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**GOINGLOBAL**

# *Going Global Series*

## **Assessing International Risk**

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## **Building Nations with Education, Innovation and Confidence in Each Other**

"Commercial Credit is the creation of modern times and belongs in its highest perfection only to the most enlightened and best governed nations. Credit is the vital air of the system of modern commerce. It has done more, a thousand times more, to enrich nations than all the minds of the world."

Daniel Webster, 1834



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# **‘Going Global’ Checklist**



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## Your Checklist Should Include:

- ✓ Credit Policy
- ✓ Credit Investigation – Know your Customer
- ✓ Financial Information for the International Credit Decision
- ✓ Assessing International Risk
- ✓ Credit Insurance
- ✓ Commercial Letters of Credit
- ✓ Resources - Agencies
- ✓ Trade Credit Financing
- ✓ Correspondent Banking Relationships
- ✓ Compliance and Ethics





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Does your company have a written process for determining the International risk of your customers?

- Yes
- No



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# Assessing International Risk

## Key Points

- Confidentiality of credit information is essential.
- Credit investigations require ethical treatment.
- Privacy laws vary around the world.
- There are legal aspects to consider regarding the exchange of credit information.
- Different accounting standards around the world
- The effective management of credit is both an “art” and a “science”. The art part is just as important as the science part.





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# Assessing International Risk

## Key Points

- Gathering enough information to make an informed risk assessment can be difficult.
- Credit executives must also evaluate the customer using the 5 "C's" of credit risk management: character, capacity, capital, conditions and collateral.
- Customer, country, and currency risks are inextricably linked, so assessing risk must consider all three factors in unison.
- Increasing global competition, continued nationalistic governmental policies, and other factors necessitate a holistic approach to risk assessment



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# Assessing International Risk

## Six “P’s” of Credit

- People (who’s running the business)
- Profit (your margins)
- Payment (track record, new financials)
- Protection (security obtained)
- Politics (country conditions)
- Perspective (assessment of earlier “P’s” taken together, cost-benefit analysis)





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# Global Economic Risk

- Intense global competition is forcing international credit management to look at all aspects of the global economic picture.
- Country, geopolitical, currency, and cultural risks in addition to customer risks are all inextricably linked and must all be considered simultaneously in order to effectively evaluate international risks.
- Globalization is happening all around us as companies look at the world market as if there are no national boundaries.
- Frequently, nationalistic laws create highly uneven playing fields.

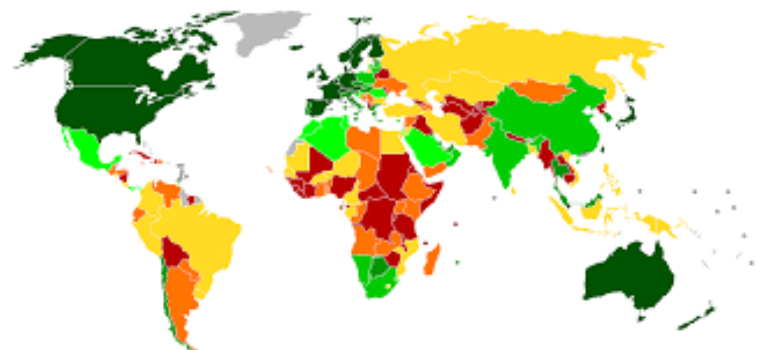


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# Country Risk

- **Dimensions of Country Risk**
  - Current Growth Momentum
  - Long-term growth potential
  - Volatility
  - Political/Social risks
  - Economic





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# Country Risk

- Avoid the main pitfalls of country risk assessment by looking for information in a variety of places, doing relevant analysis, and changing your opinions if necessary.
- Set acceptable risk objectives based on your company's reward goals and risk tolerance.
- Remember that risk is neither good nor bad, but is relative and necessary.



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# Country Risk – CAMEL Method

- **CAMEL**
  - Capital Adequacy
  - Asset Quality
  - Management Quality
  - Earnings Potential
  - Liquidity





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# Capital Adequacy

- Current earnings in the **Country Risk** context
  - Most information on such earnings is contained in the balance of payments
    - Usually published by the Central Bank
    - Not too different from a company's financial statement
  - Unfortunately, countries use differing accounting methods for compiling their payments balances
- The single most important and authoritative source of comparable data is the International Monetary Fund in Washington





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# Asset Quality

- A country's natural, human and general economic resource
  - A close meshing of all three gives a nation true economic and financial strength
    - Some countries with a wealth of natural resources remain desperately poor because they lack the human resources to exploit their bounty to the benefit of all
      - Zambia
    - Others lack natural resources, but do quite well on the basis of their human and general economic resources
      - Switzerland
      - Japan





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# Management Quality

- The government and the way in which it is running the nation's affairs
  - Ill-designed and badly implemented government policies can ruin the most affluent countries
  - Good policies can make a world of difference for nations that are resource-poor





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# Management Quality

- Of particular interest in this context should be:
  - How those in power run their fiscal affairs
    - Spending and taxation
  - How well monetary and credit management are adapted to the country's real needs
  - Which way interest rates are trending and whether there is a big risk premium in local bond rates
  - How inflation is being managed
  - What kind of labor (especially wage) policy is being pursued
  - Whether local/international investors show confidence
    - This will depend largely on how social and political stability is perceived



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# Earnings Potential

- How well a nation could do if it had the best possible government (read: management)
- Among internal criteria are such things as:
  - The “quality” of the population (health, longevity, literacy, skills)
  - The local wealth distribution (very large gaps tend to create socio-political tensions, while a sizeable and well-living middle class gives a country stability)
  - Whether there are protectionist tendencies in the populace, among the leaders, or both



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# Liquidity

- A nation's foreign exchange cash flow prospects
  - Example: the risk of an export sale made on 180-day terms
- Up-to-date information is most difficult to obtain, and one must often rely on inside information, since the published data rarely show the most relevant indicators





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# Liquidity

- But some idea of a nation's Liquidity can be gained also from regularly revealed indicators, such as:
  - Official international monetary reserves
  - Foreign exchange holdings in the local banking system
  - Pending IMF and World Bank facilities
  - Foreign debt payment schedules
  - Official borrowing facilities a nation may have abroad



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# Geopolitical Risk

- Global risks are more likely to be geopolitical.
  - Geopolitical risks account for three of the top five most likely risks.
- Geopolitical risks are linked to business risks.
  - Economic
  - Environmental
  - Social
  - Technological
- These affect supply chain, international trade, and decision about new markets and acquisitions.





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# Geopolitical Risk

- As geopolitical events increasingly come in the form of cyber attacks, companies of all sizes become victims.
- It's crucial that businesses have expertise to identify all geopolitical risks.
- How do you proactively deal with the unpredictable impacts of geopolitical risks?
  - Diversification
  - Risk assessment
  - Risk mitigation



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# Geopolitical Risk

- In Conclusion: geopolitical risks are challenging for companies, they are hard to predict, interconnected with other business risks and can significantly impact operations.





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# Currency Risk

- **What is it?**
  - Currency risk is the potential of loss from fluctuating foreign exchange rates when an investor has exposure to foreign currency or in foreign-currency-traded investments.
- **Why it matters:**
  - Currency risk is important to understand because foreign currency exchange rates can drastically change an investor's total return investment, despite how well the investment performed.



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# Currency Risk

- Currencies from top Organization for Economic Co-operation and Development (OECD) nations have low transfer or convertibility risk.
- Companies can usually eliminate the risk from volatile exchange at acceptable cost.
- World currencies are no longer combined into a single system.
- Technical and psychological factors have replaced macro-economic variables as the dominant influences on forecasting foreign exchange rates.



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# Currency Risk

- The **Foreign Exchange** (FX) market is an enormous, sophisticated, and efficient global communications system operating around the clock to enable transactions.
- Large commercial banks are the dominant players in the FX market, serving as intermediaries between supply and demand; corporations are the principal end users.
- FX transactions are speculative by nature and thus can be volatile, increasing risk.
- Three basic transactions for managing FX risk are spot transactions, forward transactions, and options.





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# Cultural Risk

- **Cultural risk** is a term describing the values, beliefs, knowledge, attitudes and understanding about risk shared by a group of people with a common purpose, in particular the employees of an organization.
- **Cross Cultural Risk** is a situation or event where a cultural miscommunication puts some human value at stake
- **Cross Cultural Risk** occurs when people in different environments characterized by unfamiliar languages and unique value systems, beliefs and behaviors interact.





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# Cultural Risk

- **What culture is:**
  - Culture relates to a system of shared assumptions, ideas, beliefs, and values that guide human behavior
  - Appears in statements, actions, material items
  - Culture is acquired. Acquisition of cultural norms and patterns is a subtle process
  - Culture is transmitted from generation to generation with embellishment and adaptation over time



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# Cultural Risk

- **What culture is not:**
  - Not right or wrong – culture is relative. There is no cultural absolute. Different nationalities simply perceive the world differently.
  - Not about individual behavior – culture is about groups. It refers to a collective phenomenon of shared values and meanings.
  - Not inherited – culture is derived from the social environment. We are not born with a shared set of values and attitudes; we learn and acquire as we grow up.



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# Cultural Risk

- **Methods to Maximize Success in Understanding Culture**
  - Observing and listening
    - Verbal and non-verbal communication
  - Language barriers
    - Terms and phrases
  - Geography
    - Time lapses, climate differences
  - Stereotyping people
    - Putting people in one category



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# Cultural Risk

- **Observing and listening**
  - Using “go betweens”
    - Using locals: bankers, accountants, in country
  - Silence
    - Understand that other cultures do not always have to talk
  - Re-stating the question
    - Be careful: don't be impatient
  - Inexperience
    - Do your homework on basic greeting, customs
  - What “yes” and “no” mean
    - In Japan, “yes” means I understand



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# Cultural Risk

- **Language as a barrier and challenge**
  - Examples:
    - Ton – gross or metric? Define your terms
  - Use of phrases:
    - “Sweeps under the rug” means what?
    - “Teaming” means a low occupation in Thailand





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# Cultural Risk

- **Geography**
  - Examples:
    - Time lapses: in shipping to Pacific Rim from the U.S.
    - Climate zones: change your packaging to allow for temperature changes
    - Time zones: consider times zones when scheduling conference calls, meetings and waiting on responses to communications





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# Cultural Risk

- **Stereotyping people – Guilty!**
  - What is stereotyping?
    - Putting people in one category: i.e. All Americans are loud or impatient or All Pac Rim countries have the same culture
  - How do we use the activity?
    - We make decisions based on our prejudices vs. the facts
  - What happens to the individual?
    - May be insulted, not want your business
  - What is the tendency when visiting other countries
    - Treating them like they are the “foreigners”



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## **Cultural Profile Traits**

- **Australia**
  - Humanistic
    - Not always as driven as westerners for the profit motive
- **Latin America**
  - Family
    - Is of central importance and loyalty: often determines career and promotions
  - Authority
    - High confidence is expressed in the judgment of people in authority



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## Cultural Profile Traits

- **Japan**
  - “WA” – Inner harmony: some Japanese will have eyes closed at meetings – they are gathering their thoughts, not sleeping!
  - Management: Very participative and team-oriented
- **India**
  - Caste System: Underlying cultural variable that structures a person’s life
  - Management: Managers generally make most decisions; employees follow rules



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Do you feel it is important to have a policy governing International Risk to protect your Company's A/R portfolio?

- Yes
- No



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## **Your Detailed Checklist Now!**

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# Look for Future Educational Opportunities at FCIB:

## Going Global Webinar Series – 2016

### May

*12<sup>th</sup>, Protecting Your International A/R Portfolio with Trade Credit Insurance*

*26<sup>th</sup>, Commercial LCs*

### June

#### ***Live Sessions at NACM Credit Congress Include:***

*25020 – International Credit Policy – Monday, June 13<sup>th</sup>*

*25030 – Credit Investigations and Getting to Know Your Customer – Monday, June 13<sup>th</sup>*

*25080 – Role of Financial Information in Global Credit Decision Making – Wednesday, June 15<sup>th</sup>*

### July

*20<sup>th</sup>, Credit Resources*

*21<sup>st</sup>, Trade Credit Financing*





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# Questions?

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