EMERGING CROSS BORDER RISKS IN GLOBAL BUSINESS

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ABSTRACT
Cross border businesses are hedged with several risks and therefore there is an imperative need for such business entities to take adequate precaution to safeguard themselves against the risks by putting in place an effective risk management system and reviewing the same from time to time.

Key Words: Cross Border Risks, Types of Risks, Risk Management.

INTRODUCTION

Cross Border Businesses basically cover two types of business namely Trade and Investment. The days when business enterprises were purely nationalistic in their business strategies are almost over. Even many of the smallest companies now operate across multiple jurisdictions. In fact, some companies are today 'born global' and derive a high proportion of their revenues from overseas customers from their inception. E-Commerce is a special category of borderless business or having limits in its operation beyond borders. For e-Commerce, the world is indeed "flat." Cross-Border Businesses, Multinational Corporations (MNCs) or Transnational Corporations (TNCs), Foreign Institutional Investors (FIIs), Foreign Direct Investors (FDIs) have long played an important role in the world economy. Greater international exposure introduces companies with potential opportunities. Local opportunities for revenue growth constrained for some years bound many companies across the region – both in Europe's better performing and 'deep crisis' economies – are directing their exports and capital investments beyond the European Union (EU). Greater specialization and supply chain complexity can also cause companies to look overseas, because the best – and often the cheapest – services, such as manufacturing or business process outsourcing, may be found many thousands of miles away from corporate headquarters. All these International trade and investment associated with higher levels of diversified risks.

DIFFERENT TYPES OF RISKS

Micro and Macro Risks

These are risks that a foreign government may significantly alter its policies or other regulations so that it negatively impacts the business climate in that country or the returns on a particular industry, company, or project. Macro-country risk deal with policy changes that harm, say, exporters or foreign-owned businesses in general, while micro-country risk implies that a government will deliberately target a particular company or way of making a living. For example, the political climate of a country in which defense contractors operate may turn against one particular company because of its perceived excesses or against defense contractors in general. This may cause the government to revoke contracts for one or more defense contractors.

Political Risks

Political risk is the risk that a foreign government will significantly alter its policies or other regulations so that it significantly affects one's investment. Political risk is a fact of commercial life for companies and institutions with overseas investments and contracts. More broadly, it can apply to the risk that a nation will refuse to comply with an agreement to which it is a party, or that political violence will hurt an investment or business. For example, if one exports goods to a foreign nation, and that nation elects a new government that enacts protectionist tariffs, this will negatively impact the export business. Recent events in the Ivory Coast, Egypt, Greece, Italy and Libya have highlighted the growing risk issues around cross border trading. Many businesses are more than aware of the physical and more obvious risks in this area, but are less familiar with the potential for interruption caused by politically driven regulation including sanctions, arising from multiple multilateral, national, regional and domestic sources. Politically motivated violence, wars, terrorism and civil wars continue to affect over half of the countries of the world and many do not have the institutional robustness to absorb such events. Furthermore, there have been plenty of examples in recent years of resource nationalism, Government

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restrictions on capital flows and breach of contract. Politics are exerting ever greater influence over cross border trade and it seems that this influence will continue.

Foreign Exchange Risk

In foreign exchange, the risk is that a foreign central bank will significantly alter its monetary policy or other foreign exchange regulations so that it significantly affects one's currency trades. More broadly, it can apply to any political risk that a nation will refuse to comply with an agreement to which it is a party. For example, if one conducts a currency trade involving a pegged currency and the country in question decides to let its currency float, it can significantly impact the profitability of the currency trade. Governments can impose restrictions on levels of foreign ownership, foreign exchange availability and rates, or movements of cash and securities. Any of these events, especially when they occur without prior notice, can impede and/or delay settlement in the related market. To the extent that relationships exist between transactions in the restricted market and other markets, liquidity and credit risks can increase, ultimately spreading to other markets. In Fixed Currency, the government may link the value of another currency or, rarely, some valuable commodity like gold. For example, under the Bretton Woods System, most world currencies fixed themselves to the U.S. dollar, which in turn fixed itself to gold. A government may fix its currency by holding reserves of the other currency (or the asset to which it is fixed) in the central bank. For example, if a country fixes its currency to the British pound, it must hold enough pounds in reserve to account for all of its currency in circulation.

Geographic Risk

This is a risk to an investment in a specific geographic area. Specifically, it refers to the possibility that a natural disaster to which an area is prone will negatively impact an investment. For example, a company pumping oil in the Gulf of Mexico carries a geographic risk that a hurricane will destroy its infrastructure. In Turkey Regional Investment Incentives Scheme Instruments are provided to the Investors to invest in six different regions. The Government of India has put in place several policy measures and incentives to attract investors to establish business into the underdeveloped or least developed and Special Economic Zones. The Industrial zones of Baddi in Himachal Pradesh, Pauri in Uttarakhand come under Himalayan region.

Environmental Risk

It is an estimate of the likelihood or probability of an adverse impact on the environment resulting from human activities. The environment is important because of its ecological, economic or social significance to an ecosystem. All species human, animal and plant have an intrinsic right to a healthy environment and this right extends beyond the present generation to the future generations. A factor affecting ecosystem processes functions or attributes, which are related to human actions. Impacts from past pressures have resulted in a variety of cumulative effects (e.g., land use decisions, dam construction, etc.) The Union Carbide Gas disaster in Bhopal is a classic case of Environmental impact. The Vedanta Alumina has established a 1 mtpa plant in Lanjigarh in Odisha and they are now not allowed to get Bauxite from Niyamgiri which is a tribal inhabitation and a relentless campaign has been launched against mining of bauxite by certain sections of society, political class, NGOs, in the name of environment and tradition. In certain cases the business has adverse impact and in some cases there is opposition perceiving environment impact.

Financial Risk

Financial risk is an umbrella term for multiple types of risk associated with financing, including financial transactions that include company loans in risk of default. Risk is a term often used to imply downside risk, meaning the uncertainty of a return and the potential for financial loss. In addition to financial risks, there are five broad categories of investment risks known as five risks. Financial risk more particularly covers credit risk and market risk. Other types include Foreign exchange, Share Volatility, Sector, Liquidity, Inflation risks, etc. Market risk is the risk of losses in positions arising from movements in market prices. Some market risks include:

1. Equity risk, the risk that stock or stock indexes (e.g. NSE 50, etc.) prices and/or their implied volatility will change.

2. Interest rate risk, the risk those interest rates (e.g. Libor, Euribor, etc.) and/or their implied volatility will change.
3. Currency risk, the risk that foreign exchange rates (e.g. INR/USD, EUR/GBP, etc.) and/or their implied volatility will change.
4. Commodity risk, the risk that commodity prices (e.g. corn, copper, crude oil, etc.) and/or their implied volatility will change. Risk of rapid and extreme changes in value due to: smaller markets; differing accounting, reporting, or auditing standards; nationalization, expropriation or confiscatory taxation; economic conflict; or political or diplomatic changes. Valuation, liquidity, and regulatory issues may also add to foreign investment risk.

Systemic Risk

Systemic Risk is commonly referred to as the inability of one institution to meet its obligations when due which will cause other institutions to be unable to meet their obligations. A settlement system where the primary means of settling in a default is an unwind increases the risk of subsequent defaults or fails by other local or cross-border intermediaries. Depending upon the availability of cash and/or securities to complete trades, unwinds could have a liquidity domino effect on otherwise non-defaulting parties.

Legal Risk

Legal Risk, is defined as the risk of loss that arises from an unexpected application of law or regulation or because a governing contract cannot be enforced. The outdatedness and discordant nature of various countries' lien and bankruptcy laws may jeopardize the ability to obtain clearly perfected collateral interests. This in turn may lead to reluctance to undertake transactions, failure by intermediaries to protect themselves by taking collateral, or the upsetting of legitimate commercial expectations if arrangements in which collateral is assigned are not respected by a bankruptcy court.

Sovereign Risk

Sovereign Risk arises when a government takes an action, with or without notice, which affects the market price of assets or restricts movement of assets and funds. Governments can impose restrictions on levels of foreign ownership, foreign exchange availability and rates, or movements of cash and securities. Any of these events, especially when they occur without prior notice, can impede and/or delay settlement in the related market. To the extent that relationships exist between transactions in the restricted market and other markets, liquidity and credit risks can increase, ultimately spreading to other markets.

RISK MANAGEMENT

A more diverse international footprint also exposes companies to higher levels of risk. It is only natural in this transformed landscape that cross border businesses would contemplate assuming cross border risk with a greater degree of caution. A combination of a decade of globalization, decoupling in growth patterns between the developed and developing worlds, and the seemingly constant nature of political change implies a new risk profile – whether trading or investing in developed or emerging economies. Indeed, the rapidity with which political upheaval dominates the air waves has many risk managers assessing their firm's readiness for the increasingly unpredictable and fragile markets to which they are exposed and the due diligence is required for more secured trade and investment in other countries. Among the many challenges facing risk managers one crucial issue is how to effectively manage cross-border risks, which is more important today than in the past. The risks associated with cross-border transactions are high and risk aversion is high, but the margin for error is low. This means that risk managers' jobs have become more difficult. As value chains become more extended and complex, companies must be able to identify, assess and mitigate risks across multiple and less familiar jurisdictions. This requires a highly robust risk management and insurance framework, and an alertness and adaptability that depend on the right local knowledge and global capability to deal with highly divergent political, economic and regulatory environments. The responsibility for fundamental strategic decisions concerning risks lies with the board of directors. As part of its systematic risk analysis and the internal control system based on it, this body is charged with supervising and controlling, capturing, limiting and monitoring all substantial risks. This also includes the

legal and reputational risks associated with the cross-border business. Executive management, for its part, must develop appropriate processes that enable cross-border business risks to be identified, measured, evaluated, assessed and controlled. In the context of the cross-border business, high importance should be attached to establishing risk tolerance, defining target countries (e.g. countries from which a large proportion of existing clients come, or in which clients are to be actively solicited in future) and the associated marketing strategies, because these factors have a substantial impact on an institution's strategic orientation. The basic law of business is nothing can be gained unless risks are taken, and risks cannot be eliminated entirely. However, risk can be minimized or managed through best practices. Therefore, disclosure of the operational risks taken by the company to the public every quarter of the year has become a customary best practice. This is why certain risk management techniques have become a standard requirement. There are many risk management techniques and they vary according to the type of \ business. Nonetheless there are five basic risk management techniques recommended and generally applicable to all types of businesses.
Risk Management Method

Managing cross border risks is a process of thinking systematically about all possible undesirable outcomes before they happen and then setting up procedures that will either avoid or minimize these risks, or help to cope with their impact. There are six basic elements in the risk management process:

- Identify the risks
- Assess probability and possible consequences of the risks
- Develop strategies to mitigate these risks
- Monitor and review the outcomes
- Communicate and consult with all parties involved.

CONCLUSION

While understanding the cross border risks is challenging, it is possible and this understanding will be key to successful trade and investment in the current and future international business environment. There is also a well-established insurance market that can underwrite risks associated with international trade and investment, which together with appropriate risk analysis provide many businesses with the security and confidence to realize trading opportunities in the challenging environment we operate in today. Inadequacies in the law need to be addressed suitably by the government. Choosing right partners and the right professional advisers is a major step in mitigating risks. Bankers, corporate advisors like Company Secretaries, Lawyers, Insurers and Accountants are able to provide knowledgeable advice about the risks the business may face in overseas markets. A Risk management checklist needs to be prepared defining the areas where the overseas risk differs from the domestic risk profile. List these risks and prepare an action plan as to how to manage or mitigate them by developing a risk management matrix. Regular review of risk profile is necessary to avert the possible risks.

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