.4.2 Cost

Cost factors are ranked the second most significant FDI driver and are key when seeking to invest in a specific country, these cost include labour, transportation and raw material as presented in Table 5.5. Interviewee 3 from the mining sector highlighted the importance of transportations cost: “The cost of developing the surrounding infrastructures sinks many projects. So for us we looked at the existing infrastructure, we looked at the whole package. But you must also bear in mind that if it is easy to do it (invest in a country) then why hasn't anyone done it. So we typically look at the opportunity and institutional voids and we try and address those institutional voids in order to have a profitable project.”

### 5.4.4.3 Infrastructure and Natural Resources

Infrastructure is ranked the third most significant FDI driver. The logistics infrastructure is more prevalent and important for the mining sector which needs to transport the natural resources it has extracted to the ports and to their final destination. MNCs are attracted to countries which have an integrated infrastructure as alluded to by interviewee 1: “Infrastructure is important especially in the mining sector, [lack of] infrastructure tends to be a constraint because mining is such a capital intensive industry and relies a lot on

*infrastructure. Example logistics infrastructure is a very important element in order for us to transport what we have mined to the destination, and mostly the natural resources are transported by railway towards the harbour, so location also plays an important role.”*

There should be an integrated logistics infrastructure which runs from the mine directly to the port and sufficient power supply for the operations to run efficiently.

#### 5.4.4.4 Market

Interviewee 6, from the banking sector, stressed the importance of market size when seeking to invest in a country, this is what he had to say: *“We as a bank typically look at the market size, how big the population is and what is it we can offer. With a growing economy and the upliftment of the population from poverty, our services become in demand.”*

#### 5.4.5 Research Question 2 Results: Investment Strategies

**Table 5.8: Investment Strategies**

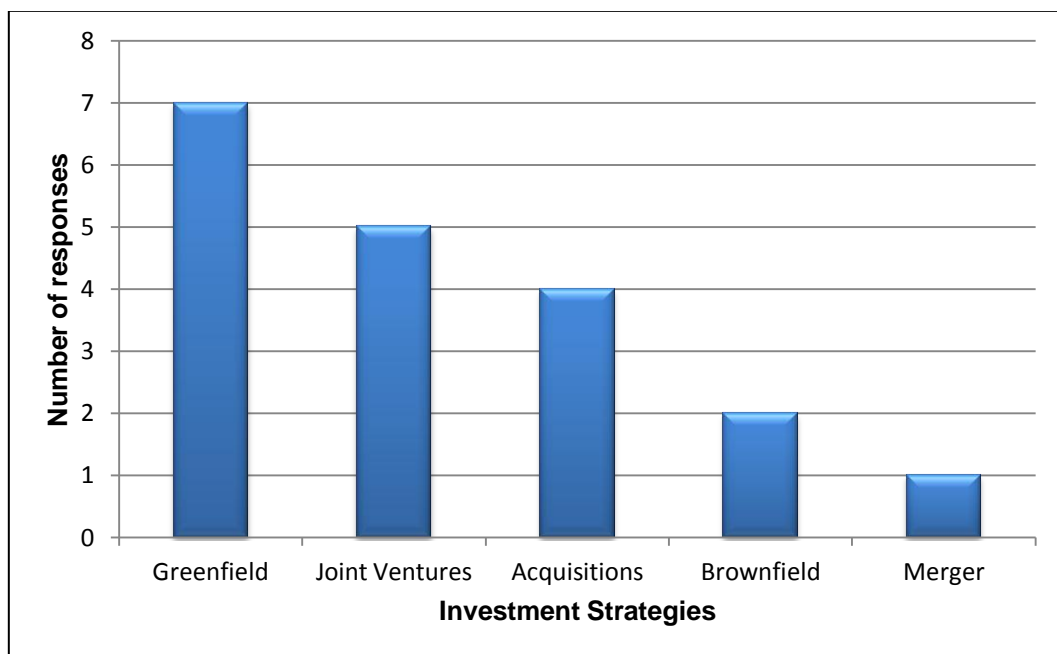
Types of investment strategies in politically risky country	Interviewees								Total
	1	2	3	4	5	6	7	8	
Greenfield	0	1	1	1	1	1	1	1	7
Brownfield	1	0	0	1	0	0	0	0	2
Merger	0	0	0	1	0	0	0	0	1
Acquisitions	0	0	1	1	0	1	1	0	4
Joint Ventures	1	1	1	1	1	0	0	0	5

Table 5.8: Type of investment strategies in politically risky country, the data presents the strategies MNCs have used to gained entry into the politically risky country. At times an MNC may enter into a country by a combination of strategies, example interviewee 1 mentioned that his MNC entered into a specific country by entering into a joint venture with another company and started to mine in an area which was not being fully exploited (brownfield).

As presented in Figure 5.3 most of the MNCs gained entry by starting new operation from scratch, 7 of the interviewee cited to have used a greenfield strategy when entering a politically risky country.

- 5 joined ventures
- 4 acquisitions
- 2 brownfield
- 1 a merger

**Figure 5.3: Investment Strategies**



## 5.5 Research Question 3: What is the decision making process that MNCs undertake prior to investing in a country deemed to be politically risky?

### 5.5.1 Research Question 3

This question attempts establish the rationale behind MNCs investing in politically risk countries, it explores the decision making process when MNCs seek to invest in politically risky countries. What are the key steps taken when deciding to enter a politically risky country?

- Which departments are involved in the decision making process.
- How do MNCs familiarise themselves with the country's: judicial system, economic environment, government structures and trade policies between host country and MNCs country.
- How do MNCs relate with the incumbent government and organs of state?

### 5.5.2 Research Question 3 Results: Investment decision making process

**Table 5.9: Departments involved in Investment Decisions**

Departments involved in decisions making process	Interviewees								Total
	1	2	3	4	5	6	7	8	
Business Development/ Strategy	1	1	1	1	1	1	1	1	8
Corporate Affairs/ Communications	1	0	0	0	0	1	1	0	3
Credit Risk	0	0	0	0	0	1	1	0	2
Economics	0	0	0	0	0	1	1	0	2
Human resources	0	0	1	0	0	1	1	0	3
Legal	1	1	1	1	1	1	1	1	8
Market Risk	0	0	0	0	0	1	1	0	2
Marketing	0	0	0	0	0	0	0	0	0
Operational Risk	0	0	0	0	0	1	1	0	2
Technical/Operations	1	1	1	1	1	1	0	1	7
Environmental	1	1	1	1	1	0	0	1	6

**Table 5.10: Departments involved in Investment Decisions - Ranking**

Rank	Departments involved in decisions process	Count
1	Business Development/ Strategy	8
1	Legal	8
2	Technical/Operations	7
3	Environmental	6
3	Finance	6
4	Corporate Affairs/ communications	3
4	Human resources	3
5	Credit Risk	2
5	Economics	2
5	Market Risk	2
5	Operational Risk	2

Table 5.9 presents the internal departments involved in the decision making processes. The number “1” indicates that the interviewee mentioned that that specific department is involved in the decision making process and “0” indicates that that department is not involved.

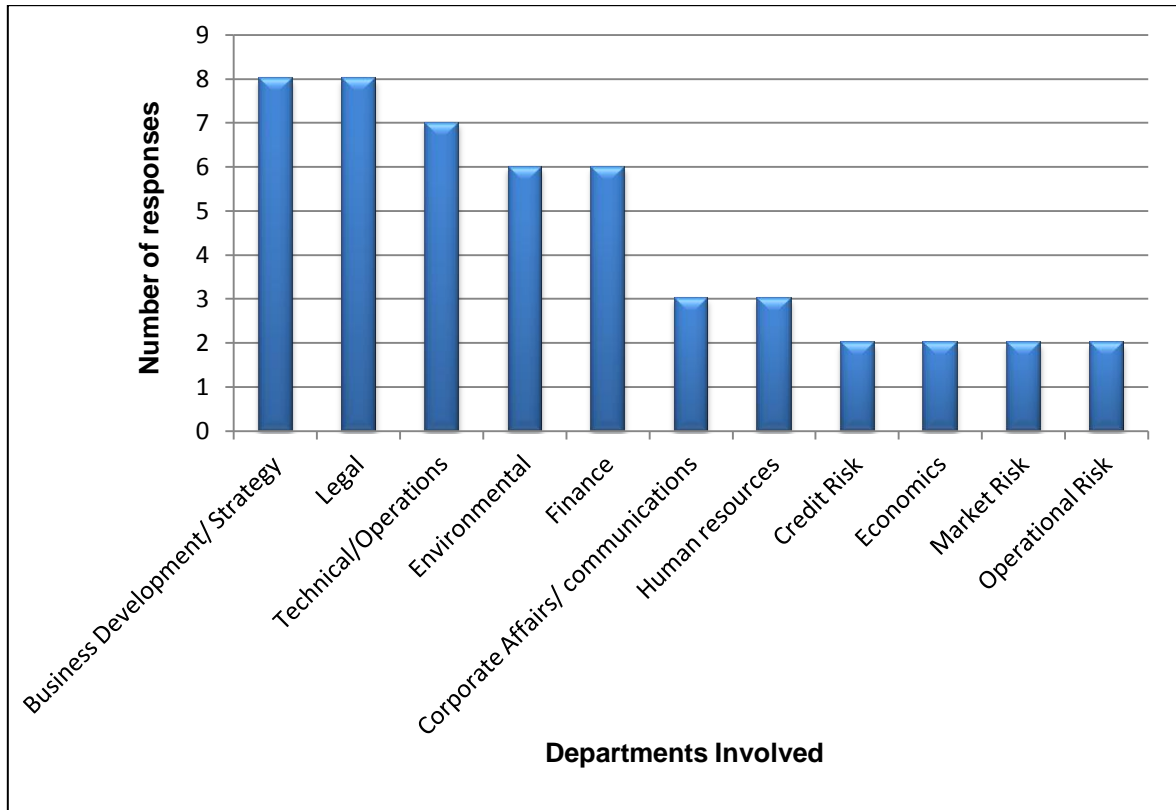
As indicated in Figure 5.4, the Business Development or Strategy Departments were the most mentioned departments to have participated or even have to lead the decision making process all the 8 interviewees cited as the Business Development/Strategy Department being involved.

The Legal Department was cited by all 8 interviewees as being involved in the decision making process. The technical and operations were also cited by most interviewees (7). The least cited departments to have been involved in the process were the following departments, (all being cited only twice): Credit Risk, Economics, Market Risk and Operational Risk Departments.

Typically all MNCs interviewed had a dedicated Business Development Department which was responsible for sourcing new business and investments, even in politically risky countries. The banks are the ones that would generally use the lowly ranked departments in Table 5.9, namely Credit, Market and Operational Risk Departments.



**Figure 5.4: Departments involved in Investment Decisions**



### 5.5.3 Research Question 3 Discussion: Investment Decisions

The Business Development Department is the key department that gets involved in investment decisions across all the three sectors. They typically engage with the different stakeholders and government representatives at all levels to understand the political environment of the country which they seek to invest in. The Legal Department is also significantly involved from a due diligence, legal and industry regulations point of view, they are tasked with understanding the local legal system and advise which system will be used in case of dispute or and other business transaction issues. The Technical Department analyses the physical feasibility of conducting business in that country whereas the Environmental Department will analyse the environmental impact the MNC's operations will have in that country an in-depth analysis will be conducted in Chapter 6 - Data Analysis.

## 5.6 Research Question 4: How do MNCs manage political risk?

### 5.6.1 Research Question 4

Once a company has invested in a country a politically risky event can occur, how do MNCs insulate themselves from such risks? This question firstly attempts to establish if the MNC has a dedicated department that monitors the threat of political risk. If so how does this department monitor the political risk? Once the risk has been identified, how do MNCs handle risk, are there disinvestment strategies which MNCs deploy. Do the MNCs have country risk insurance?

### 5.6.2 Research Question 4 Results: Managing political risk

**Table 5.11: Managing Political Risk**

Managing Political Risk	Interviewees							
	1	2	3	4	5	6	7	8
Do you have a department that is purely dedicated to monitoring risk on an ongoing basis? Y (yes) and N (no)	N	N	N	N	Y	Y	Y	N
Do you have disinvestment strategies? Y (yes) and N (no)	Y	N	N	N	N	N	N	N
Do you have country risk insurance? Y (yes) and N (no)	N	N	Y	N	Y	Y	Y	N

Table 5.11 presents data pertaining to how MNCs manage political risk in a country.

Out of the 8 interviewees, 5 stated that they did not have a specialised or specific department solely dedicated to political risk monitoring risk and only 3 stated they have a department solely dedicated to monitoring political risk.

In terms of disinvestment strategies, out of the 8 interviewees, 7 stated that they had no disinvestment strategies and only 1 interviewee had a disinvestment strategy.

When asked whether the MNCs had country risk insurance the responses were balanced half (4 interviewees) stated they had and the other half (4 interviewees) stated they do not have country risk insurance.

### 5.6.3 Research Question 4 Discussion: Managing Political Risk

As presented in Figure 5.5 most of the MNCs stated that they do not have a department solely dedicated to monitoring risk. However those that stated that they monitor political risk said they did this on a continual basis and it was a collaborative effort by all the concerned departments of the company. The source of information on political risk is from different avenues which include media, industry conferences, risk journal, political analyst, economic analysts, industry experts, consulting firms and government officials just to name a few.

**Figure 5.5: Monitoring Political Risk**

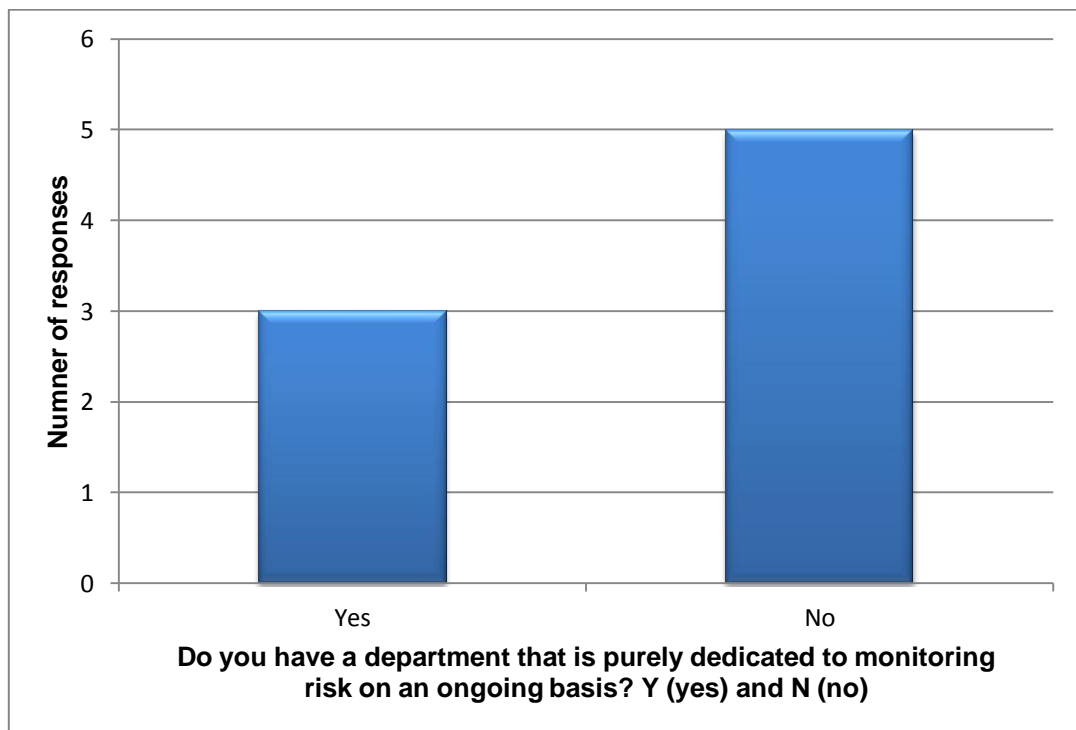
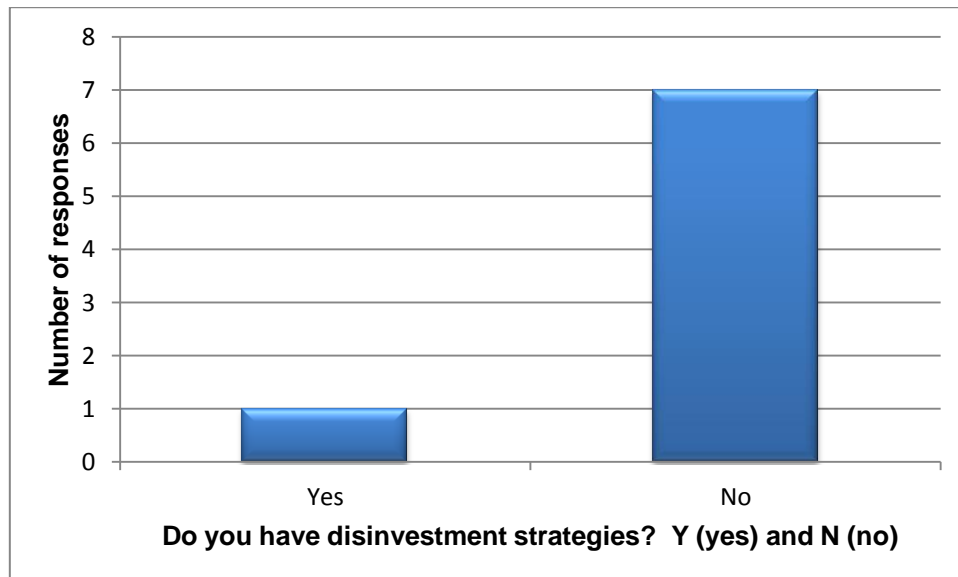


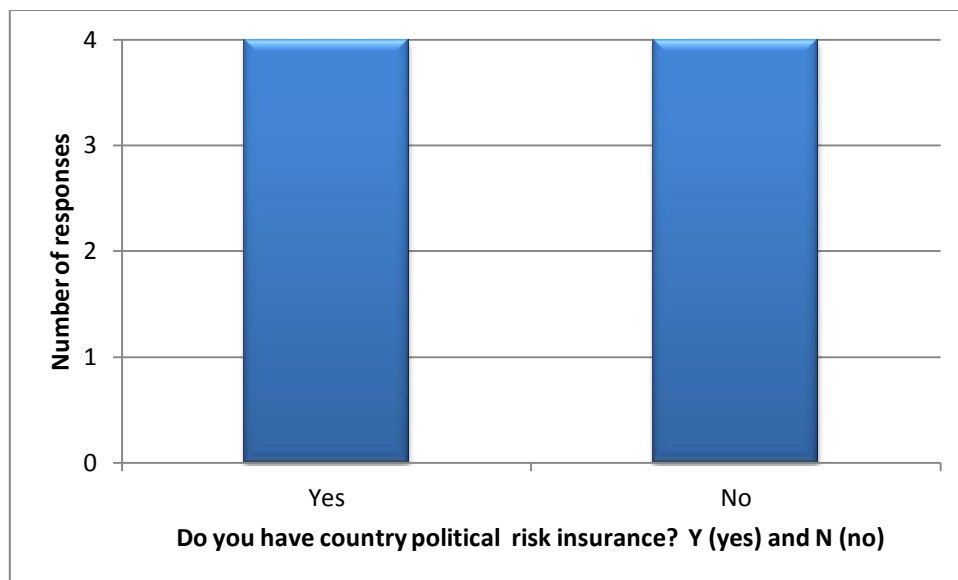
Figure 5.6 presents data pertaining to whether MNCs have disinvestment strategies once they have invested in a country and a political risk event occurs. An overwhelming majority of the interviewee said they do not have disinvestment strategies. Interviewee 2 further went on to say: *“Mining is very capital intensive so it’s not easy to disinvest, its not a decision which could be made easily. We insure the commodity but not the operations.”*

**Figure 5.6: Disinvestment Strategies**



When it comes to country risk insurance, half of the interviewees had country risk insurance while the other half did not as presented in Figure 5.7. Interviewee 2 who's company does not have country risk insurance said: *“In terms of insurance we do not have, political risk insurance per se however we cater for financial risk internally which is done by our internal financial department.”* Those that mentioned that they had country risk insurance, it was typically offered by specialities insurance organisations like MIGA (Multilateral Investment Guarantee Agency).

**Figure 5.7: Political Risk Insurance**



## 5.7 Conclusion

Chapter 5 is a consolidation of the data captured during the qualitative interviews. However this is not empirical evidence in that these were personal views and experiences of the interviewees. The data has been presented in frequency and rank tables in order for it to be comprehensible and establish key themes per Research Question asked in Chapter 3. Chapter 6 will analyse the above data in more detail and interpret it by using the literature review conducted in Chapter 2.

## **6. CHAPTER 6: DATA ANALYSIS**

### **6.1 Introduction**

Chapter 6 discusses the four research questions posed in Chapter 3, the results to the research questions were collected by way of semi-structured interviews as highlighted in Chapter 4 and presented in Chapter 5. In Chapter 5 the results were presented in raw format and then organised in order to establish trends, common themes and anomalies by way of frequency, content and ranking analysis, therefore Chapter 5 presents the value add to the raw data collected. Chapter 6 takes the above data and analyses it more detail, thus the purpose of this chapter is to do three things namely: to support, add or contradict the data collected in Chapter 5 with the literature used in Chapter 2.

### **6.2 Discussion of Results for Question 1**

#### **What are the political risk factors that MNCs consider before investing in a country?**

The aim of Research Question 1 was to establish what are the factors that constitute political risk and what political risk factors do MNC consider prior to investing in a country. The results for Research Question 1 are presented in Tables 5.2, 5.3 and 5.4 in Chapter 5. The tables clearly indicate that government stability is the key factor that MNCs consider as political risk. The political risk factors identified in Table 5.4 namely (government, economic, violence nationalisation & land expropriation and legal) are discussed below.

#### **6.2.1 Political Risk Factors**

PriceWaterhouseCoopers (2012) defines political risk as any political change that alters the expected outcome and value of a given economic action by changing the probability of achieving business objectives. This section discusses the factors which are deemed significant to political risk.

### 6.2.1.1 Government

As presented in Table 5.4 the government or governance factor is ranked first with a weighting of 55. Table 5.4 presents government factor as the key political risk factor considered by MNCs prior to investing in a country. Certain aspects pertaining to this factor include the running of elections, how the results are viewed by the electorate and if the election brings about a transition in government leadership, how that transition transpires. Elections are deemed a key determinant of a country's political risk, the electorate may not always be content with the results of the elections and their discontentment may bring about violence, another political risk factor identified in Table 5.4. The above is consistent with Ekpenyong & Umoren (2010), who suggest that if not handled properly, elections can be catalyst to political uprising, they further state that elections can signal a change in the regime. One of the interviewees stated the following when asked about the importance of stability of government as political risk factor. *"it is absolutely important for the country to have strong government institutions as they set the tone for the rest of the country and to have strong government institutions you need strong government leadership and transition thereof"*. Prior to investing in a country, MNCs need some form of security and guarantee from the government once they start operating in that country. The interviewees were not perturbed by the duration of the incumbent in government, however some stated that they would prefer to have the incumbent for a prolonged period of time in that they would have established a relationship with them and a transition in government leadership may mean establishing new relationships with the new leadership, and this in itself maybe risky. Aisen & Veiga (2010) support this notion and state that frequent change in government leadership may indicate some form of democracy however one runs the risk of the frequent change in economic policies and legislature which in itself can bring about political risk and have an adverse effect on MNCs. This frequent change of government is witnessed in Nigeria where the Muslim north and Christian south take turns at governing the country however this has brought about tensions in recent years and more specifically with the passing away of President Yar'Adua in 2010, midway through his term. This led to ethnic and religious tensions a political risk element presented in Table 5.3.

However Asiedu (2006) and Drahekoupil (2008) suggest that governments that have been in power for a prolonged period of time tend to be perceived as rigid and this may bring about civil unrest and political uprising.

### **6.2.1.2 Economic**

Globalisation is a process of rising acceptance of political risk in search of greater economic rewards. Economic success has bred acceptance of ever-greater political-risk exposure (PriceWaterhouseCoopers, 2012). Economic theory argues that capital should chase the highest return on investment, and returns should be highest in countries with relatively low levels of capital stock where investment is needed.

### **6.2.1.3 Violence**

Violence was ranked third as presented in Table 5.4. The overall weighting for violence was 36 and was made up of a number of individual factors which included riots, coup d'état, political assassinations, lack of security, civil uprising, civil war, genocides and ethnic tensions as presented in Table 5.3. Violence is considered a result of political risk and emanating from the other political risk factors presented in Table 5.3. Coups and attempted coups are ranked relatively high under the violence factor. Coups typically arise as a result of a disgruntled, relatively small group of armed forces seeking to overthrow the incumbent government. This disgruntlement may arise from armed forces feeling: an urge to change the incumbent government, elections were not free and fair or the transition of government did not transpire in a democratic manner. Coups are violent in nature and tend to be targeted at the government and may at times involve: political assassinations (a political risk factor presented in Table 5.3) kidnapping of political heads, seizing of country's key government offices, communications media and infrastructure. Goldstone, et al., (2010) note that coups failed or successful have the potential to lead to civil wars a factor ranked number ninth in Table 5.3, if they gather momentum.

A very interesting statement was made by two different interviewees, they state that at times organisations prefer a country to be politically risky and even go to the extent of financing coups and civil wars. They state the rationale for this is that in a country which is politically risky and is going through war, some organisations are able to operate better and at lower costs because they do not need to abide to stringent regulations and local laws. However they do make mention that the organisations that do this tend to be smaller in nature and do not have a reputational risk which a large MNCs has. They further state that MNCs stand to lose a lot should they be involved in such activities and are found guilty, because no other country or government would want to be associated with them.



#### 6.2.1.4 Nationalisation and Land Expropriation

Table 5.4 presents Nationalisation and land expropriation as ranked 4th with a total weighting of 27. Nationalisation and land expropriation have become a hot topic, a very prominent example is that of Zimbabwe, where the mining regulations require all mining companies to relinquish 51% stake to a local company (RMB, 2012). Namibia has also decided to give future mining and exploration rights in the country to a state-owned firm, Epangelo Mining. Interviewees considered this as a very pertinent element especially in the mining, manufacturing and telecoms sectors, given the very capital intensive nature of these sectors. Ernst & Young (2012) suggests that resource nationalisation has jumped to the top of the list of problematic factors for some of the biggest global miners.

Firstly in mining, the mining company would typically be given mining rights which would encompass the right to mine the natural resources on a piece of land and to own those resources and the revenues generated from the resources. Therefore a huge sum of capital is required to attain these licenses, mineral rights and the land.

Secondly the operating assets required by the above mentioned sectors are immense, typically MNCs need to purchase these mining or manufacturing equipment from overseas suppliers and transport them to the site of operation. At times MNCs would actually need to set up plant or construct roads, bridges and railways in order to support their main operations. If there is uncertain about ownership of these assets, more especially the government seeking to own majority or all the assets, this could be deemed as a political risk factor. However despite a rise in nationalisation, RMB (2012) cites that seven of the ten biggest mining deals in 2011 were African, proving that the sector remains profitable regardless of increased government ownership.

## 6.3 Discussion of Results for Question 2

### What are the key FDI drivers that attract MNCs into a country?

The aim of Research Question 2 was to establish firstly what MNCs consider FDI to be and what are the key FDI factors they consider prior to investing in a country, the results are presented in Table 5.6 and 5.7. The second sub-question of Research Question 2 was to establish what investment strategies do MNCs deploy, the results are presented in Table 5.8.

#### 6.3.1 Foreign Direct Investment Factors

Table 5.6 presents the responses per interviewee of how many times a specific element was mentioned as an FDI driver they consider prior to making an investment in a country. Table 5.7 presents the ranking of the FDI drivers namely political and legal, cost, infrastructure & technology, market and social and cultural factors. The next section discusses each factor.

##### 6.3.1.1 Political and Legal

Table 6.1 below presents the political and legal factors of FDI drivers and is an extract from Table 5.6 in chapter 5.

**Table 6.1: Political and Legal Factors**

Rank	FDI Drivers	Frequency-Weighting
1	<b>Political and legal factors</b>	<b>61</b>
	Political stability	23
	International trade agreements	17
	Tax reduction in host country	13
	Benign environmental legislation towards FDI	8

Political and legal factors are ranked first with a weighting of 61. Within this FDI driver political instability was cited as the most influential factor for FDI accounting for a weighting of 23, thereby constituting 38% of the frequency-weighting. This factor is consistent with the political risk factor mentioned in section 6.2.1. This indicates the importance of political

stability of country as a consideration by MNCs prior to investing in a country. International Trade agreements ranked second after political instability. MNCs favour a country which has in place some sort of trade agreements with their own country. These trade agreements are typically protected by major trade organisations such as the World Trade and Organisation (WTO) and Preferential Trade Agreements (PTA) as cited by (Buthe & Milner, 2008). MNCs are attracted by tax incentives in a country, some countries establish tax free industrial zones in order to attract FDI into the county. Such policies are established at very high levels within the government structures of the country therefore one needs to appreciate the relationships that exist between the political stability of the country and the trade and economic policies. It follows that with a politically stable country there tends to be positive political, economic and legal implications for FDI attraction. By contrast, PriceWaterhouseCoopers (2012) suggests that countries such as China, with a high potential for instability, can become magnets for external investment, despite poorly specified regulatory and legal protections.

MNCs interact to a great extent with government institutions, and these relationships are important in establishing trust between the MNCs and the government and the local people. Example with mining companies, they interact with a number of government institutions which include the minerals, environmental, labour, finance and public works to name a few and their interactions are at different levels (national, regional and local). From a legal and regulation perspective, typically in markets that are not well established, there tends to be no proper industry regulations. However this is an opportunity for the industry to assist the host country in formulating industry regulation. Feinberg & Gupta (2009) caution MNCs when attempting the above as individual companies, they may be perceived to be trying to influence the government in an manner that would favour the individual company. They further suggest that industry regulations should be established with the involvement of the whole industry and not just the individual company.

### 6.3.1.2 Cost

Table 6.2 below presents the cost factors of FDI drivers and is an extract from Table 5.6.

**Table 6.2: Cost Factors**

Rank	FDI Drivers	Frequency-Weighting
2	<b>Cost factors</b>	<b>46</b>
	Return on investment	19
	Transportation/ logistic cost	15
	Labour costs	9
	Low cost of raw materials	3

Cost factors ranks second as an FDI driver and includes labour, transportation, raw material and return on investment. This notion is consistent with FDI theory because MNCs typically invest in environments where the cost of generating a “single rand” should be as low as possible. MNCs invest in order to generate greater margins, therefore the bigger the gap between revenues and costs, the greater the margins. Return on investment is ranked first within cost factors, as presented in Table 6.2. Desordes (2010) suggests that MNCs are hindered from investing in politically risky countries because the cost for doing business in those countries is extremely high. However Feinberg & Gupta (2009) are of a different view and find that despite the political risks in countries, MNCs still invest. This notion could be attributed to the fact that it is actually less costly for MNCs to invest in politically risky countries because MNCs do not need to abide to stringent regulations and licensing costs, however this scenario is more applicable to service-oriented industries like the financial and consulting services. The mining and manufacturing sectors, despite also having an advantage of not needing to conform to stringent laws and high licences fees, are faced with underdeveloped infrastructure and therefore have to invest a significant amount of capital in supporting infrastructure before they can even invest in the infrastructure of their actual operations.

When interviewing the mining companies, they often cited infrastructure as one of the main determinants in investing in a country despite the fact that the country is rich in minerals. The construction of roads, rails, bridges and ports to transport the commodities from point A to point B is very capital intensive and consumes a huge portion of the capital expenditure. In manufacturing, the two most important cost elements are the cost of raw material and labour. Typically manufacturing companies have to make difficult decisions

about where to setup their manufacturing plants, should it be close to their raw material or distribution points. The decisions are made more difficult when in a politically risky country which lacks the logistics infrastructure. However the norm is to setup operations close to the raw materials and then develop the logistics infrastructure surrounding the manufacturing plant.

### 6.3.1.3 Infrastructure and Technological

Table 6.3 below presents infrastructure and technological factors as ranked number third as FDI drivers.

**Table 6.3: Infrastructure and Technological Factors**

Rank	FDI Drivers	Frequency-Weighting
3	<b>Infrastructure and technological factors</b>	<b>43</b>
	Level of infrastructure	18
	Availability of well qualify of work force	13
	Access to reliable and corporative suppliers	10
	High industrial concentration (Clustering)	2

Table 6.3 indicates that the level of infrastructure is important in attracting MNCs into the country. Politically risky countries typically have poor infrastructure because they have been neglected for a number of years. However this is a key determinant for FDI, infrastructure is associated with the cost of doing business, the better the infrastructure of a country the cheaper it is for goods to be transported from point A to B. Mining and manufacturing depend heavily on transport logistics. Mining companies need to transport the commodity they have mined to other parts of the world where additional value will be added, therefore a well developed railway and port system is key to mining. This also applies to manufacturing where the manufacturer should have the ability to transport their input materials to the manufacturing plant. The level of technology infrastructure is also important however the PriceWaterhouseCoopers (2012) research finds that MNCs would typically import their technology from outside the country. However some may even request a supplier to construct a plant where they can manufacture their equipment purely for the purpose of the project that they are undertaking. The assembly of the equipment

used by the mining or manufacturing company will be done in-country, onsite. This approach is done in order to mitigate lag time between the ordering of equipment or technology and the actual receipt of it. It also mitigates any other risk of getting the equipment to the site.

Within the financial sector telecommunication plays an important role, given the move towards banking being heavily depended on technology that is real-time (transactions need to be done in real time). The availability of a skilled workforce is cited as another important element, this was particularly cited by the banks which require specialist skills. One of the interviewee from a South African bank that has operations in Nigeria and Ghana, cited that they needed to get expatriates from London and New York to work in those countries and these expatriates came at a very high premium.

#### 6.3.1.4 Market

Africa's diversity is evident in the size of its economies, ranging from the very small islands like the Comoros and São Tomé and Príncipe to the continental giants of Nigeria, Egypt and South Africa (RMB, 2012). Table 6.4 below presents the market factors of FDI drivers, they are ranked 4th in the overall FDI drivers.

**Table 6.4: Market Factors**

Rank	FDI Drivers	Frequency-Weighting
4	<b>Market factors</b>	<b>42</b>
	Demand in host country	14
	Level of competition in host market	13
	Large size of host markets	11
	Economic stability	4

Siddiqi (2007) suggests the size of the market is a key FDI determinant, there ought to be a significant market in order to attract MNCs. Therefore countries like Nigeria (160 million people), Ethiopia (82 million) and Egypt (83 million) attract the likes of banks and telecommunications companies, because these sectors rely heavily on market size of these countries. However market size is not enough, there needs to be a demand for the products and services of the company. As noted in Table 6.4, the demand in the host country was ranked the highest market factor. The size of the population does not

necessarily correlate with the economic size, although the above mentioned countries have huge populations, in terms of economic size Egypt is second (South Africa is first) Nigeria is third and Ethiopia does not even feature in the top ten.

However MNCs are becoming cognisant of the specific needs of the country despite it being politically risky. MNCs are mindful not to replicate their products and service in these countries, example FMCG and retailers will package their products to suit the specific needs of those countries. Countries differ in their cultural, ethnic religious and religious compositions and MNCs have come to appreciate this fact. What is interesting about the results in Table 6.4 is the lowly ranked economic stability factor, the low ranking could emanate from the fact that the MNCs see an opportunity to bring about economic stability in the country. They are aware of the fact that the country is politically risky and it will inevitably mean that the economy too is not stable, therefore this bears little significance to them.

#### 6.3.1.5 Social & Cultural

Table 6.5 below presents the social and cultural factors. It is interesting to see that the factor “*Attitude of the local community toward the firm*” is ranked higher than “*Cultural distance*”. This could be attributed to the fact that MNCs would like to be viewed in a positive light when investing in a specific environment, “*they want to be liked*”.

**Table 6.5: Social and Cultural Factors**

Rank	FDI Drivers	Frequency
5	<b>Social &amp; Cultural factors</b>	<b>21</b>
	Attitude of the local community toward the firm	17
	Cultural distance	4

During the interviews a number of the interviewees mentioned that they have an individual or team of people who represent their company and spell a positive message in communities which they seek to invest and operate in. This function is done by the Corporate Affairs Department as presented in Table 5.9 and 5.10.

MNCs seek buy-in from the communities in which they operate, this is also a risk mitigator should a politically risky event happen, they can be assured that there will be some degree of sympathy from the local community. MNCs are spending a considerable amount of time

understanding the local cultures, religions and different ethnic groups. The 2008 Kenya uprising were brought about by ethnic tensions between the Luos and Kikuyus, this meant that any company seeking to invest in Kenya at that time or after, needed to be mindful of the ethnic divisions in the country. The same applies in Nigeria where there were tensions between the Muslim north and the Christian south.

### **6.3.2 Investment Strategies**

Table 5.8 in presents the types of investment strategies that MNCs follow when investing in countries.

Greenfield projects rank the highest with seven interviewees citing that they have invested in politically risky countries deploying this strategy. This can be explained by the fact that the countries in which they invest are typically risky, however they may possess natural resources yet no one has ever invested in them. These environments have never been invested in due to political instability therefore MNCs see the opportunity of being the first mover and thereby gaining an opportunity over other risk-averse MNCs. With greenfield projects the risk is typically higher therefore MNCs would set themselves a higher hurdle rate and require a high rate of return. This strategy is prevalent amongst the mining companies, they would typically use consultant geologist to conduct exploration in countries they seek to invest in.

The mining companies and the geologist would form a joint venture for this phase of the project where they conduct feasibility studies. Joint ventures are ranked second in Table 5.8, with five interviewees mentioning that they have deployed this strategy. Besides conducting joint ventures with consulting companies, some MNCs go into joint ventures with the government or a local company of that country, this is also a way in which to share the risk with the other party, so they do not bear the full risk. Feinberg & Gupta (2009) cite a smaller MNC ownership stake reduces the amount of investment that is at risk in the host country. When going into joint ventures with the government, the government shares part of the risk it is therefore in the best interest that the government creates an environment which is conducive to doing business.

Some MNCs prefer to merge with an already existing company which is already operating in that country, banks favour this strategy because the existing bank would have already established itself in that environment, have a brand and significant market size which was discussed in section 6.3.1.4 market factors.



Table 5.8 presents brownfields which are lowly ranked and only two interviewees mentioned it. This type of strategies entails MNCs seeing an opportunity in an operation which has been deserted or is not being exploited to its full potential and this could be due to a political risk event having arisen. This strategy is typically used by mining companies who see an opportunity to revive a dormant mine that has been neglected, other companies would have been reluctant to invest in this mine due to political risk. Typically MNCs that invest in brownfields would do so during periods of political instability as indicated in Table 5.5.

## **6.4 Discussion of Results for Question 3**

### **What is the decision making process that MNCs undertake prior to investing in a country deemed to be politically risky?**

Table 5.8 presents the different departments involved in the decision making process when MNCs seek to invest in other countries more specifically in countries deemed to be politically risk.

#### **6.4.1 Business Development**

The Business Development Departments are usually the driving force behind investment decisions. Table 5.9 indicates that the involvement of the Business Development Department is ranked first with all the interviewees stating that they use the Business Development Department during their investment decision process. The Business Development Department is mandated to go and seek new business ventures in order for the MNC to grow and some of these new business ventures present themselves in very unfamiliar territories like countries which are ravaged by wars. The Business Development Department usually engages with the different stakeholders in the country and this includes government institutions at all levels (national, regional and local). *“The process cannot be done by remote control sitting in the head office in Johannesburg, you physically have to be there in the country”* as one of the interviewees stated. The Business Development Department is at the core of investment decisions and works closely with other departments which will be discussed individually below. The Business Development

Departments have a very integrated approach when making these investment decisions and are typically part of, or close to the executive management team. Tu & Bao (2009), cite that executive of MNCs play and critical role in the investment decisions of MNCs and are the ones that make the final decision.

#### **6.4.2 Legal**

It is important that the MNC gets accustomed with the country's legal system as well as the industry regulations and this calls upon the expertise of the Legal Department. As presented in Table 5.9, all eight interviewees stated that they involve the Legal Department when deciding upon an investment destination. The involved of the Legal Department is of paramount importance in that the countries that they seek to invest in usually have different laws to the laws used by the country of the MNCs origin. Decisions need to be made with regards to where disputes will be resolved and which legal system will be utilised in order to resolve these disputes.

PriceWaterhouseCoopers (2012) notes that there are three principal actors involved in all structural reforms: executives, legislators, and political and economic factors outside the legislative process. Analysing possible legislative-process trajectories requires that one identify which legislators stand firmly on an issue, which remain undecided or can be swayed, and which actors are capable of influencing legislators. The above strongly supports the involvement the Legal Department when seeking to invest in other countries.

#### **6.4.3 Technical and Operations**

When conducting feasibility analysis, the potential investment needs to be technically and operationally sound. Table 5.9 presents technical and operations as ranked second, with seven out of the eight interviewees citing that they involve this department when making investment decisions. MNCs conduct what is called technical visits to the potential investment destinations, Ernst & Young (2012) cite these technical visits entail looking at the quality of minerals if it is a mining company or level of incomes, expenditure and concentration of the population if it is for banks or telecoms. The visits will also entail engaging with industry technical experts which would usually come from consulting companies. In the mining sector, the mines would bring with them geologists to survey the quality of the minerals in the country whereas with the banking and telecoms sectors consulting companies like McKinsey, PriceWaterhouseCoopers and Ernst and Young

would conduct the market feasibility on behalf of the MNC. The consultants should preferably have had experience in consulting for MNCs seeking to invest in politically risky countries, there is an added dynamic in such cases which is that of political risk (or potential thereof).

#### **6.4.4 Finance**

MNCs invest in countries regardless of their political status to make profits, they typically invest in politically risky countries and seek even higher profit margins given the risk that they take. This is the typical higher risk higher return phenomenon which is followed by all profit-seeking organisations. Table 5.8 presents Finance as being ranked third with six of the eighth interviewees citing that the Finance Department is involved in the investment decision making process. An interesting view by one of the interviewees was that, in order to mitigate the risk MNCs tend to raise capital within the country they seek to invest in. Therefore the lenders of money are based in the country and are the ones that will tend to lose should and adverse political event arise.

#### **6.4.5 Other areas involved in investment decisions**

Other departments which are involved in the investment decision making process include; Environmental, Corporate Affairs/ Communication, Human Resources, Credit Risk, Economics, Market Risk and Operational Risk Departments. Depending on the industry these departments get involved in varying degrees. With the banking sector the risk departments (credit, market and operational risk) are very much involved in the investment decisions. Banks want to know what financial exposure they will have in a country. They use country risk rating from the credit rating agencies which include the likes of Standard & Poors and Moody's.

Not all industries have a specialised Environmental Department; however these departments are usually found in manufacturing, mining and of late retail industries as their operations do have an impact on the environment. The environmental departments would be tasked with scanning the area in which the MNC seeks to operate, they will usually engage with the different institutional structures of the incumbent government. These structures include the departments of minerals and energy, environmental affairs, water affairs and forestry. As one would appreciate it, this is an integrated approach and there

are enforceable environmental laws to abide by, the Legal Department would also be involved in this process.

Credit Risk Department would be concerned with the ability of lenders, in the host country, to pay. Prior to investing in a country they would have established with some degree of certainty that there is a market. The typical risk based pricing principle will be used, that is where the individual lenders will be charged higher interest rates according to their risk profiles. However in countries that are politically risky a much higher interest rate than normal would be charged. As mentioned in section 6.4.4 of this chapter, MNC will tend to raise the capital in the country in order to mitigate the risk, this would be more applicable were the country is politically risky. Market risk entails the monitoring of market indicators which included interest rates, money market and bond rate volatility. Because the markets in politically risky countries are either not sophisticated or do not have indicators therefore this is of less importance to the bank. The respondents who claim they involve the market risk department are themselves from the banking sector.

## **6.5 Discussion of Results for Question 4**

### **How do MNCs manage Political Risk?**

The aim of Research Question 4 was to establish how MNCs manage political risk once they have setup operations in other countries. Multinational enterprises (MNE) have to adapt their optimal investment strategy to local conditions worldwide. Most notably, they have to respond to different political environments that may give rise to varying political risks at different locations (Kesternich, 2007). Table 5.11 presents data pertaining to the managing of political risk by MNCs. Section 5.6.2 asks three key questions regards to managing political risk namely:

1. Do you have a department that is purely dedicated to monitoring political risk on an ongoing basis?
2. Do you have disinvestment strategies in place should political risk event arise?
3. Do you have country political risk insurance?

#### **6.5.1 Monitoring, Identifying and Managing Political Risk**

As presented in Figure 5.5 only three of the eight interviewees said they had a business area or department purely dedicated to monitoring and managing political risk. This is

consistent with Wood (2009) who notes that the monitoring and management of political risk has been given little or no attention by MNCs and that other forms of risk like credit, operational and market risk are given more attention. This is somewhat an interesting aspect when viewed with the findings presented in Table 5.10 which suggest that credit, operational and market risk are given lesser attention than other areas of the business during the decision making process. However these aspects are given more attention than political risk. This attributed to the fact that monitoring political risk is an integrated effort by the MNC as a whole and not one department is purely dedicated to doing this task. Interviewees suggest that as an MNC operating in a politically risky country, one needs to have their ear to the ground and pick up subtle indicators of political risk and this entails engaging with the locals at different levels of government, communities and political analysts. Some sources of information on political risk are captured in Appendix 1, Research Question 3, these come in the form of media, risk journals, economist and political analyst to name a few.

As presented in Table 5.8 and noted in section 6.3.2, in order to manage and mitigate the impact of political risk, MNCs go into joint ventures with the government, another MNC or a local company. This is in line with literature by Feinberg & Gupta (2009) and Lim (2011) who suggest that MNCs minimise the impact of political risk by having a reduced stake or exposure to the country and this comes in the formation of joint ventures with local companies. The interviewees further stated that the rationale behind going into a joint ventures specifically with a local company is that the communities within which the MNC operates see this as a positive indication that the MNCs is willing to uplift the community and it's not about exploiting it. Feinberg & Gupta (2009) further cite that local partners have a stronger political connection with the host country government. This type of investment strategy as noted in section 6.3.2 is particularly prevalent in the mining sector. Banks would rather acquire or merge with an already existing local company. Most of the MNCs interviewed cited the importance of engaging the incumbent government and the local communities as documented in section 5.5.3. This has been a common thread throughout this research, however what is interesting is the type of engagements that take place. Most interviewees cited the collaborative engagement with the government. Interesting enough one interviewee mentioned that some MNCs lobby for political parties and go to the extent of financing political parties during the elections, this with the aim of having the ability to manipulate the government in terms of policies and legislations. Another interviewee went on to state that some companies prefer a country to be politically

unstable, they inject money into the civil wars by actually engaging and supporting both rebel groups and the government as is the case with a certain company operating in eastern DRC. However the interviewee did state that companies that typically do this are small and have little to lose in reputational risk as opposed to giant MNCs.

### **6.5.2 Disinvestment Strategies**

A divestment strategy involves the sale or liquidation of a portion of business, a major division, profit centre or SBU (Wood, 2009). MNCs invest in other countries besides their own country, because they are seeking opportunities and higher returns. When seeking opportunities in politically risky countries they expect returns to be higher than normal, because of the risk element associated with that country. They typically invest in a country with a long term view and this notion is presented in Figure 5.6 whereas only one interviewee out of eight cited that their MNC has a disinvestment strategy. Whereas MNCs have a sound investment strategy with thorough analysis of the environment which they seek in invest in as presented in Figure 5.3 there seems to be little attention given to the disinvestment strategy in that country should political risk arise. One of the interviewees from a mining company stated that the fact that mining is so capital intensive the idea is to operate in a country for a prolonged period of time until the resources are depleted, should a political risky event arise the safety of their people is priority above anything else. Another interviewee shared the same sentiments citing that when the civil war broke out in the DRC they immediately arranged for a charter flight to the neighbouring Congo Republic to get their employees to safety.

### **6.5.3 Political Risk Insurance**

Political risk insurance is available for political violence such as revolution, insurrection, civil unrest, terrorism or war; governmental expropriation or confiscation of assets; governmental frustration or repudiation of contracts; wrongful calling of demand guaranties; and inconvertibility of foreign currency or the inability to repatriate funds ([www.dnaindia.com](http://www.dnaindia.com)). Table 5.10 presents four interviewees stating that they have political risk insurance. Out of the four interviewees that claimed to have insurance two of them said that insurance was from within the company and was structured by the Finance

Department of the MNC. The other two interviewees mentioned that they had taken insurance through Multilateral Investment Guarantee Agency (MIGA) and these were typically large sized project which also involved the government as an investor. One of the projects involved the governments of five countries either as investors, project funders or advisors.

On July 7, 2011, MIGA issued guarantees totalling \$80.4 million to MTN Group Limited of South Africa for its investment in MTN Afghanistan (MTNA), formerly known as Areeba Afghanistan LLC. The coverage is for a period of up to 10 years against the risks of transfer restriction and expropriation (MIGA, 2012). This is an indication of the move for MNCs firstly to invest in politically risky countries and secondly to involve reputable institutions such as MIGA to guard against the impact of political risk.

## **7. Chapter 7: CONCLUSION**

### **7.1 Introduction**

The purpose of this chapter is to outline the key findings in the research, to draw conclusions from the key findings, make recommendations to interested parties and finally recommend future research areas. However one needs to be cognisant of the fact that the findings are based on individuals' views pertaining to MNCs investing in politically risky countries and therefore is not empirical evidence. Chapter 6 does however make a connection between the data collected by way of interviews as indicated in Chapter 4 and the data presented in Chapter 5 as well as the literature review documented in Chapter 2.

### **7.2 Research Findings**

The research sought out to understand in depth the impact of political risk on FDI by South African MNCs. With globalisation there is an increasing number of MNCs investing in other countries other than their own countries, they do this seeking or motivated by a number of factors which include cheaper labour, raw material, natural resources, large market to name but a few. However these investment destinations are at times in areas which are plagued by political risk and MNCs need to make tough decisions on how they go about in investing in these politically risky destinations.

Different political risk factors affect different industries in varying degrees. What might be a significant political risk factor to one industry may not be as significant to the other industry, an example is nationalisation and expropriation. This may have higher significance for a mining or manufacturing company than it would have for a bank, because mines typically buy the rights to mine on a piece of land and own the resources they extract from that land. If there is a threat of nationalisation and or expropriation of land this will have a far adverse effect on a mining company than it would on a bank. So the impact of political risk is important when seeking to identify political risk elements.



### **7.2.1 Political Risk Factors**

As outlined in the section above political risk factors vary in significance per industry, however the key factors established in the research are government stability, violence, nationalisation and expropriation, economic and legal.

Government stability is viewed as the most significant political risk factor, it is so because it is a potential catalyst to all other political risk factors. Government stability is predetermined by the transition in government which typically takes place after an election in a democratic country or could take place by means of coups in non-democratic countries. A smooth transition of government leadership is seen as a result of citizens of the country being content with this transition. However the discontentment of citizens may lead to politically motivated violence which may come in the form of coups, riots, political assassinations and civil wars. The new government leadership may bring about changes in economic policies or judiciary, these two factors are considered political risk factors too in that they are brought about by change in political leadership.

In countries where hasn't been a change in political leadership for decades, this in itself is a political risk factor. Such governments tend to be dictatorial and suppress a lot of the human, legal and press rights. Zimbabwe is a perfect example where there hasn't been a change in government leadership and the incumbent is able to change legislation and economic policies (in the form of nationalisation and expropriation) to suit their own needs. It is therefore important that MNCs be cognisant of the internal political environment of the country which they seek to invest in, as such elements have far reaching consequences to the investment decision making process of that MNC.

### **7.2.2 Foreign Direct Investments**

#### **7.2.2.1 Foreign Direct Investment Drivers**

Prior to a MNCs investing in a country there are factors which attract the MNCs to the destination, they include the cost of doing business in that country, size of the potential market, availability of infrastructure, political and legal soundness as well as the general social well being of the country. MNCs invest in other countries besides their own in order to make higher returns on their investments. Mines invest in countries which are rich in

natural resources, manufacturing companies in countries which have cheaper raw material and labour, banks and telecom in countries which have large market size.

As highlighted in the previous section, what attracts MNCs to a particular country is a stable political environment. MNCs want to be assured that the investment they put in will reap rewards. They do not want to be concerned with the disruption of their operations due to political instability, civil wars, labour strikes and other acts of violence. The stability of government institutions is a key FDI factor. MNCs typically have to deal with these institutions prior to operating in the country and if they find difficulty during the investment decisions phase, it becomes difficult for them to decide to invest in that country. An independent judicial system makes it easy to resolve business contractual agreements between the MNC and any other party within that country. The handling of disputes and which legal route to take when a dispute arise are issues which are dealt with during the due diligence phase are key when try to understand the industry regulation of that specific country.

Cost factors are the pulling factors into investing in a country, with lower cost and higher revenue a MNCs is able to generate higher returns. These lower costs may come in different forms: labour, transportation or raw material. However MNCs need to be cognisant of the cost of lower cost, in other words if there are lower labour costs are you not abusing labour rights of that country? Are you conducting business in a fair manner and would you conduct the same practices in your country of origin?

In most, if not all, politically risk countries infrastructure has been neglected and this poses a hindrance to investment for MNCs wanting to invest in that country. Despite the cost of setting up operations in the country there is also a cost of infrastructure development in the surrounding area of the operations and this infrastructure may include ports, roads, railways, bridges and telecommunication network. These are some of the positive spill overs from FDI by MNCs and generally involve the collaboration of government and the MNCs and are usually welcomed by the local communities. MNCs want to be viewed in good light by the communities within which they operate, therefore the social collaboration aspect of investment remains key to MNCs more especially operating in politically risky countries.

There ought to be a demand for the products and services the MNCs is offering in that country, this is what attracts MNCs to a particular destination. MNCs are becoming mindful that different countries have different requirements, and that and MNCs cannot use the

*copy and paste* approach when entering dynamic countries. They need to customise their products and services for the local market.

### **7.2.2.2 Investment Strategies**

MNCs typically look for opportunities where no one else has tread with the view of seeking the first mover advantage and reap higher returns. However these opportunities at time present themselves in very unfamiliar environments some which are politically risky. An example is the DRC which is rich in minerals, the country alone is the size of Western Europe and every mining and exploration company wants to see themselves conducting business in this country. However the country has been fuelled by civil war for the better part of the past 20 years. MNCs that go into such countries use a greenfield strategy i.e. they invest in sectors or areas that have never been explored with the view of the first mover advantage.

At times MNCs prefer to invest in a country by way of joint ventures and these joint ventures may be with another MNCs, a local company or even the government of that the country. By doing this the MNCs mitigate the risk and they only take part of the risk. If there is a company already operating in the country, the MNC may decide to merge or acquire that company, this approach is typically done by banks and retailers. After the merger or acquisition they would keep the branding and operations of the original company in this way the customer will still remain loyal without fear of drastic change to the company.

When an operation in the country is dormant or not being fully utilised to its potential, an MNC may decide to inject some capital into it operations to kick start it, this approach is called a brownfield investment strategy and is typically used by mining company that invest in a dormant mine.

### **7.2.3 Investment Decisions**

When seeking to invest in a country there a number of factors to consider which include: the investment strategy to use (as highlighted in the previous section), industry regulation, legal issues, how to finance the ventures, labour issues and a host of other aspects. These issues become even more complex when having to decide to invest in a country deemed to be politically risky. This needs the collaboration of all the internal departments along

with the engagement of the host country government institutions at all levels (national, provincial and local).

The Business Development Department typically spearheads the decision making process, as they are the ones tasked with the duty of growing the business and seeking new business opportunities globally. However they do this with the collaboration of the Legal, Technical/Operations and Finance Departments. The Legal Department is tasked with conducting due diligence of the country and understand how the local legal system works, as well as industry regulations. The Technical Department is tasked with analysing the feasibility of conducting business in that environment given the information at their disposal. The Finance Department is responsible for raising capital to start operations in that country, they need to determine if the investment is sound and makes economic sense. All of this decisions and tasks are a collaborative effort and need the engagement of government. Investing in countries which are politically risky is difficult and requires MNC representatives to be on the ground in the target country and getting to understand the environment first hand.

#### **7.2.4 Managing Political Risk**

MNCs may have invested in a country which may have not been politically risky at the time of investment, however political instability may arise, how do MNCs firstly identify the threat of political risk and what strategies do they have to manage this risk.

MNCs should at all times be informed about the environment within which they operate, the source of information may be varied and may include the press, news, journals, consultants, economist, government and industry conferences, and their own representatives in the country. MNCs that operate in politically risky countries are always on the lookout for risk indicators and engaging with government institutions and political leaders, this how they typically manage political risk. However the political environment may get to a situation where it is intolerable to operate in that country and the first important thing that MNCs do is to protect their personnel, physical assets and other investments are secondary.

### **7.3 Recommendations for Stakeholders**

The following recommendations stem from the data that has been collected via interviews and presented in Chapter 5 and the analysis that was conducted in Chapter 6.

As South African MNCs seek opportunities elsewhere besides South Africa, they find themselves presented with these opportunities in unfamiliar and harsh environments. Some of these environments are politically unstable yet present great investment opportunities, therefore here lies the dilemma. MNCs need to be cognisant that one cannot separate economic/business from politics, if anything politics drive economics.

As more and more MNCs are seeking investment opportunities in the rest of Africa, they need to be more mindful of this fact. MNCs need to understand the political environment of the country which they seek to invest in, and this means actively engaging with government representatives at all levels. Most of the time the media portrays bleak images of a country, yet one sees MNCs investing in that country and successfully so. There is a huge risk in investing in a politically risky country, however the returns are also generous, it all depends on how MNCs engage with the different stakeholders in the country. MNCs should accustom themselves with the political environment by gathering as much information as possible in order to establish key political risk indicators, as presented in Chapter 5. Different industries view political risk indicators in different ways, having the ability to engage with government leadership and local communities enables MNCs to establish the political climate within the country.

There are key FDI factors which attract an MNC to a country despite it being politically risky and these factors differ from industry to industry, example in mining the key driver would be mineral resources and in manufacturing it would be cheap labour and raw materials. However MNC need to be mindful that their operations do not operate in isolations, although a country may be rich in resources (which would attract a mining company) it may lack in transport infrastructure, which is essential to transport the extract resources. It is therefore essential that MNCs engage government leadership in the development of such infrastructure. The development of such infrastructure is spillovers of FDI which benefits the country as a whole and are welcomed by the citizens of the country. Therefore with government buy-in this becomes a form of minimising political risk for the MNCs in that government and the citizen have a vested interest in the development of their country.

The investment decision process requires the involvement of all concerned parties from the Business Development, Legal, Human Resources and Risk departments. In the past

MNCs were purely focused on the financial aspects and neglecting the economic and political aspects of developing a new business, more attention should be given to these aspects.

#### **7.4 Recommendations for Future Research**

As this research was qualitative in nature it sought to understand in depth the impact that political risk has on investment decisions by South Africa MNCs. It is also subjective in nature because these were personal views of the interviewees. With interviews the researcher was able to establish new themes per construct as highlighted in Chapter 5, Tables 5.1 to 5.11.

- From these themes a quantitative research can be conducted which would approve or disprove the information collected using the qualitative method (interviews). The quantitative approach can be conducted by way of questionnaires using a 5 point likert scale. The quantitative method will be more expansive targeting a larger audience of at least 60 professionals involved in the investment decisions of the MNCs and these individuals would typically be from the business departments mentioned in Table 5.10.
- A potential research area could involve the same research however focussing specifically on the mining industry, because a considerable number of South African mining companies are now having operations in other natural resource rich countries which include the likes of the DRC, Nigeria and Angola which are or have historically been politically risky to operate in.
- The spill over effects of MNCs investing into politically risky countries is an area which requires some research more especially in this era of the African Renaissance, Millennium Development Goals and the time for Africa to be uplifted and catch-up with the rest of the world. How do South African MNCs impact the country's economy in which they invest? Are there any relations between FDI and economic growth and employment rate of a country?

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## 1. Appendices

### 1.1 Appendix A : Interview Guide



# Interview Guide

**The impact of political risk on foreign direct investment decisions  
by South African multinational corporations**

**Thabo Koboekae**



## Interview Questions

The interview questions will be made up of two sections firstly general questions pertaining to the company and the second section focusses on the research questions.

### General Questions

Elements	
Interviewee Name:	
Designation	
Company Name	
Industry	
Countries operating in	
Subsidiaries	
History of the organisation	
General information	

### Research Questions

This section of the interview will include the core discussion with reference to the research questions.

#### Question 1 - Political Risk

***Define what political risk is, in your understanding, with specific attention to the elements that constitute it?***

1. Briefly describe what you understand political risk to be?
2. What are the key indicators that maybe catalyst to political risk?
3. Is your company operating in a politically risky country?
4. If so which one(s)?
5. How long has your MNC been operating in a politically risky country?
6. Did the political risk arise before or after you had started operating in that politically risky country?
7. Which of the below would best describe the type of political risk the country in which you operate is experiencing:

- Land Expropriations and Nationalisation
  - Coup d'état, Civil War
  - Civil uprising
  - Corruption
  - Import restrictions and discriminatory taxes
  - Inconvertibility of assets and profits
8. Elaborate on the above selection.

## **Question 2 Foreign Direct Investment**

### ***Define Foreign Direct Investment***

1. What does foreign direct investment mean to you as an MNC?
2. What are the elements that constitute FDI?
3. How have you invested in other countries i.e. type of investment?
  - Infrastructure
  - Technology
  - Skills
4. Elaborate on the above?
5. What has been the biggest hindrance in investing in a politically risk country?
6. How have you invested in politically risky country?
  - Start-ups (Greenfield projects)
  - Mergers
  - Acquisition



### Question 3 Decision making process of MNCs

***How does political risk impact investment decisions by MNCs and more specifically in your company?***

***Why do MNCs invest in countries that are deemed to be politically unstable?***

1. Briefly explain the decision making process that takes place when seeking to invest in a country that is politically risky?
2. Which parties/departments in your organisation are involved when deciding to invest in a politically risk country?
3. Do you conduct in country visits prior or during the investment decision making process?
4. How do you familiarise yourself with the host country legal systems?
5. How do you familiarise yourself with the host country economic environment?
6. How do you assess the risk of a country?
  - Media
  - Rating agencies (e.g. Moody's, Fitch, Standard and Poor's)
  - Local representatives, Economist, Industry Experts
  - International Sources (e.g. World Bank, International Monetary Fund)
  - Risk Journals
  - Other
7. How does political risk of a country influence investment decision making process?
8. What influence does the type of government have in the investment decision making process?
9. What role does democracy play in the investment decision making process?
10. What type of trade policies would you consider when looking at investing in a country?
11. Do you consider intergovernmental relationships between host country and the MNC's country?

12. Rank the below factors of FDI in order of importance, in the context of your industry and investment decision making process.

- Infrastructure
- Skilled Labour Force
- Property rights, royalties
- Press freedom
- Independent Judicial system
- Democratically elected government
- Natural Resources
- Cheap Labour
- Cheap Raw Materials

13. How far ahead do you forecast prior to investing?

14. How do you relate with government and state organs?

15. How do you relate with pressure groups, civil movements unions and social interest groups?

16. How do you relate with local companies and communities in which you operate?

#### **Question 4 Managing Political Risk**

***Once MNCs have invested in a politically unstable country, how do they manage/mitigate risk thereafter?***

1. In your company do you have a department that is purely dedicated to the monitoring of country political risk?
2. What actions do MNCs take in order to mitigate risk?
3. Do you have partnership with local companies, if so what is the structure of these companies
4. What socio- economic initiative (i.e. CSR projects) are you involved in, in that country?
5. How do you factor and measure in risk components when investing in risky environments?
6. How do you deal with an adverse situation when it arises- political unrest?

7. What are the disinvestment strategies you deploy if any, should an adverse situation occur?
8. Do you have country risk insurance?
9. How do you manage the impact of Geo-Political risk – political risk arising from countries that are neighbours to the country you have invested in?

### **Closing Questions**

1. Is there any other information or comments that you would like to share regarding this topic?
2. Are there any questions you would like to ask me?