FDI Confidence Index®

Global Business Policy Council

February 2001
Volume 4

A.T. KEARNEY
an EDS company

G L O B A L   B U S I N E S S   P O L I C Y   C O U N C I L

The Global Business Policy Council assists chief executives to monitor and capitalize on geopolitical, economic, social and technological change worldwide. Council membership is limited to a selected group of corporate leaders and their companies. The Council's core program includes periodic meetings in strategically important parts of the world, tailored analytical products, regular member briefings, regional events and other services.

Global Business Policy Council
A.T. Kearney, Inc.

333 John Carlyle Street
Alexandria, Virginia 22314, U.S.A.
Telephone 1 703 739 4714
Fax 1 703 739 4741

www.atkearney.com

A.T. Kearney is the management consulting subsidiary of EDS, a leader in the global information technology services industry for more than 35 years.

Introduction

The past year began with enormous promise for the world economy and ended with great uncertainty, leaving investors cautious regarding global prospects for 2001. This year senior executives brace themselves for an inevitable “landing” of the U.S. economy—with the only question being the severity of the impact. In contrast, Europe begins 2001 stable and stronger despite the euro hitting record lows during the last year. Eastern European countries continue their transition toward market economies uninterrupted. Russia benefited from last year’s higher energy prices, and has improved its macroeconomic situation and normalized its credit relations with the West.

Asia is still striving to fully recover from the lingering effects of past crises, but 2001 brings promise for the economies of China, Singapore and Taiwan. Japan’s economy showed signs of improved growth in 2000, although it is still struggling. In the Americas, projections for the year are mixed. As economic expansion in the United States slows, prospects for its NAFTA trading partners and for Latin America—which greatly depend on U.S. demand for their exports—shine less brightly.

It is in this global context that A.T. Kearney conducted its latest *FDI Confidence Index®* survey, which tracks the impact of likely political, economic and regulatory changes on the foreign direct investment (FDI) intentions and preferences of the leaders of the world’s largest corporations *(see figure 1, page 2).**

For four years, we have surveyed CEOs, CFOs and other top decision-makers of the world’s largest 1,000 firms about their opinions of various FDI destinations, and their intentions for FDI flows. Responses from participating firms about their views of 60 countries, which receive 90 percent of global FDI flows, reveal likely foreign direct investment flows and point to the factors that drive corporate decisions to invest abroad. The companies surveyed are responsible for about 70 percent of global FDI flows and generate more than US$16 trillion in annual sales. These companies represent all regions and all industry sectors.

The following report also contains special market attractiveness profiles on Brazil, China and India.

**Foreign direct investment (FDI) includes investment in physical assets, such as plant equipment, in a foreign country. Holdings of 10 percent equity, or more, in a foreign enterprise is the commonly accepted threshold between direct and portfolio investment as it demonstrates an intent to influence management of the foreign entity. The main types of FDI are acquisition of a subsidiary or production facility, participation in a joint venture, licensing, and establishment of a greenfield operation.*

Major Findings

CEO OPTIMISM ABOUT THE GLOBAL ECONOMY DETERIORATES

Signs of a slowing United States economy call world economic prospects into question. More than one-third of global decision-makers from the world's largest firms reveal a more negative outlook for the global economy *(see figure 2, page 3)*. Despite growing concerns over world economic prospects, 85 percent of these investors indicate their intention to maintain or increase their investments abroad. In addition, the world Index score—a GDP-weighted proxy for likelihood of foreign direct investment—rose from 1.33 to 1.44. This 8 percent increase in the aggregate Index score over the past year suggests that the worldwide amount of cross-border investment flows will likely increase.

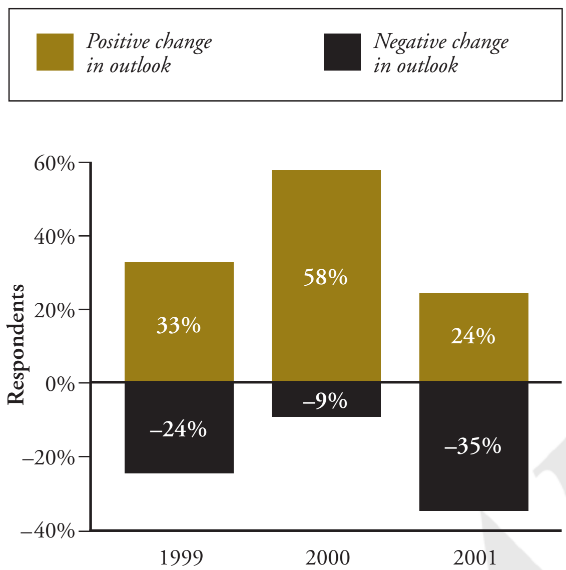
Executives from U.S. firms have the bleakest outlook on the global economy: More than one-third of American CEOs express a negative outlook for 2001, up from 13 percent one year ago. These results stand in stark contrast with the euphoria expressed in 2000, when close to 60 percent of decision-makers from America's largest multinationals felt optimistic about the global environment. Nevertheless, two-thirds of companies in the United States plan to sit tight this year, investing abroad at approximately last year's levels, with 13 percent preparing to cut back on planned investment.

European investors plan to significantly increase their investments this year—more so than investors from any other region—but reveal a split personality with respect to global outlook. French and British firms express mostly negative views on global economic prospects. Conversely, German firms are for the

FIGURE 1: FDI Confidence Index®
(top 25, February 2001)

Source: A.T. Kearney

FIGURE 2: Outlook on the global economy compared to one year ago



Source: A.T. Kearney

most part optimistic, with 41 percent of CEOs planning to increase international investments. However, compared to their outlook one year ago, prospects have clearly worsened from the viewpoint of all European executives. Half of British decision-makers had positive global outlooks in 2000 compared to the previous year, but this number plummeted to 9 percent in 2001. No French executives, for example, expressed increased pessimism last year, while almost 30 percent convey a more-negative outlook today. And optimism among German investors, though strong compared to others, is down from two-thirds of executives last year to less than half (44 percent) today.

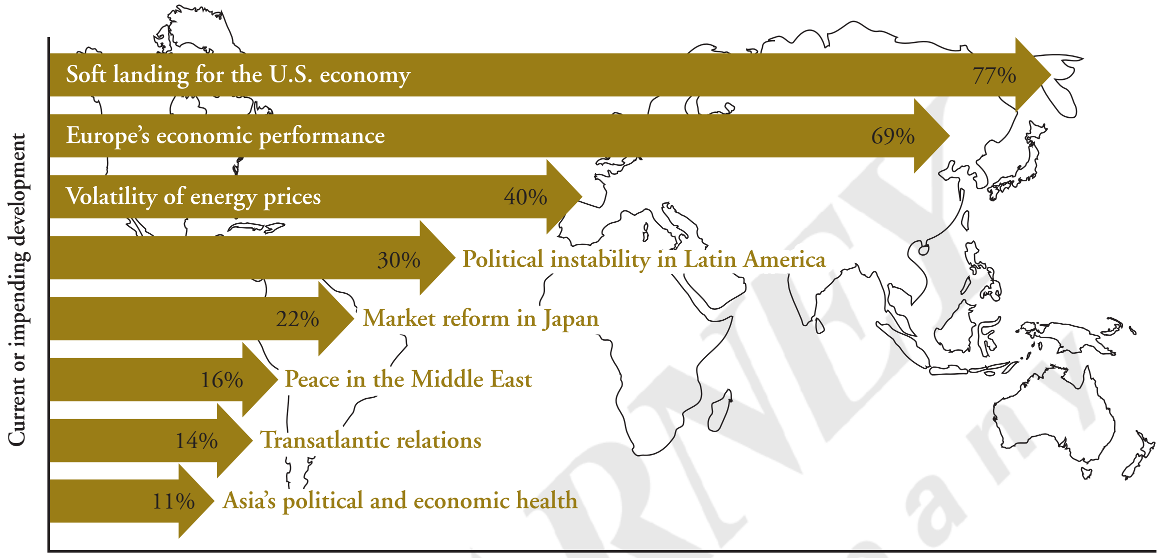
Asia stands out for the optimism of its decision-makers: Nearly half remain upbeat going into 2001 and more than one-third plan to increase their levels of FDI. The Japanese maintain high expectations for the performance of the global economy this year. Nonetheless, the number of Japanese CEOs who expressed pessimism about world economic prospects has more than tripled from last year, and one-fifth plan to decrease FDI—more than the intentions of investors from any other country.

The U.S. economy principal concern for investors. For investors from all countries and industry sectors, a soft landing for the U.S. economy topped the list of major developments judged most likely to affect investment decisions this year *(see figure 3, page 4)*. Nearly two-thirds of all CEOs ranked a soft landing for the U.S. economy as their primary or secondary concern, and more than one-third singled it out as the most important factor affecting their plans in 2001. With the U.S. economy being the main driving force behind global economic growth over the past three years, it is not surprising that the state of the American economy would be the principal factor shaping FDI intentions.

The majority of European CEOs also ranked a U.S. slowdown as more important to their decision-making than their own region's economic performance. However, Europe's performance is considered one of the top two concerns by more than half of all participating corporate investors, with nearly one-fifth ranking it as the most-important factor in their investment decisions this year.

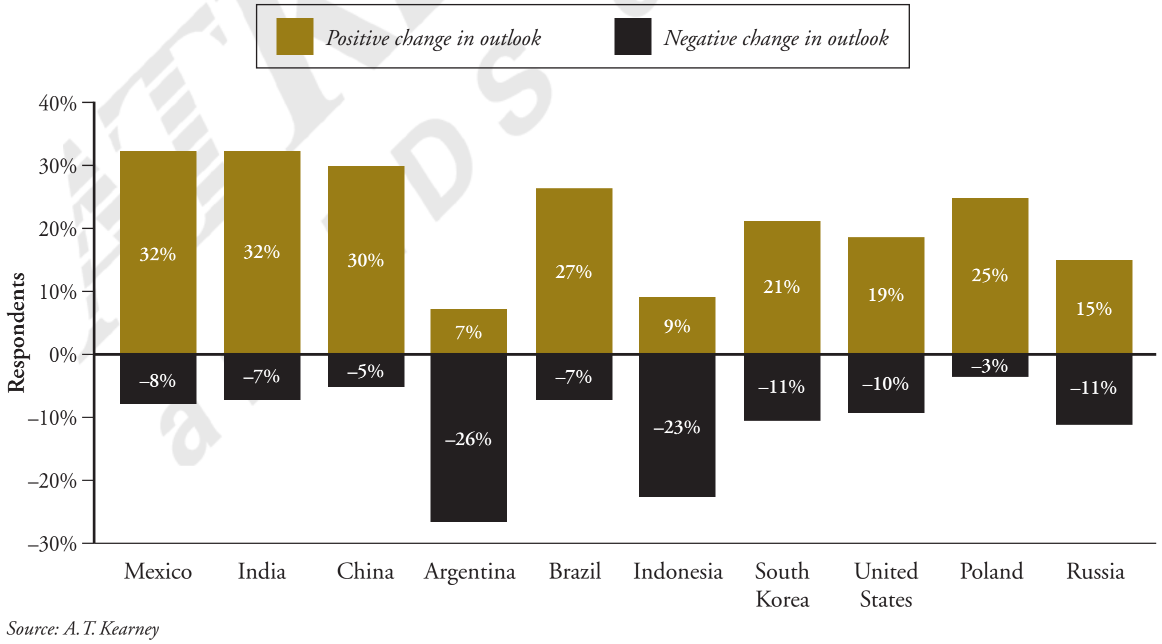
Volatile energy prices topped the list of investor concerns for nearly 20 percent of senior executives. The utilities sector, understandably, ranked price volatility as its chief preoccupation and ranked peace in the Middle East as a close second. The quadrupling of world oil prices in the past year and growing

FIGURE 3: Global developments most likely to influence FDI decisions



Source: A.T. Kearney

FIGURE 4: Countries experiencing the largest sentiment shift compared to January 2000



Source: A.T. Kearney

uncertainty about geopolitical conditions in the Middle East may well continue to exert even greater influence over investor intentions throughout 2001.

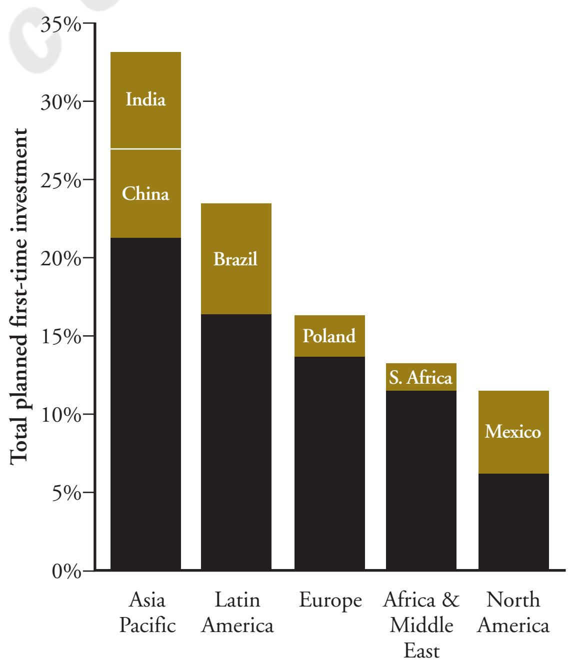
As for other factors that will significantly affect FDI in 2001, certain regional and industry trends stand out. One-third of Japanese executives, for example, perceive Japanese market reform and Asian economic recovery to be critical. German CEOs express the greatest concern about transatlantic trade relations, while British decision-makers consider peace in the Middle East an important factor in shaping their FDI decisions. North American firms cite political stability in Latin America as influential to their investment decisions, as do executives from the financial services sector worldwide. In industry, light manufacturers view Japanese market reforms as important to their FDI planning, while the wholesale and retail sectors find transatlantic trade relations a significant factor in their FDI decisions.

EMERGING MARKETS RE-EMERGE

The large emerging markets have returned to position themselves among the most-attractive markets for foreign investment, a status they enjoyed prior to the global economic dislocation of 1998. In fact, seven out of the eight countries experiencing the largest positive change in investor outlook are emerging markets, led by Mexico, India, China and Brazil *(see figure 4)*. China and Brazil, for example, overtook the United Kingdom in the overall destination rankings, taking second and third place in the Index. But the biggest comeback story is Mexico: More than 30 percent of investors today view it more positively than one year ago.

The attractiveness of emerging economies is also underscored by the fact that more than three-quarters of all planned first-time investments over the next three years will likely be made in developing economies—with Brazil, China, Mexico and India topping the list of likely first-time investment destinations *(see figure 5)*. Brazil established itself as the country most preferred for planned first-time investment and is being considered as a target for 40 percent of all proposed investment commitments to South America. India and China followed as the second- and third-biggest likely hosts for first-time investment, together accounting for 36 percent of planned first-time investments to Asia *(see The Emerging Giants, page 27)*.

FIGURE 5: Percent of total planned first-time investments



Source: A.T. Kearney

In regional terms, executives indicated that Asian emerging markets are being considered as destinations for nearly one-third of all planned first-time FDI. Central and Eastern Europe dominated European first-time FDI, taking in roughly 50 percent of planned investment.

RENEWED INVESTOR INTEREST IN ASIA

Nearly half of Asian executives express optimism for world economic prospects, positioning investors from the region as the most positively predisposed group of investors the world over. This global outlook is based primarily on Asian investor perceptions of their own economic recovery and the region's prospects for long-term growth. China's attractiveness (ranking second in the Index) and mounting interest for first-time investments in the region invigorate the region's prospects for 2001. Significant improvement in attractiveness in Singapore and Taiwan also promoted a better outlook for Asia. Singapore leaped from 21st to 13th position in the FDI Confidence Index this year, registering a 32 percent increase in investor interest compared to 2000. Taiwan followed suit and ranked 19th, moving up four spots from last year's position on the Index.

INVESTOR PREFERENCE FOR MERGERS AND ACQUISITIONS DECLINES SLIGHTLY

M&A is still clearly the preferred mode of investment entry, with approximately 60 percent of decision-makers declaring it as their likely choice, representing a modest falloff from the 71 percent registered last year. This drop is consistent with the reduction in the growth of global M&A activity over the course of 2000 *(see figure 6)*. While both the value and number of transactions continued to grow in 2000, that growth has slowed. The number of transactions grew 10 percent last year, down from 30 percent in 1999. Likewise, the total value of completed M&A transactions in 2000 increased by 45 percent, following a peak of 78 percent in 1998 and 57 percent in 1999.

Inside the Mind of the International Investor

What factors determine an investment destination? Are macroeconomic factors in a host country more important to the investment decision than industry trends? To further clarify the drivers of global investment flows, the FDI Confidence Index probed corporate investors on those factors shaping their foreign investment decisions.

TEXTBOOK CRITERIA DRIVES INVESTORS' DECISIONS

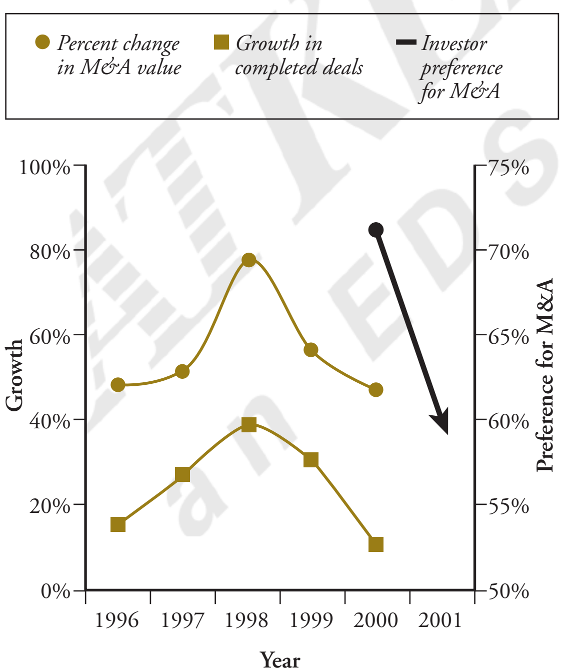
Top executives from global 1,000 firms cite firm-specific priorities as the most influential determinants likely to drive their foreign investment decisions over the next two to three years *(see figure 7)*. Industry and competitor trends followed closely behind, with country-specific macroeconomic issues rounding out the top three determinants. Executives state that in the near term, government policies and technology opportunities exert somewhat less influence on their decisions. Japanese executives, however, view macroeconomic factors as most central to their investment decisions. These factors also weighed most heavily in the FDI decisions of financial services and primary sector executives.

Among the firm-specific priorities and industry and competitor trend factors volunteered, executives continued to give greater importance to the more tangible factors affecting the balance sheet. From the firm perspective, shareholder value, sales, profitability, cash flow and rate of return are seen as central to the FDI decision-making process. The executives surveyed regard asset diversification, improvements in production costs and organizational and management skills as less central to FDI objectives. From the point of view of industry and competitor trends, executives cite competitive pressures, consolidation and enhancing core business activities as the most important FDI objectives.

TECHNOLOGY NOT CENTRAL TO FDI DECISIONS

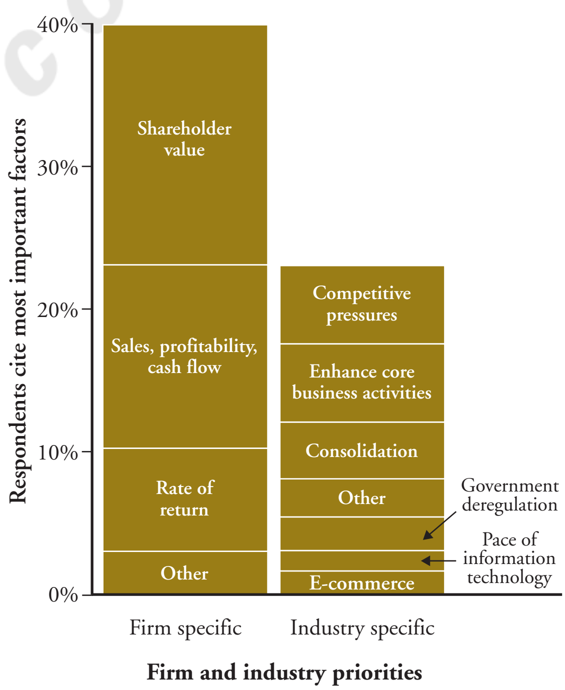
While technology is reshaping the corporate landscape, it does not appear to be a critical driver of corporate FDI decisions. Whereas roughly 75 percent of executives cite competitive pressures within their industry as vital to their FDI decisions, only 21 percent see e-commerce as an important FDI driver over the next two to three years. Though 65 percent of executives are likely to invest abroad to help improve core business activities, only 18 percent expect to invest based on the pace of technology. Although the technology transfer associated with FDI clearly offers benefits to host countries—particularly in developing

FIGURE 6: Investor preference for M&A



Source: A.T. Kearney; KPMG

FIGURE 7: Factors driving FDI decisions



Source: A.T. Kearney

and transitioning economies—it appears that technology alone does not propel executives to invest.

CROSS-BORDER MERGERS AND ACQUISITIONS DRIVEN BY FIRM AND INDUSTRY PRIORITIES

Mergers and acquisitions continue to comprise most of FDI activity globally, with the majority of executives rating M&A as their preferred mode of entry into foreign markets. Seventy percent of executives from financial services firms—more than any other sector—prefer M&A as an FDI mode of entry. Executives who state a preference for M&As offer the previously cited firm- and industry-specific factors as motivating their decisions. Nearly 80 percent said that industry and competitor trends are likely to be most important when making investment decisions in the next one to three years. Over the next two to three years, about 70 percent expect consolidation within their industry to be the most important factor influencing their FDI decisions.

Senior executives who prefer cross-border M&As also cited profitability, lower risk and the opportunity to transform a firm's business model as the greatest benefits of an M&A mode of entry for FDI. Those in the heavy manufacturing sector put profitability at the top of their lists; light manufacturers tend to look for acquisitions with lower risk and those deals that provide an opportunity to transform their own business models.

FIRST-TIME INVESTMENT TRENDS REVEAL GEO-STRATEGIC FDI APPROACHES

Two-thirds of corporate investors are planning first-time investments over the next three years, with the majority forecasting multiple first-time investments (averaging 2.8 per firm). Two important strategic dynamics appear to influence the FDI decisions of these new foreign-market entrants. First, three of every four firms planning multiple first-time investments are intending to pursue a regional strategy, with the majority of these investments targeting one particular region. Attempting to penetrate a region with multiple investments is seen as a hedge against obstacles to investment that may be presented by any one country. Second, an "emerging giant" strategy also surfaced. First-time investors entering one of the three emerging-giant economies (Brazil, India and China) and who are planning additional first-time investments indicated a 30 percent likelihood of also investing in another emerging giant. Hence, investors indicate a strong interest in positioning themselves in the biggest emerging markets.

Regional Analysis

NORTH AMERICA

The United States stays ahead of the pack. The United States retains its lead as the top investment destination worldwide this year, maintaining its position at the center of global FDI flows. Going into 2000, the United States was the largest recipient of FDI inflows and the second-largest source of FDI outflows. But despite America's top ranking, nearly all respondents expressed concern about the slowdown of the U.S. economy, with American respondents expressing the most pessimism about the global economic outlook.

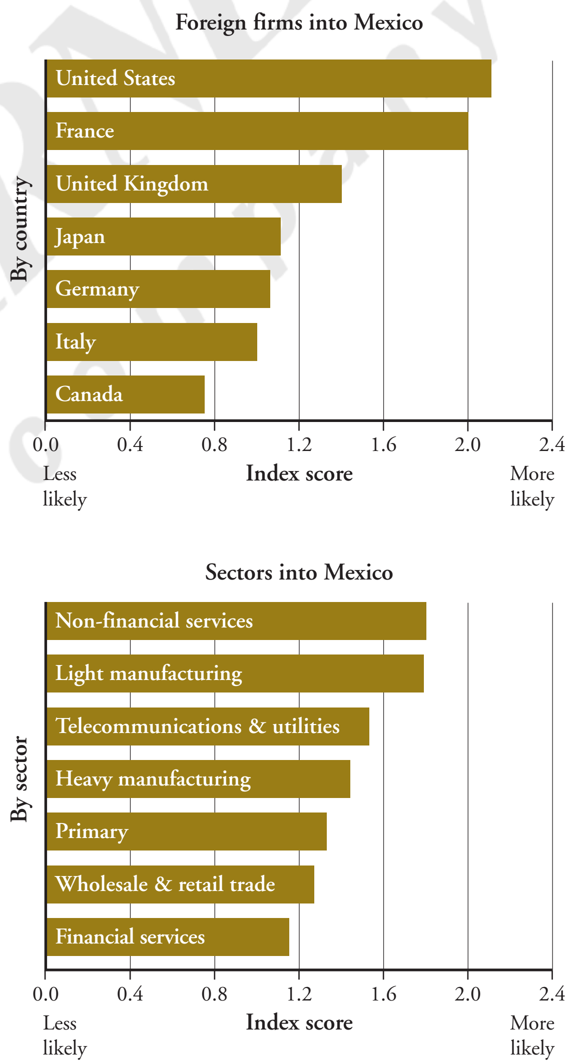
Just as they did last year, British, Japanese, German and Canadian respondents designate the United States as their number one investment destination worldwide. In addition, more than 20 percent of CEOs express an even more favorable outlook on the United States than one year ago. This optimism is led principally by German and Japanese investors. The attractiveness of the United States as an investment destination cuts across all industry sectors. The only sectors that do not include the United States at the top of their FDI destination lists are the primary and non-financial services sectors. Notably, the United States is the only developed country among the top five investment destinations being considered for first-time investments over the next one to three years. Nonetheless, the strength of the U.S. lead has been eclipsed somewhat by the strong number two finish of China in this year's Index.

Canada moves up one spot to 12th position. FDI inflows into Canada last year surpassed 1999's record total, and Canadian FDI outflows strongly recovered from the previous year's slump. The majority of FDI inflows came from the United States, which ranks Canada fourth (tied with Australia) on its list of preferred markets for investment. These inflows are spurred by the weak Canadian dollar, and are concentrated in the forestry and high-tech sectors. Of all the respondents, Canadian executives are the most attracted to Asia, and aside from the United States (Canadian executives' preferred destination for FDI), Canada's top 10 investment targets are in Asia.

MEXICO: SPECIAL FOCUS

Mexico enters into the top five. Mexico jumped from 7th to 5th place in this year's Index, and the percentage of investors confident about Mexico has more than doubled—from 15 percent last year to 32 percent this year *(see figure 8).* This places Mexico highest among 60 countries—both industrialized and developing—with regard to positive investment outlook improvement, followed by India, China and Brazil. For the first time, Mexico ranks as the

FIGURE 8: Likelihood of investment into Mexico



Source: A.T. Kearney

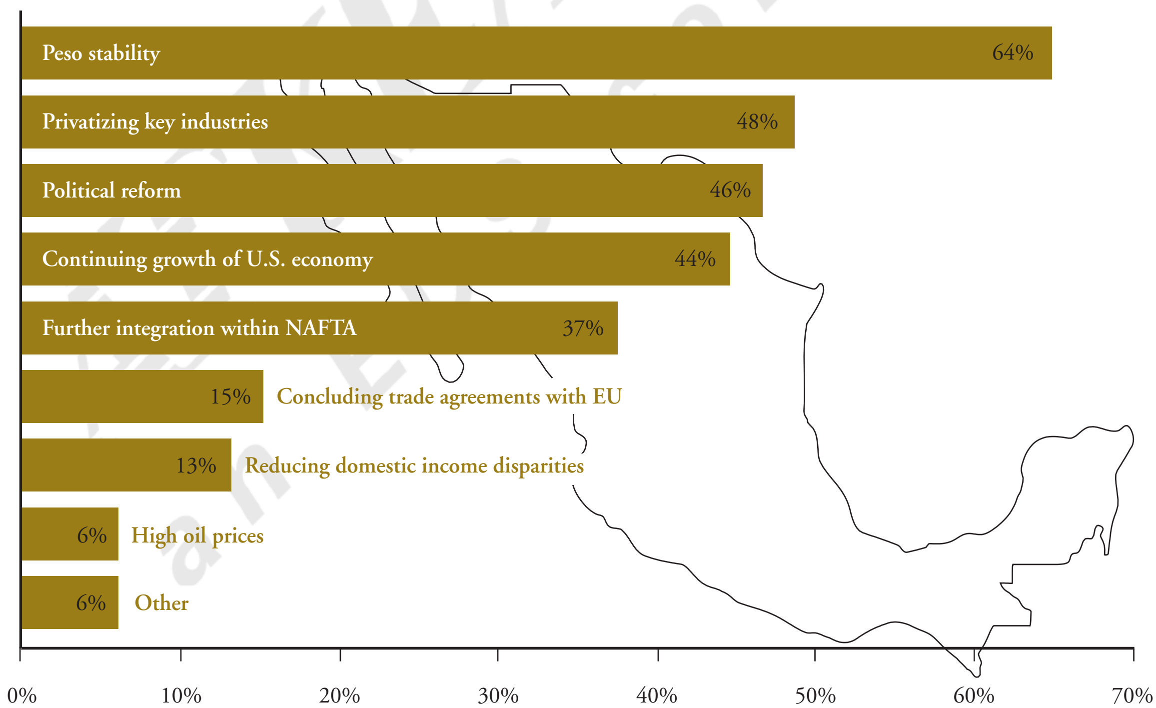
most-likely investment destination for American firms. Among those countries pegged as being most seriously considered for first-time investments, Mexico ranks fourth.

Newly-elected President Vicente Fox—a former business executive—has successfully completed a smooth transition into power, bringing an end to the country's cycle of "end-of-term crises" which has traditionally heralded political and economic instability. Fox's election has prompted widespread optimism among investors, a fact underscored in the latest results of the FDI Confidence Index.

Overall, respondents maintain that stabilizing the peso, privatizing key industries and embarking on political reforms will be among the most important challenges the new president will face as he seeks to attract larger flows of FDI into Mexico *(see figure 9)*.

CEOs consider peso stability critical to increasing FDI. Two-thirds of senior executives cite peso stability as most important to achieving President Fox's goal of doubling FDI inflows. Mexico's NAFTA partners, the United States and Canada, and those industries most likely to invest in Mexico—non-financial services, light manufacturing, and telecommunications and utilities—also consider peso stability as fundamental to improving FDI flows. Moreover, increased FDI flows would likely have a

FIGURE 9: Most important factors for increasing FDI flows to Mexico



Source: A.T. Kearney

compounded effect: They will reinforce macroeconomic stability by reducing Mexico's dependence on volatile portfolio investments that have largely contributed to the country's financial turbulence in the past. Greater peso stability will impress investors and in turn encourage further FDI.

Though a sensitive issue, privatization is seen as vital to attracting FDI. Nearly half of all executives surveyed, particularly those from telecommunications, utilities and primary sector firms, cite privatization of key industries as important to increasing Mexico's FDI. The Fox administration has hinted that it will strengthen the economy through further privatization, though prior attempts to privatize parts of petrochemical and electricity production have met overwhelming opposition.

Mexico's increased energy demand will require structural reforms, and substantial capital investment beyond the resources likely to be committed by the government. Despite historical opposition to privatization of this sector, foreign investor sentiment has already shifted, with more than half of executives from the electric and gas sector expressing greater optimism about Mexico than in previous years.

Political reforms will likely affect FDI flows. Close behind privatization, political reform ranks as the third most-important factor likely to influence increased FDI flows to Mexico. American and Canadian investors seem to be more concerned about the reform agenda than investors from other countries, as do 83 percent of executives from the non-financial services sector who rank this as being a critical factor. The Index results indicate that by attacking Mexico's perceived problem of official corruption, the new government will undoubtedly create even greater positive momentum for increasing FDI flows into the country.

Executives are betting on TVs, cell phones and the Internet. In 1999, Mexico exported roughly 25,000 television sets per day to the United States—more than Hong Kong delivers to the United States in an entire year. Not surprisingly, executives from the electronics industry rank Mexico the third most attractive market globally, and half of these executives are more positive in their outlook than they were one year ago. Corporate investors will likely continue to seek the benefits of Mexico's skilled manufacturing labor force, low production costs and access to robust domestic, Canadian, and U.S. markets.

The new Mexican government has brought with it a breath of renewed confidence among investors and has helped spawn a positive outlook for the country's investment prospects twice that of what it was a year ago.

Telecommunications and utilities executives offer the most improved outlook for Mexico as an investment destination in part because of the renewed impetus behind privatization. With cellular subscribers quadrupling to more than 12 million since 1998, investors are acutely aware of opportunities in the Mexican telecommunications industry. New regulatory changes are also providing greater entry opportunity for U.S. firms already invested in Mexico, and are drawing the attention of other new foreign entrants. For example, Telmex's mobile subsidiary partnered with Ericsson of Sweden and recently introduced a wireless Internet service, and in October 2000, Spain's Telefonica acquired five mobile phone companies in northern Mexico.

U.S. growth secondary to Mexican FDI. Just under half (44 percent) of executives believe that the continuing growth of the U.S. economy is important to increasing Mexico's FDI flows. (More than 80 percent of Mexico's exports are bound for the United States and overall exports represent 30 percent of its GDP.) However, from the CEO perspective, Mexican macroeconomic stability and domestic reforms are more central to increasing FDI flows into Mexico than the growth of the U.S. economy.

Though crucial to FDI flows, NAFTA seems less important to providing new investment. Since NAFTA's inception in 1994, Mexico has enjoyed huge increases in FDI and healthy economic growth. According to the Mexican Investment Board, the United States and Canada accounted for 58 percent and European countries for 36 percent of the total projected investments for 2000. While judged important, trade regimes are considered less central to FDI decisions than peso stability and political reforms. Only 37 percent of executives view further regional integration as a factor important to increasing FDI flows, and trade agreements with the EU were deemed even less essential to increasing FDI flows.

LATIN AMERICA

GDP growth in South America reached 4 percent last year, following meager regional growth in 1999 of less than 1 percent. This increased economic growth can be attributed to an export-led expansion, which included rapid sales growth to the United States, an increase in oil prices and a rebound in intra-regional trade. At the same time, relative investment attractiveness ratings across Latin America varied considerably. Only two South American countries scored among the top 25: Brazil rose to become the third most-attractive investment destination worldwide, but Argentina barely maintained its position among the top 25, clinging to position 24. Brazil and Argentina represent two of the most extreme shifts in investor outlook globally *(see figure 4, page 4).*

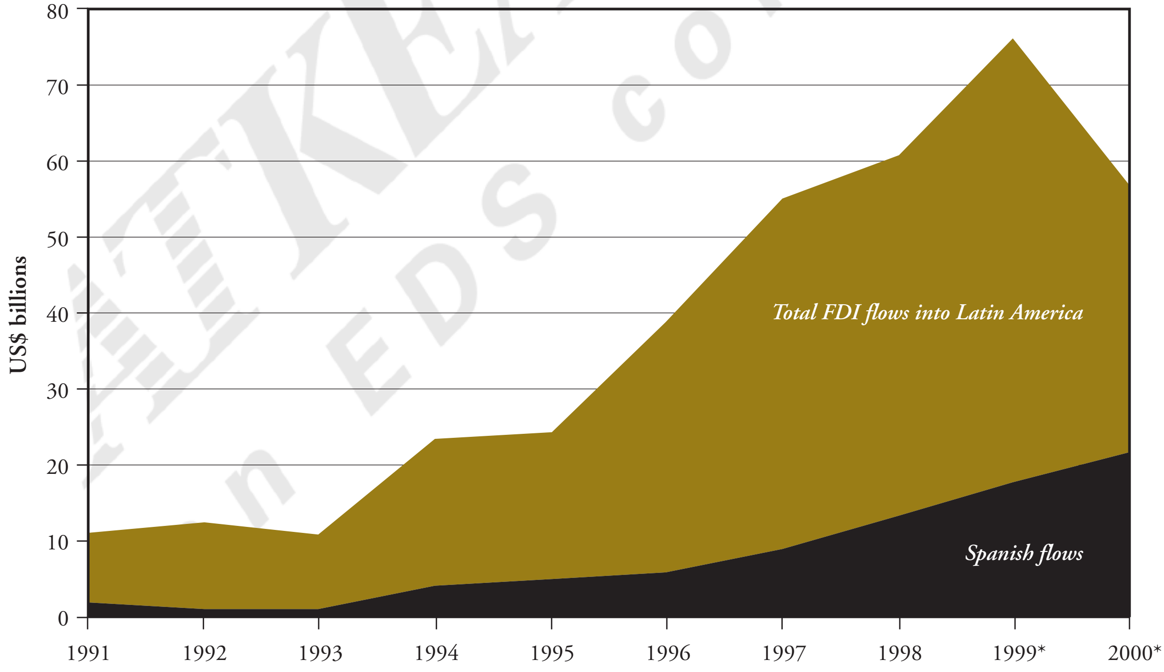
Other South American countries fared less well, all ranking well below the top 25 preferred FDI destinations. Moreover, South American countries dominated the group of nations suffering from a negative change in overall investor outlook in the last year. Argentina topped the list, making it the country with the most deteriorated outlook. Colombia, Venezuela and Peru all followed closely behind and suffered substantially from negative investor opinion.

FDI into Latin America slowed in 2000, falling approximately 25 percent compared to 1999 levels; however, this amount is consistent with the volumes of FDI that flowed into the region between 1996 and 1998. Brazil captured the largest share of FDI into the region in 2000 *(see The Emerging Giants, page 27).* Bolivia, Ecuador and the Dominican Republic also experienced increases (off of a small base) in inflows, while investment flows into Argentina, Chile and Peru decreased from 1999 levels.

Increased Spanish interest in Latin America. Latin American countries figure most prominently among Spanish executives' top rankings of preferred investment destinations. Brazil, Mexico and Chile secured the top-three positions for Spanish investors, while Argentina, Venezuela, Bolivia, Central America, Colombia and Peru all rank among their top 20 destinations. Spanish investment in Latin America has increased consistently since 1991, reaching an estimated one-third (US$18 billion) of total FDI to the region in 2000 *(see figure 10)*. Spain overtook the United States as the major source of foreign investment to Brazil in 2000, and was also the source of Brazil's single largest FDI transaction of the year: the Banco Santander Central Hispano acquired Brazil's Banco do Estado de São Paulo.

Argentina loses further ground. One-fourth of senior executives have a negative outlook for Argentina—making it the country whose prospects deteriorated the most over the past year. Argentina's downward spiral has been dramatic: After being ranked the eighth most-attractive investment destination in January 1999, Argentina dropped from 19th in 2000 to 24th this year. Investors were deterred by Argentina's economic downturn. Following a 3.1 percent economic contraction in 1999, the Argentine economy was stagnant last year as

FIGURE 10: FDI flows into Latin America



Source: UN–ECLAC, 2001
**Estimated, ECLAC*

the country experienced depressed domestic demand, high levels of unemployment and uncertainty about the country's financial prospects. The IMF recently granted Argentina a US$39.7 billion emergency-assistance package that the de la Rua government will use to press ahead with policies designed to reduce the country's risk premium through fiscal discipline and structural reform. Reform proposals, however, have been met with strong opposition.

Andean countries struggle to maintain investor interest. Political crises in Colombia and Peru and investor wariness of political developments in Venezuela contributed to lower investor confidence in these three Andean markets. Continued violence in the midst of a drawn-out peace process in Colombia—which aggravated the worst recession to hit the country in a century—further dampened investor interest. Peru's political crisis, which culminated in President Alberto Fujimori's resignation, also deterred investors. As Venezuela suffered from political uncertainty and struggled with the highest inflation levels in Latin America, investor confidence deteriorated and the country dropped below the top-25 preferred FDI destinations.

Chile gains position in 2001. Senior executives viewed Chile in a more favorable light going into 2001, increasing its Index score and raising its ranking to just below the top 25 destinations. The primary sector views Chile as its sixth most-attractive investment destination, and 60 percent of executives in this sector have a more positive outlook for Chile today than they did last year. Non-financial services firms also showed special interest in Chile, ranking it among their top-15 investment destinations. Chile exhibited strong economic growth in 2000, with an estimated 5.5 percent growth in GDP. Also, late last year, Chilean officials began preliminary talks with their American counterparts on the possibility of a bilateral free-trade agreement.

EUROPE

Europe provides sound economic conditions for FDI. Overall, executives are more likely to invest in Europe than they were one year ago. The United Kingdom, Germany, France, Italy and Spain all registered improvements in their Index scores and rank among the top 10 most-attractive countries for FDI. Of those markets tagged by executives for first-time investments, European destinations were cited more than 20 percent of the time.

Despite the euro's depreciation during 2000, Europeans have enjoyed macroeconomic stability and lower levels of unemployment and inflation over the past year. Healthy economic conditions across Europe combined with ongoing product and labor market reforms help explain these improvements. Europe will also likely benefit from its lower-risk environment, particularly in light of the less optimistic outlook for the U.S. economy.

Europe's economic performance is the second-biggest concern for global investors. Europe's economic performance is second only to the severity of the U.S. economic slowdown as the most important factor influencing this year's FDI decisions. Nearly 70 percent of all participants ranked Europe's economic performance among the top three most-vital factors affecting FDI decision-making.

North America and Western Europe are the predominant sources of global FDI, and are each other's largest investor. Nonetheless, executives do not seem particularly troubled by likely transatlantic frictions. Trade disputes between the United States and the EU over bananas and hormone-treated beef continue to go unresolved. Similarly, the recent funding of European Airbus's super-jumbo jet has also added friction. Yet executives on both sides of the Atlantic believe these issues are unlikely to affect their FDI decisions.

European investors plan to significantly increase their investments this year—more so than investors from any other region.

Europeans maintain an appetite for mergers and acquisitions, bucking the global trend. In 1999, EU firms invested US$510 billion abroad (including intra-EU), which is almost two-thirds of global flows. EU outflows increased by 20 percent and rose for the sixth consecutive year in a row, making the EU the world's most important source of FDI. The EU accounted for nearly half of all global cross-border sales and roughly 70 percent of global purchases, in M&A transactions. Overall, Europeans favor M&A the most as a method of foreign direct investment. Less than 45 percent of American and Japanese investors prefer M&As, while more than two-thirds of French, German, Italian and British executives prefer M&As as a mode of entry.

Guided by EU and national policies, continuing integration and liberalization across a variety of European industries has encouraged increased cross-border FDI flows in Europe. Eight of the top 10 cross-border M&A deals in 2000 involved a European firm, and five were exclusively European deals. The emergence of a liquid corporate bond market fostered by the euro has also helped firms finance this M&A activity. The most notable deal was British Vodafone AirTouch Plc's acquisition of Germany's Mannesmann AG for roughly US$172 billion. The second largest deal in Europe was France Telecom's acquisition of the Orange unit of Vodafone for US$47 billion.

However, the pursuit of M&A targets by European executives has not been limited to their home turf. European investors still consider the United States the best destination for FDI. In 1999, Europe was the largest investor in the United States, accounting for about 86 percent of its FDI inflows. This trend continued in 2000, as one-third of the largest M&A deals involved European firms acquiring North American ones. Europe's continued enthusiasm for M&A and significant contributions to global FDI flows suggest that future M&A activity may be tempered by changes in the European markets. The continuing search for size in the burgeoning EU or distressed consolidations prompted by a global economic slowdown could exert more influence over the future course of overall M&A activity.

Investors remain confident about Germany and foresee opportunities in financial services. Germany maintained its sixth-position ranking in the Index and remains the second most-attractive market in Europe after the United Kingdom. While American executives are less optimistic about Germany compared to last year, its investment outlook has changed more positively among its neighbors—primarily Spanish, Italian and French firms.

Manufacturers—particularly retail firms—continue to be attracted to Germany, likely prompted by the consolidation occurring among Germany's largest retail chains. Banking executives have the most positive outlook as EU market reforms and Frankfurt's role as a European financial center (and home to the European Central Bank) continue to galvanize corporate restructuring. New legislation to be implemented in 2001 will lower corporate taxes and reduce the tax burden associated with unwinding Germany's cross-shareholder relationships that will in turn help free up underused capital and foster M&A activity.

France returns to the top 10 in the Index, but is slow to adopt EU reforms. France has edged up slightly from 12th to 10th position in the Index and investors have a more positive outlook for the country than they did a year ago. German, Italian and British firms are the most attracted to the French market, with the Germans leading the way. In 1999, FDI inflows into France rose by more than 30 percent. Benefiting from the improved economic conditions across Europe and continued global demand, growth has averaged 3 percent over the last two years.

Despite the fact that eight national banking groups dominate the French banking industry, France ranked fifth overall in attractiveness and had the greatest positive outlook change among financial services investors. The takeover of Credit Commercial de France by the U.K.-based financial services group HSBC is reflective of new investor focus and the expected continued privatization of state-owned banks will likely continue to generate intense interest in this sector.

Italy is given high marks and sparks the attention of telecommunications executives. Italy continues to hold eighth position in the Index and ranks as the third most-attractive country in Europe after the United Kingdom and Germany; it has also garnered the third-highest positive investor outlook change among European investment destinations. In 1999, FDI inflows rose to US$5 billion—still well below levels received by other European countries, including Spain and Ireland. Yet Italy's central location in Europe, its economic stability under the constraints of the euro, and its abundant, well-educated workforce draw the attention of many investors.

The telecommunication industry ranks Italy second only to the United States as most-attractive market worldwide. Telecom Italia was privatized in 1997 and EU liberalization went into force in January 1998. The decline of long-distance tariffs, ongoing privatization, and sales of mobile phone licenses are expected to further enhance competition. International operators offer alternative services and the market is beginning to experience intense competition.

Spain becomes an important source of European investment outflows; Portugal lags behind. Both Spain and Portugal have benefited enormously from EU membership. Access to trade and investment in the common market, EU structural funds and macroeconomic stability under the euro criteria have brought them closer economically to their more wealthy European neighbors.

Spain maintains its position in 9th place in the Index and is among the most attractive European investment destinations. Telecommunications and utilities firms rank Spain the fourth most-attractive market. The nearly complete privatization of utilities under EU directives is likely spurring positive investor sentiment. Spain's FDI outflows rose by 86 percent, reaching US$35 billion in 1999, nearly doubling as a percentage of GDP. In 2000, more than one-third of all European investment into Brazil was Spanish, helping Europe to surpass the United States as the top investor in Latin America.

Europe will likely benefit from its lower-risk environment, particularly in light of the less optimistic outlook for the U.S. economy.

Portugal's overall standing in the Index improved somewhat, although it remains ranked below the top 25 investment destinations. In 1999, FDI inflows dropped by 80 percent, down from US$2.8 billion to US$570 million, as Portugal struggled to attract investor attention. However, nearly twice as many investors are more optimistic than they were a year ago, with 9 percent of executives seeing brighter prospects for investment opportunities in Portugal. The government is currently seeking strategic partners for key state-run companies and continues to adopt policies aimed at private enterprise and competition.

As Central and Eastern Europe continue to attract investors, the front-running EU accession states and Russia lead the pack. European senior executives indicate that they are considering Central and Eastern European countries as destinations for roughly half of all their planned first-time investments in Europe. Poland, the Czech Republic, Russia and Hungary accounted for three-fourths of total inward FDI flows in Central and Eastern Europe in 1999. As a number of these countries continue to move forward with market reforms, privatization and their accession to the European Union, investors will carefully seek out new opportunities. FDI interest in the region is concentrated on the EU accession front-runners—Poland, the Czech Republic and Hungary. These countries also benefit from their geographic proximity to the EU, low unit labor costs and large internal markets.

Poland dropped significantly from the fifth to 11th spot in the Index. Though less sought after than other emerging markets, Poland is a strong regional player with global prospects: It registered the highest investor outlook change in Europe and scored significant improvement in global investor outlook (one-quarter of executives are more optimistic than one year ago). Poland also was among the most frequently cited first-time investment destinations among telecommunications and utilities firms *(see figure 5, page 5)*. France Telecom's purchase of a stake in Poland's telecom operator TPSA is expected to account for roughly half of Poland's total FDI inflow expected for 2000. This transaction is the single largest FDI investment in the region since the beginning of transition. However, Poland's attractiveness ranking plummeted among insurance executives, likely the result of Poland's bid to overturn a 1999 privatization agreement that is being challenged by a Dutch insurance firm.

To some extent, all executives agreed that the uncertainty over joining the EMU could have some negative impact on likely investment flows into the United Kingdom.

The Czech Republic edged slightly from 18th to 16th position in the Index. Non-financial services executives ranked the Czech market the third most-attractive destination for investment worldwide. The Czech Republic also placed in the top 10 for most industry sectors, except for financial services and heavy industry. The slow pace of reforms in banking regulation is expected to dampen interest by the financial services sector. While foreign companies operate under the same tax and labor codes as domestic firms, investors may be less encouraged by weak transparency within the country's business and financial institutions.

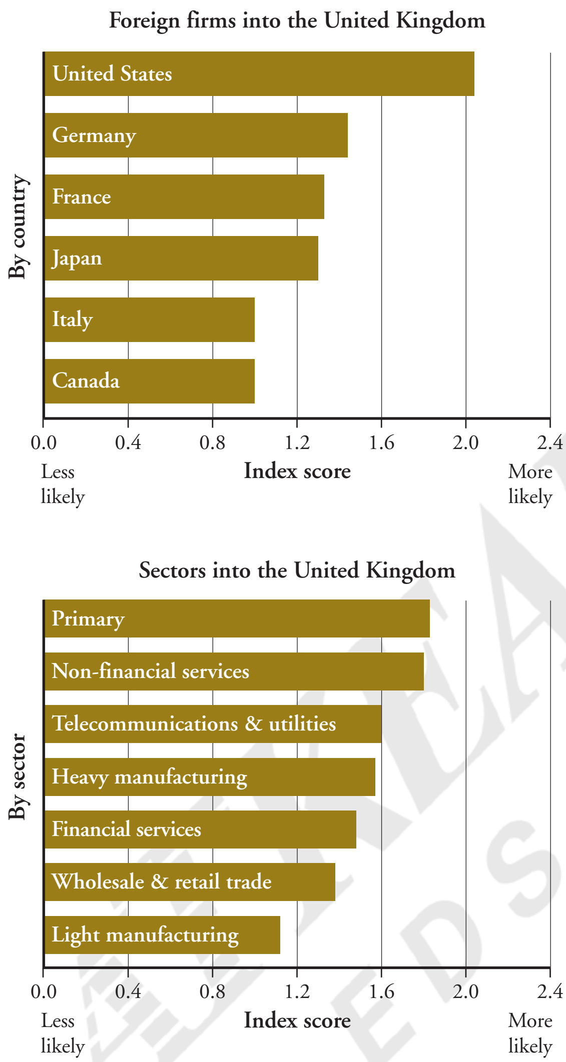
Hungary fell one notch from 20th to 21st in the Index, yet it enjoys the second greatest positive change in investor outlook among European countries. Its macroeconomic environment has improved, and advances have been made in establishing a legal and institutional framework for foreign investors. Since beginning its economic transition, Hungary has privatized significant portions of its economy, with 80 percent of the nation's GDP currently derived from private sector contributions.

Russia, although still not among the top 25 investment destinations, moved up significantly in the Index, reflecting the beginning of a return of investor confidence in the wake of the 1998 financial crisis. While the financial turmoil of 1998 resulted in a decline of FDI flows by more than half, they bounced back in 1999 to US$2.9 billion, the second highest level of inflows since transition began. An agreement struck between the London Club of creditors and the Russian government in February 2000 helped to further restore some market confidence. However, most investors continue to be leery of Russia and express concerns about corporate governance issues, such as clear standards and rules governing the investment environment aimed at greater transparency and protecting rights of minority shareholders.

UNITED KINGDOM: SPECIAL FOCUS

The United Kingdom becomes largest FDI source. Overtaken by two of the emerging giants—Brazil and China—the United Kingdom was bumped out of second place, falling to fourth spot in this year's Index. However, the United Kingdom remains especially attractive to American investors *(see figure 11).* The United Kingdom continued to lead the world as FDI destination and source in 1999, along with the United States. In fact, the United Kingdom surpassed the United States as the largest global outward investor, sending US$199 billion to foreign destinations. The United Kingdom was the source of 27 percent of all FDI flows going

FIGURE 11: Likelihood of investment into the United Kingdom



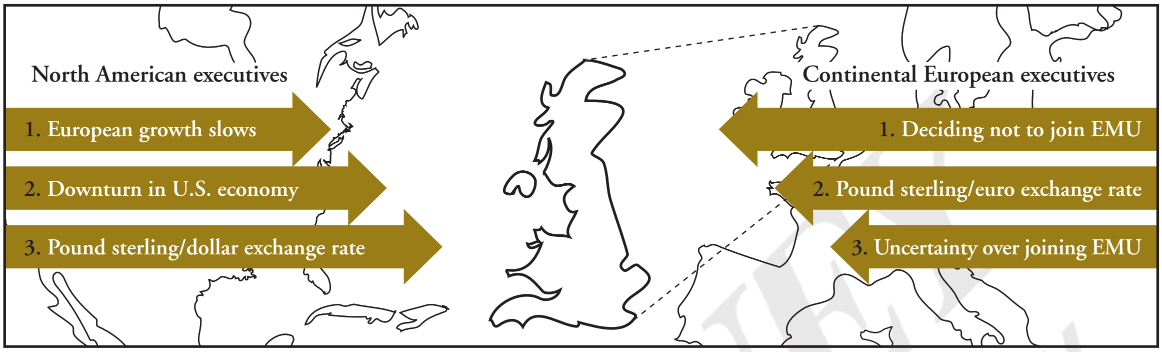
Source: A.T. Kearney

into EU countries and was responsible for roughly half of the 86 percent of the U.S. inflows coming from Europe.

To join or not to join, that is the question. The United Kingdom's flexible work practices, favorable regulatory environment and membership in the European Union have continued to attract investors over the years. Although questions have been raised as to whether the United Kingdom can hold its paramount position as a destination for FDI without adopting the euro, it continues to maintain a very strong FDI position. While FDI flows into the euro countries dropped slightly (2 percent) in 1999, inflows to United Kingdom increased by 30 percent, reaching US$82 billion—more than double those of Germany, the next largest European investment destination. Investors have been aware of the United Kingdom's reluctance to commit to the common currency for almost a decade, but according to the executives surveyed, their investment decisions have not been negatively affected by this attitude and their intentions to invest still place the United Kingdom far in front of the eurozone countries. The United Kingdom is the most attractive European destination for investment globally and, despite having fallen into fourth place on the Index, an improved outlook by U.S. and Japanese investors has edged up its attractiveness score from last year.

Macroeconomic fundamentals and growth are more relevant than entry into the eurozone. Of the factors that executives suggested could undermine the United Kingdom's preeminent FDI position, the most important one was the pound sterling-euro exchange rate, followed by the slowing of European growth. North American executives considered European growth and the downturn of the U.S. economy as the two most-important factors that could affect the United Kingdom's investment possibilities. They also considered the pound-dollar exchange rate to be important. Asian executives cited the pound-euro exchange rate as their biggest concern about the United Kingdom as

FIGURE 12: Factors affecting FDI flows into the United Kingdom



Source: A.T. Kearney

an investment destination. They also indicated that signs of slower European growth levels would likely have a negative impact on U.K. investment plans.

Macroeconomic issues proved most important to those sectors expressing the greatest investor interest in the United Kingdom—nonfinancial services, primary resources, telecommunications and utilities, and heavy manufacturing. Exchange rates and growth are the greatest concerns to those investors most attracted to the United Kingdom; the euro debate, however, does create significant concern.

The United Kingdom and Europe part ways over the euro. Continental Europeans consider the United Kingdom's unwillingness to commit to the common currency to be most detrimental *(see figure 12).* Half of continental European executives consider the pound-euro exchange rate important—in line with other global investors. However, more than half of executives across Europe indicated that a decision not to join the eurozone would likely dissuade further investment into the United Kingdom (71 percent of French firms, 50 percent of German firms, and 67 percent of Italian firms expressed this notion). In most cases, European growth—as well as the U.K. decision not to join—were offered as the factors of highest relevance to the FDI decisions of European executives.

By contrast, British firms are more closely allied with their American counterparts in concluding that the United Kingdom's standing as an attractive investment destination is more likely to be affected by basic macroeconomic developments than from any decision not to join the euro. Both American and British firms ranked European economic growth and the state of the U.S. economy as the first and second most-important factors likely to impact the United Kingdom's ability to attract FDI. Less than 18 percent of North American and British executives considered the United Kingdom's unwillingness to commit to the euro as a matter of serious consequence.

Choppy Channel waters ahead? European executives on the continent stand apart from other global investors with their views of the United Kingdom. While Asian and North

American investors are increasingly more optimistic about the U.K. investment environment, Europeans are less so, with most citing either a neutral or more negative outlook toward the United Kingdom. Overall, 10 percent of European executives are more negative, with none offering a more positive outlook toward the United Kingdom. The French showed the greatest negative shift in sentiment, with 40 percent expressing increased pessimism over last year.

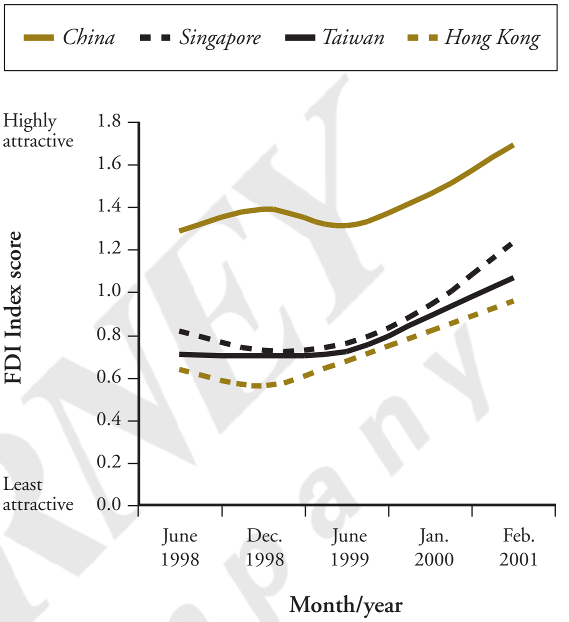
However, American investors are more likely to invest in the U.K. market than they were a year ago, ranking it their second most-attractive investment destination—an increase of one spot over last year. Asian investors are also more likely to invest in the United Kingdom compared to last year—it moved up four positions to the sixth most-attractive investment destination among Asian executives. However, Europeans are less likely to invest in the United Kingdom, which dropped from second to ninth place among European investors. In particular, French, German and Italian firms show much less enthusiasm for investing across the Channel.

Uncertainty over entry into currency union adverse for the United Kingdom. To some extent, all executives agreed that the uncertainty over joining could have some negative impact on likely investment flows into the United Kingdom. The uncertainty of the U.K.'s adoption of the euro is of greatest concern to European executives and to the financial services sector in particular, which ranked this issue as the most important deciding factor for FDI.

ASIA

The tiger economies are roaring again. Economic performance in East Asia has improved significantly since the Asian financial crisis struck more than two years ago, and several key markets have recorded strong growth in 2000. China and the East Asian tigers (Singapore, Taiwan, Hong Kong and South Korea) all have registered increased Index scores and posted impressive annual economic growth rates *(see figure 13)*. The four Asian tigers all moved up into the FDI Confidence Index's top 25 investment destinations for the first time since June 1999. Asia's two largest nations, China and India, have both significantly improved their attractiveness to investors this year *(see The Emerging Giants on page 27)*.

FIGURE 13: Asia's outlook improves



Source: A.T. Kearney

By comparison, the performance of Southeast Asia and Japan has been considerably weaker. With the world's second-largest economy, Japan continues to stagnate, and is perceived to be a less attractive investment destination this year than those of other Asian countries. Although Thailand recorded modest gains, the Philippines, Indonesia and Malaysia continue to be perceived with some apprehension and their attractiveness has not improved significantly. In fact, the Philippines is one of only a dozen countries to see its Index score actually fall this year. These differences in political and economic performance, along with perceived investor attractiveness, underlie the disparities in actual flows within Asia.

Asia stands out for the optimism of its decision-makers: Nearly half remain upbeat going into 2001 and more than one-third plan to increase their levels of FDI.

Singapore's attractiveness improves the most, making it a top investment destination. Singapore jumped from 21st to 13th position, and its attractiveness score rose by 32 percent, giving it the most improved score of any nation this year. This performance improvement catapults Singapore to the second most-attractive investment destination position in East Asia, after China. Almost universally positive impressions from investors prompted the strong showing, with nearly one-fifth of all respondents citing an improved perception of Singapore over the past year, and less than 5 percent volunteering a more negative outlook for Singapore.

Singapore's attractiveness stems from its strong macroeconomic performance and the government's efforts to improve the investment environment. Spurred by strong export performance in manufactured goods and electronics, Singapore's economy grew by more than 9 percent in 2000. The government has also embarked on a successful program to liberalize the financial services sector and increase FDI inflows. Financial firms rank Singapore 13th overall, and just below China, Taiwan and Hong Kong as their favorite Asian investment destination. When rating the attractiveness of investment destinations in Asia, heavy and light manufacturers rank Singapore as their second and third choices, respectively. Asian investors, who supply a significant portion of its FDI, consider Singapore among their top-five investment destinations worldwide.

Taiwan greatly improves Index score and ranks among top investment destinations for Asians. Taiwan closely followed Singapore in improving its Index score, jumping four slots to 19th position. This strong improvement puts Taiwan within the top 20 investment destinations worldwide for the first time since June 1999. FDI inflows increased dramatically two years ago, and Taiwan appears to have maintained the approximately US$3 billion in FDI inflows for 2000. While the recent election of Chen Shuibian has heightened tensions with China, new initiatives offer foreign investors increased access to certain sectors of Taiwan's economy. For example, new banking laws are liberalizing the financial sector and infrastructure projects are more open to foreign investment.

Asian investors rank Taiwan as the fourth most-attractive investment destination overall, and their third favorite destination in Asia. Taiwan also does extremely well among financial services firms, ranking among their top 10 investment destinations worldwide, and their third favorite destination in Asia. Similarly, wholesale and retail firms rate Taiwan as their second most-favorite investment destination in Asia.

Hong Kong regains its position among the top 25 investment destinations. Falling somewhat after the Asian financial crisis, Hong Kong has regained its position as the 25th most-attractive investment destination worldwide. Going into 2000, Hong Kong became the second biggest recipient of FDI inflows in Asia. Led by surging exports, Hong Kong's GDP grew by nearly 10 percent in 2000.*

Compared to North American and European executives, Asian investors find Hong Kong the most attractive, and they rank it 11th overall. Japanese executives rate Hong Kong 14th globally. Financial services firms rank Hong Kong as their second most-favorite investment destination in Asia after China.

South Korea's Index score improves, but its ranking slips. Although South Korea's Index score rose this year, upward movement on the Index by competitor destinations caused this tiger economy to drop slightly from the 15th to the 17th place on the Index. Despite this fall, respondents have expressed an overall positive change in the perception of South Korea as an investment destination. More than one-fifth of respondents cited an improved investment outlook, while only one-tenth had a negative change in perception. South Korea's exports grew an astounding 20 percent in 2000, leading its annual GDP to nearly 9 percent growth. FDI inflows into South Korea nearly doubled in 1999, reaching almost US$10.5 billion. This increase made South Korea Asia's third-largest recipient of FDI, and estimates for 2000 indicate an increase in South Korea's FDI inflows. South Korea is tied with Hong Kong as the third-favorite investment destination in Asia for wholesale and retail investors; light manufacturers also rate South Korea highly as an investment destination in Asia.

The large emerging markets have returned to position themselves among the top five most-attractive markets for foreign investment—a status enjoyed prior to 1998.

The Japanese economy continues to stagnate and investors remain cautious. Japan fell four rungs to the 20th spot on the Index this year, though it maintained the same Index score. In 1999, FDI inflows quadrupled to US$13 billion, mostly because of reforms that opened the way for a flurry of foreign investment activity. This increase in FDI also confirms last

**While China's increased attractiveness bodes well for Hong Kong, Hong Kong still benefits from a unique investment personality that boosted its attractiveness this year.*

year's result in which a majority of executives stated that Japan's difficulties would result in more opportunities to acquire Japanese assets. Australia, France and Germany are bullish in their outlook toward Japan.

Japanese executives ranked China, Thailand, Taiwan and Singapore among the highest in overall investor attractiveness, behind the first-ranked United States. Japanese firms view market reforms in Japan and Asia's economic recovery as the most important developments likely to affect their FDI decisions, second only to the state of the U.S. economy. Other Asian executives view market reforms in Japan as more important than Asia's recovery in the factors most likely to influence their investment decisions. Japanese companies view a country's macroeconomic factors as the most important determinants of their FDI decisions, followed by industry and competitor trends. Japan's ongoing struggle to reactivate its economy will likely reduce its ability to serve as a generator of FDI outflows to the rest of Asia-Pacific this year, with fewer Japanese investors planning to maintain or increase their FDI compared to last year.

Despite an overall drop, Australia remains a top Asia-Pacific investment destination for North American firms. Australia's downward slide on the Index, which began in June 1999, has continued as it drops fives spots to the 15th position. Although Asian investors have cooled on Australia, dropping its ranking from fourth place last year to 10th in 2001, North American investors find Australia a more attractive destination than they did one year ago. U.S. investors ranked Australia higher, tying it with Canada as America's fourth most-attractive investment destination overall, and consider it their favorite investment destination in the Asia-Pacific region. Australia's investment appeal makes it the second most-favorite destination in Asia for utilities and light manufacturers.

Hindered by political uncertainty, Thailand posts modest gains. With the exception of Singapore, Thailand has improved its standing the most of all Southeast Asian countries since the Asian financial crisis. Thailand ranks as the second most-attractive investment destination in Southeast Asia, and has retained its 14th place overall on the Index. Yet, significant obstacles still deter potential investors: The country has suffered from political uncertainty and high levels of government debt restrict its ability to use fiscal policy to boost its sluggish economy. Despite these hurdles, Thailand's economy is estimated to have grown by 4.5 percent in 2000, spurred by strong exports. Asian respondents, in fact, rate Thailand as one of their top investment destinations worldwide—ranking it as their third-favorite investment destination, behind only the United States and China. Although North American investors give Thailand a lower Index score, their change in perception of Thailand has been wholly positive—26 percent have a more positive outlook and none offered a more negative assessment of the country. Thailand is also the favorite destination for utilities firms in the Asia-Pacific region.

AFRICA AND THE MIDDLE EAST

Although its FDI plunged last year, South Africa still leads in regional attractiveness. South Africa has retained its position as the most attractive investment destination in Africa and the Middle East, and its score has improved somewhat this year. Nonetheless, FDI flows into South Africa plunged by 52 percent last year. Regional unrest became a major issue for foreign investors, despite South Africa's relative stability. South Africa has had difficulty differentiating itself from its less attractive neighboring investment environments. The rest of Africa and the Middle East trail far behind South Africa in Index ranking. Despite the generally low rankings, actual FDI flows to the region have picked up marginally, a departure from decreasing FDI the previous year.

Conclusion

Surveyed between October and December 2000, CEOs from the world's largest 1,000 firms are less optimistic than they were one year ago. However, this change in sentiment is not expected significantly to affect their investment strategies, with investors planning to maintain or increase their foreign direct investment over the next one to three years. The most important development of concern to global investors is the state of the U.S. economy. The United States continues to be the number-one preferred investment destination by companies from all regions of the world. But while uncertainty over the U.S. economy prevails in the minds of executives, they are most optimistic about its immediate neighbor to the south: The new Mexican government has brought with it a breath of renewed confidence among investors and has helped spawn a positive outlook for the country's investment prospects twice that of what it was a year ago. Brazil rose to become the third most-attractive investment location in the world, while other countries in the region ranked further down in the Index due to political turmoil or uncertainty.

The United Kingdom, Germany, France, Italy and Spain are the leading European investment destinations, ranking among the top 10 most-attractive countries. After a troubling year for the euro, Europeans are benefiting from macroeconomic stability and record levels of lower unemployment and inflation. European executives remain enthusiastic about embarking in M&As. Though overtaken by China and Brazil, the United Kingdom continues to be the most attractive European investment location, driven largely by U.S. and Japanese investor interest. For most global investors, economic fundamentals and growth take precedence over questions related to the United Kingdom adopting the euro.

While Asian CEOs are more optimistic about their prospects, investor sentiment about the region is split. On the one hand, China, Hong Kong, Singapore, Taiwan and South Korea once again enjoy investor confidence. These tigers are leading Asia in economic performance, with Singapore at the forefront. On the other hand, most Southeast Asian countries suffer from weaker economies and political turbulence. And although Japan's economic difficulties have helped create opportunities for increased FDI inflows, investors are still deterred by the country's intractable economic slump.

Executives are less inclined to use mergers and acquisitions as a mode of foreign direct investment than in the past, though this is still expected to be the overwhelming investment vehicle of choice. This finding is consistent with the observed slowdown in the rate of growth of mergers and acquisitions in 2000. Executives are largely motivated to engage in M&A activity by traditional drivers: firm-specific goals and industry-related factors. While a host of other variables influence investors' decisions, these firm- and industry-specific factors are still the predominant drivers of FDI decision-making.

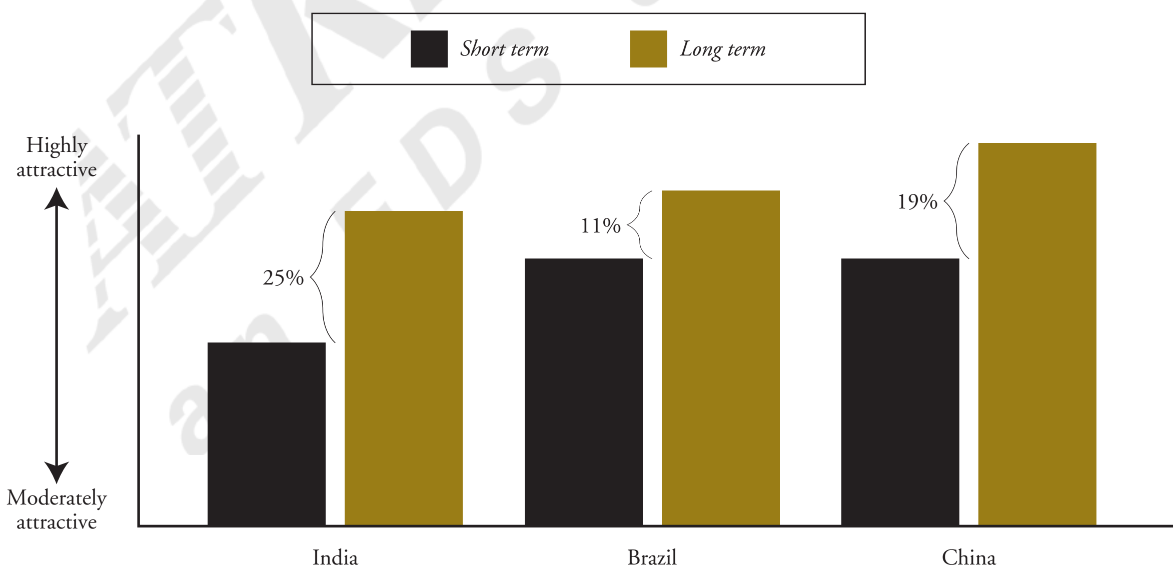
The Emerging Giants: China, Brazil and India

Over the past three years, Brazil, China and India have ranked consistently among the seven most attractive foreign direct investment destinations. In fact, these countries receive almost half of FDI inflows to emerging markets. What explains the appeal of these markets? With a consumer base of 2.5 billion and a workforce half as large, these three countries present considerable potential. But how do investors differentiate between these emerging giants? In this section we explore how, in the minds of corporate investors, China, India and Brazil present unique investment opportunities and challenges.

Senior decision-makers believe China and Brazil offer equal promise, with almost 60 percent of CEOs citing them as attractive or very attractive in the short term (three years). China's pending accession to the WTO and Brazil's successful economic reform programs, among other factors, contribute to positive perceptions of these markets. In contrast, only 40 percent have similarly positive perceptions of India over the next three years, with more than 25 percent of senior executives believing India is "unattractive" over the same period—compared with 16 percent for China and 12 percent for Brazil.

In the short term, the Chinese and Brazilian markets are not just more attractive, but they are more likely to convert this positive investor outlook into actual investment commitments. Nearly 70

FIGURE 14: Difference in short-term and long-term attractiveness of the emerging giants



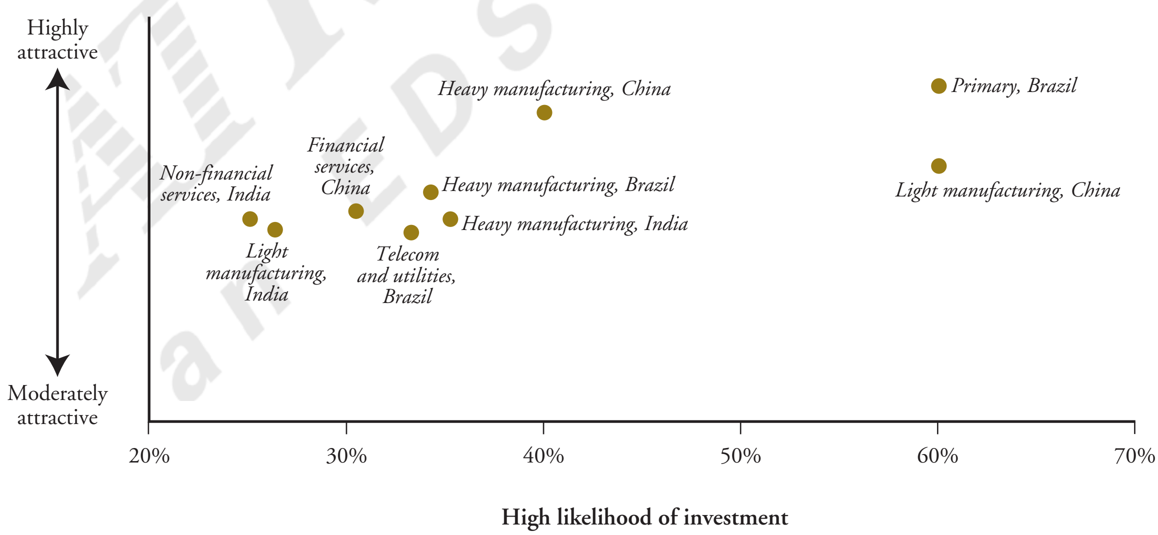
Source: A.T. Kearney

percent of CEOs who indicated a positive outlook change for China projected a high likelihood of investing in China in the coming year. Similarly, 65 percent of senior executives who cited a positive improvement in outlook for Brazil have a high likelihood of investing in that market in the coming year. By contrast, only 42 percent of investors who have had a positive outlook change for India over the last year have high likelihood of investing there this coming year.

In addition to these short-term differences in attractiveness between the emerging giants, investors also differentiate these markets over the long run (10 years). While the competition for investment in the near term between China and Brazil is strong, China edges out its Latin American counterpart as the most attractive investment destination over the long term. Nearly 80 percent of firms describe China as either attractive or very attractive in the long term, whereas 72 percent describe Brazil similarly; India followed closely with just under 70 percent. China also received the fewest citations as an "unattractive" destination (6 percent), followed by Brazil (9 percent) and India (11 percent) over the long term. In addition to its long-term attractiveness, investors rank China ahead of Brazil and India in terms of size of domestic market and potential as an export platform.

Despite India's likely weaker FDI performance than the other two emerging markets in both the short and long term, the country's potential is undeniable: India closely rivals Brazil in long-term attractiveness. Interestingly, however, India's attractiveness grows at a dramatic rate when investors

FIGURE 15: Most attractive sectors in the emerging giants



Source: A.T. Kearney

lengthen their time horizons—a rate of growth that actually surpasses China and Brazil's *(see figure 14, page 27)*. The difference between short- and long-term perceptions of India reflects the considerable preference investors assign to the country once expected deregulation, privatization and application of WTO guidelines are implemented. Investors likely expect these reforms to fuel investment, competition and market expansion. Thus despite its current position, global investors believe India's latent capacity and future potential for growth offer competitive advantages that cannot be ignored.

By contrast, Brazil is consistently the preferred choice of senior decision-makers across a broad range of factors relating to the investment environment, including availability of M&A targets, ease of project implementation, regulatory regime, transparency of investment process and effectiveness of local partners. Perceptions of Brazil as having more favorable profit-repatriation regulations and lower levels of corruption help give Brazil a more attractive profile than that of the other emerging giants. It is also the only one of the three to be classified as medium-risk on average by senior executives; China and India are both rated as higher risk environments.

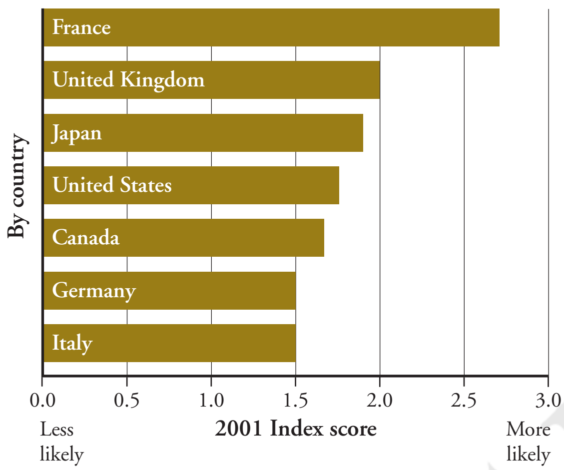
The following country profiles display further detail on the individual assets and liabilities of each of these emerging giants, comparing factors important in FDI decision-making.

China

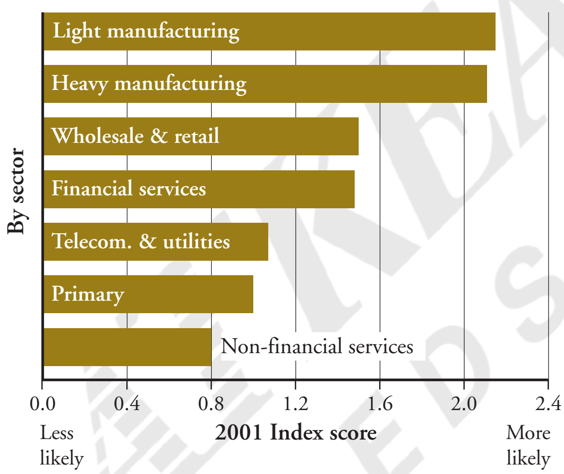
Rank 2, score 1.69

LIKELIHOOD OF INVESTMENT

Foreign firms into China

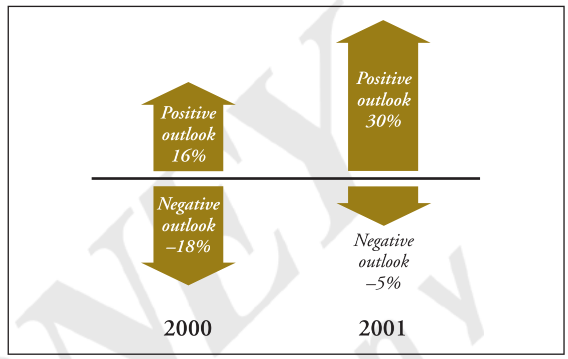


Sectors into China



Source: A.T. Kearney

Outlook on investing in China compared to one year ago



ATTRACTIVE SECTORS FOR INVESTMENT

Financial services and telecommunications. After WTO accession, these sectors will gain more access to the domestic market. Beijing will allow up to 49 percent foreign ownership of fixed-line services and 51 percent ownership of wireless services in selected large cities. Also, international banks will be able to conduct business in the local currency with Chinese enterprises and citizens within five years.

Petrochemicals. China is the world's fastest growing market for petroleum products, and executives from this sector rate China as their second most-preferred investment destination globally. Beijing is opening up this sector to foreign investment and several Chinese petroleum firms, including PetroChina and Sinopec, both of which launched IPOs last year.

Manufacturing and electronics. Because of China's success as an export platform, this sector receives the majority of China's FDI. While textiles have long been a major recipient, the electronics sector has increased its export performance and FDI attractiveness. Electronics firms rank China and the United States equally as their most attractive investment destinations worldwide.

INVESTMENT ENVIRONMENT

(+) Export platform and domestic market potential attraction. Respondents rank China highly as an export platform and for its domestic market size. Preferential policies and geographic advantages make China the world's ninth largest trading nation. Consumption and urban incomes continue to rise, and foreign firms have greater access to local consumers than ever before.

(–) Lack of transparency. Index respondents give China universally poor ratings for the unfriendliness of investor regulations and lack of transparency of the investment process. Investing in many sectors remains difficult, and the bureaucratic approval process—although more efficient in certain locations—remains generally problematic.

Country profile — China

INVESTMENT ENVIRONMENT (CONTINUED)

(+) WTO and investment incentives. WTO accession will offer major new opportunities for FDI in many sectors. China will soon "nationalize treatment" of foreign-invested enterprises, eliminating firm-specific preferential investment benefits. As a result, international investors will gain wider access to the domestic market and face fewer restrictions.

(+) Long-term commitment to attracting FDI. Beijing is committed to attracting FDI as an important source of capital. Last year, the government increased its efforts to attract investment into China's inland regions by offering incentives and opening projects previously forbidden to foreign investors.

(–) Ineffectiveness of local partners. Most FDICI respondents—with the exception of the Japanese—found their local partners in China to be ineffective compared to those in India or Brazil. Virtually no respondents believe China has attractive M&A targets.

(–) Corruption. Despite high profile efforts to fight graft, corruption remains a significant and pervasive obstacle to investment in China. The latest corruption perception index released by Transparency International ranks China 58th (out of 99), a slight worsening from 54th place the previous year.

MAJOR FOREIGN INVESTORS IN CHINA

China Mobile Hong Kong (CMHK) agreed to pay US$32 billion to purchase seven provincial networks from its parent company, China Mobile Communications. Once complete, this deal will make CMHK the world's second largest operator, when measured by subscriber volume.

Royal Dutch/Shell sealed one of China's biggest investments, a US$4 billion joint venture with China National Offshore Oil Corp, a major petrochemical corporation.

Motorola reinvested nearly US$2 billion in a communications chip plant in Tianjin. The project will require a total investment of US$3.4 billion.

BP launched a US$3 billion joint venture with Sinopec in Shanghai, and has made major equity purchases of PetroChina's IPO.

BASF initiated a US$2.6 billion joint venture for an integrated petrochemical plant with Sinopec, making it the largest German-China joint venture and one of China's biggest.

OUTLOOK

China's attractiveness among international investors improved this year, moving it up from third to regain second place in overall investment destination ranking. China's Index score also increased, narrowing the investment-attractiveness gap between China and the United States to its closest margin in more than three years. The perceptions of international investors also improved over the past year as China edged closer toward entry into the World Trade Organization. In fact, nearly one-third of all respondents volunteered a more positive outlook toward China's market over last year; only 5 percent have a more negative outlook.

Furthermore, despite a gloomier global outlook, most investors believe that China's near-term potential is strong. Of respondents citing a definite negative global economic outlook, two-thirds still believe that China is an attractive near-term investment destination, suggesting confidence in the Mainland's economic future. China was also the third most-important destination for first-time investors, with more than 16 percent of these investors and across all sectors planning first-time investments on the Mainland in the coming three years.

Since 1993, China has been the largest recipient of FDI in the developing world, and received more than US$40 billion in 1999. Despite a 2 percent drop in actual FDI, China's contracted FDI jumped 36 percent to US$48.6 billion last year. The country also raised more than US$18 billion and further privatized its state-owned sector through a string of IPOs last year, and plans to launch several major IPOs this year.

China experienced strong economic performance last year and appears poised to increase FDI inflows in 2001. China's annual economic growth rate for 2000 increased to nearly 8 percent, up from 7.2 percent the year before. This growth was helped by a surge in high-tech, electronics and machinery exports—raising the export total by nearly 28 percent to more than US$249 billion. Another boost came from a program of large fiscal expenditures: Beijing has initiated a major effort known as the Western Development Campaign to reduce the

Country profile — China

OUTLOOK

poverty of inland China by strengthening its infrastructure and increasing foreign investment. Officials hope that improved infrastructure and the campaign's preferential investment policies will attract foreign capital to Western China. Currently, the region receives only a tiny fraction of China's FDI. These moves are timely: last year, one-half of the Index's respondents listed poor infrastructure as a significant deterrent for investment in China.

Asian respondents give China the highest attractiveness score. China is Japan's second favorite investment destination, and Asian nations continue to be the largest source of FDI for China. Led by Hong Kong, Asian nations contributed two-thirds of China's US$40.3 billion in FDI inflows for 1999. Although North American investors rate China lower than Asian investors, China is their most attractive investment destination in East Asia. Europeans are more divided in their outlook. Investors from France and the United Kingdom give China top ratings, but German investors remain cautious.

China is extremely attractive to foreign investors as an export platform, with the majority of executives ranking it higher than India or Brazil. China's success in this area is a result of both geographic advantages and deliberate policy. China has abundant natural resources and low-cost labor, making it an extremely attractive manufacturing base. Also, China offers producers easier distribution to the major Asian, and Central Asian markets. Beijing has also actively sought to attract FDI into the export-manufacturing sector. This year, manufacturers rate China as their second most-attractive investment destination worldwide.

China's domestic market potential has attracted foreign investors eager to establish a foothold in the market, and respondents cite this as the primary investment consideration. China is the largest, fastest growing, underdeveloped market in the world, and many firms apparently are willing to endure small short-term profits in order to secure a larger long-term market share.

Differences in investor outlook on China's attractiveness over the next decade likely reflect uncertainty about China's immediate economic challenges balanced by confidence in its long-term prospects. Although China embarked on economic reforms over two decades ago, progress has been deliberately measured. WTO accession will expose many sectors of the domestic economy to severe competitive pressure for the first time.

Investment risk and implementation vary across China. Compared to the other emerging giants, the majority of investors rate China poorly across various investment factors such as transparency of investment process, ease of implementation, friendliness of investor regime and availability of M&A targets. In particular, German respondents find investing in China more difficult, especially in terms of the regulatory environment. In contrast, Japanese investors find China an easier investment destination than other respondents, with one-half ranking it first for regional access and for the effectiveness of local partners. Japanese investors also consider China a more moderate risk than their North American or European counterparts who rate China as being high-risk. Interestingly though, Japanese investors report that they are less likely to meet profit targets in China than other respondents. Realizing its investment regime is a deterrent, in recent years Beijing has initiated efforts to streamline the process.

Although investors generally consider China a high-risk investment destination, coastal China is considered less risky. Nearly 60 percent of investors rate China as high-risk, but only one-third rate the coastal region similarly. Investor-friendly investment zones, superior infrastructure and business culture on the coast support this reduction in investment risk perception. The perceived reduction in risk on the coast is largest for the manufacturing sector, while the financial sector alone reports no difference in risk between the coast and the country as a whole. Correspondingly, the majority of respondents report that they meet profit targets on the coast, but more than half report that they are not meeting profit targets nationwide. Hong Kong is considered much lower risk than either China or its coast, and a higher percentage (%) of respondents report meeting profit targets.

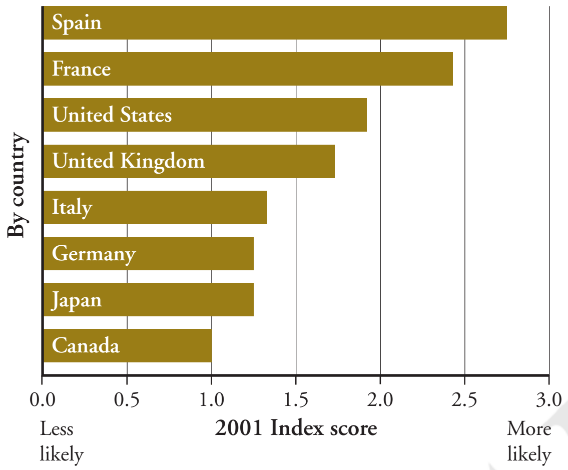
Interestingly, these regional differences allow foreign firms to select varying levels of investment risk. As economic reforms progress nationwide, China's national risk rating may fall as inland regions increasingly share similar regulations, infrastructure and business culture with the medium-risk coastal region.

Brazil

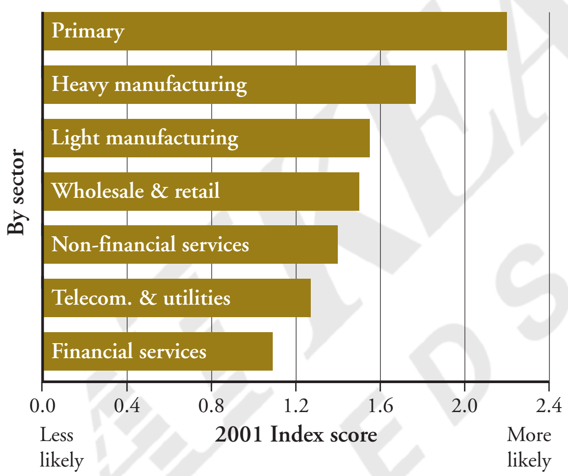
Rank 3, score 1.50

LIKELIHOOD OF INVESTMENT

Foreign firms into Brazil

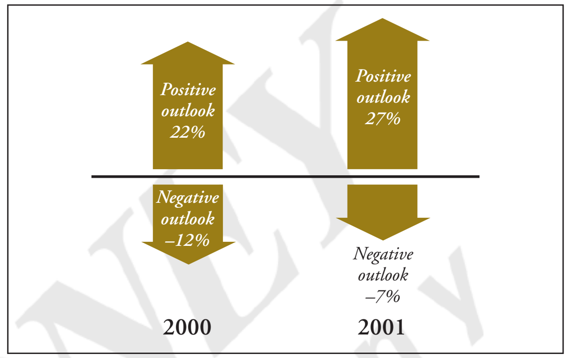


Sectors into Brazil



Source: A. T. Kearney

Outlook on investing in Brazil compared to one year ago



ATTRACTIVE SECTORS FOR INVESTMENT

Primary. Brazil is the second most-attractive destination worldwide for the primary sector following Canada. Approximately 60 percent of CEOs in the primary sector indicate a high likelihood of investment in Brazil and 75 percent have a more positive outlook for Brazil this year than last year.

Heavy manufacturing. More than one-quarter of heavy manufacturing CEOs have a more favorable outlook of Brazil over last year and ranked it the third most-attractive destination for FDI. The size of the Brazilian market, its competent and growing labor force, and access to other South American markets has increased its attractiveness to this industry.

Telecommunications and utilities. The ongoing sales of state-owned power, telecommunications and sanitation companies have provided many investment opportunities. In fact, 75 percent of total FDI into Brazil in 2000 flowed into these sectors and one third of executives from these industries have a high likelihood of investing in Brazil in the near term.

INVESTMENT ENVIRONMENT

(+) Ease of foreign investment. Brazil's investment regulations and ease of project implementation make the country an attractive FDI destination. Brazilian law ensures strict protection of intellectual property rights. The government has actively sought to remove barriers to investment and, for the most part, treats foreign investors as equal to their domestic counterparts.

(–) Opposition to economic reforms. The Cardoso administration could face political difficulties in ensuring that austere fiscal reforms and privatization will continue. Although the government is expected to maintain its reform agenda, the October 2002 election may cause tension as the coalition becomes hesitant to support unpopular reform measures.

Country profile — Brazil

INVESTMENT ENVIRONMENT (CONTINUED)

(+) Regional market access. The majority of global investors consider Brazil's regional market access superior to that of China's or India's. Membership in Mercosur increases Brazil's attractiveness to investors eager to tap into this regional bloc and market of 220 million people.

(+) Skilled workforce. Brazil's large population includes a skilled workforce that is growing at a rate of 3.2 percent annually, higher than the rate of population growth. This educated workforce makes Brazil attractive to manufacturing and high-tech industries.

(–) Privatization nearing an end. Many of the state-owned enterprises have now been sold, diminishing one important source of FDI flows into Brazil. The country has used privatization revenues to counterbalance its current account deficit, and lower levels of FDI could leave the country vulnerable to an external shock.

(–) Additional reforms still needed. Despite the progress that has been made in Brazil in recent years, the country still faces numerous social development issues. Tax and pension reforms as well as overhaul of a notoriously corrupt judicial system are needed.

MAJOR FOREIGN INVESTORS IN BRAZIL

Banco Santander Central Hispano acquired the Brazilian state bank BANESPA for US$3.6 billion, making it the largest single acquisition last year in Brazil.

Fiat, one of Brazil's largest foreign investors, has initiated a project to invest US$1.5 billion over the next three years. The plant will manufacture and market trucks in the Brazilian market, which is Fiat's largest market outside of Italy.

Telecom Italia Mobile paid US$777 million for the right to provide wireless service in two Brazilian regions, and will invest US$1.5 billion to develop the areas.

Portugal Telecom (PT) acquired Global Telecom, Brazil's second largest mobile operator, for US$1.2 billion. PT also merged with Spain's Telefonica in a US$10 billion joint venture, making PT the largest mobile operator in South America.

OUTLOOK

Brazil moves up one spot to 3rd position, displacing the United Kingdom and increasing its market attractiveness score. Nearly one-third of CEOs have a more positive investment outlook toward Brazil compared to only 7 percent of executives who expressed a more negative outlook compared to last year. Brazil was the top destination of choice for first-time investments most seriously being considered for the next three years, with 20 percent of decision-makers expecting to commit new investments to Brazil. This improvement in perception suggests that investors applaud the sound economic policies that the government has followed since the 1999 financial crisis.

Brazil reportedly attracted a record amount of foreign direct investment last year, with US$33.5 billion flowing into the country, up from US$31.5 billion in 1999. Much of FDI revenue for Brazil came from the sale of state enterprises, such as banks and telecommunication services. Privatization and subsequent foreign competition have served as incentives for Brazilian firms to seek higher levels of efficiency. The sale of state-owned firms has also helped to cut the size of the government. Investment outside of privatization also peaked in 2000, rising by almost 20 percent to US$26.5 billion. The record amount of non-privatization investment is an important trend for Brazil as the government will not be able to continue to depend on privatization revenues in the future.

As the world's seventh largest economy, Brazil has a modern and diversified productive sector and strong financial and democratic institutions. Brazil experienced healthy economic growth last year, 4 percent of GDP compared to only 0.9 percent of GDP in 1999. This improvement in growth figures can be credited to exports and industry-led growth. Fiscal and monetary discipline has kept inflation controlled and the government envisions sizeable fiscal surpluses in the primary sector, which in turn will be used to gradually reduce public sector debt. Almost one million jobs were created in 2000, bringing the unemployment rate down to 7 percent. In July 2000, under the improved economic conditions, the Central Bank reduced interest rates.

Spanish CEOs rank Brazil as the most attractive destination for FDI and indicate a very high likelihood of investment. Spanish investment was the largest source of FDI into Brazil last year, topping 21 percent of the country's total inflows and, for the first time, surpassing the United States as the largest source of FDI inflows. The largest acquisition in Brazil in 2000 was made by the Spanish firm Banco Santander Central Hispano, which acquired the Brazilian state bank BANESPA for US$3.6 billion. American and

Country profile — Brazil

OUTLOOK

French executives also indicate a high likelihood of investment. Brazil is the second and third most preferred destination of American and French CEOs respectively.

Primary-sector executives find Brazil the second-most attractive destination for FDI with 80 percent of primary sector CEOs indicating a high or medium likelihood of investment. The primary sector ranks Brazil the highest—among all sectors of the emerging giants *(see figure 15, page 28)*. On October 19, 2000, the Brazilian National Petroleum Agency announced that it would be auctioning off 53 blocks for petroleum and natural gas exploration, the largest such auction by Brazilian authorities to date. The licensing auction will take place in mid-2001.

Risk perception is balanced across all country sources of FDI. Almost 70 percent of CEOs worldwide consider Brazil a medium-risk investment with Spanish and French executives most confident about meeting their profitability targets. A majority of CEOs also consider the São Paulo region a medium-risk environment, with only 13 percent labeling it as low risk. Thus, Brazil's investment attractiveness is not likely limited to any particular area but rather is reflective of the country's overall good image in the minds if investors.

Brazil stands out for its superior investment environment though its current advantages may diminish in the long term. For most investor considerations, such as business climate and investment ease, executives view Brazil as superior to China and India. Brazil does not impose a limit or a tax on profit remittance or capital repatriation. However, a larger number of executives find China to be more attractive than Brazil in the long term. Furthermore, India's attractiveness gains over the 10-year period are much larger than Brazil's. This indicates that decision-makers do not expect significant long-term changes in Brazil's investment environment as they do for the other two emerging giants. Fiscal, monetary and regulatory reforms have already altered the economic landscape of the country while India and China are perceived to have further to go in adopting reforms. Thus, Brazil may have a more difficult time sustaining its rates of FDI growth vis-à-vis the other emerging giants if they move on the same reform agenda—a situation that is reflected in the long-term expectations of executives.

Brazil's membership in the regional trading bloc Mercosur boosts FDI attractiveness. Trade between the Mercosur bloc and the rest of the world has increased 79 percent between 1990 and 1998 and trade between Mercosur member countries has increased five times, from US$4.1 billion to US$21.4 billion in the same time period. Mercosur enhances Brazil's economic potential and the larger market created by Mercosur allows companies within the bloc to enjoy greater economies of scale. The Cardoso administration is very interested in deepening ties within Mercosur, as well as integrating other South American countries into the bloc.

Despite economic and institutional reforms, Brazil still faces a number of challenges including deep income inequality, widespread poverty, and sub-par health and educational standards. Reforms—especially tax reforms—are still needed. The Central Bank has predicted FDI flows for 2001 to fall 19 percent from 2000 levels as privatizations are nearing an end. It estimates that revenue from privatization will fall from US$6.8 billion in 2000 to US$4 billion in 2001. The numbers could increase if the several small state institutions, due to be auctioned off in 2001, yield higher than expected revenues. Foreign investors, while impressed by the efforts that Brazil has made thus far, still complain of heavy taxation and burdensome regulations.

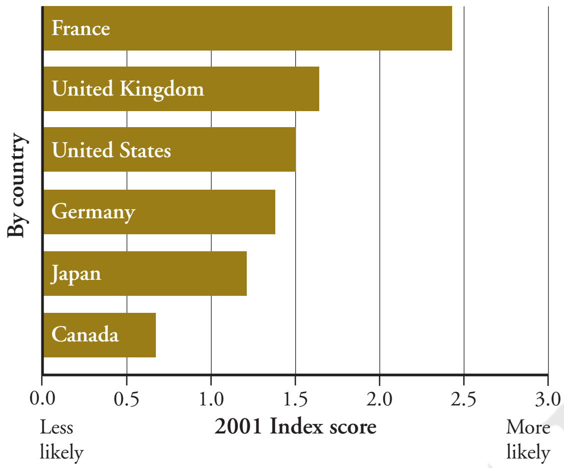
Brazil will undoubtedly continue to attract foreign investment. Brazil's respectable growth rate, its economic and institutional reforms, and its open economy should all lend themselves to a high investor attractiveness.

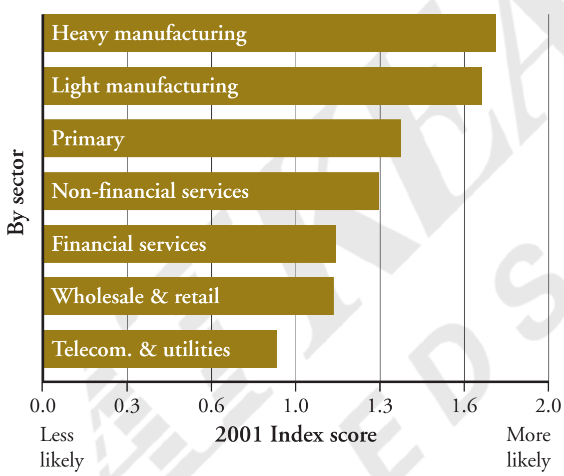
India

Rank 7, score 1.35

LIKELIHOOD OF INVESTMENT

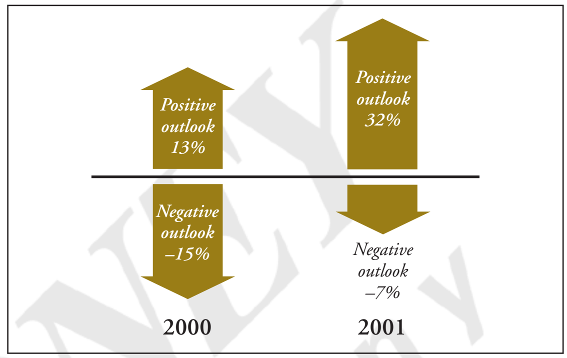
Foreign firms into India





Source: A.T. Kearney

Outlook on investing in India compared to one year ago



ATTRACTIVE SECTORS FOR INVESTMENT

Manufacturing. Firms from the manufacturing sector are the most attracted to India and expressed the highest likelihood of investing there over the short term (one to three years). India's vast domestic market will likely continue to gain the attention of global investors. In order to maintain its WTO commitments, India will further lower trade restrictions in April 2001, making it even more attractive to manufacturers.

Services. Over the past decade the proportion of total global FDI flowing toward service sector activities has been growing steadily. Insurance services, just recently liberalized and now qualified for automatic approval, provide enormous opportunity for foreign investors, particularly given the size of the Indian market and the low degree of existing insurance coverage. The government has recently opened long-distance phone services and direct-to-home broadcasting services to foreign investors, although it has maintained equity caps for foreign ownership. Print media and retail trade, two other potentially attractive sectors for FDI, remain closed to outside investment.

INVESTMENT ENVIRONMENT

(+) India's potential reflected in long-term attractiveness. India's potential makes it a more attractive market in the long term. Services firms expressed the strongest opinion regarding short- versus long-term attraction. Non-financial services executives indicated that India will be 70 percent more attractive in 10 years than it is now; the financial sector sees a near 40 percent increase in investment appeal over the same term. Utilities firms also perceive a higher than average boost (37 percent) over a 10-year period.

Country profile — India

INVESTMENT ENVIRONMENT (CONTINUED)

(+) Opportunities for M&A exist. Close to two-thirds of executives believe that India provides better opportunities for FDI through M&A than China does. While Brazil leads the emerging giants in this respect, the existence of M&A targets, if properly promoted, can aid India in substantially increasing FDI flows. Financial, non-financial services and utilities express the stronger preference for India over China in this respect.

(+) Competitive regulatory regime. Corporate investors clearly position Brazil at the top of categories such as "investor-friendly regulatory regime" and "ease of project implementation." India and China, however, battle for second place, facing similar and difficult investment regulatory regimes. European executives stand out for preferring India's regulatory framework, while the majority of Japanese and American decision-makers have an easier time dealing with the Chinese investment regime.

(–) Less attractive for investment in the short term. India lags China and Brazil in near-term attractiveness. Significantly, the utilities sector finds India only half as attractive as it does Brazil, and 40 percent as appealing for investment in the short term as it does China. The wholesale and retail sector also puts India notably behind China and significantly below Brazil in the short term.

(–) Negative image as an export platform. Two factors affect India's potential as an export platform. First, the world market does not perceive the "Made in India" label to be synonymous with quality. Second, export costs are perceived to be higher as a result of inadequate infrastructure (including roads, railroads and ports) and taxes levied on the transportation of goods from state to state.

MAJOR FOREIGN INVESTORS IN INDIA

Enron, the U.S. energy producer, is one of India's largest foreign investors and has made the country's single biggest foreign investment—a US$2.2 billion electricity generating plant in Dabhol.

Dow Chemical has proposed a US$1 billion joint venture to establish over the next three years a naphtha cracking plant that will produce polyethylene and polypropylene.

Hutchinson Whampoa is one of the largest foreign investors in India's mobile telephone market and the company recently invested an additional US$500 million in mobile assets.

American International Group, encouraged by service sector reform plans to sell life insurance, intending to invest US$20 million in India. This would bring its total investment to US$220 million.

IBM has recently received approval for additional investments in the Indian software sector. The proposal includes manufacturing, marketing and export of computer systems and network product software.

OUTLOOK

India is recovering lost ground in the eyes of corporate investors. Having dropped from sixth to eleventh place in 2000, India now rejoins the top 10 in the Index, taking seventh place in market attractiveness. One-third of senior executives say their outlook has improved over the previous year. India's Index score rose 18 percent over the previous year, jumping to 1.35 from 1.14. This notable transformation in perceptions makes India second only to Mexico in renewed investor optimism.

French and German executives expressed the highest likelihood of investing in India over the next one to three years. They surpassed British and U.S. investors, who had shown the most interest in the market last year. India ranked as the fourth most-attractive market for short-term investment for both French and British firms. From an industry perspective, manufacturing firms and non-financial services companies have the highest probability of investing in India over the short term. Financial services firms, though not as likely to invest heavily in the country over this year, did significantly change their outlook, going from zero to a 37 percent positive change in outlook over the year 2000.

Although FDI dropped in 1999, it is estimated that foreign flows into India will regain momentum, reaching an estimated US$2.6 billion in 2000. The government has set as its goal to quadruple this amount, and after Prime Minister Vajpayee's visit to the United States last year, possible deals of up to US$5 billion were announced. The Indian economy grew by a substantial 6.4 percent last year, on par with average economic growth throughout the late 1990s. Stable agricultural output and growth in the export sector (11.4 percent) helped India's performance, and inflation last year (4.7 percent) remained several points below the historic average. Despite India's devastating earthquake this January, the national economy has not been deeply disrupted. However, India's large trade and fiscal deficits give cause for concern.

The 1990s witnessed spectacular growth in FDI flows to India, propelled by the economic reforms set forward at the

Country profile — India

OUTLOOK

beginning of the decade. The country registered a 15-fold increase in foreign direct investment, leaping from its small base of US$234 million a year in 1990 to US$3.57 billion in 1997. But by 1999, FDI flows were again below 1996 levels at US$2.17 billion. India's nuclear tests in May 1998 as well as the flight from emerging markets in the wake of the Asian crisis reduced inflows. Latest data available from the Reserve Bank of India estimates that a slight increase will be observed for 2000, with a forecast of US$2.63 billion in FDI. Yet, with over one billion people, India's estimated per capita FDI inflow for 2000 comes in at a mere US$2.63, while China received US$ 40.4 and Brazil US$ 31.4 per capita. In a regional context, FDI flows to India represented little more than 2 percent of inflows to South, East and Southeast Asia and 1 percent of inflows to all emerging markets in 1999.

More than 60 percent of India's foreign investment dollars flowed into a few sectors: engineering, electronics and electrical equipment, food and dairy products, chemical and allied products, services and computers. Close to 80 percent of these flows come from an equally select group of countries: Mauritius (which, as a tax haven, channels investment flows from other countries), Japan, Italy, Germany, South Korea, the United States and the Netherlands.

Market size and potential give India a definite advantage over most other comparable investment destinations. Executives cite India's highly educated workforce with strong technical capabilities and competitive wages as a strong investment asset.

The country's investment profile, however, is also conditional, based on factors that inhibit foreign direct investment. Excessive bureaucracy tops the list of investor concerns, and in the long run, could act as the greatest barrier to increasing FDI flows by undermining India's ability to materialize investor interest. A perceived slowdown in the reform process also generates doubts about the market's long-term potential. Also, India has historically realized only one out of every five dollars of announced FDI. Unlike China and Brazil, investor interest does not easily translate into actual flows of investment.

Attempts to create investment opportunities in oil and natural gas, trading activities, power, roads, telecommunications and tourism lie at the core of the Indian government's investment promotion efforts. However, these industries represent less than one-quarter of global FDI flows, and the relatively more important services sector has not been the focus of government policies.

This need for more aggressive promotion of the services sector is made more pressing by the stiff market competition posed by China and Brazil. In 1999, the Brazilian services sector alone captured US$7 billion, more than twice the total amount of FDI received by India that year. In the same year, China quadrupled India's capture of telecom services investment. Together, telecom, high-tech and financial services FDI represented slightly over 15 percent of total flows to India in 1999, leaving the market far from saturated with this type of investment. The convergence of investor interest, and the existing opportunity to benefit from a global trend of increasing services sector flows, provides a watershed for redirecting India's investment promotion strategy.

Recent A.T. Kearney research reveals that although senior executives consider China to be a comparable investment destination to India, the majority is more inclined to invest in China than in India. This result is consistent with China's five-spot lead over India in the Index this year. In the telecommunications and high-tech sector, China is an especially strong competitor for FDI. The majority (83 percent) of telecom and high-tech participants believe that China and India have comparable investment climates. However, 75 percent of these executives are more inclined to invest in China than in India, with the remainder planning to invest equally in both countries.

FDI Confidence Audit participants viewed China and India as close rivals in terms of market size and potential; however, the majority of respondents (84 percent) believe that the Chinese market is larger than India's for their products. For example, nearly one-quarter of respondents state that China's market for their product is twice as large as India's while another one-quarter indicate that China's market is 10 times larger. In addition to market size, *Audit* respondents note several other comparable factors between the two countries, including demand, workforce, economic development, and the state of the countries' infrastructure.

When asked to volunteer factors that distinguish India and China as investment destinations, no participant mentioned language. However, when probed specifically about India's English-speaking population, telecom and high-tech, consumer products, and power and utilities firms consider it to be a significantly positive distinguishing characteristic. In fact, two-thirds of the telecom and high-tech respondents note that India's English-speaking population differentiates it from China as an investment destination.

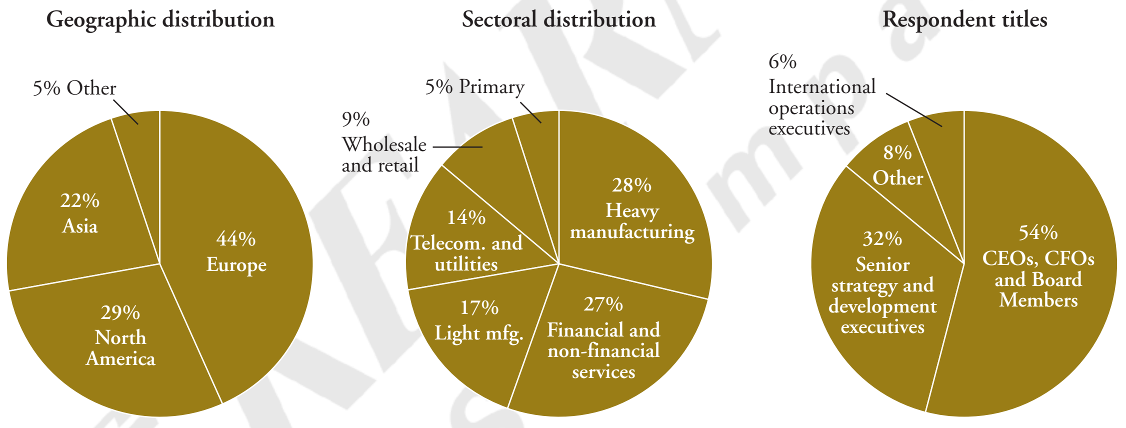
To capitalize on its potential for FDI, India needs to accelerate efforts to institutionalize government efficiency and continue to implement promised reforms. Other strategic efforts should include focusing the market on India's relatively high rates of return and long-term potential, addressing the issue of transforming the country into a viable export platform, and encouraging strategic alliances with foreign investors.

For more information, visit www.atkearney.com.

Methodology

The FDI Confidence Index was constructed using primary data from a proprietary survey administered to senior executives of the world's 1000 largest corporations. The survey was designed to gauge the likelihood of investment in specific markets in order to gain insights into likely trends in global FDI flows over the next one to three years. The population of companies was selected from the Global 1,000, as determined by 1999 revenues. The 1,000 companies that received surveys represent 41 countries and 20 different industries (as categorized by three-digit SIC codes). These firms, furthermore, had combined corporate revenues of over US$13 trillion in 1999. The countries represented in the survey account for 90 percent of total global FDI flows in 1999.

Profile of FDI Confidence Index participants



Source: A. T. Kearney

The participating executives include CEOs, CFOs, Board Members, and senior corporate strategists from 35 countries and 19 specific industries. The participating companies closely approximate the country and sector coverage of the Global 1,000 population, and generate US$2.3 trillion in annual sales.

The Index was computed as a weighted average of the number of high, medium, low and "no interest" responses to a question about the likelihood of direct investment in a market over the next one to three year period. Index values are based on non-source country responses about various markets. For example, the Index ranking for the United States, Germany and Canada reflects all non-U.S., German and Canadian company responses about these markets, respectively. All Index values have been calculated on a scale of zero to three, with three representing highly attractive and zero not attractive.

The main secondary sources used in this analysis are UNCTAD, the World Bank, the International Monetary Fund, the OECD Economic Outlook, the EBRD, the UN-ECLAC and the Economist Intelligence Unit. Additional sources used in the Emerging Giants Profiles include: country investment promotion agencies, country central banks, country ministries of finance or trade, as well as major newspaper and magazines.

A.T. Kearney's Global Business Policy Council administers the FDI Confidence Index® survey every year.

February 2001		January 2000		June 1999		December 1998		June 1998	
RANK	COUNTRY	RANK	COUNTRY	RANK	COUNTRY	RANK	COUNTRY	RANK	COUNTRY
1.	United States	1.	United States	1.	United States	1.	United States	1.	United States
2.	China	2.	United Kingdom	2.	China	2.	Brazil	2.	Brazil
3.	Brazil	3.	China	3.	United Kingdom	3.	China	3.	China
4.	United Kingdom	4.	Brazil	4.	Brazil	4.	United Kingdom	4.	United Kingdom
5.	Mexico	5.	Poland	5.	Mexico	5.	India	5.	Germany
6.	Germany	6.	Germany	6.	India	6.	Mexico	6.	Poland
7.	India	7.	Mexico	7.	Australia	7.	Poland	7.	India
8.	Italy	8.	Italy	8.	Poland	8.	Argentina	8.	Mexico
9.	Spain	9.	Spain	9.	Germany	9.	Australia	9.	Spain
10.	France	10.	Australia	10.	France	10.	Germany	10.	France
11.	Poland	11.	India	11.	Italy	11.	Spain	11.	Italy
12.	Canada	12.	France	12.	Canada	12.	Italy	12.	Argentina
13.	Singapore	13.	Canada	13.	Spain	13.	Russia	13.	Netherlands
14.	Thailand	14.	Thailand	14.	Argentina	14.	Hungary	14.	Australia
15.	Australia	15.	South Korea	15.	Thailand	15.	Thailand	15.	Thailand
16.	Czech Republic	16.	Japan	16.	Czech Republic	16.	Czech Republic	16.	South Korea
17.	South Korea	17.	Netherlands	17.	South Korea	17.	Canada	17.	Canada
18.	Netherlands	18.	Czech Republic	18.	Hungary	18.	Indonesia	18.	Czech Republic
19.	Taiwan	19.	Argentina	19.	Netherlands	19.	France	19.	Japan
20.	Japan	20.	Hungary	20.	Singapore	20.	Chile	20.	Ireland
21.	Hungary	21.	Singapore	21.	Japan	21.	South Korea	21.	Hungary
22.	Malaysia	22.	Malaysia	22.	Malaysia	22.	Malaysia	22.	Singapore
23.	Turkey	23.	Taiwan	23.	Taiwan	23.	Japan	23.	Chile
24.	Argentina	24.	Belgium	24.	Philippines	24.	Singapore	24.	Belgium
25.	Hong Kong	25.	Ireland	25.	Hong Kong	25.	Philippines	25.	Taiwan

Source: A.T. Kearney

A.T. Kearney is an innovative, corporate-focused, e-business consulting firm and one of the largest high-value management consultancies. The firm was established 75 years ago to focus on management advice and issues on the CEO's agenda. Our 5,000 employees worldwide serve the largest global clients in all major industries. A.T. Kearney's offices are located in 60 cities in 35 countries in Europe, Asia Pacific, the Americas and Africa.

AMERICAS

Atlanta
Boston
Buenos Aires
Caracas
Chicago
Cleveland
Dallas
Detroit
Los Angeles
Mexico City
Miami
Minneapolis
New York
Plano
San Diego
San Francisco
São Paulo
Silicon Valley
Stamford
Toronto
Washington, D.C.

AFRICA

Johannesburg

ASIA PACIFIC

Beijing
Hong Kong
Jakarta
Kuala Lumpur
Melbourne
New Delhi
Seoul
Shanghai
Singapore
Sydney
Tokyo
Wellington

EUROPE

Amsterdam
Barcelona
Berlin
Brussels
Budapest
Copenhagen
Düsseldorf
Frankfurt
Geneva
Helsinki
Istanbul
Lisbon
London
Madrid
Milan
Moscow
Munich
Oslo
Paris
Prague
Rome
Stockholm
Stuttgart
Vienna
Warsaw
Zurich

For more information or additional copies, contact Marketing & Communications at:

A.T. Kearney, Inc.
222 West Adams Street
Chicago, Illinois 60606 U.S.A.
1 312 648 0111
fax 1 312 223 6200
email: insight@atkearney.com
www.atkearney.com

EDS, the leading global services company, provides strategy, implementation and hosting for clients managing the business and technology complexities of the digital economy. EDS brings together the world's best technologies to address critical client business imperatives. It helps clients eliminate boundaries, collaborate in new ways, establish their customers' trust and continuously seek improvement. EDS, with its management consulting subsidiary, A.T. Kearney, serves the world's leading companies and governments in 55 countries.

ATKEARNEY ®
an EDS company

301/7.5M/497