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SHORT-TERM INSURANCE OF POLITICAL RISKS IN SOUTH AFRICA

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DECLARATION

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ABSTRACT

Almost all enterprises, individuals and organisations face some form of political risk on a continuous basis. In the past, mines have been lost, terrorist attacks have been devastating, and financial markets have experienced large losses due to political risk factors. We live in an ever-increasing politically insecure world where political risk factors and the analysis thereof receive increasing attention from both international and domestic establishments. From a business perspective, making the correct business decisions and determining the appropriate risk management strategy consequently are crucial to the success of an enterprise, due to the ever-present nature of political risk factors in the business environment.

Especially in the emerging market economies of the world, political risk is an important phenomenon. In such emerging market economies, political risk factors could play a role that is as important as the economic factors that are decisive in the performance of markets. It is well known that the emerging market economies of the world have been the main recipients of foreign direct investments. A closer study of these economies has indicated that the majority of such investments have gone to the so-called BRICS countries (the Federative Republic of Brazil, the Russian Federation, the Republic of India, the People's Republic of China, and the Republic of South Africa).

After having studied the political and economic environments of the BRICS countries, it was concluded that ten political risk factors are common to these countries, namely nationalisation, confiscation, creeping expropriation, currency inconvertibility, breach of contract, non-honouring of government guarantees, war, violent civil unrest, non-violent civil unrest and terrorism. These political risk factors were investigated in a South African context by means of an empirical survey. A census was undertaken that consisted of structured personal interviews (based on a questionnaire) that were pre-arranged with most of the agents who sell Sasria insurance on behalf of Sasria Ltd. These agents mainly were conventional short-term insurers who handled claims on behalf of Sasria Ltd., which placed them in an excellent position to provide the study with valuable information.

Violent civil unrest and non-violent civil unrest have not only been the political risk factors that had the most important impact on the total annual claims amount of the

respondents over the past five years, but have also been the political risk factors that most frequently resulted in claims. It therefore did not come as a surprise that these were the two political risk factors for which there had been the highest level of demand for cover over the past five years. In terms of the importance of impact, the frequency of claims and the demand for cover, violent civil unrest and non-violent civil unrest are expected to remain the two most important political risk factors in South Africa over the next five years. When compared to the past five years, all the political risk factors (excluding breach of contract) are expected to have an increased impact in South Africa over the next five years. They are also expected to present an equal number or more claims in general. While excluding war and terrorism, the expectation is that the demand for cover against them will generally remain at the same level, but may increase.

The South African short-term insurance industry generally faces considerable challenges regarding the cover provided against political risk factors to the public and businesses in South Africa. The industry and the South African public therefore need to be aware of the impact that various political risk factors have on the cover that is provided. This research study should assist the executives of short-term insurance in making better risk management decisions and exercising better control over their responsibilities regarding specific political risk factors in South Africa.

OPSOMMING

Feitlik alle ondernemings, individue en organisasies kom voortdurend voor een of ander politieke risiko te staan. In die verlede was daar verlies van myne, terroriste-aanvalle het verwoesting gesaai en finansiële markte het groot skade gely vanweë politieke risikofaktore. Ons bevind onsself in ‘n wêreld van toenemende politieke onsekerheid waarin internasionale sowel as binnelandse instellings meer en meer aandag aan politieke risikofaktore en die ontleding daarvan wy. Vanuit ‘n sakeperspektief word korrekte besigheidsbesluitneming en die vasstelling van toepaslike risikobestuurstrategië vanweë die voortdurende teenwoordigheid van politieke risikofaktore binne die sake-omgewing gevolglik van uiterste belang vir die sukses van ‘n onderneming.

Politieke risiko is veral in die ontluikende mark-ekonomieë van die wêreld ‘n belangrike verskynsel. In hierdie ontluikende mark-ekonomieë kan politieke risikofaktore ‘n rol speel wat net so belangrik is as die ekonomiese faktore wat deurslaggewend is ten opsigte van hoe markte presteer. Dit is welbekend dat die ontluikende mark-ekonomieë van die wêreld die vernaamste ontvangers van buitelandse direkte beleggings is. ‘n Nadere beskouing van hierdie ekonomieë het getoon dat die meerderheid van sulke beleggings na die sogenaamde BRICS-lande (die Bondsrepubliek van Brasilië, die Russiese Federasie, die Republiek van Indië, die Volksrepubliek van China en die Republiek van Suid-Afrika) gaan.

‘n Studie van die politieke en ekonomiese omgewings van die BRICS-lande het tot die gevolgtrekking gelei dat hierdie lande tien politieke risikofaktore in gemeen het, naamlik nasionalisering, beslaglegging, kruipende onteiening, onverwisselbaarheid van valuta, kontrakbreuk, nie-nakoming van regeringswaarborge, oorlog, gewelddadige burgerlike onrus, nie-gewelddadige burgerlike onrus, en terrorisme. Hierdie politieke risikofaktore is met behulp van ‘n empiriese ondersoek binne die Suid-Afrikaanse konteks ondersoek. Gestruktureerde persoonlike onderhoude (wat op ‘n vraelys gebaseer was), is gebruik om ‘n sensus te onderneem. Hierdie onderhoude is vooraf met agente wat Sasria-versekering namens Sasria Bpk. verkoop, gereël. Die agente was hoofsaaklik konvensionele korttermyn-versekeraars wat alle eise namens Sasria Bpk. hanteer. Hulle was dus in ‘n uitstekende posisie om die studie van waardevolle inligting te voorsien.

Gewelddadige burgerlike onrus en nie-gewelddadige burgerlike onrus was nie net die politieke risikofaktore wat die grootste impak op die totale jaarlikse eisebedrag van die respondente oor die afgelope vyf jaar gehad het nie, maar was ook die politieke risikofaktore wat met die hoogste frekwensie tot eise gelei het. Dit was dus geensins verrassend om te vind dat hierdie twee risikofaktore oor die afgelope vyf jaar verantwoordelik was vir die hoogste aanvraag vir dekking. In terme van die belangrikheid van die impak, die frekwensie van eise, en die aanvraag na dekking word verwag dat gewelddadige burgerlike onrus en nie-gewelddadige burgerlike onrus ook vir die volgende vyf jaar die belangrikste politieke risikofaktore in Suid-Afrika sal bly. In vergelyking met die voorafgaande vyf jaar word verwag dat al die politieke risikofaktore (met die uitsondering van kontrakbreuk) oor die komende vyf jaar ‘n toenemende uitwerking in Suid-Afrika sal hê. Die verdere verwagting is dat ‘n gelyke of groter getal eise oor die algemeen uit hierdie risikofaktore sal voortvloei. Terselfdertyd word verwag dat die aanvraag na dekking teen hierdie faktore (uitgeslote oorlog en terrorisme) oor die algemeen óf op dieselfde vlak sal bly, óf sal toeneem.

Die Suid-Afrikaanse korttermyn-versekeringsbedryf kom oor die algemeen voor groot uitdagings te staan met betrekking tot die dekking wat teen politieke risikofaktore aan die Suid-Afrikaanse publiek en besighede voorsien word. Dit is dus noodsaaklik vir die bedryf, sowel as vir die Suid-Afrikaanse publiek, om bewus te wees van die uitwerking van die onderskeie politieke risikofaktore op die dekking wat voorsien word. Hierdie navorsingstudie behoort die uitvoerende beamptes van die korttermyn-versekeringsbedryf in staat te stel om beter risikobestuursbesluite te neem en beter beheer oor die bedryf se verantwoordelikhede ten opsigte van spesifieke politieke risikofaktore in Suid-Afrika uit te oefen.

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GLORY TO OUR LORD JESUS CHRIST

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CHAPTER 1

INTRODUCTION, OBJECTIVES AND SCOPE OF THE STUDY

1.1 INTRODUCTION

Political risk factors play an increasingly important role in modern global business. Terrorism and riots are but a few of the political risk factors that can cause major financial losses to both local and foreign enterprises. This places extreme pressure on the insurance industry, since this industry is expected to provide cover for such financial losses.

Especially in an emerging market economy, political risk factors are of major concern due to its impact on the business environment. As an emerging market economy, South Africa is faced with this dilemma, since the South African public is in need of insurance against financial losses occurring due to political risk factors.

Current literature makes it obvious that more awareness should be raised concerning the impact of political risk factors on the South African short-term insurance industry. Since no similar research could be found, this study focused on current literature to support its primary objective, namely to assist the executives of short-term insurance companies in South Africa in making better risk management decisions and to exercise better control over their responsibilities regarding specific political risk factors.

This study focused on the political risk factors that were identified in the so-called BRICS countries comprising the Federative Republic of Brazil, the Russian Federation, the Republic of India, the People's Republic of China, and the Republic of South Africa. The aim was to identify possible political risk factors in these countries and then to manage them appropriately. The ability to anticipate and identify political risk factors in the Republic of South Africa could facilitate the short-term insurance industry to be adjusted to provide the South African public with more applicable short-term cover.

A study of this magnitude posed one particular difficulty from a researcher's perspective. This involved finding someone who had been trained in the fields of economics, political science, business management, law and sociology (Simon, 1984:124). It was important to combine knowledge from each of these fields.

After having studied the results of this research, the reader should be able to identify and anticipate various political risk factors that may exist in the Republic of South Africa. It should also give the reader an understanding of how cover for political risk factors is provided in the country to accommodate financial losses covered by short-term insurance.

1.2 PROBLEM STATEMENT

South Africa was one of 22 emerging market economies in the world at the time when this research was conducted (Morgan Stanley Capital Investment, 2010). As in other emerging market economies, political risk factors are sensitive issues in the Republic of South Africa and play a major role in the insurance industry. These particular political risk factors exist mainly due to the nature of emerging market economies.

The short-term insurance industry and the South African public need to be aware of the impact that various political risk factors have on the cover provided. Sasria Limited (hereafter referred to as Sasria Ltd.) provides cover for financial losses that occur as a result of political actions aimed at the government by means of riots, strikes, and public disorder which is caused by fear, terrorism and violence. This study of the BRICS countries may assist South African short-term insurance companies to improve their decision-making process regarding the cover provided to the South African public. Suitable cover should be offered by South African short-term insurance companies at acceptable premiums and with acceptable stipulations.

1.3 OBJECTIVES OF THE STUDY

South African short-term insurance companies generally face big challenges regarding the cover provided to the South African public. Political risk factors usually affect the probability of financial losses which are then expected to be covered by short-term insurance. Political risk factors are common in the Republic of South Africa and this study was therefore expected to be of benefit to Sasria Ltd. for determining the existence, spread and impact of such political risk factors. The *primary objective* of this study was to assist the executives of short-term insurance companies in South Africa in making better risk management decisions and to exercise better control over their responsibilities regarding specific political risk factors.

The *secondary objective* of this study was to identify and assess the various political risk factors in the Republic of South Africa. These political risk factors would be identified by studying the applicable literature, which included studying each of the BRICS countries. This was expected to provide more insight for the identification, analysis and assessment of the following aspects of political risk factors:

- The importance of the specific political risk factors based on the financial impact thereof;
- The frequency of claims arising from specific political risk factors;
- The demand for cover against specific political risk factors;
- Problems experienced concerning cover for specific political risk factors;
- Solutions to solve the identified problems; and
- Trends of specific political risk factors over the past five years, as well as trends expected for the next five years.

1.4 IMPORTANCE OF THE STUDY

This study could assist South African short-term insurance companies to determine possible political risk factors which might occur and for which it will be expected to provide cover to the South African public and business community. By being able to identify and assess political risk factors in the Republic of South Africa, as well as being aware of and understanding the implications of the various political risk factors, more applicable cover could be provided to South African businesses and the public at large through short-term insurance. The possibility of financial risks can often be foreseen and premiums can therefore be calculated accordingly, while the stipulations are adjusted. This study should also assist the executives of short-term insurance companies in making better risk management decisions and to exercise better control over their responsibilities regarding political risk factors.

1.5 SCOPE AND LIMITATIONS OF THE STUDY

This study was limited by the fact that, due to time and financial constrains, not all the emerging market economies in the world could be studied to identify and understand the existence and occurrence of political risk factors. The BRICS countries were studied to identify the main political risk factors in emerging market economies.

It should be kept in mind that this study could only be as good as the data available to it. If insufficient or false data were gathered, or the studies of the BRICS countries were inaccurate, important political risk factors could have been overlooked, or assessing the identified political risk factors could lead to inaccurate results.

1.6 LITERATURE REVIEW

The literature review consists of two chapters. The first chapter (Chapter 2) provides a theoretical discussion of political risk factors in general, while the second chapter (Chapter 3) focuses on emerging market economies and the BRICS countries. Consequently the identification of political risk factors in these countries formed an important part of the literature review. The following sections provide further details about these two chapters.

1.6.1 Chapter 2: Political risk, analysis and insurance.

This section is divided into four parts. The first part entails an overview of political risk. The second part focuses on political risk analysis, and the third part on political risk insurance. The fourth part entails an overview of various insurable political risk factors.

1.6.1.1 Political risk

A relationship between politics and business has existed for as long as mankind can remember. Brink (2004:11) emphasised how the business environment within a country is highly influenced by the host country’s political system, political climate, and political and business culture. This clearly indicates that political risk plays a major role in the business environment (Chaddick & Howell, 1994:71; Schmidt, 1986:43).

Various definitions of political risk are available, but, for the purpose of this study, the most appropriate definition is provided by Brink, who defines political risk as “... the probability that business will ... suffer losses ... as a result of stakeholders within a political system's (in)actions or reactions to events, decisions and policies..." (Brink, 2004:18). Political risk factors exist in the macro as well as the micro environment, with macro political risk factors being those that affect *all* businesses in a country and micro political risk factors only impact on *certain* industries in that country (Brink, 2004:38). Macro political risk factors include war and freedom-related conflicts, while micro political risk factors include unexpected detrimental influences on a particular industry or enterprise (Alon & Martin, 1998:12; Robock, 1971:9-10; Venter, 1998:7-15).

Brink (2004:2) identified 411 underlying indicators and 103 political risk factors. The underlying indicators may be viewed as *situations* which may lead to political risk factors. By being able to identify these *indicators* and understanding the relationship between them, the executive might be able to *anticipate* political risk factors and therefore *manage* it appropriately. Such political *risk factors* include, amongst others, terrorism, war and civil strife damage, corruption, nationalisation, confiscation, currency inconvertibility, and discriminatory taxation.

Political risk factors can be part of numerous classifications. One of these classifications was made by Frynas and Mellahi (2003:545) who stated that *political risk* and *instability* should be separated. According to them, risk refers to an expectation of losses, while instability can be observed as actual damage. Chaddick and Howell (1994:82) made a distinction between political risk factors resulting from *internal* causes, such as social conditions in a business organisation, and political risk factors occurring due to *external* causes, such as the negative influence of regional political forces. Another distinction has already been made between macro and micro political risk factors.

It was believed that avoiding risky countries at all costs is the best approach that businesses can follow when it comes to foreign investment. However, it is possible for a business to use political risk to its advantage. Political risk can be employed, and may even lead to higher profitability, if the nature and the extent of all the involved risks are determined and examined (Brink, 2004:4; Robock, 1971:7). An investor can miss out on good investments if investing in a country with political risk factors is simply avoided (Tarzi, 1992:436). The existence of political risk insurance supports this statement.

Political risk factors, such as expropriation, currency inconvertibility, war damage, and civil strife damage, can be covered by obtaining political risk insurance (Chaddick & Howell, 1994:72; Control Risks, 2009(a); Nel, 2009:104). Political risk insurance can be obtained from public agencies such as the Overseas Private Investment Corporation (OPIC) or, in the Republic of South Africa, from Sasria Limited. It is obvious in all of the above-mentioned political risk factors that government involvement is often the origin of the political risk factors. Financial losses usually occur due to acts performed in reaction to government policies (Brink, 2004:19-20; Howell, 1998:4).

1.6.1.2 Political risk analysis

This research took a closer look at *political risk analysis*. Political risk analysis involves a process to determine the probability that political risk factors might occur. This is made possible by identifying the various underlying *indicators* of political risk factors. Various political risk factors can then be anticipated. Political risk analysis enables the anticipation of the possible occurrence of political risk factors to enable the management thereof (Brink, 2004:4). This is an ongoing process, since indicators and political risk factors are constantly changing in all countries. Political risk factors cannot be anticipated on a statistical basis due to the human nature thereof (Venter, 1998:6). Factors that require attention include, amongst others, the effectiveness of the political system, socio-economic conditions, conflict, and religion (Alon & Martin, 1998:11; Brink, 2004:80-88; Control Risks, 2009(a)). Political risk factors can ultimately result in financial loss to businesses and citizens in both the host and the foreign country.

Simon (1984:130) has emphasised the importance of making a distinction between *open* and *closed* political systems when analysing political risk in a country. He explained that the degree of openness in a society indicates the tendency and ability of non-governmental parties to influence events in that country. It is thus obvious that the openness of a society is an important facilitator of political risk factors. Actions such as protests, boycotts and other types of non-violent activity could easily occur in an open political system, while more violent activities are likely to occur in a closed political system (Simon, 1984:130-134). Whether the host country has democracy will also contribute to the degree of political risk (Jensen, 2008:1041-1042).

Political and social risks are at its highest during the recovery phase of an economic slowdown. This is mainly due to the inability of reality to live up to expectations. Fulfilling people's expectations can reduce the possibility of certain political risk factors (Control Risks, 2009(b); Groth & Roberts, 2001:302-304).

Traditionally, an emerging market economy is politically more risky than a developed market economy (Bilson, Brailsford & Hooper, 2002:14; Diamonte, Liew & Stevens, 1996:72). One of the main explanations for this has been the typical economic conditions, such as poverty, that exist in an emerging market economy. Such conditions may contribute to political risk. A study by *Control Risks* (2007) indicated that 57 per cent of emerging market economies have a medium or even higher political risk rating. Political instability is generally also more likely to occur in emerging and less developed market economies than in developed market economies (Kouznetsov, 2009:378; Nakata & Sivakumar, 1997:469). However, it is important to note that political risk factors are not limited to emerging market economies (Berlin, Berlin & Vrooman, 2003:2). These also occur in developed market economies, whether, for example, in the form of corruption or of unfavourable trade regulations (Brink, 2004:29; Wood, 2009).

1.6.1.3 Political risk insurance

Political risk insurance possibly is the most effective risk management strategy to follow for protection against political risk factors. It provides investors with protection against the financial impact of political events that could adversely affect their investments (Nel, 2009:89). A political risk insurance policy can be an efficient source of protection against political risk factors with the assistance of the proper political risk insurer. The political risk insurance industry thus contributes towards a more stable business and investment environment (Nel, 2009:112).

The purpose of political risk insurance is to provide cover against political risk factors which can limit an enterprise's business operations in a foreign as well as the domestic country (Lewis, 1979:67). Political risk insurance for limited political risk factors is available under very strict conditions. The political risk insurance industry can be subdivided into a public and private sector; the industry consists of private insurers such as the underwriters at Lloyd's of London, and public political risk insurers such as the Overseas Private Investment Company (OPIC), the Multilateral Investment Guarantee Agency (MIGA) of the World Bank, and Sasria Ltd. in South Africa (Alon & Martin, 1998:18; Clark & Marois, 1996:242; Howell, 2007:404). In this study, further research was conducted on Sasria Ltd. since it is the main political risk insurer in the Republic of South Africa.

1.6.1.4 Insurable political risk factors

The main insurable political risk factors that were studied included expropriation, currency inconvertibility, breach of contract, war and civil strife, and terrorism. Expropriation refers to the government taking control of property in the interest of the public. Currency inconvertibility implies the realisation of financial losses due to restrictive legislation concerning foreign exchange controls, and breach of contract refers to a host country failing to fulfil the terms of a contract. War generally refers to international conflict, while internal domestic conflict is referred to as civil strife or civil unrest. Terrorism mostly implies violent actions or threats with the ultimate goal to intimidate the society through fear, and ultimately impact on government. Cover against the aforementioned political risk factors is not always available in South Africa and is sometimes obtained from abroad.

1.6.2 Chapter 3: Emerging market economies and the BRICS countries

The first section of this chapter provides a brief discussion of emerging market economies and their characteristics. In the second part of the chapter, the BRICS countries are discussed in order to identify political risk factors that might be of concern to this study.

1.6.2.1 Emerging market economies

To start with, no official general publication regarding a list of emerging market economies in the world was obtained at the time when this study was commenced. For the remainder of the study it was accepted that there were 22 emerging market economies in the world, as according to Morgan Stanley Capital Investment (2010), which is regarded as the most reliable source. These emerging market economies are listed in Table 1.1.

Table 1.1: List of emerging market economies

1. Brazil	9. Indonesia	17. Russia
2. Chile	10. Israel	18. South Africa
3. China	11. Malaysia	19. South Korea
4. Columbia	12. Mexico	20. Taiwan
5. Czech Republic	13. Morocco	21. Thailand
6. Egypt	14. Peru	22. Turkey
7. Hungary	15. Philippines	
8. India	16. Poland	

Source: Morgan Stanley Capital Investment, 2010

Emerging market economies have certain common characteristics. They are economies with fast growing populations, low per capita income levels and supply a significant percentage of global demand. In short, they are considered economies with fast growth rates. Emerging market economies thus have all the necessary indicators of significant market potential (Akbar, 2006; Baack & Boggs, 2008:129-136; Enderwick, 2009(a):7; Enderwick, 2009(b):358; Heakal, 2010; Nakata & Sivakumar, 1997:463). It is for this reason that investors increasingly focus their attention on emerging market economies (Girard & Rahman, 2007:117).

According to the World Bank, a country must have a gross national income of $11,456 or less to be classified as an emerging market economy. Experts have argued that by 2015, all the emerging market economies combined will have a gross domestic product of more than the top 20 developed market economies (Vital Wave Consulting, 2009). A similar argument stated that emerging market economies will be amongst the top 10 wealthiest countries in the world, supplying more than half of the total global output by 2020 (Nakata & Sivakumar, 1997:462).

Investing in an emerging market economy is a process which is dynamic and requires a lot of attention (Green, 2006). According to Mobius (2009), a sudden decrease in the money supply that leads to increased interest rates is the main risk in an emerging market economy. Creighton (2008) adds that stagflation, declined growth and increasing inflation are also important risk factors. Typically, emerging market economies have very promising long-term prospects, but in the short term they are highly volatile (Van der Merwe, 2006). It often happens that an emerging market economy does not deliver according to its potential or meets expectations (Frynas & Mellahi, 2003:545). This mainly is the result of underdevelopment or internal political issues (Control Risks, 2009(b)).

Apart from investment opportunities, an emerging market economy offers other valuable opportunities to international business operators. It offers opportunities such as learning from experienced and successful companies which, amongst others, enable cost reductions (Enderwick, 2009(a)).

Kouznetsov (2009) emphasised the importance of a thorough study of an emerging market economy's political, economic, socio-cultural, technological and legal environment before undertaking investments in these countries. An emerging market economy differs from a developed market economy in terms of these environments. Property rights, interference by the government, complicated barriers to entry and policy uncertainty are but a few of the factors facing an emerging market economy. Furthermore, each country has overall political risk, the structure of a country's industry might not be normal, and business cultures relate to specific situations (Liu, Zhang & Zhang, 2007:752-760).

1.6.2.2 The BRICS countries

Womack (2009) emphasises the existence of risks in an emerging market economy, especially political risk factors such as corruption, government interference and unpredictable legal systems. This section will attempt to identify the political risk factors that exist within the BRICS countries.

The BRICS acronym is a new phenomenon. The former BRIC acronym referred to the combined economies of the Federative Republic of Brazil, the Russian Federation, the Republic of India, and the People's Republic of China. These four countries were considered the largest emerging market economies in the world (Reuters, 2010). Recently, however, the Republic of South Africa joined the group of the largest emerging market economies. Consequently the acronym changed to BRICS. A brief discussion of the BRICS countries is provided in this second section on the literature (Purushothaman & Wilson, 2003:4-5).

1.7 METHODOLOGY

This section describes the research design, research instrument and census used in this study.

1.7.1 Research design

For the purpose of this study, the research was divided into two separate parts. The first part of this study entailed a thorough study of available secondary data. Studying and analysing the secondary data made it possible to provide a comprehensive discussion of political risk factors in terms of the nature and some of the types thereof. As part of the analysis of the secondary data, this study also includes a discussion of the BRICS countries in order to adjust the literature study in terms of applicable political risk factors. Through the analysis thereof, it was attempted to identify political risk factors that may exist in the Republic of South Africa.

The second part of the study consisted of an empirical survey. Questionnaires based on the secondary data served as an *aide-mémoire* for structured personal interviews that were conducted with the agents who sell Sasria insurance on behalf of Sasria Ltd. These agents mainly were conventional short-term insurers and were located all across the Republic of South Africa. Through the co-operation of these agents, valuable information was provided that contributed to the primary objective of the study, namely to improve decision-making by South African short-term insurers when providing insurance cover to the South African public and businesses.

1.7.2 Research instrument

A questionnaire was designed on the basis of the secondary data. The agents that underwrite Sasria cover acted as the respondents for the questionnaire. The questionnaire required the respondents to rate the importance of the identified political risk factors in terms of the financial impact experienced during the *previous five years*, as well as the expected impact thereof over the *next five years*. They were required to rate the various identified political risk factors on a five-point Likert interval scale. By calculating weighted average responses concerning the various identified political risk factors, it was possible to determine the importance of the various political risk factors in the Republic of South Africa. The respondents were also required to rate the same factors on the basis of the frequency of claims related to these factors, as well as demand for cover against the specific political risk factors, on a similar basis. This helped to identify any possible trends with regard to the various political risk factors.

Furthermore, the respondents were required to indicate the *provinces* in the Republic of South Africa that present the most claims in the country due to political risk factors. Special attention was also paid to the *problems areas identified* by the respondents concerning the management of political risks. *Possible solutions* to solve the problems encountered also formed part of the empirical study. The South African short-term insurance industry thereby may be enabled to adjust the cover provided to the South African public, while current and potential policyholders and intermediaries should also benefit from the empirical study.

1.7.3 Census

The population of this study was the 54 agents that underwrite Sasria insurance. These agents mainly were conventional short-term insurers operating in the Republic of South Africa who did all the underwriting for Sasria Ltd. These agents also handled all the claims on behalf of Sasria Ltd. They thus were the first to be aware of any increase in claims due to political risk factors. For this reason it could be concluded that these agents were experts in the field of insurance and knew all the details and applications of Sasria insurance. They therefore were in an excellent position to provide this study with the necessary primary data. Sasria Ltd. provided the necessary assistance to make personal contact will all the Sasria agents.

1.8 STRUCTURE OF THE THESIS

This thesis consists of the following chapters:

- Chapter 1: Introduction, objectives and scope of the study
- Chapter 2: Political risk, analysis and insurance
- Chapter 3: Emerging market economies and the BRICS countries
- Chapter 4: Research methodology of the empirical study
- Chapter 5: Results of the empirical study

- Chapter 6: Main findings, recommendations and conclusions

1.9 CONCLUSION

This chapter embodies a discussion of the aim of the study and explains how it was achieved by means of the discussed research methodology. The following chapters provide more thorough discussions on the matters addressed in this chapter. Having studied this chapter, the reader should have a better understanding of the proposed objectives, purposes and methodology of the study. The results of the empirical study should assist the executives of short-term insurance companies in South Africa in making better risk management decisions and to exercise better control over responsibilities regarding specific political risk factors.

CHAPTER 2

POLITICAL RISK, ANALYSIS AND INSURANCE

2.1 INTRODUCTION

All individuals and enterprises daily face various risks. This is inevitable, and it is part of our daily lives. The spectrum of these risks is extremely wide. Risks present themselves in different forms which can vary from as wide as health problems or fires to terrorism or tax increases. The outcomes associated with risks are generally negative (Miller, 1992:311).

Especially when foreign investments are made, numerous risks and uncertainties are faced. These risks and uncertainties are applicable to foreign as well as local businesses. Various factors could be crucial to make the investment worthwhile. It is extremely important that sufficient information is gathered concerning the presence of different risks and also the implications of these risks for the business and investment environment. The occurrence of a specific event or happening can ultimately be the telling difference between the success and failure of a business or investment. Recent evidence include the global recession, credit crisis, and increased political unrest and terrorism (Groves, 2010).

Since risks are ever-present in the business environment, making the correct business decisions and determining the appropriate risk management strategy are crucial to the success of an enterprise. Traditional risks faced by enterprises include market risk, credit or default risk, operational risk, liquidity risk, and political risk (Berlin *et al.*, 2003:1). Previous studies have indicated that political risk and a country's market potential have been the two most important factors taken into consideration by decision-makers when they consider foreign investments (Kamga Wafo, 1998:62; Kobrin, 1979:74; Lewis, 1979:163). Other important factors have included economic stability, technological capacity and government policies (Pekeur, 2003:93).

In a political context, risks are very complicated. Globalisation, ethnic nationalism, and easily executed terrorism are not unusual activities in today's world economy (Howell, 2007:404). We live in an ever-increasing politically insecure world where political risk factors and the analysis thereof receive increasing attention from both international and domestic establishments (Lambrechts, 2010:1).

Political risk factors can be extremely harmful. Political disruptions could have a major influence on the economic performance of a country (Dougherty & Specter, 1982:9). In the past, mines have been lost, terrorist attacks have been devastating, and financial markets have experienced large losses due to political risk factors (Wood, 2009). Nowadays multinational enterprises in particular are becoming more concerned about an increase in global political risk factors (Groves, 2010). The relationship between political risk and foreign direct investment is usually negative. High degrees of political risk discourage foreign direct investment, while low degrees of political risk promote foreign direct investment (Brink, 2004:164; Nel, 2007:10).

Both the public and the private sector have been faced with political risk factors. Large enterprises with numerous foreign investments generally have more exposure to political risk factors and for this reason they commit a lot of resources to the management thereof. Smaller enterprises do not have the same capacity to manage political risk factors as larger ones and as a result they often have to make use of public experts for advice concerning political risk management (Howard, 1993:3).

This chapter provides the reader with knowledge concerning political risk, political risk analysis, and the political risk insurance industry in South Africa. It provides a discussion of some of the basic concepts of political risk with attention to its origins and sources, and to its impact on not only the political environment, but also on the economic, socio-cultural, business and investment environments. The process of political risk analysis and the importance of the successful identification, assessment and management response to political risk factors are also of concern. The political risk insurance industry is put under the spotlight, with a discussion of its functionality, purpose, some of the actors in this industry, and also the main insurable political risk factors.

2.2 POLITICAL RISK

Risk typically refers to the realisation of unexpected adverse results. The realisation of an unanticipated event often produces these unexpected adverse results (Nel, 2007:13). The focus of this study is on a particular type of risk, namely political risk.

All individuals and enterprises face political risk factors on a regular basis. It is an inescapable reality. Any political event that has the potential to change the value of an economic asset, whether direct or indirect, can be classified as a political risk factor. The number of existing political risk factors is large, ranging from an expropriation law, an act of terror, and the announcement of war to unexpected changes in tax regulations and sanctions arising from trade regulations (Bremmer & Keat, 2009:9; Stein, 1983:18).

Literature sources differ when defining political risk. Some refer to political risk as a business impact or as losses; some refer to unpredictability and uncertainty; some focus on environmental factors or the involvement of political forces; and some refer to discontinuities in the business environment (Allers & De Mortanges, 1996:305). Generally, the most common definitions of political risk refer to unforeseen government actions which adversely impact on the business environment (Luther & Prakash Sethi, 1986:59). A particular political event thus has the potential to alter economic results (Bremmer & Keat, 2009:5). For this study, political risk is defined as “the probability that business will either earn less money, or suffer losses in profit as a result of stakeholders within a political system’s (in)actions or reactions to events, decisions and policies” (Brink, 2004:18).

Although most definitions of political risk refer to the consequences of unforeseen government actions or interference, the government is not the sole player in the political environment that can produce political risk factors. Lewis (1979:66) explained that political actions can be undertaken by two groups. Firstly, “executive political groups” are those groups situated at the top levels of the government. Political risk factors could originate from these groups through actions or inactions taken by the government and involved political parties. Secondly there are the “political pressure groups”. These are local or international non-governmental organisations or individuals that have the ability to engage in political action, and as a result can produce political risk factors. These parties include important social groups, local and foreign competitors, and community groups (Andrews, 1995:38; Clark & Marois, 1996:55; Control Risks, 2009(a); Lewis, 1979:138). Although these groups cannot change legislation directly, they have the ability to take action that could disrupt the business environment either directly or indirectly (Lewis, 1979:66; Lindeberg & Mörndal, 2002:1). It is important to understand that the role players in the political environment often operate interdependently of one other, which means that the actions taken by one role player may come as a result of actions taken by another. However, they can also operate independently of each other (Howard, 1993:42). Ultimately, the government remains the most important role player in a country's political environment since it implements policies, and these policies shape the business environment.

Political risk has a number of characteristics. A classic characteristic of any risk is that it is often interdependent on another risk. This implies that one form of risk could easily give rise to another (Bremmer & Keat, 2009:6). An example of this is seen in how corruption will change the setup of the business and investment environment. In this instance a political risk factor will produce, amongst others, economic risks. This characteristic of interdependency holds true for political risk factors as well. It is often interdependent on other political risk factors. For example, riots could result from constant xenophobic attacks. Political risk factors also evolve over time as various events occur in the international, national, domestic and personal arena (Clark, 1997:478). Political risk factors are often uncontrollable and unpredictable (Groth & Roberts, 2001:304). However, particular political events could occur regularly, be evolutionary, and be predictable from past trends (Kobrin, 1978:114). A typical example of such an event is national elections. Political risk factors would be more probable during such times.

Political risk factors differ from economic, environmental and financial risks in the sense that they normally originate from individuals. This means that a political risk factor could arise because a particular individual has a specific motivation or agenda for his or her actions, which could obviously have drawbacks (Bremmer & Keat, 2009:21). Politics are highly influenced by human behaviour and the convergence of sudden and often unexpected events (Bremmer, 2005:59; Kumar, n.d.). The nature of political risk factors can be either intentional or unintentional, with an intentional political risk factor referring to a political risk factor that intends to harm a specific individual or enterprise, and an unintentional political risk factor referring to those political risk factors that harm individuals or enterprises without specifically targeting them (Howard, 1993:41).

It should be mentioned that throughout this study, when reference is made to political risk instituted by a country that has monetary effects, the focus is on a country's *unwillingness* to make payments. The *inability* of a country to make payments is a different type of risk altogether, namely country risk. Country risk typically has two subcomponents, namely political risk and sovereign risk (Lier & Tanner, 2007:6). Country risk and political risk are not directly related. A country may be willing to make its payments, but be unable to do so. A country that is unwilling to make payments, however, may not necessarily be unable to do so (Bremmer, 2005:52; Brink, 2004:23). Due to the scope of this study, country risk will not be studied in more detail. Thus, for the duration of this study, political risk with monetary consequences only refers to a country's unwillingness to fulfil its financial obligations.

The political environment, which includes the political system and political culture, ultimately determines the business environment (Brink, 2004:11). Political risk factors are not limited to the political environment only. It involves all the main parts of the external environment, namely the political, economic, social, cultural and legal environments (Kobrin, 1982:29). However, political risk factors only refer to losses occurring due to political situations or events in these environments. Losses due to economic or business situations do not form part of political risk factors although they can be very closely related and it can sometimes be very hard to separate one from another (Chaddick & Howell, 1994:73; Kobrin, 1982:31). Robock (1971:8) explained that government actions are always driven by politics. Significant economic decisions are, however, often made by political leaders in order to achieve their own political desires (Bremmer & Keat, 2009:63). In hindsight, politics could thus easily make economic decisions seem stupid (Bremmer & DiPiazza, 2006:8). This clearly indicates a relationship between the economic and political environment. Where politics are involved, the economic environment could be influenced (Brink, 2004:82; Kobrin, 1979:69). This relationship between politics and business has always existed (Brink, 2004:4). Economic and social environments are also related, since economic problems are often reflected in the society (Nel, 2007:26). Previous studies have also concluded that when the socio-cultural environments of countries are vastly different, political risk factors concerning foreign investments between those countries should be important (Howard, 1993:88). Since government legislation is a product of the legal environment, political risk factors in the form of adverse regimes are not uncommon. Ultimately, the fact that political risk factors can adversely influence all the aforementioned environments make this field of study a crucial part of an enterprise's future success (Andrews, 1995:33).

The political environment has undergone numerous changes in the 21st century. In the previous century, the political environment was marked with ideological power struggles, territorial objectives, power balancing clashes, and countries wanting to be self-sufficient. Conversely, the political environment in the 21st century has until now revolved around economic growth, market expansion and integration, globalisation, and countries' attempts to encourage foreign investment and trade (Nel, 2007:3). One major explanation for the changes in the global political environment has been geographical political power shifts. The countries that have been controlling the energy and oil supplies of the world have been a growing force in the global political environment since they have had power over these important and scarce resources. It explains why the countries of the western world have been losing their dominant global grip in the recent past, while it has been increasingly obvious that political power has begun to shift to the eastern world and especially the Middle East. Additionally, more and more parties have had the ability to give rise to political risk factors. The traditional political pressure groups are numerous, ranging from non-governmental organisations to multinational and country agencies (Silke, 2010).

The business environment has also changed over time. Over time, governments have tended to become more actively involved in business environments. This has complicated the global business environment as governments could interfere with operations and investments within their national borders. Political risk factors also impact on the ownership of the business environment (Nel, 2007:108). Classic political risk factors such as nationalisation and confiscation were common in the previous century. Although these still exist, modern political risk factors that attract more attention include terrorism and corruption (Lewis, 1979:1; Nel, 2007:3-4).

One of the main reasons why political risk factors have been applicable to all stakeholders is globalisation (Control Risks, 2009(a); Kobrin, 1982:56). Globalisation has been one of the most important developments during recent years (Nel, 2007:59). Bremmer and Keat (2009:3) have stated that "... the dramatic increases in global economic integration, trade, and capital mobility in recent decades, combined with growing political instability and government intervention in markets, have created a climate in which political risk is more relevant than ever...". The world is interconnected and borders no longer exist between domestic and international complexities. Consequently, there are numerous role players in the political environment (Bremmer & Keat, 2009:33). No matter what size an enterprise is, global politics could ultimately decide its success (Bremmer & DiPiazza, 2006:26).

As a result of globalisation, investors seek opportunities in new, foreign markets and regions. The longer that an enterprise operates in foreign countries, the more likely it is to face political risk factors (Kobrin, 1982:73). Once an enterprise moves abroad, it leaves a familiar domestic political, economic, legal, and socio-cultural environment and enters a country with which it is unfamiliar in terms of these environments (Chambers & Jacobs, 2007:60; Lewis, 1979:65). Consequently, when investors move to foreign markets, more opportunities could arise, but exposure to more risks (economic, socio-cultural and, in particular, political risk) is inevitable (Control Risks, 2009(a); Friedmann & Kim, 1988:71). A foreign political and social system may be rife with instability; foreign governments may want more control over international activities; and international relationships may change (Simon, 1984:123). These are examples of conditions which contribute to political risk factors. Pretty much all investments are faced with political risk factors (Lindeberg & Mörndal, 2002:1). As long as global business is pursued, political risk factors will always require close attention (Lewis, 1979:295).

Robock (1971:7) has identified three situations under which international business will be subject to political risk. The author suggested that the *occurrence* of discontinuities in the business environment; the *difficulties* concerning the *anticipation* of these discontinuities; and the *political changes that produce* these discontinuities are three of the main situations that expose international business to political risk. Recognising how discontinuities and changes occur in the political environment enables one to understand the nature of political risk factors (Lewis, 1979:70). However, these discontinuities cannot be classified as risks if they cannot result in adverse financial results to the enterprise (Robock, 1971:7). The discontinuities are not necessarily catastrophic. The main issue is that they are unexpected (Howard, 1993:37). If the complex nature of a political risk factor is not properly understood, it is extremely hard to attempt to manage it appropriately

(Howard, 1993:114). The following section presents a discussion of the analysis and management of political risk factors.

2.3 POLITICAL RISK ANALYSIS

An enterprise is required to implement the appropriate risk management strategy as a means of managing risks effectively. Enterprises undertake risk management in order to build an effective risk management strategy that would enable them to manage their daily risks successfully. Failure to incorporate an appropriate risk management strategy could ultimately lead to the enterprise's demise. Risk management is a process whereby risks are identified, assessed, and an appropriate management strategy is adopted. Having sufficient knowledge of a particular risk is thus crucial. If a risk is not properly understood, it could be extremely difficult to manage it effectively (Bremmer & Keat, 2009:191). The purpose of a risk management strategy would be to either minimise the risk itself, or to reduce the possible detrimental financial impact thereof. Risk management attempts to minimise the possibility of unfavourable outcomes and thus provides a form of protection not only against financial loss, but also against possible physical damage (Lindeberg & Mörndal, 2002:25).

The top management of an enterprise comprise the ultimate decision-makers. They determine the actions and location of operations that lead to exposure to risk. Another important factor that contributes to risk exposure is the management's attitude towards risk. Previous studies have found that a large proportion of businessmen are highly averse to risk (Lindeberg & Mörndal, 2002:21). It is clear that risk management needs to be implemented at the top level of an enterprise (Lu & Strebel, 2010:19-20).

It is possible to understand and manage political risk factors relatively successfully. In the modern business world, decision-makers traditionally apply one of three approaches when they are confronted with political risk factors in unfamiliar environments. Firstly, they could argue that political risk factors are inevitable or that it is much too complicated to even attempt to manage it. The second approach suggests that an enterprise should look at how other successful enterprises manage political risk factors, and then follow in their footsteps. The third approach entails that an enterprise simply relies on individuals who seem to know the environment.

According to Bremmer and Keat (2009:2), neither of the above-mentioned approaches is successful. Each of them is constrained by limitations and inaccuracies. In order to manage political risk factors effectively, an appropriate political risk management strategy should be incorporated that is constructed by experts, is flexible and also possesses the necessary creativity. It has also been shown that enterprises with effective political risk management skills are more likely to do business in countries with higher levels of political risk (Holburn, 2001:2).

There is no official formal method or model cast in stone for political risk management (Pekeur, 2003:78). Analyses differ in terms of data sources with regard to political risk management, the scope of cover, whether it is structured and systematic or not (Tarzi, 1992:434-435). However, the basic model of risk management is applied to political risk in order to provide guidelines for political risk management. This approach to political risk management is known as political risk analysis. It implies that political risk factors must firstly be identified, then analysed, before a proper strategy can be generated for the successful management thereof (Andrews, 1995:21; Lindeberg & Mörndal, 2002:25-38; Nel, 2007:45). Political risk analysis can be defined as "... the examination and explanation of the probability that interrelated factors caused or influenced by government political decisions, (in)actions, reactions, or other unforeseen external or internal events will affect business and investment climates in such a way, that investors will lose money or not make as much money as they expected when the initial decision to investment was made..." (Brink, 2004:25).

Political risk analysis does not enable analysts to predict political events with absolute certainty, but rather enables the anticipation thereof (Brink, 2004:27). As long as a political event can be anticipated, an enterprise can construct its strategies and objectives accordingly (Nel, 2007:5). The aim of political risk analysis is not only to be able to anticipate political risk factors, but also to explain how they arise (Brink, 2004:25). Ultimately, political risk analysis is a tool used to protect against possible financial or physical losses (Nel, 2007:54). By being able to anticipate and understand the implications of political change for its business operations, an enterprise would have the ability to make timely decisions concerning business operations, provide existing foreign investments with some form of protection, enhance its business performance, identify opportunities, or exit unstable markets (Chambers & Jacobs, 2007:60).

Political risk analysis serves two main purposes; firstly the ability to anticipate political risk factors, and secondly to manage the anticipated political risk factors appropriately (Galvao, 2001:35; Nel, 2007:45). Through the application of political risk analysis, analysts can identify, assess and manage the adverse impact that a specific political risk event could have on the business environment. When applying political risk analysis, it is important to consider both local and international political, economic and socio-cultural environments (Howard, 1993:10; Luther & Prakash Sethi, 1986:61). A political risk analyst should thus be familiar with the political environment and investment environment of not only the host country, but all the countries of concern (Lloyd, 1974:30; Nel, 2007:154). In order to study a foreign business environment properly, the analyst should have sufficient knowledge concerning the foreign country's economics, politics, laws, history and culture (Brink, 2004:21). The ideal political risk analyst should be qualified in the fields of economics, political sciences, business management, legal expertise and sociology (Simon, 1984:124).

Ultimately, four main complications concerning political risk analysis are identified. The first is the lack of a *generally* accepted definition of political risk. Secondly, being able to predict political risk factors totally accurately is impossible. The third complication arises due to certain analysts' over-sensitivity to certain political risk factors. Finally, data which incorporate subjective assumptions are used to derive objective conclusions. As a result, over-simplified or even over-complicated results could be produced (Friedmann & Kim, 1988:67).

Political risk analysis is applied in an increasingly complex environment (Brink, 2004:3). The political environment is complex and dynamic in nature (Bremmer, & Keat, 2009:2). The political situation in the world can change very quickly and thus it is possible that an attractive trading environment can be transformed into a dreadful one in a fairly short space of time (Dyson, 2005:4). Being able to accurately forecast changes in this environment thus is a mere fantasy. How these changes will impact on global enterprises is also uncertain. This suggests the possibility of political actions having a negative impact on the business environment (Lewis, 1979:66).

Green (1974:29) explained that the analyses of political environments are complicated because governments differ in term of their political forms, characters and ideologies. Appropriate political risk analysis models can be applied to assess the political risk factors concerned with an investment by studying political, economic and social factors. Actual losses are not simply the consequences of an unstable political, economic or social environment. An actual political event must occur which will ultimately result in actual losses (Clark & Tunaru, 2001:158). Brink (2004:88-115) identified 103 political risk factors related to the political, economic and social environment of a country.

It can be dangerous to ignore political risk; avoiding political risk can be short-sighted; and using political risk correctly could be profitable (Bremmer, 2007). Political risk analysis provides an enterprise with the necessary aid to manage and approach political risk in an appropriate and effective manner. Decision-makers are provided with the necessary assistance to anticipate political risk factors and thus construct the appropriate political risk management strategy. Additionally, decision-makers are also provided with the knowledge to understand the implications of existing political risk factors and the impact these could have on an enterprise. Ultimately, an enterprise would ideally want to hedge itself against political risk factors. By *identifying*, *assessing* and *managing* the political risk factors in the following sections of this thesis, an enterprise can minimise its exposure to losses (Nel, 2007:151). Another important aspect of the recognition of political risk factors is the effective communication thereof. A political risk factor can be accurately analysed, perfectly identified and understood, but if it is not communicated properly in an enterprise, all the hard work will be useless (Bremmer & Keat, 2009:12).

2.3.1 Risk identification

In order to identify political risk factors, political risk analysis makes a distinction between an actual political event and the circumstances which lead to the event. *Political risk factors* refer to the actual political events that occur in the business environment and have the potential to impact the business environment adversely (Schmidt, 1986:44). The *underlying political risk indicators* refer to the specific circumstances or situations that influence the occurrence of a political risk factor (Tarzi, 1992:444). These circumstances or situations should be studied so that such events can be anticipated. Once the political risk factors are identified, the consequences thereof can be considered. According to Nel (2007:153), the challenge to a political risk analyst is firstly to identify the internal and external sources of *political risk factors*. The second goal is to identify the *circumstances* which can lead to a political event. Finally, the *impact* of the political risk factor should be evaluated.

A utility that has been used to identify trends in the political environment is the conflict cycle (Lewis, 1979:169). The conflict cycle suggests that it is possible to anticipate general global political risk factors by identifying the present stage of the cycle, establishing the nature of the conflict, assessing the political structure and stability, and studying possible attitudes towards an investment. When the level of conflict is low according to the conflict cycle, territorial-related conflicts are expected, while government policies and ruling parties will be in the spotlight during a high level of the conflict cycle. This utility thus enables analysts to anticipate the state of the political environment, and consequently accommodate possible political incidents (Lewis, 1979:169-172).

A distinction can be made between internal and external conflict. Internal conflict refers to domestic political violence and its impact on the government. Terrorism, civil war and civil disorder are some of the most influential political risk factors of internal conflict. On the other hand, external conflict refers to consequences faced by the ruling government brought about by foreign parties. These consequences can be of a violent nature, such as war or conflicts over borders, or of a non-violent nature, such as sanctions or trade restrictions.

Clark and Marois (1996:56-60) provided a comprehensive discussion on the degree of violence and the degree of visibility concerning the effects of political risk factors. According to their study, the more violent the effect of a political risk factor is, the more visible the political risk factor will be to the society. An obvious example is a terrorist attack. This political risk factor is extremely violent and is witnessed by all. A political risk factor with very visible effects, however, is not necessarily violent. Nationalisation will be very noticeable even though it is not a political risk factor with violent effects. All the aforementioned political risk factors increase a country's overall political risk (Kumar, n.d.; The Political Risk Services Group, 2010).

Lindeberg and Mörndal (2002:26) suggested that it is possible to identify political risk factors by studying historical political conditions that ultimately lead to damage or financial loss. The past have taught us that radical political activity often occurred in countries where impressive economic and social growth were experienced and then was followed by a sudden period of stumbling blocks. It has also been found that when the gap between public expectations and the realised standard of living has been too big for the public, political unrest and action were more likely to occur (Knudsen, 1974:53).

Robock (1971:12) suggested six underlying indicators which could potentially reveal political risk factors. The first are *social unrest and disorder*, not only because they imply unfriendly attitudes towards foreign enterprises, but also because they disrupt the business environment. Secondly, political risk factors can surface *when law is not enforced* effectively. A good place to start when identifying political risk factors is the legal system within a country's legal environment. Both foreign and domestic legal systems are of concern (Lewis, 1979:64). The third underlying indicator suggested that *war, revolutions or riots* have the potential to harm the business environment. Fourthly, when countries *reach independence* they face uncertainties regarding their future political environment. This is mainly due to the fact that newly independent countries often have inexperienced political leaders and a period of policy experimentation could follow. The fifth underlying factor that is suggested is that *changes in public policies* could occur in an attempt to accommodate international alliances. The final underlying factor is the *domestic business environment*. Domestic parties have the ability to motivate political actions in an attempt to protect the domestic business environment (Robock, 1971:12).

Political risk factors have numerous possible sources. Sources that can be categorised under politics and governance include political instability, corruption, changing tax regulations and unclear legislation. Security sources include civil unrest, kidnapping, terrorism, labour unrest, and theft (Control Risks, 2009(a)). Although political risk factors mostly result from a country's political system, the economic, cultural and social conditions within a country should not be ignored (Berlin *et al.*, 2003:2; Bremmer, 2009). Ethnic and religious conflict, economic stress, and foreign government intervention are just a few more examples of factors that require consideration (Brink, 2004:80; Lindeberg & Mörndal, 2002:23).

Political risk analysis classifies political risk factors in various categories. Broadly stated, political risk factors are categorised according to their causal effects, their targets, and their origin. When taking a closer look at the various political risk factors, it is clear that a political risk factor can target only a specific industry, enterprise or project. Political risk factors can also emerge through different types of groups, and political risk factors can be placed in categories according to the broad purpose they intend to serve (Friedmann & Kim, 1988:66-67). This study will focus on the following main categories, namely:

- Macro and micro political risk factors;
- Internal and external political risk factors; and
- Government-related and society-related political risk factors.

2.3.1.1 Macro versus micro political risk factors

One of the first classifications of political risk factors was made by Robock (1971:9) who made a distinction between macro and micro political risk factors. This classification is based on the targeted victims of the political risk factor. Macro political risk factors are systematic and affect the public at large, while micro political risk factors refer to specific changes in the political environment which will impact a particular industry (Tarzi, 1992:445). Macro political risk factors therefore refer to the more generic political risk factors that affect all enterprises and individuals within a specific country, while micro political risk factors affect only specific enterprises, specific industries, or specific projects that are being undertaken (Alon & Martin, 1998:12). Political risk factors can thus be aimed at particular operations, which implies that the consequences will not be the same for all enterprises. Also, the nature of a project itself will determine what type of unanticipated events or actions could arise (Kobrin, 1981:267). It is thus possible that a political risk factor of concern to one enterprise will not be of concern to another (Robock, 1971:8). Previous research has also stated that micro political risk factors may be beneficial for one enterprise, while being harmful to others (Frynas & Mellahi, 2003:561).

Zaayman (2003:16) proposed that three recent macro political risk factors concern the so-called “creeping expropriation”, “external precipitants” and “temporary restrictions”. It often occurs that, instead of expropriating an asset, a government imposes legislation that limits the asset's operations in such a way that the government is actually depriving the owner of its asset. This is known as "creeping expropriation" (Robock, 1971:13). "External precipitants" refer to government actions with the purpose of benefitting the public. It could help solve conflicts regarding ownership of natural resources and land for religious or cultural reasons. "Temporary restrictions" refer to the imposition of exchange controls which limit the transfer of funds across borders (Zaayman, 2003:16). Over time, the main macro political risk factors have been war, political instability, civil unrest, political turmoil, changes in political legislation, and drastic changes in investment legislation (Tarzi, 1992:443).

Lewis (1979:75) explained that macro political risk factors are usually encouraged by ideologies. On the other hand, micro political risk factors arise from conflicts of interest between the government and specific enterprises or industries (Howard, 1993:53; Lewis, 1979:78). These conflicts occur because the enterprise attempts to generate profits, while the government attempts to fulfil its objectives set for the political, economic and socio-cultural environments (Hal Mason, 1974:7; Tarzi, 1992:433). An enterprise can thus reduce its exposure to political risk factors by aligning its objectives with that of the host country (Lloyd, 1974:30; Pike, 1980:35). Gaining acceptance from the government and society could also reduce the possibility that national or regional governments, or any political pressure group, could interfere with its operations for political reasons (Markwick, 1998:52).

The impact of a political risk factor will vary for different industries and enterprises (Baker & Hashimi, 1988:43). The targets of micro political risk factors will change according to conflict of interests. Since conflicts can arise at any time, an enterprise might be vulnerable to political risk factors at certain times, while at other times those political risk factors will not be of concern (Robock, 1971:10). Conflict of interest between an investor and the host government is often the biggest cause of political risk factors (Howard, 1993:50).

As long as an enterprise's objectives satisfy those of the government, micro political risk factors are unlikely. The "obsolescing bargain model" is a very familiar model used to describe a government's dependence on a particular enterprise. The more dependent the government is on an enterprise, the less likely the enterprise will face certain micro political risk factors. It is unlikely that the host government will take action that will adversely affect an enterprise which provides important economic value to the country, whether it is in the form of special technological expertise or provides high employment (Wells, 1998:28). While the enterprise wants profits and growth, the government could benefit from specialised technology, management and marketing expertise, and tax gains (Jakobsen, 2006:72; Kobrin, 1982:79; Nel, 2007:76; Vachani, 1995:166-167). The "obsolescing bargain model", however, does not seem to be true when focusing on the mining industry of the Republic of South Africa; although this industry is an important contributor to the country's economic growth, there have been constant talks about nationalising it (discussed in the next chapter).

Not only does the high dependence of a host government on a particular enterprise imply a low possibility of micro political risk factors for that enterprise, but it should also prove to be less severe with these enterprises than with others. Confiscation is an example of a severe political action, while earnings restrictions are viewed as less severe political actions. It should be noted, however, that a host government could possibly become less dependent on the enterprise over time, indicating that the enterprise's "bargaining power" diminishes (Jakobsen, 2006:72). Reasons for this could include, amongst others, domestic competition, outdated technology, and changes to the host country's political climate (Vachani, 1995:163). When an enterprise loses its bargaining power, it could imply that the enterprise is no longer protected against certain micro political risk factors (Lewis, 1979:80-82; Schmidt, 1986:49). In these situations, an enterprise could easily be threatened, in particular with expropriation (Kobrin, 1982:39-40). For some time the main micro political risk factors have been foreign exchange control, tax regimes, public image, and, most importantly, enterprise-specific risks such as product restrictions and price controls (Tarzi, 1992:444).

Political risk analysts should study the political environment of the countries in which an enterprise operates (macro political risk factors), as well as political risk factors applicable to the particular enterprise and its operations (micro political risk factors), since this will ultimately determine its exposure to political risk factors in the future (Andrews, 1995:22). When developing a risk management strategy it thus is important to not only study the political risk factors associated with the country itself, but also the political risk factors associated with the specific industry. Although an enterprise has no power over what the future holds, it can position itself in such a manner that it can minimise the damage of adverse events if they do occur.

2.3.1.2 Internal versus external political risk factors

Political risk factors can originate within the country itself, in which case it will be referred to as internal political risk factors, or from outside a country, in which case it is referred to as an external political risk factors. Riots and civil wars are typical examples of internal political risk factors. On the other hand, two common examples of external political risk factors are international terrorism or war (Alon & Martin, 1998:12; Bremmer & Keat, 2009:88).

When studying the internal causes of political risk factors, one tends to focus only on the government and other important pressure groups in the political environment. The importance of the host country's bureaucracy and the institutional success thereof, however, should not be underestimated. A country with a poor bureaucracy is more likely to experience radical political changes as new governments come to power (Brink, 2004:87). The institutional strength and quality of a bureaucracy determines how dramatic policies could change when a new government takes over (The Political Risk Services Group, 2010). Previous studies have indicated that there is often a close relationship between a country's institutional strength and the strength of its bureaucracy (Busse & Hefeker, 2005:3). Understanding the public sector and being able to anticipate changes in the business environment when operating in foreign countries raises the importance of the host country's bureaucracy (Howard, 1993:41).

External causes of political risk factors are also of importance, since the ability of the foreign government, as well as of foreign non-governmental organisations to complicate the business environment should not be underestimated (Howard, 1993:42).

2.3.1.3 Government-related versus society-related political risk factors

Political risk factors can be classified as government-related or society-related on the basis of whether they originate from a country's government or from society. Civil strife, which includes riots and terrorism, is caused by the broader society and not directly by the government. For this reason it is classified as a society-related political risk factor. Political risk factors such as expropriation and regulatory discrimination, on the other hand, are clearly caused by the government. Consequently, they are classified as government-related political risk factors (Bremmer & Keat, 2009:88).

Three main categories of government-related political risk factors that result from regulatory change have been suggested. These are transfer risks, operational risks, and ownership-control risks. Transfer risks refer to regulations that affect the ability of an enterprise to transfer funds, either from one location, one currency, or one form, to another. It could also refer to restrictions concerning the transfer of products, technology and people. Examples of transfer risks include import and export restrictions, and foreign exchange control. The second category of political risk factors, namely operational risks, covers regulations that could hinder the management and results of an enterprise's operations. It mostly implies uncertainty concerning future regulations and policies. The most notable examples of operational risks include changes in tax legislation and price controls. The third type, ownership-control risks, are those regulations that aim to change the ownership of a concerned object. An enterprise will generally be exposed to more political risk factors if it has a foreign owner (Clark & Marois, 1996:54; Phillips-Patrick, 1989:652). Expropriation is the most obvious example of ownership-control risks (Howard, 1993:48-49; Schmidt, 1986:45).

Government-related political risk factors are often economically motivated. It could be the result of a government's reaction to economic pressure or factors such as changing ideologies and leadership. The government may impose restrictions such as borrowing restrictions and foreign registration restrictions. Governments have three main reasons for imposing restrictions on foreign activities. Firstly, governments are afraid that the objectives of foreign-controlled enterprises may differ from their own to such a degree that conflicts of interest will be severe. In these situations, the government has to take action to prevent the foreign-controlled enterprise from harming the business environment. The second reason is the protection of the local businesses. Governments want to prevent foreign-controlled enterprises from eliminating opportunities for local enterprises. Finally, the government want to protect its economic resources (Nel, 2007:65). Government-related political risk factors can also be operational, such as interference in the form of price controls and expropriation. The government may be interested especially in taking ownership of foreign assets, which indicates a social motivation (Lewis, 1979:198; Pike, 1980:35). All the above-mentioned forms of government-related political risk factors could be economically motivated.

It is clear that political risk factors that develop from government actions are determined by internal and external changes in both the social and economic environment. These government actions can vary from leadership issues to ideological changes and are reflected through changing laws and regulations. The most common government-related political risk factors are confiscation (including “creeping expropriation”), repatriation restrictions, import restrictions, operational restrictions, price controls, currency inconvertibility, devaluation, employment restrictions, technology controls, and tax changes (Lewis, 1979:221-222).

Societies request stability, security and respect for their property rights (Karl & Laster, 2007:9). If their demands are not met, they could cause trouble. Society-related political risk factors are determined by the ability of the society to hinder a government’s actions or cause political tension. These political risk factors typically originate from world public opinion, disinvestment pressures, and regional diversity and incompatible interests. World public opinion originates from outside a country, disinvestment pressure is typified by negative media focus, and war or general political instability could easily result from regional diversity and incompatible interests (Alon & Martin, 1998:15). Factors that are of concern are unemployment, poverty and consumer confidence (The Political Risk Services Group, 2010).

Society-related political risk factors are expected to occur less frequently in countries where the society at large is satisfied with the political, economic and socio-cultural conditions in the country. As pleasant as this may seem, it is but a dream for every government to keep the whole society satisfied. Not everybody’s demands can be met, and, as a result, society-related political risk factors are inevitable.

The following figure categorises a number of political risk factors on the basis of macro or micro political risk factors, internal or external political risk factors, and government-related or society-related political risk factors. The figure enables the reader to identify the various categories of particular political risk factors.

Figure 2.1: Classifications of political risk factors

		External risk	Internal risk
Macro risks	Society-related risks	• Cross-national guerrilla warfare • International terrorism • World public opinion • Disinvestment pressure	• Revolution • Civil war • Factional conflict • Ethnic / religious turmoil • Widespread riots / terrorism • Nationwide strikes / boycotts • Shifts in public opinion • Union activism
	Government-related risk	• Nuclear war • Conventional war • Border conflicts • Alliance shifts • Repatriation restrictions • Embargoes / international boycotts • International economic instability	• Nationalisation / expropriation • Creeping expropriation • Leadership struggle • Radical regime change • High inflation • High interest rates • Bureaucratic politics
Micro risks	Society-related risks	• International activist groups • Foreign multinational enterprise competition • Selective international terrorism • International boycott of an enterprise	• Selective terrorism • Selective strikes • Selective protests • National boycott of an enterprise
	Government-related risk	• Diplomatic pressure • Bilateral trade agreements • Import / export restrictions	• Selective nationalisation / expropriation • Discriminatory taxes • Selective local content / hiring laws • Industry-specific regulations • Subsidisation of local competition • Selective price controls

Source: Adapted from Lindeberg & Mörndal, 2002:24.

The first step in the political risk analysis process is to identify the possible political risk factor. It is not enough to simply identify a risk; the risk needs to be assessed and understood properly so that the appropriate responsive action can be taken (Bremmer & Keat, 2009:165). The following section provides a discussion on the assessment of the identified political risk factor.

2.3.2 Risk assessment

Before focusing on the core of political risk assessment, this section presents a discussion of the important distinction between political risk and political uncertainty. This distinction is important as it explains the key to the quantification of possible outcomes. A risk refers to a situation where the probabilities of all the possible future outcomes are known with certainty. Since the probabilities of all the outcomes are known, together with the possible impacts, it is possible to measure the potential loss that could result from the risk (Bremmer & Keat, 2009:4). The definition of risk can be stretched to include the inability to take the necessary responsive action to prevent the occurrence of an adverse event (Lewis, 1979:69). Thus, when referring to a political risk, the various possible outcomes, as well as the probabilities thereof are known, and for the probabilities of the various outcomes to be known, the risk must be measurable. It should thus be possible to measure a political risk.

Uncertainty, on the other hand, implies that the probabilities or the various outcomes of a future event are unknown (Lindeberg & Mörndal, 2002:19). Uncertainty clearly indicates unpredictability or inadequate information (Brink, 2004:19; Miller, 1992:312; Taljaard, 1997:2). Thus, political uncertainty is not measurable and requires subjective assessment (Heenan & Rummel, 1978:68). The ultimate goal of risk analysis is to convert uncertainties into measurable and probabilistic assessments. Simply stated, risk analysis attempts to convert uncertainties into risks (Bremmer & Keat, 2009:17). This is the basis on which political risk analysis is built.

Five types of uncertainty have been identified. These are social uncertainty, government policy uncertainty, political uncertainty, natural uncertainty and macro-economic uncertainty. Social uncertainty, government policy uncertainty and political uncertainty are generally *politically* related either in a direct or an indirect manner. Social uncertainty refers to the inability to anticipate the society's emotions and opinions on certain matters. Government policy uncertainty refers to the inability to anticipate government policy instability. Finally, political instability refers to the hazards and opportunities arising from violent political events such as war, or other actual or potential changes in the political system (Miller, 1992:313-316). This study, however, is only interested in political uncertainty.

Political risk traditionally is very hard to calculate on a statistical basis; it therefore is extremely difficult to allocate statistical probability to the possible political outcomes (Venter, 1998:6). As a result, much of what has generally been referred to as political risk has, in fact, been political uncertainty (Bremmer & Keat, 2009:25; Lindeberg & Mörndal, 2002:20). Consequently, political risk is more often analysed on a qualitative than quantitative basis (Lindeberg & Mörndal, 2002:73). The moment the analyst is able to allocate probability to political uncertainty it is no longer classified as political uncertainty, but instead is classified as a political risk (Andrews, 1995:31; Bremmer & DiPiazza, 2006:8).

Now that the difference between political uncertainty and political risk has been explained, this study can begin to investigate the actual assessment of political risk factors. The political environment of a country has three major role players that need to be assessed. The first is the government, which includes the various political parties involved. The second is the political and economic ideologies propounded by the government. Finally, the public's attitude towards the government will also be a decisive variable in the political environment (Schmidt, 1986:43).

One of the most important determinants of a country's political environment is its political system. A country's political system can be based on common law, civil law, or on a religious platform as in Islamic law (Lewis, 1979:63). However, religious tension can easily result when a single religious group dominates the government or produces legislation based on a particular religious law that could hurt other religious groups. Religious freedom ultimately is suppressed. Ethnic tension commonly results from nationality, or racial, language, and other cultural conflicts (The Political Risk Services Group, 2010). Countries differ in terms of their legal systems with the result that an enterprise that operates across borders faces more than one political jurisdiction. It is important, therefore, that both the foreign and domestic political and legal systems are studied. Political and legal developments should be monitored frequently (Lewis, 1979:66). Political risk factors linked to a country's political environment include national security, capital controls and foreign exchange controls (Lewis, 1979:223).

A country's political environment is determined by four core factors, namely domestic instability, foreign conflict, and the political and economic climates. Domestic instability reflects the likelihood of internal national conflict and foreign conflict refers to the country's relationships with other countries. The political climate reflects the likelihood that differing ideologies could bring about political change, and the economic climate refers to the country's global economic performance (Heenan & Rummel, 1978:71). These factors should be studied individually for the purpose of decision-making (Tarzi, 1992:433). However, since these factors should not necessarily become political risk factors by themselves, their potential combined abilities should not be overlooked (Heenan & Rummel, 1978:75). The political environment must be assessed separately but also in combination with the economic environment when studying the impact it could have on an enterprise (Fitzpatrick, 1983:251).

Unlike economic and financial risks, losses due to political risk factors are very hard to quantify and are thus often assessed subjectively. From an analysis point of view, it has been suggested that industries should be assessed differently (Bremmer & Keat, 2009:196). One of the primary objectives of managers is to manage risk effectively (Miller, 1992:311). Ultimately, the aim of the risk assessment process is to improve managers' decision-making and strategic planning. Lindeberg and Mörndal (2002:27) have emphasised that, in the event of certain activities, such as student riots, analysts must be wary of being oversensitive to these events, since it could lead to lost financial and investment opportunities due to a perception of higher than actual risk. Political instability is one of the factors that greatly influence one's perception of risk (Kamga Wafo, 1998:66). On the other hand, not being sensitive enough to these events could result in the analyst underestimating or being unable to identify political risk factors, thus causing major losses.

Even if political risk factors are appropriately understood in the context of the political environment, it may remain impossible to quantify them directly. It is, however, possible to analyse political risk factors by studying the underlying incidents that cause the factors to occur (Howard, 1993:109). Also, it has been proved that it is possible to identify domestic and international political risk trends (Zaayman, 2003:11). Both the political risk factors and the underlying political risk indicators are numerous. Brink (2004:2) identified 103 political risk factors and 411 underlying political risk indicators.

Lewis (1979:69) differentiated between high political risk and low political risk on the basis of decision-makers' ability to take preventative action against political events. The argument stated that, when overall political risk is low, adequate time is available to obtain knowledge on a possible event for an appropriate strategy to be developed. If a political event occurs, the enterprise should be able to anticipate it and have the necessary structures in place to accommodate it. High political risk, however, means that political events cannot be anticipated, usually due to a lack of information and knowledge. An enterprise might thus lack the necessary structures to cope with certain political events.

Analysts make use of various approaches in order to assess political risk factors. Qualitative approaches to political risk analysis that can be applied include the “grand tours” and “old hands” approach, the Delphi technique, and the Business Environment Risk Index (BERI) method. Quantitative methods, such as multiple regressions and sophisticated computer software, are also available to enable the analyst to forecast political trends and find correlations between underlying political risk indicators according to expert interpretations (Allers & De Mortanges, 1996:306-309; Heenan & Rummel, 1978:68-70; Kamga Wafo, 1998:25-28; Lindeberg & Mörndal, 2002:29; Pekeur, 2003:79; Venter, 1998:6). In the short term, it may also prove sufficient to assess a foreign investment by only studying a country’s sovereign rating (creditworthiness) and ensuring a good relationship with the government. In the longer term, however, factors such as social fairness, education, religion, and political freedom could determine the success of a foreign investment. Corruption, bureaucratic disturbances and poor social conditions may also have the potential to produce disastrous results. This clearly emphasises the importance of focusing on political risk factors in the long term (Galvao, 2001:35). The remainder of this section will focus on some of the main political risk factors that must be assessed for the purpose of political risk analysis.

2.3.2.1 Political instability

The interest of global stability has increased, and as a result the successful management of political risk factors and the need to understand them thoroughly have become critical (Bremmer & Keat, 2009:13). Robock (1971:8) explained that political instability is not necessarily a political risk factor in itself, but could be an underlying indicator of a political risk factor. It is thus important to understand that political risk factors could arise from conditions that have no relationship to political instability. Politically stable countries can also present political risk factors (Nel, 2007:24). They could face economic problems which are driven by politics, as was the case in Japan in the 1990s (Bremmer & DiPiazza, 2006:20). Additionally, regulatory problems in politically stable countries, such as the United States of

America and Japan, are often driven by politics and could easily have dramatic consequences for the business environment (Bremmer & Keat, 2009:4). In general, though, the countries with the strongest economies have been politically stable (Bremmer & DiPiazza, 2006:17). Politically stable countries tend to gain more foreign direct investment and have a stronger foundation for financial development than politically unstable countries (Lewis, 1979:165). Additionally, it has often been accepted that political instability is limited to emerging market economies. This is not true. Although emerging market economies are prone to political instability, developed market economies may also experience political instability (Luther & Prakash Sethi, 1986:58).

Apart from the confusion surrounding political risk and political uncertainty (as discussed earlier), political instability also complicates the concept of political risk. Political risk, political uncertainty and political instability are separate occurrences, but they are also indirectly interrelated (Nel, 2007:153). Assessing political risk purely on a basis of political instability will provide an inadequate reflection of the total political risk in a country (Nel, 2007:21). Political instability indicates the possibility of the political environment undergoing sudden change (Friedmann & Kim, 1988:64). It could be the result of the government or other political organisations not living up to the society's expectations; as a result other actors in the political environment may take action to meet the expectations of the society (Howard, 1993:69). The political risk analyst must at all times be careful not to confuse political risk with political instability.

When political risk factors are identified in terms of political instability, it is important that relationships between political and economic developments are established, and also that the flow of investments and economic development is taken into account (Andrews, 1995:88). Political instability normally is a property of the environment (Kobrin, 1978:114). It usually has a clear negative effect on economic development (Dutt & Mitra, 2008:1285). Political stability is based on political policy, government and regime changes. When any of these aspects changes, it influences a country's overall stability. Particularly when regime changes occur, much uncertainty concerning future economic policies arises (Dutt & Mitra, 2008:1300). Policies, governments and regimes are all likely to change regularly; so do political risk factors (Bremmer & DiPiazza, 2006:18). Studying the occurrence of internal and external conflicts, social disorder, government stability, military involvement in politics, ethnic conflict, and regime legitimacy are but a few of the factors that give an indication of a country's overall political stability (Brink, 2004:84). One of the main victims of political instability is the tourism industry. Studies have shown that political instability plays a major role in the development of a country's tourism industry (Altinay, Altinay & Bicak, 2002:181).

Political risk tests the underlying strength of a government (Bremmer, 2009). A government's stability is measured according to its capacity to implement its desired policies and its ability to maintain a political balance in the case of any unexpected event. These unexpected events are often referred to as shocks. Countries react differently to the same shocks, depending on their stability (Bremmer, 2005:54). Shocks can arise from both inside or outside a country and are presented in various forms. Earthquakes, terrorist attacks, assassinations, and radical changes in tax regimes are a few examples of unexpected events or shocks that could influence the political stability of a country. Politically stable governments are more likely to cope with these shocks (Bremmer & DiPiazza, 2006:22; Bremmer & Keat, 2009:28).

Haner (1979:19-21) identified six internal causes (in a country) and one external cause (from abroad) of public conflict and political instability. The first internal cause is related to political power being divided amongst multiple parties. Adverse governmental changes are likely to occur under these conditions. Secondly, dividing people according to religion or culture can encourage government changes. The third cause derives from severe action required to contain opposition parties. The fourth cause is that of actions such as xenophobia and nationalisation. Social conditions can also cause political risk factors. The sixth and final cause identified by Haner (1979:19-21) is the possibility of sudden changes of objectives. The external cause is the reliance on an aggressive political power and negative influences from foreign political powers. The aforementioned causes have the ability to disrupt the political environment in the form of political instability or public conflict.

The potential political instability of a country can be assessed by studying the possibility of political unrest, monitoring political activities, the demography and also the infrastructure of the capital cities (Bremmer & Keat, 2009:86). In situations where public welfare is lower than expected or desired, whether socially or economically, society might become politically dissatisfied (Knudsen, 1974:53). This gap between the expected and realised standards of living is an important underlying indicator of political dissatisfaction. Such political dissatisfaction is one of the major determinants of political instability (Howard, 1993:69). Similarly, public dissatisfaction concerning government policies could force governments to bring about changes in legislation (Brink, 2004:85). Another source of political dissatisfaction is high involvement of foreign enterprises in a country's business environment (Hal Mason, 1974:5). Political dissatisfaction does not necessarily result in violent political action. Knudsen (1974:68) found that the tendency to expropriate property increases significantly when a high degree of political dissatisfaction is present in a country.

The most drastic events in the business environment are usually caused by political instability (Green & Korth, 1974:23). Having adequate understanding of the current political instability of a country could therefore enable the investor to anticipate and prepare for such a scenario. A useful model was proposed by Green and Korth (1974:26); it is known as the Feierabend Index. This index provides numerous underlying indicators of political instability, as presented in Table 2.1.

Table 2.1: The Feierabend Index of political instability indicators

1	Elections	12	Arrests and / or imprisonment of insignificant individuals
2	Vacating of office by individuals	13	Assassinations
3	Acquisition of office by individuals	14	Martial law
4	Significant change of laws	15	Execution of significant individuals
5	Severe trouble within non-governmental organisations	16	Execution of insignificant individuals
6	Organisation of opposition party	17	Terrorism and sabotage
7	Governmental action against significant groups	18	Guerrilla warfare
8	Strikes	19	Civil war
9	Demonstrations	20	Overthrow of government (coups d'état)
10	Riots	21	Revolts
11	Arrests and / or imprisonment of significant individuals	22	Exile of individuals

Source: Adjusted from Green & Korth, 1974:26

According to this index, a particular country is studied to identify which of the listed indicators are present in the country of concern. The identified indicators on the index are applied to compute a political instability rating for a particular country. The reason for the inclusion of this model is to provide the reader with a list of various underlying indicators that could contribute to political instability. These are just some of the factors that need to be considered.

When political instability becomes a serious problem, fundamental political changes can occur (Green, 1974:29). A new government with new objectives and ideologies could come to power (Brink, 2004:84). A change of government is likely to go along with changes in the business environment. Uncertainties regarding future policies could exist and may result in an increase in political risk. The main underlying indicators of a fundamental change in political regime are issues regarding leadership succession, legitimisation problems, political system crisis, political corruption, planned elections, military takeovers, and rebellions by either internal or external political actors (Pike, 1980:35; Tarzi, 1992:443).

2.3.2.2 Democratic versus authoritarian government form

The next valuable part of political risk assessment is an assessment of the form of government in the country of concern. According to Green (1974:35) the form of the government is an indication of the political environment of a country. In countries with democratic political systems, governments will usually have the ability to respond promptly to political needs, which reduces the possibility that sudden huge political changes will occur. The political environment consequently is expected to be reasonably stable (Green, 1974:30). Research has shown that democratic countries are less likely to experience undermining levels of civil strife (Bremmer & Keat, 2009:87).

Issues concerning democracy could give rise to political risk factors (Lindeberg & Mörndal, 2002:1). The present degree of democracy in a country gives an indication of the country’s accountability. It indicates a country’s ability to respond to public needs (Brink, 2004:84). Democratic accountability contributes to a country’s overall political risk rating in that it highlights the importance of the government’s ability to react to society’s demands. The lack of responsiveness of the government is an important underlying indicator of political risk. Poor responsiveness could easily lead to a government’s demise. When a country’s economy is experiencing difficulties, the government must have the power to take the necessary and appropriate action promptly (Brink, 2004:24).

Jensen (2008:1041-1043) argued that democracies could decrease or increase political risk. The author explained that a democracy reduces political risk because policies are more stable and enterprises have the ability to influence policy outcomes. Politics are more transparent, and political leaders would not need to pursue actions, such as expropriation, in order to protect their reputations. However, some of these factors that should reduce political risk may, in fact, increase political risk. In a democracy, political pressure groups could easily influence the government, and political instability may not be unfamiliar. The occurrence of regular and fair elections and the presence of active political oppositions are only two indicators of a country's democratic accountability (Brink, 2004:84). Elections provide valuable information concerning the possibility of government change (Bremmer & Keat, 2009:78). Policies could be unstable due to changes in government resulting from elections, and since different organisations have the ability to influence the government in a democracy, changes in policies could be common. The moment there is a change of government, the risk arises that the new government may impose regulations that could adversely impact the business environment. More importantly, the risk arises that the new government may cancel previous obligations (Kumar, n.d.). The rise of a new government often goes with new ideologies and new government policies. With changing ideologies comes regulatory change. As a result, discontinuity regarding political policies should not be uncommon (Lewis, 1979:73).

Democracies have the ability to present "good governance". Societies have the ability to take action against inappropriate government leaders, should it be required. Elections could take place, after which old, weak, or even corrupt leaders could be replaced (Nel, 2007:82). More severe approaches can also be followed. Military involvement could be the result of government distortion. Governments may experience military takeovers if they do not govern the country effectively (Brink, 2004:86; Green 1974:32). In a democratic country, this demise usually is a non-violent process, while violent actions can be expected in non-democratic countries. Special attention is paid to the time served by the ruling party, the occurrence of regular and fair elections, and the domination of one political party. Particularly poor democratic accountability is likely to produce military involvement in politics. It has been explained that the military could become politically involved in an attempt to bring about regulatory changes. This could easily be the case if the government fails to effectively administer a country (The Political Risk Services Group, 2010).

Democracies arguably offer more accountability to foreign investors in order to attract them. At the same time, however, more opposing parties may cause complications for foreign investors (Markwick, 1998:44). When an enterprise has foreign investments in a democratic country, it may be more likely to encounter political risk than in some authoritarian countries (Wells, 1998:23).

Authoritarian countries have traditionally been more fragile with regard to regime types than democratic countries. Bremmer and Keat (2009:72) explained that political competition in an authoritarian country could easily threaten the endurance of a regime, while political competition is normal in democratic countries. Also, since the aim of an authoritarian country is to look after its people, such countries could be susceptible to changes in the international environment (Bremmer & Keat, 2009:72). However, the stability of an authoritarian regime in the past should not be taken as an indication of future political stability (Brewer, 1981:8). Ultimately, the most stable countries are those that operate midway between a full democracy and a strict autocracy (Bremmer & Keat, 2009:87).

2.3.2.3 Open versus closed approach in a country

The next important aspect to assess is the degree of openness within a country. The openness of a country refers to the degree to which goods and services, people, ideas, and information can move freely within the borders of a country (Bremmer, 2007).

According to Simon (1984:130), the degree of openness within a country indicates the ability of non-governmental organisations within a country to encourage political events. How societies are allowed to express their opinions regarding political actions could easily determine the political risk factors that might arise. In a closed society, political risk factors of a violent nature are likely, while more non-violent political risk factors, such as protests, are more likely to occur in an open society.

Whether a country is open or closed does not necessarily mean that it will be politically stable or unstable. Countries such as Brazil, Japan and Germany have been politically stable because they have been open. At the same time, some countries may be politically stable because they are closed. The ruling elites of these countries isolate their citizens from the rest of the world. If any of these countries experienced even a little opening, political instability could be inevitable in the near future. Examples of politically stable closed countries are China, Cuba and Myanmar (previously Burma) (Bremmer, 2007). Closed countries are often pressured to be more open, but the transition from a closed to an open country goes along with political instability. South Africa is one of a few nations that actually succeeded in its transition from a closed to an open country (Bremmer, 2005:56).

The degree of openness within a society contributes to the possibility that enterprises may decide to invest or disinvest. Disinvestment is more often faced by global enterprises operating in closed countries than those operating in open countries (Simon, 1984:131). One particular political risk factor that originates from “political pressure groups” in closed countries is that of forced disinvestment (Alon & Martin, 1998:15). This implies that an enterprise can be forced to cancel its foreign investments. Along with a country being closed, differing ideologies are often the major motivation for forced disinvestment and this can cause financial and strategic losses (Lewis, 1979:223).

The gap between the expected and realised standard of living of the society is also influenced by the openness of the country. In a closed country, the gap between the expected and the realised standard of living of the society may be wide (Simon, 1984:131). Some form of internal conflict could therefore arise from the society since they want to show their dissatisfaction with economic conditions. In an open country, however, the gap is expected to be of lesser concern. This means that it is less likely that society would produce internal conflict, since they might not be too dissatisfied with their economic conditions (Nel, 2007:67; Simon, 1984:125).

2.3.2.4 Economic aspects

The economic situation within a country is another area of risk assessment. It can easily give rise to political risk factors. The economic aspects of a country are studied so that possible political risk factors can be anticipated. Economic development could easily be undermined by high levels of conflict resulting from racial, language, or other cultural disputes (Busse & Hefeker, 2005:14).

A number of factors contribute to a country's economic performance. A country could fail to live up to its economic potential if factors such as underdevelopment, negative political conditions and internal political strife arise (Control Risks. 2009(b)). Economic growth is an important requirement for social stability and political change. At the same time, social stability and political change contribute to growth (Taljaard, 1997:9). It is possible to identify a relationship between economic performance and political risk factors and it is clear that political risk factors have the potential to constrain a country's economic performance if not properly managed. Increasing unemployment could easily result in civil unrest (Multilateral Investment Guarantee Agency, 2010:9). This is yet another example of how economic issues contribute to political risk factors.

In terms of a country's economic development, two important determinants are, amongst others, political risk and openness (Kamga Wafo, 1998:21). Economic development goes along with political instability, and sudden political changes make countries vulnerable to conflict (Howard, 1993:69; Lewis, 1979:180; Simon, 1984:130). Foreign direct investment is one of the key factors that support economic growth. One of the reasons for this is the provision of employment through foreign direct investment (Pekeur, 2003:93). Such investment, however, depends to a large extent on political stability. Economic aspects such as low levels of adult literacy and unemployment give rise to political risk factors (Brink, 2004:25), while high unemployment is also related to high crime rates (Brink, 2004:111). Previous studies have found that the main underlying political risk indicator of a revolution is poverty or increasing poverty; a wide or increasing gap in the distribution of wealth will lead to political disorder, which could ultimately result in political instability (Howard, 1993:69).

Political events can significantly influence a country's gross domestic product (GDP). On the other hand, social trouble is more likely to develop when the national economic performance is good. When the GDP growth rate is at a peak, internal unrest and socialistic pervasion can be common. A low GDP growth rate may, however, lead to a political leader's downfall. A declining GDP growth rate can easily result in conflict between strong political role players, and a new national leader may emerge. The possibility of a military takeover also increases when the GDP growth rate declines (Dougherty & Specter, 1982:19).

Overall political risk in a country may be higher than usual during periods of economic struggle. These periods may result from government introducing regimes that may adversely impact on the business environment (Brink, 2004:18). The government would then be expected to take action before the public causes chaos. The most obvious action taken by the government would be restrictive legislation, but severe government interventions, such as expropriation and nationalisation could also be applied (Nel, 2007:71). In countries with resource-driven economic growth, political stability is highly dependent on such economic growth. If an economic struggle were to occur in such a country, the society is likely to unite and start a revolution, while the government may be undermined (Bremmer & Keat, 2009:91). However, a country is most vulnerable to political risk during a period of economic recovery, mainly due to possible failure to live up to the society's expectations (Control Risks. 2009(b)). This indicates that the political risk analyst should take the economic situation of a country into consideration as part of the risk assessment process.

2.3.2.5 Political risk rating

Another means of assessing a country's overall political risk is to make use of political risk ratings. There are expert organisations that specialise in allocating political risk ratings to various countries. The Political Risk Service (PRS) model, the Economist model, and the Business Environment Risk Index (BERI) are some of the best known models for the allocation of overall political risk ratings to countries. Although these models are all differently constructed from numerous variables, some of the variables are common to all the models. Amongst others, ethnic tension, religious tension, and corruption are incorporated in all of the above-mentioned models. The political risk analyst could thus benefit by taking a country's political risk rating into consideration as part of the political risk assessment process.

2.3.3 Risk management

The potential financial losses and physical damage caused to an enterprise cannot be prevented or reduced by merely identifying and assessing political risk factors. As mentioned earlier, risk management typically consists of three main steps. The first is the identification of risk, the second is the assessment of the identified risk, and the final step is to develop and implement a risk management strategy. This section provides a discussion of the risk management of an identified and assessed political risk factor.

Common risk management response strategies involve, amongst others, retaining, reducing, avoiding or transferring possible risks. Avoiding or transferring a risk can be seen as a defensive approach, because it reduces the exposure to possible loss without taking any actual preventative action. Retaining or reducing the risk is a more offensive approach in which operations are adjusted or modified to reduce the exposure to possible loss (Baker, Ponniah & Smith, 1999:207-211). The ideal risk management strategy is to combine these approaches. Simply obtaining insurance is not always an efficient solution (Lewis, 1979:262; Lindeberg & Mörndal, 2002:32-38). Apart from obtaining insurance, other major political risk management strategies include financial derivatives and options, legal agreements, commercial treaties, and negotiations (Bremmer & Keat, 2009:197).

When a proper political risk management strategy is applied, it is important that the political environment is continuously monitored due to the dynamic nature thereof (Brink, 2004:31; Kamga Wafo, 1998:34). Successful political risk management is a continuous process that requires input from persons with expert knowledge of the country, political risk analysts and senior management (Chambers & Jacobs, 2007:61; Henisz & Zelner, 2004:168). What might be a relevant political risk factor at a specific point in time could easily become less relevant in the future (Bremmer & Keat, 2009:197). The dynamic nature of the political environment also makes it difficult to foresee political risk factors (Kobrin, 1982:42). Not all political risk factors can be acted upon, but for those that can, the importance of appropriate action in a changing political environment cannot be overemphasised. The impact of a political event can be devastating (Lindeberg & Mörndal, 2002:87). The political violence that occurred in Egypt early in 2011 is a typical example of the dynamic, sudden and unforeseeable nature of political risk factors. Ultimately, political risk analysis needs to be integrated in an enterprise's risk management strategy, which should be managed at the highest levels in an enterprise (Wood, 2009).

2.3.3.1 Risk retention

Retaining a risk implies that it is withheld, either partially or completely. Risk retention is not always intentional and can occur unintentionally as well. Intentional risk retention can be viewed as self-insurance and includes actions such as creating a captive insurance company or building a sufficient contingency fund. A benefit of risk retention is that it may be significantly cheaper as a risk management strategy than the cost of obtaining insurance. Unintentional risk retention simply implies that a risk is retained without actually realising it. It is proper to note that, in the modern world, people are more aware of risk and thus unintentional risk retention rarely occurs (Lindeberg & Mörndal, 2002:34).

2.3.3.2 Risk reduction

Risk reduction refers to actions taken by an enterprise to either prevent a loss or to minimise the possible loss associated with an event. The latter is often referred to as loss control. A general means of loss control is diversification (Lindeberg & Mörndal, 2002:34-35). Hedging techniques can be applied to reduce exposure to political risk. An enterprise, for example, could implement a strategy that allows it to undertake business with the safest countries only, while avoiding countries that are perceived as being politically more risky than others (Clark & Marois, 1996:226). Acquiring sufficient knowledge of a specific country's political environment thus enables an enterprise to take risk reduction action in order to minimise its exposure to possible political risk factors (Lindeberg & Mörndal, 2002:52).

2.3.3.3 Risk avoidance

This action simply implies that any specific action or operation that causes exposure to risk will not be undertaken. This strategy, however, can be extremely costly, since potential opportunities may be lost. Apart from avoiding a country from the start, risk avoidance can also occur in the later stages of operations, when the preferred action would be to divest. The key determinant in risk avoidance is the degree of risk tolerance (or risk aversion) of the decision-makers (Lindeberg & Mörndal, 2002:38).

It would be ideal if everyone could simply avoid all risks at all times. Unfortunately it is not possible, although the typical reaction to political risk is simply to avoid it (Kobrin, 1979:75). It is sometimes possible to minimise political risk, but it can rarely be fully eliminated. Certain risk factors, such as terrorism and global warming, can only be eased in terms of their impact (Bremmer & Keat, 2009:34). For this reason it is important that political risk factors are managed actively (Henisz & Zelner, 2004:167). It is not recommended that risk should be avoided at all times, since lost opportunities can be too costly to an enterprise.

2.3.3.4 Risk transfer

It has been stated that it is difficult to reduce political risk exposure through means other than financial risk management (Lindeberg & Mörndal, 2002:55). The idea behind risk transfer is to transfer the financial burden brought on by a risk to an outside party. This can be achieved through a number of actions. A risk can be hedged with the help of financial institutions such as banks. Contractual agreements such as joint ventures or risk pools can be used to share or shift risks completely to other parties (Lloyd, 1974:31; Wood, 2009). The most obvious form of risk transfer, however, is achieved by obtaining insurance (Lindeberg & Mörndal, 2002:35). In addition to political risk insurance, letters of credit can provide another means of risk transfer. This protects the insured against the financial aspects of commercial risks that might exist. Letters of credit, like political risk insurance, is an expensive means of risk transfer (Lindeberg & Mörndal, 2002:83).

2.4 POLITICAL RISK INSURANCE

One of the best alternative strategies to risk avoidance is for an enterprise to obtain political risk insurance (Nel, 2007:111). Political risk insurance is a successful form of political risk management against financial losses in particular (Nel, 2007:91). However, if the cost of insurance is too high, the better decision could be to avoid the particular situation (Lindeberg & Mörndal, 2002:85). It must be remembered that insurance may cover the financial impact of risks, but cannot prevent the occurrence thereof.

Political risk insurance possibly is the most effective risk management strategy to follow for protection against political risk factors. It provides investors with protection against the financial impact of political events that could adversely affect their investments (Nel, 2007:89). A political risk insurance policy can be an efficient source of protection against political risk factors with the assistance of a proper political risk insurer. The political risk insurance industry thus contributes towards a more stable business and investment environment (Nel, 2007:112). It is important to note that the purpose of obtaining political risk insurance should not be to put the insured in a better financial position than before the detrimental event occurred. It is supposed to put the insured in the same financial position as before the occurrence of a particular insurable political event (Jenney, 2005:115).

It is important to understand that, in general, the insurance industry is usually interested in pure risks. Pure risks refer to risks which could potentially lead to a loss, while a speculative risk could lead to either a loss or a gain. The probabilities and various outcomes of pure risks can be determined, while it may be difficult to do the same for speculative risks. Traditionally, only pure risks can be insured, but in the political risk insurance industry there may sometimes be a demand for cover against speculative risks (Howard, 1993:39). Lindeberg and Mörndal (2002:89) have argued that characteristics such as the size and duration of a project, and its geographical location, can ultimately determine whether a particular asset requires insurance or not. The more unpredictable a risk is, the less likely that it will be insurable, and if it is, it could be very expensive (Skogh, 1998:249). The cost of political risk insurance often is the reason for enterprises not obtaining cover.

An insurance policy is a legal contract between two parties, namely the insurance provider (insurer) and the policyholder (insured). When a political risk insurance policy is constructed, numerous factors are considered. Some of these factors include the government's dependence on the industry, the structure of the enterprise's ownership, business operations, foreign experience of the insured, legal protections, liquidity of the insurer, economic prospects, and regulatory and political risk factors. The insured pays a regular premium to the insurer for this service. Political risk insurance premiums are determined by factors such as the size of investments, the country of concern, and the risks associated with the countries involved (Nel, 2007:91-95).

As the awareness of political risk factors has increased, the demand for political risk insurance has also increased (Nel, 2007:108). One of the main factors contributing to an increasing awareness of political risk factors is the critical consequences that could follow political instability. Enterprises fear that their assets may be expropriated as a result of a change of government or of other dramatic events. Adverse foreign exchange regulations also raise concern (Dyson, 2005:2). It has been noticed lately that the demand for cover concerning trade finance has increased, while the demand for cover concerning the more traditional political risk factors such as expropriation has decreased somewhat (Hofmann, 2006:10). Foreign investments have increased with the development of emerging market economies and the privatisation of enterprises. The demand for political risk insurance could ultimately be determined by the magnitude of foreign investments (Nel, 2007:109).

The purpose of political risk insurance is to provide cover against political risk factors which can limit an enterprise's business operations in a foreign as well as a domestic country (Lewis, 1979:67). Political risk insurance is available for limited political risk factors under very strict conditions. There is a wide variety of different types of risk transfer products in the insurance industry. While some insurers, like the private political risk insurance sector, have only been operating for a few decades, others, such as marine insurance, have been around for centuries. Niche products only make out a small proportion of insurance costs, while others, such as property insurance, account for large proportions of insurance costs (Tobin, 2005:129). One should always remember that political risk insurance will not provide protection to the insured if the insured is engaged in bribery, corruption, or contributes to environmental pollution (Berlin *et al.,* 2003:10).

As far as available literature has recorded, the most common insurable political risk factors have been expropriation and nationalisation, war or civil unrest, and currency inconvertibility (Berlin *et al.*, 2003:5). Although these political risk factors still exist, they have received much less attention in recent times since they have occurred much less frequently (Control Risks, 2009(a)). Expropriation and nationalisation especially occur much less frequently, but terrorism is an ever-increasing risk (Alon, Gurumoorthy, Mitchell & Steen, 2006:626). Previous studies have indicated that the political risk factors that have the most severe impact occur less frequently than political risk factors that have a less severe impact (Brink, 2004:169). However, it is important to note that frequent, low-impact events cumulate and could easily produce catastrophic results (Bremmer & Keat, 2009:21). Unlike in the past, political risk management cannot focus on the three major historical political risk factors of war, revolution and currency inconvertibility only. There are other political risk factors, like terrorism, that require special attention (Andrews, 1995:42).

An enterprise can benefit from political risk insurance in numerous ways. Firstly, financing costs may be reduced due to the lowering of the overall political risk. Political risk insurance will often enable an enterprise to acquire more loan capital at a cheaper rate, since it reduces the risks faced by the banks providing the loans. It could also protect the financial statements of an enterprise; in the event of unexpected or major political events, the results may not reflect heavily in the financial statements of the enterprise. Political risk insurance also protects the shareholders' value by reducing corporate liabilities (Galvao, 2001:42). Most importantly, political risk insurance lessens and soaks up the possible detrimental impact of political events; it enhances the business activities and enables an enterprise to enter new markets. Above all, political risk insurance gives the insured access to professional political advice and support (Nel, 2007:90).

The political risk insurance industry has grown from a low presence industry to a well-established one over the past 20 years (Multilateral Investment Guarantee Agency, 2010:9). Political risk insurers can now provide cover for more political risk factors because the capacity of the reinsurance market for political risk factors is an increasingly promising feature. The political risk insurance industry is particularly willing to provide cover for investors in emerging market economies that are unable to protect their foreign investments (Dyson, 2005:1).

Political risk insurance should continue to play a critical role in the facilitation of trade and investments in emerging market economies in the future (Palmer, 2008:223). With political risk factors receiving more attention in the global business environment, and foreign investment in emerging market economies continuing to sustain, the political risk insurance industry should increasingly be provided with more opportunities to provide cover. In the short and medium term, there should be a continuation of opportunities for the political risk insurance industry, especially when looking at infrastructure and the extractive industries. Breach of contract, expropriation, and other related political risk factors are expected to remain a cause of concern. Terrorism, civil unrest and other forms of political violence should continue to occur, especially in the short and medium term (Multilateral Investment Guarantee Agency, 2010:8), and nationalisation, currency instability and political violence are expected to raise the demand for political risk insurance in the future (Multilateral Investment Guarantee Agency, 2010:45). For the political risk insurance industry to be successful in the long term, insurers should construct flexible and creative cover instead of attempting to predict future events (Westholm-Schröder, 2008:215). Ultimately, the future of the political risk insurance industry could be determined by global and emerging market economic development (Westholm-Schröder, 2008:209).

The political risk insurance industry can be subdivided into a public and a private sector. This industry consists of *private* insurers such as the American International Group (AIG), the underwriters at Lloyd's of London and the Credit Guarantee Insurance Corporation of Africa Limited, and *public* political risk insurers include the government-sponsored Overseas Private Investment Company (OPIC) and combined organisations such as the Multilateral Investment Guarantee Agency (MIGA) of the World Bank and Sasria Ltd. in South Africa (Alon & Martin, 1998:18; Clark & Marois, 1996:242; Howell, 2007:404). In the past, political risk insurance was seen as a product for the public sector and the government (Stephens, 1998:149). In the recent past, however, the private sector and reinsurers have had increased capacity and have become more willing to provide cover against political risk factors (Stephens, 1998:153-154).

2.4.1 Public political risk insurance

Public political risk insurers often are backed financially by the government. The government usually forms, or gives financial support to political risk insurers, for the purpose of providing protection against adverse regime changes in the foreign political environment. Political risk insurance provided and financed by the state will provide cover that will usually not be available otherwise. This sector is non-profit orientated and attempts to stimulate and encourage the economic growth of a country, especially through the enhancement of investment and development (Nel, 2007:101).

Public political risk insurance is an effective tool for preventing governments from interfering with investments (Markwick, 1998:54). The public sector typically provides cover against expropriation or confiscation, war or civil unrest and currency inconvertibility (Control Risks, 2009(a)).

Government-sponsored political risk insurers typically are very constrained by the type of policies which they issue. However, through co-operating with the private insurance sector, they are able to be more flexible with their policies. Co-operation between the two sectors is common (Nel, 2007:107).

The best known government-sponsored political risk insurance provider is the Overseas Private Investment Company (OPIC). OPIC is a government-sponsored political risk insurer in the United States of America that offers unique cover to American individuals and enterprises that make foreign investments (Dyson, 2005:2). However, OPIC does not provide cover for foreign investments in all countries (Hofmann, 2006:12). It does not operate in countries that disrespect workers' rights, such as the use of cheap and child labour, and it will not support operations that could result in job losses to citizens of the United States of America (Lempres, 2004:2). Traditional cover provided by OPIC includes protection against currency inconvertibility, expropriation, political violence, and a stand-alone terrorism policy. Compensation is provided for business interruption and physical damage to assets due to political violence (Nel, 2007:106). Other developed nations that have government-sponsored political risk insurers include Japan, Germany, the United Kingdom, and Canada (Kamga Wafo, 1998:56).

2.4.1.1 Sasria Limited

Sasria Ltd. is a South African-based political risk insurer. The South African Special Risks Insurance Association (SASRIA, as written in capital letters at that time) originated after the Soweto riots in 1976 in order to provide the South African insurance market with financial aid for claims resulting from political events (Kalisa, 2009). Political unrest was a major concern in South Africa at the time, and consequently conventional short-term insurers were not willing to underwrite risks related to political riots (Insurance Guide, 2008). The riots served the purpose of attempting to change the social and political conditions that existed in South Africa;

as such it was a fundamental risk that affected the whole country. Losses connected to political riots were near equal to those arising from civil war risks (Sasria Limited, n.d.(b)). Since no insurance company at that time was willing to provide cover against losses relating to riots, companies were extremely vulnerable to the risks that were associated with such political events (Insurance Guide, 2008).

SASRIA officially opened its doors on April 1, 1979 (Sasria Limited, 2007; Sasria Limited, n.d.(b)). The South African Insurance Association (SAIA) met with the government to discuss the possible provision of cover for terrorism, riots, and other politically motivated acts. They agreed to form an association that would carry the important responsibilities concerning these mounting political risk factors. This association became known as the South African Special Risks Insurance Association (SASRIA) (Kalisa, 2009; Sasria Limited, 2009(a)).

After reinsurance companies refused to provide cover for losses arising from common strikes and riots in 1987, SASRIA widened its cover. Cover is currently available for risks which are political or non-political in nature. Risks that are covered include riots, strikes, civil commotion, lockout, terrorism and labour disturbances (Insurance Guide, 2008; Sasria Limited, 2009(a); Sasria Limited, 2009(b)). In 1998, SASRIA was converted to a public company which is now known as Sasria Ltd. The South African government is the sole shareholder in Sasria Ltd. (Sasria Limited, 2007; Sasria Limited, 2009(a)).

Sasria Ltd. provides cover that would otherwise not be available from conventional short-term insurers in South Africa, and is limited to the Republic of South Africa, as only risks within the national borders and territorial waters are covered by Sasria Ltd. A similar organisation, Nasria, exists in Namibia (Sasria Limited, n.d.(b)). The classes of insurance covered by Sasria Ltd. and conventional short-term insurers are indicated in Figure 2.2.

Figure 2.2: Classes of insurance covered by Sasria Ltd. and conventional short-term insurers

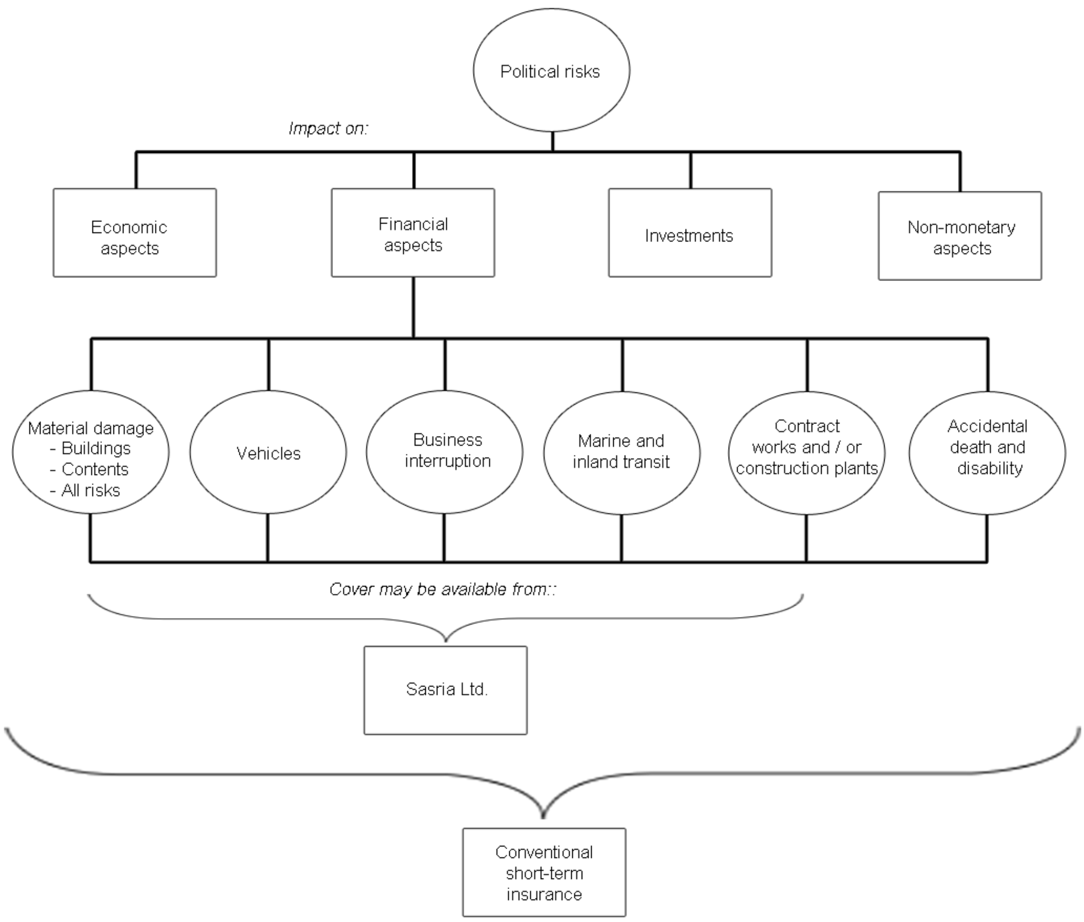


Figure 2.2 clearly shows that political risk factors have an impact on economic, financial, investment and non-monetary aspects (such as personal safety and convenience). Cover is available for the financial aspects. Classes of insurance that exist include material damage, motor vehicles, business interruption (consequential loss), marine and inland transit, contract works and construction plant insurance (such as engineering risks), and accidental death and disability. Cover for these classes of insurance may be obtained from a conventional short-term insurer. Apart from accidental death and disability cover, all the above-mentioned classes of insurance are available for political risk factors from Sasria Ltd. (Sasria Limited, 2009(a)).

Contract works and / or construction plant cover protects against some engineering type risks. Consequential loss cover is for losses from business interruption. The motor policy cover is for all motor vehicles. Marine and inland transit cover has special agreements since marine insurance typically covers strike, riot and civil commotion. Finally, material damage cover provides protection against risks concerning buildings, contents thereof and all risks insurance (Sasria Limited, n.d.(b)).

According to the details of a policy from Sasria Ltd., an insured can claim from Sasria Ltd. whenever the loss of or damage to insured property is directly related to or caused by:

“i. any act (whether on behalf of any organisation, body or person, or group of persons) calculated or directed to overthrow or influence any State or government, or any provincial, local or tribal authority with force, or by means of fear, terrorism or violence;

ii. any act which is calculated or directed to bring about loss or damage in order to further any political aim, objective or cause, or to bring about any social or economic change, or in protest against any State or government, or any provincial, local or tribal authority, or for the purpose of inspiring fear in the public, or any section thereof;

iii. any riot, strike or public disorder, or any act or activity which is calculated or directed to bring about a riot, strike or public disorder;

iv. any attempt to perform any act referred to in i, ii or iii above;

v. the act of any lawfully established authority in controlling, preventing, suppressing or in any other way dealing with any occurrence referred to in i, ii, iii or iv above” (Sasria Limited, n.d.(a)).

The cover available from Sasria Ltd. acts as supplementary cover to the normal short-term insurance taken out by an individual or a business. Sasria Ltd. has agents all over South Africa that handle its underwriting and the administration of its cover. Premiums are collected by means of a small percentage which is usually automatically added to the cover provided by conventional short-term insurers (Sasria Limited, 2007).

The South African public thus usually has access to cover against losses that relate to political risk factors as stipulated in the policy details of Sasria Ltd.

2.4.2 Private political risk insurance

Political risk insurers in the private sector serve the primary purpose of filling the gaps in the market. Unlike those in the public sector, they are driven by profits. They provide cover that cannot be obtained otherwise (Lempres, 2004:1). As a result, policies will often be tailor-made to suit the policyholders. Consequently, cover provided by the private sector could be expensive compared to cover offered by the public sector (Clark & Marois, 1996:234-235; Lewis, 1979:265; Nel, 2007:92; Stein, 1983:18).

The general difficulties brought about by the quantification of political risk factors make the products of political risk insurance complicated. Private insurance companies therefore typically are hesitant to provide political risk insurance. Although political risk insurance is expensive, it is worth the cost should a political event occur. It could be the defining difference between being solvent or insolvent (Lindeberg & Mörndal, 2002:81).

Cover provided by the private political risk insurance sector can be categorised as either asset-based or contract-based. *Asset-based* cover will provide protection against political risk factors such as expropriation, forced divestiture, forced abandonment, embargoes and import or export license cancellations, and war and political violence. Confiscation, nationalisation and deprivation are included as part of expropriation. The basic expropriation cover provides protection against loss of assets due to selective or discriminatory government action. The next political risk factor that is covered by asset-based cover is forced divestiture. This implies the loss of control over an investment due to the government taking control of the enterprise's share capital. Forced abandonment is another political risk factor covered by asset-based cover. This signifies that poor security conditions forced an enterprise to abandon a business environment. Embargoes and import or export license cancellations can prevent companies from importing or exporting goods, services or technology. Assets can also be protected against losses resulting from war or political violence such as strikes or terrorism (Galvao, 2001:41).

Contract-based political risk factors are becoming the political risk factors more frequently faced by foreign investors. Contract-based cover provides protection against political risk factors such as currency inconvertibility, foreign exchange transfer risk, breach of contract, and unfair or wrongful callings of guarantees. Currency inconvertibility refers to legislation that prevents the conversion of the local currency to a foreign currency; foreign exchange transfer risks refer to the inability to transfer local funds to a foreign country due to legislation; and breach of contract indicates that contracts are not fulfilled due to political events, which can include any of the above-mentioned political risk factors covered by contract-based cover. The power production and distribution industry are more frequently confronted with contract frustration. Finally, unfair or wrongful guarantee calling refer to guarantees imposed by authorities on businesses in order to have a detrimental impact on them (Galvao, 2001:37-42).

The private political risk insurance industry is more flexible than the public political risk insurance industry in terms of its cover. Policies are often tailor-made to suit the policyholders and can be settled quickly since this industry has fewer constraints than government-sponsored insurers (Galvao, 2001:41). However, the private political risk insurance industry is often criticised for focusing too much on the short term instead of being long-term orientated (Avasthi, 1994:69; Nel, 2007:94).

The relationship between the private political risk sector and the government has traditionally been poor. The private sector has viewed the government as a competitor and was threatened by it. On the other hand, the government has seen the private sector as insignificant or unwanted competition. This has been changing; these two sectors have started to co-operate (Lempres, 2004:1). With this relationship continuing to improve, the future of the private insurance sector is becoming more prosperous (Salinger, 1998:171). James (2001:179) suggested that the future success of the private political risk insurance sector could be determined by its ability to develop and adjust its conventional limitations, such as its reinsurance capacity.

A well-known private political risk insurer in South Africa is the Credit Guarantee Insurance Corporation of Africa Limited. It is a company based in South Africa which provides credit insurance to South African exporting companies or to any enterprise that sells goods or services on credit in South Africa (Nel, 2007:98). Enterprises can obtain cover for losses arising from payment defaults or particular pre-specified political risk factors. A number of risks are covered by insurance provided by the company. The first involves laws that prevent or restrict importation. Foreign exchange limitations or laws that pose limitations on payments from importing countries can also be covered and protection against violent events, such as war or rebellion in the exporting country can be obtained. The risk that the payer could default on its obligations, whether through bankruptcy, or simply refusing to pay, can also be covered (Nel, 2007:98). The company provides access to expert advice like the risk ratings of countries, it provides the ability to develop and penetrate new markets, and provides higher financial security (Credit Guarantee, 2008). They also provide the Alternative Risk Transfer (ART) service, which involves risk financing services that increase the awareness of risk and strategic risk management in an enterprise. Ultimately, clients have the ability to retain risks without a possible poor reflection on their financial statements (Nel, 2007:98).

2.5 INSURABLE POLITICAL RISK FACTORS

As already mentioned, the number of identified political risk factors is huge. The political risk insurance industry, however, does not provide traditional cover against all these political risk factors. This section provides a discussion on some of the most common insurable political risk factors available through political risk insurance. These include expropriation, currency inconvertibility, breach of contract by a host country, war and civil strife, and terrorism. It should be noted that, depending on the political risk insurer, the definitions of these insurable political risk factors may differ according to their own coverage. Therefore, the following discussions provide only the general facts that may be of concern to the reader.

2.5.1 Expropriation

Expropriation probably is the political risk factor of most concern to foreign investment (Pike, 1980:35). It represents the wider meaning of such an act and can take a number of forms, namely *confiscation*, *nationalisation*, or “*creeping expropriation*”. Expropriation comes down to the government taking control of property in the interest of the public. With confiscation, the owner of an enterprise receives no compensation for the seized property (Lewis, 1979:221). Nationalisation, on the other hand, usually implies taking control of foreign investments without offering full compensation, and is traditionally aimed at a general class of property, instead of targeting a particular enterprise (Howell, 1998:4). Ultimately, a major characteristic of nationalisation is that it should be aimed at a particular enterprise or a particular type of property (Lloyd, 1974:27). Mines are a classic example of a class of property that can be nationalised. The more frequent form of expropriation that occurs in the modern era is the so-called “creeping expropriation”. This implies that the government progressively implements legislation which limits the owner’s ability to operate freely (Robock, 1971:13). Over time, the owner therefore loses power over the asset. The government ultimately may want to take over the business, or might only want to provide more benefit to the domestic society (Lewis, 1979:84).

The most common forces that produce expropriation are ideology, nationalism, international economics, and international and domestic politics (Bremmer & Keat, 2009:125). It generally is a legal and political issue. The host government may expropriate foreign property owned by foreign enterprises as it pleases, although certain *conditions* govern this action. *Firstly*, only assets within the host government’s borders can be expropriated. *Secondly*, the host government should not expropriate assets on discriminating grounds, in other words, not just because it is foreign owned. Some governments welcome foreign investment, while others might adapt a hostile approach towards it, and expropriation consequently is no uncommon occurrence in such countries (Lewis, 1979:64). Robock (1971:11) explained that a hostile approach is often the result of socialism and nationalism. The *third* condition to be met for an expropriation to be legitimate is that the society of the host government must benefit from the expropriated asset, and not just the government or particular individuals. If these conditions are not met, an expropriation could be considered illegal (Lewis, 1979:144). Research has also shown that there might sometimes be a relationship between expropriations and economic growth. During difficult economic times, a government can expropriate, amongst others, large enterprises which will provide them with instant funds (Bremmer & Keat, 2009:129).

Bradley (1977:75) found that governments are more likely to expropriate larger investments than smaller ones, and different industries also face different degrees of expropriation risk. High-technology industries are far more attractive than low-technology industries, but low-technology industries are easier to expropriate than high-technology industries. The main explanation for this is that high-technology industries usually require highly unique operational skills, which the host government may not possess. In the past, the mining and petroleum industries have been prime candidates for expropriation, and this explains why investors are more concerned about political risk factors in the extractive sector than in any other sector (Hal Mason, 1974:6; Multilateral Investment Guarantee Agency, 2010:31). Governments should also reconsider before expropriating an investment that is vertically integrated with other operating channels, because it is possible that the other operating channels will eliminate the expropriated investment from their operating channels (Bradley, 1977:81).

A number of general factors have encouraged governments to expropriate in the past, with the main factors being differing ideologies, nationalism, economic development, bureaucratic development, and the protection of the interests of domestic groups. Domestic enterprises could be threatened by the involvement of foreign enterprises in the business environment (Bremmer & Keat, 2009:8; Bunn & Mustafaoglu, 1978:1564-1565). The risk of expropriation is reduced in democracies and where political constraints exist. Ultimately, expropriation, including confiscation or nationalisation, can be anticipated by having sufficient knowledge on a foreign country's political structure, ideologies, objectives, and the socio-cultural environment (Brink, 2004:20).

Expropriation has occurred less frequently over the past decade as countries have increasingly tried to follow the World Trade Organisation's policies concerning arbitration and awards. However, expropriation could still be applied during periods of economic recession when governments take action as a preventative measure against public disturbance (Galvao, 2001:36). Bremmer and Keat (2009:124) believe that expropriation will remain a political risk factor in the foreseeable future.

2.5.2 Currency inconvertibility

Currency inconvertibility refers to the realisation of financial losses due to restrictive legislation concerning foreign exchange controls. The government has the power to implement regulations that will prevent the conversion of one currency into another

(Howell, 1998:4). Adverse foreign exchange regulations could disable the conversion of the foreign currency to the domestic currency, while excessive delays of currencies could also result in losses that fall under currency inconvertibility. However, it is important to note that financial losses resulting from currency fluctuations or devaluation are not included as currency inconvertibility (Berlin *et al.,* 2003:7; Stein, 1983:20).

Currency inconvertibility can be crucial to banks; banks consequently have been amongst the primary obtainers of political risk insurance in the past decade, especially for coverage against currency inconvertibility (Coppola & Riordan, 2005:188).

2.5.3 Breach of contract by a host country

Breach of contract refers to a host country failing to fulfil the terms of a contract. An investor could suffer financial losses due to a government's repudiation of a contractual agreement. Certain government policy changes that could influence cash flows and profitability also reflect breach of contract (Multilateral Investment Guarantee Agency, 2010:47). Cover for this political risk factor is available to an investor when investments are made in a foreign country (Berlin *et al.*, 2003:7).

The risk of breach of contract on the part of a host country is reduced in democracies and where political constraints exist. Investors in emerging market economies argue that breach of contract is the political risk factor that most concerns them (Multilateral Investment Guarantee Agency, 2010:31).

2.5.4 War and civil strife

The financial consequences of war and civil strife require no introduction. These political risk factors pose enormous financial threats to any enterprise and individual. Losses can result from international as well as internal domestic conflict. War generally refers to international conflict, while internal domestic conflict is referred to as civil strife or civil unrest (Howell, 1998:4). Countries that experience a financial crisis due to civil strife are less likely to attract foreign investors than countries that are politically stable and democratic (Brown, 2004:24).

A detailed discussion on war should not be necessary for the purpose of this study. When war breaks out between countries, the risks are obvious. Not only property but also human lives are at risk. War is a rare happening but should be anticipated nevertheless. Bunn and Mustafaoglu (1978:1564) stated that the main underlying indicators of war are sudden ideological change, the negation of a threat, and the imposition of adverse sanctions. Tarzi (1992:443) added that independence and pre-emptive strikes are also underlying indicators of war. In the modern era hardcore wars are rare and few, and they are relatively easy to foresee (Kumar, n.d.). The losses resulting from a war can be protected to some degree by obtaining coverage against this political risk factor.

The next insurable political risk factor concerns losses arising from civil strife. Civil strife is the result of high internal conflict within a country (Brink, 2004:85). This is a broad term that refers to societal actions resulting from any rigorous regime or government instability and crises, for example riots and revolutions (Bremmer & Keat, 2009:84). It traditionally refers to political turmoil such as strikes and riots, to conspiracies such as political assassinations and takeovers, and to internal war, which includes civil wars and terrorism (Gurr, 1968:1107). It is one of the political risk factors most frequently faced by enterprises and governments.

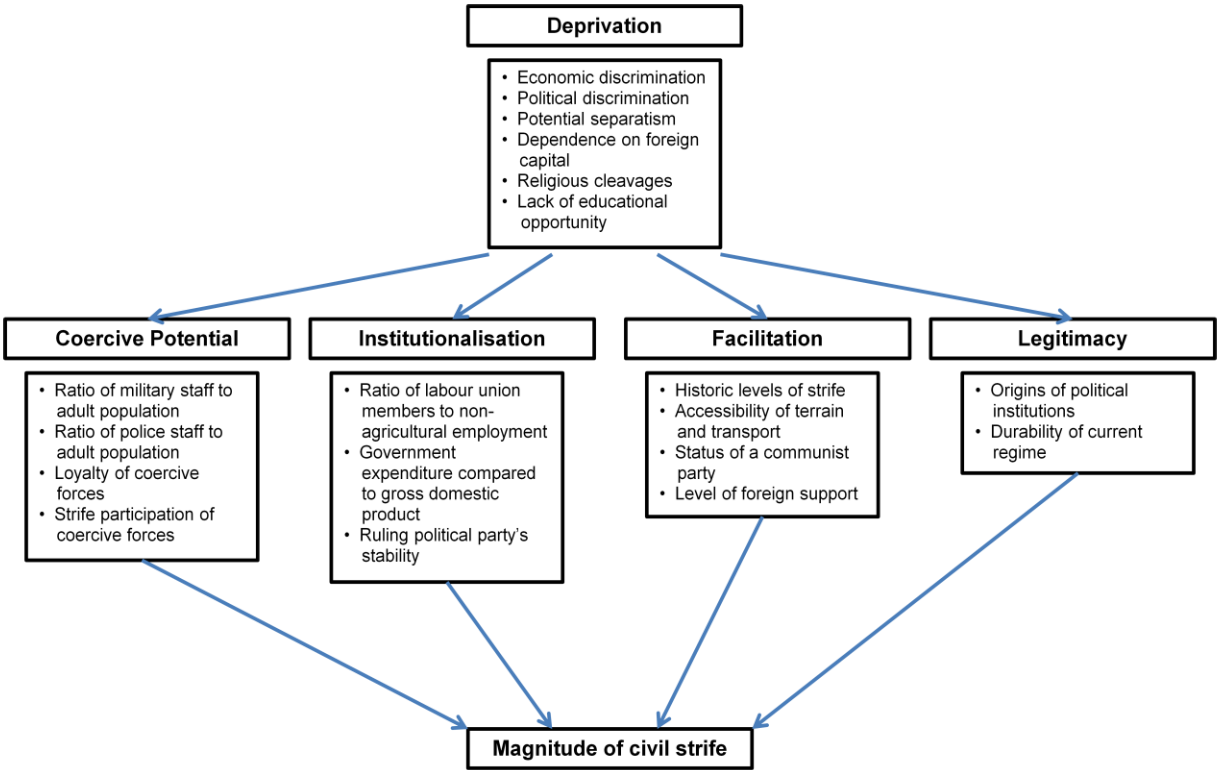
It is possible to anticipate political turmoil by monitoring infant mortality, human needs such as housing and drinking water, and also the age and gender composition of the population. Research has indicated that people between the ages of 15 and 25 are more likely to start revolutions than others, and a male-dominant youth also tend to resolve to violence (Bremmer & Keat, 2009:85). All the aforementioned indicators of civil strife can result in financial and business disturbances (Tarzi, 1992:448). It can force a government to change its policies or, in extreme conditions, even bring down a government. This can impact severely on the business environment. It can therefore prove beneficial to evaluate potential civil strife in a country and then take the necessary action to manage the impact it may have on the business environment.

The most difficult form of civil strife to forecast is that of riots, since they are of a spontaneous nature. A riot does not necessarily develop over time; indications of riots could appear couple of days, or even hours beforehand. They have the potential to be of a high magnitude and if they are sustained, the damage could be enormous. Businesses can be destroyed and the insurance industry may have to carry large financial losses. In emerging market economies, riots can easily have the same effect as a civil war. Businesses and governments in developed countries are also concerned with riots, especially as they could easily give rise to other risks (Bremmer & Keat, 2009:99-100).

Although Kobrin (1978:118) believed that civil strife mostly occurs in rural informal areas and could be controlled by means of military involvement, civil war has occurred in various countries, ranging from developing to developed countries. However, research has shown that this has mostly occurred in poor, state-divided and autocratic countries (Bremmer & Keat, 2009:92). The chances of a civil war are reduced when the government decentralises its power, giving local authorities the right to make certain important decisions. The reason for this theory is simple; local authorities can act upon demands and the society consequently should not need to take more drastic action (Wells, 1998:24).

Gurr (1968:1104) explained the phenomenon of civil strife by referring to so-called “relative deprivation”. The degree of civil strife is determined by the level of deprivation in the society. Deprivation consists of four factors, each with its own measures. As illustrated in Figure 2.3, these factors are coercive potential, institutionalisation, facilitation, and legitimacy. This model provides some guidelines towards the anticipation and evaluation of civil strife and could be very useful to the political risk analyst.

Figure 2.3: Factors and measures of civil strife



Source: Gurr, 1968:1105-1115; Lewis, 1979:174.

Coercive potential refers to the government's ability to prevent or limit the frequency civil strife. The necessary structures should be in place which will provide the government with some sort of control over possible violent political events. A high coercive potential may reduce the enormity of civil unrest. *Institutionalisation* refers to the structures that are in place which enables the society to show its dissatisfaction in a non-violent approach. Higher levels of institutionalisation should reduce the degree of civil strife. *Facilitation* implies the environmental circumstances that encourage civil strife. High levels of facilitation may increase the degree of civil strife. *Legitimacy* refers to how acceptable government actions are in the eyes of the public. Civil strife should be of a lesser magnitude when regimes are perceived to be legit (Gurr, 1968:1105-1106).

Some of the main political indicators underlying civil strife include poor economic performance, an increasing gap between the expected and realised standard of living for the public, the lack of a fair leadership succession system, socio-economic restraints, political restraints, the lack of a legitimate regime, political corruption, liberty movements, a hostile attitude towards a country, and foreign involvement (Bunn & Mustafaoglu, 1978:1563-1564; Tarzi, 1992:449).

2.5.5 Terrorism

Before explaining the phenomenon of terrorism, a distinction should be made between terrorism and guerrilla activities for the purpose of political risk insurance. This distinction is often confusing and it is thus important that the reader understands that this section is focused on terrorism only. Terrorism mostly implies violent actions or threats with the ultimate goal to intimidate the society through fear, and ultimately may impact on government. It can, however, also imply violent acts aimed at society on a random basis. Guerrilla acts are usually directly aimed at government organisations, such as the military, instead of the society (Brink, 2004:91).

One of the most comprehensive definitions of terrorism was provided by the U.S. Department of Defence. They define terrorism as "... the calculated use of an unlawful violence ... to inculcate fear; intended to coerce or to intimidate governments or societies in the pursuit of goals that are generally political, religious, or ideological" (Bremmer & Keat, 2009:106). Terrorism traditionally indicates the destruction of property, kidnapping, assassinations and hijackings. While some terrorist groups avoid large-scale bombings, recent terrorist groups have tended to make use of suicide attacks (Bremmer & Keat, 2009:112).

Before the events of September 11, 2001 in the United States of America, terrorism was treated as a phenomenon associated with emerging market economies only, and not with the developed world (James, 2004:29). The total loss from the September 11 event has been rated as the largest aggregate insurance loss in history, and has been estimated at $41 billion (Salinger, 2004:41). Since this, the demand for stand-alone terrorism cover has increased dramatically (Brown, 2004:20; Duperreault, 2004:47). As a result, the terrorism insurance industry has been very successful. It has been very profitable and has experienced rapid growth. This is mainly due to the exclusion of terrorism from the general insurance policies available from general insurers and reinsurers (Berry, 2008:16), with the American International Group (AIG) and the underwriters at Lloyd's of London traditionally having been the main providers of terrorism insurance (James, 2004:34).

Terrorism is not always classified as a political risk insurance product; some political risk insurers provide both political risk insurance and terrorism insurance, and some provide political risk insurance only, excluding terrorism insurance (Berry, 2008:28-29). The political risk insurance industry often treats terrorism as a separate and unique form of insurance. Especially in emerging market economies, the separation of terrorism from political risk factors is often impossible. Berry (2008:21) explained that terrorism is a phenomenon that escalates, especially in emerging market economies. It could start off as something as simple as an insurrection, then grow to a rebellion, to civil war, and could potentially result in a revolution. This is known as the various "rungs of the terrorism ladder". The risk of terrorism is often measured according to its position on the terrorism ladder. It is easy to understand the terrorism ladder, but identifying a terrorist group's position on the ladder is not that simple (Berry, 2008:26). It is worth mentioning that terrorist groups are faced with the same organisational issues as other complex organisations. These issues include governance, members, financing, and resources. They are formed over time, and with the support of the community, it becomes easier for terrorist groups to recruit members and gather the necessary resources (Bremmer & Keat, 2009:109).

The terrorism insurance market often requires government protection. Apart from the fact that the government is expected to provide aid to the victims of a major terrorist attack, the traditional characteristics of an insurable risk do not apply to terrorism. The risk is not measurable; loss occurrences are not independent; loss frequency is usually low; acceptable premium rates cannot be determined easily; and the market often has insufficient capacity. When considering these facts, it is difficult to diversify the risk. Ultimately, the potential losses of a terrorist attack depend on the creativity of the terrorists themselves. As a result, the cost of terrorism insurance can easily be very high. The insurance industry often does not have sufficient capacity to cope with losses that result from major terrorism events (Karl & Laster, 2007:3-6; Lier & Tanner, 2007:3).

With appropriate and diligent analyses and quick responsive actions, it may be possible to prevent terrorist attacks (Bremmer & Keat, 2009:118). However, it is not always possible to anticipate or prevent terrorist attacks. With the necessary actions, though, precautions can still be taken. An enterprise cannot undertake countermeasures, but it can still prepare itself for the possible occurrence of such an event. If an enterprise does not take the necessary precautions, such as obtaining insurance or utilising risk management against terrorism, its exposure to possible financial losses increases significantly. Governments, on the other hand, should have the ability to take preventative action against terrorism. Apart from capturing terrorist groups, or using the military as an offensive strategy, they may attempt to satisfy the terrorists' demands which may not always be accepted by the public (Bremmer & Keat, 2009:116-117).

Terrorism insurance fills a number of gaps in the market. It is not only to the advantage of the public, but also provides opportunities to insurance providers. James (2004:37) believed that stand-alone terrorism insurance will remain important in the future.

2.6 CONCLUSION

This chapter has provided a discussion on some of the basic concepts of political risk. Attention was given to its origins and sources, to its impact on the political environment, and on the economic, socio-cultural, business and investment environments. The second major concern of this chapter was the process of political risk analysis and the importance of the successful identification, assessment and management response to political risk factors.

The importance of conducting thorough political risk analysis cannot be over emphasised. Ignorance and misinterpretation of political risk analysis can lead to losses as extreme as complete loss of assets (Brink, 2004:7). Ultimately, there are certain attributes which are extremely valuable. These include experience and familiarity with the political, economic and socio-cultural environments of the countries involved, a well-constructed long-term approach, and familiarity with public needs and expectancies (Luther & Prakash Sethi, 1984:67).

As part of the risk management strategy section, the political risk insurance industry was put in the spotlight, with a discussion of its functionality, purpose, some of the actors in this industry, and also some of the main insurable political risk factors. It is important to remind the reader that political risk insurance is not the sole solution to managing political risk factors effectively. It has certain shortcomings, such as the fact that it could be difficult to obtain cover for the insured's specific needs, and can consequently be very expensive (Control Risks, 2009(a)).

Although only the negative effects of political risk factors are reflected in this research, the reader must remember that overall political risk can also offer positive effects. As an example, it has been stated that political instability is not necessarily a bad thing, since it can mean that government changes could actually be for the good of the country (Brink, 2004:21; Howard, 1993:69; Lewis, 1979:184). As long as the nature and extent of political risk factors are understood, it is possible that these risks can be used to an enterprise's advantage (Brink, 2004:4). When managed properly, political risk factors can often result in financial gains or smaller detrimental results (Howard, 1993:31; Robock, 1971:7).

Political risk factors are not something that is going to disappear in the future. Terrorism, civil strife, war and expropriation are but a few examples of political risk factors that will continue to exist (Bremmer & Keat, 2009:196). In having studied this chapter, the reader should have increased knowledge concerning the identification of political risk factors, political risk analysis, political risk management, and the political risk insurance industry. This is necessary as the next chapter provides a discussion of the political risk factors that could be present in emerging market economies and in the BRICS countries in particular.

CHAPTER 3

EMERGING MARKET ECONOMIES AND THE BRICS COUNTRIES

3.1 INTRODUCTION

Emerging market economies are often in the news due to the fact that they represent some of the best investment opportunities. Foreign investors generally have been quickly attracted to a country if it is home to a number of factors. These factors have included rapid economic growth, large domestic markets, and small public sector deficits. Privatised and relatively open countries have also tended to attract more interest from foreign investors (Nel, 2007:57). The aforementioned factors are only a few examples of the typical features of emerging market economies that have attracted foreign investors (Avasthi, 1994:64; Heakal, 2010).

The first section of this chapter provides a discussion on emerging market economies, focusing on the characteristics of these economies and the impact on foreign investment. It will be explained how the emerging market economies of the world have revealed common general risks, especially political and economic risks.

The discussion on the classification of emerging market economies in general is followed by closer attention to the four largest emerging market economies in the world, namely the Federative Republic of Brazil, the Russian Federation, the Republic of India, and the People's Republic of China. These four emerging market economies were more commonly known as the BRIC countries. However, after the Republic of South Africa joined this group of large emerging market economies, the acronym was changed to BRICS. The political and economic environments of each of the five BRICS countries will be investigated in order to identify the common political risk factors that may exist in each of these countries.

This chapter should provide the reader with a better understanding of emerging market economies. More knowledge of the BRICS countries is provided and how certain political risk factors are common to these emerging market economies is clarified. This makes it possible to compare the current circumstances and risks in the four formerly known BRIC countries to those of the Republic of South Africa, enabling the reader to identify the political risk factors that may be common amongst the emerging market economies studied in this research.

3.2 EMERGING MARKET ECONOMIES

A country is classified as an "emerging market economy" when it appears to be "emerging" from being classified as a less developed economy to becoming a developed market economy (Bekaert & Harvey, 2002:429).

The World Bank has defined an emerging market economy as a developing country with a gross national income (GNI) of $11,456 per capita or less. An emerging market economy typically has a per capita income level that ranges between the low and middle income levels. Emerging market economies are generally classified according to their gross domestic product (GDP) per capita, since this measure provides a good indication of the level of an individual's income as well as the general level of a country's economic development (Alon, 2006:10). While 20 per cent of the world's combined economy is already covered by the combined economies of the emerging markets, it is expected that the combined gross domestic product (GDP) of all the emerging market economies in the world may be higher by 2015 than that of the top 20 developed market economies combined. These emerging market economies also represent a large proportion of the world's total population, a proportion that previous studies have indicated as approximately 75 to 80 per cent of the world's total population (Chung, Day, Ishman & McKay, 2004:798; Heakal, 2010; Vital Wave Consulting, 2009).

Emerging market economies are counted amongst the countries showing the fastest economic growth in the world. These countries typically experience rapid economic growth and they generally improve living standards for a large proportion of the world population (Nakata & Sivakumar, 1997:464). A country's economic growth rate reflects the increased added value produced by the operating enterprises and individuals in that country (The World Bank, 2009:390).

Increased international business and globalisation usually enhance a country's economic growth rate (Lier & Tanner, 2007:3), but two particular sources that have enabled emerging market economies to produce these extraordinary economic growth rates have been identified. Firstly, they have typically had less capital per worker than developed market economies. As a result capital returns have generally been high. This would have increased investment returns and consequently could attract foreign investors. Secondly, emerging market economies have had the benefit of implementing the advanced technologies that have often been developed by the developed market economies. This enabled the emerging market economies to "catch up" with the developed market economies in terms of technological gains (Purushothaman & Wilson, 2003:6).

The economic development of the emerging market economies of the world has traditionally been highly dependent on access to long-term funding (Garvey, Mullins & Murphy, 2008:46). In the past, bilateral and multilateral loans were the primary source of funding for capital flows into emerging market economies. Nowadays, however, private sources mostly are utilised for funding in emerging market economies (Westholm-Schröder, 2005:174). It therefore seems that these countries have constantly improved their global economic position to acquire financing. This has been achieved by increasing investment opportunities, by improving macro-economic aspects, by being more open to foreign investment, and by advancing their business environment (Multilateral Investment Guarantee Agency, 2010:16). An increase in domestic and foreign investment thus has been a key characteristic of emerging market economies. Domestic investment generally indicates confidence in the local economy, while foreign investment generally indicates that other countries are showing interest in the emerging market economy (Heakal, 2010). The governments of emerging market economies have traditionally adjusted the countries' policies in order to promote foreign direct investment. Additionally, economic restructuring and market liberalisation have encouraged foreign direct investments in the emerging market economies (Kouznetsov, 2009:375). As emerging market economies tend to have strong economic fundamentals, such as high volumes of foreign reserves and advanced institutional businesses (Hess, Karl & Wong, 2009:24), foreign investors have continuously shown interest in emerging market economies (Multilateral Investment Guarantee Agency, 2010:45).

It is important to note, however, that emerging market economies have generally been extremely volatile. While their economic growth might have been rapid, increased political and economic risks have not been uncommon (Baack & Boggs, 2008:134). Unlike in the past, though, emerging market economies have in recent years been able to simultaneously experience impressive economic growth and be politically more stable in general (Boone, 2007). However, global terrorism, the nationalisation of resources, global warming, the recent economic crisis, and the volatility of the political and economic power of the formerly known BRIC countries, provide evidence that economic and political instability and turmoil have not vanished entirely (Berry, 2009:3). A number of the discussed factors that may attract foreign investors, for instance openness to foreign investment, could thus also hamper a country's economic development (Chambers & Jacobs, 2007:60). Also, a lack of essential human, financial and other resources have often been observed; while unskilled labour is usually plentiful and cheap, skilled labour is usually limited. There often has also been a lack of sufficient capital in emerging market economies (Baack & Boggs, 2008:129). Some of the main risks facing investments in emerging market economies have included sluggish economic growth, stagflation, liquidity risk, foreign currency risk, political risk, and economic policy risk (Bekaert & Harvey, 2002:431; Bekaert, Harvey & Lundblad, 2007:1784; Creighton, 2008).

Emerging market economies have traditionally been perceived as less integrated than developed market economies. Being less integrated generally indicates certain obstacles. These obstacles could be macro-economic, such as foreign exchange controls or economic policy, or specific to the market, such as the market size. These obstacles could contribute to political risk factors (Bilson *et al.*, 2002:3). However, as regional integration advances, risk-related costs can be reduced. In general, emerging market economies have seemed to be improving in terms of overall risk factors through continued improvement concerning legal and regulatory regimes, in order to encourage foreign investments (Tobin, 2005:136).

An important issue with regard to emerging market economies has been the inability to anticipate future political and economic situations in these countries, mainly due to their changing nature and lack of reliable data (Alon, 2006:19). Although foreign investors have found emerging market economies attractive, they have remained cautious on account of political risk, since political risk factors are mostly beyond their control. These political risk factors have included corruption, restrictive labour markets, foreign currency instability, unstructured financial systems, unreliable legal and regulatory regimes, and weak government institutions (Boone, 2007). This has been supported by research that has shown that when multinational enterprises invest in emerging market economies, they mainly are concerned about political risk, followed by macro-economic instability, access to finance, corruption, access to qualified staff, infrastructure capacity, limited market opportunities, and increased government intervention (in that declining order). The political risk factors that have been of most concern to foreign investors in emerging market economies have included breach of contract, transfer and currency convertibility restrictions, war and civil disturbances, non-honouring of government guarantees, adverse regulatory changes, expropriation, and terrorism (in that declining order) (Multilateral Investment Guarantee Agency, 2010:29-30). Macro political risk factors particularly have tended to be related to political, ethnic and religious conflict in emerging market economies (Ye, 2007; Zaayman, 2003:15). When taking a close look at these political risk factors it is clear that governments could intervene in an attempt to achieve desired outcomes (Faber, 1998:109).

In emerging market economies, political risk factors could play a role that is just as important as the economic factors that are decisive in the performance of markets (Bremmer, 2009; Bremmer & Keat, 2009:68). Politics usually play a more prominent role in emerging market economies than in developed market economies (Bekaert & Harvey, 2002:443). Additionally, socio-political and macro-economic stability are often more worrying in emerging market economies than in developed market economies. As a result, foreign trade and globalisation related to emerging market economies could easily result in increased exposure to political risk factors (Lier & Tanner, 2007:3; Lindeberg & Mörndal, 2002:1). It is thus understandable that politics has usually been closely related to financial instability in these countries (Garvey *et al.*, 2008:49). A closer look at the emerging market economies in terms of capital flows reveals that it is also in these countries that political risk factors seem to have increased (Boone, 2007). Exposure to political risk factors usually does not concern investors in developed market economies (Clark & Tunaru, 2001:155). Consequently, it should not come as a big surprise to find that political risk insurance has traditionally played a vital role in aiding capital flows to emerging market economies (Johnston, Mikhailova, & Wray, 2009:7). Thus it is understandable that insurance products have developed faster in emerging market economies than in developed market economies (Hess *et al.*, 2009:5).

In the past, emerging market economies have generally been perceived as politically more risky than developed market economies (Diamonte *et al.*, 1996:72). A previous study indicated that 57 per cent of emerging market economies had a political risk rating of medium or higher (Control Risks, 2007). In the past, for example, expropriation was a political risk factor typically associated with emerging market economies (Errunza & Losq, 1987:64). However, although emerging market economies have some characteristics in common, they could differ in numerous ways, such as size, growth, economic development, government styles, and political, economic and legal regimes (Kouznetsov, 2009:376). They are generally also scattered all over the world, which underlines the fact that some political risk factors faced by foreign investors could be bound to specific countries or political systems only (Boone, 2007).

Political instability also has generally been associated more with emerging market economies than with developed market economies (Kouznetsov, 2009:378; Nakata & Sivakumar, 1997:469). Compared to developed market economies, emerging market economies have typically been associated with weak, undeveloped and unstable political, social, and economic environments (Markwick, 1998:45). The infrastructures of these countries have often been inadequate and deteriorating (Nakata & Sivakumar, 1997:466). Corruption, political interference and unreliable legal systems have usually been common (Womack, 2009). Emerging market economies are expected to have large, isolated, young, and poor populations. These populations often turn to rebellious activities in order to show dissatisfaction. This could explain why terrorism has often been a political risk factor associated in particular with emerging market economies (Berry, 2008:23).

Various authors have also emphasised that corruption has been a major issue in emerging market economies (Chung *et al.*, 2004:800; Stepek, 2007). Corruption has adverse effects on a country's income and macro-economic stability: stable economic growth is suppressed; business enterprises are hampered; and the poor are finding it harder to prosper due to their inability to afford unusual payments or bribes. Most importantly, corruption reduces a country's integrity and its global status (Zaayman, 2003:22). Corruption should thus be an agonising concern for the host governments of emerging market economies.

Another issue in emerging market economies that is worth mentioning is that of environmental preservation. Environmental damage has historically been a phenomenon in most industrial countries (Kahn & Yardley, 2007). Growing industrialisation and the urgency to expand business operations and create jobs have often caused emerging market economies to finance infrastructure development instead of addressing environmental damage (Chung *et al.*, 2004:800). Awareness of this issue has increased drastically during the recent past. Demonstrations and other forms of unrest have occurred as a result. Although these events are mostly non-violent, there is always the risk that it could lead to violent action and thus pose serious political risk. This could be a problem for emerging market economies, which generally tend to pollute on a large scale. Environmental preservation needs to be a top priority in all countries around the world.

It is important to emphasise that no official general publication that provides a list of all the emerging market economies of the world existed at the time of this research. It was accepted that there were 22 emerging market economies in the world during the research period, as indicated by Morgan Stanley Capital Investment (2010), which was regarded as the most reliable source. These 22 emerging market economies are listed in Table 1.1 (Chapter 1), which is repeated here as Table 3.1.

Table 3.1: List of emerging market economies

1. Brazil	9. Indonesia	17. Russia
2. Chile	10. Israel	18. South Africa
3. China	11. Malaysia	19. South Korea
4. Columbia	12. Mexico	20. Taiwan
5. Czech Republic	13. Morocco	21. Thailand
6. Egypt	14. Peru	22. Turkey
7. Hungary	15. Philippines	
8. India	16. Poland	

Source: Morgan Stanley Capital Investment, 2010.

Due to the scope of this study, not all 22 emerging market economies formed part of this research. The following section takes a closer look at five emerging market economies, namely the Federative Republic of Brazil, the Russian Federation, the Republic of India, the People’s Republic of China, and the Republic of South Africa. These five countries are collectively known as the BRICS countries.

3.3 THE BRICS COUNTRIES

In 2003 two economists at Goldman Sachs delivered a paper on emerging market economies in which the authors predicted that the Federative Republic of Brazil, the

Russian Federation, the Republic of India, and the People's Republic of China could have economies larger than any other country in the world by 2050. Only the United States of America and Japan were expected to feature alongside these four countries by that date. These predictions were based on the high economic growth potential and demographic accumulation of these four countries. The Federative Republic of Brazil, the Russian Federation, the Republic of India, and the People's Republic of China were collectively labelled as the BRIC countries. The BRIC acronym has stuck ever since. It is important, however, to understand that predictions concerning the BRIC countries' achievements by the year 2050 could easily be altered in the event of major economic shocks, by a sudden pause in economic development, or by political unrest (Bird & Cahoy, 2007:401; Bremmer & Keat, 2009:67; Standard & Poor's, 2009:13).

In early 2011 the Republic of South Africa joined this group of the large emerging market economies, so that the group is now known as the BRICS countries (Battersby & Lu, 2011). The inclusion of the Republic of South Africa to the group was expected to improve the co-operation between emerging market economies and to boost the development of the five BRICS countries (The South African Press Association, 2010). The Federative Republic of Brazil and the Russian Federation are expected to become the leading suppliers of raw materials while the Republic of India and the People's Republic of China are expected to flourish as suppliers of manufactured products and services (Hult, 2009:1). Where the acronym BRICS is used in this research, it will refer to the five countries just mentioned.

Global foreign direct investment in all the emerging market economies has not been spread equally amongst them (Brown, 2004:16). Over the past decade, most foreign direct investment in the emerging market economies has gone to the former BRIC countries (Multilateral Investment Guarantee Agency, 2010:16), with Asia being a top attraction for foreign investors, led by the People's Republic of China (Palmer, 2008:216). Africa, however, has shown indications of becoming a top investment destination in recent years (Battersby & Lu, 2011).

As already mentioned, the former BRIC countries were considered the four largest emerging market economies in the world. These countries cover 25 per cent of the world's total land and are home to 40 per cent of the world's population (Hult, 2009:1; Reuters, 2010); at the end of 2008, statistics indicated that the Federative Republic of Brazil, the Russian Federation, the Republic of India, and the People's Republic of China had total populations of 192 million, 142 million, 1.140 billion, and 1.326 billion respectively (The World Bank, 2009:378-379).

Apart from high economic growth potential and large populations, the former BRIC countries had other factors in common, including political risk factors. Since the core of this research is to study the political risk factors that may exist in emerging market economies, attention is paid to the political risk factors existing in these BRIC countries during the research period. By looking at these countries' political risk ratings, it was possible to get a general idea of the degree of political risk that could be present in these emerging market economies. For 2010, all the former BRIC countries obtained a medium political risk rating from Control Risks (2009(b)). This rating implied that foreign enterprises could encounter interference from the government or other political actors present in these countries. Additionally, important factors that could be of concern included corruption, capricious policymaking, import and export restrictions, weak political organisations, a lack of sufficient legal guarantees, and strong or hostile lobby groups. A medium political risk rating also suggests that military or other illegal interference could occur (Control Risks, 2009(b)).

While taking a closer look at multinational enterprises in the former BRIC countries, is was found that these enterprises generally seemed to be more concerned about political risk factors than multinational enterprises in any other country. The political risk factors of most concern to them have typically been breach of contract and transfer and currency convertibility restrictions (Satyanand, 2010(a)).

Multinational enterprises in the former BRIC countries have generally been confident about their ability to manage known and existing political risk factors in their own capacities. However, when having to anticipate and manage political risk factors that have not been of concern previously, they have generally been less confident of their ability to manage them (Satyanand, 2010(a)). The main reasons why these enterprises have found it difficult to mitigate political risk factors have included a lack of the appropriate political risk analysis instruments and available insurance products, and also insufficient knowledge of the concerned geographical areas

(Wells, 1998:26). Surprisingly, it was found that some multinational enterprises had not perceived the degree of political risk factors in the former BRIC countries to be high enough to be of concern to them. As mitigation strategy for political risk factors, informal and internal means have been the most common strategies followed by multinational enterprises in the former BRIC countries. Such approaches generally are low-cost when compared to more formal approaches. The most popular risk mitigation methods for the multinational enterprises in the former BRIC countries have been to conduct political risk analysis, to work together with host governments, or to form alliances or joint ventures with existing enterprises in the host country. Russian multinational enterprises were the only ones amongst the former BRIC multinational enterprises to utilise political risk insurance on a regular basis (Multilateral Investment Guarantee Agency, 2010:40).

In terms of the availability of political risk insurance in the former BRIC countries, not all these countries had national investment insurance organisations that provided political risk insurance. For investment insurance, Indian enterprises could utilise the Export Credit Guarantee Corporation (ECGC) and Chinese enterprises could utilise Sinosure. No national investment insurance schemes could be identified in the Federative Republic of Brazil and the Russian Federation. This implied that investors from these countries have had to utilise private or multilateral organisations for basic political risk insurance needs. Some of these multilateral organisations included the African Trade Insurance Agency (ATI), the Asian Development Bank, the Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC), and the Multilateral Investment Guarantee Agency (MIGA) (Multilateral Investment Guarantee Agency, 2010:59).

The following sections of this chapter provide separate discussions on each of the five BRICS countries. The Federative Republic of Brazil, the Russian Federation, the Republic of India, the People’s Republic of China, and the Republic of South Africa will be studied. The extensive information provided on these countries is also presented in Table 3.2 at the end of the section. This table provides a brief summary of the main issues that are identified in the literature study.

3.3.1 The Federative Republic of Brazil

The Federative Republic of Brazil (henceforth referred to as Brazil) has the largest economy in South America. The country is known for its large and well-developed mining, agricultural, industrial and service sectors (Economy Watch, n.d.(a)). Brazil has rich natural resources which, amongst others, include gold, platinum, petroleum, iron ore, and manganese. Agricultural products, such as sugarcane and coffee, have also been a major contributor to the country's economic growth. The industrial sector has accounted for approximately one third of the country's gross domestic product (GDP) and has also been one of the best developed industrial sectors in Latin America. Some of the industries in this sector have included the manufacture of machinery and equipment, automobiles, and textiles. Finally, the service sector has been diverse and sophisticated, with examples being the well-developed telecommunications, banking and financial services (Bureau of Western Hemisphere Affairs, 2010; Central Intelligence Agency, 2010(a)).

On the global stage, Brazil has continuously improved its standing. Apart from having been the largest economy on the South American continent, Brazil has also been the largest receiver of foreign direct investment in the region, with the United States of America traditionally being its largest contributor. The financial services sector has been the highest attractor of foreign direct investment, followed by the industrial product manufacturing sector. This is understandable when one considers that, in recent years, Brazil has maintained an astonishingly stable financial environment compared to that of the past (Australian Department of Foreign Affairs and Trade, 2010; Bureau of Western Hemisphere Affairs, 2010; Central Intelligence Agency, 2010(a); Garvey *et al*., 2008:47; Multilateral Investment Guarantee Agency, 2010:18).

Brazil's insurance market has benefitted from the strong development of the aforementioned sectors. It should not come as a surprise that Brazil has had the largest insurance market in Latin America. This market has experienced constant growth in the recent past (Koncept Analytics, 2010). The improved financial services sector especially has been beneficial for Brazilian insurance companies since these insurance companies themselves have had opportunities to be more successful as investors (Business Monitor International, 2010).

Brazil is governed as a federal republic and is one of the largest democracies in the world (British Broadcasting Corporation, 2010(a)). Elections have produced a number of political risk factors in the past. Elections generally introduce the possibility of changing government regimes and government intervention (Colitt, 2010), therefore future political situations in a country could be uncertain (Oxford Analytica, 2005). Government intervention can have an impact on political and economic stability by means of, for example, a weakened foreign currency or changing interest rates. Additionally, political noise and market swings have not been uncommon in Brazil in the past (Parra-Bernal, 2010), but what is important is that Brazil has had a consolidated democracy that has contributed to increased political stability (Hargis & He, 2009). While the Landless Workers' Movement has been one of the major political pressure groups in the country, others have included the labour unions (also known as trade unions), large farmers' organisations, and religious groups which have mostly been connected to evangelical Christian churches and the Catholic Church (Central Intelligence Agency, 2010(a)).

Brazil's abundance of natural resources has been a key strength of the country. Also, as already mentioned, Brazil's financial environment has improved. However, like most other South American countries, Brazil has also experienced economic booms and busts in the past. The country's economy has been hampered by large foreign debt, a high inflation rate, and the shortcoming of a solid social infrastructure (British Broadcasting Corporation, 2010(a); Hult, 2009:2). Historically, the Latin American countries typically viewed global finances as an adverse force, and consequently the possibility of political risk factors was high in these countries. Threats to default on debt and actual defaults were sometimes undertaken as political strategies. This clearly shows that Brazil's financial environment was a risky arena (Garvey *et al.*, 2008:48). It comes as no surprise that previous research indicated that the political risk factor of most concern to investors focusing on Brazil has been breach of contract. The other major political risk factors that have been identified are the non-honouring of government guarantees and restrictions on transfers and currency convertibility (Multilateral Investment Guarantee Agency, 2010:39; Satyanand, 2010(a); Satyanand, 2010(b)).

A number of international disputes have also put Brazil under the spotlight. Money laundering, smuggling, and arms and illegal narcotics trading have been but a few issues that have caused trouble in the recent past (Central Intelligence Agency, 2010(a)). Corruption has been a key concern in Brazil (Colitt, 2010; Oxford Analytica, 2005). Even the government itself has been accused of corruption (Australian Department of Foreign Affairs and Trade, 2010); therefore corruption has probably been the greatest form of organised crime in Brazil. Statistics indicated that, early in 2010, 147 of the 513 members of the lower house of Congress, as well as 21 of the 81 senators in Brazil faced either criminal charges in the Supreme Court, or were being investigated for alleged corruption. These crimes mostly involved violations of laws on campaign finance or theft of public money (The Economist, 2010(a)).

Political unrest has also occurred in the past, especially in the form of protests. Depending on the issue that was at stake, protests have at times attracted very large crowds. Although most protests have been non-violent, violent protests sometimes arose and resulted in riots, considerable damage to property, and increased involvement by the police (The Overseas Security Advisory Council, 2007(a); The Overseas Security Advisory Council, 2010). Terrorism, however, has not been a major concern in Brazil. Neither has Brazil been targeted by any recognised radical groups and has not had major noteworthy enemies (The Overseas Security Advisory Council, 2007(b)).

There are a number of risk mitigation strategies that can be adopted in order to manage political risk factors effectively. The most common political risk mitigation strategies followed by multinational enterprises in Brazil have been scenario planning, political and economic risk analysis, and the use of joint ventures or alliances with local enterprises (Multilateral Investment Guarantee Agency, 2010:41; Satyanand, 2010(a); Satyanand, 2010(b)).

Apart from political risk factors, a number of economic and social issues have also been present in Brazil. Even though Brazil has had impressive economic growth and has been improving its global presence, political, economic and social development has been restrained by inequality and issues concerning the rule of law. Economic and social inequality has been one of these economic issues. Income has traditionally been very unevenly distributed. The gap between the rich and the poor has been very wide (British Broadcasting Corporation, 2010(a)). It should be mentioned, though, that this gap has been decreasing during recent years. Brazil also has typically had extremely high interest rates and low levels of public investment. A high tax burden has been present and the business environment has been subject to oppressive regulation (Australian Department of Foreign Affairs and Trade, 2010; Bureau of Western Hemisphere Affairs, 2010; The Economist, 2010(b)). Issues concerning crime, violence and corruption in the informal settlements have been indications of a breakdown of social order in major cities in Brazil, and experts have suggested that crime and corruption would not be brought under control in the near future, especially not while the rule of law is not being strengthened (Hargis & He, 2009; The Economist, 2010(c)).

3.3.2 The Russian Federation

In terms of geographical area, the Russian Federation (henceforth referred to as Russia) is the largest country in the world (Economy Watch, n.d.(b)). Russia is rich in natural resources, including oil, coal, natural gas, and a large number of strategic minerals. Oil and gas have been Russia's most important natural resources, and it is also thanks to these two natural resources that the country has achieved its prominent economic power (British Broadcasting Corporation, 2010(d)). It should be noted that the country's climate, geographical distance, terrain and natural hazards have produced serious obstacles that have limited the country's ability to exploit its natural resources. Some of these natural hazards have included permafrost, volcanic activity, earthquakes, spring floods, and summer and autumn forest fires. Some of the main agricultural products include sugar beet, sunflower seeds, vegetables, fruit, and meat. The country has an entire range of mining and extractive industries involving, amongst others, oil, metals, coal and gas. Russia also has a very well-developed manufacturing sector (Bureau of European and Eurasian Affairs, 2010; Central Intelligence Agency, 2010(d)).

The Russian government has the form of a federation, and the country has had an abundance of political pressure groups. The Association of Citizens with Initiative of Russia, the Confederation of Labour of Russia, the Federation of Independent Labour Unions of Russia, and Greenpeace Russia are some of these political pressure groups (Bureau of European and Eurasian Affairs, 2010; Central Intelligence Agency, 2010(d)).

Some authors have stated that the main reason why Russia has been an emerging market economy has been the state's successful management of the country's natural resources (especially natural gas and crude oil) and thereby benefitting both economically and politically (Bremmer & Keat, 2009:69). Key strengths in the country have been its highly skilled labour force, its abundance of natural resources, and its reasonably stable political environment (Hult, 2009:2). After a decade of post-Soviet political and economic turmoil, Russia remarkably emerged to obtain its powerful global standing (British Broadcasting Corporation, 2010(d)).

Russia has been perceived as one of the riskiest emerging market economies in the world. The country's legal system has been subject to inconsistent, overlapping, and brisk law and regulation changes. Implementation of these changes often has also been irregular. The judiciary has not operated independently and it has often been manipulated by political authorities. Additionally, corruption has been extensive. The tricky business climate, the lack of lucidity, the weak rule of law, and the presence of corruption have made Russia's business environment extremely unpredictable and risky (Bureau of European and Eurasian Affairs, 2010; Kouznetsov, 2009:379). Russia has also been involved in a number of international territorial disputes in the past (Central Intelligence Agency, 2010(d)).

Research has clearly indicated that the political risk factor of most concern to investors concerning Russia has been breach of contract. The other two major political risk factors that have been identified are the failure of the government to honour its guarantees, and expropriation (Multilateral Investment Guarantee Agency, 2010:39; Satyanand, 2010(a); Satyanand, 2010(b)). Other sources, however, have pointed to terrorism as a major political risk factor in Russia (Bhattacharji, 2010; Bureau of European and Eurasian Affairs, 2010).

Chechen terrorism has been a major concern in Russia. The Chechens are an ethnic minority (largely Muslim) that mainly occupy in the mountainous North Caucasus district of Russia. These groups have attempted to make Chechnya independent since the fall of the Soviet Union. Not only acts of terrorism, but also abuses and other acts of violence have been committed by these rebel groups (Bureau of European and Eurasian Affairs, 2010; Central Intelligence Agency, 2010(d)). Two devastating wars and ongoing rebellious action have resulted from Chechnya's struggle for independence and Chechen rebels have been held responsible for causing the most and largest co-ordinated terrorist attacks in Russia. The majority of these groups' terrorist attacks have been bombings. Some authors have gone so far as to state that there are similarities between the Chechen groups and al-Qaeda. Since 2008, violence in the North Caucasus district has soared. There were 795 and 1100 reported incidents of violence in 2008 and 2009 respectively, while suicide bombings increased significantly in 2009, and the majority of these occurred in Chechnya (Bhattacharji, 2010).

Multinational enterprises in Russia, however, have been aware of these political risk factors and have risk mitigation strategies in place. The most common political risk mitigation strategies followed by these multinational enterprises have been to engage with host governments, to obtain political risk insurance, or to perform political and economic risk analysis (Multilateral Investment Guarantee Agency, 2010:41; Satyanand, 2010(a); Satyanand, 2010(b)).

3.3.3 The Republic of India

The Republic of India (henceforth referred to as India) has rich natural resources, including coal, manganese, diamonds and limestone. The country has a diverse economy consisting of its traditional village farming, modern agriculture, crafting, a wide variety of modern industries, and a massive number of services. Some of the main agricultural products include rice, cotton, sugar and tea. Major industries in India are centred on chemicals, steel, mining, cement, and software. Although the majority of the country's workforce is employed in agriculture, the country's economic growth has mainly resulted from its multitude of services (Bureau of South and Central Asia Affairs, 2010; Central Intelligence Agency, 2010(c)).

In terms of geographical area, India covers 2.4 per cent of the world's total surface, but it is home to over 15 per cent of the world's population. The Peoples Republic of China is the only country in the world that has a larger population than India, making India the country with the second largest population in the world (Bureau of South and Central Asia Affairs, 2010).

India, as a federal republic, is the largest democracy in the world. The country is highly diverse in terms of caste, culture, religion and language (Bureau of South and

Central Asia Affairs, 2010). This is witnessed in the country's federal political system. As a result, societal and regional tensions have sometimes disturbed its politics, which then pressured the country's long-established secular and democratic beliefs (British Broadcasting Corporation, 2010(c)). The majority of India's political pressure groups involve separatist groups and religious organisations (Central Intelligence Agency, 2010(c)).

The country's political risk factors have often been related to ethnic and religious tensions (Creighton, 2008). Research has shown that Indian enterprises have been very concerned about terrorism in the country and have been less concerned about expropriation and payment and transfer restrictions. However, restrictions on payments and currency convertibility have been important political risk factors causing concern for investors, along with the general concern of sudden policy changes and breach of contract (Multilateral Investment Guarantee Agency, 2010:39; Satyanand, 2010(a); Satyanand, 2010(b)).

India has been involved in numerous international disputes. India and China have had continuous disputes concerning militarised boundaries and nuclear developments and India has also hosted the world's largest and most militarised territorial dispute with China, Pakistan and India all claiming a part of Kashmir. Additionally there have also been issues concerning the Indian-Bangladeshi border; illegal trade, migration, violence, and the movement of terrorists across this border have been a constant problem (Central Intelligence Agency, 2010(c)). Terrorism in India has been a political risk factor worth emphasising, with terrorist attacks in India not being uncommon. Some of the recorded attacks include Mumbai in July 2006 and November 2008, and Kabul in July 2008 (Bureau of South and Central Asia Affairs, 2010).

The presence of these political risk factors has clearly suggested that multinational enterprises have required adequate risk mitigation strategies in order to survive. The most common political risk mitigation strategies followed by such multinational enterprises have been to form joint ventures or alliances with local enterprises, to engage with the host government, to make use of outside consultants, or to perform political or economic risk analysis (Multilateral Investment Guarantee Agency, 2010:41; Satyanand, 2010(a); Satyanand, 2010(b)). Political risk insurance, however, can be obtained. In India, the Export Credit Guarantee Corporation has offered cover against the traditional insurable political risk factors, namely expropriation, war risks, and payment restrictions. The Export Credit Guarantee Corporation is a political risk insurance provider in India that primarily offers export insurance. Short-term export insurance makes up the largest proportion of this insurer's business (Satyanand, 2007).

As mentioned, the country has a powerful and rapidly growing economy. Like most emerging market economies, however, India also has a number of economic and social problems that have constrained its economic growth. These include, amongst others, inadequate infrastructure, an unwieldy bureaucracy and inflexible labour market, overpopulation, dreadful environmental conditions, extensive poverty and corruption, and high fiscal deficits (Bureau of South and Central Asia Affairs, 2010). India is also well known for its very low labour costs (Standard & Poor's, 2009:4).

Despite all of these problems, however, India has continuously strengthened its position on the global stage through its rapid economic development (Central Intelligence Agency, 2010(c)). Some authors believe that the main reason why India has been an emerging market economy has been the country's political leaders' tightening grip on globalisation (Bremmer & Keat, 2009:69). Key strengths in India's economy have been the success of private Indian companies. These private companies have gained from various economic sectors. The aforementioned political, economic and social issues, however, have hampered the country's economic development (Hult, 2009:2).

3.3.4 The People's Republic of China

The People's Republic of China (henceforth referred to as China) is the most populated country in the world (British Broadcasting Corporation, 2010(b)). Over the past 30 years, China's economy has changed from a centrally planned system to a more market-orientated economy. In the past, the country's economy was closed to international trade, but in the modern era this country with its fast growing private sector has become a key player in the global economy (Bureau of East Asian and Pacific Affairs, 2010; Central Intelligence Agency, 2010(b)). China has attracted foreign investors not only because of its investment climate, but also because of its huge domestic market and low labour costs (Australian Export Finance and Insurance Corporation, 2010; Battersby & Lu, 2011; Gwertzman, 2004; Standard & Poor's, 2009:4).

Like the other former BRIC countries, China also has an abundance of natural resources. These include, amongst others, coal, natural gas, tin, manganese, and aluminium. China also has the largest hydropower potential in the world. More than 40 per cent of the country's labour force is employed in agriculture, with rice, millet, barley and cotton being some of the main agricultural products. Key industries include mining and ore processing and the manufacture of telecommunications equipment and consumer products such as footwear, electronics and toys (Bureau of East Asian and Pacific Affairs, 2010; Central Intelligence Agency, 2010(b)). The services sector is the highest attractor of foreign direct investment, followed by the mining and manufacturing sector (Multilateral Investment Guarantee Agency, 2010:18).

China is a communist state dominated by a single party. The country is politically centralised and is led by the Chinese Communist Party. This political party is authoritarian in terms of its structure and ideologies (Bureau of East Asian and Pacific Affairs, 2010; Lanhove, 2004:25), which has led to a general lack of political freedom (Shah, 2010). The Chinese Communist Party has been in power since 1949, when China's civil war came to an end (Australian Export Finance and Insurance Corporation, 2010). Although many believe that there are no substantial political pressure groups in China (Central Intelligence Agency, 2010(b)), there are indications that political power in China has become somewhat competitive. Some of the role players in the political system of China include the People's Liberation Army and the National People's Congress (Martin, 2010:3).

China has gained a decent political rating for the effectiveness of its government, which entails the capacity of civil services, the quality of public services and policy-making, and its independence from political pressure groups. However, the country has received poor ratings for political stability and accountability, rule of law, anti-corruption measures, and regulatory quality (Australian Export Finance and Insurance Corporation, 2010). These issues need to be attended to.

Various sources have mentioned corruption as a major problem and political risk factor in China (Reuters, 2009). Even within the government there have been incidents of corruption. Law enforcement has often gone along with corruption (Kahn & Yardley, 2007). China's decentralised fiscal structure has also provided opportunities for local leaders to engage in self-enrichment. Some leaders of the Chinese Communist Party have used their power to guarantee influential positions for their family members. In many situations these family members have not had the necessary training or the required experience and abilities (Martin, 2010:6). Then there are also the so-called 'princelings'. These are the relatives of government officials who sometimes use their family connection to gain wealth, special privileges, or even powerful positions (Martin, 2010:14). Both these common occurrences can be viewed as small forms of corruption and they have sometimes led to scenarios of more serious corruption. Corruption often has also been fostered by low wages paid to civil workers, by the Chinese economic price control systems, by local trade barriers, and by sociological factors such as discrimination (Lanhove, 2004:27-28). Another common form of corruption in China is the illegal transfer of property (Gwertzman, 2004).

The risk of out-and-out expropriation (confiscation) in China is low. The last recorded case of expropriation occurred in 1979. Nationalisation of foreign enterprises is only legitimate under strict circumstances. In such instances, compensation is offered to the owners of the nationalised enterprises, but whether the compensation is fair and sufficient is not known. The risk of creeping expropriation, however, has been quite significant in China. Although the country's legal system has been improving, inconsistency has been a problem in the past, with local Chinese authorities bending rules without great difficulty. Disputes have often been won by those who have connections in high places (Australian Export Finance and Insurance Corporation, 2010).

China has been involved in numerous international disputes. As mentioned in an earlier section of this chapter, India and China have had continuous disputes concerning militarised boundaries and nuclear developments. Together with India and Pakistan, China has also been part of the large territorial dispute concerning Kashmir (Central Intelligence Agency, 2010(b)).

Civil unrest in general has not posed a sizable threat to foreign enterprises. Although demonstrations and violent protests have been frequent in the past, these activities have mostly revolved around domestic economic issues. There have been few violent incidents of civil unrest with a political undertone. Common domestic issues have included economic inequality, dissatisfaction with wages and working conditions, high inflation, environmental damage, property seizures and corruption (Australian Export Finance and Insurance Corporation, 2010; Bremmer & Zakaria, 2006:1; Gwertzman, 2004). Environmental damage and pollution in particular are factors that could easily have led to social unrest in China (Kahn & Yardley, 2007; Reuters, 2009).

Recent research found that the political risk factors of most concern to investors differ somewhat from those in the other BRIC countries. The research indicated that the political risk factor of most concern to investors has been war and civil disturbances. Other major political risk factors are identified as terrorism and restrictions on transfer and currency convertibility (Multilateral Investment Guarantee Agency, 2010:39; Satyanand, 2010(a); Satyanand, 2010(b)).

As multinational enterprises have become more aware of the presence and impact of these political risk factors, they have realised the importance of implementing appropriate risk mitigation strategies. The most common political risk mitigation strategies followed by these multinational enterprises have been to conduct political and economic risk analysis, to form joint ventures or alliances with local enterprises, or to engage with the host government (Multilateral Investment Guarantee Agency, 2010:41; Satyanand, 2010(a); Satyanand, 2010(b)).

Some authors state that the main reason why China has been an emerging market economy is the political advantages gained by the political leaders through their attempt to liberalise the country's economy (Bremmer & Keat, 2009:69). High foreign investment and industrial competitiveness have enhanced the Chinese economy. At the same time, however, economic, environmental and social issues have been constraining this country's economy (Hult, 2009:2).

The biggest social issue in China has probably been the huge economic inequality of citizens in the metropolitan regions and in the countryside (Lanhove, 2004:23). China is rated as one of the countries in the world with the most uneven income distribution

(Gwertzman, 2004). Social dissatisfaction consequently is common and this is especially visible in protests by farmers and other workers (Australian Export Finance and Insurance Corporation, 2010; British Broadcasting Corporation, 2010(b); Bremmer, 2005:54). China, however, has managed to improve the living standards and extent of personal decision-making for much of its population and has at the same time maintained very tight political control (Central Intelligence Agency, 2010(b)). In terms of human rights, China has violated a number of international standards, mainly due to inadequate rights with regard to basic freedom. Freedom of speech and the press are examples of areas where severe restrictions are applied (Bureau of East Asian and Pacific Affairs, 2010).

The Chinese government has faced a number of key challenges regarding China's economic development. Firstly, the country's domestic savings rate has been too high, and the domestic demand consequently has been low. This situation could be reduced by increasing business transfers and reinforcing the social safety net. Another challenge facing the Chinese government concerns sustainment of an adequate employment growth rate, particularly regarding the large number of migrants and new entrants into the Chinese labour force. Containing environmental damage and social contention that contribute to the country's rapid economic change should also be attended to (Gwertzman, 2004). Reducing corruption and other forms of economic crimes has been another huge challenge for the Chinese government (Central Intelligence Agency, 2010(b); Martin, 2010:15). The growing HIV infection rate also is a big concern (Australian Export Finance and Insurance Corporation, 2010; British Broadcasting Corporation, 2010(b)). By paying attention to all the aforementioned issues, China could possibly experience even more rapid growth.

3.3.5. The Republic of South Africa

As mentioned earlier, the Republic of South Africa (henceforth referred to as South Africa) recently joined the former BRIC countries. South Africa is an emerging market economy that had an estimated total population of 49 million people at the end of 2008 (The World Bank, 2009:379). With an abundance of natural resources, the country has enjoyed almost all essential commodities. It has a well-developed mining industry and is the largest producer of chromium, gold and platinum in the world. Agricultural products include, amongst others, wheat, vegetables, fruit, dairy products and meat. South Africa also has a well-developed financial and legal system and has the 18th largest stock exchange market in the world (Bureau of African Affairs, 2010; Central Intelligence Agency, 2010(e); South Africa Info, 2009).

South Africa is governed as a parliamentary democracy (Bureau of African Affairs, 2010). This democratic country has numerous identifiable political pressure groups, but labour unions (also known as trade unions) in particular have been strong political pressure groups. These groups have instigated strikes in the past during which the entire country has come to an economic standstill, which makes it obvious that these labour unions are crucial political pressure groups in South Africa (Pekeur, 2003:83). Amongst the identified political pressure groups in South Africa are the Congress of South African Trade Unions (COSATU), the South African Communist Party (SACP) and the South African National Civics Organisation (SANCO) (Central Intelligence Agency, 2010(e)).

South Africa has been identified as one of the most stable economies on the African continent. It has been the economic giant of Africa and has not only been the leading producer of minerals, but also is the country with the highest industrial output on the African continent. Above all, it has been responsible for the generation of a very large proportion of the continent’s electricity (Economy Watch, n.d.(c); South Africa Info, 2009). Being situated on the African continent, however, has had some very unfortunate consequences for South Africa. The continent has been perceived as very risky due to uncertainty over the potential of policy reversals, prolonged reorganisation, and political and civil unrest (Pekeur, 2003:94). Political risk factors in African countries particularly have traditionally been exaggerated (Control Risks, 2007). Foreign investors also generally associate business in Africa with corruption (Zaayman, 2003:24). This, however, is not an issue related to African countries only. As seen in the earlier discussions on the former BRIC countries, corruption is an issue in all of them and South Africa could thus be expected to also have issues concerning corruption (Venter, 2005:44). South Africa has also constantly faced threats of expropriation in the recent past. Issues surrounding land reform and the nationalisation of mines have been sensitive subjects in the country (Zaayman, 2003:25).

Unlike the former BRIC countries that received a medium political risk rating from Control Risks (2009(b)), South Africa received a low rating for 2010 with regard to political risk. A low political risk rating implies that businesses are able to operate without any inconvenience. Political organisations are expected to be stable, although the possibility remains that adverse policy changes may occur. The possibility that regulatory or judicial insecurity can become an issue is unlikely, but non-government actors could obstruct business activities from time to time (Control Risks, 2009(b)).

South Africa has been fortunate in the sense that there has not been any significant terrorist activity in the country recently. One explanation for this could be South Africa’s low global presence. South Africa has not had enough major global authority or involvement that could turn the country into a potential target for terrorist organisations. The country has also been highly represented by its diverse cultures, which may be extremely valuable since terrorism has often been linked strongly to religious and cultural issues (Silke, 2010). The country’s diverse cultures, however, have sometimes given rise to ethnic conflict (Venter, 2005:39).

Issues around Black Economic Empowerment (BEE) have often presented political risk factors. This has usually come in the form of potential government intervention. Employment has sometimes been hampered by affirmative action quotas whereby management sometimes is prevented from selecting the most suitable persons for particular positions. The country’s development consequently may have been restrained (Venter, 2005:40; Zaayman, 2003:38).

The South African economy presents two sides. On the one hand it competes with developed countries through its well-developed mining, agricultural, manufacturing, and services sectors. On the other hand, however, it has struggled with its infrastructure and has shown the characteristics of a developing country. Outdated infrastructure has greatly constrained the country’s economic growth (Bureau of African Affairs, 2010; Central Intelligence Agency, 2010(e)).

South Africa is a middle-income country facing a number of serious economic problems (Economy Watch, n.d.(c)). Economic inequality has been a big concern, as the economic difference between the rich and the poor is amongst the biggest in the world (British Broadcasting Corporation, 2010(e)). South Africa has had a high unemployment rate which, being the primary source of poverty, could fuel social instability and violent strife against the government. Economic inequality and unemployment, combined with dissatisfaction concerning low wages and poor government performance, probably account for most of the strikes and riots witnessed in the country. Other socio-economic problems include a high crime rate and HIV infection rate (Bureau of African Affairs, 2010; Venter, 2005:41; Zaayman, 2003:58). As long as the aforementioned factors are not under control, South Africa's economic growth will continue to be constrained.

3.4 CONCLUSION

This chapter has presented a discussion on emerging market economies, focusing on their characteristics and impact on foreign investment. It was shown that the emerging market economies of the world have some common general risks, especially political and economic risks. The discussion on emerging market economies was followed by a closer study of the BRICS countries, namely the Federative Republic of Brazil, the Russian Federation, the Republic of India, the People's Republic of China, and the Republic of South Africa. The political and economic environments of each of these five countries were studied in order to identify the common political risk factors that exist in each.

The theoretical research conducted on each of the BRICS countries produced numerous results. Unsurprisingly all of these emerging market economies have *rich natural resources*, have *very large labour forces* and have *well-developed industrial sectors*. Apart from the common features that have contributed to these countries' rapid economic growth, it is also obvious that all the BRICS countries have *political, economic and social issues* in common, particularly corruption and economic inequality. *Political risk factors* are not uncommon at all. Compared to other emerging market economies, Brazil, China and South Africa have enjoyed reasonably stable political environments (Creighton, 2008). A summary of the main political issues identified with regard to the BRICS countries is provided in Table 3.2.

Table 3.2: Political issues in the BRICS countries (according to the preceding literature study)

Common political issues identified	**Prevalent in:**
Political instability	Brazil Russia India China
Corruption	Brazil Russia India China South Africa
Breach of contract	Brazil Russia India
Restrictions on payments and transfers	Brazil India China
Currency inconvertibility	Brazil India China
Non-honouring of government guarantees	Brazil Russia
Expropriation	Russia India China South Africa
Terrorism	Russia India China
War	China
Violent civil unrest	Brazil China South Africa
Non-violent civil unrest	Brazil China South Africa

Table 3.2 lists the main political issues that emerged from the literature that was studied with regard to the BRICS countries. It is obvious that most of the identified issues were common to most of the BRICS countries.

This chapter has been aimed at providing a better understanding of emerging market economies and more knowledge of the five well-known emerging market economies in the world, namely the BRICS countries. That certain political risk factors are common to these emerging market economies has also been made clear. The following chapters will attempt to determine the applicability of these political risk factors in South Africa.

CHAPTER 4

RESEARCH METHODOLOGY OF THE EMPIRICAL STUDY

4.1 INTRODUCTION

An empirical survey was conducted for this study. For an empirical study to be credible, it is important that it is conducted in a transparent manner. The research methodology should be explained, since this clarifies how the data were collected and also serves as a justification for the actions taken in the research. This chapter provides a discussion of the research methodology that was followed for this study.

The research consisted of two parts. Secondary data were studied, from which a questionnaire was constructed. The empirical survey was undertaken with the help of the questionnaire, which was used as an *aide-mémoire* for structured personal interviews. This facilitated gathering the necessary primary data. A copy of the questionnaire is provided in Annexure A. This chapter also provides a discussion of the research design, the research instrument, the census, and the data analysis conducted in this study.

The purpose of this study was not to test a theory, but rather to determine the past and expected future impact of particular identified political risk factors on the South African short-term insurance industry. How these political risk factors are generally managed by short-term insurers in the country also formed an important part of the study. In view of the above, this chapter should provide a clear understanding of the research method followed to enable the researcher to reach the conclusions, as well as a clear understanding of how the responses obtained through the empirical survey were analysed and interpreted to serve the main objective of this study, namely to improve decision-making by South African short-term insurance companies when providing insurance cover against political risk factors to the South African public and businesses.

4.2 RESEARCH DESIGN

The objective of this research was achieved through investigating particular political risk factors in the Republic of South Africa. No similar research has been conducted in this country; therefore there was insufficient current secondary information that could be used for this study. The study therefore was expected to provide unique results. The research design provides the outline of the research that was conducted during this study (Blumberg, Cooper & Schindler, 2008:195).

First, it is necessary to distinguish between an exploratory study and a formal study. This distinction is quite simple: an exploratory study has the main objective of identifying the possible value of conducting more thorough research on the topic of concern. There usually is a general expectation that further research will be required in order to reach more accurate conclusions (Babin & Zikmund, 2007:51). The moment the topic of concern is actually being researched with thorough intent, the study can be classified as a formal study (Blumberg *et al.*, 2008:196). As the current study attempted to identify areas in the short-term insurance industry where there might be opportunities for new insurance products, or to suggest possible changes to current political risk insurance in South Africa, this study can be classified as an exploratory study, but it also represents a formal study as thorough research was done.

The study was divided into two parts. The first part used secondary data to identify the political risk factors that could be of importance in the Republic of South Africa. Secondary data comprise data that are available before the research is conducted (Babbie & Mouton, 2001:76). Such data have already been analysed and prepared by someone else in the past and are available for public use. Using secondary data generally has two big advantages; it saves the researcher both time and money. The researcher should, however, always bear in mind that the data could have been gathered and analysed to serve a different purpose and thus may not provide sufficient information for the purpose of the new study (Blumberg *et al.*, 2008:316-317). The possibility exists that the information could be outdated, that terms could be differently defined, that it may not be possible to verify the accuracy of the data, and also that different measurement units may have been used in the previous study (Babin & Zikmund, 2007:161).

As mentioned in an earlier chapter, a very large number of political risk factors have been identified by previous researchers. Brink (2004:2), for example, identified 103 political risk factors. To test the importance and impact of all these political risk factors in the Republic of South Africa would involve an enormous study. In order to limit the number of political factors, it was decided that the study would focus on the political risk factors that are common in emerging market economies. Since the Republic of South Africa is classified as an emerging market economy, the political risk factors that were identified in other emerging market economies could be expected to also apply to this country. It was, however, not possible to study all 22 emerging market economies identified by Morgan Stanley Capital Investment (2010). The secondary data consequently were gathered by studying the four biggest emerging market economies in the world, namely the Federative Republic of Brazil, the Russian Federation, the Republic of India, and the People's Republic of China, the so-called BRIC countries.

An earlier study by the Multilateral Investment Guarantee Agency (2010) had identified the political risk factors that are of most concern in these BRIC countries, and this was extremely valuable to the current study. Political risk factors that could be applicable to the Republic of South Africa were identified through studying the information on the BRIC countries. This was discussed in the preceding chapters. Once these political risk factors had been identified, the second part of this study, namely the gathering of the primary data, could commence. The identified political risk factors could be tested in a South African context to ultimately determine to what degree they apply to the Republic of South Africa.

Primary data involve data that are not available before a study is conducted as the data are gathered by the researcher (Babbie & Mouton, 2001:76). The primary data for this study were gathered by means of an empirical survey. A questionnaire based on the secondary data was compiled and pre-arranged structured personal interviews were conducted with the agents who underwrite Sasria insurance in the Republic of South Africa, with the questionnaire serving as an *aide-mémoire* during the interviews. These agents were conventional short-term insurers located across the Republic of South Africa. The co-operation of these agents provided this study with valuable information that contributed to the primary objective of the study, namely to improve decision-making by South African short-term insurance companies when providing insurance cover for particular political risk factors.

The research instrument that was used to gather the primary data for this study is discussed in the following section.

4.3 RESEARCH INSTRUMENT

The desired outcome for this study could not be achieved by studying and analysing only secondary data. The research instrument that was used to gather the primary data for the research was an empirical survey. A survey provides the researcher with the opportunity to gather primary data quickly, efficiently, accurately and reasonably inexpensively (Babin & Zikmund, 2007:187).

The first part of the survey was meant to determine what data gathering approach was to be followed. Two data gathering approaches have been identified, namely quantitative and qualitative research. The distinction between these two types is based on the type of information that is used in a study. As the labels suggest, quantitative research makes use of quantitative information such as numbers and statistics, while qualitative research is based on qualitative information obtained through interviews and observations. Neither of these two types of research is superior to the other. Whether a study makes use of qualitative or quantitative research depends mainly on the researcher's personal preferences (Babin & Zikmund, 2007:130; Blumberg *et al.*, 2008:191-192). Qualitative research was conducted in this study, after which the responses were weighted to obtain quantitative results.

The empirical survey consisted of personal interviews that were conducted with all the agents that underwrite Sasria insurance in the Republic of South Africa. A personal interview, also referred to as face-to-face communication, comprises a two-way conversation during which an interviewer puts questions to a respondent in order to gather the necessary information (Blumberg *et al.*, 2008:281). The personal interviews were based on the designed questionnaire, which served as an *aide-mémoire* for the interviews. The personal interviews were therefore structured. A structured interview typically makes use of a questionnaire and thus has a set of predefined questions (Blumberg *et al.*, 2008:386).

Although a questionnaire was used as the research instrument, it was decided that, instead of a mail survey, structured personal interviews should be conducted in order to collect the data. As already mentioned, the structured personal interviews were based on the designed questionnaire. A questionnaire that is used in an interview is also known as an interview schedule (Blumberg *et al.*, 2008:505). The main motivation for conducting structured personal interviews instead of a mail survey was to improve the response rate. Another advantage was that the interviewer would be able to clarify matters whenever a respondent was unsure of a question. A further advantage of an interview schedule is that the interviewer has the opportunity to not only ask questions, but also to observe the respondents (Babbie & Mouton, 2001:250; Babin & Zikmund, 2007:210-211). However, requiring the respondent to complete the questionnaire during the interview introduces the risk that respondents may attempt to complete the questions with some dishonesty. This may happen if the respondents attempt to protect the reputations of the enterprises which they represent or if they attempt to boost their personal reputations. The respondents could attempt to provide answers that will make them look good. This phenomenon is known as “the social desirability of questions and answers” and is a common occurrence in face-to-face interviews (Babbie & Mouton, 2001:238). In an attempt to prevent this problem from being an issue in this study, the questionnaire avoided any questions that required highly confidential information concerning the enterprises. Other disadvantages of personal interviews include high costs and long data-collection periods (Babin & Zikmund, 2007:212; Blumberg *et al.*, 2008:283).

As already mentioned, a questionnaire was designed, taking the secondary data into account. Two types of questions can typically be put in a questionnaire, namely open-ended and close-ended questions. In an open-ended question the respondent is required to provide his or her own answer to a particular question. A close-ended question, on the other hand, provides the respondent with various options to a particular question from which he or she should then select the most applicable or accurate answer to the question. It is obvious that open-ended questions have the potential of producing a wide spectrum of different answers since respondents may differ in terms of perspectives, experiences and views. Although more alternative answers could result, the analysis of these responses could prove to be time-consuming, difficult and costly. Close-ended questions, on the other hand, are much easier to analyse and interpret since factors can be weighted. It is, however, important to make sure that the response categories are exhaustive, meaning that all the possible responses that could be expected in the survey must be included. For this reason, researchers generally add a category for the respondent to select and specify whenever the desired category is not available under the various options

(Babbie & Mouton, 2001:233-234). The questionnaire that was used in this study mostly made use of close-ended questions and made minimal use of open-ended questions.

A copy of the questionnaire was sent to all the enterprises that participated in the empirical survey beforehand. This enabled the enterprises to appoint the appropriate respondent with whom the researcher could conduct the personal interview. It also allowed the selected respondents to prepare themselves for the personal interviews. The personal interviews mostly involved one individual only. On several occasions, however, more than one individual was present. In these cases the enterprise either felt that one respondent alone would not be able to answer all the questions correctly, or wanted to make sure that no inappropriate information was shared. Although the questionnaire did not include confidential questions, most companies had standard legal protocols in place that required that outgoing information that is representative of the enterprise had to be cleared by their legal departments. Even though this was done beforehand, the researcher was still required to sign confidentiality statements during a number of the personal interviews.

During most of the personal interviews, the respondents indicated that they found the interviews quite stimulating. They showed interest in and excitement about the study, and on numerous occasions the respondents requested a summary of the main findings of the study upon completion. This request did not only reflect curiosity about the results of the study, but the respondents also wanted to compare their own responses with the results of the census. Some of the topics led to long discussions which made both the researcher and respondents think carefully and differently about certain aspects of the study. Some respondents were also excited about the opportunity to express their opinions on the current status of political risk insurance in South Africa.

The empirical survey provided the study with information from a wide spectrum of respondents, each with his / her own opinions and perspectives. It was thus possible to gather information that revealed a wide variety of attitudes, intentions, opinions and expectations. (Blumberg *et al.*, 2008:278). These were valuable findings which contributed towards the primary objective of this study, namely to improve decision-making by South African short-term insurance companies when providing insurance cover against political risk factors to the South African public and businesses.

The following section provides a discussion on the census that was conducted in this study.

4.4 CENSUS

In order to gather the primary data of a study, an appropriate unit of analysis should firstly be determined. The unit of analysis refers to the people or objects that provide the necessary primary data for the study (Babin & Zikmund, 2007:114; Blumberg *et al.*, 2008:224). After the unit of analysis has been determined, an appropriate sample may be drawn. The process of drawing up a sample implies the selection of the observations that will be used in the study (Babbie & Mouton, 2001:164). By selecting some of the observations of a population, it may be possible to derive conclusions from a portion of the population that could in fact apply to the entire population (Babin & Zikmund, 2007:65). A sample is drawn since it is generally not possible to include the whole population in the study. The moment that the aggregate characteristics of the population are reflected by the aggregate characteristics of the sample, it can be concluded that the sample was representative of the population (Babbie & Mouton, 2001:172).

The purpose of sampling is to select a sample that could reflect as much of the characteristics of the entire target population as possible. Advantages of sampling include lower costs and faster data-collection (Blumberg *et al.*, 2008:228). However, when the population is small (as was the case in this study), a census is more appropriate. A census implies that the entire target population is included for the gathering of the primary data (Babin & Zikmund, 2007:403).

For this study, the units of analysis were the agents that operate and underwrite Sasria insurance in the Republic of South Africa. There were 54 of these agents and they were located across the country. These agents mostly were conventional short-term insurers and did all the underwriting for Sasria Ltd. They also handled all the claims on behalf of Sasria Ltd. and would thus be the first to be aware of increased claims due to the identified political risk factors. For this reason it could be concluded that these agents were experts in the field of short-term insurance and knew all the details and applications of Sasria insurance. They were therefore in an excellent position to provide this study with the necessary primary data.

The 54 agents who underwrite Sasria insurance formed the target population of this study. A census was undertaken during which structured personal interviews were pre-arranged with most of the agents. Not all the agents were included in the census for a simple reason; numerous occasions were found of various agents of Sasria Ltd. operating as captives. This meant that the same respondent represented more than one agent, which decreased the number of potential respondents to 45.

As already mentioned, the interview schedule (questionnaire) served as an *aide-mémoire* during the personal interviews. Unfortunately it was not possible to arrange personal interviews with respondents from all the enterprises, mainly due to time constrains. Some respondents did not have time available to arrange personal interviews with them. In these cases the respondents could still take part in the census by completing the questionnaire and returning it to the researcher via e-mail. This greatly contributed to an extended data collection period as some respondents took a lot of time to complete and return the questionnaire. Additionally, some respondents did not return the completed questionnaire and they had to be eliminated from the survey due to the limited period of the study. Hardly any enterprises refused to arrange the interviews due to non-clearance by their legal department, although there were a few such incidents. After having acquired as many completed questionnaires as possible, there were 32 participants in the empirical survey. Since there were 45 potential respondents to the survey, the study had a 71 per cent response ratio. The co-operation of the agents of Sasria Ltd. who participated in the empirical survey provided this study with the necessary primary data.

The following section provides a discussion of the data analysis of this study.

4.5 DATA ANALYSIS

A number of aspects concerning the primary data, such as the reliability and validity of the acquired data, are traditionally of extreme importance. Reliability implies that the research techniques applied in a study must produce consistent results whenever they are repeated (Babbie & Mouton, 2001:119; Babin & Zikmund, 2007:321; Blumberg *et al.*, 2008:455). Validity refers to the accuracy of a measure. Bias should not be present in the sample or census (Blumberg *et al.*, 2008:232). It is also important that the results of the study truly address the concepts that were applicable to the study (Babbie & Mouton, 2001:122; Babin & Zikmund, 2007:323).

To ensure the validity and reliability of the primary data, the necessary pre-test was conducted. A well-established national brokerage enterprise was visited. During this visit the underwriting manager of the enterprise was interviewed by the researcher. The respondent in this interview was required to complete the questionnaire and comment on all the questions. This enabled the researcher to determine whether the respondent understood the questions, and also whether the questions would be valid for all the respondents. Consequently, the researcher was able to make the recommended and necessary adjustments to the original questionnaire to ensure that the questions were relevant and that all instructions were clear.

Data analysis refers to the interpretation of the data that are gathered (Babin & Zikmund, 2007:68). This study made use of an empirical survey to gather its primary data. The questions in the questionnaire were designed in a manner that allowed the researcher to weight and analyse the responses in order to make valuable conclusions to serve the objectives of this study.

Once the questionnaires were completed, the data were checked for completeness, legibility and consistency before the analysis and interpretation of the data could commence. The process during which data are checked is known as editing (Babin & Zikmund, 2007:480). Once the editing was completed, the researcher commenced with the analysis and interpretation of the data.

Using close-ended questions and making minimal use of open-ended questions in the questionnaire simplified the data analysis process. The questionnaire frequently applied rating scales to enable the various factors to be weighted and compared to one another. Scaling is a process by which specific numerical values are allocated to particular responses (Blumberg *et al.*, 2008:460). A rating scale that was frequently used in the questionnaire was a five-point Likert interval scale. A Likert interval scale measures a respondent's attitude towards particular factors by requesting the respondent to rate the factors on a scale ranging from a very high or positive perception to a very low or negative perception (Babin & Zikmund, 2007:333).

Weighting was possible as it was explicitly stated on the questionnaire that the five options form a continuum (Albright, Winston & Zappe, 2002:224-229). The numerical values that were allocated to the Likert interval scale responses are indicated in Table 4.1.

Table 4.1: Allocated factor weights

Assign a weight of:	Importance	Violence	Frequency	Level
5	Extremely important	Extremely violent	Always	Very high
4	Highly important	Highly violent	Very often	High
3	Moderately important	Moderately violent	Sometimes	Medium
2	Little important	Little violent	Seldom	Low
1	Not important	Not violent	Never	Very low

The responses were accumulated, which allowed the researcher to weight and rank the factors in a decreasing order of importance, violence, frequency, or level. Consequently it was possible to determine weighted average responses that could be used for further statistical analysis. The statistical tests that would be applied include the Wilcoxon Test, which can be applied to determine whether values are significant by deriving probability values (more commonly known as p-values) (Ferguson, 1987:406-408), and the McNemar-Bowker Test and the Mosteller Test, which can be applied to test for changes in observations (Bowker, 1948; Mosteller, 1951(a); Mosteller, 1951(b)).

Nominal and ratio scales were also incorporated in the questionnaire. Classification questions and checklists (where the order of the responses were not important) typically produced nominal data, while ratio data resulted from actual numerical responses that were provided by the respondents (Blumberg *et al.*, 2008:440). The nominal data allowed the researcher to compare factors on the basis of frequency. The respondents were also required to provide numerical values to certain questions, which enabled the researcher to analyse and interpret the data by means of descriptive statistics, such as mean and median values. As mentioned earlier, open-ended questions were seldom used in the questionnaire. Qualitative data were therefore gathered, after which the responses were weighted to obtain quantitative results.

4.6 CONCLUSION

This chapter, in providing a discussion of the research method that was followed in this study, has focused on the research design, the research instrument, the census, and the data analysis that were applied in this study.

The entire target population was included in this study, therefore a census was used. An empirical survey was conducted by means of structured personal interviews that were based on an interview schedule. The interview schedule (a questionnaire) was developed from findings that were derived from the analysis of the secondary data. The primary data were gathered through the questionnaires. Afterwards, the primary data were properly analysed to enable the researcher to interpret the data that had been gathered.

This chapter should have provided a clear understanding of the research methodology that was followed to enable the researcher to make the necessary conclusions from the empirical study. The reader should also have a clear understanding of how the responses to the empirical survey were analysed and interpreted to serve the main objective of this study, namely to improve decision-making by South African short-term insurance companies when providing insurance cover with regard to political risk factors in South Africa.

CHAPTER 5

RESULTS OF THE EMPIRICAL STUDY

5.1 INTRODUCTION

A comprehensive discussion of the gathering of the primary data for the study was provided in the previous chapter (Chapter 4). The census had a response ratio of 71 per cent, with 32 respondents out of a possible 45 respondents having participated in the survey.

The questionnaire consisted of four broad questions. Each question comprised a number of underlying questions. The cumulative results obtained from the four questions of the questionnaire are presented in this chapter in the order that they appeared in the questionnaire.

Question 1 addressed a variety of aspects related to political risk insurance in South Africa. The aspects under consideration were derived from the conducted literature study. These aspects included:

- How frequently does the South African public purchase political risk insurance compared to the need thereof?
- How important is the role of political risk insurers (both domestic and foreign) in South Africa?
- Is environmental preservation a source of political risk factors in South Africa, and if so, how violent are political risk factors related to environmental preservation in South Africa?
- Have the premium income of political risk insurance in South Africa changed over the past five years, and is it expected to change over the next five years?
- Should political risk insurance in South Africa be more flexible?
- Do short-term insurers in South Africa conduct political risk analysis in general?
- What were the main sources of political risk factors in South Africa over the past five years, and are these sources expected to change over the next five years?

- Was there a change in the annual claims amount of short-term insurers in South Africa in 2009 and 2010, when the country hosted a national election and the FIFA World Cup respectively?

It was concluded from Chapter 3 that there are ten political risk factors common to emerging market economies. Question 2 required the respondents to rate the ten political risk factors according to three aspects, namely the importance of their impacts, the frequency with which the factors lead to claims, and the demand for cover against them. A comparison was made between what happened in the past five years and what is expected to happen in the next five years for each of the aspects examined. Question 3 used the same list of political risk factors in an attempt to identify which of the political risk factors can be regarded as the main problem areas for underwriters in South Africa. Attention was also paid to how these problem areas can be managed. The final question of the questionnaire (Question 4) attempted to identify which of the nine South African provinces present the most claims related to political risk factors.

The results obtained from the four questions are analysed and processed appropriately in order to derive possible conclusions. This chapter provides a comprehensive discussion of the results that were obtained by the empirical survey. The results are presented and discussed in the order in which they occurred in the questionnaire.

5.2 EMPIRICAL RESULTS

The questionnaire consisted of four questions. For the purpose of simplicity the four questions are referred to as Questions 1 to 4. The first question of the questionnaire (Question 1) focused on a number of aspects concerning political risk insurance in South Africa. The remaining questions (Question 2, Question 3 and Question 4) all had one focus only. It was explained in Chapter 4 how the factors would be weighted (refer back to Table 4.1). The remainder of this section will provide a discussion of the results obtained.

5.2.1 Purchase frequency of political risk insurance in South Africa

The first question (Question 1.1) required the respondent to indicate how frequently the South African public purchases political risk insurance compared to the need thereof. This had to be indicated by means of a rating on a scale of frequency. The five possible responses (always, very often, sometimes, seldom and never) formed a continuum and the responses could therefore be weighted as indicated in Table 4.1 of the previous chapter, which is repeated here as Table 5.1 to further the interpretation of the empirical results.

Table 5.1: Allocated factor weights

Assign a weight of:	Importance	Violence	Frequency	Level
5	Extremely important	Extremely violent	Always	Very high
4	Highly important	Highly violent	Very often	High
3	Moderately important	Moderately violent	Sometimes	Medium
2	Little important	Little violent	Seldom	Low
1	Not important	Not violent	Never	Very low

Weighting according to the Likert interval scale is presented in this chapter. Table 5.2 presents the results obtained from this question.

Table 5.2: Purchase frequency of political risk insurance by the South African public, as perceived by the respondents

	Always	Very often	Sometimes	Seldom	Never
Number of respondents	11	17	3	0	0
Percentage of respondents	35	55	10	0	0
Weighted responses	55	68	9	0	0

Number of valid responses = 31

Table 5.2 indicates the proportions of the respondents who recorded the various responses. The results are also presented visually in Figure 5.1.

Figure 5.1: Purchase frequency of political risk insurance by the South African public, as perceived by the respondents

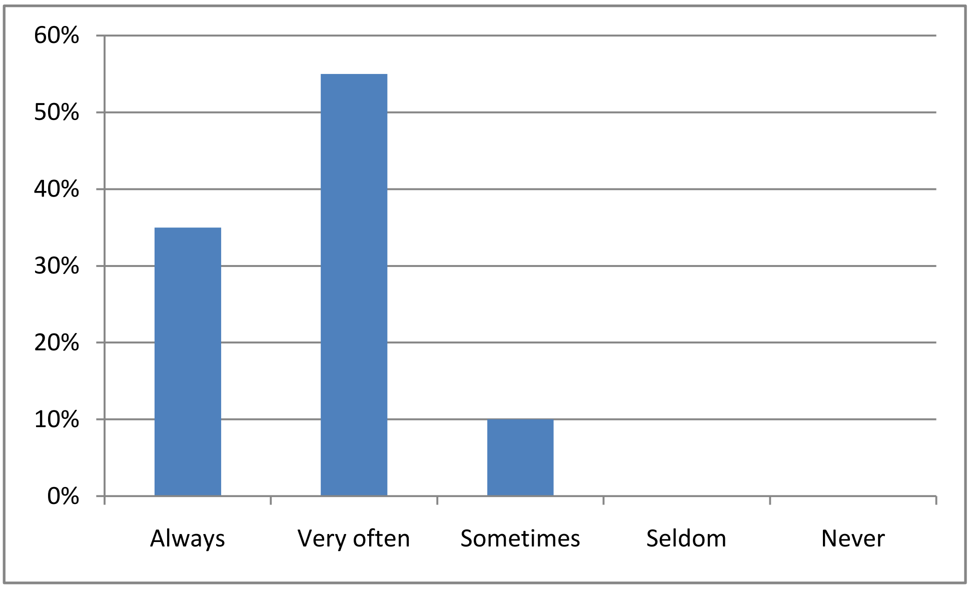


Table 5.2 and Figure 5.1 clearly suggest that the majority of the respondents (90 per cent) indicated that political risk insurance is purchased very often or more frequently by the South African public.

5.2.2 The importance of the role of political risk insurers in South Africa

Question 1.2 required the respondents to rate how important the role of political risk insurers (both domestic and foreign) is perceived in South Africa on a scale of importance. The five possible responses (extremely, highly, moderately, little and not important) formed a continuum and the responses could therefore be weighted. Table 5.3 presents the results obtained from this question.

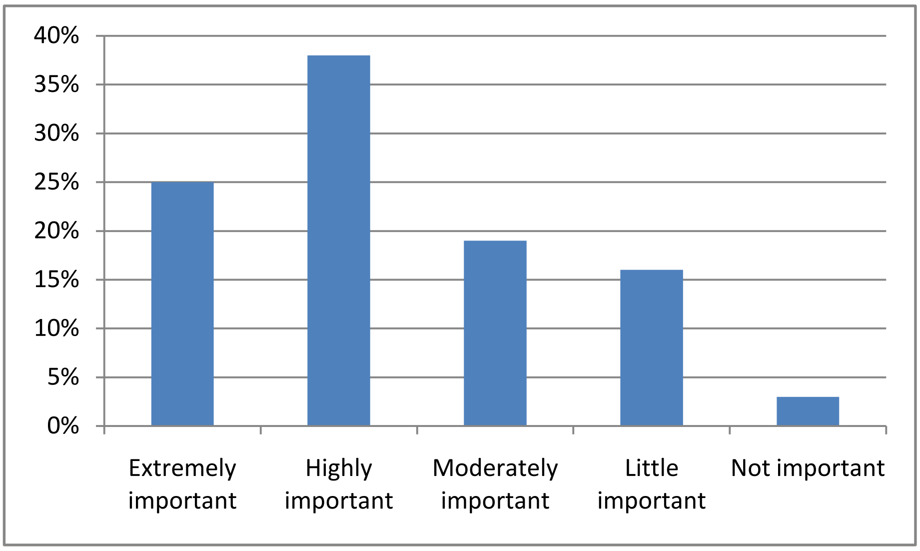
Table 5.3: The importance of the role of political risk insurers in South Africa, as perceived by the respondents

	Extremely important	**Highly important**	**Moderately important**	**Little important**	**Not important**
Number of respondents	8	12	6	5	1
Percentage of respondents	25	37	19	16	3
Weighted responses	40	48	18	10	1

Number of valid responses = 32

Table 5.3 indicates the proportions of the respondents that indicated the various responses. The results are also presented visually in Figure 5.2.

Figure 5.2: The importance of the role of political risk insurers in South Africa, as perceived by the respondents



It is clear from Table 5.3 and Figure 5.2 that a large proportion of the respondents indicated that political risk insurers (both domestic and foreign) do play an important role in South Africa. Only three per cent of the respondents perceived the role of political risk insurers not to be important in South Africa and 16 per cent perceived the role as of little importance.

The next table to be considered is Table 5.4. The table presents the relevant descriptive statistics for Question 1.1 and Question 1.2.

Table 5.4: Descriptive statistics concerning the purchase frequency of political risk insurance by the South African public, as well as the importance of the role of South African political risk insurers

Aspect	Weighted mean value	Median value	Standard deviation
Purchase frequency	4.26	4.0	0.63
Importance of insurers	3.66	4.0	1.12

The statistics presented in Table 5.4 enable the reader to get an idea of the distribution of the results that are presented in Table 5.2 and Table 5.3. For both variables the weighted mean value is very close to the median value (based on the weights), and the standard deviations suggest that the responses do no vary much from the weighted mean values.

Before the results are interpreted, it is important to understand that political risk insurance is not always an optional addition to a short-term insurance policy and can sometimes be included automatically by short-term insurers. Political risk insurance sometimes is a compulsory addition to personal policies and / or commercial policies. Whether it will be included automatically often depends on the line of business underwritten by the insurer. This can explain why the results indicate that political risk insurance is purchased very often, but not always, by the South African public.

There also seems to be a general belief that political risk insurers (both domestic and foreign) play an important role in South Africa. The responses to this question were mostly given on the basis of the respondents' experiences or need for political risk insurance in the past. A large number of the respondents indicated that they had not experienced any claims or losses related to political risk factors in the recent past. These respondents consequently indicated that political risk insurers do not play an important role in South Africa. The weighted mean value and median value (based on the weights), however, suggest otherwise: these indicate a moderate to high level of importance. A possible explanation for the higher level of importance assigned could be the respondents' expectations regarding the occurrence of political risk factors as well as their attitudes towards political risk insurers in the future.

5.2.3 The importance of environmental preservation as a source of political risk factors in South Africa

The study also included a brief glance at political risk factors related to environmental preservation in South Africa. It was discussed in Chapter 3 that environment preservation can be an important source of political risk factors in emerging market economies. With Question 1.3.1 and Question 1.3.2 the researcher investigated how applicable this could be to South Africa. Question 1.3.1 required the respondent to indicate how important environmental preservation is perceived to be as a source of political risk factors in South Africa on a five-point Likert interval scale. Table 5.5 presents the results obtained from Question 1.3.1.

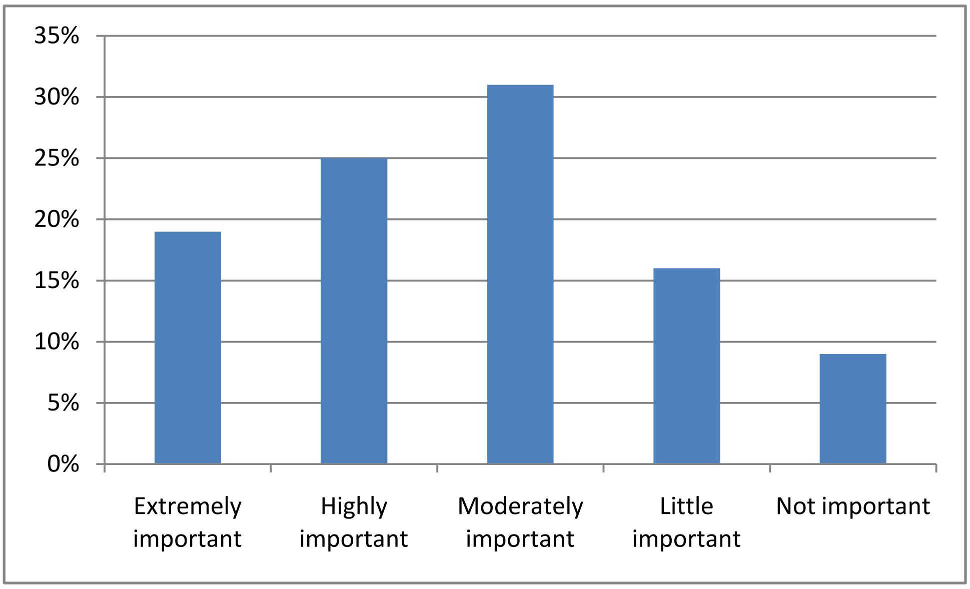
Table 5.5: The importance of environmental preservation as a source of political risk factors in South Africa, as perceived by the respondents

	Extremely important	Highly important	Moderately important	Little important	Not important
Number of respondents	6	8	10	5	3
Percentage of respondents	19	25	31	16	9
Weighted responses	30	32	30	10	3

Number of valid responses = 32

Table 5.5 presents the proportions of the respondents who recorded the various responses. The results are also presented visually in Figure 5.3.

Figure 5.3: The importance of environmental preservation as a source of political risk factors in South Africa, as perceived by the respondents



The results presented in Table 5.5 and Figure 5.3 clearly indicate that the majority of the respondents perceive environmental preservation as a moderately to extremely important cause of political risk factors in South Africa, since 75 per cent of the respondents indicated that it is at least moderately important.

5.2.4 The degree of violence of political risk factors related to environmental preservation in South Africa

More attention was focused to political risk factors related to environmental preservation in Question 1.3.2: The degree of violence of political risk factors related to environmental preservation was investigated. The findings are presented in Table 5.6.

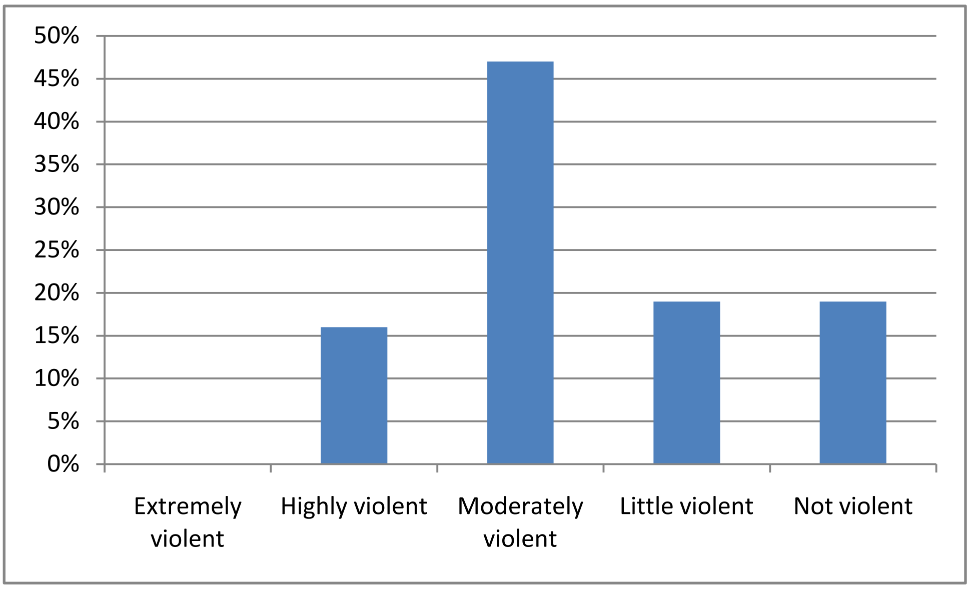
Table 5.6: The degree of violence of political risk factors related to environmental preservation in South Africa, as perceived by the respondents

	Extremely violent	**Highly violent**	**Moderately violent**	**Little violent**	**Not violent**
Number of respondents	0	5	15	6	6
Percentage of respondents	0	15	47	19	19
Weighted responses	0	20	45	12	6

Number of valid responses = 32

Table 5.6 presents the proportions of the respondents who recorded the various responses. The results are also presented visually in Figure 5.4.

Figure 5.4: The degree of violence of political risk factors related to environmental preservation in South Africa, as perceived by the respondents



According to the results presented in Table 5.6 and Figure 5.4, 19 per cent of the respondents indicated that the political risk factors arising due to environmental preservation are not violent, another 19 per cent indicated that it is little violent and 47 per cent indicated that it is moderately violent. Eighty-five per cent of the respondents thus indicated that the political risk factors related to environmental preservation are moderately or less violent. The findings suggest that the respondents are not really concerned about such political risk factors, since it is generally expected that violent political risk factors should lead to experiencing significant claims.

The next table presents the relevant descriptive statistics for Table 5.5 and Table 5.6.

Table 5.7: Descriptive statistics concerning environmental preservation, focusing on the importance and the degree of violence, as perceived by the respondents

Measure	Weighted mean value	Median value	Standard deviation
Importance of environmental preservation	3.28	3.0	1.22
Degree of violence	2.59	3.0	0.98

The statistics presented in Table 5.7 enable the reader to get an idea of the distribution of the results presented in Table 5.5 and Table 5.6. For both variables, the weighted mean value is very close to the median value (based on the weights), and the standard deviations suggest that the responses do no vary much from the weighted mean values.

As a source of political risk factors in South Africa, environmental preservation seems to be moderately important. Although some the respondents indicated that environmental preservation might not be an important source of political risk factors in South Africa yet, it may become more important in the near future as environmental conditions worsen in the country.

When studying the degree of violence of the political risk factors related to environmental preservation, the results suggest that such political risk factors traditionally are not of a violent nature. This does not come as much of a surprise if one considers the type of individual that is expected to show dissatisfaction concerning environmental preservation; the so-called “green” people have generally not been seen as violent individuals.

5.2.5 Changes in the percentage of total premium income from political risk insurance in South Africa, focusing on the past five years and the next five years

The next two questions in the questionnaire investigated the total premium income of political risk insurance in South Africa. Question 1.4.1 focused on the percentage change thereof over the past five years, while Question 1.4.2 focused on the expected change during the next five years. The results of the two questions are presented in Table 5.8.

Table 5.8: Changes in the percentage of total premium income of political risk insurance in South Africa according to the respondents, focusing on the past five years and the next five years

Category	Past five years			Next five years		
	Increase of:	Responses	Category count	Expected increase:	Responses	Category count
< 0%	-	-	0	-	-	0
0%	0%	2	2	0%	3	3
1% - 9%	5%	2	4	5%	3	6
	7%	2		7%	3	
10% - 29%	10%	5	11	10%	4	10
	12.5%	1		15%	1	
	15%	1		20%	4	
	20%	4		25%	1	
30% - 59%	30%	1	7	30%	1	4
	35%	1		35%	1	
	40%	2		40%	1	
	45%	1		50%	1	
	50%	2		-	-	
60% - 99%	-	-	0	90%	1	1
> 99%	300%	2	2	300%	1	1

Note: With regard to the past and the next five years, 26 and 25 respondents respectively answered this question of the questionnaire.

The respondents were required to indicate the change in percentage of the total premium income from political risk insurance in South Africa (in monetary terms) over the past five years, as well as the expected percentage change thereof during the next five years. Table 5.8 summarises the results that were obtained. Since the respondents could present any value of their choosing, Question 1.4.1 and Question 1.4.2 can be seen as open questions. The responses were placed in categories to simplify the interpretation of the results. The actual percentage of change for the past five years and the next five years that were provided by the respondents are indicated next to the category in which they fall, together with the number of respondents that provided the exact percentage of change. The number of respondents that fall into the same category were added together to present a cumulated number of responses for each category.

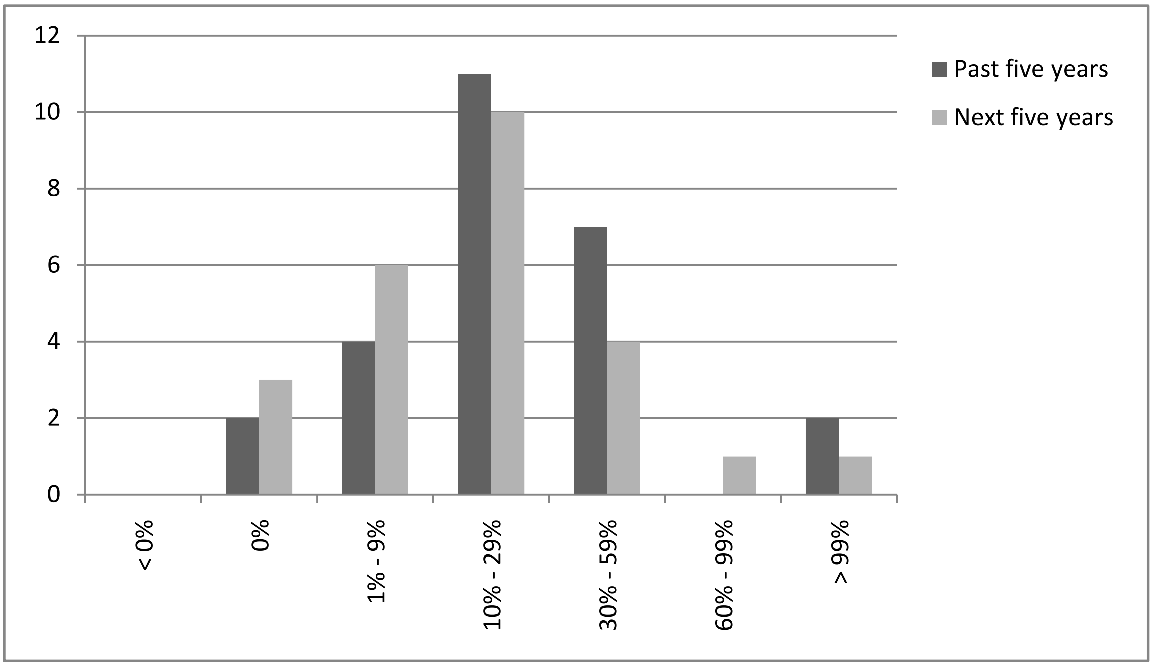
According to Table 5.8, none of the respondents indicated that the total premium income from political risk insurance had decreased over the past five years, and none of the respondents indicated that they expected it to do so during the next five years either. Only two respondents indicated that the total premium income from political risk insurance had not changed over the past five years and three respondents indicated that they did not expect it to change during the next five years. When focusing on the past five years it will be noticed that the two categories with the most responses show an increase of 10 per cent and an increase of 20 per cent (indicated by five and four respondents respectively). The most commonly expected percentage increases for the total premium income from political risk insurance during the next five years were also 10 per cent and 20 per cent (both indicated by four of respondents each). It is important to note that the respondents indicated that the increase of the total premium income from political risk insurance for both periods (past five years and next five years) appear to be in the 10 per cent to 29 per cent category (indicated by 11 and 10 respondents for the past five years and the next five years respectively). Table 5.9 presents the relevant descriptive statistics for the results presented in Table 5.8.

Table 5.9: Descriptive statistics for changes in the percentage of the total premium income from political risk insurance in South Africa according to the respondents, focusing on the past five years and the next five years

Period	Mean value	Median value	Standard deviation
Past five years	41.21	17.5	77.67
Next five years	29.64	10	59.66

The statistics presented in Table 5.9 enable the reader to get an idea of the distribution of the results presented in Table 5.8. The statistics indicate that the average increase (mean value) in total premium income from political risk insurance for the past five years and the next five years was recorded as 41.21 per cent and 29.64 per cent respectively. Two important aspects, however, have to be noted. Firstly, the median values for both the past five years and the next five years differ greatly from the mean values. Secondly, the standard deviations are high for both variables. This implies that variation from the mean values could be high. This will be explained more easily by studying Figure 5.5.

Figure 5.5: Changes in the percentage total premium income from political risk insurance in South Africa according to the respondents, focusing on the past five years and the next five years



The two histograms presented in Figure 5.5 clearly illustrate how a small number of respondents indicated large changes for both periods (past five years and next five years). Although these responses were few, the large values that were provided have a big impact on the mean values (as indicated by the standard deviations). Regardless of such responses, there is one important conclusion to be made from the findings, viz. that the total premium income from political risk insurance has increased over the past five years and is expected to continue doing so during the next five years.

The respondents provided reasons for the large variation in responses. The first is that premium income can typically be determined by the underlying value of the insured assets. Therefore, as the value of the asset changes, the premium will have to be adjusted; consequently the total premium income should change as well. Since the values of insured assets were different for different respondents, it is understandable that the responses could have varied. Secondly, some respondents indicated that their total political risk insurance premium income changed with the occurrence of political events. When there were indications that political events could occur, the demand for political risk insurance was generally higher, with the result that the premium income would have increased. On the other hand, if there were no indications of political events occurring, the demand for political risk insurance could have remained constant; consequently the premium income did not change. A third explanation is that some respondents were new to the short-term insurance industry and they, as a result, experienced very high growth in premium income. Finally (and this is probably the most obvious reason), premium income could have increased due to an increase in political risk insurance rates.

5.2.6 Importance of flexibility concerning various aspects of political risk insurance in South Africa

The next question (Question 1.5) gathered the respondents' opinions on the current status of political risk insurance in South Africa. The respondents were required to indicate how important they believed it to be that political risk insurance should have more flexibility concerning a number of aspects of political risk insurance. They had to rate six factors on a scale of importance. The five possible responses (extremely, highly, moderately, little and not important) formed a continuum and the responses could therefore be weighted. The results are presented in Table 5.10.

Table 5.10: Importance of flexibility concerning various aspects of political risk insurance in South Africa, as perceived by the respondents

Aspect of political risk insurance	Extremely important	Highly important	Moderately important	Little important	Not important	Weighted responses
General conditions of cover	6	13	8	3	2	114
Availability of special endorse-ments for specific insureds	7	14	6	5	0	119
Extent of cover provided	10	10	10	2	0	124
More leniency in acknowled-ging political risk factors	10	10	10	1	1	123
Level of premiums on an ad hoc basis	5	12	9	5	1	111
Availability of no-claim bonuses to all insureds	6	9	2	10	5	97

Number of valid responses = 32

Table 5.10 indicates the number of respondents that recorded the various responses to each of the presented aspects of political risk insurance. Further conclusions can be drawn by studying the relevant descriptive statistics presented in Table 5.11.

Table 5.11: Descriptive statistics concerning the importance of flexibility concerning various aspects of political risk insurance in South Africa, according to the respondents

Aspect of political risk insurance	Weighted mean value	Median value	Standard deviation
General conditions	3.56	4.0	1.11
Special endorsements	3.72	4.0	0.99
Extent of cover	3.88	4.0	0.94
Leniency in acknowledgement of political risk factors	3.84	4.0	1.02
Level of premiums	3.47	4.0	1.05
No-claim bonuses	3.03	3.0	1.43

The statistics presented in Table 5.11 indicate that the weighted mean value of each variable is very similar to its median value (based on the weights). The standard deviations suggest that responses generally did not vary much from the weighted mean value. It can thus be concluded that it is moderately important to highly important that there should be more flexibility concerning all of the following aspects of political risk insurance in South Africa, i.e. the general conditions of cover, the availability of special endorsements for specific insureds, the extent of cover provided, the leniency in the acknowledgement of political risk factors, the level of premiums on an ad hoc basis, and the availability of no-claim bonuses to all insureds.

In terms of the *availability of special endorsements* for specific insureds, respondents highlighted the importance of having tailor-made policies for insureds. Business interruption insurance is often not included in political risk insurance policies and some of the respondents indicated that they believed it should be; this would thus fall under the *extent of cover* provided. The responses to the *level of premiums* on an ad hoc basis depended highly on each respondent’s line of business, viz. the cost of political risk insurance for personal / individual insurance cover is usually low, while commercial insurance cover can be very costly in South Africa. Respondents added that risks in geographical regions as well as industries differ. Consequently they were of the opinion that premiums should be adjusted on the basis of these two aspects in particular. It might also be a good idea for political risk insurers to take the insured’s claims history into consideration when calculating his / her political risk insurance premium. When focusing on the importance of providing more flexibility concerning the *availability of no-claim bonuses* to all insureds, the line of the respondent's business once again played an important role in his / her response. A general consensus was that a no-claim bonus is important for commercial insurance since such premiums are generally high, while individuals pay low premiums and might therefore not be concerned about it. Additionally, some respondents indicated that they had not received any political risk insurance claims in years and therefore it did not come as a surprise when they indicated that it is important that more flexibility concerning the availability of no-claim bonuses should be provided to all insureds. The respondents offered no comments concerning more flexibility in terms of the *general conditions* of cover or the *leniency in acknowledging political risk factors*.

5.2.7 Whether the respondents are conducting political risk analysis in South Africa

It was mentioned in the chapters dealing with the literature review that some enterprises conduct their own political risk analysis, while other enterprises make use of independent researchers, agencies or analysts to provide them with information concerning political risk in a country. Question 1.6 was included in the questionnaire to determine which approach was common for South African short-term insurance companies at the time. The respondents were required to indicate whether they conducted their own political risk analysis, and if so, they were required to indicate whether they applied quantitative methods, qualitative methods, or both quantitative and qualitative methods. The results are presented in Table 5.12.

Table 5.12: Whether the respondents conduct political risk analysis in South Africa, and if so, which methods are applied

	Not conducting own political risk analysis	**Applying quantitative methods only**	**Applying qualitative methods only**	**Applying both qualitative methods and quantitative methods**
Number of respondents	24	2	0	5
Percentage of respondents	77	7	0	16

Number of valid responses = 31

The results presented in Table 5.12 are illustrated in Figure 5.6.

Figure 5.6: Whether the respondents are conducting political risk analysis in South Africa, and if so, which methods are applied

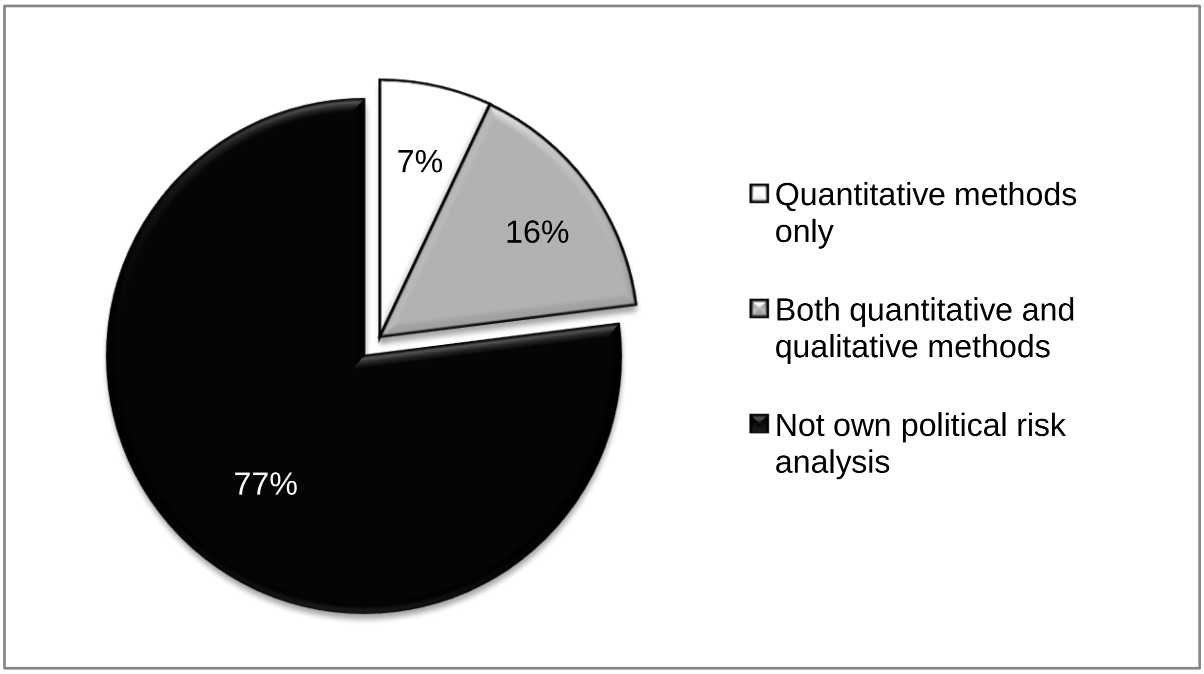


Table 5.12 and Figure 5.6 show that the majority of the respondents (77 per cent) indicated that they do not conduct their own political risk analysis. Both quantitative methods and qualitative methods of political risk analysis are applied by 16 per cent of the respondents who participated in the survey. Only seven per cent of the respondents indicated that they conduct quantitative methods only, while none indicated that they conduct qualitative methods only.

A high proportion of the respondents that indicated that they do not conduct their own political risk analysis, stated that they believed that they receive sufficient information concerning political risk factors in South Africa from Sasria Ltd. Others mentioned that they obtain information from overseas enterprises that specialise in political risk analysis, from current publications, or from reinsurers.

5.2.8 Most important sources of political risk factors in South Africa

Chapter 2 indicated that the sources of political risk factors in emerging market economies are often common. A national strike, for example, could have been instigated by a national labour union. In this example, the national labour union would be regarded as the source of the political risk factor. Some of the possible sources of political risk factors were listed in Question 1.7.1 and Question 1.7.2. The respondents were required to identify the three sources that they regarded as the main origins of political risk factors in South Africa over the past five years (Question 1.7.1) and for the next five years (Question 1.7.2). They were also required to estimate the percentage contribution that each of the identified sources made to their total annual claims amount related to political risk factors. This enabled the researcher to identify which of the three identified sources of political risk factors were considered most important by each of the respondents.

Some respondents did not provide three sources of political risk factors as requested and it was therefore decided to take only the *most* important source according to each respondent into consideration. It is important to note that, since a number of the respondents had not received political risk insurance claims during the past five years, they did not respond to this question and therefore the number of responses was limited. The results from Question 1.7.1 and Question 1.7.2 are presented in Table 5.13 where only the *most* important source of political risk factors according to each respondent is used.

Table 5.13: Most important sources of political risk factors in South Africa, as perceived by the respondents

Source	Past five years		Next five years	
	Number of respondents	Percentage of respondents	Number of respondents	Percentage of respondents
Local governments	5	26	5	26
Provincial governments	0	0	0	0
National government	1	5	0	0
Foreign governments	0	0	0	0
Local labour unions	2	11	3	16
Other local societies	0	0	0	0
Provincial labour unions	1	5	2	11
Other provincial societies	0	0	0	0
National labour unions	10	53	9	47
Other national societies	0	0	0	0
Foreign labour unions	0	0	0	0
Other foreign societies	0	0	0	0

Number of valid responses = 19

Table 5.13 indicates the proportions of the respondents who indicated each source as the *main* source of political risk factors. The results of the past five years can be compared with the expected results for the next five years. To simplify the comparisons, the results presented in Table 5.13 are illustrated in Figure 5.7.

Figure 5.7: Most important sources of political risk factors in South Africa, as perceived by the respondents

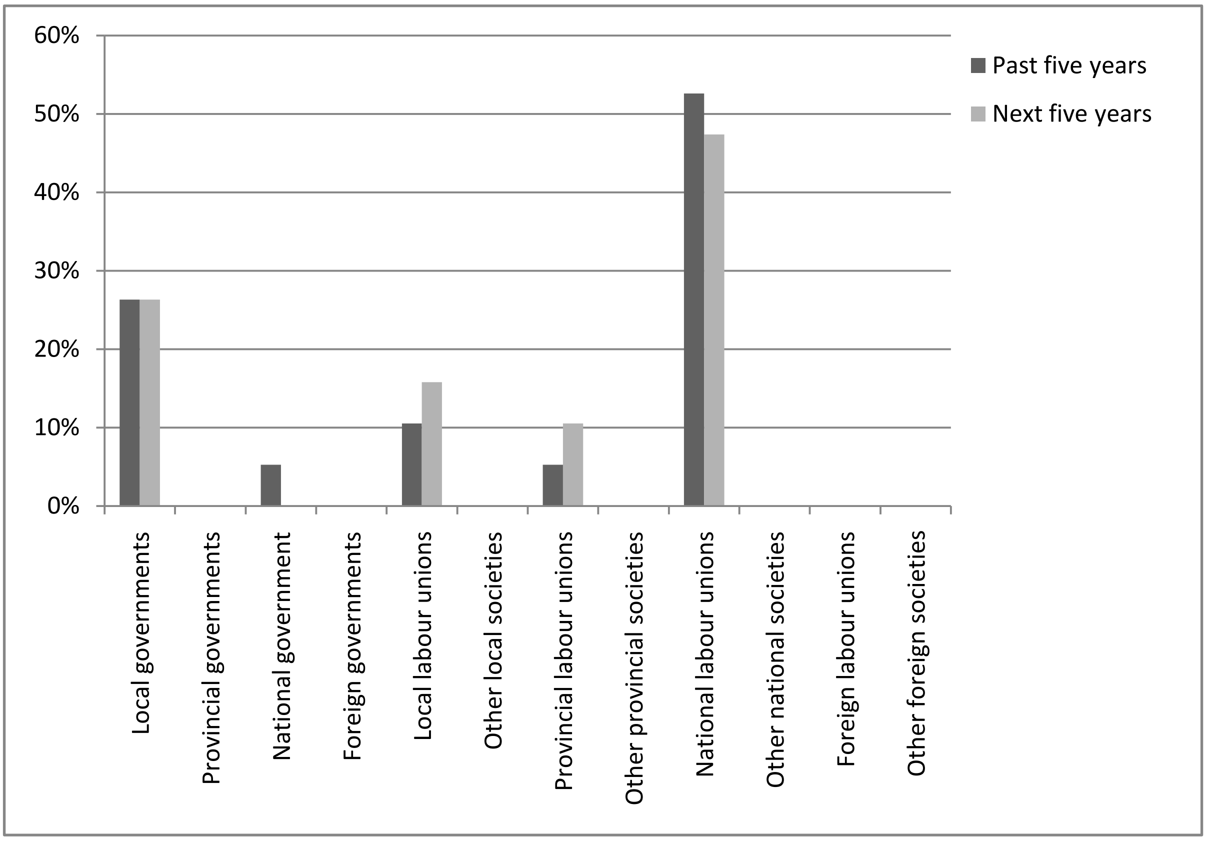


Figure 5.7 clearly illustrates that national labour unions in South Africa were most often identified as the most important source of political risk factors during the past five years (identified by 53 per cent of the respondents). The results also indicate that this finding is not expected to be different during the next five years: national labour unions are expected to remain the most common source of losses related to political risk factors in South Africa (identified by 47 per cent of the respondents). Other sources that were identified included local governments in South Africa, the national government, local labour unions in South Africa and provincial labour unions in South Africa. In general, the results suggest that the main sources of losses related to political risk insurance over the past five years were not expected to change much during the next five years.

An appropriate statistical approach had to be applied in order to determine whether significant changes between the most important sources of political risk factors in South Africa during the past five years and the next five years were expected. The McNemar-Bowker Test was the most appropriate test to be used since it tests whether symmetry exists in contingency tables (Bowker, 1948). It thus tests for changes in observations.

Only five sources could be included in the McNemar-Bowker Test, since seven of the sources were not identified even once by the respondents as the most important source of political risk factors, either during the past five years or for the next five years. The sources included in the McNemar-Bowker Test were local governments in South Africa, the national government of South Africa, local labour unions, provincial labour unions and national labour unions.

Unfortunately, the results for the two periods (past five years and next five years) did not present sufficient change to enable the test to be executed successfully; the test resulted in an error as indicated by the p-value (probability value), which suggested that there are no significant changes in the observations. It can therefore be concluded that the most important sources of political risk factors during the past five years (national labour unions, local governments, the national government, local labour unions and provincial labour unions) are not expected to be different during the next five years.

It was also explained in Chapter 2 that political risk factors can be classified as government-related or society-related. The sources listed in Table 5.13 can be categorised accordingly to determine whether the sources of political risk factors in South Africa are more government-related or society-related. The results are presented in Table 5.14.

Table 5.14: Most important sources of political risk factors in South Africa, classified according to government-related and society-related sources for the past five years and the next five years, as perceived by the respondents

<table>
<tr><th rowspan="2">Category</th><th rowspan="2">Source</th><th colspan="3">Past five years</th><th colspan="3">Next five years</th></tr>
<tr><th>Identified</th><th colspan="2">Category number</th><th>Identified</th><th colspan="2">Category number</th></tr>
<tr><td rowspan="4">Govern-ment-related</td><td>Local governments</td><td>5</td><td rowspan="4" colspan="2">6</td><td>5</td><td rowspan="4" colspan="2">5</td></tr>
<tr><td>Provincial governments</td><td>0</td><td>0</td></tr>
<tr><td>National government</td><td>1</td><td>0</td></tr>
<tr><td>Foreign governments</td><td>0</td><td>0</td></tr>
<tr><td rowspan="4">Society-related (labour unions)</td><td>Local labour unions</td><td>2</td><td rowspan="4">13</td><td rowspan="8">13</td><td>3</td><td rowspan="4">14</td><td rowspan="8">14</td></tr>
<tr><td>Provincial labour unions</td><td>1</td><td>2</td></tr>
<tr><td>National labour unions</td><td>10</td><td>9</td></tr>
<tr><td>Foreign labour unions</td><td>0</td><td>0</td></tr>
<tr><td rowspan="4">Society-related (other than labour unions)</td><td>Other local societies</td><td>0</td><td rowspan="4">0</td><td>0</td><td rowspan="4">0</td></tr>
<tr><td>Other provincial societies</td><td>0</td><td>0</td></tr>
<tr><td>Other national societies</td><td>0</td><td>0</td></tr>
<tr><td>Other foreign societies</td><td>0</td><td>0</td></tr>
</table>

Number of valid responses = 19

In Table 5.14 each of the listed sources are categorised as either government-related or society-related. Society-related sources of political risk factors are separated into labour unions and society-related sources other than labour unions. The number of respondents that indicated each source is indicated. The numbers of the sources that fall in the same categories are added to give a cumulated response for the category. This is done for the past five years as well as for the next five years. According to the results presented in Table 5.14, society-related sources of political risk factors were indicated by more respondents than government-related sources of political risk factors for the past five years (indicated by 13 respondents and six respondents respectively). The finding is not expected to change during the next five years (indicated by 14 respondents and five respondents respectively). If closer attention is paid to the society-related sources of political risk factors for the past five years as well as the next five years, it is clear that the identified sources of political risk factors are labour unions, especially national labour unions.

An appropriate statistical approach had to be applied in order to determine whether significant changes for the two categories during the two periods of concern occurred. The Mosteller Test was the most appropriate test to be used. This test can be used when comparing paired observations and is especially useful when working with small samples (Mosteller, 1951(a); Mosteller, 1951(b)).

The two categories, viz. government-related and society-related sources of political risk factors, were compared for the past five years and the next five years by means of the Mosteller Test. A very small p-value serves as an indication of significant evidence that changes between the two categories exist for the two periods of concern. A p-value of less than 0.05 is typically regarded as significant (Gujarati, 2006:123). The test presented a p-value of 0.25 which suggests that no significant change in the observations was revealed. It can therefore be concluded that society-related sources of political risk factors are expected to remain the most important sources of political risk factors in South Africa during the next five years.

5.2.9 Whether years with big events hosted in South Africa resulted in more claims to short-term insurers in the country

It was mentioned in Chapter 2 that previous research found that the risk of political risk factors is higher in a country during years that see big events take place. Question 1.8 investigated this issue in South Africa. Both 2009 and 2010 saw South Africa host big events: the South African National Elections took place in 2009 and South Africa hosted the 2010 FIFA World Cup. The study briefly investigated the two years. The respondents were required to indicate whether the years 2009 and 2010 presented significantly different total annual claims amounts compared to the immediate preceding years. The results are presented in Table 5.15.

Table 5.15: Changes in total annual claims amounts during years with big events in South Africa, as perceived by the respondents

Category	2009 National Elections			2010 FIFA World Cup		
	Increase of:	Responses	Category response	Increase of:	Responses	Category response
< 0%	-10%	1	2	-30%	1	9
	-3%	1		-15%	2	
				-10%	5	
				-5%	1	
0%	0%	16	16	0%	15	15
1% - 9%	4%	1	1	4%	1	1
10% - 29%	15%	1	4	10%	1	2
	17.5%	1		20%	1	
	20%	2				
30% - 59%	35%	1	1			0
> 60%			0	300%	1	2
				800%	1	

Note: The question with regard to the 2009 National Elections was answered by 24 respondents, while 29 respondents answered the question with regard to the 2010 FIFA World Cup.

Question 1.8.1 and Question 1.8.2 elicited a wide variety of different results as each respondent presented a perceived percentage change. The researcher therefore put the responses into categories in Table 5.15 which would facilitate general conclusions. The percentage of changes recorded by the respondents for 2009 and 2010 are indicated along with the number of respondents who recorded the same change. The number of respondents that fell in the same category were added together to present a cumulated response number for each category.

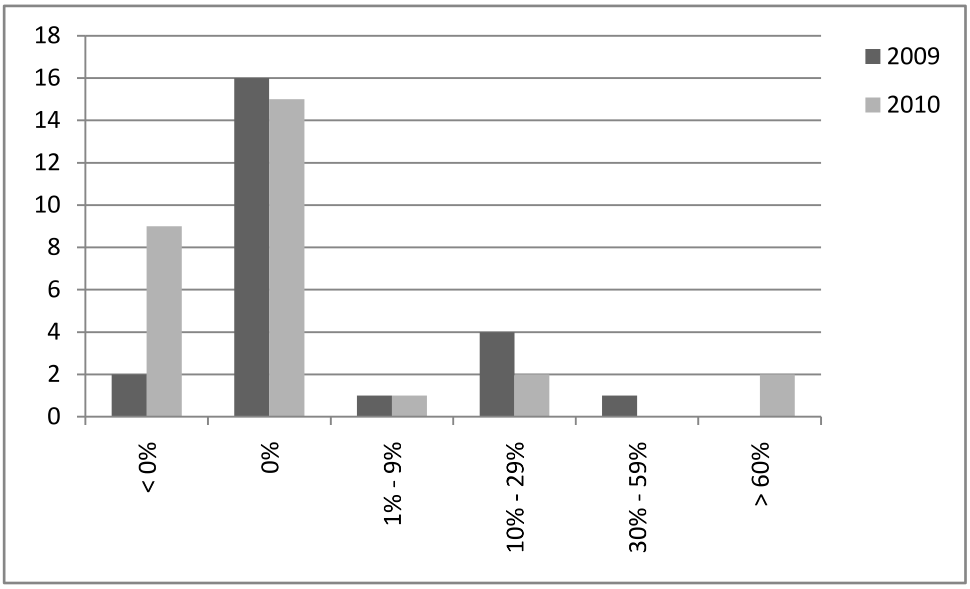
According to the results presented in Table 5.15, the majority of the respondents indicated that there were no changes in the total annual claims amount for either 2009 or 2010 when compared to the immediately preceding years (indicated by 16 respondents and 15 respondents respectively). A large number of respondents indicated that they, in fact, experienced a percentage decrease in the total annual claims amount for 2010, compared to only a few for 2009. Only a minority of respondents indicated a percentage increase in the total annual claims amount for 2009 and 2010. Table 5.16 presents the relevant descriptive statistics of the findings presented in Table 5.15.

Table 5.16: Descriptive statistics for years with big events in South Africa

Event	Mean value	Median value	Standard deviation
2009 National Elections	4.1	0	9.95
2010 FIFA World Cup	35.14	0	157.73

The statistics presented in Table 5.16 enable the reader to get an idea of the distribution of the results presented in Table 5.15. Although the majority of the respondents indicated that they experienced no change or even saw a decrease in the total annual claims amount in 2009 and 2010, the mean values for both periods are positive. The standard deviation is 9.96 for 2009, but 157.73 for 2010. This can be explained by studying Figure 5.8.

Figure 5.8: Percentage change in the total annual claims amount in 2009 and 2010, as perceived by the respondents



The results related to the 2009 National Elections suggest that there was no unusual percentage increase in the total annual claims amount for that year. The main explanation for this finding could be the impact of the economic recession at that time. During an economic recession people cut their expenses and insurance policies were typically one of the first expenses eliminated. This may have led to a decrease in the number of insureds and therefore the percentage change in the total annual claims amount would provide a mean value of about four per cent (according to Table 5.16)

A high proportion of the respondents stated that the main reasons why their enterprises experienced a percentage decrease in their 2010 total annual claims amount was the increased security in South Africa, better infrastructure, and also the good and positive spirit of the public during the 2010 FIFA World Cup. The few respondents who indicated a percentage increase in their 2010 total annual claims amount explained that, since there were more tourists in South Africa in 2010 (mainly due to the FIFA World Cup), more people demanded insurance cover. Consequently, exposure to risk increased and an increase in claims would have been inevitable.

Even though South Africa had two big events in two years, namely the 2009 National Elections and the 2010 FIFA World Cup, there is no indication that these years presented unusual percentage changes in the total annual claims amounts. According to the literature there could have been an increase in political risk factors during these periods, but it does not seem to have had an adverse impact on the South African short-term insurance industry.

5.2.10 Importance of the impact of political risk factors in South Africa

The bulk of the questionnaire formed part of Question 2. It consisted of three broad questions, each focusing on two time periods (past five years and next five years). Question 2 thus consisted of six underlying questions.

It was concluded from Chapter 3 that there are some political risk factors that are common to emerging market economies. A list of 10 of these political risk factors was constructed in order to test how applicable these political risk factors are to South Africa.

Question 2.1 was the first of the three broad questions under Question 2. It required the respondents to rate the political risk factors on a Likert interval scale of importance. Question 2.1.1 required the respondents to indicate the importance of the political risk factors in terms of its impact on their total annual claims amount over the past five years. The five possible responses (extremely, highly, moderately, little and not important) formed a continuum and the responses could therefore be weighted. The results are presented in Table 5.17.

Table 5.17: Importance of the impact of political risk factors over the past five years on the respondents' total annual claims amount

Political risk factor	Extremely important	Highly important	Moderately important	Little important	Not important	Weighted responses
Nationalisation	1	4	3	8	16	62
Confiscation	2	2	4	7	17	61
Creeping expropriation	0	7	5	5	15	68
Currency inconvertibility	2	1	3	8	18	57
Breach of contract	4	1	4	8	15	67
Non-honouring of government payments	3	3	3	6	17	65
War	4	0	3	5	20	59
Violent civil unrest	7	10	6	3	6	105
Non-violent civil unrest	2	7	10	5	8	86
Terrorism	4	1	4	5	18	64

Number of valid responses = 32

Table 5.17 indicates how the respondents rated each of the presented political risk factors in terms of the importance of its impact on their total annual claims amount over the past five years.

Question 2.1.2 required the respondents to indicate the importance of the expected impact of the political risk factors on the total annual claims amount of their enterprises over the next five years. The five possible responses (extremely, highly, moderately, little and not important) formed a continuum and the responses could therefore be weighted. The results are presented in Table 5.18.

Table 5.18: Importance of the expected impact of political risk factors over the next five years on the respondents' total annual claims amount

Political risk factor	Extremely important	Highly important	Moderately important	Little important	Not important	Weighted responses
Nationalisation	6	9	6	3	8	98
Confiscation	6	8	6	5	7	97
Creeping expropriation	6	9	5	6	6	99
Currency inconvertibility	3	2	6	9	12	71
Breach of contract	4	4	4	10	10	78
Non-honouring of government payments	5	8	5	7	7	93
War	6	0	4	8	14	72
Violent civil unrest	12	15	2	3	0	132
Non-violent civil unrest	4	12	5	6	5	100
Terrorism	8	1	9	8	6	93

Number of valid responses = 32

Table 5.18 indicates how the respondents rated each of the presented political risk factors in terms of the importance of its expected impact on their enterprises' total annual claims amount over the next five years.

The results presented in Table 5.17 and Table 5.18 can be compared on the basis of some of their descriptive statistics. The relevant descriptive statistics are presented in Table 5.19.

Table 5.19: Descriptive statistics for the importance of the impact of political risk factors in South Africa on the respondents' total annual claims amount, focusing on the past five years and the next five years

Political risk factor	Past five years		Next five years	
	Weighted mean value	Median value	Weighted mean value	Median value
Nationalisation	1.94	1.5	3.06	3.0
Confiscation	1.91	1.0	3.03	3.0
Creeping expropriation	2.13	2.0	3.09	3.0
Currency inconvertibility	1.78	1.0	2.22	2.0
Breach of contract	2.09	2.0	2.44	2.0
Non-honouring of government payments	2.03	1.0	2.91	3.0
War	1.84	1.0	2.25	2.0
Violent civil unrest	3.28	4.0	4.13	4.0
Non-violent civil unrest	2.69	3.0	3.13	3.5
Terrorism	2.00	1.0	2.91	3.0

Table 5.19 presents the weighted mean value and median value (based on the weights) for each political risk factor over the past five years as well as the next five years. The table should be interpreted as follows: the weighted mean value and median value for nationalisation, for example, were 1.94 and 1.5 respectively over the past five years. For the next five years, however, the weighted mean value and median value for nationalisation are expected to be 3.06 and 3.0 respectively. The weighted mean values can be used to construct a ranking of the most to the least important political risk factors in terms of the importance of its impact on the total annual claims amount of the respondents The ranking for the past five years can then be compared with the expected ranking for the next five years. The median values (based on the weights), on the other hand, can be used to determine whether

there is a significant difference between the ratings of the political risk factors for the past five years and the ratings for the next five years.

Based on the weighted mean values of the political risk factors, it is possible to rank them in a declining order of importance for the past five years as well as for the next five years. This allowed the researcher to identify which political risk factors had the most important impact on the total annual claims amount of the respondents over the past five years, and also whether this ranking is expected to change over the next five years. The ranking is presented in Table 5.20.

Table 5.20: Ranking of the importance of the impact of the political risk factors on the respondents' total annual claims amount over the past five years and the next five years, in a declining order of importance

Past five years			Next five years		
Weighted mean value	**Ranking**	**Political risk factor**	**Weighted mean value**	**Ranking**	**Political risk factor**
3.28	1	Violent civil unrest	4.13	1	Violent civil unrest
2.69	2	Non-violent civil unrest	3.13	2	Non-violent civil unrest
2.13	3	Creeping expropriation	3.09	3	Creeping expropriation
2.09	4	Breach of contract	3.06	4	Nationalisation
2.03	5	Non-honouring of government payments	3.03	5	Confiscation
2.00	6	Terrorism	2.91	6	Non-honouring of government payments
1.94	7	Nationalisation	2.91	6	Terrorism
1.91	8	Confiscation	2.44	8	Breach of contract
1.84	9	War	2.25	9	War
1.78	10	Currency inconvertibility	2.22	10	Currency inconvertibility

Table 5.20 indicates that, over the past five years, violent civil unrest, non-violent civil unrest and creeping expropriation (with weighted mean values of 3.28, 2.69 and

2.13 respectively) have been the most important political risk factors in terms of the importance of its impact on the total annual claims amount of the respondents, while war and currency inconvertibility (with weighted mean values of 1.84 and 1.78 respectively) were the least important political risk factors during this period. The ranking was not expected to change much over the next five years; violent civil unrest, non-violent civil unrest and creeping expropriation (with weighted mean values of 4.13 3.13 and 3.09 respectively) were expected to remain the most important political risk factors, and war and currency inconvertibility (with weighted mean values of 2.25 and 2.22 respectively) were expected to remain the least important political risk factors. Nationalisation and confiscation, however, were expected to move up on the ranking of importance, while breach of contract was expected to move down.

Based on the median values (based on the weights) of the political risk factors, it is possible to determine whether there are significant differences between the ratings of the past five years and the ratings for the next five years. The Wilcoxon Test enabled the study to derive p-values for the changes in the median values (Ferguson, 1987:406-408). Since a p-value of less than 0.05 indicates that the change is significant, it is possible to determine whether there is a significant difference between the median value over the past five years and the median value for the next five years for each political risk factor. The results are presented in Table 5.21.

Table 5.21: Wilcoxon Test for changes in the importance of the impact of political risk factors on the respondents' total annual claims amount, focusing on the past five years and the next five years

Political risk factor	Median value		p-value
	Past five years	Next five years	
Nationalisation	1.5	3.0	0.000355
Confiscation	1.0	3.0	0.000293
Creeping expropriation	2.0	3.0	0.000438
Currency inconvertibility	1.0	2.0	0.016605
Breach of contract	2.0	2.0	0.061885
Non-honouring of government payments	1.0	3.0	0.001696
War	1.0	2.0	0.020880
Violent civil unrest	4.0	4.0	0.000777
Non-violent civil unrest	3.0	3.5	0.018604
Terrorism	1.0	3.0	0.000935

Table 5.21 presents the median value (based on the weights) of the past five years as well as the next five years for each political risk factor. The p-value for the change between the two median values is also provided. Nationalisation, for example, has a median value of 1.5 for the past five years and 3.0 for the next five years respectively. The p-value for this change is 0.000355, which is less than 0.05, and it can therefore be concluded that the change in the median values for nationalisation is significant. There is thus an indication that the median value based on the importance of the impact of nationalisation on the total annual claims amount of the respondents is expected to increase over the next five years in comparison to the past five years.

It is clear from Table 5.21 that, with the exception of breach of contract, the p-values for the political risk factors are all less than 0.05. It can therefore be concluded that the median values based on the importance of the impact of all the political risk factors mentioned (excluding breach of contract and violent civil unrest) on the total annual claims amount should increase during the next five years, compared to the previous five years. The importance of the impact of violent civil unrest should remain the same during the next five years, compared to the previous five years.

Respondents indicated that the constant threat of nationalisation is a major concern and they fear the realisation of this threat. Respondents with clients in the mining industry of South Africa particularly emphasised their concern over possible nationalisation in the future. The threats of confiscation and creeping expropriation also were increasing concerns for the respondents. Confiscation is expected to increase in importance for the agents of Sasria Ltd. insuring multinational enterprises in particular.

5.2.11 Frequency of claims related to political risk factors in South Africa

Question 2.2 was the second of the three broad questions under Question 2 and required the respondents to rate the political risk factors on a scale of frequency. Question 2.2.1 required the respondents to indicate how frequently they received claims related to the political risk factors over the past five years. The five possible responses (always, very often, sometimes, seldom, never) formed a continuum and the responses could therefore be weighted. The results are presented in Table 5.22.

Table 5.22: Frequency of claims related to political risk factors over the past five years, as perceived by the respondents

Political risk factor	Always	Very often	Sometimes	Seldom	Never	Weighted responses
Nationalisation	0	0	0	3	29	35
Confiscation	0	0	0	4	28	36
Creeping expropriation	0	0	0	4	28	36
Currency inconvertibility	0	0	0	0	32	32
Breach of contract	0	0	1	2	29	36
Non-honouring of government payments	0	0	0	2	30	34
War	0	0	0	0	32	32
Violent civil unrest	4	4	6	7	11	79
Non-violent civil unrest	1	1	7	5	18	58
Terrorism	0	0	0	1	31	33

Number of valid responses = 32

According to Table 5.22, 29 respondents indicated that their enterprises had, for example, not received claims related to nationalisation over the past five years. The remaining three respondents indicated that they seldom had claims related to nationalisation over the past five years. It is clear from Table 5.22 that the frequency of claims related to all the political risk factors has generally been low.

Question 2.2.2 required the respondents to indicate how frequently they expected to receive claims related to the political risk factors over the next five years. The five possible responses (always, very often, sometimes, seldom, never) again formed a continuum and the responses could therefore be weighted. The results are presented in Table 5.23.

Table 5.23: Expected frequency of claims related to political risk factors over the next five years, as perceived by the respondents

Political risk factor	Always	Very often	Sometimes	Seldom	Never	Weighted responses
Nationalisation	1	4	5	9	12	66
Confiscation	1	2	5	8	15	59
Creeping expropriation	2	1	8	5	15	63
Currency inconvertibility	1	0	4	7	19	50
Breach of contract	2	1	5	5	18	57
Non-honouring of government payments	1	3	4	7	16	59
War	1	0	0	6	24	41
Violent civil unrest	6	7	7	8	3	98
Non-violent civil unrest	3	3	9	8	8	78
Terrorism	1	0	4	10	16	53

Number of valid responses = 31

According to Table 5.23, 12 respondents indicated that their enterprises do not, for example, expect to receive claims related to nationalisation over the next five years. Another nine respondents recorded ‘seldom’, while five respondents, four respondents and one respondent indicated that they expect to receive claims related to nationalisation sometimes, very often, and always respectively.

The results presented in Table 5.22 and Table 5.23 can be compared on the basis of some of their descriptive statistics. The relevant descriptive statistics are presented in Table 5.24.

Table 5.24: Descriptive statistics for the frequency of claims related to political risk factors in South Africa as perceived by the respondents, focusing on the past five years and the next five years

Political risk factor	Past five years		Next five years	
	Weighted mean value	Median value	Weighted mean value	Median value
Nationalisation	1.09	1.0	2.13	2.0
Confiscation	1.13	1.0	1.90	2.0
Creeping expropriation	1.13	1.0	2.03	2.0
Currency inconvertibility	1.00	1.0	1.61	1.0
Breach of contract	1.13	1.0	1.84	1.0
Non-honouring of government payments	1.06	1.0	1.90	1.0
War	1.00	1.0	1.32	1.0
Violent civil unrest	2.47	2.0	3.16	3.0
Non-violent civil unrest	1.81	1.0	2.52	2.0
Terrorism	1.03	1.0	1.71	1.0

Table 5.24 presents the weighted mean value and median value (based on the weights) for each political risk factor over the past five years as well as for the next five years. The table should be interpreted as follows: the weighted mean value and median value for nationalisation, for example, were 1.06 and 1.0 respectively over the past five years. For the next five years, however, the weighted mean value and median value for nationalisation are expected to be 2.13 and 2.0 respectively. The weighted mean values are used to construct a ranking of the political risk factors based on the frequency level of the related claims. The ranking for the past five years can then be compared to the expected ranking for the next five years. This allowed the researcher to identify which political risk factors most frequently caused claims due to political risk factors over the past five years, and also whether this ranking was expected to change over the next five years. The median values (based on the weights), on the other hand, could be used to determine whether there are

significant differences between the ratings for the past five years and the ratings for the next five years.

The ranking of the political risk factors is presented in Table 5.25.

Table 5.25: Ranking of political risk factors in terms of the frequency of the claims over the past five years and the next five years, in a declining order of frequency

Past five years			Next five years		
Weighted mean value	**Ranking**	**Political risk factor**	**Weighted mean value**	**Ranking**	**Political risk factor**
2.47	1	Violent civil unrest	3.16	1	Violent civil unrest
1.81	2	Non-violent civil unrest	2.52	2	Non-violent civil unrest
1.13	3	Breach of contract	2.13	3	Nationalisation
1.13	3	Confiscation	2.03	4	Creeping expropriation
1.13	3	Creeping expropriation	1.90	5	Confiscation
1.09	6	Nationalisation	1.90	5	Non-honouring of government payments
1.06	7	Non-honouring of government payments	1.84	7	Breach of contract
1.03	8	Terrorism	1.71	8	Terrorism
1.00	9	Currency inconvertibility	1.61	9	Currency inconvertibility
1.00	9	War	1.32	10	War

Table 5.25 indicates that, over the past five years violent civil unrest and non-violent civil unrest (with weighted mean values of 2.47 and 1.81 respectively) were the political risk factors that most frequently resulted in claims from the respondents over the past five years, while currency inconvertibility and war (both with a weighted mean value of 1.00) were the political risk factors that least frequently led to claims during this period. The ranking was not expected to change much over the next five years; violent civil unrest and non-violent civil unrest (with weighted mean values of

3.16 and 2.52 respectively) were expected to remain the political risk factors leading to claims most frequently, and currency inconvertibility and war (with weighted mean values of 1.61 and 1.32 respectively) were expected to remain the political risk factors resulting in claims least frequently. Nationalisation and confiscation, however, were expected to move up on the ranking, while breach of contract was expected to move down.

Based on the median values (based on the weights) of the claims frequency of the political risk factors, it is possible to determine whether there are significant differences between the ratings of the past five years and the ratings for the next five years. The Wilcoxon Test enabled the study to derive p-values for the changes in the median values. Since a p-value of less than 0.05 indicates that the change is significant, it was possible to determine whether there is a significant difference between the median value for the past five years and the median value for the next five years for each political risk factor. The results are presented in Table 5.26.

Table 5.26: Wilcoxon Test for changes in the claims frequency reported by respondents as due to political risk factors, focusing on the past five years and the next five years

Political risk factor	Median value		p-value
	Past five years	Next five years	
Nationalisation	1.0	2.0	0.000132
Confiscation	1.0	2.0	0.000438
Creeping expropriation	1.0	2.0	0.000438
Currency inconvertibility	1.0	1.0	0.002218
Breach of contract	1.0	1.0	0.002218
Non-honouring of government payments	1.0	1.0	0.000655
War	1.0	1.0	0.017961
Violent civil unrest	2.0	3.0	0.001474
Non-violent civil unrest	1.0	2.0	0.001474
Terrorism	1.0	1.0	0.000982

Table 5.26 presents the median value (based on the weights) of the past five years and the next five years for each political risk factor. The p-values for the change between the two median values are also provided. Nationalisation, for example, has a median value of 1.0 for the past five years and 2.0 for the next five years. The p-

value for this change is 0.000132, which is less than 0.05, and it can therefore be concluded that the change in the median values for nationalisation is significant. Thus, there is an indication that nationalisation is expected to lead to more frequent claims on the agents of Sasria Ltd. over the next five years in comparison to the past five years.

It is clear from Table 5.26 that all the political risk factors have p-values smaller than 0.05. It could therefore be concluded that, based on the frequency of claims due to all the political risk factors mentioned, the median values should increase or remain constant during the next five years, compared to the previous five years.

5.2.12 Level of demand for cover against political risk factors in South Africa

Question 2.3 was the final one of the three broad questions under Question 2. The respondents had to indicate the level of demand for cover against the political risk factors that they had experienced on a scale of demand. Question 2.3.1 focused on the past five years. The five possible responses (very high, high, medium, low and very low) formed a continuum and the responses could therefore be weighted. The results are presented in Table 5.27.

Table 5.27: Level of demand for cover against political risk factors over the past five years, as perceived by the respondents

Political risk factor	Very high	High	Medium	Low	Very low	Weighted responses
Nationalisation	1	3	3	8	16	58
Confiscation	1	2	4	8	16	57
Creeping expropriation	1	3	4	6	17	58
Currency inconvertibility	2	2	3	7	17	58
Breach of contract	2	4	2	6	17	61
Non-honouring of government payments	1	4	3	6	17	59
War	4	4	5	6	12	75
Violent civil unrest	8	9	5	2	7	102
Non-violent civil unrest	6	5	6	5	9	87
Terrorism	6	5	3	4	13	80

Number of valid responses = 31

As shown in Table 5.27, 16 respondents indicated that the level of demand for cover against nationalisation, for example, was very low over the past five years. It was rated low by eight respondents, while three respondents recorded medium, another three respondents indicated high demand and one respondent indicated that the demand for cover against nationalisation had been extremely high over the past five years. It can be observed from Table 5.27 that, with the exception of violent civil unrest, the demand for cover against the political risk factors generally had been low.

Question 2.3.2 required the respondents to indicate the level of demand for cover against the political risk factors that their enterprises expected to experience over the next five years. The five possible responses (very high, high, medium, low and very low) again formed a continuum and the responses could therefore be weighted. The results are presented in Table 5.28.

Table 5.28: Expected level of demand for cover against political risk factors over the next five years, as perceived by the respondents

Political risk factor	Very high	High	Medium	Low	Very low	Weighted responses
Nationalisation	1	7	9	7	7	81
Confiscation	1	7	9	6	8	80
Creeping expropriation	1	7	9	5	9	79
Currency inconvertibility	3	3	6	9	10	73
Breach of contract	4	3	8	6	10	78
Non-honouring of government payments	3	7	6	5	10	81
War	5	4	5	7	10	80
Violent civil unrest	11	8	8	1	3	116
Non-violent civil unrest	9	3	11	3	5	101
Terrorism	7	3	6	6	9	86

Number of valid responses = 31

According to Table 5.28, seven respondents indicated that the level of demand for cover against nationalisation, for example, was expected to be very low over the next five years. It was rated low by another seven respondents; nine respondents recorded ‘medium’; another seven respondents indicated ‘high’ and one respondent indicated that the demand for cover against nationalisation was expected to be extremely high over the next five years.

The results presented in Table 5.27 and Table 5.28 can be compared on the basis of some of their descriptive statistics. The relevant descriptive statistics are presented in Table 5.29.

Table 5.29: Descriptive statistics for the demand for cover against political risk factors in South Africa as perceived by the respondents, focusing on the past five years and the next five years

Political risk factor	Past five years		Next five years	
	Weighted mean value	Median value	Weighted mean value	Median value
Nationalisation	1.87	1.0	2.61	3.0
Confiscation	1.84	1.0	2.58	3.0
Creeping expropriation	1.87	1.0	2.55	3.0
Currency inconvertibility	1.87	1.0	2.35	2.0
Breach of contract	1.97	1.0	2.52	2.0
Non-honouring of government payments	1.90	1.0	2.61	3.0
War	2.42	2.0	2.58	2.0
Violent civil unrest	3.29	4.0	3.74	4.0
Non-violent civil unrest	2.81	3.0	3.26	3.0
Terrorism	2.58	2.0	2.77	3.0

Table 5.29 presents the weighted mean value and median value (based on the weights) for each political risk factor over the past five years as well as for the next five years. The table should be interpreted as follows: the weighted mean value and median value for nationalisation, for example, were 1.87 and 1.0 respectively over the past five years. For the next five years, however, the weighted mean value and median value for nationalisation are expected to be 2.61 and 3.0 respectively. The weighted mean values could be used to rank the political risk factors in terms of the level of demand for cover against risk in South Africa. The ranking for the past five years could then be compared to the expected ranking for the next five years. The median values (based on the weights), on the other hand, could be used to determine whether there is a significant difference between the demand for cover for the past five years and the demand for cover during the next five years.

Based on the weighted mean values of the political risk factors it was possible to rank them in a declining manner according to the level of demand for cover against risk over the past five years, as well as the next five years. The political risk factors with the highest level of demand for cover against risk over the past five years in South Africa could then be identified. It also enabled the researcher to determine whether the ranking is expected to change over the next five years. The ranking is presented in Table 5.30.

Table 5.30: Ranking of political risk factors in terms of the level of demand for cover over the past five years and the next five years, in a declining order of the level of demand

Past five years			Next five years		
Weighted mean value	**Ranking**	**Political risk factor**	**Weighted mean value**	**Ranking**	**Political risk factor**
3.29	1	Violent civil unrest	3.74	1	Violent civil unrest
2.81	2	Non-violent civil unrest	3.26	2	Non-violent civil unrest
2.58	3	Terrorism	2.77	3	Terrorism
2.42	4	War	2.61	4	Nationalisation
1.97	5	Breach of contract	2.61	4	Non-honouring of government payments
1.90	6	Non-honouring of government payments	2.58	6	Confiscation
1.87	7	Creeping expropriation	2.58	6	War
1.87	7	Currency inconvertibility	2.55	8	Creeping expropriation
1.87	7	Nationalisation	2.52	9	Breach of contract
1.84	10	Confiscation	2.35	10	Currency inconvertibility

Table 5.30 indicates that, over the past five years, the political risk factors for which the highest levels of demand for cover were observed were violent civil unrest, non-violent civil unrest and terrorism (with weighted mean values of 3.29, 2.81 and 2.58

respectively), while the levels of demand were the lowest for cover against creeping expropriation, currency inconvertibility, nationalisation (each with a weighted mean value of 1.87) and confiscation (with a weighted mean value of 1.84). The ranking was not expected to change in terms of the top three political risk factors over the next five years; violent civil unrest, non-violent civil unrest and terrorism (with weighted mean values of 3.74, 3.26 and 2.77 respectively) were indicated as the three political risk factors for which the highest demand for cover is expected during the next five years. In terms of the remaining seven political risk factors, however, the ranking is expected to change, with some of the notable changes including nationalisation and confiscation moving up the rank and breach of contract and war moving down.

Based on the median values (based on the weights) of the levels of demand for cover against the political risk factors, it was possible to determine whether there are significant differences between the ratings of the past five years and the ratings for the next five years. The Wilcoxon Test enabled the study to derive p-values for the changes in the median values. Since a p-value of less than 0.05 indicates that the change is significant, it was possible to determine whether a significant difference existed between the median value for the past five years and the median value for the next five years for each political risk factor. The results are presented in Table 5.31.

Table 5.31: Wilcoxon Test for changes in the level of demand for cover against political risk factors according to the respondents

Political risk factor	**Median value**		**p-value**
	Past five years	**Next five years**	
Nationalisation	1.0	3.0	0.004193
Confiscation	1.0	3.0	0.002977
Creeping expropriation	1.0	3.0	0.004742
Currency inconvertibility	1.0	2.0	0.014433
Breach of contract	1.0	2.0	0.010827
Non-honouring of government payments	1.0	3.0	0.004742
War	2.0	2.0	0.115852
Violent civil unrest	4.0	4.0	0.017818
Non-violent civil unrest	3.0	3.0	0.017818
Terrorism	2.0	3.0	0.093493

Table 5.31 presents the median value (based on the weights) of the past five years and for the next five years for each political risk factor. The p-value for the change between the two median values is also provided. Nationalisation, for example, has a median value of 1.0 for the past value and of 3.0 for the next five years. The p-value for this change was 0.004193 which was less than 0.05 and it could therefore be concluded that the change in the median values for nationalisation is significant. Thus there was an indication that the level of demand for cover against nationalisation was expected to increase over the next five years in comparison with the level of demand for cover experienced over the past five years in South Africa.

It is clear from Table 5.31 that only war and terrorism have p-values larger than 0.05. It can therefore be concluded that the median values based on the level of demand due to all the political risk factors (excluding war and terrorism) should increase or remain constant during the next five years, compared to the previous five years.

5.2.13 Political risk factors identified as problem areas in South Africa

The second last question of the questionnaire presented the same list of political risk factors that was used for Question 2. In this instance the respondents were required to indentify up to five of the political risk factors from the list that they considered as main problem areas for them as underwriters. The results are presented in Table 5.32.

Table 5.32: Political risk factors identified as problem areas by the respondents, in a declining order according to the number of respondents who identified it

Number of respondents who identified it	Rank according to the number of respondents	Political risk factor
26	1	Violent civil unrest
19	2	Non-violent civil unrest
15	3	Nationalisation
12	4	Terrorism
11	5	Confiscation
9	6	Creeping expropriation
8	7	War
7	8	Non-honouring of government payments
5	9	Breach of contract
3	10	Currency inconvertibility

Note: Some of the respondents did not complete this question or indicated fewer than five problem areas.

Table 5.32 indicates the number of times that each political risk factor was identified as a problem area by the respondents. Based on this number, the political risk factors were also ranked in a decreasing manner. The results indicate that violent civil unrest represents the most common problem area for the respondents in South Africa (indicated 26 times). Non-violent civil unrest is second on the list, followed by nationalisation, terrorism and confiscation (indicated 19 times, 15 times, 12 times and 11 times respectively). Currency inconvertibility, breach of contract and non-honouring of government guarantees were identified as problem areas for the least number of times.

In addition to the identification of the main problem areas, the respondents were also required to provide possible management solutions for the political risk factors that they identified. A general comment made by the respondents concerning the three political risk factors related to nationalisation, confiscation and creeping expropriation was that, in fact, not much can be done to manage these political risk factors. Nationalisation, confiscation and creeping expropriation typically are excluded from the cover provided by most short-term insurers in South Africa and should sometimes rather be obtained from abroad. Currency inconvertibility, breach of contract and the non-honouring of government guarantees also are typically excluded from cover provided by short-term insurers in South Africa. Respondents suggested that legal protection could be a valuable management solution for the non-honouring of government guarantees and breach of contract.

Violent civil unrest, non-violent civil unrest, terrorism and war are political risk factors for which cover is provided by Sasria Ltd. in South Africa. Since Sasria Ltd. was established with the purpose of providing cover against such political risk factors, short-term insurers in South Africa do not provide cover against these political risk factors in their own capacity. These political risk factors therefore are typically excluded from cover provided by short-term insurers in South Africa. Cover against these political risk factors can sometimes be obtained from abroad as well, but it may be very expensive. Additional cover against political riots includes political riot wrap-around cover, which typically provides cover for losses in excess of those covered by Sasria Ltd. According to some respondents, however, an implication of the low frequency of the political risk factors is that the cost of managing it by means of insurance cover could easily outweigh the benefits which are provided.

5.2.14 Provinces in South Africa presenting the largest annual claims amount due to political risk factors

The fourth and final question of the questionnaire required the respondents to indicate up to four provinces in South Africa that presented them with the largest annual claims amount related to political risk factors over the past five years. They also had to indicate up to four provinces that they expect will do so over the next five years. The results are presented in Table 5.33. It is important to bear in mind that the respondents' answers to these questions were mainly determined by the geographic distribution and exposure of their clients.

Table 5.33: Provinces in South Africa presenting the largest annual claims amount due to political risk factors, as perceived by the respondents

Province	Identified	
	Past five years	Next five years
The Eastern Cape	6	11
The Free State	1	3
Gauteng	23	28
Kwazulu-Natal	17	20
Limpopo	5	8
Mpumalanga	8	12
The Northern Cape	0	1
North West	3	3
The Western Cape	13	18

Note: Some of the respondents did not complete this question or provided less than four provinces.

Table 5.33 indicates the number of times that each province of South Africa was identified as one of the main contributors to the annual claims amount related to political risk factors as perceived by the respondents. The three provinces that presented the largest annual claims amount related to political risk factors according to the respondents over the past five years were Gauteng, Kwazulu-Natal and the Western Cape (identified 23 times, 17 times and 13 times respectively). This was not expected to change over the next three years, with Gauteng, Kwazulu-Natal and the Western Cape again being indicated as the provinces expected to present the largest annual claims amount to the respondents (identified 28 times, 20 times and 18 times respectively). Since a large number of business units are situated in Gauteng (especially business headquarters), more exposure to political risk factors should be present in this province. The realisation of more claims related to political risk factors in this region is thus inevitable. On the other hand, Kwazulu-Natal and the Western Cape have been home to a number of struggles between the local political parties which could have been a major contributing factor to the high annual claims amount related to political risk factors in the two provinces.

The Northern Cape, the Free State and North West were identified as the provinces that presented the lowest claims amount related to political risk factors (not identified, once and three times respectively) over the past five years. Over the next five years this ranking was expected to remain the same, with the Northern Cape identified once, and the Free State and North West both identified three times.

5.3 CONCLUSION

This chapter has provided a comprehensive discussion on the results that were obtained from the empirical survey. The results obtained were analysed and processed appropriately in order to derive possible conclusions.

It was concluded from the empirical results and based on the perceptions of the majority of the respondents that:

- The South African public, compared to the need thereof, very often or always purchases political risk insurance.
- The role of political risk insurers (both domestic and foreign) in South Africa is perceived as at least highly important.
- Environmental preservation is at least moderately important as a cause of political risk factors in South Africa, and the political risk factors related to environmental preservation are moderately or highly violent.
- The total premium income of political risk insurance in South Africa has increased over the past five years, and is it expected to continue doing so over the next five years.
- It is at least moderately important that political risk insurance in South Africa should be more flexible concerning the general conditions of coverage, the availability of special endorsements for specific insureds, the extent of cover provided, the acknowledgement of political risk factors, the adjustment of the premiums for levels on an ad hoc basis, and the availability of no-claim bonuses.
- South African agents of Sasria Ltd. do not conduct their own political risk analysis in general.
- Over the past five years the sources of political risk factors in South Africa have mostly been society-related (particularly to labour unions in the country) instead of government-related and this is not expected to change over the next five years.

- There were no unusual changes in the annual claims amount of the respondents in 2009 and 2010 when the country hosted a National Election and the FIFA World Cup respectively.

The results from the empirical study suggested that violent civil unrest and non-violent civil unrest have not only been the political risk factors that had the most important impact on the total annual claims amount of the respondents over the past five years, but they have also been the political risk factors that most frequently resulted in claims. Consequently it did not come as a surprise that they were the two political risk factors for which there had been the highest level of demand over the past five years. In terms of the importance of impact, the frequency of claims and the demand for cover, violent civil unrest and non-violent civil unrest are expected to remain the two most important political risk factors in South Africa over the next five years.

When compared to the past five years, all the political risk factors (excluding breach of contract) are expected to have an increased or constant impact in South Africa over the next five years. They are also expected to present an equal number or more claims in general. At the same time, it is expected that the level of demand for cover against them will remain the same or increase in general, excluding war and terrorism.

The results further suggested that violent civil unrest and non-violent civil unrest have been the most common problem areas for the respondents, while breach of contract and currency inconvertibility have been the least common problem areas.

The findings obtained from the empirical study also suggested that Gauteng, Kwazulu-Natal and the Western Cape have been the provinces in South Africa that presented the largest annual claims amount related to political risk factors over the past five years. These provinces are expected to continue to do so over the next five years.

Having studied this chapter, the reader should have a general idea of the results obtained from the survey. The next chapter provides a concise summary of the results, along with important conclusions and recommendations.

CHAPTER 6

MAIN FINDINGS, RECOMMENDATIONS AND CONCLUSIONS

6.1 INTRODUCTION

The preceding chapters of the study have provided a thorough discussion of the introduction and background, the literature review, the research methodology and the empirical results of the study. Now it is possible to derive conclusions and make recommendations on the basis of the information presented in the aforementioned chapters. This chapter therefore provides a concise summary of the results, along with important conclusions and recommendations.

The first section of this chapter provides a background related to political risk factors and emerging market economies. This is necessary as the literature served as the basis of the study. A discussion of the application of the study comprising the layout of the research as well as the research methodology follows this introductory section.

This chapter further provides a concise summary of the main findings of the study followed by a detailed discussion of the conclusions derived from the main findings. Recommendations will also be made on the basis of the conclusions that are drawn. The final sections of this chapter present various limitations to the study as well as recommendations for future research.

The primary objective of this study was to assist the executives of short-term insurance companies in South Africa in making better risk management decisions and to exercise better control over their responsibilities regarding specific political risk factors. The secondary objective was to identify and assess the various political risk factors existing in South Africa. The reader should also gain a better understanding of political risk factors that may exist in South Africa, which highlights the importance of the availability of sufficient political risk insurance cover.

6.2 BACKGROUND OF THE STUDY

All individuals and enterprises face various risks on a daily basis; this is inevitable and part of our daily lives. The spectrum of these risks is very wide. Risks present themselves in different forms which can vary from health problems or fires to terrorism or tax increases. From a business perspective, making the correct business decisions and determining the appropriate management strategy are crucial to the success of an enterprise due to the ever-present nature of risks in the business environment.

The relationship between politics and business has existed for as long as mankind can remember. The business environment within a country is highly influenced by the country's political system, political climate, and political and business culture. Almost all enterprises, individuals and organisations face some form of political risk on a continuous basis. In the past, mines have been lost, terrorist attacks have been devastating, and financial markets have experienced large losses due to political risk factors. We live in an ever-increasing politically insecure world where political risk factors and the analysis thereof receive increasing attention from both international and domestic establishments.

An important phenomenon of modern-day business is the impact of globalisation. As a result of globalisation, investors continuously seek opportunities in foreign markets and regions. When investors move to foreign markets, more opportunities could arise, but exposure to more risks (economic, socio-cultural and, in particular, political risk) is inevitable. Most investments are faced with political risk factors and therefore political risk factors will always require close attention for as long as global business is pursued. Nowadays multinational enterprises in particular are becoming more concerned about an increase in global political risk factors.

Foreign investment and global business have traditionally been associated with the emerging market economies of the world. In emerging market economies, political risk factors could play a role that is just as important as the economic factors that are decisive in the performance of markets. The emerging market economies of the world share some common general risks, especially political and economic risks. The political and economic environments of the BRICS countries (the Federative Republic of Brazil, the Russian Federation, the Republic of India, the People's Republic of China, and the Republic of South Africa) were studied in order to identify the common political risk factors that exist in each of them.

The findings derived from the investigation of the BRICS countries suggested that all of these emerging market economies have rich natural resources, have very large labour forces and have well-developed industrial sectors. Apart from the common features that have contributed to these countries' rapid economic growth, it was also obvious that all the BRICS countries have political, economic and social issues in common, particularly corruption and economic inequality. Political risk factors therefore are not uncommon at all. Compared to other emerging market economies, Brazil, China and South Africa have enjoyed reasonably stable political environments. In taking a closer look at multinational enterprises in the former BRIC countries, it was found that these enterprises generally seemed to be more concerned about political risk factors than multinational enterprises in developed market economies. The political risk factors of most concern to them have typically been breach of contract and transfer and currency convertibility restrictions. It was obvious that most of the identified issues were common to most of the BRIC countries. As an emerging market economy and the youngest member of the BRICS countries, these findings could therefore also apply to the Republic of South Africa.

6.3 LAYOUT OF THE STUDY

The previous section suggests that political risk factors play an increasingly important role in modern global business. Political risk factors usually enhance the probability of financial losses, which are then expected to be covered by short-term insurance. Terrorism and riots are but a few of the political risk factors that can cause major financial losses to both local and foreign enterprises.

The primary objective of this study therefore is to assist the executives of short-term insurance companies in South Africa to make better risk management decisions and to exercise better control over their responsibilities regarding specific political risk factors. The secondary objective of the study was to identify and assess the various political risk factors that are present in the Republic of South Africa.

The literature review encompassed two chapters. The first chapter dealing with the literature (Chapter 2) provided a theoretical discussion of some of the basic concepts of political risk with attention to its origins and sources, and to its impact not only on the political environment, but also on the economic, socio-cultural, business and investment environments. The process of political risk analysis and the importance of the successful identification, assessment and management response to political risk factors were also studied. Furthermore, the political risk insurance industry was put under the spotlight, with a discussion of its functionality, purpose, some of the main actors in this industry, and the main insurable political risk factors.

The second chapter on the literature (Chapter 3) focused on emerging market economies and the BRICS countries. The BRICS countries were studied specifically to identify political risk factors that might be of concern to this study. The aim was to identify possible political risk factors in these countries and then identify possible solutions to manage such risks appropriately. The identification of political risk factors in the BRICS countries thus formed an important part of the literature review. After the identification of the political risk factors had been completed, the study could commence with the gathering of the necessary primary data.

A questionnaire based on the secondary data served as an *aide-mémoire* for structured personal interviews that were conducted with the agents who sell Sasria insurance on behalf of Sasria Ltd. There were 54 such agents and they formed the target population for this study. These agents mainly were conventional short-term insurers located across the Republic of South Africa. These agents also handled all the claims on behalf of Sasria Ltd. They thus were the first to become aware of any increase in claims due to political risk factors. For this reason it could be assumed that these agents were experts in the field of insurance and had knowledge of all the details and applications of Sasria insurance. They therefore were in an excellent position to provide this study with the necessary primary data. A census was undertaken during which structured personal interviews were pre-arranged with most of the agents. The study had a 71 per cent response rate.

South African short-term insurance companies generally face big challenges regarding the cover provided to the South African public. They therefore need to be aware of the impact that various political risk factors have on the cover that is provided. Valuable information that contributed to the primary objective of the study, namely to improve decision-making by South African short-term insurers when providing insurance cover to the South African public and businesses regarding political risk factors, was provided through the co-operation of the agents that underwrite Sasria insurance in South Africa.

6.4 MAIN FINDINGS OF THE STUDY

The questionnaire consisted of four broad questions. The results obtained were analysed and processed appropriately in order to derive relevant conclusions. The main findings from the questionnaire are presented in this section.

The empirical results obtained on the basis of the *perceptions* of the majority of the respondents led to the conclusion that:

- The South African public very often or always purchases political risk insurance in correspondence with the need thereof.
- The role of political risk insurers (both domestic and foreign) is perceived as at least highly important in South Africa.
- Environmental preservation is seen as at least moderately important as a source of political risk factors in South Africa, and the political risk factors related to environmental preservation are moderately or highly violent.
- The total premium income from political risk insurance in South Africa has increased over the past five years, and it is expected to continue doing so over the next five years.
- It is at least moderately important for political risk insurance in South Africa to be more flexible concerning the general conditions of coverage, the availability of special endorsements for specific insureds, the extent of cover provided, the acknowledgement of political risk factors, the adjustment of the level of premiums on an ad hoc basis, and the availability of no-claim bonuses.
- South African agents of Sasria Ltd. generally do not conduct their own political risk analysis.
- Over the past five years, the causes of political risk factors in South Africa have mostly been society-related (particularly with regard to labour unions in the country) instead of government-related. This is not expected to change over the next five years.
- There were no unusual changes in the annual claims amount of the respondents when the country had a National Election in 2009 and hosted the FIFA World Cup in 2010.

The results obtained from the empirical study suggested that violent civil unrest and non-violent civil unrest were at the root of the *political risk factors* that had the most important impact on the total annual claims amount of the respondents over the past five years, and have also been the political risk factors that most frequently resulted in claims. Consequently it did not come as a surprise that they were the two political risk factors for which there had been the highest level of demand for cover over the past five years. In terms of the importance of impact, the frequency of claims and the demand for cover, violent civil unrest and non-violent civil unrest are expected to remain the two most important political risk factors in South Africa over the next five years. When compared to the past five years, all the political risk factors (excluding breach of contract) are expected to have an increased or constant impact in South Africa over the next five years. They are also expected to present an equal number or more claims in general. At the same time, it is expected that the demand for cover against them is expected to remain the same or to increase in general, with the exclusion of war and terrorism.

The results further suggested that violent civil unrest and non-violent civil unrest have been the most common *problem areas* for the respondents, while breach of contract and currency inconvertibility have been the least common problem areas.

The findings obtained from the empirical survey also suggested that Gauteng, Kwazulu-Natal and the Western Cape are the *provinces* in South Africa that presented the largest annual claims amount related to political risk factors over the past five years. According to the respondents, these provinces should continue to do so over the next five years.

6.5 CONCLUSIONS OF THE STUDY

The study found that the South African public very often or always purchases political risk insurance in relation to the need thereof. It is important to understand that political risk insurance is not always to be seen an optional addition to a short-term insurance policy, and can sometimes be included automatically by short-term insurers. Sometimes political risk insurance is a compulsory addition to personal policies and / or commercial policies. Whether it will be included automatically often depends on the line of business underwritten by the insurer. This can explain why the results indicate that political risk insurance is purchased very often, but not always, by the South African public.

There seems to be a general belief that political risk insurers (both domestic and foreign) play an *important role* in South Africa, with the results suggesting that the role of political risk insurers in South Africa is perceived as at least highly important. This finding was based on the respondents' experiences or need for political risk insurance in the past. A large number of the respondents indicated that they did not receive any claims for losses related to political risk factors in the recent past. These respondents consequently indicated that political risk insurers may not be playing an important role in South Africa. The findings, however, still suggested that the role of political risk insurers in South Africa were rated as having a moderate to high level of importance. A possible explanation for the higher level of importance could be the respondents' expectations regarding the occurrence of political risk factors in the future, as well as their attitudes towards political risk insurers.

That *environmental preservation* can be an important source of political risk factors in emerging market economies was discussed in a previous chapter. As a source of political risk factors in South Africa, environmental preservation is seen as at least moderately important and the political risk factors related to environmental preservation are regarded as moderately or highly violent in the country. Although it was indicated that environmental preservation might not be an important source of political risk factors in South Africa as yet, it may become more important in the near future if environmental conditions worsen. When studying the degree to which political risk factors stemming from environmental preservation in South Africa can be rated as violent, the results suggested that such political risk factors traditionally are not of a violent nature. This does not come as much of a surprise if one considers the type of individual who is typically expected to show dissatisfaction on account of environmental preservation or the failure thereof; the so-called "green" people have generally not been seen as violent individuals.

The *total premium income* from political risk insurance in South Africa has increased over the past five years and it is expected to continue to increase over the next five years. The most obvious reason for this forecast was that the total premium income could increase due to an increase in political risk insurance rates. Another reason was the fact that premium income is typically determined by the underlying value of the insured assets and the total premium income could therefore increase if the underlying assets increase in value.

It is at least moderately important that political risk insurance in South Africa should be more flexible with regard to the general conditions of coverage, the availability of special endorsements for specific insureds, the extent of cover provided, the acknowledgement of political risk factors to be covered, the adjustment of the level of premiums on an ad hoc basis, and the availability of no-claim bonuses. In terms of the *availability of special endorsements* for specific insureds, the importance of having tailor-made policies for insureds is highlighted. Business interruption insurance often is not included in political risk insurance policies and some respondents indicated that this should be the case; this would thus fall under the *extent of cover* provided. Whether it is important that the *level of premiums* should be adjusted on an ad hoc basis depends highly on the line of business, viz. the cost of political risk insurance for personal / individual insurance cover is usually low, while commercial insurance cover in South Africa can be costly. Risks differ in different geographical regions and in different industries and premiums consequently could be adjusted on the basis of the aforementioned aspects in particular. It might also be a good idea for political risk insurers to take the insured's claims history into consideration when calculation his / her political risk insurance premium. When focusing on the importance of providing more flexibility concerning the *availability of no-claim bonuses* to all insureds, the line of the respondent's business once again plays an important role. The general consensus was that a no-claim bonus is important for commercial insurance since such premiums are generally high, while individuals pay low premiums and might therefore not be concerned about receiving a no-claim bonus. Additionally, since some political risk insurers in South Africa have not received any political risk insurance claims in years, it could be important to them that more flexibility concerning the availability of no-claim bonuses should be provided to all insureds. There were no comments concerning more flexibility in terms of the *general conditions* of cover or the *leniency of acknowledging political risk factors,* as these two aspects of political risk insurance speak for themselves.

South African agents of Sasria Ltd. generally do not conduct their own *political risk analysis.* Most of the agents believe that they receive sufficient information concerning political risk factors in South Africa from Sasria Ltd. Other agents obtain the information from overseas enterprises that specialise in political risk analysis, from current publications, or from reinsurers.

It was found that the *sources from which political risk factors arise* in emerging market economies are often fairly common. A national strike, for example, could be instigated by a national labour union. In this instance, the national labour union would be regarded as the source of the political risk factor. National labour unions have most often been identified as the main sources of political risk factors in South Africa over the past five years. Other important sources that were identified in South Africa include local governments, the national government, local labour unions and provincial labour unions. The most important sources of political risk factors in the country over the past five years (national labour unions, local governments, the national government, local labour unions and provincial labour unions) are not expected to be different over the next five years. It was also concluded that the sources of political risk factors in South Africa have mostly been society-related (particularly regarding labour unions in the country) instead of government-related over the past five years; this also is not expected to change over the next five years.

Traditionally there have been two major underlying *motivations for riots and strikes* in South Africa in recent times. The first involves poor service delivery: local municipalities are regarded as the parties responsible for this issue, with the result that local governments in South Africa have emerged as an important source of political risk factors in the country. The other major underlying motivation for riots and strikes in South Africa is derived from wage disputes: labour unions (particularly local labour unions and national labour unions) have typically been the instigators of such events. It has happened that other labour unions were often soon to follow when one labour union has started a strike. What may have started off as a local strike, for example, could thus easily have developed into a national strike. Local labour unions and national labour unions are therefore considered as major sources of political risk factors in South Africa.

Previous research has found that the risk from political risk factors is higher during years that see *big events* take place in a country. Both 2009 and 2010 saw South Africa hosting big events: the South African National Elections took place in 2009 and South Africa hosted the 2010 FIFA World Cup. Concerning 2009, it was found that there was no unusual percentage increase in the total annual claims amount for that year. The main explanation for this finding may be the impact of the economic recession at the time. During an economic recession people cut their expenses and insurance policies typically are one of the first expenses to be eliminated. This may have led to a decrease in the number of insureds and therefore the percentage change in the total annual claims amount would be small. Concerning 2010, it was found that some agents of Sasria Ltd. experienced a percentage decrease in their total annual claims amount for that year. This could be credited to the increased security in South Africa, the better infrastructure, and also the good and positive spirit of the public during the 2010 FIFA World Cup. However, since there were more tourists in South Africa in 2010 (mainly due to the FIFA World Cup), some agents would have experienced an increase in the demand for insurance cover. Exposure to risk consequently increased and an increase in claims would have been inevitable. This may explain why the percentage change in the 2010 total annual claims was relatively small.

Even though South Africa hosted two big events in two years, namely the 2009 National Elections and the 2010 FIFA World Cup, there was no indication that these years presented unusual percentage changes in the total annual claims amounts. The literature suggested that there could have been an increase in political risk factors during these periods, but it does not seem to have had an adverse impact on the South African short-term insurance industry.

The conclusion drawn from Chapter 3 was that ten *political risk factors* are common to emerging market economies. These political risk factors are nationalisation, confiscation, creeping expropriation, currency inconvertibility, breach of contract, non-honouring of government guarantees, war, violent civil unrest, non-violent civil unrest and terrorism. The ten political risk factors were studied in the South African context from three aspects, namely the importance of their impacts, the frequency that the factors led to claims, and the demand for cover against them. A comparison was made between what happened in the past five years and what is expected to happen in the next five years for each of the aspects examined.

Violent civil unrest, non-violent civil unrest and creeping expropriation were identified as the most important political risk factors in terms of the *importance* of its impact on the total annual claims amount of the respondents over the past five years, while war and currency inconvertibility were the least important political risk factors during this period. This is not expected to change over the next five years. It was also found that, with the exception of breach of contract, the importance of the impact of all the political risk factors mentioned on the total annual claims amount should increase or remain constant during the next five years, compared to the previous five years.

Violent civil unrest and non-violent civil unrest were the political risk factors that most *frequently* resulted in claims from the respondents over the past five years, while currency inconvertibility and war were the political risk factors that least frequently led to claims during this period. This is not expected to change over the next five years, but it was also indicated that the frequency of claims due to all the political risk factors mentioned should increase or remain constant over the next five years, compared to the previous five years.

The political risk factors for which the highest *levels of demand* for cover existed over the past five years were violent civil unrest, non-violent civil unrest and terrorism, while the levels of demand were the lowest for cover against creeping expropriation, currency inconvertibility, nationalisation and confiscation. It was found that, with the exception of violent civil unrest, the demand for cover against the political risk factors had generally been low. The level of demand is expected to be the highest for violent civil unrest, non-violent civil unrest and terrorism over the next five years, while the level of demand is expected to be the lowest for creeping expropriation, breach of contract and currency inconvertibility over this period. It was also found that the level of demand for cover against all the political risk factors (excluding war and terrorism) should increase or remain constant over the next five years, compared to the previous five years.

Violent civil unrest, non-violent civil unrest, terrorism and war are political risk factors for which *cover is provided* by Sasria Ltd. in South Africa. Since Sasria Ltd. was established with the purpose of providing cover against such political risk factors, short-term insurers in South Africa do not provide cover against these factors in their own capacity. These political risk factors therefore are typically excluded from cover provided by short-term insurers in South Africa. While cover against these political risk factors can sometimes be obtained from abroad, it may be very expensive. Additional cover against political riots includes political riot wrap-around cover, which typically provides cover for losses in excess of those covered by Sasria Ltd. However, an implication of the low frequency of the political risk factors is that the cost of managing it by means of insurance cover could easily outweigh the benefits which are provided. When focusing on nationalisation, confiscation and creeping expropriation, a general consensus is that not much can in fact be done to manage these political risk factors. The three aforementioned political risk factors are therefore typically excluded from the cover provided by most short-term insurers in South Africa and cover is sometimes rather obtained from abroad.

Violent civil unrest, non-violent civil unrest, nationalisation, terrorism and confiscation provided the most common *problem areas* for the agents of Sasria Ltd. in South Africa. Currency inconvertibility, breach of contract and the non-honouring of government guarantees, on the other hand, were the least common problem areas in the country. The latter three political risk factors are also typically excluded from cover provided by short-term insurers in South Africa. Legal protection would be a valuable management solution for the non-honouring of government guarantees and breach of contract.

The study found that the three *provinces* of South Africa that presented the largest annual claims amount related to political risk factors over the past five years were Gauteng, Kwazulu-Natal and the Western Cape. This is not expected to change as these provinces are expected to continue presenting the largest annual claims amount related to political risk factors over the next five years. It is important to keep in mind that the findings are highly dependent on the geographic distribution and exposure of the clients of the respondents to the survey. Since a large number of business units are situated in Gauteng (especially business headquarters) the exposure to political risk factors should be greater in this province. The realisation of more claims related to political risk factors in this region is thus inevitable. However, Kwazulu-Natal and the Western Cape have been home to a number of struggles between the local political parties, which could have been a major contributing factor to the high annual claims amount related to political risk factors in the two provinces. The Northern Cape, the Free State and North West, on the other hand, have been the provinces that presented the lowest claims amount related to political risk factors over the past five years and it is expected that this will continue to be the case over the next five years.

6.6 RECOMMENDATIONS FROM THE STUDY

This study ultimately provides valuable information to the executives of short-term insurance companies in South Africa in particular; the findings could assist these executives in making better risk management decisions in South Africa and to exercise better control over their responsibilities concerning specific political risk factors. These recommendations are made on the basis of the main findings of the study.

As opportunities for risk management seem to exist, the conclusion can be drawn that current political risk insurers in South Africa may face the *threat of new entrants* to the market. The South African public "very often" or "always" purchases political risk insurance in accordance with the need thereof and political risk insurers play an important role in this country. Additionally, it would not be unusual for the total premium income from political risk insurance in South Africa to increase over the next five years, and years that see the country host big events may not present unusual changes to the industry's total annual claims amount. The future outlook for this market could therefore be positive and, consequently, attractive.

Environmental preservation is an issue that should be closely monitored by the short-term insurance industry of South Africa. This issue has been at least moderately important as a source of political risk factors in the country, and the political risk factors related to this issue have been rated as moderately or highly violent. Environmental preservation could therefore become an important source of political risk factors and could lead to significant claims in the future.

Political risk insurers in South Africa could accommodate their South African clients by being *more flexible* concerning the following aspects of political risk insurance:

- the general conditions of cover;
- the availability of special endorsements for specific insureds;
- the extent of coverage provided;
- more leniency in acknowledging political risk factors;

- setting the level of premiums on an ad hoc basis; and
- the availability of no-claim bonuses to all insureds.

Some recommendations related to the aforementioned aspects include the importance of constructing *tailor-made policies* to specific insureds and incorporating *business interruption insurance* in political risk insurance policies. Since risks are different in various *geographical regions and industries*, political risk insurance premiums could be adjusted on the basis of these differences. This argument is supported by the finding that Gauteng, Kwazulu-Natal and the Western Cape are the three provinces in South Africa that have presented the largest annual claims amount, while the Northern Cape, the Free State and North West have presented the smallest annual claims amount. The difference in political risk exposure between provinces is therefore clear, which suggests that political risk insurance premiums should differ accordingly. Political risk insurers could also take the *claims history* of an insured into consideration when calculation his / her political risk insurance premium. The availability of *no-claim bonuses* to all insureds should be a serious consideration, specifically for commercial insurance policies.

It could be to the benefit of political risk insurers in South Africa to adjust policies on the basis of whether claims related to political risk factors are *society-related or government-related*. As long as service delivery and wage disputes remain constant issues in South Africa, as is expected to be the case, society-related sources of political risk factors should remain the most important sources of political risk factors in the country. However, as soon as government-related sources of political risk factors become a reality, political risk factors such as nationalisation and confiscation should lead to enormous claims. It may therefore be a good innovation on the part of political risk insurers in South Africa to separate the cover and premiums for society-related sources and government-related sources of political risk factors.

The study has found that ten *political risk factors* are common to emerging market economies. These are nationalisation, confiscation, creeping expropriation, currency inconvertibility, breach of contract, non-honouring of government guarantees, war, violent civil unrest, non-violent civil unrest and terrorism. Cover has not been provided against all of these political risk factors by political risk insurers in South Africa. Violent civil unrest and non-violent civil unrest have been the two most significant political risk factors in South Africa, but the other political risk factors should not be ignored. There may be opportunities for political risk insurers in South Africa to develop cover against such political risk factors. This is supported by three of the findings from the study that clearly indicate that it would be a good idea for the industry to develop such cover against political risk factors for which no cover exists in South Africa. These findings state that:

- The importance of the impact of all the political risk factors mentioned (excluding breach of contract) on the total annual claims amount should increase or remain constant in the near future.
- The frequency of claims due to all the political risk factors mentioned should increase or remain constant in the near future.
- The level of demand for cover against all the political risk factors mentioned (excluding war and terrorism) should increase or remain constant in the near future.

In addition to the above findings, violent civil unrest, non-violent civil unrest, nationalisation, terrorism and confiscation were identified as the most common *problem areas* for the agents of Sasria Ltd., which suggests that the available cover may not be comprehensive and sufficient. Cover for political risk factors for which cover is not available in South Africa is often obtained from abroad. Such cover may be expensive, which suggests that it may be feasible and beneficial for political risk insurers in South Africa to provide such cover.

6.7 LIMITATIONS TO THE STUDY

This study was limited by the fact that, due to time and financial constraints, not all the emerging market economies in the world could be studied to identify and understand the existence and occurrence of political risk factors. Only the BRICS countries were studied to identify the main political risk factors in emerging market economies. It is therefore possible that some political risk factors may have been overlooked and therefore excluded from the empirical survey. It should also be borne in mind that this study could only be as good as the data available to it. If insufficient or false data were gathered, or the studies of the BRICS countries were inaccurate, important political risk factors could have been overlooked as a result, or assessment of the identified political risk factors could have led to inaccurate results.

As already mentioned, this study unfortunately did not have a 100 per cent response rate as only 32 of the potential 45 respondents took part in the empirical survey (71 per cent response rate). Thus there is a possibility that the findings of the empirical survey may have been different had the other 13 respondents (29 per cent) participated in the survey.

Another limitation of this study arose from the nature of the indicators of political risk factors. It should be understood that, as explained in Chapter 2, the indicators of political risk factors vary and change on a continuous basis. It should be added that, although the occurrence of the indicators may vary, the financial impact of the political risk factors is generally more stable.

Another limitation is due to the fact that the findings of the study are based on the perceptions of individuals. The responses may therefore not have provided accurate representations of the agents that underwrite Sasria insurance in South Africa. It could be argued, though, that the structured personal interviews should have presented acceptable and accurate results.

6.8 RECOMMENDATIONS FOR FUTURE RESEARCH

The findings of the study revealed numerous opportunities for future research. More emerging market economies could be studied in order to identify other political risk factors that could be applicable to South Africa. These political risk factors should then be included in a survey and a higher response rate may be desirable.

It is also recommended that a similar study should be conducted by applying historic and accounting information. This should present more accurate findings in terms of the actual impact of political risk factors on the total annual claims amount of short-term insurance companies in South Africa.

The most obvious recommendations for future research are related to adjustments in cover for political risk factors in South Africa and the development of more extensive cover against political risk factors. The empirical survey suggested that it is at least moderately important that political risk insurance in South Africa should be more flexible concerning the general conditions of coverage, the availability of special endorsements for specific insureds, the extent of cover provided, the acknowledgement of political risk factors, the adjustment of the level of premiums on an ad hoc basis, and the availability of no-claim bonuses. How political risk insurance in South Africa could be made more flexible concerning the aforementioned aspects should be investigated. The possibility of developing an appropriate method to adjust premiums on the basis of geographical region should be investigated, particularly when studying the possibility of adjusting the level of premiums on an ad hoc basis, since this study has clearly indicated that some provinces contribute more to the annual claims amount of short-term insurance companies concerning political risk insurance than other provinces in South Africa.

This study has indicated that some political risk factors are expected to increase in terms of the importance of their impact, the frequency of claims that they present, and the level of demand for cover against such risks. The possibility of new insurance products should therefore be investigated. As mentioned, cover against all the political risk factors that were identified in the BRICS countries is not available in South Africa. Cover against nationalisation, for example, is a possible product which could be developed. Additionally, how much clients would be willing to pay for such cover could also be investigated. Cover against the most common political risk factors in South Africa, such as violent civil unrest, could also be adjusted in terms of conditions and cost to justify the fact that it may be the most important political risk factor in South Africa (as suggested by this study).

This study found that the annual claims amount of South African short-term insurance companies related to political risk factors differs across provinces. A similar study could be conducted to compare the annual claims amount related to political risk factors for various industries. It should be valuable to be able to differentiate between industries on this basis.

It was mentioned in a Chapter 2 that political risk insurance will not provide insurance cover to the insured if the insured is engaged in corruption or contributes to environmental preservation. Corruption therefore was not investigated as a political risk factor in South Africa, even though it was identified as a political risk factor which is common to emerging market economies. This study did include a brief glance at political risk factors related to environmental preservation in South Africa. Corruption and environmental preservation could therefore be topics for further research in South Africa.

6.9 CONCLUDING REMARKS

This chapter has presented a discussion on the political risk factors and emerging market economies which served as the background and introduction to the study. A discussion of the layout of the study followed. This included information on the research methodology as well as the empirical research which was done.

This was followed by a concise summary of the main findings of the study, the conclusions drawn from the findings of the research, and recommendations derived from the findings. Various limitations of the study that were identified, were provided and recommendations for future research have also been provided.

The primary objective of this study was to assist the executives of short-term insurance companies in South Africa to make better risk management decisions and to exercise better control over their responsibilities regarding specific political risk factors. The secondary objective was to identify and assess the various political risk factors in South Africa. The information that has been presented should have given the reader a clear understanding of how this study could assist the executives of short-term insurance companies in South Africa to make such decisions and exercise better control over their responsibilities. The reader should also have a better understanding of the political risk factors that may present a threat in South Africa, which highlights the importance of having appropriate political risk insurance cover.

The importance of the study and the findings that were derived from it does not require further elaboration. Political risk factors will not disappear in the future; they are here to stay. Terrorism, civil strife, war and expropriation are but a few examples of political risk factors that will continue to exist. Political risk insurance in South Africa should therefore constantly be adapting; the industry should constantly be on the lookout for possible modifications and adjustments to the products that are available at present, and should strive to develop and provide cover against political risk factors for which cover may not be available in the country. This should enable short-term insurers in South Africa to provide better cover to the South African public and businesses at large.

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APPENDIX A:

Copy of Questionnaire

UNIVERSITEIT·STELLENBOSCH·UNIVERSITY
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Faculty of Economic and Management Sciences
Department of Business Management

Questionnaire on the short-term insurance of political risks in South Africa

PLEASE NOTE:

The information obtained will be treated in the strictest confidence and in such a manner that no enterprise can be identified.

Please provide the following information:

Name of your enterprise	
Position of the official who completes the questionnaire	
Your telephone number	
Your e-mail address	

1. Please complete the following questions by making a cross [X] in the applicable blocks.

1.1 Please indicate how **frequently** the South African public **purchases** political risk insurance compared to the need thereof, according to your perception (where always, very often, sometimes, seldom and never form a continuum).

Always	Very often	Sometimes	Seldom	Never

1.2 Please indicate how **important** you currently perceive the **role** of political risk **insurers** in South Africa (where extremely, highly, moderately, little and not important form a continuum).

Extremely important	Highly important	Moderately important	Little important	Not important

1.3.1 Please indicate how **important** you currently perceive environmental preservation (such as clean air and water) to be as a **source** of political risk factors in South Africa (where extremely, highly, moderately, little and not important form a continuum).

Extremely important	Highly important	Moderately important	Little important	Not important

1.3.2 Please indicate the **degree of violence** of the political risk factors that originate due to **environmental preservation** in South Africa, according to your current perception (where extremely, highly, moderately, little and non-violent form a continuum).

Extremely violent	Highly violent	Moderately violent	Little violent	Non-violent

1.4.1 Please provide the approximate **percentage change**, in monetary terms, of the total premium income of political risk insurance during the **past five years**.

Increase	**Decrease**	**Percentage change**	**Unsure**

1.4.2 Please provide the expected **percentage change**, in monetary terms, of the total premium income of political risk insurance during the **next five years**.

Increase	**Decrease**	**Percentage change**	**Unsure**

1.5 Please indicate the **importance** of providing more **flexibility** concerning the following aspects of political risk insurance (where extremely, highly, moderately, little and not important form a continuum).

Aspects of political risk insurance	**Extremely important**	**Highly important**	**Moderately important**	**Little important**	**Not important**
General conditions of coverage					
Availability of *special* endorsements for specific insureds					
Extent of coverage provided					
More leniency in acknowledging political risk factors					
Level of premiums on an ad hoc basis					
Availability of no-claim bonuses to all insureds					
Other (please specify):					

1.6 As underwriter, does your enterprise conduct any form of **political risk analysis** in **general**?

Yes	No	Unsure

If **YES**, please indicate which **approach(es)** you use

Quantitative methods	Qualitative methods	Both quantitative and qualitative methods

1.7.1 Please indicate the **three sources** that you perceive as the main causes of the political risk factors that caused the largest **annual claims amount** of your enterprise over the **previous five financial years**.

Also estimate the **percentage contribution** of these sources to your enterprise's **total annual claims amount** for the **same period**.

Source	Three main sources	Percentage contribution to your total annual claims amount
Local governments in South Africa		
Provincial governments in South Africa		
National government of South Africa		
Foreign governments		
Local labour / trade unions in South Africa		
Other local societies in South Africa		
Provincial labour / trade unions in South Africa		
Other provincial societies in South Africa		
National labour / trade unions in South Africa		
Other national societies in South Africa		
Foreign labour / trade unions		
Other foreign societies		
Other (please specify):		

1.7.2 Please indicate the **three sources** that you perceive as the main causes of the political risk factors that will cause the largest **annual claims amount** of your enterprise over the **next five financial years**.

Also estimate the **percentage contribution** of these sources to your enterprise's **total annual claims amount** for the **same period**.

Source	Three main sources	Percentage contribution to your total annual claims amount
Local governments in South Africa		
Provincial governments in South Africa		
National government of South Africa		
Foreign governments		
Local labour / trade unions in South Africa		
Other local societies in South Africa		
Provincial labour / trade unions in South Africa		
Other provincial societies in South Africa		
National labour / trade unions in South Africa		
Other national societies in South Africa		
Foreign labour / trade unions		
Other foreign societies		
Other (please specify):		

1.8.1 What was the **percentage change** in the **total annual claims amount** of your enterprise due to the **2010 FIFA World Cup** compared to the immediate preceding financial year?

Increase	Decrease	Percentage change	Unsure

1.8.2 What was the **percentage change** in the **total annual claims amount** of your enterprise due to the **2009 National Elections** compared to the immediate preceding financial year?

Increase	Decrease	Percentage change	Unsure

2. Please make crosses [X] in the applicable blocks when you answer the following questions.

2.1 Impact of political risk factors (irrespective of a particular political risk insurer).

2.1.1 How **important** do you perceive the **impact** of the following **political risk factors** in terms of the **total annual claims amount**, due to political risk factors, of your enterprise over the **past five financial years** (where extremely, highly, moderately, little and not important form a continuum)?

Political risk factor	**Extremely important**	**Highly important**	**Moderately important**	**Little important**	**Not important**
Nationalisation (with compen-sation)					
Confiscation (without any com-pensation)					
Creeping expropriation					
Currency inconvertibility					
Other regulatory discrimination (excluding the above four). Please specify:					
Breach of contract by non-government parties					
Non-honouring of government guarantees					
War					
Violent civil unrest					
Non-violent civil unrest					
Terrorism					
Other (please specify)					

2.1.2 How **important** do you perceive the **impact** of the following **political risk factors** in terms of the **total annual claims amount**, due to political risk factors, of your enterprise over the **next five financial years** (where extremely, highly, moderately, little and not important form a continuum)?

Political risk factor	**Extremely important**	**Highly important**	**Moderately important**	**Little important**	**Not important**
Nationalisation (with compensation)					
Confiscation (without any compensation)					
Creeping expropriation					
Currency inconvertibility					
Other regulatory discrimination (excluding the above four). Please specify:					
Breach of contract by non-government parties					
Non-honouring of government guarantees					
War					
Violent civil unrest					
Non-violent civil unrest					
Terrorism					
Other (please specify):					

2.2 Frequency of claims (irrespective of a particular political risk insurer).

2.2.1 How **frequently** did your enterprise **receive claims** due to the following political risk factors over the **past five financial years** (where always, very often, sometimes, seldom and never form a continuum)?

Political risk factor	**Always**	**Very often**	**Sometimes**	**Seldom**	**Never**
Nationalisation (with compensation)					
Confiscation (without any compensation)					
Creeping expropriation					
Currency inconvertibility					
Other regulatory discrimination (excluding the above four). Please specify:					
Breach of contract by non-government parties					
Non-honouring of government guarantees					
War					
Violent civil unrest					
Non-violent civil unrest					
Terrorism					
Other (please specify):					

2.2.2 How **frequently** does your enterprise expect to **receive claims** due to the following political risk factors over the **next five financial years** (where always, very often, sometimes, seldom and never form a continuum)?

Political risk factor	**Always**	**Very often**	**Sometimes**	**Seldom**	**Never**
Nationalisation (with compen-sation)					
Confiscation (without any com-pensation)					
Creeping expropriation					
Currency inconvertibility					
Other regulatory discrimination (excluding the above four). Please specify:					
Breach of contract by non-government parties					
Non-honouring of government guarantees					
War					
Violent civil unrest					
Non-violent civil unrest					
Terrorism					
Other (please specify):					

2.3 Demand for cover.

2.3.1 Please indicate the **level of demand** experienced by your enterprise for **cover** against the following political risk factors over the **past five financial years,** according to your perception (where very high, high, medium, low and very low form a continuum).

Political risk factor	Very high	High	Medium	Low	Very low
Nationalisation (with compensation)					
Confiscation (without any compensation)					
Creeping expropriation					
Currency inconvertibility					
Other regulatory discrimination (excluding the above four). Please specify:					
Breach of contract by non-government parties					
Non-honouring of government guarantees					
War					
Violent civil unrest					
Non-violent civil unrest					
Terrorism					
Other (please specify):					

2.3.2 Please indicate the expected **level of demand** that will be experienced by your enterprise for **cover** against the following political risk factors over the **next five financial years,** according to your perception (where very high, high, medium, low and very low form a continuum).

Political risk factor	**Very high**	**High**	**Medium**	**Low**	**Very low**
Nationalisation (with compen-sation)					
Confiscation (without any com-pensation)					
Creeping expropriation					
Currency inconvertibility					
Other regulatory discrimination (excluding the above four). Please specify:					
Breach of contract by non-government parties					
Non-honouring of government guarantees					
War					
Violent civil unrest					
Non-violent civil unrest					
Terrorism					
Other (please specify):					

3. Please make crosses [X] in the applicable blocks when you answer the following question. Please note that this question consists of two pages.

Please indicate the **five** political risk factors that are considered the main **problem areas** for you as an underwriter in South Africa, and please provide possible **solutions** to manage these identified problem areas.

Political risk factor	**Five most important factors**	**Management solutions**
Nationalisation (with compensation)		
Confiscation (without any compensation)		
Creeping expropriation		
Currency inconvertibility		
Other regulatory discrimination (excluding the above four). Please specify:		

(question continues on next page)

Political risk factor	**Five most important factors**	**Management solutions**
Breach of contract by non-government parties		
Non-honouring of government guarantees		
War		
Violent civil unrest		
Non-violent civil unrest		
Terrorism		
Other (please specify):		

4. Please complete the following questions.

4.1 Please indicate up to **four** provinces in South Africa that, in your opinion, presented the **largest annual claims amount** to your enterprise due to political risk factors over the **past five financial years**.

The Eastern Cape		Mpumalanga	
The Free state		The Northern Cape	
Gauteng		North West	
Kwazulu-Natal		The Western Cape	
Limpopo			

4.2 Please indicate up to **four** provinces in South Africa that, in your opinion, are expected to present the **largest annual claims amount** to your enterprise due to political risk factors over the **next five financial years**.

The Eastern Cape		Mpumalanga	
The Free state		The Northern Cape	
Gauteng		North West	
Kwazulu-Natal		The Western Cape	
Limpopo			

THANK YOU FOR YOUR CO-OPERATION