

Crisis in the D&E Markets: Invest, Lay Dormant or Run for Cover?

By Eleanor Eaton & Lothar Katz

Background

The world-wide interest in D&E (Developing and Emerging) markets sparked in the 1990's with the emergence of two simultaneous phenomena:

- Businesses in the industrialized countries (and elsewhere) went global, and
- the mature, older markets of the U.S. and Western Europe began to experience disappointing growth.

The world turned its attention to the exploration of the new, recently liberated markets of Eastern Europe, Russia, and China. In parallel, India started opening itself up to foreign investors and businesses, with relaxed government regulations and ensuing improvements of the business climate. Brazil –and several others– followed suit.

Finally, about five years ago a new term became fashionable: BRIC. While technically no more than an acronym for Brazil, Russia, India and China, the largest markets in the D&E universe, the term conveys several images that reach far beyond:

- BRIC denotes a strong foundation and conveys an image of solidity, and
- BRIC epitomizes development, growth and a higher level of achievement.

How did these countries become so hot and lucrative for global business, in spite of their

obvious problems, challenges and a high degree of risk, particularly in Russia?

The formula determining the health of developed and established markets, such as the U.S., Western Europe, Japan or Australia, is well understood: these markets offer a healthy balance of supply and demand: the demand for goods is based on an economy's capacity to produce products or services that, in turn, enable the creation and consumption of further goods and services. As we will see, the BRIC countries' "rise to glory" in a business sense took different paths and did not always conform to this formula. Therefore, each country and market warrants individual study and requires specific strategies for business success.

It is important to note that the economic uncertainty and crisis that first emerged in 2008 continues to affect market conditions worldwide, including the BRIC group. Changes occur almost on a daily basis, from the fluctuating price of oil that affects suppliers such as Russia and Brazil to the unreliable demand for goods and services that impacts (out-)sourcing powerhouses such as China and India. Nevertheless, underlying market factors that predict mid- to long-term economic trends remain valid, recommending strategies for foreign investors that are ever so sound in these adverse economic times.

Brazil

A. Market Characteristics

Carnival, high poverty, poor levels of education, inflation troubles, and a low-tech economy? Except for the carnival part, forget all of that when looking at Latin America's largest and most populous country. Over the past 5-10 years, Brazil has

been enjoying tremendous economic growth, at twice its historic rates, across a variety of sectors, from energy to industrial manufacturing, from automotive to farming. High growth in farming? Indeed: while agriculture always mattered in this sparsely inhabited country, with a population density of a mere 21 citizens per square mile (compared to the U.S. at 86);

farming exports grew by more than 8% each year over the last decade.

Brazil's economy underwent dramatic changes. New oil discoveries have begun to thrust it into the ranks of the global oil powers. The banking system is now strong and foreign trade is diversified. With the United States accounting for a relatively low 15 % and Europe around 20-22% of Brazilian trade, the country's trade partners include key emerging markets and the developing world.

Yet while exports of commodities like oil and agricultural goods are one success factor, Brazil also has the advantage of having a huge domestic market with a sizable new middle class. While the top 10 percent of Brazil's earners saw incomes rising by 7 percent from 2001 to 2006, the bottom 10 percent shot up by 58 percent. Growth is seen in nearly all parts of the economy, creating a new class of super rich as well as lifting many into the expanding middle class. Brazil's population of 185 million is young: almost a third of the population is less than 15 years old. Accordingly, there is now a sizeable consumer market with a focus on the "young, hip and upwardly mobile."

How did it happen? To no small degree, the miracle of Brazil's transformation is owed to President Luiz Inácio Lula da Silva, first elected in 2002. A simple man and leftist leader who initially triggered considerable worries among foreign investors, he demonstrated a light touch when it came to economic stewardship, avoiding the populist impulses of leaders elsewhere in the region. Lula, as he is affectionately called, helped bring stability and prosperity through a series of legislative measures designed to develop country and people. Politically neutral, Brazil transformed itself to something akin of an island of stability in Latin America.

B. Current State of the Market

2008 was another strong year for Brazil, with its economy growing at around 5% and

the country gaining further clout in international trade. Its continuing weakness, however, is that much of Brazil's domestic industrial production originates from local subsidiaries of foreign multinationals, which introduces a strong dependency on the world economy. Nevertheless, Brazil at the moment looks to be the BRIC country that will be the least affected by the global recession. Economic prospects for 2009 and beyond remain fairly positive. While the global recession will impact Brazil as well, the Organization for Economic Cooperation and Development, OECD, expects it to be one of very few nations in the world that can avoid a strong economic slump.

In addition to exporting raw materials, commodities, oil & gas, and food, Brazil continues to be an attractive location for manufacturing, especially because of its role as a gateway to other Latin American markets. It has also become the prime center for IT outsourcing in the region. Further declines of the oil price and a slowdown of foreign investments represent the biggest threats to the country's economy. The Brazilian government has introduced cautious measures to stimulate the economy, for instance by freeing up credit and reducing taxes on purchases of smaller cars. It is considering initiatives for other sectors.

C. Government and Business

Though the country with the greatest economic freedom in the BRIC group, government interventions are not at all uncommon in Brazil when it comes to protecting economic interests. Government-owned and/or -controlled companies dominate a number of market segments. For example, huge oil companies, such as Exxon/Mobil, BP or Shell, have found themselves in unfair competition. Taking on the likes of Petrobras, Brazil's oil giant who morphed into a strong and innovative global player, can be akin to taking on the government itself.

Nevertheless, there are numerous examples of successful foreign investments from the United States, members of the European

Union, China, and others. The list of Brazil's top importers and exporters not only includes several foreign car manufacturers, such as Fiat, Ford, GM, Mercedes-Benz, and Volkswagen, but also other global players, such as telecom giant Ericsson or white goods maker Whirlpool.

D. Best Course of Action for Foreign Businesses in Brazil

Investments in Brazil look like one of the safest choices at this time of global uncertainty. They seem easier as Western businesses generally find familiar business, cultural and political structures in the country. Further growth in size and monetary reach of the country's middle class is expectable, as are productivity gains in the industrial sector. The fastest route to new engagements in Brazil may be through joint ventures with local companies or acquisitions of existing firms.

Russia

A. Market Characteristics

The Russian market opened up in the middle of the 90's, relatively late in comparison with other countries. For many years and more so than in any other market, its growth was largely powered by a huge, pent-up consumer demand. As a supplier, the country lags far behind China and India, predominantly offering natural resources such as oil, minerals and non-ferrous metals. A relatively small IT outsourcing sector has formed in recent years but is no competition to the giant players in this field, the most prominent one being India.

Russia's geography and demographics present huge challenges. With twice the landmass of the United States, it is sparsely populated, with only 60 citizens per square mile. Most of the population is concentrated in the western parts of Russia, with the dominant metropolises of Moscow (about 10 million people) and St. Petersburg (about 5-

In addition to the foreign economic influences outlined above, two local risk factors must be considered amid the current euphoria over Brazil's rapid development:

- The country's success still largely hinges on President Lula da Silva. He spearheaded the development of its business-friendly climate that is grounded in political neutrality and a desire to learn and grow. Whether this direction will change once Lula leaves office is subject to speculation.
- Insufficient infrastructure can be another pitfall in Brazil. Its road systems are still largely in a dismal state and its vast hinterlands almost impossible to access in an economic manner. Products are usually imported into the country along the more developed parts east coast of Brazil. Reaching for low-cost sourcing in the middle and western parts of the country can be difficult, as roads are neither well developed nor totally secure yet.

6 million). The country's infrastructure is still not capable of sustaining rapid economic growth, in spite of the strong progress the Russian government made in this area, especially around Moscow. Healthcare and the availability of medical services are equally limited in much of the country. While the Russian population is older than that of any other BRIC country, the average life expectancy is only 66 years, the lowest in the group and significantly below the Western world.

B. Current State of the Market

The Russian market is presently undergoing dramatic changes. Before the current recession, it was awash with money earned from oil and gas. Foreign companies operating in Russia had uneven patterns of success, with manufacturers of consumer goods, construction materials, security equipment, and food, as well as retailers and various service providers, faring best. Moscow had become a

magnet for all things luxury, such as designer brands, expensive cars, and upscale household items. Farther away from Moscow, markets were more moderate and focused on middle class needs. Overall, though, the Russian consumer market was among the fastest growing ones in the world.

One reason was that in time of shortages in the former Soviet Union, consumers got used to paying high premiums for hard-to-get import goods, even if that meant skimping on food. With increasing wealth, saving on food became less necessary for many, while buying foreign goods remained a huge status symbol in Russia.

We have to note that supplying products into Russia or establishing a manufacturing base was particularly challenging for Western businesses as most of them had to pay “protection” money to the Russian mafia – a unique market characteristic that does not exist in other BRIC countries.

Now that the global recession has hit the country and prices of oil and other commodities plummeted together with the global demand for them, Russia suddenly finds itself struggling with dwindling cash reserves and rapidly weakening local markets.

In retrospect, the country’s biggest mistake may have been using the money acquired in times of high prices mostly to heighten its financial influence and military presence. Only a miniscule portion of these windfall profits was dedicated to creating an industrial base that would make the country self-sustainable and create value-added products that would allow it to thrive in global markets. To a large degree, Russia remains a country sourcing raw materials. As can be frequently observed in Africa and, to a lesser extent, South America, this means strong exposure to demand fluctuations, natural disasters and other perils of commodity markets.

The current recession has created nothing short of a panic in Russian business circles as well as among the general population. By the end of 2008, Russians would wish each other “Merry Crisis” instead of “Merry

Christmas.” Consumption levels dropped substantially, owing to several factors:

- About 20% of production facilities either went into short work hours or closed altogether,
- the wealthiest business leaders faced a liquidity crisis that precipitated the fire sales of available assets,
- over the course of only two months, the Ruble was devalued seven times and lost about 30% of its value.

C. Government and Business

Even in times of prosperity, Russia had become more belligerent. The rising wealth emboldened its rulers, who were intent on reclaiming the country’s superpower status. Russia created or strengthened alliances with other major oil suppliers, building stronger ties to anti-American/anti-Western players such as Venezuela or Iran.

Many Russians feel that the country’s weakening economic position in the midst of the global recession threatens to cause “loss of face” in the world arena. The government, keen on increasing the country’s power and influence, is turning bullish any time it perceives a threat to its aspired status in the world, as the issues with Georgia and Ukraine have repeatedly demonstrated. Russia is using gas supplies to Europe as a political weapon, attempting to bias Europe against the planned U.S. anti-missile shield in Poland.

Further steps in this direction seem likely. At a time when a Czech presides over the EU, which reminds Russia of its loss of influence, Europe is considering alternatives to Russian gas deliveries via Ukraine, such as liquefied gas. Russia will interpret all this as hostile and may take aggressive countermeasures, short of a military option. We expect closer ties with Iran, active attempts to meddle in the Middle East, and aggressive courting of Latin American countries.

In the domestic market, industrial companies, especially those in resource exploration industries, met with increasing government interference and a high degree of disregard for

the limited legal system that Russia hastily put in place in the early 2000's. The Russian government is notorious for bullying Western partners, as evidenced by the experience of BP and Exxon in the country. Recent developments in the justice system indicate that foreign businesses will find their legal positions weakening further, largely leaving them unprotected and exposed to open intimidation.

In light of this gloomy assessment, we would like to emphasize two more encouraging aspects:

– For better or worse, the Russian government over the years became a powerful partner with Western businesses. Its primary interests lie in the industrial and resource exploration sectors. Thus far, other markets segments, such as consumer goods, were largely left alone; some manufacturers even managed to get along without paying any protection money. In fact, a number of foreign businesses count their Russian divisions among their most profitable.

Of course, this was before the recession. Now, with a rapidly contracting consumer market and reduced discretionary incomes, manufacturers and retailers have to re-think their portfolios, focusing on more moderate and value-focused products and offerings instead of the high end.

– Markets in Siberia (e.g., Krasnoyarsk, Novosibirsk), along the Volga river (Nizhny Novgorod, Saratov or Samara) and in the Far East (Vladivostok, Nakhodka) have become politically stronger, more prosperous and less dependent on the central government. While their remoteness promoted this trend, the most important factor was that these areas created their own wealth-generating enterprises, often based on alliances with Western manufacturers in the automotive, aircraft/engine, chemical and other industries. Chinese and Japanese businesses used this approach to

their advantage, as China is rapidly developing Siberia and Japan dominates the Far East.

D. Best Course of Action for Foreign Businesses in Russia

Businesses already established in Russia should stay, particularly if their focus lies in consumer goods for the mass market. However, given the uncertain legal framework, they need to be very cautious with new investments. We advise against any significant investments in brick and mortar for the next 18-24 months, at which time two key factors should have become clear:

- the Obama administration's approach to Russia and the new dynamics in the relations between the two countries, and
- the trends out of the global recession and their implications for the Russian market.

We urge consumer goods manufacturers to review their portfolio of products and use innovative techniques in product development and merchandising to counteract rapid declines in demand. Products for children will likely be more immune to the recession. Luxury items, construction materials and high technology may fare worst, whilst even simple household cleaning products may see weakening consumer demand.

Industrial businesses that are still considering entering the Russian market ought to concentrate on two strategies:

- staying local and forming alliances with local governments, businesses and academia, and
- remaining below the radar of the central government.

More promising industrial areas are those offering immediate benefits to a region, such as wind energy generation, medical facilities, education, service and maintenance across industries, household appliances and other consumer goods.

India

A. Market Characteristics

Long internally focused and largely isolated from world trade, the Indian market since the early 90's evolved from subcontracting and grew rapidly to become the world largest supplier of educated labor, especially in the areas of high technology, research and development. This spurred both the rise of the Indian middle class and a rapid increase in consumer demand.

India is densely populated across most of its regions, with an average of 1,000 citizens per square mile. However, its population outside of major metropolitan centers, such as Chennai, Delhi, Kolkata and Mumbai, has not changed that all that much. Religious processes, caste system and cultural habits remain obstacles for Western businesses, both in terms of catering to local market demands as well as in creating local manufacturing facilities. India's population is very young. About a third are less than 15 years old, compared with 20% in China and only 15% in Russia. An average population growth rate of 1.6% means that the country is adding about 18 million residents per year, a huge economic and cultural challenge – but also a foundation for further progressive market development.

The infrastructure of India is still in poor shape outside of the Golden Quadrilateral, a modern highway system that is nearly finished and will connect the subcontinent's four largest centers. Most other roads are poorly maintained. Accordingly, reaching many Indian regions remains challenging and slow.

B. Current State of the Market

Global recession hit India head-on in its main growth generating business: outsourcing. As the world's, and especially the U.S.', manufacturing and trade activities are being scaled down, there are substantially fewer calls for new software or IT development. Small-to-medium size firms have virtually stopped their expansion activities, resulting

in a contraction of India's IT outsourcing sector by as much as 15-20% in 2008.

While some analysts expected businesses to increase their outsourcing activities in order to cut costs, the slowing pace in manufacturing in the U.S. and Western Europe, as well as the overall economic uncertainty that forced businesses to put off major expansion, led to this steep decline and hurt India considerably. For example, Infosys, one of India's largest and fastest-growing outsourcing companies, recently put a freeze on all recruiting efforts.

This downturn stands to re-shape the outsourcing industry in two ways. First, the nature of the outsourcing projects is changing: instead of software development, outsourcing focuses on infrastructure management services such as corporate network monitoring. Such services run at much lower margins than development projects do. As a result, employee compensation declined 17% from an annual average of \$18,000 in mid-2007 to \$15,000 at the end of 2008.

In parallel, the client base is also changing: formerly a mix of companies of all sizes, it is now predominantly comprised of larger ones, who have substantially more clout and negotiating power. This introduced further pressures on margins, corporate profits, and incomes.

All of this has affected consumption rates and spending patterns of India's middle class. It is important to realize that Indians as a consumer group are far from homogeneous. Those interested in and able to afford Western goods and services represent only about 10% of the total "consuming middle class." The remaining 90% of the group base their buying decisions more on price and ease of use, not to change their lifestyles but to make them more convenient.

Tata Motors targets this larger group: the Nano, its most basic version of a conventional car, without air condition but priced at around \$2,500, drew tremendous attention in the price-conscious Indian automotive market.

Tata initially plans to produce 250,000 Nanos, with an eventual increase to 1 million within the next 2-3 years.

In today's market environment, manufacturers have to be highly price-sensitive regarding the products they bring to India. Developing and manufacturing products locally would help Western manufacturers better understand the market needs, as well as achieve substantial reductions in cost. On the other hand, creating manufacturing facilities in India is wrought with potential pitfalls and unpleasant surprises.

Past successes of foreign businesses in India are centered on setting up outsourced entities such as call centers or development facilities, in the IT industry and elsewhere. These companies are usually located in large metropolitan areas, with good infrastructure and access to a more sophisticated urban population, drawing from the huge pool of highly-educated Indian researchers, scientists and engineers.

In contrast, setting up large-scale manufacturing operations away from the more expensive megacenters can be very difficult: it means dealing with a low-skilled, uneducated and often prejudiced labor base with deeply entrenched religious and cultural beliefs that can be at conflict with the needs of an effective business operation. Tata Motors is a prime example; the company had to learn this first-hand when moving manufacturing capacity from the eastern state of West Bengal to the west of India.

C. Government and Business

Compounding the country's issues and problems, India in 2008 experienced the terrorist attack in Mumbai, which resulted in increasing tensions with Pakistan and ensuing political instability in the country. This affects Western businesses in two important ways:

- Normal caution is amplified by security concerns and resulting complications that will slow down business initiatives.

- The government, traditionally receptive to foreign investments and entries, will likely remain pre-occupied with political issues. Obtaining licenses, permits, and most importantly, funding, will be subject to prolonged bureaucratic hurdles, delays, extra scrutiny and an inevitable surge in corruption.

The Indian government, like any other, can be and often is a detriment to business, local or of foreign origin. One of the most notorious examples is the Indian Oil and Gas Company, ONGC. The company provides about a quarter of India's oil and gas needs; the rest is imported. As it accounts for 80% or more of the total oil and gas production in the country, ONGC's success is critical for India's growth. Being largely government-owned (the government holds a 74% stake), however, it is subject to a bureaucratic system involving no less than ten government entities, including the Central Planning and Central Vigilance Commissions. This system makes swift business decisions, such as new oil field acquisitions or joint ventures, all but impossible and has prevented ONGC from assuming its natural leadership position. Instead, the company continually struggles to grow and is lagging behind other, much smaller private rivals.

Adding to the country's challenges, India's business reputation has been tarnished by the global fraud scandal around the CEO of outsourcing service provider Satyam. It may stimulate Indian regulatory agencies to be more watchful over big businesses, which would further complicate and drag out business decision making.

D. Best Course of Action for Foreign Businesses in India

The best advice to give at this point is to stay put. In spite of its troubles, the Indian market is still one of the largest D&E markets in the world and will continue to gain importance once the global recession has eased out. While adopting a wait-and-see attitude, at least for the next six months, businesses should take a good look at low-key, below-the radar

investment opportunities in two different areas:

– New R&D capabilities: India is gradually transforming itself from being strongly dependent on IT outsourcing, which over time will become more commoditized and less profitable, into an R&D lab for the world. Many chemical and pharmaceutical companies, such as Monsanto or Merck, already recognized this and responded either by adding full-scale R&D capabilities or by partnering with local players in order to leverage Indian talent for their global efforts.

– Focus on local markets: A promising strategy is to carefully select areas that offer a business-friendly environment, shift government relation building efforts from the central to the local level, and identify specific local needs for improved social services, such as medical and education programs. Businesses will benefit from investments into such programs in the long-run, creating a highly skilled and less volatile labor force and cementing relationships with local communities and their governments.

China

A. Market Characteristics

The People's Republic of China attracted global business attention in the mid-80's as a supplier of low-cost labor with good work ethics and a desire to learn, ultimately to become "the world's factory." Although the country has been maintaining a moderate population growth rate by continuing its one-child policy, one in five humans lives in this densely-populated country of 1.3 billion. Its hunger for industrial and consumer goods, as well as energy, is enormous, which given its vast area requires a modern transportation system. Over the course of the past 10-15 years, China has invested heavily in expanding and modernizing its road system, railway tracks, and airports. Some parts of the country lag behind in infrastructure development but have also seen substantial improvements, partly driven by investments by foreign companies, such as Procter&Gamble.

China's rise to becoming the fastest growing consumer market was spurred by its culture, which –even during the Communist rule– always included a strong propensity for business, an upwardly mobile society, the re-integration of Hong Kong, and the Chinese tradition to provide for their children without limitation and reservations.

B. Current State of the Market

The largest and strongest of all emerging markets, China stands to lose the most in the heat of the global recession. In fact, the year 2008 already made it clear that the fate of the Chinese economy continues to depend on that of the United States and, to a lesser degree, Europe more strongly than most observers had assumed. The shrinking global consumer demand that has severely limited the output of China's factories is not the only factor to blame. With labor costs almost doubling over the past four years, manufacturers, unable to raise prices, were already operating on razor-thin margins. Now, many of them are unable to cope with the weakening demand. In some sectors, such as clothing or toys, about half of all Chinese factories are expected to close soon or have already done so.

Economic growth is now predicted to stay at around 5% or even below in 2009, indicating tough times ahead when compared with the double-digit growth rates of the past. At the same time, such growth rates are still subject to the envy of most other countries. The Chinese government unveiled its economic stimulus plan, leveraging the country's huge monetary reserves and worth about \$590 billion, in November of 2008. It aims to increase public spending in sectors such as education and construction, as well as stimulate private consumption. According to a petition filed by the

U.S. with the WTO in December of 2008, the People's Republic also gives massive subsidies to local exporters of Chinese-branded products through cash grants and cheap loans.

Beijing's biggest asset in this tough environment may be its unfaltering dedication to transforming the country from a low-cost manufacturing hotspot into a powerhouse in innovation and product development. The red giant so far has not slowed down much in its efforts to improve education, grow a stronger, more technologically savvy workforce, nurture academic and private research, and gain greater access to foreign technology and know-how. China's vision is to have an agricultural sector that can support its enormous population, a manufacturing sector that is strong but less dominant, and an industrial and technological sector powerful enough to support an ever-growing middle class and powerful overall economy.

Secretly, the country's leaders may actually think that the crisis in the manufacturing sector is not all bad news, given their strategic objective of reducing the country's dangerous dependence on factory output. Officials estimate that more than 10 million migrant workers have already returned from the country's industrial centers in the East to their native rural regions. Though creating personal hardships, this migration brings welcome relief to China's agricultural sector, not long ago dangerously thinned by the waves of workers moving to big cities.

China is working hard to pursue another economic objective: bolstering growth rates in domestic markets by expanding the country's service sector and stimulating greater consumer demand. Prior to the recession, only about 40 percent of GDP was created by services, compared with almost 80 percent in the United States and just over 70 percent in the European Union. Breaking down barriers as well as providing tax incentives and other stimuli, Beijing aims to grow the share of services to 43 percent by 2010 and 50 percent by 2018.

The toughest obstacle may be that the recent economic woes have only amplified the traditional Chinese propensity to save a substantial share of available incomes. The average savings rate is estimated at or above 25 percent, higher than anywhere else in the world and a primary reason for China's consumer demand not being commensurate with its overall economic role. The government's economic stimulus plan attempts to address this through relaxed credit conditions, lower value added taxes, cuts in road tolls, and tax cuts designed to get citizens to spend more money.

C. Government and Business

The various levels of the Chinese government keep a tight control of all companies, public and private alike. If an industry or venture is well aligned with government priorities, it will find open doors and strong support. Otherwise, it may not be impossible to thrive, but expect the government to erect quite a few hurdles along the way.

In spite of China's financial support for the manufacturing sector, foreign companies focusing on low-cost sourcing strategies find the People's Republic less welcoming than it was only a few years ago. Cost increases, stricter labor laws, and new regulations have brought China more in line with other low-cost destinations. While remaining attractive and competitive as a source of cost-effective goods, the country is no longer the world's factory in the way it used to. This happens to be exactly what Beijing wants. Even in the midst of the current recession, there is little indication of the softness in the manufacturing sector creating panic among China's leaders. However, an increasingly disgruntled population that is facing high unemployment and economic pressures might force the government to modify this strategy.

National, provincial and local Chinese governments alike continue to focus on attracting Western investments in research and product development, promoting and sometimes enforcing the transfer of technological know-how to domestic companies. Foreign compa-

nies with significant R&D investments in China meet with much goodwill and favorable market conditions. Alcatel-Lucent, for instance, employs a staff of more than 15,000 people, among them more than 6,000 in R&D, through a joint venture with a state-owned commission in China. It became one of the biggest players in the Chinese communications market and recently signed a billion-dollar deal with China Mobile.

Beijing is also creating forums for venture capital in order to stimulate a start-up business culture that can power innovation in the country. Although intellectual property aspects continue to be a concern, it has unmistakably made substantial progress in establishing and enforcing stronger IP protection rules. Microsoft recently implemented the Chinese version of its controversial Windows Genuine Advantage program and, to its own surprise, found at least cautious support from the government – hard to imagine only a decade ago. Even networking giant Cisco, once stuck in a gruesome legal IP battle with local champion Huawei, is now a major player in China, with more than 3,000 employees in the country, including a sizeable R&D group.

D. Best Course of Action for Foreign Businesses in China

No matter how tough the current recession may get and how long it takes, China seems likely to emerge a winner. The country's leaders continue to hold their economic course, which suggests that foreign companies looking to do business in areas China considers strategic are well advised to continue investing and growing their presence in the country. Success in China has always required a long-term perspective, strategies that are well aligned with government objectives and strong ties with officials and influencers. None of that has been changed by the impact of the global recession.

We view China's all-powerful and business-minded government a blessing rather than a detriment. Bent on quick recovery and not

held back by slow democratic decision-making processes, we expect the recovery/bailout program to be effective soon. This is the time for savvy businesspeople to build and intensify government alliances by offering to participate in the recovery program and providing the necessary support, a step that will yield highly beneficial results in a not-too-distant future. Four areas hold particular promise for foreign companies in China:

- R&D investments – In parallel to China improving its educational systems, language is becoming far less of a problem than it used to be, with many millions of Chinese learning English. Taken together with the government focus on technology and the market access it is willing to grant, these factors make the People's Republic an attractive destination for technology-heavy players in consumer electronics, IT, communications, industrial markets, medical applications, and other market segments.
- China's growing consumer class creates opportunities to sell products and to establish new service industries. The opportunities are huge. For instance, only about 5 million Chinese work in healthcare and 4 million in the banking and insurance sector today. These and other sectors will probably see significant growth within a few years. In particular, investments in the healthcare sector are likely to find strong government support.
- China's elderly represent a relevant consumer class of their own. Though few of them have substantial financial means, state pensions as well as strong family support provide them with at least some disposable income. This increasingly creates market opportunities in healthcare, assisted living, and other sectors.
- More powerful logistics networks, supply chains that extend into the interior regions of the country, and advanced operations management training will be in high demand for the foreseeable future.

Summary

We have analyzed all four BRIC countries in terms of market state and outlook, analyzing pitfalls and opportunities in these unprecedented times of global recession. Recognizing the multitude of challenges Western businesses are facing in the BRIC markets, we come to the following conclusions:

- a. Each BRIC country and market is different. Individual geographies and demographics, cultural and religious traditions, legal and business practices, as well as each country's unique political and economic environment all suggest different near-term and long-term success strategies that require careful planning and execution. A "one size fits all" approach to the BRIC group has no realistic chance of success.
- b. All four countries are currently being hurt by the global recession, creating panic among consumers, businesses and governments that in turn impacts the ways business is done in each of them. Foreign companies need to reassess their strategies accordingly, whether they are already established players in a country or just looking in from the outside.
- c. The price of oil will be a significant factor. This applies disproportionately to Brazil and Russia, who will both look for ways to compensate for the loss of revenues and profits. The impact on Western businesses may look very different, though: it is likely adverse in Russia and positive in Brazil.
- d. While all BRIC countries are hurting, they differ considerably in how well they position themselves beyond the recession. We place our bets on China as the most organized and disciplined country that will pull out of recession quicker than the other three. Brazil holds promise, while India faces challenges. Russia remains the biggest question mark, as political considerations continue to get in the way of sound economic policies.
- e. In no way do we recommend that existing Western businesses run for cover or stay dormant in the BRIC markets, or for that matter, most other developing and emerging countries. Opportunities for business growth in times of global recession are aplenty for those vigilant and agile enough to take them.
- f. Existing plans for investment and expansion require careful reassessment. Knee-jerk reactions to shelve them, however, are unwarranted and could prove counterproductive. Proceed with caution, keep looking over your shoulder, and be nimble and creative in forging alliances with local businesses, regional governments and, in case of Brazil and China, with influential branches of the central government.

Figures 1a through 1d illustrate our comparative analysis. Each shows an assessment of the respective country's relative strength with regards to key economic and business factors (outer mark = 10, center = 0). In this context, we have considered the following factors when assessing market attractiveness: market size, market growth, pent-up demand, country demographics, upward mobility, cultural compatibility with major Western markets, and existing infrastructure.

The number shown in the circle represents the country's overall score.

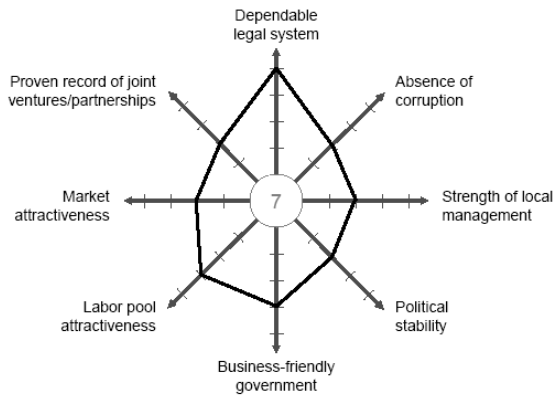


Figure 1a: Brazil

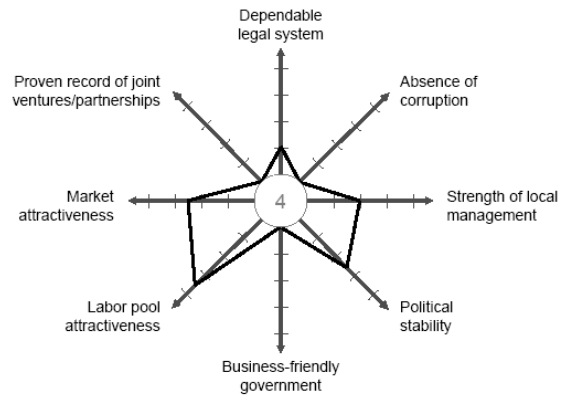


Figure 1b: Russia

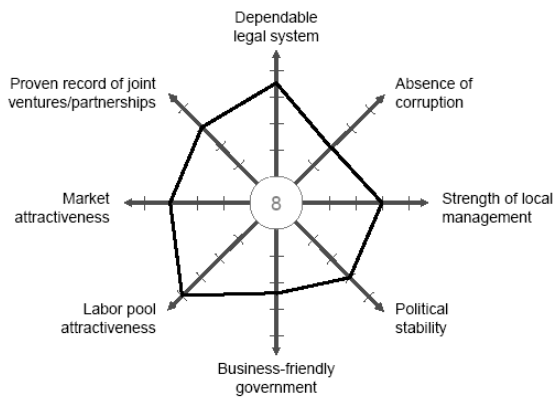


Figure 1c: India

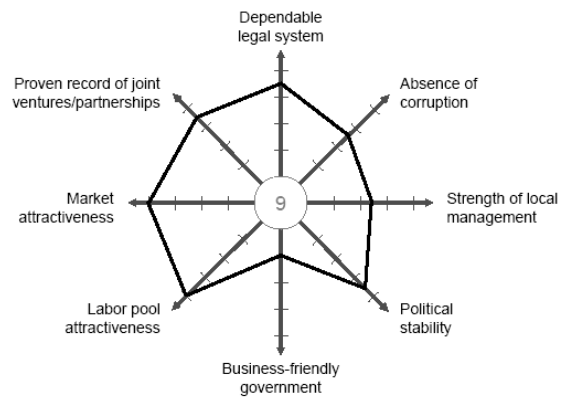


Figure 1d: China

For a closer look at the relative attractiveness of each BRIC market and a brief summary of strategic options, please refer to Figures 2 and 3.

<u>Country</u>	<u>Attractiveness</u> <small>(scale of 1 to 10)</small>	<u>Issues/Concerns</u>	<u>Outlook</u>
<i>China</i>	9	- High dependency on Western demand	<i>China will pull out of recession the quickest, possibly in financial collaboration with the United States.</i>
<i>India</i>	8	- Conflict with Pakistan - Halo effect of Satyam scandal	<i>India will remain mired in political and business quagmires for a while. Together with the Mumbai fiasco, this suggests that a change in government is not unlikely.</i>
<i>Brazil</i>	7	- No replacement for da Silva in sight - Instability of oil prices - Slowdown of foreign investments	<i>Brazil is less affected by the recession and will continue its growth path. The country's future is strongly influenced by the pace of industrialization and largely driven by foreign investments.</i>
<i>Russia</i>	4	- Political aggressiveness - High economic volatility - Weakness of legal system	<i>Russia is likely to slip deeper into the recession for another 2-3 years. This will mostly affect the western parts around Moscow. The regions to the east of the Volga river will become more independent and economically strong.</i>

Figure 2: BRIC Countries, Rank Ordered by Attractiveness to Foreign Businesses

<u>Country</u>	<u>Run for Cover</u>	<u>Lay Dormant</u>	<u>Invest</u>	<u>Rationale</u>
Brazil	Absolutely not	Absolutely not	Expand through local partnerships or acquisitions	<ul style="list-style-type: none"> - Very stable market - Highly favorable business climate - Great resource base
Russia	No	Be vigilant	Explore the distant regions along the Volga river and further east	<ul style="list-style-type: none"> - Remote regions will become more independent in decision-making - Experience shows that staying under the radar of the central government is prudent - The recession will mostly hurt the Western region, with Moscow as the epicenter
India	No	No	Carefully invest with local or regional presence and forge alliances with regional authorities that are pro-business	<ul style="list-style-type: none"> - Watch out for the fallout of recent political and business events - Beware of increased government regulations and bureaucracy
China	Absolutely not	Absolutely not	Actively explore opportunities to lend support to regional and central authorities, including financing	<ul style="list-style-type: none"> - The government is striving to rapidly improve the economy. They will not forget their friends, so investing in areas of government interest now will likely reap substantial long-term benefits

Figure 3: Strategic Options for BRIC Markets

Eleanor Eaton is a consultant for global business growth across several industries. Her clients are Fortune 50 companies, for many of whom she has developed and helped implement successful entry strategies for the developing and emerging markets. Prior to becoming a consultant, she worked at Procter & Gamble in brand management, consulted with McKinsey&Co and was the first woman in the executive management position of Vice President of Marketing in the aerospace industry. Ms. Eaton has lived and worked in Europe for many years and is fluent in French, Russian, Spanish and Italian. She has made multiple presentations on the subject at various business events and has written articles published on professional websites. She also teaches marketing and public relations at the University of Phoenix. Her company website is www.eleanoreaton.com.

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