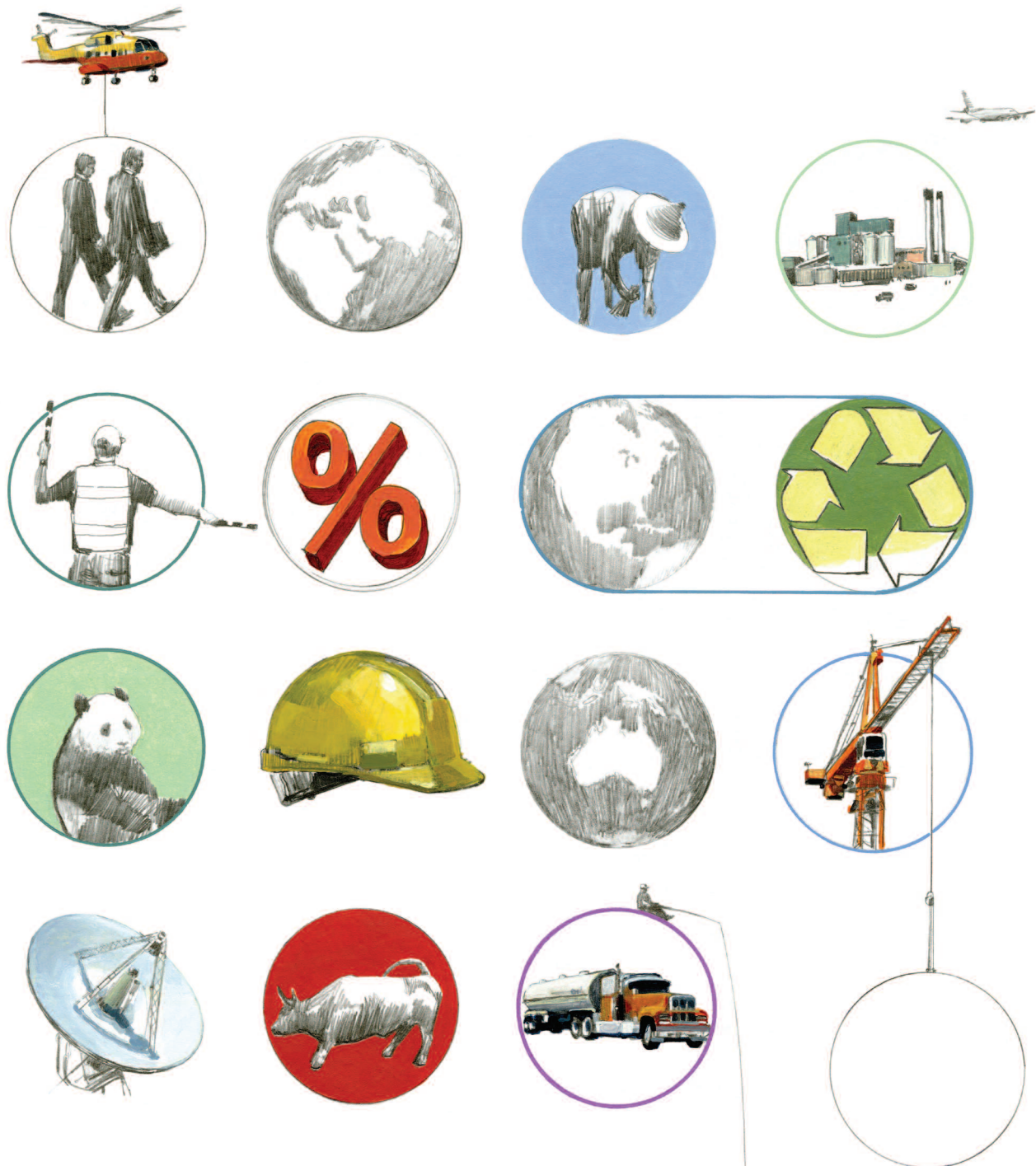


Privately held businesses: the world's economic engine.

International Business Report 2008 – Global overview



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Introduction

The financial turmoil of the past year has dramatically changed the plans and outlook for privately held businesses (PHBs) the world over. Such businesses, including entrepreneurs, family businesses and non-listed entities account for over 98 per cent of businesses worldwide and are considered the lifeblood of the global economy.

The Grant Thornton International Business Report (IBR) 2008 expanded this year to cover 7,800 respondents from 34 economies in its 16th year of existence.

This year's research coincided with the growing international economic disquiet following the ending of the most protracted global boom in a generation. The reversal was felt most acutely in mature economies, notably the United States; however the effects are being felt across the world.

Although the decline in overall business confidence was not dramatic at a global level (down just 5 percentage points on 2007) expectations for revenue in the year ahead fell from the 2007 all-time high of +70 per cent to +63 per cent and exports from a balance of +20 per cent to +18 per cent.

Figures were, in part, held up by rapid growth from emerging economies who are benefiting from strong domestic demand, helping insulate them from falling demand by the United States. Momentum in some cases was sustained by soaring commodity prices, particularly for oil and food. While price increases are beneficial for many businesses, they have served to rekindle inflationary pressures across the globe. After the subdued inflation of the past decade, this creates a new challenge for PHBs. This is demonstrated in PHBs' expectations for selling prices, having increased from +11 per cent in 2003 to +30 per cent this year as businesses expect to recoup a proportion of higher input costs from consumers.

This research was conducted just six months into the 'credit crunch' and provides an excellent trend analysis of expectations among PHBs as well as providing a benchmark for years to come.

This report also examines a number of key issues that PHBs need to manage in order to survive the economic downturn and be well prepared for the upturn. Issues such as human resource strategies, merger or acquisition plans and competitive strategies will be examined offering solutions and action areas in order to help cope with the changing environment.

PHBs will need to make fundamental changes to their strategies and how they assess risks and opportunities. There are undoubtedly going to be casualties, even if a widespread recession is averted, with only the most decisive and well-managed businesses emerging as market leaders.



Alex MacBeath
Global leader – privately held business services
Grant Thornton International

1 Economic prospects

The year ahead

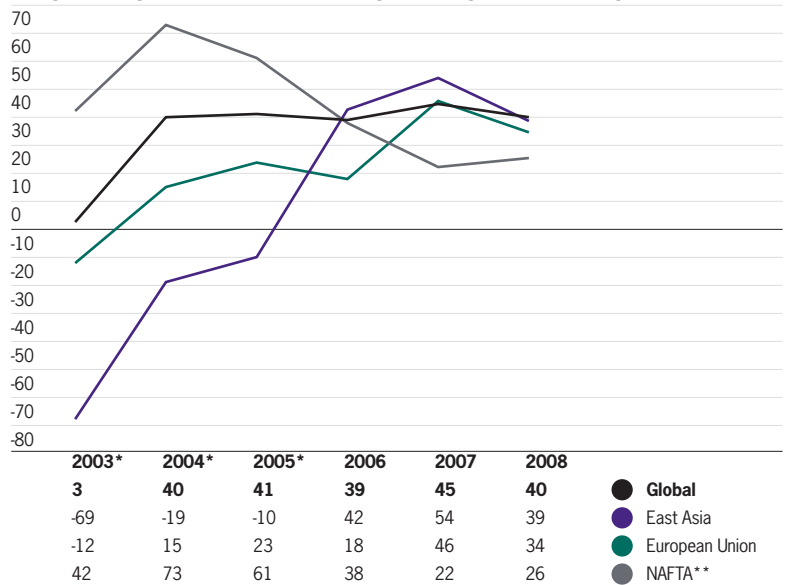
The global economic boom that began in 2003 ended a few months before this survey was conducted during the final quarter of 2007. It was becoming clear by then that the housing market crisis in the United States and ensuing credit crunch were creating a far less favourable economic backdrop for business operations, especially in the mature economies. In addition, an inflationary threat from surging energy and food prices was emerging.

It was not surprising then, that the survey showed businesses to be less optimistic about prospects for their economies in the year ahead than they were in the previous survey (see figure 1.1). The global optimism/pessimism balance fell from +45 per cent in 2007 to +40 per cent in 2008 – reversing much of the growth in optimism seen last year. In the light of the ensuing economic developments, we expect the rate to fall throughout the year.

This decline was most marked in East Asian economies who saw a 15 percentage point drop in optimism, followed by European Union countries whose optimism fell by 12 percentage points as the impact of financial market turbulence, higher energy prices and euro appreciation threatened the economic revival that began in 2006. However, the magnitude of the decline was constrained as optimism in France and Germany picked up slightly, perhaps because at that time businesses in those countries felt reasonably immune from the fall-out from the United States' sub-prime crisis.

Figure 1.1: Outlook for the economy over next 12 months

Average percentage balance of businesses indicating optimism against those indicating pessimism



*not including mainland China

**North American Free Trade Agreement countries

Source: Grant Thornton IBR 2008

Figure 1.2: Outlook for the economy over next 12 months – by economy
 Percentage balance of businesses indicating optimism against those indicating pessimism

Extremely optimistic	Optimistic	Fairly optimistic	Neutral	Pessimistic
95 India	58 Russia	39 Argentina	0 Italy	-5 Spain
95 Philippines	55 Mexico	38 Malaysia		-9 Taiwan
87 Vietnam	41 Canada	35 France		-30 Thailand
84 Singapore		30 New Zealand		-49 Japan
81 Hong Kong		28 Turkey		
78 Mainland China		24 Belgium		
78 Poland		22 Greece		
75 South Africa		22 United States		
74 Denmark		15 Ireland		
70 Netherlands		10 United Kingdom		
69 Brazil				
67 Australia				
67 Germany				
66 Botswana				
61 Armenia				
61 Sweden				

Source: Grant Thornton IBR 2008

The North American Free Trade Agreement (NAFTA) group of countries, however, recorded an increase in optimism boosted by the United States whose optimism increased to +22 per cent from its record low of +14 per cent in 2007. An upturn in confidence in this year's circumstances is surprising until it is recalled that in the autumn/winter of 2006 political uncertainties severely undermined confidence and that the optimism/pessimism balance is still very low by historic standards.

Asian businesses, in general, remain upbeat, (apart from Japan, Thailand and Taiwan) with sentiment exceptionally high in India and the Philippines (both +95 per cent). They were followed by Vietnam (+87 per cent) and Singapore (+84 per cent). The high level of optimism in many countries in Asia reflects sustained vigorous economic progress and the view that these economies are largely insulated from the effects of slower growth and credit problems affecting the world's more mature economies. The top six economies, in terms of optimism for the economy in the year ahead, are all in Asia.

But as highlighted in figure 1.2, this optimism is by no means general in the region. The bottom three economies in the rankings are also in Asia. This reflects a variety of factors – in Japan, the fragile confidence in the economy that built up during the global boom evaporated as the darkening external environment threatened exports and undermined business confidence, causing optimism to fall from -5 per cent to -49 per cent. There was an even sharper fall in Thailand, from +30 per cent to -30 per cent as political uncertainties continued to depress confidence and Taiwan's fall from -3 per cent to -9 per cent suggests increasing concerns over regional competitive pressures on the economy.

“The weak dollar is helping many US PHBs through a difficult period of slack domestic demand. The second half of 2008 may prove even tougher as global demand weakens and domestic spending takes a further hit from soaring oil prices. However, we expect a turnaround in household spending to support business turnover in 2009 as export sales suffer from a reviving dollar.”

Mike Hall
Grant Thornton, United States



Declining prospects

In addition to the sharp drop in optimism for Thailand and Japan there were some very pronounced declines in several other countries (see figure 1.3). These declines reflect serious concern in Ireland, Spain and the United Kingdom at the potential impact of the credit crunch and financial turbulence. The housing boom of recent years has been particularly strong in these countries, and the associated rise in credit has left consumers extremely vulnerable to a housing market collapse.

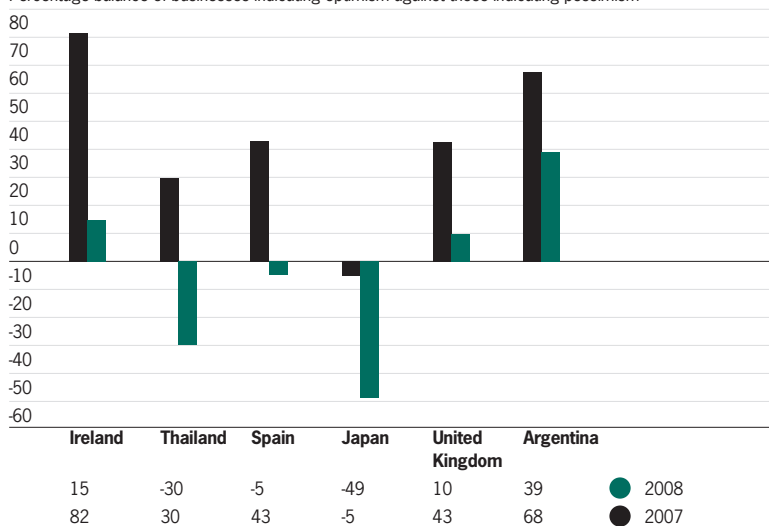
United Kingdom optimism fell by 33 percentage points to its lowest level since 2006 when business sentiment was severely affected in the wake of terrorist activity in London. The United Kingdom is one economy which stands to be worst affected by problems in the financial services sector. The decline of manufacturing and increasing reliance on banking over the past decade could make the United Kingdom's economy more vulnerable than most to ongoing financial problems.

The marked decline in sentiment in the European Union over the past year is also largely due to the impact of the three countries – Ireland, Spain and the United Kingdom – with anxieties about fragile housing markets and financially over-extended households. Italy, whose economic outlook is clouded by weak and declining growth, political instability, budget concerns, and rising inflation, also contributed. Elsewhere, changes were more generally modest and even included upturns noted earlier in optimism in France and Germany.

In Argentina, the decline might reflect fears that the robust recovery from the recession of the early years of this decade, which has boosted sentiment in the past two surveys, will lose momentum as it reaches maturity. But the optimism/pessimism balance is still high at +39 per cent.

Figure 1.3: Sharpest falls in optimism between 2007 and 2008

Percentage balance of businesses indicating optimism against those indicating pessimism



Source: Grant Thornton IBR 2008



2 Performance

The global perspective

Following four years of economic boom during which key indicators of business performance became increasingly buoyant, a more difficult outlook prevailed during the 2008 survey period. On all key indicators businesses were less upbeat, with particularly marked falls in expectations over the next 12 months for employment, profitability and investment (see figure 2.1).

Revenue (turnover)

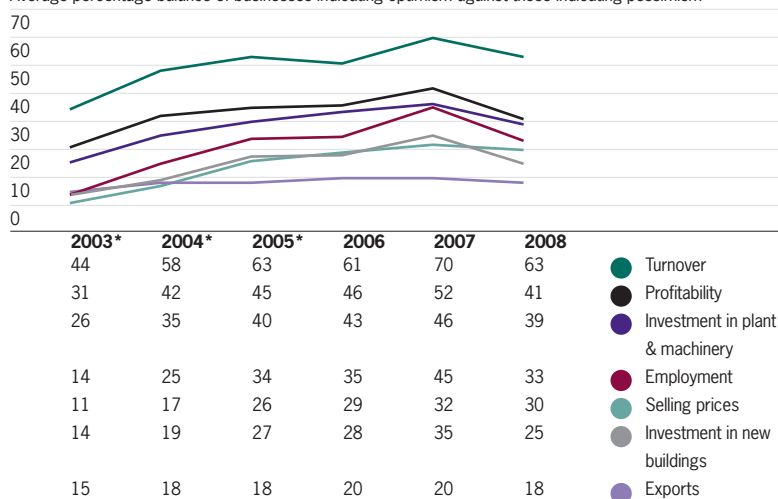
Dynamic East Asian economies show the most buoyant expectations for revenue, with Vietnam most optimistic (+98 per cent) followed by mainland China (+88 per cent) and India (+84 per cent).

The largest increase compared with the 2007 survey was seen in Germany, up 26 percentage points to +79 per cent (see figure 2.2) as businesses drew confidence from the better showing of the economy and in particular consumer demand in 2006 and 2007 after years of lacklustre growth. This is likely to have been coupled with expectations that the economy would be resilient in the face of financial problems in the United States.

Apart from Thailand's remarkable fall from a balance of +61 per cent to -23 per cent, the largest falls were in Ireland (-29 per cent), the United States (-28 per cent) and Canada (-14 per cent), demonstrating the vulnerability of these three countries to the fall out from the financial crisis.

Figure 2.1: Global business performance expectations

Average percentage balance of businesses indicating optimism against those indicating pessimism



*not including mainland China
Source: Grant Thornton IBR 2008

Figure 2.2: Largest rise and falls in expectations for key business performance indicators 2007-8 – by economy
Percentage balance of businesses indicating optimism against those indicating pessimism

Economy	Largest increase in expectation	Largest fall in expectation
Argentina	Selling prices +27	Employment -7; Revenue -7
Armenia	Investment in plant & machinery +10	Selling prices -12
Australia	Selling prices +27	Investment in plant & machinery -4
Belgium*	–	–
Botswana	Profitability +23	Selling prices +3
Brazil	Employment +17	Selling prices -6
Canada	Investment in new buildings 0	Exports -15
Mainland China	Revenue 0	Investment in new buildings -51
Denmark*	–	–
France	Selling prices +6	Profitability -4; Investment in plant & machinery -4
Germany	Revenue +26	Selling prices -6
Greece	Investment in plant & machinery +8	Exports -6; Profitability -6
Hong Kong	Selling prices +17	Exports -13
India	Exports +14	Revenue -8
Ireland	Exports +6	Revenue -29
Italy	Selling prices +9; Investment in plant & machinery +9	Profitability -10
Japan	Employment +6	Profitability -17
Malaysia	Investment in plant & machinery +12	Profitability -16
Mexico	Revenue +9	Investment in plant & machinery -18
Netherlands	Employment +16	Investment in new buildings -6
New Zealand	Exports +1	Profitability -12
Philippines	Exports +24	Revenue -14
Poland	Selling prices +18	Investment in plant & machinery -10
Russia	Profitability +18	Employment -4
Singapore	Investment in plant & machinery +14	Revenue -8
South Africa	Selling prices +4; Investment in new buildings +4	Revenue -10; Employment -10
Spain	Exports +4	Profitability -32
Sweden	Selling prices +10	Profitability -7
Taiwan	Employment +7	Investment in new buildings -7
Thailand	Investment in plant & machinery -3	Profitability -117
Turkey	Exports +13	Profitability -10
United Kingdom	Selling prices +8	Profitability -3
United States	Selling prices +9	Revenue -28
Vietnam*	–	–

*economy did not feature in the 2007 survey
Source: Grant Thornton IBR 2008

Profitability

Expectations regarding profitability, which reached a record high of +52 per cent last year, have been hit by the ending of the global economic boom and consistently rising commodity prices. The global balance has fallen to +41 per cent, its lowest level since 2003 when the world economy was in the early stages of recovery from the post-dot.com slowdown.

Profitability for PHBs is perhaps the greatest challenge they face over the coming months. It is clear that costs are increasing for virtually all types of business, however, raising selling prices against a backdrop of weak consumer demand and increased living costs will be very difficult.

The largest falls in expectations for profitability were in Thailand (down a massive -117 per cent), Spain (-32 per cent) and Ireland (-27 per cent).

Investment

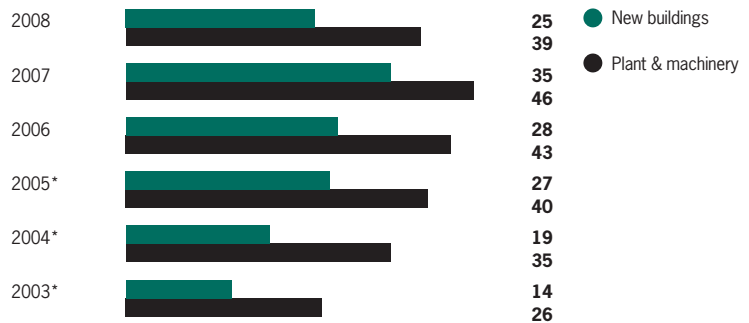
Investment intentions for both plant & machinery and new buildings have eased in line with less buoyant prospects for the global economy in the next few years, reversing the sustained increase of recent years (see figure 2.3).

From a national perspective, investment expectations are strongest in Armenia for both plant & machinery and new buildings. Armenian businesses are being boosted by the rapid expansion of the economy and in particular the development of a modern manufacturing capacity.

Expectations for investment in plant & machinery rose most strongly in Botswana increasing 20 percentage points followed by Germany (up 14 percentage points) and Brazil and the Philippines (both up 13 percentage points).

Figure 2.3: Global expectations of investment

Average percentage balance of businesses indicating optimism against those indicating pessimism



*not including mainland China
Source: Grant Thornton IBR 2008

Botswana also recorded the largest growth in expectations for investment in new buildings (up 17 percentage points) ahead of Poland (up 12 percentage points). This reflects a large investment in natural resources in Botswana and the rebuilding of Poland's ageing industrial base aided by their membership of the European Union.

In mainland China investment intentions for the year ahead have plummeted. Expectations for investment in new buildings fell by 51 percentage points and for plant & machinery by 42 percentage points. After years of high growth, businesses are less exuberant in the face of slowing demand and a credit crunch inspired by government measures to cool overheating. Cost management and profit protection look to be the main priorities for the coming year.

“Spain’s decade-long construction and property boom has come to a dramatic end. The sector’s problems have been intensified by the global financial crisis and is now firmly in recession. However, while construction and property businesses may have to endure a tough period ahead, the ending of the bubble offers the prospect of more sustainable and balanced growth in the economy as a whole.”

José María Fernández
Grant Thornton, Spain



Employment

Global employment remained on a strong upward path in 2007 as the world economy continued to expand despite growing financial difficulties. A balance of +41 per cent of businesses increased their number of employees, an outcome almost as strong as that seen in IBR 2007 (+44 per cent).

Prospects for 2008 are perceived as less buoyant, but one-third of businesses still expect to increase employment. The position in the European Union is unchanged, with a balance of +27 per cent of businesses expecting to increase job numbers; however the United States shows a drop of 14 percentage points.

The most substantial decline in expectations was in mainland China where only +15 per cent of firms expect to increase employment in the next 12 months, compared with +58 per cent in the 2007 survey. The decline can be attributed to increasing labour market shortages in key production locations in the southern coastal region and fears of slower export growth.

The strongest and weakest expectations for employment in the next 12 months and the actual change in the past year are shown in figure 2.4.

- **Strong expectations** are most evident in Vietnam, which also led the way during 2007. India, the Philippines and Armenia are also expecting to continue their recent rapid rate of job creation amid further vigorous economic expansion. Output expansion in Brazil, though brisk, is not as rapid as in the other four countries in this group. But job creation was strong last year and is expected to become even stronger.

Figure 2.4: Change in number of people employed in past year and expectations for 2008

Top and bottom five economies

Percentage balance of businesses indicating optimism against those indicating pessimism



Source: Grant Thornton IBR 2008

- **Weak expectations** are led by Thailand where optimism is low on all economic indicators surveyed. Italy and France feature regularly among the bottom group of job-creating countries given their slow economic growth and inflexible labour markets respectively. The major surprise is the appearance of mainland China in this group, following a marked slowdown in job creation expected this year after years of vigorous expansion. In Ireland too businesses expect much more modest employment creation than in recent years.

Selling prices

Selling prices continued their upward path with the balance of businesses expecting an increase rising from +11 per cent in 2003 to +37 per cent this year¹. Despite the weakening outlook, widespread expectations persist that continued healthy global demand will enable businesses to pass on at least part of the increased costs of raw materials and energy to consumers.

A big question remains about how customers will be able to cope with continued increases in selling prices. The obvious answer is that they will merely pass their extra costs onto consumers.

However, consumers are increasingly having to cut back on expenses as living costs increase due to factors such as increasing food prices and greater debt servicing obligations.

As growth prospects stall, the likelihood of increasing inflationary pressures from selling prices presents central banks with the problem of potential 'stagflation' and an inability to use interest rate cuts to boost growth without fuelling price increases.

Exports

Expectations for exports have been remarkably stable over the past six years with prospects falling only slightly this year from +20 per cent, the result in both 2006 and 2007, to +18 per cent, the level seen in 2005. This fall was largely due to a significant decline in the balance in mainland China, from +26 per cent to +3 per cent, probably reflecting concern at the potential impact on demand of growing problems in the United States, reinforced by the appreciation of the Chinese renminbi against the United States dollar.

There was also a large decline in Canada from +16 per cent in 2007 to +1 per cent, again reflecting concern at developments in the major export partner to the south.

These declines were largely offset by more positive expectations in several countries led by the Philippines, India, Turkey, Malaysia and Germany where businesses appear to have felt that falling demand from the United States would be outweighed by expansion in the economies of more important trading partners.

As global demand eases further, export opportunities for many businesses will fall. Businesses reliant on exporting will need to prepare themselves for any further drop in demand by ensuring that costs are kept to a minimum, that they are not over-reliant on foreign trade and that plans and procedures are in place to survive a downturn.

¹ Excluding mainland China to enable a six-year comparison to be made

3 Constraints

Lack of skilled workers

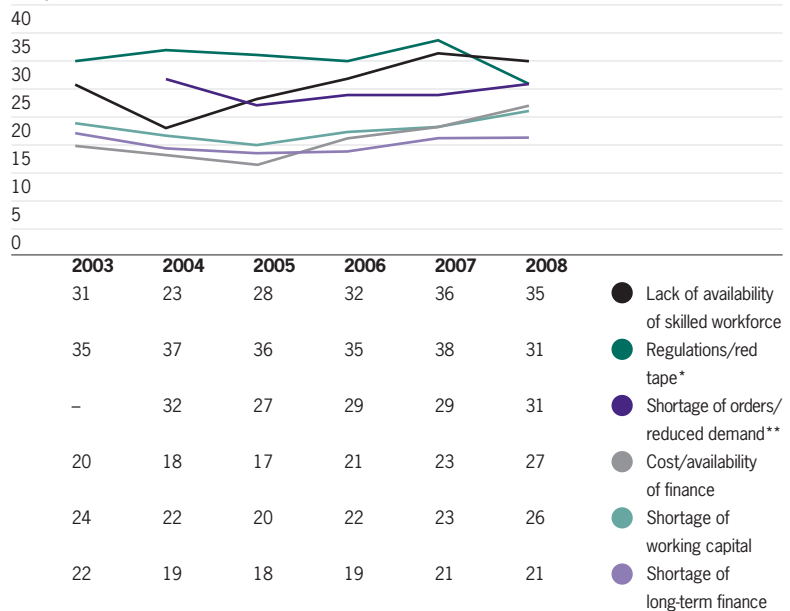
For the first time, regulations/red tape is not the greatest constraint on business expansion. Lack of availability of skilled workforce has risen steadily in recent years and has now taken over in first place, with 35 per cent of businesses recognising it as a factor limiting growth (see figure 3.1).

Despite the expanding global population and more people progressing to further education than ever before, it appears that PHBs are increasingly struggling to find the right people – and it is a growing problem. Skills issues are being heightened by the fact that many business owners are facing succession planning issues as more children develop different career aspirations than to follow in their parents’ footsteps.

Lack of skilled workers was the most significant constraint on growth in over 50 per cent of economies surveyed (see figure 3.2). It was greatest in Thailand (68 per cent) followed by New Zealand (61 per cent) and Australia (58 per cent). In Thailand’s case, the increase from last year was substantial and surprising given the pessimism about revenue, but in Australia and New Zealand the results were virtually unchanged.

Figure 3.1: Constraints on expansion – globally

Average percentage of businesses rating this 4 or 5 on a scale of 1 to 5, when 1 is not a constraint and 5 is a major constraint



*this option was not asked in mainland China in 2008

**this option was not surveyed in 2003

Source: Grant Thornton IBR 2008

Figure 3.2: Most significant constraint on growth in 2008 – by economy

Percentage of businesses rating this 4 or 5 on a scale of 1 to 5, when 1 is not a constraint and 5 is a major constraint

Lack of availability of skilled workforce	Regulations/red tape	Shortage of orders/reduced demand	Shortage of long-term finance	Cost of finance	Shortage of working capital
Australia	Brazil	Denmark	Argentina	Mexico*	Mainland China*
Belgium	Greece	France	Armenia		
Botswana	Ireland	Japan			
Canada	Italy	Mainland China*			
Germany	Mexico*	Taiwan			
Hong Kong	Poland	Thailand			
India					
Malaysia					
Netherlands					
New Zealand					
Philippines					
Russia					
Singapore					
South Africa					
Spain					
Sweden					
Turkey					
United Kingdom					
United States					
Vietnam					

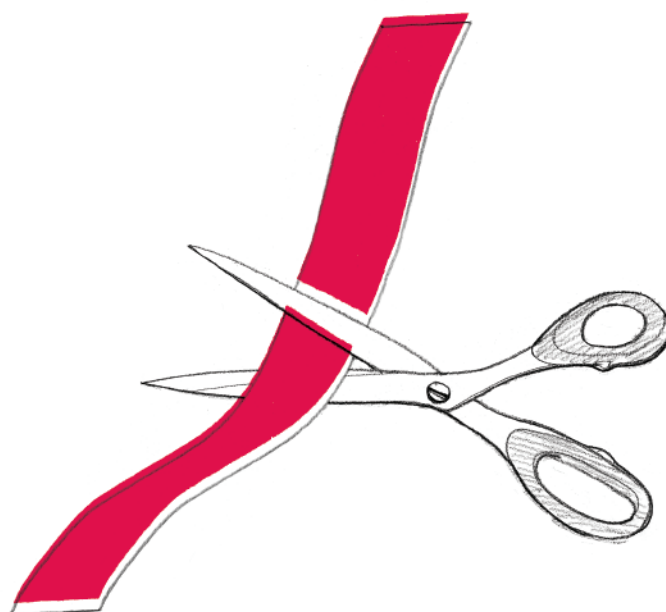
*tied with another constraint
Source: Grant Thornton IBR 2008

Regulations/red tape

As a constraint on growth, regulations/red tape has fallen to its lowest level globally since the international survey began, with a pronounced drop from 37 per cent in 2004 to 31 per cent of businesses citing this factor in 2008.

Substantial declines in the United States (34 per cent in 2007 to 16 per cent in 2008) and Germany (49 per cent to 35 per cent) are primarily responsible for the marked drop in the overall proportion of respondents citing this factor. However, this is still the most significant factor limiting growth in six economies – all from either Europe or Latin America.

The figures suggest that although progress is being made in the effort to reduce the burden of regulations on businesses, there is still much work to do. Governments and institutions must continue to work with PHBs to help identify their future needs and aim to address regulatory issues ahead.



“The economic reforms of recent years in Germany have secured some important gains. The marked decline in the number of PHBs in our survey citing regulations/red tape as a constraint on expansion highlights this achievement and the boost to business it promises.”

Christian Kirnberger
Grant Thornton, Germany



Shortage of orders/reduced demand

Shortage of orders/reduced demand is now viewed almost as important a constraint as regulations/red tape, having risen from 29 per cent of respondents in the two previous surveys, when the global economy was booming, to 31 per cent this year. This suggests that the impact of reduced demand in some more mature economies, especially the United States, is starting to affect expectations of PHBs globally.

This was the most significant constraint in the East Asian economies of mainland China (jointly with shortage of working capital), Japan, Taiwan and Thailand.

For Japan and their sluggish economy, this is unsurprising. However, the high domestic growth rates of mainland China, Taiwan and Thailand suggests that PHBs in these economies are concerned about the fall in demand from consumers in Europe and North America on the back of the economic slowdown as well as increased regional competition.

Financial constraints

The onset of the global credit crunch, in the wake of the sub-prime crisis, is highlighted by the fact that financial factors (shortage of working capital, cost of finance, shortage of long-term finance) are regarded as much stronger constraints in this year's survey and are at or near record highs.

The general increase, however, is probably just the start of future greater financial woes for PHBs across the globe. The credit crunch is putting more pressure on all kinds of businesses now and it is likely that in 12 months' time the shortage of long-term finance, working capital and the increasing cost of finance will be even bigger issues.

4 Competitiveness

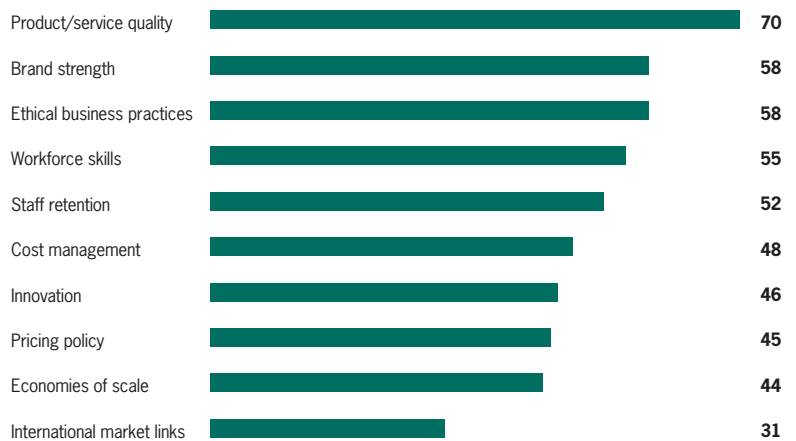
The Grant Thornton IBR 2008 survey asked PHBs what they perceived as their business' main sources of competitive advantage. Product/service quality emerged as the main factor, rated highest by every economy except mainland China and India. Nevertheless, in India, 78 per cent of respondents rated this factor as a key competitive advantage, but there were slightly higher proportions for brand strength and pricing policy.

In mainland China only 46 per cent of respondents rated product/service quality as a source of competitive advantage, the lowest by a wide margin (Japan was next with 60 per cent, then Singapore with 67 per cent). However, elsewhere in the region this factor was regarded as extremely important with, for example, 92 per cent of respondents in Vietnam, 85 per cent in Taiwan and 74 per cent in Hong Kong citing it. For businesses in mainland China, brand strength was the principal factor with 48 per cent.

The significance of product/service quality is highlighted by the fact that, excluding mainland China, 77 per cent of respondents rated it as a key source of competitive advantage. In the European Union the proportion was even higher (81 per cent) well ahead of the next factor, workforce skills, at 62 per cent. Similarly, in Latin America, 81 per cent identified product/service quality, followed by brand strength and ethical business practices, both at 72 per cent.

Figure 4.1: Main sources of competitive advantage – global

Average percentage of businesses rating the strength of advantage 4 or 5 where 1 is not very strong and 5 is very strong



Source: Grant Thornton IBR 2008

Ethical business practices were also rated highly in this context in emerging markets outside Latin America, 84 per cent in Botswana, 83 per cent in Vietnam and 75 per cent in India. Among more mature economies, New Zealand led the way with 75 per cent followed by the United States, 70 per cent. The proportion was 49 per cent in the European Union and even lower, 44 per cent, in Japan.

If the global economic downturn is as deep as many economists are predicting, PHBs may have to examine their competitive strategy and look to cost management and strategic pricing policies. Disposable incomes are likely to be squeezed in many countries by increases in living expenses and the soaring cost of credit.



5 Emerging markets

PHBs around the world are simply no longer able to operate domestically without reference to foreign markets. Emerging markets require specific attention as they transform themselves and create new opportunities. These markets offer exciting growth prospects even as the global economy as a whole faces a slowdown.

Grant Thornton IBR emerging markets index

To help identify where potential opportunities lie and where new competition may come from, we have created the Grant Thornton IBR emerging markets index (see figure 5.1).

The index shows that it is not only the BRIC economies (Brazil, Russia, India and mainland China) that deserve serious attention. Taking account of key factors such as size, wealth, involvement in world trade and growth potential, it shows that at least 27 emerging economies offer both opportunities for investment and trade with their large, rapidly expanding and increasingly affluent economies. Mainland China is some way ahead of the pack, thanks to its size and remarkable GDP and trade growth. India and Russia are unsurprisingly the other highest rated markets, but the index also reveals Mexico as one of the leading economies in this category – ahead of Brazil.



For more detailed information on emerging markets please see: Emerging markets: reshaping the global economy, available at www.internationalbusinessreport.com/Reports

Figure 5.1: Grant Thornton IBR emerging markets index 2008

Score based on a weighted calculation of key indicators including GDP, population size, international trade and growth projections

Mainland China	496
India	234
Russia	142
Mexico	125
Brazil	113
Poland	95
Indonesia	92
Thailand	92
Malaysia	91
Turkey	89
Hungary	84
Argentina	84
South Africa	79
Iran	76
Chile	72
Ukraine	69
Philippines	69
Vietnam	68
Venezuela	64
Colombia	63
Romania	63
Pakistan	63
Egypt	59
Algeria	58
Peru	57
Bangladesh	55
Nigeria	47

Source: Grant Thornton IBR 2008

Exploring the opportunities

A common factor in these emerging economies is that import requirements for machinery and equipment, in particular, are strong as they are needed to support industry growth. As these economies expand and households become increasingly wealthy, consumer demand increases. PHBs that can supply industrial equipment, consumer products and internationally tradable business and financial services will find these countries particularly attractive places with which to do business.

Foreign direct investment (FDI) is usually welcomed by rapidly growing countries as the benefits of closer integration into the global economy are appreciated. Total FDI into emerging markets stood at US\$255.6 billion in 2007. There is potential for much more. PHBs from mature economies can become more directly involved in a dynamic economy, either through greenfield investment by establishing new facilities or expanding an existing operation or through a merger or an acquisition of a local business.

Grant Thornton IBR results

Exports

While there has been an appreciable global increase in the number of PHBs that export in the last year, up from 34 per cent in 2007 to 39 per cent in 2008, the real story is in the regional differences. It is notable that the strongest upturn has been in East Asia, from 30 per cent in 2007 to 39 per cent in 2008.

PHBs in the European Union have raised their figures steadily, but at a slower pace in the last year than East Asian businesses. The powerful German export machine, however, saw a more solid increase, from 50 per cent to 61 per cent, an example to other mature economies since recent media reports suggest that this growth is at least partly attributable to growing exports to emerging markets.

NAFTA countries, in complete contrast to most economies in our studies, have seen an appreciable fall (from 36 to 30 per cent) in the number of PHBs exporting since 2003. This reflects huge domestic demand in the United States to some extent, but it is surprising at a time when the economy is struggling and the dollar is weak.

Imports

Although businesses in small countries in both mature and emerging categories were the top importers in our survey, the research does highlight that PHBs in a number of emerging economies were well above the global average. A very high proportion of businesses in countries such as Botswana (75 per cent), Denmark (74 per cent) and Armenia (72 per cent) were importers.

Investment determinants

The survey results show that PHBs in most countries give primary importance to political and economic stability along with market size and growth potential in determining the geographical focus of their export strategies – both at 56 per cent.

The competitive environment

The survey also asked businesses where they saw their primary competition coming from – local, national or international sources. At a global level, responses showed national competition to be the primary concern (42 per cent), closely followed by the local threat (36 per cent) with international competition trailing (22 per cent).

The emerging markets strategy

The effect of rapid growth in emerging markets is an important issue for businesses. PHBs should develop a specific strategy to capitalise on new opportunities and mitigate potential risks. They should, however, also be aware of the risks they face by deciding not to enter a new market.

They must act on their economic assessment and strategic review with their strategy, whether capitalising on opportunities or defending their traditional market, should become a key element of their firm-wide strategy with a defined and realistic implementation plan.

There are, of course, risks associated with emerging markets. These risks, however, can be as great through lack of action as they can be through ill-conceived action.

6 Corporate social responsibility

Hardly a day goes by without some mention in the media of corporate social responsibility and its growing significance for good business practices. CSR, as it is commonly known, is becoming increasingly important to us all, both as individuals and in our professional lives. Despite much public focus on large multinationals, it is the changing behaviour of the PHB sector that is likely to make the greatest impact on global corporate social responsibility.

With growing scrutiny of business operations, organisations are increasingly being driven to satisfy the expectations of opinion formers, governments and customers in order to thrive. In essence, businesses adopting CSR principles believe that by operating ethically and responsibly, they have a greater chance of success. For PHBs with fewer stakeholders to satisfy, their greatest concern appears to be their customers and their own ability to satisfy the demand for products effectively.

Businesses are demonstrating that well-managed corporate responsibility actually supports business objectives, especially amongst large corporates, where improved compliance, reputation and relationships have been shown to increase shareholder value and profitability.

What are PHBs doing?

Although public attention is often focused on large multinationals and how ethical their business practices are, PHBs are expected to adhere to the same ethical practices. However, the two sets of businesses differ greatly in terms of size and structure. When adopting more ethical business practices, PHBs are at a distinct disadvantage to their multinational counterparts. This is primarily due to lack of resources, but PHBs also lack experience or peers in their industry group to develop examples of 'best practice'. PHBs are also less exposed to the weight of expectation and attention which falls on multinationals who impact our daily lives.



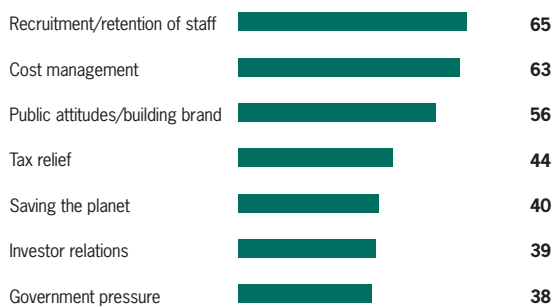
For more detailed information on corporate social responsibility please see: Corporate Social Responsibility: a necessity not a choice, available at www.internationalbusinessreport.com/Reports

“Brazilian PHBs are strongly up-beat about turnover, profitability and investment as the economy continues on a high growth path despite global financial problems and surging oil prices. However, there is considerable concern among businesses about the impact of regulations/red tape on their ability to expand.”

André Viola Ferreira
Grant Thornton, Brazil



Figure 6.1: Drivers of corporate responsibility – globally
Average percentage of businesses citing factor as important



Source: Grant Thornton IBR 2008

Controlling costs

The Grant Thornton IBR results show widespread agreement that the need to control costs encourages ethical behaviour amongst PHBs. In only one country (Singapore) did less than 50 per cent of respondents cite this issue.

In terms of driving corporate responsibility, the results emphasise a key point – that the adoption of ethical business practices is fundamental to the success of PHBs. The main factor driving corporate responsibility is the need for PHBs to attract and retain high quality staff to meet current and future demands. This was identified by 65 per cent of respondents (see figure 6.1).

Taxation is one area that governments can use to force businesses to change their actions. However, it is not evident from the IBR results that any CSR related taxes are having a strong effect on PHBs, which poses a question: Have governments around the world utilised taxes or tax breaks effectively enough to positively affect global business ethics?

While they may not be under the same scrutiny as multinationals, PHBs still identify responsible behaviour as being integral to reputational management and long-term strategy. This is highlighted by public attitudes/building brand being cited by 56 per cent of respondents globally as a key driver of ethical business behaviour.

Implementing corporate social responsibility

When businesses were asked what they had done in the past year to manage their corporate responsibility, workforce related matters topped the list.

This complemented the result which showed staff attraction/retention as a key driver of ethical behaviour. Four of the top five initiatives were directly associated with people and their workplace – active promotion of workforce health and well-being (71 per cent of respondents); provision of internships/apprenticeships and work experience (67 per cent); promotion of diversity/equality at work (64 per cent) and allowing flexible working (62 per cent). These all have an important role in the context of social responsibility, though the initiatives also play a key role in human resource management (see figure 6.2).

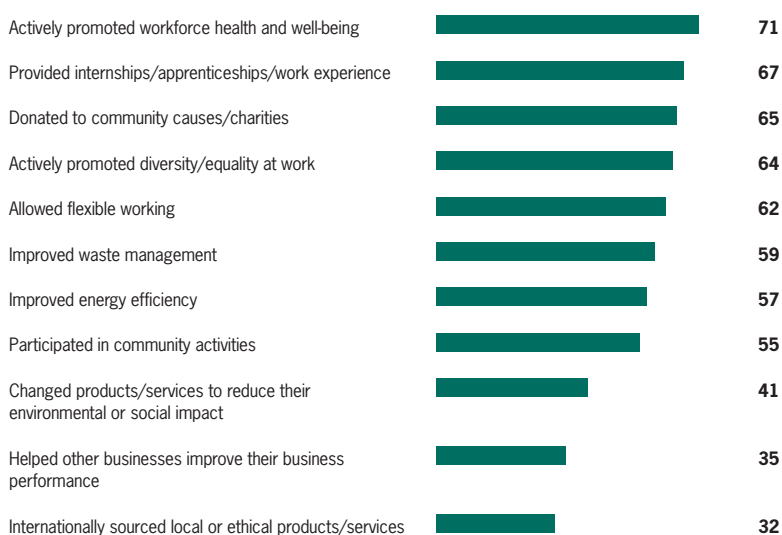
A formalised strategy?

We asked PHBs whether corporate responsibility policies were incorporated into a written document or strategy. Amongst all businesses, 56 per cent said they had a formalised programme.

The need for change

Corporate social responsibility is no longer the domain of the large corporate and is now a necessity rather than a choice for all businesses. Those PHBs adopting ethical business practices quickly and efficiently will survive. These are the businesses who will secure the skilled workers and the contracts with the large multinationals. Those failing to act now could face an uncertain future.

Figure 6.2: Corporate responsibility initiatives undertaken in the past year – globally
Percentage of businesses



Source: Grant Thornton IBR 2008

7 Recruitment and retention

A focus on recruitment and retention of staff is essential for today's PHBs. They are aware that competitiveness is derived from talent and it follows that recruitment and retention are an important part of business strategy.

To keep talent within an organisation, PHBs are increasingly focusing on the development of internal talent. Retention is critical for all businesses. Existing employees are an organisation's best advocates and can be a cost-effective way of introducing new talent into the organisation.

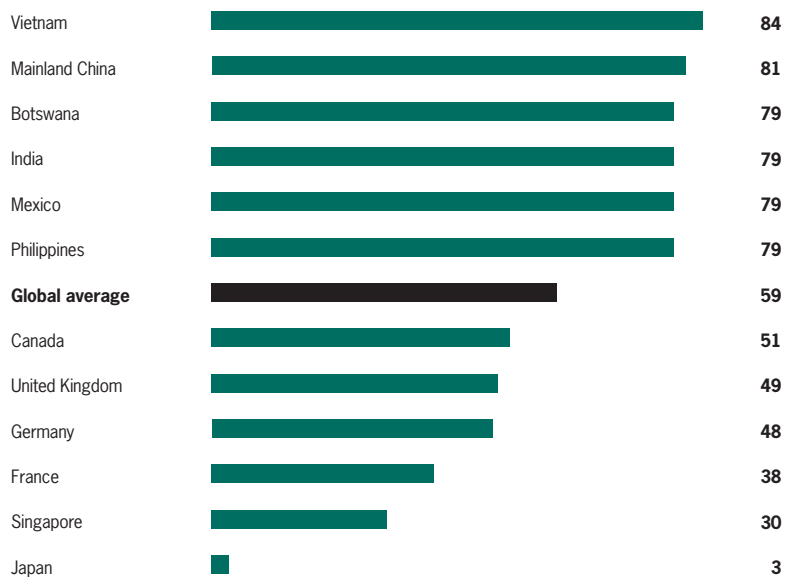
The power of the employee

Employees today are socially aware, want to contribute to society and have defined values. They choose to work for an organisation that displays similar values to their own. PHBs are in a strong position. They tend to have defined values, often imbued by the company founders. Employees can clearly see the effects of their hard work and the contribution they make to the organisation. This provides a strong foundation for an attractive 'employer brand'.



For more detailed information on recruitment and retention issues please see: recruitment and retention: the quest for the right talent, available at www.internationalbusinessreport.com/Reports

Figure 7.1: Economies more focused on recruitment and retention than they were one year ago
Top and bottom six
Percentage balance of businesses stating they are more focused against those that are less focused



Source: Grant Thornton IBR 2008

Company values/employer brand

For an employee, working for a PHB is potentially very attractive. Employees like the opportunity to be involved in building and creating an entity where they can make and see the difference. They like to have their views valued. PHBs often provide an important close direct connection between employees and the ownership or management. Unlike multinationals, where there is a large group of stakeholders to appease, PHBs often have greater ability to focus their employer brand on their current and prospective employees.

The internet has transformed recruitment mechanisms for PHBs. It is a more cost-effective medium than traditional advertising. Vacancies can be promoted locally, internationally, through specialised sites, on job boards and to specific audiences. The corporate website is an important communication tool.

Focus on recruitment/retention

A balance of 59 per cent of PHBs are more focused than a year ago on recruiting and retaining staff. In some countries this is due to staff shortages but equally it may reflect the fact that PHBs are recognising the importance of people to their future competitiveness (see figure 7.1).

Development of talent

Recruitment is an expensive exercise. An organisation that continuously hires while losing talent will suffer in comparison with peers who are more successful in retaining staff. Focusing on the internal development of employees is important and it provides a continuous pipeline of fresh talent for leadership positions. It also engenders loyalty. An organisation that looks after its staff will reap the benefits and the Grant Thornton IBR shows that PHBs are indeed focused on the development of their talent. The most widely adopted strategy for developing talent is to make certain all employees understand the company's core values, mission and goals with 64 per cent stating they adopt this practice to a high level (see figure 7.2).

Figure 7.2: Developing talent – what PHBs are doing globally

Average percentage of businesses conducting these activities to a level 4 or 5 on a scale of 1 to 5 where 1 is not at all and 5 is a great deal



Source: Grant Thornton IBR 2008



PHBs need to have a strong secondary level management structure in place to be able to identify high performers and develop top talent pools. The survey showed that training and mentoring top performers for leadership positions is practised by 57 per cent of PHBs.

The training and developing of all employees takes lower precedence than developing those for leadership. Nevertheless, half of PHBs use employee development programmes a great deal to develop talent.

Increasing pay and benefits used to be the overriding factor in recruiting and retaining staff. This is no longer the case. Employees look at the bigger picture – assessing career progression, development, CSR policies and the values of the organisation. In 2005, two thirds of PHBs said they developed competitive reward systems and benefit packages to recruit and retain staff. In 2008, this figure falls to 55 per cent.

Only 45 per cent of PHBs have a flexible attitude to working patterns.

Retention issues

Staff attrition is disruptive. Increased workload for remaining staff is identified as the main problem caused by attrition (41 per cent of respondents), followed by increased operating costs cited by 38 per cent of businesses and loss of business to competitors (32 per cent).

Wage pressures

Although the recent global economic boom is over, inflationary pressures have increased significantly largely due to surging commodity prices. Inflation is also reflected in labour markets which generally remain tight. The survey shows that 63 per cent of PHBs globally are paying significantly more in staff costs (over and above inflation) than a year ago.

Importance of recruitment and retention systems

As the global market for labour tightens, PHBs must ensure that they have systems in place for finding and identifying the right talent. A strong employer brand coupled with visibility of opportunity can serve as powerful vehicles to strengthen the quest. PHBs then need to define a roadmap and competency framework so that they recruit the right people, ensure they are in the right job, and develop them in the right way.

“Demand on the tight labour market will dampen as levels of optimism in the economy slip further. The oil price and credit crunch impact has been severe, and the economy has slowed so abruptly in recent months that the threat of recession in New Zealand is very real. If there is one bright spot, it is that the outlook for meat and dairy exports is positive.”

Peter Sherwin
Grant Thornton, New Zealand



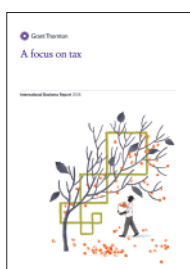
8 Tax

Tax is a critical issue for all businesses. It is one of a handful of factors which can determine the long-term viability of an enterprise. This is a common feature worldwide, although there is considerable variation on which taxes are seen to be a burden for specific firms. The views of major multinational companies on tax issues are well documented. But there has been little comprehensive research done on the impact of taxes on PHBs.

Leaders of PHBs want to see governments act to reduce the burden of taxes on employment and profits in their home states. They also seek meaningful tax incentives to invest in new markets. But governments throughout the world face a major challenge on tax policy. How do they meet their domestic budgetary demands while providing a vibrant economy for business and meeting the understandable demands of corporates?

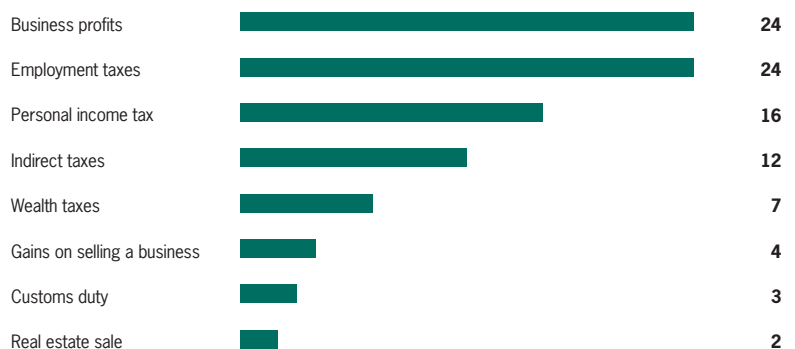
Tax burdens

The Grant Thornton IBR survey found that the most burdensome domestic taxes, from the perspective of PHBs, are taxes on business profits and on employment. Almost a quarter of all respondents (24 per cent) identified these aspects as being most burdensome, followed by personal income tax (16 per cent), and indirect taxes (12 per cent), see figure 8.1.



For more detailed information on taxation issues please visit www.internationalbusinessreport.com/Reports

Figure 8.1: Most burdensome taxes – globally
Average percentage of businesses



NB: Excluding mainland China
Source: Grant Thornton IBR 2008

Employment related taxes are the most burdensome for businesses in the European Union with seven European countries identifying this as the main burden.

Businesses in East Asia feel that taxes on business profits are more burdensome than any other taxes.

At a global level, the burden of personal income taxes is felt greatest by respondents in the NAFTA region (23 per cent). But respondents in some countries in other parts of the world consider this to be an even more significant burden: Denmark (69 per cent), New Zealand (40 per cent) and the Netherlands (31 per cent).

Nearly a third of businesses in Latin America pinpoint indirect taxes as their highest tax burden. This is the greatest burden for PHBs in the region cited by 28 per cent of businesses – just ahead of employment taxes (27 per cent).

Establishing an operating base abroad

When considering establishing an operating base abroad, 77 per cent of businesses globally attach significance to taxation issues. But this proportion rises to 91 per cent in Latin America (see figure 8.2).

Some individual countries have even higher figures: 100 per cent in Thailand and 97 per cent in Singapore, Turkey and Vietnam followed by Poland (95 per cent). European Union countries dominate those giving least significance to taxation when developing bases overseas. Sweden gave tax least prominence with just 44 per cent of respondents citing this as a significant factor (see figures 8.3).

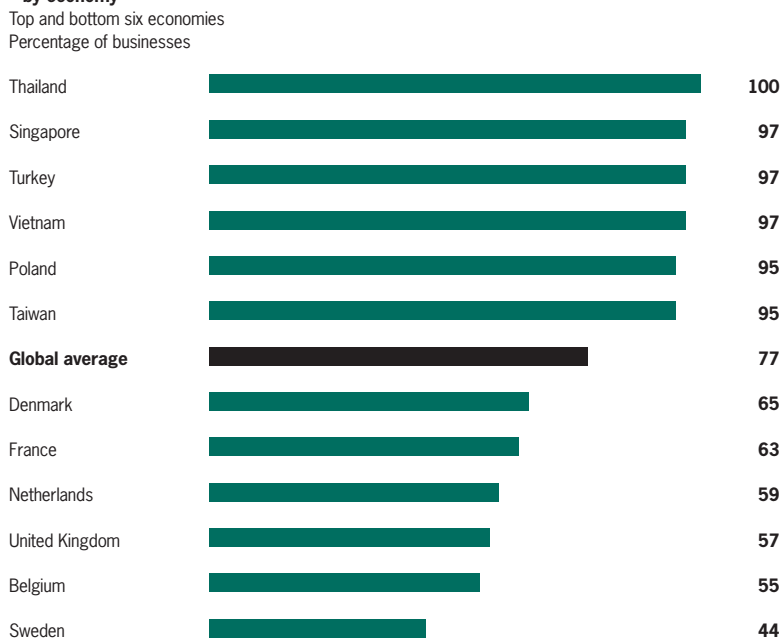
Although tax is still considered a key issue in Sweden, PHBs appear to feel that tax is less of a burden due, primarily, to substantial cuts in recent years to the headline rate of corporation tax.

Figure 8.2: Significance given to taxation when considering establishing an operating base abroad – regionally



Source: Grant Thornton IBR 2008

Figure 8.3: Significance given to taxation when considering establishing an operating base abroad – by economy



Source: Grant Thornton IBR 2008

Factors considered globally when setting up operations overseas

Nearly half of all businesses (48 per cent) considered a tax-free period for five years and low rates of tax on business profits as influences on their choice of location when considering establishing an operating base overseas. Businesses also valued a stable tax regime (46 per cent) as well as incentives for capital investment (41 per cent).

The importance of tax issues when setting up operations abroad is highlighted by recent decisions by some multinational corporations to relocate their headquarters in lower tax jurisdictions. A trend that PHBs are likely to mirror.

Taxation challenges

There is a clear message to governments worldwide that for PHBs, tax is a central factor in determining their long-term investment priorities. The findings of this survey represent a significant challenge to the development of tax policy throughout the world.

Businesses are broadly consistent about the taxes which are the biggest barriers to growth in home markets. And they share similar thoughts about what they want from overseas governments as incentives to invest. Any governments keen to boost economic performance would do well to listen to the messages from domestic PHBs. If administrations seek to boost direct investment, they need to address issues of high taxes on business profits and to offer fiscal stability and tax-free periods.

The principal concerns stand out in stark relief. Perhaps the key message of this research is that PHBs need to make their concerns more widely heard and that governments need to listen.



“The remarkable transformation of Vietnam’s economy underpins a buoyant business climate. Expectations for turnover and profitability are still up-beat as the economy’s progress continues – even with the fiscal measures taken by the Government midway through 2008. However, the risks of overheating have become very evident in a tight labour market with the emergence of high inflation and a widening trade deficit.”

Ken Atkinson
Grant Thornton, Vietnam



9 Mergers and acquisitions

Global mergers and acquisitions (M&A) have become a reality of life for all kinds of companies. The headlines might be dominated by a few ‘mega’ deals involving corporate giants, but that is not the whole picture. PHBs have recognised that, in an increasingly competitive, changing and challenging environment, well thought out and carefully executed cross-border M&A transactions can boost the value of their businesses. Global opportunities have become visible and attainable and PHBs, with their inherently entrepreneurial and dynamic character, have been quick to seize opportunities.

Global deals

Our study shows that all over the world the appetite for M&A is strong among PHBs. In the most acquisitive regions, North America and the BRIC economies, between 40 per cent and 67 per cent of the businesses surveyed said they expected to grow through acquisition in the next three years.

While the tightening of lending policy by the major global banks has had an impact on transactions at the top end of the market, particularly those involving highly leveraged private equity transactions, deals in the mid-market are appearing less exposed. For many shrewd, asset-rich trade buyers, the next 12 months should offer an opportunity to undertake strategic acquisitions at realistic valuations.



For more detailed information on mergers and acquisitions please see: Mergers and acquisitions: opportunities for global growth, available at www.internationalbusinessreport.com/Reports

Figure 9.1: Businesses planning to grow through acquisition in the next three years
Average percentage of businesses



Source: Grant Thornton IBR 2008

The results show only 8 per cent of business owners surveyed anticipated they would be selling during the next three years.

A far greater proportion of respondents from the BRIC economies are expecting to undertake a public listing in the next three years than is evident in more mature markets. The survey also reveals that business owners in the fast-growing BRIC economies are now enthusiastically embracing M&A, and are often more likely to grow through acquisition than businesses in more mature markets. Overall, 59 per cent of businesses surveyed in the BRIC economies said they anticipated an acquisition in the next three years.

PHBs in the BRIC economies appear more focused on building value rather than looking to realise it at this stage and are excited about following their own growth strategies through domestic and cross-border acquisitions. This is clearly visible, with mainland China (67 per cent) and Brazil (64 per cent) polling the highest percentage of participants planning an acquisition, a much higher proportion than in the United States (48 per cent).

Figure 9.2: Businesses planning to undertake a public listing in the next three years
Average percentage of businesses



Source: Grant Thornton IBR 2008

North America: cross-border ambitions

Given its strong sophisticated M&A market, it is not surprising that over 40 per cent of respondents across North America expect to grow through acquisition over the next three years, despite the uncertain economic climate. Both the United States and Canada have depth in their domestic market, and while a tightening of lending policies associated with the 'credit crunch' could lead to a more challenging 2008 for large deals, the survey suggests the transaction environment for successful mid-market companies will remain strong over the next three years.

Mainland Europe: higher cross-border activity

Price transparency and stability since the introduction of the euro, coupled with a degree of standardisation in legislation across the European Union, is having a positive effect on cross-border M&A in mainland Europe. Cross-border deals, especially within mainland Europe, are high on the agenda for European PHBs. The survey shows over 30 per cent of European business owners anticipate making an acquisition in the next three years, of whom some 37 per cent expect to do so across national borders.

United Kingdom & Ireland: open for business

The survey suggests that despite current problems, deal flow will stay healthy, with 40 per cent of United Kingdom and 39 per cent of Irish companies interviewed anticipating an acquisition within the next three years. While the proportion of respondents planning an acquisition was almost identical, 40 per cent of Irish respondents expect a cross-border transaction compared to only 26 per cent of United Kingdom businesses. This reflects the fact that in many sectors the United Kingdom marketplace continues to present a significant number of quality targets allowing local PHBs to transact domestically.



10 Fraud management

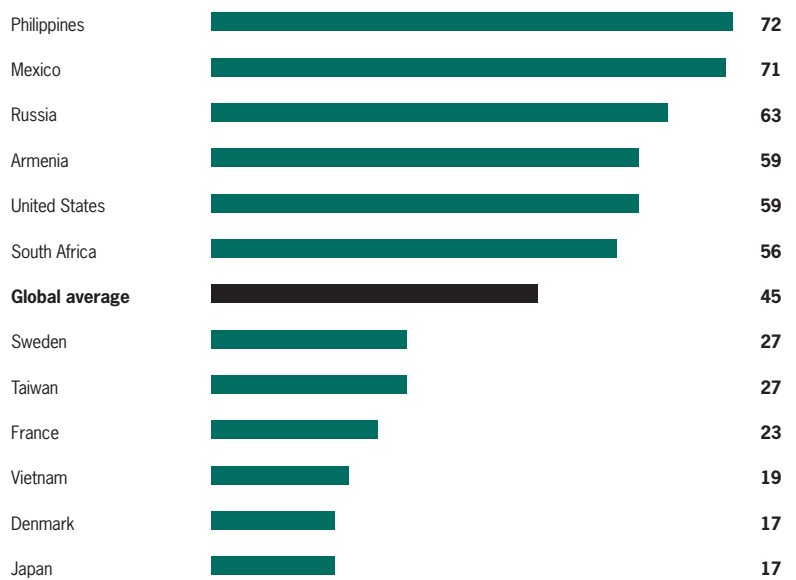
Globally, fraud costs businesses billions of dollars each year. It is important for all businesses to take steps to protect themselves against such activity. Whether specialists are employed or not, processes need to be in place to ensure that potential deceptive activity is caught in the early stages.

Whistleblowing can be an invaluable way to alert management of fraud and improper activities within the workplace. Often this can be the only way that information about issues such as rule breaking, criminal activity, cover-ups and fraud can be brought to management's attention before serious damage is suffered.

Fraud

Less than half (45 per cent) of PHBs have specialist staff in place to detect and prevent fraud with the Philippines highest at 72 per cent and Denmark and Japan lowest – both on 17 per cent (see figure 10.1).

Figure 10.1: Specialist staff responsible for preventing/detecting fraud
Percentage of businesses



NB: Excluding mainland China
Source: Grant Thornton IBR 2008

Globally, 12 per cent of businesses reported that the number of people involved in anti-fraud activity had increased over the past year. Regionally, NAFTA countries led the way with 16 per cent reporting an increase, while 6 per cent of European Union businesses experienced a rise.

The Philippines not only has the highest percentage of PHBs reporting having employees in place to detect and prevent fraud, but those businesses also report the highest increase in the number of employees working to prevent fraud (60 per cent).

Philippine business owners appear to be becoming increasingly aware of the need to install an internal system to combat fraud perhaps due to the recent spate of news on public corruption. Many businesses are unsure of the appropriate prevention and detection methods to handle common business fraud, particularly misappropriation of company assets and resources as a result of inadequate segregation of duties and misplaced trust on key personnel.

As the global economy weakens, and jobs are under threat, the temptation to commit fraud could increase. Businesses will need to be extra vigilant in these difficult times to ensure that their business is adequately protected.



“There is a real danger that a record 16 years of uninterrupted growth in the UK will end in the next few quarters. PHBs established during that healthy period will have to cope with the effects of stagnation or worse for the first time in their existence. They will have to cut costs but retain key staff in readiness for the upturn expected in 2010.”

Alysoun Stewart
Grant Thornton, United Kingdom



Whistleblowing

Globally, 45 per cent of businesses have measures in place to accommodate whistleblowers. Regionally, Latin America has the highest percentage (68 per cent) of businesses with support for whistleblowers, while, with 29 per cent of businesses reporting positively, East Asia (excluding mainland China) has the lowest percentage (see figure 10.2).

Figure 10.3 shows that Brazilian PHBs are the top country to provide support to accommodate whistleblowing (85 per cent) followed by the Scandinavian economies of Denmark and Sweden (both 71 per cent). Greek businesses come at the bottom of the table with just 18 per cent of PHBs providing support, closely followed by two East Asian economies Taiwan (18 per cent) and Hong Kong (20 per cent).

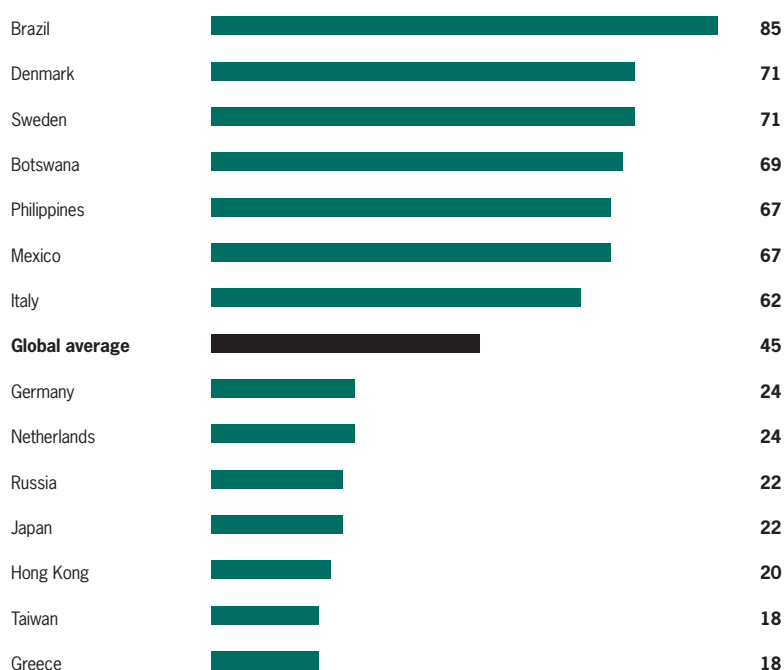
Businesses can greatly benefit from the introduction of measures to accommodate potential whistleblowers. Without sufficient measures in place, whistleblowers can be victimised as informants or traitors rather than a valuable early warning system which can save lives, money and reputations. The other, and perhaps greater and more prevalent risk, is that they remain quiet or leave the organisation and the underlying issues remain undetected.

Figure 10.2: Businesses providing support to potential whistleblowers – by region
Average percentage of businesses



NB: Excluding mainland China
Source: Grant Thornton IBR 2008

Figure 10.3: Businesses providing support to potential whistleblowers – by economy
Top and bottom seven economies
Percentage of businesses



Source: Grant Thornton IBR 2008

The demand for action

With the global economy on a downward curve, privately held businesses are having to take measures to help cope with the effects of easing demand. However, many such measures will be easy to implement for well-structured and managed businesses.

In a downturn, successful businesses put strategies in place to capitalise on the eventual global economic upturn – predicted by many economists to be in 2010.

The recovery is likely to involve a resumption of strong international trade growth, but competition will remain fierce. International strategies should focus on a broad approach, balancing the established markets such as western Europe and North America with the vigorously-growing but riskier emerging economies of Asia, Latin America, Eastern Europe and the former Soviet Union.

An effective corporate social responsibility strategy is increasingly becoming a requirement rather than an option. Businesses must continue to adopt ethical business practices quickly and efficiently to secure skilled workers and contracts with large multinational businesses.

Within any economic phase, finding and keeping the right talent is a challenge. Privately held businesses must ensure they have systems in place for finding and identifying people with the desired skills. A strong employer brand coupled with visibility of opportunity can serve as powerful vehicles to strengthen this quest.

With regard to taxation issues, there is a clear message to governments worldwide that for privately held businesses, tax is a central factor in determining their long-term investment priorities. A key message of this research is that privately held businesses need to make their concerns more widely heard and that governments must listen and act accordingly.

The next 12 months are likely to be the most demanding that privately held businesses have faced in decades. Demand is set to ease further while increases in commodity prices are going to squeeze margins. Businesses adopting a strong strategic approach into and out of the downturn will be the stars of the future.

Those failing to plan, or not responding effectively, face a very difficult future.

IBR contacts

The Grant Thornton International Business Report (IBR), formerly known as the International Business Owners Survey (IBOS), provides insight into the views and expectations of over 7,800 privately held businesses (PHBs) across 34 economies. This unique survey draws upon 16 years of trend data for most European participants and six years for many non-European economies. The research was conducted by Experian Business Strategies.

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