

# GUIDE TO:

# Multinational risks

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## A global perspective

*Companies seeking growth in new markets will face risks that may be different from those they have encountered at home*

**D**OING BUSINESS, WHEREVER IN the world that might be, is becoming increasingly complex.

More and more companies are seeking growth in new markets and regions and, although this provides opportunities, it also brings greater risks.

Some of these risks can be challenging and daunting, even for the most astute risk professionals, not least

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*More and more companies are seeking growth in new markets and regions*

because they are often subject to unexpected changes.

In this guide to multinational risks, compiled with our partners at AIG, we explore some of the key risks faced by businesses and risk managers in a number of regions around the world.

Within each section, we highlight some of the potential threats and also provide some possible solutions that might assist risk managers to deal with them in the most efficient and effective way.

Throughout this guide you will find expert analysis of the main issues and insightful thought leadership.

Working across a number of multinational jurisdictions is never easy. This publication highlights the most pressing issues and provides guidance on how to deal with a range of current and emerging risks.

We hope you will find it a useful reference tool now and in the future.

*Mike Jones,  
editor, StrategicRISK*

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# Outward bound in dangerous seas

As more established markets become too saturated, some companies look to venture into emerging economies. However, although the risks inherent to these markets may broadly be of the same nature as in the more traditional ones, sometimes priorities differ

**A**S COMPANIES FROM MATURE markets move into exciting and fast-developing territories, another wave of outward-bound businesses is expanding into other emerging economies. Hailing in general from Latin America and Asia, they are working in close collaboration with the insurance industry as they tackle countries that western multinationals may consider a step too far.

As AIG's Maggie Nicol, manager for political risk, points out, these companies are open to doing business in politically unstable countries, but with their eyes wide open. She says: "They are companies with a higher tolerance for risk and we see a trend of investors from Brazil, China and India taking the place of the more cautious western multinationals", she explains. "This phenomenon is likely to increase, particularly in areas where sanctions apply to companies from the EU and the US, but not to other potential outside investors."

Other observers such as Chris Lay, head of business development for

Marsh's international division, identify the same trend. Many of our clients in Asia and Latin America are moving into MENA and Africa, including East Africa," he says. "There's a lot of activity and growth across regions."

As they dip their toes into these sometimes dangerous waters, the outward-bound multinationals are adopting appropriate measures to protect the business. "The risks they face are the same as those of mature multinationals, but their priorities are different," explains Lay. "Whereas established companies are more concerned with compliance and reputational risk, emerging multinationals are preoccupied with the security of their people, liquidity, cash and payments, as opposed to assets and liability."

In short, they are concerned by the more immediate issues.

The further they venture from their home base, the more country risk becomes a top priority. "Beyond the well-known difficult countries such as Venezuela, Egypt and – most recently –

Companies cannot  
assume the current  
landscape will stay  
the same'

Chris Lay, Marsh

Ukraine, and to a more frightening degree Russia, we see that multinationals are exposed to, and concerned about, increased political instability in less obvious areas", adds AIG's Nicol.

Ranges of exposure

Nigeria's mounting problems with terrorist group Boko Haram serve as a warning, but Nicol cites a list of other less dramatic political risks by way of evidence. Trade restrictions (export ban of nickel in Indonesia), civil disorder and political stalemate (red shirts versus yellow shirts in Thailand, which has led to a military takeover), infrastructure bottlenecks (the difficulties of exporting coal from the new resources projects in Mozambique), and corruption and expropriation (mining in Guinea). To varying degrees, all of these are the results of unstable or ineffectual regimes.

For many of these emerging multinationals, the learning curve is rapid. As South-East Asia-based AIG's Rudi Spaan, head of broker and client management, points out, Asian companies

A common problem for most multinationals is, ironically, multinational coverage. As Guenter Droese, chairman of the European Captive Insurance and Reinsurance Owners' Association, points out: "One of the most challenging concerns is how multinationals can cover all their risks in various countries based on a locally issued policy linked with excess layers in an international programme. The local policy doesn't usually cover either the breadth of insurable risks or the limits wanted by the multinational within the programme. Non-admittance is the big issue."

in particular face more than their fair share of problems in managing risks in a new environment, in part because they had limited exposure to the broader concept of risk management. Back home, a policy against fire, physical loss or damage is often considered sufficient for the job.

Thus, Asian companies often get a rude shock when they move further afield. "As they compete on a global scale, some are finding out the hard way that aspects of liability and compliance in doing business overseas are very different to those in their home country – and so too are the insurance requirements," Spaan says.

Further, the range of exposures in

# INTRO



the developing world appears to be growing rather than diminishing. Despite the best efforts of the UN, the International Monetary Fund and other multilateral agencies, commercial risks abound in many regions. As Marsh's Lay notes, the firm's risk-weighted map of the world features only a handful of

green spots. "Most of it is covered with ambers and reds," he says.

Moreover, risk is a moving target. As Lay summarises: "Companies cannot assume the current landscape will stay the same. They have to make decisions on the basis that it is volatile. The pace of change is ever-increasing." **SR**

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# A well-structured and timely approach

**T**HE WORLD IS BECOMING AN increasingly complex place to navigate and as a result, so is the role of the risk manager. The pace and degree of change that this report examines combined with the fact that businesses are more and more seeking opportunities abroad highlights the importance of working with the right team to properly understand and manage risk consistently across the globe.

When designing a programme, informed decisions need to be made and numerous scenarios considered. Programme design must take into account a general trend towards increased regulatory and tax scrutiny and an internal focus in local geographies, but also claims payment, loss adjustment, type of coverage and numerous other factors. It is and will become increasingly important to understand how local regulators will be asking various questions and also how responses will be interpreted in different jurisdictions.

The absence of a single global insurance regulator is the challenge the multinational insurance world continues to face; but, insurance regulation is not the only regulation that needs to be considered – some of which is considered in this report. Different local standards of

construction, risk management and resource to respond to an incident add a further dimension that must always be part of an informed decision-making process when designing a multinational insurance programme.

However, there is one element within our control that everyone (that is, customer, broker and insurer) needs to get better at. Highlighted as part of Airmic's *Efficacy of Business Insurance* guide, a clear strategy and decisions need to be made before the inception date, starting with the premium allocation methodology.

The particularities that each country brings to a multinational insurance programme, some of which are discussed in this report, further supports a well structured and timely approach from the point of initial programme design to final service delivery. This is something that customers, brokers and insurers readily agree upon; however, we must all make better effort to change this from theory into reality. Airmic recommends agreement by all parties of final terms and conditions 30-45 days prior to inception. We think this is sound advice.

*Stephen Morton, head of multinational risk practice, EMEA, AIG*

## The Asian rollercoaster

The incredible growth of Chinese urban areas presents companies operating there with unprecedented opportunities and problems

**T**HE UNSTOPPABLE URBANISATION of China is transforming the nation, with significant implications for companies operating there. More than 300 million Chinese have migrated from the country to the cities in only 30 years and another 350 million will follow in short order.

What does that mean for multinationals? China already boasts 160 cities with populations of more than one million as well as 14 megalopolises that are home to more than five million inhabitants. As these cities expand and coalesce into neighbouring ones, companies will be manufacturing and marketing for urban areas of 30 million people or more.

The scale – and the commercial challenges – presented by these giant conurbations are unprecedented. “[These cities] are the size of many European countries,” global management consulting firm McKinsey points out in a recently released study.

China’s collective buying power reflects this tectonic shift in populations. Disposable income per capita has

soared threefold in the past 25 years – and much of that is being invested in real estate. Indeed, the property boom dwarfs that of any other nation and will continue to break all records for the foreseeable future, with the fast-rising middle class as the biggest buyers. Just one developer, the Vanke group, sells 80,000 apartments per year.

### Matching challenges

However, China’s record-breaking growth is creating challenges to match, and they affect domestic and foreign businesses alike. No company can ignore them and expect to prosper in a situation for which there is no precedent. As historical economists point out, there are no tried-and-tested rules to fall back on here: see Changing face of China, on p9.

In the meantime, a similar phenomenon is occurring across much of Asia, albeit in different ways. Moreover, this is happening at a speed that makes it difficult for foreign companies to keep up. As the International Monetary Fund (IMF) and other multinational bodies point out, most Asian nations are



transforming their economies through a series of rapid-fire reforms.

Nothing seems to indicate that the pace of change will slow. As the IMF pointed out in its latest assessment of the region, Asia-wide economic growth is forecast to hold at 5.4% for 2014, rising to 5.5% in 2015. Brussels can only envy such figures.

However, for those multinationals that can ride this roller coaster, the potential is vast. For example, the 10 ASEAN countries alone boast a total population of 600 million, who are hungry for western-style products and services. Anchored by Singapore, Indonesia,

Malaysia and Thailand, ASEAN already has a combined gross domestic product of \$2.5trn.

But that is only for now – every reputable forecaster expects that figure to rise rapidly in the next few years. For example, the latest available numbers show that emerging Asia garnered a quarter of all global foreign direct investment in 2012, and the momentum has increased since. It is hardly surprising then that observers such as academic John Vong of the Singapore Management University expect ASEAN to turn into Asia's "third engine of growth". **SR**

## Independent directors in the firing line

As various Asian countries introduce legal reforms to regulate the business world, the take-up for insurance has increased greatly

**T**HE TIDAL WAVE OF ECONOMIC transformation across Asia will exert a profound influence in the boardroom, as India's new Companies Act 2013 is already showing. Nothing if not comprehensive, the law is being introduced in stages, but it is already clear the statute will transform the nature of responsibilities in the upper levels of all domestic and international companies.

According to veterans of the Indian business scene, the main lesson foreign companies must take from the Act is that the rights of shareholders are now supreme under law. For example, directors will for the first time be exposed to class action suits in a game-changing democratisation of shareholder rights.

Predictably, the reform has precipitated a scramble for insurance. India has long been a laggard in directors' and officers' (D&O) coverage but, galvanised by the implicit risks embedded in the Act, its boardrooms are catching up fast. (Currently only about 10% of companies have D&O cover, according to Mumbai-based Abi Malkan, a research analyst in JLT Wealth Management's financial risks division.) Another cata-

lyst is the Bombay Stock Exchange, which will soon require all listed companies to buy insurance for its directors.

Anticipating the trend, Tata Steel recently took out global cover of \$160m with Indian insurers. Other leading companies have responded by insuring their senior officers for up to \$100m.

### A big shake-up

In general, the legislation has shaken up boardrooms. "Several boards have revisited their D&O programme limits and coverage," explains Manoj As, head-financial lines, Tata AIG General Insurance Co Ltd. "We are also seeing a change in buying behaviour by senior management."

The trigger for the change of attitude is that regulators are now entitled to invoke measurable provisions under which directors' duties are clearly defined. Prosecution will be more effective and timely. Further boosting demand for D&O cover, penal provisions are stringent, with higher fines, penalties and imprisonment.

The trend towards western-style civil actions is developing. Alleging racial

## CHANGING FACE OF CHINA

As risk and safety manager of Hong Kong Engine Aero Services Ltd, a joint venture owned by Rolls Royce, Hong Kong Aircraft Engineering and SIA Engineering, Kevin Rookes has an unparalleled view of the manufacturing scene in China. Although he continues to predict a bright future for the mainland, he sees looming problems ahead. Below are his views:

**Rising production costs:** “For the past 20 years or so, China was the default choice for manufacturing, and many multinationals made the move without considering other countries. However with rising production costs and talent shortfalls together with intellectual property risk and diminishing government incentives, China is becoming less attractive to manufacturers. This has prompted many multinationals to explore other locations so they can reduce transportation costs and supply chain risk by moving closer to their customers.”

**Contest for talent:** “Cheap, plentiful labour used to be China’s biggest advantage – but that benefit is shrinking. Foreign companies and fast-growing local businesses are all competing for qualified employees – especially workers with skills such as fluency in English – making it harder for businesses to attract and retain top talent.”

**Land values:** “Real estate costs have risen at alarming rates following the institution of government-mandated

minimum land prices. Electricity rates are also increasing and corporate income tax rates for most foreign companies have risen from 15% to 25%, while tax-related incentives are disappearing or becoming increasingly difficult to obtain.”

**Intellectual property:** “Foreign companies in China have long been worried about protecting their intellectual property, but seemingly little progress has been made. It remains one of the top risks.”

**Changing places:** “Despite the downturn China’s role in manufacturing will likely continue to be significant. However, rather than supplying the world, the role will most probably move to supplying only China.”

**Trouble in Taiwan:** “China’s slowdown and financial instability are likely to have a significant effect on Taiwan’s economy because of the strong trade and financial linkages. Additionally, the pending Taiwan-China trade agreement for the services sector has led to protests and political tensions in the economy. This is sure to affect Taiwan’s relationship with China.”

discrimination, sexual harassment and unfair dismissal, these claims have almost overnight exposed directors to the ire of regulators, shareholders, creditors and employees.

“Recently, Indian firms saw as many as 340 independent directors resigning from their positions, fearing their reputation might be at stake if

the company failed to live up to investor expectations,” notes Malkan. The independent directors see themselves as being particularly vulnerable because many sit on a number of boards that are active in different sectors of commerce.

The growing demand for D&O cover is an Asia-wide phenomenon. Although precise figures are

*'This rise in legislation and the increasing emphasis on enforcing it are reflected not only by the rise in the number of underlyers included in a D&O multinational insurance programme but also the limits of those underlyers. The additional challenge that comes with side-A when assessing exposure and claims payment is an extra dynamic when considering where to buy a local policy and what a sensible limit should be. At AIG, D&O is one of our fastest-growing lines of business in the multinational arena and has been for a number of years.'*

**Stephen Morton**, AIG

elusive, the insurance industry estimates the continent's D&O market at more than \$400m, with Hong Kong and Singapore being the hot spots. But like India, Malaysia is also catching up fast after the central bank – Bank Negara Malaysia – introduced last year a 600-page regulatory package that not only gives it much stronger supervisory powers over the financial sector, but also places a heavier burden of responsibility on directors.

By no means least, Malaysia's new regulations greatly extend the likelihood of imprisonment for misdemeanours. But, instead of only directors, chief executives and senior management facing time in Kajang prison for serious illegalities, any individual involved in the chain of decision making leading up to an offence may also be imprisoned.



### **A sign of the times**

Moreover, the central bank has given itself the power to take civil action on behalf of any corporation or individual it believes has a legitimate grievance. The regulations also affect the boardroom in the hip pocket – directors will be liable for restitution for loss or damage caused by an offence committed by an employee.

Although Malaysia's regulations concern only the financial sector, that may change. Many observers believe it is only a question of time before they are extended across the entire commercial sector in what is undoubtedly a sign of the times. **SR**

## INDIA MAKES CORPORATE SOCIAL RESPONSIBILITY OBLIGATORY

Another of the consequences of India's Companies Act 2013 is the formalisation for the first time of corporate social responsibility (CSR). Henceforth, businesses will be required to spend a defined amount every year on helping the underprivileged in a wide variety of ways.

Soon, say veteran observers of Indian commerce, all operators will be judged by their good works as much as by their profits. "The introduction of the comply-or-explain principle in CSR can be considered visionary", says Vishesh Chandio, managing partner of Grant Thornton India.

Until now, charitable actions have been voluntary. In future, they will be obligatory. Effective from April, companies of a defined size, including foreign companies with branches or activities in India, will be required to spend 2% of their deemed average net profits of the previous three years on defined projects. They will have to explain any failure to do so.

The law will catch a wide swathe of the business world, applying to companies with a minimum net worth of 500 crore (\$85m) turnover up to 1,000 crore (\$170.6m) and net profit of at least 5 crore (\$853, 375) in any financial year. In effect, this means

that industry will be expected to act almost as a branch of the welfare, education, environmental and healthcare sectors.

Responsibilities will be broad. As the Act specifies, companies are now mandated to help deal with poverty, malnutrition and hunger; improve the education and vocational skills of children, women and elderly; promote gender equality; provide facilities for senior citizens, women and orphans in the shape of hostels; help protect the flora and fauna

while maintaining the quality of air, water and soil; help build public libraries; promote craftsmanship, fund sport programmes, including those for the Olympics.

When the good works have been accomplished, they must be described in detail and posted on the corporation's website. However, consultants suggest that companies should see this as an opportunity to burnish their reputation, rather than as a burden.



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## China battles pollution

Businesses can expect increased scrutiny until the country has cleaned itself up

**C**HINA'S BREAKNECK ECONOMIC growth has come at a perceived heavy price in terms of its effect on the environment. No less than 40% of its rivers are so contaminated that they are unfit for use and the authorities have earmarked \$636bn between now and 2020 to address what premier Li Keqiang calls a "war on pollution".

The implications for manufacturing businesses will be considerable until such time as the government considers the problem to have been resolved, which is a long way hence. Until then, companies can expect relentless regulation and constant monitoring of their environmental responsibilities.

Since March, for instance, industries have been coming to grips with a much more heavily enforced anti-pollution

regime. Factories are now managing effluents under a highly public rating system that assesses them on a scale between green (good) and red (bad). Such is the pressure to show respect for the environment that most observers believe that even those firms that fall outside the system will volunteer to join as a demonstration of good corporate citizenship.

### Fines and penalties

Disciplined compliance with these tough new standards should at least go to the bottom line. Late last year, the amount of penalties offenders paid were raised across the nation and they are likely to increase again.

Fines on polluting enterprises in Beijing, for example, have recently increased fivefold for first offenders,

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*'We certainly see environmental liabilities as an amplified emerging risk. There are two fundamental drivers: the increase in frequency and the complexity of claims. Regulatory and legal changes continue to advance globally and the public and even lending institutions are increasingly aware of these issues. It is likely there will be a rise in allegations that companies have caused damage to the environment, bodily injury and even pollution. This has the potential to disrupt business and land development. In addition, clean-ups and environmental claims are becoming more and more complex, as these incidents come into the public eye and regulations continue to develop around the clean-up and restitution of environmental damages.'*

**Stephen Andrews**, head of environmental EMEA, AIG

while penalties for multiple breaches are no longer capped.

The authorities are taking the problem seriously. According to local media, no less than 652 industrial facilities were fined in the first four months of 2014, mainly for air pollution. Beijing's Environmental Protection Bureau, which took charge of supervising pollution levels earlier this year, levied fines equivalent to \$2.3m.

Pollution has now abruptly turned into an important reputational issue. Although the authorities, and particularly the powerful Ministry of Environmental Protection, were already moving towards a clean-up of the environment, they have lately been put under severe pressure by activist groups unwilling to tolerate unhealthy living conditions any longer.

#### Increased demands

However, the crackdown also presents

immense opportunities because, in the next few years, about one billion city dwellers will demand the same environmental quality as western-style nations.

This is the case in the broadest sense. They will expect efficient transportation and public services, clean drinking water and other critical resources, purer air, family-friendly open spaces and all the other public amenities that citizens in more developed nations assume to be their right.

New regulation in respect of environmental responsibility is not unique to Asia. The EU Industrial Emissions Directive, for example, is creating and changing responsibilities across the EU, and although stand-alone local policies (often the default position) provide protection, there is no reason why these cannot be integrated into a global programme for multinationals to enjoy the benefits it brings. **SR**

## Young democracies

Companies setting up in emerging Asia need to be aware of some of particular risks inherent to countries where democracy has not been enjoyed for long

**A**S MANY ASIA-BASED RISK consultants advise, in-bound multinationals need to be aware they are entering nations with young and often fragile democracies attempting to reconcile multiple cultures. Of these, Indonesia is a prime example. The third-largest democracy in the world, its first legislative elections in 44 years were conducted barely 15 years ago.

To boot, the nation faces a secessionist movement in resource-rich Papua and bouts of Islamic terrorism – both “old threats”, as South-East Asia specialist Gil Pérez Javier of the Centre for European and North Atlantic Affairs describes them.

But Indonesia also confronts a daunting variety of other threats, which inevitably affect the way multinationals do business there. Take just geophysical threats in a country prone to natural disasters comprising earthquakes, floods, volcanic eruptions, land-



slides and fires. Climate change is said to be a main contributing factor and the related – and rising – incidence of infectious diseases has implications for the welfare of personnel.

Furthermore, food shortages are frequent. People smuggling and drugs trafficking are also endemic problems.

### Attracting investment

Combined, these phenomena spill over into the commercial world. High rates of unemployment have triggered stiff regulations on foreign labour, while an outbreak of economic protectionism has resulted in a wave of hefty tariffs that are affecting profit margins.

In the same vein, regulations on foreign ownership are getting more stringent, especially in the extractive and related industries.

By contrast, domestic watchdogs may be more lenient on local companies. Indeed, the risk manager of one multina-



tional refers to a “loose regulatory environment” in other respects.

Despite the challenges, multinationals are flocking to Indonesia. As Pérez Javier says, “the economy is stable and will grow at about 5.8% in 2014”. Nissan, Suzuki and Daihatsu recently invested \$1.5bn in Indonesia. India’s Tata Motors selected the country as its manufacturing and distribution hub for all of South-East Asia. Foxconn, contract manufacturer of the iPhone, is investing some \$10bn in Indonesia for the production of electronic devices. A haven for foreign direct investment, in 2012 alone, Indonesia attracted some \$20bn in outside capital.

#### Another story

If foreign investors continue to pour into Indonesia, they are sitting on the fence in Thailand, which remains mired in a damaging political stalemate that may take years to resolve.

From her office in the heart of Bang-

kok’s main shopping district, Phatchada Muenthong has a ringside seat of the upheavals. She is director of governance, risk management and compliance at publicly listed retail group Big C Supercenter, and protesters have choked the streets outside her building. On one occasion, shots were fired.

As sales have plummeted – consumer confidence is at a 12 and-a-half-year low, management has been preoccupied with managing the considerable risks presented by the unusual political situation. At first, her overworked team met on a daily basis to review the situation. Now, they monitor a series of key risk indicators that, if they show a steady deterioration, would trigger action.

Muenthong is a risk manager who believes she should shoulder the decision-making process – “not everything should be decided by the president”, she explains. Early on, she moved some critical functions to safer locations. **SR**

## WHEN ENGLISH IS NOT ENOUGH

The burning issue of multilingual contracts has come to the fore recently in Indonesia, making some multinationals wonder whether they are worth the paper on which they are printed. The main concern is a tough-minded interpretation of a 2009 law and it arose when a court in West Jakarta ruled last year that an agreement between a Texas lender and a local company was void because it had been drafted only in English.

Immediately, concerns arose. Could thousands of English-language contracts be invalid?

Although the decision is being appealed, the local office of law firm Reed Smith counsels caution. "There is now a judicial basis for Indonesian entities to challenge the validity of international

contracts under the language law", the firm warned earlier this year. "Ideally, and as a matter of prudence, agreements between Indonesian and foreign parties should be drafted as a dual-language agreement in English and Bahasa Indonesia, regardless of the governing law."

In short, the use of Bahasa in contracts will become an integral part of doing business in Indonesia. According to Reed Smith partner Charles Ball: "We expect to see many more such cases brought to the courts in the coming months and years. Foreign companies doing business in Asia need to be aware of this issue and should take the necessary steps to comply with the law." This is particularly true if they rely on

Indonesian courts for the enforcement of contracts.

However, too few businesses see the danger. As Philip Antcliffe, another Reed Smith partner specialising in the region, reports: "We are telling clients that, even if they enter into non-Indonesian law governed contracts with Indonesian parties, they should ideally be executing dual language contracts, or, less safely but more practically, attaching a certified Indonesian translation to the foreign language contract."

That may not be the end of the matter. Although certified translators are available in Jakarta, translations can still be questioned on the basis of accuracy and end up in court. The main lesson, say lawyers, is that equal weight should be given to both languages when drafting contracts.

## How Asia's risk managers are raising the game

**W**ESTERN COMPANIES – AND INSURANCE firms such as AIG – are exerting a profound influence on the techniques of risk management across Asia in a fruitful two-way process.

Typically, South-East Asian companies apply risk management in practical and conventional

ways. As Deloitte consultants pointed out to business leaders in an AIG-organised breakfast conference earlier this year, risk managers are working hard to mitigate threats to business continuity.

As a Deloitte survey showed, 90% of risk managers have moved to strengthen the structure of internal controls. More than 75% conduct continuous audits. Almost 60% are installing or overhauling systems for managing enterprise risk. Slightly more than half have made it easier for whistleblowers to report misdemeanours and most are improving disclosure practices. Finally, 46% conduct regular external audits.

## UNIVERSALITY OF RISK

Local policy language, permitted jurisdiction and translations are important considerations in multinational programme design. This is not only the case with regard to the local policy itself, but jurisdiction, in particular, can also extend to any reinsurance of that local policy. A dispute in two different jurisdictions may be interpreted in two different ways and not all territories uphold arbitration clauses.

Stephen Morton, head of multinational risk practice, EMEA, at AIG, said: "Indonesian insurance regulators require all wordings to be filed and there is an option for either a local or English language policy wording. However, in the event of a dispute involving language, Bahasa Indonesia prevails. Jurisdiction is usually limited to Indonesia although this can be changed by special agreement. A simple translation error, for example 'watch' instead of 'clock' can have significant meaning from an insurance perspective." **SR**

So far, so good. But as Tony McHarg, head AIG multinational Asia Pacific, has identified after lengthy discussions with risk managers in the region, many of them face a plethora of problems unfamiliar to some of their counterparts in more developed markets.

"Talent is a big issue, in terms of attracting, retaining and developing it," he explains.

(Other risk managers in the region agree. As Big C Supercenter's director of governance, risk management and

The commonality of risk around the world is growing, as a compilation of emerging commercial threats by InterContinental Hotel Group's Shuh Lin Tan, director, head of risk management in Asia and Australasia, reveals. The degree of the risks may vary between countries and regions, but her counterparts around the world will recognise a similar range of challenges as the ones she faces.

She particularly identifies those risks presented by human capital, burden of regulation, potentially ruinous cyber attacks and other security matters, prevalence of natural catastrophes, conduct of employees and, interestingly, social media, which has the power to make or break a company. Here is her list in more detail:

- Human capital: lack of loyalty and ambition to succeed; lack of global exposure for local talent; wages issues in emerging markets
- Regulatory : lack of familiarity with each country's regulations, which leads to increased costs in consultants and legal counsels; no proper due diligence triggering risk exposures; dearth of risk mitigation measures
- Cyber: compromised privacy; insufficiently advanced preventive technology; hackers in the dark; sale of private data especially common in this region
- Social media: brand image capable of being compromised, used by whistle blowers
- Conduct: bribery and corruption in Asia; frauds techniques
- Security: terrorism, including from lone wolf attacks, rising wage gaps creating tensions
- Natural catastrophes: lack of preventive infrastructure in many developing countries and ability to deal with them

As her compilation shows, the problems facing risk managers everywhere vary mainly in degree.

compliance Phatchada Muenthong in Thailand says: “It isn’t easy to recruit talent and keep it. If we outsource this function, we need to work closely with our service provider.”)

Regional risk managers must continually find new ways of doing business to meet challenging price points – “emerging markets demand products at a fraction of the price of mature markets”, adds McHarg.

Despite the inherent promise of emerging markets, they do not develop in the neat and predictable ways that inbound companies are often led to believe. “They can be difficult to assess and easy to overestimate”, says McHarg.

### Head-office syndrome

Some regional risk managers labour under inflexible regimes drawn up by their head office – “companies’ speed and autonomy can be constrained by the global group’s systems of governance”.

In short, emerging markets do not run to order. But broader, western-style concepts of enterprise risk management are coming to the rescue. “The idea of true risk management is a relatively new

concept in the region”, explains Rudi Spaan, AIG’s head of broker and client management. “This addresses commercial and political risk, customer and supplier interdependencies, exposure to natural catastrophes as well as physical loss or damage to assets, risk mitigation, retention and transfer.”

### Need for change

Others support the need for change. “I understand that the majority of the companies listed on the stock exchange of Thailand have adopted ERM”, says Muenthong. “But the level of appreciation varies. Some are not keen to apply international methodologies, while subsidiaries of multinationals may adopt ERM in a formal way but not get the true benefit from it. There are big opportunities for ERM in Thailand.”

Right on cue, a forward-thinking group of professional risk managers has established a body called the Pan-Asia Risk and Insurance Management Association (PARIMA). Chaired by Franck Baron, group general manager for risk management and insurance at International SOS, PARIMA

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## Tougher regulation

**R**EGULATORS ACROSS Asia are lowering the barriers for new entrants into most sectors, but none more so than in the telecommunications market.

Inevitably, this puts even more pressure on existing operators. In Singapore’s already saturated telecommunications

market, for instance, regulators are opening the way for mobile virtual network operators as well as facilitating new mobile entrants.

Simultaneously, invoking the Code of Practice for Telecommunication Service Resiliency, Singapore is punishing any disruptions or breaches of data

protection with increasingly heavy fines and penalties. “Without competent in-house legal and regulatory support, it would be difficult to keep abreast of developments and to comply accordingly,” explains one senior risk manager. “Regulatory and compliance risks are top of my list.” **SR**

## A REGION DEFINED BY DIFFERENCES

is dedicated to developing skills in ERM, risk financing and prevention and is already lining up international schools and experts to spread the word. Board members have already been appointed in Singapore, Hong Kong, Malaysia, Vietnam, Taiwan and China and soon every Asian country will have a representative.

"PARIMA is steadily developing a footprint right across Asia," says Baron. "Until now, there has not been an organisation like that, where you can meet like-minded people and exchange information. The ultimate ambition is that PARIMA becomes a game-changer for the risk-management profession in Asia." As an opening salvo, the new body's first conference will take place 3-5 December.

"PARIMA is a big start in shining a light on risk management in Asia Pacific", enthuses Spaan. **SR**

*'Some Thai companies listed on the stock exchange are not keen to apply international methodologies, while subsidiaries of multinationals may adopt ERM in a formal way but not get the true benefit from it'*

**Phatchada Muenthong**, Big C Supercenter

Throughout my many years in Asia, I have seen broad interpretations of the meaning of "emerging risk", says AIG's Rudi Spaan, a veteran of the region. Sometimes, it is defined as deeper insurance penetration because of the increase in first-time buyers identifying the risks posed by natural catastrophes or by cyber risk or it could be taken to mean changes in legislation that create new liability risk.

But one of the most complex challenges for manufacturers and insurers to grasp is the complexity of interdependencies triggered by large events. The global financial crisis, Japanese tsunami and Thai floods provide perfect examples. It is only when these incidents occur that companies come to understand how vulnerable they are when a supplier or customer is put out of operation. True risk management is about the ability to foresee and understand these scenarios to provide the correct protection for each individual business.

Another area of considerable difference is the varying attitudes and regulations relating to liability. Companies typically respond by buying only basic third-party liability, sometimes complemented by workman's compensation, depending on the regulations. More sophisticated products are seldom purchased. This would include environmental liability, product liability, manufacturers' errors and omissions – including more specialised covers such as product recall, malicious tampering and professional indemnity. The exceptions are when retailers and counterparties, most often from more mature markets, insist on it.

*Rudi Spaan, head of broker distribution and client management Asia-Pacific, AIG*



## Twenty-two countries – all different

Latin America appears homogenous, but the common links are actually few

**T**HERE ARE 22 COUNTRIES IN Latin America, each very much with its own identity. The way in which each country conducts business is also varied and unique. In terms of economic performance, rule of law, quality of government, stability of the currency, tax, environmental regulation, corruption, labour and the general ease of doing business, these nations are markedly different from each other.

Although English is used in a few countries, most of Latin America conducts business in Spanish or Portuguese.

“Keep in mind that Latin America is not a country”, advises David Gambioni, founder of Risk Boutique. “Approximately 600 million people live there.”

But with the exceptions of Argentina and Venezuela, both the subjects of protectionist economics and the latter also experiencing civil disturbances, most of Latin America exhibits one common denominator. In different ways each country is open to foreign business.

Even once-shunned Panama has thrown out the welcome mat, having established free and favourable trade deals with 11 countries, including Taiwan and Singapore. A greenback-based economy without its own paper currency, Panama is growing rapidly by virtue of such useful innovations as Proinvex, a one-stop-shop that provides much of the information that foreign investors should need.

Similarly, Mexico, Colombia, Peru and Costa Rica made the league table of countries that achieved steady progress



towards an increasingly favourable commercial climate.

Taking Mexico as a prime example with its 121 million population, it has consistently improved in the past decade. In 2013 alone, it substantially reduced the number of procedures to start a business, eliminated unproductive paperwork, made the payment of taxes easier and reduced logistical barriers for exporters among other genuine reforms.

The momentum is undoubtedly heading in the right direction. As the World Bank's institution for the private sector, International Finance Corporation, approved: "The good news is that at least half of Latin American countries carried out regulatory reform to improve these indicators."

### Endemic corruption

Unfortunately, another common denominator has been endemic corruption. However, although bribes and

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*'This diversity extends into the way insurance is purchased and administered. Latin American countries will view risk differently and will not face the same risks. There are also different insurance patterns. Several countries in Latin America are seeing an increase in overall costs of litigation owing to a variety of causes. However, at present, liability insurances make up less than 1% of the total market. Some local practices enhance the complexity of multinational insurance programmes. For example, in Chile, the insurer and insured have only 10 days to respond to a loss adjuster's report. Also, it is not uncommon for the insurer to be required to pursue subrogation in its own name in Latin America.'*

**Stephen Morton, AIG**



Albeit at different rates, most Latin American countries are ticking the right boxes. Last year, Guatemala implemented more reforms than any other nation and made the global top 10 in terms of doing business. One of its initiatives was the establishment of a single online platform that enables companies to register a new business with all the relevant government agencies.

In Chile, officially Latin America's most business-friendly economy, a start-up can gain all the necessary approvals in a single day.

As for Argentina, the situation is getting worse. Although multinationals continue to flock to the country, corruption is rising in the absence of effective control of fraud of all kinds. Indeed, the most egregious cases have come to light through the action of foreign anti-corruption agencies, not through domestic enforcement.

"The level of acceptances of bribery and corruption has increased significantly," explains Andrea Rey of EY Argentina.

Currently, levels are running at a rate that is almost twice as high as in Europe. According to Rey, a 25-year veteran of fraud investigations, no less than 81% of foreign businesses perceive Argentina as a high-risk market.



# Environmental patchwork

Regulations and their enforcement are lacking in consistency and clarity

**W**HEN COLORADO-BASED mining giant Newmont and Peru's Buenaventura group started work last year on the \$5bn Minas Conga copper and gold project high in the Peruvian Andes, they thought they had covered all environmental issues. But the joint venture partners had hardly started when they ran into trouble from local environmentalists in the region of Cajamarca and from the anti-mining regional government, which claimed the project would affect the local water supply – an emotional issue in the region.

As Laurence Allan, senior manager of the IHS Country Risk's analysis and forecasting team for Latin America, explains,

*'How do you figure out what the environmental risk is in Ecuador when, on the one hand, the government guarantees the rights of nature and, on the other, allows oil exploitation in the Amazon?'*

**Laurence Allan**, IHS Country Risk

the mining companies became caught in the political crossfire. "Disagreements over compliance concerning reservoirs have been amplified by differences between the national government of president Ollanta Humala and the regional government of Gregorio Santos," he says. "While Humala supports the mine for reasons of national economic development, Santos has leveraged local discontent around regulation of the water resources. As a result, there have been significant delays to the project."

More than delays, in fact. In January 2014, protesters invaded the site and destroyed infrastructure.

## Thorough review

The lesson for multinationals in the increasingly sensitive mining sector in Latin America is that they must take into account all stakeholders, including local communities. They should take the time to understand the relationships between all the actors. As Allan adds, "it's all too easy to underestimate the impact that a seemingly minor difference between two relevant parties can have on finding a way through the labyrinth of environmental regulation."

## INSURANCE HURDLES

In a relatively lawless environment, the implications for insurance of personnel and fixed assets are obvious. However, here, things are changing too. As ALG's Marty Scherzer, president, global risk solutions and multinational, points out, regulation of offshore-based insurance arrangements is on the increase as some governments adopt protectionist measures. "This is regime-affected – governments want the action to stay in the country as much as possible", he explains.

This takes several forms. In Brazil, for instance, local brokers have to be involved in the provision of cover in a way that brings more foreign capital into the country. Additionally, increasingly tough limits have been placed on the amount of reinsurance risk that can be taken offshore.

Further, in hard-pressed countries such as Argentina and Venezuela, any offshoring of insurance capital is allowed only after a three-stage vetting process. First, independent auditors check the appropriateness of the application. Next, an insurance commission reviews it. Finally, if it clears the first two hurdles, the Treasury has the final say. Even then, the maximum tranche that can be shifted is \$250,000.

Scherzer believes this kind of regulation is here to stay and that multinationals will simply have to be more flexible and will need to structure their programmes around the issues that will impact their organisation.

As in other issues, environmental regulation, – and its enforcement – differs across Latin America and clear rules are few, even in relatively mature regulatory countries such as Chile. Often, a wide range of bureaucracies and institutions oversee environmental issues. Further, within countries, different levels of authority at national, provincial and local levels all compete to have a say, a situation that may trigger turf wars. For good measure, governments will invoke regulations for unspecified non-environmental reasons.

"How do you figure out what the environmental risk is in Ecuador when, on the one hand, the government guarantees the rights of nature and, on the other, allows oil exploitation in the Amazon?," asks Allan rhetorically.

### Grey areas

The result is a number of grey areas that operators can find extremely challenging to negotiate. In Brazil, as in other countries, the award of permits may be subject to long delays, which can have important implications for a project's viability. For instance, the economics of the stalled Minas Congas

mine are deteriorating steadily.

The resources sector is not the only one affected Allan predicts a new emerging frontier for environmental activism in Latin America, namely, genetically-modified (GM) crops. He cites Monsanto's GM seed facility in Argentina. Having cleared all the environmental hurdles set by the provincial authorities, a local court in Cordoba province suspended construction of the projection environmental grounds. **SR**

## Winds of change

Some Latin American countries have started a fight against corruption

IT IS UNLIKELY THAT former El Salvador president Francisco Flores Pérez expected to be detained in May for “grave acts of corruption” allegedly committed during his five years in office. The charges, which result from an investigation spanning three nations, include the misappropriation of \$10m in funds emanating from Taiwan.

The alleged offences took place more than a decade ago and the detention of the former president counts as a warning to other holders of high office in Latin America. This is the first time in El Salvador’s recent history that anybody in such a position has been arrested on these grounds, despite the country being repeatedly named by internal and external organisations for high levels of corruption.

The winds of change are sweeping across the region, with Brazil setting the pace. Once notorious for brown envelopes, the home of the 2014 World Cup



triggered its new anti-corruption law earlier this year. Known as the Clean Companies Act, law no 12.846 will “affect almost every company that is headquartered in Brazil or operates there locally”, points out Ryan Bonistalli of international law firm McGuireWoods.

### Cleaning up

The price of not being a clean company is punitively high. Any “illicit acts practiced against local and foreign public institutions” will trigger a range of penalties, explains São Paulo-based law firm TozziniFreire. A particular target will be multinationals attempting to slip brown envelopes – or the equivalent – to public officials in inducements to win public tenders and other government contracts.

The implications for boardroom liability are obvious. The law puts in the

*‘We are possibly witnessing a milestone in terms of culture and the behaviour of the Brazilian business segment’*

**Edimara Wieczorek**, Demarest



firing line a firm's "officers, directors, employees and agents who perform, participate or aid in the performance of an unlawful act".

"We are possibly witnessing a milestone in terms of culture and the behaviour of the Brazilian business segment," predicts Edimara Wiczorek of law firm Demarest. That observation is relevant elsewhere in Latin America as nations embrace anti-corruption packages that bear strong resemblances to the US Foreign Corrupt Practices Act and the UK Bribery Act 2010, not least in the way they aim to snare cross-border breaches.

In Brazil, the turning point was the "mensalão" (big monthly allowance) scandal. After an eight-year investigation, former ministers, bankers and businessmen are being sentenced for paying coalition parties substantial amounts of public funds for political support. »

## TOUGH ON FOULS

Multinationals operating in Brazil could do worse than see parallels between the way World Cup referees were instructed to punish misdemeanours on the pitch and the way watchdogs are penalising corruption across the region. In something of a template for anti-corruption legislation in Latin America, this is what companies need to know:

- No brown envelopes: bribes of domestic or foreign official at any level of government are prohibited.
- Co-operate with the authorities: any attempt to interfere with a government investigation is now seen as a heinous offence.
- Vet all payments to third parties with the utmost care: all 'facilitation' payments are forbidden. There is no de minimis exception as under the US Foreign Corrupt Practices Act.
- Continually check all internal anti-corruption systems: if it can be proved that a punishable act resulted from a compliance failure within the firm, that will be enough for the authorities.
- When wrong, grin and bear it: offences will inevitably result in what law firm Demarest describes as "harsh administrative and civil sanctions".



» **Brazil gets tough**

Brazil's anti-corruption legislation is particularly unforgiving. Cross-border enquiries, which would once have been unthinkable, are now an increasing part of an investigation process. A company can be held liable regardless of the liability of the individual "without the need to prove that the management or directors had a corrupt intent," Tozzini-Freire partner Shin Jae Kim points out.

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*'Judicial sanctions include loss of assets, rights and valuables, suspension or partial interdiction of the company's activities'*

**Shin Jae Kim**, TozziniFreire

The financial and reputational penalties of breaking the law will be high. Any company in breach will have to pay a hefty fine – up to 20% of gross revenue or, failing that, up to R60m (\$27m). In addition, the company will be put on the official blacklist, losing access to public funds such as subsidies or grants for a defined period.

As Kim explains, the government is taking corruption seriously: "Judicial sanctions include loss of assets, rights and valuables, suspension or partial interdiction of the company's activities." Thus, reputational damage is guaranteed – the judgment in all its unfavourable detail must be widely circulated through the media.

Firms can, however, take steps to mitigate the fall out. If the offender can point to determined efforts to comply

## MEXICO TURNS A CORNER



with the principles of the anti-corruption laws through internal codes of conduct and ethics, anti-corruption training, investigations of employees' links with government officials and other measures, the courts will take this into account. "It is expected that companies with compliance programmes will benefit," adds Kim.

### Problem nation

However, Argentina, is unlikely to follow this path soon. When vice-president Amado Boudou was accused of illegal enrichment and money laundering, among other illegal practices, over the bankruptcy of a mint and printing company, he responded by making criminal charges against the prosecutor, who was then forced to resign. The judge was summarily removed.

Mexico is following Brazil's lead in the wake of the US aggressive application of the Foreign Corrupt Practices Act (FCPA). In its case, though, reform is starting at the top with the energy industry. "US companies looking to enter the oil, gas and electric markets will need to stay vigilant to anti-corruption risks and plan ahead to ensure they have adequate compliance structures in place," explains law firm McGuireWoods.

Since the FCPA is having a significant effect on regulations in Latin America, all foreign subsidiaries in Mexico and other countries are advised to keep detailed records of expenses and internal controls. It will be vital to install robust anti-corruption systems.

It should be noted, however, that the FCPA may clash with national anti-bribery laws in a potentially confusing situation. As law firm McDermott Will & Emery warns, while so-called 'grease' payments – money given to an official to secure routine government action – are permitted under the FCPA, this may be illegal in other jurisdictions. As a result, "international energy companies move into the Mexican market under an uncertain regulatory environment".

This is the case in Brazil and elsewhere in Latin America. Most consultants suggest firms should adopt flexible, country-specific strategies, but with the FCPA and the UK Bribery Act 2010 as their backbone.

As the World Bank drily notes, "integrity in the judicial system is compromised owing to inefficiencies and excessive delays."

Nobody expects business practices to change overnight, even in Brazil because much still needs to be improved. According to Transparency International's latest league table of corruption levels, Brazil ranks an unimpressive 72nd out of 179 countries. However, the new law may mark the beginning of the end of "*jeitinho brasileiro*" – the Brazilian way of doing things. **SR**

## THE VENTURE CAPITALIST WHO TURNED RISK MANAGER

For years, investors in Brazil have been nervous of the “*custo Brasil*” – the cost of doing business best symbolised by what are known as TLLCs. These are the hidden, steadily accumulating charges that dramatically affect M&A transactions, but that many companies discover too late.

As Alexandra de Haan, managing director of 25 year-old venture capital investor Ideiasnet, says, TLLC is short for tax, labour and legal contingencies – historic, conflicting but sleeping imposts, imposed by municipal, state and federal agencies. They can decimate value in the sale of companies. However, they usually emerge only in the due diligence process, when it is too late.

She provides some examples of why TLLCs may detonate in the face of vendor and acquirer:

- The use of labour that does not comply with the applicable law, whether local, state or federal.
- Application of incorrect, lower tax regimes without sound legal grounding.
- Failure to control lawsuits and to make appropriate provision for them.

In themselves, these may seem innocent mistakes. However, as De Haan says, based on a quarter century’s experience: “Penalties and compound

interest on unpaid burdens are high in Brazil, so a small mistake today can turn into a significant contingency five years later if it’s not caught quickly.”

When they are identified (usually when the company is up for sale), arguments in respect of the liabilities can lead to delays of two to five years, with equity funds stuck in escrow accounts until the issue has been settled. Although Brazil’s biggest law firms and the big four accounting firms have simplified the due diligence process and authorities have taken steps to simplify procedures, TLLCs can still present serious obstacles in a sale.

The solution adopted by Ideiasnet was to assume the role of risk management and governance in its portfolio companies, often against the wishes of the entrepreneur. It now runs an internal audit team whose sole role is to reduce contingency risk within the portfolio by checking for TLLCs that could blow up in the company’s face.

De Haan’s advice is straightforward: “It’s imperative that the governance and risk management discussion begins before any investment [takes place]. Today, hands-off venture capital investing no longer works in Brazil. To preserve value, venture capital firms must become actively engaged in the governance, compliance, and risk management of the companies in which they invest.”

## TWO LONG-TERM THREATS

Of all the countries in Latin America, two in particular worry the International Monetary Fund (IMF), namely Argentina and Venezuela.

To take the first, under president Cristina Fernández de Kirchner, Argentina presents

growing exchange-rate risks in the wake of the depreciation of the official rate in January.

Exchange rate risk can wipe out a company. “Many of the multinationals we insure are not so concerned with the failure of individual buyers”, explains Neil

Ross, AIG’s regional manager EMEA trade credit. “It’s the country event that can seriously affect their balance sheet. A sudden currency devaluation in a key market could lead to a wide-scale default as importers struggle to raise additional

funds to meet higher foreign exchange conversion.”

Furthermore, as he adds, the risk of such an event rises in direct proportion to the increase in the size and number of trading corridors.

Argentina also has other problems. Output has stagnated and will likely decline. As has been shown, its campaign against corruption stalled before it even started: see Winds of change, on p26.

The IMF estimates, however, that, despite the country

accounting for more than 10% of Latin America's total gross domestic product, Argentina's long-running economic mismanagement will have only “limited real-sector spillovers to most neighbours, except for Uruguay”. Similarly, financial market spillovers should be largely contained.

Venezuela is another matter. As the country spirals out of control, fears are mounting that it will contaminate a large section of Latin America.

For instance, exchange rate

risk. In the so-called parallel – or black – markets, the bolivar/greenback rate has exploded to eight to 13 times higher than the official rate.

Moreover, the economy's headlong retreat in the wake of the failure of the economic experiment of the late president Hugo Chávez forms a mounting threat. “Economic distress in Venezuela could pose spillover risks to some countries in the region, mostly in Central America and the Caribbean”, predicts the IMF.

## THE MYTH OF LOW-COST LOCATIONS

Any multinational planning to establish a foothold in Latin America on the assumption that it will be able to produce goods more cheaply there may have to rethink its strategy. As Harold Sirkin, senior partner at the Boston Consulting Group (BCG) explains, the bus has already left the depot. “Many companies are making manufacturing investment decisions on the basis of a decades-old world view that is sorely out of date,” he said in April in the wake of a new study that debunks the low-wage myth.

As BCG's latest cost-competitiveness index of the 25 biggest-exporting countries shows, many emerging markets have lost the low-cost advantage they had a decade ago. For instance, Brazil has become one of the most expensive countries in the world for manufacturing, as measured by wages, productivity growth, energy costs and exchange rates. (It may shock multinational chief executives that under these benchmarks China's manufacturing-cost advantage over the US has shrunk to less than 5%.)

The good news is that there are significant regional variations across Latin America, as indeed

across Asia. In Mexico, for example, manufacturing costs have fallen below those of China.

As AIG's regional manager EMEA trade credit Neil Ross explains, this could be positive for multinationals that are unsure about China.

“Many companies are reassessing their low-cost manufacturing in China, and Mexico is one country to benefit. Wages are now comparable, but Mexico has the added advantage of lower transportation costs and shorter delivery times to the US.”

Echoing BCG's Sirkin, he points out that in the case of complex or critical goods and components, cost often takes second place to reliability or reputation. “Vulnerability often results from being too dependent on key, smaller supplies,” he adds.

“We've seen a growing demand for supply chain finance that ensures these suppliers continue to receive working capital.”

Taken as a whole, BCG's figures illustrate the importance of thinking far ahead. “When companies build new manufacturing capacity, they are typically placing bets for 25 years or more,” adds Sirkin.

“They must carefully consider how relative cost structures have changed and how they are likely to evolve in the future.”

## Dangerous borders

The terrorist attack on the Algerian In Amenas gas plant served as a reminder to multinationals investing in North Africa that the region is still not safe

**J**UST WHEN THE SECURITY SITUATION was supposedly improving in North Africa, the deadly 2013 al-Qaeda-linked attack on the Tigantourine gas facility in In Amenas, Algeria, served as a reminder of the risks of doing business in the country's remoter regions.

After the Algerian government had mounted a widely condemned operation to rescue about 800 hostages held at the plant, at least 39 foreign workers were killed, out of the 107 who had been originally captured.

Understandably, the attack shocked all three partners in the Tigantourine facility: Algerian state oil company Sonatrach, BP and Norway's Statoil. In the wake of the atrocities many multinationals, including the last two above, ago-

nised over continuing investment in Algeria and other high-risk countries in the MENA region. As a recent World Bank report notes, "the crisis serves as a grim reminder that investing in politically unstable countries is risky".

### Porous borders

NYA International, a crisis prevention and response consultancy, would agree, at least in relation to parts of North Africa. "Despite an increase in security awareness and application of measures post-In Amenas, the risk of terrorism in Algeria remains moderate to high, particularly along the borders with Mauritania, Mali, Niger and Libya," it points out in its latest report. "AQIM [an Al-Qaeda linked group] and other jihadist groups operate across these porous borders and pose a significant kidnapping risk to foreign nationals in the more isolated southern and eastern border regions and the northeast Kabylie region."

The attack led all the main parties to review their risk management methodology: see Lessons from Tigantourine, on p36.



The attack also fuelled the debate about the degree to which political uncertainty hampers investments, if at all.

Despite the obvious dangers many multinationals, and especially energy companies, operate almost as a matter of course in high-risk regions. Late last year, Italy's Eni SpA announced a major investment in Egypt's oil and natural gas sector, while Kazakh oil company Kaz-MunaiGaz has committed to a long-term

involvement in Libya, whose political situation is deteriorating.

However, are companies really deterred from pouring resources and committing personnel into unstable regions? The academic literature on this trillion-dollar issue is contradictory. "Empirical studies on the effect of political instability of foreign direct investment (FDI) have yielded distinctly divergent results," the World Bank paper notes. "Some have documented a

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*‘Despite an increase in security awareness and application of measures post-In Amenas, the risk of terrorism in Algeria remains moderate to high’*

**NYA International report**

strong negative relationship between FDI and political turmoil, while others have found no significant effects and concluded that political unrest and institutional quality are not important determinants of investment flows.”

As several North African nations struggle to restore an investment-friendly environment in the wake of the Arab Spring, the issue will be a hot topic in the boardrooms of multinationals for the foreseeable future. It certainly is the case at Spain’s Repsol group. As chief executive Antonio Brufau Niubó told shareholders recently, the oil giant is proceeding with caution in Libya. “Our company has demonstrated its ability to manage a complicated context characterised by the conflict in Libya and its general economic deterioration”.

**Porous borders**

Some of the bolder foreign companies have profited from instability such as diamond miners in Angola during its civil war. They did so, the World Bank points out, because they were able to negotiate lower licensing costs – hence leading to higher profits – because the Angolan authorities found themselves in a weak bargaining position. These companies have since established a



foothold in Angola, although at some risk to personnel. As the World Bank report adds, the risks were seen to be justified by the higher rewards gained by first-mover advantages.

Judging by the World Bank’s definition of political instability, a number of countries in North and Sub-Saharan Africa would qualify. The definition encompasses any country with unstable

## CONSEQUENCES OF REGIME CHANGE

The arrival of a new government in emerging markets can rewrite the commercial situation overnight.

Citing political upheavals in Ukraine, Venezuela, certain African nations as well as simmering disturbances in Turkey and the Sino-Japanese border, Marsh's Chris Lay, head of business development for the international division, observes: "Regime change can bring a different perspective in the way companies do business in a country."

For instance, sweeping, politically motivated changes are often made to regulations that may severely affect costs. That is particularly true in the case of protectionist governments that, although not confiscating assets, may otherwise interfere in their disposal or in other ways. For instance, the transfer or repatriation of assets may become a contentious issue when the political climate turns hostile. Inevitably, the safety of personnel becomes paramount.

In an unpredictable commercial environment, the integrity of joint venture arrangements may be compromised. That is why multinationals are not entering politically volatile territories with their eyes shut – "we find that many companies want to take protection around these contracts," adds Lay.



regimes or governments – that is, ranked by political, religious and ethnic violence. Another warning sign is a business environment characterised by opaque practices in contracts. Finally, erratic enforcement of law and order by a weak judiciary is another indicator.

Obviously, political stability is desirable. As International Monetary Fund president Christine Lagarde said in

Morocco in mid-May: "The good news is that the economic situation in the Arab transition countries is looking up – higher exports, higher public investment and signs that private investment will rise. Countries such as Morocco are reaping the fruits of their efforts by diversifying and spurring exports and foreign investment – especially in high value-added areas such as cars, aeronautics, and electronics".

As Lagarde added, "none of this is accidental". **SR**



Thomson Reuters

## Lessons from Tigantourine

**R**EELING FROM THE LOSS OF five employees, a shocked Statoil overhauled its risk management procedures following the Tigantourine terrorist attack in what amounts to a lesson to all multinationals operating in unstable MENA countries.

As the rapid-response team of crisis prevention and response consultancy

NYA International points out, there are plenty. “Between the 2003 invasion of Iraq, the 2011 Arab Spring and the ongoing conflict in Syria, large parts of the region have been affected by political instability, sectarian conflict, the significant displacement of people and increased terrorist and insurgent activity in weakened states,” notes its latest report.

“Both politically and financially motivated kidnappings by [terrorist] groups pose a high risk to local and foreign nationals working or travelling in much of the region, particularly in Syria, Iraq and Yemen. Continued political instability has ensured that political evacuation and the repatriation of staff remains a real concern for businesses operating in the Middle East.”

Iraq remains the hot spot, with 59 cases of kidnap and ransom recorded between 2013-14 so far. Other high-risk countries include Lebanon and Turkey.

Statistics such as these prompted Statoil to implement several measures following its own investigation into Tigantourine:

- Improve early-warning techniques: security measures at the site were deemed inadequate and the Algerian military “were not able to detect or prevent the attackers from reaching the site”.
- Do not rely on local armed forces: although none of the contractors could have prevented the attack, they should not have relied as much as they did on Algerian military protection.

‘Between the 2003 invasion of Iraq, the 2011 Arab Spring and the ongoing conflict in Syria, large parts of the region have been affected by political instability, sectarian conflict, the significant displacement of people and increased terrorist and insurgent activity in weakened states’

#### **NYA International report**

- Appoint a dedicated team: a special executive unit was established to implement the 19 security-related recommendations outlined in the report throughout Statoil sites.
- Prepare for the worst: Statoil now holds emergency response drills and runs training courses in travel, security and hostage survival.
- Talk everything through: priority has been given to the regular meetings of Statoil’s major accident forum, an internal, company-wide group that meets to discuss major accidents.
- A problem shared...: Statoil, joint venture partners and other energy firms are now working together on joint security projects. **SR**

# Crimes against commerce

Organised crime against businesses is becoming more prevalent in the MENA region and companies should invest more time and money into preventive measures

IN THE GULF STATES, THERE IS A discrepancy between what governments and some official outside agencies are saying about fraud and corruption and what is actually happening.

As the latest fraud report from risk consultant Kroll notes, the Gulf has the unhappy record in the MENA region as a source of many kinds of crimes against business in a disappointing turnaround from previous trends. It notes that 35% of respondents reported incidents of information theft; 30% fraud by vendors or procurers along the supply chain; 28% market collusion; and

24% conflict of interest among management. One of the few types of fraud to which companies feel they are not exposed is money laundering.

To take only the frequency of conflict of interest, it means that managers in no less than one quarter of respondent companies were actually working against the interests of their employers. Faced with such a multitude of threats, it is unsurprising that more and more Gulf-based companies are investing in information security and financial controls.

However, according to Kroll, this may not be sufficient. The company suggests multinationals should be investing more time and money into staff training and – normally an effective preventive measure – whistleblower hotlines.

### Cost of fraud

In the meantime, the average cost of fraud in the Gulf, measured in financial terms alone, is said to be running at 1.6% of corporate revenues.

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*‘We’ve seen techniques that are used to set up companies that pass normal credit-vetting procedures, only to disappear in the future and leave no trace of the goods supplied on credit terms’*

Neil Ross, AIG

## MODEL MOROCCO

Every year, Morocco improves its business climate. Last year, for instance, it eliminated the minimum capital requirement for limited liability companies, and already this year, it has reduced company registration fees. The kingdom has thus become something of a haven for multinationals. Those that have recently selected Morocco as their foothold in the region include Renault, which opened a plant in Tangier in 2012, Bombardier, which will invest \$200m in the next eight years, and French aeronautical group Ratier-Figeac. In April, French pharmaceutical firm Sanofi announced a €20m (\$27.3m) logistics hub in Casablanca.

Foreign control does not seem to be a problem either. Late last year, US Kraft Foods took full control of Bimo, the kingdom's biggest biscuit manufacturer in a \$151m transaction.

As the commercial environment grows more attractive, Morocco has become a honey pot for **foreign direct investment** (FDI). In 2012, the latest available figures, FDI flows totalled \$2.84bn. According to the UN's world investment report, Morocco is the region's top recipient of **foreign direct investment** FDI. Worldwide, it ranks 39th out of 189 countries in ease of doing business, only two places behind the region's pace-setting United Arab Emirates.

Multinationals, especially those from France, are having a beneficial influence in workplace practices. At the behest of Jean-Marc Berlioz, responsible for compliance with group-wide laws, regulations and ethical principles at Renault, France's biggest automobile manufacturer is one of several French multinationals leading an overdue campaign to reduce accidents. More than half of Moroccan companies fail to meet official safety standards. But now, working with the National Institute for Working Conditions, risk managers are under pressure to hire full-time doctors among other measures. (In France, chief executives bear a legal liability for the death or injury of employees.)

Although not confined to the MENA region, organised crime against business is becoming more sophisticated and threatening. For instance, trade financing is usually an attractive method of funding because it is short term, self-liquidating and spread over several parties. However, as Neil Ross, AIG's regional manager EMEA trade credit, warns: "We've seen techniques that are used to set up companies that pass normal credit-vetting procedures, only to disappear in the future and leave no trace of the goods supplied on credit terms." One such fraud to watch for is 'fresh-air invoicing' by the client, which is often difficult to track because of the high volume of transactions being financed.

The lesson, Ross says, is to use extra checks rather than relying solely on publicly available information. Working closely with funders and clients, AIG has developed a technology that provides full visibility and tracking of the receivable assets on their sometimes perilous journey. **SR**

## Siren song

The attractions may be many, but so are the pitfalls awaiting the unwary

**W**ITHOUT THE SIREN SONG OF high profits in Sub-Saharan Africa, few multinationals would face the risks posed by some of the fastest-growing but most volatile countries. Behind the headlines of runaway growth – the International Monetary Fund (IMF) expects collective GDP in the region to increase by about 6% in 2014 and the medium-term future – lurk multiple threats that may catch even the most experienced companies off guard.

When resources giant Rio Tinto had to book a \$14bn impairment last year, forcing chief executive Tom Albanese to resign, a main contributing factor was the creaking rail infrastructure of Mozambique. At Albanese's direction Rio Tinto had bought heavily into coal reserves there, but was unable to open up a transport corridor that could justify the investment.

As risk consultancy Kroll's Alexander Booth, senior director in the Middle East and Africa, warns, the incident illustrates why prospective entrants to this deeply complex region need to look before they leap: "Although there is potentially tremendous upside to doing business in Africa, many hidden risks are not always identified by traditional legal and financial due diligence."

### Peculiar risks

In summary, western methods of analysis may not capture all the operating pitfalls – and the infrastructure boom is a case in point. Although the region will require about \$100bn a year in private-sector investment between now and 2020 in the form of transport, power and other essential projects, these are long-term projects that subject contractors to a peculiarly Sub-Saharan array of risks.

As Kroll points out, Africa has recently been involved various infrastructure-related cases that run the gamut. They include regulatory and



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*‘Although there is potentially tremendous upside to doing business in Africa, many hidden risks are not always identified by traditional legal and financial due diligence’*

**Alexander Booth**, Kroll

compliance breaches (important because they usually lead to deteriorating relationships with governments and sub-contractors), conflicts of interest by management, clashes over different ways of doing business, influence of organised crime, the existence of previously undisclosed interests, political instability in a region notorious for fragile governments and contested elections, and straight fraud by vendors and suppliers: see Frightening fraud, on p42. In other words, take your pick.

What is the solution? Apart from conducting rigorous profiling of prospective partners or acquisitions to identify any vulnerabilities that could return to haunt the relationship, companies should, as a matter of course, adopt a procedure rarely required in the more politically stable environment of Europe or North America, namely establishing who is in charge.

Booth explains: “It is only by fully understanding where power lies, how it is exercised and who might bring influence to bear on a partner or acquisition target that investors can accurately gauge this risk.”

Thus, Africa remains a promising investment destination, provided companies step carefully. Kroll warns: “More than ever, companies and investors that succeed in Africa will likely be those that have invested heavily in understanding the local political environment, background screening of third parties, training staff, and carefully implementing risk management strategies.”

As a first step, risk consultants suggest that companies engage strongly with host governments and non-governmental organisations. It is the most effective protection if they are on your side.

### **Justified danger**

The learning curve will be steep, but the potential rewards are high. Oil-exporting countries such as Nigeria are expected to show real GDP growth of 7.7% this year, according to the IMF. Even middle-income nations such as South Africa are slated for a collective 3.6% GDP growth and the low-income nations such as Côte d’Ivoire are forecast to expand by 6.9%.

For many multinationals, those numbers justify the dangers. **SR**

# Frightening fraud

Companies operating in Africa can expect to deal with corruption at all levels, which will affect their profits

**A**NY COMPANY OPERATING IN Africa should automatically cut 2.4% off its anticipated annual revenues. This figure is the average loss across the region for fraud, according to the latest report and survey by risk consultancy Kroll.

Although companies also suffer from more sophisticated crimes such as internal financial misappropriation and theft of intellectual property, most of the losses come in the old-fashioned form of burglary of physical assets and in outright corruption, Africa's abiding condition.

The numbers for the former are 47% and 30% for the latter, by far the highest for any region. Overall, 77 of surveyed companies say they have been affected

by one or both. Worse, in general, the numbers are heading in the wrong direction, some at disturbing speed.

For instance, vendor and procurement fraud soared by 250% – from 9% to 23% in a year. In one of the few bright spots in a dark scene, information theft halved last year, compared to 2012.

### Cause for concern

Particularly alarming in a region that has been under pressure to tighten up its governmental procedures, elected or appointed officials were involved in about a third of cases.

As the latest Kroll fraud report summarises, "corruption remains a deeply rooted problem in Africa". **SR**



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# People at risk

Oil-rich Nigeria remains a high-risk country for foreign nationals, with kidnappings and armed attacks happening commonly

**T**HE TIMING WAS OBVIOUSLY deliberate. A week after a meeting of Africa's World Economic Forum at the Nigerian capital Abuja in early May, a car bomb killed 19 people on the outskirts of the city. The atrocity followed an attack in the same area, on 14 April, by terrorist group Boko Haram that had left at least 70 dead.

Inevitably, the attacks raised concerns about the region. "Africa is now our highest-risk location", explains Jon Gregory, head of AIG's kidnap and ransom division. "Nigeria stands in the top three locations for kidnap now. The influence of Islamic affiliates such as Boko Haram and [militant group] Ansaru also changes the dynamic of abductions."

The violence presents a dilemma to foreign investors. Canada's department of foreign affairs, for instance, warns that most of the country should be regarded as being off limits for foreigners, with the exception of certain areas of Abuja, Calabar and Lagos.

Even there, a high degree of caution is advised. "The security situation throughout the country is unpredictable and there is a significant risk of terrorism, crime, inter-communal clashes, armed attacks and kidnappings," notes the department.

If Nigeria is not getting safer, neither is the region in general: see Africa's test case, on p46.

According to the latest, six-monthly index of conflict and political violence issued by Maplecroft in May, no less than five of the 16 countries rated as "extreme risk" are located in Africa. For the record, they are second-ranked Central African Republic outranking even Iraq, secessionist South Sudan (fourth) one place ahead of Afghanistan, Somalia (sixth), the Democratic Republic of Congo (DRC) (seventh) and Sudan (ninth).

### Lack of stability

"Despite sustained economic growth, Sub-Saharan Africa is undergoing serious challenges to its stability, presenting multiple risks to businesses", judges NYA International, a crisis prevention and response consultancy.

"Certain countries continue to struggle with chronic insecurity. Somalia remains without effective government, while South Sudan and the Central African Republic are teetering on the brink of civil war, destabilising the impoverished central region."

Indeed, Maplecroft's researchers are pessimistic about the future of some of these countries. They are by no means certain, for instance, that the DRC can even survive as a nation given the tensions spreading across its territories. As for the other countries, 14 coups or attempted coups have taken place in Sub-Saharan Africa in the past three years.

### Protecting assets and personnel

The implications for risk managers are profound. "Overall, we are seeing more concern over much of Africa. In the past, risk managers would have worried about protests or civil wars and not terrorism, but that perception is changing," explains Dr Elizabeth Stephens, JLT Specialty's head of political risk and analysis. In the absence of effective official measures to deal with terrorism, companies were moving to protect assets as well as personnel.

If an employee is kidnapped, risk managers may be involved in complex political issues. "[An event such as this] necessarily involves the sanctions departments within the US, the UN and the EU and this carries responsibilities that clients and insurers – carriers and brokers – must respect", adds AIG's Gregory: see Collision course, on p47.

How should companies respond to the risks to life and limb? A convoy of armoured Hummers should not be hired, warn security specialists such as

Ed Daly, watch operations director of security specialist iJet. This only attracts attention. The best preparation is a "pre-trip, full-spectrum deployment briefing" that covers all the likely risks and, most importantly, how to deal with them. "You can go almost anywhere if you take the right precautions."

Whatever risk rating a country attracts, its nature and degree may vary between cities. For instance Nigeria's most populous city, Lagos, is ranked as a "steady four" by iJet's calculations because of a rising likelihood of kidnapping, but Abuja rates a "high three to four" because of lower-end criminal activity.

And yet, most of the problems experienced by personnel in even the more dangerous locations are what risk specialists describe as "high-frequency, low impact", such as delays in travel, loss of commercially sensitive data and misdirected baggage rather than the "low-frequency, high-impact" events such as sudden illness, car crashes, natural disasters and kidnapping.

Even so, caution is advised. **SR**

*'Despite sustained economic growth, Sub-Saharan Africa is undergoing serious challenges to its stability, presenting multiple risks to businesses'*

**NYA International**



### Africa's test case

Firms working in Nigeria will need to choose the right partner to show them the ropes

**B**ECAUSE OF ITS PERSISTENT problems, Nigeria has become a test case in Africa. The deteriorating security issue adds to a list of impediments for foreign investors.

As consultancy KPMG points out in its latest report on this teeming nation of 168 million inhabitants, the commercial threats include unreliable power supply, poor infrastructure (roads, rails and port are run-down), slow pace of reform, restrictive trade policies, an inconsistent regulatory environment, a slow and largely ineffective judicial system, pervasive corruption and growing insecurity.

However, the country remains the region's biggest recipient of foreign direct investment.

As JLT Specialty's Dr Elizabeth Stephens explains in a note of caution: "Boko Haram's activity has had a relatively limited impact so far on business

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*'Companies are seeking new markets, but they do not always understand the additional challenges'*

**Neil Ross, AIG**

and foreign direct investment because it has been confined to the north-east and has not affected Lagos or the oil interests in the south".

#### Anti-bribery programmes

Echoing risk consultancy Kroll's advisers, KPMG suggests: "Potential investors should understand the corruption risk involved in the Nigerian business environment and develop anti-bribery compliance programmes that involve local staff and Nigerian partners."



Further, it is best to travel with a savvy friend with on-the-ground experience. “Companies are seeking new markets, but they do not always understand the additional challenges”, explains Neil Ross, AIG’s regional manager EMEA trade credit.

“We’ve seen many exporting companies appoint local partners to guide them through the cultural, trading and regulatory differences of these new markets. But choosing the right one can be a hit-and-miss affair.”

However conscientiously a foreign company does its country due diligence in Nigeria or in any other Sub-Saharan nation, most risk managers say they are ready to pull out if the situation becomes too dangerous or difficult. The trigger for an exit would most likely be a terrorist attack on an important commercial centre. **SR**

Human assets are in the firing line in Africa, as opposing forces clash, argues Jon Gregory, AIG’s head of kidnap and ransom division. “The collision of foreign investment and fundamentalism combined with poor infrastructure and equally inadequate law and order is a historical recipe for trouble and human assets are in the firing line,” he says.

In this potentially explosive confrontation, insurance has a crucial – and creative – role to play. “We cherish the value of insurance and the transference of financial risk it provides in these circumstances,” adds Gregory.

“Also, the risk engineering – and the prevention – that our consultants provide to clients is of equal value. We would rather help a client avoid a loss in the first place, than try and help them manage one when it has occurred.”

# Plugging the gaps in the supply chain

International lenders are now increasingly offering supply chain finance

**A**S MULTINATIONALS GRAPPLE with the complexities of maintaining the financial integrity of supply chains in an explosion of trade with emerging markets such as Africa with its challenging and often contradictory payment regulations, an unexpected friend is emerging. They are called banks.

Help is certainly overdue. As David Noble, group chief executive of UK's Chartered Institute of Purchasing & Supply, observed in May, on the release of the institute's first quarterly index of supply-chain risk: "With political instability across the developing world, it is vital that businesses and economies recognise the risks to their supply chains and make the appropriate provisions before it is too late. Supply chains have a critical role to play in operational profitability and economic stability, but global supply chains have scarcely been at greater risk than today."

The lowest-cost supply chain should not be the main factor and others should enter a company's calculations, suggests Neil Ross, AIG's regional manager for EMEA trade credit. "Cost often takes second place to reliability or reputation when it comes to more complex or critical goods and components. Vul-

nerability can result from too great a dependence on key smaller supplies."

Too many multinational managers overestimate the value of cutting costs, argues Guenter Droese, chairman of the European Captive and Reinsurance Owners' Association, citing an over-reliance on just-in-time warehousing and other supposed gains. The result is breakdowns in overstretched supply chains because of natural catastrophes, strikes and other events that may be predictable. "These kinds of entrepreneurial decisions are always risk decisions and they can increase or reduce profits," he says.

### Supply chain finance

The growing realisation of the dangers inherent in complex supply lines is a significant reason why AIG has experienced an increasing demand for supply chain finance. Its officers have been busy channelling financial resources to key suppliers so they have continuous access to vital working capital.

Traditional lenders have also jumped into the breach as supply chain finance is stretched to breaking point. A major anxiety for chief financial officers is the rapid increase in regulatory changes across the globe that have inevitably made transactions more complex and finely balanced. The phenomenon has been dubbed "regulation fragmentation".

A solution could be at hand, though, namely a product known as supply chain finance (SCF) that is offered by a growing number of international lend-

ers with specific regional expertise. As Venkatesh Somanathan, director – regional trade finance product manager at Deutsche Bank, points out, lenders have devised highly integrated SCF platforms that move the entire supply chain fully online, for buyer and seller.

“This has enhanced automation and transformed the transaction process”, he explains. “The increased transparency throughout the supply chain is particularly valuable to corporates exploring unfamiliar trading routes, where transaction requirements are diverse and effective risk mitigation is paramount,” he suggests.

### Increased efficiency

In practice, SCF aims to deliver benefits along every link in the supply chain. For buyers, the system can, for instance, extend the number of days payable outstanding. For suppliers, it provides an injection of liquidity. Overall, the goal is to enhance transparency, provide better payment security, reduce costs and improve cash flow. As all corporate treasurers know, all these serve to reduce risk.

Further, lenders claim SCF makes financing more efficient. “It facilitates the rapid reconciliation of purchase orders through electronic bill of lading documents”, adds Somanathan. “Such platforms also bring greater clarity.”

Thus, banks with on-the-ground expertise should be able to guide companies through the red tape of unfamiliar

trade corridors. Almost all African countries apply different systems, as do those in Asia and elsewhere. For instance, India has specific rules on payments and foreign exchange, as well as onerous reporting requirements for export financing, while China expects exporters and banks to file regulatory reports online through a portal and a customs registration form.

However, Africa, in particular, is infamous for running creaking payment methods that weaken the financing of the supply chain. Although banks are becoming involved more than they did in the wake of the financial crisis, European institutions in particular are more likely to provide finance only to the strongest, lowest-risk multinationals.



*‘Cost often takes second place to reliability or reputation when it comes to more complex or critical goods and components. Vulnerability can result from too great a dependence on key smaller supplies’*

**Neil Ross, AIG**

Here, insurance companies are plugging the gaps. As AIG’s Ross explains: “Insurance companies can play a bigger role as effective, risk-sharing partners for banks. We’ve seen a rising demand from lenders for credit insurance support.”

In short, insurance in the most practical and helpful of ways. **SR**



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