Ernst & Young
Quality In Everything We Do

Risk Management in Emerging Markets

Contents

Introduction

> **Note about reporting**
>
> **Analysis of the findings from these interviews suggested that there is a rich and useful contrast to be made between the views of companies in emerging and developed markets, and there are lessons to be learned from each side. Where appropriate, we have shown the contrasting perspectives throughout the report.**
>
> **In most questions throughout the study, respondents were asked to speak about actions and issues connected to specific relationships in a specific country, and not 'emerging markets' in general. Our interest lies in case studies rather than anecdote.**

With this global study, we are continuing the Ernst & Young global research into business risk and risk management practices. Our recent studies into strategic business risk have found that the emerging markets are a dominant strategic business risk for most sectors of the global economy. Moreover, our earlier research into company controls found that companies themselves were identifying international market entry as an area of weakness.

This study has therefore been undertaken to explore risk management in emerging markets. We were not interested in determining whether individual markets are more or less risky – that is inherent in emerging markets given the scale and pace of change and their current level of economic development. Experience tells us the conditions that make them riskier than mature markets will continue to apply for some time, hence, in an increasingly interconnected global economy, managing risk in emerging markets is and will continue to be an essential competence for multinational organizations.

The objective of this study is to explore how companies from developed markets are managing risks as they invest and operate in emerging markets and to compare and contrast the view from both developed and emerging market operations. Our goal is also to build a picture of best or leading practice, to see how companies are successfully managing risk in order that others can leverage their work.

We have distinguished between those companies based in the developed economies and who have operations around the world – Developed Market (DM), from those who are based in the emerging market itself – Emerging Market (EM). Stakeholders of major corporations expect that they have robust risk management processes in place – the view from the emerging market subsidiaries and partners gives an interesting perspective on how accurate this expectation currently is.

> **What is an emerging market?**
>
> **The term 'emerging markets' is generally used to describe the group of low-to-middle-income countries pursuing substantial political and economic reform and a more complete integration into the global economy. There is no precise accepted definition, although the search for one can make for useful and thought-provoking reading. The following characteristics are commonly associated with these markets:**
>
> - **Low-to-middle-income on World Bank income per head benchmark**
> - **Recent or relatively recent economic liberalization, reduction in the state's role in the economy, privatization of previously state-owned companies, removal of foreign exchange controls and obstacles to foreign investment**
> - **Recent liberalization of the political system and a move towards greater participation in the political process**
> - **Scale and dynamics of change.**
>
> **This report focuses on five markets in particular: Brazil, China, India, Russia and Turkey. At least for the near future, these can all be considered as emerging markets.**

Brazil, China, India, Russia and Turkey make up 43% or 2.89 billion of the world's population. Compared to a growing 13% (US$6 trillion) of the global GDP according to the World Bank.

- Brazil: population 187 million, global GDP proportion 2%
- China: 1.3 billion, GDP 6%
- India: 1.1 billion, GDP 2%
- Russia: 142 million, GDP 2%
- Turkey: 75 million, GDP 1%

Source: 2006 UN and World Bank data.

Our approach

This is a major survey; we conducted over 900 interviews around the world. The primary emerging markets in our study are Brazil, China, India, Russia and Turkey. Focusing on these countries provided sufficiently specific data and commentary to build a robust view on how risk is actually being managed in these markets.

We present the views of senior business and financial executives who are responsible for risk management, from either multinational headquarters or the emerging markets.

In companion reports, to be released later this year, we examine in more detail the findings in connection with the individual market countries addressed in the study.

We also believe that risk and appropriate risk management vary significantly by sector. Therefore, we are also looking at this issue from an industry perspective, and will be publishing in-depth industry reports for many of the major sectors of the global economy.

This study – as with all the projects in the Ernst & Young risk program to date – is intended to further the discussion that is taking place within many companies around the world as to how they manage risk and achieve the essential balance between the risk taking inherent in a competitive market and the risk management demanded by good practice and regulations. We welcome contributions to this debate.

Risk from two points of view

To better understand the management challenge, we wanted to look at risk management from both perspectives. So we set out to find headquarter companies with significant links to emerging markets and we spoke to people in emerging market companies with relationships with developed markets.

- We interviewed 435 large multinational companies with headquarters in 12 developed market countries
  - These companies had a total of 1,342 links with emerging market companies
  - 272 subsidiaries, 127 joint ventures, 235 third party intermediaries and 382 sizeable customers or suppliers
  - We examined 557 of these relationships in detail.
- We interviewed 501 companies in emerging markets
  - 220 of these were subsidiaries of companies in the relevant developed market countries
  - 190 were with joint ventures, intermediaries and sizeable customers or suppliers.

Survey findings

> **A significant number of companies who invest and operate in these markets are still working out the most effective approaches to risk management.**

- **The main goal in emerging markets is growth.** Just under two thirds of both developed and emerging market companies identify their key objective for being there as growth and the market potential of the country itself. This is a reflection of the sheer scale and growing economic power of these economies. This finding confirms the hypothesis that companies have moved considerably from the traditional view that the primary objective of investment in emerging markets is cost saving. Only 14% of respondents say that cost savings and increased efficiency are the main reason behind the investment. Organic growth is the most common approach to achieving these goals in Brazil, Russia and China, with partnerships and alliances the most common in India and Turkey.
- **Emerging markets continue to be dynamic.** Our findings show that while many companies have been in these key emerging markets for some time, more are continuing to move into them. 38% of the DM companies have been in these relationships for longer than ten years. However, a further 40% have had a significant relationship in the emerging market for less than five years. Given that it takes considerable time to establish operations and learn to operate effectively in these markets, the implication is that a significant number of companies are still working out the most effective approaches to risk management.
- **Risk priorities differ by location.** DM companies place a significantly greater emphasis on political, operational and supply chain risk. EM companies, in turn, are significantly more likely to focus on market and competitive risk, currency, workforce, pricing and tax risk.
- **And by relationship or status.** DM companies focus more on trade credit and supply chain risk with regard to their third party relationships, and they focus more on political, compliance and market risk as they apply to subsidiaries and joint ventures. Companies (non-subsidiaries) located in emerging markets prioritize market and currency risk.

In terms of the **overall risk management approach**, there is evidence of leading practice, but no clear framework, and overall room for improvement.

- **Boards are focusing on risk in emerging markets.** There is consensus across DM and EM companies that Boards are giving enough attention to risk in these markets. Given the scale of the market opportunity and the enhanced role of the Board, this is not surprising.
- **But this does not translate to consistent risk strategies.** Only 41% of DM companies have a risk strategy for emerging markets, with more than half (56%) saying that no strategy is in place. 51% of the subsidiaries themselves identify a specific emerging market strategy. Given that good risk management requires connecting risk processes and management processes with the strategic and business objectives of the company, we believe that there is considerable work to be done in this area.

- Surprisingly to us, given the recent focus on risk management and controls within the US, only 25% of North American companies have a risk management strategy that specifically covers emerging markets. The proportion is considerably higher in Europe at 46%, and higher still in the Far East at 52%, but all regions have considerable opportunity to improve.

- **Developed and emerging market companies differ in their view on quality of risk communications.** DM companies are significantly less likely to agree that the information provided by local country management is sufficient. While 71% of EM subsidiaries feel that they provide sufficiently regular and robust information on risk, only 44% of the parent companies would say the same. The implications of this discrepancy are the continued need for clear two-way communications on risk in an aligned way throughout the organization, both in terms of emerging market operations providing sufficient detail, and headquarters' willingness to accept the truth.

- **And on the quality of internal audit.** DM companies have less confidence in the quality of the internal audit testing of their subsidiaries than do EM subsidiaries. This raises the question of whether DM companies internal audit functions are in a position to adequately test subsidiary controls, whether it is an issue of the skills of the local internal audit team, or whether centralized resources visiting an emerging market are in a position to give an accurate assessment of the controls in place. Companies located in EM countries have more confidence in the quality of internal audit testing.

  On the two issues above, companies in the Far East are significantly more likely to be satisfied with both the quality of local risk reporting and the quality of internal audit than are those in Europe or North America.

- **There is leading practice.** EM subsidiaries with a documented risk management strategy that specifically covers both the parent company and the local EM subsidiary appear to be managing risk more effectively in a number of other ways, including the quality of communications, internal audit, and parent company focus.

- **Risks are managed to a greater extent in the local market.** Across all types of relationships, with very few exceptions for individual risks, the emerging market operation undertakes higher levels of active management across the range of risks. Those closest to the risks are able to assess what needs to be done, and take steps to reduce exposure, but they are least well-placed to compare performance with other markets and develop benchmark guidance.

- **However, responsibility for most risks is shared across developed and emerging markets.** The findings show that only a small number of risks, including workforce, property, security and data protection are managed predominantly in the local market. Apart from these, the data does not suggest a natural 'home' for different types of risks. All other risks, to a greater or lesser degree, are mixed or shared responsibility.
  - Parent companies are the most active in relation to their subsidiaries. This is not surprising, since they are managing the risks faced by a part of their global organization.
  - For joint ventures, fraud and supply chain risk are more likely to be a shared responsibility.
  - Developed market companies are less active towards risks facing third parties. Needing to work with partners to move forward and do business, they are exposed to considerable risk that they cannot control.

"You have to form strong relationships with the suppliers of emerging markets. You need to have an agent that is trusted by the emerging markets and by yourself."

CFO, Canada

- **Political risk – of adverse political change – cannot be 'managed' by companies themselves.** Companies are proactively monitoring and preparing themselves for the consequences of potential change: only a small number of large organizations appear to have a significant voice in the local market.

Risk management lessons learned

1. **Understand the individual market**
2. **Use local expertise**
3. **Find a partner**
4. **Understand local laws**
5. **Understand the culture**
6. **Be cautious and vigilant**
7. **Communicate**
8. **Be present**
9. **Be flexible in response to changing conditions**
10. **Think long term.**

Risk management lessons learned

Survey respondents were asked to identify the one key thing that their organization has learned about risk management in these markets. Executives across developed and emerging markets were consistent in their view that it is critical for organizations to develop a deep understanding of the local market, to work closely with local experts and partners, to understand the local culture, to be vigilant, cautious and flexible.

1. Understand the individual market. This is the primary lesson. Executives consistently say that failing to develop a thorough market understanding is the fastest way to get into trouble. Markets are very different, risks and conditions differ from country to country. A combination of in-house research, personal interaction and consultation with experts is needed on an ongoing basis. These markets are more volatile and require more attention. When taking the opportunities, it is essential not to forget about the risks.

2. Use local expertise. There is no substitute for local knowledge; local advisers have the in-depth understanding and judgment that cannot be imported. Experts provide a combination of independent data and in-depth qualitative understanding of the market, both are critical.

"At first we had a very optimistic view about low risks and excellent results. In the long term, with our experience, it ended up being a balance between them."

Business Unit CFO, Brazil

3. Find a partner. Whether it is with joint venture partners, large clients or suppliers, companies say that it is essential to establish strong relationships, even prior to entering the market and it is important not to go it alone. This is not work that can be done at a distance. It is often more effective to deploy local executives in positions of responsibility than to rely on expatriates with an incomplete knowledge and contacts.

"It is important to have the participation of a local partner. To develop commercial activities it is important not to go it alone." Business Unit CFO, Brazil

4. Understand local laws. This includes laws, regulations and ethical standards; compliance rests on this. Do not assume that the regulations in your home market apply in the new market.

5. Understand the culture. Consistent actions can produce wildly different outputs in different markets. Recognizing this is absolutely critical in order to do business effectively. Instead of seeing these differences as the source of the problem, developed market executives need to realize that they cannot act exactly as they would in their country of origin.

"Employ local people with knowledge and expertise, people with the in-depth knowledge only a local would have. You can't really import expertise from the UK." Business Director, UK

6. Be cautious and vigilant. A considerable number of companies commented that they had learned this to their cost, citing the need to pay attention to the details, dare to question, and to be skeptical about reporting. It is crucial not to be pulled along too easily in the search for opportunity, without fully analyzing and verifying the potential risks.

7. Communicate. Open two-way communication and reporting on risk is essential within the business unit and between the developed and emerging market operations. Recognize that communication is what is understood by the other party rather than what is said. Communication 'gaps' are a causal source of misunderstanding that undermine the quality of decision-making.

8. Be present. Relationships and understanding do not come quickly; it may take a period of years for executives from the DM country to assimilate the knowledge they need to be effective in the local market. The typical three year assignment length may well not be sufficient. Travel in both directions is beneficial.

"You get your fingers burnt if you don't do it properly. It's important to pay attention to detail." Group Risk Director, UK

9. Be flexible in response to changing conditions. Developed market companies have often been surprised at the pace of change and political changes can quickly affect the business environment. The key lesson for many companies is that these markets are riskier and more volatile than established markets. While still maintaining necessary control and formalization, a dynamic and flexible approach is required.

10. Think long-term. Ensure there is the capacity and resources to support the investment. These are highly competitive markets where organizations need confidence and competence to survive. Risk management is an important aspect, but so are productivity, quality, delivery and consistency.

Risk design principles for companies in emerging markets

This survey provides a rich body of insight into how risk is currently being managed in emerging markets, across geographies, and types of organization. We spoke to hundreds of senior executives who are successfully managing investments and operations in multiple challenging and changeable markets. They told us how they are going about it, at the same time openly and honestly acknowledging that they don't have all the answers, and have often learned lessons the hard way.

They did not describe a 'one size fits all' approach to risk management in emerging markets. While we were able to identify a group of companies that we believe is following leading practice, and all can learn from their structured approach, they did not provide us with a primer or framework that set out the full range of risks, saying where and how each should be managed. On one level, this is not surprising – risk management permeates all aspects of the business and is certainly not a discrete box-ticking activity that can be clearly prescribed and conducted.

Though minimization of business risks through sophisticated modeling or controls may not be possible in the short term, establishing a risk culture, properly aligning organization structure and risk management processes and improving communication can set a strong foundation for better risk management.

Our experience in working closely with many of these organizations tells us that, in addition to the lessons learned coming from the survey, there are a number of key principles for managing risk with particular application for emerging markets.

- **Hedge risks that are not specific to the organization.** If there were no cost to hedging, organizations would be best off hedging all risks. However, the cost of hedging risk increases precipitously as the risks hedged become more unique. Since firms cannot cheaply reduce their exposure to risks that are unique to their business, it is even more important for them to reduce their exposure to, and hedge, risks that are not unique to them. By doing so, they can take on the more difficult-to-hedge core business risks themselves.
- **Beware the effect of decision-making under uncertainty.** Paradoxically, the risks in emerging markets can be both overestimated and underestimated by companies coming from the outside. In the first instance, decision-makers consistently overestimate new risks, assuming greater prevalence and downside to risks they are unfamiliar with, eg workforce risk. On the other hand, those with a history of and confidence in controls may underestimate the real risks, and take on more risk than is wise to do. These preconceptions can be alleviated to a great degree by building a full knowledge of the individual market.

- **Allow two-way communication with emerging market operations and be prepared to hear the truth.** To a large degree, risk management is a knowledge management exercise where, even in the absence of other activity, companies can benefit substantially by communicating accurately vertically and across the organization. Lack of effective communication inevitably increases risk, so presenting a problem is a better option than presenting nothing. However, if communicating the true situation is met with interference by headquarters' managers who do not have full knowledge, or if reporting a problem is always perceived as a failure to implement, those in EM operations assume that headquarters does not or will not accept the truth, and adjust their communications accordingly. The company is then likely to make sub-optimal risk decisions on the basis of incomplete knowledge.
- **Link risk management with performance assessment.** Risks will only be truly 'owned' and managed if the manager's performance evaluation is affected. This is particularly true in high-risk areas and countries. This is another argument for aligning risk management and communication with other business processes.
- **Structure risk approach to reflect the business model.** Risk management should reflect the company's management philosophy – if the business model is centralized, then the most effective risk approach will be centralized as well. Note that, as in all management processes, a decentralized approach that may deliver faster and more effective response needs to be compensated for with better communications.
- **In general, manage risks at their source.** The people closest to the risks are in the best position to assess what steps should be taken to reduce the firm's exposure to these risks, but they will lack the benefit of comparative and benchmark insight that the center may be able to provide. Between a small number of risks which are inherently more local (property, workforce, transactional), and others that are more central (reputation, strategic), the majority of individual risk types will be mixed or shared responsibilities, and need to be considered individually.

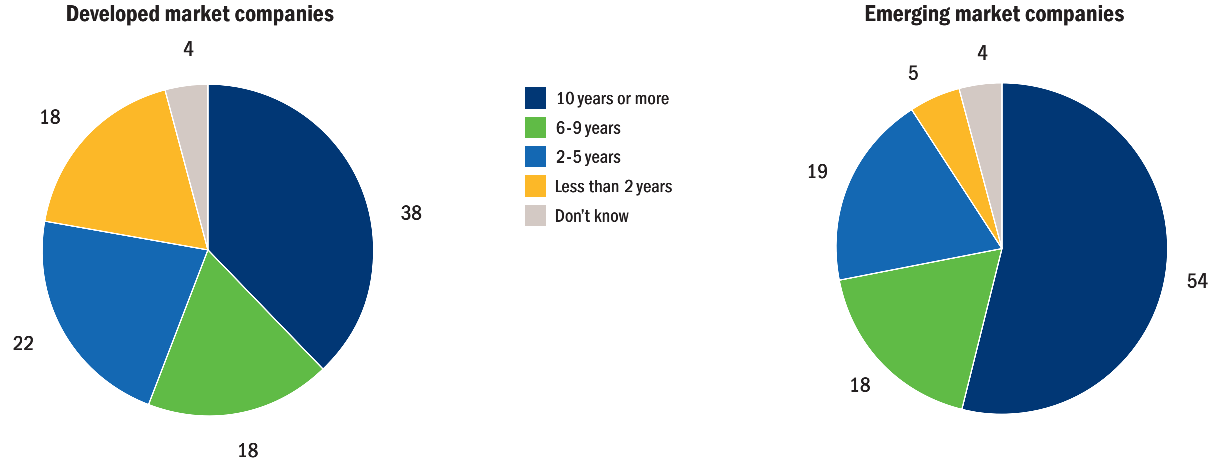
In deciding where a specific risk should be managed, or how to plan resources for risk management, companies should consider:

- ***How containable is the risk if it occurs*** **– if containable, it is best managed locally.**
- ***How pervasive it is to the entire organization*** **– If pervasive, it will range from local management supported by heavy communication to shared local and developed market.**
- **Some examples of mixed/shared risks across the risk universe:**
  - ***Market risk*** **– Is it created by conditions outside the local market, ie the actions of global competitors?**
  - ***Fraud and corruption*** **– Depends on the spill-over effect, taking into account how wide the consequences are**
  - ***Pricing*** **– Is the client base purely local, or multinational?**
  - ***Currency*** **– Depends on the local operation size, scope and type. Smaller operations may get away with a natural hedge, multinational banks have central treasury departments**
  - ***Supply chain*** **– If the supply chain crosses borders, then the risk approach needs to adjust**
  - ***Compliance*** **– Organizations need to be compliant within both jurisdictions**
  - ***Tax*** **– Tax risk is managed at both levels, a function of both internal control and processes of the whole organization, as well as the tax regimes in which it operates.**

Business context – looking for growth

At the start of our survey, respondents were asked to outline, briefly, the nature of their company's involvement in the emerging market countries. Many respondents are directly responsible for these operations, and we wanted to learn more about the broader goals for the relationships, before engaging in a detailed discussion of the risks that accompany them. We regard this as important because these goals should play a central role in determining the appropriate risk management strategy to adopt.

Figure 1: Duration of relationship between developed and emerging market companies



Q: How long has your organization been involved in the business relationship (subsidiary, JV, third party)? Percentage of respondents.
BASE: Developed market relationships with emerging markets (557), emerging market companies with relationships to developed markets (380)

‘Emerging Markets’ are not a new phenomenon. Some global organizations have been operating in these markets for a very long time. However, our survey supports the widely held view that there are a growing number of companies entering these markets. We are witnessing a new and dynamic phase of globalization.

There are a number of long-standing relationships in the sample, with 38% of the DM companies and 54% of the EM companies saying they have held these relationships for more than ten years. Indeed, some companies have been in some of the emerging markets for many decades. This period is enough time to have learned lessons in terms of risk management and to have developed leading practices. But it will also have been a period that has seen many changes as the local market has developed.

It is not surprising that this figure is higher for EM respondents in many cases, they are the smaller partners in the business relationship, more likely to be aware of an overseas relationship than a larger DM company with multiple overseas trading partners.

However, we also see that 58% of DM companies and 42% of EM companies have been in a working relationship for less than ten years. Indeed almost 20% of DM companies have been in these markets for less than two years. While many of these relationships will be well established, there continues to be a period of settling in and developing the most effective approaches to managing risk. In addition, we have seen that an appreciation for, and understanding of, the local culture is an essential prerequisite for building the trust needed to operate effectively. In some highly complex markets, a number of years is required to develop this trust.

Figure 2: Duration of involvement in emerging markets: regional view

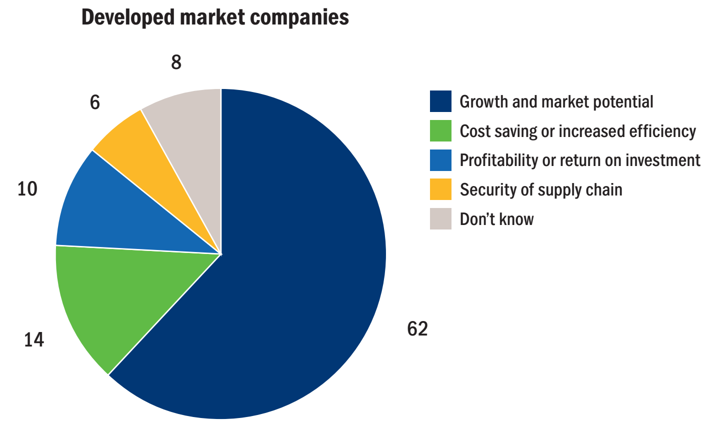
		North America	Europe	Far East
Brazil	10 years or more	63%	44%	–
	2-9 years	26%	39%	–
	Less than 2 years	7%	12%	–
China	10 years or more	25%	26%	60%
	2-9 years	52%	48%	33%
	Less than 2 years	22%	19%	5%
India	10 years or more	12%	32%	36%
	2-9 years	51%	41%	42%
	Less than 2 years	33%	25%	21%
Russia	10 years or more	53%	53%	–
	2-9 years	32%	32%	–
	Less than 2 years	15%	13%	–

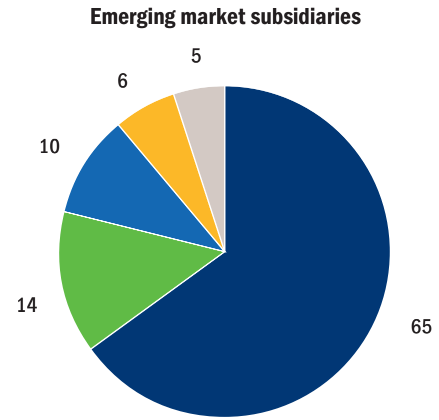
BASE: Developed market relationships with Brazil: N. America (27), Europe (59); relationships with China: N. America (55), Europe (99), Far East (48); relationships with India: N. America (33), Europe (73), Far East (14), relationships with Russia: N. America (19), Europe (78)

Looking at the EM countries, China and India have high levels of recent investment and activity. One third of North American companies have a relationship with companies in India of less than two years; 22% of them have been involved with China for a similar short period.

Regional results also illustrate the traditional trading patterns. North American companies have the longest-standing relationships with Brazil; Europeans have longer-standing relationships in India. Companies from Japan and Singapore (Far East) had significant relationships with China and India, but our survey included only a limited number of respondents in the Far East who had significant experience of Russia and Brazil.

Figure 3: Strategic objective for investment in emerging market countries





Q: What was the key strategic objective underpinning your company's involvement in the emerging market? Percentage of respondents.
BASE: Developed market relationships with emerging markets (557), emerging market subsidiaries (220)

We asked companies to identify the strategic objective behind their investment. Significantly, just under two thirds of both developed and emerging market companies identify the key objective behind their involvement in emerging markets as growth and market potential. This finding confirms the hypothesis that companies have moved considerably from the traditional view that the primary objective of investment in these markets is cost savings.

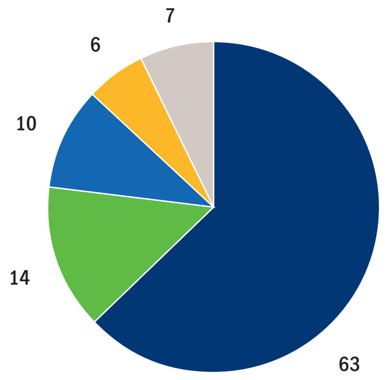
Responses are remarkably consistent, 62% of DM companies and 65% of EM companies say the primary driver is market growth. Only 14% of executives overall say that cost savings and increased efficiency are the main reason behind the investment. This is clear evidence of a move away from the view of emerging markets as a source of raw materials for the West, in the transition from being the source of inputs to the destination of outputs.

"We have learned that in emerging markets you have to make the case from a value standpoint, and maximize the return on investment."

Group Risk Director, US

Figure 4: Strategic objective variation across emerging markets

Developed market companies and emerging market subsidiaries



B	R	I	C	T
71	73	54	55	78
4	3	22	20	8
8	8	11	11	3
7	8	5	5	5
10	7	8	6	8

- Growth and market potential
- Cost saving or increased efficiency
- Profitability or return on investment
- Security of supply chain
- Don't know

Q: What was the key strategic objective underpinning your company's involvement in the emerging market? Percentage of respondents.

BASE: Developed market relationships with emerging markets and emerging market subsidiaries (734), comprising relationships with subsidiary in Brazil (168), Russia (118), India (169), China (279), Turkey (43)

We explored whether there was variation in strategic objectives between markets and found that, while growth remains the overwhelming goal of all markets, there is some country level variation.

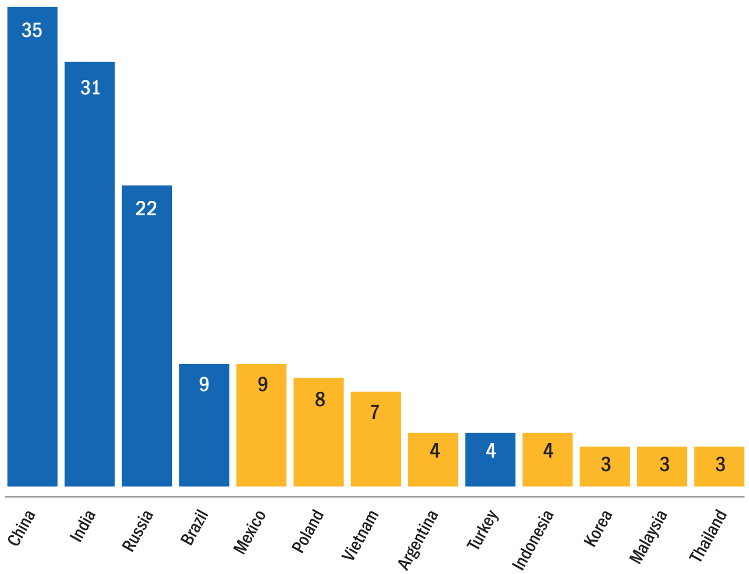
- Companies operating primarily in Brazil, Russia and Turkey are more likely to be looking for growth
- A sizeable number are seeking cost savings as their primary reason for investing in India (22%) and China (20%)
- A slightly higher number regard their investment in Brazil and Russia as being to improve the security of their supply chain.

However, growth remains overwhelmingly the predominate goal. In order to confirm this, we have spoken to investing companies who are managing the full spectrum of risks as they work towards their growth objective rather than a narrower set of operational objectives.

Respondents identified additional key growth areas in the following regions:

- Eastern Europe & Baltic (21%)
- Africa (9%)
- Middle East (9%)
- Latin America (6%)
- Far East (3%)

Figure 5: Future growth markets



Q: Name three emerging market countries which you see becoming the next key growth areas for your organization. Percentage of respondents.
Base: Developed market companies (435)

These are not the only markets where companies are looking for growth but China and India, together with Russia, are overwhelmingly the major targets and the largest markets from a global perspective.

Companies in this survey were significantly less likely to identify Brazil as a key growth area. But this may be set to change as Brazil's growth plan, announced in 2007, aims to encourage investment by boosting incentives to private investors, increasing infrastructure spending, and cutting bureaucracy.

Also of note were the high scores for Mexico and Poland – both large countries, but neither currently perceived in the same way as 'BRIC'. We can speculate that their proximity to the developed markets of the US and Western Europe, respectively, may have shown a higher importance being placed on cost reduction than in the countries we have studied.

Also of note is the relatively low position of Turkey, evidence perhaps that this market has yet to receive the full focus of the global economy.

Figure 6: Companies with growth objective: regional breakdown

	North America	Europe	Far East
Brazil	70%	64%	–
China	53%	57%	60%
India	39%	52%	86%
Russia	78%	77%	–

Base: N. America (19-55), Europe (59-99), Far East (14-48)

A breakdown of DM companies who have growth as the key objective in their operations in emerging markets shows some differences:

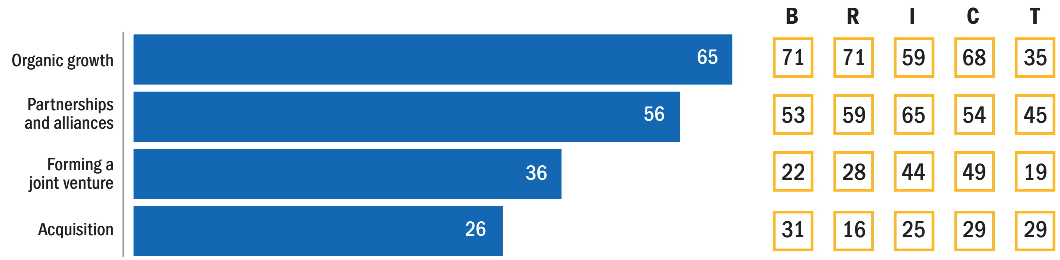
- North American companies are looking most frequently to Brazil and Russia for growth, with relatively less involvement in India.
- A high percentage of Far East companies have growth as their objective for China and India. In the course of this study, we spoke to a relatively low percentage of companies in the Far East that had significant relationships in Brazil and Russia.
- Europeans look to Russia and, to a lesser, degree Brazil, but also show a considerable interest in both China and India. There appears to be some support for the perception that European companies are more global in outlook than some of their regional rivals.

We found a strong correlation between the duration of the relationship in a country, and a primary objective of growth and market potential. The longer a company has been in a market, the more likely it is to list the growth and market potential of that country as its primary goal. This suggests that some companies who may have originally gone to a market for cost-saving purposes have now refocused on the local potential and growth opportunities of the market.

"You have to take a bigger part in the operation over a long period. To succeed organically you have to make sure to support the capacity and resources."

Group Risk Director, US

Figure 7: Strategies used to achieve growth in emerging markets



Q: What are the main strategies used by your organization to grow your operation in the emerging market? Percentage of respondents.
BASE: Developed market companies with growth objective (342), in Brazil (58), Russia (79), India (63), China (111), Turkey (31)

We found differences in the approaches being adopted to achieve the growth objectives.

Traditionally, we have observed a trade-off between speed and control in market entry and growth strategies.

- Organic growth can be perceived as the slowest entry route, but gives the investor the greatest degree of control
- Partnerships and alliances bring local expertise, but can also bring conflicting agendas
- Joint ventures share the risk of the venture, but can embed conflicting agendas into the operations; and
- Acquisitions are traditionally the fastest entry route and the way to achieve step-change strategic growth. However, they are notoriously risky and a significant majority fail to deliver their original goals.

The favored route for growth in these particular emerging markets is organic growth, with the low number of acquisitions reflecting a combination of difficulties in finding attractive targets, legal constraints, and the time required to complete transactions in emerging markets.

There is however, variation by market. DM companies looking for growth in Brazil, Russia and China are more likely to achieve this through organic growth. Whereas in India and Turkey, the first route is through partnerships and alliances.

The risks companies face

By political risk, respondents meant the possibility of change in government or policy that affected their operations, and entailed the need for a management response.

The EY Risk Universe is a comprehensive view of risks that promotes an aligned view of risk across all parts of the business. While often related and interconnected, individual risks can be categorized between:

Strategic risks – *market dynamics, stakeholders, planning & resource allocation, governance*

Operational risks – *value chain, physical assets, people, knowledge, information technology*

Compliance risks – *legal, regulatory, standards of business conduct*

Financial risks – *market, liquidity & credit, accounting & reporting, capital structure*

We know that investing and operating in emerging markets has significant risk attached to it, but demonstrating this was not the primary purpose of this study – that observation could be made about any part of the world.

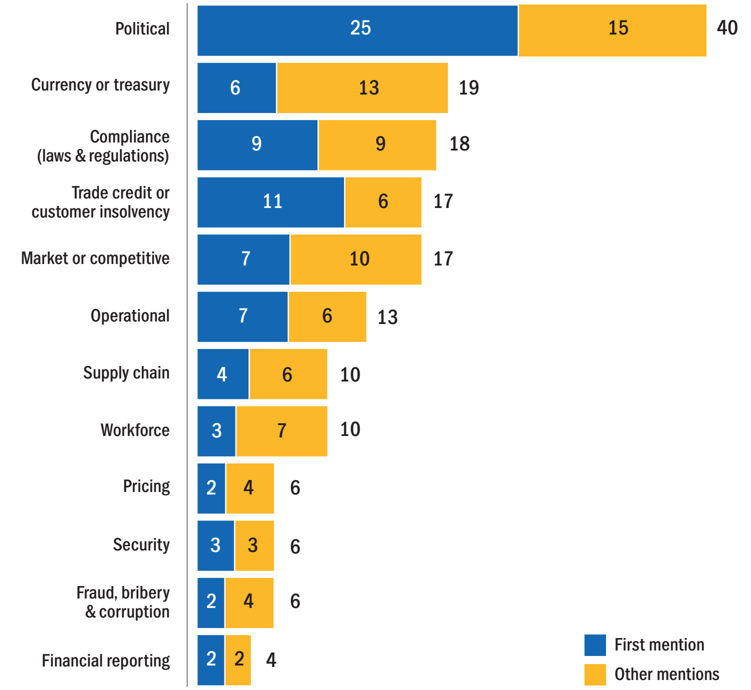
We were, however, interested in exploring what DM and EM companies see as the relative risk priorities in emerging markets. This provided the context for their priorities and activities in terms of risk management.

Respondents were asked to identify the top risk connected to a specific relationship in a specific country, in an effort to move away from generalized comments and sweeping statements about 'emerging markets.' They identified a range of strategic, operational, compliance and financial risks.

From the perspective of the developed market, the key risk to companies' operations is political risk, an important strategic risk. Emerging markets inherently have higher levels of political risk. These are countries going through dynamic change and government policies may change in response to perceived wider development needs rather than those of the particular commercial operation. However, while accepting that these markets present greater levels of political risk, this finding also demonstrates the principle that distance increases the perception of risk. The wider geographical perspective of DM companies may increase awareness of potential changes that, at the local level, are neither feasible nor likely. For those newer to emerging markets, it may also reflect one of the dynamics in decision-making under uncertainty, wherein new risks are given greater weight than those that are already known.

Figure 8: Key risks in emerging markets

Developed market view



Q: What is the single most important risk facing your organization in relation to its involvement in the emerging market? Name two other key risks. Spontaneous responses shown. Percentage of respondents.

BASE: Developed market relationships with emerging markets (557)

"The most important thing we've learned is that you have to be competitive in a global scenario. Your costs have to be up-to-date in terms of productivity, quality, delivery and consistency."

CFO, India

Somewhat surprisingly, given some of our earlier research, we see that even companies in developed markets and at some distance from the local operation, do not tend to identify, on a spontaneous basis, fraud and corruption as a key risk. Compared with other risk types, it is not 'top of mind.' However, had respondents been prompted with a list of risks and asked to say how significant a risk fraud is, we know from previous research that it would have been rated as considerably more important compared with other risks.

In contrast to the views of developed markets or, indeed, head offices, political risk falls significantly as a key priority for companies located in the emerging market countries themselves.

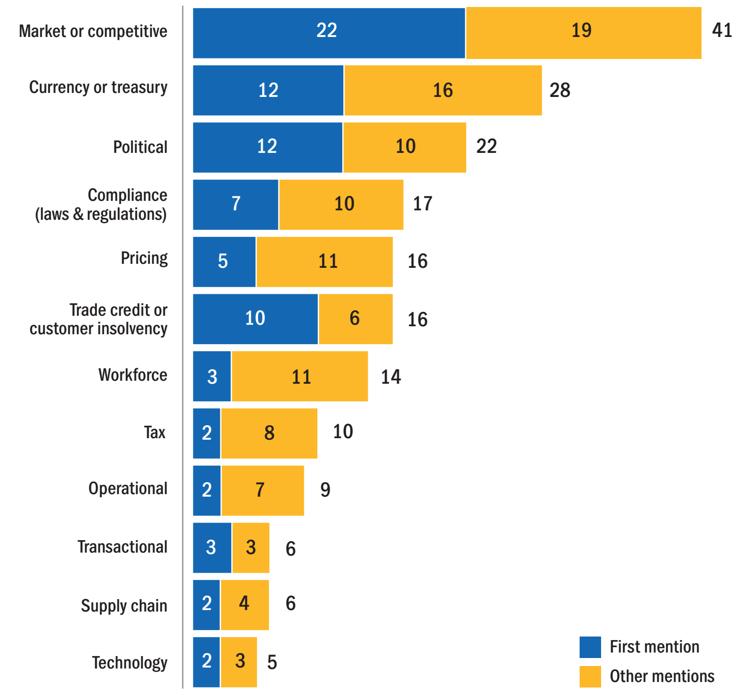
For them, the top risk by some margin is market or competitive risk (rated equal fourth for DM companies), followed by currency and political risk.

From a DM perspective, the risk of market change is significant but companies are typically operating in more than one market and have options as to future action and investments. On the contrary, for operations in emerging markets, market risk is foremost and central to their performance. They understand that a fundamental change in the market conditions in their market will determine their very survival.

For EM companies, compliance is rated as the fourth risk overall, similar to developed markets. Compliance risk is more commonly identified, but not as the top risk.

Figure 9: Key risks facing operations in emerging markets

Emerging market view



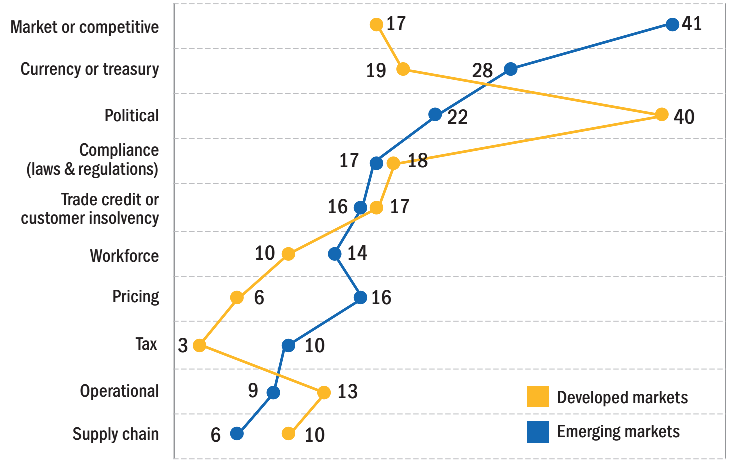
Q: What is the single most important risk facing your organization in relation to its involvement in the emerging market? Name two other key risks. Spontaneous responses shown. Percentage of respondents.

BASE: Emerging market companies (501)

> *"Risks in developing economies are different from established market economies in that the former involve more political risks and require more attention."*
>
> Business Director, Russia

Figure 10: The most important risks in emerging markets – all responses

Developed market vs. emerging market companies



Q: What is the single most important risk facing your organization in relation to its involvement in the emerging market? Name two other key risks. Spontaneous mentions shown. Percentage of respondents.

BASE: Developed market relationships with emerging markets (557), emerging market companies (501)

A read-across of key risks as identified by respondents highlights a number of interesting gaps that illustrate relative priorities and, as noted, relative vantage points.

- Developed market companies place a significantly greater emphasis on political, operational and supply chain risk
- Emerging market companies, in turn, are significantly more likely to focus on market and competitive risk, currency, pricing, tax and workforce risk.

Figure 11: The single most important risk facing operations in emerging markets – first response

	Parent/Subsidiaries	Joint Ventures	Third Parties
Developed market respondents	Political	Political	Political
	Compliance	Compliance	Trade credit
	Market or competitive	Market or competitive	Compliance
	Currency or treasury	Trade credit	Operational
	Operational	Operational	Currency or treasury
	Trade credit	Security	Market or competitive
	Security	Pricing	Supply chain
	Workforce	Currency or treasury	Strategic
Emerging market respondents	Political	Market or competitive	Market or competitive
	Market or competitive	Political	Currency or treasury
	Currency or treasury	Currency or treasury	Political
	Compliance	Pricing	Trade credit
	Pricing	Trade credit	Compliance
	Workforce	Compliance	Pricing
	Trade credit	Workforce	Workforce
	Economic	Operational	Transactional

In addition to the differences in view driven by location, the survey also shows the influence of organization and relationship type on relative priorities. This is particularly true if we look only at top of mind risks, the first mentions.

The developed market view varies:

- Trade credit and supply chain risk are relatively more important for companies with third party relationships
- Political, compliance and market risk are consistently important for parent companies and those with joint ventures.

The emerging market view:

- Market risk is the top issue for local companies and joint ventures, and second only to political risk for local subsidiaries
- Currency risk is relatively more important for local companies in a third-party relationship with developed market companies
- Subsidiaries identify political risk first, reflecting their status as part of global organization from outside the area
- Compliance falls as a priority – although still an issue
- Workforce is an issue for all.

Overall risk management approach

Risk management is the process of seeking to mitigate the risks that an organization faces.

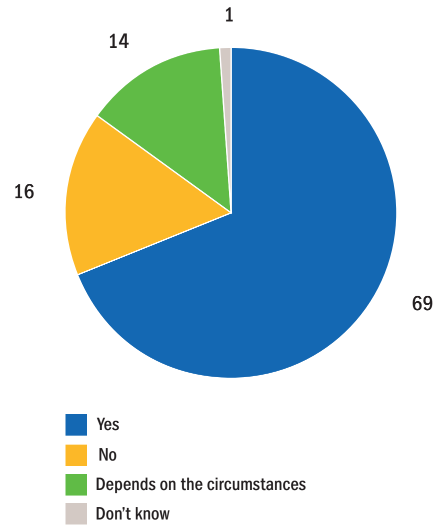
Ernst & Young has conducted a significant volume of global research into risk management over the past two years, looking at this issue across stakeholders, geographic areas and risk types. This research has shown that a number of elements are critical for success:

- Alignment (between goals, risks and controls and across functions)
- Priority with Board and senior management
- Communication, to senior management and the Board and at the operational level.

Just over two thirds of the companies do a formal risk assessment when considering whether to become involved in a new market, with a further 14% saying they would do so depending on the circumstances. On the surface, this finding presents some concern, with considerable room for improvement. We know that these levels vary across geographies and industries, and that some companies rely more on an informal assessment from their partners on the ground.

We would say that, because emerging markets inherently have changeable risk profiles, it is essential that a thorough assessment, whether it is ‘formal’ or not, be carried out not only before entering a new market. This should also be done periodically from that point, to make sure that changes in the environment can be registered and addressed.

Figure 12: Companies conducting formal risk assessments when considering entry into new emerging markets

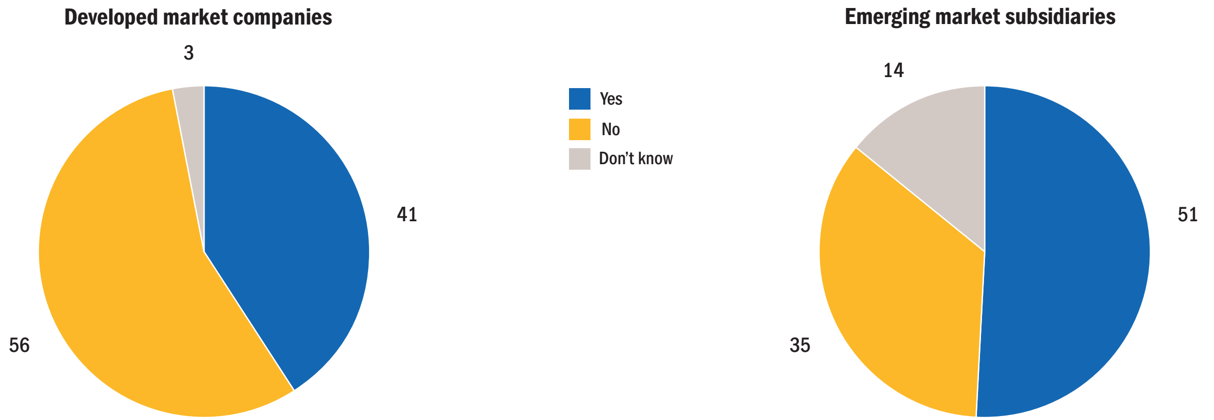


Q: Does your organization conduct a formal risk assessment when considering whether to become involved in a new emerging market? Percentage of respondents.
BASE: Developed market companies (435)

"Our risk strategy has not yet been strategically developed there. We'll need to watch the market more closely and decide what we want to do in that region."

Business Director, Russia

Figure 13: Documented risk management strategies for emerging markets



Q: Does your organization have a documented risk management strategy that specifically covers the ongoing management of risk in emerging markets? Percentage of respondents.

BASE: Developed market companies (435), emerging market subsidiaries (220)

Overall, 41% of respondents in DM countries told us that their company had a risk strategy for emerging markets. However, more than half (56%) said that this strategy was not in place. Respondents in EM subsidiaries closer to the markets in question were more likely to say yes, reflecting their perspective or greater knowledge of what was in place. 51% of the subsidiaries identify a documented EM strategy.

Documentation may seem a relatively minor issue, but its creation ensures that a process of risk identification has been undertaken, and that a management approach has been articulated. It provides the basis for consistent communication across an organization.

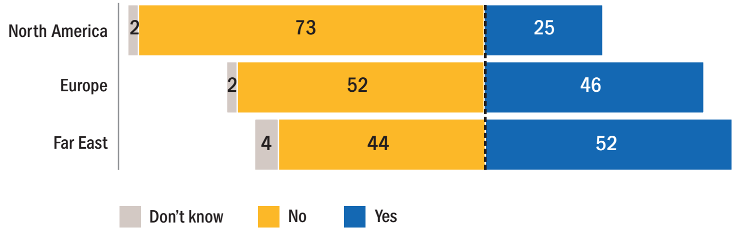
On a global basis, we see clear room for improvement in this area, underscoring the need to connect risk processes and management processes in a more integrated manner, so that the risk approach serves the strategic and business objectives.

There is considerable variation in the findings by geography and by sector.

> **A high-level discussion of whether or not to go into new markets is insufficient, boards have the responsibility to obtain analysis and direct feedback about the risk landscape in a particular market.**

Figure 13 ***continued***

Regional comparison



Q: Does your organization have a documented risk management strategy that specifically covers the ongoing management of risk in emerging markets? Percentage of respondents.

BASE: N. America (110), Europe (271), Far East (54)

Our research on risk with the investor community demonstrated that investors want clear and transparent evidence that companies are successfully managing risk. There is a clear value chain from compliance to transparency to the premium they are prepared to pay for good risk management. Articulation of the strategy for risk in emerging markets is an essential element for a company seeking to obtain this premium from investors.

Looking at the regional findings, we see significant differences in approach. While only 25% of North American companies have a risk management strategy that specifically covers emerging markets, the proportion is higher in Europe at 46%, and even higher still in the Far East, 52%.

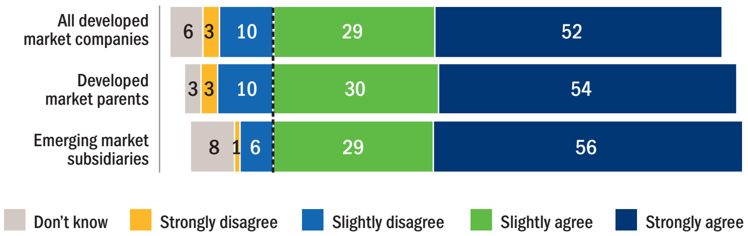
On the surface, the US findings are surprising given the amount of attention devoted to risk management in the US in recent years. It may very well be that these companies have an integrated approach for all markets and do not make a particular distinction for emerging markets.

However, even if this were the case, we would suggest the need for companies from all regions to revisit their policy. Companies are increasingly recognizing emerging markets as one of their major strategic business risks, but over 50% – and indeed over 75% in the US, have yet to develop specific approaches to managing this risk.

"At regular board meetings, they look at the financial position, track ongoing risks and address emerging risks if necessary."

Business Director, US

Figure 14: Board of directors focus on risk in emerging markets



Q: Does the board and senior management give enough attention to risk in emerging markets compared with more developed markets? Percentage of respondents.

BASE: All developed market companies (435), developed market parents (272), emerging market subsidiaries (220)

Risk and risk management have been important issues for Boards of Directors for some time. As such, they are becoming increasingly involved and active in this area. We asked respondents whether their Boards of Directors gave enough attention to risk specifically in connection with emerging markets. The responses were largely positive, in both DM and EM companies the general consensus is that this is an issue well managed by the Board. DM companies with subsidiaries are just a little more likely to say that the Board is paying enough attention than those with other types of relationships.

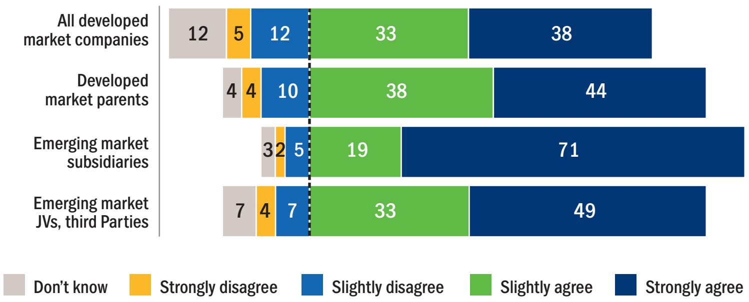
There is some regional variation. 56% of respondents in the Far East strongly agree that the Board is sufficiently focused, compared with 52% in Europe and 49% in North America. While the number of respondents we spoke to in the Far East is smaller, and are focused primarily on China, we see a consistent pattern – a higher level of risk management activity and greater awareness in this region.

Insight from Ernst & Young's ongoing Audit Committee Leadership Network discussions confirms the importance of the Board's attention to risk in emerging markets. Network members believe that discussion of risk in major emerging markets should begin with the Board. A high-level discussion of whether or not to go into new markets is insufficient; Boards have the responsibility to obtain analysis and direct feedback about the risk landscape in a particular market. This includes working with local political risk advisers, creating dedicated risk advisory boards, and speaking directly with local partners and external auditors.

"Transparent information is necessary. It means that all information available needs to flow freely between local companies and the head office."

Group Risk Director, Sweden

Figure 15: Perception gap in quality of risk information coming from emerging markets



Q: Does the local country management provide sufficiently regular and robust information on risk to the parent or partner company? Percentage of respondents.
BASE: All developed market companies (435), developed market parents (272), emerging market subsidiaries (220), emerging market joint ventures and third parties (163)

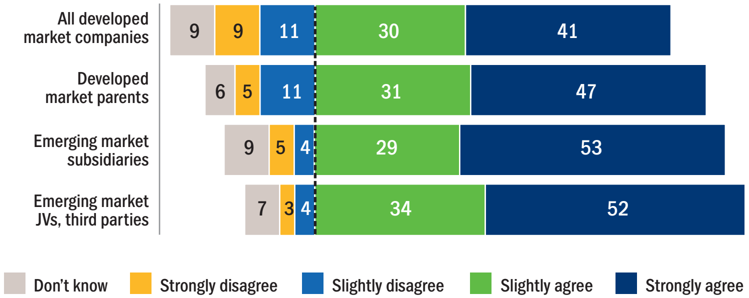
While there is a general agreement that the Board's focus is sufficient, there are contrasting views on whether the information provided by local country management is sufficient. Overall, DM companies are significantly less likely to agree that this is the case. We see a regional difference, with companies in the Far East more likely to be very happy with the level of information (54%) than those in Europe (37%) or North America (35%).

The clearest contrast in the quality of risk information applies to subsidiaries. While 71% of EM subsidiaries feel that they provide sufficiently regular and robust information on risk to the parent company, only 44% of the parent companies would say the same.

A number of factors contribute to this communications 'gap'. We accept the view that the individuals closest to the risks are often in the best position to assess the steps that should be taken to reduce the company's exposure to those risks. While headquarters frequently may not be clear in terms of their expectations, experience also suggests that, in many circumstances, headquarters executives are not accepting of the reality, and react in an inappropriate fashion. The belief that a local problem is a failure to effectively implement the centrally determined strategy is widespread. Consequently, in order to avoid micro-management that is not based on true understanding, local executives come to believe that the best route may not be to provide the complete picture, but rather the picture that the center is looking to see. Then follows a negative spiral, wherein incomplete information results in surprises and creates suspicion, so that even when reporting and communication is adequate, it is viewed by headquarters with mistrust.

The implications of this discrepancy are the continued need for clear communication on risk in an aligned way throughout the organization, both in terms of EM operations providing sufficient levels, and parent companies making clear their expectations for communicating on risk. This also underlines the need to continue to build and foster trust throughout the organization, and for DM executives to increase their knowledge of and appreciation for local market conditions.

Figure 16: Perception of internal audit effectiveness



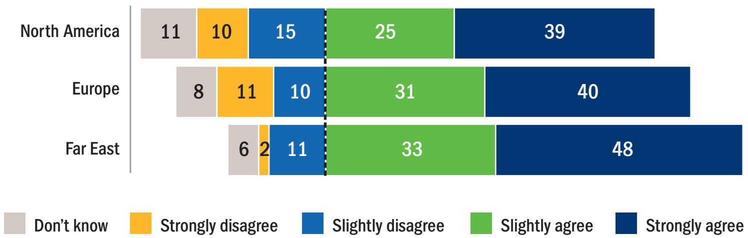
Q: Does the internal audit function of your company in emerging market conduct sufficient testing of risk management systems and processes? Percentage of respondents.

BASE: All developed market companies (435), developed market parents (272), emerging market subsidiaries (220), emerging market joint ventures and third parties (163)

A similar communications 'gap' appears in relation to internal audit. Developed market headquarters have less confidence in the quality of the internal audit testing of their subsidiaries than do the subsidiaries themselves. And we see a consistent difference by geographic region. All companies in the Far East are more likely to strongly agree that local internal audit is effective (48%), compared with those in Europe (40%) or North America (39%).

We are seeing evidence around the world of the internal audit function coming under increasing pressure. The scope of its responsibilities is increasing, but often beyond the level and/or skills base of its resources. Our survey appears to support the view that DM companies' internal audit functions are not well placed to test subsidiary risk because the typical internal auditor from headquarters is not equipped with the specialized skills to be effective. Internal audit should be done locally, by people with the appropriate knowledge.

Figure 17: Perception of internal audit effectiveness: regional breakdown

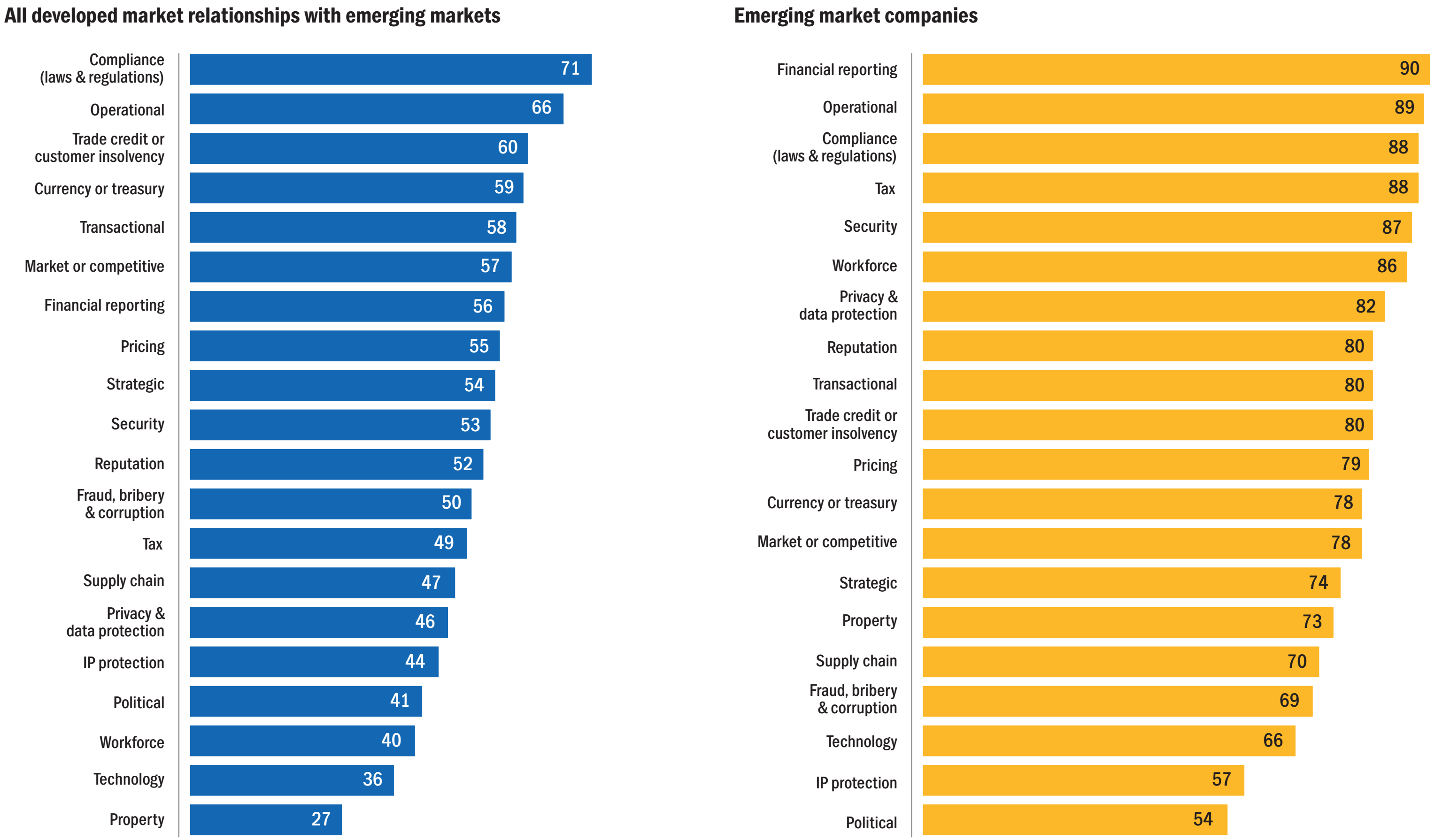


Q: Does the internal audit function of your company in emerging market conduct sufficient testing of risk management systems and processes? Percentage of respondents.

BASE: N. America (110), Europe (271), Far East (54)

Risks being managed

Figure 18: Risks managed in Emerging Markets



Q: Does your organization actively manage the risk in the emerging market? (right). Percentage of respondents.

BASE: Developed market relationships with emerging markets (557)

Q: Does your organization actively manage specific risk in the emerging market? (far right). Percentage of respondents.

BASE: Emerging market respondents (501)

A skilled executive board may be able to combine these risky investments into a lower-risk portfolio. Risks associated with each individual investment become less relevant than their contribution to the overall corporate risk portfolio risk.

We presented respondents with a range of risk types, and asked them to tell us whether or not their organization actively managed specific risks in emerging markets. This data is based on all companies in the study: a combination of parents, joint ventures and third-party relationships in developed markets, and a combination of local subsidiaries, joint ventures and third parties in emerging markets. So the comparison is for overall context only. Later in this section, we provide a direct read-across by type of organization.

However, a look at the two figures for DM and EM companies together clearly shows higher levels of risk management in emerging markets, evidence of the first design principle that risk is normally best managed locally. Those closest to the risks are certainly best placed to assess what should be done to reduce exposure to these risks, also illustrating the maxim 'risk management is knowledge management'.

Developed market companies may be taking a portfolio approach, spreading their investments across various (emerging) countries. Each of these individual investments has some risk and return expectation. This is a critical distinction to help explain how corporate officers and local country managers may view and handle the same risks differently.

Accepting the principle that risk is best managed close to the source, where people understand the conditions contributing to the risk, and the actions needed to address it, at the enterprise level, several factors play a role in the decision on where a risk should be managed:

- The company's business model, ie more or less centralized
- How containable a risk is if it occurs
- Whether the consequences of the risk affect the whole organization.

It is essential that a decentralized risk approach needs to be compensated for with better communications, so that headquarters managers have thorough knowledge of the situation, and do not allow the organization to be exposed to risks with significant consequences. As noted earlier, good communication is a two-way process, and relies, at least partially, on DM executives being prepared to accept the full story, and not pressurize local management to only send good news.

A number of individual risks tend to be best managed locally, examples are property, workforce and transactional risk. Others are better addressed more centrally, including reputation, strategic, and financial reporting.

However, the majority of risks fall into the ‘it depends’ category, with decisions and resourcing based on the factors listed above. Some examples are:

- Pricing – If the client base is purely local, then concentrate the risk and manage it locally. If clients are multinational, then the risk needs to be addressed at both levels
- Fraud and corruption – The approach will depend on the spill-over effect of a potential fraud, taking into account how wide the consequences are likely to be
- Market – The approach will depend on whether the competitive risks can be addressed locally, or are created by conditions outside the local market, ie the actions of global competitors
- Currency – Again, the approach will depend on the size, scope and type of the local operation. For example, smaller operations may get away with a national hedge, multinational banks have central treasury departments
- Supply chain – If the supply chain crosses borders, then the risk approach needs to adjust at that time.

Another set of risks are by their nature ‘mixed,’ requiring management at both the developed and emerging market levels. The two major examples are:

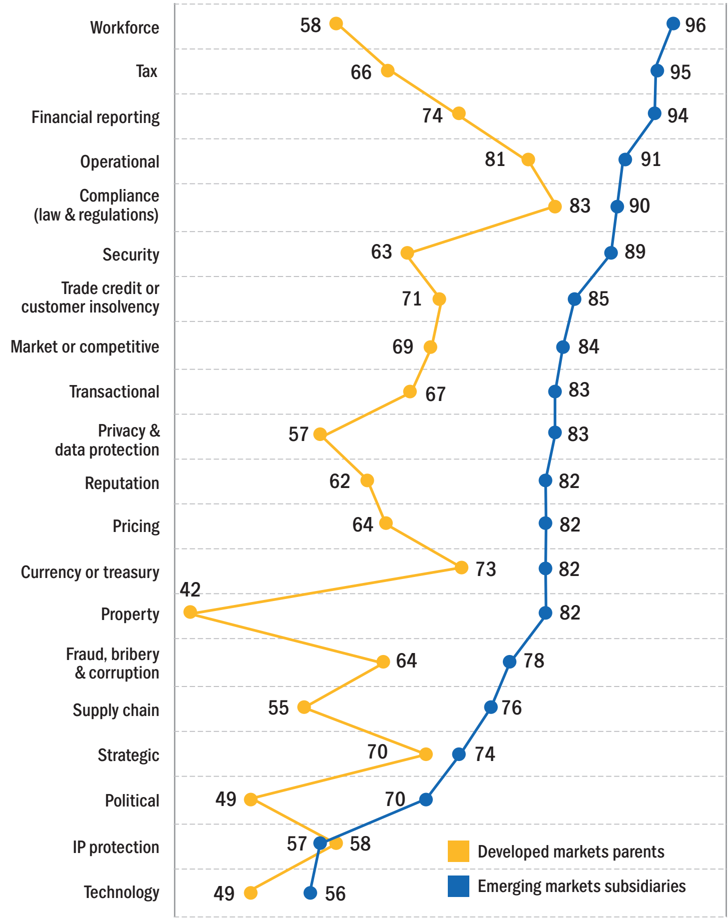
- Compliance – Organizations need to be compliant within both jurisdictions
- Tax – Tax risk is a function of both internal control and processes of the whole organization, as well as the tax regimes in which it operates.

Considering only multinationals, and reading across both DM headquarters and the EM subsidiaries, we see higher levels of risk management at the subsidiary level across the board. This is not surprising, as these managers are those closest to the specific types of risk. The data also suggests the following pattern:

- Local subsidiaries are more actively managing the workforce, tax, security, privacy and data protection, property, supply chain and political risk
- Responsibility and activities are mixed/shared in terms of financial reporting, operational risk, compliance, trade credit, market, transactional, and currency risk
- Headquarters have a particularly strong role in terms of addressing compliance, strategic and IP protection risk.

Figure 19: Risks managed in emerging markets

Parents and subsidiaries



In the case of multinationals, overall, we see relatively higher levels of risk management at the subsidiary level for a number of operational risks, including workforce, tax, security, data protection, property and supply chain.

However, the decision on the 'home' of several of these risks depends very much on an organization's individual structure and strategy. It would seem essential that a company investing or operating in these markets thinks through the best approach for these risks as part of its ongoing risk assessment exercise.

We spoke with senior finance and business executives in this study. It is worth noting that for a number of risks, eg tax, we could have had very different responses had we spoken directly to the tax departments in developing markets, who would have reported considerably higher levels of management of tax risk.

There were some notable differences in the developed market responses by geographic area, with the highest levels of activity in Far East companies, followed by North American, and then European. In this case, we may be seeing evidence of more centralized decision-making models being used in the Far East and North America in contrast with a more de-centralized approach that is favored in Europe.

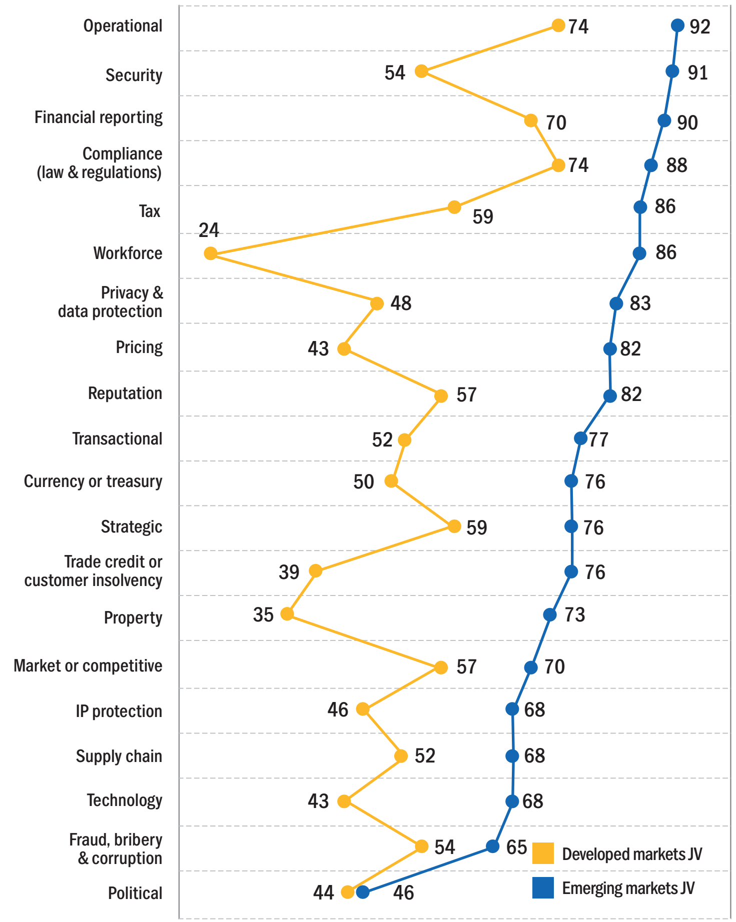
Q: Does your organization actively manage specific risk in the emerging market? Percentage of respondents.

BASE: Developed market parents (272), emerging market subsidiaries (220)

> *"Success depends on having the proper joint venture partner."*
>
> Head of Internal Audit, US

> *"You can't manage all the risks, it's too macro. We keep our investment low and rely on our joint venture partner who understands the local culture."*
>
> CFO, Singapore

Figure 20: Joint ventures



We identified a substantial number of organizations in a joint venture relationship in both developed and emerging markets. Joint venture respondents differed from subsidiaries in that their most managed risks are operational and security, as opposed to workforce and tax.

We see evidence of developed market companies taking responsibility for managing market or competitive risk, fraud and corruption risk, and compliance risk.

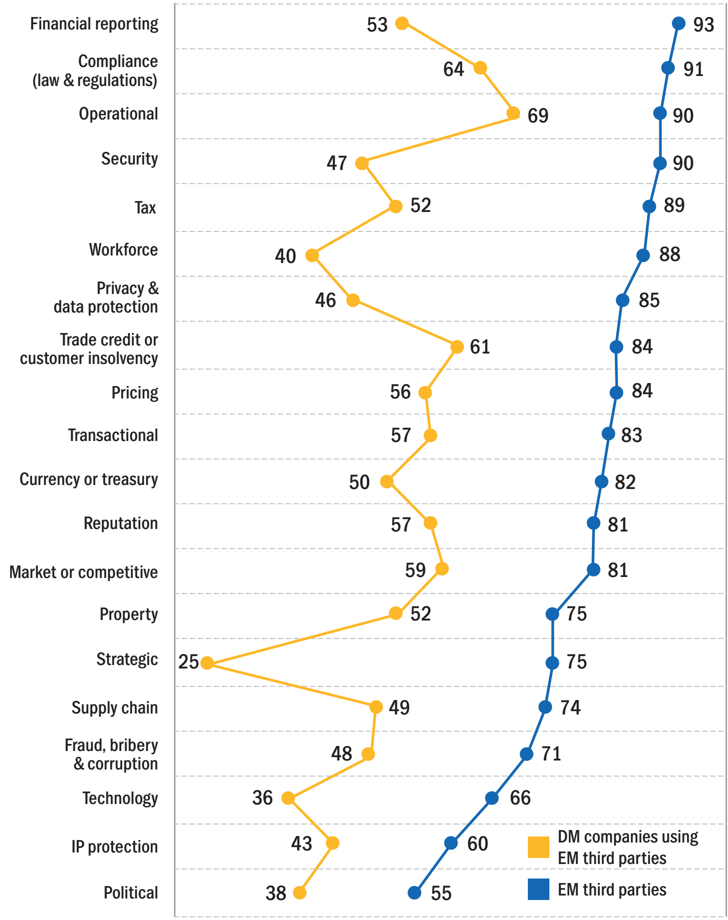
While security, trade credit, workforce and property look to be properly the responsibility of the local market, the range of other risks are considered to be shared.

Q: Does your organization actively manage specific risk in the emerging market? Percentage of respondents.

BASE: Developed market joint venture partners (127), emerging market joint ventures (114)

> "It always pays to put in the effort to ensure you have the right partner and understand the local scenarios."
>
> Corporate Development Officer, UK

Figure 21: Third parties (agents, customers, suppliers)



Understandably, DM companies are considerably less likely to actively manage the full range of risks associated with their relationships with third parties, including large customers and suppliers. In partnerships and joint ventures, a greater level of control brings with it the potential for more control of risk. With third parties, however, companies need the 'uncontrollable' local agent to do business, this is a necessary condition for moving forward, but their ability to exert control is limited.

The implication is that there can be an inverse relationship between the size of the operation and its impact on the risk profile, ie the smaller the operation, the greater the (uncontrolled) risk. An asset base is not required to provide considerable risk to an organization. The implication of this is that DM companies would benefit from paying more attention to the whole spectrum of risks in relation to third parties, to explore whether any more certainty can be brought into the relationship.

Q: Does your organization actively manage specific risk in the emerging market? Percentage of respondents.

BASE: Developed market companies with emerging market third parties/suppliers (449), emerging market third parties/suppliers (334)

Is there leading practice?

'Aligned' companies have a documented risk management strategy that specifically covers both the parent company and the local emerging market subsidiary.

We spoke in depth with 220 subsidiaries located in emerging markets whose parent company is located in a developed market. Forty percent of these said that they have a documented risk management strategy that specifically covers both the parent company and the local emerging market subsidiary. Their responses on the risk management approach suggest that this group has benefited from the *Lessons Learned* outline.

Analysis of the survey data suggests that this finding identifies a leading practice group of companies. While their view of the risks faced is consistent, they are distinct in terms of response and share other positive characteristics and behavior (see table).

This group of companies are pursuing an aligned approach to risk management. That related survey findings identify them as performing well in other areas is evidence of the benefits of alignment.

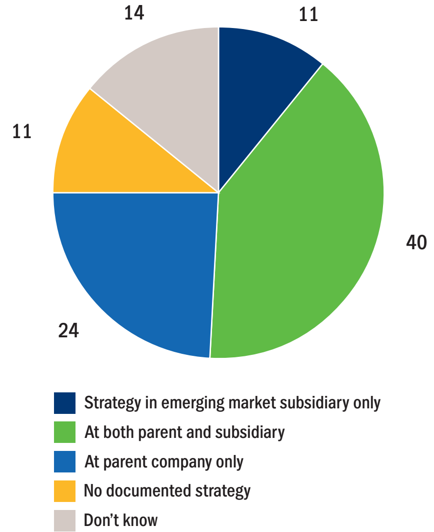
"You need to have a clear strategy. The local facts are always different from country to country. Look at country risks, but also risks to individual business partners. You can never generalize." CFO, Germany

Characteristics of aligned companies

- **They are more likely to manage shared responsibility for risks at both the parent and subsidiary level**
- **Parent companies have a greater focus on risks in emerging markets**
- **A greater level of confidence in both local and parent-company internal audit functions**
- **A greater level of confidence that the flow of risk management information between emerging markets and the global HQ is adequate**
- **A greater level of satisfaction, as perceived by emerging market-based executives, with the overall quality of risk management.**

> *"We know our risks but we have to constantly monitor and audit them. Ideally risks should be included in the company strategy. It's very important for us because a little mistake incurs huge damage."*
>
> COO, Russia

Figure 22: Alignment of strategies for emerging markets



Q: Is there a documented risk management strategy that specifically covers the ongoing management of risk in emerging markets? Percentage of respondents.
BASE: Emerging market subsidiaries (220)

Forty percent of EM subsidiaries said that their company had a strategy for risk management at both the parent and subsidiary level. This aligned approach to risk management identifies this group as particularly effective in terms of risk management and as an example of leading practice.

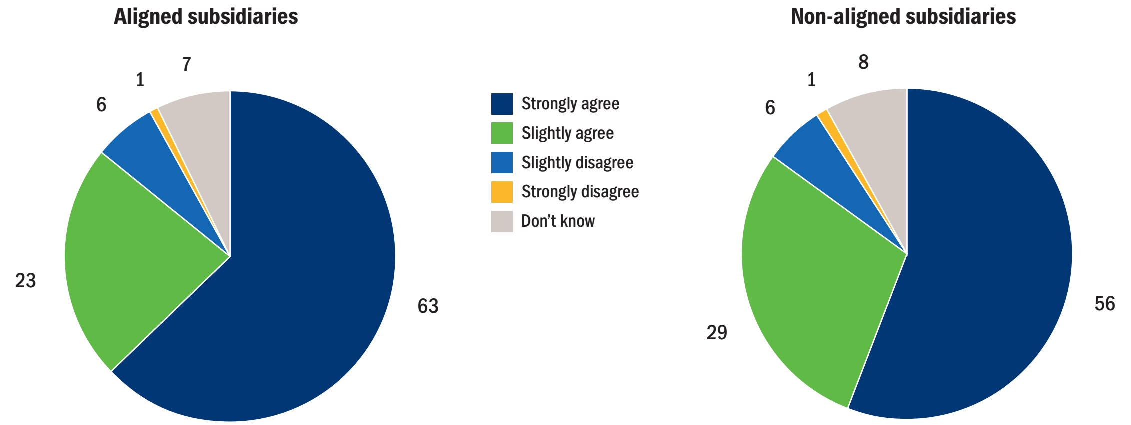
Previous research shows us that companies with an aligned approach are better able to focus on the risks that matter and manage them effectively, and better able to act on opportunities to gain competitive advantage, achieve real growth and create value. Alignment also means less waste in terms of time, money and effort.

Companies which have subsidiaries with an aligned approach to risk management are more than twice as likely as 'non-aligned' companies to have profitability or return on investment as the primary reason behind their involvement in emerging markets (14% vs 6%).

A look at this group by geography shows that companies with aligned risk management tend to be located in Europe, at 44%. Somewhat fewer, 31% are in North America, and 25% are in the Far East.

> “Things would be easier if there was more support for risk management from our parent company.”
>
> Corporate Development Officer, China

Figure 23: Parent company attention to risk in emerging markets



Q: Does the board and senior management of your parent company give enough attention to risk in emerging markets compared with more developed markets? Percentage of respondents.

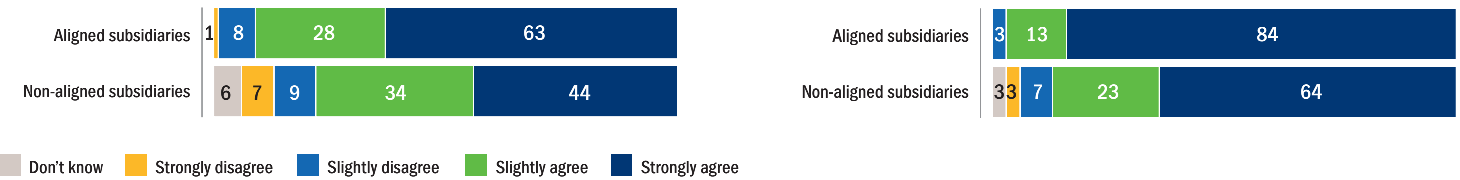
BASE: Aligned subsidiaries (86), non-aligned subsidiaries (99)

Not surprisingly, respondents from ‘aligned’ subsidiaries are more likely to believe that the board and senior management of the parent company focuses sufficiently on risk in emerging markets, compared with more developed markets. We see this as further evidence of a virtuous circle of companies with a joined-up approach to risk management.

Figure 24: Aligned subsidiaries communicating more effectively on risk

Local management receives sufficiently regular and robust risk information from internal teams

Local management provides sufficiently regular and robust risk information to parent



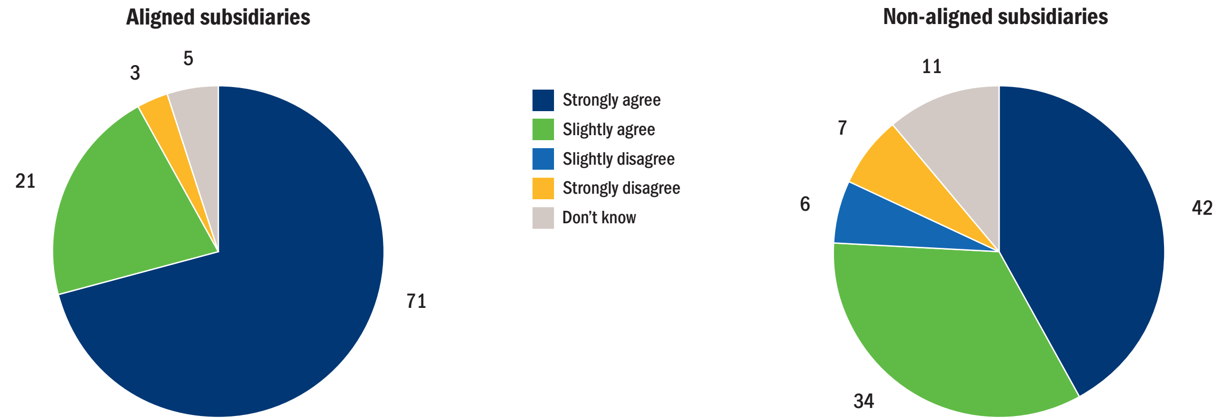
Q: Can you tell me whether you agree or disagree with the following statements. Percentage of respondents.

BASE: Aligned subsidiaries (86), non-aligned subsidiaries (99)

In research conducted by Ernst & Young in late 2006 *(Stakeholders on Risk)*, the quality of communication on risk was a major differentiator between companies who were high performers in terms of risk management and those that were not.

We find consistent messages in an emerging market context. Leading practice companies are much more likely to communicate effectively both at the local level and between the subsidiary and parent. Sixty three percent of aligned subsidiaries strongly agree that local management receives sufficiently regular and robust risk information from local teams; while an impressive 84% believes that local management provides this information to the parent. In contrast, only 44% of non-aligned subsidiaries have a high level of confidence in risk information at the local level, and 64% at the group level.

Figure 25: Effectiveness of local internal audit



Q: Agreement that company's local internal audit function sufficiently tests risk management controls. Percentage of respondents.
BASE: Aligned subsidiaries (86), non-aligned subsidiaries (99)

In the *Risks Managed* section of this report, respondents speak of the importance of internal audit to test and improve the risk management controls, particularly for compliance, financial reporting and fraud risk.

Again, we see a very large difference in the views of aligned and non-aligned subsidiaries. Seventy one percent of aligned subsidiaries agree strongly that the local internal audit function sufficiently tests risk management controls, in sharp contrast with the 42% of non-aligned subsidiaries who share this view.

And finally, aligned subsidiaries, those with a risk strategy that covers both the parent and subsidiary, are significantly more likely to have confidence in their organization's approach to risk management in relation to the individual market. Over half, 52%, of aligned subsidiaries have a high degree of confidence (ie, 8-10 on a 10-point scale), compared with only 37% of non-aligned companies.

Sector variation

The strategies of companies will vary extensively based on the sector that they are operating in. This may be the key factor in determining both the markets they have prioritized for entry and the goal that they are seeking from that presence. One can, for example, understand why an Oil & Gas company would prioritize an investment in Russia over, say an investment in India. Or why they would be looking to achieve very different things from operations in either market.

As part of this study, we have worked closely with the sector groups that Ernst & Young has established to focus on the major sectors in the global economy. We have consciously interviewed companies from this cross-section of industry sectors – and indeed asked respondents some supplementary questions determined by the sector that they are in. For Automotive, for example, we have explored the explicit nature of operational risk and the role of customs risk. For Pharmaceutical and Biotechnology, we have explored their specific concerns about intellectual property and product safety.

As a companion to this global report, we will publish a series of reports with data and insights drawn from and tailored to the major industry sectors of the global economy. At this stage, however, we have focused on seeing what conclusions can be drawn from looking across all these sectors.

Figure 26: Key future growth areas in emerging markets: sector view

China	India	Russia	Brazil	Turkey
Automotive (58)	Automotive (58)	Banking (33)	Insurance (30)	Insurance (10)
Biotechnology (50)	Telecommunications (44)	Consumer Products (28)	Pharmaceuticals (29)	Banking (8)
Pharmaceuticals (47)	Banking (43)	Automotive (27)	Telecommunications (22)	Pharmaceuticals (6)
Telecommunications (44)	Biotechnology (43)	Telecommunications (22)	Automotive (17)	Utilities (6)
Insurance (40)	Insurance (40)	Biotechnology (21)	Biotechnology (14)	Automotive (3)
Technology (38)	Pharmaceuticals (35)	Pharmaceuticals (21)	Technology (14)	Oil & Gas (3)
Banking (35)	Technology (31)	Insurance (20)	Oil & Gas (13)	Real Estate (3)
Media & Entertainment (32)	Oil & Gas (28)	Oil & Gas (13)	Banking (8)	Consumer Products (2)
Consumer Products (31)	Media & Entertainment (27)	Real Estate (10)	Real Estate (8)	Turkey was only asked in France, Italy and Spain
Oil & Gas (31)	Consumer Products (26)	Media & Entertainment (9)	Consumer Products (6)	
Real Estate (23)	Real Estate (23)	Utilities (6)	Utilities (6)	
Utilities (18)	Utilities (18)	Technology (3)	Media & Entertainment (5)	

Q: Name three emerging market countries which you see becoming the next key growth areas for your organization. Percentage of respondents.
SHOWN: Percentage of companies in each sector saying each country

Where are they investing?

The first observation to be made is that these markets – the 'BRIC' countries plus Turkey – are not of equal importance to all the sectors that we have studied. The most active sectors across these markets are Automotive, Biotechnology, Pharmaceuticals, Telecommunications, Banking, Insurance and Technology, but there is significant variation. Banking respondents, for example, regard Russia as being their top priority, whereas Technology respondents regard Russia as being the least important of the group. Similarly, Consumer Products has a special focus on the Russian market as a key growth market compared to the other three countries.

Utilities, Oil & Gas and Real Estate appear to have the least interest in Brazil, China, India, Russia and Turkey of the sectors that we studied.

Looking beyond the EM countries in our survey, we found that Utilities, Oil & Gas and Real Estate had a much greater focus on Africa, Eastern Europe, Far East, Latin America and the Middle East. Indeed, nearly three in five Utilities companies put Eastern Europe as a future growth area.

Figure 27: Other key future growth markets

Africa	Eastern Europe	Far East	Latin America	Middle East
Oil & Gas (25)	Utilities (59)	Insurance (50)	Media & Entertainment (32)	Oil & Gas (22)
Utilities (18)	Consumer Products (37)	Biotechnology (28)	Utilities (30)	Media & Entertainment (14)
Real Estate (15)	Pharmaceuticals (27)	Consumer Products (28)	Oil & Gas (25)	Technology (14)
Pharmaceuticals (12)	Banking (26)	Oil & Gas (21)	Pharmaceuticals (24)	Utilities (12)
Technology (7)	Real Estate (26)	Real Estate (21)	Consumer Products (23)	Banking (8)
Banking (5)	Oil & Gas (22)	Automotive (20)	Technology (20)	Real Estate (8)
Consumer Products (2)	Technology (21)	Pharmaceuticals (18)	Automotive (18)	Consumer Products (6)
	Insurance (20)	Technology (16)	Banking (16)	Pharmaceuticals (6)
	Media & Entertainment (19)	Banking (11)	Telecommunications (11)	
	Telecommunications (11)	Telecommunications (11)	Real Estate (8)	
	Automotive (9)	Media & Entertainment (10)		

Q: Name three emerging market countries which you see becoming the next key growth areas for your organization.
SHOWN: Percentage of companies in each sector saying each region

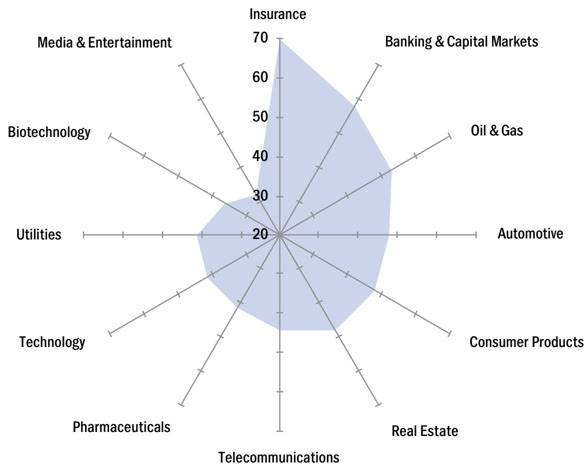
"You need to have a clear strategy. The local facts are always different from country to country. Look at country risks, but also risks to individual business partners. You can never generalize."

CFO, Germany

What risks are they worried about?

Eight sectors listed political risk as their greatest concern. As we mentioned earlier, this is the risk that the major companies appear to see as being furthest outside their direct control. Two sectors – Automotive and Technology listed market/competitive risk as being their main concern – with Pharmaceuticals and Consumer Products listing it as their second most pressing concern. Banking, however, is more concerned with trade credit while Insurance, Media, Utilities and Oil & Gas respondents have their greatest worries about compliance.

Figure 28: Documented risk management strategies for emerging markets: sector view



Q: Does your organization have a documented risk management strategy that specifically covers the ongoing management of risk in emerging markets? Percentage of respondents.

SHOWN: Percentage 'Yes'

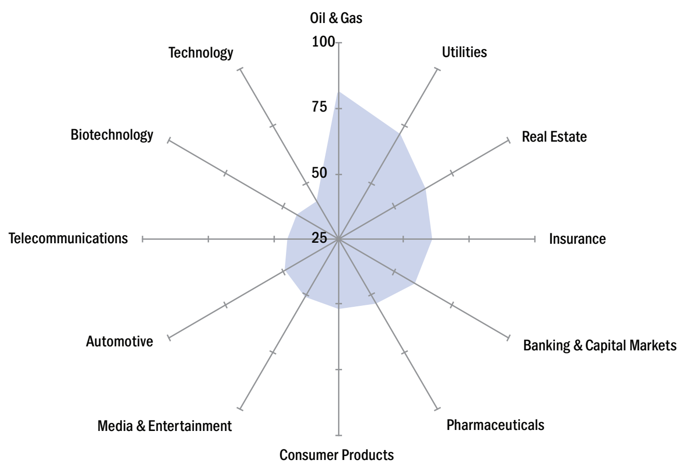
The degree of variation between sectors can be considerable. Given that we believe that a documented risk strategy for emerging markets is the starting point of good practice, the variation in response is stark. Not surprisingly for an industry where risk is the *raison d'etre*, we found Insurance companies lead in having a documented risk strategy for emerging markets. Even here, however, only 70% of insurance respondents had such a documented strategy.

Nine of the sectors studied had a lower than 50% response to this question and at the bottom level of performance, only 30 – 40% of respondents from Media and Biotechnology companies have a documented risk management strategy.

Documentation of risk is one of those rare processes where both the input and the output add value. The documentation plays the central role in determining consistent communication – all parties received the same information at the same time. However, the process of producing the documentation probably generates greatest value by ensuring that risks are identified, evaluated and shared.

> “Emerging markets are different from well established markets. They develop fast, their economy and politics are continuously developing. While we try to grasp the opportunities there, we also have to pay attention to the risks.”
>
> CFO, Insurance

Figure 29: Are boards paying enough attention to risk in emerging markets?



Q: Does the board and senior management give enough attention to risk in emerging markets compared with more developed markets? Percentage of respondents.
SHOWN: Percentage ‘Agree Strongly’

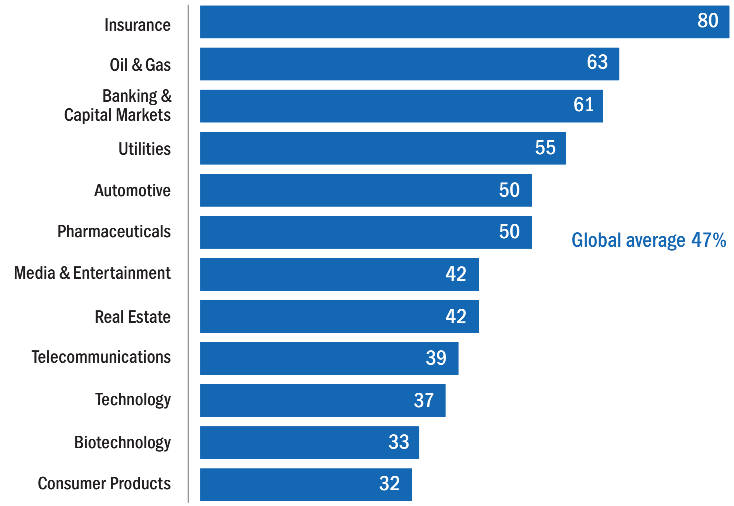
Six sectors had less than 50 % of respondents strongly believing that their Board and senior management were paying enough attention to risk in emerging markets. It could be argued that, in practice, these Boards were paying a good deal or sufficient attention to the issue but that the respondents believed that they simply needed to do more. Such an argument does not reflect the reality of this type of survey approach which typically highlights an absence rather than underplays the presence.

Both Biotechnology and Telecommunications respondents identified political risk at the top of their concerns, followed by intellectual property and pricing, respectively. Given the role of government regulation in both these sectors, this is understandable. Perhaps their relatively low scores for management is further evidence that companies believe that there is little that they can do to manage this risk. Alternatively, it might reflect the relatively small role currently played by these markets in these sectors.

Responses consistently highlight the difficulty of seeking to manage political risk. We would expect, however, to find the sectors where government and regulation play a central role in the operation and profitability of the market, to be at the top in seeking to achieve this. It is not surprising therefore to find Insurance, Oil & Gas, Banking and Utilities at the top of our list of respondents – albeit that only Insurance has a clearly high score. The scale of investment and the life-cycle of projects in these industries require an engagement with local authorities in any market in which players are seeking to operate.

The low score of Telecommunications – again a sector with long life-cycles and high regulation – is surprising given the close relationship with government that these companies have historically enjoyed within developed markets.

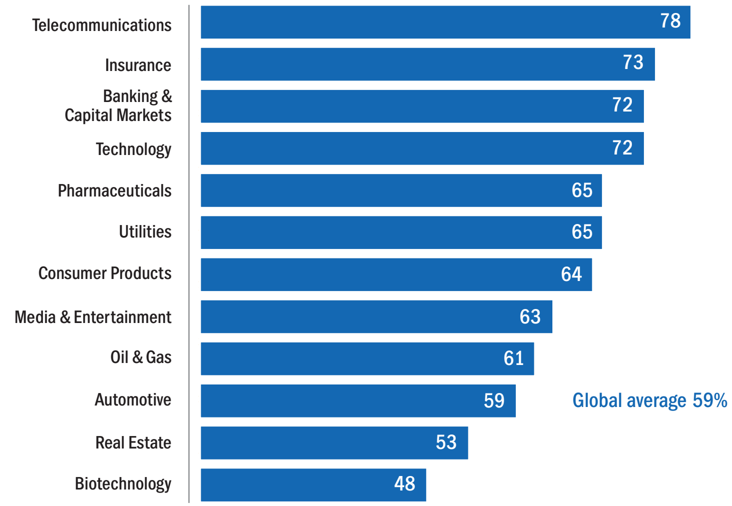
Figure 30: Companies actively managing political risk in emerging markets



Q: Which of the following types of risk does your organization actively manage? Percentage of respondents.
SHOWN: Percentage saying political risk managed

When we explore the approach to fraud risk, however, we find that Telecommunications companies come at the top of our respondents in seeking to actively reduce this risk. Insurance and Banking – with their concerns about credit and compliance – are predictably in the top three. Companies in other more regulated sectors fall a little lower in response to this risk. Technology and Pharmaceuticals both have to address real concerns about intellectual property – as do Biotechnology companies, whose respondents rated lowest in seeking to address this issue.

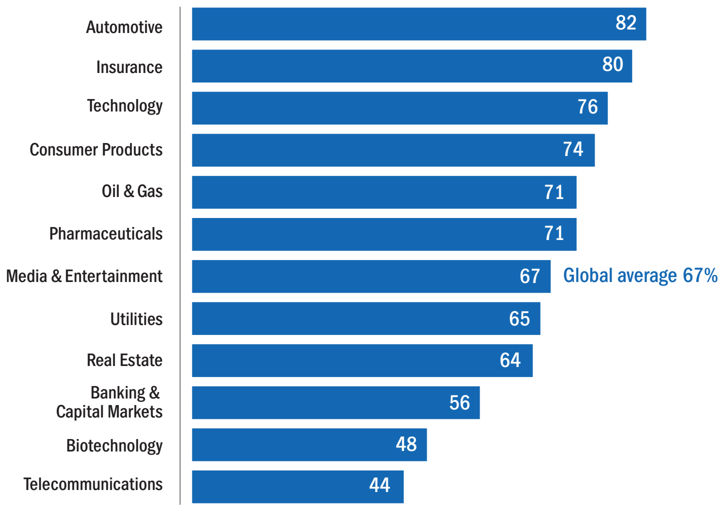
Figure 31: Companies actively managing fraud risk in emerging markets



Q: Which of the following types of risk does your organization actively manage? Percentage of respondents.

SHOWN: Percentage saying fraud, bribery and corruption risk managed

Figure 32: Companies actively managing market risk in emerging markets



Q: Which of the following types of risk does your organization actively manage? Percentage of respondents.

SHOWN: Percentage saying market or competitive risk managed

Automotive, Technology and Consumer Products are engaged in heated competition in these countries and as conscious of the emergence of local competitors as they are of the performance of global rivals.

Similarly, Oil & Gas companies are going through a dynamic period of both partnership and competition with national entities in these emerging markets.

At the other end of the scale, Banking, Biotechnology and Telecommunications are less active in managing market risk. These are three sectors where emerging markets have, to date, been more battlefields for global competition than the source of major new competitors.

How companies are managing their risks – a detailed account

"We evaluate the different political risk exposures – currency, political violence. We structure contracts to negotiate or limit the risks and insure the rest."

Chief Risk Officer, US

The purpose of our survey was to move beyond describing activity levels, to provide insight into the steps large organizations are actually taking in terms of risk management in developed markets and the concrete steps they are taking to successfully address risk in emerging markets.

The following is an account of the specific actions both EM and DM companies are taking to manage individual risks, where we have sufficient commentary to support this. They are summaries of what respondents said in their own words in response to open-ended questions. For each of the risk areas, the key activities are presented in headline tables, then filled out, where appropriate, with more detailed actions. We have presented these in the overall risk categories.

One risk that does not appear here is operational risk. Despite frequent and consistent comments that this is an important issue that needs careful attention, respondents in both developed markets and emerging markets were less forthcoming with specific actions for this broad risk area. It would seem that operational risk means different things to different people. Reflecting the umbrella nature of this category, individual actions were widespread, and largely in connection with other risk types mentioned. The range included product quality, safety measures, anti-fraud programs, currency risk hedging and understanding local politics.

Transaction risk was not treated in depth by respondents in this study. This risk area is addressed in the recently released Ernst & Young Global Transaction Leaders Study, *Cross-border Transaction: Emerging Markets*, which addresses cross-border deals with over 300 transaction leaders from 95 global companies. The study identifies good practices and addresses what should be considered when assessing or setting up transactions in emerging markets.

Strategic risks

Managing political risk

Political risk is the risk of a change in government or policy that requires a change or response from the business; it does not connote unstable regimes at the macro-political level. There is a shared perspective from both developed and emerging markets that political risk, while it may be significant, cannot really be managed. There was a significant response to this question, respondents clearly having considered this issue in depth.

"We participate in the industry organization and we have many key people who have a lot of influence. We also pray." Business Director, Canada

Developed market	Emerging market
Political risk cannot be managed	The only response is compliance
Monitoring and assessing	Monitoring and assessing
Insurance policies	Communicating proactively with the local government
Communicating with local and HQ governments	Participating in business and trade associations
Taking advice from consultants	Obtaining legal and professional advice Subsidiaries look to Headquarters Political risk is a non-issue

> *"There are no possibilities to understand political risk in China, one needs to recognize it."*
>
> Business Director, Germany

Developed markets

Political risk cannot be managed. DM companies are in agreement with those in emerging markets on this issue.

Monitoring and assessing. This view is also consistent with that of EM companies, citing the need for "intensive observation of the markets and of the market development." Respondents provided a long list of data sources, many of these are used in conjunction with one another:

- Local subsidiaries and operations; acquisition of data from other companies; local employees with specific reporting responsibility; political consultants; local lawyers; specialized local intelligence agencies; internal intelligence departments; HQ government intelligence; third party political analysis; and elections calendar.

Insurance policies. A significant proportion of companies are using political risk insurance, as well as other insurance to cover the downside of political risk, eg credit risk.

Communicating with local and HQ governments. DM companies are building relationships where possible either directly or through business and trade associations. As with the EM companies, the efforts at this level are to obtain as much information as possible, to be transparent, and also to influence the local authorities to the extent possible. In one integrated example, a CRO works to build relationships with the Swiss-Indian Embassy in India and with the Swiss-Indian chamber of commerce at home.

Taking advice from consultants, including independent consulting agencies, lawyers and accountants.

Emerging markets

The only response is compliance. The majority of companies say that political risk cannot be managed, and there are no specific steps for this area of risk. Companies are taking steps to stay on the right side of the law, to meet all statutory requirements and to adapt to changes in government policy.

Monitoring and assessing. The majority of companies are gathering information about the political environment at multiple levels to put themselves in the best possible position to respond to any political changes. They do this through:

- Internal divisions and committees responsible for monitoring and developing company response; specialist legal research; consultancy and audit at HQ level; meetings with local organizations to understand the priorities of the region
- Stress testing the strategic plan.

Communicating proactively with the local government. A substantial percentage of companies are taking active steps to build relationships with government departments and political parties to stay as up-to-date as possible, get first hand information, and also to put forward the company view. They are establishing a public relations division to keep information flow going in both directions, and also participating in activities that are organized politically, eg sponsorship of the Beijing Olympics.

“We have ‘good governance’ and internal audits. We have a code of practice that is very detailed and we ask especially senior board members to sign and respect it. The aim is to allow for business management with integrity and yearly audits to ensure that such a code of conduct is indeed respected to the letter.

Corporate Development Officer, France

Participating in business and trade associations. Companies are using these associations as the vehicles for their communication and representation to the government. This happens through direct communication and also use of the associations as a public voice for company leaders.

Obtaining legal and professional advice. In addition to law firms, other advisers include political consultants and accounting firms.

Subsidiaries look to headquarters in a small number of cases to provide direction, advice and any action, if necessary.

Political risk is a non-issue for a small number of companies. This view is that, for an organization managed in a disciplined way, political risk holds no danger.

Other risk reduction approaches pursued by a minority of organizations include:

- Maintaining an international chain of suppliers and markets
- Investing only in countries with political stability
- Limiting the amount of liquid assets and reducing capital in particular countries
- Avoiding interaction with people (individuals) with political exposure.

Managing market and competitive risk

The primary response to this risk is the thorough and continuous testing of market conditions, including competitor analysis and customer needs.

Developed market	Emerging market
Market analysis and testing	Market analysis and testing
Staying connected with the local market	Focus on quality
Alliances with competitors	Building client relationships
Buying out the competition	Investing in technology
	Reducing costs
	Selling and brand building
	Expanding

Developed markets

Market analysis and testing. The first principle for investing companies is to “understand the particular market, including the customers, competitors and suppliers.” They do this when considering the investment and then monitor it on a consistent basis. This is done through surveys, secondary research and consultation with legal and financial experts.

Staying connected with the local market. Companies do this through parent company audits, senior management visits and operational reviews.

Other. Alliances with competitors; buying out the competition.

"We rely on the parent company's brand, promote the work of our research and development division, focus more on our sales channels and enhance service quality."

Chief Risk Officer, China

"We have processes and procedures, it is important for respective ground staff to respect and operate within the requirements."

COO, Singapore

Emerging markets

Market analysis and testing. This is done through in-house market research departments, customized research, use of ratings and published intelligence, and participation in industry conferences and associations. A number of respondents identify new product research and development as their key focus.

Focus on quality. Companies are building and enhancing the quality of their products and services.

Building client relationships. Staying in frequent contact with clients and working towards long-term contracts. A number of companies refer to tailored delivery of products and services.

Investing in technology. This refers to technology of the products themselves, and the processes surrounding production and distribution.

Reducing costs. They are achieving this through operational efficiency in production, often with high volume and margins. They are looking for greater distribution efficiency, competing through logistics.

Selling and brand building. Through targeted sales efforts, advertising and public relations. A number of respondents referred to brand image in emerging markets as a tool to address market risk.

Expanding. Through acquisition of new companies, launch of new products, and entrance into new markets.

"We only try to put up technology and cost barriers. We share information with them. I think there is room for all of us. We can do our best to make life a little more difficult for them. We upgrade technology. We are sustaining and improving margins along the line." CFO, India

Compliance risks

Managing compliance risk

Compliance is an important risk area for both DM and EM companies, and is the top managed risk in developed markets. DM companies rely on local advisers to help implement strategy developed centrally. In the emerging markets themselves, the focus is on monitoring legislation to be ready for changes with the potential to affect the company.

"We try to make sure that the holding company's risk management principles are implemented in every new market from the beginning."
Head of Strategy, Sweden

Developed market	Emerging market
Using local legal, accounting and tax advisers	Monitoring legislation
Management at Headquarters level	Follow legal and advice
Use of internal legal team	Using accounting firms and other advisers
Internal audit	Internal compliance departments
Lobbying	Consultation with trade associations
Insurance	

"We complied with the rules, followed the standard procedures in a very rigid way and we followed strictly the ethical norms of such countries."

CFO, Italy

Developed markets

Using local legal, accounting and tax advisers. Companies consult local lawyers to advise on legislation and its applicability, and accountants for financial reporting. They recognize that, at the parent level, they do not have a sufficient understanding of the language, rules or regulations.

Management at Headquarters level. The compliance function is monitored and controlled from the center, with managers traveling to the EM location. Enforcement of parent company standards.

Use of internal legal team. Legal officers need to have a good knowledge of local regulations in order to comply with the relevant laws.

Internal audit. Compliance is checked by different levels of internal audit.

Lobbying. Parent company tax directors mention lobbying with economic partners and local governments.

Insurance. In a very small number of cases, companies take out insurance with the World Bank in case there is a radical change in the law.

Emerging markets

Monitoring legislation. Companies are actively staying up-to-date on changes in laws and legislation, checking decrees and regulations, staying in touch with government agencies to be aware of laws and rules that could affect them.

Follow legal and advice. They consult legal advisers to follow developments and advise accordingly.

Using accounting firms and other advisers. For some, lawyers are the last option. Accounting firms and financial consultants are used to structure transactions in compliance with local regulations.

Internal compliance departments. Larger companies have departments and supervisory committees to manage legal and compliance issues.

Consultation with trade associations. For some organizations, the compliance approach is managed through a class association rather than through the company itself.

"We put in place a trustworthy management team and also recruited an external accountant to lower risks to a minimum in terms of fraud."

Corporate Development Officer, France

"People we employ are screened for integrity and background."

Business Unit Head, Singapore

"We know the market participants and their behavior. It is easy to check out newcomers, put their reliability and integrity to the test."

CFO, Germany

Managing fraud, bribery and corruption risk

A substantial body of comment shows that fraud risk is addressed in an equally robust way in DM and EM companies. The approaches are also consistent – a strong system of internal controls, internal audit, a code of conduct and anti-fraud policies and units. Respondents spoke widely of a management ethos that has no tolerance for fraud. Here, we see risk management very much aligned with general management: a way of doing business, not just a response to a specific risk.

Developed market	Emerging market
Internal controls	Internal controls
Management priority	Code of conduct
Code of conduct	Management policy
Internal audit	Internal audit
External audit	External audit
Training and communication	Insurance
Anti-fraud programs	Anti-fraud departments
Anti-fraud departments	Anti-fraud programs
Focus on people and partners	Use of third parties
Whistleblowing	Whistleblowing
Monitoring of local conditions	
Insurance	
Use of third parties	

Developed markets

Internal controls. DM companies identify internal controls as a key response to fraud risk. They refer to group standards and controls that apply across the global organization. Specifically, these involve limits on spending, liquid cash and money streams; documentation and monitoring of transactions; clear signing authority and use of double signatures.

Management priority. Distinct from the formal policies and controls that are in place, a number of respondents spoke of the anti-fraud ethos at senior levels. This was often a "zero tolerance" attitude communicated throughout the organization, and to external stakeholders.

Code of conduct. A considerable number of companies referred to an ethical business policy documented in a written code. This code is frequently signed by all employees, in both the parent company and EM subsidiary.

Internal audit. This process covers both the financial internal controls and wider code of conduct, often done as a combined effort by the internal audit function and senior management reviews.

External audit. Companies refer primarily to external accountants, with a small group using security companies and boutiques.

Training and communication. This covers the DM companies and extends to EM subsidiaries and partners. It includes both technical aspects, eg the Foreign Corrupt Practices Act/OECD Anti-Bribery Convention, compliance and standards training, and more general anti-fraud awareness communication.

"We follow the parent company's norms. We have a whistleblower policy and regular reporting of such instances to senior management and the board."

Chief Risk Officer, India

Anti-fraud programs. Going beyond a general code of conduct, anti-fraud policies provide 'a prevention guideline' for employees, stating clearly what is and is not acceptable. The approach for uncovering and dealing with fraud events is set out, frauds are recorded and analyzed.

Anti-fraud departments. Dedicated teams oversee all aspects of an anti-fraud program, from awareness building to investigations. A number of companies are sending specialist fraud risk management representatives from headquarters to the emerging market locations.

Focus on people and partners. Companies are taking steps to hire people with integrity and also to work with partners who can be trusted. This rests on rigorous recruitment and performance monitoring procedures in the case of employees, and thorough due diligence in the case of local partners.

Whistleblowing. A small minority of companies has a whistleblowing mechanism in place.

Monitoring of local conditions. Companies stay informed of new legislation in EM countries, conduct market intelligence and transaction observations.

Insurance. Fraud insurance is mentioned by a small number of developed market companies.

Use of third parties. A small minority rely on local agents or a local supervisory office.

"We build up an image that shows people we are not open to bribery."
Business Unit CFO, India

Emerging markets

Internal controls. The predominant approach for fraud risk in EM companies is through the appropriate internal control procedures and policies. A number spoke of compliance with Sarbanes-Oxley legislation. Specifically, these controls involve:

- Sharing responsibilities – for job responsibility, signing authority, "four eyes principle"
- Authorization hierarchy or cascade – clear authorization limits, requirement for approval at senior level
- Triggers for scrutiny at set limits, or when a particular purchase is over standard costs
- Standardized purchase and sales procedures.

Code of conduct. The code of conduct or ethics is a central element in the company's approach to fraud risk. The code is communicated, signed, and enforced – "an action guide that controls all company activities from president to workers." In a very small number of cases, suppliers are asked to sign an agreement.

Management policy. The comments from EM respondents refer to a way of doing business, a mindset that governs the company's activities, in addition to formal policies and procedures – "a very strict orientation for rejection of those types of practice." This attitude is supported by willingness to act against transgressors.

"One of the key import costs is logistics and we are spreading our manufacturing facilities to different regions of the country to reduce the logistics cost. That way, we would be able to take care of risk related to pricing."
CEO, India

Internal audit. This is conducted both locally and by internal audit teams from the parent company. It is supported by strengthening the information systems connected with the head office. The remit varies, for example, covering financial controls, regulatory compliance, corporate governance issues, product pricing, and tax collection.

External audit. Internal audit is supported by (often frequent) independent feedback from external agencies, primarily accounting firms.

Insurance. This is largely burglary and theft insurance, covering both physical property and actions by staff members.

Anti-fraud departments. A number refer to specialist security departments, largely at the parent company level with global responsibility for fraud issues. Locally, committees monitor compliance and investigate specific instances.

Anti-fraud program. This includes adherence to the parent company standards and compliance with local legal and regulatory requirements (eg Risk Segregation Bill 198). It also includes training on the company's position on fraud in addition to external regulation.

Use of third parties. Companies are using outside legal consultants locally to manage the legal action phase.

Whistleblowing. Largely following the parent company policy, subsidiaries have channels for anonymous reports on fraud and corruption.

Operations risks

Managing pricing risk

In emerging markets, the predominant approach to pricing risk is to achieve cost efficiencies in materials, production and logistics. Companies are negotiating and sourcing materials at the best prices and also extending the supplier base.

Developed market companies refer also to strategic sourcing globally, economies of scale, and more efficient global distribution. Monitoring import and export costs is also important.

At both levels, a small number of companies are working closely with customers to provide value for money, and to distinguish themselves from the competition.

"Having employees out there who can review production on site. Having legal understanding of import and export and monitoring freight costs."
Head of Internal Audit, US

"We have a very tight recruitment process, we try to recruit a large percentage from campus. We also do background checks and have a detailed induction and training program. We make sure the code of business conduct is followed. We also have internal audits to review the high risk areas."

CRO, India

Developed market	Emerging market
Managing input costs through – strategic sourcing globally – economies of scale – more efficient global distribution	Managing input costs predominately through local cost efficiencies
Monitoring import and export costs	Market analysis and benchmarking local performance
Market analysis and benchmarking at macro level	Focusing on value
Focusing on value	

Managing workforce risk

Workforce risk is significantly more important for EM companies, due to its very nature and is more actively managed there. These companies are implementing the elements of Human Resource strategies to mitigate this risk.

Although this risk is largely managed in the EM company itself, there are some actions at the parent company level.

Developed market	Emerging market
Managing from HQ	Training
Transfer of qualified people	Providing competitive salaries
Training	Recruiting procedures
	Performance development systems
	Complying with local laws
	Using external advisers
	Hiring outside the local market

Developed markets

Managing from HQ. At this level, companies are developing and monitoring the approach in the local market. They communicate regularly on specific issues like training, recruitment and vetting.

Transfer of qualified people. They are transferring people across subsidiaries to ensure competency across the organization.

Training. People from the parent company travel to the local market to conduct training.

"We try to use a centralized ticket reservation system. We have a security system to access our buildings and critical information. We have personal security for the company management, also we use armored cars."

CFO, Brazil

Emerging markets

Training. A significant proportion of companies run training and education programs, or planning to increase and improve the training provided.

Providing competitive salaries. In most cases, this means salary and benefits adjustments, there were a couple of references to negotiating with and 'tackling' local unions. A number are benchmarking salaries, using salary reports from large HR consultants.

Recruiting procedures. Including background and reference checks.

Performance development systems. Implementing appraisal and development systems, including identification and development of high performers.

Complying with local laws. Companies are ensuring that they follow laws correctly, some maintaining good communication with government employment departments.

Using external advisers. This involves outsourcing of investigations and of training.

Hiring outside the local market. Either bringing people from outside the country, or moving the work itself outside the country.

Managing security risk

With the exception of taking out insurance, the actions to address security risk in EM companies were fairly fragmented. DM companies were more forthcoming about their actions in this area.

"Know your customer, his background, his market coverage and capacity. Conduct due diligence of the customers business strategy, how he approaches the market." CFO, Germany

Developed market	Emerging market
Security planning including	Using insurance
– Reviewing partners	Security planning
– Conducting security reviews	Reviewing partners
– Environmental reviews	Conducting security reviews
	Environmental reviews

"We are simply insured to manage the relations with our suppliers."

Tax Director, Canada

"We travel over there and verify the supply chain process. Visit and inspect so that we all have the same understanding."

Group Risk Director, US

Developed markets

Reviewing partners. Developing an understanding of their operational capabilities and their ability to protect goods delivered to the local markets.

Conducting security reviews. Monitoring security data, using local experts and staff from the DM country to conduct visits and inspections.

Environmental reviews. At a macro level, a number of companies get information from local partners or government departments and follow the country's politics and finances. They place the emphasis on safety when choosing an office location and a place of residence for their representatives.

Emerging markets

Using insurance. This largely involves physical and property insurance and insurance specific to the company's industry, examples are medical, operational and chemicals-related. A number have insurance committees.

Security planning. A small number of companies referred to their security plans, some were developed by outside consultants.

"If we're operating in a more difficult area we do a specific assessment for each deployment, making sure we send trained people with the right equipment and have a contingency plan." Business Unit Manager, UK

Managing supply chain risk

Both EM and DM companies are spreading the risk across individual suppliers and markets.

DM companies, in particular, refer to customer and supplier reviews and assessments. This includes auditing suppliers from both a financial and quality assurance point of view. They also rely on local operations, seeing this as more of a local issue, counting on agents to establish good relationships with distributors and suppliers.

EM companies are making frequent contact with clients, and selecting customers that are closer to their own operations. Well organized transportation is also a priority.

Developed market	Emerging market
Using alternative suppliers and multiple sourcing	Using alternative suppliers and multiple sourcing
Customer and supplier review and assessment	Direct customer contact
Relying on local operations	Focus on organized transportation

"First, we formed an association of foreign publishers in India and put pressure on the government to change the laws. Second, we educate customers, informing them what is allowed and what is not in IPP. Third, we make our products available in India at one seventh, or eighth of the US price."

CEO, India

Managing intellectual property risk

Protection of intellectual property rights is an issue in emerging markets, where legal protection is not guaranteed, especially in the case of joint ventures. The actions taken to manage intellectual property risk are taken equally at both DM and EM levels.

Developed market	Emerging market
Patent protection extension	Patent protection
Contract protection	Contract protection
Monitoring and acting on infringement	Physical security
Selection of production markets	Monitoring and acting on infringement

Patent protection. In the first instance, companies in both markets apply for patents and obtain trademark protection. DM companies ensure that their patents extend to the emerging market country.

Contract protection. They work with lawyers to ensure the proper documentation of agreements, covering technological information in contracts.

Physical security. These measures involve physical security for factories, limiting turnover of local workers and avoiding products being seen on public platforms.

Monitoring and acting on infringement. They are taking action against counterfeit products, working with law firms to identify and pursue 'knock-offs'.

Selection of production markets. A small number of DM companies are avoiding the risk altogether, and not undertaking critical production of manufacturing products with a high element of technology in particular markets.

"We have developed a scoring system to help assess and evaluate our choice of agents."

Business Director, Russia

"We hedge the various currencies in which we are dealing. We exercise both the options of forward buying and selling of currency and also have to use value added derivatives for foreign currency swaps."

Business Director, India

Financial risks

Managing currency or treasury risk

Companies in both developed and emerging markets are managing this risk, which is often a shared responsibility in the case of subsidiaries. The main steps are formal hedges, natural hedges and limiting exposure.

Developed market	Emerging market
Hedging	Hedging
Limiting exposure to currencies	Natural hedging
Treasury department	Monitoring
Monitoring/forecasting	Limiting exposure
Insuring the exposure	Risk not managed at local level
Limited management of this risk	

"We try to have consistent group control through the central treasury, which our branches have to follow." Group Risk Director, Italy

Developed markets

Hedging. Developed market companies are working with their banks to hedge the risk through exchange rate contracts.

Limiting exposures to currencies. Negotiations and operations are done in international currencies like euros or dollars, as well as matching currencies (natural hedging).

Treasury department. Currency risk is managed through treasury department policies that are responsible for control and counteractive measures.

Monitoring/forecasting. Sometimes using specialist advice, companies monitor exchange rate movements to plan for cover, to time transactions, or, to look for alternate suppliers.

Insuring the exposure. Primarily in relation to individual transactions, companies use insurance to cover the transaction, or as part of the contract itself.

Limited management of this risk. For a number of companies, currency risk is either not a priority, or is not yet being managed effectively.

"We use currency insurance; insure the currency against fluctuations for the duration of the business deal." Chief Risk Officer, Sweden

"We have a senior supervisory management committee which manages the legal and compliance issues. It reports to the board on a quarterly basis. We try to stay on top of the compliance framework and the key thing is to understand the compliance regulations in India and have the senior committee constantly monitor it."

Group Risk Director, India

Emerging markets

Hedging. Hedging is taking place at a relatively higher level in the emerging markets themselves. A number of subsidiaries are doing both external and internal hedges, as a high percentage of their transactions take place within the organization.

Natural hedging. EM companies are also working to create natural hedges, matching receivables and payables in a particular currency, or equalizing importations and exportations.

Monitoring. Like a number of DM respondents, companies in the emerging markets are closely monitoring changes in the exchanges rates to plan for currency transactions.

Limiting exposure. They are also working with different suppliers to spread the risk, pushing the risks on to customers, keeping cash flows to a minimum, setting limits on credit and on fixed investment and financing.

Risk not managed at local level. This activity is frequently a responsibility of parent company.

"We work with an external partner to ensure that we abide by the legislation and have an understanding of how it affects us." Group Risk Director, Sweden

Managing trade credit risk

The primary approach for EM companies is to work with partners with good credit reputations. Before signing contracts, companies assess customer credit ratings and histories, internally and through third parties.

In a clear contrast with EM companies who have a more operational response to credit risk, the most common approach towards credit risk in DM companies is to take out insurance.

Developed market	Emerging market
Credit insurance	Analysis and checking of clients
Analysis and checking of clients	Apply internal credit policy
Credit policy	Imposing credit terms
Imposing payment terms	Obtaining legal advice
Using letters of credit	
Taking external advice	

Developed markets

Credit insurance. Most companies made general references to trade credit insurance, a small number mentioned specialist insurance companies and insuring customers on an individual basis.

"It's enough to say that we have credit insurance, isn't it?"
CFO, Sweden

Analysis and checking of clients. Consistent with EM companies, this group is doing internal analysis and consulting specialist research agencies. They work with local partners and send people from the home country to the local market. In contrast with the EM respondents, a small number conduct direct information sessions with customers.

Credit policy. Part of the financial internal controls, policies governing the credit given to customers and suppliers.

Imposing payment terms. Primarily cash payments.

Using letters of credit. Other guarantees of payment.

Taking external advice. A small number rely on credit export agencies to assess risk levels for countries and customers.

Emerging markets

Analysis and checking of clients. To work with partners with good credit reputations, and before signing contracts, companies are assessing customer credit ratings and histories, internally and through third parties.

Apply internal credit policy. Credit analysis and scoring is applied to determine trading partners.

Imposing credit terms. Most companies in this group refer to credit limits and short payment terms. A small number are enforcing 100% prepayment, and looking ahead to stop supplying goods if there is a possibility of bad debt.

Obtaining legal advice. This action refers particularly to recovery and bad debts.

Managing financial reporting risk

A relatively high proportion of companies in both developed and emerging markets say that they are actively managing financial reporting risk. However, only a small percentage identify this as one of their key risks. As such, the account of actions taken to manage this risk is relatively brief.

Developed market	Emerging market
Structured guidelines	Data systems integrated directly with headquarters
Regular reporting with subsidiaries	Internal audit
Management visits	Verification of financial quotations

"Frequent follow up in all the operations and analysis. Providing support with all the decisions taken in financial issues." Business Unit Head, Brazil

"Once every three months, the headquarters goes to India to check if all the procedures are being followed and applied." Group Risk Director, France

Survey approach

From February through April 2007, our researchers interviewed 936 senior finance, risk and business decision-makers in large organizations, across major industry sectors. Interviews were conducted across 17 countries. Five of these were emerging markets: Brazil, China, India, Russia and Turkey. Interviews in these countries were conducted with companies that were either subsidiaries of developed market multinationals, or had some kind of trading relationship with developed markets. In turn, interviews in the developed markets were with parent companies with subsidiaries or trading partners in emerging markets. In all cases, respondents were knowledgeable about and involved in risk management in relation to emerging markets.

Respondent job titles

Finance Stakeholders	Total
CFO	223
Business Unit CFO	58
Group Financial Director	43
Tax Director	21
Financial Controller	14
Senior Finance Manager	10
Treasurer	5
Total	**374**

Risk Stakeholders	Total
Group Risk Director	99
CRO	82
Head of Internal Audit	53
Total	**234**

Business Stakeholders	Total
Business Director	131
Business Unit Head	68
CEO	39
Corporate Development Officer	25
COO	20
Head of Strategy	18
Head of Legal	8
Head of Marketing	8
Company Secretary	3
Other respondents	8
Total	**328**

BASE: All respondents (936)

[1] The telephone-based survey was conducted by Taylor Nelson Sofres

Industry sectors

Sector	Total
Consumer Products	94
Banking & Capital Markets	88
Automotive	87
Real Estate, Hospitality, Construction	58
Technology	44
Oil & Gas	43
Pharmaceuticals	36
Media & Entertainment	25
Utilities	21
Biotechnology	21
Insurance	20
Telecommunications	18
Total	**555**

Sector	Total
Retail and Wholesale	82
Diversified Industrial Products	68
Industrial Equipment	66
Food & Beverage	57
Professional Firms & Services	29
Transportation	22
Mining	13
Aerospace & Defense	10
Provider Care	8
Public Services	4
Airlines	3
Other Industries	19
Total	**381**

BASE: All respondents (936)

Geography

Emerging markets	Total
Brazil	121
India	120
China	120
Russia	100
Turkey	40
Total	**501**

Developed markets	Total
US	75
France	50
Italy	50
Spain	37
UK	36
Canada	35
Singapore	35
Sweden	35
Germany	31
Switzerland	26
Japan	19
Other countries	6
Total	**435**

BASE: All respondents (936)

Emerging market respondents

Parent/Partner location	Brazil	Russia	India	China	Turkey	Total
US	29%	15%	24%	12%	7%	18%
Germany	20%	21%	14%	12%	18%	17%
Japan	5%	7%	9%	37%	6%	11%
France	10%	9%	6%	7%	12%	9%
UK	4%	9%	12%	3%	11%	8%
Italy	8%	7%	7%	4%	12%	7%
Spain	8%	6%	3%	4%	7%	6%
Canada	2%	6%	4%	4%	5%	4%
Singapore	2%	3%	6%	9%	1%	4%
Switzerland	5%	5%	5%	2%	3%	4%
Sweden	1%	4%	3%	2%	5%	3%
Other	6%	8%	7%	5%	13%	8%

BASE: All emerging market companies (501)

The sample contains:

220 interviews with emerging market subsidiaries of foreign companies

190 interviews with joint venture partners, third-party agents or intermediaries and major suppliers of foreign companies doing business with emerging market countries

91 interviews were carried out with leadings businesses in emerging market countries

Developed market respondents

The developed market respondents were taken from 435 headquarter organizations across 12 countries. We examined in detail 557 geographic relationships between developed market HQs and their operations in the following emerging markets: Brazil (89), China (202), India (120), Russia (106), Turkey (40).

This represents a combined total of 1342 links with emerging market countries comprising of: 272 subsidiaries, 127 joint ventures, 235 third party agents or intermediaries, 326 properties (owned & leased), and 382 significant customers or suppliers. Distribution shown below:

	US	Singapore	France	Italy	Spain	Canada	Germany	UK	Sweden	Switzerland	Japan	Other countries	Total
Brazil	53	3	29	16	42	16	23	16	17	10	0	5	230
Russia	16	10	19	37	17	28	36	15	29	15	8	3	233
India	40	33	29	28	9	19	16	36	16	15	3	0	244
China	96	138	44	43	31	46	29	30	29	22	36	9	553
Turkey	0	0	33	29	20	0	0	0	0	0	0	0	82
Total	**205**	**184**	**154**	**153**	**119**	**109**	**104**	**97**	**91**	**62**	**47**	**17**	**1342**

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