COUNTRY RISK RATINGS METHODOLOGY

COUNTRY RATING: (E = most risky)

COUNTRY RISK SCORES: (100 = highest risk)

OVERVIEW

The operational risk model provides a standard framework for the analysis provided on Risk Briefing. It quantifies the risks to business profitability in each of the countries covered by the service. In these assessments we take into account present conditions and our expectations for the coming two years.

Twenty-four additional indices, in which indicators are weighted to reflect the concerns of a range of investors covering seven industrial sectors, provide more targeted risk assessments.

STRUCTURE OF THE MODEL

The operational risk model considers ten separate risk criteria:

- security
- political stability
- government effectiveness
- the legal and regulatory environment
- macroeconomic risks
- foreign trade and payments issues
- labour markets
- financial risks
- tax policy
- the standard of local infrastructure

(See more details below)

In considering each of these criteria we examine a number of indicators. There are 66 in all, but the number of risk indicators in each category ranges from four (tax policy) to ten (legal and regulatory). The Economist Intelligence Unit assesses each of the 66 indicators over a forecast horizon of two-calendar years.

MEASUREMENT

We assess the ten criteria on a scale of 0-100, with 0 indicating very little risk to business profitability and 100 indicating very high risk. Each of the 66 indicators within the main criteria is scored on a scale from 0 (very little risk) to 4 (very high risk). Each indicator is given the same weight within its category in the standard scores, and the overall assessment is a simple average of the scores for the ten categories. In addition, separate ratings are available for 24 sub-sectors from seven industries, in which the weightings and overall assessment are adjusted to reflect the particular concerns of that sub-sector (see more details below).

None of the 180 countries assessed earns a score of 0 or 100. This reflects the fact that risks are present even in the least risky countries and that even at the other end of the scale the risks could yet increase.

QUANTITATIVE VERSUS QUALITATIVE FACTORS

As the product looks forward and as we forecast future risk rather than simply extrapolate present trends into the future, we rely on both qualitative indicators (e.g. the risk that capital controls will be applied in time of crisis), and quantitative indicators. Even so, about two-thirds of the indicators are based on quantitative data (e.g. crime statistics), and are mostly drawn from recognised national and international statistical sources. The comparability of the qualitative assessments is made more rigorous by the extensive guidance provided to analysts on each indicator, the ability of analysts constantly to view the scoring for other countries and oversight by the Risk Briefing editorial team.

RESOURCES

Ultimately, the ratings and scores for the operational risk model rely on the expert opinion of our analysts working in regional teams. These analysts have a wide range of open and closed sources at their disposal. One of the main closed sources is our network of in-country experts who provide detailed, regular information on conditions within a country. The business operating risk model also draws on the existing analytic work already developed at the Economist Intelligence Unit through its Country Risk Model (available through the Country Risk Service) and business environment rankings model (available through the Country Forecasts).

The use of open sources is extensive and includes country-specific sources such as central bank reports, statistical yearbooks and country websites. International open sources include publications from the UN, CIA, IMF, World Bank, Heritage Foundation, International Institute for Management Development, International Labour Organisation, US Social Security Administration, World Economic Forum, Interpol and the US Commerce Department.

DESCRIPTION OF THE RISK BRIEFING CATEGORIES

Security risk

This category asks: is the physical environment sufficiently secure? It covers the following issues: Is this country presently subject to armed conflict or is there at least a moderate risk of such conflict in the forecast period? Is armed conflict likely to be contained? Are violent demonstrations or violent civil/labour unrest likely to pose a threat to property or the conduct of business? Has one of the parties in the armed conflict or demonstrations/civil unrest shown hostility to foreigners or private ownership? Is violent crime likely to pose a significant problem for government and/or business? Is organised crime likely to be a problem for government and/or business? Are government or business at risk from kidnapping and/or extortion?

Political stability risk

This category addresses the degree to which political institutions are sufficiently stable to support the needs of businesses and investors. It covers the following issues: What is the risk of significant social unrest during the next two years? How clear, established, and accepted are constitutional mechanisms for the orderly transfer of power from one government to another? How likely is it that an opposition party or group will come to power and cause a significant deterioration in business operating conditions? Is excessive power concentrated, or likely to be concentrated, in the executive, so that executive authority lacks accountability and possesses excessive discretion? Is there a risk that international disputes/tensions will negatively affect the economy and/or polity?

Government effectiveness risk

This category asks whether the political culture fosters the ability of business to operate effectively. The questions it covers are these: Is the present/prospective government likely to espouse and implement open, liberal and pro-business policies for nationals and foreigners? What is the quality of the bureaucracy in terms of overall competency/training; morale/dedication; and compensation/status? How pervasive is red tape? To what degree do vested interests/cronyism distort decision-making in the public and/or private sectors? How pervasive is corruption among public officials? How accountable are public officials? Is there a risk that this country could be accused of serious human rights abuses?

Legal & regulatory risk

Here we look at the risk that the legal system will fail to safeguard investment, focusing on the following issues: How vulnerable is the legal process to interference or distortion to serve particular interests? What is the risk that contract rights will not be enforced? To what extent is the judicial process speedy and efficient? To what extent do the authorities favour domestic interests over foreign companies in legal matters? How much risk is there of expropriation of foreign assets? What is government policy on actively promoting competition and curbing unfair business practices? How reliable is the protection of intellectual property? To what degree are private property rights guaranteed and protected? What is the risk that business financial statements are inconsistent or misleading? Are price controls in place, and what is the risk that these would be extended in times of economic stress?

Macroeconomic risk

Here we ask whether or not the economy is stable and predictable. We look at these issues: What is the risk of exchange rate volatility? What is the risk that the economy will experience recession in the next two years? What is the risk that the economy will experience price instability in same period? What is the risk of crowding out as indicated by domestic public debt/M2 ratio? What is the risk of interest rate volatility in the domestic financial markets?

Foreign trade & payments risk

This category looks at the risks to getting inputs/money into or out of country. It covers the following issues: What is the risk that the country will be subject to a trade embargo sponsored either by a major international organisation, a significant trading partner, or one or more of the G8 countries? What is the risk that a financial crisis could curtail access to foreign exchange for direct investors? What is the risk of discriminatory tariffs? What is the risk of excessive protection (tariff and non-tariff) in the next two years? Can investors move money in and out of the country with ease for financial transactions? Can investors make payments for goods and services and access foreign exchange without restriction? What is the risk that capital controls would be applied or, if already in place, tightened in time of economic or financial crisis?

Financial risk

Here we look at the following questions: What is the risk of a major devaluation? What is the availability and depth of financing in the local market? Is there a liquid, deep local-currency denominated fixed-rate medium-term (five-years or more) bond market in marketable debt (debt that is traded freely)? What is the risk of a systemic crisis in the banking sector? How liquid is the stockmarket?

Tax policy risk

We ask whether taxes are low, predictable and transparent, focusing on the following issues: Is the tax regime clear and predictable? What is the risk that corporations will face discriminatory taxes? Is the corporate tax rate low (or is the prevailing rate of corporate tax actually paid low)? What is the risk from retroactive taxation?

Labour market risk

This category looks at the degree to which labour market factors are likely to disrupt business operations. It covers the following issues: How much power do trade unions wield? How common are labour strikes? How restrictive will labour laws be in the next two years? What is the risk that finding skilled labour will be a problem? What is the risk that finding specialised labour will be a problem? To what extent are increases in wages directly related to productivity increases? What is the risk that freedom of association and right to collective bargaining will not be respected?

Infrastructure risk

In this category we assess the risk that infrastructure deficiencies will cause a loss of income. Specifically, we ask: What is the risk that port facilities, air transport, the retail and wholesale distribution networks, the telephone network and the ground transport network will prove inadequate to business needs? What is the risk that power shortages will disrupt business activities? What is the risk that the information technology infrastructure will prove inadequate to business needs?