



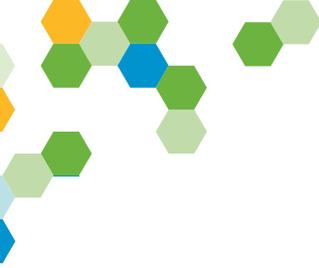
SPECIAL REPORT

# 10 Business Trends for Cuba in 2017

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1. INTRODUCTION
  2. CUBA IS FASHIONABLE
  3. THE ECONOMY'S ACHILLES HEEL
  4. CONFRONTING INEVITABLE CHALLENGES
  5. TEN TRENDS FOR CONSIDERATION IN 2017

AUTHORS

## 1. INTRODUCTION

For Cuba, 2016 has been an intense year. Its image has shone brightly across the world and the country has become fashionable. However, it has also been a year of contradictions and a great share of bad news. Donald Trump's victory in the American presidential elections, the death of commander-in-chief and former President Fidel Castro, and the deterioration of the already ailing economy, have jeopardized the last quarter of the year and the new direction that President Raul Castro seemed to be taking.

Nevertheless, Cuba has returned to its former status as "Pearl of the Caribbean" for some people. For those people, Cuba is now irradiating its charms internationally and generating an unusual interest in not only politics, but also in economics and touristic areas. A trend that is mainly driven by the thaw in relations with its powerful neighbour: the US. The relation between nations has improved particularly with ex-president Barack Obama's symbolic visit to the island on March 21<sup>st</sup>, 2016. A cascade of globally significant events has followed, such as the mythical Rolling Stones concert in Havana, or the Chanel fashion show in which the luxury brand launched its new collection; these are examples of the special momentum experienced by the island throughout the year.

“Cuba is again generating interest that is inversely proportional to its size and economic potential”

## 2. CUBA IS FASHIONABLE

Cuba has also been experiencing particularly good times regarding the political and institutional fields. Hundreds of high-level governmental delegations from all the continents have landed in Havana to rekindle political relations. Also, they have shown special interest in positioning their companies in potential deals and contracts in light of new reformatory measures, or the renewal of the economic model—put in Cuban political terminology.

Cuba is again generating interest that is inversely proportional to its size and economic potential. In addition to the appearances made by the United States' ex-president or the traditional allies and partners, such as the Venezuelan former president, Hugo Chavez, or the Bolivian leader, Hugo Morales; other Prime Ministers or Presidents of G20 member countries have also visited Cuba. The list includes leaders from Canada (Cuba's prime investor), China, Japan, Mexico, Italy, and emerging powers like the Iranian President, Rohaní.

President Raúl Castro's visit to France in the beginning of 2016 also deserves a special mention. Raúl Castro's visit to Paris marked the strengthening of relations and reciprocated the French President's visit to the island in May 2015. Despite

not having an official public agenda, he was welcomed and treated with all honours by President François Hollande.

The result is that bilateral relations have been strengthened and the interests of the French in the island have risen. Only a few months after that meeting the French consortium formed by Aéroports de Paris and the construction company Bouygues had won the renovation and expansion of José Martí International' airport in Havana; the latter having already a strong presence on the island.

Finally, the culmination of the peace agreements between the Colombian government and the FARC (Revolutionary Armed Forces of Colombia), sponsored by the Cuban government, has endorsed its political role in the region and signifies international diplomatic success for the Cuban government. These agreements end fifty years of armed conflict which have been responsible for more than 220.000 deaths, 50.000 disappearances and five million displaced people.

## 3. THE ECONOMY'S ACHILLES HEEL

In spite of the apparent good times Cuba is experiencing, the economy has once again proven to be the country's Achilles

**“The country can be defined by its chronic inadequacy and low efficiency in most of its economic sectors”**

heel. The huge expectations created by the US-Cuba thaw, the receptiveness to foreign investment, the announced arrival of North American companies such as Starwoods, Marriot, Airbnb or Google, as well as a record-breaking four million tourists, have not, however, been enough to accelerate the country's economic development and growth.

The Cuban government forecasted growth of 2 percent of GDP in 2016. This was later reduced to 1 percent at the midyear point by the government itself. This was justified, mainly, by the volatile international economic situation: the crisis in Venezuela—Cuba's principal commercial partner, supplier of reduced priced oil and its main professional services client—and the slump in both the export and prices of raw materials, such as nickel.

Finally, the vice president of the Council of Ministers the Economy and Planning, Ricardo Cabrisas Ruiz, announced at the presentation of the National Assembly of People's Power, on December 27<sup>th</sup>, 2016, that the economic results for that year were going to be poor, with an expected downturn of 0.9 percent of the GDP. As a consequence, financial resources will be scarce; putting a strain, once

more, the country's foreign currency balance and the meaning that opening up to foreign investment are expected to become more necessary than ever.

#### **4. CONFRONTING INEVITABLE CHALLENGES**

The events and statistics from 2016 have revealed some inconvenient truths, as well as new challenges that the country inevitably has to face, in order to release the island's full economic and social development potential.

On the one hand, to support a modern and productive structure; the country can be defined by its chronic inadequacy and low efficiency in most of its economic sectors. Mainly, as a consequence of the US economic blockades, but also due to mismanagement methods that are no longer in use. Low production and lack of incentives for production, and the deficient management and distribution system, together with the State's enormous bureaucratic machine, hinder all efforts to get the country's economy off the ground.

On the other hand, official statements and public interventions by the country's senior leadership are trying hard to stimulate new ways

**“The country holds great potential if it unlocks a good part of the talented capacity that it already has important assets that make it unique in the region”**

and practices that promote, facilitate and improve the efficiency of the production structure. Nevertheless, this is in conflict with the dynamics, inertia and culture of a centralised and tightly controlled economy. It will require new measures and incentives for facilitating modernisation and improving the economy’s efficiency. This is especially overwhelming regarding the decision of former President Barack Obama during his last days of office, to end the “wet feet, dry feet” policy that had been effective since 1995.

This executive order allowed Cubans who arrived on United States soil (dry feet) to remain legally and obtain residency in the country, unless they were intercepted at sea (“wet feet”), when they would be deported to Cuba. A policy that had, in reality, became an escape valve from the scarce opportunities on the island, and that generated a constant flow of economic migrants to the US. This is now history and will now oblige authorities to seek solutions to allow new forms of economic and social development outside of the public sector framework.

Cuba is a small market of only eleven million habitants and four million tourists a year; with numerous shortcomings and contradictions.

Nevertheless, the country holds great potential if it unlocks a good part of the talented capacity that it already has important assets that make it unique in the region and could create a runway for the economy to take off in the upcoming years, offering many interesting opportunities. Also, the country’s labour force possesses extraordinary skills; the ingenuity and creativity of Cuban people could command a brilliant future if it manages to deploy a comprehensive strategy for the development and exportation of professional services.

Even so, some believe that this process is impossible if the country does not broaden its political boundaries. The socialist planned economy is not expected to collapse in the short term, in spite of its problems, and neither is it expected to immediately open up to a free market system, like its immediate neighbours. The success of this new transition will largely depend on its capacity to create a virtuous growth cycle, generating prosperity for the Cuban people, removing the obsolete foundations of an outdated economic system. What are the key points and trends for Cuba’s immediate future then? Where are the main opportunities? What are the risks that foreign investors face?

“Ricardo Cabrisas, predicted a 2 percent growth for 2017, but the financial limitations that have weighed on the GDP in 2016 are not going to dissipate so easily”

## 5. TEN TRENDS FOR CONSIDERATION IN 2017

### 1- POLITICAL STABILITY

The death of Fidel Castro, commander-in-chief of the Revolutionary Armed Forces (FAR) and ex-president of the country, has coincided with the 60th anniversary of the arrival of the guerrilla group in the yacht named *Granma*. All of this has generated a massive institutional and social mobilisation and demonstrations of grief in the country. In the same way, Castro's death has fostered, outside of Cuba's borders, an avalanche of analysis about the country's political future and a possible transition, or even, the end of the regime. Nevertheless, the regime's political and institutional stability seems to be guaranteed in the short to medium term. The government and institutions have now been working for ten years without the permanent presence of Fidel Castro, and the current President, Raúl Castro has been developing a discrete but efficient strategy to replace the political and corporate frameworks, with people with FAR backgrounds who guarantee the control and stability of the country. Raúl Castro's anticipated withdrawal from the presidency, planned for 2018, implies a handover at the core of the government and a generation change for natural reasons, giving the power away to a new ruling group that

holds his trust—perhaps with a shared leadership. In any case, Raúl Castro will continue as first secretary of the Communist Party for at least another mandate.

### 2- SLOW ECONOMIC GROWTH

Despite measures taken by President Raúl Castro in recent years, which have resulted in a clear change in the country's economic direction, they have proved to be insufficient. The country still maintains an enormous dependence on its main commercial partner, Venezuela. Both in terms of oil supply and the exportation of professional services. As a result, the Cuban economy is likely to continue to experience a slow rate of growth in relation to its potential, and should continue to explore new policies and measures. The island's Minister of Economy and Planning, Ricardo Cabrisas, predicted a 2 percent growth for 2017, but the financial limitations that have weighed on the GDP in 2016 are not going to dissipate so easily. This could imply a curb in the growth, especially if the country continues to suffer from huge limitations in the energy and in the foreign exchange fields.

### 3- METHODS FOR ATTRACTING FOREIGN INVESTMENT

The disappointing economic and growth statistics from 2016 mean that the Cuban government will have to

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introduce new measures to streamline and facilitate the entry of foreign investors in order to boost its economy. The country urgently needs to stimulate, in addition to tourism, its industrial and agro-industrial sectors to substitute importations by national production and relieve the pressure on the country's foreign currency balance. To this end, the country has designed a roadmap and identified priority investment sectors in the Portfolio of Opportunities published by the Ministry of Foreign Trade and Investment (MINCEX). However, even though some investments are beginning to materialise, especially in the Mariel Special Development Zone—located 45 km west of Havana and intended as a consolidation of businesses that contribute to innovation, clean technology and generate industrial concentration—the statistics show that the country has to streamline negotiations and procedures to ensure that these new investments become reality.

#### **4- THE AGRO-FOOD SECTOR AS A NECESSITY**

The agro-food sector stands out among the different productive sectors that the island needs to develop. Low production and deficiencies in agricultural and agro-industrial distribution mean that the island has to import 70 percent of the products it consumes.

This costs about two billion dollars a year, resulting in a huge economic burden and a foreign currency haemorrhage for the country. The need for modernisation and its priority level, makes the sector an interesting opportunity for foreign investment. This could even include a fast track scheme for investors that wish to take a chance on a country that not only needs capital, but also the know-how and technology, and benefit from the millions of unexplored land all over the country.

#### **5- THE TOURIST BOOM IS SET TO CONTINUE**

The tourist sector has become the country's economic engine. With four million visitors in 2016, Cuba has recorded the best year in history with a 13-point higher than in 2015, resulting in a year-end figure above the most optimistic forecasts. A year marked by affluence of new tourists, mainly from the US and Europe, together with the launch of hundreds of new airline routes to Cuba. Finding a hotel room in the island today, whether for tourism or for a business trip, is now an increasingly difficult task. The Cuban government has opted to become more open to foreign companies' capital, and their experience in this sector, to alleviate the lack of accommodation in the short term. The strategy is part of an ambitious hotel construction

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plan with investment projects to build 67 hotels with over 32.000 rooms in the coming years. Most of the hotels international chains are looking to Havana searching for opportunities.

#### **6- THE RISE OF THE SERVICE SECTOR**

The service sector is emerging as one of the most important development sectors in the country. Tourism, the arrival of foreign companies and investors, and new forms of consumption mean that the country has to develop a whole range of new professional services. Some years ago, the government allowed the concept of self-employment to help development, and at the end of 2016 there were, according to the Ministry of Labour and Social Security (MTSS), more than 535.000 people who run bars, businesses and restaurants. Nevertheless, this is not allowed in many other sectors and there are no financing mechanisms for new businesses. Only those that can obtain financing from their families abroad have the possibility to do so, which slows down Cuba's entrepreneurial potential and talent development. This current activity is not enough to meet the growing demand in the country, and the informal economy occupies the space

that should belong to small and medium companies. For this reason, authorisation for SMEs is expected in the near future and represents one of the great opportunities for economic development and employment. At the current time, the establishment of non-agricultural service cooperatives is already permitted to respond to the needs that public companies cannot efficiently meet (construction gangs, management agencies, transport services, furniture craftsmen, etc.).

#### **7- THE OPENING OF THE WHOLESALE DISTRIBUTION SECTOR**

The absence of the wholesale market is one of the country's bottlenecks to business development and the distribution improvement of a wide range of products. Hence, the government wants to develop the sector, focusing on ZED Mariel as a great wholesale platform. Interesting opportunities exist in the wholesale distribution of food or construction materials, as well as in the retail sector. On the other hand, even though retail is not currently expected to be opened up for foreign investors, it's likely that this sector in particular will very shortly see the development of shopping centres, with foreign know-how and foreign financing.

“Trump initially supported Obama’s policies towards Cuba, he changed his stance during the electoral campaign, mainly looking after Florida’s Cuban-American community’s support”

### 8- FRANCHISING: A MODEL OF OPPORTUNITY

One of the country’s emerging niche markets is the development of the franchising model *a la Cubana*, or rather, constituted by a public company with one local partner. The several responsible companies in the retail sector and the dollar stores (TRD) are already starting to finalise agreements to open stores with international brands. It’s practically an unexplored market and presents real opportunities in the light of growing demand from the population, from tourism, also, with the rise of the amount of Cubans with purchasing power that are eager to consume.

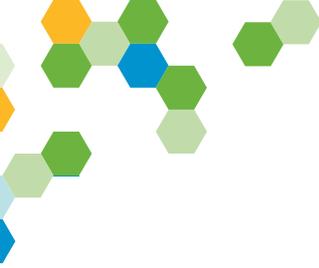
### 9- A NEW CUBA-US DIALOGUE

The victory in the November 2016 American elections has shaken the roadmap that attempted to gradually normalise the relationship initiated by Barack Obama and Raúl Castro in recent years. The new Trump administration will have a much more demanding speech towards Cuba, even though it may not be as radical as it seems. American companies now export merchandise with a value of almost \$380 million to the island since the beginning of the thaw, according to official statistics from the

United States Census Bureau. There is huge potential like Commerce Secretary, Penny Pritzker, declared in 2016 that her department had awarded 490 licences to the value of \$43 billion to companies interested in doing business with Cuba. While Donald Trump initially supported Obama’s policies towards Cuba, he changed his stance during the electoral campaign, mainly looking after Florida’s Cuban-American community’s support. Uncertainty still exists about his strategy for Cuba, although it is likely that he will adopt a strict approach and somewhat more lenient in reality; *Business is Business*.

### 10- EUROPE’S NEW ROLE

A New Political Dialogue and Cooperation Agreement between Brussels and Havana was signed in December 2016, ending 20 years of the European Common Position, which has tainted and marked relations between the island and the continent, and now re-establishes normal relations. Among the objectives highlighted in this agreement are the strengthening of commerce and development cooperation, as well as support during the process of economic and social updating. This opens new windows of opportunity and suggests a competitive advantage for European companies and



**“Despite offering interesting business opportunities in the short and medium-term, the Cuban market has extremely complex characteristics from a political, institutional, and operational point of view”**

investors over Americans, especially at a time when the new American administration, with its new rhetoric, could generate uncertainty and slow down the entry of new North American investors.

Hence, 2017 will be a crucial year for Cuba’s future development. The country will continue to have a leading role on the international scene and will continue to pursue foreign investors, thanks to its virtually unexplored consumption and industrial market, an

enviable geostrategic position and a highly trained and qualified population.

However, despite offering interesting business opportunities in the short and medium-term, the Cuban market has extremely complex characteristics from a political, institutional, and operational point of view. Thus, achieving success on the island requires the help of expert guidance and support, in order to deploy an intelligent strategic approach with a sensitive concentration of effort.

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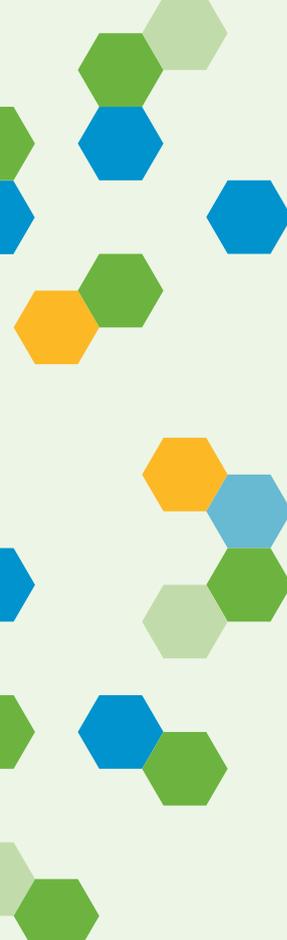
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