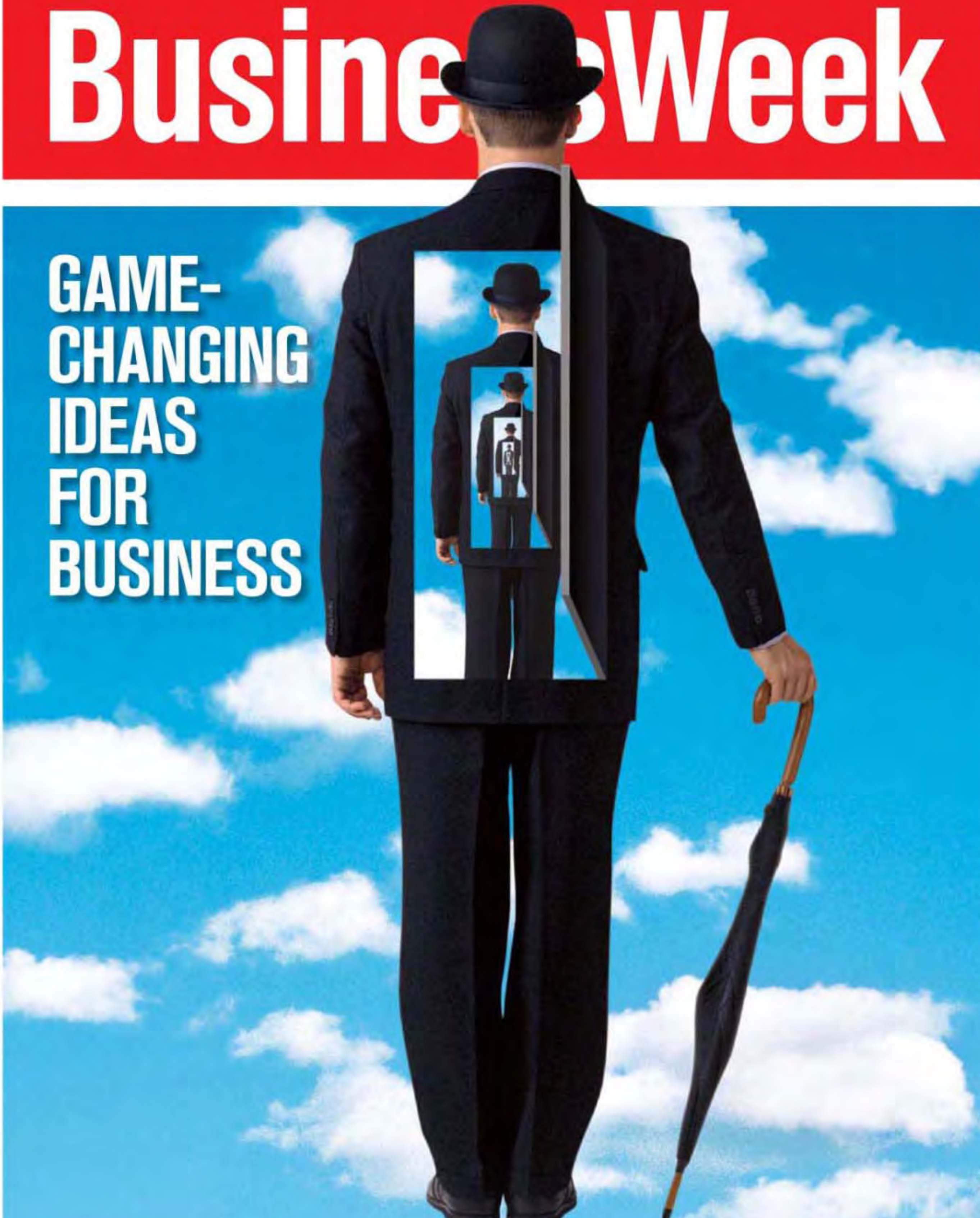
SPECIAL ISSUE | MANAGING SMARTER

BusinessWeek

GAME-CHANGING IDEAS FOR BUSINESS



The McGraw·Hill Companies

MARCH 23 & 30, 2009 | BUSINESSWEEK.COM


40 Million
Credit Card Numbers Stolen from TJX
98,930 Affected In Forever 21 Data Breach
Trojan horse captures data on 2,300 Oregon taxpayers ■5C
Hotel Chain Falls Victim to 14,000 Data-Stealing Malware incidents
University of Indianapolis Hacked: 11K Student, Faculty, Staff Records Stolen
4C
6,700 Data-Stealing Malware Infections Plague US Healthcare Company


60% OF BUSINESSES
ARE HIT BY CYBERCRIME.*
Think your data isn't as attractive as theirs?
THINK AGAIN.
Data-stealing malware is on the rise. These new Web threats are stealthy, fast, and after your corporate and financial data—threatening your brand and risking your reputation. They are infiltrating the most secure businesses and yours could be next. But with on-premise or hosted solutions and services powered by the Trend Micro™ Smart Protection Network, you'll be ready. This unique cloud-based security infrastructure protects you by blocking threats before they can reach your network and damage your business. The Smart Protection Network—it's security made smarter.
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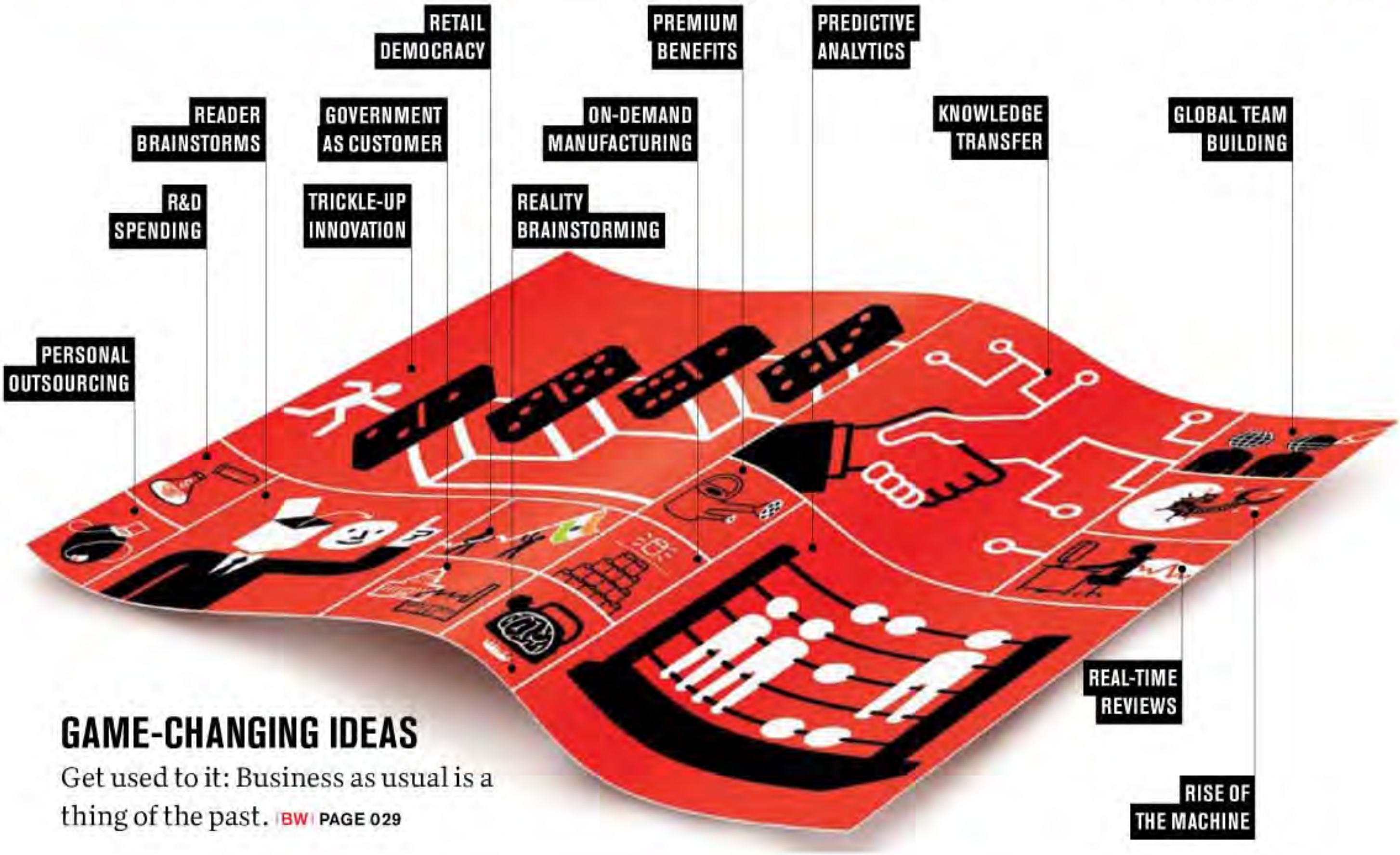

GAME-CHANGING IDEAS

Get used to it: Business as usual is a thing of the past. BW PAGE 029

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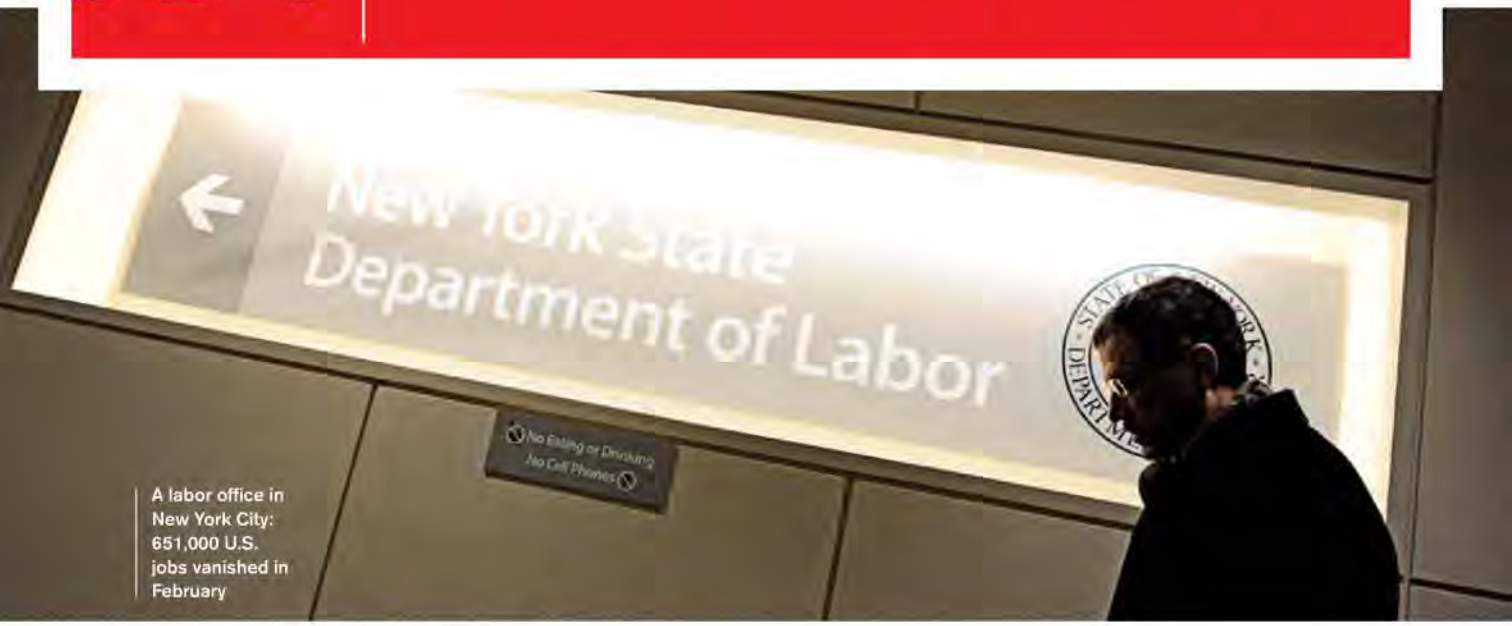
(COVER) (MAN WITH UMBRELLA) STEVE HAMBLIN/CORBIS; (CLOUDS) CRAIG AURNESS/CORBIS; PHOTO ILLUSTRATION BY DAVID RUDES/BW; (ABOVE) ILLUSTRATION BY CHRISTOPH NEIMANN

THE BUSINESS WEEK

EDITED BY HARRY MAURER & CRISTINA LINDBLAD



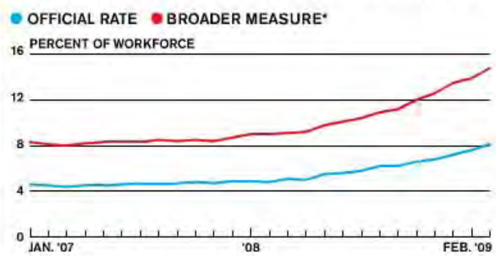
A labor office in New York City: 651,000 U.S. jobs vanished in February

JOB LOSSES: NO END IN SIGHT

That giant sucking sound is U.S. jobs going down the drain: 651,000 positions disappeared in February, said the **Labor Dept.** on Mar. 6, with the unemployment rate jumping to 8.1%. And forecasters say we ain't seen nothin' yet. On Mar. 10, Bloomberg reported that economists in its monthly survey expect U.S. joblessness to reach 9.4% by yearend. The **World Bank** predicted on Mar. 8 that "the global economy is likely to shrink this year for the first time since World War II." That's why **Treasury Secretary Timothy Geithner,** headed for a meeting of the Group of 20 finance ministers in London, will be pushing his brethren for far stronger stimulus.

BW PAGE 018 "A Dogfight Over the Rescue Plan" PAGE 023 "The Two Best Cures for the Economy"

UNEMPLOYMENT: TWO VIEWS



*Includes persons who have stopped looking for work and those working part-time when they'd prefer to work full-time

Data: Bureau of Labor Statistics

CITI SPURS THE STREET

Longing for some reason to hope, Wall Street caught a whiff of good news from **Citigroup** on Mar. 11 and promptly staged the biggest rally of the year, with the Dow jumping 379 points, or 5.8%. In a memo sent to employees the night before, **CEO Vikram Pandit** said the beleaguered bank had booked more than $8 billion in operating profit in January and February. And after putting Citi through a stress test that used more pessimistic assumptions than the Fed's own upcoming tests, Pandit proclaimed his confidence in its capital strength. Citi stock rose 38% that day, though that's not saying much, since it closed at 1.45, far below the 7 it traded for at the start of the year and a world away from its peak of about 55 in 2007.

Traders were also cheered by two other developments. Fed Chairman Ben Bernanke, in a Washington speech, said he favors easing the strict mark-to-market rules that force financial institutions to carry assets on their books at their current value—which these days

JUSTIN LANE / EPA / CORBIS

is often zero, since there's no market at all. And the **SEC** announced that it will examine reinstating the so-called uptick rule, which sets limits on the short-selling many feel has exacerbated the dizzying fall in the equity markets. In other banking news, New York Attorney General Andrew Cuomo on Mar. 11 accused Merrill Lynch of "misleading" Congress about the timing of those now-infamous bonuses.

"Citi: Pandit's Defense Boosts Wall Street" businessweek.com/magazine

GEITHNER SPEAKS

Appearing on PBS's *Charlie Rose* show on Mar. 10, **Treasury Secretary Geithner** sketched in some details of his promised public-private partnership to extract toxic assets from bank balance sheets. The basic idea is that Washington will offer financing to private investors to buy the assets—and will inject capital into the banks as an incentive to sell them, presumably at deep discounts. "The art" in carrying out the plan, Geithner told Rose, will be to price the government loans cheaply enough to make them attractive now, but high enough to send investors to private lenders once the credit markets start to function more smoothly.

SCANTY STIMULUS?

The world's biggest economies aren't doing enough to counteract the downturn—at least, so says a March paper from the **Brookings Institution.** Looking at the Group of 20 nations, economist **Eswar Prasad** and researcher **Isaac Sorkin** figured that the various stimulus plans announced by governments add up to a little more than 1.1% percent of global GDP, whereas the **IMF** has said 2% is what's needed to drag the world out of its slump. Only the U.S. and China "have responded forcefully, with impressive packages," they write.

Brookings Institution

MERCK'S GROWTH PILL

Another pharma outfit down the hatch: Merck agreed to swallow New Jersey neighbor **Schering-Plough** for $41.1 billion on Mar. 9, six weeks after **Pfizer** said it will buy **Wyeth** for $68 billion. Merck, like Pfizer, faces anemic revenues over the next few years as its top drugs lose patent protection, so Merck **CEO Richard Clark** aims to grab new products to replace the old. Expect more pharma deals as companies look to beef up to compete with their newly muscled rivals. Next in line: **Roche** is widely expected to win its four-month campaign for

BRENDAN MCDERMID/REUTERS

Merck's Clark: Trying to replenish the pipeline with a takeover

006 NEWS YOU NEED TO KNOW

the 44% of **Genentech** it doesn't already own.

BW | PAGE 026 "Pharma Mergers' Harsh Side Effects"

OIL ON THE RISE

To nearly everyone's astonishment, **OPEC** appears to be putting a floor under oil prices—and perhaps even pushing them toward its $75-per-barrel target. A barrel of black gold has climbed from a low of $34 in December to about $47 on Mar. 10, though it sank back to around $42 the next day on rumors that the cartel won't ask for more cuts at its Mar. 15 meeting in Vienna. OPEC has already called for cuts of 4.2 million barrels per day, and compliance, at about 80%, has been better than expected. What's more, the decline in demand appears to be slowing.

GRINDING GEARS IN ASIA

China's mighty machine continues to seize up. Mainland exports collapsed by 25.7% in February from the same month in 2008, after a 17.5% fall in January as consumers in the U.S. and Europe kept their wallets tightly shut. Given the resulting job losses, it's not surprising that domestic sales are slow as well: Weak demand led to China's first bout of deflation in six years, with the February consumer price index falling 1.6% from a year ago. And across the Sea of Japan, Tokyo said January exports tanked by 45.7%, yielding a record monthly trade deficit of $9.85 billion.

"Recession Slams Chinese Exports Again"
businessweek.com/magazine

MADOFF'S PLEA

When **Bernard Madoff** first told the feds that he may have fleeced investors to the tune of $50 billion, some thought the figure improbably grandiose. But in charges unsealed on Mar. 10, prosecutors say the amount is more like $65 billion. At a hearing scheduled for Mar. 12, Madoff was expected to plead guilty to 11 felonies, including wire and securities fraud, money laundering, perjury, and theft, which would likely land the 70-year-old alleged Ponzi king in prison for the rest of his life. Since his arrest in December, Madoff has been free on $10 million bail, but prosecutors could ask that it be revoked once he pleads guilty. And while recent filings hint that he may have had help carrying out his decades-long scheme, the authorities have yet to say anything concrete about employees or family members.

Madoff was scheduled to plead guilty and could receive a life sentence

UTC GETS EVEN SLIMMER

Although **Ben Bernanke** still wistfully mentions the hope that a recovery could begin later this year, the companies out there making things beg to differ. **United Technologies,** owner of **Otis** elevators and **Pratt & Whitney** jet engines among other businesses, said on Mar. 10 that it will cut 11,600 more jobs this year as orders in its aerospace and construction markets have evaporated. Along with layoffs already announced, the cuts will total 18,000 jobs, or 8% of the workforce. A recovery in

A market in Zhengzhou: Chinese consumer prices fell in February

(TOP) JIN LEE/BLOOMBERG NEWS; (BOTTOM) ZHOU MIN/IMAGINECHINA/ZUMA PRESS


WANT TO GET A GRIP ON DATA ENTRY?
TRY USING TWO HANDS.
Introducing the Sharp® MX-Series with Full-size Keyboard.
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*Keyboard not available on all models

A possible rescue package for Opel has been stalled by political battles in Germany

VOLKER HARTMANN/AFP/GETTY IMAGES

the back half of 2009 "now appears unlikely," said **CEO Louis Chenevert.**

DOW SAYS: OH, ALL RIGHT

Sometimes a court date can powerfully concentrate the mind. Just days before heading to trial, **Dow Chemica**l agreed to buy **Rohm & Haas** after all in a deal originally struck last July. Dow had hoped to wriggle out as the recession worsened, which prompted Rohm to sue in January. The settlement calls for Rohm's two biggest shareholders to invest as much as $3 billion in the combined company, which pares the amount Dow will need to borrow. Still, the $16.3 billion deal saddles Dow with an enormous debt load, and credit-rating agencies weren't happy.

WILL OPEL CRASH?

General Motors' Opel unit is running on fumes as the German government debates whether to support a $4.2 billion repair plan. As Opel's finances have grown more shaky, politicians from regions with Opel factories have been clashing with those whose constituencies include rival carmakers **Volkswagen, BMW,** and **Daimler.** But a rescue, which would probably also be funded by other countries that have Opel plants, such as Britain, still seems likely. In an election year, **Chancellor Angela Merkel** won't want the blame for throwing 28,000 German Opel workers out of work—not to mention many more at parts suppliers.

A SUCCESSOR AT P&G?

The race for the coveted chief executive's chair at **Procter & Gamble** suddenly looks easier to call now that **Susan Arnold,** head of global business units, has officially dropped out. P&G announced Arnold's resignation on Mar. 9, thrusting **COO Robert McDonald** into the front-runner spot to replace **CEO A.G. Lafley.** Lafley, 61, has held the job nearly a decade and is approaching P&G's retirement age of 65. Though McDonald, 55, now looks like the heir apparent, should Lafley decide to serve for more than a couple of years, a younger officer, such as **Robert Steele** or **Ed Shirley,** could surge into contention.

"P&G's Succession Race Narrows"
businessweek.com/magazine

MOBILE WARS IN THE GULF

A discount battle has broken out between mobile-phone companies in the Gulf States as more carriers have entered the market, reports the March edition of *BusinessWeek Al-Arabiya*. In the United Arab Emirates, cell-phone penetration surpasses that of the U.S. The competition in some markets has become so fierce that it's forcing even dominant players to look outside their borders for growth. Kuwait's **Zain Group,** which already has a footprint in 22 countries, in February unveiled a plan to roll out mobile banking to more than 100 million customers in Africa via a new service called **Zap.**

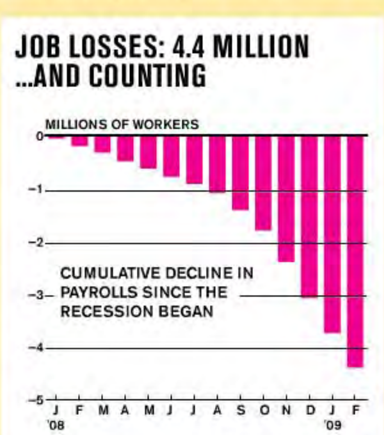
A RAY OF HOPE IN WASHINGTON'S WAR ON FEAR

Solving the problem of weak banks loaded with toxic assets won't be easy, but a promising program aimed at reviving the credit markets is ready to roll

One of the defining features of this recession is the major role played by confidence—or rather, the lack of it. Fear of the future has sent consumers, businesses, and investors into retreat, to the great detriment of the economy. What will turn sentiment around? That's easy: signs that the worst of the recession has passed and that prospects for a recovery are improving. However, restoring confidence will be far more difficult than in past recessions because the economy's natural recuperative powers have been blunted by the financial crisis. This time, it's not just a question of overcoming worries about future profits and paychecks. Faith in the system itself has been shaken.

As a result, Washington policy is playing an outsize role in trying to heal the economy and restore confidence. The historic size of the commitment—trillions of dollars' worth of fiscal stimulus, monetary easing, and direct bank support—would appear to guarantee eventual success. Yet doubt remains. Ultimately, for policy action to work, it will have to break the mutually reinforcing weakness between the financial markets and the economy.

To date, there has been little progress toward ending this vicious cycle. The economy appears to be contracting this quarter about as fast as its 6.2% shrinkage in the fourth quarter, with further contraction widely expected in the second quarter. The dropoff in consumer spending has slowed, but businesses are still slashing capital spending, inventories, and hiring, as seen in the 651,000 decline in February payrolls (chart). Meanwhile, some indicators of credit market stress have worsened in recent weeks, reflecting worries about the banks.



Data: Bureau of Labor Statistics, IHS Global Insight

Easily the biggest concern hanging over investors right now is the fear of bank insolvency. Citigroup's improved profit outlook on Mar. 10 eased those fears, but policymakers have made little progress on the key issue of relieving banks of their toxic mortgage-related assets. Although the Treasury Dept.'s idea to form a Public-Private Investment Fund to tackle the problem is moving forward, any plan would most likely involve banks absorbing sizable losses. If the proposal turns out to be unworkable, its failure could be a big blow to investor confidence.

In areas other than banking, policy efforts are progressing faster. One of the most promising programs, say analysts, is the Term Asset-Backed Securities Loan Facility (TALF), a joint program of the Treasury and the Federal Reserve that begins on Mar. 17. The TALF is aimed at unclogging the credit markets by reviving loan securitization, or the packaging and selling of loans in the secondary market. The TALF will purchase up to $1 trillion in new asset-backed securities, which will include consumer and business loans and some securities backed by commercial and residential mortgages.

The TALF is important because about half of all credit flowing to households and businesses gets securitized. But by the end of last year, issuance of asset-backed securities had dropped to essentially zero, as the secondary market dried up. This market dysfunction is a big reason why the Fed's interest-rate cuts have been largely ineffective in easing financial conditions. Analysts believe the TALF will make a variety of consumer and business loans more readily available.

In addition to increasing the potency of the Fed's rate cuts, improving credit market functioning would also bolster the impact of the fiscal stimulus program. The first effects of that will show up as early as the second quarter, as take-home pay rises after companies adjust their tax-withholding schedules by Apr. 1. The Congressional Budget Office estimates the stimulus package will lift the level of real gross domestic product between 1.4% and 3.8% above where it would otherwise have been at yearend, depending on the size of the multiplier effects.

That's a prescription for halting the decline in GDP in the second half. And if policy efforts aimed at the financial markets and housing begin to show results, it will also be a remedy for restoring confidence in the future. | BW |

BRAD TRENT; CHART BY RAY VELLA/BW

NUMBERS

AMERICAN BUSINESS LOSES GROUND IN U.S. PATENTS

By Tara Kalwarski/Charts by Laurel Daunis-Allen

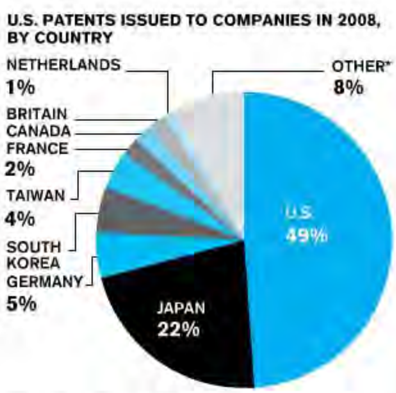
In 2008, U.S. companies collected fewer than half of the 182,556 patents issued to businesses by the U.S., according to research firm IFI Patent Intelligence. Among companies, IBM claimed the No. 1 spot, with 4,186 patents for inventions, also known as utility patents. But six Asian information technology companies, including Samsung, placed in the top 10.

1.2

Millions of patent applications pending. Patents issued in 2008 took an average of 32.3 months to move from filing to approval/termination.

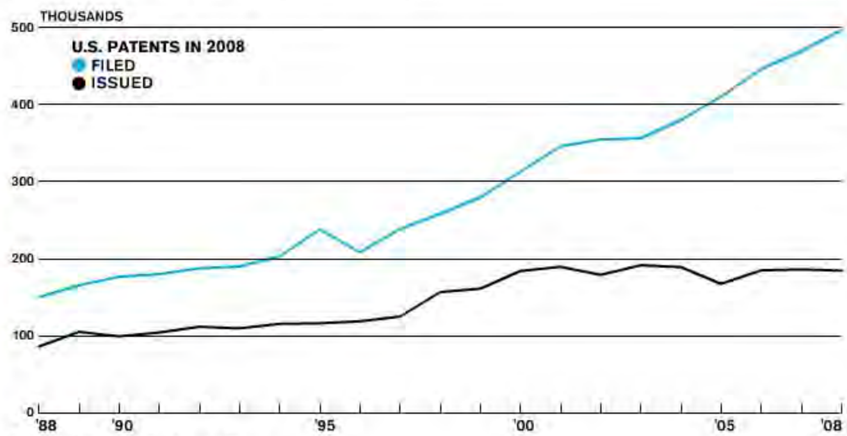
Data: U.S. Patent & Trademark Office

Tipped Balance: American businesses won 49% of U.S. patents last year, down from 50% in 2007.



*Includes China, Italy, and Sweden
Data: IFI Patent Intelligence

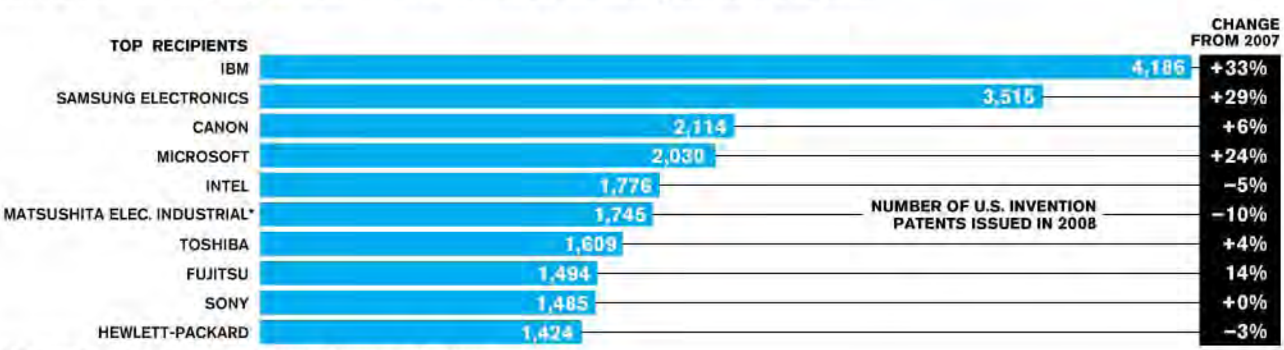
Rising Tide of Ideas: Patent applications grew 6% last year, while the number of patents issued was flat.



Data: U.S. Patent & Trademark Office

RECORD ACHIEVEMENT FOR AN INNOVATOR

IBM is the first company to receive more than 4,000 invention patents in one year.

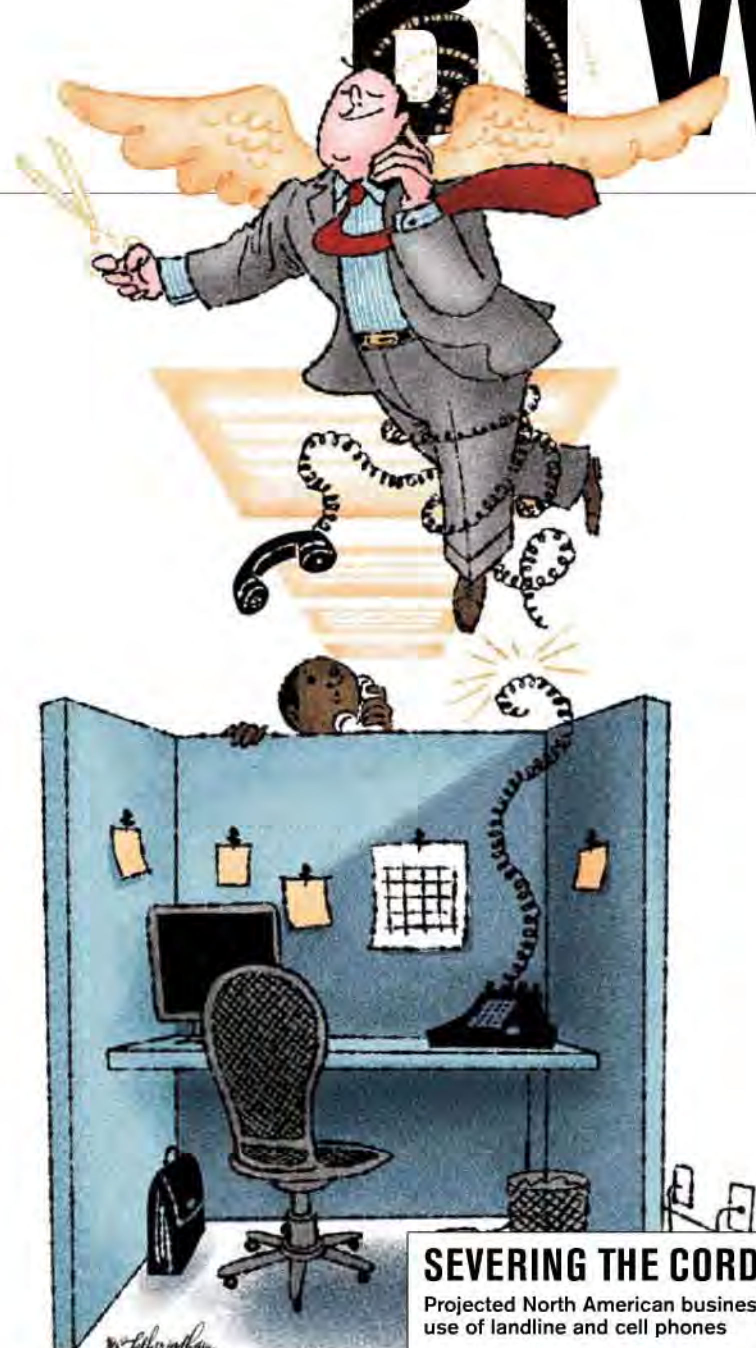


Data: IFI Patent Intelligence

*Became Panasonic in Oct. 2008

EDITED BY DEBORAH STEAD

WHO NEEDS A DESK PHONE?



Are companies ready to cut the cord? A forecast by research firm Gartner suggests that more businesses could soon join the many households that have unplugged from their landlines to go mobile-only. Gartner predicts that by 2012 about 23% of North American businesses will be doing without desk phones—up from 4% in 2008.

At the forefront of this trend are outfits like San Jose Web design firm Yogirt. Co-founder Brian Yoshida didn't even bother with desk phones when he set up the company five years ago. Wireless-only is "the future," he says.

That's music to the ears of makers of so-called smartphones—including Research in Motion, Nokia, and Acer. In their pitches to corporate clients, they emphasize the cost savings that come with switching to mobile.

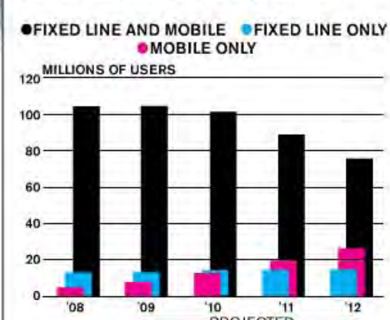
Initially installing one desk phone can cost up to $500, and the monthly per-line fee must be paid even if an employee is rarely in the office. For cell phones the average initial cost per employee is about $200, plus monthly charges. Given companies' concerns about controlling employees' cell-phone usage, however, most businesses are likely to buy mobiles but link them to their phone networks.

That's what CIO Tim Campos opted for when he was faced with the need to upgrade his phone system at KLA-Tencor, which makes semiconductor inspection tools. The company, based in Milpitas, Calif., spent about $8,000 to install RIM's Mobile Voice System, which routes employees' BlackBerry calls through the corporate landline. Employees get a single number for both desk and mobile phones, with the mobiles getting the company's long-distance rate. (No roaming charges.) "You get the best of both worlds," says Campos, who plans to roll out the BlackBerrys to 3,000 U.S. employees in the next year. The system will cost about half the $400 per employee the company would have spent to upgrade its desk phones, he says. *–Cliff Edwards*

ILLUSTRATION BY EDWIN FOTHERINGHAM

SEVERING THE CORD

Projected North American business use of landline and cell phones



Data: Gartner

ANALYZE THIS

By Kerry J. Sulkowicz, M.D.

Given the excesses that preceded it, it's no surprise that the current crisis is generating a backlash against lavish spending. The danger for CEOs? Embracing frugality for frugality's sake.

There are obvious virtues to the cultural shift away from exorbitant or ostentatious spending. It's not a bad thing for business leaders, in particular, to be more circumspect about displays of their personal wealth—and to be prudent about large-scale corporate purchases. But it's one thing to restrain the impulse to buy a new Bentley or book a company retreat at an ultraluxe resort. It's another to hold off on purchasing or investing in things that are affordable—or necessary—out of shame or because of societal pressure.

I've been seeing such inhibitions against routine spending in some of the CEOs and entrepreneurs I advise. Feeling vulnerable because of the prevailing public sentiment against profligate or reckless business leaders, they're postponing purchases that would seem to make sense—everything from clothes to other companies.

One client confessed that while he needed a new suit, he was embarrassed about being seen in the fitting room of the upscale retail shop that carries the brand he wears. Another is sitting on a merger idea, fearing that his board will look askance at what might have earlier been seen as a prudent strategic acquisition. Still another is putting on hold a key senior manager hire, worried that it will trigger resentment among other executives, who were told that budgets will be tight this year.

How to overcome such inhibitions? By realizing that a paranoid, guilt-ridden, and ultimately false frugality doesn't make any sense. Simply refusing to spend, in the hope that this is the safe thing to do, is hardly inspired leadership. And inspired leadership is what's needed in tough times.

My advice: Use the scrutiny you're under to highlight your decision-making process. Acknowledging that the zeitgeist favors retrenching, explain to the board why the acquisition you're considering is nonetheless a wise step. Talk to your management team about the importance of filling that key post, even amid a company freeze on raises that has them worried. Then, while your courage is up, decide about that new suit.

Kerry J. Sulkowicz, M.D., a psychoanalyst and founder of Boswell Group, advises CEOs on psychological aspects of business. Send him questions at analyzethis@businessweek.com.

Queueing up for a job fair in Shanghai

A PINK-SLIP PANDEMIC

The dismal jobs outlook is only going to get drearier worldwide, suggests a new study by Bain & Co. The consulting firm's latest biannual Management Tools & Trends survey found that of 1,430 managers polled globally, 59% plan layoffs in 2009. Some 34% said they had already made job cuts in 2008.

North America has the highest share of companies planning layoffs (70%). But the pain in 2009 may be greatest in Europe (60%), Asia (61%), and Latin America (52%), where there is a bigger year-over-year rise in planned staff reductions. Only 35% of Asian managers in the survey cut jobs last year.

What's especially worrisome, says Darrell Rigby, the Bain partner who headed the study: Of the executives around the world who downsized in 2008, some 88% plan more cuts this year. "We know from previous downturns that companies that have to do multiple layoffs do not get helped by the stock market and tend to lose the focus of their employees," he says, adding that workers just keep "waiting for the next round." *—Jena McGregor*

(FROM TOP) PHOTOGRAPH BY ALY SONG/REUTERS; ILLUSTRATION BY EDWIN FOTHERINGHAM

FACETIME

MARIA BARTIROMO

(TOP) BRAD TRENT; (BOTTOM) JEFF HUTCHENS/GETTY IMAGES

BYRON DORGAN ON WHY THE FINANCIAL CRISIS NEEDS INVESTIGATING

On Mar. 3, Byron Dorgan, Democrat of North Dakota, and John McCain, Republican of Arizona, issued a bipartisan call for the establishment of a special Senate committee to investigate the causes of the financial crisis. Whether that "select committee," which would have subpoena power, ever comes into being is still an open question. What isn't in question is that Dorgan spoke out against deregulation of the banking system, which many say sowed the seeds of the crisis. The Business Exchange box at the end of this column directs you to a video of Dorgan taking to the Senate floor to warn against breaking down the walls between commercial and investment banks. "I think in 10 years time we will look back and say, 'We should not have done that,' because we forgot the lessons of the past," the senator said. That was 1999. Now Dorgan is looking for lessons to guide America as it navigates a treacherous future.

MARIA BARTIROMO

You and Senator McCain want to investigate the roots of the financial crisis. What are you looking to accomplish?

SENATOR BYRON DORGAN

I think Congress and the American people need to understand all of the dimensions of this crisis. I mean, we know portions of it, but there's much we don't know. Even actions of the government are not fully understood. No one knows exactly what the Fed has done to this point, how much exposure exists with respect to the Fed's loans and guarantees. It's estimated that somewhere around $9 trillion in loans and guarantees and so on have been committed on behalf of the American taxpayer.

One black hole seems to be all the money handed to AIG. Where is this money going, Senator?
Oh, I assume it's going right through their hands to counterparties, because AIG, as you know, had a unit in London that made very, very large bets with respect to credit default swaps.

"[SHOULD WE] RECONNECT SOME PORTION OF GLASS-STEAGALL? ...I DON'T THINK IT'S OLD-FASHIONED TO GO BACK TO PROTECTIONS THAT PREVIOUSLY EXISTED"

Should Washington put a deadline in place and tell these companies, "Yes, we will be supportive, but after a certain amount of time, you're on your own"?
Many of the largest banks got involved in very risky enterprises, and I don't think they necessarily have a divine right to be saved. In 1999 I was one of eight senators who worked against what was called the Gramm-Leach-Bliley Act, named after Senator Phil Gramm. But it was fully supported by President Clinton and Bob Rubin, Larry Summers, etc. And it repealed the Glass-Steagall Act and many of the protections put in place after the Great Depression. I wasn't so prescient, but I just felt that allowing the banks to create big holding companies with so-called firewalls, which turn out to be tissue-paper firewalls, and then to take on massive risk from real estate and securities, was just fundamentally wrong.

Gramm in 1999: He was one of the key players pushing bank deregulation

Would the investigation you're proposing seek testimony from Clinton, Alan Greenspan, Rubin, Gramm, Summers, and other deregulation players like Sandy Weill?
I think anybody who proposed dismantling deregulation and protections put in place 70 years ago needs to answer for it. I happen to think [banking deregulation] was a significant cause of what we're now experiencing, and we ought to hold people accountable. If this country made bad decisions, let's understand what those bad decisions were, who was pushing them, and what we can learn from them. One of the important discussions no one is having at the moment, even as trillions of dollars in taxpayer money are being pushed out the door, is the future. Is the future to go back and reconnect some portion of Glass-Steagall? Some say that can't be done; others say it must be done. But that decision has to be made, and I don't think it's old-fashioned to go back to protections that previously existed.

What about American consumers? They also helped cause this train wreck by taking on mortgages they couldn't afford.
Right, and not just mortgages. Take a look at what's happened to credit-card and consumer debt. The country was living beyond its means—as was the federal government and business. But I would make the case that sophisticated mortgage brokers and unscrupulous banks had a lot to do with this crisis.

With all due respect, Senator, does Congress really know enough about the financial system and these complex instruments to mount an effective probe?
It's a fair point. But one might ask, do the biggest and most sophisticated bankers in the country know enough about these financial instruments? Apparently not.

Do you think that people involved in this crisis at the highest levels of major financial institutions should go to jail for misleading investors and jeopardizing the economic strength of this country?
I think anyone who's broken the law should bear the consequence, but I don't think we know enough yet. BW

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

Business Exchange

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Prophetic Words
Byron Dorgan was one of a handful of senators who opposed repeal of the Glass-Steagall Act and warned against creating financial supermarkets that would embrace more risk than might be prudent.

To view a video of Dorgan's speech, go to http://bx.businessweek.com/bailout/reference/

DOUGLAS GRAHAM/GETTY IMAGES

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A DOGFIGHT OVER THE RESCUE PLAN

Why economists can't decide whether massive stimulus will help—or drive America further down

By Peter Coy

Is the economy in a dangerous downward spiral, or is this a painful but ultimately healthy adjustment leading to a sustainable growth path?

Misdiagnosing this recession could lead to bad economic policy, with devastating consequences. If we're in a self-perpetuating spiral but don't respond with massive stimulus spending, the economy could fall into a trough that would rival the Great Depression. If, on the other hand, the economy is naturally finding a bottom, heavy spending could jack up inflation dangerously and saddle future generations with a huge debt burden.

With the unemployment rate at a 26-year high of 8.1% and hopes for a second-half recovery waning, Congress is deeply split over how to interpret and cope with the crisis. On Mar. 10, House Speaker Nancy Pelosi (D-Calif.) said "we have to leave the door open" to even more spending than is in the Obama Administration's newly passed $787 billion stimulus plan. But Senate Minority Whip Jon Kyl (R-Ariz.) warned the same day against wasteful government spending. Kyl earlier accused President Barack Obama of "rather casually throwing out some careless language" after the President warned Congress that failure to pass the original stimulus bill would jeopardize the nation's economy.

Unfortunately, economists aren't much help in this debate. They're tussling over stimulus like rival surgeons battling for the scalpel in an operating room. Nobel laureates took opposite sides in *BusinessWeek* interviews. Robert M. Solow of Massachusetts Institute of Technology (Nobel 1987) says the only thing wrong with the Administration's fiscal stimulus is that it's too small. In contrast, Edward C. Prescott of Arizona State University (Nobel 2004) argued that Obama's stimulus measures "are depressing the economy."

Most economic forecasters, who are judged on accuracy rather than academic rigor, seem to think stimulus is necessary. (Of course, they've been wrong before.)

The median forecast of a

THEORIES ON THE ECONOMIC CRISIS: THE EXTREMES

	DOWNWARD SPIRAL SCHOOL	NATURAL EQUILIBRIUM SCHOOL
THE PROBLEM	Job cuts lead to reductions in consumer spending and business investment, as well as more foreclosures and deeper losses at banks. In turn, these lead to even more job cuts.	Poor government policy, including too-low interest rates, led to overconstruction of housing and too much debt. Today, the economy is in a messy and painful transition back to a sustainable growth path.
THE SOLUTION	The federal government must rescue the economy by boosting spending to create jobs and compensate for the drop in private consumption, investment, and lending.	The economy will only find a bottom when falling prices and wages make consumer goods, investments, and labor more affordable. For long-term growth, government should cut taxes and regulations.

Data: BW

ALEX WILLIAMSON

broad range of Wall Street economists surveyed by *The Wall Street Journal* in February was that the Obama stimulus plan would save about a million jobs over the next year.

That irks the stimulus skeptics, who doubt the wisdom of heavy-handed government intervention. About 250 economists, including Prescott and two other Nobel laureates, signed an open letter to Obama sponsored by the libertarian Cato Institute that said "it is a triumph of hope over experience to believe that more government spending will help the U.S. today." They favor cuts in tax rates and a rollback of regulation to promote long-term growth.

The dispute over spiral vs. stability goes back 75 years to the Great Depression and British economist John Maynard Keynes. Before Keynes, most economists believed that economies naturally tended toward full employment. But Keynes argued that an industrialized economy can spiral downward when job reductions depress consumer spending, causing businesses to cut more jobs and decrease investment, and so on. Only government can break that spiral by spending to lift demand, he contended.

Keynesian views held sway well into the 1960s. But academia's fear of economic instability began to ebb in the 1970s as a new wave of economists argued that consumers and businesses are rational and farseeing, and not likely to be stampeded into recession. What's more, the argument went, government can't spend its way out of a recession because consumers realize that extra government spending now will necessitate higher taxes in the future. They'll save more to prepare for that day, offsetting the stimulus.

DEALING WITH ANIMAL SPIRITS

The current crisis has revived the debate, in intense form. Economists who advocate active government intervention to break a downward spiral have become much louder. George A. Akerlof of the University of California at Berkeley (Nobel 2001) and *Irrational Exuberance* author Robert J. Shiller of Yale University call for "truly aggressive measures" to deal with the current crisis in *Animal Spirits*, their new book reviewed in this issue (page 095).

In contrast, the most extreme academic opponents of stimulus say that unemployment is mostly a case of workers asking for too much money—and will solve itself if wages are allowed to fall. Arizona State's Prescott, who has a reputation for being outspoken, is at least partly in that camp. "People are getting a little more hungry for jobs," he says. "It's great that I can get...some work done on my house." John H. Cochrane of the University of Chicago Booth School of Business agrees that "in the past, credit crunches like this when left alone have led to a sharp decline in output that did fairly quickly rebound." Cochrane opposes the Obama stimulus, while favoring careful interventions to get securitized lending flowing again.

The country can't wait for economists to agree. Right now, the risk of doing too little to stop the downturn probably outweighs the risk of doing too much, because if the economy gets too deep in a hole, it will be hard to climb out. There will be time for fights over theory when the crisis is past. |BW|

SCOOPING UP THE COLLEGE STIMULUS

For-profit schools, criticized for low graduation rates and dubious recruiting methods, are getting a fresh windfall

By Ben Elgin and Jessica Silver-Greenberg

President Barack Obama's stimulus package directs billions in new funding to higher education. Poised to cash in on the largesse are a group of large for-profit universities that specialize in scooping up student aid dollars. Some of the schools, known for aggressive recruiting, are increasing advertising and seeing enrollments rise.

But are these education businesses appropriate beneficiaries of fresh taxpayer generosity? For years skeptics have raised questions about the schools' marketing tactics, graduation rates, and quality of education.

Asked about the coming boom in the for-profit industry, Arne Duncan, the new Education Secretary, told *BusinessWeek* (page 22) that he intends to increase monitoring of federal student aid to all schools, private and public: "I am creating an internal task force to optimize our procedures and to build better connections to other consumer protection agencies."

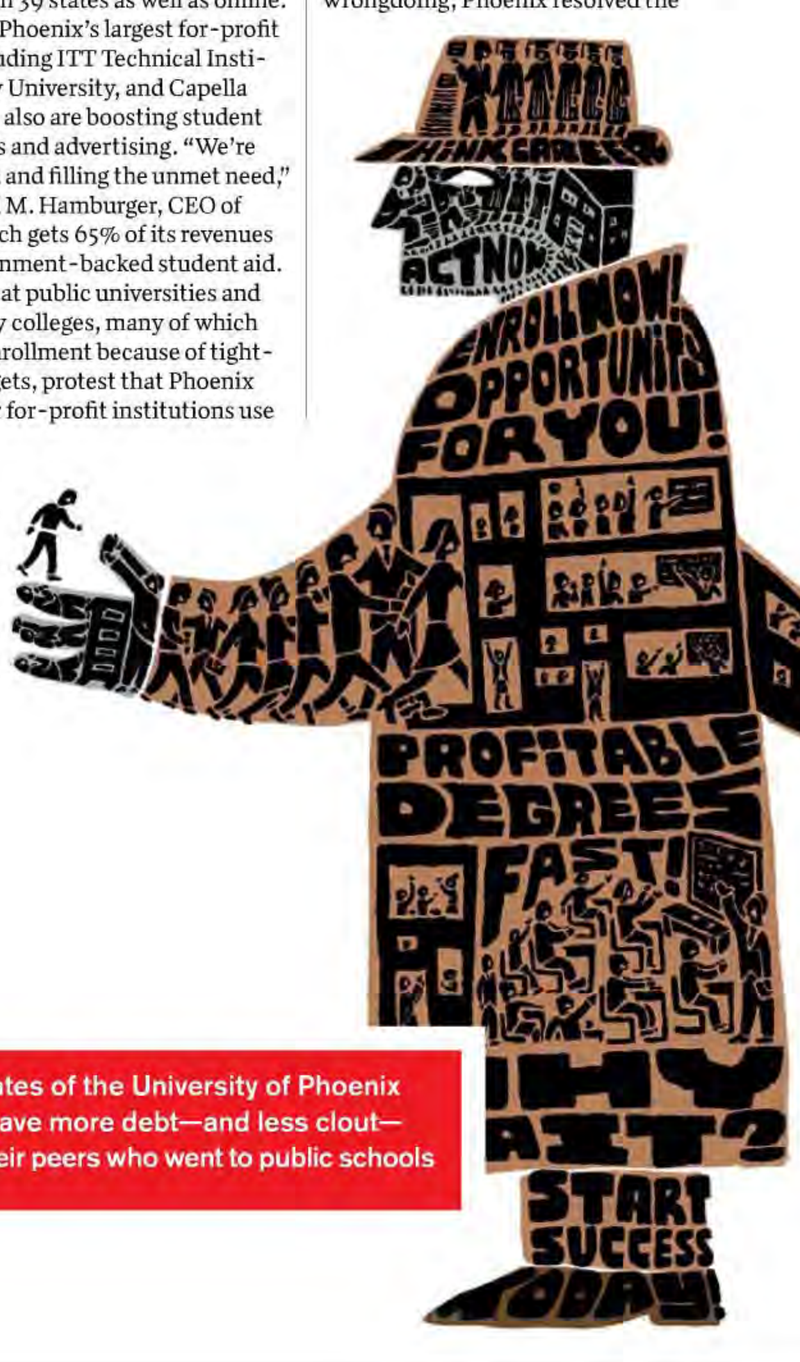
Career-oriented schools such as the University of Phoenix, a unit of publicly traded Apollo Group, have been benefiting from lean times as adults scramble for credentials they hope will help them find work. The stimulus enacted last month will accelerate this trend by providing an additional $15 billion in Pell Grants for students over the next two years.

Apollo, which received more than three-quarters of its $3.1 billion in revenue from federal student aid in the fiscal year that ended Aug. 31, is well positioned to take advantage of the stimulus. Its Phoenix unit already is the biggest recipient of government student aid. In its most recent quarter, which ended Nov. 30, Phoenix boosted ad spending by 24%, to $88 million. Its enrollment rose in the quarter by 18%, to 385,000 students, who study at campuses in 39 states as well as online.

Some of Phoenix's largest for-profit rivals, including ITT Technical Institute, DeVry University, and Capella Education, also are boosting student headcounts and advertising. "We're stepping in and filling the unmet need," says Daniel M. Hamburger, CEO of DeVry, which gets 65% of its revenues from government-backed student aid.

Officials at public universities and community colleges, many of which have cut enrollment because of tightening budgets, protest that Phoenix and similar for-profit institutions use questionable methods to lure students. "These schools are clearly attempting to capitalize on the financial difficulties that families face," says Barmak Nassirian, associate executive director of the American Association of Collegiate Registrars & Admissions Officers.

In 2004 the Education Dept. blasted Phoenix for fostering a corporate culture in which "ethics often are set aside" in a race to increase enrollment and profits. The agency charged that Phoenix paid recruiters solely based on the number of students they signed up, a practice barred by the Higher Education Act. Without admitting wrongdoing, Phoenix resolved the



Graduates of the University of Phoenix often have more debt—and less clout—than their peers who went to public schools

case for $10 million, the largest settlement of its kind. Phoenix executives say they have always paid employees only partly based on the number of recruits, which is legal.

The executives stand behind the quality of Phoenix's education and business practices. They say they cater to underserved constituencies, such as adults who want to attend part-time and members of the military and minority groups. Testing of their students shows improvement in reading and math, they say, and adult grads typically earn 9% to 27% more upon receiving degrees. "There's a lot of bias against recruiting into a college," says Terri C. Bishop, Phoenix's vice-president for external affairs. "We recruit properly, and we take care of students once they're here."

Critics point out that degrees earned at for-profit schools, including Phoenix, often carry less clout in the marketplace, despite price tags comparable to those at many public universities. "I don't think a degree from the University of Phoenix adds any value at all," says Edward Fleischman, chief executive of Execu/Search Group, a New York recruiting firm that specializes in financial services and health care. "It means you could not get into a better school."

MISLEADING MATH?

Graduation rates at some for-profit schools tend to lag overall levels, at least by the federal standard. The Education Dept. measures the percentage of first-time undergraduates who obtain a degree within six years. Phoenix has a rate of 4%, among the nation's lowest, according to the government. The national average is 57.3%. But Phoenix criticizes the federal approach as misleading in its case because the school serves mostly older students who began college elsewhere. Phoenix claims a 38% overall graduation rate for students seeking bachelor's degrees.

Students who attend for-profit schools tend to carry heavy debt loads. According to data from the College Entrance Examination Board, the average total debt per for-profit university graduate is $29,900, vs. $10,500 for graduates of public four-year schools. Phoenix says its graduates have debt levels of $14,200 to $25,221, depending on the degree they pursue. Tuition for a two-year associate's degree from Phoenix comes to about $19,500; a four-year degree costs about $51,600.

Last July, long before the $787 billion stimulus, the fed boosted its guaranteed educational loan limits by $2,000 per student in response to worries that privately funded lending would dry up in the recession. To maximize revenue—and federal aid dollars—Phoenix employs more than 6,000 enrollment staff members. Names of prospective students, gleaned from online ads and phone inquiries, are funneled to recruiters. Those employees strive to convert each lead into a paying student, according to interviews with former Phoenix workers.

An e-mail sent in late 2006 by an enrollment manager in San Diego urged employees to use "trick messages" to get prospective students to call back. One such message: "Can you please call me, John.... [Y]ou have an unresolved issue that I need to discuss with you as soon as possible." The e-mail was disclosed in a whistleblower lawsuit filed against Phoenix by two former employees in federal court in Sacramento. The pending suit accuses the company of improper compensation of recruiters. Phoenix argues that the suit lacks any merit but acknowledges that it has tightened enrollment practices in recent years. The alleged acts of one or two rogue recruiters don't represent company policy overall, it contends. "We have always recruited students legally," says Bishop. "This isn't a boiler-room environment."

Several enrollment workers told *BusinessWeek* that they felt pressure to sign up as many people as possible. "They were giving you [financial] incentives to stick whoever you could into class," says Christopher Lother, who worked as an enrollment employee and manager at Phoenix until last November. "It's not what college is all about. I couldn't do the job because it was unethical, and I couldn't sleep at night." BW

—With Steve LeVine in Washington

Business Exchange

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What's a Web Degree Worth?

Consumers Digest raised questions about for-profit online universities in a report issued on Mar. 3. Estimating that Internet-based schools constitute a $6.2 billion industry with 620,000 students, the magazine said its research suggests that the institutions exaggerate the value of their degrees and mislead students on costs.

To read the full article, go to **http://bx.businessweek.com/business-of-higher-education/reference/**

GEORGE BATES

A NEW VISION FOR U.S. SCHOOLS

Education Secretary Arne Duncan talks about the Obama Administration's priorities: Math, science, and rigor

Duncan says No Child Left Behind resulted in "dumbing down" the curriculum

MELISSA GOLDEN/BLOOMBERG NEWS

In a major speech on education on Mar. 10, the President called for linking teacher pay to performance, rolling out more charter schools to increase parents' choices, and closing schools that don't make the grade. A few days before the President's speech, Education Secretary Arne Duncan discussed this provocative agenda with *BusinessWeek* Editor-in-Chief Stephen J. Adler, Washington Bureau Chief Jane Sasseen, and Correspondent Steve LeVine.

The business community is very concerned about student proficiency in math and science. How will you treat these areas?
We have 20 English teachers for every job and can't find a math teacher, and that's a problem. We have to pay math and science teachers differently. I also think early exposure for kids is really important. If you wait until high school to instill in kids lots of math and science, it's too late. We've got to push to get more kids taking algebra in eighth grade, and then you start to think about calculus in that fourth year [of high school].

In Chicago, you brought in math and science teachers from outside. Where did they come from?
One pool was the young guns. The second was people coming out of industry, 30, 35, or 40 [years old]. I had folks who took 60%, 70%, 80% pay cuts to come teach in the inner city. I had one couple that walked away from Motorola, who wanted to come teach.

The third group were people at retirement age. So we had a Troops-to-Teachers program for folks coming out of the military. You have people 50, 55, who have lots of good years left.

> "[We have] a tremendous opportunity to produce the workers that the corporate sector needs"

How will you set national standards?
We're going to pick a set of states who are willing to drive a national conversation [about standards], to commit to do the whole package of reforms. We'll make some mistakes, get the kinks out. But we'll use that to say, "As a country, this is where we need to go."

How concerned are you about "teaching to the test?" and to the standards?
If you're teaching to a bad test, it's a problem. If you're teaching to a good test, it's good. One downside of No Child Left Behind was 50 states dumbing down things.

What role do you see for community colleges?
We're going to make a play around community colleges. Green jobs, tech jobs, health jobs. [We have] a tremendous opportunity to produce the workers that the corporate sector needs.

Bill Gates recently suggested that much of the $2 billion his foundation has spent on education basically achieved very little. What are the lessons here?
They invested early just on creating small schools. What they did right was work hard to get the culture right. The next step is you have to drive more students into taking AP classes, college-level classes. When you combine those two, it's extraordinarily powerful. If all you do is change the structure, and don't change the content, you're not doing enough for the kids.

Is there a model school for all?
We need to create a range of great options, and let the marketplace play. The schools that are doing a great job and where there are waiting lists, let's build a lot more of those. [In Chicago] we had one military academy and a long waiting list, and we ended up with six. There are very few high-performing schools with empty seats. The more we empower parents, [the more] they are going to figure out the best learning environment for their child. BW

THE TWO BEST CURES FOR THE ECONOMY

Spending on health care and education will be the fastest way to create jobs while other sectors recover

MANDEL ON ECONOMICS

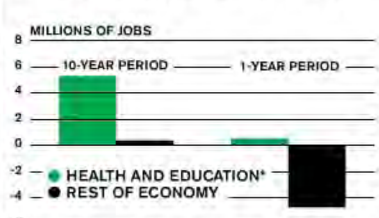
By Michael Mandel

Here's a thought experiment. Suppose that you have \$50,000. Using that cash, you can: a) remodel your outmoded bathroom; b) purchase an expensive new car; c) replace your arthritic and failing knee; or d) pay for two years of college for your child at your state university.

Which of these do you choose? My guess is that most people would pick either "c" or "d." These days, fixing up your house or getting a new set of wheels feels like a luxury. But even in tough times, health and education are still necessities to most people. What's more, the public seems to support increased government spending in these areas. In an early February Gallup poll, 56% of Americans considered aid for education "one of the most important" items to have in a stimulus bill, beating everything else, including tax cuts.

The public support for health and education carries a broader economic implication. The two sectors, long maligned as inefficient, may turn out to be the best hope for sustaining the economy. Hospitals, universities, and the like employ about 30 million workers, or 22% of the workforce. These employees are numerous enough and well-paid enough, on average, to prop up the economy while housing and finance recover.

HEALTH AND EDUCATION: THE BIG JOB ENGINES



*Includes private and public health and education services, and drug and medical equipment manufacturing

Data: Bureau of Labor Statistics, *BusinessWeek*

STABILIZING INFLUENCE

If additional stimulus is needed, the health and education fiscal policy channel is still functioning, while other ways of getting money into the economy have broken down. Taxpayer money given to banks, businesses, or households will likely be saved with little stimulative effect. But funds directed to schools and hospitals—as called for in President Barack Obama's recent stimulus bill—will almost certainly be spent on buying equipment, putting up new buildings, and hiring workers. Health-care employers in particular seem willing to hire nurses, medical technicians, home aides, and the like. Over the past year the number of health and education workers has risen by 500,000.

Ordinarily, such spend-and-hire behavior would be objectionable. After all, most people on both sides of the political aisle agree that health and education are overpriced and hobbled by world-class bureaucracies. Indeed, on Mar. 10, Obama unveiled his education reform program. Health-care reform is high on his agenda as well.

But these are no ordinary circumstances. In many regions—especially the hard-hit manufacturing belt—people working in health and education are crucial to keeping local economies afloat. In Michigan, health and education now provide 23.7% of jobs while manufacturing has dropped to half that, only 12.5%.

Looking back over the past decade, health and education have been a stabilizing influence nationally, hiring at a steady pace and adding 5.3 million jobs since 1999. Meanwhile the rest of the economy has gone through booms and busts, creating fewer than 400,000 new jobs in 10 years as offshoring ate away at manufacturing.

Spending on health and education eventually will have to be reined in. But that crisis is 5 or 10 years down the road. For now, schools and hospitals may be the best choice we have for keeping the labor market afloat. BW

BRAD TRENT; ILLUSTRATION BY GEORGE BATES; CHART BY DAVID RUDES/BW

Union members hope the bill will win 60 Senate votes

ALEX WONG/GETTY IMAGES

LABOR'S FAVORITE BILL HITS A WALL

Business is determined to kill a proposal in Congress to help workers join unions. Will a compromise save it?

By Jane Sasseen

In this time of political clashes, nothing is generating more heat in Washington than the fight over card check. The debate is reaching a critical stage.

Card check is the nickname for a legislative proposal by labor to make it easier for workers to unionize. Today companies can demand that workers who want a union vote by secret ballot. Labor officials instead want workers to opt for union representation simply by signing a card. Once 51% of the workers had signed a pro-union card, the company would have to ink a contract with the union within 120 days—or face binding arbitration.

Card check has aroused the ire of business and the GOP. "We are going to kill it," vows Steven J. Law, the general counsel for the U.S. Chamber of Commerce. The Chamber says the bill, which has just been introduced into both houses of Congress, would open workers to intimidation by unions and deprive management of the chance to make its case in an organized vote. The unions say it's the companies that do the intimidating, not them.

Right now the GOP is gaining the upper hand in the Senate by drawing moderate Democrats toward their camp, potentially depriving labor of the 60 votes it needs. The Democrats know President Barack Obama cannot afford a big defeat, so they are starting to talk compromise. "I wouldn't be supportive of what's introduced, but I'm keeping my options open to see what amendments come forward," says Senator Ben Nelson (D-Neb.). Senator Mark Warner (D-Va.), who has strong ties to business, has also signaled a desire to bridge the two camps.

If labor pulls back from the most controversial parts of the bill, that might provide cover for the hesitant—such as Nelson and fellow Democrats Mark Pryor and Blanche Lincoln of Arkansas—to sign up. "There is searching [for a solution] going on," says William B. Gould IV, a former head of the National Labor Relations Board who now teaches at Stanford Law School. Gould has discussed alternatives with the staff of Senator Arlen Specter (R-Pa.).

Adds Gould: "It's unclear at this point what the precise substance will be, but people are looking for options."

One possible compromise: Retain the secret ballot but require companies to hold an election for a union shortly after workers indicate interest in one. One aide to Nelson says Congress might also stiffen the largely toothless penalties for companies that delay elections or otherwise violate collective bargaining laws. Those changes might eliminate the long waits before balloting that, the Democrats argue, give companies the chance to scare employees into rejecting unions. The mandate for binding arbitration might also be weakened.

Senator Specter could be key to any deal. At least one GOP vote will be needed for passage—and he's the only Republican to show any sympathy so far toward card check. While he argues that the time is not yet ripe for a compromise, he comes from a pro-union state and he co-authored a law journal article exploring alternatives similar to some now on the table.

Everyone involved says it's still early to call the outcome of the battle. The AFL-CIO and United Auto Workers insist they have the votes to win, but others are more cautious. Andy Stern, head of the Service Employees International Union, believes the unions have the 60 votes needed to bring the bill to the floor of the Senate for a full debate. But he knows changes may be needed to guarantee passage. "There are a lot of different ideas floating around," he says. "We'll ask Blanche Lincoln and the others what would make the bill work for them. And we'll listen." | BW |

CARD-CHECK LEGISLATION: THE BASICS

END OF THE SECRET BALLOT

The current bill could end the secret ballot in labor elections; a union would be recognized if 51% of the workers signed cards asking for one. Opponents say that would leave workers open to intimidation by labor organizers.

RAPID ARBITRATION

Once workers vote for a union, the law would mandate binding arbitration if the two sides can't agree to a contract after 120 days. Business fears that would hand government-appointed negotiators too much sway over work rules and pay.

Data: *BusinessWeek*

THE DRUG MERGERS' HARSH SIDE EFFECTS

The recent wave of deals will solve drugmakers' short-term woes, but history shows R&D is likely to suffer

By Catherine Arnst

The future of a pharmaceutical company rides on its pipeline—the roster of drugs it hopes to get out of labs and into pharmacies before its previous round of medicines loses earning power. But the recent wave of pharma mergers doesn't bode well for that replacement process. The one part of a drugmaker's operation that never seems to do well in a megamerger is research and development.

It's true that Merck's acquisition of Schering-Plough for $41 billion, announced on Mar. 9, will improve the bottom line for the next two to three years, as will Pfizer's planned purchase of Wyeth, announced six weeks earlier, for $64 billion. Both buyers said the deals will allow them to cut some 15% of staff—a total of more than 30,000 jobs—and streamline operating costs.

But a few years from now they may find themselves in the same wobbly boat they're in now, with no major drugs to replace the best-sellers that are on the verge of losing patent protection. "Making R&D bigger does not make it more efficient," warns Dr. Joseph Schlessinger, chairman of the pharmacology department at Yale University School of Medicine and the founder of three biotechnology companies. "It's very hard to manage science when you have huge teams."

Genentech: Roche is pushing to buy the 44% of the biotech it doesn't already own

ELLERINGMANN/STERN/LAIF/REDUX

For proof, look at the recent past. The drug industry has been transformed by megamergers over the past 15 years, but the bigger the companies get, the fewer new drugs they produce. U.S. pharmaceutical makers spent $65.2 billion in 2008 on R&D, compared with $36 billion in 2002, though for many reasons only eight totally new drugs reached the market last year, half as many as in 2001.

Pfizer has spent more than $60 billion on R&D since 2000 but has not produced one drug from its own labs in that time. In the pharma industry, "when you have 5,000 to 10,000 scientists working around the world, you can't know every project," says Kim Wagner, a senior partner at Boston Consulting Group. "You end up trying to standardize processes that really can't be standardized."

DEFENSIVE, NOT STRATEGIC

Pharma mergers do solve near-term problems, so deals will keep coming. Next up: Roche Holding is pushing to buy the 44% of Genentech it doesn't already own. Both Merck and Pfizer are gaining buffers against the loss of billions of dollars in revenues when their best-selling drugs go off patent in the next three years. Existing Wyeth and Schering-Plough drugs have several more years to go on their patents. That makes the mergers "defensive acquisitions, not strategic," says Matt Gurin, a senior consultant at Hay Group Consulting. "They're just filling the gaps in their existing product lines."

$128 billion

Amount U.S. drug companies spent on R&D in 2007-08. Only eight completely new drugs were approved by the FDA last year.

Data: Pharmaceutical Research & Manufacturers

Merck CEO Richard Clark said when he announced the Schering deal that it will boost R&D, not harm it. He added that the number of drugs Merck has in late-stage development will double as a result, to 18.

But combining the companies could end up slowing development of those drugs considerably, warns Yale's Schlessinger. He speaks from experience: After selling one of his startups, Sugen, to Pharmacia in 1999, he watched Pfizer dismantle the Sugen lab when it bought Pharmacia in 2000. "Until the merger is completed, everyone in the labs of Wyeth and Pfizer and Merck and Schering will stop doing anything except talking about 'What is going to happen to me?'" he predicts. | BW |

GAME-CHANGING MANAGEMENT IDEAS

THE SHIFTING LANDSCAPE

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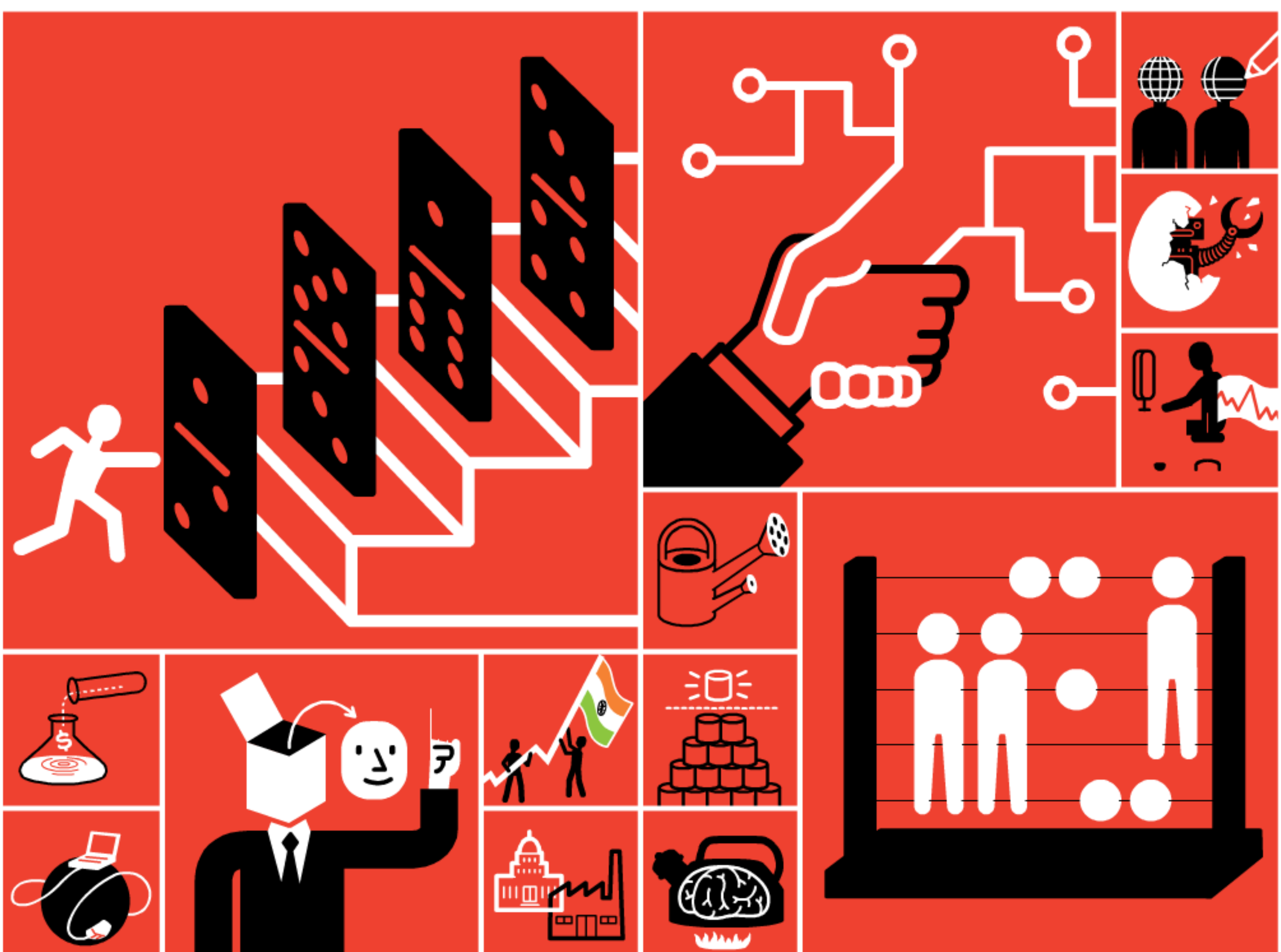


GAME-CHANGING IDEAS

'THERE IS NO MORE NORMAL'

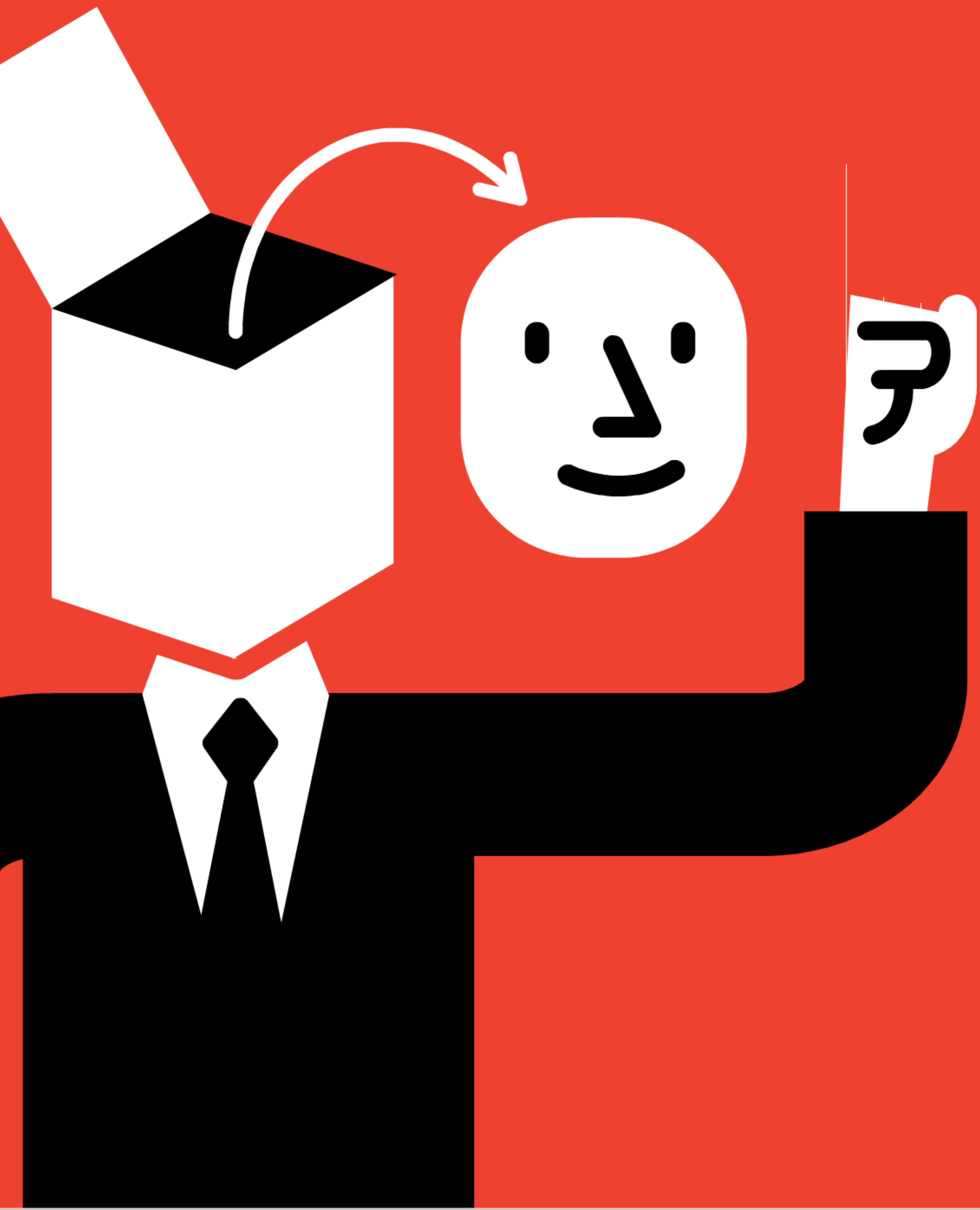
By Jena McGregor

Illustrations by Christoph Niemann

Breakthrough management ideas for a world in which the game will never be the same

John Chambers knows what it feels like to survive a crash. In 2000, Cisco Systems had the largest market cap in the world and more than 50% annual sales growth. Then the dot-com bubble burst, and the Cisco chief executive watched the networking giant's stock drop 86%, from 80 to just over 11 by September 2001. Chambers laid off thousands of employees, shrank the number of suppliers, and simplified or jettisoned many products. He also radically changed the way he managed, turning a command-and-control hierarchy into a more democratic organizational structure. The company emerged from that recession more profitable than ever and went on to outperform many tech rivals. In retrospect, Chambers wonders if he could have done even more. "Without exception," he says, "all of my biggest mistakes occurred because I moved too slowly."

The challenge for many business leaders is figuring out what moves to make now. Whether you see signs of life in the economy or think the worst is yet to



come, there's no question that the game has changed for business. The tools managers once used with great success, from how they pay their people to where they seek out new product innovations, are being reevaluated. Manufacturing processes that worked seamlessly a year ago may be a recipe for piled-up inventory as spending slows. And strategies once deemed unthinkable, such as cutting the salaries of rank-and-file managers, are being embraced by some of the world's largest companies, including FedEx and Hewlett-Packard.

Our special issue on breakthrough management ideas examines how leaders are responding to a fast-shifting world. At a time when many managers have already shored up cash, downsized risk, and found ways to cut costs while enhancing execution, the smart ones are looking to position themselves for the future. On the following pages, we outline bold new ideas and approaches that have heightened relevance in today's changing landscape. We have organized these ideas into the three areas we believe reflect top priorities for business right now—strategies for driving growth, methods for managing talent, and ideas for improving relationships with customers and suppliers. We profile game-changing managers—the people making an impact with radical ideas. And we highlight blue-sky concepts that might one day alter how business is done.

After all, the best businesses have to do more than just survive this recession. Jeffrey Immelt, General Electric's chief executive officer, believes that what the corporate world faces now is a fundamental "reset." He argues that the shift in the financial services sector and the increased role of government in business "will be with us for the rest of our careers."

He's right. Many consumers will be forced to accept a more frugal lifestyle for years to come. Sectors such as retail, housing, media, and manufacturing are being transformed. And layoffs could permanently alter not just the size of some companies but also the nature of relationships between employees and their bosses.

"WITHOUT EXCEPTION, ALL OF MY BIGGEST MISTAKES OCCURRED BECAUSE I MOVED TOO SLOWLY" CISCO CEO JOHN CHAMBERS

Smart leaders recognize that they can use this crisis as a catalyst to spark new ways of thinking and doing business. Niko Canner, co-founder of consultancy Katzenbach Partners, notes that the challenge is to look beyond the critical work of plugging financial holes to forge fresh strategies. Right now, he argues, "people are using approaches that are insufficiently powerful to get them where they need to go." Some CEOs are determined to avoid that trap. Ray Davis, who heads regional bank Umpqua Holdings, asserts that "there is no more normal." His top priority: position Umpqua to succeed in the coming years. Despite the turmoil, he has launched an eco-oriented lending unit to fund green ventures and is building an asset-management division. The Oregon bank is suffering like many of its peers, though it didn't offer subprime loans to customers. But

PHOTOGRAPH BY SPENCER PLATT/GETTY IMAGES

A HISTORY OF BIG IDEAS

Some of the most powerful and lasting management methods were launched during tough times, when companies needed new ways to manage costs and grow. Here is a look back at some of the biggest ideas over the past 100 years.

1910

THE ASSEMBLY LINE

With demand soaring for his Model T, Henry Ford took cues from brewers' conveyor systems and slaughterhouses' overhead trolleys to build his assembly line, increasing annual production from 78,000 cars in 1910 to 2 million by the 1920s.

1920

MARKET SEGMENTATION

General Motors CEO Alfred P. Sloan managed GM's car models through loosely monitored "divisions," which operated as separate companies with Sloan's oversight, laying the groundwork for today's corporation.

1931

BRAND MANAGEMENT

After Procter & Gamble began targeting soap brands to different demographics, it set up brand management, an organizational structure that makes individual managers responsible for each brand's success.

1943

SKUNK WORKS

To build a new fighter jet in just 143 days, Lockheed created an organization called Skunk Works, which used small groups and advance funding to work with little interference from its corporate parent.

1950s

LEAN MANUFACTURING

After a 1950 strike, Toyota workers were given lifetime employment. Manager Taiichi Ohno developed ways to up efficiency without cutting jobs, leading to "pull production" in 1954 and "Total Quality Control" in 1961.

Data: *Giant Steps in Management: Innovations that change the way we work,* by Michael Mol and Julian Birkinshaw; companies doing nothing beyond hunkering down simply isn't an option. "I feel like I'm sitting in the middle of a railroad track," says Davis. "Standing still is how you kill the company."

Consider the approach taken by Gerard Kleisterlee, CEO of Royal Philips Electronics. While his company has long sold its health-care equipment, lighting, and electronics in developing countries, Kleisterlee is shifting more people, advertising dollars, and research to developing regions this year. In addition to cutting costs, the hope is that the benefits will trickle back to Europe and North America. As he puts it: "We're looking at opportunities to bring some of what we have [developed for] emerging markets" to the rest of the world.

With U.S. and European markets in deep freeze, companies are even more interested in tracking market trends in emerging economies. About a year ago, MasterCard launched a process it calls "dynamic strategy." It created seven global networks that study developments such as technology, consumer behavior, and business spending. The heads of each network present their findings at twice-yearly forums attended by MasterCard's top brass. Already, the initiative is helping executives understand the impact of developments such as payments by cell phone. "Normally those smaller markets get pushed to the side," says Senior Vice-President Randy Shuken, who oversees the project. Even simple technology solutions, he explains, "could affect our industry fundamentally."

WORKING WITH OUTSIDERS

As the old methods fall short, executives need to bring a wider array of skills and backgrounds to the table. Companies are testing fresh methods to develop global leaders while tapping innovative collaboration tools and social networks to speed up productivity and decision-making. Perhaps no company has done more in this vein than Cisco. As part of his move to democratize management, Chambers set up a new hierarchy within the company. "Councils" are teams of executives who make decisions on \$10 billion opportunities. "Boards" consist of executives who have authority to make calls on \$1 billion bets, and "working groups" are organized to deal with a specific issue for a limited period of time. Chambers—who typically isn't involved in the decisions—believes his approach is a path others will need to follow. "When you have command and control by the top 10 people, you can only do one or two things at a time," he says. "The future is about collaboration and teamwork and making decisions with a replicable process that offers scale, speed, and flexibility."

Business Exchange

Read, save, and add content on BW's new Web 2.0 topic network

What Matters Now

Management consulting firm McKinsey has launched an online site called "What Matters" that assembles essays from smart thinkers on topics ranging from innovation to globalization. Read why Google CEO Eric E. Schmidt thinks companies need to "collaborate or perish," what Stanford professor Jeffrey Pfeffer says will come "after the corporation," and why Craigslist founder Craig A. Newmark thinks we're headed for a "participatory technocracy."

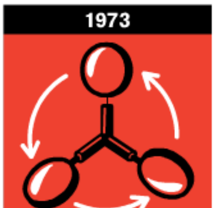
To check out McKinsey's new site, go to **http://bx.businessweek.com/management-ideas/reference/**

1967

SCENARIO PLANNING

The practice involves envisioning multiple future events and developing plans for responding to them. Shell first experimented with scenario planning in 1967, helping it navigate the oil shock of the 1970s.

1973



360-DEGREE REVIEWS

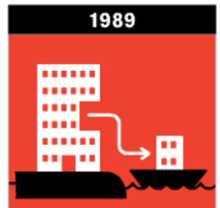
Getting feedback from peers, managers, and underlings may be the scourge of time-strapped managers. But when companies first adopted these reviews (DuPont was first in 1973), they were seen as a leap ahead.

1987

SIX SIGMA

Invented at Motorola, the process, designed to reduce defects and increase efficiency, is most associated with General Electric. Widely used today, the jargon-laden tool has been the butt of recent jokes on TV sitcoms such as *30 Rock*.

1989



OUTSOURCING

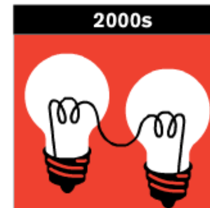
While the practice of hiring outside tech services dates to the 1960s, outsourcing took root later. In 1989, IBM landed a deal to manage Kodak's data-processing needs. By the 1990s, much of that work started moving offshore.

1990

REENGINEERING

Technically defined as a radical rethinking of processes, the fad was often associated with the layoffs it spurred and with consultant Michael Hammer, who cited Ford in his 1990 article "Reengineering Work: Don't Automate, Obliterate."

2000s



OPEN INNOVATION

Many companies are ditching fears of "not invented here." Instead, they are buying or licensing inventions and collaborating with companies and customers. Procter & Gamble aims to capture half of its innovations from outsiders.

The recession is prompting companies to reconsider how they work with outsiders, too. A critical new skill is learning to work with regulators and other public-sector executives whose role in business has vastly expanded. In the financial sector, that could mean interacting with government as owner. In other cases, it means looking for ways to tap the stimulus money now being doled out across the globe. Immelt, for one, has ramped up a companywide effort to track stimulus spending, monitor public-funded projects, and share expertise among GE business units.

SKIN IN THE GAME

Creative retailers, meanwhile, are getting more involved with struggling suppliers and customers. Some are exploring ways to help with financing where they can, while others are putting more emphasis on services as product sales drop off. Brian Dunn, who will take over as Best Buy's CEO this summer, says the consumer-electronics retailer is in "the early innings" of its expansion into technology services such as its Geek Squad tech support team. As customers spend less on new gadgets and want the ones they own to last longer, they're "really hungry not just for a transaction," Dunn says. "They're interested in who is going to help them get the benefit of what they're buying over the life of it."

In the past, solving customers' problems was often just talk. Now, it has become critical throughout a number of industries. Those who can't do it risk losing the business altogether; those who do may gain market share. India-based outsourcer HCL Technologies has been testing new ways to help customers trim costs, from deferring payments to helping them look for ways to cut overall IT spending. Naturally, the $5 billion-a-year company hopes happy customers will bring it more business. But the more immediate concern is that some clients may not survive if they don't find ways to take costs out of their bottom lines.

That's one reason CEO Vineet Nayar believes there's no choice but to put more of his own skin in the game. When a software client wanted to shelve a product it was developing, Nayar had HCL take over the project in exchange for a share of its future revenues. In another case, a media customer couldn't afford to install software that would save it money. So Nayar made the investment instead and plans to pay himself back out of the money his client will save. "I'm a big believer that buying will come back with a vengeance," he says. "But it will come back only to people who have created trusted partnerships at the weakest point for their customers." |BW|

–With Peter Burrows in San Mateo, Calif.

BUSINESSWEEK.COM | To find out why Cisco CEO John Chambers calls these challenging times "the greatest opportunity of our careers" and to see more ideas for dealing with the downturn from *BusinessWeek* readers, go to businessweek.com/go/09/ideas

Coming Soon to Every Kind of Screen Near You

GAME-CHANGER

Hollywood studios face a conundrum: **How to put movies online without hurting ticket and DVD sales?** The answer in most cases is to wait months between releases. Thomas Lesinski is helping to blow up that model.

Lesinksi, 49, worked on the Pepsi and Gillette advertising accounts for BBDO in New York before heading to Hollywood to market DVDs for Warner Bros. and then Paramount. He was named Paramount's first digital czar in 2006. Determined to bring the studio into the 21st Century, Lesinski looked outside Hollywood for talent, hiring **techies from AT&T, game maker Electronic Arts, and the online music service RealNetworks.** "The key thing about any new technology is whether it creates a bigger market than it cannibalizes," says Lesinski. "And we think it is largely additive."

Lesinski builds unconventional partnerships—with computer makers, for example. Dell, to launch its movie download service in September, paid for the right to stream Paramount's *Iron Man*; it also pre-loaded the comic book movie on its new PCs the same day it appeared as a DVD. Lesinski has cut deals with mobile phone makers, as well. Paramount licensed *Mission: Impossible III* and *Transformers* to Nokia, which included the movies as a bonus on some of its phones in Japan. And Lesinski has cut a deal with Facebook, where visitors can watch clips of Paramount movies—followed by a plug to buy the DVD.

Meantime, he has been building a digital studio within a studio. Its first release, *Jackass 2.5*, first appeared last year on Blockbuster's site. The premiere attracted 15 million viewers and built buzz for the DVD, which was released later and sold a million copies. Lesinski's producers are now working on four movies that should premiere online this year. Lesinski's team also is churning out titles based on such flicks as the upcoming *Star Trek* that can be played on iPhones and other mobile devices.

–Ronald Grover in Los Angeles

Lesinski is putting movies on PCs, mobile phones, and Facebook

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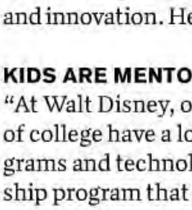
READERS AT THE WHITEBOARD

More than 350 contributed ideas and strategies for dealing with the economic slowdown. Here's a sampling

By Aili McConnon and Jena McGregor



Everyone is looking for fresh ideas on how to manage through the recession. So over the past three months we sought insights through *BusinessWeek*'s Market Advisory Board, a volunteer panel of readers, and our ManagementIQ blog. More than 350 people responded. While the downturn has forced many to cut back, it has also spurred experimentation and innovation. Here's a selection of proposals from readers:

KIDS ARE MENTORS, TOO

"At Walt Disney, often the younger employees coming out of college have a lot of knowledge about new computer programs and technological advances. So we have a mentorship program that goes both ways. More seasoned veterans mentor the younger workforce, and the kids out of college teach people who have been out of school for a long time how to use the latest versions of programs like SketchUp, a 3-D sketching software for design, as effectively as possible. As you hit tough economic times, it's even more important for the entire workforce to be up on the most current and efficient technologies."
Emily Dow, designer
Walt Disney, Los Angeles

LIGHTS, CAMERA—TEAM!

"I see more product and service development moving from an employee-based model toward a Hollywood-style arrangement, wherein teams of contractors possessing required skills are assembled for a specific development project and then are disbanded when the project is complete. They effectively create a temporary company for a one-time project, spreading out the risk and the costs."
Tim Barry, president
Intelligent Technologies
Vancouver, Wash.

THE NAKED SUPPLY CHAIN

"We're on the verge of seeing a completely new set of information available to people who manage supply chains. It's not just cost and delivery time, the classic things. Now, a company can determine whether a supplier might be making products in a way that could cause risks to its reputation or even the environment. There is an explosion of data—largely unmanaged and untapped—that will enable people to identify suppliers' environmental liabilities, the social benefits they're creating, and reputational risks. Flying blind is no longer acceptable."
David Rankin, vice-president
Great Lakes Protection Fund, Evanston, Ill.

ANDY MARTIN

VOTE FOR THE BOSS

"One of the biggest reasons for the collapse of the financial-services industry was hubris, the tendency of top leaders to believe their own spin. Unfortunately, the organizations below them did not push back. Employees do not feel empowered enough to talk openly when wrongdoing is taking place. What's required is a fundamental change in the way management operates. I recently read a groundbreaking paper, 'Why Your Boss is Programmed To Be a Dictator,' that advocates a radical idea: subordinates actually voting for their bosses."
Paul Ken (via the Web)

REINVENT THE BUDGET COMMITTEE

"We had a 25% budget cut. To help people understand the budgeting process, we formed a committee comprising only people who are not senior managers. It started conversations between departments and created a greater understanding of how our money is spent. People serve for a year. Each department gives recommendations like 'we're spending $70,000 a year on cleaning, so now everyone should clean their own offices and only use a cleaner once a week.' One benefit of bringing in a variety of people is you don't come up with the same ideas over and over again."
Autumn Parrott
Frist Center for the Visual Arts, Nashville

SET UP WIKIS WITH CUSTOMERS

"I work in financial services, and people only collaborate within one or two departments. Companies need to explore the wiki idea—a type of collaborative Web site—further. It could allow them to collect ideas generated by customers, vendors, suppliers, and employees. Those companies that are going to survive will reach out to everyone involved in their product or service and let them bounce ideas off each other."
Joel Whipple
Financial analyst, Boston

TAKE A PAGE FROM GOOGLE

"Google has the best understanding of how technology can be applied in our daily lives. I started using Gmail in 2005 because I liked the way it presented linked information alongside my e-mails. I think that capability could be used inside company software, too. Let's say I'm a General Electric employee, and I'm e-mailing a colleague about fluorescent lightbulbs. It would be useful if all of my company's information on that topic and on the employees who work in that business appeared as links, like Google ads, beside my e-mail."
Joe Vetrano, IT consultant
Experience for Success, Vernon Hills, Ill.

THE NEW MIDDLEMEN

"I believe there is going to be a rise in the practice of something I call brokering. It's like a high-end temp agency. Brokers keep a roster of talented people and lease them in contract positions as required. I think it's a practice that's spreading as companies increasingly keep just core staff. The pro side is that specialized talent has another way of finding work, albeit short-term, and companies can keep overhead down. The downside is that many knowledge workers already are subcontracted to competitors in areas such as communications, technology, and project management."
Gail Severini, CEO
Symphini Change Management, Aurora, Ont.

INFORMATION OVERLOAD? TRY VISUALIZATION

In times of turmoil, the natural reaction is to want more data. But people have maxed out on the amount of information they can handle and, as a result, they're becoming much less certain about making changes. By looking at a spreadsheet with hundreds of deadlines on it, you can't get a feel for what's going on and whether you're behind or in front. We use a tool internally that takes spreadsheets and illustrates them with graphics and symbols. You can take a look quickly and get an overall view of the most salient points. There's a very small amount of data that people can absorb. Finding out what's relevant is a big issue for companies.
S.C., technology designer
Los Angeles

"THOSE COMPANIES THAT ARE GOING TO SURVIVE WILL REACH OUT TO EVERYONE INVOLVED ... AND LET THEM BOUNCE IDEAS OFF EACH OTHER."

ANDY MARTIN

NEW IDEAS FOR GROWTH

INSPIRATION FROM EMERGING ECONOMIES

Innovation used to trickle down to developing markets from rich countries. But the flow can go the other way, too

By Reena Jana

Photograph by Kiyoshi Togashi

TRICKLE-UP INNOVATION

This month, General Electric's healthcare division will begin marketing a first-of-its-kind electrocardiograph machine in the U.S. Although packed with the latest technology, the battery-powered device weighs just six pounds, half as much as the smallest ECG machine currently for sale. It will retail for a mere $2,500, an 80% markdown from products with similar capabilities. But what really distinguishes the MAC 800 is its lineage. The machine is basically the same field model that GE Healthcare developed for doctors in India and China in 2008.

As such, the diagnostic tool exemplifies a way of thinking that may be ideally suited to dealing with the widening recession: creating entry-level goods for emerging markets and then quickly and cheaply repackaging them for sale in rich nations, where customers are increasingly hungry for bargains. The term for this new approach is trickle-up innovation.

The process turns conventional product development on its head. Over the years, multinationals have prospered by turning out premium-priced products for the world's affluent. Rather than also designing products for poorer people elsewhere, many businesses found they could simply pass yesteryear's models down, as if they were unloading fleets of used cars. Lately, big companies such as Microsoft, Nokia, and Procter & Gamble are discovering that they can profit by targeting the world's masses first. And they can score again by selling these low-priced products elsewhere.

"The dominant logic holds that innovation comes from the U.S., goes to Europe and Japan, then gravitates to poor countries," says C.K. Prahalad, a strategy professor at the University of Michigan's Ross School of Business and author of *The Fortune at the Bottom of the Pyramid: Eradicating Poverty Through Profits*. "But now we're starting to see a reversal of that flow."

This topsy-turvy approach could even stir demand in markets that seem tapped out. GE Healthcare dominates the market for big-ticket diagnostic machines, selling 34% of ECG machines now used in hospitals and clinics in the U.S. While

some of these customers may also buy a MAC 800, the smaller, cheaper machine will be pitched to a new set of medical professionals—primary-care doctors, rural clinics, and visiting nurses—who need a device they can easily tote or simply can't afford the pricier models. The company projects first-year sales of \$2.5 million in the U.S.

That's a revenue rivulet for GE, which boasted a record \$182.5 billion in sales in 2008. But the company needs every extra dime to meet Chief Executive Jeffrey R. Immelt's pledge to return to double-digit growth by 2010 and rescue GE's shredded stock, which has fallen 80% from its 52-week high. To conserve cash, the company just slashed its dividend by two-thirds, the first reduction since the Great Depression.

The idea to bring the MAC 800 to the U.S. trickled up from inside GE Healthcare. Last June, Veronica Chew, a GE Healthcare global project manager, had just finished doing market testing in China for the MAC 800. After returning to Waukesha, Wis., where GE Healthcare's U.S. operation is based, she started telling her customers about the new device. After a nurse at a clinic in nearby Menomonee Falls said she could use such a machine, Chew tipped off the executive team of GE Healthcare Clinical Systems. The company began holding focus groups across the U.S. last fall to help it decide whether it made sense to adapt the MAC 800 for the U.S.

WHO WANTS A YUGO?

In the past, developing an ECG machine from scratch took GE Healthcare up to five years and cost as much as \$2 million. By merely adding a few new features to the Chinese prototype—USB, ethernet, and telephone ports so patient readings can be uploaded—the company slashed its U.S. development costs to \$225,000 while shrinking the time to market to a few months. The MAC 800 could become a prototype for other parts of GE, says Vice-Chairman John Rice, CEO of GE's Technology Infrastructure group. "Often, the trap is thinking that innovation is about making the next iPod or BlackBerry. But maybe it's a simpler, lower-cost version of those. The innovation in all of our businesses now is bringing costs down."

Nestlé now markets its Maggi noodles—a low-cost South Asian hit—in Australia

Selling emerging-market hand-me-ups in the U.S. or

CAN COMPANIES SHARE ONE NERVOUS SYSTEM?

BLUE-SKY IDEA

Companies have long formed alliances and joint ventures. Recently, they've come together to swap employees, a practice Google and Procter & Gamble have experimented with to share expertise.

The next wave could be "federations." In such arrangements, companies can exchange much more than their knowledge, profits, or workers. They share access to parts of their info tech systems. Today the practice is common between such business partners as employers and their 401(k) providers.

But some tech experts

Western Europe carries risks. The biggest is that the less-expensive products may cannibalize sales of higher-priced goods with bigger markups. Philips Electronics, for example, is intrigued by the concept of taking low-cost, solar-powered lighting it designed for Ghana and marketing it throughout the developed world. But CEO Gerard J. Kleisterlee has held off to protect Philips' existing product line. His concern, he says, is "hurting margins if you go too far down."

Also, low-priced offerings for lower-income regions often carry a stigma. Even a quarter of a century after the Yugo was introduced as the cheapest car in the U.S., the brand name remains synonymous with shoddy materials and workmanship, and is a reminder that quality is as important as price in industrialized nations. "The Yugo example has stopped so many people from doing this," says Harold Sirkin, a senior partner at management consultants Boston Consulting Group and co-author of *Globality: Competing with Everyone from Everywhere for Everything*. "The key is that these products need to be what the U.S. market wants."

SENDING "INNOVATION MANAGERS" ABROAD

Still, the success of basic products in Asia and Africa and the collapse of the Western consumer are prompting more companies to try their hand at trickle-up innovation. Nokia recently researched how young people in Ghana and Morocco share handsets to listen communally to conversations. The company's aim was not only to come up with a more practical phone for Africa but also to work out where to put powerful speakers in the 5800 Express phones released in the U.S. in late February, enabling owners to share MP3 music and YouTube videos with others. "There has been a pull from emerging markets as much as a push into them," says Alistair Curtis, chief designer at Nokia.

Other companies are creating formal processes to streamline ways to borrow from emerging markets. In February, Xerox hired two researchers the company calls "innovation managers" who will hunt for inventions and products from Indian startups that Xerox might adapt for North America. And Hewlett-Packard is using its research lab in India to see how it can migrate Web-interface applications for mobile phones in Asia and Africa to developed markets.

At Microsoft, 15-year company veteran Amit Mital heads a similar effort. The impetus was a realization that its Windows XP Starter Edition might have wider applications. The software had always been intended for tech-unsavvy customers in poor areas of the world with low-end PCs. Microsoft now is incorporating the Starter Edition's simplified "help" menu, with its easy-to-follow how-to videos, into future U.S. editions of its Windows operating system.

Some makers of consumer goods are finding new markets for their developing-world products, too. For Nestlé, it was taking its Maggi brand dried noodles—a popular, low-fat meal created for rural Pakistan and India that sells for about 20¢ a serving—and repositioning it in 2008 as a budget-friendly health food in Australia and New Zealand. For P&G, it was expanding the customer base of its Vicks Honey Cough cold-remedy syrup beyond Mexico to Western Europe and the U.S.

As GE Healthcare has found with its MAC 800, though, trickle-up innovation requires balance—retaining emerging-world prices while winning over customers spoiled by an abundance of options. To reduce both its weight and cost, the new ECG machine does not have a built-in keyboard. Instead it has a large, 12-button keypad like those used to send text messages on mobile phones. "It's risky," says Michael J. Barber, chief technology officer of GE Healthcare. "But it's an exciting and challenging trade-off." |BW|

PHOTOGRAPH BY MICHAEL RUBENSTEIN/REDUX; ILLUSTRATION BY DAN PAGE

believe federations could have a far broader impact when it comes to cross-company collaboration. Frank Modruson, chief information officer at Accenture, says his company recently gave Microsoft employees access to its collaboration software. That means staff can find, chat with, instant message, or videoconference with any employee at the other company. Modruson says he has received eight requests from clients in the past month to set up a similar structure with Accenture, up from none in January.

Federating the same software between two companies is fairly simple. But opening up systems that involve multiple applications and dozens, if not hundreds, of companies is much more complex. That's not happening yet, but it should, says John Hagel, co-chairman of Deloitte's Center for Edge Innovation. Companies increasingly design products and run supply chains with large groups of specialized partners. "For the companies that can figure this out," says Hagel, "it's a massive opportunity."

And federated IT systems could be the building blocks for ad hoc ventures that pop up for specific projects. Accenture's chief scientist, Kishore Swaminathan, sees federation as a way to handle sudden spikes in demand or share data between agencies in criminal investigations. Ideally, he says, "it could be turned on and off instantly." —*Jena McGregor*

REAL LIFE IMITATES *REAL WORLD*

Companies looking for "Eureka!" moments are asking employees to share quarters in an idea incubator

By Reena Jana

It sounds more like reality TV than a reasoned strategy. Last year, Best Buy picked four groups of salespeople in their 20s and early 30s and asked the strangers to room together for 10 weeks in a Los Angeles apartment complex. On the agenda, besides hanging out at the beach: coming up with businesses the electronics retailer could roll out quickly and cheaply.

Believe it or not, the arrangement worked. Today, in a dozen stores in greater Los Angeles, Best Buy offers a service called Best Buy Studio, which provides Web-design consulting for small businesses. Jeremy Sevush, a former sales-floor department supervisor in West Hollywood, came up with the idea and then worked with executives to launch the venture only a couple of weeks after he moved out of the company apartment last May.

"My friends joked and said I was joining 'Real World: Best Buy Edition,'" says Sevush, 29, referring to the MTV television series that features a youthful cast sharing a home. "Living together and knowing we only had 10 weeks sped up our team-building process. We voluntarily worked longer hours, talking about business models while making spaghetti."

$75 thousand

The cost to run a Team upStart brainstorming session, all inclusive

Data: Team upStart

Extreme brainstorming sessions like Best Buy's may be common in the tech sector, where programmers and engineers are sequestered so they can better focus on the next breakthrough. Now other companies are turning employees into temporary housemates, too. Whirlpool, for example, packs eight sales reps off to a house in Benton Harbor, Mich., to cook and clean together for seven weeks under a program called Real Whirled. By thoroughly familiarizing themselves with Whirlpool appliances, the company hopes, salespeople will become sharper marketers of the goods.

Jeremy Sevush hatched the idea for Best Buy Studio during his session

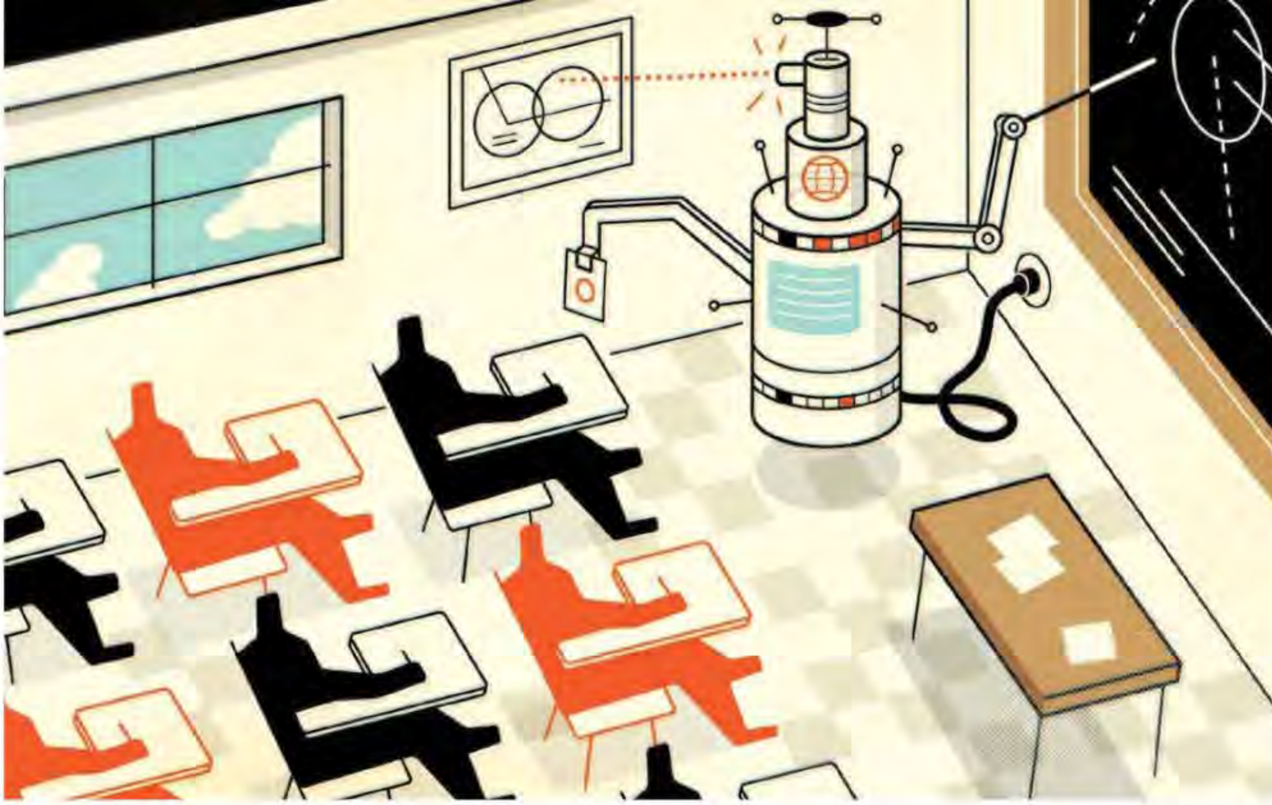
A PRESSURE COOKER FOR IDEAS

Best Buy retained former IBM manager John Wolpert to create and oversee its innovation project. Wolpert, who runs Team upStart, a consultancy in Sunnyvale, Calif., had used a similar real-life approach at IBM's Extreme Blue incubator in Austin, but never before at a retailer. He charges up to $75,000 for each 10-week immersive session, including room and board for employees, who are assured they'll get their old jobs back. "There's something magical about taking smart people out of their safety zones and making them spend night and day together," he says. "You have to prioritize on steroids and be absolutely ruthless to prove what you want to do can be done."

With consumers cutting down on electronics purchases these days—Best Buy's same-store sales have been declining since last fall—the Minneapolis company is reevaluating outlays. Best Buy executives won't say whether the real world version of *The Real World* will be renewed for 2009.

But they say they're keeping Best Buy Studio going to see if it should be expanded. They also want front-line employees to continue to offer up business ideas. "Employees don't need permission to create or innovate," says Brian Dunn, Best Buy's president and chief operating officer, who will succeed Chief Executive Brad Anderson in June. Dunn admits to having a soft spot for store clerks. He started as one 23 years ago. | BW |

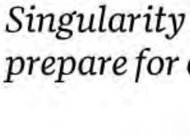
MAX S. GERBER



THE SCHOOL OF FUTURE KNOCKS

Singularity University offers crash courses in how to prepare for disruptive technologies in years to come

By Ellen Gibson



Bill Gates calls him "the best person I know at predicting the future of artificial intelligence." Computer scientist Douglas Hofstadter classifies his ideas as "the craziest sort of dog excrement."

Ray Kurzweil is no stranger to controversy. For more than a decade, the inventor-turned-author has been issuing predictions about superhuman cyborgs and biotech-based immortality that border on science fiction. Yet Kurzweil's theories continue to gain traction among mainstream techies, and they are also making their presence felt in corporate boardrooms. The latest vindication: Google and NASA are backing a new university modeled on his ideas, with additional funding from X Prize creator Peter H. Diamandis.

Dubbed "Singularity University" and housed at NASA Ames Research Center in Mountain View, Calif., the institute will feature intense 3- and 10-day workshops to help senior executives steer their companies into the future. Announced at the Technology, Entertainment, Design (TED) conference in February, the school has recruited top-tier faculty, including Vint Cerf, Google's chief internet evangelist, and Jim Karkanias, a research director at Microsoft. And among the students inquiring about the first executive classes this fall are venture capitalist Heidi Roizen and Judy Estrin, former chief technology officer of Cisco Systems.

Some of the topics discussed in class would feel right at home at a Star Trek convention. Take the name of the new institute. In astrophysics, "singularity" refers to conditions on the far side of a black hole. But it was Kurzweil who gave the term new resonance in his 2005 best seller, *The Singularity Is Near*. Here, it designates a point in the not-so-distant future when artificial intelligence will outstrip human brainpower and ingenuity. (Think IBM's Deep Blue vs. Kasparov, on a planet-wide scale.) In Kurzweil's best-case scenario, man will merge with machines via tiny robotic devices implanted in our bodies and brains, extending our lifespans and vastly enhancing our mental prowess. Bionic brains, Kurzweil says, will make short work of the world's intractable problems, from climate change to drug-resistant diseases.

The school's mission isn't to indoctrinate students with Kurzweil's futurology—or even grant degrees. Instead, it's to help them grasp the implications of fast-changing fields

ILLUSTRATION (TOP) BY HARRY CAMPBELL

such as biotechnology and robotics. Graduate and postgrad students will have nine weeks to absorb these lessons, while accelerated classes for C-suite teams will provide an overview of how disruptive technologies trample existing industries and forge new ones. Executives will be placed in small groups for focused peer-to-peer engagement. For example, the CEO of a company that makes silicon-based solar cells will be in a group that explores the impact of exotic new materials. Managing intellectual property, of course, is part of the core curriculum.

"We're going to be focusing very much on the science, not the science fiction," says Salim Ismail, the university's executive director and former product development chief at Yahoo! Five years ago, people might have been shocked to hear that ink-jet printing could be used to assemble living cells into artificial organs. "Today they're close to getting prototypes working in labs," he says. "What will we see in the next five years?"

FAST AND FAR-REACHING

Borrowing from microelectronics, Kurzweil uses the paradigm called Moore's Law to show that the singularity isn't just plausible but inevitable. Simply put, it states that the power of semiconductors doubles every two years. Engineers have repeatedly declared the end of this cycle, only to see computers grow more and more powerful. Turning to biology, Kurzweil notes that it took 15 years to sequence the HIV virus. In 2003 scientists took less than a month to sequence the newly emerged SARS virus.

Societies, meanwhile, are adopting technology more rapidly with each passing generation. Telephones required half a century to become ubiquitous; cell phones pulled off the same feat in just 8 years. As the time frame for such developments collapses, the advances themselves grow more disruptive, and their impact increases exponentially. "As leaders of companies, we're focused on the day-to-day, and we don't take time to pull back and think about the technologies that are going to rock our world," says Diamandis. "It's how automobiles caught buggy manufacturers blind."

Yet not everyone is convinced the world needs Singularity U. Prominent scientists have questioned many of Kurzweil's ideas—from the assumptions of exponential technological progress to the ability of neuroscientists to reverse-engineer such a complex a structure as the human brain. Some tech bloggers have derided the institute as a playground for Silicon Valley types with too much time and money. (A 10-day executive course is expected to cost $15,000.) On his CNET blog, tech analyst Peter Glaskowsky predicts the curriculum will be "a painful muddle of science and science fiction identifying no clear path to a future we might not even want."

Many take the endeavor seriously, however. Stephanie Langhoff, chief scientist at NASA Ames, signed up as a faculty adviser. And grad-student applications for this summer's pilot program have poured in from more than 60 countries, leaving administrators struggling to cull applicants. Lots of executives have expressed interest, too. Says Ismail: "If CEOs are not asking themselves big questions about how rapidly accelerating technologies apply to their business, you have to start asking them some questions." BW

(RIGHT) CHRIS KLEPONIS/BLOOMBERG NEWS

THE RETURN ON RESEARCH

HP's R&D productivity index shows which projects have the biggest payoffs

By Cliff Edwards

Business leaders are often vexed by research and development spending. How much money do you put into R&D when it could be 10 years before you see a payoff as products hit the market?

Hewlett-Packard CEO Mark Hurd has pushed hard to take guesswork out of the equation. Since arriving at HP four years ago, he's developed one of the most quantitative approaches to R&D in the tech industry. The strategy has helped HP keep its footing during the economic downturn, even as rivals like Dell have struggled. "They have the gold standard," says James Andrew, head of the global innovation practice at Boston Consulting Group.

The key is linking R&D spending to specific product lines. Of the $3.5 billion that goes into HP Labs, the company allocates the money based on where it expects the biggest payoffs. To standardize across a product line that includes everything from printer ink to giant server computers, HP uses a metric it calls "R&D productivity," which is research spending as a percentage of gross margin. A standard desktop computer with low margins may get one or two innovative features. But a laptop, with fatter margins, would get more flash, such as touchscreen technology and cool design materials. "We try to focus a bigger percentage of our overall budget on game-changing types of technologies," says Hurd.

CEO Hurd puts more of the budget on "game-changing technologies"

HP's investments in things like multi-touch technology have helped it surpass Dell as the world's top PC maker. Hurd says more standout technologies are on the way, including gesture-based controls, so you can point at your PC to launch a music or photo program. "We [are] trying to get innovation to the highest level we can," says Hurd. BW

NEW IDEAS FOR TALENT

HOW MUCH IS THAT WORKER WORTH?

As data mining makes it to HR, sophisticated math can help determine each employee's value

By Stephen Baker
Illustration by Kate Banazi

The chart looks like colorful pop-art doughnuts flying through space. The message, though, is anything but playful. Based on a mathematical analysis of work at an undisclosed Internet company, each circle represents an employee. Those who generate or pass along valuable information within the company are portrayed as large and dark-colored. And the others? "On a relative scale, they don't add a hell of a lot," says Elizabeth Charnock, chief executive of Cataphora, the Redwood City (Calif.) company that carried out the study for a client. The upshot for managers faced with a mandate to downsize: Small and pale circles might be a good place to start cutting.

For most of its eight-year history, Cataphora has focused on digital sleuthing. The company hunts for statistical signs of fraud. But in the past few years, Cataphora has been dispatching its data miners into a new market: statistical studies of employee performance.

The trend, though early, is unmistakable, and it extends far beyond Redwood City. Number crunching, a staple for decades in the quantifiable domains of engineering and finance, has spread in recent years into marketing and sales. Companies can now model and optimize operations, and can calculate the return on investment on everything from corporate jets to Super Bowl ads. These successes have led to the next math project: the worker. "You have to bring the same rigor you bring to operations and finance to the analysis of people," says Rupert Bader, director of workforce planning at Microsoft.

Such a mission might have been laughable a decade ago. But as the role of computers in the workplace expands, employees leave digital trails detailing their behavior, their schedule, their interests, and expertise. For executives to calculate the return on investment of each worker, their human resources departments are starting to open their doors to the quants.

Master Burnett, managing director of HR consultancy Dr. John Sullivan & Associates, estimates that only 1% to 2% of large corporations have begun harnessing analytics to evalu-

ate their workforces. They're led by the data-focused tech companies, including IBM, Microsoft, and Oracle, along with finance players such as Capital One Financial. Elsewhere, says Burnett, HR pros often lack number-crunching skills. But as competition grows, he predicts, a new wave of math-savvy managers will do the numbers on "human capital."

A common starting point is to decode the patterns of success. Microsoft, for example, studies correlations between thriving workers and the schools and companies they arrived from. Also, by analyzing communications within Microsoft, analysts can ID "superconnectors" who help share ideas and others who appear to hold them up, so-called bottlenecks.

CAREER NUMBERS

How to hold on to hotshots? New software offers a data-mining approach. An employee retention program developed by software company SAS, for example, crunches data on employees who have quit in the past five years—their skills, profiles, studies, and friendships. Then it finds current employees with similar patterns. Another SAS program pinpoints the workers most likely to suffer accidents.

The eventual goal is to project how much workers will produce over their careers. In a number-driven labor market, the value of their skills will rise and fall. With these figures in hand, companies will be able to carry out cost-benefit studies on recruiting, training, and employee retention (along with its counterpart, layoffs).

IBM leads the way on such studies. Research analysts are charting the skills and experience of the entire workforce. Then, studying technology and economic trends, they're trying to predict the skills IBM will need down the road—and whether the needed knowhow should be taught or recruited.

While tracking the value of a knowledge worker's ideas is in its infancy, social networks provide valuable laboratories. A few giants, such as IBM, build their own social nets. Others implement offerings from software makers such as SAS. These are designed to link workers and to study their ideas and circles of influence.

The challenge, then, is to figure out which workers come up with winning ideas. Cataphora starts by studying communications through a company. Certain employees produce chunks of data—whether words or software code—that later pop up in other messages. The people copied most often, Cataphora concludes, are thought leaders. They get big dark blue circles. Other people spot the valuable content and pass it on. Those are networked curators. Their circles are bright red.

What about the worker who dispenses priceless wisdom the old-fashioned way, through spoken words at the coffee machine? Much of that goes unrecorded by the analytic team. So there are limits to number crunching. Machines may advance in HR, but humans will retain a strong supporting role. | BW |

READING THE BODY LANGUAGE OF LEADERSHIP

BLUE-SKY IDEA

Humans instinctively transmit signals that date back to our primal roots. People use vocal tones and cadence to establish dominance or trust. Or they impose their will by showing up late to meetings or feigning lack of interest when others speak.

Researchers at Massachusetts Institute of Technology are focusing

the latest sensor technology on such behavior in the workplace. **Using high-tech badges that transmit data on an individual's gestures, eye movements, voice levels, and even proximity to other people, MIT is parsing the physical traits of leadership.** Along with highlighting effective managers, researchers hope the data will help train workers to be more effective at everything from networking to dealing with customers.

Professor Alex (Sandy) Pentland, who heads the research through MIT's Human Dynamics lab, argues that the technology goes beyond anything captured in a typical personality test. With it, he notes, "you can suddenly look at hundreds of people on a millisecond-by-millisecond basis." In call centers, for example, the MIT team predicts successes and flubs by studying patterns of listening and voice modulations. (Workers with high scores listen more and alter their voice to express interest.) The unit is working with companies such as Hitachi and Bank of America to study employee communication patterns.

While MIT's methods are beyond the technical range of most companies, the science of human behavior is becoming more accessible to everyone. A host of everyday technologies from Web cams to corporate IDs with radio tags can provide ever richer behavioral data. Companies may soon be able to size up both employees and job applicants—not only by experience and skills but also by the nature of their inner ape.

—By Stephen Baker

THE CHORE GOES OFFSHORE

Pfizer is allowing its professionals to farm out such tasks as Web searches and number crunching

By Jena McGregor

David Cain loves his job. Well, most of it anyway. As an executive director for global engineering at Pfizer, Cain finds real satisfaction in assessing environmental real estate risks, managing facilities, and overseeing a multimillion-dollar budget for the pharmaceutical giant. What he doesn't love so much: creating PowerPoint slides and riffling through spreadsheets.

Lucky for Cain, Pfizer now lets him punt those tedious and time-consuming tasks to India with the click of a button. PfizerWorks, launched early last year, permits some 4,000 employees to pass off parts of their job to outsiders. You might call it personal outsourcing. With workers in India handling everything from basic market research projects to presentations, professionals such as Cain can focus on higher-value work. "It has really been a godsend," says Cain. "I can send them something in the evening, and the next morning it's waiting for me when I get to the office."

This novel twist on outsourcing comes at a time when other resources are dwindling. As companies cull people by the thousands—Pfizer itself announced some 8,000 job cuts in January—those who stay behind are being asked to do more. In a down economy, though, it's especially critical that executives direct their energies to motivating teams, creating new products, and thinking strategically about their next move. "The stakes go up even higher," says David Kreutter, Pfizer's vice-president for U.S. commercial operations.

66,500

Estimated hours saved by employees who use PfizerWorks

Data: Pfizer

Originally dubbed the Office of the Future, PfizerWorks is partly the by-product of a cost-cutting push that began several years ago. Jordan Cohen, the architect and head of the program, came up with the idea after reading Thomas L. Friedman's book *The World Is Flat* and observing how his own team worked. Cohen recalls seeing one of his recruits from the consulting firm McKinsey & Co., a new father, stay late at the office one night to crunch numbers and search for information on the Web. To Cohen, it didn't seem like time best spent.

Instead of shifting jobs overseas, as companies have done for years, Cohen wanted to find a way to shift tasks. He also felt the program should let employees do one-stop shopping. Instead of setting up a few specialized services, Pfizer employees click a single button on their computer desktop that sends them to the PfizerWorks site. They write up what they need on an online form, which is sent to one of two Indian service-outsourcing firms: Genpact, in Gurgaon, and a unit of Chicago's R.R. Donnelley.

Once a request is received, a team member such as R.R. Donnelley's Biju Kurian in India sets up a call with the Pfizer employee to clarify what's needed and when. The costs involved in each project are charged to the employee's department. Says

PHOTOGRAPHS (LEFT TO RIGHT) BY JENNIFER S. ALTMAN; NAMAS BHOJANI

Pfizer's David Cain gets help from Biju Kurian of R.R. Donnelley

Shantanu Ghosh, a senior-vice president at Genpact: "The way Pfizer's model is constructed is really pretty unique."

Pfizer is now looking to expand the program to more employees and to a wider array of tasks. While he was introducing a group of Pfizer scientists to the service last year, Cohen says, one of them immediately pointed out its limitations. "I got it, Jordan, we can use this," the researcher said. "But what I really need is a smart guy for a day." He had a point. Some tasks can't easily be broken down into instructions on an online form, Cohen admits, and sometimes employees need an assistant working in the same time zone.

LOCAL HELP

As a result, Pfizer is testing an arrangement with a small Columbus (Ohio)-based firm called Pearl Interactive Network. Pearl employs mostly people with physical disabilities who help with such administrative tasks as organizing a marketing team's research documents on a shared server or scheduling meetings. While the partnership is modest and isn't meant to supplant arrangements in India or administrative jobs, Cohen hopes it will make Pfizer staff even more productive.

Although PfizerWorks hasn't quite reached its first anniversary, Cohen estimates that it has already freed up 66,500 hours for employees. Pfizer finds employees are now spending less money on other providers, such as graphic design shops or market research firms. Employees are asked to rate their satisfaction with the finished product. If the score isn't high enough, a department can refuse to pay, which has happened only a handful of times.

Cain, for one, relishes working with what he prefers to call his "personal consulting organization." After getting such good results with basic spreadsheets and PowerPoints, he has asked teams in India to help him with more complex projects. One was to mine archived company "playbooks" on past acquisitions and pull together any lessons on what worked and what didn't when it came to consolidating facilities. That prep work should benefit the pharma giant now that it has announced a $68 billion acquisition of Wyeth.

The facilities report came together in a month, says Cain, vs. the six months it would have taken him to do it alone. "Pfizer pays me not to work tactically," he says, "but to work strategically." |BW|

THE CASE FOR UNEQUAL PERKS

Treating top performers the same as weaker ones is "suicide," say backers of a compensation revolution

By Michelle Conlin

A cabal of HR renegades is taking advantage of the economic downturn to push an unorthodox notion: that the current vogue of slashing perks and pay is managerial insanity. Officeland may be burning, but Richard W. Beatty, who teaches human resources strategy at Rutgers University, says the tendency to treat everyone the same is "misguided and absolutely the wrong approach. It's strategic suicide."

Beatty and like-minded thinkers argue that the prevailing attitude is equivalent to an airline sticking its platinum passengers in coach with scratchy blankets and shrink-wrapped food. Once the good times reappear, or so the argument goes, disenchanted top players will bolt for better treatment and more pay. Companies that hew to the status quo will "pay dearly," says Beatty, who, with Brian Becker and Mark Huselid, co-authored the upcoming *The Differentiated Workforce* and consults for Sony, GlaxoSmithKline, Lockheed Martin, and others.

The Beatty approach has attracted a growing number of adherents. HR czars at companies as varied as Sony and metal manufacturer Precision Castparts are engaging in nothing less than a compensation revolution: steerage treatment for mediocre players—and business-class benefits for superstars. At these organizations, HR departments are morphing into what amounts to a concierge service dedicated to the care and feeding of the people whose positions and performance are making their companies the most money.

HR types tend to believe in an egalitarian approach, so the idea that people in the same position would be treated differently is counterintuitive. Traditionalists also argue that one-size-fits-all cuts help prevent layoffs and protect companies from being understaffed when the economy rebounds. The credo could be summed up as: Everybody is in this together. "There are a lot of HR people who don't think [preferential treatment] is right, who think it's really unfair," says Beatty. "They want to save everybody and be the St. Bernards."

Not Craig E. Schneier. The HR boss at pharma giant Biogen Idec is more like a terrier. Schneier is maniacal about fine-tuning Biogen's employee measurement and performance

(TOP) ILLUSTRATION BY DAVID PLUNKERT

appraisal systems. "A lot of companies talk about this," says Schneier. "But if you look at their outcomes in regard to pay, you will see they don't necessarily differentiate at the end of the day." Sure, there's a percentage or two difference in the raise or bonus. But most employees in similar positions languish in the same pay bands and are shuttled off to the same conferences as the slackers and sub-stellar.

Schneier doesn't believe all people—or positions—are equal. At Biotec Idec, it's common for one vice-president to get double what the guy in the next office doing a similar job gets. "Twice as big a merit increase, twice as big a bonus, and twice as big an equity grant," says Schneier. Performance metrics at Biogen are so exacting that employees essentially must re-earn their standard of living every year.

MICROMEASURING PERFORMANCE

In this new world, thicker paychecks come with training and development par excellence, more lunches with top leaders, and personal attention lavished on the A player's every whim. Where there are two classes of workers, even the office events can be different. The American Heart Assn., for example, has swankier events for über-achievers. Last year the Association took 13 of them to the World Business Forum in New York City.

How does one pay for rewards for top performers at a time when budgets are under siege? Beatty and Huselid say they have clients who are starting to stealthily freeze or cut pay for some so as to be able to reward others. "They are robbing Peter to pay Paul," Beatty says. "Look, there are an awful lot of long-term employees who are poor performers who have locked-in high salaries through cost-of-living increases."

Companies are getting better at deploying their techno-brawn to monitor, measure, and analyze their workforces—from those who placed which call that landed what deal to those who are infamous for talking up their work only to underdeliver. These granular measures of performance are making it far easier to tailor rewards, doling out different deals to different employees. This will lead to a more Darwinian workplace.

Federal rules currently prohibit companies from sculpting benefits like health care, 401(k) matches, or maternity leaves to fit individuals. The regulations enforce one-size-fits-all and prevent a cafeteria-style approach. But experts believe the rules will get a performance-era update within five years. You can already hear HR luminaries like Microsoft's Lisa Brummel and IBM's Randall MacDonald fantasize about it: customizing benefits and compensation to life stages, performance levels, and work styles. The day may not be far off when the childless Gen Yer will be able to pick more vacation over adoption benefits or the graying boomer will be able to opt out of tuition assistance in favor of better elder care. As MacDonald says: "Why can't I make my 401(k) performance-based?" BW

CISCO: TUNING A WORKFORCE TO LOCAL MARKETS

GAME-CHANGER

Like many companies, Cisco Systems has focused on emerging markets to sell its products, which range from Web plumbing to videoconferencing systems. But San Jose-based Cisco doesn't simply set up sales offices staffed with expatriates. Instead, it has adopted a hyper-local approach to recruiting the people it needs to ensure its wares and services are tuned to specific markets.

Elfrink: Landing high-tech talent in Saudi Arabia and Jordan

The man in charge of the effort is Cisco's globalization chief, Wim Elfrink, whose idea it was to set up a second headquarters in Bangalore in 2007. "It wasn't just about being in India," says Elfrink, who now lives in Bangalore with his family. "It was about being outside of California, so we could look at Cisco outside-in."

With hundreds of engineers from emerging markets to choose from in Bangalore, Elfrink deploys teams to build networks for governments and companies from Russia to Chile. The teams then return to Bangalore to turn these custom jobs into solutions that can be sold around the globe. Elfrink also has launched what Cisco calls its Global Talent Acceleration Program in Jordan, Saudi Arabia, South Africa, and elsewhere. Cisco likes candidates who have worked on at least two continents and speak two languages. Engineering grads and young managers train for six months or so to learn selling and basic finance. Cisco then provides follow-up mentoring by hooking up trainees with Cisco veterans. "We want to prepare the next generation of leaders," Elfrink says.

Besides spotting up-and-coming managers, Elfrink says, it's crucial to develop a high-tech workforce in these regions to help Cisco maximize sales there. To that end, Elfrink has added thousands of Cisco training centers in emerging markets and has championed Silatech, a nonprofit dedicated to creating jobs among Middle Eastern youth. There's even a program to encourage employees to invest $100 in micro-startups in rural India. Says Elfrink: "One of these kids is going to be the next Bill Gates."
—By Peter Burrows in San Francisco

PHOTOGRAPH BY ERICMILLETTE.COM

IBMers work together in groups of 8 to 10 in emerging markets

THE GLOBE IS IBM'S CLASSROOM

It has set up a Peace Corps-like program that aims to turn top management prospects into global players

By Steve Hamm

When 10 IBM management trainees piled into a minibus in the Philippines for a weekend tour last October, the last thing they expected was to wind up local heroes. Yet that's what happened in the tiny village of Carmen. After passing a water well project, they learned the effort had stalled because of engineering mistakes and a lack of money. The IBMers decided to do something about it. They organized a meeting of the key people involved in the project and volunteered to pay $250 out of their own pockets for additional building materials. Two weeks later the well was completed. Locals would no longer have to walk four miles for drinkable water. And the trainees learned a lesson in collaborative problem-solving. "You motivate people to take the extra step, you create a shared vision, you divide the labor, and the impact can be big," says Erwin van Overbeek, 40, who runs environmental sustainability projects for IBM clients.

While saving a village well wasn't part of the group agenda for that trip, it's the kind of experience the architects of IBM's Corporate Service Corps had in mind when they launched the initiative last year. Modeled on the U.S. Peace Corps, the program aims to turn IBM employees into global citizens. Last year, IBM selected 300 top management prospects out of 5,400 applicants. It then trained and dispatched them to emerging markets for a month in groups of 8 to 10 to help solve economic and social problems. The goal, says IBM's human resources chief, J. Randall MacDonald, is to help future leaders "understand how the world works, show them how to network, and show them how to work collaboratively with people who are far away."

Like most corporations, IBM trains managers in classrooms, so this represents a dramatic departure. And while other companies encourage employees to volunteer for social service, IBM is the first to use such programs for management

(LEFT) ILLUSTRATION BY DAVID RUDES/BW

training, says Rosabeth Moss Kanter, a professor at Harvard Business School. "This is a big innovation. This kind of active service is a good way to train managers."

The program is growing rapidly. This year some 500 people will participate, and the list of countries will expand from five to nine, including Brazil, India, Malaysia, and South Africa. The teams spend three months before going overseas reading about their host countries, studying the problems they're assigned to work on, and getting to know their teammates via teleconferences and social networking Web sites. On location, they work with local governments, universities, and business groups to do anything from upgrading technology for a government agency to improving public water quality.

MALARIA AND WILD DOGS

Participating in the program is not without its risks. Charlie Ung, a new-media producer from IBM Canada, got malaria while working in Ghana and spent a week in the hospital. Other participants report encounters with wild dogs in Romania. IBM planners deliberately choose out-of-the-way places and bunk the teams in guest houses that lack such amenities as Western food and CNN. "We want them to have a transformative experience, so they're shaken up and walk away feeling they're better equipped to confront the challenges of the 21st century," says Kevin Thompson, the IBMer who conceived of the CSC program and now manages it.

HOW TO PLAY IT 086

IBM concedes that one month overseas is a short stint, but it believes participants can pick up valuable lessons. Debbie Maconnel, a 45-year-old IT project manager in Lexington, Ky., says the trip prompted her to change her management style. She coordinates the activities of 13 people in the U.S. and 12 in India, Mexico, and China. She used to give assignments to the overseas employees and then leave them on their own. Now she spends more time trying to build a global team.

Harvard Business School assistant professor Christopher Marquis, who's writing a Harvard case study on the program, recommends that others build similar teams. "As the world gets flatter, cultural differences and the ability to manage across them is going to be much more important." | BW |

McDowell sought help to get a promotion

ROBERT SEALE

MATCH.COM FOR MENTORS

IBM's Web-based program tries to democratize career advice

By Steve Hamm

It may be time-tested, but there's something uninspiring about the corporate mentoring protocol, wherein a seasoned veteran gets assigned to impart wisdom to an ambitious young talent. IBM is putting a fresh spin on the practice by democratizing its mentoring program. As of January, the company began empowering employees to reach across its global empire with the click of a button for advice on everything from preparing for a promotion to learning how to innovate.

The changes reflect the company's effort to become a truly global enterprise that relies on cross-border information-sharing and collaboration. "It became obvious that we had to make mentoring a tool for transferring knowledge globally," says Sheila Forte-Trammell, an IBM human resources consultant who helped launch the initiative.

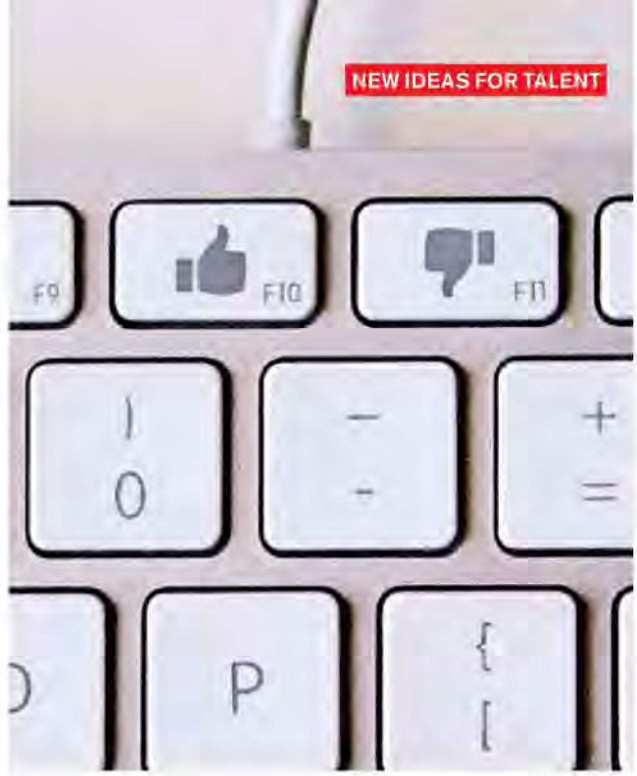
Any IBM employee can now sign up to give or receive advice by filling out a profile in a Web-based employee directory called BluePages. Think of it as Match.com for mentoring. In less than two months, 3,000 people have joined.

Jocelyn Koh McDowell, a 22-year IBM veteran who lives in Houston, sought a mentor who could give her detailed advice on how to qualify for a promotion. Using a Web search tool, she found the right person in minutes: Lisa Squires, a 13-year veteran in Sacramento who oversees a technology certification program McDowell needs to complete. "She had even more experience than I was looking for," says McDowell.

IBM's program earns praise from experts. Belle Rose Ragins, a human resource management professor at the University of Wisconsin at Milwaukee, says IBM has "broken new ground in using the Internet to develop global relationships." | BW |

JOB REVIEW IN 140 KEYSTROKES

Social networking-style systems lighten up the dreaded performance evaluation



By Jena McGregor

In the world of Facebook or Twitter, people love to hear feedback about what they're up to. But sit them down for a performance review, and suddenly the experience becomes traumatic.

Now companies are taking a page from social networking sites to make the performance evaluation process more fun and useful. Accenture has developed a Facebook-style program called Performance Multiplier in which, among other things, employees post status updates, photos, and two or three weekly goals that can be viewed by fellow staffers. Even more immediate: new software from a Toronto startup called Rypple that lets people post Twitter-length questions about their performance in exchange for anonymous feedback. Companies ranging from sandwich chain Great Harvest Bread Co. to Firefox developer Mozilla have signed on as clients.

Such initiatives upend the dreaded rite of annual reviews by making performance feedback a much more real-time and ongoing process. Stanford University management professor Robert Sutton argues that performance reviews "mostly suck" because they're conceived from the top rather than designed with employees' needs in mind. "If you have regular conversations with people, and they know where they stand, then the performance evaluation is maybe unnecessary," says Sutton.

What Rypple's and Accenture's tools do is create a process in which evaluations become dynamic—and more democratic. Rypple, for example, gives employees the chance to post brief, 140-character questions, such as "What did you think of my presentation?" or "How can I run meetings better?" The queries are e-mailed to managers, peers, or anyone else the user selects. Short anonymous responses are then aggregated and sent back, providing a quick-and-dirty 360-degree review. The basic service is free. But corporate clients can pay for a premium version that includes tech support, extra security, and analysis of which topics figure highest in employee posts. Rypple's co-founders have also launched software called TouchBase that's meant to replace the standard annual review with quick monthly surveys and discussions.

GALVANIZING GOALS

Accenture's software, which it's using internally and hoping to sell to outside clients, is more about motivating employees than it is about measuring them. With help from management guru Marcus Buckingham, the consultancy's product has a similar look and feel to other corporate social networks. The major difference is that users are expected to post brief goals for the week on their profile page, as well as a couple for each quarter. If they don't, the lack of goals is visible to their managers, who are also alerted of the omission by e-mail. By prompting people to document and adjust their goals constantly, Accenture hopes the formal discussions will improve. "You don't have to desperately recreate examples of what you've done," says Buckingham. Typically, "managers and employees are scrambling to fill [evaluation forms] out in the 24 hours before HR calls saying 'where's yours?' "

2/3

Portion of questions on Rypple posted by managers rather than employees

Data: Rypple

If having your performance goals posted for the world to see sounds a bit Orwellian, consider this: Rypple reports that some two-thirds of the questions posted on its service come from managers wanting feedback about business questions or their own performance. The biggest payoff of these social network-style tools may prove to be better performance by the boss. | BW |

ILLUSTRATION BY OLIVER MUNDAY

NEW IDEAS FOR PARTNERS

LEAN AND MEAN GETS EXTREME

More manufacturers are cutting costs by producing only what they know will sell

By Pete Engardio

Photograph by Brad Trent

ON-DEMAND MANUFACTURING

When surgical device maker Conmed decided in 2007 to streamline production, executives explored the usual options. The Utica (N.Y.) company could ship more manufacturing to China. Or it could invest in automation.

Conmed chose a third path instead: It completely overhauled its production. Long assembly lines at its 600-worker Utica plant have given way to compact U-shaped workstations. Piles of plastic boxes stuffed with enough parts to last weeks have been replaced by just a few bins containing the exact number of parts needed.

No longer do workers furiously crank out products that languish in warehouses. Instead they build only as many as customers need at the time. Conmed calculates that every 90 seconds hospitals worldwide use one of its disposable devices for inserting and removing fluids around joints during orthoscopic surgery. So that's precisely how long it takes for a new one to roll off its assembly line. A growing number of products, such as instruments for cutting bone, are assembled only after hospitals place orders. "The goal is to link our operations as closely as possible to the ultimate buyer of the product," says David A. Johnson, vice-president for global operations.

Lean manufacturing—producing goods with minimal waste of time, materials, and money—was pioneered by Japanese companies such as Toyota Motor decades ago. Now a growing number of U.S. businesses are trying a more extreme form of lean. Besides making factories superefficient, they are gearing output to current demand rather than three- to six-month forecasts. "We're seeing a precipitous rise in companies adopting a religious commitment to producing only what they know will sell," says William A. Schwartz, managing director for business development at TBM Consulting in Durham, N.C., which shapes make-to-demand strategies for producers of chemicals, building materials, and packaged foods.

In capital-starved times, companies can ill afford to tie up cash by letting parts

Global operations chief Johnson with employees at Conmed's Utica (N.Y.) plant

and finished goods lie idle in inventory. And these days, even if companies place orders, there's no guarantee they'll get the financing to complete the purchase. In most past recessions, notes Richard Seaman, CEO of Seaman Corp., a Wooster (Ohio) maker of heavy fabrics for industry and construction, companies could generally predict demand for the next month with an accuracy within 5%. "In the past four or five months," he says, "there has been a sea change." Converting to very lean manufacturing helped the company adjust to the new environment. It used to fill large orders in six weeks. Now some fabrics are out the door 48 hours after an order is placed.

TYING EVERYONE IN

The next challenge is getting a clearer picture of what's happening on the customer's end. Celestica, the $7.7 billion contract manufacturer of electronics gear, is rolling out a system it calls Liveshare. Within two years, the company hopes Liveshare will let all of Celestica's customers, global factory network, and 4,000 suppliers share real-time data on demand, production, inventories, and shipping for every product. Some suppliers already use Liveshare, but the plan is to include major electronics buyers as well.

Say a purchase manager for Best Buy needs supplies of a hot video game console assembled by Celestica. Today, most buyers would use phone, fax, and e-mail to assess how quickly Celestica could deliver. But a buyer checking Celestica's online database would see up-to-the-minute diagrams showing how many consoles are rolling off production lines. And Celestica could peer into Best Buy's inventory and sales data to estimate how many consoles the chain needed. "What a tremendous breakthrough this would be," says CEO Craig Muhlhauser.

Not all goods can or should be built to order. Some 80% of Conmed's $742 million in 2008 sales came from disposables sold by the millions to hospitals, where demand is fairly steady. For mass-produced items, it bases hourly output targets on forecasts updated every few months. Before, mass quantities of goods sat in warehouses until they were sold.

At Conmed's Utica plant, the assembly area for fluid-injection devices once consumed 3,300 square feet and had $93,000 worth of parts on hand. Now it covers one-fifth that space and stocks just $6,000 worth of parts. Output per worker is up 21%. Do the improvements yield savings superior to what could be had in China? Wages there, though vastly lower, are largely offset by the costs of long lead times, inventory pileup, quality problems, and unforeseen delays. "If more U.S. companies deploy these production methods," says Johnson, "we can compete with anybody." | BW |

–With Jena McGregor in New York

ZAPPOS' SECRET: IT'S AN OPEN BOOK

GAME-CHANGER

Since Tony Hsieh became CEO of Zappos.com in 2000, the e-tailer has sold shoes, lots and lots of shoes. More recently he added clothes, accessories, and electronics. And Zappos continues to grow in a recession. Ask Hsieh to describe his secret sauce, and he'll tell you that much of Zappos' success comes down to the company's culture and the unusual amount of openness he encourages among employees, vendors, and other businesses.

Hsieh, a major early investor in Zappos who takes home a $36,000 annual salary, describes his philosophy this way: **"If we get the culture right, most of the other stuff, like the brand and the customer service, will just happen. With most companies, as they grow the culture goes downhill. We want the culture to grow stronger and stronger as we grow."**

Potential employees at Zappos' Henderson (Nev.) headquarters get a sense of that right away. The job application for call center reps includes such questions as: How lucky in life do you consider yourself to be on a scale from 1 to 10? Hsieh is so confident about Zappos' appeal that he offers $2,000 to anyone who completes the week-long training program and doesn't want to stay. So far, few have taken it.

Once hired, workers are urged to communicate freely.

Hsieh offers hires who complete Zappos' training program $2,000 to leave. Few accept

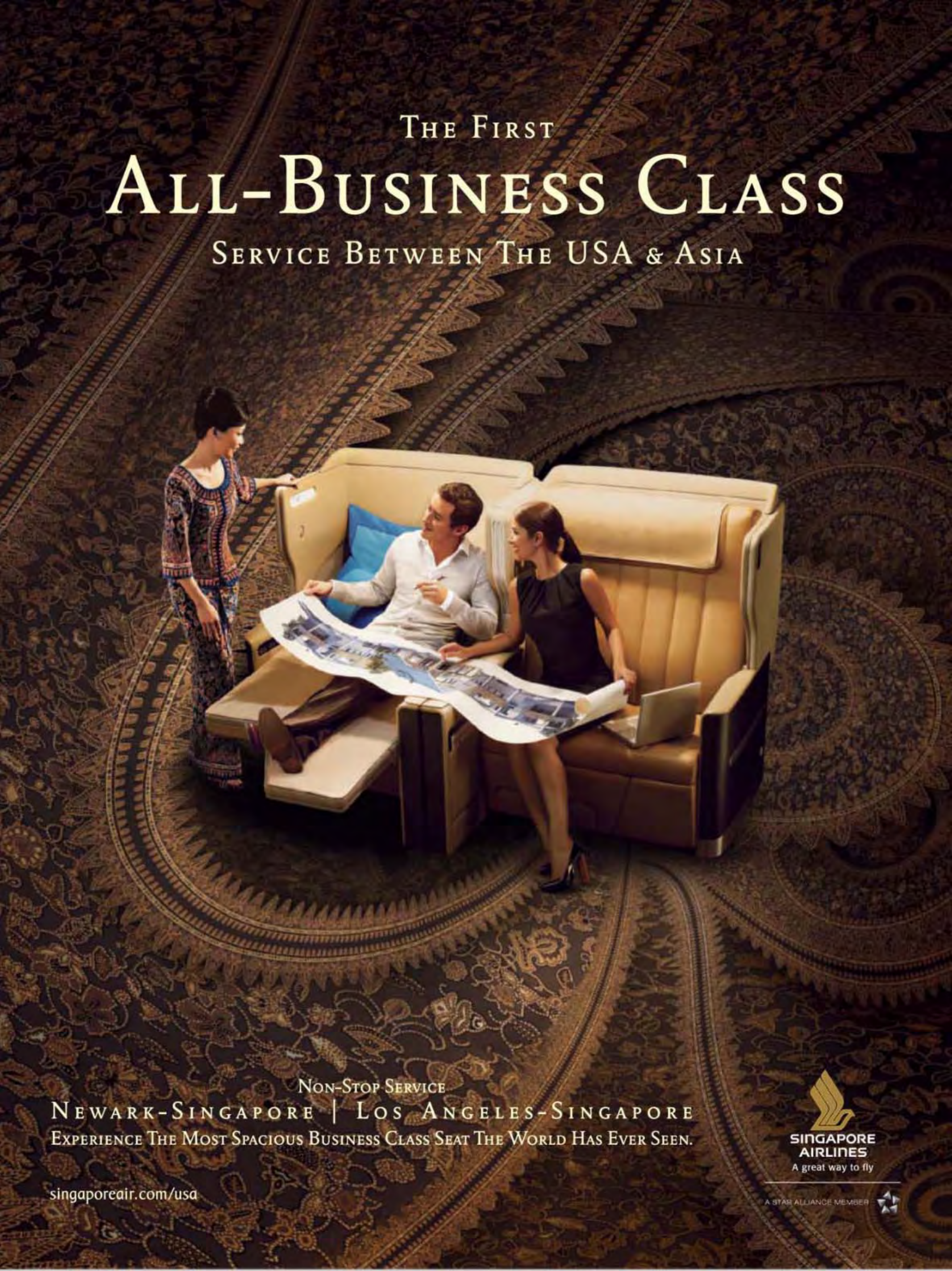
Hsieh, 35, is an avid Twitterer and encourages workers to use the microblogging service. When Zappos had to cut 8% of its staff in November amid a worsening retail environment, people posted about it on Twitter.

In some ways he treats suppliers like employees, too. Desks are set aside for some of them on site, and they can access much of the same data as Zappos' buyers. **"It's like having an extra 1,500 pairs of eyes to help us manage the business," he says. Even if some data end up with rivals, "the benefits outweigh any costs."**

Recently, Hsieh launched Zappos Insights, a $39.95-a-month service for entrepreneurs who want to learn about Zappos' culture and business practices. "We're happy to share pretty much anything," he says.

–Jena McGregor

STEVE LABADESSA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WEAVING A NEW KIND OF COMPANY

By encouraging its suppliers to become shareholders, an Indian retailer may become a model for the developing world

By Manjeet Kripalani

Fabindia, a purveyor of hand-woven garments and home furnishings, is one of India's premier retail brands. It has reached that level in part by bringing its suppliers inside the tent. The private company encourages the artisans who make its wares to become shareholders. Selling suppliers a piece of the company is unconventional, especially when most of the partners are illiterate. But if it succeeds, Fabindia could become a model for all kinds of companies, especially in the developing world.

Fabindia was founded in 1960 by John Bissell, an American working for the Ford Foundation in New Delhi, and is now run by his 42-year-old son, William. It has 97 stores in India's big cities and small towns. In 2008, it had revenues of $65 million, an increase of 30% over the previous year. And as Fabindia has grown, it has come to depend entirely on some 22,000 weavers, block printers, woodworkers, and organic farmers to provide the handmade goods it sells. "We're somewhere between the 17th century, with our artisan suppliers, and the 21st century, with our consumers," says Bissell.

Bissell and his staff have worked with the artisans to integrate them into Fabindia and, by extension, the modern economy. At first that meant helping artisans refine their traditional homespun designs to appeal to more chic urban tastes as well as improving the consistency of their wares.

Two years ago, Bissell went even further. He set up 17 centers throughout India, each organized around a particular region's artisanal tradition. These centers, in turn, were incorporated as companies in which artisans collectively own 26%. Fabindia encourages each artisan to buy shares, which cost $2 apiece—a reasonable sum for a weaver who might make a monthly profit of $100 from selling his woven cotton to Fabindia. A wholly owned Fabindia company controls 49% of each subsidiary; the rest is held by other Fabindia employees and private investors. So far, 15,000 artisans have become shareholders. The ownership structure is mutually beneficial for Fabindia and the artisans; the retailer ensures it has the supplies it needs, while the weavers, dyers, and so forth lock in steady income. "We pool our effort and funds, the artisans pool theirs, and we share the risk," says Bissell.

One believer is Mohammad Yaseen Chhipa, who dyes fabric in the dusty village of Pipar in Rajasthan and has been a

MICHAEL RUBENSTEIN/REDUX

MATCHING PRICES TO DEMAND—IN REAL TIME

BLUE-SKY IDEA

Can an ice cream shop charge more for a cone on a hot day? Should a parking space get costlier as the garage fills up?

Boston Consulting Group senior adviser George Stalk believes businesses can—and should—charge according to demand. The idea builds on a longtime strategy most associated with the airline industry, called yield management, in which carriers shift prices as planes fill up. The consultant, who in the late 1980s coined the term "time-based competition," the notion that time is a strategic weapon, thinks far more companies could take similar steps to match prices to real-time customer demand. Such moves are especially critical following a year when oil and commodities prices swung wildly, he notes, and "companies couldn't change prices as fast as they needed to."

Stalk says existing technologies such as radio-frequency identification, GPS, and wireless networks could someday make what he calls dynamic pricing a reality. He points to Ohio auto insurer Progressive, which is expanding its MyRate program that offers discounts in return for

CEO Bissell: "We pool our efforts and funds...and we share the risk"

Fabindia supplier for two decades. Chhipa, 52, is a prosperous man now. His yearly income has grown as Fabindia has, from $8,500 in 1989 to $170,000 today. He owns 560 shares and would like to buy more, but they're in such demand that few people are selling. The artisans can sell their shares to each other only twice a year. Although not many transactions have taken place, there have been enough to triple the share price to $6. Chhipa and other shareholders receive dividends, too, based on how much they produce.

As Bissell makes plans to open 150 more stores in the next four years, he's had to think about how to overcome the natural constraints of his business model. While offering his suppliers a chance to own a piece of the company has helped him lock in suppliers, Bissell won't find it easy to scale up. A yard of *khadi,* the traditional cloth worn by many Indians, takes two hours to weave—and right now Fabindia requires hundreds of thousands of yards a month. Bissell estimates he might need to triple his number of artisans to grow as quickly as he'd like, which would mean setting up several more regional centers. Maintaining the standards of quality would be a challenge. Even if he can solve those two problems, there's still the vexing issue of inventory control. "The whole idea of the Japanese just-in-time inventory is difficult to manage," Bissell says. "Here, it's more like just-in-a-year."

Bissell has been wrestling with possible solutions. One idea is to shift responsibility down the supply chain to the regional centers. His hope is that one day they might be able to do much more in the way of distribution, warehousing, and design. To that end, Bissell has arranged bank credit for these companies so they have access to working capital. And he is bringing some of the centers' employees to Fabindia's New Delhi headquarters for basic business training. The key, says Bissell, is to use what's intrinsic to India. "When you have an appropriate structure," he says, "all the forces flow in your direction and work with you." | BW |

ILLUSTRATION BY DAN PAGE

demonstrably safe driving habits. Customers who opt in to the program can plug a device into their cars' diagnostic ports, often situated beneath the steering wheel. The devices then wirelessly upload data to Progressive on how many miles customers travel, how fast they drive, and other factors. Progressive uses the information to offer policyholders discounts every six months for safe behavior and, in states where it's allowed by law, to tack on surcharges for risky driving.

Dynamic pricing, says Stalk, could eventually be much more real-time, with prices on store shelves automatically shifting up and down based on inventory levels, commodity costs, and consumer spending habits. How customers may respond to such constant fluctuations—and whether businesses will want to invest in such technology—are important questions. Stalk acknowledges that the model best fits companies such as travel operators or movie theaters, where scarcity can be a factor. But others, he says, could see the payoff of making pricing reflect "the economics of the moment." —*Jena McGregor*

YOUR NEW CUSTOMER: THE STATE

As private demand falls, companies are focusing on government stimulus work

By Jena McGregor, Matthew Boyle, and Peter Burrows

Five months ago, Willem Houck was working with Starwood Hotels & Resorts to put eco-friendly TVs in its inns. Today, Houck, a vice-president for strategy and business development at Philips North America, is meeting with admirals who want to make naval bases in the Southwestern U.S. more energy-efficient. "If you'd told me I'd be talking about how to create a sustainable U.S. Navy base," Houck says, "I'd have said you were crazy."

From Beijing to Washington, governments are unleashing billions of dollars of stimulus spending on energy, health care, and infrastructure projects. And with private demand collapsing, executives are scrambling to get a piece of it. George Nolen, CEO of Siemens Corp., the U.S. subsidiary of the German giant, aims to win $75 billion of Washington's $787 billion stimulus package. "If you're not prepared," says Nolen, "you will not be able to take advantage."

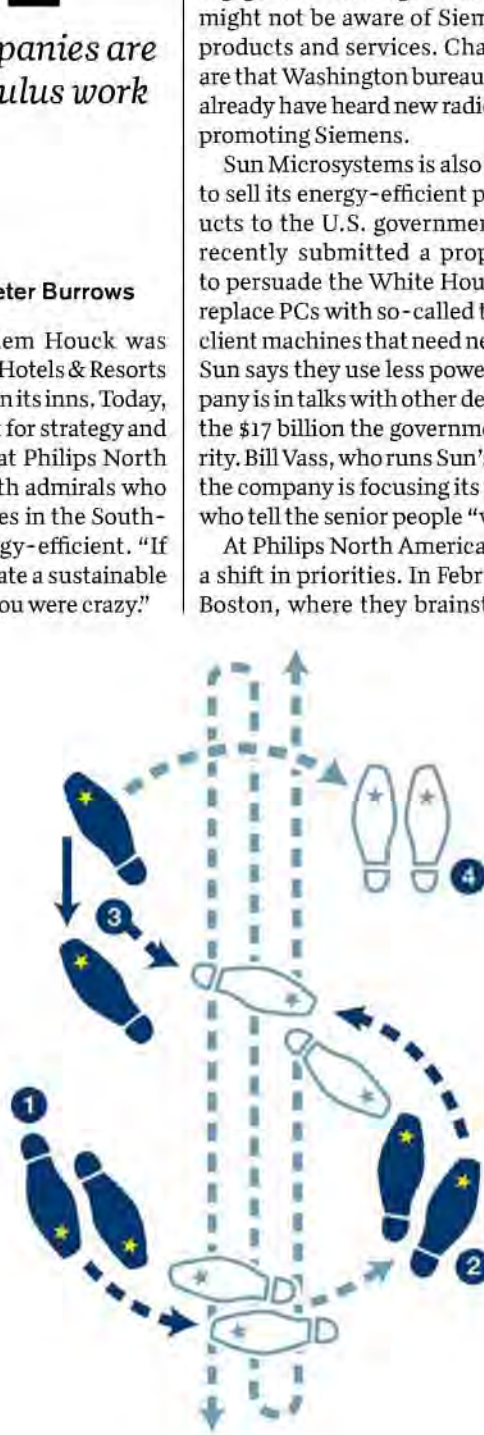
Some companies have been working with the public sector for years. General Electric's aviation and energy units, for example, have long had federal contracts. But GE is so eager to get in on the new action that it is tracking stimulus money and public-sector contracts in two dozen countries and is encouraging business units with government experience to share information with other divisions.

Siemens is one of 16 companies selected by the U.S. Energy Dept. to overhaul the efficiency of federal buildings by adding lighting controls and temperature sensors. Because Siemens has little experience handling such projects for the feds, Nolen says, the company "will need to build new relationships." To do that, Siemens has beefed up its government affairs team. And in mid-February, 30 sales executives convened in Washington to figure out how to grab the most stimulus money. Also attending were members of the marketing team, who are pitching government agencies that might not be aware of Siemens' products and services. Chances are that Washington bureaucrats already have heard new radio ads promoting Siemens.

Nolen, CEO of Siemens' U.S. subsidiary, is chasing stimulus money

Sun Microsystems is also keen to sell its energy-efficient products to the U.S. government. It recently submitted a proposal to persuade the White House to replace PCs with so-called thin-client machines that need neither a disk drive nor a processor. Sun says they use less power and are more secure. The company is in talks with other departments as well. It's also eyeing the $17 billion the government has allocated for cyber security. Bill Vass, who runs Sun's government-business unit, says the company is focusing its pitch largely on midlevel officials who tell the senior people "which technologies to pick."

At Philips North America, the pump-priming has sparked a shift in priorities. In February top executives convened in Boston, where they brainstormed about how to sell to the government. Meanwhile, Philips' lobbyists have been helping managers figure out how and where to get the right information about contracts. Already, says Houck, 1,000 U.S. staffers are tailoring many of their pitches to government agencies.



Working with the government can require adjustments—some subtle. Houck says that while companies tend to focus on brand, the feds are more about functionality. Asked if his meetings with the U.S. Navy involved the wining-and-dining typical of the corporate world, Houck demurred. "They invited us," he said. "And we didn't eat." |BW|

PHOTOGRAPH BY AMY T. ZIELINSKI/NEWSCAST; ILLUSTRATION BY MATT DORFMAN

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ECONOMICS & POLICY

Public Debts, Hired Guns

Strapped cities and states are retaining private debt collectors—but that may not be cost-effective

By Jessica Silver-Greenberg and Peter Carbonara

States and cities are desperate for cash—so desperate they're turning to private debt collectors to go after delinquent taxpayers and other scofflaws. The thinking is that it's cheaper to outsource the task of collecting unpaid utility bills, library fines, and the like to independent contractors than to hire more public employees.

Turns out the opposite may be true. That, anyway, was the conclusion of the IRS, which on Mar. 6 ended a four-year, $80 billion program to chase down tax deadbeats. "After a thorough review of the program, I have decided not to renew the contracts," says IRS Commissioner Douglas H. Shulman, who plans to hire more than 1,000 tax collectors at the agency. "I believe this work is best done by IRS employees." Recent IRS studies have found that the program recouped far less than the IRS could have collected on its own.

It gets worse. Not only are private debt collectors less effective than public ones, but a number of companies benefiting from the privatization trend have been slammed by regulators and prosecutors for overcharging municipalities, bribing public officials, and other predatory behavior. Some municipalities have stopped outsourcing their debt collection efforts altogether.

Private players defend their practices, arguing that they pursue debts that municipalities don't have the resources or skills to recover. "The entities wouldn't get that money otherwise," says Bruce Cummings, president of Municipal Services Bureau, a large debt collector in Austin, Tex., that recently won a contract with the government of Hamilton, Ohio. "The industry provides a worthwhile service."

That argument continues to hold sway for many states and cities suffering from declining tax receipts and a deep economic downturn. Consider tiny Bluff City, Tenn. To help fill its depleted coffers, the town of 1,500 near the Virginia border is farming out its collection work to private contractors. Officials figure that the city is owed $50,000 in back taxes and unpaid speeding tickets—real money in a municipality with an annual budget of $1 million. "We're fighting a very tight budget," says Todd Malone, Bluff

Montana revenue director Bucks quadrupled cost efficiency by going in-house

(LEFT) KENNETH JARECKE/CONTACT

Cummings of Municipal Services says collectors recoup money cities can't

(RIGHT) BRENT HUMPHREYS

City's mayor. All told, some $24 billion of uncollected municipal debt is up for grabs nationwide, according to mygovwatch.com, which tracks government contracts. That's up from $16 billion a few years ago.

Debt collectors are also angling to cash in on the U.S. Treasury's "bad bank" proposal to buy mortgages, credit-card debt, auto loans, and other distressed assets. An investing consortium has offered a plan to purchase portfolios of toxic debt. If they have their way, debt collectors would help work out the underlying loans, tracking down delinquent borrowers and ultimately sharing in the profits. The debt collection industry feasted on similar government work after the savings and loan crisis of the late 1980s. "This is a real growth area," says Mike Ginsberg, president of industry researcher Kaulkin Ginsberg.

The privatization boom, oddly enough, comes just as the IRS is retreating from private collectors. The government's decision follows research done by the IRS taxpayer advocate, Nina E. Olson. She found that two firms, CBE Group in Waterloo, Iowa, and Pioneer Credit Recovery in Arcade, N.Y., collected $37 million last year on behalf of the IRS, pocketing $7.5 million in fees and commissions. Olson calculates that if the IRS had used that same $7.5 million to retrain existing staff, the agency would have collected $250 million. "You really do get much more money for spending $1 on a federal employee than you do paying a $1 commission to a private collection firm," says Olson.

THE UPPER HAND

The IRS and other public agencies have a major advantage in their collection efforts. Unlike private players, federal and municipal employees can impose liens or garnishee wages to recoup unpaid debts. Private debt collectors, in contrast, rely mainly on their powers of persuasion to get consumers to pay up.

The companies cited by the IRS dispute claims of inefficiency. Randall Kamm, vice-president for government services at CBE Group, says the program never operated at its full capacity. "The program was designed for 10 vendors [not two]," says Kamm. "It never had a chance to work properly." Pioneer didn't return calls for comment.

Some municipalities have seen inefficiencies as well. Montana's revenue director, Dan Bucks, decided to cancel the state's tax collection contract with Houston's GC Services in 2005 after a wave of taxpayer complaints about the firm. Bucks then plowed funds into the state's collection efforts. Montana's revenue department collects $21.08 for every $1 spent on salaries and expenses. GC Services' record: $5.01 collected for every $1 of cost. "Complaints have gone way down and cost-effectiveness way up," says Bucks. GC Services—which recently won a piece of an estimated $1 billion contract to handle debt collection efforts for the state of Missouri—didn't return calls or e-

Air Force Captain Iraheta says his family was harassed by a debt collector

mails for comment.

Accusations of predatory behavior are proliferating, too. Private debt collectors in New Jersey "padded the bill," according to state investigators. In 2005, New Jersey officials discovered that Outsourcing Solutions (OSI) in Horsham, Pa., which had been hired to collect $1 billion in back taxes, had "lavished...gifts and entertainment," including $65,000 worth of liquor, meals, customized golf balls, gourmet chocolates, and imported cigars, on high-level officials in the state's revenue department. Those officials, says New Jersey's Commission of Investigation, then "turned a blind eye" as OSI overcharged the state government by around $1 million. "Other states are just as vulnerable to the same kind of abuse," says Lee Seglum, who headed up the state's investigation.

New Jersey fined OSI $2 million in 2007 and banned the company from new government contracts for five years. The state's attorney general recently brought criminal charges against three former OSI executives involved in the matter. Three former state officials have also been indicted. Meanwhile, OSI and its new parent, NCO Group, are still busy collecting back taxes and other government debt in 35 states. OSI didn't return phone calls or e-mails seeking comment.

Some firms have had numerous run-ins with regulators. Take San Antonio law firm Linebarger, Goggan, Blair & Sampson. In 2005 one of its partners pleaded guilty to bribing a San Antonio councilman to win the city's tax collection contract. Linebarger lost another contract with Mansfield, Tex., in 2006 after an employee made a controversial campaign donation to the town's mayor after his election.

Linebarger maintains that the firm provides an important service to municipalities, especially in a recession. "The current state of the global economy has certainly caused many [local officials] to take a second look at the valuable assistance we can provide

Business Exchange

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Reining in Abuses

In a February 2009 report, the Federal Trade Commission urges lawmakers to reform and modernize the rules governing the debt collection industry. The commission proposes banning debt collectors from contacting consumers via cell phone or text message without their permission. It also recommends that companies get consumers' authorization before accessing their account records.

To read the full report, go to http://bx.businessweek.com/debt-collectors/reference/

(RIGHT) CHRIS USHER

Olson of the IRS: Outsourcing tax collection didn't add up

to them and their constituents," says Joe Householder, a spokesman for Linebarger.

Chicago officials either overlooked or weren't aware of Linebarger's previous infractions—even in their own city—before inking a fresh deal with the firm. In early 2008 Linebarger forfeited a contract to collect overdue parking tickets after an investigation by Chicago Inspector General David Hoffman found that the firm had paid for an out-of-state trip by a top government employee. Yet in November Linebarger, which had earned $33 million in fees on the previous Chicago contract, landed another collection deal with the city worth $3.4 million. Linebarger says the firm has provided additional training to its Chicago employees, and the attorney admonished in the previous matter doesn't work on the new municipal contract.

UNSAVORY TACTICS

The growing prominence of private debt collectors only adds to critics' concerns about the industry, long known for its hard-nosed tactics with consumers. U.S. Air Force Captain Jose Iraheta, who is currently serving his second tour of duty in the Middle East, says Linebarger harassed his family over $7,000 in back property taxes on his Victorian-style home. Under Texas law, active armed services members can defer property taxes until they complete their overseas tours.

Nonetheless, says Iraheta, Linebarger sued and threatened to foreclose on the house—even though it had no legal authority to do so. Iraheta says he had to call for months from the Middle East via satellite phone before the firm agreed to drop the matter in June 2007. Iraheta is now suing Linebarger for damages and legal fees. Linebarger wouldn't comment on individual cases. Says Iraheta: "I have only a few rights, yet Linebarger tried to take those from me." | BW |

INFO TECH

Tech Spending: The Great Divide

Hardware and software vendors are hurting, but services-oriented companies are going great guns

By Steve Hamm

There's something puzzling going on in the computer industry. Sales of many products for businesses are plummeting, while other categories are doing quite well. Makers of powerful server computers, for instance, have seen quarterly sales drops of 20% or more. In contrast, Salesforce.com, which sells customer-management software as a service delivered over the Internet, saw revenues grow 34% last quarter, to $290 million.

The main reason for the disparity: Salesforce.com typically receives monthly checks from its customers. Companies don't have to rack up capital expenses or borrow money from tightfisted lenders to pay for computers and software. "Traditional hardware and software purchases are made through capital expenditures. That's an incredibly difficult thing to do in the current environment," says Marc Benioff, Salesforce.com's CEO. He says we're moving into "a zero-capex world." Avon Products recently opted to use Salesforce.com's service to track 75,000 salespeople.

A great divide is opening up in the tech industry for companies that sell to businesses. Because of the severe economic downturn and credit crunch, companies such as Salesforce.com that rely on customers making purchases as an operating expense have a distinct edge over those whose customers use capital expenditures to pay for technology. The trend gives an advantage to services-oriented companies.

Outfits on the wrong end of the situation can't switch business models overnight. They're being forced to come up with ways of addressing their vulnerabilities—including, in some cases, becoming zero-interest banks for customers. Dell, for instance, recently rolled out a package of promotional financing for some server computers, including interest-free financing for certain products for up to three years. Cisco Systems is also offering interest-free financing for some customers on certain products.

IBM'S EDGE

Software companies that rely primarily on capital expenditures are making adjustments, too. German software giant SAP has begun marketing its software in smaller, more-affordable pieces—hoping that when the economy improves customers will come back to it for more. Microsoft has laid out a sweeping vision of managing software for corporate customers, allowing them to rent rather than buy outright.

On the happy side of the divide are tech services companies. Accenture and Indian tech leaders Infosys Technologies and Tata Consultancy Services continue to see revenue growth, while IBM, with about half of its revenues coming from services, is holding up better than rival HP, which is more dependent on computer sales. IBM has another edge: its healthy balance sheet. It's able to make interest-bearing loans to customers so they can afford its high-end computers. Financing brought IBM $700 million in revenues and pretax margins of 38.2% last quarter. "Our high-end server business is strong, and I'm sure the financing business helped with some of those sales," says Jesse Green, vice-president for financial management.

The credit crunch has given rise to some surprising situations. Ruckus Wireless, a four-year-old maker of networking gear, just received its first request from a customer for a zero-interest loan so it could buy equipment. "Can you imagine?" says CEO Selina Lo. "We're a startup, and we're being asked to provide vendor financing." Ruckus has no plans to offer customers no-interest loans. | BW |

THOMAS FUCHS

THE INTERNET

Why This Web Site Looks So Healthy

Everyday Health has raced to the head of a pack of destinations once led by WebMD

By Catherine Arnst

The Internet is the primary source of health information for 70% of U.S. adults, with much of the traffic going to giants such as WebMD, Google, Yahoo!, and Microsoft. Yet the most heavily trafficked health destination is one most people have never heard of. Everyday Health, owned by Waterfront Media in Brooklyn, N.Y., is a conglomeration of diet, pregnancy, and disease-specific sites. It bumped WebMD out of the top position last October when it swallowed a much larger site, RevolutionHealth.com, for about $100 million.

CEO Wolin offers advertisers a package deal on popular sites

The deal was a coup, since RevolutionHealth was founded in 2005 with much hoopla by AOL founder Steve Case. He wanted to give consumers the information they craved while letting them store their medical data on the site. But Revolution ran into trouble in part because few people have access to records kept by their doctors and hospitals—if these even exist in digital form.

Waterfront Chief Executive Benjamin Wolin, 34, and President Michael Keriakos, 33, took a much different approach when they teamed up in 2002. Starting in the kitchen of Wolin's apartment in the scruffy Brooklyn building where they both lived, they decided to make Everyday Health a network linking a broad assortment of small, popular brands, some of which already had their own Web sites. These include South Beach Diet, alternative medicine guru Dr. Andrew Weil, and What to Expect—based on the pregnancy book read by 93% of first-time mothers in the U.S. Each brand has legions of fans, and Wolin and Keriakos correctly wagered that many of them would click on linked Web sites once they arrived at their destination.

Waterfront pays each site a royalty, aggregates them under the Everyday Health umbrella, then offers advertisers a package deal in which they pay one price to place ads across a range of targeted sites. "They are almost like the Condé Nast of online health information," says Jane Sarasohn-Kahn, founder of health-care consultant Think-Health. "They publish a lot of different online 'magazines,' all with different brands that appeal to different groups of consumers." With the Revolution deal completed, Everyday Health boasts 24.7 million unique visitors a month. Wolin says revenues are running "north of $100 million" and that Waterfront will be profitable this year. He and Keriakos have raised $63 million in venture capital.

Stashing patient records could still end up being part of the equation, since President Barack Obama has earmarked $19 billion in stimulus money for the creation of digital health records. Steve Case, now Waterfront's largest shareholder, says he's confident this commitment to information technology will transform health care: "That's why there is so much interest and investment in this sector." BW

MARK STANTON

GLOBAL CRISIS

The *Krisis* in Russia's Industrial Heartland

Tensions rise as once-booming Yaroslavl and other factory cities come to a screeching halt

By Jason Bush

YAROSLAVL, RUSSIA

Tempers are fraying at the Freedom Road job center in the Russian city of Yaroslavl. "It's not my fault your staff is incompetent!" a burly, red-faced man in a fur hat shouts at a dour woman behind a desk. People in heavy winter coats crouch over questionnaires, huddle around counters, and cram the corridors waiting their turn. There's shoving and scuffling in the crush.

The agency, it seems, isn't used to handling so many job-seekers. Until recently the biggest problem facing companies in the city of 600,000 was an acute labor shortage. That has all changed. "Companies are cutting back," says Nataliya Kuznetsova, a job counselor at the center. "Everyone who comes here is despondent."

Recently laid-off workers at a retraining center in Yaroslavl

The whole country is now reeling from what Russians call the *krizis*, or crisis. Moscow was hit hard and fast by the downturn. Now the pain is spreading to far-flung industrial cities such as Yaroslavl, 150 miles northeast of the capital, where auto-parts manufacturers and multinationals Eastman Kodak, Japanese heavy-equipment maker Komatsu, and German publisher Bertelsmann have set up shop.

On the surface, the 1,000-year-old city on the Volga doesn't look like it's facing hard times. Gold-domed monasteries and churches peek out from under the snow. On the busy Moscow Highway, a Home Center hypermarket, showrooms for Ford and General Motors, and new apartment towers stand as testament to Russia's boom.

VALERI NISTRATOV/AGENCY.PHOTOGRAPHER.RU (2)

An unemployment office in Yaroslavl, where local factories have cut thousands of jobs

But look more closely, and the prosperity seems to be fading. In the city center, cafés and bars are empty. Bulldozers and cranes stand idle at a half-built shopping center. And utility bills in Yaroslavl jumped by 30% in January, while inflation overall is running at about 15% annually.

On Oktober Prospekt, on the edge of town, Yaroslavl Motor Works (Avtodizel) is eerily quiet. A sign announces the plant's founding in 1916, while a digital clock and thermometer reveals that the temperature is a brisk -12C (10F) at 1 p.m. The facade still sports a large picture of Lenin, marking an award won during its Soviet heyday. Back then, the factory employed 40,000 workers. It still has 11,000, but on a recent Friday just a few office staffers are on hand. Orders for its diesel engines have fallen by 75% since the summer, forcing Avtodizel to shed 3,000 jobs—more than 20% of its workforce—last fall. Since Feb. 1 the plant has been operating just three days a week.

TWO-WHEELED CAR

The troubles reflect a nationwide industrial paralysis. Avtodizel and other local companies are suffering mightily as vehicle sales are forecast to decline by a third or more this year. "The whole auto sector is standing still," says Renat Chapes, an independent union leader at the plant. Avtodizel largely relies on orders from two big truck makers, Kamaz and MAZ, both of which are also on three-day weeks. Chapes brandishes a sheaf of statistics—management documents, he says—that indicate an additional 3,000 layoffs are in the cards. Avtodizel's management declined to be interviewed.

The woe goes far beyond autos. Yaroslavl's big chemical and metalworking plants have seen output slump by more than half over the past year, reflecting plummeting exports and a nationwide slowdown in construction. Even the city's renowned symphony orchestra was forced to dismiss three cellists and several support staff. Conductor Murad Annamamedov fumes at the "imbeciles and idiots" responsible. "To a bureaucrat, it doesn't make any difference," he says, "but it's like taking two wheels away from a car!"

Tension is rising across Russia. In many cities, including Yaroslavl, angry workers have staged demonstrations in recent weeks. Most have been small, but in Russia any protest is unusual.

"You shouldn't lay off people so quickly," says Yuri Lichenko, a mechanic who just lost his job at Avtodizel. "Workers," he says as he fills in forms at the employment center, "are losing a lot." The city's blood bank, meanwhile, is doing brisk business. Donations are up by 15% as the unemployed queue to earn as much as $28 for their blood. "People

Despite the downturn, Russia's leaders still enjoy high approval ratings

have no means of support, so naturally they're coming to us," says chief doctor Anatoly Voronin.

Yet for now, at least, the discontent doesn't seem to have tarnished Russia's leaders. While opinion polls indicate that pessimism is rising, Prime Minister Vladimir Putin has an approval rating of 78% and President Dimitry Medvedev is close behind with 71%. Vladimir Savelev, a member of the regional parliament from Putin's party, plays down the risk of significant strife. Recent protests are just "PR actions by the Communists, which attract only pity," he says with a dismissive wave of his hand.

A MORALITY TALE

But some predict the anger will grow. "There'll be a merciless uprising like [the Russian Revolution] in 1917," says union activist Mikhail Golovanov. Jabbing the air with a copy of the local Communist weekly, *Sovietskaya Yaroslaviya*, the gray-haired laborer says, "The Russian will tolerate a lot, but if you push him too far... Kaput!"

Businesspeople in Yaroslavl acknowledge that Russians themselves are largely to blame for the crisis. The underlying causes—lax lending standards and a real estate bubble—were all too evident in Yaroslavl itself. "We jumped into consumption with gusto," says Sergei Kiselyov, a dapper young executive from oil company Tatneft. Over coffee at Vanilla Sky, a trendy café on the icy riverfront, he says that a few months ago the restaurant would have been full of businessmen cutting deals and tucking into cream cakes and espressos. On a recent Thursday, it's nearly empty. "We have apartments costing $3 million in Yaroslavl, but this isn't Moscow or New York," he says.

The view of the crisis as a morality tale, in which all share blame, may explain the remarkable nonchalance with which many local businessmen seem to be facing the downturn. Of course, they're no strangers to economic turmoil: The city has been through tough times before, during the collapse of the Soviet Union and its aftermath.

Lev Molev, manager of Markon, a small maker of brake pads for cars and trucks, says January sales were down by 49% from the previous year. His factory, a concrete building in an industrial zone along the river, is unusually quiet as many workers have been furloughed. But Molev points out the potential for long-term growth: Car ownership in Russia is still only a third of the European average, and a recent 30% devaluation of the ruble should make his products more competitive with imports. In 1998, when the ruble fell by 70%, he says, sales almost doubled. "It's sad, of course," Molev says. "But on the whole we feel secure."

Optimists in Yaroslavl point to measures being taken by Moscow, which has been spending freely to ease the pain. Yuri Borodin, head of the job center, says a $15 million program will help 32,000 people get retraining or temporary jobs on farms or public works projects. "Very serious measures have been taken to support working citizens," he says.

But the impact of the crisis on Yaroslavl is only now beginning to be felt. While registered unemployment in the region is still a surprisingly low 2%, Borodin says the real number is about twice the official level and that it could double this year. Alexander Maikov, an entrepreneur who heads a local lobbying group for small businesses, says it was only in January that the city's retailers started to see sales tumble, after the big factories started laying off workers. "There are big rain clouds. At the moment it's quiet, but you can feel the tension," Maikov says. "When will the thunder come? What will the wind be? We don't yet know." | BW |

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Putin's "Social Contract"

Russians have accepted Vladimir Putin's authoritarian rule in exchange for rising living standards. But the economic crisis threatens that tacit agreement, Arkady Ostrovsky writes in *Foreign Policy*. As dissent spills into the streets, Ostrovsky fears "an increasingly desperate Kremlin will resort to greater violence and repression to maintain its splintering social contract."

To read the *Foreign Policy* article, visit **http://bx.businessweek.com/russian-economy/**

VALERI NISTRATOV/AGENCY.PHOTOGRAPHER.RU

GLOBAL CRISIS

Prying Open Asian Wallets

With exports plunging, governments are prodding consumers to save less and spend more

By Frederik Balfour

Clare Cheng's family is crazy about seafood. So when Cheng received a voucher worth $108 from the Taiwanese government in January, she treated her parents and two sisters to oysters, salmon, and scallops at a local restaurant. "My mother loves the all-you-can-eat buffet," says Cheng. "We used up the entire voucher."

Cheng's family outing came courtesy of an Asia-wide push to persuade people to spend. One of Asia's traditional strengths, a penchant for saving, has become a weakness in the current downturn. Their fat bank accounts funded Asia's exporters. Now, with exports off by nearly half in some countries, governments from Beijing to Bangkok are scrambling to boost consumption to make up the difference.

Most countries seem to think extra cash will get people to open their wallets. In Taiwan's $2.5 billion program, each of the island's 23 million residents got a $108 voucher that can be used just like cash—except that it must be spent by yearend. In China, Hangzhou, Nanjing, Ningbo, and other cities are handing out coupons worth up to $30 for locals to spend in restaurants and hotels. Thailand is sending checks worth $58 to more than 10 million low-income workers, and Japan is distributing $130-$200 to every citizen—some $20 billion in all.

Economists say Taiwan's voucher program is the right approach. While Japan's cash payments can be stuffed under the futon, vouchers force recipients to actually spend. Taiwan's scheme has gotten an extra boost from additional discounts some retailers are offering to those paying with vouchers. "It's quite a good thing at the right time," says Norman Yin, a finance professor at National Chengchi University in Taipei, who spent his handout on computer accessories. "But it's only a short-term means."

Japan is giving checks to every citizen to get them into shops like this one in Tokyo

EVERETT KENNEDY BROWN/CORBIS

Therein lies the rub. One-off payments aren't about to alter lifelong saving habits. To encourage higher spending, governments need to improve public health, education, and retirement benefits; without them, people are inclined to save rather than shop. Worse, it's unclear whether any amount of domestic spending can make up for falling exports anytime soon. While programs aimed at getting Asians to hit the mall may have some effect, they won't be enough to offset the global slowdown. Says Supavud Saicheua, a Merrill Lynch economist in Bangkok: "We can only hope for some sort of miracle in the U.S. and Europe." BW

A test Mini: BMW says plenty of customers shelled out to lease the electric version

GREEN BIZ

The Bimmer, Plugged In

BMW is working on an electric car. But will battery prices fall enough to make it viable?

By Jack Ewing

FRANKFURT

For years, BMW resisted building hybrid cars, believing that more efficient gasoline or diesel models were a smarter bet. But as the hybrid gives way to the all-electric vehicle—at least in the eyes of optimists—the German automaker aims to be at the front of the pack. BMW is spending more than $1 billion to develop a small car for urban drivers that will include an electric-powered version. "We [in the auto industry] have the internal combustion engine so strongly fixed in our minds that we think it will last forever," says BMW Chief Executive Norbert Reithofer. "I don't believe that."

Although Reithofer is vague on the timing, BMW is working on the electric vehicle under an initiative called Project i. Reithofer says he may even create a new brand for high-end city cars, in addition to the company's current BMW, Mini, and Rolls-Royce nameplates. To gauge interest and test the concept, in New York and Los Angeles BMW is leasing 500 Mini sedans that have been modified to run on batteries.

To head Project i, Reithofer tapped one of his star executives, Senior Vice-President Ulrich Kranz, who was instrumental in transforming the British-built Mini into a hip, upscale brand. Project i will also develop vehicles with gasoline engines, a necessity in emerging markets lacking reliable power grids. But the 80-member team has increasingly focused on battery propulsion, Kranz says, as regulators around the world tighten emissions standards.

CEO Reithofer hints at a new high-end brand

BMW's Mini test project in New York and L.A. has helped allay one of the industry's big fears about electric cars: that few would be willing to pay a premium for a vehicle that can travel only 150 miles between charges. BMW says it had no trouble finding customers eager to shell out $850 a month to lease the modified Minis, even though the cars seat only two because batteries displace the rear seats. Sure, a BMW 5 Series midsize sedan can be leased for less. But with the electric Mini, Kranz says, "you're driving the future."

"WILLING TO PAY"?

Skeptics counter that the future may be a long way off. Even if battery prices fall to a third of their current level, they'll still cost $14,000 per car, Boston Consulting Group estimates. Such concerns have spurred caution in the industry. Rival Daimler is testing electric Smart cars in London, but the company has yet "to see proof that the relatively high numbers of people who say they are interested in these vehicles are willing to pay what it costs to make them," says CEO Dieter Zetsche.

Others are optimistic. Consultant Bain & Co. figures battery costs could fall to $4,000 per vehicle by 2015, which means the showroom price of an electric could be as low as $20,000—about half what most manufacturers envision for their first electric models. At that level, Bain estimates, automakers could sell as many as 175,000 electrics a year in the U.S. alone. "We can bring these vehicles to market for a reasonable price," Reithofer says.

The well-heeled folks who drive Bimmers might be just the kind of buyers who would want a sporty electric for commuting and short trips around town. That would put BMW in a better position than rivals such as Mitsubishi, Renault, and General Motors, which also plan to make battery-powered vehicles. "Premium customers," says Gregor Matthies, a Bain partner in Munich, "want to buy from a trusted brand." BW

(TOP TO BOTTOM) PHOTOGRAPHS BY JOHANNES EISELE/REUTERS; GUIDO KRZIKOWSKI/BLOOMBERG NEWS

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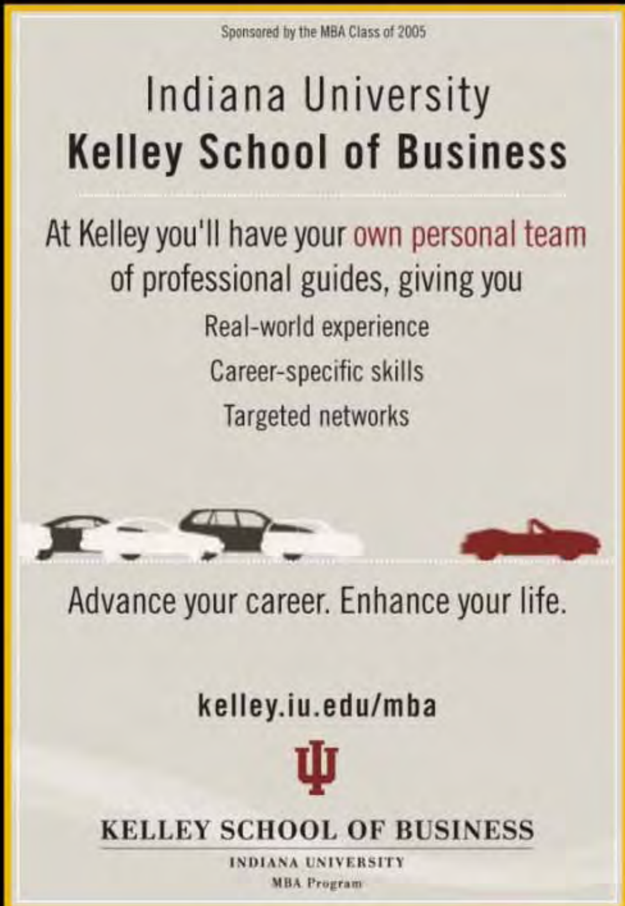
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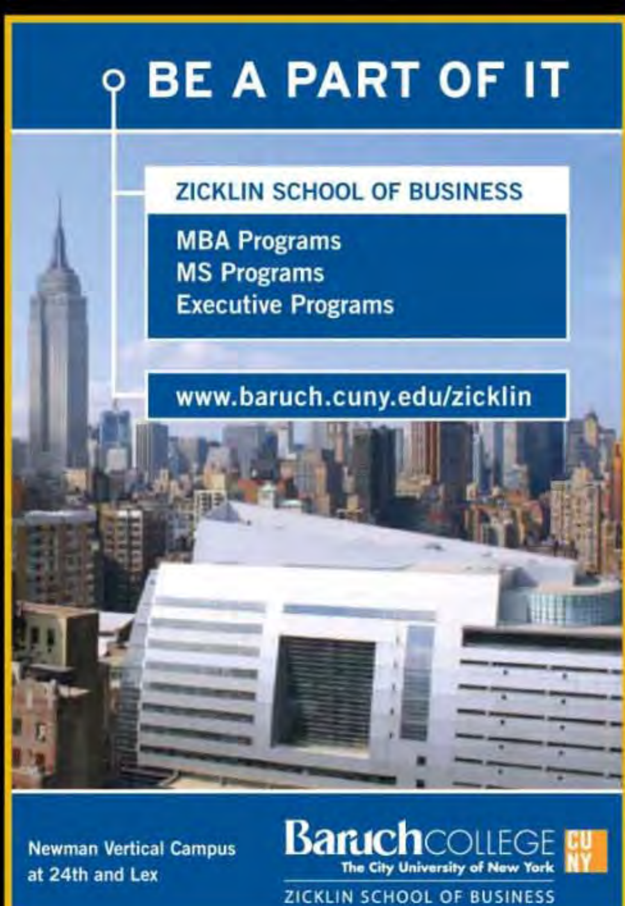
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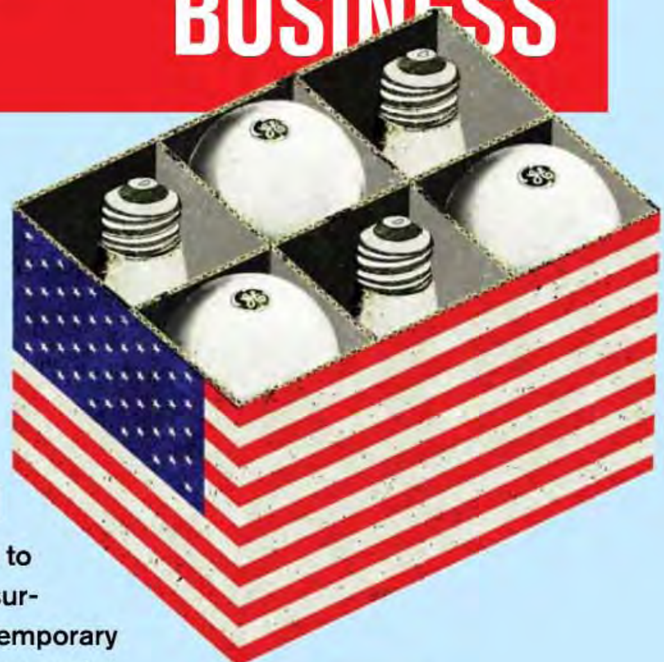


MONEY REPORT

DEBT: SAFER AND SAFEST

General Electric and Bank of America just unveiled plans to sell a total of more than $16 billion in Federal Deposit Insurance Corp.-insured bonds under the U.S. government's Temporary Liquidity Guarantee Program. The bonds yield one percentage point more than an equivalent Treasury. "A lot of investors looking for high-quality paper are considering them," says Matt Tucker, head of fixed-income investment strategy at Barclays Capital. (The iShares Barclays Agency Bond exchange-traded fund includes one FDIC-insured bond, issued by Bank of America, among its 19 holdings.) But Thomas Atteberry, co-manager of First Pacific Advisors' New Income Fund, says not to confuse insured debt with ultrasafe U.S. government debt. Insurance is an iffy proposition, he says—just ask buyers of Fannie Mae and Freddie Mac preferred shares who assumed the government would have their backs. He's been buying 2003 and 2004 pools of mortgage-backed debt packaged by Fannie and Freddie. Underwriting standards were still strong then, he says. *-Ben Levisohn*

First Pacific Advisors' Atteberry

PHOTOGRAPH BY BRENDAN MCDERMID/REUTERS; ILLUSTRATION BY BRIAN STAUFFER

STOCKS

BEWARE THE REVERSE SPLIT

Almost 10%, or 47 companies, in the Standard & Poor's 500-stock index are trading under 5, and three under 1. That's why more companies are expected to do reverse stock splits—cosmetic maneuvers that make a stock appear more valuable by decreasing the number of shares outstanding. Time Warner Cable is slated to complete one by Mar. 12 as part of its separation from Time Warner, which should wrap up its own reverse split soon after. Both involve exchanging three shares for one, which will then trade at a higher price.

Is a reverse split a signal to dump a stock? A 2008 study of 1,600 companies that did reverse splits found that the typical stock underperforms the broad market by 50% on a risk-adjusted basis during the three-year period after the action. "Reverse stock splits are a strong indicator the company is going to be a significant underperformer during the near future," says Jim Rosenfeld, co-author of the study and an associate professor of finance at Emory University's Goizueta Business School in Atlanta. *–Lauren Young*

MERGERS

NO MERCK BOUNCE

What moves the market these days? Apparently not a pickup in M&A. On Mar. 9 pharmaceutical giant Merck announced the $41 billion takeover of Schering-Plough. And while news of a big deal often spurs a rally, Merck's bid failed to improve the market's mood, and the S&P 500 slipped 1%. MF Global Research's Nick Kalivas says that shows how preoccupied investors are with the health of the financial system. As if to buttress his point, the S&P 500 rose 6.4% on Mar. 10 on news that Citigroup had an operating profit in January and February, its first since 2007. *–B.L.*

THE GLOBE IS IBM'S CLASSROOM

(FROM PAGE 056)

By Steve Hamm

In late February, IBM announced a breakthrough deal with Denmark's largest utility, DONG Energy, to help pave the way for wide acceptance of electric cars among Danes. In happier days that might have caused a ripple of excitement among IBM investors. This time the news was met with a shrug. That says a lot about IBM's short-term prospects. Big Blue is hugely ambitious: Its latest focus is on providing technology and expertise to improve the effectiveness of everything from electrical grids to urban transportation hubs. Long term, that could lead to big gains. But in today's environment, major funding of such projects doesn't seem likely.

For now the company's financial strength will come from what it is already doing well. In the fourth quarter, net income grew 12%, to \$4.4 billion, even while revenues slipped 6%, to \$27 billion. Through a combination of strategic acquisitions and internal product development, IBM's software business, with pretax margins of 32%, grew at 3% in spite of the economic slowdown. Meanwhile, efficient use of offshore labor and automation of tasks with software have helped improve profit margins in the global-services unit from 8.7% in 2004 to 12.4% last year.

Numbers like that have analyst A.M. Sacconaghi Jr. of Bernstein Research calling IBM "an attractive defensive name in an uncertain tech-spending environment." After peaking at 130 last year, the stock now trades around 85; Sacconaghi's price target for the next six months to a year is 110. Other analysts, such as Ben Reitzes of Barclays Capital, are more cautious, noting IBM's weak computer hardware sales. Reitzes has a one-year target of 95.

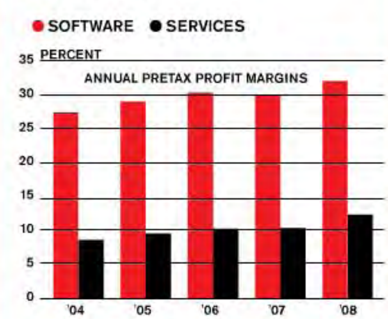
In the longer run, IBM's "Smarter Planet" strategy, publicly introduced by CEO Samuel Palmisano in a speech to the Council on Foreign Relations last November, could drive the stock price up. The goal, Palmisano said, is to infuse more digital intelligence into the way the world works using a combination of sensors, data-analysis software, high-performance computers, and consulting expertise. The company has, in fact, been moving in this direction for years. After buying PricewaterhouseCoopers Consulting in 2002, IBM began creating expertise and technology aimed at improving the performance of industries from health care to telecommunications. It has landed 50 contracts to upgrade electric distribution systems with so-called smart grid technologies. In recent months it has rolled out or beefed up consulting practices in water conservation, urban transportation, and food-quality traceability.

Eventually there will be plenty of money to be made in those areas. Tech researcher IDC estimates that sales of IT products and services for physical infrastructure will top \$122 billion by 2012, and IBM is one of the leaders. Analysts expect the economic stimulus packages put together by the U.S., China, and other major countries to drive demand for such technology.

That may be so, especially in the case of electrical grid upgrades and improvements in medical recordkeeping. But as details of the U.S. stimulus plans drip out, it's becoming clear that much of the money will go to existing social-services programs and old-fashioned infrastructure projects such as road paving.

That means IBM shareholders will likely have to wait for a potential payoff. Still, they can take satisfaction in the fact that, in a terrible market, Big Blue is a true blue chip. |BW|

IBM'S IMPROVING MARGINS



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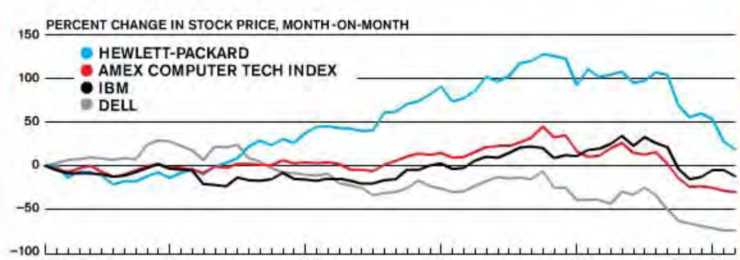
A STABLE PERFORMER



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B-SCHOOL LIFE

MBA candidate Smith, left, worries about the couple's job prospects

BRINGING THE FAMILY TO B-SCHOOL

By Alison Damast

Libby Smith toured Emory University's Goizueta Business School when she was pregnant and arrived on the Atlanta campus this fall with her six-month-old baby, Jackson, in tow. In between changing diapers and playing with her son, she juggled schoolwork, an internship search, and a long-distance relationship with her husband, Rob, an army operations officer stationed two hours away at Fort Benning. Says Smith: "It's been harder than I thought it would be."

Now a new worry is surfacing. With her husband's stint in the military set to end in six months, the couple, who recently purchased a home in the Atlanta area, soon won't have a paycheck coming in unless Rob finds a job fast—no mean feat in a crumbling economy. With mortgage payments to meet and looming student loans, Smith has taken to "living a little cheaper," clipping coupons and buying supermarket-brand paper towels instead of Brawny. Though she has a summer internship at consulting firm Booz Allen Hamilton, Smith, 29, is wary of the future. "It's stressful to think that nothing is guaranteed anymore," she says.

56%

B-schools reporting a decline in job recruiting this winter.

Data: MBA Career Services Council

Juggling school and family life has never been easy, but the economic downturn is adding a new wrinkle. In recent years, as B-schools have gotten better at helping families make the transition to academic life, more students with partners and young children have headed to campus. To accommodate the needs of these students and perhaps entice them away from rivals, B-schools have created organizations for spouses and partners, launched child playgroups, and offered job and relocation assistance. Some schools let spouses audit classes, invite them to school functions, and offer free

ANN STATES


In these challenging economic times,
your people are your most important asset.

Monte Searle moved his family to Indiana while he earns his MBA there

counseling services and support groups—perks that will become more essential in lean economic times, particularly for partners of newly admitted students. "The networking and job assistance has been ramped up because people are a little more nervous," says Wendy Metter, associate director of student affairs at Northwestern's Kellogg School of Management. "They want help finding a job now, as opposed to June."

As the economy unravels, that's not all they'll need help with. Long-distance relationships may become more common as partners stay behind to keep jobs rather than risk losing the family's sole source of income. And relationships could grow more strained as students struggle to find jobs in an increasingly grim market. Nearly 56% of B-schools reported a significant drop in recruiting activity on campus this winter, according to a survey by the MBA Career Services Council, an association of business school career officers.

Schools are preparing for the worst. At Dartmouth's Tuck School of Business, where 40% of students have partners or young families, the therapist who runs the partner-support group will keep a closer eye on students this spring. And at the University of Virginia's Darden School of Business, which has 65 married students among this year's class of 333, the student affairs office is posting information about signs of depression and how to help friends struggling with it.

For students with young families, the pressure can be intense. Richard Core, 27, a second-year student at Darden, is in the midst of a wide-ranging job search that so far has produced no offers. As he nears graduation, his search has taken on an "added layer of stress" because he feels responsible not only for himself but for his three-month-old son, Trip, and wife, Mandy, on maternity leave from her finance job. The couple

has contingency plans to move in with Richard's parents in New Jersey if the search drags on. "There's a bit more urgency to finding a job now," says Core, who worked at Merrill Lynch before business school. "I'm at the stage of life where making sure I have things like health insurance is more important than I ever realized."

Even students who land jobs feel insecure. Monte Searle, 39, at Indiana University's Kelley School of Business, moved 1,500 miles with his wife and three children, ages 10, 12, and 14, from their home near Salt Lake City to Bloomington. Searle's decision to go to B-school has strained family finances. His wife, Tanya, took on a 30-hour-a-week job as a teacher's aide to make ends meet. The couple has cut costly organized sports activities for the children, and their daughter pays for half of her piano lessons with babysitting money. Books come from the library, not Barnes & Noble. "We've cut back as much as we can without the kids feeling like they're really sacrificing a lot," Tanya says.

The family was relieved when Monte got a job offer in the corporate finance department at Dow Chemical, but they have lingering concerns, from the stability of the job market to whether they'll be able to get a mortgage. "I've seen worry and anxiety on my children's faces, and I'm definitely still worried to see how this plays out," Searle says. "It's something that's always in the back of my mind." BW

EASING THE TRANSITION

Social Circles
At Indiana University's Kelley School, 110 partners of MBA students can join book clubs, pottery nights, and knitting circles.

Kid-Friendly Programs
Schools such as Northwestern's Kellogg have started offering play groups, art classes, and other organized activities for the children of MBA students.

Job Resources
Many schools offer relocation and job assistance for spouses. Virginia's Darden School even helps international students without work visas find volunteer work.

Support Systems
At Dartmouth's Tuck School, a certified marriage and family counselor offers a weekly support group for those struggling with the transition to B-school.

MICHAEL L. ABRAMSON

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DAMAGED DIVIDENDS

By Amy Feldman

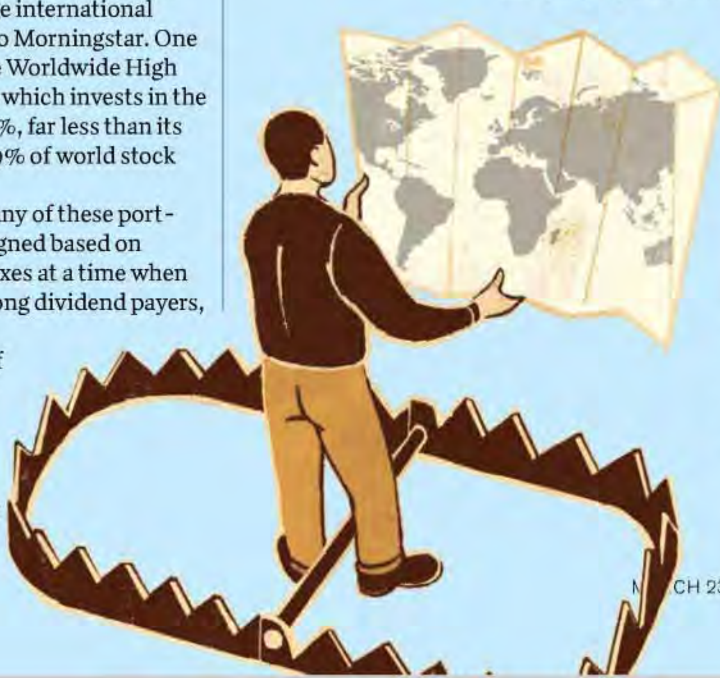
Over the past two years at least 12 mutual funds and exchange-traded funds (ETFs) were launched to focus on investing in international dividend-paying stocks. It's an intriguing strategy since overseas dividends are, on average, higher than those in the U.S., and dividends have historically accounted for 30% of total return from global equities, according to Citi Investment Research.

But the launches could not have come at a worse time. International stocks have been decimated, and dividend cuts have spread throughout the financial sector. Lord Abbett International Dividend Fund is down 49% since its inception last June, while Wisdom Tree International Dividend Top 100 Fund, an ETF, and iShares Dow Jones EPAC Select Dividend ETF, both launched in 2007, are off 57% and 61%, respectively, for the past year. All told, the universe of international funds and ETFs with "dividend" in their names has fallen an average of 54% (through Mar. 6), vs. a 53% decline for the average international equity offering, according to Morningstar. One exception: Tweedy, Browne Worldwide High Dividend Yield Value Fund, which invests in the U.S. and overseas. It fell 40%, far less than its peers, and ranks in the top 9% of world stock funds, says Morningstar.

One big problem with many of these portfolios is that they were designed based on international dividend indexes at a time when financials, traditionally strong dividend payers, dominated those indexes. But even active managers of dividend-oriented portfolios have not been able to avoid the troubled financial sector. "We have not dodged all the bullets," says Lord Abbett manager Vincent McBride, noting the fund's 18% position in financials. "Yields are higher overseas, so you are being paid to wait. But dividends have been cut, and they'll continue to be cut." As the financial crisis worsened, McBride says, he has become increasingly focused on balance-sheet strength. "The yield in the portfolio has not gone down, but we have upgraded the quality of companies," he says. Among the stocks he's bought recently are Japan's Nintendo and Canon.

The key, more than ever, is picking wisely in a treacherous market. While many of the international dividend funds have performed miserably, there are good reasons to include dividend stocks in an overseas portfolio, especially in a down market. Dividend yield has consistently produced more return in developed international markets than in the U.S., according to Empirical Research Partners. Some 90% of international companies offer dividends, vs. roughly half of U.S. companies, and their yields are typically higher. The dividend yield of companies in the MSCI EAFE index (which tracks stocks in developed countries in Europe, Australasia, and the Far East) averages 5.8%, vs. 3.3% for the Standard & Poor's 500-stock index, and fund managers say they are finding strong global franchises yielding 6%.

Simply targeting the highest yields is a recipe for disaster. The companies that pay them are often stretched financially and are the most likely to cut dividends. The value managers at Tweedy Browne look for companies that are trading at discounts to intrinsic value (what a private buyer would pay for all of the company's parts) and that have above-average dividends and a long history of paying dividends, says Managing Director Robert Wyckoff Jr. Top holdings include Unilever, headquartered in London and Rotterdam, which yields 6%, and Britain's GlaxoSmithKline, with a yield of 6.6%. Says Wyckoff: "Everything is down now, but I don't think the defensive nature of dividend investing has been tainted by this crisis." |BW|



EDEL RODRIGUEZ

A TASTE FOR FOOD STOCKS

As investment managers continue to shake up their portfolios and dump losers to stop the bleeding, the market has sunk lower. Severe meltdowns are usually followed by bursts of opportunistic buying, but so far those have been fleeting. Nonetheless, recent moves by some big investors indicate some pros are starting to nibble.

EDIBLE: KELLOGG, MEAD, AND KRAFT

Data: Bloomberg

"Today's prices offer the opportunity of a lifetime," says Edwin Walczak, chief investment officer for U.S. equities at Vontobel Asset Management in New York. Given the market's free fall, the "array of possible buy candidates has increased, and we have been upgrading our portfolio," he adds.

Jeffrey Kleintop, chief market strategist at LPL Financial, says: "Investors have priced in a scenario even worse than the Great Depression." The market is oversold on a technical basis, he thinks, and could bounce sharply. "We believe we are nearing an opportunity to increase exposure to stocks rather than going entirely to cash," he says. What could trigger an upturn? "There are policy actions and stimulus in the pipeline that should soon begin to have a measurable impact," notes Kleintop. The nonpartisan Congressional Budget Office has forecast that the $800 billion fiscal stimulus package will add 4% to gross domestic product in the third and fourth quarters this year, he points out.

Vontobel's Walczak, whose portfolio took a beating in 2008 but still outscored the S&P 500-stock index, used its cash to add Kellogg (K), Mead Johnson Nutrition (MJN), and Kraft Foods (KFT) to the company's portfolio. Early this year he had sold his big stakes in General Electric and American Express.

Walczak thinks Kellogg, a major provider of cereals and fruit snacks, is worth 55 a share. Down to 38.57 from 58 in September, he figures it's now attractively priced. Jon Anderson of investment firm William Blair says Kellogg is an "established growth" stock and rates it outperform. He sees it earning $3.04 a share in 2009 and $3.35 in 2010.

Mead Johnson, spun off by Bristol-Myers Squibb last year, went public on Feb. 10, 2009, at 24. It has since edged up to 26.64. A maker of food products for infants (Enfamil is its top brand), Mead posted revenues of $2.9 billion in 2008. No analyst covers Mead just yet, but Walczak believes it is a long-term growth story. His 12-month stock price target for Mead is 40.

Kraft, a food and beverage leader, fell to 21.31 from 34 in September. With a dividend yield of 5.3%, the stock is cheap, says Walczak, who values it at 30. Its defensive, or lower-risk, profile makes it attractive in the current environment, he notes.

DaVITA'S RECENT DIVE

Data: Bloomberg

Is DaVita Ready to Revive?

In times of economic weakness, recession-resistant stocks are supposed to be safe havens. But it ain't necessarily so. One such outfit is Big Board-listed DaVita (DVA), the second-largest U.S. provider of dialysis services for chronic kidney failure. Shares fell to 43.40 from 58 in September, although earnings are on the rise. The company's balance sheet is robust, generating yearly cash flow of $400 million, or $4 a share, notes Andreas Dirnagl, managing director at investment bank Stephens, who rates DaVita outperform, with a 12-month target of 67. Worries that the recession will trim profits and revenues are groundless, says Dirnagl. He sees earnings of $3.81 in 2009 and $4.24 in 2010.

Justin Lake of UBS says DaVita is a core health-care holding, given key defensive factors, such as its life-sustaining care services and robust cash-generation capability. | BW |

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BRAD TRENT; CHARTS BY LAUREL DAUNIS-ALLEN/BW

BOOKS | MICHAEL MANDEL

Irrational Exuberance Writ Large

Two superstar economists on how psychological factors led to the bust and may impede a turnaround

JONNY HANNAH

Animal Spirits: How Human Psychology Drives the Economy, and Why It Matters for Global Capitalism is a book with a blue ribbon pedigree. It was written by two of the top economists in the world, George A. Akerlof of the University of California at Berkeley and Robert J. Shiller of Yale University. Akerlof won the Nobel prize in Economics in 2001; Shiller is famous for his research into stock and housing prices as well as for having predicted both the tech bust and the housing crisis.

The two superstars have produced a truly innovative and bold work that attempts to show how psychological factors explain the origins of the current mess and offer clues for possible solutions. At a time when plummeting confidence is dragging down the market and the economy, the authors' focus on the psychological aspect of economics is incredibly important.

The book, which the authors started writing more than five years ago, seems bolted together out of parts that don't necessarily mesh. It includes some sweeping claims that are not well supported, as well as chapters on topics—such as minority poverty—that are interesting but don't really belong. In some ways, *Animal Spirits* feels like a beta version of a breakthrough computer program: promising and a potential big winner, but not polished.

Their main thesis is simple. Akerlof and Shiller argue that conventional macroeconomics is wedded to the idea that people and businesses are rational actors. But this model falters during booms and busts. Instead, the authors say, the only way to understand today's crisis is to focus on noneconomic motivations and irrational behavior, or what they call "animal spirits."

That term was first popularized in the 1930s by John Maynard Keynes, who used it to refer to the optimism and confidence that allow business owners to invest for the future. Akerlof and Shiller's definition of animal spirits is much broader. It includes "confidence, fairness, corruption and antisocial behavior" as well as "stories," or the natural inclination of people to put together tales about the way the world works. If this seems like a broad collection of phenomena, well, it is.

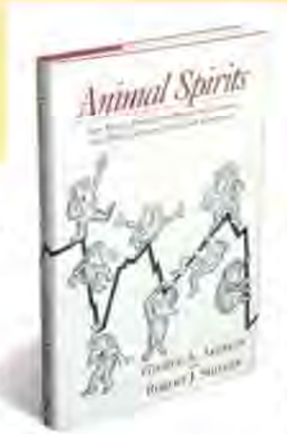
UNDERMINING TRUST

Key economic developments, including booms and busts, are driven by shifts in animal spirits, say the authors. It is not uncommon, they suggest, for massive financial frauds—such as Bernard Madoff's alleged Ponzi scheme—to help fuel booms. Later, the discovery of the frauds helps to undermine trust and propel a bust. In the authors' words: "The business cycle is connected to fluctuations in personal commitment to principles of good behavior and to fluctuations in predatory activity."

Another example of animal spirits, say Akerlof and Shiller, is the willingness of people to believe in stories "that purport to describe historic changes that will propel the economy into a brand-new era." These "new-era stories" help fuel unsustainable booms because they encourage investors, consumers, and businesses to cast aside prudence and reckon that it's different this time.

The authors make powerful claims about the strength of their analysis. "We provide a theory that explains fully and naturally how the U.S. economy, and indeed the world economy, has fallen into the current crisis," they declare. But the pair have little to say about technology, while globalization, a key trend of recent years, does not appear in the index.

The omission is disturbing: It is difficult to believe that a world economy with near-instantaneous communications, and including a mix of Western and Asian cultures, is driven by the same psychological factors as those that held sway during the last great U.S. boom and bust, in the 1920s and '30s—a period the authors look to often. Indeed, one alternative to the Akerlof-Shiller theory is that, prior to the recent meltdown, investors, consumers, and businesses simply made a mistake when faced with the complexities of globalization and technological change.



Animal Spirits: How Human Psychology Drives the Economy, and Why It Matters for Global Capitalism
by George A. Akerlof and Robert J. Shiller; Princeton; 230 pp.; $24.95

Animal Spirits is filled with provocative ideas, some of which are not fully developed. Early in the book, Akerlof and Shiller put forth the notion of a "confidence multiplier." In their view, just as government spending can have a wide-ranging impact on growth—the so-called fiscal multiplier—government actions to boost confidence can have an impact that far exceeds the original effort. But after introducing the concept, the authors do little with it. When they offer solutions for the current crisis in the postscript to chapter 7, the term doesn't appear. Instead, they advise policymakers to aggressively push credit into the economy, as the Fed and Treasury have already been doing. These actions are necessary, they say, to take the place of parts of the financial system handicapped by negative animal spirits. Perhaps, but it leaves open the issue of whether government can directly boost confidence.

The authors' overarching message is that government needs to act forcefully to tame animal spirits, almost like enforcing rules on a child. In fact, they think government should follow the model in parenting books that advise being neither too authoritarian nor too permissive. Given the depth of today's downturn, such a prescription may find a highly receptive audience. |BW|

Business Exchange

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The Making of a Bubble
"Why do we have bubbles?" asks Robert J. Shiller in a recent speech. They are the result, he asserts, of a flawed feedback system in which rising share prices generate excitement and stock purchases—which in turn generate more enthusiasm and perpetuate the cycle. Shiller calls for such changes as "a new information infrastructure" to help the public make improved financial decisions.

To watch a video of the speech, go to: **http://bx.businessweek.com/economic-analysis/reference/**

TECH & YOU | STEPHEN H. WILDSTROM

Just Ahead: Touch-Sensitive Desktops

Dell and others are taking the technology beyond phones. But don't trash your mouse yet

One of the most striking effects of Apple's success with the iPhone is that it has made us think of touch as a natural and efficient way to interact with our electronic tools. So far, the touch revolution has been limited mainly to phones and other handheld devices, but it's coming to computers, and it is going to make a big difference.

Touch-sensitive screens have been around for some years, but until the development of a technology called capacitive touch—the sort used on the iPhone—the displays were intended for use with a pen or stylus. Capacitive touch gives reasonably precise results even when poked with a fat finger. And, more important, the new screens can sense multiple touches at once, enabling sophisticated ways of interacting, such as using your fingers to stretch or shrink images on the screen.

Touch will come to PCs in a big way this fall when Microsoft launches Windows 7. The latest version of Windows includes extensive support for multitouch screens, but while test versions of Windows 7 are readily available, hardware to run it is scarce. Fortunately, Dell has just come out with a new version of its Latitude XT, a so-called tablet computer that can be used without a keyboard. The new XT2 ($2,300 and up—big capacitive screens are expensive) comes with a 12-in. display from N-trig. Its DuoSense technology lets you control programs either with a pen or with your finger. You can use this convertible laptop either as a conventional clamshell notebook or, by rotating the screen, as a slate. It features a faster processor, longer battery life, and lots of other goodies.

I loaded the XT2 with Windows 7 and preliminary multitouch software from N-trig. The result isn't perfect. But it does point to a new way of interacting with a computer, one that could move touchscreens from niche applications in vertical markets such as inventory processing to the mainstream of computing.

The Latitude XT2's touch-sensitive screen rotates so it can work like a slate

At the simplest level, your finger is a mouse. That idea may be familiar if you have used an iPhone or seen it demonstrated on TV, but somehow it's more revolutionary on a larger device running work-related programs. Touching an onscreen object selects it, tapping an icon or link acts as a mouse click. If you hold your finger on the title bar of a window, you can drag the window around the screen. The same gesture on the edge or bottom of the window lets you increase the size or shrink it.

With Dell's XT2, you can run programs with a pen or with your finger. Nice, but the Windows 7 software has a ways to go

That's helpful, but not all that surprising. I was more taken with the ability, in some programs, to scroll through content in the window by sliding my finger up and down or side to side. This works nicely in Internet Explorer but not in Firefox, a problem that should be fixed before Windows 7 ships. Pinching or stretching out two fingers on the screen lets you shrink or expand the contents of a window, so you can zoom in or out on a Web page, map, or picture. (Oddly, this works fine in Firefox.)

There are some other two-finger tricks. If you touch something on the screen with one finger down and tap with a second, you bring up a menu of content-specific actions, the equivalent of a right click. In Windows Photo Gallery, you can rotate a picture with a circular gesture using two fingers. And tapping an icon at the edge of the screen brings up a big onscreen keyboard designed for use with fingers rather than a stylus.

Windows 7 touch has a ways to go before people start abandoning keyboards and mice in droves. Developers have to do some work to get programs and even components of Windows to respond consistently to touch gestures. The response should be crisper—though the sluggishness I experienced may indicate that the hardware itself and the low-level N-trig software that runs it still need work. Also, there have to be a lot more touch-capable computers. Right now the field is limited to the Latitude XT2 and the Hewlett-Packard TouchSmart.

I am sure that as the hardware and software get better, touch will become an important feature of Windows. Once you've used it for a while, it feels a lot more natural than a mouse. | BW |

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(TOP) BRAD TRENT

Obama's Tax Plan Will Hurt Nonprofits

A 28% cap on deductions would reduce giving at a time when charities already are reeling

Americans have a unique commitment to philanthropy. Our culture emphasizes giving, and our citizens respond: Some 83% of all charitable donations in the U.S. come from individuals, according to Giving USA Foundation. In 2007 (the latest year for which figures are available) that meant 83% of more than $306 billion.

Now, amid the widespread destruction of wealth that has accompanied the current economic crisis—and with more economic challenges to come—it's more important than ever to support education, health care, art, culture, and efforts to alleviate poverty. Together they provide a vital outlet for those looking to make a difference in someone else's life. They also help create the sort of society we all want to live in: one with healthy, schooled citizens and workers.

How to rally the citizenry to lend a hand? Given his popularity, the best thing we have going for us is President Barack Obama. (I believe if there had been an election for President of the world in November, he would have been victorious by multiples of his winning margin in the U.S. election.) I enthusiastically embrace his plan—the only viable plan we have—to get the country back on track.

Still, I'd like to add my voice to those in Congress who worry that the proposed philanthropic tax deductions in Obama's budget will bring a decline in gifts to charities.

Under Obama's fiscal blueprint, families making more than $250,000 will be able to claim only 28% of their charitable giving as a tax deduction starting in 2011. At the same time, the ordinary income tax rate for such families will be raised to 39.6%. (Currently, the top ordinary income tax rate, 35%, is reserved for families making more than $357,700. For these households, charitable deductions are capped at 35%.)

The new 39.6% income tax rate for families making more than a quarter-million dollars should not cause alarm: It is imperative, after all, that we make a down payment on health-care reform and begin reducing the deficit, as the Administration suggests. Let's not forget, too, that those in the upper brackets enjoyed many years of economic prosperity at this same 39.6% tax rate during President Bill Clinton's time in office.

But capping charitable deductions at 28% is cause for great concern when it comes to our country's not-for-profit organizations, which already have been harmed by the economy's free fall. The Center on Philanthropy at Indiana University studied what would have happened to charitable giving in 2006 (the last year for which we have itemized data) had these proposals to limit deductions and raise rates been in effect for households with incomes above $250,000 a year. The researchers found it would have reduced giving by those households by nearly 5%, or $3.87 billion.

Why not raise the top ordinary income tax rate to 40.6% and at the same time lift the cap on charitable deductions to 40.6%?

So here's my proposal: Why not raise the proposed top ordinary income tax rate by one percentage point, to 40.6%, and at the same time lift the cap on charitable deductions to 40.6%? The increase in the top tax rate could make up for the decrease in tax revenues resulting from the bigger deduction for charitable giving. It's win-win for all sides—the government, individuals, not-for-profits, and certainly our local communities.

Such a move would send a powerful signal, one that would encourage people to donate to the causes that move them, to give back to society at a crucial time in our country's history. A period of change, and that includes hard times, can create such opportunities.

Decades ago, virtuoso violinist Isaac Stern, who helped save Carnegie Hall, instructed me in the importance of philanthropy, of giving back. He led by example, in the belief that music and the arts were a way to help bridge cultural divides. All of us owe it to the likes of Isaac Stern, Andrew Carnegie, David Rockefeller, and Bill and Melinda Gates to continue building the nation's philanthropic foundations. It's our duty to uphold this tradition—one that helps define us as Americans. BW

Sandy Weill, chairman emeritus of Citigroup, is chairman of Carnegie Hall and the Weill Cornell Medical College. He is also founder and chairman of the National Academy Foundation, a global network of career-themed high schools.

DIANE BONDAREFF/POLARIS; ILLUSTRATION JAMES STEINBERG

MEDIA CENTRIC | JON FINE

A Sweet New-Media Formula

San Francisco blog company Sugar has developed an array of ways to make a buck online

You might spend some time with Sugar, the family company that owns and runs 16 blogs aimed at young women, and leave thinking its properties have the collective editorial heft of a strand of silk. Or you might see in Sugar an unusually canny media play that, with remarkable speed, attracted major advertisers—Mattel, Microsoft, Neiman Marcus, I could go on—and diversified its revenues to a degree that most companies would envy. Since its formation four years ago, the San Francisco-based Sugar has gone from a simple blog to an ad-supported blog to a company that, according to co-founder Brian Sugar, last year derived 40% its revenues from non-advertising sources, thanks to an e-commerce technology it licenses and a platform that aspiring bloggers can use.

POP START

All this started—in the classic new-media equivalent of being discovered working at an ice cream shop—when Lisa Sugar, then 29 and employed by ad agency Goodby, Silverstein & Partners, began blogging about her celebrity obsession on a site she called PopSugar. At the time, her prior writing experience was largely restricted to e-mails and term papers. In a less classic fashion, Sugar, the company, came about a year later, when her husband, Brian, was working at a telecom company but mulling a media startup. "We basically took a lot of women's magazines and we sorted them by circulation and ad dollars," says Brian. "*Glamour*. *Lucky*. *InStyle*. *Us*. *People*. Bam! [We thought,] 'Let's go after that.'" They did, with $15 million from NBC Universal (disclosure: I am a paid contributor to its cable channel CNBC) and major venture capital firm Sequoia Capital.

Sugar's editorial voice skews so earnest and chipper—Lisa and Brian have both long stressed its blogs are snide-free zones—that it actually seems slightly dull by the standards of the Web. And it can't exactly go toe-to-toe with the titles Brian mentioned. Sugar's roughly $10 million of revenue last year would amount to a pretty bad single issue for *People*. Still, PopSugar started running ads in late 2006—Neiman Marcus bought the first ones—and

Co-founders Lisa and Brian Sugar

PopSugar's spawn quickly proliferated: There's FabSugar (fashion), LilSugar (parenting), CasaSugar (home), GeekSugar (technology)...you get the idea. (Sugar trademarked KarmaSugar and AirSugar for future launches that would focus on volunteerism and travel, although Brian says the latter blog might also be called JetSugar.)

Its funding enabled acquisitions, most notably the shopping site ShopStyle. There, among other things, users can click on galleries of celebrity outfits to be directed to retailers' sites that sell those goods, or close replicas. Sugar gets a small fee either when a reader clicks through or when a related sale takes place, depending on how retailers' deals are structured. (Sugar also licenses ShopStyle's technology to *InStyle*'s site, as well as those of other magazines it originally targeted.) In October, Sugar launched OnSugar, a platform on which bloggers can self-publish. OnSugar's platform enables Sugar to sell ads across all blogs published on it—and it allows users to take advantage of ShopStyle technology, thus opening additional ways for Sugar (and those bloggers) to wring revenue from the Web. Since half of Sugar's revenue last year came from non-ad sources, evidently all those clicks add up.

Still, Sugar has had growing pains. Late last year it laid off nine of its 80 or so editorial staffers. (Brian says it did so in order to hire an ad staff, since NBC Universal is no longer handling ad sales.) And Sugar's ambitions generally have forsaken the modest for the grandiose. An early investor presentation, according to reports, said Sugar would notch $15 million in revenue in 2008 and $40 million in 2009; don't hold your breath waiting for that, kids. More recently, Sugar has signaled that it foresees one day hitting $25 million in profit, with around 40% of revenues coming from non-ad sources. (Brian would not confirm or deny revenue and profit details.) That would be a tall order, even in a good economy. But subtract out some startup hubris, and Sugar suggests an interesting way forward for media. | BW |

BUSINESSWEEK.COM |

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

(FROM TOP) BRAD TRENT; MARKHAM JOHNSON/WONDERFUL MACHINE

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THE FINANCIAL CRISIS
JIM ROGERS' TOUGH LOVE

Reactions to "Jim Rogers Doesn't Mince Words About the Crisis," (FaceTime, Mar. 9), my interview with one of the most outspoken global investors, were a lot like the positions Rogers takes: black or white. The readers who loved what he had to say were most attracted by his Darwinian approach to the financial crisis: Let weak banks and car companies wither and make way for the strong. Others bristled at that, with one reader dubbing it Hoover-era "déja 'voodoo.'" *–Maria Bartiromo*

Rogers is on target. It is nonsensical to think that we can work our way out of this depression by loading more debt onto the taxpayer.
Screen name: Barry Marcus

Jim Rogers, please come home and run for President.
Screen name: Viking Mar

In a vacuum, there might be something to what Rogers says. But he should stick to picking stocks. Help the companies survive, because Americans need stability.
Screen name: Stephen Tiano

Andrew Mellon, President Hoover's Treasury Secretary, is well known for saying, as the Great Depression was picking up steam: "Liquidate labor, liquidate stocks, liquidate the farmers, liquidate real estate." [Rogers] sounds like déja "voodoo." Without liquidity by way of lending from banks, the economy won't recover. It is wiser to have some moral hazards from reorganized mortgages and a restructured banking system than another depression.
Robert Singer
HAMDEN, CONN.

I agree with Jim Rogers. Handing out money to these banks is like giving a loaded gun to a felon. I kind of like bailing out automakers, though. They just flush the funds down the toilets to keep inflation low.
Screen name: Andrew Smith

MEDIA
WHAT'S BRINGING IN THOSE LATE-NIGHT NUMBERS

Regarding "What's So Prime About That Time?" (Media Centric, Mar. 9): It's spurious to correlate an increase in late-night TV viewing with decreases in prime-time viewing since September 2008.

Over that period, the unemployment rate rose 2.3%, allowing more people to watch late-night television now. They're joined by those who can't sleep for fear of joining their ranks.
Mark Woodward
DURHAM, N.C.

LEADERSHIP
MIDDLE MANAGEMENT'S CRITICAL ROLE

Regarding "Speaking Up for the Organization Man," Books, Mar. 9): Paul Osterman's observation that "the need for strong middle managers is as great as ever" is welcome.

Until the early 1980s, when many of them were fired, middle managers held the institutional memory and consciousness that guided [corporations] for many years. It's not surprising that we are in the current economic mess: Middle managers played an important role in moderating risk, based on their knowledge and expertise.
Robert Stemper
SUNNYSIDE, N.Y.

CUSTOMER CARE
EXTRAORDINARY VALOR... AND BUSINESS AS USUAL

"When Service Means Survival" (In Depth, Mar. 2) listed several international hotel chains as customer service champs. Overlooked was the extreme customer service exhibited by the staff at the Taj Mahal and Oberoi hotels in Mumbai during the terrorist siege in November. Under the most adverse circumstances, staff at both hotels displayed selflessness, presence of mind, and extraordinary valor in protecting their guests.
Subhabrata Rontu Basu
MUMBAI

Shortly after reading your story, which emphasized the importance of customer service during the downturn, I received a mass e-mail from US Airways. With the subject line "We're bringing back free drinks," the e-mail stated: "We believe in our pay-for-what-you-choose-to-use... business model, but it's a work in progress." I appreciated the candor, until I read the next sentence: "You still have the choice to only pay for the things you want—like checked bags..."
Ron Silver
ELLICOTT CITY, MD.

DAVID HARTUNG

An open letter from Las Vegas.

Recently, a prominent financial firm canceled a meeting in Las Vegas and moved it to another city because of the perception that Las Vegas is a "fun" trip or an unwarranted extravagance.

We admit, Las Vegas is more fun than any other place on the planet. Guilty as charged. However, serious business is done here every day.

Las Vegas has been the No. 1 destination for meetings and conventions for many years now. We have more meeting space, more convention space and more hotel rooms in a concentrated area than any other destination in the world. It's the perfect infrastructure for successful meetings.

There were more than 22,000 serious business meetings here last year alone. And don't forget the impressive list of conventions held here like the International Consumer Electronics Show (CES), hosting the latest innovations in electronics; MAGIC, the preeminent trade event in the international fashion industry; and the National Association of Broadcasters, whose convention alone creates $68.6 billion in commerce worldwide.*

The tourism industry isn't the only engine that keeps the men and women of Las Vegas working. Conventions and meetings account for a large percentage of the travel here. And like most of America, jobs are in the balance.

Facts:

Las Vegas is home to three world-class convention facilities totaling 6.7 million square feet, with an additional 3 million square feet of meeting space at individual properties.

The city hosted 22,454 conventions and meetings that attracted more than 6 million business people and conventioneers in 2008.

It accounted for an economic impact of $8.5 billion, employed more than 46,000 Southern Nevadans (75,000 with indirect employment), and represents close to 15 percent of the city's total visitation.

Don't get us wrong. We don't think taxpayer dollars should be spent for any unnecessary expenses. But at a time when America is getting back to basics, there is no room for playing the perception game. Las Vegas has been doing business for decades and has the track record to prove it. That's the reality.

If you're looking for places that are less fun than Las Vegas, you could find them easily. Close your eyes and point at a map. If you're looking for a destination that has the chops for business, check out the facts.

Sincerely,

Las Vegas

ONLY Vegas™

*Source: National Association of Broadcasters

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Layoffs: HR's Moment of Truth

When employees are let go, treat them with the respect they got at their hiring

What is the role of human resources as the world goes through turmoil, and what is its future as so many industries face extreme change?

Effendi Ibnoe
BALI, INDONESIA

Talk about timing. Your question arrived in our in-box the same day that we received a note from an acquaintance who had just been let go from his job in publishing, certainly one of the industries that is facing, as you put it, "extreme change." He described his layoff as a practically Orwellian experience in which he was ushered into a conference room to meet with an outplacement consultant who, after dispensing with logistics, informed him that she would call him at home that evening to make sure everything was all right.

"I assured her I had friends and loved ones and a dog," he wrote, "and since my relationship with her could be measured in terms of seconds, they could take care of that end of things."

"Memo to HR: Instead of saddling dismissed employees with solicitous outplacement reps," he noted wryly, "put them in a room with some crockery for a few therapeutic minutes of smashing things against a wall."

While we enjoy our friend's sense of humor, we'd suggest a different memo to HR. "Layoffs are your moment of truth," it would say, "when your company must show departing employees the same kind of attentiveness and dignity that was showered upon them when they entered. Layoffs are when HR proves its mettle and its worth, demonstrating whether a company really cares about its people."

Look, we've written before about HR and the game-changing role we believe it can—and should—play as the engine of an organization's hiring, appraisal, and development processes. We've asserted that too many companies relegate HR to the mundane busy-work of newsletters, picnics, and benefits, and we've made the case that every CEO should elevate his head of HR to the same stature as the CFO.

But if there was ever a time to underscore the importance of HR, it has arrived. And, sadly, if there was ever a time to see how few companies get HR right, it has arrived, too, as our acquaintance's experience shows.

So, to your question: What is HR's correct role now—especially in terms of layoffs?

First, HR has to make sure people are let go by their managers, not strangers. Being fired is dehumanizing in any event, but to get the news from a "hired gun" only makes matters worse. That's why HR must ensure that managers accept their duty, which is to be in on the one conversation at work that must be personal. Pink slips should be delivered face-to-face, eyeball-to-eyeball.

Second, HR's role is to serve as the company's arbiter of equity. Nothing raises hackles more during a layoff than the sense that some people—namely the loudmouths and the litigious—are getting better deals than others. HR can mitigate that dynamic by making sure across units and divisions that severance arrangements, if they exist, are appropriate and evenhanded. You simply don't want people to leave feeling as if they got you-know-what. They need to walk out saying: "At least I know I was treated fairly."

We've said it before: HR rarely gets enough emphasis. At times like these, it becomes obvious how few companies get it right

Finally, HR's role is to absorb pain. In the hours and days after being let go, people need to vent, and it is HR's job to be completely available to console. At some point, an outplacement consultant can come into the mix to assist with a transition, but HR can never let "the departed" feel as if they've been sent to a leper colony. Someone connected to each let-go employee—either a colleague or HR staffer—should check in regularly. And not just to ask, "Is everything O.K.?" but to listen to the answer with an open heart, and when appropriate, offer to serve as a reference to prospective employers.

Three years ago, we wrote a column called, "So Many CEOs Get This Wrong," and while many letters supported our stance that too many companies undervalue HR, a significant minority pooh-poohed HR as irrelevant to the "real work" of business. Given the state of things, we wonder how those same HR-minimalists feel now.

If their company is in crisis—or their own career—perhaps at last they've seen the light. HR matters enormously in good times.

It defines you in the bad. BW

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