PRS Methodology

About "PRS" and the Coplin-O'Leary System™

"*Political Risk Services*"™ (*PRS*) or the "Coplin-O'Leary Country Risk Rating System"™ is the methodology developed by Professors William D. Coplin and Michael K. O'Leary during 20 years of research at the Maxwell School of Citizenship & Public Affairs, Syracuse University with the U.S. Department of State, the Central Intelligence Agency, other government agencies, and major multinational corporations.

Political Risk Services is the most widely accepted system of completely independent political risk forecasting. All publications based on this system are included in the "Political Risk Services" product line. Political Risk Services methodology and research produce 100 *Country Reports* and various service packages and related publications, including our premier service, PRS Online, and the academic version of our premier service, *Political Risk Yearbook*.

Political Risk Services – The Risk Model

Political Risk Services (PRS) provides a decision-focused political risk model with three industry forecasts at the micro level. The PRS system forecasts risk for investors in two stages, first identifying the three most likely future regime scenarios for each country over two time periods and then by assigning a probability to each scenario over each time period, 18 months and five years. For each regime scenario, PRS's experts then establish likely changes in the level of political turmoil and 11 types of government intervention that affect the business climate.

After calculating consolidated scores for all regimes (100% of possibilities), the PRS system converts these numbers into letter grades (on a scale from A+ to D-) for three investment areas: financial transfers (banking and lending), foreign direct investment (e.g. retail, manufacturing, mining), and exports to the host country market. PRS' unique system provides only industry specific forecasts, not a generic macro level assessment, as is usually the case.

Users can customize the PRS forecasting model to individual projects or the particular exposures of a firm with an optional weighting system, adding or subtracting variables and adjusting the model to fit specific firm or project attributes.

PRS *Country Reports* forecast the risk of doing business in 100 countries. PRS updates these 100 reports as political events dictate in each country. Each includes comments and analysis on recent events, profiles of key political players, and wide-ranging forecast scenarios, as well as basic historical and political background and data on the government, political entities, the environment, and the economy, including key sectors.

---Llewellyn D. Howell, Ph.D.

The PRS Group, Inc., applies the Coplin-O'Leary Rating System™ every day as the editorial staff for our Political Risk Services product line produces 100 *Country Reports*. In addition to defining the Coplin-O'Leary Rating System™ and related terminology we use in producing the *Country Reports*, this explanation also describes a set of calculations that you can use to create risk ratings. In the 18-month and five-year forecasts of our *Country Reports*, the risk ratings indicate the placement of countries from least risky (A+) to most risky (D-) for financial transfer, direct investment, and export markets. The system is designed in such a way that it can be adjusted to suit the needs of a particular project or combination of corporate interests.

The Coplin-O'Leary System™ is a general risk model. Figure A.1 (under "Steps in Calculating"), our "Standard Worksheet for Coplin-O'Leary Model," will help you understand how risk assessments are translated into numbers and how the numbers are used to calculate risk ratings in our *Country Reports*. Figure A.2 (Adjusting the Ratings for Your Own Use) then gives you a "Customized Worksheet To Design Your Own Model"-based on the Coplin-O'Leary System™.

An Overview of the Ratings System

A series of risk ratings summarize the in-depth analyses and forecasts provided in each *Country Report*, consisting of 50-70 pages. Each Country Report provides the current level and likely changes of the following 17 risk components (12 in the 18-month forecast and five in the five-year forecast), which are also used to compile the risk scores.

18-Month Risk Factors

Twelve factors are analyzed from an 18-month forecast perspective, including political turmoil, which is included in both the 18-month and the five-year forecasts.

Turmoil. Actions that can result in threats or harm to people or property by political groups or foreign governments, operating within the country or from an external base:

- Riots and demonstrations
- Politically motivated strikes
- Disputes with other countries that may affect business
- Terrorism and guerrilla activities
- Civil or international war
- Street crime that might affect international business personnel
- Organized crime having an impact on political stability or foreign business

Not included in turmoil are legal, work-related labor strikes that do not lead to violence.

Equity Restrictions. Limitations on the foreign ownership of businesses, emphasizing sectors where limitations are either especially liberal or especially restrictive.

Operations Restrictions. Restrictions on procurement, hiring foreign personnel, or locating business activities, as well as the efficiency and honesty of officials with whom business executives must deal and the effectiveness and integrity of the judicial system.

Taxation Discrimination. The formal and informal tax policies that either lead to bias against, or special advantages favoring international business.

Repatriation Restrictions. Formal and informal rules regarding the reparation of profits, dividends, and investment capital.

Exchange Controls. Formal policies, informal practices, and financial conditions that either ease or inhibit converting local currency to foreign currency, normally a firm's home currency.

Tariff Barriers. The average and range of financial costs imposed on imports.

Other Import Barriers. Formal and informal quotas, licensing provisions, or other restrictions on imports.

Payment Delays. The punctuality, or otherwise, with which government and private importers pay their foreign creditors, based on government policies, domestic economic conditions, and international financial conditions.

Fiscal and Monetary Expansion. An assessment of the effect of the government's spending, taxing, interest rate and other monetary policies. The assessment is based on a judgment as to whether the expansion is inadequate for a healthy business climate, acceptably expansionist, or so excessively expansionist as to threaten inflation or other economic disorder.

Labor Policies. Government policies, trade union activity, and productivity of the labor force that create either high or low costs for businesses.

Foreign Debt. The magnitude of all foreign debt relative to the size of the economy and the ability of the country's public and private institutions to repay debt service obligations promptly.

Five-Year Risk Factors

Four additional factors are analyzed from a five-year forecast perspective. (Turmoil is included in both the 18-month and the five-year forecasts.)

Investment Restrictions. The current base and likely changes in the general climate for restricting foreign investments.

Trade Restrictions. The current base and the likely changes in the general climate for restricting the entry of foreign trade.

Domestic Economic Problems. A country's ranking according to its most recent five-year performance record in per capita GDP, GDP growth, inflation, unemployment, capital investment, and budget balance.

International Economic Problems. A country's ranking according to its most recent five-year performance record in current account (as a percentage of GDP), the ratio of debt service to exports, and the annual percentage change in the value of the currency.

We use these 17 factors in our summary risk ratings, first estimating the current risk level of each factor and then forecasting the change in its risk level under each of the three most likely regime scenarios. The numerical equivalents of these current and forecast levels are then used to calculate the risk scores.

Regime Stability & Risk Ratings

Every PRS *Country Report* forecasts the "Most Likely Regimes and Their Probabilities." We predict the government most likely to be in power over two forecast periods, 18 months and five years, from the date of publication. The percentages after the regime names show the probabilities of those forecasts. In the "Forecast Summary," we show when a change has been made in the probability of a particular regime by giving the previous probability rating in parentheses. An asterisk (*) preceding a regime name indicates the forecast of a different regime from that of the incumbent, whether the change occurs by coup, election, change in orientation, or any other means.

A Note about Regime Names: The label assigned to a regime indicates the most powerful component of the government. This can be an individual leader and a political party, the dominant orientation within the leadership, or groups such as the military or a civilian-military alliance. The probabilities assigned to the most likely regimes are derived from the opinions of our country risk specialists.

Turmoil Risk Ratings

The first content page of each *Country Report* shows the 18-month and five-year risk from turmoil. The term "turmoil" includes large-scale protests, general strikes, demonstrations, riots, terrorism, guerrilla warfare, civil war, and cross-border war. It also includes turmoil caused by a government's reaction to unrest. The short-term risk of turmoil affecting international business is rated as Low, Moderate, High, or Very High. The five-year rating is calculated from the "base" - the relative balance of forces supporting and opposing - and the forecasts of change under the three most likely regime scenarios. A previous rating appears in parentheses when the turmoil forecast changes. The 18-month forecast of turmoil risk is calculated according to a clearly defined formula based on the current level and the likely change under each of the three most likely regimes. The five-year forecast of turmoil risk comes from another formula combining the 18-month forecast, the long-term base level, and the likely change over the next five years under the three most likely regime scenarios.

Low Risk. For countries with this rating, most discontent is expressed peacefully, and the extremely rare occurrences of violence from political causes almost never affect international business directly or indirectly.

Moderate Risk. These are countries in which international business can sometimes be affected by occasional riots, acts of terrorism, and significant levels of labor unrest or other kinds of discontent.

High Risk. High-risk countries experience levels of violence or potential violence that could seriously affect international business.

Very High Risk. The turmoil level in such countries creates conditions that approach a state of war.

Financial Transfer Risk Ratings

The term “transfer” in our risk Forecast Summary refers to the risk from financial transfer, non-convertibility from the local currency to the desired foreign currency, and the transfer of foreign currency out of the country. The transfer could be for the payment of exports, repatriation of profits or capital, or for any other business purpose. Risk ratings, expressed as letter grades, are used in both the 18-month and five-year periods. A previous rating appears in parentheses when a forecast changes. Countries are rated for financial transfer risk according to a scale ranging from A+ for the least risky to D- for the most risky. The 18-month letter grades are determined by four equally weighted factors, each combining the current level and the forecasts of change under the three most likely regimes. These are the factors:

1. Exchange controls on international business.
2. Payment delays facing exports to that country.
3. Policy related to fiscal and monetary expansion.
4. Governmental foreign borrowing.

Five-year letter grades are determined by three equally weighted factors:

1. The average score obtained from the 18-month calculations.
2. The level of turmoil forecast for the 18-month period and the level forecast under the three most likely five-year regime scenarios.
3. The average rank of the country on the indicators of international financial problems and the forecasts of change under the three most likely regime scenarios.

“A” Countries. No exchange controls, or other barriers to financial transfer, and little likelihood that controls will increase in the forecast period.

“B” Countries. Modest or sporadic delays in financial transfers; a reasonable chance that delays will be high in the forecast period.

“C” Countries. Modest to heavy delays and even blockage of financial transfers; a reasonable chance for barriers to increase, and little chance to decrease, within the forecast period.

“D” Countries. Heavy exchange controls and long delays for the transfer of currency; little chance that conditions will improve within the forecast period.

Direct Investment Risk Ratings

The term “investment” refers to the risks to foreign investment in wholly owned subsidiaries, joint ventures, and other forms of direct ownership of assets in a foreign country. Risk ratings, expressed as letter grades, are used in both the 18-month and five-year periods. A previous rating appears in parentheses when a forecast changes. Countries are rated for direct investment risk according to a scale ranging from A+ for the least risky to D- for the most risky. The 18-month letter grades are determined by seven equally weighted factors, each combining the current level and the forecasts of change under the three most likely regimes. These are the factors:

1. Turmoil
2. Equity Restrictions
3. Restrictions on Local Operations (labor, management, and procurement)
4. Taxation Discrimination
5. Repatriation Restrictions
6. Exchange Controls
7. Labor Costs

Five-year letter grades are determined by four equally weighted factors:

1. The average score obtained from the 18-month calculations.
2. The level of turmoil forecast for the 18-month period and the level forecast under the three most likely five-year regime scenarios.
3. The relative strength of forces supporting and opposing restrictions on international investment and the forecasts of change under the three most likely five-year regime scenarios.
4. The average rank of the country on indicators of domestic economic problems and the forecasts of change under the three most likely five-year regime scenarios.

"A" Countries. Few restrictions on equity ownership in most industries; few controls on local operations, the repatriation of funds, or foreign exchange; taxation policy that does not discriminate between foreign and domestic business. Little likelihood that restrictions will increase, and little threat from political turmoil.

"B" Countries. Some threat on equity ownership, frequently in the form of a requirement for partial ownership by nationals; restrictions on local operations, particularly regarding local procurement; few restrictions on repatriation, but some exchange controls possible; some threat to business from political turmoil; and a possibility that restrictions and turmoil may increase.

"C" Countries. Considerable restriction on equity ownership, including a requirement that nationals hold a majority percentage; considerable restriction on local operations, repatriation, and foreign exchange; some taxation discrimination possible; and a serious threat of political turmoil. A good chance that restrictions and turmoil will remain high or increase during the forecast period.

"D" Countries. Considerable restriction on equity ownership, including a prohibition against equity ownership by foreigners; substantial regulation of local operations, repatriation, and foreign exchange; taxation discrimination; political turmoil that may present a serious threat. A good chance that restrictions and turmoil will remain high or increase during the forecast period.

Export Market Risk Ratings

The term “export” refers to the risks facing exporters to the country, especially risks related to market conditions, barriers to imports, and delays or difficulties in receiving payment for goods. Risk ratings, expressed as letter grades, indicate the climate for foreign exporters for both the 18-month and five-year forecast periods. A previous rating appears in parentheses when a forecast changes. As potential export markets, countries are rated for risk according to a scale ranging from A+ for the least risky to D- for the most risky. The 18-month letter grades are determined by six equally weighted factors, each combining the current level and the forecasts of change under the three most likely regimes.

These are the factors:

1. Turmoil
2. Exchange Controls
3. Tariffs
4. Other Trade Barriers
5. Payment Delays
6. Foreign Debt

Five-year letter grades are determined by five equally weighted factors:

1. The average score obtained from the 18-month calculations.
2. The level of turmoil forecast for the 18-month period and the level forecast under the three most likely five-year regime scenarios.
3. The relative strength of forces supporting and opposing restrictions on trade and the forecasts of change under the three most likely five-year regime scenarios.
4. The average rank of the country on indicators of domestic economic problems and the forecasts of change under the three most likely five-year regime scenarios.
5. The average rank of the country on indicators of international economic problems and the forecasts of change under the three most likely five-year regime scenarios.

“A” Countries. Stable politically and economically; low trade barriers and adequate foreign reserves to allow for prompt payment; little chance that conditions will deteriorate.

“B” Countries. Some protectionist sentiment and a poor foreign exchange position may lead to moderate tariff and non-tariff trade barriers; modest delays in payment result from poor economic conditions; some chance that the business climate will deteriorate.

“C” Countries. Strong protectionist sentiment and weak foreign exchange position, producing high tariff and other barriers to trade; the risk of prolonged payment delays or non-payment, requiring conservative credit policies; little chance that conditions will improve and a strong chance that they will deteriorate.

“D” Countries. High tariff and non-tariff barriers resulting from a combination of protectionist sentiment and a lack of foreign currency; prolonged payment delays or non-payment likely; little chance that conditions will improve and a strong chance that they will deteriorate further.

Steps in Calculating

All data in our worksheets come directly from the assessments and forecasts of country specialists (the “Forecast Summary of any report). Calculations on the worksheet generate a score for each of 17 variables (12 for the 18-month forecast period and five for the five-year period). Different combinations of variables make up the three risk ratings.

For the 18-month forecast, TRANSFER uses variables 6, 9, 10, and 12; INVESTMENT uses variables 1, 2, 3, 4, 5, 6, and 11; and EXPORT uses 1, 6, 7, 8, 9, and 12.

For the five-year forecast, TRANSFER uses variables 13 and 17; INVESTMENT uses variables 13, 14, and 16; EXPORT uses variables 13, 15, 16, and 17. In addition, the corresponding 18-month score is a component of each five-year risk score.

Figure A.1: Standard Worksheet for Coplin-O’Leary Country Risk Model

Country ____________________________ Date ___________________

18-MONTH	**C.L.**	**REG1** ( )	**REG2** ( )	**REG3** ( )	**TRANS**	**INVEST**	**EXPORT**
1) Turmoil	____	____	____	____		____	____
2) Equity	____	____	____	____		____	
3) Local	____	____	____	____		____	
4) Tax	____	____	____	____		____	
5) Repatriation	____	____	____	____		____	
6) Exchange	____	____	____	____	____	____	____
7) Tariffs	____	____	____	____			____
8) Other	____	____	____	____			____
9) Payment	____	____	____	____	____		____
10) Expansion	____	____	____	____	____		
11) Labor	____	____	____	____		____	
12) Debt	____	____	____	____	____		____
				Totals	____	____	____
				Means	(/4) ____( )	(/7) ____( )	(/6) ____( )
					Prev ( )	Prev ( )	Prev ( )

FIVE-YEAR	**BASE**	**REG1** ( )	**REG2** ( )	**REG3** ( )			
13) Turmoil	____	____	____	____	____	____	____
14) Invest	____	____	____	____		____	
15) Trade	____	____	____	____			____
16) Domestic	____	____	____	____		____	____
17) Int’l	____	____	____	____	____		____
				Totals	____	____	____
				Means	(/3) ____( )	(/4) ____( )	(/5) ____( )
					Prev ( )	Prev ( )	Prev ( )

Step One: Current & Base Level of Restrictions

First, the number for the first blank next to variables 1-12 (column headed C.L.) is obtained from the CURRENT & BASE listings for “Turmoil,” “Invest,” and “Trade” on the Forecast Summary. Current & Base risk or restriction levels are scaled as follows:

For Current and Base Levels of Restrictions	=	Value
Low	=	0
Moderate	=	1
High	=	2
Very High	=	3

Step Two: Economic Rankings

The base number for variable 16, Domestic Economic Problems, represents the average rank of the country for the six domestic economic indicators in the Economic Performance Profile (EPP). The base number for variable 17, International Economic Problems, represents the average rank of the country for the three international economic indicators in the EPP. The rankings are converted to numbers, using the following scale, and then averaged for entry on the worksheet.

For Domestic and International Economic Rankings	=	Value
Best 25%	=	0
Second 25%	=	1
Third 25%	=	2
Worst 25%	=	3

Step Three: Risk Forecasts

Filling in the second, third, and fourth blanks (REG1, REG2, REG3) for all 17 variables requires calculation of the product of two numbers. From the Forecast Summary, the forecast for each regime is obtained and scaled as follows:

For Forecast Levels	=	Value
LESS	=	-1.0
SLIGHTLY LESS	=	-0.5
Same	=	0.0
SLIGHTLY MORE	=	+0.5
MORE	=	+1.0
MUCH MORE	=	+2.0

Then each number representing a forecast is multiplied by the probability for the corresponding regime (at the head of the appropriate column in the Forecast Summary).

Step Four: Calculation

For each risk factor, the number representing the current or base level is added to the three numbers obtained in Step 3. This sum incorporates the current or base level of risk and the expected change under each of the three most likely regimes.

Step Five: Letter Grades

For each risk category, the appropriate sum from Step 4 is entered where the variable applies, and then the TRANS, INVEST, and EXPORT numbers are averaged to create the 18-month and five-year risk ratings. (As noted before, the average 18-month score is one component of the five-year score.) These numerical scores are converted to create alphabetical ratings for financial transfer, investment, and export markets according to the following table:

< = 0.25	=	A+	1.51-1.75	=	C+
0.26-0.50	=	A	1.76-2.00	=	C
0.51-0.75	=	A-	2.01-2.25	=	C-
0.76-1.00	=	B+	2.26-2.50	=	D+
1.01-1.25	=	B	2.51-2.75	=	D
1.26-1.50	=	B-	>2.75	=	D-

After conversion, the letter grades are reported for each country, and space is provided on the worksheet to enter previous letter grades when they have changed (which are also reported for each country).

Adjusting Risk Ratings for Your Own Use

The calculating procedure used to generate our 18-month and five-year ratings summarizes the information for each country in a concise letter range (A+ to D-). Remember that the ratings in our *Country Reports* are, because of the simplification necessary to consolidate the data, highly general, but they provide a quick summary of forecasts and allow cross-country comparisons.

Design Your Own Ratings

The Coplin-O'Leary Country Risk Model™ can be used to generate risk ratings (or letter grades) to produce customized risk scores with comparable ratings, specifically designed for one or more proposed investment or ongoing project. To simplify the system for general use, PRS treats each risk factor as equal in determining country risk ratings. This system, looking at risk factors in terms of current level and forecast level under alternative regime scenarios, is at the heart of the Coplin-O'Leary System™.

Figure A.2: Customized Worksheet To Design Your Own Model

RISK CALCULATIONS FOR ____
PROJECT________________COUNTRY _____________TIME-FRAME_____________________
DATE _____________________PREPARED BY ______________________________________

Risk or Restriction	Current Level		Regime 1 F x P		Regime 2 F x P		Regime 3 F x P		Score x Weight	Weighted =SCORE
Turmoil	_____	+	(__x__)	+	(__x__)	+	(__x__)	=	___x___	=____
Equity Restrictions	_____	+	(__x__)	+	(__x__)	+	(__x__)	=	___x___	=____
Local Operations Restrictions	_____	+	(__x__)	+	(__x__)	+	(__x__)	=	___x___	=____
Taxation Discrimination	_____	+	(__x__)	+	(__x__)	+	(__x__)	=	___x___	=____
Repatriation Restrictions	_____	+	(__x__)	+	(__x__)	+	(__x__)	=	___x___	=____
Exchange Controls	_____	+	(__x__)	+	(__x__)	+	(__x__)	=	___x___	=____
Tariff Barriers	_____	+	(__x__)	+	(__x__)	+	(__x__)	=	___x___	=____
Other Barriers	_____	+	(__x__)	+	(__x__)	+	(__x__)	=	___x___	=____
Payment Delays	_____	+	(__x__)	+	(__x__)	+	(__x__)	=	___x___	=____
Fiscal/Monetary Expansion	_____	+	(__x__)	+	(__x__)	+	(__x__)	=	___x___	=____
Labor Costs	_____	+	(__x__)	+	(__x__)	+	(__x__)	=	___x___	=____
Foreign Debt	_____	+	(__x__)	+	(__x__)	+	(__x__)	=	___x___	=____
FACTORS SPECIFIED BY USER:										
____________________	_____	+	(__x__)	+	(__x__)	+	(__x__)	=	___x___	=____
____________________	_____	+	(__x__)	+	(__x__)	+	(__x__)	=	___x___	=____
____________________	_____	+	(__x__)	+	(__x__)	+	(__x__)	=	___x___	=____
							SUMS:		________ WEIGHTS	_______ WEIGHTED SCORES

SUM OF WEIGHTED SCORES/SUM OF WEIGHTS = ____/___ = ______ WEIGHTED MEAN

F = FORECAST
P = PROBABILITY

Using both our factors and your own, complete the worksheet as indicated, assigning whatever relative weights are most appropriate for your firm or industrial sector.

You may want to assign weights in terms of the importance of particular variables in relation to the project or country you are analyzing. Use the Customized Worksheet (shown in Figure A.2) to combine our variables with others relevant to your company's needs and to incorporate needed changes in the weight of certain factors, thus creating a project-specific risk analysis. The customized worksheet uses the same scaling procedures used in the Standard Worksheet (Figure A.1). Calculate the weighted average according to the instructions on the customized worksheet. You can use the numbers generated for greater precision or use the same rules as in the Coplin-O'Leary System™ to convert the numerical scores to letter ratings.

Creating a General Risk Summary from Specific Risk Forecasts

The resulting numerical scores can be used in a variety of ways. For example, PRS uses the numerical risk scores to calculate unified risk scores, producing the PRS Risk Index, providing a basic, convenient way for users to compare countries directly.

Sectoral Risk Scores

The 17 risk values can also be used selectively to calculate 18-month and five-year risk scores for different categories of risk values. In each *Country Report* we report summary ratings for four categories of risk: turmoil, financial transfer, direct investment, and export market. You can use the numerical scores, rather than letters, as the ratings, as part of a monitoring procedure, keeping in mind that the numbers are ultimately based on judgmental estimates. Just as PRS uses the numerical risk scores to calculate unified risk scores for the PRS Risk Index™, you can create an index from the PRS ratings modified in a way that most appropriately allows your organization to compare and monitor countries and/or regions. The Coplin-O'Leary ratings for 100 countries are available at CountryData (in spreadsheet format, including both the alphabetical scores and their numerical equivalents.)

Calculation of the PRS Risk Index™

This overall measure of risk for a country is calculated by using all 17 risk components, 12 with an 18-month forecast horizon and five with a five-year forecast horizon.

The 18-month risk components of the PRS Risk Index™ are:

1. Turmoil
2. Restrictions on equity
3. Restrictions on local operations
4. Taxation discrimination
5. Repatriation restrictions
6. Exchange controls
7. Tariff barriers
8. Nontariff barriers
9. Payment delays
10. Expansionary economic policies
11. Labor costs
12. Foreign debt

The five-year risk components are:

1. Turmoil
2. Investment restrictions
3. Restrictions on foreign trade
4. Domestic economic problems
5. International economic problems

Each factor's contribution to the index is based on its risk value, computed as described in "Steps in Calculating." Each of the 17 factors has a theoretical range of zero (in case of a "Low" current level and a forecast of no change under any of the three regimes) to +4.0 (in case of a very high current level and a forecast of more restrictive policies).

The 17 risk values are summed, and the resulting total is scaled so that a raw score of 0 (representing low risk) is reported as 100 and a score of 68 (representing very high risk) is reported as 0. The index, therefore, ranges from zero, for countries with the most unfavorable climate for international business, to 100, for countries with the most favorable climate. A raw score is converted to an PRS Risk Index number by the formula

$$((RS-68)/(-68))*100$$

where RS is the raw score obtained by summing all 17 risk values.

A Few Basic Assumptions

Underlying all PRS calculations are several assumptions:

Equal Weighting. First, we assume that each factor included in the three basic risk ratings (financial transfer, direct investment, and export markets) is relevant to the rating, and all are weighted equally. Obviously, for some business investments, other risk factors may be important; furthermore, in some analyses certain factors should be weighted more heavily than others. In such cases, you can adjust the aggregating procedure as you wish by adding or deleting factors or by weighting some more than others.

The Elements of Change. Second, we assume that risks are a combination of current government policy and any changes that each regime may produce. The changes are scaled so that if there is no change, the risk factor has the same value as the current level. A regime that will add conditions or restrictions increases the current or base level, and one that will lessen them reduces the magnitude.

The Probability Factor. Third, the amount added or reduced by each of the three most likely regimes is weighted by the likelihood (probability) that that regime would come to power before being added to the current level of risk or restrictions.

Long-Term Economic Forecasting

Our reports also include five-year economic forecasts based on the expected policies and other considerations for each of the three forecast regimes. Our country and economic specialists provide the information from which we produce the forecasts, which are structured to provide:

1. Current estimates.
2. A one year estimate or forecast for each of three indicators under each of three alternative regime scenarios.
3. A five year forecast average for each of three indicators under each regime scenario.

Our forecasts are based on the following considerations:

- World and regional economic trends
- How those trends affect the country
- Local conditions affecting the economy of the country
- Turmoil and social conditions under the three most likely regimes
- Business and economic policies expected under each of the three most likely regimes

How and Where to Use Political Risk Forecasts

Individuals holding nearly any position of responsibility in an internationally oriented firm can use political risk forecasts. Typical users include the president, vice president, manager, director, planner, finance officer, international officer, security officer, economist, researcher, market analyst, and librarian. This variety is evidence of the importance of political risk information. The many uses also present companies with a challenge to determine how to maximize political risk information throughout the organization, especially in the major areas of need. A discussion of how to apply our risk ratings follows, and a summary of applications appears in Table 1.

Table A.3. Most Frequent Uses of Country and Political Risk Forecasts

Type of Use	Percent Using
General background	51%
Evaluating risks to specific projects or investments	36%
Briefing upper-level management	32%
Supplement to other outside sources	30%
Briefing before overseas trips	28%
Strategic planning	27%
Supplement to information from foreign subsidiaries	25%
Briefing colleagues	21%
Making decisions about security	19%
Determining new business opportunities	18%
Identification of key people and institutions	16%
Tempering upper management's "inside information"	16%
Sales or marketing decisions	15%
Supplement to headquarters research and analysis	15%
Preparing for negotiations	10%
Giving perspective to news stories	9%
Planning and evaluating insurance coverage	9%
Assistance in public information activities	5%
Briefing employees going overseas	4%

Source: PRS Client Survey

PRS Can Help Your Company Design a Risk Forecasting System

- How do you identify the risks of investing in emerging markets?
- Does political or country risk affect your industry?
- What political forces may affect your business decisions?
- How do you anticipate and measure political and country risks?

Your company may be investing millions in technology, including internal risk models. But the political risk layer of these models may pose the most significant challenge. PRS can help by sending one of our experts to sit down one-on-one with your experts.

PRS is well qualified to help. We have been analyzing political and country risk since 1979. Our founders, William D. Coplin and Michael K. O'Leary, developed this field of analysis and have trained countless experts. Now our experts can help your company massage political and country risk data to fit your company's customized risk model. Or if you don't have a risk model yet, we can help you develop one.

Contact our offices (+1-315-431-0511 or custserv@prsgroup.com) to arrange a Political and Country Risk Workshop that will help you adapt country risk forecasts for your company's specific needs.

Sources of Our Data

Each PRS *Country Report* includes a comprehensive Fact Sheet that provides 15 categories of information on the country, its government, and its leaders, as well as a spreadsheet Databank containing 39 economic variables and 13 social variables, all of which include data for the most recent 10 years for each country.

Not only is this compilation of economic data comprehensive and extensive, it is also more up-to-date than any other source of which we are aware, printed or online. In addition to gathering data from official sources, we routinely make updated estimates of the current year's figures for each variable, and we equate and report every country's data in the same currency, the US dollar, for ease of cross-country comparisons.

Of course, estimates during a particular year need to be adjusted as a more complete picture evolves. We completely revise and update both the data and forecasts for each country on a quarterly basis. Our policy of keeping our data as timely as possible does mean that many of the figures we report, especially the most recent, require updating over time. We believe that the inevitability of revision and updating is no reason to delay the reporting of the best estimates as they become available.

For the economic data contained in each country's Databank, our primary source is *International Financial Statistics* (IFS). This monthly publication of the International Monetary Fund (IMF) is the most reliable, comprehensive, and timely source available for making comparisons between countries. Other sources (listed in the Bibliography below), as well as news sources, regional and technical journals, and electronic news services help us track day-to-day events that may necessitate changes in both our Databanks and our Fact Sheets. Our research and editorial staff also rely on publications of individual governments, the World Bank, regional international banks, agencies of the US and other governments, and embassies. We also maintain direct personal contact with officials and researchers in these organizations in order to obtain information and estimates quickly and reliably.

Our only goal is to publish unbiased forecasts and timely, accurate data

Our forecasts avoid the inevitable biases found in other sources of risk analysis. Financial institutions tend to be excessively optimistic in their forecasts, especially regarding those countries in which they themselves hold a substantial stake. Governments generally make projections about a country—either optimistic or pessimistic—depending on the state of diplomatic relations with the country. They rarely provide forecasts inconsistent with their own objectives. By contrast, insurance companies, who are concerned with loss and risk, are inclined toward chronic pessimism.

Newspapers tend to cover stories that relate to the latest events, following a country closely when it is newsworthy, and otherwise ignoring it. They also will emphasize those countries in which their reporters are located or where they happen to be visiting. Internal corporate sources are perhaps the most suspect of all. They are overwhelmingly motivated to shape their views around the interests of top corporate officials. The staffs of foreign divisions of corporations are notorious for their tendency to become apologists for their own country, usually reporting back to headquarters based on information provided by the officials of the host government and others protecting the status quo.

In short, all these other sources provide reports and analyses shaped by their interests and particular points of view. By contrast, our own self-interest is simple: to provide the most accurate, timely, and objective information, analysis, and forecasting possible. We neither advocate nor discourage investments in any country. We simply try to provide a comprehensive and useful *Country Report* possible for each country we monitor.

Our website *www.prsgroup.com* provides a free sample Country Report for you to view online or download for further consideration.

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