INTERNATIONAL BUSINESS:
Challenges in a Changing World

Janet Morrison

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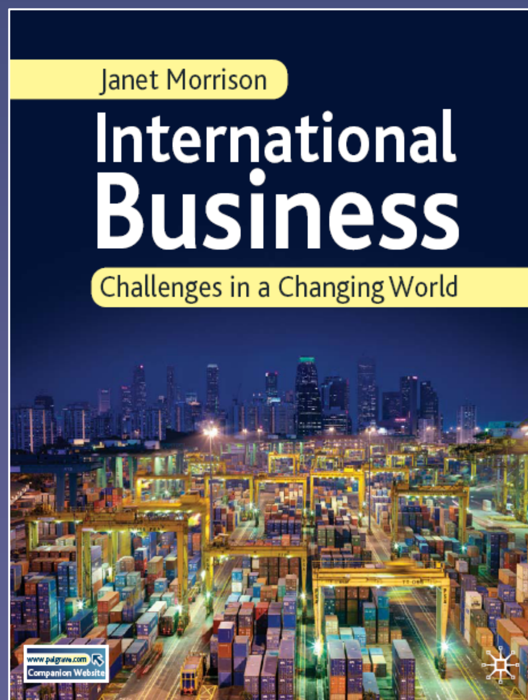

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Introduction

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 These are correct at the time of online publication, but they may go out of date in subsequent months.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.

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

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PART 1

The global economy

Slowing world trade flows and the spectre of protectionism

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International business textbooks (this one included) point out that growing world trade has been an engine of globalization and economic growth, noting that in the post-war period trade flows globally have grown faster than growth in output. Moreover, this period has seen many more countries becoming active in trade, including developing and emerging economies. This steady expansion in trade has now faltered with the global downturn. The WTO estimates that the volume of global merchandise trade in 2009 will be 9% down on 2008. The fall is most dramatic in the developed countries, where exports are falling by 10%, while developing country exports are falling by 2-3%. We look at the causes, impacts and the consequences now unfolding.

The major factor in diminishing trade has been weakening consumer demand, which has led to a downturn in global production. The drying up of funding is a contributory factor, as much trade is financed through credit. Manufacturers of consumer goods, such as electronics and cars, have been hit hard, and, in turn, the countries which rely on exports in these sectors have seen sharp falls in their exports. Germany, China and Japan are among them. Commodity exporters have also suffered, due to falling demand for raw materials and energy. Looking at some of the bleak figures, China's exports in February 2009 fell 25% in comparison with the same month in 2008. The impact on the Chinese economy has been dramatic, with some 20 million migrant workers now jobless. These workers, who had migrated from the rural areas to the coastal manufacturing centres, face the prospect of returning home, their future now uncertain. Japan's exports for January 2009 were 46% down on the previous January. The millions of people employed in Japan's 'non-regular' workforce, without secure employment, are losing their jobs.

Most of the products from these big exporters would normally be destined for American consumers, but they are now suffering from recession and putting spending plans on hold. At first glance, we might think that this is not all bad news, as a resolution of global imbalances could be taking place. America's trade deficit and China's trade surplus have both grown to huge proportions. However, the slump in trade is not having this effect. China's imports in January 2009 fell 43% from the previous year, recording a bigger drop than the fall in exports. Around 50% of China's imports are materials and components of final products which are re-exported. The US trade deficit has improved only slightly: although consumers were not buying as many imported goods, US exports weakened. Economic stimulus policies to boost domestic consumption are now being prioritized by

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governments in major trading countries. However, political leaders are treading a tightrope, aware that boosting consumer demand could result in an upturn in demand for imported goods, which would thwart their policy aim of increasing domestic economic activity. No doubt aware of the pitfalls, the Chinese government is looking to large transport and infrastructure projects to stimulate the economy.

In the US, the Obama administration has put together a wide-ranging stimulus package, attempting to placate the many sectors of business and society weakened by recession: they range from bail-outs for the car industry to relief for people unable to keep up mortgage payments. Controversially but perhaps predictably, a 'Buy American' clause has been inserted. It specifies that only US-made steel, iron and manufactured goods be used in projects funded by federal bail-out funds. This clause was amended at the last minute by a provision to ensure that it did not contravene American free trade agreements such as Nafta. However, in practice, the adherence to free trade commitments is proving to be weak in practice. This is mainly because a large proportion of the federal funds are dispensed to individual states and cities, which are not themselves parties to trade treaties. Their officials have tended to take a strict view of the Buy American clause, ruling out any foreign products in projects which use federal money. The consequences have been dramatic in some cases. Canadian municipalities have begun boycotting US-made products, as Canadian companies have been frozen out of bidding for projects in the US. Perplexed businesspeople in the US, who have built up export sales with Canada, are now seeing their businesses falter. They are arguing that Buy American is actually jeopardizing American jobs, rather than saving them. However, many US legislators are calling for even more Buy American measures, such as a condition that federal money for the bail-out of General Motors (GM) and Chrysler would be conditional on no use of foreign parts, even from US-owned foreign plants.

The G20 developed and emerging economies have voiced support for principles of free trade, reiterated at their April 2009 summit, but in practice, governments are under pressure to aid their domestic economies. In the three months following the November 2008 summit, 17 of the 20 governments had announced a total of 47 measures which restrict trade. Political leaders are very sensitive to protectionist pressures. Protectionist policies come in a variety of different guises, sometimes making it unclear which measures comply with WTO rules and which do not. Raising import tariffs is a classic tool, and is now being used extensively by developing countries. WTO tariff ceilings are generally higher than tariffs actually applied by governments. The gap is bigger for developing than developed countries, leaving scope for raising tariffs without breaking WTO commitments. Subsidies to national industries are also becoming more common. Numerous countries are pumping funds into their motor industries, including Brazil, China, France, Germany, Spain, Sweden and the US. If targeted at ailing industries, these subsidies are also within WTO rules. The policy of discriminatory procurement provisions, such as the Buy American policy, is possibly more problematic. However, its main drawback, as with other protectionist measures, is not the strictly legal one, but, as noted above, the damage which can be unleashed if retaliatory measures are adopted

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by trading partners. Economists remind us of the lessons of the 1930s, when the damage wreaked by protectionism, largely in the form of tariff barriers, prolonged the Great Depression.

For international business, the potential damage of a new wave of protectionism would be huge. In today's systems of global production, supply chains span numerous countries, in contrast to manufacturing in the 1930s, when a whole product was produced in one country. Now, a complex product such as a car is made up of numerous imported components and raw materials, which might cross borders several times. A tariff increase at any stage would have repercussions throughout the entire chain. It is not difficult to see why American carmakers are asking for direct subsidies: import tariffs would add to the costs of imported inputs they use in final products. It is estimated that by March 2009, $48 billion globally had been channelled into the car industry, most of it in the world's rich countries.

This figure is likely to rise, as carmakers still assert they need more. Furthermore, if one industry is in receipt of generous subsidies, how do governments draw the line? Other sectors can make good cases for bail-out funds. In the UK, it has been the banks which have received huge sums in bail-outs, despite the fact that their own poor management of risk was a major factor in their downfall. Manufacturing CEOs can argue that, as their businesses have been better managed, their grounds for government help are more justified, and, moreover, manufacturing jobs should be a policy priority. In France, subsidies to carmakers seemed to be influential in Renault's decision to bring manufacturing jobs back to France from Slovenia.

As world trade declines, the effects of protectionist measures could cause the disintegration of global supply chains, in what is sometimes referred to as 'de-globalization'. Political leaders profess to retain faith in multilateralism, wishing to see a resumption of the stalled Doha round trade talks (although no date was set at the April G20 summit). In the face of growing economic nationalism, perhaps the best source of hope is that government and business leaders learn the lessons of history, that protectionism leads inevitably to retaliation, in a spiral which produces no winners.

Find out more...

- WTO (2009) 'WTO sees 9% global trade decline in 2009 as recession strikes', Press 554, 23 March, at www.wto.org This is a 21-page press release, giving a summary of the WTO's prospects for 2009.
- *The Economist*, 'Too many moving parts', 7 February 2009.
- *The Economist*, 'The nuts and bolts come apart', Briefing on globalisation and trade, 28 March 2009.
- *The Economist*, 'Turning their backs on the world', 21 February 2009.
- Beattie, A., 'Treading a tricky path to recovery', *Financial Times*, 17 March 2009.
- Hufbauer, G., and Schott, J., 'America's free trade promises must be honoured', *Financial Times*, 20 May 2009.

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- *Financial Times*, 'G20 Summit' and 'G20: China and the world', 2 April 2009. These are special reports featuring numerous articles.

Has capitalism failed?

Chapter links:
- Chapter 2
- Chapter 3
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Capitalism, especially in its free-wheeling Anglo-American incarnation, is being targeted for criticism from a variety of quarters at present. Among the critics are academics, NGOs, and political leaders outside the liberal capitalist sphere. Leaders of China and Russia have recently laid the blame for the current global economic crisis on rampaging unregulated markets and unbridled profit-seeking, stemming mainly from America. The strongest concrete evidence supporting these views has been the combination of global financial crisis and recession, which have undermined the faith in markets on which capitalism rests. Not only the credibility of the US as a model market economy is being questioned, but also its continued status as the world's most powerful nation. Is capitalism proving to be fatally flawed, and have the critics got any better ideas?

It is worth reminding ourselves that capitalism has evolved over time and in different countries. The era of extolling the virtues of unfettered markets is itself only some three decades old. In the 1930s, when the US was mired in depression, the US government was influenced by the views of John Maynard Keynes, who believed that governments play a crucial role in managing the national economy, with special responsibility for job creation. Beginning with the Reagan-Thatcher era in the 1980s, the economic orthodoxy shifted to a belief in a minimal role for government. Markets, it was felt, would maintain stability through self-regulation, and liberalization was the best path towards prosperity. The demise of the communist planned economies of the Soviet Union, together with the market reforms in China, seemed to confirm the superiority of the American model and the values which lay behind it. However, the model and also the values are now being questioned.

It is suggested that the liberalization which facilitated globalization contained the seeds of its own destruction (Wolf, 9 March 2009). Global economic growth in the decades since 1980 can be attributed mainly to the spread of markets and financial innovation. However, the boom in markets, as a series of financial crises in the 1990s showed, can turn to bust when lack of confidence sets in. Those crises were mainly confined to regions and countries exposed to global financial flows which their fragile economies could not withstand. The current crisis had its roots in America, which most people assumed was too big and strong to succumb to crisis. However, what we now see as dangerous excesses and risk had been building up for a number of years. They included:

- Excessive build-up of debt by households and firms, facilitated by low interest rates and favourable tax treatment of debt. By 2007, overall debt in the US reached 350% of GDP, up from 160% in 1980.
- Rampant growth in the financial sector, fuelled by debt and the proliferation of

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innovative financial instruments (such as derivatives) largely outside regulatory frameworks

- Ballooning asset values, exacerbated by easy and cheap credit
- Huge current account deficits in the US, mirrored by surpluses elsewhere, especially China; the resulting accumulation of foreign exchange reserves was poured into the purchase of US government debt (the US took in up to 70% of the world's surplus savings).
- Excessive risks by banks and other financial institutions, leaving them perilously close to bankruptcy when investments turned sour
- Rocketing rewards for executives, especially in the financial sector, which they were able to cushion from tax in their home countries through the use of tax haven territories.

The financial system failed spectacularly in late 2008, leading to a worldwide slump in the 'real' economy, which is touching nearly every sector and every country. Governments are now pumping money into their economies, with America's massive stimulus packages for ailing companies leading the way. Critics voice concerns that the bail-outs are simply reviving a system that is essentially broken, financed by even greater debt burdens on the public finances. What is needed, they say, is a new system with greater regulation to prevent future disasters. Would alternative models (discussed in Chapter 3) have avoided the current crisis, and do they offer clues to how to fashion a new economic system? We look to China and Europe for some answers.

The world's largest emerging superpower is an obvious place to start. The economic system in every country is shaped by culture, history, geography and regional factors. Two aspects of China can be highlighted. The Chinese pride themselves on high levels of personal savings and on the strong role of the state, but neither is unequivocally a good thing. The arguments can be summarized as follows:

1. The propensity to save in China, as in other Asian countries, is not simply a matter of cultural frugality, but reflects poor social and welfare provisions in countries where families are seen as the main providers. The Chinese are perhaps ill advised to lecture the Americans on the values of thrift. Without spendthrift Americans buying imported goods, China would not be the manufacturing powerhouse it has become. With exports collapsing, China now needs its own citizens to indulge in more consumer spending, although this is difficult to imagine in a context of rising unemployment. The Japanese propensity to save was a factor in prolonging Japan's decade-long economic slump.
2. Chinese state-owned industries do not have a good record of efficient allocation of capital. Economic development did not take off until market reforms and privatizations became official policy, taking a leaf out of the capitalist book. Now, two-thirds of China's economic growth derives from the private sector, which is allowed roughly to function on market principles

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> (although with state intervention). Market reforms, including the listing of state-owned companies, are the key to China's economic growth, and the state sector, if anything, has had a negative impact. However, it is notable that, as economic downturn deepens, the state seems to be exerting stronger control.

European criticisms of the liberal economic model also point to the role of the state, especially in social justice and welfare policies. Although Europe is home to a number of differing capitalist models, most emphasize the need for tempering markets through regulation, providing social welfare and allowing the state to take a direct role in the economy. President Sarkozy of France and Chancellor Merkel of Germany have been vocal critics of the capitalist excesses outlined above. France can point to some successful companies, either state owned or controlled, which have now become global players (see feature on EDF in the November 2008 update). However, their successes are largely down to market reforms, such as privatizations, listings and acquisition strategies – all taking advantage of liberalized markets. In France, social charges to pay for welfare provisions weigh heavily on businesses, and a continuing concern is the weakness of entrepreneurial activities. Germany and the Scandinavian countries share these concerns. These countries grew strongly in the post-war years when they were catching up with America, but recent years have seen stagnant economic growth, casting doubt on the sustainability of their economic models. Where will the dynamism and innovation come from, to revive recession-hit economies? Finland is home to Nokia, which is just the sort of company that is needed, but the likeliest place to find more Nokias is probably no surprise – it is in the US, where entrepreneurial spirits still run high.

Find out more...

- Pilling, D., and Atkins, R., 'A quest for other ways', *Financial Times*, 16 March 2009.
- Wolf, M., 'Seeds of its own destruction', *Financial Times*, 9 March 2009. This is the first of a series of articles in the 'Future of capitalism' series. An editorial piece on 14 April 2009 summarizes the paper's conclusions from the series. A separate magazine, entitled 'The future of capitalism', was published on 12 May 2009. This contains a selection of key articles in the series which had appeared in the paper.
- Eaglesham, J., 'Another country?', *Financial Times*, 21 April 2009. This article examines the British model.
- *The Economist*, 'Vive la différence!', 9 May 2009. This is a briefing article on the French model.
- *The Economist*, 'So much for capitalism', 7 March 2009.
- *The Economist*, 'Global heroes: A special report on entrepreneurship', 14 March 2009. There are 8 articles in this 18-page report.

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Piracy poses increasing threats to trade

Chapter links:
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Pirates operating from Somalia have become a major threat to shipping, with far-reaching implications for international business. The waters off Somalia are among the world's busiest for shipping, but they have now also become the world's most dangerous. The rising risks are posing challenges for businesses and governments. The issues are complex, including how to deal with the risks and how to resolve the root causes. Dealing with the bandits, both in repelling the attacks themselves and prosecuting those responsible, is being actively considered by governments. Dealing with the causes, which lie in the instabilities of impoverished and conflict-torn Somalia itself, is equally challenging.

The Gulf of Aden off Somalia's northern coast and the Indian Ocean to the east are major trade routes linking the Middle East and Asia with Europe. Twenty thousand ships each year pass through the Gulf of Aden, leading to the Suez canal. As Somalia has descended into anarchy, attacks on shipping by Somalian pirates have grown. Not only as the number of attacks grown, but their range has expanded, now up to 800 miles off the coast. Pirate attacks off Somalia in 2008 numbered 111, a threefold increase on the previous year. Among these attacks were 39 seizures of vessels, usually for ransom money paid by the ship owners or their governments. The figures up to May 2009 were 96 attacks and 18 seizures. The pirates have become increasingly organized and adept at seizing what they see as prize targets. An attack on a Saudi supertanker, the *Sirius Star*, in November 2008, caused shockwaves across the world. The vessel was four times the size of any vessel previously seized, and was carrying over 2 million barrels of Gulf oil to Europe and the US. It was seized 420 nautical miles off the Somali coast, on a route routinely used by crude oil tankers. To mount such an attack, pirates operate from a 'mother' ship laden with arms, from which small boats are launched. Following the payment of a ransom by the ship's owners to free the vessel and her crew, the *Sirius Star* was released over three weeks later. As pirates can demand ransoms of up to $3 million, it is not difficult to see why piracy is thriving in Somalia.

In another high-profile incident in April 2009, the *Maersk Alabama*, a US-registered ship owned by an American subsidiary of the Danish company, AP Moller Maersk, was hijacked by pirates. Its captain was kidnapped and kept for four days floating in a lifeboat. The *Alabama* was carrying aid destined for the Kenyan port of Mombasa. Its owners have called for more international shipping patrols, but patrols alone would not stop the attacks. Twenty foreign warships now patrol off the Somalian coast, but policing 1.1 million square miles of sea would require many more ships. Airbases on land, along with patrol aircraft, would be needed to reach the scene of an attack quickly. It is estimated that it would take 140 warships to police the Gulf of Aden alone. Many ship owners have stopped using the Suez canal, opting for the long route around Africa's Cape of Good Hope. Although this route can add up to 20 days to a round-trip voyage, it has become a viable alternative. Apart from avoiding pirate-infested waters, the appeal of the long route

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has been enhanced by lower oil prices in recent months and the rising costs of the canal route. The steep fees charged by Egypt's Suez Canal Authority to use the canal ($600,000 for a large container ship) and huge rises in insurance costs have been additional factors weighing with ship owners, especially at a time when demand in the shipping industry is weak.

Can legal means effectively control piracy? Domestic criminals are usually deterred by the risk of being caught and prosecuted, with the prospect of a heavy prison sentence for serious crime. For piracy, with is international dimension, the situation is much less clear. Although countries are obliged by international law to fight piracy, and could legally prosecute pirates they catch, many take a narrow interpretation of the relevant law. Portugal's position is that it will prosecute only those who attack a Portuguese ship. This is why Portuguese special forces set free pirates they had caught boarding a Greek tanker, the *Kition*, on 1 May 2009. The EU has in place a policy to send captured pirates to Kenya for prosecution. But many of those captured are being set free, albeit without their weapons. In early June, 2009, a British warship, the *HMS Portland*, captured 10 suspected pirates in small boats in the Gulf of Aden. Their boats were laden with rocket-propelled grenades, machine guns, ammunition, grappling hooks and extra barrels of fuel. Yet the navy commander released the suspected pirates, arguing that it was clear they had intent to commit piracy, but unless they were carrying out an actual attack or on the point of launching one, they could not be arrested.

Most would agree that the problems of Somalia as a failed state lie at the heart of the causes. Reducing piracy in the long term involves restoring a functioning government and institutions. Ongoing conflicts between groups striving for ascendancy in the country have lead to economic deterioration and human suffering on a large scale. Warlords have been vying for supremacy for many years. UN peacekeepers were forced to leave the country in the 1990s. A coalition of Islamic groups contained the warlords in 2006, but some of these groups were perceived as a threat by the US, which backed an invasion of military forces from Ethiopia. These troops have now withdrawn, and a moderate Islamic leader, Sheikh Sharif Sheikh Ahmed, has returned from exile, to lead a new government. He admits he does not control the whole of the territory, and is threatened by groups of Islamic insurgents, despite his own religious affinity with them. He now faces the unenviable tasks of taming these insurgents, as well as the pirates who have flourished in the absence of state institutions. At a UN-sponsored meeting of aid donors in Brussels in April 2009, $213 million was pledged to stabilizing the country, much of the money allocated to an African Union peacekeeping force. The 60 countries represented in Brussels, as well as the UN Secretary General, hope that the new government will have greater success than the many previous attempts to unite the country, motivated both by a need to alleviate the suffering of Somalia's people and also a need to alleviate the threat to world trade from Somali pirates. Their initiatives highlight the role of global governance mechanisms in international business, as well as in co-ordinated efforts to restore peace and stability in this war-torn country.

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Find out more...

- *The Economist*, 'Perils of the sea', 18 April 2009.
- *Financial Times*, Transport & Logistics (special report), 26 May 2009. This report deals with a range of current shipping issues.

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PART 2

Country spotlights

The UK: The government bails out ailing banks, but questions remain

Chapter links:
- Chapter 2
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- *CF 3.1*

As G20 leaders were gathering prior to a meeting in London on 1 April 2009, protesters were also assembling across London, their placards exhibiting a wide range of issues. Wars, poverty and climate change featured, but the global financial crisis – specifically who is to blame - was the most prominent. Crowds gathered at the headquarters of the Bank of England, which many accuse of regulatory failings. Angry protestors also attacked the City of London branch of the Royal Bank of Scotland (RBS). Although most British banks have struggled in the financial crisis, the RBS has attracted particularly hostile publicity. Disquiet focuses on the government's injection of huge sums of public money to rescue the bank, at a time when the executives who were responsible for management failures were awarded generous bonuses and pensions. Here we look at the dramatic downfall of RBS, which highlights the fatal weaknesses of the British banking sector generally. We then assess whether the measures taken by the government are likely to work.

The UK tends to be linked with the US as examples of the capitalist excesses (outlined in the article on capitalism in this update). It has been vulnerable in the global financial crisis because of its huge financial sector. The globalization of finance brought immense prosperity to London as a financial centre, largely due to the attractions of the UK's tradition of light regulation. However, regulatory failings are now seen as contributing to the pattern of risk-taking behaviour in the country's banks, which left them exposed to US sub-prime debt. RBS is a good example, whose global banking and markets division made huge losses in 2008. In recent years, the bank has looked to this division, which was its investment banking operation, to achieve high rates of growth. It became involved in financing private equity buyouts and commercial property deals. The bank's international expansion has focused on acquisitions. However, in 2007, the CEO, Sir Fred Goodwin, launched an ambitious takeover of the Dutch bank, ABN Amro, which was to prove fatal. ABN Amro was thought to be a manageable acquisition, with good potential for profitability, but RBS failed to delve deeply enough into the Dutch bank's finances. Following its success in a bidding battle, RBS discovered that ABN Amro's finances were not as sound as had been thought. A rapid deterioration in markets and the over-ambitious acquisition left RBS in deep financial trouble.

The regulator, the Financial Services Authority (FSA), advised RBS to sell its insurance business to raise capital, and a £12 billion call for more capital went out to shareholders. As it became clear that the ABN Amro acquisition was a mistake, large depositors withdrew funding, leaving RBS in a precarious position. On 10

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October 2008, the FSA announced the injection of £20 billion into RBS, effectively nationalizing the bank, and Sir Fred Goodwin announced his departure.

Public outrage focused particularly on the award of a pension of nearly £700,000 for life (he was 50 at the time). It was unclear whether the size of his pension had been known to government negotiators at the time of the discussions to bail out the bank. Sir Fred Goodwin's home in Scotland had been vandalized the previous week. In just over a year, British banks descended from being lauded at gleaming examples of global finance to being vilified as reckless risk-taking institutions, whose overpaid executives responsible for the mess were still able to claim millions in bonuses and pensions.

The British government devised a complex plan to allow RBS to continue functioning, by providing insurance to underwrite the bank's toxic assets. In return, the company is compelled to lend £25 billion to British consumers and business over the next two years (9 in mortgages and 16 to small businesses and companies). The UK government is now a significant shareholder in major banks: 70% of RBS, 43% of Lloyd's Group (including the failed Halifax Bank of Scotland); and sole owner of Northern Rock and Bradford & Bingley. In theory, the government is in a strong position to impose regulation and control excessive rewards.

The UK government has set up UK Financial Investments (UKFI), an agency which will manage its bank investments. UKFI's brief is to promote the interests of the taxpayer as shareholder, and to take decisions independently of the Treasury. A concern is that the UKFI, following in the British tradition of self-regulation, will acquiesce in allowing the banks to carry on as before, rather than take bold steps to alter strategy. The UKFI has achieved some success in reining in RBS bonuses, recognizing the public clamour for failure not to be rewarded. An early test came at the RBS annual general meeting on 3 April 2009, when private shareholders turned out in large numbers. The company's remuneration report was rejected by a 90% majority, which included the UKFI vote. Adding in the abstentions, the remuneration report was approved by only 8.4% of shareholders, the lowest percentage every recorded. Although the Chairman asked Sir Fred Goodwin to relinquish at least some of his huge pension, which was the focus of much public anger, Sir Fred rejected the request.

Regulatory reforms are being considered by the British government, but a change in culture towards responsibility and accountability is also seen as necessary. It is widely perceived that there needs to be a shift from the aggressive, profit-maximizing culture which rewarded individuals so lavishly, to the more traditional culture of banking, which values prudence in both investments and rewards. The UKFI could take an active role in corporate governance to bring about such changes, but it might well be reluctant to do, in the belief that managers rather than government officials are better placed to make strategic decisions. It is also clear that, as the large banks had grown into global institutions with operations in many countries, international regulation is now rising up the agenda. The actions of national authorities, which have organized bail-outs with public money and are now addressing regulatory reform in their own countries, could lead to banks retreating

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into national markets and create barriers for foreign banks. Recall that the RBS was required to increase lending at home as part of its bail-out package. The FSA met with hostility from foreign banks when it proposed that they should raise the proportion of assets they hold in their London subsidiaries. London's heyday of competitive advantage in financial services based on its light-touch regulation seem over, but a return to national banking would be out of step with the highly integrated global strategies and operations of modern MNEs. International governmental co-operation is needed both to facilitate cross-border financial flows and maintain confidence in the banking sector globally.

Find out more...

- *The Economist*, 'The go-between', 7 March 2009.
- Larsen, P., 'Goodwin's undoing', *Financial Times*, 25 February 2009.
- Larsen, P., 'RBS scheme is verging on state control', *Financial Times*, 27 February 2009.
- Treanor, J., 'Sir Fred Goodwin defies revolt of RBS shareholders', *The Guardian*, 4 April 2009.
- Larsen, P., 'A lot to be straightened out', *Financial Times*, 31 March 2009.

India: Business receives welcome lift in India

Chapter links:

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- Chapter 15
- *CF 2.2*
- *CS 9.2*

Following the convincing re-election of the Congress Party in May 2009, India, the world's second largest emerging economy, is optimistic that it will weather the global economic downturn and boost annual growth to 8%. Recent turbulence in the country has made foreign investors wary. The prospect of an inconclusive election result, giving regional and caste parties power to determine the make-up of a coalition government, looked likely to lead to political instability and a weakening investment climate. The election of a strengthened Congress government, needing the support of only a few smaller parties to govern, offers the prospect of continued economic growth, although with provisos that a fragmented political landscape still prevails, and the country still has much to do to improve social and economic conditions for its society.

Corporate India can point with pride to attaining global status in sectors such as IT outsourcing and pharmaceuticals. However, its prestige was dealt a blow when scandal erupted at Satyam Computing Services, the country's fourth largest outsourcing company. Its Chairman, Ramalinga Raju, confessed in 2008 that he had been operating an elaborate fraud over the past several years, amounting to $1 billion. He admitted to inflating profits and even inventing employees. Following the shock announcement, the immediate worry for India's business community was the apparent failure to spot anything wrong by the company's auditor, PricewaterhouseCoopers (PwC) and the regulators, including stock market authorities in India, the US and the Netherlands, where Satyam is listed. The scandal drew attention to weaknesses within Indian business, including crony capitalism and weak disclosure standards. Many of India's companies, including over half of its

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listed ones, are controlled by families, whose members have links with government. Satyam was a family-controlled company, in contrast to its two larger rivals, Tata Consultancy Services (TCS) and Infosys, which are managed by professionals. Ramalinga Raju was proud of his rags-to-riches story, having risen from a humble background and earned an MBA from Ohio University. Although India's corporate governance is still considered better than that in many emerging markets, the example of Satyam indicates that boards with nominally independent directors are not the safeguard that they seem to be, as selection is controlled by the family. The Indian regulator, the Securities and Exchange Board of India, is taking steps to tighten disclosure rules, but this reform has been in the pipeline for years, suggesting that progress towards transparency and independent boards is slow.

India has made strides in opening its economy to foreign businesses, which are attracted by its huge market and location advantages, such as low-cost labour. However, social and religious tensions are never far beneath the surface (see feature on Tata in the update of 20 November 2008). Furthermore, attacks have sometimes been targeted at foreigners. A co-ordinated set of terrorist attacks in Mumbai, 26-29 November 2008, killed 170 people. The attacks targeted hotels and other venues used by businesspeople, both Indian and foreign. The Indian police and military seemed to be caught unprepared and were criticized for their handling of the incidents. The government has been keen to show that it would now be better prepared. Blame for the attacks was laid on Islamist groups from Pakistan, where growing instability has spilled over into neighbouring countries.

The political scene in India has become more fragmented since the elections of 2004, with the continuing rise of religious, regional and caste parties. It was feared that these disparate parties would gain the upper hand in the 2009 election, reducing the standing of the two major national parties. In the event, the two main parties accounted for 47.3% of the vote. Voter support for Congress itself rose from 26.5% in 2004 to 28.5%. This was not a resounding victory over the smaller parties, but it did give Congress a significant increase in parliamentary seats, from 145 (of a total of 545) in 2004 to 206 in 2009. The Congress Party chose as its campaign song the theme from *Slumdog Millionaire*, the Oscar-winning film about the slums of Mumbai (although many in India consider the British-produced film not to be truly Indian). The party's traditional electoral support comes from India's vast swathe of poor, rural inhabitants. Agriculture accounts for only 20% of GDP, but 60% of the workforce. Although this sector has not seen the levels of prosperity enjoyed by the urban middle classes in service-sector jobs, rural incomes have improved and rural projects have had an impact on reducing India's widespread poverty. A write-off of rural debt for 43 million farmers in 2008 was popular with voters, although it cost the government 1.6% of GDP. Rural Indians are expecting continued improvement in their lives, however, and the new government is aware that it needs to raise economic growth from the current 4% to 8%, to provide jobs for the 14 million people who enter the jobs market each year. The Prime Minister, Manmohan Singh, now assured another term of office, has acknowledged the challenges of meeting voter expectations.

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Foreign investors have reason to be optimistic that continued economic reforms will take place, opening up key sectors of the economy, albeit slowly. In particular, they are hoping for the government to ease the restrictions on foreign ownership in sectors such as telecommunications and retailing. The government will also be expected to rein in India's corruption and reform its creaking bureaucracy, which hamper both domestic and foreign businesses. India can be proud that its 417 million voters in this, the world's largest democracy, have delivered a workable coalition government. India is a pivotal country among emerging markets, and its new government is in a position to take a lead role on global issues such as trade and climate change. However, the domestic social and economic environment still looms large on the political agenda.

Find out more...

- *The Economist*, Special report on India, 13 December 2008. This contains 7 articles on Indian business and society.
- Leahy, J., 'Calamitous confession', *Financial Times*, 14 January 2009.
- *Financial Times*, 30 January 2009, 'India and globalisation'. This is a special report, which contains a number of articles.
- *The Economist*, 23 May 2009, Briefing on India's election.

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PART 3

Companies in the news

World's largest steelmaker faces protracted slump in demand

Chapter links:
- Chapter 1
- Chapter 3
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- Chapter 11
- *CF 5.2*
- *CS 11.1*

ArcelorMittal, the world's largest steelmaker, is facing testing times as global demand for steel falls and prices likewise come down. Mittal built a global network of steel plants through acquisitions, adding capacity as the global economy grew. That growth has now gone into reverse. The World Steel Association, a steel trade body, estimates a fall in global demand of 15% for 2009. The largest falls will be in the US (36%) and the EU (30%). Causes are not hard to find. The global contraction of the car industry and construction industry, both key users of steel, are the main factors. Moreover, these users had amassed huge inventories at the end of 2008, which they are still whittling down. Lakshmi Mittal, ArcelorMittal's chairman, CEO and main shareholder, owning 45% of the company, is keeping a watchful eye on the market. The company recorded a loss of $2.6 billion in the final quarter of 2008, in contrast to a net profit of $2.4 billion in the same quarter in 2007. The company's debt amounts to $26.5 billion, and with falling sales, there is a risk that it would be unable to keep up its interest payments. ArcelorMittal's earnings for 2009 are likely to be around $9 billion before interest, tax, depreciation and other items are taken into account, contrasting with $24.5 billion for 2008. The company's share price fell 75% from June to April, 2009.

Output at many of the company's plants has dropped by 40% or more in the last six months. Tens of thousands of workers have been reduced to short-time working, out of a total workforce of 300,000. Many of the company's steel plants have closed temporarily. Although the company has not as yet permanently closed down or sold a factory, these drastic actions might be considered in future. In June, 2009, the company agreed a deal with the Spanish government, under which up to 40% of the company's 12,000 workforce in Spain could be laid off until at least the end of the year. With the help of funding from Spanish taxpayers, the staff affected could receive 90% of their salaries, even in periods when they are at home because of lack of work.

Bringing down the level of debt has become a priority for the company. It has considered a number of options for reducing debt by about $4 billion by the end of 2009. Dividend payments are being cut by half, saving $1 billion. It could issue more shares in what is termed a 'rights issue', or Mittal could sell a stake in the company to an outside company, such as a Chinese state-owned one. It is thought that the Chinese would be highly interested in such an offer, giving them a stake in a global operation. However, for the time being, he has not taken this radical step, choosing to raise funds in the marketplace. Share and bond issues amounting to $3 billion

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were announced by Aditya Mittal, the son of Lakshmi Mittal and corporate chief financial officer. The issuing of 'convertible' bonds allows the holder to convert them into equity at a later date. Lakshmi Mittal said he would take up a 10% portion of the offer. The issue was popular with the bond markets, being heavily oversubscribed. It has demonstrated confidence in the soundness of the company for the time being. Mittal had expected global demand for steel to resume growing in 2009, but the deal struck with the Spanish government suggests that he now envisages a longer slump. The longer the slump, the more seriously he will be thinking about drastic measures such as permanent closures in his vast steelmaking empire.

Find out more...

- Marsh, P., 'Mittal steels himself for slump', *Financial Times*, 27 April 2009.
- Marsh, P., 'Arcelor seals Spain lay-off deal', *Financial Times*, 4 June 2009.

Online gambling's future is getting brighter

Chapter links:
- Chapter 2
- Chapter 4
- Chapter 5
- Chapter 6
- *CS 5.1*

Online gambling companies have been confident for some time that there is much demand for their services worldwide, but legal uncertainties have cast a shadow over their activities. In many countries, governments have taken a hard line against online gambling, partly responding to moral and religious objections and also seeking to protect established land-based organizations in the sector, both private-sector companies and state-controlled betting organizations such as national lotteries. The online gambling companies tend to be set up on 'offshore' locations, such as Costa Rica and the Caribbean islands, targeting American customers. Some governments have sought to ban their activities, most notably the US, through legislation passed in 2006. However, the companies have remained optimistic that their services, allowing people to bet and enjoy gaming in their homes, will eventually overcome national legal restrictions. They are being encouraged by developments in two areas:

- *Enforcement of international trade rules* - The US lost a legal case mounted by Antigua and Barbuda through the WTO dispute settlement procedure. Now, the European Commission is threatening to take action against the US for restrictions on online gambling which violate WTO trade rules.
- *Liberalization by governments* - The European Commission is warning member states that it will take enforcement action if they continue restrictions. The pressure is beginning to be effective, as France is liberalizing its laws, allowing the industry to operate within a regulatory framework. As for the US, the industry breathed a sigh of relief in February 2009, when the Chairman of the US House of Representatives' financial services committee, Barney Frank, announced the intention to repeal the 2006 ban on online gambling.

The 2006 legislation prohibited the use of credit cards to pay for online bets. Difficulties experienced by the finance companies in enforcing the prohibition in

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practice delayed the law coming into effect until January 2009. In the meantime, the US Department of Justice had been active in arresting and prosecuting executives of the companies under 1961 legislation. The co-founder of PartyGaming was one of the executives prosecuted. Now, with the new administration in Washington, D.C., liberalization is likely to take place, albeit slowly. Lobbying by some casino operators will attempt to halt repeal of the ban, especially as they have seen reduced revenues with the economic downturn. However, other casino operators have now themselves entered the online gambling market, and favour liberalization. The strongest point in favour of liberalization in the US is probably the fact that the ban encroaches on personal freedom, which is a strongly persuasive factor in contemporary America.

The growth of online gambling exemplifies key aspects of globalization. Companies which enter this market see themselves as operating a global business model from the outset, taking advantage of offshore locations to access markets. Despite legal setbacks, they have grown in size, largely by refining and improving their offerings to customers. They now offer a wide range of sports and games, and, thanks to improving technology, can offer these in languages specific to markets – all under the company's global brand. For example, PartyGaming offers a Mission: Impossible game, to European customers. For the companies, their mission to enter more markets as broadband penetration expands now looks anything but impossible.

Find out more...

- Blitz, R., 'A better hand', *Financial Times*, 4 February 2009.

Crisis-hit Citigroup struggles to survive

Chapter links:
- Chapter 4
- Chapter 5
- Chapter 11
- Chapter 15
- *CS 4.1*

Citigroup was formed by the merger of Citibank and Travelers in 1998, creating a global financial conglomerate which offered a supermarket-type range of financial services. Known as the 'universal banking' model, it not only combined commercial and investment banking, but offered other financial products, including credit cards and insurance, all under one umbrella. In theory, it would benefit from economies of scale in IT and access to capital, which would allow it to serve customers efficiently around the world. The universal banking model was thought to be a source of competitive advantage, especially by investment banks, which had been established as stand-alone institutions following the US Glass-Steagall Act of the 1930s, which was repealed in 1999. The reality of the expanded Citigroup, however, proved rather different. The new company retained two sets of executives from the merged companies, making it cumbersome to manage, delaying integration and adding to costs. Cultural differences between the two companies persisted. The bank embarked on an acquisition strategy, but integration of the acquired companies was often slow, and, because of the size and complexity of the parent company, strategic focus and performance goals were unclear.

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The bank's sheer size exposed it to crises and corporate failures, both at home and abroad. It was hard hit by the bursting of the dotcom bubble in 2000, and also by the bankruptcy of Enron in 2001, WorldCom in 2002 and Parmalat of Italy in 2003. In 2004, Japanese regulatory authorities shut down one of its banking businesses for market abuses which had not been put right. In 2005, the US Federal Reserve even barred it temporarily from making further acquisitions, due to its regulatory breaches. The bank began to look to financial markets to generate growth. These were markets in derivative products, in which hedge funds were active. Citigroup also moved into the risky market of subprime mortgages. However, this turned out to be another bubble, which, when the collapse came, left Citigroup again in trouble, only this time, the situation was nearly fatal. The company's indulgence in mortgage-backed securities left its balance sheet burdened by tens of billions of dollars' worth of suspect or 'toxic' assets. The bank's share price fell 78% in 2008.

Citigroup has been forced to ask the US government for help in the form of a series of bail-outs, resulting in government ownership of a stake in the company which could be as high as 36%. The government guaranteed $306 billion of problematic assets and bought $27 billion of shares in the form of preference stock. Preference shares, which are non-voting shares and compel the company to pay a dividend, contrast with ordinary shares, which carry voting rights but no legal guarantee of a dividend. By initially issuing preference shares to the government, the company hoped to avoid the label of nationalization, which would technically occur if the shares are converted into ordinary shares, involving the possibility of government membership of the board. Citi was somewhat bolstered by results of the first quarter of 2009, which showed that it had made a profit, the first in six quarters. However, it became apparent that, after payment of a 9% dividend to the government for its preference shares, the company had actually made a loss.

The US government required the 19 largest US banks to undergo 'stress tests', designed to reveal whether they have sufficient capital to be viable, although the exact criteria were not revealed. The results for Citigroup indicated that the bank needed more equity, projected to be about $50 million. It urgently needed to streamline the sprawling company to raise funds, and wished to raise the money without having to ask the government for more. The CEO, Vikram Pandit, announced the group would be split into two, separating its commercial business from its global banking operations. The restructured group would need to scale back operations and reduce employee numbers, already down to 300,000 from 375,000 in 2007. The investment banking division, where business has sharply diminished, will lose the most jobs. Meanwhile, Citigroup is attempting to sell non-core businesses. It is seeking a buyer for Nikko Cordial, one of its largest acquisitions and Japan's third largest brokerage business. This sale could bring in over $5 billion, but would significantly reduce its operations in Japan, formerly seen as a key market. On the other hand, the bank announced in May 2009 that it would rule out selling investments in China and India.

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Citigroup has been described as 'too big to fail' and 'too big to manage' (Farrell, 2008, listed below). The first of these observations seems to have found support from the US government, which has bought into its equity. However, this still-sprawling bank will need to become slimmer, more efficient and less risk-prone to survive.

Find out more...

- Farrell, G., 'Citi crisis has been brewing for 10 years, say analysts', *Financial Times*, 18 November 2008.
- Larsen, P., and Cox, A., 'Citi revived but its ills are not cured', *Financial Times*, 25 November 2008.
- *The Economist*, 'A supertanker in trouble', 22 November 20008.
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- Guerrera, F., 'Citi scrambles to raise capital', *Financial Times*, 29 April 2009.
- Guerrera, F., and Farrell, G., 'Citigroup and BofA need most capital', *Financial Times*, 7 May 2009.
- *The Economist*, 'A ghoulish prospect', and 'Stress-test mess', 28 February 2009. These articles appear in a briefing report on American banks in this issue.

Lenovo stumbles as the competitive environment gets tougher

Chapter links:

- Chapter 2
- Chapter 4
- Chapter 7
- *CS 2.2*

Lenovo's acquisition of IBM's PC business in 2004 propelled the Chinese company to third place in the global PC market. Little known outside China until then, the company set about rapidly transforming itself into a global organization. The deal with IBM was designed to utilize the advantages of IBM's size, experience and premium brand. IBM's PC head was appointed as Lenovo CEO, and the company's headquarters were shifted to North Carolina in the US. Sceptics questioned whether Lenovo could overcome the challenges, but the company was confident that it could compete globally. However, its sternest test proved to be the rapidly changing market, in which agility and rapid responses to changing demand were to prove essential. In these respects, Lenovo found itself losing ground to more nimble competitors, especially the Taiwanese companies, Acer and Asustek.

Lenovo inherited IBM's rather bureaucratic management style, as well as its focus on premium business customers. These turned out to be disadvantages when the PC market started to change dramatically. Business customers have cut back on spending with the economic downturn, and the growth sector has shifted to low-end consumer products. Asustek quickly built market share with a low-end notebook. Furthermore, the low-cost 'sub-notebook', or 'netbook', has created a new fast-growing segment. Lenovo was caught unprepared for these developments. Its premium Thinkpad brand was in the weakening area of the market, and it was unable to adapt to the changed circumstances. It lost market share in 2008, as Acer became the third ranked PC maker. Lenovo reported net losses of $97 million for the quarter ending December 2008, in contrast to $171.75 million profits for the same quarter the previous year.

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Management changes at the top followed early in 2009. The American CEO was replaced by Yang Yuanquing, a co-founder, who had been CEO from 2001 to 2004. He had been moved to the role of chairman at the time of the takeover. Replacing him as chairman is Liu Chuanzhi, the other co-founder. These changes signal a refocusing on the Chinese market and on cheaper products. The returning CEO stresses that other emerging markets (such as India and Asia-Pacific) will also be important, as these are where the greatest growth is expected. The company will aim to use its expertise in the Chinese domestic market to make strides in these other emerging markets. Staff reductions will be needed, and these will be mainly overseas rather than in China. The company does not envisage itself as returning to its former role as a mainly Chinese company, stressing that it still sees itself as a multinational. It has considered acquisitions as a means of expansion, and has targeted Positivo, Brazil's largest PC company. Such an acquisition would help Lenovo to gain ground on Acer, which acquired Gateway and Packard Bell in 2007. The Brazilian acquisition, however, has not as yet materialized, and the uncertain financial environment has affected acquisition activity generally.

Critics might say that the return of the Chinese CEO to lead Lenovo indicates that the company was not ready for the role of a global PC maker. Yang Yuanquing stresses that 'the IT industry...is changing frequently in terms of technology, pricing and products, and if you want to win, you have to adapt to those changes' (Hille, 12 February, 2009, listed below). The PC unit Lenovo inherited from IBM had not been competitive, and Mr Yang now seeks to build competitive advantage from strengths closer to home.

Find out more...

- Hille, K., 'Back to the future for Lenovo', interview with Yang Yuanqing, *Financial Times*, 12 February 2009.
- Hille, K., 'Left behind in the advance of the nimble', *Financial Times*, 6 February 2009.

Shell rethinks its strategy and structure

Chapter links:
- Chapter 7
- Chapter 11
- Chapter 12
- Chapter 14
- *CS 5.2*

Royal Dutch Shell will be welcoming a new CEO on 1 July, 2009. Peter Voser, who will take over from Jeroen van de Veer, is taking the helm at a particularly troubled moment for the Anglo-Dutch oil company, facing an array of both internal and external pressures. Shareholders are looking for improved performance from the company's investments, downturn, both in the industry and the global economy, has squeezed profits.

The fall in oil prices to less than $33 a barrel, while good news in many industries, has been a cause of concern for the oil industry generally. The price is now on the rise again, but Shell's calculations were based on a figure of $100 a barrel. Shell is looking for future growth to come from its huge, long-term investments, but many of these have been challenging and costly, such as the Canadian oil sands projects and investments in liquefied natural gas production.

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These investments have led to rising debt, putting pressure on cash flows. Shell has also been active in Nigeria, where instability and production losses have mounted. The new CEO, formerly chief financial officer, will be looking to cut costs and assure shareholders of future growth.

Shell has had three divisions: exploration and production, gas and power, and downstream activities (including marketing and chemicals). Perhaps following the lead of BP, which reduced its divisions from three to two, Shell announced in late May 2009 that it was to slim down to two divisions. Cost savings should result, but considerable upheaval is also likely, with the ensuing job cuts. Of the a total of 102,000 employees, 24,000 could lose their jobs, including 30% of senior executives. Such radical restructuring and swingeing job cuts are indicative of Mr Voser's firmer management style, which contrasts with the more consensual style of his predecessor, Mr van der Veer. A slimming-down of the board is also likely. Shell's executive committee consists of eight members, five of whom are members of the board of directors. The number of executive directors could be reduced to four.

Shell executives incurred hostility from shareholders at its annual general meeting in May 2009, when the company's remuneration report was rejected. The board had decided to pay five senior directors €4.2 million in bonuses even though they had failed to reach targets. Mr van der Veer was given €1.35 million from the same discretionary fund, constituting a rise in pay of 58% from the previous year, and bringing his remuneration for 2008 to €10.3 million. More than 59% of Shell's shareholders voted against the pay report, a proportion exceeded only by that at RBS. (see earlier feature on the UK in this update). Although the vote against the pay report is non-binding, it signalled to the company a high level of shareholder disapproval. Normally, institutional investors abstain when they are unhappy about executive pay, but in Shell's case, only 2% of shareholders abstained, in an indication of the general perception that excessive pay is no longer tolerable, especially in the context of weak performance and job losses.

In its operations, Shell has suffered from a range of recent problems. Workforce deaths in 2007 were higher than those in operations run by rival Western oil companies. Shell's death rate was over twice that of BP. Operations in dangerous locations, such as Nigeria and Russia, accounted for a number of these deaths. The company must now look to improving health and safety, and also security. In Nigeria, the government has launched military operations to quell the militant groups who systematically threaten production and disrupt pipelines. Shell's earlier operations in Ogoniland in the Niger delta have now come back into the spotlight as the Nigerian national oil company is hoping to resume production. Shell ceased production there in 1993, when mass protests and repression by security forces led to the company's withdrawal. A leading activist and author, Ken Saro-Wiwa, along with 8 others, were hanged after leading a campaign against the company. Shell has long been accused of complicity in these events, which it has strongly denied, stating that it had urged the government to show clemency. The executions led to legal attempts to sue the Shell in the US. Finally, in May 2009, a trial in New York began, brought by Mr Saro-Wiwa's relatives against Shell, its Nigerian subsidiary and its

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then chief executive for damages. However, before the trial got fully under way, Shell agreed to pay $15.5 million in a settlement with the families. Some of the money would also go to a development trust for the Ogoni people. Admitting no wrongdoing, the company felt that paying the compensation and funding development in the region would be the most constructive way forward. The death of Ken Saro-Wiwa, who became an iconic figure for the Ogonis, led to a rethink among oil companies about their responsibilities in local communities. Shell suffered reputational damage as a result of the events in Ogoniland. The episode is a reminder of the possible legal liability that MNEs face for harms which occur in foreign locations.

Find out more...

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- Burgess, K., and Milne, R., 'Floored boards', *Financial Times*, 2 June 2009.

Other corporate news in brief

B&Q in China

Chapter links:
- Chapter 2
- Chapter 3
- Chapter 7
- *CS 4.2*
- *CF 8.1*

The Kingfisher group of Britain, which has invested heavily in building its B&Q do-it-yourself outlets in China, has now had to radically alter its expectations for growth in the Chinese market. B&Q's expansion in China has rested on a booming housing sector, which had been growing at 40% a year. With economic downturn, housing is now contracting at about 10% a year. As most of the company's market is in the furnishing of new homes, this reversal has come as a huge blow. In addition, the company found that expanding from the middle- and upper-income groups into the lower-income groups was proving more challenging than anticipated, especially in the more diverse urban centres away from the main centres with which it has become familiar. B&Q's CEO now recognizes that over-expansion is partly to blame, reflected in the losses these operations are incurring. The company now plans to reduce shop space by 40% in China over the next two years. Twenty-two of the company's 63 stores in China are due to be closed by the middle of 2010. It will revamp the remaining stores and reduce their size, allowing the firm to rent out the surplus space to other retailers such as Carrefour or Tesco. B&Q aims to keep its presence in China, maintaining operations on this lower-profile level until the Chinese market recovers.

Inditex plots cautious expansion

Chapter links:
- Chapter 8
- Chapter 10
- *CF 10.1 on Spain*

Inditex of Spain has been hailed as having revolutionized supply chain management in the clothing industry. Its success is evident in its thousands of retail outlets under a variety of brands including the most well known one, Zara. The company has

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4,300 stores worldwide, and is Europe's biggest clothing retailer. But how would the market for middle-range, designer-inspired clothing hold up in the midst of severe economic downturn? One would expect sales to dive, as consumers cut back on non-essentials and trade down to lower-cost alternatives. The fact that sales of Primark, a low-cost fashion retailer, have weathered the downturn, are an indication. But Inditex's performance for 2008 was not as gloomy as might have been expected, showing same-store sales to be roughly at the same levels of the previous year. This comes at a time when many of its competitors have seen sharp declines in revenues and profits. Nonetheless, Inditex's CEO realizes that its strategy must be adjusted to take account of the downturn, especially in its home market of Spain. Expansion plans are therefore being revised to reflect the areas where growth is more likely, and to curtail expansion in those where recession has taken a strong grip. About 95% of new store openings in 2009 will be outside Spain, and half of the 100-plus new stores would be in China. In addition to Zara, the Bershka, Massimo Dutti, and Pull and Bear brands would feature. Under a joint venture with Tata, Zara will be rolled out in India. The CEO is taking a realistic perspective on potential growth in these markets, realizing that the next year or so could show little progress, but he feels that long-term potential over 10 years makes these investments sound.

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