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Political Risk Faced by Indian Industry-Its Repercussions and Ways of Minimising It.

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The discernment of the Board of directors of the MNC's whether to invest substantially in the host country or not is directly related to the political risk present in the economy. As the certain change in the policy creates expropriation of investing MNC's profit or assets. Political Risk is not just a term but it is like an epidemic which is spreading in the different regions of the country. Presently in India if external environmental scanning is been done by an investor may be Indian or Foreign there can be scant areas where he would like to pump his capital, not only on the perspective of well established business houses but also from the Governmental departments also. The agitation and demonstrations has been increasing in the recent past years.

The presence of political risk in India has deep roots in the history since the first war of Independence Britshers confiscated Indian rulers' kingdom in the excuse of absence of inheritance and at present this risk is present due to lack of proper Land Acquisition policies and imbalance of generation employment opportunities in areas where MNC's are investing huge capital.

This papers aims at investigating the reasons for the growing political risk in India. It would involve on the analytical study of the losses occurred to the industry and the current scenario of the political risk in the country. This paper would find ways to manage the political risk present in India and how the risk can be covered.

Keywords: political risk, environmental scanning, agitations and demonstration.

Introduction

It totally depends on the execution of political power by the government for creating or solving political risk for the investors. . For example, a dramatic political event may pose little risk to a multinational enterprise, while subtle policy changes can greatly impact a firm's performance. A student-led protest for political change may not change the investment climate at all, while a change in local tax law can erode a firm's profits very quickly.

Defining Political Risk

Well the question of defining political risk had been hovering into various people's mind and there can be not only one definition which could be standard for explaining Political Risk as there had been various studies which has come to different opinion or conflicting opinion on the nature and scope of it. As for example Kobrin defined political risk in terms of host government's interference with business operations, and Fitzpatrick, concentrated his definition on the adverse government actions, other scholars look at political risk in broader terms. For example, Truitt defined political risk as all "non-business" risks which include expropriation. Frynas and Mellahi argued that all social political risks are political risk with three major dimensions: political risk, government policy risk and social risk.

Robock for example, in viewing political risk from an operational dimension, argued that political risk in business exists when discontinuities (which are difficult to anticipate) occur in the business environment as a result of political change. In his view these changes in the business environment constitute a risk if they have the potential to affect to a significant extent the profit or other goals of a particular enterprise.

Political risk according to Simon constitutes governmental or societal actions and policies that originate either within or outside the host country and which negatively affect either a select group or the majority of foreign business operations and investments. Lastly political risk as defined from the behavioural angle, argues that it is the behaviour of the Multinational Corporations (MNCs), and socio-political stakeholders that causes political risk.

In totality political risk as we consider is any disturbance or the interruption in the business enterprise's operations due to change in the country's national policy or a change in of court of law which subsequently hampers the production of goods or services rendered or the confiscation of assets of the business is political risk.

Execution of political power is the root cause of political risks in international business. How political power is exercised determines whether

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government action threatens a firm's value. For example, a dramatic political event may pose little risk to a multinational enterprise, while subtle policy changes can greatly impact a firm's performance. A student-led protest for political change may not change the investment climate at all, while a change in local tax law can erode a firm's profits very quickly. It is the task of the risk manager or company CFO to identify whether a government action poses a threat to a firm's financial well-being.

Types of Political Risks

1. If we want to distinct between the firm-specific political risks and country-specific political risks the first distinction will be that Firm-specific political risks are risks directed at a particular company and are, by nature, discriminatory. For instance, the risk that a government will nullify its contract with a given firm or that a terrorist group will target the firm's physical operations are firm-specific. By contrast, country-specific political risks are not directed at a firm, but are countrywide, and may affect firm performance. Examples include a government's decision to forbid currency transfers or the outbreak of a civil war within the host country.
2. There is a second distinction to be made between types of political risk: government risks and instability risks. Government risks are those that arise from the actions of a governmental authority, whether that authority is used legally or not. A legitimately enacted tax hike or an extortion ring that is allowed to operate and is led by a local police chief may both be considered government risks. Indeed, many government risks, particularly those that are firm-specific, contain an ambiguous mixture of legal and illegal elements. Instability risks, on the other hand, arise from political power struggles. These conflicts could be between members of a government fighting over succession, or mass riots in response to deteriorating social conditions.

Due to this very political risk which has been present in India since from a very long time ago after our independence and in 1977 we have seen winding up of Coca Cola in India due to the Government Policy on Patent Act and 1973 Foreign Exchange Regulation Act.

Some examples of sources of political risk which exist in the World are:

- Political: Shifts in power
- Terror: 9/11, Turkey, Russia, Spain....
- War and Civil Conflict: Iraq, Kashmir, Africa, Middle East
- Finance: Asian & South American financial crises
- Health: disruption from SARS, Asian Bird Flu, HIV/AIDS
- Business Trends: Greater corporate social responsibility, transparency and fair trade
- Environmental: Shell Brent Spa, Baku-Ceyhan pipeline.

Present Political Risks and its Repercussions In India

Politics

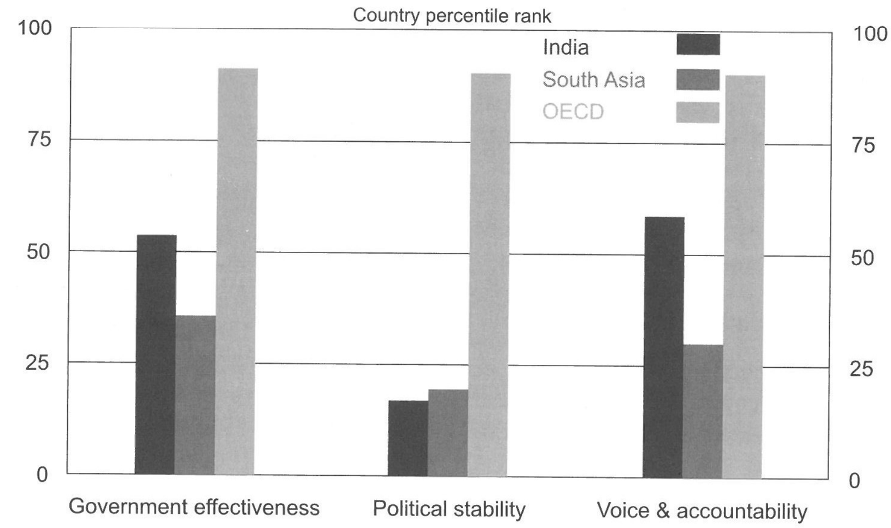
World's largest democracy India is following a British-style parliamentary system. Freedom House, the political and civil rights monitor, rates India as 'Free', one of the few countries in Asia to gain this rating.

In spite of this robust democracy, India ranks in the bottom quartile of countries for political stability, according to the World Bank, in (Chart 1). A competitive electoral showing the Congress Party-led United Progressive Alliance (UPA) in 2009 gave Prime Minister Manmohan Singh an opportunity to forge a relatively stable second-term government, primarily because the UPA did not have to rely on support from far-left parties to maintain its parliamentary majority.

The government has been continually trying to pursue economic reforms and liberalisation, but changes have been, and will continue to be, gradual. Not least because there is some resistance to economic reforms from within the Congress Party.

	Government Risks	Instability Risks
Micro Level - Specific Risks	• Discriminatory regulations • "Creeping" expropriation • Breach of contract	• Sabotage • Kidnappings • Firm-specific boycotts
Macro Level - Risks	• Mass nationalizations • Regulatory changes • Currency inconvertibility	• Mass labour strikes • Urban rioting • Civil wars

Chart 1 Political Indicator



Source: *World Bank Governance Database*

Land Acquisition Controversial Laws

In our country where 65% of population of India is economically dependent on agriculture and the government had the power to acquire any private land which it thinks is needed for a "public purpose" but later what had been findings the 'acquired land' has been sold to Realtors at a very humongous prices in comparison to the prices which government has paid to farmers while acquiring the land.

Hence the controversial continues as the decision has just declared by the supreme court for the villages in the Noida regarding the acquisition of land taken from farmers, the acquired land has to be returned to the farmers, Our country has been watching how investors are now compelled to pay the compensation or the land has to be transfer to the farmers again, even of non-countable chances or instances when INDIA has to face such situation, Similarly the case of Singoor where TATA's ambitious dream was broken into pieces and TATA had to shift their operations to the Sanand, Gujrat.

Discrepancies in the Sale of 2G Spectrum

The **2G spectrum scam** involved officials in the government of India illegally undercharging mobile telephony companies for frequency allocation licenses, which they would use to create 2G subscriptions for cell phones. The shortfall between the money collected and the money which the law mandated to be collected is 1, 76,379 crore rupees or USD 39 billion. The issuing of licenses occurred in 2008, but the scam came to public notice when the Indian Income Tax Department was investigating political lobbyist Nira Radia.

Organized Terrorism

Recently India has been pushed against the wall; it has faced the worst terrorist attacks on its soil since 2004, second only to Iraq in terms of lives lost to arise. Due to Marginalization, inequalities and poor standards of living a favourable field for terrorism had been created. Regional tensions create a high risk of terrorist attacks in India, which may threaten overall security and economic development in the country. In major cases, external terrorist groups are responsible for attacks in India. On the contrary terrorist groups are benefiting from the government's inability to deliver adequate services and ensure security, by offering another option to the people and attracting them to their network. India's economic development and ability to implement a more inclusive growth may contribute to reducing the spread of extremism in the country.

In holistic, India could be viewed as relatively stable (Chart 2), however, the government is dealing with a few security issues. Foreign embassies continue to warn of a high terrorist threat. In November 2008, a series of coordinated terrorist attacks was launched in Mumbai. More than 170 people were killed. Attacks have occurred elsewhere in India in recent years, including New Delhi.

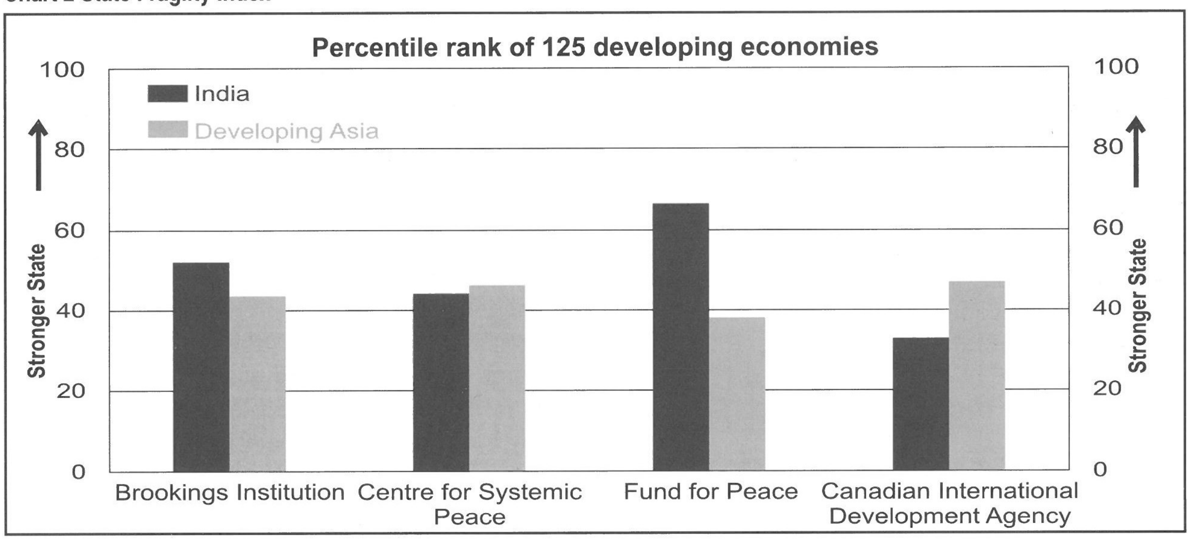
'Naxalites' as the term has been coined for the Maoist rebels which are active in parts of east and central India. They are a significant force in rural areas of Bihar, Jharkhand, Chhattisgarh, West Bengal and Orissa and have attacked government officials, infrastructure and industry, including mining operations. India's seven north-eastern states (Assam, Meghalaya, Tripura, Arunachal Pradesh, Mizoram, Manipur, and Nagaland) has been effected by insurgent groups operating in it . These groups are seeking greater autonomy or independence for their ethnic or tribal group. According to the South Asia Terrorism Portal (SATP), violence is particularly concentrated in Manipur and Assam.

Due to the presence of Organised Terror strike in India Foreign countries as well as native Tourist share in India's GDP is Declining.

Peace and Conflict studies indicated that a Fragile state where public institutions are falling to meet core state functions (economic, political equality, governance, security) are more likely to experience violence where as the eminent presence of Political Risk in India.

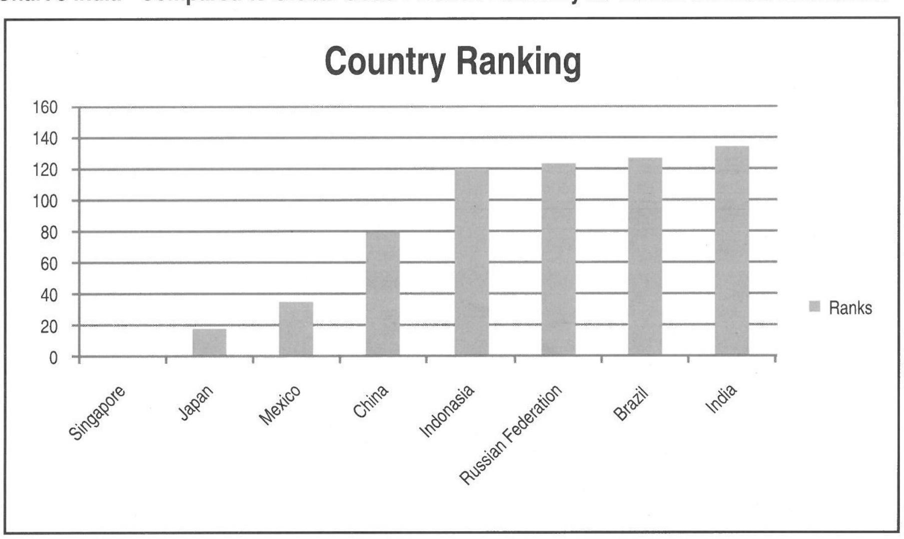
Chart 3, clearly brings out India's rank as134 out 183 economies in world, Singapore is the top ranked economy in the according to Ease of Doing Business Report June2011, India's place as compared to its neighbouring countries which in spite of late Independence and less natural resources rank much better than Our's which has celebrated 63rd Independence day. In BRIC countries group also the other member countries Brazil rank 127, Russia a country totally devastated ranks 123 and China ranks 79.

Chart 2 State Fragilty Index



Sources: *Brooking Institution, Centre for Systematic Peace, Fund for Peace, Canadian International Development Agency.*

Chart 3 India - Compared to Global Good Practice Economy as well as Selected Economies



Sources: *Ease of Doing Business Report June 2011*

Table 1 - India's Ranking in Doing Business 2011

Rank	Doing Business 2011
Ease of Doing Business	134
Starting a Business	165
Dealing with Construction Permits	177
Registering Property	94
Getting Credit	32
Protecting Investors	44
Paying Taxes	164
Trading Across Borders	100
Enforcing Contracts	182
Closing a Business	134

The above table clearly depicts where actually our Indian economy lies when a Entrepreneur or a conglomerate think of an entering in our business environment as compared to other economies. After adhering to all these long procedures not by the foreign investors but also from the domestic industrialist we have seen the huge losses of our industry houses in million USD.

There are several cases where industrialist has suffered and the locals have suffered financially as well as emotionally lot but now as the need of hour says Indian govt should start serious thinking on reducing the political risk in country.

Why Does India not Lure Foreign Investors ?

After the New Economic Policy in 1991 introduced by the then Finance Minister which has helped to raise our economic growth from an average of 5.5% a year in the 1980s to almost 8% over the past 15 years (Chart 4). Correspondingly, poverty has fallen; while still low, per capita income has risen from around US$300 in the 1980s to almost US$1300. Overall, India is the 11th largest economy at market exchange rates, but a high growth rate and large population means that it is likely to move quickly up the league tables.

In Chart 5 we try to summarise the key risks which are present in India and against which exporters and investors has to take precautionary steps. Most macro risks such as business cycle volatility and the risk of sovereign default are low by emerging market standards. A greater impediment is the business climate, particularly contract enforceability.

At present many foreign investors before pumping their capital in various Indian sectors try to do an analysis for the risk associated with the investment which can adversely affect the commercial viability of their investments and future business plans in India. These developments include:

- political instability leads to slow-down in government decisions.
- Unpredictability on foreign investment adverse changes or, import, ownership, pricing or tax issues
- Delays or legal disputes due to local partners and suppliers, cultural problems.
- industrial action and labour unrest.
- social and political unrest creates disruption of normal business.
- bureaucratic inefficiency and corruption.
- Unexpected delays and cost-overruns due to overlapping governmental jurisdiction
- Fluctuation in interest, inflation and currency rates.

Risk Management Techniques for Political Risk

Out of the numerous ways of minding the present probabilities of political risk that are endangering the firm, but proper planning and due diligence are the most important. It's been said also without doing a catalytic a business should not employ its Men money machine and capital but too many businesses begin operations in an unfamiliar country without having taken the time and devoted the resources necessary to ensure a better-than-average chance of success.

An option can be trying to make long and concrete relations with the the government authorities of the country where the businessmen wants to venture, but this may not always be possible or even desirable.

Measures Which Companies Take Against Political Risk

When an Investor whether Indian or Foreign thinks of parking his capital in new area may be of his own country or host country, the perquisite is to take certain steps before taking any strategic decision. This involves careful scanning of the state of country analysis otherwise huge amount of capital as well as asset loss has to be suffered which may also lead to failure of the project or insolvency of the investing company.

There are certain measure which should be followed for analysing and minimising the present Political risk in the country such as:

1. To do in-depth analysis of present of political risk and its consequences also like expropriation, changes in currency or trade controls, changes in tax, changes in labour laws.
2. Quantitative measures to evaluate Political Stability by measured by Measured by, frequency of government changes, level of violence, number of armed insurrections, conflict with other states.
3. Economic Factors like indicators of political unrest, rampant inflation, balance of payment deficits, slowed growth of per capita GDP.

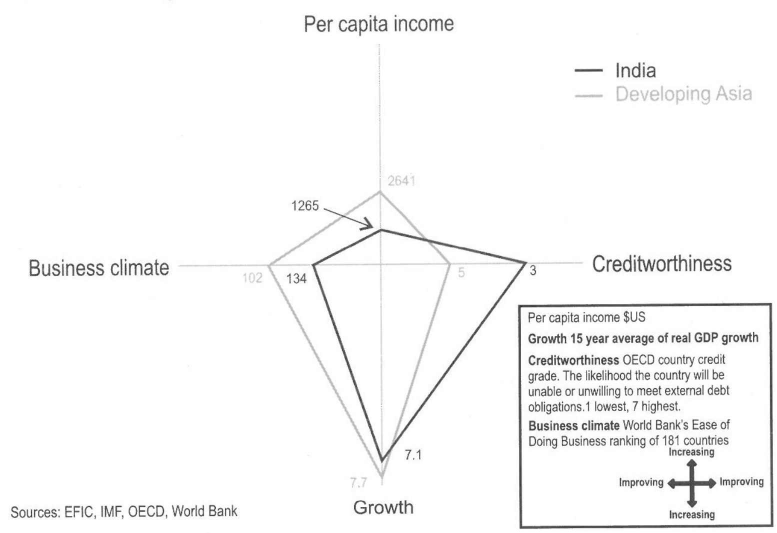
IN INDIA POLITICAL RISK ARE COVERED UNDER CREDIT INSURANCE

Export Credit Guarantee Corporation of India

In India political risk is covered under credit insurance and ECGC is the only provider which has issued just 55 policies worthUS$155 million since it was set up fifty years ago. These investment covers were in respect of two large phosparicacid plants in Jordan and Morocco. It currently has only 6 policies in force worth US$76 million.

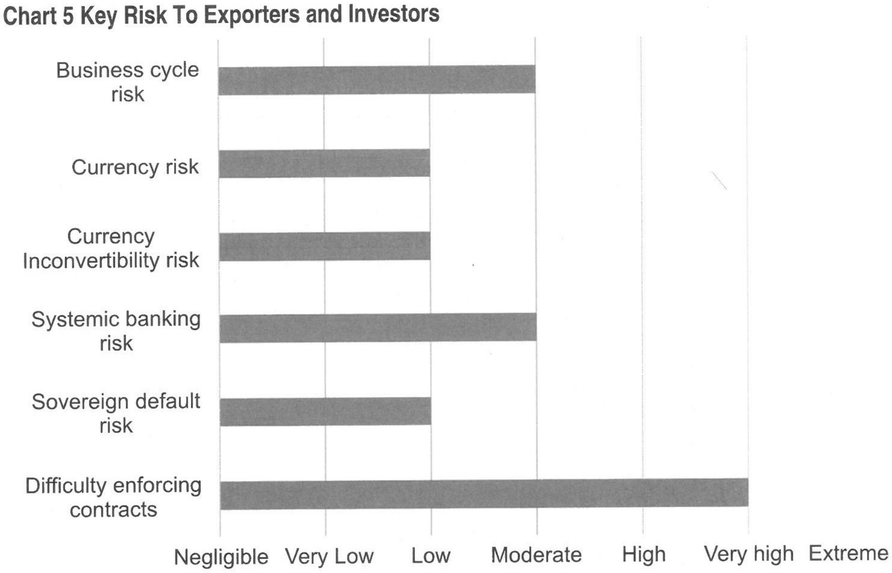
ECGC did relatively brisk business in the 1980s, issuing 32 policies. Growth thereafter slumped due

Chart 4 India at a glance..



Sources: EFIC, IMF, OECD, World Bank

Chart 5 Key Risk To Exporters and Investors



***Source:** EFIC IMF*

to investor wariness triggered by the 1991Gulf War. ECGC issued just 11 policies in the 1990s and 12 policies after 2000.

Average policy size, however, has risen dramatically from US$200,000 in the 1980s to US$7 million post-2000.The largest policy issued to-date is theUS$48 million policy to the Indian Oil Corporation in 2003.The geographic concentration of these policies has also shifted significantly.

South-East Asia Indonesia, in particular accounted for two-thirds of all ECGC policies in the 1980s, and Nigeria and Kenya for one-sixth. In the1990s, the Middle East and emerging Europe rose in significance, and so Credit Insurance Policies.

ECGC has only had to pay out one claim in its entire history of US$0.3million to Usha Martin, a steel wire rope manufacturing company, for an investment in the former Yugoslavia.

Following are the policies under which political risk can be covered in India

- Shipments (Comprehensive Risks) Policy, commonly known as the Standard Policy
- Small Exporters Policy
- Specific Shipment Policy - Short Term(SSP-ST)
- Export (Specific Buyers) Policy
- IT-enabled Services (Specific Customer) Policy
- Insurance Cover for Buyer's Credit And Line of Credit

Suggestions for Managing Political Risk

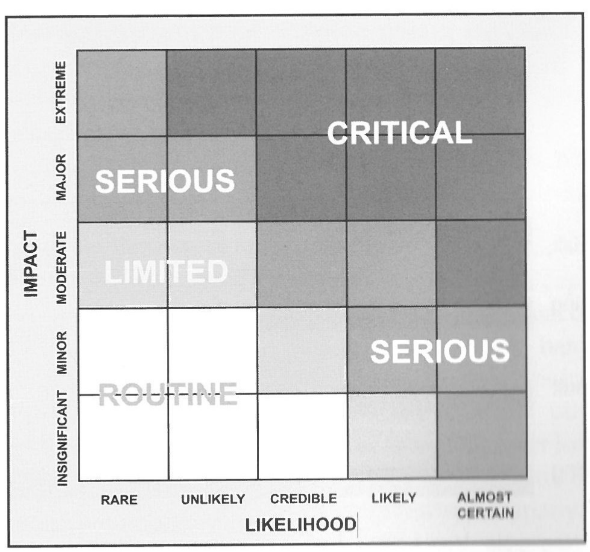
1. Developing solid relations with relevant governing authorities is the preferred approach, but this may not always be possible or even desirable.
2. Establish a good relationship with your workforce. Too often, foreign businesses are perceived as having uncaring managers who do not appreciate their workers.
3. One of the best ways to protect your assets is to generate a loyal workforce.
4. Be alert to what is happening in your host country.
5. Finally, don't underestimate the potential benefits of using Political Risk Insurance (PRI) to manage your political risks.

Likewise while assessing political risk in a particular economy a businessmen should try to find out the impact of and likelihood of present risk in the country. In the (Chart 6) it's have been discussed how a businessmen can categorised the different risk in the category of Critical, Serious, Limited and Routine and take precautionary measures to whether to take that risk or not.

Conclusion

As we are observing there is so much turmoil in our country regarding political atmosphere, we have seen the unrest in Tata Motor's SINGUR and present Land acquisition controversy, organised

Chart 6 Assessing Impact & Likelihood of Political Risk



Source: *The Institute of Risk Management* terrorism therefore there is huge chances of selling political risk insurance product in India.

Political risk insurance can be opted by businesses of any size against political risk, when the risk of revolution or other political conditions results in a loss. It is available for various shades of political risks, including political violence, insurrection, civil unrest, terrorism or war. As with any insurance, the precise scope of coverage is governed by the terms of the insurance policy. But one cannot get a venture covered against government decisions that affect projects.

General insurers like ICICI Lombard, United India Insurance and National Insurance see a huge opportunity for customised political risk covers for big business houses setting up green field ventures in challenging locations.

Political risk cover will shield projects scrapped due to political turmoil, in our country at present we can say that Political Insurance Market in India is a Blue Ocean.

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