RISKS FACED BY SOUTH AFRICAN OFFSHORE INVESTORS

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DECLARATION

I declare that 'Risks faced by South African offshore investors' is my own work and that all the sources that I have used or quoted have been indicated and acknowledged by means of complete references.

NJ Godi *30 January 2013*

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Signature Date

ABSTRACT

Risks faced by South African offshore investors is a study that seeks to identify and rank in order of importance the risks that are faced by South African offshore investors. As a global player, South African investment institutions exchange trades with institutions in other countries. These trades are, however, not risk free. Trading in foreign markets can lead to institutions collapsing if their investment plans are not well formulated. There are many factors to consider when planning an offshore investment. For example, what products to invest in, which countries to invest in, why invest in such countries or institutions, how long is the investment going to be, and what are the expected returns, taking into account all the risks involved. All these questions and many others should be answered before investing offshore.

South African investment brokers registered with the Financial Services Board and licensed to trade offshore were selected as the target population to respond to a questionnaire designed for this study. A web-based questionnaire using LimeSurvey was used to collate data from the respondents. The SPSS statistical methodology was used for the analysis from where recommendations and conclusions were drawn.

Key words: Offshore risks; offshore investments; risk management; risk exposure; diversification; exchanges rates; currency; returns; investment markets; liquidity.

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Table of Contents

LIST OF FIGURES

TITLE **PAGE**

LIST OF TABLES

TITLE **PAGE**

GLOSSARY

Abbreviation	
FMCG	Fast-moving consumer goods
FSB	Financial Services Board
JSE	Johannesburg Securities Exchange
SARB	South African Reserve Bank
SARS	South African Revenue Services
ROI	Return on investments
ZAR	South African Rand
PPP	Purchasing power parity
GDP	Gross domestic product
IFE	International Fisher effect
CRS	Country risk service
CPI	Consumer price index
PPI	Producer price index
TIPS	Treasury inflation-protected securities
DTA	Double taxation agreement
VaR	Value-at-risk

CHAPTER 1

INTRODUCTION

1.1 Background

Investors have suffered losses in the past, forcing several major investors into bankruptcy and throwing many families into disarray through job losses. Uncontrolled risks can be regarded as the main reason that lead to unfavourable results. Generally, investors strive toward an investment that produces the greatest possible income with the least possible risk. In South Africa, investments and financial planning are in a process of evolution as they move from being a sales-orientated industry to being a fully fledged profession where investors are capitalising on market fluctuations as they tap into different markets around the world.

This financial planning process, which has been going on over the past number of years, has recently picked up momentum because of the introduction of the regulatory framework in the form of the Financial Advisory and Intermediary Services Act 37 of 2002 (referred to as the FAIS Act) in the industry. Financial planning means different things to different people. One view, for example, is that financial planning is regarded as the process of meeting life goals through the proper management of finances. Life goals include among other things buying a property, investing in children's education, or saving for retirement (FPI, 2008). As such, this process involves gathering relevant financial information, setting life goals and examining current financial status. This is then followed by developing a strategy or plan on how to meet the set goals, given the current situation. The strategic plan should be reviewed on an ongoing basis to detect any deviations from the set objectives.

According to Hull (2007), the need for financial planning is critical, irrespective of the size of income or number of assets owned by an individual or household, the only difference being the complexity of the planning. In order to achieve objectives, risks need to be controlled. For risks to be controlled, they should first be identified, evaluated and ranked in order of importance. This study sought to identify those risks that can be detrimental to offshore investors when making an offshore investment plan.

Financial planning is possibly one of the most important activities undertaken by an individual or household in order to achieve its financial and lifestyle goals, and therefore needs to be taken seriously. It is important for an investor to understand that financial planning does not necessarily mean that it will gain great wealth, but rather that it has taken control of its own financial affairs (Blanchard, 2009).

In addition, Blanchard (2009) indicates that offshore investors must plan for the risks and uncertainties of investing offshore, regardless of its investment size or structure in order to improve prospects for long-term survival. An offshore investor could be an individual, institution or company, corporation, unit trust, and many more. However, what is important is that a potential investor should be knowledgeable and have a good understanding of the principles of offshore investments and the risks of investing in offshore countries. If offshore investors have not identified risks associated with offshore investments, immeasurable losses may be suffered, although these investments may generally sound like a good investment. According to Ale (2009), risk identification aims at making the consequences of risk as insignificant as possible.

The South African economy has developed rapidly in the past number of years and it is affected by global market fluctuations. Many South African investors are becoming global players by investing in foreign countries and markets. As such, this creates a need to identify and evaluate, in order of importance, any risks that could be detrimental to offshore investment objectives. This chapter will focus on the main players in the offshore investment market, the goal of the study, the research methodology to be used as well as the scope of the study.

1.2 Main players in the risk and offshore investment market

The main players in the risk and offshore investment market could be listed as investment brokers, governments, security exchanges and banks. When considering an offshore investment, it is crucial for other investors to know the main players involved in this market.

For the purposes of this study, investment brokers, particularly offshore investment brokers, were used as the target population. Investment brokers are well placed as they deal with all other parties who invest offshore.

According to Piper (2010), offshore investment brokers' roles and responsibilities include amongst others:

- investment planning processes;
- analysis of clients' needs;
- market analysis of investment opportunities;
- choosing the suitable investment vehicles;
- choosing the suitable investment products; and
- portfolio management.

1.3 Goal of the study

This study was based on the hypothesis that risk identification techniques, processes are not streamlined to guard against offshore losses, and that there is huge scope for improvement in the quality of risk identification approaches. Therefore, the goal of the study was to identify and rank in order of importance the risks that are faced by South African offshore investors.

The following components were researched and analysed to determine if, and to what extent, they could influence a risk identification technique:

- the level of understanding the offshore risks and risk exposures by potential offshore investors;
- the attitude towards offshore investments; and
- the knowledge and understanding of the risk management processes.

1.4 Objectives of the study

The following primary and secondary objectives have been derived from the goal of the study:

Primary objectives:

- to identify the various risks faced by offshore investors; and
- to rank the offshore risks in order of importance when making an investment decision.

Secondary objectives:

- to research the relevant literature on risks and investments with emphasis on risk identification techniques during an offshore investment process;
- to formulate a structured guideline for potential investors, to help them manage and control risks exposure when investing offshore. .

1.5 Research methodology

According to Leedy and Ormrod (2005), research is a systematic process of collecting, analysing and interpreting information in order to increase an interested or concerned phenomenon. As such, the literature review aims to collate the most recent information on offshore investments and the risks facing offshore investors from a South African perspective.

This study can be described as exploratory, which means the gathering of preliminary information that helped define problems and suggest possible solutions. The study was qualitative in nature. Qualitative studies typically serve one or more of the following purposes (Peshkin, 1993):

- **description** – can reveal the nature of certain situations, settings, processes, relationships, systems or people;
- **interpretation** – enable a researcher to gain new insights about a particular phenomenon, develop new concepts or theoretical perspectives about the phenomenon, and discover the problems that exist within the phenomenon;
- **verification** – allows a researcher to test the validity of certain assumptions, claims theories, or generalisations within real-world contexts; and
- **evaluation** – provide a means through which a researcher can judge the effectiveness of particular policies, practices or innovations.

This study sought to reveal and verify the nature of certain assumptions, claims and theories with regard to offshore risks and their importance when making an offshore investment decision. The qualitative research was conducted in the form of a questionnaire.
The results were analysed statistically using descriptive analysis. Thus, SPSS (originally, Statistical Package for the Social Sciences) software was used to analyse data received from respondents. Based on these results, this report will conclude with a list of offshore risks and a structured risk management approach for potential South African offshore investors.

1.6 The importance of the study

According to (Govender, 2009), a number of problems seem to exist in South Africa in the areas of savings and investments, especially offshore investments, and the risks involved, including the following:

- a lack of clarity with regard to risks and investment returns; and
- a lack of a clear strategy to aid South African offshore investors in making a sound risk identification and investment decision. In general, it seems that identification of risks is regarded from a narrow perspective. For example, risk management is only considered as investing in First World countries by some investors (Zeelie, De Beer, Jacobs, Rossouw, Stapelberg and Watson, 1998).

The predicament at hand is that offshore investors stand a chance of suffering immeasurable losses, possibly due to them being unfamiliar with risks associated with offshore investments. As such, a need has emerged to investigate the risks facing potential offshore investors and the way to manage such risks effectively and according to a structured approach.

1.7 Scope of the research report

This research report will be divided into the following sections:

- a literature study pertaining to risks, risk management and offshore investments;
- an outline of the research methodology for the empirical research;
- analysis and interpretation of data; and
- recommendations and conclusion.

1.8 The layout of the thesis

Chapter 1 provides a background to the study, particularly addressing the meaning and importance of financial planning during an offshore investment process.

Chapter 2 provides part one of the literature review, which focuses on risk management, particularly risk and risk exposure as well as the different risk types considered during an offshore investment decision. Risk management processes are also incorporated in this chapter.

Chapter 3 provides part two of the literature review, which is devoted to offshore investments. It outlines the fundamental differences between offshore and domestic investments from a risk, returns, and investment duration perspective. Reasons and benefits for investing offshore are also discussed in this chapter as well as offshore investment pitfalls.

Chapter 4 focuses on the research design for the study, and provides further details of the research methodology that was used to gather data as well as the statistical techniques that were used to analyse data for this study.

Chapter 5 focuses on the analysis and interpretation of data gathered and also discuss the results and findings of the study.

Chapter 6 summarises all the findings and results, which form the basis for recommendations.

CHAPTER 2

RISK MANAGEMENT

2.1 Introduction

The focus of this study was the identification of risks faced by South African offshore investors. It is therefore appropriate to begin with a detailed definition of risk and risk exposure. These theoretical aspects of risk and risk exposure on offshore investments were used in the survey to evaluate the respondents' knowledge level of risks and risk exposures. The knowledge level then forms the platform for recommendations to potential investors. This chapter also covers topics such as the rules of risk management, risk management processes and risk types.

2.2 Risk and risk exposure

When choosing an investment, investors need to think carefully about how much risk they are willing to take. This is according to Lucas (2009), who warns that while money may ensure security, placing capital in a high-risk environment could cause investors more worry than the investment is worth. In addition, in the financial markets' volatile state, the risk of investments should be considered more carefully than in easier times. It is at times like these that investors are reminded that there is no such thing as risk-free investments. Everything has its price, and in the case of offshore financial markets, that price is risk. In the face of plunging markets, some investors discover that they are not quite as tolerant to risk as they might have thought. A number of investment portfolios are adjusted during difficult times, with investors adopting a mix of assets which they consider to be profitable in the long term. When reassessing investment portfolios, offshore investors can use risk analysis as an essential tool for adjusting their portfolios.

According to Aven (2003), risk analysis is defined as a technique used to identify and assess the factors that may jeopardise the success of a project or of achieving a goal. This technique also helps to define preventive measures used to reduce the probability of these factors from occurring and identify countermeasures to deal with these constraints successfully. Therefore, analysis can help investors decide whether a given investment is too volatile or if the investment is not providing a return proportionate to the risk associated with it.
Before analysing the risk types and their impacts on investments, it is important to look at the definition of risk and risk management processes in more detail.

2.2.1 Defining risk

Various authors have formulated various definitions of risk. The following are examples:

- According to Vaughan (1997), risk is a condition in which there is a possibility of an adverse deviation from the desired outcome that is expected. This definition of risk is a combination of circumstances in the external environment and in this combination of circumstances, there is a possibility of loss. There is no requirement that the possibility be measurable, only that it must exist.

- According to Swart (2002), risk is a concept that denotes a potential negative impact on an asset or some characteristic of value that may arise from some present process or future event.

- Reilly and Brown (2003) define risk as the uncertainty that an investment will earn its expected rate of return. It is the possibility that the actual outcome of a situation is going to differ from what it is expected to be.

- Thakerse (2005) defines risk as uncertainty that the outcome might deviate from the anticipated result. If not properly managed, uncertainty could adversely influence the achievement of an investor's objectives.

- According to Workman (2008), risk is the uncertainty of an event occurring that could have an impact on the achievement of objectives,

- Hands, Dawson and Cloete (2008) define risk as the measurable possibility of losing capital or not gaining value and the chance that invested capital will lose value.

- Lastly, according to Lucas (2009), risk is the degree of consistency (of performance) displayed by a particular investment.

There are sometimes contradictory definitions of risk. Insurance and risk management can be used as an example. Insurance and risk management theories have used the definitions of risk derived from other fields. For example, in the insurance business, the term **risk** is used to mean either a peril or hazard insured against. Valsamakis, Vivian and Du Toit (2005) define **peril** as

the source of loss and **hazard** as the environment surrounding the cause of loss. Additionally, Valsamakis *et al.* (2005) warns that some insurance companies regard young vehicle drivers as high risk.

For the purposes of this study and based on the above-mentioned definitions, risk is defined as an adverse deviation from a desired outcome, indicating a situation in which an uncertainty and an exposure to losses exist. The reference to a desired outcome that is either expected or hoped for contemplates both individual and aggregate loss exposures. The investor hopes that adversity will not occur and it is the possibility that this hope will not be fulfilled that constitutes risk. For example, a property investor hopes that a property will not catch fire. If the property catches fire, this will be the undesirable event, which is described as an adverse deviation from a desired outcome that is expected or hoped for.

For risk to exist, an element of uncertainty and an exposure to that uncertainty has to be present. For example, if a decrease in a share price is certain, there is no risk since a certain loss is imminent. By the same measure, if an investor does not own shares, there is no risk, since an exposure does not exist. To manage risk effectively, an investor must consider the degree of risk exposure on an investment under consideration.

According to Du Plessis (2000), there are basically two groups of risks, namely common risks and specific risks. Common risk is also known as systematic risk, systemic risk, market risk and un-diversifiable risk, which is the risk that applies to a whole market or market segment. Common risk includes those risk factors, which stem from the total system in which all companies operate and which affect all stocks. The investor or institution that issues the stock is not in itself responsible for the existence of the risk factor.

Specific risk is also known as unsystematic risk, which refers to those risk factors, which can be attributable to the circumstances and the involvement and actions of the particular institution which issues the stock or which has specific relevance to it.

2.2.2 Risk exposure

According to Miller (2005), risk exposure is part of any investment undertaking. According to Crane (2009), risk exposure is a calculation that gives a numeric value to a risk, enabling

different risks to be compared. The calculation enables investors to compare different risk types, the degree of exposure and the possible loss should a risk event occur. The importance of managing risk exposures cannot be overlooked, as there is no perfect investment. No one investment can meet all the needs of all clients. Indeed, it is unlikely that any one investment can meet all the needs of a single client. Investors with a considerable appetite for risk and aiming for maximum capital growth need to be mindful of many factors such as liquidity exposure (Hull, 2007). A good spread of investments in different asset classes is recommended to minimise liquidity exposure in case an investor needs money for emergencies or other investment opportunities. Thus, investors should hold a well-diversified portfolio of investments because the success of an investor's strategy could be determined by the diversification between the different asset classes of risk and risk exposure.

A quandary exists when an investor has many risks to consider, since it is difficult to decide which risks are worth mitigating. The risk exposure should be derived from the investor's objectives, targets and risk appetite. For example, a conservative investor should consider low volatile investments while an aggressive investor could consider investing in high volatile investments. In addition, Damodaran (2008) warns that potential offshore investors need to consider risk exposure thoroughly as there are many risks involved when investing in a foreign country or market compared to domestic markets. For example, in 1998, offshore investors in Malaysia discovered that while they could sell their shares, they could not repatriate the funds (Boorman, Lane, Schulze-Ghattas, BulíY and Ghosh, 2000).

The difference between being blindsided by the realisation of risk exposure and making great returns rests in the proper consideration of risk exposure when making investment decisions. It is, therefore, imperative for investors to appreciate the different types of risks and risk exposures involved in the variety of investment choices under consideration. The objective to optimise returns and still avoid risks hinges on the extent to which risk exposure and investment volatility are minimised. According to Miller (2005), the volatility of investment is regarded as a measure of risks.

Volatility is a statistic measurement of the susceptibility of the market or a security to gain or lose value (Madura and Fox, 2007). A highly volatile market could have huge price fluctuations in a short period of time. Thus, investments that are very volatile are risky and, conversely, low volatility translates to low risk. According to an article by Sanlam (2008), the volatility of the rand

has been unstable, fluctuating at an average of 6% per annum against the US dollar, increasing investors' exposure at an international level.

When investing offshore, an investment volatility and degree of risk exposure should be considered. Then an investment vehicle that aligns with the investor's objectives can be determined. While considering the suitable investment vehicle, offshore investors must comply with the numerous rules and regulations, as well as policies and procedures of investing abroad (IOB, 2006). Failure to comply could result in cancellation of the offshore investment or in losses.

Many countries have regulations that seek to monitor and control the movement of incoming and outgoing capital. Some of the regulations are instituted to prevent a large outflow of capital from the country as a result of factors such as domestic political mismanagement and poor economic conditions. Therefore, offshore investors should pursue investment decisions that align with foreign countries' regulations and policies and follow the right procedures.

Having made the decision to diversify globally, investors should give careful consideration to the portion of their portfolio they wish to invest offshore, the investment vehicle available, and the associated costs and tax implications. The following is an example of how risk exposure is calculated:

Risk exposure of any given risk = Probability of risk occurring X Total loss if risk occurs

RE= p x V

Example: The risk exposure *(RE)* on Mr B's investment in shares will be R2 000 if the probability of risk occurring (*p*) is 20% on R10 000 worth of shares *(V).* Calculated as follows:
p = 20%, V= *R10 000*

RE = p x V
RE = 20/100 x 10 000
RE = R2 000

The above calculation may be employed when quantifying the investor's risk exposure, providing investors with an idea of possible loss should an unfavourable event occur. In conclusion, an investor should assess the risk exposure of all investments under consideration. Therefore, an informed decision on which investment to pursue can be made depending on the investor's risk exposure.

2.3 Risk management

The core theme of this study was the identification of risks faced by offshore investors. It is therefore, necessary to understand the meaning of risk management by looking at various definitions, the rules of risk management and the risk management processes.

2.3.1 Defining risk management

Various authors define risk management as follows:

- Valsamakis *et al*. (1992) defines risk management as a managerial function aimed at protecting the organisation, its people, assets and profits against the consequences (adverse) of pure risk, more particularly aimed at reducing the severity and variability of losses. Pure risk is defined as risk, which only has the possibility of a loss.

- According to Vaughan (1997), risk management is a scientific approach to dealing with risks by anticipating possible accidental losses, and designing and implementing procedures that minimise the occurrence of loss or financial impact of the losses that occur.

- According to Valsamakis, Vivian and Du Toit (2010), risk management is an art and science of managing risks and returns.

- Risk management is a systematic approach used to identify, evaluate and reduce or eliminate the possibility of an unfavourable deviation from the expected outcome (Guidebook, 2008).

- According to Harmony (2009), risk management is the identification and acceptance or offsetting of the risks threatening the profitability or existence of an organisation. With respect to foreign exchange, this process involves consideration of market, sovereign, country, transfer, delivery, credit and counterparty risk.

- According to Damodaran (2008), risk management is the employment of financial analysis and trading techniques to reduce and/or control exposure to various types of risk.

For the purposes of this study, risk management was regarded as the identification, assessment, and prioritisation of risks followed by a coordinated and economical application of resources to minimise, monitor and control the probability and/or impact of unfortunate events or to maximise the realisation of opportunities. Once the concept of risk management is understood, it is necessary to discuss the rules of risk management applied during an investment decision process.

2.3.2 Rules of risk management

The development of risk management as a special function has increased attention devoted to formalising its principles and techniques in order to provide guidelines in the risk management decision-making process. According to Vaughan (1997), the development of the risk management field has set the rules of risk management. The rules are as follows:

- investors should not risk more than they can afford to lose;
- investors need to consider the odds; and
- investors should not risk a lot for a little.

Vaughan (1997) regards these rules as common sense principles applied to risk situations or during an investment decision process. These rules provide a basic framework within which risk management decisions can be made; however, they are sometimes misunderstood and often neglected.

According to Du Plessis (2000), investors may suffer a loss as a result of engaging in offshore investments without taking into account the rules of risk management. Proper planning and research can help investors understand and analyse the common and specific risks connected with offshore investments. To avoid suffering a loss and in order to manage risks and expectations, investors can use, amongst other tools, a policy statement to cultivate and realise their offshore aspirations by effectively containing the risk exposures. According to Reilly and Brown (2003), a policy statement is a road map used by investors to define their investment objectives and risk appetite. Investors outline the acceptable risks, the investment objectives and constraints in a policy statement. A policy statement could also serve as a control tool to ensure that investors act within their parameters of objectives and constraints. It is imperative that an investor base all investment decisions on a policy statement, as this would ensure that the appropriate investment decisions are made.

Risks differ in terms of nature and characteristics and it is therefore important to consider risks separately. However, to make a sound investment decision, it is crucial for an investor to identify all the risks related to a specific asset being considered as a potential investment (Hull, 2007). Therefore, a structured risk management process should be adopted.

2.3.3 Risk management process

Risk management has been defined as the identification, assessment and prioritisation of risks followed by a coordinated and economical application of resources to minimise, monitor and control the probability and/or impact of unfortunate events or to maximise the realisation of opportunities. Thus, it is important for investors to consider the risk management process in detail in order to manage risks. The risk management process will determine the proposed steps followed by different authors when managing risks and returns. There are various views on the components, which form part of a risk management process.

According to Vaughan (1997), risk management represents a scientific approach to dealing with risks, implying that the process involves a logical sequence of six steps, namely determining objectives, identifying risks, evaluating the risks, considering alternatives and selecting the risk treatment device, implementing a decision, evaluating and reviewing. According to Marx, Mpofu and Van de Venter (2003), the risk management process can be categorised according to four steps: identify risk exposure, quantify exposure, evaluate alternative actions and manage risk.
According to Valsamakis *et al.* (2005), a risk management process consists of the following four steps: risk identification, risk evaluation and assessment, risk control and risk financing. According to Young (2006), the risk management process can be defined as the systematic application of risk policies, procedures and practices by means of identification, evaluation, control, financing and monitoring of risks. For the purposes of this study, the following components of a risk management process were taken into consideration: risk identification, risk evaluation and assessment, risk control, risk financing and risk monitoring.

2.3.3.1 Risk identification

According to Young (2006), risk identification refers to the need for an investor to define and understand the nature of the risks he or she is exposed to. It acknowledges the risk exposure of each investment initiative and the impact on the overall risk profile of an investor. Risk

identification is regarded as the first step in a risk management process. According to Valsamakis *et al.* (2010), risk and the sources of risk must be identified before any attention can be focused on the management of risk. According to Vaughan (1997), investors must be aware of the risks they are exposed to before deciding how to neutralise them.

It is difficult to generalise about the investor's risks because differences in conditions give rise to differing risks. In many instances, identification is self-evident, while in others it requires more insight. Consultation with experts is sometimes required to identify all sources of risk, which may give rise to multiple risk situations. Valsamakis *et al.* (2005) argue that risk identification consists of two related activities. Firstly, risks that affect the investor must be identified. Identification of risk is usually accompanied by both hazard identification and exposure identification. Hazards are activities or conditions that create or increase the likelihood of loss (gain) or the loss (gain) amount. An exposure to loss (or gain) would be the object, individual or situation subject to loss (gain).

Secondly, identification is followed by analysis. It is not sufficient to know that hazards, risk factors and exposures to loss or gain exist. An investor must understand the nature of those hazards, risk factors and exposures, how they come to exist, and how they interact to result in a loss or gain. This would result in identifying risk, which should then be evaluated.

2.3.3.2 Risk evaluation and assessment

According to Valsamakis *et al.* (2005), risk evaluation is the second most important step in the overall risk management process, because together with identification of possible sources of loss, it represents the foundation for planning, organising and managing the risk to reduce the impact of possible losses. Risk evaluation entails quantifying the risk and determining its possible impact on an investor. Ammann (2001) refers to the process of risk evaluation as the analysis of loss exposures, where attention is focused on how frequent and how severe accidents are likely to be and how they may interfere with the business objectives (offshore investments). More particularly, risk evaluation and assessment concern the following:

- The evaluation of both loss frequency and loss severity, which will provide, *inter alia,* the two significant measures of expected average loss and maximum possible loss. Since the characteristics of risk and the frequency and severity of losses are all constantly changing, evaluation becomes a continuous process.

- An analysis of the financial strength of an investor, which entails the assessment of the business risk-retention capacity. The objective is to ascertain what the impact of an identified risk might be relative to the financial strength of an investor (Valsamakis *et al.* 2005).

According to Vaughan (1997), risk evaluation involves measuring the potential size of the loss and the probability that the loss is likely to occur and then providing some ranking in order of priorities. Certain risks will demand attention prior to others, and in most instances, there will be a number of exposures that are equally demanding because of the severity of the possible loss. Any exposure that involves a loss that would represent a financial catastrophe in the same category, and no distinction is made among risks in this class. It makes little difference when bankruptcy results from a liability loss, a flood or an uninsured fire loss, if the net effect is the same. Therefore, rather than ranking exposures in some numerical order of importance, it is more appropriate to rank them according to general classifications such as critical, important and unimportant. A criterion that may be used to establish a priority ranking that focuses on the potential financial impact of the loss is explained in Table 2.1 below:

Table 2.1: Ranking exposure in numerical order of importance

Rank	Degree of exposure
Critical risks	All offshore exposures to loss in which possible offshore losses are of magnitude that will result in bankruptcy.
Important risks	Those offshore exposures in which possible losses will not result in bankruptcy, but which will require the business to borrow in order to continue with offshore operations.
Unimportant risks	Those offshore exposures in which possible losses can be met out of the business's existing assets or current income without imposing undue financial strain.

The assignment of individual exposures to one of these three categories requires determining the amount of financial loss that might result from the given offshore exposure and assessing the ability to absorb such losses with an aim of making a profit.

Risk evaluation was defined as a measurement of possible loss. Damodaran (2008) defines risk measurement as an evaluation of the likelihood and extent (magnitude) of a risk. The evaluation of the magnitude of risk usually involves developing a set of risk factors that are observed and measured to detect the presence of risk. This activity entails the assessment and measurement of the identified risk exposures. Measurement entails quantifying risk to determine the risk types and extent of risk exposures (Ammann, 2001)

Risk measurement also serves as a basis for risk control mechanisms. According to Ale (2009), risk assessments aim to measure the potential frequency and severity of the exposures that have been identified. Any risk management system must enable a business to assess and manage the risks exposed to. Thus, a risk management methodology that allows comparisons to be made across the different risk types should be in place. The measurement of risk is important for investors, as planning ahead prior to embracing the offshore arena will not only ensure that opportunities that exist are optimally utilised, but also that concomitant pitfalls will be avoided (Ware and Roper, 2001). Whether an investor is simply choosing a jurisdiction for investment or setting up a company or trust, investing abroad is not without pitfalls. According to Vaughan (1997), it is intuitively obvious that risk is greater in some situations than in others. Just as experts should agree on what they mean when they use the term **risk**, they should agree on the ways in which risk can be measured.

It would seem that the most commonly accepted meaning of a degree of risk is related to the likelihood of occurrence. Events with a high probability of loss are considered to be riskier than those with low probability. This intuitive notion of the degree of risk is consistent with the definition of risk by (Vaughan, 1997), when risk is defined as the possibility of an adverse deviation from a desired outcome that is expected or hoped for.

The degree of risk can be measured by the probability of the adverse deviation. In the case of an investor, the vision is that no loss will occur, so that the probability of a deviation from what is envisaged (which is the measure of risk) varies directly with the probability that a loss will occur. In case of an individual exposure, the risk is measured in terms of the probability of an adverse deviation from what is hoped for. In the case of a large number of exposure units, estimates can be made about the likelihood that a given number of losses will occur, and predictions can be made based on these estimates.

The expectation is that the predicted number of losses will occur. In the case of aggregate exposures, the degree of risk is not the probability of a single occurrence or loss; it is the probability of some outcome different from that predicted or expected (Daniels and Vanhoose, 2005). At times, the terms **more risk** and **less risk** are used to indicate a measure of the possible size of the loss. Many investors would know that more risk is involved in a possible loss of R1 000.00 than a loss of R100.00 even though the probability of loss is the same in both cases. The probability that a loss may occur and the potential severity of the loss if it does occur contribute to the intensity of one's reaction to risk. It seems, therefore, that a measurement of risk should recognise the magnitude of the potential loss.

Given two situations, one involving a R1 000.00 exposure and the other a R100.00 exposure, and assuming the same probability in each case, it seems more appropriate to state that there is a greater risk in the case of the possible loss of R1 000.00. This is consistent with the definition of risk, since the loss of R1 000.00 is a greater deviation from what is hoped for (that is, no loss) than is the loss of R100.00. On the other hand, given two situations where the amount exposed is the same (R1 000.00), there is more risk in the situation with the greater probability of loss. Although it may be difficult to relate the size of the potential loss and the probability of that loss in the measurement of risk, the concept of expected value may be used to relate these two facets of a given risk situation.

The expected value of a loss in a given situation is the probability of that loss multiplied by the amount of the potential loss. If the amount of risk is R10.00 and the probability of loss is 0.10, the expected value of the loss is 0.01; the expected value is R1.00. The above calculation is summarised in Table 2.2 below.

Table 2.2: Calculation of expected value

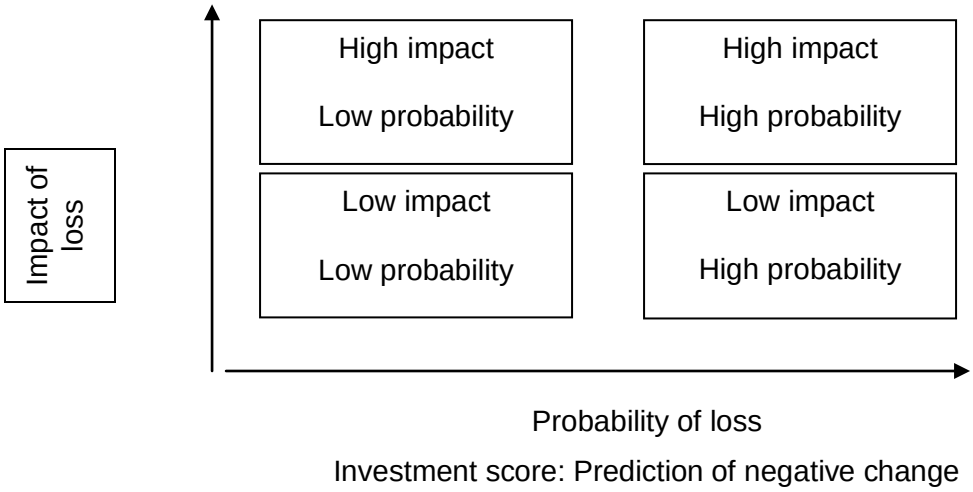
Scenario 1	**Scenario 2**
In this case, the investor invests R10.00 and the probability of loss is 10%	In this case, the investor invests R1 000.00 and the probability of loss is 10%
Formula: Expected value *(EV)* = Probability of loss (p) X invested amount *(A).*	Formula: Expected value (*EV)* = Probability of loss *(p)* X invested amount *(A).*
EV= p x A: R10 x 10/100 = R1	*EV= p x A:* R1000 x 10/100 = R100
The investor could lose R1, other things being equal.	The investor could lose R100, other things being equal.

The table above confirms the statement made earlier that there is more risk involved when a big amount is invested compared to a small amount even though the loss probability is the same. After the possible risk and loss have been measured, investors need to decide which investment suits them best, taking into account the expected returns. These could be followed by taking appropriate steps to mitigate the possible loss on the investments. Therefore, the practice of investing funds and managing portfolios should focus primarily on the probability of loss, meaning managing the risks (Williams, Smith and Young, 1998)

According to Winterboer (2004), investors need to ensure that other financial obligations are satisfied before taking on an investment programme. As such, no investment plan should be implemented until a potential investor has adequate income to cover living expenses and has a safety net should the unexpected occur. As a result, one of the initial steps in developing a financial plan is to have adequate coverage in case unexpected losses occur.

According to Shapiro (2010), the basic principle of an investor who fails to plan, plans to fail, since investors cannot achieve success if they are not aware of the objectives and the time available for achieving these objectives. Investors must become aware of the long-term implications of this very important investment decision.

After assessing the household financial situation, identifying the needs and objectives (over the short, medium and long term), an investment strategy can be put in place. A lack of insurance coverage can ruin the best-planned investment programme. It is important to have a cash reserve to help meet these occasions. In addition to providing a safety cushion, a cash reserve reduces the likelihood of being forced to sell investments at inopportune times to cover unexpected losses. Risk therefore comprises of two measurable aspects: the impact or effect of the loss (intensity) and the probability or likelihood of the loss (frequency), depicted in Figure 2.1 below.



Investment score: Prediction of negative change

Figure 2.1: Risk Measurement

Source: Adapted from Lawlor and Haynes (2003)

Once the impact of loss and probability of loss have been identified and quantified, a clear part of profiling can be obtained of the risk associated with an offshore investment transaction. The ability to deal with such a loss is then assessed to determine an appropriate response. The effort and amount of work investors put in at the beginning of an investment phase will be minimal compared to the effort exerted should investors lose all their investments (Lucas, 2009). In addition, even when an investor has a good relationship with a broker and the broker is prepared to offer help and advice, investors still need to have a basic idea of the type of portfolio

allocation they prefer, the risks involved, and things to look out for in order to avoid being misled or misguided. In conclusion, risk measurement helps potential investors quantify the probabilities of loss should unfavourable conditions occur. Once the risk has been measured and the investors have all the possibilities at their disposal, they can apply the different techniques for dealing with risk depending on their risk appetite. This process is regarded as risk control.

2.3.3.3 Risk control

After evaluating the risks, the next step is to minimise the risk through design and implementation of a risk management control programme (Ale, 2009). Such programmes would aim to achieve the following goals:

- reduction of the magnitude of the exposure;
- reduction of the frequency of the loss-producing events;
- dealing with loss-producing events; and
- recovery from loss-producing events.

According to Valsamakis *et al.* (2010), risk control programmes may be referred to as practical in the sense that they are conducted at the sources of risk. According to Vaughan (1997), risk control involves the application of techniques to reduce the probability of loss. Risk control aims to eliminate or minimise the potential effect of the identified risk exposures. Risk is repulsive and as such, investors deal with it through avoidance, reduction, retention and transfer. In some cases, two of these approaches (transfer and retention) can be combined to create the fifth technique, called risk sharing.

This phase of the risk management process is primarily a predicament in decision-making, since it entails deciding which of the techniques available should be used in dealing with each risk. The extent to which an investor must make this decision alone varies depending on different situations and circumstances. In attempting to determine which technique to use in dealing with a given risk, the investor or risk manager should consider the size of the potential loss, the probability of the loss and the resources that would be available to reduce the possible loss. The benefits and costs involved in each approach are evaluated and then, on the basis of the best information available and under the guidance of the risk management policy, an informed decision can be made. The following are risk management techniques that can be applied when dealing with risks.

2.3.3.3.1 Risk avoidance

Risk is avoided when the investor refuses to accept it even for an instant. The exposure is not permitted to come into existence. This is accompanied by not engaging in the action that gives rise to risk. If an investor cannot bear losing assets, then he or she should not invest. For example, if an investor wants to avoid the risks associated with the ownership of a property, then he or she should not purchase the property but lease or rent it instead.

The avoidance of risk is one method of dealing with risk, but it is a negative rather than a positive technique. For this reason, it is sometimes an unsatisfactory approach to dealing with many risks. If risk avoidance were used extensively, the business would have been deprived of many opportunities for profit and would probably not be able to achieve its objectives.

2.3.3.3.2 Risk reduction

Risk may be reduced in two ways. The first is through loss prevention and control. Commonly used practices include diversification, insurance, hedging or forward contracting, maintaining cash reserves and maintaining flexibility in the offshore operation.

Some techniques are designed to prevent the occurrence of the loss, whereas others, such as future contracts, are intended to control the severity of the loss if it does happen. From one point of view, loss prevention is the most desirable way of dealing with risk. If the possibility of loss could be completely eliminated, then risk would also be eliminated. And yet, loss prevention can also be viewed as an inadequate approach to dealing with risk. No matter how hard investors may try, it is impossible to avoid all losses. In addition, in some cases, the loss prevention may cost more than the losses themselves. For example, insurance could be more expensive than the actual losses suffered.

2.3.3.3.3 Risk retention

According to Chapman (2006), risk retention is perhaps the most common method of dealing with risk. When some positive action is not taken to avoid, reduce or transfer the risk, the possibility of loss involved in that risk is retained, since investors face an almost unlimited number of risks. Additionally, risk retention may be conscious or unconscious.

Conscious risk retention takes place when the risk is perceived and not transferred or reduced. When the risk is not recognised, it is unconsciously retained. In this case, the investor retains the financial consequences of the possible loss without realising that he or she does so. Risk retention may also be voluntary or involuntary. Voluntary risk retention is characterised by the recognition that the risk exists, and a tacit agreement to assume the losses involved. The decision to retain risks voluntarily is usually made because there are no better alternatives.

Involuntary risk retention takes place when risks are unconsciously retained and also when the risk cannot be avoided, transferred or reduced. According to Vaughan (1997), risk retention is a legitimate method of dealing with risk. Every investor must decide which risks to retain and which to avoid or transfer on the basis of margin for contingencies or ability to bear the loss. A loss that might be a financial disaster for one investor might be insignificant for another investor. As a general rule, risks that should be retained are those that lead to relatively small certain losses and high profits.

The decision to retain a risk may be accomplished with or without a reserve fund. If the decision is made to include the accumulation of a fund, the administrative procedure must be inaugurated to implement the decision. If the decision is made to use loss prevention to deal with a particular risk, the proper loss prevention programme must be designed and implemented. The decision to transfer the risk through insurance must be followed by the selection of an insurer and negotiations with the insurance company.

2.3.3.3.4 Risk transfer

Risk may be transferred from one individual to another who is willing to bear the risk. An excellent example of using a transfer technique when dealing with risks is the process of hedging. Hedging is a method of risk transfer accomplished by buying and selling for future delivery, whereby dealers and processors protect themselves against a decline or increase in market price between the time they buy a product and the time they sell it (Valsamakis *et al.* 2005). According to Saler (1996), hedging is the purchase or sale of one security for the purposes of offsetting risks taken in another.

Hedging consists of simultaneous purchase or sale for immediate delivery and purchase or sale for future delivery, such as the sale of futures in the wheat market at the same time that a purchase is made in the spot market. Risks are often transferred or shifted through contracts. An agreement where one individual assumes another's possibility of loss is an example of such a transfer. For example, a tenant may agree under the terms of a lease to pay any judgements against the landlord, which arise out of the use of the premises. Contractual transfers of risk are quite common in the construction industry, but are also used between manufacturers and retailers with respect to the product liability exposure. Insurance is also a means of transferring risk. In consideration of a specific payment (the premium) by one party, the second party contracts to indemnify the first party up to a certain limit for the specified loss that may occur.

2.3.3.3.5 Risk sharing

Risk sharing is a special case of risk transfer; however, it is also a form of retention. When risks are shared, the possibility of loss is transferred from an individual to a group. However, sharing is also a form of retention in which the risks transferred to the group are retained, along with the risks of the other members of the group. Individuals and organisations share risk in a number of ways. One outstanding example of a device through which risk is shared is the corporation. Under this form of business, the investments of a large number of persons are pooled. A number of investors may pool their capital, each bearing only a portion of the risk that the enterprise may fail.

Insurance is another device designed to deal with risk through sharing, as one of the basic characteristics of the insurance device is the sharing of risk by members of the group. These techniques need to be applied with caution, as investors' needs and risk exposure differs. Some techniques will be more applicable under certain conditions than others. For example, a wealthy investor might choose to retain most risks, while a relatively less wealthy investor might opt to transfer or share some of the exposures. In conclusion, Valsamakis *et al.* (2005) highlight the responses to offshore risk in Table 2.3.

Table 2.3: Responses to offshore risk

Response	Impact on risk
Avoiding investing offshore	Offshore risks can be avoided by refraining from investing offshore. The risk of losing capital in a stock market can, for example, be avoided by not investing in stock exchanges. Avoiding a risk is, unfortunately, rarely possible in the business environment.
Offshore acceptance	Offshore risks are inherent to businesses that have investments in foreign countries. Trying to avoid risk would mean disinvesting from a particular industry. If the risk-return properties are acceptable, the risk associated with that industry or type of business needs to be accepted.
Offshore mitigation	Once risk is accepted, it should be mitigated. Offshore mitigation is aimed at lessening the impact of offshore risks. Risk control activities are those that focus upon avoiding, preventing, reducing or otherwise controlling risks and uncertainties.

Source: Adapted Valsamakis *et al.* (2005)

The responses to risk stress the importance of effective risk management for offshore investment success. Considerable attention has been given to ensuring comprehensive identification and objective assessment of offshore risks to provide a clear understanding of the extent of risk exposure faced by offshore investments. Many techniques have been developed to support these stages in the risk process, which could work well when used properly. However, identification and assessment will be worthless unless responses can be developed and implemented which will really make a difference in addressing identified risks. Risk response development is perhaps the weakest part of the risk process, and it is here that many organisations fail to gain the full benefits of risk management. The next section will focus on risk financing as another component of a risk management process.

2.3.3.4 Risk financing

According to Young (2006) and Valsamakis *et al.* (2010), risk financing entails the financial provision for losses that may occur. It therefore selects the most efficient method of financially providing for the consequences of risk. Thus, risk financing refers to the provision of sufficient funds to meet loss situations as they occur. Funding can be provided by a variety of internal and external financial resources, insurance and risk-based pricing.

Risk financing activities provide the means of reimbursing losses that occur and for funding other programmes to reduce uncertainty and risk, or to enhance positive outcomes. Normally, some losses will occur despite risk control efforts. The financing of these losses can include measures such as the purchase of insurance coverage, the establishment of a captive insurance subsidiary, or the use of letters of credit. In the selection of the most efficient method of financially providing for the consequences of risk, the following choices become evident:

- the retention of risk under a deliberate self-funding plan;
- the risk transfer cost to third parties, through techniques such as insurance; and
- the combination of risks (diversifying or hedging) to obtain the benefit of greater certainty in predicting the loss occurrences through the use of the law of large numbers. This method can be used by businesses, individual investors and indeed insurers. It has its limitations, however, since the scope of combination or diversification may be limited.

The evaluation of the advantages and cost of alternative methods and the selection of the most efficient method or technique are difficult tasks. Prudent risk retention is underpinned by relatively complex quantitative analyses aimed at determining probable quantum of losses, which are to be self-financed. Other aspects include whether a given risk should be transferred to an insurance company (third party) or retained. If retained, an investor should determine the limit beyond which the risk should be transferred to a third party. If the insurance is purchased, the limit must be determined. Risk control and risk financing activities are not always mutually exclusive. Banks, for example, are actively involved in credit and interest rate risk management activities (such as interest rate swaps) that might reasonably be seen as both risk financing and risk control (Valsamakis *et al.,* 2005). Risk control was defined as the application of technique to reduce the probability of loss. Therefore, insurance by a third party can be regarded as risk control. However, insurance by a third party can also be regarded as risk financing since it is a provision for losses that may occur.

2.3.3.5 Risk monitoring

The final component of a risk management process involves ensuring the effectiveness of the risk management systems and techniques. Risk monitoring ensures that operations are within the defined risk policies and procedures, and that all other activities of the risk management process are effective. Ongoing monitoring is an important aspect of any risk management process to ensure that the techniques used to retain risks are relevant under the current conditions.

Monitoring is important for two reasons. Firstly, a risk management process does not take place in a vacuum: things change, new risks arise and old risks disappear. Therefore, the techniques that were appropriate last year may not be the most relevant this year, and constant attention is required. Secondly, mistakes are sometimes made. Monitoring of the risk management programme permits the investor to review decisions and discover mistakes – if any – before they become costly. Monitoring is a continuous process, which forms an integrated part of the management of risk. In order to ensure an appropriate and timely response, an organisation should have a mechanism in place to allow the organisation to monitor its risks and controls. According to Chapman (2006), monitoring should establish a programme that will do the following:

- monitor the qualitative assessments and quantitative measurements of risk exposures;
- assess the quality and appropriateness of mitigating actions, including the extent to which risks can be transferred;
- ensure that adequate internal controls, processes and systems are in place to identify and address problems on a proactive basis;
- ensure the optimum risk management process;
- ensure that the cost of risk does not exceed the reward;
- ensure efficient reporting of risk management information;
- ensure the efficiency of risk management systems; and
- ensure the efficiency of the risk management strategy.

The continuous monitoring of risk is essential in order to ensure the quality of the risk management process and to ensure that changing circumstances do not alter risk management priorities.

2.3.4 Concluding remarks

This section focused on different facets of risk management. Firstly, various definitions of risk management were discussed, and for the purposes of this study, it was concluded that risk management will be defined as the identification, assessment and prioritisation of risks followed by a coordinated and economical application of resources to minimise, monitor and control the probability and/or impact of unfortunate events or to maximise the realisation of opportunities. The definitions of risk management were followed by a section that focused on the rules of risk management. The rules mainly focused on the principles applied to risk situations or during an investment decision process.

Thirdly, the risk management process, which aims to minimise risks, was considered. Four risk management processes were compared and discussed. The processes differ from each other; however they all seek to achieve the same results, namely identifying possible risks, evaluating and assessing the extent of loss, then controlling them by employing different techniques. This leads to a choice of strategy to mitigate the risk while constantly monitoring the relevance of the techniques used to mitigate such risks. Few risks remain constant, which necessitates an ongoing review of the exposures to ensure that management actions remain relevant. Therefore, the step-by-step risk management process can be summarised as:

- **risk identification** – refers to the process of compiling all the possible risks the investor can be exposed to, which necessitates the need for an investor to define and understand the nature of the risks;
- **risk evaluation** – entails quantifying the risk and determining its possible impact on an investor. Risk evaluation is concerned with assessing probability and impact of individual risks, taking into account any interdependencies;
- **risk control** – refers to the method by which investors evaluate potential losses and take action to reduce or eliminate such threats. Risk control is a technique that utilises findings from risk assessments (identifying potential risk factors, such as technical and non-technical aspects of the business, financial policies and other policies that may have an impact on the well-being of the firm), and implementing changes to reduce risk in these areas;
- **risk financing** – providing funds to cover the financial effect of unexpected losses experienced by a firm. Traditional forms of finance include risk transfer, funded retention by way of reserves (often called self-insurance) and risk pooling; and

- **risk monitoring** – the process of identifying and analysing new risks, keeping track of these new risks and forming contingency plans in case any risks arise. Risk monitoring ensures that the investment plan stays on track and continues until the investment reaches maturity.

These risk management steps should be reviewed from time to time to ensure that the investment objectives are achieved. The next section will focus on the risk types faced by offshore investors.

2.4 Risk types facing offshore investors

Most investors are debating the differences between risk types. Although some regard this debate as semantic, it is necessary to clearly define each risk type and the potential impact it has on offshore investments. This understanding will allow investors to identify the risk proactively and manage it, thus protecting their investments. Hence, a logical departure point would be to take a closer look at the definition and description of some of the major risk types and its impact on offshore investments. According to Chapman (2006) and Saunders and Cornett (2008), the following are regarded as major risk types that need to be analysed when considering an investment decision:

- exchange rate risk
- country risk
- market risk
- inflation risk
- interest rate risk
- financial risk
- credit risk
- liquidity risk
- legal risk
- technology risk.

Each of these risks will be discussed in more detail in the ensuing sections, which will also highlight risk's interface and applicability towards offshore investments.

2.4.1 Exchange rate risk

According to Casu, Girardone, Molyneux, (2006), exchange rate risk is the uncertainty of returns to an investor who acquires securities denominated in a foreign currency. Exchange rate risk is sometimes referred to as currency risk. For the purposes of this study, the term **exchange rate** risk will be used. According to Madura (2009), exchange rate risk is a form of risk that arises from the change in price or value of one currency against another currency. Exchange rate risk is defined as the risk that exchange rate changes can affect the value of an investor's assets and liabilities denominated in foreign currency (Saunders and Cornett, 2008). Whenever investors or companies have assets or business operations across national borders, they face exchange rate risk. As economic conditions, such as import and export, change exchange rates can change substantially. A decline in a currency value is often referred to as depreciation, while an increase is referred to as appreciation (Madura, 2009). When a foreign currency's spot rates at two specific points in time are compared, the spot rate at the more recent date is denoted as *S* and the spot rate at the earlier date is denoted as *St-1*. The percentage change in the value of the foreign currency is computed as follows:

$$\textbf{Per cent } \Delta \textbf{ in foreign currency value} = \frac{S - St\text{-}1}{St\text{-}1}$$

A positive percentage change indicates that the foreign currency has appreciated, while a negative percentage change indicates that it has depreciated. Currency appreciation could be advantageous when offshore investors are buying foreign assets or investments. However, when offshore investors expropriate returns, strong domestic currency can be disadvantageous, meaning the returns will be significantly low compared to an expropriation when the currency is weak. Currency depreciation will yield inverse results. The next section will focus on the factors to be considered by potential offshore investors, mainly looking at the relationship between exchange rates, inflation and interest rates.

2.4.1.1 Factors of exchange rate risk

The likelihood of incurring exchange rate risk is becoming greater for investors who buy and sell assets around the world, as opposed to those who invest assets within their own countries. For example, if money must be converted from South African rand into a different currency such as the US dollar to make a certain investment, changes in the value of the South African rand relative to the US dollar will affect the total loss or gain on the investment when the money is converted back to South African rand. This risk usually affects businesses with operations in many countries, but it can also affect individual investors who make international investments. For example, a South African investor who buys Japanese stock denominated in Japanese yen must consider not only the uncertainty of the return in Japanese yen but also any changes in the exchange value of the Japanese yen relative to the South African rand. The offshore investor must consider the additional uncertainty of the return on the Japanese stock when it is converted from Japanese yen to South African rand.

The currency price is usually determined by demand and supply of a particular currency. Another example is when a US investor has stocks in Canada. The return that the investor will realise is affected by both the change in the price of the stocks and the change in the value of the Canadian dollar against the US dollar. If the investor realises a 15% return in Canadian stocks but the Canadian dollar depreciates by 15% against the US dollar, this will amount to no gain at all as the 15% return will be reduced by the 15% depreciation of the Canadian dollar relative to the US dollar.

Competition for a fraction of global markets is increasing, particularly at developing nations. According to Blanchard (2009), economies (and currencies) in developing nations may be quite volatile due to political upheaval and factors like the price of oil adding to the instability of the economies. The investors' balance sheets, cash flow and earnings can be dramatic, and thus influencing the reasons for doing business internationally as inherently risky. For example, when profits are exchanged for the domestic currency, there is a risk that such profits could be reduced and in extreme cases, the investor may suffer a loss. Investors may sometimes struggle to compete with competitors from countries where currencies are weaker because the costs of acquiring currency is lower and could consequently offer lower prices to customers. Furthermore, international trade and money markets may also devalue the currency, decreasing its purchasing power abroad even further during times of low inflation. The risk faced by

investors in foreign bond and stock funds is that the foreign currency may appreciate relative to the currencies in which the securities are denominated, resulting in a currency loss.

A more pragmatic approach for investors is to learn about the fundamentals of exchange rate risk in order to reduce its negative impact. Exchange rate is a complex subject; therefore, professional advice could be one way of containing this kind of risk. However, investors need to be knowledgeable enough to be able to act wisely on advice. Thus, offshore investors must continuously monitor exchange rates because their cash flows are highly dependent on exchange rates movements. Investors need to understand which factors influence exchange rates so that they can anticipate how exchange rates may change in response to specific conditions. The main indicators of exchange rate risk are the relationships between interest, inflation and exchange rates. These relationships are measured by using the following:

- **Purchasing power parity (PPP)** – according to Madura (2003), PPP is an economic technique used when attempting to determine the relative values of two currencies. It is useful because often the amount of goods a currency can purchase between two nations varies drastically based on availability of goods and the demand for the goods. PPP solves this problem by taking some international measure and determining the cost for that measure in each of the two currencies, then comparing that amount. The idea is that in a stable marketplace, the relationship between exchange rates of different countries should be in the same ratio as the price of a fixed basket of goods and services. In other words, there is parity between the purchasing power of currencies and their exchange rates. There are different ways of expressing this, but most commonly it is:

  Rate of change of exchange rate = difference in inflation rates

  According to Ong (2003), the PPP theory uses the long-term equilibrium exchange rate of two currencies to equalise their purchasing power, which is based on the law of one price. The theory states that, in ideally efficient markets, identical goods should have only one price. The purchasing power rate equalises the purchasing power of different currencies in their home countries for a given basket of goods. Additionally, using a PPP basis is arguably more useful when comparing differences in living standards for the whole nation because PPP takes into account the relative cost of living and the inflation rates of different countries, rather than just a nominal gross domestic product (GDP) comparison; and

- **International Fisher effect (IFE)** – according to Madura and Fox (2007), IFE states that an estimated change in the current exchange rate between any two currencies is directly proportional to the difference between the two countries' nominal interest rates at a particular time. This theory is also known as **the assumption of uncovered interest parity**. According to Fisher's hypothesis (2001), the real interest rate in a particular economy is independent of monetary variables. With the assumption that real interest rates are calculated across countries, it can also be concluded that a country with a lower interest rate would also have a lower inflation rate. This will increase the real value of the country's currency over time.

  According to the generalised Fisher effect, real interest rates should be the same across borders. But the validity of the generalised Fisher effect largely depends on the integration of the capital market. That is, the capital in the market needs to be free to flow across borders. Usually, the capital markets of the developed countries are integrated in nature. It has been seen that, in underdeveloped countries, currency flow is restricted. This theory suggests that differences in interest rates between countries are expected to be offset by future changes in exchange rates. For example, if an investor earns a higher interest rate in another country, any gains are offset by an unfavourable exchange rate. The relationship is expressed as:

  The expected rate of change of the exchange rate = the interest rate differential

  The above measures depend on careful monitoring when protecting an investor against exchange rate risk. Exchange rates are furthermore affected by politics, inflation, the state of import and export markets, capital flow, consumer confidence, and many other economic and social factors (Eun and Resnick, 2007). Moreover, individual governments often take action, sometimes controversially, to control the volatility of currencies. Madura and Fox (2007) warn that exchange rates cannot be forecasted with perfect accuracy, but the business can at least measure its exposure to exchange rate fluctuations. If the business is highly exposed to exchange rate fluctuations, it can consider different techniques to reduce its exposure. Additionally, it is conventional to classify the exposure to exchange rate fluctuations into three types: economic, translation and transaction exposure.

2.4.1.2 Types of exposure

As investors and companies invest in foreign markets, many are exposed to the risk of fluctuating exchange rates. Changes in exchange rates may affect the settlement of contracts, cash flows, and the business valuation (Eun and Resnick, 2007). It is thus important for investors to know the foreign exchange rate exposure. The following are foreign exchange rate exposures that could affect an offshore investment:

- **Economic exposure** – according to Madura and Fox (2007), economic exposure is defined as the risk that a company's profits will be eroded by exchange rate changes because of rising operating costs. Companies are very limited in the actions they can take to protect themselves in this situation. According to Eun and Resnick (2007), economic exposure is defined as the extent to which the value of the business would be affected by unanticipated changes in exchange rates. Any anticipated changes in exchange rates would already have been discounted and reflected in the business's value. Changes in exchange rates can have a profound effect on the business's competitive position in the world market and thus on its cash flows and market value.

- **Translation exposure** – according to Madura and Fox (2007), translation exposure is the risk that exchange rate changes will diminish a company's income, assets, equity or liabilities. According to Eun and Resnick (2007), translation exposure refers to the potential that the business's consolidated financial statements can be affected by changes in exchange rates. Consolidation involves translation of subsidiaries' financial statements from local currencies to the home currency. For example, a US multinational business that has subsidiaries in South Africa and the United Kingdom will produce financial statements in local currency. To consolidate the financial statement globally, the business must translate the subsidiaries' financial statements in local currency into US dollar, the home currency. The denomination is therefore significant, although some analysts believe that real assets (those that are physical and identifiable rather than financial) are hardly affected by currency movements at all. To insulate against this risk, fund managers undertake currency hedging. Currency hedging is a sophisticated technique involving keeping a close watch on exchange rate changes and diversification of a company's holdings in different currencies (Madura, 2003).

- **Transaction exposure** – this is the risk that exchange rates will change after a contract has been agreed, but before it is completed (or after borrowing/lending agreements have been established but before repayments are made), and that major losses will occur as a result (Madura and Fox 2007). According to Eun and Resnick (2007), transaction exposure is defined as sensitivity of realised domestic currency values of the business's contractual cash flows denominated in foreign currencies to unexpected exchange rate changes. Since settlements of these contractual cash flows affect the business's domestic currency cash flows, transaction exposure is sometimes regarded as a short-term economic exposure.

  Transaction exposure arises from fixed-price contracting in a world where exchange rates are changing randomly. Companies working in international markets frequently face this problem. It is not usually practical to demand advance payment from customers (and impossible to apply this in a borrowing/lending situation); thus, a technique called factoring is used to reduce the risk. According to Posner (1990), factoring involves selling off a company's foreign accounts receivable to a factoring house, which then takes on the responsibility for credit and collections. Factoring houses typically buy the accounts receivable at 90–95% of their value, although the discount may be greater. Offshore investors often recoup their losses through product price adjustment.

2.4.1.3 Impact of exchange rates

According to Madura and Fox (2007), each currency is valued in terms of other currencies, so that currencies can be exchanged to facilitate offshore transactions. The values of most currencies fluctuate over time because of market and government forces. Exchange rates are thus affected by risks associated with a particular country. For example, there may be political or military involvement, and restrictions may be imposed. There are also commercial factors, like a major foreign customer becoming bankrupt or defaulting. Major customers in the domestic country can also default; however, they are not operating under unfamiliar legal or regulatory systems. It is possible for companies to insure themselves against such risks, but this can be costly. Many South African companies trade with companies overseas or obtain foreign capital abroad; therefore, they are not insulated from exchange rate risk, political instability, inflation, economic policy, interest rates, unemployment and the economic growth rate that can lead to changes in exchange rates.

Furthermore, Madura and Fox (2007) explain the impact of exchange rate risk by means of the following example: A tennis racket which sells in the UK for £100 will require a payment of 150 euro by a French importer if the euro is valued at 1.5 euro = £1. If the British pound then becomes more expensive, costing 1.8 euro, the French importer will have to pay 180 euro to buy the tennis racket. The French importer will not be affected. However, the cost of the racket for the French importer has increased by (180-150)/150 = 0.2 or 20%, so it seems likely that the French importer will look elsewhere and the UK will experience a decrease in export quantities and value.

2.4.1.4 Control measures

There are at least four ways, according to Du Plessis (2000), in which investors can minimise exchange rate risk. The method and the way in which the control measure is applied will depend on the company's exchange rate expectations. Firstly, an investor can avoid unnecessary losses caused by an increase in exchange rates by paying for the transaction immediately at the rate of exchange ruling when the agreement is concluded.

Secondly, a futures transaction can be concluded. The rate of exchange, which will be used at date of payment, in other words, after 90 days, is agreed at the beginning of the transaction. In this way, the 90 days' credit is still used and there is no uncertainty as to which rate of exchange will be used.

Thirdly, it is possible to borrow the relevant amount of South African rand at the time of the transaction and invest this in American interest-bearing stock with the same term as the transaction debt. By realising the investment at redemption date, the correct amount will be available to settle the debt. The cost of this method will amount to the difference between the interest paid on the loan and interest received on the stock. However, a South African company might probably experience problems in obtaining permission from SARS to use this method.

Fourthly, one can take out cover against exchange rate fluctuations with a certain financial institution at a fixed commission. Because financial institutions such as banks usually keep abreast of expected changes in the exchange rate, they offer a service whereby a company can take out cover against changes in the exchange rate on payment of a commission. Apart from the element of remuneration, the commission usually makes provision for the expected change

in exchange rates. The advantage for the company is that it is relieved of the risk of unexpected exchange rate fluctuations.

If a South African company is owed foreign currency, it is referred to as being in a long position, since it will profit if the exchange rate increases in favour of the foreign currency. However, if the company owes foreign currency, it is in a short position, seeing that it will be at a disadvantage if the exchange rates increase in favour of the currency. In both cases there may be a converse risk if the exchange rates change in the opposite direction. From an investment point of view, it is therefore important to be aware of the nature and extent of the foreign debt or revenue of the company in which an investor is considering an investment. This applies particularly to companies, which obtain foreign capital abroad. An investor must ascertain whether sufficient provision has been made to ensure that unexpected fluctuations in the exchange rate do not adversely affect the financial position of the company.

In conclusion, exchange rate risk can be regarded as an important risk to consider when investing offshore (Saccomanni, 2008). This section dealt with the impacts of exchange rate risk, the types of foreign exchange exposure as well as the control measures of containing foreign exchange rates movements. The next section will focus on country risk, which is arguably the most important risk to consider when investing abroad.

2.4.2 Country risk

When investors engage in international transactions and operations, they encounter additional risks compared to investing domestically. Different languages, currencies, jurisdictions, customs and habits can be translated into extra informational asymmetries and transaction costs that may impact upon the smooth operation of business. According to Saunders and Cornett (2008), an offshore-oriented investor that mismatches the size and maturities of its foreign assets and liabilities is exposed to foreign currency and foreign interest rate risks. Even beyond these risks, and even when investing in dollars, holding assets in a foreign country can expose an investor to an additional type of foreign investment risk called country risk.

This section introduces the various definitions of country risk, the factors that should be considered by offshore investors, as well as the control measures for country risk and country instability. Various authors define country risk as follows:

- Levich (1998) defines country risk as the deviation from interest rate parity.

- Shapiro (2010) defines country risk as the general level of political and economic uncertainty in a country affecting the value of loans or investments in that country. From a bank's standpoint, it refers to the possibility that borrowers in a country will be unable to service or repay their debts to foreign lenders in a timely manner.

- Eiteman, Stonehill and Moffett (2004) define country risk as the risk that affects international investors at corporate level and which originates at country level.

- Madura and Fox (2007) define country risk as the uncertainty of returns caused by the possibility of a major change in the political or economic environment of a country.

- Saunders and Cornett (2008) define country risk as the risk that repayment from foreign borrowers may be interrupted because of interference from foreign governments.

- Country risk is a collection of risks associated with investing in a foreign country (Investorwords, 2009).

According to Frenkel, Karmann and Scholtens (2004), the term **country risk** has not gained a clear definition from academia. Instead, a lot of different terms that have come into use are often seen as almost identical to **country risk.** So, for example, are **political risk**, **exchange rate risk, economic risk, sovereign risk, financial risk, cross-border risk, international business risk** and **transfer risk** all terms used to refer to the ability or willingness of an economy or country to honour its financial obligations.

The terms are often used interchangeably; however, for the purposes of this study, country risk was regarded as the adverse impact of a country's environment on the value of an investor's international investments, operations and transactions.

Country risk varies from one country to the next, with some having extremely high risks that discourage a lot of foreign investment. For example, when a domestic corporation is unable or unwilling to repay a loan, an investor usually recourses to the domestic bankruptcy courts and eventually may recoup at least a portion of its original investment when the assets of the defaulted firm are liquidated or restructured. By comparison, a foreign corporation may be unable to repay the principal or interest on a loan even if it would like to.

Most commonly, the government of the country in which the corporation is headquartered may prohibit or limit debt payments because of foreign currency shortages and adverse political reasons. In the event of such restrictions, rescheduling or outright prohibitions on the payment of debt obligations by sovereign governments, the investor has little, if any, recourse to the local bankruptcy courts or an international civil claims court. The major leverage available to an investor to ensure or increase repayment probabilities and amounts is its control over the future supply of loans or funds to the country concerned. However, such leverage may be very weak in the face of a country's collapsing currency and government (Saunders and Cornett, 2008).

The notion of country risk itself is very old and integrated into the assessment of risk and return in international operations. Usually, it was seen as inextricably linked with doing business abroad. Seldom a distinction was made with currency risk. Instead, country and currency risk were seen as two sides of the same coin. However, the concept of country risk strongly evolved in the 1960s and 1970s. This especially was a response to the international banking sector's efforts to define and measure its exposure to losses on cross-border lending (Clark, 1997). Investors need to consider a lot of factors prior to investing offshore, since changes in political and economic policies can be detrimental to investors' success.

2.4.2.1 Factors of country risk

According to Frenkel *et al.* (2004) politics is a major factor in determining the overall structure of financial markets and the regulatory framework. Countries have different rules that regulate investments in their countries. For this reason, offshore investors investing in countries that have unstable political economic systems must consider adding a country risk premium when determining their required rate of return for these additional uncertainties. **Country risk premium** refers to an increment in interest rates that would have to be paid for loans and investment projects in a particular country (Chapman, 2006). One way of establishing the

country risk premium for a country is to compare the interest rate that the market establishes for a standard security in the country to the comparable security in the benchmark country. For the securities to be comparable, they must have the same maturity and should involve payment in the same currency.

The reason why the payments must be the same is that otherwise the differential in the interest rates would reflect the differential rates of inflation in the two countries instead of solely the market perceived risk of non-payment. The interest rate that is relevant is the market-determined yield to maturity rather than the coupon interest rate. The coupon interest rate is valid only if the issuers were careful to set the coupon rate so that it is equal to the yield to maturity of the security.

For example, suppose the US government has issued a five-year bond that has a yield to maturity of 6 per cent and the government of Poland borrows dollars by selling a five-year bond that pays in dollars and the yield to maturity of that bond is 8 per cent. The country risk premium for Poland would be 2%. The 2% is the correct value providing the yields to maturity, which are expressed as instantaneous rates. If they are expressed as effective annual rates then the correct computation of the risk premium (ρ) is as follows:

$$1+\rho = (1+0.08)/(1+0.06) = 1.01887$$

and thus

$$\rho = 0.01887$$

Source: Adapted Frenkel *et al.* (2004)

The above procedure is easily implemented if a country's government borrows through securities denominated in dollars. This is common among the various emerging market economies but rare in the developed economies. A Table in Annexure A provides estimates of the country risk premiums compiled by Huang (2009) based upon information from Moody's bond ratings. Developed nations like the United States are generally considered the benchmark for low country risk, and most nations can have their risk measured as compared to the United States (Huang, 2009).

Thus, political analysts as well as economic analysts are increasingly drawn into the debate of the interplay between politics and stock markets. In this regard, Moran (1998) warns investors that, if different political parties manipulate the economy according to their policies, the results would be reflected on the stock market. In addition, it is assumed that electoral uncertainty is directly related to stock market volatility and that political events, such as the election of a politician who is expected to enact market-friendly policies, lead to increases in stock market returns. Conversely, political events that are expected to have a negative impact on the economy and specific businesses lead to decreases in stock market returns. Therefore, it can be said that political variables cause fluctuations in stock market returns. According to Saunders and Cornett (2008), political variables take many different shapes and forms as changes in domestic and foreign policy, as well as uncertainty brought about by national elections. The re-distribution of political power could have important implications in the future political and economic course of a country.

Consequently, an election brings a major uncertainty to both domestic and foreign investors. Although exchange control regulations in South Africa have been dramatically eased since 1996, investors still need to follow a bureaucratic process when they wish to invest offshore using their R2 m foreign investment allowance (Thorne and Cloete, 2010). Investors should ensure that they follow domestic as well as international rules and regulations, as in many cases, international investment and trade agreements are extremely convoluted and complicated and may involve not just one international agreement between two countries, but agreements between multiple countries. As a result, international investments can be confusing and difficult to maintain, particularly if those investments span several different industries.

The decision to invest offshore is not one to be taken lightly, as an array of investments that may not be available in the onshore jurisdiction may be available offshore. Thus, it is appropriate to discuss the types of offshore investment issues pertaining to investments in foreign countries. Ware and Roper (2001) warn investors that the following issues may arise when investing offshore:

- **Jurisdictional issues** – the importance of choosing an appropriate jurisdiction cannot be overemphasised, for example where a trust is set up to house the investment. The choice of jurisdiction may affect the jurisdiction where the trust is to be set up as well as the jurisdiction chosen as the proper law of the trust. Furthermore, one should also take cognisance of the

investment contract and the proper law that governs the investment contract. With regard to the law that governs property, a distinction should be made between movable and immovable property, for, regardless of the proper law chosen, the legislation of the jurisdiction where the assets are situated may override the proper law. For example, the law where the property is situated is the governing contract. Choosing a jurisdiction suitable for an offshore investor can be difficult, as there are many recognised jurisdictions to choose from. This decision has to be made in conjunction with the decision on an appropriate structure and offshore investment vehicle.

- **Tax issues** – can be attributable to choice of jurisdiction or choice of investment. Each type of investment carries its own tax consequences as onshore and offshore jurisdictions have their own tax codes. Prospective investors often make decisions considering offshore taxes in isolation and disregard the tax laws of their domestic jurisdiction. Offshore investors need to ascertain if their domestic jurisdiction tax is on a worldwide basis or on a source basis, as this matter may affect the tax equation. It may sometimes be appropriate to invest in tax havens that do not deduct source-based taxes whereas at other times it may pay to invest in jurisdiction where taxes are deducted. It should be borne in mind that, once paid, relief can only be sought in terms of a double taxation agreement (DTA) or, failing this, unilateral relief may be sought in terms of domestic legislation.

- **Investment issues** – careful consideration has to be given to the currency in which the investment is denominated. A decision has to be made whether to invest in strong currency (US dollar, euro, yen or a combination thereof) or to invest in a weak currency. For risk-averse investors, the focus of the investments should be on strong currencies and markets. Exposure to emerging markets should be carefully considered, as there could be more instability.

- **Trust issues** – a careful analysis is necessary to balance the benefits of trust structuring with the associated charges, before settling a trust. The benefits of using a trust should not be limited to tax opportunities only as the use of a trust purely for avoiding income and wealth taxes at the expense of commercial benefits can only be tantamount to economic suicide.

2.4.2.2 Control measures

Investors, financial institutions and companies require authoritative and trusted assessment of credit risk to pursue profitable business opportunities in difficult markets. In assessing the credit risk, offshore investors can use country risk service (CRS), which provides an in-depth and timely analysis of the risks of financial exposure in many countries. The services can help an investor make an informed and timely decision about international creditworthiness and financial risks of a country under consideration.

According to Lessard (2009), the service is specifically designed to assist investors to set and review country credit lines or to manage financial exposures to foreign countries. The service provides an assessment of risks tailored to a client's particular exposure to the sovereign and currency risk or to the banking sector and the broader private sector. CRS monitors emerging markets on a continuous basis at regular intervals. The service provides comprehensive tables of quarterly and annual data, including two-year forecasts for most annual series. Variables covered include external debt stocks and flows, external financing requirements, the balance of payments, foreign exchange reserves, public finances and credit. In addition, Lessard (2009) advises that CRS can assist investors in the following ways:

- by assessing sovereign, currency and banking sector risk in many markets;
- by manipulating, displaying and analysing data in investors' financial and risk-rating models;
- by comparing risks across countries, using standardised risk and forecasting methodology;
- by assessing business risk, taking into account macroeconomic variables in each report;
- by analysing credit risk posed by the political and economic situation in each country; and
- by limiting risk in markets with the help of timely warnings of likely rating downgrades.

As with all risks, effective management of country risk requires an integration of assessments, policies and processes as well as internal and external information. Country risk should be analysed to monitor countries where investors have business interests. If the country risk level of a particular country begins to increase, the investor may consider divesting its business located there. Country risk analysis is not only limited to predicting major crises, but an investor may also use this analysis to revise its investments or financing decisions in light of recent events.

In any given week, the following unrelated international events might occur around the world:

- a terrorist attack, like the September 11, 2001 terrorist attack on the United States, which heightened the awareness of country risk;
- a major labour strike in an industry;
- concern about a country's banking system that may cause a major outflow of funds;
- a political crisis due to a scandal within a country; and
- the imposition of trade restrictions on imports.

Any of these international events may affect the potential returns or the cost of financing projects and therefore affect the value of an investment. An investor should consider whether its returns will be affected and whether there has been a change in policy to which it should respond. Managing international events is an ongoing process.

2.4.3 Market risk

Markets are highly competitive. Thousands of intelligent and well-backed analysts constantly scour the securities markets searching for the best buys. This competition means that investors should expect to find few, if any, investments that are obvious bargains. Market risk is therefore another important risk that needs to be mitigated for the success of an offshore investment plan. The following authors provide definitions of market risk:

- According Banks and Dunn (2003), market risk is the risk of loss due to an adverse move in the market value of an asset – a stock, a bond, a loan, foreign exchange, a commodity or a derivative contract linked to these assets. Market risk can also be contrasted with specific risk, which measures the risk of a decrease in an investment due to a change in a specific industry or sector, as opposed to a market-wide move.

- Banks and Dunn (2003) indicate that market risk is the most familiar risk of all risks, also referred to as volatility, i.e. the day-to-day fluctuation in the price of a stock. Market risk applies mainly to stocks and options. As a whole, stocks tend to perform well during a bull market and poorly during a bear market. Volatility is not so much a cause but an effect of certain market forces. Volatility is also a measure of risk since it refers to the behaviour or temperament of investment rather than the reason for this behaviour.

- Chapman (2006) defines market risk as the exposure to a potential loss arising from diminishing sales or margins resulting from changes in market conditions outside the control of the business. All businesses are exposed to some form of market risk as discuss The level and source of market risk differ from industry to industry and from company to company within the same industry.

- Ong (2003) defines market risk as the possibility that the price of an asset may decline or that the value of obligations (such as swap exposures, options or future contracts) may grow over a given period simply because of economic changes or other events that impact the market price of securities, commodities and interest rates. Market risk is somewhat unique in that it can be largely hedged, using an array of market products designed specifically for this purpose, including options, futures and other derivates.

- Young (2006) defines market risk as the risk of a decrease in the value of a financial portfolio as a result of adverse movement in market variables such as prices, currency exchange rates and interest rates. In other words, market risk is exposure arising from adverse changes in the market value of a financial instrument or portfolio.

- According to Gitman and Joehnk (2008), market risk is the risk that investment returns will decline because of market factors independent of the given investment. Examples include political, economic and social events, as well as changes in investor tastes and preferences.

- Saunders and Cornett (2008) define market risk as the risk related to the uncertainty of an investor's earnings on its trading portfolio caused by changes, and particularly extreme changes, in market conditions such as the price of an asset, interest rates, market volatility and market liquidity. Thus, risks such as interest rates affect market risk.

- According to Waddell (2009), market risk is the possibility that the value of an investment will decrease because of a general decline in the financial markets.

For the purpose of this study, market risk was simplified as the exposure arising from adverse changes in the market value of a financial instrument. Market risk depends on many things, including the price of the reference asset, its volatility, prevailing interest rates and time. Intuitively it makes sense that a change in any of these will cause a corresponding change in the

risk and the value of the investment asset. For example, favourable changes could generate profits, while unfavourable changes could result in a loss.

Market risk is a broad term and can sometimes be confused with other risks. According to Banks and Dunn (2003), some of the most common types of market risks include:

- **Directional risk** – the risk of loss due to an adverse move in the direction of the underlying reference assets. Changes in market direction occur because supply and demand forces are constantly at work, meaning that bargains struck between buyers and sellers set asset prices. These move both up and down and are used as reference points for valuing many outstanding assets.

- **Volatility risk** – the risk of loss due to an adverse movement in volatility prices. Volatility is a measure of turbulence or tranquillity in a particular market. A calm market has low volatility; a turbulent market, high volatility.

- **Time decay risk** – the risk of loss due to the passage of time. This risk is found primarily in derivatives, which obtain some of their value from time. In general, the more time until the maturity of the contract, the greater its value and vice versa.

- **Curve risk** – the risk of loss due to an adverse change in the maturity structure of a reference risk, such as interest rate, security price and volatility level.

- **Spread risk** – the risk of loss due to adverse changes between two reference assets that may not have a common link, such as risk-free assets and a risky bond. The spread between the two assets fluctuates all the time based on supply and demand forces, market and liquidity conditions, as well as credit events.

- **Basis risk** – like spread risk, basis risk is the risk of loss due to adverse changes between two reference assets. In this case, the reference assets are related in some way, but are not perfectly fungible. Some events might push the price of one up and the other down, causing a gain or loss.

- **Correlation risk** – the risk of loss due to an adverse move in the correlations and price relationships between assets and markets. When looking at the history of financial prices, it is clear that assets sometimes trade with or against one another. These price relationships, expressed in terms of correlation, are often used as the basis for hedging or investing. Correlation risk is actually contained in assets and hedge relationships (and is a key component of the spread and basis risks described above). An investment manager might look at the historical price movement between two securities and determine that there is a high probability that the prices will converge; thus, buy one asset and sell the other. If the asset prices decouple, the historical correlation between the two diverges and the investment manager could suffer a loss.

In addition, Waddell (2009) indicates that market risk is closely tied to interest rate risk. As interest rates increase, prices decline and vice versa. As a result, the value of an investment can decrease due to movements in market risk factors. Market risk could embody a number of different risks. According to Waddell (2009), the following are market risk factors:

- **equity risk** – the risk that stock prices will change;
- **interest rate risk** – the risk that interest rates will change;
- **currency risk** – the risk that foreign exchange rates will change;
- **commodity risk** – the risk that commodity prices (grains and metals) will change; and
- **equity index risk** – the risk that stock or other index prices will change adversely.

Additionally, Gitman and Joehnk (2008) warn investors that the impact of market factors on investment returns is not uniform. Both the degree and the direction of change differ among investment vehicles. For example, legislation placing restrictive import quotas on Japanese goods may result in a significant increase in the value (and therefore the return) of Japanese automobile and electronics stocks. Essentially, market risk is reflected in the price volatility of a security: the more the volatile the price of a security, the greater its perceived market risk.

2.4.3.1 Factors of market risk

According to Ong (2003), an entire class of assets and/or liabilities carries market risk. Market risk may apply to a certain country or industry, or to the entire global economy. It is impossible to reduce market risk for the global economy (complete global shutdown is always theoretically possible), but one may mitigate other forms of market risk by buying different kinds of securities and/or by buying in different industries. For example, all oil companies have the market risk that someday their market (oil drilling) could be dry. An investor may mitigate this risk by investing in both oil companies and/or companies having nothing to do with oil.

It is important for any business to recognise the extent of market risk in the environment and how it can be responded to. This naturally requires understanding of the environment and its various components. Figure 2.2 depicts market risk and its components.

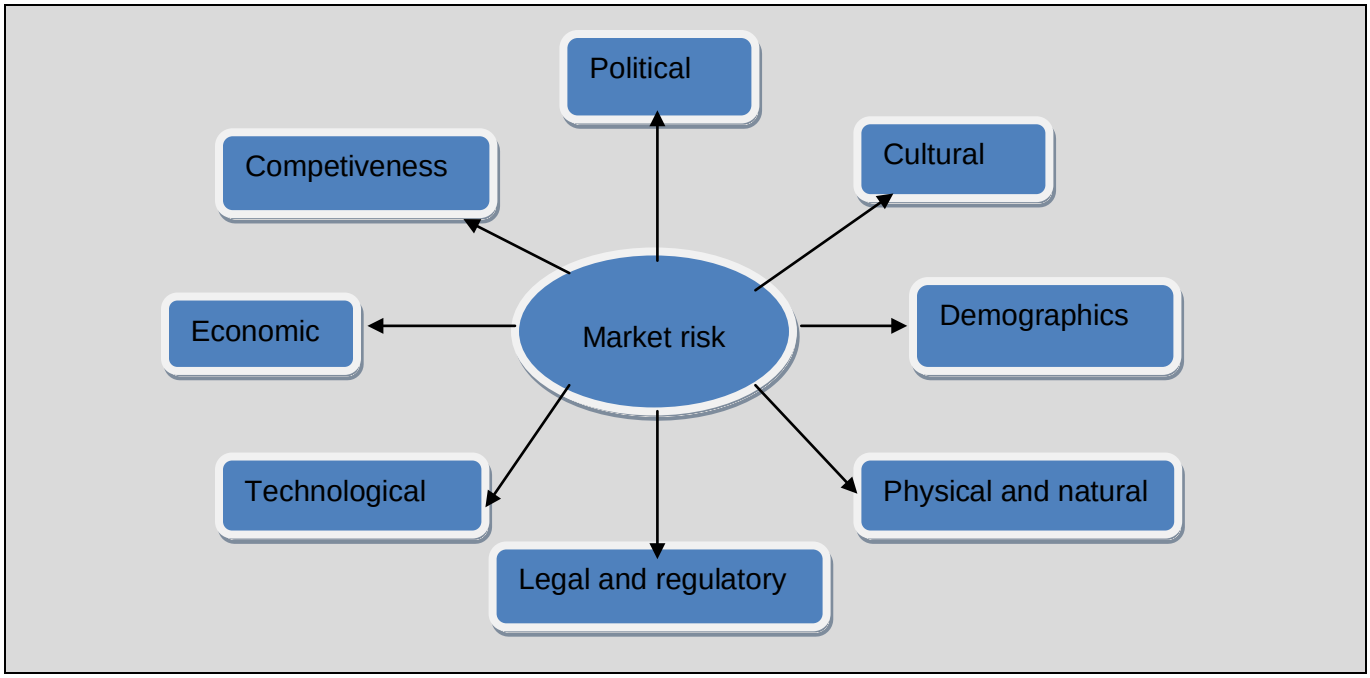


Figure 2.2: Market risk and its components

Source: Adapted from Chapman (2006)

According to Chapman (2006), each component has a direct impact on the welfare of a business:

- demographics trends affect the size of the market, its location and, to a degree, the kind of goods and services required.
- the legal and political characteristics of the environment affect a business particularly with regard to the ability to participate in foreign markets and the ease with which foreign competitors are able to enter the domestic market.
- changes in the economic environment affect marketing by way of the pattern of economic growth and movements in interest and exchange rates.
- innovation and technological advances introduce standards for competition and opportunities for the marketing of new products and services.
- competition can both limit and erode market share.
- legislation introduced to protect the environment can raise the unit cost of production while at the same time creating new opportunities. It is necessary for any business to monitor the macro environment to ensure that an appropriate response is adopted at micro level.
- environmental analysis allows the business to respond to changes and to cope with marketing uncertainty.

The market prices of existing bonds generally decrease as interest rates increase because investors are not willing to pay par value to own a bond that pays less interest than other bonds available in the marketplace. Consequently, if an investor wants to sell their existing bonds, they would probably have to settle for less than they paid to buy them. Asset allocation is generally considered an antidote for market risk. If an investor's portfolio includes multiple asset classes it tends to be less vulnerable to a downturn in any one class. It may be necessary to liquidate a position during a down period in the cycle, because general market pressures will cause the value of an investment to fluctuate. Market risk is high for securities with above-average price volatility and low for stable securities such as treasury bills.

According to Du Plessis (2000), market risk manifests itself when there is a general decline in market prices, which are not necessarily directly related to the specific company. It can be described as an abnormal difference between the market price and the intrinsic value of shares. Sometimes, after an in-depth examination has shown that the earning potential of an investor/company justifies the price at which the share was bought, the market price still drops to

below this value. This leads to a capital loss if the investor is forced to sell. Sometimes even an increase in the earnings of a company is accompanied by a decrease in the market share price.

According to Chapman (2006), market risk is typically measured using a value-at-risk (VaR) methodology. VaR measures the worst loss that might be expected over a given time interval, given normal market conditions and with a specific confidence level. VaR is well established as a risk management technique, but it contains a number of limiting assumptions that constrain its accuracy. The first assumption is that the composition of the portfolio measured remains unchanged over the single period of the model. For short-time horizons, this limiting assumption is often regarded as acceptable. For longer-time horizons, many of the transactions in the portfolio may mature during the modelling period. Intervening cash flow, embedded options, changes in floating interest rates, and so on are ignored in a single period modelling technique. Since market movement is the reason why investors make money from stocks, volatility is essential for returns, and the more unstable the investment the better the chances that it will experience a dramatic change in either direction (realising a profit or making a loss). Protection against market instability is crucial for investment success, which will be covered in the next section.

2.4.3.2 Control measures

Du Plessis (2000) discusses certain preventative measures, which can be taken to protect an investment against market risk to a certain extent. Firstly, the historical price behaviour of a share requires careful study. Just as a historically stable pattern of growth will tend to maintain itself in future, a historically fluctuating market price will probably also fluctuate in future. Shares, which have a stable growth pattern, stable income and further growth potential, offer the best protection against market risk.

Secondly, with careful planning, an investor could avoid buying shares at relatively high prices during a general bull market, when the market risk is at its greatest. Technical analysis can be of great value when timing the market movements.

Thirdly, an investor could maintain a sufficiently long investment period to survive any decline as a result of the market risk and then turn the ensuing increase in the general market price to good account.

Fourthly, investment in the so-called rand-hedged shares and stocks offers a certain amount of protection since the income and dividends of these institutions are not subject to the economic and political instability of South Africa. The assets and activities of these institutions usually fall outside the boundaries of South Africa, with the result that their performance depends on the political and economic climate of the countries within which they operate. Since an important holding interest of such companies is still established in South Africa, the profits are channelled back here and paid out to investors. Rand-hedgers, however, are generally relatively expensive. As with other classes of risk examined, market risk must be addressed as a primary risk and opportunity. Clearly, market risk has some overlap with several of the other classes of risk, such as technological, economic and social risk. The primary importance to any understanding of market risk for an investor is comprehension of the market structure to understand both the opportunities and the threats from existing and potential competition. Hence, the market forecasting process is crucial in addressing the sources of risk. Since market risk is closely linked to inflation and interest rate risk, the next section will focus on inflation risk, followed by interest rate risk.

2.4.4 Inflation risk

When inflation occurs (the cost of goods and services increase), the value of a currency decreases because investors will not be able to purchase as much with the same currency as they previously could. For example, if one rand could buy three candy bars last year and today it can buy only two, the purchasing power of the rand has decreased. In periods of declining price levels (deflation), the purchasing power of a currency increases. The following are definitions of inflation risk by various authors:

- According to Du Plessis (2000), inflation risk refers to the general increase in prices, without the necessarily increase in productivity.

- Chapman (2006) defines inflation risk as a sustained general increase in prices which negatively affects the value of an investment;

- Appel (2008) defines inflation as the overall general upward price movement of goods and services in an economy, usually measured by the consumer price index (CPI) and the producer price index (PPI).

- According to Gitman and Joehnk (2008), inflation risk is a possibility that changing price levels will adversely affect investment returns. Inflation is also known as the purchasing power of goods and services (Appel, 2008).

For the purposes of this study, inflation is defined as the sustained upward price movement, which negatively affects the value of an investment. There are two types of inflation: demand inflation and cost-push inflation (Du Plessis, 2000). Demand inflation means too much money in circulation and too few goods and services for the money to buy; therefore, prices increase. Under cost-push inflation, input costs increase for various reasons, such as higher labour costs and weakening of the exchange rate (Gitman and Joehnk, 2008). Offshore investors should take into account the following factors when considering inflation risk.

2.4.4.1 Factors of inflation risk

According to Appel (2008), inflation is greatly feared by investors because it decreases the value of their investments. For example, R100.00 today is not the same as R100.00 ten years ago. It is therefore crucial for investors to include measures of expected inflation when calculating the expected return on investments.

Another example is that, if R1 000.00 is invested for a year with an expected return of 5%, an investor will be giving up R1 000,00 today for R1 050.00 in one year. If, over the course of the year, there had been an inflation rate of 6%, the purchasing power of R1 000.00 would have decreased by R60.00 and an investor would actually have lost value. This means the investor would have lost R10.00 (R1 050.00-R1 060.00) in real terms. Capital gains tax investors pay may also increase the loss value. It is, therefore, important for investors to be aware of the effects of inflation on their investments. This could be done by always determining the real rate of return, which is the return after factoring in the effects of inflation. Inflation can erode the value of investments, such as stocks, cash and bonds. According to Roelf (2009), some investors believe that investments in real goods, such as property, are protected from inflation.

This is because the value of a real good is determined to a large extent by its intrinsic nature, as opposed to money, which is valued only for what investors can trade it for. When inflation is on the increase, the price of property or a car may simply increase at a similar rate, insulating it from price erosion. However, the same cannot be said for a 10-year bond. As a result, some investors seek protection from inflation and investment options, which protect them from inflation like Treasury Inflation-Protected Securities, commonly known as TIPS. These investments are like bonds, except that they are insulated from the effects of inflation.

The above description explains why investors follow CPI and PPI reports closely. In addition to being aware of the current rate of inflation, it is crucial for investors to be aware of expected inflation rate movements. Both the value of current investments and the attractiveness of future investments will change depending on the outlook of inflation. The effect of inflation is that money has less purchasing power. If the general increase in prices (rate of inflation) is higher than the rate of return on an investment, the real return will be negative. Investors need to be mindful of the effects of inflation and guard against any movement that can be detrimental to their investment success.

2.4.4.2 Control measures

According Du Plessis (2000), investors will have to adapt the strategy for their entire portfolio as a hedge against the inflation risk. Firstly, it is unwise to put all eggs in one basket. The diversification of investments into monetary assets, ordinary shares and real assets spreads the risk, since inflation does not affect all assets to the same extent.

Secondly, timing is extremely important, because the largest portion of the portfolio should continually be channelled where the effects of inflation are the least felt. Most non-monetary assets tend at least to increase in value with the inflation rate.

Thirdly, seeing that some countries are more successful in curbing the inflation rate than other, international diversification is a solution for the wealthy investor. However, exchange controls regulations can curb diversification as far as South Africans are concerned (South Africans are limited to R2 m offshore investment). Political instability in other parts of the world can also put a damper on such diversification.

Fourthly, the prudent choice of company shares in industries with considerable growth potential, which have good opportunities for expansion in their market, will usually yield real growth. Certain stock, such as participative preference shares, convertible preference shares and debentures, offer the investor the opportunity of sharing in the success of the company if the expected growth in profit is realised.

Finally, investments in rand-hedged shares and stock also offer protection against the inflation risk, since the income and earnings are not subject to the fairly high South African inflation rate (Du Plessis, 2000).

In conclusion, Chapman (2006) warns that inflation is generally considered a problem for investors. Some economists, mainly monetarists, have claimed that inflation creates unemployment, lowers growth and increases cost of production and uncertainty. This lowers the profitability of investments and makes businesses less likely to take risk associated with any investment project. Lower investments result in restricted long-term growth. Monetarists argue that inflation is caused by excessive increases in the money supply. Some Keynesians[1] believe that excess demand in the economy is the principal cause of inflation. Whatever the reasons for high inflation, investors need to be mindful of the effect of inflation and how best to position their offshore investments to contain inflation risk.

2.4.5 Interest rate risk

According to Whittaker (2009), interest rate is the rate payable on borrowed money. This rate is applied to the principal of a loan and can be compounded in many ways. For example, interest rates can be compounded daily, weekly, monthly or annually. According to Sharpe (2007), interest rate risk is a general increase or decrease in market interest rates as a result of the monetary policy of the central bank. After the central bank has adapted its general lending rate, those in the banking sector alter their own prime and other lending rates accordingly. This has a ripple effect throughout the entire economy and influences all economic activities because changes in interest rates affect cash, bonds and stocks.

[1]Keynesian economies are based on the work of John Maynard Keynes, who is referred to as the creator on modern macroeconomics. His idea is recorded in his very popular book called *The General Theory of Employment, Interest and Money.*

2.4.5.1 Factors of interest rate risk

According to Bodie, Kane and Marcus (2004), changes in interest rates influence the value of investor's stocks, cash and shares. As a result, the risk of a particular investment could increase as interest rates increase. As risk increases, the cost of stocks decreases and investors may lose money. However, the converse is actually beneficial. For example, if interest rates are reduced, stock prices are bound to increase. Investors could make money by selling stock at a higher price. An increase in interest rates will increase the cost of capital (Chapman, 2006).

An investment company operating under a high interest rate phase needs to ensure that they create high returns for their stakeholders, as high interest rates decrease profits. High interest rates decrease profits by reducing stock value, and a company can suffer a loss as a result. It is important to keep in mind that investment companies also have debts. An increase in interest rates means that the companies' monthly obligations go up in price. If the company cannot afford the increase, their viability will be compromised. An increase in interest rates is usually an indicator of a slowing economy. A higher interest rate deters households and businesses from purchasing goods and services and investing in stock options that may increase investment growth, respectively. This causes sales, profits and stock prices to decline.

In addition, Sharpe (2007) warns that there is normally an inverse relationship between an investment asset and the interest rate. For example, interest rate risk arises when the market value of a share is low due to market forces (demand and supply of a particular asset). Should interest rates decrease, share prices ought to increase, for the converse reasons.

According to Sharpe (2007), interest rate levels change frequently due to changes in the demand for and supply of funds in the capital markets. Any movement in the level of interest rates results in a change in bond values. This is because the prices of bonds are determined by discounting the cash flow expected by investors. Since the coupon rate and the time to maturity of bonds remain constant, all capital gains or losses could, in fact, be ascribed to interest rate risks. Interest rate risk arises when the market value of a share decreases as a result of an increase in market interest rates. This may affect both ordinary shares as well as fixed-interest-bearing securities.

The result of an increase in interest rates is that a certain portion of the capital invested in shares is channelled into interest-bearing investments, because the higher income from interest with relatively less risk makes it more attractive to some investors than the risk-return relationship of ordinary shares. The ensuing drop in share prices should stabilise at the level where the accompanying increase in total yield rate compensates for the greater risk of the shares.

According to Mody (2007), the amount of capital which will be affected by such changes in interest rates will depend on the investor's risk-return profile. A fixed-interest-bearing security with a relatively low coupon rate and a long term remaining to maturity will have a relatively larger price change for a given change in market interest rates than one with a high coupon rate and a short term remaining before maturity. This change in price occurs despite the fact that the investment merits of the issuer of the security have not changed in any way.

The role of interest rates in investing can sometimes be complicated and difficult to understand. In general, increasing interest rates are unfavourable for investors because it is unfavourable for the companies they are investing in. Investors need to educate themselves about interest rates and systems used to determine the movements of interest rates by foreign countries. This could help offshore investors adjust their financial plan and investment portfolio to compensate for the increased rates if they anticipate a rise in the interest rate and vice versa.

2.4.5.2 The movement and forecasting of interest rates

Investors in bonds are particularly interested in the future level of interest rates in order to determine the effect interest rates might have on price movements. It is therefore of the utmost importance to be able to forecast interest rate movements as accurately as possible since bond prices have a direct effect on capital gains and losses for investors. The forecasting of the general level of interest rates and the variables can be explained by looking at the most important economic factors, as set out in the sections below.

2.4.5.2.1 Demand for and supply of funds

Market forces such as the demand for and the supply of funds determine interest rates. A country's total savings represent the amount of funds available for investment. The amount of savings that enters the financial markets of a country originates from the following:

- **Personal savings** – represent the surplus income of all individuals after taxation. There are two kinds of personal savings, namely contractual savings and discretionary savings. Contractual savings consist of savings at financial institutions according to a contractual agreement between a depositor and a particular financial institution, such as a pension fund contribution. Discretionary savings, on the other hand, are voluntary savings without any previous contractual commitment (Mody, 2007).

- **Net savings by private businesses** – consist of net profit after provision for depreciation plus capital gains or losses not paid out as dividends. Parts of these funds are usually invested in debentures and ordinary shares issued by private companies, and eventually end up in the money and capital markets.

- **Government savings** – consists of the surplus funds available after expenditure by all central and regional government departments, local authorities and government organisations. The demand for funds represents claims on the funds which have been saved within an economy. This demand for funds originates in the private sector, government organisations and the central government itself. In circumstances where demand exceeds the supply of funds, this pressure causes an increase in the general level of interest rates.

2.4.5.2.2 Monetary policy of the government

According to Bodie *et al.* (2004), monetary policy refers to the manipulation of the money supply to affect the macro-economy and is the other main leg of the demand-side policy. Monetary policy works largely through its impact on interest rates. Increases in the money supply lower short-term interest rates, ultimately encouraging investment and consumption demand. Over longer periods, however, most economists believe a higher money supply leads only to a higher price level and does not have a permanent effect on economic activity.

Thus, the monetary authorities face a difficult balancing act. Expansionary monetary policy will probably lower interest rates and thereby stimulate investment and some consumption demand in the short run, but these circumstances will ultimately only lead to higher prices. In order to combat inflation, the monetary authorities in a country usually tighten monetary policy, which entails various actions that could affect long-term interest rates in general. If the growth rate of the money supply exceeds the target set by monetary authorities, the demand for consumer credit may be restricted by increasing the bank rate, which will eventually influence the trend of interest rates in general.

2.4.5.2.3 Fiscal policy developments in the country

According to Bodie *et al.* (2004), fiscal policy refers to the government's spending and tax actions and is part of demand-side management. Fiscal policy is probably the most direct way either to stimulate or to slow the economy. Decreases in government spending directly deflate the demand for goods and services. Similarly, increases in tax rates immediately siphon income from consumers and result in fairly rapid decreases in consumption.

When there is increased pressure on government to spend more, this may cause a deficit in the central government budget. A further deficit may arise when the government fiscal policy does not make sufficient provision for the budgeted expenditure. This will lead to an increase in the demand for local as well as international financing. The competition between the government and other local lenders pushes interest rates above the level which would normally prevail if the government had not been a participant in the capital market.

2.4.5.2.4 Political attitude of investors

The perceptions of foreign investors with regard to investment opportunities in South Africa are influenced, to a large extent, by political development in the country. For example, when investment confidence in South Africa turns negative, both South African and foreign investors will start to disinvest and also become reluctant to make any further investments in the country. Any outflow of foreign capital causes a decline in the supply of funds and consequently also has a negative effect on the current account of the balance of payments. A further consequence is an increase in the demand for funds both here and abroad, which will eventually exert upward pressure on interest rates, resulting in a declining economy.

2.4.5.2.5 Inflation

Efforts on the part of government to curb the rate of inflation are usually accompanied by an increase in interest rates. Higher interest rates, in turn, increase the cost of credit, and this could eventually limit the demand for goods and services in a country. Some of the main factors, which have an influence on the interest rate as well as other factors, do not function in isolation, but have implications for many other aspects of a country's economy.

2.4.5.3 Control measures

The trend of market interest rates should be researched and analysed as accurately as possible. There are usually very clear signs and indicators when a change in the market interest rate is imminent. The knowledge gained in this way should be used to invest accordingly. If an increase in market interest rates is expected, the relatively conservative investor can possibly liquidate share investments so as to have cash available to invest in interest-bearing stock. The interest rate risk on fixed-interest-bearing stock can be reduced in the following ways:

- by concentrating on stock with a short remaining term;
- by retaining stock until maturity date, when a face value is paid out; and
- by distributing investment among stocks so that they are not all purchased at the same coupon rate.

The balance sheet and cash flow statements of companies, which have a high foreign capital component should be carefully analysed, bearing in mind the effect that an increase in interest rates can have on such companies' cash flow. At the same time, an analysis should also be made of foreign capital in order to establish how it is divided into long-, medium- and short-term investments.

2.4.6 Financial risk

Investors need to understand what risk means to its business operations (Olson and Dash Wu, 2008). Essentially, this means knowing whether risks complement, enhance or harm business activities, or whether risks form a significant part of revenue generation. A typical bank, for instance, is in the business of taking risks and generating revenues based on extending risks. Risk activities should be consistent with the overall goals, so the bank's philosophy should encourage initiatives related to the prudent management of risk exposures. Various authors define financial risk as follows:

- According to a Risk Management guide by University of South Africa (2005), financial risk entails an exposure to uncertainty that could lead to a possible monetary loss. However, to be able to manage the risks, it is important to measure it.

- According to Van Horne and Wachowicz (2005), financial risk is the uncertainty introduced by the method by which the business finances its investments. If a business uses only common stock to finance investments, it incurs only business risk. If a business borrows money to finance investments, it must pay fixed financing charges in the form of interest to creditors prior to providing income to the common stockholders, so the uncertainty of returns to the equity investor increases. This increase in uncertainty because of fixed-cost financing is called financial risk or financial leverage, and this causes an increase in the stock's risk premium. Depending on the nature of the investment, the type of investment risk will vary. High-risk investments have greater potential rewards, but also have greater potential consequences.

- Chapman (2006) defines financial risk as the exposure to adverse events that erode profitability and, in extreme circumstances, bring about business collapse.

- According to Wikipedia (2009), financial risk is normally any risk associated with any form of financing. Risk is a probability of an unfavourable condition in the financial sector. It can also be seen as the probability of actual return being less than expected return. There is uncertainty in every business. The level of uncertainty present is called risk.

According to Chapman (2006), financial risks also include the following:

- failure of financial systems, regulatory non-conformances or compliance issues;
- bad debt, adverse changes in exchange rates, overdependence on a single supplier;
- loss of key customers, loss of offshore investments and poor hedging decisions; and
- poor investment decisions.

The sources of risk considered to be embraced within the term **financial risk** are considerable. Chapman (2006) considers these to include but not limited to:

- liquidity risk arising from a short-term inability to meet financial obligations, such as the business suppliers, the premise's landlord or staff remunerations;
- credit risk, stemming from lack of payment of goods supplied to the business on credit;
- interest rate risk, affects consumer's disposable income, resulting in trade deterioration;
- currency risk in terms of expected cash flow from overseas investments being adversely affected by fluctuations in exchange rates;
- funding risk for borrowers in relation to being unable to meet capital repayment requirements (and interest) and having to pay fixed charges on the company assets;
- foreign investment risk, such as restrictions on the right to repatriate funds, high levels of taxation on profits earned offshore, the temporary freezing of bank account balances and/or the expropriation of assets;
- derivatives risk arising from speculation in the markets or hedging by buying forward with the aim of buying a commodity at a price lower than the prevailing price;
- systems risk, such as loss as a result of failure caused by the breakdown of business procedures, processes or systems and controls;
- outsourcing risk arising from a default of a counterparty that has gone into liquidation, failed to deliver goods by due date or breached contract conditions; and
- capital risk arising from a loss of initial amount invested.

When considering an offshore investment, the above-mentioned financial risks should be reduced to the minimum. According to Aggarwal (2005), financial risk management is the practice of creating economic value in a business by financial instruments to manage exposure to risk, particularly credit risk and market risk. Other types include foreign exchange, shape, volatility, sector, liquidity and inflation risks. Similar to general risk management, financial risk

management requires identifying its sources, measuring it, and putting control measures in place.

In practice, financial markets are not likely to be perfect markets. This suggests that business managers are likely to have many opportunities to create value for shareholders using financial risk management. The challenge is to determine costly risks in relation to less costly risks for the investors to manage. A general rule of thumb, however, is that market risks that result in unique risks for the business are the potential for financial risk management. According to Chapman (2006), financial risk management presents investors with opportunities such as:

- improving financial planning and management, which is the focus of corporate governance;
- facilitating more robust investment decisions;
- informing hedging decisions;
- encouraging the development of constant monitoring of markets and the economy to make informed decisions; and
- encouraging the practice of due diligence when outsourcing and engaging with counter-parties.

In conclusion, financial economics prescribes that investors should take on an investment that increases value. Finance theory also shows that fund managers cannot create value for investors by taking on investments that investors could do for themselves at the same cost. When applied to financial risk management, this implies that fund managers should not hedge risks that investors can hedge for themselves at the same cost. This notion is captured by the hedging irrelevance proposition. In a perfect market, the investment company cannot create value by hedging a risk when the price of bearing that risk within the business is the same as the price of bearing it outside of the business. Financial risk is one risk no business can afford to neglect. It is therefore critical for investors to develop a sound system of financial risk management.

This section focused on the management of financial risk by considering the various definitions of financial risk and the benefits of financial risk management. One of the sources of risk considered to be embraced within the term **financial risk** is credit risk, which will be discussed next.

2.4.7 Credit risk

Movements of financial capital between countries are normally dependent on either credit or equity transfers. Credit is in turn dependent on the reputation or creditworthiness of an investor that takes responsibility for the funds. This section will focus on credit risk as an essential risk to consider when investing offshore. The following are definitions of credit risk by various authors:

- Banks and Dunn (2003) define credit risk as loss due to an inability or unwillingness by a counterparty to pay on its financial obligations, which usually leads to a default and losses for those extending credit.

- According to Bilardello and Ganguin (2005), credit risk is defined as a risk that a counter-party to a transaction will fail to perform according to the terms and conditions of the contract, thus causing the holder of the claim to suffer a loss.

- For Chapman (2006), credit risk is defined as the economic loss suffered due to the default of a borrower or counterparty. Banking institutions describe credit risk as the risk that customers default, in other words, they fail to comply with their obligations to service debt.

- According to Young (2006), credit risk is the risk that a counterparty to a financial transaction may fail to perform according to the terms and condition of the contract.

- Wagner (2008) defines credit risk as a failure to make required debt payments on a timely basis or to comply with other conditions of an obligation or agreement. It may comprise, for example, the possibility that a bond issuer will default by failing to repay the principal amount and interest in the time agreed upon.

- According to Olson and Dash Wu (2008), credit risk is the risk that a counterparty may be unable to perform an obligation.

Actual credit losses depend on the collateral and netting agreements. In some (but not all) instances, collateral taken can be liquidated upon default to cover losses, while a netting agreement allows a portfolio of deals to be collapsed into a single payable or receivable.

According to Banks and Dunn (2003), credit risk can appear in the form of:

- **direct credit risk** – the risk of a counterparty defaulting on the direct, unilateral extension of credit, such as a loan, security, receivable or deposit;
- **trading credit risk** – the risk of loss due to a counterparty defaulting on a bilateral obligation, like derivatives or repurchase agreement;
- **contingent credit risk** – is the risk of loss due to a counterparty defaulting on a possible future extension of credit;
- **correlated credit risk** – appears in certain financial transactions and increases the magnitude of potential loss;
- **settlement risk** – the loss due to a default after a payment of foreign exchange or delivery of securities has been made to a counterparty, but before an equivalent exchange has been received from the same counterparty; and
- **sovereign risk** – the risk of loss due to actions taken within a country's financial system. This can occur through exchange controls and devaluation, for example a regulation preventing offshore participants from converting and possibly withdrawing local funds or a large financial depreciation in the value of a local currency.

According to Rose and Hudgins (2005), an investor must consider three issues when assessing credit risk from a single counterparty:

- **Default probability** – assesses the likelihood that the counterparty will default on its obligation either over the life of the obligation or over some specified horizon, such as a year. When calculated for a one-year horizon, this is called the expected default frequency.
- **Credit exposure** – assesses the credit exposure in the event of a default, and the size of the outstanding obligation when the default occurs; and
- **Recovery rate** – which means that, in the event of a default, a fraction of the exposure may be recovered through bankruptcy proceedings or some other form of settlement.

When credit quality of an obligation is considered, this refers generally to the counterparty's ability to perform on that obligation. This encompasses both the obligation's default probability and the anticipated recovery rate. Many forms of credit risk, especially those associated with larger institutional counterparties, are complicated or unique or they are of such a nature that it is worth assessing them in a less prescribed manner. The term **credit analysis** is used to describe any process for assessing the credit quality of a counterparty.

While the term **credit risk** can encompass credit scoring, it is more commonly used to refer to processes that entail human judgment. Offshore investors should assess and review information about the counterparty. This might include the counterparty's balance sheet, income statement, recent trends in its industry, and the current economic environment. Credit risk provides another likely explanation of why the required rate of return is not always realised. Default bonds are defined as those which constitute failure to pay interest or where the interest is in arrears. From an investor's point of view, insolvency can be regarded as a serious issue where the repayment of the capital sum in total or in part is at stake. When the required rate of return is equal to the actual rate of return, this means that the issuer has met the obligations stipulated in the agreement.

Accordingly, investors will receive the required rate of return provided that all the obligations are met at the time of maturity. The extent of credit risk is determined by the difference between the yield on risk-free government stock and the yield on company debentures with a certain degree of risk. This difference indicates the additional return investors require on risky debentures to induce them to invest in such securities. According to Rose and Hudgins (2005), credit risk is determined by the extent of financial and business risk to which the issuer is exposed. In the case of company debentures, the extent of business risk is determined by the uncertainty surrounding the enterprise's product prices, markets input prices and technological and management efficiency. These factors, in turn, are affected by the general level of business activities, business confidence, the monetary and fiscal policy of a country and many other related aspects.

In conclusion, Chapman (2006) argues that credit risk is the oldest and perhaps the most important of all risks in terms of the size of potential losses. Defaults by a small number of large customers can generate large losses, which can lead to insolvency. Thus, offshore investors need to mitigate credit risk at all cost. Credit risk can be mitigated by taking out credit risk insurance, which is available in many countries for local and offshore investors. When credit risk is well managed, offshore investors will not be exposed to liquidity and legal risk, which will be discussed in the next section.

2.4.8 Liquidity risk

A liquid asset has some or more of the following features. It can be sold rapidly, with minimal loss of value, any time within market hours. The essential characteristic of a liquid market is that there are ready and willing buyers and sellers at all times. Liquidity risk is defined as follows:

- Williams, Smith and Young (1998) define liquidity risk as the uncertainty introduced by the secondary market for an investment.

- Banks and Dunn (2003) define liquidity risk as the loss due to a mismatch between cash inflows and outflows and this may arise from an inability to sell a position (asset liquidity risk), fund a position (funding liquidity risk), or both.

- Bodie *et al.* (2004) define liquidity risk as the difficulty with which an asset can be sold and still fetch a fair price. It is the relationship between the time dimension (how long it will take to sell) and the price dimension (the discount from fair market price) of an investment asset.

- According to Tracy (2005), liquidity risk is an investment that has no immediate access to either the ability to buy or sell the investment, such as a stock or mutual fund, or the ability to access and withdraw funds, such as a savings account.

- For Chapman (2006), liquidity risk is the risk that a business will be unable to obtain funds to meet its obligations as they fall due either by increasing liabilities or by converting assets into money without loss of value.

- Gitman and Joehnk (2008) define liquidity risk as the inability to convert an investment into cash quickly and with little or no loss in value. It is absolutely crucial for investors that some of the investments made be liquid enough to be disposed of easily should they run into cash-flow difficulties.

The advantages of liquid investments are twofold: firstly, many banks prefer liquid assets, and so are more likely to extend a credit line should investors run into a cash flow crisis; and secondly, even if the bank does not like it, investors can always sell the assets themselves (Tracy, 2005).

Highly illiquid and non-traded investments, such as private real estate, leveraged buyouts and venture capital, have historically been very hard to compare to traditional investments. This is particularly problematic when investors consider how to include these assets in a traditional portfolio of assets.

For the purposes of asset allocation, it is critical that illiquid asset classes be made comparable to liquid asset classes. An estimation procedure may help to assess the true risks and diversification benefits presented by illiquid asset classes more accurately. Even though the approach involves some assumptions, it should provide a better picture of the variations in illiquid returns. When an investor acquires an asset, it expects that the investment will mature or that it will be sellable to another investor.

In either case, the investor expects to be able to convert the security into cash and use the proceeds for current consumption or other investments. The more difficult it is to make this conversion, the greater the liquidity risk. According to Rose and Hudgins (2005), an investor must consider two questions when assessing the liquidity risk of an investment:

- how long will it take to convert the investment into cash?
- how certain is the price to be received?

Similarly, uncertainty faces an investor who wants to acquire an asset:

- how long will it take to acquire the asset?
- how uncertain is the price to be paid?

Liquidity risk can be regarded as one of the key risks an investor should consider when investing offshore. Liquidity management will not only ensure that risks are kept minimal but also that opportunities presented are exploited.

2.4.9 Legal risk

According to Young (2006), legal risk is the risk arising from violation of or non-compliance with laws, rules, regulations, prescribed policies and ethical standards. This risk also arises when laws or rules governing certain products or activities of an organisation's customers are unclear or untested. According to Chapman (2006), legal risk is defined as failing to operate within the law, to be aware of legal obligations, to honour contractual commitments, to agree remedies for

compensation with the offshore company in the event of default, and to show evidence that an institution has operated within the law, or to recognise and effectively manage legal threats. According to Rose (1999), the scope of legal risk for a business may be considered to include, but is not limited to:

- breach of environmental legislation;
- inaccurate listing information in terms of misstatements, material omissions or misleading opinions;
- breach of copyright;
- loss of business as a result of senior management time being lost through a protracted legal dispute;
- prosecution for breach of the law;
- legal disputes with offshore trading partners arising from a lack of appreciation of the difference between the local laws and English law;
- loss of reputation as a result of a prosecution or a dispute with a customer, partner or supplier; and
- loss of legal disputes through poor record keeping.

Offshore investors' objectives may be compromised when legal risk is not minimised in a foreign country. Failure to manage legal risk can result in the cancellation of offshore investment contracts, penalties, fines and termination of trading licenses in extreme cases, which will be detrimental to the investors' objectives in the international arena. However, when legal risk is managed, offshore investors can realise great benefits, which will be discussed next.

2.4.9.1 Benefits of legal risk management

Non-compliance can expose the organisation to fines, financial penalties, payment of damages, and the voiding of contracts. It could also lead to a diminished reputation, reduced franchise value, limited business opportunities, restricted developments and an inability to enforce contracts (Young, 2006). According to Chapman (2006), legal risk management affords an offshore investor benefits as it:

- reduces the amount of management and external support time in legal disputes;
- provides for greater offshore contractual, regulatory and statutory compliance;

- reduces the offshore risk of reputational damage; and
- promotes a more thorough review of contracts engaged in domestically and offshore.

Just like any other risk, a well-managed legal risk can offer investors good returns, a good reputation and a competitive edge in an offshore country. Managing legal risk is an ongoing process as offshore countries revise trading rules and regulations from time to time. Therefore, it is necessary to have control measures in place in case legal threats arise.

2.4.9.2 Control measures

Offshore investors need to be well aware of the consequences of legal risk and should contain this risk as it could damage the reputation of the company and ultimately cease offshore operations, resulting in investors losing their investments. Chapman (2006) argues that the development of a sound system of legal risk management will depend on a number of issues such as:

- understanding the legal framework within which companies operate;
- having legal representatives review major contracts before completion;
- maintaining legal representation;
- ensuring annual reports and accounts are accurate;
- ensuring compliance with client confidentiality requirements;
- ensuring compliance with copyright, trademark and patent law;
- reviewing current product law prior to the release of new products into existing and new markets;
- maintaining systems and processes which adhere to employment law;
- ensuring employees are aware of the law that they have to adhere to in the fulfilment of their role and duties and providing training and monitoring where required; and
- providing effective legal defence against challenges.

Legal risk should be considered before investing in offshore countries by ensuring a good understanding of the offshore legal framework within which investments are envisaged to be channelled to. Investors need to ensure compliance with copyright, trademark and technological advancement of the offshore country in relation to domestic country. Technological risk will be discussed next.

2.4.10 Technological risk

Technological risk has become a major concern for offshore investors in recent years. Since the 1980s, banks, insurance companies and offshore investment companies have sought to improve operational efficiency with major investments in internal and external communications, computers and an expanded technological infrastructure.

Technological risk arises when existing technology malfunctions or back-office support systems break down (Saunders and Cornett, 2008). According to Chapman (2006), technology risk refers to sources of risk that are considered to be embraced within the term **technology**. Technology risk includes the following:

- lack of investment in technology and the resultant erosion of the ability to compete;
- inadequate technology governance and, in particular, IT governance;
- inadequate management of outsourcing;
- lack of alignment of information technology (IT) to the business objectives;
- inadequate protection against viruses, hacking and loss of confidentiality of information; and
- inadequate flexibility of production to be able to produce small production runs in an economic way.

Poor technology can lead to offshore investments having to withdraw offshore investments as a result of an inability to compete, leading to frustrations and losses. When investors envisage offshore investments, they need to ensure that they can afford the technology needed to trade with their offshore counterparts. There are technological factors that need to be considered by offshore investors before investing offshore. These factors are discussed in the next section.

2.4.10.1 Factors of technological risk

Without up-to-date technology, investors may fail to notice opportunities emerging in an offshore arena. Investors may also suffer losses due to late reaction on an anticipated loss that could have been prevented if up-to-date technology was in place. According to Wilkinson (2009), technology risk management affords an investor benefits as it:

- improves the quality of information for decision-making; hence, business leaders who succeed will take advantage of a new way of doing business based on the increasing velocity of information and building advanced processes and products faster than the competition;
- sets out the risks to investment in technology and promotes a proactive approach to managing technology projects;
- maps the threats of existing business practices from emerging businesses to customer relationships;
- draws attention to exposure to the loss of market share arising from a competitor's improvement in product design; and
- provides insights into the disadvantage of not aligning technology to strategy and offshore business operations.

Offshore investors need up-to-date technology to take advantage of offshore opportunities and benefits while keeping technological threats to the minimum. For any offshore investment to succeed, investors should have control measure in place should any threats arise. The next section will focus on the control measures that can be deployed to minimise technological threats.

2.4.10.2 Control measures

According to Wilkinson (2009), the development of a sound system of technology risk management will depend on attention being paid to a number of issues, including but not limited to the following:

- managing investment in technology to secure business objectives and optimise offshore investment benefits;

- ensuring the right information reaches the right people at the right time through a combination of management information systems and channels;
- understanding the risks of outsourcing;
- monitoring competitors to avoid being outmanoeuvred by the introduction of new technologies that shift industrial boundaries;
- embracing new developments in e-commerce; and
- implementing information security.

A key aspect of technology risk management is that of not being outwitted by the opposition and as a minimum keeping in pace with the opposition's developments. The omnipresent technologies of today are information, communication and controls. These technologies can raise productivity, lower cost and drive growth. Therefore, changes in technology are both an opportunity and a threat in terms of market share and market development. In addition, the introduction of technology within a business can also open the door to a series of debilitating risks, which may seriously erode profitability and competitive advantage, or at worst lead to business failure.

As such, technological changes can present opportunities as well as threats to offshore investments. Therefore, it is important for investors to conduct a thorough research of the technology used by their offshore counterparts to optimise the benefits while keeping risks at bay. Failure to manage technological risk or any other risk discussed above could lead to failure of an offshore investment plan.

2.5 Conclusion

Investors have several avenues through which they can invest internationally, but opportunities in international markets do not come without risk (Bodie *et al.* 2004). This chapter covered the definition of risk and risk exposure by various authors, and it was revealed that risk management is critical in successfully achieving offshore investments. Risk management was discussed in more detail by focusing on the rules of risk management and the risk management processes. It can be concluded that risk management processes are perceived differently by many authors; however, the key common components came out as: risk identification, risk evaluation, risk control, risk financing and risk monitoring.

These components need to be followed in a proper manner to minimise risk. For example, if a risk is not properly identified, then the evaluation will be misplaced, and the control measures will not minimise the risk. This could lead to financing and monitoring an insignificant risk, while the significant risk is ignored or overlooked.

Following the risk management processes was a detailed analysis of risk types considered to be a threat when investing offshore. The analysis of risk types was subdivided into definitions by various authors, factors to be considered by offshore investors as well as the control measures to put in place to minimise the risks. It was also evident that some risks are embraced in other risks. For example, finance risk is considered to include liquidity risk, credit risk, currency and capital risk. The critical point for investors is to consider risks in relation to their investment objectives, as some offshore investments will be free from certain risks while more exposed to others.

The next chapter will focus on the characteristics of offshore investments and the reasons and benefits of investing offshore. It will also distinguish offshore investments from domestic investments, and it concludes with an analysis of offshore investment pitfalls.

CHAPTER 3

OFFSHORE INVESTMENTS

3.1 Introduction

Since the value growth of domestic equities has far exceeded that of offshore investments in some years, some investors are asking this question: **What is the point of investing offshore?** This is, according to Thakerse (2005), who warns that offshore diversification is essential in reducing investment risk. The long-term case for diversifying offshore remains powerful even though the domestic currency might strengthen. Investing in multi-currency vehicles that diversify offshore risks across a range of currencies could be vital for offshore investors.

The core of this study was to manage the risks and risk exposures when investing offshore, which was dealt with in Chapter 2. Chapter 3 will focus on the term investments, the characteristics of offshore investments, the reasons and advantages of investing offshore as well as the offshore investment pitfalls.

3.2 Defining investments

Investments can be seen as a way of increasing wealth; however, there is generally no guarantee that investors will make a profit or even that they will get back the same amount invested in the first place. According to Rose and Hudgins (2005), investments are different from savings. They are typically designed for the longer term, and involve different types of risk. The next section will focus on the definitions of the term **investment** by various authors:

- According to Naidoo (2003), investment is the transfer of purchasing power to third parties for the purchase of assets. These assets could be Kruger rands, diamonds, coins, stamps, antiques and securities aimed at earning an income or a return. Returns could be in the form of interests or dividends.

- According to Reilly and Brown (2003), an investment is the current commitment of purchasing power for a period of time in order to derive future payments that will compensate the investor for the time the funds are committed.

- Farlex Financial Dictionary (2009) defines **investment** as the act of placing capital into a project or business with the intent of making a profit on the initial placing of capital. An investment may involve the extension of a loan or line of credit, which entitles the investor to a repayment with interest. An investment may involve buying an ownership stake in a business, hoping that the business will become profitable. It may, furthermore, involve buying a particular asset with the intent to resell it in future at a higher price.

- In finance, investment is regarded as the purchase of a financial product or other item of value with an expectation of favourable future returns. In general terms, an investment means the use of money in the hope of a possible gain (Investorwords, 2009).

For the purposes of this study, investment is summarised as the undertaking of risk and uncertainty for returns and rewards at a future date. Since the study focused on mitigating offshore investment risks, it is appropriate to explore the definition of offshore investments in detail.

3.3 Offshore investments

According to Kruger and Roper (2003), an offshore investment is an investment conducted in foreign countries, for example a South African investor investing assets in an institution or fund based in other countries. According to Wikipedia (2009), an offshore investment is the allocation of assets in a jurisdiction other than the investor's country of residence. This section focuses on the characteristics of offshore investments, the reasons and advantages of investing offshore as well as the offshore investment pitfalls.

3.3.1 Characteristics of offshore investments

According to Thakerse (2005), investing offshore became a common practice with many South African investors investing a portion of their investment assets in different foreign countries. This could have been influenced by the notion that diversifying investments globally would give investors a balanced exposure to different risks and returns as opposed to investments in domestic markets. Although this seems to be a good approach to investing, the level of offshore risk exposures and the type of investments chosen should be dependent on the investor's

objectives and risk tolerance. The characteristics of offshore investment will be discussed by exploring two components: asset allocation and investment performance.

3.3.1.1 Asset allocation

Asset allocation is not an isolated option but a component in an investment management process. In its simplest terms, asset allocation is the practice of dividing resources among different categories such as stocks, bonds, mutual funds, investment partnerships, real estate, cash equivalents and private equity (Kennon, 2009). According to Reilly and Brown (2003), asset allocation is the process of deciding how to distribute an investor's wealth among different countries and asset classes for investment purposes. According to Evans (2007), asset allocation reduces the likelihood of losses related to an offshore portfolio relative to those associated with funds focused on a single asset class or market. The theory is that the investor can lessen risks because each asset class has a different correlation to the other assets. For example, when stocks increase, bonds often decrease. At a time when the stock market begins to decrease, real estate may begin generating above-average returns. However, investors need to be mindful that investing in foreign countries will not necessarily translate into success. Success on offshore investment is dependent on thorough research and planning as offshore investments could pose a threat if investments are made without proper research and risk evaluation (Reilly and Brown 2003).

To ensure success on offshore investments, investors could use an asset allocation model. This model may be used to determine the amount of assets placed into each class of the total portfolio. Asset allocation models are designed to reflect the personal goals and risk tolerance of an investor. Furthermore, individual asset classes can be sub-divided into sectors. If the asset allocation model warrants for 40% of the total portfolio to be invested in stocks, the investor may recommend different allocations within the field of stocks, such as recommending a certain percentage in banking, mining, manufacturing or telecommunications (Gitman and Joehnk, 2008). Asset allocation in this case means that once a decision to invest in stock is taken, the investor still needs to decide which stock to invest into.

The way investors allocate investments between asset portfolios is one of the most important decisions investors should make. According to Hull (2007), asset allocation affects overall performances of investments far more than market timing and individual investment selections.

Additionally, investors are cautioned not to be too concerned about domestic currency but to focus on diversifying investments into other countries. However, history has shown that investors cannot ignore the domestic currency completely, since the movement of the domestic currency in relation to other foreign currencies will have an effect on South African offshore investments, especially when returns are paid in domestic currency (Stopford, 2005). Focusing on domestic currency might be risky in the short term; however, investors should be able to preserve the buying power of their money in the longer term.

Once a decision to allocate assets in foreign countries is made, an offshore investor should consider an investment vehicle for investing offshore. According to Sharpe (2007), an investment vehicle is any method used to invest. According to Hands *et al.* (2008), the choice of an offshore investment vehicle will be influenced by the source of funds. The funds may already be held offshore, for example inheritances, foreign earnings and immigrant's funds. According to Naidoo (2008) and Hands *et al.* (2008), South African investors have two main entry points to foreign markets:

- **Direct offshore investment** – according to Hands *et al.* (2008), there are two categories of assets which South African residents may legitimately hold outside South Africa, and which may be invested directly into offshore investment vehicles.

  Firstly, there is a concession of R2m per person or R4m per family unit in foreign investments. The concession is available to natural persons over the age of 18 and is subject to the obtaining of a tax clearance certificate from the receiver of revenue. There are no limitations on the usage of the funds in terms of expenditure or investing in certain assets. The concession is a one-off and any portion used is set off against any future allowance of investing offshore. When investors use this option, the domestic currency is converted to foreign currency and the investor then has complete flexibility of choice with regard to the investment vehicles to use.

  Secondly, South African residents may also legitimately hold certain categories of foreign-sourced assets. These would include immigrant's funds, foreign income and inheritances from non-South African residents. While the investor may now have the benefit of a much larger investment universe to choose from, it necessitates a more vigilant approach to investing. Investors are cautioned to do their homework beforehand (Naidoo, 2008). The

homework could be done by using asset managers registered with a reputable financial services board (FSB). Using FSB-registered asset managers may relieve the administrative burden and also reduces potential administrative risks like lack of disclosure, embezzlement and fraud, which are often associated with investing in offshore markets.

According to David (2008), when using the direct offshore investment method, investors need to follow a bureaucratic process before investing offshore. Thus, South African offshore investors must:

- be over the age of 18;
- be registered as a taxpayer; and
- have a tax clearance certificate from South African Revenue Services (SARS).

Without meeting the above requirements, an offshore investor will not be eligible to invest offshore. However, once permission has been granted, the offshore allowance may be converted into the preferred currency and can be used to buy foreign investments. Therefore, offshore investors should have a reasonably good idea about countries they intend to invest in before they apply for the certificate.

Directly investing offshore may seem as the best way of entering the offshore arena. However, it is vital for offshore investors to take a look at the advantages and the disadvantages of using this option in relation to investing offshore indirectly. According to Hands *et al.* (2008), the following are advantages of direct offshore investments:

- **currency hedging** – any decrease in the value of the domestic currency will enhance performance;
- **hedging political risk** – the investment is in a stable political environment;
- **lower cost** – direct offshore investment usually has a lower cost;
- **choice of currency** – both the investment and the proceeds may be in the currency of the investor's choice;
- **freedom from exchange controls** – the investment may be made and proceeds may be paid wherever the investor wishes; and
- **tax** – income tax, estate duty and donations tax advantages, depending on the circumstances.

In addition, Hands *et al.* (2008), considers the following as disadvantages of direct offshore investments:

- **high entry levels** – can be high by South African standards since direct offshore investments are usually denominated in strong currencies; and
- **tax and estate planning** – specialist advice might be sought in these areas.

Investors' preferences differ. It may be ideal for some investors to use a direct offshore investment method while others may find the indirect offshore investment method more relevant to them and their circumstances. This discussion is now followed by the second entry point to foreign markets, the indirect offshore investment.

- **Indirect offshore investments** – when the South African government reduced exchange regulations, a number of options were introduced. One of these was the indirect offshore investment also known as **asset swap investment**. According to Hartmann and Veldtman (2001), this relaxation essentially meant that certain types of domestic institutions were allowed to take a percentage of the value of assets under management offshore, provided they were able to secure a reciprocal investment in South Africa.

  This allowed South Africans to enjoy some of the benefits of offshore investments, while ensuring that there was no drain on the country's foreign exchange reserves. The reciprocal investment requirement has since been done away with and institutions are allowed to invest assets outside South Africa. According to an article by Sanlam (2008), South African investors can invest offshore with a rand-denominated offshore investment option, meaning that investors can invest abroad using a domestic currency.

  There is no need per se for investors to apply to the South African Reserve Bank (SARB) for foreign exchange or to seek approval from SARS. This option allows fund managers to use investors' domestic currency to buy foreign investments through an asset swap arrangement with foreign partners. Under this option, the offshore investor receives its returns in domestic currency. Buying offshore investments in this way enables investors to gain access to foreign markets at lower entry levels. This effectively provides investors with exposure to foreign markets without having to physically take their money offshore. The value of the investment will be determined by the fluctuations of the underlying assets in the foreign market.

The fund manager may use an investment company's offshore allowance to invest in foreign markets, either directly or by securing the expertise of a foreign-based manager. A distinct advantage of this approach is that investors do not have to apply to the SARB for foreign exchange or seek approval from SARS to take funds offshore. Investors could also enjoy the protection of such a fund falling under the domestic regulatory umbrella of the FSB. On maturity or disposal of the indirect offshore investment vehicle, the proceeds will be paid out in South African rands (ZAR) (Saler, 1996). The indirect offshore investment has the following advantages:

- **currency hedging** – any decrease in the value of the domestic currency will enhance performance;
- **familiarity** – asset swaps are available in most familiar domestic investment vehicles, such as unit trusts, endowment policies and retirement annuities; and
- **low entry levels** – asset swaps in domestic investment vehicles are usually available with much lower contribution levels than direct offshore investments, and with regular monthly contributions.

On the other hand, Saler (1996) and Mody (2007) consider the following as some of the disadvantages of indirect offshore investment:

- **No country risk hedging** – the investment proceeds will be paid in ZAR, under the political, fiscal and exchange control regimes that are in effect at that time.
- **Higher cost** – there is often a double layer of management, with a domestic product provider and a foreign fund manager.
- **Tax** – the investment will be subject to whatever tax is applicable to the relevant domestic vehicle.
- **Capping** – many institutions have reached the limits imposed, meaning that they cannot accept further investment. Also, if the value of their domestic assets under management decreases, the offshore portion may exceed the limit. Under these circumstances, fund managers are sometimes forced to sell foreign securities and acquire domestic assets; and
- **Limited options** – the choice of vehicles and funds is limited.

- **Conclusion** – in both instances, potential investors need to understand the tax implications and costs before investing, because these could impact significantly on the end results. The appropriate asset allocation in different asset classes should increase the overall investment performance. Asset allocation is one of the most important investment principles for reducing risk exposures. The South African market represents about 2% of global assets allocations totals (as indicated in Figure 3.2 in the next section). Therefore, it stands to reason that limiting all financial exposure to one relatively small component of world markets leads to a high concentration of risks (Naidoo, 2008). The next section focuses on investment performance as the second component of the offshore investment characteristics.

3.3.1.2 Investment performance

According to Solnik and McLeavey (2003), investment performance is defined as the returns on an investment portfolio. The investment portfolio can contain a single asset or multiple assets. Investment performance could be measured over a specific period of time and in a specific currency. Investors often distinguish between different types of returns, for instance, the distinction between the total return and the price return, where the former takes into account income (interest and dividends), whereas the latter only takes into account capital appreciation.

According to Thakerse (2005), the correct asset allocation may improve investment performance and reduce risk. The reason for this could be that asset classes perform differently under different economic conditions, and maintaining the optimum balance between risk and return is fundamental to investment successes. This section focuses on three key factors of offshore investment performances in relation to domestic investment performances, namely risk, investment returns and investment duration.

- **Risk** – according to Veldtman (2001), offshore investments are generally more risky when compared to domestic investments and in turn yield higher returns than the latter. One reason could be that offshore investments have in the past yielded better returns on investments and saved investors more on taxes. In many cases, this could be true, but to earn higher returns, investors expose their assets to higher risks, including scams that promise high returns on offshore investments. Additionally, Veldtman (2001) indicates that, since offshore investments are traded in foreign countries, offshore investors expect a higher compensation for the higher risk taken by investing abroad.

In addition to the above statement, Gitman and Joehnk (2008) note that offshore investments perform better than domestic investments even when global markets are not performing well. An offshore investor's overall global investment performance may be negative; however, the domestic investor's overall investment performance could be worse if the domestic market performed badly. The investment performance in a certain country could be negative and certain sectors could be performing badly. For example, when the world experienced a financial crisis in 2008, some countries were more affected than others while yet others contained the crisis. In this scenario, an offshore investor could have suffered a loss in one country but maintained a good position in another country.

The reasons for different investment performances by various countries could be due to their monetary and fiscal policies. According to Cecchetti (2008), monetary policy is the process by which the monetary authority of a country controls the supply of money, often targeting a rate of interest to attain a set of objectives oriented towards the growth and stability of the economy. Cecchetti (2008) defines fiscal policy as the use of government expenditure and revenue collection to influence the economy. For instance, a Japanese investor with investments across the globe could have suffered a bigger loss in the USA than in South Africa. In addition, the same investor could have suffered smaller losses in the fast-moving consumer goods (FMCG) sector when compared to the investment losses in the mining sector. The mining sector relies heavily on exports for revenue which could have declined due to the crisis. For this reason, it can be concluded that asset allocation in different foreign countries and different asset classes put an investor in a better situation than domestic investors who diversify investments domestically.

- **Investment returns** – are regarded as the reward or compensation expected from an investment (Phillips, 2003). According to Needham (2007), foreign markets offer more investment opportunities and choices than the domestic market, which in turn yields higher returns. However, returns on investments are driven by many factors, such as country and exchange rate risks. While taking into account the risks involved, the investment returns can be premeditated and quantified using return on investment (ROI) calculations. ROI is a performance measure used to evaluate the efficiency of an investment and to compare the efficiency of a number of different investments (Beattie, 2010). To calculate ROI, the benefit (return) of an investment is divided by the cost of the investment and the result is expressed

as a percentage or a ratio. Formula 1 explores the calculation of ROI when Mr Khoza invests an amount of R1 000.00 for one year on the JSE with an anticipated return of R1 500.00.

Formula 1: Calculation of the return on investment

$$ROI = \frac{(\text{Gain from Investment} - \text{Cost of Investment})}{\text{Cost of Investment}}$$

When Mr Khoza invests R1 000.00 on the JSE, anticipating a R1 500.00 return in year 1, the ROI will be:

$$ROI = \frac{R1500.00 - R1000.00}{R1000.00}$$

ROI = 50%

But if the actual gain or loss is R900.00, then Mr Khoza would have suffered a loss of 10%:

$$ROI = \frac{R900.00 - R1\,000.00}{R1\,000.00}$$

ROI= - 10%

ROI is a popular metric because of its versatility and simplicity. That is, if an investment does not have a positive ROI, or if there are other opportunities with a higher ROI, then the investment should be re-evaluated. Investors need to be aware that the calculation of ROI and the definition thereof can be modified to suit a particular situation. The outcome depends on what is included as returns and costs (Beattie, 2010).

The definition of the term in the broadest sense attempts to measure the profitability of an investment. As such, investors must use this measure as an indication of the outcome and not as the final results of the performance of an investment. For example, a marketer may compare two different products by dividing the revenue that each product has generated by its respective marketing expenses.

A financial analyst, however, may compare the same two products using an entirely different ROI calculation, for example by dividing the net income of an investment by the total value of all resources that have been employed to make and sell the product. When using this metric,

investors should ensure that they understand the inputs that are being used (Gitman and Joehnk, 2008). In addition, Hyman (2006) warns that ROI does not guarantee the investment returns calculated. It is difficult to predict the future, and an investment opportunity that looks excellent today may turn out very differently in the future. Under normal circumstances, stocks, bonds, real estate, commodities and other typical investment vehicles vary in value, and there is no law or agency that will protect investors from the normal fluctuation of markets.

- **Investment duration** – according to Zeelie *et al.* (1998), for any investor, time means money. This is because investments fluctuate a lot and these fluctuations can result in a profit or loss in a short period. Domestic investments usually have a shorter investment period than foreign investments because some onshore investors are focused on making quick profits, and this exposes them to short-term fluctuations which could be high risk (Saler, 1996). Exposure to one asset class increases the risks, which could result in large losses. In contrast to this, Goede (2007) indicates that there are less confusion and uncertainty regarding investments conducted domestically, due to easy access to data and professional advice while it can take a couple of weeks before an investor can gather solid data on foreign opportunities and advice.

  While the investment term is of importance in offshore investment, the decision to invest offshore should be made in the context of investors' entire investment portfolio (Naidoo, 2003). It should be a strategic or long-term consideration, not based on short-term market events. Investors attempting profits in the short term are often spectacularly unsuccessful and this could have dire long-term consequences on assets. Additionally, Naidoo (2003) warns that share prices invariably increase and decrease, but to a long-term investor, the short-term fluctuations in the stock market should not be a primary concern. In contrast, investors have a much higher degree of clarity over a long term, where shares have consistently delivered inflation-beating returns as a result of longer-term growth and ongoing reviews of objectives and action plans.

3.3.2 Conclusion

Offshore investment seems to be the appropriate vehicle for minimising risks and maximising returns. The characteristics of offshore investments in relation to domestic investments were discussed by looking at key differentials of offshore compared to domestic investments. It can be concluded from the above discussion that offshore investments are high risk compared to domestic investments, and in turn yields higher returns under good conditions. However, losses could just be as high should the market perform badly. The important thing is to maintain a good balance of offshore and domestic investments as well as a good mix of asset classes. The next section focuses on the reasons and advantages of investing offshore.

3.4 Reasons and advantages of investing offshore

There are numerous reasons for investing offshore. According to Gough (1998), investors are motivated by a number of factors, but the main reason for investing offshore should be the protection of assets rather than making money. The reason for protecting assets is that the principles of sound investing stress that assets should be protected before measures to create more wealth are put in place. According to Swart (2002), it is logical that various investors will invest offshore and this may be fashionable for some, but for those living in emerging countries, with a secured job or financial means, it is an essential requirement. It is regarded as an essential requirement since diversification is a key principle of sound offshore investing (Ware and Roper, 2001. The reasons for investing offshore as well as investors' financial situations and investment objectives consequently differ. The following are regarded as common reasons for and advantages of investing offshore.

3.4.1 Diversification

According to Ware and Roper (2001), diversification gives investors an opportunity to spread risks over more than one market with investments in both established and emerging markets. South Africa is considered a high risk because it is an emerging market, and emerging markets can often be very volatile, while established markets offer the prospect of steadier growth. A balance of both high-risk and low-risk market exposures can provide the growth investors need without excessive risks.

Any investment planning should involve diversification (spreading the risk), whether across currencies, investment vehicles or markets. In this regard, the risks associated with confining investments to the South African investment market alone should be carefully considered. The fluctuation of the rand relative to developed world counterparts is a motivation to invest in hard currencies (Rainbow, 2010). The relative strength of the rand over four months (Figure 3.1 below) may well create an ideal opportunity to purchase hard currencies. When the domestic currency appreciates, it creates an opportunity to buy offshore investments relatively cheaper, exposing domestic investors to international markets.

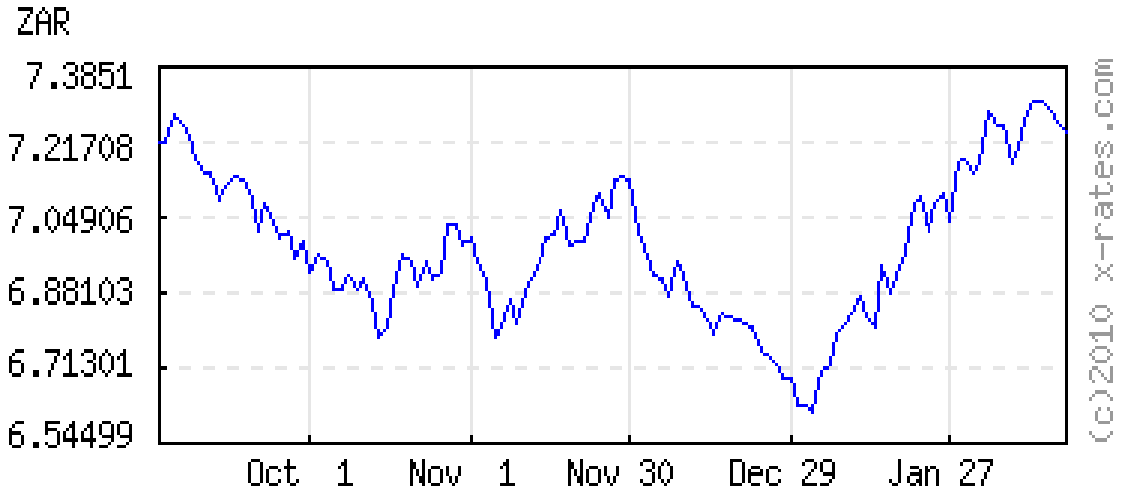


Figure 3.1: The strength of the rand relative to a dollar from October 2010–January 2011: South African rand to 1 USD

Source: Rainbow, 2010

Additionally, Rainbow (2010) warns that, as South Africa has been classified as an emerging market, no matter how solid South African political, economic and investment fundamentals are, difficulties in other emerging economies can have a negative effect on South African markets. Being part of the African market may also imply political risk, which can be minimised by investing part of the investor's wealth in more stable regions. Investing in an offshore portfolio means that the investment is not influenced by one country's political and economic stability alone. Should the rand decrease in value, the investor could actually expect a higher return on its investment (in rand terms), meaning that the investor is also diversifying currency risk.

3.4.2 Geographic spread

According to Du Preez (2005), geographic spread is investing in different countries at different stages of their growth cycles. Diversifying investments across several economies is regarded as a way of smoothing out returns. Smoothing out returns is done by combining investments from economies experiencing rapid growth with those that are growing slowly. There is a vast array of investment products available worldwide. Some of these products are not offered in South Africa; therefore, the offshore arena increases the range of investment opportunities available to the investor. When investing offshore, the investor is not limited to the domestic market but has a choice of investing in different currencies, investment vehicles and markets, where the best possible opportunities for a good return exists.

The South African stock market constitutes about 2% of the world stock market capitalisation. The total of all emerging markets is about 8%. It would thus probably be prudent to consider investing in more mature markets, other than emerging markets only. The following figure indicates the size of South African stock market relative to other stock markets.

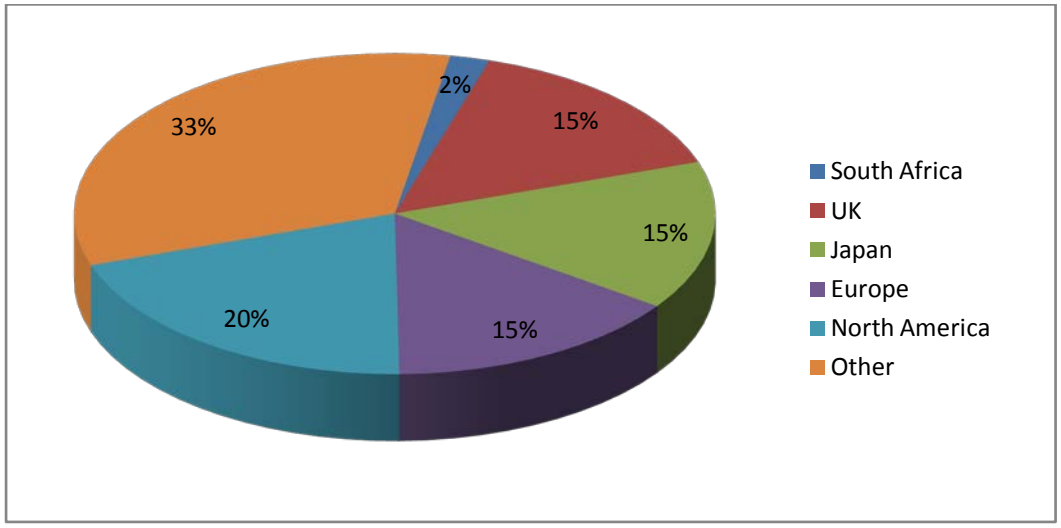


Figure 3.2: World stock market capitalisation

Source: Adapted from Business Times, 2009

3.4.3 Enhancing returns

The diversification of an investor's portfolio across markets, structures and instruments could mean that the investor who makes informed choices could greatly increase the total return on an investment portfolio. According to Kruger and Roper (2003), investors should ensure that the investor's profile is considered before choosing an offshore investment portfolio. A balanced spread between equities, bonds, cash and other investments should be sought, based on the investor's risk profile, as well as short-, medium- and long-term needs. The performance of the offshore investment made should be considered in light of the envisaged time horizon. It should not be expected that a direct equity portfolio would show magnificent returns in the first few months or even a year. This is especially true if one considers that in the year 2000, equities had their worst performance year in the last 25 years. This has continued into 2001 and 2002, which emphasises the importance of appropriate planning and investment diversification between different asset classes. The availability of offshore investments could mean that the investor who makes careful and informed choices of offshore investments could enhance the return on the total investment portfolio as a result of a wider choice of investment options.

3.4.4 Rand hedging

According to Klein (1998), inflation has radically changed investors' attitude towards investments. However, diversifying globally could increase inflation-beating returns. When exchange controls were relaxed in 1997, the rate of exchange was R4,60 to the US dollar. At the end of 2001, the rand depreciated to almost R14 to the US dollar. The long-term trendline indicates that R10,1 as at December 2008 was consistent with the past performance and could have been foreseen. In that period, the rand had lost a compound 10% per annum by November 2008. This is a trend that appears likely to continue and the reasons provided for the rand's deterioration in the year 2007 included, inter alia, continuing emerging market woes, the lack of domestic and international confidence in the South African market.

Higher potential earnings and higher potential capital gains with investments in foreign currencies that offset any decline in the values of the rand (and therefore the value of domestic investments) are likely to improve the risk-return ratio in any portfolio.

3.4.5 Confidentiality

Many offshore jurisdictions offer the complementary benefit of secrecy legislation. These countries have enacted laws establishing strict corporate and banking confidentiality. If this confidentiality is breached, there could be serious consequences. For example, a breach of banking confidentiality is regarded as divulging customer identities or disclosing shareholder's profile. This secrecy does not mean that only drug lords and other criminals invest offshore. Offshore laws will allow identity disclosure in clear instances of drug trafficking, money laundering or other illegal activity (Hyman, 2006).

3.4.6 Increased investment opportunities

The offshore investment arena provides increased opportunities, since investors can invest in various countries, products and industries. The opportunities range from foreign currency fixed-period bank deposits, foreign government and corporate bonds to shares on different stock markets and foreign venture capital. This spread will give a balanced exposure to different risks and returns. According to Morris (2007), internationalised investment has lower risk and higher returns over the long term. Investors can also protect themselves against a decrease in their real wealth by sourcing expert advice from offshore fund managers. With expert advice available, it is imperative that an acceptable level of risk be clearly defined and measured. The investment duration should also be considered as far as possible in order to simplify the investment decision and make the objectives more meaningful.

According to Swart (2002), several offshore investors who never planned their investment ended up being insolvent or suffering losses. The continued relaxation of exchange from R750 000.00 in 1997 to R4m per family unit in 2010 has led South Africans to embrace the offshore marketplace in greater numbers. Indeed, when the relaxation was originally introduced in July 1997, it was mooted in the press that all South Africans should have at least 20% to 30% of their investment portfolios invested offshore. An article by Sanlam (2008) advises that, in general, 25% to 30% of an investor's portfolio should be invested abroad. Those wishing to take a higher risk profile (a younger person) might take it up to 50%, while a pensioner would be well advised to restrict foreign investments to around 20% of the total portfolio.

Needham (2007) warns offshore investors to invest in a diversified portfolio. However, the percentage of an investment portfolio that should be invested offshore depends on the investor's individual circumstances. Offshore investors should not invest more than 30% of their assets oversees if they have expenses to pay in ZAR. Apart from this, the rules for investing abroad should be the same as investors would apply when investing domestically.

3.4.7 A balanced portfolio

According to Solnik and McLeavey (2003), offshore investments do not necessary always outperform a domestic investment portfolio in the short term. However, in the long term, an investment portfolio with adequate offshore exposure should always outperform a portfolio with pure domestic exposure. A five-year comparison would show the offshore portfolio to mostly outperform a South African-only portfolio. A factor that could contribute to an offshore portfolio outperforming a domestic portfolio could be the rand's depreciation against other major currencies. Additionally, over the five years before the World Trade Centre attack on the 11 September 2001, the rand depreciated by 15% per year against the US dollar, 13% against the British pound and 9% against the euro. If this trend continued, the cost of a US dollar in 2011 would have been R32.

Domestic investors could suffer a loss or realise low returns due to a single disaster, while in the case of an offshore investor, a disaster in Switzerland may be offset by gains in the United Kingdom. Moreover, foreign investors benefit from the cycles of different asset classes and economies. Keeping all assets in one currency is hard to justify in a world where traditional barriers are being broken down (Swart, 2002). Investors who make informed choices when investing offshore could enhance the return of their total investment portfolio, while simultaneously reducing the overall risk. The right choice of currency, market segment, geographical region and asset class could lead to a balanced portfolio (Du Preez, 2005).

3.5 Conclusion

Irrespective of the financial situation, risk profile and the reasons for investing offshore, offshore investors need to be knowledgeable about facts and underlying risk factors pertaining to offshore investments. As such, no investment alternative is entirely without risk. Therefore, potential investors should predetermine the risks and the potential return in order to ensure that

the investment is aligned with their objectives. Each investor has an own unique attitude towards risk and return, and the degree of risk an investor is willing to accept should be a derivative of its investment objectives. This section focused on the advantages and reasons of investing offshore in relation to investing domestically. As no investment is entirely without risks and disadvantages, the next section is dedicated to offshore investment pitfalls.

3.6 Offshore investment pitfalls

South African offshore investors are relatively newcomers to the offshore investment arena. If the South African investment arena is perceived as complex, this is so much more the case in the offshore marketplace. As such it is crucial that certain offshore investment pitfalls that may be encountered are highlighted. Milazi (2009) warns against these offshore investment pitfalls.

3.6.1 High returns expectations

The main purpose of investing offshore should be to diversify an investment portfolio by gaining exposure to world markets and currencies which may be more stable and mature than the domestic market. The South African market is classified as an emerging market and performances of these markets are normally more volatile than those of mature markets. In good times (bull market), the domestic securities exchange can outperform many other markets, but in the case of a crash (bear market), the effect is often more severe and the recovery slower. A financial adviser who sells an offshore investment on the grounds that the rate of return of offshore investments is always superior to that of the domestic market could have difficulty explaining a year like 1999 and the first quarter of 2001 when the JSE performed well and the rand was stable relative to most hard currencies.

This pitfall can be eliminated by positioning the offshore investment correctly. A stable investment could offer consistent returns which, over the long term, will be enhanced by the depreciation of the rand against other major currencies.

3.6.2 Monitoring offshore investments

Offshore investment funds are normally transferred from the authorised dealer to the offshore bank account of the product provider. A problem may arise if the funds are already in an offshore bank account. In such a case, the particular bank has to be notified of the transfer of funds to the product provider who may be an unknown entity to the foreign bank. In these circumstances, it may well happen that the funds are not matched immediately by the product provider. It could be very frustrating to have made a transfer of funds if the product provider or the offshore trust created fails to make an investment in time.

The best solution to this pitfall is to diarise it and hand it in against a signature from the product provider and the authorised dealer. Monitoring offshore investments should be closely monitored and continuously followed up via phone calls and e-mails to all the relevant parties. As far as possible, cross-references should be made on all documentation as far as the investor's details and the application numbers are concerned. This will enable administrators to match the funds and application forms, especially if covering letters explaining the details of the investment are also attached to the original forms. As an alternative, the investor could request the transfer of funds out of the relevant bank account, thus obviating the need for the product provider to deal with the bank at all.

3.6.3 Investing in products without a South African presence

Offshore investors should invest in products that they are conversant with to avoid unnecessary administrative problems. Logistically, it will become a burden to always have to communicate a query to an offshore office. It may become an unnecessary expense. There are many offshore scams told about South African investors who invested in offshore sham companies and lost a lot of assets invested through these offshore scams. This could have resulted from the fact that these transactions were concluded illegally in the time when offshore investments were not permissible in South Africa.

The investors had to deal in secrecy without properly investigating the investment house. These investors are often left to fend for themselves against ruthless exploiters as the South African authorities do not know about these product providers and they have not been approved by the

FSB. The investors also did not have any legal recourse, as they did not want the authorities to know about their contravention of exchange control regulations.

The worst case is that offshore investors could struggle to get information about their investments. All investors should be satisfied that the product they are investing in is suitable to their needs and that there is administrative backing provided from within South Africa. If the product provider does not have an intermediary in South Africa, it should at least have an arrangement with a South African provider to distribute its products.

3.6.4 Trading in foreign language

English is generally the accepted language for most international transactions. However, it may happen that the investor has funds in a bank of a country where English is not the normal business language, for example Germany, France and Switzerland. Offshore investors with investments in such countries may give an instruction to transfer the funds to the product provider or the bank in English. The pitfall can be the possibility that the fund manager at that office might not understand the instruction and therefore does not act in time. The instruction may be sent to a translator once received to verify the contents. Then the translated letter is sent back to the investor for acceptance.

All of the aforesaid may waste time and delay the completion of the transaction. In cases like these, an investor should hire a translator who writes all the instructions and covering letters in the appropriate language on the investor's behalf to speed up the process.

3.6.5 Timing the currency

The fluctuations of the rand against other strong currencies seem to form a pattern where the rand remains stable for few months and then suddenly fluctuates in a high trend in another month. This is normally due to a monetary crisis or financial market instability, or an attack on the rand by speculators. If an investor has decided to make an offshore investment during a stable period (where the fluctuation of the rand is stable for few months), it does not make sense to time the small currency movements. The time and date of the next big depreciation is unpredictable, and playing around to make a small gain might not be worth it.

3.6.6 Registering all family members as taxpayers

Due to the possible tax implications of offshore investments, SARS has an active interest in the performance and the income earned from offshore investments. In some cases, an investor may donate or lend money to his or her spouse and children over the age of 18 years who are not taxpayers in their own right, for example students and housewives, to increase the amount of investments offshore. In most cases, SARS will only grant a tax clearance for these persons in respect of offshore investments once these investors have completed a tax form (IT12). This form can accompany the clearance application to SARS for an offshore investment. If this is ignored, SARS is unlikely to give these persons the necessary permission. If a wealthy investor does this, the amount of his family's exposure to offshore investments can be extended. The extension has the following downside:

- these individuals will have to submit annual tax returns; and
- in certain circumstances, their investment income will be deemed to be their own income as a result of the application of section 7 of the Income Tax Act, as stated (South Africa, 1962).

Wealthy offshore investors face this challenge more often than other investors. The pros and cons of registering all family members as taxpayers should be taken into account before taking this action.

3.6.7 Restrictions on the value of offshore investments

Certain investors are biased towards offshore investment or their assets are so vast that the R4m offshore allowance is insufficient to balance their portfolio. If the investor is married, he or she could donate an amount to his or her spouse and children over the age of 18 years, who could utilise such funds for offshore investments. The added advantage is that such a donation is exempted from donations tax in terms of section 56 of the Income Tax Act. The income that accrues to or is received by the spouses from the investment could, however, be deemed to be that of the donor spouse in terms of section 7(2) of the same Act.

Donations to children are, however, not exempt from donation tax. All donations above R30 000 per taxpayer per tax year are taxable at the rate of 20%. If an investor has children of 18 years and older, such investors could lend their children money on condition that they utilise it to make

an offshore investment. There should not be a problem if such investment is structured as an interest-free national transaction; thus, section 31(2) of the Income Tax Act is not applicable as long as the family members are all residents of South Africa. An investor, who is not married or does not have children above the age of 18 years or other suitable family members, may utilise institutional offshore investments and containers to invest offshore.

3.6.8 Hidden trust and product costs

Offshore product providers are normally transparent about the cost of setting up and investing in their products. Initial investment advice fees are similar for most products. The financial adviser may often reduce this fee by forfeiting some upfront commission. For every percentage the financial advisors forfeits, the product becomes a percentage cheaper. The hidden costs are normally not so apparent, for example if the investor withdraws funds from the investment, he or she may have to pay an early withdrawal penalty. Switches between funds, requests for valuations and transfers from bank accounts may also appear more expensive in the offshore environment than in the South African environment.

3.6.9 Tax pitfalls

Tax issues may be attributable to choice of jurisdiction or choice of investment. The choice of investment is extremely important but this is heightened by virtue of the fact that there are more than 60 tax jurisdictions. The mistake most prospective investors make, is that jurisdictions are selected where taxes are deducted, rather than investing in tax havens that do not deduct source-based taxes. Once paid, relief has to be sought in terms of the appropriate double taxation agreement (DTA) or, failing a DTA, in terms of section 6 of the South African Income Tax Act. Tax considerations based on choice of investment are also important. Care should be taken in structuring an investment or offshore structure so as not to invoke the transfer pricing provisions in section 31 of the Act.

3.6.10 Pitfalls when selecting a jurisdiction

The choice of jurisdiction must be considered cognisant of a developed system of law and comprehensive trust law. Other considerations include:

- political and economic stability;
- taxes on income or capital;
- activeness of banking sector;
- effectiveness of communications;
- logistics and time variances; and
- professional, corporate and banking services.

The above factors will ensure that the appropriate offshore trust is set up. A jurisdiction where investments are channelled is important as the costs of setting up and administering offshore trusts vary considerably. Offshore investors need to understand the type of trust and what it could be used for, and this should be reflected in the price.

3.6.11 Selecting a currency

Investors should carefully consider the currency in which the investment is denominated, taking into account the fluctuations of the currency in relation to other currencies. The main objective when selecting a currency should be to align the objectives of the investment with the currency that will guide the investment to the intended results.

3.6.12 Trust pitfalls

According to an article by Sanlam (2008), a trust is an agreement between an owner of assets and trustees. In terms of this agreement, the trustees undertake that they will administer the assets of the trust with the necessary care to the benefit of the beneficiaries. It is an efficient and flexible way to ensure that assets are looked after. It also ensures that assets are objectively managed and controlled by appointed trustees in the best interests of the beneficiaries. In this case, the offshore investor will be the beneficiary in the trust.

Offshore investors should be aware that a trust is not appropriate for every single investor and careful analysis is necessary to balance the benefits of trust structuring with the associated charges. An investor must consider the benefits of the proposed trust from an income and inheritance tax perspective, as well as other possible advantages that the creation of the trust may hold.

3.6.13 Not divesting from trust assets

Trusts and other offshore structures could be expensive in rand terms and as a result, the investment should be for the long term, if estate-planning objectives are to be met. Investors often make the mistake of creating a trust and then they include these assets in their immediate South African financial planning. Remitting the capital to South Africa before at least 5 years have expired is often not worth the additional cost. The transfer of income or interest back to South Africa after few years is expensive due to the cost of converting currencies, taxes and fees by the trustees. According to Hill (2007), offshore investments must be long term in nature, allowing movements in the different investment phases and maturity.

The placement of assets as collateral security in an offshore trust for a debt with a domestic institution could be complicated and expensive. This may involve the issuing of a Letter of Comfort by the offshore trustee (Hill, 2007). South African institutions are hesitant to place high security value on these investments due to the complications of legal actions. All of the foregoing are examples of problems which could be prevented with a proper financial plan. In all of these instances, some of the tax and other benefits of a trust are lost and the settler (a person who settles property on trust law for the benefit of beneficiaries) does not divest from the trust assets. The divestment of the settler control must be fully conversed with the trust parties before a trust is set up in the first instance.

3.6.14 Taking money belonging to another person offshore

A wealthy person would often need to invest more than the R4m offshore, which a family unit is allowed to invest. A close friend or family member could be approached to utilise his or her offshore allowance and travel allowance to transfer money offshore on behalf of the wealthy person.

This is a contravention of regulation 10 (i) (c) of the Exchange Control Regulations (Act No. 9 of 1933). Such a person could thus be liable for penalties for helping direct or indirect exportation of capital without the approval of SARS. According to the South African Income Tax Act (1962) as amended, the burden of proof as to the whereabouts of and income produced by those funds lies with the taxpayers if these funds and income are never disclosed on an income tax return. SARS can assess the individual on an assumed interest rate on the relevant amount. Even if these funds were transferred directly into an offshore trust for the benefit of another person, it could lead to contraventions of exchange controls and negative tax consequences for the transferor of the funds.

3.7 Conclusion

This chapter dealt with offshore investments. Various definitions of investments were discussed, which led to the conclusion that investment is an undertaking of risks for later rewards. Since the core of this study was to provide mitigation for risks faced by offshore investors, the characteristics of offshore investments were discussed. The discussion focused on two components: asset allocation and investment performance of offshore investments in relation to domestic investments. Asset allocation focused on two entry points to foreign markets: direct and indirect offshore investment methods. The pros and cons of each were illustrated to ensure that investors make an informed decision when using any of the methods to enter offshore markets. Investment performance focused on three key factors of offshore investment performance in relation to domestic performance. Investors were warned to diversify their investments in order to increase their prospects for long-term growth and high returns.

Offshore investors have different reasons for investing offshore, and consequently, the common reasons and advantages of investing offshore were discussed. It was evident that, regardless of the reasons for going offshore, a thorough offshore investment plan must be in place before investing offshore. This was followed by a discussion of offshore investment pitfalls that could negatively influence an offshore investment plan. Investors need to be mindful of this pitfall before investing offshore.

The next chapter will focus on the research design and methodology used for the gathering and analysis of data for this study.

CHAPTER 4

RESEARCH DESIGN AND METHODOLOGY

4.1 Introduction

From the literature review (Chapters 2 and 3), ten offshore investment risks were identified using a detailed literature study on risks and risk exposure as well as offshore investments. The objective of this study was to validate the risks identified through a literature review. The aim of this chapter is to provide the research methodology used to gather and analyse data in order to confirm the risks faced by South African offshore investors.

To achieve this objective, this chapter will focus on the theory of research design, research methods and statistical techniques that were used to analysis data.

4.2 Theoretical introduction to the design strategy

This section will briefly describe the purpose of the study and the need for research in this field. According to Leedy and Ormrod (2005), when deciding on the broader design, the following factors should be considered:

- understanding the research problem;
- identification of resources;
- deciding on the design procedure; and
- deciding on the data requirements.

The research problem and the resources needed for this study have been identified in Chapter 1. The research problem was to identify the risks faced by South African offshore investors when making an investment decision. Before we discuss the research design, it is important to describe the basic steps in the research process briefly. According to Leedy and Ormrod (2005), there are nine steps in the research process:

Step 1: The researcher asks a question that has no known resolution
Step 2: The researcher converts the question into a clearly stated research problem
Step 3: The researcher poses a provisional hypothesis or series of hypotheses

Step 4: The researcher searches the literature for ideas on the problem and for strategies that may help to address it

Step 5: The researcher collects data that potentially relate to the problem

Step 6: The researcher arranges the data into a logical organisational structure

Step 7: The researcher analyses and interprets the data to determine its meaning

Step 8: Either the data appears to resolve the problem or not

Step 9: Either the data supports the hypothesis or not.

The above steps were used as a guideline in this study and were also confirmed by Cant, Gerber-Nel, Nel and Kotze (2003), as necessary for the proper execution of a research study. Thus, the steps were incorporated in the various chapters as follows: Steps 1, 2 and 3 were incorporated in Chapter 1. Step 4, which focuses on the literature that shed light on the problem and ways to address it, was incorporated in Chapters 2 and 3. Steps 5, 6 and 7 were addressed in Chapter 4. Chapter 5, which is based on the results generated from the data collected in Chapter 4, addressed Step 8. Step 9 is addressed in Chapter 6 which focuses on the recommendations and conclusions of the study. The next section will focus on the purpose of the study and the need for research in this study.

4.2.1 Purpose of the study

The main purpose of the study was to identify and rank in order of importance the risks that are faced by South African offshore investors . The following components will be researched and analysed to determine whether they could influence an offshore investment plan, and to which extent, if any:

- the level of understanding the risks and risk exposures by offshore investors; and
- the knowledge, understanding and attitude towards offshore investments,

4.2.2 Need for research in this field

South Africans are investing offshore, and it was indicated in previous chapters that no investment is entirely without risk. Hence, the risks faced by offshore investors need to be identified, and then minimised to achieve great returns. The results and conclusions drawn from

the analysis and interpretation of results will be used as a basis for recommendations. The next section will focus on the research design used in this study.

4.3 Research design

According to Gill and Johnson (1991), **research design** is a master plan that specifies the methods and procedures that are used for the collection and analysis of information that is required. According to Gupta (1993), the research design is the plan, structure and strategy of investigation conceived so as to obtain answers to research questions and control variance. A research design may be considered as a general plan or blueprint used to guide the research process from formulation of the research questions and hypothesis to the reporting of the research findings (Kalaian, 2008; Kumar, 2005).

Additionally, Kalaian (2008) indicates that any mode of research (descriptive, explorative, experimental, evaluative, diagnostic or prognostic) incorporates all the essential components of a research design. However, some substance is given to certain aspects of a research design, in a particular type of research compared to the other. Research approaches that are widely used are the quantitative and qualitative approaches (Guthrie, 2010).

4.3.1 Quantitative research design

According to Buckingham and Saunders (2004), quantitative research is a variable-oriented approach, which is theory-centred. In this approach, generality is given precedence over complexity because the researcher is interested in testing propositions derived from general theories. Kalaian (2008) states that quantitative research is a deductive theory-based research process that focuses primarily on testing theories and research hypotheses. This type of research investigates differences and relationships using numeric data and statistical methods to make specific conclusions about the phenomena. According to Guthrie (2010), quantitative research primarily focuses on the measurement of objective variables that affect individuals or groups.

4.3.2 Qualitative research design

According to Berg (2001), qualitative research refers to meanings, concepts, definitions, characteristics, metaphors, symbols and description of things. According to Leedy and Ormrod (2005), qualitative research methods focus on phenomena that occur in the real world and involve studying those phenomena in all their complexity. Qualitative researchers rarely try to simplify what they observe. Instead, they recognise that the issue they are studying has many dimensions and layers, and so they try to portray the issue in its multifaceted form. According to Kalaian (2008), qualitative research is inductive and context-specific research that focuses on observing and describing a specific phenomenon, behaviour, opinions and events that exist through data collected by observations, documents, physical artefacts interviews and focus groups to generate hypotheses and theories.

The aim of this study was to identify and rank in order of importance the risks that are faced by South African offshore investors Since the study was not based on deductive theory-based research but on inductive and context-specific research that focuses on observing and describing the behaviour of offshore investors, a qualitative approach was chosen as the appropriate tool for this study. When considering the associated tools for conducting the study, research has shown that a survey can be a useful tool when collecting data describing a specific phenomenon. A survey is one of the four main research design techniques that are used to collect data, and so this will be discussed in the next section.

4.4 Research design techniques

Once the research design conditions and the research approach (qualitative or quantitative) discussed above have been satisfied, it is important to consider the design techniques that may be used to collect data. The four main design techniques are surveys (most commonly used to generate primary data), experiments, secondary data and observations.

4.4.1 Surveys

According to Leedy and Ormrod (2005), surveys involve acquiring information about one or more groups of people, perhaps about their characteristics, opinions, attitudes or previous experiences and tabulating their answers. Surveys are classified as a research technique where

information is collected from a sample of people by means of interviews (verbally) or questionnaires (non-verbally). A survey research is a systematic research method for collecting data from a representative sample of individuals using instruments composed of closed-ended and/or open-ended questions, observations and interviews (Kalaian, 2008).

4.4.1.1 Interviews

According to Zikmund (1999) as well as Whitehead and McNiff (2006), interviews have certain advantages and disadvantages when used as research technique:

- Advantages
  - the opportunity to provide feedback in the clarification of instruments of certain questions between the interviewer and the respondent;
  - more detail can be obtained than from lengthy questionnaires;
  - the completeness of the survey may be increased by ensuring responses to all questions; and
  - the percentage of people completing the questionnaire is increased by the presence of an interviewer.

- Disadvantages
  - respondents may not want to supply confidential information due to the fact that they are not anonymous;
  - the interviewer's demographics characteristics may have an influence on the respondents' answers;
  - interviewer's bias may be created through different interview techniques; and
  - personal interviews are more expensive and time-consuming than questionnaires.

The advantages and disadvantages discussed above were taken into consideration to determine whether interviews would be the best techniques to collect data for this study. Therefore, based on the nature of the study, the advantages and disadvantages discussed above as well as the profile of the respondents, interviews were not used to collect data for this study.

4.4.1.2 Questionnaires

Many situations exist where it is not essential to make use of an interview but rather to gather data by making use of a questionnaire. According to Hussey and Hussey (1997), a questionnaire is defined as list of well-structured questions that was chosen after careful and considerable testing and which aims at getting reliable responses from the chosen sample. According to Buckingham and Saunders (2004), a questionnaire is a prepared set of written questions, used for statistical compilation or comparison of the information gathered. The aim of a questionnaire is to determine what a selected group of participants do, feel and think. Zikmund (1999) states the advantages and disadvantages of using questionnaires as follows:

- the use of questionnaires make data gathering geographically easier due to the fact that mail questionnaires reach respondents at the same time over a widely distributed area, and it is cost-effective;
- using mail to send questionnaires to the sample population is not totally inexpensive but is low in cost compared to personal and telephone interviews;
- questionnaires are more convenient for the respondents who can complete the questionnaires in their own time with more time to think about their responses;
- in the absence of an interviewer the respondent will be more likely to supply sensitive information; however, this can also be a disadvantage of the researcher as they have no control over the responses provided by respondents and there is no opportunity for clarity;
- mail questionnaires consist of mostly well-structured questions that are standardised, clear cut and straight forward;
- the response rate may be low due to the fact that the survey may be boring, unclear or complex. Therefore, disregarded by most respondents; and
- individuals who show interest in the subject matter will have a higher response rate than those with less interest or experience. To increase the responses to mail surveys researchers can make use of prepaid return envelops, designing attractive questionnaires and using easy to understand language.

A questionnaire is one of the most widely used research designs across disciplines (Guthrie, 2010). A questionnaire collects a large amount of survey data from a representative sample of individuals, sampled from the targeted population and using a variety of delivery methods such as face-to-face, telephone, mail, and electronic (web-based and email) interviews and questionnaires. Each of these data collection methods has its own advantages and

disadvantages in terms of cost, duration, and response rate. Some of the most popular methods along with their associated advantages and disadvantages are elaborated on in the table below.

Table 4.1: Advantages and disadvantages of survey methods

Methods	Advantages	Disadvantages
Postal	• Low cost per response • Survey participants can choose to remain anonymous • It is not labour-intensive • Interviewer's absence may lead to a more candid response	• Mail is subject to postal delays, which can be substantial when posting to remote areas, or unpredictable events such as natural disasters could cause delays. • Interviewer's absence may lead to a lack of control over how the questionnaire is answered.
Telephone	• Interviews can be conducted swiftly. • Rapport can be established with respondents. • Higher response rate compared to postal and electronic questionnaires	• More prone to social desirability biases than other modes, so telephone interviews are generally not suitable for sensitive topics. • The interviewer cannot see or respond to non-verbal signs.
Electronic	• Low cost. • Questionnaires can be conducted swiftly, without postal delays. • Survey participants can choose to remain anonymous. • It is not labour-intensive. • Questions can be more detailed, as opposed to the limits of paper or telephones. • Help or instructions can be dynamically displayed with the question as needed, and automatic sequencing means the computer can determine the next question, rather than relying on respondents to correctly follow skip instructions.	• Not all of the sample may be able to access the electronic form, and therefore results may not be representative of the target population.
Personally administered	• Questions can be more detailed, as opposed to the limits of paper or telephones. • Rapport with respondents is generally higher than other modes. • Typically higher response rate than other modes.	• Can be extremely expensive and time-consuming to train and maintain an interview panel. • Each interview also has a marginal cost associated with collecting the data. • Interviewer can introduce bias by leading the interview.

From Table 4.1 above, the electronic method appears to have the most advantages and also the most manageable disadvantages, in comparison to the other methods. When examining the postal method of conducting the survey, given the geographical distribution of the sample group along with the time to administer the survey through mail, this method was not considered as the best option. The telephone method of conducting the survey was considered but due to the seniority of the participants involved in the study, the telephonic survey was deemed to be more intrusive and time-consuming compared to the electronic method, which has the advantage of being completed by the respondents in their own time and across several sessions. The personally administered method was not considered due to the geographic dispersion of the participants involved.

When examining which tool to use for the survey, Guthrie (2010) identified a questionnaire as the main instrument for collecting data for a survey research. Additionally, Guthrie (2010) described a questionnaire as a set of standardised questions, often called items, which follow a fixed scheme in order to collect individual data about one or more specific topics. A questionnaire was consequently chosen as the most appropriate tool to collect data, based on the objectives of this study. The other research design tools that were considered for this study were experiments, secondary data and observations.

4.4.2 Experiments

According to Leedy (1993), an experimental method is defined as data that is derived from an experimental control situation or present/post-test design where two separate groups, or one group, from which date is derived at two separate intervals, are involved. It is also known as the laboratory method or the cause-and-effect method. According to Goddard and Melville (1996), the aim of experiments is to manipulate the independent variables so that the effect on the dependent variable can be observed.

Leedy (1993) warns that experimental studies attempt to control the entire research situation except for certain input variables that show the cause of the different changes that take place with research design. The major disadvantage of experiments is that the laboratory settings do not always reflect the actual environment that is tested (Hussey and Hussey, 1997). Thus, experiments were not considered as an appropriate tool for this study.

4.4.3 Secondary data

Secondary data – also known as historical data – is data that was previously collected and analysed for another research project. This data is usually found inside the company or in the library (Zikmund, 1994). Secondary data include data found in books, articles and documents such as published statistics, annual reports and accounts of companies (Kumar, 2005).

According to Zikmund (1994) as well as Kumar (2005), there are certain advantages and disadvantages in using secondary data as a research technique.

- Advantages
  - secondary data builds the research on past research outputs which increases the body of business knowledge in the market;
  - secondary data can be obtained at a lower cost and faster than primary data; and
  - the use of secondary data is of greater value than primary data when doing exploratory research.

- Disadvantages
  - secondary data can be outdated and does not always meet the needs of the researcher because it was collected for another purpose; and
  - secondary data that is available can be inadequate because of outdated information, variation in the definition of the terms used, different units of measurement and a lack of information to verify the accuracy of the data.

The purpose of most studies is to utilise information for future purposes. Therefore, for secondary data to be helpful it must be timely and accurate (Zikmund, 1994). The aim of this study was to obtain primary data from the respondents; thus, secondary data was not used in the study.

4.4.4 Observations

According to Hussey and Hussey (1997), an observation is a method of collecting data either in a laboratory setting or in a natural setting. The objective of the observation technique of research design is merely to record what can be observed. According to Zikmund (1994), the following six factors can be observed:

- physical action or evidence, for example the work patterns of people or television viewing;
- verbal behaviour, like office conversations;
- expressive behaviour, for example tone of voice or facial expression;
- spatial relations and locations like the physical distance between workers;
- temporal patterns like time spent shopping; and
- verbal records, for example the content of the memoranda of a meeting.

There are, however, also advantages and disadvantages associated with this technique. According to Kumar (2005), one of the advantages of observations is that behaviour can be recorded without relying on the reports of the respondents. However, Zikmund (1994) warns that observed behaviour is generally of short duration. Observations were not deemed appropriate for this study due to the seniority of the respondents; thus, this method was not used.

After considering the different research designs and techniques described above, it was concluded that a survey, in particular a questionnaire survey, was the most appropriate method to gather data for this study, based on the following reasons:

- secondary data was not suitable as a research design technique due to the absence of secondary database pertaining to the identification of offshore risks and risk exposures;
- it was also inappropriate to use an observation technique or an experiment due to the nature of the data that was required;
- telephone interviews have a high cost, and the time the respondents have to answer the questions is limited;
- a web-based questionnaire is the most efficient way of reaching investment brokers, allowing for immediate delivery of the questionnaire and faster response; and
- respondents can be more open and relaxed by completing the questionnaires in their own time.

Research techniques give a researcher a tool to collect data based on the data requirements and the type of study conducted. Based on the above discussion, a questionnaire was chosen as the appropriate tool for this study, taking into account the geographic challenges and the cost of reaching all the targeted respondents. The next section focuses on the data gathering method used for this study.

4.5 Data gathering method used for this study

Based on the advantages and disadvantages of the various survey delivery methods, a web-based questionnaire was selected as the best tool to conduct the primary research. The benefits of using a web-based survey are briefly discussed in Table 4.2 below.

Table 4.2: Benefits of using a web-based survey

Benefit(s)	Description of benefit(s)
Flexible instrument	Provides a flexible survey instrument that can include text, images, sounds and video as well as dynamic filtering by the respondents.
Sampling	Can access larger and geographically broader samples.
Human resources	Requires fewer resources, for example no photocopying, folding or coding verification.
Time resources	Improved survey available all the time and shorter delivery time.
Material resources	Requires less material, for example paper and stamps.
Reduced cost	Less human and material required.
Analysis	• Direct transmission of data, including coding and analysis. • More complete replies to open-ended questions. • Potential for customer feedback.

Source: Perkins (2004)

Fricker and Schonlau (2002) also recognised increased sample-size availability, time efficiencies and other benefits such as reduced cost. Additionally, it was found that web-based surveys lead to an improvement in data capture and analysis because there is no need to enter the data manually. With manual data entry, there are always risks of input errors (McDonald and Adam, 2003). Significant time savings through response speed due to high availability and fast delivery were also identified.

In this study, the most important advantages of a web-based survey compared to other methods were:

- it is the most efficient method of sending and receiving data, as a web-based questionnaire has –
  - response validation to ensure a minimum numbers of questions are answered as well as validation to ensure correct entry of data;
  - automated skip logic, based on respondents input; and
  - speed of completion;
- it can be completed anywhere, any time of day; and
- it can also be completed across several sessions, which reduces the single amount of time the respondent needs to commit.

The web-based software used to collect data in this study is called the LimeSurvey. According to Wikipedia (2011), LimeSurvey is a user-friendly open source online survey application designed to develop and publish surveys and collect responses, without doing any coding. LimeSurvey has no limit on the number of surveys a user can create, nor is there a limit on how many participants can respond. Aside from technical and practical constraints, there is also no limit on the number of questions each survey may have. LimeSurvey also offers several more advanced features:

- it provides basic statistical and graphical analysis of survey results;
- surveys can be either publicly accessible or strictly controlled through the user (access granted only to selected participants); and
- participants can be anonymous.

LimeSurvey has a variety of applications, as it allows users to create and host high-quality surveys, ideal for general data gathering purposes. It can be used in many different areas for collecting data from participants. In this study, a LimeSurvey was used to gather data from participants on offshore risks and investments as the core of this study. The data was then exported to SPSS for statistical analysis. SPSS will be discussed in the ensuing sections.

According to Fricker and Schonlau (2002), the main disadvantage of using electronic surveys cited in the academic literature has been associated with lower response rates and higher drop-out rates than traditional surveys. According to Sheehan (2001), the lower response rate has been attributed to increased surveying and spam, the threat of viruses and the possibility that the novelty aspect of completing surveys online has passed.

To manage this risk, all identified offshore investment brokers were contacted telephonically to invite them to participate in the survey, followed by a formal invitation letter. The invitation letter detailed the purpose of the study, processes and timelines in the study. To entice participation in the questionnaire, it was agreed that a copy of the results would be shared with the respondents after the study had been completed if they so wished.

Therefore, a web-based survey tool was the primary tool for disseminating the questionnaire as well as gathering and analysing the responses. A LimeSurvey was chosen as the tool to construct and disseminate the questionnaire. This type of survey was chosen for its ease of use and the full list of features in designing and analysing questionnaire responses. Being a web-based tool, a LimeSurvey allows the respondents to complete the questionnaire online in their own time and space without having to download any specific software.

4.5.1 Data requirements

Research design involves a great deal of careful planning. First, as part of the research proposal, a decision must be made on exactly which group of people or objects need to be studied to get the information that is required. Then, the study usually focuses on a sample taken from the entire group. Sampling is one of the foundations of research methods and design, because research design nearly always involves recognition of samples (Guthrie, 2010). The aim in any sample is that its participants should be broadly representative of the population from which they are drawn (Buckingham and Saunders, 2004). This section forms a key part of this study as it focuses on the sample design, sample population as well as the sample size.

4.5.1.1 Sample design

A sample could consist of a tiny fraction of the whole target population, provided it is selected carefully and methodologically. It can provide remarkable and accurate estimates of the parameters of the whole population (Guthrie, 2010). Estimates of population parameters made from small samples will never be completely accurate, and occasionally they may turn out to be inaccurate. However, researchers rarely need total accuracy (May, 2011). According to Buckingham and Saunders (2004), a fairly accurate estimate derived from a small sample can be achieved much quicker and cheaper than a completely accurate figure based on contacting a total population.

This section focuses on how to draw a sample of appropriate size, which will accurately reflect the views of the target population. According to Steyn, Smit, Du Toit and Strashem (1996) as well as Buckingham and Saunders (2004) and May (2011), there are two types of sampling designs: probability and non-probability sampling.

4.5.1.1.1 Probability sampling

According to May (2011), probability sampling enables the researcher to express the mathematical probability of sample characteristics being reproduced in the target population. An important principle is that each person in the population of interest has an equal chance of being part of the sample. According to Sekaran (2003), probability sampling can be unrestricted or restricted in nature.

- **Unrestricted sampling**

Unrestricted sampling is commonly known as simple random sampling and involves every element that has a known and equal chance of being selected in the sample. According to Sekaran (2003), unrestricted sampling provides the least biased results and offers the best generalisation of results.

- **Restricted sampling**

Restricted or complex probability sampling offers a viable alternative to unrestricted designs and improves the efficiency in that more information can be obtained than with the random sampling designs. According to Buckingham and Saunders (2004), May (2011), Salant and Dillman (1994) as well as Steyn *et al.* (1996), there are five common complex probability designs:

- **systematic sampling** involves the drawing of every *n*-th element out of the population starting with a randomly chosen element between 1 and *n;*
- **stratified random** sampling involves dividing the population into two or more relevant and significant groups based on certain attributes, determining the representation of each of these groups in the sample, and then selecting elements of these groups randomly for inclusion in the sample;
- **cluster sampling** means groups of elements that would provide heterogeneity among members within each group are chosen, which is similar to a stratified sample except for the fact that the criteria for the representation of a group differ;
- **area sampling** involves geographical clusters; and
- **double sampling** involves gathering further information when needed from a subset of the group from which the information was gathered.

Probability sampling requires the existence of some sort of sampling frame and, importantly, the size of *n* must be known. This is not always the case or perhaps no sampling frame is available. In these cases, the researcher must use a non-probability sample.

4.5.1.1.2 Non-probability sampling

Non-probability sampling designs do not attach any probability to elements being chosen. For this reason, the findings from this form of sampling cannot confidently be generalised to the population. According to Sekaran (2003), non-probability sampling is classified into two broad categories, namely convenience and purposive sampling.

- **Convenience sampling**

Convenience sampling concerns the collection of information from members of the population that are conveniently available. This type of sampling is most often used during the exploratory phase of the research and is seen as one of the best ways to get basic information quickly and efficiently.

- **Purposive sampling**

This sampling method involves getting information from a specified target group. The group is usually confined to specific types of people who will be able to supply the information needed. The two major types of purposive sampling are:

- **judgment sampling** which involves choosing respondents who are most advantageously placed to provide the information needed; and
- **quota sampling** which ensures that certain groups are adequately represented in the study.

The above section focused on a brief overview of the most important sampling techniques used in practice. With this background knowledge, a researcher should be able to design meaningful sample schemes for different types of research surveys. However, no sampling procedure can be implemented routinely without a careful study of the background and objectives of the investigation concerned (Steyn *et al.* 1996).

Probability sampling was not appropriate for this study because an important principle with regard to this technique is that each person in the population of interest has an equal chance of being part of the sample. The investment industry is very broad and this study only focused on investors who invest offshore. Thus, a purposive non-probability sampling techniques was chosen as the most relevant to this study. This decision was based on the fact that the data needed for the study was from a specified target group. This group was confined to specific types of investors who would be able to supply the information needed. The respondents who were most advantageously placed to provide the information needed were South African investment brokers registered with the financial services board, which manages offshore investments. The next section will focus on the sample population and size.

4.5.1.2 Sample population and size

According to Zikmund (1999) and Kumar (2005), a sample population can be described as a complete group of specific population elements that is relevant to the research project. According to Steyn *et al.* (1996), a sample is any subset of the population, while a population is defined as the total group of persons or universal collection of items to which the study relates. A suitable sampling method can only be selected once the researcher has acquired a complete description of the population from which the sample is to be drawn.

One of the problems in sampling is determining the size of the sample. Sometimes thousands of people are sampled to get the data that is required, for example political telephone surveys. On other occasions, a sample might be as small as one. Sample size depends on many factors, including the purpose of the study, the size of the universe and the research techniques used (Guthrie, 2010). According to Neethling (2001), the main purpose of empirical research is to obtain information regarding the characteristics of a target population.

According to the data obtained from the financial services board, the investment industry in South Africa consisted of fifty-two (52) investment brokers in July 2011. With the assistance of the FSB, a selection methodology based on trading license levels was used to identify respondents to participate in the survey. The FSB furthermore confirmed that only twenty-eight (28) out of the fifty-two investment brokers in their database were registered and licensed to trade offshore. Refer to Annexure B for the investment brokers' database on FSB as in July 2011.

An attempt to reach all 28 was made but only 25 investment brokers were reached telephonically and an invitation letter to participate in the survey was emailed to them. Seven investment brokers declined the invitation to take part in the survey and cited amongst others, the following reasons for not taking part in the survey:

- confidentiality of trade secrets;
- licensed to trade offshore but not actively exploring the offshore market;
- too busy to take part; and
- against company policies.

This study was qualitative in nature and focused on one target group. This group has been at the forefront of offshore investment and plays a key role in the South African offshore investment market. The sample size consisted of 18 South African investment brokers registered with the financial services board and licensed to trade offshore. These brokers were contacted and they agreed to take part in the study. The next section will focus on the design of the survey questionnaire of this study.

4.6 Design of the survey questionnaire

The type of population, the nature of the research question and the resources available will determine the type of questionnaire to be used. For the purposes of this study, as discussed in previous sections, a web-based LimeSurvey questionnaire was used to disseminate and collect data. According to Aldridge and Levine (2001), Guthrie (2010) and Leedy and Ormrod (2005), the following are guidelines for developing a survey questionnaire:

- keep it short;
- use simple, clear, unambiguous language;
- check for unwanted assumptions implicit in your questions;
- word questions in ways that do not give clues about preferred or more desirable responses;
- check for consistency;
- determine in advance how to code the responses;
- keep the respondent's task simple;
- provide clear instructions;
- give a rationale for any items whose purpose may be unclear;
- make the questionnaire attractive and professional looking;
- conduct a pilot test; and
- scrutinise the product just before the final stage to ensure that it meets the needs.

These guidelines were taken into account when formulating questions for the survey questionnaire to improve the response rate. Questionnaires are often equated with surveys. This is wrong, according to Guthrie (2010), because questionnaires are one of the techniques that can be used to collect data using the survey method. This section will focus on the ethical considerations in research, the structure of the questionnaire, choice of measuring scale and pre-testing the questionnaire.

4.6.1 Ethical considerations in research

According to Cant *et al.* (2003), ethics within society pertain to commonly accepted standards of right or wrong behaviour. Ethics provide guidelines for decision-making and determine an organisation's socially responsive actions. Ethics can be defined as the body of moral principles or values governing or distinctive of a particular organisation (Cohen, Manion and Marrison, 2000). When conducting research, researchers have general ethical obligations to participants who provide data in their research studies.

These obligations include that participants should be comfortable, not be deceived, be willing and informed, and that data should be held in confidence (Salant and Dillman, 1994). Therefore, it is important that, when conducting research, researchers should minimise problems associated with research projects and make it as convenient as possible for respondents to participate. It is also important that researchers adopt a high standard of professionalism.

Ethics and professionalism go hand in hand. As discussed in previous sections, all respondents were contacted telephonically to inform them of the study and to ask for permission to invite them to take part in the study. Participants should be willing and informed about the research being conducted. However, when researchers approach respondents, it may take longer to inform them about the study than actually completing the questionnaire. Participants could, therefore, only be informed about:

- who is doing the research;
- what the research is about; and
- how long it will take.

The above was included in the invitation letter (refer to Annexure C) and, furthermore, participants were informed about the confidentiality clause and the reasons for undertaking a study of this nature. In conclusion, a high standard of professionalism was maintained. Thus, the data collected from participants was dealt with in a strictly confidential manner and the results thereof cannot be linked to any participant.

4.6.2 Structure of the questionnaire

The questionnaire comprised of two main parts: the cover letter (introduction and instructions) and the body. The questionnaire finished with thanking the respondents for their valuable input into the study. The cover letter introduced the research and motivated the respondents to cooperate with the survey objectives. It also explained the aim of the research and guaranteed the anonymity or at least the confidentiality of the respondents. The main body of the questionnaire consisted of all the questions that the respondent had to answer. Leedy and Ormrod (2005), notes that during the development of the questionnaire, the following guidelines should be adhered to:

- use simple, conventional language used to avoid complexity;
- avoid leading and loaded questions;
- avoid ambiguity by being as specific as possible;
- do not make any assumptions; and
- avoid burdensome questions that may impose the respondent's memory.

According to Ader, Mellenbergh and Hand (2008), the following types of questions should be avoided when developing a questionnaire:

- double-barrelled questions, forcing respondents to make two decisions in one;
- double negative questions;
- hypothetical questions, which are too difficult for respondents since they require more scrutiny;
- biased questions, which incorporate the researcher's feelings or attitudes towards a topic; and
- questions with long lists, as such questions may tire respondents or respondents may lose track of questions.

According Zikmund (1999), there are two main types of questions used in questionnaires:

- open-ended response questions, which give the respondents the freedom to answer the question in their own words; and

- fixed-alternative questions (closed questions), which provide the respondents with a specific or limited alternative in answering the question, only asking the respondents to choose the one closest to their own viewpoint.

The web-based questionnaire consisted of closed-ended questions, where the respondent only had to select an option. Closed-ended questions were used for the following reasons:

- these questions are usually self-exploratory and the presence of an interviewer is not required;
- the questions may be answered faster and the respondent's time is not wasted;
- such questions require fewer instructions; and
- closed-ended questions focus the attention of the respondent on a specific issue.

The above guidelines were taken into account when the questionnaire was developed. The questionnaire design consisted of four sections. Section A had two demographic questions, Section B had nine questions focusing on risks and other critical decision factors when investing offshore, Section C consisted of two questions focusing on offshore investment pitfalls, while Section D had one question focusing on offshore investment customs (Refer to Annexure E).

4.6.3 Choice of measuring scale

Answers to survey questions are typically a choice of position, either within some category or along some continuous spectrum. A measuring scale is merely a representation of the categories or continuum along which respondents will arrange themselves (Alreck and Settle, 2004). When scales are used, reports describe the distribution of respondents along the scale or in the categories. The position of various individuals or groups can then be compared with one another. Scales can be coded with numbers. Numeric codes that represent answers to questions are used because they are easier to manipulate than words. Using a numeric database also saves time and helps to ensure accuracy, reliability and validity. Scales can be arranged so they capture answers to many questions quickly and in very little space. Scales are both efficient and practical (Guthrie, 2010).

There are many measuring scales that researchers may use. Some may be used to measure a broad range of topics and objects while others are only recommended for very specific tasks (Buckingham and Saunders, 2004). According to Knight (2002), the Likert scale is a special type of the more general class of summated rating scales constructed from multiple ordered-category rating items. Additionally, Knight (2002) indicates that the Likert scale has the following distinguishing characteristics:

- each item uses a set of symmetrically balanced bipolar response categories indicating varying levels of agreement or disagreement with a specific stimulus statement expressing an attitude or opinion;
- the response category points of each item are individually labelled; and
- the descriptive text of these labels is chosen so that gradations between each pair of consecutive points seem similar.

Based on the above discussion, the Likert scale was chosen as the most appropriate scale for this study. Likert response sets may include four or more points, though five categories are traditional. In this study, two five-points category scales have been selected as indicated in Tables 4.3 and 4.4 below.

Table 4.3: Likert-type scale 1

Scale value	Scale name	Scale description
1	Irrelevant	Indicates that the statement is irrelevant to consider when making an offshore investment decision according to the respondents' views and experiences.
2	Unimportant	Indicates that the statement is not important to consider when making an offshore investment decision according to the respondents' views and experiences.
3	Neutral	Indicates that the respondents are neutral regarding the statement when making an offshore investment decision according to their views and experiences.
4	Important	Indicates that the statement is important to consider when making an offshore investment decision according to the respondents' views and experiences.
5	Very important	Indicates that the statement is very important to consider when making an offshore investment decision according to the respondents' views and experiences.

Table 4.4: Likert-type scale 2

Scale Value	Scale name	Scale description
1	Strongly disagree	Indicates that the respondents strongly disagree with the statement when making an offshore investment decision according to their views and experiences.
2	Disagree	Indicates that the respondents disagree with the statement when making an offshore investment decision according to their views and experiences.
3	Neutral	Indicates that the respondents are neutral regarding the statement when making an offshore investment decision according to their views and experiences.
4	Agree	Indicates that the respondents strongly agree with the statement when making an offshore investment decision according to their views and experiences.
5	Strongly agree	Indicates that the respondents strongly agree with the statement when making an offshore investment decision according to their views and experiences.

The questions in the questionnaire used in this study were formulated based on the offshore investment risks identified in the literature study in Chapters 2 and 3. Prior to distribution among the target population, a pre-test or pilot study was conducted to establish validity and reliability of the questionnaire.

4.6.4 Pre-testing the questionnaire

Once the draft questionnaire is done, it is important to conduct a pre-test. According to Salant and Dillman (1994), pre-testing is far more than sending questionnaires to a sample of respondents and then counting how many come back. Pre-testing a questionnaire is important as it tends to:

- examine the reliability, validity, accuracy, integrity and ambiguity of the questionnaire;
- identify any omission of important factors; and
- examine any needs to integrate or remove certain factors from the questionnaire.

A draft questionnaire (refer to Annexure D) was pre-tested to determine its validity, reliability, objectivity and generalisation in cooperation with senior researchers and professors from University of South Africa who are experts in the field of finance, risk management and banking. The pre-test aimed to test the following questions:

- did each question get the information it was intended to get?
- were all the words understood?
- were the questions interpreted the same by all the respondents?
- did all closed-ended questions have an answer that applied to each respondent?
- did the questionnaire create a positive impression that warranted a response?
- were the questions answered correctly and in a way that could be understood by the researcher?

The validity, reliability, objectivity and generalisation pre-test on this questionnaire were performed with a group of senior researchers from the department of finance, risk management and banking at the University of South Africa.

4.6.4.1 Validity

According to Alreck and Settle (2004), a measurement of any kind is valid to the degree it measures all of that which it is supposed to measure and only that which it is supposed to measure. According to Litwin (1995), any measuring instrument is considered to be valid when it measures what it purports to measure. For example, an intelligence test, constructed for measuring intelligence, should measure intelligence only and nothing else.

According to Punch (2005), validity is primarily a measurement term, which has to do with the relevance of a measuring instrument for a particular purpose. As in the case of reliability, there are a good number of procedures for establishing the validity test, for example validating the present data against a simultaneous criterion or a future criterion or theory.

In this study, content validity was tested. Content validity is based on the extent to which a measurement reflects the specific intended domain of content (Howell, Miller, Park, Sattler, Schack, Spery, Widhalm and Palmquist, 2005). Content validity is the most appropriate validity type of this study as the proposed questionnaire measured the attitudes and opinions of offshore investors towards a set of predefined offshore investment risks.

Content validity was tested by means of a pilot study with a selected panel of experts in the field of finance and risk management from the University of South Africa. This test is in agreement with the statement by Sedera, Gable and Chan (2003) that an instrument can be considered valid in content if it has drawn representative questions from a universal pool and if it has been subjected to a thorough reviewing process of the items by experts. The experts at the University of South Africa confirmed that the questionnaire for the current study was valid from a content perspective and that it was in line with academic research principles.

4.6.4.2 Reliability

According to Alreck and Settle (2004), reliability refers to consistency throughout a series of measurements. For example, if a respondent gives a response to a particular item, the respondent is expected to give the same response to that item whenever he/she is asked subsequently. On the other hand, if a respondent keeps on changing his or her responses to the same item when asked repeatedly, then the researcher will be facing a difficulty in considering

which one of these responses is the genuine response of the respondent (Litwin, 1995). Thus, the researcher should frame the items in such a way that the respondent cannot but give only one genuine response.

For the purposes of ensuring reliability in this study, a pre-testing exercise was conducted with the same panel of experts in the field of finance and risk management from the University of South Africa. These experts were used because they had substantive and practical knowledge about the kind of data that was being collected and also had the ability to notice potential challenges that could arise.

Another reliability test was conducted using Cronbach's alpha to ascertain whether the questionnaire was valid and reliable. Alpha was developed by Lee Cronbach in 1951, to provide a measure of the internal consistency of a test or scale (Schmitt, 1996. Alpha is expressed as a number between 0 and 1. Internal consistency describes the extent to which all the items in a test measure the same concept or construct, and hence the connection to the inter-relatedness of the items within the test. According to Tavakol, Mohagheghi and Dennick (2008), internal consistency should be determined before a test can be employed for research purposes to ensure validity and reliability.

In addition, reliability estimates show the amount of measurement error in a test. Put simply, this interpretation of reliability is the correlation of the test with itself. Squaring this correlation and subtracting from 1.00 produces the index of measurement error. For example, if a test has a reliability of 0.80, there is 0.36 error variance (random error) in the scores (0.80×0.80 = 0.64; 1.00⁄0.64 = 0.36). As the estimate of reliability increases, the fraction of a test score that is attributable to error will decrease.

If the items in a test are correlated to each other, the value of alpha is increased. However, a high coefficient alpha does not always mean a high degree of internal consistency. This is because alpha is also affected by the length of the test. If the test length is too short, the value of alpha is reduced. Thus, to increase alpha, more related items testing the same concept should be added to the test. It is also important to note that alpha is a property of the scores on a test from a specific sample of testees. Therefore, investigators should not rely on published alpha estimates and should measure alpha each time the test is administered (Cohen and Swerdlik, 2002).

According to Cortina (1993), the improper use of alpha can lead to situations in which either a test or scale is wrongly discarded or the test is criticised for not generating trustworthy results. To avoid this situation an understanding of the associated concepts of internal consistency, homogeneity or unidimensionality may help to improve the use of alpha. Internal consistency is concerned with the interrelatedness of a sample of test items, whereas homogeneity refers to unidimensionality. A measure is said to be unidimensional if its items measure a single latent trait or construct. Internal consistency is a necessary but not sufficient condition for measuring homogeneity or unidimensionality in a sample of test items.

Fundamentally, the concept of reliability assumes that unidimensionality exists in a sample of test items and, if this assumption is violated, it causes a major underestimate of reliability. It has been well documented that a multidimensional test does not necessary have a lower alpha than a unidimensional test. Thus, a more rigorous view of alpha is that it cannot simply be interpreted as an index for the internal consistency of a test.

Alpha, therefore, does not simply measure the unidimensionality of a set of items, but can be used to confirm whether or not a sample of items is actually unidimensional (Lawson, 2006). On the other hand, if a test has more than one concept or construct, it may not make sense to report alpha for the test as a whole as the larger number of questions will inevitable inflate the value of alpha. In principle therefore, alpha should be calculated for each of the concepts rather than for the entire test or scale. The implication for a summative examination containing heterogeneous, case-based questions is that alpha should be calculated for each case. In this study, the alpha test on reliability was conducted in Sections B, C and D. Section A was not tested as it focused on the demographics of the respondents. The alpha test results for Sections B, C and D were as follows:

Reliability Section B

Reliability statistics

Cronbach's alpha	Number of items
.685	14

Reliability Section C

Reliability statistics

Cronbach's alpha	Number of items
.672	11

Reliability Section D

Reliability statistics

Cronbach's alpha	Number of items
.713	11

The values of alpha ranged between 0.672 and 0.713 as indicated in the reliability tests above. These values are in line with the acceptable standards of Cronbach's alpha as discussed above. Thus, the questionnaire has complied with the general accepted standards of Cronbach's alpha. High-quality tests are important to evaluate the reliability of data supplied in a research study. Alpha is a commonly employed index of test reliability. Alpha is affected by the test length and dimensionality. Alpha, as an index of reliability, should follow the assumptions of the essentially tau-equivalent approach. A low alpha suggests that these assumptions have not been met. Alpha does not simply measure test homogeneity or unidimensionality as test reliability is a function of test length. A longer test increases the reliability of a test regardless of whether the test is homogenous or not. A high value of alpha (> 0.90) may suggest redundancies and show that the test length should be shortened.

4.6.4.3 Objectivity

The objectivity of the findings pertains to the methods of collection of data and scoring of the responses (Howell *et al.* 2005). The objectivity of the procedure (either collection of data or scoring of the responses or both) may be judged by the degree of agreement between the final scores assigned to different individuals by more than one independent observer. The more 'subjective' the observation, recording and evaluation of the responses, the less the different observers agree.

Researchers who use closed-ended questionnaires (questionnaires in which each item is supplied with certain alternatives thus forcing the respondent to choose one among them) are said to be collecting data with the help of objective tools because all the scores can apply a scoring key and agree perfectly on the result (Cohen, Manion and Marrison, 2000). In contrast, the open-ended questionnaires (questionnaires in which the respondents are allowed to give free responses to each of the items) allow room for great disagreement among the scores. However, in certain instances, questionnaires consisting of both types of items are used

purposefully. In such instances, free response items and observations can be made fairly objective by giving careful instructions and guidelines to the observer or scorer (Punch, 2005).

Thus, any research design should permit the use of measuring instruments which are fairly objective and in which every observer or judge seeing a performance arrives at precisely the same report. This ensures the objectivity of the collected data which will be used for the analysis, inferences and generalisations. In this study, a closed-ended questionnaire was designed based on the conclusions from the literature review. This was followed by the pre-test conducted by a panel of experts in the field of finance and risk management from the University of South Africa, to ensure that objectivity was incorporated in the study.

4.6.4.4 Generalisation

Once it is ensured that the measuring instruments used in a research investigation yield objective, reliable and valid data, the next important problem, in a well-planned research design has to answer the generalisability of the findings of the present study (Cohen, Manion and Marrison, 2000). That is how the data collected from a sample can be utilised best for drawing certain generalisations applicable to a larger group (population) from which the sample is drawn. In other words, it reflects the degree of authority and confidence with which a researcher can say that the same findings will be obtained even though the data is collected from the total population from which the sample is selected (Kumar, 2005).

A research design thus helps a researcher in his attempt to generalise the findings, provided he or she has taken due care in defining the population, selecting the sample and using the appropriate statistical analysis while planning his research design (Creswell, 2005). Thus, a good research design should ensure that:

- the measuring instruments will yield objective, reliable and valid data;
- the population is defined in unequivocal terms;
- the requisite sample size is selected by using the most appropriate technique of sample selection;
- the appropriate statistical analysis has been employed; and
- the findings of the present study can be generalised without being contaminated by the errors of measurement or sampling errors or any other interfering factors.

The designing aspect of a study is complex. The selection of a method or methods of logic and planning of the design in time do not guarantee sound results. However, in this study the above factors were incorporated to ensure that generalisation is valid. The study was tested for objectivity, reliability and validity by a panel of experts in the field of finance and risk management from the University of South Africa. The targeted population was unambiguous since it was South African investment brokers registered with the FSB. A LimeSurvey was used to collect data and the data was exported to SPSS for statistical analysis. Thus, the findings could be generalised without being contaminated by the errors of measurement or any other interfering factors.

4.7 Statistical analysis of findings

According to Kumar (2005), statistical techniques are tools applied by the researcher in the measurement, comparison and control of any uncertainties. According to Zikmund (1999), Antonius (2003) and Heffner (2004), there are two types of statistical techniques:

- inferential statistics, which conduct the inference around the population/sample; and
- descriptive statistics that describe the characteristics for the population/sample.

As the questionnaire comprised of a Likert scale and the respondents were not a random sample but rather a purposive sample, a descriptive analysis was chosen as the most appropriate technique to interpret the data for this study. According to Diamantopoulos and Schlegelmilch (2000), data description is a typical first step in any data analysis project. In addition to being an important self-standing activity, when a descriptive focus characterises the analysis objectives, descriptive analysis provides a very useful initial examination of the data, even when the ultimate concern of the investigator is inferential in nature. For the purpose of this study, descriptive analysis was used to:

- provide preliminary insights as to the nature of the responses obtained, as reflected in the distribution of values for each variable of interest;
- help detect errors in the coding process, and according to Cant *et al.* (2003), coding refers to the process of assigning a code or symbol, preferably a number, to each possible answer to a particular question;
- provide a means for presenting the data in an understandable manner, through the use of tables and graphs;

- provide summary measures of typical or average responses as well as the extent of variation in responses for a given variable; and
- provide an early opportunity for checking whether the distributional assumptions of subsequent statistical tests are likely to be satisfied.

In contrast to the analytical survey, a descriptive survey is primarily concerned with addressing the particular characteristics of a specific population of subjects, either at a fixed point in time or at varying times for comparative purposes (Creswell, 2005). As such they do not share the emphasis in analytical designs upon control but they do share a concern to secure a representative sample of the relevant population. This is to ensure that any subsequent assessments of the attributes of the population are accurate and the findings are generalisable, meaning that they have population validity. However, this is not to say that descriptive surveys are theoretical and that prior reviews of the literature are not as important as in the case of an analytical survey. Rather, prior consideration of the relevant theory and literature may be vital in determining the kind of questions needed to be asked. In this study, an SPSS was used to analyse the data imported from the LimeSurvey.

According to Nie (1970), SPSS was released in its first version in 1968. SPSS is among the most widely used programs for statistical analysis in social science. It is used by market researchers, health researchers, survey companies, government, education researchers, marketing organisations and others (Buckingham and Saunders, 2004). In addition to statistical analysis, data management (case selection, file reshaping, creating derived data) and data documentation (a metadata dictionary is stored in the data file) are features of the base software (Morgan, Leech, Gloeckner, and Barrett, 2011). Other statistics included in the base software are:

- descriptive statistics: cross-tabulation, frequencies, descriptives, descriptive ratio statistics;
- bivariate statistics: means, t-test, ANOVA, correlation (bivariate, partial, distances), nonparametric tests;
- prediction for numerical outcomes: linear regression; and
- prediction for identifying groups: factor analysis, cluster analysis (two-step, K-means, hierarchical), and discriminant statistics.

Based on the above features of SPSS and taking into account that the survey is descriptive in nature, SPSS was chosen as the most appropriate tool to analyse data collected. The other

reason for using SPSS is that it is compatible with other research tools like the LimeSurvey, which was used to collect data. The two research tools were used in conjunction: LimeSurvey was used to define the variables and collect data while SPSS was used for statistical analysis of the data collected. The data collected was exported from LimeSurvey to SPSS for statistical analysis. After the data was exported and stored in SPSS, a statistical run was performed, which produced a statistical analysis summary (refer to Annexure F), based on the frequency of responses on each question asked.

The categorical data was summarised by reporting the percentage of respondents falling into each category. The percentages were then used to depict pie charts. The pie charts summarised the results of the questionnaire where findings were drawn. The findings were used to draw conclusions and formulate recommendations for further research.

4.8 Chapter summary

The chapter focused on the theoretical introduction to the design strategy and a review of the research design for the primary research aspect of the study. The design was examined from both the qualitative and quantitative perspectives. Through academic research, a survey methodology was identified as one of the most widely used non-experimental research designs. As several survey methodologies were considered, an analysis was conducted to review the advantages and disadvantages of each of the specific methods, with the electronic survey methods being selected as the most appropriate for this study.

The use of a questionnaire was identified as the most appropriate data gathering method for this study. The questionnaire was then developed to determine whether the risks identified in Chapter 2 were indeed critical when making an offshore investment decision. The questionnaire was pre-tested by means of a pilot study, which found the questionnaire to be valid from a content perspective.

After the questionnaire was tested for validity and reliability, the target population within the South African investment brokers industry was defined and the questionnaire distributed using LimeSurvey. The data collected using LimeSurvey was then exported to SPSS for descriptive analysis. SPSS was chosen as the most appropriate statistical tool to analyse the results of the study.

Chapter 5 focuses on the analysis and interpretation of the research results following the methodology outlined in this chapter.

CHAPTER 5

RESULTS, DISCUSSION OF RESULTS AND FINDINGS

5.1 Introduction

This chapter contains the results obtained from the analysis of the data in the returned questionnaires. Eighteen investment brokers were sent an electronic copy of the questionnaire and eight completed and submitted the questionnaire by the due date. This represents a response rate of 44.4%. Research findings were evaluated in relation to the goal and objectives of the study.

5.2 Respondent profile

The first section of the questionnaire required demographic information for statistical purposes. This section consisted of two questions. The first question intended to establish the duration that the respondents have operated as investment brokers.

The results indicated that 75% of the respondents have operated as investment brokers for less than 5 years, 12.5% have operated for more than 11 years but not more than 15 years. The other 12.5% have operated as investment brokers for more than 15 years.

FINDING 1

Most respondents have not operated as investment brokers for a longer period, meaning they are not highly experienced in this field.

The breakdown of years that respondents have operated as investment brokers is indicated in figure 5.1 below.

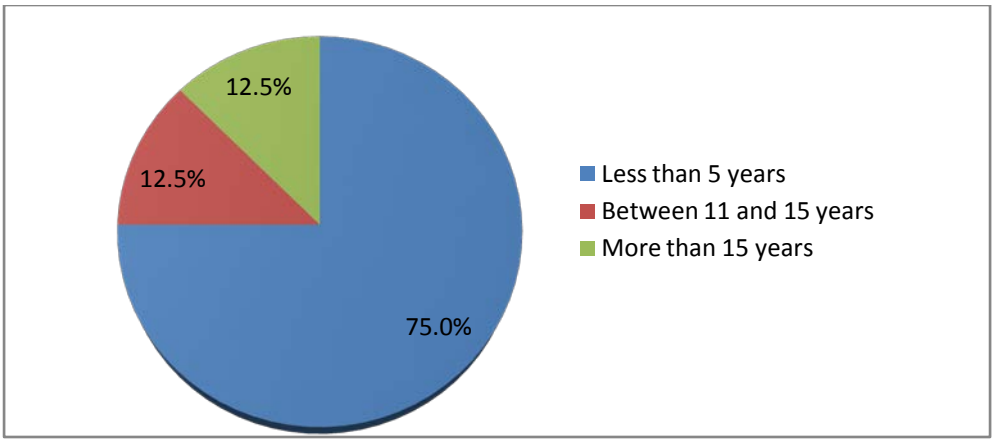


Figure 5.1: Breakdown of years operated as investment brokers

When determining the respondents' highest qualification level, it was discovered that 12.5% of the respondents had a master's or doctoral degree. 37.5% had an honours degree, another 37.5% had a bachelor's degree while 12.5 % had a National Senior Certificate as indicated in figure 5.2 below:

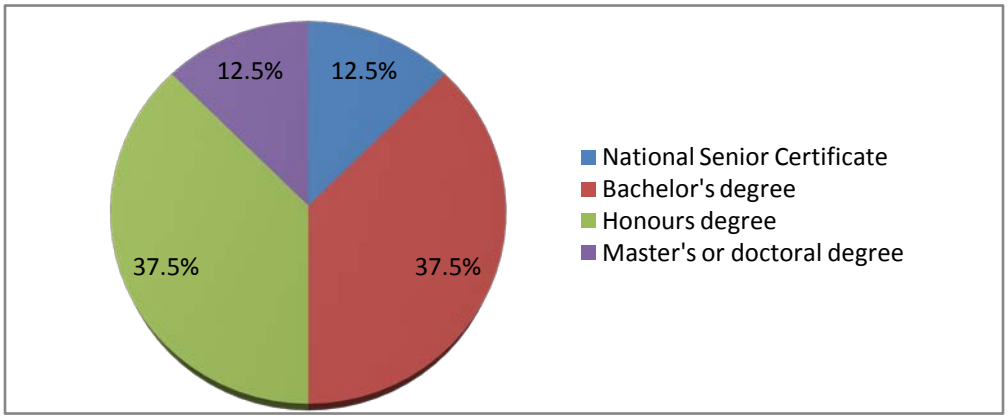


Figure 5.2: Breakdown of respondents' qualification level

FINDING 2
The respondents were a group of well-qualified investment brokers, most of whom held bachelor's and honours degrees.

DISCUSSION OF RESULTS

The demographic section indicated that these respondents have a fair amount of expertise and the educational support to make strategic decisions when considering offshore investments. This section has indicated that investing offshore is still a relatively new concept to some South African investment brokers. This could be contributed to the fact that South Africa is still a developing country that has not fully taken advantage of trading in offshore countries. Seventy-five per cent of the respondents had operated for less than five years as investment brokers. However, it was discovered that many investment brokers had the educational background to assist them in aiding the right strategic decisions when investing offshore.

5.3 The respondents level of understanding offshore risks

To determine the risks faced by offshore investors, ten risks identified through the literature review were rated. The respondents were asked to rate the importance of considering these risks when investing offshore from **Unimportant** to **Very important**. Each reason was assigned a value from 1 for **Unimportant** to 5 for **Very important** and the weighted average per risk was computed. A description of the Likert scale-rating value used can be found in section 4.6.3: Table 4.3.

5.3.1 Exchange rate risk or currency risk

When rating the importance of considering exchange rate risk during an offshore investment decision, 66% of the respondents regarded exchange rate risk as very important. Seventeen per cent regarded exchange rate risk as important while the other 17% regarded exchange rate risk as unimportant as indicated in figure 5.3 below.

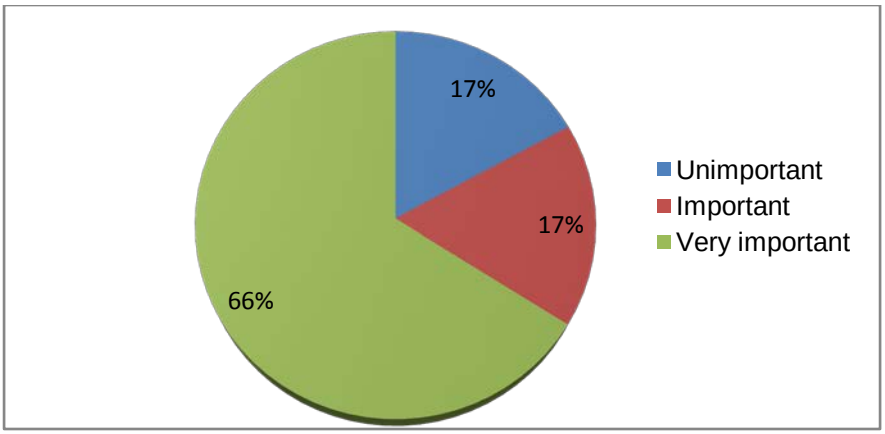


Figure 5.3: Exchange rate risk

FINDING 3

Sixty-six per cent of the respondents regarded exchange rate risk as very important to consider when making an offshore investment decision.

5.3.2 Country risk

All respondents regarded country risk as very important to consider when making an offshore investment decision as indicated in figure 5.4 below:

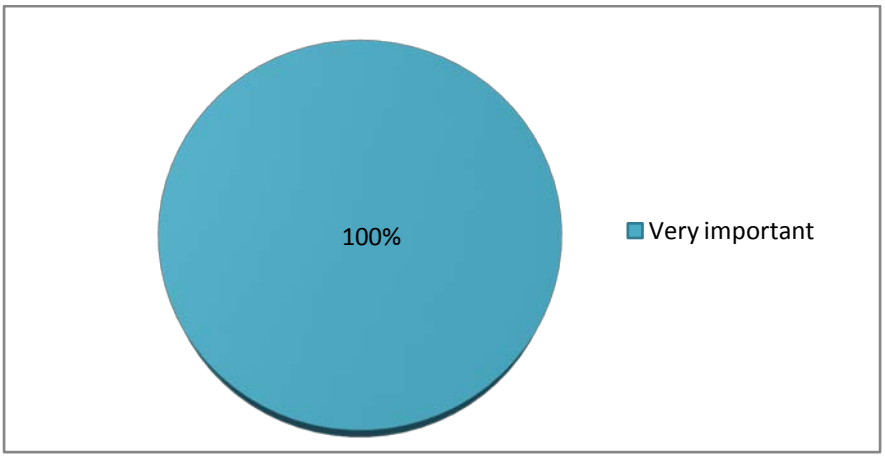


Figure 5.4: Country risk

FINDING 4

Hundred per cent of the respondents regarded country risk as very important to consider when considering offshore investments.

5.3.3 Market risk

When rating the importance of considering market risk during an offshore investment decision, 67% of the respondents regarded market risk as very important, while 33% regarded market risk as important as indicated in figure 5.5 below.

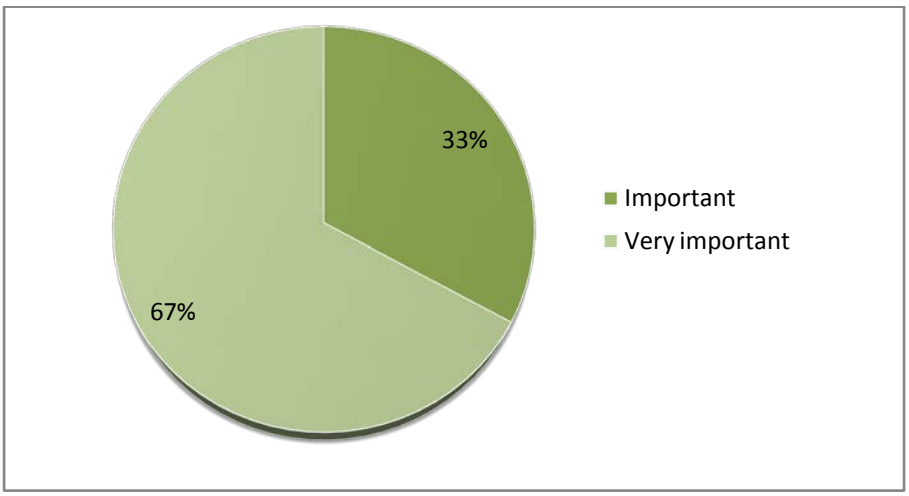


Figure 5.5: Market risk

FINDING 5

Two-thirds of the respondents regarded market risk as very important to consider when making an offshore investment decision.

5.3.4 Inflation risk

The importance of considering inflation risk when making an offshore investment decision is indicated in figure 5.6 below. Fifty per cent of the respondents regarded inflation risk as very important. Thirty-three per cent regarded inflation risk as important and 17% were neutral as far as inflation risk is concerned.

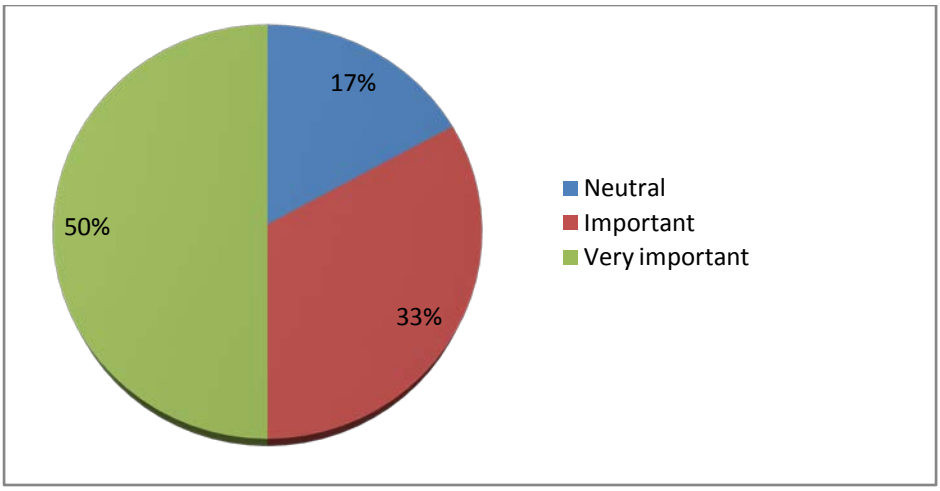


Figure 5.6: Inflation risk

FINDING 6

Half of the respondents regarded inflation risk as very important to consider when making an offshore investment decision. Thirty-three per cent and 17% regarded inflation risk as important and as neutral respectively.

5.3.5 Interest rate risk

Of the respondents, 67% regarded interest rate risk as very important to consider when making an offshore investment decision. Seventeen per cent regarded interest rate risk as important and the other 17% were neutral as far as interest rate risk is concerned as indicated in figure 5.7 below.

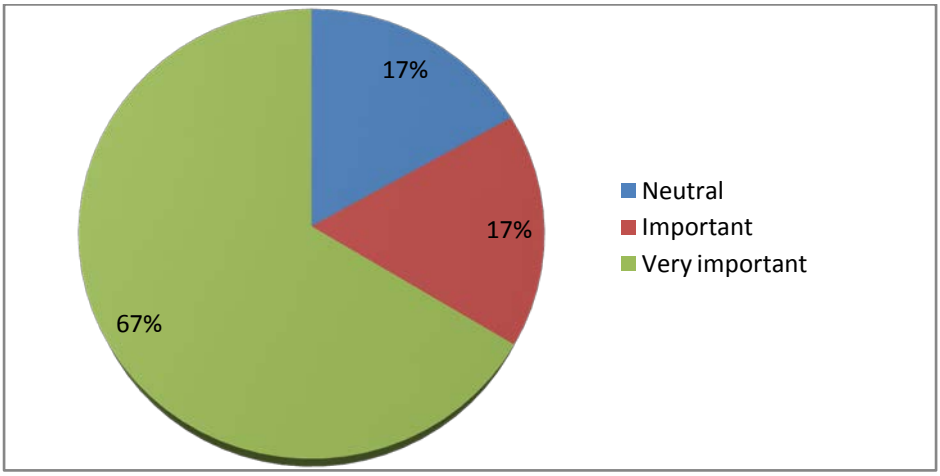


Figure 5.7: Interest rate risk

FINDING 7

Two-thirds of the respondents regarded interest rate risk as very important to consider when making an offshore investment decision. Thirty-four per cent was equally divided between unimportant and important.

5.3.6 Financial risk

When rating the importance of considering financial risk during an offshore investment decision, 80% of the respondents regarded financial risk as very important. Twenty per cent of the respondents were neutral about financial risk as indicated in figure 5.8 below.

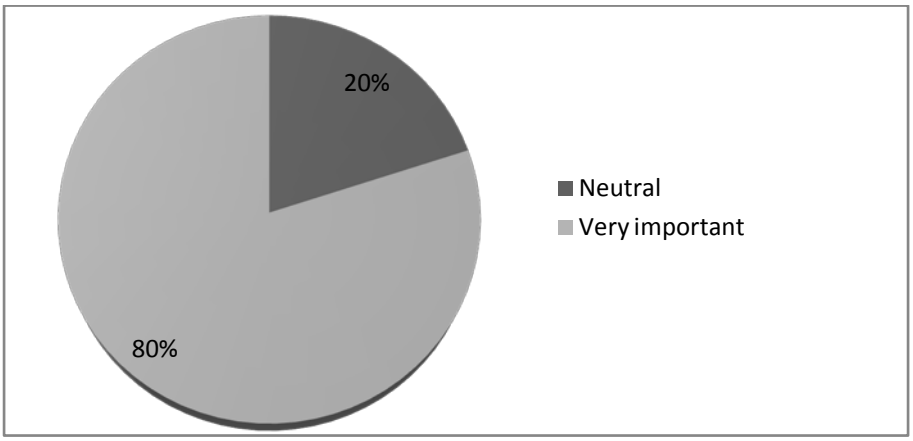


Figure 5.8: Financial risk

FINDING 8

Eighty per cent of the respondents regarded financial risk as very important to consider when making an offshore investment decision.

5.3.7 Credit risk

The respondents were equally divided on very important and important respectively when rating the importance of considering credit risk during an offshore investment decision as indicated in figure 5.9 below.

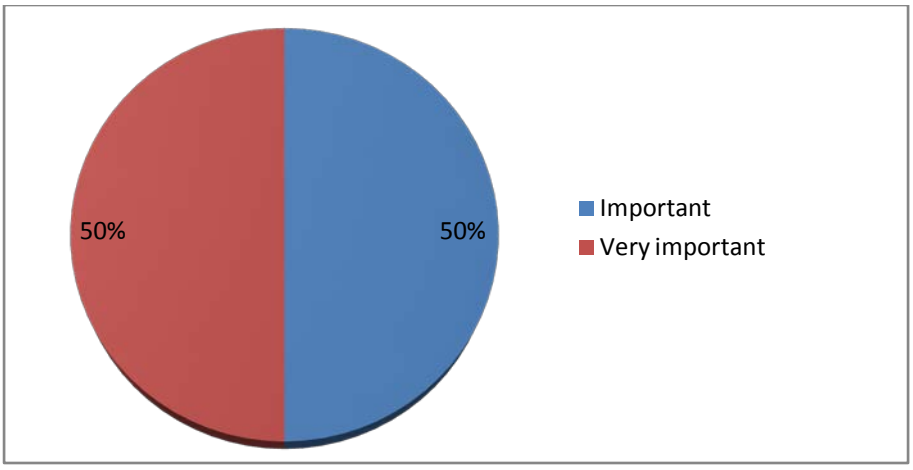


Figure 5.9: Credit risk

FINDING 9
Fifty per cent of the respondents regarded credit risk as very important to consider when making an offshore investment decision. The other fifty per cent regarded credit risk as just important when making an offshore investment decision.

5.3.8 Liquidity risk

Of the respondents, 67% regarded liquidity risk as very important are, while 33% regarded it as important to consider when making an offshore investment decision. The respondents' ratings are indicated in figure 5.10 below.

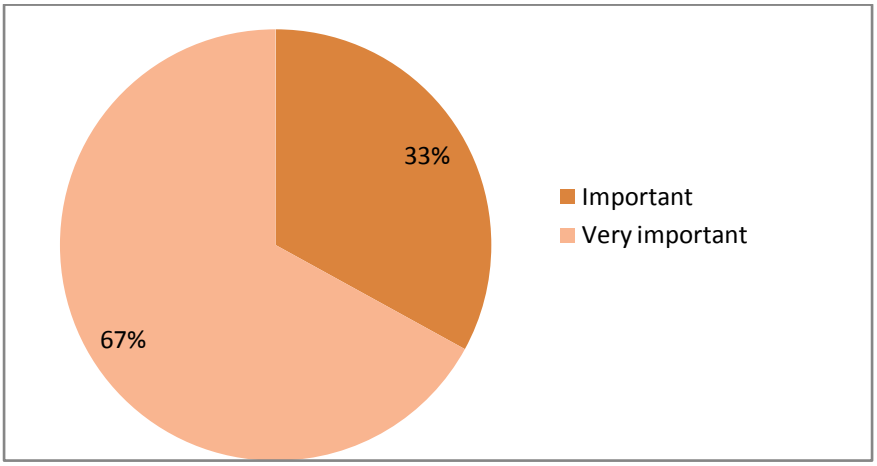


Figure 5.10: Liquidity risk

FINDING 10

Two-thirds of the respondents regarded liquidity risk as very important to consider when making an offshore investment decision. Thirty-three per cent regarded liquidity risk as important.

5.3.9 Legal risk

Figure 5.11 below indicates the respondents' ratings when considering the importance of legal risk during an offshore investment decision. Sixty-seven per cent of the respondents regarded legal risk as very important, 17% regarded legal risk as important and the other 17% were neutral as far as legal risk is concerned.

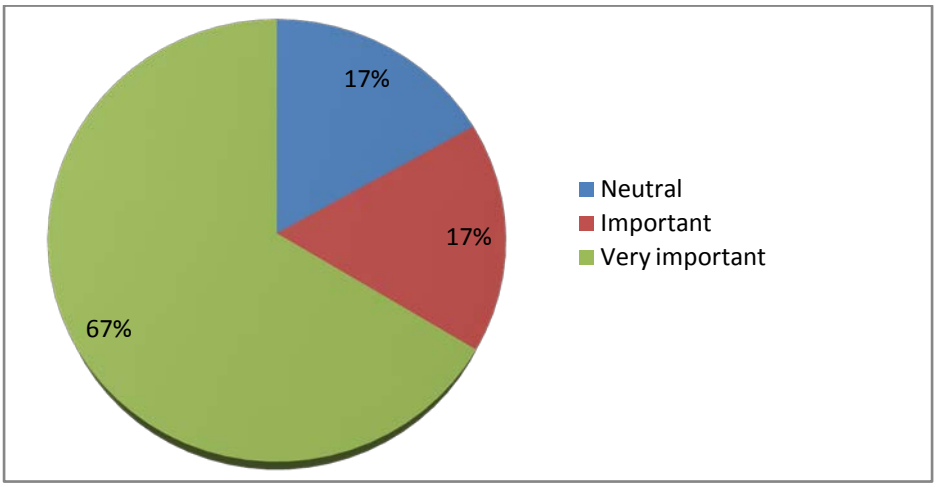


Figure 5.11: Legal risk

FINDING 11

Two-thirds of the respondents regarded legal risk as very important to consider when making an offshore investment decision. Thirty-three per cent were equally divided between neutral and important.

5.3.10 Technology risk

The respondents were equally divided between very important and important regarding the importance of considering technology risk when making an offshore investment decision as indicated in figure 5.12 below.

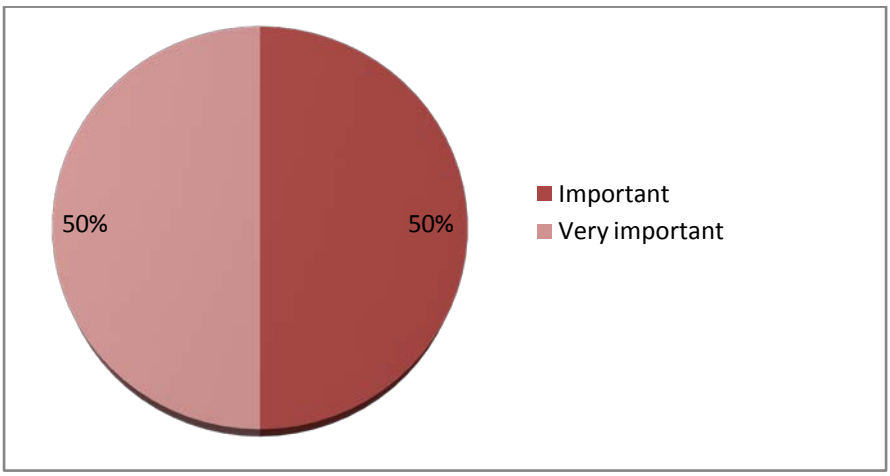


Figure 5.12: Technology risk

FINDING 12
When considering the importance of technology risk, the respondents were equally divided on important and very important.

DISCUSSION OF FINDINGS

The ten risks identified in the literature review were confirmed as risks that are important to consider when making an offshore investment decision. However, the respondents rated the risks' level of importance differently.

Two-thirds majority of the respondents confirmed exchange rate risk as very important to consider when making an offshore investment decision. The movement in exchange rate can enhance or reduce the value of an offshore investment; hence, it is vitally important to contain this risk when making offshore investments.

All respondents regarded country risk as very important to consider when making an offshore investment decision. Country risk includes, amongst others, political decisions in offshore countries, monetary and fiscal policies, which could lead to losses if they are against investments in the country. Offshore investors need to track the political trends in the country they intend to invest in. Unstable countries or countries with unstable politics should not be considered.

Market risk, interest rate risk, liquidity risk as well as legal risk has been confirmed by 67% of the respondents as very important to consider when making an offshore investment decision. Market fluctuations can make or break a perfect investment plan. Highly volatile markets have higher risks in relation to lower volatile markets. When diversifying investments in offshore countries, investors need to strike a good balance between these markets.

Changes in interest rates influence the value of the investor's stocks, cash and shares. As a result, the risk of a particular investment could increase as interest rates increase, and decrease as interest rates decrease. Offshore investors need to be mindful of these movements. Liquidity risk can be regarded as one of the key risks an investor should mitigate when investing offshore. Liquidity management will not only ensure that risks are kept minimal but also that opportunities presented are exploited.

None of the respondents rated credit risk and technology risk as unimportant to consider. The respondents were equally divided when rating credit risk and technology risk as important and very important to consider when making an offshore investment decision. This confirms that these risks can be detrimental to an offshore investment plan if not minimised. In order of importance, the risks that should receive the highest attention from most important to the least important were ranked as follows:

1. Country risk
2. Financial risk
3. Market risk
4. Interest rate risk
5. Liquidity risk
6. Legal risk
7. Exchange rate risk

8. Inflation risk
9. Credit risk
10. Technological risk

The next section focuses on the respondents' level of understanding offshore investment factors when making an offshore investment decision.

5.4 The offshore investment factors during an offshore investment decision

To determine the offshore investment factors during an offshore investment decision, seven offshore investment factors identified through the literature review were rated. The respondents were asked to rate the importance of considering these factors during an offshore investment decision from **Unimportant** to **Very important**. Each reason was assigned a value from 1 for **Unimportant** to 5 for **Very important** and the weighted average per investment factor was computed. A description of the Likert scale-rating value used can be found in section 4.6.3: Table 4.3.

5.4.1 Currency fluctuations in the offshore country

The respondents rated currency fluctuations in the offshore country when making an offshore investment decision as follows. Eighty-three per cent regarded it as very important, while 17% regarded it as important, as indicated in figure 5.13 below.

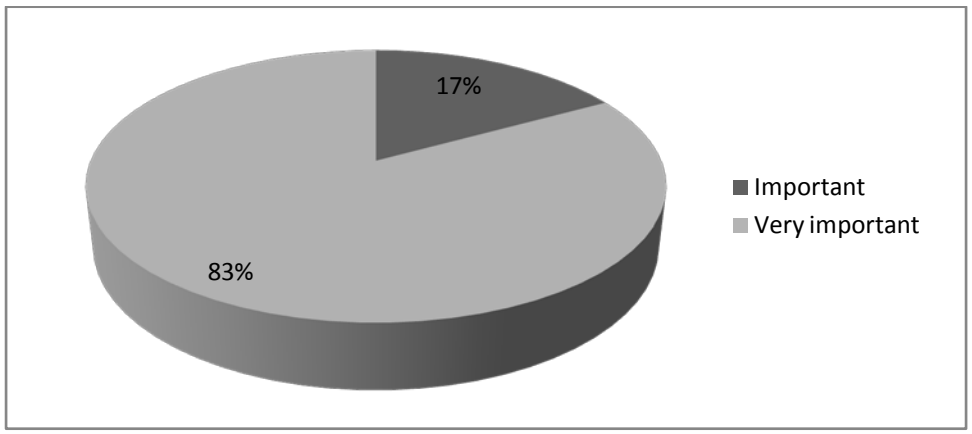


Figure 5.13: Currency fluctuations in the offshore country

FINDING 13

Eighty-three per cent of the respondents regarded currency fluctuations in the offshore country as very important to consider when considering offshore investments, while 17% regarded it as just important.

5.4.2 Economic stability of the offshore country

The respondents' rating of the economic stability of the offshore country when making an offshore investment decision is indicated in figure 5.14 below. Eighty-three per cent regarded it as very important, while 17% regarded it as important.

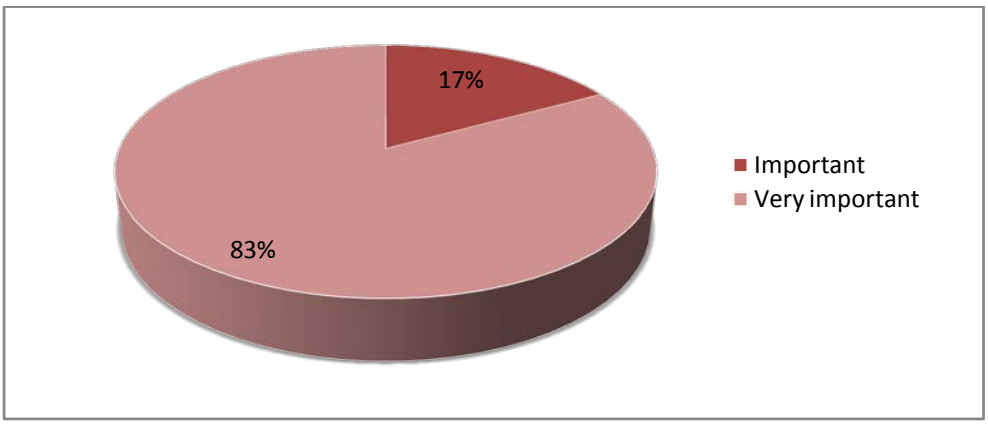


Figure 5.14: Economic stability of the offshore country

FINDING 14

Eighty-three per cent of the respondents regarded economic stability of the offshore country as very important to consider when considering offshore investments, while 17% regarded it as important.

5.4.3 Liquidity of offshore investment assets

When rating the importance of considering the liquidity of offshore investment assets during an offshore investment decision, 67% of the respondents regarded it as very important while 33% regarded it as just important as indicated in figure 5.15 below.

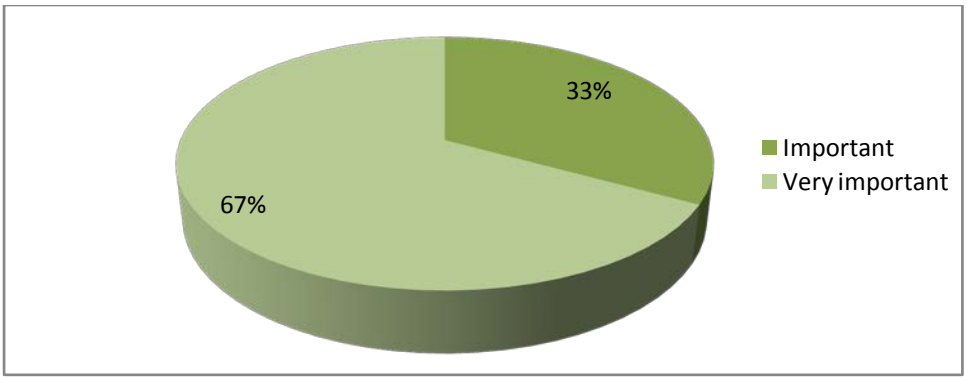


Figure 5.15: Liquidity of the offshore investment assets

FINDING 15

Two-thirds of the respondents regarded liquidity as very important to consider when considering offshore investments assets, while 33% regarded it as important.

5.4.4 Inflation in the offshore country

When rating the importance of considering inflation in the offshore country during an offshore investment decision, 67% of the respondents regarded it as important while 33% regarded it as very important as indicated in figure 5.16 below.

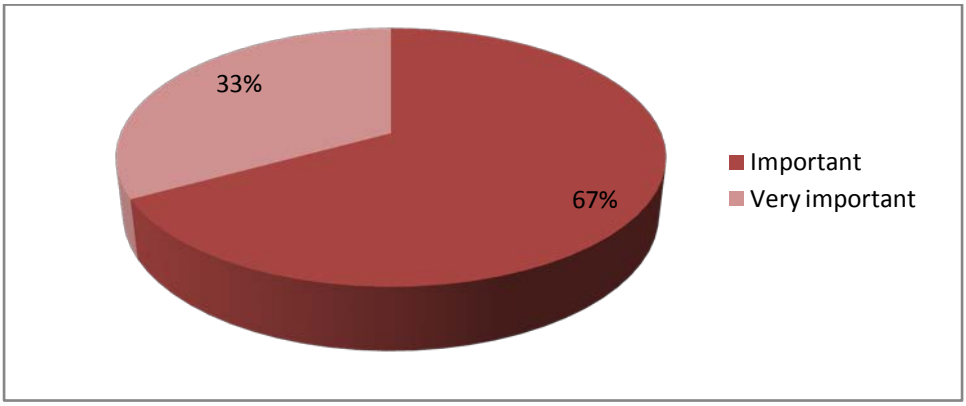


Figure 5.16: Inflation in the offshore country

FINDING 16

Two-thirds of the respondents regarded inflation in the offshore country as important to consider when considering offshore investments, while 33% regarded it as very important.

5.4.5 The cost of the offshore investment asset

When considering the cost of the offshore investment asset during an offshore investment decision, the respondents were equally divided between very important and important as indicated in figure 5.17 below.

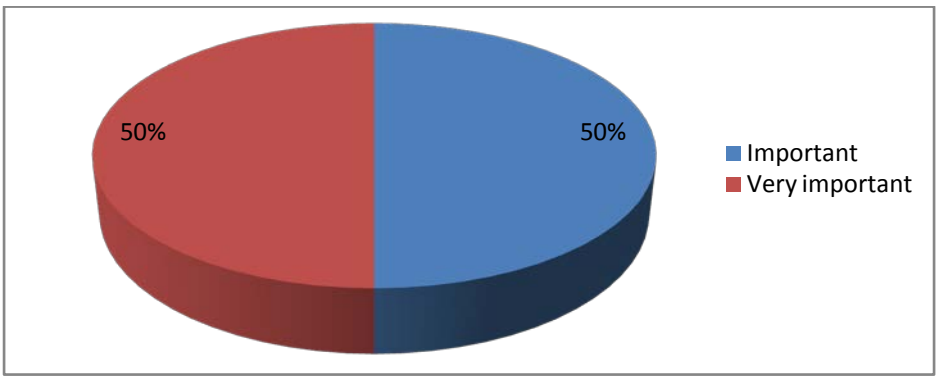


Figure 5.17: The cost of the offshore investment asset

FINDING 17

The respondents were equally divided on important and very important with regard to considering the cost of the offshore investment asset during an offshore investment decision.

5.4.6 Risks and scams

All respondents regarded risks and scams as very important to consider when making an offshore investment decision as indicated in figure 5.18 below.

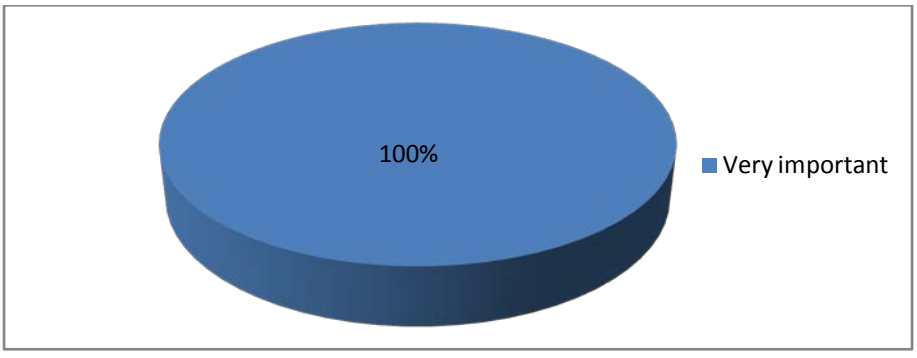


Figure 5.18: Risks and scams

FINDING 18

Hundred per cent of the respondents regarded risks and scams as very important to consider when making an offshore investment decision.

5.4.7 Taxation regulations in the offshore country

All respondents regarded taxation regulations in the offshore country as very important to consider when making an offshore investment decision as indicated in figure 5.19 below.

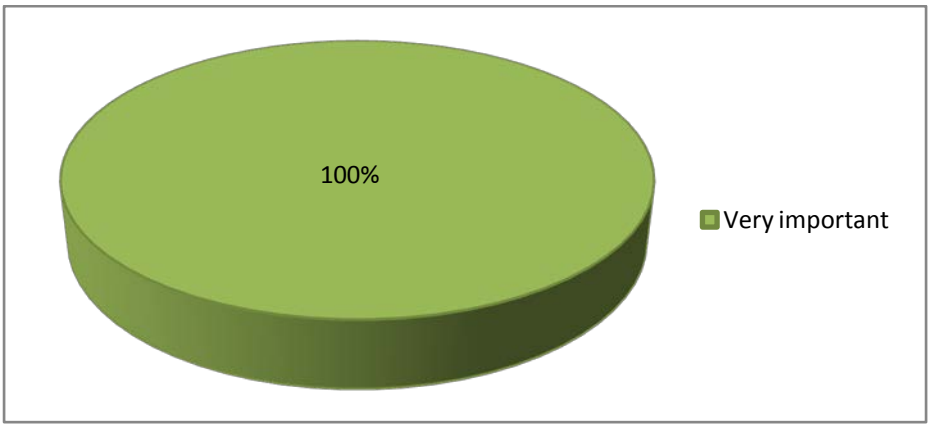


Figure 5.19: Taxation regulations in the offshore country

FINDING 19

Hundred per cent of the respondents regarded taxation regulations in the offshore country as very important to consider when making offshore investment.

DISCUSSION OF FINDINGS

The findings revealed that respondents unanimously regarded risks and scams as well as taxation regulations in the offshore country as the most important factors to consider when making an offshore investment decision. More than 80% of the respondents regarded economic stability and currency fluctuations in the offshore country as very important to consider when making an offshore investment decision. Currency fluctuation can increase or decrease the value on an investment when converted to domestic currency. Economic stability refers to the absence of excessive fluctuations in the economy (Rainbow, 2010).

An economy with fairly constant output growth and low and stable inflation would be considered economically stable. An economy with frequent large recessions, a pronounced business cycle, very high or variable inflation, or frequent financial crises would be considered economically unstable (Madura, 2009).

Two-thirds of the respondents revealed that inflation in the offshore country and liquidity of the offshore investment assets cannot be overemphasised as key factors to consider when making an offshore investment decision. Inflation was defined by Appel (2008), as the rise in the general level of prices of goods and services in an economy over a period of time. When the general price level rises, each unit of currency buys fewer goods and services. Thus, it is important for offshore investors to take into account the inflation rate in the offshore country concerned. Consequently, inflation also reflects erosion in the purchasing power of money, a loss of real value in the internal medium of exchange and unit of account in the economy (Gitman and Joehnk, 2008). A chief measure of price inflation is the inflation rate, the annualised percentage change in a general price index (normally the CPI) over time.

Liquidity is an asset's ability to be sold without causing a significant movement in the price and with minimum loss of value. Money, or cash, is the most liquid asset, and can be used immediately to perform economic actions like buying, selling, paying debt or meeting immediate wants and needs. However, currencies, even major currencies, can suffer loss of market liquidity in large liquidation events. For instance, scenarios considering a major dump of US dollar bonds by China or Saudi Arabia or Japan, each of which holds trillions in such bonds, would certainly affect the market liquidity of the US dollar and US dollar-denominated assets. There is no asset whatsoever that can be sold with no effect on the market. Thus, offshore investors need to be mindful of the liquidity of the assets or investment they intend to invest in.

5.5 Reasons for investing offshore

To determine the reasons for investing offshore, seven reasons identified through the literature review were rated. The respondents were asked to rate their level of agreement from **strongly disagree** to **strongly agree**. Each reason was assigned a value from 1 for s**trongly disagree** to 5 for **strongly agree** and the weighted average per reason was computed. A description of the Likert scale rating value used can be found in section 4.6.3: Table 4.4.

5.5.1 Diversification of risks

When determining whether diversification of risks is a reason for investing offshore, 50% of the respondents strongly agreed and the other 50% agreed as indicated in figure 5.20 below.

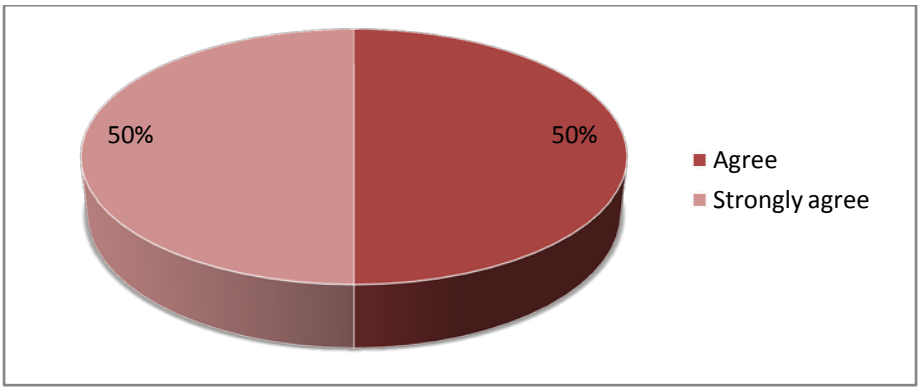


Figure 5.20: Diversification of risks

FINDING 20

Fifty per cent of the respondents agreed and another fifty strongly agreed that diversification of risks is a reason for investing offshore.

5.5.2 Enhancement of returns

Of the respondents, 67% and 33% strongly agreed and agreed respectively that enhancement of returns is a reason for investing offshore, as indicated in figure 5.21 below.

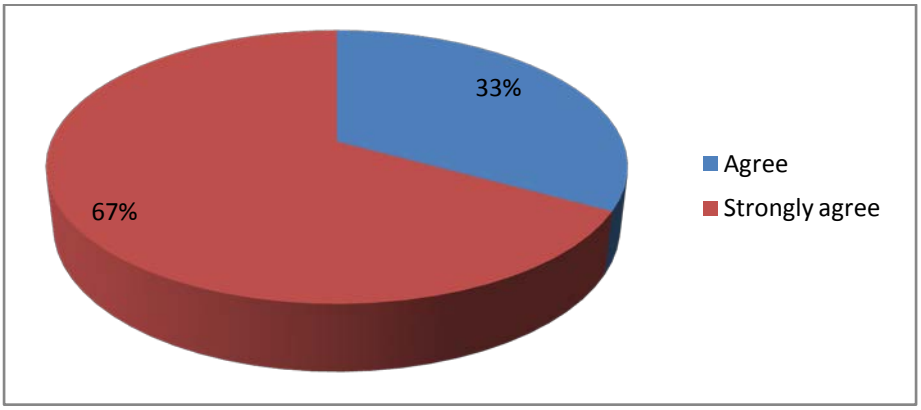


Figure 5.21: Enhancement of returns

FINDING 21

Two-thirds of the respondents strongly agreed that enhancement of returns is a reason for investing offshore, while 33% agreed.

5.5.3 Exploitation of offshore markets

When determining exploitation of offshore markets as a reason for investing offshore, 33.3% of the respondents strongly agreed, 33.3% agreed while the other 33.3% were neutral as indicated in figure 5.22 below.

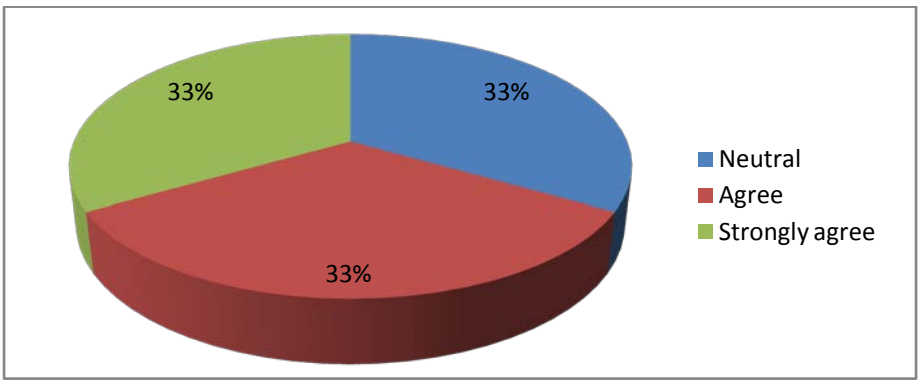


Figure 5.22: Exploitation of offshore markets

FINDING 22

Thirty-three per cent of the respondents were neutral, 33% agreed and another 33% strongly agreed that exploitation of offshore markets is a reason for investing offshore.

5.5.4 To increase investment opportunities

The respondents were equally divided on strongly agree and agree when determining whether increasing investment opportunities is a reason for investing offshore. The results are indicated in figure 5.23 below.

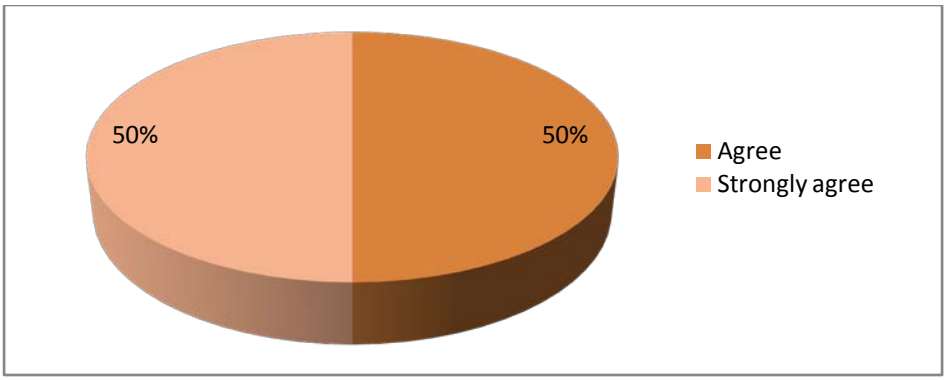


Figure 5.23: To increase investment opportunities

FINDING 23
Fifty per cent of the respondents agreed and another 50% strongly agreed that increasing investment opportunities is a reason for investing offshore.

5.5.5 To balance an investment portfolio

The respondents were equally divided in terms of **strongly agree** and **agree** when determining whether balancing an investment portfolio is a reason for investing offshore. The results are indicated in figure 5.24 below.

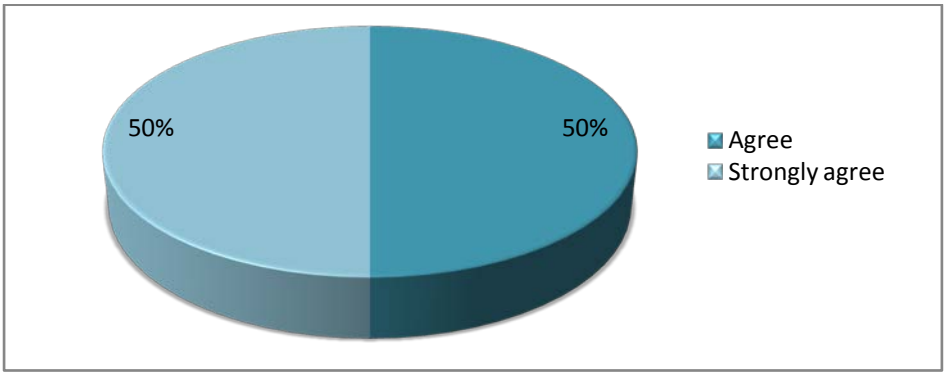


Figure 5.24: To balance an investment portfolio

FINDING 24
Fifty per cent of the respondents agreed and another 50% strongly agreed that balancing an investment portfolio is a reason for investing offshore.

5.5.6 To hedge funds

Of the respondents, 83% and 17% agreed and strongly agreed respectively that hedging funds is a reason for investing offshore as indicated in figure 5.25 below.

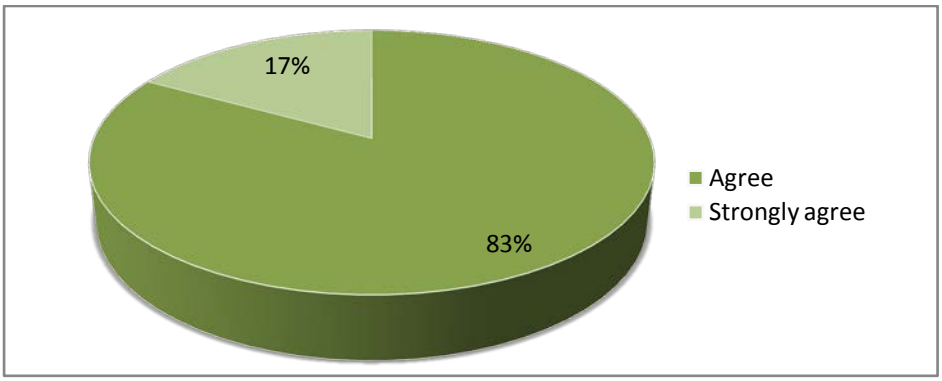


Figure 5.25: Hedging funds

FINDING 25

Eighty-three per cent of the respondents agreed and 17% strongly agreed that hedging funds is a reason for investing offshore.

5.5.7 Confidence in the offshore country

When determining confidence in the offshore country as a reason for investing offshore, only 17% of the respondents strongly agreed, 67% just agreed while 17% were neutral as indicated in figure 5.26 below.

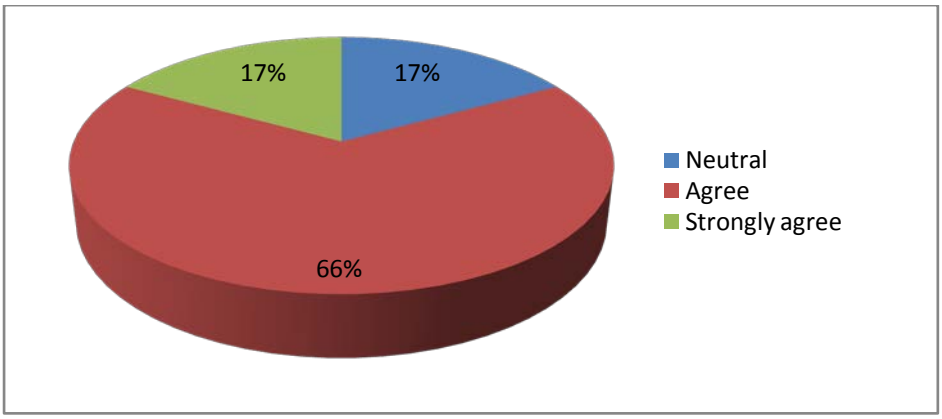


Figure 5.26: Confidence in the offshore country

FINDING 26

Sixty-six per cent of the respondents agreed that confidence in the offshore country is a reason for investing offshore while 17% strongly agreed and another 17% were neutral.

DISCUSSION OF RESULTS

The respondents confirmed all the reasons for investing offshore that were discussed in the literature review as valid reasons for investing in foreign countries. It must, however, be emphasised that these reasons cannot be regarded as the only reasons for investing offshore. Regardless of the reasons for investing offshore, offshore investors should ensure that a proper research has been conducted before investing offshore. There are different types of investments and each has its own level of risk. There is generally no guarantee that investors will make money or even that investors will get back the same amount invested in the first place.

Before investing, it is usually a good idea to have sorted out all debts, ensuring that protection against unforeseen events and a proper investment plan are in place. There are different types of risk involved in investing. Therefore, it is important for investors to identify such risks and to consider their willingness to take these risks. Risks should be considered per investment plan as risks might be right for some investors and too risky for others. The reasons for investing offshore should be directly proportional to the risks of investing offshore (Gough, 1998).

5.6 The main indicators of exchange rate risk

This question focused on the main indicators of exchange rate risk when investing offshore. Three indicators were identified from the literature review and the respondents were asked to rate their level of agreement. The respondents' ratings are indicated in the next sections.

5.6.1 The relationships between countries' interest rates

The respondents were equally divided between strongly agree and agree that the relationships between countries' interest rates are important indicators of exchange rate risk as indicated in figure 5.27 below.

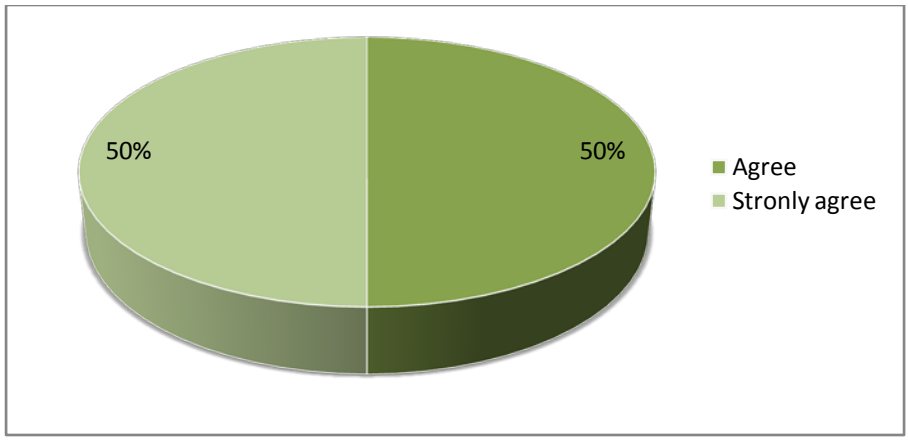


Figure 5.27: The relationships between countries' interest rates

FINDING 27

Fifty per cent of the respondents agreed and another 50% strongly agreed that the relationships between countries' interest rates are main indicators of exchange rate risk.

5.6.2 The relationships between countries' inflation rates

When determining the relationships between countries' inflation rates as a main indicator of exchange rate risk, 66% of the respondents strongly agreed, 17% agreed and another 17% were neutral as indicated in figure 5.28 below.

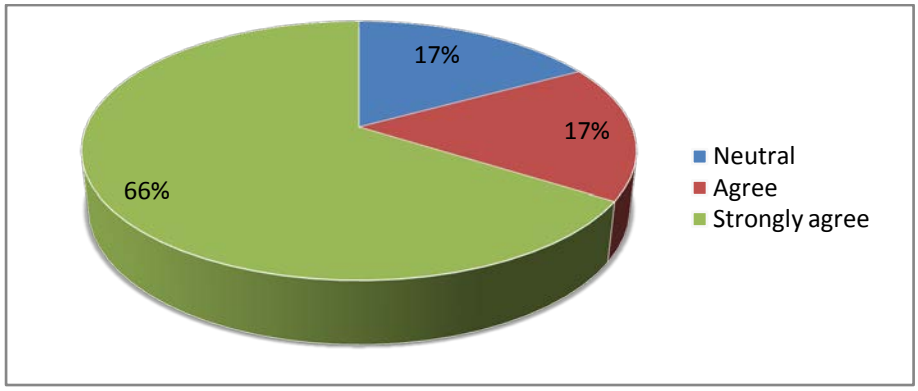


Figure 5.28: The relationships between countries' inflation rates

FINDING 28

Sixty-six per cent of the respondents strongly agreed that the relationships between countries' inflation rates is an important indicator of exchange rate risk, while 17% agreed and another 17% were neutral.

5.6.3 The relationships between countries' exchange rates

The respondents strongly agreed and agreed – 67% and 33% respectively – that the relationships between countries' exchange rates is an important indicator of exchange rate risk as indicated in figure 5.29 below.

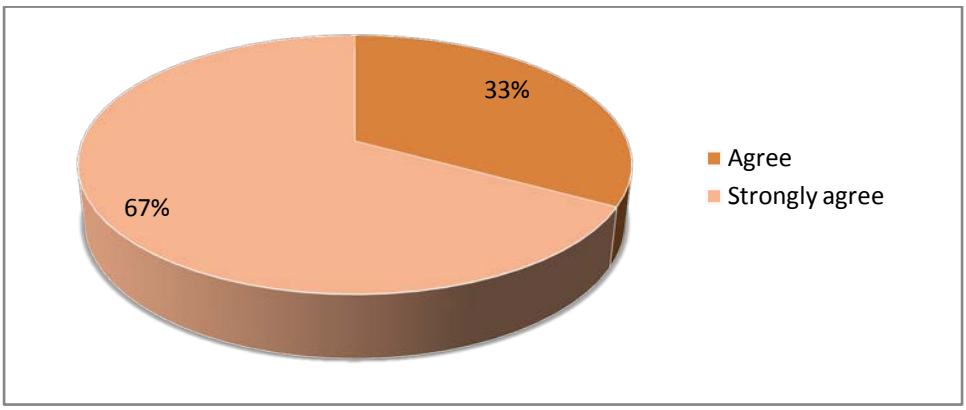


Figure 5.29: The relationships between countries' exchange rates

FINDING 29
Two-thirds of the respondents strongly agreed that the relationships between countries' exchange rates are the main indicators of exchange rate risk, while 33% agreed.

DISCUSSION OF RESULTS

The main indicators of exchange rates discussed in the literature review have been confirmed as vital to consider when planning to invest offshore. The relationships between countries' interest rates, countries' inflation rates and countries' exchange rates play an important role in the end results of any offshore investment. The movement in interest rates, inflation rates and exchange rates determines to a greater or lesser extent the value of the offshore investment. Offshore investors should compare domestic interest rates, inflation rates and exchange rates with their foreign counterparts to guard against negative returns on offshore investments.

5.7 Country risk factors

To determine the country risk factors to consider during an offshore investment decision, the four factors identified from the literature review were put to test. The respondents were asked to rate the importance of considering these factors when making an offshore investment decision using the Likert scale rating value discussed in section 4.6.3: Table 4.3.

5.7.1 Jurisdiction issues

When determining the importance of considering jurisdiction issues as a factor to consider when making an offshore investment decision, 80% regarded it as very important versus 20% who regarded it as just important. The results are indicated in figure 5.30 below.

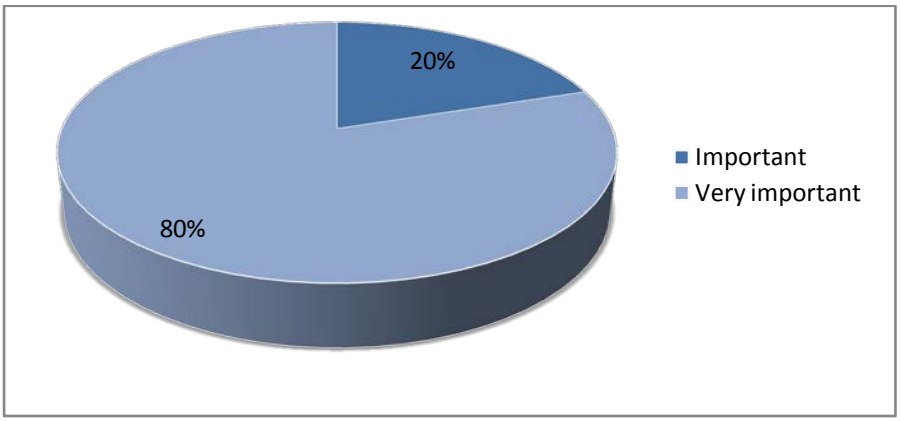


Figure 5.30: Jurisdiction issues

FINDING 30

Eighty per cent of the respondents considered jurisdiction issues as very important to consider when making an offshore investment decision, while 20% regarded it as important.

5.7.2 Tax issues

In terms of the importance of considering tax issues as a key factor to consider when making an offshore investment decision, 80% regarded it as very important versus 20% who regarded it as just important. The results are indicated in figure 5.31 below.

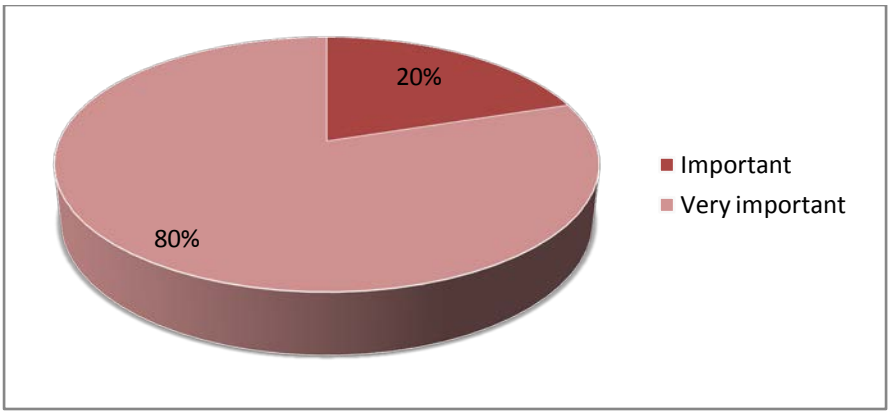


Figure 5.31: Tax issues

FINDING 31

Eighty per cent of the respondents considered tax issues as very important to consider when considering offshore investments, while 20% regarded it as just important.

5.7.3 Investment issues

Regarding the importance of taking into account the investment issues as a key factor to consider when considering offshore investments, 60% saw it as important versus 40% who saw it as very important. The results are indicated in figure 5.32 below.

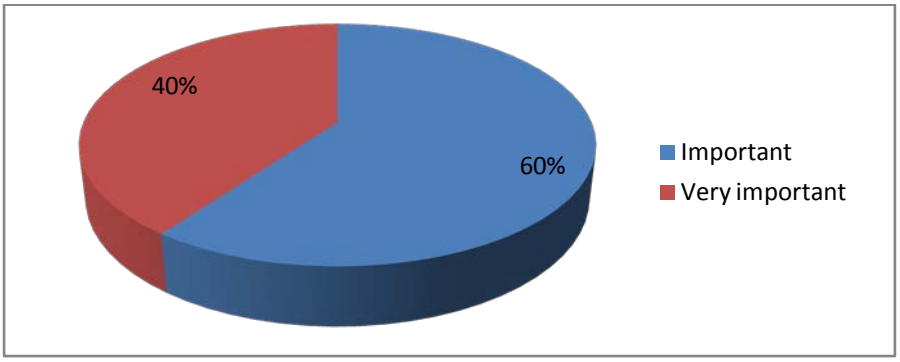


Figure 5.32: Investment issues

FINDING 32

Sixty per cent of the respondents regarded investment issues as important to consider when considering offshore investments, while 40% regarded it as very important.

5.7.4 Trust issues

In terms of the importance of taking into account the trust issues as a key factor to take into account when considering offshore investments, 60% regarded it as important, 20% regarded it as very important while the other 20% were neutral as indicated in figure 5.33 below.

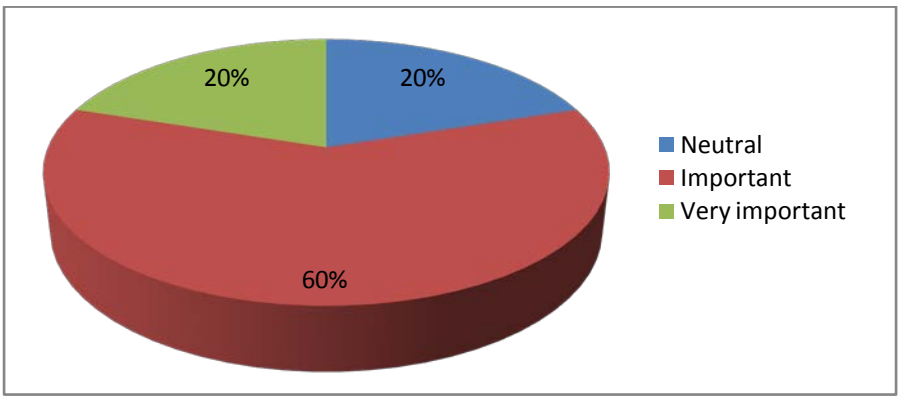


Figure 5.33: Trust issues

FINDING 33

Sixty per cent of the respondents regarded trust issues as important to consider when considering offshore investments, while 40% were equally divided between neutral and very important.

DISCUSSION OF RESULTS

The importance of country risk factors cannot be overemphasised. Without containing these factors, an offshore investment plan could spiral out of control and result in losses. More than 66% of the respondents have unanimously agreed that the jurisdiction issues, tax issues, investment issues and trust issues are key factors to consider when planning an offshore investment. If investors are not aware of tax and investment regulations in offshore countries, they could find themselves at a disadvantage when they plan to cash in their investments.

5.8 Reduction of country risk

This question focused on the control measures applied to reduce country risk during an offshore investment decision. The respondents rated their level of agreement on the control measures that were identified from the literature review as summarised below.

5.8.1 Assessment of sovereign, currency and banking sector

The respondents agreed and strongly agreed – 60% and 40% respectively – that the assessment of sovereign, currency and banking sector risk in offshore markets is a control measure to reduce country risk. The results are indicated in figure 5.34 below.

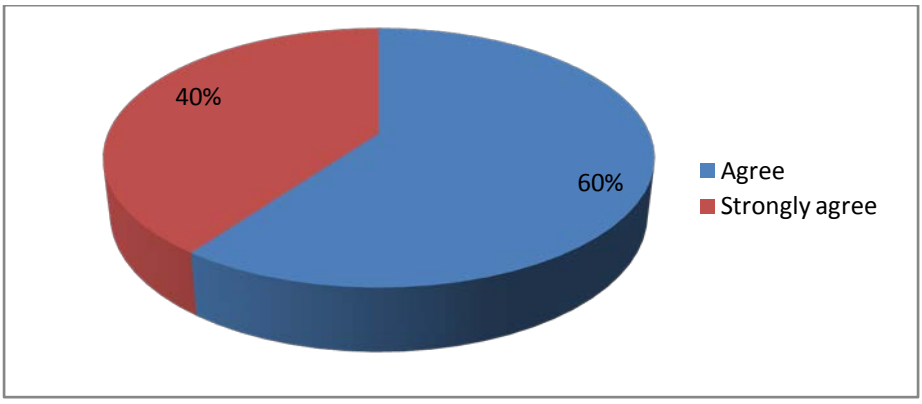


Figure 5.34: Assessment of sovereign, currency and banking sector

FINDING 34

Sixty per cent and 40% of the respondents respectively agreed and strongly agreed that the assessment of sovereign, currency and banking sector risk in offshore markets would reduce country risk when investing offshore.

5.8.2 Analysis of credit risk

All the respondents strongly agreed that the analysis of credit risk posed by the political and economic situation in each country would reduce country risk when investing offshore as indicated in figure 5.35 below.

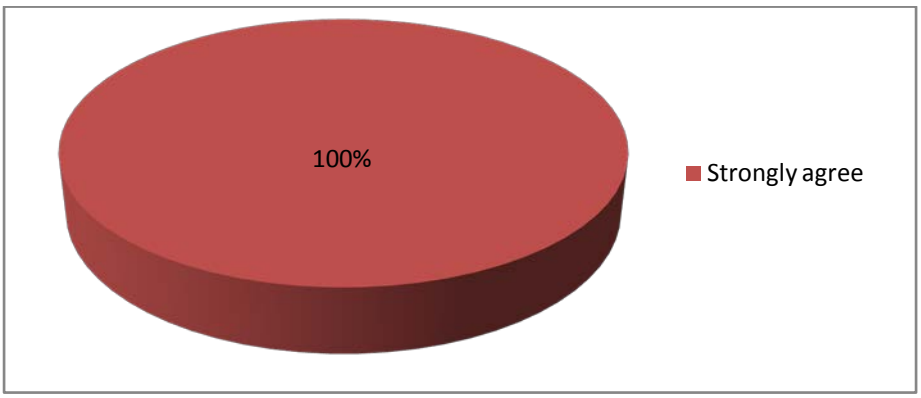


Figure 5.35: Analysis of credit risk

FINDING 35

All of the respondents strongly agreed that the analysis of credit risk posed by the political and economic situation in each country would reduce country risk when investing offshore.

5.8.3 Comparison of risks across countries

Of the respondents, 60% strongly agreed that the comparison of risks across countries, using standardised risk and forecasting methodology could reduce country risk. The other 40% just agreed as indicated in figure 5.36 below.

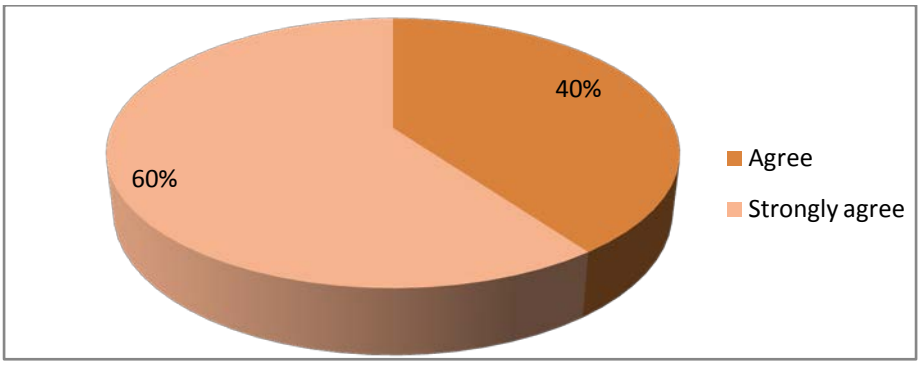


Figure 5.36: Comparison of risks across countries

FINDING 36

Of the respondents, 60% and 40% strongly agreed and agreed respectively that the comparison of risks across countries, using standardised risk and forecasting methodology could reduce country risk when investing offshore.

5.8.4 Assessment of business risk

Of the respondents, 60% that strongly agreed that the assessment of business risk, taking into account macroeconomic variables, could reduce country risk when investing offshore, while 40% just agreed. as indicated in figure 5.37 below.

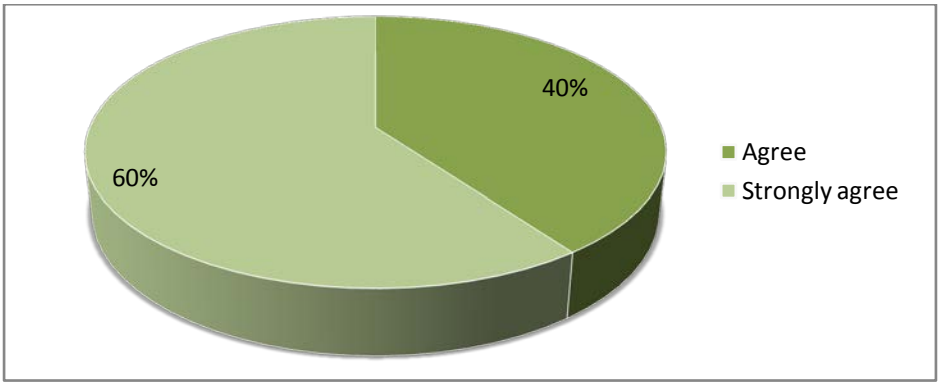


Figure 5.37: Assessment of business risk

FINDING 37

Of the respondents, 60% and 40% strongly agreed and agreed respectively that the assessment of business risk, taking into account macroeconomic variables, could reduce country risk when investing offshore.

5.8.5 Manipulate, display and analyse data

Of the respondents 60% strongly agreed, 20% agreed and the other 20% were neutral about the question whether the manipulation, display and analysis of data using financial and risk rating models could reduce country risk, as indicated in figure 5.38 below

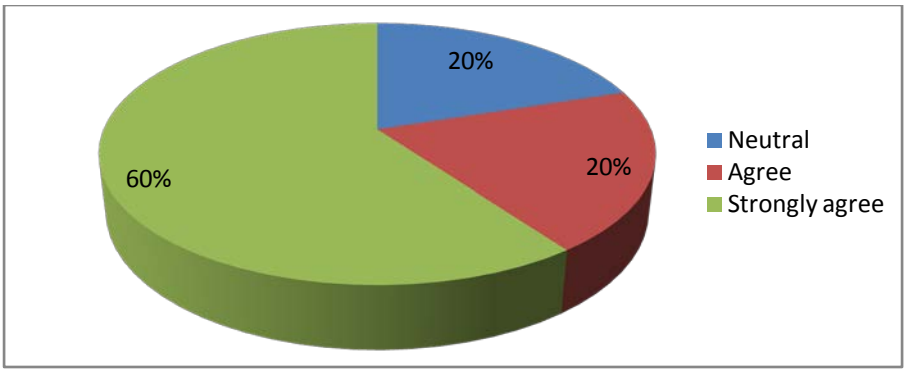


Figure 5.38: Manipulate, display and analyse data

FINDING 38

Sixty per cent of the respondents strongly agreed that the manipulation, display and analysis of data in investors' own financial and risk rating models could reduce country risk when investing offshore. Twenty per cent is neutral while the other twenty per cent agrees.

5.8.6 Limited risk in markets

The respondents agreed and strongly agreed – 60% and 40% respectively – that limited risk could reduce country risk in offshore markets with the help of timely warnings, as indicated in figure 5.39 below.

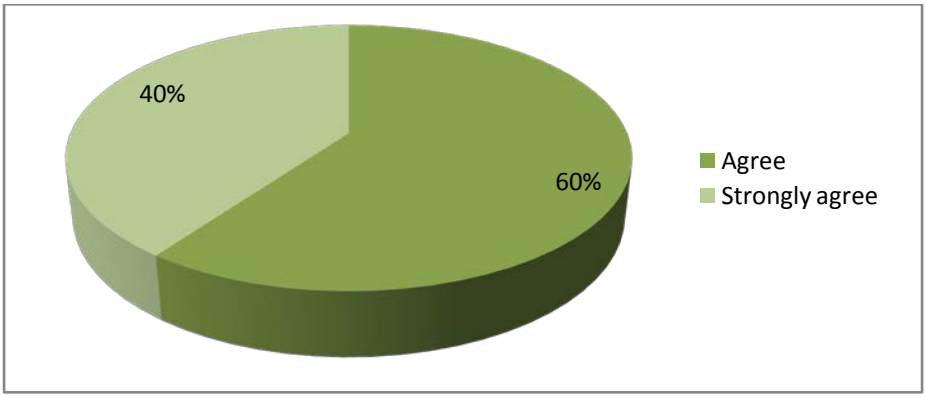


Figure 5.39: Limited risk in markets

FINDING 39

Sixty and forty per cent of the respondents agreed and strongly agreed respectively that the limited risk in markets with the help of timely warnings could reduce country risk on offshore investments.

DISCUSSION OF RESULTS

The respondents' responses in this section validated the earlier response in question 5.3.2 that focused on the importance of considering country risk when making offshore investments. Hundred per cent of the respondents confirmed and ranked country risk as the most important risk to consider when investing offshore. More than two-thirds of the respondents confirmed that the six control measures discussed in the literature review could reduce country risk in offshore investments. Thus, all the respondents agreed that offshore investors should take into account control measures in order to minimise country risk.

5.9 The movement and forecasting of interest rates

To determine the importance of the factors that were considered to have an effect on the movement and forecasting of interest rates in offshore countries, the five factors identified from the literature review were rated. The respondents were asked to rate each factor from **strongly disagree** to **strongly agree**. A description of the Likert scale rating value used can be found in section 4.6.3: Table 4.4.

5.9.1 Demand and supply of funds in the offshore country

The respondents agreed and strongly agreed – 60% and 40% respectively – that the demand and supply of funds in the offshore country could have an effect on the movement and forecasting of interest rates. The respondents' results are indicated in figure 5.40 below.

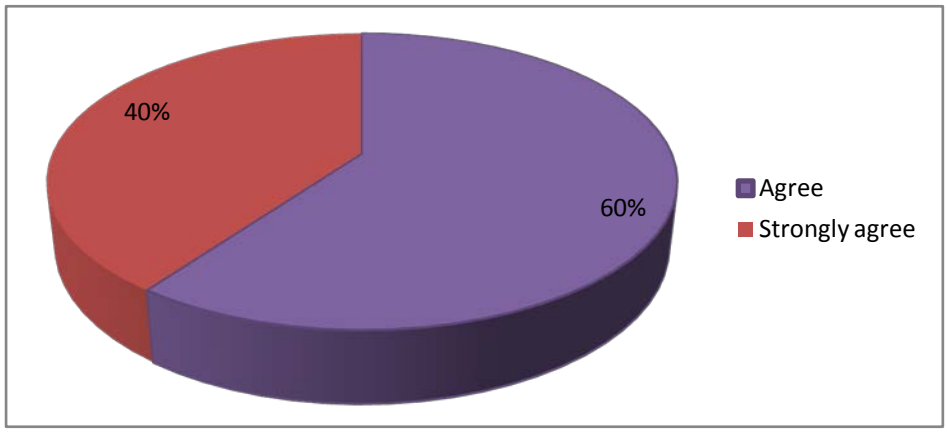


Figure 5.40: Demand and supply of funds in the offshore country

FINDING 40

Sixty and forty per cent of the respondents agreed and strongly agreed that the demand and supply of funds in the offshore country could have an effect on the movement and forecasting of interest rates.

5.9.2 Monetary policy of the offshore government

Of the respondents, 80% strongly agreed that monetary policy of the offshore government could have an effect on the movement and forecasting of interest rates in offshore countries. The other 20% just agreed as indicated in figure 5.41 below.

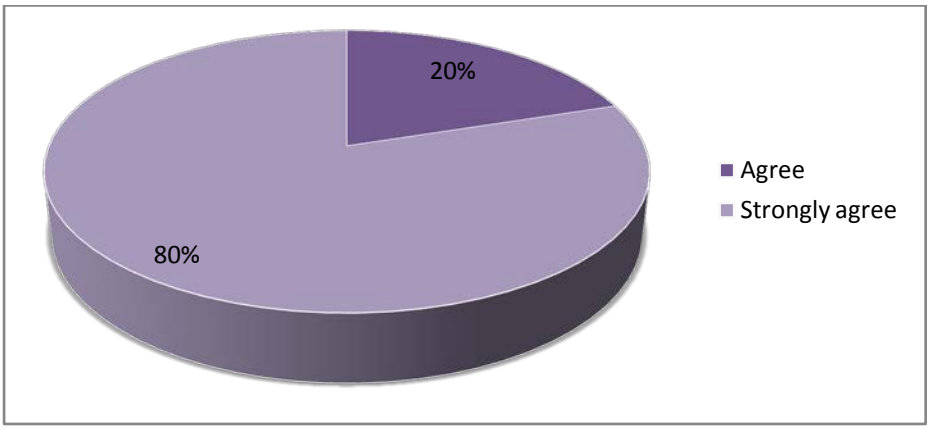


Figure 5.41: Monetary policy of the offshore government

FINDING 41

Eighty per cent of the respondents strongly agreed that the monetary policy of the offshore government could have an effect on the movement and forecasting of interest rates in offshore countries, while 20% just agreed.

5.9.3 Fiscal policy developments in the offshore country

Eighty per cent of the respondents strongly agreed that the fiscal policy developments in the offshore country could have an effect on the movement and forecasting of interest rates in offshore countries, while 20% just agreed as indicated in figure 5.42 below.

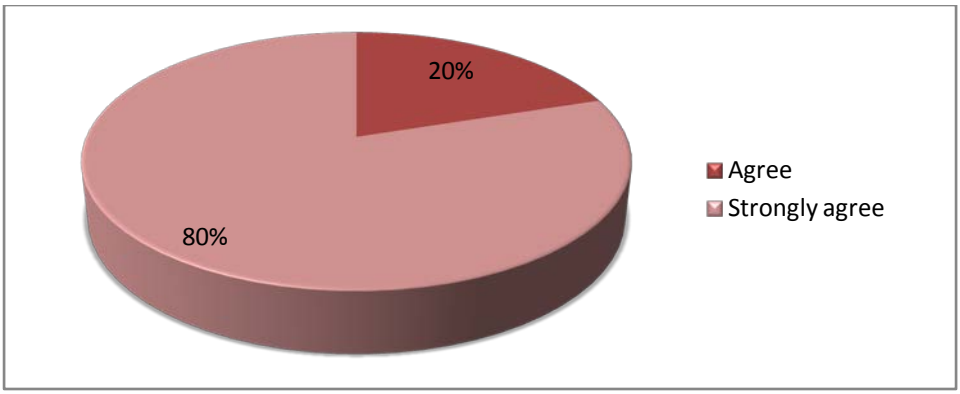


Figure 5.42: Fiscal policy development in the offshore country

FINDING 42

Eighty per cent of the respondents strongly agreed that the fiscal policy developments in the offshore country could have an effect on the movement and forecasting of interest rates in offshore countries, while 20% just agreed.

5.9.4 Political attitude of foreign investors

The political attitude of foreign investors could have an effect on the movement and forecasting of interest rates in offshore countries, and 60% and 40% of the respondents agreed and strongly agreed respectively with this statement as indicated in figure 5.43 below.

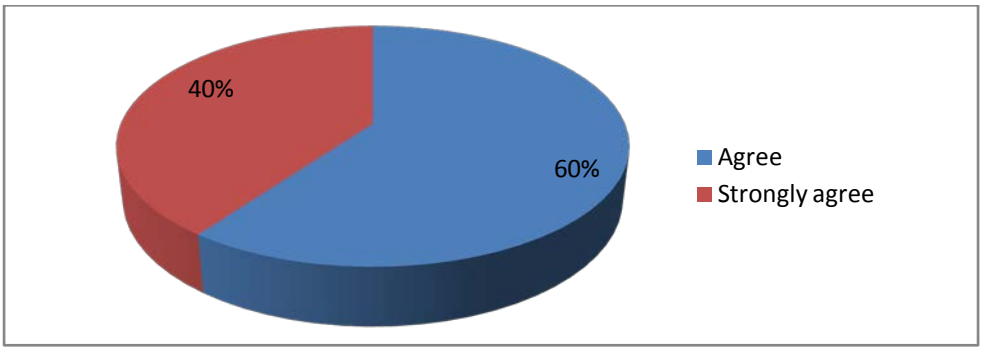


Figure 5.43: Political attitude of foreign investors

FINDING 43

Sixty and forty per cent of the respondents agreed and strongly agreed respectively that the political attitude of foreign investors could have an effect on the movement and forecasting of interest rates in offshore countries.

5.9.5 Inflation rate in the offshore country

Sixty per cent of the respondents strongly agreed that the inflation rate in the offshore country could have an effect on the movement and forecasting of interest rates in offshore countries. The remaining 40% just agreed, as indicated in figure 5.44 below.

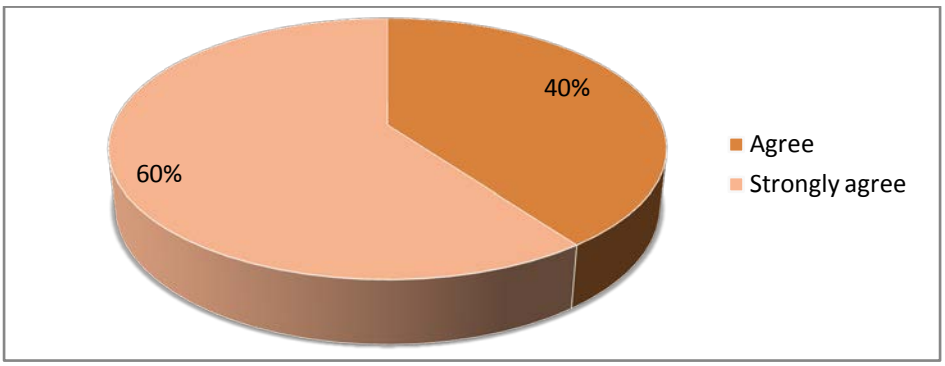


Figure 5.44: Inflation rate in the offshore country

FINDING 44

Sixty and forty per cent of the respondents strongly agreed and agreed respectively that the inflation rate in the offshore country could have an effect on the movement and forecasting of interest rates in offshore countries.

DISCUSSION OF RESULTS

Interest rates were confirmed and rated as one of the key risks that could influence the outcome of offshore investments. The movement and the forecasting of interest rates are critical for the end results of an offshore investment. The respondents confirmed that the five factors considered above have an effect on the movement and forecasting of interest rates. Therefore, offshore investors need to be aware of these movements to ensure that threats are minimised and opportunities exploited. Failure to forecast the movements of interest rates could lead to missed opportunities by offshore investors.

5.10 Offshore investment pitfalls

The above section focused on questions relating to the importance of minimising offshore investment pitfalls. Seven offshore investment pitfalls were identified in the literature review and respondents were asked to rate the level of importance of these issues when considering offshore investments.

5.10.1 Higher expectations on investment performance

Regarding higher expectations on investment performance as an investment challenge, 60% of the respondents saw it as important to consider, 20% regarded it as very important while the other 20% regarded it as unimportant as indicated in figure 5.45 below.

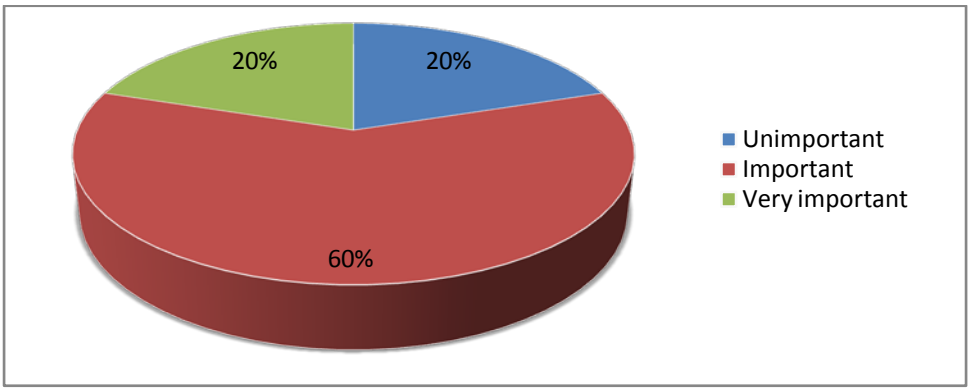


Figure 5.45: Higher expectations on investment performance

FINDING 45

Sixty per cent of the respondents regarded higher expectations on investment performance as an important investment challenge to consider, while 20% saw it as very important and another 20% deemed not important.

5.10.2 Monitoring offshore investments

Regarding monitoring offshore investments as an investment challenge, 60% of the respondents thought it was important to consider, 20% regarded it as very important while the other 20% thought it was unimportant, as indicated in figure 5.46 below.

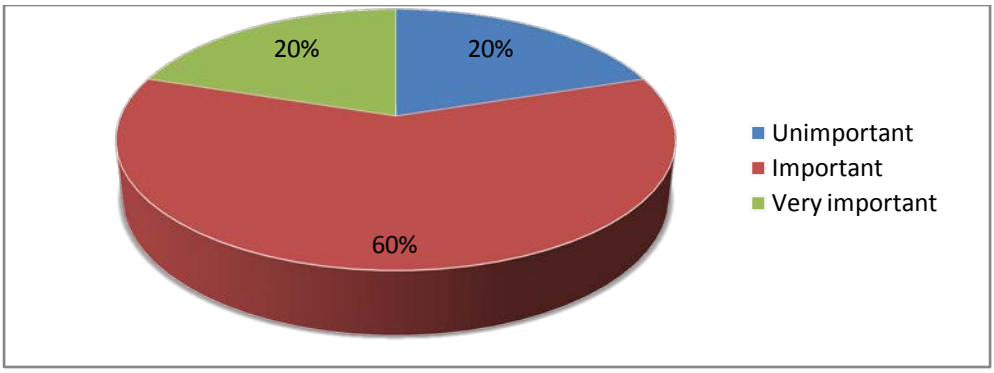


Figure 5.46: Monitoring offshore investments

FINDING 46

Sixty per cent of the respondents regarded monitoring offshore investments as an important investment challenge to consider, while 20% deemed it very important and the other 20% thought it was unimportant.

5.10.3 Investing in products without a domestic presence

When examining investing in products without a domestic presence as an investment challenge, 60% of the respondents were neutral while 40% regarded it as very important to consider as indicated in figure 5.47 below.

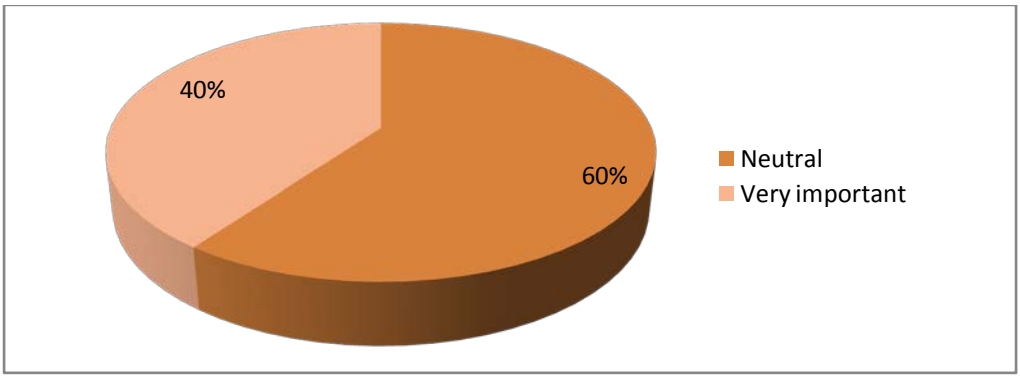


Figure 5.47: Investing in products without a domestic presence

FINDING 47

Sixty per cent of the respondents were neutral regarding investing in products without a domestic presence as an important challenge to consider, and 40% regarded it as very important.

5.10.4 Trading in foreign language

In terms of trading in a foreign language as an investment challenge, 40% of the respondents regarded it as important, 40% were neutral while 20% regarded it as very important to consider as indicated in figure 5.48 below.

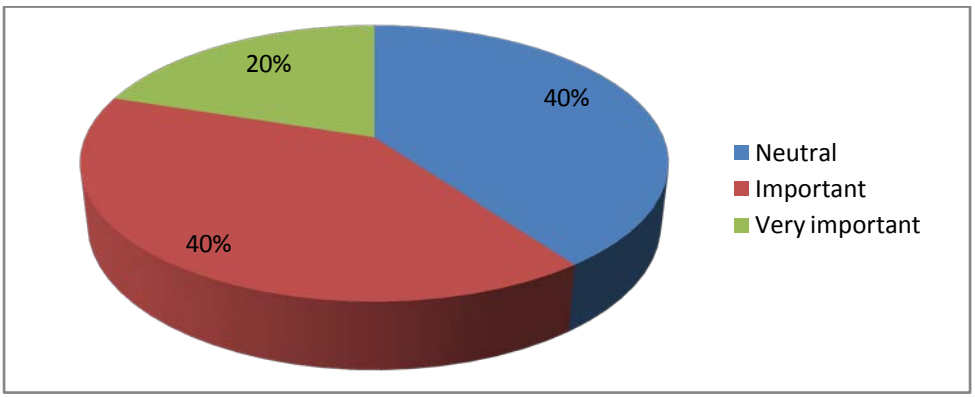


Figure 5.48: Trading in foreign language

FINDING 48

Forty per cent of the respondents were neutral, 40% agreed and 20% strongly agreed that trading in a foreign language is an important challenge to consider.

5.10.5 Timing the currency

When examining timing the currency as an investment challenge, 80% of the respondents regarded it as very important to consider while 20% were neutral as indicated in figure 5.49 below.

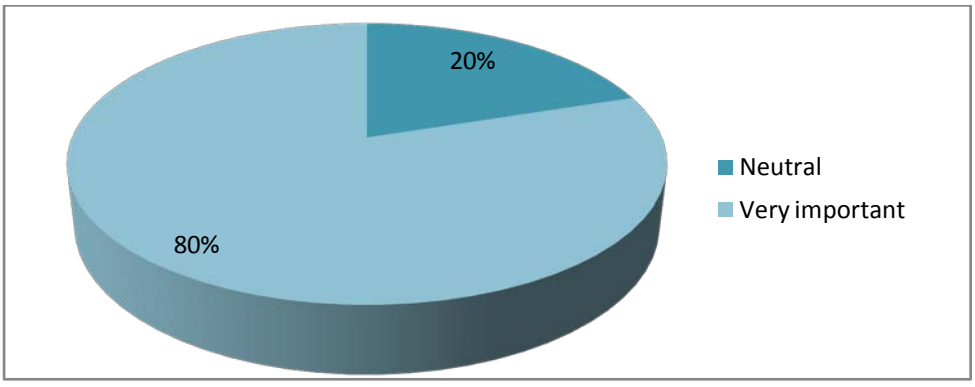


Figure 5.49: Timing the currency

FINDING 49

Eighty per cent of the respondents regarded timing the currency as very important to consider as an investment challenge, while 20% were neutral.

5.10.6 Restrictions on the value of offshore investments

When examining restrictions on the value of offshore investments as an investment challenge, 60% of the respondents regarded it as important while 40% regarded it as a very important matter to consider as indicated in figure 5.50 below.

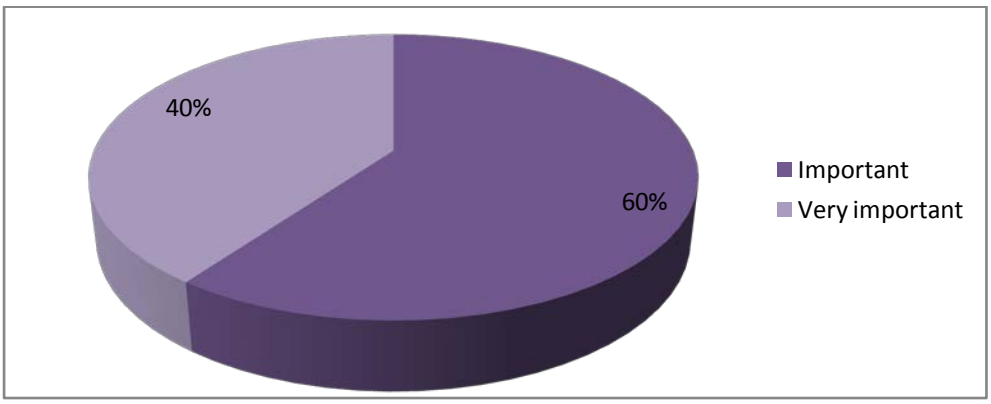


Figure 5.50: Restrictions on the value of offshore investments

FINDING 50

Of the respondents, 60% and 40% regarded restrictions on the value of offshore investments as important and very important to consider as an investment challenge respectively.

5.10.7 Hidden product costs and tax pitfalls

In terms of hidden product costs and tax pitfalls as an investment challenge, 60% regarded it as very important, 20% regarded it as important and another 20% were neutral as indicated in figure 5.50 below.

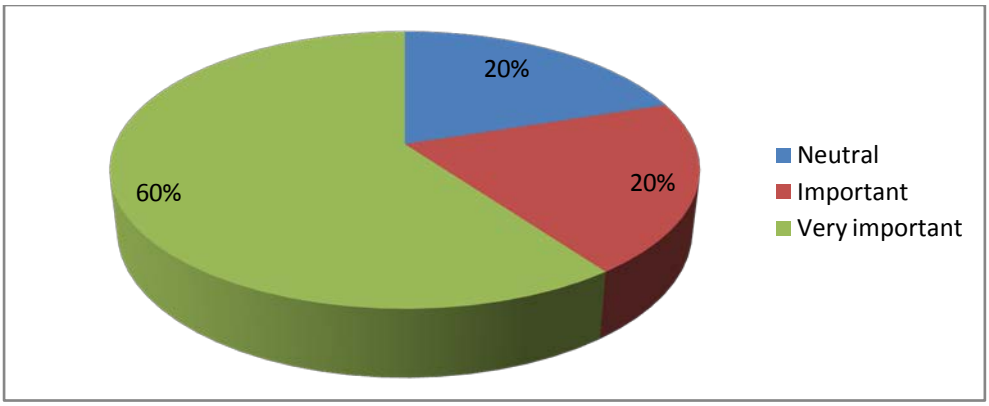


Figure 5.51: Hidden product costs and tax pitfalls

FINDING 51

Sixty per cent of the respondents regarded hidden product costs and tax pitfalls as very important to consider as an investment challenge, while 20% regarded it as important and another 20% were neutral about the matter.

DISCUSSION OF RESULTS

The seven offshore investment pitfalls discussed in section (3.6) were confirmed by the respondents to be core pitfalls when investing offshore. The respondents indicated that having **higher expectations in investment performance** and **timing the currency** (as discussed in section 3.6.1 and 3.6.5 respectively) could be detrimental to an investment. The respondents' views also indicated that investment brokers were aware of the pitfalls of investing in foreign countries. If these pitfalls are not properly managed, a well-planned investment could be implemented wrongly, leading to confusion and losses.

5.11 Offshore investments

This section focuses on general statements regarding offshore investments. Seven general offshore investment statements were identified in the literature review and respondents were asked to rate their level of agreement to these statements.

5.11.1 Good understanding of offshore investment risks

All respondents strongly agreed that offshore investors need a good understanding of offshore investment risks and risk exposures before investing offshore as indicated in figure 5.52 below.

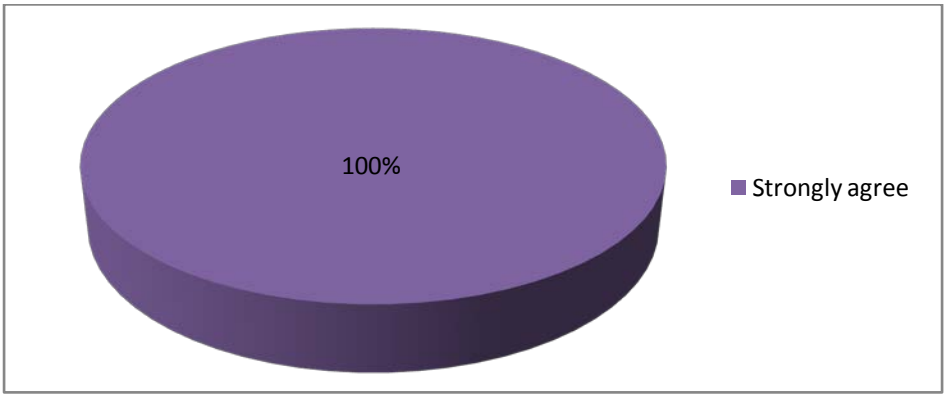


Figure 5.52: Good understanding of offshore investment risks

FINDING 52

All participants strongly agreed that offshore investors need a good understanding of offshore investment risks and risk exposures before investing offshore.

5.11.2 Provision for an emergency fund before investing offshore

Of the respondents, 40% strongly agreed that offshore investors need to make provision for an emergency fund before investing offshore. The other 40% were neutral while 20% just agreed as indicated in figure 5.53 below.

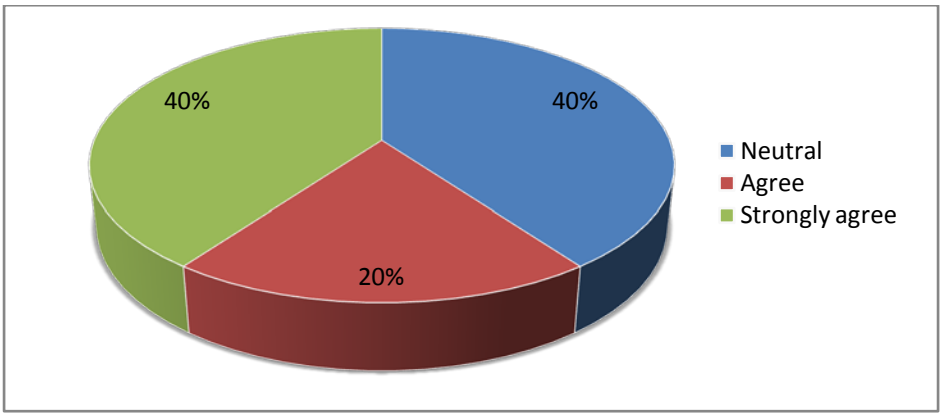


Figure 5.53: Provision for an emergency fund

FINDING 53

Forty per cent of the respondents were neutral, 40% strongly agreed and 20% agreed that there is a need to make provision for an emergency fund before investing offshore.

5.11.3 Offshore investments are considered as good investments

Of the respondents, 60% agreed that offshore investments are good investments. The remaining 40% were neutral as indicated in figure 5.54 below.

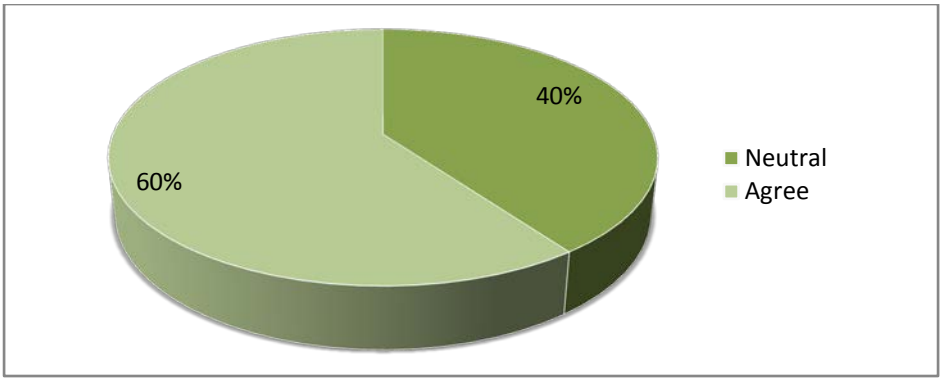


Figure 5.54: Offshore investments are considered as good investments.

FINDING 54

Sixty per cent of the respondents agreed that offshore investments are considered as good investments, while 40% were neutral.

5.11.4 Offshore investments are considered as high-risk investments

Offshore investments are considered as high-risk investments, and 60% of the respondents agreed with this statement, 20% disagreed while the other 20% strongly agreed as indicated in figure 5.55 below.

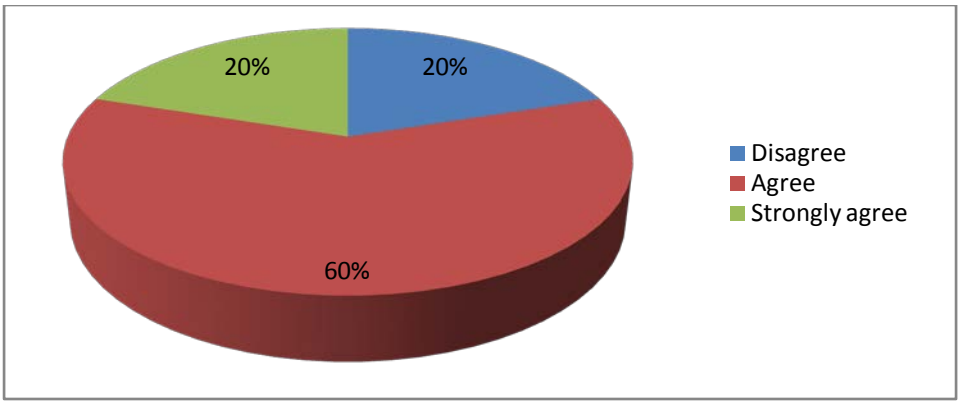


Figure 5.55: Offshore investments are considered as high-risk investments

FINDING 55

Sixty per cent of the respondents agreed that offshore investments are considered as high-risk investments, 20% disagreed and another 20% strongly agreed.

5.11.5 Offshore investments yield higher returns compared to domestic investments

Of the respondents 80% agreed that offshore investments yield higher returns compared to domestic investments, while 20% disagreed, as indicated in figure 5.56 below.

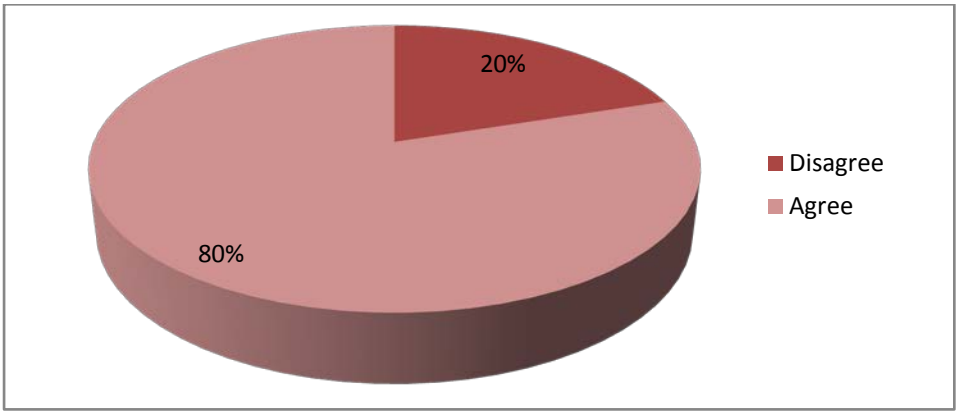


Figure 5:56: Offshore investments yield higher returns

FINDING 56

Eighty per cent of the respondents agreed that offshore investments yield higher returns compared to domestic investments and 20% disagreed.

5.11.6 Offshore investments are complicated to monitor

Of the respondents, 80% were neutral about the question whether offshore investments are complicated to monitor, while 20% strongly disagreed as indicated in figure 5.57 below.

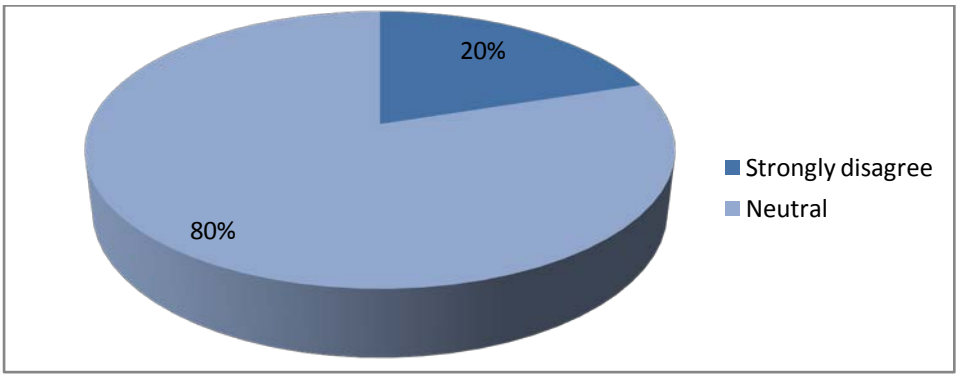


Figure 5.57: Offshore investments are complicated to monitor

FINDING 57

Eighty per cent of the respondents are neutral about the question whether offshore investments are complicated to monitor and 20% strongly disagreed.

5.11.7 Offshore investments are complicated to administer

Of the respondents, 80% were neutral about the question whether offshore investments are complicated to administer, while 20% strongly disagreed as indicated in figure 5.58 below.

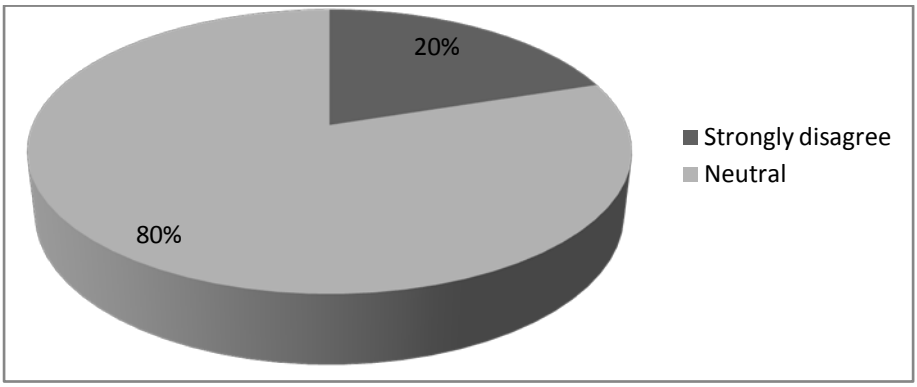


Figure 5.58: Offshore investments are complicated to administer

FINDING 58

Eighty per cent of the respondents were neutral about the question whether offshore investments are complicated to administer and 20% strongly disagreed.

DISCUSSION OF RESULTS

The last section of the questionnaire focused on the general statements that circulate the offshore investment markets. The respondents confirmed that most of the statements are actually true. In terms of the respondents' level of agreements, the above statements were ranked from **strongly agree** to **strongly disagree** as follows:

1. Good understanding of offshore investment risks
2. Provision for an emergency fund
3. Offshore investments are considered as good investments
4. Offshore investments are considered as high-risk investments
5. Offshore investments yield higher returns
6. Offshore investments are complicated to monitor
7. Offshore investments are complicated to administer

The above general statements could be relevant to a specific situation and are not necessarily applicable across the offshore investment industry. Offshore investors need to familiarise themselves with the industry myths and jargon to guard against general statements that could be misleading.

5.12 Conclusion

From the analysis and interpretation of the data, it is evident that there are many risks to consider when investing offshore. The risks were rated individually to assess the possible impact on offshore investments and thereafter ranked, amongst others, in terms of importance. Country risk was rated as the most important risk to consider when investing offshore, while technological risk was rated the least important. Offshore investment factors identified in the literature were also rated in terms of importance when considering investing offshore. The study revealed that risks and scams as well as taxation regulations in the offshore country are the most important factors to consider when making an offshore investment decision.

Diversification of risks was rated as the most important reason for investing offshore, while confidence in the offshore country as the least important. The main indicators of exchange rate risk between countries concluded that countries' exchange rates determine the end result of an offshore investment. Jurisdiction and tax issues were rated as the most important issues to consider when determining country risk factors on offshore investments. The movement and forecasting of interest rates as well as the offshore investment pitfalls were also rated in this chapter. Trading in a foreign language was rated the least important challenge to consider when investing offshore.

The next chapter will focus on the recommendations when considering offshore investment and the conclusions derived from the previous chapters.

CHAPTER 6

RECOMMENDATIONS AND CONCLUSION

6.1 Introduction

The previous chapters focused on a specific area of research. In Chapter 1, the background, the problem statement and the purpose of the research were discussed. Chapter 2 focused on the first part of the literature review, which mainly focused on risks and risk management. Chapter 3 focused on the second part of the literature review, and offshore investments were discussed. Chapter 4 described the methodology as applied, and Chapter 5 presented the findings of the research.

The objective of this study was to identify a list of risks that are important to consider when making an offshore investment decision. To achieve this, a two-tier approach was adopted. First, a literature review was conducted to understand which risks existed in the current academic literature. Second, the risks that were identified were put to the test by means of a research survey.

Chapter 6 provides a summary and overview of the research, and then the findings and conclusions are presented. Finally, limitations and recommendations for further study into risks for offshore investment implementations are set out.

6.2 Summary and overview of the research

South Africa is a player in the global markets. Global players are affected by changes, movements and the position taken by other players. The risks faced by South African offshore investors were established during a study that identified the risks that could influence an offshore investment plan. The literature review was conducted in two parts; the first part (Chapter 2) focused on risks, risk exposure as well as risk management. The academic literature revealed that offshore investors were exposed to many risks when investing offshore. These risks are caused by a multitude of factors and these factors need to be controlled and monitored throughout the offshore investment plan.

To increase the probability of a successful offshore investment plan, offshore investors must understand the basic principles of investing. Investors must also understand the country's political and financial stability as well as the risk exposure in the offshore country.

The objective of this study was to identify the risks that are critical in the successful implementation of an offshore investment plan. By identifying risks prior to executing an offshore investment plan, it was envisaged that offshore investors would be provided with an understanding of risks that need to be minimised when investing offshore.

The second part of the literature review (Chapter 3) focused on the characteristics of offshore investments, the reasons and advantages of investing offshore as well as the offshore investment pitfalls. The academic literature revealed the characteristics of offshore investments in relation to domestic investments. To successfully choose the appropriate portfolio when investing offshore, investors must outline their reasons for investing offshore, understand the regulations in the offshore country as well as the challenges of offshore investments.

It was revealed in the study that the success of every investment plan is dependent on the critical assessment of all risks and risk exposures in the offshore country as well as the implementation of the investment plan. The study also revealed that there were ten key risks that need to be considered when making an offshore investment decision.

The next phase of the research made use of a questionnaire to validate the ten identified risks when investing offshore within the context of the South African investment industry. Respondents to the questionnaire were asked to rate each risk from **unimportant** to **very important.** The study found that the risks identified through the literature review were regarded as important by a minimum of two-thirds majority of the respondents, while two risks were considered very important by all respondents.

6.3 Findings and conclusions

The cumulative results from the questionnaire enabled the risks to be ranked in their order of importance. The main conclusions were then grouped in order of priority according to the ten identified risks discussed in the literature review.

In order of importance, the respondents indicated that the risks that should receive the highest attention from most important to the least important are:

1. Country risk
2. Financial risk
3. Market risk
4. Interest rate risk
5. Liquidity risk
6. Legal risk
7. Exchange rate risk
8. Inflation risk
9. Credit risk
10. Technological risk

It was observed that, in general, the highest risks tended to be those that influenced or had an impact on the whole country. Furthermore, it was observed that the lower prioritised risks were found to have an influence on a specific industry. For example, country risk and financial risk tend to influence the country as a whole, and they were prioritised as the top two risks. Technological and credit risk are more industry-specific and were prioritised as the lowest risks.

The analysis seemed to indicate that, for an offshore investment plan to have the highest probability of success, the risks that affect the whole country must first be examined and put in place before concentrating on more industry-specific risks. Furthermore, risks are not equal, and investors can and should limit their investment risks to what is comfortable for them. If investors are willing to take on some element of uncertainty in pursuit of larger returns, the following offshore critical success factors were revealed and ranked in order of importance from most important to least important:

1. Risks and scams
2. Taxation regulations in the offshore country
3. Currency fluctuations in the offshore country
4. Economic stability of the offshore country
5. Inflation in the offshore country
6. Liquidity of the offshore investment assets
7. Cost of the offshore investment assets

Risks and offshore critical success factors evolve over time. Thus, offshore investors should continually review their plans taking into account the new risks and success factors. The study also revealed the reasons for investing in offshore countries as follows:

1. Diversification of risks
2. Enhancement of returns
3. Exploitation of offshore markets
4. Increasing investment opportunities
5. Balancing an investment portfolio
6. Hedging funds
7. Confidence in the offshore country

The above reasons were classified as the main reasons for investing offshore. However, offshore investors should keep in mind that reasons alone do not guarantee greater returns. A successful offshore investment is dependent on the proper planning and implementation. The current study also identified the main indicators of exchange rate risk that affect offshore investments returns, namely the relationship between countries' interest rates, countries' inflation rates and countries' exchange rates. The movement in interest rates, inflation rates and exchange rates in different countries determines the returns on offshore investments. The study also revealed the offshore investment pitfalls facing investors when making offshore investment plans. These pitfalls were ranked as follows from most important to least important:

1. Timing the currency
2. Investing in products without a domestic presence
3. Restrictions on the value of offshore investments
4. Monitoring offshore investments
5. Higher expectations on investment performance
6. Hidden product costs and tax pitfalls
7. Trading in foreign language

In the process of conducting the literature review and research, several areas for future improvement were identified. Possible limitations to the existing research as well as areas for future research were identified and are discussed in the next section.

6.4 Limitations and recommendations for further research

The limitations to the current research are noted along with recommendations to further identify risks that are faced by offshore investors for the successful implementation of an offshore investment plan.

The limitations of this research should be borne in mind when interpreting the findings. These limitations, however, provide some opportunities or areas of improvement to be considered for future research. The main limitation of this study concerns the size of the population due to a restricted number of registered offshore investors. However, this could change in the future when more investors register with the FSB. Then this research could form the basis for a similar survey to confirm the priority risks in future.

6.5 Concluding remarks

In conclusion, despite the current limitations of the research, the study has identified ten risks that are important to consider when compiling an offshore investment plan. The rankings of these risks in terms of their importance should provide offshore investors with the ability to improve their offshore investment strategy. These recommendations are in line with the primary objectives of the study stipulated in the first chapter, namely:

- to identify the various risks faced by offshore investors; and
- to rank the offshore risks in order of importance when making an investment decision.

The study managed to achieve these objectives by applying an approach to research the relevant literature on offshore risks and investments. It became clear that offshore investment plans cannot be successful if the indentified risks are not addressed. As such, this study provides a prioritised list of risks that should be considered before finalising and implementing an offshore investment plan. In addition, the study adds value by providing reasons for offshore investments and the potential pitfalls which could hamper the success of such an investment. When an offshore investor considers these risks, reasons and potential pitfalls during a structured assessment process, the chances of a successful offshore investment would surely increase.

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ANNEXURE A: COUNTRY RISK PREMIUMS

In the table below are estimates of the country risk premiums compiled by Allan Huang of San Jose State University based upon information from Moody's bond ratings.

Estimates of country risk premiums			
Country	Long-term rating	Typical interest rate	Country risk premium
United States	Aaa	6.10%	0.00%
Andorra	Aa2	6.75%	0.65%
Argentina	Ba3	10.10%	4.00%
Australia	Aa2	6.75%	0.65%
Austria	Aaa	6.10%	0.00%
Bahamas	A3	7.05%	0.95%
Bahrain	Ba1	8.60%	2.50%
Barbados	Ba1	8.60%	2.50%
Belgium	Aaa	6.10%	0.00%
Belize	Ba2	9.10%	3.00%
Bermuda	Aa1	6.70%	0.60%
Bolivia	B1	10.60%	4.50%
Brazil	B2	11.60%	5.50%
Bulgaria	B2	11.60%	5.50%
Canada	Aa2	6.75%	0.65%
Cayman Islands	Aa3	6.80%	0.70%
Chile	Baa1	7.30%	1.20%
China	A3	7.05%	0.95%
Colombia	Baa3	7.55%	1.45%
Costa Rica	Ba1	8.60%	2.50%
Croatia	Baa3	7.55%	1.45%
Cyprus	A2	7.00%	0.90%
Czech Republic	Baa1	7.30%	1.20%
Denmark	Aa1	6.70%	0.60%
Dominican Republic	B1	10.60%	4.50%
Ecuador	B3	12.60%	6.50%
Egypt	Ba1	8.60%	2.50%
El Salvador	Baa3	7.55%	1.45%
Estonia	Baa1	7.30%	1.20%
Finland	Aaa	6.10%	0.00%
France	Aaa	6.10%	0.00%
Germany	Aaa	6.10%	0.00%
Gibraltar	Aaa	6.10%	0.00%
Greece	Baa1	7.30%	1.20%
Guatemala	Ba2	9.10%	3.00%
Guernsey	Aaa	6.10%	0.00%
Honduras	B2	11.60%	5.50%
Hong Kong	A3	7.05%	0.95%
Hungary	Baa2	7.40%	1.30%
Iceland	Aa3	6.80%	0.70%
India	Ba2	9.10%	3.00%
Indonesia	B3	12.60%	6.50%

Ireland	Aaa	6.10%	0.00%
Isle of Man	Aaa	6.10%	0.00%
Israel	A3	7.05%	0.95%
Italy	Aaa	6.10%	0.00%
Jamaica	Ba3	10.10%	4.00%
Japan	Aa1	6.70%	0.60%
Jersey	Aaa	6.10%	0.00%
Jordan	Ba3	10.10%	4.00%
Kazakhstan	Ba3	10.10%	4.00%
Korea	Baa3	7.55%	1.45%
Kuwait	Baa1	7.30%	1.20%
Latvia	Baa2	7.40%	1.30%
Lebanon	B1	10.60%	4.50%
Liechtenstein	Aaa	6.10%	0.00%
Lithuania	Ba1	8.60%	2.50%
Luxembourg	Aaa	6.10%	0.00%
Macau	Baa1	7.30%	1.20%
Malaysia	Baa3	7.55%	1.45%
Malta	A3	7.05%	0.95%
Mauritius	Baa2	7.40%	1.30%
Mexico	Ba2	9.10%	3.00%
Moldova	B2	11.60%	5.50%
Monaco	Aaa	6.10%	0.00%
Morocco	Ba1	8.60%	2.50%
Netherlands	Aaa	6.10%	0.00%
New Zealand	Aa2	6.75%	0.65%
Nicaragua	B2	11.60%	5.50%
Norway	Aaa	6.10%	0.00%
Oman	Baa2	7.40%	1.30%
Pakistan	Caa1	13.60%	7.50%
Panama	Baa1	7.30%	1.20%
Papua New Guinea	B1	10.60%	4.50%
Paraguay	B2	11.60%	5.50%
Peru	Ba3	10.10%	4.00%
Philippines	Ba1	8.60%	2.50%
Poland	Baa3	7.55%	1.45%
Portugal	Aaa	6.10%	0.00%
Qatar	Baa2	7.40%	1.30%
Romania	B3	12.60%	6.50%
Russia	B3	12.60%	6.50%
San Marino	Aa3	6.80%	0.70%
Sark	Aaa	6.10%	0.00%
Saudi Arabia	Baa3	7.55%	1.45%
Singapore	Aa1	6.70%	0.60%
Slovakia	Ba1	8.60%	2.50%
Slovenia	A3	7.05%	0.95%
South Africa	Baa3	7.55%	1.45%
Spain	Aaa	6.10%	0.00%
Sweden	Aa2	6.75%	0.65%
Switzerland	Aaa	6.10%	0.00%
Taiwan	Aa3	6.80%	0.70%
Thailand	Ba1	8.60%	2.50%
Trinidad & Tobago	Ba1	8.60%	2.50%

Tunisia	Baa3	7.55%	1.45%
Turkey	B1	10.60%	4.50%
Turkmenistan	B2	11.60%	5.50%
Ukraine	B3	12.60%	6.50%
United Arab Emirates	A2	7.00%	0.90%
United Kingdom	Aaa	6.10%	0.00%
Uruguay	Baa3	7.55%	1.45%
Venezuela	B2	11.60%	5.50%
Vietnam	B1	10.60%	4.50%

The correspondences between the bond ratings and the above risk premiums are given in the table below.

Risk premiums by rating class (in basis points)		
Rating	Country risk premium for corporate bonds	Country risk premium for government bonds
Aaa	0	0
Aa1	60	75
Aa2	65	85
Aa3	70	90
A1	80	100
A2	90	125
A3	85	135
Baa1	120	150
Baa2	130	175
Baa3	145	200
Ba1	250	325
Ba2	300	400
Ba3	400	525
B1	450	600
B2	550	750
B3	650	850
Caa	750	900
Based upon information from Moody's and Bondonline.com		

ANNEXURE B: INVESTMENT BROKERS

FSP No	FSP Name	Trading name	FY End	Status	
99	LES.B.SMITH ASSURANCE & INVESTMENT BROKER CC		28/02	Authorised 1	Details
767	FIRST GLOBAL INVESTMENT BROKERS (PTY) LTD		28/02	Authorised 2	Details
1119	WEDGEWOOD INSURANCE & INVESTMENT BROKERS CC	WEDGEWOOD BROKERS	28/02	Authorised 3	Details
1599	INSURANCE AND INVESTMENT BROKERS CC	RC GREEN & COMPANY	28/02	Authorised 4	Details
1669	E AND M INVESTMENT BROKERS CC	E AND M BROKERS	28/02	License Withdrawn	Details
3321	JACQUES BERNARD NIGRINI	NIGRINI INVESTMENT BROKERS	28/02	Lapsed	Details
3462	DUDLEY WOLHUTER INSURANCE & INVESTMENT BROKERS CC		31/12	Lapsed	Details
5553	JOHANNES CHRISTIAN MOSTERT	MEDSURE INVESTMENT BROKERS	28/02	Authorised 5	Details
5752	GAVIN BESTER ASSURANCE & INVESTMENT BROKERS CC		28/02	Authorised 6	Details
5839	GRAEME JOHN PRATT	GRAEME PRATT INSURANCE AND INVESTMENT BROKERS	28/02	Lapsed	Details
5992	RICHARD MARGETTS INVESTMENT BROKERS CC		28/02	Authorised 7	Details
6034	RIAN VAN DER MERWE INSURANCE AND INVESTMENT BROKERS CC	RIAN VAN DER MERWE AND ASSOCIATES	28/02	Authorised (requested laps)	Details
6918	INSURACOM INVESTMENT BROKERS CC		28/02	Authorised 8	Details
7268	EVEREST HOUSE INSURANCE AND INVESTMENT BROKERS CC		28/02	License suspended	Details
7946	CUAN STUART FORDER	CUAN FORDER INVESTMENT BROKERS	30/06	Authorised 9	Details
8180	EN MASHER	MASHFIN INVESTMENT BROKERS	28/02	Lapsed	Details
8308	MARANATA TRUST IT 825/2003	MARANATA INVESTMENT BROKERS	28/02	Lapsed	Details
10025	LAWRENCE LISLE RANGER	RANHOF INVESTMENT BROKERS	28/02	Lapsed	Details
10575	INSURED INVESTMENT BROKERS CC		31/08	Authorised 10	Details
10706	MIDRAND INVESTMENT BROKERS (PTY) LTD		28/02	Lapsed	Details
10816	BARDEN INVESTMENT BROKERS CC		28/02	License withdrawn	Details

11065	DEDEKIND ASSURANCE & INVESTMENT BROKERS CC		28/02	Lapsed	Details
11833	RON BAILEY	RON BAILEY INVESTMENT BROKERS	28/02	Lapsed	Details
11993	FRANCOIS O'KENNEDY	PRO SURE INVESTMENT BROKERS	28/02	Authorised 11	Details
12752	NUMMAG INVESTMENTS CC	EASTERN CAPE INSURANCE AND INVESTMENT BROKERS	31/03	Authorised 12	Details
12818	PARFITT INSURANCE & INVESTMENT BROKERS CC		28/02	Authorised 13	Details
12863	DAVE BROTHERS INSURANCE & INVESTMENT BROKERS CC	DAVE BROTHERS	28/02	Lapsed	Details
13580	MARIUS LE ROUX	MARIUS LE ROUX INSURANCE AND INVESTMENT BROKER	28/02	Authorised 14	Details
13864	QLB INVESTMENT BROKERS CC		28/02	Authorised 15	Details
14522	LEGAL AND GENERAL INVESTMENT BROKERS CC		28/02	Authorised 16	Details
14533	ROBERT THOMSON HOW	ROB HOW INVESTMENT BROKERS	28/02	Authorised 17	Details
15005	EXECUMED FINANCIAL & INVESTMENT BROKERS	EXECUMED	28/02	Lapsed	Details
15204	GARDEN ROUTE LIFE & INVESTMENT BROKERS CC		28/02	Authorised 18	Details
15576	DANNHAUSER MULDER	FINANCIAL INVESTMENT BROKER SERVICES	28/02	Lapsed	Details
15972	NTOMBI GRACE ZWANE	GRACE INVESTMENT BROKERS	28/02	Authorised 19	Details
17841	UNITYSURE INVESTMENT BROKERS CC		28/02	License withdrawn	Details
18588	THELELA AMOS MOKWANA	DYNAMIC INVESTMENT BROKERS	28/02	License suspended	Details
18697	ADAM JOHANNES WILLEMSE WELDING	MED-LIFE FINANCIAL & INVESTMENT BROKERS	28/02	Lapsed	Details
20362	SANANA GEORGE MOSHESHA	BATUBATSI INVESTMENT BROKERS	28/02	Authorised 20	Details
21959	ZEROTH THANDA NXUMALO	MULTI PAYOUTS INVESTMENT BROKER	31/03	License withdrawn	Details
22860	HEALTHCOR SA INVESTMENT BROKERS CC		28/02	Authorised 21	Details
22985	ALEC JEFFREY LEVIN	ALEC LEVIN INSURANCE AND INVESTMENT BROKERS	28/02	Lapsed	Details
25970	LIGHTWARRIOR INVESTMENT BROKERS AND CONSULTANTS CC		28/02	Rejected	Details
25981	THOMELCO INVESTMENT BROKERS CC		28/02	Authorised 22	Details

27071	SPHIWE VINCENT NYAWOSE	VINCENT INVESTMENT BROKERS	28/02	Authorised 23	Details
29255	ALEC LEVIN INSURANCE AND INVESTMENT BROKERS CC		28/02	Authorised 24	Details
30374	TSHEDIMOSETSO INVESTMENT BROKERS CC		28/02	License withdrawn	Details
32408	RAYMOND ERIC WIENAND	RAYMOND WIENAND INVESTMENT BROKERS	28/02	License withdrawn	Details
32826	DANNY MULDER FINANCIAL INVESTMENT BROKER SERVICES CC		28/02	Authorised 25	Details
35992	JB NIGRINI INVESTMENT BROKERS CC		28/02	Authorised 26	Details
39352	LETSOLATHEBE RISK AND INVESTMENT BROKERS CC	NHLAPO INSURANCE BROKERS	28/02	Authorised 27	Details
40361	PHILIPPUS LODEWIKUS ERASMUS	GAUTENG INSURANCE AND INVESTMENT BROKERS	28/02	Authorised 28	Details

ANNEXURE C: INVITATION LETTER

To whom it may concern

PARTICIPATION IN AN ACADEMIC RESEARCH STUDY

Mr. J Godi is a current registered student with the University of South Africa for the Masters in Commerce Degree. Part of the study involves a survey on the following topic:

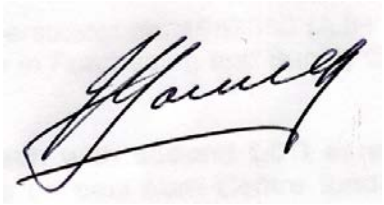
Risks faced by South African offshore investors

This survey forms an important part of the research and it is therefore crucial to collate applicable information from experts in the field of investment risk management. As such, you were identified as a respondent to a questionnaire and it will be appreciated if you would participate in the survey and support the candidate to gather sufficient information as part of his research.

All information will be confidential. Should you want feedback on the results of the survey, please indicate so during your feedback, although all information will be anonymous.

Thank you for your support.

Best regards



Prof J Young
Department: Finance, Risk Management & Banking
University of South Africa
012 429 3010
July 2011

ANNEXURE D: DRAFT QUESTIONNAIRE

SECTION A: DEMOGRAPHIC INFORMATION

Section A is solely for statistical purposes, and will not be shared with anyone. Please choose one option.

A.1. How long have you operated as an offshore investment broker.

Less than 5 years	6-10 years	11-15 years	More than 15 years

A.2. What is your highest qualification.

National Senior Certificate	Bachelors degree	Honours degree	Masters or doctoral degree

SECTION B: CRITICAL DECISION FACTORS

Section B contains questions relating to the importance of critical decision factors and their impact during an offshore investment decision process.

B.1. Please rate the importance of each of the following risks that an offshore investor need to consider when making an offshore investment decision. *Please put a cross (X) next to your choice.*

Offshore risks	Irrelevant	Unimportant	Neutral	Important	Very important
B.1.1. Exchange rate risk / currency risk					
B.1.2. Country risk / political risk					
B.1.3. Market risk					
B.1.4. Inflation risk					
B.1.5. Interest rate risk					
B.1.6. Financial risk					
B.1.7. Credit risk					
B.1.8. Liquidity risk					
B.1.9. Legal risk					
B.1.10. Technology risk					

B.2. Please allocate 100 points across all of the following offshore risks in terms of their importance, e.g. if exchange rate risk is considered as the most important risk, it should have the highest points. The sum, over the ten risks, must add up to 100.

Offshore risks	Point (s)
B.2.1. Exchange rate risk / currency risk	
B.2.2. Country risk / political risk	
B.2.3. Market risk	
B.2.4. Inflation risk	
B.2.5. Interest rate risk	
B.2.6. Financial risk	
B.2.7. Credit risk	
B.2.8. Liquidity risk	
B.2.9. Legal risk	
B.2.10. Technology risk	
Total points	100

B.3. Please rate the importance of the following offshore investment factors when making an offshore investment decision.

Offshore investment factors	Irrelevant	Unimportant	Neutral	Important	Very important
B.3.1. Currency fluctuations in the offshore country					
B.3.2. Economic stability of the offshore country					
B.3.3. Liquidity of the offshore investment assets					
B.3.4. Inflation in the offshore country					
B.3.5. Cost of the offshore investment assets					
B.3.6. Risks and Scams					
B.3.7. Taxation regulations in the offshore country					

B.4. Please allocate 100 points across all of the following offshore investment factors in terms of their importance. The sum, over the seven factors, must add up to 100.

Offshore investment factors	Point(s)
B.4.1. Currency fluctuations in the offshore country	
B.4.2. Economic stability of the offshore country	
B.4.3. Liquidity of the offshore investment assets	
B.4.4. Inflation in the offshore country	
B.4.5. Cost of the offshore investment asset	
B.4.6. Risks and Scams	
B.4.7. Taxation regulations in the offshore country	
Total points	100

B.5. The following are considered as reasons for investing offshore. Please rate your level of agreement.

Reasons for investing offshore	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
B.5.1. Diversification of risks					
B.5.2. Enhancements of returns					
B.5.3. Exploitation of offshore markets					
B.5.4. To increase investment opportunities					
B.5.5. To balance an investment portfolio					
B.5.6. To hedge funds					
B.5.7. Confidence in the offshore country					

B.6. The following are considered as the main indicators of exchange rate risk. Please rate your level of agreement.

Indicators of exchange rate risk	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
B.6.1. The relationships between countries interest rates					
B.6.2. The relationships between countries inflation rates					
B.6.3. The relationships between countries exchange rates					

B.7. Please rate the importance of each of the following factors when considering country risk during an offshore investment decision process.

Factors arising as country risk	Irrelevant	Unimportant	Neutral	Important	Very important
B.7.1. Jurisdiction issues - the laws that govern investments in the offshore country					
B.7.2. Tax issues - each type of investment carries its own tax consequences as onshore and offshore jurisdiction has their own tax codes					
B.7.3. Investment issues - balance between strong currencies, markets and exposure to emerging markets could be a daunting task					
B.7.4. Trust issues - Before settling a trust, a careful analysis is necessary to balance the benefits of trust structuring with the associated charges					

B.8. The following control measure are considered to reduce country risk. Please rate your level of agreement.

Factors controlling country risk	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
B.8.1. Assessment of sovereign, currency and banking sector risk in offshore markets					
B.8.2. Analysis of credit risk posed by political and economic situation in each country					
B.8.3. Comparison of risks across countries, using standardised risk and forecasting methodology					
B.8.4. Assessment of business risk, taking into account macroeconomic variables					
B.8.5. Manipulate, display and analyse data in investors own financial and risk rating models					
B.8.6. Limit risk in markets with the help of timely warnings of likely rating downgrades					

B.9. The following factors are considered to have an effect on the movement and forecasting of interest rates in offshore countries. Please rate your level of agreement.

Factors affecting the movement and forecasting of interest rate risk	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
B.9.1. Demand and supply of funds in the offshore country					
B.9.2. Monetary policy of the offshore government					
B.9.3. Fiscal policy developments in the offshore country					
B.9.4. Political attitude of foreign investors					
B.9.5. Inflation rate in the offshore country					

SECTION C: OFFSHORE INVESTMENT PITFALLS

Section C contains questions relating to the importance of minimising offshore investment pitfalls.

C.1. Please rate the importance of the following offshore investment pitfalls when making an offshore investment decision.

Offshore investment pitfalls	Irrelevant	Unimportant	Neutral	Important	Very important
C.1.1. Higher expectations on investment performance					
C.1.2. Monitoring offshore investments					
C.1.3. Investing in products without a domestic presence					
C.1.4. Trading in foreign language					
C.1.5. Timing the currency					
C.1.6. Restrictions on the value of offshore investments					
C.1.7. Hidden product costs and tax pitfalls					

C.2. Please allocate 100 points across all of the following offshore investment pitfalls in terms of their importance. The sum, over the seven pitfalls, must add up to 100.

Offshore investment pitfalls	Point(s)
C.2.1. Monitoring offshore investments	
C.2.2. Investing in products without a South African presence	
C.2.3. Trading in foreign language	
C.2.4. Timing the currency	
C.2.5. Restrictions on the value of offshore investments	
C.2.6. Hidden product costs and tax pitfalls	
Total points	

SECTION D: OFFSHORE INVESTMENTS

Section D contains questions regarding offshore investments. Please rate your level of agreement.

Offshore investments	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
D.1. Offshore investors need a good understanding of offshore investment risks and risk exposures before investing offshore.					
D.2. Offshore investors need to make a provision for an emergency fund before investing offshore.					
D.3. Offshore investments are considered as good investments.					
D4. Offshore investments are considered as high risk investments.					
D5. Offshore investments yield higher returns compared to domestic investments.					
D.6. Offshore investments are complicated to monitor.					
D.7. Offshore investments are complicated to administer.					

Please indicate if you would like a copy of the results of this survey: **Yes/No**
If Yes, please provide your details below.

Name of broker: _____ Today's date: _____

Address: _____

Telephone: (____) _____- _____ Email: _____

ANNEXURE E: QUESTIONNAIRE

Office 3-108
AJH Van Der Walt
Muckleneuk
Pretoria
0003
July 2011

Dear Sir/Madam

RE: Risks faced by South African offshore investors

Investing offshore has its advantages and disadvantages. It is important to identify and calculate risks before deciding on investing offshore. In order to identify the risks faced by South African offshore investors, I have launched a research project on this matter.

As an offshore investment broker, you have been selected to participate in this important research project. I believe that your insight and input can make an important contribution to the success of this study. I appeal to you to kindly spend a few minutes of your time to complete this questionnaire and submit it at your earliest convenience. I hope to analyse the feedback from all respondents by 15 August 2011. The results and findings of the study will be available to all participants as a token of appreciation for taking part in the survey.

The information provided will be regarded as strictly confidential and no personal or business information will be linked to the final results.

Thank you for your valuable time and assistance. I'm looking forward to your inputs, which could add value to offshore investors in the future.

Your cooperation is highly appreciated.

Yours sincerely

Ntwanano Jethro Godi
Student (University of South Africa)

The main purpose of this survey is to identify risks faced by South African offshore investors when making an offshore investment decision.

SECTION A: DEMOGRAPHIC INFORMATION

Section A is solely for statistical purposes, and will not be shared with anyone. Please choose one option.

A.1. How long have you operated as an offshore investment broker.

Less than 5 years	6 - 10 years	11-15 years	More than 15 years

A.2. What is your highest qualification.

National Senior Certificate	Bachelors degree	Honours degree	Masters or doctoral degree

SECTION B: CRITICAL DECISION FACTORS

Section B contains questions relating to the importance of critical decision factors and their impact during an offshore investment decision process.

B.1. Please rate the importance of each of the following risks that an offshore investor need to consider when making an offshore investment decision. *Please put a cross (X) next to your choice.*

Offshore risks	Irrelevant	Unimportant	Neutral	Important	Very important
B.1.1. Exchange rate risk / currency risk					
B.1.2. Country risk / political risk					
B.1.3. Market risk					
B.1.4. Inflation risk					
B.1.5. Interest rate risk					
B.1.6. Financial risk					
B.1.7. Credit risk					
B.1.8. Liquidity risk					
B.1.9. Legal risk					
B.1.10. Technology risk					

B.2. Please allocate 100 points across all of the following offshore risks in terms of their importance, e.g. if exchange rate risk is considered as the most important risk, it should have the highest points. The sum, over the ten risks, must add up to 100.

Offshore risks	Point (s)
B.2.1. Exchange rate risk / currency risk	
B.2.2. Country risk / political risk	
B.2.3. Market risk	
B.2.4. Inflation risk	
B.2.5. Interest rate risk	
B.2.6. Financial risk	
B.2.7. Credit risk	
B.2.8. Liquidity risk	
B.2.9. Legal risk	
B.2.10. Technology risk	
Total points	100

B.3. Please rate the importance of the following offshore investment factors when making an offshore investment decision.

Offshore investment factors	Irrelevant	Unimportant	Neutral	Important	Very important
B.3.1. Currency fluctuations in the offshore country					
B.3.2. Economic stability of the offshore country					
B.3.3. Liquidity of the offshore investment assets					
B.3.4. Inflation in the offshore country					
B.3.5. Cost of the offshore investment assets					
B.3.6. Risks and Scams					
B.3.7. Taxation regulations in the offshore country					

B.4. Please allocate 100 points across all of the following offshore investment factors in terms of their importance. The sum, over the seven factors, must add up to 100.

Offshore investment factors	Point(s)
B.4.1. Currency fluctuations in the offshore country	
B.4.2. Economic stability of the offshore country	
B.4.3. Liquidity of the offshore investment assets	
B.4.4. Inflation in the offshore country	
B.4.5. Cost of the offshore investment asset	
B.4.6. Risks and Scams	
B.4.7. Taxation regulations in the offshore country	
Total points	100

B.5. The following are considered as reasons for investing offshore. Please rate your level of agreement.

Reasons for investing offshore	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
B.5.1. Diversification of risks					
B.5.2. Enhancements of returns					
B.5.3. Exploitation of offshore markets					
B.5.4. To increase investment opportunities					
B.5.5. To balance an investment portfolio					
B.5.6. To hedge funds					
B.5.7. Confidence in the offshore country					

B.6. The following are considered as the main indicators of exchange rate risk. Please rate your level of agreement.

Indicators of exchange rate risk	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
B.6.1. The relationships between countries interest rates					
B.6.2. The relationships between countries inflation rates					
B.6.3. The relationships between countries exchange rates					

B.7. Please rate the importance of each of the following factors when considering country risk during an offshore investment decision process.

Factors arising as country risk	Irrelevant	Unimportant	Neutral	Important	Very important
B.7.1. Jurisdiction issues - the laws that govern investments in the offshore country					
B.7.2. Tax issues - each type of investment carries its own tax consequences as onshore and offshore jurisdiction has their own tax codes					
B.7.3. Investment issues - balance between strong currencies, markets and exposure to emerging markets could be a daunting task					
B.7.4. Trust issues - Before settling a trust, a careful analysis is necessary to balance the benefits of trust structuring with the associated charges					

B.8. The following control measure are considered to reduce country risk. Please rate your level of agreement.

Factors controlling country risk	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
B.8.1. Assessment of sovereign, currency and banking sector risk in offshore markets					
B.8.2. Analysis of credit risk posed by political and economic situation in each country					
B.8.3. Comparison of risks across countries, using standardised risk and forecasting methodology					
B.8.4. Assessment of business risk, taking into account macroeconomic variables					
B.8.5. Manipulate, display and analyse data in investors own financial and risk rating models					
B.8.6. Limit risk in markets with the help of timely warnings of likely rating downgrades					

B.9. The following factors are considered to have an effect on the movement and forecasting of interest rates in offshore countries. Please rate your level of agreement.

Factors affecting the movement and forecasting of interest rate risk	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
B.9.1. Demand and supply of funds in the offshore country					
B.9.2. Monetary policy of the offshore government					
B.9.3. Fiscal policy developments in the offshore country					
B.9.4. Political attitude of foreign investors					
B.9.5. Inflation rate in the offshore country					

SECTION C: OFFSHORE INVESTMENT PITFALLS

Section C contains questions relating to the importance of minimising offshore investment pitfalls.

C.1. Please rate the importance of the following offshore investment pitfalls when making an offshore investment decision.

Offshore investment pitfalls	Irrelevant	Unimportant	Neutral	Important	Very important
C.1.1. Higher expectations on investment performance					
C.1.2. Monitoring offshore investments					
C.1.3. Investing in products without a domestic presence					
C.1.4. Trading in foreign language					
C.1.5. Timing the currency					
C.1.6. Restrictions on the value of offshore investments					
C.1.7. Hidden product costs and tax pitfalls					

C.2. Please allocate 100 points across all of the following offshore investment pitfalls in terms of their importance. The sum, over the seven pitfalls, must add up to 100.

Offshore investment pitfalls	Point(s)
C.2.1. Monitoring offshore investments	
C.2.2. Investing in products without a South African presence	
C.2.3. Trading in foreign language	
C.2.4. Timing the currency	
C.2.5. Restrictions on the value of offshore investments	
C.2.6. Hidden product costs and tax pitfalls	
Total points	

SECTION D: OFFSHORE INVESTMENTS

Section D contains questions regarding offshore investments. Please rate your level of agreement.

Offshore investments	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
D.1. Offshore investors need a good understanding of offshore investment risks and risk exposures before investing offshore.					
D.2. Offshore investors need to make a provision for an emergency fund before investing offshore.					
D.3. Offshore investments are considered as good investments.					
D4. Offshore investments are considered as high risk investments.					
D5. Offshore investments yield higher returns compared to domestic investments.					
D.6. Offshore investments are complicated to monitor.					
D.7. Offshore investments are complicated to administer.					

Please indicate if you would like a copy of the results of this survey: **Yes/No**
If Yes, please provide your details below.

Name of broker: _____ Today's date: _____

Address: _____

Telephone: (____) _____- _____ Email: _____

THANK YOU VERY MUCH FOR YOUR TIME AND FOR PARTICIPATING IN THIS SURVEY!

ANNEXURE F: STATISTICAL ANALYSIS SUMMARY

Notes

Output created		04-JUL-2012 11:47:22
Comments		
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	Filter	<none>
	Weight	<none>
	Split file	<none>
	N of rows in working data file	9
Missing value handling	Definition of missing	User-defined missing values are treated as missing.
	Cases used	Statistics are based on all cases with valid data.

Frequency table

How long have you operated as an offshore investment broker?

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Less than 5 years	6	66.7	75.0	75.0
	11–15 years	1	11.1	12.5	87.5
	More than 15 years	1	11.1	12.5	100.0
	Total	8	88.9	100.0	
Missing	System	1	11.1		
Total		9	100.0		

What is your highest qualification?

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	National Senior Certificate	1	11.1	12.5	12.5
	Bachelor's degree	3	33.3	37.5	50.0
	Honours degree	3	33.3	37.5	87.5
	Master's or doctoral degree	1	11.1	12.5	100.0
	Total	8	88.9	100.0	
Missing	System	1	11.1		
Total		9	100.0		

Please rate the importance of each of the following risks that an offshore investor needs to consider when making an offshore investment decision [B.1.1 Exchange rate risk/currency risk]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Unimportant	1	11.1	16.7	16.7
	Important	1	11.1	16.7	33.3
	Very important	4	44.4	66.7	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

Please rate the importance of each of the following risks that an offshore investor needs to consider when making an offshore investment decision [B.1.2. Country risk/political risk]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Very important	6	66.7	100.0	100.0
Missing	System	3	33.3		
Total		9	100.0		

Please rate the importance of each of the following risks that an offshore investor needs to consider when making an offshore investment decision [B.1.3. Market risk]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Important	2	22.2	33.3	33.3
	Very important	4	44.4	66.7	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

Please rate the importance of each of the following risks that an offshore investor needs to consider when making an offshore investment decision [B.1.4. Inflation risk]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Neutral	1	11.1	16.7	16.7
	Important	2	22.2	33.3	50.0
	Very important	3	33.3	50.0	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

Please rate the importance of each of the following risks that an offshore investor needs to consider when making an offshore investment decision [B.1.5. Interest rate risk]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Neutral	1	11.1	16.7	16.7
	Important	1	11.1	16.7	33.3
	Very important	4	44.4	66.7	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

Please rate the importance of each of the following risks that an offshore investor needs to consider when making an offshore investment decision [B.1.6. Financial risk]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Neutral	1	11.1	20.0	20.0
	Very important	4	44.4	80.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

Please rate the importance of each of the following risks that an offshore investors need to consider when making an offshore investment decision [B.1.7. Credit risk]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Important	3	33.3	50.0	50.0
	Very important	3	33.3	50.0	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

Please rate the importance of each of the following risks that an offshore investor needs to consider when making an offshore investment decision [B.1.8. Liquidity risk]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Important	2	22.2	33.3	33.3
	Very important	4	44.4	66.7	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

Please rate the importance of each of the following risks that an offshore investor needs to consider when making an offshore investment decision [B.1.9. Legal risk]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Neutral	1	11.1	16.7	16.7
	Important	1	11.1	16.7	33.3
	Very important	4	44.4	66.7	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

Please rate the importance of each of the following risks that an offshore investor needs to consider when making an offshore investment decision [B.1.10. Technology risk]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Important	3	33.3	50.0	50.0
	Very important	3	33.3	50.0	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

[1]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	B.2.1. Exchange rate risk/currency risk	2	22.2	33.3	33.3
	B.2.2. Country risk/political risk	3	33.3	50.0	83.3
	B.2.4. Inflation risk	1	11.1	16.7	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

[2]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	B.2.1. Exchange rate risk/currency risk	1	11.1	16.7	16.7
	B.2.2. Country risk/political risk	1	11.1	16.7	33.3
	B.2.6. Financial risk	1	11.1	16.7	50.0
	B.2.7. Credit risk	1	11.1	16.7	66.7
	B.2.8. Liquidity risk	1	11.1	16.7	83.3
	B.2.9. Legal risk	1	11.1	16.7	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

[3]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	B.2.1. Exchange rate risk/currency risk	1	11.1	16.7	16.7
	B.2.3. Market risk	1	11.1	16.7	33.3
	B.2.5. Interest rate risk	1	11.1	16.7	50.0
	B.2.7. Credit risk	1	11.1	16.7	66.7
	B.2.8. Liquidity risk	1	11.1	16.7	83.3
	B.2.9. Legal risk	1	11.1	16.7	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

[4]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	B.2.2. Country risk/political risk	1	11.1	16.7	16.7
	B.2.3. Market risk	1	11.1	16.7	33.3
	B.2.6. Financial risk	3	33.3	50.0	83.3
	B.2.7. Credit risk	1	11.1	16.7	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

[5]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	B.2.1. Exchange rate risk/currency risk	1	11.1	16.7	16.7
	B.2.3. Market risk	2	22.2	33.3	50.0
	B.2.4. Inflation risk	1	11.1	16.7	66.7
	B.2.7. Credit risk	1	11.1	16.7	83.3
	B.2.9. Legal risk	1	11.1	16.7	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

[6]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	B.2.3. Market risk	2	22.2	33.3	33.3
	B.2.4. Inflation risk	1	11.1	16.7	50.0
	B.2.5. Interest rate risk	1	11.1	16.7	66.7
	B.2.6. Financial risk	1	11.1	16.7	83.3
	B.2.8. Liquidity risk	1	11.1	16.7	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

[7]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	B.2.5. Interest rate risk	3	33.3	50.0	50.0
	B.2.6. Financial risk	1	11.1	16.7	66.7
	B.2.7. Credit risk	1	11.1	16.7	83.3
	B.2.10. Technology risk	1	11.1	16.7	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

[8]

		Frequency	Per cent	Valid per cent	Cumulative Per cent
Valid	B.2.4. Inflation risk	1	11.1	16.7	16.7
	B.2.5. Interest rate risk	1	11.1	16.7	33.3
	B.2.7. Credit risk	1	11.1	16.7	50.0
	B.2.8. Liquidity risk	2	22.2	33.3	83.3
	B.2.10. Technology risk	1	11.1	16.7	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

[9]

		Frequency	Per cent	Valid per cent	Cumulative Per cent
Valid	B.2.2. Country risk/political risk	1	11.1	16.7	16.7
	B.2.4. Inflation risk	2	22.2	33.3	50.0
	B.2.9. Legal risk	2	22.2	33.3	83.3
	B.2.10. Technology risk	1	11.1	16.7	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

[10]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	B.2.1. Exchange rate risk/currency risk	1	11.1	16.7	16.7
	B.2.8. Liquidity risk	1	11.1	16.7	33.3
	B.2.9. Legal risk	1	11.1	16.7	50.0
	B.2.10. Technology risk	3	33.3	50.0	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

Please rate the importance of the following offshore investment factors when making an offshore investment decision [B.3.1. Currency fluctuations in the offshore country]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Unimportant	1	11.1	16.7	16.7
	Very important	5	55.6	83.3	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

Please rate the importance of the following offshore investment factors when making an offshore investment decision [B.3.2. Economic stability of the offshore country]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Important	1	11.1	16.7	16.7
	Very important	5	55.6	83.3	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

Please rate the importance of the following offshore investment factors when making an offshore investment decision [B.3.3. Liquidity of the offshore investment assets]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Important	2	22.2	33.3	33.3
	Very important	4	44.4	66.7	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

Please rate the importance of the following offshore investment factors when making an offshore investment decision [B.3.4. Inflation in the offshore country]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Important	4	44.4	66.7	66.7
	Very important	2	22.2	33.3	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

Please rate the importance of the following offshore investment factors when making an offshore investment decision [B.3.5. Cost of the offshore investment assets]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Important	3	33.3	50.0	50.0
	Very important	3	33.3	50.0	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

Please rate the importance of the following offshore investment factors when making an offshore investment decision [B.3.6. Risks & scams]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Very important	6	66.7	100.0	100.0
Missing	System	3	33.3		
Total		9	100.0		

Please rate the importance of the following offshore investment factors when making an offshore investment decision [B.3.7. Taxation regulations in the offshore country]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Very important	6	66.7	100.0	100.0
Missing	System	3	33.3		
Total		9	100.0		

[1]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	B.4.1. Currency fluctuations in the offshore country	2	22.2	33.3	33.3
	B.4.2. Economic stability of the offshore country	3	33.3	50.0	83.3
	B.4.6. Risks and scams	1	11.1	16.7	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

[2]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	B.4.2. Economic stability of the offshore country	1	11.1	16.7	16.7
	B.4.4. Inflation in the offshore country	2	22.2	33.3	50.0
	B.4.6. Risks and scams	3	33.3	50.0	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

[3]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	B.4.1. Currency fluctuations in the offshore country	1	11.1	16.7	16.7
	B.4.3. Liquidity of the offshore investment assets	1	11.1	16.7	33.3
	B.4.5. Cost of the offshore investment asset	1	11.1	16.7	50.0
	B.4.6. Risks and scams	1	11.1	16.7	66.7
	B.4.7. Taxation regulations in the offshore country	2	22.2	33.3	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

[4]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	B.4.1. Currency fluctuations in the offshore country	1	11.1	16.7	16.7
	B.4.2. Economic stability of the offshore country	1	11.1	16.7	33.3
	B.4.5. Cost of the offshore investment asset	2	22.2	33.3	66.7
	B.4.7. Taxation regulations in the offshore country	2	22.2	33.3	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

[5]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	B.4.2. Economic stability of the offshore country	1	11.1	16.7	16.7
	B.4.3. Liquidity of the offshore investment assets	2	22.2	33.3	50.0
	B.4.5. Cost of the offshore investment asset	2	22.2	33.3	83.3
	B.4.7. Taxation regulations in the offshore country	1	11.1	16.7	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

[6]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	B.4.1. Currency fluctuations in the offshore country	1	11.1	16.7	16.7
	B.4.3. Liquidity of the offshore investment assets	3	33.3	50.0	66.7
	B.4.4. Inflation in the offshore country	1	11.1	16.7	83.3
	B.4.7. Taxation regulations in the offshore country	1	11.1	16.7	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

[7]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	B.4.1. Currency fluctuations in the offshore country	1	11.1	16.7	16.7
	B.4.4. Inflation in the offshore country	3	33.3	50.0	66.7
	B.4.5. Cost of the offshore investment asset	1	11.1	16.7	83.3
	B.4.6. Risks and scams	1	11.1	16.7	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

The following are considered as reasons for investing offshore. Please rate your level of agreement.

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	4=Agree	3	33.3	50.0	50.0
	5=Strongly agree	3	33.3	50.0	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

The following are considered as reasons for investing offshore. Please rate your level of agreement.

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	4=Agree	2	22.2	33.3	33.3
	5=Strongly agree	4	44.4	66.7	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

The following are considered as reasons for investing offshore. Please rate your level of agreement.

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	3=Neutral	2	22.2	33.3	33.3
	4=Agree	2	22.2	33.3	66.7
	5=Strongly agree	2	22.2	33.3	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

The following are considered as reasons for investing offshore. Please rate your level of agreement.

		Frequency	Per cent	Valid per cent	Cumulative Per cent
Valid	4=Agree	3	33.3	50.0	50.0
	5=Strongly agree	3	33.3	50.0	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

The following are considered as reasons for investing offshore. Please rate your level of agreement.

		Frequency	Per cent	Valid per cent	Cumulative Per cent
Valid	4=Agree	3	33.3	50.0	50.0
	5=Strongly agree	3	33.3	50.0	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

The following are considered as reasons for investing offshore. Please rate your level of agreement.

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	4=Agree	5	55.6	83.3	83.3
	5=Strongly agree	1	11.1	16.7	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

The following are considered as reasons for investing offshore. Please rate your level of agreement.

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	3=Neutral	1	11.1	16.7	16.7
	4=Agree	4	44.4	66.7	83.3
	5=Strongly agree	1	11.1	16.7	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

The following are considered as the main indicators of exchange rate risk. Please rate your level of agreement. [B.6.1. The relationships between countries interest rates]

		Frequency	Per cent	Valid per cent	Cumulative Per cent
Valid	4=Agree	3	33.3	50.0	50.0
	5=Strongly agree	3	33.3	50.0	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

The following are considered as the main indicators of exchange rate risk. Please rate your level of agreement. [B.6.2. The relationships between countries inflation rates]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	3=Neutral	1	11.1	16.7	16.7
	4=Agree	1	11.1	16.7	33.3
	5=Strongly agree	4	44.4	66.7	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

The following are considered as the main indicators of exchange rate risk. Please rate your level of agreement. [B.6.3. The relationships between countries exchange rates]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	4=Agree	2	22.2	33.3	33.3
	5=Strongly agree	4	44.4	66.7	100.0
	Total	6	66.7	100.0	
Missing	System	3	33.3		
Total		9	100.0		

Please rate the importance of each of the following factors when considering country risk during an offshore investment decision process. [B.7.1. Jurisdiction issues – the laws that govern investments in the offshore country]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Important	1	11.1	20.0	20.0
	Very important	4	44.4	80.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

Please rate the importance of each of the following factors when considering country risk during an offshore investment decision process. [B.7.2. Tax issues – each type of investment carries its own tax consequences as onshore and offshore jurisdiction

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Important	1	11.1	20.0	20.0
	Very important	4	44.4	80.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

Please rate the importance of each of the following factors when considering country risk during an offshore investment decision process. [B.7.3. Investment issues – balance between strong currencies, markets and exposure to emerging markets

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Important	3	33.3	60.0	60.0
	Very important	2	22.2	40.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

Please rate the importance of each of the following factors when considering country risk during an offshore investment decision process. [B.7.4. Trust issues – before settling a trust, a careful analysis is necessary to balance the benefits of a trust.

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Neutral	1	11.1	20.0	20.0
	Important	3	33.3	60.0	80.0
	Very important	1	11.1	20.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

The following control measures are considered to reduce country risk. Please rate your level of agreement. [B.8.1. Assessment of sovereign, currency and banking sector risk in offshore markets]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	4=Agree	3	33.3	60.0	60.0
	5=Strongly agree	2	22.2	40.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

The following control measures are considered to reduce country risk. Please rate your level of agreement. [B.8.2. Analysis of credit risk posed by political and economic situation in each country]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	5=Strongly agree	5	55.6	100.0	100.0
Missing	System	4	44.4		
Total		9	100.0		

The following control measures are considered to reduce country risk. Please rate your level of agreement. [B.8.3. Comparison of risks across countries, using standardised risk and forecasting methodology]

		Frequency	Per cent	Valid per cent	Cumulative Per cent
Valid	4=Agree	2	22.2	40.0	40.0
	5=Strongly agree	3	33.3	60.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

The following control measures are considered to reduce country risk. Please rate your level of agreement. [B.8.4. Assessment of business risk, taking into account macroeconomic variables]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	4=Agree	2	22.2	40.0	40.0
	5=Strongly agree	3	33.3	60.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

The following control measures are considered to reduce country risk. Please rate your level of agreement. [B.8.5. Manipulate, display and analyse data in investors own financial and risk rating models]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	3=Neutral	1	11.1	20.0	20.0
	4=Agree	1	11.1	20.0	40.0
	5=Strongly agree	3	33.3	60.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

The following control measures are considered to reduce country risk. Please rate your level of agreement. [B.8.6. Limit risk in markets with the help of timely warnings of likely rating downgrades]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	4=Agree	3	33.3	60.0	60.0
	5=Strongly agree	2	22.2	40.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

The following factors are considered to have an effect on the movement and forecasting of interest rates in offshore countries. Please rate your level of agreement. [B.9.1. Demand and supply of funds in the offshore country]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	4=Agree	3	33.3	60.0	60.0
	5=Strongly agree	2	22.2	40.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

The following factors are considered to have an effect on the movement and forecasting of interest rates in offshore countries. Please rate your level of agreement. [B.9.2. Monetary policy of the offshore government]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	4=Agree	1	11.1	20.0	20.0
	5=Strongly agree	4	44.4	80.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

The following factors are considered to have an effect on the movement and forecasting of interest rates in offshore countries. Please rate your level of agreement. [B.9.3. Fiscal policy developments in the offshore country]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	4=Agree	1	11.1	20.0	20.0
	5=Strongly agree	4	44.4	80.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

The following factors are considered to have an effect on the movement and forecasting of interest rates in offshore countries. Please rate your level of agreement. [B.9.4. Political attitude of foreign investors]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	4=Agree	3	33.3	60.0	60.0
	5=Strongly agree	2	22.2	40.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

The following factors are considered to have an effect on the movement and forecasting of interest rates in offshore countries. Please rate your level of agreement. [B.9.5. Inflation rate in the offshore country]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	4=Agree	2	22.2	40.0	40.0
	5=Strongly agree	3	33.3	60.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

Please rate the importance of the following offshore investment pitfalls when making an offshore investment decision. [C.1.1. Higher expectations on investment performance]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Unimportant	1	11.1	20.0	20.0
	Important	3	33.3	60.0	80.0
	Very important	1	11.1	20.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

Please rate the importance of the following offshore investment pitfalls when making an offshore investment decision. [C.1.2. Monitoring offshore investments]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Neutral	1	11.1	20.0	20.0
	Important	3	33.3	60.0	80.0
	Very important	1	11.1	20.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

Please rate the importance of the following offshore investment pitfalls when making an offshore investment decision. [C.1.3. Investing in products without a domestic presence]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Neutral	3	33.3	60.0	60.0
	Very important	2	22.2	40.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

Please rate the importance of the following offshore investment pitfalls when making an offshore investment decision. [C.1.4. Trading in foreign language]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Neutral	2	22.2	40.0	40.0
	Important	2	22.2	40.0	80.0
	Very important	1	11.1	20.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

Please rate the importance of the following offshore investment pitfalls when making an offshore investment decision. [C.1.5. Timing the currency]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Neutral	1	11.1	20.0	20.0
	Very important	4	44.4	80.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

Please rate the importance of the following offshore investment pitfalls when making an offshore investment decision. [C.1.6. Restrictions on the value of offshore investments]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Important	3	33.3	60.0	60.0
	Very important	2	22.2	40.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

Please rate the importance of the following offshore investment pitfalls when making an offshore investment decision. [C.1.7. Hidden product costs and tax pitfalls]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Neutral	1	11.1	20.0	20.0
	Important	1	11.1	20.0	40.0
	Very important	3	33.3	60.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

[1]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Higher expectations on investment performance	2	22.2	40.0	40.0
	Monitoring offshore investments	1	11.1	20.0	60.0
	Timing the currency	1	11.1	20.0	80.0
	Restrictions on the value of offshore investments	1	11.1	20.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

[2]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Higher expectations on investment performance	1	11.1	20.0	20.0
	Investing in products without a South African presence	1	11.1	20.0	40.0
	Timing the currency	1	11.1	20.0	60.0
	Restrictions on the value of offshore investments	1	11.1	20.0	80.0
	Hidden product costs and tax pitfalls	1	11.1	20.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

[3]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Monitoring offshore investments	1	11.1	20.0	20.0
	Investing in products without a South African presence	1	11.1	20.0	40.0
	Trading in foreign language	1	11.1	20.0	60.0
	Timing the currency	1	11.1	20.0	80.0
	Hidden product costs and tax pitfalls	1	11.1	20.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

[4]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Higher expectations on investment performance	1	11.1	20.0	20.0
	Monitoring offshore investments	1	11.1	20.0	40.0
	Restrictions on the value of offshore investments	3	33.3	60.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

[5]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Trading in foreign language	2	22.2	40.0	40.0
	Hidden product costs and tax pitfalls	3	33.3	60.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

[6]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Higher expectations on investment performance	1	11.1	20.0	20.0
	Monitoring offshore investments	1	11.1	20.0	40.0
	Investing in products without a South African presence	2	22.2	40.0	80.0
	Timing the currency	1	11.1	20.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

[7]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Monitoring offshore investments	1	11.1	20.0	20.0
	Investing in products without a South African presence	1	11.1	20.0	40.0
	Trading in foreign language	2	22.2	40.0	80.0
	Timing the currency	1	11.1	20.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

Contains questions regarding offshore investments. Please rate your level of agreement. [D.1. Offshore investors need a good understanding of offshore investment risks and risk exposures before investing offshore]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	5=Strongly agree	5	55.6	100.0	100.0
Missing	System	4	44.4		
Total		9	100.0		

Contains questions regarding offshore investments. Please rate your level of agreement. [D.2. Offshore investors need to make a provision for an emergency fund before investing offshore]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	3=Neutral	2	22.2	40.0	40.0
	4=Agree	1	11.1	20.0	60.0
	5=Strongly agree	2	22.2	40.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

Contains questions regarding offshore investments. Please rate your level of agreement. [D.3. Offshore investments are considered as good investments]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	3=Neutral	2	22.2	40.0	40.0
	4=Agree	3	33.3	60.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

Contains questions regarding offshore investments. Please rate your level of agreement. [D4. Offshore investments are considered as high-risk investments.]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	2=Disagree	1	11.1	20.0	20.0
	4=Agree	3	33.3	60.0	80.0
	5=Strongly agree	1	11.1	20.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

Contains questions regarding offshore investments. Please rate your level of agreement. [D5. Offshore investments yield higher returns compared to domestic investments]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	2=Disagree	1	11.1	20.0	20.0
	4=Agree	4	44.4	80.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

Contains questions regarding offshore investments. Please rate your level of agreement. [D.6. Offshore investments are complicated to monitor.]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	1=Strongly disagree	1	11.1	20.0	20.0
	3=Neutral	4	44.4	80.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

Contains questions regarding offshore investments. Please rate your level of agreement. [D.7. Offshore investments are complicated to administer]

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	1=Strongly disagree	1	11.1	20.0	20.0
	3=Neutral	4	44.4	80.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

Please indicate if you would like a copy of the results of this survey

		Frequency	Per cent	Valid per cent	Cumulative per cent
Valid	Yes	4	44.4	80.0	80.0
	No	1	11.1	20.0	100.0
	Total	5	55.6	100.0	
Missing	System	4	44.4		
Total		9	100.0		

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