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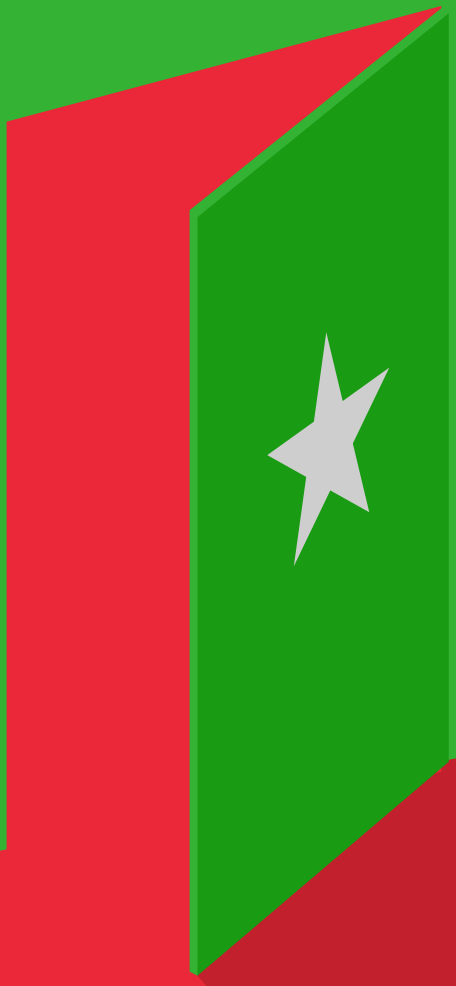
MYANMAR AT A PIVOTAL STAGE: WILL FORTUNE FAVOR THE BOLD?



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After nearly 50 years of economic decline and political isolation, Myanmar is experiencing a stampede of foreign companies seeking to stake their claim in one of the world's last economic frontiers. After the United States, Canada and the European Union eased sanctions in 2012, foreign direct investment soared more than 40 percent — from US$1.9 billion in 2011-12 to US$2.7 billion in 2012-13[1] . The race of companies planting their flags in the market is so intense that office space practically is unavailable. Some businesses are housing a skeleton staff in villas renting for as much as US$25,000 a month.

Economists and analysts have been promoting the country's potential for several years. Labor costs in Myanmar are among the lowest in the world, far less than those in China. Myanmar's location between India and China also provides ample opportunities to serve those countries' affluent customers at a lower cost. With a population of nearly 60 million, Myanmar offers one of the world's largest untapped domestic consumer markets. Many Asian countries have maintained their presence in Myanmar and are taking the lead in opening up the country. Myanmar's role as ASEAN chair in 2014 points to the trade advantages other countries in the region see in Myanmar.

However, this new Asian tiger can bite. Although the government has embarked on extensive political and economic reforms, questions linger about whether reform-minded parties such as Aung San Suu Kyi's National League for Democracy (NLD) can continue to hold the military in check. Should the military exert undue influence over the 2015 elections, sanctions could be reinstated, wreaking havoc on foreign investments. In addition, the country's infrastructure still suffers from decades of neglect, with frequent power outages and a transportation network in serious disrepair.

MYANMAR'S LURES

Facing civilian revolt because of the country's low standard of living, Myanmar's government declared a "Roadmap to Democracy" in its 2008 constitution designed to drive economic growth through a functioning democracy and strong private sector. The reforms made headlines when Aung San Suu Kyi won a seat in parliament in April 2012 after being released from two decades of house arrest two years before.

Myanmar's reforms have led to significant improvements in its investment climate. In 2012, the Myanmar parliament passed a comprehensive foreign investment law permitting wholly foreign-owned subsidiaries and joint ventures with local companies. The country also lifted investment restrictions in many sectors such as agriculture. Also in 2012, the United States began allowing imports from Myanmar and lifted bans on investments and on the provision of certain financial services. Canada and the European Union eased their sanctions as well.

To further spur investment , the government now grants tax breaks for up to five years and guarantees that Myanmar businesses with foreign investment will not be nationalized during the contract period. The government also is managing the float of its currency, the kyat, closing gaps between the official rate and the currency's market value.

RICH NATURAL RESOURCES

Political and economic reforms are drawing the world's attention to Myanmar's many economic bounties. The country has a rich stock of natural resources, including sizable hydrocarbon reserves. Its energy sector is strong, and the government is planning to increase the number of blocks available for oil and gas drilling. Myanmar supplies approximately 30 percent of the world's teak (used in furniture and boat decks) and is a major global supplier of copper and nickel. The country also produces some 90 percent of the world's rubies, although these still are under U.S. sanctions.

Myanmar's flat, fertile plains and tropical climate are ideal for agriculture, which is the country's largest industry. The government says it is committed to improving agricultural production, which will open new opportunities for cash and industrial crops, livestock and food processing technology. Myanmar already is one of the world's largest suppliers of rice, and foreign businesses are investing to improve production efficiency and develop high-end rice products for the North American and European markets.

A VAST NUMBER OF POTENTIAL WORKERS AND CONSUMERS

With a population of nearly 60 million, Myanmar offers a large pool of low-cost labor. Although an official minimum wage law does not take effect until late 2014, the law requires companies to pay day laborers US$2.30 per diem, compared with roughly US$3.20 in Cambodia, US$4.80 in Vietnam and US$10.34 in Thailand[2]. Because of its history as a British colony, Myanmar's citizens are more adept in using the English language than many of their Asian neighbors, making it easier for employees of multinational corporations to communicate.

The outsourced manufacturing sector is expected to heat up as companies face growing labor costs in other parts of Asia. Textile manufacturing is a specific strength. Before sanctions were imposed in the late 1990s, textiles accounted for 85 percent of the country's exports. About a quarter of those — more than US$350 million—were shipped to the United States each year. Although much of the country's textile manufacturing industry is unsophisticated, Korean and Japanese companies are opening factories that will provide more advanced manufacturing capabilities.

Myanmar also is a largely untapped consumer market. The population is unusually young and has the capacity to become an employable and consumer-driven generation. For years, sanctions have kept most branded products out of the market. Today, however, leading consumer and electronics companies are returning. Although low wages limit current consumer returns, companies such as GE Healthcare and PepsiCo are absorbing short-term losses to gain a foothold in the market.

STRATEGIC LOCATION

Myanmar is well-located to cater to the growing middle classes in India and China. The extensive deposits of jade, rubies and sapphires can meet the increasing demand for these precious stones among the Indian and Chinese middle classes. In addition, proposed oil and gas pipeline construction has the capability to make the country a regional player in the energy sector.

Myanmar's location makes it a potentially important regional hub. With more than 1,200 miles of coastline on the Indian Ocean, including areas that could become deep water ports, shipping goods through Myanmar would be less expensive than going through the Strait of Malacca, which connects the Indian and Pacific oceans.

MYANMAR'S PITFALLS

The military's role in government still is an open question. Today, the military has effective control of judges and has been known to influence judicial decisions. With little separation of powers, foreign investors cannot count on due process, especially in disagreements with companies closely tied to the military. Although Myanmar has acceded to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, the country has been slow to implement the convention in its domestic law. Foreign investors continue to be at risk.

Although the military to date has been a strong advocate of reform, that position could change in the 2015 general elections. There is considerable grass-root support to elect Aung San Suu Kyi as the country's next president, replacing the former junta member and reformist Thein Sein. A clause in the constitution, however, bars any Myanmar president from having a spouse or children who "owe allegiance to a foreign power." Many believe that that clause, put into law in 2008, is aimed at Aung San Suu Kyi, whose two sons hold British passports. By constitutional mandate, the military is guaranteed 25 percent of seats in parliament, and there may not be enough support to enact constitutional change. Preventing Aung San Suu Kyi from running in 2015 could ignite more civil unrest. Should that occur, the United States and the European Union may reinstate their sanctions if the military re-exerts its control.

AN INFRASTRUCTURE IN DECAY

Politics and the military are not the only challenges confronting foreign players in Myanmar. An aging infrastructure makes conducting business difficult and can erode gains from tax breaks and low labor costs. Electricity is chronically in short supply, and blackouts are so common that businesses must invest in expensive backup power generation systems. The country's transportation network is in serious disrepair, adding significant shipping costs to manufacturing operations located far from the country's few ports. In terms of education, the country's system currently is not prepared to develop managerial talent or to train workers for complex tasks or technologies.

ENDEMIC CORRUPTION

Perhaps most worrisome to foreign executives is the pervasive presence of corruption. Transparency International ranked Myanmar 157th out of 175 countries in its Corruption Perceptions Index 2013, equal with Zimbabwe and below the Democratic Republic of Congo and Tajikistan.

Corruption in distribution channels is increasing, particularly in border areas. Armed groups at informal checkpoints often demand bribes, sometimes known as "tea money," in order to allow goods to pass. Additionally, bureaucrats commonly expect payments to perform duties in license applications. And the government requires companies to "donate" cash for quasi charitable causes. These donations help businesses maintain good government relations while also encouraging the public to view the government as a supporter of the private sector and of social enterprise.

The tax department is one of the most corrupt government functions. In Myanmar, corporate taxes are based on sales, not profit. To lessen the tax burden, local companies do not find it difficult to manipulate their financial data. It also is common to bribe tax officials in return for favorable treatment. All imports and exports require customs approval, and customs officials are notorious for soliciting bribes.

ETHNIC AND RELIGIOUS UNREST

Myanmar is an ethnically diverse nation, with 135 officially recognized ethnic groups and others that are not sanctioned. Ethnic and religious tensions have not subsided, and ongoing violence in the state of Rakhine is a reminder of how divisive the antagonisms are. Many observers point out that neither the government nor Aung San Suu Kyi's NLD has done much to prevent hostilities from escalating. Some accuse Aung San Suu Kyi and the NLD of avoiding anything unpopular with the Buddhist majority in order to court their vote in the 2015 elections. Although the country recently has taken small steps, including attempts to negotiate a universal ceasefire with representatives of 18 armed ethnic groups, ongoing conflict remains a concern.

KNOW WHOM YOU'RE WORKING WITH

In their haste to stake a claim and beat competitors to the best partners and acquisitions in Myanmar, foreign businesses often skimp on due diligence efforts. In many cases, that diligence simply consists of giving accountants financial documents (of dubious reliability) to review or conducting a search of public documents, including sanctions lists. However, without an on-the-ground due diligence effort, red flags revealing reputational or other risks are unlikely to surface.

In most countries, at least some information about a company and its leaders is available publically. China, for example, has active blogs where people discuss companies and their issues. Historically, such blogs in Burmese almost never contain negative comments about a company or an individual, especially if there is a military tie. These military connections are hard to assess without a deeper investigation. Understanding the nature of those connections is critical in selecting a partner or in making an acquisition. The military has sizable financial interests in a wide range of companies that previously were part of state-run monopolies. Many of these companies have been the target of Western government sanctions.

Even sanctions lists can be misleading. Burmese names can be confusing as surnames are not handed down to each generation, and wives rarely take their husband's name. As a result, numerous people in Myanmar have similar names, and it can be difficult to determine if the person on the sanctions list is the same person the company is investigating.

Myanmar also is a black hole of company information. Public records are practically non-existent, making it extremely complicated to investigate a potential partner or acquisition. Although Myanmar law requires companies to provide access to their official records, these usually are available only in person at the company's registrar. Frequently, the information is out of date. In one case with which we are familiar, the records of incorporation listed a director who had passed away several years before.

Since corruption is endemic, executives in countries with stringent anti-corruption laws may be exposed to significant risk if poor or uninformed choices are made. Before jumping into the gold rush, company leaders should take the time to understand Myanmar's opportunities and pitfalls and strive to obtain deep knowledge about the parties with whom work is being considered.

A CASE FROM THE FILES

Recently, a leading Japanese food and beverage company was planning to enter the Myanmar market and compete with foreign companies already in place, including The Coca-Cola Company and PepsiCo. The Japanese company identified several potential distribution partners. The initial assessment of the parties, however, stood in stark contrast to the picture that emerged after the company conducted its due diligence.

A leading contender was a large conglomerate with a good reputation and a well-known chief executive officer. However, the investigation found that the organization had historical ties to sanctioned entities and also had been involved in the government's controversial seizing of land from farmers. The conglomerate's reputation on the ground was much weaker than was thought at the outset.

Another contender had deep experience as a former distributor for PepsiCo, which had left the market after sanctions in 1997. Due diligence found evidence that suggested the organization also may have been distributing cola products through grey market channels. In addition, after PepsiCo left Myanmar, the distributor developed its own product and packaging, inspired by PepsiCo's colors and package design.

Conducting due diligence on a third potential partner found that parts of its distribution network, particularly those in the border areas, may have been associated with drug trafficking issues in the past. Ultimately, the company chose a partner with less capacity but a good reputation, reliable workforce and, importantly, no military connections or drug trafficking concerns.

Myanmar's gold rush is attracting investors from all over the world. However, companies should temper their expectations of success and be prepared for a myriad of challenges given the bureaucratic hurdles, political risks and infrastructure Myanmar presents. Conducting effective due diligence demands a strong knowledge of the risks of doing business in Myanmar, as well as professionals skilled in gathering reliable information that may not be apparent from the financial records. As Aung San Suu Kyi once told a gathering at the World Economic Forum, investors should view the opportunities the country offers with healthy skepticism, not reckless optimism.

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