

July 11th, 2017

TOUR DE VALUE



Team iiBV Tours the Global Valuation Landscape

AGENDA

- Country Specific Risk Premiums with Raymond Rath
- The Bid Premium in Business Valuation with Andrew Strickland
- US GAAP and IFRS with Mark Weston
- International Valuation Standards with John Barton

- Moderated by Ray Moran

TOUR DE VALUE: COUNTRY SPECIFIC RISK PREMIUMS

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GLOBALVIEW ADVISORS

DISCLAIMER

- The views expressed are my own and do not necessarily reflect those of any other individuals or organizations.

INTRODUCTION – ONE VIEW ON COUNTRY RISK PREMIUMS

- In most **emerging** market valuations, a “country risk premium” is added to the CAPM discount rate of an equivalent investment in a developed market. However, this is not only a flawed procedure, but it is also extremely difficult to gauge how country risk might affect the discount rate.
- This article is **proposed to appraise country risk mainly through its impact on projected cash flows**, leaving its **possible effect on the discount rate as a secondary consideration**.
- The main emphasis is on building a model where all relevant variables and risks are adequately integrated.
- Then a Monte Carlo simulation is performed to obtain a probability distribution for the present values of the firm or project.
- Finally, the discount rates selected by the analyst (however inaccurate) together with their corresponding expected present values are contrasted with the simulation’s results in order to make an educated decision
- *Source: A Practical Approach for Quantifying Country Risk*, Jaime Sabal, Professor of Finance, ESADE, GCG Georgetown University - *Universia* 2008 Vol. 2 Num. 3 ISSN: 1988-7116 .

KEY CONCERN

- Greater potential uncertainty for projections for emerging markets. Significant country specific risk factors should be addressed.
- Less uncertainty for developed markets given their greater integration with other developed markets and lower degree of idiosyncratic risk.
- See Damodaran's calculated country risk premiums on his website.
- Given the significant judgments associated with country risk premiums for developing emerging country discount rates, capturing risks in the expected cash flows rather than in the discount rate requires consideration. This is consistent with the FASB and IASB general perspectives as set forth in ASC 805 and IFRS 13.
- For emerging countries, with limited information on debt and equity returns, incorporating risks into the cash flows would seem appropriate.

TYPES OF RISKS FOR INTERNATIONAL INVESTMENTS

1. Financial
 - a. Currency volatility
 - b. Default / restructuring
 - c. Other
2. Economic
 - a. Inflation
 - b. Other
3. Political
 - a. Repudiation / expropriation
 - b. Other

COUNTRY RISK PREMIUM CHALLENGES

- In principle, incorporating a country risk premium in the discount rate is flawed for several reasons:
 - First, **not all projects and/or companies are equally exposed to country risk in every country.**
 - Second, whenever country risk is quantified as the yield spread between the relevant country government bonds and their “risk-free” equivalent (i.e. US T-Bonds), the **risk premium is contaminated with the risk of default of the developing country’s government.** Although there might be some linkage between the probability of default and country risk, this relationship tends to be quite tenuous for most business propositions.
 - . . . an acceptable proxy for country risk is generally hard to pinpoint
- *Source: A Practical Approach for Quantifying Country Risk, Jaime Sabal, Professor of Finance, ESADE, GCG Georgetown University - Universia 2008 Vol. 2 Num. 3 ISSN: 1988-7116 .*

DISCOUNT RATES AND CURRENCY OF PROJECTIONS

- Discount rate and currency of projections should be consistent
- Assume value opinion to be expressed in USD
 - Option 1
 - Local-currency cash flows should generally be converted to USD at the forward rates to appropriately address currency risk, and the discount rate should be based on USD denominated yields
 - Country risk premium should be included in the weighted average cost of capital ("WACC") to appropriately address systematic risks related to country-specific issues
 - (i.e., political, social or economic issues), which are not otherwise addressed in the cash flows.
 - Option 2
 - Use the local currency CF and discount rate.
 - Convert value indication using the spot exchange rate between local currency and USD.

METHODS TO ESTIMATE INTERNATIONAL COST OF EQUITY

1. Global CAPM
 - Beta measured using a world portfolio of stocks
 2. Single country version of CAPM
 - CAPM with all inputs from subject country
 3. Country Risk Spread Models
 - Include adjustment for relative risk free rates
 4. Relative Volatility Models
 - Uses U.S. CAPM and adds a relative volatility adjustment
 5. Erb-Harvey-Viskanta Country Credit Rating Model
 - Regresses country credit ratings from Institutional Investor
- Source: International Cost of Capital – How to price international country risk and use the *2015 International Valuation Handbook – Guide to Cost of Capital*, Roger Grabowski, Managing Director, Duff & Phelps, ASA Advanced BV Conference October 2015, Las Vegas, NV

DAMODARAN - 2017 ESTIMATED COUNTRY RISK PREMIUMS BY REGION

<i>Region</i>	<i>Weighted Average: TRP</i>	<i>Weighted Average: CRP</i>	<i>Weighted Average: Default Spreads</i>	<i>Tax Rate</i>
Africa	12.00%	8.31%	5.12%	27.91%
Asia	7.12%	1.43%	1.16%	26.68%
Australia & New Zealand	5.70%	0.01%	0.01%	29.76%
Caribbean	13.92%	8.23%	6.69%	24.50%
Central and South America	10.21%	4.52%	3.67%	31.09%
Eastern Europe & Russia	9.09%	3.40%	2.77%	18.97%
Middle East	7.50%	1.81%	1.47%	20.81%
North America	5.69%	0.00%	0.00%	38.93%
Western Europe	6.81%	1.12%	0.91%	26.36%
Global	7.08%	1.39%	1.13%	29.76%

Source: Aswath Damodaran, Ph.D, website. Information from January 2017

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DISCUSSION

TOUR DE VALUE: THE BID PREMIUM IN BUSINESS VALUATION

ANDREW STRICKLAND, FCA

SCRUTTON BLAND CHARTERED ACCOUNTANTS

LISTED COMPANY MARKET FACTS

- Prices are set by the last trade on each day;
- That trade will be in respect of an insignificant minority holding;
- 3% or so of companies taken over each year;
- In many takeover bids, premiums of 30% to 40% are offered

ASSUMPTIONS FROM ABOVE FACTS

- The market price is a minority price;
- There is a higher level of value in control;
- The bid premium is a control premium;
- If valuing a majority holding in private company, apply a control premium to metrics from public markets

RECENT CASES IN UK COURTS SUPPORTING THE ABOVE

- Foulser and Foulser v HMRC [2015] (40%)
- Arbuthnott v Bonnyman [2014] (40%)
- Work v Gray [2016] (not stated)
- N Green v HMRC [2015] (30%)
- S Marks v HMRC [2011] (30%)

FOULSER AND FOULSER V HMRC

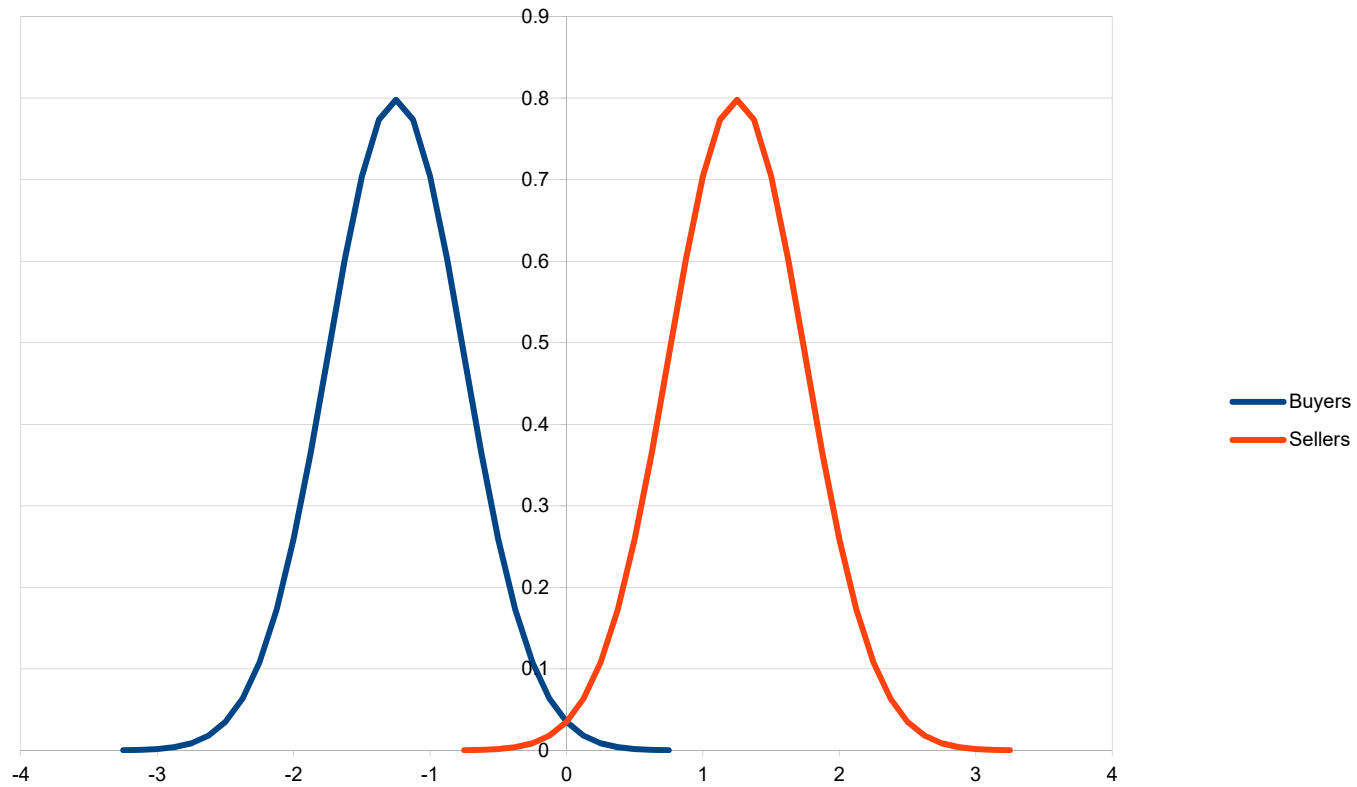
- The Tribunal on the Control Premium
- “That was a logical step, and one we consider appropriate to the valuation process employed by [the Expert].”

SIX REASONS FOR TAKEOVERS

- Benefits of Synergy
- Company Under-priced by Market
- Company over-priced by Buyer
- Weak Management of Target
- Self-interest of management of Buyer
- Economically irrational

A VIEW OF THE MARKET

Market price as clearing price



1,937 TAKEOVERS IN USA MARKET

- 1995 to 2011
- 8.4% at a discount to prevailing market price (162 transactions)

THE APPRAISAL FOUNDATION AUTHORISED BY CONGRESS FOR THE DEVELOPMENT OF BUSINESS APPRAISAL STANDARDS

- The Market Participant Acquisition Premium
- Exposure Draft (Second Exposure November 2015)

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THE INTERNATIONAL VALUATION STANDARDS COUNCIL IVS 2017 “BASIS FOR CONCLUSIONS” PAPER



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IPEV 2012 AND 2015

- “.....the presumption in these Valuation Guidelines is that the market based multiples are indicative of the value of the company as a whole.”

A GUIDE TO THE MINORITY DISCOUNT? STEP-IN RIGHTS?

DISCUSSION

TOUR DE VALUE: US GAAP AND IFRS

OVERVIEW OF CONVERGENCE - FAIR VALUE MEASUREMENT,
BUSINESS COMBINATIONS AND IMPAIRMENT TESTING

MARK WESTON CPA, CA, CFF, CBV

DAVIDSON & COMPANY LLP

DISCLAIMER – NON AUTHORITATIVE

- The following slides present a high level overview of some of the similarities and differences between aspects of US Generally Accepted Accounting Policies and International Financial Reporting Standards pertaining to fair value measurement, business combinations and impairment testing.
- The information contained herein is not, and should not be considered, authoritative.
- Readers are strongly encouraged to carefully review the standards referenced herein, prior to placing any reliance on the information presented in these slides.

RESOURCES

- [IFRS Compared to US GAAP – An Overview](#), December 2016, KPMG
- [Accounting Standards Update 2017-04, Intangibles – Goodwill and Other](#), Financial Accounting Standards Board

CONVERGENCE

- Convergence between IFRS and US GAAP has long been considered uncertain.
- In the US, a dual GAAP environment will likely continue as International Accounting Standards Board and Financial Accounting Standards Board continue to pursue their own independent agendas.
- It is important for valuation professionals involved in valuation for financial reporting to understand the key differences between IFRS and US GAAP.

IMPORTANT STANDARDS TO BE FAMILIAR WITH

US GAAP

- ASC 805 – Fair Value Measurement
- ASC 820 – Business Combinations
- ASC 350 – Intangibles, Goodwill and Other
- ASC 360 – Property, Plant and Equipment

IFRS

- IFRS 13 – Fair Value Measurement
- IFRS 3 – Business Combinations
- IAS 36 – Impairment of Assets
- IAS 38 – Intangible Assets

FAIR VALUE MEASUREMENT

US GAAP

- ASC 805 – Fair Value Measurement

IFRS

- IFRS 13 – Fair Value Measurement

FAIR VALUE MEASUREMENT

ASC 805 and IFRS 13: Highly, if not Absolutely, Converged

- The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.
- Based on market-related assumptions.
- An exit-price definition of fair value that would result from the market participants' behavior.

FAIR VALUE MEASUREMENT

ASC 805 and IFRS 13: Highly, if not Absolutely, Converged

- Based on the valuation technique that is appropriate in the circumstances
 - For which sufficient data is available, that
 - Maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs.

FAIR VALUE MEASUREMENT

ASC 805 and IFRS 13: Highly, if not Absolutely, Converged

- Fair value measurement, under both US GAAP and IFRS, also incorporates other notional concepts such as:
 - Highest and best use (for non-financial assets);
 - Principal (most advantageous) market; and
 - Fair value hierarchy (based on inputs).

BUSINESS COMBINATIONS

US GAAP

- ASC 820 – Business Combinations

IFRS

- IFRS 3 – Business Combinations

BUSINESS COMBINATIONS

ASC 820 and IFRS 3: Highly Converged

- The acquisition of a collection of assets that does not constitute a business is NOT a business combination.
- In an asset acquisition the acquiring entity allocates the cost of the acquisition to the acquired assets and liabilities.
- Goodwill is NOT recognized.

BUSINESS COMBINATIONS

ASC 820 and IFRS 3: Highly Converged

- Business combination is a transaction or event in which an acquirer obtains control of one or more businesses (US GAAP guidance on control differs.)
- Accounted for using the acquisition method.
- Date of acquisition is the date the acquirer obtains control.
- Consideration measured at fair value at the date of acquisition.
- Contingent consideration recorded as a liability (or asset) remeasured based on Fair Value until settlement

BUSINESS COMBINATIONS

ASC 820 and IFRS 3: Highly Converged

- Identifiable assets acquired and liabilities assumed are recognized separately from goodwill.
- Exceptions regarding the recognition of contingent liabilities, deferred tax assets and liabilities, indemnification assets, and others.
- Goodwill measured as a residual and recognized as an asset.
- Negative goodwill (bargain purchase) recognized in profit or loss ... after reassessing values used in acquisition accounting.

INTANGIBLE ASSETS AND GOODWILL

US GAAP

- ASC 350 – Intangibles, Goodwill and Other

IFRS

- IAS 38 – Intangible Assets

INTANGIBLE ASSETS AND GOODWILL

ASC 350 and IAS 38: Partially Converged

- An intangible asset is a non-monetary / non-financial asset without physical substance.
- An intangible asset is considered 'identifiable' if it separable or arises from contractual or legal rights.

INTANGIBLE ASSETS AND GOODWILL

ASC 350 and IAS 38: Partially Converged

- Goodwill is only recognized in a business combination and is a residual amount.
- Goodwill and identifiable intangible assets with indefinite lives are:
 - Not subject to amortization
 - Subject to impairment testing (the test between US GAAP and IFRS differs)
- Finite-lived intangible assets are amortized over their useful lives.

IMPAIRMENT OF NON-FINANCIAL ASSETS – NOT CONVERGED

US GAAP

- ASC 350, ASC 360

IFRS

- IAS 36 – Impairment of Assets

IMPAIRMENT OF NON-FINANCIAL ASSETS

IAS 36 – Impairment of Assets

- Covers the impairment of PP&E, intangible assets and goodwill.
- Testing required when indication of impairment exists.
- Annual testing required for goodwill, indefinite lived intangible assets and intangible assets not-yet-available for use.

IMPAIRMENT OF NON-FINANCIAL ASSETS

IAS 36 – Impairment of Assets

- Tested on an individual basis or as part of a cash generating unit (“CGU”)
- Test is to compare the asset’s /CGU’s carrying amount with its recoverable amount.
- Recoverable amount is the higher of fair value less cost to dispose and value in use (“VIU”).
- VIU based on management’s expectations regarding cash flows from existing assets (may differ from those of market participants)
- Impairment loss recognized when an asset’s / CGU’s recoverable amount is less than its carrying amount.

IMPAIRMENT OF NON-FINANCIAL ASSETS

ASC 350, 360

- Similar to IAS 36:
 - Testing required when indication of impairment exists.
 - Annual testing required for goodwill and indefinite lived intangible assets.

IMPAIRMENT OF NON-FINANCIAL ASSETS

ASC 350, 360

- Unlike IAS 36:
 - Intangible assets not-yet-available for use are only tested for impairment when an indication of impairment exists.
 - Assets tested as individual assets, group of assets or at reporting unit (“RU”) level.
 - Note: Determination/ assessment of CGUs and RUs are the responsibility of management / auditors – not valuation professionals.

IMPAIRMENT OF NON-FINANCIAL ASSETS

ASC 350, 360

- Long-lived assets subject to depreciation are tested for impairment on a stand-alone basis if possible (otherwise on an asset group basis).

IMPAIRMENT OF GOODWILL

ASC 350

- Current test is 2 Step test
 - Step 1: Compare the fair value of a RU to its carrying amount.
 - Step 2: If fair value < carrying amount calculate the impairment charge by comparing the implied fair value of the goodwill with its carrying amount.

IMPAIRMENT OF GOODWILL

ASU 2017-04

- On Jan 26, 2017 FASB released ASU 2017-04, which simplifies the accounting for goodwill impairment by eliminating Step 2 from the goodwill impairment test.
- In accordance with the new guidance an entity will:
 - Test goodwill by comparing the fair value of a RU with its carrying amount; and
 - Recognize an impairment charge for the amount by which the carrying amount exceeds the RU's fair value (limited to the total amount of goodwill allocated to that reporting unit.)

IMPAIRMENT OF GOODWILL

Convergence With IAS 36

- Removing Step 2 from the goodwill impairment test under ASC 350 more closely aligns U.S. GAAP with IAS 36.

IMPAIRMENT OF GOODWILL

Convergence With IAS 36

- A number of differences remain:
 - IAS 36 is performed at the CGU level while the impairment test under ASC 350 is performed at the RU level.
 - IAS 36 requires an entity to compare the carrying amount of the CGU with its recoverable amount (higher of FVLCD and VIU) whereas the ASU requires an entity to compare the carrying amount of a RU unit with its fair value.

IMPAIRMENT OF GOODWILL

- The ASU is effective for public entities that are SEC filers, for annual / interim impairment tests for periods beginning after December 15, 2019.

CONCLUSION

- ASC 805 and IFRS 13 – Fully Converged
- ASC 820 and IFRS 3 – Highly Converged
- ASC 350 and IAS 36 – Somewhat converged

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THANK YOU

DISCUSSION

TOUR DE VALUE: INTERNATIONAL VALUATION STANDARDS

JOHN BARTON, MA, MBA, CPA

BRANDYWINE VALUATION CONSULTANTS, INC.

WHAT IS THE INTERNATIONAL VALUATION STANDARDS COUNCIL (IVSC)?

- Organization consisting of about 80 members which are mostly valuation professional organizations (VPOs), corporations, and other financial institutions. Membership does not exist at the individual level.
- Operates through 3 Boards:
 - Board of Trustees
 - Membership & Standards Recognition Board (issues the IVS)
 - Standards Review Board

WHO FOLLOWS WHICH SET OF STANDARDS?

- Within the United States there are multiple sets of valuation standards that govern practitioners with significant overlap, including:
 - USPAP (all VPOs belonging to the Appraisal Foundation)
 - ASA-BV standards (ASAs)
 - AICPA standards (CPAs)
 - CICBV standards
 - IVS (all members of the Royal Institution of Chartered Surveyors – RICS)
- Outside the U.S. business valuation VPOs are less developed. Practitioners tend to adhere to their employer's standards and/or the IVS.

IVS 2017

- The Membership and Standards Board revised the outstanding 2013 IVS Standards with a new publication which became effective last week on July 1, 2017.
- IVS 2017 is a streamlined set of standards that is multi-disciplinary, applying to real estate, business, machinery, financial instruments, and intangible assets.
- IVS 2017 simplified the IVS framework into two sets of standards:
 - General Standards
 - Asset Standards

IVS 2017

- General Standards
 - IVS 101 – Scope of Work
 - IVS 102 – Investigations & Compliance
 - IVS 103 – Reporting
 - IVS 104 – Bases of Value
 - IVS 105 – Valuation Approaches and Methods

IVS 2017

- Asset Standards
 - IVS 200 – Business & Business Interests
 - IVS 210 – Intangible Assets
 - IVS 300 – Plant & Machinery
 - IVS 400 – Real Property Interests
 - IVS 410 – Development Property
 - IVS 500 – Financial Instruments

IVS 2017 – GENERAL STANDARDS

- **IVS 101** – Scope – details the points that need to be identified to the client at the outset of the assignment (purpose, valuation date, basis of value, sources of information, assumptions, limitations, etc.)
- **IVS 102** – the extent of the investigation and limits thereof must be noted. Record keeping, compliance with other standards.
- **IVS 103** – All valuation reports, regardless of the format, must at a minimum convey the scope of the assignment, the methods applied, key inputs, assumptions, conclusions, and valuation date. All reports must be understandable to an experienced professional. Norms for Review Reports also discussed.

IVS 2017 – GENERAL STANDARDS

- **IVS 104** – Bases of Value
 - Market Value
 - Market Rent
 - Equitable Value
 - Investment Value
 - Synergistic Value
 - Liquidation Value
 - Other (bases of value established by accounting or legal norms, such as Fair Value, are recognized)
- **IVS 105** – The approaches and methods are the same as other standards (i.e. income, market, cost).

IVS 2017 – ASSET STANDARDS

- IVS 200 – Overview of the basic principles of business valuation including exposition on the process, investigation and analysis of the valuation of a business enterprise.
- IVS 210 – Overview of the basic principles of intangible asset valuation including an exposition on the types of intangible assets and the methodologies used to value each.
 - Income approaches (excess earnings, greenfield, relief from royalty, with and without method, distributor method)
 - Market approach
 - Cost approach

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THANK YOU DISCUSSION

TOUR DE VALUE: THE NEED TO TAKE CULTURAL DIFFERENCES INTO ACCOUNT WHEN ASSESSING COUNTRY RISK

JOHN C. HAWTHORNE, ASA, CFA

ESTIMATING THE COST OF CAPITAL

- ***The cost of capital*** is sometimes referred to as the opportunity cost of capital. Opportunity cost refers to a potential investment returns that an investor could have received, but gave up, to invest in another opportunity with similar risk. In investing, it is the difference in return between a chosen investment and one that is necessarily passed up given an equal level of risk.

ESTIMATING THE COST OF CAPITAL

- ***Estimating the cost of capital is critical*** when assessing the long-run expected return on investments. From valuing individual securities or capital projects to evaluating mergers or acquisitions, estimating the cost of capital is one of the most important assessments that corporate finance professionals make in evaluating investment opportunities.

ESTIMATING THE COST OF CAPITAL

- ***Assessing the cost of capital in well developed economies*** with large diversified and liquid capital markets is a non-trivial exercising, requiring the assessment of a variety of risk factors such as the “riskless return” on government bonds, the equity risk premium, sector or industry risk, size risk and company specific risk.

ESTIMATING THE COST OF CAPITAL

- ***Are there additional risks associated with investing in foreign economies?*** Country risk can reduce the expected return on an investment and must be taken into consideration whenever investing in foreign economies. Some country risk does not have an effective hedge. Other risk, such as exchange rate risk, can be protected against through the option/futures market with a marginal loss of profit potential. .

WHAT IS 'COUNTRY RISK'?

One definition provided by an Investopedia is:

- Country risk is a collection of risks associated with investing in a foreign country. These risks include political risk, exchange rate risk, economic risk, sovereign risk and transfer risk, which is the risk of capital being locked up or frozen by government action. Country risk varies from one country to the next. Some countries have high enough risk to discourage much foreign investment.
- The United States is generally considered the benchmark for low country risk and most nations can have their risk measured as compared to the U.S. Country risk is higher with longer term investments and direct investments, which are investments not made through a regulated market or exchange.

THERE IS A VARIETY FINANCIAL OF MODELS DEVELOPED ASSESSING COUNTRY RISK

- Over the past few years, a variety of financial models have emerged to assist financial professionals in assessing the country risk component of cost of capital in foreign markets. Some of the more popular of these models are:
 - Local Country CAPM (basic CAPM model using only local market inputs)
 - International or World (Global) CAPM
 - Country Risk Rating Model
 - Country Spread Model
 - Relative Standard Deviation Model
 - Damodaran Local Country Risk Exposure Model
 - Alternative Risk Measure (downside) Model

NON-QUANTIFIABLE COUNTRY RISKS – CULTURAL RISK FACTORS

- However, there are additional less quantifiable country specific risk factors affect investment risk. ***Fundamentally these additional risk factors derive from differences in culture.***

WHAT IS CULTURE?

One definition provided by an introductory Anthropology textbook is:

- Culture is the system of shared beliefs, values, customs, behaviors, and artifacts that the members of society use to cope with their world and with one another, and that are transmitted from generation to generation through learning.

GLOBALIZATION HAS OUTPACED THE ABILITY OF MANY ORGANISATIONS TO MANAGE THE ACCOMPANYING CULTURAL SHIFTS.

- The focus has been on overcoming legal, political, technological, and economic barriers, while cultural barriers are often unacknowledged or discounted.
- Ignorance of cultural differences can result in weak market share, low or negative return on investment, missed opportunities, and reputational damage, as well as legal challenges, productivity losses, expatriate failure, and the premature termination of contracts, joint ventures, and partnerships. The misunderstandings, tensions, and biases caused by cultural differences can even lead to outright failure.

TOP 10 CULTURAL RISKS FOR GLOBAL BUSINESS

- The following material is taken from an article of the same name on the “Culture Plus Consulting” website, and provides a good overview of the additional risk components inherent in investing in foreign economies with significant cultural differences.³
- The main cultural risks facing global businesses include:

FAILING TO ADAPT GLOBAL BUSINESS MODELS TO THE LOCAL MARKET

- Consumer attitudes and behaviors are highly influenced by culture. When a company moves into a new market, business models should be modified to reflect local preferences, customs, and habits. For example, changes should be made to product and service offerings, pricing, and marketing. Unless local cultures drive business models, foreign businesses have a high risk of failure. The costs associated with failure in a foreign market can be significant - on average, international retailers absorb seven years of losses before they shut down or sell their operations to a local competitor.

FAILING TO IDENTIFY REGIONAL AND SUBCULTURE DIFFERENCES

- Cultural barriers may be just as relevant intranationally as internationally. Within emerging markets, there are significant regional variations in consumer preferences and market conditions, yet within-country differences are often overlooked — four-fifths of multinationals report that their offshore decision-making occurs at the country rather than the city level. Subcultures are not limited to regional or ethnic variations. For example, consider the different consumer profiles of males and females in the United States. Although females account for 88 percent of retail purchases, marketing campaigns, advertisers often overlook differences in male and female consumer behavior and thinking. Moreover, female consumer habits and preferences vary across generational, ethnic, and occupational groups.

FAILING TO UNDERSTAND LOCAL BUSINESS PRACTICES

- Cultural barriers don't only occur at the customer interface. International business success also requires an in-depth understanding of local business customs. Without a full appreciation of how business is done in a foreign market—including economic, political, regulatory, and cultural influences—new entrants can quickly find themselves on the back foot with stakeholders.

FAILING TO ADAPT MANAGEMENT PRACTICES ACROSS CULTURES

- Most, if not all, management theories, models, and practices are laden with culture-specific assumptions. No organizational theory is universal, yet the cultural assumptions underlying management practices are often unacknowledged. Ideas are transferred to other cultural environments without consideration of cultural variations. But when practices are translated across cultures without adjustment for cultural differences they can fail—and may even lead to losses.

FAILING TO IDENTIFY NEW OPPORTUNITIES

- Cultural barriers may result in missed opportunities. There are examples of well-established North American or European companies that have overlooked the potential of certain developing markets, failing to establish an early market presence and leaving them unable to catch up to other foreign companies or local competitors. Other companies have withdrawn from emerging markets prematurely, damaging relationships and leaving a legacy of weak commitment in the process.

FAILING TO UNDERSTAND LOCAL LEGAL AND ETHICAL ISSUES

- Global companies face a complex web of legal and ethical issues. In 2012, Hermès lost a trademark case in China after a fifteen-year battle with a local firm Foshan. In 1995, Foshan had registered a Chinese-character trademark with similar pronunciation but a slightly different written form than the Hermès name in Chinese.
- Another example from China is the custom of guanxi: the establishment of long-term reciprocal relationships via the giving of gifts. Guanxi is critical for establishing the trust that underpins successful business in China, but home-country laws (for example, the U.S. Foreign Corrupt Practices Act or the U.K. Bribery Act) may prohibit global organizations from engaging in this practice. When this is the case, foreign companies must seek alternative means of fostering trust.

FAILING TO ADAPT HUMAN RESOURCE MANAGEMENT TO LOCAL MARKETS

- Cultural ignorance may threaten a firm's ability to attract, retain, and leverage its pool of global talent. When foreign companies employ local staff, human resource policies need to be adapted to reflect the cultural profile of local employees. Factors that influence employee motivation, job satisfaction, and organizational commitment vary across cultures. In addition, conflict resolution and giving and receiving feedback differ widely across cultures, with significant implications for performance-appraisal.

INEFFECTIVE DIVERSITY MANAGEMENT

- Research shows that diversity is a double-edged sword. Diverse teams may either improve or detract from performance. On the positive side, the successful integration of diverse perspectives fosters innovation and creativity, inclusive workplaces attract and energize top global talent, a diverse workforce can better understand and respond to the needs of varied customers, and employee diversity can increase access to new suppliers and other stakeholders.
- But unless carefully managed, diverse workgroups may experience greater conflict and less trust and cohesion than homogenous teams. Companies need to effectively manage cultural conflicts, bias, and discrimination. Those that do not address those internal tensions will fail to leverage the advantages of a diverse workforce and may face costly discrimination claims.

STAKEHOLDER CONFLICT

- Diversity increases the complexity of our exchanges. It enhances the potential for language and other communication barriers and it heightens the risk of ambiguity, value conflicts, and reasoning and decision-making differences. In addition, stereotypes and other forms of bias can threaten rapport and stifle the exchange of information and ideas.

ASSIGNMENT FAILURES

- Expatriate research indicates failure rates of between 15 and 25 percent, and even up to 70 percent in some regions.
- It is estimated that the total direct costs of a four-year expatriate posting may be as high as USD2 million. In addition, expatriate failures may lead to relationship or reputational damage in the host country.
- Most expatriate failures are not due to technical or professional incompetence. The main causal factors involve difficulties with cultural adaptation: culture shock, spousal adjustment, communication barriers, interpersonal conflicts, lifestyle changes, local business practices, and isolation.

DECREASING BUSINESS RISK WITH CULTURAL INTELLIGENCE

- **CQ Drive** is the willingness to work with others from diverse backgrounds. It includes an ability to overcome explicit or unconscious bias and the capacity to persist in challenging intercultural settings—even when the individual feels confused, frustrated, or burnt out.
- **CQ Knowledge** is an understanding of culture and cultural differences. That involves more than awareness of variations in language, customs, and appearance. Core cultural differences like values, assumptions, and beliefs are often invisible but cause the most problems—and are frequently overlooked.

DECREASING BUSINESS RISK WITH CULTURAL INTELLIGENCE

- **CQ Strategy** is the ability to flex mentally. With high CQ Strategy, individuals are not confined to a single worldview. They are open to new or integrative ideas.
- **CQ Action** is the ability to flex verbal and non-verbal behavior. CQ Action decreases the risk of miscommunication and helps an individual respond to diverse others in a manner that conveys respect and builds trust and rapport.

CONCLUSION

- In conclusion, finance professionals need to be aware of “Culture Risk” in assessing an investment in a foreign economy. Cultural differences can impact both perception and performance. In the end, cultural intelligence (CQ) is an essential component of the financial professional’s toolkit required to successfully operate in the global capital markets.

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THANK YOU

DISCUSSION

THANK YOU

