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THE LAUDER GLOBAL BUSINESS INSIGHT REPORT

Facing — and Embracing — Change



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Across the world, business leaders, policy makers and ordinary citizens are coming together to effect change and create a better tomorrow. As they look to what worked in the past, they face the future knowing that growing pains are inevitable. In this special report, students from the Joseph H. Lauder Institute for Management & International Studies traveled the globe to offer unique perspectives gleaned from interviews, observation and research into the ways countries are confronting change on a global scale.

Dive into the politics of culture as developing economies work to redefine their identity in the face of unprecedented global change. A similar struggle is taking place across Europe, where the resettlement of millions of refugees is raising tough questions about how to integrate them into society.

All countries seek to expand their economies, but the best path forward isn't always clear. The divergent interests of stakeholders, budgetary constraints, history, ideology and other factors combine to create formidable obstacles to growth. In Brazil, for example, the national bank is working to emerge from a recent scandal, redefine itself and establish new ways of doing business that will help spur the economy. Meanwhile, a project in South Africa is helping black entrepreneurs hurdle the legacy barriers left from the days of apartheid.

Technology also poses a challenge for nations just trying to keep up with the lightning speed of change. E-commerce and big data have the potential to revolutionize business in Brazil and Colombia, but success requires a heavy investment in infrastructure. Finally, environmental concerns are causing the public and private sectors to re-evaluate the impact of human activity.

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Making ‘Womenomics’ Work: Encouraging Employment Equality in Japan

Political and cultural barriers have created a persistent gender gap in the Japanese labor market, but that is slowly changing. While there is still much work to be done, the public and private sectors are pushing forward with “womenomics.”

Many of the scholars who are studying the looming demographic crisis in Japan propose the same solution: leverage the potential of women in the workforce. Women traditionally have been an underutilized resource in Japan’s labor market. In 2013, Japan ranked 105 out of 135 countries in the World Economic Forum’s Global Gender Gap Report. Female employment in Japan is characterized by an M-shaped curve, with 60% of women dropping out of the workforce after getting married and returning only after their children have left home. Evidence supports the

demonstrated his commitment to encourage greater female participation in the workforce, which became one of the three “arrows” of the Abenomics policy. His administration’s specific goals are to increase female participation in the workforce by 3 million and target 30% of managerial positions to be filled by women by 2020. Since the introduction of “womenomics,” about 1 million women have entered the labor market. However, a wide gender gap persists. This article outlines the structural and policy initiatives implemented so far and examines some of the remaining challenges and social barriers.

Women who must leave work earlier to care for children can be perceived negatively, regardless of their actual contributions.

premise that if the country can unleash the talent of women in the workforce, it will achieve higher economic growth, thus reducing the burdens of an aging population.

Prime Minister Shinzo Abe’s 2013 speech at the 68th Session of the United Nations General Assembly

Explaining the Status Quo

One reason frequently cited for gender disparity in Japan involves the expectations surrounding women’s childrearing responsibilities. The country is known for a corporate culture that praises hard work and long hours. In this strong face-time culture, where employees sometimes feel pressured to stay at the office until their boss goes home, women who must leave work earlier to care for children can be perceived negatively, regardless of their actual contributions. This mindset applies to after-hours gatherings as well. After-work drinks and get-

togethers among colleagues are a crucial aspect of forming relationships within Japanese companies, including with upper management. New mothers who cannot participate might be at a disadvantage during promotion discussions. In addition, the lifetime employment system and the tendency to promote based on the number of years an employee has been at a company make it more difficult for women to return to an organization after maternity leave. The high cost of any missed time may explain, in part, why fewer than 2% of men take paternity leave, according to government statistics.

Both the strong emphasis on continuous participation and expectations that women will leave the workforce after having a child influence hiring decisions. Japan has a two-tiered hiring system: one for career-track workers, called *sogoshoku*, and another for administrative workers, called *ippanshoku*. According to the Japanese Ministry of Labor, Health and Welfare, in 2014 only 22.2% of the *sogoshoku* were female, compared with 82.1% of the *ippanshoku*. The belief that men are largely in career-track positions while women are predominantly in support roles can lead to discrimination toward the latter group. According to Natsuko Tanaka, a woman who works in the Tokyo office of a global technology company, “men in their late 40s to 50s still expect women to pour their drinks whenever we are out.”

Harassment toward pregnant women, called *matahara* (short for maternity harassment), is also well documented. For example, women who become pregnant are sometimes bullied, accused of being a burden or forced out of the company. According to a 2015 survey conducted by the Japanese Trade Union Confederation, 20.9% of working females have experienced *matahara*.

Structural factors also contribute to Japan's corporate gender disparity. From a practical standpoint, it can be difficult for women in Japan to work full time while raising a family. For example, there is a chronic lack of day care facilities in urban areas, where more than 23,000 children are currently on waiting lists. In addition, Japan's strict immigration policies allow only foreign diplomats to hire foreign housekeepers, so it is difficult to find child care help if one lacks access to a family support network. Due to the difficulties of raising a child while working, many women must choose between having a family or a career. “Of my

female colleagues at my firm who are married, I would say half choose not to have kids just because they know how hard it is to juggle both career and family,” Tanaka said.

Other structural drivers include the country's social security system and tax code, which provide strong incentives for women to stay out of the workforce. The head of the household in Japan, typically the husband, can receive a special reduction of about US\$3,500 from taxable income if the spouse earns less than US\$9,400 annually.

Due to the difficulties of raising a child while working, many women must choose between having a family or a career.

Public and Private Initiatives

In order to increase women's workforce participation, particularly in high-paying corporate roles, a number of initiatives have been enacted by the government and corporations. The government's approach emphasizes two aspects: support for life events that impact women's careers disproportionately, such as marriage, childbirth, child care and senior care; and women's career empowerment, including recruiting, career-switching, work-life balance and promotion improvement.

Life-event support plays a critical role in enabling women to continue to work while raising children or taking care of elderly parents. For example, a bill passed in 2016 grants subsidies to corporations that allow men to take paternity leave. Some local governments give an allowance benefit of US\$200 a month to working mothers for child care. In addition, the spousal income-tax deduction was amended in 2017 to lift the income threshold from US\$10,000 to US\$14,000 to mitigate the disincentives for women to step into more high-paying positions. Local governments have also been working closely with the private sector to increase the capacity of child care facilities. The Japanese government has pledged to subsidize 400,000 day care spots by 2018 to free young mothers from time constraints. In addition, the government has increased the budget to

subsidize eldercare workers in rural areas, where many women have to quit their jobs in the city to take care of their ailing parents.

Meanwhile, the government has endorsed career empowerment to promote a more frequent and higher level of female employment. Legislation to protect equal employment in Japan was not introduced until 1986, 22 years after the United States took this step. In 2015, amendments on sexual harassment and discrimination against pregnant women were added to the equal employment opportunity law. It is now illegal for employers to lay off women who choose to take maternity leave. Another part of the government strategy promotes more female role models in the corporate sector. Prime Minister Abe has set an ambitious goal to have women occupy 30% of leadership positions in the public and private sectors by 2020, which is nearly five times the current rate of 6.6%.

The Japanese government has also put protocols in place to encourage companies to increase the overall number of female employees. In 2015, legislation was passed that requires corporations with more than 300 employees to report the percentage of new hires who are women and the percentage of women who comprise the management team. Moreover, each company that has figures significantly below the national average must provide the local government with its action plan to track its performance review and improvement.

Companies are also taking steps to better accommodate female employees. For example, Chie Kobayashi, from Nissan's human resources department, addresses how her company is actively seeking to incorporate the participation of female car dealers. "We have established a diversity committee that works with recruiting and HR to cultivate future female leaders," she said. "We have also doubled the number of employees who can telecommute for family reasons."

Some companies in Japan have built their own day care centers for female employees with children. Kent Garneau, chief financial officer of Asia Pacific Securities Division at Goldman Sachs' Japan office, said his company provides day care for all employees. "Our firm may have lost out on many talented female employees if we did not offer this service," he said.

Challenges and Unaddressed Issues

While Japan is taking steps to address women's workforce participation and has made progress, the issue may prove difficult to solve through policy initiatives alone. In addition to the structural issues that have been the focus of policy initiatives, there are many social and cultural barriers that are more complicated to resolve in the short term.

For example, gaps in women's abilities and desires to participate in corporate life appear from a young age. While 45% of Japan's college graduates are women, they comprise only 19% of the student body at the University of Tokyo, Japan's top-ranked university. In the country's highly education-driven society, attending a top university can be a prerequisite for employment at the best companies. Acceptance into Japanese universities is determined almost exclusively by challenging entrance exams that students must begin preparing for as early as grade school. Accordingly, to increase gender diversity at the managerial level, it will be necessary to address setbacks even earlier in the educational pipeline.

In addition to educational discrepancies, many women do not seem enthusiastic about participating in Japanese corporate life. According to a 2017 analysis by Sony Life, only 6.2% of the women surveyed felt enthusiastic about their current career position. In addition, fewer than 20% said they would accept a managerial position. Ongoing work-life-balance reforms that address the long hours and inflexible lifestyle may improve perceptions of working for corporate Japan and mitigate this problem somewhat. However, according to the same Sony study, 80% of the participants believed that women are at a disadvantage when it comes to working in Japan, and only 50% of women felt they are paid a salary equal to their male peers. Clearly, much more work needs to be done to create an environment where women feel they have equal opportunities to succeed.

While the total employment rate for women in Japan is over 60%, about 55% of working women hold irregular positions, such as part-time and temporary jobs that pay lower salaries and offer fewer benefits. The increasing utilization of nonstandard employment in Japan — an issue for both men and women — needs to be addressed to ensure that gains in labor participation will provide

meaningful financial security and opportunities for all Japanese women.

Finally, making real progress in attaining work equality means addressing underlying social norms and expectations. For example, the ideal that a woman's role as a mother takes precedence over all is still ingrained in the Japanese culture. According to a 2016 survey by the cabinet office, only half of the Japanese people approve of women continuing to work after having a baby. "Mindset differences exist between men and women," said Tsukiko Tsukahara, president of Catalyst, a global nonprofit that helps companies build up female employment. Research by Catalyst shows Japanese men spend an average of 1 hour and 7 minutes a day on housework and child care, which is less than half of American men's average of 2 hours and 45 minutes. Reducing the stigma surrounding men's participation in domestic duties — such as household chores and childrearing — will be necessary for Japanese women to be able to balance family and career. This will require advocacy from both men and women.

Women have the potential to play key roles in invigorating economic dynamism as Japan faces a rapidly aging

Women have the potential to play key roles in invigorating economic dynamism as Japan faces a rapidly aging population and a shrinking working population.

population and a shrinking working population. Unlocking women's potential and reducing gender inequality will require serious efforts by the public and private sectors as well as long-term social change to address the underlying causes that put women at a disadvantage in their careers.

This article was written by Shunsuke Aonuma, Jiayi Li, Michael Rosenzweig, Vishal Soam and Rachel Winograd, members of the Lauder Class of 2019.

Refugees in France and Germany: Governmental and Nongovernmental Support

The number of internationally displaced persons is at an all-time high, according to the United Nations. Europe has been hit especially hard because of its proximity to troubled countries in the Middle East and Africa, and governments are struggling to deal with the influx. This article showcases different responses and how nongovernmental organizations are helping fill the gaps.

Europe has been experiencing an extended crisis of displaced persons that has developed into an unprecedented humanitarian emergency. By the end of 2016, 5.2 million refugees and migrants had made their way to the European Union from Syria, Iraq, Afghanistan and other countries ravaged by war, political strife and economic troubles. France and Germany, two of the largest countries in the European Union, are struggling to manage the formal state-run systems by which migrants seek asylum and the integration of those who obtain refugee status. According to the United Nations Refugee Agency (UNCHR), there were 304,546 refugees, 62,771 asylum seekers and 1,370 stateless persons in France at the end of 2016. At the same time in Germany, there were 669,482 refugees, 587,346 asylum seekers and 12,017 stateless persons in Germany. The formal integration processes in both countries are falling short of fully serving the needs of refugees. Nongovernmental organizations (NGOs) in Germany have filled significant gaps in providing aid to refugees, while those in France have not had a significant impact.

France and Germany are struggling to manage the formal state-run systems by which migrants seek asylum and the integration of those who obtain refugee status.

Different Government Responses

In France, refugees who have gained official status as defined by the Geneva Convention have already completed a grueling administrative and legal process, beginning with their request for asylum through the national office

of refugees and stateless persons of France (l'Ofpra). L'Ofpra requires an extensive application and interview. The average wait for a decision from this office in 2015 was 262 days. During this time, an asylum seeker does not have the right to work in France and may not have a place to live. Even though lodging is available for asylum seekers throughout the country, the process is not well run or organized, as demonstrated by camps of migrants living on the street, such as those found at Porte de la Chapelle in one of Paris' northern districts.

Porte de la Chapelle demonstrates the systemic holes in the French government's management of migrants. Migrants of varying legal statuses who did not have other shelter made their way there to sleep under the highway. In 2015, the French government began its first mass evacuation effort to put all of them into housing. Since then, evacuations have been conducted on a regular basis. In November 2016, as a result of the ever-increasing number of migrants sleeping on the ground every night at Porte de la Chapelle, the government of Paris opened a welcome center there to process migrants seeking refuge on French soil and to provide very short-term housing (400 beds) for solo male migrants. Today, the wait time to enter this facility can range from days to weeks. That the demand exceeds the 400-bed capacity is evident in the number of people who remain on the street, waiting for their turn to enter.

Samu Social France and Singa, two French NGOs designed to help refugees, have not yet succeeded in filling the gaps in the French government's processes for integrating refugees. In 2016, the French government pledged to increase housing for refugees, and Minister of the Interior Emmanuelle Cosse called on NGOs across the country to assist in the process of placing refugees in French homes in exchange for monetary incentives (up to €1,500 per person per year). Even a joint venture such as this has barely

scratched the surface in alleviating the issue of temporary housing for refugees. Migrant homelessness remains a widespread problem. The streets of Porte de la Chapelle remain filled with people. In July 2017, police removed nearly 3,000 migrants from squalid conditions there and transferred them to temporary housing. It was the 34th time the government undertook such action since 2015.

French President Emmanuel Macron recognizes that Europe is facing an unprecedented migratory crisis exacerbated by geopolitical issues ranging from violence in the Middle East to weakened economies. While he sees offering asylum to persecuted peoples as “France’s duty and honor,” this offer extends only to refugees seeking protection. He has said that the EU cannot possibly accept all those “in pursuit of a better life.” In essence, thousands of migrants in France who do not qualify for refugee status under the relatively rigid Geneva Convention definition are in a precarious legal position. Although many displaced Syrians have arrived in Europe, a majority of asylum recipients in France in 2015 were Sudanese. In addition to Syria and sub-Saharan Africa, there is significant migratory pressure coming from Kosovo, Bangladesh, Haiti and Afghanistan. It is unclear how Macron’s focus on refugees will change the pressure on the French system to provide a quick and dignified response.

In 2017, Macron and Prime Minister Edouard Philippe passed several measures to address the migration crisis. First, they proposed reducing the delay in processing asylum seekers from two years to six months, in addition to streamlining the process for repatriating those who are not granted asylum. The French government also pledged to build facilities to accommodate 7,500 additional migrants by the end of 2019. However, the reality persists that France is not culturally predisposed to diversification, as evidenced by its integration policies. Its objective regarding immigration is to prioritize integration, with language study at the forefront. Macron’s party, En Marche, maintains that “integration in France depends above all on the mastery of the language,” requiring that all immigrants seeking nationalization obtain B1 (intermediate) language-level certification. Beyond the language requirement, integration programs include cultural assimilation and a civil course covering France’s “essential values.” The country’s policies prioritize integration through study of the language and

culture, from offering access to language courses to achieving a minimum level for nationalization to demonstrating knowledge of the local culture. Asylum is granted only to those who demonstrate sufficient knowledge of French society through both language skills and an understanding of cultural values. These policies reflect simultaneous acknowledgement of the EU’s collective responsibility to accommodate refugees and the French desire to preserve a national identity.

In Germany, the federal government has responded to the recent influx of refugees by means of numerous government mechanisms implemented largely at the *bundesland* or state level. These measures range from definitional to programmatic, from defining how external educational degrees will be recognized to developing outreach from the German higher education system to

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provide opportunities to refugees. Language and education are perceived as critical to successful integration, with the overarching goal of facilitating workforce participation. However, official government support measures do not suffice for the majority of these asylum-seeking migrants. A particular challenge is the long period between arrival and attaining both lingual sufficiency and the legal standing required to take part in government-led programs. For example, one must typically achieve a B1 level of German ability and either “good staying potential” or approved status to live and work in Germany. It typically takes a year, and often much longer, to secure both. That’s a long time during which these individuals must live within their *heim* (home, the word commonly used to refer to regulated living quarters for refugees) and may not pursue the education and work opportunities ostensibly available to them.

Civil Society's Response

In France, there is anecdotal evidence that civil society has been slow to fill in the gaps left by the government. For instance, there were more than twice the usual number of applications from German civil society organizations (CSOs) to the 2016 European Economic and Social Committee's Civil Society Prize, which funds work with migrants. French CSOs that do engage tend to be larger and centered on ensuring that migrants receive basic aid (e.g., food, blankets and clothing), rather than a more small-scale, community-led effort. There is research that indicates the stronger religious infrastructure and lower birth rates in Germany could be primary factors in the differing responses between France and Germany. Another factor may be the French government's ambivalence to nongovernmental organizations taking on a larger role. As recently as February 2017, *Solidarité Migrants Wilson*, which serves food to migrants at Porte de la Chapelle, was fined by the government for illegal parking during meal-service periods. Nevertheless, several NGOs in Paris are working to integrate refugees organically into French society. The nonprofit Techfugees regularly holds weekend hackathons, where mixed teams of refugees and French citizens come together to pitch technology-led solutions to refugee challenges. Topics range from cultural integration via sports to consolidated, up-to-date information on asylum claims. Macron's government has been eager to support organizations such as Techfugees, suggesting that the new administration may push further for civil society solutions to act as a stopgap for bureaucratic shortcomings.

Aware of the challenges asylum seekers with neither language skills nor visas face, many individuals, NGOs and public-private partnerships have emerged in Germany. At the most grass-roots level, initiatives such as Anna Gyulai Gaal's Refugee Supper Club seek to provide informal income and integration opportunities for Syrian asylum seekers who have not yet achieved the language level or visa status required to take part in the formal labor market. More complex partnerships, such as the Moving Network, provide broader support and empower refugees through self-led education spanning German culture to technical skills. Entrepreneurs have also risen to the challenge. For example, Cucula furniture company's program participants are paid employees who have a customized shift schedule

that allows for in-house language and career courses, so the employed refugees can simultaneously earn a living and receive the education required to succeed.

On the most collaborative end of the spectrum lie publicly funded organizations selected by the government to address refugees' needs that are not met by existing programs. Some of their activities focus on identifying job opportunities, often working in partnership with federal agencies that track labor-market needs, and preparing new asylum seekers for these opportunities. Arrivo Berlin and its sub-projects, such as the hospitality-industry-focused Project Hospitality, do just this. They recruit refugees into Germany's dual education system, in which participants receive classroom education in combination with practical apprenticeships to deepen skills through real-world applications. As an independently run entity, Arrivo Berlin communicates directly with potential apprentices and full-time employers to develop mutually beneficial labor-market matches. Arrivo Berlin highlights a common "use case" for its business partners and program participants — persuading a private employer to employ a program participant who has yet to meet the required language or technical skill level while simultaneously working with that student to fill his or her skill gaps through language or technical skill-training sessions.

Still, many of these grass-roots initiatives struggle with an unsettling prospect: All of their work might be for naught. As Nadja Türke, project manager at Arrivo Berlin, explains, many asylum seekers do not yet know whether their futures lie in Germany. She notes that a significant segment of the refugee population in Germany intends to either travel on to other countries or return to their home countries after the conflict ends. Thus, organizations that strive to persuade employers to invest time and resources in training refugees risk losing critical collaboration partners if trainees do not follow through on their commitment. Those funding such ventures must decide whether their willingness to invest in these refugees' futures is contingent upon where those futures will take place. Corinna Sy, founder of Cucula, the German furniture-making venture that employs refugees, notes a similar dynamic within Germany can also be a challenge. Refugees often arrive with no other options for employment and opt into the solutions available at the time. But once they

have settled into a stable position, they may shift toward a different field. For employers making the investment to recruit, onboard and support these employees through job training, language, legal and other facets of their arrival in Germany, this turnover can be frustrating.

Germany's civil society appears to be engaging more deeply with asylum-seeking migrants in order to fill the gaps between official efforts and refugees' needs. In addition to the economic impact of Europe's ability — or inability — to integrate refugees successfully, it is important to consider the identity-related implications of integration.

How might integration impact refugees' sense of identity? Conversely, how might Germany and France's identities as countries shift as they integrate large communities from diverse cultures? While it is certainly too early to predict, the differing approaches described above will certainly contribute to longer-term cultural dynamics in Germany, France and all the other European countries seeking solutions to current migration challenges.

This article was written by Katelyn Halldorson, Lily Rogath, Alexandra Salzman and Judith Ternes, members of the Lauder Class of 2019.

The Economic and Social Dimensions of India's Cow Politics

In India, cows have become more than just livestock. This humble farm animal is at the epicenter of a growing debate that has affected nearly every sector of society — from government to religion to culture to the economy — and sparked a surge of violence. This article explains how national identity is at the heart of so-called cow politics and what it means for the country's future.

It was a hot day in June 2017 when 15-year-old Junaid Khan, who was traveling to Delhi with his brother by train to buy new clothes for the Muslim holy festival of Eid, became embroiled in an argument with his fellow passengers over seating. The argument soon escalated to include insults about religion, with Hindu passengers taunting the boys as “beef eaters.” Khan was stabbed, thrown out of the carriage and taken to a local hospital, where he was declared dead. His shocking death was the latest case of a particularly brutal kind of mob violence dubbed “beef lynching” that is making headlines in India with morbid regularity these days.

Cow vigilantism is a perfect example of the conundrum that Modi and his administration face: How to deliver economic growth while balancing a religious agenda?

In India's religiously fragmented and fraught landscape, the politics of food, especially that of cow vigilantism (violence in the name of cow protection), seems to have gained fervor since the 2014 election of Prime Minister Narendra Modi and his Hindu nationalist Bharatiya Janata Party (BJP). Modi was a controversial candidate. If his critics accused him of promoting communal strife, his followers adored him for his promises to deliver economic growth and development for India. Many also cheered BJP's tacit approval of *Hindutva* (Hinduness), which is an ideology rooted in the belief that a cross-cutting Hindu identity forms the basis for India as a nation. For *Hindutva* ideologues, cow protection has become a matter of national

allegiance. Modi's government has followed policies that target India's beef export and leather industries, which contribute significantly to the country's gross domestic product and employ millions. In many ways, cow vigilantism is a perfect example of the conundrum that Modi and his administration face: How to deliver economic growth while balancing a religious agenda? On a broader level, the government's policies and silence in the face of cow vigilantism raise more extensive ramifications for India's sociopolitical fabric.

Religious Origins of the Practice

To fully understand the importance of cow worship to right-wing politics in India, it is important to look at the animal's historical role in India's agrarian society and its relationship with Hinduism, the religion practiced by the majority of Indians. Cattle are an important part of any agrarian economy, and in India they continue to hold significance given the lack of systematic efforts to industrialize the country's agricultural sector prior to its decolonization in 1947. Further, given Hinduism's pagan roots, it is believed that reverence for the cow and restrictions on beef consumption stem from the agrarian economic setup, rather than any scriptural sanction. For example, Hindu religious texts, such as the Rig Veda, explain that killing cattle for meat and rituals was a common practice, even among the priestly Brahmin caste. The transition to deeming the cow as sacred began around the fourth century. University of Chicago professor Wendy Doniger, a religious historian who specializes in Hinduism and mythology, points out that the transition to a pastoral economy, with increasing domestication of wild cattle, was accompanied by the appearance of mythical stories in Hinduism where the earth takes the form of the cow, whose milk symbolizes the grain and vegetation that the

soil yields. Clearly, in this new economic landscape, the cow was more useful alive than dead. It plowed the field and provided milk for the family.

Indian historian Romila Thapar, professor emerita at Jawaharlal Nehru University in New Delhi, notes that in addition to being associated with religious motifs, the cow also became entangled with Hinduism's dense caste structure. As the cow gained reverential status in India, there was a move away from eating beef, especially among the upper-caste Brahmins. Before the caste system ossified into the rigid, immutable levels seen today, people often gave up beef in their attempts to move up the social ladder. This social history highlights the fact that sacredness was bestowed on the cow largely by elite groups that had little real interaction with cattle. It did not reflect the realities of lower-caste Hindus and, over time, Muslims and Christians who were bound to cattle-related professions and relied on beef as a source of protein.

Economic Impact

These paradoxes can be seen in India's economy even today. In fact, in looking at statistics on India's beef production, consumption and exports, a very different picture emerges from the stereotypical view of a country that eschews beef altogether.

India is the fourth-largest producer of beef in the world, behind Brazil, the European Union and China. According to the country's Department of Animal Husbandry, Dairying and Fisheries, most of this meat comes from buffalo and the rest from other cattle. In addition, India was listed as the world's third-largest exporter of beef for 2016-2017 (after Brazil and Australia) and is projected to hold that position over the next decade, according to the Food and Agriculture Organization (FAO) and the Organisation for Economic Co-operation and Development (OECD). The country's beef export industry is worth \$4 billion and employs millions of people. In addition, India is also the world's fifth-largest beef-eating nation, with consumption rising steadily over the past few years. According to India's National Sample Survey Office (NSSO), one out of every 13 Indians currently eats beef or buffalo meat.

During his 2014 campaign for prime minister, Modi repeatedly made cow protection an electoral issue. As part of his speeches, he charged the government of the day (the United Progressive Alliance coalition) with spearheading what he called a "pink revolution." He claimed that the government had lost interest in promoting the agriculture sector and was instead subsidizing slaughterhouses and promoting meat exports through tax breaks. Despite such incendiary rhetoric, the BJP government did not take any immediate steps to target the beef industry after coming to power. In fact, beef exports have increased by 16% since Modi became prime minister. The government's regulatory inaction was perhaps a sign of the industry's economic importance.

In the face of a regulatory status quo, cow vigilantism increased while the government turned a blind eye. Then in May 2017, the environment ministry ordered that cattle, including water buffalo, no longer be sold in open markets for the express purpose of slaughter. The ruling was issued as a means of preventing cruelty to animals, and the definition of cattle was expanded to include oxen, camels, water buffalo and cows. The order prompted an outcry from both meat exporters and India's \$12 billion leather industry. In addition, while cow slaughter is illegal in much of India, the states — especially in the northeast and south — with significant beef-eating populations refused to implement the order and vowed to fight the central government's intrusion in dietary choices. In July 2017, a month after Junaid Khan's slaying, India's Supreme Court put the central government's order on hold.

Sociopolitical Impact

Such policies and the violence that has accompanied cow vigilantism have had a broader societal impact as well because they have targeted and alienated both India's large Muslim minority and those who belong to India's marginalized lower castes.

The country's slaughterhouses are run largely by Muslims, who make up 14% of India's population. Cow-protection efforts that directly impact the meat industry have a disproportionately adverse economic impact on this

community. The most visceral and vicious effect of cow vigilantism has been a visible increase in the number of open attacks on Muslims accused of eating or selling cow meat, especially in northern India. Apoorvand Jha, a professor of Hindi at Delhi University and a prominent cultural critic, notes that while such violence in the name of the cow has resulted in the deaths of Muslims, it has “failed to arouse disgust in the larger political class, while the general Hindu population remains in callous apathy.”

If the BJP is to truly realize its goal of a national Hindu identity, it must appeal to those who are put off by its upper-caste antecedents. Cow vigilantism is a challenge here.

Alienation of the Muslim community has never been of great concern for the BJP. The party has always had an antagonistic relationship with this group and has consistently criticized what it calls pseudo-secularism — secularism dressed in the form of Muslim appeasement. It has been more difficult for the BJP to navigate its relationship with lower-caste Hindu voters. The epicenter of the BJP’s voter base is still north India, where political power is gained by making delicate political arrangements based on caste identity. If the BJP is to truly realize its goal of a national Hindu identity, it must appeal to those who are put off by its upper-caste antecedents. Cow

vigilantism is a challenge here. In India’s caste-ridden society, marginalized groups have traditionally carried out tasks such as removing the corpses of dead cows, and they have been associated with the leather industry. It is not surprising that these groups have also been the targets of right-wing Hindu mobs. In 2016, seven Dalits were flogged for skinning a dead cow. In response, the caste group fought back, pointedly leaving carcasses of cows outside a government building. In response, Modi notably avoided placing blame, pleading that he would prefer to be attacked himself rather than see violence against his lower-caste brethren. It was only following the murder of Khan that he finally stated, “killing human beings in the name of *gau bhakti* (reverence for cows) is unacceptable.” In a stark rejection of this message, that day a mob of more than 100 people in the eastern state of Jharkhand lynched a 45-year-old Muslim trader they suspected of carrying beef in his car.

For the BJP, the tension of playing to a violent, right-wing base, propounding modernity and economic development, and wishing to expand its political base to become a truly pan-Indian party, including in states where beef consumption is commonplace, is a challenge. For observers of India, the stance of Modi’s government on cow politics is likely to provide deeper insights about the country’s trajectory for the reasons detailed above than might seem obvious at first glance. It remains to be seen how his administration, and successive leaders, will navigate this issue in the years to come.

This article was written by Kartik Das, Vedica Kant and Kanishk Raghuvanshi, members of the Lauder Class of 2019.

Avianca and the Airline Industry in Colombia

In a country as diverse as Colombia, it's difficult to ascertain a singular national identity. But Avianca, the country's legacy airline and the second-oldest commercial carrier in the world, seems to be a proud part of that identity from any point of view. This article explores the factors behind the brand's success.

Defining Colombia's national identity is a complex and controversial task in our globalized and interconnected world. Today, countries have not only endogenous influences from their diverse regions or states but also exogenous influences, particularly from Western cultures such as the United States and Europe. Thus, connecting identity and authenticity remains a daunting notion. In Colombia, iconic symbols of national identity include the coffee-grower tradition, the vallenato music genre and the typical arepa food. In addition to these symbols, the aviation industry — led by Avianca — stands as a symbol of national identity. Avianca was the first company to solve Colombia's transportation issues, facilitating travel across the country's challenging topography. The company promoted nationalism and tourism where the government and other private companies had failed to do so. In addition, its highly successful business model, focused on Colombian values and customer service, has made it the nation's leader in the airline industry and a proud brand that the Colombian people celebrate.

To grasp Avianca's significance, one must understand the importance of Colombia's airline industry. According to Karim León Vargas, an aviation historian, Colombia was the first country in the Americas to initiate commercial air transportation, which grew out of the necessity to find alternative transportation and travel routes to cross the region's mountainous terrain. Thus, Colombia's airline industry grew as the country developed. The industry contributes 3.9% of total gross domestic product, according to the Colombian Transportation Ministry. As consumer demand for air travel continues to increase each year, the airline plays a major role in the country's economic development through commerce and tourism.

Ever since Avianca became the second commercial airline in the world in 1919, its global brand has represented Colombia both nationally and globally. It has developed in

tandem with the country's social, political and economic climate across the 20th century and into the 21st century. Even as new companies have entered the market as low-cost competitors — including VivaColombia and Wingo — Avianca's market participation rate for domestic flights has diminished only marginally in the last few years, from 59.4% in 2008 to 57.8% in 2016, which further highlights the company's dominance in the market and importance in the industry.

Avianca successfully provided Colombian businesses and citizens with a safe and efficient means to transport goods, unite families and benefit from tourism.

Since its inception, Avianca has offered transportation to domestic tourists, fostering a sense of customer loyalty that served as a first-mover, early-adopter opportunity for the company. The country's difficult topography, including three Andean mountain ranges that divide it, complicates domestic travel via railway and automobile. The airline industry's development represented a strategic solution. At the same time, Colombia's long history of violence also contributed to the challenges. Because of the conflict among guerillas, the paramilitary and drug traffickers, transportation via main roads and highways remained historically dangerous and inefficient, with constant checkpoints. This long conflict also meant a deficit in the development of proper infrastructure to travel between cities. Avianca successfully provided Colombian businesses and citizens with a safe and efficient means to transport goods, unite families and benefit from tourism, where the government and other private companies had failed.

In 2016, Avianca offered 5,700 weekly domestic flights, providing Colombians with ample opportunity to move around the country. The result is a company that promotes unification and contributes to the reduction of regionalism in the country.

Corporate Strategy

Avianca's successful corporate strategy has allowed it to maintain its status as the region's market leader. It is the trademark that represents the Latin American airlines under Avianca Holdings S.A. According to a 2017 company report, its mission is to connect the world with Latin America: "[W]ith the best people and technology for an exceptional experience, we will be the preferred Latin American airline in the world." Avianca has a global reach with 81 bases and 21,000 employees worldwide. It is recognized for its excellent world-class service and remains a member of the Star Alliance, a consortium of 29 airlines worldwide. Its exceptional service is exemplified in its LifeMiles loyalty program, which includes nearly 7 million members. And it dominates the Colombian market with 57.8% of market share, followed by VivaColombia with 16.2%, LATAM Airlines with 15.7%, Satena with 4.2%, Wingo with 1.1% and others totaling 5%. According to Felipe Groot Montoya, the company's coordinator of strategic projects, Avianca's success in Colombia has resulted from its keen attention to corporate strategy.

Avianca's international presence continues to demonstrate strong growth.

To begin with, Avianca's competitive advantage includes unique full service. According to Groot Montoya, travelers choose to fly with the airline because its fare covers all the amenities. Airlines such as LATAM, VivaColombia and Wingo fall into the low-cost airlines category that lag behind in terms of what they offer. Full-service airlines automatically provide food, assigned seats, entertainment and the right to carry luggage, while low-cost airlines tack on additional fees for them. While Avianca uses major airports and has international power stations, low-cost airlines frequently use secondary airports to lower the costs of air-field fees. Full-

service carriers tend to use a variety of aircraft. Avianca's 181 aircraft comprise 10 different types of planes with an average age of 5.9 years. Low-cost airlines usually use fewer models to save on crew training costs. Finally, full-service airlines are usually part of alliances with other airlines and offer loyalty programs. Thus, Avianca's competitive advantage has given it the largest share of the Colombian market.

Second, Avianca strategically attracts corporate travelers via Preference, its business-travel program. According to its marketing materials, "the Preference Program, with its advantages and benefits, connects Latino entrepreneurs in their travels and business meetings." Marketing that targets business clientele is reinforced on Avianca's website, with images of professionals dressed in formal business attire and advertisements for executive-class tickets. Similarly, in 2014 the airline introduced a business travel program in Bolivia with incentives to companies to manage travel in a simpler way that optimizes companies' costs while absorbing other benefits such as discounts, class upgrades and loyalty program courtesy cards. Avianca thus aims to meet the growing demand for corporate travel in Latin America. Indeed, this strategy for attracting business travelers has been effective. "In 2012 and 2014, business travelers and readers of Business Traveler magazine chose Avianca SA as the best airline in South America and Latin America," according to CEO Hernán Rincón. Furthermore, Groot Montoya suggests that this strategy has enabled Avianca to maintain its market-leader position in Colombia, considering that an increasing number of low-cost competitors, such as VivaColombia, have not significantly affected Avianca's market share because the airline has a loyal base of corporate travelers who are not incentivized by reduced fares.

An additional corporate strategy that contributes to Avianca's success is its six different lines of business. The traditional line is passenger transport. In 2015, the airline served 27 million passengers — an increase of 3 million over 2014 — most of whom came from the Americas: 54% from Colombia, 13% from North America, 9% from Central America and the Caribbean, 5% from Peru, 2% from Ecuador, 7% from the rest of South America, 3% from Europe and 7% from other countries. Avianca Cargo transports goods mainly between Bogotá and Miami, Florida, covering 22 cities with five cargo planes. For example, it transported 11,200 tons of flowers for Valentine's Day in 2017, representing a 15% increase over

the previous year. Avianca Tours organizes travel packages that bundle travel, accommodations and a car. LifeMiles, the loyalty program for frequent travelers, has nearly 7 million registered members. Avianca Services commercializes engineering, maintenance and training services for airports and other airlines. Finally, Deprisa provides logistics solutions for air transportation and the delivery of national and international packages and merchandise. In combination, these six components enable Avianca to maintain a highly successful, diversified and lucrative business that satisfies Colombian travelers' diverse needs.

Finally, Avianca's international presence continues to demonstrate strong growth. Its 5,607 weekly flights to 100 destinations in 26 countries prove its broad global reach. Hubs in the capital cities of Bogotá, San Salvador and Lima serve as the airline's connections to distribute freight and passengers to other destinations. Each year its management expands into new pathways, such as the recently added routes of Bogotá to Boston (U.S.), Bogotá to Montevideo (Uruguay), and Medellín to Monteria. In addition, following its acquisition of Taca Group Holdings, Avianca Holdings S.A. integrated regional airlines in Peru, Nicaragua, Costa Rica and Honduras into its network. Groot Montoya expects Avianca's strong growth to continue in light of the airline's recent negotiations for a strategic alliance with United Airlines. In addition, ongoing discussions regarding a potential

integration of Avianca Brazil under Avianca Holdings S.A. look promising. These developments demonstrate that Avianca continues to strategize to grow internationally to satisfy its customers' demands.

While Avianca dominates the Colombian market, its competitors still lead the Latin American market overall. The airline has considerable influence in Latin America, as it also dominates Central America with 50.2% of the market. But LATAM continues to lead the Latin American market in terms of market share and revenues. Despite Avianca's operating revenues of \$4.7 billion and 25 million passengers in 2014, LATAM significantly outperformed it with \$12.1 billion and 68 million passengers during the same period. Groot Montoya notes that his company is not aiming to be the market leader in Latin America, but rather to be the No. 1 airline in the region. Independent of its market results, Avianca and the airline industry remain an integral component of Colombian identity. It remains to be seen whether its growth strategy will continue to be effective as Colombia opens up to a wave of domestic tourism arising from the recent peace accords with the rebel group FARC, or if low-cost airlines are indeed the growth leaders of the future.

This article was written by Jessica Beckhart, Andrea Rivera and Raley White, members of the Lauder Class of 2019.

Lobbying in Russia

Russian oligarchs have made headlines in the United States recently in the context of presidential politics, but their real power lies in their influence at home. This article shows the sphere of influence held by the oligarchs and explains how understanding Russia's political hierarchy can help multinational businesses looking to establish themselves there.

Russian oligarch Oleg Deripaska has described successful business in Russia as “40% government relations, 40% public relations, and only 20% business.” He clearly meant the statement to be humorous, but in every good joke lies a kernel of truth. Just as a corporate-government relationship is necessary for a business to function optimally in any country, a constructive relationship with government regulators, fostered through effective advocacy and lobbying efforts, is particularly crucial in Russia.

The tumultuous privatization of the 1990s created an atmosphere ripe for corruption as a new class of oligarchs began converting their wealth into political power.

Following the breakup of the Soviet Union, the tumultuous privatization of the 1990s created an atmosphere ripe for corruption as a new class of oligarchs began converting their wealth into political power. This new class, which controlled over 60% of the Russian economy, could single-handedly influence government decisions because they held strong positions within the Boris Yeltsin administration. Oligarch Vladimir Potanin, for example, served as deputy prime minister, while Boris Berezovsky was elected to office in the Duma, the lower house of Russia's parliament. Even though this behavior was curtailed significantly toward the end of President Vladimir Putin's first term in office, given his stated objective of “detaching oligarchs from political authority,” the relics of this model continue to influence the nature of business within the country.

Many elements of government relations and lobbying activities in Russia are modeled on Western practices.

Businesses can rely on a number of actors to influence government decisions, including professional lobbyists, in-house government relations managers, trade unions, industry associations and think tanks. These actors lobby both the executive and legislative branches to establish new laws. The extent to which these actors can effect change, however, varies largely according to the industry. While some sectors have developed along Western lobbying norms, others are subject to challenges unique to Russia's domestic realities. This article explores some of these challenges by examining three industries: information technology (IT), tobacco and medical devices.

IT Industry Challenges

Russia's unique relationship with IT introduces additional challenges for foreign companies operating in this sector. During the Soviet period, the authorities registered photocopiers and launched dense networks of satellite jammers to control access to information. Today's state agencies monitor telephone and internet traffic using the System for Operative Investigative Activities (SORM), with technological capabilities comparable to the U.S. PRISM surveillance program that Edward Snowden brought to public attention. As policymakers introduce increasingly complex legislation, technology companies must adapt to operating in an ever-more complicated landscape.

Analyst Zach Witlin, of the political risk consulting firm Eurasia Group, divides restrictive Russian policies into three major categories: content controls that ban materials on the internet related to narcotics, extremism, suicide and other areas; registration rules that media outlets or online services must comply with; and infrastructure-related rules such as the localization of data and storage of information and metadata from communications.

The third category presents some of the greatest challenges for technology companies. Laws requiring that data on Russian citizens be kept on servers in Russia

would necessitate large-scale infrastructure investments and introduce questions about government access to companies' data. Officials have said that about 80% of companies are complying with the law, including Apple, Samsung, Alibaba Group, Viber and others. Social networks Twitter and Facebook have yet to comply and are in negotiations about implementation. More worrisome for these companies, however, is the so-called Yarovaya anti-terrorism law, named for the parliamentarian who proposed it. This law, scheduled to take effect in 2018 despite some attempts to soften its provisions, will require communications services to retain the content of user communications for six months and the associated metadata for three years.

Such laws highlight the disconnect between lawmakers, who often propose laws on an ideological basis, and practical policies. Russia's largest telecom operators estimate that meeting the requirements of the Yarovaya law, for example, would cost more than \$2.2 trillion (about US\$39 billion) to fully implement — equal to approximately 10% of the Russian state budget. Much of the rhetoric from policymakers is bombast, however. In 2014, United Russia parliamentarian Yevgeney Fyodorov cited the blue and yellow letters in Google's logo as evidence the company was promoting pro-Ukraine propaganda, further declaring that he had requested the prosecutor general's office to nationalize the technology company in Russia. But more serious challenges are still present. In a bellicose 2014 interview, Maksim Ksendzov, deputy head of telecom watchdog Roskomnadzor, declared the agency could block Twitter or Facebook in Russia "in a few minutes," adding that a shutdown would be preferable to the harm to Russian society caused by "non-constructive positions by the leadership of international companies." The comments were later retracted, but the threat to technology companies is nevertheless real.

The most high-profile victim of noncompliance with Russian legislation so far has been LinkedIn, which the authorities blocked in December 2016. With its popularity in the West and low adoption rates in Russia, this employment social network could be seen as a low-risk target meant to serve as an example. The late Anton Nossik, a respected figure in the Russian internet sphere, suggested a more cynical explanation in an article for the Russian newspaper Sobesednik: "A different question is

what and to whom they want to make a statement. We can, of course, assume that they want to scare Facebook. But in reality, officials are trying to create an impression that they are actually working." Witlin suggests the move was a warning to Western internet firms that authorities are developing the mechanisms and procedures for executing such a closure, even as the actual capacity for enforcing these laws is uncertain.

The tobacco industry's experiences in Russia have been cited as a textbook example of the power of lobbying organizations.

The move for social media firms, Witlin said, will be to develop good working relationships with authorities. "These laws are typically broadly defined, top-down initiatives with few directives on the details. The challenge for social media and internet firms is convincing regulators to implement these laws on favorable terms," he said. This seems to be part of the plan at Facebook, which is building its public relations team by hiring a public-policy manager who will be based in Warsaw. (Facebook currently has no office in Russia.) The company has had limited cooperation with authorities, for example, in removing a large number of posts featuring banned suicide-promotion content on Facebook's Instagram. However, the extent of this cooperative strategy and the extent to which Facebook intends to increase its profile in Russia remain to be seen.

Tobacco Industry Challenges

The tobacco industry's experiences in Russia have been cited as a textbook example of the power of lobbying organizations. Tobacco companies were some of the first foreign corporations to enter the Russian market following the collapse of the Soviet Union. When the government's tobacco monopoly ended in 1992, firms such as Philip Morris, British American Tobacco and Japan Tobacco International (JTI) swiftly filled the void. As early entrants into a highly unregulated and chaotic market, these tobacco giants took advantage of a wide-open playing field, establishing strong ties with key government representatives and securing an unprecedented level of

influence over regulating agencies.

In 2004, to protect the industry's interests, Philip Morris, JTI and the Baltic Tobacco Factory formed the Council for the Development of the Tobacco Industry, which became one of the most powerful lobbying organizations in Russia. The council was viewed as a prime example of the "revolving door" between business and government. In 2006, Nadezhda Shkolnikina, the head of the council, simultaneously became the leader of the Agriculture Ministry's Public Council, which oversees the tobacco industry. Through this relationship, as well as several other close government ties, industry representatives carved out niche roles for themselves in drafting industry controls. Industry advocates have been so influential that competing lobbying organizations were able to persuade legislators to maintain a complex combination of taxes to meet the varied needs for both high- and low-end tobacco producers for many years.

As a result of the close ties established between tobacco-industry leaders and government officials, industry representatives were able to exert an extraordinary degree of influence over the nature of the regulations that were passed. Following an eight-month probe, the International Consortium of Investigative Journalists (ICIJ) reported that principal rules on smoking and tobacco advertising in Russia were drafted by tobacco lobbyists working in close coordination with an influential former deputy prime minister. Industry lobbyists have further leveraged these connections to influence regulations outside Russia's borders. The ICIJ found that, while leading talks on new tobacco rules for former Soviet countries in 2010, Russian representatives presented the lobbyist-authored controls. This allegation was substantiated by promotional claims made on the website of Tabakprom (Association of Tobacco Producers). At times, industry representatives have even participated directly in government negotiations. In response to claims that the Russian delegation at Eurasian Economic Community talks included four executives of tobacco-lobbying groups and two employees of Philip Morris Russia, Philip Morris spokesman Sergey Chernenko defended this participation as "a natural democratic approach to legislation."

Despite the vast scale of tobacco-industry lobbying initiatives, the most effective strategies employed in this

pursuit frequently consist of ad hoc relationship building and influence-peddling efforts. While lauded by some for its impressive results, this model has also been criticized widely for employing unethical tactics and creating inexcusable conflicts of interest. In recent years, the tobacco industry has faced increasing challenges from organizations opposed to its questionable methodology.

Challenges for the Medical Device Industry

Conversely, the medical device industry has adopted a far more systematic approach to government advocacy. This can be attributed in part to the predominance of multinational corporations that are accustomed to formalized Western approaches to government advocacy and anti-corruption regulations within this sphere, such as the U.S. Foreign Corrupt Practices Act. Despite significant governmental efforts to develop a robust domestic medical-technology industry, the market is currently dominated by suppliers from Germany, the U.S. and China. Even under the weakened ruble, the U.S. Department of Commerce anticipates positive opportunities for foreign medical device producers in the coming years as public medical facilities prefer to buy devices from foreign manufacturers whenever possible.

The Russian government has attempted to foster a competitive national industry through the introduction of regulations that disadvantage foreign producers. In 2012, Russia introduced new registration procedures requiring that all medical devices, including those previously approved for use there, be re-registered with the regulatory body Roszdravnadzor. In February 2015, new legislation also barred foreign medical device manufacturers from participating in government tenders for certain devices if two producers from the Eurasian Economic Union (EAEU) participated in the tender. This list was expanded in December 2016 to include 86 additional products. The medical device industry is also facing increased pressure because of attempts to impose government-mandated price controls, which are complicated by the fact that, given the absence of a domestic industry, regulators have limited expertise regarding how to establish reasonable pricing thresholds.

In response to such regulations, which may be disruptive to current market participants, industry leaders have formed a noncommercial organization to unite

international manufacturers of medical equipment, devices and supplies represented on the Russian market. Per its mission statement, the International Medical Device Manufacturers Association (IMEDA) represents and defends the interests of its members before state authorities and officials, and it supplies information and support on urgent issues related to the medical device industry. Rather than operating through ad hoc mechanisms or personal relationships, as effectively championed by the tobacco industry, IMEDA seeks to formulate consolidated positions on behalf of the industry. Companies united under this organization have also developed a code of ethics, which IMEDA cites as the first of its kind in the Russian market. This code establishes high standards of transparency for doing business in the Russian market and allows IMEDA to create self-regulating mechanisms for the industry.

Working through formalized structures, IMEDA and other stakeholders have effectively mobilized to engage authorities on proposed regulations such as price controls and the requirement that devices be reregistered with Roszdravnadzor. Trevor Gunn, vice president of International Relations at Medtronic, highlights the importance of proactive engagement and sustained and frequent contact with decision makers, explaining, “You can’t just look in the sky for answers.... If you are looking to make a company successful in Russia, there are a limited number of things you can do outside of Russia on an ongoing basis.” Effective engagement requires working with organizations on the ground that have daily interactions with policymakers, rather than attempting to manage government relations via weekly or monthly “fly-in” appointments, which in Russia may provide just enough contact to create a misunderstanding on the ground, but not enough time or trust to resolve it properly.

The results of this formalized, collaborative approach have been encouraging. Following a request made by IMEDA in August 2016 and outreach by other vocal stakeholders, the deadline for re-registering devices with Roszdravnadzor was extended until 2021. Similarly, while discussions on price controls remain ongoing, indications of extended timelines and the government’s willingness to engage in

further discourse with industry representatives are strong endorsements for this model’s effectiveness.

Key Takeaways Across Industries

Even though the three industries highlighted above differ markedly with regard to the nature of both their products and their approach to government engagement, several key insights, applicable across industries, can be gleaned from their experiences. First and foremost, developing a successful business in Russia requires a sustained investment in time and resources. Whether operating through trade associations or ad hoc relationship building, establishing the reputation and trust necessary to be an effective counterpart to government regulators requires consistent interaction and a long-term commitment. Second, as is the case in many countries, establishing a foundation for effective lobbying often requires educational rather than political efforts. From technology firms clarifying the astronomical costs of meeting the Yarovaya requirements to medical device companies delineating what constitutes a reasonable price threshold, the foundation of effective government engagement is ensuring that policymakers have sufficient industry-specific technical expertise to develop reasonable legislation. And third, while it is unwise to expect Western lobbying models to work similarly in Russia, that does not mean there is no value in understanding and adapting Western best practices to the local political context. Applying such models can be valuable, particularly for companies concerned about running afoul of cross-border anti-corruption regulations such as the U.S. Foreign Corrupt Practices Act. However, these models should be tailored carefully to the Russian environment, including the establishment of an on-the-ground presence with local representatives.

By understanding these fundamental realities and the industry-specific context of public-private relations, as highlighted in the three examples above, international companies looking to enter or expand in Russia can build an effective platform to engage with policymakers.

This article was written by Boris Alergant, Morgan Dowd and Kenneth Martinez, members of the Lauder Class of 2019.

Has South Korea Transformed from an Economic Miracle to ‘Hell Chosun’ for Millennials?

This article looks at the conditions that have created a “living hell” for young people in South Korea. Pressures ranging from rising housing costs, unemployment and an unrelenting work culture are driving many South Koreans out of their homeland in search of a better life. But there are some steps being taken to stop this unique form of brain drain.

The issue of brain drain has occurred in many areas of the world as the middle class expands and more workers move from rural to urban areas in search of opportunities. Brain drain manifests in a unique way in South Korea, where unhappy millennial workers are expressing their frustrations with living in a *hell chosun*. The term is a way of referring to modern Korean society as hell, and it reflects a disillusioned state centered around hopelessness and frustration.

South Koreans spend about \$3.4 billion annually on foreign education.

The popular sentiment has galvanized around growing inequality and lack of social mobility. This term stirs up the question of how a nation that previously prided itself on its economic miracle (“Miracle on the Han River” refers to the period of rapid economic growth in South Korea following the Korean War) has regressed so much. Pundits wonder if the shift in mindset is generational because millennials are struggling through a period of slower economic growth and higher unemployment than what their parents experienced. This article draws on lectures by professors at Yonsei University in Seoul, interviews with South Koreans educated abroad and interviews with South Korean employees to analyze the societal and demographic changes that are causing this phenomenon. It will also outline initiatives by the public and private sectors to foster greater work-life balance, gender equality and a more tolerant society.

In July 2017, daily newspaper *Segye Ilbo* published an article on *yoohak*, a term that refers to Koreans seeking education abroad. South Koreans spend about \$3.4 billion annually on

foreign education. In the article, several Korean students cited *hell chosun* among the reasons they sought a foreign education and were choosing to remain abroad rather than return to their homeland. When investigating the underlying reasons for a lack of opportunities, we found that the South Korean economy is not growing due to stagnant industries and a lack of disruption.

The dominance of *chaebol* — a large South Korean business conglomerate that is typically family-owned — across all sectors and industries simply does not allow disruption to occur. Hyundai Motors, for example, has the highest-paid employees among all South Korean car manufacturers as a result of collective bargaining. In addition, the country no longer holds an advantage in heavy industries and needs to branch out into the high-technology sector. But innovation is stifled because old business models are simply replicated among successful enterprises.

Samsung Electronics, a prominent *chaebol* that found success during the country’s golden era of economic growth, boasts over \$300 billion in revenue and accounts for about 20% of South Korea’s gross domestic product.

Samsung D’Light, which models a digital playground showcasing impressive technology, demonstrates the various innovations the company continues to achieve. While *chaebols* drive the South Korean economy, they are heavily intertwined with the government, which has a propensity for corruption. In August 2017, one of Samsung’s top executives, Lee Jae-yong, was sentenced to five years in prison for bribery involving former South Korean President Park Geun-hye. The dominance of *chaebols* often hinders the emergence of disruptive technology and the growth of new opportunities.

Even though employment opportunities are plentiful in small and medium-sized enterprises (SMEs), young

South Korean graduates seek the prestige and stability of working for *chaebols* such as Samsung, Hyundai and LG. Several South Korean students noted that the perception of entrepreneurship and SMEs took a negative turn when most of the latter went bankrupt during the 1998 Asian financial crisis. This negatively impacted perceptions of SMEs and incentivized job-seekers to pursue employment at *chaebols*, which enjoy greater protection from the government. Thus, the *chaebol* system contributes to youth unemployment in South Korea, which is currently at its highest level since 1998.

Since South Korea's rapid economic growth from the 1950s to the 1980s, its people have been known for their impressive work ethic and intense academic competitiveness. South Korean students who have been educated both at home and abroad criticize the domestic education policies as rigid, unbalanced, overly strong and test driven. At the same time, the country has one of the highest education attainment rates, including college graduation. Competition to get into Seoul's top universities is extremely tough because a prestigious education is considered a prerequisite for successful employment.

Those fortunate enough to find good jobs face long hours. One Korean student recalled how she never saw much of her father during her childhood because he was always at his job at Korea Telecom, a large conglomerate. Another South Korean student also pointed to the country's lack of work-life balance as one of his reasons for not returning to South Korea after graduating from an MBA program in the U.S. He said there is no return on investment for the amount of time people work: "You slave away at Samsung for 30 years, and where does it get you?"

Another component of *hell chosun* is the persistence of gender inequality. The common thread in the education, consumer products and financial services sectors is that, despite efforts to foster equality, women are still paid less and hold fewer corporate leadership positions than men. A Wharton alumnus who worked as an investment banker for seven years said that women at the junior level are valued for their hard work. However, in terms of promotions to the vice-president level, male vice presidents are dismissive of their female subordinates in order to avoid situations where women could potentially be their competition.

A staff member at Yonsei University said that her son, who was working at a bank in Korea, would avoid hiring women primarily because maternity leave disrupts the team dynamic. Women face similar struggles in balancing their roles at home. Professor Chung Yeo Hoon of Yonsei University's Korean Language Department shared her personal struggle in balancing the long-standing cultural expectation that women do all the housework instead of their husbands sharing the chores.

A subset of men is reacting negatively to the unfavorable conditions of *hell chosun* by blaming women.

The South Korean government recognizes these issues and is taking steps to resolve gender inequality. Companies are re-evaluating maternity leave policies to encourage women to return to work after childbirth. With the nation's workforce steadily declining over the past few years, President Moon Jae-in has urged parliament to approve extra funds to cover training for returning women. The decline in female labor is significant after childbirth, and both the government and companies have been working to improve the situation. For example, AmorePacific Corporation, a beauty conglomerate in South Korea, offers flexible work hours to cater to women with children.

But there are other factors that contribute to *hell chosun*. Rising housing costs, unemployment and other pressures have led to *sampo saedae*, a generation that is giving up on courtship, marriage and having children. *Hell chosun* is exacerbated further, leading to *chilpo saedae*, the generation giving up on the three mentioned goals along with four more attributes, including hope. "Kangaroo" families are becoming more widespread as Koreans in their 20s and 30s continue living with their parents, even after marrying, because of exorbitant housing costs.

Professor Kim Young-Hee of Yonsei's Culture Department, said a subset of men is reacting to the unfavorable conditions of *hell chosun* by blaming women. The anti-

feminist mindset and macho attitude centered on objectification and denigration are reinforced in particular in *gundae*, the 21-month mandatory military service for Korean men. *Gundae* is both revered and hated in South Korean society. Culturally, it is a rite of passage for men, as they deem themselves having reached manhood only after completing their service. According to Ehwa University political science professor Leif Eric Easley, *gundae* is how the Republic of Korea maintains a steady supply of ready forces.

Professor Kim Chan-Ho, of Yonsei's Sociology Department, said *gundae* was established decades ago to deal with security threats from North Korea. Even though it is no longer necessary or relevant in an age of advanced technological warfare, it remains for political reasons. South Korean men currently find *gundae* highly inconvenient because it must be completed during an age that disrupts their plans for higher education or employment. Pregnant women will often elect to give birth abroad to guarantee foreign citizenship for sons who can then avoid *gundae*. Some men emigrate and completely renounce their native citizenship, which ultimately contributes to brain drain. After reviewing the necessity and efficiency of *gundae*, President Moon's administration announced it will decrease the required service from 21 months to 18 months.

The impacts of demographic trends on economic dynamism, public policy and society are prevalent throughout South Korea. The population is rapidly aging due to increased life expectancy and plunging birth rates. According to Statistics Korea, a central government organization that aims to provide statistical standards across the nation, a country is defined as "aging" if the percentage of the elderly population exceeds 7%, "aged" if the percentage exceeds 14% and "super-aged" when the percentage exceeds 20%. As of January 2017, more than 7 million elderly people comprised 13.6% of the population. Statistics Korea predicts that the country will become an "aged" society in 2018.

This has affected the younger generation and brain drain on multiple fronts, primarily because of South Korea's strong Confucian culture of respecting and taking care of the elderly. Professor Chan-Ho said members of the younger generation feel the societal burden to take care of parents and grandparents, so they have become stuck in a

financial struggle between starting their own families and supporting family elders.

In addition to gender inequality, societal issues concerning South Korea's mono-ethnic society have also surfaced. From the Chosun Dynasty (1392-1897) to the present, citizens have always taken pride in their pure Korean blood. Professor Young-Hee said because the country is surrounded by the two large powers of China and Japan, South Koreans have always been rooted in the unity of the people (*woori*). Despite the country's rapid globalization, multiracial families and foreigners in the workplace still find less acceptance.

A Samsung employee spoke of the inability of many foreigners to step outside the expat bubble and form relationships with local Koreans. While some employees choose not to immerse themselves fully in the culture, those who do still find racial discrimination in the workplace and a glass ceiling in the corporate hierarchy. However, a South Korean national with a graduate degree indicated that the country's mono-ethnic society has already begun to shift, particularly in the countryside.

With more women leaving rural areas to pursue careers, there has been a trend among men in the countryside to marry women immigrating from Southeast Asia. He noted that many of the multi-ethnic children born from these marriages will move to their mothers' home countries upon completing their primary and secondary education in South Korea. Considered less privileged in their country of birth, they will enter the upper echelons of society in Southeast Asia due to their "foreign upbringing." This will allow them to pursue careers in areas that may have been closed to them in South Korea — another form of brain drain. While this is all anecdotal, it will be interesting to see if this generation will perhaps return to South Korea, thus shifting the demographic dynamic yet again.

Despite these societal struggles, a number of political, economic and technological initiatives are in place. For example, President Moon instituted his initiative to raise the basic pension for those aged 65 and up from 206,050 KRW (USD \$188.25) to 300,000 KRW (USD \$274.09) a month. In addition, the number of young entrepreneurs is increasing with the help of startup incubators such as DCamp, an upswing in family funds and a development of new investments for next-generation *chaebols* — most

notably in Mark Tetto's TCK Investment Management.

AmorePacific has been expanding into Southeast Asia by setting up research and development labs in various cities to develop new products. The culture of entrepreneurship has changed recently with the success of tech startups such as Naver, an internet search engine, and Kakao, a mobile messenger that has expanded to mobile banking. People are seeing tech startups in a positive light, and some U.S.-educated Koreans are returning to South Korea to participate in the tech scene.

Societal issues and demographic trends are informing and influencing economic, commercial and political dialogues in South Korea. Despite issues concerning youth unemployment, competition, gender inequality and the

aging population, the government and corporations have been leading initiatives to better the work environment and to create innovation within the large conglomerates, as well as opportunities within small to mid-sized companies.

Brain drain and the concept of *hell chosun* will not be resolved overnight, but generations of South Koreans are looking back to their "miracle" roots and striving to revive the country's innovative nature and potential. In principle, brain drain can be reversed. Acknowledging and approaching these issues is a first step, and bouncing back to create change will further globalization and ultimately return lost talent to the mother country.

This article was written by Ellen Hahm and Amy Kim, members of the Lauder Class of 2019.

A Brewing Battle: Craft Beer in China

Beer lovers around the world are abandoning traditional commercial brews for small-batch craft beers. The market has been gaining ground in China, creating conditions that are ripe for a standoff between big industry brands and independent brewers.

A battle is brewing in the Chinese beer industry. In recent years, the traditional beer market has shown signs of contracting, with worldwide sales volume declining by 1.8% in 2016. But the global craft beer market is large and growing. According to business consulting firm Grand View Research Inc., this market was valued at just over \$85 billion in 2015 and is predicted to hit nearly \$503 billion by 2025. The market share of craft beer in China has been increasing steadily, causing significant disruption in the industry. Will Tsingtao, China's top-selling brew and one of the country's best known brands, go the way of Budweiser, which has seen a decline of 35% since 2008? News agency Reuters projects that by 2020, craft beers will comprise over a third of the value of the Chinese beer market, compared with less than 10% in 2010. A showdown between China's growing number of beer entrepreneurs — global brewers such as Ab InBev and large Chinese brewers such as CR Enterprise — seems increasingly inevitable.

Global brewing giants are trying desperately to avoid missing out on China's craft-beer revolution.

China is the world's largest beer market, with a total consumption of 45.7 billion liters in 2016 and a total value of more than \$70 billion per year, according to industry figures. While the total volume of sales has followed the global trend and has seen modest declines over the past few years, the total value of sales has risen as producers aim to capture an increasingly growing share of the premium market. In China today, much of the value of premium beer arises from imports. In 2016, consumption of imported beer from countries such as Germany, Belgium and the U.S. increased 40%. Nevertheless, similar to trends in China's smartphone markets, consumers there are

looking increasingly to high-quality domestic products to satisfy demand. These consumers have led to a significant increase in demand for craft beer, a product category that became the highest-value segment of the beer market in 2017, according to *The Morning Advertiser*, a trade publication.

A stroll down the streets of Beijing or Shanghai reveals the pace of this change to even the casual observer. Attempting to capitalize on the strong lifestyle brand value associated with craft beer, many small breweries now occupy trendy, charming and historical neighborhoods like the hutongs that surround Beijing's Drum and Bell Tower or Shanghai's French Concession, in buildings that were formerly private residences, convenience stores or even produce stalls. Many have also set up shop in retail and nightlife districts to appeal primarily to younger, upwardly mobile consumers with disposable income. This phenomenon is not limited to China's so-called tier 1 cities. NBeerBar, a popular tap house in Beijing's Xicheng district, near the tourist site known as Huguosi, carries exclusively Chinese craft beers from around the country, including provinces such as Gansu and Guizhou, which are among China's least-developed regions. Xenon Yuan, NBeerBar's beer quality-control director and one of China's only certified cicerones — a certification similar to a sommelier for wine — notes that even in these smaller cities, "consumer demand for craft is bananas."

Global brewing giants are beginning to take notice of this change and are trying desperately to avoid missing out on China's craft-beer revolution. In early 2017, Fortune magazine called AB InBev's failure to anticipate the sharp increase of craft beer market share in the United States a "catastrophic mistake." Highlighting the importance of China's emerging craft beer sector to large multinational brewers, Jean Jereissati, president of AB InBev in China, was quoted by The New York Times in September 2016 as saying, "All of this premiumization and trading up is

the biggest revenue driver of our industry ... and it is very relevant for our company.” Attempting to course-correct in the U.S. has proven costly, and the company hopes to avoid the same fate in China.

China’s craft brewers are preparing to stand their ground. When a large multinational brewer acquires a smaller craft brewer, quality is often sacrificed in order to ramp up output to meet the new demand created through the large brewers’ distribution networks. As incomes rise, Chinese consumers’ preferences are also changing, which bodes well for smaller Chinese craft brewers. Explaining the growth of craft beer in China requires a deeper understanding of several factors, ranging from socioeconomic to cultural, political, legal and technological elements.

The most obvious driver is that overall economic growth in China has created a rising middle class with disposable income, which has pushed growth across many industries. According to global consultancy McKinsey & Co., the percentage of China’s urban population that is considered to be in this segment (defined as households that earn US\$9,000 to US\$34,000 annually) will increase from just 4% in 2000 to 76% in 2022. This study also shows that the disposable income of these urban, middle-class households will double from roughly \$4,000 in 2010 to about \$8,000 in 2020. These increasing middle-class pockets directly impact consumption patterns across the country.

Non-necessity goods across the board have seen surges in demand in China, including alcoholic beverages such as beer and wine. Unlike wine, which is positioned as a luxury good and suffers from heavy import taxes, beer is far more accessible to everyday consumers, so it commands a greater share of growth. However, because growth in the number of craft breweries and bars selling craft beer significantly outpaced overall economic growth in China, additional factors must be identified to explain this change.

Increased social awareness of alcohol options offers one clue for the booming popularity of craft beer. Along with economic growth came increased travel abroad. According to Yuan, Chinese consumers began traveling abroad more often in the last decade. As a result, they were exposed to a variety of cultures, tastes and experiences that stimulated demand for foreign goods and services in China. This

helped to break down the existing social understanding of beer. As Yuan notes, the common conception was that the best beers are German and must follow a very strict set of rules in their production. Through broader travels, however, the Chinese have seen the vast variety and creativity of beer products, especially in the United States, completely shifting people’s understanding of beer. No longer must this beverage adhere to the strict German standards.

Increased social awareness of alcohol options offers one clue for the booming popularity of craft beer.

On a related note, craft-brewing technology has also improved, becoming cheaper and more accessible. Paired with the greater variety of ingredients available, this has facilitated the do-it-yourself nature of the industry and thus reduced the barrier to entry for the typical bar owner. While previous beer-brewing technology was dominated by German-style equipment, a wide array of customized equipment has become available in tandem with rising demand. China’s high level of small-to-medium-sized entrepreneurship and access to low-cost manufacturing uniquely enables the country to shift supply to meet increasing demand in the craft beer industry.

Several political factors have also fueled the growth of Chinese craft beer. In particular, Chinese nationalism has affected purchasing behavior. The demand for greater beer variety, according to Yuan, is characterized by both a shift away from imports and an increased affinity for Chinese-owned and Chinese-brewed craft beers. China’s largest mass market beer companies are state-run enterprises that have set a nationalist tone for the beer industry at large, including the craft brewing industry. CR Snow is one such enterprise. The brand has engaged Chinese celebrities to endorse and market its domestic products, activities that are framed as acts of patriotism. The company has been criticized for refusing to introduce additional foreign beer labels into the Chinese market from SABMiller, its multinational joint-venture partner.

From a grass-roots perspective, it has become clear that China's increasing influence on the world stage has led to a corresponding rise in interest among domestic consumers in buying authentically Chinese brands. This extends to the craft-brewing industry. Carl Setzer, an American entrepreneur who launched Beijing's popular craft brewery Great Leap Brewing, attributes part of his early success to "incorporat[ing] Chinese literature and historical references in the naming and branding of their beers." One clear example is Great Leap's Little General IPA (少帅IPA), which, in the original Chinese, is a nod to World War II

It has become clear that China's increasing influence on the world stage has led to a corresponding rise in interest among domestic consumers in buying authentically Chinese brands.

patriot Zhang Xueliang. Yuan added that local consumers began favoring homegrown brands over imported brands most noticeably since 2014. At NBeerPub, where Yuan works, 80% of the craft beer products on tap are now brands brewed within China's borders and operated by Chinese owners. "By pure numbers, there are now more Chinese-owned and Chinese-operated craft breweries than foreign owned ones," he said. Interestingly, the Chinese nationalism dynamic has played out across China in Homebrew Societies. These professional associations, organized at the city level for craft brewers, have typically segregated themselves into two distinct groups in each locale — Chinese in one camp and foreign expats in the other. There appears to be a clear difference between domestic and foreign craft brewing communities in China, with the former becoming increasingly popular.

Boosting the Bottom Line for Craft Beers

While growth in the Chinese craft brewing industry has been remarkable, it still comprises a scant 1% to 2% of the

total beer market, compared to the 12% of the market that craft breweries enjoy in the United States, according to industry figures. The Chinese government can take several concrete regulatory actions to accelerate the industry's growth.

Yuan noted that the first industry obstacle is existing bottling regulations. Currently, most craft brewers brew their beer privately and then sell the product at their own commercial establishments (e.g., a bar or restaurant they own) — a gray zone that is neither compliant nor illegal. These regulations make it difficult for brewers to bottle their craft beers and sell their brands beyond their own premises. "Currently, brewers must be able to produce a minimum batch of 10,000 units of beer in order to qualify for bottling," Yuan said. "This is insurmountable for any small craft brewer." At least one local craft brewery has resorted to brewing its beer in China, bottling it in the U.S. and then shipping it back for sale in the Chinese market. Reducing the requirements needed to bottle, and thereby more easily distribute craft beer, would enable many small craft brewing enterprises to participate in China's beer economy.

Yuan cites existing QS certification requirements as the second barrier in the industry. These certifications signify that a certain product meets quality and safety requirements for mass distribution within the Chinese market and are required for craft breweries to sell their premium beer products to a wider market. "It can take up to 10 years to obtain a QS certification for craft beers in Beijing," Yuan said. Removing the bureaucratic red tape can also pay dividends for the Chinese craft-brewing industry.

Looking forward, the Chinese craft-brewing industry appears to have a bright future. Existing mass-market beer companies such as CR Snow, Tsingtao and Yanjing are currently attempting to emulate the success of microbreweries by producing their own premium craft beer brands. Some large players have even begun to buy up small Chinese craft breweries, such as AB InBev's acquisition of Shanghai's popular Boxing Cat Brewery in early 2017. Several small craft breweries in China are actively seeking such a buyout.

When asked to predict what's next for the craft brewing industry, Yuan is cautious. "Predicting the future in China is a fool's errand," he said. However, when pressed, he becomes more optimistic. "While Chinese craft brewers are not exporting abroad now, I would be surprised if they aren't exporting to foreign markets 10 years from now."

China's craft breweries have much room for growth, and the industry will be an exciting space for both new and existing entrants for years to come.

This article was written by Rahul Rastogi, Benjamin Roth and Shawn Xu, members of the Lauder Class of 2019.

Forty Years of the *Gaokao*: Revisiting China's College Entrance Exam and Education System

The thread of education policy in China is woven into a long and tangled history. The *gaokao*, a standardized college entrance exam, is one of the biggest knots along the thread, stirring controversy over its fairness in the treatment of urban and rural students. This article explores China's attempts at education reform and solutions to smooth out the kinks in the system.

In 2017, China marked the 40th anniversary of the reinstatement of the *gaokao* — the country's nationwide college entrance examination. The histories of both the *gaokao* and educational policy reform are closely intertwined with the history of the nation. The early 20th century saw not only the demise of the Qing dynasty but also a period of tremendous progress in education policies. The numbers and influence of scholars increased significantly, and more universities were established. Following the Sino-Japanese War (1937-1945), the *gaokao* was discontinued, which adversely affected both the quality of and access to education. During the Cultural Revolution (1966-1976), many universities were shut down and the government forcibly sent educated youth to the countryside to learn from living in rural poverty. The number of teachers also plummeted. In a move to restore the country's education system, Deng Xiaoping in 1977 re-introduced the *gaokao*, which covers diverse subjects, including mathematics, the humanities, Chinese and English.

The *gaokao* serves to standardize how students across China are evaluated.

The *gaokao* serves to standardize how students across China are evaluated and formalizes their secondary education curriculum in preparation for the exam. Its reinstatement inspired a vision of equal opportunity and social mobility for people across the country. In theory, admission to universities would be based on academic merit rather than social and political affiliations. The choice of college is critical in China, so the exam has become a decisive tool for determining who will find a well-paying job and have a successful career.

For students from rural villages or disadvantaged families, it represents a lifeline to emerge from poverty and ascend the socioeconomic ladder. A June 2017 *Xinhua News* article reported that, for 40 years, "the fierce but fair competition has been almost the only way for students from poor, rural areas to change their lives. Over 9 million students take the world's largest exam (each year) in pursuit of their dreams and to join the drive for national rejuvenation, the Chinese Dream." Of this group, more than four million may go to university. From 1977 to 2016, 120 million Chinese enrolled in college. Dai Jiagan, deputy director of the Chinese Society of Education, said in the article, "The average number of years in education for our labor force increased from 5.7 to 11.9. Without the *gaokao*, we could not have reached our current phase of development. The fate of the *gaokao* has been closely related to that of the country and the people."

College students who graduated after the *gaokao*'s restoration have formed the core of China's economic rise and development. During the first three years alone, more than 900,000 university students became working professionals. "This group of people was a key driving force in reform and opening up," according to Liu Haifeng, head of Xiamen University's Institute of Education. "Despite its weak points, such as the heavy burden on students, the *gaokao* is a test that fits China's overall conditions and is a fair start for all. The successes of the past 30-odd years have a lot to do with the *gaokao* system." Sun Pishu, who took the *gaokao* in 1978 and is now chairman of Inspur, a global big data and cloud computing company, said he was driven to serve his country after having the chance to attend college.

Of course, the *gaokao* hasn't worked for everyone. As Zhao Mengfan, a teaching assistant at Peking University, explained in an interview, "Questions were not encouraged

in the classroom as the focus for teachers became high test scores, which could only be obtained through the right answers, as defined by the writers of the exam.” As a result, critical and innovative thinking was stifled, which has negatively impacted Chinese society today. Students who were naturally proficient in a certain area — math, sports or music — were made into well-rounded students for the *gaokao*, which tested all subject areas. Parents also arranged for their children to receive additional preparation outside of school; students who did not participate would lag behind in the classroom and be at greater risk of failing the exam.

To provide more students with access to higher education, the Chinese government has increased its investment in the sector fivefold since 1997, according to a 2016 article in *The Economist*. In addition, the number of universities has nearly doubled. They also were allowed to enroll more students, increasing admission rates significantly. In 1998, 46% of secondary-school graduates went on to university. Today, about 88% do so. But while more students may be gaining access to higher education and social mobility, inequality in educational opportunity has also increased due to regional and socioeconomic factors.

Inequality in Educational Opportunities

The Chinese education system is geared toward the *gaokao*, which has been shown to be a reasonably effective method for maintaining social mobility in the world’s most populous country. The examination’s standardized nature implies that the test is fair. Unfortunately, rapid urbanization, coupled with demographic policies adopted by the Chinese government, has led to increasing inequality between students from urban and rural areas. *Teach for China* estimates that over 80% of students from Tier 1 cities attend a university, compared with only 5% of those from rural villages. The system, which is intended to maintain educational equity in an increasingly capitalistic country, is seen as unfair due primarily to the varying access to and quality of primary and secondary education.

Rapid changes in demographic structures are the primary factors driving the deteriorating access to education in China’s rural areas. According to a 2017 article in *The Economist*, three-quarters of the rural primary schools closed between 2000 and 2015 due to declining enrollments that followed the introduction of the One

Child Policy in 1979. These schools were hit particularly hard as a result of strict controls in terms of the number of children born and the large-scale rural-to-urban migration in China. Authorities responded by closing schools in villages and merging them with schools in regional centers located in larger towns and cities. This initiative resulted in the closure of nearly 300,000 schools in rural China, thus severely limiting students’ access to education.

Even those fortunate enough to attend secondary schools often receive a subpar education.

The cost of attending high school in China also limits access to secondary education. Both elementary- and middle-school education are mandatory, which means they are tuition-free if they are run by the government. However, high school is not mandatory and requires a fee, which is often beyond the means of poor rural families. Many students from villages also have to board at these schools in select regional centers.

The cost of tuition and board often adds up to thousands of yuan over the three years, equivalent to more than a year’s income for poorer farming families in rural China. These costs, combined with the limited availability of schools, have significantly affected attendance rates at rural high schools. According to an article in *The Economist*, less than 10% of rural students attended high schools in 2017, compared with 70% of urban students. These figures directly affect university attendance rates, which show roughly 33% of urban students complete university, compared with only 8% of rural attendees.

Even those fortunate enough to attend secondary schools often receive a subpar education. In China, education is administered by regional governments, so regional economic conditions directly impact the amount of investment for education. Take Guizhou, for example, which is a mountainous province in southwest China dotted with traditional rural villages inhabited by ethnic minorities. Its average gross domestic product per capita is around \$3,100, far below that of the national average of \$8,000. In contrast, the figure for Beijing is \$17,000.

According to *The Economist* article, government spending for education per person in this village is less than half the amount spent in Beijing. With less money, boarding schools in the rural provinces provide unhygienic living conditions, such as insufficient toilet facilities. The food provided to children is also substandard; some schools do not offer three meals a day. Statistics also show that rural children who boarded were, on average, slightly more than an inch shorter than those who did not.

Meanwhile, the system is also not so kind to children who migrate to cities with their parents. *Hukou* — a household registration system that grants health care, education and other government benefits to residents in designated geographical areas — prevents migrant children from attending public schools in urban areas, which have a better quality of education. Instead, these children must enroll in private schools, which charge higher tuition while offering an inferior quality of education.

Resolving inequality in the distribution of educational resources in a country as enormous as China is a colossal task.

Gaokao Reforms

The inequality of educational opportunities has led to calls for a fairer and more equitable *gaokao*. Chinese authorities are well aware of this desire for reform. In September 2014, the Chinese Ministry of Education announced a range of policy measures to overhaul the *gaokao* and the university enrollment system. The revamped examination was piloted in Zhejiang and Shanghai in 2017, with plans to implement the changes nationwide by 2020.

Among other things, the policy reforms include allowing students to choose any three out of seven “minor” subjects — physics, chemistry, biology, technology, politics, history and geography. Students previously had to choose three science or three liberal arts minor subjects. This change allows students more latitude to pursue the subjects of their choice. The new *gaokao* also allows students to sit twice for examinations in certain subjects and to choose

the higher of the two scores to count toward the overall *gaokao* grade. Previously, many students had to retake the entire exam the following year if they were dissatisfied with their scores. This change was intended to ease some of the pressure for candidates.

In a 2017 interview with *China Daily*, Zhong Binglin, the president of the Chinese Society of Education and an active participant in the reform process, said one of the goals was “improving fairness in education and creating equal opportunities to enter prestigious universities.”

However, while these reforms have improved certain aspects of the *gaokao*, the key issues remain unresolved: the disproportionate advantages offered to privileged children with *hukou* tied to Tier 1 cities, and the growing disparity of access to resources and opportunities between the haves and the have-nots. Other challenges remain: Who defines what is fair and equal? Which constituents in Chinese society should policymakers choose for advantages to engender equity and promote social mobility? In recent years, state and provincial governments have sought to manage the divergent interests of different segments of society. This has required maintaining a delicate balance across the social fault lines in Chinese society — between the city dwellers and rural villagers, as well as between the majority Han Chinese and ethnic minorities.

In spring 2016, China’s Ministry of Education and the National Development and Reform Commission announced plans to increase enrollment quotas at the top universities in 12 regions to allocate more places for students from poorer inland provinces. Following the announcement, thousands of parents from cities such as Wuhan and Nanjing demonstrated outside provincial government buildings to protest what they perceived as the government’s unfair move to increase places for non-locals at the expense of locals. Some protests turned violent.

Similarly, members of the Han Chinese majority lobbied against the Chinese government’s long-standing policy of offering bonus points to members of ethnic minorities sitting for the *gaokao*. Dissenters contended that these bonus points constituted unfair competition and created an unequal playing field. Lucy Chen, a graduate student at Beijing Foreign Studies University, noted in an interview that some rural Han Chinese came from even more

disadvantaged backgrounds than the ethnic minorities, but they did not benefit from the bonus points. In response to these concerns, in recent years many provinces have reduced or eliminated bonus points for ethnic minorities.

Improving the System

Clearly, planning for a fairer and more equitable *gaokao* will not be easy. To the greatest extent possible, the system must guarantee that two students with equal capabilities have equal shots at gaining a place at a top university, regardless of family background, ethnicity or *hukou*. Policymakers will need the political will and commitment to undertake deep reform and to balance the demands of different segments of Chinese society before the vision of a meritocratic *gaokao* can be realized.

Resolving inequality in the distribution of educational resources in a country as enormous as China is a colossal task. Governmental policy changes implemented thus far have not been effective, including the *gaokao* reform that failed to address problems such as the rural and urban gap regarding access to and the quality of education. More affluent families will continue to spend more on education for their children, while students in urban areas will continue to receive better education from more qualified teachers in superior schools.

Existing academic research provides a potential policy solution for local government. Empirical studies of the unequal distribution of spending on education and the quality of schools and instructors on the academic performance have all clearly demonstrated the correlation. University of Washington's Margaret Plecki and Tino Castaneda in 2011 and London School of Economics' Stephen Gibbons, Sandra McNally and Martina Viarengo in 2012 showed how increased expenditures for education can improve academic performance.

In addition, University of Maryland's Jennifer King Rice in 2003 and academics Steven Rivkin, Eric Hanushek and John Kain in 2005 showed how improved teacher quality can enhance students' academic performance. Hence, without addressing the issue of inequality, opportunities for all students to perform equally well on the *gaokao* seem unattainable. The key is equalizing the distribution

of educational spending across administrative regions that have divergent levels of economic development through adjusted allocations of state budgets.

In a study published in the *Journal of Public Economics* in 2002, David Card and Abigail Payne examined the effect of U.S. school finance reforms on the distribution of expenditures across districts with varying income levels. They found that spending equalization is key to reducing the performance gap among students. The researchers said states that "increased the relative funding of low-income districts ... [through] increasing state aid available to poorer districts ... saw a narrowing of test score outcomes across family background groups."

The inequality of educational opportunities has led to calls for a fairer and more equitable *gaokao*.

Their research used scores from the SAT, which is similar to the *gaokao* as it is a standardized measure of scholastic aptitude for entrance into U.S. colleges. Thus, the amount of a state's educational budget allocation has a reverse correlation to the income level in a given district. To resolve the issue of inequality in educational resources, local governments must provide much higher levels of aid to schools in poorer rural areas to bring overall educational spending in these districts closer to the levels found in more urban, richer areas.

Unfortunately, this is not the case in China, where state aid is insufficient to equalize the vastly unequal expenditure levels for education across regions. Because less economically developed localities have much smaller budgets for education, this initiative is not feasible without the active support of the central government. For the viability of the overall Chinese education system, both the central and the local governments must cooperate to close the gap going forward.

This article was written by Taejae Ha, Krista Ryu, Henry Tang and Zed Teo, members of the Lauder Class of 2019.



BNDES: A Development Bank at a Crossroads

Many political institutions and businesses in Brazil were hit hard during Operation Car Wash — the government’s multiyear investigation into widespread corruption. BNDES, the country’s development bank, was bruised, but it is still standing. As it emerges from the scandal, it must commit to a higher standard of ethics and a different strategy if it is to fulfill its mission of strengthening Brazil’s battered economy.

Brazil’s national development bank, Banco Nacional de Desenvolvimento Econômico e Social (BNDES), has served as a key player in the country’s modernization and a catalyst for its economic recovery. But it is now facing challenges that transcend a recession. The state-controlled bank became part of a criminal investigation known as Lava Jato (Operation Car Wash), which was launched in 2014

BNDES’ actions have raised the possibility that it was more than a passive victim of changes wrought by the corruption scandals.

that uncovered widespread corruption. At the fringe of the largest political crisis in Brazilian history, BNDES must now adapt its role and support more entrepreneurial ventures while shifting away from corruption-prone activities. An examination of the bank’s current endeavors sheds light on its evolving role as it develops new techniques and strategies to support small businesses, stimulate economic development and finance major corporations, while also

realizing its place in the complex, messy environment of a post-Lava Jato Brazil.

BNDES and the Political Crisis

The political establishment in Brazil has lost much of its credibility, in light of the scandal and public backlash due to widespread allegations of corruption. It was this public outrage that led to a decline in support for then-President Dilma Rousseff, ultimately resulting in her downfall. She was impeached in 2016 on charges she manipulated the budget to hide the country’s economic problems.

As with much of Brazil’s state machinery, BNDES underwent significant changes following Rousseff’s impeachment. When Vice President Michel Temer took over, he made changes to the bank’s leadership and strategy. The bank’s new president, Maria Silvia Bastos Marques, was tasked with implementing the new government’s vision. Chief among her priorities was addressing a major decline in bank funding from the Brazilian National Treasury.

Previously, BNDES amassed the majority of its funding from payroll taxes. But in 2008, the Worker’s Party

(PT) government instituted a policy of lending the bank additional funds from the treasury, which it was supposed to inject into the economy to boost growth. The scale of the government's lending to the bank was substantial. According to a BNDES institutional presentation, at its peak in 2014 nearly 60% of the bank's financing came from the treasury. In total, R\$500 billion (US\$160 billion) were transferred to BNDES via this mechanism.

However, the recent reduction in the bank's scope went hand in hand with a change in its focus: It would no longer be selecting, backing and building so-called national champions. In the past, the PT governments practiced a policy of creating national champions — large Brazilian companies that would become global leaders in their respective industries. Inspired by the example of large South Korean exporters, the Brazilian government believed these champions would spur development along an entire value chain while growing the country's economy. This was the case with Brazilian beef giant JBS SA, which received over R\$8 billion (US\$2.5 billion) from BNDES and then went on an acquisition spree abroad. It is now the largest meat producer in the world. Nevertheless, BNDES' new leadership discontinued this practice, seeking instead to promote growth among small and medium-sized businesses.

BNDES' actions have raised the possibility that it was more than a passive victim of changes wrought by the corruption scandals. The bank has long offered below-market loans to its clients, subsidized by Brazilian taxpayers. The available discounts reached significant levels. Between 2015 and 2016, the base rate BNDES used in its credit offerings, known by the Portuguese acronym TJLP, ranged from 6.5% to 7.5% annually. This reduced rate was very attractive when compared to the Brazilian central bank's benchmark Selic rate of over 14% during the same period.

It seems likely that the bank itself was involved in wrongdoing by giving preferential access to these loans. Industrialist Marcelo Odebrecht, already sentenced to prison for his role in the Petrobras scandal, alleged in his testimony that his company hired and overpaid a consultancy with ties to leaders in the Ministry of Finance and BNDES in order to “maintain good relations” with those institutions. In the now-infamous tape recording of JBS SA owner Joesley Batista with President Temer, the businessman complains of how “stuck” and “problematic” things had become at BNDES. In light of this piece of

evidence, the Federal Police became involved and in May 2017 opened an investigation into possible irregularities in investments made by BNDES' equity investment arm.

It comes as no surprise that a state organ as large as BNDES would become embroiled in kickback schemes in modern Brazil.

It comes as no surprise that a state organ as large as BNDES — and one offering such a valuable economic benefit — would become embroiled in kickback schemes in modern Brazil. The large national champions it helped to create had incentives to seek yet more resources from the bank, and the relationships between large private companies and Brazil's state have often been ethically dubious. If the bank is to retain a central role in Brazil's economic growth, it must further demonstrate its ability to act ethically and transparently — and in the interests of the Brazilian citizens it is meant to serve. Moving away from a policy of building massive firms and towards one that supports entrepreneurship and small businesses might reduce future temptation to engage in corrupt practices.

BNDES as a Catalyst for SME Growth

Following the instructions of the Ministry of Planning, Development and Management, BNDES has begun to undertake substantial efforts to shift the focus of its investments from large corporations to small companies. As a result, it has recently implemented numerous changes in order to offer more opportunities to small and medium-sized enterprises (SMEs).

The main product BNDES has developed to approach these companies and offer appealing financial opportunities is the Cartão BNDES (BNDES Card). Since 2012, several financial institutions accredited by BNDES have been able to issue this credit card instrument, which offers SMEs the ability to pay in installments up to 48 months and with a credit limit of up to R\$2 million (US\$600,000) per client and per bank.

Tarso Frota, an entrepreneur from Brasília with a range of businesses in the food and distribution sectors, said the card has proven to be extremely successful, despite its costly and lengthy application process. In 2016 alone, over

400,000 transactions were recorded and R\$5.6 million (US\$1.8 million) disbursed. Indeed, this tool has been so successful that the credit limit was doubled in 2017 from R\$1 million (US\$303,000) to the current R\$2 million (US\$606,000), as confirmed by Alexandre Theme, service coordinator in BNDES' communications department. Moreover, the card has allowed BNDES to distribute its resources beyond Brazil's largest cities, reaching 98% of Brazil's municipalities, according to the bank's annual report for 2016.

BNDES is undergoing a marked expansion of its role.

In addition to the card, BNDES has designed and launched other financing instruments for the most innovative SMEs, such as venture capital and venture debt instruments. According to Small Business Insight, in 2016 the bank launched its third venture capital fund-of-funds offering, Criatec 3, with assets of R\$220 million (US\$70 million). Its objective is to "invest in private funds that will then invest in innovative sectors such as IT and biotechnology, with an annual revenue of up to R\$12 million (\$3.6 million)." As for the venture debt instrument, BNDES announced in April 2017 that it would use this tool to help support innovative small businesses. In particular, this instrument aims to grant credit to SMEs in the information technology, biotechnology, nanotechnology and audiovisual industries.

Taking into account the essential role that entrepreneurship plays in the sustained dynamism of the modern market economy, BNDES appears to be on the right track to continue promoting the development of the Brazilian economy. Nevertheless, its efforts need to be accompanied by changes in the legal and regulatory environment to facilitate the creation and sustainability of new businesses. According to Ernst & Young's G20 Entrepreneurship Barometer of 2013, bureaucracy continues to be the greatest challenge for SMEs in Brazil. The bank must also consider what role it wants in Brazil's future.

Choosing Its Role in the Economic Recovery

As Brazil desperately attempts to gain control of its budget and to shift momentum toward economic recovery, BNDES is undergoing a marked expansion of its role. At the onset

of the deep recession in 2015, demand for the bank's subsidized loans fell by 20% in the first few months of 2014, according to Reuters. Nonetheless, by the first quarter of 2017, it had bounced back, posting a year-over-year increase of approximately 25%, according to Valor.

However, BNDES finds itself embedded in the Brazilian budget crisis as the country grapples with lower-than-expected tax revenue. In August 2017, the Temer administration requested a transfer of R\$100 billion (US\$32 billion) in BNDES funds to the National Treasury to address a growing deficit, Reuters reported. The bank had already completed a similar transfer in 2016 as the government reduced the bank's activities. But the increased demand for loans and Temer's diminished political capital mean the bank is more resistant to historically out-of-scope activities. BNDES must prioritize: supporting loans for businesses and individuals in an attempt to aid economic recovery and stability, or funding an unpopular administration.

BNDES and the Path Forward

Once Brazil emerges from its deep recession, BNDES and its government overseers must determine how the bank will perform in the volatile Brazilian economy. They must decide whether BNDES should prioritize supporting the major corporations it has helped build in recent years; encouraging and enabling Brazil's emerging enterprises and entrepreneurs; or bailing out the cash-strapped government. An optimal solution may exist somewhere across the three, but each path will affect vastly different stakeholders in meaningfully different ways. If there is one common theme, it centers on BNDES' fundamental requirement to develop and strengthen its processes and procedures to improve accountability and transparency. Moreover, the bank must contend with new players entering the space as financial technology firms have attempted to bridge the gap between the oligopoly of commercial banks and BNDES to provide more affordable, accessible financing. BNDES' future goals, therefore, vary dramatically from each another. The bank's future centers on leveraging its improved ethical standards to strengthen its national image, to build trust across its national network and to encourage impactful, sustainable development in Brazil.

This article was written by Inés Bultó Riera, Júlio Erdos and Marty Long, members of the Lauder Class of 2019.

The Informal Sector in Sub-Saharan Africa

Getting a handle on the informal business sector in sub-Saharan Africa is no small task. It is mired in history, politics and a general distrust of government institutions, and entrepreneurs in the informal sector often don't have incentives to formalize. But that is changing with help from governments, the private sector and business associations.

The informal sector plays a major role in the sub-Saharan African economy, representing about 70% of total employment by most estimates. The International Labour Organization (ILO), a United Nations agency, estimates that this sector generates about 41% of the region's gross domestic product and accounts for up to 60% of GDP in Nigeria, Tanzania and several other nations. In most countries, GDP growth correlates positively to the growth of the informal sector.

The informal economy is one of the primary drivers of poverty reduction across Africa, providing entrepreneurial opportunities to uneducated and marginalized populations. About 84% of employed women are in the informal sector, and 93% of newly created jobs in Africa during the 1990s were part of this sector. However, as its presence and impact have grown, the informal sector has drawn increasing criticism and scrutiny because of unregulated business practices, risks to employees and consumers, and the fragility of the informal businesses themselves. As a result, despite the informal sector's major role across the continent, many actors — including business associations, governments and private-sector entities — are working to encourage formalization.

The informal sector is often based on a strong sense of community in which local entities usually define their own rules and organization. This community orientation is aligned directly with African cultures, which often exhibit disdain for and defiance of state domination, rooted in their colonial histories. In many African countries, trust in government is rather low, especially after myriad corruption scandals across the continent, and large segments of the population fail to see the benefit of operating a business within the formal sector. Because of this defiance and the nature of the informal economy, governments struggle to assess the extent of the informal industry and the needs of the population. This complexity makes formalizing economic activity particularly challenging.

What Is the Informal Sector?

Defining the informal sector is a challenge for those studying the economies of developing countries. Economists use a variety of criteria to define participants in an economy's non-agricultural informal sector. This article focuses on the three main aspects: the size of the organization, registration with government entities and compliance with government regulations.

The organizational size criterion is derived from the ILO approach, which defines an informal activity as an “unregistered firm where the owner is an individual or a household whose capital is not separable from that of the firm and for which there is not reliable accounting that could permit retracing the operations of the firm.” While this definition may appear straightforward, it is difficult to ascertain. Identifying the firms and organizations that meet this definition is left to the discretion of individual countries, so it varies widely.

The first and probably most important feature of the informal sector is its diversity across the continent.

The criterion of registration with government entities is also ambiguous and difficult to standardize internationally, especially because business registration can differ from country to country and even town to town. Most researchers utilize registration with the national tax authority when measuring this aspect of formality or lack thereof. At the same time, some firms obscure a portion of their outputs or activities from government entities, thus putting them in a gray area along the formal/informal continuum.

The criterion of compliance with government regulations can also cover a wide range of activity types, including entities that conform to regulations, remain in the “sphere of regulation” but do not conform, adjust their activities to remain within the regulatory sphere or remain outside the sphere altogether. This metric deems any firm described by the three latter categories as informal.

Informal activities, hidden from authorities, are often relatively free from government oversight and taxation.

Professor Aly Mbaye of the University of Cheikh Anta Diop in Dakar, Senegal, is one of the leading experts on the informal sector in West Africa. He believes “the most effective way to determine informality is along a spectrum of characteristics, so as to better understand the nature and the level of the informality of any particular enterprise.” In his work with Nancy Benjamin of the World Bank, Mbaye offers six levels of informality according to the number of criteria a particular firm meets. These levels encompass the differences between large and small informal sector operators, the social and demographic attributes of the owners, the fragility/stability of a firm and the level of participation in global markets, and other factors.

Other criteria that can be used to define or measure a business’s level of informality include (1) self-employment (an estimated two-thirds of informal firms in Africa comprise only the owner); (2) bookkeeping, both as a process and in practice (building further on the ILO definition above); (3) what sorts of taxes are paid to whom and how; (4) how employees are paid and whether they receive benefits or contribute to social security; (5) mobility in the work location and; (6) a business’s access to credit. A firm that meets any or all of these criteria finds itself along the spectrum of informality.

Examples of informal businesses help to characterize this sector in Africa. In Dakar, public transportation options include buses called cars rapides or ndiaga ndiaye, which

navigate throughout the city. Cheaper than taxis, they are used by most residents, from students to commuters. These buses are part of formally registered companies, but most of their employees belong to the informal sector. In Lagos, Nigeria, young men selling everything from biscuits to coffee machines can be found at traffic lights. In the West African nation of Benin, drivers buy gasoline in the street instead of going to a traditional gas station. In Abidjan, Côte d’Ivoire, small, informal restaurants called maquis are set up on sidewalks to sell grilled chicken or fish.

The first and probably most important feature of the informal sector is its diversity across the continent. For example, in Dakar the majority of informal companies are registered and implement some form of bookkeeping. However, they are usually small companies with very mobile businesses and limited access to credit or social-welfare programs for their employees. At the same time, in Yaoundé, Cameroon, informal businesses tend to be larger and locally established, with better access to credit than in Dakar and lower government registration rates.

Several other interesting features explain the informal sector’s dynamism. First, launching an informal business requires no administrative procedures. Informal activities, hidden from authorities, are often relatively free from government oversight and taxation. Also, informal commercial transactions require no costly processes or lengthy procedures (e.g., tracking accounting transactions, reporting invoices or closing financial years).

These features may be appealing, but they expose the stakeholders of these informal businesses to multiple risks. For example, the products sold can be dangerous or damaging to consumers (e.g., unregulated medications available at street drugstores). Informal businesses are also fragile; they are mostly unprotected from rackets by corrupt officials. These activities lack access to formal funding channels or public markets. In addition, informality brings significant difficulties to scale and fragility. Data gathered by Mbaye reveal that in a country like Burkina Faso, approximately 45% of informal businesses go bankrupt or simply cease operations within two to five years. Business owners are also at great risk from the consequences of potential bankruptcies because their personal belongings can be seized. For example, Bocar

Samba Dieye, one of the most prominent importers of rice, millet and maize in Senegal, lost three of his houses because his business owed banks €9 million.

Before designing policies or actions to manage the informal sector, it is necessary to understand the reasons for its development and why owners do not want to abandon this unstructured condition. First, research has shown that the unfavorable business environment, coupled with governments' inability to enforce laws, led to the informal sector's rapid development. For example, in West Africa, high electricity costs, high taxes, complex taxation systems, tax harassment, lengthy administrative procedures, limited transportation infrastructures and complex labor-market regulations inherited from colonization all explain why a business may remain in the informal sector. A 2016 World Bank study of Benin's program to formalize companies demonstrated that 80% to 90% of firms remained informal despite various actions such as in-person visits, access to government training programs, support to open bank accounts and tax breaks. This finding supports the assertion that informal businesses remain informal because of structural conditions.

Second, informal operators often have limited management skills. This may prevent them from knowing how best to manage, sustain and scale their businesses. For instance, the women of UNACOIS (a Senegalese association of entrepreneurs based in Dakar) expressed the need to better understand how to manage their businesses financially, how import/export or tax regulations apply to their businesses and, more generally, how the benefits of formalization can be outweighed by the associated costs. An entrepreneur who belongs to UNACOIS said many of her fellow entrepreneurs do not know how to export their products from Senegal to Mali. The lack of a proper export process and the corruption faced along the road pose significant barriers to the profitability of small businesses attempting to scale.

Initiatives to Manage the Informal Sector

Considering the hurdles faced by entrepreneurs in their formalization endeavors, several initiatives can be pursued to manage the informal activities in an attempt to benefit all the participants involved. Because they all contribute to and benefit from a more structured business environment,

three sets of actors play critical roles: businesses associations, governments and private actors. Associations of entrepreneurs identify their members' needs and develop solutions to meet them. For example, the dearth of skills among UNACOIS members prompted the association to partner with the University of Cheikh Anta Diop in 2014 to study topics ranging from tax reforms to protectionism initiatives (e.g., how to protect Senegal from competitive rice imports). UNACOIS also provides training and on-demand support, such as simplified documentation explaining the registration processes, to its members who need to improve their business-management skills or who decide to enter the formal economy.

In Lagos, Solomon A. Aderoju, chairman of the Nigerian Association of Small and Medium Enterprises (NASME), has proposed solutions to help entrepreneurs. His association offers networking opportunities to its members, including business forums and events where people can learn how to structure their firms more effectively for growth.

To support formalization, some government institutions facilitate business-creation procedures by simplifying the regulations or by training companies. For example, the chambers of commerce in Côte d'Ivoire and Nigeria organize training seminars, provide customers with a database and accelerate registration procedures to help informal entrepreneurs.

Other initiatives include the Nigerian government's decision to forgive past-due taxes and lower interest rates, encouraging currently informal businesses to begin formalizing. This move has been driven primarily by the drop in oil prices. Following several years of substantial oil revenues, the Nigerian government is now forced to rely on other sources of revenue, including taxes that numerous Nigerian companies have not yet paid. Even in North Africa, the government of Morocco created a "self-entrepreneur" status to enable individuals to launch their companies easily, without undertaking the heavy process required of businesses with more than two employees.

The private sector's role in the formalization process is just as important. In Kenya, the sanitation company Sanergy proposes a profitable formal business model to individuals who buy and run innovative public toilets, often offering residents their first opportunity for formal employment. With its mobile banking system, M-PESA,

Safaricom enables Kenyan companies to have an account that helps record their transactions and contributes to their formalization. In Dakar, Somtou offers a tablet to help small enterprises easily record their daily transactions and run basic financial accounting. For Ted Boulou, Somtou's founder, this tablet is a fundamentally useful tool for Senegalese entrepreneurs who aspire to grow their businesses. The company plans to enter the Ivorian market in 2018.

Whether they contribute to improving skills, to ensuring visibility to the government or to structuring how the businesses are managed, numerous initiatives toward formalization, run by all stakeholders, are indispensable for managing the sector and offering opportunities for growth and formalization.

It is clear that the informal sector is not only prevalent and central to the economies of many African nations, but its features and complications also vary greatly across nations. This makes the task of analyzing its impact, and proposing measures to better integrate it into society, fundamentally important and requiring tailored understanding. Indeed,

it seems impossible to propose general solutions. Yet the informal sector should not be regarded as the enemy of organized society. Rather, it may be a powerful source of growth and entrepreneurial flexibility. Efforts to better integrate it into society should focus on minimizing its less-social features, such as the lack of taxes or the difficulty in enforcing health and sanitation regulations. It is also fundamental to sustain its flexibility and protect it from the risks, such as difficulty in accessing capital or the likelihood of being targeted by corruption.

Going forward, initiatives involving all stakeholders in the informal sector should continue to be supported and fostered. Organizations such as UNACOIS, NASME and the chambers of commerce, coupled with emerging technological developments such as mobile banking, will likely accelerate the holistic integration of informal businesses and informal workers into the overall society.

This article was written by Medora Brown, Gracian Kamgang, Killian Marie, Isidro Pascual, Matheus Proença and Sadio Wade, members of the Lauder Class of 2019.

Is a Unified European Welfare State Possible?

European nations have a proud history of social benefits for their citizens. But these programs vary widely from state to state, even among the 19 members of the European Union. This article looks at the difficulties of implementing a unified welfare state across Europe and asks whether such convergence is even possible.

Few European political projects evoke the same level of cultural identity as the welfare state. Its history is as entrenched in the collective mind of its citizens as wine is in Italy, fine art in France or medieval town squares across Europe. However, the future of European welfare states, which can be traced to the 19th century, is uncertain given the evolving state of European integration.

Since Europe's integration into an economic unit through the 1957 Treaty of Rome, which aimed to create "an ever closer union," economists have recognized the need for European federalization of a number of traditionally sovereign functions. The question remains: Can the status quo be maintained for separate welfare states, or is a Europe-wide unification strategy necessary?

The Current Landscape Suggests Dispersion

There is a heterogeneous landscape of welfare states within Europe, leading to disparities in benefits for everything from health care to pensions, labor standards to unemployment benefits. Differences in welfare benefit levels among countries can be stark, even in neighboring nations such as France, Germany and Poland, which will serve as a case study here. Despite strides to elevate economic and social conditions across member-states of the European Union, Eurostat, the European Commission's Directorate-General of statistical data, highlights significant variations. Germany's €2.9 billion gross domestic product in 2014 represented over seven times that of Poland, while France's GDP was five times that of Poland. Unsurprisingly, government spending is correlated with GDP and thus reflects this disparity in wealth. In 2014, Poland spent about 8% of GDP on pensions, while Germany spent about 9% and France about 12%. On a per capita basis, that translates roughly to €850 per year in Poland versus €4,000 in France.

Two other areas require further attention: healthcare and unemployment. In Poland, government spending on health

care is a mere 6% of GDP, while France and Germany spend roughly 11%. On a per capita basis, that equals less than €700 in Poland and roughly €3,600 and €4,000 in France and Germany, respectively. This same pattern holds true for unemployment spending. Poland spent 0.2% of GDP on unemployment in 2014, compared to 2% in France and 1% in Germany. This equals a €650 outlay per capita in France — more than 20 times Poland's €30. If cost-of-living adjustments are taken into account, this variation may seem less meaningful. And these differences can be further explained by differences in Poland's currency value.

In Poland, government spending on health care is a mere 6% of GDP, while France and Germany spend roughly 11%.

Another fundamental issue of the current system is the inefficiency of redistribution and the duplication of structures in every nation. While redistributing benefits evenly across countries may be politically taboo, the current redistribution experienced through bailout packages could be seen as a manifestation of the presently unsustainable separation of welfare states. For example, Greece's welfare benefits as a percentage of GDP remain higher than average compared with its European peers. However, based on bailout packages negotiated and funded largely by European taxpayers, a transfer of wealth to fund these inequalities is already occurring. Likewise, structures such as national tax collection services are duplicated in each country, contributing to overhead fixed-cost inefficiencies.

In addition, debates as to how workers should accrue benefits when working outside their home countries are becoming more prominent. The disparities among

these systems and sovereign levels not only perpetuate inequalities in the quality of life across the EU, but also cause issues for citizens who must track a summary of benefits accrued across countries. Due to the free movement of labor across the EU, workers are now increasingly likely to be employed across multiple countries over their careers, including living in one location and working in another. For example, one could work and pay taxes in Germany, live and receive health care in France and retire and receive a pension in Spain. From the government's perspective, this is also problematic as pensions could be excessive for citizens living abroad and hence a wasteful expenditure.

It is clear that the status quo is unsustainable, given the inefficiencies and negative manifestations on both citizens and governments alike.

To pour funds into an effectively collective EU pot and distribute them evenly per person across countries would imply an averaging, which would be a politically uncomfortable reality.

A Historic Convergence Trend

Two primary courses of action should be investigated to resolve Europe's current welfare-state situation: allow the status quo to continue, recognizing that convergence is already underway; or push for an official, fully unified system. Evidence indeed suggests the former has already begun. This puts into question the true need for official reforms. Traditionally, wealthier countries, including France and Germany, have seen a reduction in welfare-state spending, contrasted with former Eastern Bloc members' increasing coverage levels across the board.

While substantial differences exist between Western European welfare states and the systems of newer members, it is worth noting that these differences may be overstated by politicians, heightening the fear that unification would be fraught with disaster. According to Siobhan McGarry, a director at the EU-focused public-

affairs consultancy Avisa, "Immigrants (from Eastern Europe) move for higher wages, not for social welfare. The disparities are not as important as populist parties such as Germany's Reformed Federal Democrats and France's National Front make them to be." The perception that EU citizens are moving to exploit social systems plays politically to concerned German and French citizens, although jobs and the free movement of labor are more important factors.

In particular, income and consumption levels have increased for the new member states that have joined since the EU expansion of the early 2000s. The effects of the "European convergence machine," as described by Tim Goedemé and Diego Collado in 2016 in the *Journal of Common Market Studies*, support this improved quality of life for poorer member states, including Eastern countries. For example, Poland has seen a dramatic improvement in many areas since joining the EU. In addition to substantial GDP growth, EU membership has helped modernize legal, institutional, economic, political and social aspects of life there. This increase in prosperity also appears, to some extent, in an enhanced welfare state and its systems. After the collapse of the Soviet Union, the eight new EU member states instituted a Bismarckian type of social-health insurance during the 1990s. In addition, many of these countries slowed or reversed the privatization trends in pensions in the 2000s, with Hungary adopting these plans and Poland and Slovakia pivoting to a pay-as-you-go system.

While relatively poorer countries have improved social-welfare standards since joining the EU, wealthier members have reduced the scale of their welfare states. In France, President Emmanuel Macron and his *En Marche!* party have adopted a pro-business and EU-centric reform platform. As reported by *The New York Times*, France's state spending has increased to 57% of GDP from 51% a decade ago, 18% higher than the average for developed nations. Macron has called this trend "no longer sustainable." Following through on campaign promises to reduce spending to 52% of GDP, he has already begun several initiatives to boost the economy and cut social spending. His first priority has been labor reforms, with laws already being presented to make managing employees easier for companies there. These reforms come at the expense of France's strong employee

protections and union power. Macron has also begun to rein in other public spending, including housing benefits, and has pledged to reform the pension system in 2018. However, his popularity has seen a steep decline recently, and past efforts to curb France's state spending have failed, including those by Macron when he was part of former President Francois Hollande's government. Even so, Macron's parliamentary support and business backing boost his chances of implementation, resulting in an overall predicted downward trajectory for France's welfare state.

This same downward trend has been observed in Germany, where the changing landscape of social welfare becomes apparent when speaking to the older generation there. According to renowned German author and journalist Helmut Kuhn, the 1960s and 1970s represented a "social paradise" within the country. Indeed, unemployment insurance, which was as much as 80% of prior salary then, has been drastically slashed since. As Kuhn notes, "Back then, German coffers were full. But after the wall fell, this all changed after reunification." For political reasons, there was generally no debate surrounding the spread of consistent social welfare benefits across the newly unified federal republic. Labor unions urged wage harmonization and have been criticized as partially responsible for inciting a period of high unemployment. Perhaps one of the most drastic reforms to the social welfare system was the Hartz Reform Package of 2005, which reduced benefits substantially for long-term unemployed citizens, from over 50% to around 20% of prior wages. While many economists praised the resulting 11% drop in unemployment, there has been criticism regarding the societal impacts. According to Kuhn, "The unemployment data [do] not accurately reflect the situation. While there is no absolute poverty, relative poverty remains a problem. For example, the income earned by a hairdresser is simply insufficient. Many citizens are forced to work part-time jobs and are just living paycheck to paycheck." Despite relatively high levels of benefits coverage in Germany, it is clear that this represents a modern low-point when contrasted with historic experience. Despite substantial convergence, the optimal solution remains elusive and, based on the pace of convergence, may not be realized for many years, if ever.

Is a Unified System Feasible?

Theoretically speaking, a unified EU-wide system would alleviate both the inequitable distribution of benefits received by citizens throughout Europe and much of the related debate described herein. The feasibility of this proposal hinges on which components of the system would be unified. Healthcare, pension planning, unemployment benefits and employee rights constitute core components of welfare-state benefits. But what mechanism could be used to administer such an overarching mandate?

While it is simple to agree upon constant levels of taxpayer-funded benefits, practical implementation can be challenging. A primary concern is equality of distribution. Varying levels of per capita GDP within the EU affect tax levels and the state budgets from which benefits are distributed. To pour these funds into an effectively collective EU pot and distribute them evenly per person across countries would imply an averaging, whereby citizens in some countries would see increasing benefit levels and others would see decreasing levels, which would be a politically uncomfortable reality.

Another challenge for implementation would be defining and agreeing upon minimum welfare standards. Given the current dispersion across countries and the sensitivity of the subject matter, this would be no easy task.

One potential solution would be a flexible framework that could ensure minimum standards but be adapted to different national realities, such as demographic dynamics, social protections, levels of national prosperity and priorities. One such example is the so-called "corridor model," proposed by Klaus Busch, an emeritus professor of European Studies at the University of Osnabrück. This model would create a coordination of welfare spending to regulate social expenditures, and national social expenditures could fluctuate nationally within this "corridor" or range. Governments would continue to be responsible for determining specific levels of benefits and services offered to citizens. Busch's research also suggests the introduction of minimum standards, including tax harmonization, minimum wage and other social standards. Such a system would be beneficial, for example, for Eastern

European countries that still need to reach a level of development similar to that of other EU states.

“As an introduction, the EU could allow citizens to opt-in to this system,” said McGarry from Avisa. States could then exempt those citizens from national contributions or pensions. “A unified pension system could be implemented in steps. It would be more feasible than healthcare, which is a sensitive subject since all countries think they have the best system.” Nevertheless, management of such a system would require a heavy administrative burden.

Additional challenges remain. A prerequisite is the political will to propose and implement such reform. Ewa Gallou, founder of a French firm that advises corporations on intercultural management, does not believe this is currently sufficient. She believes ideologically European countries should consider welfare a national concern, rather than a European one. This can be seen in the current international debate on the “Posted Workers Directive,” which allows European workers to retain social benefits when working abroad, where disagreements remain polarizing.

Finally, the administrative mechanism to implement unification would be complex and likely result initially in high costs. Other tactics within the EU toward further integration have been fraught with negative effects and, in

some cases, have not lived up to expectations. The biggest example remains the integration of the European Monetary Union (EMU) itself and the resulting joint currency. Despite this quite symbolic move toward one currency, the divergence of fiscal policy has resulted in a clear north-south divide of winners and losers. Hence, concerns about the viability of welfare unification, given the EU’s track record on integration resulting in consistent benefits for each member state, may be justified.

The state of the welfare system in European nations today may be suboptimal, even unfair. But given the lack of political will, a more efficient solution seems unfeasible despite the substantial and growing administrative burden to maintain coordination between fragmented systems. As the transition to an “ever closer union” progresses and the free movement of labor continues to become more pervasive, the disparity between benefits earned in one country and paid in another will likely increase. At such time, it may become necessary to unify welfare benefits across countries in order to avoid inefficiencies and to streamline these benefits for all.

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Can Brazil Become an Attractive Investment Destination?

Brazil has struggled under the weight of political corruption and economic uncertainty for years, which has made investors predictably reluctant to spend their cash there. But the country is poised to emerge as a strong investment contender thanks to increasing stability in the markets and an effort to reduce bureaucracy.

Brazil is going through arguably the worst political crisis in its history. Confidence in the country's political system is at an all-time low, and the negative publicity has poisoned the investment climate. But it is important to recognize this crisis as primarily political. Many regulatory problems need to be resolved through dialogue among the various stakeholders. Bureaucracy and overly burdensome requirements for starting a new company, paying taxes and even hiring employees have hindered the private sector for the past decade.

The news is not all bad, however, as Brazil's economy seems to be recovering from a deep recession over the last two years. The drop in oil prices, a wide trade deficit and high inflation exacerbated the economic downturn already intensified by some of the country's structural issues. With the gross domestic product beginning to grow again and inflation under control, investors seem particularly optimistic in the near to medium term for the prospect of investing their capital in the largest country in Latin America.

Despite its political mess, Brazil has solid economic fundamentals, such as low inflation and a relatively stable currency (by Latin American standards). Fortunately, its economy has been managed by capable finance ministers, including Henrique Meirelles and Nelson Barbosa, over the last decade. Despite all the political turmoil, they have been able to keep the economy from failing. Once the political situation stabilizes, Brazil is on the right track to excel. Unfortunately, the high level of uncertainty surrounding the country's political situation will continue until the 2018 elections.

Brazil's recent economic conditions rattled even the most composed investors, with a decline in GDP for 2015 and 2016 and the fall in oil prices. But the country's economy appears to be righting itself, with GDP projected to grow at 0.5% during 2017 and inflation under control at about

4%, according to the Central Bank of Brazil (CBB). In addition, Brazil's current risk-free rate, the SELIC, is at 10.25%, which provides an important monetary policy lever to stimulate the economy if necessary. While this rate could also be seen as an opportunity cost for investors and consumers, it also raises a question: Are returns attractive enough for investors to take their cash out of the bank and invest in risky assets?

Brazil's recent economic conditions rattled even the most composed investors.

Demographic Dividend or Tax?

Investing in Brazil is riskier than in more developed regions, but the potential rewards more than compensate. Brazil finds itself in an enviable demographic position in many respects. With the largest population in Latin America, at over 200 million, the country represents a market ready for growth driven by domestic consumption. For context, a company would need operations in Colombia, Argentina, Peru, Chile, Ecuador, Paraguay and Uruguay to match the market in Brazil. Thus, it offers a hugely attractive market for mass-market goods.

Brazil's Human Development Index has grown consistently over the last two decades. In addition, the country has more phone lines — 283 million — than inhabitants, according to the Latin America Private Equity and Venture Capital Association, leaving it ripe for mobile-first business models to experience large-scale growth. Despite this seemingly positive backdrop, important challenges lie ahead. Employee productivity lags at levels last seen in 1980, and

bureaucracy is often cited as one of the most important hurdles for the Brazilian economy.

Several aspects must be improved for Brazil to reach its full potential. Probably the most critical is the country's lack of funding for small and medium-sized enterprises. Historically, the Banco Nacional de Desenvolvimento Econômico e Social (BNDES), Brazil's national bank, has loaned money only to large Brazilian conglomerates. This must change. By freeing up capital, companies will be able to expand much faster, thus driving economic growth. One positive, given the economic downturn, is suppressed company valuations that offer a great deal of upside, which makes Brazil a prime destination for investors who are not afraid to take risks.

Third-party capital is necessary for businesses to reach scale and drive economic growth.

What Investors Say

Third-party capital is necessary for businesses to reach scale and drive economic growth. Even though credit is an important part of the equation in developed markets, Brazilian financial institutions are still not meeting the demand from small and medium-sized companies. In the instances where they do, interest rates exceed the rational cost of capital for many potential borrowers, especially considering the burden of servicing that debt. In this case, equity investors need to fill the void. As suggested above in the context of high interest rates, a return commensurate with Brazil's risk needs to be considered. According to the Brazilian Association of Private Equity and Venture Capital (ABVCAP), R\$18.5 billion was invested in 2015, an increase of 39% year-over-year and the largest amount invested since 2011. Brazil also continues to be a destination for foreign direct investment and received US\$65 billion in 2015, the eighth-highest FDI in the world. These numbers are a positive indicator, but what are investors expecting for the future?

According to a 2017 study by ABVCAP and the Brazilian Agency for Promotion of Exports and Investment (Apex-Brasil), 88% of investors surveyed expected to increase

the amount committed to investment in Brazil, and none expected to reduce their current allocations despite the economic and political situation. The study also found that 82% are interested in increasing their investment in Brazilian fund managers. In addition, it notes that, "the global tendency was to increase investment and maintain or reduce fund manager relationships" in previous years, signaling an important shift in investor sentiment. Another study, conducted in 2016 by Cambridge Associates and LAVCA, reached similar conclusions. It found that 59% of investors surveyed "plan to increase their bets in Brazil" and have a preference for funds focused on Brazil in particular.

The heavy regulation and bureaucracy that characterize the domestic market is not completely negative, given that it often acts as a barrier to entry. Businesses and investors still face a number of challenges and, despite the current political turmoil affecting the country, Brazil is in the process of implementing a number of market-friendly legal reforms.

Barriers for Private Investors

Brazilian law accords no preferential treatment to domestic companies over foreign-owned competitors. However, there are still limitations to foreign investment in sectors such as financial services, aviation, communications, defense and security, among others. Another challenge facing both domestic and international private investors is the subsidized interest rate (well below market) offered by BNDES in its investment projects. Private investors find it very difficult to compete as their margins cannot withstand a reduction in the interest rate that would put them in the running. According to Renato Jansson, chief of Investor Relations at the CBB, measures should be implemented to bring BNDES' interest rates close to market levels in an effort to favor competitiveness and to open new investment opportunities.

As previously mentioned, Brazil is taking the necessary steps toward making reforms that are key to attracting investment. One such step is the project to reform labor laws, which is known as Consolidação das Leis do Trabalho or CLT. The project was approved by the Senate on July 11, 2017, and will be subject to further discussion between the government and the opposition. It aims to give more flexibility to the labor market, favoring private negotiations

between companies and employees. This can improve hiring and help create new jobs by lowering some of the hurdles and expenses related to hiring and dismissing employees currently borne by companies, to the benefit of both companies and investors.

From the private-sector perspective, the project of reform is seen in a very positive light. According to Alexandre Stephan of Aqua Capital, a São Paulo-based private equity firm, the proposed reforms would help companies increase hiring. Issues such as the modification of how hours in itinere (time spent commuting to work) are regulated — currently considered part of working hours — and the reduction of breaks during the work shift — from one hour to 30 minutes — are examples of steps taken toward regulation more in line with the current challenges facing the labor market. However, Stephan also believes it is necessary not only to change the law, but also to change the culture of paternalism toward workers.

More Reforms Ahead

The CBB considers reform of the Brazilian pension system, currently under discussion, an essential measure. According to Jansson, this reform is essential for the country's future fiscal viability because the current unfunded pension liability gap will be impossible to bridge. Santiago Fernández Valbuena, a partner at São Paulo-based venture capital and private equity firm Invest Tech, thinks the pension reform will free up resources that could be invested by companies in other phases of the production process.

In Jansson's opinion, if and when labor and pension reforms are finally approved, the next step must be a reformation

of the tax system. Fernández agrees, especially with regard to "indirect taxes," that is, taxes hidden within the costs of goods and services. He also advocates a simpler tax system that reduces the estimated 2,000 hours and vast resources companies dedicate to preparing and filing tax returns.

Finally, businesses in Brazil face the challenge of excessive red tape. According to the World Bank, in 2016 it took 79.5 days to start a company there, by far the longest period compared to other Latin American countries such as Chile (5.5), Mexico (8.4) and Colombia (9), and nearly four times more than the world's average (20.9). However, it is important to recognize the considerable effort past governments demonstrated in reducing this period from 159 days in 2003.

It is difficult to predict whether Brazil will stop being the "country of tomorrow" and become the attractive destination for capital, companies and workers that many have long expected it to be. Much of this will depend on whether the government can actually work through Operation Car Wash, a criminal investigation covering widespread corruption among politicians and large Brazilian corporations, and institute the necessary reforms. Despite the current political crisis, the fact that rampant corruption is being identified and prosecuted is a sign that the country's institutions are somewhat functional. If it can emerge stronger on the other side and clear some of the government-imposed hurdles, the investment upside could be substantial. Investors seem optimistic and increasingly willing to focus their efforts on Brazil.

This article was written by Alejandro Navarro, Federico Navas and Néstor Hugo Solari, members of the Lauder Class of 2019.

The Awethu Project: Creating Opportunity for South African Entrepreneurs

The Awethu Project of South Africa finds and develops talent in places that most others ignore. By investing in entrepreneurs who come from traditionally disadvantaged backgrounds, Awethu is redressing the legacy of apartheid and empowering citizens to contribute to their communities. Can Awethu's successful model be applied in other poverty-stricken locations?

The English proverb that “opportunity knocks at every man’s door” may be true for most of the developed world, but it rarely applies in regions with great inequality. Opportunities combined with talent, preparation and hard work feed a positive spiral that enhances success, but even the most talented would struggle to thrive under less-privileged circumstances. In fact, in most of the poorest communities, it is much easier to fall into a downward spiral where impoverished conditions are reinforced, drawing talent further away from life-changing opportunities. The Awethu Project (hereafter Awethu), a South African investment company and small-to-medium enterprise (SME) incubator, has developed innovative ways that tap into and leverage these talents. It aims to democratize opportunity and create a fair playing field in which all entrepreneurs in developing countries can realize their potential. With a deep understanding of South Africa’s historical and political context, it has aptly implemented talent search and matching methods and has introduced new financing and investment strategies that provide alternative solutions to political and regulatory demands.

Awethu believes ‘leadership means conviction’ and works toward unlocking candidates’ real potential.

Mining for Talent

Awethu believes in the IQ-curve distribution, an idea that relies on the statistical probability that people with talent and an entrepreneurial spirit can be found anywhere, regardless of economic or educational background. To take advantage of this distribution and leverage this talent,

Awethu implemented its first “brick-and-mortar mining for talent” approach in 2012.

Awethu began with the aim of distributing \$1.5 million of investment to 500 micro-entrepreneurs. To mine 500 talented individuals and create 1,000 jobs in the process, it developed a traditional brick-and-mortar method, starting with 30,000 applications that eventually resulted in a shortlist of 512 candidates. Of this group, only five to 10 had investable business ideas. But Awethu did not want to leave the other 490 entrepreneurs behind, as they had the real opportunity handicap. According to Awethu Chief Investment Officer Rob LeBlanc, these candidates lacked bankable ideas because of their historical lack of education, meaningful professional exposure and socioeconomic standing, which were not factors unique to South Africa. Awethu believes that education and exposure can help source high-quality ideas for these talents. By 2017, it improved its traditional method and processed over 100,000 applications. As CEO Yusuf Randera-Rees noted, “Over the last four years, 100,000 people applied to our incubator. We only had the resources to incubate the top 2,100, and those entrepreneurs have created over 2,500 jobs.”

How is Awethu seeking talent? The mining method involves setting up events in South Africa’s poorest neighborhoods, such as in the township of Soweto, often in collaboration with high schools and governmental organizations such as the National Treasury’s Job Fund. These events are at their peak on national holidays such as Youth Day, which is held June 16 to commemorate the contribution of youth in the downfall of apartheid. By using proprietary methods such as psychometric tests and screening, Awethu first seeks candidates with English literacy, basic numeracy and a drive to escape the downward spiral. LeBlanc said by lowering barriers to entry this way, it levels the playing

field and leaves the rest to hard work. After being admitted to the training program, these candidates are further evaluated on attendance and performance. “The better an entrepreneur does, the more access to resources, markets and networks she/he can earn into,” LeBlanc said. Thus, mining unearths talents from the IQ-curve, and training weeds out those who are not committed to prospering while equipping those who remain with the proficiency to succeed.

Awethu has recently revolutionized this method through technology. “With the launch of our virtual incubation app, we hope to unlock the talent and ambition of tens of thousands more,” LeBlanc said. “This is, therefore, an exciting time.” Since it was launched in July 2017, the app has been downloaded more than 9,000 times and been rated 4.5 out of 5 stars in Google Play. Going forward, LeBlanc believes this app will be more effective than the brick-and-mortar method, primarily because it casts a much wider net. In addition, the app does not preclude in-person incubation because an app “graduate” can always apply for the traditional brick-and-mortar offering. App accessibility — specifically smartphone and data availability — is a concern, but Awethu has always been pragmatic in developing its incubation and investment models. If there are five million informal entrepreneurs in South Africa and smartphone penetration of close to 85% with marginal data costs, then Awethu’s innovative talent-finding process theoretically could reach 4.25 million people — a much greater yield than the traditional approach.

Bridging the Employment Gap

Awethu’s innovation is not limited to mining talent through technology in developing countries. It also capitalizes on the gap between unemployed talent and business opportunities. South Africa has a unique business environment: In the aftermath of apartheid, the government has implemented a program to accord economic privileges to previously disadvantaged black workers. The Broad-Based Black Economic Empowerment Act (B-BBEE), which was introduced in 2007 as a modified version of the BEE Act implemented in 2003, has been a challenge for white-owned companies that are required to recruit black employees for their workforce and management positions. Awethu helps these companies through what is called the Awethu Investment Process, an

investment strategy that recruits and trains talented black candidates to join white-owned companies and ameliorate the companies’ B-BBEE scorecard.

The strategy serves as a platform for search funding in which Awethu takes on the risk of training a candidate suitable for a B-BBEE-compliant position among SMEs that cannot afford the cost of the hiring process or do not have access to a pool of talented individuals. This innovative process combines in-house training for the candidate (who is called the black principal) with professional coaching as well as funding to the SME in the form of equity capital. The training component includes both learning technical aspects of the business along with managerial and leadership preparation for the black principal’s future succession of the incumbent management team. Awethu believes “leadership means conviction” and works toward unlocking candidates’ real potential. In addition, by committing capital, it aligns interests with other stakeholders and provides a different value proposition than traditional headhunters do. As LeBlanc explains, “a headhunter only finds and places a candidate. In addition to supporting this process, we also invest equity in the business, make some of our shareholding available to the black principal over time, and then invest in the training and development of the black principal for the five- to seven-year life of the investment, in addition to providing post-investment support to the entire business.”

By applying Awethu’s black principal approach of committing to train and fund talent development for gender diversity, the current gender gap in the workplace could be narrowed.

A New Way of Financing

Awethu’s innovative approach is not just about talent search and matching. With capital injection from large companies such as the South African Breweries Ltd. (SAB) and Imperial Logistics, Awethu has launched SME equity funds that are designated specifically for investment within

the supply chain of these companies. The SAB Thrive Fund and Sinawe Fund (Imperial Logistics) are managed exclusively by Awethu and epitomize financial innovations that attempt to tackle both economic and political issues in South Africa. Economically, not only do they provide supply-chain companies with scarce capital, but they also give these SMEs long-term offtake agreements with their customers. From the investor's perspective, with checks as small as \$140,000, they are able to de-risk investments by investing in suppliers with better earnings stability due to these agreements. By creating a fund structure around their own suppliers, the Enterprise and Supplier Development (E&SD) paradigm shifts from a traditional cost-intensive initiative vigorously mandated by the B-BBEE codes to a profit-centered relationship with commercially competitive return targets of more than 20%. Other benefits to investors include a low-cost underwriting model with due diligence managed by Awethu in collaboration with the investment targets who are expected to prepare documentation on their own pre-deal, as well as proprietary investment screening models and fund management expertise provided by the Awethu team.

These funds also address the growing pressure of complying with the B-BBEE initiative. Funds such as Sinawe are considered black private equity funds, which have a special designation in the B-BBEE codes, allowing companies to invest their B-BBEE budgets in its suppliers for returns. In addition to delivering high returns and compliance with the codes, further introduction of these funds can ultimately drive greater black representation and overall growth of SME suppliers for many sectors while adding jobs and addressing South Africa's legacy of inequality fortified by apartheid.

The Applicability of the Awethu Investment Approach

The black principal-centric process, focused on helping businesses seeking B-BBEE solutions, is unique to South Africa. However, we could consider the B-BBEE legislation more broadly as an example of politically and legally mandated solutions. Would it be any different from requiring that women serve on boards of directors or setting minimum requirements for disabled employees' tax benefits? For example, the "King Report on Governance for South Africa" in 2002, along with the "King Code of

Governance for South Africa" in 2009 (part of what is known collectively as King III), require that boards of directors of public companies be balanced in terms of age, nationality, diversity, gender and experience.

Gender equality, in and of itself, is seen as a daunting task for many countries. Educational and cultural limitations constrain women from actually gaining access to the same pool of opportunities. Such situations may present an opportunity to replicate the process focused on placing black principals for equal-opportunity employers. In tailoring Awethu's investment in black principals to focus more exclusively on female principals, SMEs would be incentivized to hire women. The training component would empower women who are willing to take on higher-level responsibilities but do not currently have access to managerial positions given their lack of experience. In addition, Awethu's investment in the hiring company would provide greater appeal to hiring women. This combined approach would channel both knowledge and funds so women could be educated and businesses could benefit from gender diversity. By applying Awethu's black principal approach of committing to train and fund talent development for gender diversity, the current gender gap in the workplace could be narrowed.

This approach could also tackle ad hoc problems elsewhere, such as the refugee crisis. Based on Awethu's belief in equality, assuming that the distribution of the IQ-curve is also applicable within refugee communities, there should be an opportunity to seek out talent there. Given the current levels of refugees and unemployment, an efficient process for (1) selecting and helping the best prospects develop the skills to integrate into the labor market and (2) helping to fund the companies that hire them should be highly attractive to countries with a high influx of refugees, such as Germany and Jordan. Awethu's program could be championed by multilateral institutions such as the World Bank or the United Nations as a means of reducing inequality while fostering long-term and sustainable solutions for unemployment and forced human mobility.

Prospects for the Future

Driven by the massive gap in access to finance that SMEs experience in developing countries, there seems to be considerable demand for innovative financing models such as Awethu's. According to the World Bank, approximately

70% of micro, small and medium-sized enterprises (MSMEs) in emerging markets face insufficient access to capital. Current credit gaps for formal SMEs and for both formal and informal SMEs are estimated to be as high as \$1.2 trillion and \$2.6 trillion, respectively. The credit gap is particularly wide in Asia and Africa, according to research conducted in 2015 by the World Bank. Moreover, limited access to finance is hindering SMEs' participation in the global value chains, which is an important driver of economic development. This integration of SMEs into the global value chains is especially critical in developing countries, where these businesses represent about 80% to 90% of total employment, based on a 2014 report by the Organisation for Economic Cooperation and Development (OECD), the World Trade Organization (WTO) and the World Bank. Moreover, such integration benefits the home countries through spillovers of production technology and management expertise. Nevertheless, the lack of capital is cited as a challenge that undermines SMEs' engagement in global value chains.

Several fundamental economic, regulatory and social conditions need to be in place for Awethu's equity fund model to succeed in other developing countries: (1) a sufficiently large number of operating partners who are willing to invest their own capital to develop local SME supply chains, (2) local or regional capital markets that are mature enough to accommodate exits of investments, (3) a local regulatory framework to facilitate the large number of equity acquisitions by such micro-cap funds

and (4) receptivity by the SME owners, many of whom rely primarily on traditional financing options such as bank and non-bank credit and informal individual borrowing, to equity capital. Regulatory restrictions and SME owners' perceptions pose challenges when the operating partners are foreign-owned entities in sectors that are generally subject to government control, such as agriculture and retail. However, recent developments in pro-business regulatory changes and capital markets in a number of developing countries are hopeful signs.

The Awethu Project epitomizes innovative spirit and the alignment of intricate stakeholders' interests. Its innovative spirit is evident in its effort to bring fresh perspectives and applications to business ideas that have existed for a long time: talent search, venture incubator and private equity fund model. Awethu's initial success probably would have been impossible without its ability to align the interests of critical stakeholders, including local entrepreneurs, business partners and the local government, especially because the company operates at the intersection of business and sociopolitical challenges. Implementing Awethu's business innovation in other markets requires this unique intersection. The most critical first step is keeping an open mind when these ideas knock on the door.

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China's Belt and Road Initiative

The Belt and Road Initiative is an ambitious infrastructure project that, if completed, would give China unparalleled economic power in the world. Although funding for the initiative has begun, questions remain on whether this dream of a connected global trade corridor will be realized, and how China would wield such massive power.

The year 2008 was a significant global tipping point. The Western world was grappling with a crippling, systemic financial crisis triggered by the collapsing real estate market in the United States. At the same time, Beijing was excitedly preparing to put its best foot forward on the world stage by hosting the Olympic Games. The U.S. was in decline while China was on the rise, imbuing its people with a new sense of self-confidence in its system and its values. In 2008, the country was still hesitant to take a leading global role, but much had changed by 2017. While the U.S. has submitted to widespread protectionist domestic sentiment by withdrawing from the Trans-Pacific Partnership (TPP), cutting international aid to balance its budget and entertaining restrictive immigration and trade policies, China has adopted a growing globalist demeanor, exploring ways it can expand its international influence. Nothing embodies this newfound Chinese identity more than its plan to reconstruct the ancient Silk Road trading routes: the Belt and Road Initiative.

The U.S. was in decline while China was on the rise, imbuing its people with a new sense of self-confidence in its system and its values.

What Is the Belt and Road Initiative?

President Xi Jinping first introduced the Belt and Road Initiative (BRI)—formerly called the One Belt, One Road initiative—in 2013. It is one of China's key national strategies that seek to develop an infrastructure network of railways, roads, utility grids, ports and more, extending through six economic corridors that connect Asia,

Europe, the Middle East and Africa. It is a global project of unprecedented scale, involving more than 60 countries and 60% of the world's population, and it will impact more than one-third of the global gross domestic product.

In order to resurrect the old Silk Road, China has already signed bilateral cooperation agreements with a number of countries, including Hungary, Mongolia, Russia, Tajikistan and Turkey. It has also established new financial institutions, such as the Asian Infrastructure Investment Bank (AIIB), to help finance the project along with its other current commercial banks—the China Development Bank and the Export-Import Bank. While financials for the project have not been made public, an Oxford Economics analysis estimates that Chinese state-owned banks gave more than \$90 billion in loans to BRI countries in 2016 alone. Credit Suisse projects that Chinese investment in foreign countries will exceed \$500 billion over the next five years.

Through the BRI platform, China seeks not only to connect the world physically and reduce the transaction cost of trade, but also to strengthen its global position through enhanced economic, social, cultural and policy cooperation.

What Are China's Motives for the BRI?

If successful, China stands to gain tremendously from the BRI. At the 2017 Wharton Global Alumni Forum in Hong Kong, former Australian Prime Minister Kevin Rudd explained the country's four primary motives for promoting this initiative.

First, China has excess capacity for laborers, and the BRI has the potential to create millions of jobs for Chinese workers abroad. Professor Justin Yifu Lin, former chief economist at the World Bank and a key China strategist, explained during a talk at the Penn-Wharton China Center in June 2017 that infrastructure development propelled

China's growth over the last three decades. Thus, China has the expertise and capacity to help other nations develop their own much-needed infrastructures and economies. The Communist Party's foremost fear is an economic slowdown. The People's Republic of China (PRC) is able to govern in an autocratic manner largely because it has increased its citizens' wealth. But if China's economy continues to slow down, a rebellion by the people will become a possibility. To hold on to its power, Rudd noted, China cannot afford to have idle laborers. The BRI provides an excellent opportunity to deploy and keep busy the millions of construction workers who may soon run out of work in mainland China.

Second, demand for infrastructure improvement is at an all-time high. A research study conducted by the McKinsey Global Institute estimates that, even as the world invests \$2.5 trillion a year in infrastructure, it needs to invest \$3.3 trillion to support the current rate of growth. Underdeveloped countries that would be connected as part of the BRI — such as Sri Lanka, Laos, Kenya and Kyrgyzstan — stand to benefit greatly from the infusion of investments, and the return from these infrastructure projects will fuel further economic development in these nations.

Third, there is still a mistrust of the Chinese government, with accusations of currency manipulation and a lack of transparency in its business dealings and operations of state-owned enterprises. Even though China has experienced phenomenal GDP growth over the past three decades, the country's risk profile is still high. Thus, it is relatively difficult to attract foreign direct investments (FDI). While China has already made a massive financial commitment to the BRI, the scheme needs many more investments from other governments and foreign enterprises. Through the BRI, the country seeks to attract even more FDI to propel its economic growth.

Lastly, China stands to gain much from strengthening its relationship with its neighbors. It shares land borders with 14 countries. While it is on track to surpass the U.S. financially, it is far behind the U.S. militarily. By helping its neighbors and other regions develop economically and playing the role of a benign leader, China seeks to gain political points as it ascends the global stage.

Why Does It Matter?

Why is the BRI such a critical project today, with some even calling it the most important project of the 21st century? At the 2017 Wharton Forum, a number of leaders from across Asia explained why everyone should be paying close attention. If successful, the BRI will boost China's global influence significantly and give China the opportunity to overtake the U.S. as the new global leader.

AIIB, the bank set up specifically to raise funding for the BRI, is already giving other development banks a run for their money. It competes with the World Bank on investments, and the new pressure it may pose could be a catalyst for speedier (albeit lower-standard) development for countries around the world that desperately need capital.

If successful, China stands to gain tremendously from the BRI.

Yasushi Katsuma, a leading professor of global public health at Waseda University, discussed the possibility of the TPP being established without U.S. participation. The Trump administration pulled out of the TPP in early 2017, creating uncertainty about the future of Japan's trade practices. Since then, Japan has taken the unprecedented initiative of negotiating its own trade deals. Katsuma touched on the potential of an economic partnership agreement between Japan and Europe. After decades of rapid globalization, many nations, including the U.S. and Japan, are witnessing a reversing trend to economic protectionism and nationalism. If successful, the BRI would impede these political movements.

Not everyone is so pessimistic about China's rise and the BRI project. Kiyoyuki Seguchi, director of the Canon Institute, a leading think tank in Japan, acknowledges the growing "exclusive regionalism and protectionism." At the same time, he also emphasizes that a successful BRI would bring much-needed economic development for countries, making it a win-win situation for all the nations involved. In particular, he believes Japan has the unique technologies that would be highly valuable to the BRI project, and the

country could benefit financially by partnering with China on this initiative.

Currently, it is difficult to decipher the potential opportunities and costs of the BRI because this is only the beginning. During the May 2017 Belt and Road Forum in Beijing, President Xi Jinping presented a vision of the values the initiative could promote in the world. Referencing the idyllic image of the ancient Silk Road, he emphasized the potential to rekindle the spirit of peace and cooperation, openness and inclusiveness, mutual learning and mutual benefit among Asian, European and African neighbors. Many support his view, acknowledging the potential improvements that Chinese financing could drive in developing countries that are economically restrained by their lack of modern domestic infrastructure. Chinese conglomerates, such as the CITIC Group, that are managing the infrastructure directly, laud the initiative for offering a state-sponsored, no-strings-attached funding source. For many developing countries, that is a welcome alternative to funds offered by the IFC, the World Bank or the U.S. government that often tie adherence to standards for societal issues such as human rights or environmental protection. Developing countries also see an opportunity to adopt a proven economic development model. “Socialism with Chinese characteristics” successfully lifted 439 million people out of poverty, and China has built the credibility to help other countries in the region.

Regional peers such as Japan, Korea and Singapore also see benefits from the initiative. For the Singaporean Ministry of Trade and SPRING, Singapore’s initiative to support domestic startups, China’s growing influence is generally a good thing, providing Singapore — a small nation with limited resources — with a mutually beneficial value chain to deliver new products and services abroad. It means a growing consumer population that will bring more opportunities for Singapore to provide and export high-tech services such as cybersecurity.

While many observers perceive the policy as positive for

China’s domestic economy and the Asian region as a whole, others are more skeptical, viewing the initiative as a way to build China’s dominance in Asia and on the world stage. As American pundits see it, the BRI is a neo-colonialist initiative: By funding much-needed infrastructure projects in developing nations, China could be developing a system of international dependence and geopolitical leverage. Others doubt the transparency behind explanations of the initiative. Bilahari Kausikan, ambassador-at-large at the Singaporean Ministry of Foreign Affairs, said, “China can use the BRI as an excuse for anything,” even developing military resources to operate in the South China Sea. It is also not only the experts who doubt the Chinese government’s motivations. Even a cab driver in Beijing claimed, “every country’s the same to the people.... There’s no way they’ll give it to the people. Everyone who serves the government will take money for themselves.”

While it is difficult to know precisely how China’s ambitious BRI will impact the world, one thing is clear. How the country implements the policy will provide a hint of an answer to a question long debated in the international community: What are China’s global ambitions and what sort of global power will China be? In making the BRI a reality, China will finalize its identity as a world power. Will it be a regional bully, taking advantage of its newfound economic leverage over other countries? Or will it be a role model, exporting its successful model of economic development to others? Will it uphold Western norms and cooperate with the international organizations that have structured international politics for the last 100 years? Or will it create its own system influenced by Chinese values? Will the BRI be sufficient to maintain Chinese economic growth? Or will unsustainable debt levels bring it crashing down? This initiative will determine how we will decipher what sort of leader China will be and what impact it is destined to have on the world.

This article was written by Julia Madden and Sijia Yu, members of the Lauder Class of 2019.

Refining Palates: Colombian Coffee's Transition in the Third Wave

Colombian coffee has long been popular for its taste and quality, but the national export is facing new challenges in the era of specialty coffees known as the third wave. This article looks at the profit decline of Colombian coffee and what the sector can do to get back on top.

Wine, beer and whiskey all have something in common. Each is considered an ancient beverage that has been enjoyed for centuries as a commodity. Yet over the past century, markets have emerged around unique and rare varieties of these beverages, some of which have become specialty products.

Coffee is undergoing a similar transformation known as the third wave. The first wave, which started roughly in the 1950s, is considered the era in which coffee was produced, blended and roasted on an industrial scale, sacrificing taste and quality. Instant coffees, made by American brands such as Maxwell House, Folgers and their European counterparts, were consumed primarily in the home. The second wave, which began in the late 1990s, was characterized by an increased focus on better-tasting coffee and the emergence of a massive retail industry, marked by the dominance of Starbucks. The Roasters Guild broadly defines the third wave as a movement in which a coffee's value is based on its origins and artisan methods of production and preparation. According to industry publication Craft Beverage Jobs, this movement is characterized by small independent roasters and coffee shops such as Intelligentsia or Stumptown. The term third wave is often used interchangeably with "specialty coffee," but they should be treated as two distinct concepts.

The key ingredient of the third-wave movement is the product itself. Certified graders assess coffee beans a cup score that ranges from 0 to 100. The Specialty Coffee Association (SCA) defines specialty coffee as Arabica coffee with a cup score of 80 or higher. The SCA also gathers data from roasters and retailers and publishes specialty coffee industry benchmarks. The popularity of this movement facilitated a 193% growth in the specialty-coffee market in the U.S. alone from 2003 to 2013, according to SCA data. While the primary consumers of specialty coffee are in

developed markets, their producers are almost exclusively located in developing countries. Growers in Ethiopia, Brazil, Costa Rica and especially Colombia, among others, have benefited from rising consumption in developed countries. Nevertheless, compared to the consumption of all Colombian coffee, Colombia's specialty varieties constitute only a modest share of the market.

Colombian growers struggle to command top prices in the ultra-premium market for single-origin coffees.

The domestic coffee market in the U.S. has an estimated value of \$48 billion, of which \$26.4 billion (or 55%) is considered specialty. Despite Colombia's popular reputation for high-quality coffee, it represents only \$4 billion (or 15%) of U.S. specialty coffee imports in terms of value, compared with \$6.6 billion (or 31%) for non-specialty coffee.

One variety of specialty coffee is known as single-origin. These beans are unique in the manner they are sourced and roasted. Most importers sell blended coffee — purchasing beans from a variety of countries and regions, then blending those beans to create a balanced flavor. Importers of single-origin coffees, however, source beans from a single area, often from a single farmer. In some cases, farmers may even set aside micro-lots — or small-production quantities from specific areas of their farms — that produce beans of exceptional quality. These growers can command a substantial price premium for their unique products, according to Caffé Society, a firm based in the United Kingdom.

Is Colombia Left Behind by Coffee's Third Wave?

Since the emergence of the third wave, Colombia has struggled relative to other coffee-producing countries and has seen its historical price premium evaporate. Many of its producers have had difficulty accessing the U.S.-based micro-roasters at the forefront of the movement. In addition, the country's national coffee business cooperative, the National Federation of Colombian Coffee Growers (FNC, its Spanish acronym), had to adapt from initially promoting all Colombian coffee as high quality to now catering to a market that demands increasingly smaller batches of coffee to deliver more pronounced flavor profiles.

Awareness, access and logistics are major challenges for small producers in Colombia who want to partner with third-wave importers.

Historically, Colombian coffee commanded a price premium in international markets. According to data from the International Coffee Organization from 1990 to 2000, on average Colombian arabica coffees sold for 7.7% more than comparable coffees from all other countries excluding Brazil. This was due in no small part to the FNC's quality control and marketing efforts. Beginning in 1958, the cooperative promoted Colombia's product internationally through the Juan Valdez brand. According to a report by Hein Jan van Hilten and Joost Pierrot at the International Trade Center (ITC), the marketing campaign successfully established "100% Colombian coffee" as a differentiator and a marker of quality. Craig Deahl, co-founder of Brooklyn-based roaster Superlost Coffee Roasters, confirmed this reputation is well deserved: "Most production in Colombia is higher quality. They harvest cherries individually when they are ripe, not all at once. The tradition is very strong. There is a culture of high quality production that the FNC has helped cultivate."

Despite Colombia's reputation for offering high-quality coffee, the premium the country's producers had been able to command in recent years has decreased substantially.

Since 2013, following Colombia's recovery from the *la roya* coffee blight that had decimated output, the premium for the country's arabicas has disappeared. In fact, data from the International Coffee Organization shows that Colombian coffees sold at a slight discount compared to other non-Brazilian arabicas in 2016. (Brazilian arabicas consistently sell at a 10% to 20% discount to the overall market.)

Moreover, Colombian growers struggle to command top prices in the ultra-premium market for single-origin coffees. In fact, within this important and growing niche segment, Colombian coffee does not appear to command any price premium. The Alliance for Coffee Excellence organizes the annual Cup of Excellence awards, during which growers of the world's best single-source coffees can auction their beans to buyers from all over the world. In 2015, the most recent year for which full data is available, Colombian coffees sold for lower prices on average than those from any other country (excluding Brazil) in which these auctions were conducted. While Colombian single-origin micro-lot coffee auctioned for \$5.65 per pound on average, micro-lot products in El Salvador, Costa Rica, Guatemala and Rwanda sold for nearly twice as much on average.

From Commodity to Niche: The Challenge for Colombian Producers

In lieu of quality, the challenges for Colombian producers involve adapting to the demands of a new type of partnership with buyers. Awareness, access and logistics are major challenges for small producers in Colombia who want to partner with third-wave importers.

Many third-wave importers have exacting quality standards and are prepared to work with all levels of the value chain to ensure they are met. This approach differs from the traditional model of sourcing coffee, in which importers and producers have an arms-length relationship. Many individual producers are not aware of or accustomed to the new model. Successful single-origin producers need to be aware of their buyers' specifications. For example, the SCA, whose guidelines are representative of third-wave importers, sets specific standards for maximum levels of defects in samples of green (or unprocessed) coffee beans. The FNC could do more to publicize these guidelines and the premium prices that can be achieved by meeting them.

While the FNC has supported and promoted specialty and single-origin Colombian coffees abroad, primarily through its Juan Valdez brand and retail subsidiary, it has not done enough to facilitate direct commercial relationships between producers and third-wave roasters. These connections are key to the third-wave approach. The challenge for the FNC today is to adapt to a model that shifts the focus to individual producers and micro-lots — instead of regional or national origin — as markers of quality.

As a result, importers must take the initiative to identify exceptional producers because the FNC's promotional model does not meet this need. According to Geoff Watts, Intelligentsia's buyer for Colombian coffee, his company's philosophy is to identify individual farmers with the optimal growing conditions and ability to produce coffee of exceptional quality. Intelligentsia's goal is to highlight the sensory traits of an individual coffee and focus on the life story of the farmer who produced it, he said. In Watts' view, the FNC's attempts to produce department- and region-specific coffees will still fail to meet the quality standards desired by third-wave consumers because each product will still be a blend of bean qualities based on artificial geographic boundaries and will not yield the exceptional quality and moving story that some individual farmers offer.

For this reason, most third-wave importers do not source through the FNC directly. Sweet Maria's, an Oakland, California-based premium coffee roaster, takes a similar approach to Intelligentsia. To ensure maximum control over product quality, the company highlights that it avoids the regional coffee blends that FNC promotes (e.g., coffees from the Huila, Antioquia or Cauca departments) and focuses instead on partnerships with individual producers to import micro-lots. Superlost Coffee likewise sources directly from producers, not through the FNC.

In addition to awareness and access, the logistical challenges for small-scale exporters working directly with third-wave importers are substantial. Outputs for these producers are often insufficient to fill an entire shipping container, adding substantially to supply-chain cost and complexity. "A major challenge for single-origin sourcing is scale and supply chain," according to Deahl of Superlost Coffee. His team was able to work with an exporter who let them piggyback on a larger shipment, allowing them to import a batch of their Solo Sábado coffee from a

single producer in Valle del Cauca. For many producers, coordinating similar small shipments would not be feasible.

New Opportunities

Despite these challenges, the growing specialty market could distribute significantly higher profit margins to Colombian producers. Historically, the FNC has focused on promoting high-volume exports both domestically and abroad, including standard coffee for household use and mass-market specialty brands such as Starbucks and Nespresso. According to a senior executive at Juan Valdez, the high-volume strategy has allowed the FNC to maintain its purchase guarantee agreement with Colombian coffee producers.

The third wave marks a transformational point for the global coffee industry, and traditional market certainties are now in a state of flux.

However, research by Ximena Rueda, of the University of Los Andes in Bogotá, and Eric Lambin, of Stanford University in California, concludes that traditional coffee channels distribute the least value per kilogram to coffee producers while specialty brands like Starbucks and Nespresso offer a higher dollar yield per kilogram. Most third-wave cafés roast in house, and local Colombian specialty café brands, such as Varietale and Café San Alberto, buy directly from producers rather than through the FNC. While research remains incomplete on producer profit share for smaller third-wave coffee shops, higher consumer prices and fewer middlemen likely mean that more value per kilogram makes its way back to producers.

A Path Forward

Colombia is well positioned to capitalize on this new opportunity, despite having fallen short over the past few years. The country's reputation as a producer of high-quality coffee means consumers will be amenable to its offerings in third-wave retail shops. The FNC possesses

both the technical expertise and a long history of successful coordination among producers across Colombia. In addition, it has used Juan Valdez cafes in Colombia and abroad to promote high-quality Colombian coffee and can leverage these shops and the brand to promote some single-origin offerings.

Colombia's key advantage in accessing the third-wave market should be the resources and coordination provided by the FNC. Today, this cooperative aids Colombian producers through purchase guarantees and technical support, such as consultations from agronomists and the development of disease-resistant varieties. However, the FNC model does not address the challenges small-scale producers face in accessing the premium single-origin market. To encourage the growth of Colombian single-origin coffees, the FNC will need to focus more on this segment's unique needs.

The FNC's consumer brand, Juan Valdez, is the retail ambassador for Colombian coffee, with over 230 locations in Colombia and more than 120 international locations, including nine in the U.S. The FNC uses the brand to target the third-wave segment in Colombia and other countries, according to a Juan Valdez senior executive. The brand has recently begun promoting single-origin coffees from different regions in Colombia with different taste profiles (e.g., its new café de origen series features single-region blended products). Continuing to push regional differentiation could drive demand for Colombian coffee in the third-wave market (e.g., Elixir Coffee in Philadelphia differentiates its Colombian beans by region). This could represent a preliminary step toward the promotion of micro-lot batches from individual producers.

Intelligentsia's Watts believes the FNC needs to start by recognizing the enormous diversity and potential across the sector. By working with farmers to understand their individual potential — based on the soil quality, the genetics of their coffee, environmental conditions and their ability and willingness to produce high quality — the FNC can help them identify whether they are better suited to producing high-volume (the FNC's historical bread and butter) or high-quality coffee to target the third-wave market. Events like the Cup of Excellence auctions can help promote these

producers. Finally, by working with third-wave-focused importers and coffee shops, the FNC could strive to understand this market's requirements. It could then help Colombian producers capitalize on this potentially lucrative market.

What the Future Holds

The third wave marks a transformational point for the global coffee industry, and traditional market certainties are now in a state of flux. Colombian coffee, once regarded as belonging firmly in the top ranks of high-end products, currently struggles to capture market share in the ultra-high-end, single-origin segment. The price commanded by Colombian single-origin coffee lags well behind that of regional competitors such as Costa Rica, El Salvador and Guatemala.

If Colombia is to succeed in the single-origin market and its coffee growers are to benefit from this industry transformation, the current model will need to change. The FNC must adapt to focus simultaneously on volume markets and ultra-high-end markets. This shift will enable the FNC to maintain its purchase guarantee for the benefit of all Colombian producers while giving top-quality producers an avenue for rightfully accessing a higher-margin market.

One should not discount the level of complexity this will add to the FNC's mission. Achieving economies of scale in the single-origin, ultra-high-end market requires that the FNC identify new sales avenues and establish new supply-chain networks. Of additional concern is the implication for the top-end branding of all Colombian coffee when some of its products are deemed to be of higher quality than others. The FNC may find that the single-origin market's preference for individual micro-producers is at odds with its mission of promoting Colombian coffee in general. Nevertheless, such solutions must be implemented to ensure that Colombia's producers are getting the greatest value possible from their yields and that the Colombian market remains competitive in a changing world.

This article was written by Bryan Lee, Jake McKenzie, Ben Salcetti and Jack Winstead, members of the Lauder Class of 2019.

Boosting Direct Investments in Developing Nations

The challenge of growing the economy in a developing country is a bit of a vicious circle. These nations need foreign investment in order to raise capital, but they have to provide the right conditions for that investment to come. The task is increasingly difficult as prosperous nations pursue more isolationist policies. But there are things that struggling countries can do to improve their attractiveness to foreign investors.

In light of the current backlash against globalization and free trade, wealthy countries such as the United States and the United Kingdom are responding to populist pressures to restore jobs and capital. This corresponds with declining volumes of foreign direct investment (FDI) and can ultimately hamper the growth of developing countries. With increasing uncertainty on the global stage, governments seeking FDI must actively address domestic variables to continue attracting inflows of capital investment.

Direct investment into developing countries fell from \$431 billion in 2015 to \$209 billion in 2016 — a 51% drop — with most of the current investments targeting Asian and Latin American economies, according to the United Nations. With protectionism on the agenda of many governments and a rising sentiment against free trade and immigration, developing countries face increasing uncertainty in foreign capital and talent inflows. Considering this scenario, Vera Songwe, executive secretary of the Economic Commission for Africa, advocated at the 37th Southern African Development Community Heads of State and Government Summit in 2017 that “we cannot leave our development agenda at the whims of unpredictable factors beyond our control.”

FDI refers to “an investment made to acquire lasting interest in enterprises operating outside of the economy of the investor,” according to the United Nations Conference on Trade and Development. The investments can be in the form of equity capital (e.g., establishing business operations or acquiring business assets), earnings reinvestments and/or intra-company loans. In the context of developing countries, researchers have argued recently that FDI is a healthy engine for economic development. Dambisa Moyo, a Zambian-born economist whom Time magazine named among the 100 Most Influential in the World in 2009, said FDI can support development initiatives and “create more jobs, assist in the transfer of new technology, help stimulate

the formation of ... capital markets, improve management expertise, and aid indigenous firms to open up to the international markets.”

While governments in developing countries are unable to control external factors, they can control domestic factors to make their economies more attractive for foreign players and expand existing businesses. In particular, these governments can attract FDI inflows by reducing key domestic roadblocks and bottlenecks. There is no panacea for attracting FDI, but governments can increase their attractiveness and viability by strengthening public institutions, establishing business-friendly policies and improving infrastructure.

Direct investment into developing countries fell from \$431 billion in 2015 to \$209 billion in 2016.

Strong National Institutions Are Essential

Strong institutions — marked by a robust process for political transition, a solid legal framework and an established market structure — create the requisite stability and incentive to foster businesses that are sufficiently robust and commercially appealing to bring in foreign capital. From startups to mature organizations, companies and organizations across the developing world are strongly affected by domestic institutions, leading to varying outcomes on FDI.

Vietnam, for example, is limited by weak political and market institutions that hinder the ability of local entrepreneurs and mature companies to attract much needed FDI for growth. In Ho Chi Minh City, which serves as the country’s business hub, many companies take pains to avoid the “North” — a colloquial reference

for the Vietnamese government. Graft and corruption remain pressing issues there, creating inequity in business outcomes and unpredictability for investors. Many Vietnamese entrepreneurs steer clear of government involvement or support because they have little faith in the country's weak legal, political and economic institutions.

This avoidance also applies to mature industries. For example, the shrimp and fishing industry in Vietnam has taken deliberate steps to assure investors and visitors of its independence from the government. The government, rather than providing the necessary safeguards for foreign investors, actually deters FDI due to the institutional vacuum for stability and growth. Institutions are so weak that the country is listed as one of two non-market economies in the world that were not former Soviet countries (the other is China). This hinders much needed investment and exports for the fishing industry and others like it.

Where institutions are weak and aid is ineffective, FDI abates.

This is particularly important given investor aversion to political uncertainty. Some countries address this aversion by providing political insurance for private investors through government agencies, such as the Overseas Private Investment Corporation (OPIC) in the U.S. These institutions plug the vacuum left by weak foreign institutions. They ensure against the risk of war, civil strife, coups and other acts of politically motivated violence (including terrorism); they protect against expropriation and other improper government interference; and, more tactically, they help ensure against restrictions on the conversion and transfer of local currency earnings.

In contrast, Vietnam's neighbor to the east, Hong Kong, has been able to leverage its strong institutions as a competitive advantage for attracting FDI. It touts its robust political process, strong rule of law and transparent market structure as key differentiators that make it a gateway to Asia — a place where risk is minimized, predictability heightened and capital protected. Even in a competitive region like the Pearl Delta, Hong Kong is able to hold its own against emerging city powerhouses such as

Shenzhen and Shanghai due to its strong legacy and robust institutions, which are not found as reliably in Mainland counterparts.

Most notably, the impact of institutions affects not only foreign investments in for-profit institutions but also foreign aid. In his book, *In Search of Prosperity: Analytic Narratives on Economic Growth*, Harvard University economist Dani Rodrik argues that African countries such as Botswana and Mauritius “largely owe their economic success to the presence (or creation) of institutions that have generated market-oriented incentives, protected the property rights of current and future investors, and deterred social and political instability.” This also extends to foreign aid, which is instrumental in the provision of public goods that provide the necessary ecosystem for private business. Here, the quality of institutions is critical. As Rodrik notes, good institutions must “provide public officials with the incentives to provide market-fostering public goods at [the] least [possible] cost in terms of corruption and rent seeking.” Where institutions are weak and aid is ineffective, FDI abates.

Economic Development Policies Can Help Foster FDI

The lack of coordinated efforts between public-sector agencies and private partners to create coherent, synergistic economic development opportunities can hamper FDI inflows. It creates lost opportunities and connections with potential investors and a programming shortage for needed business resources (e.g., infrastructure and a skilled workforce). Misaligned initiatives and actions to promote local businesses, such as changes in regulations, bureaucracy or lack of support from specific departments, can deter FDI and undermine opportunities to boost economic development and job creation.

For instance, in South Africa the lack of alignment among the current government, private businesses and foreign investors has created regulatory challenges for the mining sector, which accounts for about 9% of the country's GDP. In June 2017, Mosebenzi Zwane, the country's mineral resources minister, announced a new charter for mining regulations that requires mining companies to attain a black partnership of at least 30% — an increase from an earlier threshold of 26%, which remains controversial. Improving black ownership is a complicated socioeconomic

process, which is part of the Black Economic Empowerment Program that aims to redress the inequalities of apartheid and reverse imbalances in industries dominated by highly paid white male executives. Following announcement of the charter, share prices of major mining companies fell sharply and foreign investor interest declined as uncertainty emerged about the government's commitment to private property rights.

The new charter was unique in its isolation of the business community, given that previous charters have always been developed in consultation or partnership with company and industry representatives. According to the Chamber of Mines — a private-sector body that represents more than 90% of South Africa's mining industry — the targets of the charter were set by the government alone, without comprehending its broader impact on finances and investment.

The chamber's decision to go to court in an attempt to prevent the implementation of the new regulations exacerbated the popular perception that private corporations are opposed to socioeconomic transformation, aggravating social tensions in the country. This scandal followed a series of shaft closures due to stricter interpretations of existing regulations and hostile government inspections. This added to political uncertainty and industry risk for the top foreign investors. Across the industry, investors are now debating the merits and the risks of new investments in South Africa.

In comparison, government-led efforts to attract FDI in the U.S. have seen demonstrable success. For example, South Carolina ranks as one of the top states in terms of FDI inflows, due primarily to local government guidance. In recent years, the South Carolina Department of Commerce has worked to align regional government goals and other state agencies' (e.g., ports and forestry) interests to support existing businesses and expand the markets of new companies that are considering investments there. Through these efforts, South Carolina has achieved outstanding numbers in job creation by new and expanding international companies. Between 2011 and 2016, the state developed more than 31,200 new jobs and attracted \$14.3 billion in capital investment.

By investing in areas such as highway accessibility, workforce education and corporate incentives for businesses with

significant potential for job creation, South Carolina has become a hub for FDI. The state is also recognized for its industry clusters, which offer opportunities for academia, businesses and government organizations to engage in synergistic collaborations on a particular topic, function and/or industry in close proximity. These clusters help to advance research and promote local economic development. For example, the Clemson University International Center for Automotive Research (CU-ICAR) promotes automotive engineering research. It has contributed by engaging the student community in technology development and attracts both major corporations (e.g., BMW) and new innovative companies (e.g., Proterra, a manufacturer of zero-emission electric buses).

The lack of infrastructure ... is particularly unfavorable to the entrepreneurial sector.

Connective Infrastructure Boosts FDI

A lack of infrastructure refers to the absence of basic physical and digital structures, such as roads, power and internet that are necessary for an increase in productivity in a country. Without basic structures, countries are less likely to attract interest from individuals and/or companies due to the significant obstacles to operating a business efficiently.

Ghana, one of the few well-established democracies in Africa, is an example of a country with inadequate infrastructure, which challenges its ability to attract FDI. For instance, the country does not have a strong network of paved roads. Even in the capital city of Accra, dirt roads are the norm. The country also struggles with frequent power outages that challenge connectivity and internet stability, even though it has Africa's second-highest electrification rate. Finally, there is a lack of available working space, which has caused property and rental prices to increase significantly in the capital.

The lack of infrastructure is detrimental to many facets of the economy, but it is particularly unfavorable to the entrepreneurial sector. Many Ghanaians, similar to workers in other developing countries, are employed in

small and medium-sized enterprises. Because of unreliable working spaces and electricity, entrepreneurs must fulfill basic business needs out-of-pocket — which are capital-intensive and often cost-prohibitive — before they even start pursuing other opportunities and tackling other challenges. Organizations that help plug the infrastructure gap for entrepreneurs have been emerging across the country. Impact Hub Accra, for example, provides working spaces and access to steady electricity/internet service so that startups have a reliable environment in which to operate. More broadly, Impact Hub's leadership envisions far-reaching impact growth across all of West Africa.

Access to capital is the single-most reliable predictor of entrepreneurial success across the globe, and FDI is critical to bridging this gap in developing nations like Ghana. As the entrepreneurial sector develops further, the country will require more FDI. Local Ghanaian entrepreneurs rely on foreign funding and can serve as viable acquisition targets for foreign companies that want to enter the local market. Overcoming the infrastructure deficits that currently exist is critical for attracting and benefitting from FDI.

At the other end of the continuum is Singapore, a country that leveraged FDI and its geographical location to establish itself as a global logistical hub through strategic infrastructural development. The country ties infrastructure

planning directly to FDI objectives. Through infrastructure, it creates strategic business clusters in partnership with the JTC Corporation — a state-owned real estate company that is also a statutory board under the Ministry of Trade and Industry. JTC has built several industrial parks, such as Jurong Park, where companies including Chevron Phillips and Exxon Mobil are located, and Tuas Biomedical Park, where global biomedical companies including Merck and Pfizer operate. These industrial parks are built with reliable and widespread infrastructure, which attracts many companies. The Singaporean government's efforts to be at the forefront of connected infrastructure and strategic urban planning have enabled the country to become a major hub in Southeast Asia and Asia at large, frequently attracting foreign interest and hosting the headquarters of several international companies.

Governments that foster a combination of strong institutions, business-friendly policies and infrastructure developments can significantly increase the chances that their countries will attract and benefit from FDI on the global scale. In the current geopolitical environment, it is increasingly important that governments take an active role in shaping the factors that they can control.

This article was written by Dorcy Chen, Rafael Kraus and Nicole Reichert, members of the Lauder Class of 2019.



Intellectual Property Rights in China: The Critical Driver for an Innovative Economy

As China's economy continues to grow, the country must attend more closely to protecting intellectual property rights, particularly for the burgeoning technology sector. Establishing a better ecosystem for IPR is paramount if China wants to sustain an innovation-driven economy.

The gap in the enforcement of intellectual property rights (IPR) between China and the United States has been a politically charged issue for many years and continues to stir conflict between the two countries. A 2011 study by the U.S. International Trade Commission estimated that if China raised IPR protection to a level similar to that found in the U.S., then U.S. revenue from sales would increase by \$107 billion and approximately 2.1 million jobs would be created. Clearly, IPR enforcement in China has vast economic consequences and implications for businesses on both sides of the globe.

A common perception in the West is that cultural factors explain the differences in attitudes toward intellectual property between Chinese and Western consumers. While some academic research supports the existence of cultural differences, a growing case can be made that attitudes toward IPR and IPR policies in China are dictated less by culture and more by economic drivers. China seeks to become an innovation-driven economy. To achieve this goal, it is increasingly important for the country to

develop a strong intellectual property protection system and build itself as an IP powerhouse. There is consensus that innovation cannot happen without significant improvements in IP protection in China.

As China transitions to a more high-tech service economy, the consequences of lax IP enforcement are growing more severe.

In recent years, China has implemented dramatic IP reform, which has had significant implications for businesses there. An evolving IP ecosystem presents unique challenges and opportunities for both domestic and foreign businesses in China. This article considers the rapidly changing IP landscape from the perspective of the government, businesses and consumers.

Intellectual Property in China

Throughout history, the Chinese culture has never emphasized IPR protection. According to Harvard Law professor William P. Alford, there was no fully established system of IPR in Imperial China. In addition, researchers Kay Ka-Yuk Lai and Judith Lynne Zaichkowsky found in a 1999 study that a longstanding cultural emphasis on sharing contributes to a weakened sense of individual ownership over IP in China today. For example, communist China under Mao Tse Tung emphasized a collectivist culture with no concept of privately owned property. Other studies have found that, even though China has experienced dramatic social and economic change, these historical attitudes toward IPR have persisted to the present day.

As China expands patent growth, it must also promote patent quality.

As China went through *gaige kaifang* (reform and opening up) and gradually opened its borders for more international trade, the Chinese government implemented a series of policies to strengthen IPR enforcement. China first joined the World Intellectual Property Office in 1980, followed by the Paris Convention for the Protection of Industrial Property Rights in 1985 and the Patent Cooperation Treaty in 1994. When the country joined the World Trade Organization in 2001, it agreed to a comprehensive series of reforms to further strengthen its IP laws. Even though the U.S. continues to criticize China for failing to adhere fully to its WTO commitments, the former acknowledges that the latter has made significant progress on IPR since joining the organization.

Over the past few years, China has demonstrated an intensified commitment to IPR enforcement. For example, on May 1, 2014, the government amended the Trademark Law of the People's Republic of China. In addition to streamlining procedures for registering trademarks in China, the change also established harsher penalties for trademark infringers and a reduced burden of proof in litigation for the trademark holder. In 2017, a Chinese court awarded \$1.5 million in damages to New Balance

after three Chinese imitator companies infringed on its trademark. The ruling was a stunning reversal from a 2015 decision in which New Balance was fined \$16 million for infringing on a Chinese man who had registered the Chinese name for New Balance, and it demonstrated China's commitment to its new IPR policies.

Leadership from the Top

When China experienced rapid economic growth through low-wage labor and export-oriented manufacturing, there was little economic incentive to enforce strong IP laws. However, as the country transitions to a more high-tech service economy, the consequences of lax IP enforcement are growing more severe. In August 2016, the Chinese government published its 13th Five-year Plan on Scientific and Technological Innovation, which focuses on improving the quality and value harnessed from IP. If the quality of patents and the enforcement of IP infringements become more reliable, companies will be able to generate more value from IP protection and be more willing to innovate.

The four main types of IPR include patents, copyrights, trademarks and trade secrets. Patents in China have increased rapidly. In 2015, they totaled approximately the same amount as the next three countries combined (U.S., Japan and South Korea). The Chinese government is also continuing to promote patent growth proactively. According to the 13th Five-year Plan, China will increase patents from 6.3 per 10,000 people in 2015 to 12 per 10,000 people in 2020, double international patent applications from 30,000 to 60,000, and increase royalties earned abroad from \$4.4 billion to \$10 billion. While the number is increasing, many of China's patents are of low quality and face more stringent requirements internationally. A large number of domestic Chinese patents are not "invention" patents but rather fall into the lower innovation standards of "utility model" or "design" patents. Bad or low-quality patents undermine the patent system and the institutions that support IP protection. As China expands patent growth, it must also promote patent quality.

As found in other countries, China addresses IP infringement cases through the courts. The Chinese court system has four levels: The Supreme Court in Beijing, higher courts in provinces, intermediate courts in cities and basic courts in districts. The three types of IP cases — patent,

copyright and trademark — begin in the intermediate courts. Unless specific basic courts are granted jurisdiction, intermediate courts are best suited to handle the complex and technical knowledge needed to address these cases. In addition, special IP courts have recently been established in Beijing, Shanghai and Guangzhou. For the most part, plaintiffs include individuals, state-owned enterprises (SOEs), private firms and foreign firms. Defendants are generally limited to SOEs and domestic private firms.

If China wants to protect and support IPR, the courts must uphold an unbiased, just society for both domestic and foreign businesses. Historically, Chinese companies considering a patent found themselves in a difficult predicament. For a company to be granted a patent, it had to first disclose its invention. Many companies did not want to divulge their trade secrets as they saw no teeth behind the enforcement. Conversely, there was no security without a patent. This negatively lose-lose perception affected businesses' ability to take risks and drive innovation.

While the quality of IP laws in China aligns with international standards, there is still room for improvement in enforcement. A 2014 study conducted by professors Cheryl Xiaoning Long and Jun Wang at Xiamen University's School of Economics confirmed judicial local protectionism in the intermediate courts. Their empirical work proved that plaintiffs who resided in the court's location greatly benefited in their ability to receive a favorable ruling. Fortunately, they also found that higher-level courts, which have the authority to correct lower-court decisions, are not influenced by these same biases. For foreign plaintiffs, the court system is demonstrating significant progress in instilling more confidence in foreign and U.S. firms that want to do business in China. In 2015, 100% of the cases brought to the special IP court in Beijing were decided in favor of the foreign plaintiffs.

A Proactive Private Sector

While the Chinese government has yet to address fully the structural challenges of IP protection, domestic companies have already taken matters into their own hands.

Previously, companies in China were concerned mainly with increasing their levels of productivity and profitability by adopting innovative technology and know-how. As income

levels within China have increased and as the marketplace has grown increasingly competitive, domestic companies have used Chinese courts more and more to protect their economic interests and uphold IP ownership rights. According to a May 21, 2017, Wall Street Journal article, "Nearly 87,000 copyright-related cases were filed in China last year, according to data compiled by China's Supreme People's Court, a 15-fold increase from 2006."

At the forefront of the changing IPR landscape are China's largest technology companies. Creative industries used to accuse Chinese tech companies, such as Tencent and Baidu, of facilitating the spread of pirated content, but now these internet giants have become protectors of IPR. Their transformations reflect an underlying change in their business products and services to include original and acquired content. Tencent's spending on content alone jumped from just under ¥5 billion (approximately US\$755 million) in 2011 to more than ¥20 billion (approximately US\$3 billion) in 2016.

If China wants to protect and support IPR, the courts must uphold an unbiased, just society for both domestic and foreign businesses.

Because Chinese tech companies now actively defend IPR, Western companies are choosing to partner with these companies rather than attempting to safeguard their content in China. During the 2017 licensing deal between Universal Music Group (UMG) and Tencent, UMG executive vice president Michael Nash said, "Chinese consumers are clearly embracing licensed services, fueling an expansion of China's music economy, increasing the importance of this market internationally and accelerating the development of Chinese artists for the enrichment of China's culture and the enjoyment of audiences globally."

Shifting Consumer Support

China's public and private sectors' defense of IPR is linked inextricably with changing Chinese consumer attitudes toward paying for content. Due to the rising level of wealth

and the growing amount of disposable income, Chinese citizens are more inclined to pay for the convenience of consuming copyrighted digital content to avoid the hassle of broken links and slow streaming speeds. There is also an increasing association between counterfeit and poor-quality products. Members of China's aspirational middle class want original, genuine products and are willing to pay a premium for them.

Furthermore, paying for content allows consumers to have exclusive, first-look access to new and trendy products. According to Li Lei Tsien, former director of Kindle content in China, "Chinese consumers are realizing that to get the content they want, they must pay for it." For example, Kindle recently launched a partnership with state-owned China Mobile Communications Corp. (CMCC) to offer serialized online literature, where a publication is released in installments. By paying for a subscription, readers not only access these very popular serializations but can also write to the author and shape the plot of each installment. This innovative business model will likely facilitate a strong relationship between the consumer and the content creator.

Tencent's businesses have also benefited from consumer demand for premium content. In the company's 2016 annual report, Chairman and CEO Pony Ma stated, "For video, we expanded our subscriber base via further investments in premium content, in particular exclusive content where we are deeply involved in production. For music, we drove subscription growth with premium content.... For literature, we ... strengthened our anti-piracy efforts, and sought to enhance IP value via original productions of movies and TV series." Subscription-based business models have created value for Chinese companies and consumers alike.

Future Evolution

The establishment of a formal commitment from the government is promising for the future trajectory of IP

protection in China, but a policy change alone will not be enough. It is important for Chinese businesses to continue to innovate, even as the IPR system in China has areas for improvement. If the private sector can continue to push the limits of innovation and help drive IPR protection, China's goal of becoming an innovation economy will become attainable. Top-down institutional changes from the government and businesses will only be as effective as a bottom-up cultural shift. The Chinese government and business protection and advocacy for IPR need to be aligned closely to influence consumer behavioral changes.

Overall, the future is optimistic for China. Chinese companies have been leading in patent filings globally, and the country is aiming to increase its commitment to IP, such as its 2014 Trademark Law and ongoing debates on revising the 2008 Patent Law. If the government can promote good-quality patents and do its part to uphold a just court system, Chinese companies will be encouraged to find and maintain their competitive advantages. A well-protected and legitimate IPR system provides opportunities for both domestic Chinese companies and foreign companies attracted to the Chinese market. As discussed above, while it is certainly in Chinese companies' interests to strengthen IP enforcement in China, there are also reciprocal benefits for foreign companies. For example, after receiving the favorable ruling, New Balance's senior counsel for intellectual property, Daniel McKinnon, noted that this ruling gave New Balance "a renewed confidence in our aggressive intellectual-property protection strategy in China." There is still certainly room for stronger IP protection, but foreign companies can be increasingly optimistic that their IP investment in China is not only secure but also welcome. A safe IP ecosystem will drive increased innovation from both foreign and domestic companies in China going forward.

This article was written by Louis Gilbert, Aisha Price, Ran Tao and Carmen To, members of the Lauder Class of 2019.

An Analysis of Colombia's Tech-enabled Food Delivery Market

App-based food delivery businesses aren't a sure thing in the United States, where many of them have failed to scale despite the growing demand for such services. But these businesses are thriving in Colombia. This article explores why tech-based food delivery services are doing so well in the country.

Money can buy anything except time. This is the philosophy behind the emergence of technology-enabled food-delivery companies in Silicon Valley. Whether fast-food delivery, groceries on demand or the delivery of made-to-order recipes, tech companies have found ways to please the palates of consumers in distinct and creative formats. Despite attracting hundreds of millions of dollars in venture capital, these business models, however, are still largely unproven, with a multitude of failed attempts to monetize in the United States and Europe. Of the companies that continue to operate, only a small number have achieved sustainable profitability. Interestingly, the emergence of similar companies in developing countries such as Colombia have attracted significant capital from global investment funds and have found clearer pathways to long-term financial success. Their accomplishments in the Colombian context have been facilitated by local market characteristics, socioeconomic conditions, regional technological trends and structural cost advantages in the labor market.

Tech-enabled food delivery is currently a high-volume, low-margin business. Margins vary by product, but a company operating in this space can expect an average gross margin of 5%. Managing a workforce of hundreds of employees who transport orders on foot, by bike and by car is extremely challenging. For this reason, many American and European tech companies that specialize in food delivery have either failed or are financially unsustainable. RocketSpoon, a U.S. company that prepared and delivered complete meals, closed its virtual doors in 2016. Eat Easy, a European food-delivery service that partnered with restaurants, went bankrupt the same year. In August 2017, Blue Apron, a private-turned-public U.S. company focused on delivering recipes with fresh ingredients to consumers, lost 40% of its market value because investors lacked confidence in its business model. In November 2016, Bloomberg reported that Square, the financial-payments

technology company, tried and failed to sell off Caviar, its mobile food-delivery application, because investor confidence in the business was weak.

The Colombian labor market has contributed to the financial success of the country's mobile delivery services.

In the Colombian capital of Bogotá, encountering men and women dressed in neon orange, clicking away on their phones and waiting at restaurants or in grocery store lines has become the norm. They are shoppers, but they are not shopping for themselves. They are members of Rappi's delivery fleet. Over 2,000 rappideros, as they are called, receive notifications day and night on their smartphones, with instructions to purchase and deliver groceries and meals on behalf of Rappi's customers. As in the U.S., similar mobile applications connect stores and restaurants through a digital platform where the user can access almost any local good and receive it within the hour. In Colombia, this delivery-app market is currently valued at around \$40 million and includes five principal players: Rappi, UberEats, Mercadoni, Domicilios.com and Merqueo.com. Why are these types of businesses positioned to succeed in Colombia even though they would likely fail in the U.S. or Europe? This phenomenon can be explained by considering several distinctive elements of the Colombian market.

Complementary Customer Lifestyles and Behaviors

A critical aspect of the delivery app market's success in Colombia is a deep understanding of daily life in the nation and the ability to translate this into user acquisition. Simon Borrero, general manager of Rappi, said the company

offered one of the first digital apps to allow cash payments. This seemingly simple capability gave the company “access to thousands of additional customers who did not have credit cards or access to online banking.” Looking beyond the financial system and focusing on customer behavior, Colombia has traditionally been a place where urban consumers outsource food-delivery services. For example, many middle- and upper-class families use domestic labor (maids and au pairs) to run their personal errands.

Tech-enabled food delivery is currently a high-volume, low-margin business.

This is in contrast to the U.S., where domestic labor is significantly more expensive and consumers often want to evaluate the food in person at the restaurant or grocery store before buying it. Research by Market Track in 2017 showed a majority of 1,200 American consumers surveyed preferred to shop for groceries at a physical store. In addition, a majority of American families preferred not to outsource grocery purchasing so they can compare brands and prices directly. “Compared to the American consumer, the Colombian consumer is much more likely to value having one app to do all his/her orders because he/she does not enjoy the experience of having too many options typical of a grocery store,” Borrero said. In addition, the fragmentation of the supermarket into specialized stores carrying only certain items gives delivery apps the advantage of consolidating what would normally be several trips for the consumer.

According to Pedro Freire, co-founder and general manager of Mercadoni, a Colombia delivery app focused exclusively on supermarkets, a Colombian family spends on average four hours each week buying the same items (e.g., meat, vegetables, pet food, personal beauty products and medicine). The company said in a statement that “Latin American cities tend to have security problems and heavy traffic...therefore, consumers appreciate the convenience of delivery apps more than consumers do in other parts of the world.” It is no wonder then that Sebastian Mejía, one of the co-founders of Rappi, said he “likes [operating

in] big cities with high levels of density and less-developed infrastructure.” These types of features in the market, which a local company is best-equipped to understand and address, suggest Colombia could see a greater increase in the food-delivery app market compared with the U.S.

Favorable Economic and Technological Trends

Economic and technological trends in Colombia suggest that mobile app-based delivery services will be a winning model, at least in the short and medium terms. Bogotá has a growing middle class that is more willing to pay a premium for convenience. A November 2016 article in *Fortune* magazine stated that “a growing middle and upper class is increasingly warming to the idea of having their meals and groceries delivered to them via motorcycles and bicycles.” By contrast, statistics from the World Bank indicate that the middle classes in the U.S. and in most of Europe are shrinking. But urbanization statistics in Colombia indicate that the demand for delivery services is growing in absolute terms. According to the World Bank, 77% of the Colombian population is currently living in urban areas, and this figure will continue to grow at a rate of 1.2% per year over the next decade. At the same time, technology trends in Colombia are also positively impacting web-based delivery services. As discussed in *Dinero.com*, “Bogotá, a city of more than eight million inhabitants, has harnessed an emerging entrepreneur culture and a recent need for web-based apps that target daily life problems.”

Borrero said the primary contributor to Rappi’s success is the penetration of smartphones in Colombia and Latin America. Currently, the majority of young people own a smartphone, which facilitates their use of apps such as Rappi. eMarketer noted that Colombia is the third-largest Latin American country in terms of mobile phone users and has the second-highest smartphone penetration rate. At the end of 2016, about 19 million people, or 40.2% of Colombia’s population, were smartphone users. This number has increased considerably in urban areas, where penetration has grown to 58.1%, an increase of 16% compared with 2014. The same study notes that 45% of smartphone and tablet users ages 14 to 29 have already utilized mobile platforms to purchase a product or service. This percentage decreases to 38% for ages 30 to 49 and 22.8% for ages 50 and up. These demographic trends are

expected to continue, favorably affecting Colombia's tech-enabled delivery companies.

Cheaper Cost of Labor

The Colombian labor market has contributed to the financial success of the country's mobile delivery services, which have been able to tap into the large labor supply there. UberEATS representatives have highlighted, for example, that "from the point of view of [their] delivery partners, the app opens new opportunities for people who do not possess a car but have other means of transportation such as bicycles or motorcycles, offering the same flexibility and independence as an Uber driver." Mercadoni said its delivery workforce consists of "stay-at-home moms, high school and college students, or individuals seeking work flexibility." Rappi uses its *rappitenderos* for both food and grocery deliveries, thus maximizing drivers' working hours.

Emerging markets such as Colombia have offered significantly lower labor costs than more developed economies. For example, Colombia's minimum monthly wage is about \$250. But Borrero said in an interview with *Semana* that *rappitenderos* could earn 2.7 times more, or about \$670 per month, through the hybrid model the company uses to pay its drivers. With associated restaurants and shops, each *rappitendero* receives the customer's delivery fee along with any voluntary customer tips, while Rappi receives a commission from the restaurant. In conventional establishments that are not part of Rappi's network, the person making the delivery generally receives the delivery fee, and Rappi charges 10% of the total cost. As in the U.S., Colombian companies can use service-provider contracts (*contratos de prestación de servicios*) as a means of keeping labor costs low. To this point, Rappi is not required to hire full-time delivery personnel but can employ them as independent contractors. However, it is not clear whether this type of business model offers quality employment and a sustainable source of income for the delivery personnel, or if it contributes to more exploitative practices benefiting the companies through a supply of cheap labor. Labor contracts in Colombia require

that companies provide mandatory health insurance, pensions, severance and overtime that can prove costly in an industry of low margins. By using service-provider contracts, Colombian companies are exempt from these expenses, which significantly reduces their labor costs. The labor environment in markets such as Colombia has been instrumental in allowing these tech-enabled companies to become profitable in a short time. Sebastián Noguera, CEO of Merqueo, explained, "our objective is to become the cheapest Colombian online supermarket. To achieve this, we negotiate directly with our providers and brands, and we administer our own warehouses." Cost reduction and efficiency gains will also be realized outside of labor through technology advances such as micro-optimization of algorithms and improvement in logistics.

Bogotá has a growing middle class that is more willing to pay a premium for convenience.

Local consumption, the economic environment and low labor-cost trends have enabled tech-based food-delivery companies in Colombia to achieve what U.S. and European companies have failed to do in their respective markets. "The on-demand economy, we feel, is meant to be in emerging markets," Borrero said in *Fortune* in October 2016. He is certain the Latin American market is better suited for delivery services than the more developed markets. The evidence is clear. Today, Rappi's app not only enables customers to order food from restaurants or grocery stores, but also allows them to pay bills, deliver documents and cash and convert *rappitenderos* into dog walkers, onion choppers and even PlayStation-playing partners. The conditions in Latin American countries such as Colombia enable these technology-enabled food companies to grow and, more importantly, to scale.

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Brazil's Fintech Opportunities

A longstanding legacy of financial illiteracy and distrust has shaped Brazil's economy for decades. Technology is helping to change that: New apps and robo-advisers are giving everyday Brazilians the knowledge and confidence to invest without traditional reliance on banks or the government.

Brazil is in the midst of the deepest recession in its history. After a slump of nearly four years, most analysts predict that the country will finally emerge from this recession in 2018. However, a weak labor market and exorbitant levels of household debt threaten the vigor of a recovery. Amid rising political and financial upheaval, President Michel Temer is championing landmark labor and pension reforms, causing further disarray in the country. As large segments of the population struggle through these uncertain times and see their social security pensions at dire risk, the younger generation is turning to private alternatives to secure its financial future. While increasing numbers of Brazilians are seeking knowledge to make informed money management decisions, overall financial literacy levels remain low.

Against this backdrop, emerging fintech players want to disrupt and increase access to a historically oligopolistic financial sector. Whether they will succeed will depend, in part, on shifting client behavior in a country where financial education is limited and many consumers continue to rely on in-person banking.

Emerging fintech players want to disrupt and increase access to a historically oligopolistic financial sector.

Financial Illiteracy and Brazil's Banking Sector

Financial illiteracy in Brazil is deeply rooted in the structure of the country's consumer banking oligopoly and a government-dominated pension system. Historically, both have created few incentives for innovation and widespread financial education. Between the 1970s and early 1990s, Brazil was dominated largely by a climate of economic

instability. Banks generally focused on themselves and those who already had money, and private investing remained a chimera for most Brazilians. In addition, the overwhelming majority of the formally employed continue to remain dependent on an unsustainable pension regime. According to the United Nations Population Division, Brazil will face the third-worst demographic crunch among the developing economies: Currently, more than eight younger workers pay for the welfare benefits of each Brazilian pensioner, compared with an estimate of just under three workers by 2050.

However, the pessimistic projections fail to encourage changes in investment habits among the Brazilian population, which also struggles to find alternatives for allocating savings. Instead, amid the lack of accessible and attractive financial products, Brazilians with any discretionary income tend to purchase real estate.

According to author and financial adviser Gustavo Cerbasi, the topic of financial education in Brazil, even well into the 1990s, was restricted to covering investment tips for a "small and fragile financial system, including stock exchanges, private pension plans and the largest banks in the Brazilian market." Aggravated by lasting hyperinflation, access to the financial system remained complex, with few products for those who were attempting to invest limited amounts of capital.

Government or private companies had no interest in teaching the masses how to invest. Their focus was on attracting the affluent. This period was marked by high inflation, a lack of transparency and limited access to credit. The average Brazilian worker lived paycheck-to-paycheck and saw the concept of saving as an unattainable goal.

From Plano Real to Credit Hangover

The Plano Real, a set of policies implemented in 1994 to stabilize the economy after 14 years of hyperinflation, began to pave the way to economic recovery in Brazil. By

1999, with inflation finally under control, banks began to expand their customer base systematically and loosen access to credit, with lasting consequences.

What was once unattainable for the average Brazilian worker became a reality. An emerging class of financially illiterate Brazilians began to borrow and consume as banks' annual lending rates increased by almost 50% in the late 1990s. Consumption became a symbol of prosperity, and Brazilians felt that economic and social developments were evolving simultaneously.

Unfortunately, this sense of growing prosperity was short-lived. At a time when financial education was more important than ever, banks remained the primary resource for financial information for new customers. Unsurprisingly, incentives between borrowers and their institutional lenders were hardly aligned. According to Tito Gusmão, founder and CEO of Oi Warren and a former partner at XP Investimentos, Brazil's largest independent investment platform, banks benefited from Brazilians' financial illiteracy, increasing credit rates while household demand remained unreactive to these changes.

As the economy gained traction with this new class of financially illiterate consumers entering the market, credit card debt began to increase at an alarming rate. Consumer borrowing became unsustainable, and Brazil entered a period of "credit hangover." Suddenly, Brazilians were forced to focus on cleaning their credit. The country's private debt, which represented around 50% of its GDP in the late 1990s, substantially decreased at the beginning of the 21st century following a de-leveraging phase in which private debt to GDP levels were decreased to under 30% in 2005.

Following this period of financial mayhem, banks became less lenient and consumers more savvy. Brazilians began to realize the value of saving and planning for a more stable and secure future. Within this environment, financial education began to receive due attention to promote a healthy relationship between Brazilians and their money.

Economic Reform and the Financial Sector

Since the onset of Brazil's current economic crisis, the country's labor and pension regimes have been the target of widespread criticism by those in favor of pro-market reforms. The situation is "a ticking time bomb," according to Artur Wichmann, global portfolio manager at Verde

Asset Management, who points to the decrease in labor-force growth and productivity stagnation as two of the main factors that could lead to a collapse of the country's economy. Largely aligned with this analysis, President Temer's government is attempting to legislate a set of structural reforms, including one for the country's pension system.

While it remains to be seen whether Temer will manage to enact these reforms as he faces nearly a dozen corruption charges amid record-low approval ratings, the mere proposal is perceived more as a threat than a solution. Given their historic reliance on the public pension system, large segments of Brazil's formal workforce are concerned about the proposals' repercussions on their long-term financial security.

The average Brazilian worker lived paycheck-to-paycheck and saw the concept of saving as an unattainable goal.

Older generations, who rely almost entirely on public pension plans, are particularly alarmed at the prospect of seeing their only guarantee for retirement at risk. At the same time, the more financially savvy segments of Brazil's white-collar labor force are increasingly exploring financial products, including pension plans, offered by local banks.

Increased consumer demand comes precisely when Brazil's mainstream banks have little reason to innovate beyond business-as-usual. A 2017 report from U.S. investment bank Goldman Sachs on Brazil's banking industry noted its "oligopolistic market structure" that has only "become more concentrated since the financial crisis." According to this report, five consumer banks now operate 90% of branches, an increase from just over 70% in 2007 and 50% higher than in the U.S.

Technology and Financial Education

Over the past two decades, globalization, technological development and regulatory changes have taken Brazil to a new level, with the government now assuming a prominent role in providing financial education and services. It has

become clear that well-informed consumers make better decisions affecting the nation as a whole.

As a result, the country has seen a myriad of new initiatives aimed at expanding access to financial information, education and services. Brazil has experienced an increase in the number of investors as the population has become more sophisticated and demanding. According to BlackRock, the world's largest asset manager, internet channels are now the most popular investing vehicle in Brazil.

Government policies are also moving toward expanding the reach of financial education. In 2010, the federal government implemented the National Financial Education Strategy aimed at promoting comprehensive financial education in Brazil. More recently, the government is testing a requirement that financial education be taught in public schools.

Government or private companies had no interest in teaching the masses how to invest. Their focus was on attracting the affluent.

The private sector is also tackling this issue, and many companies are developing projects to help people manage their money and avoid excessive financial leverage. In the corporate arena, BlackRock estimates that many companies in Brazil are modernizing financial education through technology.

Fintech Disrupts Traditional Banks

A number of players are attempting to challenge the primacy of traditional consumer banks at a time when Brazilian consumers are increasingly willing to explore alternatives to traditional financial products offered by banking giants and the government's potentially shaky pension system. These include a number of fintech (financial technology) companies that seek to bring the efficiencies associated with technological solutions from the startup world to Brazil's financial sector. These companies, whose businesses are often aimed at younger

generations, promise services that are easier to use, cheaper, more intuitive and accessible through mobile applications.

According to Goldman Sachs' Fintech Brazil's Moment report in 2017, there are approximately 200 fintech players in the country, South America's largest economy. Together, these entities could generate a revenue of up to US\$24 billion over the next 10 years.

This new generation of fintech startups covers a wide range of areas within the consumer financial services industry, some of which include mobile payments, foreign exchange, crypto currencies, health and life insurance, and financial advice. The latter focuses on the development of algorithm-based advisory tools known as robo-advisers, seen as potentially one of the main strategic drivers for financial literacy in emerging economies.

Oi Warren: Brazil's First Robo-adviser

Oi Warren is a robo-advising tool developed with the mission to "create a new generation of investors in Brazil," according to Gusmão. His asset management company launched the tool to bring a new investment experience to the Brazilian people. A group of Brazilians working for XP Investimentos created this platform in a New York City apartment. The team gathered a significant amount of data and information on investor profiles, which later helped them initiate Oi Warren. They entered the Brazilian market in 2016 under the CVM Rule, a new regulation that allowed asset management companies to distribute financial products without a need for intermediaries. Oi Warren launched in the southern state of Porto Alegre.

The average management fee charged by the fund industry in Brazil is 2.1% per year. Oi Warren charges 0.8%. It seeks to make the investment world more accessible and personalized, with each investor supported by an automated guide. Its objective is not only to increase accessibility and personalization levels, but also to introduce engagement into the equation. The robo-adviser uses gamification (in-app games) to help customers understand the most complicated concepts and learn how to handle their investments.

The Spanish company Advicefy notes that the introduction of fintech advisory applications substantially improves

both customer literacy and client conversion. Led by Alvaro Benitez and with user engagement at the core of its strategy, the company specializes in the creation and implementation of chat-bots and robo-advisers in established financial institutions. Its data show that 99% of potential customers complete their virtual financial literacy tests — four times more than those using traditional methods — and 18% of those who finish begin to invest through the platform, versus the 4% customer-conversion figures attained through traditional methods.

Gusmão explains that robo-advisers offer “automated investment allocation using an algorithm to assemble portfolios comprised of a combination of fixed income and equity.” This technology attracts people who would not normally invest, thereby broadening access and offering a more transparent and secure gate to Brazilian financial markets.

When asked about the greatest challenges for the industry, for robo-advisers and for financial education in Brazil, Gusmão said, “The main barrier to overcome is security. The average Brazilian is accustomed to having their financial life with one of the four major banks in Brazil, not just their checking account, credit cards, etc., but also their investments. It is what Brazilians know and are familiar and comfortable with. It is what their parents did, and where everything seems safe. While banks appear safer, financial advisers do not always have the same goals as the client and their incentives are often misaligned.”

With regard to the current level of financial education in Brazil, Gusmão noted, “The level is still low, not only regarding investing but also personal finances. Financial planning, or planning for the future, was not part of the routine of previous generations, and that is why the new generations know very little about planning for their futures.” He said his company was created to explain the importance of saving and investing for the future.

Gusmão said the company also plans to “improve its content portal on financial education and partner with the education-focused NGO Junior Achievement to help create a new generation that can handle personal finances and investments.” Oi Warren is an example of how technology is a key instrument toward disseminating vital information on financial literacy in Brazil.

Brazil’s mainstream banks have little reason to innovate beyond business-as-usual.

Efforts to better equip Brazilians to manage their investments are well underway. Most experts agree on the need to include financial education in schools to instill a culture of saving in young children. They also agree on the need to coordinate efforts between the government and society to monitor the quality of programs offered and to teach concepts on the appropriate use of credit. As Brazil emerges from its current crisis, it will bring a new generation of financially literate citizens who are able to interrupt this historical pattern of ignorance and dependence on archaic systems and government regulations. It will be a generation able to stand up for what it believes in and effect change, a generation that demands more transparency and accountability, removing bottlenecks that prevent knowledge from driving economic development and from reducing social inequalities. These conscientious citizens will propel the country into a bright and prosperous future armed with knowledge to generate individual and shared wealth and well-being.

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Is Brazil's Future Green?

Brazil, the world's sixth most populous country, is working to diversify its energy production by shifting reliance on traditional hydroelectric power to more sustainable sources. But there are formidable challenges. This article looks at the obstacles in the way of Brazil's greener future.

At first glance, Brazil appears to have great prospects for energy sustainability. But a closer look reveals major challenges. According to the Renewables 2017 Global Status Report, which is published by the Renewable Policy Network for the 21st Century (REN21), Brazil is ranked first in Latin America and third in the world by installed capacity of renewable energy generation, most of it due to traditional hydroelectric generation. More than 60% of total installed capacity in the country comes from hydroelectric plants. This dependence is more apparent when looking at hydroelectric production, which represents more than 80% of the total electricity produced

construction of traditional large hydroelectric plants may pose considerable environmental risks. This realization has spurred Brazil's pursuit of non-conventional renewable sources to diversify its matrix.

In order for Brazil to overcome its energy security and sustainability challenges, the government, in conjunction with the private sector, must work to address a number of major obstacles. This article discusses the challenges Brazil faces as it moves to diversify its energy mix in a sustainable way.

An Energy Matrix Too Dependent on Hydroelectric Power Generation

Brazil's over-dependence on hydropower is not surprising. With its large rivers, the country has the third-largest hydraulic potential on the planet, behind only China and Russia. Even though REN21 projects that Brazil will remain the second-largest hydroelectric market in the world, the country's dependence on hydraulic power poses several problems going forward. First, while this massive potential has allowed Brazil to maintain a relatively small carbon footprint in meeting the country's energy needs, hydroelectric plants have great environmental

Today, BNDES is the only source of affordable long-term financing for renewable energy projects in Brazil.

in an average year (many of Brazil's existing non-hydro plants provide reserve capacity). But changing climatic patterns, exacerbated by global warming, pose a serious challenge for Brazil as hydroelectric power generation becomes more volatile and unpredictable. In addition, the

and social impacts, such as the displacement of riparian and indigenous populations, and the disruption of natural habitats. Thus, there has been increasing opposition to new construction projects, not only in Brazil but across the entire region. According to Luis Alberto Posada, director of research and development at ISAGEN, a privately owned power-generation company in Colombia, “large hydroelectric projects in Latin America are facing increasing opposition from environmental groups. And while in theory there is still plenty of untapped hydroelectric potential in the region, the projects that can be sustainably developed with minimal negative impacts to the environment are becoming increasingly scarce.” Due to the difficulties in obtaining environmental licenses, in 2017 only three hydroelectric dams were in the construction stage in Brazil: Belo Monte, Santo Antonio and Jirau.

Second, hydroelectric power is especially vulnerable to weather conditions. During the World Cup in June-July 2014, for example, during a notably dry winter season, hydro plants fell short in meeting peak demand, which resulted in supply restrictions and power outages. To keep the lights on and the factories running, all the major thermal power plants had to operate at full capacity at very high marginal generation costs. The impact of global warming on long-term rainfall patterns, even if they are still not well understood, may continue to affect this vulnerability in Brazil’s power grid.

Third, hydroelectric power plants in Brazil are built far from the country’s large cities, which translates into expensive transmissions costs. For these reasons, the country has decided to diversify its energy sources to include more non-hydroelectric renewable resources, such as wind and solar. “Due to global warming, there is no guarantee that the abundance of hydraulic resources we have had in the region up until now will continue in the same way in the future,” warns Posada, adding that “wind and solar can help rebalance the energy mix and reduce the risk of over-dependence on hydroelectric power.”

Adapting the Regulatory System to Generate the Right Incentives

As Brazil seeks to change its energy mix, it is important to note that its electricity-generation sector is regulated primarily by the central government, under the Ministry

of Mines and Energy (MME) and its sub-agencies. This oversight began in 1996 with the establishment of the National Electric Energy Agency (ANEEL) as the body responsible for implementing and regulating energy policy, including the operation of all bidding procedures. The country’s foundational National Energy Policy, established in 1997, included the formation of the National Energy Policy Council (CNPE), a body that advises the president on the formulation of energy policies and guidelines to meet energy demand in the short, medium and long terms. Its suggestions and resulting policies are based on studies and projections by the Energy Research Company (EPE), which was created in 2004.

Brazilian solar panels are 40% more expensive than those manufactured in China.

The Ten-Year Energy Expansion Plan 2024 (PDE), updated every two years by the EPE, plays a central role in guiding Brazil’s energy policy and the development of its energy matrix. The most recent update in 2017 estimates that total energy generation should increase by 73GW by 2024, from 133GW to 206GW. With this expansion, non-conventional renewable sources (such as wind, solar and biomass) should increase their share of the pie from the current 16% to 27%, with hydroelectric generation still at the helm and traditional thermal power continuing to play a stabilizing role.

According to the Renewable Energy Policy Brief: Brazil, published in June 2015 by the International Renewable Energy Agency (IRENA), the Brazilian government utilizes power purchase agreement (PPA) auctions as the primary mechanism to promote renewable energy generation. These PPAs enable the government to intervene in the market by mandating which renewable technologies can participate in each auction, guided by current PDE projections. For companies, issues such as the duration and characteristics of each PPA, the maximum allowable prices and the requirements of the transmission connection are critical for evaluating the projects. According to Posada, “Auctions in many countries in Latin America have shown a

drastic drop in prices for non-conventional energy sources. If this trend continues, we can expect marginal energy prices of solar and wind to become much more competitive over the following years.”

In addition to the PDE’s guidance, the Brazilian government has established several incentives for developing renewable energies, such as those highlighted by the Renewable Energy Policy Brief: (1) The Special Regime for Incentives for Infrastructure Development (REIDI) provides fiscal incentives for constructing new projects. (2) Decree 7,660, issued in 2011 and revoked in 2016, exempted the import tax for wind equipment and reduced the fees for photovoltaic panels (in case equivalents are not produced locally). And (3) Laws 9,427 and 13,360 mandate steep tariff reductions for the use of transmission and distribution systems by hydroelectric projects up to 5MW, and for solar, wind, biomass and cogeneration plants up to 30MW. The government’s primary tool for incentivizing the construction of alternative renewable sources has been the heavily subsidized financing offered by the National Bank for Economic and Social Development (BNDES).

Brazil has the capacity to lead renewable energy investments worldwide.

Adapting existing regulations could also help tackle another pressing issue in the energy matrix: the lack of existing infrastructure for transmission and distribution, which creates bottlenecks in the expansion of energy-generation capacity. This deficient infrastructure is also responsible for the low percentage of renewable energy projects that have been formalized after being auctioned off. The transmission and distribution segments suffer from excessive state intervention, such as the establishment of tariffs. Rates that are not adjusted in line with inflation are delayed, reducing incentives for investments in any network expansions. According to experts in the sector, the Brazilian government needs to better coordinate and plan how the new electricity generated will be connected to existing power grids.

The Retreat of BNDES and the Side Effects of Local Component Policies

Today, BNDES is the only source of affordable long-term financing for renewable energy projects in Brazil. Most of the companies in the sector that receive licenses to operate in the country expect to receive BNDES financing. According to Ana Fontes and Valentina Cumo from Darby Private Equity, “One of the current challenges is that the BNDES received large subsidies from the national government to grant its loans. Today, in a context of fiscal adjustment, the state no longer has the budget to continue to provide financing, and the bank must reduce the number of transactions to focus on productive investments.” As a result, the subsidized financing that industry firms have received might be coming to an end, which would force the firms to seek new investors with the typical concomitant difficulties this presents. Ironically, the national bank’s interference in the energy sector through subsidized loans has prevented the creation of developed capital markets to address this problem.

Brazil established important trade barriers against importing the components and technology used in renewable energies. The problem is that increasing non-hydro clean energies can be achieved only through a combination of local and imported technologies because the country lacks technologically advanced renewable-energy companies. Under current regulations, BNDES loans are available only to players who commit to using locally produced equipment. Because there are so few local manufacturers, solar-park development companies have very limited options for meeting these rules. These barriers, rather than diminishing, are growing because of BNDES. Currently, the bank requires that, depending on the type of energy and equipment, at least 60% to 70% of the equipment be produced locally in order for a company to receive loans. Luciano Costa, a Brazil-based commodities reporter with Thomson Reuters, has written that the negative effects of this policy may be most noticeable in the solar-power sector as only 19 of the 111 solar farms awarded loans in 2017 had begun the construction phase. According to a 2017 survey by the regulatory agency ANEEL, 24 approved plants had difficulty establishing the economic viability of their projects. At the same time, only one new factory designated to build local equipment

had begun production. Solar-energy companies are struggling with Brazilian manufacturers' production costs. Brazilian solar panels are 40% more expensive than those manufactured in China.

Brazil is currently the second-largest market in the world for wind power. The sector's expansion has been driven by resource availability in the country's northeastern region, government power auctions and preferential BNDES financing. According to PDE's projections, wind-power capacity will increase by 19GW over the next eight years, a jump from 4% to 12% of the power supply. BNDES' debt, however, has created financial distortions that will affect incentives in the long term. The Brazilian government has made BNDES capital conditional to local content requirements, with an eye toward incentivizing local production. Local equipment has unfavorable price conditions, an element that, in the past, has been offset by lower-interest financing rates. Nevertheless, as BNDES faces budget constraints to fund new projects in the near future, local and international commercial banks will have to finance new projects at higher rates and with more flexible local-content regulations. In the meantime, BNDES issued a debt approval of more than \$300 million in 2017 for the construction of three wind farms with a combined installed capacity of more than 310MW in the states of Bahia and Ceará. The farms will be built by the French company EDF Énergies Nouvelles, the Italian company Enel, and an alliance of the local mining company Vale and the Brazilian electric company Cemig.

With regard to solar power, the only energy auction scheduled for 2016 was canceled, and most projects were put on hold due to a combination of excessive local content rules and difficulties in obtaining affordable financing. In other words, to meet PDE projections, market distortions triggered by BNDES must be resolved. According to Fontes,

achieving growth in photovoltaic addition will be challenging if local content requirements are maintained, given that Chinese companies such as Yingli, Trina and JA Solar have a competitive advantage by manufacturing solar panels that are both efficient and cheap. Another challenge for the development of solar power in the states of Tocantins, Piauí and Ceará will be the paucity of transmission lines to remote geographies with enough solar radiation for construction to take place.

Working Toward a New Consensus

Brazil has the capacity to lead renewable energy investments worldwide. The country counts on ideal natural conditions, a solid technological and industrial base, and sufficient domestic demand to sustain the industry's unprecedented expansion. In addition, the PDE is effective in guiding policymakers toward this goal. However, enormous challenges stand in the way of this green revolution. In particular, Brazil requires the development of alternative private financing mechanisms not tied to BNDES' budget constraints, the redesign of local content regulations to permit foreign investors to bring in capital and equipment, a simplification of its electric regulation, an update of its electric power model and a clearer path for investors seeking a predictable environment and social permitting. While the political and economic environments for achieving these reforms are not ideal, it is in the interest of the government, companies, investors and society to reach the consensus needed to sustain a new wave of investment and economic growth.

This article was written by Juan Manuel Botero, Daniel Panebianco, Jandro Riveron and Pablo Tempone, members of the Lauder Class of 2019.

Three Lessons Learned from Going Green: A Comparative Perspective

For businesses that want to cash in on the trend of sustainability, it isn't enough to brand themselves as environmentally responsible; companies must give customers a true sense of value. This article explores six businesses that have done exactly that and some of the challenges they face going forward.

Founding green businesses and implementing sustainable business practices have become increasingly popular over the last decade. While many green start-ups struggle to thrive, there is a slender segment of successful companies. From the growth enterprises that integrated sustainability into their business models early on, through start-ups that focus on unique green business opportunities and on to nongovernment institutions with sustainable missions, successful green ventures share several fundamental commonalities. They all strive to internalize green values within their unique value propositions, adapt to new circumstances while remaining true to their missions and develop the talents necessary for future development.

Going green has become the buzzword in business, and sustainability has made it to the agenda of most top executives.

In 1789, Thomas Jefferson wrote that “the Earth belongs to each generation during its course, fully and in its right ... no generation can contract debts greater than may be paid during the course of its existence.” More than two centuries later, “going green” has become the buzzword in business, and sustainability has made it to the agenda of most top executives. According to Advertising Age, sales of environmentally friendly products in the United States exceeded \$40 billion in 2011. The German consulting firm Roland Berger predicts that the market size for green technologies will reach a projected \$2.74 billion by 2020. This market opportunity is also catching investors' interest. According to a 2016 study conducted by global management firm BCG, 75% of senior executives

in investment firms see a company's sustainability performance as a key input for their investment decisions.

However, not all green businesses can strike a balance between sustainability and financial viability. This article analyses six successful organizations with a sustainable element to identify their common traits, and it synthesizes three key lessons from them.

A Unique Initial Value Proposition

To thrive amid cutthroat competition, green businesses must offer a unique value proposition that is more efficient, scalable and profitable than those found in traditional businesses. To illustrate how important this is for green businesses, this section examines Moringa Connect, Proterra, Off Grid Electric and Green Cape. These four organizations attribute their current market positions to a similar set of key factors: an underappreciated asset, diversified sources of funding and an integrated value chain.

Moringa Connect is a social enterprise in Ghana that unlocks the potential of the moringa tree, which has been prized for millennia for its health benefits. Started by two MIT graduates who developed a proprietary technology to cold-press the seeds into a nutritious oil, the business aimed to outsource oil production to the farmers who harvested the leaves and seeds in order to focus on commoditizing the end product. Kwami Williams, CEO and co-founder of Moringa Connect, developed the value proposition with the most impressive monetization among the dozens of companies doing business in this sector. Realizing the high nutritional content of the moringa trees, he decided that this underutilized vegetation in Ghana contained the perfect ingredients for cosmetic products and super-foods. Abundant moringa trees in Ghanaians' backyards then became his value-generating asset, helping Moringa Connect win market share of both the organic beauty industry and the health food and beverage markets in Ghana.

Proterra, an American electric bus manufacturer, took a different approach. The company is an ideal case study to demonstrate that a green product needs to provide a value proposition that is irresistible to customers. Unlike similar companies, Proterra does not just replace the diesel combustion engine with an electric motor. It invests millions into developing the lightest materials that allow for more efficient combustion. Proterra's buses are now helping municipalities in the U.S. save millions of dollars in fuel costs each year.

Off Grid Electric, a solar company that provides off-the-grid solar home systems in sub-Saharan Africa, chose a different path by integrating its entire value chain. After going through some initial challenges in Tanzania, where it first launched its products, the company realized that the lack of sizable distributors and financial partners in Africa was hindering the company's growth. As a reliable partner was not available, it decided to go it alone. Currently, in addition to its core solar-panel and battery development, it also has separate operations for its distribution business and financing services. These subsidiaries also cross-sell electronic devices, such as high-definition televisions, to maximize the revenue earned per customer. These devices are the best means to educate rural Africans about their need for more electricity and to generate demand for upgrading solar panels and generators.

Finally, the value proposition of Green Cape, a South African non-profit advisory organization that focuses on economically viable green economy solutions, demonstrates the importance of diverse sources of funding. As an NGO, it carefully diversified its investor base from 100% municipal government to a healthy mix of national, municipal and city governments as well as the private sector. Because of this diversification, Green Cape has not yet been used as a political tool. That is exactly why businesses trust Green Cape as an independent adviser and provide it with additional sources of funding through its consulting income.

Each of these organizations possesses its own unique initial value proposition in addition to being green. Similar businesses have much to learn from these four cases that place the green attribute at the heart of their enterprises, which aligns their businesses for the next stage of growth.

Adaptability to Changing Circumstances

Having a unique value proposition is not enough. Equally important is the organization's adaptability — its ability to adjust its business strategy to changing circumstances. Teams that are nimble enough to adapt early to both their customers' and stakeholders' needs lay a foundation for a resilient business model capable of weathering some of the more serious challenges that lie ahead. In looking at Proterra and Moringa Connect, a strong case emerges for the role of adaptability in scaling up the business and achieving operational efficiencies and profitability.

To thrive amid cutthroat competition, green businesses must offer a unique value proposition that is more efficient, scalable and profitable than those found in traditional businesses.

Hailed as the "Tesla of mass transit" and the poster child for the financial success of the green business model, Proterra offers two key insights into how to adapt operational capabilities and develop complementary product lines. Since its inception in Colorado in 2004, the company has relocated its production line to Greenville, South Carolina, moved the management team to Silicon Valley and shifted its R&D team to Detroit while opening an additional plant near Los Angeles. At first glance, one might ask why the lean business would spread itself across four time zones rather than centralize its operations in South Carolina, where its most successful vehicle, the battery-electric-powered Catalyst, is built. Talking to management, it quickly becomes clear that, with a vision to build the bus for the future of urban transit, the team had to draw on the top talent in engineering, finance and operations. Strategic relocation of manufacturing to South Carolina in 2011 was driven by the strong partnership with the Clemson University International Center for Automotive Research (ICAR) and the state's right-to-work benefits. Relocating headquarters to Silicon Valley in 2014 resulted from the latest round of fundraising spearheaded by Kleiner Perkins and the appointment of new CEO Ryan Popple,

who saw Proterra as a technology company first and bus manufacturer second. Finally, the latest moves to expand manufacturing capabilities and outsource part of R&D to the Detroit hub were driven by rising demand and the current renaissance of automotive innovation there.

Concurrent with optimizing its business operations, Proterra's product development team was also pushing the innovative design of its flagship Catalyst zero-emissions bus, which resulted in the 2016 unveiling of the Catalyst E2. This new model has achieved performance on par with typical urban-transit diesel models and can travel 350 miles on a single overnight charge. While it seems that this new model might make the earlier one, which requires a 10-minute charge following each 60-mile loop, obsolete, U.S. transit authorities view this long-distance bus as a complementary solution for the suburban commuter market. The strategic decisions made to date were never part of a master plan, according to the management team, but gradually evolved based on Proterra's ability to adapt to market needs.

The government still has much work to do. It must listen to various constituents and promulgate policies that do not simply shift the burden of food waste from one actor to another.

Moringa Connect offers a different lesson in business adaptability. Not long after the company's formation, it became apparent that the farmers had no interest in pressing for oil and would rather do what they knew best, which is grow and harvest the raw stock. Williams and his team in Accra had to move the production of oil in-house quickly and find a way to cover the initial investment in the rollout. Among the many benefits of the "miracle tree" is its highly nutritious oil, which has been used by the locals in beauty products. Thus, the Moringa Connect team decided to shift its production toward the segment that offered potentially lucrative sales channels. After receiving encouraging signals from the market, the company

retooled its facility and was able to launch successfully True Moringa, an organic beauty label that is expanding across West African resorts and spas and making inroads into the U.S. market. The latest addition to the product line is Minga Foods, which uses the leaves to produce teas and powders geared toward the rapidly growing super-foods market. Moringa Connect is gearing up for its follow-up fundraising, but, as Williams points out, had it not been for adapting the business at a critical juncture, it would no longer exist.

Both Proterra and Moringa Connect adapted their operations and products in response to early signals from the market, preparing their businesses to challenge the automotive and cosmetics giants, respectively, with their green value propositions.

Talent Acquisition and Development

A third pivotal success factor for sustainable enterprises is finding the right talent to implement the green vision. The importance of human resources becomes apparent in the cases of Moringa Connect, the Chinese branch of a globally operating NGO called the Natural Resource Defense Council (NRDC), and Sky Greens, a Singaporean vertical-farming business that grows leafy greens on rotating greenhouse shelves.

Having flourished from an idea to an internationally operating business over four years, Moringa Connect needed to hire employees for its middle and top management. The major challenge was finding people who combined the right level of education, the vision and passion for a socially and environmentally sustainable business, and sufficient experience in the local Ghanaian market. Even if the company were able to fill some of the required key positions by now, talent acquisition still limits Moringa Connect's future growth.

As a globally operating organization, the NRDC faced a slightly different challenge. In addition to finding local talent who understand the Chinese culture and business environment, it was critical to establish trust with both foreign and Chinese partners. As an NGO, it is extremely important for the NRDC to be perceived as an independent and knowledgeable partner. According to senior adviser Fuqiang Yang, former director of global climate solutions for WWF International and a well-regarded expert in the field of carbon emissions reduction and renewable energy

technologies, bringing high-calibre experts on board was a great way for the NRDC to raise the organization's credibility and appeal to a number of key stakeholders — that is, government-run enterprises.

While the NRDC in China is backed by a global brand and Moringa Connect operates in an attractive area combining the beauty industry with social impact, other green businesses have a hard time competing in the recruiting market. For example, Sky Greens, a vertical farm business in Singapore, developed a stable technology to grow vegetables on rotating vertical shelves using only a small fraction of the ground needed in traditional farming. Despite its innovative technology, it faces a serious obstacle in supporting its growth through hiring young talent. According to Roshe Wong, head business manager of Sky Greens, “farming just isn't sexy enough.” In light of a booming start-up scene, not only in Singapore but also around the world, it might become even more challenging for green companies in more established sectors, such as agriculture, to attract the right talent.

The examples of Moringa Connect, the NRDC and Sky Greens demonstrate how important and challenging it can be for green businesses around the globe to find employees with the right education, experience and mindset. Even when these businesses have a thoughtful value proposition,

the human factor should not be underestimated in growing scale and profits.

As sustainability rises to the top of corporate boardroom agendas, it becomes increasingly critical to leverage the best practices in the industry. Both mature enterprises installing sustainable practices across their business and young companies instilling sustainability values at the heart of their activities can learn from each other and complement their strategies in response to ever-increasing demand from customers, stakeholders and investors for greater resource stewardship. Whether one operates in China, Singapore, Ghana or the U.S., drawing lessons from the global pool of green business pioneers provides unique insight into strategies that might prove transformative for mature and young enterprises alike. Coming to market with a unique value proposition, adapting to dynamically changing circumstances and, finally, growing the right talent for the future are just some of the ways to ensure the long-term viability of green value propositions. A business that can internalize these critical lessons early and integrate them into decision-making and product development are poised to ride the green wave to new heights.

This article was written by Michal Benedykciński, Ka Ki Karl Chan and Annabell Hillenbrand, members of the Lauder Class of 2019.



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