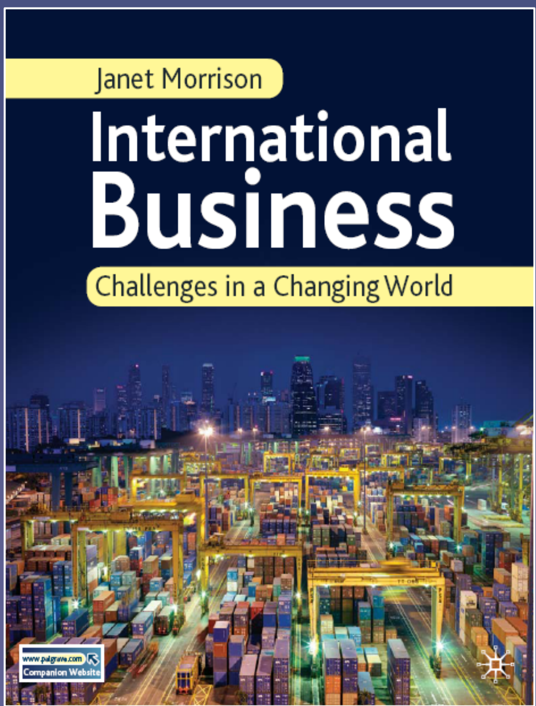
INTERNATIONAL BUSINESS:
Challenges in a Changing World

Janet Morrison

NEWSLETTER 1
2009 – Issue 1



Contents

Introduction

This update feature is designed to supplement the textbook, *International Business*. A word of explanation is appropriate at the outset, to say why this feature is being launched and what it aims to achieve.

Textbooks are sometimes viewed rather narrowly as a body of material which must be learned by students, assuming a cut-off date when the author(s) finished writing it. Encouragingly, many lecturers and students seek updated information, partly wishing to find out 'what happened next', but also to gain deeper knowledge and be better equipped to face tomorrow's challenges. This update feature accords with that approach, providing an easily accessible source for update material.

The world of international business is constantly changing, and there have been significant developments since the text of this book was finalized in March 2008. This update feature will highlight many of those changes, linking them to the discussion in the book, so that readers are able to relate current events and trends to background information and analysis which appear in the chapters. This new material is grouped under the following headings:

- **The global economy** – issues and challenges gaining international attention
- **Country spotlights** – developments in countries featured in the country focus features
- **Companies in the news** – developments involving companies and industries featured in the case studies and country focus features

These update notes contain mainly new information and do not repeat background material which appears in the text, so familiarity with the text is needed in order to benefit from these updates.

Readers are referred to other up-to-date sources for further comment and analysis on the major issues. Where possible, precise web links to relevant articles are provided. These are correct at the time of online publication, but they may go out of date in subsequent months. If this happens, students and lecturers should be able to locate the material by searching the relevant websites (such as www.economist.com or www.ft.com) or by referring to print copies held at university libraries.

We hope that readers will find these brief notes informative, engaging and beneficial in illuminating the themes of the book.

Janet Morrison

Chapter links key

- *CF* = Country focus
- *CS* = Case study
- *SX* = Strategic crossroads
- *OV* = Chapter opening vignette

PART 1

The global economy

Global financial crisis is met with rapid government responses

Chapter links:
- Chapter 2
- Chapter 3
- Chapter 5
- Chapter 11
- Chapter 15

The past two months have seen the deepening financial gloom of the past year turn into a global financial crisis, with collapsing banks, a drying up of lending and rapidly falling stock markets. In the week of 6 October, markets globally fell over 20%, causing shockwaves in the global economy. Governments quickly stepped in, showing willingness to co-operate with each other in measures to shore up the financial system. We will look first at the chief causes of the current crisis, and then at government responses and their prospects of success.

Causes of the crisis

As highlighted in **Chapter 11**, the derivatives market, the bulk of which is unregulated, has spiralled in recent years. Derivatives can be securitized – that is, packaged as securities which can be traded and used as security for loans. However, pricing these products involves an element of guesswork and thus added risk. Adding to the uncertainty in derivatives trading has been the influx of mortgage-backed securities, mainly in the US. When property values were rising, these did not seem to pose high levels of risk: even the 'sub-prime' lending to borrowers with weak credit profiles seemed safe in a market of rising prices. But the US housing boom collapsed and property values fell, leading to uncertainty and distrust of mortgage-backed securities – troubled assets on which much of the financial system had come to depend. As banks' asset bases suddenly looked shaky, share values fell and inter-bank lending fell to a trickle as banks ceased to trust each other. Businesses found banks unwilling to lend to them (the 'credit crunch'), and people feared for their savings, investments and pensions.

Government responses

Governments stepped in quickly with a number of measures:

- *Deposit guarantees* – Savers in most countries enjoy protection for money they deposit in banks (up to a defined ceiling) through savings insurance schemes, such as the Federal Deposit Insurance Corporation (FDIC) in the US. However, in the event of a 'bank run' affecting several large banks, these arrangements would soon run out of funds. In the current crisis, governments raised the ceiling on guarantees, and even assured depositors with savings over the defined limit that all their savings were guaranteed. This helped to contain the risk of a bank run.

- *Liquidity operations* – Central banks stepped in to aid banks directly. In the UK, under the Special Liquidity Scheme, announced on 8 October, £200 billion was injected into money markets and £250 billion was made available to banks over 3 years to guarantee medium-term debt, and help to restore inter-bank lending.
- *Government purchase of mortgage-backed securities* – In the US, a bail-out bill was quickly drawn up and presented to the US Congress, known as the Troubled Asset Recovery Programme (TARP). A sum of $700 billion was roughly calculated to be the amount necessary to purchase the troubled assets from banks. The US Treasury would be left with the difficult task of valuing and selling these troubled assets, but an immediate benefit would be to remove them from the banking system. However, since the passage of the bill, its policy has shifted away from this strategy to one of injecting funds directly into troubled organizations (see next item).
- *Part-nationalization* – Some governments have taken over swathes of the equity of troubled banks as part of a rescue package. In its bail-out package for the banks, the US did not propose taking equity positions in banks, but by mid-November, the US Treasury announced that it was changing its policy on how to use the bail-out funds, and would be using them for recapitalization, rather than buying troubled assets. In countries with a history of nationalized industries, nationalization is more readily accepted than in the US. The US and UK are now embracing active intervention of the state, in a significant reversal of liberal market principles. In its banking crisis of the early 1990s, Sweden nationalized banks, and the UK nationalized the Northern Rock when it was near collapse in late 2007, having over-engaged in issuing mortgage-backed securities. The resort to use of taxpayers' money in this way is often criticized: if bankers acted irresponsibly in pursuing risky practices, the market solution is to let them fail. However, governments fearing collapse of the entire system reached for public ownership to restore confidence.

Prospects of success

The recognition that government bail-outs were needed in systems such as the US and UK, which have been foremost exponents of non-intervention in markets, has been remarkable. The capitalist model, long held up by the US to the rest of the world as the example to follow, now seems deeply flawed. Some would even say it has failed. A more moderate view is that markets are not *per se* to blame, only lack of adequate regulation. In EU countries, there is no unified regulatory structure, and European governments have attempted to co-ordinate policies, under the EU presidency of France, led by President Sarkozy. As some banks' liabilities are greater than their home countries' GDP, co-operation has been necessary. However, President Sarkozy, who favours greater regulation, warns that statist solutions of the past are not the solution, and that the benefits of liberal trade and markets should be preserved.

The major developed countries, whose excesses in credit derivatives markets were largely to blame for the recent financial turmoil, are all facing recession. It was hoped that the government measures outlined above would encourage lending, benefiting businesses in the 'real economy'. Central banks have reduced interest rates, despite inflationary pressures, in order to encourage economic activity. In a concerted effort, central banks in the US, Canada, the UK, Switzerland, Sweden and the eurozone, all reduced rates by 0.5% simultaneously on 8 October 2008. China also made an adjustment, but China and other large emerging economies have generally remained on the sidelines. These economies have continued to enjoy robust growth, while the developed economies have been slowing over the past year. Most forecasters, including the IMF, are now revising downwards estimates for growth in the developed countries, estimating that some will either stagnate or contract over the next year, implying high unemployment and declining consumer spending. The consequences are already being felt in China, as growth is slowing and demand in western markets for its manufactured goods is weakening. As Chinese manufacturers are forced to cut back their production, jobs and consumer demand in China are showing signs of slowing. Plummeting stock exchanges of late have afflicted the large emerging economies. Russia and Brazil both suspended trading in the turbulent week of 6 October, to calm markets.

A meeting of the G20 countries took place in Washington, D.C., on 15 November, under the auspices of the IMF. The G20 group, formed in 1999, consists of both developed and developing nations. Its members are the G8 (Canada, Japan, Germany, France, Italy, UK, US, Russia) plus Argentina, Australia, Brazil, China, India, Indonesia, South Korea, Mexico, Saudi Arabia, South Africa and Turkey. The 20th member is the EU presidency, if that is not held by a G7 country. France was represented both as a G7 country and EU presidency. In addition, Spain and The Netherlands were represented, bringing the number to more than 20 countries. The meeting discussed only broad principles, including the need for transparency and better regulation of the global economy, scheduling further meetings to discuss details. Significantly, the meeting expressed a wish to continue multilateral trade negotiations, despite the failed talks in July 2008 (see next item).

Find out more...

- *Financial Times*, Global Agenda: special report, 7 November 2008. www.ft.com/reports/global-agenda-nov2008
- *The Economist*, 'When fortune frowned: A special report on the world economy', 11 October 2008. www.economist.com/specialreports/displayStory.cfm?source=hptextfeature&story_id=12373696
- *The Economist,* 'Briefing: The global economic summit', 15 November 2008. www.economist.com/finance/displaystory.cfm?story_id=12597176
- World Bank, 'G20: Global Financial Crisis: Responding Today Securing Tomorrow', background paper, 15 November 2008, at www.worldbank.org

The collapse of the WTO Doha Round of trade negotiations

Chapter links:
- Chapter 6
- Chapter 15
- *SX 6.1*
- *CF 15.2*

The Doha Round of multilateral negotiations, which was launched in 2001, had ambitious aims to open markets in agriculture, manufacturing and services, with a focus on development. A series of meetings has ensued, culminating in what was meant to be a final attempt to reach agreement in Geneva in July, 2008. However, after nine intense days of meetings between representatives of the major negotiating countries, the parties failed to agree. Earlier meetings had foundered on the differences in bargaining positions of the rich countries and the developing ones. Rich countries demanded that developing-country markets for their goods (including agricultural commodities and manufactured products) be opened, while developing countries demanded the dismantling of protectionist barriers in rich countries' markets. Brazil, as a large agricultural producer, has attempted to put forward a compromise solution, urging developing countries to go further in opening their markets. However, at the Geneva meeting, representatives of the US and India, who dominated the discussions, took strong positions which could not be reconciled. The talks stumbled on the provision of a 'special safeguard mechanism', which would allow developing countries to protect small farmers from sudden surges in imports of agricultural commodities. This is a sensitive issue for India, as some 70% of its billion plus population consists of small farmers, many of whom are engaged in subsistence farming. The outspoken Indian trade minister, Kamal Nath, contrasted their position with America's 2 million farmers in an export-oriented agricultural sector, who would continue to be heavily subsidized.

The breakdown of the talks is likely to lead to further fragmentation in world trade, with increasing use of bilateral trade agreements and an upsurge in the use of the WTO's dispute resolution procedure. The use of bilateral agreements has been growing for several years. The major developed and emerging economic powers in today's world have sought agreements with a range of countries, typically covering issues well beyond trade, which benefit the interests of the major power. This trend is now likely to accelerate. Similarly, for developing countries, resort to the dispute settlement process is now a growing prospect. A complaint by Brazil against illegal subsidies to US cotton farmers was upheld by the WTO in June 2008. Although this decision gave Brazil the right to retaliate by imposing sanctions on US goods, it had not done so, in the hope that the Doha negotiations would agree across-the-board reductions in a number of US subsidies affecting Brazilian exports, including ethanol and other farm products besides cotton. Brazil is now likely to take further action through the WTO on cotton and on the US import tariffs levied on Brazilian ethanol.

Africa's poor cotton farmers had hoped that reductions in US cotton subsidies would be agreed in Geneva. At the Geneva talks, Mamadou Sanou, the trade minister of Burkina Faso, represented three other West African cotton-producing countries (Mali, Senegal and Benin). Prior to the Geneva meeting, the US had provisionally agreed a reduction in cotton subsidies. However, the US had stated that it would only reduce its cotton subsidies if China lowered its trade barriers to US cotton exports.

In the event, cotton subsidies were not discussed at Geneva, and the failure of the talks meant that it felt no obligation to act on the issue. The African countries watched from the sidelines as their hopes of reductions were dashed. Although Brazil is now preparing to resume its case against the US at the WTO, this could take years. African leaders are hoping for the Doha talks to resume, despite the fact that the Geneva meeting had been envisaged as the final one.

They could well see a resumption of talks, as many negotiators, including the Indian trade minister, are urging that the talks should be viewed as a 'pause' rather than a 'breakdown' (Beattie, A., 'Hangovers but no anger on the morning after', *Financial Times*, 31 July 2008) The G20 meeting of 15 November raised the possibility of continuing the Doha process. Thus, further meetings in 2009 and even 2010 could be organized. However, as protectionist tendencies grow in response to economic slowdown, the hopes for multilateral accord look remote.

Find out more...

- Bhagwati, J., 'The selfish hegemon must offer a New Deal on trade', *Financial Times*, 20 August 2008. Professor Bhagwati expresses the arguments from the point of view of developing countries. http://us.ft.com/ftgateway/superpage.ft?news_id=fto081920081345476228
- *Financial Times*, 'The World Economy 2008' (Special Report), 10 October 2008. This supplement covers a range of topics. It has a section on multilateral bodies, including the WTO.

Global issues of poverty and food insecurity take on urgency

Chapter links:
- Chapter 2
- Chapter 5
- Chapter 13
- Chapter 15

Surging food prices have become a global phenomenon. Three broad causes are responsible:

- *Growing demand* – The new middle-class consumers in emerging markets such as China are eating more protein-rich foods such as meat. Meat production creates extra demand for cereal crops and water. Population pressures in the developing world generally are also contributing to increased demand. China has half the world's cultivated lands, but because of growing demand, has become an importer of food, and its government now prioritizes security of food supply.
- *Spiralling energy prices* – Large-scale food production depends heavily on energy, as modern farming is largely industrialized. Moreover, the cost of fertilizers is linked to energy costs. The 'green revolution' which brought about dramatic rises in productivity in the 1960s was made possible by extensive use of fertilizers and widespread irrigation, but these depended on cheap fuel and abundant water. The situation today is much changed: energy has spiralled in price and water is becoming scarce in many regions.
- *Slowing growth in productivity of the world's cultivated lands* – Supply of food is now struggling to keep up with demand, as the world is consuming more than it produces. Crop failures due to drought, flooding and extreme weather are

becoming more common due to climate change.

In the 1960s, huge rises in productivity in the major producing countries led to abundant cheap food, even food 'mountains'. Research on further improving productivity thus rather lost impetus, and productivity is rising only slightly, although demand is soaring. What is now needed is research into growing food with a minimum amount of water and fertilizer. These innovations are most urgently needed in Africa, where poverty and hunger are rife. In many of these countries, agriculture once thrived, but gradual degradation of the soil – now so thin and poor in nutrients it can hardly support crops – has resulted in these countries becoming net food importers. In the EU's new member states in Central and Eastern Europe, soil degradation affects one-third of the land. In China, industrial pollution is leading to low productivity, combined with the effects of contaminated water or depletion of water, under strain of demand from industrial and urban users.

Consequences and solutions

In poor developing countries, the fears of social unrest are growing. Food riots have occurred in a number of countries, including Haiti and Bangladesh. As prices of basic commodities rise, hunger is spreading in the growing urban areas, particularly in the poorest countries of Africa. Food represents 50% or more of what the poorest consumers buy, and price rises – such as the doubling of the price of rice in three months – have caused the food import bills to rocket. The UN, under the World Food Programme (WFP), provides emergency food aid to countries in greatest need. However, the costs of this emergency aid have risen steeply, in line with global prices, leaving the agency facing a shortfall of funds at a time when the need is greatest. The WFP announced a change of policy in September 2008. It would shift away from buying its food stocks from the developed countries (especially the US), and start purchasing from the world's poorest farmers. This policy shift acknowledges a change in its role from providing emergency aid to promoting development. It is now seeking to buy from 350,000 farmers in sub-Saharan Africa, Latin America and Asia. These farmers have lacked access to markets and suffer from poor infrastructure such as storage depots. They stand to gain from the WFP proposal, which has the added benefit of reducing transport time, as the food will be near to the places where it is needed. The new procurement programme is being funded in part by the Gates Foundation and the Buffett Foundation.

The IMF has also stepped in to help developing countries suffering from deteriorating balance of payments as a result of steep rises in food and oil prices. Although oil prices have recently fallen, the fear is that, in the long term, supply strains will push them back up. The IMF is particularly concerned that food and oil prices could seriously weaken the economies of up to 75 developing countries. It has doubled funding to Burkina Faso, Kyrgyzstan, Mali, Niger and Benin.

Long-term food security

Food insecurity is not confined to poor countries. Governments of all countries which rely on imports are concerned that both supply and prices fluctuate for products traded in world markets. Alarms sounded when exporting countries restricted exports in the summer of 2008. They included India, Russia, Argentina and Vietnam. Some countries are now actively seeking to acquire land abroad to invest in agriculture, producing crops in foreign lands which would be shipped to the investing country. Saudi Arabia and other oil-rich Middle Eastern states have made such investments. China has also tentatively looked at buying farmland abroad. Daewoo Logistics of South Korea has leased 1.3 million hectares of farmland in Madagascar to grow food for South Korea using labour from South Africa. This is a 99-year lease, and covers about half of Madagascar's farmland.

Other countries which have expressed interest in providing land include Sudan, Ethiopia and Ukraine. Sudan's investment ministry is selling 17 large-scale farming projects covering 880,000 hectares. Ethiopia is also keen to provide hundreds of thousands of hectares. These potential host countries have high levels of poverty, and it is not clear how they would benefit from the foreign investment envisaged. The nightmare scenario would see crops being transported out of a country while local people suffer from hunger. That fear is heightened by the mechanisms written into lopsided bilateral trade agreements devised by the investors, which restrict the host country from imposing export restrictions in times of food crisis. Sudan is currently in receipt of emergency aid from the WFP, which feeds 5.6 million people in the country. Nonetheless, Sudan could soon be exporting food to rich nations such as Saudi Arabia.

The director-general of the UN Food and Agriculture Organisation (FAO) has warned that moves by countries to gain food security through direct investment in overseas production could amount to food 'neo-colonialism' (Blas, J. 'UN warns of food 'neo-colonialism'' *Financial Times*, 20 August 2008). It is particularly concerned that host countries generally have weak legal environments and farmers have weak rights of tenure and little access to compensation. A framework such as the Extractive Industries Transparency Initiative which attempts to control corruption in oil, gas and mining industries, could be devised. However, this could take a long time to agree, and rich countries wish to secure deals immediately to commence food shipments from the next plantings. It would also suffer from the weaknesses of voluntary codes of practice generally. It should be borne in mind that although some of the parties would be private-sector organizations, the power would rest with the sovereign players, such as investment groups acting under the sponsorship of their governments. Countries which have so far expressed interest in acquisition of foreign agricultural land, such as China and the Middle Eastern states, are governed by regimes which are among the world's least transparent and accountable to their peoples. Fear of social unrest among the poorest sections of these societies is driving their governments to seek security of food supplies.

Find out more...

- Blas, J., 'The end of abundance', *Financial Times*, 2 June 2008. http://us.ft.com/ftgateway/superpage.ft?news_id=fto060120081432222607
- Blas, J., and England, A., 'Foreign fields', *Financial Times*, 20 August 2008. http://us.ft.com/ftgateway/superpage.ft?news_id=fto081920081445476265
- Harvey, F., 'Soil under strain', *Financial Times*, 17 July 2008. http://us.ft.com/ftgateway/superpage.ft?news_id=fto071620081443350301

PART 2

Country spotlights

Among countries which have dominated the media over the past few months are China and the US. We look first at developments in these two countries, followed by a selection of other countries where there have been notable changes in the international business environment.

China

Chapter links:
- Chapter 3
- Chapter 5
- Chapter 14
- *CF 8.1*
- *OV Chapter 4*

The period leading up to the Olympics was envisaged as a time to celebrate China's accomplishments as a modernizing country, delivering a showcase event to universal acclaim. In reality, the months preceding the games proved difficult for China's leadership. Severe winter snowstorms disrupted the plans of millions of migrant workers seeking to travel home for Chinese New Year celebrations (see opening vignette in **Chapter 4, page 118**). A massive earthquake struck Sichuan province in May, leaving a death toll of over 69,000, and 5 million homeless. The disaster received unprecedented media coverage globally. Official rescue efforts and the work of thousands of civilian volunteers were praised, but it became clear that the most devastating losses were from hundreds of collapsed schools, while resplendent new government office buildings remained standing. Protests by parents over sub-standard construction of schools attracted the attention of the foreign media, prompting Beijing authorities to order a halt to media coverage of the protests. Nonetheless, reporters from western media gathered considerable evidence of poor design safety in the building of schools and hospitals across the affected region, despite the fact that it was a known earthquake zone.

The Olympic torch procession, designed as a city-to-city relay around the world, was launched in April 2008, as 'journey of harmony', to spread the Olympic message of 'one world, one dream'. (Dyer. G., and Thornhill, J., 'Feeling the heat', *Financial Times,* 2 May 2008). The symbolism of the Olympic torch was soon overshadowed by protests in western capitals, particularly by those objecting to China's harsh crackdown in Tibet. In reality, the torch relay highlighted the gap in perceptions of China: many westerners view China as a threat, while the Chinese themselves are proud their growing global status. Anxiety about China has been strong in Europe. In addition to sympathy with the desire of Tibet to maintain its own culture, there is unease about China's lack of civil and political freedoms, and there is criticism of the government's huge investment in Sudan, whose president has been indicted for war crimes by the International Criminal Court.

The Olympics, one commentator has said, 'taught China more about the world and the world more about China' (Sthephens, P. 'China after the Olympics; a great but hesitant power', *Financial Times*, 26 September 2008). China's new selfconfidence is grounded in an acute sense of national sovereignty. Its leaders reacted strongly to international criticism of its treatment of Tibetan separatists and dissidents generally. This reaction was mirrored in nationalist demonstrations across China, for example, outside Carrefour hypermarkets. China wishes to be recognized as an economic superpower by the international community, but it has not accepted that this status brings scrutiny of its internal governance and its international activities by outsiders. As global recession looms, China is experiencing a slowdown in growth. Economic downturn and an upsurge in human hardship could create new challenges for Chinese authorities, especially with rising unemployment. Vulnerable workers include those who have enjoyed years of increasing prosperity in export-oriented industries, as well as the millions of rural inhabitants who have not shared in the benefits of globalization.

Find out more...

- Dyer, G., and Thornhill, J., 'Feeling the heat', *Financial Times*, 2 May 2008. http://us.ft.com/ftgateway/superpage.ft?news_id=fto050120081449431899
- *The Economist*, 'China before the Olympics', 2 August 2008. www.economist.com/world/asia/displaystory.cfm?story_id=11841531
- *The Economist*, 'A ravenous dragon: Special report on China's quest for resources', 15 March 2008. www.economist.com/specialreports/displaystory.cfm?story_id=10795714

The US

Chapter links:
- Chapter 1
- Chapter 2
- Chapter 3
- Chapter 5
- Chapter 11
- Chapter 15
- *CF 2.1*

As noted in the section on the global economy, the causes of global financial turmoil owe much to the sub-prime mortgage crisis in the US. Crisis in the housing sector has been accompanied by a sharp downturn in consumer spending. Much consumer spending in the US has been funded by debt linked to property, and has declined in line with falling property values during the credit crunch. As the country focus highlighted, much labour-intensive US manufacturing, especially the motor industry, has suffered from weakening competitiveness. This plight is exacerbated by slowing consumer demand. Having seen Congress agree a bail-out package for financial institutions, the major motor manufacturers (Ford, Chrysler and General Motors) are now seeking bail-out funding from the US government (see feature on the US motor industry below).

Economic issues became the main battleground of the US election campaign in the autumn, 2008. The Republican Party, traditionally perceived by voters the stronger party in terms of national security, found that, as the issues shifted to the economy, their campaign messages were not winning voters, who were becoming increasingly concerned about jobs, homes and healthcare. After all, the administration of President Bush, now reaching the end of its second four-year term, had presided over the build-up of a financial bubble of mortgage-based debt. The Republican presidential candidate, Senator McCain, found it difficult to dissociate himself from the Republican legacy of apparent financial mismanagement and regulatory failures, while the Democratic candidate, Senator Obama, argued persuasively for change.

The message of change reached voters, delivering a Democratic victory on 4 November. Unusually in US elections, Senator Obama received an absolute majority of the votes cast – 52.7% to 46% for Senator McCain. This was the first election since 1976 in which the winner has won an absolute majority of the votes cast. US elections are decided by an electoral college, each state having representatives equal in number to their members of Congress. The more populous states are key to victory, and a marginal win in a populous states delivers all that state's electoral college votes to the winning candidate. In the event, Obama received 365 votes in the electoral college, to McCain's 162 – a result which was much more decisive than the popular vote. Turnout, expected to be very high, following campaigns to sign up new voters, was just over 60%. This was high, but not unprecedented, and it was thought that many traditional Republican voters, disenchanted with their candidate or their party generally, simply did not vote.

Recession is reaching most of America's states, some more deeply than others, reflecting partly the employment pattern in each. The farming states, where farmers are in receipt of federal government subsidies, are less affected by downturn that the states where heavy industry has been concentrated. Growing inequality has been highlighted by the economist, Paul Krugman, in *The Conscience of a Liberal: Reclaiming America from the Right.* A study of inequality in OECD countries has revealed differences between countries. This study shows that the poor in the US are relatively worse off than the poor in countries with stronger welfare states, such as the Scandinavian countries. The poorest 10% in Sweden have incomes 1.5 times the level of the poorest 10% in the US, even though US incomes are much higher. Addressing the social issues, especially healthcare, will be high on the agenda of the new president when he takes office in January 2009.

Find out more...

- Krugman, P. (2008) *The Conscience of a Liberal: Reclaiming America from the Right* (Allen Lane).
  www.amazon.co.uk/Conscience-Liberal-Reclaiming-America-Right/dp/1846141079
- *The Economist*, 'Challenges facing Barack Obama', 8 November 2008.
  www.economist.com/displaystory.cfm?story_id=12551938
- OECD (2008), *Growing unequal? Income distribution and poverty in OECD countries*, at www.oecd.org/els/social/inequality

Myanmar (Burma)

Chapter links:
- Chapter 5
- Chapter 14
- Chapter 15
- *CF 14.2*

Cyclone Nargis swept across Burma 2-3 May 2008, leaving an estimated 138,000 people dead or missing and causing more than $4 billion in damage to the country. In addition, some 2.4 million survivors saw their livelihoods and homes destroyed. Although the survivors were in desperate need of immediate aid, Burma's secretive military government refused for three weeks to let international aid workers into the country, stating that it was carrying out the rescue on its own. The contrast between this situation and the relative speed and openness of the Chinese rescue efforts following the Sichuan earthquake have attracted international attention. By the end of the third week following the cyclone, about 1 million people had received some aid, but this was mostly around the capital, Rangoon, rather than in the worst affected areas of the Irrawaddy delta.

The disaster brought to light the isolation of the military regime and the suffering of the Burmese people, who have long received much less aid than other authoritarian states, such as Zimbabwe and North Korea. Western countries have focused on economic sanctions against Myanmar, and calls for recognition of Aung San Suu Kyi as the country's democratically elected leader. The regime, however, has refused to give way, and is bolstered by support from neighbouring countries. The fact that the military, which had asserted its national self-reliance, eventually let in aid workers and relief supplies, is perhaps a sign that it is opening up slightly to the outside world. However, the disaster also highlighted the issue of western policies towards Myanmar, where a humanitarian tragedy has long been unfolding.

Find out more...

- Kazmin, A., and Jack, A., 'Into the delta', *Financial Times*, 30 May 2008. www.ft.com/cms/s/0/3878af90-2da3-11dd-b92a-000077b07658,dwp_uuid=6a365390-7032-11dc-a6d1-0000779fd2ac.html?nclick_check=1
- *The Economist*, 'Spring postponed: Briefing Myanmar', 12 April 2008. www.economist.com/world/asia/displaystory.cfm?story_id=11011992

Global financial crisis and the economies of Central and Eastern Europe

Chapter links:
- Chapter 3
- Chapter 5
- Chapter 6
- Chapter 11
- Chapter 15
- *CF 5.1*
- *CF 7.1*
- *CF 10.2*
- *CF 15.1*
- *SX 9.2*

While recent headlines have been dominated by the credit crisis and looming recession in the US and EU15, the impacts of global financial turmoil are also being felt in other economies. The transition economies of Central and Eastern Europe have been beneficiaries of globalization. These countries have attracted FDI, improved domestic living standards dramatically, and enjoyed relatively high economic growth rates. But how are they being affected by the global credit squeeze and financial turmoil? Foreign banks, notably the Austrian banks, have invested heavily in neighbouring countries to the East, where foreign debt has mounted. There are growing concerns about their ability to repay, linked to concerns that their currencies are weakening. Worrying current account and budget deficits have affected the countries of Central and Eastern Europe. Hungary's economy is more precarious than the others, having seen only modest recent growth, in contrast to the healthier growth in Slovakia. In October 2008, the European Central Bank provided short-term credit facilities to Hungary, following sharp falls in its currency and stock market. Currencies and stock markets have also fallen in Poland and the Czech Republic.

Continuing economic growth would help export industries in the countries with high current account deficits, but slowdown in the markets of western Europe, where their main customers are located, would deepen the gloom in these emerging economies. For these former communist countries, transition was a matter of both economic liberalization and building democracy. The market economy has brought greater prosperity, on which their young democratic governments have been based. Economic hardship could be a stern test of their democratic depth, especially in the context of corruption, which remains a concern.

The economically diversified economies of democratic transition states in Central Europe differ markedly from the resource-rich authoritarian states of Russia and Kazakhstan. The Russian economy has amassed foreign currency reserves of nearly $491 billion, thanks to rising oil prices, and has generally been considered to have a sound economy. However, Russia's stock market lost 50% of its value between May and October 2008. Russian companies have amassed considerable foreign debt, as there are few domestic sources of long-term capital. Economic growth is bound to slow, and is being affected by recent falls in the price of oil. A number of Russian banks have seen rises in withdrawals and account closures, as confidence in the banking system falters. The Russian government has put together a rescue package for the banks, and is planning to buy shares in key companies. Investors have flocked to Russia in recent years, but foreigners have withdrawn billions of dollars from the country since August 2008, partly out of fears about what the increasingly authoritarian government will do next (see the case of BP in the next section).

Find out more...

- Clover, C., 'Onward to 1998', *Financial Times*, 27 October 2008. www.ft.com/cms/s/0/2f081936-a379-11dd-942c-000077b07658.html
- *The Economist*, 'Russia's economy', 1 March 2008.

PART 3

Companies in the news

In this section, we give brief accounts of some of the changes taking place in the organization, strategy and operations of companies featured in the case studies.

Salvaging BP's Russian joint venture

Chapter links:
- Chapter 1
- Chapter 2
- Chapter 3
- Chapter 5
- Chapter 15
- *CS 5.1*
- *CS 13.1*

TNK-BP is a 50:50 joint venture company launched by BP and its Russian partner in 2003. By 2003, it had become Russia's third-largest oil company. Based in Moscow, its output was largely responsible for BP's growth in the following two years, and it is crucial to BP's replenishment of oil and gas reserves.

Management and governance issues have created problems for the running of the company, however, especially in the context of increasing influence of the Russian government in the energy sector. The Russian shareholders in TNK-BP consist mainly of three billionaire oligarchs, two of whom are executive directors. In March 2008, the Moscow offices of TNK-BP were raided by Russian security officers in an investigation of tax evasion and alleged violation of labour laws. Robert Dudley, the TNK-BP CEO was called for questioning, and in August, appeared before a Moscow court on related charges. The court suspended Dudley as CEO, and the authorities refused to renew his visa, but he intended to appeal, and BP announced that he would carry on running the company from a secret location. The Russian oligarchs said they were not involved in the actions against Dudley, but it was clear that they wished to see him replaced by an independent CEO. For its part, BP wished to see the two powerful Russian shareholder managers step down.

To salvage the joint venture, BP's CEO, Tony Hayward, held talks with their Russian partners. They agreed to keep the 50:50 equity split, but Dudley would be replaced by an independent Russian-speaking CEO, who must be approved unanimously by the board. Moreover, the two shareholder executives would keep their places on the board. BP had feared that the conflict within TNK-BP would result in a reduction of their equity stake, but, although their ownership stake has been maintained, the control of the company has arguably shifted towards to the Russian owners.

Battles of the global internet companies

Chapter links:
- Chapter 1
- Chapter 2
- Chapter 5
- Chapter 11
- Chapter 12
- Chapter 15
- *SX 5.2*
- *CS 15.1*

Microsoft has long been concerned about Google's rise to dominance in internet search business and eyed the lucrative advertising it generates. Both companies have attempted to link up with a third major player, Yahoo. A difficulty faced by links among these global companies is the possible infringement of competition law. Here we update readers on the latest developments.

Contrary to expectations, Microsoft decided to appeal against the record fine imposed by the European Commission in March 2008. The appeal coincided with the Commission opening fresh investigations into the company's alleged abuse of a dominant market position with its Office software and integration of its Internet Explorer browser into Windows. The March decision had required that the company offer technical information to rivals on 'reasonable terms', but had not specified what prices would be reasonable for the licences. The appeal would offer the opportunity to clarify the terms.

Microsoft has sought expansion into the internet search business, launching a bid for Yahoo, whose search engine and advertising offered prospects of mounting a serious challenge to Google, the dominant player. Microsoft was bolstered in these ambitions by support from Carl Icahn, an activist investor in Yahoo who has been unhappy with the leadership of CEO, Jerry Yang. Yang robustly fended off the advances of Microsoft, asserting it was not in the best interests of shareholders. Meanwhile, Yang negotiated with Google on a deal to allow Google's search advertising to appear on Yahoo search results. This proposed Google-Yahoo alliance, in which Google would clearly be the stronger partner, ran into regulatory storms with both the US and European competition authorities. Efforts to complete the deal were therefore dropped, leaving Yahoo in a precarious position, made worse by a slump in advertising due to the economic downturn.

On 18 November 2008, the embattled Jerry Yang stepped down as Yahoo CEO, clearing the way for Icahn to exert control. Microsoft is renewing interest in a deal with Yahoo, which could potentially create a large player, able to provide stiff competition to Google in internet search and advertising activities.

Porsche seeks greater control of Volkswagen

Chapter links:
- Chapter 1
- Chapter 2
- Chapter 11
- Chapter 14
- Chapter 15
- *CS 1.2*

In September 2008, Porsche increased its stake in Volkswagen (VW) to 35%, and announced its intention to raise it further to more than 50%. However, in the meantime, it had been active in options trading activities. It had acquired options on VW shares, taking its stake to 74.1%. (see section on derivatives, pp 404-5). Porsche's sudden disclosure of this news on Sunday, 26 October, stunned markets and meant that the free float was reduced from 45% to only 5.8%. This had dramatic implications for hedge funds, which have been in the habit of 'shorting' VW shares, a practice by which shares are lent out to the shortseller, who buys them back later at a lower price, making a profit before restoring them to the owner. The shortseller, in effect, bets on the stock market price falling. With free-floating shares so scarce, VW shares quadrupled in value in two days, making VW temporarily the second largest company in the world by market value, hitting a peak of €296 billion on Tuesday, 28 October. This would make it worth more than Wal-Mart or Microsoft. Meanwhile, hedge funds, forced to buy shares to cover their positions from a shrunken pool of free-floating shares, were left licking their wounds.

Two issues have emerged. First, Germany's financial regulator, Bafin, announced it was investigating the huge rise in VW's value, as the workings of Germany's capital markets and corporate governance have come under the spotlight. Porsche was within the law in its derivatives activities: it was not obliged to disclose its positions as they were settled in cash, rather than shares. Porsche had consulted Bafin as it was planning its takeover, and strongly denied allegations of market manipulation. Nonetheless, Porsche has used tactics which many would consider unethical in mounting a takeover by stealth, by using options to get around disclosure requirements.

Secondly, Porsche has been criticized for its options trading activities. Is it a carmaker or a hedge fund in disguise? Porsche makes three times more profits from options trading that it does from making cars. The company made €3.6 billion from trading in VW options in 2006-7, and only €1 billion from making cars. Some politicians in Germany have taken a dim view of hedge funds and private equity groups, calling them 'locusts' (see p. 420). However, it has emerged that other German family-owned businesses have also been active in derivatives trading, with its attendant financial risks. A winner to emerge from the recent movements in VW's share price was the government of Lower Saxony, which saw its stake of 20% rise to a value of €47 billion.

US car manufacturers struggle to survive

Chapter links:
- Chapter 2
- Chapter 3
- Chapter 5
- Chapter 11
- *CF 2.1*

As US banks were breathing a sigh of relief over the $700 billion bail-out package passed by Congress, American carmakers were approaching the brink of collapse. Although rising costs have accounted for many of the woes of Detroit's 'big three' – General Motors (GM), Ford and Chrysler – the companies' senior executives have taken steps to deal with them, for example, in devising new deals with the trade unions. The current crisis seems to more about simply running out of cash. GM announced on 4 November 2008 that it would run out of cash before the end of the year. Ford could last longer, and but the situation is unclear at Chrysler, which is now a private company (80% owned by Cerberus, the private equity group). It is expected that Chrysler is too weak to remain independent. Lack of consumer demand and the closure of the credit markets have left these companies on the brink of disaster. There are few options. One would be to seek protection of Chapter 11 bankruptcy, and another is to seek bail-out funds from the federal government. Both are fraught with difficulties.

The option of Chapter 11 bankruptcy, in theory, would look appropriate. GM and Ford have good long-term prospects when the markets recover. Their businesses are successful in Europe and in emerging markets. Following painful restructuring, their production is efficient, and they are producing more fuel-efficient cars than they have in the past. However, surveys indicate that consumers would be loathe to purchase a new car from a company which has filed for bankruptcy. They were happy to fly with airlines in this situation, but buying a car involves a longer term relationship with the manufacturer, for service, parts and warranties. In addition, worry that used-car values could plummet would weigh with consumers.

Bankruptcy would have huge economic repercussions in the US, hitting component makers, and impacting on the foreign car manufacturers. The ultimate toll in jobs lost could be in the millions. This prospect is helping to persuade politicians that a $50 billion bail-out from federal funds is needed. The bail-out is supported by president-elect Obama, but many in Congress would feel that the TARP legislation was not designed for this purpose. Loans have been proposed for long-term support, in projects such as building fuel-efficient vehicles, but raising support for short-term relief will be more of a challenge for the legislators.

Boeing and Airbus encounter turbulence

Chapter links:

- Chapter 1
- Chapter 2
- Chapter 6
- Chapter 7
- Chapter 9
- *CS 6.1*

Competition to win a lucrative contract to provide in-flight refuelling tankers for the US Air Force has pitted Boeing against a partnership of Northrop Grumman of the US and EADS, the owner of Airbus. In February 2008, Northrop and EADS were awarded the $35 billion contract, to the surprise of some analysts, who doubted that the Pentagon would award such a large contract to a European-US partnership over US company, Boeing. The Northrop-EADS partnership had significant support within the US, however, as the planes would be largely constructed there, mainly in Alabama, which welcomed the result of the bidding contest. The saga of the contract for the refuelling tanker goes back many years. Boeing was awarded the contract in 2002, but political objections to the costs (in which Senator John McCain was vocal), as well as a corruption scandal between Boeing and an Air Force weapons buyer, led to the re-opening of the bidding. Both the Boeing chief financial officer and a leading Air Force weapons buyer pleaded guilty to corruption charges and received prison sentences.

Disappointed at losing out the second time round, Boeing appealed against the decision to award the contract to Northrop-EADS. Its case is being investigated by the General Accountability Office, which has criticized the process by which the contract was awarded. Boeing is hopeful that it will be third-time lucky in winning the contract. However, labour troubles have rather dampened its outlook in recent months.

A strike by machinists halted production at key Boeing factories for much of the autumn. Members of the machinists' union at Boeing, numbering 27,000, have been in dispute with the management, and commenced strike action on 6 September. In addition to pay and conditions, the dispute concerns the company's wish to outsource work to other companies. The union strongly opposes outsourcing of any work which has traditionally been done by machinists. In particular, they object to deals which allow components to be delivered directly to the assembly lines, as many machinists' jobs involve receiving parts for the factory floor. They highlight Boeing's use of a non-union logistics company, New Breed Logistics, which delivers parts to the 787 production line.

This bitter labour dispute has halted production on Boeing's 737, 747, 767, 777 and 787 Dreamliner aircraft. The 787 Dreamliner was already behind schedule, and the strike has dealt a further blow to the company, which saw falls in its income in the third quarter of 2008, when the strike was in its seventh week. The two sides in the dispute had had little contact with each other directly, and attempts to settle it rested on government mediators. A tentative agreement was reached on 28 October 2008. A 15% wage rise over four years was agreed, and Boeing agreed to limit the amount of work given to outside contractors. Nonetheless, executives have stated that the agreement gives them sufficient flexibility to outsource, which they feel is imperative to remain competitive.

EADS is hoping that the tanker contract will lead to further business in the US, giving it added confidence internationally. The company has suffered delays in the development of the A380 super-jumbo jet, aggravated by tension between its dual German and French management structure. It now has a revised corporate governance structure, with a single CEO in place of the French and German co-CEOs.

EDF's takeover of British Energy adds to its international profile

Chapter links:
- Chapter 1
- Chapter 2
- Chapter 3
- Chapter 5
- Chapter 11
- Chapter 13
- *CF 5.2*

French utility giant EDF owns stakes in foreign energy groups in Italy and Germany, but has yearned to make a large acquisition to establish its credentials in growing nuclear energy markets. The sale of British Energy presented an excellent opportunity. The UK government made it clear in its 2006 energy review (see p. 504) that it wanted to invest in nuclear power. British Energy, 35% government owned, owns eight nuclear power stations and several sites for new ones. It approached a number of large European companies in search of a bid. The main ones which came forward were EDF, Centrica (the British utility company which owns British Gas), RWE of Germany and Suez (a French-Belgian group). Although the British government stayed out of the negotiations initially, it soon became clear that its influence was shaping the outcome of the sale.

EDF emerged as the leading contender in July 2008, having bid £12.3 billion for British Energy. The deal seemed to be secure, but objections from British Energy's two largest institutional shareholders led to rejection by the board. The two institutions had backed a Centrica deal and felt EDF's offer price was not enough. EDF was disappointed, but found that their offer was not entirely ruled out. More negotiations followed, and seven weeks later, they secured the deal for a price of £12.5 billion, just 1% above their earlier offer. EDF gained the majority of British Energy's nuclear power stations, and committed itself to investing substantially in building four large new ones.

The key to EDF's successful bid, it became clear, was the UK government's influence behind the scenes. The government was convinced that nuclear power was to play a major role in future energy needs, and EDF was their preferred bidder. Nuclear power has always entailed a huge long-term commitment, in which governments, have a crucial role to play, directly and indirectly. It is possible that EDF is expecting some indirect aid or incentives from the UK government, which would enhance the deal.

Find out more...

- *Financial Times*, Energy: special report, 3 November 2008. www.ft.com/reports/energy-oct2008

Other corporate news in brief

Ranbaxy, the Indian pharmaceutical company

Chapter links:
- Chapter 2
- Chapter 7
- Chapter 12
- *CF 2.2*
- *CS 12.2*

Ranbaxy, India's largest pharmaceutical company, with a reputation as an aggressive generics manufacturer, agreed to be taken over by Daiichi Sankyo of Japan, for $4.6 billion. Though it seemed an improbable match, the rationale for the Japanese company (which is a research-based organization) was to gain access to Ranbaxy's low-cost manufacturing facilities. For Ranbaxy, the move could smooth entry into the Japanese market, which is the world's second-largest pharmaceuticals market, and one which has traditionally been resistant to generic drugs.

Tata Motors of India

Chapter links:
- Chapter 4
- Chapter 5
- Chapter 8
- Chapter 10
- *OV, Chapter 8*

Tata has been compelled to shift proposed production of its Nano 'people's' car away from West Bengal. Even though construction of the factory was nearly complete, violence from local farmers jeopardized the safety of workers. The state of communist-led West Bengal had been keen to acquire the factory, with the prospect of 10,000 jobs, and offered numerous incentives, including a free plot of land, low-cost electricity and tax concessions. However, protests by poor farmers led to violence, and Tata eventually decided to move to Gujarat, which is more industrialized. Here, perhaps paradoxically as the state government is Hindu nationalist, the political climate is more favourable for such projects.

Find out more...

- Leahy, J., 'Journey into conflict', *Financial Times*, 15 September 2008. www.ft.com/cms/s/0/191e6304-8264-11dd-a019-000077b07658.html
- *The Economist,* 'A new home for the Nano', 11 October 2008. www.economist.com/business/displaystory.cfm?story_id=12381021

AP Møller-Maersk, the Danish shipping giant

Chapter links:
- Chapter 2
- Chapter 7
- Chapter 10
- *SX 10.2*

Like other large shipping companies, Maersk has seen falling volumes due to economic downturn. It has changed its strategy in two significant ways.

- First, it has appointed its first CEO from outside the company. The new CEO, Nils Smedegaard Anderson, is former CEO of Carlsberg, the brewer.
- Second, it has announced that it will modify its vertical integration policy, by which the company's line would use its own ships, carry its own containers, dock at its own ports, and even use its own tugs and trucks. APM Terminals will now be looking to bring in more business from third parties, and Maersk's logistics operations will choose the best shipping line and container supplier for each contract, not just those owned by the parent company.

ABC Learning Centres forced to scale back global ambitions

Chapter links:
- Chapter 5
- Chapter 11
- *SX 5.1*

In April 2008, ABC Learning Centres sold most of its US business to a US private equity group. ABC had seen a 42% decline in half-year profits, triggering fears that it would be unable to pay off its debts. Charismatic CEO, Eddy Groves, was confident that the deal would help restore confidence in the business.

Cadbury and Schweppes demerge

Chapter links:
- Chapter 7
- Chapter 11
- *CS 11.2*

The demerger of Cadbury Schweppes took place on 7 May 2008. Cadbury will now focus on confectionary, and Schweppes, now a separate company, will focus on the drinks businesses.