RISKS ENCOUNTERED IN INTERNATIONAL BUSINESS

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At international level, there is a multitude of risks linked with the process of investment. Each category of risk is determined by a multitude of factors which generate risk.

Therefore it is extremely important for managers to take into consideration the whole range of aspects which exist at the origin of elaborating the decision to investment.

Depending on various approaches, the set of manifested risks, when a company operates on an international field, can be classified into:

- macro-risks, which appear as a result generated by the process of evolution of the business environment from the point of view of investment placement;
- micro-risks, which are set either on factors of endogenous nature, specific to the company's domain of activity, or resulting from the differences which appear between the specificity of the activity, on one side, and the limitations imposed on the business environment by the respective country, on the other side.

If the notion of risk is analyzed from another perspective, one notices that multinational companies are facing two important categories of risks, which are:

- Systematic risks or un-diversifiable risks, which depend on the economic factors of general nature, which can influence the economic situation of the respective country (inflation, politic divergences). "As far as systematic risks are concerned, the investor accepts the possibility of their materialization without having many available means of minimization (it is generally considered that companies cannot significantly influence the economic situation of the host country)."[50]
- Unsystematic risks or diversifiable risks, which are determined by those factors of risk that are influenced directly by the conditions existing at company level. The investor can minimize these risks by adopting some measures meant to ensure a substantial improvement of the current situation of the company.

In other words, the major difference between the two categories of risks described previously is given by the factors which lay at the origin of their upcoming. In practice it is more important to make a detailed analysis of systematic risks.

The companies which invest abroad must take into consideration the existence of two categories of risk, namely:

- Country risk which is tightly liked to the economic and social stability of a certain country. Among the most important actions which are subject to country risk, we mentioned: implanting a certain company abroad, as well as all categories of loan which are granted to certain foreign companies by the empowered specialized financial institutions. When an investor analyzes the opportunities to invest in a country which is considered vulnerable from a politic and economic point of view, s/he must not start from the false assumption that, whatever course is taken, only losses will be recorded. Thus, country risk is defined as "potential financial loss determined by the problems caused by the macro-economic phenomena and/ or political events from a certain country"[51]. The given definition entails a negativist approach which associates the notion of risk with the notion of loss. Hence, risk must also be defined in terms of probability and possibility. Each investor must know and approximate the quantum of future gains, as well as the quantum of potential losses. In order to do so, he must take into consideration the following aspects:
  - Economic, politic and military system allows making a correct evaluation of the existing situation, as well as anticipating possible reactions to the changes appeared both internally and externally. If the investor will be able to understand this 'mixture' of elements, then there is the possibility of establishing a short or medium term strategy.
  - Identifying the essential vulnerabilities which can be speculated upon by the investor in order to achieve its interest. To this category of vulnerabilities belong: civil wars, financial crashes, national culture or hidden interests of some business partners.
  - Determining the existence of risk centres which are based on punctual approaches, from this point of view global approaches are unjustifiable. There are still areas which are favourable to the business environment, even if the conditions existing in that particular

[50] Stevenson R., "Fundamentals of investments", West Publishing Company, 1988, p.13

[51] Muntean C., Vâslan C., "Investiții internaționale", Oscar Print, 1995, p.84

country imply an increased level of vulnerability. These areas must be exploited at their maximum capacity, because on short term they are the most profitable ones.
    - The relation between the investor's country of origin and the country s/he wishes to invest in. The similarities of cultural nature, as well as the interests of strategic nature contribute substantially to the transfer of a certain part of the risk, thus reducing the probability of failure.
- Transfer risk refers to all cash flows resulting from investing in another country than the country of origin. Assuming that a certain investment generates a profit given in that country currency, the parent company wants to change this profit in convertible currency, and the entire profit amount is to be transferred outside country borders, where the company has its activity. In this situation, the state may interfere by rejecting or delaying the transaction, with the purpose of discouraging external transfers of the financial resources outside the country borders. Thus, multinational companies are 'forced' to take into consideration both the action of reinvesting the profits which have been obtained in that country, as well as the action of searching for new ways of recovering the gained profit. Frequently, this category of risk is analyzed within financial risk.

"The other categories of risk operate either on granted external credits (sovereign risk, interest risk, country risk regarding external loans), or operate at company level (financing risk, commercial risk, financial risk, juridical risk, etc.). A special category of risks is the one linked to the ulterior development of a company activity on the foreign market. Some of these risks are considered pure (country risk, transfer risk, sovereignty risk, juridical risk), while others are considered strategic risks (commercial risk, financing risks, financial risks, implanting risks)."[52]

Sovereign risk is implied in the operations generated by the credit flow taking place from banks towards certain governments. It derives from the existence of the possibility for a certain government not to have the capacity or the necessary desire to pay back external debt. Derived forms of this type of risk appearing in the delicate situation in which a state is incapable to pay or refuses to pay the debt are: regrouping risk, renegotiation risk or repudiation risk.

From the point of view of exposure to risk, multinational companies are exposed to financial risk more that national societies. This state of fact is also determined by multinational companies having the majority of their operations in foreign currency. Due to the fluctuating nature of currencies, there is always the possibility of turning certain gain into loss. Namely, when an investment is made, companies have in mind a weak currency, so that for the repatriation of the profit made in this country a powerful currency is preferred. The consortiums represent a body made of several companies, where, one of them is called parent company and exerts the full control over the entire group. These have appeared and developed as a natural consequence of a group of companies supported by the following categories of factors:

- the appearance and the development of some powerful companies which operate, mainly, in certain areas often surpassing the boundaries of the country of origin, these been also favoured by the fact that they have a dominant position on the market;
- the existence and the permanent development of the financial market, which has favoured the exertion of a certain type of control and of a certain influence from the buying company over the issuing company.

Similarly, the manifestation of financial risk can be also achieved in the case of transfers made between companies belonging to the group that operates on various sectors of the market. This situation will generate a strong impact which will negatively affect: the volume of received credits, the quantum of granted loans, the totality of banking deposits, as well as the totality of cash and payments expressed in the foreign currency.

Another category of risks is the interest risk, operating not only from the point of view of the creditor, but also from the point of view of the companies that do not have sufficient financing resources and are forced to consider banking credits. That is why the company will have to anticipate a possible future evolution of the interest rate for its credits, because a significant increase of the interest rate may determine and influence negatively the cost regarding the borrowed capital. This increase of the costs with the borrowed capital also brings along an increase of the specific costs of the investment made. In order to prevent this phenomenon, the company must know very well the totality of determining specific factors of the banking interest, such as: inflation rate, general economic situation, etc.

Another risk that operates at company level is the financing risk which is strongly influenced by the cost of the necessary capital for the investment process. Companies may themselves finance the investment made, both on account of their own resources, as well as by considering borrowed resources, when the necessary capital for achieving the set objectives is not sufficient. Structurally, the necessary capital for supporting the investment process is set by taking into consideration the following aspects:

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[52] Păun C., Păun L., "Riscul de țară", Economical Publishing House, Bucharest, 1999, p.23

- the size of the company;
- the increase rate of the investments;
- the analysis of the actives structure;
- company's level of indebtment.

The quantum of the interest paid, the totality of expenses regarding the issuing of shares and bonds, the banking commissions and costs, etc. are elements which have a decisive influence on the cost of the capital assigned to investment processes. The phenomenon of self-financing or the cost of the profit to be re-invested is given by the opportunity cost assigned to that particular activity.

At an international level, multinational societies face a series of risks generated by the deterioration of the buying power, this leading to a delicate situation according to which, a company can no longer purchase an equal amount goods or services from the external market. The investor will record loss, if the annual rate of inflation is higher than the profit rate obtained by the company.

The companies which invest on the international market frequently face operational risk. This is determined by the specificity of the entire range of activities which will take place. It belongs to the category of unsystematic risks existing at company level. To prevent it, company management has an extremely important role, in the sense that they will try to limit the negative effects of the market. These risks appear as a consequence of the development of the company activity at international level, just as a consequence of the manner in which the subsidiaries of multinational companies handle the available resources.

"According to the specialists, the most important operational risks specific to foreign investments are:

- the impossibility of creating some adequate channels of distribution for the products;
- insufficiently trained personnel;
- delays for cash and payments;
- difficulties in the raw material supply;
- problems generated by improper use of installations;
- problems generated by insufficient adjustment to the specific conditions of the market;
- leaks of information regarding the product or the technology involved."[53]

Since the risks mentioned previously appear even from the exploitation stage, the subsidiary managers have an important role in fighting and limiting the negative effects. In order to do this, the management of parent company has to be permanently alert in the selection of competent managers to run the subsidiaries and to successfully cope with the challenges coming from the international business environment.

Multinational companies must take into consideration, when investing abroad, the implanting risk, which entails the use of an inadequate strategy for the specific conditions of the business environment of the host country. If a company does not take into account the specific conditions encountered on the international market, then it must consider the increase of the real costs involved in the implanting operation. Among the most important measures for diminishing the negative effects generated by the implanting risk we distinguish:

- the elaboration of a detailed analysis on the country risk and the incorporation of this analysis within the elaboration of implanting project the investment abroad;
- the organization of the selection and training process for the managers in the respective country;
- the development of actions of promotional nature before the introduction of the company on a certain market.

Another important category of risk is juridical risk, which refers to the totality of the agreements concluded by a multinational company. Also, one must take into consideration both the parties involved in the agreement, as well as the characteristics of the juridical system in which this agreement is made. The risks determined by the existence of certain restrictions, regarding property, control of currency exchange, profit repatriation or the application of the rules present in the stock exchange field are also from this category of risk.

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[53] Dunois A., "S'internationaliser", Dalloz Publishing House, Paris, 1995

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