“The nature of competitiveness of corporations operating both within the EU and outside of the EU should the Euro collapse?”

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Abstract

This paper evaluates the impact the Euro zone crisis has on strategic decisions corporations today must make, as well as act upon in the future, to survive and profit while operating both in the Euro zone and the wider twenty-eight country European Union (EU). The Euro zone is an economic and monetary union comprised of eighteen member states that have adopted the Euro as their common currency. Monetary policy of the Euro zone is the responsibility of the European Central Bank (ECB). The Euro zone has been, and continues to be, confronted with an uncertain Euro and the question remains whether the banking union recently structured by EU countries will guarantee the survival of the Euro. Should this not occur Multinational corporations (MNCs) and small to medium enterprises (SMEs) will have to reevaluate strategies to enable their corporations to sustain a competitive advantage within the EU. Strategic decisions made now, and in the future, by company executives will be of utmost importance for the survival and future profitability of their companies.

Keywords: Euro zone, competitiveness, Euro collapse, corporate strategies.

Introduction

Rules imposed by the European Union in 2013 restricted capital flows out of Cyprus as a condition for the bailout of Cypriot banks. President of Cyprus Nicos Anastasiades believed his country was already out of the Euro zone since the restriction of the flow of Euros from Cyprus was an indication that the value of currency in his country is different from the value of the Euro in the countries of the other Euro zone members. Does this event trigger the possibility that the Euro zone will eventually break up and the Euro will therefore collapse? Perhaps not. According to Hankel, Hauskrecht and Stuart in their paper, *The Euro-Project at Risk*, "Given the umbrella-like protection the Euro zone has provided its member countries during the recent financial crisis, there are no incentives for a highly indebted member country to opt out of the monetary union."

What happened when the Euro zone was formed was that countries locked themselves into an initial exchange rate, and promised never to change that exchange rate. This was betting that their economies would converge in productivity and the Greeks, for example, would become more like the Germans vis-a-vis productivity (Bedford, 2012). This has not occurred. Europe is now struggling with the inevitable adverse consequences of imposing a single currency on a very heterogeneous collection of countries. (Feldstein, Business Day, December 2, 2011). In fact, the Euro is a currency without a country. (O'Driscoll, WSJ, June 12, 2012). With so many nationalities and cultures there is little possibility there can be a lasting financial or monetary union (Alfonso, Barcelona, October 16, 2013). In the eyes of Euro-skeptics the Euro is so much more than just a coin. It is not only a metaphor for the loss of sovereignty but for German domination (MacDonogh, Herald Tribune, June 26, 2013). A lack of political integration, arguable differences and historical animosities have yet to be resolved and are an impediment to a union like the Euro zone (Roubini, The Business Times, Singapore, May 11, 2013). Economists like Kenneth Rogoff at Harvard are skeptical the Euro can survive the conflict between economically slow growing countries in the south and healthier ones in the north. Technically the Euro is dead, however, it is the flagship of the European Union and there is a political commitment to keep the Euro alive (Alfonso).

1. Present situation of the Euro zone

Events in Greece, Ireland, Italy, Spain and Portugal have placed the Euro in jeopardy (Bedford, 2012). The economic fundamentals of Euro area member countries have not harmonized (Hankel et al., 2010). The political goal of creating a harmonious Europe has failed (Feldstein, Foreign Affairs, January/February, 2012). The Euro zone has engaged in only limited fiscal integration (Bedford, 2012). According to Robert Mundell's *Optimum Currency Area Theory*, "A common currency without fiscal union is inherently unstable." A recent Pew Report indicates that out of eight EU countries surveyed the number of people that favored the EU fell from a median of 60% in 2012 to 45% in 2013. The report commented that, "The effort over the past half century to create a more united Europe is now the principle casualty of the Euro crisis." The report also notes that 78% of the Greek population now believe economic integration has weakened their economy and that 75% of the Italians and 60% of the Spanish have the same feeling (Pew Research, 2013). Table 1 reflects the sentiments of citizens from eight EU countries about their economies. Of particular note, only 1% of the Greeks, 4% of the Spanish and 3% of the Italians feel their economies are good.

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Table 1. National conditions grim economic conditions (%)

	2007 (%)	2013 (%)	Change
Spain	65	4	-61
Britain	69	15	-54
Italy	25	3	-22
Czech Republic	41	20	-21
France	30	9	-21
Poland	36	27	-09
Germany	63	75	+12
Greece	-	1	-

Source: Pew Research Center Q4.
Note: Five of the countries above use the Euro while Britain, Czech Republic and Poland do not.

According to Simon Tilford, "Just the sheer enormity of quitting the Euro has so far militated against a surge of support to leave" (WSJ, May 20, 2013). European leaders will do whatever it takes to keep the Euro in place because the consequences of the Euro's destruction are so catastrophic that no sensible leader could let it happen (The Economist, November 26, 2011). However, large and small companies are preparing for this eventuality. For example, 28 percent of Chief Financial Officers (CFO's) of the UK companies indicate that they have plans to cope with the break-up of the Euro. In an article published in *The Times of Malta* in July, 2012 CFO's in the UK predicted that there was a 36 percent probability one or more countries would leave the Euro by the end of the year 2013. Although that has not yet occurred the probability still appears relevant. Euro enthusiasts say that, "Europe only integrates in the face of a crisis." This does not appear likely to occur given the track record, thus far, of European political leaders. When 17 countries (now 18) decided to adopt the Euro first without a political union they got it backward (O'Driscoll, WSJ, June 12, 2012).

2. Euro uncertainty

Toward the end of 2013 the opportunity to lessen the volatility of the Euro as well as the risk of countries fleeing the Euro was given birth. Finance ministers of EU countries agreed to give the European Central Bank (ECB) regulatory authority over banks, particularly the larger banks, in countries that use the Euro. The ECB will have direct responsibility for banks with assets of more than 30 billion Euros. A major question remains, however, regarding who pays to recapitalize weak banks and clean up the excessive spending by many of the banks. Starting mid 2014 the ECB will begin the job of banking supervisor. Prior to that time the ECB is conducting stress tests of the banks.

For the moment the Euro zone's banking problems have been put to rest by ruling out debt mutualization which, of course, lets debtor countries off the hook. However, creditor countries demand that debts be paid. They are not prepared to fund debt write-offs based on promises by debtor countries they will behave in the future. Therefore, any hope for debt relief now rides on whether the minimalist banking union regime will be sufficient to ward off another crisis for the Euro arising from protests or economic stagnation (Paul Gillespie, The Irish Times, January 16, 2014).

The ability to predict the future of the Euro is uncertain when consideration is given to the Euro zone's economic woes which have resulted, for example, in massive bailouts. Additionally, EU leaders have been slow to embrace far-reaching reforms. The fundamental problems that have driven the Euro crisis for the last four years remain. Jean Pisani-Ferry, currently serving as Commissioner-General for Policy Planning in Paris notes, "Complacency about the Euro crisis is misguided, the fixes adopted so far do not go far enough to ensure lasting stability" (Project Syndicate, December 31, 2013).

3. Competitive strategies

Small and Medium Enterprises (SMEs), in particular, have in the past been reluctant to venture outside the Euro zone but the crisis has sped up their exploration of opportunities in other world markets, specifically emerging economies. It is, therefore, not only the MNC's but also the SME's that are adjusting their strategies and, in some cases, reinventing themselves to become more flexible and explore new markets. They are focusing more on innovation, both of products and processes, as well as technology. Nimo Fernandes, a Professor at IMD Lausanne, believes that if a company generates more than half of its sales outside of Europe, particularly from emerging markets, it is on safer grounds then companies not pursuing the same strategy. According to Jean-Marc Gales, CEO of the European Suppliers Association, "Growth in the next 10 years will come outside of Europe."

The collapse of the Euro would severely hamper access to credit as well as the ability to issue bonds. Companies need to prepare for this eventuality by eliminating non-productive assets and minimizing costs by optimizing operations and maximizing the productivity of scarce resources. A company's success, and survival, is highly dependent on cash whether acquired by cash flow or the ability to secure credit. A strategy already taken by some companies operating within countries that are 'at risk' in the Euro zone has been to reduce the amount of cash they have in the country and move it outside of the Euro zone. In mid January 2014 there was currency anxiety within several emerging countries.

If Euro anxiety was to once again threaten its existence, and eventually cause its collapse in some countries, there would be a significant devaluation of the national currencies of these countries as they exit the Euro. This, in turn, would make imports by companies located in these countries very expensive. Therefore, companies in the Euro zone must remain in close touch with their suppliers, who might be located either in or outside the Euro zone, in order to anticipate what strategic actions they (the suppliers) would take vis-a-vis exports to a country exiting the Euro.

At the very core of the issue for European companies both within and outside the Euro zone is the need for an integrated industrial policy for the region. The European Commission issued a statement on October 28, 2010 indicating that industry must be placed center stage if Europe was to remain a global leader. The message was straight forward, "Europe needs an integrated industrial policy for the globalization era." This communication by the Commission sets out a strategy to boost growth and jobs by supporting a diversified and competitive industrial base offering well paid jobs while, at the same time, becoming more resource efficient. European companies have excellent resources such as well educated workforces, good access to higher education, a strong and mostly reliable public sector and a diversity of people. They need to exploit these resources and invest more time and effort into emerging markets many of which offer excellent opportunities. The Commission also made the case that in an era of intense globalization the concept of national sectors and industries is obsolete. A coordinated European industrial policy is needed. An EU industrial policy needs to emphasize the creation and growth of SME's. The only way to create the critical mass needed for industry to succeed in the Euro zone, as well as the rest of Europe, is through a well structured and effective industrial policy (Bedford, 2012).

According to Nicholas Heymann, an analyst at William Blair and Co., "If you have a lot of exposure in Euro zone economies, you're not doing so well." Mr. Heymann noted several companies experiencing sluggish sales in Europe are exploring new markets and, in some cases, buying companies in areas such as North America where demand for products (such as electrical gear) has been stable (*Wall Street Journal*, May 20, 2013). Other companies recognize the need to become more flexible in order to respond to markets that are constantly changing in EU countries.

EU companies have also been revamping their Business Model recognizing the realities of the Euro zone and the uncertainty of the Euro. To become more efficient they are forming joint ventures (JVs) to take advantage of each others core competencies. Economies of scale result from such JVs which, in turn, help companies trim costs. They are carrying out due diligence on their suppliers and strengthening supply chains upstream and downstream where weaknesses appear. Often they are supplying financial support to a supply chain member impacted by the economic crisis in Europe.

Conclusions

Contingency planning on the part of companies operating both in the Euro zone and the EU is of utmost importance in preparation of a possible collapse of the Euro. A decision mechanism that incorporates Euro break-up risk probabilities would give management a valuable tool to make more informed decisions when faced with greater volatility in the markets. For example, a company needs to evaluate various disruptive scenarios up and down the supply chain and be prepared with alternative action plans should disruptions occur. Such mechanisms would give a company a competitive advantage and the ability to continue being profitable. Corporate operations would also be seriously affected with a break-up of the Euro and having decision mechanisms to evaluate various outcomes both within and outside an organization would allow a company to put in place action plans that would minimize the impact on operations as well as give the company the ability to comply with new laws and regulations.

In today's fiercely competitive business environment a company's strong relationships with its clients and customers gives it a definite advantage over competitors. These relationships most likely are built on a company's ability to meet obligations to clients as well as deliver to customers a quality product or service on time, at a fair price and to then be available to assist when required. Such relationships also give clients the confidence a company has the capability to respond to unexpected changes which, indeed, could be the collapse of the Euro.

To be competitive in the Euro zone, both short and long term, entails having, at a minimum, a Business Model that is robust, flexible and dynamic. It must emphasize: (1) contingency plans that are fluid; (2) the continual building of client and customer relationships; and (3) how currency obligations, such as contracts, would be handled if the Euro should collapse. A Business Model, exhibiting these characteristics, gives a company operating in the Euro zone, a competitive advantage other companies would find difficult to duplicate.

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