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Re-thinking country risk: insights from entrepreneurship theory

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Abstract

Though country risk analysis is a well-established field within international business, evidence indicates that established measures of country risk are unreliable predictors of actual volatility. Conventional strategies aimed at minimizing or otherwise avoiding downside risk are likely to yield limited results at best; at worst, these strategies will lead managers to miss entrepreneurial opportunities, which are likely to be greatest during conditions of disequilibrium. Drawing from entrepreneurship theory, I propose an alternative perspective from which to approach country risk. By focusing on both the downside and upside elements of country risk, strategies may be devised to harvest upside volatility while containing downside volatility. Rather than being something to always avoid, country risk becomes an opportunity to profit from uncertainty.

Keywords: Country risk; International entrepreneurship; Business strategy; Real options

In their review of international entrepreneurship, McDougall and Oviatt (1997) indicated that since entrepreneurship and international business are two of the most explosive fields in US business schools, international entrepreneurship is bound to attract substantial interest. This assertion has subsequently been validated by the issuance of special issues on the subject in the Academy of Management Journal, the Journal of International Management, Small Business Economics, and the present call for papers in the International Business Review, as well as by the creation of a new journal entitled the Journal of International Entrepreneurship.

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Nevertheless, a substantial risk remains that the recent surge of interest in international entrepreneurship will merely be a fad or the trendy re-labeling of old wine. Although the field is new in name, there is a substantial body of literature on closely related subjects, such as the internationalization of small- and medium-sized enterprises (SMEs). There are also broad areas of entrepreneurship, international business, and strategy research that are directly applicable to international entrepreneurship issues.

Perhaps the greatest challenge, then, to the budding field of international entrepreneurship is the need to generate theoretical contributions that are distinct from, and possibly even in conflict with, well-established theories in the parent fields of entrepreneurship, international business, and strategy. This may in fact be accomplished via the juxtaposition of theory from two or more of these disciplines, and/or through empirical findings that contradict established theory in one of the parent disciplines. A good example of this may be seen in McDougall, Shane, and Oviatt's (1994) work on international new ventures (see also Knight & Cavusgil, 1996). These authors have identified a phenomenon—the presence of newly created firms that exhibit a high degree of internationalization—which is not effectively explained and is at least partially incompatible with established theories of international business.

In this paper, I draw on recent research in entrepreneurship and related fields to refute the relevance of a well-established stream of research in international business pertaining to country risk. Country risk analysis is commonly used to identify potential sources of volatility and downside risk in international environments, so as to steer investments away from high-risk situations. These measures have a poor track record, and have been proven unreliable in predicting future volatility (Oetzel, Bettis, & Zenner, 2001). It appears, therefore, that these measures are ineffective in helping managers minimize the downside risk associated with international business endeavors.

In addition to being ineffective measures of downside risk, country risk measures may lead managers to inadvertently minimize the upside potential of international endeavors as well. Drawing from the entrepreneurship literature and Austrian economics, it follows that entrepreneurial opportunities are likely to be greatest when markets exhibit characteristics of disequilibrium. Since country risk measures appear to be lagging rather than leading indicators of environmental volatility, not only are companies that base investment decisions on country risk measures likely to fail in minimizing *downside* risk, but they might actually experience reduced or minimized *upside* risk.

The incorporation of entrepreneurship ideas provides a fresh perspective from which to view country risk. In Section 3 of this paper, I adopt this perspective to identify and evaluate eight strategies that may be used to manage country risk. Traditional strategies aimed at minimizing downside risk are likely to be unsuccessful, due to the inherent uncertainty international markets exhibit. Entrepreneurial strategies aimed at exploiting uncertainty, on the other hand, may be used to harvest the upside dimension of country risk.

The scope of this paper includes the entrepreneurial international activities of new ventures as well as established firms. While some approaches to entrepreneurship research focus principally on SMEs (e.g. Aldrich, 1999) or on new ventures (e.g. Vesper, 1990),