With Global Acumen, we now have an accurate tool to account for the risks that companies face in global markets. We constructed it by comparing measures of political, economic, and cultural institutions across countries, relying on a combination of institutional distance and difference approaches to generate country-specific institutional risk spreads. The question now becomes: How can we apply those risk spreads to real-world problems so as to enhance managers’ toolkits and improve global management practices?

In this chapter I explain how to incorporate cross-country risk spreads into existing strategic and financial analyses. The process is quite simple, really. Recall that Global Acumen generates risk spreads that indicate the additional political, economic, and cultural risks that a company faces when it does business in another country. The Global Acumen tool reports risk spreads in a way that reflects the additional compensation—expressed in interest rate terms—that a company ought to expect in exchange for bearing the political, economic, and cultural risks of doing business in that country.

Armed with that knowledge, we can revisit the Newlandia example from chapter 2 to demonstrate how to add Global Acumen’s risk spreads to a company’s domestic discount rate to generate a country-specific discount rate that better accounts for political, economic, and cultural risks. By varying the levels of institutional risk present
in a fictitious country like Newlandia, we can readily observe the impact of globalization risk on a company’s bottom line.

This leads to a number of realizations. First, with the appropriate risk measures, it is relatively easy and straightforward to account for the financial impact of country-specific political, economic, and cultural risks. It is simply a matter of incorporating Global Acumen’s risk spreads into familiar financial techniques that managers use regularly. Second, there is no longer any excuse to ignore institutional risk, and managers who continue to ignore such risks do so at their financial peril.

Revisiting the Newlandia Example

To get a sense of how Global Acumen’s risk spreads work in practice, it is helpful to revisit the financial and strategic analyses presented in chapter 2. There I suggested that managers typically evaluate globalization opportunities by generating pro forma financial projections to gain insight into how globalization is likely to impact revenues, costs, and ultimately profitability. Managers try to detail and quantify every possible revenue and cost associated with the expansion and then use those estimates to assess whether they can profitably globalize. I use a simple hypothetical example to illustrate the process in which a US-based company considers expanding to an invented foreign country (“Newlandia”).

Refreshing Your Memory

The Newlandia example in table 2.3 assumes a five-year business opportunity that would generate $1,000 in revenues per year at a cost of $800 per year and thus at an annual profit of $200. Next, I assume a required initial investment of $550 to enter Newlandia (see table 2.2). I then ask whether given this scenario it makes sense—in terms of overall profitability—to invest in Newlandia.

Managers typically rely on discounted cash flow techniques to determine whether business opportunities generate sufficient profitability to justify the investment. They discount future profits by an opportunity cost of capital—an interest rate that they could