Crowe Horwath.

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The Global Corporate Advisor

The Corporate Finance newsletter of Crowe Horwath International

Welcome to the July edition of the Global Corporate Advisor (GCA) newsletter

Another month has passed, bringing with it a fresh set of anxieties over the state of the global economy. Euro nations continue to wrestle with the best way forward, and a sluggish United States is searching for the right answers to secure its economic recovery. This month we narrow our focus and turn our attention to the Caribbean. One of the world's most idyllic locations, it's a region that's struggled with the issue of funding in recent times. Lenders have the funds, but borrowers are reluctant to take them up. What's the outlook for funding in this very diverse region?

Securing funding is a major challenge in a number of business contexts. In this edition, we examine the issues businesses heavy on intellectual property (IP) face when trying to raise capital. Some lenders prefer tangible assets to the intangible nature of IP – no matter how valuable the IP might be. Nicola Horton from Crowe Horwath's London office looks at ways such companies can still secure the capital that's vital to ensuring their operations can grow and prosper.

Elsewhere in this edition, we look at the hot topic of cloud computing. As more and more businesses turn to the cloud, they need to carefully weigh up the safety and security concerns cloud services can bring. Warren Chan from Crowe Horwath's Chicago office examines the potential risks and ways to manage them, as part of including an assessment of cloud computing during the due diligence process.

If you'd like to follow-up anything in this issue, or if you have any needs relating to transaction support, capital raising or managing operations in foreign countries, please don't hesitate to contact me or the team.

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Inside This Issue:

Lean Times: The Challenges of Sourcing Funding in the Caribbean

By Sotero Peralta, Matthew Brailsford and Juan Mendez, Dominican Republic

The Caribbean has suffered alongside the rest of the world in the aftermath of the global financial crisis, particularly in the ability of governments and local businesses to obtain funding. In this article, we examine the current constraints in the Caribbean funding market, using data from various central banks and international organizations as well as in-depth interviews with members of the Caribbean's banking and financial sector. While many Caribbean nations continue to experience issues in sourcing funds, we see positive signs and funding is picking up in certain locations.

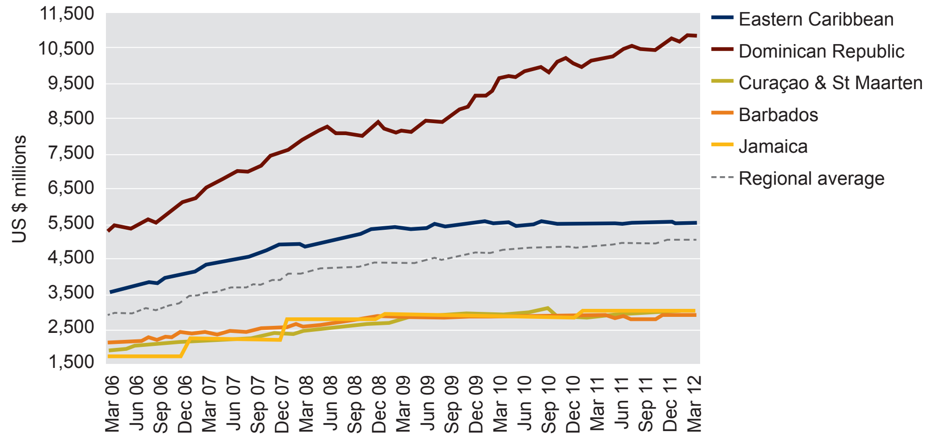
Finding funding in the Caribbean

The GFC sent shockwaves through the Caribbean's financial sector, stalling the growth in loans during 2008 and 2009. The consequences continue to be felt today. For instance, from March 2006 to March 2009, loans and advances in the Eastern Caribbean grew by US$1.8 billion. But from March 2009 to March 2012, loans only rose by US$146 million – a 92% decline in funding growth compared with the previous three years.

Indeed, a challenging funding situation remains for the Eastern Caribbean[1], Aruba and Barbados, where there has been limited or zero growth in sources of funding. There is still a long way to go before these countries match the funding growth rates experienced before the crisis.

However it's important to note that conditions are not identical across the region. The demand for loans and advances is growing in the Dominican Republic, Jamaica, Curaçao and St Maarten[2]. This patchy picture is evident in figure 1.1 below.

Figure 1.1: Growth in monthly loans and advances in Caribbean nations/regions



Source: Central Banks of the Eastern Caribbean, Dominican Republic, Curaçao and St Maarten, Barbados and Jamaica

The interviews we conducted with members of the Caribbean's banking and finance sector provided the following insights into the availability of funds:

- There is less demand for funding now compared to 2007.
- The requirements on borrowers are stricter than in previous years.
- Borrowers must comply with all aspects of risk evaluation, and are no longer able to negotiate over certain criteria, for example business experience or references.
- Funding deals and projects are smaller than before, with deals dropping from around US$100 million in 2007 to around US$50 million in 2011.
- Loan guarantees need to be backed up with more collateral than before, for example with increased equity stakes in client projects.

The impact of interest rates

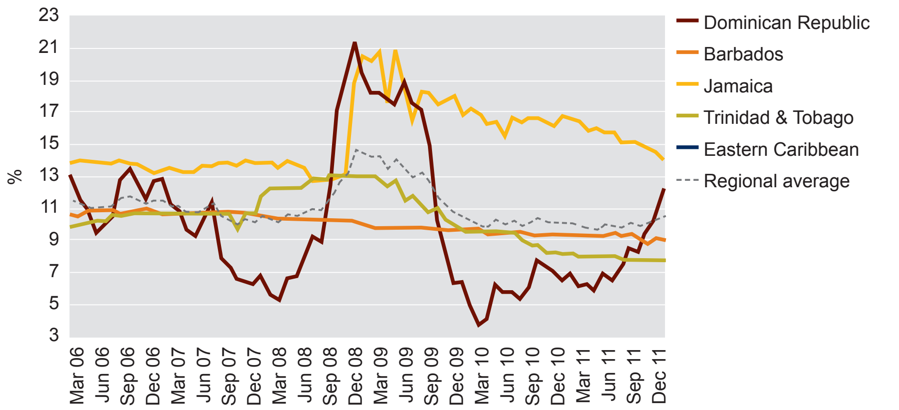
We also examined the average interest rates that applied to lending, to find out if this was a factor influencing funding constraints. Generally, the higher the interest rates, the lower the demand for borrowed funds.

With the exception of Barbados and the Eastern Caribbean, interest rates rose sharply during the GFC. The funding freeze during the GFC saw lending rates peak, and banks and other lenders have been reducing interest rates since the start of 2010 to encourage borrowing. Since this period, most countries have continued to lower lending rates, and interest rates are now at pre-GFC levels or lower.

1 The Eastern Caribbean Central Bank monitors the countries of Anguilla, Antigua and Barbuda, the Commonwealth of Dominica, Grenada, Montserrat, St Kitts and Nevis, St Lucia, St Vincent and the Grenadines. The 'Eastern Caribbean' in this article refers to these countries.
2 The data for Curaçao & St Maarten has been combined as they are both monitored by the same central bank.

The information contained in figure 1.1 above, combined with the insights from our interviews, suggests banks are trying to drive demand for funding by charging lower interest rates at a time of decreased demand. This is the exact opposite of what happened during the GFC, when funding growth stopped and interest rates rocketed. An exception, however, is the Dominican Republic, where interest rates have been rising and demand for funding is growing (see figure 2.1). This is because Dominican Republic is the largest in relation to the other countries in the region, and receives by far the highest foreign investment and tourist arrivals in the Caribbean.

Figure 2.1: Average commercial weighted lending rates in Caribbean nations/regions



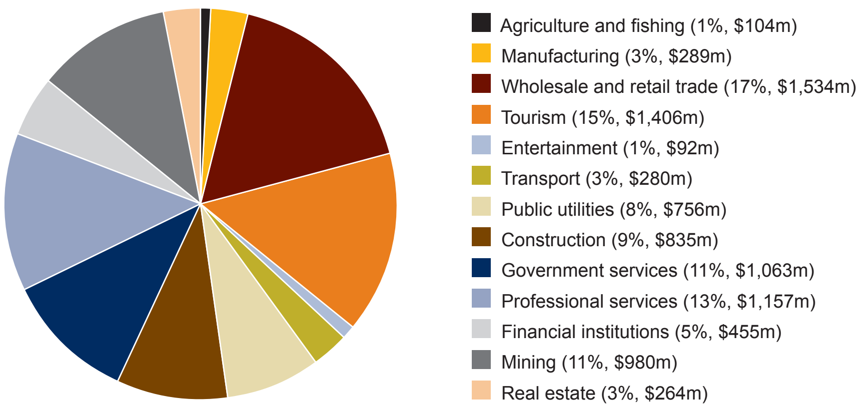
Source: Central Banks of the Eastern Caribbean, Dominican Republic, Barbados, Jamaica, and Trinidad and Tobago

The distribution of funding across the Caribbean economy

In 2011, the Caribbean's wholesale and retail trade sector secured the largest slice of funding from local and foreign sources. Its 17% share of the funding pie was worth just over US$1.5 billion. Our interviews supported these findings (see figure 3.1).

The wholesale and retail trade, public utilities, construction and tourism sectors have steadily built up their share of funding over the past five years. In contrast, government funding has sharply decreased over this same period.

Figure 3.1: Share of funding by sector in the Caribbean (USD$)

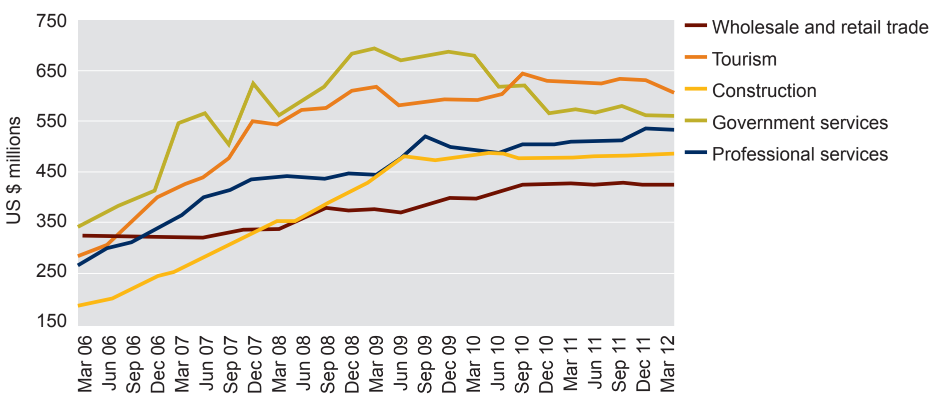


Source: Central Banks of the Eastern Caribbean, Dominican Republic, Aruba, Barbados and Jamaica

Eastern Caribbean

In the Eastern Caribbean, the tourism industry is now the most highly funded sector in the economy, whereas six years ago, it was the third most funded sector. The wholesale and retail trade sector saw a large drop in funding from 2006 to 2011, falling from the second to the fifth most highly funded sector. Government services have experienced the biggest drop, with funding cut by US$131 million in the period from December 2009 to March this year (as shown in figure 3.2).

Figure 3.2: Distribution of credit by economy sector, Eastern Caribbean

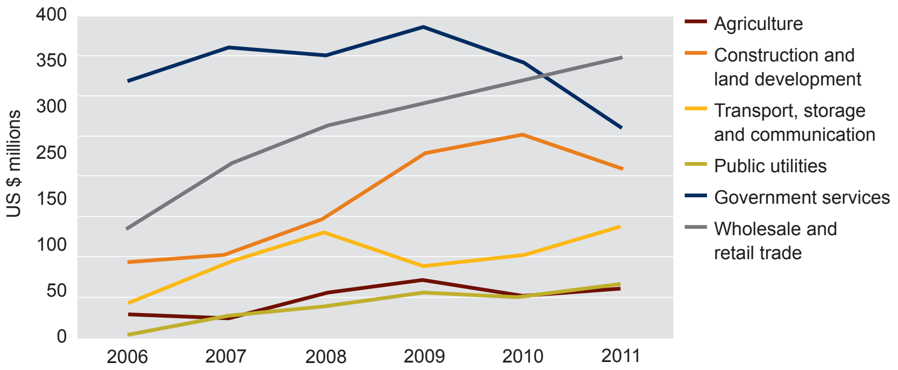


Source: Central Bank of the Eastern Caribbean

Jamaica

Jamaica saw a similar decline in the share of money allocated to government services. This sector's budget was cut by over US$125 million between March 2009 and March 2012. In contrast, Jamaica's wholesale and retail trade and public utilities sectors experienced the biggest increase in funding since 2006, while the construction sector's funding fell after a huge increase over the previous four years. This can be seen in figure 3.3.

Figure 3.3: Loans and advances by economy sector, Jamaica



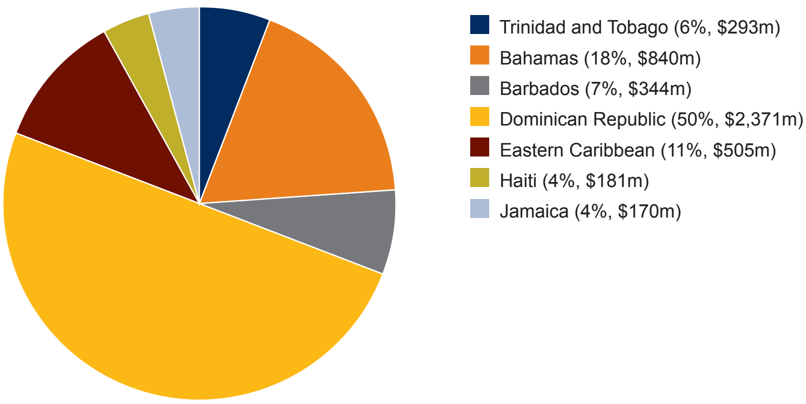
Source: Central Bank of Jamaica

Foreign investment in the Caribbean

The Dominican Republic currently attracts the same amount of foreign investment as all the other Caribbean countries combined (see figure 3.4). In 2011, the nation secured US$2.37 billion in foreign investment, mainly from Canada, the United States and Spain (see figure 3.5).

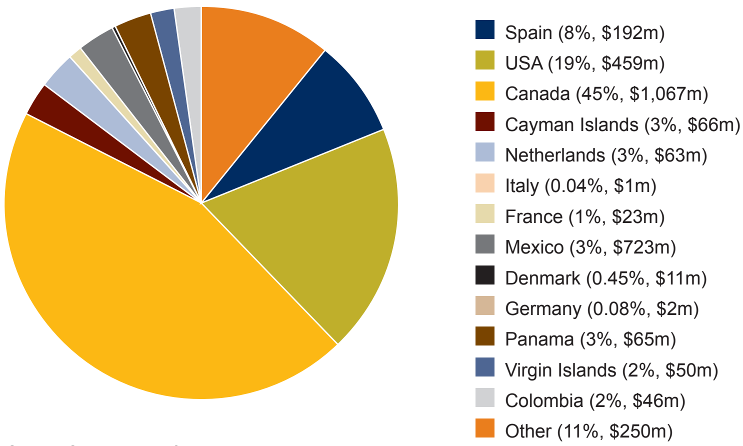
The Dominican Republic's mining and public utilities sector secured the largest share of foreign funding in 2011. Since 2006, the mining industry has received more funding than any other economic sector (as seen in figure 3.6). Our interviews found that real estate in the Dominican Republic experienced the largest drop in foreign investment over the same period. This is consistent with Central Bank data, as shown in figure 3.7.

Figure 3.4: Share of foreign investment among Caribbean nations (USD$)



Source: CEPAL (Comisión Económica para América Latina y el Caribe)

Figure 3.5: Sources of foreign investment in the Dominican Republic (USD$)

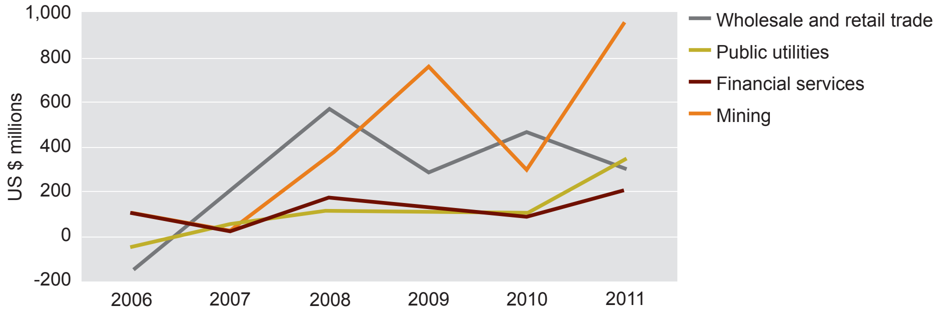


Source: Central Bank of the Dominican Republic

Funding the future

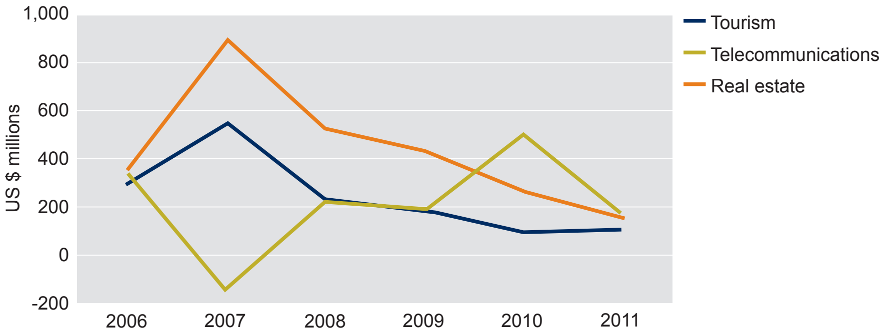
The funding picture across the Caribbean is far from uniform. While some nations have seen the demand for funding stagnate since the GFC, others, such as the Dominican Republic, are seeing signs of improvement. In an overall sense, we expect the current constraints in the funding market to continue at least until the end of 2012.

Figure 3.6 Sectors with largest increase in foreign investment, Dominican Republic



Source: Central Bank of the Dominican Republic

Figure 3.7: Sectors with largest decrease in foreign investment, Dominican Republic



Source: Central Bank of the Dominican Republic

Figure 3.8: The region

Countries	Land Area (km²)	Population (million)	GDP per capita (US$)	Tourist arrivals in 2011 (million)
Dominican Republic	48,442	9.4	$5,215	4.31
Cuba	109,884	11.2	$5,397	2.72
Puerto Rico	9,104	3.7	$24,198	1.44
Jamaica	10,991	2.9	$5,275	1.76
Barbados	431	0.28	$14,998	0.57
Eastern Caribbean	3,070	0.64	$8,028	1.22
Haiti	27,750	9.7	$671	-
Curaçao	444	0.14	$20,567	0.39
St Maarten	34	0.04	$11,400	0.42
Aruba	179	0.1	$24,625	0.87
Trinidad and Tobago	5,131	1.2	$15,365	0.38
Bahamas	3,888	0.31	$22,454	1.3
Other Caribbean countries	–	2.4	–	7.8
Caribbean	**–**	**42.0**	**–**	**23.8**

Source: World Bank, Caribbean Tourism Organization and United Nations
Note: we chose not to include Cuba in the comparative analysis due to a lack of information from its central banks. Puerto Rico has also been left out, as it is closely related to the US economy.

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Grow Now, and in the Future: Securing Finance for IP-based Businesses

By Nicola Horton, London

Financing any growing business can be a challenge. Just as shareholders congratulate themselves on achieving an upsurge in orders, finding a major new route to market or taking share from competitors, a realisation dawns: this growing business may consume financial resources faster than it can earn profits that can be reinvested in operations.

As a company grows, it may need to employ more staff, move to bigger premises and invest in larger quantities of inventory. How will this need for more working capital be met?

A business can take a number of internal steps to improve its working capital position. For instance, it can follow up with customers to ensure accounts are paid, and take full advantage of suppliers' terms. However, a point may come where a business needs to seek external funding.

There are a number of ways to secure additional working capital. Firstly, a business can approach lending institutions to obtain an invoice discounting facility. Secondly, a company can leverage its assets to secure additional funds. Finally, a company can turn to equity providers, in the form of 'business angels' or private equity houses.

Growing businesses can often find it challenging to find additional financing. But businesses with significant intellectual property (IP) assets can find it even tougher when they seek out third-party debt funding.

It may be the case that what the business considers its most prized asset – its IP – is not accorded significant value on the balance sheet. And even if the business' IP appears on the balance sheet as a valuable asset, traditional lenders may be unwilling to lend against it, preferring tangible assets such as property, plant and equipment, inventory and debtors.

While IP is likely to add value to a company in terms of its ability to generate future revenues or profits, lenders may see it differently. Banks are often more concerned with what security they can take over the asset in question to protect their position, and they may find IP a difficult asset to secure against.

To further complicate matters, not all intangible assets are created equal. Some IP assets may be more attractive to lending institutions than others, depending on the nature of the IP and the reputation, size and track record of the business. For example, lenders will want to know whether the IP is protected by a patent, trademark or copyright registration. Further, they will check whether the IP is licensed to third parties, as this provides a business with a visible and ongoing stream of royalty payments.

Banks are generally cautious about lending against intangible assets. So for businesses with significant IP assets and good growth prospects, the equity fundraising route might instead represent a more appropriate source of funding.

A number of venture capital and private equity houses specialise in backing technology or media businesses. They are therefore experienced in evaluating the value of IP. The owners of an IP business should seek out the most experienced institutions in their sector, and the ones who will likely be the most receptive to their plans and requirements.

A business' shareholders may be celebrating growth now. But it's important for a company to take steps to ensure this growth continues into the future, by securing the right source of sustainable finance for an IP-based business.

For more information:

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Managing Risks in the Cloud: An Enterprise Risk Management Framework for Cloud Computing

More and more businesses are adopting cloud computing solutions as part of their IT strategies. Research firm Gartner estimates that by 2014, cloud computing will be a US$140 billion industry. As this trend continues, purchasers of new businesses must carefully assess the safety and security of outsourced IT infrastructure, especially around cloud services, as part of any due diligence process.

To help board members and executives more effectively manage the risks of cloud computing, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) has published a paper entitled *Enterprise Risk Management for Cloud Computing*. Written by a team of Crowe Horwath technology risk professionals led by Warren Chan, the paper sets out a series of principles to assess and mitigate the risks arising from cloud computing, by using COSO's *Enterprise Risk Management – Integrated Framework*.

Below is a summary of the key findings from the paper. The full document can be downloaded at www.coso.org.

Moving to the cloud

Cloud computing lets an organization access its computing resources and applications from any location via an internet connection. Depending on the type of cloud solution, all or parts of an organization's hardware, software, and data may no longer reside within its own technology infrastructure. Instead, these resources are managed by a third-party vendor and shared with other organizations.

The opportunities and challenges of doing business in the cloud

While cloud computing presents many potential opportunities for businesses, it is not without its share of risks. These challenges must be carefully managed to ensure the benefits to a company are realized.

The potential benefits of implementing a cloud solution include:

- **cost savings:** cloud customers pay only for the IT resources they use, rather than purchasing or leasing equipment that may not be used at all times. There could also be reduced costs in no longer having to maintain a data center on site.
- **speedier deployment of computing resources:** cloud providers can meet the demand for computing resources much more quickly than most internal IT functions. This can reduce fulfillment times from months to hours.
- **easier adjustment of IT infrastructure to meet changes in demand:** an organization can scale up and down its capacity from one server to hundreds without capital expenditures. This gives a company the flexibility to adjust resources during high or low demand periods.
- **reduced effort to manage technology:** cloud services puts technical support and management in the hands of vendors, and allows an organization to focus on its core purpose and goals.
- **lower environmental impact:** by replacing private data centers with cloud computing, organizations reduce their power consumption, carbon emissions and land use.

But the use of cloud computing solutions can increase an organization's risk level. While the extent of the risk will depend on how cloud solutions are implemented, and what they are used for, enlisting cloud service providers (CSP) can increase the likelihood and impact of risk events. These events would include risks that by the nature of the area inherently have certain risks (e.g., being a target for hackers or system failure due to human error). The risk profile would also be impacted by the risks remaining in an area when taking into consideration mitigation controls that may only partially address the risk (i.e., mitigation controls implemented by CSPs may offset the risks to a different degree than those implemented by the organization itself).

The risks associated with cloud computing include:

- **reliance on CSPs:** by adopting cloud solutions, organizations become dependent on their CSPs in terms of legal liability, risk management, incident escalation and more. The actions of a CSP could have major impacts on a company's operations.
- **lack of transparency:** a CSP is unlikely to divulge detailed information about its processes, operations, controls and methodologies. For instance, companies are unlikely to know how customer data is segregated within the cloud.
- **reliability and performance issues:** a cloud tenant or incident can put unexpected resource demand on the cloud infrastructure, and affect a company's ability to access or work effectively within the cloud.

- **being locked in to vendor systems:** many CSPs offer proprietary tools that may only work within the CSP's systems. As a consequence, a company's applications and software may not work effectively within the cloud solution. And the more applications developed with these proprietary tools, the harder it can be to change cloud providers.
- **security and compliance concerns:** there are many data privacy and other regulations companies around the world have to comply with. In the cloud, the data is located outside the organization's direct control and it may be difficult to ensure all necessary regulations are being complied with.
- **cyber attacks:** the consolidation of multiple data on a cloud can represent a more attractive target than a single organization. The risk levels of a CSP solution can be higher in terms of confidentiality and data integrity.
- **loss of sensitive data:** as a cloud shares resources, there's a greater risk of data leakage than when dedicated servers and resources are used exclusively by one organization.

It's important that organizations apply enterprise risk management (ERM) policies in evaluating cloud computing solutions. For instance, some cloud solutions can be adopted in a relatively short period of time with only a small financial investment and the involvement of few people. As a result, management may neglect time consuming but important tasks such as ensuring that the solutions meet compliance and regulatory requirements.

An organization must recognize the risks and other effects cloud computing can have on its operations. A company needs to use risk assessments, audits and steering committees to evaluate the appropriateness of these solutions.

ERM and cloud computing

Adopting a cloud computing solution can be a major change for an organization and its ERM program. The degree of change depends on the business processes the cloud supports, the deployment model, the service delivery model and the robustness of a CSP's risks and control environment.

Management can use a proven ERM framework to assess and manage the related risks. The framework in COSO's *Enterprise Risk Management – Integrated Framework* paper can be used to construct an effective governance program tailored to a specific cloud solution. It's also important to note that an effective ERM program must address the ERM components of an organization and its CSP.

In creating an effective ERM framework, the COSO approach considers the following issues:

- **a company's internal environment:** does management have a policy of not outsourcing any of its operations? If so, this will limit viable options for cloud solutions.
- **setting objectives:** how does cloud computing align with an organization's overall objectives? Does it help achieve existing objectives or deliver a competitive advantage?
- **event identification:** management must identify events that could affect the achievement of objectives. This task becomes more complex when cloud providers are engaged.
- **risk assessment:** in assessing cloud solutions, a company must take into account its risk profile, as well as the likelihood and impact of major risks.
- **risk response:** after potential cloud computing risks have been identified, how would an organization respond? This covers strategies including avoidance, reduction, sharing and acceptance.
- **control activities:** when adopting cloud solutions, it's imperative a company already has good internal controls and processes in place. A cloud solution will exacerbate any current weaknesses in internal data controls.
- **information and communication:** with cloud computing, the information received from a CSP might not be as timely or as high quality than if it was sourced from an internal IT department. As a result, management may need extra information from different sources.
- **monitoring:** management must monitor their ERM programs on an ongoing basis to ensure they are meeting an organization's objectives.

Even if a cloud solution has already been implemented, an effective cloud governance program can still be established. The COSO ERM framework can be used to create a governance program from scratch, or to refine and evaluate existing arrangements. It can also be used to perform a quality assurance check, to ensure all major aspects of the program – including objectives, risk assessment and risk response – have been addressed in line with management's requirements.

Recommended risk responses

A list of potential risks and appropriate responses follows:

Risk	Response
Unauthorized cloud activity	Implement cloud policies and controls
Lack of transparency	Evaluate the CSP's control measures and processes
Security, compliance, data leaks and data jurisdiction	Establish and enforce data classification policies and processes
Issues with transparency and relinquishing control to a third party CSP	Put in place adequate management oversight and operations monitoring controls
Problems with reliability, performance and addressing the risks of cyber attacks	Establish effective incident management arrangements
Non-compliance with regulations	Confirm that the organization is up-to-date with the latest regulations and changes in the external environment
Being locked in to vendor systems	Prepare an exit strategy from current CSP arrangements
Non-compliance with disclosure requirements	Update financial reporting disclosure obligations

The involvement of boards and management in cloud solutions

Given the benefits and risks of cloud computing, an organization's board and management need to consider a range of questions in choosing to adopt cloud solutions and putting in place governance arrangements.

For instance, board members must decide if cloud computing initiatives are aligned with the organization's risk appetite. This is in addition to questions around whether current and on-going due diligence processes are adequate to properly evaluate cloud vendors, and whether management has established minimum service-level expectations for cloud providers.

From the perspective of management, senior staff need to address a number of key issues regarding the adoption of cloud computing. As with other business decisions, management must perform a return on investment analysis, a total cost of ownership analysis and prospective vendor due diligence on cloud solutions. It may also be prudent to begin with a pilot program before rolling out an organization-wide strategy. Management should also consult with their legal counsel to determine if cloud computing would pose any risks or challenges to complying with applicable laws.

The full COSO paper sets out a series of more detailed questions for both groups in relation to the adoption of cloud solutions.

Conclusion

To effectively implement cloud computing solutions, an organization must clearly understand the risks involved and its own risk profile. By using the COSO ERM framework, management can take an effective and consistent approach to identifying specific risks and risk responses to implement more successful cloud strategies.

The more aware executives are of the risks and other issues related to cloud computing, the more likely they are to achieve their organization's objectives when implementing cloud solutions.

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