American Perspectives*

2008	2009	2010	2011	2012	2013
2014	2015	2016	2017	2018	2019
2020	2021	2022	2023	2024	2025
2026	2027	2028	2029	2030	2031

*connectedthinking

PricewaterhouseCoopers

“The world will be both increasingly competitive and increasingly volatile.”

US-focused media and entertainment

Realigning world economic balance
Reorienting US perspectives

As robust growth and affluence reach new corners of the world, companies in advanced regions like the US often find themselves questioning if their own historical prosperity can continue: Will the pie be big enough to be shared or be gobbled up by newcomers? PricewaterhouseCoopers' economic projections show that rising world prosperity will actually *drive* US economic growth over the next two decades, not threaten it. Roles and alignments may be altered. But the contributions the US makes to the world—and what we receive in kind—will remain very healthy.

Emerging markets already account for more than half of world economic output in terms of purchasing power. As industrializing countries flourish, they increasingly provide the skills and services necessary in a global economy. But they also provide capital and consumers. For US companies, this opens up new opportunities.

In the words of a technology executive interviewed as part of the firm's long-term planning efforts: “The rise of the global middle class is the biggest economic driver we've ever seen.” Among the emerging markets, Brazil, Russia, India and China (the BRICs) hold sway as the most formidable. Accordingly, our forecast segments the world market into four broad categories: the US, other developed countries, BRICs and other developing countries. Overall, our outlook anticipates the most rapid economic expansion of all developing countries, with BRICs in the lead.

The upside of change

In the industrializing world, many countries have accumulated sizable cash reserves that serve as a social safety net or as a resource to stimulate domestic business investment and consumer spending. Their surpluses often find a home in the US, as the weakening dollar makes American products and assets more attractive. In some cases foreign investors make headlines when they buy controlling stakes in American businesses. That can prove a disquieting turn. But it also represents an investment in future US growth.

From our perspective, the rise of new economies signals more of a shift—a natural part of an era in which major changes are to be expected—than a decline for America and its businesses.

US companies will find themselves adapting their strategies and operational approaches to new economic realities. Businesses will confront major cultural adjustments, reinventing traditional attitudes and methods of management (as the third section, on the way we will live and work in the next decade, discusses). Business leaders will also be called upon to discover the opportunities that underlie the tumultuous surface of change.

The good news is that US companies are profiting by taking these paths today and will continue to develop better ideas and approaches. Agility is built into the country's foundation.

As a developed-world traditionalist said two centuries ago as he watched a young nation challenge the assumptions of that day, the American outlook “accepts tradition only as a means of information, and existing facts only as a lesson to be used in doing better.” From our perspective, de Tocqueville's 19th-century observation[1] retains the ring of truth for a new millennium and for a new era of multilateralism, globalization, risk and opportunity.

1 *Democracy in America,* 1873, by Alexis de Tocqueville. Translated by Henry Reeve.

"The emerging markets issue is huge, traditionally more so because we are a North American–focused company. We are really concerned about how you go into these markets and who your partners are."

Global furniture design/manufacturing

"US markets and US economic leadership are facing a 'structural correction.' US-only corporations, as opposed to multinationals, will be especially vulnerable to future corrections."

Global consumer products

"American voters just don't want to hear about the realities of globalization. They want to be told that we can just make the challenges go away."

Domestic public policy

"China and India are very different ball games in terms of channel strategies. You need to customize the distribution strategy, even if the product is the same. We are just sorting that out."

Global electronics

"Many things that Americans view as American the rest of the world views as global. It has become harder to distinguish 'brand America' from much of what is going on elsewhere."

University

"We view China as a massive opportunity, but no more so than eastern Europe."

Global shipping and logistics

"The BRIC concept is outdated. Growth will come from many new and surprising places."

Global science/technology manufacturing

"Two years ago, senior US officials in commerce and trade could have influenced pricing and tariffs impacting materials that we routinely buy overseas. My impression is that this is no longer true… Trade protectionism could put a huge dent in the US economy."

US-focused manufacturing

"The world is catching up to our talent levels, more than we are falling behind."

Global science/technology manufacturing

"Democracy and capitalism will not be the only systems influencing the redistribution. Values are an important form of power, and there are important global conversations going on about which and whose values will prevail over time."

University

"Real estate, in particular, is expected to have tremendous upside in emerging markets. Other aspects of infrastructure build-out—roads, electrical grids, water management—are also expected to present tremendous opportunity."

US-based hedge fund

"We produce almost all of our content in the US and we sell it all over the world. I'm not sure how viable that remains going forward."

US-focused media and entertainment

"China's low-cost manufacturing will be severely disruptive if they catch up with our quality anytime soon. Right now it's a race to the middle, and I would give them the upper hand."

Global technology and consumer goods

"We don't question that the BRICs will drive growth. What we question are the new and hidden risks in the upside."

Global consumer products

"China, India and Southeast Asia will be very important commercial centers across a range of dimensions. Players will need to develop distinctive operations there and don't know how to do that. My guess is that the business models will evolve with substantial influence from the US and UK. But we don't really know."

University

What we're hearing about realigning the world

Dynamic transitions

The American Century is transforming: The US retains a rich but reapportioned share of the world pie

Figure 1
Global economic growth: A relative shift, but an absolute increase

World GDP valued at purchasing power parities 1990-2030 (Trillions of 2000 US dollars)

Rapid and sustained growth in major emerging markets is leading to significant shifts in the relative sizes of world economies. In 1990, the US was by far the world's largest economy. At $7 trillion, its GDP alone was equal to the collective output of the BRIC economies. In 2010, BRIC is projected to be larger than the American economy by around $10 trillion. Yet the US will still be the largest economy. By 2030, BRIC will almost triple in size to more than $60 trillion, and China will be the world's largest economy. Other developing countries will also grow rapidly and their economic output would more than double from 2010 to 2030.

The BRIC economies, which accounted for only around a fifth of the global GDP in 1990, will increase their share to more than 40% by 2030. Over the same period, America's share of world output will decline from 21% to 15%.

But the absolute sizes of the US and other developed countries will increase even as their proportions of the whole decline. Our projections show that by 2030 the US will be at least a $20-trillion economy, increasing its size by around three-quarters in two decades. Other developed countries will increase their size by around 50% from 2010 to 2030. An important driver of this growth will be increased demand for goods and services from developing countries.

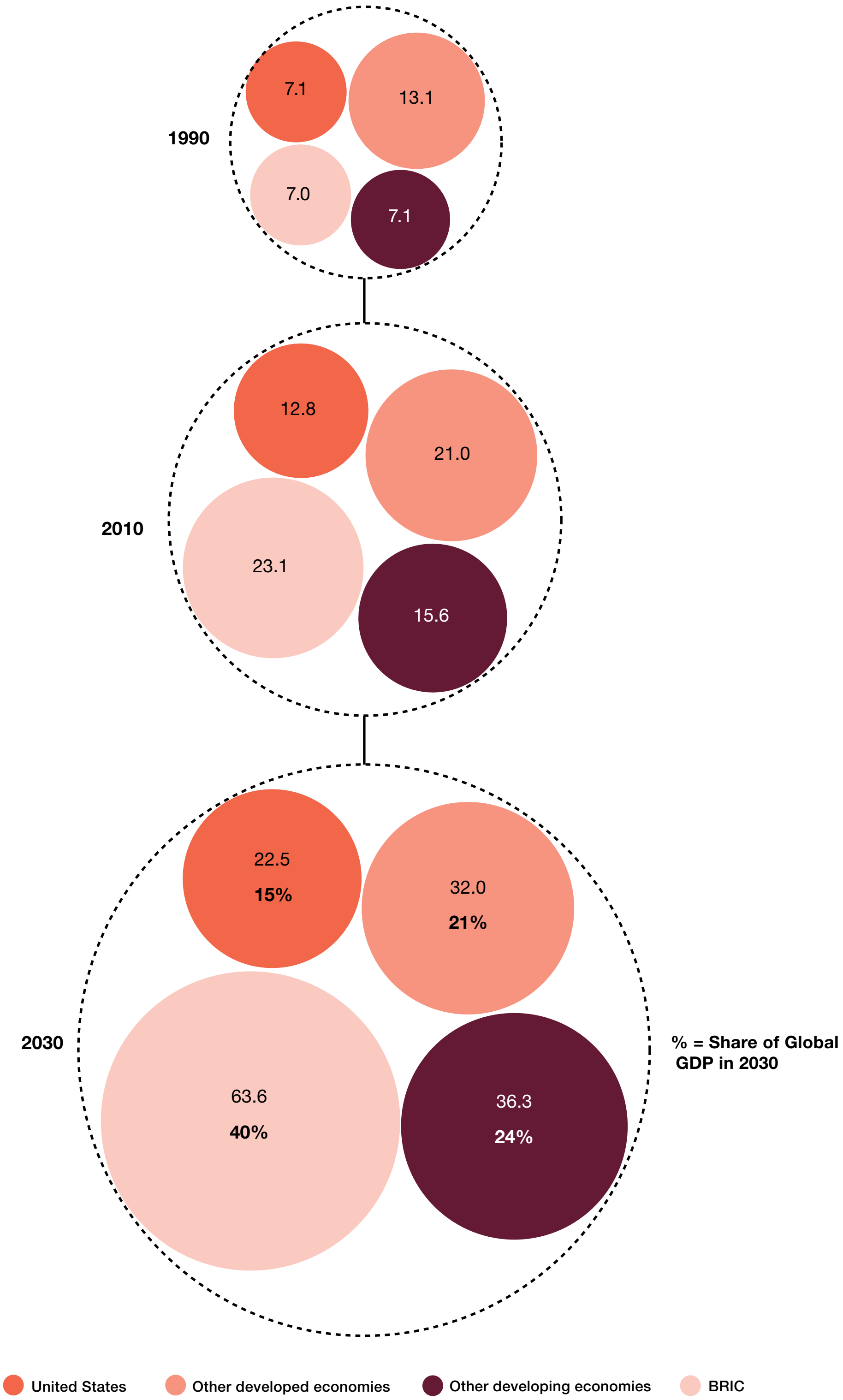
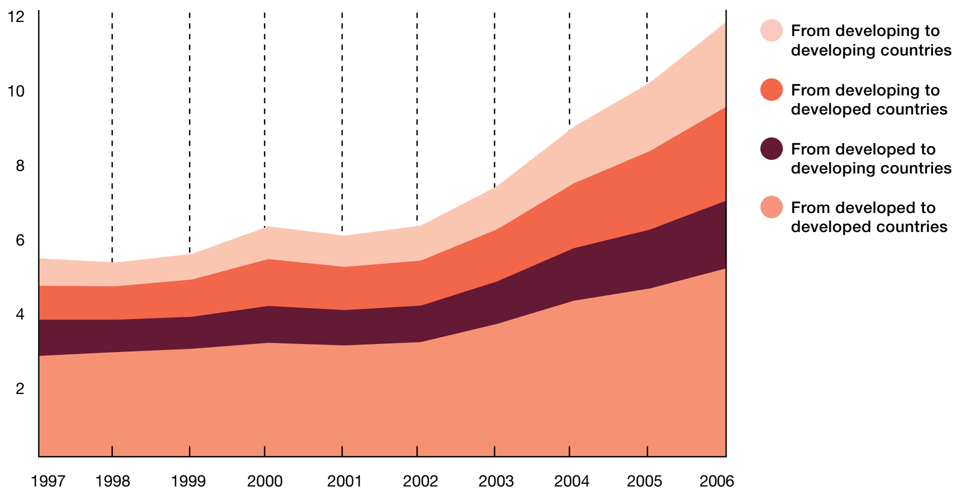


Figure 2
Developing countries are driving growth in global trade

Merchandise exports by origin and destination (Trillions of US dollars)



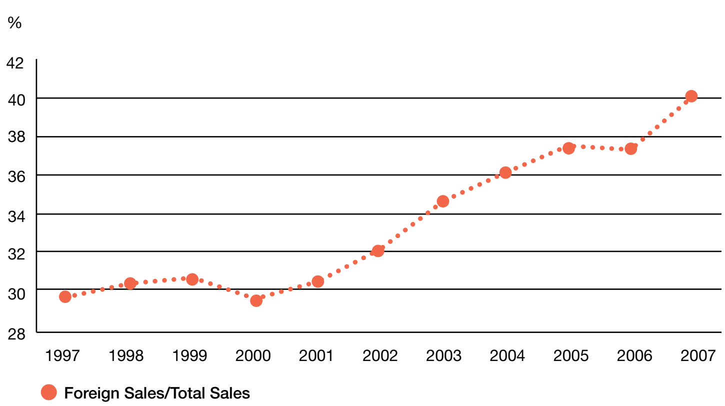
Source: PwC Analysis based on UNCTAD data

Developed countries are already benefiting from robust demand in emerging markets. The value of merchandise exports from developed to developing countries hovered below a trillion dollars in the late 1990s. But as domestic consumption and investment in major emerging markets gained momentum in the new millennium, exports from developed countries have surged. They were valued at $1.8 trillion in 2006.

Trade among developing countries has also thrived in this decade, crossing the trillion-dollar mark in 2003 and increasing to more than $2 trillion within the next three years.

Figure 3
Foreign sales grow more important to US-headquartered companies

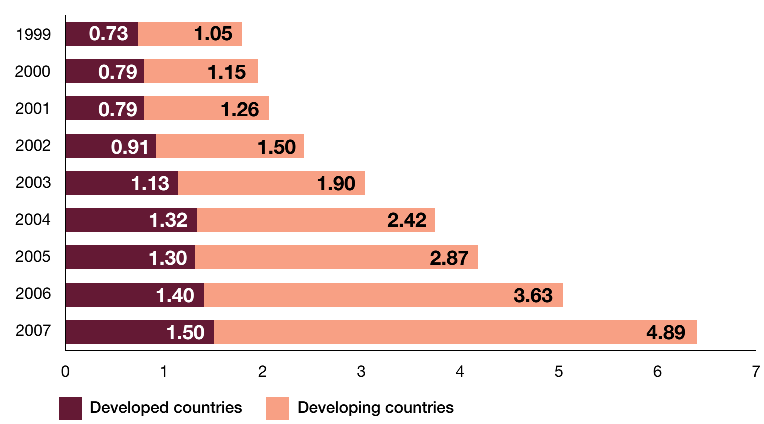
Foreign sales as a percentage of total sales
Top 1,000 US-based companies in terms of foreign sales



Source: PwC Analysis based on Thomson Financial data

Figure 4
Investing dollars back into the US

Foreign exchange reserve holdings—all currencies (Trillions of dollars)



Source: PwC Analysis based on IMF data

US companies that are major exporters and/or overseas investors are taking advantage of these new market opportunities. The top 1,000 US companies by foreign sales have rapidly increased their proportion of international revenues since 2001. Their foreign sales, as a percentage of total sales, rose from 30% in 2001 to 40% in 2007. As the global economy adjusts to a sustained weakness in the dollar, companies with strong sales growth in emerging markets will enjoy a competitive advantage.

For growing emerging markets, an economic slowdown in America may no longer spell crisis. Many have accumulated large cash reserves, which can be deployed to stimulate domestic capital and consumer spending. At almost $5 trillion, the reserve assets of developing countries accounted for more than three-quarters of the global total at the end of 2007. This is a significant increase from 1999, when they had accumulated just over a trillion dollars. These dollars, which reflect persistently large US current account deficits, are also being recycled back into the US economy. Thus, even as economic dependence on the US has decreased, global financial linkages have strengthened.

Dips happen!

The dollar's decline fits a pattern, and businesses should understand the implications if weakness persists

US businesses cannot count on a quick rebound in the strength of the dollar and must make appropriate strategic and operational adjustments in the face of protracted periods of weakness. Such adjustments will be easier for those with the perspective to understand that a relatively weak dollar is neither an anomaly nor a precursor to the stagnation of the American economy.

From a historical standpoint, the dollar value fluctuates in regularly occurring cycles. Previous periods of weakness[1] include 1973-1981 and 1987-1997, when the dollar reached a bottom comparable to today's. While relative dollar strength can be intense, relative weakness tends to be moderate but protracted. Today's decline began in 2002, entering the "weak" zone only toward the end of 2006, suggesting the onset of a continued trough.

The export dividend

The distinction in this cycle is that the dollar has dropped even while global growth has remained robust. The situation benefits US exports. In May 2008, growth in export earnings helped offset the rising cost of oil imports, and the US trade deficit declined by $0.7 billion to just under $60 billion.[2] But the dollar is not declining in a benign environment. Oil and commodity prices are rising swiftly, increasing costs for US-based importers. The adjacent charts show which industries are most affected by currency fluctuations. For those most reliant on both exports and imports, the dollar is a particularly complicated puzzle.

Reassess and relocate

Many companies hedge against the risk of a falling dollar through financial instruments. But in the interconnected global economy, operations require hedging as well, by shifting manufacturing and other activities closer to the markets one serves.

IBM, for example, is known for investing directly in emerging economies through extensive IT infrastructure projects. The company describes this part of its business as a "very profitable and sustainable" opportunity. In the most recent quarter, emerging markets accounted for 18% of IBM's total revenues. Within five years, it expects to earn almost a third of its revenues from those countries.[3]

Those targeting American buyers could spark a "mini reindustrialization" in the US. For instance, Tesla Motors, a manufacturer of electric cars, recently transferred its battery assembly operations from Thailand to a location near its headquarters in San Carlos, California. The company determined that its shipping costs to the US would negate the advantage of lower Asian wages.[4]

Such fundamental shifts are not quickly achieved, but US companies will benefit by considering them.

1 "Weakness" denotes the dollar exchange rate falling below its median value when measured in real broad trade-weighted terms. "Trade-weighted" refers to the dollar's exchange value against a basket of currencies weighted by the importance of US trade with each respective nation; "real" means the resulting index is adjusted for differential inflation rates in the basket countries.

Given that the episodes of relative dollar strength have been shorter and more intense than the episodes of relative weakness (implying significant skew in the distribution) the median is a better indicator of the "normal" value of the dollar than the mean.

2 US Census Bureau, US Bureau of Economic Analysis, and US Department of Commerce press release, May 2008.

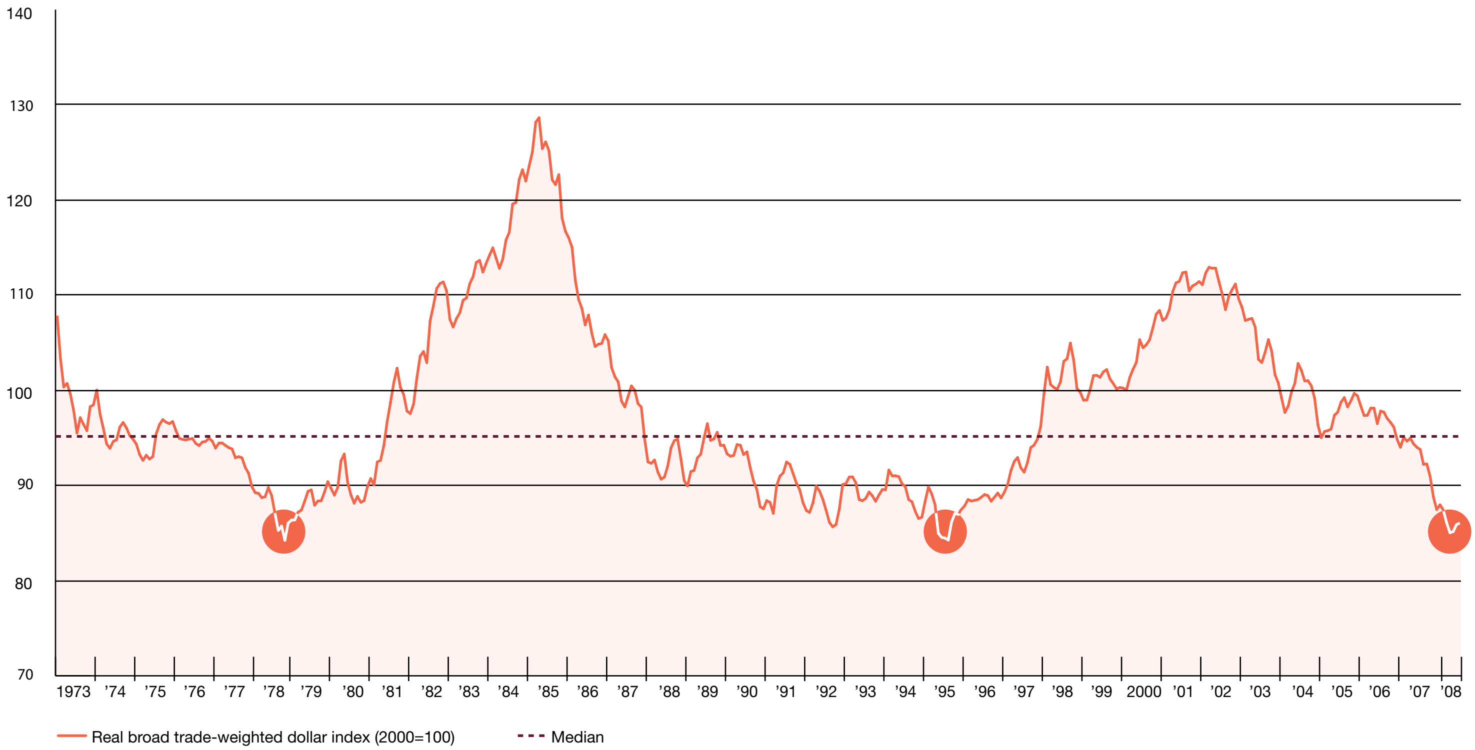
3 Richard Waters, Emerging markets let IBM ride out turbulence, *The Financial Times*, July 20, 2008.

4 Pete Engardio, Can the US bring jobs back from China? *BusinessWeek*, June 19, 2008.

"US capital markets will continue to be the global leader in allocation of capital. And the dollar will continue to be the currency of choice because of our capital market dominance."

US-focused manufacturing

Figure 5
History shows precedents for current dollar weakness

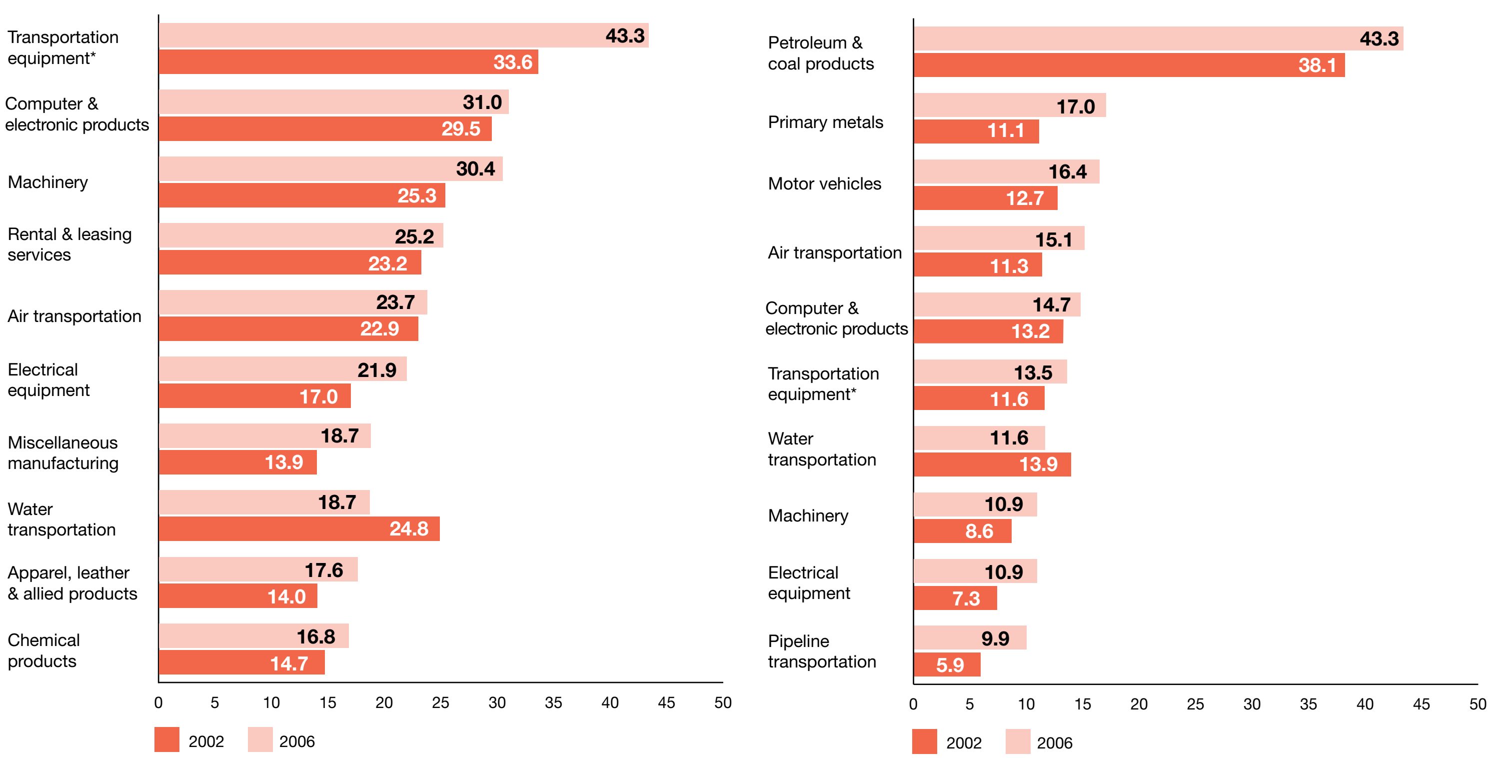


Source: PwC Analysis based on Federal Reserve data

Figure 6
Economic impact of dollar weakness and high commodity prices differs by industry

Exports and imports as a percentage of total industry output

Exports (%) **Imports (%)**



Source: PwC Analysis based on BEA Input-Output Accounts
*Except motor vehicles.

Figure 7

Adjusting to a weak dollar: Lingering decline will call for flexible planning and agile action

Situation	Potential impact	Actions to consider for scenario planning
Exports **“Mini-reindustrialization”**	American producers face lower costs, an advantage for US exporters	Invest in US exporting industries, including manufacturing and agriculture
	Profit margins remain solid amid robust output growth, attracting significant capital to the industry	
	Brisk export growth benefits manufacturing in particular, setting off a trend of partial “reindustrialization” of the US economy	
	Bottlenecks to reindustrialization emerge; pressure on infrastructure, including trucking routes, railroads, ports and power supply	Assess future demand, increase energy efficiency and install new capacity, especially in sources like wind power
		Invest in transportation infrastructure
	Increased demand for manufacturing-related talent leads to higher wage growth for engineers and project managers	Anticipate higher demand for engineers, project managers and others with technical skills
		Attract, nurture and retain manufacturing, operational and engineering talent
	Lower costs at home reduce the incentives to outsource production to other countries	Revaluate cost savings from outsourcing
		Reconfigure supply chains to reflect lower domestic production costs and higher global transportation costs
Imports **“A belt-tightening”**	Importers face higher costs and are at a competitive disadvantage	Recognize the prospect of sluggish growth and compressed margins
	Importers’ profit margins are squeezed amid sluggish output growth, reducing capital to the industry	Move beyond financial hedging to strategic and operational hedging, incurring costs where most revenue is earned
Financial markets **“Sowing seeds for the future”**	Rising import prices will gradually seep into domestic economy, creating inflationary pressures. The Federal Reserve will fight inflation by raising interest rates	Lock in low interest rates before Fed takes action against price pressures
	Foreign central banks and other investors shift portfolio investment into higher-yielding investments, as the dollar remains weak	As demand for corporate and municipal bonds rises, take advantage of the smaller yield spread
	US assets are inexpensive by historical and current international standards	Increase “home bias” in portfolio by investing more heavily in US assets
		Invite capital from foreign sources with appropriate risk management
Foreign policy **“Reorienting ambitions”**	Domestic voters become conscious of the cost of international involvement	Adapt to a multipolar world
	Dollar becomes less effective as an incentive	Participate in global business coalitions to tackle major issues

Running the gantlet of protectionism

"Glocalized" approaches and awareness of risks can help businesses avoid the worst and seize opportunity

Globalization is a fact. And in today's interconnected world it makes more sense to collaborate in many ways than compete. But that doesn't mean the path to multilateral cooperation or fluid free trade will be smooth. Newfound success, wide ranges in standards of living, old and new resentments and fears and basic national pride can stir cultural resistance to outsiders in both the industrializing and developed nations. US businesses must navigate these crosscurrents with awareness and caution.

For example, after the devastating earthquake in May 2008 in China's Sichuan province, bloggers there called for boycotts of those companies that they believed were not contributing generously to the relief efforts.[1] A few years ago Procter & Gamble was targeted by a grassroots campaign in Egypt that claimed its leading detergent, Ariel, had been named after the Israeli political leader, Ariel Sharon.[2]

Bridging the divide

US businesses cannot ignore such protests in emerging markets, since corporate health increasingly depends on overseas revenue. Business planners can expect intermittent bursts of nationalism and protectionism, often cast in terms of national security, health and safety and sustainable development. Leaders in developing countries are often eager to assert that the playing field has been leveled, and that their socioeconomic and political priorities can no longer be secondary in Western eyes.

To reduce the risk of a nationalistic backlash, forward-looking US businesses must present themselves as equal partners and competitors in the global business arena. Successful American companies are adopting a strategy of "glocalization"—thinking globally but acting locally.

In Russia, with love

Consider McDonald's success in Russia, where it holds two-thirds of the fast-food market. Even as the brand represents America, the company has carefully used a strategy of glocalization. It describes McDonald's in Russia as a "Russian company that knows the priorities of the Russian community." In communications it highlights facts such as its extensive use of local produce and the creation of more than 70,000 jobs.[3] The company even won the coveted "Best Employer in Russia" award last year.

The problem solvers

Coca-Cola and PepsiCo have cited water scarcity as a crucial risk and are actively working with local communities to manage the problem. In Kenya, for example, Coca-Cola has worked with public health and water sanitation experts to provide for water treatment and storage systems as well as hygiene advice to local schools.[4] In India, PepsiCo intends to become a "positive water balance company"; external auditors will verify that the company is replenishing more water than it is using. PepsiCo plans to state this on the labels of its bottled water, Aquafina, next year.[5]

Many US companies with global ambitions are taking similar approaches as they recognize the importance of showing local communities how they are sharing the risks and rewards. Merck is collaborating with the Bill & Melinda Gates Foundation and the government of Botswana in combating AIDS. This program has brought 85% of those affected in Botswana under treatment, the highest proportion in an African country.[6] The program also demonstrates Merck's commitment to the indigent and needy, countering claims that Western drugs are priced beyond the reach of the poor.

Steps like these are investments in the current and future growth of emerging markets. Studies have shown that in most countries (with China an exception), educated and affluent consumers trust businesses more than governments.[7] In other words, the populace is holding global businesses to high standards.

Making friends

Forming trustworthy alliances can help in meeting local regulations. Wal-Mart's strategy for entering India takes into account the country's restrictive investment policy, as well as popular and political opposition to big-box retailers. Wal-Mart has entered a joint venture with the Indian conglomerate Bharti Enterprises, which would own Wal-Mart franchise stores while Wal-Mart would invest in wholesale outlets.[8] The potential for Wal-Mart to take a commanding share of a $200-billion-plus retail market that is traditionally served by mom-and-pop stores is apparent. For its part, Bharti describes the partnership as potentially transformational, because it expects Wal-Mart to modernize the agricultural supply chain from farm to store, benefiting farmers who feel left out of the economic boom originating in services and manufacturing.[9]

“‘Petropolitics’ will continue to loom large. We are struggling to position ourselves well for the future, with growing tendencies for states to nationalize oil supplies.”

Global petroleum

On the home front

Business leaders also have a job to do at home in articulating the benefits of global economic integration. Nationalistic impulses can stir American public opinion no less than in other countries. When the French government, for example, condemned the US invasion of Iraq, the quantity of French wine sold here dropped by 27% in a populist boycott.[10] More serious is the protectionist attitude that can surface in election seasons. In 2008, for example, it is not unusual to hear economic woes being directly attributed to China. For business, however, finger-pointing seldom proves a winning strategy.

In the words of Jim Owens, chairman and CEO of Caterpillar Inc. and one of the leaders interviewed in depth in PwC’s 11th Annual Global CEO Survey: “If you got the CEOs of the top 20 US manufacturing companies together, you’d get a concurrence that the risk of the United States and the [rest of the] world turning inward in a more protectionist way, following years of steady, progressive trade liberalization, is the biggest single risk we have.… We’ve got to think about how we can do a better job of working with the public at large to help them understand the benefits of global engagement and international competition and how these can benefit and lift everyone.”

1 Dexter Roberts, China: Multinationals hear It online, *BusinessWeek*, May 30, 2008.

2 Saleh Alshebil, Abdul A. Rasheed and Hussam Al-Shammari, Battling boycotts, *The Wall Street Journal*, April 28, 2007.

3 McDonald’s in Russia, www.mcdonald’s.com.

4 Betsy McKay, Why Coke aims to slake global thirst for safe water, March 15, 2007.

5 Ratna Bhushan, Pepsi to replace packs of Aquafina with new labels, *The Economic Times*, March 17, 2008.

6 A stitch in time, *The Economist*, January 17, 2008, and http://www.merck.com.

7 Edelman Trust Barometer 2008.

8 Anand Giridhardas and Saritha Rai, Wal-Mart to open hundreds of stores in India, *The New York Times*, November 27, 2006.

9 Jo Johnson, Indian infrastructure 2006, Interview: Sunil Bharti Mittal, *Financial Times*, April 24 2006.

10 Larry Chavis, Kenan-Flagler Business School, University of North Carolina, and Phillip Leslie, Graduate School of Business, Stanford University, Consumer boycotts: The impact of the Iraq War on French wine sales in the US, published by National Bureau of Economic Research, February 2008.

Figure 8

Protectionism: Its toll and its antidotes

Protectionist trend	Potential impact	Actions to consider
Trade barriers		
• World Trade Organization's Doha Round talks collapse over divide between developed and developing countries on agricultural subsidies • Countries pursue bilateral and regional trade agreement in the absence of multilateral talks—politically easier but economically less beneficial • General public increasingly skeptical about benefits of free trade	• Failure to move forward with further efforts to ease multilateral trade leads to comparatively weaker global economic growth • Rise of bilateral and regional agreements advances trade but also creates a "spaghetti bowl" of complex rules, resulting in higher business and administration costs	• Participate in worldwide coalitions to promote open trade and investment policies • Articulate the benefits of free trade to domestic constituents • Strengthen risk management to address the complexity of differing regulations and standards
Foreign direct investment restrictions		
• Increased scrutiny of foreign direct investment deals due to political considerations, such as the protection of domestic industries or national security • Strategic sectors such as defense, energy, telecommunications and critical infrastructure most likely to be protected	• FDI approvals become more politicized and unpredictable, particularly when companies are seeking to invest in critical companies and sectors • Countries with restrictions lose opportunities such as access to new technology, job creation and management know-how	• Demonstrate to local communities how risks and rewards are being shared • Build strategic partnerships to navigate different cultures and regulations • Promote creation of global standard industry practices and guidelines that address concerns like national security
Anti-immigrant backlash		
• Developed and emerging-market countries resist immigration, even as many face labor shortages	• Efforts to stem illegal immigration could limit legal immigration, intensifying the war for talent • Shortages of skilled labor, particularly managers, scientists and engineers, can lead to declines in productivity and innovation	• Participate in informational campaigns directed at political decision makers • Align with public interest and advocacy groups in formulating and presenting policies that will enhance US competitiveness
Supply chain scrutiny		
• Concerns with food safety, health and climate change drive tighter regulation of products manufactured overseas • Environmental and other social considerations become nontariff barriers	• Growing web of regulation on environment, health, safety and other areas adds to business cost and complexity • Supply chains become more vulnerable to sudden breakdowns, harming shareholder value and company profitability	• Balance cost cutting with investment in supply chain resilience • Integrate management of reputational risks with operational ones • Provide visibility into supply chain activities and communicate values to all stakeholders

Enrique Rueda-Sabater

…Sees technology and diversity building business bridges to unexpected corners of the globe

Enrique Rueda-Sabater is currently director of strategy and business development in emerging markets at Cisco Systems in San Jose, California. Before joining Cisco, Rueda-Sabater spent two decades at the World Bank. His last role was as director of strategy and integrated risk management, and his career also included policy roles, fund-raising activities and operational work with countries in Asia, Africa and the former Soviet Union. He is a Spanish national with degrees in business and economics. We talked with him about the future of globalization and about the human resources and environmental characteristics that will be essential for success in a realigning world.

PwC: Will globalization continue at its current pace?

ER-S: I think that we have only seen the first wave of productivity increases from globalization. This first wave of globalization has been, in large part, about getting people who were grossly underemployed in places like India and China to become productive. It's running its course, particularly in China, but there is still potential in other parts of Asia and in Africa.

PwC: What's the next wave?

ER-S: I believe even more strongly that we have only seen the beginning of productivity increases from technology. As this wave gathers momentum, you'll have unexpected bases for all kinds of business activities, and importantly, you may see creativity coming from unexpected places. And these may well be different places than where you have other capacities.

PwC: Have business leaders embraced this new way of thinking about globalization?

ER-S: Not enough. I suspect people are still thinking in very 'tangible' ways. Everyone could understand easily what globalization meant when it was about moving your factory somewhere else and lowering your costs of labor. But now we are moving from what could be called a long era of the tangibles to an economy of the intangibles.

PwC: Where will the hotspots in this second, ICT-enabled (information and communications technologies), wave of globalization be?

ER-S: Right now, you see unexpected places like Estonia and Israel doing very well. They are enabling widespread technology adoption and creating a loop between adoption and new technology generation. Some decisive factors will be the ones you already think about: the regulatory framework, protection of property rights, the business environment, etc. But to have a chance to really anticipate new future hotspots, you'll have to look not just at a snapshot but also at moving frames from the recent past *and* also at the willingness to take risks.

We've learned that there is a lag to success. It took Ireland a decade of persistence with conducive policies and a good, stable business environment—sending the right signals internationally. So you want to be looking at places that have had significant institutional stability for a good while—consolidating the rule of law, transparency, protection of property rights, etc. But also you want to look for institutional settings with risk tolerance. Most of Europe has the former, but not the latter.

PwC: So are the next Estonias where business leaders should be thinking about investing?

ER-S: Well, that will depend on what your business produces. You have to focus on those bridges between where you generate the product or service idea, and where you produce that product or service, and where you take it to market. Those bridges will become much more diverse. Outsourcing manufacturing is just the beginning of a massive redefinition of what it means to be a manufacturer or service provider.

But I think there may be a bigger question than where to invest, and that's how you manage your partnerships and alliances. That's going to be crucial. For some corporations, the biggest handicap they have is that they just don't know how to navigate relationships in complicated places. When you move out of Western Europe and the US, there are very different rules about how you relate to partners and allies.

"A cultural diversity where challenges are welcomed and where people who are out in left field are not immediately ignored. People who bring in the 'soft' issues relevant to cultural relationships need to be allowed into decision loops."

PwC: So how do you get good at managing partners in complicated places?

ER-S: First, you have to have people who aside from having technical and managerial expertise can connect with other people across cultures. This isn't just about speaking the language and being connected through the Internet. There are huge cultural factors involved in the ways team members and managers relate to each other across countries and cultures. So, first, you need people who have the ability to actually connect with others who are different than themselves on fundamental levels.

Second, you have to have breadth and depth of diversity internally. And I don't just mean going through a checklist saying, "Do I have enough of these? Do I have enough of those?" I also mean a cultural diversity where challenges are welcomed and where people who are out in left field are not immediately ignored. People who bring in the "soft" issues relevant to cultural relationships need to be allowed into decision loops.

I think there were a few Japanese firms twenty years ago who, in a different sphere, understood something about how to build the kind of capacities I'm talking about. They hired talented, bright young people, even if they didn't have specific jobs for them. They were creating a stable of good brains. We could use more of that approach.

PwC: Are there other intangible skills that will be essential in the future?

ER-S: One of the things we've seen again and again is how hard it is for most of us to call out that "the emperor has no clothes." In the dot-com boom, and again recently with the repackaging of mortgages and credit risks, it was easy to be scared that if you didn't play along, you'd be the only one left out of this big boom. It was true for portfolio managers, and it was true for individual investors. Good risk management in the big strategic sense will require having around people who can see that the emperor has no clothes, and creating an environment in which they feel free to call that out.

You'll also want people who understand the modern world and how ICT is changing it and people who have managed in messy environments. At a high level there is a cohort with much of that among Indian CEOs in their 40s: People who have experience in doing business in difficult environments, with social challenges, political uncertainties, rapidly changing technology, economic ups and downs. And at the same time, they have good educations and are young enough to have been exposed to global partnerships from the beginning.

PwC: What kind of environments will be most conducive to making the kinds of people you have described most successful?

ER-S: Some years ago I tried to understand what we could learn from Silicon Valley for developing countries. I remember asking a French scientist at a high tech company why he was working there, rather than at home. He said: "Very simple. I can do here in one year things that would take me several years and a lot of hassle back home." He understood some of the most important obstacles to bringing an idea to fruition: too much regulation that closes doors to alternative business models, a lack of private and nimble venture capital, and tax systems that are more suspicious of business than supportive of entrepreneurial endeavors. You've got to have a system that enables people to take risks in a fairly stable, but flexible and unencumbered environment.

Read more at:
www.pwc.com/AmericanPerspectives

The long and short of it

Sovereign wealth funds may cause a commotion, but understanding and perspective are in order

The turmoil in the credit markets that began in 2007 produced an unusual phenomenon: an infusion of capital from developing countries.

That inflow to investment banks represented a reversal of historical roles. The term *sovereign wealth fund* entered the business lexicon.

Sovereign wealth funds (SWFs) are the investing arms of foreign governments, often those of oil-producing countries and Asian exporters. SWFs do not fit the Western assumption that global economic expansion is a matter for private business. But any unease over state capitalism may be premature. SWFs' share of the world pie is small; their holdings account for less than 2% of global financial assets. Forecasts say that even a doubling in size of SWFs in the next five years is unlikely to approach double-digit trillion-dollar figures.[1]

SWFs recognize the US as a market prized by international investors and marketers. This could put American companies in a strong position to influence the decisions of these relatively new fund managers. US companies, when partnering with players in emerging economies, would be wise to uphold the principles of transparency and accountability that underlie a fair and efficient economic system.

Where GE leads

General Electric, for example, completed plans this year to start an $8-billion fund based in Abu Dhabi in a joint venture with Mubadala, an SWF from the United Arab Emirates. The fund is intended to build up assets worth more than $40 billion in Africa and the Middle East within two years.

There is little mystery surrounding this deal. Mubadala says its goal is to become one of GE's top 10 shareholders through stock purchases in the open market. GE has welcomed a long-term strategic investor, as well as the opportunity to "reallocate to higher return opportunities in commercial finance." For GE, the Middle East accounted for its greatest growth by region.[2]

The state as stakeholder

State capitalism is also evident in the rise of state-owned enterprises (SOEs) that retain control over key industries in their home countries. The most visible examples are the energy giants PetroChina of China, Gazprom of Russia and Petrobras of Brazil, which are among the world's top 10 publicly traded companies and are all government controlled.

Like SWFs, SOEs can also be strategic partners. Petrobras, for example, is one of the world's most efficient producers of sugar-based ethanol and is being courted by buyers in major energy-consuming countries like Japan, China and South Korea.[3] Dubai World, an Abu Dhabi–based SOE with a varied portfolio of infrastructure projects, recently invested $2.7 billion in MGM Mirage's CityCenter project in Las Vegas. The deal gives the US-headquartered company access not only to capital but also to Dubai's lucrative domestic market, where it can sell the CityCenter condos.[4]

Dubai World's entry into the US had a rocky start. Only a couple of years ago, its ambitions to manage the operation of American ports were thwarted by US national security concerns. It is possible that barriers to the influence of state capitalism have been lowered in light of the credit crisis.

Balancing risks

The downside of state-directed investment cannot be ignored. State-owned investment funds and companies can be opaque in their management and set nationalistic rather than commercial agendas. They may pose a risk to brand and reputation. Last year, for example, Fidelity Investments sold its stake in PetroChina because of China's controversial pursuit of oil in Sudan.[5] Yet businesses cannot ignore important sources of capital and commodities. SWFs and SOEs can be valuable partners, provided that regulatory, reputational and business risks are assessed and managed. Adherence to standard industry practices on both sides should help mitigate the risks while maintaining the traditional US commitment to open markets.

SWFs' share of the world pie is small; their holdings account for less than 2% of global financial assets.

"While sovereign investment funds represent massive amounts of capital, many of them want to diversify away from oil. In time we'll see less of a connection between oil and these pools of capital."

Global petroleum

Steps in that direction are already being taken. The US Treasury has agreed to a set of investment principles with two of the world's largest SWFs: GIC of Singapore and ADIA of Abu Dhabi. The principles emphasize transparency, disclosures and avoidance of protectionism.[6] The OECD has released similar principles regarding SWFs and is now working on standard industry practices and reform guidelines for SOEs, stressing corporate governance and risk management while avoiding placing new laws on SOEs in international markets.[7] The IMF is expected to release voluntary standard industry practices for SWFs at the annual IMF–World Bank meetings later this year.

Voluntary beats mandatory

Many state-owned entities are likely to welcome these developments, and some are already making voluntary disclosures. For example, Kuwait Investment Authority reports its asset size and performance. In Singapore, Temasek has released its consolidated financial statements for the past five years. China Investment Corporation (CIC) has disclosed its size and funding sources and says it will not seek strategic assets abroad. It has also started using private equity firms like Blackstone and JC Flowers as investment intermediaries. Such deals allow funds like CIC to acquire financial market expertise and make a less controversial entry into the US.[8]

Without ignoring the risks, US businesses should recognize their leverage over new investors. It may be that a "recoupling" is taking place as foreigners invest in continued US economic growth. If managed well, deeper financial linkages will mean greater stakes for all in international stability.

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3 Antonio Regaldo and Bernd Radowitz, Overtures to Brazil show differing ethanol interests: Japan rushes to secure supply deals, but US moves little beyond talk, *The Wall Street Journal*, April 17, 2007.

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8 Asia-Pacific M&A Bulletin, Steaming into choppy waters, *Year-end 2007*, PricewaterhouseCoopers 2008.

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