SPAG | STRATEGIC PARTNERS GROUP

POLITICAL RISK™ ANALYSIS

Measuring the Political, Business Scenario and Associated Risks

FOREWORD

India's testing moment

The year 2014 is a make-or-break year for India. It is the year that will decide how quickly and urgently the country can go back to its decade of high growth; India's GDP grew at an average of 8.3 per cent per annum between 2003 and 2011; or whether the lower growth rates, policy paralysis, tax and trade wars, corruption scandals and high inflation crises of the past two years have settled into a nagging medium-term problem.

The election in April-May 2014 is expected to provide some clarity. The composition and leadership of the new government, its commitment to business and to economic reform, will provide clues. Investors – both international and domestic – who have held on to their capital and investment decisions over the past few years are waiting for the current Congress party led government to leave and hoping for a stable new administration, with a strong mandate to fix the economy. The likelihood of a right-of-centre government led by the BJP and its prime ministerial candidate, Narendra Modi, is predicted by many opinion polls. Yet, there is also the chance of an unwieldy coalition of regional and smaller parties. The implications of these two outcomes will be very different.

Irrespective of how the elections go, there will be a new set of policy-makers and policy imperatives at work in New Delhi. A quality political risk analysis practice would anticipate and identify the possible key decision makers and priority areas. That aside, as India's politics has become more competitive and its polity more federal, the role of state governments and smaller/state-level political parties in influencing policy or becoming key interlocutors for specific businesses and investors has also heightened. This makes political risk analysis in India that much more fascinating and crucial to running a business or taking an investment decision. This is the general truth for the medium to long term; it is absolutely vital in the coming year, 2014-15.

Ashok Malik, Public Policy Analyst and Political Commentator

PREFACE

Political Risks: Need For An Early Warning System

Political risk analysis has emerged as a vital tool for businesses globally to assess ground realities before taking any major decisions.

With political uncertainties and policy paralysis gripping most emerging nations,market investors are growing more anxious, directing their efforts to spot them early on.

A recent news report by Reuters stated that political risks have been amplified in the so-called **'Fragile Five'** of Turkey, South Africa, India, Indonesia and Brazil, the emerging economies with the biggest overseas financing needs.
Independent political commentator Mr Ashok Malik says ‘’Political risk analysis has become more relevant in the current situation as it enables business to make better decisions, negotiate fair contracts and create risk mitigation strategies.”

As most businesses look for predictability in policy, taxation and regulation, and a sustainable environment to do business, it is imperative to spot the risks that may arise due to political uncertainties early on, and find solutions to mitigate them.

The consultation paper **Political Risk Analysis – Measuring Political & Business Scenario and Associated Risks** is an attempt to empower businesses with insights on risks and new opportunities.

Corporate leaders and risk managers across entities need to be empowered to assess the ground realities before taking a business decision. Our expertise combined with quantitative and qualitative data, management and policy politico analysis will allow us to provide our clients with commercially relevant research and analysis which will enable them to identify new opportunities and mitigate risks.

Aman Gupta
Managing Partner
Strategic Partners Group

Political Risk Analysis and its Relevance

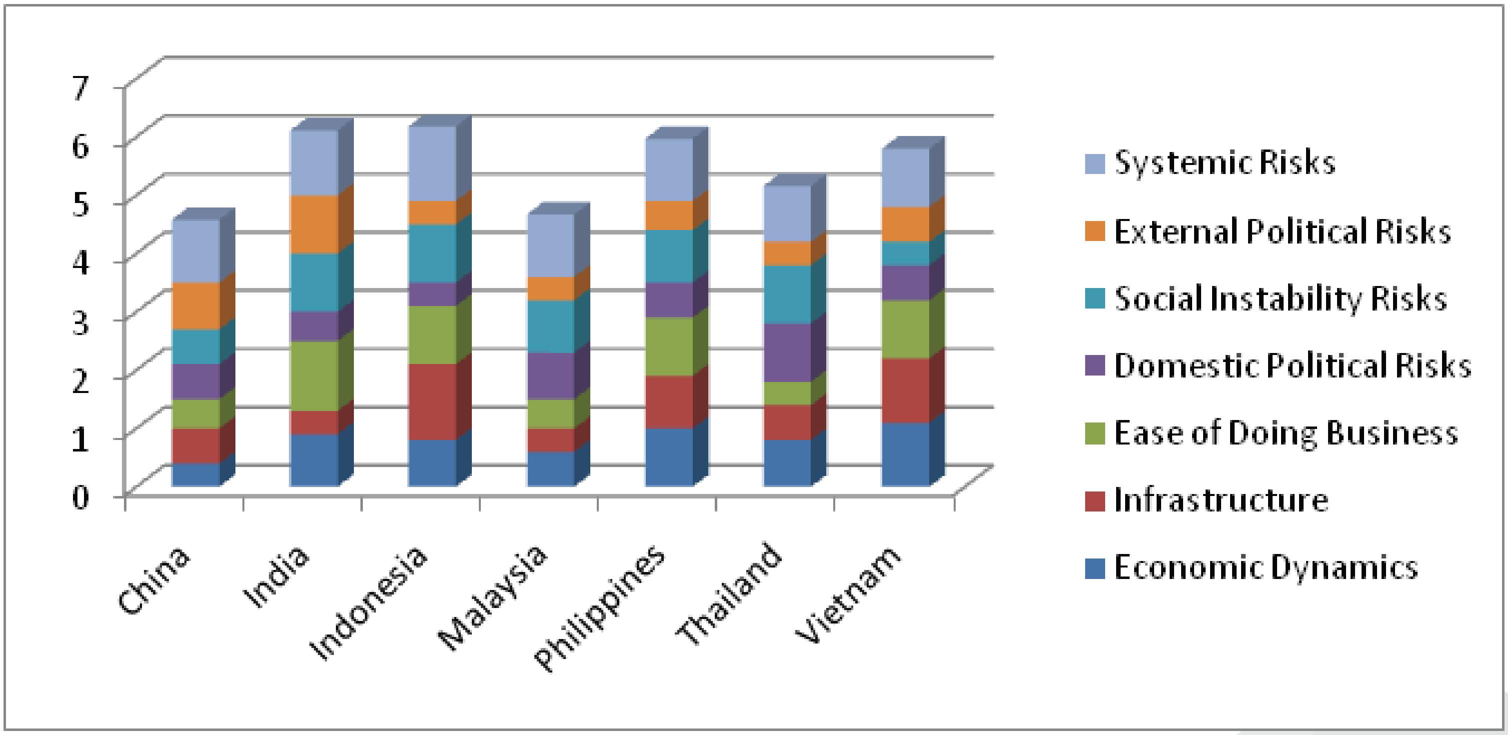
Political risk is directly related to political and policy decisions that may have negative effects on the business plans, goals and potential revenues of companies operating in the host country. In other terms, political risk can more precisely be associated with the risk of losing money as a result of changes in a country's government or its policy and regulatory environment. As such, political risk analysis plays a significant role in enabling companies to decide on the feasibility of their investments and future business plans.

Political risk analysis is gaining prominence nowadays in India and its Southeast Asian peers as the business environment is quite challenging, where a single political development, unforeseen, unanticipated and often ignored by other types of risk analysis, can spell the difference between significant business advance and setback. Companies can use political risk analysis to mitigate these uncertainties in their narrow fields.

Assessment of Business Environment

In today's environment, more and more companies are expanding internationally, and particular in the growing Asian markets, in order to increase their global reach and enhance revenue and profit streams. Each country has its own strengths and weaknesses, which leads to lots of opportunities and threats.

Overall Business Environment Scores



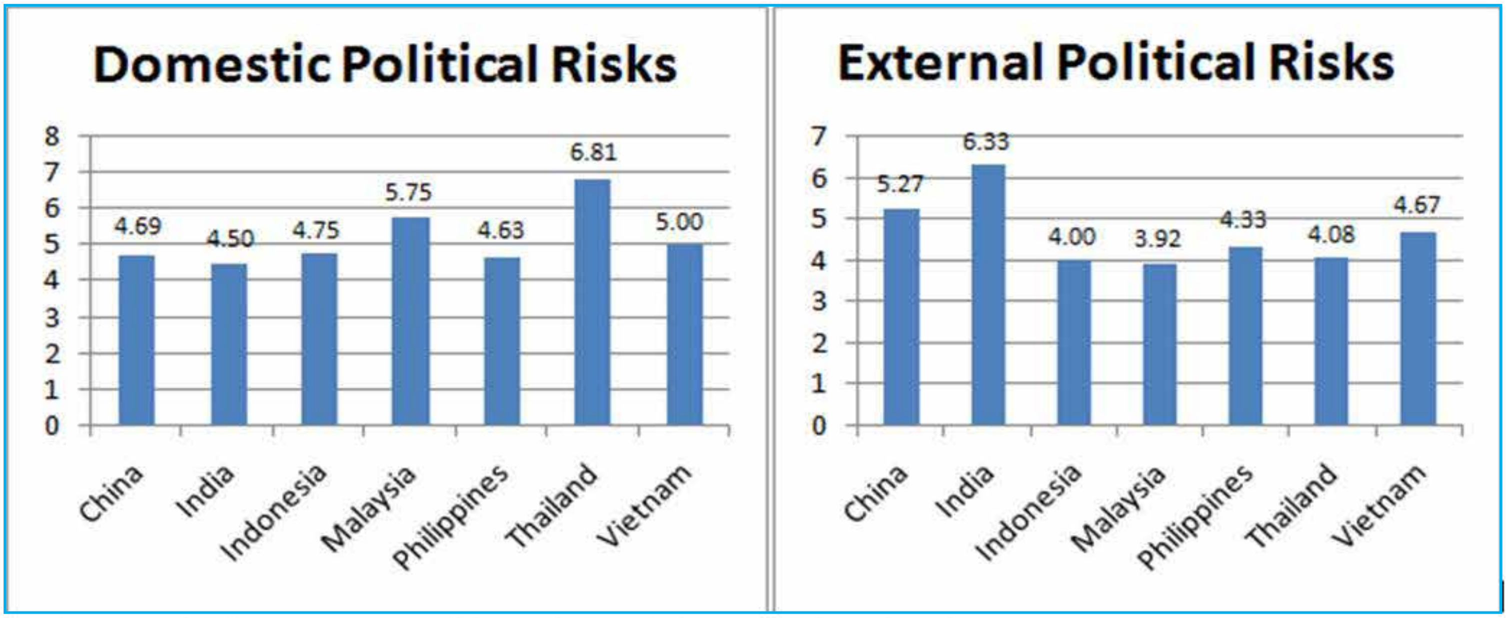
Grades are scaled from 0 to 10, with 0 being the best possible and 10 the worst

Excerpt from Emerging Asia SWOT Report, a publication of Political & Economic Risk Consultancy, Ltd.

Analysis

- China has the best overall score of the emerging Asian economies, while Indonesia has the worst overall score.
- India is the most difficult country to do business, followed by Indonesia and the Philippines, while Thailand and Malaysia are to two countries where it is easiest for foreign investors to do business.
- Social instability risks are highest in India and Indonesia, while they are lowest in Vietnam and China.
- External political risks are highest for India mainly due to security threats posed by Pakistan, while China is in second spot in terms of external risks, as it is encountering more friction with many of its neighbors.

Political Risk: A Significant Aspect of Business Environment



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The domestic political risk section analyzes risks to the business environment caused by potential threats to government stability and the quality of government policies. Policies can change quite radically from one government to the next, and even if there is no change in government it is possible for the party in power to change policies in ways that alter the business environment. An ancillary risk is associated to a government's efficacy, capacity and ability to implement its policies effectively and efficiently.

The external political risk section is associated with changes in other countries, or in the international system, that could directly or indirectly affect the business environment in the country being analyzed. Some forms of direct external risks are the possibility of trade and related discriminatory protocols or barriers. Indirect forms of external risks include policies of other governments that might affect global economic and trade growth, exchange rate stability, immigration flows and direct investment trends.

As leading Indian business journalist Deepak Joshi puts it, "Businesses look for predictability in policy, taxation and regulation. Emerging economies such as India tend to be volatile on these fronts. Political risk analysis therefore becomes necessary tool."

Current Risk Assessment and Forecast (2013)

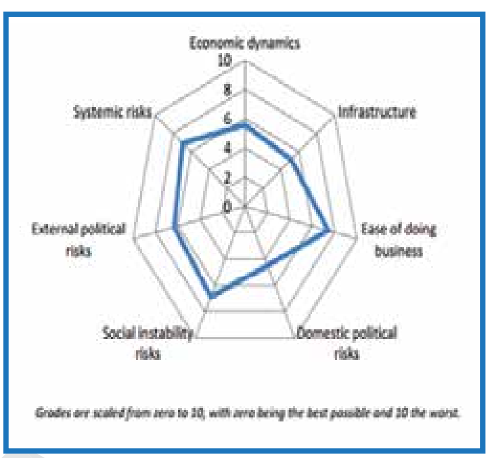
Country	CURRENT RATINGS				COMPOSITE RATINGS				
	Political Risk 01/13	Financial Risk 01/13	Economic Risk 01/13	Year Ago 02/12	Current Rating 01/13	Forecasts One Year WC	Forecasts One Year BC	Five Year WC	Five Year BC
Australia	83.0	34.0	40.5	76.8	78.8	74.0	81.0	70.8	84.3
Bangladesh	49.0	41.0	34.0	61.5	62.0	56.3	66.8	51.5	71.0
Brunei	80.5	48.0	47.0	88.8	87.8	83.0	88.3	75.3	88.5
China	62.0	47.5	40.5	74.0	75.0	70.0	78.5	59.8	81.5
Hong Kong	77.0	41.5	42.0	83.0	80.3	76.8	83.8	73.5	86.8
India	58.5	41.5	32.5	66.5	66.3	63.0	71.5	56.5	76.5
Indonesia	55.0	41.5	36.5	67.8	66.5	63.8	70.8	57.0	73.5
Japan	79.5	41.0	37.5	80.0	79.0	76.8	83.5	71.8	86.5
Korea, DPR	47.0	33.5	28.0	54.0	54.3	48.3	56.5	42.3	61.5
Korea, Rep	77.0	41.5	42.5	78.5	80.5	75.5	83.3	70.5	86.0
Malaysia	70.5	43.0	40.5	76.8	77.0	72.3	79.3	65.8	83.5
Mongolia	65.5	39.5	30.0	68.0	67.5	62.5	70.8	59.0	74.5
Myanmar	54.0	41.5	33.0	65.3	64.3	57.3	68.5	49.5	73.0
New Zealand	87.5	37.0	38.5	80.3	81.5	76.3	83.0	71.0	86.5
Pakistan	45.0	35.5	31.0	57.3	55.8	51.8	61.8	45.5	65.5
Papua New Guinea	60.5	38.0	27.0	62.5	62.8	56.8	65.8	51.8	71.3
Philippines	62.0	44.0	39.0	71.0	72.5	67.5	75.0	62.3	78.3
Singapore	83.0	45.5	44.0	87.0	86.3	81.5	88.8	75.8	91.0
Sri Lanka	54.5	35.0	33.0	62.8	61.3	56.5	66.0	51.8	70.8
Taiwan	77.0	45.5	40.5	83.5	81.5	75.8	83.8	69.3	86.5
Thailand	57.5	43.0	38.0	70.5	69.3	62.5	72.0	56.8	78.5
Vietnam	61.5	39.0	34.5	66.0	67.5	62.8	70.8	57.0	74.3

Excerpt from Table 2B, International Country Risk Guide, a publication of The PRS Group, Inc.

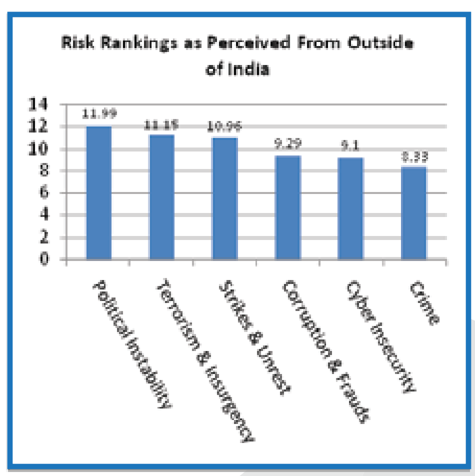
India’s Business Environment: Brief View

Over the last few years, internal and external political and economic forces have played a significant role in influencing the terms and conditions surrounding foreign direct investment in India. Insufficient efforts by the government and political leadership, regulatory and policy hurdles, an inconsistent and aggressive tax regime, reversals in trade openness and sensitivity to intellectual property, and a slowdown in economic growth have contributed to making foreign investors wary. The country recorded a sharp decline in FDI from $41.7 billion in 2008-09 to $26.9 billion in 2012-13 .

- Corruption is a big problem and a potential source of social and political instability in the near term.
- India’s development strategy for far too many years emphasized import substitution and government intervention. This has created systemic weaknesses.
- The country’s bureaucracy is seen to be overbearing and the political system so vulnerable to special interest groups that even key reforms and projects are implemented slowly.
- India's weak power, transport and communications infrastructure is increasingly seen to be a constraint on economic growth.
- 'Political and Governance Instability' and 'Terrorism & Insurgency' emerged as risk number one and two respectively by companies having headquarters outside of India.
- Enhanced politicization, increased violence and insouciance towards likely consequences are the three most critical factors influencing 'strikes, closure and unrest' in India.
- In 2012, India was ranked 94 among 176 countries on the Corruption Perception Index released by Transparency International. In 2011, India was ranked 95 out of 183 countries on the same Index.
- Norton Cyber Crime Report reveals that in 2012, approximately 42 million people became victims of cyber-attacks in India, having a direct financial implication of USD 8 billion.



Excerpt from Emerging Asia SWOT Report, a publication of Political & Economic Risk Consultancy, Ltd.



Excerpt from India Risk Survey 2013, a publication of FICCI and Pinkerton

http://www.livemint.com/Politics/p9JUO2eUrjkuOITEp1KndL/Do-foreign-investors-still-buy-the-India-story.html

General Elections: The Game Changer

A majority of credit rating agencies and analysts are of the opinion that India would start attracting foreign investment only after general elections and the positive policy signals from a new government, likely to take office in the second half of May 2014. Prospective investors have adopted 'wait and watch' approach as they want to see how second-generation economic reforms unfold in the coming months and gauge the new government's political stability as well as policy commitment to growth-oriented economics. As Pramit Pal Chaudhari, foreign editor of Hindustan Times and member of India's National Security Advisory Board, says, "Political risk is emerging as the number one factor in determining investment and business decisions for international companies looking at India."

The case is similar with other Asian and Indo-Pacific countries that have either seen elections in 2013 or are due to vote in 2014 and 2015, including Australia (2013), Malaysia (2013), Philippines (2013), Cambodia (2013), Nepal (2013), Pakistan (2013), Bhutan (2013), Indonesia (2014), Bangladesh (2014), Thailand (2015) and Myanmar (2015).

Policy Paralysis: A Growth Barrier

As the second term of the Congress-led coalition government comes to an end in India, its record has disappointed business. Policy paralysis and slow decision making have resulted in a weak macroeconomic situation, with high fiscal and trade deficits, high interest rates and high consumer inflation. India stands at 179th position in terms of ease of starting a business, down from 177th rank a year earlier, according to the World Bank. The best of intentions can falter if the government cannot sell them to the public or get government institutions responsible for implementing policies to do their jobs properly. It a nutshell, this landscape political risk analysis helps businesses navigate.

One of the latest incidents of the government's policy paralysis is the breakdown of partnership between Bharti and Walmart, which blamed India's foreign investment rules behind the split. Another such example is FDI in the retail industry, in which the government has so far not received even a single proposal due to lack of clarity. The insurance sector is alsosuffering as the government is still struggling to increase the FDI cap from the existing 26% .

http://www.dawn.com/news/1053894/policy-paralysis-in-india
http://www.livemint.com/Politics/p9JUO2eUrjkuOlTEp1KndL/Do-foreign-investors-still-buy-the-India-story.html

Conclusion

Political risk analysis has emerged as the most significant tool for the private sector over the past decade, with growing number of firms depending on it to inform their business choices. The assessment of political risk enables your business to make better decisions, negotiate fair contracts and create risk mitigation scenarios. The risk assessments lead to accurate plans that are less likely to result in budget overruns or delays. Government policies, economic growth, FDI rules, tax regimes, infrastructure and approval procedures among others are all part of the political risk analysis that define the goal of business strategy and the favorability of doing business in a country.

Political Risk Analysis: A Specialised Offering by SPAG Asia

Political Risk Analysis is a specialized offering by Strategic Partners Group (SPAG Asia), bringing together a highly experienced team of former officials, political analysts and sectoral experts, to analyse the ground realities and empowering clients with insights on risks and new opportunities.

It is a mix of quantitative and qualitative data, and management and policy politico analysis to help global entities take informed business decisions and mitigate risks arising due to political uncertainties and policy paralysis.
The key offerings include Economic and Political Risk Assessment; Regulatory Risk Analysis; Parliamentary Monitoring; and Media Monitoring and Analysis.

SPAG Asia is a multi-disciplinary Marketing Communications and Advocacy firm with expertise in the areas of Branding, Marketing, Public Relation, Advocacy and Digital Marketing. Headquartered in Singapore and with offices spread across key locations in the Asia-Pacific region, we have a parallel set-up in India (Gurgaon), supported by affiliates across all the India states.

For any queries, please contact

Aman Gupta
aman.gupta@spag.asia
Mobile: +91-9810091402

Siddhartha Kashyap
siddhartha.kashyap@spag.asia
Mobile: +91-9971455999

Gaurav Chaudhary
gaurav.chaudhary@spag.asia
Mobile: +91-9717466376