Global Balance: Law, BRICs and the Developing World

A REPORT BY JOMATI CONSULTANTS LLP, MAY 2013

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About this Report

This is the tenth Jomati Consultants report on key issues affecting the legal sector. The report focusses on the growing importance of the developing world to global law firms, in particular the BRICs.

Jomati Consultants LLP has won the Queen's Award for Enterprise: International Trade 2012. The award recognises Jomati's success in growing its international revenues year on year and for advising an increasing number of clients globally. It also recognises Jomati's position as the leading adviser on law firm mergers.

THE QUEEN'S AWARDS
FOR ENTERPRISE:
INTERNATIONAL TRADE
2012

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Contact Information

Jomati Consultants LLP
3 Amen Lodge, Warwick Lane
London EC4M 7BY
United Kingdom

Principal, Tony Williams. Contact: + 44 (0)207 248 1045, tony.williams@jomati.com

Consultant/Head of Research, Richard Tromans. Contact: + 44 (0)207 248 1045, richard.tromans@jomati.com

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Data has been sourced from the publications and authorities that published the information. Jomati Consultants would very much like to thank everyone who has participated in interviews for this report.

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Introduction

"Every successful example of economic development [among poorer nations] this past century has taken place via globalisation."

Professor Paul Krugman, Nobel Prize-winning US economist.[1]

The world is changing. Developing nations that only ten years ago would have appeared very low on some law firm radars are now seen as vital both to meeting client needs and boosting the bottom line. Today, nearly all of the world's 196 nations can generate interesting legal work. An increasingly large number of developing economies will see growing demand for high value legal services, domestic and cross-border, both inbound and outbound.

For some markets this initially will be via the extractive industries, but later banks and large corporates will seek to enter the jurisdiction as it broadens its economy. Outbound work may also follow as local corporates and foreign investment grow. Some nations may even evolve into regional financial centres, tapping into the global currents of capital that now flow not just West to East, but in every compass direction. Yet, finding your strategic balance as a global law firm amid the myriad economies is not easy, especially given the impossibility of investing everywhere clients and partners would like. Law firm partnerships were never designed to provide huge capital investment to fund global growth. Investments, for example, in Asia, will necessitate money coming out of the budget for somewhere else. The partnership's funds are finite, but investment choices are multiple and increasing.

So, beyond the world's most developed nations, where should firms invest? In this report we have taken the approach that the BRICs, the four largest developing economies, and especially China, remain hugely important despite their challenges and have to be considered first. Brazil, Russia, India and China are not 'easy' markets and perhaps never will be. Protective Bar rules, corruption, lower fee expectations, increasing levels of competition from global rivals and fast-learning local firms all add to the challenges. In addition, smaller 'new' markets from Malaysia to Mexico present equal balances of opportunity and risk, and cannot be ignored. We also examine this 'chasing pack' of the other large developing nations.

In approaching legal services with a worldwide outlook that combines the developed and developing nations, 'global' law firms are for the first time living up to their names. This is an important evolutionary step in the history of the legal sector. This integrative process will continue to grow as globalisation continues to both force change upon your clients and help create new clients in countries one would have never dreamed opening offices in, let alone seeing as the fertile ground from which many of your new clients will come.

We hope this report goes some small way in illuminating what law firms are considering as they seek the right balance of investment needed to follow their old clients and generate new clients, while continuing to compete against the strategies of equally ambitious rivals in this brave new, fully globalised, legal market.

[1] In 2008 Professor Krugman won the Nobel Memorial Prize in Economic Sciences for his contributions to explaining patterns of international trade and geographic concentration of wealth.

Chapter One: The Right Balance

The New World Order[2]

A new global balance is taking shape. We are in a world where the Chinese middle class with their growing disposable income will outnumber the entire American population; where the GDP of the BRICs will very soon overtake the total economic output of the United States[3] or the EU; and where global law firms expect to see 25% of their revenues coming from the developing world[4] by 2020. Consider table 1 and you will see the future.

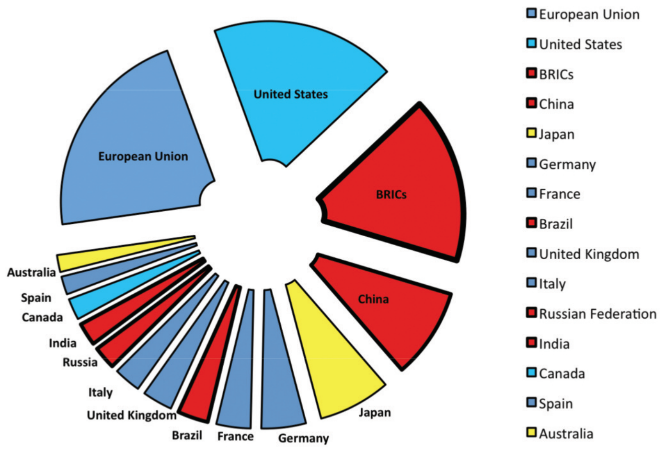

Table 1: Relative size of GDP (current US$) of the 14 largest regional and national economies, plus the BRICs. World Bank data. 2011. (EU and BRICs segments contain constituents).

Accepting that Brazil has a greater economic output than the UK despite its huge financial services sector and major banks and global corporates; or that China produced 49% of US output in 2011 and is still growing at least 7% per annum even as it experiences its own 'downturn', are unnerving for some in the West. A little of the shock and awe about the BRICs' phenomenal growth may have faded[5] since the early 2000s, but the cold economic facts remain about the strength of the developing world, and this strength is only going to grow.

Here is another example of how the world has found a new balance. Consider table 2. The inflow of FDI into developing nations is around three times higher now in dollar value than it was at the turn of the Millennium. Developing world investment equalled the flow of FDI[6] into the developed world in 2010. This is an extraordinary change in global capital flows.

[2] A phrase popularised in the early 1990s after the collapse of the USSR, but which now has new meaning and encapsulates not the idea of a single 'super power' hegemon i.e. the US, but a world of several economic power blocs in generally mutually beneficial commercial relationships. That is perhaps the true triumph of capitalism.
[3] US GDP (current dollars) $14.99 tn, BRICs GDP (current dollars) $13.5 tn. World Bank as of end 2011.
[4] In the interests of clarity we will seek to use only the terms developed and developing nations, i.e. 'emerging' 'high growth' and 'E7' economies or any other euphemism are included under the term 'developing'.
[5] See more on the birth of the BRICs concept and the challenges it produces for investors and law firms in Chapter Two and following country profile chapters.
[6] In this case FDI refers to all equity investments abroad, plus loans from parent enterprises to affiliate enterprises abroad. UN data.

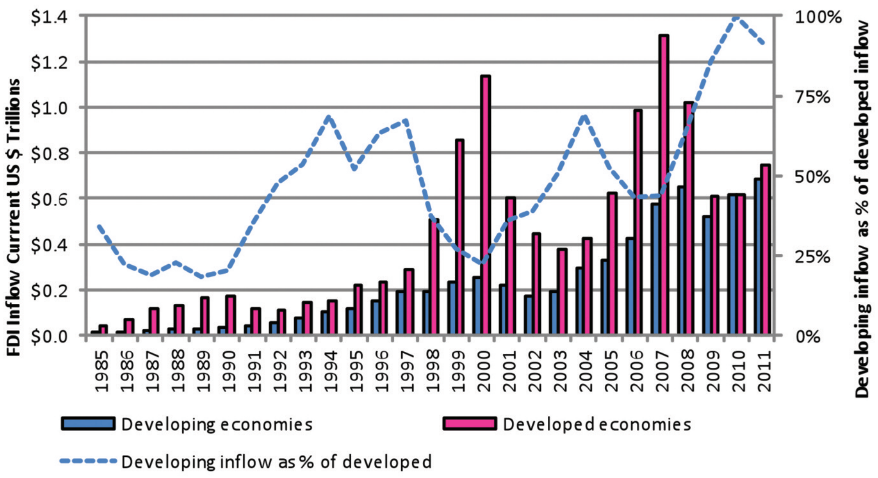

Table 2: FDI inflow to developed and developing nations, plus FDI inflow to developing nations as percentage of FDI into developed nations, 1985 to 2011. UN data.

In the late 1980s, at the beginning of the 'Big Bang' in the UK's financial markets and a period of great financial services growth in the US, the developing world only received around 20% of the investment the US and Europe received. Though investment flows will rise and fall, it seems unlikely that the developing world will ever be starved of capital as it once was. This in turn means more financial and corporate activity in the developing world and with it the need for banking, accounting, tax and legal advice. Consider table 3.

	2004	*2005*	*2006*	*2007*	*2008*	*2009*	*2010*	*2011*	*2012*
BRIC (M&A Value of Deals, $bn)	77	103	169	250	248	222	287	299	321

Table 3: Value of BRIC M&A deals 2004 to 2012. Based upon MergerMarket data.

As can be seen, the global financial crisis did not damage M&A in the BRICs for more than one year. While the US and EU continue to struggle and have to try hard to feel confident, the demand for corporate growth in the developing world is leading to growing levels of M&A to acquire market share, to buy in IP and know how, or sometimes simply to gain a foothold in a new market. Given that the developing markets are by nature far from a developmental plateau we can expect further healthy growth in transactions, though there will be equally peaks and troughs even among the activity of the BRICs.

This new geographical balance is the inevitable outcome of a globalised market economy. The World Trade Organisation's (WTO) macro-economic dream, dating back to the aspirations of the Bretton Woods settlement at the end of World War Two has, 60 years later, largely been realised. This is a triumph for proponents of the free market, but it also has its problems: relentless global competition and the inability of a nation, or a major corporation, to ever rest on its laurels. It also puts a continual strain on major law firms to follow their ever-expanding clients around the globe, often into markets they know very little about, while constantly building up their cost base in the process (more about the challenges for law firms later).

The Global Economy: Bigger, Better, Slower

Globalisation and the development of poorer countries may at first seem a 'take it or leave it' opportunity. However, it is much more than that: the growth of the developing world is essential for overall global economic growth and the development of businesses headquartered in the West, i.e. the majority of your client base. Without the BRICs and the dozens of smaller 'growth' economies, the West would face stagnant international commerce and far less cross-border investment. This is because Western nations peaked in terms of GDP growth in the 1960s. Moreover, global growth as a whole has been slowing down for some years, and what growth exists today is strongly supported by the BRICs and multiple small, fast-growing economies. Consider tables 4 and 5.

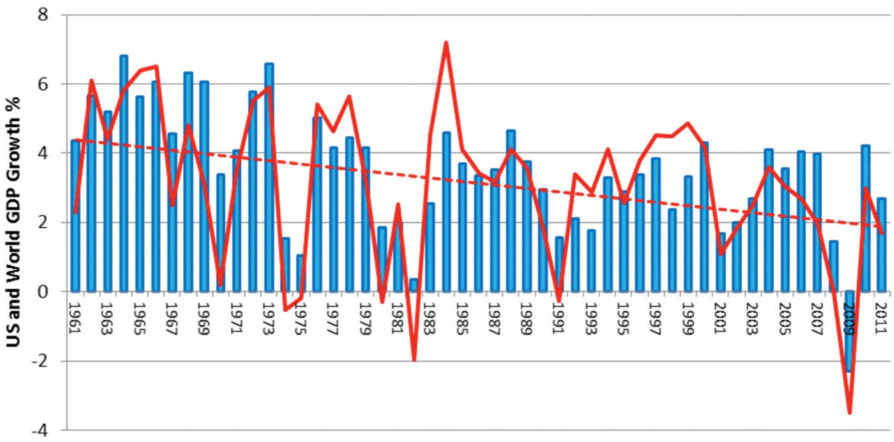

Table 4: Annual GDP growth rate, US (red) and world (blue). Dotted red line shows 50-year US trend downward from 1961 of above 4% growth to below 2%. World Bank Data.

The value of world GDP may have risen[7] over the last 50 years, from less than \$1.5 trillion[8] in 1960 to over \$63 trillion in 2010, but global economic growth per annum (blue columns in table 4) fell from peaks of 6.8% in the 1960s, to around 4% in the 2000s[9]. Table 5 shows that Western growth began to decline long before 2008. In this respect the 'writing is on the wall' for the future of capitalism: it will need to fully embrace globalisation to deliver economic growth to the 7 billion people around the world. This process will take your firm with it, whether you like it or not.

[7] One could say this is similar to the inflation of a balloon: even though the total volume of the balloon is greater as it is inflated, very rapidly at first, its ability to expand slows as all parts of its structure are stretched into a stable, lasting form.
[8] In current US dollars.
[9] It should be noted that since 1989 the number of 'additional people' added to the global population has been shrinking. In 1989, 87.4m people were added. In 2012 it had fallen to 77.6m. By 2049 it will have fallen to just 43m people. I.e. the human race peaked in terms of 'biological output' 20 years ago, US Census Bureau.

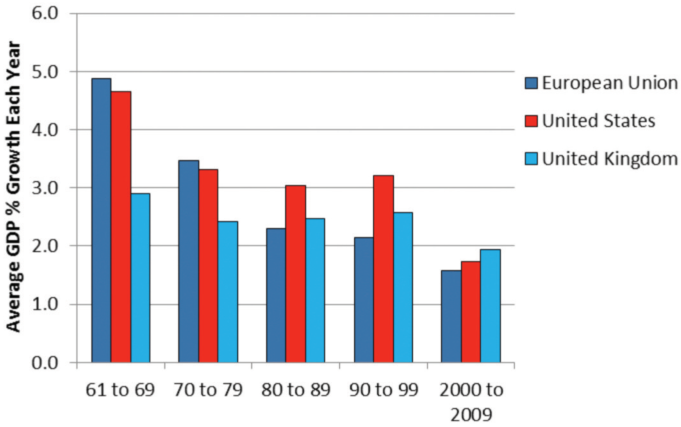

Table 5: Average GDP growth by decade[10]. World Bank data, starts from 1961. (EU includes UK, and also separate data shown).

But, why has growth been slowing in the West over such a long period? Does it mean the developing world is 'stealing' the growth of the West, as some protectionist commentators have tried to suggest? We would argue, and so would many others, that one nation's growth does not have to come at the expense of another's. It is more to do with the maturing of industrial development, plus the ability of new technology to deliver huge productivity gains as occurred after World War Two and again in the 1990s with computerisation. It is also because of slowing population growth in the West. These constraints may change in the future, but not for some years to come. And one might add, given Europe's indebtedness, achieving any significant growth in the EU is unlikely for some years. The US has a better long term outlook, in part due to efforts to achieve energy independence. But, even the US has huge structural barriers to overcome to regularly produce more than 3% growth per annum. Low growth in the West and slowing growth in terms of an aggregate global trend are simply facts of life we are going to have to get used to.

Law Firms and Globalisation: The Growth Ultimatum

Datamonitor estimates the value of the global legal market at $550bn with the US share of this steadily falling from its current 45% share, due to relative growth of legal markets in Asia and elsewhere. The UK and Europe's share will remain second, though it will also fall relative to the growing share of the developing markets. The reason for this growth in total legal demand is twofold: greater social and economic development globally; and expansion abroad of the world's largest companies, banks and funds. Where money and sophisticated commercial challenges meet legal demand is always to be found.

Even so, there is a degree of reticence about the need to globalise one's law firm among law firm leaders, and that is understandable. It is expensive and difficult enough operating a single office strategy; multiply those offices, the management time, the flight time of partners, the added complexity of multiple currencies, multiple local issues and potential liabilities, and an ever-growing number of lawyers from different cultures to train, evaluate and integrate, and you have a much larger challenge just getting from one day to the next as a manager, let alone being held responsible for the firm turning ever-increasing profits.

10 It is interesting to consider what could hypothetically launch the US back into 6%-plus growth. A massive migration into the US on the scale of the late 1800s would be one answer, though unlikely. A huge productivity gain on the scale delivered by the computer, would be another possibility and also unlikely in the short term. Limitless cheap power, such as nuclear fusion whose cost benefits were enjoyed by customers rather than exploited by asset holders, is another long term possibility.

As the managing partner of one global law firm explained, his firm did not always choose to open abroad: it simply had no choice. First, they explained, if they did not then the firm would appear 'weak' or 'behind' its other global firm peers and that would inevitably result in brand damage that could become toxic to the entire firm over time. Second, if clients wanted on-the-ground legal support and they refused to give it while others could offer that, then they stood to lose not just a piece of work, but eventually, the client as a whole. In effect, they were 'strategically chained' to their peers.

The consolation, and a key factor in the evolution of global law firms, is that international deals are also often more profitable than purely domestic work. One global law firm recently carried out an experiment to prove this. They counted how many offices were involved in a range of deals and then calculated the overall profit to the firm from each transaction once costs were factored in. They found that the more offices that were involved on a deal the greater the realised profit (see table 6). Of course, the 'global synergy reward' only arrives if multiple offices are used in unison and that often demands a very large deal for a significant client. Lots of offices working as independent domestic 'silos' are the antithesis of this and do not give the same benefits, and in fact may add disproportionately to the cost base. The strategic message is: build abroad, but tie your offices together with shared work and shared clients. Or, one might say, think of your offices as a network that is growing together, not each moving in their own direction.

Table 6: Multi-jurisdictional benefits for law firms.

Of course, not all firms approach globalisation in the same way. Some firms can reasonably be considered to have a truly global practice but have few offices abroad. However, this demands:

- Partners willing to spend a significant amount of time flying between the Americas, Europe and Asia, whilst not being available to work on matters while travelling[11].
- Partners who will be credible in a multitude of foreign settings and with sufficient knowledge of multiple markets to give real value to clients abroad.
- Considerable around the clock associate support back in the 'domestic' offices, as well as the right IT and backroom support to enable the partners to function.
- Clients that do not see an advantage in using a rival that has a permanent presence in the target market.
- Extremely good correspondent law firms in the new markets that you trust your clients with, that will work well with you and match your service levels.

[11] It is a given that you cannot work on client matters in a public place, let alone the confines of an airplane. We do still hear stories of partners 'advertising' their work on trains and planes, but for most a flight is at best going to be used for catching up on sleep or reading useful market commentary and news on their practice area.

Understandably, the fly-in/fly-out global firms that succeed are few, though some of the elite Wall Street firms do manage this. Instead, what is becoming increasingly popular is to merge internationally to build a far larger firm that meets most of your clients' needs and prevents your global peers from moving so far ahead of you that your brand and capability to serve clients weakens relatively. Some recent global merger deals include:

- Norton Rose's series of mergers with Fulbright & Jaworski; Canada's Ogilvy Renault and Macleod Dixon, plus Armstrong Mitchell; Australia's Deacons and South Africa's Denys Reitz.
- Herbert Smith's merger with Australia's Freehills.
- Ashurst's pre-merger alliance with Australia's Blake Dawson
- SNR Dentons' mergers with Canada's FMC and Paris-based international firm Salans.
- China's King & Wood merger with Australia's Mallesons.

Earlier transatlantic transactions produced Hogan Lovells and DLA Piper. All of the above only represent mergers and do not include the myriad of office openings, transfers of partner talent abroad to new offices, hiring of local talent, joint ventures, alliances, associations and network building programmes the world's leading firms have embarked on since the 2008 crisis in the West. The steady movement of the largest firms to businesses that gained 90% of their revenues from their home market, to firms that can see more than 50% of their revenues derived abroad is creating a new dynamic, even for US firms that have the largest and most profitable domestic legal market in the world to tap into.

Clifford Chance, one of the British Magic Circle and seen by many as a quintessential pillar of the London legal establishment, now has over 70% of its lawyers outside the UK, with a significant number not even practising English law. Also, an increasing number of nominally US-based law firms now have more than 25% of their lawyers based abroad (see Appendix A). While it may not be a surprise that Baker & McKenzie and White & Case both have the majority of their lawyers outside the US, it is a sign of the globalised times we live in that two New York stalwarts, Cleary Gottlieb and Sherman & Sterling have 47% and 46% of their lawyers based abroad respectively.

Moreover, some of the most ambitious firms that seek to become significant global players are fast approaching the quarter of lawyers abroad benchmark, such as America's K&L Gates, Debevoise & Plimpton, Paul Hastings, Willkie Farr, Milbank Tweed and the UK's Berwin Leighton Paisner. When they reach this benchmark just over one third of the Global 100 will have 25% or more of their lawyers abroad. Even after meeting that historic point in law firm evolution we expect this proportion to keep growing, because this is not a niche strategy pursued by a few: this is going to become the dominant strategy for most large scale law firms[12]. This also seems to prove the belief there would by now be a Big Four of global law firms that dominated the market was entirely incorrect. There is clearly room enough, and sufficient benefits to the partners, for multiple global law firms to grow and prosper. The continuing growth of the developing nations will only accelerate this process.

[12] This was something that Jomati predicted in its March 2010 report, 'The Next Wave: Globalisation after the Crisis' and we appear to be on track so far.

Chapter Two: Permanent BRICs

The BRICs' Growing Importance

The euphoria surrounding the BRICs[13] has declined since the acronym was first coined[14] in the early 2000s. The sometimes hyperbolic language about China's rising economy has receded somewhat to be replaced in some Western circles with a degree of wariness and even schadenfreude at the nation's slowing pace[15]. Hopes that India would become China's economic equal have subsided and dismay at the direction President Putin's Russia has taken has harmed confidence there. Meanwhile, Brazil's GDP growth in 2012 slowed to 0.9%.

Does this mean the BRICs' story is over? Are the kings of the developing world heading for an eventual return to the economic backwaters? The simple answer is: no. In fact, evidence points the other way, toward an ever-greater share of global GDP (see table 7).

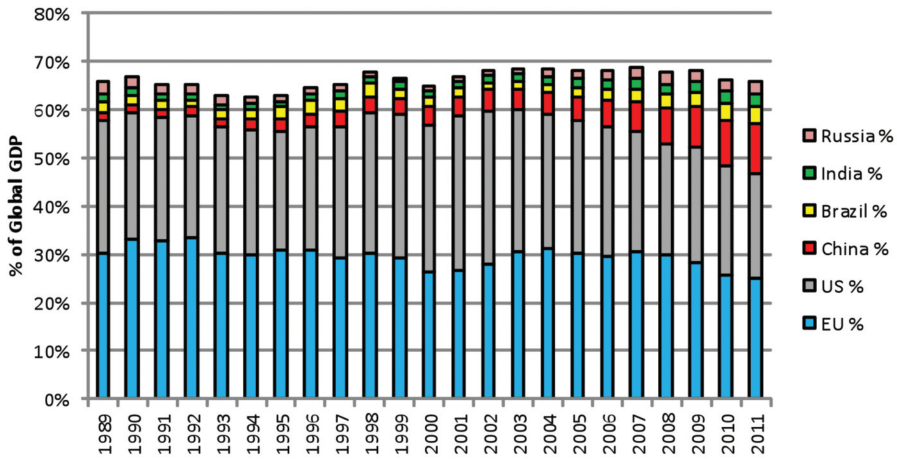

Table 7: Share of global GDP from 1989 to 2011. World Bank data.

What is true, however, is that the BRICs are not becoming significantly easier markets to do business in for clients or lawyers. Their business people may speak English and generally subscribe to the idea of a free market, but the BRICs also can be alien, infuriatingly bureaucratic and corrupt, at times destructively protectionist and remain plagued with huge structural and social problems that can test the patience of the largest global corporation. Speak to managing partners of the world's leading law firms and they will tell you the BRICs have proved to be hard markets despite the hype.

Yet, the BRICs still reign as the undisputed leaders of the developing world and their influence is growing. Consider table 8. In five years from 2007 to 2012 the number of Fortune Global 500 BRIC companies rose by nearly 150% to 96, of which 73 are Chinese.

13 The following chapters will examine each of the BRICs separately.

14 The 2003 Goldman Sachs research paper, 'Dreaming with BRICs: The Path to 2050' was the report that received the most attention. Though it was the earlier 2001 research paper 'Building Better Global Economic BRICs' that started it all.

15 Today, rather than extolling the virtues of China's growth, the Western media often focusses on issues such as China's extreme air pollution, its belligerence toward Japan and its hacking of foreign companies (and law firms).

Country/Region	2007	2012	Increase/Decrease over Five Years in Number of Fortune Global 500 Companies
EU	177	153	-13.6%
US	162	132	-18.5%
BRICs	39	96	+146.2%
China	24	73	+204.2%
France	38	32	-15.8%
Germany	37	32	-13.5%
UK	34	27	-20.6%
Brazil	5	8	+60.0%
India	6	8	+33.3%
Russia	4	7	+75.0%

Table 8: Number of Fortune Global 500 companies by region and country, 2007 to 2012.

The US scored 132 Fortune Global 500 companies in 2012 and the EU combined scored the most with 153. From what had practically been a standing start 20 years ago where the combined global companies of the BRICs would have been in single figures, the BRICs may equal the number of American Global 500 companies by 2018. Many of these developing market companies are relatively smaller than some of the EU and US giants and sit below the top 100 companies such as Shell, Exxon Mobil and Wal-Mart, but we should not be complacent. The fifth and sixth largest companies in the world by revenue are now Chinese, Sinopec and China National Petroleum. Other giants will eventually follow, moreover the major companies of the future are also the future clients of the world's global law firms. You may not want such clients, but such a view may also exclude you from ever becoming a global law firm.

Will the BRICs be Overtaken?

It seems logical to assume that if four countries that the West once paid little attention to in terms of their economic power can become so important so quickly then surely there will be many more like this. Perhaps the BRICs will be overtaken by other developing nations?

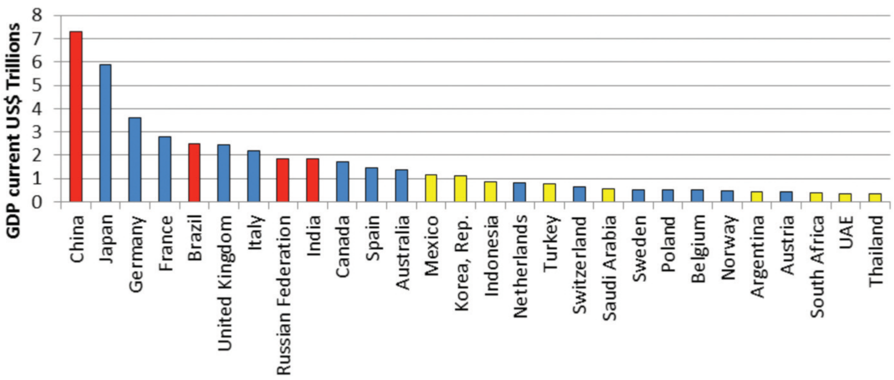

Table 9: Largest economies after the US. World Bank, last data 2011. (Red: BRICs, yellow: other developing economies).

There are other large developing markets with great potential, such as Mexico and South Korea[16] (see table 9), but they have an economic mountain to climb to catch up with the BRICs. Mexico, for example, would have to see phenomenal growth to add an extra $700bn in output, or the equivalent of a leap of 60% in GDP to match India, the weakest BRIC. But, India's population will keep on climbing in number and move up the developmental ladder, thereby slowly increasing productivity and total economic output. That would mean Mexico would not only have to make up a huge shortfall in output, but accelerate its development to the point where it removed any capacity benefits such a huge nation had; in effect rising to the level of a highly advanced nation like the US. That seems very unlikely. South Korea also has some interesting prospects (see more later) but with a population of only 50 million it is just 4% the size of India in terms of population. In which case, we must have doubts over the possibility that the BRICs will be crowded out and overtaken by new rivals any time soon.

Super-High Growth Nations

If the nearest developing nations by GDP cannot catch up with the BRICs, then what about the far smaller, but much faster-growing economies, such as Qatar and Mongolia?

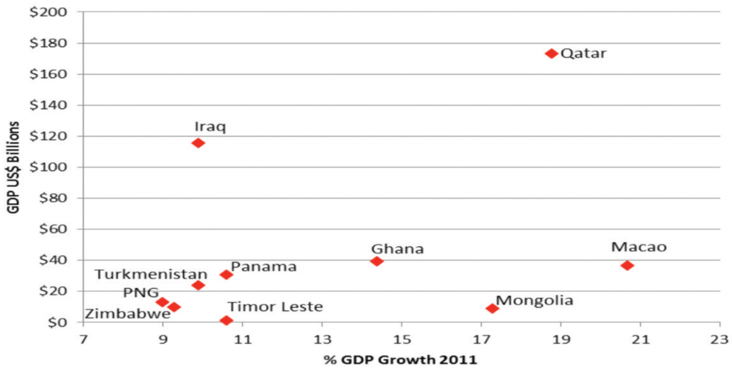

Table 10: Ten of the fastest growing economies in 2011, not including China, World Bank data.

With double digit GDP growth, year-after-year, sometimes as high as 20% and routinely over 9%, these nations surely must be set to become major global economies in the medium to long term? Again, the answer is most likely: no. In most cases these super-high growth economies have very small populations and current GDPs that are miniscule relative to the top 20 economies (see table 10).

Take Mongolia for example, where a small number of law firms have relationships with the Government and a handful of major mining clients[17]. Mongolia may be as geographically large as Western Europe and border China, but with a GDP of just $8.6bn some suburbs of London have a higher economic output. It would take decades for a country such as Mongolia to reach the levels of economic development the BRICs have. One might say: a handful of 'mega-mines' do not make an equally impressive economy.

[16] We will consider in more detail the 'chasing pack' of developing nations in Chapter Seven.
[17] Currently even the few major projects that exist there have been beset by disputes that threaten to prevent mines operating. At time of writing the $6.6bn Oyu Tolgoi mine was facing what is called 'a mounting dispute' between the Mongolian Government and Rio Tinto. FT 1 March, 2013.

This does not mean that small, fast growing nations cannot provide law firms with some very profitable work. If one of your clients is Qatar Gas, considered the world's leading liquefied natural gas company, then you may well see such a small legal market as a huge opportunity. Qatar may also be providing construction and infrastructure finance work for a number of law firms as it carefully spends it gas wealth on improving its wider economy, but Qatar is rare in this regard. In many other developing nations, such as across much of Africa, it is simply not clear whether sufficient profits from oil and mineral extraction are being re-invested in the local infrastructure to build a wider, more attractive economy that in turn will generate work for Western lawyers across the full range of practice areas. Interestingly, Qatar has also been a significant investor in Western companies and real estate.

But, this does not mean these small markets are to be avoided, just that they need to be viewed realistically in terms of what they can deliver. As one global law firm's managing partner explained to us, they often found their offices in the smaller jurisdictions to be very profitable. This was because the investment needed to set up the office was minimal compared with the benefits of the work flow from an equally small, but focussed, group of blue chip clients that had few other global firms to turn to in the jurisdiction. But, in such markets first-mover advantage is critical, as a firm must establish its brand and its connection to the new market before others crowd it out and gain client interest. The truth is that certain 'micro' markets with limited in-bound or out-bound investors may only have a brief window of opportunity to build credible capability. Another factor is that in a small market dependent upon a handful of large clients for inbound work, if those clients pull out, or run into 'local problems', such as political upheaval, terrorism, or reneging of land rights that create long delays in projects, then offices there can become painful investments for a law firm.

The truth is that there is no 'right answer' as to where to invest, only balances of risk against levels of possible reward, and that equation is always especially acute in the developing world.

Chapter Three: China, the BRIC King

Broken China?

China's GDP is one of the most watched economic indicators in the world. When it rises many in the G7 nations feel excitement at new business prospects, while others fear its growing strength, especially Japan[18]. When it dips, as it did to around 7.7% in 2012, pundits proclaim that China is now heading for a crash[19] under the weight of demographic, political and financial forces. Yet, the truth is that China has been incredibly resilient as an economy for decades, riding out revolution and domestic turmoil as well as huge fluctuations in the global economy, not to mention the 'North Atlantic Crisis' of 2008 to 2012. As we examine below, despite the doom-laded predictions, it seems China has plenty of momentum still. It is also by far the largest of the BRICs and the king of the developing world. For that reason alone no law firm should avoid factoring China's importance into its long term investment strategy.

As can be seen in table 11, China was very turbulent in the 1960s, but has seen generally high growth for nearly half a century. It saw 19.4% GDP growth in 1970, falling to lows of 3.8% in 1990, but, on average across 50 years Chinese growth has been 8.9%. This is an incredible achievement. Very few nations have managed such sustained growth, not even the US.

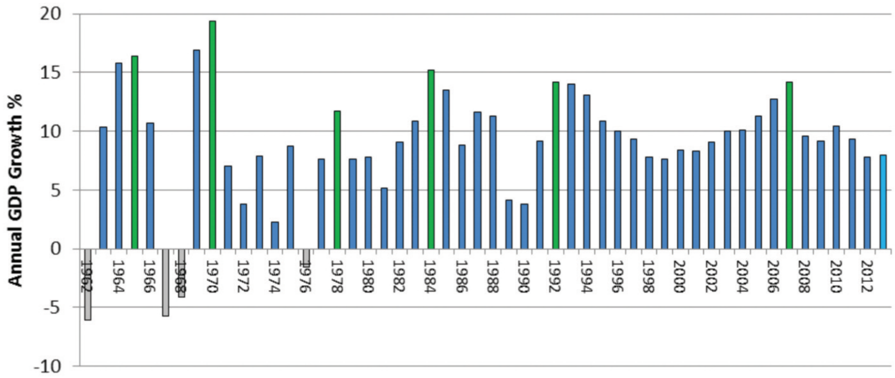

Table 11: Chinese annual GDP growth, 1962 to 2013 (estimated). World Bank data. (Green shows significant peak years, grey shows economic contraction).

Predicting long term GDP growth is more an art than a science, but historic trends often give some validity to predictions. In China's case it seems unlikely that growth will drop below 5% for some years to come. This is because China's population is advancing through higher levels of development at a terrific speed. Where in other nations only a tiny elite can realistically aspire to a 'Western lifestyle', in China literally hundreds of millions of people now want it, and will have it. Only a small percentage of China's 1.3 billion people have reached anything like a plateau in terms of their standard of living[20]. There remains huge unfulfilled demand for a better life: more cars, bigger houses, educated children, pensions, life insurance, foreign holidays and everything we take for granted. This is critical as it is movement towards a larger, higher value, domestic consumer market that will drive growth in China's future economy.

[18] China's neighbour and historical foe understandably fears Chinese dominance more than most. The most recent expression of tensions have come over ownership of oil and gas deposits around the disputed Senkaku islands. The spat then led to the wrecking of Japanese cars and showrooms in China and a drop-off in purchases of Japanese goods. Japan is well aware that China's consumers could make or break its fortunes.

[19] 'China's growth miracle will end in seven years', The Telegraph, 4 Feb, 2012.

[20] The reverse seems true in the West, where the standard of living for the majority is now falling with eroding pay, cuts to public services, high energy and food bills, increasing education costs, uncertainty over pensions and an inability to buy property among the young.

As can be seen, around 50% of Chinese people now live in cities (table 12) and this will slowly increase. This matters as city dwellers become both industrial labour and drive domestic demand. For example, in 2011, China's household spending doubled to $2.7 trillion compared to 2006[21]. Meanwhile, Gross National Income (GNI) per Capita, or simply put the total output divided by the population, is still rising at over 15% per annum.

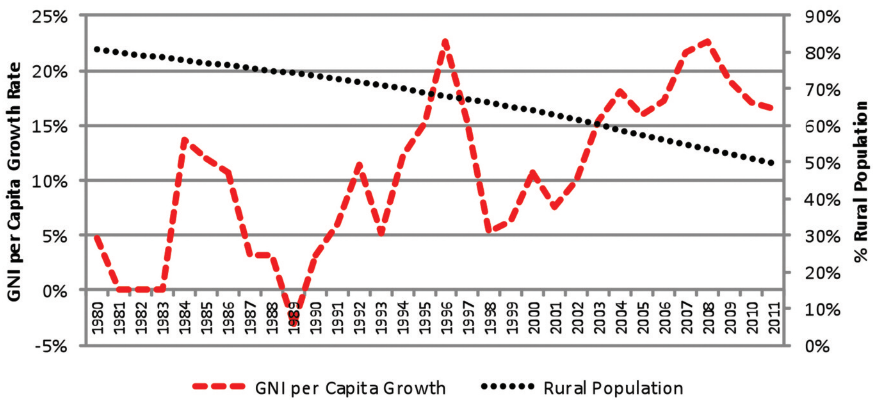

Table 12: Annual growth in Gross National Income per Capita versus level of rural population in China. World Bank data.

This suggests that China is not about to 'run out of steam' any time soon. While in terms of its place in the global economy, its State and private businesses will connect ever more closely with other nations, 'integrating'[22] knowhow and new technology to boost productivity, as well as developing new goods and services to export to an ever-wider range of markets, which now include an increasing number of other developing economies. Its frenetic growth therefore may have slowed, but any managing partner who believes they can now take their eye off China and its impact on the Asia-Pacific region would be misguided.

The Challenges Ahead

Though China will keep growing, it does still face several structural challenges. One theory circulating among economists is that old age and the one child policy will create a Lewis Turning Point[23], whereby there is insufficient labour to meet industrial demand. This in turn pushes up wages, makes Chinese goods, or intermediate goods assembled in China at factories such as those owned by Taiwanese-owned Foxconn, too expensive and so business goes elsewhere. The end game is mass unemployment in China, civil unrest and the predicted political implosion of the Communist Party as the social compact of no democracy in exchange for better living standards fails. This scenario appears compelling. But is it likely? As table 13 shows, at face value it is possible.

[21] Wall Street Journal, Dec 26, 2012.
[22] Some might say 'stealing', but that is another matter.
[23] Sir William Arthur Lewis, 1915-1991, a Nobel Prize-winning economist. Though as noted earlier with a steady movement of rural peasants into cities it seems unlikely there will be insufficient labour.

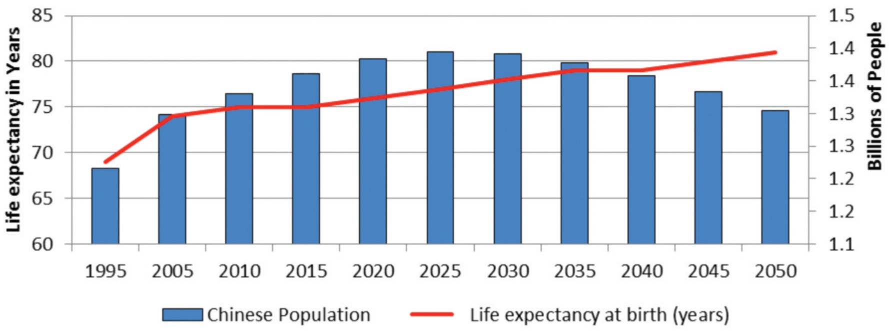

Table 13: Chinese population peaks in 2025 and age increases rapidly, US International Census Data.

China's population will peak in 2025 and then contract with far more of the population in the older age groups than before. The biggest age group in China in 2010 was 20-24 years old, at 125 million; i.e. young, energetic and recently educated workers. By 2030 this key group of 20-24 year olds , will have shrunk to just 84 million people, about a third less. Moreover, by 2050 the largest group in Chinese society will be aged 65-69, or retired by Western standards. This looks worrying, but ignores several points:

- **Offshore Manufacturing** – African countries, in some cases almost client nations now, could perhaps be a source of new manpower through Chinese-owned factories operating in Africa. This would be instead of China accepting economic migrants[24].
- **Higher Productivity** – China is increasing its productivity with higher levels of mechanisation in factories triumphing over the brute power of sheer numbers of cheap, but inefficient agricultural migrant labour used in the past. Better production needs less people. This does not remove the possible rise in unemployment which China will have to pay for, but it does reduce the impact on more expensive labour. Also, high unemployment tends to reduce wage pressure.
- **More Service-Based Economy** – the economy will develop a greater service sector, again not requiring huge amounts of manpower, but rather investments in IT and process management.
- **The Old Keep Working** – with better health there is no reason why older people cannot keep working, especially in the less physical services sector. China does not yet have a large social care burden[25], even if they too face a funding gap one day.
- **End the One Child Policy** – By the 2030s China could revoke the policy, which is already avoided by some urban residents, in order to rejuvenate the workforce.

Even so, labour costs are integral to China's success and wage demands are rising rapidly. If responses are not found and rural migrants do not provide sufficient 'cheap labour' then is this BRIC in serious trouble even if it beats the Lewis Point? After all, a report by Ernst & Young, quoted by the China Daily[26], stated the average labour costs in China nearly doubled between 2007 and 2011, going from 25,000 RMB to 40,000 RMB ($6,420). If wages do keep rising, will companies move manufacturing and assembly work to Mexico, Poland, or even Nigeria? At first this sounds plausible. But the reality is that China is the world's workshop for more than just cheap labour. Reasons why China will likely retain its role even if labour costs go up include:

[24] The failure to embrace immigration is seen by some economists as a key reason why Japan has failed to grow since its loss of confidence in the 1990s. Welcoming migrants is conversely seen as a key reason for America's continued ability to respond to crisis after crisis.

[25] It also only has 4% unemployment and the IMF does not expect this to change, at least until 2017. Such full employment delivers significant funding benefits for China in the future.

[26] http://www.chinadaily.com.cn/bizchina/2012-09/26/content_15783913.htm.

- No other developing country has the capacity to absorb huge volume orders as China does.
- Few other countries have the right energy, road and telecoms infrastructure in place, and some, such as Nigeria, may be willing to take on low value assembly work, but cannot readily do so without the right investment first.
- China is potentially one of the world's largest consumer markets; producing and selling there makes economic sense for many manufacturers.

Another economic stick used to beat China with is the alleged deliberate devaluation of its currency, the Renminbi or RMB. The standard theory is that China has so artificially deflated its currency that when it is one day forced to let it float free it will appreciate too quickly and cause chaos. But, some economists suggest the RMB is now only a little undervalued at best, while others have even suggested the RMB is now overvalued. But, perhaps this debate is academic. Until Beijing allows a free float we will never really know its market value. All we can say is that between 2008 and 2013 the RMB has increased 15% in value versus the US dollar, which has helped China in its purchases of foreign commodities and raw energy. And, if China can move into 'consumer-mode' then a stronger RMB will be a great advantage as the economy re-balances.

The last great theme[27] of 'China-bashing' is that democracy will soon prevail as wealth inequality increases and the poor rise up to remove the oligarchs in the Communist Party and their spoilt children who appear in some cases to be above the law. But, before one cheers on the 'democracy is unstoppable' theory, consider table 14.

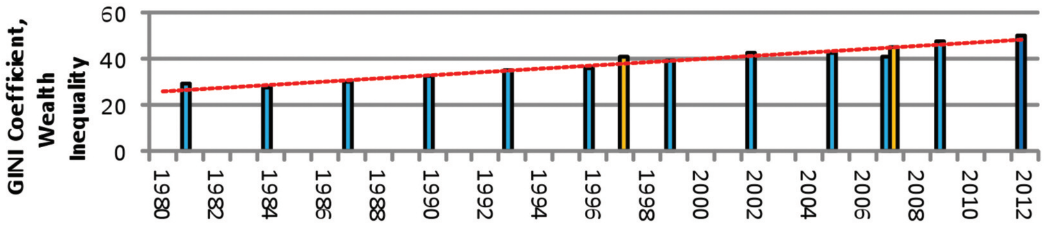

Table 14: Wealth inequality via GINI Coefficient system, China (blue) and US (yellow). 2012 is estimate[28]. Red line shows Chinese trend toward growing inequality. World Bank and CIA Data.

Chinese wealth inequality, at least by the GINI Index, is not that radically different from growing inequality between the rich and poor in America. It is not that the poorest US citizens are as poor as Chinese peasants, but the US rich are so much richer than before while middle class Americans have seen their incomes stagnate. Is America on the verge of social unrest? No. But then, neither is China. Moreover, workers' rights and wages are improving in China, unlike in the US. Foxconn for example, is to allow its workers to create a representative union for the first time, while even the poorest Chinese are seeing a steady increase in wages.

[27] Perhaps one other predicted crisis point would be a military confrontation between China and Japan over the Senkaku Islands. This would inevitably bring the US into the fray and at that point no one really knows what would happen if this new Pacific 'cold war' became 'hot'. We are not military analysts and so will leave predicting the fall-out to those better placed. However, we would suggest that China is a pragmatic nation and though it enjoys threatening its old foe, Japan, this dispute is ultimately a symbolic claim on regional hegemony.

[28] The higher the number the more wealth inequality. Many European nations have a score in the mid-30s.

China and Law Firms

In the world's most important developing market one would expect a very large number of international law firms and there are around 80 large US and UK firms with offices in China, and more opening every month[29]. Many of these have two offices, usually in both Beijing and Shanghai, and a small number with offices in Guangzhou and other cities. The remaining offices are operated by Australian, European, Singaporean, Japanese and South Korean law firms. In total there are now over 200 licensed offices in mainland China, even though foreign lawyers still cannot offer Chinese law advice and any Chinese lawyer joining one of these offices must give up their practising certificate. We also saw in March 2012 the first major Chinese/Western law firm merger with King & Wood and Australia's Mallesons joining forces.

Some lawyers are very optimistic about working in China with inbound American and European clients and also gaining outbound Chinese work, primarily because the scope of investments abroad are widening. Understandably, outbound strategic M&A such as China National Offshore Oil Corporation's $17.6bn deal with Canada's Nexen oil company steal the headlines. And it is true the majority of outbound deals by value are still extractive in nature. But things are changing. In 2012, Dalian Wanda Group bought America's second largest movie theatre company, AMC Entertainment, for $2.6bn from a group of private equity funds including the Carlyle Group. While in February this year, China's biggest property developer, Vanke, made its first investment in the US with a major high-end residential development in San Francisco[30]. On face value that may not seem especially important, but it shows that Chinese business people are thinking about foreign markets in much the same way Western investors do. This deal was not strategic for China's energy or raw material needs, it does not deliver know-how or new technology; these are just apparently very sound deals seeking a healthy ROI for shareholders. If all of China's potential investors scanned the 'outside' world, and not just over-priced apartments in Hong Kong or Macao, for similar 'pure' investment opportunities then there would be a surge of outbound work given the depressed valuations of many Western corporations and property assets. Medium size investments abroad may also increase as China seeks to deflate its housing bubble by enforcing higher capital gains taxes on domestic property sales[31], driving the rich to speculate abroad instead.

And yet, there is a degree of pessimism among Western lawyers about China that remains strong. This is mainly due to local challenges. For example, at a recent seminar on the country the speaker asked everyone to raise their hands if they were 'making a profit' in mainland China. Hardly anyone raised their hand, a law firm leader recounts. Some problems law firms that have invested heavily in China face, include:

- Many Chinese clients do not want to pay UK and US rates for legal work. As one global firm chairman puts it politely: 'It is a cost conscious society.' Another managing partner wryly noted that Chinese law firms also prefer foreign clients 'because they usually pay better'.
- With 80 very good US and UK law firms there, plus a growing number of Chinese firms with the confidence to expand abroad, this is a service buyers' market.
- Foreign firms face a domestic practice ban[32] and so lose a huge part of the market. Even when they bend the rules and 'advise on but don't practice local law' the best local firms are sophisticated enough now to meet client needs, and at a lower price.

[29] Legal Week estimates six more US and UK firms are set to open in Beijing in the coming months, while some existing offices have added partner level hires. 1 March, 2013.
[30] http://www.ft.com/cms/s/0/9cef36ce-79a2-11e2-b377-00144feabdc0.html
[31] http://www.ft.com/cms/s/0/b08c0486-84c0-11e2-891d-00144feabdc0.html.
[32] One managing partner who knew the Chinese Ministry of Justice well said that there was 'No chance' the country would 'ever' open up the right to practice locally to foreign law firms. Though harsh this seems a realistic assessment, at least while the nominally Communist Party reigns supreme.

- Most US and UK law firms encourage avoidance of the Chinese courts, and even its arbitration centres. As one China expert put it: 'Their court system does not give comfort to people.' Instead much regional litigation and arbitration is taking place in Hong Kong and also in Singapore, with some firms moving very senior disputes partners to Hong Kong from Europe and America to exploit the growth.

We have to be frank: China is not about to change its commercial or legal culture because Western lawyers want more work. But, China still sees huge inflows of FDI, over $220bn in 2011. Its listed companies grow week by week, over 2,340 by the end of 2011, with Hong Kong listed companies rising steadily, even if IPOs have fallen back from their earlier global highs (see table 15).

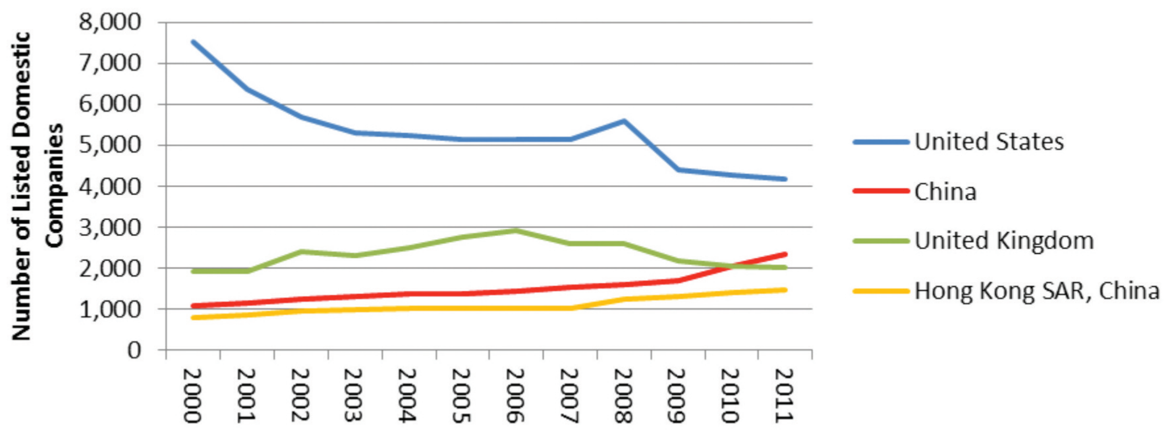

Table 15: number of listed domestic companies[33] across all exchanges, by country/region. World Bank Data.

And outbound M&A, (as noted above), still sees significant activity with a generally upward trend that will build over the long term. For example, in 2011 outbound Chinese M&A reached a value of $63.1bn with 177 major transactions[34], and the number of $1bn-plus outbound deals between June 2011 and June 2012 reached a record 22 deals. The figures would have been far higher if American protectionism, or self-defence[35], depending on your point of view, had not stopped acquisitions of 'sensitive' assets by China, such as Huawei in its attempt to buy part of US server company 3Leaf.

China, as with all the BRICs, is a difficult market with complex challenges both for clients and law firms. The challenges will not end soon. But the long term outlook for China and, at least its outbound, legal work is a positive one. It seems strange to say given how much has been written about China over the last decade, but these are early days for China and for its legal market.

33 Listed domestic companies are the 'domestically incorporated' companies listed on the country's stock exchanges at the end of the year. This indicator does not include investment companies, mutual funds, or other collective investment vehicles.
34 Research by Squire Sanders and mergermarket.com.
35 Understandably the US becomes very nervous when they see Chinese companies buying IT or energy companies. The two nations are co-dependent in a way Russia and the US never were during the Cold War, yet many in America cannot help but see China as its future enemy.

Chapter Four: Russia on Thin Ice

Split Personality

For foreign businesses and global law firms there are two Russias. One is populated with optimistic investors and young entrepreneurs with huge ambition. The other Russia is a cynical place populated by those in the public and private sector who believe bribery, fraud, intimidation, and in extreme cases even murder, to conceal their crimes, are acceptable[36]. This has led Transparency International (TI) to give Russia a score of 28 out 100 for corruption[37]. As TI explains, 'any score below 50 indicates a serious problem'. This score (see table 16) suggests you are as likely to experience 'straight dealing' in Moscow as you are currently in Iran or Pakistan, and that is 22 years after Russia supposedly became a free market economy. And this is not just small bribes to petty bureaucrats, but sums of money moving through a black economy that are so great it would destabilise a smaller nation. For example, Russia's outgoing Central Bank governor stated recently $49bn-worth of Russian capital had been transferred out of the country illegally just in 2012[38], often using shell companies. The most worrying aspect is that skilled professionals must have helped on either side of the country's border, while dozens of officials and bank staff did nothing to intervene.

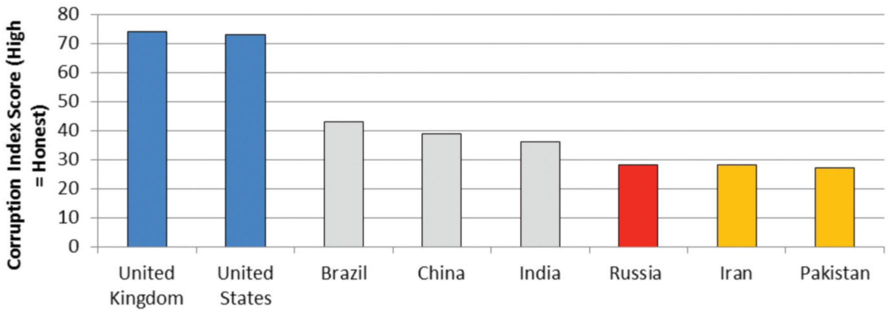

Table 16: Corruption Perceptions Index. Higher scores are most honest. Any score below 50 denotes a 'serious' corruption problem. TI data.

Ironically, corruption drives demand for US and UK law firms in Russia, (at least for some potential clients), as it makes honesty and accountability valuable commodities, while extra-jurisdictional laws such as the UK Anti-Bribery Act and the US Foreign Corrupt Practices Act help to underline that Western lawyers will 'do the right thing' no matter what the counter party may want.

Even so, for some lawyers Russia has become insufferable. As one partner at a global law firm put it: 'It is so uncertain. There is a lack of the rule of law, there is total uncertainty on tax and there is a lack of personal safety.' One feels that if the firm could pull out of Russia without upsetting clients then it would. But, Russia is too big to ignore, and so inevitably a global firm must be prepared to invest there or watch clients cross the road to a rival. Though, there is one positive for law firms: Russia is the only BRIC nation to allow relatively open access for foreign lawyers, (see more later).

[36] One of the more extreme cases of fraudsters intimidating the honest was the death of Sergei Magnitsky, a Russian lawyer and auditor who worked for international law firm Firestone Duncan in Moscow. After uncovering a fraud, allegedly committed by public officials, he was arrested, imprisoned for 11 months without trial and later died in prison. The US passed the Magnitksy Act in retaliation, which targets Russian human rights violations. Ironically, the Russian Government is now prosecuting Magnitsky posthumously for 'aiding tax evasion'. More recently, Alexander Perepilichnyy, a key informant in a Moscow tax fraud, died suddenly outside his home in London in November 2012 due to 'causes unknown'.

[37] The higher the score the more honest, the lower the most corrupt. The most corrupt nations in the world are North Korea, Somalia and Afghanistan, all of which see scores of 8, effectively guaranteeing a bad outcome for any financial transaction or commercial contract. Denmark, Finland and New Zealand are the most honest nations on the planet, with scores of 90 out of 100, sadly they represent a tiny fraction of world business.

[38] www.ft.com/cms/s/0/cf4fc11e-7b7e-11e2-95b9-00144feabdc0.html.

The Macro-Economic Case

When Goldman Sachs first included Russia in its developing world tetrarchy it had good reasons to, even if the country's 142 million population is now both shrinking and aging fast, leading to what the Financial Times calls 'a ballooning pensions deficit[39]' that threatens impending fiscal problems. Given the corruption, the unpredictable power of President Putin and the dependency on oil and gas revenues to maintain the nation's public finances can we still feel optimistic economically, or are law firms investing into a looming crisis that will see clients pulling out and the need for firms to rapidly downsize in a few years' time?

One potential positive for Russia is its manpower: it is the ninth largest nation, with the eighth largest workforce in the world, with 10 million more workers than Japan and has only 6% unemployment. Though it is rare to see 'Made in Russia' on any goods sold in the West, CIS states receive significant Russian imports. The second positive is that Russia remains one of the world's greatest exporters by value, (see table 17), primarily due to oil and gas, plus raw metals.

Rank	*Country*	*2012 Value of Exports US$*
1	China	$2,021bn
2	United States	$1,612bn
3	Germany	$1,492bn
4	Japan	$792.9bn
5	France	$567.5bn
6	Netherlands	$556.5bn
7	Korea, South	$548.2bn
8	Russia	$542.5bn
9	Italy	$483.3bn
10	Canada	$481.7bn

Table 17: Top 10 Exporters in 2012. CIA Data. (Note the absence of the UK).

These commodity exports 'crowd out' most other economic activity but they keep Russia's financial and public sectors well-funded. For now Russia has a captive market for energy[40]: 80% of all Russian oil exports and 70% of all its gas exports go to the EU, mostly to Central and Eastern European countries. Its huge neighbour China has not become a critical importer of Russian energy[41], which would in turn generate even greater export revenues.

The problem for Russia is that it has become dependent on hydrocarbon prices just as much as Saudi Arabia has, but unlike Saudi, Russia has 142 million people not 28 million people to consider with around 28% of GDP already accounted for by public spending. As we examined in our last report[42] gas prices may be affected by US successes in fracking, though it is fair to say global market prices will continue to hold sway for some time outside of North America. But, that may change eventually. If Ukraine and Poland developed their fracking potential then demand for Russian gas could fall, or at least see more price competition. Ukraine has an estimated 42 trillion cubic feet of technically recoverable shale gas reserves[43] and has attracted serious investment from Shell, while Poland 'is sitting on the EU's biggest reserves, enough to last at least 50 years and free it from dependence on Russia', according to the Polish

[39] http://www.ft.com/cms/s/0/198de822-21e4-11e2-9ffd-00144feabdc0.html.
[40] http://ec.europa.eu/energy/international/russia/russia_en.htm, last EU data was for 2009.
[41] One might expect Russia's largest energy importer to be China, given their shared border. Increasing energy exports to China are being discussed, but remain low. This is due to refusing to sell cheaply produced natural gas cheaply, but also exclusion of China in the upstream development of oil and gas on CIS soil. As one observer commented: 'There has been a fatal lack of trust between the two former Cold War opponents,' see http://blogs.platts.com/2012/12/18/russia_china.
[42] Jomati report, 'Power Struggle: Law and the Energy Sector', Oct 2012.
[43] Vinson & Elkins data. http://fracking.velaw.com/shale-development-in-ukraine/

Geological Institute[44]. Then there is oil, which if US, Mexican and Canadian plans for greater oil production go as hoped could see North America as a whole greatly reducing its need for foreign oil. As one partner explained: 'If oil prices drop below $100 then they are in trouble. There is a risk of social unrest [in Russia] because there will be a lot of unhappiness if living standards fall.' In April this year Brent Crude fell to $99 a barrel, but has since returned to over $100. Of course, prices could rise rapidly again. There are also hopes in Russia that it can exploit US shale fracking technology to gain access to so-called 'tight oil' in Siberia, greatly increasing its reserves[45].

Then there is the possible impact of slowing demand for Russian metals, such as steel, aluminium, nickel and copper. China can only build a national network of railways once every few decades, and though building continues apace in China's western cities even this construction juggernaut cannot continue to create 'a new Shanghai' every few years. For example, copper[46], fundamental to electrical wiring in homes, is a bellwether for global building demand. Its price has fallen around a third from its highs in 2011.

And finally, what worries some Russia observers is its citizens' increasingly Western-style approach to credit. Consumer debt is growing rapidly. The household debt to GDP ratio rose to around 10% last year, which sounds relatively low, but this is a country where only a decade ago it was 2%[47]. Its total external debt owed abroad by the Russian private and public sector was $543bn in 2012, double the level in 2006 and likely to be now larger still[48], which is close to its foreign exchange reserves. This suggests that at present Russia is balanced, but a decline in commodities revenues or employment would soon trigger serious concern. For now its debt receives a BBB rating from Standard & Poor's, but that could change very quickly. A downgrade would create market turmoil as foreign investors pulled out capital. A crisis would generate plenty of panicked legal work for the top global firms, but continuity is preferable to a repeat of the 1998 crash[49] that saw a number of firms severely downsize offices and some US law firms pull out entirely.

Hopes for Russia's Financial Sector

President Putin wants Moscow to rapidly build up its financial services sector, with Moscow becoming a global financial centre. Given the levels of corruption noted above this may seem unlikely. But, Moscow's corporates have plenty of capital, while Russia has the second largest group of billionaires in the world after America[50]. The State, rich from oil and gas revenues, also needs to invest its capital. The middle class want private pensions, health insurance and when possible to invest in managed funds, or speculate individually in bonds and equities, whether locally or abroad. Combined, this is a large, liquid client base.

Toward that goal: the Government has created a centralised securities depository; the Moscow Exchange (MICEX-RTS) carried out an IPO of its own trading platform in February, which was an apparent success, raising $499m; while Russian officials are talking up the rouble as an international currency and promoting Moscow as a centre for settling international commercial disputes (see more below). It is a programme of modernisation and reassurance to the outside world that Russian financial services operate by the same rules as those of London or New York. Russia has also joined the WTO, becoming the last major economy to join, in 2012, after years of standing outside its global trading norms, and opening the prospect for harmonization with trading partners on a range of economic issues.

44 Bloomberg, Feb 8, 2013.
45 http://www.ft.com/cms/s/0/45ffb86e-9146-11e2-b839-00144feabdc0.html.
46 Russia contains around 10% of world copper reserves, www.copperinvestingnews.com.
47 http://blogs.ft.com/beyond-brics/2012/12/04/russian-banks-growing-risks-in-spectacular-consumer-debt-expansion/.
48 World Bank data.
49 The crisis of August 1998, when the Russian Government devalued the rouble and defaulted on its debt.
50 Forbes, 'The World's Billionaires' 2012 (in US dollars). Russia has 96 billionaires according to Forbes, though it seems a number of them no longer live in Russia. China just loses out with 95 billionaires. The US leads with 434, while the UK has 46 billionaires, though only one is in double figures: the Duke of Westminster with $11bn.

Bankers and capital markets lawyers also have been moderately encouraged by Russia's listing in London and Moscow of a number of major companies. Most recently, last November's IPO of Russia's second-biggest mobile phone operator, Megafon, that raised $1.7 billion. After a weak launch, Megafon has steadily risen in value and this has whetted the appetite for more large IPOs outside the commodities sector, which critics rightly point out dominates the MICEX, dangerously exposing it to commodity prices. Other notable IPOs using London and Moscow in 2012 included: Sberbank which raised $5.2bn and MD Medical Group, a healthcare group, which raised $311m[51].

Is Moscow, despite all its challenges, turning into a world class financial centre? It is too soon to tell. One factor that worries some observers is Russians' propensity to divert capital out of the country. A major recipient of this money is Cyprus, which has its own financial challenges; it has been forced to accept a €10bn EU bail out that demands depositors in Cyprian banks, i.e. including many Russians, 'bail in' with their capital, to help with the EU rescue[52]. Cyprus, which has become the de facto low tax, and some may say tax evasion, centre for Russian money now has deposits estimated between $8bn and $35bn[53] there. Even VTB, one of Russia's largest banks, was criticised after it transferred up to $5.1bn in bad loans to a Cyprus subsidiary then swapped them for promissory to make its balance sheet appear more healthy[54]. This behaviour makes Moscow an uncertain future financial centre, though UK and US banks have done far worse it must be said. Ultimately financial centres thrive not just because of liquidity, but on trust, and gaining that will test Moscow for many years to come.

Russia and Law Firms

Unlike the three other BRICs, Russia has been open to foreign lawyers ever since the end of the USSR in 1991. Where other nations have refused to realise they have insufficient commercial lawyers to help a free market economy take shape, Russia has been very open-minded. There are currently around 25 major US and UK law firms with offices in Moscow with office sizes ranging from a handful of partners to well over 100 lawyers. However, some of these have been quietly reducing their head count in recent years, even as others have been rapidly expanding, such as US firm King & Spalding. This expansive firm states on its website: 'Russia is one of the most important and dynamic countries in the world'[55] and now has a mix of US, British and Russian lawyers in the office handling matters ranging from cross-border litigation and M&A, to the expected energy and commodities matters. Clearly not all law firms see Russia the same way.

But, those that are winning the trickle of significant mandates are encouraged. With a small number of huge energy companies in Russia, when they conduct a major transaction it is sufficient to have a huge impact on the offices of law firms that win the work (see table 18). For example, last year we saw Rosneft acquire 100% of TNK-BP in two steps, $31.1bn in November and then $28bn in December, or a total of $59.1bn, i.e. far larger than the much-touted Glencore/Xstrata merger worth $45.6bn. This provided work for a raft of law firms, such as London-based Linklaters, which advised seller BP, but also a number of US firms including Cleary Gottlieb, Cravath, Akin Gump, Skadden Arps and White & Case[56].

[51] http://blogs.ft.com/beyond-brics/2012/10/16/russian-ipos-case-by-case.

[52] At time of going to press there was an agreement to 'bail in' deposits over €100,000 at a rate of 40%.

[53] http://www.ft.com/cms/s/0/3ac3f02a-6962-11e2-b254-00144feab49a.html , though this is probably small compared to the wealth of Americans and European 'stored' offshore, which is estimated at around a third of High Net Worth Individuals' wealth, (Merrill Lynch and Gemini Consulting).

[54] Ibid.

[55] http://www.kslaw.com/offices/moscow

[56] MergerMarket data Jan 2013.

	Law Firm	*Russian M&A Deal Value in 2012 ($m)*	*Deal Count*
1	Cleary Gottlieb Steen & Hamilton	69,823	13
2	Cravath, Swaine & Moore	63,940	3
3	Linklaters	41,996	10
4	White & Case	38,626	18
5	Skadden Arps Slate Meagher & Flom	37,770	11
6	Weil Gotshal & Manges	28,103	2
7	Conyers Dill & Pearman	28,000	1
8	Akin Gump Strauss Hauer & Feld	15,346	9
9	DLA Piper	4,134	7
10	Kinstellar	3,760	1
11	Taboglu & Demirhan	3,760	1
12	Hogan Lovells	3,491	5
13	Clifford Chance	2,765	8
14	Debevoise & Plimpton	2,712	7
15	Freshfields Bruckhaus Deringer	1,918	6

Table 18: Russian M&A deals in 2012. Blue-shaded firms named by Merger Market as advising on one or both of the Rosneft/TNK-BP acquisitions.

As can be seen, among those global firms fighting for the non-Rosneft work in Russia there were a number of deals, but little more activity than one would find in many far smaller national markets. Though, unlike in many other markets no home-grown law firms figured highly for transactional work, indicating just how strong US and UK firms' hold on the Russian legal market is. In comparison, the best transactional teams in Germany saw a far more impressive 2012 despite the Euro Crisis, with all but one of the top 15 firms by deal value working on $10bn-plus worth of transactions over the same 12 month period.

There may be more litigation work in Moscow if President Putin achieves his goal to keep Russia-related litigation at home. It is understood he and his ministers are not impressed that many wealthy Russians see the English courts as a better forum for legal disputes than their native country. There is now a campaign to improve the standing of Russia's courts, though, as with the financial centre plans, success here remains to be seen.

Ultimately, Russia may be open to foreign firms but major work is sporadic, corruption is always a threat and there is a risk that if oil prices dip major investments in large offices here could badly backfire. Yet, Russia remains, and likely will remain, one of the world's largest economies at least over the medium term. There is perhaps therefore no choice but to have the capacity to handle deals in Russia lest one alienates investment banking and corporate clients who still very much need you there.

Chapter Five: Indian Promises

China Is Not India

Many observers have compared India to China, pointing out they are the two largest nations in the world, both BRICs, both in Asia, share a long border and are both rapidly moving up the developmental ladder. That is where the easy comparisons end. Chindia[57] is a clever neologism, but India really is not like China[58], and not just because it is a democracy. This in turn will affect the way global firms approach this huge country. Take GDP growth for example, (see table 19), a factor where the two nations are often thought to be very similar.

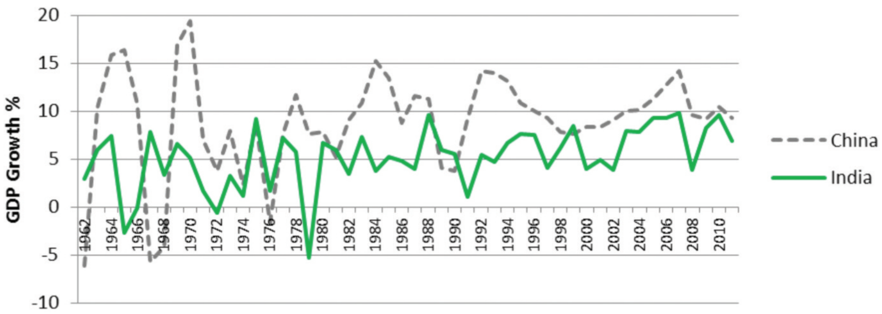

Table 19: Long term pattern of growth, India vs China GDP growth. World Bank data.

As the data shows, India has generally underperformed China since the early 1960s. And yet, why isn't it growing as fast if it has a faster-growing population[59]? One answer is that productivity has not increased as fast as in China. India's use of advanced mechanisation, widespread use of IT (and not just in Gurgaon and Bangalore), investment in infrastructure and energy networks, have not matched China. In fact, one could argue that some of India's growth is simply down to more people rather than economic development. For example, between 2003 and the end of 2013 India will have added 163 million extra people to its population, or more than half the US population in ten years[60].

Then there is the critical issue of standard of living. The higher the mean income level the more important it is to a global consumer or financial services company to be present. There is no point in being in a jurisdiction where only very few people can buy your goods and services[61]. Steel and IT billionaires and some very rich Indian commercial lawyers aside, the Chinese generally have a better standard of living than Indians (see table 20), at least if one considers GDP per Capita.

[57] It is interesting to note the term was coined by Indian Member of Parliament, Jairam Ramesh, in part one could argue to tie India more closely to China's more positive story.

[58] It may be harsh, but one reason why China has raced ahead of India is because it is not a democracy. When China's leaders want to do something it is done. Of course, this totalitarianism also has severe social downsides.

[59] By 2025 India will be larger than China. But, more importantly, its population will still be growing at around 1% a year, while China's population will have stopped growing entirely based on current trends.

[60] In comparison the US will have added 26.5 million, of which 36% will be net immigration, US Census data.

[61] Unless a company is targeting the luxury and High Net Worth Individual sector.

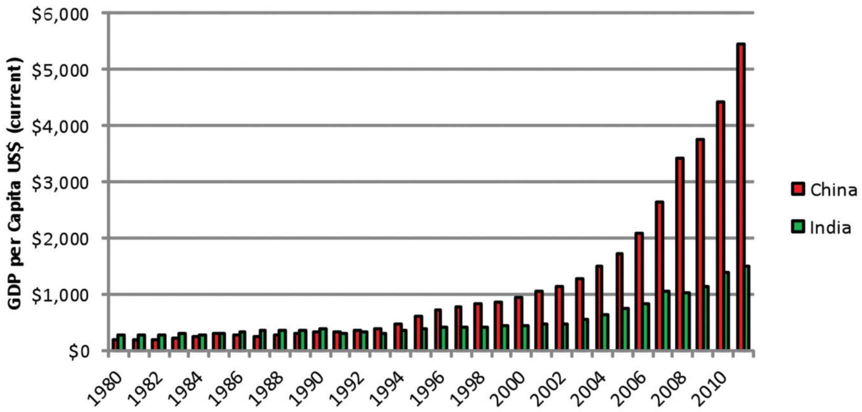

Table 20: India vs China GDP per capita (current US$). World Bank Data.

As can be seen, China's GDP per capita is now roughly quadruple that of India's, though both nations are still a very long way behind Western GDP per capita figures. What must be galling to Indian economists is that during the 1980s, India had higher per capita wealth than China, but has squandered its lead. Population plays a part in this disparity, but does not explain everything. Another factor is India's persistent rural dominance[62], with farming and rural communities still representing 68.5% of the population[63], which effectively means over two thirds of the population is living in borderline poverty. This is better than the 80% in 1970, but this helps to illustrate how China and India are not at the same stage of development.

Another factor is erratic Government and illogical policies, in particular in relation to protectionism, which scares investors. Where China sets out five year plans and usually keeps to them, India could not be more different. The debacle over supermarkets is a case in point. In 2011 the Government agreed to allow Wal-Mart, Tesco and Carrefour to build supermarkets in India after years of lobbying. But the Government soon made a U-turn after a public outcry and revoked the plan. Then in September last year, after criticism for back-tracking on modernisation, the Government gave consent again. Even so, Tesco only operates in India via a franchise with the powerful home-grown Tata Group, and mainly provides IT systems, technical support and management advice on retail matters rather than having real autonomy. Meanwhile, Wal-Mart had already formed a joint venture with local retail giant Bharti Enterprises in 2007, though only to run wholesale stores. Emblematic of India's challenges is that a few weeks after receiving legal permission from the Government to open retail stories, the Reserve Bank of India launched an investigation into Wal-Mart accusing it of 'secretly investing in supermarkets' while the ban was in place[64], a charge it denies. Investors now realise that in India while one group of politicians is opening the door to them another equally strong group seeks to lock them out, which can cause considerable delays and legal problems.

[62] A large rural population is neither good nor bad in itself, but in relation to national economic growth there is a limit to the income of small scale farmers even if crop yields have greatly increased. Also, agricultural activity is not especially efficient here, as much as a third of the food grown in India rots before it gets to market because of a lack of cold storage facilities (BBC, 24 Dec 2012).

[63] China's rural population is now 50% and falling steadily. Also, one could ask: How many of the new arrivals in the slums of Indian megacities such as Mumbai are earning an income significantly higher than an agricultural worker? In 2009 the UN estimated that 29% of India's urban centres were 'slums', though this has fallen rapidly from 45% in the 1990s. The UN also made a similar estimate for China, though India does not have as many factories as China to provide incomes to the newly arrived poor. N.B. A slum, as defined by the UN is 'a run-down area of a city characterized by substandard housing, squalor, and lacking in tenure security'.

[64] FT, 18 Oct 2012.

The tortured saga of Vodafone and the never-ending court battle in India over its multi-billion dollar off-shore tax liabilities are well known[65], but provide another example of unpredictability that scares foreign investors. More worryingly, India analysts believe if Vodafone is ultimately forced to concede to India's tax authorities, this would open up multiple attacks on other global businesses that operate in India, such as SAB Miller and General Electric[66]. China is not an easy place to do business either and there are frequent complaints about a lack of transparency and influence of high-ranking Communist Party members. However, foreign companies in China do at least know where they stand once given permission to operate, something they may never feel wholly confident of in India.

India and Law Firms

Given that foreign law firms can no-longer open representative offices in India, that any law firm that lets its lawyers spend in aggregate over 90 days in the country face local taxation, and that many of the alliances and associations with Indian law firms have failed, one might assume that this erstwhile rival to China was now an unattractive legal market (see Box A). That some foreign companies can find India incredibly difficult may only strengthen that assumption. Yet, some of the global law firm leaders we spoke to were more optimistic about India than China in terms of gaining interesting, high paying legal work, though primarily on outbound matters.

As one managing partner explained: 'India is very good. We are acting for lots of Indian companies all around the world. They may not use foreign lawyers at home, but abroad they go to the top firms.' This suggests two things: one, that large Indian companies are prepared to pay for the best legal advice abroad, and two, that there are a growing number of Indian companies and investors active across multiple markets. Another global firm leader is a little more cautious on the level of outbound work, but generally agrees: 'Large Indian companies are getting used to our fees.' This sounds promising, however, last year was not a great period for Indian M&A, inbound or outbound (see table 21).

	2012		*2011*	
All Indian M&A Deals	*Number*	*Value $m*	*Number*	*Value $m*
Domestic	412	12,220	540	9,135
Inbound	188	4,311	238	35,822
Outbound	164	8,328	240	15,120
Total	764	24,859	1,018	60,077

Table 21: Types of Indian M&A deal, 2011 and 2012. Ernst & Young data.

Merger Market estimates that Indian M&A last year represented only around 7% of emerging nations totals, compared to China at 25%, Russia at 21%, largely due to the Rosneft mega-deals, and Brazil with around 10% of emerging market deals by value. Meanwhile, Ernst & Young estimates total Indian deal numbers have fallen to 764 in 2012 down from a peak of 1,357 in 2008, and with total deal values dropping by 46% over the same period.

65 In 2007 Vodafone was involved in a $2.5 billion off shore tax dispute with the Indian Income Tax Department over its purchase of Hutchison Essar Telecom services in April 2007. In January 2012 the Supreme Court ruled in favour of Vodafone, so the Government changed the law, made it retrospective, plus demanded interest and fines. At time of writing the case still continues, six years after the local merger.

66 Ibid.

Key factors in this downturn have been several regulatory changes including new powers for the Competition Commission of India, a new Takeover Code that raised the trigger threshold for a takeover from 15% to 25%, and the new, and frighteningly retrospective, tax law passed by the Government to force Vodafone to pay tax in relation to activities in India. These changes 'spooked' many CEOs and killed off plans for takeovers and investment in the country. Fears over the fiscal cliff in the US and Eurozone worries also delayed investment.

The question now is: will deals pick up again? In the long term there seems to be no reason why outbound and inbound M&A should not increase if companies, general counsel and their legal advisers can become used to the new regulations[67]. India may be more dysfunctional than China, but it is still on an upward development trajectory, creating opportunities for inbound investors and demand from domestic companies to expand abroad, ranging from IT, where it has strengths, to energy, where India is highly dependent on foreign resources. An example of what we may see more of in the future was the key energy deal for India of 2012: India's ONGC paying $5bn for ConocoPhillips's 8.4% stake in Kazakhstan's Kashagan oil project. The year before, Vedanta Resources acquired a 58.5% stake for $8.67bn in Cairn India, the previously spun-off local division of UK-listed Cairn Energy.

India also needs to catch up with Chinese levels of infrastructure spending if it is to stand a chance of chasing after its rival. There is plenty of talk in India about huge projects now, especially after the debacle of the world's largest power cut in August last year that affected 670 million Indians[68]. When UK Prime Minister, David Cameron, visited India on a trade mission in February this year there was the announcement of a plan to build an 'industrial corridor' stretching 1,000km between Mumbai and Bangalore, with investment levels predicted to range from $20bn to $60bn[69]. The ambitious project is meant to mirror a Japanese-backed scheme for another industrial corridor between Delhi and Mumbai, involving Hitachi, Mitsubishi and Toshiba. But, it will come as no surprise to India-watchers that the Japanese scheme, announced in 2006, is heavily delayed, with targets now pushed back to 2017. It is possible the British-inspired corridor will go the same way. Moreover, for all the talk of spending billions on infrastructure, the Government has said many billions of rupees will be spent on agriculture and food subsidies, which is understandable given that the countryside is where the majority of India's people still live. But this will not help produce much financing work for foreign banks, nor construction work for Western companies, and hence little work for UK and US law firms.

Overall, India is a mix of opportunities though primarily for out-bound work at present, with big promises on domestic projects that are rarely delivered and plenty of legal and regulatory challenges to deter corporates. As a member of the British Foreign Office said recently at a meeting which Jomati attended: 'India will keep getting it wrong until it gets things right, but it will eventually get things right.' The question is how long must the global investment community wait? Perhaps when India realises just how far behind China it has fallen.

[67] As long as these very important developments do not suddenly change character again, which has to be a possibility given India's historic dithering and back-tracking.

[68] Moreover, around 300 million Indians still do not have regular mains power. See earlier Jomati report, 'Power Struggle: Law and the Energy Sector'.

[69] http://www.ft.com/cms/s/0/f16ce936-79b5-11e2-9015-00144feabdc0.html

BOX A: India's Hostility to Foreign Firms

The saga of UK and US law firms' efforts to operate in India has been long and painful, and the court cases that banned them from opening offices here are well documented. Predictions that protectionism would end were not well-founded. In fact, some would argue the regulatory environment is increasingly hostile.

A foreign law firm's lawyers cannot spend more than 90 days in India if the firm wants to escape tax residency. This has led to some firms developing software applications specifically to count exactly how many hours their lawyers are on the ground in India. Today some US and UK firms actively avoid even travelling to India and instead handle work from 'India desks' in locations such as Singapore.

As to future talks on liberalisation, there is a general pessimism. Nothing is expected from the Bar Council of India, which regulates the profession and is dominated by small firms opposed to US and UK lawyers working there on the irrational grounds that they will take away local disputes work, as well as a very powerful top tier of Indian firms whose partners want to sustain a monopoly[70].

The leading commercial Indian firms still have a very strong position, a situation one does not find in Russia, for example. One leading firm, Amarchand & Mangaldas & Suresh A Shroff & Co worked on $20.2bn-worth of M&A deals in 2012[71]. This 550-plus lawyer firm has just 70 partners[72], of which very few are likely to have major equity stakes.

The Indian Ministry of Justice is also seen as a powerless body transfixed by the desire to keep its constituents happy, and as it is not the 'front line' regulator of the legal profession it can do little in any case. The final avenue often mentioned by baffled global law firm partners is that WTO commitments will eventually prevail. Sadly, this is unlikely to happen. India's on-going WTO trade talks via the General Agreement on Trade in Services do not currently include legal services[73]. This is because, as one commentator observed, Indian lawyers do not especially want the right to expand their law firms abroad, hence there is little hope of gaining reciprocal rights in return. It appears that without a forceful political move by senior Indian ministers to push through legal liberalisation, which they have little incentive to do, the door will remain firmly closed.

In such circumstances alliances and associations with Indian firms have stalled. After all, what use is an alliance that cuts off referrals if you will never be allowed to merge with your Western suitor?

[70] Tales of the wealth of some Indian partners are now legendary and make the once ridiculed wealth of Italian law firm founding partners seem paltry in comparison. Though some stories may well be exaggerated, there remains some truth to the view that a handful of senior Indian partners maintain a strangle-hold on high value domestic commercial matters with local corporates having no other choice but to use them.

[71] Eight of the top 15 M&A advisers by value, and 14 out of 15 by volume, for India-related work were Indian firms, Merger Market 2012. In China, over the same period, only two Chinese firms were in the top 15 for M&A deals by value.

[72] Data: http://www.whoswholegal.com/firms/755/office/1149/amarchand-mangaldas-suresh-shroff-co.

[73] ABA dial-in conference, 'BRICs in the Wall? Offering Legal Services in Brazil, Russia, India and China Part 1: India', February 2013.

Chapter Four: Brazil, the Latin Giant

Defying the Critics

In 2002 when the Workers' Party of Brazil, led by Luiz Inácio Lula da Silva[74], won the presidential elections free market commentators feared the worst. Perhaps the BRICs would soon lose their 'B'? Such was the hysteria over 'socialists' taking over Brazil that ratings agencies downgraded its debt, the currency weakened and the stock market slid. Of course, as he prepared to step down in 2010 the view of President Lula was very different. The economy was booming under his leadership and around 20 million people had been lifted out of acute poverty. Investment bankers and oil company executives prospered too. Testament to his success across all segments of society is that when Lula left office he had an approval rating of 85%[75], a rare event in politics in any country.

But where now for Brazil, whose economy is showing signs of losing momentum and where GDP growth in 2012 was just 0.9%? It has won the right to host the 2016 Olympic Games, the first South American nation to do so[76], and the World Cup for the second time in 2014. These will give a boost, though cannot dispel deeper macro-economic issues and the need for higher productivity (see more below). Regardless of what challenges Brazil will face over this decade it is a far greater economy than before, now the sixth largest economy in the world. Its 200 million people also constitute the largest economy in the Southern Hemisphere[77] that towers over the other eleven South American nations (see table 22).

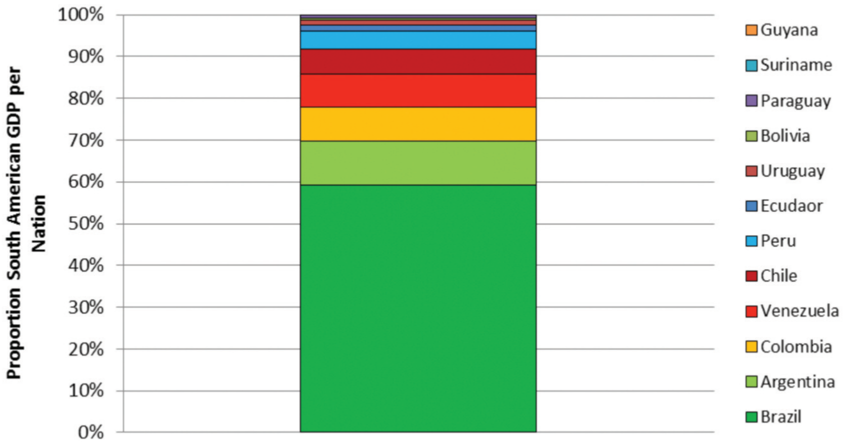

Table 22: Proportion of South America's GDP among the 12 constituent nations.

As can be seen, Brazil represents just below 60% of the entire South American[78] economy and half its people, dwarfing Argentina, the next largest economy. Understandably many global corporations and banks interested in taking global market share have seen the value in developing a presence in this country. This is despite a less impressive economic growth history than rivals such as China. As can be seen in table 23, Brazil saw the greatest growth, albeit from a very low level, in the 1960s and 1970s. Between 2003 and 2012 Brazil has seen average growth of around 3.6%, hardly stratospheric, though this is still more than double the 1.7% growth for the US over the same period[79].

[74] His effective term in office was from the start of 2003 to the end of 2010. The current President is former Energy Minister, Dilma Rousseff, once a political prisoner in Brazil and also from the Workers' Party, now regarded as an accomplished technocrat that the US feels comfortable with. Even with plenty of goodwill, she faces a stiff challenge to follow Lula's achievements.

[75] http://en.wikipedia.org/wiki/File:Lula_approval_rating.PNG.

[76] North America's Mexico also hosted the Olympic Games in 1968; the first 'Latin' American nation to do so.

[77] Rivals Australia and South Africa are smaller in terms of output, though population is a factor.

[78] South America's population is 387m, therefore Brazil also represents 52% of all South Americans.

[79] It is worth noting that even in 2006, a 'boom year' for many parts of the US economy such as housing and private equity, and law firms in general, when credit markets were flooded with capital, the US economy as a whole only grew 2.66%. World Bank data.

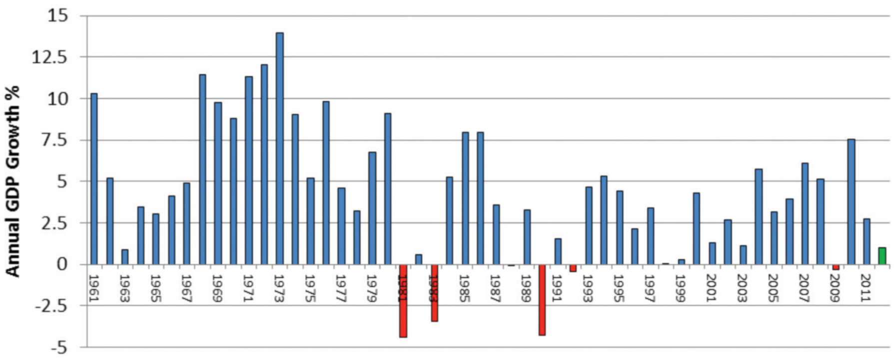

Table 23: Annual GDP growth since 1961, (green shows 2012 estimate) .

Brazil's growth can be erratic, in part because it is closely linked to US boom/bust cycles, but the economy appears to be on a firm footing for the long term. Fundamentally, the factors that had held it back for many years such as wealth inequality[80], political instability and energy dependence have been largely addressed. For example, the development of its own oil, gas and ethanol industries have been a huge success. Today, Brazil imports only around 7% of its energy needs, less than the US does. Whereas in 1978 around 45% of energy was imported, a factor that led to heavy Government borrowing, which in turn led to many economic and then social problems.

That said, economists point out that Brazil appears to be caught in 'the middle income trap', i.e. joining in globalisation and investing in industrial and infrastructure development has raised millions out of poverty, but Brazil has not yet achieved the levels of productivity and technical development to compete well against Western nations for producing higher value goods and services. One interesting indicator of global services potential is the level of English as a second language. One study[81] claims Brazil is 46th in the world for its level of English, far below China, or even Iran. And a 2009 study by local recruiter, Catho, found that while 24% of Brazilian professionals speak excellent English, only 8% of Brazilian company executives speak fluent English.

Law Firms in Brazil

Given that foreign lawyers cannot practise Brazilian law and that the local Bar is increasingly hostile even to 'associations' with local Brazilian firms (see box below) it may be surprising that there are at least 22 UK and US law firms with permanent bases in the country, though most remain small offices with few partners. Of these at least 16 are US law firms, which gives an important indicator of the relevance of South America's largest economy to North America's largest economy. And there are more major law firms queuing up to enter the market. Among those firms that have publicly stated[82] a desire to open in Brazil are: Norton Rose Fulbright, Hogan Lovells and Baker Botts, with the country's oil and gas sector probably acting as a strong attractor to all three.

80 Brazil had truly stunning wealth inequality in the past, with a GINI coefficient in the late 1980s and early 1990s in the high 50s and up to 63 at its peak. This signifies considerable wealth in the hands of a very small minority, amid a far larger group of relatively very poor people. By way of comparison, Canada has a score of around 31, showing a balanced society. World Bank data.

81 Rankings by EF International compiled from the results of 1.7 million adults who took online English tests between 2009 and 2011.

82 http://www.thelawyer.com/opportunities-outweigh-challenges-in-latin-america-says-bakers-latam-chair/1015820.article

Not only are there more US law firms in Brazil than from any other nation, there is also more activity from major US investment banks than from any other major economy. For example, (see table 24), last year's top ten M&A adviser banks were divided into: four for Brazil, four for the US, and two for Europe: Credit Suisse and Rothschild & Co, even if both conduct a huge part of their business outside the EU.

Deal Adviser	*M&A Deal Value 2012 (US$ Bn)*	*Deal Volume 2012*
Credit Suisse	$ 28.4	45
Itau BBA	$ 21.1	70
Rothschild & Co	$ 17.5	20
JPMorgan Chase	$ 16.9	13
BTG Pactual	$ 16.5	72
Citigroup GB&M	$ 16.1	9
Bank of America	$ 15.1	12
Goldman Sachs	$ 14.6	12
Bradesco BBI	$ 13.6	36
BR Partners	$ 7.3	13

Table 24: Top 10 adviser banks to Brazilian M&A on 278 deals with $60bn total value. Total Brazilian M&A deal value was $71bn. Thomson Reuters Data.

Brazil's own banking sector continues to control significant market share. Brazil's banks have also performed very well on debt issuance, which is an increasingly important area for Latin American capital markets. Brazilian public bodies and companies issued a total of $50.9bn in debt in 2012, up from $37.3bn in 2011, in part to tap into investor demand for higher yields. In this segment of the market, Brazil's Itau was number one manager, beating the UK's HSBC and Spain's Banco Santander[83]. For law firms this means two things: first that when combined with the ban of local law advice Brazilian law firms are gaining a significant amount of available high value work, and two: that US law firms, at least when it comes to major M&A, may have an advantage over their UK cousins. The strength of the connection between the US and Brazil is further underlined by examining the CVs of the leadership teams of financial services businesses in Sao Paolo and Rio de Janiero. One quickly sees that a significant number not only studied in the US's top universities, but were 'apprenticed' inside the likes of Goldman Sachs or Morgan Stanley. Moreover, examine the CVs of the Brazilian lawyers and one also sees a strong link to the US legal education system. But, English law is still important for some inbound clients, such as for financing foreign-backed infrastructure projects in Brazil. International shipping and insurance issues may also be a strong card for UK firms here.

[83] Thomson Reuters.

Box B: Brazilian Bar on the Defensive[84]

Brazil has always maintained a ban on foreign firms offering local legal advice, but allowed global firms to open offices to operate as 'consultants' and have formal relationships with Brazilian lawyers, to the point of creating what appeared to be 'captive' local law offices. However, Brazil's leading firms and their Bar have now taken a far more defensive stance. In October 2012 the Ordem dos Advogados do Brasil (OAB) demanded an end to any perceived lack of independence of local lawyers, though in practice the OAB has merely re-stated its existing rules, just with more vigour than before. While this does not automatically prevent loose associations with US and UK firms, it does appear to prevent the use of captive Brazilian firms and puts pressure on 'appearances', in effect preventing any suggestion a foreign firm can offer local advice in any way. At least one firm has closed its Rio office entirely[85].

One of the most high profile cooperation agreements, maintained by global firm Linklaters with Lefosse Advogados, was also terminated. As noted above, some firms are still trying to set up in Brazil despite the drawbacks. One reason for maintaining an office there is to manage cross border work, for example an international bond issue sponsored by a Wall Street bank, or international financing of domestic projects under English law. In such cases a local office provides client reassurance and a useful business development resource. However, the majority of such work will be done abroad and it seems unlikely that under current rules foreign firms' Sao Paolo offices will grow significantly in the short term. Though, such bases could eventually become regional hubs for business development and deal management in the rest of South America and that could see their headcount rise more rapidly.

[84] The Am Law DailyDecember 13, 2012.

[85] Squire Sanders, www.thelawyer.com/linklaters-ditches-brazil-ally-in-light-of-stringent-local-bar-rules/1015930.article.

Chapter Six: The Other 160[86]

Where Next?

'Where next?' is a question managing partners need to ask themselves and their clients again and again. But, as noted earlier, high growth alone does not necessarily mean a bountiful legal market. In which case where in the developing world after the BRICs is neither too small to invest in, nor too dangerous[87] to attract client investment, but sufficiently likely to keep growing and building a diverse economy to make a long term commitment to the jurisdiction a profitable investment? Below we outline seven developing markets that receive growing attention from global law firms, though each have significant challenges.

Turkey

This nation of 74 million people and the 18th largest economy is strategically located between Europe, the Middle East and Central Asia. Foreign law firms have been handling work in Turkey for decades, while a handful had offices here in the late 1990s. However, since the financial crisis of 2008 and the need for new markets Turkey has become far more important to a wider range of firms. Turkey is generating significant capital markets and M&A work, underlined by the Government's plan to sell off at least $15bn of State assets to help balance public deficits[88].

A spate of law firm openings has already begun to crowd the market. More recent arrivals include: Baker & McKenzie, Allen & Overy, Clifford Chance, Pinsent Masons and Chadbourne & Parke. However, local Bar rules demand foreign firms form alliances with local lawyers to offer Turkish legal expertise. This in turn has led to many smaller and medium size Turkish firms quickly joining forces with the US and UK firms. In other cases firms have built 'captives' by encouraging partners from leading firms to create a new business, which they can than formally associate with. The remaining top tier of Turkish firms understandably do not wish to cede their independence in such a buoyant market.

But, Turkey remains an erratic nation. As table 25 shows, growth appears to arrive in sudden spurts, followed by equally sudden collapses, primarily due to its EU-linkage. Though the drop in activity in 2009 could be predicted, the sudden drop in growth in 2012 was more significant and was affected not only by Eurozone weaknesses, but also by the regional instability following the Arab Spring, most notably the current situation in Syria.

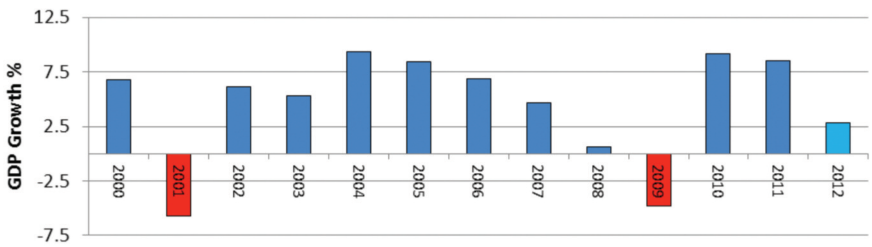

Table 25: Turkey GDP growth, 2012 estimate and World Bank data[89].

[86] If one subtracts the EU, the other G7 nations such as the US, and a number of smaller highly developed jurisdictions with vibrant economies such as Australia, Hong Kong and Singapore from the UN recognised group of 196 nations, then one is left with a huge number of developing economies to consider. Developing nations outnumber developed nations by at least four to one, and that gives clients a lot of new markets to consider.

[87] Some of the most interesting developing markets for global law firms on paper are currently seen as highly unlikely destinations, despite great potential due to large and growing populations and/or commodity wealth, such as Iran and Pakistan. However, neither nation is likely to figure on any US or UK law firm's strategic priority list for many years to come for political, regulatory and security reasons.

[88] http://www.bloomberg.com/news/2013-01-03/deloitte-sees-turkey-2013-m-a-falling-to-3-percent-of-gdp.html

[89] http://www.iif.com/emr/eu/turkey/

Even so, there are a number of very positive factors that will support long term Turkish growth. One is its growing workforce, with a quarter of its population under 15. Another is a widening economy and rising incomes that support consumer brands and financial services from the West that seek to enter the market. France has reignited stalled EU accession talks, a move that though unlikely to see European entry for some years gives extra confidence for foreign and local investors. Turkey is pushing to export more, especially to other developing markets and neighbours such as Iraq, which has become a key trading partner. European trade is also large, with combined imports and exports totalling €120bn in 2011[90].

The negatives however are potentially quite serious. A key problem for Turkey is that it imports 71% of its energy, creating acute exposure to oil and gas prices. Even though there is talk of importing gas from Israel's nearby Tamar gas field by pipeline, for now it is at the mercy of global markets. While its population grows and industrialisation continues demand also rises. Energy use per capita grew by around 50% from 2001 to 2011[91]. There are also strategic concerns, the chief one is Syria's civil war on its border. NATO member Turkey also borders Iran and a possible Israeli attack on its nuclear facilities would both destabilise the region and drag Turkey's economy down with high energy prices.

South Korea

It is estimated the South Korean legal market for foreign law firms was worth $1.4bn in 2011 and may rise to $2bn by 2016[92]. Following free trade agreements (FTA) with the US in March 2012 and EU in July 2011, South Korea has partially opened its legal market to foreign law firms. Law firms still need to apply to the Korean Bar for a licence to set up an office and they cannot yet practise local law. Under the phased system of liberalisation[93], two years after the FTAs foreign firms are expected to be allowed to form fee-sharing alliances with local firms. This has been interpreted as starting this July, at least for EU firms. Five years after the FTAs have been agreed foreign firms will be able to hire local lawyers, and in effect merge with Korean firms. This latter stage, expected around 2016, will have a profound impact on the Korean legal market and many local firms are already preparing themselves.

Some law firms, especially US firms, have relocated American lawyers with Korean heritage to give their office an advantage. Baker & McKenzie has also reportedly[94] hired a New York-qualified lawyer from a leading local firm. At time of writing the South Asian nation had 16 international firms with approval to open, which if there is insufficient workflow could lead to another crowded market.

The liberalisation step and trade agreements are part of wider economic and cultural change in Korea. One hope for reformers is that small and medium-size companies will spring up to eventually take on the family-controlled chaebol that produce, or some might say control, just below half of the nation's GDP[95]. Though companies such as LG and Samsung are already global in scale, and also produce significant work for Western law firms such as in IP, experts believe the economy is too rigid, too consolidated and may not be able to compete globally in the future. Koreans are well aware that in 2001 they were the 12th largest economy in the world, just behind Brazil. But, by 2011 Korea was the 15th largest economy and its erstwhile peer, Brazil, had climbed to 6th place. It is not that Korea is failing badly, but rather its developing world peers are doing much better. With only 50 million people it cannot afford to fall behind and become a relatively 'small' economy.

90 Eurostat, Wikipedia.
91 World Bank data.
92 http://www.ft.com/cms/s/0/30966bac-e2c4-11e1-a463-00144feab49a.html#axzz2Ojzixz8j.
93 http://www.thelawyer.com/eu-south-korea-free-trade-agreement-heralds-new-dawn-for-western-practices/1007094.article.
94 http://www.thelawyer.com/bakers-snatches-senior-foreign-lawyer-from-kim-and-chang-ahead-of-seoul-launch/1016412.article.
95 http://www.businessweek.com/articles/2012-11-21/how-powerful-should-koreas-chaebol-be.

The ongoing military threats from North Korea create uncertainty and are a serious deterrent to inbound investors, at least until the current crisis is resolved. However, in the long term we are likely to see higher levels of both inbound and outbound M&A and investment, as well as greenfield developments and greater use of international capital markets by ambitious non-chaebol clients. The challenge for foreign firms undoubtedly will be market saturation even for attracting outbound work. The four leading Korean law firms[96] are already large, some with 400-plus lawyers, and will need to be worked closely with, though they will have no illusions about the long term intentions of US and UK firms. Some are not waiting to be 'cornered' when foreign firms can practise locally. For example, Kim & Chang is opening an office in Hong Kong and we may see more strategic expansion of this kind.

Malaysia

Large international firms have been handling inbound and outbound matters in Kuala Lumpur for many years, often via Singapore. Now, Malaysia has also, at least nominally, opened up its legal market to foreign firms. Liberalisation came via the Legal Professional Amendment Act, or LPA, last June[97]. Foreign firms can now open offices in Malaysia as 'qualified foreign law firms' (or QFLF) and also separately 'partner with a local law firm', though licences will be required in both cases. It is not clear how such a 'partnering' arrangement would work with a local firm, even if the rules state the combination could 'bill its clients as a single firm' and 'recover costs and retain payments in respect of such practice'. If this leads to the type of arguments between firms that stemmed from Singapore's first iteration of its joint venture system, then US and UK lawyers may need to be cautious. It is early days, but commentators have suggested the Malaysian Bar is trying to reduce foreign firm activity[98] by using the LPA to prevent non-licensed law firms from operating in the country, even on a fly-in/fly-out basis. Even so, Baker & McKenzie, for example, are already associated with 100-lawyer Wong & Partners, while UK firm Trowers & Hamlins has already opened a 'non-trading office' after gaining permission from the Malaysia Investment Development Authority.

Bar rules aside, can Malaysia, the 35th largest economy, become an important legal market for multiple global law firms? One growth area is the Islamic bond, or sukuk, market, where Malaysia is the world leader. Sukuk issuances in Malaysian currency represent 74% of worldwide sukuk offerings in 2012, compared with 49% in 2008[99]. Standard & Poor's expect at least $100bn in Sharia-compliant Malaysian debt securities to be issued in 2013, though this is around $38bn below 2012. An extension of a tax break to foreign entities that sell bonds in Malaysia has also been extended to 2014. Over the long term there may well be a growing demand for international law firms' input, even if the local law aspects remain dominated by Malaysian law firms.

Beyond sukuk bonds, the future is less clear. Though it is often paired with Indonesia, Malaysia is a minnow with just 29 million people and a GDP the size of Greece. It has only one Fortune 500 Global company, the immense State-owned Petronas oil and gas company, which towers over[100] the economy with annual revenues of $97bn, or 34% of Malaysia's GDP and contributes around 45% of the Government's budget[101]. This does not bode well for a diverse, client-rich environment that will sustain multiple law firms. But, there is client work beyond Petronas. Malaysia's AirAsia and India's Tata Group are planning to jointly develop a new airline, while global financial services groups such as the UK's RSA insurance are understood[102] to be looking at Malaysia for investment. In another major deal, this January ING sold part of its Malaysian insurance business to AIA for $1.7bn. There are also some significant outbound investments into Europe, such as last year's $600m purchase of London's iconic Battersea Power Station by a consortium of Malaysian companies. The landmark site is now undergoing a massive redevelopment.

[96] Kim & Chang, Lee & Ko, Bae Kim & Lee and Shin & Kim.
[97] www.federalgazette.agc.gov.my/outputaktap/20120920_A1444_BI_BI%20A1444.pdf.
[98] www.thelawyer.com/malaysia-tightens-grip-on-foreign-law-firms/1014330.article.
[99] http://www.kinibiz.com/story/corporate/11305/sp-sees-malaysia-leading-sukuk-as-poll-nears.html.
[100] Both figuratively and literally via the Petronas Towers, the third largest sky scraper in the world.
[101] www.thedailystar.net/newDesign/news-details.php?nid=240660.
[102] www.ft.com/cms/s/0/4feed6c2-7b32-11e2-8eb3-00144feabdc0.html.

Mexico

Frequent reports of drug gang killings may make Mexico appear too dangerous for you and your clients. It is true that 'prohibition'[103] is having a catastrophic effect in areas where drugs are transported. UN data recorded 27,200 murders in 2011 and this puts Mexico at 23.7 homicides per 100,000 people. But in Brazil, which is 75% larger than Mexico, around 40,000 people are murdered every year, giving it the second highest total murders in the world[104]. Aspiring BRIC member, South Africa, is far more dangerous than either with a murder rate of 31.8 per 100,000 people, or around 16,000 homicides in a population of just 50.5 million. Mexico is not New England, but lawyers and CEOs should stay open-minded; this country is not a war-zone by any means and far safer than many developing rivals.

Mexico is a 115 million-strong nation that borders the largest economy in the world, the US, with which it shares huge volumes of investment and trade. It also has been undergoing sustained economic growth for several years despite a sharp one year drop in 2009. Today, many large companies, if not already there, understand that when looking for important developing markets to enter then Mexico, the world's 14th largest economy, cannot be ignored. With a GDP per capita of $10,047 in 2011, and still rising, Mexico is attractive to both consumer goods and global financial services companies, and with $22.8bn in workers' cash remittances, mostly from the US back into Mexico, families see additional income that drives a relatively buoyant economy.

Growth is expected to be 3.8% in 2012, which given its dependence on its larger neighbour for much of its economic activity is a good performance. In the long term Mexico's challenge will be whether it can finance sufficient improvements in education and infrastructure to permit higher levels of productivity. If it cannot, it is likely to remain a provider of energy, raw materials and cheap labour to wealthier economies and remain in the 'middle income trap'. This scenario is sustainable, but limits the long term scope for interesting work for global law firms. Also, Mexico only has three Fortune Global 500 companies: CFE the state-owned electricity company, America Movil the local telecoms giant and the huge national oil and gas company Pemex, with revenues of $125bn, making it one of, if not the largest, company in Latin America.

Mexico's capital markets are small but robust and experts are predicting a steady increase of IPOs. ABC Aerolineas, operator of Interjet, is planning an initial public offering in September[105]. However, IPOs in Mexico tend to be few. In 2012 there were just seven new companies listed on the Mexican Exchange, one of which included Banco Santander listing a tranche of shares worth $4bn. This is clearly not New York, but investment banks are optimistic, especially with regard to inward investment in local equities. Goldman Sachs recently gained authorisation for a local brokerage, while Morgan Stanley has tripled its headcount in Mexico since 2010[106]. The main IPC:MEX index is floating around historic highs and is about 30% higher than in the previous peak years of 2006 and 2007.

Unlike many developing nations, Mexico is open to foreign law firms and they may hire partners to practise local law. About a dozen global law firms, mostly from the US, have offices in Mexico City, with at least two Big Four accountants operating legal practices there. In 2012 DLA Piper launched there by taking a local team from US firm Thompson & Knight. The UK's DAC Beachcroft is also there, though it is clear that most inbound and outbound transactional work is often in relation to the US or other parts of Latin America where US firms have a cultural advantage (see Brazil earlier).

103 Of cocaine in this case, not alcohol as happened in the US between 1920 to 1933 that had a similar bloody effect in American cities, such as Chicago, until alcohol was finally legalised and corporatised again.

104 www.unodc.org/unodc/en/data-and-analysis/homicide.html. Surprisingly, India, a nation famous for non-violence, has the highest total murder rate in the world (42,923 murders in 2011), but its murder per capita score is low due to a high population.

105 Bloomberg, 24 Jan, 2013.

106 www.bloomberg.com/news/2013-02-13/morgan-stanley-triples-mexico-staff-as-ipos-beat-brazil-s.html.

Also, when major equity or debt issues under-written or arranged by Wall Street banks take place, one can expect US white shoe firms to fly in and out to advise. Mexico's legal market is therefore already fairly well served. This does not mean the legal market will not grow larger, but new entrants need to have a well-designed strategy to make an impact.

South Africa

South Africa has claimed to be the 'S' in BRICs. Though it is no doubt a very important developing economy, other nations such as Turkey, Saudi Arabia and Mexico have larger GDPs. Even so, the four true BRICs have been willing to accept South Africa into their club, perhaps in part because of China's desire to forge close ties to Africa. They frequently meet to discuss global trade issues, have pledged to support each other's currencies, and have even agreed to create a joint development bank, though cynics believe concrete action here is very far off. The country is also unlike any other BRIC in that it has always had a very wealthy group of people living lives not that dissimilar to those of, for example, people in America. This white minority still holds huge interests in mining, banking, tourism and agriculture, while the majority of black South Africans have lived, and still live, in relative poverty.

We have already considered South Africa, and Africa in general, in an earlier report[107], however, it is worth noting a number of important developments. Most significantly: Baker & McKenzie opened an office in Johannesburg last May with the office of defunct Dewey & LeBoeuf and Magic Circle firm Linklaters formed an alliance with leading South African firm Webber Wentzel this February. Back in 2011 Norton Rose took the bold step of merging with local firm Deneys Reitz, a step that highlighted the need for other firms to choose a strategy to manage work in South Africa. And in 2012 Canada's Fasken Martineau merged with Bell Dewar. These are important developments, but do not guarantee significant influence across Africa as a continent. South African law is by no means accepted as the 'Lex Africa' and its role in Africa's 53 other nations remains restricted.

For now many other global firms are focussing on how to 'do Africa', with many believing the first step will be to form close working relationships with local firms. The challenge is that nearly every major firm has exactly the same plan and top local firms are few in number, in South Africa and across Africa in general. This means there is little loyalty for those that do not tie down their alliances.

For now we do not expect an Australia-style invasion of South Africa, the 28th-largest economy in the world. That said, and as we explored in our Africa report, this continent of 1 billion people and 54 nations is only going to move steadily up the developmental ladder and produce more interesting legal work in the future. South Africa is without doubt the financial centre of Africa, with the largest domestic banks, the highest number of foreign banks, and the most developed legal market. There is also significant interest from global telecoms companies, as well as property sector clients, in developing a presence in South Africa. Opportunities may therefore grow steadily.

But, realism is needed. South Africa's population of 50.5 million is not a huge market for legal services, primarily because around 30% of its people live in absolute poverty[108], and considerably more not much better, even if swimming pools and vineyards of the white minority are the expectation among tourists. Perhaps the most indicative piece of data to understand South Africa's real situation is its average life expectancy, which is just 52 years, compared to around 80 in the West. This describes a painfully divided nation still, and that means its potential to become a large, balanced, consumer-led market is severely limited. This will tend to keep global law firms restricted in what work they do, with extractive industry clients likely to continue to dominate for some years to come.

107 'Jomati Report, May 2012, 'Africa's Turn: Law and the Last Great Emerging Market'.

108 I.e. earn less than $2 per day, last figures for 2009, using purchasing power parity conversions based on 2005 US dollars. World Bank data.

Indonesia

242-million strong Indonesia is the 16th largest economy in the world and has been growing on average 5.7% per year over a decade[109]. Around a dozen US and UK law firms have now launched formal alliances and close associations with Jakarta-based law firms, primarily because the local Bar does not allow foreign firms to open their own offices there. The international side of Indonesian deals are often run out of Hong Kong or Singapore offices instead. This 'at arm's length' barrier maintained by the local Bar, alongside the growth of other Asia-Pacific economies such as China and Australia, has tended to draw away some of the enthusiasm for Indonesia despite its size.

Another reason for a slightly lower level of US and UK law firm attention for Indonesia is that the majority of the country's trade is with other Asian nations, especially Japan and China. Only around 8% of its exports, such as oil, gas, textiles and timber, go to the US. It may be a large economy relative to some South East Asian neighbours, but its strength is primarily regional. It is also still quite poor. Despite a growing middle class around half the population lives on less than $2 a day[110], i.e. far too poor to buy Western consumer goods and retail financial services and that will impact the range of inward investors. As global firms expand in Asia, Jakarta may become more important, though may never be as vital a hub for cross-border work as Singapore is.

That said, several natural resource companies are major players in Indonesia and recently those with international listings, especially in London, such as Bumi and Churchill Mining have seen significant disputes. AIM-listed Churchill has been involved in a long-running dispute with Indonesian authorities over the revoking of licences in 2010 and is now pursuing arbitration. The far larger FTSE-listed Bumi coal mining company has seen a management dispute between major shareholder, Nat Rothschild, and the board following allegations of 'financial irregularities'[111]. Meanwhile transactional work has come via direct investment by foreign corporates, such as L'Oréal and Toyota seeking to target wealthier urban Indonesians.

Among domestic clients, the elite group of family conglomerates, such as Ciputra, the Bakrie Group and Sinar Mas, may not be Fortune 500 Global companies, but they are cash rich from years of economic growth and are investing in multiple domestic investment and construction projects[112], though in the latter case, foreign law firms may have a minimal role advising when funding is sourced locally. Finally, Indonesian capital markets work is limited but Goldman Sachs, JP Morgan and many other Wall Street institutions have bases in Jakarta working on domestic and international equity and debt issues and this provides some interesting work. Overall, Indonesia is a little less attractive as a legal market in reality than it perhaps should be given its size.

[109] http://www.ft.com/cms/s/0/e1a1c812-6fa3-11e2-956b-00144feab49a.html

[110] http://www.ft.com/cms/s/0/7e1411f0-7e3b-11e2-a6d1-00144feabdc0.html. This poverty has led to a longstanding fuel subsidy, which weakens the public balance sheet but is so popular politicians fear a violent backlash if it is removed or reduced, as happened when a similar move was suggested in Nigeria.

[111] www.telegraph.co.uk/finance/newsbysector/industry/mining/9562136/Bumi-investigates-alleged-financial-irregularities.html.

[112] http://www.ft.com/cms/s/0/e1a1c812-6fa3-11e2-956b-00144feab49a.html.

Burma (Myanmar)

We have been waiting some years to write about Burma. This country of 60 million people with large oil and gas reserves is now 'open for business' following years of brave work toward democracy from campaigners such as Aung San Suu Kyi, chairperson of the National League for Democracy. Trade links with the US and EU have now been opened and investors and corporates are lining up to seize opportunities. Law firms are also considering their options in what currently is the 72nd largest economy in the world.

As one local commentator pointed out, decent hotel rooms have risen from a few dollars a night to more expensive than London in some cases, in the space of a year. What will happen next, other than rapid inflation, is not known. One might assume the prime targets for investment are the nation's energy reserves, but these are hardly virgin territory. Despite protests over the regime's use of forced labour in the past, foreign oil companies such as Premier Oil, were heavily involved in Burma long before 2012. Chinese State-owned oil companies and France's Total, as well as other regional oil majors such as Petronas, have also been heavily engaged in developing Burma's oil and gas reserves for years. Unlike Premier Oil[113] these companies did not pull out. The move toward democracy will see further exploration and more investment, as well as perhaps development of new pipelines, liquefied natural gas plants, improved tanker ports and other oil and gas infrastructure. But, there is a limit to the entry of new oil companies and incumbent licence holders will no doubt seek to consolidate their positions. We can also expect China to increase its political and economic influence, initially through its demand for Burmese energy resources and then via broader trading by road given its shared 1,300 mile border with north eastern Burma and sea via Burma's well-placed ports, along with greater FDI.

Aside from oil field development, after 50 years of isolation transport infrastructure and telecoms modernisation will be paramount, followed by a very incremental growth in investment from the world's large consumer brands. But we need to be cautious. GDP per capita in Burma is estimated at $1,400 using the purchasing power parity system, giving it sub-Saharan Africa levels of poverty and rural dominance. North Korea has a higher GDP per capita than Burma[114], perhaps a factor that supported the move to democracy. Some may assume Burma could be the next Vietnam in terms of providing low cost manufacturing labour. However, weak infrastructure, ancient ports and power generation will be a challenge to this strategy.

At least publicly, no major US or UK law firms have yet been licensed to operate fully functioning offices in the commercial capital Yangon[115]. Developing regulation to facilitate the entry of foreign law firms is probably low down the current Government's list of priorities. That said, leading Singapore firm Rajah & Tann and Malaysia's Zaid Ibrahim & Co (ZICO Law), have both now opened in Yangon[116]. For now most inbound deals have been handled by UK and US law firms from their Hong Kong, Singapore or Thailand offices. Understandably, the local legal market is also seriously under-developed. Though, there are a few established entities already there, such as Laos-based legal and tax firm DFDL, run by a mix of French, English and American accountants and lawyers, which operates through an associated firm, Myanmar Thanlwin Legal Services. Meanwhile, Baker & McKenzie, was reported[117] to have hired a locally qualified lawyer to its office in Thailand. Burma will clearly grow very fast and this will deliver interesting work to some law firms, however, this country is a long way behind its Asian peers. The extractive industries already arrived some years ago, while areas where Burma desperately needs development for the wider economy may not necessarily see significant investment for some years.

113 Premier Oil eventually left Burma in 2002

114 CIA World Factbook.

115 The administrative capital was officially moved farther inland in 2005 to Naypyidaw. Reasons suggested for the move vary, from fears over a seaborne invasion, to the need to control the nation from a more central location. Another reason could have been to protect the leadership from a challenge to its dictatorship by the disgruntled citizens of the more populous Yangon.

116 http://www.thelawyer.com/myanmar-horizons/1016445.article

117 Ibid.

Chapter Seven: Scenario Planning in the Developing World

Protect Your Investments

Opening an office in any new market is ultimately an investment decision, and especially today a decision taken in extremely tight financial circumstances. Most law firms cannot do what their corporate clients do on a regular basis to share the investment burden: they do not issue shares, nor sell equity stakes[118] to outside investors to provide them with extra capital. They must fund their growth out of annual earnings, even if use of bank debt and a growing tendency to retain partner earnings helps[119] a little. This creates a zero sum dilemma for management: what you spend on one location this year cannot go toward supporting growth in another jurisdiction, regardless of what partners, or even your clients, may think.

Management must predict their clients' needs, consider their rivals' actions and decipher the direction of the macro-economy then stake the firm's capital on where they see the best return for the firm. They can never know for certain; sometimes the bet works, other times it fails. The legal press is full of stories that describe both types of outcome. But, unlike their clients lawyers cannot share this risk with anyone else[120]; their equity partners must shoulder any strategic failures directly through lower profits, which can make them appear less successful than partners in rival firms, setting off numerous unwelcome outcomes.

Management must therefore think very carefully about where they choose to build offices and also consider what might happen if such investments do not deliver[121]. As seen, such decisions in the developing world are made even harder by a more alien and often unpredictable environment. Below we consider the issues that any managing partner will want to carefully gauge before making an investment:

Client Demand – Small and developing markets will often see equally small numbers of your clients interested in a location. In some cases there may even be just one large client that has major legal needs in relation to a developing market. Should you refuse to open on such a narrow basis? Expressed demand even among a minority of clients is better than ambivalence, but is that enough? What if the client makes you a 'hostage' to its plans but soon changes its mind and pulls out? Or, what will happen once the client is settled in the new environment and no longer needs your project finance teams back in London or New York, and now needs far more advice from politically connected local lawyers who your firm may not be allowed to hire?

It is doubtful that GCs will give you a commitment of a certain level of fees for a certain number of years in a new market. Or if they do they may be taking a risk themselves as they cannot know what will happen to the Government in, for example, a small African nation in five years' time, nor predict commodity prices. Risk/reward planning seems to be a sensible way forward in the face of significant unpredictability. Also, scenario-planning and future financial modelling is useful as it enables management to be frank with the partnership and moderate expectations while setting out what could realistically be achieved.

118 Though of course in Australia and the UK that can now happen, while in the US the issue of external investment is currently being debated in the courts.
119 Although increasing bank debt and retaining partner earnings create their own special problems, which we cannot go into detail in this report. Another alternative is to merge in order to gain economies of scale and reduce cost per partner of new investment.
120 See 118.
121 Or perhaps give a return on investment greater than one would have gained by taking higher remuneration instead and giving the difference to an investment fund manager. I.e. if your foreign offices are not delivering a steady return by way of increased partner profits after several years one must ask whether these truly were wise investments. After all, you would not keep millions of dollars wrapped up in a stock that fell in value.

The Right People – Many 'new' markets quickly see other entrants arrive, which in turn puts pressure on your office's staff to not only perform but to hold onto the clients you plan to serve there. You need to ask: can these relocated lawyers grow the business? Have they shown they can manage an office, are they equipped with the right skills? Equally, will local lawyers you have hired fit in or will they become remote and isolated? And are lateral hires from other US and UK firms' outposts in the developing world moving to you for the right reasons? Conversely, even those partners who appear well suited to leading a foreign office may baulk at the idea of moving to the polluted streets of Beijing. But, sending those not up to the task is worse than not opening an office at all. Getting the right people is critical.

Staffing an office will never be a science, primarily because no one knows how a partner will perform until he or she is embedded in the new market. Mandarin-speakers may become tongue tied when faced with a real presentation to an all Chinese audience, or the confident corporate partner may crack when made office head and now must push up local revenues in a culture they do not understand. Again, forward planning is the answer. You may need to scenario plan how different teams of lawyers would behave in a new foreign office under various situations and make a pragmatic choice, and not necessarily opt for the partners who are eager to move abroad, but choose those who are truly best-suited to your objectives.

Local Alliances – The need to practise local law will not always be relevant, nor possible because of Bar rules. But, working closely with local lawyers will always be imperative. Some firms quickly move past working with multiple firms and seek a more permanent local relationship that will reassure clients and enable know-how and service standard sharing. The major challenge in the developing world is the lack of top local firms that will agree to form exclusive or publicly branded relationships, especially when there is an influx of direct investment. Some firms have decided it is better to make a deal with a lower tier firm just to have 'local alliance' in their marketing material. This can be a bad decision and permanently link your firm to a weaker team, which clients will sense. The alternative is to create a 'custom built' captive, using a willing partner from an elite local firm. However, as seen in Brazil, this strategy can draw attention from regulators. Joint ventures can also backfire when division of client fees becomes an issue. Though it is tempting to forge local alliances to 'look good' unless you can feel wholly confident it is often better to leave such links alone. Marketing is important, and so is matching rivals' local capabilities, but a bad local relationship just for show is a high price to pay and may hinder your strategic aims.

Network Firms – There will be some jurisdictions where the flow of work is infrequent and it is not yet worth investing heavily in a local alliance or branded association. Instead, the firm may seek to rely on more informal referral relationships. Increasingly, firms are using referral 'clubs', though many of these 'pay to play' groups have major challenges due to their lack of uniform quality or shared values. There are now dozens of such clubs, though only a handful achieve what they set out to do. Some larger international firms have instead sought to build links abroad via alumni networks, such as McKinsey & Co famously does, ensuring that no one who has ever worked for the firm, or been closely associated with it, remains an untapped resource. Such alumni networks usually remain unpublicised, though clients can be told with some reassurance that work is to be handled by, for example, a former senior associate who is now perhaps an experienced partner of a firm in the developing world.

Competition – If your firm has identified a booming market with very few other law firms present, plus a rising level of inward investment from multiple corporates, the likelihood is that most of your rivals also have. In which case moving early and establishing credibility before your peers begin to open and share the market may prove a valuable step. Likewise, moving into a market where nearly every global firm is already present may seem reassuring, after all, two dozen other law firms cannot be wrong, can they? The reality is that moving into a congested market requires perseverance and an extremely robust strategy to grow the business. Incumbent firms, perhaps located in this market for several years, will have a huge advantage over you and will be determined not to let you take market share off them. They will also be intrigued by the clients you bring with you and encouraged to approach them too, perhaps with lower fees as well as the quite possibly factually correct announcement that they have more on-the-ground experience of this market than you do.

It may be worth modelling how much competition the firm can sustain before it needs to invest significantly to fight back and give the potential client base a more compelling offering in the new market. You certainly do not want to wait until you have received several years of poor financial data on an office before deciding that this base you invested $20m in is seriously at risk of eclipse from rivals.

That you will face rising competition when you enter a new market is usually a given. But firms should not always see competition as a negative. Competition from other global law firms in a new location unused to UK and US lawyers can help to develop demand as local clients learn to value your services and understand how you can help their businesses. Being the only firm in a developing market is therefore not necessarily something you want to be.

Exit Strategy – Whenever a business opens in a new market, especially a developing market where economic, regulatory and political change can have a sudden and negative impact, it is wise to look ahead and consider under what circumstances you would close, or spin off, an office. If one examines the behaviour of your corporate and banking clients you will see that opening and disposing of businesses is part of everyday operations, and many would argue a very healthy aspect of their business strategy. Law firms cannot operate in such a rapid way, in part due to the relative cost to the business of launching an office, but there is something to be learnt here, especially as global firms develop more and more offices globally.

It may be wise to consider future trigger points that would result in a shut down or spin off, such as the level of profit per lawyer in an office, or the number of inbound, outbound and domestic clients serviced, or the average value of assignments over a period. In the past the belief has been that closing offices when work dries up, as happened to some US firms in Moscow in the 1990s, is bad for a firm’s image. It may now be time to challenge that assumption. After all, your clients may well respect you more for taking hard-headed business decisions. Moreover, in today’s tight cost environment can you really afford to keep unprofitable offices running just out of pride? Would it perhaps be better to reinvest the money saved in new, developing markets elsewhere?

Conclusion

In this report we have sought to answer three key questions: how important is the developing world to global law firms; will the BRICs remain the largest developing nations and hence among the most important legal markets outside the West; and which are the most promising 'chasing pack' nations after the BRICs?

The answer to the first question can only be an affirmative 'very', at least as far as our research and interviews with managing partners have led us to conclude. With Europe in the economic doldrums, Japan struggling to stimulate growth and the US still hampered by structural problems, corporates and investors have to embrace the developing world if they want growth. The developed world remains the home of many of the world's largest and most advanced companies, the world's leading capital markets and banks, and is rich in technology and know-how. For that reason, the developing world's companies will increasingly invest in the West. Therefore, law firms stand to tap work in either direction.

Will the BRICs remain the ruling tetrarchy of the developing world and what will it mean to law firms? It seems highly likely that unless there is a collapse in hydrocarbon prices, or a lack of interest in labour arbitrage, or a rejection of relatively large and growing new middle class consumer groups, that the BRICs will not lose their economic place. In China's case it may well surpass even its own economic aspirations. But will the BRICs deliver on their promise as major legal markets? As we have explored, this is a far more challenging picture and there are many obstacles for foreign law firms. But, over the long term the BRICs are growing legal markets for inbound and outbound work that cannot be ignored, albeit needing some careful strategic planning and tailoring of manpower and the investment required.

And the chasing pack? Countries such as Indonesia, Malaysia or Mexico are no less challenging than the BRICs. Moreover, their economies are smaller than the BRICs. Will they develop new companies that will generate significant legal work? Yes. Will Western clients increasingly integrate with these markets thereby creating new cross-border pathways for generating complex, multi-jurisdictional legal work? Certainly. In which case, no global firm can reasonably operate a worldwide strategy without taking into account these markets, even if for now they do not always merit, or permit, a permanent office.

In conclusion, global law firms that want to stay competitive will have to embrace the developing world, its leading nations as well as its chasing pack, and also its dozens of smaller economies. Major businesses, whether corporates, banks, or law firms, that ignore the majority of the world's population, the majority of the world's jurisdictions, and the root of most of the world's future growth, will not have the right global balance. In which case, we predict investment in developing world jurisdictions will increase year on year among the world's leading law firms, even if this does not always lead to office openings. In the very long term the share of revenues derived from developed and developing markets will be equal. And at that point global law firms truly will have reached a perfect balance.

Appendices:

Appendix A: Percentage of Lawyers Abroad Among Global Firms

Rank	Name[122]	% Lawyers outside 'home' country in 2012
1	**Baker & McKenzie**	84%
2	Norton Rose	80%
3	CMS[123]	79%
4	Clifford Chance	71%
5	Bird & Bird	70%
6	Freshfields	69%
7	**DLA Piper**	66%
8	Allen & Overy	65%
9	**White & Case**	65%
10	Linklaters	64%
11	**Hogan Lovells**	64%
12	**Squire Sanders**	53%
13	Simmons & Simmons	53%
14	Ashurst	50%
15	**Cleary Gottlieb**	47%
16	**Shearman & Sterling**	46%
17	**SNR Denton**	46%
18	**Mayer Brown**	43%
19	Herbert Smith	41%
20	Clyde & Co	40%
21	**Orrick**	37%
22	**Latham & Watkins**	30%
23	Loyens & Loeff	30%
24	**Reed Smith**	29%
25	**Jones Day**	28%
26	**Weil Gotshal**	27%
27	**Dechert**	26%

Firms in 2012 with more than 25% of lawyers outside home country, within the AmLaw Global 100[124]*. (Firms in bold are US-based, or formed by US mergers).*

[122] Norton Rose has since merged with US firm Fulbright & Jaworski, SNR Denton has merged with Salans and Canada's FMC, while Herbert Smith has merged with Australia's Freehills. Ashurst has also formed a close alliance with Australia's Blake Dawson with provision to merge in the future.

[123] CMS refers to the entire CMS alliance group of European firms, qualifying as a 'global firm' due to close integration rather than merger. CMS is not financially integrated, nor operating via a Verein structure. It is a European Economic Interest Grouping that coordinates an organisation of independent member firms.

[124] There are law firms which have more than 25% of their lawyers abroad but whose revenues are currently too small to be included in the Global 100 data. Though, there is generally a strong correlation between very large law firms and the percentage of lawyers abroad.

Jomati Consultants LLP
3 Amen Lodge
Warwick Lane
London
EC4M 7BY

Tel: +44 (0) 20 7248 1045

www.jomati.com

jomati
consultants LLP