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The Assessment and Evaluation of Non-Economic
Environments by American Firms: A Preliminary Report

Stephen J. Kobrin

with John Basek, Stephen Blank and Joseph La Palombara

WP 1073a

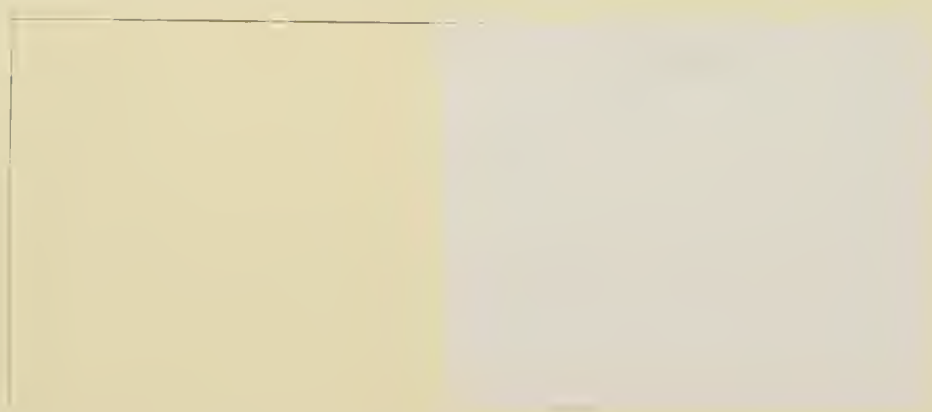
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Introduction^{*}

Discontinuities such as the overthrow of the Shah in Iran have focused a great deal of attention on the impact of politics on international business operations. However, when one probes more deeply, it becomes clear that these dramatic and well publicized events are merely one manifestation of the increased importance of the non-economic environment to private enterprise.¹ This trend appears to be a well established result of secular changes in political-economic structures.² In response, a relatively new managerial function concerned with the assessment and evaluation of non-market environment is gradually emerging.

This paper reports preliminary results of a study of how relatively large U.S. firms operating internationally (1976 sales of \$100 million or more and operations in two or more countries) assess foreign social and political environments, how the resulting evaluations are integrated into decision making and how the process impacts upon managerial strategy. Research entailed both a mailed questionnaire sent to the entire population (a 42% usable response rate produced a sample of 193) and personal interviews with approximately 113 managers in 37 firms selected via a stratified quota sample of survey respondents. It must be emphasized that this paper reports only preliminary results based primarily upon analysis of the mailed questionnaires. The personal interviews serve as background and an aid to understanding at this point; results based upon a systematic evaluation of protocols will be reported at a later date.

Our objectives are basically positive and analytical rather than normative. First, through the use of a mail survey of the entire population

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combined with relatively rigorous interview selection, we would like to establish a benchmark; that is to accurately describe current practice. Second, we would like to suggest hypotheses which attempt to explain the evolution of non-economic environmental evaluation in terms of both organization and process. While our conclusions will certainly have implications for practice, a basic objective is to generate further efforts directed specifically at improvement of this emerging, and critically important, managerial function.

The Literature³

In general results of recent surveys of how firms assess and evaluate foreign political environments do not differ significantly from those of the earliest efforts.⁴ First, politics, typically discussed in terms of political stability or political risk, is considered to be a major or even a dominant factor in the foreign direct investment decision.⁵

Second, the process of assessment and evaluation of non-market environments appears to be relatively unsophisticated and unstructured. Root, reporting a study of large U.S. firms, concluded that, "... no executive offered any evidence of a systematic evaluation of political risks, involving their identification, their likely incidence, and their specific consequences for company operations."⁶ Similarly, Behrman, Boddewyn and Kapoor noted that executives react to environmental developments rather than, "... anticipate them through systematic forecasting."⁷ In a recent study, La Palombara and Blank found that while the environmental analysis function exists in most firms, it is typically quite loose and casual.⁸

Third, decision makers' information about external environments typically comes from general rather than specialized sources. The single most important source of information is internal to the firm; managers stationed

abroad and those in headquarters with international responsibilities. Aguilar, for example, reports that subordinates, peers, and superiors account for 32% of sources of important external information mentioned by respondents to his study.⁹ Zink and Keegan¹⁰ both confirm this finding and report that the most important external information sources are banks and the public press. One finding that emerges clearly from previous studies is that managers rely heavily on inter-personal contact for information about external environments. Both Aguilar and the Behrman; Boddewyn and Kapoor study explicitly refer to personal nets of communication.¹¹

Fourth, the resulting evaluations of foreign non-market environments tend to be subjective and often ethnocentric. A Conference Board study concluded that "... obstacles to investment exist in the mind of the investor...certain countries are dismissed from consideration as investment sites on the basis of information that is incomplete, outdated or in some cases even erroneous."¹² Root found that subjective and general perceptions of instability were important determinants of managers' attitudes about the safety and profitability of specific investments.¹³ La Palombara and Blank noted that the environmental assessment process in most firms developed a subjective "... feel for the political situation."¹⁴

In summary, previous studies of the assessment and evaluation of external environments are relatively consistent. The process tends to be reactive rather than active and rigorous and systematic procedures are the exception rather than the rule. Decision makers' perceptions are most frequently based upon information generated by subordinates in host countries and tend to be somewhat subjective and general. As a result, it is difficult to integrate environmental assessments into a formal decision making process (e.g. capital budgeting).¹⁵ The outcome is often avoidance;

as a practitioner notes, "Even those corporations which have made commitments overseas, by and large, try to avoid political risk by investing in 'safe' countries."¹⁶

Methodology

As noted above, this study involved two sequential steps; a mailed survey followed by extensive personal interviews. First, using Conference Board data, 455 U.S. firms were identified which satisfied two criteria: sales of \$100 million or more and operations in two or more countries. Questionnaires were mailed the last week of August 1978 to the C.E.O., asking that they be directed to the appropriate international officer. One hundred and ninety-three usable replies (42.4%) were received by the "cut-off" date of November 1.¹⁷

Respondents were compared to the total population (of 455 firms) on the basis of sales, industrial sector, and the number of countries in which the firm operated majority owned manufacturing or mining/extractive subsidiaries. The only significant difference (at the .05 level) found is that respondents tended to operate majority owned manufacturing subsidiaries in more countries than the population at large (a mean of 8.1 versus 5.9). No significant difference was found in distribution across industrial subsectors, the average number of countries in which mining/extractive operations were located, or mean sales. (However, mean sales of respondents were directionally greater than that of the population (\$2573 million versus \$2028 million.))¹⁸

The sub-sample for personal interviews was selected from the respondents to the mailed survey using a quota sample stratified on the basis of industrial sub-sector and size. Approximately one quarter of the respondents in each of seventeen sub-sectors were randomly selected. However, if the number of firms selected in any given sector was four or more, respondents were divided

at the median on the basis of sales and half were selected from below and half from about it. A total of 113 managers in 37 firms were actually interviewed.¹⁹ As noted above, this paper reports preliminary results of the study based upon systematic analysis of only the mailed survey. Thus, while the interviews both aid interpretation of and increased confidence in the survey results, our interpretation of them is both impressionistic and tentative at this point.

FINDINGS

Demographics

Appendix 1 contains demographic data describing the 193 respondents to the mailed survey. Thirty three percent have sales of under \$750 million (small firms), 37% of \$751-2500 million (medium) and 31% of over \$2,501 million (large firms). The median firm generates 11-25% of its sales abroad, has operations in 11 to 20 countries and established its first overseas subsidiary between 1945 and 1965. However, a very sizeable minority are relatively international; 42% assign over one-quarter of sales to international operations, 39% have operations in more than 20 countries and 38% established their first subsidiary before World War II.

While over half of the firms reports an international division, that result is difficult to interpret as a negative reply is consistent with both minimal international operations and a global structure. If one looks at only the larger (sales over \$750 million) more international (operations in 11 or more countries and 11% or more of sales generated abroad) firms, one can make the assumption that respondents not reporting an international division are globally organized. Sixty-five percent of 91 firms meeting

this criteria report international divisions and thus 35% are presumed to be globally structured. As can be seen from Appendix I, there is a significant difference in the way firms in these two categories are organized. While over two-thirds of the firms with international divisions report international operations are organized on the basis of area, half of the global firms report product divisions. Seventeen percent of the global firms and 10% of those with international divisions report a matrix structure (the difference is not significant).²⁰

Organization of the Assessment Function

Over half (55%) of respondents reported a group (or groups) within corporate headquarters that reviews overseas political and social factors when new investments are proposed: 56% indicate that a similar (or the same) group monitors existing operations. Our interview data strongly suggests that respondents who answered affirmatively have centralized and institutionalized the environmental assessment function: that is, there are one or more organizational units with formal responsibility for environmental assessment and evaluation. (Over half of our respondents have two or more "groups" with assessment responsibilities.)

However, there is considerable variation in the degree of centralization and institutionalization. The organization of the assessment function can best be described as a continuum ranging from one relatively junior staff analyst with part-time responsibilities for country studies to a group with five or more professionals who are charged with developing and implementing a formal assessment methodology on a continuous basis. We can provide examples of three points on the continuum. In a relatively large manufacturing firm an analyst in the International Treasurer's office has the responsibility for country studies when required by new investments

proposals. The environments of existing operations are monitored only informally.

One of the largest U.S. manufacturing firms provides an example of a midpoint on the continuum. Two individuals (with foreign service backgrounds) have full-time responsibility for environmental assessment. They do country analysis which accompanies investment proposals and attempt to follow environments in which the company has current operations. Both the format of their reports and their relationship with operating management appear relatively unstructured.

Last, a natural resource based company has a group composed of a number of professionals (including political scientists and statisticians) who have developed and implemented a rather complex methodology -- based upon subjective assessments by a panel of country experts -- for evaluating political risk. We estimate that only a very small minority of firms with an institutionalized assessment function (less than 10%) have this type of unit in place. We suspect the majority would fall on the less structured half of our continuum.

We can draw inferences about the characteristics of firms that have institutionalized the assessment function.²¹ First, as one would suspect, they are likely to be larger and more international than those who have not. There is a significant relationship (at the .05 level)²² between the existence of an assessment group(s) and firm size (sales), the percent of sales generated abroad, and the number of countries in which the firm has operations. (Table 1)

(Insert Table 1)

Second, and considerably more tentatively, it appears that institutionalization of the assessment function is more likely in industrial sectors which are more vulnerable to environmental impacts. Not surprisingly, firms in natural resource based industries, which are politicized in most

countries,²³ are significantly more likely (at the .10 level) to have group(s) reviewing social/political environments of new investments or monitoring them where operations already exist. (Seventy-one percent of natural resource based firms versus 55% of all respondents.)

Industrial sub-sectors were also aggregated into sectors containing final and intermediate goods²⁴ producers. Only 47% of final goods producers report institutionalizing the assessment function, while the percentage for intermediate products producers is slightly above that for all respondents. The differences (the relationship between sector and institutionalization is significant at .08) might well be a function of vulnerability and viability. Firms producing consumer goods, food products and beverages generally establish operations to serve a market, utilize a mature technology and require a relatively low investment in plant and equipment. While they may be vulnerable (because of a decline in the perceived value of resources transferred), their bargaining power is low. However, investments -- which are motivated by the need to gain or protect market share -- are quite low and payback is achieved in a relatively short period of time.

On the other hand, investments in intermediate products -- such as machine tools and chemicals -- require relatively large amounts of capital. While they may be more viable in terms of bargaining power, they are also more vulnerable in terms of assets at risk. The investment is much more of a financial and less of a marketing decision.

As noted above, over half the firms that have institutionalized the assessment function have two or more groups (or individuals) with environmental responsibilities and/or have five or more professionals involved.²⁵ Where are these groups likely to be found? Table 2 contains relevant data. Sixty percent or more of respondents (who said that such groups exist) indicate that they are located in the treasurer/finance function in planning, in legal or in the international division. They are much less likely to be found in

either Corporate Economics (26%)²⁶ or Public Affairs (22%). Again, the reader is reminded that the "groups" involved may entail only one individual with part-time responsibilities.

(Insert Table 2)

In firms that have not institutionalized the assessment function (45% of respondents) top management is likely to bear responsibility for environmental evaluation. Seventy-three percent of these firms indicate top management has primary responsibility for evaluating overseas social and political environments and 77% of firms with an international division report responsibility lies there. Only a minority of these firms (less than 20%) indicate staff groups had environmental responsibilities.

The Context: When Are Environments Assessed?

In general, we found the assessment and evaluation of social and political environments to be reactive rather than active. The process is typically motivated by an internal event such as an investment proposal or the planning cycle, or less frequently by an external event such as a major change in a country of interest to the firm. Environmental assessments are rarely conducted independently of some sort of recommendation.

Eighty percent of respondents reply that they conduct environmental analyses of a given country "on demand" (i.e. motivated by a specific event) and only 34% indicated that they do so routinely each year. (The two are not mutually exclusive.) Firms with institutionalized assessment responsibilities are significantly (at .05) more likely to do routine environmental analyses (51%). There is also a significant relationship (chi squared at the .05 level) between the propensity to do routine country analyses and internationalization of the firm in terms of importance of overseas sales, number of countries with operations and duration of international experience.

Given the essentially reactive nature of the assessment process, it follows that environmental analyses are likely to be utilized in conjunction with specific activities which require "action." As can be seen from table 3, the vast majority of respondents use environmental analysis in conjunction with initial investment decisions and strategic planning. Only slightly over one-quarter indicate that assessments are systematically utilized in day to day operations. While findings from our interview data must be considered impressionistic at this point, we believe that the firms we visited are most likely to conduct environmental analysis when a "need" -- most typically an investment proposal -- requires it and that the resulting evaluations are most likely to be forwarded as part of a proposal (or plan) submission.

(Insert Table 3)

Sources of Information

Our findings are consistent with those of previous research. The only sources of environmental information considered important by a majority of firms were internal -- subsidiary and regional managers and headquarters personnel. Banks were clearly the most important external source of information. Our personal interviews clearly support the findings of the mailed survey and suggest a distinct preference for obtaining political/social assessments through inter-personnel communication in the context of well established "networks."

We asked respondents to rate the relative importance of each of seventeen sources of information about overseas social/political factors from 1 (most important) to 5 (least important). Thus a rating of 1 or 2 can be considered relatively important, 4 or 5 relatively unimportant and 3 obviously a neutral point. Table 4 reports results; the percent of respondents rating each source relatively important and the median rating.

(Insert Table 4)

The findings are quite clear. Internal sources are considered relatively important by a large percentage of respondents; subsidiary managers by 75%, regional managers by 69% and headquarters personnel by 65%. The only external source considered relatively important by anywhere near half of the respondents are banks. One then observes a sharp demarcation. Four other external sources are considered relatively important by approximately one-quarter of respondents: consultants, business periodicals, other firms and agents. The other nine information sources all had a median rating of relatively unimportant (4 or 5).

This pattern holds when one disaggregates by size, internationalization or organizational structure. While disaggregation results in some minor changes in rankings, in all cases the internal sources are the only ones considered relatively important by a majority of respondents and banks are clearly the most important external source. In fact there is a definite tendency (significant in some cases) for a higher proportion of the larger and more international firms to rate internal sources, and particularly regional and subsidiary managers, as relatively important. As would be expected a higher proportion of firms with international structures based upon area rank regional and subsidiary managers as relatively important information sources (78 and 82%) than do those organized on the basis of product lines (60 and 65%). Differences are significant at the .05 level.

While only 28% of respondents rate consultants as a relatively important source of information, 40% of the firms use consultants in the political/social analysis process and 21% use them regularly (several times a year). It is interesting to note that firms which are larger, more international or which have institutionalized the assessment function are

more likely to use consultants and to use them regularly.

Impressions gained from our interviews corroborate the survey findings. In most of the firms we visited, the most important source of information about external environments is clearly international management. In countries where operations exist, assessments are prepared by host country management. As noted above, they are often forwarded as part of an investment proposal, the update of a strategic plan or in the context of the annual budget review. Subsidiary managers may also include comments about the social/political environment in a regular report (a monthly or weekly letter) and will certainly discuss important events directly. When investments are considered in new countries, external sources obviously become more important. However, managers with responsibility for/expertise in the region in question are still quite important.

We would also suggest that the managers we spoke with have a definite preference for obtaining environmental assessments directly, from people they know and trust. They rely on their subordinates in the field, colleagues in other companies,²⁷ their banks and impressions they obtain during relatively frequent trips to the areas in question. Furthermore, we would suggest that this tendency increases as one rises in the managerial hierarchy and applies as well to companies with relatively sophisticated environmental assessment units.

For example, the chairman of a major manufacturing company told us that there were two dozen people he has respect for. "This is my best source of overseas information. I have learned to ask them the best questions." The head of international operations of another large company made the point quite clearly, "I will bet on people every time."

It would also appear that the position of staff analysts preparing non-economic environmental assessments is often ambiguous. We found a number of instances of overt conflict between staff analysts and line managers in terms of the former representing a "threat" to the latter. It was also far from clear how the formal staff analyses were utilized by decision makers. Again, there appears to be a preference for direct interpersonal communication. For example, we asked a vice-president in charge of a major product line about his sources of environmental information. His first response was two groups within the company charged with assessment responsibilities. However, he then said that when it comes to a country where he had extensive operations, "I tell them to keep out. I know more about _____ than they do, and I get better information from my people in _____ than they can supply." We will return to both of these points later.

The Process: Assessment Methodologies

We will not review specific firm's assessment methodologies in this paper. Rather, we will attempt to provide an overview of what U.S. firms are doing. The mailed survey asked about routine usage of six assessment methodologies: standardized country checklists, computerized investment models, statistical analysis, scenario development, structured qualitative format, and delphi techniques. Respondents' replies are summarized in table 5.

Fifty-six percent of respondents use at least one of the methodologies routinely. As can be seen, the most popular assessment methodologies are country checklists and scenario development used by 30% and 26% of respondents respectively. Aggregating, we find 46% use some sort of structured qualitative format, that is checklists, scenario development

and/or structured qualitative methods. A much lower proportion of respondents (19%) use any sort of quantitative method; investment models or statistical analysis.

(Insert Table 5)

It is quite important to note that even those firms that use specific assessment methodologies do not appear to rely on them a great deal. We asked respondents to rate each method used routinely from one (heavy reliance) to five (low reliance). With the exception of a structured qualitative format, the median response for all methodologies was 3 or below.

To probe further and ask which types of firms are more likely to use formal methodologies we constructed two aggregates-- quantitative and structured qualitative methods -- as described above. First, as would be expected, firms who institutionalized assessment responsibilities are significantly more likely (at the .01 level) to use some formal methodology than those who did not; 65% versus 45%. The difference also holds for use of any structured qualitative (61% versus 30% or quantitative (28% versus 10%) method.

Second, firms which are larger (sales over \$2.5 billion), operate in 20 or more counties, generate more than 25% of their sales abroad or who use consultants routinely are significantly more likely to use a structured qualitative method than the average respondent.²⁸ However, no significant relationships were observed between firm characteristics and the tendency to use quantitative methods.

Thus, slightly over half of our respondents use some sort of assessment methodology ranging from a structured qualitative format (perhaps an outline for a country study) to reasonably sophisticated quantitative model. Based upon the personal interviews we would suggest two "typical" sorts of assessment procedures. First, subsidiary and regional managers often

prepare environmental assessments in conjunction with submissions such as investment proposals and strategic plans. These tend to be generally unstructured, as to both substance and format, and may range from a few "bullet" paragraphs to several pages or more. They may be included within the proposal or plan itself or forwarded separately. It is important to note that it is our distinct impression that in many if not most cases line environment analysis is a "bottom up" procedure. Subsidiary and regional managers not only prepare the assessment but generally decide which aspects of the environment merit coverage. (There are, of course, times in every firm when questions dealing with the non-economic environment flow from the "top down.")

Second, staff-analysts will be asked to prepare a country study when, for example, a new investment is being considered or an environmental event (e.g. a change in regime) raises concern. Typically, the analyst might be guided by a checklist or format that delineates the topics to be included in the report. Again, it should be noted that almost half of respondents did not report use of any formal assessment methodology at all. This includes 35% of those with institutionalized assessment responsibilities, 33% of large firms, 31% of those with operations in twenty or more countries and 38% of those with more than one quarter of sales generated abroad.

Integration into Decision Making

First, it should be noted that any definitive conclusions about this crucial step in the assessment and evaluation process will require systematic analysis of our interview data. However, it is our distinct impression that formal, systematic and objective integration of evaluations of political/social environments into the decision making process (e.g. an

investment proposal or a strategic plan) are the exception rather than the rule. Environmental information whether it comes in the form of formal assessments, conversations with colleagues in other firms, bankers' opinions, published reports (by sources such as Business International or The Economist), or evaluations by subordinates, generally appears to serve as input to decision makers' subjective impressions of non-economic factors and their likely impact upon operations. These subjective impressions, in turn, serve as a background against which -- or perhaps a context in which -- the decision is taken.

Our respondents tend to be most concerned with general, rather than specific, aspects of the environment. We asked respondents to select the four (of ten) most important aspects of the overseas environment. Results are tabulated in table 6. As can be seen almost eighty percent of the firms feel that political stability and the foreign investment climate are of import. The only other aspects selected by over half of the respondents are both financial/accounting concerns; remittance/exchange constraints and taxation. With the exception of expropriation (28%), none of the more specific sources of constraints on operations were selected as important by even one-quarter of the respondents.

(Insert Table 6)

Interestingly, with one exception this pattern does not change significantly when one disaggregates by factors such as size, internationalization or industrial sector. The exception is no surprise; more raw material producers are concerned about expropriation than firms at large (54% versus 28%). In fact when one looks at firms with institutionalized assessment responsibilities the pattern becomes even more polarized. A higher percentage of these respondents selected the two general factors (investment climate and stability) and generally a lower percentage

the more specific constraints.

Response to means of improving the environmental analysis process lends support to our tentative conclusions regarding integration of assessment into decision making. We asked respondents to rate five alternative means of improvement as essential, useful or unnecessary. Results are presented in Table 7. Fifty-eight percent of respondents replied that integration of environmental analysis into decision making was an essential improvement; almost all felt that this step was essential or useful. Only about half as many respondents felt that relating analysis to operations was essential; not even 10% felt so for the other steps suggested. It is quite clear that managers are aware of a problem in this area.

(Insert Table 7)

We also obtained information on the distribution of reports on overseas political and social environments, which is reported in Table 8. In the vast majority of firms reports are routinely forwarded (frequently or occasionally) to the Chief Executive Officer and the Chief Financial Officer and to the General Manager of the international division (when that structure exists). Interestingly only a minority of firms routinely forward environmental reports to the corporate economist (30%) or the director of public (26%) or government (17%) affairs.

(Insert Table 8)

Conclusions

We must again point out that any conclusions drawn at this point still must be considered tentative. This paper reports preliminary results based upon analysis of the mailed survey. While, given its rate and pattern of response, we are confident that the survey is both accurate and valid, more definitive conclusions must await systematic analysis of the interview

data. Keeping that caveat in mind, we draw several conclusions from the study.

Assessment and evaluation of non-market environments is clearly emerging as a management function in U.S. international firms. Over half of our respondents had institutionalized responsibilities in this area in the form of a group (or groups) formally -- although by no means necessarily exclusively -- concerned with environmental analysis. Over half of our respondents utilized some sort of identifiable, if loosely structured, methodology. We believe that the high response rate to our survey and our ease of access to firms for direct interviews are indicative of the level of managerial interest in this area. There has obviously been some degree of progress made in the decade since Root found no evidence of systemic evaluation of political risks.²⁹

Assessment and evaluation of non-market environments tends to be reactive rather than active. Assessments are typically motivated by either the need to support an investment recommendation or strategic plan or some reasonably dramatic environmental event. We found relatively few instances of environmental analysis being routinely conducted and updated. The primary source of environmental information is clearly corporate managers in the field and at headquarters. Thus, the most important source of environmental analysis is likely to be host country management in the context of an investment proposal, annual budget submission or review of the strategic plan.

As a result, assessment and evaluation of political/social environments is rarely conducted in a manner conducive to independent and objective analysis. We would certainly agree that the network of host country managers, who are often local nationals, is one of the primary sources of

comparative advantage of an international firm. However, we would suggest that independent assessments are necessary for several reasons. First, in most instances, subsidiary managers are members of the local elite. As one of the managers we interviewed put it, "... it is not that they like the establishment, but they they are the establishment." While their contacts with the existing regime may be excellent, their very position makes it difficult to maintain communication with, and even to understand the position and potential strength of, opposition groups.

Second, host country managers are rewarded for aggressive management of the business. They are oriented towards achievement in the sense of overcoming a reasonably large number of obstacles to attainment of profit, market share or sales targets. It thus may not be reasonable to expect objective and unbiased analysis of social and political factors (which appear more often as potential constraints than as potential opportunities) in the context of a recommendation or proposal the manager is attempting to "sell."

We would suggest that the critical problems in this area involve managerial processes rather than access to information. First, while there has been progress made, in almost half of the firms the assessment and evaluation of non-market environments is non-systematic and ad hoc. No institutionalized responsibility for assessment even nominally independent of line management exists and no attempts are made to impose even a loose structure on analyses. As noted above, this applies to a sizeable minority of large and relatively international firms.

Second, the process is typically "bottom up" in nature; it lacks strategic direction from top management. In many instances the choice of aspects of the environment or events selected for reporting and/or analysis, as well as the form of that analysis itself, is made by host country management or staff analysts. There is no reason to expect comparability between countries or regions. We found little evidence of attempts to set company-wide objec-

tives, or of strategic planning in the sense of attempts at reasonably rigorous delineation of how social/political environments might actually affect the firm's operations. More thought needs to be given to which aspects of the environment are important and why.

Last, and perhaps most important, attention needs to be paid to the problem of integrating environmental assessments into decision making in a more systematic and objective manner. We found few instances of attempts to actually utilize evaluations systematically in, for example, a capital budgeting process. Rather, evaluations serve as one of many inputs to decision makers' somewhat subjective impressions of political and social "conditions" in a given country. The managers we spoke to were often quite well informed in a general sense. They travel and read a great deal and have an extensive inter-personal network of colleagues in other firms, bankers and host government officials with whom they speak frequently. While the information they obtain is often valuable, there is no reason to expect that it allows for an objective analysis of the impact of environmental factors on either expected returns or business risk. Furthermore, it is difficult, if not impossible, to systematically aggregate and compare subjective impressions across either projects or countries. In summary, current practice does not facilitate rigorous planning or decision making.

Table 1

Existence of Group(s) to Review
Political/Social Factors

(% of respondents replying yes)

	<u>%</u>	
All respondents	55.2	
<u>By Size (Sales)</u>		
Small	36.5	$\chi^2 = 13.6$
Medium	60.9	(P = .001)
Large	67.8	
<u>By % Sales Abroad</u>		
0-10	47.4	$\chi^2 = 6.49$
11-25	48.5	(P = .039)
26 plus	67.1	
<u>By # nations</u>		
1-4	32.4	$\chi^2 = 10.69$
5-10	54.8	(P = .014)
11-20	56.4	
20 plus	66.2	

Table 2

Location of Assessment Responsibilities¹
 (% of respondents who have groups which
 review or monitor overseas political/
 social factors)

N = 111

Finance/Treasurer	69.4
Planning	68.5
International Division	91.3 ²
Legal	59.6
Product Lines	43.2
Corporate Economist	26.1
Public Affairs	21.6

¹ review new investments, monitor existing investments or both.

² includes only those firms with an international division

Table 3

Activities Where Environmental
Analysis Is Systematically Utilized

(% of Respondents)

Initial investment	80.0
Reinvestment	66.8
Strategic Planning	71.1
Divestment	47.9
Repatriation & Other Exchange Operations	42.6
Day-to-day operations	25.9

Table 4

Relative Importance of Information Sources

	<u>% of Respondents Rating 1 or 2</u>	<u>Median Rating</u>
Subsidiary managers	74.6	1
Regional managers	68.9	1
HQ Personnel	64.7	2
Banks	44.6	2
Consultants	27.9	3
Business periodicals	24.9	3
Other firms	22.8	3
Agents & outside counsels	22.3	3
U.S. Embassies	17.2	4
Domestic agencies of U.S. gov't	16.6	4
Professional journals	14.5	3-4
Trade associations	12.9	4
International organizations	10.8	4
Newspapers, radio, TV	10.3	4
Academics	9.4	4
Journalists	8.3	5
American Chambers of Commerce	8.3	4

Table 5

Assessment Methodologies

(% of respondents who use routinely)

Any Method		55.9
Quantitative		19.2
Investment model	10.9	
Statistical analysis	13.5	
Structured Qualitative		46.1
Checklists	30.1	
Scenario development	26.4	
Structured qualitative	16.1	
Delphi		9.8

Handwritten annotations: A circle around the value 26.4, an arrow pointing from the circle to a question mark in a circle, and another arrow pointing from the question mark to the value 16.1.

Table 6

Most Important Aspects of the Overseas Environment¹

(% of respondents)

Political stability	79.5
Foreign investment climate	79.5
Profit remittances and exchange controls	69.4
Taxation	51.4
Expropriation	28.4
Political party attitudes towards foreign investors	24.2
Labor strikes and unrest	21.1
Administrative procedures	15.8
Public sector industrial activities	13.2
Public image of the firm	5.3

¹ Respondents were asked to select four.

Table 7

Importance of Steps to Improve
The Environmental Analysis Function

(% of Respondents)

	<u>Essential</u>	<u>Useful</u>	<u>Unnecessary</u>
integrate analysis with planning and investment decisions	58.0	33.2	1.6
relate analysis to operational problems	30.6	51.3	9.3
modify recruitment	9.3	36.3	38.9
establish better guidelines for provision of relevant information	8.3	53.9	20.7
modify relative weights assigned to political and economic factors	8.3	42.0	29.0

Table 8

Frequency of Distribution of Environmental Reports

(% of respondents checking frequently or occasionally)

Chief executive officer	80.8
Chief financial officer	77.2
Director of planning	56.5
Legal counsel	57.0
General manager, international division	75.0 ¹
Corporate economist	29.5
Director of public affairs	26.4
Director of government affairs	17.7

¹ Tabulated only for firms reporting an international division

Appendix 1

Demographics

(% of Respondents)

<u>Sales (\$ millions)</u>		
<u>-750</u>	<u>751-2500</u>	<u>2501+</u>
32.8	36.5	30.7

<u>% International Sales</u>			
<u>0-10</u>	<u>11-25</u>	<u>26-50</u>	<u>51-75</u>
20.8	37.2	35.0	7.1

Number of Countries

<u>1-4</u>	<u>5-10</u>	<u>11-20</u>	<u>20+</u>
18.1	22.5	20.9	38.5

First Overseas Affiliate Established

<u>Prior WW II</u>	<u>1945-1965</u>	<u>1966+</u>
38.3	46.9	14.8

Organization of International Operations*

	<u>Area</u>	<u>Product</u>	<u>Matrix</u>	<u>Other</u>
No int. div (34.1)	20.0	50.0	16.7	13.3
Int. div (65.9)	67.2	17.2	10.3	5.2

* Tabulated for firms with sales of more than \$750 million, operations in eleven or more countries and with at least 11% of sales generated abroad. (N = 91)

Footnotes

1. In his recent report dealing primarily with the Harvard Business school, President Bok noted that, "New work is also needed to explore the process of devising strategies for multinational firms which must somehow take account of economic and political developments in many different countries and cultures...The most difficult frontier for planning involves the need to take more systematic account of changes in political and regulatory policies that may affect corporate performance." See, The Presidents Report, 1977-78, Harvard University.
2. As Nye notes, "Most national security policies in today's world are designed not merely to insure the physical survival of individuals within a nation's boundaries, but to insure some minimal degree of economic welfare, a certain political and social autonomy for the nation..." Joseph S. Nye Jr., "Multinational Corporations in World Politics," Foreign Affairs (53) 1974, p.154.
3. For a more complete review of the literature see, Stephen J. Kobrin, "Political Risk: A Review and Reconsideration," Journal of International Business Studies Spring, 1979.
4. Yair Aharoni, The Foreign Investment Decision Process, Boston: Division of Research, Graduate School of Business, Harvard University, 1966 and R.S.Basi, Determinants of United States Private Direct Investment in Foreign Countries, Kent: Kent State University, 1963.
5. See Aharoni, The Foreign Investment Decision Process, National Industrial Conference Board, Obstacles and Incentives to Private Foreign Investment, 1967-68, Volume I: Obstacles, New York: National Industrial Conference Board, 1969, Franklin Root, "Attitudes of American Executives Towards Foreign Investment Opportunities," Economics and Business Bulletin, Temple University (20) January 1968, pp. 14-23, and Dolph Warren Zink, The Political Risks for Multinational Enterprise in Developing Countries, New York: Praeger Publishers, 1973.
6. Franklin Root, "U.S. Business Abroad and Political Risks," MSU Business Topics, Winter 1968, pp. 73-80.
7. Jack N. Behrman, J.J. Boddewyn and Ashok Kapoor, International Business-Government Communications: U.S. Structures, Actors and Issues, Lexington: Lexington Books, 1975.
8. Joseph LaPalombara and Stephen Blank, Multinational Corporations in Comparative Perspective, New York: The Conference Board, 1977, p.65. Also see, Warren Keegan, "Multinational Scanning: A Study of Information Sources Used By Headquarters

Executives in Multinational Companies," Administrative Science Quarterly, September 1974, pp.411-421, Robert B. Stobough Jr., "How to Analyze Foreign Investment Climates," Harvard Business Review (47) September-October 1969, pp. 100-107, and Zink, The Political Risks for Multinational Enterprise...

9. Francis Joseph Aguilar, Scanning The Business Environment, New York: The MacMillian Co., 1967, p.69.

10. Keegan, Multinational Scannings..., Zink, The Political Risks for Multinational Enterprise...

11. Aguilar, Scanning The Business Environment, pp. 68 and 69, Berhman, Boddewen and Kapoor, International Business- Government Communications... p. 45. In a classic study of American exporters the authors concluded, "Knowledge of foreign economic affairs came either from the most general news sources or, more vividly, from correspondence and personal experience." Raymond A. Bauer, Ithiel de Sola Pool and Lewis A. Dexter, American Business and Public Policy, 2nd Edition, Chicago: Aldine-Atherton, Inc., 1972, p.470.

12. National Industrial Conference Board, Obstacles and Incentives..., p. 2, Also see Aharoni, The Foreign Investment Decision Process and LaPalombara and Blank, Multinational Corporations in Comparative Perspective, for discussion of the subjectivity of perceptions of foreign political environments.

13. Root, "Attitudes of American Executives..."

14. LaPalombara and Blank, Multinational Corporations in Comparative Perspective, p. 65.

15. See Stobough, "How to Analyze Foreign Investment Climates" for a report of a survey of firms on this topic.

16. Antoine VanAgstmael, "How Business Has Dealt With Political Risk," Financial Executive (44) January 1976, p. 26.

17. Thus all replies used were recieved before the 1978/79 crisis in Iran significantly increased the salience of this topic among American managers.

18. As we interviewed about 20 percent of the firms who completed the mailed questionnaire we were able to check the validity of the responses. In every instance, we contacted the manager who had signed the questionnaire. While we found several cases where a subordinate had actually filled out the form, in every instance the actual respondent was a manager who was

qualified to provide the information requested. We were quite impressed with the care our respondents took in completing the survey instrument. Population data was provided by The Conference Board. All firms which met the selection criteria were included in the mailed survey.

19. To our surprise, very few companies refused our request for a visit. However, when we encountered a refusal, a replacement was drawn from the same "strata" as the original. The only sector where we experienced considerable difficulty and were not able to interview our "quota" of firms was consumer products.

20. Given differences in both the population and in time, our sample appears reasonably comparable with that of the Harvard project on multinational enterprise. (The Harvard sample was drawn from a population based upon the Fortune 500 and thus ours includes smaller firms. Their data is a decade older than ours. Last, they define a multinational firm as one with operations in six or more countries.) For example, fifty-three point one percent of the firms in the Harvard sample reported less than 20 percent of sales were generated abroad, 35.2 percent 21 to 39 percent of sales and 11.7 percent over 39 percent. Twenty-seven percent reported operating in 6-9 countries, 25.3 10-13, 22.8 in more than 17. See, John M. Stopford and Louis T. Wells Jr., *Managing the Multinational Enterprise*, New York: Basic Books, 1971.

21. The following analysis is based on the question dealing with the existence of groups oriented towards the environments of new investments. The reader will recall that we also gathered data on groups oriented towards the monitoring of environments where operations exist. As cross-tabulating with either produces virtually identical results we report only the former. However, analyses were run for both and any significant differences that were found are reported.

22. Using the Chi-Squared distribution.

23. Stephen J. Kobrin, "The Expropriation of Natural Resource Based Industries in Developing Countries," *Journal of Business Administration* (University of British Columbia) Spring, 1979.

24. Three sectors are utilized. Final products includes consumer products, textiles, furniture, appliances, automobiles, beverages, etc. Intermediate products includes chemicals, rubber, plastics, construction machinery, industrial machinery, computers, office machinery, etc. Raw materials includes basic metals and petroleum. Because of their very special characteristics drugs and pharmaceuticals were not included.

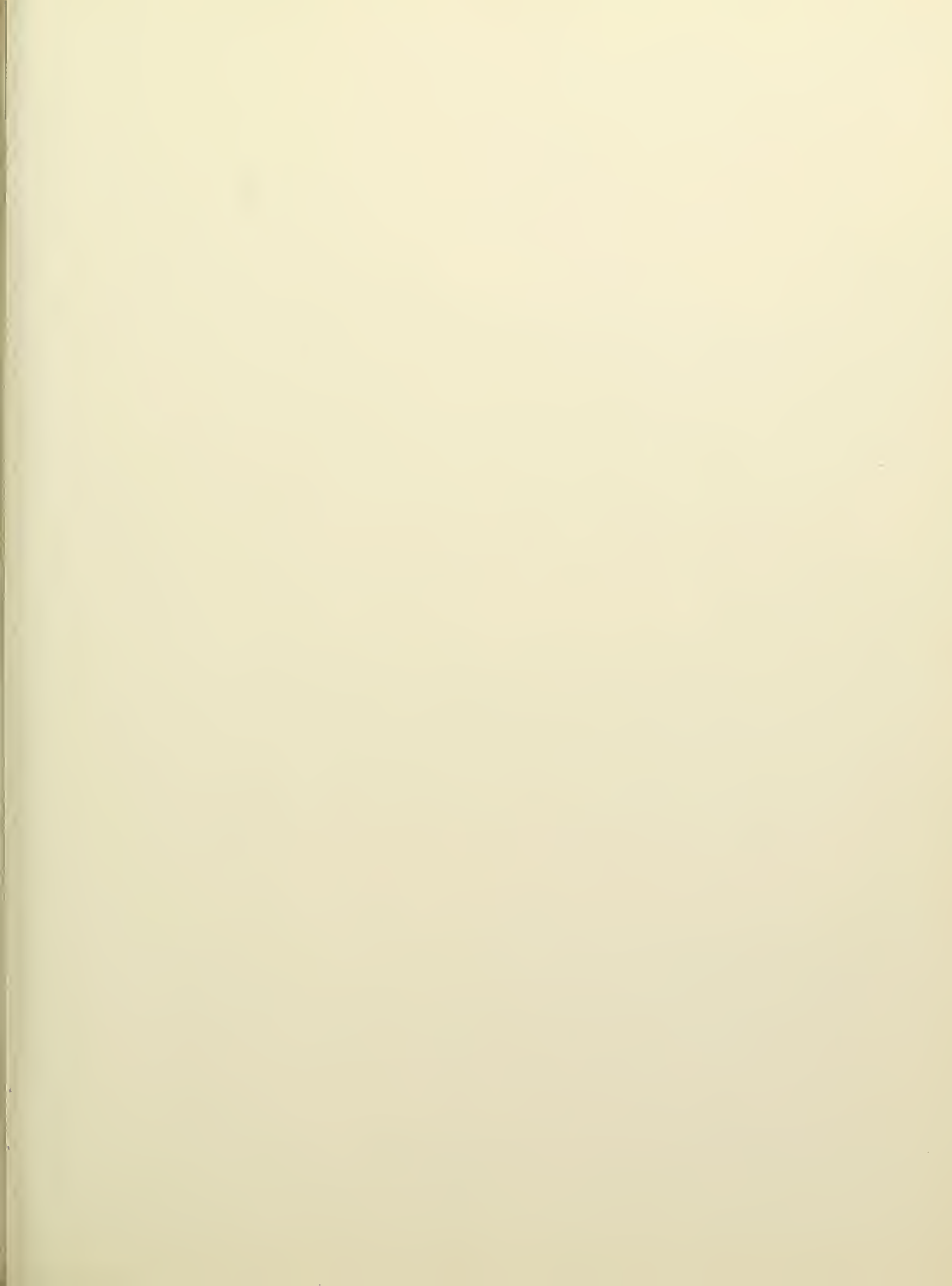
25. Only 75 of the 105 firms indicating that they had groups responsible for assessing new investment environments reported the number of professionals involved. However, among those 75 firms there is a significant relationship between the number of professionals and firm size as one would suspect the relationship is positive. (P=.04.)

26. Petroleum is an exception as 42.9 located assessment responsibilities in the corporate economist's office. It should be noted that the fact that assessment responsibilities are not frequently located in the public affairs or government affairs departments may be, at least in part, due to the fact that those functions are themselves newly emerging.

27. A good example is provided by one of the tire producers we interviewed who noted that the original equipment manufacturers are important sources of information about political/social environments.

28. Size and percent sales abroad are significant at the .10 level, the number of countries at .05 and use of consultants at .01.

29. Footnote 6. *supra*.



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