The different types of country risk

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Generally, risk is defined as a performance variance, whether it impacts the business operation positively or negatively. The country risk means the potential risk that likely caused by engaging in credit, investment and financial transaction across national borders. Commonly, the occurrence of the country risk is caused by the act of country's sovereignty in the international economic activity. Meldrum (2000) argued that " All business transaction involve some degree of risk. When business transactions occur across international borders, they carry additional risk not present in domestic transaction. These additional risks are called country risk". The country risk is based on the transaction between countries. In the context of sovereign risk, the breath of faith activities of country directly causes risks. For example, country stops paying the principal or interest of an external debt. Furthermore, the changes of policies and regulations can indirectly cause risks such as the adjusting of exchange rate and tax rate.

Sources of risk

There are two main streams of risk which were argued by Desta (1985). One of them is the impact of the sovereign and governmental intervention. Sovereign government or government agencies may refuse to refund debts or refuse to bear the security responsibilities depends on considering their own profits. Thereby, the risks may be occurred for the investors and investment institutions in the country. This may be issues by that the sovereign government or government agencies implement relevant policies or laws. Most people focus on the narrowly country risk which originates from the negative actions of government or sovereign (Feils and Sabac, 2000). However, another stream is that the impact of the instable environment. In

this stream, risks are caused by some social factors and economic factors in the business environment. For instance, the society instability with social conflict and the low speed of the domestic economy can all cause risks.

Different types of country risk

There are many methods of categorizing country risks according to the different standards. For example, some researchers and analyzers assort country risk depends on the nature of events. They divide the country risk to three categories such as political, economic, and social risk. Besides, the country risk can also categorized depends on the borrower's behavior and morphology. Many of these categorizing methods are overlapped each other. However, The country risk is generally assort to six different types such as political risk, sovereign risk, economic risk, transfer risk, exchange rate risk, and location or neighborhood risk. This kind of classification method can introduce each type of country risk more detailed and independently to prevent duplications.

Firstly, political risk is the risk of a country's external relations has undergone significant changes. For example, the war is occurred with other countries or the occupation of territory. Sometimes the political risk is an internal instability environment of the country, such as the coup caused by the ideological differences, the unrest caused by terrorist, the conflict of economic institutions, and the local separatist struggle. All of these phenomenons will likely lead to loss and cause the country risk.

The second type of country risk is the sovereign risk. The sovereign risk is the risk that the acts of sovereign government or government agencies

affect to the lenders. Sometimes, the sovereign government or government agencies may refuse to carry out the debt refunding or refuse to bear the surety responsibility. Consequently, that will lead losses to the lending banks.

Thirdly, the economic risk is the risk caused by a country refuse to pay the external debt. The reasons of the payment refusing may be variety such as the slow national economic growth, the low investment willingness, the decreasing of the exporting revenues, the balance of payment deteriorated, and the shortage of foreign exchange.

Fourthly, the transfer risk is due to the host government policies or regulations prohibiting or restricting the transfer of funds, thus composes the threat to the lenders. In the international business, as the foreign exchange control and regulation of capital movements of the host country, banks' deposits and income cannot be exported in the host country, and the principle of loans cannot be recovered. For instance, in the Asian currency crisis, the capital control of Malaysia was a political solution to solve the exchange rate problem in their country. That led the deposits and income of foreign countries in Malaysia against high risks and may not be recovered.

After that, exchange risk means that the potential loss from any negative unexpected changes of exchange rate. The exchange risk generally caused by different factors such as the international receipts and payments and currency reserves, interest rate, inflation, and the political situation. For example, the international receipt and payment is a contract between the total currency income and total expenditure which paid to the other

countries. On one hand, if the monetary income amount is greater than the expenditure, the surplus of international receipts and payments will be appeared. On the contrary, the trade deficit will be broke out. The international receipts and payments have a direct impact to the exchange risk. Surplus sends currency exchange rate up and deficit drops it down.

The last type of country risk is the location or neighborhood risk. Meldrum (1999) states this type of risk as " spillover effects caused by problems in a region, in a country's trading partner, or in countries with similar perceived characteristics". Several more sectors can also cause the location or neighborhood risk such as geographic position, international business partner and trading institution and organizations.