

THE CORPORATIONS AND THE CHALLENGES OF THE POLITICAL RISKS

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*Four some has an enviable truths which cannot be spoken,
for the one who speaks first has more to lose politically'.*

Abstract: The present paper is aimed to address political risks from the perspective of the conceptual distinction between the two levels at which they manifest themselves (micro- and macro risk). The political risk is the risk affecting corporations and can generate significant negative consequences over the operations and economic activities within a country, as well as its stakeholders. Studies show that all corporations value at present the potential political risks for their subsidiaries and that the management of such risks has become one of the most important functions of them. The aim of this work is to describe and explain the political risks to which corporations are subject to (with examples from the oil sector) which are operating in a global business environment and present the main ideas related to management of these risks (practices used in the identification and their measurement).

Key words: globalization, corporations, political risk

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THE POLITICAL RISK - CONCEPTUAL FRAMEWORK

If we look back at on the time horizon of the last decades, we may disclose an evolution in the assessment of risk and uncertainty (Hurduzeu et. al, 2014) and, at the same time, the expression of several main trends in the projection of their stages: (i) the increase in at an unprecedented pace of the situations of risk and uncertainty; (ii) the use of more intensive scientific resources in the processes of the study of the risk and uncertainty of the social economic system; and (iii) the magnification and diversification of the consequences the

applications and the risk analysis techniques and uncertainty have generated in the social environment, in nature, at the level of each economic agent, etc. (Strange, 2002). The rise of the international economic transactions, even more present in the context of globalization, subject to multi-national corporations (and the foreign investors in general) of various hazards, which may require the accelerated development solutions increasingly complex in its management. One of the dimensions of such developments is the *political risk*. It refers to those events and processes from the political environment which affect corporate performance.

The political risk expressed its existence since Ancient time, both in ancient Greece and the Roman Empire by robbing assets and expropriating the foreign investors. It acquired a status after the Second World War, when the flow of foreign investments from North America and Western Europe towards developing states has intensified. In particular, the interest for this type of risk widened with the nationalization of the foreign assets of the Suez Channel (1956), in Cuba (1959), as well as land owned by the Fruit Company from the United States in Guatemala in 1951. It has evolved and acquired various forms through the centuries by acquiring the today's complex typology.

Green (1974) defines the political risk as likelihood stopping the activity of a multinational company because of some political events, be it spent within the country in which the company operates, either at the international level. In the host countries, the political risk is determined not only by the uncertainty of the governmental actions and the political institutions, but also the influences of the minority groups, such as the lobby groups.

Alon și Herbert (2007) define this risk as "a neutral phenomenon to which probabilities are associated so that the effects may be positive or negative for the participants". The political risks may take various forms such as: (i) the risk arising from investments which paralyze the economic activity of the receiver or of the participant of this direct investment; (ii) the risk resulting from the imposition of the moratorium on repayment of foreign debt and it occurs in the countries with large external debts which are obliged to resort to postpone their reimbursement and the payment of interest on long and uncertain terms and to this purpose we sign a governmental moratorium; and (iii) risks arising from the customs tariff policy consists in the establishment of discriminatory customs duties on imports from countries which do not benefit from the nation clause of the most-favored regions; (iv) the risk posed by its non-preferential system occurs in connection with the production of developing countries which as a result of the obsolete technology, lack of qualified staff, undiversification, resulting in substantial costs of manufacture; (v) the risk from dumping. It is considered dumping, the situation in which a product is exported at a lower price than that on the domestic market of the exporting country or, in the absence of such a price at a price lower than the highest price charged for export from a third country times lower than the cost of production in the country of origin; (vi) the risk determined by non-tariff restrictions (qualitative restrictions), quantitative restrictions, restrictions to prices etc; (vii) the risk arising from different natural disasters.

Initially, the corporations viewed the political risks in simplistic way, as a simple negative relationship between the governmental measures and the entrepreneurial activity. But the political processes, in their turn, are influenced by various factors specific to the environmental analysis of the country. These

factors can be divided into two categories: *domestic factors* and *external factors*. The latter have their origin outside the country and may include host interstate conflicts or, on the contrary, the efforts of cooperation between the countries. In contrast, the domestic factors are in the host country and include governmental favors, religious or social conflicts between different factions of the same nationality, change in the law (Alon și Herbert, 2009).

The economic sectors in the field of the natural resources have high degree of vulnerability. The political risk characteristic to the petroleum sector tends to be significantly higher, and in particular if the states are emerging, characterized by a higher level of instability (Witold and Bennet, 2003). The natural resources may cause an appreciation of the national currency and, as a result, deindustrialization, the tendency to move towards an authoritarian regime and increasing social instability, which can lead to - over time - civil conflicts. Thus, the oil industry, in particular, is frequently in distress by increasing of the nationalist feeling and the conviction that the natural resources available to a country should be used for the good of that nation and not for the profit of the investing companies. At present, many countries are characterized by a significant political instability (e.g. Algeria, Libya, Iran, Iraq, Afghanistan, Angola, Sudan, Lebanon, Nigeria, the Russian Federation s.a) and represent considerable sources of risk for the multinational companies.

Box 1. Examples of political risk in oil sector:

- a. Peru, took over the management of one subsidiary of Exxon Mobil in 1968.
- b. In Peru, in 1985, the police armed with guns took the control over the headquarters of Belco Petroleum in Lima in the property of the United States. This was followed by the nationalization of the company, taking control over its property and its freezing of the bank accounts. The Peruvian president at that time - Alan Garcia - claimed that Belco Petroleum declined to accept new conditions for the application of a reinvestment its own profits in exploration and production.
- c. The Lebanon, which expropriated the Western companies from the oil industry in 1969.
- d. Angola, when 1986 a group conservatory with political activity in the United States organized a offensive to force Chevron and Gulf Oil to leave Angola. Posters and package leaflets were distributed at ythe gas stations with titles such as: "Wanted for the delivery of annual aid to Soviet enemy of America in Angola occupied by Cubans who in an amount of 2 trillion \$" together with a photo of the president of Chevron. Their purpose was to impeach the government.
- e. Bolivia, where president Evo Morales decided the nationalization of the oil sector and of the natural gas. Companies like Petrobras (Brazil) or Repsol (Spain) have invested over time approximately \$3.5 billion in development of such branches in Bolivia. The head of state's actions were also extended to the area of more frequent energy checks and more detailed on the foreign companies active in this market and forcing them to renegotiate their profit sharing in the favor of the government.
- f. Nigeria, Shell operations in this country. In Nigeria the militants often kidnap the representatives of the multinational, requiring large sums of money or forced the company to offer jobs. 10% of the national production is lost in favor of law breakers, but the low costs of exploitation, still mentain the company in the African territory - with obvious cosst. And the experience of Shell and other corporations are not singular, it illustrates the extent of the risks the oil companies are faced with in their international operations.

THE DIMENSIONS OF THE POLITICAL RISK: MICRO VERSUS MACRO RISK

The first researcher who referred to the need for this division is Robock, in 1971, but was later taken over in a variety of scientific works.

Simon (1982), Schmidt (1986), Kennedy (1988) and Brewer (1994), adapt this classification to different models of risk assessment and integrate it later in different management strategies.

Kobrin (1979) classified in his turn, the contemporary political risk in the two dimensions. The first dimension makes the distinction between *a country's specific risk*, or macro, affecting all foreign companies in a country, without taking into account what they do, and *the specific risk with the firm*, or micro, which is typical of a branch in the industry, a company or a project. The specific risk with the country is the most worrying for the international bankers, which often grant loans with very high interest to certain countries due to their perception of the risk of that country. The company specific risk concerns most multinational companies. The second dimension of Kobrin makes the distinction between those political events affecting the ownership of goods, such as those involving expropriation, and those which affect a firm operations and, in so doing, revenue and cash-flows. Kobrin claims that the most contemporary political risk for the multinational corporations is the specific risk affecting the company's operations rather than its property. As a result, the political risk often leads to disruptions in major's business operations. Most of the times the changes imposed by policy suppose limitations, such as restrictions on the free fixing of prices, the use of experiences labor force, or changes in the local regulations of the property.

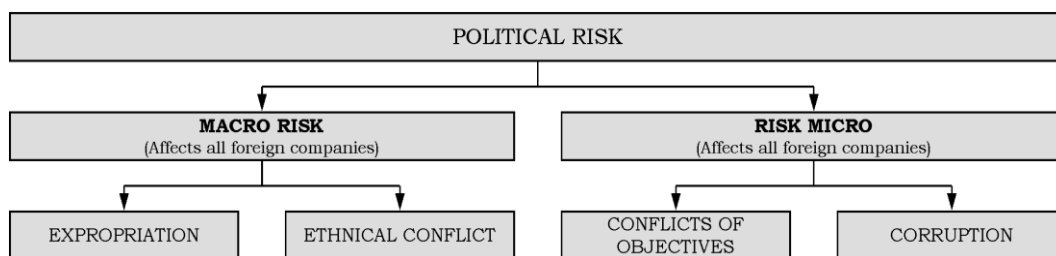


Figure 1. Classification of the political risk micro-macro

According to Alon and Herbert, the difference between these two dimensions is that the micro politic risk affects only "certain industries, companies or projects", while the macro has negative consequences on all the firms in a given country. Furthermore, as Martin and Alon state, both the micro politic risk, as well as at macro politic would be neutral. When we analyze the political risk from a macro perspective, we will take into account the main characteristics of the host country. We will refer to factors more general, such as the probability of civil wars. In comparison, a micro approach stresses particularly the analysis of the nationality of the transnationals which enter the market in question, but also the specifics of the project in question in relation to the characteristics of the host country. The political risks faced by successful multinational companies differ not only from country to country, but also within the same country. To importance of making such distinctions was justified by Gurumoorthy (2006), who shows that the high incidence is common to the micro politic risk, in contrast to expropriations carried out on a large scale, whose number is declining. Although the differences are obvious, we can assert an area of intersection of the two dimensions. Thus, both are determined by economic, social and governmental factors. The difference is that the micro approach reveals few special features of the company, designed to reduce or, on the contrary, to emphasize the exposure to risk. Therefore, the micro size has the advantage of a sound financial management. However, we should note that it is necessary to analyze both aspects, as they do not exclude each other and that

the micro politic risk, though more specific, does not eliminate the importance of assessment at the macro level. The relationship between these two dimensions is, therefore, one of complementarity. If a company knows its micro politic profile, it will be able to adjust better to host country's characteristics, therefore the macro politic risk. More, both risks affect both successful multinational companies with a view to entering on a market, as well as those already working on that market. Examples of events which are included within the scope of the macro politic risk are represented by the fall of governments by the profound change in the way the economic system (switching from one ideology to another), and it is difficult to estimate with probabilistic calculus. Certain companies are more vulnerable according to this dimension, in particular successful multinational companies which operate in industries considered to be strategic (such as that of energy), because they are subject usually to increased governmental pressure. Between the factors influencing the size of micro political risk we must mention, primary the economic ones. For example, the conditions of employment in certain industries may be more or less favourable, and the governments can invoke the argument incipient industries to protect certain firms. Then, it should not be overlooked the social impact of the factors, which include cultural differences between the host country and the multinational (distance from power or uncertainty avoidance). The governmental factors are significant if we look through the point of view of a high degree of nationalism (take the example Bolivia, where the fields of exploitation of natural gas have been taken over by the government as a nationalisation of reserves of energy foreign owned) or the level of corruption. Between the external factors we note: the economic dependence on other country, the economic policies of the host country in a specific field, the deficit of trade balance, the risk is assessed, first of all because a state's policy has a direct impact on the national economy.

THE MANAGEMENT OF THE POLITICAL RISK

The studies on the political risk management have taken into account a variety of data from different countries and industries addressed both the specific characteristics of the host country as well as the individual attribute of the investment project.

The term 'political risk management' appeared for the first time in 1950 when the companies have integrated stand-alone departments. In the next decade (years 60) the interest given to those departments has increased substantially, so that Canadian company Massez-Ferguson was the first company which has recognized and implemented the concept of risk management. During this period a high emphasis was placed on the insurance mechanism as the main method of risk management. In the 1970s the insurance companies were no longer been able to cope, to more and more numerous claims and the financial capacity required by the market. The causes of these changes on the insurance market are to be found in the inflationary pressures, but also a significant increase in the value of assets secured especially in the case aviation fleets and technological developments. As a result, companies have started to take more and more risks, becoming aware that they had to take other measures to protect their assets in addition to the insurance policies (Sera, 1995). More and more companies have started to use alternative methods to protect against the risks, as well as loss prevention and control and the implementation of risk management.

In general the evaluations of the political risk take, as a rule, the form of a numeric score, or a letter on a gradual scale, granted to a country as a whole, together with its support in theory and methods for the determination of them. Companies are influenced largely by these assessments, although they have especially a character of recommendation. On the basis of the classification of the country, the corporations may decide to avoid certain countries, but, most often, the negotiations are continued, whereas the existence risk involves paradoxically and the existence of opportunities: it can be so, that other companies have abandoned the location of an investment; in addition, the company may take measures to protect itself against the risk in question, or simply can look at the risk concerned as a challenge. As a matter of fact, a high risk involves also high possibilities of gain.

Coplin and O'Leary have worked up a model on the basis of a prediction and against a complex Delphi technique specially adapted for the political risk. The procedure initiated by the two specialists, called initially 'World Political Risk Forecasts' (WPRF), provide forecasts over a period of 18 months and a 5-year period in respect of most likely political risks, the risk of transfer (currency convertibility), investment risk (restrictions on participation in the share capital) and the risk of export (the risk faced by exporters).

Rummel and Heenan proposed a method of converting the political uncertainty in probabilities, using the term 'risk' as 'mechanism for objective assessment of investment climate'. Haner developed the BERI (Business Environment Risk Information) index as a guide for quantitative classifications based on other rankings, and Coplin and O'Leary initiated in 1979, what was to become the rating system PRS (Political Risk Services). These methods have been used extensively beginning in the 80s by corporations.

BERI uses an indicator based on scores assigned by experts to a number of 10 political variables. The 10 variables are classified in three categories: domestic causes of political risk; external causes to the political risk; symptoms of the political risk. Initially, each of the 10 BERI variables may receive a number of up to 7 percentage points of the analyst expert. The maximum number of points (7) shall be considered to be equivalent to an optimum of the circumstances, a situation in which the risk is minimal. But it can be added the bonuses, so that BERI is created on the basis of a 100 basis points. The guide for the classification of the level of the political risk is the following: (a) 70 - 100 points the environment is stable characteristic to industrialized regions of the world, low-risk; and (b) 55-69 points = moderate risk, certain complications which could influence operations in the short term being possible; (c) 40-54 points = high risk for business; (d) 0-39 points conditions of risk for carrying out businesses unacceptable.

Based on individual scores for the variables of the model, to which we add any bonuses, it is obtained the BERI index. The method provides different rankings for 'Present conditions', 'Conditions likely to happen in the following next 5 years' and 'Conditions likely to happen over 10 years'.

In 1986, 'The Economist' published an analysis of the political risk entitled 'Countries in difficulty'. Its authors explained on three pages the methods used and presented a table summarizing the results. Although this method was not described as a whole, and the theoretical foundations weren't even mentioned, it nevertheless presented the advantage of clarity and simplicity, which was later taken over by businesspeople. In short, the analysis presented a list of factors of

an economic, social and political nature, provided a diagram for quantifying the impact of the role of an individual and their relative role and gave out a method for combining scores of risk and their classification by investors. The study aimed only the losses due to socio-political factors, and it did not take into account the variables of an economic nature.

Henisz and Zelner (2003) show that traditional methods used by the companies to keep under control the risks to which their branches may be subject to, prove to be ineffective, the only solution would be the board's decision to negotiate directly with the government of the countries in which they intend to make investments, or even entry directly in, the political game. As companies have demonstrated, for example, the giant oil Italian Eni, the management of the political risks involves mixing the operational efficiency and the political capital, the art of lobbying and putting a pressure on the local decision forces, which are committed also to handle effectively the analytical techniques and tactics. Frynas and Mellahi (2003) on the basis of the political risk differentiation in micro and macro show that the assessment of the size and the management of the micro-and macro dimensions proves to be very specific and complex. A solution would be to create a model of quality, as the one proposed by Alon and Herbert (2007), which identifies the factors of influence of the micropolitic risk and give them some importance (weighted). Based on this, each business in part will quantify the own risk. The advantage would be that each company will be able to see what are the factors which have the greatest negative impact on its business and to remedy this situation. The disadvantage is given by the fact that the model may have a high degree of subjectivity (for example, in the association of the weights of factors) and, therefore, to the adoption of some poor management solution.

Another way is to try managing the individual influence of each factor. The strategies used must be primarily proactive: for example, providing very good conditions of employment can result in reducing the risk reputational.

Also, conducting market studies before the implantation may reduce the negative impact of cultural differences. Depending on the sector in which they operate multinational, according to Gurumoorthy (2006), several ways of assessment and management can be distinguished. For example, in the financial sector we have encountered models like CAMEL (capital, assets, management, earnings, liquidity - analyzed qualitatively), Zonis (built on three indices: Political Stability Index, Policy Foundations Index and Institutional Strengths Index) or the model made by the Bank of America (constructed on the basis of the ten variables economic and financial with impact on the political climate). Once assessed the risk, the author shows the need to go to the action, the base being the lobby, which may come from both the transnational, as well as from the government of the country. Gurumoorthy argues that this strategy extremely efficient can be applied to both micro and macro level.

Business Environmental Risk Index (BEER), Political System Stability Index (PSSI) and Institutional Investor include economic variables in political risk assessments.

In connection with management and micropolitic risk assessment and that of macro risk can be achieved by developing a model quality. Such a model is the one proposed by Martin and Alon (2000), which, according to the authors, has the following advantages: it proposes a proactive approach, enables comparisons, can be used for risk assessment and management in various countries, allows managers to change the weighting or importance of the variables included. Martin

and Alon show that such an instrument of management is necessary in accordance with the conditions in which the methods traditionally used to proactive management have proved to be often ineffective. The new strategies in the management of this risk should take into account three types of factors, categories similar to those in size to the micro management: the governmental factors (wars, revolution, nationalization, regulatory measures, corruption, diplomatic relations, human rights), industry (revolt, demonstrations, terrorism, strikes, violence, crime, certain segments of mass-media) and economic (hyperinflation, poverty, low productivity, fluctuations in the exchange rate and interest rates, public debt, trade balance). Account should be taken of the fact that the importance of these factors varies from country to country. Martin (2000) shows that the macropolitic risk can be managed by means of private company, such as International Group and Citicorp, of public agencies as well as Overseas Private Insurance Corporation and Foreign Credit Insurance Agency or international organizations, such as the World Bank/MIGA. The author considers these strategies to be much more efficient than the traditional methods as well as the call to insurance undertakings or agreements between business and certain governmental members.

In the management of the risk both dimensions may rise the question of who should have to deal with this issue, in such a way that the result is objective. Alon and Herbert (2007) advocates for the assesment of the micropolitic risk by the partners from abroad (in order to avoid interference of some organizational interests), and of the macropolitic risk by staff at the location of the multinational (provided that they do not have dual interests - both in the company, as well as in the establishment of good relations with local elites). Martin and Alon (2000) claim that the macropolitic risk must be managed by a group of experts in the field of host country of the multinational.

In this respect, the political risk analysts at the firm Conoco have implemented a system for the assessment of the political risk. Thus, initially they have drawn up a comparative study on the implications of three different scenarios on business operations abroad. The study included global scenarios, covering a larger number of variables of a political, social and economic environment. But the study was not well received, most managers received it with a lack of interest and wereeven disappointed by it. As a result of this experience, the analysts from Conoco decided that, in order to be successful within the organization, the political risk assessment must be one of the following: (i) the relevance for the work of the top managers or the operational departments; (ii) must be closely linked to the immediate aims of the company, such as specific investment decisions or operational problems; (iii) facing a concrete program for action to improve the scheduling process or to influence course of events. When the analysts from Conoco have carried out a second study of external affairs, they took in seriously their own conclusions and have concentrated on decision makers with a critical influence in the progress of the operations in the field oil, and a series of specific problems such as: risk diversification and taxation. The study also enjoyed a successful feast, this time, far from having a global or purely theoretical character.

Gurumoorthy (2006) provides the example of an effective strategy of micro risk management, carried out by British Petroleum. This has implemented strategies which may serve as a model for risk assessment and management. The model BP although it has not made public the detailed rules for micropolitic

risk management, it is possible to use the BP model of risk management through its perspective on operational safety. The representatives of the company said at that time that there are very few states where petroleum transnational was not be able to operate, and most risks were manageable from their point of view. There are three levels of management: ex-ante evaluation, continuous and ex-post. BP has implanted in states with raised macropolitic risk, Algeria or Azerbaijan, but has not developed an internal system of security with specialists from the various areas of the security. The corporate maintains good relations with the local governmental agencies, recruits people from the companies local in security and adapts its strategies depending on the country in which it operates. BP has adapted well to laws and conventions and establishing strong ties with the public order forces of the host states.

The Eni approach, the society of exploitation of oil owned by the state of Italy in Kazakhstan by subsidiarul Agip KOC is an example of how to approach, they favored the suppliers of raw materials, have transferred knowledge of pipelines transports, have developed the local people, have carried out a policy of employment in which at least 60% to be citizens cazahi, have contributed to local interest objectives o from the national library to the houses for the poor winning people's sympathy and bringing both of the government and of the population who feels now that he is part of the success the success of Eni. So this company has developed the relationship with host country so now is not very least exposed to micro/macro political risks.

A prime example is the one for the Austrian oil company OMV which has been forced to desinvest its assets in Sudan in 2004 after pressure put by the human rights activists. In addition, in the year 2011 the company has been affected by events related to Arabic revolution in January and February in the countries of North Africa. The production of oil in Libya has been strongly affected, and was stopped in the first quarter of 2011. The Board has monitored closely the development programs to mitigate the adverse effectst of thepolitical risk (a team of managers has been sent to Tripoli to stabilize the situation) and have improved local security, in such a way that production was restarted in November 2011, at a capacity of 30 % of the before crisis. In Libya, demonstrated its political instability, but OMV has stated that if this situation will remain stable in the long term, the supply of crude oil in Libya would be replaced by another region. In addition OMV got actively involved in the Community by establishing a center for young people affected by revolution: 'Libya Tomorrow'. The instability in Yemen of the political environment and marked negatively the investment of OMV. In the first half of 2011 the work has been stopped and remained still owe to the political turbulence that seem to deteriorate. Damages were both substantive and loss of human lives: a consultant OMV in Yemen was deadly shot in the company premises in Haddah. As regards the activity OMV in Tunisia, this plays an important role in the history company, in January 2011, OMV has purchased Pioneer Natural Resources Tunisia Ltd. At the price of 840 mn \$. Riots in Tunisia in 2011 did not affect production of oil of the company.

CONCLUSIONS

The management of a transnational management must acknowledge that political analysis of the environment is as important as the economic analysis of the host state. As regards the political risk management, the company must adapt to changes in the political environment and implicitly of the business. But

regardless of the method of analysis and evaluation used, the political risk will not be able to be eliminated entirely from the international affairs of corporations, as it remains always a certain level of uncertainty. The degree of uncertainty is given by those risks that cannot be identified by the company at the time, while the level of the risk is given by the risks identified. The more, in an economic environment, the risk percentage is non-identifiable, the more the purpose of actions implemented is uncertain. Even if the company can find out most of the risks involved in its operations, the uncertainty cannot be eliminated. As a result, in the current context of globalization we are now witnessing, it is necessary and it is absolutely necessary to implement performance systems of risk management within the multinational companies that want to be efficient and competitive.

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