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COUNTRY RISK ANALYSIS OF BANGLADESH

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Abstract *In the endeavour of conquering the world's consumers, multinational companies face enormous risks. Such risks may arise from different political, economic, and financial factors. These factors are commonly referred to country risk as a whole. Focusing Bangladesh in this regard, objective of this study is to find out the level of country risk in terms of political, economic, and financial riskiness. Analysis of country risk has been done using an internationally recognised methodology named International Country Risk Guide (ICRG). For political risk analysis, primary data has been collected from 20 journalists, bureaucrats and policy makers, business persons, corporate professionals, and academicians with a structured closed-ended questionnaire. Results indicate that Bangladesh is in high risk position in terms of political risk, low risk position in terms of economic risk and very low risk position in terms of financial risk. Compositely, Bangladesh has been found to be a moderately risky country for investment.*

Keyword: *Country Risk, Economic, Financial, Political, ICRG*

BACKGROUND OF THE STUDY

Before making investment decision, every type of companies make all relevant analysis regarding the profitability, potential variability in their expectations, availability of resources, company's capability etc. When a company considers investing abroad, it has to make analyses specific to its business as well as the foreign country. The term country risk analysis comes to the focus at this point (Sharma, 2009; Vardar, 2010). Bangladesh is a small third world country which is advancing rapidly to its development goal, mixing up and being open to the era of globalisation. The global credit rating agency Moody's Investors Service rated Bangladesh with Ba3 (Islam, 2013) and Standard & Poor's rating services rated 'BB-' long-term and 'B' short-term sovereign credit ratings for Bangladesh in 2013 (Benard & Phua, 2013). Currently, Bangladesh is catching the attention of FDI investors especially because of its natural resource endowment and cheap labour (World Bank, 2013). For this reason, a detailed country risk analysis with respect to Bangladesh is a demand of time today.

Bangladesh is distinguished among the least developed countries because of its relative success in economic and rural development. However rapid industrialisation is necessary in this country to keep pace with the global development process. Low rate of gross domestic savings and gross domestic investment, low level of technology base, weak infrastructure and administration, corruption etc. hamper the expected industrialisation. Therefore, FDI is viewed as a major stimulus to economic growth and industrialisation process of this country (Muttakin & Ahmed, 2005; Talukdar, Biswas, & Pattak, 2009; Rayhan, 2009). Country risk analysis is an important step in the FDI decision by a foreign firm (Alleyne & Broome, 2010; Samara & Kyrkilis, 2012). Though each firm will have separate type of operational and investment risks, overall, being Multinational Corporation (MNC), these firms share a common set of risks. There is no such research work focusing FDI risk in Bangladesh. Therefore, this study will act as a baseline for such MNCs-considering entrance into Bangladesh. These firms will be able to adjust their company specific risk factors with this overall state of country risk. Also, this study will be a great help for the policy makers of Bangladesh to get an overview of the weaker areas. Consequently, it will be possible to take necessary steps regarding those risky areas.

OBJECTIVE

Primary objective of this study is to analyse the country risk of Bangladesh.To accomplish this objective this study has tried to identify the existing and potential political, financial and economic risks.

LITERATURE REVIEW

Investment risk can be defined as the as the level of uncertainty of achieving the desired returns or the probability of realising unexpected results, variability of the actual return or simply the likelihood of occurrence of losses (The Economic Times, 2013). The review of literature suggests three broad categories of investment risks- political, financial and economic.When firms engage in international transactions and operations, they encounter additional risks because of different languages, currencies, jurisdictions, customs,

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habits, etc. that constitute country risk which may affect the value of international assets, investment projects and cash-flows (Levy & Yoon, 1996; Scholtens, 2004). Such as rules and regulations pertaining to the entry and operations, standards of treatment of foreign affiliates, the functioning and efficiency of local markets, trade and privatisation policy, business facilitation measures, restrictions related to repatriation of earnings, market size and growth prospects, infrastructure, property rights protection, stability of political environment, corruption, openness of the host country to international trade, exchange rates, interest rates, taxes, trade protection, availability of information, good governance and transparency in government (Sharma, 2009; Vardar, 2010). Different researchers assessed country risk in various dimensions. Some of them used political, economic, and financial factors in their analysis (PRS Group, 1992; Erb, Harvey, & Viskanta, 1996; Nath, 2008; Basu, Deepthi, & Reddy, 2011). Others analysed based on socio-political, economic, and natural risks (Bouchet, Clark, & Groslambert, 2003) or even only political risk and economic risk (McGowan & Moeller, 2007). In his study on China, Jayaraman (2009) cited political, legal, cultural, negotiation and quality related, scale and demographical, market behavioural, economic and trade policy challenges as country risk factors. Levy and Yoon (1996) based their analysis on economic and non-economic risks where non-economic factor includes political and social conditions, Bialowolski and Bialowolska (2013) worked on macroeconomic and law-related factors.

For MNCs, investigation of the actual and potential risks foreign countries represent has significant impact on their entry and smooth operation in future. Political risk can lead a firm to expropriation, higher taxes or tariffs, reduced FDI incentives, local ownership requirements, local content requirements, labour unrest or strikes or currency inconvertibility that can ultimately result the loss of assets, the termination of operations, reduced after-tax income, higher import costs, reduced revenue, management restrictions, higher production and operational costs, or an inability to repatriate funds (Wafo, Ursprung, & Schweinberger, 1998; Bouchet *et al*., 2003; McGowan & Moeller, 2007). Macro-economic mismanagement can lead to higher inflation and higher interest rates leading to higher costs, planning difficulties, and higher interest costs. As analyzing and assessing country risks is taking the center stage, use of diversified and vibrant models to analyze such risks are more evident now a days. Such models are both quantitative and qualitative in nature. Country risk assessment models can be broadly categorised in five types: the qualitative, structural approach; rating; econometric and mathematical methods; risk models andinternational investment portfolio analysis (Bouchet *et al*., 2003). In the literature of country risk analysis, researchers adopted any or several forms simultaneously from the above mentioned models. Basu *et al*. (2011) used Beta Country Risk Model, as described by Erb *et al*. (1996) and used by Andrade and Teles (2004) for Brazil. Nath (2008) listed the popular quantitative methods used for country risk analysis. Many scholars have performed fully qualitative analysis based on secondary data for country risk assessment (SIDA, 2001; Buthe & Milner, 2008; Jayaraman, 2009; Belligoli, 2011; Danielsen, 2011). Goldblatt (2013) used International Country Risk Guide (ICRG) factors in descriptive ways. Kasatuka and Minnitt (2006) stressed the use of ICRG model to assess non-commercial risk. However, most of the researcher has used several models collectively. For example, Erb *et al*. (1996) used ICRG model along with composite risk measures and Institutional Investor's (II) country credit ratings, Hauser (2005) used rating, indices, composite rating models and correlation of indices, White and Fan (2006) suggested weighted rating method using Delphi technique, Petrovic and Stankovic (2009) proposed methods combining historical data and expected cash flow.

The field of country risk analysis has been well enriched from time to time with great many researches directed to different related aspects of country risk. Studies were done relating to the factors that influence FDI decisions by potential investors (Alleyne & Broome, 2010) and foreign direct investment behaviour of multinational corporations. Devereux and Schiantarelli (1990) investigated upon the link among investment, financial factors, and cash flow with U.K. panel data. Researchers also worked on more specific areas, like, external factors affecting investment decisions of companies were identified by Bialowolski and Bialowolska (2013). Again numerous studies were conducted regarding individual risk factors that influence FDI decisions. Many of them were solely on political risk factor. For example, Goldblatt (2013) analyzed political risk in the perspective of Turkey, Wafo *et al*. (1998) linked political risk with foreign direct investment and Hendrix (1991) related political risk and international business. Furthermore, Butler and Joaquin (1998) provided a note on political risk and the required return on foreign direct investment. Some other studies were on social risk factor as Bekafi, Jenkins, and Kytle (2006) has explained social risk as strategic risk. Financial risk was also analyzed solely by Jorion (2011). Scholtens (2004) associated sovereign risk with financial crises. Other researchers worked on a mixture or risk components, for example McGowan and Moeller (2007) provided a model for making foreign direct investment decisions using real variables for political and economic risk analysis and Erb *et al*. (1996) accumulated all of the three mostly influential risk factors for international investors namely, political risk, economic risk and financial risk.On the other hand, numerous scholars analyzed total country risk and they applied different methods in their analyses. For instance, Basu *et al*. (2011) worked on India to focus country risk analysis in emerging markets and used beta country risk model for that and Jayaraman (2009) performed a qualitative risk analysis for doing business in China. International business

and country risk has been linked by Samara and Kyrkilis (2012) who explored the interaction between foreign direct investment and country risk as well as by Krayenbuehl (2001) who presented an assessment and monitoring of cross-border exposures and country Risk. Some researchers focused on the methods and assessment techniques of country risk analysis, rather than a particular analysis for a specific area itself. Such as, Bouchet *et al*. (2003) provided a guide to global investment strategy focusing country risk assessment, Nath (2008) surveyed the quantitative methods for country risk analysis and Kosmidou, Doumpos, and Zopounidis (2008) summarised methods and applications for country risk evaluation. In addition, methods of country risk assessment for international market-entry decision were discussed by Levy and Yoon (1996).

Above discussion points out that, most of the researches were different country or region based. However, in Bangladesh, no such detailed country risk analysis has been done using internationally accepted models for country risk assessment. Very recently some credit rating agencies are providing credit rating of Bangladesh but their main target users are foreign lenders. Again, some other organisations have performed risk analysis from their respective required points. Therefore there is a gap in the existing literature. This study is intended to fulfill that gap because it will act as a base analysis for any types of MNC looking for FDI and also for foreign lenders.

METHODOLOGY

To identify and analyse the country risk in Bangladesh, International Country Risk Guide (ICRG) 's method has been applied. Political risk rating index is calculated as the sum of twelve political risk components which are qualitative in nature. To collect data on political risk, 20 experts have been selected applying convenience sampling method from five levels: journalists, bureaucrats and policy makers, business persons, corporate professionals, and academicians. Survey methodology with a structured, closed-ended questionnaire has been used to collect response from these experts by face-to-face interview, and email survey. The questionnaire sought demographic profile of respondents but the main body included thirty questions, placed under twelve factors. Questions have been measured on five-point Likert scale having a range from 1 (= strongly disagreed) to 5 (= strongly agreed). After calculating mean score for each question a combined mean score for each of the twelve components has been computed using these question's mean scores. The combined mean score has been divided by 5 to get a percentage point as five-point scale has been used. Finally, the derived percentage points have been multiplied by the respective weights of each component suggested by ICRG method to obtain the overall points awarded. According to ICRG, the score may vary between zero and 100 points. Below 50% is considered as very high risk; 50% to 59.9% is high risk; 60% to 69.9% is seen as moderate risk; 70% to 79.9% is low risk; and 80% to 100% is perceived as very low risk. Therefore, following this benchmark, riskiness of each separate component has been found using weighted combined means.Finally the overall riskiness of political factor has been found using the composite weighted rating that follows the same benchmark used to identify the risk levels of individual components. Financial and economic risk rating have included five components each. There are separate rating index for each of the components of both financial and economic risk factors. Though, the benchmark for the evaluation of each individual component's risk level is same as the political risks, the benchmark for identifying overall financial and economic risk levels is different. For these two, a risk rating of 0.0% to 24.5% indicates a very high risk; 25.0% to 29.9% high risk; 30.0% to 34.9% moderate risk; 35.0% to 39.9% low Risk; and 40.0% to 50%very low risk. After finding the risk rating for political, financial and economic risks, a composite risk rating for Bangladesh has been found following the formula suggested by ICRG method. Again for composite rating 0% to 49.9% is considered as very high risk; 50% to 59.9% is high risk; 60% to 69.9% is seen as moderate risk; 70% to 79.9% is low risk; and 80% to 100% is perceived as very low risk.

POLITICAL RISK ANALYSIS

Political risk can be defined as the most volatile risk among all risk components affecting business operation (Bouchet *et al*., 2003). According to ICRG, the twelve components of political risk index and their weights are: government stability (12), socioeconomic conditions (12), investment profile (12), internal conflict (12), external conflict (12), corruption (6), military in politics (6), ethnic tensions (6), law and order (6), religious tension (6), democratic accountability (6), and bureaucracy quality (4). Now here are the risk ratings to these components from Bangladesh perspective:

Government Stability

For efficiency and stability, government system does require the unity of all of its sub-parts ensuring proper coordination of judiciary, administrative and legislative systems (Lamech & Saeed, 2003) along with its different representative parts (Belligoli, 2011). The strength of the government to formulate, actualize and administer updated and modernised laws and their proper implementation (Rayhan, 2009) and support of the people of a country in government's actions and programs are also important. For a congenial business environment, government stability is a must (Lamech & Saeed, 2003; White & Fan, 2006; Goldblatt, 2013). Individual

mean scores of three subcomponents of government stability are 2.55, 2.80, and 2.60, respectively. It represents that there is deficiency of proper coordination of different government instruments; government hasn't enough strength to enforce the legislation and it hasn't that much popularity and support in its decisions and programs. Combined mean scores of these three represents mean score for government stability which is 2.650. Adjusting this score with the awarded weight 12, a rating of 6.36 is found. It signifies that, in terms of government stability, Bangladesh is in highly risky situation.

Socioeconomic Conditions

Among innumerable socioeconomic factors, ICRG rating method has pointed three factors to be highly correlated to business risk: unemployment, consumer confidence and poverty (PRS Group, 1992; Goldblatt, 2013). High unemployment causes social instability and insecurity, less purchasing capability, propensity to criminal act, or even mass revolution against government (White & Fan, 2006). Lack of consumer confidence in market without free flowing and certain supply of products, stability of price level,quality of products and promises of companies, makes it really very tough for a foreign company to operate. Again, poverty affect education, purchasing choice and capacity, savings, nutrition status of labours (Rayhan, 2009), birth and death rates, employment, consciousness, beliefs and so on. All of these have direct impact on business. Socio-economic conditions of Bangladesh is much better that its government stability. Subcomponents of this component have obtained mean scores 3.50, 1.90, and 3.65, respectively. It shows that, although unemployment rate and poverty is declining, consumers don't feel much confidence about market situations. Combined mean score 3.017 is converted to a rating of 7.24. This rating is gained by adjusting for the weight of 12 for the component socio-economic condition. The rating caused Bangladesh to be moderately risky in this regard.

Investment Profile

Before making an entry, multinational companies formulate different contracts with government, partners, suppliers, customers, employees or other related parties. Broken contracts can create great losses for the company (Lamech & Saeed, 2003). In many cases, generally due to changes in government bodies, companies face expropriation of their assets (Hendrix, 1991). Again, all countries don't allow profit repatriation in similar ways (McGowan & Moeller, 2007). Moreover, at the time of common business dealings companies may face payment delays (White & Fan, 2006). This can create critical working capital shortage, liquidity problem or even default of business credits (Bialowolski & Bialowolska, 2013; Goldblatt, 2013). For foreign investment, Bangladesh is a good place in terms of investing environment. The mean scores of individual components are 3.20, 3.95, and 3.1. There are very few incidence of contract viability and expropriation act from the part of government and profit repatriation is too much easier. However, payment delays happen sometimes though it is reducing now-a-days. Combined mean score of these three subcomponents is 3.417 and weight was 12 in this case also. After adjustment it provides a rating of 8.20. Therefore, Bangladesh is only moderately risky in terms of its investment profile.

Internal Conflict

Internal conflict may involve ethnic or religious groups within a country fighting against each other or against the government to secure autonomy, independence, or well-being (Hendrix, 1991). Common forms of internal conflicts are civil war, widespread and ungovernable terrorism, extreme political violence, civil disorder or coup. Internal conflict has a grave impact on human life, environmental balances, economic growth, development and political stability (Petrovic & Stankovic, 2009; White & Fan, 2006). These conflicts often disrupt economic activity, produce refugees, and influence the internal politics of other counties (Wafo *et al*., 1998). Neighbouring countries and leading world powers often come to stop these conflicts. This interference may affect sovereignty of a nation (Samara & Kyrkilis, 2012). Therefore, countries with ongoing or potential internal conflict are sincerely avoided by the international investors (Muttakin & Ahmed, 2005). In Bangladesh there is a little risk of civil war or coup threat and civil disorder. However, the level of terrorism and political violence is much higher. These situations are revealed with the individual mean scores of 2.85, 2.60 and 1.80 respectively. Combined mean score becomes 2.417 which with a weight of 12 gives a rating of 5.80. It represents that Bangladesh is in very highly risky condition in terms of internal conflict.

External Conflict

Conflicts involving two or more countries or crossing the national borders are referred to as external or interstate conflict that may range from non-violent foreign pressures to violent external pressures (PRS Group, 1992). Non-violent pressures may include diplomatic pressures and violent pressures include cross-border conflicts and direct war (Hendrix, 1991; White & Fan, 2006; Goldblatt, 2013). External conflicts generally impose restrictions, sanctions or boycott on operations of trade and investment between or among countries that are involved in conflict. Total wreck in the government, political, economic, and social life happens and a country relapses many stages back to

the development process (McGowan & Moeller, 2007). Unlike internal conflict, Bangladesh is in a better condition in terms of external conflicts. The combined mean score is 3.033 which converted to a rating of 7.28 after required adjustment with the weight of 12. Individual component's scores 4.30, 2.95, and 1.85, respectively represent that there is almost zero possibility of any external war and cross border conflict is much lower. However with some foreign pressures Bangladesh is a moderately risky country in terms of this component.

Corruption

This component is an assessment of corruption within the political system (PRS Group, 1992). Corruption can take both monetary (like, bribes) and nonmonetary (favouritism) form. Corruption destroys economic and financial environment and reduces the efficiency of government and business. It benefits unskilled people,introduces an inherent instability into the political process, national economy becomes uncontrollable, encourages black market, breaks law and order down and makes it difficult to conduct business effectively and in some cases, may force the withdrawal or withholding of an investment. Corruption can be so destructive toinflame a massive hostile public reaction that resultchange of government or political institutions (PRS Group, 1992; Wafo *et al*., 1998 and Rayhan, 2009). Worst rating has been obtained with respect to corruption in Bangladesh and it caused the country to be very highly risky from the perspective of corruption. Combined mean 1.450 becomes a rating of 1.74 within the weight of 6 points. Corruption in political system, financial corruption and favouritism in business and investment dealings are the identified subcomponents, all of which gained very bad remarks with mean scores of 1.30, 1.45, and 1.60, respectively.

Military in Politics

Military is the armed force of a country whose duty is to protect the country from mostly external and often internal threat. Involvement of military in political system is the sign of emergency, abnormalsituation, indication of an actual or created internal or external threat (PRS Group, 1992). Too much military involvement may change government policies, services or even government, increase corruption and democratic unaccountability or even lead to direct takeover by the military. However, it is an indication that the government is unable to function effectively and the country therefore has an uneasy environment for foreign businesses. From the expert's opinion it can be seen that there is a risk of military take-over in Bangladesh and military exerts some influence in politics. These facts are revealed from individual mean score of these two subcomponents 2.95 and 2.15 respectively. A combined mean score of 2.550 is got from these scores. An overall rating of 3.06 is obtained by adjusting the combined mean with a weight of 6. This rating signifies that Bangladesh is in high risk condition in this regard.

Religious Tensions

Religious tensions may arise when a single religious group tries to dominate the society or the government by replacing civil law by religious law and to exclude other religions from the political and social process (White & Fan, 2006). In this situation, freedom of people from other religions is suppressed (Goldblatt, 2013), social security is in a flux, inappropriate policies are imposed, law and order situation can be broken, international outlook of the country is destroyed, civil dissent, and even civil war may result. Investors from foreign countries who are of separate religion find it tremendously risky and unsafe to come for business in the country (PRS Group, 1992). Religious tensions in Bangladesh cause it to be in highly risky position with a rating of 3.27 within a weight of 6 points. Combined mean score is 2.725 which come from the individual mean scores 2.90 and 2.55 respectively of the two identified subcomponents. It means that there is little possibility of domination by single religious group and also suppression of religious freedom.

Law and Order

A country's overall condition of living, social security, business and economic ease and freedom, government stability, and international influence; everything is affected by law and order situation (Belligoli, 2011). When any of these two is disturbed, other must also be. Often the total absence or the disturbed law and order condition may bring the military into action. International businessmen always search a country that will reserve their rights and safeguard their contracts, intellectual properties and business activities (Lamech & Saeed, 2003; Rayhan, 2009; Bialowolski & Bialowolska, 2013). Law and order situation has got a very poor rating of only 2.37 within a maximum weight of 6. Legal system of Bangladesh is thought to be weak and biased while judicial system is also regarded as weak. These subcomponents have achieved mean scores 2.00 and 1.95 correspondingly. In total, Bangladesh is considered as a very highly risky country with respect to its law and order.

Ethnic Tensions

Often tension arises within a country due to racial, nationality, or language based divisions (Bekafi *et al*., 2006). Countries where racial and nationality tensions are high because opposing groups are intolerant and unwilling to compromise, social risk may arise as well (Hauser, 2005). Often this divisional discrimination results in riots, disorder, criminal acts and even civil war (Goldblatt, 2013). Therefore, in countries where such ethnic tensions prevail, general business environment may be hampered (PRS Group, 1992). Sometimes, international community intervenes during this type of troublesome situations.But this intervention disturbs national sovereignty and international image of a country. Ethnic tensions are assessed with two subcomponents identified. The first one is the presence of racial, national and linguistic divisions and second one is the level of tolerance of opposing majority groups. These two subcomponents have got 3.00 and 3.05 as their individual mean scores. Combined mean score for the risk component ethnic tensions have been calculated to be 3.025. This score is adjusted with a weight of 6 to get the overall rating of 3.63. It symbolises that in Bangladesh there is moderate ethnic tensions.

Democratic Accountability

Countries with effective democracy can avoid internal conflicts, discontent and dissatisfaction (McGowan & Moeller, 2007). Lack of democracy may distort electoral system, autarchy may prevail, opposition to government may be stopped to be created and unaccountability of political leaders may harm freedom and safety of people. Even, the threat of expropriation is not unlikely. A democratic country is the ideal place for foreign investors to do business because their risk level is very low here (PRS Group, 1992). Analysing the mean scores of individual subcomponents of "Democratic Accountability" it can be observed that freedom, fairness, transparency and timeliness of national as well as local elections and election commission are in quite good condition. These two subcomponents have got 3.35 and 2.90 as mean scores. But as political leaders of this country are not accountable to general public, it has got 1.75 points as mean. Thus the combined score becomes 2.667 and the rating becomes 3.20 within a weight of 6. Besides, Bangladesh positioned as a highly risky country in this regard.

Bureaucracy Quality

In order to influence the country positively, bureaucracy must have the required autonomy, strength and expertise (Muttakin & Ahmed, 2005). Strong and impartial bureaucracy can minimize the sudden policy changesdue to governments' alteration (McGowan & Moeller, 2007). Businesses become risky in these countries, because a change in government can lead to a dramatic change in policy formulation and interruptions in government services (PRS Group, 1992; White & Fan, 2006). Bureaucracy quality is measured by its strength and expertise to govern without any drastic changes in policy or interruption in government services. Without any subcomponent the mean score has been 2.85. It has given the component a rating of 2.28 within a maximum weight of 4. Bangladesh is considered as a highly risky country in terms of bureaucracy quality.

Overall Assessment of Political Risk

Compiling the components together, here is the overview of each individual component's earned score, maximum total score of respective component that indicate its weight in the overall rating, and finally the calculated percentage to make comment on the risk level:

Table 1: Overview of Political Risk

Components	Earned Score	Total Score	Percentage	Risk Level
Government Stability	6.36	12	53.0	High
Socioeconomic Conditions	7.24	12	60.3	Moderate
Investment Profile	8.20	12	68.3	Moderate
Internal Conflict	5.80	12	48.3	Very high
External Conflict	7.28	12	60.7	Moderate
Corruption	1.74	6	29.0	Very high
Military in Politics	3.06	6	51.0	High
Religious Tensions	3.27	6	54.5	High
Law and Order	2.37	6	39.5	Very high
Ethnic Tensions	3.63	6	60.5	Moderate
Democratic Accountability	3.20	6	53.3	High
Bureaucracy Quality	2.28	4	57.0	High
Total	54.43	100		

Therefore without any kind of adjustment needed the overall risk rating for political factor for Bangladesh will be:

Table 2: Political Risk Level

Earned Points (1)	Total Points (2)	Rating within 100% (1/2) *100= (3)	Risk Level (4)
54.43	100.0	54.43%	High Risk

Summarising the above discussions it can be noted that, as all these twelve components represent the overall political risk, better ratings in some components are supposed to compensate for the poor risk rating in some other component.

Having four very high risk components, five high risk components and three moderately risky components, overall rating for Bangladesh have come to a high risk point. However, this is very easy to understand that, individual components have made adjustments within themselves to provide this overall rating and risk level.

ECONOMIC RISK ANALYSIS

It is hard to operate in an economically unstable country. Because here, along with cost and revenue problems, finding potential business partners, getting government and other supports are also very uncertain (Bialowolski & Bialowolska, 2013). Weak economy countries generally impose barriers to international trade; restrict capital movement, limit profit repatriation, control import of supplies, demand unnecessary high taxes and so on (Erb *et al*., 1996). Now here are the risk ratings to five individual components according to ICRG:

GDP per Head

GDP or Gross Domestic Product represents the market value of all goods and services produced by a country's economy during a certain period being measured (Hobijn & Steindel, 2009; Davis, 2013). To permit inter-country consistent comparisons, GDP is stated as per person basis which shows the relative performance of the countries and the extent to which the total production of a county can be shared by its population. A rise in per capita GDP signals growth, increased productivity,and standard of living in an economy. When the economy is healthy, unemployment level is generally low and wage level is high. A sound economy is desirable to every investor as a bad economy usually means lower profits for companies, which in turn means lower stock prices for firms (Davis, 2013). Considering such importance, comparing GDP per head (per capita) is the first component of Economic risk analysis using ICRG model. ICRG model states that, GDP per head of the particular country is to be expressed as a percentage of the average of all countries per head GDP (PRS Group, 1992). Total GDP per capita in 2012 of all countries covered by ICRG amounts to US$ 2,272,550.51 and the average is US$ 16,709.93while per capita GDP of Bangladesh in 2012 comes to US$ 817.95 (International Monetary Fund, 2013). So, GDP per head of Bangladesh as a percentage of the average of the estimated total GDP per head of all the countries covered by ICRG is 4.8949936%. Bangladesh scores 0.0 points in GDP per head component because GDP up to 9.9% scores 0.0 points as per ICRG rating and Bangladesh has a GDP percent of 4.89499356. Here, for this component Bangladesh scores 0.0 while the maximum point awardable was 5.0. It signifies that, GDP per capita of Bangladesh is very poor in compare to the average of other country's GDP per head. This may be because of the huge population burden of Bangladesh.

Real GDP Growth

Real or inflation adjusted GDP shows the true growth, expansion or contraction and position of the economy in the business cycle and reflects changes in total well-being of the population (Hobijn & Steindel, 2009; Davis, 2013). Positive real GDP growth represents economic expansion along with investment, employment and personal income. Negative growth signals economy heading towards or is already in a recession, business's cutting investment and hiring resulting unemployment rise and less consumers purchases (Mankiw, 2008). Therefore, investors look at this indicator, to observe the direction of economy andto adjust their asset allocation. ICRG model states that, the annual change in the estimated GDP, at constant prices, of a given country is to be expressed as a percentage increase or decrease (PRS Group, 1992). For Bangladesh, in 2012, percentage change in Gross domestic product at constant prices (2005 base year) or Real GDP growth rate is 6.051% (International Monetary Fund, 2013). Following ICRG model, more than 6.0% positive change in real GDP growth is to be rated by 10.0 points and Bangladesh has experienced 6.051% in 2012, thus scored 10.0. Here, maximum point awardable was 10.0. This magnificent result represents that, GDP growth rate in real terms, or at constant price level is very much impressive for Bangladesh. However, this output may seem controversial to the previous one: GDP per head, because Bangladesh earned 0.0 points in that component but has earned 10.0 points in real GDP growth. In fact, when a country is just improving from a very lower level, its growth rate will seem more impressive than a country that is already in a good position and maintaining the position with lower or zero growth. That is what happened in this case. Bangladesh is a developing country that has a very lower GDP level in compare to other countries but it has started to climb over the development curve. For this reason, in spite of having poor rating in per head GDP, it has scored quite well in terms of real GDP growth. However, growth is the factor that investors search because it represents new opportunities.

Annual Inflation Rate

Inflation commonly means the reduction in the value of money. Though controlled lower inflation is beneficial, high level or unanticipated inflation has negative impact (Miller, 2002; Li, 2012). Direct impact on business performances are: less profit, difficulty in planning and budgeting, hidden tax increases, pressure by trade unions to increase wages, productivity reduction, increase in unemployment rates, small and less liquid equity markets,variabilityin stock return, redistribution of purchasing power between international trading partners etc. (Gokal & Hanif, 2004). Due to this huge impact on riskiness of business, ICRG rating model proposed that the estimated annual inflation rate (the

unweighted average of the Consumer Price Index) is to be calculated as a percentage change (PRS Group, 1992). During 2012, annual inflation rate (unweighted average consumer prices) of Bangladesh, expressed in percent change is 8.719 (International Monetary Fund, 2013). In accordance with ICRG model rating table, if change percentage is between 8.0 and 9.9, scores awarded will be 7.5 points and 8.719% falls in this grade. Here, for this component Bangladesh scores 7.5 while the maximum point awardable was 10.0. The rating shows that, annual inflation rate of Bangladesh is not too risky; however, it still presents some degree of risk.

Budget Balance as a Percentage of GDP

The budget balance is the difference between government revenues and spending (Mankiw, 2008; Arnold, 2010). Government's strong budgetary positions results low debt levels while continuous deficit balance leads borrowing year after year (Checherita & Rother, 2010). This accumulation of more and more debt causes higher interest rate on debt by government and at some point debt crisis and default loans (Hayati & Rahman, 2012). Deficit balance may cause tax increment and reduction of government spending on servicescongenial to business environment. The budget balance is usually reported as percent of GDP, also to be done in ICRG model. It tells how large the deficit or surplus is relative to the economy. In another words, this ratio provides an indication of how much of this year's production a country would have to give up in order paying off its debt when it has some deficit balance. In 2012 for Bangladesh, government revenue amounts to 1,186.610 billion taka and government expenditure 1,500.914 billion taka (International Monetary Fund, 2013). So her budget balance is -314.304 (Deficit balance). Estimated GDP for year 2012 in the national currency is 9,763.026 billion taka (International Monetary Fund, 2013). Therefore, budget balance is -3.22% of GDP.According to ICRG rating, when budget balance as a percentage of GDP is within -3.0 to -3.9, the country earns 6.0 points. Budget balance for Bangladesh in 2012 is -3.22%, therefore the country scores 6.0 pointswhile the maximum point awardable was 10.0. The result specifies that, budget balance (deficit) of Bangladesh is moderately large in compare to its economy's output.

Current Account as a Percentage of GDP

Current account balance is derived by subtracting import cost and other payouts from export revenue and other incoming payments in international level (Ickes, 2008). This balance may have different meanings. Current account deficit may indicate competitiveness problems or imply an excess of investment over savings which may point to a highly productive, growing economy ormay mean low savings rather than high investment which could be caused by reckless fiscal policy or consumption overdo. In other times, it can reflect perfectly sensible inter-temporal trade (Mennillo, Schlenzig, & Friedrich, 2012). However, high current account deficits can depress exchange rate indicating a risk of future sudden reversal of international financial flows (Obstfeld, 2012). Again, a country with current account deficit is building up liabilities to the rest of the world that are needed to be paid back. Failure to payback foreign liabilities may question to its basic solvency (Blanchard & Milesi-Ferretti, 2011).

The current account balance is therefore another important indicator for the investors to look at. Current account is often expressed as a percentage of total gross domestic products (GDP). It is an important metric because it shows how large the current account number is in relation to overall output in the economy. In other words, it indicates, how well the country's economy can backup its current account balances (Miller, 2002). ICRG model requires that it is to be expressed as a percentage of the estimated GDP in US dollar of the country concerned (PRS Group, 1992). During 2012, current account balance and estimated GDP of Bangladesh is US$ 0.452 billion and US$ 122.724 billion respectively (International Monetary Fund, 2013). Therefore, current account is 0.368% of GDP. The resulted percentage is above 0.0 but below 10.0 ICRG suggests 12.0 points for countries with current account as 0.0 to 0.9 percent of GDP. Bangladesh has a current account balance of 0.368% of its GDP in 2012. Therefore Bangladesh scores 12.0 while the maximum point awardable was 15.0. It represents that, it is not completely impossible for Bangladesh to cover up current account balance with its GDP.

Overall Assessment of Economic Risk

Compiling the components together, here is the overview of each individual component's earned score, maximum total score of respective component that indicate its weight in the overall rating, and finally the calculated percentage to make comment on the risk level:

Table 3: Overview of Economic Risk

Components	Earned Score	Total Score	Percentage	Risk Level
GDP per head	0.0	5.0	0	Very high
Real GDP growth	10.0	10.0	100	Very Low
Annual Inflation	7.5	10.0	75	Low
Budget Balance as a Percentage of GDP	6.0	10.0	60	Moder-ate

Current Account as a Percentage of GDP	12.0	15.0	80	Very Low
Total	35.5	50.0		

Although the risk levels of individual components are assessed within a range from 0% to 100%, according to ICRG method, overall economic risk rating is to be done with a maximum of 50%. Therefore to comment on the overall economic risk level of Bangladesh, it is needed to make some adjustments:

Table 4:Economic Risk Level

Earned Points (1)	Total Points (2)	Rating within 50% (3)	Final Rating (3) = (4)	Risk Level (5)
35.5	50	(35.5/50) *50	35.5%	Low Risk

With a thorough review of last page's discussion, it is found to be happened that, in spite of having a very high risk component (with extremely unfavourable 0% rating), two very low risk components (with one tremendously favourable 100% rating) and other moderate to low risk components, overall rating of Bangladesh have come to a low risk point. Clearly, favourable and unfavourable components have made an adjustment within themselves to provide such a quite favourable rating.

FINANCIAL RISK ANALYSIS

Financial risks may be market- dependent, being determined by market factors.It may also be operational, resulting from fraudulent behaviour of the borrower (Devereux & Schiantarelli, 1990). International financial risk is the possibility that the borrowing country will be unable or unwilling to meet its financial obligations. That means the inability of a national economy to generate enough foreign exchange to meet its foreign debt obligation may cause financial risk to the lending party (Erb *et al*., 1996). Interest rate, amount of credit, unavailability of enough credit to support growth opportunities etc. affect influence borrowers willingness and ability to repay debt. Bankruptcy of borrower, overall market risk, foreign exchange rate risk,etc. creates default risks for lenders. It can be said that, financial risk includes capital, market, currency, operational, liquidity, reputational, volatility, settlement, profit, systematic, credit and interest rate risk (Jorion, 2011). Now here are the risk ratings to five individual components according to ICRG:

Foreign Debt as a Percentage of GDP

Foreign debt is the money owed to the foreign residents, businesses, governments or other international organisations by a particular country's businesses, governments, and to some extent its residents. High foreign debt may raise default risk and can destroy the value of home currency (Cecchetti, Mohanty, & Zampolli, 2011). Total foreign debt to GDP is calculated dividing total foreign or external debt by GDP of the borrowing country. The ratio gives investors a rough estimate of a country's ability to pay off its debt (Checherita & Rother, 2010), its financial leverage and compares what a country owes to what it produces. Every country aims for a low debt-to-GDP ratio. It indicates that the economy produces and sells goods and services sufficient to pay back debts without incurring further debt. A country with huge debt in comparison to its economic support finds a few lenders to extend further credits, asked for much higher interest rates (Fosu, 2007), faces debt crisis and subsequently default. This may also affect the country's sovereign credit rating. ICRG rating model thus has started financial risk rating with foreign debt to GDP ratio as the first component. During 2012, for Bangladesh, foreign debt as a percentage of GDP was 21.46% (Asian Development Bank, 2012). According to ICRG rating method, a country with foreign debt being 20.0% to 24.9% of GDP will get 8.0 points. As for Bangladesh this percentage is 21.46%, Bangladesh will also acquire 8.0 points while the maximum point awardable was 10.0. It indicates, Bangladesh is in very low risk zone for this component. That means, the economy of Bangladesh can backup its foreign debt quite well.

Foreign Debt Service as a Percentage of Exports of Goods and Services

The debt service is simply how much money is owed on a loan, including both the interest and the principal amounts. Foreign debt service is the cash that is required for a particular time period to cover the repayment of interest and principal on foreign debt. When a country is not able to make payments to service the debt, it is said to be unable to service debt (Drehmann & Juselius, 2012). In fact, foreign debt service to export of goods and service ratio is an indicator that measure whether debt levels are sustainable and signals investors the future and probable financial crisis of a country, and thereby indicate business risk (Khan & Ajayi, 2000). According to ICRG model, the estimated foreign debt service for a given year is to be expressed as a percentage of the sum of the estimated total exports of goods and services for that year (PRS Group, 1992). For Bangladesh, Total debt service in 2012 amounts to US$ 2792.5 million, while exports of goods and services come to a figure of US$ 28896.47 million (The World Bank, 2013). Therefore, foreign debt service as a percentage of exports of goods and services is 9.66%. According to ICRG rating, debt service ratio of

9.0 to 12.9 has a score of 9.0 points. As Bangladesh has got 9.66% debt service to exports ratio, it also scores 9.0 points while the maximum point awardable was 10.0. Therefore, Bangladesh is in very low risk zone for this component. The result specifies that with its export income, Bangladesh will be able to service her debt obligation, comfortably.

Current Account as a Percentage of Exports of Goods and Services

Export of goods and services is just a sub-component of current account (Miller, 2002). Current account balance is often expressed as a percentage of export of goods and services to see how large the current account balance is in compare to export income. It also indicates a rough comparison of export revenue and all other revenue and expense items of current account in balance of payment. The higher the percentage of current account balance better is the condition for the investors. Because current account balance as the percentage of export will be positive and higher when there are greater amount of inflow related items than outflows. It also indicates that the country is not dependent just on export revenue rather it has other income accounts to offset imports and other expenses (Obstfeld, 2012). Current account balance of Bangladesh in 2012 is US$ 0.452 billion (International Monetary Fund, 2013), while export of goods and services is US$ 28.896 billion (The World Bank, 2013). Therefore, current account balance as percentage of exports of goods and services is 1.564%. When current account balance is within 0.0% to 4.9% of export of goods and services, ICRG awards the country with 12.5 points. Here, for Bangladesh the percentage is 1.564, therefore, this country will also get 12.5 points while the maximum point awardable was 15.0. Bangladesh is again in very low risk zone for this component. It signifies that Bangladesh can quite well support its current account balance positions with its export income not being too much dependent on other income items of current account component in balance of payment.

Net International Liquidity as Months of Import Cover

Countries with free trade and floating exchange rates, international liquidity is thought to be the foreign exchange assets and credit available to residents and government of a country to import from abroad at their discretion. International liquidity provides a measure of a country's ability to finance its deficit in balance of payments (Andrews, 2006). It is often viewed as months of import cover that represents the relationship between foreign liquid assets and current external transactions requiring foreign currency. This ratio is an indicator of short term financial distress.In long term, it signals sovereign risk of a country (Epstein, 2005). In ICRG rating method there is a measure to provide a comparative liquidity risk ratio that indicates how many months of imports can be financed with reserves. During 2012, official reserve of Bangladesh is US$ 3,51,38,68,312 and total merchandise import cost for the year is US$ 34,13,21,00,000 and for a month is 2,84,43,41,667 (The World Bank, 2013). Therefore, required net international liquidity as months of import cover is 1.235. According to ICRG rating, 1.0 point is to be scored for a country with net liquidity in between 1.0 to 1.9 months. With 1.235 months of net liquidity, Bangladesh will also obtain 1.0 point while the maximum point awardable was 5.0. Thus, Bangladesh is in very high risk zone for this component. It means that the official reserve of Bangladesh is in endangered position to cover its merchandise import costs.

Exchange Rate Stability

Exchange rate- the price of a currency tends to fluctuate with market demand and supply condition which is risky for international business (Arnold, 2010). Exchange rates affect a country's export and import and thereby trade balance, international capital flows, interest rates, inflation, unemployment rate, government trade and investment policy, monetary policy, tax rates and capital market efficiency (Miller, 2002). When the price of a currency increases, it is said to be appreciated. The opposite is said to be depreciated. In general sense, depreciation is a negative word, and appreciation is positive. However, in case of exchange rates, too much fluctuation in any direction is detrimental. Exchange rate variability creates uncertainty and risks for business. Therefore, in ICRG model, exchange rate stability is another component of risks that takes into account both the positive and negative side fluctuations. It is mentioned in this model that, the appreciation or depreciation of a currency against the US dollar over a calendar year or the most recent 12-month period is to be calculated as a percentage change. National currency of Bangladesh is Taka. At the beginning of the calendar year 2012, exchange rate between Taka and US dollar was $ 1 = TK 82.0409 and at the end $ 1 = TK 79.6042. Here, Taka had been appreciated against UD dollar and the appreciation rate is 2.97%. Now if the rating provided by ICRG is followed, it can be found that an appreciation change percentage of 0.0 to 9.9 for a currency earns 10.0 points. For Bangladesh, in the calendar year 2012, currency (Taka) appreciation against US dollar rate was 2.97% which falls in between 0.0% to 9.9% category. Therefore, Bangladesh will also earn 10.0 points while the maximum point awardable was 10.0. So, Bangladesh is in very low risk zone for this component. It shows that, in Bangladesh, exchange rate of Taka against US dollar is more or less stable.

Table 5: Overview of Financial Risk

Components	Earned Score	Total Score	Percentage	Risk Level
Foreign Debt as a Percentage of GDP	8.0	10.0	80.0	Very Low
Foreign Debt Service as a Percentage of Exports of Goods and Services	9.0	10.0	90.0	Very Low
Current Account as a Percentage of Exports of Goods and Services	12.5	15.0	80.3	Very Low
Net International Liquidity as Months of Import Cover	1.0	5.0	20.0	Very High
Exchange Rate Stability	10.0	10.0	100.0	Very Low
Total	41.0	50.0		

Table 6: Financial Risk Level

Earned Points (1)	Total Points (2)	Rating within 50% (3)	Final Rating (3)=(4)	Risk Level (5)
41.0	50.0	(41.0/50)*50	41.0%	Very Low Risk

Overall Assessment of Financial Risk

Before going to the overall rating of financial risk, here is the overview of each individual component's earned score, maximum total score and risk level. Maximum total score of respective component indicates its weight in the overall rating. Using earned and total scores a percentage is calculated to make comment on the risk level:

Overall financial risk rating method is same as the overall economic risk rating. Here is the needed adjustment and the comment on overall financial risk level of Bangladesh:

From the above discussion, it can be summarised that, in spite of having a very high risk component (with an unfavourable 20% rating), four other very low risk components (with one tremendously favourable 100% rating) overall rating of Bangladesh have come to a very low risk point. Thus, rating for the unfavourable component has been well offset by other component's very much favourable rating to provide such an overall favourable rating.

COMPOSITE RISK ANALYSIS

According to International Country Risk Guide (ICRG) composite risk of a country can be found by adding sub-components within each category of risk to provide a risk rating for each risk category (Political, Financial, or Economic). Then the risk ratings for these categories are combined to provide the country's overall, or composite, risk rating on the basis of a formula. During the calculation using the formula, political risk rating contributes 50% and financial and economic risk rating each contributes 25% of the composite rating 100% (Bouchet *et al*., 2003). The formula used to calculate the composite risk rating is:CPFER (country X) = 0.5 (PR + FR + ER). Where,CPFER = Composite political, financial and economic risk ratings, PR = Total political risk indicators, FR = Total financial risk indicators and ER = Total economic risk indicators. Therefore, the CPFER for Bangladesh is 0.5 (54.43 + 41.0 + 35.5) or 65.465. It indicates that for foreign investors, based on political, financial and economic conditions, Bangladesh is a moderately risky country.

FINDINGS

Following the detailed analysis of different relevant factors related to the country risk of Bangladesh, key findings of this study can be summarised. In terms of political risk, Bangladesh falls into the high risk category. Among the components, Bangladesh has been found to be moderately risky in terms of socio-economic conditions, investment profile, external conflict and ethnic tensions. This country is highly risky in terms of government stability, military influence in politics and religious tensions. Moreover, internal conflict, corruption and law and order situation have found to make the country very risky. With respect to economic risk Bangladesh has been leveled as a low risk country. Having a huge population with low level of GDP, Bangladesh has fallen into very high risk category. But, with relatively low level of budget deficit compared to GDP and small increase in annual inflation rate, it has been considered as moderate and low risk country respectively. However, with wonderful real GDP growth rate and tolerable level of current account balance as a percentage of GDP, this country has received very low risk mark. In case of financial risk it has fallen into very low risk category. In fact, Bangladesh is in very risky position in terms of its international liquidity expressed as months of import cover. Except this one, all other four sub-components like foreign debt compared to GDP, foreign debt service and current account balance both compared to exports of goods and services and exchange rate stability have represented very low level of riskiness. Combining all these three risk components, namely, political, economic and financial, a composite risk rating for

Bangladesh represents that, it is in a moderate risk position for the investors.

CONCLUSION

Investment in an economy raises output and improves standard of living of the people. Since the supply of capital from the local source in Bangladesh is not adequate to meet the growing need for investment due to low rate of domestic savings, the importance of foreign capital in the form of Foreign Direct Investment (FDI) is increasing gradually. FDI brings prosperity to the recipient countries through technological transfer, increasing volume of exports, enhancing job opportunities and increasing government revenue. Bangladesh offers one of the most liberal regimes for FDI in South Asia (The World Bank, 2013). Despite this, FDI inflow in Bangladesh is not satisfactory. Obstacles of FDI and weak points of business areas are more or less explicit to all. However, there are some risk factors that are embedded implicitly in this country's political, economic, financial that causes MNCs to hesitate at the time of FDI decisions (Muttakin & Ahmed, 2005; Talukdar *et al*., 2009; Rayhan, 2009). What are those risks, and how risky are they really, to investigate these matters, this study has been conducted. The study has not focused the risk of any particular industry of Bangladesh. Therefore, it may act as a base or initial outlook for every industry as the factors included here are the common factors related to the overall country risk. To boost foreign investors' confidence and encourage them to invest in Bangladesh, government and policy makers should initiate immediate actions. These actions should involve the reduction of riskiness identified in this study and the improvement of business environment.

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APPENDIX 1

Table A1: Political Risk Analysis

Government Stability			
(1)	(2)	(3)	(4)
Individual Sub-components	**Individual Mean Score**	**Combined Mean Score**	**[(3)/5]*W**
Government Unity	2.55	2.650	6.36
Legislative Strength	2.80		
Popular Support	2.60		
Socio-economic Conditions			
Unemployment	3.50	3.017	7.24
Consumer Confidence	1.90		
Poverty	3.65		
Investment Profile			
Contract Viability/Expropriation	3.20	3.417	8.20
Profit Repatriation	3.95		
Payment delays	3.10		
Internal Conflict			
Civil war or Coup threat	2.85	2.417	5.80
Terrorism or Political violence	1.80		
Civil Disorder	2.60		
External Conflict			
War	4.30	3.033	7.28
Cross Border Conflict	2.95		
Foreign Pressures	1.85		
Corruption			
Political System Corruption	1.30	1.450	1.74
Financial Corruption	1.45		
Favouritism in business	1.60		
Military in Politics			
Military Take-over	2.95	2.550	3.06
Military influence in politics	2.15		
Religious Tensions			
Domination by single religious group	2.90	2.725	3.27
Suppression of religious freedom	2.55		
Law and Order			

Strength and impartiality of legal system	2.00	1.975	2.37
Strength of judicial system	1.95		
Ethnic Tensions			
Racial, national or linguistic divisions	3.00	3.025	3.63
Tolerance of opposite majority groups	3.05		
Democratic Accountability			
Political Accountability	1.75	2.667	3.20
Free, Fair, Transparent and Timely Elections	3.35		
Freedom of Election Commission	2.90		
Bureaucracy Quality			
Strength and Expertise of Bureaucracy	2.85	2.850	2.28