Balancing Opportunities with Practical Business Risks

The removal of many international sanctions on Iran in early 2016 looks certain to boost the country's economic prospects. However, enhancement of the investment climate in the medium-term notwithstanding. Following years of isolation from the global financial and trade system, the country's reformist government will need time to help Iranian companies re-connect with the western world, reform its economic structures, and reduce the cost of doing business in the country, in addition to addressing macroeconomic issues and fostering a level playing field for all investors. Issues to consider are:

- Hidden ownership structures of Iranian companies will pose additional risks to investors from a reputational and compliance perspective. Investors will need to conduct enhanced due diligence investigations to identity the ultimate beneficiaries of their prospective Iranian business partners in order to understand whether these entities are linked to sanctioned individuals or companies, or to politically exposed persons.
- The reinstating of sanctions (so-called 'snap back') will remain a possibility throughout the implementation of the JCPOA over the next decade. Investors should map the different scenarios for the implementation of the JCPOA, monitor those scenarios' triggers, and structure their contracts and business to account for that threat.
- Sectors of strategic importance to the government and/or with high levels of state ownership will likely be affected by regulatory unpredictability and political interference due to factional politics and government efforts to balance private and public interests. Investors will be successful in these sectors only if they understand and monitor patterns of local decision-making and use this understanding to pre-empt and plan for regulatory fluctuations.
- A lack of local understanding of international compliance requirements and entrenched corrupt behaviours will challenge corporate governance standards imposed by foreign companies. Investors will have to understand these challenges and factor them in as they shape their local operations.

As a result of these risks, Control Risks recommends that companies looking to conduct business in or with Iran consider the following steps to inform their market entry strategy.

Proactively identify and manage the reputational risks of engaging with Iran. Doing business in or with Iran will continue to be a highly politicised and sensitive issue for companies with ongoing business in the US. This is due to the extent of political animosity to Iran and the JCPOA at both a federal and state level. Companies with US business interests must be prepared for US politicians, lobby groups, single-action groups and the media to publicise and criticise their business with Iran using a variety of tactics. Furthermore, Saudi Arabia has indicated that it will seek to limit trade ties with Iran given the recent termination of diplomatic relations between the two countries. Although the implications of this are still being worked out, it is a clear indication that companies with existing business interests in some of the Gulf Cooperation Council states can expect negative reactions to their attempts to do business with Iran. Multinational companies should identify where their brand is most exposed to reputational challenges and take proactive steps to limit the impact of those challenges on shareholder value.

Assure yourself and your stakeholders about the identity of any business partners in Iran through conducting enhanced due diligence investigations. Understanding the beneficial owners of your local partners and clients is particularly important in Iran given the remaining sanctions on Iranian individuals and companies (both state-owned and private). Iranian companies have attempted in recent years to disguise their ownership structures in order to hide the roles of politically exposed and sanctioned entities and individuals. Iran is a complex business and political environment, but in our experience it is possible to identify the role of politically exposed individuals in business transactions in Iran. To achieve this with any degree of assurance, on-the-ground source enquiries are usually necessary. Beyond helping you comply with remaining sanctions, due diligence on third parties will also allow you to assure stakeholders, such as investors, banks and business partners – or even shareholders and boards – that your business is reputationally and legally sound.

Map the different scenarios for the implementation of the JCPOA. Companies investing capital or establishing a permanent presence in Iran must understand how different events and outcomes for the implementation of the JCPOA, and additional US sanctions beyond the scope of the JCPOA, could affect their ability to continue doing business in the country. Understanding these scenarios will allow companies to structure contracts that provide some assurance in case of sanctions being reinstated post Implementation Day, particularly in the 'snapback' scenario. It will also equip investors with a list of triggers they can monitor to understand how such changes could influence the trajectory and success of their business. These indicators range from the influence of US presidential elections on a potential snapback of sanctions to upcoming national elections in Iran and any ensuing regulatory changes affecting the business environment. Monitoring such factors will allow organisations to review their posture and adapt their market entry strategy and compliance procedures accordingly.

Understand the sector in which you will be operating. Following years of exclusion from international markets and access to technological know-how, and because of the broadly left-wing economic ideology of the Islamic republic, many of the key industrial sectors in Iran are controlled or significantly influenced by the state and its representatives, or by affiliated prominent local businesspeople. This has led to frequent overlap between regulators and regulated entities and a general opacity in decision-making. Investors entering these sectors are likely to face significant regulatory unpredictability as the system is 'reset' to provide a better balance between local and foreign interests. Until then, companies could experience frequent changes in the regulations pertaining to their sector, including certain protectionist measures (such as local content requirements) aimed at supporting local businesses and employees. Therefore, investors must identify and understand the key local stakeholders in their sector of operation, as well as the decision-making processes of various regulatory bodies. This will allow companies to get ahead of the game, by helping them to pre-empt regulatory changes, run an engaged government affairs strategy and introduce enough flexibility in the business to allow it to adapt quickly to changes in the local market.

Seek to strongly embed corporate governance standards when setting up a business on the ground. Iran has operated as an isolated market under the considerable stress and strain of comprehensive sanctions since 2006. Competition over scarce business opportunities and an over-reliance on the state have fuelled corrupt practices and, more broadly, poor corporate governance standards among local businesses and employees. Patience and persistence will be required to communicate and enforce anti-corruption and sanctions compliance standards among employees and third parties.

How to Plan for Doing Business in Iran

In summary, and based on experience of international companies, there are five notable challenges that deserve immediate attention in order to reap the benefits of the Iranian market:

- **Updating global compliance policies.** A comprehensive compliance strategy is the essential bedrock for building and implementing a successful Iran plan. Companies need to confirm that their policies are compliant by consulting with an external sanctions lawyer.

- **Overcoming a lack of market data.** Companies looking to enter the market should identify and track leading macroeconomic indicators of specific customer segments. Focusing on data such as population growth, inflation, and GDP growth is a way to anticipate market developments.
- **Finding the right local partners.** While it is possible to set up a direct presence, using local distributors at first is strongly advised. The best way to identify new partners involves in-person due diligence.
- **Reclaiming brand equity.** Customers may have distorted views of foreign goods that are in Iran illegally. Senior executives should be ready to trace the origins of and combat grey market trade and counterfeits of their products in Iran. Otherwise, companies risk facing challenges related to pricing, value, and positioning against competitors.
- **Accessing foreign exchange.** Often, local companies spend weeks waiting for access to foreign currency to import goods from their foreign partners. Without access to the U.S. financial system, this pressure will not ease in the near term. Moreover, this problem is likely to persist because Iran is unifying dual currency exchange rates while also seeking to protect local producers from volatility.

Opportunities outweigh the risks

Even with these challenges there are foreign companies seizing the opportunity ahead of their competitors. While the oil and gas sector gets the most attention, Iran's diversified economy is attracting companies across industries. In particular, consumer-oriented sectors are counting on Iran's large (nearly 80 million), young (more than 60% under 30 years old), and urbanized (more than 70%) population to be loyal customers in the future.

For example, South Korea–based LG Electronics, which maintained an Iran presence despite sanctions, is in discussions to establish a manufacturing plant in Tehran that will produce more than 1.5 million refrigerators, televisions, and washing machines per year. French automaker Renault has taken advantage of sanctions relief, assembling nearly 15,000 cars between January and April, a sevenfold increase from the same period in 2015. And Danish pharmaceutical company Novo Nordisk is building on its Iran presence by doubling local staff to nearly 300 and investing $76 million in a new factory.

The country's tourism sector attracted fewer than five million visitors in 2014 while neighboring Turkey attracted 39 million people. Given Iran's top 10 ranking in the number of UNESCO world heritage cultural sites in the world, this is poised to change. Luxury hotel brand Melia is joining Accor and Rotana to open the country's first international five-star hotel, the Gran Melia Ghoo.

Looking further into the future, Iran is a potential global trade hub. Already nearly 20% of oil trade passes through the Strait of Hormuz, the narrow waterway off Iran's southern coast, which is the only sea route out of the Persian Gulf and one of the world's most strategic transit points. Furthermore, the International North-South Transport Corridor will make Iran a key link in connecting India, Central Asia, and Russia, while Iran's role as part of China's new Silk Road(especially with rail links) could boost bilateral trade between those countries to up to $600 billion. There are lucrative export and investment opportunities elsewhere in the region, such as in Afghanistan, which is seeking to tap mineral wealth, and in emerging giants such as India, Pakistan, and Turkey, which need natural gas to fuel economic development.