

## **Risky Business in Conflict Zones: Opportunities and Threats in Post Conflict Economies**

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Attracting international businesses and enterprises to transfer both resources and capabilities into post conflict economies is a must for sustaining long term stability, economic growth and success of recovery process. Recently, international business organizations operating in post-conflict countries became more integrated with recovery and transition process of post conflict economies. In this study, the opportunities and threats for international firms operating in post conflicted economies have been evaluated based on literature review. This study also demonstrates that (1) investment opportunities in transition economies are attractive for short and mid-term, (2) capturing undervalued firms, accessing unique marketplace, benefiting incentives, accessing IMF's and the World Bank's low cost credit resources and having a good reputation via contributing into stability and peace are just some of the major advantage (3) the loss of control and capital attached to the risk of unstable political conditions, the possibility of high ethnic tensions and violent riots, the lack effective corporate culture and high burden of inside conflicts, the lack of sustainable economic growth and the risk of new tax packages have negative impacts on long term success for the firms (4) the conflict risk itself is major problem dissolving investment conditions.

Keywords: international business, investment, recession, conflict, economics

### **Introduction**

In the era of European Debt Crisis, ambiguity and volatility in capital markets were intensified significantly similar to the financial situation in the last quarter of 2008, which had transmitted into a global recession resulting in sharp slowdowns in financial and economic activities (IMF, 2002).

In the mid of global economic crisis, intensive costs of measures taken and capital injections made to stabilize the financial system, devastated the healthy fiscal structures and balance of European economies. In addition to the first impacts of the Sovereign Crisis in Europe, political risks spilled over some countries in Middle East and North Africa. Volatility in financial markets and skyrocketing energy prices simultaneously affected economic growth in emerging and post-conflicted countries. In order to fuel economic activities and to stabilize the financial system in these markets, they finally began to privatize state owned industries opening their doors to international business entrepreneurs deliberately. Following the governmental incentives and privatization opportunities, the major threat of global economic crisis finally turned into an investment opportunity for international businesses daring to step into questioning and risky areas. What is the scale and scope of the risks available for international companies investing and operating in conflict zones?

What kind of measures must be taken into consideration? During financial turmoil, is it an opportunity to invest in countries where governments demand capital flow to stabilize and fuel economic activities? Questioning the investment decisions of international business entrepreneurs on post conflicting economies is in fact easy but answer is not simple too. There are some advantages and interests of investing in conflict torn economies. The major advantages of investing in transition economies are; (i) capturing undervalued firms and (ii) accessing to their unique marketplace (iii) benefiting from governmental incentives, (iv) being part of recovery and reconstruction process opens long term low cost credit resources such as the World Bank and IMF, (v) contributing into stability and peace as well as the investment increases the level of employment in post conflicted countries.

On the other hand, there are some major disadvantages are available too. (i) the risk of unstable political conditions. The lack of political stability can produce tensions and violent riots against international firms' assets and workers. (ii) The risk of high rate of unemployment. The lack and inequality of income among individuals of different ethnic groups might be a strong base for internal conflict within an organization. (iii) the low growth rate and financial stability. The lack of sustainable economic growth might have pressures on local government to implement new tax packages for extra income. (iv) high possibility of increasing sovereign risks might degrade economic

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conditions. (v) the conflict risk itself is major problem dissolving investment conditions corrupting suitable investment climate. Subsequently, investment opportunities are attractive. However, if the risks related to economic and political conditions are not managed well, the results then might have fatal effects on international business operations and capital (Collier, 1999; Collier, Hoeffler & Rohner, 2006; Collier & Hoeffler, 2004; Collier, Hoeffler & Soderbom, 2007; Orhan, Zehir & Hacıoğlu, 2009; Starr, 2004; Mills & Qimiao, 2006; Hacıoğlu, 2009; Yılmaz, 2007; Karluk, 1999).

In this study there are three main sections. In the first section, the link between Global Economic Crisis and European Debt Crisis has been evaluated. It is also emphasized that the economic and political risks emerging lately devastated post conflict economies and have impact on fiscal balance. In the second section, risky business operations and the conflict Issue in International Business has been evaluated within strategic management perspective. In the final section, the main financial and operational opportunities of risky business in Emerging and Post-Conflict Countries have been illustrated.

### **Economic Outlook: The Era of Global Economic Crisis and European Debt Crisis**

In the era of European Sovereign Crisis, ambiguity and volatility in capital markets were intensified significantly similar to the financial situation in the last quarter of 2008, which had transmitted into a global recession resulting in sharp slowdowns in financial and economic activities. Some of advanced economies dramatically experienced recessions during economic collapse. Moreover, the major impacts of 2008 financial crises on banking industries did not only result in the collapse of many reputable and giant banks, but also fiscal balance of European economies (Moshirian, 2011; IMF, 2009; Shahrokhi, 2011; Bracke & Fidora, 2012; Mun & Brookds, 2012; Gronmotikas & Vermeulen, 2012; Hui & Chung, 2011; Dias, 2012).

Following the first impacts of global economic crisis and financial turmoil in the capital markets, some of pioneering financial institutions faced bankruptcy and major industries experienced fatal slowdowns (Shahrokhi, 2011; Gronmotikas & Vermeulen, 2012). Some of them were assisted by central authority and consolidated by capital injections. Stabilized financial institutions began to take rebounds in financial activity following regulations in capital markets (IMF, 2002). Moreover, following the first three years, recovery process of the world financial system and economy has some positive signs of progress. However, the cost of recovery process and measures taken to

functionalize the financial system again, significantly has some negative effects on the balance sheets of advanced economies (Gronmotikas & Vermeulen, 2012). The financial stress in the marketplace has finally returned. The nature of governmental securities which had been defined before as risk free instruments in literature became another risk basis for the capital markets following the degradation of fiscal discipline.

One of the major risks nowadays affecting the world economy stems from political area. By the end of 2010, the revolutionary Arab Spring movements which had first took place in Tunisia spilled over the North African states including Egypt, Algeria, Morocco, Libya, Jordan, Bahrain and finally Syria. Conflicts in these countries become intensified in 2011 and oppositions took superiority over reversed leaders with the support of pioneering western countries. However, the conflicts in the Middle East and the North Africa were not stabilized yet. The ambiguity and political turmoil affected the safety energy routes and result in the energy price increases. For many low currency countries and emerging economies, this meant fiscal impacts over economy. The adverse fiscal effects of high fuel prices over emerging and transition economies caused significant obstacles challenging for development and stability.

The impact of macroeconomic risks and political risks over emerging and conflict torn economies increased the need for financial resources. Privatization and capital flow nowadays seem to be good solutions for these economies. Therefore, it should be considered as an opportunity for International Business Entrepreneurs operating in emerging and conflict-torn economies. Operating in post conflicted economies such as Libya and Egypt initially seem to have some significant operational risks. However, in the near future, a negative investment decision would be much more costly in comparison with risky investment decision.

### **Risky Business Operations in Conflict Zones**

#### *Conflict issue for international business operations transition economies*

In literature, there is a debate on the classification of *Conflict* studies. In fact, the *conflict* is an interdisciplinary issue while the *conflict* occurs in actual life among individuals, societies, businesses, governmental organizations and states (Zorlu & Hacıoğlu, 2011). International Business organizations operating in post-conflict countries became more integrated with transition process of conflict-torn economies. Without the contribution of international enterprises and actors, it is not easy to have success in recovery and reconstruction process of post conflict economies. Post conflict economies in

transition process face some significant obstacles in front of globalization and competitive market conditions. To sustain growth and development in recovery process, it is necessary to attract international businesses and enterprises transferring both resources and capabilities into domestic economies (Mills & Qimiao, 2006; Hacıoglu, 2009; Yılmaz, 2007; Karluk, 1999; Zorlu & Hacıoglu, 2011). On the other hand, the lack of political and economic stability discourages entrepreneurship activities.

Globalization as a challenging issue for transition and emerging requires them to be more competitive and adaptive to the change dynamics. Transition economies in Europe such as Kosovo and Bosnia- Herzegovina have difficult task on stabilizing the economy, fulfilling the requirement of recovery process, adapting to EU integration process, fighting against poverty, corruption, social inequality and war fugitives, functionalizing autonomous economic and politic institutions, providing necessary environment for foreign investors.

### ***Conflict risk in transition economies and its effects***

The risk of conflict in transition economies depend on economic, social and politic factors. In terms of economic activity, strong monetary discipline, economic stability, growth and employment are preliminary elements of lowering the conflict risk (Collier et al., 2007; Starr, 2004; Mills & Qimiao, 2006; Hacıoglu, 2009). Other causes of conflicts in transition economies are corruption, poverty and social inequality (Collier, 1999; Collier, Hoeffler & Rohner, 2006; Collier & Hoeffler, 2004; Collier et al., 2007; Orhan et al., 2009; Starr, 2004; Mills & Qimiao, 2006; Hacıoglu, 2009; Yılmaz, 2007; Bennett, 2002).

Conflict in transition economies at macro level affect international businesses operating inside. Moreover, deteriorating conditions for international businesses result in outflow of capital and foreign exchange. Conflicts have negative effects on investment climate, economic and financial stability, business and trade activities, and workforce (Orhan, Zehir & Hacıoğlu, 2009; Starr, 2004; Mills & Qimiao, 2006; Hacıoglu, 2009; Karluk, 1999).

Conflict in transition economies at micro level creates disputes among individuals in work groups. Changing conditions at workplace affect Individual aspirations, desires and motives. Ambiguity at management ranks, ascending risks of business operations, communication problems among business units and intra-group activities, transfer of skilled workers to outside for combating and deteriorating infrastructure and facilities are some effects of conflict situations (Hacıoglu, 2010a;

Hacıoglu, 2009; Hacıoglu, 2010b; Hacıoglu & Seratas, 2011).

### ***Devastative effects of international business operations on post-conflict conditions***

International business actors operating in post conflict area may cause social impacts also, contributing to conflict risk escalation. Some of the business failures results in social impacts are misuse of land, deepening power imbalances, special privileges on staff from one ethnic group, supporting election campaigns, talking about politics, and causing wage gaps among individuals. The lack of sustainable and suitable recruitment policy is also subject to imbalance in social life and might result in escalation of the conflict risks (Collier, 1999; Collier et al., 2006; Collier & Hoeffler, 2004; Collier et al., 2007).

Employee relations in international companies operating in transition economies may lead to conflict in some cases: treating workers unequal, supplying unhealthy working conditions (Collier, 1999), improper use of poor legislative rules and procedures, dealing workers with heavy workloads, low wages, wage gaps, discrimination, and special privileges (Collier et al., 2006; Collier & Hoeffler 2004) for individuals from one ethnic group in group works (Collier et al., 2007; Orhan et al., 2009; Starr, 2004; Mills & Qimiao, 2006; Hacıoglu, 2009).

### **Main Economic and Operational Opportunities and Threats in Emerging and Post-Conflict Countries**

#### ***Conflict management for international business in transition economies***

International Businesses operating in conflict zones have significant roles in transition process. However, they face problems in managing cross-cultural relations at company level. In some cases, international businesses are ambitious to manage conflicts for social responsibility and entrepreneurial opportunities (Mahrokian, et al., 2010; Jehn & Bendersky, 2003; Gladwin & Walter, 1980; Rubin, Pruitt & Kim, 1994; Banfield, Haufler & Lilly, 2003). However, many international businesses also benefit from ambiguity and lack of authority in transition economies as well as capturing profit opportunities on employing cheap work force, cheap assets and etc. Gladwin and Walter (1980) described (Gladwin & Walter, 1980) how social conflicts are managed by international enterprises. Assertiveness and cooperativeness are at the core of model. Assertiveness refers to the company's willingness to have control as dealing with policy issues on its own initiatives. Cooperativeness refers to the

company's willing less to create on improved environment in which business operate (Gladwin & Walter, 1980; Robbins, 1998; Thomas, 1992; Jomali & Mirshak, 2010). Five contributing political factors are also adapted to the model (1) competing, (2) collaborating, (3) compromising, (4) avoiding, (5) accommodating (Gladwin & Walter, 1980; Jomali &

Mirshak, 2010). Gladwin and Walter (1980) also argue that the contributing factors in the model affect organization's political behavior strategies and their inclination to participate in conflict resolution and commit effort and resources (Gladwin & Walter, 1980).

Table 1. Critical determinants of corporate engagements in conflict situations.

| Form of engagement | Situational variables            | Influenced by  |
|--------------------|----------------------------------|--|
| Assertiveness      | Outcome stakes                   | Managerial Perceptions, timing, strategic considerations, Financial Condition  |
|                    | Firm relative power and leverage | Firm Size, financial base, human resources, leadership quality<br>Communication skills, and formation of coalition         |
| Cooperativeness    | Interdependence of interests     | Concurrence of goals, compatibility of goals and views<br>Elements of trust, recognition of legitimacy of other interests, |
|                    | relationship quality             | open communication and willingness to help   |

Source: Gladwin and Walter, (1980).

Jomali and Mirshak contributes to the study of Gladwin and Walter, noticing that outcome stakes are directly influenced by managerial perceptions, firm strategy, financial condition and urgency, and that management wants to avoid conflicts that damage a firm's distinctive competencies, degree of control, or unique capabilities (Jomali & Mirshak, 2010).

#### ***Opportunities and threats for international business operations in post conflict and emerging economies***

Human rights, labor issues, global warming and other environmental issues were traditionally discussed in literature. Especially, in the mid of 1990's the contribution of international participations, multinational corporations and other non-governmental organizations into the stability, recovery, and peace process in conflict zones, takes many applauds and directs scholars attention towards corporate social responsibility (Bennett, 2002; Gladwin & Walter, 1980; Banfield et al., 2003; Fial, Pratt & O'Connor, 2009; Moran & Riesenberger, 1994; Rhinesmith, 1996; Srinivas, 1995).

In transition economies, international business can support recovery process participating commercially and transforming goods and services, technology, resources and know-how. Development in commercial life, rebuilding infrastructure and investment in major sectors are only to be sustainable by contribution of international business enterprises into recovery process (Bennett, 2002).

International Business in transition economies also expand their investment activities based on investor's expectations on future returns on equity. According to World Bank Reports, for investors there are many opportunities investing in transition economies. Reports illustrate that 80 percent of the

world's poorest 20 countries in the last 15 years, experienced major conflicts. Just over the next five years from conflict, the post conflict economies in transition sustained significant economic growth up to 44 percent (World Bank, 2003).

Globalization gives some opportunities and pressures for domestic corporations in emerging economies to be innovative and improve their competitiveness (Gorodnichenko, Svejnar & Terrell, 2009).

As a result of globalization, multinational corporations have launched new initiatives that investigate the market potential as well (Lorentz & Pervez, 2010). Successful strategies in these areas suggest the importance of companies developing a global capability in social embeddedness. However, understanding how international business environment creates competitive advantage and examining what strategies are valuable for protecting core competencies when the firm is faced with permeable and shifting boundaries. Therefore, investment in emerging and post-conflict countries is important for the firms to gain competitive advantage in global market (London and Hart, 2004).

Improved policy fundamentals and reduced vulnerabilities of emerging markets in the pre-crisis period protect from the sharp rise in global risk aversion. Policy makers in many emerging markets work on capital flows, macroeconomic management and pressures in asset markets (Pradhan, et al., 2011). Thus, faster growing trading partners could be available with relatively good fundamentals due to accommodative policies in developed economies (Moghadam, 2010).

Sovereign risk, plays a crucial role in international capital flows and cross-border flows to individual firms, has been very low over the past few years in emerging markets. And also, sovereign credit ratings can be used to evaluate

countries' access to international capital markets (Jaramillo, 2010). Diminishing sovereign risk could be one of the most prominent opportunities as a result of the strong rise in business volumes (Udaibir, et al., 2010).

Direct investment can be well explained in terms of economic fundamentals (Garibaldi, et al., 2002), understanding global economic conditions and specially changes in FDI inflows has also gained importance with the recent global economic crisis. In contrast to recession has negative effects on growth, stock market performance (Llaudes, Salman & Chivakul, 2010), FDI has increasingly been viewed by policy makers in developing and emerging market economies as a tool to finance development, increase productivity and import new technologies.

Therefore, foreign direct investment in emerging and post-conflict economies is one of the main indicators that show whether international business is enough or not. For this purpose, contributions to the foreign investment should be progressively increased in emerging and post-conflict markets (Arbatli, 2011; Bevan, Estrin & Meyer, 2004).

#### *Managing cross-cultural differentials diminishes the level of social conflict.*

David, Bastos and Mills (2011) examine the variables related to cross-country differentials in growth performance in the results of social conflict (David et al. 2011). According to the study, changes in the terms of trade are the most important correlate of economic performance in post-conflict environments. Second most important factor in this study is institutional quality and then foreign aid is listed with very limited ability to explain differentials in growth performance, and trade openness are not found to have a statistically significant effect (David et al. 2011). Otherwise, post-conflict aid, consists of humanitarian and reconstruction aids, is meaningfully different than conventional development aid in terms of goals, circumstances economics effects. During conflict, investment and saving decisions are disrupted, because of the magnitude of these problems in post-conflict economies (Demekas, McHugh & Kosma, 2002). Foreign investors take into account the main factors of the location choice such as terms of trade, institutional quality, foreign aid, exchange rate, transport costs (Bakhache, et al., 2006; Lipschitz, Lane & Mourmouras, 2002; Collier & Hoeffler, 2004). Thus, growth performance of risky business in the post-conflict economics and emerging markets are possible to evaluate (Campos & Kinoshita, 2003).

#### *Economic recovery and FDI improves financial opportunities*

A number of findings show that less attention has been paid to the recent rapid recovery and sharp fall in output in transition economies in the 1990s. In this manner, stabilization policies should play an important role in the recent recovery. Some researchers also determine the same findings that include a positive and strong link between progress in market-oriented reforms and economic growth in transition economies (Iradian, 2007; Kolodko, 2000).

However, the banking sector in transition economies during the 1990s are argued about the size of bad loans inherited from the centrally planned system, and weaknesses in implemented restructuring policies. In this way, the system affects the overall fiscal costs but some studies implies that there is no significant relationship between the size of restructuring cost and overall improvement in banking sector performance in transition economies (Zoli, 2001). Nevertheless, private sector in transition economies has increasing access to long-term bank financing (Tasic & Valev, 2010). Therefore, it is necessary to focus on regulation and performance results in banking sector to success at the risky business in post conflict and emerging economies; furthermore, sustainable development in banking sector increases awareness of business risks and opportunities (International Finance Corporation, 2007).

#### *Corruption as a threat is still a major concern for risky business environment*

Adverse impact of corruption on economic performance also produces prominent results at evaluation of risky business in post-conflict and emerging markets. Aberd and Davoodi (2000) identify that corruption is widely an evidence of underlying weakness in public policies and institutions (Abed & Davoodi, 2000). Besides this, provides deeper insights into economic performance than do measures of perceived corruption. So, strengthening in public policies could be boost the economic stability and reduce corruption and thus, risky business in countries might become an opportunity for foreign corporations.

#### *The lack of sufficient leadership on economy has impact on growth*

It is seen in recent studies changing in leadership has an impact on national growth too. Some post-conflict situations are characterized by changes in leadership and a new leader could have more advantages for high growth in emerging and post-conflict markets (Hoeffler, Ijaz & Billerbeck, 2010).

*The nature of the post conflict situation is complex and has impact on investment climate*

Investment climate in post-conflict situations is generally negative because of the macroeconomic instability. All attention to change these conditions is to build investable environment including institutions, governance, capacity and social capital. If a private sector is supported by a good investment climate in the post conflict recovery process, Production, employment rate and growth increases due to taking advantage of them. For this reason, the private sector helps reduce the possibility of a return to conflict (Mills & Qimiao, 2006).

## Conclusions

The latest turmoil in global financial markets has illustrated once more again the importance of developing long term strategy planning and implementing capabilities of the firms. One way to boost economic returns as a strategic output is to implement risky business operations in post conflict areas where some significant opportunities and threats available. Recently, international business organizations operating in post-conflict countries became more integrated with transition and recovery process of conflict-torn economies. Moreover, it is clear that without the contribution of international enterprises and actors, it is not easy to have success in recovery and reconstruction process of post conflict economies. To sustain growth and development in recovery process, it is necessary to attract international businesses and enterprises transferring both resources and capabilities into domestic economies. On the other hand, the post conflict economies in transition process face some significant obstacles in front of globalization and competitive market conditions. Notwithstanding this, the lack of political and economic stability discourages entrepreneurship activities.

Capturing undervalued firms, accessing unique marketplace, benefiting incentives, accessing IMF's and the World Bank's low cost credit resources and having a good reputation via contributing into stability and peace are just some of the major advantages. However, risks are available too, including the loss of control and capital attached to the risk of unstable political conditions, the lack of political stability, high ethnic tensions and violent riots against international firms' assets and workers, the lack effective corporate culture and burden of inside conflicts, the lack of sustainable economic growth and the risk of new tax packages implemented for extra income. Moreover, increasing sovereign risks based on degrading economic performance have impacts on investment

climate and political stability. In fact, the conflict risk itself is major problem dissolving investment conditions corrupting suitable investment climate. Subsequently, investment opportunities in transition economies are attractive for short and mid-term. However, if the risks related to economic and political conditions are not managed well in strategic planning process, the results then might have fatal effects on international business operations and capital structure in long term.

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