

“Developing corporate strategies to successfully conduct business in an uncertain euro zone”

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Developing corporate strategies to successfully conduct business in an uncertain euro zone

Abstract

Growth has been slowed in the euro zone as a result of the debt crisis. During the last quarter of 2011 Italy and the Netherlands fell into a recession and Germany experienced negative growth for the first time since 2009. Spain's growth has diminished to one percent annually. This paper evaluates the risks and opportunities facing corporations conducting business in the euro zone during the next several years and develops business strategies for earning above average returns in this region. The paper acknowledges the uncertainties of needed reform in a few of the euro zone countries and whether the governments of these countries will gain public support for these reforms. Further, it recognizes the importance of issues not yet resolved such as the need by euro one countries to contribute more money to a rescue fund and the additional resources required by the IMF to help stem the debt crisis.

Keywords: euro zone, debt crisis, euro breakup, corporate strategies.

Introduction

The euro zone (EMU) is an economic and monetary union comprised of seventeen member states that have adopted the euro as their common currency. To date (July 25, 2012) no state has left the union and there are no provisions to do so or to be expelled. Monetary policy of the euro zone is the responsibility of the European Central Bank (ECB) and its main responsibility is to keep inflation under control. The euro zone has engaged in limited fiscal integration, however, there is a peer review of each other's national budgets. Euro zone reform is ongoing but is mired in politics.

The purpose of this paper is to evaluate the probability that the euro zone may breakup and introduce possible strategies Multinational Enterprises (MNE's) as well as Small and Medium Enterprises (SME's) located both within and outside the euro zone should consider in order to take advantage of opportunities and earn above average returns.

The study is based on qualitative research relating to the possible demise of the euro, primary research within the euro zone and an examination of strategic actions companies have taken in somewhat similar environments.

Additionally, the following literature was reviewed. Arthuis, Jean "Avenir de la zone euro: l'Integration ou le Chaos" where the author finds fault in the administration of the euro and that the euro is not enough to guarantee growth and strategic competitiveness.

Buchanan, Pat "The Death of the West" where the author discusses the deliberate and systematic demolition of cultural values and family system in Europe.

1. The euro zone

Apparently successful and certainly hailed over the last decade the euro zone now faces the possibility of ceasing to exist. Recent events in Greece, Ireland, Italy and now Spain have placed the future of the euro in jeopardy. During a recent meeting of the European Parliament in Strasbourg the honorable member from the UK, Mr. Nigel Farage, shouted "the Euro breakup is inevitable, it is just a question of how...Euro is doomed" (Farage, 2012). In an article that has recently appeared in the *Independent* it is noted that it is not the financial markets that are going to break the euro zone but it is the politics. It further noted that there is a rising sense of resentment of inequalities in many of the euro zone countries. World Bank economists, Indermit Gill and Martin Raiser, have concluded that Europe's growth model of the last five decades is threatened. The immense debts of the continent are the result of, "public spending to protect societies from the rougher facets of private enterprise." They call Europe a "lifestyle superpower." It attracts tourists by the thousands and Europeans enjoy peace and a good standard of living. But it's not getting any richer. It needs to put income growth ahead of income security and unless it does it will continue to decline as an economic power (Gil and Raiser, 2012). Economists like Kenneth Rogoff at Harvard University are skeptical the euro can survive the conflict between economically slow growing countries in the south and healthier ones in the north. David Cameron, Britain's Prime Minister, has suggested that he could imagine the single currency breaking up. In an interview with the BBC Cameron responded, "What is happening in the euro zone is a massive tension between the single currency that (member) countries are finding very difficult to adapt to" (Cameron, 2012). Mr. Cameron has been known to bash the euro because of its lack of competitiveness.

In May 2012 currency traders indicated that the support level for the euro is US\$1.2974. Richard Ross, head of global technical strategy at New York brokerage Auerbach Grayson, believes that if the US\$1.2974 is breached there is a good chance the euro could go into a tailspin (Ross, 2012). On July 25, 2012 the euro had dropped to US\$1.2146.

On April 20, 2012 finance officials from many of the world's richest countries agreed to boost their financial commitments to the International Monetary Fund (IMF) in order to protect the global economy as the European crisis threatened recovery for the third year. The IMF announced pledges by many of its members to double its lending capacity by more than US\$700 billion creating what was called a "global firewall" directed at containing the euro zone debt crisis. Prior to this, members of the Group of 20 leading economies had been pressing for an increase in the euro zone's commitment to lend to troubled countries. Combining the 440 billion euro European Financial Stability Facility (EFSF), a temporary fund, into its successor, the European Stability Mechanism (ESM) would give the euro zone a bailout capacity of 940 billion euros.

The two funds, IMF's US\$700 billion and ESM's 940 billion euros appear to be sufficient enough to stabilize the single currency by assuring that governments will not default on their debts. However, political constraints may negate this. Also, if Spain and Italy together asked to be rescued the funds would probably not be sufficient. How will the funds be dispersed, if needed? For example, if Spain were to request funds from the ESM other European governments would have to agree to releasing such funds. This procedure revealed a lack of unity by governments within Europe when Greece previously requested funds. Securing funds from the IMF would be equally challenging. Such a request would require a vote of IMF's board which represents its 188 members (shareholders). Many of these shareholders, which include some of the largest contributors, are strongly against contributing more money to the euro zone after already handing out large sums to Greece, Ireland and Portugal. Of additional concern is the probability that governments that receive "bailout" funds will not undertake the reforms necessary to compete in the global economy.

IMF and government officials agree that the pledges of added funds will not necessarily end the crisis. Troubled governments need to make the tough decisions to rein in their budgets and overhaul their economies. However, there are now movements across the European Union to move 180 degrees away from austerity reforms to sustainable economic growth and jobs. George Soros, the billionaire

investor argues that the German prescription (of austerity) to heal the debt crisis may do more harm than good. He has publicly stated that by imposing an orthodox austerity policy Germany risks creating a deflationary spiral that could lead to a lost decade in Europe.

The global edition of The New York Times reported on June 5, 2012 that, "the sense of panic and doubts about the euro zone's future are even higher now than they were last autumn...the euro zone's unemployment is at a record of 11 percent, and Spain is trying to figure out how to pay for a bailout of its troubled banks." In the past the ECB (European Central Bank) has come to the rescue since its mission is to preserve the euro zone. However, this time ECB officials believe euro zone politicians need to toughen their stance that governments further cut spending. The questions at this time of writing are: Will the euro deteriorate further thus threatening the euro zone and will Greece remain in the euro zone? With an economy in free fall and 22 percent unemployment there is the probability that Greece will drop the euro and perhaps default on its debts. This could be the beginning of other countries such as Spain, Portugal and Ireland also disengaging themselves from the euro and the dismemberment of the common currency into as many as seventeen different parts.

The Greek election on June 17th eased concerns about the survival of the euro in the immediate future when the Greek party, New Democracy, placed first in the election. This party is pro-European and wants to renegotiate Greece's loan with creditors and stay in the euro. However, inspectors from the EU, European Central Bank and International Monetary Fund are presently deciding (July 24, 2012) whether to keep it (Greece) hooked up to a 130 billion euro lifeline or let it go bust (Toyer and Baker, 2012). Three EU officials have said they were likely to conclude Athens couldn't repay what it owes. Attention is also now on Spain. The country deepened the euro zone's crisis on July 20, 2012 despite winning the backing of finance ministers from the euro's major economies for a hundred billion euro bank rescue fund. There are concerns that Madrid is running out of options to bring down the debts of both its banks and bankrupt regions and this sent the country's borrowing costs to an unprecedented high rate of 7.2 percent, a rate seen as unsustainable (Inman and Tremlett, 2012). Italy also is likely to require a bailout of sorts, and presently there does not appear to be enough money in the coffers of the three troikas (IMF, ECB, EU) to underwrite Italian sovereign debt. The answer then, for the survival of the euro, is fiscal union to achieve monetary union

in the euro zone. That is, the national central banks – including Germany's Bundesbank and the Bank of France – should become subsidiaries of the ECB like the 12 Federal Reserve Banks in the United States. A banking union would, in effect, insulate countries from their troubled banks and vice versa. The union would require a regulatory agency for the banks that would have the absolute power to regulate. However, such a union will not be possible without a tighter political union of the euro zone countries. Additionally, to bolster ailing banks in southern Europe, the ECB needs to insure deposits. The deposit guarantee fund would be part of the banking union. All banks in the euro zone need to be under regulators who would have the authority to shut down failing banks. When the banks offer credit they should accept only marketable securities as collateral. This has not always been the case because the criteria for the collateral put up in exchange for central bank loans was relaxed in Spain and Italy and was almost completely discarded in Greece, Portugal and Ireland (Tornell and Westermann, 2012). If this would occur then banks throughout the euro zone would need to be subject to "stress tests" and those not meeting the necessary benchmarks would have to be cleaned up. What happens to the outstanding government debt? Euro-enthusiasts will say that, "Europe only integrates in the face of crisis" (Johnson, 2012). And that is not likely to occur in the near term given the track record, thus far, of European political leaders. The euro will continue to be under pressure until monetary union occurs, if it occurs.

A growing number of policy makers within the troika as well as the Bank for International Settlements (BIS) are pressing euro zone leaders to lay the groundwork quickly for a banking union to end the problems of overly indebted governments and poorly capitalized banks. Discussions have occurred amongst leaders to pool euro zone debt, however, Germany most likely would not agree to such a move until a fiscal union has been constructed that would allow euro zone countries to veto excessive spending.

At an all-night summit meeting on June 30, 2012 European leaders made a breakthrough toward more central control over their banking system. They also granted their bailout funds more flexibility in rescuing Spain and potentially Italy. For example, bailout funds could be used to loan directly to Spanish banks which, in turn, could then buy government bonds thus not increasing sovereign debt and push borrowing costs higher (Italy and Spain's interest rates have periodically reached levels that are considered unsustainable). Germany also won an agree-

ment, at the meeting, of a single banking supervisory agency with the ECB playing a central role similar to the US Federal Reserve. However, the meeting was unable to deal with some of the fundamental problems of the euro zone such as a deposit guarantee or a bank resolution authority with respect to a banking union.

Optimism grew out of this summit meeting but many economists were not convinced saying that problems confronting the euro zone are too great to overcome. Charles Dumas, Chairman of Lombard Street Research, a London consulting firm, indicated there was a seventy-five percent probability that the euro zone would fail (Dumas, 2012).

David Marquand, author and former official at the European Commission, states it well by saying, "No iron law decrees that a democratic federal union based unequivocally on the principle of popular sovereignty and designed to foster civic engagement on all levels of government is beyond the bounds of possibility. The obstacles, however, are timidity, lack of imagination and small minded nationalism" (Marquand, 2011).

2. The business equation

Business leaders are clear about the fact that they desperately desire to save the euro zone. Businesses of all nationalities will not want to leave their money in euros in a bank that resides in a country perceived to be at risk of leaving the euro. This risk has motivated companies such as Vodafone and GlaxoSmithKline to move surplus cash out of euros and out of the euro zone on a daily basis. It is the fiduciary obligation of companies to their owners (shareholders) to not allow their liquid assets become devalued by letting them reside in countries such as Italy and Spain.

3. Corporate opportunities and resulting strategies

Corporate opportunities and resulting strategies in an uncertain euro zone: SME's, 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, are reinventing themselves to become more flexible and explore new markets. In order to compete more favorably in world markets many of these companies are forming joint ventures to take advantage of their partner's core competencies to become more efficient and trim costs. For example, they are strengthening their supply chains and sharing research and development capabilities. Companies must carefully analyze what

parts of their organization constitute their core competencies and let other business organizations take care of producing parts or supplying services that are not their core competencies. According to Shay Scott, Director of the University of Tennessee's Global Supply Chain Forum that was held in Paris on June 2012 – the current challenging European economy requires that supply chain organizations deliver increasing levels of value to their customers and organizations. Mark Gregory, a London partner at Ernst and Young, recognizes how vulnerable supply chains are when there is a crisis and indicates that some European companies are thinking about whether they would provide financing to a supplier who could not produce a part for lack of bank credit (Scott, 2012).

The European crisis opens opportunities for Foreign Direct Investment (FDI) by companies outside of the euro zone. There are European companies that are running short of cash and need assistance in their quest to explore new markets. Helping to internationalize these companies would be a strategic move that would benefit corporations both within and outside the euro zone and would be “pro-globalization.” For example, Chinese FDI into Europe during the first three months of this year (2012) was US\$21.4 billion mainly in the resource sector. However, major targets for Chinese companies outside the resource sector were companies in Europe with commercial considerations (Gough, 2012). The Chinese are recognizing the necessity to focus on improving quality and cutting costs in the European market and by doing so there is evidence that some are experiencing growth in this market.

A study by Accenture, the American consulting firm, highlights a gap between the skills of European workers and the needs of European companies. The study also points out that there is a shortage of skilled labor despite a persistently high unemployment rate in Europe. The European Commission, in a presentation on April 18, 2012, noted that twenty-four million Europeans are unemployed yet four million job vacancies remain unfilled. At a conference organized by the European Employers' Federation “Business Europe” and the Belgian Employers' Federation (FEB) held on April 26, 2012 in Brussels, participants called for greater involvement of economic decision makers in the management of universities. Students need to be guided in their choice of training and informed about career opportunities. Representatives of major industrial sectors attending the conference noted that young people were adverse to risk taking and urged political leaders to promote entrepreneurship.

Daiichi-Sankyo UK Ltd., a company selling pharmaceutical related products, considers Europe to be

a growth market and intends to carry out a growth strategy in Europe that is forecast to increase net sales to 1.1 billion euros by the end of fiscal year 2012. Presently growth rates in the pharmaceutical industry are low. The company's mission is “to create and supply innovative pharmaceutical products to address diversified, unmet medical needs.” The company's vision is to “grow faster than the market.” It maintains a lean but effective management structure. The company has strengthened its position as an important pharmaceutical enterprise in Europe by investing in internal resources and extending its field-force capabilities. It has also forged licensing agreements with other pharmaceutical companies in Europe.

At the very core of the issue for companies within the euro zone as well as European companies outside of 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.” The 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. 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. European industry, in a coordinated effort, needs to analyze the value chain (for strengths as well as weaknesses) and evaluate ways to minimize costs and maximize efficiencies. 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.

Conclusion

Private companies within most countries of the euro zone need to become more efficient, more productive and compete more effectively against imports. The economies of countries within the euro zone need to converge in productivity. 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. This has not occurred (Johnson, 2012). The money that many of the governments borrowed was

not put into infrastructure and training, but rather was spent in a way that would keep them popular and helped them win elections. The present emphasis by countries within the euro zone needs to be on “growth” rather than on the fiscal discipline which equated to austerity measures. There has been talk amongst euro zone leaders of the creation of “project bonds” within the euro zone that would provide credit to private companies for infrastructure projects that would, in turn, create jobs. Although this has not yet occurred, Italian Prime Minister Monti recently announced that various incentives would be offered to construction companies to participate in infrastructure projects and for companies to hire highly educated workers to counteract the “brain drain” currently underway in that country.

European companies have excellent resources such as a well educated workforce, 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 which presently offer excellent opportunities such as Turkey. They might consider developing new versions of existing products that are cheaper and may contain do-it-yourself components. Productivity (most likely by means of automation) and energy usage must be made more effective to lower costs. And during this period of a crisis they need to make an extra effort at building even stronger relationships with customers, suppliers and other stakeholders.

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