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THE OLYMPICS & INNOVATION

036

How companies use the Games to develop new products & ideas

PLUS

McCAIN VS. OBAMA 050

Why their economic plans don't add up

BusinessWeek

ECONOMIC PROMISES VS. REALITY

John McCain and Barack Obama each have ambitious economic programs. But the weak economy and ballooning deficit will cut the next President's ability to maneuver. |BW|

PAGE 050

COVER ILLUSTRATION BY CHANG PARK; (ABOVE LEFT TO RIGHT) JEFF CHIU/AP PHOTO; JERRY WOLFORD/POLARIS

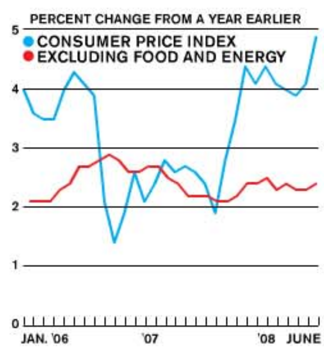
002 THE BUSINESS WEEK

EDITED BY HARRY MAURER & CRISTINA LINDBLAD

THE FED STANDS PAT, WALL STREET CHEERS

Ben Bernanke and his band still fear inflation, but they sounded a bit more dovish on Aug. 5 as they left the benchmark rate at 2%. The carefully worded statement said "labor markets have softened further and financial markets remain under considerable stress." No argument there: On Aug. 1 the **Labor Dept.** said the country lost 51,000 jobs in July as unemployment rose to a four-year high of 5.7%. A day earlier, the **Commerce Dept.** estimated the economy grew at an annual rate of just 1.9% in the second quarter. On the happier side, a plunge in oil prices, which by Aug. 6 had sunk more than 18% from their peak in July, soothed the Fed and wowed investors, who pushed up the Dow 331 points on Aug. 5.

INFLATION TWO WAYS



Data: Commerce Dept.

CHEAPER COMMODITIES

Oil isn't the only item tumbling from extreme heights. As of Aug. 6, corn was off 33% from its 2008 high, orange juice 33%, soybeans 26%, platinum 30%, and nickel 47%. The slide gathered speed on Aug. 5 and helped fuel Wall Street's celebration. Look out, though: One factor behind the commodity crush is slowing economic growth around the globe and the prospect of more weakness to come.

| BW | **Page 026, "Commodities Are Down...Hooray?"**

MASSIVE IDENTITY THEFT

It was a simple and wildly successful ploy—until the baddies got caught, that is. On Aug. 5 federal authorities said they'd busted an international ring responsible for hacking into retailers' computer systems and absconding with 40 million credit- and debit-card numbers. The feds said ring members sat in cars outside shopping centers and, with laptops, cracked into the systems of stores using unsecured wireless networks. They then sold the numbers on the black market or used them to withdraw large sums from ATMs. Among the targets: **Barnes & Noble, BJ's Wholesale Club, OfficeMax,** and **TJX,** not to mention their customers. The crooks' take, according to the government: tens of millions of dollars. A lawyer for one of the men arrested said he's planning to fight the charges.

Looking for work in New York City: The jobless rate jumped to 5.7% in July

ICAHN RESISTS...

Activist investor Carl Icahn popped up all over the news this week, a testament to the breadth of his activities. First, he's balking at **Bristol-Myers Squibb's** July 31 offer to pay $4.5 billion for the 83% of ImClone Systems it doesn't already own. Icahn, ImClone's chairman, says the July 31 offer short-changes the biotech, which makes the cancer drug Erbitux and became famous a few years back for the insider-trading scandal that sent both **Martha Stewart** and former **CEO Sam Waksal** to jail. The bid, worth $60 a share, shot adrenaline into ImClone stock, which leaped 40%, to $64. Despite Icahn's disdain, the deal is far from dead:

Icahn is resisting Bristol-Myers' $4.5 billion bid to gain control of ImClone

CHIP EAST/BLOOMBERG NEWS; CHART BY RAY VELLA/BW

ImClone's board appointed a special committee to look into it further.

"Bristol-Myers Squibb's Big Bet on ImClone" businessweek.com/magazine

...AND TAKES HIS LUMPS

Funny, this is one investment Icahn has omitted on his new I'm-the-shareholder-champion blog, *The Icahn Report*. Florida homebuilder **WCI Communities**—in which Icahn took a big stake in early 2007 before becoming chairman the following September—filed for Chapter 11 bankruptcy on Aug. 4. The builder blamed its woes on the housing bust and credit crunch, which left the company unable to refinance its lofty $1.8 billion debt load. Icahn lost roughly $110 million, and other shareholders some $620 million during the same period.

RECOUNT AT YAHOO

Yahoo!'s critics have long complained that **Jerry Yang** counted out **Microsoft's** offer too soon. Now they say the firm it hired to tabulate shareholder votes simply can't count. On Aug. 5, **Broadridge Financial Solutions,** the company that tallied votes in favor of Yang & Co.'s reelection to the board, said it made a mistake. Instead

(TOP) SPENCER PLATT/GETTY IMAGES

004 NEWS YOU NEED TO KNOW

of 85.4% approving Yang's reelection, fewer than two-thirds backed him—a steep protest by corporate standards. The recount was requested by Yahoo's largest shareholder, **Capital Research Global Investors,** on the belief that its decision to withhold votes in favor of Yang was not reflected in the initial results.

NO, YOU CAN'T BORROW

That nice home equity line of credit you've got? Forget about it. So said **Morgan Stanley,** the No.2 U.S. securities firm, to thousands of its clients recently, according to a person familiar with the situation. The clients, most of them occupying houses whose value had tumbled, won't be able to tap their credit lines, and the firm plans to review such lines monthly from now on. A spokesman confirmed that "a segment of clients was recently notified of a change in the status" of their line of credit.

Bloomberg

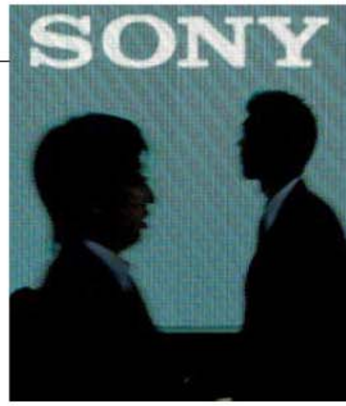
PENSIONS, PLEASE

Wall Street banks, reeling from the subprime mess they had a big hand in creating, are eyeing a new money-making venture: taking on troubled pension plans from companies that want to unload them. For nearly a year, a group of banks, insurers, private equity firms, and other players have lobbied regulators about the idea, which is being called pension buyouts on the Street. Those lobbying efforts are starting to pay off. The **Treasury Dept.** on Aug. 6 issued a series of legislative guidelines that would permit pension buyouts under certain circumstances. The edict from Treasury now pushes the matter to Capitol Hill, where, not surprisingly, many elected officials are skeptical of letting Wall Street lay its hands on any more of retirees' nest eggs.

| BW | Page 020, "Wall Street Eyes the Pension Pot"

UNWINDING SONY BMG

Figuring that a rush of digital initiatives can overcome perpetually withering CD sales, **Sony** paid $900 million to buy the half of music company Sony BMG it doesn't own. Sony got it for a song, paying on the low end to **Bertelsmann,** which wants to beat a retreat from the music biz. The joint venture dates from 2004. Sony forked over $600 million in cash plus $300 million, half the money on the music company's balance sheet. For that, it gets a roster that includes **Bruce Springsteen, Justin Timberlake,** and **Alicia Keys.**



In Tokyo: Sony will pay Bertelsmann $900 million for its half of Sony BMG

"Sony Buys the Rest of Ailing Sony BMG" businessweek.com/magazine

MOTOROLA REACHES OUT

The star-crossed mobile-phone maker is betting big that an industry veteran can change its luck. On Aug. 4, **Motorola** lured former **Qualcomm COO Sanjay Jha** to be co-chief executive and leader of the handset biz. Jha received a fat pay package, including $3.6 million in salary and bonus this year and a boatload of stock options, to bring his vast experience to Motorola. He'll focus on executing a spinoff of the phone division by next summer and spiffing up a stale product portfolio.

"Motorola: The New CEO's Real Challenge" businessweek.com/magazine

Jha in a Qualcomm testing lab: Can he boost Motorola?

NEW WOES AT CITI

Citigroup suffered more dents to its reputational armor. **David Markowitz,** head of New York State's **Investor Protection Bureau,** accused the bank on July 31 of destroying records subpoenaed by **New York Attorney General Andrew Cuomo,** who plans to sue the bank for its role in the collapsed auction-rate securities market. Citi said it recycled tapes related to the securities by accident and that most could be recovered. Citi is also shuttering a $400 million convertible arbitrage hedge fund, more evidence of its failure to reach the lofty goal of building a $20 billion alternative assets group, **Tribeca Global Investments.** Meanwhile, another

29.1%

Percent of parents who say they will spend less this year on back-to-school purchases.

Data: America's Research Group

(TOP TO BOTTOM) KATSUMI KASAHARA/AP PHOTO; LENNY IGNELZI/AP PHOTO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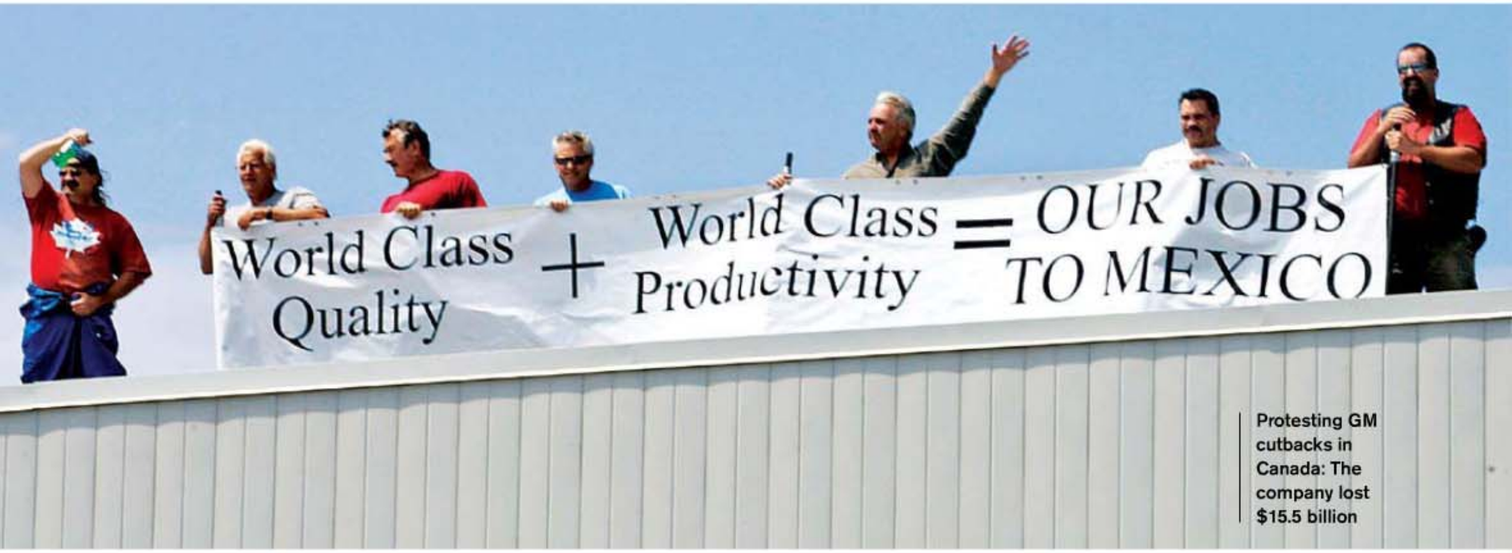
006 NEWS YOU NEED TO KNOW



Protesting GM cutbacks in Canada: The company lost $15.5 billion

giant is hurting: Insurer **American International Group** lost $5.4 billion in the second quarter.

FREDDIE: MORE RED INK

Freddie Mac CEO Richard Syron had cheery news for investors on Aug 6: The government-sponsored enterprise continues to fulfill its mission to provide financing to American homebuyers. After that, however, the negatives predominated. The company announced a net loss of $821 million, three times the expected amount and the fourth straight quarter of red ink. Freddie also doubled reserves to cover its growing number of mortgage losses and cut its common stock dividend from 25¢ to at least 5¢—or even lower. Alarmed investors sent shares cascading 19%, as the announcement renewed questions about Freddie's solvency and threatened to force it to turn to federal largesse to prop it up.

A DARK DAY FOR GM

If **General Motors** is any indication, the U.S. auto industry will be in a ditch for a while. GM on Aug. 1 reported a $15.5 billion second-quarter loss, its third-largest ever. Even disregarding special items and restructuring charges, the company bled $6.3 billion. **GMAC,** the finance company 49% owned by GM, lost $2.5 billion because of its troubled mortgage business and SUVs coming off lease with lower-than-expected values. But here's the scariest number: GM's revenue dropped almost $10 billion, to $19.8 billion for the quarter.

"GM Staggers Under Losses" businessweek.com/magazine

GO EAST, YOUNG EUROPEAN

When a flock of Eastern European nations joined the EU in 2004, millions of residents of those nations promptly decamped for the more promising economic climes to the west. Now it appears many are packing up and heading home. A recent study by a British think tank discovered that some 50% of migrants to Britain from new member states of the EU have returned to their native lands. What's drawing them back? In a word, jobs. The Eastern European economies are growing, while Britain's is not.

Institute for Public Policy Research

MERGER TALK IN JAPAN

Would growing even larger help two Japanese finance giants weather an economic slowdown? Executives at **Orix**, the country's largest leasing company, and **Credit Saison,** a credit-card firm, seem to think so. The daily *Nikkei* said on Aug. 5 that the two are in talks to create Japan's largest financing group outside the banking sector, with $106 billion in assets. A merger would boost both sides, but they must first persuade Credit Saison's largest investor, **Mizuho Financial Group,** to sell its 12% stake. The deal could set off a new bout of consolidation in Japan's consumer finance industry, which has struggled since recent Japanese Supreme Court rulings capped rates on consumer loans at 20% and forced companies to repay some borrowers.

THAILAND GOES VROOM!

The world's 14th-ranking auto manufacturer, Thailand, has long dreamed of becoming the Detroit of Asia. And auto investment there has picked up this year thanks to new tax incentives, reports the August edition of *BusinessWeek Thailand*. Indian giant **Tata Motors** plowed $39 million into a pickup truck assembly plant, while **Toyota** sank $162 million into a diesel engine facility. Still, experts say the industry has a long way to motor before arriving at global player status—not to mention the competition it faces from China and India..

J.P. MOCZULSKI/THE CANADIAN PRESS/AP PHOTO

THAT SINKING FEELING

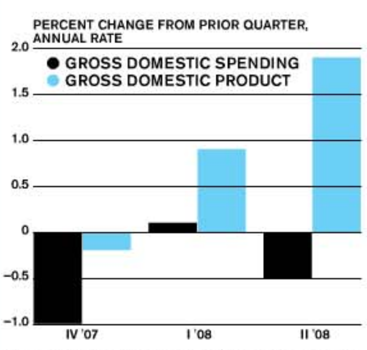
Brisk foreign trade has been propping up the U.S. economy. But as that growth slows, the pain of the downturn at home will become only more acute

By now, the definition of a recession, as stated by the experts at the National Bureau of Economic Research (NBER), has become hardwired into the minds of the business press. Repeat after me: "a significant decline in economic activity spread across the economy, lasting more than a few months." So based on the Commerce Dept.'s revised numbers on real gross domestic product, what the U.S. has so far is an insignificant decline in activity, concentrated in housing and autos and lasting only three months. But if it's not a recession, at least not yet, why does it look and feel like one?

For starters, the NBER, which concentrates on the big picture, says real GDP is the single best measure of overall activity. However, in order to see what's happening right now, you have to look separately at domestic U.S. performance, setting aside the enormous contribution to growth from net foreign trade—exports minus imports. The GDP numbers say the economy contracted 0.2% in the fourth quarter, but expansion resumed in the first and second quarters, with growth of 0.9% and 1.9%, respectively. Plus, the pace outside of homebuilding and auto output—only about 6% of real GDP—has been a sturdy 2.7%.

But look at the domestic economy, which is a lot sicker than the top-line GDP number implies. Over the past three quarters, while real GDP growth has averaged 0.9%, gross domestic spending, which is GDP excluding net foreign trade, has shrunk 0.5%. Without foreign trade, real GDP would have contracted 1% in the fourth quarter, idled in the first quarter, and fallen 0.5% last quarter (chart).

WHERE THE RECESSION IS —AND ISN'T



Data: Bureau of Economic Analysis, Global Insight

Trade's influence is also evident in corporate profits. Revised Commerce figures through the first quarter show operating earnings, which exclude writedowns, fell $24 billion from a year ago. However, domestic profits plunged $125 billion, while a $100 billion rise in overseas earnings cushioned the blow. Receipts from abroad now account for 35% of total earnings.

Profit margins also have declined from their record levels, but they remain high by historical standards. That's partly because productivity growth, which typically falls in a downturn, has held up well. Once again, foreign trade, lifted by booming U.S. exports, is a key reason: Export industries tend to be very efficient. Trade's boost to profits is one reason why companies have not cut back on capital spending and payrolls to the same extent as in past recessions.

But there are downsides to this foreign dependence. Overseas profits are skewed toward big multinationals, while small businesses must cope with weak U.S. demand and rising costs. Also, many companies, and not just exporters, are making do with fewer full-time workers, as seen in the weak July jobs report. Even though jobs and hours worked fell throughout the first half, real GDP continued to rise, meaning productivity gains accounted for all of the economy's growth.

So is it a recession or not? Despite trade gains, the domestic economy may well be weaker than the GDP data now show. When the NBER in October 2001 declared the last recession began in March 2001, the GDP numbers showed only a single quarterly contraction in the third quarter of 2001. Nine months later, Commerce's revisions showed three straight declines beginning in the year's first quarter.

Such revisions may be in the offing again. All four monthly indicators the NBER follows to determine when the economy has turned down have started to fall. Real personal income minus government handouts and real business sales peaked last October. Employment hit its apex in December, and industrial production topped out this February. Given that pattern, it would be unusual for the current period not to end up being called a recession.

Moreover, while foreign trade has helped ease the pain of domestic weakness, there's a catch for the coming year: Growth overseas is now slowing, and so will U.S. exports. With homegrown demand likely to remain frail, that would only prolong the recessionary feel. |BW|

PHOTO BY BRAD TRENT; CHART BY LAUREL DAUNIS-ALLEN/BW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TO CATCH THE ONE THAT GOT AWAY.
INTRODUCING POINTS YOU CAN SPEND LIKE CASH.
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NUMBERS

U.S. EARNINGS TAKE A HARD TUMBLE

By Tara Kalwarski/Charts by Ray Vella

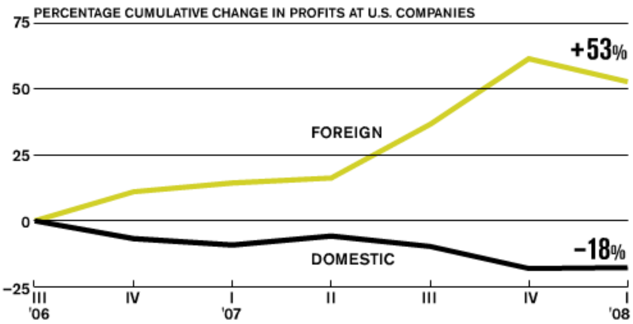
Companies in the Standard & Poor's 500-stock index appear on track to report their fourth consecutive quarter of falling earnings, mostly because of a decline in domestic profits, particularly in the financial and consumer-discretionary sectors.

-20%

Current estimate of the S&P 500's growth in second-quarter 2008 earnings from a year earlier. The estimate seven months ago: +5%.

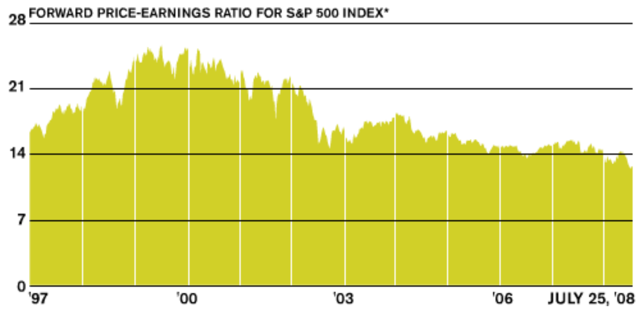
Data: Thomson Reuters

Profits: Overall, U.S. companies have seen earnings slide at home and surge abroad since late 2006.



Data: Bureau of Economic Analysis, Haver Analytics

P-E Ratio: The S&P 500 is modestly valued because prices are down more than future earnings estimates.

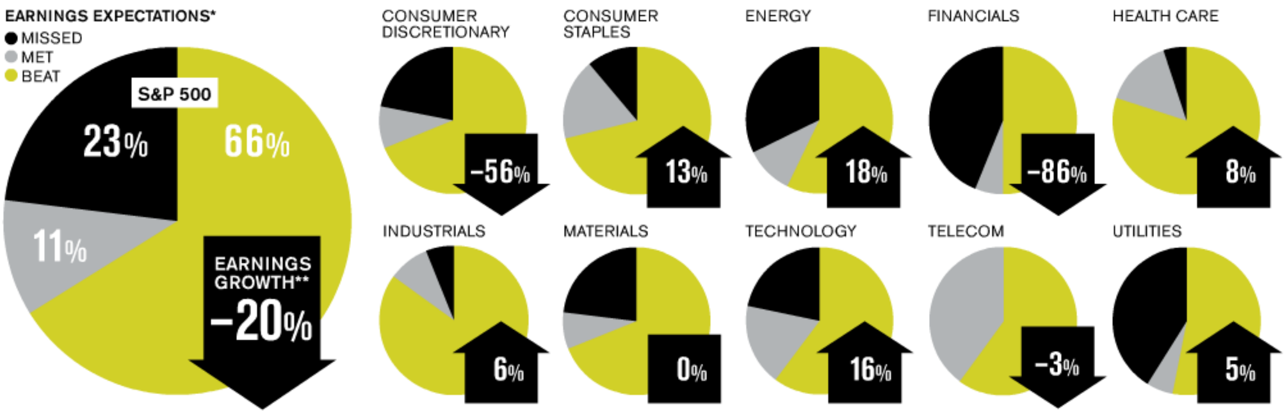


*S&P 500 INDEX LEVEL DIVIDED BY 12-MONTH CONSENSUS EXPECTED OPERATING EARNINGS PER SHARE USING MID-MONTH DATA

Data: Yardeni Research, Bloomberg Financial Services

SECOND-QUARTER 2008: EARNINGS AND EXPECTATIONS

Earnings at S&P 500 companies declined by an estimated 20%, with the 86% drop for financials leading the way down. Telecom profits also fell, but by no more than expected.



Data: Thomson Reuters

*AS OF AUG. 1 **ESTIMATED FOR ALL S&P 500 COMPANIES, WITH 373 COMPANIES REPORTING

THE NEXT BUSINESS WEEK

BUSINESSWEEK.COM

Running your own business isn't easy. But doing it from home presents its own set of challenges, as some 16.5 million entrepreneurs can attest. In a Special Report, we offer some tips on setting up shop where you also eat and sleep. Take a look at how one company defied conventional wisdom and went from commercial offices to home offices—as it expanded. Then find out how the weak economy and competition from big e-tailers are squeezing those who make a living via online marketplaces such as eBay and craigslist. Finally, see some standout home workspaces and vote for your favorite. Go to **businessweek.com/go/08/homebiz** for the goods. | BW |

BUSINESSWEEK TV

HOME ECONOMICS
Is it safe to dive back into the real estate pool? We look at whether now is the time to buy and lay out strategies for those currently house hunting. Plus: bargains and pitfalls in the vacation home market.

HOLD ON TO YOUR IDENTITY
A case of identity theft occurs every three and a half seconds in the U.S. We speak with the head of Affinion Security Center about new technology for fighting ID theft and tips for protecting yourself.

DANCE OF THE CAR DEALER
With the industry in turmoil, what are dealers doing to maintain sales? We talk to one dealer who is struggling to keep small cars in stock. Others are turning to imaginative strategies for selling gas-guzzling SUVs.

GARDENS IN THE SKY
City rooftops are going green, literally. Research shows that a roof covered in plants is affordable, better for the environment, and brings other benefits to residents. Find out how one is installed—and learn about the tax breaks.

Watch our weekly program, *BusinessWeek TV*. To see video clips or find your local station and airtime by Zip Code, go to businessweektv.com.

ROSS ANANIA/GETTY IMAGES

EDITED BY CRISTINA LINDBLAD

A volunteer cans wheat for storage at an LDS facility

THE MORMON INDEX

Gas prices are at roughly $4 a gallon, unemployment hovers at 5.7%, and the worst financial crisis since the Great Depression is grinding along. Is this the end of the world as we know it? Perhaps, judging from the growing waiting lists to shop at the 100 food warehouses run by the Church of Jesus Christ of Latter-Day Saints in the U.S. and Canada. Run by appointment, these depots sell wheat, flour, rice, canned goods, and other nonperishables at cost. They were originally set up to supply the faithful in the event of a catastrophic event, such as the Great Tribulation—a period of suffering that, according to the New Testament, precedes the Apocalypse. But lately, rising costs at the grocery, fear of national food shortages, and growing job insecurity have boosted traffic at the centers to levels not seen since the Y2K scare and the September 11 terrorist attacks. Mormons anxious about hard times are building stockpiles for their families, says Greg Mott, the stake president (a lay church leader who overseas local congregations) for the Spokane (Wash.) area. And it's not just the faithful who are stocking up: Mott says about 5% of customers at the Spokane warehouse now are nonchurch members –*Douglas MacMillan*

NOT GOING FOR THE GOLD

The 2008 Olympics in Beijing has been hyped as a blockbuster for marketers—a once-in-a-lifetime chance to ride a wave of Chinese national pride that may translate into billions of dollars in sales of Samsung cell phones and Cokes. In what amounts to an Olympic record, 12 global sponsors paid $866 million, an average of $72 million apiece, to support the 2006 Winter Games in Turin and the Summer Games in Beijing. (Sponsorships are sold in four-year packages.) Yet the results of a recent survey may give some of these big spenders pause.

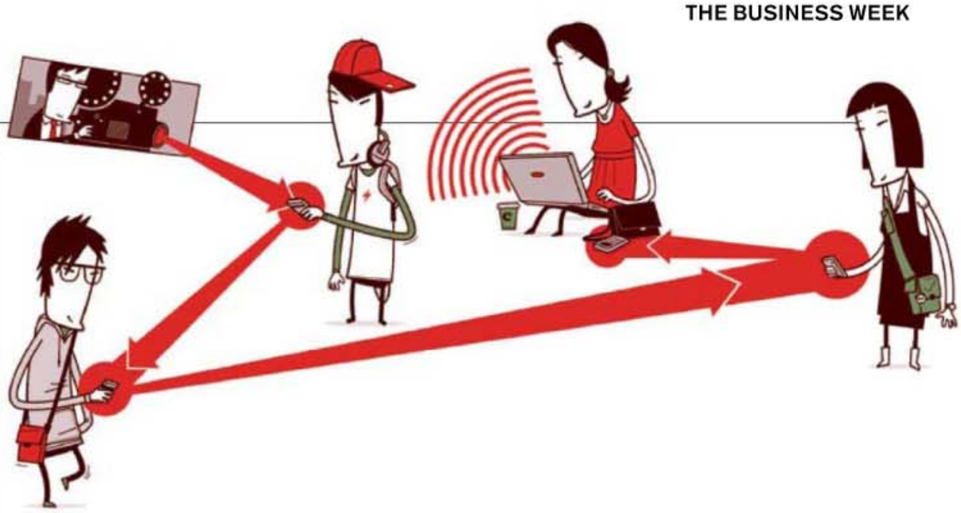
In a poll of 1,500 Chinese city dwellers earlier this year by London's Fournaise Marketing Group, only 40% could name one sponsor and just 15% could identify two. "If you are a traditional marketer, it's a big waste of money," says Fournaise CEO Jerome Fontaine. That's a conclusion some companies appear to have reached on their own. Absent so far from the lineup for the 2012 Summer Olympics in London are Lenovo, Johnson & Johnson, and Manulife Financial. Eastman Kodak is bowing out, too. Says Kodak CEO Antonio Perez: "It's just not the best way for us to spend our money." –*Frederik Balfour and Reena Jana*

A poll puts the payoff from sponsoring the Beijing Games in question

(FROM TOP) PHOTOGRAPHS BY THE CHURCH OF JESUS CHRIST OF LATTER-DAY SAINTS; CHINA PHOTOS/GETTY IMAGES

TINTIN LOSES $7.6 BILLION

The daily routine of a bank employee doesn't sound like promising material for a comic book...unless the employee is Jérôme Kerviel. *The Diary of Jérôme Kerviel*, a fictionalized account of how the 31-year-old rogue trader at Société Générale lost the French bank more than $7.6 billion, is set to hit Paris bookstores in mid-September. Kerviel, who is awaiting trial, had no involvement in the project, says Xavier Thomas, whose Paris-based Thomas Editions is issuing the 40-page volume. Thomas says he hopes the book, which is aimed at the large audience of French adults who regularly read comics, will educate readers about the workings of financial markets. The comic is in French, but non-Francophones can catch the general drift from the illustrations, one of which depicts a dejected Kerviel sitting on the jail square of a Monopoly game board. *–Carol Matlack*



CAN YOU SEE IT NOW?

Movie marketers know word of mouth is crucial. That's why, to build buzz in Japan for the April release of the Hollywood sci-fi flick *Next*, the film's local distributors handpicked 50 digerati, among them bloggers and youngsters active on social-networking sites, to preview the film. But instead of handing out tickets to an old-fashioned screening, distributors Shochiku and Gaga Communications arranged to have the 96-minute film streamed onto invitees' cell phones. Watching a movie beamed in real time ordinarily costs a lot, since the handset has to stay online the whole time. So Shochiku worked with wireless operator NTT DoCoMo to pick phone users who pay a flat fee for unlimited Net use. Because streaming video can quickly sap a phone's battery, invitees were also directed to plug their phones into a wall socket. The distributors claim the stunt sparked the desired viral effect, at little cost. But 40% of the audience said they didn't get through the entire pic. That may be yet another sign that feature-length movies may not be coming to a (very small) screen near you anytime soon. *–Kenji Hall*

4 DAYS, 3 NIGHTS, 1 CATASTROPHE

Had enough of sun and surf? For your next vacation, consider visiting a disaster zone. Tours by Isabelle of New Orleans reports that some 10,000 people have forked over $60 for its three-hour tour of the Lower Ninth Ward and other areas ravaged by Hurricane Katrina. In Ukraine, $135 will buy you an all-day bus tour of Chernobyl. Stops include the sarcophagus covering the nuclear reactor's still-smoldering core and the nearby ghost town of Pripyat. "Some people go just to hear the buzz of the Geiger counter," says organizer Sergei Ivanchuk. Other tour operators offer trips to the Caribbean Island of Montserrat, whose capital was wiped out by a 1995 volcanic eruption, and the former Yugoslavia, where the wreckage of the 1999 NATO bombing campaign is still on view. After all, how many people can turn to their loved one and say: "Honey, we'll always have Chernobyl." *–Matt Mabe*

Disaster tourists in New Orleans view the wreckage from Hurricane Katrina

(TOP) ILLUSTRATION BY SPENCER WILSON

FACETIME | MARIA BARTIROMO

(TOP) BRAD TRENT; (BOTTOM) ERIC THAYER/REUTERS/LANDOV

JOHN THAIN ON THE FIRE SALE OF TOXIC ASSETS AT MERRILL

Ever since he took charge at Merrill Lynch in November 2007, former New York Stock Exchange chief John Thain has been struggling against enormous odds to revive the storied investment bank, badly battered by the global credit crisis. He's selling Merrill's stake in Bloomberg, and on July 28 he made his most radical move so far, unloading billions of dollars in toxic mortgage investments to the Dallas private equity firm Lone Star Funds for pennies on the dollar. I talked with Thain on Aug. 4.

MARIA BARTIROMO

You've made some extraordinary moves in the past week, selling more than $30 billion worth of CDOs [collateralized debt obligations] for the bargain price of $6.7 billion, or 22¢ on the dollar, compared with the 36¢ you valued the securities at just a quarter before. Why take this hit and do the sale immediately?

JOHN A. THAIN

This sale of CDOs is a huge move in reducing the risky assets on our balance sheet. It's a continuation of the process we've been going through for the past seven months, but it's most significant in that these assets and their related hedges represent approximately 70% of all the losses that we've taken over the past 12 months. And the ability to get this sale done in one bulk trade to a single buyer, where there has been almost no liquidity in this marketplace, made sense for us both to reduce risk and eliminate the overhang of continued losses from asset devaluations.

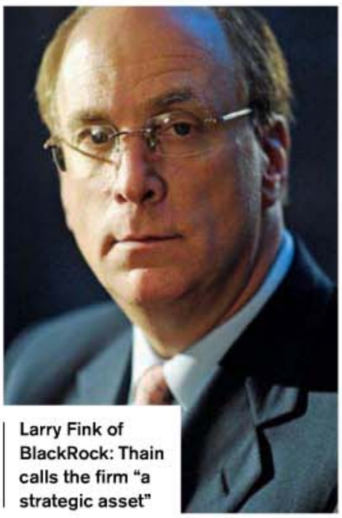
Explain this deal to me, because people still don't get it. They feel that you still have exposure here. If Merrill

is financing 75% of the purchase price, and Lone Star can put the CDOs back to Merrill if they drop too much in value, don't you still have downside exposure? How has the bank's risk been reduced?
First, there's no put back to us whatsoever. Second, the financing is structured in a way that makes it extremely unlikely that we would ever have any exposure on these assets again. It is a true sale. And the paydown on the cash flows amortizes our loan in a way that makes it almost impossible—not totally, but almost impossible—that we would ever have exposure on these loans.

"IT [IS] ALMOST IMPOSSIBLE—NOT TOTALLY, BUT ALMOST IMPOSSIBLE—THAT WE WOULD EVER HAVE EXPOSURE ON THESE LOANS"

The *International Herald Tribune* reported that Lone Star has the right to put the CDOs back to Merrill. So you're saying that is wrong?
That is wrong.

Let me ask you about your credibility, John. I last spoke to you for *BusinessWeek* when you first took the Merrill CEO job in November of '07. At that time you said you saw 6 to 12 months of subprime pain ahead. What's your best guess now as to when this debacle will work its way through the system, and why did you say back in December that you weren't going to raise capital—indicating that Merrill had enough money and wouldn't need further cash infusions? What changed?
The simple answer is: The market changed. At the end of '07, we lost $8.6 billion for the year, and we raised $12.8 billion of new capital. So almost 50% more than we lost. By January we were well capitalized. Unfortunately, the world didn't stay the same. Asset values declined dramatically over the next six months. As asset prices declined, particularly mortgage-related assets, that created incremental losses and incremental needs for capital. Besides the decline in asset values, the changes included the demise of Bear Stearns, dramatic widening in credit spreads, and a tremendous lack of liquidity.


Larry Fink of BlackRock: Thain calls the firm "a strategic asset"

So will you stop saying you don't need to raise more capital?
No. I still have to answer the question as of a specific point in time. Today, with the transactions we did last week, we are well capitalized. If the world continues to deteriorate and asset values continue to decline, then in the future we may have to make different choices.

Is the dividend in jeopardy?
We evaluate the dividend every quarter. We believe that we will, in a short period of time, be able to earn and cover the dividend, but that is something that we always evaluate.

In an interview with Brad Hintz of Sanford C. Bernstein in March, you said Merrill intended to hold on to as many of the CDOs as possible and sell them off gradually as prices recovered. In this deal, isn't Merrill basically giving away any upside recovery?
We are giving away any upside recovery. We are selling 100%, so we're not anticipating any upside recovery. The biggest change is the impact on our 60,000 employees, who generate $7.5 billion in revenues, earn just under $2 billion pretax, and have all their efforts overwhelmed by write-offs coming from these assets. So we decided it was better for our company and shareholders to rid ourselves of these assets and go forward with our core business, which is wealth management, investment banking, and trading—not a hedge fund investing in illiquid assets.

Have there been any reverberations from your decision to value the CDOs at just 22¢ on the dollar? Have other bank CEOs called you to complain?
No one has specifically called me to complain. And remember, this is a bulk sale price of $30 billion. And also the first trade like that, because there has been almost no liquidity in the CDO market. I expect there will be follow-on trades.

So the Lehmans and Citis of the world will be right behind you?
I can't speak for anyone else, but all of the investment banks and commercial banks are shrinking balance sheets and reducing assets, and this is one of the most toxic of assets.

Is it fair to say the price is 22¢ on the dollar today?
I can only say that the price was 22¢ on the dollar to sell $30 billion worth to a single buyer in a single trade.

If there is a need at some point for further capital, would you consider selling the BlackRock stake?
We have always said, from the first of the year, that we would evaluate all of our options and decide what was in the best long-term interest of our shareholders. We do view our BlackRock stake as a strategic asset, but we would always look to all of our alternatives. | BW |

Maria Bartiromo is the anchor of CNBC's Closing Bell.

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WALL STREET EYES THE PENSION POT

Despite being mired in the subprime debacle, moneymen have found receptive ears in Washington for a trillion-dollar gambit to buy up retirement plans

By Matthew Goldstein

Some of the folks that brought us the subprime meltdown and the global credit crisis have a bold new idea that could solve a slew of problems for U.S. companies—but also might cause a whole set of troubles for employees.

A broad coalition of Wall Street firms, from banks and insurers to hedge funds and private equity firms, are pushing lawmakers to let them buy and manage so-called frozen corporate pension plans, which no longer accept new members but must continue to cover current ones. Of the $2.3 trillion in U.S. corporate pension fund assets, some $500 billion sits in frozen plans, including those of big companies such as IBM, Hewlett-Packard, Verizon, and Alcoa.

At first blush the idea would seem to be a tough sell in Washington. Not only are Wall Street firms scrambling to boost profits and raise capital to stay afloat—they're also fighting allegations that they knowingly dumped toxic securities on unwitting investors during and after the mortgage boom.

Yet firms are getting a receptive ear from the Treasury Dept. After the IRS ruled that the concept needed legislative approval, Treasury on Aug. 6 offered a blueprint for lawmakers to allow "financially strong entities in well-regulated sectors" to acquire pension plans. Now the debate moves to Congress, which would have to change existing law.

For companies, offloading pension plans could be a boon. Many have struggled in recent years to make good on their generous pension promises, swinging from surpluses to deficits depending on the whims of the stock market. For example, Ford Motor, which reported an $8.7 billion loss in the latest quarter, has a pension plan that's underfunded by $9 billion, according to Credit Suisse analyst David Zion. Problems like that are a big reason why Charles Millard, director of the Pension Benefit Guaranty Corp., the federal insurer of last resort of corporate pension plans, is behind the Wall Street plan. He says it would "create greater security for retirees and the pension system," though he warns that

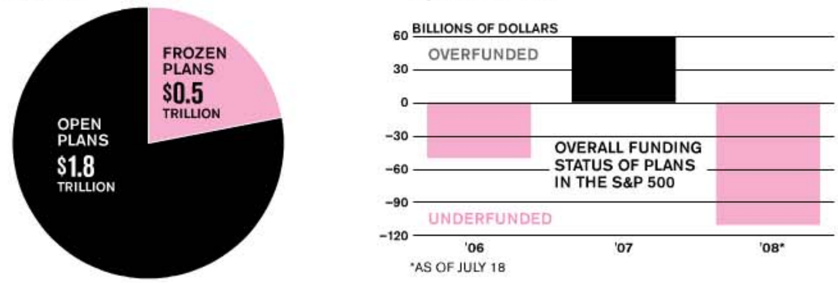
ILLUSTRATION BY RICHARD MIA; CHART BY LAUREL DAUNIS-ALLEN/BW

THE PENSION PROBLEM

With plans increasingly on shaky ground, companies may need creative solutions to

More employers are freezing pension plans...

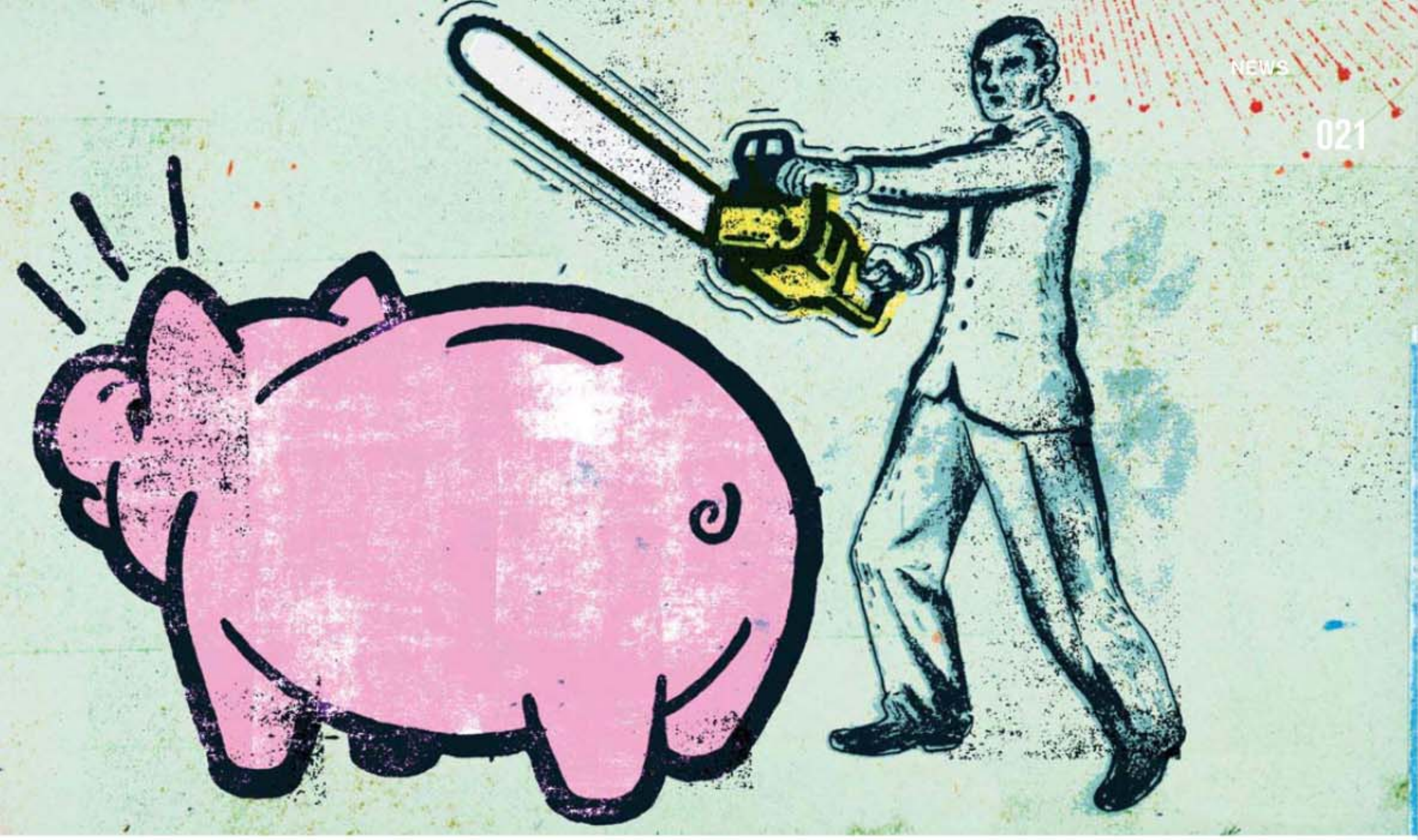
...more plans are getting hit by the market...



*AS OF JULY 18

Data: McKinsey, Goverment Accountability Office

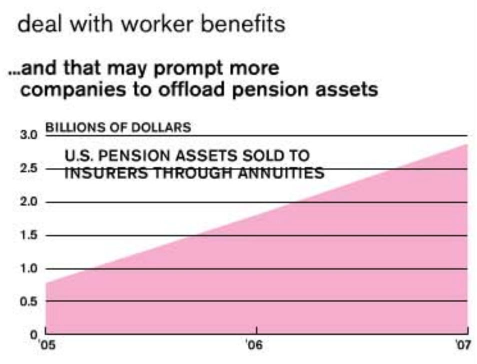
Data: Credit Suisse Group



"these deals should only be permitted when the acquiring entity has a higher credit-rating than the seller."

Dumping plans seems especially opportune for companies now. Since 2007, companies have been required to list pension-fund figures on their balance sheets, but that doesn't affect earnings. But new accounting standards that are supposed to take effect over the next two years will require them for the first time to include fluctuations in the value of pension assets or liabilities as part of their quarterly earnings totals, a change that could devastate profit results for some. "We have identified several clients who would be willing to be first to sell a plan," says Scott Macey, a senior vice-president with Aon Consulting, one of the firms lobbying hard for the new rules, alongside Citigroup, JPMorgan Chase, Morgan Stanley, Prudential Financial, Cerberus Capital Management, and others.

Wall Street, of course, has a different motivation—fees. As companies increasingly decide they can no longer offer the lavish benefits they once did and stop using pension plans as a recruiting tool, consulting firm McKinsey & Co. predicts that the assets in frozen plans will more than triple, to $1.7 trillion, by 2012. By taking over frozen plans, Wall Street firms could charge fees based on the total assets, perhaps in line with the standard 1% to 2% levied by many money managers.



Data: LIMRA International

"A TERRIBLE IDEA"

But the gambit to turn pensions into moneymakers raises plenty of questions. Critics, including some on Capitol Hill, worry that financial firms won't always have workers' best interests at heart, putting some 44 million current and future retirees at risk. "We think this is just a terrible idea," says Karen Friedman, policy director for the advocacy group Pension Rights Center. "In the wake of the subprime crisis, it would be crazy to allow financial institutions to manage these plans."

Historically, pension portfolios have been managed in a conservative fashion, investing mainly in stocks and bonds. Alternative investments such as hedge funds, derivatives, and asset-backed securities typically represent less than 25% of pension assets. If financial firms get in, the fees they collect would present a financial incentive to boost assets under management. One way to do that would be to move pension plans into riskier investments. Even worse, critics say, Wall Street firms could use pension portfolios as a dumping ground for ailing investments on their own books. They point to the auction-rate securities market, where, regulators allege, some Wall Street firms pushed stockpiles of failing investments onto unsuspecting clients.

If Wall Street gambles with those

Ex-PBGC Director Belt is now a top advocate of letting smaller firms buy pension assets

DAVID DEAL

pension assets and loses, U.S. taxpayers could be stuck with the tab. When a company with a pension goes under, the PBGC, under federal law, has to pay out the fund's obligations up to a certain amount. It's a costly burden: The PBGC currently runs a $14.1 billion deficit.

Former PBGC Director Bradley D. Belt argues that pension buyouts could strengthen the agency. If financially strapped companies were to jettison their plans, the businesses might avoid bankruptcy, and the PBGC wouldn't have to step in and pick up the pieces. "While there are legitimate regulatory and policy considerations, much of the criticism is misplaced," says Belt, who two years ago teamed up with private equity firm Reservoir Capital Group to form Palisades Capital Advisors, a pension advisory firm.

With Treasury approving the general concept of pension buyouts, lawmakers are gearing up for a legislative battle. Earlier this year, the Government Accountability Office, at the behest of skeptics in Congress, began studying the issue, and it plans to publish a report later this year. The big firms pursuing the idea will likely ramp up their lobbying efforts. JPMorgan has been particularly active, sending a letter in September 2007 to several federal agencies with its own "guidelines for pension transfers." JPMorgan's newest property, Bear Stearns, was among the first to lobby Congress and regulators. It started last year, just as two of its hedge funds were imploding.

Not all firms are on equal footing in the race for pension assets. Under federal pension laws, an employer can deduct from its taxes part of its pension plan contributions. But the IRS recently declared that the tax break doesn't apply to banks, private equity shops, or other financial firms that buy plans merely as a business opportunity. Congress would have to remove the restriction to open the door for those players at all.

Small, independent outfits that aren't tied to the books of a bigger financial entity could be out of luck entirely. The worry is that such stand-alone entities wouldn't have the balance-sheet heft to take on big chunks of pension assets. Belt, a former top aide to presumptive Republican Presidential nominee Senator John McCain (R-Ariz.)(page 50), has been the most vocal proponent of letting smaller independent firms like his buy pension plans. Although he says it's too soon to tell whether that option is off the table, his proposal has stirred controversy. In its letter to regulators last September, JPMorgan took pains to distance itself from Belt's idea, supporting buyouts only by "institutions and structures that are well regulated" and "subject to high standards of financial strength and stability."

BACKUP PLAN

But even if Congress rejects every element of the proposal, at least some Wall Street firms will dip their hands in the pension fund honeypot. They could follow Britain's lead, where companies offload pension assets by purchasing a group annuity from an insurer. The market took off 18 months ago, when British regulators instituted stricter pension-accounting standards. Since then, nearly a dozen small, specialized insurers have begun offering the investments, many backed by Goldman Sachs, JPMorgan, Cerberus, Warburg Pincus, and Deutsche Bank—some of the same firms leading the charge in the U.S.

A dozen U.S. life insurance companies, including John Hancock, Prudential, and MetLife, already offer a way for companies to get rid of their pension burdens through such annuities. Although the market remains small, insurers sold $2.88 billion worth of policies last year, triple the amount three years ago. If Congress stymies Wall Street's frontal assault, big firms could switch to Plan B, setting up little insurance subsidiaries to offer those types of annuities. There's no end to Wall Street's creativity when billions of dollars in assets are up for grabs. **BW**

LINKS

Gaming Pensions for Perks
Some companies are tapping their pension plans to pay for the perks of high-ranking officials, *The Wall Street Journal* reported on Aug. 4. Intel, CenturyTel, Illinois Tool Works, and others have been moving millions of dollars of executives' benefits into their pension piggy banks, allowing them to take advantage of certain tax breaks intended for rank-and-file plans. The article notes that the move "can drain assets from pension plans and make them more likely to fail."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SELLING TOXIC DEBT TO SENIORS

Memphis broker Morgan Keegan is under fire for allegedly failing to disclose the subprime risks of seven funds

By Mara Der Hovanesian

The subprime securities that created carnage on Wall Street are bringing new pain to Main Street. Regulators in five states are investigating whether Memphis brokerage Morgan Keegan failed to disclose the risks of seven mutual funds stuffed with toxic debt and whether it inappropriately sold them to seniors and other small investors. Six lawsuits and dozens of arbitration cases claim it did.

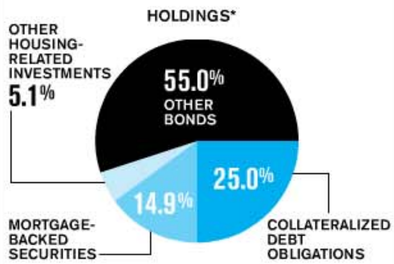
Three years ago Katherine and Lester Poer needed a safe place to tuck away $250,000, part of a windfall from a land sale. With no investing experience, the retired couple from Gulf Shores, Ala., sought advice from Morgan Keegan, which manages $80 billion in assets. Lester Poer, 81, says he told the adviser "not to take any chances." The recommendation: an in-house fund, RMK Select Intermediate Bond.

STAR MANAGER

But that portfolio was loaded with risky securities, including some backed by subprime mortgages. Collateralized debt obligations, the same investments that have wiped out billions on Wall Street, made up a quarter of the holdings. RMK Intermediate has lost 86% in the past year, making it the worst-performing fund in its category, according to research firm Morningstar. When the Poers sold the fund earlier this year, the account had $37,000 left. "We've got elderly clients in a fund that's based on speculative investments," alleges Pensacola (Fla.) attorney Peter Mougey, who says he plans to file 200 arbitration claims on behalf of the Poers and others. A Morgan Keegan spokeswoman declined to comment.

BAD BONDS

RMK Select Intermediate Bond, down 86% over the past year, had huge exposure to the mortgage mess



Data: SEC filings

*AT JUNE 2007

The investigations, lawsuits, and arbitration cases focus on bond funds formerly run by Keegan's James C. Kelsoe, once a star manager. Unlike many peers, Kelsoe sidestepped the problems in the bond market when WorldCom imploded in 2002. His RMK Select High Income ranked in the top 1% of its category every year but one between 2000 and 2005, according to Morningstar.

Morgan Keegan promoted Kelsoe's funds as a stable source of income. Sales materials for the High Income fund noted its "relative conservative credit posture" without "excessive credit risk." "[Our broker] knew we were conservative," says Arlene Berman, a retired nurse in Gulf Breeze, Fla., who lost much of the $100,000 she invested in a Morgan Keegan fund.

One lawsuit, filed in Tennessee federal court on July 11, alleges investors didn't know about the portfolios' underlying risks. The suit claims some of the funds kept as much as 50% of their assets in "exotic, complex, thinly traded, market-untested" securities such as CDOs, which violated rules in the prospectuses limiting such illiquid securities to 15%. Some of those investments have deteriorated rapidly. As of March, the RMK Multi-Sector fund owned part of a mortgage pool created by the now defunct lender First Franklin Financial valued at $310, down from $3.1 million. Says Atlanta attorney Brian N. Smiley, who represents former Morgan Keegan investors: "What you have here are investments that carried huge risks."

Over the past year, the seven funds under Kelsoe's purview have lost 51% to 86%. On July 29 shareholders voted to replace Morgan Keegan and hire New York's Hyperion Brookfield Asset Management to run the funds. "Getting a new set of eyes on the portfolio is not a bad thing," says Morningstar senior fund analyst Lawrence Jones. "But that by no means suggests investors should have hope." | BW |

ANN STATES

Berman lost much of the $100,000 she invested in one Keegan fund

A smelter in Russia: Norilsk Nickel's production is up 14% over a year ago

LEV FEDOSEYEV/ITAR-TASS/LANDOV

COMMODITIES ARE DOWN...HOORAY?

Lower prices are welcome, but a global slowdown is a big reason for the drop, and that's no reason to cheer

By Peter Coy

These days, even the good news is bad news. The good news, which helped the stock market to its biggest gain in four months on Aug. 5, is that commodity prices, led by oil, have been plunging. The bad news is why commodities have fallen: One big factor is a slowdown in global economic growth, with prospects for worse ahead.

On the bright side, lower commodity prices, all else being equal, help hold down inflation and ease strains on consumers and commodity-buying businesses. Prices of oil, copper, aluminum, corn, and soybeans began dropping sharply earlier this summer, joining zinc, tin, nickel, and platinum, which began falling earlier. Crude oil fell 18% from its July 3 peak of $145 a barrel through Aug. 6, when it closed at $118.60 on the New York Mercantile Exchange. Nickel is down 47% from its 2008 high; orange juice, down 33%; platinum, down 30%; soybeans, down 26%. Overall, the S&P GSCI—a global commodity index created by Standard & Poor's and Goldman Sachs Group—is off 19% since early July.

Trouble is, the welcome price drop owes a lot to unwelcome world economic weakness. Traders are bailing out of commodities in part because of evidence of weakening demand and in part because they predict demand will soften in the months ahead as the economic slump and credit crunch that began in the U.S. a year ago spread abroad. On Aug. 5, JPMorgan Chase said "global GDP has decelerated markedly since last year and is currently expanding at a tepid annualized pace of 1.3%." The International Monetary Fund on July 17 predicted global growth of 3% in the fourth quarter of 2008 compared with a year earlier, down from 5% annual growth in all of 2007. "The market is starting to catch up to a demand pullback," says John Kingston, global oil director for Platts, an information provider owned by The McGraw-Hill Companies.

DOOM AND GLOOM

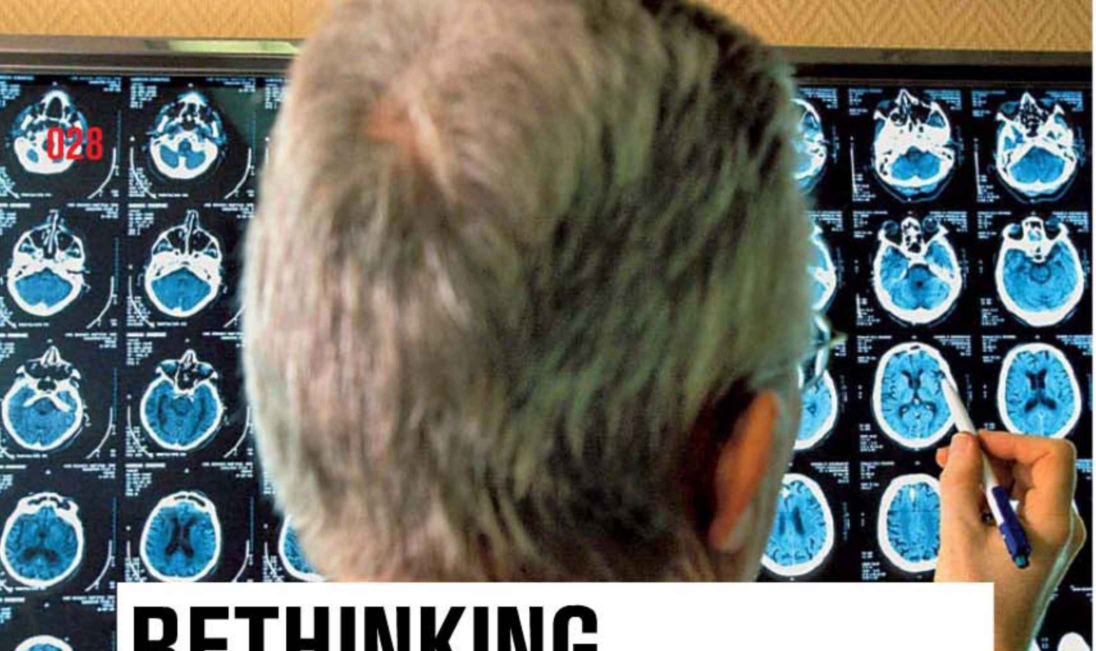
Slowing auto production has cut demand for palladium for catalytic converters. Jiangxi Copper told Bloomberg Financial Markets on Aug. 5 that Chinese makers of refrigerators and air conditioners cut copper purchases because of slowing demand. And high prices have encouraged increased production of food and some metals, swelling inventories. Moscow-based Norilsk Nickel says its first-half nickel production was up 14% from a year earlier.

Some speculators are bailing because they've decided the party's over for now, while others fear punitive regulations in the U.S., analysts say. "The sense of doom and gloom overhanging the commodity markets at the moment is palpable," John Reade, a bullish analyst at UBS in London, wrote in an Aug. 5 recent report.

Will it last? Environmentalists cheer the commodity plunge as evidence of "demand destruction"—as when utilities permanently quit using oil to generate electricity after its price spiked in the 1970s. But analyst Kevin Norrish of Barclays Capital in London thinks demand will snap back soon despite the sluggish economy, partly because of today's lower prices. Indeed, MasterCard Advisors estimated on Aug. 5 that the volume of gasoline purchased in the U.S. had risen for the previous four weeks in a row as prices fell. That's certainly not good news. BW

COMMODITIES' SHARP SLIDE

Data: Bloomberg Financial Markets



Most new drugs target amyloid protein. Rember goes after the Tau protein

BIGOT/ANDIA.FR/DRR.NET

RETHINKING ALZHEIMER'S

By taking a new tack in fighting the disease, a tiny Singapore startup may have the jump on Big Pharma

By Catherine Arnst

Take a Scottish scientist and a Singapore investor who met because their sons were schoolmates. Add in the accidental discovery that a 100-year-old malaria drug can repair damaged brains. The result is one of the few bright spots amid a slew of notable failures in Alzheimer's drug development.

TauRx Therapeutics, a private company based in Singapore, just reported that its drug Rember reduced mental decline by 81% over 12 months in a small phase II trial. The results have yet to be published and need to be confirmed by a larger trial. But so far, Rember has outperformed high-profile Alzheimer's drugs made by far larger companies. And it works by going after a completely different target.

Virtually every major pharmaceutical and biotech company is trying to develop a drug that can reverse or delay Alzheimer's, the biggest unmet medical need out there. Pfizer's Aricept and three other drugs now in use can only alleviate symptoms for a few months. Given that 26 million people worldwide have Alzheimer's, and 106 million could be afflicted by 2050, any treatment that alters the course of the disease would quickly become a multibillion-dollar drug.

To date, most Alzheimer's researchers have pursued compounds that would clear out toxic clumps of a protein called amyloid that clog the brains of Alzheimer's victims. One amyloid drug after another has failed in trials, however. The most recent disappointment: an antibody developed by Wyeth and Elan Pharmaceuticals that some analysts predicted would bring in $9 billion in yearly sales. On July 29 the two companies released mediocre trial results. The next day Wyeth's stock dropped 11.8% and Elan's 40%.

30

Number of Alzheimer's drugs in human clinical trials

A month earlier, Myriad Genetics announced that its anti-amyloid drug, Flurizan, failed to show efficacy, and Myriad pulled the plug. And a year ago another once-promising amyloid drug, Alzhemed from Bellus Health, was also abandoned after failing a trial.

Against that background, Rember looks pretty good. Dr. Claude Wischik, at the University of Aberdeen in Scotland, rejects amyloid as a cause of Alzheimer's. He has long studied another protein, Tau, which masses into tangles in diseased brains. In 1988 he tried to dye these tangles in a test tube with an old malaria drug, methylene blue, to make them more visible. Instead, the tangles dissolved.

Wischik spent the next two decades figuring out why that happened, and in 2002 he formed TauRx. The $60 million in seed money was raised by the late Dr. K.M. Seng, a Singapore venture capitalist who Wischik met when their sons were school friends. Now Wischik is seeking a drug company partner.

The seeming efficacy of Rember has revived an old controversy in the Alzheimer's field: Has too much money and scientific energy been funneled into clearing amyloid at the expense of better targets? One of the few positive Alzheimer's trial results this year besides Rember was for another anti-Tau drug created by startup Allon Therapeutics of Vancouver, B.C. In a small trial of patients with mild memory impairment the drug, AL-108, improved some aspects of cognition.

Despite the recent failures, many scientists and company executives see the glass as half full. There are at least 30 drugs in human trials today; 20 years ago there were none. "I think we must continue to pursue all targets," says Dr. John Q. Trojanowski, a leading researcher at the University of Pennsylvania. "I predict we will eventually have 10 different drugs for Alzheimer's." | BW |

Zuckerberg has offloaded shares and is letting employees do the same

HAS FACEBOOK'S VALUE TAKEN A HIT?

Insiders are selling stock in the company—and getting a fraction of the price it appeared to command last year

By Spencer E. Ante

Insiders at Facebook are selling stock in the social-networking giant, and the prices they're getting for their shares suggest the sky-high valuation backers once placed on the company may prove unrealistic.

Just a few months ago, Facebook was widely viewed as the next Google in Silicon Valley. Microsoft bought a small preferred equity stake last October that the two companies said implied a valuation of $15 billion for all of Facebook. Shareholders in the still-private company appeared to be setting themselves up for a blockbuster initial public offering.

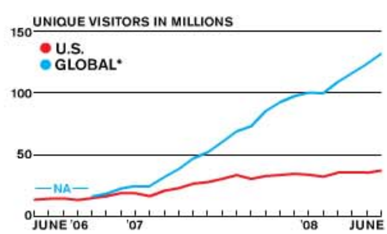
But in recent months, a number of current and former executives have put some of their common stock up for sale. Laurence Albukerk, who brokers the sale of stock in private companies in the Valley, says he knows of at least nine people who have sold or are trying to sell Facebook shares. He estimates that "dozens" are unloading stock, through him or other brokers. Another finance executive, who would not speak for attribution, confirmed Facebook insiders are selling. Among those who have reportedly sold are founder and CEO Mark Zuckerberg and departing vice-president Matt Cohler. A Facebook spokeswoman said both declined comment for this story.

The prices for Facebook shares in these transactions reflect a total valuation far lower than $15 billion. Albukerk, the founder and managing director of EB Exchange Funds, says that two current directors and one former executive recently contacted him about selling some of their stock for prices implying a $5 billion valuation. He also says that two investment firms have bought large chunks of Facebook stock at a valuation of about $3.75 billion. Hans Swildens, founder of Industry Ventures, a San Francisco firm that buys stock in private companies, says his firm has been talking with a growing number of Facebook employees. "There's a lot of interest among people to sell shares," says Swildens.

The stock sales at Facebook don't necessarily mean Microsoft CEO Steve Ballmer cut a bad deal. The software giant paid $240 million for a 1.6% stake, but it bought preferred stock that carries special rights. For example, it has "liquidation preferences" that mean it gets paid before common stockholders if the company is sold. Microsoft also got rights to place international ads on Facebook.

THE TWO FACES OF FACEBOOK

U.S. growth is slowing, while worldwide increases are strong



Data: ComScore

*WORLDWIDE INCLUDING U.S.

RANK-AND-FILE GRUMBLING

Stock sales are unusual at technology startups. In the past, entrepreneurs rarely had the chance to cash in until their companies went public or were sold. When they do sell, it can create conflicts of interest with venture backers and other employees who hadn't realized the same wealth. Eric Hippeau, managing partner at venture firm SoftBank Capital, says none of the two dozen companies his firm has invested in have programs for employees

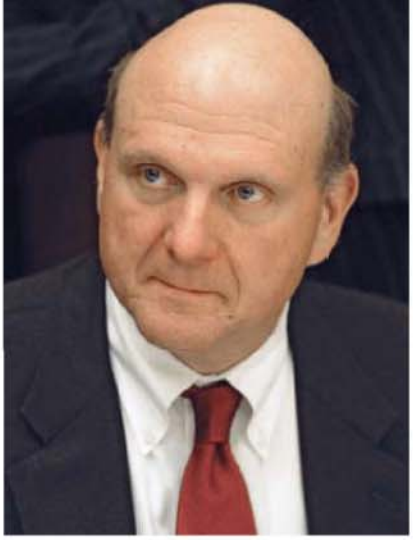
PHOTOGRAPH BY NOAH BERGER/THE NEW YORK TIMES/REDUX; CHART BY RAY VELLA/BW

to sell stock. "I'd tell them to get back to work," says Hippeau.

The sales at Facebook have led to controversy within the graffiti-covered walls of its Palo Alto (Calif.) offices. After employees heard that Zuckerberg and Cohler had sold, there was grumbling among the rank and file, say two sources who have spoken with staff.

Facebook is taking steps to address the issue. On Aug. 5 the company issued a statement announcing it will help current employees sell some of their stock. "To provide employees with a financial cushion while we continue to build the company, Facebook has designed a onetime program to enable employees to realize some liquidity," the company said in a statement. Facebook declined to outline details of the plan. But VentureBeat, a blog that first reported the existence of the program, said the plan would limit Facebook workers to selling 20% of their vested stock options at a \$4 billion valuation, starting this fall.

The company is also putting restrictions on stock sales by some employees who leave the company, *BusinessWeek* has learned. Facebook is requiring such workers to sign agreements that prevent them from selling shares at more than a \$3.75 billion valuation, according to one source close to the company. That figure has special significance. According to a lawsuit involving Facebook filed in federal court, the startup's board approved a so-called formal valuation resolution required by the Internal Revenue Service valuing the common shares at \$3.75 billion.



SAMUEL KUBANI/AFP/GETTY IMAGES

Ballmer cut a deal for a stake in Facebook last year that valued it at \$15 billion

There are at least two possible reasons for the restriction. First, it could suppress stock sales by employees who think their shares are worth more. Second, it could help Facebook avoid raising its valuation with the IRS. Raising it could trigger tax bills for employees and make it harder to lure top talent.

There are several reasons that Facebook is likely worth less than the \$15 billion value it cited when announcing the Microsoft deal. The public equity markets have gotten crushed over the last year, and skittish investors have also lost their appetite for IPOs.

And the social-networking business doesn't look as promising as it did 10 months ago. Growth in the number of U.S. users at Facebook, MySpace, and other sites has slowed this year. Social networks have also struggled to generate revenue through advertising at the rates originally expected. Google, which places ads on News Corp.'s MySpace, has said making money off social networks has proven difficult. | BW |

HASBRO LEARNS TO SPELL B-O-T-C-H

The maker of Monopoly and Scrabble flubs its move onto Facebook when replacing a popular knockoff

By Christopher Palmeri

For much of the past year, Hasbro has been on a tear. Its stock is up 50% since January. And thanks to everything from its roaring Transformers line to its cuddly Littlest Pet Shop franchise, the toymaker posted a record $330 million profit in 2007, on sales of $3.8 billion.

But Hasbro goofed with how it handled Scrabulous, a digital knockoff of its Scrabble board game on Facebook. The Pawtucket (R.I.) manufacturer not only stood idle as Scrabulous drew a half-million daily players to the social networking site over the past year. On July 30, after suing the two Indian brothers behind it and forcing them to pull it down, Hasbro put up a clunky, slower replacement. The result: howls of protest from the audience it was hoping to attract. "Hasbro just got greedy," fumes Rhonda Talbot, a Los Angeles Scrabulous fan. "If they weren't clever enough to create a Scrabulous, they don't deserve the players."

The Facebook fracas is a rare misstep for Hasbro. Along with underestimating users' loyalty to the Indian knockoff, it was slow to come up with free digital versions of board games such as Monopoly and Scrabble in order to draw ads, preferring to make money through subscriptions, game discs, or downloads. (Hasbro owns the rights to Scrabble in the U.S. and Canada; Mattel, which is also suing the Scrabulous founders, holds the rights elsewhere.) Another mistake, says Chuck Tanowitz, New Media strategist at Schwartz Communications, was attacking a product that revived interest in Scrabble. "They had new publicity for a brand that was old and stale."

Hasbro set out to forge high-tech versions of its brands last August through a licensing deal with video game maker Electronic Arts. EA formed a 140-person Hasbro games division, which has since produced popular downloadable versions of Scrabble, Yahtzee, and Monopoly for cell phones. More than 600,000 copies of the three were downloaded in the second quarter, at $5 to $10 per game.

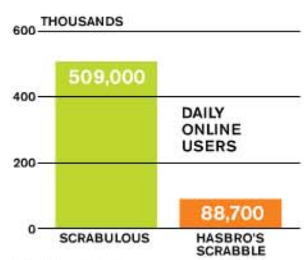
Hasbro executive Mark Blecher, who heads up electronic gaming efforts, concedes that the company was slow to focus on Facebook and notes that Scrabulous showed them "how powerful social networking could be." Both Hasbro and EA wanted to get up an early version of the game so they could get input from consumers. But users say Hasbro made a mistake in forcing them to play a version that wasn't as good as the knockoff. Blecher says kinks are being worked out.

Even so, Hasbro says its Facebook game already draws about 90,000 players a day. Scrabulous co-founder Jayant Agarwalla says a new, altered Scrabble substitute, called Wordscraper, "has witnessed tremendous usage in the past couple of days." Facebook says it draws 68,000 daily users. Agarwalla says Scrabulous was taken down "in deference to Facebook's concerns" and hopes "to bring fans brighter news in the days to come." Hasbro has learned its lesson. It plans to launch free versions of such Hasbro staples as Boggle, Battleship, and Yahtzee on Facebook. **BW**

–With Nandini Lakshman in Mumbai

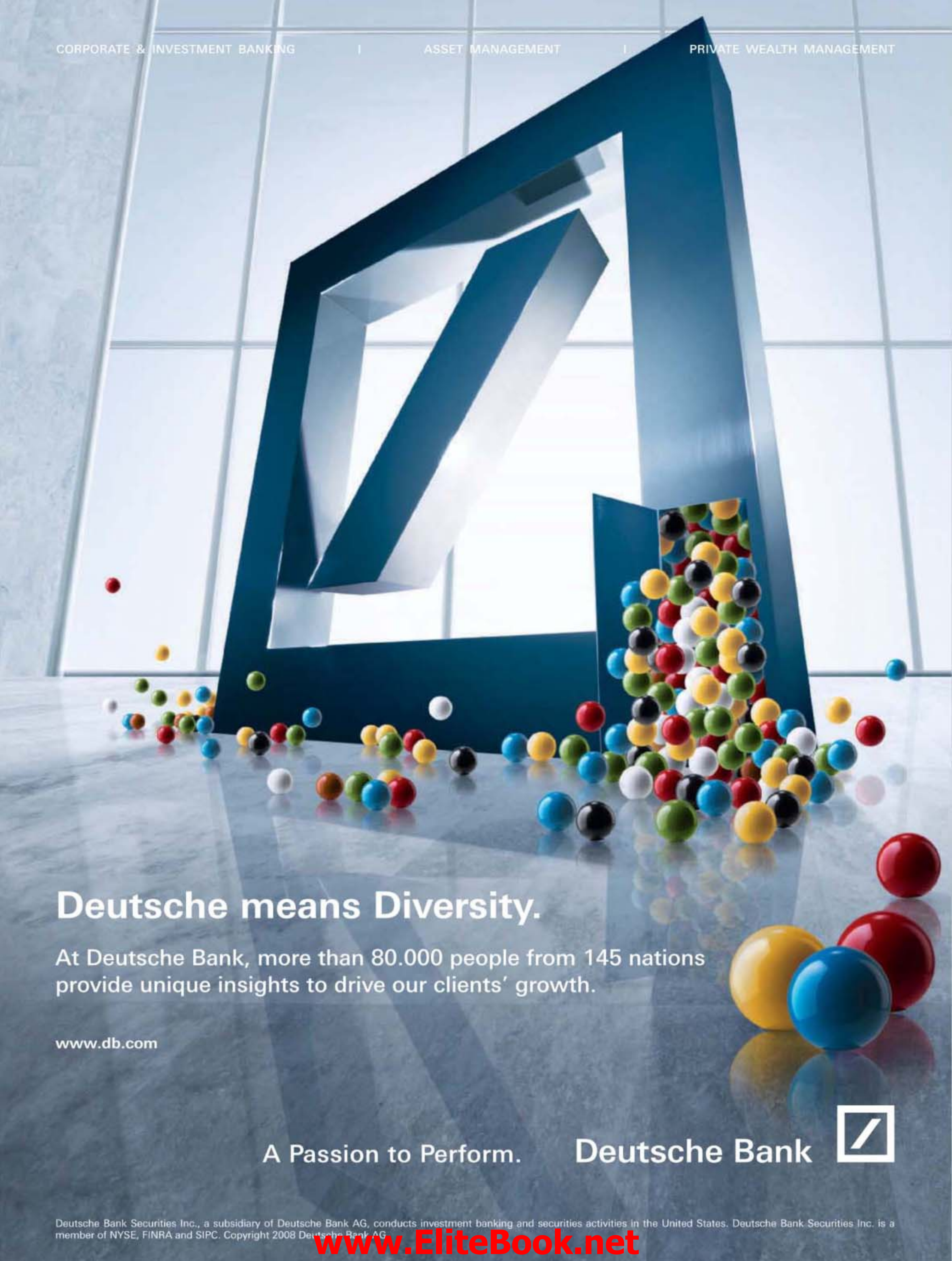
HARD SCRABBLE

Hasbro's official game has yet to catch up with the knockoff it replaced



Data: Facebook

ACME ILLUSTRATORS; CHART BY RAY VELLA/BW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BUSINESS & THE GAMES

TONY LAW/REDUX

LEARNING FROM THE OLYMPICS

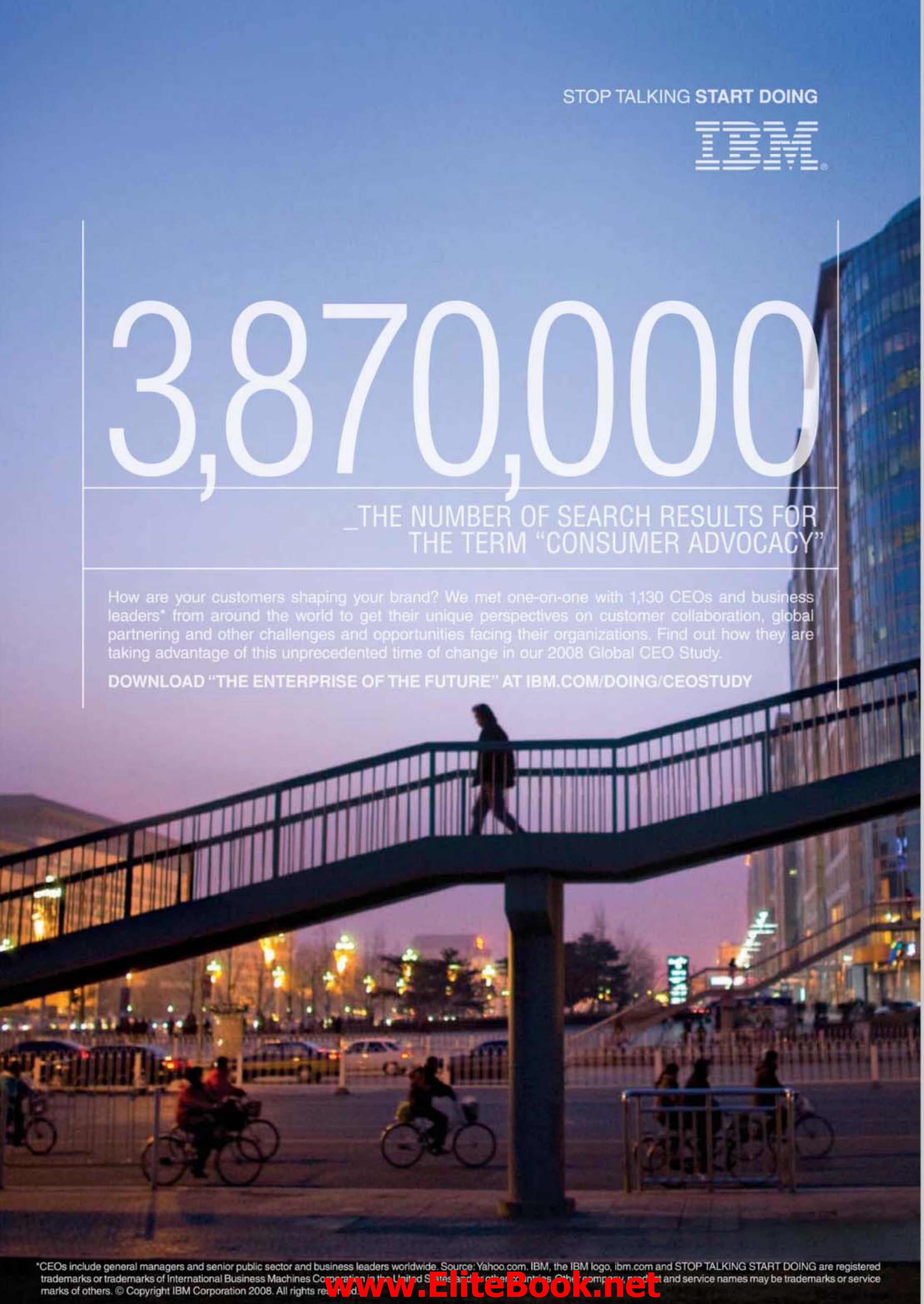
By Reena Jana, Frederik Balfour, and Oriana Schwindt

From GE to Nestlé to watchmaker Omega, companies use the Games to test-drive new ideas—and strut their stuff

When U.S. Women's soccer defender Heather Mitts hits the field for the Olympics, she'll rely on more than her gear, teammates, and fans for support. Mitts suffered a torn ligament last year and had to sit out the World Cup in September. But she's back for the Beijing Games. And her confidence will no doubt be boosted by the knowledge that doctors are nearby, ready to scan her knee at the first signs of stress. They'll be using a compact ultrasound machine, the LOGIQ i from General Electric Healthcare. The 12-pound device can produce detailed images of even the tiniest tears in her ligament—every bit as sharp as those from the 800-pound machines found in hospitals.

It's part of GE's strategy of using the Olympics to show off its latest innovations. GE deployed an earlier version of the LOGIQ i at the 2006 Winter Games in Turin, giving researchers a chance to test-drive the equipment in a high-profile environment where extreme injuries often occur. Feedback from athletes and train-

STORY CONTINUES INSIDE GATEFOLD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3,870,000
_THE NUMBER OF SEARCH RESULTS FOR THE TERM "CONSUMER ADVOCACY"
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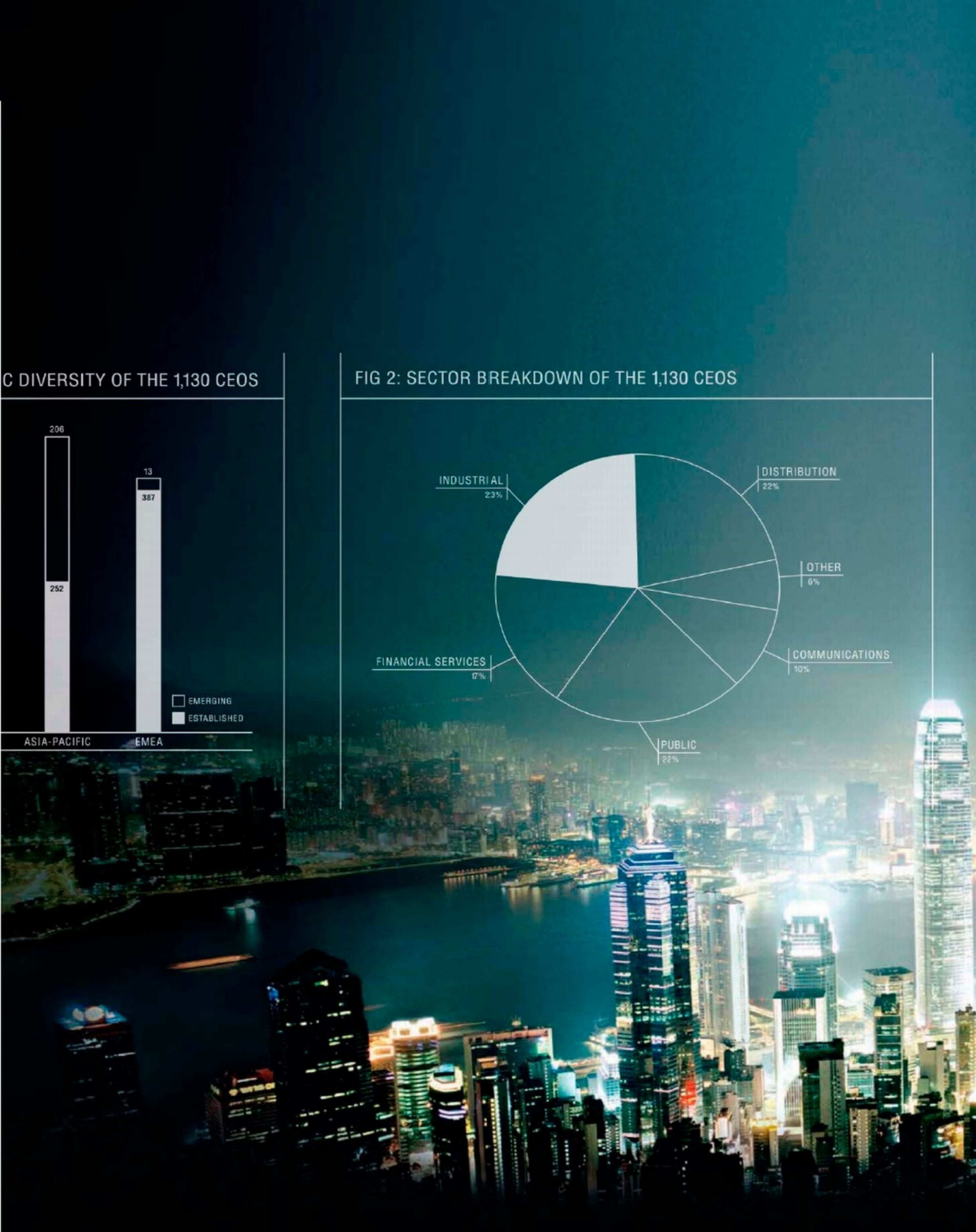

C DIVERSITY OF THE 1,130 CEOS
206
252
13
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EMERGING
ESTABLISHED
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FIG 2: SECTOR BREAKDOWN OF THE 1,130 CEOS
INDUSTRIAL
23%
DISTRIBUTION
22%
OTHER
6%
COMMUNICATIONS
10%
FINANCIAL SERVICES
17%
PUBLIC
22%


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ers, meanwhile, helped improve the machine. And just as important for GE, sales of its ultrasound equipment used for sports medicine have jumped 75% since Turin. "The Olympics are a huge marketing opportunity for GE," says Peter Foss, GE's Olympics sponsorship chief.

The Olympics have long been a showcase for cool athletic gear, from the ultralight Adidas track shoes worn at Tokyo in 1964 by German gold medalist Willi Holdorf to Nike's lightweight, moisture-wicking shirt worn by sprinter Kathy Freeman at Sydney in 2000. And the Beijing Games are no different. Kobe Bryant and LeBron James will sport Nike's Hyperdunk basketball shoes, which feature a webbing of liquid-crystal fibers that are five times stronger than steel. Swimmer Michael Phelps may shave a few milliseconds off his times by wearing a sleek pair of goggles from Speedo. And a $25,000 bike, with a frame formed from a single, superstrong piece of carbon fiber, could give a boost to Australia's track cycling team.

But it's not just sporting goods and sportswear companies that use the Olympics to drive their innovation strategies. Companies from a host of industries—architecture, technology, food production, and more—have benefited from working with athletes or local Olympic organizing committees to develop fresh ideas. At the 1960 Squaw Valley Winter Olympics, the first to feature computerized scoring, IBM exhibited its mainframes behind a glass wall, hoping to impress business customers. Four years later, at the Winter Games in Innsbruck, Xerox showed off five of its newest photocopiers, which were used to run off copies of score sheets at the torrid pace of seven pages per minute.

Watchmaker Omega, the Games' official timekeeper since 1932, has long showcased new technologies at the Olympics, even if they have little to do with the timepieces that are the company's mainstay. Back in 1964, for example, Omega unveiled a system for superimposing athletes' times on a TV screen, a technique that became the norm in sports broadcasting. In Beijing, the company has introduced motion sensors (to spot false starts) and global positioning satellite systems (to track rowers). Omega says that showing off inventions from its R&D labs at the Games boosts its reputation for precision. "Timing a prestigious sporting event gives real credibility to our brand," says Stephen Urquhart, president of Omega Worldwide.

FIE X-CHANGE VISION 2000 FENCING MASK

Leon Paul Fencing Equipment, $495

The first mask with a transparent visor approved by fencing's governing body. The scratch-resistant visor is coated with an antifog compound developed for jet pilots. The metal mesh can be adjusted by Velcro straps, making it fit snugly without adding weight.

French-Chinese tech company ASK-TongFang has developed radio-frequency-identification chips for the Games, similar to technology that retailers worldwide are likely to use soon to track products from the factory floor all the way to the consumer's home. The Beijing organizing committee wanted to eliminate counterfeiting of tickets, so it hired ASK-TongFang to make tickets with tiny computer chips that can hold various bits of information. For most events, these contain only fairly basic data such as the seat number, but for the opening and closing ceremonies each ticket will have the bearer's name, passport or ID card number, and other details. The cost: 45¢ per ticket, compared with about 3¢ for regular bar-coded tickets.

Given the billions of dollars Beijing has spent sprucing up for the Games, many of the Olympic venues have become innovation showcases. The main stadium, by Swiss architects Herzog & de Meuron, features an unorthodox steel structure that makes it look like a giant bird's nest. That spurred Chinese construction companies to learn hyper-precise welding techniques they had never attempted before. The National Aquatics Center, nicknamed the Water Cube, is clad in a shimmering blue plastic coating that looks like bubbles. It traps 90% of the solar energy that hits the structure to keep the building warm, so the facility uses less energy to heat its five pools. At the basketball stadium, an aluminum alloy skin reflects most of the sun's rays, so the gym's cooling system will use less than half the energy of a more conventional structure.

Most of the innovation, of course, happens on a much smaller scale. PowerBar, for instance, a Nestlé subsidiary that makes vitamin-enhanced energy foods for athletes, has come up with a new, user-friendly package for an energy liquid that Nestlé says can boost cyclists' speeds. These are used by bikers who want a quick blast of carbohydrates when their legs start to give out. But squeezing the sticky liquids out of foil pouches was messy. So Nestlé researchers in Switzerland came up with the idea of bite-size gel casings that make it easier for athletes to handle the goop even while running or riding a bike.

The Olympics are an unparalleled marketing platform, and companies see innovation as a way to grab the public's attention. Speedo, for instance, got so much press at the 2004 Games in Athens for its full-body swim-

CONTINUES ON PAGE 045

BUSINESSWEEK | For details of more performance-enhancing apparel, athlete-aiding equipment and architectural innovation, as well as an exclusive *BusinessWeek* series on business and the Olympics, go to businessweek.com/go/08/beijing

FASTER, HIGHER, STRONGER

Sporting equipment makers push their R&D teams to come up with gear that can help Olympians break records—and draw consumers to their products.

BT BLADE TRACK BICYCLE

Bike Technologies Australia, $25,000

The Australian track cycling team will ride this sleek machine in Beijing. Its frame is made from a single piece of carbon fiber, so it's ultrastrong but weighs just 15 pounds. And an aerospace engineering company helped design the frame for minimum drag.

MIKASA MVA200 INDOOR VOLLEYBALL

Mikasa Sports, $60

The ball is made of eight panels instead of the usual 18. And the panels—microfiber rather than leather—are glued to the rubber core only at the seams. The innovations improve control because the ball's surface is smoother and rounder.

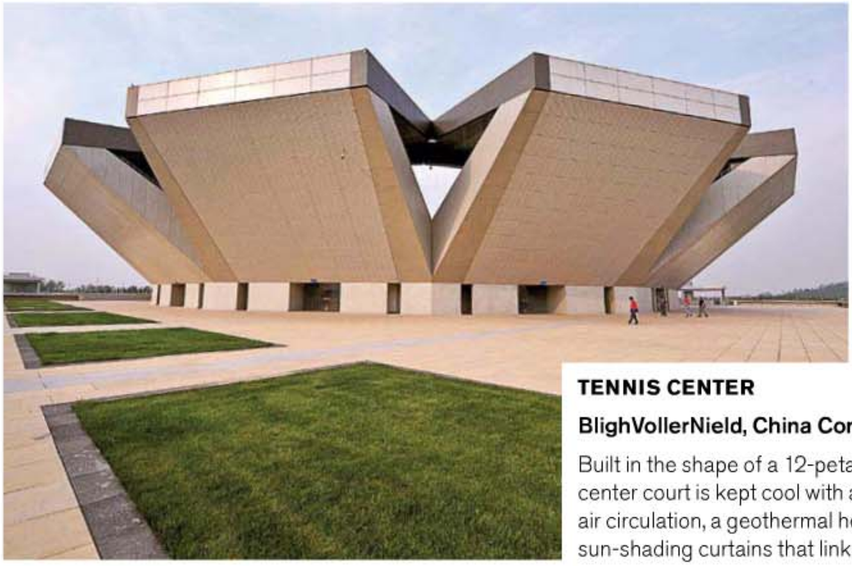
CHILLED-OUT ARCHITECTURE

Beijing has invested billions of dollars on event venues for the Games, many of which are innovation showcases featuring advances in energy-efficiency.

BASKETBALL GYMNASIUM

Beijing Architecture Research Institute

The 18,000-seat venue for the Games' basketball and handball competitions features an aluminum alloy skin that reflects most of the sun's rays. That's expected to cut the gym's cooling bill in half.



TENNIS CENTER

BlighVollerNield, China Construction Design Intl.

Built in the shape of a 12-petal lotus flower, the semi-enclosed center court is kept cool with a design that allows for maximum air circulation, a geothermal heat pump system, and automatic sun-shading curtains that link the "petals."

(BASKETBALL GYM) FENG LI/GETTY IMAGES ; (TENNIS CENTER) XINHUA/PHOTOSHOT; (RUNNER) ANDY LYONS/GETTY IMAGES

LONE STAR TRACK SPIKE

Adidas

These shoes were developed for Athens gold medalist Jeremy Wariner. The spikes on the left and right soles are different from each other because Wariner mostly propels with his right foot and stabilizes with his left. And the plates the spikes attach to are made from ultralight—but superstrong—carbon nanotubes, keeping weight to a minimum. Adidas is using the design as the basis for new versions of its mass-market adiZero and Bounce running shoes.

THE OLYMPIC RINGS' HALO EFFECT

Sometimes innovation pops up in unexpected places—from ticket technology to starting guns. Makers of these goods hope to get an added marketing boost from their ties to the Olympics.

DHS HURRICANE KING TABLE TENNIS PADDLE

Double Happiness Sports $173

Wang Liqin, winner of two Olympic medals, consulted on this paddle's design. The Hurricane King is a bit lighter than standard models, and its rubber covering helps Wang put more topspin on the ball.

STARTING SYSTEM

Omega

The official Olympic timekeeper since 1932, Omega this year has linked the starting gun to loudspeakers at each starting block. That way, all the runners hear the "pop!" simultaneously, and those farther from the gun are no longer at a disadvantage. Motion sensors in the blocks will detect false starts.

SIDEWINDER MIRROR GOGGLE

Speedo, $25

Modeled after no-frills, plastic goggles popular among competitive swimmers, the minimalist Sidewinder offers a lean look that reduces drag in the water. Even though they have no cushioning, their contoured shape keeps the water out. And the silicone headstrap keeps them in place even at world-record speeds.

RFID TICKETS

ASK-TongFang

Tickets in Beijing are embedded with radio-frequency-identification chips, which store seat, event, and other info in a central database. That helps to prevent forgery and provide greater security.

(TICKETS) FENG LI/GETTY IMAGES

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suits—which help swimmers glide through the water with less resistance—that it decided not to spend a dime on advertising related to the Beijing Olympics. The decision "was risky," says Craig Brommers, Speedo's vice-president for marketing. But it has paid off. The company in February introduced an updated line of full-body suits, called the LZR Racer, and swimmers wearing them have since broken numerous world records. That has generated tons of free media coverage, which leaves money to spend on mass-market swimwear using LZR technology. By the 2008 holiday season, Brommers says, Speedo will offer men's swim shorts that repel water like the LZR does and a suit for women that shapes the torso to reduce drag.

General Electric may be going the furthest with its innovation-related marketing push. It's building a 16,500-square-foot "Imagination Center" with displays of new products such as the ultrasound machine that Heather Mitts will benefit from and a selection of the company's 400 other Olympics-related projects. These include rainwater-recycling at the National Stadium, wind turbines for powering the games, and a small, energy-efficient MRI machine at the Olympic Village hospital. All told, the company says it has racked up $700 million in sales from the Games. After the event, the entire Imagination Center and its exhibits will be transported to GE's Shanghai offices. Clearly, GE hopes the spirit of the Olympics will live on—not only the spectacle, of course, but also the fierce competitiveness—to bring new, profitable innovations to market. Says Foss: "The Olympics are a commercial laboratory for us to prove how we can do a better job for customers." BW

CAROLYN DJANOGLY

U.S. Olympian Amy Tryon will wear Nike's Ippeas boots at the Games

NIKE'S SWOOSH SADDLES UP

Its new riding boot raises eyebrows in equestrian rings

By Jay Greene

When Nike unveiled new footwear for athletes in all 28 sports at the Olympic Games, one of its offerings prompted skepticism: an equestrian boot. One rider opined on a Web site that it looks like "the stripper boot of the horse world." U.S. Olympic rider Gina Miles wonders if wearing a swoosh might lead to lower scores in a sport that prides itself on centuries-old traditions. And Nike archrival Adidas, which is also creating new shoes for the Games, said no to riding boots. "We didn't feel we could come in with some meaningful innovation," says James Carnes, Adidas' creative director.

Nike insists its offering, dubbed the Ippeas (Greek for "rider"), allows for better performance than hand-cobbled leather boots. It used its Air Zoom cushioning—a staple in its sneakers—in the sole to make the boot more comfortable. The century-old spur system was replaced with a titanium screw-in model that was easier to install and adjust. Instead of a vertical zipper on the back of the boot, Nike designed one that wraps around the calf. There's also grippy rubber on the part of the boot that touches the saddle to improve handling, as well as red piping and a shiny heel for flourish.

The world will get to see the Ippeas on the feet of U.S. rider Amy Tryon, a bronze medal winner at the 2004 Athens Games, as well as on the 14 members of the Chinese equestrian team. Tryon says the snug fit gives her greater control over her horse than any other boot she has worn. "If nobody tries to push the envelope, nothing changes," she says.

In the broader equestrian world, the reception remains mixed. Nike's Olympic footwear director, Sean McDowell, concedes that the idea of a new riding boot was initially a tough sell, but he's happy with the end result. Emily Esterson, editor of trade publication *Equestrian Retailer*, notes that "for a sport that's perceived to be so elitist, Nike brings a populism to it." Still, Nike says it hasn't decided if it will leverage its Olympic marketing play into a product for the general horse-riding public. It recently stopped mass-producing shoes for cycling because the market was too small. Just getting its swoosh in the equestrian ring, though, is a victory in itself.

OLYMPICS SECURITY IS NO GAME

By Dexter Roberts

U.S. companies are supplying high-tech surveillance gear to Beijing. The concern is how it might be used after the Games

REUTERS

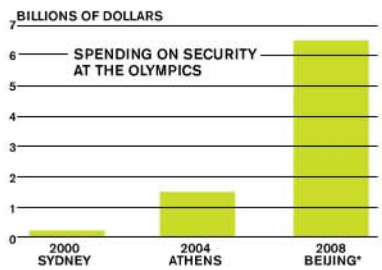
BEIJING

Even as the likes of McDonald's, Adidas, and Coca-Cola spend millions of dollars trumpeting their affiliation with the Beijing Olympics, a different group of multinationals is less eager for the spotlight. China is spending some $6.5 billion on security for the Games, and much of that has gone to foreigners. But given the sensitive nature of those contracts—and a skittishness over being perceived as supporting China's authoritarian government—these companies are often reluctant to discuss what they're doing or how much they're making. "We want to avoid answering sensitive questions," says a staffer in the Beijing office of Panasonic, which has sold surveillance cameras for use at the Games.

That doesn't mean these companies haven't been aggressive in courting business. General Electric, IBM, Honeywell, Siemens, Panasonic, and LG have all won major contracts providing security technology for the Olympics—one of the biggest security-business opportunities ever, and a shot at lots of ongoing business for those that get in early. The Chinese are laying out more than four times the $1.5 billion that Athens spent on security in 2004, says the Security Industry Assn., a Washington trade group.

The hefty increase is due in part to the immense size of the 2008 Games. Beijing alone has 31 Olympic venues; six other cities—the most ever for an Olympics—will play host to soccer, equestrian events, and sailing. In attendance will be 10,000 athletes, 30,000 journalists, and more than 80 heads of state, including George W. Bush and France's Nicolas Sarkozy. "Hosting the Games is, in the context of the U.S., like having two Super Bowls every day for 16 days," says Harvey W. Schiller, chairman of New York risk consultant GlobalOptions Group and a former executive director of the U.S. Olympic Committee.

SAFETY IN NUMBERS



*INCLUDES SPENDING ON SECURITY INFRASTRUCTURE, 2001-2008

Data: International Olympic Committee, Security Industry Assn.

BUSINESS BONANZA

Beijing's legitimate concerns about terrorism also are behind the big spending. On Aug. 4 two men attacked a group of policemen in western China, killing 16 of them. So China has deployed 34,000 People's Liberation Army soldiers and more than 75,000 other security personnel to keep an eye on the Games. Anti-aircraft missiles are in place around the "Bird's Nest" stadium, the centerpiece of the Olympics. And Beijing's airport was scheduled to shut

down during the Aug. 8 opening ceremonies in the stadium. "Safety is our top concern here," Vice-President Xi Jinping said while touring Olympic venues on July 21.

Foreign companies are a big part of the safety equation. Nearly 90% of the security equipment used directly in Olympic venues will be supplied by foreigners, the Security Industry Assn. estimates. Honeywell Security has sold intrusion detectors and surveillance cameras for use at more than 10 Olympic venues, including a $20 million contract for the Bird's Nest. Panasonic has provided some 2,000 surveillance cameras for the National Convention Center, site of the fencing competitions and the press center. Siemens sold more than $7 million worth of building-automation and security-control systems for the National Aquatics Center. And an IBM product called Smart Surveillance System, or S3, helps authorities keep track of images from some of the 300,000 video cameras watching for potential troublemakers on the streets of the capital, IDG News Service reported in December. IBM declined to comment.

Smaller companies are stepping in, too. Segway, the maker

Paramilitary police on Segways (above) and a rehearsal for the opening ceremony at the "Bird's Nest" stadium, where Honeywell has a $20 million contract

(RIGHT) SAEED KHAN/AFP

of two-wheeled, electric-powered scooters, has sold more than 100 of the $5,300 transporters for use at the Games. Many of these will be manned by police and other security-agency personnel. And ASK-TongFang, a French-Chinese tech outfit, is providing tickets with radio-frequency-identification chips in them. These allow authorities to maintain a central database of information on ticket holders and track their movements (page 39).

Probably no foreign company is more involved in Olympics security than GE. Its gear is installed in 22 venues, and it has 150 technicians on hand in case of breakdowns during the Games. At the Beijing airport the company has supplied seven detection systems that sniff the air for particles indicating that a passerby might be carrying a bomb or drugs. And the newly built subway line No. 10, which skirts the Olympic Village, is using GE video-surveillance devices. All told, 168 buildings in the capital have GE security equipment, and the company recently won the entire security contract for the new headquarters of national broadcaster CCTV, built in part as a showcase for the Olympics. GE declines to say how much the deal is worth.

Business doesn't end when the Games wrap up, either. Contracts for the Olympics are crucial to break into security in China, a market that will likely grow 30% this year, to nearly $11 billion—just behind the U.S., according to the Security Industry Assn. GE will provide security equipment for the 2010 World Expo in Shanghai and for that year's Asian Games in the southern city of Guangzhou. "These are mega-events with big infrastructure needs," says James D. Fisher, who oversees GE's Olympics-related business. Moreover, China has more than a dozen cities with populations topping 5 million, and "every one of these is building new subways, new airports, new stadiums, and new commercial buildings," says Fisher. "These are all huge opportunities."

Some experts warn that multinationals need to weigh such opportunities against the risks. China, after all, has a checkered human rights record. And the public security force, which is the buyer of most security equipment, is at the heart of efforts to clamp down on dissent—and could well end up using the nifty new gear to do just that. "All this top security technology is being employed for the Olympics," says Richard Chace, CEO of the Security Industry Assn. "The question is, what happens to it and how is it used after the Games?" |BW|

—With Ellen Gibson in New York

LINKS

And in 2010...
South Africa, which is gearing up to host soccer's 2010 World Cup, may be the next stop for global security heavyweights. The country's high crime rate and history of ethnic violence have spurred concerns for the safety of athletes and spectators. Australia's *Daily Telegraph* reports that South Africa will spend more than $133 million on security for the event, and in March the military conducted a simulated hijacking in Capetown to test its readiness.

HARRY HOW/GETTY IMAGES

3.5 MILLION MEALS IN 16 DAYS

By Nanette Byrnes

For Philadelphia food-services giant Aramark, the Beijing Games are the ultimate logistical challenge

After catering 13 Olympics since 1968, Aramark has pretty much seen it all—from scrambling to get enough staff for the Atlanta Games in 1996 to construction challenges in Athens four years ago. But feeding athletes, staff, and media at the Beijing Games is its toughest challenge yet.

The Philadelphia food-services company is trying to pull off its biggest Olympics while navigating the particular challeng-

Aramark recruited and trained nearly 7,000 locals to staff its Olympic facilities

es of doing business in China. The sheer scale of the project is just the start: close to 20 million servings of rice to prepare, 743,000 potatoes to peel, and a million-plus apples to scrub in the process of serving up to 10,000 people per hour. Add in the challenges of haphazard food distribution and the difficulty of finding Western staples like cheese. China's reputation for using high levels of pesticides and hormones in food production also has many athletes looking to avoid any food that's locally grown—putting more pressure on Aramark to prove the dishes it serves are perfectly safe. "It is a high-risk operation for us," says Aramark Chief Executive Officer Joseph Neubauer, whose company has spent the past two years in Beijing preparing for the 16-day event.

NOW SERVING

By closing ceremonies, Aramark will have dished up:

70,000	Kilos of chicken
800,000	Eggs
936,000	Bananas
3.5	Million meals

Data: Aramark

NO HOUSEHOLD NAME

The Beijing Games are likely to draw remarkable scrutiny for a company that's used to operating outside the limelight. Although odds are most Americans have eaten Aramark food at sports stadiums and amusement parks, few would recognize the name. The 49-year-old company employs 250,000 people in 19 countries—with 20% of its food-service sales outside the U.S.—and counts colleges, prisons, and hospitals among its clients. In January 2007, Neubauer led an $8.3 billion buyout to take the company private. Wachovia Capital Markets analyst Bryan C. Hunt expects revenues of $13.2 billion for the fiscal year ending Sept. 27, up 6.5% from 2007, with a gross profit of $1.3 billion.

While Aramark won't say how much it stands to make from this year's Olympics contract, Neubauer clearly hopes to leverage the high-profile deal into more business. China is one of his fastest-growing markets with annual sales of about $100 million. "I don't need to tell you how much the Chinese have been looking forward to these Olympics, how proud they are," he says. Aramark already runs employee cafeterias for Lenovo Group, Toyota Motor, and Dell operations in China, and has the contract to feed Formula 1 racing fans in Shanghai.

All the more reason to obsess over getting the Beijing Games right. To start, Aramark had to recruit nearly 7,000 mainlanders, mostly hospitality students, to staff its facilities and then teach them about Western standards of service in a matter of months. One challenge: teaching servers to make eye contact with customers and engage in some discussion of the food they are ordering. Aramark also asked the government to help local farmers learn how to cultivate unusual foods like squash, while teaching food suppliers the finer points of pizza- and ravioli-making. For Chinese food, Aramark deferred to a local partner's expertise, even building a hidden kitchen so that a renowned local chef could prepare his secret Peking Duck recipe away from prying eyes.

Coping with the country's nascent distribution network was daunting. Despite China's size and population, refrigerated trucks and warehouses are rare. Many people buy food at local markets, and shipping standards are lax. In March, Aramark, with a local partner, completed construction of a warehouse in Beijing to allow chilled and frozen storage for its food.

Although it has tried to buy most of its food in China, Aramark is importing somewhere between 20% and 30% of its ingredients, in part because it's too hard to find local sources of such mainstays of European and American diets as turkey slices for sandwiches. Aramark has been regularly running surprise soil and water inspections at supplier farms, but safety concerns linger for many. U.S. Olympic Committee spokeswoman Nicole Saunches says the U.S. team plans to import about a third of the food for its training facility at Beijing Normal University, standard practice for any Olympics. The U.S. delegation, she adds, "isn't concerned about the food that will be served by Aramark." So far, managers say, they have had no issues over food quality.

In putting together the massive project, Aramark executives say they have learned as much as they have taught. Catherine Toolan, Aramark's executive director for its Olympic Catering Services Project, says the slow and consensus-focused style of management in China has prompted her to "become a more patient person." Then again, nothing spurs action like a looming deadline. As Toolan puts it: "In the past six weeks people have really embraced decision-making." | BW |

—With Chi-Chu Tschang in Beijing

(BOTTOM, L TO R) PHOTOGRAPHS BY FRANK POLICH/REUTERS; SCOTT J. FERRELL/CONGRESSIONAL QUARTERLY/GETTY IMAGES

WHY THEIR ECONOMIC PLANS DON'T ADD UP

By Jane Sasseen
Illustrations by
Seymour Chwast

ELECTION WATCH

As he crisscrosses the country in his quest for the Presidency, Senator John McCain frequently repeats his vow to keep today's low income tax rates in place, take a further whack at the estate tax, and ease the tax burden on business. "I want to look you in the eye," he said at a July 30 town hall meeting at a local Caterpillar dealer in Aurora, Colo. "I will not raise your taxes nor support a tax increase. I will not do it."

Yet how much faith should voters put in the Arizona Republican's proposals? Or for that matter in Senator Barack Obama's bold plans to spend hundreds of billions on national health care, infrastructure, education, and energy? Put another way, how likely is it that the plans now being spelled out on the campaign trail will actually come to pass? In two words, not very.

Politics, the weak economy, and the reality of the ballooning federal budget will all limit the next President's room for maneuver. McCain's low-tax strategy could well be chewed up in a Congress that is likely to be even more Democratic than it is today. Obama's lofty plans could be undone by the hefty costs of his health-care plan and other programs. Even some Democrats may not stomach the huge expense and vast complexity of Obama's proposals.

In every election there is a big gap between what the candidates promise and what they can actually deliver. Think of Bill Clinton campaigning on middle-class tax cuts, universal health care, and infrastructure development. He spent much of his Administration cutting the deficit, not implementing big new programs. Or George W. Bush, who said he would trim greenhouse gas emissions in a move to buff his eco-credentials when facing off against Al Gore. Bush quickly abandoned that idea once the race was won.

A ROCKY ECONOMY MEANS THE GAP BETWEEN CAMPAIGN PROMISES AND GOVERNING REALITIES MAY BE LARGER THAN EVER THIS YEAR

This year that gap between promise and reality may be even larger than usual. "Whoever wins will face a big wake-up call as soon as the election is over," says Daniel Clifton, head of Washington policy research for investment group Strategas Research Partners. "Many campaign promises will need to be scuttled."

The 2009 economy will offer tough conditions for a President set on bold new policies. The next Administration will face anemic growth, sluggish employment, a housing downturn expected to continue at least through much of next year, and continued tight credit markets as the shakeout works its way through the financial sector.

And in part because of last spring's $168 billion stimulus, the federal deficit will rise to nearly $500 billion next year, almost three times fiscal 2007 levels. There's a growing sense in Washington, particularly among Democrats, that another round of stimulus or further moves to bail out the housing or financial markets could be needed. Such spending could add tens if not hundreds of billions to the deficit. In the face of that tab, the question will be whether McCain or Obama can find the money to fund many of their tax cuts and spending proposals.

Some economists think the next President will have more room to maneuver than those deficit estimates suggest. A $500 billion deficit would be about 3.6% of gross domestic product, still well below the 6% high reached in 1983. Many economists also think heavy deficit spending is the right move in a slowdown. But sustained continued deficits do still matter, especially given the looming costs of Medicare and Social Security—it's the trajectory that counts, says James Poterba, the head of the economics department at Massachusetts Institute of Technology. And "there is no question that the proposals of either candidate would dramatically worsen the fiscal situation," adds Maya MacGuineas, president of the bipartisan Committee for a Responsible Federal Budget, a project of the New America Foundation, a think tank.

Start with McCain, who believes tax cuts create growth and jobs. Along with making the Bush tax cuts permanent on income, capital gains, and dividends, he would whittle back the much disliked Alternative Minimum Tax, reduce the estate tax from its planned 2009 rate of 45% to 15%, and double deductions that can be taken for children and other dependents, from $3,500 to $7,000. He'd also trim the corporate tax rate—one of the world's highest—from 35% to 25%.

Doing anything close to that could lead to a big hole in the Federal budget, however. Because all of the Bush tax cuts are set to expire by 2011, the official budget and deficit estimates include the big rise in tax revenues that would result from rates returning to earlier levels. Those estimates also assume that the AMT is fully collected, even though Congress "temporarily" adjusts it every year to keep many middle-class taxpayers from being hit.

So all the tax changes McCain calls for would be costly. According to estimates by the nonpartisan Tax Policy Center (TPC), extending most of the Bush tax cuts now set to expire in 2011 would cost an average of $170 billion a year in lost revenue between 2009 and 2018. Indexing the AMT so that it nabs fewer middle-class folk would nip $120 billion more from Uncle Sam's purse. McCain's proposed reductions in the corporate tax rate would lop off $73 billion annually on average. All told, estimates the TPC, McCain's tax proposals would reduce estimated tax revenues over the next decade by some $4.2 trillion.

What does the McCain camp say? Douglas J. Holtz-Eakin, McCain's top economics policy adviser, argues that McCain's proposals should be judged against the tax policies in effect today, since no one in Washington thinks it realistic that all the Bush tax cuts will snap back. Seen in that light, the McCain plan would cut tax revenues by $600 billion over the decade.

THE CANDIDATES' ECONOMIC PROGRAMS—AND THEIR PROSPECTS

BARACK OBAMA: Big Plans, Big Spending

Obama Promises	What's Likely
TAXES	
Plans a $1,000 tax cut for 95% of families, while boosting income, capital gains, and dividend taxes for those earning more than $250,000. Will target corporate breaks, too.	Increased taxes for high-end earners are all but guaranteed, but getting all he wants on the corporate side could be tough. Some middle-class cuts may have to be shelved.
ECONOMIC STIMULUS	
Backs $50 billion in aid for infrastructure and to help communities hit by the downturn, plus $1,000 family rebates to offset energy costs.	The cost of immediate stimulus could force cutbacks in other priorities.
DEFICIT	
Says he'll bring the deficit down from projected level of $500 billion by balancing social welfare plans with tax hikes or spending cuts elsewhere.	The revenue sources and spending cuts Obama is counting may not be enough to contain the deficit and pay for new spending.
ENERGY	
Would tap the Strategic Oil Reserve to cut gas prices and spend $150 billion to develop alternative energy and help automakers and others develop fuel-efficient technology. Backs a windfall profits tax on oil companies.	His plans to fund alternative energy development by essentially taxing utilities and other companies that emit greenhouse gases could face heavy opposition; the outlook for a windfall profits tax is also uncertain.
HEALTH CARE	
Proposes spending $65 billion a year to give coverage to the uninsured. Says better management and cost controls would also cut premiums by $2,500 for the average family.	The high price tag, particularly in the face of growing deficits, could lead the proposals to be scaled back. And getting all the proposed savings could be tough.

JOHN McCAIN: Low Taxes, Less Government

McCain Promises	What's Likely
TAXES	
Would extend the Bush tax cuts, keep the current capital gains tax, trim the alternative minimum tax, double the value of exemptions for dependents, and slash corporate rates.	Such cuts could significantly boost the deficit and give much bigger breaks to high-end earners than lower- or middle-class families. A Dem Congress will likely balk.
ECONOMIC STIMULUS	
Would give time for current stimulus measures to play out through the economy before going ahead with further moves.	If the economy continues to decline or the fallout from the housing crisis worsens, McCain, too, may consider further stimulus.
DEFICIT	
Promises to balance the budget by the end of his first term by slashing wasteful programs, slowing spending growth, and closing tax loopholes.	Most budget experts are highly skeptical he can achieve this, particularly if he is able to win big tax cuts.
ENERGY	
Calls for suspending the 18.4¢-a-gallon federal gas tax and ending restrictions on offshore drilling. Backs aggressive expansion of nuclear power along with modest measures to boost clean coal and alternative energy.	Support for offshore drilling is growing, but Congress so far has shown little interest in suspending the gas tax. Nukes remain a question as long as a solution to waste disposal is unavailable.
HEALTH CARE	
Would give families a $5,000 tax credit to help the uninsured afford coverage and boost competition. Argues the move, along with improved management, will trim costs.	Spurring the private sector alone may not be enough to cover the uninsured. And those with insurance from their employer will be taxed on that benefit. A tough sell.

(L TO R) PHOTOGRAPHS BY SCOUT TUFANKJIAN/POLARIS; ALEXIS C. GLENN/UPI/DRR.NET

By either measure, Holtz-Eakin argues that the TPC numbers don't take account of the economic expansion that would be stoked by reducing taxes.

Roberton Williams, a Congressional Budget Office veteran now at the Tax Policy Center, points out there would be a sizable shortfall in revenue if McCain got his tax cuts. Current federal spending accounts for about 20% of GDP. The TPC says McCain's proposals would cut projected tax revenues to just 17.6% of GDP. "You'd need an awful lot of growth—or some awfully large spending cuts—to close that gap," says Williams.

That breach shows how tough it will be for McCain to meet his pledge to balance the federal budget by the end of his first term. He says he can cut $100 billion a year from the budget by going after earmarks and other wasteful programs in the military, in farm subsidies, and in health care. Holtz-Eakin adds that McCain would push Congress to limit government spending to a 2.4% annual increase. That's well under the 4.3% rise projected by the Congressional Budget Office, and cutting pork-barrel spending or popular government programs is one of the hardest political tasks going. Every candidate promises to cut waste. Few have ever delivered.

Obama has been more specific than McCain in detailing the tax hikes and spending cuts that would allow his Administration to pay its way. His thesis is that the squeeze on working- and middle-class families lies at the core of the economy's problems. "It's time to restore balance and fairness to our economy so it works for all Americans," he told a town hall meeting in Springfield, Mo., on July 30.

To address these imbalances, Obama backs $50 billion in near-term stimulus. Longer-term, he would spend $65 billion a year on a broad-based health insurance program to cover the uninsured, plus $150 billion on green energy technologies and $60 billion on infrastructure over the next decade. Some $18 billion annually would go into early childhood education, while college students would get $4,000 in tuition tax credits. Then there's a $1,000 rebate for families hit by high energy costs.

Who will pay for this largesse? For families bringing in more than $250,000, Obama would raise the top two income tax brackets back to the 36% and 39.6% rates in effect in the Clinton years. He would also boost taxes on capital gains and dividends for high earners from today's 15% to between 20% and 25%. The TPC estimates those moves could bring in an average of $28 billion a year. Obama also proposes to raise taxes on oil and gas companies, tax the gains of private equity partners as regular income rather than at the lower capital gains rate they now pay, and target overseas tax havens and income earned overseas. These moves could bring in some $92 billion a year.

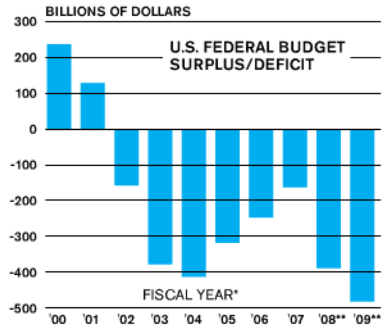
Still, because of host of other tax breaks he has proposed—indexing the AMT for inflation, further cuts for seniors and working families, and an extension of the Bush tax cuts for families making under $250,000—the TPC estimates Obama's plan would cut tax revenues over the next decade by some $2.8 trillion. Overall, says Williams, the Democrats' plans would bring in tax revenues of 18.3% of GDP—more than McCain's plan, but still below the estimates of expected federal spending.

Like Holtz-Eakin, Obama's top economic adviser, Jason Furman, argues that Obama's plan should be measured against current tax rates, rather than having to add back the full cost of ending the Bush tax cuts. By that measure, Obama would raise $778 billion over the next decade and help whittle down the current deficit. Those numbers, however, don't take into account many of Obama's plans to boost spending in areas like health care and green energy.

Furman argues that the Obama camp will also bring down spending in other ways that aren't in the TPC tally. Using more technology, better managing chronic illnesses, and reducing drug prices would drive down health-care costs for everyone and fund the expense of adding the uninsured to the rolls. Money would be freed up by redirecting much of the $10 billion a month now being spent on Iraq. Funding for green technology would come from establishing a market-based "cap and trade" system to control the harmful carbon emissions that cause global warming. Auctioning off the rights to emit such carbon to oil refiners, coal-fired power plants, and others would bring in more than the $150 billion Obama wants to pour into alternative energy development. "With each policy, we've laid out what we'll do and how we'll pay for it," says Austan Goolsbee, another top economic adviser. "Our budget adds up."

It would add up—but only if all those projected new revenues come in. That's an aggressive assumption, say budget experts. Even if the decision to leave Iraq were made tomorrow, the costs of drawing down the troops and refurbishing the military's equipment will continue to eat up much of that sum for several years.

A DEEPER HOLE



*FISCAL YEAR BEGINS IN OCTOBER OF THE PREVIOUS CALENDAR YEAR **ESTIMATES

Data: Congressional Budget Office, White House Office of Management and Budget

CHART BY LAUREL DAUNIS-ALLEN/BW

LINKS

Do Deficits Matter?

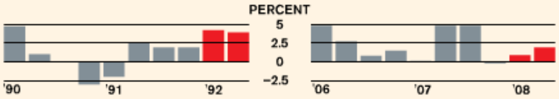
H. Ross Perot turned the U.S. budget deficit into a central theme of the 1992 election. A poll carried out by the Pew Research Center for the People & the Press (pewresearch.org) on the eve of that vote showed that 40% of Americans rated the deficit as the most important challenge facing the incoming Administration. These days, though, voters don't seem anxious about what will be a huge shortfall by next year. In Pew's latest poll, conducted July 23-27, just 2% of respondents said the deficit was the most important economic problem facing the nation. Which issue rated highest on the list? You guessed it: gas prices.

THE VIEW FROM '92

The last Presidential election during which economic conditions were this bad was in 1992, when Democrat Bill Clinton challenged George H.W. Bush's reelection bid. "Change" was a big theme back then, too. *–By Peter Coy*

1992 vs. **2008**

ANNUALIZED RATE OF GDP GROWTH



Data: Bureau of Economic Analysis

MISERY INDEX

JUNE 1992		JUNE 2008	
7.8%	3%	5.5%	4.9%

● UNEMPLOYMENT RATE ● INFLATION RATE

Data: Bureau of Labor Statistics

PRICE OF A GALLON OF REGULAR GASOLINE

JULY 27, 1992	JULY 28, 2008
$1.13	$3.96

Data: Energy Information Administration

MEDIAN SINGLE-FAMILY HOME PRICE

(AND 12-MONTH PRICE CHANGE)

JUNE 1992	JUNE 2008
$107,000 (+2%)	$213,800 (–7%)

Data: National Association of Realtors

TOP BRACKET FOR PERSONAL INCOME TAX

(AND WHERE IT KICKS IN)

HIGHEST RATE	KICKED IN AT	HIGHEST RATE	KICKED IN AT
31%	$86,500	35%	$357,701

Data: IRS

POLLING FOR PRESIDENT

AUG. 6-7, 1992		JULY 31-AUG. 2, 2008	
Democrat Bill Clinton	49%	Democrat Barack Obama	45%
Republican George H.W. Bush	32%	Republican John McCain	44%

Data: Gallup Poll

THE CANDIDATES ON "CHANGE"

Democrat Clinton
"I represent real hope for change."

Republican Bush:
"Change for change's sake isn't enough."

Democrat Obama
"Change we can believe in."

Republican McCain:
"The choice is between the right change and the wrong change."

Alan Viard, a tax policy expert at the American Enterprise Institute, also points out that closing corporate loopholes is a perennially popular idea, "but it's a lot harder to do when you get down to specifics." Private equity firms already defeated one congressional attempt to boost their tax rates last year, thanks to heavy lobbying. Obtaining big savings through better management of the health-care system will also be a big challenge. "The truth is, no one really knows how much cost savings such moves can generate," says MacGuineas of New America's budget committee.

Money won't be the only constraint on the candidates. Tom Gallagher, the head of Washington research for financial services firm ISI Group, argues that much will also depend on where Congress stands. That simple truth could spell big difficulties for McCain's Presidency. If current trends hold, the Democrats look likely to strengthen their majorities in both houses. Much of what McCain is now promising to voters could be very difficult to get past Congress.

Take McCain's pledge to maintain all of the Bush tax cuts, even for the affluent. There is little Democratic support for maintaining today's lower rates for top-end taxpayers on income, capital gains, or dividends. "Those rates are gone for taxpayers making over $250,000 come 2011—unless Congress restores them, and Congress is simply not going to do that," says the AEI's Viard. As for McCain's plan to slash corporate rates? Viard and others say don't count on those either.

Obama may not have an easy path himself. A strained budget could force him to dial back on his health-care plans or drop some of his proposed tax cuts. Obama's attempts to fund his $150 billion alternative energy plans could run into especially strong headwinds. He wants to auction off carbon emission rights to the utilities, oil refiners, and others who are largely responsible for such pollution. But auctioning those rights off rather than initially giving many of them away—as McCain and others have advocated—could put a bigger financial strain on the companies involved.

A less stringent emissions plan than Obama supports has already foundered in the Senate. "A bill that's less business-friendly than the one that stalled in June would be even less viable," says Vicki Arroyo, the director of policy analysis for the Pew Center on Global Climate Change.

Furman says the Obama campaign has been conservative in estimating the savings and revenues it can count on to fund its proposals. As for the politics, Obama's willingness to push for such changes and show how he'd pay for them will make the difference to Congress. "Having Presidential support will change the dynamic completely," Furman says. On that, if little else, Furman and Holtz-Eakin agree. If McCain is elected on a platform of low taxes and contained spending, he'll have a mandate the Democrats will have to heed. "Congress can't ignore the evidence," says Holtz-Eakin.

Come January, the next President will have to take a much clearer stand as to where his priorities truly lie. The problem for voters is that it is impossible now to tell which of many competing goals Obama or McCain will back when the time comes to move from campaigning to governing. In either case, Americans will likely get much less than what's being offered in the heat of the campaign. | BW |

RETAILING

A Fashion Guy Gets Gap Back to Basics

Charged with reviving the ailing brand, Patrick Robinson is putting a modern spin on classics

By Jane Porter

In recent months, Gap has made many of the basic moves one would expect from an apparel chain that has grown too big and lost its way. It has whacked inventory by a third, nixed TV ads to reduce marketing costs, cut from 12 to 9 months the time it takes to move clothes from concept to rack, and staked out the demographic middle, 25- to 35-year-olds.

Sales remain anemic (chart), and Gap needs to get people excited about its clothes again even as consumers pull back and the competition heats up. The man largely responsible for making that happen is design chief Patrick Robinson. No mass merchandiser, Robinson worked for Anne Klein, Giorgio Armani, Perry Ellis, and, most recently, Paco Rabanne. Since his appointment 14 months ago, Robinson, 41, has pushed Gap to reconnect with its roots: classic American apparel with a modern twist. He is now rolling out his first large collection, the fall line, and the industry will be watching to see how it sells. Robinson can't turn Gap around by himself. But, says Mark Montagna, who covers retail for the investment bank CL King & Associates, "he can single-handedly sink it."

Gap President Hansen urged collaboration with store managers

OUT OF FASHION

*FOR STORES OPEN AT LEAST 12 MONTHS IN NORTH AMERICA

Data: Gap; CL King & Associates

When Gary Muto, who oversees adult apparel for Gap, opened Robinson's portfolio, he saw what he was looking for: the ability to create a cohesive look for everything from belt buckles to blouses, a skill Gap had lost in recent years. "If you look at his work," says Muto, "there is a consistent handwriting and point of view." Beyond bringing clarity to the brand, Gap's aim is to allow shoppers to mix and match garments and come up with different looks that make them feel individual. The hope, of course, is that Jane or Joe Consumer will buy several items per visit.

Beyond that, Robinson had a pretty good idea of what ailed Gap. It was targeting too young a customer (18- to 24-year-olds), stocking poor quality clothes, and imitating Uniqlo, H&M, and Zara, which have transformed the industry with their focus on fast fashion—rapid-fire mini-trends. "It wasn't being Gap," says Robinson, who was determined to get off the

Design chief Robinson sporting a classic Gap T-shirt

(L TO R) CHART BY DAVID RUDES/BW; THE GAP VIA BLOOMBERG NEWS; BRAD HARRIS

LINKS

A Mall's New Best Friend?
Foreign retailers are descending on the U.S., *Women's Wear Daily* reported Aug. 4. *WWD* says "mall operators have embraced [them] at a time when many American retailers are closing stores or scaling back expansion plans." Latest newcomer: Sandwich, a Dutch purveyor of women's clothing that opened in Las Vegas.

trend treadmill and revive the signature classics that he wore growing up in California.

But first he needed to revive his team's animal spirits. Robinson quickly noticed that few of his staffers were wearing their own designs, never a good sign. Nor were they talking to each other. On his first day he discovered that the accessories people were using a belt pattern that the women's apparel team had stopped using. "You don't want one team doing van Gogh prints and one doing polka dots and stripes," he says. Robinson pulled the two teams into one room. That set the tone. "Before Patrick got here," says Michael Jarvela, who designs men's apparel, "It felt like a scramble."

For several years, Gap, under former Disney executive Paul Pressler, relied heavily on focus groups and spent little time in the stores. Early on, Gap North American President Marka Hansen encouraged Robinson to have breakfast with store managers at Gap's flagship on 34th Street in New York City. As he scribbled furiously in a yellow pad, the salespeople pointed out flaws: tank top straps that dug into women's shoulders; confusing sizing that made male shoppers cross-eyed. And they rejected plans to revive a much-loathed novelty item called a sock monkey (yes, a monkey doll made from socks). "It was eye-opening," says Robinson of the meeting with store managers. "They are the only people who don't have a motive except to sell product. I've said to every designer, 'Get into the stores and talk to the salespeople.' "

Since arriving, Robinson has brought a measure of common sense to Gap. But some wonder if his high-fashion background will trip him up. One industry expert says some of Robinson's color choices (purple plaids, anyone?) may be too sophisticated for the everyday shopper. With consumers cutting back and competitors muscling in, Robinson will need to find that delicate balance: turning shoppers on without scaring them off.

Robinson's handiwork is evident in stores, which practically blare the back-to-basics theme. The quality is more consistent. At the Manhattan flagship, the same cardigan is fitted on five mannequins—one in a pink polka dot dress, another in brown slacks and a flowery top, another in pin-striped jeans and silver flats—showcasing different looks for different women. Industry analyst Montagna says more shoppers are buying on first or second markdown rather than the fifth or sixth. It's a sign, however tentative, that consumers are starting to respond to the changes.

Robinson, mindful of the huge challenge ahead of him, knows great clothes can take Gap only so far. "I can design the best T-shirt," he says. "But if we don't put it in the right stores in the right amount of sizes..." Well, that's out of his hands. "It's going to take this whole company to do it," he says. BW

The Bear Starts Mauling Lawyers

The mortgage bust has even hit New York powerhouses long immune to big layoffs

By Michael Orey

At a time when businesses from banks to bakery suppliers are shedding tens of thousands of workers, news that a New York law firm is pink-slipping 96 attorneys might seem like a speck of flotsam in a sea of economic pain. But Cadwalader, Wickersham & Taft's announcement on July 30 has set top-tier law shops abuzz nationwide. Economic downsizing is rare in such circles. And the number of lawyers the venerable Wall Street firm, founded in 1792, is letting go reflects the pain the credit crisis is inflicting,

The depth of the cuts—about 15% of its lawyers—is emblematic of the hard-headed management mindset that has taken hold at firms once known for their clubby ways. Associate attorneys (nonpartners) at blue-chip firms have enjoyed unusual job security since the recession of the early 1990s. With broad practices in areas from dealmaking to bankruptcy, firms could keep people on amid the normal ebb and flow of business cycles.

Law firms that rode the credit-finance boom to lofty heights are now so overstaffed they have to downsize

In the current downturn, though, some are suffering such a glut that they have to downsize. Even partners, who have an equity stake in the business, are not immune from being pushed out. Those "with less than ideal books [of business] or in practice areas that cannot command top dollar are being reevaluated from an economic point of view and are vulnerable," says Martha Fay Africa, managing director of legal recruiter Major, Lindsey & Africa in San Francisco.

"THE MUSIC STOPPED"

The stress is especially acute at places that rode the credit-finance boom to lofty heights. In May, Chicago's Sonnenschein Nath & Rosenthal laid off 37 attorneys along with 87 other staffers, most of whom worked in real-estate securitization. Thacher Proffitt & Wood, a Wall Street firm with a big stake in structured finance, has shed 60 attorneys since Jan. 1—a 25% drop. Managing partner Paul D. Tvetenstrand says firms nationwide have been hurt by the weak economy, but those in New York have been hit especially hard.

Few were as vulnerable as Cadwalader. It became the dominant player in transactions involving commercial mortgage-backed securities (CMBS), the finance method of choice for some of the biggest deals of the past three years. The number of lawyers grew along with the market, peaking at 669 this past January. Cadwalader partners' share of the firm's profits averaged $2.7 million each last year, among the highest in the nation.

Then, says Cadwalader managing partner W. Christopher White, "the music stopped." In January the firm axed 35 lawyers. The assumption, White says, was that the froth would come off the market and that CMBS issuance would resume at a more moderate pace. Instead, it cratered, dropping from a market high of $314 billion in 2007 to a projected $68 billion this year—prompting the latest cuts.

Some give Cadwalader credit for being up-front about the fact that its layoffs are economically driven. Most firms tend to engage in "stealth layoffs," upping the standards for performance reviews when times are tough. The result stigmatizes those attorneys who are let go. Indeed, Cadwalader's move may offer cover for other firms to do the same. Notes Ward Bower of law firm consultant Altman Weil: "These things tend to happen in bunches."

Cadwalader has held on to about 150 lawyers in its real-estate securitization practice who are ready to resume work once the deals pick up. Still, White says, they're likely to be underutilized, perhaps until 2010. | BW |

–With Carl Winfield in New York

KYLE T. WEBSTER

"I will not ship until we are the fastest...in the world," says Trollope

Security That Won't Slow Down Your PC

Symantec is scrambling to get the bloat out of Norton software—and stop the slide in market share

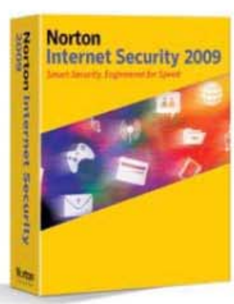
By Cliff Edwards

In 2006, Rowan Trollope, a top executive at Symantec, declared war on his own engineers. The company's Norton computer-security software was getting so overloaded with features that his best friends told him they turn off the software rather than deal with the problems it causes. "I realized then we were pigs, taking up way too many PC resources," says Trollope, senior vice-president for consumer products.

Within weeks, half the team's managers were gone. Then Trollope embarked on a plan to shake up Symantec and change the way people think about protecting their computers from viruses and other assaults. His goal? To make sure Norton software not only lost its bloat but also sped up the performance of PCs. It's the first step in a five-year plan to make Symantec software easier to use. "It was pretty obvious we needed a new game plan," Trollope says.

Many computer users would agree. While security software protects computers, it's also a primary reason PCs have become such headaches. Firewalls block you from watching videos on the Net. Pop-up windows interrupt regularly to ask permission for mundane tasks. And virus scans slow your computer to a crawl.

No company has more on the line in this market than Symantec. Norton is the company's most important product, accounting for 30% of its $5.9 billion in revenue last year. And though Norton is the leading security software, it has been losing market share.



Many customers have found they can download simpler security software free off the Web from such rivals as Japan's Trend Micro. "A lot of people notice their PC suddenly is faster after that Norton trial subscription expires," says Richard Doherty, research director at consultant Envisioneering Group.

Symantec CEO John Thompson tapped Trollope to overhaul Norton in 2006. Trollope, who turns 36 on Aug. 16, has a reputation as a fixer. He started in customer service at Symantec at 18 and soon moved to bigger roles. A mountain climber and motorcycle racer, he seems to relish high-risk situations.

He certainly faces one now. Sitting with 14 department heads in late July, he argues about which bells and whistles must be jettisoned to make the Aug. 26 shipping deadline for Norton 2009. His team has hit a number of ambitious goals. But in recent days, rival Kaspersky Lab has released a product that's faster than Norton at virus scanning. "I will not ship until we are the fastest security-suite product in the world," says Trollope.

BASH AND MR. CLEAN

He's betting two innovations will help him hit the goal. One is a technology, dubbed Mr. Clean, that makes virus scans more efficient. Instead of checking every photo and document on your computer, Mr. Clean will skip over any files associated with an application it judges to be "good." Bash, the other technology, uses a similar approach. Instead of checking each application against more than 500,000 viruses, it will zip through scans by looking only for "virus-like" behavior. Together, the two could cut scan times by more than 90%.

As the deadline nears, Trollope says Symantec looks likely to reach its goal of having the swiftest security scans. The difference with rival products may be measured in seconds. But it's vital, he says, to winning back computer users who think security software is a big hassle. "We have to fix that," he says. | BW |

SIAN KENNEDY

Stalking the Wild Copycats

In Africa, no consumer product seems too small or too cheap to be targeted by Chinese counterfeiters

(TOP) VANESSA VICK/REDUX

By David Rocks in Kampala, Uganda, and Alex Halperin in Nairobi, Kenya

A few years ago, consumer products giant Sara Lee started seeing knockoffs of its biggest seller in Africa, Kiwi shoe polish. The company fought back by updating the Kiwi label, but the counterfeiters quickly matched it. So Sara Lee introduced new packaging sizes. A half-year later the fakes were showing up in the new sizes. Then the company changed the mold to give the Kiwi tins a deeper rim, but counterfeiters soon had nearly identical ones on the market. "Every time we change something, their lead time gets shorter and shorter," says Joab Ouma, who at the time was Sara Lee's marketing director for East Africa and now works independently as the company's distributor in Uganda. "First it was six months, and now it's as little as six weeks."

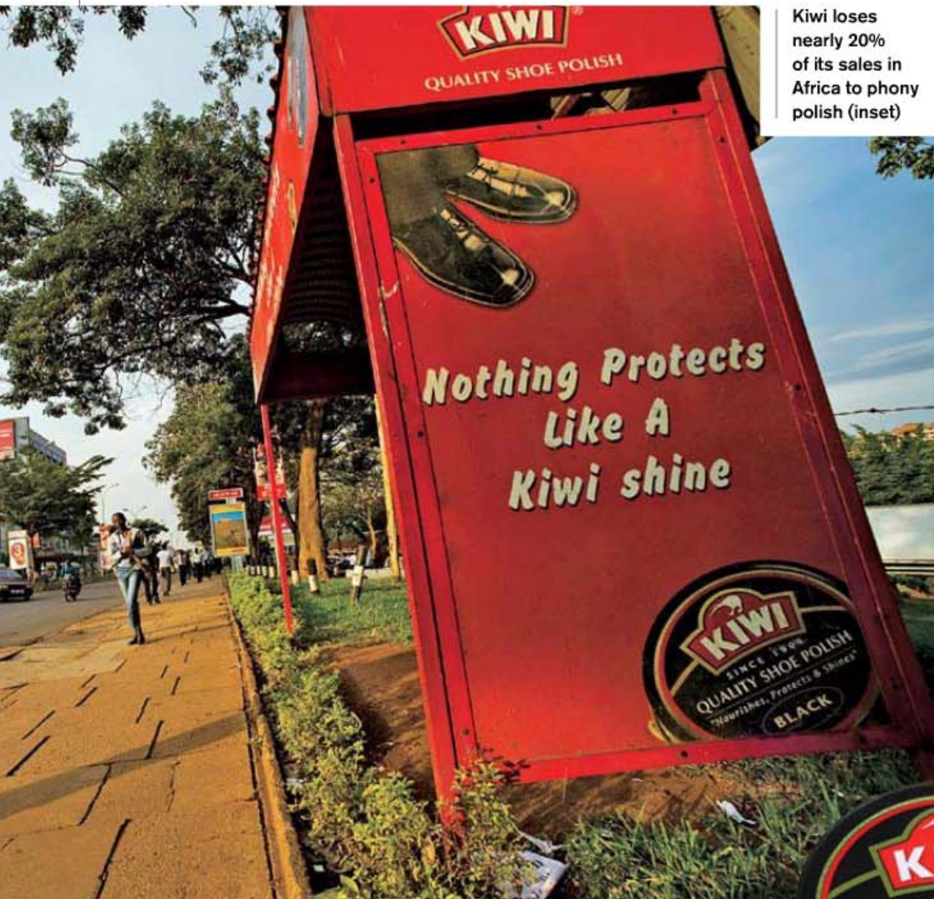
The focus of this game of cat-and-mouse: shoe polish that retails for as little as 35¢ per tin. Kiwi is far and away the biggest shoe polish brand on the continent, with overall sales of more than $50 million and perhaps 80% market share. But in Uganda and some other countries roughly half the "Kiwi" for sale is fake, cutting Sara Lee's shoe polish sales by about 20% across the continent. "The biggest competitor we have is our own brand," Ouma says.

Forget knockoff Rolexes, ersatz Louis Vuitton handbags, and fake Viagra. Chinese counterfeiters targeting Africa head directly for the bottom of the market. Low-end, high-volume goods such as ballpoint pens selling for a dime, tiny packages of soap or deodorant, and Kiwi shoe polish (a surprisingly big business in Africa, where people often keep shoes for years, shining them fastidiously) are all prime targets for China's legions of factories making knockoffs. Kiwi has closed factories in Malawi and Zambia, and a plant making BiC pens has shut down in Mozambique—all in part because of piracy.

It's easy to see why the fakers like Africa. While they're happy to sell obvious knockoffs, it's far better for them if they can sneak their products into the legitimate retail-sales chain and fetch full price. Nowhere is that easier than in sub-Saharan Africa, where the vast majority of sales are rung up in tiny cinder-block storefronts or kiosks thrown together from scrap wood. While the few big chains keep suppliers on a tighter rein, Africa's hundreds of thousands of small merchants buy their wares from the cheapest source they can find. The Uganda National Bureau of Standards estimates that nearly a third of consumer goods sold in the country could be fake.

Legitimate manufacturers themselves can't always spot a fake (at right)

And the counterfeiters can make money, even with items that sell for pennies. Kampala-based Nice House of Plastics makes toothbrushes sold only in Uganda and neighboring countries. These days, it's shipping fewer than 800,000 brushes monthly, down from about 2 million before Chinese manufacturers started copying them two years ago. "People used to use tree branches to brush their teeth, but as they get more money they're buying toothbrushes, so sales should be growing," says James Mulwana, managing director of Nice. Although the retail price of a Nice brush is just 20¢, and Mulwana makes less than 2¢ profit on



Kiwi loses nearly 20% of its sales in Africa to phony polish (inset)

each sale, the counterfeiters' margins are higher because they don't have any advertising or marketing costs. "Once the Chinese find that your product is selling, they'll copy it," he says.

It helps that the counterfeiters make really good copies. The faux Nice toothbrushes come in a plastic blister pack that's virtually indistinguishable from Nice's packaging, except that the knockoffs say "Design in Germany" while the real ones say "Made in Uganda." In Nairobi, Haco Industries manufactures BiC pens under license. Haco has seen pens fall from 90% of its $25 million in annual sales to just 50% as the market has been inundated with fakes that even company executives have difficulty telling from the genuine article. Haco Managing Director Polycarp Igathe takes one of the copies and smashes it against the glass top of his desk, but it doesn't break. "This is bloody good," he says, examining the unbruised pen. "They are getting better every day."

African governments realize they have a problem, but they have a hard time fixing it. "Protection of intellectual property rights in developing countries...is a new thing," says Wycliffe Swanya of the Kenya Association of Manufacturers. Kenya and Uganda have floated anti-counterfeit legislation, but the measures haven't passed yet. Even if they become law, inexpensive consumer goods won't likely be a top priority. "The authorities say, 'If we have to go after either someone selling counterfeit drugs or someone selling fake shoe polish, the choice is clear,' " Ouma says.

That means brand owners are left to fight the problem on their own. Sara Lee, Nice, Haco, and others often sue importers of counterfeits under a hodgepodge of existing regulations. But those outfits tend to be shell companies that fold after bringing in just one or two shipments, making it tough to find the owners. Sara Lee has found dozens of factories in China that counterfeit its products, and says it has made progress in fighting the problem. But while Sara Lee can sometimes impound the goods it finds, it's much harder to seize manufacturing equipment. "Have we really shut them down? No," says Sander Bakker, a Sara Lee anti-counterfeit executive. At the Canton Fair, a twice-yearly confab in the Chinese city of Guangzhou, Bakker says he has seen catalogs from counterfeiters offering products masquerading as various global brands.

As for the product itself, Sara Lee says the counterfeiters take shortcuts that make for inferior polish. They use kerosene, while real Kiwi is based on a more refined petroleum byproduct called white spirits, which Sara Lee says better protects shoes. Ouma sniffs a tin of fake Kiwi and turns up his nose, but a less discriminating sniffer can't discern a difference.

At Haco, meanwhile, workers pour plastics through injection molds to form the components of a BiC. Other employees assemble pens by hand and sort them into boxes for shipping. Can Haco keep providing those jobs? Igathe says the counterfeiting might eventually force the company to outsource its production to China. "It's a real question in our strategic plan," he says. "But it would make me bleed." | BW |

LINKS

Crocs Crackdown

Piracy fighters can take heart from a recent South African court victory for plastic sandals-maker Crocs. Intellectual property blog AFRO-IP says police confiscated 10,000 pairs of sandals that looked like Crocs from retailer Shoprite Checkers. Shoprite challenged the seizure, saying the shoes weren't sold as Crocs. But the court ruled that Crocs' distinctive shape gives it trademark protection anyway.

Gerber Is Following Kids to Preschool

Nestlé rolls out a line of convenience food for the under-five set, but is it the healthy choice?

By Aili McConnon

Nestlé is trying to keep kids hooked on the Gerber brand until kindergarten. Next month, the Swiss food giant will launch convenience food aimed at the two- to four-year-old crowd. U.S. retailers such as Wal-Mart Stores plan to stock the line, dubbed Graduates for Preschoolers, in anticipation that busy parents will leap at the chance to buy fruit twists and microwaveable entrées for little kids.

Nestlé's latest move is part of an ongoing effort to reduce its reliance on offerings such as Nescafé coffee and Kit Kat chocolate bars in favor of a more health-conscious image. "We are focused on becoming the premier health and wellness company," says Kurt Schmidt, CEO of Nestlé Nutrition in North America. Among its offerings: food for cancer patients and the Jenny Craig weight-loss products. With the $5.5 billion acquisition of Gerber from Novartis last year, Schmidt says, "We have died and gone to heaven." The nutrition segment generated more than 10% of Nestlé's $102 billion in sales last year, with sales up 14% in the first quarter.

Still, some question whether there's a need for "preschooler" meals. Setting aside special food for young children is not only expensive but it also may dissuade kids from trying anything new, they say. And serving separate food goes against the idea of a family meal. "Preschoolers' nutritional needs are not that different from adults," says Mary L. Gavin, a pediatrician at the Wilmington (Del.)-based Alfred I. DuPont Hospital for Children's Weight Management Clinic.

Moreover, it's debatable how healthy the meals are. Sarah Krieger of the American Dietetic Assn. notes that the 450-gram sodium content of a Gerber entrée such as cheesy pasta and chicken and vegetables is nearly half the U.S. Food & Drug Administration's recommended daily limit for a three-year-old. And while Gerber says its "Fruit Twists" are made of 99% real fruit juice and puree, they contain little discernible fiber. "It's always better to have a real piece of fruit," says Krieger. Nestlé responds that it's trying to reduce sodium and notes that it has U.S. Agriculture Dept. approval to put "healthy meals" on its packaging.

Gerber already has shown a knack for moving babies up the food chain with the Graduates for Toddlers label launched in 1990. That line, which consists of items ranging from fruit puffs to cut-up cooked carrots in baby-food jars, had $400 million in sales last year. Analysts such as Marco Gulpers of financial services firm ING note that retailers tend to like products targeted to children because mothers buy 2.5 times more than the average customer.

PRICE-SENSITIVE PARENTS

Still, Nestlé is launching the line in a tough economic climate. One Gerber preschool entrée will sell for $2.49, while each fruit twist will cost 60¢. Although parents of toddlers and preschoolers rarely trade down to cheaper store brands for their children, Gulpers says, they're more price-sensitive than the parents of infants.

For all the challenges, though, Nestlé is not alone in spotting this new demographic to target. Unilever markets a margarine fortified with vitamins for children, and Kraft Foods last year launched Lunchables Jr., a snack line that includes miniature crackers with cheddar and ham aimed at preschoolers. While Kraft won't disclose sales, a spokeswoman says 50% of those who tried it became repeat customers.

Nestlé, of course, sees great potential in its preschool offerings. "Once we make the consumer need apparent, mothers will understand it," says Dianne Jacobs, Nestlé's senior vice-president for infant nutrition. While the company is initially launching seven preschool products this fall, Jacobs expects the line to grow and generate about $60 million in sales over the next year. And if it's successful, she adds, the company plans to expand into specialized food for school-age children and pregnant moms. | BW |

ROBERT NEUBECKER

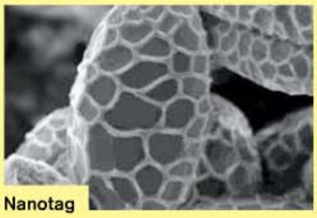
SCI TECH

BY ARLENE WEINTRAUB

NANOTECH

Pollinating the Crime Scene

Criminals often escape detection because fingerprints don't stick to the smooth surfaces of bullet cartridges. So a team of scientists at five British universities has tried applying tiny "nanotags" to the cartridges. These latch on to the shooter's hands and don't easily wash off. So cops can match the tags on the cartridge with those on the perp's hand. The tags are made with one of nature's most effective adhesives: pollen. It's mixed with fine metals to give each tag a unique signature.



Nanotag

GENETICS

How Dachshunds May Show Us the Light

The noble wiener dog may offer new hope for blind people—and not by serving as a guide. An international team of scientists, writing in *Genome Research,* says it has found a gene mutation in the standard wirehaired dachshund that is responsible for one type of inherited blindness in that breed. Now breeders may be able to eradicate the mutation. But more important, knowing the genetics could lead to a treatment for humans, who sometimes suffer from the same condition. In dogs and people, it's linked with diseases known as cone-rod dystrophies (CRDs), which destroy the light-processing cells in the retina, robbing victims of the ability to see bright light.

HEALTH

Soy Vey! The Trouble with Tofu

A new study may cast a shadow over soy's reputation as the ultimate health food. Scientists at North Carolina State University discovered that two compounds in soy can cause changes in the structure of female rats' brains that, they believe, can cause early-onset puberty and menopause.

Doctors have long understood that soy contains natural estrogens, which may not be great for growing boys. In this study, the researchers injected newborn female rats with quantities of soy proportionate to what's found in normal servings of soy-based baby formula. They then observed the brain throughout the rodents' lives and discovered changes in the region of the hypothalamus that regulates puberty and ovulation.

CANCER

Viagra and Brain Tumors

Neurologists at Cedars-Sinai Medical Center in Los Angeles discovered that pairing chemotherapy with Viagra improved the chemo's ability to reach brain tumors in rats. Animals that got both drugs had smaller tumors and lived longer than rats that got chemo alone. Makes sense. Erectile dysfunction drugs work by increasing blood flow to the penis. The same process seems to speed life-saving medicines to the brain.

(TOP) ANNA HEDSTROM/JUPITERIMAGES; (BOTTOM) ANGELO CAVALLI/GETTY IMAGES

REAL ESTATE: TIPS FOR THE INTREPID

By Lauren Young

Is it safe to venture back into the property market? Some real estate pros are switching into full bargain-hunting mode even as home prices continue to fall nationwide. But if you're tempted to join them in bottom-feeding, look out. Not only is there a chance home prices will fall more and not recover for years (page 68), but even seasoned professionals are struggling as they try to work out deals.

Among the bargain-seekers is Jim Gillespie, president and chief executive of Coldwell Banker Real Estate. In April he closed on a 35-year-old, three-bedroom, two-bath ranch house just south of Santa Rosa, Calif. A year and a half ago the seller paid more than \$450,000; Gillespie got it for \$320,000. He wasn't trying to make a killing: "The way I look at it, I got a fair market price," he says. "I'm not saying it will go up to \$450,000 overnight, but it's going to be a good investment. People shouldn't try to time the market."

Gillespie purchased the house for his son and family (they're renting it from him) in what is called a short sale. Here's how it works: A lender allows a property to be sold for less than the total amount due on the mortgage and any other loans on the property. If a homeowner has a \$300,000 mortgage but the house has sunk in value—the most it can fetch is, say, \$250,000—the bank can choose to forgive \$50,000 of the mortgage to get the property off its books. For homeowners, short sales offer a way to avoid foreclosure and still pay off their loans by settling with the lender. Negotiations take place between the buyer and the bank.

The transactions are complex, and Gillespie waited five months to

Durliat expects to pay \$1 million for a Miami condo he figures is worth \$1.6 million

(CENTER) JEFFERY SALTER/REDUX

hear that his offer was accepted. It was only then that he learned from the bank that there was a second mortgage on the home he hadn't known about. "We had put this much time into getting this house that [we decided] we could wait longer," he says. Luckily, Gillespie ultimately wasn't asked to pay more to cover the mortgage. "To our surprise, the decision by the second-mortgage holder to waive their stake took less than two weeks," he says.

Another real estate insider trying to get a deal through a short sale is Mark Durliat, CEO and co-owner of Grace Bay Club, a resort in the Caribbean islands of Turks and Caicos. He's wading into the battered Miami market to buy a second home, and it has been a deeply frustrating process.

Durliat, who spends about 30% of his time in Miami, found his dream home through a real estate broker about five months ago. It's a luxury condominium on Brickell Bay Drive, with three bedrooms and an ocean view. He expects to pay about $1 million on a property he figures is worth $1.6 million based on the prices buyers were paying for properties identical to his in the same building two years ago. "My position is that it will require three to four years to reach this value, which suits me fine," Durliat says. It will take that long for the Miami market to work through its glut of inventory, he adds.

Durliat has spent more time than he bargained for negotiating—"actually, waiting to negotiate"—a price. It often takes several weeks to get a response from the seller's bank every time a change to the offer is made. "This has been a brutal exercise," he says. "If you are not patient and you are desperate for a home, this certainly isn't the way to do it." An even bigger frustration, however, is financing. In June, Durliat lined up a mortgage to cover 70% of the purchase. Now his bank, JPMorgan Chase, says it will finance only 60%, so he needs to find a new lender.

Financing is also proving to be more of a hassle for Paul Johnson, the ex-mayor of Phoenix. He now runs a homebuilding company called Old World Communities as well as a distressed-property investment fund. He's looking for a vacation property in the mountains of Colorado to buy with three of his brothers. They plan to use it for vacations six times a year and rent it out the rest of the time.

The Johnsons have made three offers on Telluride properties in six months and have put down a deposit for a $3.5 million, nine-bedroom, nine-bath home. A year ago it was listed for $9 million. "I know construction and lot prices really well," Johnson says. "You couldn't buy the land and build this property" for $3.5 million. Johnson expects they will need to put up to 50% down instead of 10%, which would have been the norm a year ago.

CASH HELPS

Anil Pereira, founder of SecondSpace, which operates Web sites that connect second-home buyers with sellers, has a different strategy for picking up bargains. He's focusing on raw land in resort areas. "Raw land often sells at a discount since most impulse buyers—people who fall in love with a recreational area while on vacation—find it hard to envision what a home on that property will look like," he says. Financing won't be an issue, says Pereira, since he plans to do a cash deal. And since the land is undeveloped, taxes should be low.

Yes, deals abound. But financing is likely to take time and involve a few detours, so bargain hunters need plenty of patience

In late July, Pereira spent his vacation evaluating waterfront properties in the Gulf Islands of British Columbia. He is also looking at lakefront lots in North Carolina and northwest Florida, which are selling at 10% to 25% discounts when compared with prices a few years ago. If prices start to climb, he says, the value of undeveloped land should move in lockstep.

Not everyone is taking a speculative approach to the drop in housing prices. With one son nearing college, Dave Sears, co-founder of OptHome, a real estate site that helps sellers and buyers find experienced brokers, figures it's a good time to downsize. In March, Sears and his

BUSINESSWEEK TV

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wife, Lucia, sold their 4,900-square-foot home in Southborough, Mass. The house, which had been on the market for 16 months, sold at a 13% loss, and the couple bought a brand-new home in the neighboring town of Northborough. Sears figures they'll recoup their money in just a few years because the Northborough property is 1,000 square feet smaller. "I'm saving money every month, not just on the mortgage, but also on the landscaping, homeowner's insurance, heating and cooling bills," Sears says. A big savings comes from taxes: His annual bill will be about $7,000 less.

Although their original home took a lot longer to sell than he expected, what surprised Sears most was the assistance he got from the builder of his new home—who was also the builder of his old home. To help Sears ready the old property for the closing, the builder agreed to fix the roof and a hole in the garage ceiling, as well as a few cracks in the basement's foundation. He also replaced a window and finished a vent in the attic. Sears figures these free repairs saved him about $2,000 in contractor fees. Purchasing a home in this market is "a lot like buying a 2008 car model this coming fall," Sears says. "Because the market is slow, there are extra concessions available—you just have to ask for them."

For some investors, opportunities in real estate don't even involve bricks and mortar. Dionisio Meneses Jr., co-manager of the $193 million Schwab Global Real Estate Fund, owns properties in his personal portfolio. He's negotiating the sale of his interest in a commercial building in the mid-Atlantic region he has owned for several years. But instead of using the proceeds to buy another building, Meneses is considering investing in real estate securities instead. "Right now the opportunities are in the equity and debt side of real estate," where there's more liquidity, and it's easier to diversify, he says.

Meneses sees the best real estate deals in the mortgage-debt arena, where high-net-worth investors can buy into distressed-mortgage-debt funds, typically via their financial advisers, for as little as $50,000. "You have to take a contrarian view right now. That's where the money can be made," he adds. Still, don't expect to see his mutual fund stocking up on mortgage debt: "My fund is not as aggressive as I am." BW

Johnson and his brothers have a deposit on this $3.5 million Telluride (Colo.) home, which was listed for $9 million a year ago

HE'S NOT BUYING IT

Why one real estate pro is keeping his wallet shut

By Amy Feldman

Among those who believe it's too early to hunt for bargains in the real estate market is John Burns (right), president of John Burns Real Estate Consulting, which advises large builders and investment firms. "Prices stabilize last, after sales volumes and foreclosures," he explains. "There's no way the real estate market is going to be stable next year."

Here's the way Burns sees it: Supply and demand are way out of whack, with a more than 10-month supply of homes on the market (that's 4.5 million homes for resale). Only when that imbalance gets worked out—which would mean a 46% decline in the inventory of homes for resale, according to his calculations—will prices start to recover.

With fewer buyers and increasing foreclosures adding to supply, that's going to take time. Around 2010, Burns reasons, the least bubbly of the markets will start reaching equilibrium, and in 2011 the national market should move into better balance.

In the worst markets, which include certain outlying areas in California (where Burns is based, in Irvine), his grim prognosis is that balance won't come until 2014. The bottom that California and Florida resale values are hitting is even lower than that of the early 1990s, so it will take longer for home prices to rebound. That's why Burns isn't buying, and his advice to his California employees who are looking to buy is unequivocal: Wait. BW

EDITED BY SUZANNE WOOLLEY

RISK-FREE AGGRESSION

Zvi Bodie, finance professor at Boston University and author of *Investments*, a leading finance textbook, has a suggestion for conflicted investors who want to protect principal while making aggressive stock market bets.

Here's how it works: Say you have \$100,000 to invest, and you'll need it in three years. You buy \$88,900 in 3-year certificates of deposit with an annual percentage yield (APR) of 3.95%. In three years you'll have just a bit over \$100,000. That leaves \$11,100 for a riskier play.

Some people might want to take a flyer on a bank stock or gamble on an emerging market. But Bodie likes the Long-Term Equity Anticipation Securities (LEAPS) tied to the Standard & Poor's 500-stock index and sold by the Chicago Board Options Exchange. It's a three-year call option—a bet that the market will rise—and can be exercised only just before it expires. The less likely the call is to pay off, the cheaper it is to buy.

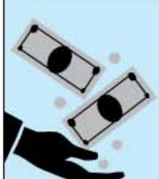
Bodie says \$11,100 can buy roughly 20 S&P 500 LEAPS that will pay off if the index doubles in price in three years. If that doesn't happen, the option expires and you've lost your \$11,100. You still have \$100,000. But if the market does come through for you and doubles, you'll pocket \$20,000 for every percentage point above that mark. So, if the S&P 500 winds up 10 percentage points above your target, you'll have \$300,000—\$200,000 from the option plus \$100,000 from the CD, before costs and taxes. –*Christopher Farrell*

CLUES FROM A PACK OF BEARS

It would have taken a crystal ball to know that the Standard & Poor's 500-stock index would bounce after hitting a new low for the year on July 15. But watchers of the Nova/Ursa Ratio, a gauge of investor sentiment used by Schaeffer's Investment Research, had a good idea something was up. The ratio is based on asset flows into the Rydex Nova Fund, which uses leverage to return 150% of the S&P 500's performance, and the Rydex Ursa Fund, which shorts the index. Schaeffer divides the assets that flow into Nova by those going into Ursa, after factoring out market movement (Rydex publishes fund prices and total assets daily, so it's possible to determine asset changes based just on money flows). Bullish investors buy Nova and sell Ursa; bearish ones do the reverse.

The lower the number, the more bearish the sentiment—and investors tend to be most bearish just when a market is set to rise. On July 7 the indicator sank to 0.61, below its level when Bear Stearns nearly collapsed. That signaled a possible bounce; six trading days later, the market rose. The ratio is "a complementary tool," not a replacement for fundamental and technical analysis, says Todd Salamone, Schaeffer's senior vice-president for research. –*Ben Levisohn*

CHARITY, DRESSED UP AS A FUND FEE



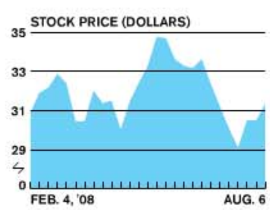
Here's a novel come-on: Invest in my mutual fund, and a third of my 1.5% management fee will go to charity through an affiliated foundation. "It's a way for charities to gain money without asking for donations," says Bill Davlin, whose \$1.6 million (mostly his own money) Davlin Philanthropic Fund launched in July. It's a creative idea, and some 300 nonprofits signed on. (Investors can decide where their money goes.) But it doesn't make sense at tax time, and Davlin's history managing other people's money is minimal. (He picked stocks at Royce Funds in his twenties before becoming the chief financial officer of a Web ad firm for 10 years.) Giving via his fund could mean losing tax benefits. Charitable gifts are deducted from taxable income, while management fees (like Davlin's donations) reduce net asset value. Taxes aren't the point, Davlin argues. "The question is, are you going to pay those fees to your portfolio manager or your favorite charity?" For big givers, donating appreciated securities on their own is the smart move. Givers can take the charitable deduction for the (higher) market value and avoid capital-gains taxes on the gift. –*Amy Feldman*

ILLUSTRATION BY BRIAN STAUFFER

AT DISNEY'S PARKS, A SURPRISING ASCENT

Despite high gas prices and the spike in airline fares exacerbated by flight cutbacks, Walt Disney (DIS) has pretty much avoided serious bumps. The entertainment giant, whose theme parks were expected to take a big fall in attendance, beat the Street's dim third-quarter forecasts. Instead, Disney delivered solid results for the third quarter ended June 28, with earnings of 66¢ a share vs. 58¢ a year ago. Its parks posted a 5% rise in sales.

DISNEY: BUOYED BY ITS BREADTH



Data: Bloomberg Financial Markets

"The results solidified Disney's best-in-class status operationally," says media analyst Mark Wienkes of Goldman Sachs (it did business with Disney), "by leveraging its content franchises across multiple platforms." He rates the stock, which has fallen to 31.42 a share from 35 a year ago, a buy with a yearend target of 35. The Burbank (Calif.) company's businesses, including films, TV, and cable, aren't immune to cyclical pressures. Even so, Wienkes forecasts an 8% rise in fourth-quarter earnings on the "resiliency of its asset mix." He also upped his 2008 earnings estimate to $2.28 from $2.25 a share on sales of $37.6 billion. For 2009 he sees $2.35 a share on $38.2 billion. Disney has been buying back stock—$1.5 billion in the first quarter, $900 million in the second, $1.5 billion in the third.

Laura Martin of New York-based Soleil Securities rates Disney a buy with a 12-month target of 40 based on a steady earnings growth rate.

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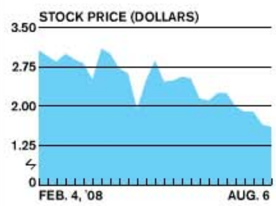
RECOVERY AT VIA PHARMACEUTICALS?



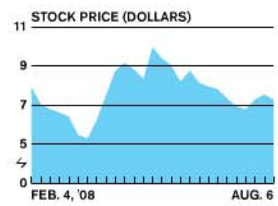
Data: Bloomberg Financial Markets

VIA Gets the Bulls' Blood Going

What the hedge funds giveth, they can taketh back fast, with little or no warning. That's how VIA Pharmaceuticals (VIAP) shares crumbled: Three such major holders dumped 1.5 million shares, driving the stock down to 1.69 from 3.10 in March. But that hasn't fazed the bulls. "Via is now even more attractive at this price," says Soham Pandya of investment firm Think-Panmure (it did business with Via). He pegs the stock a buy with a target of 5. It hit 10 on Jan. 18, 2007.

Via's lead compound, VIA-2291, seeks to reduce inflammation in blood vessel walls, an underlying cause of atherosclerosis and related ailments, including heart attack and stroke, says CEO Larry Cohen. It is in Phase II clinical tests, and Pandya expects positive data by yearend. Vernon Bernardino of Rodman & Renshaw remains positive about the drug's prospects and rates VIA outperform.

CHINA DIRECT MAY PROVE ITS METTLE



Data: Bloomberg Financial Markets

China Direct: A Magnesium Bet

China Direct (CDS) isn't your run-of-the-mill company: The Deerfield Beach (Fla.) outfit does business in China through China-based companies in which it has controlling stakes. "It's one of the fastest-growing companies in the U.S.," says President Marc Siegel, who owns 17% of China Direct. "Earnings jumped from $169,000 in 2006 on sales of $14 million to an estimated profit of $26 million in 2008 on $320 million."

China Direct now controls eight Chinese companies, including four that process magnesium, used in metallurgy and manufacturing. China produces 80% of the world's magnesium; China Direct's share is 15% of that output, says Otis Bradley of Gilford Securities (it did business with Direct). He rates the stock, now at 7.30, a buy. Global Hunter Securities' Ping Luo says magnesium will drive growth for Direct (a client) and sees the stock at 13 in a year. | BW |

BRAD TRENT; CHARTS BY DAVID FOSTER

OUTSIDE SHOT | PATRICK SMITH

Japan and China Edge Closer

Just ahead is a New Asian Order in which the U.S. is a player—but not the dominant one

The Japanese destroyer *Sazanami* made an historic stop in China in June

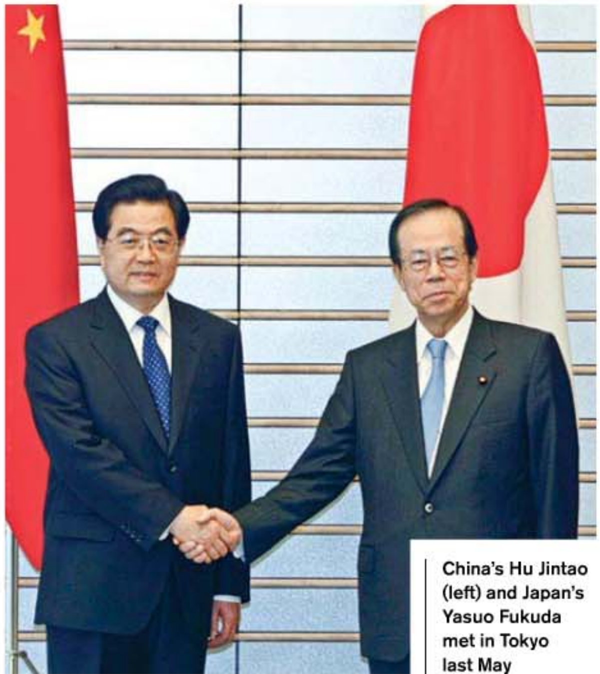
For six decades the U.S. has been the dominant force in the Pacific, its economic, military, and diplomatic power unrivaled by either the rich but reticent Japanese or a resurgent China. But signs are emerging that this old order is beginning to change. The latest indicator has to be counted the most significant to date: The Chinese and Japanese are taking their first steps toward a kind of Asian entente cordiale.

After years of animosity, ties between Japan and China are unmistakably on the mend. State visits now are almost routine. In June, Tokyo and Beijing resolved a five-year dispute over gas fields in the East China Sea. Earlier this summer the Japanese destroyer *Sazanami* docked for a five-day call at a naval port on China's southern coast. The crowd onshore waved just the right mix of Chinese flags and the red and white of the Rising Sun. It was the first visit to China by a Japanese naval vessel since World War II, and it is unlikely to be the last. "Whether things will hold steady is still a question," says Kazuhiko Togo, a former Japanese ambassador and now a professor at Temple University's Tokyo campus. "But politically, relations are in much better shape. The trajectory is right."

Consider Japan and China as something like the Germany and France of Asia, and the implications are evident. Valéry Giscard d'Estaing and Helmut Schmidt brought stability and a new potential for European cooperation when they solidified a Franco-German rapprochement in the late 1970s. Japan and China, whose economies already are tightly intertwined, could do the same for Asia. Over time we may also see a foreign policy coming out of Tokyo that is more independent of Washington's. Washington, indeed, should take note (as it surely has): The Sino-Japanese connection eventually will counterbalance the U.S. role as the bedrock guarantor of Asia's security.

This new turn in relations represents a considerable salvage job. Junichiro Koizumi stepped down as Japan's Prime Minister two years ago with relations at their most acrimonious in a decade, primarily because of his visits to Yasukuni Shrine, the memorial to Japan's war dead, including convicted war

(FROM TOP) ROBIN MOYER; TORU FUTAGAMI/AP PHOTO



China's Hu Jintao (left) and Japan's Yasuo Fukuda met in Tokyo last May

criminals. His successor, Shinzo Abe, lasted only a year, but he pulled off a Nixon-in-China gambit that surprised practically everyone. A nationalist and a tough talker on China, Abe signaled quickly that he would avoid the shrine; three weeks after assuming office he flew to Beijing to show the priority he put on repairing relations.

It was enough to thaw what seemed a hopelessly frozen relationship. Both Hu Jintao and Wen Jiabao, China's President and Premier, respectively, have since been to Tokyo and made all the right noises. Abe's successor, Yasuo Fukuda, has pushed Abe's stance toward Yasukuni a step further: While Abe stayed away but declined to state a position publicly, Fukuda has declared flatly that he will not go to the shrine so long as he holds office. Fukuda also visited Beijing within six months of taking over.

The gas deal announced in June suggests just how far the two sides have come. Less than a year ago, China was sending bombers into the airspace above the disputed fields—sorties viewed in Tokyo as provocative displays of force. Now the two nations have agreed to establish a joint development zone and shelve questions of offshore sovereignty.

Unknowns aplenty remain. Two Japanese Prime Ministers have avoided Yasukuni, but an official policy on the shrine is nowhere in sight. The disputes over Japanese textbook accounts of Japan's war with China could erupt again. And Tokyo has yet to articulate a clear (let alone satisfactory) stance on the matter of wartime "comfort women," those Chinese and Koreans forced to serve as prostitutes for the Imperial Japanese Army.

Among issues that give Japan pause are China's military spending, its uncertain social climate, and its lack of progress toward democracy. Furthermore, a troubling anti-Japanese sentiment seems just below the surface: Beijing censored coverage of both the *Sazanami*'s visit and the gas deal for fear of arousing nationalist feelings, and officials in Tokyo took note.

Some serious psychodrama also comes into play as this relationship evolves. Japan and China have alternated roles as teacher and student for a millennium and a half. China's rise is a heavily freighted phenomenon in Japan—a fact that is often lost on Westerners—and evokes complex fears and emotions there. Ever since the Japanese began to modernize more than a century ago, they have agonized over their place in Asia. Are we part of it? Are we part of the West? Do we mediate between the two? Elaborating a 21st century relationship with the mainland is part of a larger undertaking to "enter Asia," as the Japanese put it, and thus will be a gradual process.

Both China and Japan now want to advance beyond their disputes to cooperate more closely on security

Setting history aside, the *Sazanami*'s port call sent the U.S. an interesting message: Both China and Japan now want to advance beyond their disputes to cooperate more closely on security. Some Japanese officials suggest that the mechanism for this is already in place: the six-party talks (between China, Japan, the U.S., North and South Korea, and Russia) convened to resolve the North Korean nuclear question. "We have to think about a regional security framework like NATO," says Yoshimasa Hayashi, a member of the upper house of the Japanese legislature from the governing Liberal Democrats. "So the six-party talks—five countries tackling the problems of the sixth—should remain. Even if the issue is settled, we should keep the framework."

There is an emerging subtext. This region's security relations have long been likened to a bicycle wheel, with Washington the hub and Asian nations the spokes: Direct ties among Asians have been weak to nonexistent. This is now changing, as the new Sino-Japanese amity suggests.

To put it simply, Asia is becoming more Asian. No one, not even China, wants to elbow the U.S. aside. America has a lot of frontage on the Pacific lake, and most East Asians like it that way. But the American voice is gradually becoming one among many, and even its closest friends in the region—the Japanese first among them—like that, too. |BW|

ISSEI KATO/REUTERS

TECH & YOU | JAY GREENE

Next: Cameras That Wash Your Car

Too often, the silly additions on today's digitals don't make for better pictures

Remember when camera makers competed for who could offer the most megapixels? At first, two sounded like a lot. Then it was four, six, or eight. These days, 10 seems to be the sweet spot. And for less than $300 you also get image stabilization, red-eye reduction, an LCD viewfinder you can see in broad daylight, and much more.

So how's a camera maker supposed to differentiate a new product? More gimmicks, of course—all of them designed to make picture-taking stupid-proof. Some cameras will keep your kid in focus as she streaks across the soccer field. Others offer a collection of "modes" that preload the best settings for a candle-lit dinner, a fireworks display, or a sun-glazed day on the ski slopes. The latest trick: cameras that won't even snap unless they detect a toothy smile on your subject's face.

I recently tried three new ultracompact digital cameras to see if all this feature-creep actually makes it easier to take great photos. All three were in the 10-plus megapixel class, and all yielded superb results. But more often than not the silly feature additions didn't make for better pictures, and in some cases they made things more complicated.

Let's start with the svelte Sony Cyber-shot DSC-W170 with a Carl Zeiss 5x optical zoom lens and a 2.7-inch LCD display. It's supposed to help the novice shoot like a pro, aided (if you can say that) by Smile Shutter technology, which shoots only when a smile is detected. The user sets the sensitivity level. My kids and I had fun trying to trick the sensor with a variety of goofy-looking smiles. Then we turned the feature off. All those forced smiles were a little creepy.

The mode menu on Panasonic's Lumix FX35 is refreshingly clear and simple

The W170 also has something called intelligent scene recognition technology. When it's activated, you can still adjust the settings for light and motion. But if the camera thinks it can do better, it will quickly snap a second picture using the settings it thinks you should have selected. Apart from the fact that the camera seemed to be saying "I told you so," this software is pretty impressive, particularly when you're shooting in tricky lighting. The one thing I really didn't like was the dial on the back of the W170 that you spin to choose different settings. It's cluttered and confusing, with some settings indicated by icons and others by words.

Panasonic's Lumix DMC-FX35 fared well in my less-than-scientific test. Just a smidge trimmer than the Sony, it has a 25mm Leica lens and a 2.5-inch LCD display. The mode menu's 22 selections are wonderfully simple: a candelabra to indicate shooting a candle-lit scene, a palm tree by an ocean for beach shots, and an island with clouds floating by for pictures taken from airplanes.

There's also an Intelligent Auto mode that figures out the optimal settings for each shot, while gyrosensors correct for a shaking hand.

Nikon's Coolpix S600 has Nikon's own Nikkor 4x optical zoom lens and is just a bit smaller than the Lumix, even with a 2.7-inch LCD. There are 15 modes to choose from, some of which made little sense to me. Is "museum" mode good for shooting anything other than art on walls? The answer: This mode is for indoors when flash photography is prohibited. And how is Active Child mode different from Sports mode? Not very. The Sports mode allows for continuous shots that capture motion.

Neither mode worked well for me. I took the S600 to shoot my 13-year-old son's Ultimate Frisbee practice in challenging dusk light and got a bunch of blurry snaps.

Turns out most of the gimmicks designed to make photography easier don't live up to the hype. Then again, all the cameras took phenomenal pictures when I picked the basic settings, pointed, and shot. Camera makers now have very smart software. They should give that technology something useful to do. | BW |

How different is Active Child mode from Sports mode? Not very, from what I could tell—and neither worked well for me

BUSINESSWEEK.COM |

Steve Wildstrom is on vacation. For past columns and online-only reviews, go to businessweek.com/go/techmaven.

(TOP) ROCHELLE HOWE

How Long Will GE Hang On to NBC?

Tight credit and a lack of buyers mean the unlikely marriage will continue for a while

The Beijing Olympics are finally upon us, and from Aug. 8-24 viewers will see the NBC peacock in full preen. An orgy of 3,600 hours of programming will be dished out on NBC itself, on its five sibling cable channels, and, of course, on NBCOlympics.com. It will be big. It will be impressive. And it will do nothing to answer one key question for NBC Universal's owner GE: hold or sell NBC Universal?

The media unit is plainly out of place in the massive conglomerate, for which in 2007 it provided just under 9% of revenue. While in '07 NBC's profit margins topped all GE segments, its revenue growth lagged that of the overall company in '06 and '07 and slowed to 0.1% in the first half of 2008. And no one today forecasts stability for big media companies. The stock price of GE has more or less stagnated since CEO Jeff Immelt took over in 2001, in part because the notion of bona fide multi-industry titans like GE is considered passé. (Even media conglomerates are now passé.) And the governing narrative of GE is hard to extend to NBC. A key tenet of GE exceptionalism holds that it adds value to anything it touches by obsessing over management and management processes like Six Sigma. But that which debugs, say, making turbines simply won't work for the woolly and unstandardizable ways in which movies and TV shows are made. (Disclosure: I am a paid contributor to NBC Universal unit CNBC.)

In mid-July my *BusinessWeek* colleague Jena McGregor asked Immelt if he expected NBC to still be with GE in two years. He said yes, without qualification, and heaped praise on the unit's cash flow and strategic fit. He's long maintained this line, both publicly and privately. Still, whisperers insist that NBC's recent, complex deal to buy the Weather Channel—it partnered with private equity firms Bain Capital and Blackstone Group instead of buying the asset outright, as they've frequently done—is a sign of GE's diminishing commitment to media. A GE spokesman vociferously denies this, and even excluding the Weather Channel deal, GE has spent over $1.5 billion on media deals in the past twelve months.

CEO Immelt likes NBC Universal's cash flow and insists the unit will not be sold

The doubters may have a point. But there is no reason to disbelieve Immelt, though that may have less to do with GE's love for NBC than with the peculiarities of this situation. For one thing: There are no real buyers. NBC Universal last year had $15.4 billion in revenue and $3.1 billion in profit. One media banker familiar with the company says a reasonable purchase price approaches $40 billion. Frozen debt markets nix any private equity player from getting near such a sum, and anyone with that kind of coin is likely running from media assets, not toward them. (Microsoft, which can afford it, couldn't stomach paying up for Yahoo!, a media company that pays much less to produce its wares than NBC.)

There is always Time Warner. The prospect of combining the companies' entertainment assets into a joint venture has been tentatively discussed. But if the game is to get GE out of media, a joint venture doesn't do it. And arguably Time Warner's bulk already causes headaches—it's hard to see how going bigger will help.

Also, for the foreseeable future media deal prices will be depressed, no matter how many hours of Olympics coverage NBC will air nor however many millions its stations will pick up from political ads this year. If NBC Universal were big enough to give GE a stock bump should the unit disappear, that could override valuation concerns. But it isn't.

There is one big wild card. Former Universal owner, Vivendi, maintains a 20% stake in NBC Universal and has an option each year to sell. Should it decide to, GE might suddenly revisit selling all or part of NBC Universal to get the billions it would take to buy Vivendi out. And perhaps some kind of complex financial engineering, imperceptible to journalists' minds, could conjure a plausible deal. Otherwise, you only see stasis. The issue facing GE and NBC Universal is one common to media and conglomerates today: A current situation might not make sense, but no conceivable solution is better. | BW |

BUSINESSWEEK.COM |

For Jon Fine's blog on media and advertising, go to businessweek.com/innovate/FineOnMedia.

(FROM TOP) BRAD TRENT, FRED PROUSER / REUTERS

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CHEAP OIL
THE AMERICAN WAY?

Oil and gasoline prices bring out strong opinions. In more than 200 responses to our Aug. 4 cover story—"The Real Question: Should Oil Be Cheap?"—readers called us "communists" and "leftist ideologues." Others thanked us for the "excellent" article. Most agreed with the story's basic premise: Cheap oil prices lead to greater use of oil, while higher prices stimulate efficiency gains and the development of alternatives. More controversial was the suggestion that putting a floor under the price of energy could make market forces work more effectively by removing volatility and uncertainty. While many readers liked the idea, others saw it as a dangerous "socialist agenda." *–John Carey*

Oil should be very cheap. Big trucks and SUVs should be taxed heavily. Tax the people who squander all the resources, reward those who conserve. You will see the price of oil go down drastically.
Screen name: John Westcot

Why isn't it better to let the market work through this naturally than to have decisions of supply and demand dictated to us by politicians and pundits?
Screen name: Tom Cover

A floor on oil prices is an irresponsible idea. Please, no more talking about forcing new, high, phony prices that put our own economy at a disadvantage just to help a few new entrepreneurs!
Screen name: Rex

The higher oil is, the better. Why? Because every challenge yields technological progress. At $40 a barrel, no money would flow into new technology, which appears to have become a major source of employment for the world.
Screen name: Nick

The answer to high gasoline prices is simple. Strengthen the dollar, drill for more oil, and put a 100% sales tax on any vehicle that doesn't get at least 30/35 miles per gallon. Cheap oil is the American way, and if you're against cheap oil, you're against America!
Screen name: John Galt

HEALTH CARE
A PRESCRIPTION FOR EFFICIENCY

"They Know What's In Your Medicine Cabinet" (Special Report, Aug. 4) ignored the benefits that [prescription database] technology brings to consumers.

There is nothing new about consumers authorizing the release of their medical records to insurers. This standard process, in place for decades, enables companies to make decisions about rates and insurability. However, it is slow and costly. Electronic prescription histories dramatically accelerate the application process, while significantly reducing the cost. Now, rather than waiting weeks or months for paper records, insurers can often make decisions the same day the consumer applies for coverage.

Most important, no medical information is ever obtained without the applicant's specific authorization. The authorization must follow the strict requirements specified under federal privacy law.

A technology that makes it easier, faster, and cheaper for an individual to obtain coverage should be celebrated, not vilified.

Mark Franzen
Managing Director
Milliman IntelliScript
BROOKFIELD, WIS.

CORRECTIONS & CLARIFICATIONS
"Outsourcing's Dubious Kingmakers" (What's Next, July 14 & 21) misstated the year in which Brown-Wilson Group (erroneously called Brown & Wilson in the article) first published its ranking of IT outsourcers. It was 2004, not 2005.

SEAN MCCABE

COMPANY INDEX

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names.
Companies listed only in tables are not included.

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What I Learned at Harvard Business School

An opinionated journalist goes to Cambridge for his MBA and finds "a factory for unhappy people"

Philip Delves Broughton is not what anyone would describe as a typical Harvard Business School student. In 2004, when he left his job as the Paris bureau chief for Britain's *Daily Telegraph* to get his MBA, he was 32—a bit older than most other students—and had a two-year-old son. He had studied Latin and Greek literature, history, and philosophy, but knew little about business. Businesspeople, he thought, were "gin-swilling, golf-playing, dull, predictable slaves to money."

By the time he had earned his MBA two years later, Broughton's understanding of business was considerably deepened, but his opinion of the business world was not much different. One may wonder if he went to Harvard largely in order to write about it. But it seems that he sincerely wanted to change his life, thinking he'd profit from "a general competence in business." All the same, the main beneficiaries of his experience may be his readers.

In *Ahead of the Curve: Two Years at Harvard Business School*, Broughton provides an insightful and entertaining, behind-the-scenes glimpse at a powerful institution that he sees as generally succeeding in its mission of transforming students into business leaders. But he views HBS as failing them in almost every other way. It is, in his persuasive account, a "factory for unhappy people."

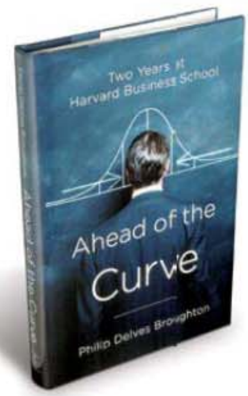
Why this should be, despite the obvious successes and accomplishments of graduates, is a complex subject that Broughton dissects with a reporter's eye for detail. In his retelling, the 895 members of his class were men and women of modest talents but outsize ambition. Boastful, insecure, and occasionally charming, they were destined for careers that required them to sacrifice family and friends for the success they felt they so richly deserved.

As one of the handful of students who came to HBS in 2004 with few ambitions of his own—he had no idea what he wanted to do—Broughton was well qualified to describe how Harvard in particular, and B-school in general, does such people a disservice. With a second child on the way, he struggled to find a career path that would allow him to spend time with his family—a requirement that kept him from joining the droves in pursuit of consulting and investment-banking careers. The pressure to follow conventional paths is a recurring theme, with classmate after classmate either battling the forces of conformity or succumbing to the siren song. In the end, Broughton spent the summer after his first year in Cambridge working on a novel instead of an internship and graduated without a job after interviews at Google and McKinsey. Today, he retains one foot in journalism while pursuing a few "entrepreneurial ventures."

Broughton found little to criticize and much to praise about the HBS case study method, which gets students to find fixes for company problems. It's a testament to the method of the Harvard faculty that Broughton managed to become conversant in the language of business with so little prior exposure to it.

Broughton describes a group of amoral strivers who are willing to sacrifice family and friends for successful careers

But ethics is another matter. Many of Broughton's classmates came to HBS ethically challenged, he says; some qualified for financial aid by depleting their savings with the purchase of expensive cars. But HBS didn't much alter their attitudes. In 2005, for example, 119 HBS applicants were caught attempting to hack into a Web site that stored admissions information. For those who had been accepted, Harvard retracted its offers, and its dean called the behavior "a serious breach of trust." But in Broughton's "corporate accountability" class, it was Harvard that was faulted—75% of the class sided with the hackers.



Ahead of the Curve: Two Years at Harvard Business School **by Philip Delves Broughton; Penguin Press; 283pp; $25.95**

The author gives insight into daily life at Harvard and the "fear of missing out" that leads many students to attend every event, no matter how trivial. But in the end he didn't seem to find it "transformational," at least not in the way HBS hopes it will be. If anything, exposure to business in all its forms deepened his cultural bias against it. He came away appalled by the power that business wields in our society and by the ability of an institution like Harvard to perpetuate that state of affairs. "Has society allotted too much authority to a single, narcissistic class of spreadsheet makers and PowerPoint presenters?" he asks. Broughton leaves no doubt about what he thinks. | BW |

Jack and Suzy Welch are on vacation.