StrategicRISK

GUIDE TO:

Global risks for mid-sized companies

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New frontiers

Expanding into foreign markets need not be daunting if companies are well prepared

BUSINESSES WILL SEEK GROWTH wherever there is an opportunity and often this will mean trading beyond the borders of their country of origin.

However, the pursuit of such potential rewards can also be fraught with risks of many kinds – from compliance to political, economic to catastrophe.

Overcoming such threats is a challenge which can often vex the most experienced risk practitioners at the largest multinational businesses.

Mid-sized companies may not have the expertise or insights of their larger counterparts

As such, it can be even more daunting for mid-sized companies that may not have the expertise or insights of their larger counterparts.

This StrategicRISK *Guide to global risks for mid-sized companies* aims to overcome some of these problems by providing expert pointers and references for businesses seeking to operate in any, or all, of the five main economic regions around the world.

By highlighting some of the key issues in each geographical area and combining this with a series of thought leadership articles, we hope to help mid-sized companies make the right decisions when looking to expand into new territories.

Only when businesses fully understand the risks they face can they develop a strategy that will protect their interests wherever they operate.

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The regulation jungle

Smaller firms are disproportionately hampered by red tape, jeopardising their ability to do business in Europe

ALL PUBLIC COMPANIES WITHIN Europe accept their obligation to conduct their business as transparently as possible.

In Germany, however, the federal government goes one giant step further. Under five-year-old transparency laws, all mid-sized companies – the famed Mittelstand – are obliged to file their financial reports on an annual basis or face being fined.

And according to a recent investigation by *Handelsblatt*, the financial newspaper, some 150,000 of these mainly family-owned companies of a total 1.1 million have refused to expose their profit-and-loss figures on a publicly accessible website, as required.

As a result of this non-compliance, the state's coffers are benefiting. Since 2008 the Mittelstand companies have chosen to pay a total €387m in penalties rather than disclose their affairs. In 2012 alone, their bill for non-compliance ran to €92m.

Not all these companies refused outright to comply – some were fined for filing their details too late. The scale of the penalties starts at around €500 for smaller firms and rises to €25,000 for repeated offences. Despite the often hefty bill, a sizeable chunk of Germany's middle-sized commercial community prefers to grin and bear it.

Germany's insistence on private sector transparency is not typical in Europe, but the avalanche of EU-wide regulations, whether related to transparency or other commercial activities, has become a risk. Even Brussels admits the dangers and says smaller firms are "disproportionately affected by regulation" with costs, as measured per employee, up to 10 times higher than for larger firms. The European Commission has been studying the problem for two years.

Slipping behind

Until something is done, critics say the overall result will be that even the bigger

Since 2008 the Mittelstand firms have chosen to pay €387m in penalties rather than disclose their affairs

European economies will continue to slip behind in terms of ease of doing business, as the latest rankings by the International Financial Corporation (IFC) – part of the World Bank – make clear. Germany is the leader in Western Europe but ranks only 20th, ahead of Austria, Portugal, the Netherlands, Belgium and France, ranked between 29th and 34th respectively. Lagging behind are Spain in 40th and Italy in 73rd, with Greece in a lowly 78th position.

The bright lights are primarily in Scandinavia and certain Eastern European nations such as Estonia (21st), Latvia (25th) and Lithuania (27th). But the way things are heading, most UK firms doing business in Europe can expect to run into a growing thicket of regulation [see box, page 5].

And though the UK Confederation of British Industry often grumbles about red tape, the UK comes an impressive seventh in the IFC's rankings, which are headed by Singapore. **SR**

CLIPPED WINGS

Europe's general aviation industry – that is, just about all operators except commercial airlines – is an essential element of the business world. In France alone it turns over €4.5bn every year. But the EU's aviation regulations, particularly in terms of safety, have become a particular bone of contention for operators, who say they are unnecessarily burdensome and even irrelevant. "We must simplify the bureaucratic nightmare that is slowly killing general aviation," warns Jacques Callies, president of the industry body in France. Software entrepreneur Matthias Albrecht would wholeheartedly agree. He uses two Piaggio Avanti aircraft to fly his 350 employees to meet customers all over Europe from his base in the east of Germany. But the regulations are making it increasingly difficult and stifling his business. "I pay twice as much to fly as do my competitors in the US," he told an aviation conference recently. "And now EASA [European Aviation Safety Agency] … is introducing a whole series of pointless and costly new requirements that will affect my operations. How many employees will my company, and many others like it, have to dump to afford this?"

Gone in 30 seconds

Brussels is set to impose EU-wide laws to protect consumer data, but will the costs to industry be too high?

A CYBER ATTACK IS A SERIOUS enough risk to any business, big or small, as Swiss holding company Renova discovered in October this year when its homepage was cracked by a 'rip-dealer' network. The main investment vehicle for Russian oligarch Viktor Vekselberg, who controls steel company Schmolz & Bickenbach among other assets, Renova was embarrassed by the breach. But even worse, says the company's compliance officer Rolf Schatzmann, the attacker left "visiting cards" in Vekselberg's name on at least seven other sites.

But such a breach will soon entail heavy regulatory obligations. Under proposed EU-wide legislation designed to protect consumer data, firms will be required to disclose breaches more or less immediately, as Renova did.

According to a directive now under debate, Brussels is determined to provide "a coherent and robust data protection framework with strong and enforceable rights for individuals".

This is a game-changing piece of regulation, says John Yeo, director at UK-based Trustwave, a provider of data security and compliance. It is vital that compliance officers understand the principles behind the directive as much as the technicalities. "One of the driving forces behind the regulation is to bring about a change in mindset of how businesses treat their customers' data," he says. "Businesses need to acknowledge the concept that they are the custodians of their customers' data and have a duty of care to protect it."

Among several other business associations, Germany's leading industry body, the BDI, is firmly opposed to the terms of the law as outlined, arguing that the costs will be much too high. As framed, the directive would greatly increase the legal power of individuals in the case of a dispute. Also, under the "right of portability", a consumer would be entitled to take any information, however valuable it may be to the firm, and give it to another firm.

Right to be forgotten

In a threat to a company's intellectual property, the directive creates the "right

TOP FIVE RISKS IN EUROPE

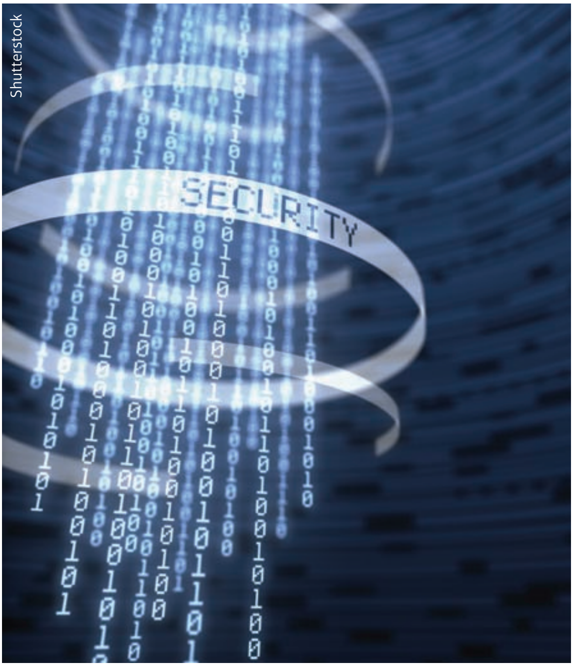
1. High Brussels-led **regulatory burden** in all sectors of business
2. **Foreign exchange risk** because of instability of eurozone
3. Continuing **shortage of bank credit**
4. **Wide variation** in ease of doing business across Europe – it is nearly 50 times more expensive to start a business in the Netherlands as it is in Ireland
5. **Director liability** – low in France, high in Slovenia, with considerable variations in other EU countries

'Businesses need to acknowledge that they are the custodians of their customers' data and have a duty of care to protect it'

John Yeo Trustwave

to be forgotten". If a consumer wants any information erased, the company must comply. A new kind of employee, a data protection officer, would also have to evaluate data on its "sensitivity" in terms of religious belief, political opinion, sexual orientation, health, race, and even past membership of organisations.

The European Commission believes there is a strong business case for the new regulatory code, estimating that it could save firms around €2.3bn a year. So far, few firms holding valuable intellectual property are convinced. **SR**



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Swimming with the current

If the salmon cannot spawn, the polluter must pay – or be named and shamed

THE RHINE, FLOWING 1,223KM through Switzerland, Germany and the Netherlands, can be taken as a symbol of the pressure on companies to clean up their environmental act throughout Europe. All along the river, hundreds of businesses are subject to strict controls on waste management as environmental authorities combine to clean up the waterway to the point where salmon return in greater numbers.

Currently in the firing line are eight power stations owned by Alsace-based Electricité de France that are blamed for stopping the fish from swimming upstream. "After the words we want to see some concrete action," says Ruedi Bösiger of the World Wildlife Fund (WWF) in Switzerland. The WWF, with 20 other environmental organisations, is putting pressure on Electricité de France to build fish ladders so the salmon can get all the way up to Basel by 2020.

The 20-year battle to clean up the Rhine illustrates the EU-wide insistence that all companies should act as good citizens on green issues. Failure to do so entails significant risks.

Most regions have their own environmental ministers who work with non-governmental agencies in a common cause that Brussels links to human rights. Indeed, the high commissioner for human rights points out that "the protection of the environment and the promotion of human rights are increasingly seen as intertwined".

Therefore any business that presents a pollution risk must be licensed. Offending companies are named and shamed for contravening national and regional laws. And fines and penalties are rising all the time, notably for illegal landfills. **SR**

THOUGHT LEADERSHIP

When discussing EU risks, one must note differences between mature Western European and new Central and Eastern European markets. We will focus on Poland and the Czech Republic, comparing the five top risks.

Both Poland (PL) and the Czech Republic (CZ) are EU members so Brussels-led regulatory impact on industry is similar to Western peers. Locally, the picture is different. The market reacted positively to recent austerity easing in CZ. PL has been less obsessed with austerity in recent years and outperformed most EU peers.

With foreign exchange risk, PL and CZ are not within the eurozone and both remain far less leveraged and indebted. The eurozone's relative weakness has benefited them. Both Central Banks will accept a weaker Polish zloty and Czech koruna to defend export strength, industrial output and balance fortifying local currencies. And both have considerable hard currency reserves to defend the local currencies (PL holds €81bn reserves). Both currencies sit on good fundamentals of moderate public and foreign debt, low current account deficits, good foreign exchange reserves and good credit ratings. Large institutional investors view them as inherently safe, while offering higher bond yields than Germany or the UK.

Relative to Western EU states, both PL and CZ maintain easy and cheap access to international financing. A large percentage of local companies sit on cash and remain relatively profitable. Credit from local sources is also available. In PL, for example, the GBK (Development Bank) will provide €3bn in loans until 2014 to stimulate further growth. PL remains a market where companies can still finance themselves and re-invest; it is fourth in terms of the ease of obtaining credit ranking, tied with the US.

Overall ease of doing business in PL and CZ is rising rapidly. They lag behind some Western EU peers, but internal reforms produced a rapid jump in the rankings (PL +12.3 spots, rank 55/CZ +9.8 spots, rank 65). Both governments firmly support continued improvement.

Concerning director liability, company directors can be held personally liable in PL and CZ, but the litigious environment is far less dramatic compared with Western Europe. As an indicator, directors' and officers' activity in PL and CZ is predominantly defence costs and premiums have been softening severely for years.

There are several advantages to the Central and Eastern European markets; PL and CZ essentially represent hybrids. They are no longer emerging markets, nor are they experiencing the stagnation of more mature European Union members.

R Erich Bentz, business development manager, Russia/CIS Insurance XL Group

The attractions of Asean – more rewards than risks

Singapore is leading the charge of increasingly sophisticated, industrially savvy and export-oriented Asia-Pacific countries

THE BEST PLACE TO LOOK FOR where the Asia-Pacific is heading in terms of a commercially friendly environment is the nation state of Singapore. For the second consecutive year it has topped the International Finance Corporation's global ranking for ease of doing business. And that is out of 185 countries.

It is food for thought that all of the top four rankings for ease of doing business are held by the Asia-Pacific nations. In line behind Singapore are Hong Kong, China and New Zealand.

Singapore is a nation whose mission is to make businesses of all sizes feel at home. With English as the official and commercial language, the country ranks inside the top 10 in most of the categories that matter to an enterprise. These are – in starting a business – dealing with construction permits, obtaining electricity, protection of investors, payment of taxes, strict laws for the protection of intellectual property as well as political stability, the kingpin issue for most companies.

And vitally for export-oriented firms, the state occupies the top spot in ease of trading across borders. In concrete terms that means Singapore-based firms have almost untrammelled access to the vast market of Asean countries with a combined population of 600 million. Numbering 10 in all including Singapore, these are Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Thailand and Vietnam.

Lingering trade barriers

And Singapore is the model to which they aspire as the leader in ease of doing business. But some Asean nations have a long way to go to match the world number one. "[They] must strike down lingering intra-Asean trade barriers and do more to curb endemic corruption," said the Asia Business Council recently.

For example, Thailand may be on the way up, but it trails Singapore by a wide margin in terms of political stability, corruption and the efficiency of the legal system. As risk analysis firm AM Burns pointed out in a September assessment of the country: "Continued political uncertainty is one of the largest issues facing Thailand … and has had a significant »

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Singapore is the number one country for welcoming foreign trade

Five Asean countries provide parts for Boeing's Dreamliner airplane

» negative impact on economic prospects." The firm's verdict on the legal system is that it "operates fairly well but can be cumbersome and is affected by government corruption". Overall, AM Burns rates Thailand at CRT-3 (country risk tier 3), or roughly the same as other South-East Asian countries apart from Singapore, the sole nation to rank CRT-1.

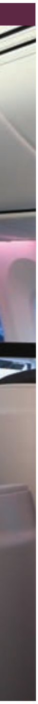
Yet their rate of progress is extraordinary, as their economic growth attests. Over the past 20 years the Asean chunk of the Asia-Pacific community has rattled up a compound annual rate of growth of nearly 9% that has been driven chiefly by the core economies of Singapore, Malaysia and Indonesia.

In 2012 the combined gross domestic product (GDP) of Asean countries topped \$2trn. And when these countries establish an EU-like economic community by 2015 through the elimination of import duties and non-tariff barriers, most forecasters expect average GDP growth to hit double digits. Tariffs on more than 90% of products have already been cut to between nothing and 5%.

Within the Asia-Pacific as a whole, the dynamics of these economies make them important for ambitious European companies. At present EU and US firms make up two of the top four trading partners, but their relative dominance is under pressure as other Asia-based businesses take up the slack in a profound economic transformation.

More sophistication

Take the automotive industry. Seeing where things are heading, Mitsubishi and Samsung opened plants in Vietnam. Almost below the radar, automotive



TOP FIVE RISKS IN ASIA-PACIFIC

1. **Occupational health and safety issues** coming to the fore, especially in Australia following a series of legal rulings
2. **Foreign exchange risk** between trading blocs such as Asean
3. **Increasingly tough environmental and "good citizen" regulations** across much of Asia and Australasia
4. **Corrupt practices** by partner companies, as World Bank and other authorities step up investigations and fines, especially in healthcare, transportation, water and energy
5. **Inadequate telecommunications and banking infrastructure** in late-developing countries such as Myanmar

manufacturing has become Thailand's second-biggest industry. Between them, Nissan, Suzuki and Daihatsu lately invested $1.5bn in Indonesia, while India's Tata Motors chose the country as its manufacturing and distribution base for all of South-East Asia.

Asean businesses have become much more sophisticated. Five Asean countries now provide parts for Boeing's Dreamliner and 777 models, while Japan's Nikkiso group produces components for General Electric jet engines in Vietnam. Foxconn, contract manufacturer of the iPhone, will invest up to $10bn to produce electronic devices in Indonesia. And the Philippines has taken over from India as the call centre of the world.

Still, business-friendly as they are, risks abound in some of the emerging Asean countries. **SR**

Clampdown on fraud

China is rooting out corruption – other nations must follow suit

NOTHING SAYS MORE ABOUT China – and the Asia-Pacific's – new-found zeal to tackle endemic corruption than the arrest in October of the chairman of Yunnan Tin, one of the world's biggest resource companies, on grounds of alleged bribery. Industrialist Lei Yi is accused of accepting 20m yuan (€2.04m) from four people, according to the local government.

Once notorious for bribery and corruption, China is now the poster boy in the region for cleaning up its business world. The arrest of Yunnan Tin's boss follows other big cases, including several mounted against high-ranking officials in what amounts to a stark warning to foreign companies operating in China and the broader region.

As easily the biggest exporter and investor in the Asia-Pacific, China is setting the tone for corporate governance. Its ally is the International Finance Corporation (IFC), which is playing an important role across the region in lifting standards of governance. The IFC's strategy is to start with publicly listed companies such as Yunnan Tin »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» and make them role models for privately owned enterprises and especially the large family-run ones.

Behind the scenes the campaign has been going on for years, but is now beginning to bear fruit. As Chen Qingtai, chairman of the newly established China Association for Public Companies, said in August, there is still a lot more work to be done. He singled out issues such as transparency, concentration of ownership, board, effectiveness and family governance.

The word is reaching other Asia-Pacific nations including India, Asia-Pacific's serial offender in fraud and related risks. According to the latest Global Fraud report by Kroll, more than two out of every three companies in India were affected by fraud, making it second only to Africa in the frequency of offences. Worse, eight of the top 10 fraudulent acts were more widespread in India than they were globally.

At least something is being done in India, albeit belatedly. Its neighbour Pakistan, which holds the wooden spoon in corporate governance on practically every measure, appears uninterested. As a result, foreign investment is fleeing the country. "Pakistan remains one of the riskiest credits in the world, no surprise given its unstable political system," points out S&P Capital IQ in its latest report. Happily, Pakistan is very much the exception in a region that seems bent on reform. **SR**

A MINI-CHINA?

For companies with the long view, Myanmar could offer rich opportunities. At first sight, though, few countries offer less promising prospects than the former military-controlled Burma, with its impoverished population of 60 million. The country only began to open up in 2010 and remains a largely cash society. Its laws are complex and very much a work in progress. "Banking institutions are young, local infrastructure is weak, and the labour force is not highly trained," warns the International Finance Corporation. "The general public will not be accustomed to the presence of dominant foreign corporations."

And yet some Asia-watchers liken Myanmar to China 30 years ago, albeit on a smaller scale. At around $68 a month for reasonably skilled workers, wages are low – a fifth of those in China – and their work ethic is high. A strengthened central bank is tackling money laundering and its deputy governor Set Aung says the government's goal is to develop a business-friendly climate. Perhaps most importantly, Myanmar is desperate to join the Asean boom.


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Neglecting safety is not an option

Australia is getting tough on corporate social responsibility

MORE THAN A FEW MANAGERS and directors in Australian manufacturing companies are growing increasingly alarmed at a spate of fines – and possible prison sentences – being imposed on them over health and safety issues.

Just the latest is the A$90,000 fine [€63,000] on a small Western Australian enterprise named D&G Hoists and Cranes after the death of an employee when a pack of components fell on him. On appeal, the directors' fine was reduced to $10,000 each from $45,000.

According to the magistrate and, subsequently, the Supreme Court, the directors essentially failed in their duty to provide a safe workplace. In a finding the reverberations of which went through thousands of Australian boardrooms, the court found the fatality was attributable to neglect on the part of the directors. The dead employee had not been properly trained up and there had been "a breakdown of supervision".

As health and safety lawyer Jonathan Ivanisevic of HopgoodGanim points out,

many other workplaces are susceptible. He says: "The above circumstances, or permutations of the above circumstances, are by no means atypical in contraventions of occupational safety laws. The decision affirms it is not sufficient for directors, managers, secretaries or other officers to engage in a 'set and forget' approach to safe work procedures."

In the wake of this case, companies are being warned to take effective risk management measures and to document them thoroughly. The most important steps are to identify any hazards, assess the risks and adopt proper controls. Most importantly, say experts, companies must monitor, review and enforce all the measures adopted.

Meantime, D&G Hoists and Cranes has closed down. **SR**

THOUGHT LEADERSHIP

The Asia-Pacific region is experiencing unprecedented change and the rate and complexity of change is having an impact upon all aspects of society. Weather patterns are changing; this may lead to flood or drought. Legislation and the regulatory environments are changing; this impacts on demographics and influences economic and business priorities.

We are seeing global and European-based companies seeking growth and setting up operations in the Asia-Pacific. This move requires management to focus not just on cost-benefits but also on the requirement for data and analytics to manage legislative regimes across the region.

Companies looking to expand into the region need to consider how political change, elections and trade agreements have an impact on their ability to do business. They must consider scenarios that may seem unlikely today, but that could affect their operations, including their staff and supply chain.

Understanding local legislation is critical for compliance; for example, understanding your company's obligations under environmental legislation and ensuring that insurance protection is in place should a pollution incident occur. It is also important to understand local business and cultural practice that, when not addressed effectively, can damage a company's reputation and, ultimately, its profitability.

The unprecedented pace of change itself means that identifying, evaluating and mitigating risks is more challenging today than ever; here local knowledge combined with established expertise is key to success.

Craig Langham, regional manager – Asia-Pacific, XL Group

A gamble worth taking

Latin America is open for business, with some countries experiencing an unprecedented period of bonanza

FOR MANY EUROPEAN COMPANIES outside Portugal and Spain, Latin America is the new frontier. A vast area encompassing more than 580 million increasingly affluent citizens, the region is hungry for products and services from the Northern Hemisphere.

Judging by growth rates alone, the case for doing business in the region is undeniable. According to every reputable statistical source, most of these economies are expanding at rates that lame-duck Europe can only envy.

The latest figures from Cepal, the UN's economic commission for the region, show the gross domestic product (GDP) of these booming nations grew by a collective 2.5% in the first six months of 2013. That may be slower than the year before, but the numbers are still impressive by any standards. And they follow seven non-stop years of high single-digit, across-the-board growth.

However, blanket statistics tell only half the story. Excluding the Caribbean, the term Latin America covers no fewer than 22 countries grouped under three umbrellas – North, Central and South America – with greatly differing cultures, quality of government, rates of growth and ways of doing business.

Some Latin American countries are growing at breakneck rates as they recover from a low base after decades of poor government and even revolution. As proof of the extent of that earlier mismanagement, the region's rate of growth between 2003 and 2012 has been higher than at any time in the past 30 years. Accordingly, the past few years have been christened "the period of bonanza".

Take, for example, Panama, once an economic basket case. According to the International Monetary Fund (IMF), this nation of 3.66 million – roughly half the population of Switzerland – has averaged 8.5% growth over the past 10 years and is officially the region's economic champion in terms of rate of expansion. In that time Panama's per capita GDP has doubled, which has led it to become a bolt-hole for a flood of high-spending American retirees.

Domestic consumption grows

Even Argentina, a country of which investors are becoming increasingly wary, boasts 41 million increasingly affluent citizens. In September, for example, automobile sales jumped by 14 % over the corresponding month in 2012, reflecting an astonishing 79% increase in domestic consumption over the past decade.

As head of Argentina's automobile industry's trade body Alberto Principe explained, pockets are getting deeper »

Affluence is growing in Argentina, but foreign investors are still wary

» right across the nation.

"Demand is high not only in the urban areas like the federal capital, Buenos Aires, but in the provinces too," he says. Principe expects automobile sales to post another record year. (By contrast, automobile sales across the EU will contract in 2013 for the sixth year running.)

The smart money is backing Latin America's continued growth. According to Cepal, in the first six months of 2013 the amount of foreign direct investment grew by a thought-provoking 44% in Venezuela, 19% in Panama, 15% in Costa Rica, 8% in Uruguay and 5% in Colombia, once shunned by investors as the world's drug capital. The biggest investors are the US and Canada, the Netherlands, UK, China and Spain.

One of the most popular destinations for foreign direct investment is Peru, a nation of 30 million people and another favourite of the IMF. In September its government signed up €11bn worth of "mega-projects" to be completed by the end of next year, most of them fuelled by foreign funds. For Carlos Anderson, head of the nation's strategic planning body Ceplan, these projects are designed to improve Peruvians' quality of life.

"Our purpose is to keep growing the economy so we can eliminate the social gulfs in the nation," he says.

> *'Our purpose is to grow the economy so we can eliminate the social gulfs'*
>
> **Carlos Anderson** Ceplan

Aside from Venezuela, Bolivia and a handful of countries still practising what is sometimes described as "populist economics", most of Latin America has turned business-friendly in the past 10 years. Under Chile's three-year-old, government-run Start-Up project, for example, no fewer than 750 fledgling businesses have benefited from a €30,000 injection of seed capital including booking company Ticket Hoy, and universal translator Babelverse.

Banishing the *mañana* culture

And once-ramshackle communications are being brought rapidly to world-class standards, especially in mobile technology. In September, for example, Chile's Entel announced a €296m investment that will roll 4G broadband across Peru's biggest cities including its largest, Lima.

In short, diverse as these countries are, most of them are rapidly banishing the *mañana* culture. **SR**

Be prepared for nasty surprises

It pays to have on-the-ground intelligence when venturing into business in LatAm

EVEN COMPANIES WITH LONG experience of Latin America can fall foul of its commercial vagaries, as Spanish oil giant Repsol discovered last year.

Until May 2012, Repsol thought it had a majority stake in YPF, its Argentinian counterpart with access to the country's rich shale deposits.

But to the company's considerable shock, the government seized the shareholding, which Repsol values at €8bn, and has since offered half that much in compensation. The dispute, now in a long-running arbitration procedure under the World Bank, shows the risk of dealing with countries run by nationalistic bureaucracies and unpredictable leaders such as president Cristina Fernandez de Kirchner.

"In Argentina the government has a history of establishing short and long-term trade barriers such as quotas, additional import/export fees, or licensing and registration requirements to protect local industries," according to Trevor Schumacher and Vito Giovingo of Deloitte's financial advisory services division in Buenos Aires.

Others put it more forthrightly. Federico Sturzenegger, president of Buenos Aires-based Banco de la Ciudad, wrote recently: "The government has totally lost its way in the past few years." In that time Argentina has slipped back into the top 10 highest-risk sovereign credits.

Foreign investors are also giving highly unpredictable Venezuela a wide berth. Under its late socialist president Hugo Chavez, Venezuela doubled sales tax in 2012 as well as forcing the nationalisation of mainly foreign-owned businesses at knock-down rates. In his final full year in office, the former paratrooper appropriated a large haul of 497 companies. Not surprisingly, Venezuela fights for bottom ranking in »

TOP FIVE RISKS IN LATIN AMERICA

1. **Money laundering** – authorities are much more vigilant under pressure from the US
2. **Foreign exchange risk** – several LatAm countries are "hot money" havens that destabilise their currencies
3. **Corruption and bribery** in dealing with central and local government officials over tax issues, land use rights, government contracts, construction permits and approvals, government inspections
4. **Sudden U-turns** in tariffs and other regulations that affect pricing of goods and services
5. **Nationalisation of businesses** by socialist governments at knock-down prices

"The [Argentinian] government has totally lost its way in the past few years"

Federico Sturzenegger
Banco de la Ciudad

» the World Bank's league table for ease of doing business.

Investor pressure

But neither country is typical of Latin America as a whole. Take, for example, the headline issue of corruption.

Although Argentina has no criminal liability for corporations, most of its neighbours are heading in the opposite direction, albeit at their own pace.

In some cases under pressure from foreign investors and bodies such as the World Bank, all but a handful have adopted one of the three international anti-corruption conventions subscribed to by North America and Europe.

And some have gone further – Chile has turned the bribery of its own and foreign public officials into a crime. Although anti-corruption laws are not always vigorously enforced, the cleaner business climate is attracting big and medium-sized companies from outside.

At the time of writing, Alliance Boots was negotiating the acquisition of Mexico's publicly listed, 110 year-old Casa Saba, a nationwide distributor and retailer of pharmaceutical and beauty products.

But don't walk in with eyes tight shut. Latin America's business world is a clubby one dominated by family companies that like to stick together. They welcome outsiders of the right calibre, but it is essential to seek the guidance of on-the-ground consultants who know how things work. **SR**

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World Cup host's pitch for business

Brazil is legislating to pull itself into line with other powerhouse economic regions

IT COULD BE CALLED THE WORLD Cup effect. Historically, Brazil's commercial watchdogs have been largely ineffective – and were largely ignored by the local business world.

But the choice of Brazil as host nation for the 2014 World Cup has turned the spotlight on the country's business practices and pushed its government to »

» benchmark itself against prevailing world-best standards.

And one result of considerable importance for foreign firms is the new anti-trust laws that give the watchdog – the oddly named Economic Council for Administrative Defence – much more power to intervene in anti-competitive behaviour.

Indeed, as commercial lawyer Barbara Rosenberg of legal firm Barbosa, Mussnich & Aragão points out, the laws make Brazil broadly compliant with other powerhouse economic regions. "In a nutshell, by adopting a pre-merger review system, Brazil aligned its practice to the one existing in the mature jurisdictions, such as the United States and Europe," she says.

And the implications for foreign firms? Baldly stated, they should stick to the letter of the new law in any mergers and acquisition transactions. That means not swapping anything other than the most essential information until the authority has given its seal of approval to the deal. Exchanging data illegally – known as 'gun-jumping' – can attract fines of between €21,000 and €21m as well as an unwelcome anti-cartel type investigation.

In another reform that makes life easier for foreign firms, any fines for breaches of the regulations are now based on the local subsidiary's income rather than on the entire group's. In a break from the past, thorough documentation is everything.

Rosenberg adds: "In the context of a pre-merger review, it is important to bear in mind that the more complete the notification form, the better the chances of having the case cleared quickly. Under the old system parties normally provided limited information and waited for the authority to request any additional data it deemed necessary."

Following in the footsteps of Brazil, other seemingly unlikely countries are racing to catch up with best practice in

PERTURBING PROTECTIONISM

A common manifestation of "populist economics" in Latin America has been abrupt protectionist measures. Eighteen months ago, Brazil slammed hefty tariffs on foreign-made cars (that is, those manufactured outside the Mercosur trade region), lifted taxes on foreign capital and rewrote procurement regulations to the disadvantage of imported goods. This is one reason why foreign companies often prefer to establish physical businesses in Latin America rather than merely trade with the region.

'By adopting a pre-merger review system, Brazil aligned its practice to the one existing in mature jurisdictions, such as the US and Europe'

Barbara Rosenberg
Barbosa, Mussnich & Aragão

more mature jurisdictions. Take the Central American country of Costa Rica, neighbour to Nicaragua and Panama. Anxious not to miss out on the economic action, the government is striving to become a haven for business. It is now possible for building permits to be approved online and municipal taxes to be paid online, among other measures.

Companies of all sizes are getting the message – data-processing group Experian opened a subsidiary there in 2008 and St Jude Medical, a US producer of advanced medical technology, set up a cleanroom facility there in 2010, with a centre for training physicians to follow shortly. **SR**

THOUGHT LEADERSHIP

The Latin American markets continue to be attractive because of the potential for growth. But the changing legal and regulatory environments, which to varying degrees affect all nations throughout the region, require pause for thought.

Most of these reforms are focused on customer rights and protection or adjustments to the legal framework to allow for infrastructure development (including, in several instances, constitutional amendments). But the most progressive countries are starting to increase the flexibility of the regulatory framework and to attract foreign investments through tax incentives and legal certainty. However, others can be cumbersome jurisdictions to deal with, given the lack of legal certainty motivated by the political agenda.

Mexico's performance over the past 10 years places it firmly between the two trends. Indeed, the new insurance regulatory system based on risk management, scheduled to become effective in 2015, is progressive. It implements Solvency II-style concepts and principles that would align Mexico with the most advanced international insurance practices. It envisages strengthening corporate governance and provides for financial information and risk management disclosure requirements with respect to the transparency and reliability of insurance companies. This would allow companies with investments in the country to access reliable information to make local insurance decisions.

However, a financial reform bill proposed in September 2013 by the government to Mexico's congress shows signs completely opposite to the sophisticated new insurance regulations. New taxes affect the middle classes – those on cosmetics, soft drinks, school fees, money transfers abroad, and social security payments – but medicine and food remain VAT-free, meaning 60% of the population pay almost no taxes. These factors do not incentivise growth or provide a stable environment for foreign investors.

It is unlikely the financial reform bill will pass congress without several amendments, but it is a warning sign that changing regulations can be bad as well as good when considering entry into emerging markets.

Alvaro Salamanca, country manager Mexico, XL Group

Crackdown on corruption

America has fought its way back into the black and is changing the rules on malpractice to stay there

AFTER ITS POST-LEHMAN Brothers slip into recession, business is back in America. But this time it is different. The revelations of malpractice in the financial world have triggered a sharp reaction by enforcement authorities that has led to tougher regulation on business and bigger penalties for transgressions. And it is going to get stricter.

Take the main enforcer, the Securities and Exchange Commission (SEC), which polices the financial markets. Although it does not directly oversee the private sector, the SEC has set the tone for a general and widening intolerance of inappropriate commercial practices that is highly relevant to medium-sized businesses as well as to market leaders. A supplier to a financial entity or listed company can, for example, be investigated for any illegal behaviour simply because of its links to the former.

Under new chairman Mary Jo White, the SEC is introducing policies that "signal a shift towards more aggressive enforcement," points out lawyer Michael Trager of US firm Arnold & Porter. A specialist in financial enforcement, he warns that White is, in effect, after scalps. She announced recently that the SEC "will pursue all wrongdoers – individual and institutional, of whatever position or size" in a "bold and unrelenting" attack on corporate breaches. Fighting words, in short.

Company directors everywhere sat up when White also revealed in October a deepening interest in the integrity of the boardrooms of America. "Being a director or in any similar role where you owe a fiduciary duty is not for the uninitiated or the faint-hearted," she said, as she outlined tougher sanctions against boardrooms that fall short of the SEC's standards of behaviour.

Smallest infractions

Taking their cue from the SEC, which has pledged to chase "even the smallest infractions", commercial watchdogs in other states are on the lookout for transgressions they would have ignored a few years ago as they pursued bigger game. A particular target will be accounting fraud. As Andrew Ceresney, co-director of the SEC's enforcement division, told an American Law Institute meeting in September, the agency will devote a lot more resources to investigating the integrity of financial statements.

And then there are the whistle-blowers, the authorities' anonymous tipsters. The Dodd-Frank package of banking reforms has turned corporate insiders into legitimate – and highly rewarded – sources of information about any wrongdoing they have observed. The SEC's White is highly enthusiastic about whistle-blowers, describing them as a "tremendously effective force multiplier [that] directs us to the heart of an alleged fraud".

And Canada is following along the same route. Companies had hardly begun implementing its 2011 laws on "integrity provisions" for procurement and property transactions when they were greatly expanded in mid-2012. Now they include a laundry list of offences that closely resemble America's regulations – money laundering, criminal activities, tax evasion, bribes and drug trafficking.

So North America is very much back in business – but it is a much more rules-conscious business. **SR**

LIGHTENING THE LOAD OF LIABILITY

Closer scrutiny by shareholders, investors and watchdogs is inevitably raising the burden of liability on directors – but there are ways of lightening it. As the Canadian office of international law firm Dentons points out, in some provinces corporations are permitted to indemnify their directors and officers for various actions, provided they were acting honestly and in good faith. Indemnities are also allowable in the event of a fine, assuming the director or officer "has reasonable grounds for believing that his or her conduct was lawful". However, companies cannot protect directors in the case of a breach of fiduciary duty. And a court can strike down an indemnity it deems inappropriate. Soberingly, the firm points out that "in the context of insolvency an indemnity is only as good as the corporation's ability to honour it".

'The SEC is introducing policies that signal a shift towards more aggressive enforcement'

Michael Trager Arnold & Porter

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TOP FIVE RISKS IN NORTH AMERICA

1 **High legal costs**, especially when contracts break down
2 **Disputes with suppliers** over failure to deliver products or services to the specified quality or date of delivery
3 **Tough environmental regulations** with rising penalties including individual directorial liability
4 **Third-party suits** from consumer organisations for allegedly defective products under stiff consumer protection laws
5 **Complex and conflicting tax regulations** that vary widely between states

Open for business

The USA and Canada welcome careful foreign firms

VIGILANT AS THE NORTH American authorities are on wrongdoing, it's an easy region in which to open for business, if not necessarily to make a profit. In Canada, for example, it requires only the filing of a short notice by a foreign investor, regardless of the size of the enterprise.

The exceptions are "culturally sensitive" businesses, a category that includes publishing, and those that would trigger a national security review. Foreign takeovers are not much more challenging. Although the acquirer may have to file an application for approval, the takeover is likely to come under "general exceptions", which amounts to a virtual rubber stamp for the transaction.

But because Canadian takeover law differs in several important areas from the regulations across the border – for example, in cases of indirect control – no responsible foreign company would consider acting without engaging local consultants. **SR**


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Green is good

Penalties for environmental offences are on the rise in Canadian provinces

CANADIAN BOARDROOMS ARE among the greenest in the world, if only because they have to be. As many companies have found to their cost, the Canadian Environmental Protection Act laws for protecting the environment hold directors liable for causing or allowing any damage. They may be charged for their personal liability or as indirect actors on the basis, as the environmental authorities point out, that their control over the company and its employees has been "improperly exercised".

The list of potential transgressions is a long one under a broad definition

In the commercial capital of Ontario, directors face a blanket duty to take all reasonable care of what constitutes environmental damage. Common law liability can arise out of nuisance, negligence and trespass as well as more obvious offences such as unlawful discharges. The precise phrasing for a director's liability is that he "directed, authorised, assented to, acquiesced in or participated in" the offence. Clearly, that definition does not allow much wriggle room for a director in the line of fire.

And that's just the federal law. As the provinces become more and more concerned about the state of the planet, many of them have passed even stricter regulations. In the commercial capital of Ontario, directors face a blanket duty to "take all reasonable care" to prevent environmental offences.

The penalties are rising steadily. Even if a company has not been convicted, fines in Ontario can reach €2.9m and directors are exposed to third-party claims. Even more thought-provoking, a director can be imprisoned for up to five years less a day, although it is hard to see how a 24-hour reprieve would make much difference.

Faced with such sanctions, foreign companies could do much worse than hire an environmental consultant as well as the usual experts such as lawyers, accountants and risk managers. **SR**

THOUGHT LEADERSHIP

Historically, extreme weather events have been rare. But in the space of 10 years, two 'one-in-100-year-events' – Hurricane Katrina and Superstorm Sandy – hit the US. Nine of the 10 most expensive insured loss events occurred in the US in 2012, accounting for about €88bn of the total global economic hit.

Superstorm Sandy was a validation of the continued progress that many insurers have made in improving how they measure and manage flood risk. Continuously learning from extreme weather events, including the Thailand floods and the Japan earthquake and tsunami in 2011, we strive to capture more data to help us model and map our clients' risks and find ways to minimise their losses.

Supply chain risks, business interruption and contingent business interruption are growing concerns for companies. We've seen how natural disasters can disrupt supply chains and virtually halt a company's production if no back-up suppliers are lined up. One contaminated ingredient can make it into multiple products and be distributed all over the world. Clients have far bigger exposure to supply chain and business interruption risks than they realise and it is important for insurers to help clients understand the exposures they have.

More companies are conducting business globally. They have to take a global view of risks and how it can affect their business. The bottom line is risk knows no boundaries. Clients are looking to build seamless insurance protection to address their risks domestically and abroad in whatever markets they operate.

Ken Riegler, president, primary casualty, North America P&C, XL Group

Africa: 54 countries, and they're all different

From the stable and business-friendly to the downright dangerous, African states are slowly learning a better approach to doing business

THEY MAY BE STARTING FROM opposite ends of the commercial spectrum, but two African countries illustrate the startling differences between nations on this vast and hugely promising continent composed of 54 countries. They are Morocco, a stable kingdom that has been in the forefront of economic reform for some years, and the Democratic Republic of Congo (DRC), which had until very recently won headlines for all the wrong reasons.

In the past two years, the International Monetary Fund gave Morocco the accolade of the African country that was "the most active in implementing regulatory reforms" that enhance the commercial environment. The country launched a one-stop shop for obtaining construction permits, an initiative that greatly speeds up business openings. Companies can now pay their taxes, including VAT, much faster through more efficient electronic filing. And to settle commercial disputes more efficiently, the government passed a new law to simplify the rules of procedure.

These reforms are what outside businesses want. Nearly 3,000 international firms have established offices in Morocco and many of them are treating the country as their headquarters for the rest of Africa. And when the vast Casablanca Finance Centre opens in 2016, it will attract more foreign firms.

While Morocco has been racing ahead, the DRC has been pulling itself up by its bootstraps under a new and reformist prime minister, economist Matata Ponyo. When he took office in early 2012, the borders were racked by rebel violence and many of the country's 71 million people were living in dire poverty. The nation's bureaucracy was swollen and inefficient, corruption was rife and the rate of inflation in 2010 had peaked at a ruinous 46.2%.

What was prime minister Ponyo's solution? To create a business-friendly climate while dealing with the DRC's manifest challenges. "He sets the highest standards for himself and expects everybody else to do the same," explains Thierry Taeymans, head of Rawbank, one of the country's major financial institutions. "That attitude is necessary to bring in business and change the ways of the past."

»

Morocco has raced ahead of other African nations to implement regulatory reforms

» However, foreign business people should be careful where they go. The Goma region, a rebel stronghold, is considered dangerous and in even some less hazardous areas, the UK's Foreign and Commonwealth Office warns that foreigners should not travel alone.

Regulatory reforms

Like prime minister Ponyo, most African leaders know they have to be open for business. The latest Ease of Doing Business review by the International Finance Corporation noted, for example, a steady rate of improvement in the East African Community, a trading bloc comprising Burundi, Kenya, Rwanda, Tanzania and Uganda. Between them they have implemented an impressive 74 "institutional or regulatory reforms" in the past seven years that serve to improve the business environment for local businesses and encourage entrepreneurship in the region.

Compared with the time-consuming processes of a few years ago, just eight procedures are now required to open a business instead of 12. Even better, it costs nearly a fifth less than it did. The key reforms make it much easier to start a business, register property and process construction permits. As an example of what the DRC could do, Rwanda now ranks second on the global league table in terms of its progress in providing an environment favourable to business.

Still, there's a way to go. If a company wants to know how much it costs to register a business or property, or the fees for building permits and power link-ups, it is least likely to get information in the Africa and Middle-East regions.

There are exceptions, such as Burkina Faso, Mauritius, South Africa and Tanzania, where these fees can be found online. Otherwise, companies will have to make an appointment to meet a government official, a requirement that encourages bribery. **SR**

IT'S MORE DANGEROUS IN THE AIR

The terrorist attack on the Westgate mall in Nairobi, Kenya, in September had risk managers all over the world increasing cover for company personnel on the ground in Africa. But the danger presented by terrorists is much less than that from disease and, perhaps surprisingly, flying. Officially the most dangerous region in the world for civil aviation – the Congo's prime minister Matata Ponyo nearly died in a crash in February 2012 – sub-Saharan Africa has now seen a boom in business jets that are considered safer. Government ministers and top business people routinely cover the region in privately owned or leased aircraft. But under pressure from international aviation authorities, the main airports and many of the secondary ones are installing Western-standard safety systems.

Deterrents mount for dodgy dealings

The long reach of the law is driving home the message that the old 'nod, wink and a bung' days are long gone

AS UK PRINTING COMPANY Smith & Ouzman discovered, the long arm of the UK's Serious Fraud Office (SFO) reaches all the way to Africa. In October two directors, an employee and an agent faced accusations in a London court of making corrupt payments totalling £414,000 – allegedly to influence the award of business contracts in Kenya, Ghana, Somaliland and Mauritania between 2006 and 2010.

The case has yet to be decided, but it does show how the region's old way of doing business with a nod, a wink and a stuffed envelope is changing rapidly because of outside pressure. The SFO's case follows a three-year investigation that reflects the power of the UK's Bribery Act covering breaches committed offshore by domestic firms.

The region is unlikely to shed overnight its reputation as the world's capital of corruption, fraud and bribery but, as Kroll's latest global fraud report reveals, companies can take effective measures to combat it.

The agency explains that firms that train senior managers in the detection and prevention of fraud among other measures are significantly more likely to invest abroad because they have more confidence than those that ignore the problem. In short, it is more prudent – and probably more profitable – to be prepared.

These are also the firms that conduct forensic due diligence on partners in a look-before-you-leap strategy. Kroll says: "Such compliance activities may be opening up investment opportunities [in other countries] for companies."

Be alert to all theft

In rough order of importance (although the nature of the offences differs by »

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26% of frauds in the Gulf States involve a government official or regulator, compared with just 14% in the rest of the world

TOP FIVE RISKS IN THE MIDDLE EAST AND AFRICA

1 **Getting electricity and general ease of doing business** – varies widely across Africa
2 **Enforcing contracts**, especially against local companies such as suppliers
3 **Delays** in gaining construction and other essential permits
4 **Corruption and bribery**, especially in sub-Saharan Africa
5 **Human resources** – security of personnel in countries such as the Democratic Republic of Congo.

The Gulf States including Saudi Arabia have the lowest levels of fraud anywhere except Canada

» region), companies operating in foreign climes should be alert for straight theft of physical assets, stealing of information and intellectual property in general, supply chain fraud, and finally corruption and bribery.

By contrast, the Gulf States including Saudi Arabia have the lowest levels of fraud anywhere except Canada. However, what fraud there is surfaces in the most unexpected of places. Namely, by people in official positions.

"More strikingly, 26% of the frauds in the region involve a government official or regulator compared with just 14% in the rest of the world," says Kroll.

But then the Gulf region has long had its own way of conducting business. **SR**

Laws for locals

The lexicon of business is hard, but not impossible to learn

VETERANS OF DOING BUSINESS in the Gulf warn that laws are often designed to protect locals, a bias that has long been a big impediment to mid-sized businesses. For example, if a company wishes to terminate an arrangement with an unsatisfactory distributor or agent, it may be unable to do so without expensive court proceedings and heavy compensation.

Restrictions on foreign ownership are another problem, although they can be overcome, albeit expensively, if a firm is prepared to take the time. In other ways establishing a business in some Gulf states will be an endurance test. Generally, they are far behind even sub-Saharan Africa in their efforts to make business easier, consultants point out.

The entire business culture is different. Built around long-standing relationships, it may, for example, require the giving of gifts and hospitality that Western regulators would see as bribery and corruption but which are merely acts of courtesy in the Gulf.

The availability of labour is another peculiarly Gulf problem. Because most Gulf graduates opt for much higher-paid work in government, businesses generally end up hiring lower-cost »

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'We are behind in the Middle East and are not doing enough to serve our societies'

Adbdul Rahman Jawahery
Gulf Petrochemical Industries

» labour from the Indian sub-continent. As French economist and expert on the Middle East Hugo Micheron pointed out in an October interview with non-government body, Business for a Better World, "[there is] a sharp disequilibrium between salaries in the public and private sectors."

Corporate social responsibilty

However, one issue that unites Middle East and Western businesses is corporate social responsibility (CSR) across many fronts including female employment, energy issues and voluntary work. "We are well behind in the Middle East and are not doing enough to serve our societies," Gulf Petrochemical Industries president Abdul Rahman Jawahery told a corporate social responsibility awards ceremony in Dubai in late October.

One solution, suggests president of the Arabia CSR Network Habiba Al Marashi, is for businesses to take charge themselves. "I would like to see the private sector take the lead and not just wait for rules and regulations," he says. In fact, many are doing just that by supporting numerous social initiatives.

And according to head of sustainability for UK-based energy group Carillion in the Middle East and Africa Stuart Mee there is money in CSR. In an energy-wasteful region, Mee says that lower use of resources will see lower costs and higher profit. **SR**

THOUGHT LEADERSHIP

The Arab Spring and recent events in the Middle East will have focused the minds of those responsible for ensuring the safety and security of personnel and assets located in the region.

The unpredictable nature of such events, in terms of scale and intensity, presents significant challenges for businesses with operations in affected areas. The priority for any organisation will be the wellbeing of its employees, but there is also a need to protect physical assets and to mitigate potential disruption to business. Organisations have a duty of care to protect their people overseas, and failure to take adequate measures against foreseeable risks could lead to a breach of that duty.

Providing expert advice

Specific insurance policies are available to support organisations operating in these challenging environments. The insurance cover not only provides indemnification in the event of an insured loss, but also provides organisations with access to expert advice to help them operate in hostile environments by focusing on prevention, incident response/loss mitigation and recovery.

A kidnap and ransom policy provides access to security and response providers that can support an organisation in broader corporate security measures. For example, they can help organisations implement a robust, safe travel programme that could include the following:

- monitoring of changing threat levels and preparation for travelling employees;
- ability to locate and track travellers;
- protecting travellers in high-risk environments; and
- mechanisms in place to respond to any incident.

War, terrorism and political violence insurance cover can assist in mitigating the impact of political violence on physical assets and business interruption. As part of the insurance offering, a review can be conducted identifying steps to improve security procedures and loss prevention in the event of deterioration in the security environment.

The expectation is that, for the foreseeable future, the Middle East region will continue to experience political instability and periods of hostility between different factions. Through detailed security risk management procedures and insurance coverage, organisations can provide the measures to help protect their employees and assets in that region.

Dan O'Connell, class underwriter, war, terrorism and political risk, XL Group

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