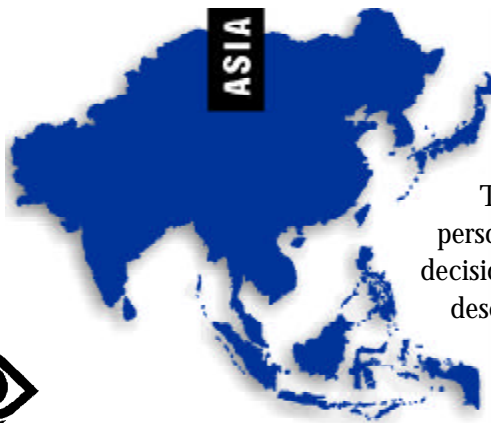


Commentary

The Asian economic crisis of 1997-98 demonstrated that countries once considered economic models are vulnerable to sudden, unexpected changes in political sentiment. The close collaboration between governments and businesses in economic management, once seen as a source of strength, became vilified as “crony capitalism,” and cited as one of the core weaknesses leading to the crisis. In the wake of the Asian collapse (and similar events elsewhere), business and government leaders have had to refine their approaches to decision-making and planning. Unfortunately, business still often takes the political environment for granted, even though post-crisis Asia in particular demonstrates the need to incorporate political risk into strategic planning.

One approach to risk management is scenario planning, in which alternative futures for a company or country are developed as a way for decision-makers to prepare for the unpredictable. The Asia Pacific is ideal for using this tool because the convulsions – and the recovery — defied the expectations of most observers, and tested the limits of corporate and government planning. Over recent years, several major Canadian businesses have grappled with political risk challenges as they attempted to exploit opportunities in Asia: Bell Canada and Montreal’s Telesystem International Wireless in China; B.C. Hydro and SNC Lavalin in Pakistan; and a number of gas and mining companies in Indonesia. While Canadian businesses will not be able to eliminate risks through scenario planning, by being prepared they can breathe easier.



Political Risk in Asia Pacific

The role of government in the Asia Pacific and the importance of personal and family connections have always been major factors in business decision-making. While the Asian crisis starting in 1997 was initially described in economic and financial terms, it soon became apparent that underlying the collapse was a permissive political framework. The development of an impartial legal structure to enforce contracts and protect property, and the evolution of more transparent public decision-making, will be an ongoing challenge.

Although economies in the region are gradually reforming in these directions, political risk factors have not disappeared; indeed, it is often in the period of transition that the greatest challenges appear. Unfortunately, business still often takes the political environment for granted. As political scientist Joseph Nye noted: “Security is like oxygen. You only notice it when it’s not there.” Crises are not anticipated, and are only addressed once they arise. In a survey of corporate leaders, Hong Kong’s Political and Economic Risk Consultancy found that businesspeople usually feel much more comfortable with “concrete” macroeconomic data than the less quantifiable – but no less important – information on the political and social environment in which they operate. However, quantitative data is often unreliable and volatile, while the challenge of political change is very real.



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**‘Old’ and ‘new’
economy firms
face political risks**

Both “old economy” and “new economy” companies face political challenges in Asia. For “old economy” businesses, especially in natural resources, the threats of expropriation, heavy regulation, and bribery have always loomed large. In the past, when strong feelings of nationalism in post-colonial governments generated suspicion toward foreign investment, expropriation was a primary concern. Nationalism certainly has not disappeared. However, today developing countries, sometimes under tutelage of the International Monetary Fund, generally follow a much more orthodox approach to economic management, and welcome foreign investment. The emergence of new forms of investment, such as BOTs (Build, Operate and Transfer) has meant there is more incentive for a host country to support the success of foreign enterprises. This does not mean these businesses are free from political pressures.

**Subtle, ‘creeping’
controls threaten
resource companies**

Today, political risks may have become more subtle than in the past, which means that they can be easily neglected. However, they cannot be ignored. As governments overhaul their regulations, firms can become caught in a complex web of change. One of the more insidious forms of political risk is what analysts refer to as “creeping expropriation,” whereby governments do not actually seize a foreign investor’s property, but slowly make it impossible for it to do business. Creeping surcharges such as export fees, or requirements to use local materials sourcing and transport can gradually reduce the feasibility of a foreign venture.

**IT firms run into
problems over
political issues**

“New economy” companies similarly face challenges, especially in countries that wish to maintain their ideology (or at least leaders who wish to retain their positions of power), while still benefiting from the advantages of a market economy and globalization. In China, for example, the powerful Ministry of the Information Industry has created several state-owned websites, and banned foreign investment in Internet operations, at least until China accedes to the World Trade Organization(WTO). Additionally, the Data Encryption Management Commission regulates all use of encryption technology in the country, acting as another barrier to e-commerce.

Canadian Businesses and Political Risk in Asia

**Canadian firms have
hit snags in North,
South and West Asia**

Examples of political risk impacting on a business are not easy to identify, because, in addition to becoming subtler, they often affect corporate performance negatively. Accordingly, many companies are reluctant to reveal the extent of the political risk challenges they grapple with on a daily basis. Nonetheless, the following examples give some sense of the range of political risks faced by Canadian companies from both the “old” and “new” economy.

- Investments by B.C. Hydro and SNC Lavalin in the Raiwind power plant project in Pakistan were put at risk in 1998 after a change in government. The new Prime Minister, Nawaz Sharif, alleged that the firm and its partners paid bribes to officials in the administration of his bitter rival and predecessor, Benazir Bhutto, in exchange for setting their tariffs at artificially high levels. SNC’s stock dropped 70 cents on the Toronto Stock Exchange when the story broke in Canada, resulting in a total loss of C\$33 million in market value. B.C. Hydro later sold its share in Raiwind to SNC, which remained in the project, for C\$2.4 million, far less than the C\$10 million initial investment.

- Resource companies operating in Indonesia, including Canadian multinationals like Inco, are grappling with challenges of the fallout from the Asian economic crisis and the threat of Indonesian disintegration. According to a November 1999 report by the Indonesian Chamber of Commerce, total Canadian investment in Indonesia was just over C\$8 billion, with C\$2.7 billion in mining, and C\$4 billion in gas production. Decentralization is considered the solution to various demands for political autonomy in the country, but it would pose a headache for foreign investors, which may face different governments claiming overlapping authority to regulate and tax.

- In October 1999, more than 20 foreign companies, including Bell Canada International Inc. and Montreal's Telesystem International Wireless, were barred from receiving money earned from their C\$2 billion joint operations with China Unicom, that country's second largest telecommunications firm. China Unicom worked with several foreign companies to devise an investment structure called "China-China-foreign" to get around the official ban on foreign participation in the telecommunications industry. The money and technical expertise acquired was used to build up its mobile-phone network. Government officials later ruled that the structure was illegal. China Unicom offered to repay the invested money plus a small amount of interest. However, few of the companies accepted the offer, citing the low return on investment that they would receive, and the value that they created for China Unicom, which launched a C\$7.3 billion initial public offering on foreign stock exchanges in June 2000. Ultimately, China Unicom reached agreements to return the investments of both Canadian firms.

These are only a few recent examples, and they likely represent only the tip of the iceberg. The majority of cases are rarely discussed in public because of their sensitivity.

Scenario Planning

How can Canadian firms learn to anticipate or limit political risk and even turn it to their advantage? One useful technique is scenario planning, which, dealing with factors broader than just political risk, such as the social and ecological changes, helps to draw out key political considerations.

Scenario planning grew out of the Second World War

Although thinking about the future has a long history, the origins of the systematic approach of scenario planning are fairly recent. During the Second World War, social and natural scientists were mobilized in unprecedented numbers to both attain the victory and plan the peace. With the development of nuclear weapons, the world confronted new uncertainties and risks. The US government, through the RAND Corporation, used scenario planning to project the potential implications of nuclear conflict. This highlights one of the enduring features of scenario planning – thinking the unthinkable, and forcing organizations to consider how they might respond.

Shell applied the technique to the private sector

The private sector, lead by firms such as Royal Dutch/Shell gradually adopted scenario planning, and the technique reached a zenith in the 1970s. Shell's recognition that producers in the developing world might restrict oil supply gave the firm a strategic edge over other companies that did not prepare for that possibility. Additionally, two leading consulting firms that deal with elements of scenario planning, Britain's Oxford Analytica and Hong Kong's Political and Economic Risk Consultancy were established in 1975 and 1976, respectively.

Recent studies have looked at the future of China . . .

The 1980s saw a lull in the use of scenario planning as corporations downsized, although leading converts, such as Royal Dutch/Shell, continued to rely on it. In the 1990s to the present, there has been a resurgence of interest in scenario planning. Part of the rise in political risk has been due to the decline of the bipolar Soviet-US system, leaving many new countries without superpower support for development. Scenario planners have turned their attention toward Asia. An American scenario planning team trained in the Shell methodology recently published a book entitled *China's Futures*, which traces three potential paths for that country through to 2022. They labeled them "China Web," "The New Mandarins," and the "The Thief of Beijing." In China Web, the country would become a vast network of decentralized enterprises, functioning along the lines of a modern market economy. In The New Mandarins, power would be shared among a small elite group of families, with both politics and business run along the lines of *guanxi*. In The Thief of Beijing, a highly centralized authority would impose itself on the country to maintain order in the face of the negative consequences of development. The authors see positive and negative sides to the first two options, but considers the centralized force in the third scenario to have only a downside.

. . . and at social change and new technology in Canada

One Canadian effort to use scenarios to help plan for the future was the Project on Governing in an Information Society, a roundtable of senior public servants, private sector representatives, and academics. Drawing on experts who were trained in the Shell methodology, the roundtable developed four possible scenarios for governing in a knowledge-based society over 1995-2005. The scenarios were based on the level of social consensus on the one hand, and economic growth on the other. The four possible futures were named "Starship," "HMS Bounty," "Windjammer," and "Titanic." In Starship, the market economy and information technology revolution create a rising tide lifting all boats, resulting in a new social harmony. Globalization yields constant innovation and change, bringing wide-ranging benefits. The opposite scenario to Starship is Titanic, in which the economic benefits of the information society prove to be largely an illusion. Much of society becomes alienated, and confidence in government erodes substantially. The intermediate scenarios are

Scenario Planning Step by Step

The Global Business Network (www.gbn.org) using a modified Shell method, suggests an eight-stage approach to scenario planning. The steps in brief are:

- (1) Identify the focal issue or decision.
- (2) Identify key forces in the local environment.
- (3) Identify driving forces – broader environment.
- (4) Rank by importance and uncertainty.
- (5) Select scenario logics – combine all the different variables to produce the sum total of the different scenarios.
- (6) Flesh out scenarios – examine the specifics of what would occur under each set of developments.
- (7) Implications – return to focal issue or decision and examine the consequence of each scenario for it.
- (8) Selection of leading indicators and signposts – signs to watch to alert you to which scenario is most accurate.

Source: Peter Schwartz. *The Art of the Long View*. New York: Doubleday, 1991.

HMS Bounty and Windjammer. In HMS Bounty, a booming economy benefits only a small elite, resulting in sharp social polarization. In Windjammer, the negative consequences of economic growth, such as environmental damage, become apparent, and Canadians place a higher priority on social consensus, fairness, and sustainability.

Rapid change makes Asia ripe for scenario planning

The Project on Governing in an Information Society dealt with the international dimension only indirectly. An information society, with the quick transmission of ideas around the world, implies an important role for globalization. The opportunity exists for Canadians to bring the international dimension more explicitly into their planning. The Asia Pacific and scenario building are a compatible match, because the region's recent developments challenge the conventional wisdom that scenarios are designed to move beyond.

Canadian business can use new tools to chart Asian strategy

Three years after the Asian economic crisis, much of the region appears to have bounced back. But appearances can be deceiving and circumstances can change dramatically. Six months ago, there would be few prepared to forecast a rapprochement between North and South Korea so quickly that Canada would be preparing to name an Ambassador to Pyongyang. Despite the discrediting of the Asian economic model, governments and political factors remain formidable forces in the Asian business environment. Economic reforms, such as privatization, will occur unevenly, and often grudgingly. In this uncertain and volatile environment, Canadians can benefit from a careful analysis of the political factors that continue to shape one of the world's most dynamic markets. Scenario planning is one tool that can help with this analysis.

For general information on APFC publications
Tel: (604)684-5986
Fax : (604)681-1370
e-mail: info@apfc.apfnet.org
or visit our website:
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Scenario Planning at the Asia Pacific Summit

The Asia Pacific Foundation of Canada's "Asia Pacific Summit," to be held on October 18 and 19 in Vancouver, will give risk analysis and scenario planning a prominent role. The Foundation has invited three leading groups, Oxford Analytica, the Political and Economic Risk Consultancy, and the Export Development Corporation, to facilitate workshops on the three-to-five year outlooks for four countries, China, Japan, South Korea, and India. These highly interactive sessions will allow participants the opportunity to build scenarios that are directly relevant to the environments in which they operate every day.

The following is a sample of some of the key risk challenges that Canadian businesses might face in the four countries.

China:

- Strategic relations with Taiwan (reunification), the United States (e.g. theatre missile defence) and India.
- Domestic consequences of integration into world economy through WTO entry (e.g. closing of state-owned enterprises).
- Beijing's ability to exert authority over its regions.

Japan:

- Northeast Asian political instability (the role of North Korea).
- Possible larger role in security in Asia, and the reaction of neighbours.
- Failure of economic policy to end recession.

South Korea:

- Prospect of failure of reconciliation with North Korea.
- Economic reform, and the role of the chaebol.
- Reactions toward increased foreign ownership of major businesses.

India:

- Strategic relations with Pakistan (e.g. Kashmir, nuclear weapons).
- Strategic relations with China (border dispute).
- Opposition to liberalization by Hindu nationalists.
- Domestic implications of the IT revolution.

For more information on the "Asia Pacific Summit" see www.asiapacific.ca/apsummit.