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Understanding the Impact of Political and Legal Environments on Business Operations

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Abstract: *This study took a conceptual approach to unraveling the political and legal environments impact on business operations. The study explains the link between business operations and adaptation to political policies capable of disrupting workflow. Political risk is a major issue that impacts firms' policy formation, implementation, and objective achievement. To adequately cope with political uncertainties, an understanding of political risk analysis procedure is paramount to free hitch business operation. Firstly, is to ascertain issues of relevance to Firms' through need assessment. Secondly, is Assessing potential political events, and lastly is addressing political risks through relationship building. Furthermore, the research outlined risk analysis, consulting local partners, and political risk insurance as the strategies needed in the management of political risks.*

Keywords: Political Environment, Legal Environment, Political risk.

Introduction

Irrespective of business scale, industry, and location, the operations of responsibly structured organisations are guided by set of guidelines known as policy. A Policy is a law, regulation, procedure, administrative action, incentive, or voluntary practice of governments and non-governmental organizations (CDC, 2015). Policy occurs at various levels and points of interaction—personal, organizational, and public. Business policy is the study of the functions and responsibilities of senior management, the crucial problems that affect success in the total enterprise, and the decisions that determine the direction of the organization and shape its future (Alsaedi, 2017). Business Policies are expected to address the intended and unexpected impact of the external environment on organisational performance. External environments comprise uncontrollable forces that are beyond organisational control. However, several types of external environment exist, but the core typologies that are central to organisational operations and performance are the political and legal environment which this study is focused on. From literature, an inseparable interaction exists between the political and legal environment of business.

Political Environment

In most countries and territories of the world, the political party in power is responsible for the creation of operational framework within which profit and nonprofit oriented organisations are expected to conduct business activities. Business performance is the effort expended by a business firm in achieving its objectives of customer satisfaction, employee satisfaction, societal satisfaction, and ultimately profitability (Mark & Nwaiwu, 2015). Business performance absolutely depends on the nature of the created framework which may affect performance positively or negatively. In an ideal country, the moment organisations report negative figures or unwanted performances that are externally caused by unfavourable governmental policies, any responsible government is expected review and evaluate its policy. Richard, Devinney, George and Johnson (2009) maintain that the successful performance of multinational companies largely depend on the political environment of the host country. Richards et al (2009), and Mark and Nwaiwu (2015), reported that the effort expended by multinational business managers in achieving their goal in Nigeria has in most cases been unsuccessful. Before venturing into any form of business in a foreign country or a locality, it is vital to have an understanding of the political actors in the prospective business immediate environment. This is because political risk differs. The business political environment refers to the political or governmental actions that affect business operations (Maiello, 2022). It is important to understand a particular government's actions with respect to taxation and property seizure. Examples of political factors associated with a country's central government are the level of bureaucracy, corruption, and government stability (Barney, 1991). A culture of corruption in a country stifles business by creating an uneven playing field where corrupt individuals are better able to achieve their business goals than those who are not corrupt (Maiello, 2022). All business firms are affected by the policy and practices of the government; which means that business firms must study and analyze the political environment to adjust it in line with emanating changes (Raiyaanakhtar, 2023). The major issue likely to affect firms' policy formation, implementation, and objective achievement is the magnitude of *political risk* in an environment.

Political Risks

In today's increasingly interconnected world, "just-in-time" supply chains, global internet connection and smartphones give SMEs the ability to conduct business activities in a global arena that was once the exclusive province of big multinationals (Allianz, 2021).

This however means the possibility for great opportunities, but businesses operating across home national borders are few steps away from political risk (Allianz, 2021). Political risk is the risk that investors, firms, organizations, and countries, will lose money or make less money than expected, due to political decisions, conditions, or events occurring in the country or emerging market in which they have invested (Spooner &Lekatis, 2020). Political risk is the possibility that an organization could suffer because of political events on a national or global scale, such as an armed conflict, constitutional referendum, elections or major policy developments (Stowe, 2022). The World Bank Group's MIGA (Multilateral Investment Guarantee Fund) defines political risk as being associated with government actions which deny or restrict the right of an investor/owner i) to use or benefit from his/her assets; or ii) which reduce the value of the firm. Political risks include war, revolutions, government seizure of property and actions to restrict the movement of profits or other revenues from within a country (Berne Union, 2007). To better understand the impact that certain political risks can have on business operations, these three types of political risks are discussed. They are; *Expropriation through Governmental Interference:* This risk measures the likelihood of government action or weak governance conditions having a significant impact on a country's commercial environment. Excessive business regulations and government interventions often limit organizations' strategic options and success except where enterprises are state-owned. Expropriation is the risk that a government forcibly takes over the ownership of privately owned property without proper compensation. The most obvious mechanism for expropriating projects is for the government to directly take over ownership of property. Alternatively, governments may expropriate property indirectly by depriving private sector property owners of the value of their interests. In practice indirect expropriation is difficult to identify. Following a coup attempt in 2016, the Turkish government targeted those domestic companies associated with the Gulen movement, which it claims was behind the attempt. The actions have included arbitrary impositions of regulatory requirements up to outright expropriation. Another example of this is the expropriation by the Venezuelan government of four heavy oil upgrading projects in 2007. *Transfer/Conversion Risk*: This Measures the tendency of a government imposing conversion or transfer restrictions, which would significantly affect the commercial environment. Conversion risk describes the potential that a business won't be able to convert one currency into another at the intended rate. One example would be if you've deposited funds in a foreign bank account. Due to the country's banking regulations, you're unable to transfer this deposit to the United States for six months while the funds are held. Imagine that during this time the value of the currency decreases, which means your business, loses money on the transaction with little recourse. Having accepted a customer's payment in foreign currency, one would be unable to convert it into your own currency; you would then lose the money due to dwindling exchange rate. *Risk of Political Violence:* Political violence is defined as any violent or hostile acts undertaken with the primary objective of either changing or overthrowing the government of the country or changing its policies. Political violence is the deliberate use of power and force to achieve political goals which is most case is characterized by both physical and psychological acts aimed at injuring or intimidating populations (World Health Organization, 2002). Some geopolitical risks result from war, terrorism, civil unrest, and coup. A typical instance is the prolonged war between Ukraine and Russia. Also recently in Africa is the Coup witnessed in Niger Republic where a democratically president was arrested and detained by presidential guard on his unhealthy and unholy alliance with the French Government which has impoverished the country, despite the abundance of Uranium in Niger.

Political Risk Analysis Procedure

The objective of this procedure is aid organisations in developing informed environmental decisions capable of determining firms' intention to enter or stay in a country when the ratio is favourable and avoid or leave a country when the ratio for them is poor. This procedure involves three steps, which are given below as:

Step 1: Ascertaining issues of relevance to Firms' through need assessment: A needs assessment is the process of identifying and determining how to close the gap between an organization's current and desired state. Through simulation, a foreign firm can assess factors that are likely to affect their performance should they decide to move abroad. The process outlines which processes a team might like to prioritize, improve or provide resources to meet the company's goals. In prioritizing issues of relevance, firms operating in a country characterized by political instability may either decide to repatriate profit to home country or decide to introduce changes that affect labour, material or technology. This is somewhat dependent on factors a firm considers as being economically relevant.

Step 2: Assessing potential political events: In general, political instability is more likely during greater periods of economic depression. However, the more the event is controllable and the more government is able and willing to exercise control, the lower the probability that the event will have a direct impact on firms' performance. It is important to estimate not only the probability of a single political event occurring or the confidence with which that prediction is made, but also the sequence of related events. *Step 3: Addressing political risks through relationship building:* During period of great political risks, countries are often plagued by series of unwanted events, as such, firms would most likely survive political turmoil pending on built relationships. Generally, political risks are addressed through the building of relationships with the various stakeholders of the company (Erevelles, Horton &Marinova, 2005):

- The government: in most countries, managers must have to stabilize the political climate of their organisation through means such as lobbying and bribery. *Lobbying* involves hiring people to represent an organizations view in political issues. *Bribery* though illegal in some countries of the world; but the fact remains that it is a means of gaining political influence in many countries.

- Customers: immediate customers are likely to support firms that have provided them with needed product and service at affordable prices.
- Employees: local employees that have good relationship with their organisation are likely to shield their firm from political or governmental interferences.
- Local community: firms that extract raw material from an environment are expected to give back to the community in the form corporate social responsibility. Building relationship with local community will speak for an organisation in periods of political instability.

Managing Political Risks for Organisational Success

Modified political risk strategies for an organisation is derived from Stowe (2022) key strategies. These strategies include: *Risk Analysis:* Political risk analysis involves researching on the factors in the local political climate, recent history, and experts' projections for the future. It also weighs the potential benefits against the likely consequences should a political turmoil arise. It is beneficial to hire specialists in political risk management analysis; as political risk consultants can better provide information on external risks and challenges facing an organization. They can also proffer political risk management strategy. *Consulting Local Partners:* Making connections within a local market permits an organization to better understand the market, its local political system, and specific risks. It is also vital to team up with local businesses, research and professional trade organizations, local governments, and political leaders to gain a deeper political awareness of a region. *Political Risk Insurance:* In managing political risk, the place or contribution of insurance firms cannot be undermined. Purchasing political risk insurance is an important way to protect an organization and investors financially. This insurance protects against political actions that would cause organizations to experience a major financial loss. Knowing that political climates can change spontaneously, it is important to safeguard business operations for long periods in order to avoid unwanted surprises.

Legal/Regulatory Environment

The legal environment in a business refers to the rules and regulations formed by different legislations or governmental bodies to govern the day-to-day activities of business organizations. The legal environment of business is much more than simple compliance with the law; it is also about understanding the legal frameworks in which a business operates so that compliance can be achieved and maintained (Peregrine, 2023). The legal environment of business pertains to code of conduct that defines the boundaries of business within a legal jurisdiction (Kumar, 2022). Ineffective regulations in many countries continue to stifle innovation, discourage investment, weaken competitiveness, compromise economic diversification, and as a result, hinder economic growth (World bank, 2021). Legal factors are external factors which refer to how the law affects business operations and customers behaviour (Bush, 2016). Firms operating internationally face major challenges in conforming to different laws, regulations, and legal systems in different countries; the legal framework to protect small and medium enterprises (SMEs), mainly to achieve social objectives, adversely influences the expansion of manufacturing capacities and achieving economies of scale in certain countries (Sarkar, 2022). International managers must therefore develop an understanding of the types of legal systems in the countries of their operations before entering into legal contracts. The importance of legal environment includes: aiding businesses in achieving legal compliance; it ensures operational stability; protects businesses from fraud, unfair competition, and other unethical practices. The core types of legal environment which impacts on business activities are: *Social Environment:* under this type of environment, issue bothering on environmental protection, discrimination, and human rights are thoroughly legalized and maintained. *Competitive Environment:* relates to specific rules and regulations preventing organisations from unethical activities. Organisations must ensure that they deal fairly with customers and competitive alike in the conduct of business activities. Such laws include intellectual property rights, protecting trade secret laws, and antitrust laws. *International Legal Environment:* international legal laws are made to govern business activities across national borders. International laws are trade laws, contractual agreements between different countries, regulation of certain kinds of industries.

Conclusion

Enormous are the impact of political and legal environment on business operations. Though these two are used interchangeably, there still exist a slight differentiable peculiarity among the variables. Based on research findings, authors have established the link between improved business performance and political stability of countries. To a measurable degree, the political system at play solely determines the operational framework within which international and domestic organisations conduct their economic activities. Care should be taken by multinational corporations to fully grasp the modus operandi of the industry in which they aim to become a key player or a market leader. Finally, having a good knowledge of a country's legal matters will shelve organizations from unwanted legal risks capable of disrupting continuous flow of business.

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