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3 Human resources: Endogenous political risk

3.1 Introduction

The majority of research and literature in Human Resource Management (HRM) focuses on organizational effectiveness, organizational culture, employee well-being, and how HRM makes a positive contribution to an organization (Beer, Spector, Lawrence, Mills & Walton, 1984).

As organizations evolve to address the multiplicity of risks witnessed in the past few decades resulting from new technologies, financial crises, terrorism, cybercrime, and cross-border conflicts, a host of Enterprise Risk Management (ERM) tools and frameworks have emerged to accompany the ISO 31000:2009 Risk management principles and guidelines (International Organization of Standardization (IS), 2009). These tools and frameworks tend to focus primarily on universally understood financial and physical risks while largely ignoring the HRM function and its processes, particularly as it pertains to identifying risk beyond those prescribed by domestic labor laws such as hiring practices, discrimination, health, safety, and sexual harassment. It should be of no surprise then that individuals like Dr. Charles Lieber (Harvard University), Edward Snowden (Booz-Allen), Shelly Adelson (Sands Hotel & Casino), Jeffrey Skilling (Enron) and others have emerged as examples of internal-risk. What joins them together is that they all not only created political risk for their organizations, but they were also once prospective candidates that went through the HR screening processes at their respective institutions.

The focus of this paper is to review the literature over the past two decades to assess the gaps in HRM practices for identifying political risk and to identify potential research in this domain. Both theoretical and empirical articles have been identified and reviewed with an aim toward evaluating weak governance in the Human Resources sector which serves as a critical and poorly understood source of political risk to an organization.

3.2 Risk and political risk

There is no single widely accepted definition of the term “risk” in academic literature (Lehtiranta, 2014; Hagigi & Sivakumar, 2009). ‘Uncertainty’ in otherwise what might be perceived as predictable outcomes in a business operation, is interchangeably used as an alternative for discussing risk (Hagigi & Sivakumar, 2009). Other definitions of risk span across a spectrum ranging from potential negative outcomes

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due to a deficit in predictability within business to others that present risk as either positive or negative outcomes of variability (Jablonowski, 2006; Jaafari, 2006; Osipova & Eriksson 2013). Aven (2010) asserts that risk comprises three intertwined actions, an occurrence, symptoms, and uncertainties. This is a commonly adopted definition in business that recognizes the existence of symptoms, either positive or negative, and related uncertainties insofar as HRM.

Historically, modern business risk management perspectives began coming to the forefront of business management between 1955 and 1964. Initially associated with equities, insurance and financial institutions, the perspectives grew into what is commonly understood as 'operational risk management' practices (Dionne, 2013). Today, managing business risk is solely viewed through multiple lens across business functions, e.g., economics, finance, treasury management, accounting, strategy, behavioral science, regulatory compliance, and information systems (Elahi, 2013).

In the broader business risk management literature, there is growing acceptance around human capital being the most critical risk in a business (Hinton, 2003), and that the risk management discipline is attuned to the fact that "human resources [related] loss" can significantly cripple an organization's ability to execute its business strategy (Nickson, 2001, p. 26). Given the discipline of risk management recognizes the relevance of human resources risks, two decades ago, Nickson (2001) argued for merging the Human Resource management field with risk management contending that, "Risk management is about mitigating risk and protecting resources. What is the most valuable resource of any company? Its people" (Nickson, 2001, p.25). In view of Nickson's argument contending that as human resources inherently involve uncertainty, and considering risk management's main focus is uncertainty, melding both risk management and HRM is critical.

At an overarching level, risks can be conceptualized in terms of their origin; exogenous (external to the organization) or endogenous (within the firm). Endogenous risks were seen to cover issues such as management attitudes, culture, and organizational practices and as such, the human resources of the firm and the associated uncertainties inherent in these (Hagigi & Sivakumar, 2009). Alternately, Dionne (2013) categorized risk and suggested that within the operational risk category, issues relating to employees (such as employee errors) should be considered. In these types of contexts, human resources are often acknowledged as an element of organizational risk, albeit in a limited way.

Considering how little control businesses have over the environments within which they operate (e.g., volatile economies, unpredictable actions of governments, competitors, clients, and suppliers), one would think companies would pay especially close attention to the one thing they can control – the quality of people they hire. Rarely does HRM engage on the topic of political risk management or "how appropriate ways of employing managing and developing the workforce will not only result in enhanced organizational outcomes but also mitigate operational risks." (Becker et. al. 2015). Daily one hears or reads about an executive saying that "people are our most important asset," yet the same executives usually do not know how best to evaluate the right people for the jobs or how to keep them from becoming disgruntled once they are working in the organization. Neither they nor their organizations know how to assess what the jobs require within the context of their organization's strategic vision, and which human characteristics would be required for optimally performing in those jobs for the duration. As a result, their companies do not know how to hire, motivate, engage, and develop the best candidates for the organization's future. Demotivated, disengaged, disgruntled employees pose a huge internal risk to an organization. They can create a stressful workplace environment by negative comments influencing the feelings and productivity of co-workers, clients, and suppliers thereby adversely affecting the brand reputation of the company. They create political risk for the company.

Human beings are an organization's most reliable resource for protecting it and helping it achieve its goals. Their experiences, worldviews, egos, judgments, values, and skills make the difference between success and failure. Bhattacharya and Wright (2005, 932) state that "any investing in human assets, from the decision to acquire (employ), develop, motivate, or retain employees, carries with it uncertainty regarding the future return." The onus therefore falls upon the HRM discipline to understand political risk.

A focus on political risk management within HRM has received limited attention across management journals and reviews (Becker, K., & Schmidt, M. 2015). Political risk inside an organization can be defined as potential harm to a business arising from an employee's political behavior. Political behavior entails operating or behaving in a manner that aims to, directly or indirectly, influence individuals in a workplace to alter the status quo for gaining, maintaining, aligning, or solidifying power for meeting one's personal, not the organization's, objectives. Every employee is also a potential political actor. In this context, the disgruntled employee is a political actor that is concerned with the social hierarchy and its underlying ideals that uses a language consisting of authority, humor, ideology which poses a unique challenge to an organization who needs to understand the fundamentals of an alternative mindset in order to identify it at the time of hiring, or address as it develops through making passive aggressive comments and/or mannerism styles visible, while keeping in mind cultural nuances. Whereas the human element is implied in some frameworks, in the risk management sphere, particularly *how* the human poses potential political risk, the question remains as to whether or not there is widespread recognition of a reconceptualization warranted on the wide range of political risks that human resources present in an organization, as well as how effective HRM practices can mitigate these risks? This paper addresses these questions, undertaking a review of the extent to the gaps in the literature and how the HRM function should be assisted with a reconceptualization of its role, especially in light of evolving technologies that enable political behavior.

3.3 Perspectives on HRM and political risk management

A large portion of Becker et al.'s analysis presents the existing literature as focusing on human resources management practices which analyze: i) specific human resources related risks; ii) specific HRM practices that create (or minimize) risk as an adoption of such practices, and iii) how HRM and risk management ought to be integrated as 'systems' instead of individual practices (Becker et. al., 2015). The literature takes into consideration how the internal audit and regulatory compliance functions within organizations perceive, drive awareness, and address risk management through operational risk management and enterprise risk management practices, which encompass sub-categories such as financial risk management, supply chain risk management, cyber risk management, etc., however, fall short of addressing the most important element, i.e., people risk.

It is important to note that HR practitioners have a herculean task in front of them as they must ensure compliance with a myriad of domestic and international federal statutes and regulations for implementing such. Of a total one hundred and ninety-three countries, the Society of Human Resources provides HR Country Guides for twenty-four (of forty-three) European nations, four (of seventeen) Middle Eastern nations, two (of fifty-three) African nations; five (of thirty-three) Asian nations, four (of twenty) South American nations. The multi-dimensionality and complexity associated with adherence and enforcement and implementation of government regulations is multiplied, especially for those organizations that operate in more than one country, in one region and, globally in multiple countries within multiple regions e.g., financial institutions, pharmaceuticals, diversified consumer products and consulting firms that hire and deal with multi-cultural and faith related matters in the workplace in some of the highest populated, politically volatile nations in the world.

In the United States, for instance, the United States Department of Labor (USDOL) administers and enforces more than one hundred and eighty federal laws. The mandates and regulations that ensure implementation are events that are audited by regulators which cover many work environment activities (USDOL). None of the events addresses endogenous political risk. As seen in the following list, most of the statutes are applicable to businesses, job seekers, workers, retirees, contractors, and grantees.

1. Wages and Hours
2. Workplace Safety and Health
3. Workers' Compensation
4. Employee Benefit and Security
5. Unions and their Members
6. Employee Protection
7. Uniformed Services Employment and Reemployment Rights
8. Employee Polygraph Protection

9. Garnishment of Wages
10. Family and Medical Leave Act
11. Veterans' Preference
12. Government Contracts, Grants, or Financial Aid
13. Migrant and Seasonal Agricultural Workers
14. Mine Safety and Health
15. Construction
16. Transportation
17. Plant Closings and Layoffs
18. Posters
    (Summary of Major Laws of the USDOL – U.S. Department of Labor, 2021)

In the United States there has been an evolution in regulatory oversight, through more than fifty-five acts and amendments however, none address political risk management or provide guidance to HR practitioners on matters pertaining to anything other than routine workforce development, workplace equity, workplace flexibility & leave, to workplace health care and workplace immigration related matters. The absence of any such regulation all but ensures that HR practitioners operating under these regulations will themselves focus scant attention to developing political risk management strategies.

In light of the above, Figure 3.2 shows the extent of Becker et al.'s (2015) contribution toward assessing the advancement of understanding human resources risks, according to which eight key HR risks, along with specific organizational or HRM practices, give rise to risks that might emerge as a result of adoption of such practices – or how the use of such practices minimizes risk.

The broad range of themes above demonstrate potential risk areas relating to human resources and identify future research directions for the two areas of risk management and HRM. In her book, *Corporate Confidential*, Cynthia Shapiro (2005) states, "HR's primary function is not to help employees, it is to protect the company from its employees." Human Resources is the entry, oversight, and exit point for employees and suppliers, i.e., contractors, consultants, and HR vendors in an organization; as such, exposes the organization to both positive and negative outcomes. The available literature, however, gives short shrift to how HR/HRM practices create *political risk* for an organization.

3.4 Political risk in an organization

The failure to consider endogenous risk is not just present in governmental regulations, it is also noticeably under-discussed in the literature. As depicted in Table 3.1, Condoleezza Rice and Amy Zegart's (2018) well known book identifies ten categories of political risk.

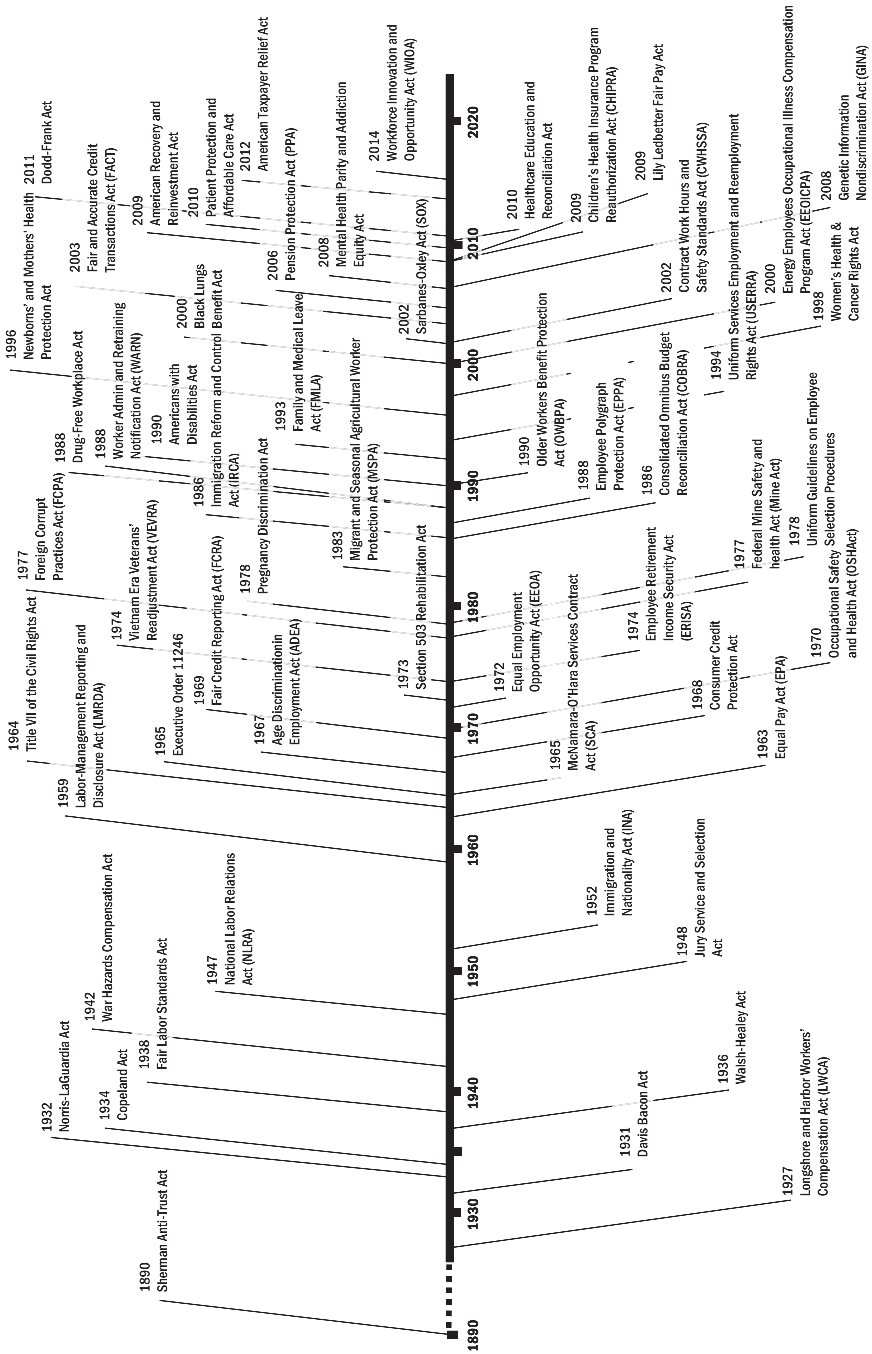

Figure 3.1: US Federal Statutes and Regulation Guiding Human Resource Management. Source: US Federal Statutes. Society for Human Resource Management (SHRM)

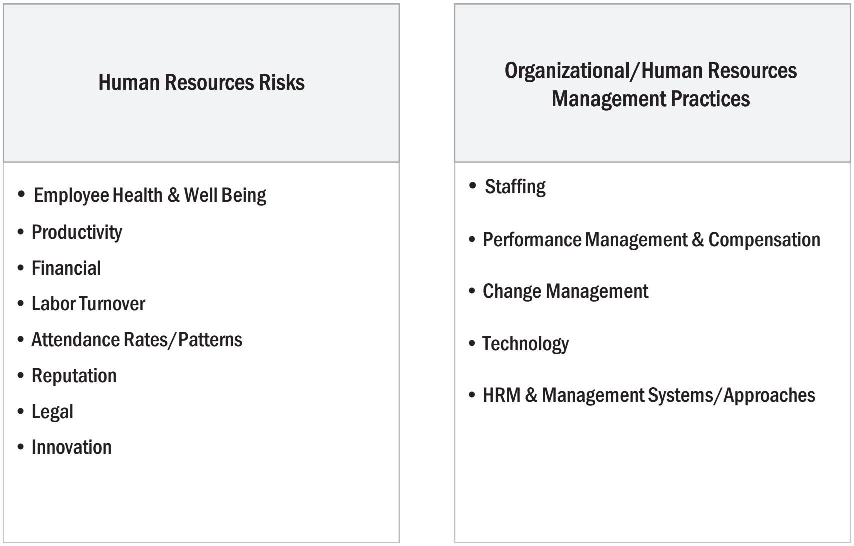

Figure 3.2: Human Resources Risks & Organizational/HRM Practices.
Source: Becker, Karen, Michelle Smidt, A risk perspective on human resource management: A review and directions for future research, Human Resource Management Review (2015)

Table 3.1: Political Risks.

No.	Political Risk Type	Examples
1.	Geopolitics	Interstate wars, great power shifts, multilateral economic sanctions, and interventions.
2.	Internal conflict	Social unrest, ethnic violence, migration, nationalism, separatism, federalism, civil wars, coups, revolutions.
3.	Laws, Regulations, Policies	Changes in foreign ownership rules, taxation, environment regulations, national laws.
4.	Breaches of contract	Government reneging on contracts, including expropriations and political motivated credit defaults.
5.	Corruption	Discriminatory taxation, systemic bribery.
6.	Extraterritorial reach	Unilateral sanctions, criminal investigation, and prosecutions.
7.	Natural resource manipulation	Politically motivated changes in supply of energy, rare earth minerals.
8.	Social activism	Events or opinions that “go viral,” facilitation collective action.
9.	Terrorism	Politically motivated threats or use of violence against persons, property.

Table 3.1 (continued)

No.	Political Risk Type	Examples
10.	Cyber threats	Theft or destruction of intellectual property, espionage, extortion, massive disruption of companies, industries, governments, societies.

Source: Rice, C., & Zegart, A. B. (2018).Political risk: How businesses and organizations can anticipate global insecurity. Twelve

Climate change and economic risks are omitted intentionally for analytical reasons. In the case of climate change, for instance, they argue that while it directly affects global agricultural production, ecosystems and the livelihood of populations living in low-lying coastal areas, it is more of a 'risk multiplier' than a risk category unto itself in that it creates circumstances that invoke social activism which in turn lead to political actions. Economic risks on the other hand, are exogenous by nature, mandated by regulators for companies to routinely examine. Rice et al (2018) argue that the focus of their work is centered on "how political actions affect businesses," and political risks that are "out there." They admit that it is "important to underscore that sometimes the biggest political risks come from within", and how organizations pay too little attention to their own corporate cultures and practices, failing to address the underlying root of endogenous risks that are best understood by and fall under the purview of HR in an organization (Rice et al, 2018).

Organizations tend to view internal operations in a traditional business management sense shrouded underneath certain 'standard operating procedures' (SOPs) that are somewhat universal. Political risk variables can be examined in PEST (Political, Economic, Social and Technological) assessments however, the political domain is strictly viewed through an exogenous lens, analogous to climate and beyond management's purview. As with climate, an unpredictable-until-foreseeable event, loss can be insured or perhaps even avoided in certain cases, but management's prescience in such situations faces limitations from a competence standpoint. The C-Suite in an organization does not have a Chief Meteorology Officer in its ranks or, in light of having a limited exogenous view only toward political risk, a Chief Political Risk Officer. HR's function is to identify, interview, screen and introduce candidates that fit a specific job description, then introduce the candidate to the hiring manager. In their book *Execution*, Larry Bossidy and Ram Charan (2002) write leaders "may not know enough about the people they're appointing." They go on to say that leaders, "may pick people with whom they're comfortable, rather than others who have better skills for the job . . . leaders aren't personally committed to the people process and deeply engaged in it." Political risk, in a company, is created through employee actions that are motivated by self-interests, i.e., political behavior, which would cause harm, or create hazard, in the form of revenue or reputation loss for the employer. Political behavior is defined as activity in which an individual engages to preserve her/his self-interest(s) and aims to achieve through influencing another person or group behavior. The most important risk facing companies, therefore, is *endogenous* that invokes political actions by staff and the lack of systematic understanding or management focus on these. After the hiring manager approves of the candidate, HR's function goes on to then make, discuss and negotiate an offer with the candidate. In light of the Employee Polygraph Protection Act (EPPA) that went into effect in 1988 in the United States – which applies to most private employers and not Federal, state, and local government agencies – most organizations' HR hiring practices do not take into consideration human psychology elements. The EPPA prohibits most[1] private employers from using lie detection tests. It is not until the candidates are hired, and during the course of employment, that in order to meet ongoing staff development requirements on a check-the-box basis, will enterprise-wide programs, questionable in and of themselves, such as personality/temperament type tests, e.g., Myers-Briggs and/or Keirsey, get rolled out by Training Departments (a subset function of HRM) to understand how staff perceives their environment and how they would react in specific situations.

There is a lack of empirical evidence pointing toward founders of organizations creating more or less political risk as compared with their staff, or leaders and employees of well-established companies creating such. Our experience shows that in startups to small companies, the organizational structures are flatter and with fewer employees, the founders, being the mascots of their companies, tend to lend themselves to constant scrutiny in the media (especially for those companies newly listed in the capital markets) and thereby more prone to creating political risk as opposed to executives from established companies where the interacting with the outside world requires training and multiple layers of internal approvals which makes it harder to have oneself heard, as in the case of Edward Snowden.

3.5 Case studies

In 2010, fourteen suicides occurred at a Foxconn plant in China. Foxconn, a Chinese company, manufactures approximately forty percent of the world's consumer electronics, including components for the iPhone, PlayStation 4, and Xbox One. Instead of drawing attention to HR/HRM practices, the suicides shone a spotlight to the poor 'labor conditions' at the factory. Investigations revealed that many of the

1 Subject to restrictions, the EPPA permits polygraph (a type of lie detector) tests to be administered to certain job applicants of security services firms (armored car, alarm, and guard) and of pharmaceutical manufacturers, distributors, and dispensers. It also permits testing of certain employees who are reasonably suspected of involvement in a workplace incident, e.g., theft, embezzlement, etc., that resulted in specific economic loss or injury to the employers. Where permitted, the EPPA examiner must be licensed if required by a state in which the test is conducted and must be bonded or have professional liability coverage (USDOL).

suicides were committed in protest of the work conditions. This not only created endogenous risk for Foxconn, but also exogenous (supplier) risk for Foxconn's clients, e.g., Apple, H-P, that conduct annual audits of their suppliers. Suicide is a symptom of endogenous political risk in an organization as it highlights a cause, the management team's inability to be attentive to the needs of its employees.

In that same year, the U.S. Commodity Futures Trading Commission (CFTC) released the results of an investigation that revealed the actions of certain rogue bankers involved in an international scheme in which their employers, leading global financial institutions, e.g., Deutsche Bank, Barclays, and UBS, were identified as having colluded to illegally manipulate interest rates for profit. Specifically, the bankers identified involved rigging the Libor (London Interbank Offered Rate).[2] In conspiring to artificially manipulate the Libor high or low, the bankers had the power to raise the value of their investments by millions of dollars with just a couple of emails. The financial effect as a result of the scandal, including total costs to states, cities, and other municipalities as high as US$6 billion, led to massive fines for the banks involved and substantial reform of how the Libor is determined. Regulators fined the banks more than US$9 billion, and administration of the Libor was shifted to the ICE Benchmark Administration. In such organizations that are under pressure to deliver consistent shareholder value, HR is accountable for developing the criteria, driving, and for ensuring employee adherence to the organization's culture.

On Sept. 7th, 2017, Equifax, the largest credit reporting agency in the United States disclosed that its internal systems had been hacked and as such, had failed to ensure protection of critical personal and financial information of more than one hundred and forty-five million US citizens – almost half of the United States' population – possibly the most important crisis facing the country today, more so than Covid-19, climate change and cyber-risk combined; and posing extreme political risk for decades to come. Franscesci-Biccheriai stated that, "information contained in the files accessed by hackers included names, dates of birth, Social Security numbers, addresses, and, in about 209,000 cases, credit card numbers [. . .] an earlier incidence, a former IT staff member reported that "someone had programmed files to be inappropriately wiped on multiple servers – an act of internal sabotage." (Vice, 2017). The breach and a multiplicity of similar IT governance related issues reported at the executive management level, raises eyebrows about Equifax's enterprise wide HRM practices.

In August 2019, WeWork, the office sharing real estate company, filed an S-1 form with the Securities and Exchange Commission for converting itself into a public company. A list of red flags, such as massive losses, questionably expensive

2 The average interest rate calculated, based on estimates submitted from a panel of global banks, used as the main benchmark for global lending rates.

lease agreements, unnecessarily complex corporate structure, and along with an all-male board of directors brought CEO Adam Neumann's integrity under the spotlight that invited further scrutiny into the company's leadership practices. Further scrutiny into Neumann's lifestyles and idiosyncratic behaviors eventually led to the IPO's collapse bringing further disrepute to the brand. Among numerous vagaries and derelictions, Neumann illegally transported cannabis in his private jet across international borders and encouraged excessive alcohol consumption in professional settings. Amid a storm of negative press, WeWork slashed its valuation from US$47 billion to US$10 billion, ousted Neumann, and laid off 2,400 employees – nearly one-fifth of its workforce. HR was fully aware of Adam Neumann posing political risk for WeWork and was remiss in ousting him.

Among the myriad of sexual conduct allegations aimed at senior executives at companies such as Harvey Weinstein (founder of Miramax), Roger Ailes (Chairman & CEO of Fox News), Les Moonves (Chairman & CEO of CBS Corporation), Andy Rubin (Google) thereby creating political risk for their organizations, no industry remains untouched by employees (at all levels) within an organization. In large pharmaceutical companies, Martin Shkreli (CEO Turing Pharmaceuticals), Michael Pearson (CEO Valeant Pharmaceuticals), Heather Bresch (CEO Mylan) all found guilty of corporate misconduct. In the fintech services industry, endogenous political risk that spilled over to suppliers and regulators, became visible when German mobile payment and worldwide banking services provider, Wirecard, once valued at US$27B collapsed as a result of CEO Markus Braun's (a former KPMG consultant) announcement stated that the organization was missing US$2.1B, highlighting not only the organization's internal HRM practices, but also those of German financial regulators and big five auditing and consulting firm EY (Ernst & Young).

Anyone who has ever been responsible for hiring, managing, and firing employees knows that there is a myriad of possibilities to sift through when dealing with human nature. Hiring a candidate into a job requires HR to first acknowledge its own biases and motivators in doing so. A mismatched hire poses political risk for an organization. Although leaders know intuitively that they are facing a problem, most choose to not make it a priority to do anything to enforce governance. Issuing directives to source the right-fit talent requires HR to know how to execute on doing so. In an attempt to get the gorilla off of their backs, HR will demonstrate an inability to deal with capacity issues by resorting to outsourcing the tasks of screening, hiring, even interviewing to so-called professional recruiters, HR consultants, employment agencies, artificial intelligence applications, thereby injecting exogenous political risk into the hiring process. Suppliers, that are not vetted on their own understanding of political risk nor on their application of such within their own hiring processes, are awarded contracts by leading companies to screen, interview, and shortlist on behalf of their clients. Exemplary of the adage: the blind leading the blind.

Research shows that, in practice, an organization's decisions to outsource are contextually drive, and not completely rational (Vernon et al., 2000). Cooke et al. (2005) confirm that the empirical literature available on the topic is fairly sparse and fragmented. Bossidy and Charan suggest that "leaders need to commit as much as forty percent of their time and emotional energy, in one form or another, to selecting, appraising, and developing people" (Bossidy and Charan, 2002). Such commitment from leaders is personally time-consuming as it requires giving continuous feedback, having meaningful conversations on-demand, and exposing oneself to critical judgment.

Relying on traditional interviews for spotting individuals that would not pose political risk for an organization requires focusing less on the chronology and roles in a candidate's career, and more knowing how to ask the right questions in order to discern how an individual perceives the world outside of the work environment. Even ethics and personality tests fall short in their efficacy to provide reliable insight into an individual's self-interests that affect their loyalty toward the employer. Whitney Martin posits that the strongest personality assessments to use in a hiring context are ones that measure stable traits, are normative in nature, evaluate a candidate's openness, that demonstrate high reliability (Martin, 2014). However, such evaluations are limited to a point in time only and in order to be effective, must be consistently rolled out on a bi-annual or annual basis.

3.6 Conclusion

Although practitioner journals currently do not offer much in the way of research findings or focus in this area, now is a particularly good time to increase research coverage and push content through social media that targets HR practitioners. Another recommendation is that journals which traditionally present only "HR" knowledge look to expanding coverage so as to include research and implementation issues related to political risk management. Other areas to bridge the vast knowledge gaps between the latest research and mainstream HRM knowledge would be to research practitioners' educational backgrounds and correlate to biases and beliefs recognizing that HR managers graduate in a wide array of educational disciplines that do not expose the student to political risk management.

A practical conclusion to this chapter is to impress upon the concept of an enterprise-wide political risk management strategy. Organizations ought to be aware about the issue in terms of a series of ongoing actions that result in embedding self-awareness and mindfulness among and, about all employees by HR. A political risk management strategy would imply developing multi-tiered and cultural-nuance aware HRM governance parameters that strike a balance between an understanding of how information security, risk transference and external relations building measures cross-influence each other and how such ought to align with shareholder tolerance for the organizations' market expansion strategies in light thereof. When exploring approaches to parametrizing HR governance through a political risk lens, HR practitioners and executive management ought to be mindful of knowing how to ask the right questions, e.g., "How aware are we about *factors* that cause political risk?" to "How can we ensure all employees digest and embody a level understanding of what constitutes political risk behaviors and acts for both themselves and our organization?"

HR practitioners ought to consider informing potential new candidates and existing employees with litigation information facing their organization. This would help encourage transparency and openness by HR to foster political risk awareness among employees about the ramifications of staff behaviors and actions.

Lastly, HR practitioners would be supported well in this area, not by the Big Four consulting firms, but management consulting firms with no audit style restrictions or conflicts of interest. Firms that can provide independent counseling uniquely positioned to deliver organizational decision-making techniques that provide not only structured but intellectually liberating safe-to-fail environments that help employees explore political risk by leveraging state-of-the-art platforms (e.g., crises simulations, on-demand scenario driven response systems, etc.) to introduce and enhance awareness among staff members at all levels and across various functions within an organization throughout an organizations' life cycle.

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