STRATEGIC MANAGEMENT OF COUNTRY RISKS

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ABSTRACT

The present article attempts to study the role of country risk management from the entrepreneur's perspective. The main purpose of the article is to identify the main patterns that determine the features of risk assessment in business as the main element contributing to the achievement of economic security of the organization. The article considers the theoretical foundations, as well as practical aspects of identifying country risks. Methods of cognition, retrospective and documentary analysis, as well as synthesis, generalization, and systematization were used in the performance of the work. In contemporary economic analysis, various methods of risk management are used. The most effective way to reduce risk in the unstable economic and political situation in Russia is diversification, i.e. the distribution of risks between several business participants.

Keywords: Model, Risk, Risk Management, Country Risk.

INTRODUCTION

In the contemporary world, a sufficiently high level of competition in domestic markets contributes to the fact that national companies strive to develop and expand their activities in foreign markets. Even though many companies already have strong positions in the most economically profitable regions, domestic entrepreneurs are still striving to maximize the benefits of the global expansion of their business by entering the international market. There is an interesting pattern here that in such conditions and realities, it is often countries with developing economies that become potential markets. Certainly, there is a high probability that the economic, political, and social market conditions will be unstable and may even be unfavorable for business development, which can lead to very negative consequences in the form of large-scale organizational and financial losses. Such risks can manifest themselves in various spheres (political, economic, social, spiritual, cultural, etc.), and also have a completely different degree and course of influence on the economic activity of the exporting company, depending on the peculiarities of the business environment condition of a particular state.

The purpose of the present study is to assess the impact of the content of country risk and investment risks on enterprise management efficiency.

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LITERATURE REVIEW

Country Risk: Concept and Content

Globalization, as well as developing and expanding international relations, contributing to sharing experience, improving and creating leading world practices create a favorable ground for international business expansion.

Country risk is the threat of financial losses in the implementation of operations that, in one way or another, are related to international activities. It is determined by the conditions of the country's development and the degree of their influence on customers and counterparties. For example, the imposition of restrictions on operations with foreign currency may cause a delay in fulfilling obligations. This threat is especially characteristic of countries where the convertibility of national monetary units has not been preserved historically.

"Country risk is a multifactorial phenomenon which is characterized by a close interweaving of many financial, economic, and socio-political variables" (Algin, 1991; Vlasov, 2013; Kiseleva & Simonovich, 2014).

Certainly, when trying to define and determine the content of country risk, the concept of the investment climate of a country or region is mentioned. Country risk is very closely related to a socio-economic category such as the investment climate of the country. The investment climate is determined by the economic, financial, and socio-political conditions in the country that affect whether individuals, banks, and institutions are ready to lend money and acquire a share (invest) in enterprises operating in a given territory.

"The subjects of country risk are foreign individuals and legal entities carrying out activities that bring them a useful commercial effect in the territory of a given state or with its residents." (Puzyrevsky et al., 2017; Avdiysky, 2012,)

Classification of Country Risks

The most common types of country risks encountered in the domestic and foreign literature are considered below (Rudko-Silivanov et al., 2012; Chernova & Kudryavtsev, 2003; Shapkin & Shapkin, 2014; Morrow et al., 2007).

The political situation in a country can have a significant impact on its risk exposure. In particular, this can be explained in four main factors:

1. Continuous and intermittent risk: countries that are deeply rooted in democracy and freedom of speech have a constant risk in the sense that the rules and regulations governing their activities are constantly challenged and changed. This means that the investor may have to contend with new capital requirements. On the other hand, in authoritarian states, dictatorial policies create a constant risk. This means that it can be difficult to change the rules and regulations, no matter how good or bad they may be from the investor's point of view.
2. Corruption and incidental charges. A high level of corruption makes it easy to circumvent the rules or completely ignore them.
3. Physical violence: internal conflicts or civil wars expose investors to both physical damage and high transaction costs, including high insurance costs and depreciation of physical assets.
4. The risk of expropriation. Expropriation risk is the risk that the government may seize ownership of the firm's assets or impose certain rights that collectively reduce the value of the firm. This can also happen when firms are subject to special taxes, either because of their presence in the country or because of the nature of their main activities.

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5. Sovereign risk. There is some overlap between political and sovereign risk, although the latter, also known as sovereign default risk, primarily considers debt. In particular, this risk category measures the accumulation of debt that is an obligation of the government or its institutions (or guaranteed by the government), and how much this government is expected to fulfill these obligations.
6. Neighborhood risk, also known as location risk, can have side effects for other sovereign states, creating turmoil in the foreign market or putting pressure on local creditors and businesses. It can be associated with countries, neighboring trading partners, as well as with strategically important partner countries.
7. Sometimes a subjective risk is distinguished as a certain kind of country risk. Subjective risk is associated with certain attitudes and may include social pressure and consumer opinions –whether in relation to certain types of goods or certain types of enterprises, which ultimately significantly affects the perception of the country in general.
8. Economic risk covers a wide range of potential problems that can lead a country to abandon its external debts or that can cause other types of currency crises (for example, a recession). The main factor here is the growth of the country's GDP and the prospects for its future. For example, if a country depends on several key export products and their prices fall, this creates an adverse outlook and may increase the economic risk for foreign trading partners. Government actions, such as interference in the money market or policy changes that cause tax instability, can also affect economic risks. Another factor concerns problems with the exchange of foreign currency, for example, the shortage of certain currencies or the devaluation of the national currency.
9. Currency risk. Any projected losses caused by sudden changes in the exchange rate are usually covered by the currency risk factor. This is another comprehensive term since fluctuations in the exchange rate of a foreign currency can be caused by a variety of factors. One example of political changes that can harm economic risk is a change in the currency regime, for example, the transition from a fixed regime to a floating one.
10. Transfer risk. It is in this case that the host government prohibits the transfer of foreign currency outside the country. Drastic controls like these may be a side effect of a country in crisis trying to prevent a creditor panic which may result in a significant capital outflow. Regardless of the reason, capital controls can prevent foreign traders from receiving profits or dividends from the host country.

From a practical standpoint, the classification of country risks is also carried out by the Organization for Economic Cooperation and Development (OECD). A group of experts on country risks from export credit institutions meets several times a year to update the list of country risk classifications. These meetings are organized in such a way as to ensure that each country will be reviewed whenever there is a fundamental change, and at least once a year. The list of country risk classifications is published publicly on the OECD website after each meeting. However, the very meetings, as well as the sharing views and discussions that are held, are strictly confidential.

METHODS

To reduce financial losses, various methods of assessing the situation in the country were used. The analysis was carried out immediately before the investment of funds. If the risk is high, then either the project was postponed, or a premium was added to the project cost. But the previously used methods of assessing country risks had one essential drawback: they embellished the information received. At present, the most popular method is Delphi. The essence of this method lies in the fact that first analysts develop a system of indicators, and then attract experts who determine the weight of each factor for a particular country. The disadvantage of this approach is the subjectivity of assessments (Kiseleva et al., 2019). Therefore, in our study, based on the analysis of the literature we identified the main modern methods and compared them.

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RESULTS AND DISCUSSION

Quantitative Assessment Methods

Certainly, a quantitative assessment of country risk is crucial for making decisions about investments in foreign countries. Therefore, the concept of a *global portfolio* was introduced, according to which the shares of investment in the assets of various states should be distributed inversely proportional to their country's risk.

Quantitative analysis uses coefficients and statistics to determine risks, such as the debt-to-GDP ratio or the beta coefficient of the MSCI index for a given country. International investors can find this information in the reports of rating agencies, magazines, such as The Economist, or through various other online sources.

Compilation of a Country Risk Catalog

The quantitative approach to country risk assessment allows comparing different countries by the degree of risk, using a single numerical risk factor that summarizes the relative impact of a certain number of socio-political factors through various political and social indicators. This factor is calculated by Formula 1:

$$R = R(q1, q2, q3, \dots, q_n) = R(q_i), i = 1, \dots, n, \tag{1}$$

Where R is a multi-factor function depending on the values of the factors taken into account (qi is the set of values of the i-th factor).

The effectiveness of employing this technique is reduced due to the difficulty of their usual extrapolation based on past data, insufficient reliable forecasting of changes in the level of country risk, lack of consideration of qualitative factors that can have a significant impact on the level of country risk, and ignoring factor weights in the final rating.

Economic Ways to Measure Country Risk

The economic method allows making all the previous methods more objective. This method is based on retrospective analysis and extrapolation based on several economic indicators that can be used for providing predicted future values. Thus, the economic approach claims to be more objective, nevertheless, analysis methodologies that are based precisely on a combination of qualitative and quantitative methods can be considered the most appropriate and free from shortcomings when assessing country risk (Kiseleva, 2002)

As for the disadvantages of this method, selecting factors and determining their relative weight remains the main problem of the quantitative method. Very often, with the economic method of analyzing insurance risk, when attempting to adjust it to international standards, a problem arises of the industry orientation of many insurance risks. As known, certain problems for one particular industry can be opportunities and prospects for another, which creates some contradictions in this method of assessment, that is, the scope of application of the quantitative methodology for assessing country risk somewhat narrows.

Qualitative Assessment Methods

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Most often, when using qualitative assessment methods, the expert assessments method is used (Hughes & Redhead, 2005; Khokhlov, 2003; Dosugova, 2011; Avdiysky, 2012). However, expert-based judgments are often very subjective, which significantly reduces the level of reliability and relevance of the information provided, and makes it difficult to analyze it. Sometimes made conclusions in no way reflect the real state of affairs. Naturally, if the experts are highly qualified, well-versed in the specifics of the country and industries, in business, then the objectivity of the results obtained is increased. Besides, by structuring and systematizing the factors that are evaluated, it is possible to increase the objectivity of the analysis results obtained. For example, one can conduct a rating by dividing countries into certain groups, that is, by enlarging the sample.

Thus, the qualitative analysis is more inclined to the subjective aspects of measurement. Any sudden political upheavals or changes in market statistics can lead to instability of the country's economy, thereby increasing its risk. Checking sovereign ratings and informing about the latest changes often help investors (Karmanov et al., 2021) International investors can find this information in financial publications, such as The Economist and The Wall Street Journal, as well as by searching on international news aggregators, such as Google News.

Combined Assessment Methods

Combined methods imply the optimal use of both quantitative and qualitative data for conducting analysis and subsequent assessment of the insurance risk. This method allows obtaining the most objective picture of reality and backing it up with facts.

In the combined assessment models, the country index is built based on:

1. Absolute and relative numerical indicators (t that, statistical and economic analysis is used to determine the weight of variables);
2. Expert assessments of qualitative indicators (for example, socio-political development); the weights of Variables are also determined by expert assessments.
3. The results obtained are summarized in the final index, whose value most often ranges from 1 to 99.

Factor Method of Statistical Assessment of Country Risk

The structural-qualitative, or as it is sometimes called, factor method is based on an expert study of two risk characteristics:

1. The probability of occurrence and the amount of losses;
2. The probability of a particular scenario.

At present, the most optimal and widespread method of risk assessment is a combination of quantitative and qualitative approaches.

A Country Risk Assessment by the Spread Method

In foreign literature, the following formula for assessing country risk by this method is used (Hughes & Redhead, 2005; Morrow et al., 2007):

$$CRP = Sp\frac{\sigma\ shares}{\sigma\ bonds}, \qquad (2)$$

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Where CRP (Country Risk Premium) is the premium for country risk; Sp is the spread on the yield of the sovereign debt of country N, σ_{shares} is the annual standard deviation of the share index of country N, and σ_{bonds} is the annual standard deviation of the market or the Sovereign Bond Index of country N.

The annual standard deviation is a measure of volatility. The rationale for comparing the volatility of the stock and sovereign bond markets for a particular country in this method is that they compete with each other for investors' funds (Kiseleva et al., 2019a). Thus, if a country's stock market is significantly more volatile than the sovereign bond market, its CRP will be on the higher side, implying that investors will demand a higher premium for investing in the country's stock market (compared to the bond market) since it will be considered riskier. It is worth mentioning that this method of assessing country risk is used only for current accounting, and it cannot be fully used for forecasting and strategic planning.

CONCLUSION

This paper considers the concept and content of a phenomenon, such as country risk, as well as studies the main types of country risk, and gives their brief characteristics. In the context of contemporary market conditions, it is especially important to correctly identify the concept of country risk, since understanding this process will allow reducing the likelihood of the impact of investment risks.

A country risk assessment can help an enterprise to identify and assess investment risks. At that, companies can determine how many these risks may affect their business and what steps they can take to manage or mitigate these risks.

Besides assessing and avoiding countries with excessive risk, diversification and hedging can also help reduce this risk. Moreover, country risk maps have been developed that provide a clear picture of the risks associated with different geographical regions. But the nature of the risk is such that some degree of uncertainty continues to exist anyway.

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