

Risk oversight in emerging markets

Executive summary

Emerging markets, long a strategic imperative for leading companies, are taking on even more importance as growth looks bleak in developed economies. Western companies are entering a new competitive environment, replete with new customers, new competitors and higher expectations from regulators. Unexpected changes – such as the introduction of democracy in the Middle East and North Africa – can bring with them new risks; meanwhile, intellectual property thieves are growing bolder and more accomplished, economic concerns continue to mount and corporations face enhanced regulatory pressures.

This edition of *InSights* looks at how companies and their boards are adapting to this new competitive environment. As one audit chair said, “How should we get to know what issues matter in our foreign operations? How do we get to know the businesses, the opportunities and the challenges? It becomes difficult to understand with any precision how companies do business in emerging markets. How do we get the insight to ensure we are in the position to provide oversight?”

This report is based on conversations with audit chairs, senior executives and a range of advisors and subject matter experts. The report notes several recent developments that have shined a spotlight on the risks of emerging markets and outlines five keys to understanding this risk environment.



A confluence of events in emerging markets spotlights shifting risks

Emerging markets look more attractive in contrast to the stagnant US and European markets. Ernst & Young predicts that “70% of world growth over the next few years will come from emerging markets, with China and India accounting for 40% of that growth.”¹ The International Monetary Fund (IMF) provides supporting data for that view: in its latest World Economic Outlook report, the IMF estimated that the Chinese economy will grow at 9.6% this year and 9.5% in 2012,² while the Indian economy will grow at 8.2% in 2011 and 7.8% in 2012.³ Since the IMF report came out, the organization has already had to adjust its predictions for US GDP growth downward, to a mere 2.5% in 2011 and 2.7% in 2012. One US audit chair said, “I don’t think we will be able to deliver what shareholders are expecting without going to [emerging markets].”

However, participants pointed to a confluence of events in the past few years that have shined a spotlight on risks in emerging markets.

Western companies are confronting new competitive dynamics. An advisor remarked, “Western corporates are now selling to customers [in emerging markets], and there are a lot more homegrown, agile, entrepreneurial players in these emerging economies than there used to be. Western companies are stuck in a top-down organized structure, while key homegrown players in emerging economies are decentralized, attuned to the domestic needs ... and move much faster.” Multinationals competing against homegrown start-ups increasingly feel they are at a disadvantage. For example, the *Harvard Business Review* notes that “a 2010 survey by the American Chamber of Commerce in China found that 38% of US companies feel unwelcome in the Chinese market, up from 23% just two years earlier.”⁴ One executive said, “In some of these countries, it is ‘their field, their ball.’ Governments will always protect the interests of their own population over the needs of investors.”

Democracy may be taking hold in the Middle East and North Africa. Participants pointed to political upheaval throughout the Middle East and North Africa as signs that those markets remain fragile. Deutsche Bank Commodities Analyst, Soozhana Choi recently told *The New York Times*, “As antigovernment protests have spread from Tunisia and Egypt to the streets of Bahrain, Yemen and OPEC member countries Algeria, Libya and Iran, concerns about geopolitical risks and the potential for supply disruptions have returned aggressively.”⁵ Matthew Lynn, a financial journalist, wrote, “There is no point in getting a 20% annual return if you then lose the lot when the government gets overturned in a revolution. The Arab spring was a reminder that emerging markets can collapse amid political turmoil. The Egyptian market rose by 430% (measured in dollar terms) in the decade leading up to 2010, but then the Egyptian bourse shut down for over a month as the country threw President Hosni Mubarak out of power. After it re-opened, stocks plunged. That was hardly a great outcome for investors.”⁶

Emerging markets may be overheating. Inflationary concerns have moved many governments to raise interest rates in emerging markets,⁷ causing anxiety among investors of imminent currency risks. David Lubin, Global Head of Emerging-Markets Research at Citi, noted, “There are a number of serious inflation threats lurking in emerging markets ... emerging markets’ policy makers are not really willing to sacrifice growth in order to achieve an inflation target.”⁸ The IMF has warned that “the challenge for many emerging and some developing economies [is] to ensure that present boom-like conditions do not develop into overheating over the coming year.”⁹

1. Tracking global trends: how six key developments are shaping the business world, Ernst & Young, 2011.
2. International Monetary Fund, “Tensions from the Two-Speed Recovery: Unemployment, Commodities, and Capital Flows,” *World Economic Outlook*, April 2011.
3. Luciana Lopez, “IMF Cuts US Growth Forecast, Warns of Crisis,” Reuters, June 17, 2011.
4. Ian Bremmer and Evan A. Feigenbaum, “Watch Out for Rising U.S.-China Competition,” HBR Blog Network (blog), April 1, 2011.

5. Steven Erlanger, “Oil Flows, but High Prices Jangle Nerves,” *The New York Times*, February 19, 2011.
6. Matthew Lynn, “Put Your Money in Emerging, Stable Democracies,” *MarketWatch*, July 13, 2011.
7. Paul J. Lim, “Suddenly, Emerging Markets Look Complicated Again,” *The New York Times*, February 26, 2011.
8. “Inflation Risks Stalk Emerging Markets, Says Citi’s Lubin,” Reuters, July 12, 2011.
9. “IMF Lowers India’s Growth Forecast to 8.2 pc for 2011,” *Hindu*, April 12, 2011.



Mr. Lubin added, "Where China leads, in many respects, other emerging markets will follow."¹⁰ While growth in China remains robust, many analysts point to the Chinese government's concern about inflation, the number of bad loans on Chinese banks' books, and overinvestment in "superfluous" projects as warning signs that the Chinese government is due for a correction.¹¹ Patrick Chovanec, an associate professor at Tsinghua University's School of Economics and Management in Beijing, said, "What China has is growth on steroids ... It looks like growth and it looks like a strong economy, but resources and energy are not being channeled to the most productive parts of the economy."¹²

Local regulatory pressures continue to grow. A recent issue of *InSights* noted that regulators continue to crack down on bribery and corruption,¹³ putting more pressure on Western companies doing business in emerging markets where, in the words of one advisor, "corruption is the norm." Regulators in emerging markets are now following US and UK regulators in stepping up their anti-corruption efforts. One advisor noted, "Local enforcement of corruption in China and other emerging markets is a real issue now. The Chinese government recognizes the importance of anti-corruption enforcement, and there are certain industries that are the target of serious anti-corruption campaigns." The *Financial Times* reported, "The more rigorous enforcement comes as western companies expand their operations in emerging markets, where officials are often poorly paid and gift giving is part of the culture."¹⁴ Asheesh Goel, from the global law firm Ropes & Gray, told the newspaper, "The US has become more aggressive. Other countries see how lucrative FCPA has been. It has become a worldwide issue."¹⁵ For example, one advisor said, "In India, the government and regulators have begun taking concrete actions to counter this menace and recently Lokpal Bill 2011 was introduced in the country's parliament, to set up an anti-corruption watchdog."¹⁶

Intellectual property risks are changing. An executive observed, "Intellectual property is a big problem, especially in China. The [counterfeiters] are so blatant about it. The authorities look the other way." Participants noted that intellectual property thieves have become increasingly emboldened to steal more than just software. Indeed, the Associated Press reported in July that counterfeiters in China are "replicating entire Apple stores."¹⁷ An advisor said, "Successful brands and products are being counterfeited and sold on an unprecedented scale in India due to the sheer size of the domestic market, high price sensitivity, and improper coordination among enforcement agencies. The lack of knowledge among customers and, most importantly, a large size of the retail industry being unorganized and unregulated account for [the] majority of counterfeit sales in the country."

The natural disaster in Japan put supply chain risks in focus. Following the tsunami in Japan, JP Morgan Economist Masamichi Adachi said that supply chain disruption was an immediate concern, with auto assemblers lacking parts, damage to factories in affected areas, power outages, and other logistical problems.¹⁸ In May 2011, Toyota Motor, whose supply chain was severely affected, said its first-quarter profit had fallen 77% from the same period last year.¹⁹ Participants said this damage done in the developed economy of Japan heightened concerns about the supply chain risks for companies operating in emerging markets. One audit chair said, "[Natural disasters] can happen anywhere, but the concern in these [developing] countries is their ability to spring back after a natural disaster." An executive noted, "The risks associated with weather, natural disasters, and volcanoes ... are at the top of the risk list."

10. "Inflation Risks Stalk Emerging Markets, Says Citi's Lubin," Reuters, July 12, 2011.

11. "Can China Conquer Its Economic Challenges?" *Deutsche Welle*, July 15, 2011.

12. Ibid.

13. Ernst & Young and Tapestry Networks, "Regulatory Compliance: Adapting to a Pressurized Environment," *InSights*, June 2011.

14. Henry Sender, "US Steps Up Foreign Anti-graft Scrutiny," *Financial Times*, July 17, 2011.

15. Ibid.

16. "Lokpal Bill introduced in Lok Sabha," *Business Line (The Hindu)*, August 5, 2011, © 2011 The Hindu Business Line.

17. Louise Watt, "iFraud: Entire Apple Stores Being Faked in China," Associated Press, July 21, 2011.

18. Gwen Robinson, "Japan: Supply Chain Update," *Financial Times*, March 22, 2011.

19. Hiroko Tabuchi and Bettina Wassener, "Earthquake and Aftermath Push Japan into a Recession," *The New York Times*, May 18, 2011.

“In recent conversations, many audit chairs have expressed a desire to discover leading practices for companies expanding into and operating in emerging markets.”

Product safety remains a key risk. In July 2011, investigations into 99 cases of salmonella in 23 US states linked the illness to papayas imported from Mexico and distributed in the United States and Canada through retail stores and wholesalers.²⁰ The US Food and Drug Administration (FDA) acknowledged that the growth of emerging markets “in the coming decade will have major implications for FDA ... As global product flows change, many individuals will encounter the growing dangers of fraud and economic or other intentional adulteration of both foods and medical products.”²¹

Participants noted that these and other risks are causing companies to rethink their approach to emerging markets. In recent conversations, many audit chairs have expressed a desire to discover leading practices for companies expanding into and operating in emerging markets. Participants highlighted five factors that the board and the audit committee should be aware of as part of their review of a company’s emerging markets strategy:

1. Understand the competitive environment
2. Understand the cultural differences
3. Rely on the right people
4. Establish partnerships with local companies
5. Review the risk and control environment

20. *Investigation Update: Ongoing Multistate Outbreak of Human Salmonella Agona Infections Linked to Whole, Fresh Imported Papayas*, Centers for Disease Control and Prevention, July 26, 2011.

21. *Pathway to Global Product Safety and Quality*, U.S. Food and Drug Administration, 2011.

Questions for audit committees

- ▶ What are the most significant risks that the company faces in emerging markets?
- ▶ How have those risks changed in recent years?
- ▶ How does the board and audit committee stay aware of these risks?
- ▶ What vulnerabilities or blind spots have been revealed in the company as it has expanded internationally?



1 Understand the competitive environment

Participants noted that the board and the audit committee should be aware that different customer preferences in emerging markets may change the way their companies go to market. An advisor said, “Take a large consumer products company that typically produces goods in large quantities when they are selling to Western customers. Now, if they are selling in Namibia, they are selling [the products] in much smaller quantities because those customers don’t have the income ... You have to reconsider your supply chain calculation and your cost to the customer.”

Participants recommended ways companies can understand and adapt to the competitive environment in emerging markets.

- ▶ **Mobilize teams to scan the business environment.** One executive said, “We put a team together ... to get a thorough understanding of the business environment ... We need to understand the regulations there. We have someone from legal to understand the business rules. We have a merchant team to look at the trends. You have to make sure the consumer is there. We have a real estate team to figure out if we build something or buy.”
- ▶ **Be prepared to adjust your go-to-market strategy.** One executive said, “The biggest mistake you can make is to run your business ... in China or any other emerging market the same way you run it here in the US. Look at the way your competitors sell to their customers. There’s a reason they do it that way, and it may be different than the way you are used to doing it. You have to get to know your customers’ preferences, and adapt.”
- ▶ **Recalibrate the risk-return equation.** An advisor noted, “Companies need to get a better grip on their risk-and-return equation. They need to identify all of the risk drivers [holistically] in calculating the potential return. Look at the regulatory environment and how local laws and guidelines are executed; look at the availability of skills – does management have the capacity to adapt to the needs of the market? Look at the way local competition is changing the way the game is played. All of these things need to be identified. What is the impact ... on the shareholder?”

Questions for audit committees

- ▶ How can the board and the audit committee familiarize themselves with the competitive landscape in emerging markets?
- ▶ How can the board and the audit committee familiarize themselves with the customers in emerging markets?

2

Understand the cultural differences

Participants said that the board and the audit committee should have heightened sensitivity to cultural differences in emerging markets. One executive explained, “In emerging markets, you often run into cultural issues about what is acceptable and what is not. There are people making really bad judgments – they may not look bad in their local country, but on a global company scale, they are bad ... For example, in India, it could be that all the relatives get part of the business. There are deals being cut that just don’t feel right.”

Participants identified three actions companies can take to address cultural differences.

- ▶ **Build relationships with foreign governments.** An audit chair remarked, “We’ve been in China since Kissinger and Nixon cracked the bamboo. You have to understand the governmental bodies. It is really important that you build relationships there. If you don’t understand the dynamics of how to work with the government, you won’t have a chance in these countries.”
- ▶ **Communicate the company’s values.** One executive noted, “Operating in emerging markets has to come from your value base: what are the values of your company? Are you willing to participate in a lot of the activities that have become custom in emerging markets, but may not be up to your standards? Our legal counsel will go around to the various places we operate in around the world and communicate this point. They will discuss anticompetitive behavior and our marketing practices, just to remind our employees of our standards.”
- ▶ **Test employees on cultural differences.** Participants noted the importance of training Western employees on the different cultures and customs in emerging markets and periodically testing whether employees are retaining that information. An executive said, “We have very good management; we work the culture really hard and do a lot to ensure the company is a good place to work. We test that with engagement surveys and really work hard from a reputational point of view.”

Questions for audit committees

- ▶ How does the company engage with local governments?
- ▶ How are the company’s values communicated through the organization?
- ▶ How does the company ensure employees are aware of the cultural differences in emerging markets? How does the company know that these efforts are sufficient?

3

Rely on the right people

One executive said, “Success in emerging markets in many ways is no different than success anywhere else: it comes down to having good people.” However, participants said it is more difficult to find the right people to help expand and operate in emerging markets. Another executive said, “The problem is always on the people side. The more time you can spend on talent, the better off you are. It’s a challenge building capability with local talent, and there is no magic to this. They have an important role to play with your brand in the region. You must have a robust talent management program, and it shouldn’t be delegated to lower levels.”

Participants suggested a number of ways companies can ensure that they have the right people at the board and executive level to excel in emerging markets.

- ▶ **Recruit executives with foreign expertise.** An audit chair remarked, “The board needs to be picking global people – people that work in global businesses, people from all over the world. [One executive] joined the board and is very familiar with Colombian and Korean trade agreements. You must be making sure you have people that fit the footprint of the company ... We want someone on the ground who has traveled extensively. Virtually all of our senior leadership has lived outside the US.”
- ▶ **Be prepared to commit senior executives’ time to emerging markets initiatives.** Several participants said companies should ensure senior executives are tasked with getting the company established in the emerging markets that the company is entering. An advisor remarked, “CEOs and group CFOs need to realize that in order to make their investment in emerging economies work, they need to spend significant executive time in these countries. My advice to the board would be to include the time that the CEO, group manager, or whomever needs to spend in these locations when considering the risk-return equation of these investments. You can’t just delegate this to locals. Why should those locals be loyal to you? They might take your resources and build their own side businesses. The only way to prevent this from failing is to invest significant time and resources.”
- ▶ **Recruit directors with international market savvy.** Directors with international expertise can broaden the board’s overall perspective. One audit chair said, “We hired a director with deep ties to [one emerging market]. He has been terrific. He’ll tell us who not to do business with and can explain to us the nuances of doing business there.”
- ▶ **Rely on advisory boards.** One audit chair said, “At one company, we [set up] an advisory board that would counsel management on certain investments in countries we were expanding into. We had people from all of these countries on the advisory board.”

Questions for audit committees

- ▶ How has the company changed the way it sources and retains talent to adapt to doing business in emerging markets?
- ▶ Is the company recruiting board directors with particular expertise in emerging markets?
- ▶ What other advisors do the board and the audit committee rely on to better understand the company’s strategy and operations in emerging markets?

4

Establish partnerships with local companies

One audit chair said, “Before you go into an emerging market, there needs to be a thorough soul searching to know if you have the platform – both the people and the understanding – to know what you are getting into.” Participants said that acquiring or partnering with a local company is one way for US companies to more quickly acclimate to emerging markets.

Participants noted that boards and audit committees must be aware of the varying benefits and risks of entry vehicles.

- ▶ **Mergers and acquisitions.** An Ernst & Young survey noted, “Enthusiasm for globalization and emerging market investment remains strong as companies look for ways of fueling growth. The percentage of companies saying they are considering an emerging market acquisition within six months is 50% higher than it was in November 2009 and continues to rise.”²² However, participants agreed that acquiring companies in these markets is fraught with risk. While acknowledging that the international market is “where the growth is,” one audit chair described international deals as “a booby trap,” and added, “Every international deal I’ve been involved with is a nightmare to try to get done.” Companies that undertake foreign acquisitions can find themselves with unforeseen liabilities: Vodafone, for example, found itself held liable for \$10.9 billion in taxes owed on its 2007 acquisition of Hutchison Essar, an Indian mobile phone operator.²³
- ▶ **Partnerships with local companies.** Participants said that partnering with local companies can help Western companies adapt better to a new environment, but stressed it is critical to keep in mind that the partnership relationship varies according to country: “It depends on the country and the culture ... They have to understand it’s a partnership. It’s not quite as critical [to
- understand it’s a partnership] in Canada and the UK. It’s essential in Latin America, South America, and Asia – the business mores and ethics in these countries are different than the way we think here in the US.” At one audit chair’s company, “The audit committee has become involved in sourcing from markets where business gets done. We validated that the manufacturer we were dealing with in these countries had good practices, so that we wouldn’t find later on that we had a supplier that could drag down the company’s reputation.” An advisor added, “Global corporations and their audit teams need to be more vigilant in managing their vendor and customer compliance relations. An effective program for vetting the partners should be a critical priority as part of anti-corruption compliance, due to vicarious liability provisions of the relevant statutes under laws like FCPA and UK Bribery Act.”
- ▶ **Joint ventures with local governments.** An executive said, “One way to enter the market is through joint ventures with [local] governments, so that there’s an alignment in terms of objectives. You have to have good relationships and a strong reputation among the countries that you operate in. You need to be able to demonstrate the benefits of the investment [to] policymakers.” However, several participants noted the difficulties of making a joint venture work. One said, “You have to be absolutely clear about your objectives at the start, and these objectives can always change.”

22. Pip McCrostie, “Fit for the Future?” *Capital Confidence Barometer*, Ernst & Young, April-October 2011.

23. James Lamont, “Vodafone Warns India Tax Bill to Hit \$5bn,” *Financial Times*, June 30, 2011.

Questions for audit committees

- ▶ What are the benefits and risks of the different entry vehicles in emerging markets?
- ▶ What is the nature and extent of the company’s due diligence on potential business partners?

5

Review the risk and control environment

One audit chair observed, “The audit committee has been much more involved in emerging-markets risk. The audit committee gets into the nitty-gritty. We are looking at the coverage internationally, on audit activities both internal and external. In January, we had the CFO of our international business in to talk to us about the risks he’s facing. He had the head of risk with him.”

Participants described several ways that the audit committee could stay on top of the control environment in emerging markets.

- ▶ **Map the company’s international risk profile.** Transparency International (TI), a non-governmental organization committed to fighting corruption, publishes an annual index measuring perceived levels of public-sector corruption in 178 countries of the world.²⁴ Mr. Richard Alderman, the Director of the UK Serious Fraud Office, told a group of audit committee chairs recently, “We will be looking at how operations in high-risk areas according to TI are being addressed.” Audit chairs at another recent audit committee network meeting described a practice in which the compliance team lays out a map of the world describing where the company does business and the extent of the company’s operations (e.g., number of employees, relationships with agents) in these locations. The audit chairs said the map provides the data that the audit committee needs to help make informed decisions. One said, “The chief compliance officer came in with a map of all of the different countries where we do business, and how we do business there: Do we sell direct? Do we use local agents? Then we asked internal and external audit and the GC [general counsel], ‘Do you go there?’”
- ▶ **Form an executive team to look at risks and controls.** One audit chair said, “Relatively early on in a new market, we bumped into some tough problems. [One of the business unit audit leaders] came to me and said, ‘We’d like to get a senior executive to start a risk-and-controls group.’ They have continued on to build this group ... [The group was] designed to figure out what policies and procedures need to be in place before going into a country and then be on the ground with management when they entered ... They go back regularly to check in to make sure policies and procedures are being followed.”
- ▶ **Tailor the audit plan for the specific market.** One executive noted, “You must find a way for your internal audit and compliance teams to have a thorough understanding of what the norms are in the countries in which you operate. You might need to outsource that activity to organizations that are on the ground there, but you need to have a really close liaison to your internal staff. I also don’t think you can rely on your own internal staff alone, unless you’ve been there for a while. It’s a long process to instill the knowledge you need to be over there.”

24. See, for example, *Corruption Perceptions Index 2010*, Transparency International, 2010.

Questions for audit committees

- ▶ Has the company’s management team adopted new practices in response to increased risks in new markets the company is entering?
- ▶ How does the company oversee risk and controls in emerging markets? What resources does the company rely on? What improvements could be made to these practices?
- ▶ Have recent events in Japan or the Middle East caused management to update crisis management plans? How prepared is the company in the event that a crisis strikes in an emerging market?



- ▶ **Source internal auditors from local countries.** One advisor noted, “The internal audit function takes on tremendous importance in emerging markets. How involved is internal audit in the different countries that the company operates in? Do they have their ears to the ground? Are they aware of the different risks and how the company is managing them?” Participants said local expertise can only aid and expedite the audit process, with one participant saying, “Our internal audit team recruited a management person [from a local market] who has a lot of business experience and speaks the languages. In some countries, we also co-source the internal audit work because our people don’t know the cultures like locals do.”
- ▶ **Rigorously follow developed-market safety standards.** While safety laws and norms vary from country to country, executives stressed the importance of ensuring that companies comply with the safety laws of the country in which they are incorporated. One said, “In [one country], for example, people are allowed to smoke indoors, and you aren’t required to have fire sprinklers and other safety features. These are just two of many examples of differences in health and safety standards. [We] must be rigorous about ensuring that all of our buildings are up to US standards because this could be a huge regulatory and headline risk.”
- ▶ **Communicate regularly with senior management.** Audit chairs advocated increasing the dialogue between the audit committee and business leaders in charge of market strategy. One said, “We visit regularly the people from international.” One audit chair emphasized that the audit committee must protect leaders in charge of the foreign expansion strategy, saying, “Those people report in their normal fashion, but they need to understand [that] they have a serious reporting line to the corporate field and that they have direct access and a direct responsibility to the audit committee. And the audit committee should talk to them in an almost executive session. You need to protect them. It doesn’t need to be formal – it can be informal; just talk to them off in the corner for a half an hour. Let them know you want to know what’s going on, that they have your ear and you have their back.”
- ▶ **Diversify the supply chain.** Participants said that the board should be aware of the company’s key suppliers and have a better understanding of potential bottlenecks in the supply chain. In order to mitigate the risk of severe weather and other disasters interrupting business, one executive advised, “Diversify your sourcing. It’s one of the main defenses.”
- ▶ **Implement a whistle-blower policy.** One advisor said, “In India, where most of the companies do not have a whistle-blowing policy, introducing one in the local company can help the audit committee to remain more in touch with the realities on the ground. Employees, customers and suppliers of a company are more likely to take action with respect to unacceptable behavior if there are complaint systems that offer near absolute confidentiality.”
- ▶ **Have a crisis management plan in place.** An audit chair noted, “Successfully navigating [international] markets is not about identifying all the risks; it’s about adapting when something comes up. A company’s agility will matter more than anything else.” While, as one executive observed, “A crisis is a crisis, no matter where it occurs,” participants said having crisis management plans in place in emerging markets takes on added importance because companies there are typically not as familiar with regulators, the media and other stakeholders. However, audit chairs noted that good crisis management flows naturally from good corporate citizenship. One noted, “When the earthquake hit Japan, and everyone was getting out of the country, our board went to Japan and had a meeting there. We said, ‘Let’s show our face.’ We distributed water, and our employees were on the ground, providing help for the people. It had nothing to do with marketing or sales; we had the resources, and it was about doing the right thing.”

Conclusion

Emerging markets are taking on even more importance as growth prospects in developed economies remain stagnant. However, a culmination of events over the past few years has highlighted the risk of doing business in emerging markets. Participants recommended that boards recruit more foreign executives and directors, forge relationships with governments and companies in emerging markets, and establish advisory boards to enhance their understanding of the business climate in emerging markets. Participants also stressed the importance of strong fundamentals, such as good people, a keen awareness of the culture in the targeted market and a robust risk management and control environment.

Many participants in this research said that the most important thing the board can do in overseeing risk in emerging markets is to continually exercise skepticism regarding the company's plan. Growth prospects in emerging markets are so seductive that many management teams formulate plans too hastily, without paying sufficient attention to the new customers, competitors and regulators in those markets. Participants said that the board should challenge management to consider all of these relevant stakeholders as it formulates the company's expansion plan. The board should also ensure that management's overarching strategy for entering an emerging market is disciplined and principles based. The audit committee has a prominent role in ensuring that the company is constantly adapting to the ever-changing risk environment in emerging markets.

About Tapestry Networks

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The views expressed in this document represent those of the individuals who participated in the research. They do not reflect the views nor constitute the advice of network members, their companies, any Ernst & Young member firm or Tapestry Networks.



Appendix: Research participants

For this report, Tapestry Networks drew upon interviews with approximately 15 audit committee chairs in the Audit Committee Leadership Network, as well as several other audit committee chairs who participate in Tapestry Networks' regional audit committee networks. For more on these networks, see http://www.tapestrynetworks.com/networks/net_audit.html.

In addition, Tapestry Networks interviewed a range of leading subject matter experts, including:

- ▶ **John Auerbach**, Partner and Greater China Leader, Fraud Investigations & Dispute Services, Ernst & Young LLP
- ▶ **Dr. C. Fred Bergsten**, Director, Peterson Institute for International Economics
- ▶ **Ian Cameron**, Senior Vice President, Corporate Development, and Chief Financial Officer, Methanex Corporation
- ▶ **Dr. Mansour Javidan**, Garvin Distinguished Professor and Director of the Global Mindset Institute, Thunderbird School of Global Management
- ▶ **Karl Johannson**, CIS Sub-Area Managing Partner, Ernst & Young LLP
- ▶ **Richard A. Johnson**, President and CEO, Foot Locker U.S., Footaction, Kids Foot Locker and Lady Foot Locker
- ▶ **Dr. Roger Lawrence**, Corporate Vice President, Quality Assurance and Regulatory, McCormick & Company, Inc.
- ▶ **Brian Loughman**, Americas Leader, Fraud Investigation & Dispute Services, Ernst & Young LLP
- ▶ **Chris Matthews**, Director, International Markets Analysis, Best Buy
- ▶ **Mike Mauler**, Executive Vice President, GameStop International, GameStop
- ▶ **Susan Schwab**, Strategic Advisor, Mayer Brown, LLP, and Independent Director, Boeing, Caterpillar and FedEx
- ▶ **Arpinder Singh**, Partner and India Leader, Fraud Investigation & Dispute Services, Ernst & Young LLP
- ▶ **Martin Studer**, Managing Partner, EMEIA (Europe, Middle East, India and Africa) Business Risk Services, Ernst & Young LLP
- ▶ **Joe Tesoriero**, Executive Vice President and Chief Financial Officer, Dole Food Company, Inc.

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