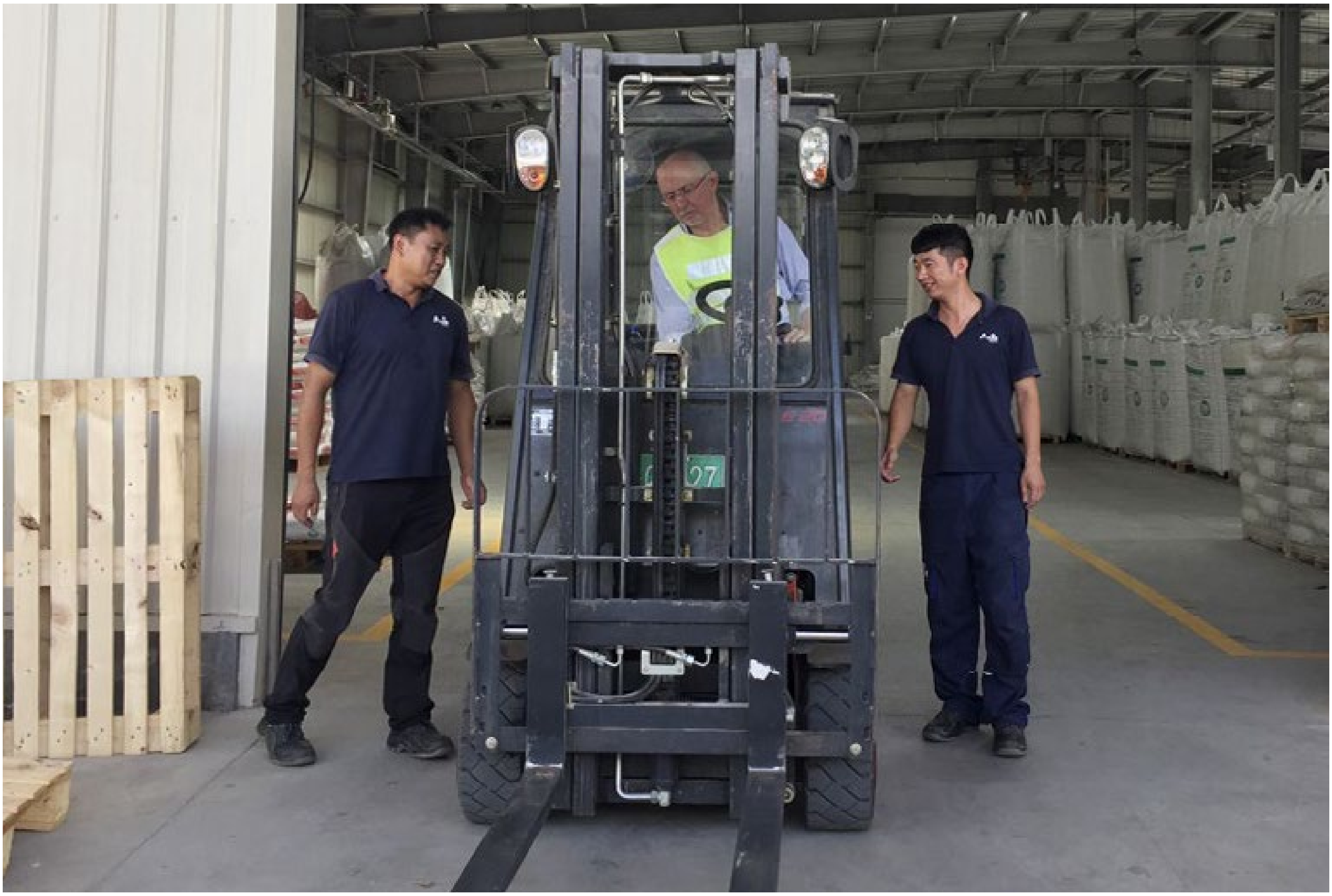
IFU'S BEST PRACTICE ON SETTING UP BUSINESS IN DEVELOPING COUNTRIES

- A HANDBOOK FOR ENTREPRENEURS



50 IFU YEARS OF EXPERIENCE 1967–2017

IFU INVESTMENT FUND FOR DEVELOPING COUNTRIES

IFU – capital for sustainable investments

IFU, Investment Fund for Developing Countries, is an independent government-owned fund offering advisory services and risk capital to companies wishing to do business in developing countries and emerging markets.

IFU invests on a commercial basis by committing equity capital or by providing loans or guarantees to project companies with Danish investors or a Danish interest. The purpose is to contribute to economic and social development in the host countries and enhance the opportunities of Danish trade and industry in new emerging markets.

In June 2018, in a first closing of USD 640 million, IFU became fund manager of the Danish SDG Investment Fund, which will contribute to the realisation of the UN Sustainable Development Goals by 2030. IFU is also fund manager of the Danish Climate Investment Fund, the Danish Agribusiness Fund, the Arab Investment Fund and IFU Investment Partners.

IFU and IFU managed funds have co-invested with Danish companies in close to 1,200 companies in more than 100 countries in Africa, Asia, Latin America and parts of Europe.

Advisory services for companies interested in developing countries are provided by IFU's investment professionals based in Copenhagen or at one of our ten regional offices in Africa, Asia, Latin America and Europe.

PREFACE

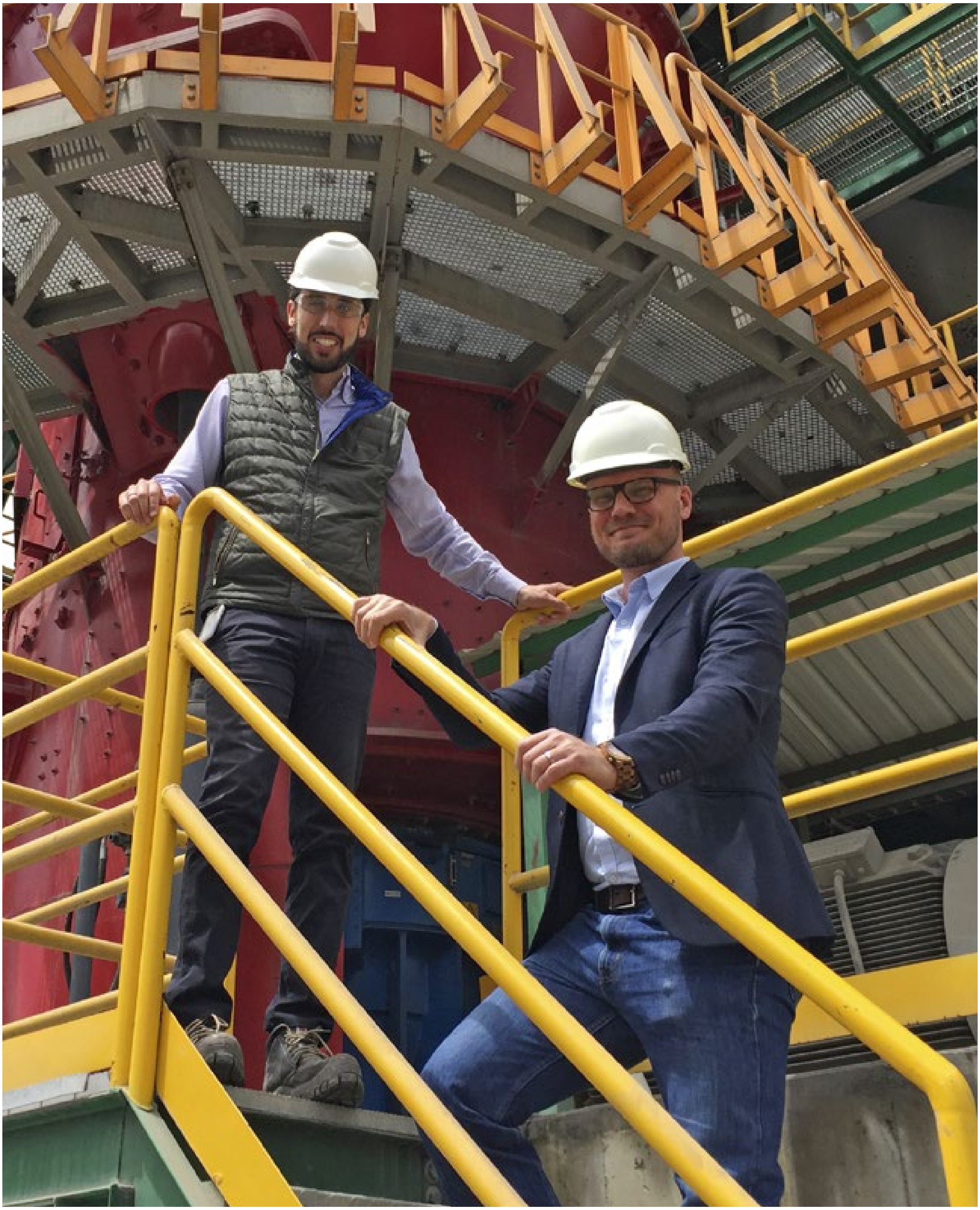
To write a small guidebook on setting up business in a developing country may seem like shooting at a very fast-moving target given the rising of many poor countries to mid-income countries. Especially given all what it entails with regards to thousands of new enterprises in old and completely new sectors that did not even exist ten years ago. When IFU makes an attempt anyway, it is because there are many basic findings, which we find useful to communicate.

This handbook is meant to serve as inspiration for primarily small and medium-sized Danish companies and will supplement the other IFU handbooks: Developing Business Plans, Board Work and Corporate Governance, Financial Handbook and Sustainable Investments. The focus of this book is on the initial start-up and on differences in base conditions of running a company in a developing country. Thus, it does not intend to prescribe any particular recipe. Instead, it highlights some of the hands-on areas, where IFU, based on 50 years of experience, has seen that Danish companies sometimes find it difficult to navigate. This includes several topics which seem trivial for experienced managers, but nevertheless are material challenges to working and setting up a business in developing countries.

The experience covered in this book has been provided by a large group of IFU's Investment Directors, and we would like to thank Birgitte Bang Nielsen, Deepa Hingorani, Hans-Jørgen Nyegaard, Henrik Frøsig, Henrik Jepsen, Jacob Klingemann, Max Kruse and Per Munkholt for valuable contributions.

We hope that the guidebook will be received well by new generations of enthusiastic business entrepreneurs, who want to embark on doing proper business in emerging markets, where both the risks and the profits are high. We wish you all the best of preparations and good luck out there.

Ib Albertsen Head of SME unit	Torben Huss Acting CEO	Morten Christiansen Senior Vice President, Investments	Andreas Brogaard Buhl Head of Sustainability and Corporate Governance



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How to use this handbook

This handbook is written for smaller or medium-sized Danish companies, which are about to set up a business in a developing country. The business plan and financing are in place, but there are still many uncertainties and issues to deal with related to the legislative framework, organisational set-up, country risks, infrastructure and economic aspects. The approach builds on IFU's core values, which are: Proper, Care, Hands-on, Can-do and Team Work.

Operating in developing countries cannot be compared to doing business in Denmark or western Europe. It requires in-depth knowledge about the business environment, commercial legislation and culture in the host country.

This handbook provides advice and inspiration based on IFU's practical experience from more than half a century as a partner and investor in projects in developing countries. It addresses the differences in business culture and business practices that are likely to be experienced when operating in developing countries, and provides checklists with key questions that are important to consider in the implementation phase. The checklists are by no means exhaustive and will have to be adjusted according to an ever-changing dynamic business environment.

The advice may be more useful when you are starting a new subsidiary company (greenfield), but there is also inspiration if you are investing in the expansion of an existing company (brownfield). You can use the checklists to identify issues that are of particular importance to your business and skip questions that do not apply to your company.

We hope that the handbook will prove a useful guide when dealing with some of these important issues. If you need further advice, you are always welcome to contact IFU's investment professionals in the head office in Copenhagen or in our regional offices abroad. IFU has a large network of advisers in the host countries, and we can assist you in gaining easier access to local authorities, trade organisations and the Danish embassies as well as lawyers, auditors and other local advisers.

Grants for preparation and start of projects

IFU and Danida have established an SME facility, which can support companies in the preparation and implementation of projects in developing countries. Partial financial support for IFU eligible projects can be obtained for e.g. preparation of a business strategy, organisational and managerial development, feasibility studies, recruitment, environmental studies, training and implementation of sustainability initiatives.

Read more about the grants at IFU's website:
https://www.ifu.dk/en/services/grants-for-project-companies/

1 Organisation

A deep understanding of the business context and regulatory framework is an important foundation for establishing a business in a developing country. Another key to success is to have the right management team and organisational set-up.

1.1 Business context

In every country you will have access to useful country and sector-specific investment knowledge from various sources. This includes overall economic intelligence available freely on the Internet or downloadable at a fee. The CIA World Fact Book (https://www.cia.gov/library/publications/resources/the-world-factbook/) and the business intelligence unit of the Economist (http://www.eiu.com/home.aspx) are good sources of information of current state of affairs in your chosen country of operation. The Danish Embassy in the country may also have some useful information on their homepage (http://um.dk/en/about-us/organisation/find-us-abroad/). Furthermore, the World Bank group is publishing an index on the ease of doing business (http://www.doingbusiness.org/reports), and this index and background reports will also help warn you of obstacles you should not ignore. For some countries, there are also investment guides published by one or more of the Big 4 consultancy firms PWC, EY, KPMG and Deloitte, which are publicly available.

It is also worth knowing the priorities of the national development plan, and how your business may or may not fit in with these. In most countries, specific plans are developed for sectors such as agriculture, fisheries, tourism, energy, etc. These insights will allow you to tell your business story in a way which shows that you are well versed with current affairs and national challenges.

The national plan for your sector will include information about major developments planned for the coming five years: It could be new power plants, an airport or a harbour. This information could come in handy when you want to access new local markets or when planning to ship large quantities of your products by truck or by sea.

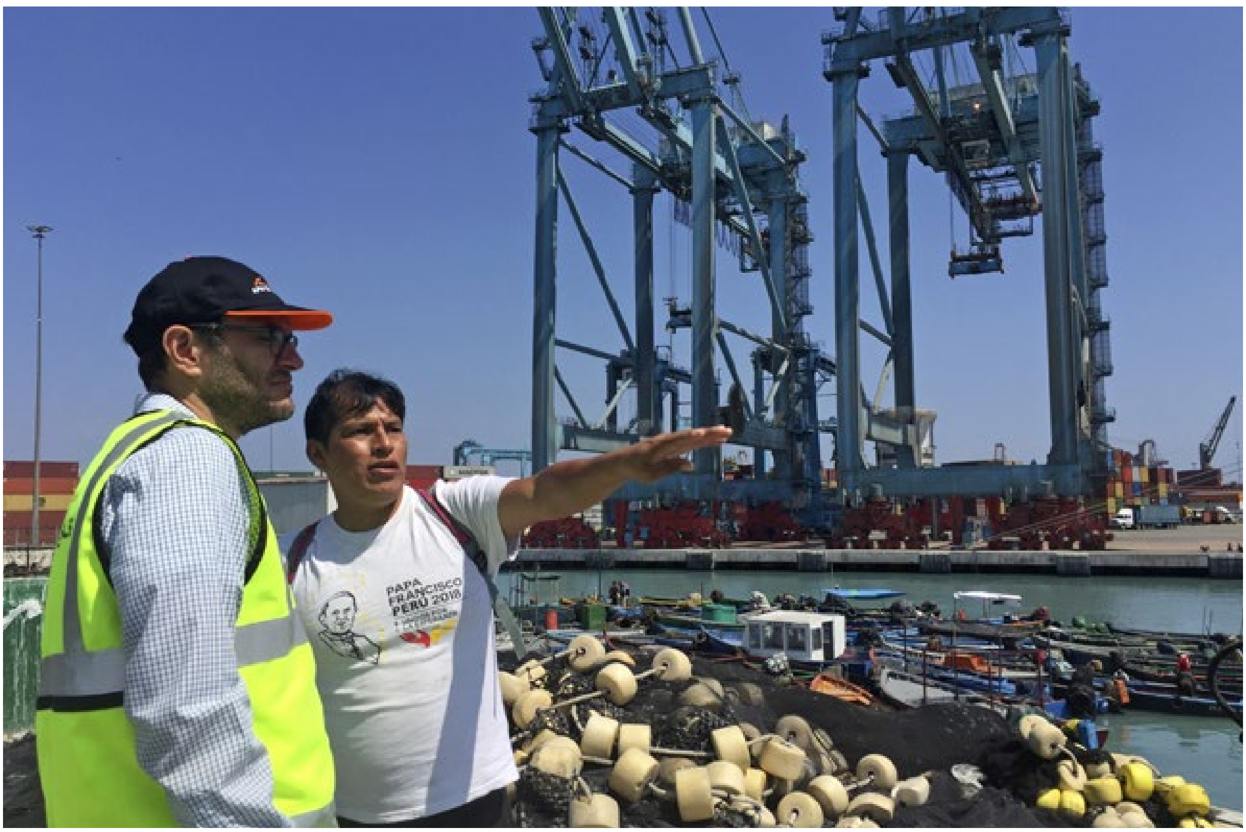
Regional, district and local municipal plans normally include possible zoning in the area of operation. The local plans could intend to promote certain types of activities such as industrial zones, which might even be export processing duty free zones. Another type of restrictive zoning could also be in place to protect forests or drinking water, restrict traffic, control pollution, etc. So, acquaint yourself with local plans before you embark on a project.

CHECKLIST

- Do you know the current state of affairs, the policies and plans of the host country, and are there any obstacles?
- Are there any development plans that might impact your business?
- Is there any local zoning in the area of operation that will impact your business?

1.2 Regulatory framework

Despite the impression you may get at a glance, most sectors and businesses in developing countries are regulated by laws and regulations. Permits and authorisations are just as important to obtain in developing countries as they are at home, and in some cases local laws and regulations may be even tougher or less flexible than in Denmark. Many countries have a high level of bureaucracy and red tape, and you must from the beginning have a realistic understanding of the processes and timelines. In some cases, not having the right permits will make you at risk to attempts of extortion. Therefore, find out what registrations and permits are required for your business and prepare a well thought out strategy for obtaining these permits. It might be best to have an experienced local intermediary to handle this, so you avoid getting into situations where you are subject to attempts of extortion. Also note that if you miss obtaining the required permits or making the correct registrations, subsequent correction can be very time consuming and resource exhausting.



Also note that many permits are given with a time limit, so you may need to have them renewed regularly. It is good practice to keep a list of all permits with expiry dates and have this reviewed periodically.

In many countries, extensive environmental regulations are in place and enforced to various degrees. If your investment project entails high environmental and social risks, an environmental and social impact assessment (ESIA) must be conducted by authorised consultants and submitted in proper time to get your environmental permits in place prior to starting operation.

In some countries, one-stop-shops or official Boards of Investment for incoming foreign companies have been established to facilitate establishment, and the expenses for this may be well spent indeed. Weigh any fees against spending days in different public offices. In most countries, lawyers and dedicated middlemen/consultants will also provide such services.

Being established inside an industrial park may be an advantage when obtaining relevant approvals, licenses, etc., as this often is part of the services provided by the park.

Use a law firm as company secretariat

Good lawyers in developing countries are quite expensive. Even so, it is best also for smaller companies to engage a law firm to ensure the right permits and authorisations and compliance with relevant local regulations. You may agree for the law firm to function as a company secretariat at a fixed yearly fee, which might also include facilitating board meetings and taking minutes.

Depending on your budget it may be a big law firm, but in most countries you have access to tier two or three types of firms, who will be happy to work for you at a slightly lower fee. But be aware that excessive economizing on these functions may be a costly mistake.

Most major Danish law firms are members of international networks, so check if your Danish lawyer may refer you to a reputable local lawyer. If not, ask around in the Danish law firms who have local partners they will vouch for. In many countries, IFU or the Danish Embassy will also be able to help with referring to law firms, including small and medium-sized with a proven track record.

IFU INSIGHTS

Be open and transparent and frame your licences and permits

In some cultures, it is customary to have all your major licences and permits framed and exposed at the reception or entrance hall of the company to show that you run a legitimate business in accordance with the national regulations. This is just one element of being open and transparent with the authorities and the general public.

In some countries, as a part of the audit process, there is an annual confirmation that the company has all the requisite registrations and approvals in place. If this is not a part of the usual audit scope, it is advisable to have such a review conducted by the auditors and placed before the board on an annual basis.

CHECKLIST

- Do you know what is legal / not legal in respect of the business you plan to do in the country?
- Do you know what kind of business registration you need, and which permits and authorisations are required for your type of business?
- Are some of the permits given with a time limit?
- Does the host country have one-stop-shops that can facilitate an easy establishment of your business?

1.3 Setting the management team

Understanding and taking advantage of the cultural differences is of utmost importance when setting the management team, and for most companies the better set-up is a team with both expatriates and local talent.

Whether the general manager or CEO should be an expat or a local depends on the type of business. If local markets are targeted, it may be an advantage to go with a local general manager, who knows the market conditions, the competitors and maybe even potential clients. If your production is advanced, high tech or intended for export, you might prefer an expat as general manager in the beginning.

However, the many local nuances and traditions, including employee issues, are often best handled by an experienced local general manager. If you bring an expat in, it will take a lot of time to figure out the local rules of business, and if the expat does not speak the local language, in countries where English may not be widely spoken or understood, it will be challenging to lead the organisation. Historically, the combination that works best is a team with a local general manager and an expat production or technical manager (CTO). With an expat as production manager you can transfer good work practices and quality parameters from Denmark.

If you want a local as general manager, you should try to find one who has already worked for another foreign company. Some of IFU's best experiences have been with internationally trained locals. You may also consider bringing the local manager to Denmark for an extended period to learn the Danish way. Another option is to find a Dane who is already well established in the country. One who already speaks the local tongue and knows his way around. In many countries, the local Balut or sports club serves as hub for internationally oriented professionals who work there.

Do not cheap out on your financial controller

The third spoke in the management team is the financial controller (CFO). Often, smaller Danish companies are reluctant to spend too much money on this. They are typically very technical and sales oriented and think it is just bookkeeping that can be handled by a junior accountant. However, in most countries the financial and tax administration is getting more and more complicated. By engaging a junior resource, you run the risk that five years down the line you realise things have been poorly organised from the start, and that you need to allot a lot of resources to remedy it.

If you do not want to hire an expensive financial resource, you can outsource the financial controller function to a local accounting firm in most countries. This may be good for a start, but when the company grows to a certain size you should hire a financial controller. The accounting firm can also help set up the right reporting system from day one, which is crucial. This should not represent a significant additional cost to the company – and is well worth it.

IFU INSIGHTS

Have an overseer on location that you trust

Many Danish companies believe it is unnecessary to have an expensive expat resource present in the country during the first years. To reduce cost in the start-up phase they think they may commute back and forth. However, to succeed and minimize risks it is essential that budgets provide for a person on location that you can entrust with overseeing everything.

CHECKLIST

- Is there an appropriate balance between expatriates and local talent in the management team?
- Do you have an experienced financial controller in your management team?
- Do you have an overseer on location that you trust?

1.4 Bringing in expatriates?

It is a costly affair to expatriate a Dane – especially if the entire family is coming along. You must often budget with an all-inclusive package, including salary, accommodation, flights, school fees, insurance, etc., becoming very expensive.

To many it comes as a surprise how hard it is to find accommodations that a Danish family will accept, and how expensive it is. A residence close to an international school is much more expensive than the equivalent in Denmark. In many countries, competent real-estate agents will help you find suitable housing. IFU and the Danish Embassy also have networks that may be able to help with these matters, and finally other Danish expats can offer advice on where to live.

An expat will obviously sustain a much higher salary than a local because he typically will come from a well-paid job in Denmark, and possibly, the spouse has also given up a good job to be expatriated. This may be difficult for a local partner to accept. Consider an arrangement that pays a part of the salary to a Danish account, so that the expat and the locals work on equal terms according to the local books. Note, that wherever the salary is paid, it is important to observe and strictly follow the personal tax income rules. Most countries have global taxation, so do not forget to pay the right tax on any salary component.

It takes a strong person

Besides the professional skills expats must have strong personal qualities. You must be adaptable, patient, tolerant and respectful towards foreign cultures and at the same time stern to dissuade people from trying to take advantage of you. As expat life may also be somewhat isolated, it is also important to be robust, possess integrity and have high moral standards. So, make sure to be aware of the personal motives before you expatriate an employee. Just thinking it would be an exciting adventure should not be the only motive. You should find people with motives that are well aligned with their function abroad, and a certain degree of hands-on craftsmanship is a plus. Some motives are outright no-gos, such as getting away from it all.

IFU INSIGHTS

Arrange a trip to get a first-hand impression

It is important that an expat-to-be knows what to expect. It may sound exotic and exciting, but after a few weeks in Africa, the honeymoon tends to be over, and everyday life sets in, and Google will not help you prepare for this. Therefore, arrange a trip to get a first-hand impression and to familiarise with living conditions. Meet with expat families living in the area and find out all the things you could never have imagined. Common sense or not, it is difficult for people to unlearn what you have come to expect. It can be simple things like the challenge of finding meat, if you are living in a region where most people are vegetarians.

CHECKLIST

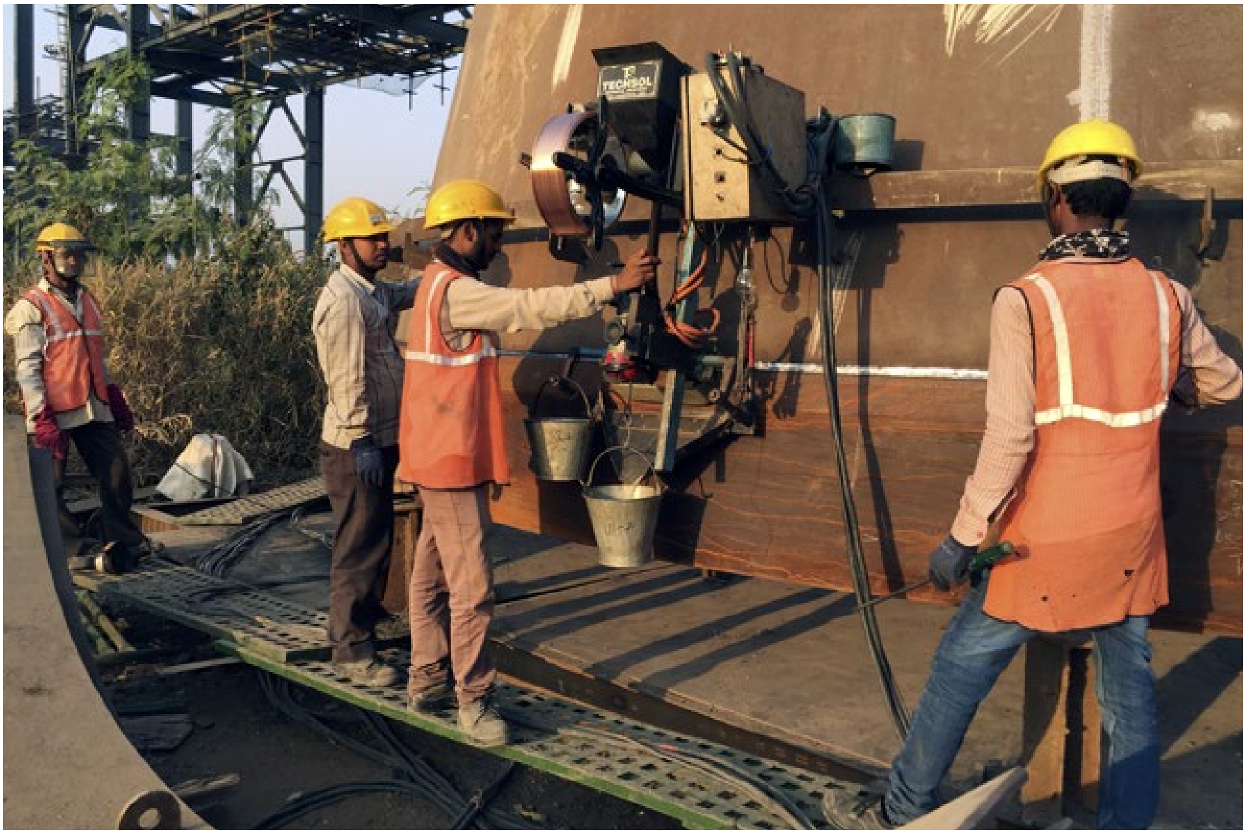
- Are expenses besides salary considered in the expat budget?
- Should some of the wages be paid to an external account abroad?
- Is all taxation regulation fully adhered to from the beginning?
- Are the personal qualities and motives clear and suited for expatriation?
- Does the expat-to-be know what to expect, and has he and his partner had a chance to get a first-hand impression?

1.5 Establishing a sound governance structure

It is essential to establish a strong corporate governance structure and procedures to reduce risk and nurture a culture that supports "doing the right thing". When you establish a subsidiary in a developing country the managerial ties between headquarters and subsidiary must be clear. In the day-to-day routines, the subsidiary must be able to manage by itself, but do not expect the company to be completely self-supporting. You must maintain backup management and keep the Danish organisation ready to provide financial as well as technical and sales support should the need arise. There should be an appointed anchorman at home to serve as liaison to the subsidiary abroad, who has sufficient overview and mandate to allocate resources from the Danish organisation as needed.

Maintain control of the finances

Financial control should be supported and monitored from Denmark from the start, as you must maintain control of the finances. Fortunately, digital banking has made it easy to introduce procedures ensuring that all major payments are authorised from Denmark. The best governance set-up is to have dual reporting



where the finance controller reports directly to the head of finance in Denmark, so he is not solely under the influence of the general manager. It is also advisable to understand and evaluate the scope of statutory audit in the country. In many countries, the scope can be based on a limited review and management representations. In such cases, an expanded scope with the auditors should be agreed to.

As co-investor, IFU wishes to monitor the development of your company. To IFU the quality of the financial reporting is an indicator of the health of the company. One of the first signs that things are not going well is when the reports fail to appear timely. In the implementation phase, reporting must take place more often than during operation. You can read about the reporting requirements in IFU's Financial Handbook as well as how to ensure not only correct financial reporting, but also reliable and sound administrative and digital accounting procedures that your performance can be audited against. The reporting forms in the annex of the handbook are also available as Excel files.

The board is central to corporate governance

Having a competent board of directors in place from the beginning ensures the setting up of proper reporting and monitoring processes. The board is central to corporate governance and functions as the link between the owners of the company, the shareholders and management. One of the key elements of good corporate governance is to clarify the role and responsibilities of the board vis-á-vis management.

IFU's Handbook on Board Work and Corporate Governance is written primarily for board members, but may be equally relevant for the management that will be ruled by the board. The handbook provides a short and easily understandable introduction to the role and purpose of the board of directors.

Especially for smaller companies it is useful to have members of the board who may help or advice the management within a variety of areas. A local lawyer on the board may be an inexpensive way to obtain legal counselling.

IFU INSIGHTS

Schedule your management meetings

If your management team consists of both locals and expats, the cultural differences may cause friction. It is usually beneficial to have recurring, short weekly management meetings with a fixed agenda. At these meetings, expectations may be aligned and potential misunderstandings cleared out. Minute the meetings so that all decisions are on record.

CHECKLIST

- What are the local rules and requirements on corporate governance?
- Does the Danish partner organisation in Denmark have the necessary managerial resources to support a subsidiary company?
- Have you appointed a person in Denmark to be anchorman and liaison?
- Does the financial reporting meet local and international standards?
- What level of decision-making has management been authorised for?
- How is compliance with the corporate governance procedures monitored?
- What is the role of the board of directors vis-à-vis management?
- Does the local partner have a clear understanding and acceptance of the board's functions and responsibilities?
- Remember, trust is good, control is better, but audit is the best.

2 Local partner and team

Part of your business planning is to consider whether or not it will be an advantage to enter into a local partnership. Also, finding the right local employees is crucial for the success of your business. Be aware that labour practices and people management are very different from back home.

2.1 Local partner or not?

The first step towards partnership is to define what functions you want the local partner to perform – and consider if a local management team hired in might be able to handle these tasks instead. You can change the manager, not the partner.

You may need a local partner to provide market access. Partnership with a local company with a strong market presence and distribution network might be a very effective path to the relevant customer base. You may also need a local partner if you want to deliver services to public institutions both for legitimacy and manoeuvrability inside the political or public administrative system.

However, it is IFU's experience that in some cases the local partner struggles to achieve market penetration and blames the lack of success on the product. After a few years, funds are depleted, and more money is needed. The local partner does not have any, and the Danish partner has granted him certain ownership rights and may spend a lot of time and money to buy him out and start all over again.

Get to know each other well

If you do need a local partner, then start by collaborating and trying each other out before engaging in the joint venture. There might be a local distributor or sales agent whom you believe has the potential to become a joint venture partner. If he delivers to promise during the first year, you can go ahead and take the next step. The most successful partnerships are those which are based on a shared history and a solid prior commercial relationship.

When entering into a partnership, it is also essential to balance expectations and aspirations for both the short and long term. Whilst Danish companies tend to favour reinvestment of profits into consolidation or development of the business, the local partner will most often be preoccupied with short-term profit because of the inherent instability in developing countries. The next regime change or natural disaster might arrive sooner than you expect, so if profits cannot be quickly made (and spent), it may not be attractive.

Share responsibility, risk and profit

You should draw an agreement where roles and responsibilities are clear, and the local partner also has money at stake. If the local partner only contributes with existing fixed assets like buildings or land and you provide the new capital, your risk exposure is considerably different. Equal 50/50 partnerships must be avoided. You should have the casting vote in case of disagreement and have procedures for dispute settlement in place from the start, including a first right of refusal to take over the shares of the local partner.

Often partnerships go wrong because the Danish partner believes he can just fly in and out five times a year, while the local partner takes care of all the practicalities. If you have the majority stake, you will need to be present in the country. The local partner will want access to your knowhow and may promise to take care of everything on the ground, but when it becomes obvious after a while that you perhaps as the major investor are getting the lion's share from their hard work, the partnership could go sour.

The distribution of expected returns can be another source of dispute. If the primary purpose of the joint venture is to service the Danish partner company, it is most likely that the Danish partner will have a clear view on how to split the profits. The local partner is equally likely to disagree, and if he feels treated unfairly, he may have numerous ways of retaliating, e.g. by letting the rent go up, control raw material supply, access to workers, infrastructure, etc. Therefore, you should be 100 per cent transparent about any conflicts of interest, e.g. intercompany trade with both local and Danish partner. Such issues should be brought openly up and mitigative measures found and written down, so it does not end up in conflicts later.

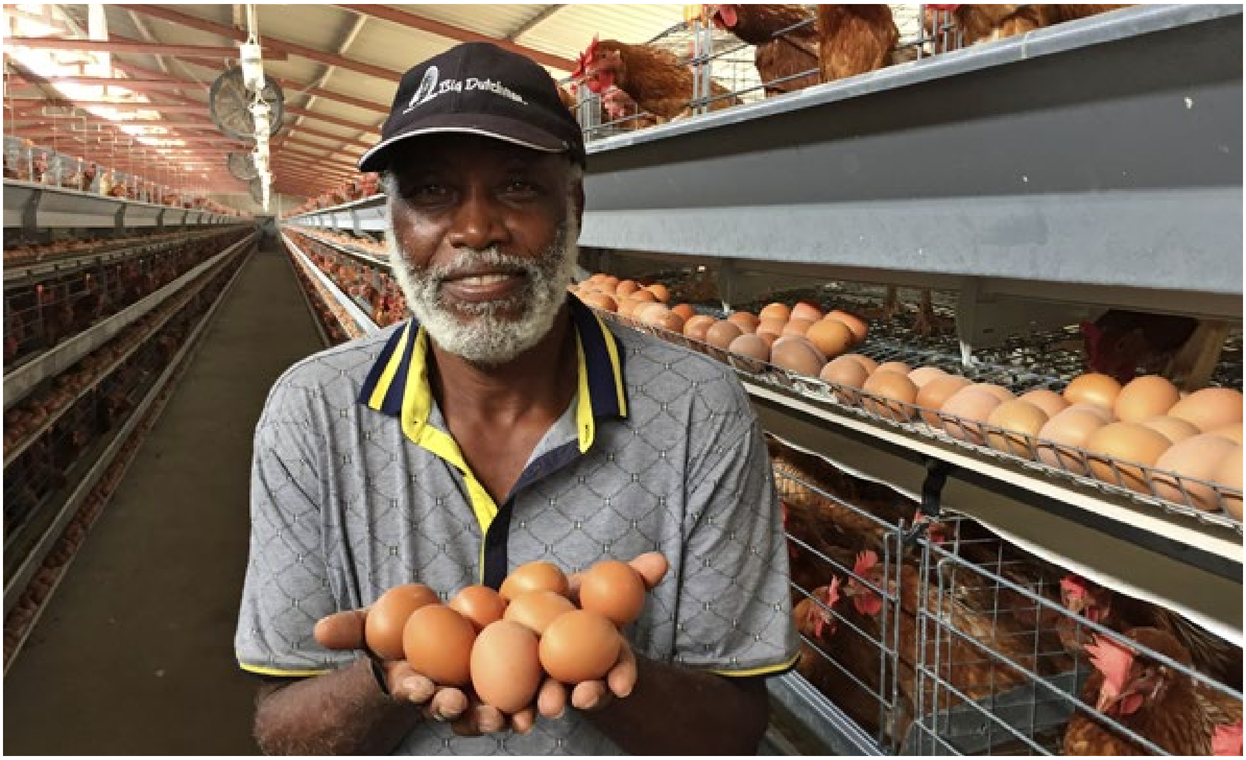
IFU INSIGHTS

Conduct a background check

Always do a background check or red flag analysis using local media and other open sources or professional intelligence service bureaus to find out what you can about a potential partner. Even with a thorough background check, it is still advisable to take time to get acquainted. Be aware that it may be difficult to get credit information/ratings on local companies. Audited annual reports are often not consolidated and are not publicly accessible. Caution needs to be observed when offering credit in the local market, and guarantees from owners are more usual than in developed countries.

CHECKLIST

- Have you considered whether the functions of a potential local manager can be performed by a local general manger as well?
- Have you performed a background check on the potential partner?
- Have you defined and agreed on expectations and aspirations before drafting the partnership agreement?
- Are the roles and responsibilities clearly specified in the partnership agreement?
- Are procedures for dispute settlement in place?



2.2 How to recruit local staff

You should engage with a professional headhunter for recruitment of white collar staff. In some countries IFU has contacts to experienced headhunters, who know what you are looking for in terms of qualifications and values and can deliver on that.

For labour staff it is usually a different recruitment process. You may use a headhunter to identify senior people and then work with them to recruit lower tier workers. When you have identified your production head and other middle management they may participate in the selection process.

Be prepared for a run-in period before you have the right team. Regardless of how well the first recruitment is conducted, you will most likely have to replace some employees already after a short while.

Patronage, nepotism and rent seeking

Outside of Denmark, patronage is not necessarily perceived as a negative concept. If you have a local partner, he may often recommend key people for your management team. He knows this guy, and maybe it turns out it is his nephew. Your local general manager might also suggest that he should appoint the finance and marketing managers. It is an easy way of recruiting employees, but it may be doubtful if these candidates are the right ones for the job. And from a governance point of view it is not advisable. In general, family relations in management should be avoided unless there is reason to believe that the relative in question is indeed the best person for the job. After all, you will want management to be loyal to the joint venture and not to the local partner. Let the local partner and the general manager recommend their candidates to the headhunter and have him evaluate the applicants. Of course, you must also avoid the same misuse of position yourself.

Procedure for blue collar recruitment

If you leave recruitment of labour staff to middle management, you may experience that they will hire friends and relatives. It cannot be completely avoided, and therefore you should also have a procedure that ensures that non-performing workers are quickly laid off.

If a substantial blue-collar staff is required, you should implement a recruitment procedure that involves background checks and ensures a certain degree of diversity. In most countries you can make a background check for blue collar, e.g. if the person has a police record or has been dismissed from another job. You should also make sure to hire people with different backgrounds. Having only employees from one tribe or local area is liable to raise tension in the local community. In some countries it is advisable to hire at the gate to bypass middlemen and to avoid the high commission the hired people will have to pay to them.

IFU INSIGHTS

Lack of technical skills

Many developing countries have no formal craftsman education, so do not expect to find craftsmen with a full vocational training background. You will have to train your craftsmen yourself. Engineers are likely to have solely theoretical knowledge from the academies, so also be prepared for the need for further practical training. Especially in high tech productions it may be necessary initially to bring a production engineer and a foreman from Denmark to train your technical staff. In several countries, basic computer skills are lacking even in employees with tertiary education. Obligatory computer tests and training during interviewing and employment can therefore be very relevant for many staff members. Offering to finance a computer for home use can also have a very positive impact on developing computer skills.

CHECKLIST

- Do you have a recruitment procedure that involves background checks and ensures gender balance and diversity?
- Do you have a fair and transparent procedure for dismissal of non-performing workers?
- Are you prepared to provide the necessary vocational training and skills development for your technical staff?

2.3 Decent jobs and labour practices

Labour practices like salaries and pension schemes are typically determined by national law, and therefore you must acquaint yourself with the local terms of employment. In fact, this should be investigated before you establish your company, as payroll cost is depending on the taxation of the locals. You may find that the payroll cost is twice the base salary because social taxes and pension payments must be added. In many places it is the employer who pays income tax and pension. It is not enough to obligate the employees to make the payments contractually, because if they do not you will eventually be presented with a huge bill. Also, in most countries, regulations regarding termination of employment are very rigid, and you may find that reversing a bad employment decision is very costly. In many countries in Latin America there is a termination fee, typically of one month's salary per year of employment. Something you must be particularly aware of if you are taking over employees from a local partner. This could also include substantial pension obligations from previous employers. One month of Christmas bonus is also customary in most Latin American countries.

In many Muslim countries you may be obliged to pay out an extra month's salary annually in connection with the Ramadan. It is also common practice to allocate one month's salary per employment year as the employee's pension, due when terminating the contract.

Furthermore, salaries in developing countries may legally have to be increased by 8-12 per cent p.a. and unless matched by a parallel increase in productivity, the profit margins are likely to be eroded over a period of time.

You may decide to have an in-house HR person to handle this or, like with the finance functions, you may outsource it. It is probably better to outsource until your company grows to a size where it is viable to have your own HR function. The HR consultant you hire to help you recruit will also be able to draw up the employment contracts.

Contract non-essential manpower

It is advisable to hire non-essential manpower as statutory workers as it allows you to reduce staff in the event you have a bad year. Usually, there are regulations on how many contract workers you can hire, but if the regulation allows 20-25 per cent you can easily identify non-essential staff, e.g. security guards and loaders to be contract workers. As the principal employer you are obligated to make sure that all the statutory payments are being made to contract workers as well. If you for example are required to pay provident funds to employees, you are also responsible for ensuring that provident funds are being paid to the contract workers.

Incentive schemes foster loyalty

Generally speaking, it is challenging to retain employees in developing countries. For both white and blue collar, the primary focus may be to maximise income, and if they get a better offer they simply quit. It is important in the employment interviews to address how you may fulfil the ambitions of the employee to retain them at least for a period. This goes especially for managing staff, otherwise your company may experience a serious set-back without local management after some months.

You should have incentive schemes that will make it attractive to stay. Start with a basic salary level, but imply there will be good opportunities to make advancement. Do not underestimate the value of an appropriate title either. The companies who do best in the developing countries are those who make an effort to promote the locals into upper management. You do well by selling "The American Dream". There are examples that employees have left Danish companies only to return, despite a lower salary, because here they may have their competencies developed, and a plausible path to upper management may be paved.

It is particularly important that key management staff have a performance-based salary or bonus package, which is aligned with the goals of the shareholders. Be very careful with the use of option schemes in which managers are given equity shares as part of their compensation packages. If you wish to dismiss a manager at a later stage, it is much more complicated if he is a shareholder. In any case, always incorporate a share buy-back option in the employment contract.

Labour staff costs may be the key driver in setting up operations in most developing countries so make sure to offer them a decent job with a proper living wage, so they won't quit the minute they are offered a little more elsewhere. You do not want to invest time and effort in developing skilled employees in vain.

IFU INSIGHTS

Skilled employees come at a cost

You won't get high quality employees in the developing countries if you are not willing to pay an attractive salary package, which may even be at a level as in Denmark. There is a limited supply of well-educated local people, and the competition for these people is much fiercer.

Take your time to decide on social benefits

Social benefits may be very effective in retaining staff, but you should exercise caution and let it follow the performance development of the company. Very often your staff will request access to loans, cars and other benefits. They will tell you that it is common practice, but you should rather pay them a bit more than go into long-term commitments. Take your time to decide on which benefits you will offer, as it will be very unpopular to withdraw benefits once introduced. And make a strict policy that you do not give loans. Later on, when you have 4-5 years of local experience you will have a better sense of this and may decide that employees after some time may get a part of their salary as loan, etc. As a rule of thumb, short term loans should only be offered to loyal employees of amounts of no more than their accumulated severance pay – and always against a strong contract with a clear monthly payment plan. In Latin America, many employees feel forced to resign in order to collect severance pay to pay for medical bills or a funeral. This can be avoided by providing such type of loan.

Some social benefits you may consider as they also benefit your company:

- **Healthcare:** If the nearest health clinic is situated far away, or local health services are of poor quality, you may consider offering a health care scheme for employees and their closest relatives. This may reduce absence significantly. However, you must make it absolutely clear to whom the offer is made, e.g. keep a record of the closest relatives concerned, so you know exactly who should have coverage.
- **Housing:** Housing is a major problem in some countries. Without you knowing, some of your employees may be migrant workers living under poor conditions, e.g. in dorms with six people sharing three beds working and sleeping in turns. If your company is situated far from urban areas, you must under all circumstances secure adequate housing for your employees with space both inside and outside for eating and leisure
- **Meal service:** You may provide your employees with a warm meal in the middle of the day so they won't leave the premises during lunch break, and so they are provided something healthy to eat. It is often not very costly to make an arrangement with a local catering service.
- **Transportation:** If no last mile transport is available you should provide transportation to and from the

workplace. If you have many female workers on shifts, there is also a security concern to be considered. You may acquire some minibuses or make an arrangement with a local bus service. Consider joining forces with other companies in the area to offer transportation.

- **Education:** Education plans for developing language skills, computing skills or other relevant adult education can be offered as an incentive to the employees. In some cases, preferential access to education for employee's children can also be negotiated.

CHECKLIST

- Are your jobs decent according to the international definition?
- Do all your employees have a written contract?
- Do local labour laws require you to provide employees with a minimum wage, benefits for social security, medical insurance, vacation and housing and clothing allowances?
- Do your workers understand that they have freedom of association and have a legal right to join a trade union?
- How easy is it to dismiss dishonest or bad workers? Is it possible to impose disciplinary procedures?
- Are there appropriate incentive schemes for key employees?
- Do you have a policy for access to loans and allocation of social benefits?
- Are your housing facilities up to international standards within this area?

2.4 Managing human resources with cultural sensitivity

One of the greater challenges for a Danish manager is to realise just how different people management is in the developing countries. The list of examples is long: You cannot just delegate a task and expect it to be taken care of – from the outset you may have to monitor and control most things. Often people will do only what they are told – do not expect much independent initiative as traditionally it is rarely being appreciated. The management culture is strictly hierarchal, and most employees will not say no to a boss or ask questions if something is not understood. It requires an adaptive management approach and often very precise instruction and supervision – having work manuals and procedures is often not sufficient.

Work procedures will deteriorate if on-going follow-up is not exercised. Non-compliance to maintenance scheduels and manuals is a common occurrence. As a leader you should not seek consensus. If a worker does shoddy work you should impose immediate consequences and you should have low tolerance towards not following procedures.

Expect to have more staff

Smaller Danish companies are characterised by having very limited administration because employees may span several work functions. If a lorry comes in, it may be that the accountant has been given a certificate so he may operate the forklift. You see that hardly anywhere else in the world. In other countries the division between work functions is strictly observed, and employees will not accept doing tasks outside of their domain. Therefore, expect to have more general and administration staff than you would in Denmark.

Serving an extended family can be a time-consuming obligation

In Africa you may have the concept of extended family where also cousins are "brothers and sisters". When you as an African ascend the hierarchy the expectations from the extended family will also soar. If you are an African manager, it may occur that some of your "brothers and sisters" will be coming to the anteroom waiting to talk to you about their problems. They may need a job, or the village water pump may be out of repair. It is expected that the illustrious son will fix stuff. This means that local managers may face a lot of pressure and spend time on things they are not hired for.

The general manager should speak the language

In many countries speaking English will not be enough. In for example Latin American, China, Ukraine or French West Africa, English skills are poor or non-existent. Therefore, you must have someone in the Danish organisation who speaks an appropriate language for the country you are operating in. And it is even more important that your general manager speaks the language, as it is almost impossible to overcome any cultural barriers if you cannot communicate directly with and follow a conversation among the employees. In Africa you must also consider that your labour staff may speak various local tribal languages, and that in itself may call for an extra layer of management.

IFU INSIGHTS

Traditions and national holidays are taken seriously

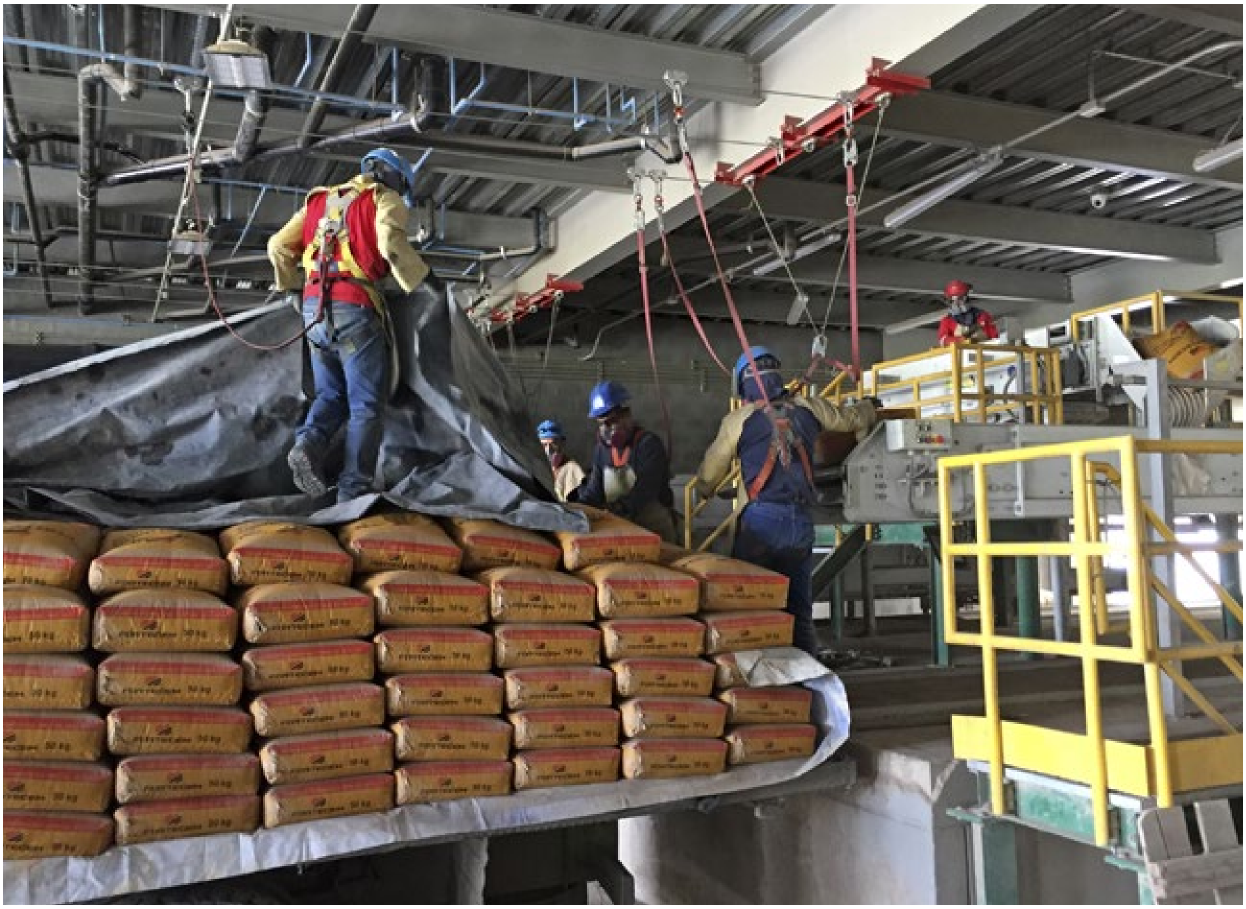
Outside Denmark national holidays are taken very seriously, which you must consider, especially if close cooperation with the Danish company is required. E.g. in many Muslim countries, Friday is a public holiday, in the Chinese New Year everything closes down, and during the Ramadan people are not allowed to eat until the sun sets, which may impact productivity. It is important to accept and observe these traditions.

CHECKLIST

- Do you demonstrate sufficient cultural sensitivity in your daily dealing with staff?
- Do you have clear work procedures, and does your staff get sufficient work instructions and supervision?
- Do you have proper procedures for monitoring that work procedures are followed?
- Do you have low or zero tolerance towards not following work procedures?
- Does the general manager speak the local language?
- Are you aware of national holidays that may impact productivity?

2.5 A healthy and safe workplace

International occupational health and safety principles (OHS principles) prescribe that workers should be protected from sickness, disease and injury arising from their employment. However, health and safety laws vary considerably from country to country, and even if the host country has legislation covering these issues, local authorities may not have a labour inspectorate to advice companies on how to ensure adherence to



law. This is a very Danish concept. Therefore, you must be prepared to be responsible for securing and enforcing a healthy and safe workplace.

You must provide workplace health and safety instructions and the necessary personal protective equipment as well as ensure that your workers are trained in handling the health and safety risks.

Involve workers in the health and safety work

For a Danish manager it is important to understand that many labourers have little background for understanding the importance of a good working environment and the benefits for both for themselves and the company. They work to make money here and now and have no long-time perspective on the health effects of dust, noise, and chemicals. However, the best way to protect workers against accidents and reduce sick leave is to involve them in the health and safety work. You must set up a health and safety committee with persons representing both management and the workers. The committee should handle concerns and complaints from workers regarding health and safety and work with risk prevention.

A healthy and safe workplace fosters more loyal and efficient employees. It also means fewer days of sickness and less staff turnover, which can cause significant costs for recruitment and training.

Read more about IFU's requirements for occupational health and safety in IFU's handbook on Sustainable Investments.

Overtime increases the risk of accidents

In many parts of the world, workers have to move far away from home to find work. These migrant workers usually have one aim, and that is to make as much money as possible for their families at home. And they will rather work long hours than have time off. However, overtime increases the risk of occupational accidents and you must set reasonable limitations on working hours. Many countries have rules to limit overtime and excessive overtime is not legal. It is also bad for productivity to have people work long hours, become tired and make mistakes.

IFU INSIGHTS

Enforce use of personal protective equipment (PPE)

It is your responsibility to ensure that your workers use the necessary personal protective equipment correctly. There are numerous examples that if the equipment inhibits the work it will not be used. Especially chord workers will not use the equipment if they can work faster without. As this may pose serious health and safety risks, you should establish penalties and other consequences if the equipment is not used. Warning about deduction from wage is likely to be effective.

CHECKLIST

- Do you provide workplace health and safety instructions and training?
- Do you provide and enforce the use of personal protective equipment?
- Do you have a health and safety committee where employees can openly address health and safety issues?
- Do you set reasonable limitations on overtime working hours?

3 Infrastructure and supplies

The provision of reliable infrastructure services to meet the demands of both businesses and households is a major challenge in developing countries and must be considered carefully when establishing your business.

3.1 Construction of new company facilities

If you are establishing a new company facility (Greenfield Company), you may benefit from outsourcing the entire construction to an EPC contractor (Engineering, Procurement and Construction contractor), who at closeout will hand over a facility ready to go. A turnkey facility will be more expensive than if you manage the construction yourself, but it will be easier and safer.

You should be careful when selecting contractor(s). Do not just hire small local construction companies. Better use larger national or international construction firms and monitor which subcontractors the contractor involves.

Whichever setup you choose, you should hire an independent consultant or quantity/quality surveyor that you can trust. Not having a keen eye on construction, even if you outsource, may really come back to haunt you, not just in terms of regulatory non-compliances, but also in the shape of shoddy workmanship that you won't know until one year later when your wall starts developing cracks.

Managing the construction may require different skills than managing operations. Your general manager is not necessarily the right person for the job. You might consider engaging one of the larger (Danish) consulting companies for this if they are present locally. Something unexpected will inevitably occur during the construction. If, for instance, you become aware of a local building regulation that will require alternative placement of machinery you will need someone on site, who can grasp the consequences for the production and make appropriate decisions.

During the construction phase, you may also realise that some changes to the design are necessary. In general, these should be implemented if you can lower your operational costs many years ahead by spending a little bit of money on improvements. Such improvements could be in terms of energy efficiency, water saving installations, etc. The earlier they are introduced, the cheaper they come, and if introduced at the drawing level they cost nothing and can really save you many recurrent expenditures later on. On the other hand, any amendment or changes to an already signed EPC contract will cost you dearly.

IFU INSIGHTS

Investigate land rights when acquiring land

Before acquiring land for your facility, you will need to investigate land ownership properly. In many developing countries, management of land presents a legal challenge, and particularly in poor and rural areas, people residing in or using the land may lack proof of ownership or usage rights. Therefore, you must ensure that past users and owners have not been wrongfully removed, and check whether local communities have land use rights like access to hunting and fishing grounds, pasture grazing land or cultural heritage. IFU has seen several examples of companies getting in trouble because they bought land from people that were not at liberty to sell the land. Make sure to seek legal advice on any potential ownership conflicts. Note, that if local rules are based on Anglo-Saxon administrative practice, it is common to rent the land for 99 years instead of acquiring it permanently. Read more about how to respect land use rights in IFU's handbook on Sustainable Investments. As a rule, land which is tainted by any type of doubt regarding its ownership – be this anecdotal, legal or otherwise – should be avoided.

CHECKLIST

- Could you rent premises as a start?
- Is an EPC contractor an option for building your facility?
- Has the pricing of the new facility been exposed to free market competition or at least benchmarked by an independent expert?
- Have you appointed an independent quantity/quality surveyor to oversee the construction?
- Have you investigated land ownership with all the relevant authorities and customary land use rights of local communities before acquiring land?

3.2 Connections to public utilities

It may take a very long time to establish telephone connections, water or power supply, so you should acquire local assistance for this task, too. Otherwise, you may easily end up waiting many days in an office to get a stamp. Expect things to take considerably longer than you can imagine.

Start by inquiring with the Danish embassy and especially other companies in the area if there are conditions that you should be particularly aware of. E.g. how stable is the power supply in the area, and how is the quality of the local water supply? Maybe you will need your own – often expensive – power generator if power is unreliable, or your own purification plant or well that may require a permit in areas with water shortage. You may also want to know what quality Internet connection and mobile coverage you can expect. Bandwidth and stability will be crucial if you will have to rely on exchanging larger quantities of data in the cloud and with colleagues in Denmark or suppliers abroad.

You may prefer to move into an industrial park where you rent an administration building or a factory building that is already hooked up with electricity, water, Internet and other utilities. Industrial parks are becoming increasingly common in developing countries and may present a huge advantage if there are facilities

that suit your business. It will of course be more expensive, but you will save yourself a lot of trouble. Ask a few companies operating on the site about their experiences.

To attract foreign investors, some countries offer free one-stop shop services for companies on how to get established, including connections to public utilities. The services may be on country, regional and local level, and you can ask the Danish embassy to assist in appointing relevant services.

IFU INSIGHTS

Contingency planning is crucial

In most places you will need to have emergency supply of power and water in the shape of generators and water tanks or reservoirs, e.g. for cooling, fire control or farm animals. Even in an industrial park where everything should be available you may need an emergency generator when the whole area suffers power shortage. If you do not have water storage, you may have to buy water privately from time to time, and that can be expensive. Your budget must also include a significant contingency component – typically 25 per cent for cost overruns.

CHECKLIST

- What are your power needs, and how reliable is the supply in the given area?
- Is water supply critical for your company, and do you need water storage?
- How is the local water quality, and do you need a purification plant?
- Is the digital infrastructure sufficient for your business now and in the future?

3.3 Bringing in technology

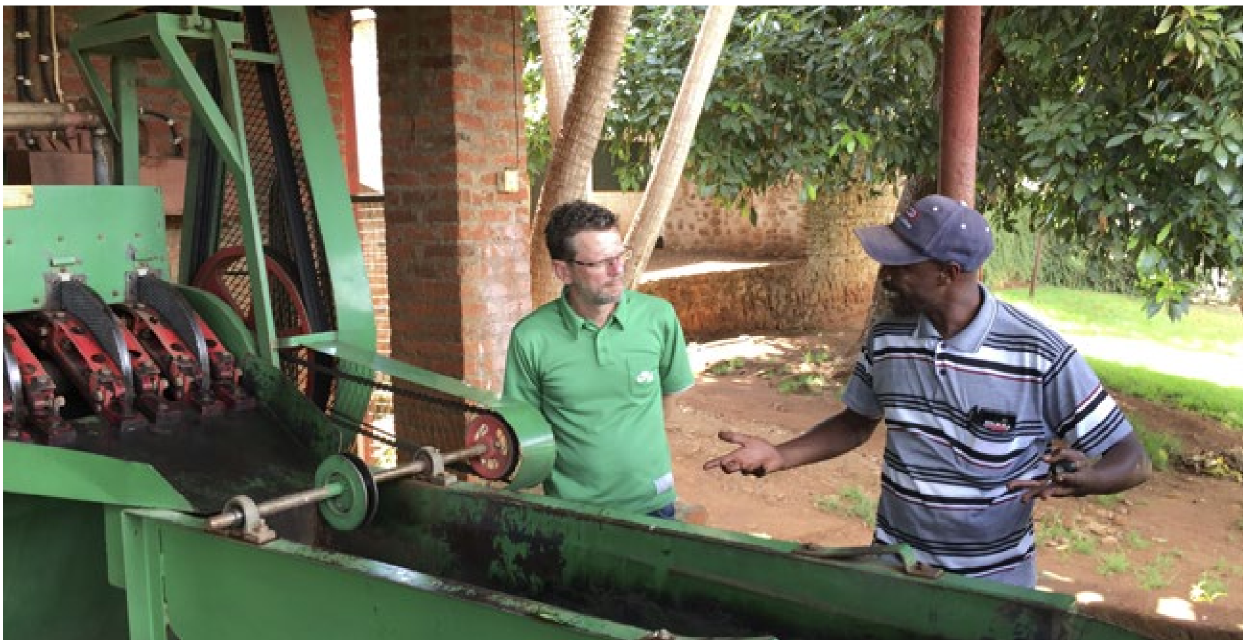
In case your production is dependent on technology brought with you from Denmark, it is very important that you consider what it will take to run machinery, digital solutions and other equipment in the new environment.

First, find out where the nearest service centre for your equipment is located (if any) and establish the terms for repairs, e.g. how many days will it take for a repairman to come to your facility. Then consider what your own capacity for doing repairs should be. In most developing countries, you will need to train your own staff to be able to do the basic repairs and maintenance of your machinery and equipment. Do not rely on being able to find a good local blacksmith, electrician or plumber – the level of technical skills you require is typically not to be found.

Also consider what spare parts are essential to your production and how much you will need in stock. You should not be dependent on spare parts flown in from abroad. Setting up redundant systems may be a viable solution, as it may take a very long time for goods to pass through customs, and the local infrastructure makes transport expensive, time consuming and generally unsafe. It may be a good investment to have all but wildly expensive spare parts in stock. What you will have in stock must be determined by an economic calculus weighing tying funds into stock and loss of profit by having to wait for it to be shipped to you.

You could ask your supplier of equipment if they have other customers in the same country, or even better in the same area, and have them tell you how the supply of spare parts actually works in your region.

You should also consider whether there are Intellectual Property Rights (IPRs) on the technology you plan to use, which prohibit you from using it in the country where you plan to operate. Finally, you should consider the need to protect any intellectual property in relation to your own production or products. Procedures for this may differ depending on country and region.



IFU INSIGHTS

Not a scrapyard for old equipment

Many Danish companies have obsolete production equipment that they believe may be operational for many years still. So, why not benefit from it in a developing country? Well – many developing countries are not interested, as they do not wish to become a scrapyard for the developed countries. In China, for instance, you are not allowed to import second hand production equipment that is more than five years old. Therefore, be aware to check up front the potential restrictions if you plan to import second hand equipment.

CHECKLIST

- Is there a service centre for your equipment nearby, and what are the terms for repairs?
- Do you need to train your own staff to be able to do basic repairs and maintenance?
- Which spare parts are essential for your production, and how many spare parts do you need in stock?
- Should you establish redundancy systems and back-up production lines?
- Is your technology easily copied and production method replicated by local competitors?
- Do you need to protect intellectual property in relation to your production or products?
- Are there restrictions on import of (older) equipment in effect?

3.4 Local procurement of supplies

Your business is important in the local setting, and the more you can source supplies locally, the higher impact you will have in the local economy. So, if quality goods and services are available, these would be the preferred option over imports with high freight costs, long deliverable time and exhausting customs clearance and duty payments.

Local procurement of goods and services are often an area where substantial variation in costs can occur both in developed and developing countries. This can be due to carelessness, incompetence or deliberate malpractice for personal gain. If your business depends on a proliferate supply chain you, are also responsible for what goes on in it, not only at tier one level (see also IFU's handbook on Sustainability Investments).

IFU INSIGHTS

Local purchase contributes to economic impact

At first, the market supply in a developing country may seem rather limited, but there are often more suppliers than one can imagine. The proper requirement and product specifications help focus the procurement process, and you must make sure that buying from major suppliers allow you to get a better price for larger quantities. All procurement of goods and services should always be at market price and verified, so that no single staff member can order overpriced items. For re-occurring services like internet, cleaning, audits and vehicle maintenance, ask for a new quotation every once in a while to ensure that your supplier stays competitive.

CHECKLIST

- Are your staff cost conscious in their dealings with local purchase of goods and services?
- Have you established a clear procurement policy and easy to understand procedure for buying supplies, including a sound practice of soliciting competing offers?
- Do you have clear threshold values for procedures separating office sundries shopping from spare parts and important bulk procurement that could affect your business and its profitability?

3.5 Transport and distribution logistics

If a distribution network already exists for the kind of goods you want distributed, you will usually be better off using that instead of having your own vehicles. Furthermore, especially in the start-up phase, product volume will rarely justify having your own trucks. If you use a transport company, you may scale up or down as you require. Having your own vehicles also enhances the complexity of your business and adds another chain that you must invest in and supervise. The local transport companies are also better suited to operate in the local area and will easier pass road blocks and be less exposed to facilitation payment. Many developing countries have a catastrophic lack of transport equipment, and therefore transport is expensive, but if transport is critical to your business this is not the place to save a penny. Use your business network and choose one that others have had good experiences with. The major international transport companies have branches or distribution networks all over the world – also in the developing countries.

IFU INSIGHTS

Own trucks for branded goods

If you sell branded consumer goods, it may be a good idea to have your own vehicles with the brand logo on as part of your marketing strategy. Especially if you produce food products where cold storage and handling during transport is critical to product quality. Even if local distributors have refrigerated vehicles you cannot be sure how many times they stop underway to collect goods, how long the loading door is open during loading, or how delayed your goods will be because other companies' goods are not ready. With your own vehicles you are obviously more in control of quality, timeliness, avoidance of loss / stealing, etc., but it is always a choice that depends on the available local logistics.

The **Incoterms** or International Commercial Terms are a series of pre-defined commercial terms, including terms of transport and distribution published by the International Chamber of Commerce (ICC) relating to international commercial law. These could be helpful to know and refer to.

CHECKLIST

- Is there a local distribution network for the goods you want to sell?
- Can the transport company guarantee the chauffeurs will transport and deliver the goods as agreed?
- Should you consider setting up your own distribution system even if it involves another chain to invest in and supervise?

4 Risk reduction and mitigation

Operating in developing countries entails not only commercial risks. Risks due to environmental and social challenges, weak digital infrastructure, changing societal attitudes, political instability and other internal problems may disrupt your plans and affect your business negatively.

4.1 Environmental and social issues

Managing your environmental and social impacts is an important element of risk and reputation management, as well as ensuring that your business adds value to society. As risks change over time, you must have procedures to ensure that you on an on-going basis identify and assess adverse sustainability impacts related to your company's own activities, but also those of your business partners in the value chain. Therefore, outsourcing functions to subcontractors is not necessarily the best solution, as it increases your need for supply chain management and control.

A sustainability action plan that describes the measures to be implemented to meet relevant international standards and IFU's sustainability requirements normally is part of your agreement with IFU and other international investors. This includes requirement for establishing an environmental and social management system (ESMS).

Establish an effective management system

An effective ESMS is a dynamic and continuous process initiated and supported by management, and involves engagement between your company, your workers, local communities directly affected by your operations and, where appropriate, other stakeholders.

Besides risk reduction and impact mitigation, the benefits of establishing a robust ESMS include better operational efficiency, greater employee retention and productivity and improved external relations and public image. On the other hand, failure to implement an ESMS could lead to fines and penalties, loss of licence to operate and new environmental liabilities as well as reduced access to markets, clients and investors.

One of the key objectives of an ESMS is the continuous improvement of the company's environmental and social performance. Therefore, it is important to identify your significant environmental and social impact and define Key Performance Indicators (KPIs) to measure your progress.

Read more about IFU's sustainability policy and requirements in IFU's handbook on Sustainable Investments.

IFU INSIGHTS

Construction entails other risks than operation

If you are building a greenfield company facility, you are also responsible for the reduction and mitigation of adverse environmental and social impacts during construction, even when the construction is outsourced to an EPC contractor. Construction often includes different and more severe health and safety risks than does operation. Also pay attention to the terms of employment for construction workers and colony housing conditions if they are living temporarily at the construction site.

CHECKLIST

- Do you have a written sustainability policy, and is it communicated to relevant stakeholders?
- Have you appointed a person with overall responsibility for sustainability?
- Have you established an environmental and social management system to ensure continuous improvement and implement sustainability decisions?
- Does it include supply chain management and control to reduce adverse impacts of sustainability issues in the supply chain?

4.2 Personal, company and cyber security

Too much security can burden your organisation, too little will leave your operations exposed. So how to decide the proper security level for your production and people?

When it comes to your production facility, fencing around the property and security guards on duty 24/7 may be a must. This will protect you from theft by intruders as well as mismanagement from employees. You must not make it too easy for people to exploit the situation. If, for instance, you are dealing with metal, some employees may be tempted to lift some scrap at night as a way to earn some extra money. Therefore, it is also necessary to have gate security, so you may control who and what goes in and out. You will not be able to fully automate this – a human interface is needed to keep record.

Security guards are relatively inexpensive, and you should hire reliable people from larger security companies. Otherwise you risk that the guards will take a bribe and look the other way. Many security companies can also provide watchdogs for security at night. Certified security companies obtain permits for firearms and deal with authorities in case of violent encounters between them and criminals. If security guards are hired and armed by the project company, the company assumes full risk and responsibility of any use or misuse of the firearms. Since the main purpose of the project company is usually not to provide physical security, it is recommended to leave this to the professionals.

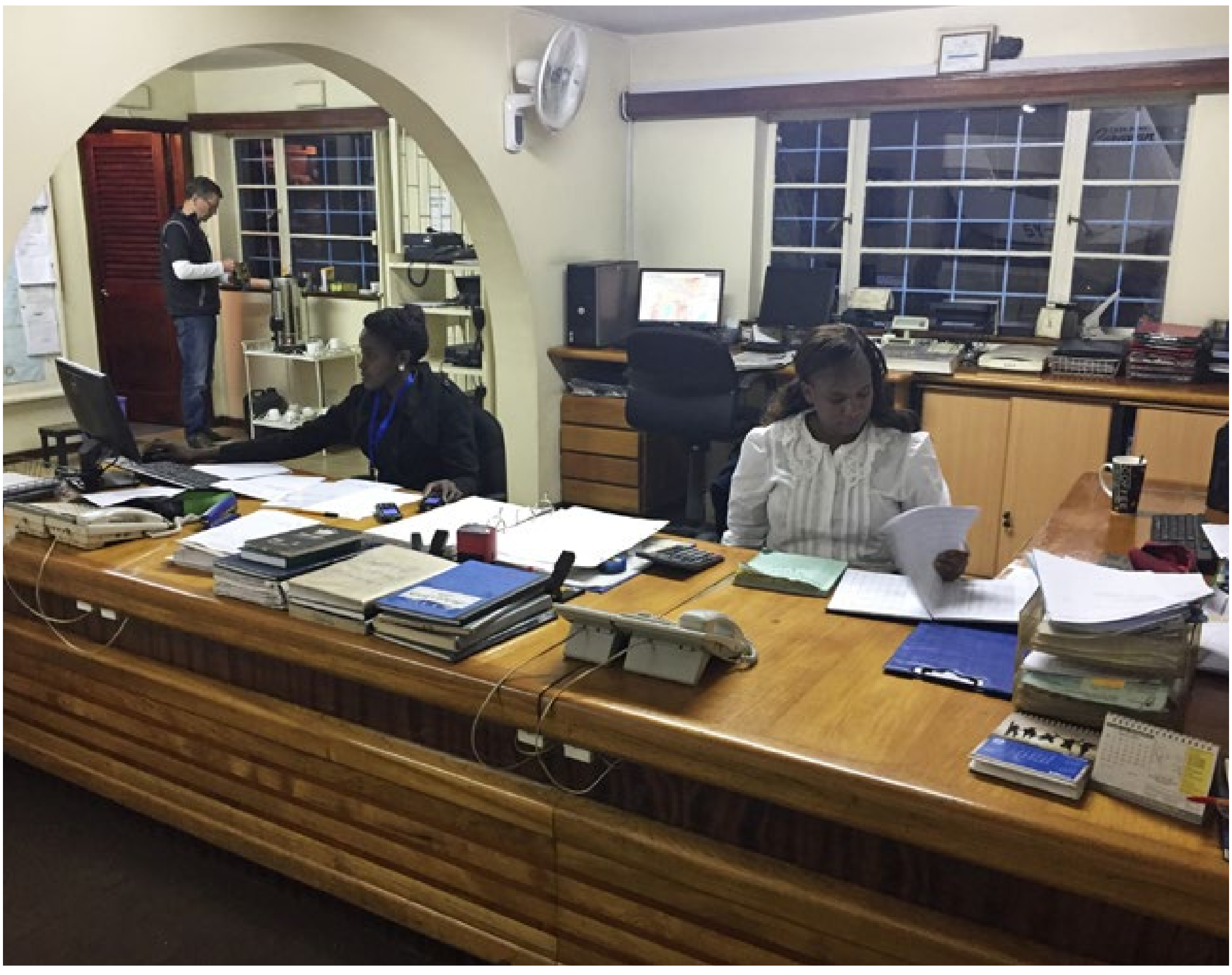
Threats to individuals are not a major issue

Generally, threats to individuals are rare, but having said that, you may have to take it into account. Local frictions may occur if you for example employ people from another province because the locals do not have the skills you need. In such case you will want to protect your workers from local troublemakers. Also, you do not want your workers to be hassled by people entering your premises trying to sell all kinds of things or asking for donations.

Actually, traffic may be the biggest personal security risk in many developing countries. It is common for expats to have a company car with a driver. You won't necessarily want an expensive car as this may attract unwanted attention. In some places it is better to blend in, especially in countries where kidnappings are common. Here you should avoid using clothes, bags or vehicles with company logos on it. In some countries expat employees live in compounds with security guards. Ask the Danish Embassy about personal risks and the proper security level.

Cyber security is critical

Both in developed and in developing countries cyber security is increasingly becoming critical. In the western world certain regulations are in place, but in most developing countries this does not exist. Your company is therefore very much at risk. Your company could be hacked, and your data access could be shut down and the company held ransom until you pay a large amount of money. Assessing the real risk of this is difficult, and you will have to enquire in the business community locally what others are doing about it.



IFU INSIGHTS

Law enforcement by security guards

It is your moral responsibility to ensure that your security guards behave in accordance with national law and international principles for law enforcement. That goes for both directly employed and contracted security guards. You must clearly define the duties of the security guards and train them in rules of conduct to prevent excessive use of force and abuse of power towards workers or local communities. You must also record and evaluate all security-related incidents.

National law may require that thefts are notified to the police, but before doing so you should consider the human rights situation in the country and the risk of contributing to human rights abuses.

CHECKLIST

- What are the company security risks and the measures necessary?
- What are the personal risks for your employees and the necessary security measures?
- Are the duties and rules of conduct for security guards described?
- Are there any human rights challenges in the country due to government laws or cultural practices?
- Is your business set-up prone to cyber attacks and do you have the necessary digital security measures in place?

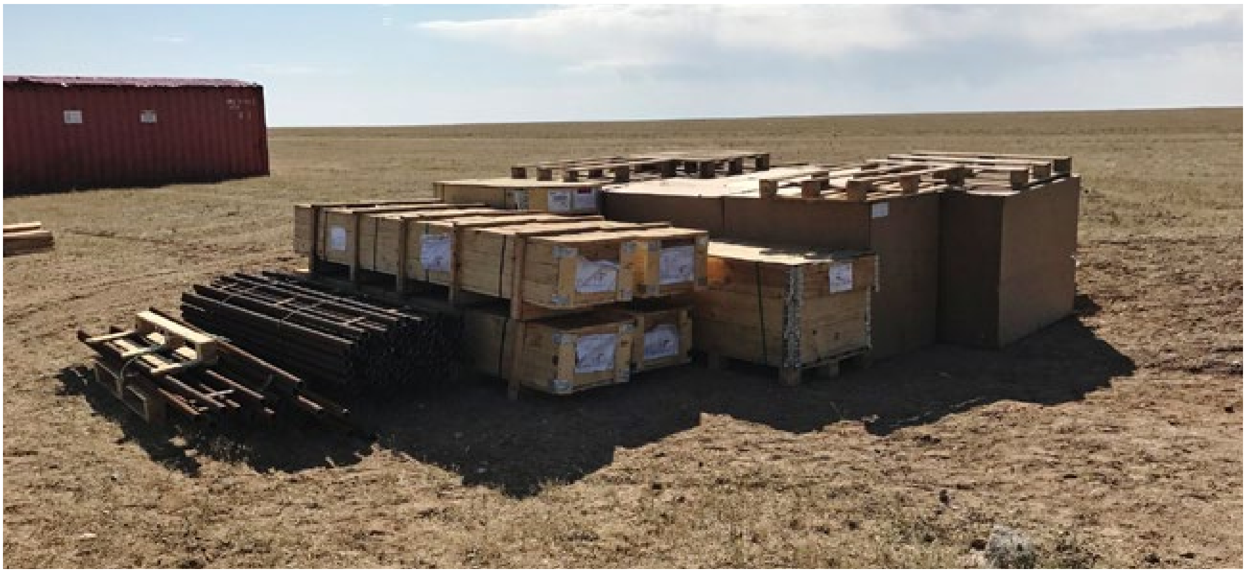
4.3 International and local insurance

Access to insurance coverage and the terms of such coverage will differ from country to country, and specific local advice should be sought on what is appropriate. In some countries, only local insurance is available.

Most local insurance companies are fine as they are in alliance with international insurance companies. Start by checking if your Danish insurance company has an alliance with a local company. And if you draw a blank there, once again you should ask other companies and your legal advisers which insurance companies are available in the region. Alternatively, you may seek advice from one of the international insurance brokers who have offices in almost every corner of the world.

Do not expect to be able to get the same insurance coverage as in Denmark. Expect to bear a greater part of the risk yourself. It is important to be thorough when evaluating the coverage in the insurance quotes you receive and also check the track record of the insurance company. You may be presented with an attractive offer, however, if you do not get compensated in the event of loss it is not much good to you.

It is crucial that your expat staff has good healthcare coverage, otherwise it may become extremely costly in hospital bills and transport abroad. Typically, you will want to ensure your staff from home via SOS International or equivalent. Buildings, fixtures, inventory and operational loss must typically be insured locally, and it varies from country to country what assets can be insured and at what cost. In some places you may not be able to insure your buildings against fire, or there may be legal requirements that e.g. vehicles are insured locally.



IFU INSIGHTS

Liability insurance can be difficult to get

In some countries you won't be able to find a local insurance company that will provide liability insurance for the managers and board members of a company. In that case, you may have to do without, as obtaining liability insurance from an international company, which has no means of evaluating or monitoring your operation, will prove prohibitively expensive.

CHECKLIST

- May your Danish insurance be expanded to cover your foreign assets and operations?
- Are there legal requirements that vehicles and some asset types are locally insured?
- Does your expat staff have proper healthcare insurance?

4.4 License to operate and stakeholder engagement

IFU encourages companies to be transparent and informative about their business and to have an open dialogue with their stakeholders. Besides your shareholders and employees, your stakeholders include business partners, the authorities and the community. Beware that your operation benefits the local community in many ways through direct, indirect and induced positive effects. Dialogue with stakeholders will provide valuable insight into their expectations and concerns, which are often higher than legal requirements, and can also improve your reputation and strengthen local trust in your company.

Therefore, mapping your stakeholders is one of the first and foremost things to attend to when you establish your company. Find out which stakeholder groups are interested in your company and for what reasons – both positive and negative – and decide whether you want to be proactive or reactive towards these groups, and how you want to engage with them.

It always pays off to mingle with the locals and establish good relationships. A membership in the local Rotary Club or similar may serve the purpose well. Make sure to become known in the community to counteract any unfavourable rumours as to who you are and what you want. Especially it is probably important to have good relations with the mayor and local authorities. Having an on-going dialogue with the local authorities and community will also benefit you in case of accidents where the community may be impacted and needs to be informed about mitigation measures.

You should consider appointing a person to deal with stakeholder relations. It could for instance be the person who has the overall responsibility for sustainability. You should also consider having a procedure to handle concerns and complaints, elsewhere also referred to as a grievance mechanism.

Read more about IFU's requirements for stakeholder dialogue and available tools in IFU's handbook on Sustainable Investments.

Adopt a policy for donations

You will be expected to contribute to the local community and you will be asked to donate everything from football shirts to school books. There may be many different groups of people, including different tribes, and if you support one group, others will expect to get something too.

It can be a slippery slope, so you need a clear policy for donations that are communicated to the community. This will help you to assess requests systematically and guide your actions. Typically, you will support things like schools, hospitals and water supply. An approach could be to put together a team of employees from different parts of the community and ask them to come up with proposals that they jointly discuss and agree to support.

IFU INSIGHTS

Arrange a customer day

If you produce capital goods you may arrange a customer day where your customers are invited to see the production facilities. This will show openness and inclusiveness and distinguish you from the local companies and contribute positively to the local business culture.

CHECKLIST

- Do you know all the related outcomes and local benefits and impacts from your company operations?
- Have you identified all relevant stakeholders?
- Are you actively communicating benefits created by your company to the community?
- Do you know what your reputation is in the local community?
- Do you have a policy for charity donations?
- Have you considered customer days or "open house" events to allow locals to gain insight into what you do at your facility?

5 Economic aspects of operations

Careful financial planning is essential when establishing your business in a developing country. Several aspects which wouldn't be given a second thought in more developed countries needs to be taken into consideration.

5.1 Choosing a banking solution

Choice of bank is an extremely important decision, and you should go about it carefully. Your first choice could be a local branch of an international bank as it is easier to handle international transactions. In Africa you may also choose one of the large South African banks that are represented in other African countries.

For some transactions, e.g. salaries, it may be more convenient to use a local bank, and you may want to work with a set-up of two banks. With regards to local banks it is generally best to do business with the largest bank in the region even if it is situated in a neighbouring town.

Again, you may start by checking with a few other foreign companies in the area to learn which banks everybody seems to prefer. This should include your main suppliers' and customers' banking preferences, since local banks may not offer immediate low cost inter-bank transfers as we know them from Europe. Therefore, in some developing countries, interbank deposits may end up being done in cash. Then meet with the preferred banks and choose the one you like best. Also make sure to find out what it takes to close the account, if you at a later stage want to change to another bank.

Even when choosing an international bank, you must expect to face a lot of bureaucracy, and it may take a long time to open accounts. International anti-money laundering regulations mean that you will be met with the same documentation requirements as in Denmark, if not even more. You must be prepared to produce an abundance of documentation both regarding the local business and the ownership structure.

Most banks offer digital solutions

The financial infrastructure is highly developed in most developing countries and most banks offer digital solutions and mobile banking. In some African countries it is more common to own a cell phone than to have electrical power in your house, and they all have accounts with the telecom companies. So they can pay and receive money electronically, and financial transactions are no longer a major cost.

Digital solutions make it easier to monitor account activity from back home and to establish control routines e.g. to prevent transactions exceeding a certain limit to go through without explicit approval.

IFU INSIGHTS

Do not expect to get credit

Local credit lines are extremely difficult to get, so cash flow is more important than at home. Very often the forecast on working capital is under-estimated, and the sales come later than expected. Therefore, it is highly recommended that an extra capital buffer of 50-100 per cent is accessible during the first 2-3 years. Likewise, it is not recommendable to extend credit to clients if not under the most stringent of contracts prepared by a local lawyer. Cash up front is a well-known and respected way of doing business and will save you many headaches during collection.

CHECKLIST

- Which considerations should apply to your choice of local bank?
- What does it take to close an account if you want to change bank?
- Can you get web access to monitor account activity anywhere, anytime?
- What is the expected requirement for working capital?

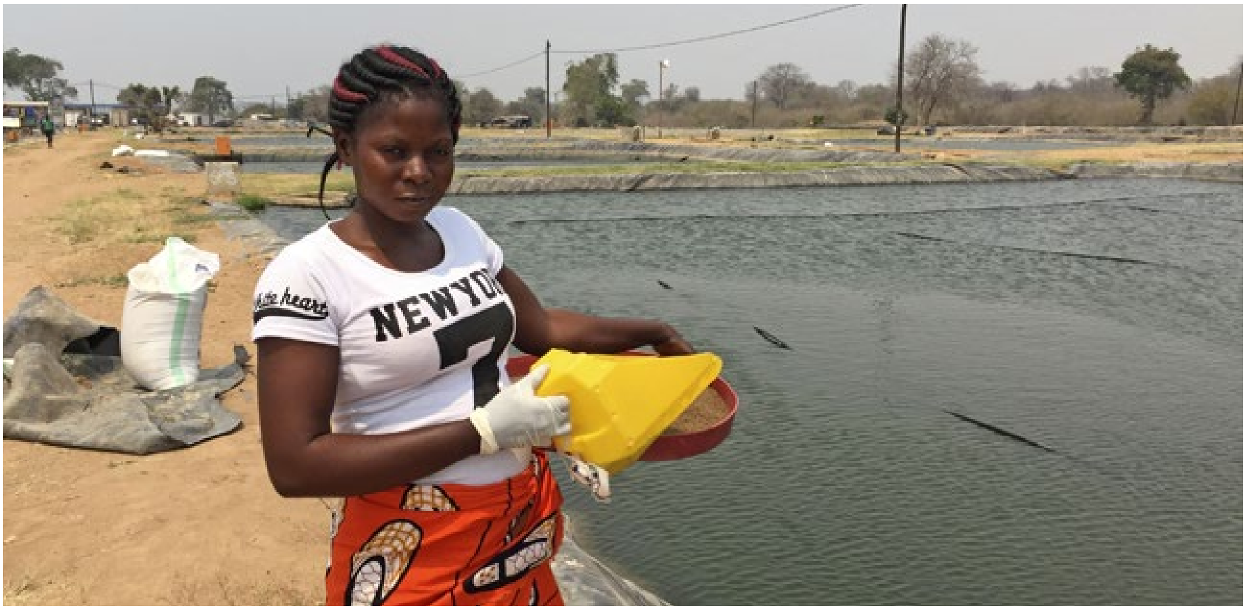
5.2 Currency exchange restrictions

You must be aware of government regulations on exchange controls and requirements for cross-border capital transfer and extraction of capital. Concerns about balance of payment difficulties in developing countries and their need to conserve foreign exchange to pay for essential goods and services reduce their ability and willingness to grant foreign companies an unrestricted right to make monetary transfers.

Host countries may restrict monetary transfers through limiting the extent to which local currency can be converted into foreign currency and controlling the conversion rate that can be obtained for such a transaction. There may also be government regulations on the types of currencies with which payments may be made and the transferability of a currency and repatriation of profits off-shore.

Such regulations can be a challenge if you receive payments in local currency, but have to incur costs in a foreign currency to service foreign debt, purchase materials that are only available abroad or pay expat workers in foreign currency.

You may find yourself in a situation where you have liquid funds in local currency, but due to lack of forex you are unable to change it into Euro or US Dollars, so you cannot pay your suppliers abroad, for instance. In some countries you may depend on forex auctions. In most cases you will be required to produce some kind of forex guarantee to be able to purchase goods and services abroad.



IFU INSIGHTS

Get a foreign currency account

If it is allowed in the country, you may benefit from having a foreign currency account for the liquid funds that are deposited for the investment or the funds you set aside for later investment. Often the initial investment is not invested immediately, but over a period of several years. To protect this from the volatility of the local currencies it is better to keep it in a hard currency. In countries with unstable currencies you will want to convert profit into Euro or US Dollars as quickly as possible to ensure against loss of value. If you are a Danish investor, Euro will typically be preferable, as the Euro and the Danish Krone are closely linked with almost no currency exchange risk.

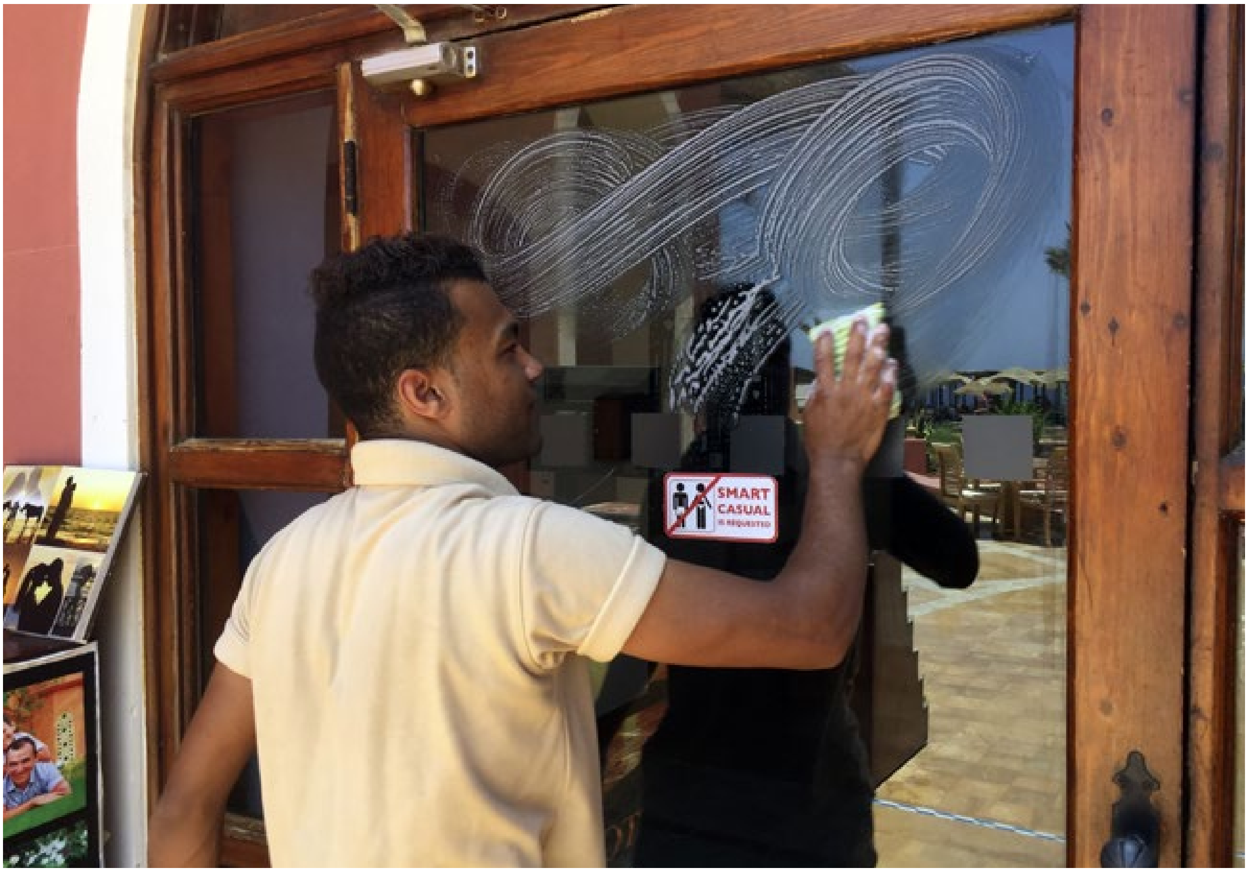
CHECKLIST

- Are there any currency exchange restrictions?
- How will you pay suppliers abroad?
- Are you entitled to operate a foreign currency account?

5.3 Taxes, commissions and fees

Companies in which IFU invests must pay the relevant taxes in the countries in which they operate and comply with local tax laws. Taxes paid to host countries are an important element of the development impact of IFU's investments.

Local tax law can have a direct impact on the profitability of your company. There may be specific tax liabilities imposed on foreign owned companies, or tax breaks and other incentive schemes which your business may benefit from.



Tax incentives are created by governments to support certain industries or activities that are important for the development of the country. When assessing a tax incentive, take into account if the expected benefit is within the spirit of the law and if the activity of the company is in fact such that the tax incentive was reasonably meant to support. One of the most common tax law incentives is the tax holiday, which exempts the company from or reduces corporate income tax or other taxes for a specific period. An often-seen variation of the tax holiday is tax stabilization, which guarantees that companies will pay no more than a specified maximum tax rate for a determined period of time. Some countries also initially grant exemptions from taxes on dividends, interest payments, property taxes and numerous other charges and fees for which your company would otherwise be liable.

Taxation may change

It is also important to be aware of changes in taxation – particularly discriminatory changes – that might impact your business. For example, the tax regime may depend on turnover. Therefore, you must check if taxation will increase when your turnover increases, and if the taxation applies from the point in time when a certain limit is crossed, or if it applies retroactively.

Pricing of transactions between companies under common ownership or control (transfer pricing) naturally has the attention of the tax authorities. If the pricing is not correct, it may distort the local taxable income, and the tax authorities may and should adjust intragroup prices with important tax consequences for the company. Your business plan may have transparent methods for pricing, but three years down the line your business may look quite different with new products, and there is a need to adjust the pricing methods.

For these reasons, documentation to the effect that intergroup transactions are made at "arms-length", i.e. on market terms, must be readily available.

It is advisable to appoint a local accounting firm that understands the applicable taxes in the country and can advise you on these matters both when making the business plan and afterwards. What you have in the business plan is assumptions, and when you start operating you need to ensure that you have the right structure in place and formalities with respect to the different taxes to be paid. You may benefit from choosing a local department of one of the large international accounting firms.

IFU INSIGHTS

Be ready for tax control and plan ahead

As a foreign company you attract attention, and you may come under more tax scrutiny than local businesses, so it is even more important than in Denmark to engage the right advisers and to use the necessary resources on tax compliance. And only leave internal control, accounting and treasury roles to your most trusted employees.

CHECKLIST

- What categories of taxation will be relevant for your company, your investors and your lenders (withholding tax, value added tax, etc.)?
- How will you have to deal with personal income tax for salaries of the staff?
- Are there specific tax liabilities imposed on foreign owned companies?
- Are there any subsidies, tax deductions or exemptions for foreign owned companies?
- Are there levies for environmental emissions and are there tax credits for cleaner technologies?
- Will your company be able to avail itself of the benefit of depreciation or write-downs of assets?

5.4 Import and export challenges

Most developing countries operate a concept of export zones where goods can be imported or exported without paying the high customs duties applying in many developing countries. Normally there are limitations for selling to the local market when production takes place in an export zone.

In many developing countries import and export come with a lot of bureaucracy, and customs may be slow and uncooperative. If you rely on imported goods for your production, you must take great care to have your paperwork and documentation in order to avoid detention of your goods. Also, stock up and order new inventory in very good time. This will affect your cash flow, but is well worth it.

Still, it is almost impossible to guard yourself against the unforeseen. You may have been informed that some particular goods are subject to a 10 per cent customs tariff, only to discover that customs claim a 40 per cent tariff for instance due to a national production of these goods. Since tariffs are a principal source of government income in developing countries - far more important than personal income taxes - customs authorities may apply interpretations of the law which are stricter than you would expect or even apply liabilities that seem to have no basis in law. Often in these situations the Danish Embassy may be able to help clarify issues.

IFU INSIGHTS

VAT refund may take time

When exporting you are entitled to reclaim locally paid VAT, but it may prove difficult to have the refund paid out. There are examples of VAT backlogs of up to 18 months. This must be taken into account in your cash flow planning.

CHECKLIST

- Have you considered correct import/export tariffs in your budget?
- Have you considered how backlog on VAT may affect your cash flow?

5.5 Combating corruption and bribery

Corruption is one of the greatest barriers to sustainable development with a disproportionate impact on developing countries. At the same time, it is also a large potential risk factor for companies entering a developing market for the first time, and dealing with requests of facilitation payments, bribery, etc. can be a challenging task.

IFU's zero tolerance policy covers bribery of public officials, private-to-private transactions and other aspects of corruption such as fraud and money laundering of the proceeds of corruption. Facilitation payments are also considered a form of bribery and are prohibited by law in most countries. Such payments are typically demanded by low-level or low-income government officials to secure or expedite a routine action or service to which you are entitled, e.g. getting a permit or connection to public utilities.

Establish an anti-corruption culture from day one

The importance of establishing a culture of anti-corruption and implementing procedures for managing corruption risk cannot be stressed enough. You must train all relevant decision makers in how to avoid and deal with corruption and introduce good business practices on an on-going basis. It should be communicated at any relevant time to ensure that it is heard and understood.

It is also crucial always to have a grip on all documents required by the authorities. Many developing countries are trying to fight corruption by implementing very restrictive and bureaucratic rules, but the increasing bureaucracy also increases the risk of you forgetting some documents, and that may escalate the pressure on you to pay facilitation.

Working with IFU as a state-owned investment fund can to some extent serve as a shield against corruption in the sense that it is clear to most people that a project backed by investments from IFU cannot entertain any form of corrupt practices. Participation in sector specific associations and local business associations may also help in sharing local experiences and go against malpractices.

Read more about IFU's requirements for anti-corruption measures and business ethics in IFU's handbook on Sustainable Investments. See also IFU's Financial Handbook.

IFU INSIGHTS

Never pay facilitation: "In for a Penny, in for a Pound..."

It is possible to do business in developing countries based on zero-tolerance, if the company has a clearly defined policy and is persistent. It might be tempting to give small amounts or gifts to make the process go easier, but it is a slippery slope. All experience shows that if a company has accepted even a small bribe once, it is very difficult to avoid the next time. The only way forward is to continue to refuse to pay even when it means that your production will be delayed, and you have to show up every day in an office until you get your permit.

CHECKLIST

- Have you taken a clear written stand against corruption and communicated it to the entire organization?
- Do you have operational procedures and written administrative procedures for managing bribery and corruption risks, including fraud and inappropriate use of company funds?
- Are you sure all employees have understood your policy and procedures?

5.6 Landing your profit from operations of the company

How to repatriate profit should be considered in the business plan along with the financing structure of the company. Local legislation and repatriation rules for investments may vary widely from country to country, and IFU always requires a legal opinion from a local lawyer, confirming that the company will be able to declare dividends, and that there is no restriction in that country for the shareholders to take out their money.

If the local repatriation rules allow you to split your investment into share capital and loan, it will make it easier to take out profit. In countries with currency restrictions, it is easier to repay loan than to take out dividends. Your company can also have an accounting deficit from the first couple of years that prevent you from taking out dividends until the share capital is restored, but if you have positive earnings and cash flow you are allowed to repay loans. However, local currencies often fluctuate, and a loan in Euro or US Dollars can be risky for you if the majority of the sales are made in local currency.

Many countries also have minimum consolidation rules. In many countries, in order to deduct the interest, you must have equity of a certain size. IFU advise to use an experienced financial and tax adviser early in the process.

IFU INSIGHTS

How to repatriate capital?

Getting the right structure from the start relative to the expected cash flow is important. If you plan to sell your company at a later date, you should consider whether it is worth paying out dividends. If the value of your investment has risen substantially, and capital gains are tax free, you may consider awaiting repatriation of capital until you sell. Also, be aware that the dividend tax may depend on the percentage of shares you own.

CHECKLIST

- Do the repatriation rules allow you to inject capital as a loan?
- Are there rules concerning minimum equity capitalization requirements?
- Are there any differences between the procedures for payment of interest and dividend?
- How are dividends taxed versus tax on capital gains?
- Are there withholding tax or currency restrictions, which can prevent repatriation of the investment?
- Are there allowances for redeemable shares?

5.7 Exiting a project

In business as well as in other venues of life it is wise to determine the desired outcome up front, so that you know how you want your investment to develop in the long term, say 5-10 years' time. In some cases, the basic idea of the investment is to stay on perpetually, but in other cases personal considerations may take priority, such as retirement or transition to another generation.

You should also investigate up front if the rules of the country allow you to take back your share capital, equipment, etc., when you decide to discontinue your engagement.

If the project is very successful, you may opt to convert loans to shares and stay on. You may also want to participate in re-financing an expansion. However, such options may only be available if it was agreed upon during the initial financial close.

When it comes to exiting a project, there are several options available, which could involve different pricing and conditions: You can put the shares up for sale after a certain time (put option). The buyer would normally be the local partner. Or your local partner can call the shares after a certain time (call option). In the case of both put and call options there should be a prior written agreement. A third option is to go public by an Initial Public Offering (IPO), which would be a convenient moment for you to sell to cash in on an expected capital gain.

For most Danish companies the basic idea of investing in a developing country is market expansion, and therefore they are inclined to stay on for as much as 15-20 years or more. For external investors there might be a pre-agreed timing for exit, if for instance the investor is a closed end investment fund like the ones IFU operates with Danish pension funds.

With IFU as investor in your project the above aspects are an integral part of the shareholding agreement.

IFU INSIGHTS

Set clear terms for partnership buy-out

A good partnership agreement also includes a dissolution strategy. If you have a local partner, and you do not have pre-agreed mechanisms for exiting, you may end up in a deadlock situation where you cannot leave. Therefore, it is important also to include the option of buying the shares of the local partner.

To determine a fair price for your partnership buyout, and to make sure that buying out your business partner is a good long-term investment, you need to know exactly how much your business is worth. Pricing of a company is complicated and may require having an independent valuation firm perform a formal business valuation. A common practice is to apply a sector specific multiple of the EBITDA, which could be a price in the range of 4-12 times the EBITDA averaged over 2-3 most recent years to be as realistic as possible. In general, pricing of non-listed private companies is arrived at by negotiation.

CHECKLIST

- When do you expect to leave the company?
- Who would most likely buy your share of the company?
- Did you agree on a first right of refusal in connection with a sale to new business partners?
- Do you have an agreed procedure for coming up with a fair and realistic price for your own share or the share of the local partner?

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