Political Risk Insurance
Solutions for Expanding Into the Global Marketplace

When conducting business abroad, most companies focus on overall strategy—how to increase sales and market share while limiting costs. One aspect of doing business abroad that often goes overlooked is political risk. Political risks can be financially devastating and bring foreign operations to a halt if an organization is not properly prepared.

What is Political Risk?

In general, a political risk is defined as any action taken by a foreign party—such as a governmental body—that affects, or could affect, the local business climate. These actions can cause companies and investors to suffer financial losses as a result of sweeping political changes or instability in the country.

Knowing how to mitigate political risks is critical to the success of any Canadian business operating abroad—especially when you consider the fact that Canada's total exports to emerging markets is expected to triple by 2025.

The following are some common political risks and examples of how they can impact investors and exporters alike:

Changes in laws and regulations. When governments introduce new laws or change their existing regulatory framework, business operations may be negatively impacted. Governments often target foreign businesses or certain industries with unfavourable restrictions that could potentially eliminate the viability of conducting business abroad altogether.

Restrictions on imports and exports. Sudden changes in import and export restrictions can greatly increase the cost of doing business abroad. Countries often center their tariff and trade barrier strategies on protecting consumers and domestic companies. What's more, an embargo or the cancellation of an import license can spell disaster for a business operating abroad.

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Transfer risk. In some instances, businesses may not be able to convert the local currency into Canadian dollars. When this happens, foreign buyers may not be able to pay exporters. Worse still, if currency restrictions are in place, the value of cash held in a foreign market may depreciate relative to the Canadian dollar.

Breach of contract by a foreign government. When a contract breach occurs (non-payment, unwarranted contract termination, etc.), it can create losses for Canadian businesses. This can happen without warning, and the financial loss can be difficult to make up.

Expropriation. This occurs when a government or other public agency seizes, sometimes unlawfully, private property in the name of public interest. This can cause losses of physical assets and revenue.

Political turmoil. Unsafe conditions due to war, terrorism, civil strife or other forms of political violence can lead to the total abandonment of an investment.

The type and potential impact of political risk varies by country. It is important to remember that some countries are more stable than others, and political risk tends to be greater in developing regions. For a general overview of potential risks, sorted by country, search Export Development Canada's Country Info Web Page.

Mitigating the Risk

While political risk is nearly unavoidable in some cases, there are ways to prepare before conducting business abroad. The following are four best practices that businesses can leverage:

1. **Identify** risk exposures that might be encountered based on geopolitical and other factors. A risk manager can help inventory these political risk types and rank them from most to least impactful based on the type of business being conducted. Examining political trends can help anticipate future events and government action.

2. **Quantify** potential risks using common measurement tools such as discounted cash flow analysis, organizational network analysis and enterprise risk management. Using these tools, companies can predict maximum probable losses, market share changes and how many potential customers could be lost. Based on this information, businesses can determine if the risk of doing business abroad is still profitable following a major political risk.

3. **Reduce** the probability of a risk and its effects by establishing a course of action. While a political risk is difficult to eliminate entirely, businesses can use data they have previously gathered to implement preventive tactics, like re-evaluating their investment type, seeking new in-country relationships, revising their operational setup and redistributing capital allocations.

4. **Monitor** political risks on a consistent basis, integrating any data and findings into a formal risk management process.

While the above tips can help mitigate the damages of political risk, it may not be enough. To counteract any gaps in protection, some businesses turn to political risk insurance. While there are many different types of insurance related to political risk, they generally protect physical assets, foreign funds, contract frustration and more.

For more information on managing risk, contact Thor Insurance & Financial today.

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